



## **Inside Spain 56**

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### **Foreign Policy**

#### *Zapatero Invited to G-8 Summit in Italy*

Prime Minister José Luis Rodríguez Zapatero will attend the G-8 summit in Italy in July along with the leaders of several other countries including China and India that do not belong to the forum comprising eight nations of the northern hemisphere.

The invitation to attend from Silvio Berlusconi, the Italian Prime Minister and host of the meeting, was announced after Elena Salgado, Spain's Finance Minister, was not invited to April's informal meeting of G-20 Finance Ministers in Washington.

Guido Mantega, Brazil's Finance Minister, irked the Spanish government when he said the US government, the host of the Washington meeting, had 'rigorously fulfilled the G-20' rules by not inviting Spain'.

Although Spain is not a G-20 country, José Luis Rodríguez Zapatero, the Prime Minister, was invited to the London summit of G-20 heads of government in April and the one in Washington last November.

Madrid had hoped that Rodríguez Zapatero's meetings with President Barack Obama during April and Spain's recent incorporation to the Financial Stability Forum (FSF), re-established as the Financial Stability Board (FSB) at the London G-20 summit, would have led to an invitation to the G-20 meeting of Finance Ministers.

The FSF was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The FSB has been placed on stronger institutional ground and its membership expanded so that it can play a greater role in proposing reforms for the financial sector.

Spain's financial system has earned plaudits for escaping the financial crisis relatively unscathed, at least so far (see the economy section). In 2000, when the economy was booming, the Bank of Spain, which exercises strong oversight, introduced the concept of anti-cyclical loan-loss provisions. These have provided a substantial cushion for the sharp rise in bad debts in the current recession, mainly resulting from the slump in the property sector. In essence, provisions are stored during the good times and used when the going gets rough.

The Elcano Royal Institute recently published a strategic proposal for enhancing Spain's role in global governance.<sup>1</sup> The paper points out Spain's comparative advantages, the areas where it could contribute most and the shortcomings that make it difficult to translate the country's economic weight into greater political influence at the global level. In order to achieve its full potential as a global player, the government needs to 'embrace a foreign policy with greater clarity'. As part of a move in this direction, Rodríguez Zapatero is expected to launch a Public Diplomacy Commission in the summer.

#### *Spain and France Press for Summit to Combat Piracy off Somalia*

Prime Minister José Luis Rodríguez Zapatero and French President Nicolas Sarkozy called for an international conference to tackle the growing problem of piracy against cargo ships off the Somali coast. Speaking at the end of their bilateral summit in Madrid, the two leaders said they also wanted to find a comprehensive solution to Somalia's broader economic and security problems.

Spain's navy is participating in an EU fleet which is patrolling the area off the Horn of Africa. Last month, Somali pirates mounted two attacks more than 500 miles from Somalia's coast.

Rodríguez Zapatero and Sarkozy also said they wanted to extend their successful cooperation over tracking down members of the Basque terrorist group ETA to the pursuit of Islamist terrorists and the repatriation of illegal immigrants. They agreed to establish a joint internal security committee to meet twice a year.

### **Domestic Scene**

#### *Historic Change of Government in the Basque Country*

The Basque Socialist leader Patxi López took over as *lehendakari* (the region's premier), putting an end to almost 30 years of rule by the Basque Nationalist Party (PNV) since the region obtained its autonomy. Juan José Ibarretxe, the outgoing head of government, who unsuccessfully pushed for a referendum (declared unconstitutional) that would have allowed greater self-determination, quit politics.

López won the top job thanks to the support in the Basque parliament of the conservative Popular Party (PP) and of Unión Progreso y Democracia (UPyD). The PP's Arantza Quiroga heads the parliament. In the national parliament in Madrid, however, the PNV and the PP are working together against the ruling Socialists.

Although the PNV was the most voted party in the March election, gaining 80,000 more votes and five more seats than the Socialists, it fell short of an absolute majority. In the past, it was able to count on the parliamentary support of *abertzale* parties (radical Basque nationalists), but none of them gained seats in parliament as they were banned, for the first time, from taking part in the elections because of links to the terrorist group ETA (see Figure 1). Almost 100,000 blank 'protest' votes were cast.

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<sup>1</sup> See

[www.realinstitutoelcano.org/wps/portal/rielcano\\_eng/Content?WCM\\_GLOBAL\\_CONTEXT=/Elcano\\_in/Zonas\\_in/00033](http://www.realinstitutoelcano.org/wps/portal/rielcano_eng/Content?WCM_GLOBAL_CONTEXT=/Elcano_in/Zonas_in/00033).

**Figure 1. Results of Elections in the Basque Country, 2009 (1)**

|                                     | <b>% of vote</b> | <b>Number of seats</b> |
|-------------------------------------|------------------|------------------------|
| Basque Nationalist Party (PNV)      | 38.5 (38.6)      | 30 (29)                |
| Basque Socialist Party (PSE-EE)     | 30.7 (22.6)      | 25 (18)                |
| Popular Party (PP)                  | 14.0 (17.4)      | 13 (15)                |
| Aralar                              | 6.0 (2.3)        | 4 (1)                  |
| Eusko Alkartasuna (EA)              | 3.6 (-)          | 1 (-)                  |
| Ezker Batua (EB)                    | 3.5 (5.3)        | 1 (3)                  |
| Unión Progreso y Democracia (UPyD)  | 2.1 (-)          | 1(-)                   |
| Communist Party of the Basque Lands | - (12.5)         | - (9)                  |

(1) 2005 results in brackets.

Ibarretxe viewed the pact between the Socialists and the PP, bitter enemies at the national level, as a strategy by the state to dilute Basque nationalism. He spent more time attacking the new Basque government in his farewell speech at López's investiture than on ETA, which has killed over 800 people in its 40-year terrorist campaign for an independent Basque Country. Representatives of associations of terrorism victims, highly critical of the PNV's policies, attended the investiture for the first time.

One of López's first measures will be to make it easier for parents to choose to have their children educated in Castillian Spanish rather than only in the Basque language. His room for manoeuvre, however, is limited. Roughly half the electorate supports nationalist parties and the ministries are staffed with PNV supporters in the top echelons, reflecting the party's 30-year grip on the reins of power.

#### *Recession Produces Sharp Fall in Arrival of Illegal Immigrants*

First quarter figures for the arrival of illegal immigrants show a very big fall over the same period of 2008, suggesting that news of the depth of Spain's recession and the dramatic rise in unemployment is reaching the countries from where these people arrive by boat or air.

The number of illegal immigrants who arrived at the airports of Madrid and Barcelona, mainly Latin Americans, and those who arrived at the port of Algeciras, the Canary Islands, the Straits of Gibraltar and the Balearic Islands, mainly in *pateras* (small boats), chiefly Sub-Saharan, dropped from 10,881 to 6,665 in the first three months of the year.

#### *Spain's 15-year-olds Continue to Rank Low in Scientific Proficiency*

Fewer than one in 20 of Spain's 15-year-olds reach the top levels of science proficiency, the same as Greece, Italy, Mexico, Portugal and Turkey, compared with close to one in five in Finland, according to the results of the OECD's latest PISA results (see Figure 2).

**Figure 2. Mean Score and Percentage of Top Level 5 Performers in Science, Reading and Mathematics**

|              | Science mean score (1) | Reading mean score (2) | Mathematics mean score (3) |
|--------------|------------------------|------------------------|----------------------------|
| Finland      | 563 (17.0%)            | 547 (16.7)             | 548 (18.1%)                |
| France       | 495 (7.2%)             | 488 (7.3%)             | 496 (9.9%)                 |
| Germany      | 516 (10.0%)            | 495 (9.9%)             | 504 (11.0%)                |
| Italy        | 475 (4.2%)             | 469 (5.2%)             | 462 (5.0%)                 |
| Poland       | 498 (6.1%)             | 508 (11.6%)            | 495 (8.6%)                 |
| <b>Spain</b> | <b>488 (4.5%)</b>      | <b>461 (1.8%)</b>      | <b>480 (6.1)</b>           |
| UK           | 515 (10.9%)            | 495 (9.0%)             | 495 (8.7)                  |
| OECD average | 500 (7.7%)             | 492 (8.6%)             | 498 (10.0%)                |

(1) Level 5 top performers: from 633.33 to 707.93 points.

(2) Level 5 top performers: above 625.61 points.

(3) Level 5 top performers: from 606.99 to 669.30 points. The respective percentages for level 5 top performers for each country are in brackets.

Source: High Performers in Science in PISA 2006, OECD.

In reading, only 1.8% of 15-year-olds in Spain reached the top performers for reading, the lowest percentage in the 30 OECD countries apart from Mexico (0.6%).

#### *State TV to Operate Without Advertising*

The government approved a draft law to eliminate advertising at Televisión Española (TVE), the state-run TV company, as of September. Instead, TVE would continue to receive funding from the state budget and, in a new departure, from 3% of the advertising revenues generated by private TV channels and 0.9% of the revenues of telecommunication operators.

The new formula gets rid of the double financing system (government funding and advertising) denounced many years ago by private TV companies as unfair competition. However, they are also not happy with the new system.

TVE would be expected to use the many hours freed up by the elimination of advertising to provide more of a quality public service and compete less with the private channels at the bottom end of the market.

TVE began to be reformed in 2006 when the government assumed its large debt and introduced rules to make it more commercially viable, including the shedding of several thousand employees. Since then the head of TVE has been appointed by parliament and not by the government, which makes the post less political, at least in theory.

The new system will not affect the many TV channels run by Spain's regional governments. Madrid, Catalonia, the Basque Country, Galicia, Valencia and Andalucia, for example, all have their own TV channels and exist on funding from their respective governments. They are a heavy burden on these governments' budgets.

#### *Spain 'An Important Base for Terrorist Organisations'*

Spain's geographical location, large population of immigrants from North Africa and the ease of travel to other European countries make the country a 'strategic crossroads for international terrorist groups', according to the US State Department's annual report on terrorism.

A total of 65 suspected Islamist terrorists were arrested in Spain in 2008. They allegedly belong to groups such as al-Qaeda, al-Qaeda in the Islamic Maghreb and the Moroccan Islamic Combat Group.

### *Spaniards Sleep Less than the French*

Spaniards, who invented the word *siesta* (afternoon nap), sleep less than the French. According to the latest social indicators survey, Society at a Glance 2009, prepared by the Organisation for Economic Co-operation and Development (OECD), the French sleep eight hours and 50 minutes a day compared with the eight hours and 34 minutes of Spaniards.

The long lunch is also not the preserve of Spaniards: the French spend two hours and 15 minutes a day eating and drinking and Spaniards one hour and 46 minutes.

## **The Economy**

### *International Monetary Fund (IMF) Confirms Hard Landing for Spain*

The IMF's latest regular assessment of Spain's economy confirms the Bank of Spain's forecast of a 3% shrinkage of GDP this year and criticises the government for not linking its fiscal stimulus 'more tightly to enacting overdue reforms that could have improved the economy's growth potential'.

The government's fiscal package, aimed at propping up demand through tax breaks and subsidies to employment, and at providing assistance to the unemployed was the 'right thing to do', but diminishes 'its long-term impact because the package will not contribute to higher growth'.

Spain is facing significant costs related to the aging of the population. These costs are projected to increase to 8.5% of GDP by 2050. The latest forecasts by the European Commission shows Spain's old-age dependency ratio rising from 24.1% in 2008 to 58.7% in 2050 compared to an EU-27 average increasing from 25.4% to 50.4% (see Figure 3). The IMF says that without reforms escalating costs will result in runaway debt.

**Figure 3. The Future of Pensions**

|              | Population (million) |             | Dependency ratio (1) |             |
|--------------|----------------------|-------------|----------------------|-------------|
|              | 2008                 | 2050        | 2008                 | 2050        |
| Germany      | 82.2                 | 74.5        | 30.3                 | 56.4        |
| France       | 61.9                 | 71.0        | 25.3                 | 44.7        |
| Italy        | 59.5                 | 61.2        | 30.5                 | 59.2        |
| Poland       | 38.1                 | 33.3        | 18.9                 | 55.7        |
| <b>Spain</b> | <b>45.3</b>          | <b>53.2</b> | <b>24.1</b>          | <b>58.7</b> |
| UK           | 61.3                 | 74.5        | 24.3                 | 38.0        |
| EU-27        | 495.4                | 515.3       | 25.4                 | 50.4        |

(1) Those over the age of 65 as a percentage of the working population between the ages of 15 and 64.

Source: European Commission.

Just over 4 million people were jobless at the end of March, 1.8 million more than a year earlier (close to 700,000 of them in the construction sector), according to the quarterly labour force survey of households by the National Statistics Institute (INE). The stated unemployment rate was 17.3%, more than double the EU-27 level. The 1.8% decline in GDP between the end of December and the end of March was the fastest shrinkage in nearly 40 years.

The number of unemployed registered in INEM's offices at the end of April was 3.6 million. It was the 13<sup>th</sup> consecutive monthly increase, but the pace of the rise was much slower (1.1%, a third of that in March and the lowest monthly increase since May 2008).

In absolute terms, Spain's unemployment has never been higher, but relative to the labour force –the size of which has grown enormously in the last decade– the jobless rate is below the 19.5% reached in 1994.

The INE figure for unemployment is regarded as more representative as it is an average for the quarter. The poorer regions of Spain, such as Extremadura and Andalucía, have unemployment rates of more than 20%. The latest European Commission forecast for Spain is a jobless rate peaking at 20.5% in 2010 (approaching 5 million unemployed). Between March 2008 and March 2009, Spain was responsible for around 45% of the more than 4 million jobs lost in the EU.

News on the consumer front was slightly better: the Consumer Confidence Index rose to 61.9 points in April from 53.7 in March, according to the Official Credit Institute. The index sank to a record low of 46.3 last July, although any reading below 100 is considered pessimistic.

Spain's economy has proved especially vulnerable to the global credit crunch because economic growth relied heavily on credit-fuelled domestic demand and a housing boom (see Figures 4 and 5). Housing starts have fallen to about one-fifth of their peak level. The IMF said that as houses are finished construction will decline further, and job losses in the sector could reach one million.

Property companies are adopting aggressive marketing strategies to reduce their stocks of unsold homes and combat competition from banks who are selling flats and houses that have been repossessed and making loans available. Discounts of up to 60% are being offered. Banks have billions of euros of real estate on their books after agreeing to swap debt for equity in property companies that collapsed.

**Figure 4. From Boom to Gloom**

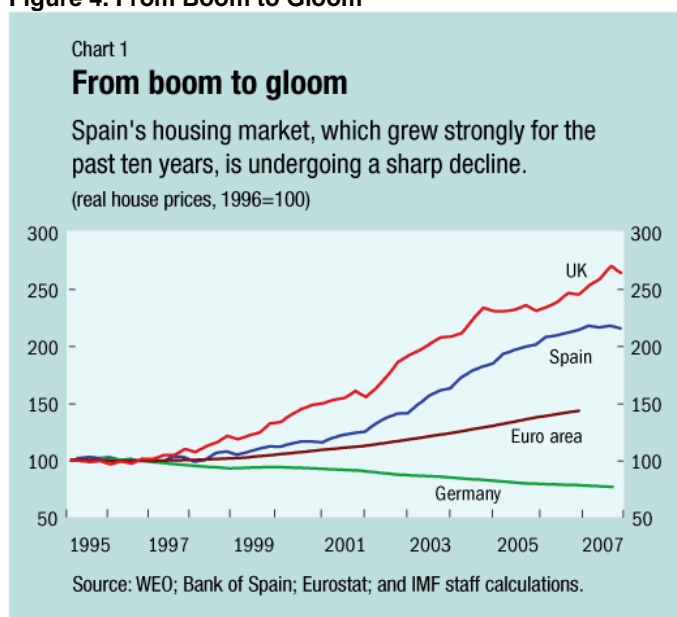


Figure 5. Easy Money



The depth of Spain's recession is not as profound as other large EU economies, such as Germany, in terms of GDP shrinkage, but, according to the European Commission, the economy will take longer to recover, partly because of its exhausted economic model.

Spain's year-on-year Consumer Price Index fell 0.2% in April, a 47-year record. This was the second consecutive month of negative inflation (0.1% in March).

#### *Government Announces More Measures to Combat the Recession*

Prime Minister José Luis Rodríguez Zapatero unveiled new measures to stimulate the economy including tax cuts for small businesses, aid to encourage new car purchases and the elimination of income-tax deductions for home purchases that were one factor behind Spain's decade-long construction boom that came to an abrupt halt last year.

'These measures have a double objective: stop job losses and prepare for economic recovery with changes in our economic model', Rodríguez Zapatero said during the annual State of the Nation debate.

The government will offer €500 toward the cost of buying a new car and has asked regional governments to match that amount and car makers to put forward an additional €1,000. The corporate tax rate for companies with fewer than 25 employees and who maintain these jobs will be cut by five percentage points.

The move to get rid of tax deductions for home purchases as of 2011 –for those with annual incomes of more than €24,000– is likely to be an unpopular measure with the middle classes and will require parliamentary approval.

Steps were also announced to improve education and move resources into higher-value-added industries such as renewable-energy production.

The government has already undertaken stimulus measures valued at around 2.3% of GDP this year and 2% last year. The European Commission's forecast deterioration in

the Spanish government's fiscal balance, of 12% of GDP between 2007 and 2010 (from a budget surplus of 2.2% of GDP to a deficit of 9.8%), is the third largest in the EU after Ireland (15.8%) and Latvia (13.2%).

*The Two Largest Banks Continued to Buck the International Trend in Profits...*

Santander and BBVA, Spain's two biggest banks, reported healthy but lower profits for the first quarter. The net profits of Santander, the euro zone's largest bank by market capitalisation, were €2.1 billion, down 5% on the same period of 2008, and those of BBVA dropped 14.2% year-on-year to €1.24 billion.

Both banks have been hit by the collapse of the property market and defaults among construction companies. Non-performing loans as a ratio of total lending rose by 1.25 percentage points at Santander to 2.49% and by 1.7 percentage points at BBVA to 3.2%, compared with an industry average of more than 4%. Santander's core capital ratio was 7.3% of risk-weighted assets at the end of March and BBVA's 6.4%.

Latin America, so far relatively unaffected by the global recession, continued to generate a substantial part of both banks' income. Latin America generated 43% of Santander's operating profit and 51% of BBVA's.

The net profits of the 35 companies that form the Ibox index on the Madrid Stock Exchange were 31.8% lower in the first quarter than a year earlier.

*... And Climbed up the BrandZ Ranking of the Top 100 Global Brands*

Santander and BBVA are ranked 38<sup>th</sup> and 55<sup>th</sup>, respectively, in the BrandZ Top 100, the only ranking based on a brand valuation methodology that is grounded in quantitative customer research and in-depth financial analysis. They respectively moved up 10 and 22 positions (see Figure 6) and are the only companies in the Top 100.

**Figure 6. BrandZ Top 100 Most Valuable Global Brands, Selected Companies**

| Brand and ranking    | Brand value 2009 (1)   | Brand contribution | Brand momentum |
|----------------------|------------------------|--------------------|----------------|
| 1. Google            | 100,039 (86,057)       | 3                  | 3              |
| 2. Microsoft         | 76,249 (70,887)        | 3                  | 8              |
| 4. IBM               | 66,622 (55,335)        | 3                  | 5              |
| 9. Vodafone          | 53,727 (36,962)        | 3                  | 2              |
| 27. Bank of China    | 21,192 (19,418)        | 2                  | N/A            |
| 30. HSBC             | 19,097 (18,479)        | 2                  | N/A            |
| <b>38. Santander</b> | <b>16,035 (14,549)</b> | <b>2</b>           | <b>N/A</b>     |
| <b>55. BBVA</b>      | <b>12,549 (9,457)</b>  | <b>3</b>           | <b>N/A</b>     |

(1) 2008 figure in brackets.

Source: Millward Brown Optimor (including data from BrandZ, Datamonitor and Bloomberg).

The brand value is calculated in three steps. First, the proportion of a company's earnings generated 'under the banner of a brand' is determined. Second, only a portion of these earnings can be considered as being driven by brand equity. This is the 'brand contribution' (displayed as an index from 1-5, with 5 the highest). It is the degree to which the brand plays a role in generating earnings. In the final step, the growth potential of these branded earnings is taken into account. The brand momentum is displayed as an index from 1-10 (10 is the highest score).

Santander (7<sup>th</sup>) and BBVA (12<sup>th</sup>) are also in the Top 15 financial institutions by brand value and 8<sup>th</sup> and 7<sup>th</sup>, respectively, in the Top 15 ranked by book value as a percentage of market capitalisation (see Figure 7).



**Figure 7. Financial Institutions, Top 15 by Brand Value, Selected Companies**

| <b>Brand and Rank</b>      | <b>Brand value (US\$ mn)</b> | <b>Brand value as % of market capitalisation</b> |
|----------------------------|------------------------------|--|
| 1. ICBC                    | 38,056                       | 21   |
| 2. China Construction Bank | 22,811                       | 18   |
| 3. Bank of China           | 21,192                       | 20   |
| <b>7. Santander</b>        | <b>16,035</b>                | <b>24</b>  |
| 8. Bank of America         | 15,480                       | 24   |
| 11. Citi                   | 14,608                       | 33   |
| <b>12. BBVA</b>            | <b>12,549</b>                | <b>30</b>  |
| 14. Chase                  | 10,582                       | 9  |

Source: Millward Brown Optimor (including data from BrandZ, Datamonitor and Bloomberg).

#### *Iberia Reports Big First Quarter Loss and Delay in Possible Merger with BA*

Iberia, the Spanish flag carrier, made a net loss of €2.6 million in the first quarter compared with one of €400,000 in the same period of 2008 and announced a further delay in a possible tie-up with British Airways.

The airline was hard hit by the downturn in global travel and the loss of business on the Madrid-Barcelona route because of competition from the high-speed train service.

Fernando Conte, Chairman and Chief Executive, announced a cost-cutting plan to save more than €200 million this year including a 10% cut (around 2,200 people) in the number of employees.

#### *Spain Wins the Contract to Produce the new Audi Q3*

The Spanish motor industry, suffering like others in Europe and the US from plummeting sales and over capacity, received a shot in the arm when Audi announced its new Q3 would be produced at the Seat plant in Martorell (Barcelona). Volkswagen is the parent company of both Audi and Seat.

After months of waiting and protracted negotiations, the Martorell plant beat off competition from factories in Bratislava (Slovakia), Gyor (Hungary) and the Audi plant in Ingolstadt (Germany).

Production of the new urban 4x4, will begin in 2011 and means that over 1,500 jobs will be saved at the Catalonia. Between 80,000 and 100,000 Q3s are expected to be built each year.

#### *Tax Burden Falls for First Time in Seven Years*

Tax receipts and social security contributions as a percentage of gross domestic product (GDP) fell sharply in 2008 for the first time in seven years. The tax burden declined from a peak of 37.1% in 2007 to an estimated 32.9%, the lowest level since the 1990s.

Among the factors behind this were the economic downturn, which resulted in lower tax revenues, the €400 tax rebate and the entry into force of lower personal and corporate income tax rates.