

Inside Spain 51

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Foreign Policy

Rodríguez Zapatero Snuggles up to Obama, May Send More Troops to Afghanistan

José Luis Rodríguez Zapatero, the Prime Minister, is seeking a more constructive and closer relationship with Barack Obama, the next US President, than the fraught one with George W. Bush, who shut him out after his withdrawal in 2004 of the peacekeeping troops sent to Iraq by his predecessor, José María Aznar. Rodríguez Zapatero is reportedly prepared to positively view Obama's expected request next year to send more troops to Afghanistan.

Emboldened by winning his offensive to attend last month's G20 summit in Washington (see *Inside Spain*, Newsletter 49, 13 November 2008), he has spoken to Obama, with whose multilateralist foreign policy he identifies –like most EU leaders–.

The groundwork for sending more troops to Afghanistan is already being laid. Carme Chacón, the Defence Minister, told parliament that the 'obsolete' ceiling of 3,000 troops abroad, set in 2005, would be increased next year to 7,700. Regardless of sending more troops to Afghanistan, the ceiling needs to be raised so that 390 military personnel can participate in the EU's anti-pirate mission off the coast of Somalia. Spain currently has close to 3,000 soldiers abroad: 1,100 in Lebanon, 778 in Afghanistan, 623 in Kosovo, 341 in Bosnia, 841 in Chad and 69 in Djibouti.

Chacón told parliament's defence committee that the government wanted a 'solid and balanced relation of cooperation' with the US Administration and would assume 'our commitments with our partners and allies'. Spain's asymmetrical defence pact with the US expires in 2010. While the pact in Spain has the category of a treaty and requires parliament's approval, in the US it is an agreement between governments.

Obama, according to US and Spanish officials, may ask Spain not only to strengthen its deployment in Afghanistan but to fight in the areas of greatest conflict in the south and not confine itself, as at present, to humanitarian and reconstruction work in the west of the country. Spanish troops are under strict rules of engagement.

The brunt of the fighting against the Taliban is being borne by US, UK, Canadian and Dutch troops in southern Afghanistan, although violence is escalating throughout the country. Two Spanish soldiers were killed by a suicide bomber last month.

Unlike the Iraq invasion, the invasion of Afghanistan is sanctioned by the UN's Security Council. The Spanish government is expected to give a sympathetic hearing to a request to send more troops to Afghanistan, particularly if the Obama Administration's strategy includes a cessation of indiscriminate bombing of the civilian population.

Previous PP Government Willing to be Involved in US Flights of Terror Suspects

The Socialists (PSOE) and the Popular Party (PP) were at loggerheads after a series of leaked notes and letters from 2002 showed that the PP government of José María Aznar was prepared to collude with the US Administration in the transfer of prisoners from Afghanistan to Guantánamo following the attack in 2001 on the Taliban regime.

A series of 'top secret' internal letters and notes, published in *El País*, showed that an official from the US Embassy in Madrid verbally informed Spain's Foreign Ministry that prisoners, detained without charge or trial, would be transported to Guantánamo via Spain, and that the government supported the request for stopovers for emergency purposes and urged discretion about the flights.

Miguel Ángel Moratinos, the Foreign Minister, confirmed to parliament that the PP government gave permission for these flights but that the Pentagon never used the authorisation which he said was within the framework of a collective NATO decision.

Of the 11 flights manned by the CIA and known to have landed in Spain, which are under investigation by a Spanish judge, nine were in 2005 and 2006 during the first government of José Luis Rodríguez Zapatero. Rodríguez Zapatero denied knowledge of these flights.

Domestic Scene

ETA Assassinates Businessman, Military Leaders Arrested in France

ETA, the Basque terrorist group, shot dead Ignacio Uría, a 71-year-old businessman. He was the fourth victim this year and the sixth since ETA officially ended its ceasefire in June 2007.

Meanwhile, French and Spanish police scored notable successes with the arrest on 17 November of Garikoitz Aspiazu Rubina, ETA's presumed military leader, and on 8 December of his alleged successor, Aitzol Iriondo. Both were captured in the south of France and are said to have been involved in the killing of two plain-clothed civil guardsmen in December 2007.

The refusal of Basque Nationalist Action (ANV), ETA's political allies, to condemn the killing of Uría led the Socialists and the conservative Popular Party (PP) to join forces to try to change legislation so that ANV and another similar party, the Communist Party of the Basque Lands (PCTV), can be dislodged from the 42 town halls where they have representatives and mayors.

The ANV and the PCTV were outlawed earlier this year but current legislation allows them to maintain their elected representatives even though the parties are illegal. ETA's political allies have long refused to condemn the group's killings.

Garzón Abandons Probe into Fate of Franco 'Disappeared'

Judge Baltazar Garzón quit his controversial investigation into the disappearance of more than 100,000 people during the 1936-39 Civil War and the ensuing 36-year dictatorship of General Francisco Franco after a court overruled him and amidst protests from the conservative Popular Party and the Catholic Church.

He had ordered exhumations from 25 mass graves containing the bodies of those shot by firing squad or on the orders of military courts.

The public prosecutor's office challenged Garzón's decision, claiming that it violated an amnesty agreed by political parties in the spirit of national reconciliation in 1977. The prosecutor said he was 'not competent to carry out this investigation' which should be 'up to the courts of each region where such atrocities were committed'. The matter is now in the hands of the 62 courts in the areas where the graves are located. A draft law being prepared by the government would put the exhumation issue in the hands of regional governments and not the courts.

In an 89-page document, Garzón said the amnesty did not apply to the crimes he was investigating as they were crimes against humanity and that if the allies had followed the same reasoning as the public prosecutor's office the 'horrors of Nazism would not have been prosecuted'.

Spain Receives Largest Number of Immigrants in the EU

More than 800,000 people emigrated to Spain in 2006, by far the largest flow of immigrants in the EU and almost one-quarter of the total number of people that settled in the Union, according to the latest comparative figures of the statistical office Eurostat (see Figure 1).

Figure 1. Foreign Immigration, Selected Countries

| Country | Number | % of which | | Immigration per 1,000 inhabitants |
|------------------|----------------|------------|-----------|-----------------------------------|
| | | EU-27 | Non-EU-27 | |
| France (1) | 182,400 | N | NA | 2.9 |
| Germany | 558,500 | 57 | 43 | 6.8 |
| Ireland | 84,800 | 77 | 23 | 19.6 |
| Poland | 1,800 | 22 | 78 | 0.0 |
| Spain (2) | 803,000 | 38 | 62 | 18.1 |
| UK | 451,700 | 31 | 69 | 7.4 |
| EU-27 | 3,000,000 | 40 | 60 | 6.2 |

(1) Including metropolitan and overseas departments and regions. The number of immigrants excludes citizens from the EU-15, Cyprus, Malta and EFTA countries.

(2) Including non-EU-27 citizens registered with the local municipality regardless of whether they have a residence permit.

Source: Eurostat.

In terms of the number of immigrants per 1,000 inhabitants of the country to which these people moved, Spain had the fourth-highest rate after Luxembourg, Ireland and Cyprus, all of them tiny countries in comparison. Spain's rate was 18.1 immigrants per 1,000 inhabitants compared to an EU-27 average of 6.2.

The total number of foreigners in Spain was 5.2 million on January 1, 2008, according to INE, the country's statistical office. This represented 11.3% of Spain's total population.

Coastline 'Increasingly Invaded' by Residential Construction

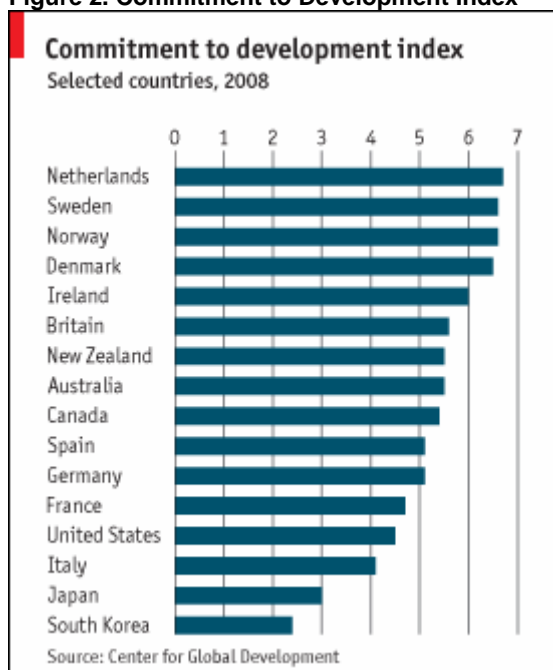
The amount of land near to all of Spain's coastline upon which homes were built between 2000 and 2005 increased by 22% and 27.5% of land –within two kilometres of the Mediterranean– is now occupied, up from 22% in 2005 and 16% in 1987, according to a satellite survey by the National Geographic Institute, part of the Public Works Ministry.

According to the Institute, an average of 140,000 square metres a day were built on during this period, double the amount in 1987-2000, a clear indication of the extent of Spain's housing boom.

Spain Improves in Commitment to Fostering Prosperity in the Developing World

Spain was ranked 15th out of 22 rich countries in the latest commitment to development index and made the third best improvement since the index was started in 2003 (see Figure 2). The ranking of the Centre for Global Development is based on seven categories: aid, trade, investment, migration, environment, security and technology. Its highest rank comes in the migration component, thanks to the large number of immigrants from developing countries entering the country.

Figure 2. Commitment to Development Index



But Ranked Low in Early Childhood Services

Spain was ranked near the bottom of UNICEF's first-ever league table of early childhood services in 25 OECD countries along with the US (see Figure 3). It achieved only three of the 10 benchmarks: subsidised and accredited early education services for 80% of 4 year-olds, 80% of all child-care staff trained and 50% of staff in accredited early education services tertiary-educated with relevant qualifications. Among the seven benchmarks it failed to attain were parental leave of one year at 50% of salary and 1% of GDP spent on early childhood services.

Figure 3. League Table of Early Childhood Services, Selected Countries

| | Number of benchmarks achieved |
|--------------|-------------------------------|
| Sweden | 10 |
| Iceland | 8 |
| France | 8 |
| Hungary | 6 |
| England | 5 |
| Germany | 4 |
| Italy | 4 |
| Spain | 3 |
| US | 3 |
| Canada | 1 |

Source: UNICEF.

The Economy

Rodríguez Zapatero Unveils €11 billion Stimulus Package to Combat Surge in Unemployment

The government, worried by the steep rise in unemployment, is to invest an extra €1 billion (1.1% of GDP) on infrastructure, the motor industry and other areas in the hope of creating 300,000 jobs in 2009.

In his fourth address on the economy in parliament in five months, the Prime Minister said Spain was ‘particularly sensitive in terms of loss of employment’. The jobless rate rose from 8.3% at the end of 2007 to close to 12% at the end of November, the highest level since 1996, when nearly 3 million people were unemployed. More than 5,700 jobs were lost each day in November, mostly in the construction sector –the former engine of the booming economy whose housing bubble has now burst– and in services. Spain’s jobless rate is rising at the fastest pace in the EU.

Overall joblessness was up 43% in a year but among immigrants it rose 91%. The gravity of the employment situation was graphically illustrated by several thousand immigrants arriving in the province of Jaén in the hope of being hired to pick olives and many more Spaniards being prepared to do this work than in previous years.

The government is seeking –through a campaign of adverts and a website– to encourage unemployed immigrants legally in Spain and paying their social security contributions to return to their country of origin under a special scheme (see *Inside Spain*, Newsletter 49, 14 October 2008).

The lion’s share of the government’s €10,850 million (€8 billion) package will go to town halls, who will be encouraged to create jobs in whatever areas they can, and €800 million to the motor industry to cut labour costs, improve training and encourage innovation (for example, development of the electric car). The sharp fall in new car sales (50% lower in November than a year earlier and 26% in the first 11 months, at 1,088,720 units) has led most producers to lay off large numbers of workers. Industrial output fell 12.8% year-on-year in October, a bigger fall than in 1993 when Spain had its last recession.

In the first eight months of 2008 429,711 homes were completed, adding to the glut of unsold homes which is estimated at between 650,000 and 1 million and is rapidly rising. The homes completed this year began to be built in 2006 and 2007. According to the construction employers’ association, housing starts in 2009 will number around 150,000, the lowest figure in 50 years.

The increase in Spain’s house prices over the last decade has been one of the steepest in the world (see Figure 4); they fell by almost 8% in the year to November.

Figure 4. The Economist’s House-Price Indicators (% change)

| | Latest (On a year earlier) | 3Q07 (On a year earlier) | 1997-2008 or latest |
|--------------|-------------------------------|-----------------------------|---------------------|
| France | 2.8 | 5.7 | 150 |
| Germany | 1.4 | -3.1 | NA |
| Italy | 1.1 | 5.1 | 104 |
| Spain | 0.4 | 5.3 | 191 |
| UK | -13.9 | 9.5 | 168 |

Source: The Economist, drawing on many sources.

Habitat, Spain's fifth-largest property company, became the latest victim of the slump in the residential property sector and the global credit crunch when it suspended payments. Its debt amounts to around €2,300 million, considerably less than Martinsa which suspended payments earlier this year with debts of €6,200, the largest bankruptcy in recorded Spanish history. Sacyr, another troubled construction company, was approached by Lukoil, a Russian oil company, to sell its 20% stake in Repsol, Spain's oil and gas conglomerate. Before this move Russia's state-controlled Gazprom said it was interested in Sacyr's stake. The government said it would oppose that sale. Lukoil's possible acquisition also raised concerns.

The non-performing loans (NPLs) of Spain's real estate developers increased fourteen-fold in the year to September to €14,417 million, according to the Bank of Spain. These bad debts represented 4.57% of their total loans. The overall NPLs of Spain's commercial and savings banks at the end of October amounted to €54,174 million (2.91% of their total loans).

The latest package of measures follows an income tax rebate of €100, mortgage relief and credit lines for businesses. The government has also created a €50 billion fund to buy assets from banks that need liquidity and said it will underwrite up to €100 billion in new bank debt. Rodríguez Zapatero ruled out a cut in income tax and the leeway for reducing VAT is small as Spain's standard rate of 16% is only one point above the minimum rate imposed by the EU.

Despite the slump in economic activity, Spain's current account deficit is forecast to be 10.1% of GDP, almost the same as in 2007 (see Figure 5). According to the OECD's latest projections, the Spanish economy will shrink 0.9% in 2009, compared with growth of 1% forecast by the government when it presented its budget to parliament in October. This compares with estimated growth of 1.3% this year and 3.7% in 2007.

Figure 5. Largest Current Account Deficits Forecast for 2008 (% of GDP)

| Country | % of GDP |
|----------------|-----------------|
| Greece | -14.0 |
| Portugal | -12.0 |
| Spain | -10.1 |
| Turkey | -6.5 |
| Australia | -4.9 |
| United States | -4.6 |
| United Kingdom | -3.6 |
| France | -2.8 |
| Italy | -2.8 |

Source: IMF.

The budget deficit in 2009 could be at least twice this year's official forecast of 1.5% of GDP and breach the EU ceiling of 3%, according to senior government officials. The EU's Stability Pact allows countries to surpass the 3% limit for 'exceptional reasons'. The general government accounts have been in surplus since 2005 (2.2% of GDP in 2007). The International Monetary Fund forecast a much larger budget deficit of more than 5% next year.

OECD and IMF Call for Structural Reforms in Spain

Spain's economy, which next year will be in recession after 15 years of sustained growth, will take longer to rebound than is officially expected and its recovery and future potential would be boosted if the government pushed through structural reforms,

according to reports by the Organisation for Economic Cooperation and Development (OECD)¹ and the International Monetary (IMF).²

While Spain enjoyed several advantages, notably a relatively robust financial sector and the rapid expansion of tertiary education over the past 20 years, the reports said the economy was being held back by several factors including a very high drop-out rate among secondary school students, job protection and wage-bargaining laws that needed to be more flexible, and weak productivity growth.

The IMF, in its annual assessment of the Spanish economy, said the main shortcoming of the government's stimulus measures was that they had not been used to achieve structural reforms that would increase medium-term growth. It warned of an L-shaped recession, a protracted period of economic stagnation like the one experienced by Japan in the 1990s after the bursting of its housing and equity bubble.

One in three secondary school students did not graduate in 2007, the second highest after Portugal and double the EU27 average (see Figure 6). Spain's drop-out rate is the only one that did not decline between 2006 and 2007. The high percentage of students repeating a grade at the levels of lower secondary education (16% in 2006, five times the OECD average) de-motivates students and leads many of them to drop out. Until this year, it was quite easy for these youngsters to find a job, particularly in the construction sector. The economic downturn has changed this dramatically.

Figure 6. Early School Leavers (% of population aged 18-24) (1)

| | 2006 | 2007 |
|--------------|-------------|-------------|
| Finland | 8.3 | 7.0 |
| France | 12.3 | 12.7 |
| Germany | 13.9 | 12.7 |
| Italy | 20.8 | 19.3 |
| Poland | 5.6 | 5.0 |
| Netherlands | 12.9 | 12.0 |
| Portugal | 39.2 | 36.3 |
| Spain | 29.9 | 31.0 |
| UK | 13.0 | NA |
| EU-27 | 15.2 | 14.8 |

(1) Those who did not graduate from secondary school and do not participate in vocational training.
Source: OECD.

The government is seeking ways to put early school leavers back into some form of education or vocational training so that their job prospects are enhanced. The need to create an economy based much more on knowledge and less on bricks and mortar requires a better-educated labour force, as well as greater spending on R&D (see Figure 7).

Figure 7. Spending on R&D (% of GDP) (1), Selected EU-27 Countries

| Country | % of GDP |
|----------------|-------------|
| Sweden | 3.80 |
| Finland | 3.48 |
| Germany | 2.48 |
| France | 2.12 |
| EU-27 | 1.84 |
| UK | 1.76 |
| Czech Republic | 1.54 |
| Spain | 1.20 |

(1) Figures for 2006, latest year available.
Source: Eurostat.

¹ www.oecd.org/document/47/0,3343,en_2649_33733_41681711_1_1_1_1,00.html.

² www.imf.org/external/np/ms/2008/120908.htm.

The OECD report on Spain, issued every two years, yet again criticised the ‘depressing impact’ on labour flexibility of Spain’s job protection laws and proposed modifying or abolishing the two-tier system of permanent contracts highly favourable to employees and temporary ones preferred by employers. One in three jobholders are on temporary contracts, the highest rate in the EU.

The OECD also continued to call for greater flexibility in annual wage bargaining agreements, saying that any indexation should be limited to an inflation measure that excludes oil and other commodity prices. The IMF said wage indexation was inconsistent with the euro zone’s currency union.

FDI up in Spain, Outward Investment Plummet

Spain received almost as much foreign direct investment in the first half of this year as in the whole of 2007, but outward investment fell sharply (see Figure 8). Inward investment was US\$49 billion, only US\$4 billion less than in 2007, and outward was US\$31 billion (US\$119.9 billion in 2007).

Figure 8. Foreign Direct Investment (US\$ billion), Selected OECD Countries

| | Inflows | | Outflows | |
|--------------|-------------|-------------|--------------|-------------|
| | 2007 | H108 | 2007 | H108 |
| France | 158.0 | 73.0 | 224.6 | 141.0 |
| Germany | 50.9 | 13.0 | 167.5 | 119.0 |
| Italy | 40.2 | -8.0 | 90.0 | 19.0 |
| Spain | 53.4 | 49.0 | 119.6 | 31.0 |
| UK | 186.0 | 102.0 | 229.9 | 76.0 |

Source: OECD.

Santander in Surprise Move to Boost its Capital, Hit by Madoff Scandal

Santander, Spain’s largest bank and the biggest in the euro zone by market capitalisation, made a deeply discounted €7.2 billion rights issue in order to boost its core capital ratio to 7% of assets from 6.31% in the third quarter. The move ruffled the market as Santander had intimated that it was in no hurry to recapitalise. The shares were sold at a 46% discount of €4.50 each and the rights issue was oversubscribed.

Merrill Lynch, the investment bank that underwrote the issue, was criticised in financial circles for saying –three weeks before Santander announced the rights issue– that the bank needed €6.6 billion in capital.

The very well managed and prudent Santander has been one of the main winners of the current global financial crisis as it has bought two collapsed UK banks and acquired full control of one it partly owned in the US this year.

In a separate development, however, Santander was one of the main high profile victims of a US\$50 billion US fraud, for which the well-known Bernard Madoff has been charged. Santander said it had €2.3 billion of funds belonging to fewer than 1,000 customers invested in hedge funds via Mr Madoff and the bank itself also had money invested in them. BBVA, Spain’s second-largest bank, said it may have lost up to €300 million.

Spain Maintains Hourly Labour Costs in Manufacturing at Below €20

Spain's hourly labour costs in manufacturing in 2007 were €19.57, below the other big EU economies (see Figure 9).

Figure 9. Hourly Labour Costs in Manufacturing (€)

| Country | € |
|----------------|--------------|
| France | 32.26 |
| West Germany | 34.29 |
| Hungary | 7.02 |
| Italy | 24.26 |
| Poland | 5.90 |
| Spain | 19.57 |
| UK | 27.19 |

Source: Eurostat.

Spain's Private Pension Funds Higher than Most Big EU Economies

Spain's private pension funds accounted for 7.5% of GDP at the end of 2007, according to the latest comparative data (see Figure 10). This was much lower than the UK but higher than the other three big EU economies –Germany, France and Italy–.

Figure 10. Pension Funds

| Country | % of GDP |
|----------------|-----------------|
| France | 1.1 |
| Germany | 4.1 |
| Italy | 3.3 |
| Spain | 7.5 |
| UK | 86.1 |
| OECD average | 75.5 |

Source: Eurostat.