SPAIN

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Hard slog to reach sunlit uplands

Victor Mallet finds plenty of people defending Spain's performance so far but they all agree there will be a tough few years ahead

Outburst: protesters occupy Puerta del Sol (above) in Madrid to complain about youth jobless rate of 45 per cent and the domination of politics by two main parties Getty

After three years of economic crisis and seven years of Socialist party rule under José Luis Rodríguez Zapatero, the prime minister, Spain looks set for a change of course.

The defeat of the Socialists in regional and local elections on May 22 was so comprehensive that the right-wing Popular party is the strong favourite to win the general election that must be held within a year – perhaps even with an absolute majority that would allow it to govern without support from small regional parties.

The local polls were preceded by an unexpected outburst of youth demonstrations.

Collectively known as the "May 15 movement", from the day on which the mobilisation was launched, the protesters occupied town centres, including Puerta del Sol, a square in the heart of Madrid, the capital, to complain about a youth unemployment rate of 45 per cent and the domination of politics by the two main parties.

The movement was a sign of frustration with the grim state of the job market and with the austerity programme belatedly and reluctantly imposed by Mr Zapatero, but seemed too amorphous to mount a serious challenge to Spain's entrenched, bipartisan political system.

The next election, then, will pitch Mariano Rajoy, the PP leader, against the Socialists' Alfredo Pérez Rubalcaba, the interior minister and chosen candidate of Mr Zapatero, who will step down after two terms.

No date has yet been fixed, although Mr Rajoy has called for an early election. It would take an extraordinary political upheaval to overcome the disadvantages of incumbency that weigh on the current government.

Neither Labour's Gordon Brown in the UK nor the Portuguese Socialist José Sócrates could avoid defeat in their encounters with the voters after years of crisis.

Whoever wins will face a daunting task over their four-year term. The challenge is to reduce unemployment – at 21 per cent of the workforce, the rate is double the European Union average – by ensuring that the anaemic economy continues to grow.

At the same time, however, Spain needs to convince the sovereign bond markets that it will not go the way of Greece, Ireland and Portugal in seeking a multibillion-euro bail-out from the EU and the International Monetary Fund.

Even if it can convince investors, who are concerned about its high level of private sector debt and its exposure to foreign creditors, that it is not next in line for a rescue, the harsh austerity measures deployed to do that could in turn endanger growth.

Spain, the fourth-largest economy in the eurozone, enjoys some formidable advantages. Its accumulated public sector debt is lower as a share of gross domestic product than that of most of its European neighbours, and its exports – albeit relatively modest in absolute terms – have been growing steadily.

Tourism is profiting this year from the arrival of holidaymakers nervous about political instability in the rival north African destinations of Egypt, Tunisia and Morocco.

Nor was the investment poured into Spain from Germany and France during the growth years before the crisis all wasted on building holiday flats or urban homes that no one now wants to buy.

A large share of the money went on transport infrastructure that has provided the country with excellent ports, roads and airports and the biggest high-speed rail network in Europe.

Perhaps most important of all, Spain boasts some of Europe's most successful global companies in sectors ranging from banking (Santander and BBVA) and clothing (Inditex with its Zara brand) to infrastructure (Abertis) and alternative energy (Iberdrola, Abengoa and Gamesa).

President Barack Obama chose a Gamesa wind-turbine factory in Pennsylvania as the background for a speech in April on the importance of new energy sources.

"Spain has created a collection of international companies that control good assets abroad," says Juan Antonio Samaranch, chief executive of GBS Finanzas, an independent investment bank.

He says that gloomy economic assessments of Spain's private sector debt burden often omit to mention the importance of corporate expansion abroad from the 1990s onwards. "A massive part of this private debt was used to buy international assets," says Mr Samaranch.

Whatever they think of the government, the country's entrepreneurs and financiers can grow quite heated in defending its economic record, in criticising the doubts of foreign investors and in rejecting the idea that the country will need a bail-out.

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Spain

Regional savings institutions consolidate

Banking system

The 'cajas' network has been at the forefront of reform, says **Victor Mallet**

Spain's banking system is undergoing one of the biggest upheavals in its modern history.

Lenders and regulators have on previous occasions struggled through banking busts after the collapse of inflated asset values, but this is the first time such a battle at home has coincided first with a global financial crisis and then with sovereign debt jitters in the eurozone.

When the world was shaken by the collapse of Lehman Brothers in September 2008, Spanish banks found themselves in a relatively comfortable position.

They were already faced with falling property values and rising bad debts, but had little exposure to the complex "toxic" derivatives and US subprime mortgage lending that wreaked such havoc elsewhere.

All Spanish banks and unlisted *cajas*, the regional savings banks that account for about half the system by assets, were also protected by large reserves of countercyclical "generic" provisions built up in the good years that preceded 2008.

The largest commercial banks, Santander and BBVA, were further insulated from trouble by their investments in fast-growing emerging markets, particularly Latin America, and have continued to generate billions of euros of net profit through the recession and afterwards.

But as year followed year, the property market continued its decline and the generic bad-loan provisions were steadily consumed to protect the bottom line, it became clear the financial system was running out of time.

This was especially true of many of the *cajas*, which were heavily exposed to property developers and home loans and often controlled by regional politicians lacking the professional skills to manage in difficult times.

Lenders have suffered on several fronts. Bankrupt customers, especially property developers and construction companies, are unable to repay their loans, while the banks and *cajas* themselves remain dependent on wholesale financing from abroad to fund their operations.

The response of the Bank of Spain and of the current government has been to push through a radical reform of the whole network of *cajas*, opaque institutions with charitable aims and unclear ownership structures that in many cases date back more than a century.

Two small, failing *cajas* were "intervened" and then sold by the central bank, while most of the rest were offered loans from the Fund for Orderly Bank Restructuring (Frob) and told to merge, cut costs or rationalise themselves in a wave of deals that has already reduced their number from 45 to 17.

In the latest phase of the reform process, the regulator has threatened the weaker *cajas* with partial nationalisation if they fail to raise capital from private sources.

Nationalisation is expected to be the fate, for example, of Caja Mediterráneo (Cam), the savings bank whose plan for a merger with three other *cajas* collapsed when they concluded that Cam's loanbook was too burdensome for the merged entity to absorb without itself being nationalised.

Others have sought outside investors, and four groups of *cajas* intend to list on the stock exchange through initial public offerings. This process is expected to reach a critical stage in the coming weeks when Bankia – the product of the merger of Caja Madrid and six other savings banks and by some measures the largest domestic bank in Spain – seeks €3bn ($4.3bn) to €4bn from the markets.

La Caixa, always the strongest of the larger *cajas*, is taking a different route and needs no IPO because it is using the existing listing of Criteria, its industrial holding group, as a vehicle to launch Caixabank on the stock exchange on July 1.

> The estimates of how much new capital the system needs range from €15bn to €120bn

The estimates of how much new capital the system needs cover an extraordinarily wide range – the Bank of Spain puts the figure at just over €15bn, while some analysts say it could reach €120bn – but even the worst outcome is regarded as a manageable sum.

Regulators and officials also argue that they have been more transparent than other European countries. That is why Spain is submitting 95 per cent of its system to European "stress tests", while some European Union states have done only the minimum 50 per cent required.

For Bankia and the other IPO candidates, these are anxious days, given the volatility of European markets and the low valuation that outside investors are inclined to give to Spanish financial institutions.

Bankia, which is so large and systemically important that the success or failure of its IPO will affect Spain's standing in the sovereign debt markets, is the linchpin.

"Every Spanish institution has an interest in making it work," says one Madrid-based investment banker. "We can't allow it not to work."


La Caixa, the strongest of the larger *cajas*, is using the listing of its holding group to launch on the stock exchange Reuters

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Hard slog to reach sunlit uplands

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"Look, a bloke in the US said the world would end three Saturdays ago," says Pedro Gómez de Baeza, GBS chairman, in a reference to the doomsday predictions of US preacher Harold Camping.

"We [Samaranch and I] are both engineers. We both like numbers. And we say there will be no bail-out for Spain."

In the real economy, it is possible to find foreign investors who are equally upbeat about Spain's prospects, at least in the longer term.

General Electric, the US technology and financial services group, is looking at making a big investment, perhaps in the energy or transport sectors.

"We're cautious about Spain in the short term," says Rafael Díaz-Granados, president and chief executive of GE Iberia. "We continue to be very bullish about Spain in the medium and long term."

Concerned observers from Spanish politicians to foreign executives, however, are painfully aware that for Spain to reach the sunlit uplands of the "medium and long term", the country is going to have to overcome a series of obstacles, many of them of its own making.

It is true that Spain is often unfairly lumped together by speculators, hedge fund analysts and bond traders with the weaker eurozone economies of Greece and Portugal and that its strengths sometimes go unrecognised.

But it is also true that Spain's rigid labour market – which makes it so expensive to fire staff that few companies want to hire them – and the bureaucracy associated with the highly devolved political system have helped undermine competitiveness in recent years.

GE executives have seen both of these obstacles close up. After years in the Americas, Mr Díaz-Granados is puzzled by the "weird incentives" of Spain's old-fashioned collective wage-bargaining system, which groups people by region as well as by sector rather than by company, leaving him with employees in a range of collective bargaining agreements, including glass (because GE makes light bulbs).

As for Spain's 17 autonomous regions and the fragmented market that results, Mr Díaz-Granados jokes that he was hired to be GE's boss in two countries, Spain and Portugal, but "found that I'm president of 18".

It is no coincidence that a future PP government would be expected to make the biggest course changes on these very issues.

Mr Rajoy is likely to hold Mr Zapatero's line on reducing the public sector deficit to appease the bond markets, but wants to liberalise the labour market and limit the negative effects of decentralisation.


Rafael Díaz-Granados: bullish about Spain in the medium and long term

Whoever ends up as the next occupant of the Moncloa prime ministerial complex in Madrid, it is a tribute to the underlying strength of Spain's economy that most analysts, at the time of going to press, still think it will pull through the crisis without the need for a bail-out that would shake the entire edifice of the euro.

On the other hand, it is a measure of the depth of the western world's fiscal and financial trauma that no one is absolutely sure – and that almost every Spanish householder and business executive foresees a very tough few years ahead.

Country takes pains to avoid a bail-out

Economy

Most urgent are deficit reduction and reform of the labour market, writes **Victor Mallet**

If Spanish politics is the tale of two beards – the leader-in-waiting of the Socialist party, Alfredo Pérez Rubalcaba, and Mariano Rajoy, chief of the opposition Popular party – then the country's economy is a story of two deficits: the budget shortfall and the current account deficit.

For the past two years, investors and speculators have been watching these two numbers, and the financial data behind them, with almost obsessive interest.

With Greece, Ireland and Portugal having already been forced to seek tens of billions of euros in rescue packages from the European Union and the International Monetary Fund, Spain finds itself sweating under the spotlight as the next most likely "peripheral" eurozone nation to need a bail-out from the spreading sovereign debt crisis.

Spanish ministers – from José Luis Rodriguez Zapatero, the prime minister, downwards – insist that the government and the country have launched enough austerity measures and economic reforms since the western world's financial crisis began three years ago to stave off a disastrous collapse of confidence in the eurozone's fourth-largest economy.

So far, most economists and bond traders agree, although they have periodically lost their nerve, sold Spanish bonds and pushed the closely observed spread between Spanish and German 10-year bonds – a measure of the greater perceived risk of holding Spanish paper – towards an uncomfortably high 300 basis points.

"It's true that markets have been going back and forth on Spain. They even once went towards questioning Italy," says Natacha Valla, Paris-based economist for Goldman Sachs. But she adds: "There is no reason why Spain should be compared to what we've seen in Greece, Portugal or Ireland."

First, the budget. Mr Zapatero was slow to accept the severity of the crisis and the need for spending restraint, leaving an embarrassingly large deficit of 11.1 per cent of gross domestic product in 2009 and attracting unwelcome attention from the markets.

For the past year, however, the government has imposed a series of austerity measures, including a 5 per cent pay cut for civil servants, a near-freeze on hiring of public employees, and tax increases.

The results are evident. The budget deficit fell to 9.2 per cent of GDP last year, and is targeted to fall further to 6 per cent this year.

That is an ambitious aim – "I think it will be difficult to reach 6 per cent," says Antonio García Pascual, chief southern European economist at Barclays Capital – in part because the country's 17 autonomous regions collectively failed to meet their deficit targets last year and look set to do so again in 2011.

Antonio Garcia Pascual: autonomous regions are unlikely to meet deficit targets for 2011

Catalonia, an economy the size of Portugal, says its deficit will be double the official limit even after harsh spending cuts.

But analysts believe the centre will compensate, at least in part, for the regional overshoot, just as it did last year. And at least Spain – unlike Gordon Brown's UK – ran a budget surplus in the boom years before the crisis and thus started from a much stronger position than its neighbours.

"The starting conditions were very favourable," says Ms Valla. "[The ratio of] outstanding public debt to GDP was one of the lowest in Europe."

The second deficit, for the current account, is potentially harder to manage downwards. As in other "peripheral" eurozone states, the deficit swelled to unsustainably high levels in the mid-2000s – to more than 10 per cent of GDP in Spain's case – as the fast-growing economy sucked in finance from abroad to fuel investment in infrastructure and unproductive real estate.

With currency devaluation not an option to boost exports and curb imports because of membership of the single currency, the weaker eurozone states are forced to curb domestic demand and try to restore competitiveness through a brutal process of "internal devaluation", including reductions in labour costs.

So far, Spain has done a fair job on this. The current account deficit fell to 4.5 per cent of GDP last year and is set to decline further to 2.9 per cent this year, according to research from BBVA, the Spanish bank.

Like other fragile European nations, Spain has to balance the need for reforms and deficit-cutting against the requirement for enough stimulation to promote continued growth, particularly since nearly 5m are unemployed.

Still, Spain has managed to boost its exports, benefiting in part from the strong performance of Germany, one of its biggest markets.

Tourism revenues are also proving to be robust this year, with many Europeans turning to the safety of Spanish holidays in preference to the riskier shores of north Africa following the upheavals in destinations such as Egypt and Tunisia.

For Spanish employers, and foreign investors, the most important reform still to be tackled concerns labour. Pressure is growing for a deeper liberalisation of the labour market – a rigid system marked by collective bargaining and costly redundancy payments that discourage employers from hiring in the first place.

Negotiations between employers and trade unions over how to modernise the system have recently broken down.

But if labour reform can be implemented, the budget deficit cut and the banking system recapitalised, policymakers say international confidence in Spain will return.

Food, festivals and history to replace sun, sea and sand

Primavera Sound festival in Barcelona attracts most of its audience from other countries

Tourism

The industry has to adapt to a drop in demand for bulk beach bookings and focus on what makes Spain a unique destination, writes **Miles Johnson**

Sun, sea and sand was once the simple maxim that governed the vast stretches of resorts lining Spain's Mediterranean coastline.

Fuelled by cheap holiday packages dropping millions at its airports each summer, and cheap credit helping the construction of new hotels to house them, for decades there seemed little reason to find a new philosophy.

That benign climate, however, has long since ended. For the country's hoteliers and tour operators, the past three years have been the most difficult in their professional memories. In 2009, the number of foreign visitors to Spain slumped by 10 per cent, leaving thousands of cheap hotel rooms empty and English-themed pubs in locations such as Benidorm eerily subdued.

The secondary effects on Spain's domestic economy have been bleak. The tourism sector, which represents 12 per cent of gross domestic product – compared with building and construction's pre-crisis peak of 18 per cent – has shed about 180,000 jobs in the past three years, escalating national unemployment levels that remain above 20 per cent.

At the same time as the collapse of Spain's construction industry, the country's other great economic motor, the model of *playa y sol*, or bulk sale beach tourism, has been called into question by industry experts who argue that structural changes will need to be made to persuade tourists to pick Spain over cheaper competitor nations such as Croatia and Turkey.

"Spain still has a model of offering capacity, with operators typically saying, 'I have this many beds, how can I sell them?'," says Professor Philip Moscoso of the Iese Business School.

"The type of tourist demand over the past 10 years has been changing, but the offer we have as a country has remained largely the same. Now, more people are coming on their own, using the internet more than tour operators, so Spain must start to think harder about how to differentiate itself."

One way destinations can win back visitors is by trading on their cultural attractions, an advantage that some experts argue should see Spanish operators attempt to emulate Italy's ability to project the attractiveness of its cuisine and art globally.

Michelle Obama's visit to Marbella last year brought welcome publicity to the increasingly unfashionable region, with operators later reporting that the First Lady's reflected glamour triggered a rise in interest from the US and beyond.

Such "cultural tourists", Prof Moscoso argues, are likely to be of higher value in the amount of money they spend and, while still a small portion of the yearly numbers of visitors, could provide a route out of high-volume, low-value beach holidays to the Canary islands and eastern coast.

Spain's cultural pull is also expected to draw more visitors from Asia over the next decade, a trend that has seen a renewed round of investment in the country's hotel industry from foreign companies.

"Europe has the most visitors of any continent in the world . . . and we think that emerging markets will provide a tremendous influx of new travellers to Spain," says Bill Marriott, chairman and chief executive of Marriott International, the US hotel chain. In June, it signed a distribution deal with Spain's AC Hotels that will see them renamed "AC by Marriott".

Cultural events, such as the growing series of music festivals, are increasingly capturing a younger market of European travellers that would have previously attended similar events in their own countries.

Barcelona has enjoyed particular success on this front, with the Sonar festival in summer and the Primavera Sound festival in the spring, which has grown from attracting just under 8,000 people in its first year in 2001 to more than 100,000 this year.

With performances from mostly American and British acts, Primavera Sound's organisers have managed to build the international profile of the festival to a level where it now regularly attracts groups of international stature and draws most of its audience from other European countries.

Bulk tourism still dominates for now, with the political upheaval and revolution in north Africa expected to increase the number of visitors to Spain by 1m after two years of successive declines. This has coincided with signs that tourism is starting to emerge from the downturn. In April, the number of foreign visitors was up 13 per cent on last year at 8.1m, with the total amount spent by tourists increasing by 24 per cent to €4.2bn.

For the country's hard-pressed hoteliers the spring also brought better news, with 53 per cent of rooms being registered as occupied by the government's national institute of tourism, an annual increase of 10.6 per cent.

For Prof Moscoso, while such signs are encouraging, they should not distract from the need to use Spain's cuisine, museums, religious monuments and festivals to reduce dependence on more fickle bulk tourism.

"We have a top location, so what can we offer, not just to compete on price, but to differentiate ourselves? This is where culture, the arts, and our historical heritage come in."

Few signs of respite in a long chain of misery

Property

Miles Johnson reports on efforts to promote real estate in a cold climate

Spain's housing minister's trip to London last month to promote real estate was always going to be a hard sell.

As Beatriz Corredor declared that investing in the country's real estate sector was "safe", a protest was being staged outside the Spanish embassy by British buyers whose place-in-the-sun dreams have soured.

Spain's decade-long property and construction bubble began to deflate at the start of the credit crisis, as cheap mortgages and development loans dried up, leaving many cities pockmarked with half built developments.

In a market where the value of the average residential property has fallen by 17 per cent since the peak, thousands of foreign buyers, have been left with nothing, after making downpayments on what are now incomplete ghost flats.

Against such a backdrop, Ms Corredor, on a trip that also took in Germany, France, Sweden and the Netherlands, argued that the price of Spanish housing was now so low that it represented a sound investment for northern Europeans.

"At the height of the biggest boom in 2008, we calculate that prices were 30 per cent higher than they should have been. But we have never made any predictions about how much prices are going to fall. We think the market has now levelled out," she says.

The multibillion euro question for Spain's public finances, its banking sector, and the millions of homeowners in negative equity, is whether Ms Corredor's relatively upbeat assessment proves correct.

Once accounting for 18 per cent of gross domestic product, 13 per cent of employment, and 60 per cent of domestic bank credit, activity in the building sector that powered the housing boom has collapsed, adding hundreds of thousands to the 21 per cent unemployment rate – the highest in the European Union.

Elsewhere in this chain of misery sit the banks that funded the developers and mortgage holders during the boom. Banks hold billions of euros in half-built developments that they are struggling to offload. A now famous statistic is that Spain built more new homes than France, Germany and the Benelux countries combined in the years preceding the crisis.

According to analysts at Nomura, Spanish banks may be funding 24 to 36 years worth of housing stock, with almost half of the €300bn of loans to the sector potentially problematic.

The Bank of Spain estimates that at least 1m homes remain unsold, while in March official data showed house prices fell for the 12th consecutive quarter. Many banks are also offering mortgages on near pre-crisis terms to offload homes they have taken back from developers.

Though a small fraction of overall lending for most banks, the fact that some new mortgages feature a loan-to-value ratio of above 80 per cent – meaning they are usually ineligible for covered bond inclusion under Spanish law – is seen as demonstrating the lengths lenders are taking to remove troubled property directly from their balance sheets.

Beatriz Corredor: hard sell

High loan-to-value mortgages made up 11.9 per cent of all house loans last year, according to central bank data.

The immediate future shows few signs of respite.

Nomura forecasts that house prices could fall by another 15 per cent at a time when the European Central Bank is signalling that it will further increase interest rates. This would put pressure on mortgage holders who had been enjoying low interest payments to compensate for losses on property investments.

While such a large overhang of property remains, the chances of a meaningful recovery in the medium term remain slim, increasing the likelihood of further promotional tours.

Spain

Young failed by system in need of structural adjustment

Education

Miles Johnson reports on the frustration of graduates without jobs

Less than a month after furious Spanish youth unexpectedly took to the streets of Madrid to protest against the country's political establishment, normal life is beginning to return to the city's occupied central square.

Bemused tour groups trundle between the scores of improvised administration tents and camp sites spread around the Puerta del Sol, and men in bright yellow jackets offer to buy gold jewellery off those passing through on their journey to work.

In spite of hundreds of open meetings held by youthful activists in the squares of Madrid and other large cities, frustration has appeared to replace the initial fervour of the "indignant ones" – the name given to the young people enraged by a sense that they are being failed by a state that has allowed youth unemployment to rise to 45 per cent.

Many of the protesters hold degrees, and the number of Spaniards attending tertiary education has increased by about 7 per cent a year since 1998, according to the Organisation for Economic Co-operation and Development. The unemployment rate for university graduates in Spain is about twice the European Union average, not helped by the country's inflexible labour laws.

Few can deny the extent of Spain's young unemployed "lost generation", as tens of thousands have graduated into a stagnant economy.

As a panel comprising top businesspeople consults with the government about strategies to improve the country's competitiveness, the crisis has also forced academics and policymakers to focus on ways that education reform can bolster the economy from the bottom up.

According to Jordi Canals, dean of the Iese business school, education reform over the coming years will be crucial to remedying economic problems.

"Education is the most important thing for the economy," he says. "The top educational institutions are world class, but we have too few of them."

The number of Spanish graduates in unskilled work is about 6 per cent higher than the EU average, according to a study by a Spanish knowledge and development think-tank – a factor that has formed part of the anger of those partaking in the recent protests.

Jordi Canals: educational institutions are rarely accountable to students and teachers

Spain has two universities ranked in the world's top 200, according to the Times Higher Educational Supplement rankings, compared with France's four, and Germany's 14.

Mr Canals argues that a large number of Spanish people are leaving school at the age of 18 with a lower standard of education than their western European counterparts.

As he sees it, this is a consequence of overly centralised educational institutions that are rarely accountable to students and teachers because of their close links with local and national government.

"What we should do is very clear," he says. "We need to improve the quality of the secondary education of kids between 10 and 18, to raise the standard of basic stuff.

"In France and Germany, the skills high school graduates have who enter straight into the workforce tends to be higher."

"Our educational institutions should be run by people who know the most about education, the teachers, rather than trade unions or non-teaching staff. Too often parents feel that the school is not their own, and this means they tend to be confrontational rather than collaborative with teachers."

Another approach to pre-university reform, designed to increase the competitiveness of younger Spaniards in the international labour market, has come in the form of state-run bilingual schools in which at least a third of all teaching time is in English.

In these schools, subjects such as music, physical education and social sciences are taught in English.

For Lucía Figar, head of education for the Madrid regional government, which has spearheaded the policy, an increase in the standards of foreign language learning is crucial to helping Spaniards catch up with other European Union members.

"Spain has not traditionally been a country with a high level of foreign language learning," she says. "Our model has been successful in teaching pupils English as they learn in a natural way."

For the graduate protesters in central Madrid, however, the talk of reform, and the programmes already under way, will be too late to be of any benefit to them.

"There is an important need to fine-tune the system," says Mr Canals. "This is not a question of resources, of spending more money, but one of making the structural changes that will have an impact for the next generation."

Cuisine is given its due by world critics and diners

Food

El Bulli restaurant has revolutionised the field, says **Victor Mallet**

In the decades of poverty and dictatorship after the second world war, Spain was *terra incognita* for international gourmets, known more for cheap wine, basic if wholesome ingredients and the bland pleasures of the tortilla, a potato omelette.

British students of the 1970s favoured a brand of wine they called "Spanish petrol", whose most attractive quality was that it could be bought for less than £1 a bottle.

It takes a long time to build the reputation of a company or a product, let alone that of a whole country, but over the past 20 years Spain has gradually established itself as a leader in global haute cuisine, just as the nation has modernised its economy and seen its industry and commerce catch up with the rest of the European Union.

Spanish produce is still far behind that its French and Italian rivals, not in terms of quality but in terms of international recognition and marketing, which means that visitors can enjoy excellent food and wine at reasonable prices.

However, the country is finally being given its due by the world's critics and diners, reaping an annual harvest of more than 100 Michelin stars, which puts it fifth in the somewhat arbitrary national rankings that can be extracted from the Michelin red guides – behind France, Japan, Italy and Germany.

Spain's most famous eatery is El Bulli. This rural restaurant on the north Catalan coast, co-owned and run by chef Ferran Adrià, is repeatedly judged the world's best place to dine.

It is typical of Mr Adrià's boldness that he and his partner, Juli Soler, have decided to close El Bulli to guests from the end of July this year, at what looks like the peak of their culinary success and international fame. The plan is to turn the restaurant, in a quiet cove near Roses, just south of the French border, into a creative research laboratory for cooking.

"At this historical moment, the culinary avant-garde of the world is here in Spain. It's the epicentre of creativity and innovation in the world," says Silviya Svejenova, professor in the business policy department of Esade, the Barcelona-based business school. "It has challenged the hegemony that French cuisine has had for a century."

Spain is not alone in enjoying a culinary renaissance. The increasing wealth and sophistication of restaurant-goers, as well as the rapid spread of ideas from one country to another, make this a worldwide phenomenon.

The UK, for example, long scorned by the rest of Europe for its terrible food, now boasts several celebrity chefs, and its restaurants are generally much better in reality than they are in the minds of Spaniards and other Europeans.

But Mr Adrià is innovative in the way he has harnessed science to the needs of the kitchen and in his business methods.

Rather than franchising the El Bulli name to subsidiary restaurants in Tokyo or New York, or encouraging the mystique of a clever chef with secret recipes and techniques, he is eager to share: the El Bulli research centre will publish everything it does each day on the internet, he says.

Ferran Adrià (above) and his partner Juli Soler are to turn the El Bulli restaurant, at the peak of its success, into a research laboratory for cooking Getty

Prof Svejenova says: "Instead of a search for recipes, there's a search for new concepts. The role of science in this is to help chefs understand better what is happening," adding that art and design help improve the aesthetics of what diners see on their plates. One of the trends of the Spanish movement is precisely this caring and sharing."

Mr Adrià and his collaborators were the first chefs explicitly to apply scientific methods to cooking, first through their workshop ElBullitaller and then through Catalonia's Alícia Foundation.

Now he teaches at Harvard University on cooking and creativity, a course that will be extended to 2015 by agreement between Alícia and Harvard and will include new chefs such as Carles Gaig. "There are not many disciplines as universal as cooking," says an enthusiastic Mr Adrià, urging Spanish businesses to take advantage of the country's success in the culinary field. "It includes science, ecology, agriculture, economics, design, art and health."

Prof Svejenova and her Esade colleague Marcel Planellas are now updating a case study on Mr Adrià's creativity. They say modern Spanish cooking has benefited from co-operation between the Basque and Catalan regional traditions represented by Juan Mari Arzak and Mr Adrià, respectively, just as it has managed to combine a drive for "zero kilometre" natural ingredients grown outside the restaurant with a fascination for Japanese and other far-flung international influences.

"The Catalan style is more Mediterranean cooking, and the Basque is more traditional French cuisine," says Prof Planellas.

What name should be given, then, to a movement that generates income for Spain but whose protagonists are motivated by passion for their peculiar concatenation of art and science, rather than by profits?

Some call it "molecular cuisine". Others say the cooking is "techno-emotional". For Prof Svejenova, these outré suggestions show "this avant-garde cuisine seeks to surprise you, to challenge you. It's very playful."

The ties that bind Catalonia

Guest Column

PANKAJ GHEMAWAT

Language is the most obvious difference between Catalonia and the rest of Spain, but there are many others. When the political temperature rises, these differences lead to calls for secession.

Discussions of the economics of secession mostly focus on Catalonia's net fiscal transfers to the rest of Spain. But what secessionists tend to ignore are the economic ties that continue to bind Catalonia rather tightly to the rest of the country.

One such tie is illustrated in the tables to the right, which rank foreign countries and other regions of Spain in proportion to their merchandise trade with Catalonia in 2007. The table of exports indicates that it sells more to the rest of Spain than to the rest of the world.

Catalonia's largest export market, in fact, is the adjacent Spanish region of Aragón, even though its second largest market, France, also adjacent, has an economy more than 50 times larger than Aragón's.

The second table shows that its imports tend to travel further than its exports. This pattern reflects Catalonia's role as an import hub. In 2007, It ran an international trade deficit of €30bn, which was largely offset by a €22bn trade surplus with the rest of Spain.

Catalonia imports products from around the world, adds value to them and sells them on to markets across the country.

What might happen to these numbers if the regional border were replaced by a national one? International economics suggests that when two companies are located on opposite sides of a national border, implying a notional physical distance of zero, trade between them falls by about two-thirds.

Analysis of more than 100 independence events since 1900 confirms a two-thirds drop in trade intensity, although how quickly this happens depends greatly on whether separation is hostile or amicable.

Exports

1	Aragón	11.3%
2	France	9.7%
3	Madrid	7%
4	Valencia	6.6%
5	Germany	5.1%
6	Italy	5%
7	Andalusia	3.9%
8	Basque Country	3.8%
9	Portugal	3.7%
10	Castilla-La Mancha	3.7%

Imports

1	Germany	13.4%
2	Italy	8.3%
3	France	7.7%
4	China	5.1%
5	Aragón	4.9%
6	Valencia	4.7%
7	Madrid	4.2%
8	Netherlands	3.5%
9	Andalusia	3.5%
10	Japan	2.9%

In the "Velvet Divorce" between the Czech Republic and Slovakia, trade intensity dropped by three-quarters within five years of the separation, even though a customs union and a cross-border payment mechanism were put in place.

The two-thirds drop-off is also consistent with how much more intensely German federal states trade with one another than with other European Union countries – and this in the country with the lowest national border effects of any big EU member.

Applying such estimates to Catalonia in 2007, a reduction of a hypothetically independent Catalonia's trade with the rest of Spain to one-third of its actual level would have caused the trade balance to widen from a deficit of 4 per cent of gross domestic product to a deficit of 13 per cent, and its GDP would have contracted by 7 per cent.

Although this is a very rough calculation that could be refined, for instance by accounting for the impact of reduced inter-regional exports on international imports, the magnitudes suggest that this is an effect that should be taken into account when weighing the pros and cons of secession.

A similar logic also applies to other parts of Europe subject to secessionist sentiments – Spain's Basque region, northern Italy, Belgium and Scotland, for example.

While secession is most often raised as a solution to artificial postcolonial boundaries in non-European parts of the old world, it is worth adding that secession is likely to be even more of an economic problem where regional integration is not as advanced as in the EU. Subdividing African countries, many of which are already considered too small to be economically efficient, does not seem the best recipe for the development that the continent desperately needs.

The broader point is that despite claims that globalisation has rendered national borders irrelevant, they continue to matter economically as well as politically. Emphasis of this point is not meant to suggest that secession never makes sense, but to make it clear that it comes at a price – with one of the costs being diminished commerce with formerly domestic trade partners.

Aspiring independent nations may conclude this is a price worth paying, but should at least weigh such pros and cons explicitly. They might also want to remember that, over the past few millennia, human progress has been spurred by expanding rather than contracting circles of co-operation.

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