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### Summary

Spain aims for a 'soft' Brexit, but Gibraltar could be a stumbling block.  
Basque separatist terrorist group ETA fulfils disarmament promise.  
Washington distances itself from Catalan independence movement.  
Fiscal deficit falls within EU targets for first time since 2008.  
Madrid rejects mega entertainment complex.

### Foreign Policy

#### Spain aims for a 'soft' Brexit, but Gibraltar could be a stumbling block

The scale of the trade and direct investment relationship between Spain and the UK and the large number of Britons living in Spain looks like putting Madrid in the 'soft' Brexit camp.

Foreign Minister Alfonso Dastis told *El País* that Spain preferred a soft Brexit, although he doubted it would be possible. 'Spain is closer to soft Brexit. We regret the UK is leaving. We want a balanced, reasonable agreement. But if they're leaving the single market and the customs union, it's difficult to think of a soft Brexit. Spain would like a close relation, as similar as possible to the one we have now.'

A 'hard' Brexit could be particularly rough for Spain. The country has enjoyed a trade surplus with the UK every year since 2002 (close to €8 billion in 2016), Spanish companies have invested heavily in Britain (much more than UK ones in Spain) and there are almost 300,000 Britons living in Spain, according to official figures, the largest British ex-pat community in Europe (unofficially the number is put at 800,000), who play a not insignificant role in the economies of the areas where most of them live.<sup>1</sup> In contrast, the number of Spaniards registered in the UK is much lower at 132,000 (see Figure 1).

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<sup>1</sup> For a much fuller analysis of the Spain-UK relation see [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_en/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_in/zonas\\_in/ari27-2017-chislett-why-spain-would-like-soft-brexit-uk](http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/ari27-2017-chislett-why-spain-would-like-soft-brexit-uk).

**Figure 1. EU citizens living in the UK (non-British population in thousands, by EU nationality)**

	<b>EU citizens in the UK (thousands)</b>
Poland	916
Ireland	332
Rumania	233
Portugal	219
Italy	192
France	165
Germany	135
<b>Spain</b>	<b>132</b>

Source: UK Office of National Statistics.

The potential stumbling block is the age-old problem of Gibraltar, the British Overseas Territory long claimed by Spain.

The origin of the latest argument is the EU's draft negotiation guidelines for Brexit sent to EU capitals at the end of March, which states that 'after the United Kingdom leaves the union, no agreement between the EU and the United Kingdom may apply to the territory of Gibraltar without the agreement between the Kingdom of Spain and the United Kingdom'.

This rather ambiguous phrase, which has been generally interpreted as meaning that neither the withdrawal agreement –so any transition arrangement for post-Brexit, which might give the UK the status quo for a few years– nor a future trade deal, can apply to Gibraltar unless Spain agrees to it.

This de facto veto power for Spain, which throws a territorial disagreement into the Brexit divorce proceedings, provoked wrath on the Rock.

'This draft suggests that Spain is trying to get away with mortgaging the future relationship between the EU and Gibraltar to its usual obsession with our homeland', said Fabian Picardo, Gibraltar's Chief Minister. 'This is a disgraceful attempt by Spain to manipulate the European Council for its own, narrow, political interests. Brexit is already complicated enough without Spain trying to complicate it further.'

The UK government then issued its standard response that it would defend Gibraltar's interests and nothing would be done without the Gibraltarians' consent.

Lord Howard, a former leader of the Conservative Party, poured oil on the flames by inferring that Theresa May, the British Prime Minister, would go to war with Spain to

defend Gibraltar, should Madrid turn aggressive. The predictable message to Spain of the jingoistic tabloid *The Sun* was 'Up yours senors!' (without the 'ñ'), in a repeat of its 'Up yours Delors' of 1990.

Both Gibraltar and London have rejected Madrid's offer of joint sovereignty of the Rock so that Gibraltar can remain in the EU. Gibraltarians voted 96% in favour of remaining in the EU.

The row over the guidelines was a storm in a teacup as Madrid would have such a veto anyway. Europe's recent free trade agreement with Canada set the precedent that wide ranging deals –such as that sought by the UK– must be ratified in all EU countries, Spain included, to take effect.

Nevertheless, the wording in the guidelines is a diplomatic coup for Spain and seemed to take London by surprise, having more important issues to be concerned about. Dastis drove the point home in the *El País* interview. 'We have talked with our partners and the [EU] institutions in recent weeks and we have made the Spanish position clear', he said. 'When the United Kingdom leaves the EU, then the EU's partner is Spain, and when it comes to Gibraltar the EU is obliged, as a result, to take the side of Spain'.

Dastis also made it clear that Spain would not close the border with Gibraltar after Britain leaves the EU. Such a move would threaten jobs on both sides, and 'I don't see how that would benefit us', he said. Spain would push during Brexit negotiations for a 'reciprocal principle' regarding workers' rights and immigration.

Some analysts believe Spain won the wording in the EU's guidelines in exchange for Madrid saying it would not close the border. Brussels wants a controlled chess game and not a battle.

### Big rise in Spain's official development assistance

Spain's net official development assistance (ODA) increased 192% in 2016 to just over US\$4 billion but as a percentage of national income (0.33%) was still less than half the target of 0.7% set by the UN (see Figure 2).

**Figure 2. Net official development assistance (% of GNI), 2015-16**

	2016	2015
France	0.38	0.37
Germany	0.70	0.52
Italy	0.26	0.22
<b>Spain</b>	<b>0.33</b>	<b>0.12</b>
UK	0.70	0.70
Average of DAC countries (1)	0.40	0.40

(1) OECD countries that are members of the Development Assistance Committee.

Source: OECD.

The surge in Spain's ODA was due to exceptional debt relief for Cuba.

José Luis Rodríguez Zapatero, the previous Socialist Prime Minister (2004-11), had set 0.7% as the target for 2012, but this was before Spain went into recession and several years of spending cuts.

### King Felipe in state visit to Japan to boost ties

King Felipe VI and Queen Letizia made a four-day state visit to Japan aimed at strengthening the ties between the two countries which next year mark the 150<sup>th</sup> anniversary of bilateral relations.<sup>2</sup>

Seven agreements were signed during the trip including an agreement to promote working holidays for young Spaniards in Japan and young Japanese in Spain and an accord on medical research cooperation. The newspaper *Yomiuri Shimbun* and the Prado Museum are to hold a Velázquez exhibition next year.

## Domestic Scene

### Basque separatist terrorist group ETA fulfils disarmament promise...

The militant Basque group ETA, which assassinated 845 people over a 40-year period in its struggle for an independent country carved out of northern Spain and south-western France, gave up its arsenal of weapons and explosives on 8 April, as previously announced, but did not say it was disbanding as the government is demanding.

<sup>2</sup> The opportunities for Spain are set out in an analysis by Luis Simón at [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_en/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_in/zonas\\_in/ari31-2017-simon-japan-strategic-awakening-opportunities-spain](http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/ari31-2017-simon-japan-strategic-awakening-opportunities-spain).

French police checked eight sites after they were notified of them. The caches contained 120 firearms, three tonnes of explosives and several thousand rounds of ammunition, a spokesman for the 'Artisans of Peace', the group that mediated between ETA and the French authorities, said.

The French Interior Minister, Matthias Fekl, hailed the move as a 'major step', but Spanish authorities were more circumspect and warned that the group could expect 'nothing' in return.

'It will not reap any political advantage or profit', said Íñigo Méndez de Vigo, the government spokesman. 'May it disarm, may it dissolve, may it ask forgiveness and help to clear up the crimes which have not been resolved', he said.

ETA was established in 1959 partly in response to the Franco dictatorship's repression. The group's first known killing was in 1968 when a Civil Guard was shot in the back after intercepting a stolen car. Its most spectacular action was the assassination of Prime Minister Luis Carrero Blanco, Franco's alter ego, in 1973, when it detonated a bomb in a T-shaped tunnel under his car in Madrid. The blast hurtled the car 30 metres into the air and over the roof of the church in which he had just been attending mass in accordance with his rigidly established timing and route.

Severely weakened by scores of arrests in Spain and France after its last killing in 2010, ETA declared a ceasefire in 2011.

The disarmament was particularly good news for, among others, María José Usandizaga, a former Popular Party councillor in San Sebastián, who for the past 22 years had a bodyguard as several attempts had been made to murder her, but which she now no longer needs.

### ... Washington distances itself from the Catalan independence movement

Visits to the US by the current and former Premiers of Catalonia to drum up political support for the illegal independence referendum scheduled for September led the US Embassy in Madrid to reaffirm that the US government's position on Catalonia was 'an internal issue for Spain' and it wanted to maintain a 'strong and united Spain'.

Carles Puigdemont, the Catalan Premier, recently made a five-day trip to Washington and New York where he met with several US Congressmen, among others, to discuss the current deadlock between Catalonia and the central government in Madrid.

He then returned to the US to meet with former President Jimmy Carter, whose foundation several days later, and at the same time as the US Embassy in Madrid, also issued a statement saying it would not get involved.

Carter's rejection, much more than the expected position of a foreign government, was a particular setback for the independence movement as his foundation is dedicated to

resolving conflicts. The decision not to intervene undermines the Catalan government's arguments in favour of independence.

Artur Mas, the former Catalan Premier, visited the US before Puigdemont and spoke at Harvard University.

The central and Catalan governments are set on a train crash. Neither side is relenting. The minority Popular Party government's position on not giving in to the demand for the unconstitutional referendum is broadly backed by the Socialists and the centrist Ciudadanos.

In a bid to defuse the economic grievances of the independence movement, Prime Minister Mariano Rajoy promised to invest €4.2 billion in Catalonia. The investment would be mostly in rail transport infrastructure between 2017 and 2020.

According to the latest opinion poll by Metroscopia, only 31% of respondents are in favour of independence compared with 46% who want Catalonia to remain part of Spain but with new and guaranteed powers and 19% who want the region to continue as it is. This shows a clear majority (65%) against outright independence.

In a sign that companies are leaving or not setting up in Catalonia, a report by D&B said the Madrid region gained 407 firms in net terms last year and Catalonia lost 279.

### Spain holds its position in UN Human Development Index

Spain remained in 27<sup>th</sup> position out of 188 countries in the latest UN Human Development Index, which is based on several factors (see Figure 3).

The country's life expectancy at birth (82.8 years) is the second highest in the EU, but its mean years of schooling is among the lowest at 9.8. Polish and Rumanian children, for example, spend more years at school.

**Figure 3. UN Human Development Index for selected countries, 2016**

Ranking (1)	Human Development Index value 2015	Life expectancy at birth 2015 (years)	Mean years of schooling (2015)	GNI per capita (2011 PPP US\$) 2015
1. Norway	0.944	81.7	12.7	67,614
4. Germany	0.926	81.1	13.2	45,000
10. US	0.920	79.2	13.2	53,245
16. UK	0.909	80.8	13.3	37,931
21. France	0.897	82.4	11.6	38,085
26. Italy	0.887	83.3	10.9	33,573
<b>27. Spain</b>	<b>0.884</b>	<b>82.8</b>	<b>9.8</b>	<b>32,779</b>

(1) Out of 188 countries.

(2) The maximum value is one.

Source: United Nations Human Development Report, 2016.

Spain's index increased from 0.755 in 1990 to 0.884 in 2015, a rise of 17%, faster than the other three big euro zone countries (Germany, France and Italy) but from a lower starting position (see Figure 4).

This index (maximum value one) is based on life expectancy at birth, mean years of schooling, expected years of schooling and gross national income per capita.

**Figure 4. Change in UN Human Development Index for selected countries, 1990-2015 (1)**

	1990	2000	2010	2012	2015	Change 1990-2015 (%)
1. Norway	0.849	0.917	0.939	0.942	0.949	11.7
4. Germany	0.801	0.860	0.912	0.919	0.926	15.6
10. US	0.860	0.884	0.910	0.915	0.920	6.9
16. UK	0.775	0.866	0.902	0.899	0.909	17.3
21. France	0.779	0.849	0.882	0.887	0.897	15.1
26. Italy	0.768	0.828	0.869	0.876	0.887	15.5
<b>27. Spain</b>	<b>0.755</b>	<b>0.825</b>	<b>0.867</b>	<b>0.874</b>	<b>0.884</b>	<b>17.0</b>

(1) The maximum value is one.

Source: UN Human Development Reports.

### Women's slow advance since the 2007 Law of Equality

Women in Spain have made slow progress since the Socialist government passed an affirmative-action law 10 years ago aimed at getting more of them into political office, as well as into company boardrooms.

The Law of Equality also requires political parties to run female candidates in at least 40% of the seats they contest, except in small towns.

Almost 40% of MPs are women, slightly more than in 2007, but only 19% of them are mayors and 19% company directors (see Figure 5).

**Figure 5. 10 years of equality legislation: percentage of women in different positions**

	2007	2015
Members of parliament (1)	36	39
Mayors	15	19
Ambassadors	7.1	7.2 (2)
Academics (members of Royal Academies)	6.1	9.7 (2)
Directors of Ibex-35 companies	6.4	19.4
Salaries (% of men's salaries)	80.9	85.6 (3)
Temporary part-time contracts	46.0	43.6
Permanent part time contracts	65.6	58.3

(1) 2004 and 2016, not 2007 and 2015.

(2) 2016.

(3) 2014.

Source: Instituto de la Mujer.

Gender-based violence remains a problem. In 2016, 44 women were killed by their partners (48 in 2015) and 21 so far this year. Special courts were introduced in 2005 to deal with these cases.

## The Economy

### Fiscal deficit falls within EU targets for first time since 2008

Spain's general government fiscal deficit in 2016 complied with the EU's Stability and Growth Pact for the first time since the global financial crisis in 2008, largely thanks to regional government finances.



The deficit came in at 4.33% of GDP, below the 4.6% agreed with Brussels. Including aid to banks, the deficit was 4.54%, down from 5.08% in 2015. The regional governments' deficit was halved to 0.82% (see Figure 6).

**Figure 6. General government accounts, 2015-17 (% of GDP)**

	2015	2016	2017 forecast
Central government	-2.59	-2.52	-1.10
Regional governments	-1.74	-0.82	-0.60
Local governments	+0.47	+0.64	0.00
Social Security	-1.22	-1.62	-1.40
General government	-5.08	-4.33	-3.10
Total including financial aid	-5.13	-4.54	–

Source: Finance Ministry.

The impact during the Socialist government of the collapse of the construction sector as of 2008 on public finances was dramatic. Rapidly falling tax revenues and rising spending, as a large part of it was allotted for essential services such as health and education, coupled with the burden of unemployment subsidies as the jobless rate soared, turned a fiscal surplus of 2% of GDP in 2007 into a deficit of 11% in 2009.

The Popular Party took office in November 2011. The deficit that year was 9.4% of GDP, well beyond the 6% target agreed with Brussels and a commitment to reduce it to the EU threshold of 3% in 2013.

The 3% target was far too ambitious a wrench for an economy in recession and in July 2012 the government was given another year to meet the threshold.

This, too, proved to be unrealistic and after missing targets in 2012 (the deficit came in at almost 7% of GDP and 10.3% including the aid to ailing banks) and struggling with the goals for 2013, due to a combination of weaker-than-expected revenues, some expenditure overruns and higher social spending resulting from massive unemployment, Brussels came to Madrid's rescue again in May 2013 and gave the government until 2016 to meet the 3% reference.

Spain narrowly avoided a fine from the European Commission last year for failing to take enough action to reduce its budget deficit. It was given until 2018 to cut the deficit to below 3%, which the government finally looks like achieving (see Figure 7).

**Figure 7. Fiscal deficit targets and outcome, 2008-16 (% of GDP)**

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Target	1.15	0.82	-9.3	-6.0	-6.3	-6.5	-5.5	-4.2	-4.6
Outcome	-4.4	-11.0	-9.5	-9.3	-6.8	-6.7	-5.9	-5.1	-4.3

Source: Finance Ministry.

While the regional governments' deficit was reduced in 2016, the social security's deficit has not stopped rising since 2011, when it went into the red (0.2% of GDP).

The social security's accounts (surplus of 1.4% of GDP in 2008) have been hard hit by a combination of a sharp fall in the number of contributors (to 17.9 million in March 2017 from 19.5 million in 2007), as a result of massive unemployment, and the inexorable ageing of the population.

Meanwhile, the minority Popular Party government unveiled a pay rise for public workers and more social spending in the hope of winning enough support in parliament to approve the much delayed draft budget for 2017. The fiscal deficit has to be reduced to 3.1% of GDP from 4.54% if Spain is to keep on complying with the target agreed with the EU.

The budget is normally approved in the autumn of the year before it comes into force but that proved impossible because of inconclusive elections in December 2015 and June 2016 and the lack of a government until the end of last October.

Civil servants will receive a 1% pay rise and more funds will be earmarked to combat child poverty and help the unemployed. The Socialists and Podemos say the pay rise is not enough as inflation is running at more than 1%.

The centrist Ciudadanos, with 32 MPs, agreed to back the budget bill but the government still needs the support of seven more MPs for it to be approved.

#### *Spain continues to top tourism ranking...*

Spain held its position for the second year running as the country with the most competitive tourism sector, according to the latest ranking of 136 countries by the World Economic Forum (WFO).

The sector, which attracted a record 75.3 million visitors last year, has gone from strength to strength. In 2011 it was eighth in the WFO ranking, in 2013 fourth and in 2015 it took the top spot for the first time (see Figure 8).

**Figure 8. Top 10 countries in tourism competitiveness ranking (1)**

Country	Score	Country	Score
1. Spain	5.4	6. US	5.1
2. France	5.3	7. Australia	5.1
3. Germany	5.3	8. Italy	5.0
4. Japan	5.3	9. Canada	5.0
5. UK	5.2	10. Switzerland	4.9

(1) Score: 1 (worst) and 7 (best).

Source: Travel and Tourism Competitiveness Report 2017, World Economic Forum.

Tourism generates around 12% of GDP and has played a key role in pulling Spain out of recession.

The Travel and Tourism (T&T) Index is based on four categories: enabling environment; T&T policy and enabling conditions; infrastructure; and natural and cultural resources.

The WFO attributes Spain's success to its unique offer of both cultural (ranked 2<sup>nd</sup>) and natural (9<sup>th</sup>) resources, combined with sound tourism service infrastructure (2<sup>nd</sup>), air transport connectivity (9<sup>th</sup>) and strong policy support (5<sup>th</sup>). It has also benefited from diverted tourism from the security troubled Middle East.

It says the challenge now is to continue to find ways to improve, given the sector's maturity. While Spain's ground transport is ranked in the top 15 economies, it has started to show signs of initial decline, suggesting that upgrades and modernisations are expected. In addition, the business environment (ranked 75<sup>th</sup>) can be improved, as dealing with construction permits remains burdensome (104<sup>th</sup>), and there is room to improve international openness further (43<sup>rd</sup>, down two places).

### ... Ranked 20<sup>th</sup> in Made-in-Country-Index

Spain is ranked 20<sup>th</sup> in an index that measures consumers' perception of products from 64 countries of origin (see Figure 9).

The 'Made-in' label, introduced by Britain at the end of the 19<sup>th</sup> century to mark goods and protect its market from cheap imports, plays an increasingly important role in countries' promotion of their products. The European Commission introduced a 'Made in the EU' label in 2003.

**Figure 9. Made-in-Country Index, 2017 (1)**

Country	
1. Germany	100
3. EU	92
4. UK	91
7. Italy	84
8. France	81
8. US	81
<b>20. Spain</b>	<b>64</b>

(1) Out of 64 countries.

Source: Statista.

The research for the index by Statista and Dalia Research confirmed many clichés, such as Swiss luxury products are internationally more regarded as status symbols than any other.

The Leading Brands of Spain Forum, founded in 1999, has done a lot to improve the image of the country's goods and make companies aware of the importance of internationalisation by using the brand as the main competitive asset.

### The inexorable rise of Spanish

The Spanish language is fast gaining ground in Latin America at the expense of indigenous languages and also in the US due to the rising Hispanic population, according to Euromonitor.

The proportion of Bolivians speaking Spanish as their first language rose from 55.3% in 1994 to 65.3% in 2016, as those speaking Aymara as their first language almost halved over the same period to 12.4% (see Figure 10).

Figure 10. Percentage of population citing Spanish as their first language



Source: Euromonitor International; national statistics; UN. Prepared by the FT.

One reason for the growth in Spanish is that a common language makes cross-border trade in Latin America easier.

Spanish is the second most spoken language in the US: the proportion of the population that consider it their first language rose from 8.9% in 1994 to 13.4% in 2016.

## Corporate scene

### Madrid rejects mega entertainment complex

The Madrid regional government turned down plans by the US developer Cordish Companies to build a US\$2.2 billion leisure and entertainment complex.

The complex on the outskirts of Madrid would have created 56,000 jobs, a major boost to the local economy.

The Popular Party regional government said the project in its current form was not 'viable from an economic and organisational point of view' and would require an investment of at least €340 million in roads and railway links.

Cordish responded by saying 'the government does not understand our application in two major respects. One, we make no requests for any public infrastructure nor any public subsidy by the government and in fact none is needed. Two, we are fully committed to a total build-out of a massive \$2.2bn integrated resort'.

### Banco Popular on the rocks

Banco Popular, which has lost more than 90% of its value over the past five years, needs to raise more capital in order to survive.

Confirmation of what analysts have been saying for some time by the bank's new Chairman, Emilio Saracho, caused Popular's share price to fall further this month.

Investors injected €2.5 billion into the bank less than a year ago, but this has not proved to be enough. As a result of another unexpected shortfall in provisions, discovered by an internal audit, it is estimated that Popular needs a capital increase of €3 billion to €4 billion.

The bank made a loss of €3.5 billion last year.

Popular's problems have somewhat dented the image that Spain got to grips with its banking crisis following the bursting of its real estate bubble as of 2008 and a prolonged recession.

### Iberdrola to build power station in Mexico

Iberdrola, the world leader in the production of wind power, was awarded a €370 million contract to construct and operate a 766 MW combined-cycle power plant in the Mexican state of Sinaloa.

By 2020, Iberdrola's total installed capacity in Mexico will exceed 10,000 MW, strengthening its position as the largest private electricity producer in the country.

### Ferrovial wins €790 million Texas highway contract

A consortium led by Ferrovial won the €790 million contract to design and build segments of the State Highway 99 ring-road known as Grand Parkway, north-west of the Greater Houston area.

The segment is 85km of toll road. The consortium includes Webber, Ferrovial's Texan subsidiary.

Ferrovial already has a notable presence in Texas, where it manages the North Tarrant Express and the LBJ Express in the Dallas-Fort Worth metro area.