**Inside Spain 60**

*William Chislett*

## Foreign Policy

*Rodríguez Zapatero Makes First Official Visit to the White House, Promises More Help for Afghanistan*

The Spanish Prime Minister, José Luis Rodríguez Zapatero, was received in the White House in his first bilateral meeting with a US President, and promised Barack Obama he would send more paramilitary civil guards to Afghanistan to help train the country's security forces.

George W Bush kept Rodríguez Zapatero at arm's length because of his withdrawal of 1,200 peacekeeping troops from Iraq in 2004, soon after taking office, which plunged US-Spain relations into crisis at the top level, although at all other levels they continued to be good. The troops had been sent to Iraq by Zapatero's conservative predecessor, José María Aznar, who forged very close ties with Bush, symbolised in several much publicised photos.

Zapatero's offer for Afghanistan, which could also include increasing the number of Spanish peacekeeping troops from around 800 to about 1,000, is a drop in the ocean compared to the call from General Stanley McChrystal, who heads the 68,000 US troops in Afghanistan as well as the 100,000 NATO forces, for 40,000 more troops.

The brunt of the fighting against the Taliban is being borne by US, UK, Canadian and Dutch troops in the southern part of the country, although violence is escalating throughout the whole country including the area where Spain's peacekeeping troops are stationed. A Spanish soldier died earlier this month after his vehicle ran over a land mine. This brought to 88 the number of Spanish army members killed since 2002 in Afghanistan (62 of them in a plane crash in Turkey in 2003 when returning to Spain and 17 in 2005 in a helicopter crash in Afghanistan).

Madrid has also agreed to take two of the almost 50 prisoners at the Guantanamo Bay prison in Cuba that Washington wants to deport to Europe as part of its plan to close the place.

Turning to Spain's Presidency of the EU in the first half of 2010, Obama called for greater co-operation over Kosovo. Spain, grappling with its own separatist movements in the Basque Country and Catalonia, refused to recognise the secession in February 2008 of the ethnic Albanian territory of Kosovo from Serbia. While Washington recognised Kosovo as 'a sovereign and independent state', Miguel Ángel Moratinos, Spain's Foreign Minister, called the independence declaration illegal. Two other EU countries, Cyprus and Greece, also do not recognise Kosovo.

After Washington Rodríguez Zapatero embarked on a trip to the Middle East, where the Obama Administration has reached an impasse in its peace strategy. The trip included stops in Syria, Israel, Lebanon and the Palestinian territories. Zapatero met with the Israeli President Simón Peres in Jerusalem and with the Palestine President Mahmud Abbas in Ramala. This was the first visit by a Spanish Prime Minister to Palestinian territory in 10 years. Zapatero advocated the existence of two states, Israel and Palestine, and called on Israel to freeze the building of more settlements. Abbas awarded him the Honour Star, the highest distinction.

Peres welcomed the decision of Madrid to modify a law that would have enabled Spanish judges, under the principles of universal jurisdiction, to seek the prosecution of Israeli leaders and officers for alleged war crimes against Palestinians.

Rodríguez Zapatero ended his trip at Marjayoun, Lebanon, where there are 1,200 Spanish peacekeeping troops. Spain will send 200 more troops to Lebanon when one of its generals assumes command of the UN peacekeeping force next February. General Alberto Asarta Cuevas is due to take over the 12,000 strong UN force from Italy's General Claudio Graziano. Spain has the third-largest number of troops in Lebanon after France and Italy.

*Moratinos in Second Visit to Cuba, Did not Meet Dissidents*
Miguel Ángel Moratinos, Spain's Foreign Minister, visited Cuba for the second time in two years in a bid to forge closer relations between the country and the EU, whose rotating Presidency Spain will assume in January.

Spain is the EU country with the closest cultural, political and economic relations with Cuba, partly because of historic ties with the former colony but also because the Socialist government believes that at this crucial moment in the island (the 83-year-old Fidel Castro is ill) it can better influence the future course of events by being friendly to the regime than by opposing it.

Other EU countries such as Sweden, Germany, the Czech Republic and the Netherlands, take a harder line. The EU's common position drawn up in 1996 makes better relations conditional on democratic change. Few political prisoners have been released.

The Popular Party criticised Moratinos' visit and particularly the decision not to meet dissidents, complying with the regime's wishes.

**Domestic Scene**

*Madrid Loses Olympics Bid Again*
Madrid lost out to Rio de Janeiro to host the 2016 Olympic Games. It was beaten in 2005 by London to hold the 2012 Games. Alberto Ruíz-Gallardón, the Mayor of Madrid who fought tirelessly for the city, did not totally rule out trying for the 2020 Games.

Madrid came top in the first round of voting with 28, followed by Rio on 26. In the second round, with Chicago knocked out, Rio almost secured the absolute majority to win outright with 46 of the 95 votes cast. Madrid came a distant second with 29, while Tokyo was eliminated after receiving 20. The final ballot saw Rio beat Madrid by 66 votes to 32. Madrid garnered the same number of votes as in 2005, showing that in the intervening years it gained no extra support.

*Spain Remains in 15th Place in Human Development Index Ranking*

Spain held its position in the UN's latest Human Development Index (HDI), a composite measure of three dimensions of human development –living a long and healthy life, being educated and having a decent standard of living (see Figure 1)–.

**Figure 1. UN Human Development Index (HDI) for Selected Countries**

| Ranking (1) | Human Development Index Value | Life Expectancy at Birth (2007) | Adult literacy rate (% aged 15 and over) | GDP per Capita (PPP US$) 2007 |
|---|---|---|---|---|
| 1. Norway | 0.971 | 80.5 | 99.0 | 53,433 |
| 4. Canada | 0.966 | 80.6 | 99.0 | 35,812 |
| 7. Sweden | 0.963 | 80.8 | 99.0 | 36,712 |
| 8. France | 0.961 | 81.0 | 99.0 | 33,674 |
| 13 US | 0.956 | 79.1 | 99.0 | 45,592 |
| **15. Spain** | **0.955** | **80.7** | **97.9** | **31,560** |
| 18. Italy | 0.951 | 81.1 | 98.9 | 30,353 |
| 22. Germany | 0.947 | 79.8 | 99.0 | 34,401 |
| 34. Portugal | 0.909 | 78.6 | 94.9 | 22,765 |
| 44. Chile | 0.878 | 78.5 | 96.5 | 13,880 |
| 53. Mexico | 0.854 | 76.0 | 92.8 | 14,104 |

(1) Out of 182 countries.
Source: United Nations Human Development Report, 2009.

Overall, Spain is ranked 15th (9th in life expectancy, 27th in adult literacy, 12th in the combined gross enrolment ratio in education and 27th in per capita income based on purchasing power parity). Between 1980, when the index first began to be issued, and 2007 (the latest year for comparative figures worldwide) Spain's HDI rose from 0.855 to 0.955.

The UN forecast Spain's stock of immigrants at 6.3 million in 2010, the sixth-highest in absolute terms among what it termed very high human development countries (see Figure 2).

**Figure 2. Stock of Immigrants (000 and %)**

| | Stock 1960 | Stock 2010 (1) | Population share 1960 (%) | Population share 2005 (%) |
|---|---|---|---|---|
| 1. US | 10,825 | 42,813 | 5.8 | 13.0 |
| 2. Germany | 2,002 | 10,758 | 2.8 | 12.9 |
| 3. Canada | 2,766 | 7,202 | 15.4 | 19.5 |
| 4. France | 3,507 | 6,684 | 7.7 | 10.6 |
| 5. UK | 1,661 | 6,451 | 3.2 | 9.7 |
| **6. Spain** | **211** | **6,377** | **0.7** | **10.7** |
| 7. Australia | 1,698 | 4,711 | 16.5 | 21.3 |
| 8. Italy | 459 | 4,463 | 0.9 | 5.2 |

(1) 2010 projections are based on long-run tendencies and may not accurately predict the effect of unexpected short-term fluctuations such as the 2009 economic crisis.
Source: United Nations Human Development Report, 2009.

*Almost Half of Spanish Adults Say They Know No Foreign Languages*

Spain compares badly with most EU countries in foreign language skills. More than 40% of adults say they know no foreign language and only just over one-quarter of upper secondary education students are learning two or more languages, compared with an EU average of 60%, according to Eurostat, the EU's statistical office (see Figures 3 and 4).

The highest shares of those speaking no foreign language were found in Hungary (75%), Portugal (51%), Spain (47%) and Bulgaria (44%).

**Figure 3. Self-Perceived Language Knowledge of Adults (25-64 years, %) (1)**

| | No foreign language | One foreign language | Two or more foreign languages |
|---|---|---|---|
| EU average (2) | 36.2 | 35.7 | 28.1 |
| Finland | 16.1 | 16.0 | 67.9 |
| France | 41.2 | 35.9 | 22.9 |
| Germany | 28.6 | 41.3 | 30.2 |
| Hungary | 74.8 | 17.6 | 7.7 |
| Italy | 38.6 | 33.8 | 27.6 |
| Poland | 37.3 | 39.0 | 23.7 |
| **Spain** | **46.6** | **35.4** | **17.9** |
| Sweden | 5.0 | 44.6 | 50.4 |
| UK (3) | 35.1 | 64.9 | – |

(1) 2007.
(2) Based on available member states and excluding the UK.
(3) The questionnaire for the UK only distinguishes ‘no foreign language’ and ‘one foreign language’. Therefore the answer ‘one foreign language’ could also include the knowledge of more languages.
Source: Eurostat.

**Figure 4. Language Learning Among Upper Secondary Education Students (%) (1)**

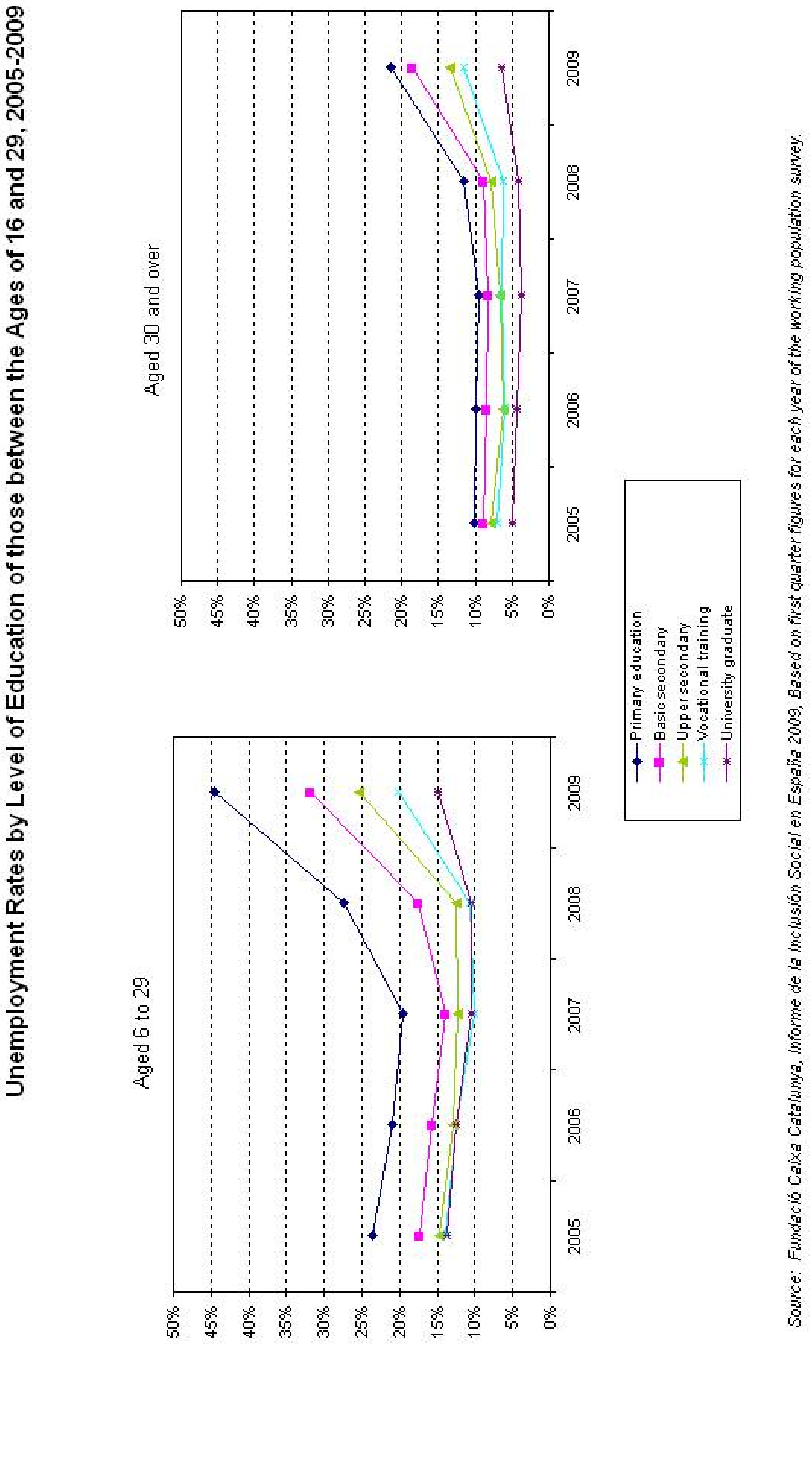
| | No foreign language | One foreign language | Two or more foreign languages |
|---|---|---|---|
| EU average (2) | 6.4 | 33.4 | 60.1 |
| Finland | 0.0 | 0.2 | 99.8 |
| France | 0.0 | 10.0 | 90.0 |
| Hungary | 1.0 | 57.2 | 41.8 |
| Italy | 1.5 | 73.9 | 24.6 |
| Poland | 0.8 | 19.9 | 79.3 |
| **Spain** | **3.9** | **67.8** | **28.3** |
| Sweden | 0.0 | 8.4 | 91.5 |
| UK | 51.4 | 42.5 | 6.1 |

(1) 2007.
(2) EU data exclude Germany, Greece, Cyprus and Portugal.
Source: Eurostat.

### *Recession Deepens Inequalities*

The share of households where all members of a family are unemployed doubled between the last months of 2008 and the first part of 2009 to 8% and the recession has also substantially widened the gap between the unemployment rate of those with solely basic education and that of those with higher education from around 10 percentage points to 30 percentage points (see Figure 5).

**Figure 5. Unemployment Rates by Level of Education of those between the Ages of 16 and 29, 2005-09**



These are some of the indicators in the annual report on social inclusion published by the Catalan savings bank Caixa Catalunya
(see [http://discoverynet.es/informe_inclusio/informe2009_castella.pdf](http://discoverynet.es/informe_inclusio/informe2009_castella.pdf)).

Among the immigrant population –which has risen by 6 million since the year 2000– the difference between the jobless rate of immigrants from developing countries and that of Spaniards and citizens from other EU and developed countries widened from 5 percentage points in 2005 to 15 percentage points in early 2009.

**The Economy**

*Tax Rates Raised in 'Austere' Budget*
The government announced tax increases and submitted to parliament what it called an 'austerity' budget for 2010 in a bid to get to grips with the massive deficit in public finances brought about by the fiscal costs of recession and social-protection expenditure. The tax rises represented a U-turn as only three months ago they were ruled out.

The budget deficit is officially forecast to rise from 3.8% of GDP in 2008 to 9.5% this year and then drop to 8.1% in 2010 and to the widely-ignored EU limit of 3% in 2012. In 2007 there was a budget surplus of 2.2% of GDP. Some economists believe the government's forecasts are optimistic. The official forecast for 2009, made when this year's budget was presented in September 2008, was a deficit of 1.9%. Public debt is predicted to shoot up to 62.5% of GDP (just above the Maastricht 60% recommended limit) from 53.4% this year and 39.7% in 2008, thereby eating up a greater proportion of revenue.

Spain is one of 12 EU countries whose public finances are at long-term high risk, according to a report by the European Commission. It has a 'sustainability gap' of 11.8% of GDP compared with the average EU level of 6.5% (see Figure 6). This means that the government will have to adjust its tax and spending plans by 11.8% of GDP, on a durable basis, to put its public finances on a sustainable path.

**Figure 6. Sustainability Gap of High-risk Countries (% of GDP)**

| Country | % of GDP |
|---|---|
| Ireland | 15.0 |
| Greece | 14.1 |
| UK | 12.4 |
| Slovenia | 12.2 |
| **Spain** | **11.8** |
| Latvia | 9.9 |
| Romania | 9.1 |
| Cyprus | 8.8 |
| Czech Republic | 7.4 |
| Slovakia | 7.4 |
| Malta | 7.0 |
| Netherlands | 6.9 |

Source: Europa.

Spain will be the last of the large economies to emerge from recession, according to the latest forecasts of the International Monetary Fund (IMF). The IMF predicted negative growth of 0.7% in 2010, higher than the government's forecast of 0.3% shrinkage (see Figure 7).

**Figure 7. IMF GDP Growth Forecasts, Selected Countries**

| | 2009 | 2010 |
|---|---|---|
| Euro zone | -4.2 | 0.3 |
| France | -2.4 | 0.9 |
| Germany | -5.3 | 0.3 |
| Italy | -5.1 | 0.3 |
| **Spain** | **-3.8** | **-0.7** |
| UK | -4.4 | 0.9 |
| US | -2.7 | 1.5 |

Source: IMF.

The rise in the standard VAT rate from 16% to 18% as of next July, higher rates on unearned income –up one percentage point to 19% and three points to 21% for annual earnings above €6,000– and the elimination of the €400 annual rebate introduced in the second half of 2008 for all 16 million taxpayers is designed to raise an extra €11 billion.

The top income-tax rate remains unchanged at 43% (see Figure 8). This rate is above the EU-27 average. In indirect taxes, however, Spain's main VAT rate is low by EU standards and two reduced rates (4% and 7%) apply to a sizeable share of the tax base. The rate for basic food items remains at 4%, while that for restaurants and hotels will rise one point to 8%. The overall tax burden increased by 3.2 percentage points between 2000 and 2007 to 37.1%, close to the EU-27 average.

**Figure 8. Top income Tax Rates (%) and Tax-to-GDP Ratios (%), Selected EU Countries**

| | Tax Rate 2000 | Tax Rate 2008 | Tax-to-GDP 2000 | Tax-to-GDP 2007 |
|---|---|---|---|---|
| Denmark | 59.7 | 59.0 | 41.9 | 48.7 |
| Sweden | 51.5 | 56.4 | 51.8 | 48.3 |
| Netherlands | 60.0 | 52.0 | 39.9 | 38.9 |
| Germany | 53.8 | 47.5 | 41.9 | 39.5 |
| France | 59.0 | 45.8 | 44.1 | 43.3 |
| Italy | 45.9 | 44.9 | 41.8 | 43.3 |
| **Spain** | **48.0** | **43.0** | **33.9** | **37.1** |
| UK | 40.0 | 40.0 | 36.7 | 36.3 |
| EU-27 | 44.7 | 37.8 | 37.2 | 37.5 |
| Bulgaria | 40.0 | 10.0 | 32.5 | 43.3 |

Source: Taxation Trends in the European Union 2009, Eurostat.

Spending on investment including infrastructure and R&D is set to decline 9.4% in nominal terms, while current expenditure including civil servants' salaries, debt payments and unemployment benefits will increase 17.8%. The largest item to grow is the payment of interest on public debt (+33%).

Unemployment benefits are estimated to cost €30,611 million, compared with €13,578 million budgeted for 2006, when the jobless rate was 8.5%. The number of unemployed registered in INEM's offices rose by 85,367 in September to 3.7 million, the second-worst September after that of 2008 since these figures began to be drawn up. According to the latest comparative figures, Spain's jobless rate was 18.9% in August, more than double the average OECD rate of 8.9%. The IMF and other international institutions predict the unemployment rate will peak at around 20%. The total number of Social Security contributors dropped below 18 million for the first time since May 2005.
The government's scientific research centres are due to suffer a 15% cut in their budget. In an open letter to the government, 50 biomedical researchers said Spain could not afford to 'cast aside university graduates and those with doctorates' and abandon projects that could not be resumed after Spain emerged from recession. The reduction sent a 'very negative message' to future generations of scientists.

The cuts do not sit well with the government's claim that it is seeking to change an economic model based excessively on construction and move towards one based more on knowledge. Ángel Gabilondo, the Education Minister, expressed his discontent by saying, 'When I was the rector of a university I said that convictions are expressed in budgets and now that I am no longer a rector, I also say it'. According to the latest comparative figures from Eurostat, Spain's public spending on education in GDP terms is amongst the lowest and unchanged since the year 2000 (see Figure 9).

**Figure 9. Public Spending on Education (% of GDP), Selected EU Countries**

| | 2006 | 2000 |
|---|---|---|
| Denmark | 7.98 | 8.29 |
| Sweden | 6.85 | 7.21 |
| France | 5.58 | 6.03 |
| UK | 5.48 | 4.46 |
| Poland | 5.25 | 4.89 |
| EU-27 | 5.05 | 4.88 |
| Italy | 4.73 | 4.55 |
| Germany | 4.41 | 4.46 |
| **Spain** | **4.28** | **4.28** |

Source: Eurostat.

Mariano Rajoy, the leader of the conservative Popular Party (PP), said the budget was a recipe for more unemployment, more deficits and more taxes. The government has until the end of the year to obtain approval for the budget. As the Socialists do not have a majority in parliament, they gained support for the budget by horse trading with regional parties.

Year-on-year consumer price inflation fell 1% in September, according to the National Statistics Office (INE). It has been negative since March. The government continued to deny any risk of deflation. Core consumer prices, which exclude energy and fresh food, increased 0.1% from a year earlier. That was the slowest pace since the current data series began in 2002 and lower than any reading on the previous series going back to 1986.

*Bank of Spain Governor Calls for Ambitious Reforms*

Miguel Ángel Fernández Ordóñez, the Governor of the Bank of Spain, stepped up his call for reforms in the labour market and other areas, without which, he said, Spain ran the risk of a long period of high unemployment and a weak economy.

Fernández Ordónez told the parliament's budget commission that no company or family that, like the government, spent 50% more than it earned could carry on that way for long. 'The leeway in budgetary policy is completely exhausted', he said. The government faces the Herculean task of slashing the budget deficit from 9.5% of GDP this year to 3% (the EU limit) in 2012. Unless there was a significant cut in unemployment, it would be very difficult to reverse the upward trend in public spending and ensure a sustained recovery in tax receipts.

The Governor urged the government to begin to plan how it was going to meet the 'medium-term challenges raised in overcoming the economy's most complicated situation in decades'. The growth model (excessively based on construction) had to be restructured as it was 'unsustainable' and ambitious reforms were needed in order to cut the budget deficit and reduce the EU's highest level of unemployment and recover the economy's potential growth rate.

He expressed particular concern at the surge in the public debt-to-GDP ratio and the difficulty in lowering it because the way in which it was done in the past –through low interest rates and high economic growth over a very long period– would not be available. Interest rates cannot go any lower; indeed, the Fed funds rate and the European Central Bank's repo rate will rise at some point.

*Government Fights for Better Deal for Opel*
The government is deeply unhappy with Magna International's plan to buy General Motors' Opel business in Europe as it fears the long-term future of Opel's large plant in Zaragoza is unduly threatened. Miguel Sebastián, Spain's Industry Minister, boycotted an inter-governmental meeting in Berlin on state financing for the deal and instead met with Siegfried Wolf, Magna's co-chief executive, in an attempt to hammer out conditions for Spain.

Meanwhile, the European Commission threw a spanner in the works when it warned that preconditions laid down for German aid for the deal appeared incompatible with EU rules.
While the UK appears to have reached an agreement with Magna, Spain still feels that it is bearing a higher proportion of the 10,500 planned job cuts than Germany, which brokered the deal, despite the Zaragoza plant being one of Opel's most productive plants. There are plans to move some production from Zaragoza to Eisenach, Germany.

*Authorities Deny Banks are Concealing the True Scale of their Losses*
Spain's banks, which have generally escaped the worst effects of the global crisis and continue to perform relatively well, are not recognising the full scale of their losses. As a result, they are not making sufficient provisions to cover the sharp rise in their bad loans, according to a report by Moody's Investors Services which annoyed the banking community.

The Bank of Spain responded by saying it did not allow banks to hide losses. Its stress tests on banks have apparently revealed no irregularities. José Manuel Campa, the Secretary of State for the Economy, said the report did not add to the pool of their information and the government had worked on a similar scenario when creating its bank recapitalisation and restructuring fund to avoid systemic risk. Miguel Martín, the head of the Association of Spanish Banks, called the report confusing.

Moody's said banks had set aside less than half the €108 billion in loan losses it estimated they would suffer. The banks still need to fund provisions of €57 billion on the basis of Moody's assumptions regarding the performance of key asset classes, earnings and available capital. Extrapolating the net loan loss provision cushions that have been built-up over the past six months (€6.3 billion), it would take banks close to five years to fully provision Moody's estimation of losses.

Banks have been buying up housing developments from insolvent construction companies hit hard by the collapse of the housing market and the non-performing loans (NPLs) of households have risen substantially.

The NPL ratio of the whole banking system was 4.93% at the end of August, the highest level since July 1996. The ratio for commercial banks was 4.41% and for savings banks 5.34%.

No Spanish bank is currently rated lower than Baa3 by Moody's (ie, they are all within the investment-grade category) and only one, Caja Castilla-La Mancha, a tiny savings bank, has so far been intervened.

*Santander's Brazil Listing, World's Largest Initial Public Offering*
Santander, the euro zone's largest bank by market capitalisation, raised €4.8 billion from the listing of a chunk of its Brazilian subsidiary, making it the world's largest initial public offering (IPO) this year.

The bank floated 16.2% of its Brazilian arm, giving it a market value of €34.2 billion, roughly the same as that of Germany's Deutsche Bank or France's Société Générale.

Aabar, an Abu Dhabi state-linked investment fund, invested €221 million in the depository shares issued by the Brazilian unit.

Santander acquired Banco Real in 2007 as part of its participation in the consortium that broke up ABN Amro, adding to the other bank it has in the country. The proceeds of the IPO will be used to expand in Brazil.

*Telefónica Outbids Vivendi for Control of Brazil's GVT*
Telefónica, the world's third-largest telecoms group by market value, launched a €2.6 billion bid for Brazil's GVT, which would enhance its already strong presence in Latin America's largest market. Telefónica's offer for 51% of GCT at R$48 per share represented a 14% premium over that of France's Vivendi media group.

GVT is a small and fast-growing provider of broadband and traditional fixed-line services with a market share of around 5%.

Telefónica already controls about 30% of Brazil's fixed line and mobile telephony markets, and the country is one of its priority growth areas.