



## **Inside Spain 49**

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### **Foreign Policy**

#### *Relations with Turkey Upgraded*

Prime Minister José Luis Rodríguez Zapatero visited Turkey and announced that the two countries would hold an annual summit as of 2009. Only five countries have such a relationship with Spain: France, Portugal, Italy, Morocco and Germany.

Spain is an active supporter of Turkey's full EU membership and Rodríguez Zapatero and his counterpart, Recep Tayyip Erdogan, are co-sponsors of the Alliance of Civilisations to defuse tensions between the Western and Islamic world. The project is supported by the UN which has assigned it a High Representative.

Rodríguez Zapatero was invited as the guest of honour in Istanbul at a fast-breaking dinner (*iftar*). Last year's guest was Angela Merkel, the German Chancellor.

#### *Barcelona Seeks to be the Headquarters of the Union for the Mediterranean*

The Spanish government is promoting Barcelona as the headquarters of the Barcelona Process: Union for the Mediterranean, a community officially established this year by the French President Nicolas Sarkozy and which was launched by Euro-Mediterranean Foreign Ministers in November 1995 in the Catalan capital. It consists of all EU countries and several non-EU ones such as Morocco, Tunisia, Algeria and Turkey. A decision will be taken in November. The other candidates are Malta, Morocco and Tunisia.

#### *Spaniards Support NATO More and Overwhelmingly Back Obama*

Spain registered the highest increase in support for NATO as an essential element in the country's security among the 12 countries surveyed in the latest Transatlantic Trends conducted by the German Marshall Fund of the United States.

Sixty percent of respondents in Spain said NATO was still essential, up from 49% in 2007. Overall, 57% of Europeans agreed that NATO is still essential to their country's security, an increase of four percentage points since 2007. The increases in Germany and France were seven percentage points.

Eighty per cent of Spaniards are in favour of Barack Obama as the next US president, the fourth-highest level after France, the Netherlands and Germany (see Figure 1), and only 33% want John McCain (see Figure 2).

**Figure 1. Views of Barack Obama**

	BG	FR	GER	IT	NL	PL	PT	RO	SK	SP	TR	UK	US
Favourable	43	85	83	81	85	53	73	48	41	<b>80</b>	20	75	54
Unfavourable	17	8	9	15	7	10	9	17	21	<b>10</b>	22	11	42
No answer	41	7	8	5	8	37	18	35	38	<b>10</b>	58	13	4

BG = Belgium; FR = France; GER = Germany; IT = Italy; NL = Netherlands; PL = Poland; PT = Portugal; RO = Rumania; SK = Slovakia; SP = Spain; TR = Turkey.

Source: Transatlantic Trends, 2008.

**Figure 2. Views of John McCain**

	BG	FR	GER	IT	NL	PL	PT	RO	SK	SP	TR	UK	USA
Favourable	25	23	28	24	33	31	35	30	25	<b>33</b>	6	33	56
Unfavourable	25	63	53	62	51	16	39	27	30	<b>47</b>	29	40	40
No answer	50	14	19	15	16	53	26	43	44	<b>20</b>	66	26	4

BG = Belgium; FR = France; GER = Germany; IT = Italy; NL = Netherlands; PL = Poland; PT = Portugal; RO = Rumania; SK = Slovakia; SP = Spain; TR = Turkey.

Source: Transatlantic Trends, 2008.

McCain's image in Spain has not been helped by his gaffe during an interview with Miami's Radio Caracol when he confused Spain with Latin America. After answering questions about the region he was asked whether, if elected President, he would officially meet with Rodríguez Zapatero. This is an important issue for Spaniards as the latter is virtually the only head of an EU government who has not been invited to the White House, because of his spat with the US Administration after withdrawing peacekeeping troops from Iraq (sent by his predecessor, José María Aznar) in 2004. McCain said he would work with anyone from the region who cooperates with the US. Maybe McCain confused Zapatero with Zapatista (the Mexican rebel group), but even when the interviewer blurted out 'I'm talking about Europe, about Spain!' McCain still did not register and went off on a tangent and praised Felipe Calderón, Mexico's President.

## Domestic Scene

### *Government Approves Return Plan for Immigrants*

The government, alarmed by the pace at which unemployment is rising, approved its plan to encourage jobless immigrants from non-EU countries to return to their countries. Those who agree to do so receive their social security benefits in a lump sum, provided they formally promise not to return for three years.

At the last official count there were more than 4.4 million immigrants legally in the country, the bulk of whom arrived over the last 10 years, and over 2.6 million people unemployed, 608,000 more than in September 2007 and the highest number since the current methodology began to be used in 1996. The unemployment rate, the highest in the EU, rose from 8.3% to 11.3% in the 12 months to August compared with a minute increase from 7.4% to 7.5% for the Euro zone as a whole. The number of jobless in Spain's construction sector, where many immigrants work, has almost doubled in a year to 443,000.

Of the unemployed immigrants, 65,000 are people who can benefit from the plan, but it is thought very few will do so for a variety of reasons. Depending on the circumstances, it is generally believed that unemployed immigrants will prefer to tough it out in Spain where they and their families have free education and healthcare rather than return home. A survey conducted by the National Statistics Institute (INE) among immigrants revealed that three-quarters of the respondents came to Spain although they had jobs in their own countries.

Immigration is entering the political agenda. Mariano Rajoy, the leader of the conservative Popular Party (PP), caused a storm last month when he said there were '180,000 foreigners receiving unemployment benefits' while '20,000 Andalusians have requested work in the French grape harvest'. The inference was that foreigners were taking jobs away from Spaniards. The Socialists accused Rajoy of being xenophobic.

Despite the growing economic crisis in Spain, illegal immigrants continue to arrive. Almost 230 people were rescued from a *cayuco* (an African fishing boat) off the coast of the Canary Islands. It had come from Mauritania and held the largest number detected on a boat so far. Around 1,200 unaccompanied minors from Africa are in special centres in the Canaries, 700 more than the islands' government says it can properly tend to.

#### *ETA Assassinates Soldier in Spain, France Arrests its Political Leaders*

The Basque terrorist group ETA murdered a soldier in a car bomb blast, its fifth victim since ending its ceasefire in June 2007, and in an unprecedented move French police arrested 14 members of ETA's political allies Batasuna, outlawed in 2003.

The car bomb was detonated in Santoña, Cantabria and killed Sergeant Major Luis Conde. In separate attacks, ETA damaged a savings bank and a court house. For the first time in almost five years all political parties in the national parliament issued a common declaration condemning the killing without adding their own nuances. This particularly applied to the Popular Party, highly critical in the past of the Socialists' approach to the ETA issue and since the March general election more disposed to back the government, whose position has also changed.

The renewed violence of ETA is in response to the recent banning of two other political parties linked to it, the Communist Party of the Basque Lands and Basque Nationalist Action.

Meanwhile, the ruling Basque Nationalist Party (PNV) said it would call for a human chain to be formed on October 25, the day it wanted to call a banned referendum as a way to seek a peace deal with the Basque terrorist group ETA, provided it renounced violence, and determine the region's position within Spain. The Constitutional Court unanimously upheld a move by the Socialist central government and the main opposition Popular Party to block the referendum.

Juan José Ibarretxe, the Basque Premier, and Patxi López and Rodolfo Ares, leaders of the Basque Socialist Party (PSE), have been summoned to appear before a court next January for meeting with leaders of Batasuna during ETA's ceasefire.

#### *Judge Receives 130,137 Names of Victims of Franco's Repression*

Judge Baltasar Garzón, who triggered controversy after requesting information about the unmarked graves of the victims of repression unleashed during and after Spain's 1936-39 Civil War by General Francisco Franco, was handed a list of 130,137 names by associations who have pursued the issue for years.

Many of the crimes happened so long ago that they are covered by a 1977 amnesty law, a key element in the Transition that turned the page on the past and enabled

Spain to move with very little bloodshed from a dictatorship of 39 years to a democracy. Only if Garzón can prove genocide can he bring anyone to trial, something regarded as highly unlikely.

After the war the Franco regime conducted a thorough accounting of the victims of Republican killings. Despite this, Garzón also opened an investigation into the thousands of victims of the so-called ‘red terror’ conducted by supporters of the Republic during the Civil War.

#### *European Commission to Investigate Urbanisations over Water*

The European Commission has opened an investigation into 264 urbanisations whose building has been approved or which are in the process of being approved, despite negative reports from water authorities saying there is not enough water for them.

The Commission’s decision follows an investigation by David Hammerstein, a Spanish politician and member of the European Parliament for *Los Verdes*, part of the European Greens, who says the urbanisations contravene the EU directive on sustainable development.

#### *Spain Slides in Corruption League*

Spain’s mainly local-government related corruption scandals are increasingly being reflected in the annual Corruption Perceptions Index drawn up by the Berlin-based Transparency International. This year Spain was ranked 28<sup>th</sup> out of 180 countries with a score of 6.5, compared with 25<sup>th</sup> in last year’s ranking with a score of 6.7 and its best ever position in 2004 (22<sup>nd</sup> with a score of 7.1). The closer to 10 the cleaner the country (see Figure 3).

**Figure 3. Corruption Perceptions Index (1)**

Country	Index
1. Denmark	9.3
14. Germany	7.9
16. UK	7.7
18. US	7.3
23. France	6.9
<b>28. Spain</b>	<b>6.5</b>
55. Italy	4.8

(1) The closer to 10 the cleaner the country.

Source: Transparency International.

#### *Tops Organ Donor Ranking*

Spain is the most generous country for donating cadaveric organs, according to a league table drawn up by the Barcelona-based Transplant Procurement Management (see Figure 4).

**Figure 4. Cadaveric Organ Donor Rates per 1 million population**

Country	Rate
<b>Spain</b>	<b>34.3</b>
US	26.6
France	25.3
Italy	20.9
Ireland	20.2
Uruguay	18.0
Canada	14.8

Source: Transplant Procurement Management.

### *Population Ageing Rapidly*

One-third of Spain's population will be 65 or over in the year 2050, double the current share held by that age group, according to the latest forecasts by Eurostat (see Figure 5). Spain's population in that year will be the second oldest in the EU-27 after Italy.

**Figure 5. Population of 65 years or more**

<b>% of total</b>	<b>2008</b>	<b>2050</b>
Italy	20.08	32.62
<b>Spain</b>	<b>16.61</b>	<b>32.11</b>
Germany	20.05	31.71
EU-27	17.08	28.81
France	16.5	25.62
UK	16.10	27.95

Source: Eurostat.

## **The Economy**

### *Government Boosts Deposit Guarantee and Creates Fund to Encourage Lending*

Spain's banking system is currently very healthy, but the government is taking no chances. It increased the guarantee for deposits in banks from €20,000 to €100,000 and created a fund of €30-50 billion in order to kick-start lending which has virtually dried up and is producing severe liquidity problems, particularly for small- and medium-sized companies deprived of working capital. The government will also provide up to €100bn of guarantees for new debt issued by commercial banks in 2008 and an unspecified further amount next year.

Prime Minister José Luis Rodríguez Zapatero said the fund, will be used to buy healthy and not toxic assets from banks in order to ensure they keep lending. He stressed that it was not a bank bailout, unlike schemes in the US and European countries to capitalise or nationalise banks. The fund, charged to public debt and not the budget, is temporary and complements injections of liquidity by the European Central Bank.

Bank of Spain data showed mortgage lending plunged by 47% in August and consumer lending fell 35%.

Rodríguez Zapatero boasted to American businessmen in New York, before the package was announced, that Spain had 'perhaps the most solid financial system in the international community'. This does not mean, however, the whole financial system. Particularly vulnerable are small local-government owned savings banks (*cajas*) which are heavily exposed to the property market and cannot raise equity as they do not have shares.

Miguel Fernández Ordóñez, the Governor of the Bank of Spain, stressed when appearing before the Congress's Budgetary Committee that Spanish banks had not been involved in generating, selling or acquiring toxic financial products.

A major reason why the Spanish financial system is relatively strong is that the Bank of Spain is a stringent regulator; for example, it penalised off-balance sheet transactions to such an extent that banks had no exposure to the effects of the US subprime debt crisis. And the substantial provisions for non-performing loans (NPLs)

accumulated during the decade-long boom of the Spanish economy, as a result of the central bank's counter-cyclical measures, are cushioning the banks against rapidly rising bad debts from the property market crash and homeowners struggling to pay their mortgages.

NPLs stood at 2.2% of total loans in July (latest figure), still low by international standards but more than double the level at the end of 2007. Bad debts are rising fast because of the economic slowdown, particularly in the property market. Sales of homes on the Costa del Sol have dropped by more than 70% in the last 18 months and there are more than 24,000 unsold properties. Some developers have clubbed together and are offering two properties for the price of one.

Despite their relatively good fundamentals Spanish bank stocks have fallen heavily. The Madrid market has plummeted 34.4% so far this year (see Figure 6).

**Figure 6. Stock Market Indices (1)**

Index	% change
Euro Stoxx 50	38.9
Dax (Frankfurt)	37.2
<b>Ibex-35 (Spain)</b>	<b>34.4</b>
FTSE 100 (London)	34.0
Dow Jones	29.2

(1) Between 1 January and 13 October 2008.

Source: Markets.

#### *Austere Budget for 2009*

The government envisages a public sector deficit of 1.9% of GDP in 2009, the highest since 1998, compared with a projected deficit of 1.5% this year and a record surplus of 2.2% in 2007.

The fall in tax receipts because of the much sharper economic slowdown than expected (coupled with the impact of lower corporate taxation) has forced the government to rein in expenditure and increase its recourse to debt. GDP growth is officially forecast at 1% next year, down from around 1.5% this year and 3.8% in 2007. The IMF is more pessimistic: it said Spain would enter recession in 2009 with negative growth of 0.2%, compared with its previous forecast of 1.2% growth, and the jobless rate would reach close to 15%.

Public debt will rise from 36.8% of GDP this year to 38.8% in 2009, according to Pedro Solbes, the Finance Minister. Between 1996 and 2007 it dropped from 63.3% to 36.2% (see Figure 7).

**Figure 7. Public Sector Balance and Public Debt**

% of GDP	1995	2000	2005	2006	2007	2008	2009
Public sector balance	-6.5	-1.0	+1.0	+1.8	+2.2	-1.5*	-1.9*
Public debt	63.3	59.3	43.0	39.6	36.2	36.8*	38.8*

Source: Ministry of Economy and Finance.

Pensions and unemployment benefits will between them absorb four out of every 10 euros of expenditure. José Luis Rodríguez Zapatero, the Prime Minister, has made defence of social spending a central plank of the budget. Reflecting the tougher times and keen to set an example of belt-tightening the salaries of Zapatero, ministers and senior officials in the judiciary, the police and the armed forces will be frozen next year.

### *Grupo Santander Acquires Another UK Bank, Takes Control of Sovereign in US*

The international financial crisis is proving to be a boon for Grupo Santander. First it bought Alliance & Leicester (A&L) at a knock down price and last month it purchased the deposits and branches of Bradford & Bingley (B&B). These two acquisitions, added to Abbey bought in 2004, make Santander one of the top retail banks in the UK in terms of deposits (around €146 billion, market share of around 10%) and total number of branches (1,286).

In the US, Santander bought the rest of Sovereign Bancorp for a tenth of the price agreed when it took a minority stake three years ago. It acquired 75.6% of the bank for €1.7 billion. The bank, hit by rising mortgage delinquencies, became the largest public savings and loan in the US last month when Seattle-based Washington Mutual Inc collapsed and was absorbed by JPMorgan Chase.

As a result of its strong capital base, the global crisis has presented Santander with a golden opportunity to continue to expand abroad at very attractive prices. Shortly before an extraordinary general meeting of shareholders in September that approved the A&L take-over, Emilio Botín, Santander's Chairman, boasted: 'We are really in a magnificent position compared with our competitors'.

Santander, predominantly a retail bank, has escaped almost unscathed from the credit crunch as a result of its prudence in credit risk, limited investment-banking operations, avoidance of toxic assets and the iron hand of the Bank of Spain.

Santander paid €787 million for B&B whose mortgage book was nationalised by the UK government, thus making the acquisition virtually risk free. It expects to make a return on this investment of 20% in 2011.

### *Abertis and Criteria Pull out of US Toll Road Privatisation*

The Spanish companies Abertis and Criteria and Citigroup, whose €8.7 billion consortium bid was the winner of a 75-year lease to operate and collect fares on Pennsylvania's only toll road, pulled out of the project because of opposition from the state's legislature. The deal was the biggest agreement of its kind in the US.

### *Outward Direct Investment Reaches New High*

Spanish companies and banks invested a record US\$119.6 billion abroad in 2007, the fifth-highest amount after the US, the UK, France and Germany. The stock of this investment amounted to US\$636.8 billion (44.3% of GDP), substantially higher than the stock of inward investment of US\$537.4 billion (37.4% of GDP), according to UNCTAD's latest World Investment Report (see Figure 8).

The outward stock in GDP terms is higher than Germany's (37.3%) and Italy's (24.7%), but lower than the UK's (61.5%) and France's (54.7%). The policy of investing abroad, which began about 15 years ago, is proving to be particularly beneficial in the current environment of downturn in the domestic market. In the first half of 2008 just under 50% of the revenues of the companies in the Ibex-35 benchmark index of the Spanish stock exchange were generated in Spain compared with 65% in 2003. Many of these companies will report bigger profits this year than in 2006, bucking the international trend.

**Figure 8. Spain's Outward Direct Investment**

	1990-2000 (annual average)	2003	2004	2005	2006	2007
Outward flow (US\$ bn)	15.1	28.7	60.5	41.8	100.3	119.6
Stock as % of GDP	3.0 (1990)	–	–	–	–	44.3

Source: World Investment Report 2008, UNCTAD.

As regards inward direct investment, Spain received US\$53.4 billion in 2007, the seventh-largest amount in the world, compared with US\$26.8 billion in 2006 when it was ranked 16<sup>th</sup> (see Figure 9). The amount that Spain received in 2007 was the fourth largest in the EU (the eighth in 2006).

**Figure 9. Top Ten Countries by Inward Foreign Direct Investment Flows, 2007**

Country	US\$ billion
1. US	232,839
2. UK	223,966
3. France	157,970
4. China	156,706
5. Canada	108,665
6. Netherlands	99,438
<b>7. Spain</b>	<b>53,385</b>
8. Russian Federation	52,475
9. Germany	50,925
10. Belgium	40,628

Source: World Investment Report 2008, UNCTAD.