

Inside Spain 55

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Foreign Policy

Zapatero Meets Obama, Agrees to Send More Soldiers to Afghanistan

Spain's Prime Minister, José Luis Rodríguez Zapatero, met President Barack Obama in Prague, ending the five-year stand-off between the White House and the head of the Spanish government caused by Zapatero's decision to withdraw Spain's peacekeeping troops from Iraq sent by his predecessor, José María Aznar.

Obama, in striking contrast to George W Bush and despite the friction caused by Spain's pull-out of troops from Kosovo (see below), said he was 'happy' to call Rodríguez Zapatero his 'friend. As if to emphasise the point, Obama put his arm on Zapatero's shoulder. The bilateral meeting, held during Obama's encounter in the Czech capital with EU-27 leaders, was the first time Zapatero had been officially received by a US president since he first took office in 2004.

Earlier, at the Nato summit meeting in Strasbourg with Obama, Rodríguez Zapatero agreed to send 450 more soldiers to Afghanistan to help guarantee security during the country's presidential elections in August. Spain will also send 40 paramilitary civil guards to help train the police force. The 450 troops will return once their mission is concluded and will not stay on and join the 778 Spanish troops already in Afghanistan. Zapatero is reluctant to increase Spain's military presence on a permanent basis or change the tight rules of engagement under which Spanish troops operate.

Rodríguez Zapatero and Obama also met in Turkey, the first Muslim country the US President decided to visit as part of his policy of reaching out to the Islamic world. Zapatero went to Istanbul for the first inter-governmental summit with Turkey, followed by a meeting of the 'Alliance of Civilisations', the UN-backed initiative co-chaired by Zapatero and Erdogan, to defuse tensions between the West and the Islamic world.

Both Obama and Rodríguez Zapatero expressed support for Turkey's bid to join the EU. Spain, unlike Germany and France, actively backs Turkey's membership bid, as do the UK and Italy, the other two big EU economies.

Spain's Troop Withdrawal from Kosovo Irks its Nato Allies

The government's decision to pull 630 peacekeeping troops out of Kosovo (see Figure 1) drew fire from the US State Department and Nato. Carme Chacón, Spain's Defence Minister, justified the move on the grounds that Spain has not recognised Kosovo's unilateral declaration of independence.

The State Department, in unusually strong language, said it was 'deeply disappointed' and recalled that Nato allies had agreed in 1999 to enter and leave Kosovo together. 'We are surprised by this decision', said spokesman Robert Wood. 'We were warned

just before it was announced publicly'. Jaap de Hoop Scheffer, the outgoing Nato Secretary-General, expressed his dismay at a meeting with Nato ambassadors.

Figure 1. Spanish Peacekeeping Troops Abroad (1)

	Number	Starting year of mission
Lebanon	1,100	2006
Afghanistan	778	2002
Kosovo	623	1999
Waters of Somalia	395	2009
Bosnia and Herzegovina	341	2004
Chad	84	2008
Democratic Republic of Congo	3	2001
Total	3,324	

(1) Start of mission in brackets.

Source: Defence Ministry.

Kosovo's independence, declared in February 2008, is recognised by 56 out of 192 UN members and by 22 of the 27 EU countries. The Socialist government's position on Kosovo, shared by the conservative Popular Party, was well known and reflected, to some extent, its concern not to fan separatism in the Basque Country and in Catalonia. The government also questions the legality of the move.

Chacón said the troops would leave by August and in 'perfect coordination' with Nato.

US Vice President Joseph Biden met Prime Minister José Luis Rodríguez Zapatero in Chile and said that despite the disagreement over Kosovo and the way in which the move was communicated Spain remained a solid ally.

All political parties in parliament –to the left and right of the Socialists and nationalist parties– criticised the government for the way in which it handled the Kosovo decision.

The Kosovo withdrawal will be the second pull-out of troops by Rodríguez Zapatero. In 2004, when first elected, he outraged the then President George W. Bush by fulfilling a campaign promise and bringing Spain's peacekeeping troops home from Iraq.

Domestic Scene

Rodríguez Zapatero Changes Cabinet in 'New Push' to Combat Recession

The Prime Minister, José Luis Rodríguez Zapatero, replaced six of his 17 ministers including Pedro Solbes (66), his highly experienced Finance Minister and a former European Commissioner, who had made no secret of his desire to quit politics.

Elena Salgado (59), the former Public Administration Minister, moved to the Finance portfolio and, like Solbes, is also the second Deputy Prime Minister. She is the first woman in Spain to be Finance Minister. She was Health Minister in Rodríguez Zapatero's first government and held positions in earlier Socialist governments between 1983 and 1996. Her two most pressing problems are a rapidly rising unemployment rate –at 15.5% in March, by far the highest in the euro zone– and an exhausted economic model, heavily dependent on construction and tourism, that needs to be changed.

Solbes questioned the wisdom of Rodríguez Zapatero's costly fiscal stimulus plans, which have had little impact so far, and saw no leeway for further expenditure. Spain's fiscal stimulus plan represents 4.5% of GDP, proportionately much higher than France and Germany (see Figure 2).

Figure 2. Total Size of Stimulus

	Amount (US\$ bn)	% of 2008 GDP	Tax cut share (%)
France	20.5	0.7	6.5
Germany	130.4	3.4	68.0
Italy	7.0	0.3	0.0
Spain	75.3	4.3	36.7
UK	40.8	1.5	73.0

Source: Eswar Prasad & Isaac Sorkin, 'Assessing the G20 Stimulus Plans', Brookings, March 2009.

Manuel Chaves, the former Premier of the Socialist regional government of Andalusia for the last 19 years and President of the Socialist Party, replaced Mrs Salgado in the renamed Ministry for Territorial Co-operation and was made third Deputy Prime Minister. His main task will be to negotiate the fractious issue of the new financing arrangement for Spain's 17 autonomous regions, a significant number of which are run by the conservative Popular Party (PP).

José Blanco, Deputy Secretary-General of the Socialist Party, replaced Magdalena Álvarez as Public Works Minister. His appointment meant that the top three positions in the Socialist party (Rodríguez Zapatero is Secretary-General) were, for the first time, in government, giving the cabinet more political weight.

Ángel Gabilondo, Rector of Madrid's Universidad Autónoma, is the new Education Minister, Trinidad Jiménez moved from being Secretary of State for Latin America to Minister of Health and Social Affairs, and the film director Ángeles González-Sinde is the new Culture Minister. Jiménez's main task is to speed up the funds that have been slow to arrive for people benefiting from the Dependency Law, passed by parliament in 2006. So far, 70% of the 893,712 requests to benefit from the law have been approved, but no figures have yet been released on how many are actually receiving aid.

Gabilondo takes over an education system that is in crisis, particularly secondary education (see story below). He also has to adapt Spain's universities to the Bologna process, which will create a European higher education area by making academic degree standards and quality assurance standards more comparable and compatible. University students and teachers have protested against it.

The reshuffle was the first once since Rodríguez Zapatero was returned to office in March 2008. Only four ministers have survived the four reshuffles since Zapatero first took office in 2004.

Spanish and French Police Arrest Head of ETA

Jurdan Martitegi Lizaso became the third head of the Basque terrorist group ETA to be arrested in five months when Spanish and French police forces detained him in Perpignan in south-eastern France. Martitegi became ETA's leader after the arrests of Aitzol Iriondo last December and Garikoitz Aspiaz Rubina in November. Two other people were detained with him.

Martitegi, born in 1980 (five years after the death of the dictator General Franco), was wanted by the police after he was caught on a security camera in November 2007 preparing a bomb that exploded near the Civil Guards barracks in Durango in the Basque Country. He had been on the run since then.

Alfredo Pérez Rubalcaba, the Interior Minister, hailed the arrests and said there was no longer any possibility of dialogue with ETA to end its 40-year struggle for independence for the Basque region of northern Spain and south-western France. ETA, which has killed more than 800 people, declared a so-called 'permanent' ceasefire in March 2006 which lasted until June 2007.

The new Basque government, run by the Socialists, will take office in May and, for the first time in 29 years, will be headed by a non-nationalist party. Rubalcaba said Martitegi planned to explode a car bomb on the day the new government took office.

The Basque Nationalist Party (PNV) did not win enough seats in the region's election in March to form a government on its own. The Socialists struck a deal under which the conservative Popular Party (PP) will support it in return for the PP's Arantza Quiroga becoming President of the Basque parliament. The PNV's loss of hegemony could produce a sea change in the way the Basque region is governed and the stance to be taken against ETA.

Attorney General Rejects Probe into 'Torture' at Guantanamo

Cándido Conde-Pumpido, Spain's Attorney General, rejected an attempt to bring a criminal case against six former US officials, including Alberto González, the former Attorney General, over torture allegations at Guantánamo Bay.

The Spanish judge, Baltasar Garzon had requested the Attorney General's advice on whether to investigate the officials following a complaint from human-rights lawyers who accused the officials of giving a legal justification for torture at the US detention centre.

Cándido Conde-Pumpido said the case had 'no merit' as they were not present when the alleged abuse took place and a trial would have turned Spain's National Court 'into a plaything' to be used for political ends.

Under the principle of 'universal justice', Spanish courts can prosecute people for crimes committed outside Spain. They have investigated alleged crimes in Argentina, Tibet, El Salvador and Rwanda.

Spain Ranked Almost Last in EU Ranking of Youth Education Attainment Level

Only 61% of people aged between 20 and 24 in Spain have acquired at least upper secondary education compared with an EU-27 average of 78%. Apart from Germany, Spain is the only country whose level of attainment declined between 2000 and 2007 (see Figure 3). The Czech Republic was ranked first and Portugal last.

Figure 3. Youth Education Attainment Level in the European Union, Selected Countries (1)

	2007	2000
Czech Republic	91.8	91.2
Poland	91.6	88.8
Finland	86.5	87.7
France	82.4	81.6
UK	78.1	76.7
EU-27	78.1	76.6
Italy	76.3	69.4
Germany	72.5	74.7
Spain	61.1	66.0
Portugal	53.4	43.2

(1) % of people aged between 20 and 24 with the equivalent of at least upper secondary education.

Source: Eurostat.

Education experts said one reason for the decline in Spain's attainment level is the influx of immigrants over the past decade, most of whom are under the age of 30. But even in 2000, when foreigners' share of Spain's population was only 2.3%, compared with more than 11% today, the country's education attainment level was still the second lowest after Portugal. And whereas Portugal's level improved by 10 percentage points between 2000 and 2007, Spain's dropped by five points. All but one of the central and eastern European countries (Rumania) that joined the EU in 2004 and 2007 have education attainment levels above the EU-27 average.

As a result of the collapse of the construction sector, which generated a disproportionate and unsustainable share of GDP (around 17% at its peak and accounting for 14% of the labour force), the government wants to create a more knowledge-based economy, but the low level of educational attainment is hindering its efforts.

Spain has Largest Share of Women in Parliament Among the Big EU Countries

Two-thirds of the members of Spain's parliament are women, the highest share among the large EU economies, according to the latest comparative figures from the Inter-Parliamentary Union (see Figure 4). Spain is ranked 10th out of 135 countries.

Figure 4. Women in Parliament (seats held as % of total) (1)

Country and ranking	Seats (%)	Number of seats
1. Rwanda	56.3	45
2. Sweden	47.0	164
3. Cuba	43.2	265
4. Finland	41.5	83
5. Netherlands	41.3	150
10. Spain	36.3	127
18. Germany	32.2	197
52. Italy	21.3	134
60. UK	19.5	126
66. France	18.2	105
World average	18.5	

(1) Lower or single house.

Source: Inter-Parliamentary Union. Based on figures provided by national parliaments at 28 February 2009.

The Economy

Bank of Spain Forecasts Much Deeper Recession than the Government

The Bank of Spain predicted the economy would shrink by 3% this year, almost double the government's 1.6% forecast made in January, and the unemployment rate would exceed 19% in 2010, more than twice the average predicted for the euro zone in the latest assessment by the Organisation for Economic Cooperation and Development (OECD).

'The Spanish economy is immersed in a period of deep contraction, where the unemployment rate, unless measures are taken, will rise to a very worrying level', said Miguel Ángel Fernández Ordóñez, the Bank of Spain's Governor. Fernández Ordóñez called for labour market reforms and warned of a looming crisis in the social security system as the surplus was rapidly disappearing. He called for the legal age of retirement to be raised and disincentives for early retirement. His remarks drew fire from the government, which denied the pensions system was in trouble.

The Bank said the general government budget deficit would rise to 8.3% of GDP this year (3.8% in 2008) and 8.7% in 2010, compared with the government's forecasts of 5.8% and 4.8%, respectively. The sharper deterioration is due, on the one hand, to higher spending on unemployment benefits and labour-intensive public works programmes and, on the other, to the fall in tax receipts. Public debt would increase from 38.5% of GDP in 2008 to close to 50% this year and around 60% in 2010.

The registered jobless rate continued to rise inexorably and for the first time in 16 years in March, traditionally a good month for employment. The total number of unemployed reached 3.6 million, 123,543 more than in February. Close to one million of the 3.6 million are not receiving unemployment benefits, either because people did not qualify for them or they no longer do so. The one glimmer of hope was that the rise in the number of unemployed in March was the lowest in six months. Nevertheless, it is widely assumed that there will be 4 million jobless by the end of the year.

Seopan, the association that represents the slumped construction sector, urged the government to increase spending on public works by €1 billion over the next two years.

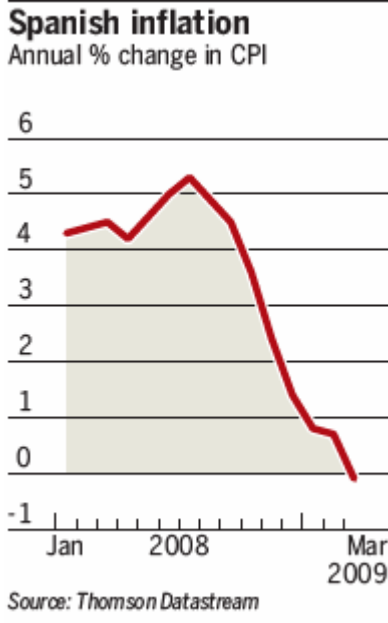
Spain Records First Negative Inflation in Euro Zone

The annual inflation rate fell to -0.1% in March, making Spain the first euro zone member to suffer negative consumer prices during the global crisis, according to the National Statistics Office. This was the first ever decline in Spain's annual inflation since records began in 1961.

The outgoing Finance Minister Pedro Solbes ruled out the risk of deflation which leads consumers and companies to hold back on spending as they wait for even cheaper prices. He said the main factor behind the fall was much lower oil prices. Spain is heavily dependent on imported energy. The Bank of Spain said the average inflation rate this year would be 0.2%, down from 3.8% in 2008.

In just six months Spain has moved from fears of stagflation to the possibility of deflation (see Figure 5).

Figure 5.



Despite the fall, trade unions are still defending a rise of more than 2% in salaries in wage bargaining agreements. Inflation was 1.4% in 2008, the lowest level in a decade. The CEOE employers association wants increases of no more than 1%.

Tourism Hit by the Global Recession

The number of tourists who came to Spain in the first two months was 13.1% lower, at 5.4 million, the worst start to the year since 1995 when Fontur began its current series of statistics.

The UK sent 22.1% fewer tourists, Germany 11.1% and France 7.2%. As well as the recession in the UK, Spain has become particularly expensive for UK tourists because of the sharp slide in sterling against the euro.

European Commission Gives Spain More Time to Reduce its Budget Deficit

The European Commission has given Spain until 2012 to reduce its spiralling budget deficit to 3% of GDP, the ceiling set in the Maastricht Treaty. Spain's deficit is forecast to exceed 6% this year and, according to some analysts, also in 2010.

Under Maastricht, governments are supposed to correct their deficit the following year (Spain's was 3.8% in 2008). Given the recession in the Euro zone, the Commission initially said the budget had to be corrected in 2011 and because of its severity in Spain the government won another year.

Government Comes to the Aid of Ailing Savings Bank

In the first such move in the current financial crisis, the government and the Bank of Spain came to the rescue of Caja Castilla La Mancha (CCM) with €9 billion of liquidity. The last time a bank was in crisis was in 1993 when the central bank took control of Banesto and subsequently sold it to Santander.

It was an open secret that it was only a matter of time before one or more banks got into difficulties. The country's commercial banks are relatively strong, but some of the 45

cajas –unlisted savings and loans institutions usually controlled by regional politicians– that account for around half the banking system are much weaker. This is because they are over-exposed in their lending to the battered property sector, several of whose largest companies are in the hands of banks because they cannot repay their loans.

The combined bad debts of commercial and savings banks reached 4.18% of their total lending in February, almost four times higher than a year earlier and the highest level in 12 years, but well below the 9.15% reached in December 1993 when the Bank of Spain took over Banesto.

The CCM accounts for less than 1% of the total assets of the financial system; its impact is thus not expected to be very significant unless it sets off a chain reaction among other *cajas*. Pedro Solbes, the Finance Minister, claimed there was ‘no other entity’ in Spain in similar circumstances. He said CCM’s management had not been ‘sufficiently cautious’ when lending to the construction sector.

The Bank of Spain dismissed the CCM’s board, headed by Juan Pedro Hernández Moltó, a former Socialist spokesman of the parliament’s Economy Committee in the 1990s, and sent in administrators.

CCM had been discussing a merger with Unicaja, the Andalusian savings bank. The € billion loan from the Bank of Spain, backed by a state guarantee, is more than twice the total in the deposit guarantee fund for all *cajas*. As they do not have shares, the *cajas* cannot be taken over by commercial banks.

Spain, unlike the US, the UK and other European countries, has not yet injected capital into any of the banks or nationalised them.

CCM’s problems could give rise to changes in the way the *cajas* are governed and reduce politicians’ influence on them. Miguel Ángel Fernández Ordóñez, the Governor of the Bank of Spain, said ‘the disputes of politicians in *cajas* are not at all positive because they complicate the situation and can cost taxpayers money’.

He warned that a prolonged international financial crisis could lead to the restructuring of some small and medium-sized institutions.

Car Sales Plummet 43% in First Quarter

The number of cars sold in the first three months (197,995) was 43.1% lower than in the same period of 2008, according to Anfac. This made the motor industry’s forecast of a 25% fall for the whole year look very optimistic.

House Prices Suffer Steep Fall

House prices fell 6.8% in the first quarter of 2009 compared with the same period of last year, according to the Housing Ministry. This was the fastest rate since records began in 1985. Analysts say the fall was much bigger because the real sale price is not always disclosed in order to reduce the tax on the transaction.

Spain’s rise in house prices between 1997 and 2008 of 184% was the third largest according to *The Economist* (see Figure 6). Credit Suisse said supply and demand in the housing market were out of kilter, with one in six people out of work and 1.5 to 2

million houses sitting unsold. It said the average Spanish home costs 7.2-times the average household's annual income, against 4.6-times in the UK and 3-times in the US. Spain's ratio of house prices to income, known as affordability, is the highest among OECD countries (see Figure 7). Despite falling prices, houses in Spain are still less affordable than in the past.

Figure 6.

The Economist's house-price indicators			
% change			
	Latest	Q4 2007	1997-
	on a year earlier	on a year earlier	2008*
Switzerland	3.7	2.0	24
Italy	1.1	5.1	104
France	0.8	5.7	152
China	-0.9	10.2	na
South Africa	-1.3	12.2	389
Sweden	-1.6	11.3	145
Japan	-1.8	-2.8	-33
Canada	-1.9	5.9	66
Germany	-2.5	-4.2	na
Spain	-3.2	4.8	184
Australia	-3.3	14.0	163
United States (OFHEO)	-4.5	0.6	84
Singapore	-4.7	31.2	na
Denmark	-4.9	1.2	119
Netherlands	-5.2	2.8	90
New Zealand	-8.9	8.0	102
Ireland	-9.8	-6.0	193
Hong Kong	-14.0	21.4	-35
Britain	-17.6	7.1	150
United States (Case-Shiller national index)	-18.2	-8.7	66
United States (Case-Shiller ten-city index)	-19.2	-8.3	102

*Or most recent available figure

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quoteable Value; Stadim; Swiss National Bank; Standard & Poors; government offices

Figure 7.



‘I think we are all aware that prices have not adjusted to their true value. This tendency shows the adjustment’, said Anunciación Romero, Director General at the Housing Ministry.

The number of homes foreclosed because their owners could no longer meet their mortgage payments more than doubled in 2008 to 58,686, according to the governing body of the Spanish judiciary, which forecast the number would exceed 76,000 this year.

Santander to Sell Stake in Oil Refiner Cepsa to Abu Dhabi’s Ipic

Santander, Spain’s biggest bank, is to sell its 32.5% stake in the oil refiner Cepsa to the International Petroleum Investment Company (Ipic) of Abu Dhabi for around €2.8 billion. The sale will see the end of Santander’s industrial portfolio so that it can concentrate solely on its banking business.

The bank has been trying to sell the stake for at least a year. Failure to do so was apparently one reason for its €7.2 billion capital increase via a rights issue last November, which boosted its core capital ratio.

Inditex To Reduce Growth in Stores

Inditex, Europe’s leading clothes retailer, is to open between 370 and 450 stores in the 12 months to the end of January 2010, compared with 573 in its 2008 financial year. The announcement was made by Pablo Isla, Inditex’s chief executive, when he reported virtually flat profits for 2008 at €1.25 billion.

At the end of January, Inditex has 4,264 stores around the world (see Figure 8). Its best-known brand is Zara. International sales accounted for 66% of total sales, up from 25% in 1994. Inditex’s sales surpassed those of the US retailer GAP for the first time (€10.4 billion vs. €10.04 billion).

Figure 8. Inditex Stores

	31 January 2007	31 January 2008	31 January 2009
Zara	1,175	1,361	1,520
Pull and Bear	467	519	583
Massimo Dutti	399	426	470
Bershka	433	510	591
Stradivarius	304	381	456
Oysho	201	290	374
Zara Home	152	204	239
Total	3,131	3,691	4,264

Source: Inditex.

Almost all the store openings this year will be outside recession-hit Spain, whose performance was one of the worst for the group, and Asia will be the main focus of new growth, particularly China.

Bank of Spain Deputy Governor to Head IMF's Monetary and Capital Markets

The International Monetary Fund (IMF) appointed José Viñals, Deputy Governor of the Bank of Spain, as its new Director of Monetary and Capital Markets Affairs. He will succeed Jaime Caruana, a Governor of the Bank of Spain between 2000 and 2006, who was recently named General Manager of the Bank for International Settlements.

Viñals' appointment is seen as further recognition of the prestige gained by the Bank of Spain for its prudent and strict management of the country's banking system. The Spanish banking system, by current international standards, is relatively healthy and solvent.