Inside Spain 69

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Foreign Policy

Release of Cuban Prisoners Aids Madrid's Bid to Change EU Policy Towards Havana

Cuba's agreement to release 52 political prisoners, about one-third of the total, enhanced the Spanish government's bid to change the EU's common position towards the Communist island.

The position, approved in 1996 on the urging of the then Spanish Prime Minister, José María Aznar, of the conservative Popular Party (PP), restricted contacts, imposed soft sanctions and sought to encourage a transition to democracy via constructive engagement with the Cuban government. The crackdown on Cuba's peaceful opposition as of March 2003, when 75 people were sentenced for up to 28 years following summary trials, made engagement more difficult.

Miguel Ángel Moratinos, Spain's Foreign Minister, has long insisted the policy was not working and needed to be changed. As the former colonial power and the largest foreign investor in Cuba, Spain has particularly close links with the island. The EU maintains better relations with Saudi Arabia, Tunis, Syria and Uzbekistan than with Cuba, although these countries' human rights records are no better or worse (based on their position in the Freedom House democracy ranking).

Moratinos made the change in policy one of the goals of Spain's six-month Presidency of the EU which ended on 30 June, but he received a setback in March when Orlando Zapata died after an 85-day hunger strike in a Cuban prison. His death was roundly condemned by the European Parliament.

Moratinos persuaded the EU to postpone its review of Cuba until September as the Roman Catholic Church was in talks with the Cuban authorities on freeing political prisoners. He visited Cuba in early July and the announcement on political prisoners followed a meeting between him, Raul Castro, the Cuban President, and the Cuban Cardinal Jaime Ortega. The release would be the biggest since Pope John Paul II visited Cuba in 1998.

As well as opening the door to better relations between the EU and Cuba, the release of prisoners could also ease the 50-year US embargo which President Barack Obama said last year had 'failed'. The EU is expected to change its current policy for one that fosters greater cooperation.

According to human-rights organisations, Cuba has 167 political prisoners, including 10 on parole. This was 39 fewer than in 2009 and about half the number reported in 2006 when Raul Castro replaced his elder brother Fidel Castro, who is ill.

Seventeen prisoners were due to leave for Spain with their families. The remainder will be released over the next four months and will be given the option to leave the country. Those to be freed will include all those still behind bars from the 2003 crackdown on dissent.

Spain's EU Presidency Opens One Chapter on Turkey's EU Accession
The Spanish EU Presidency managed to open one more accession chapter for Turkey on the very last day of its six-month rotating presidency on 30 June. As an active supporter of Turkey's bid to be a full EU member, Madrid had hoped to open four chapters.

The opening of the chapter on food security, veterinary and phytosanitary policy brought the number of chapters opened since October 2005 to 13 (only one of which has been closed) out of a total of 35. The EU summit in December 2006 froze eight chapters, because of Ankara's continued refusal to implement a protocol and open its airports and ports to Greek Cypriot traffic, and Cyprus has since then frozen another six.[1]

The Turkish government refuses to budge on the Cyprus issue until something is done to ease the economic isolation of the internationally unrecognised Turkish Republic of Northern Cyprus (TRNC) in the north of the island. This was unilaterally declared in 1983 after Turkey's military intervention in 1974 following inter-communal strife and an attempt in a military coup to incorporate Cyprus into Greece.

The obstacles placed by the Greek Cypriot administration and other countries such as France made it impossible for Spain to open more than one chapter.

Domestic Scene

Constitutional Court Rejects Parts of the Catalan Autonomy Statute
The Constitutional Court, after four years of deliberations, rejected 14 of the 233 articles of the statute granting Catalonia more self-rule and said its definition as a nation does not have legal value. Twenty-seven other articles were submitted to restrictive legal interpretations.

Most of the Catalan political class protested, including the Socialist Party that heads the three-way coalition government in the region and is allied to the ruling Socialists in the central government. Ernest Benach, President of the Catalan parliament, said the decision opened a 'crisis of state' because it 'ignores the will of the Catalan citizens'. Several hundred thousand Catalans staged a massive protest.

The statute increasing Catalonia's political and financial autonomy was approved by the Catalan parliament in 2005 and by the Spanish parliament and a Catalan referendum in 2006. The conservative Popular Party (PP), the main opposition, lodged an appeal against 114 of the statute's articles on the basis that they endangered the unity of Spain.

The 10 'conservative' and 'liberal' judges, appointed by the main political parties, locked horns over the statute until they reached a majority vote of six against four.

[1] See the author's Working Paper, 'Cyprus: Time for Partition?, published on 5 July at http://www.realinstitutoelcano.org/wps/portal/rielcano_eng/Content?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/dt21-2010.

The Court accepted the article that makes knowledge of the Catalan language compulsory, but said that a reference to Catalan as the 'preferred language' was unconstitutional. The article referring to the establishment of a governing body for the judiciary in Catalonia was struck down. Judges said it could not be created by the statute but by changes to the relevant national law.

The centre-right Convergencia i Unió (CiU) threatened to withdraw its support for the central government's 2011 budget which goes before parliament in Madrid in the autumn. Prime Minister José Luis Rodríguez Zapatero's Socialists do not have an absolute majority in the parliament and need the support of other parties, like the CiU, to pass the budget. Failure to do so could bring down the government and usher in an early general election (not due until 2012).

Rodríguez Zapatero said in 2005, regarding the statute, that whatever was approved by the Catalan parliament would be accepted by him. He now says Spain has 'concluded the phase of self-government' (started in 1978).

An opinion poll published in *El País*, the leading daily, on 4 July showed that 61% of Catalan respondents regarded the Court's decision as an injustice compared with 24% of respondents in Spain as a whole.

Economic Crisis Lowers Births for the First Time since 1998…

The number of babies born in Spain in 2009 (492,931) was 5% lower than in 2008 and the first drop in 10 years. The fertility rate rose from 1.16 to 1.46 between 1996 and 2008 and declined to 1.40 last year (see Figure 1).

Figure 1. Main Indicators of Births and Fertility

	Number of Births	Fertility
1976	676,718	2.80
1981	532,601	2.03
1986	438,303	1.56
1990	401,073	1.36
1997	368,361	1.17
1998	364,427	1.15
2000	396,626	1.23
2005	464,811	1.34
2008	518,503	1.46
2009	492,931	1.40

Source: National Statistics Office (INE).

The birth rate fell for both Spanish and foreign women. In the past decade female immigrants have accounted for an increasing share of the babies born each year (20.6% in 2009) and one significantly larger than that corresponding to the country's childbearing population, but they too are beginning to have fewer children because of the economic crisis.

The average number of children born to foreign mothers fell from 1.81 in 2008 to 1.69 in 2009 compared to a decline from 1.38 to 1.33 for Spanish mothers (see Figure 2). Spain has received around 5 million immigrants since the year 2000 and their average age is much lower than that of Spaniards.

Figure 2. Fertility Rates of Spanish and Foreign Women

	Spanish	Foreign	Both
2002	1.21	2.05	1.26
2003	1.26	1.90	1.31
2004	1.28	1.79	1.32
2005	1.30	1.70	1.34
2006	1.33	1.70	1.38
2007	1.33	1.75	1.39
2008	1.38	1.81	1.46
2009	1.33	1.69	1.40

Source: National Statistics Office (INE).

Spain's fertility rate is still among the lowest in the EU (see Figure 3).

Figure 3. Fertility Rates in the EU

	2005	2008
Finland	1.80	1.85
France	1.94	2.00
Germany	1.34	1.38
Italy	1.32	1.37
Netherlands	1.71	1.77
Portugal	1.40	1.37
Spain	**1.35**	**1.46**
Sweden	1.77	1.91

Source: National Statistics Offices.

The number of marriages also declined in 2009, falling 11% to 175,952. Of them, 36,715 (21%) were marriages where at least one of the partners was foreign. And for the first time the number of civil weddings (94,993) was higher than those in the Roman Catholic Church (80,174) and other religious ceremonies (785).

… But the Wealthy Continue to Rise

The number of Spaniards with net assets of at least US$1 million, excluding their primary residence and consumables, rose 12.5% in 2009 to 143,000, according to the latest World Wealth Report issued by Merrill Lynch and Capgemini (see Figure 4). The figure, however, was still below the peak of 161,000 in 2007. It was the 12th highest in the world (see Figure 5).

Figure 4. Number of Rich Spaniards, 2002-08

	2002	2003	2004	2005	2006	2007	2008	2009
Number	110,000	129,000	141,000	148,000	157,000	161,000	127,000	143,000

Source: Merrill Lynch and Capgemini, 2010 World Wealth Report.

Figure 5. High Net-Worth Individuals by Country (in thousands), 2008-09

	2008	2009	% rise
US	2,460	2,866	16.5
Japan	1,366	1,650	20.8
Germany	810	861	6.4
China	365	477	31.0
UK	362	448	23.8
France	346	383	10.8
Canada	213	251	17.9
Switzerland	185	222	19.7
Italy	164	179	9.2
Australia	129	174	34.4
Brazil	131	147	11.9
Spain	**127**	**143**	**12.5**

Source: Merrill Lynch and Capgemini, 2010 World Wealth Report.

In an unrelated development, tax inspectors probed some 3,000 accounts held by Spaniards at HSBC bank in Switzerland for possible tax fraud. The accounts could involve more than €6 billion.

Finance Minister Elena Salgado said the owners of the accounts had been notified and asked to clarify whether they have declared the money in the accounts. 'They have to put their accounts in order with the Treasury and of course they will receive the corresponding sanctions and penalties', Salgado said.

The French government alerted the Spanish authorities about this situation after receiving information. Salgado is struggling to cut public expenditure and boost revenues.

Quality of Spanish Democracy Declines due to Corruption
The quality of Spanish democracy has declined significantly in the last two years, according to the latest annual report of the Madrid-based Fundación Alternativas. Spain's score dropped from 6.2 to 5.8 out of 10 based on the method used by the University of Essex (England) for its democratic audit.

The main reason for the deterioration is the rise in corruption which, says the report, is, for the first time, one of the three main problems.

General Franco to be Removed from the Government's Website
General Franco, who ruled Spain between 1939 and 1975 after winning the country's three-year civil war, is to be removed from the government's new website. Currently, it lists all heads of state since 1823.

The Economy

Parliament Approves Labour Market Reforms
The parliament ratified a package of labour reforms on 22 June which the government presented in the form of a decree law after trade unions and employers failed to reach agreement by the deadline set earlier in the month.

Only the ruling Socialists voted in favour as conservative and regional parties abstained and those on the left voted against the reforms. The government agreed to debate the reforms, which followed May's cuts in public spending, in the coming months and accept amendments, so turning the decree into a parliamentary bill.

The Socialists' trade union allies protested and announced a general strike for 29 September. The last such strike against a Socialist government was in December 1988.

With the unemployment rate at 20%, the highest in the euro zone, a large budget deficit (11.2% of GDP in 2009) and rumours (denied) that Spain would have to seek help from the euro zone's rescue package, the government came under renewed pressure to act and calm the international markets.

The full details of the labour reforms have yet to be fleshed out, but the nub of the package is lower severance payments, better conditions for temporary contracts and making it easier for companies to lay off workers during bad times. Workers on permanent contracts are entitled to severance pay of as much as 45 days per year worked, one of the highest levels in Europe. Under the reforms this would be cut to 33 days for new permanent contracts.

This is the sixth package of such reforms since the advent of democracy after the death of General Franco in 1975, but none of them has yet managed to prevent the jobless rate from exceeding 20% on a number of occasions. One reason, among many, for this is that no government in the last 30 years has deeply reformed a labour market which was created during the previous paternalistic regime (jobs for life and often in the same company in return for political loyalty) and became out of line with a free market economy. Employers said the reforms were half-hearted.

Miguel Ángel Fernández Ordoñez, the Governor of the Bank of Spain, who has been calling for labour reforms for more than a year, welcomed the package, but criticised several aspects. With more than 4 million unemployed, he questioned the wisdom in the current climate of placing new limits on temporary contracts and criticised the lack of any significant change in the collective bargaining system, under which companies, regardless of their financial health, have to follow sector-wide accords. The collective bargaining issue could be one of the hottest points of the amendments put forward by the conservative Popular Party.

The proportion of total workers on temporary contracts –introduced in 1984 by the first post-Franco Socialist government as a way for employers to get around the rigidity and cost of permanent contracts– has dropped from 32% in 2007 to around 25% today (still much higher than the EU average). This fall is due to the fact that the vast majority of those who have lost their jobs in the last two years were on these contracts, and when the going gets tough they are always the first to go and with little or no severance payments. It is widely recognised that employers have abused these contracts, rolling them over and effectively making these workers permanent ones but without the firing cost.

Trade unions, strong in the public sector but not at the national level, have concentrated almost exclusively on defending workers on permanent contracts (a relatively privileged elite) as they are their members.

Companies will be allowed to reduce severance payments for permanent workers if they have a ‘negative economic situation’, an ambiguous term which will be left to labour-court judges to determine. Interpretation by judges is something employers have come to dread. It was the main reason why so many workers were ‘unjustifiably’ dismissed in the past and the higher severance payment made, as ‘justified’ firings were so time-wasting and expensive to prove, through the courts, that many employers opted for the former even though the dismissal probably was ‘justified’ and thus eligible for lower severance payments.

Celestino Corbacho, the Labour Minister, said the reforms would not create jobs, but would prevent the destruction of many. Job creation depends more on changing an economic model excessively based on a construction sector, which collapsed in 2008 and shows no signs of recovery, than on labour market reforms. The Bank of Spain said the construction sector would be responsible for GDP shrinkage of 5.4% between 2008 and 2011.

Savings Banks in Sweeping Reforms

Spain's unlisted and regionally-based savings and loans banks, many of them ailing, will be allowed to sell up to 50% of their equity to private investors under the government's major reforms.

Politicians' influence in the *cajas*, as they are called, will also be gradually limited by restricting the number of elected public officials allowed on their management and supervisory boards. Politically-motivated lending, particularly to the property sector, weakened some *cajas* significantly when the real estate bubble burst.

Prime Minister José Luis Rodríguez Zapatero described the shake-up as the 'most important in the history of the Spanish banking system'. He said there was an 'incompatibility of elected officials being members of the *cajas*' governing bodies'.

Until now the *cajas* have been restricted to selling non-voting securities known as 'participative quotas'. These quotas will now be similar to listed shares and will pay dividends and carry voting rights.

The 45 *cajas* account for about half the assets and deposits in the Spanish financial sector, and 38 of them have agreed mergers or loose tie-ups or are seeking authorisation for them (see Figure 6). The Bank of Spain has rescued two of them. The bad-loan ratio of *cajas* was 5.52% of assets in April, the highest for 14 years.

Figure 6. Integration of Savings Banks

	Type of integration	**% of sector's assets**	**FROB aid (€ million)**
Caja Madrid (lead entity)+ Bancaja+Banco de Valencia+ Insular de Canarias+Ávila+ Segovia+Laietana+Rioja	Loose tie-up (SIP)	26.3	4,464
Cajastur (lead entity)+CCM CAM+Cantabria+Extremadura	Loose tie-up (SIP)	9.9	1,493
Catalunya (lead entity)+ Tarragona+Manresa	Merger	6.1	1,250
Caixanova (lead entity)+ Banco Gallego+Galicia	Merger	6.0	1,162
Caja Murcia (lead entity)+ Penedés+Sa Nostra+Granada	Loose tie-up (SIP)	5.6	915
Caja Duero (lead entity)+	Merger		
España	Merger	3.7	525
Unnim (lead entity)+Sabadell+ Terrasa+Manlleu	Merger	2.2	380
Navarra (lead entity)+General de Canarias+Municipal de Burgos	Loose tie-up (SIP)	3.6	-
Unicaja (lead entity)+Jaén	Merger	2.8	-
La Caixa (lead entity)+Girona (1)	Merger	20.3	-
Cajasol (lead entity)+Guadalajara (1)	Merger	2.4	-
CAI+CC Burgos+Badajoz (2)			

(1) In the process of authorisation.
(2) Lead entity not yet decided.
Source: Fund for Orderly Bank Restructuring (FROB).

The government's reform of the *cajas*, founded in the 19th century, was agreed with the Popular Party. Financial analysts expressed doubts as to whether there would be investors willing to buy the quotas in the current climate. They said the reforms were long overdue and should have been made when the banking sector was in much better health.

In another development aimed at restoring confidence in the Spanish financial system, which has been a focus of international investor concerns, the government overcame German opposition during its six-month Presidency of the EU and secured support for the publication of EU-wide 'stress tests' on 23 July. Of the 91 banks undergoing stress tests, 27 are Spanish.

The results are likely to show the relative solvency of most of Spain's banks, particularly the big commercial ones –Santander and BBVA–, who feel they have been unfairly tarnished with the same brush as weak banks, resulting in plunging share prices and closure to them of international wholesale funding markets.

Spanish banks borrowed €85.6 billion in May from the European Central Bank –twice what they borrowed before Lehman Brothers' collapse in September 2008– and accounted for 16.5% of net euro-zone loans offered by the ECB.

Government Reforms Begin to Improve Investor Sentiment

The 2 percentage point increase in the standard VAT rate from 1 July to 18% and cuts in public spending as of May, in order to lower the massive budget deficit, labour market reforms to enhance employment prospects and measures to improve the health of savings and loan institutions began to have a positive impact on investor sentiment.

After falling 23.3% in the first half of the year, its worst-ever performance in a six-month period, the Madrid stock market rose 7.6% in the first 12 days of July (see Figure 7).

Figure 7. Stock Market Indices (% change) (1)

Index	% change
Ibex-35 Spain)	-15.7
Dax (Frankfurt)	+2.0
FTSE 100 (London)	-4.5
Euro Stoxx 50	-9.4
Dow Jones	-2.0
Nikkei (Tokyo)	-9.4

(1) 1 January to 12 July.
Source: Markets.

Spanish 10-year bond yields, which have an inverse relationship with prices, eased to 4.58%, down from 4.85% in the third week of June and the highest level since July 2008. The spread over German bonds –a key indicator of market confidence– dropped from 221 bp –the highest since the advent of the euro in January 1999– to 198 bp (see Figure 8).

Figure 8. 10-year Government Bond Spreads Over Bunds (pp) (1)

	Spread versus Bund
France	+0.35
Greece	+7.82
Ireland	+2.75
Italy	+1.46
Portugal	+2.83
Spain	**+1.98**
UK	+0.74

(1) At 12 July.

Telefónica Moves Nearer to Acquiring Portugal Telecom After EU 'Golden Shares' Ruling
Telefónica's bid to acquire full control of Vivo, its Brazilian mobile joint-venture with Portugal Telecom (PT), was boosted after the European Court of Justice ruled unlawful the Portuguese government's use of its 'golden shares' to override other shareholders and block Telefónica's €7.15 billion offer for 50% of Brasilcel, which controls Vivo.

The Court said the 500 so-called 'golden shares', which allow Lisbon to prevent other investors from obtaining more than 10% of PT, were a restriction on the free movement of capital.

Telefónica wants full control of Vivo in order to merge it with Telesp, its Brazilian fixed-line operation.

The Spanish telecoms giant raised its bid by 10% to €7.15 billion. This offer, which valued Vivo at a hefty multiple of 10-times its expected earnings before interest, tax, depreciation and amortisation (EBITDA), was accepted by 74% of shareholders and then blocked by the Portuguese government.

Lisbon's use of its 'golden shares', in the national interest according to José Socrates, Portugal's Prime Minister, was ironic as five years ago the Spanish government used its 'golden shares' to protect Telefónica and had to give it up.

Telefónica and PT agreed to 'look for possible solutions' to the acrimonious dispute over Vivo. One solution could be to merge Vivo with Telesp and offer PT a minority stake in the merged group.

Santander to Acquire German Unit of Sweden's SEB
Santander, the euro-zone's largest bank by market capitalisation, agreed to buy the German retail bank business of Sweden's Skandinaviska Enskilda Banken (SEB) for €555 million.

The Spanish bank is already a leading provider of car finance and consumer loans in Germany. The purchase of SEB's 173 branches will almost double the size of Santander's German branch network.

In a separate development, Santander said it was looking to increase its presence in the Latin American countries where it has a small market share, notably Peru and Colombia.

Spain Remains Above Italy in Per Capita GDP as a percentage of the EU Average
Spaniards' per capita income in 2009 remained unchanged at 103% of the EU-27 average, slightly above Italy, according to the first estimates (see Figure 9). Despite the largest rise in unemployment, the shrinkage in the Spanish economy in 2009 of 3.6% was less than the average for the whole of the EU of 4.2%. As a result, Spain maintained its per capita position. Among the five largest economies (Germany, France, Italy, the UK and Spain), the largest fall in per capita income relative to the EU average was registered by France.

Figure 9. Per Capita GDP in Purchasing Power Parity Terms (EU-27 = 100) (1)

	2009	2008
Luxembourg	268	276
Ireland	131	135
Netherlands	130	134
Austria	124	123
Sweden	120	122
Denmark	117	117
UK	117	116
Germany	116	116
Belgium	115	115
Finland	110	117
France	107	103
Spain	**103**	**103**
Italy	102	102

(1) Revised 2008 figure in brackets.
Source: Eurostat.

Spain's per capita income convergence with the EU steadily rose until 2008 when it fell from 105% to 103%. Spain overtook Italy in 2006 amidst much trumpeting by the government.