

Inside Spain 19

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Foreign Policy

Spain goes ahead with military contract with Venezuela, despite US opposition

The Spanish and Venezuelan governments signed a contract for the sale of eight Spanish patrol boats and 12 military aircraft, despite objections from Washington which said the deal could be a 'destabilising factor'.

José Bono, the Defence Minister, flew to Caracas to sign the €1.7 billion contract which he said would provide 900 jobs for nine years at the hard-pressed Spanish government-controlled shipyard Navantia. Venezuelan President Hugo Chávez, increasingly at odds with Washington for his close relations with Cuba and his *sui generis* brand of socialism, had insisted on Bono's presence at the signing ceremony in order to maximise its political significance.

Spain needs an export licence from the United States to sell the boats and aircraft because they contain US engines and instrumentation, and the sale of technology is restricted. 'We have not decided yet whether or not to grant our permission for obtaining that technology', Eduardo Aguirre, the US ambassador to Spain, said before the contract was signed. 'We hope in the end the transaction will not be carried out'. Spain could replace US components with parts made in Europe, but this would make the deal less profitable. It was not clear what would happen.

On the one hand, the contract keeps the shipyard afloat and job creation wins support at home and, on the other, the deal antagonises Washington with whom the Socialists have been patching up their relations following the withdrawal of Spanish troops from Iraq last year. Bowing to US pressure, in a country where anti-American sentiment is strong (see *Anti-Americanism in Spain: the Weight of History*, by William Chislett, available at www.realinstitutoelcano.org/documentos/230.asp), would have exposed the Socialists to criticism, mainly from the left. At the same time, the Socialists have forged closer relations with Chávez than the previous centre-right government of the Popular Party (PP) whose foreign policy basically toed the US line. Repsol, Spain's oil and gas giant, was one of seven companies recently invited to explore for oil in the Orinoco Belt in eastern Venezuela. Prime Minister José Luis Rodríguez Zapatero believes –naively in the view of Washington– his policy towards Venezuela acts as a moderating influence on Chávez.

Bono said the contract respected EU rules and did not involve offensive weapons. The boats and aircraft would be used to combat terrorism and drug trafficking. Furthermore, he said, Chávez had been democratically elected, unlike Fidel Castro in Cuba or Augusto Pinochet in Chile. His remark about Castro annoyed Havana, with whom the Socialists have also established closer relations, and led to Spain's ambassador there being summoned to the Cuban Foreign Ministry for a formal protest.

The PP, which had sold guns, grenades and anti-riot gear to Venezuela, said the contract was a 'monstrous error'.

Spain and China in strategic alliance agreement

Spain and China signed a strategic alliance agreement during the visit of President Hu Jintao. The alliance gives Spain the level of privileged relations with China previously only enjoyed by the UK, Germany, France and Canada. Of the four countries, Spain's trade with and investment in China is the lowest.

The agreement covers 12 areas of economic collaboration, including telecoms, renewable energy and financial services. The two countries also signed agreements on extradition, repatriation of prisoners, language learning and cultural centres. Spain also reaffirmed its support for negotiations with the EU to lift the embargo for EU arms sales to China, a move opposed by the US. The issue of human rights in China was briefly discussed, but did not figure prominently in Madrid's agenda.

Spain was one of three EU countries which Hu visited. The others were the UK and Germany. Spain's trade deficit with China in 2004 was €7.3 billion. The largest Spanish investment in China is that of Telefónica, the telecoms giant, which bought 3% of China Netcom Group Corp., China's second-largest fixed-line phone company, in June and is to lift it to 9.9% at an additional cost of around US\$540 million.

The two companies' strategic alliance covers cooperation in a number of areas including international business, provision of telecoms services in southern China and the development of call centres and technology purchasing.

Chirac backs Zapatero's bid to continue to receive net EU funds

France threw its weight behind Spain's bid to remain a net recipient of EU funds during the 2007-13 budgetary period when Jacques Chirac, the French President, and Jose Luis Rodríguez Zapatero, Spain's Prime Minister, met in Paris. The budget is on the negotiating table but it is by no means certain a deal will be struck at the nail-biting December 15 summit at the end of the UK's presidency of the Union.

Rodríguez Zapatero refuses to accept a 'brutal' fall in the funds that Spain receives. The country is the largest recipient in absolute terms (they represent around 0.8% of GDP a year).

As the main beneficiaries of the Common Agricultural Policy (CAP), Rodríguez Zapatero and Jacques Chirac, the French President, are also opposed to cutting CAP funds and are demanding changes to Britain's rebate.

France and Spain agreed to establish a defence and security council along the lines of the ones that Paris already has with Germany and the UK. It will meet once a year.

CIA flights using Spanish airports 'did not break the law'

The Spanish government, responding to reports that CIA planes transporting suspected Islamic terrorists had made stopovers in Spain, said it was convinced the American aircraft had broken no law. A Spanish judge is investigating reports that at least 10 CIA flights made stopovers in Mallorca. Other aircraft used Tenerife airport.

'The government is convinced, based on the result of the investigation carried out, that all the stops made in the framework of the Defence Cooperation Agreement between Spain and the United States, as well as stops by civilian planes, were made in accordance with the law', Miguel Ángel Moratinos, the Foreign Minister, told a parliamentary committee. He did not elaborate on the purpose of these flights. However, he said the government would step up checks on civilian planes that flew over or stopped in Spanish territory to make sure they were 'exclusively civilian' flights.

In the wake of 9/11, the previous centre-right PP government, which, unlike the Socialists, supported the invasion of Iraq, made the rules for US flights over Spain or making stopovers more flexible as of 2002. These rules are still in force. The previous system of authorisation on a case-by-case basis was replaced by one of blanket clearance for periods of three months.

The Council of Europe, which is investigating the alleged existence of secret CIA prisons in Poland and Rumania, asked the EU's satellite centre outside Madrid to hand over photographs taken from the air over the last three years.

First high-level group meeting of 'alliance of civilisations'

Spain and Turkey launched the 'alliance of civilisations' initiative with the first meeting of the high-level group charged with drawing up a report on ways to bridge the Christian and Muslim worlds and combat radical Islam.

Prime Minister José Luis Rodríguez Zapatero and his Turkish counterpart, Recep Tayyip Erdogan, formally launched the initiative, proposed by Zapatero a year ago and backed by the United Nations, at a meeting in Mallorca. The high-level group also includes former Iranian President Mohammad Khatamei, South African Nobel Peace Prize-winner Archbishop Desmond Tutu, Andre Azoulay, aide to Morocco's King Mohamed VI, former French Foreign Minister Hubert Vedrine and outgoing Inter-American Development Bank head Enrique Iglesias.

Domestic Scene

National parliament agrees to study Catalan autonomy charter proposal

The Spanish parliament agreed to study the Catalan charter for greater autonomy, but Socialist Prime Minister Rodríguez Zapatero said it would not be approved unless substantial amendments were made to it. MPs voted by 197 to 146 to study the project.

The 'no' votes came from the centre-right PP which vehemently opposes the charter which contentiously calls Catalonia a nation. It sets out proposals for wider powers in taxes, social security and Catalonia's judicial system, as well as controlling the

regulation and supervision of financial markets, energy, infrastructure and telecommunications.

Mariano Rajoy, the PP leader, said Rodríguez Zapatero's willingness to cede greater autonomy to Catalonia was the price he had to pay for continuing to govern. The new charter was presented by the Catalan Republican Left party (ERC), whose eight seats in the national parliament give the Socialists a working majority, the Catalan Socialist Party (PSC), which rules the region, and the centre-right nationalist Convergence and Union (CiU), which ruled the region for 23 years.

The PP won 9.7 million votes in the 2004 general election (compared with the Socialists' 11 million) and thus has the power to mobilise a lot of opposition outside parliament. It wants a referendum on the issue. Rajoy said the PP would not participate in negotiating the charter clause by clause and would only cooperate if there was a global agreement first on how far the new Catalan autonomy charter could go and a consensus on what needed to be reformed. This will not happen as the differences are too great. Equally, the PP is against reforming the Senate and turning it into a body that represents the 17 regions unless there is a deal on the Catalan charter.

The plan has also split the Socialists. Alfonso Guerra, a former Deputy Prime Minister and head of the Constitutional Commission in the parliament entrusted with studying the Catalan plan, said the financial part of the new charter was not in line with the constitution and the plan needed the widest support.

Apart from the PP's opposition, the Catalan charter was received much more cordially than the Basque plan for an 'associated free state' with the rest of Spain which was rejected as soon as it was presented to the national parliament earlier this year (see *Inside Spain*, Newsletter 10, February 7, 2005). The cordial spirit, however, is not expected to endure once hard bargaining begins. All three parties have rejected, in discreet conversations, the proposed alternative wording for 'nation' of 'national identity'.

Catholic Church heads protests against education reforms

Hundreds of thousands of Spaniards, backed by the Catholic Church, protested in Madrid at the government's education bill proposal. The most controversial point for the Church is that religious education in state schools would no longer be a subject with an exam and count towards the school leaving certificate.

The march was organised by the Episcopal Conference, the centre-right PP and Catholic family associations. The Church's influence in education has long been a contentious issue between the left and right in Spain, particularly during the 1931-36 Republic and the 1936-39 Civil War, when anti-clerical anarchists on the Republican side burned churches and killed priests, and those on the Nationalist side were given the Church's blessing for supporting General Franco and his 'crusade'. The Church was rewarded for supporting the winning side with a privileged situation during Franco's 1939-75 regime, and today still enjoys some of those privileges. It has been on the offensive against the Socialists since the government legalised same-sex marriages earlier this year.

State schools and those that receive government subsidies and where the Church's influence is often strong, known as 'concertadas' (which take 1.5 million pupils), have

to provide religious education classes but they are voluntary. By no longer having an exam on the subject the government is moving in line with Spain's increasingly secular society (and one where other religions, especially the Muslim faith, are rising because of the influx of North African immigrants), but the Catholic Church regards the move as devaluing the majority faith in Spain. It also wants those pupils who do not opt for religion classes to take a course called 'religious fact' or 'education for citizenry' which would also have an exam.

Although Spain has been a non-confessional state since the 1978 constitution, it is far from having a French-style secularism. The Catholic Church in Spain and Catholic schools officially receive more than €3 billion a year from the government, the Church is exempt from VAT and other taxes and it has the right to appoint and dismiss teachers of religion whose salaries are paid by the state (and who can be fired for being divorced or for living with a partner). The Church is the only faith in Spain that receives money via taxpayers' annual declarations –since 1987, under the first Socialist government, there is a box in the form that can be ticked and a fixed proportion (0.52%) goes to the Church–. The proportion of taxpayers who tick the box has fallen from 40% at the beginning of the 1990s to 33% in 2004. On top of this global amount from taxpayers, the government adds its contribution. By European standards, this is a generous deal. Some bishops want the 'religious tax' raised to 0.8%.

Other points of conflict in the education bill include reforms regarding the repeating of courses, the establishment of minimum contents for all of Spain in the curriculum (it varies from region to region), the admission of pupils to state schools and the 'concertadas', the amount of subsidies for the 'concertadas' and the costs they can charge. In some areas of Spain, demand for the 'concertadas' is strong (the quality of their education is often better and they are nowhere near as expensive as wholly private schools) and there are unfilled places in state schools. In these cases, the government wants the state school places to be filled rather than subsidise the building of more 'concertadas'. The Church claims this contravenes freedom of choice.

The bill has also acted as a catalyst for a wider public debate on the deteriorating state of Spain's education. The country scores very badly in the PISA tables (see *Inside Spain*, Newsletter 9, January 12, 2005), and one in every three students drop out of upper secondary education. While most other countries are reducing the drop-out rate, Spain's has been rising. Almost every government in the past 30 years has tinkered around with the education system, but has been unable to reverse this worrying trend.

The PP's identification with the Church's cause moved it away from the centre ground that it claims to represent.

Mega trial of 56 suspected Eta members and collaborators begins, 10 Islamic radicals arrested

Fifty-six people appeared before a court in Madrid in the largest ever trial related to the Basque separatist terrorist organisation Eta.

The government has offered to hold talks with Eta but only if it first lays down its arms. Eta has murdered more than 800 people since it began to fight for an independent Basque nation almost 40 years ago.

Meanwhile, Spanish police arrested 10 people suspected of setting up a support network for an Islamic extremist group thought to be linked to al-Qaeda. They are accused of giving logistical support and finance to the Algerian-based Salafist Group for Preaching and Combat.

King Juan Carlos scores high in poll to mark 30th anniversary of Franco's death

An opinion poll carried out to mark the 30th anniversary of the death of General Franco showed that 79% of respondents believe King Juan Carlos has done a good or very good job (84% in 2000 when he celebrated his 25th anniversary as king).

The Crown scored the highest mark in the poll in *El País*, the leading daily, among 10 institutions including the media, political parties and trade unions. Magistrates scored the lowest mark, probably because of the snail's pace at which the judiciary moves and the enormous backlog of cases.

Another poll, in *El Mundo*, however, showed that republican sentiment is on the rise. It suggested that almost a quarter of Spaniards considered themselves republicans. A 50% increase in declared republicans over five years was the result of a surge in the number of 18 to 29-year-olds who wanted to scrap the monarchy.

The anniversary of the death of Franco, whose dictatorship lasted from 1939 to 1975, drew a couple of hundred right-wing demonstrators who yelled slogans against Spain's democracy. Spain's economic progress since the restoration of democracy has been remarkable (see Figure 1).

Figure 1. Spain's Transformation, 1975-2005

	1975	2005
Number of cars (million)	7.0	26.4
Per capita GDP (current euros)	917	19,456
Unemployment rate (%)	4.4	9.3
Inflation (%)	14.1	3.7

(1) End of 2004; (2) June 2005; (3) September 2005.
Source: National Statistics Office.

The Economy

Gas Natural and Endesa merger moves a step forward

The European Commission ceded anti-trust powers to Spain's competition authorities in Gas Natural's €2.5 billion hostile take-over bid for Endesa, the largest electricity generator. The ruling was a victory for Gas Natural as Endesa had asked Brussels and not its government to decide whether the take-over distorted competition in Spain's electricity and gas markets. Endesa appealed against the decision.

The Commission referred the case to Spain because neither of the two companies reports more than a third of its European turnover outside Spain, the threshold above which a take-over has to be scrutinised by Brussels. Gas Natural accused Endesa of inflating its non-Spanish revenues through unaudited sales figures restated in accordance with new international accounting standards.

The debate about the proposed take-over has become increasingly acrimonious. The centre-right PP accused José Manuel Durão Barroso, the President of the European Commission, and José Luis Rodríguez Zapatero, Spain's Prime Minister, of striking a

deal under which the Commission agreed to allow Madrid to take the decision in return for Rodríguez Zapatero dropping his demands for a continuation of the large volume of EU funds in the 2007-13 budgetary period. Both Durão Barroso and Rodríguez Zapatero, who met on a Sunday afternoon in Madrid, denied this vehemently.

Spain's National Energy Commission has approved the deal, but some concerns have been expressed. A report prepared by the Spanish Finance Ministry for the competition board said the Gas Natural-Iberdrola side agreement, under which Gas Natural would sell Iberdrola €9 billion of assets, should be examined separately, as it had its own impact on competition in the energy markets. This raised questions as to whether Iberdrola would be able to raise enough money to honour the €7.8 billion cash portion of the deal. Gas Natural said it could raise the money.

The board must rule on the take-over by early January.

Government to get rid of its 'golden shares'

The government bowed to pressure from the European Commission and agreed to scrap the 'golden shares' that protected four privatised companies from foreign take-overs. The companies are the dominant players in their respective sectors: Telefónica (telecoms), Repsol (oil and gas), Iberia (airlines) and Endesa (electricity).

The 'golden shares' gave the government an effective veto over the sale of more than 10% of these companies. They were due to be cancelled in 2006 for Repsol and Iberia and in 2007 for Telefónica and Endesa.

Previous governments and the current administration never used this prerogative, but its existence, justified on the grounds that the companies controlled strategic assets, deterred foreign predators. Spain is not alone among EU countries in having 'golden shares'.

Corporate income tax rate to be cut

Spain will lower its corporate income tax rate from 35% to 30%. No date was given but it is expected to become effective as of 2007. Spain's rate is among the highest in the European Union and a reduction would make the country more attractive for foreign investment (see Figure 2).

Figure 2. Average Corporate Income Tax Rates (%)*

Germany	25.0
France	35.4
Spain	35.0
Italy	33.0
United Kingdom	30.0
Sweden	28.0
United States	28.0
Czech Republic	26.0
Finland	26.0
Poland	19.0

(*) In 2005.

Source: PricewaterhouseCoopers.

The rate for small and medium-sized companies would be reduced from 30% to 25% for the first €120,000 of profits and then 30% for the rest.

CAF wins high-speed train contract in Turkey

CAF, the Spanish rail engineering company, has won a €180 million contract to supply 10 high-speed trains to Turkey, for use on the future Ankara to Istanbul line. The contract is the first won by any Spanish company for the design and construction of high-speed trains in a foreign country.

Coal strike ends with deal

Miners ended a five-day strike after the government yielded to demands on early retirement. They will be able to continue to retire in their early 40s as opposed to 45, the limit which the government wanted as of 2008. Unions agreed to the plan to reduce the number of miners by one third to 5,800 by 2012.

Government seeks to extend retirement age

The government's proposed reform of the social security system includes extending the minimum early retirement age from 60 to 61 and providing incentives for workers who carry on after the age of 65.

Spain achieves second largest rise in employment rate in OECD

Spain's employment rate, which shows a country's ability to put its working-age population to work, rose from 32% in 1990 to 49% in 2004, the second-largest rise among OECD countries after Ireland, but it is still below the averages for the EU-15 and for the OECD as a whole (see Figure 3).

Figure 3. Employment Rate of Selected OECD Countries (%)*

Country	1990	2004
France	50.9	56.9
Germany	52.2	59.9
Ireland	36.6	55.8
Italy	36.2	45.2
Japan	55.8	57.4
Poland	53.1	46.4
Portugal	55.4	61.7
Spain	31.8	49.0
United Kingdom	62.8	66.6
United States	64.0	65.4
EU-15	48.7	57.1
Total OECD	52.5	55.8

(*) The employment rate is calculated by dividing the number of persons aged 15 to 64 in employment by the total population of the same age group.

Source: OECD.

Nevertheless, this is quite an achievement as the country's population rose from just over 39 million to 44 million during this period, largely due to Latin American and North African immigrants, and the unemployment rate dropped from a peak of 20% in 1994 to 11% in 2004. The sharp fall in unemployment is due to a rapidly growing economy –at a consistently higher pace than the EU almost every year since 1990– and the very widespread use of temporary contracts (one in every three of salaried workers).

Population continues to rise

Spain's population officially stood at 44.1 million at the beginning of 2005, 910,846 more than a year earlier and the largest annual increase (see Figure 4). Such growth is unusual in developed countries and is largely due to immigrants. The foreign-born population accounted for 8.4% of the total.

Figure 4. Spain's Population, 1999-2005* (millions)

	1999	2000	2001	2002	2003	2004	2005*
Population	40.2	40.5	41.1	41.8	42.7	43.2	44.1

(*) January 1.

Source: National Statistics Office (INE).