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Foreign Policy

Spanish Troops to Stay in Afghanistan 'as Long as Necessary'
Spain's 1,500 peacekeeping troops in Afghanistan will stay there for as long as required, José Luis Rodríguez Zapatero, the Prime Minister, told parliament.

He would not be drawn on giving a date for withdrawal. President Hamid Karzai of Afghanistan hopes the country's armed forces will be able to take over security there in 2014. The Netherlands has pulled out its troops and Canada, which has been in the front line of fighting, will do so in 2011.

Rodríguez Zapatero's cautious response to questions about Afghanistan followed a meeting in Madrid with Anders Forgh Rasmussen, the Nato Secretary General, who expressed concern about troop withdrawals.

Meanwhile, the latest annual public opinion survey measuring the attitudes of Americans and Europeans towards world affairs and transatlantic relations shows a sharp drop in Spaniards' optimism about stabilising Afghanistan (see Figure 1). Spanish troops have been in Afghanistan for nine years.

Figure 1. Optimism about Stabilising Afghanistan (%)

	2009	2010
US	56	51
Romania	44	42
Italy	39	28
UK	37	34
Netherlands	36	29
Portugal	33	26
Bulgaria	32	32
EU-11	32	23
Spain	**32**	**22**
Turkey	31	24
Poland	30	22
France	30	18
Slovakia	27	27
Germany	23	10

Source: Transatlantic Trends 2010.

In Bosnia, Spanish troops withdrew on 18 October after 18 years, ending Spain's longest international peacekeeping mission.

Rodríguez Zapatero Urges Venezuela to Probe ETA Refuge Reports
Prime Minister Jose Luis Rodríguez Zapatero called on Venezuelan authorities to probe reports that members of the Basque terrorist group ETA are trained in the South American Country.

The Venezuelan President, Hugo Chávez, dismissed the allegations made by two suspected ETA members who were arrested in Spain. Juan Carlos Besance and Xavier Atristáin told police that in Venezuela they met with ETA's alleged representative for the country, Arturo Cubillas, and received training from him in 2008. Cubillas lives in Venezuela and is a senior official in the Agriculture Ministry.

A Spanish judge, Eloy Velasco, who is investigating links between ETA and Colombia's FARC rebels, says Cubillas is responsible for coordinating relations between the two groups. He is wanted in Spain on charges that he has led ETA's activities in Latin America since 1999. Velasco ordered Spanish police to question nine former FARC members in Colombia as part of the probe into links between FARC, the Venezuelan government and ETA. Last March he accused Venezuela of helping ETA and Colombian rebels with a plot to assassinate the then-Colombian President Alvaro Uribe. Chavez called the accusation 'stupid'.

Cubillas, who has lived in Venezuela since 1989 when he was deported from Algeria after peace talks with ETA failed, asked the Venezuelan Attorney General's Office to determine the truthfulness of the accusations against him. He has Venezuelan citizenship.

Cándido Conde-Pumpido, Spain's Director of Public Prosecutions, said Spain would not 'tolerate terrorism having any international support'. He said if there were reasonable grounds to show that Cubillas supports ETA he 'should be handed over to Spain or investigated and prosecuted' in Venezuela.

ETA has killed more than 800 people in its 40-year terrorist campaign for an independent Basque state in northern Spain and southern France.

Venezuela is an important trading partner for Spain, and Rodríguez Zapatero has friendly relations with Chávez who has visited Spain several times.

Maritime Dispute Blocks Forum between Spain, Gibraltar and UK
An ongoing dispute over territorial waters led Gibraltar to suspend preparations for the next meeting of the forum involving Spain, the UK and the British overseas territory, which was launched in 2004 to allow the Rock to participate as an equal partner in relations and cooperation with Spain. Madrid claims sovereignty over Gibraltar, which was ceded to Britain under the 1713 Treaty of Utrecht.

The meeting is due to be held by the end of the year and would be the first under the UK coalition government led by David Cameron.

In the most recent incident, a Spanish police patrol vessel refused on 28 September to hand over to Gibraltarian police a suspected smuggler it had detained. The Gibraltarian Chief Minister Peter Caruana accused Spanish police of making constant incursions into the enclave's territorial waters. Spain views the waters as its own. He cancelled technical talks of the forum on police and maritime security cooperation, a decision which effectively freezes the body's activities.

The Spanish Deputy Prime Minister María Teresa Fernández de la Vega said sovereignty questions should not be linked to the forum, but should be discussed only between London and Madrid.

Spain Consolidates its Presence at G-20 Summits
The government of South Korea has invited Spain to the Group of 20-nations summit to be held in Seoul on 11 and 12 November. Spain, which is not formally a member of the G-20 group, has attended all four previous summits.

Ethiopia, Malawi, Singapore and Vietnam have also been invited to the summit.

The G-20's first summit was held in November 2008. The group's members are the G-8 countries, the EU and 11 other countries (South Korea, Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa and Turkey). Spain is the only non-member to have attended all the meetings so far.

Domestic Scene
General Strike over Austerity Measures Fails to Bring the Country to a Halt
Trade unions staged their first general strike in eight years against the Socialist government's measures to sharply reduce the large budget deficit. The response was in line with public opinion surveys before the strike on 29 September that showed most people were against it.

According to official figures, fewer than one in 10 civil servants of the central government failed to show up for work, three-quarters of employees of public sector companies carried on working and only 12% of bureaucrats in local government went on strike. In Madrid, the underground railway worked normally. The bus service, however, was sporadic. The great majority of shops and supermarkets were open. In a war of figures, the General Union of Workers (UGT) and the Workers Commissions (CCOO), the two main unions, disputed the government's version of events.

The strike was called in June after the government decided to cut civil servants' salaries by 5% on average and to liberalise the labour market and proposed an increase in the retirement age in order to reduce the budget deficit, stimulate job creation and regain the confidence of the international debt markets.

Cándido Méndez, leader of UGT, traditionally close to the Socialist party, said no government since the ending of the Franco dictatorship in 1975 had 'sought to attack on so many fronts the social and labour rights of workers'. Trade unionists are angry that the government has moved from championing social policies during Spain's long economic boom to championing what they regard as anti social ones.

The lack of confidence in the government's ability to put is economic house in order spooked markets in the summer and pushed up the cost of government debt, forcing Prime Minister José Luis Rodríguez Zapatero to make a sudden U-turn in his economic policy.

With unemployment still at more than 20%, most workers, especially in the private sector, are reluctant to risk their jobs with strikes. Most trade union support in Spain, a country where unions are not very strong (see Figure 2), comes from the public sector.

Figure 2. Trade Unions Membership in Europe (%)

Country	%
Sweden	75
Finland	72
Italy	32
UK	25
Germany	21
Spain	**19**
France	8

Source: European Industrial Relations Observatory (EIRO), Trade Unions membership, 2003-08.

The strike dented support for the Socialists. An opinion poll by Metrosciopia conducted for *El País*, the leading daily, showed increased support for the conservative Popular Party (PP) if there was an early election, as the PP never ceases to demand. The PP's advantage over the Socialists widened to 14.5 points this month from 8.9 in September (see Figure 3).

Figure 3. Voter Intention (%)

	Socialists	Popular Party
April 2008 general election	43.7	40.1
May 2009	39.6	40.8
May 2010	37.5	41.7
September 2010	32.9	41.8
October 2010	28.5	43.0

Source: Interior Ministry for April 2008 and Metroscopia for the rest.

Ageing Population Reinforces Need for Pension Reform

Spain's population growth, which quickened between 2000 and 2007, is set to slow down considerably over the next decade, but the proportion of elderly in the total will increase substantially and reach almost 20% by 2020, making reform of the pay-as-you-go pension system necessary, according to the government.

The number of those over the age of 64 will rise by 1.3 million and lift the dependency rate (those under 16 and over 64 as a percentage of those between 16 and 64) by six points to 55%. The dependency rate tells us how many young people (under 16) and older people (over 64) depend on people of working age (16 to 64). The higher the rate the more people need looking after, and the greater the possibility of the state pension system coming under strain.

The population is forecast to rise by 1.2 million (+2.7%) between 2010 and 2020 compared with an increase of 5.9 million (+14.8%) between 2000 and 2009, an annual average increase of 124,591 as against the previous 593,931. Most of the 5.9 million increase was the result of a massive influx of immigrants, many of which came from Latin America, North Africa and Rumania to work in Spain's then booming economy. With the economy in recession since 2009 and Spanish women producing fewer babies than immigrant women, population growth has peaked (see Figure 4).

Figure 4. Growth in Spain's Population, 2000-20

Year	Population at January 1 (million)
2000	40.04
2004	42.34
2006	43.75
2008	45.28
2010	45.98
2012	46.30
2014	46.58
2016	46.83
2018	47.05
2020	47.23

Source: INE.

The government wants to raise the minimum legal retirement age from 65 to 67 and increase the number of years of contributions to the social security system upon which a person's state pension is based. Celestino Corbacho, the outgoing Labour Minister, proposed raising it to the last 20 years during which a person has worked from the current 15. The life expectancy of Spaniards has risen considerably over the last 30 years –from 72.1 to 78.6 years for men and from 78.1 to 84.9 for women–.

Spain's pension replacement rate, a measure of how effectively a pension system provides income to replace earnings at retirement, is in the upper range of OECD countries (see Figure 5).

Figure 5. Pension Replacement Rates (%)

Country	Replacement rate (1)
Greece	95.7
Spain	**81.2**
Italy	67.9
France	53.3
Germany	43.0
UK	33.5

(1) Latest figures for the relation between final salary and pension.
Source: OECD.

The minimum pension will rise by 1% in 2011 plus an extra payment in January if inflation, as seems likely, is more than 1% this year (it was 2.1% year-on-year in September). The minimum pension for a married couple is €752 in 2010. The government promised to raise it to €850 in 2012, when the next general election is due, from €524 in 2005, after it first took office, but budgetary restrictions will not make this possible.

The government has also postponed the increase in paternity leave from two to four weeks which was due to enter into force next year.

Only two Spanish Universities in Top 200 of Times Ranking

Spain has only two universities in the 2010-11 ranking of the world's top 200 universities by the *Times Higher Education Supplement* compared with 28 UK universities, 13 German and four French. The first five places, headed by Harvard, are all US universities. The best-ranked Spanish university is the University of Barcelona (142nd) followed by Pompeu Fabra (155th).

The rankings are based on 13 performance indicators in five categories: teaching (worth 30% of the overall score), research (30%), citations (32.5%), industry income (2.5%) and international mix of staff and students (5%).

The Economy

Government Approves Lean 2011 Budget, Raises Taxes for the Rich

The government unveiled its budget for 2011 which aims to cut the deficit from 11.1% of GDP in 2009 to 6%, through spending cuts and an increase in income tax for the rich. Elena Salgado, the Finance Minister, called the budget the 'most austere' of recent years.

The main provisions include:

- An overall spending cut of 7.7%, to €122 billion.
- Departmental spending cuts of about 16%.
- Spending on infrastructure will be roughly the same as in 2004.
- Civil servants pay cut of 5%.
- Tax rise for personal income above €120,000.

The top marginal rate of personal income tax, currently at 43%, will rise to 44% for annual incomes over €120,000 and to 45% for those above €175,000. The extra revenue raised of €170 million-€200 million is not very significant, however, given the magnitude of the budget deficit (the target for 2010 is 9.3% of GDP).

The special capital gains exemption for *Sicavs*, investment funds used by wealthy Spaniards to manage their assets, has also been abolished.

The spotlight is on regional and local governments and whether they will be as firm as the central government in cutting expenditure and playing their part in reducing the overall budget deficit. The regions account for more than half of all spending, mainly on health and education, which have been devolved from the central government.

Miguel Ángel Fernández Ordóñez, the Governor of the Bank of Spain, told the parliament's budget committee that the measures announced so far at the local and regional level were not sufficient and that it was vital not to veer from the 'sacred' deficit figure of 6% of GDP. He called on the government to draw up a contingency plan to be used if there were signs of a deficit overshoot and criticised the lack of transparency in the accounts of local and regional governments.

An overshoot would scare the markets and cause the spread on Spanish bonds over German yields –a key indicator of market confidence– to rise. The spread has remained fairly stable in the last four weeks (see Figure 6).

Figure 6. 10-year Government Bond Spreads Over Bunds (pp)

	July 12	September 13	October 18
France	+0.35	+0.27	+0.33
Greece	+7.82	+9.15	+6.57
Ireland	+2.75	+3.41	+3.68
Italy	+1.46	+1.42	+1.35
Portugal	+2.83	+3.34	+3.19
Spain	**+1.98**	**+1.73**	**+1.63**
UK	+0.74	+0.69	+0.58

Source: ThomsonReuters.

The finances of many town halls and regional governments, including Madrid, are in dire straits. The central bank says the total debt of regional governments has doubled to almost €105 billion in five years and the 8,000 local governments owe suppliers some €13 billion, representing more than one-third of their €36 billion total debt. Aselip, an association of sanitation-service providers, says its members are owed €3.4 billion, €1 billion of which is more than one year past due. These companies cannot continue to operate under these circumstances forever.

The cash-starved government of Catalonia cannot raise money on the international markets and this month announced it would seek to raise up to €2.5 billion by selling bonds through local banks. The outlook for each of the 17 autonomous regions is listed as 'negative' by the leading credit rating agencies.

The Kingdom of Spain lost its top triple A credit status at the end of last month when Moody's joined other rating agencies and cut its rating by a notch to Aa1 from Aaa. Standard & Poor's and Fitch Ratings cut their ratings of Spanish government debt last April and May, respectively. The cut put Mood's ranking on a par with Fitch's AA+ classification, one notch above S&P's AA ranking. The move was expected and was due, said Moody's to the challenged facing the government in reducing the budget deficit at a time when the economy is hardly growing.

The International Monetary Fund (IMF) forecasts growth of just 0.7% in 2011, well below that of the other big euro zone economies (see Figure 7) and the Spanish government's projection of 1.3%.

Figure 7. GDP Growth in Main Euro Zone Economies (%)

	2008	2009	2010	2011	2012	2013	2014	2015	2008-15
France	0.09	-2.55	1.57	1.65	1.80	1.97	2.10	2.06	+8.92
Germany	0.99	-4.72	3.33	2.02	2.02	1.84	1.67	1.27	+8.52
Italy	-1.32	-5.04	1.00	1.00	1.40	1.37	1.34	1.26	+0.83
Spain	**0.86**	**-3.72**	**-0.35**	**0.73**	**1.79**	**2.11**	**2.13**	**2.01**	**+5.56**

Source: International Monetary Fund.

Unemployment is projected to remain at close to 20%, twice the EU average. The recently-approved labour market reforms are expected to make little difference to job creation, which is Spain's most pressing problem.

Car sales plummeted 27% year-on-year in September, the lowest figure that month for more than 12 years. The main reason for this was the ending of the scrappage scheme, under which buyers received a minimum of €2,000 slashed off the price of their new purchase. The motor industry is expected to start laying off more workers.

As the government is a minority one, it had to strike a deal with other parties in order to get the budget approved by parliament or face an early general election (not due until 2012). It won support from the Basque Nationalist Party (PNV), in return for a greater degree of economic autonomy for the Basque region (ruled by the Socialists), and from the Canary Islands Coalition. The eight votes of these two parties will see the budget through parliament.

Spain Slips in IMF Ranking of World Economies

Spain will move down to 12th position in the IMF's ranking of the world's largest economies this year from ninth place in 2009 as it will be overtaken by Canada, Russia and India (see Figure 8). Three years ago the Spanish economy was the eighth largest.

Figure 8. Ranking of World Economies by GDP, 2010 (US$ billion)

	2010	2009
1. US	14,624	14,119
2. China	5,745	4,984
3. Japan	5,390	5,068
4. Germany	3,305	3,338
5. France	2,555	2,656
6. UK	2,258	2,178
7. Italy	2,036	2,118
8. Brazil	2,023	1,574
9. Canada	1,563	1,336
10. Russia	1,476	1,231
11. India	1,430	1,236
12. Spain	**1,372**	**1,467**

Source: International Monetary Fund.

In purchasing power parity terms, as opposed to market exchange rates, Spain will be in 13th position.

Little Enthusiasm Among Spaniards for the Euro, Support for EU Membership

Fewer than half of Spaniards (44%) believe the euro has been a good thing for the economy, but two-thirds (67%) support membership of the EU, according to the annual Transatlantic Trends survey conducted by the German Marshall Fund of the United States (see Figure 9). Spain's support for the euro, however, was well above the average for the 11 countries surveyed of 38%.

Figure 9. EU Membership versus the Euro (%)

	EU membership has been/ would be a good thing for the economy	Using the euro has been/ would be a good thing for the economy
Netherlands (€)	75	52
Poland	75	32
Germany (€)	69	45
Portugal (€)	69	40
Slovakia (€)	68	64
Spain (€)	**67**	**44**
Romania	63	54
EU-11	63	38
Italy (€)	62	47
France (€)	61	33
UK	45	14
Bulgaria	40	28

Source: Transatlantic Trends 2010.

In essence, the low support for the euro in virtually all the countries was due to the feeling that each country's national government should have primary responsibility for dealing with the current economic crisis. Interest rates are set by the European Central Bank, for example, and a euro zone country is not allowed to devalue its currency as a way to restore competitiveness.

Regarding the disparity between support for the EU and the euro, the authors of the report said public opinion seemed to support the argument that crises tend to lead to more citizen support for integration rather than less. Italians (76%), Portuguese (70%) and Spaniards (65%) were particularly favourable to more integration, while the generally euro-sceptic British (33%) were the least in favour.

EU Bows to Coal Aid Demand
The government won its battle with the European Commission to provide state funding to Spain's hard-pressed coal industry. Around €2billion of aid will be supplied over four years, even though it goes against Brussels' efforts to phase out state aid to loss-making coal mines.

The plan, which Spanish officials defended vigorously, will give preferential access to the wholesale electricity market for power plants that run on domestic coal. The aid will be stopped on or before the end of 2014.

The coal sector has been hit by mounting industrial action.

Inditex First-Half Profits Surge 68%…
Inditex, the world's largest clothes retailer, reported a 68% year-on-year jump in first-half net profits to €628 million. This was due to a 14% increase in sales for the six months to the end of July to €5.5 billion, 28% of which came from Spain (32% in the same period of 2009) and the rest from abroad.

Inditex, whose best known brand is Zara, opened 173 new stores in 37 countries including its first Zara stores in India.

… but Banesto's Third-Quarter Profits Drop 52%
Banesto, part of Grupo Santander, the euro zone's biggest bank by market capitalisation, suffered a 52% year-on-year drop in its third quarter profit to €68.9 million, signalling the downturn in the financial sector which until now has been one of the best European performers.

Its profit for the first nine months was 18.6% lower than in the same period of 2009 at €450.6 million. The main reason for the fall was bigger provisions for bad loans, including a net deduction of €128 million due to the Bank of Spain's stricter provisioning rules.

Banesto's nonperforming loan ratio at the end of September was 3.80%, up from 3.48% in June. This was still lower than the level of more than 5% for the banking sector as a whole.

Repsol and China's Sinopec Join Forces to Develop Oil Fields in Brazil
Repsol, Spain's oil and natural gas conglomerate, and Sinpoec, China's largest oil and petrochemical company, agreed to form an alliance to develop the significant oil fields that Repsol has discovered in Brazil.

The state-owned Sinpoec will fully subscribe the €5.2 billion capital increase of Repsol Brasil, giving it 40% of the company. Repsol will control the other 60%.

The deal satisfies China's insatiable thirst for oil and gives Repsol the funds required to develop its offshore fields, which include stakes in some of the largest blocks off the southern coast. Repsol Brazil has net resources equal to 1.2 billion barrels of oil equivalent.

Antonio Bufrau, Repsol's Chairman, said almost a year ago there were three options: listing the subsidiary on the Brazilian stock market, establishing an alliance with Petrobras, Brazil's state-owned oil giant, or seeking a partner.