

Inside Spain 38

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Foreign Policy

Spain Re-establishes Cooperation with Cuba, After Four-Year Break

Spain took a further step towards full normalisation of its relations with Cuba by agreeing to restore official cooperation with the government of Fidel Castro, suspended unilaterally by Havana in 2003 in response to the diplomatic sanctions imposed by the EU after the execution by firing squad of three people, who hijacked a ferry in an attempt to flee the country, and the round-up of 75 dissidents.

Under the agreement, part of the accord reached between the two governments in April (see *Inside Spain*, Newsletter 34, of 8 May 2007), Madrid will re-establish official credit lines, when a deal is struck to renegotiate Cuba's debt, and press for the re-opening of Spain's Cultural Centre in Havana.

EU countries have taken different positions over Cuba since 2003. While the former communist countries, such as the Czech Republic, continue to take a hard line, Spain's Socialist government has taken the lead in easing the restrictions. Spain is the largest foreign investor in Cuba and the country is the third-largest export market for Spain in Latin America. Spain's exports to Cuba rose 28% in 2006 to €629 million and could be higher this year.

'It is illogical that we are not present in Cuba, as we are in the rest of Latin America', said Leire Pajín, Spain's Secretary of State for International Cooperation. She said that Spain's cooperation with Cuba had not in fact been totally frozen over the last four years because regional and municipal governments had continued to finance projects (worth US\$10 million in 2006). Even during the Franco regime, Spain had full diplomatic relations with Castro's Cuba.

The Socialists, heavily criticised by the conservative Popular Party (PP) for their stance over Cuba (José María Aznar, the former PP Prime Minister, was a prime mover behind the EU's sanctions), believe it is even more important now than ever to have official links with the island in order to be able to better influence the post-Castro future. Castro (aged 81) has not been seen at the helm of government since July 2006 when he transferred his responsibilities to his younger brother Raul (76) after undergoing surgery.

Miguel Ángel Moratinos, Spain's Foreign Minister, said the government would maintain its policy of not inviting dissidents to the October 12 National Day celebration in the Spanish embassy in Havana. He claimed that the more accommodating policy with the Cuban authorities was bearing fruit. 'We have achieved successes in political dialogue and on human rights with specific results', he said. 'Political prisoners are

being released, we have a negotiating capacity and we are promoting our country's interests'. Jorge Moragas, the PP's Secretary of International Relations, accused Moratinos of 'marginalising' dissidents and applying 'double standards'.

Two Spanish Soldiers Killed in Afghanistan, Minister Requests More Troops

Two soldiers were killed in Afghanistan and two others seriously injured in an attack by Taliban rebels, bringing the number who have died in or as a result of serving in the country to 84 (62 of whom were killed in a plane crash in Turkey in 2003 when returning home).

José Antonio Alonso, the Defence Minister, vowed to maintain Spain's peace-keeping force in Afghanistan under the Nato umbrella and requested permission from Parliament for an extra 52 soldiers to help train the Afghan army. Spain currently has 710 soldiers in the country (see Figure 1).

Figure 1. International Security Assistance Force Troops in Afghanistan

Country	Number	Country	Number
US	15,154	France	978
UK	6,678	Poland	943
Canada	3,079	Australia	883
Germany	2,908	Spain	705
Italy	2,573	Rumania	544
Netherlands	1,341	Others	2,258
Turkey	1,215	Total	34,743

Source: Nato.

Spaniards' support for troops in Afghanistan was the highest among the European countries surveyed in this year's Transatlantic Trends (see Figure 2).

Figure 2. European Support for Committing Troops to Reconstruction Efforts in Afghanistan

Country	% Approval
Spain	81
Netherlands	75
Portugal	73
France	71
Italy	70
UK	69
Romania	61
Germany	57
Poland	54
Turkey	50
Slovakia	44
Bulgaria	39

Source: Transatlantic Trends, 2007.

One of the soldiers killed was from Ecuador: the immigrant presence in Spain's armed forces is significant.

In separate developments, the Defence Ministry is to begin to employ foreign medical personnel as a result of the flight of Spanish medical staff from the armed forces. And in December Spain will assume command of the EU's military operation in Bosnia and Herzegovina (EUFOR-Althea). This will be the first time a Spanish general has taken charge of a multinational force.

Brazilian President Visits Madrid, Calls for More Spanish Investment

Luiz Inàzio 'Lula' da Silva made his first official visit to Spain as Brazil's President and presented his Growth Acceleration Programme which calls for more investment in his country. Spain is already the second-largest investor in Brazil after the US, with more than €35 billion invested. The two biggest Spanish investors are Telefónica and Grupo Santander. Spanish was recently introduced into Brazilian secondary schools as the second foreign language to be learned, after English.

Zapatero Seeks to Revive Spain-Russia Relations

José Luis Rodríguez Zapatero, Spain's Prime Minister, met his Russian counterpart, Vladimir Putin, at Sochi on the Black Sea and sought to reinvigorate relations with Russia, re-established 30 years ago after the end of the Franco regime.

The focus of the meeting was on ways to boost the economic relationship, according to reports. Iberdrola is bidding to build a €3 billion LNG plant near St. Petersburg.

The two leaders agreed to create a civic society forum.

Domestic Scene

King Juan Carlos Defends the Monarchy's Role in Post-Franco Spain

King Juan Carlos, who assumed the throne after the death of the dictator General Franco in 1975, took the unprecedented step of responding to calls by Catalan nationalists for the abolition of the Bourbon monarchy by saying it had provided Spain with the longest period of prosperity and stability in the country's democratic history.

The King made the remarks before a university audience in the northern city of Oviedo two weeks after protesters in Catalonia, who want independence for the region, burned photos of the King and hurled abuse at Crown Prince Felipe.

The small pro-independence party Republican Left of Catalonia (ERC), which won 2.5% of the national vote in the 2004 elections, said it burned the photos in order to 'open a debate on the Spanish political system that was handed down by the fascist dictatorship'. The ERC, a parliamentary ally at times of the central Socialist government, has filed more than 100 objections to the Royal Household's finances in the 2008 budget. The ERC is also seeking to strip the King of his role as Commander-in-Chief of the armed forces. Its leader, Josep Carod-Rovira, is the Deputy Premier of the Catalan regional government.

The King is immensely popular among the great majority of Spaniards for his unswerving support for democracy, sealed when he personally intervened and defused an attempted military coup in 1981, three years after the democratic constitution was approved in a referendum. In May, the King was voted the greatest Spaniard of all time in a TV poll, ahead of Christopher Columbus and Miguel de Cervantes, author of *Don Quixote*.

Miguel Ángel Moratinos, the Foreign Minister, said the portraits of the King had been burned by 'a tiny minority, a bunch of hooligans' and the protests would 'only serve to reinforce the prestige of our monarch'.

A general election has to be held by next March and regional issues will be a divisive campaign theme in Catalonia and the Basque Country.

Police Arrest Old and New Leadership of Banned Basque Separatist Party

Spanish police raided a meeting of Batasuna, the Basque separatist party banned in 2003, at which the party's old guard was handing over control to a new leadership and arrested 23 people.

Cándido Conde Pumpido, the Attorney General, said some of those arrested were accused of co-operating with the terrorist group Eta which called off a 15-month cease-fire earlier this year. 'These activities cannot be tolerated, so if the police find out about them it seems prudent that they be ordered to intervene', he said. Seventeen of them were imprisoned.

The arrests, on the orders of Baltasar Garzón, the top anti-terror judge, were made in the town of Segura. Garzón banned Batasuna in 2003 for failing to condemn violence and cut links to Eta, which has murdered more than 800 people in 40 years.

Pernando Barrena, a Batasuna leader who was not detained, called the raid a 'declaration of war' by the Spanish government.

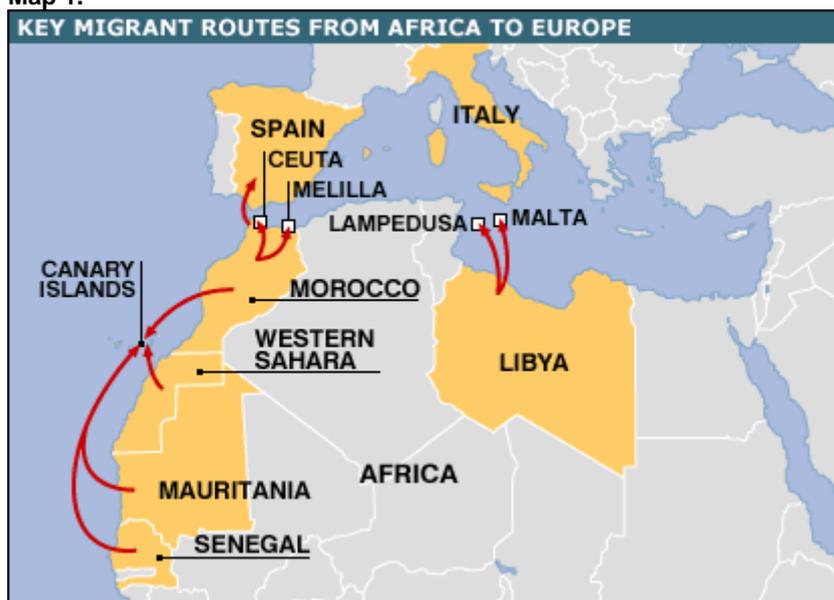
In another development, Josu Jon Imaz resigned as President of the Basque Nationalist Party (PNV). Imaz and Juan José Ibarretxe, the Basque Premier, were at loggerheads over political strategy. While Imaz defended a more moderate line including greater cooperation with the central government and with non-nationalist political parties, the ardent nationalist Ibarretxe has returned to a collision course with Madrid by resurrecting the idea of a referendum on the Basque Country's future. The referendum for an 'associated free state', rejected by the Spanish Parliament in 2005, is unconstitutional, but Ibarretxe says he will press ahead. The PNV won 38.6% of the vote in the 2005 elections in the Basque Country.

Government Begins Anti-Migration Adverts

The government has responded to the influx of illegal immigrants fleeing West Africa and arriving in the Canary Islands after a perilous 12-day crossing of the Atlantic by boat with a campaign of emotional adverts (see Map 1). The campaign complements diplomatic efforts to curb illegal immigration.

'My son left.... and we haven't heard from him in eight months', a distraught Senegalese woman says in one advert. It then cuts to a boy lying face down on the rocks, apparently drowned. 'You already know how this story ends', continues Senegalese singer Youssou N'Dour.

Map 1.



Although the number arriving is lower this year than in 2006 (6,659 in the first eight months, 66% fewer than in the same period of last year), it is still significant and a drama of tragic proportions. It is estimated that as many as 6,000 have died of drowning, thirst or starvation, although no one has any idea of the exact number.

Spain has signed cooperation and repatriation agreements with Algeria, Morocco, Senegal, Mauritania, Gambia, Guinea, Mali and Ghana.

Immigrants currently account for around 12% of the population (see Figure 3), and in 2005 Spain had the second-largest number of non-EU immigrants (2.3 million) in absolute terms (see Figure 4). The figure has declined since then, but only because Rumania and Bulgaria joined the EU this year.

Figure 3. Ten Years of Immigration (thousands)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Naturalised population (1)	732 (2%)	693 (2%)	661 (1%)	659 (1%)	638 (1%)	616 (1%)	599 (1%)	549 (1%)	510 (1%)	537 (1%)
Foreign population	4,483 (10%)	4,144 (9%)	3,731 (9%)	3,034 (7%)	2,664 (6%)	1,978 (5%)	1,371 (3%)	924 (2%)	749 (2%)	637 (2%)
Total Immigrants	5,214 (12%)	4,838 (11%)	4,391 (10%)	3,694 (9%)	3,302 (8%)	2,594 (6%)	1,969 (5%)	1,472 (4%)	1,259 (3%)	1,174 (3%)
Population born in Spain	39,903 (88%)	39,871 (89%)	39,717 (90%)	39,504 (91%)	39,415 (92%)	39,244 (94%)	39,148 (95%)	39,027 (96%)	38,943 (97%)	38,679 (97%)
Total population	45,117	44,709	44,109	43,198	42,717	41,838	41,117	40,500	40,202	39,853

(1) The naturalised population are those born abroad who live in Spain and have Spanish nationality. Percentages rounded to the nearest full number.

Note: the figures for 2007 are preliminary.

Source: INE (National Statistics Office) and the *Padrón Municipal* (those registered with their town hall at 1 January of each year).

Figure 4. Non-EU Immigrants in the European Union, Top 10 Countries (% of total population) (1)

Country	Number	% of Total Population
Germany	5,075,900	6.2
Spain	2,300,700	5.3
France	2,186,000	3.6
UK	1,982,200	3.2
Italy	1,931,300	3.3
Greece	742,900	6.7
Poland	684,000	1.8
Austria	553,500	6.7
Latvia	482,400	20.9
Netherlands	466,000	2.9
Total of all 27 countries	18,085,500	3.7

(1) Figures at 1 January 2005.

Source: Catholic University of Leuven.

Spain Slips in Corruption Perceptions Index

Spain was ranked 25th in the 2007 Corruption Perceptions Index, drawn up by the Berlin-based Transparency International, which looks at perceptions of public sector corruption in 180 countries (see Figure 5). In 2006 and 2005 Spain was ranked 23rd out of 163 and 159 countries, respectively. Its score dropped from 7 in 2005 to 6.8 in 2006 and 6.7 in 2007 (the closer to 10 the cleaner the country). However, Spain remained much ‘cleaner’ than Italy (41st), which yet again was outflanked by Botswana (38th).

Figure 5. Transparency International Corruption Perceptions Index, 2007, Selected Rankings (1)

Country	Score
1. Finland	9.4
12. UK	8.4
16. Germany	8.0
18. France	7.8
20. US	7.2
25 Spain	6.7
41 Italy	5.2

(1) Out of 180 countries.

Transparency’s report coincided with one by the office of the Director of Public Prosecutions which said that the urban development situation in Cadiz was ‘out of control’ and one in every five mayors in the province of Malaga was under investigation for urban crimes and corruption. It said the ‘Marbella effect’ (in allusion to the scandal involving the town hall discovered in 2006) had spread to other provinces where money-laundering activities were being investigated.

Catalan Government Orders School to Readmit Muslim Girl with Headscarf

The Generalitat, the Catalan government, ordered a state school to readmit an 8-year-old Muslim girl who was sent home for wearing the *hijab* on the grounds that her right to an education took precedence over a school’s internal rules.

Spain has around 1 million Muslims and so far wearing a headscarf in school has not been a conflictive issue, as it has in France, for example, where it is banned along with other overtly religious symbols. Spain has not yet legislated on this issue.

The Economy

Election Year Budget Lifts Lid on Public Spending

The government’s budget for 2008, an election year, will provide more than €2.3 billion in tax breaks for single parents and families with newborn children. There will also be payments for those aged between 22 and 30 on low salaries towards their rent.

Until now, Pedro Solbes, the highly experienced Finance Minister, has resisted pressures to increase public spending, despite having the largest budget surplus among the big EU economies. The extra spending will cut the surplus from an estimated 1.8% of GDP in 2007 to 1.15% of GDP in 2008.

The measures include €2,500 for every child born after July 2007 (dubbed ‘baby cheques’ by the media), an extra €1,000 per child for single mothers, and young employed adults earning less than €22,000 will be eligible to receive a payment of €10 towards their rent and a loan of €600 towards the cost of the rent deposit. The full details of the ‘baby cheque’ have not been released, but it seems that these payments will be granted regardless of the income level of parents and will not be means-tested.

Young adults are caught between a rock and a hard place in the housing market – property prices are high and wages low-. As a result, the generation of ‘*mileuristas*’ (those who earn €1,000 a month) are not getting a foot on the property ladder; and this in a country where home ownership has traditionally been high and where the number of housing starts in 2006 was more than in the UK, France and Germany put together.

A 27-year-old Spaniard drew attention to this plight by placing himself in a 26 square metre pre-fabricated house in front of the Reina Sofia Museum in Madrid –the size of the ‘cage’ corresponded to the number of square metres that ‘*mileuristas*’ can aspire to without committing more than 30% of their salary-. Spain’s house prices have risen the most in the EU after Ireland, but wage growth has lagged miles behind and the country’s ‘bubble factor’ is among the highest (see Figure 6).

Figure 6. House Price Indicators (%)

	Belgium	France	Spain	Sweden	UK
House price rise (1996-2006)	90.1	73.4	132.7	131.2	113.7
‘Bubble factor’ (1)	53.3	8.6	45.0	53.7	38.8
Mortgage debt-to-GDP ratio	34.2	31.8	56.1	41.3	82.8

(1) This refers to an indicator called ‘the contribution of estimated change in expected capital gains to 10-year house price growth’. It measures the extent to which expectations contribute to rising housing prices –possibly leading to a bubble-. The higher the figure the more a rise in anticipated capital gains has driven up house prices. For example, a figure of 50% means that greater optimism over capital gains over the 10-year period made house prices 50% higher. Source: David Miles & Vladimir Pillonca, *Financial Innovation and European Housing and Mortgage Markets*, Morgan Stanley Research, 18/III/2007.

The conservative Popular Party (PP) labelled the measures electioneering. Young voters played a key role in the Socialists’ victory in 2006: turnout was high as a result of the train bombings in Madrid and the PP’s decision to involve Spain in the war in Iraq which catapulted many people –who do not normally vote– to the polls. This time round, and barring any further such tragic events, the Socialists need a way to get young Spaniards to the polls again. The PP has a more bedrock electoral base.

The government also agreed with the United Left party (IU) to begin to universalise kindergarten education as of 2008 and set aside €100 million. IU had said it would not support the other measures unless the ‘baby cheques’ scheme was backdated to January 2007. It agreed to support the July date in return for the deal on education.

Catalonia will receive €26 million more funds from the central government than initially envisaged in order to improve its roads, trains and electricity, parts of which collapsed over the summer.

The government believes the sub-prime mortgage crisis in the US and the turmoil in financial markets will not affect the Spanish economy as a whole very much –GDP growth is forecast to decline from 3.8% in 2007 to 3.3% in 2007– unless it lasts a long time. David Taguas, who heads the Prime Minister’s economic office, gave an upbeat assessment (see www.la-moncloa.es/NR/rdonlyres/4AA849F6-8787-467B-A402-26BAD9C538DB/83766/InstitutodeEmpresa_25092007.pdf).

The downturn in Spain’s decade-booming property market claimed its first victim when the property company Llanera, with debts of €764 million at the end of 2006 and more than 600 employees, began bankruptcy proceedings. Debts related to the construction sector –households (mortgages), property companies and construction companies– amounted to €1,015 billion at the end of June, almost on a par with Spain’s GDP.

European Commission Fines Repsol and Cepsa for Price-Fixing

The European Commission fined Spain’s Repsol and Cepsa €80.5 million and €3.9 million, respectively, for fixing the price of bitumen (used to make asphalt) in Spain over a 12-year period. Two smaller operators, Sweden’s Nynas and Portugal’s Galp, were fined much smaller amounts.

‘They cheated customers, public authorities and tax payers by carving up the market for road-building bitumen amongst themselves’, said Neelie Kroes, the EU’s competition commissioner. BP, the UK energy group, escaped a penalty after blowing the whistle.

Spain’s Inward Foreign Direct Investment Set to Rise, Says EIU

Spain will receive more inward FDI between 2007 and 2011 –an average of US\$44.9 billion a year– than in 2002-06 (US\$26.9 billion a year), despite rising wage and non-wage costs, less flexible labour market regulations than in other EU countries and the growing attractiveness of alternative locations, according to the Economist Intelligence Unit (EIU).¹ This would be the ninth-highest amount in the world (see Figure 7).

The EIU says that Spain ‘is not an obvious location for Greenfield investments except in a few niche fields’, but it is a ‘major market and many Spanish companies are profitable, making them potentially attractive targets for takeovers’. One key issue will be whether the government impedes such take-overs in what it considers important sectors as the Socialists did in 2006 and early 2007 when they obstructed the attempt by the German energy company E.on to acquire Endesa, Spain’s largest electricity company. The two-year struggle for Endesa came to an end on 5 October when Spain’s infrastructure company Acciona and Italy’s Enel (30% owned by the Italian state), which launched their joint take-over in April, announced they controlled 92% of Endesa.

¹ See *World Investment Prospects to 2011*, Economist Intelligence Unit, 5/IX/2007, written with the Columbia Program on International Investment.

Figure 7. FDI Inflows (2007-11 average), Top Ten Recipient Countries

Country	US\$bn	% of World Total
1. US	250.9	16.75
2. UK	112.9	7.54
3. China	86.8	5.79
4. France	78.2	5.22
5. Belgium	71.6	4.78
5. Germany	66.0	4.41
6. Canada	63.2	4.22
7. Hong Kong	48.0	3.20
8. Spain	44.9	2.99
9. Italy	41.6	2.77
10. Netherlands	38.5	2.57

Source: Economist Intelligence Unit.

The EIU ranked Spain's overall business environment 22 out of 82 countries for 2007-11, the same position as in 2002-06 (see Figure 8). There are two significant changes, however, in Spain's position in the segments that comprise the overall ranking: the country's macroeconomic environment dropped from 39th to 54th, but in market opportunities it rose from 17th to 11th place.

Figure 8. Business Environment Rankings

	Score (out of 10)		Rank (out of 82)	
	2002-06	2007-11	2002-06	2007-11
Overall scores and ranks	7.4	7.82	22	22
Political environment	7.8	7.8	19	21
Macroeconomic environment	7.5	7.2	39	54
Market opportunities	7.1	7.7	17	11
Policy towards priv. enterp. & compet.	7.5	7.8	21	24
Policy towards foreign investment	8.2	8.2	17	20
Foreign trade & exchange controls	8.7	9.1	15	14
Taxes	5.6	6.3	42	42
Financing	7.8	8.9	20	18
Labour market	6.5	7.2	38	28
Infrastructure	7.5	8.2	24	22

Source: Economist Intelligence Unit.

In the latest Ease of Doing Business Index, an annual report published by the World Bank, Spain was ranked 38th out of 178 countries (see Figure 9). Spain slipped in many of the rankings, most notably in starting a business (118th in 2007, down from 108th in 2006). It still takes, on average, 47 days in Spain to satisfy the authorities that you are fit to establish and register a business compared with seven days in France, 18 in Germany and 13 in the UK. But this is nothing compared to the 152 days in Brazil. The average number of days for OECD countries is 15. And in employing workers, Spain is ranked 154th (see Figure 10).

Figure 9. Ease of Doing Business Index

Ease of...	2007 Rank (1)	2006 Rank (2)	Change in Rank
Doing Business (overall)	38	39	-1
Starting a Business	118	108	-10
Dealing with Licenses	46	48	+2
Employing Workers	154	152	-2
Registering Property	42	41	-1
Getting Credit	13	12	-1
Protecting Investors	83	81	-2
Paying Taxes	93	91	-2
Trading Across Borders	47	43	-4
Enforcing Contracts	55	59	+4
Closing a Business	17	15	-2

(1) Out of 178 countries.

(2) Out of 175 countries.

Source: Doing Business, World Bank.

Figure 10. Employing Workers

Indicator (1)	Spain	France	Germany	Italy	UK
Difficulty of Hiring Index	78	67	33	33	11
Rigidity of Hours Index	60	60	60	40	0
Difficulty of Firing Index	30	40	40	40	10
Rigidity of Employment Index	56	56	44	38	7
Non-wage labour cost (% of salary)	33	47	19	37	11
Firing Costs (weeks of wages)	56	32	69	2	22

(1) Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices.

Source: Doing Business 2008, World Bank.

INTERES, the government's inward foreign investment agency, takes issue with the World Bank's rankings. It pointed out that the Doing Business ranking is based on 38 indicators compared with the 323 used by the Swiss business school IMD in its equally well-known World Competitiveness Yearbook (which ranked Spain 30th out of 55 countries in 2007). According to the Doing Business ranking, it is easier to do business in Georgia than in Germany, France, the Netherlands and Spain, something that is hard to believe. The ranking does not take into account such important variables for investors as the size of the domestic market, the proximity to other markets or macroeconomic stability. Nevertheless, it does expose Spain's weak areas.

In the latest de-location of industrial activity, the British multinational SSL Healthcare Manufacturing announced it was closing its Durex condom factory in Rubi, Catalonia next year and transferring production to India and Thailand where costs are much lower. The plant in Rubi employs 230 people.

Iberdrola Acquires Cogeneration Plant in Oregon

Iberdrola enhanced its growing presence in the US by purchasing a 506 MW cogeneration plant in Oregon for €209 million from the city of Klamath Falls. It is the company's first such acquisition in the US and was made by its subsidiary PPM Energy, which has operated the plant since it went on stream in 2001.

More Spanish Companies in the Dow Jones Sustainability Index

Spain has 17 companies in the new Dow Jones Sustainability World Index, three more than previously (see Figure 11). The new members are Acciona, ACS and Gamesa. Launched in 1999, the DJSI tracks the financial performance of the leading sustainability-driven companies world-wide.

Figure 11. Dow Jones Sustainability World Index, Companies by Country (1)

Country – Nr of companies			
Australia – 21	France – 20	Malaysia – 1	Sweden – 6
Belgium – 1	Germany – 22	Netherlands – 15	Switzerland – 12
Brazil – 7	Hong Kong – 1	Norway – 4	Taiwan – 1
Canada – 10	Ireland – 1	South Africa – 3	Thailand – 1
Denmark – 4	Italy – 7	South Korea – 2	UK – 68
Finland – 5	Japan – 36	Spain – 17	US – 53

(1) As of 24 September 2007. The 17 Spanish companies are: Santander, Telefónica, BBVA, Endesa, Repsol YPF, Iberdrola, Abertis, Gas Natural, Ferrovial, Iberia, Inditex, Indra Sistemas, Red Eléctrica, Unión Fenosa, ACS, Gamesa and Acciona.

Source: Dow Jones.