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Between a Rock and a Hard Place: The Gibraltar Dilemma

Days after Theresa May triggered Article 50 of the Lisbon Treaty, Brussels issued a nine-page document outlining its guidelines for Brexit negotiations. One of the guidelines gave Spain the authority to veto any deal between Gibraltar and the European Union (EU). The U.K. is currently recognized as holding sovereignty over Gibraltar and thus took exception to this provision, vowing to defend the will of the people of Gibraltar.

The provision is likely the result of heavy lobbying by the Spanish government, who would like to end this 300-year dispute once and for all. A war of words between Spain and the U.K. has already started in response to the announcement. Former Tory leader Michael Howard stated that the U.K. is willing to fight for Gibraltar. Although not responding to the threat, Spain has hinted that it would not block Scotland if it were to apply to the European Union upon a potential Scesxit.¹

Despite the bravado, it is likely that the two countries will come to some sort of agreement as they have deep trade ties. In fact, Spain has been the most vocal backer of a soft Brexit. That being said, the people of Gibraltar are stuck at a crossroads regarding the dispute. On the one hand, they

voted 96% to remain in the EU, but on the other hand, they voted 99% against joint sovereignty with Spain. The situation becomes even murkier when its economy is taken into account. Gibraltar is dependent upon the U.K. for trade and Spain for labor. Nevertheless, it is unlikely that Gibraltar would have emerged from Brexit unscathed as its labor force is dependent on the free movement of immigrants permitted under the EU. Ironically, it was the free movement of immigrants that mostly caused British voters to leave the EU.

In this report, we will focus on the significance of Gibraltar, its historical context and the impact of the current dispute. We will conclude with possible market ramifications.

What's at stake?

Gibraltar is a peninsula located at the southern tip of Spain along the Strait of Gibraltar, a body of water separating the Mediterranean Sea and the Atlantic Ocean. Its location provides both economic and military advantages. The owners of the region have immense influence on trade routes as roughly half of the world's trade passes through the strait, along with a third of the world's gas and oil and 80% of goods shipped to the EU. In addition, Spain receives half of its gas from the refineries located along the Strait of Gibraltar. Its geographic location has also proved useful in maritime war during the Napoleonic Wars and both World Wars.

¹ During the run-up to the Scottish referendum, it was believed that Spain would oppose any immediate transition by Scotland into the EU if it decided to leave the U.K. because it could encourage Catalonia to move toward independence as well.



(Source: [Wikimedia Commons](#))

Recently, Gibraltar has become a hotbed for foreign direct investment due to its ultra-low tax rates. As a result, Gibraltar has become a tax haven where many British financial institutions have decided to set up shop. *The Economist* reports that about 60% of all online betting in Britain is conducted through Gibraltar.

Gibraltar has become an asset for the U.K., much to the chagrin of Spain who forfeited all of the properties belonging to Gibraltar in 1713. That being said, Spain contends that it never surrendered control of the territory and therefore owns the surrounding waters and airspace. As a result, Spain and the U.K. have each claimed ownership of the peninsula.

Spanish Succession

The start of the 18th century saw the Spanish Empire in disarray as there was no heir to the throne following the death of King Charles II, also known as “the Bewitched.” As King Charles II was childless and his grandnephew, Joseph Ferdinand of Bavaria, had died a year prior, the Spanish throne was, by virtue of his will, given to the grandson of Louis XIV, Philip of Anjou. The Archduke Charles of Austria felt slighted, believing that he was the rightful heir to the throne as the nephew of King Charles II’s second wife, Maria Anna of Neuburg. The dispute had international implications because Philip of Anjou’s ascension to the throne would ensure France’s supremacy throughout Europe. Furthermore, allegiances were split within the Spanish Empire between the Crown of Aragon, who supported the Archduke Charles of Austria, and the Crown of Castile, who supported Philip of Anjou. In response, Louis XIV, King of France and Philip of Anjou’s grandfather, invaded the Spanish Netherlands. Fearing French rule, the U.K. along with the Dutch and the Holy Roman German Empire formed the Grand Alliance and intervened in the war in support of Archduke Charles of Austria.

During this time, Gibraltar along with most of southern Spain had pledged their allegiance to Philip of Anjou, now known as King Philip V. In order to sway their allegiance, the British overwhelmed Gibraltar by invading with 1,800 men; at the time there were only 5,000 inhabitants in Gibraltar, 100 of which were in the military. Despite fighting valiantly, the city fell in two days with only 70 inhabitants remaining in Gibraltar. Following the fall of Gibraltar, many people living in the area fled to mainland Spain, primarily to the town of San Roque. The British acquisition of Gibraltar was seen as a major victory as

Gibraltar would have military and trade benefits in the future.

The war lasted for 12 years, and although the British were successful, they were unable to remove King Philip V from the Spanish throne. As the war went on, the British became less interested in fighting for the Archduke Charles of Austria and sought an end to the war. In 1712, the British and the Dutch began negotiating two separate treaties, the Treaty of Utrecht and the Treaty of Rastatt. The treaties allowed King Philip V to keep his throne within the Spanish Empire on the condition it remained separate from France. The Treaty of Utrecht, which was negotiated between the Spanish and the British, gave the U.K. control over all the properties in Gibraltar along with Port Mahon on the island of Minorca.

Treaty of Utrecht in 1713: Article X

Article X of the Treaty of Utrecht established the grounds for which Britain would be able to take control over Gibraltar:

The city and castle of Gibraltar, jointly with its ports, defenses and borders that it pertains, giving said property completely to enjoy the rights now and forever without exception or impediment...said property ceded to Great Britain is without jurisdiction of other territories and without open communication with the neighboring country.

In addition, Article X gave Spain the first right of refusal if Britain decided to sell the land.

Although all parties agreed to the wording of the treaty, it became clear that each country interpreted it differently. The British believed that ceding control of the city and all of its properties was equivalent to Spain ceding ownership of the entire peninsula.

Spain, however, believed that the treaty entitled the U.K. to the city and all of its properties but nothing more. Nevertheless, Spain argued that the isthmus, which was neutral territory during the war, was never included in the deal. The ambiguity of Article X would lead to 300 years of both military and diplomatic conflicts between the two nations.

The Great Siege of Gibraltar

In an attempt to regain control of the peninsula and settle this dispute, Spain and France laid siege on Gibraltar in 1779. This was the longest siege that Great Britain had ever been able to withstand. The location of the mountains played a pivotal role as they made it very difficult for the Spanish and French to dislodge the British. After four years and no clear winner, the British ceded Minorca and kept Gibraltar. This was the last time Spain attempted to regain control of Gibraltar using military force.

The U.N. Resolution

After the failed siege, Gibraltar's status as a British colony went unchallenged for almost 200 years. The issue came up again after the U.N. passed a resolution that called for the independence of all colonies. The disputed status of Gibraltar made it to the floor of the General Assembly in 1967 after the British had deemed it a colony in an attempt to maintain control. This caught the ire of Spain, who maintained that it had never ceded sovereignty of Gibraltar but rather only its properties. Nevertheless, the British argued that the people of Gibraltar should choose whether to remain under British sovereignty due to the longevity of occupation. In response, Spain stated that territorial integrity should take precedence over the longevity of occupation because the original inhabitants had left the region. Spain fought against a referendum because it

believed that a vote would undermine its claim of sovereignty over Gibraltar.

In 1967, against the wishes of Spain, a referendum was called that allowed the citizens of Gibraltar to decide whether to live under Spanish sovereignty or remain under British sovereignty. The referendum turned out heavily in favor of the latter, with 99% of the population choosing to remain under British rule. Two years later, the British granted Gibraltar a constitution stating that the British government “will never enter into arrangements under which the people of Gibraltar would pass under the sovereignty of another State against their freely and democratically expressed wishes.” In response, the Spanish government, under the rule of Dictator Francisco Franco, sealed the borders and ceased all communication with Gibraltar. This action had a grave effect on the people of Gibraltar who were unable to communicate with family and friends who lived in Spain.

The Brussels Process

In order to be admitted into the European Union, Spain agreed to hold talks with the U.K. over Gibraltar; these talks were referred to as the Brussels Process. During negotiations, King Juan Carlos II conceded privately that Spain had no interest in taking back Gibraltar because Morocco might seek to reclaim Cuenca and Melilla.² As a sign of good faith, Spain reopened its borders with Gibraltar in 1985. In accordance with the Brussels Process, Spain and the U.K. continued to conduct talks regarding Gibraltar. At the behest of Spain, the government of Gibraltar was left out of the discussions.

² It is worth noting that unlike Cuenca and Melilla, Gibraltar is not a part of the U.K. but rather an overseas territory.

In 1998, a breakthrough was achieved when Spanish Foreign Minister Abel Matutes proposed that the two countries hold joint sovereignty. In his plan, the two countries would share rule of the peninsula until it is transferred back to Spain. Excluding the portion about the return of Gibraltar, the British were open to the idea because it would relieve some of the financial burden associated with Gibraltar. After working out the logistics, the two countries were able to come to an agreement in 2002 that included joint sovereignty of the isthmus, maintaining the customs and traditions of the people of Gibraltar and sharing the responsibilities of defense, foreign affairs and control of maritime and airspace. The two countries also agreed to ensure that Gibraltar remained economically stable.

Gibraltar resented being excluded from the discussions and called for a referendum to determine whether the people of Gibraltar wanted the U.K. to share sovereignty with Spain. The referendum was a direct affront to Spain who wanted the referendum to be about how Gibraltar would govern itself while under joint sovereignty.³ The people of Gibraltar voted almost unanimously against joint sovereignty. Consequently, the deal between the U.K. and Spain fell apart. The two countries continued to meet in order to come to a resolution, and Gibraltar was eventually allowed to participate in the discussions.

Gibraltar vs. Spain

As Spain began to improve its relationship with the U.K., its relationship with Gibraltar became more contentious. Spain resented Gibraltar’s insistence on remaining a British territory. The bad blood only intensified after Spain was admitted into the EU as it consistently sought to undermine Gibraltar.

³ As mentioned above, Spain has maintained that it never lost sovereignty of Gibraltar.

For example, in 2015, Spain threatened to walk away from the Single European Sky initiative if Gibraltar were included. In response to this hostility, Gibraltar has tried to undermine Spain's presence on the peninsula. In 2013, at the behest of Chief Minister Fabian Picardo, an artificial reef was built around the waterway to keep Spanish fishermen from fishing in the waters of Gibraltar. Spain responded by tightening border security for those entering and leaving Gibraltar.

Due to Spain's ability to exclude Gibraltar from the Brexit deal, many Gibraltarians feel uneasy about the Brexit negotiations. As mentioned earlier, Gibraltar voted almost unanimously for the U.K. to remain within the EU, while stating simultaneously that it would like to remain independent from Spain.

Ramifications

Despite the hysteria generated by the media, we are not inclined to believe that Spain and the U.K. are willing to go to war over Gibraltar. As the world moves away from its dependence on oil and the waning significance of navies in combat, it is unlikely that Gibraltar will be a sticking

point in Brexit negotiations. In addition, the U.K. has previously expressed a willingness to share Gibraltar with Spain in exchange for financial assistance, and there is nothing to suggest the U.K. would be opposed to such a deal in the present.

Furthermore, maintaining an open border with Gibraltar helps resolve Spain's employment needs. Andalusia, an autonomous community in Spain that also shares a border with Gibraltar, has the highest unemployment rate within Spain; about 7,000 workers travel per day from Andalusia to work in Gibraltar. Therefore, Spain and the U.K. will probably come to some sort of an agreement. They will likely bypass a referendum vote in order to ensure that a deal happens, so it is unlikely that Spain will be able to claim sovereignty over Gibraltar.

In summary, we believe the Gibraltar dilemma will be market neutral. If conflicts were to break out, it would be bearish for European equities and bullish for U.S. bonds as investors will look to the U.S. as a haven.

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