Inside Spain 64

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Foreign Policy

Soldier Killed in Afghanistan
Jon Felipe Romero Meneses, a Spanish soldier of Colombian origin, was killed and six others were wounded when a military vehicle struck a mine while escorting a UN World Food Programme convoy to distribute aid in Qala-i-Naw province in Afghanistan.

Spain has around 1,000 peacekeeping troops in Afghanistan serving in the NATO-led mission and this month the government approved an increase to 1,500, partly in response to the Obama Administration's request for more help from allied nations (see *Inside Spain*, Newsletter 63, 19 January 2010).

The government has also reportedly agreed to be more flexible about the strict caveats imposed on the troops, that constrain how they are deployed, and on the use of equipment including helicopters outside their designated zone.

Spain has had troops in Afghanistan since 2002, and more than 22 have died there, including two in November 2008 when a suicide bomber rammed a convoy, and 17 in a helicopter crash in August 2005.

Obama will Not Attend the EU Summit in Madrid
President Barack Obama will not attend the EU-US summit in Madrid in May during Spain's Presidency of the EU as had been hoped. Obama's predecessors had attended these summits held by EU countries on a six-month rotating basis.

The decision was not a snub to Spain but reflected Obama's increasing focus on domestic issues. Philip Gordon, US Assistant Secretary of State for Europe, said Obama had 'travelled more to Europe in his first year probably than any President has ever done in the past, and he looks forward to continuing this engagement bilaterally with European allies, and directly with the European Union'. He said the visit to Madrid was never on Obama's agenda.

US diplomats let it be known that Obama was not very impressed by the results of previous EU summits.

Rodríguez Zapatero Speaks at the National Prayer Breakfast in Washington
Prime Minister José Luis Rodríguez Zapatero became the first Spaniard to attend the National Prayer Breakfast in Washington as a special guest. This is an annual bipartisan event organised by members of the US Congress.

He defended 'the right of every person, everywhere in the world, to make their own moral decisions, to make their own search for goodness... the freedom of everybody to live with the person they love and to build and care for their family. We do this with the same level of conviction with which we reject resolute fundamentalism. The United States knows, as does Spain, that the spurious use of religious faith to justify violence can be enormously destructive'. He finished his speech by recalling the victims of terrorism in both countries.

Domestic Scene

Immigration Enters the Political Arena

The large presence of foreigners in Spain is beginning to enter the political debate. Recession, which has pushed up the jobless rate to almost 20% (30% among immigrants), and public health and education systems under strain from a population that has grown very rapidly are leading some politicians to question how many more foreigners the country can take.

There are more than 5.6 million foreigners in Spain (12% of the population), according to the latest figures (see Figure 1). EU citizens have an automatic right to live and work in Spain, but not so those from other countries who need residency and work permits. The EU-27 accounts for 40.5% of total foreigners, followed by South America (28.1%), Africa (17.8%), Asia (5.2%), the rest of Europe (3.9%) and Central America and the Caribbean (3.4%). The largest number of foreigners (almost 800,000) come from Rumania, which joined the EU in 2004, followed by Morocco (718,000).

Figure 1. Spain's Population and Foreigners' Share, 2000-09

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Population (million)	41.1	41.8	42.7	43.2	44.1	44.7	45.2	46.1	46.7
Foreigners' share (%)	3.3	4.7	6.2	7.0	8.4	9.3	10.0	11.4	12.0

Note: the figures at 1 January of each year are based on those registered with local town halls. Foreigners have an incentive to do this as it entitles them to public health care and education, although not everyone does so.
Source: INE (National Statistics Office).

A coalition of Catalan nationalists, separatists and Socialists running the town hall of Vic in Catalonia announced a controversial plan to keep some immigrants off the municipal registers of residents. Immigrants including illegal ones have a right to register and so qualify for public healthcare and education. The plan is similar to one in place in Torrejón de Ardoz, a suburb of Madrid run by the conservative Popular Party (PP). Alicia Sánchez-Camacho, the PP leader in Catalonia, proclaimed there was not room for everyone and that the law should be changed so that town halls did not have to provide services and social benefits for everyone.

Both Vic and Torrejón de Ardoz backed down after the central government said the moves were illegal. The government, however, is planning to limit the number of people who can be registered as living in the same home (on the basis of a certain number of persons per square metre) in order to try to prevent fraud in elections, particularly local ones. There have been cases of candidates in small municipalities swelling the electoral lists in order to win an election.

Perhaps because of the country's past as a nation of emigrants during a large part of the 1939-75 dictatorship of General Franco, for economic and political reasons, Spaniards have been admirably tolerant of the huge influx of immigrants over the last decade. The country, for example, does not have a xenophobic anti-immigrant party like the UK or France and the PP, unlike other European political parties of similar ideology, has not turned immigration into an electoral issue.

The Economy

Austerity Plan Announced to Cut Massive Budget Deficit

The government announced a four-year €50 billion savings plan to cut its large general government deficit and calm the international financial markets which fear that Spain will be contaminated by Greece's fiscal problems unless it quickly puts its economy in order and tackles the problem of its ailing competitveness. Devaluation is not an option as Spain is a euro country.

The austerity plan followed the shock announcement last month that Spain's deficit in 2009 reached a record 11.4% of GDP, almost two percentage points higher than what had been forecast only two weeks before the release of the definitive figure and up from a deficit of 4.1% in 2008.

The markets, already nervous about Greece, reacted by pushing up Spain's borrowing costs and punishing its stock market. The spread of Spain's 10-year bonds against Germany's bunds –a key indicator of international confidence– widened to around a full percentage point before easing back a little after the measures were announced (see Figure 2). Spain's spread is much lower than Greece's. The Ibex-35 index of the Madrid stock market fell 13.8% between January 1 and February 15, the largest decline among the main European markets (see Figure 3). Last year, the Ibex was the best performer in Europe.

Figure 2. 10-year Government Bond Spreads Over Bunds (basis points) (1)

	Spread versus Bund
Greece	+2.75
Ireland	+1.38
Italy	+0.80
Portugal	+1.19
Spain	**+0.79**

(1) At 15 February.
Source: Thomson Reuters Datastream.

Figure 3. Stock Market Indices (% rise) (1)

Index	
Ibex-35 Spain)	-13.8
Dax (Frankfurt)	-7.5
FTSE 100 (London)	-4.5
Euro Stoxx 50	-9.5
Dow Jones	-3.1
Nikkei (Tokyo)	-5.0

(1) 1 January to 15 February.
Source: Markets.

Another sign of falling confidence is the rise in the cost of credit default swaps, a form of insuring Spain's public debt issues, which has shot up and at one point was above that for the country's two main commercial banks, BBVA and Santander (see Figure 4).

Figure 4. Credit Default Swaps (US$ per US$10 million of debt) (1)

Greece	421,686
Portugal	238,087
Ireland	171,358
Spain	**166,300**
Italy	157,487
BBVA	146,659
Santander	146,538
Germany	47,249

(1) At 8 February.
Source: Bloomberg.

Anxious to distance itself from Greece, whose situation is much worse than Spain's (see Figure 5), the government presented its stability programme to the EU. This aims to cut the budget deficit to 3% by 2013, the EU's ceiling. Spain's public debt as a proportion of GDP (66% forecast for this year) is much lower than Greece's (120%) and also that of the UK and US.

Elena Salgado, the Economy and Finance Minister, and her deputy, José Manuel Campa, went to London to convince bondholders and the financial media of the seriousness of the government's plans. Campa's disclosure that the Treasury planned to raise a net €76.8 billion through debt issuance this year unsettled the markets as it was higher than many investors expected. He told analysts the government would make further cuts in spending if they were necessary to meet the 3% target.

Figure 5. Stability Programmes of Spain, Greece and Italy, 2009-13 (1)

	2009	2010	2011	2012	2013
Real GDP growth (%)					
Spain	**-3.6**	**-0.3**	**2.0**	**2.9**	**3.1**
Greece	-1.2	-0.3	1.5	1.9	2.5
Italy	-4.8	1.1	2.0	1.9	2.5
Unemployment rate (%)					
Spain	**18.0**	**19.0**	**18.4**	**17.0**	**15.5**
Greece	9.0	9.9	10.5	10.5	10.3
Italy	7.7	8.4	8.3	8.0	NA
Fiscal deficit (% of GDP)					
Spain	**11.4**	**9.8**	**7.5**	**5.3**	**3.0**
Greece	12.7	8.7	5.6	2.8	2.0
Italy	5.3	5.0	3.9	2.8	N.A.
Public debt (% of GDP)					
Spain	**55.2**	**65.9**	**71.9**	**74.3**	**74.1**
Greece	115.1	120.4	120.6	117.7	113.4
Italy	113.4	116.9	116.5	114.6	NA

(1) Forecasts for 2010-13.
Source: European Commission.

'We have control of the ship, we have a plan', said María Teresa Fernández de la Vega, Spain's Deputy Prime Minister, shortly after José Luis Rodríguez Zapatero, the Prime Minister, had told a US audience in Washington: 'Spain has a strong and solid financial system'.

Captains of Spanish industry also threw their weight behind the efforts to restore confidence. Emilio Botín, chairman of Santander, the euro zone's largest bank by market capitalisation, said 'comparing Spain to Greece is like comparing Real Madrid to Alcoyano'. He was contrasting Spain's premier football team with one in the second division. José Blanco, the Public Works Minister, criticised 'apocalyptic commentaries' about Spain's finances.

Salgado said the suggestion by Joaquín Almunia, the European Commissioner for Economic Affairs and the Spanish Socialists' candidate for Prime Minister in the general election in 2000, that Spain's problems were similar to those of Greece was 'imprudent'.

The rating agencies, Moody's and Fitch, maintained this month their maximum ratings for Spanish public debt. Moody's, in a special comment entitled 'Spain, Portugal and Greece: Contagion or Confusion?' said the three countries share the same currency, but do not display the same credit profile.

Although Spain cannot be put in the same basket as Greece, there are concerns about the government's willingness and capacity to implement its austerity plan as it is caught between a rock and a hard place. On the one hand, failure to get to grips with its fiscal crisis would have serious consequences as it would push up the cost of its public debt even more and only add to its problems. On the other hand, it faces an election in 2012 and between now and then unpopular measures will have to be taken. The central government has little control over regional and municipal governments. A poll published in *El País*, the leading daily, on 7 February forecast 43.4% of voters would support the conservative Popular Party (PP) in an election compared with 37.5% for the Socialists. The gap had widened to 5.9 pp from 3.5 in January.

Western diplomats said the events of recent weeks had been a 'wake-up call' for Rodríguez Zapatero who now realises that structural reform, which should have been done while the economy was booming, can no longer be put off. There is stiff resistance, however, among the Socialists' core supporters and the PP has not been very co-operative in offering its support for agreements that need a wide consensus if they are to have a chance of working. The PP has made cuts in income tax, which the Socialists say is not a valid option, a condition for its support.

The number of unemployed reached 4.3 million at the end of 2009 (18.8% of the work force), according to the quarterly labour-force survey. The jobless rates vary considerably between regions, with a low of 10.5% in Navarre and a high of 26.9% in the Canary Islands. It is no coincidence that the regions with the highest unemployment rates are those where activity in the construction sector, which has ground to a halt, was the most intense (see Figure 6).

Figure 6. Jobless Rates by Regions (1)

Region	Unemployment as a %of Workforce
Canary Islands	26.9
Andalusia	26.3
Valencia	22.5
Murcia	22.4
Extremadura	21.2
Catalonia	17.0
Madrid	14.6
Basque Country	11.7
Navarre	10.5

(1) End of 2009.
Source: National Statistics Office.

A total of 1.2 million jobs were lost last year. Spain's job losses have been far greater than any other EU country (see Figure 7), due to a lopsided economic model, excessively based on the construction sector, and a two-tier labour market (up to one-third of workers have been on temporary contracts), both of which the government is seeking to reform. Campa officially recognised last month that Spain's unemployment would remain very high for several years. With the labour-intensive construction sector in the doldrums (for more than a decade it was engine of the economy), there is considerable uncertainty as to where future growth will come from. The economy shrank by 0.1% in the last three months of 2009 (-3.6% for the whole year), making it the last major economy still in recession**.**

Figure 7. Job Losses and Gains in the EU (1)

Country	Jobs
Spain	-1,640,400
Italy	-407,100
UK	-314,200
Ireland	-227,400
Portugal	-182,800
Hungary	-163,900
Poland	+593,900
Germany	+92,200
Netherlands	+69,400
France	+50,100

(1) Between the third quarter of 2007 and the same period of 2009.
Source: Eurostat.

Rodríguez Zapatero, who has made maintaining social protection one of the hallmarks of his economic policy, said the special subsidy of €420 for the unemployed would be extended for another six months and increased to €426. This subsidy was introduced last August for those whose unemployment benefits had run out. The government also hopes to create 274,000 temporary jobs this year under its €5 billion State Fund for Employment and Local Sustainability.

Employers and trade unions reached agreement on wage rises of up to 1% for this year, 2% in 2011 and more in 2012. The pay rise for central government civil servants is 0.3% and for every 10 bureaucrats who retire only one new person will be employed. Pay growth for all employees in 2009, when inflation ended the year at 0.8%, averaged 3%, according to the OECD.

Unions Oppose Government Plan to Lift Retirement Age

The government's proposal to raise the retirement age from 65 to 67 and increase the number of contribution years used to calculate pension benefits, in order to guarantee the viability of the social security system as the population ages, met with stiff resistance from trade unions who are threatening demonstrations on 23 February.

The announcement of the plan, which would be gradually introduced as of 2013, coincided with figures from the National Statistics Office (INE) showing that the proportion of the population over the age of 64 would double over the next 40 years to 32% and the dependency rate (those under the age of 16 and over 64 as a percentage of the working population) would rise from 47.8% to 89.6%. Life expectancy is forecast to reach 84.3 years in 2049 for men (6.5 years more than today) and 89.9 years for women (5.8 years higher).

The Organisation for Co-operation and Economic Development (OECD) welcomed the government's measures as an important step in the right direction as they would bring Spain closer in line with other OECD countries, that have already reformed their state pension systems. The OECD said the government should go further in promoting the sustainability of the public pension system and consider measures such as linking the retirement age to life expectancy, raising the effective as opposed to the legal retirement age and computing benefits using the entire working life. In order to raise effective retirement ages, the minimum number of years needed to be entitled to a full pension may need to be increased (from the current 35 years), and pension gains for those who continue contributing after 35 years may need to be increased, the OECD said.

The increase in the retirement age would begin as of 2013, after the next general election, at a pace of two months per year so that by 2025 67 would be the required age, though there would be exceptions in certain professions. This means that the legal retirement age would be 67 for anyone born after 1959.

The current number of contribution years used to calculate pensions –the last 15 of a person's working life– would be raised. The government's initial idea of making it 25 years, since withdrawn, was strongly opposed by trade unions as it would effectively mean lower pensions. The government also wants to increase the minimum age for early retirement from 52 to 58 years.

The General Union of Workers (UGT) and the Workers' Commissions say the social security system is in reasonable health and does not yet need to be reformed. The system generated a surplus equivalent to 0.8% of GDP in 2009 and was the only element in the general government accounts (deficit of 11.4% of GDP) that was positive. The unions believe the government's timing for this measure is wrong as it coincides with the more urgent and pressing need for massive cuts in public spending which are bound to erode support for the Socialists. The PP said the higher pension age should be voluntary.

Despite its establishment over 20 years ago, Spain's private pension system is one of the least developed in the OECD area, having accumulated assets that represent only around 7% of GDP, below the OECD average of 60%. The coverage of private pensions at 54% of the working population is relatively high compared with other countries. However, the amount of money contributed by those participating is quite low. Around 66% of participants contribute less than €300 a year.

Spain is one of 10 OECD countries planning to lift the retirement age. If the government gets its way –and the Socialists do not have an absolute majority in the parliament– Spain, along with Holland, would be the first countries to have a higher retirement age.

Car Sales up in January for Fifth Straight Month

The government's scrappage scheme continued to boost car sales, which rose in January for the fifth month running. The number sold was 18.1% higher than a year earlier, at 70,130 (see Figure 8).

Figure 8. Car Sales in January 2000-10

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
193,187	97,942	101,936	96,561	106,247	114,133	113,410	116,423	101,621	59,381	70,130

Source: Anfac.

Spain's Two Largest Banks Hit by Provisions
Santander, the euro zone's largest bank by market value, increased its net profit in 2009 by 1% to €8.94 billion, despite heavy loan-loss provisions, making it one of the world's most profitable banks, while BBVA, its main domestic rival, posted a 16% fall to €4.21 billion.

The provisions and writedowns mainly reflected the problems in the Spanish property market. Santander set aside €9.48 billion in provisions, 44% more than in 2008, of which €269 million went to write down its holding in the rescued group Metrovacesa and €1.04 billion in generic provisions for future loan losses. However, the two banks' non-performing loan ratios of 3.24% and 4.3%, respectively, were still low by international standards and below the average for the Spanish banking sector as a whole of 5%.

The other noteworthy element was the increasing importance of income from abroad, the fruit of the banks' diversification over the last decade and without which their profits would have been much lower. In Santander's case, Brazil generated 16% of total attributable profit, the rest of Latin America and the UK generated 16% each and Continental Europe 48% (compared with 26% attributable to Spain).

The US provided 11% of BBVA's profits and Asia 4%.

Three Spanish Business Schools in Global Top 20 MBA Ranking
Spain's three leading business schools are in the top 20 of the latest global MBA ranking by the *Financial Times* and one of them, IE Business School, is in the top 10 (see Figure 9).

Figure 9. Top 100 Full-time Global MBA Programmes, Selected Rankings (1)

School name	Ranking in 2009	Ranking in 2008
London Business School	1	1
Wharton (US)	2	1
Harvard Business School (US)	3	3
Columbia Business School (US)	6=	4
IE Business School (Spain)	**6=**	**6**
Iese Business School (Spain)	**11**	**12**
Esade Business School (Spain)	**19**	**18**

Source: Financial Times.