

## Inside Spain 59\*

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### **Foreign Policy**

#### *Chávez Visits Madrid, Announces Huge Gas Discovery, Bolivian Debt Cancelled*

Hugo Chávez, Venezuela's leftist President and a thorn in the flesh of previous and current US Administrations, visited Madrid at the end of a controversial international tour and announced that Spain's Repsol and Italy's Eni had made a very large offshore natural gas discovery.

The field could yield up to 8 trillion cubic feet of gas (equivalent to 1.44 billion barrels of oil), four times previous estimates and enough to supply energy-dependent Spain for more than five years. Venezuela's state-owned PDVSA will take a 35% stake in the development of the field and Repsol and ENI 32.5% each.

Chávez arrived in Madrid after visiting Turkmenistan, Belarus, Libya, Iran, Syria, Algeria and Moscow (where he was offered tanks and other weapons). He held talks with Prime Minister José Luis Rodríguez Zapatero and paid a call on King Juan Carlos whose newly grown beard he compared to that of his friend Fidel Castro. The monarch famously told Chávez in November 2007 at the Ibero-America summit to 'shut up' after he publicly called José María Aznar, Spain's Prime Minister between 1996 and 2004, a 'fascist'.

Hard on the heels of Chávez came President Evo Morales of Bolivia, his close ally. The main result of his first official visit to Madrid was an agreement for Spain to write off €60 million of debt. Rodríguez Zapatero said 60% of the debt would be forgiven outright, while 40% would go towards funding education projects. Spain is Bolivia's main donor country (€90 million this year).

While not linking the debt cancellation to anything, Rodríguez Zapatero asked Morales for a 'legal framework that provides guarantees' and 'security' for Spanish companies in Bolivia. Bolivia plans to nationalise its electricity sector and this is likely to affect some Spanish companies. The two leaders discussed the possibility of increased investment in Bolivia's nationalised energy sector where Spain's energy giant Repsol has interests.

Morales told a rally of Bolivian immigrants in a suburb of Madrid that if re-elected in December's elections he would defend the legalisation of undocumented Bolivians. According to the latest official figures, there were 227,000 Bolivians in Spain on 1 January 2009, less than half of whom are estimated to be in the country legally.

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\* The last Inside Spain was published on 21 July 2009.

The two countries also signed an accord under which Bolivians and Spaniards residing in each other's country could vote in municipal elections.

*Government Bars Honduran Officials from Entering Spain, Suspends Military Accord*

The government, one of the fiercest critics of the ousting of Honduran President Manuel Zelaya in June in the first military coup in Central America since the end of the Cold War, barred Honduran officials closely associated with the interim government of *de facto* President Roberto Micheletti from entering Spain.

Miguel Ángel Moratinos, Spain's Foreign Minister, said those who continued to block a negotiated accord based on the San José (Costa Rica) agreement and prevent the return of constitutional order and of Zelaya would not be allowed into Spain. He said the elections to be held in Honduras on 29 November would not be legitimate without Zelaya's presence. Meanwhile, Zelaya returned secretly to Honduras and took refuge in the Brazilian embassy. The government imposed a curfew.

The government also called off its military agreement with Honduras. As a result, 51 Honduran soldiers training in Spain before joining the Spanish contingent of the UN peace-keeping force in Lebanon were sent home. Spain assumed leadership of the multinational force on 15 August.

*Sharp Turnaround in Spaniards' Approval of US Foreign Policy*

Eighty-five percent of Spaniards approve of President Barack Obama's foreign policy, compared with only 11% approval of President Bush's foreign policy in 2008. After France, this is the biggest rise among the countries surveyed in the annual Transatlantic Trends by the German Marshall Fund of the United States (see Figure 1).

**Figure 1. US President Approval Ratings (%)**

	<b>Obama Approval 2009</b>	<b>Bush Approval 2008</b>
Germany	92	12
Italy	91	27
Netherlands	90	18
Portugal	90	2
France	88	11
<b>Spain</b>	<b>85</b>	<b>11</b>
UK	82	17
Belgium	72	10
Bulgaria	72	22
Slovakia	71	19
Romania	58	44
US	57	37
Poland	55	44
Turkey	50	8

Source: Transatlantic Trends, German Marshall Fund.

While only half of Spanish participants supported closer US-EU economic ties, Spain was the second-strongest supporter of closer relations (13 percentage points above the European average).

Of the countries surveyed, Spain has the largest number of participants (68%) who approve of increased support for economic reconstruction in Afghanistan, but only 26% agree with increasing the country's contribution of troops in that country. Fifty-four percent are in favour of reducing or withdrawing troops from Afghanistan (72% in Bulgaria, the highest figure, and 30% in the US, the lowest).

Spain currently has around 800 troops in Afghanistan and they are not involved, unlike US, British and Canadian soldiers, in the main areas of combat with the Taliban, although they have recently come under intensified attack (see Figure 2).

**Figure 2. Support for Greater Reconstruction in Afghanistan and for More Combat Troops (%)**

	Reconstruction	Troops
<b>Spain</b>	<b>68</b>	<b>26</b>
Italy	66	21
Netherlands	63	20
France	59	15
Portugal	56	31
Germany	55	13
Poland	50	13
Slovakia	51	11
UK	49	23
Bulgaria	46	6
Rumania	45	9
Turkey	40	27

Source: Transatlantic Trends, German Marshall Fund.

With regard to Turkey, whose full EU membership both main political parties support, the survey showed Spain, with 44%, as the second-highest country that believed Turkey shared enough common values to be part of the West.

## Domestic Scene

### *Recession Pushes Down Arrivals of Illegal Immigrants by Boat*

The number of immigrants caught entering Spain illegally by boat in the first seven month was 4,457, 40% lower than in the same period of 2008, according to provisional figures issued by the Interior Ministry.

In the Canary Islands, the favourite landing spot for Africans, particularly from the Sub Sahara, only five *sin papeles*, as they are called, arrived by *cayuco* in August, the lowest number in 10 years. The five were Moroccan and a sixth person died at sea before reaching Tenerife.

Spain's recession and an unemployment rate of 18% and the patrolling of the African coast by ships of Frontex, the EU agency responsible for external borders, are discouraging illegal immigration.

There was also a significantly smaller rise in the number of children of immigrants who registered in schools for the 2008-09 academic year. Their number was 743,696 (6% more than in 2007-08). The increase in 2007-08 over 2006-07 was 15%. Many Ecuadorean parents took their children out of school during the summer and sent them back to their home country.

### *Improvements and Failings in Educational Attainment*

Spain now has, for the first time, more adults with an educational attainment above that of compulsory secondary education than below it, according to the OECD's annual Education at a Glance report (see Figure 3). The respective figures are 51% and 49%. But the country still lags behind and, most worryingly, one in three schoolchildren do not complete their basic education.

**Figure 3. Educational Attainment of Adult Population (1) in Selected Countries (% of total)**

	Below upper secondary	Upper secondary and post-secondary non-tertiary	Tertiary
US	12	48	40
UK	14	54	32
Germany	16	60	24
Finland	19	44	36
OECD average	31	42	27
France	31	42	27
Italy	47	39	13
<b>Spain</b>	<b>49</b>	<b>22</b>	<b>29</b>
Turkey	71	18	11

(1) Aged 24-64 years and figures for 2007, the latest year.

Source: Education at a Glance 2009, OECD.

Ten years ago, the proportion of adults that had only completed compulsory secondary education and had not studied further was 69%. As of 2007, it has been below 50%, a substantial improvement (see Figure 4). Nevertheless, among OECD countries, only Mexico, Portugal and Turkey have lower attainment levels than Spain.

**Figure 4. Below Upper Secondary Education Trends, 1997-2007 (% of total)**

	1997	2007
US	14	12
UK	41	32
Germany	17	16
Finland	32	19
OECD average	37	30
France	41	31
Italy	59(1)	48
<b>Spain</b>	<b>69</b>	<b>49</b>
Turkey	79	71

(1) Figure for 1998. No figure available for 1997.

Source: Education at a Glance 2009, OECD.

Another weak area is Spain's low proportion of top performers on the science scale in the Programme for International Student Assessment (PISA), a significant shortcoming if Spain wants to build a more knowledge-based economy to replace the over-extended construction sector. Less than 5% of 15-year olds in Spain, along with those in Greece, Italy, Mexico, Portugal and Turkey, were top performers in the latest assessment compared with more than 13% in countries such as Canada, Finland, the Netherlands and the UK. Vocational training participation levels also leave a lot to be desired.

#### *Judge Testifies in Supreme Court over Controversial Franco Inquiry*

Baltasar Garzón, who tried to have General Pinochet, the former Chilean dictator, extradited from the UK to Spain, appeared before the Supreme Court after he was accused by a right-wing group of exceeding his official remit by seeking to investigate what he called 'crimes against humanity' committed during the rule of General Franco.

He ordered several mass graves to be reopened to investigate the disappearance of more than 100,000 people during and after the 1936-39 Spanish Civil War. The inquiry was shelved following opposition from state prosecutors and his fellow judges.

Garzón was greeted at the Court by supporters and opponents, exemplifying the divisiveness created by his crusade.

*Manos Limpias* (Clean Hands) alleged that Garzón was not entitled to ask government departments to hand over papers from the Franco period.

## **The Economy**

### *Taxes to be Raised to Stem Ballooning Budget Deficit*

The huge budget deficit (close to 10% of GDP this year) and the need to gradually bring it down to the 3% deficit limit set by the EU are forcing the government to raise taxes. The details have yet to be announced, but are expected to include an increase in VAT and on capital gains and possibly higher income-tax rates for the better off. The €400 tax rebate, effective as of 2008, is likely to be eliminated.

Government spending has soared in the last year in order to ease the worst effects of the recession (see the story below), while revenue has fallen. In 2007, there was a budget surplus of 2.2% of GDP and last year a deficit of 3.8%. Without a considerable rise in revenue, it is impossible to reduce the budget deficit as a significant part of it is for education, health and social spending and politically sensitive to cuts.

‘I believe in helping those who most need it, and if in order to help the needy those who can most afford it have to tighten their belts in times of hardship, then we must say so clearly to the public’, said José Blanco, the Public Works Minister and Deputy Secretary General of the Socialists.

Duties on fuel and tobacco were raised in June and ministers denied the need for tax rises.

The conservative Popular Party (PP) opposes tax rises and has called for ‘austerity’, without defining very clearly what it would do other than abolish some government posts whose impact would be minimal.

The National Statistics Institute (INE) revised last year’s GDP growth down to 0.9% from 1.2%. The economy is officially forecast to shrink 3.6% this year.

Year-on-year inflation in August was 0.8% negative, the sixth consecutive month of decline but above the record low of -1.4% in July.

### *Government Agrees Special Unemployment Subsidy*

The government, faced with the EU’s highest jobless rate, agreed to grant a monthly subsidy of €420 to those whose unemployment benefits ran out as of the beginning of the year and whose income from other sources is less than 75% of the official minimum wage.

The seasonally-adjusted jobless rate of 18.5% at the end of July remained at more than double the average of the EU-27, according to the latest comparative and harmonised figures released by Eurostat, the EU’s statistical office, based on labour force surveys (see Figure 5). Spain’s rate rose by seven percentage points in the year to July and is by far the highest in the EU, followed by tiny Latvia with 17.4%. The Netherlands has the lowest rate (3.4%). One in four of the more than 4 million unemployed in Spain has been out of work for more than a year.

The number of unemployed registered in INEM’s offices in August rose by almost 85,000 to 3.6 million, wiping out the improvement in the previous three months and despite the 400,000 short-term jobs created by the government’s €1 billion

infrastructure programme, known as the E Plan, and the tourist season. The number of tourists who came to Spain in July was 6% lower than in the same month of 2008 at 6.6 million.

The only positive news on the jobless front was that the rise in the number of registered unemployed in August was less than in the same month of 2008 (103,000).

**Figure 5. Seasonally-Adjusted Unemployment Rates in Selected EU Countries (%)**

	July 2008	July 2009
<b>Spain</b>	<b>11.4</b>	<b>18.5</b>
France	7.8	9.8
Germany	7.2	7.7
Poland	7.0	8.2
Sweden	5.7	9.2
Netherlands	2.7	3.4
EU-27	7.0	9.0
Euro zone	7.5	9.5

Source: Eurostat.

The government bowed to pressure from left-wing and nationalist opposition parties and from trade unions and agreed to grant a monthly subsidy of €420 to those not receiving any benefits as of 1 January, instead of 1 August as it had initially proposed. The move is expected to benefit around 600,000 people, 255,000 more than the number estimated on the basis of the 1 August date, and cost €1.3 billion.

The agreement should make it easier for the government, which does not have an absolute majority in the parliament, to gain approval for its austere 2010 budget.

In youth unemployment (under 25's), Spain's rate is 38.4%, followed by Hungary with 25.8% (see Figure 6). Most of these people are first-time job seekers as opposed to those who have lost their jobs.

**Figure 6. Seasonally Adjusted Youth Unemployment Rates in Selected EU Countries (%)**

	July 2008	July 2009
<b>Spain</b>	<b>25.0</b>	<b>38.4</b>
France	19.3	24.2
Germany	9.6	11.2
Poland	16.6	19.8
Sweden	17.7	27.3
Netherlands	5.3	6.6
EU-27	15.4	19.8
Euro zone	15.4	19.7

Source: Eurostat.

While the pace at which unemployment has been rising has slowed down, Celestino Corbacho, the Labour Minister, warned that the jobless rate would probably continue to rise in the autumn. The Paris-based OECD annual employment outlook, released on 16 September, predicted Spain's jobless rate would reach almost 20% by the end of 2010. It forecast Spain will have shed 2.7 million jobs between the end of 2007 and the end of 2010, almost as many as Germany (1.8 million) and France (1.0 million) combined, although the Spanish economy is much smaller.

As well as the monthly aid, the government changed private pension scheme regulations in order to allow those unemployed without benefits to draw on these funds.

### *Spain Slips in Competitiveness and Business Rankings*

Spain fell 11 places in the World Bank annual Doing Business report and it slipped four places in the latest Global Competitiveness Index of the World Economic Forum (WEF).

It was ranked 62<sup>nd</sup> out of 183 countries by the World Bank (see Figure 7), between Kuwait and Kazakhstan, and making it one of the most difficult countries in the developed world in which to conduct business. Among OECD countries, Luxembourg, the Czech Republic, Italy and Greece are below Spain. The latest report covers the period June 2008 through May 2009.

**Figure 7. Doing Business Survey, Selected Countries**

	2010 rank (1)	2009 rank (1)	2008 rank (1)
Singapore	1	1	1
US	4	4	3
UK	5	6	6
Finland	16	14	13
Germany	25	27	20
France	31	31	31
<b>Spain</b>	<b>62</b>	<b>51</b>	<b>38</b>
Italy	78	65	53

(1) Out of 183 countries for the 2010 report and 181 for the 2009 and 2008 reports.

Source: World Bank.

The Doing Business ([www.doingbusiness.org](http://www.doingbusiness.org)) ranking is based on 10 components including starting and closing a business, employing workers, obtaining credit and protecting investors. Spain's main strength for investors continued to be the ease of closing a business (19<sup>th</sup> position) and its chief weakness employing workers (157<sup>th</sup>), the lowest ranking in the EU. In opening a business (146<sup>th</sup>) Spain is also the worst placed in the EU.

Invest in Spain, the government agency for promoting foreign direct investment in the country, took issue with the low ranking and said its 'methodological inconsistencies' particularly affected Spain and the regulatory changes recently explained to the World Bank had not been taken into account. It expressed incredulity at Georgia's ranking as 11<sup>th</sup> in the league table.

In the WEF's ranking ([www.weforum.org/pdf/GCR09/GCR20092010fullreport.pdf](http://www.weforum.org/pdf/GCR09/GCR20092010fullreport.pdf)), Spain was placed 33<sup>rd</sup> (see Figure 8). The WEF said Spain's competitiveness performance continued to be boosted by the large domestic market (13th), strong technological adoption (29th in the technological readiness pillar), first-class infrastructure (22nd), and good-quality higher education and training (33rd), but there had been a measurable weakening of the country's macroeconomic stability, dropping from 30th to 62nd place. The greatest area of concern remained the highly inflexible labour market (122nd), which discourages job creation. Particularly striking, given the praise accorded to Spain's banks by world leaders, was the note that the Spanish financial sector pillar had fallen 14 positions to rank 50th. The collapse of the construction sector, as a result of the explosion of the housing bubble, has caused a sizeable hole in the balance sheets of financial institutions.

**Figure 8. Global Competitiveness Index, Selected Countries**

	2009-10 rank	2008-09 rank
Switzerland	1	2
US	2	1
Germany	7	7
UK	13	12
France	16	16
Chile	30	28
<b>Spain</b>	<b>33</b>	<b>29</b>

Source: World Economic Forum.

#### *Moody's Affirms Triple-A Rating*

Despite Spain's woes, Moody's affirmed Spain's top government bond rating of AAA, but warned that a credible exit strategy from its ballooning budget deficit was needed if it was to keep it.

The ratings agency said it did not expect the government to meet its commitment to cut its deficit to the EU ceiling of 3% of GDP by 2012.

#### *Spanish Stock Market Soars*

Although the Spanish economy is one of the hardest hit in the EU, the Madrid stock market has outperformed virtually all other markets in the developed world. The Ibex-35 rose 27.5% between 1 January and 21 September compared with a gain of 15.8% in the FTSE 100 (London), 17.8% in Dax (Frankfurt), 17.3% in the Euro Stoxx 50, 11.4% in the Dow Jones, 35.6% in Nasdaq and 17.0% in the Nikkei.

The Spanish stock market has been heartened by macroeconomic data that seem to show that the recession is bottoming out and by better than expected corporate earnings in some of the biggest companies in the Ibex-35, particularly the well-managed Banco Santander and BBVA, which have largely escaped the worst effects of the global banking crisis.

Their shares have risen by more than 150% since the lows reached on 9 March. Along with other large cap companies in the index such as Telefónica, Repsol and Iberdola their ups and downs have a considerable bearing on the Ibex-35. The weighting of these five companies in the index is around 70% and that of just Santander and BBVA 44%.

With rock-bottom official interest rates making bank deposits unattractive and a collapsed property market, investors are returning to the stock market in order to put their liquidity to better use. Whether the market is overvalued and its rise unsustainable is an open question.

#### *Foreign Direct Investment Flows in Spain, Fourth Highest Globally*

Spain received a record US\$65.5 billion of inward investment in 2008, more than double that in 2007 and the sixth highest in the world, while its outward investment amounted to US\$77.3 billion, the eighth largest (see Figures 9 and 10), according to the latest comparative figures of the annual World Investment Report by the United Nations Conference on Trade and Development (UNCTAD).

Inward investment was driven by several higher-value cross-border mergers and acquisitions, such as the US\$18 billion purchase of the Spanish cigarette producer Altadis by British Imperial Tobacco.



**Figure 9. Top 10 Countries by Inward Direct Investment Flows, 2008**

Country	US\$ billion
1. US	316,112
2. France	117,510
3. China	108,312
4. UK	96,939
5. Russian Federation	70,320
<b>6. Spain</b>	<b>65,539</b>
7. Hong Kong, China	63,003
8. Belgium	59,680
9. Australia	46,774
10. Brazil	45,058

Source: World Investment Report 2009, UNCTAD.

**Figure 10. Top 10 Countries by Outward Direct Investment Flows, 2008**

Country	US\$ billion
1. US	311,796
2. France	220,046
3. Germany	156,457
4. UK	111,411
5. Japan	128,020
6. Switzerland	86,295
7. Canada	77,667
<b>8. Spain</b>	<b>77,317</b>
9. Hong Kong, China	59,920
10. Netherlands	57,571

Source: World Investment Report 2009, UNCTAD.

Spain's stock of inward investment stood at US\$634,788 million at the end of 2008, 39.6% of GDP and the sixth highest among developed countries. The outward investment stock was US\$601,849, 37.5% of GDP (see Figure 11). In GDP terms, Spain's inward investment stock was three times higher than in 1990 and the outward investment stock 12 times higher.

**Figure 11. Inward and Outward Stocks of Direct Investment 2008, Selected EU Countries (% of GDP)**

	UK	France	Germany	Spain	Italy
Inward stock	56.7	48.9	39.8	<b>37.5</b>	22.5
Outward stock	36.9	34.7	19.2	<b>39.6</b>	14.9

Source: World Investment Report 2009, UNCTAD.

### *US Firms in Spain Gloomy on Prospects*

The degree of satisfaction of US companies in Spain, a significant force in the economy, with the state of their businesses has declined considerably over the last year, according to the 2009 barometer drawn up by the American Chamber of Commerce in Spain and the ESADE business school.

Twenty one percent of companies surveyed said they were dissatisfied, compared with 7% in 2008 and 8% in 2007. Satisfied companies represented 44% of the total surveyed, compared with 81% in 2008 and 78% in 2007. One-third of companies said they were reducing their investment plans this year. The situation was very different in 2008 when only 12% said they could not maintain their investment plans and 22% said they might invest more than initially planned.

The sectors most dissatisfied were the motor industry, chemicals and to some extent basic metallurgy. In the motor industry, a major exporter and which includes Ford and General Motors, 100% of replies to the questions were negative and 88% in chemicals.

Among the worst assessed features of the Spanish economic environment were labour laws and the way in which they are applied.

### *Telefónica Consolidates Links with China Unicom*

Telefónica, the third-largest telecoms group by customers (see Figure 12), and China Unicom entered into a cooperation and share swap agreement. Each company will buy US\$1 billion worth of shares in each other, giving Unicom 0.88% of Telefónica and raising Telefónica's stake in Unicom from 5.38% to 8%. This is the first time a Chinese telecoms group has taken a stake in a European operator.

**Figure 12. World Ranking of Telecom Operators by Total Accesses (1)**

	<b>Total Accesses (million)</b>
1. China Mobile	493.1
2. Vodafone	320.1
3. China Telecom	287.7
<b>4. Telefónica</b>	<b>263.9</b>
5. América Móvil and Telmex	234.8
6. Deutsche Telekom	216.3
7. France Télécom	186.0
8. AT&T	152.7
9. TeliaSonera	139.4

(1) June 2009.

Source: Companies.

Unicom, like Telefónica an integrated fixed-line and mobile server, hopes to use its broader alliance with Telefónica to enter Latin America, where China is seeking to secure further supplies of metals and hydrocarbons.

The companies plan to cooperate in areas such as the joint acquisition of infrastructure and equipment for customers, the joint development of wireless service platforms, the joint provision of services to multinational enterprises, roaming, R&D, sharing of best practices and technical, operational and management expertise, the joint development of a set of strategic initiatives within the framework of network and technology development, as well an exchange program for managers from both companies.

### *BBVA Expands its US Footprint*

BBVA, Spain's second-largest bank, acquired the distressed Texan bank, Guaranty Financial, auctioned by the Federal Deposit Insurance Corporation. Added to its purchases of other small banks as of 2004, the latest acquisition creates the 15<sup>th</sup>-largest commercial bank in the US.

The operation has increased the number of BBVA's customers in the US by 21% and has added €8.37 billion of assets, €1.5 billion of deposits and 164 branches in Texas and California for a total of 750. The purchase melds well with BBVA's 2007 purchase of Compass, which has nearly 600 branches over Texas, Alabama, Arizona, Florida, Colorado and New Mexico. BBVA Compass is now the fourth-largest bank in Texas with a market share of 6.4%.

BBVA, the main domestic rival of Santander and like it largely unscathed by the global financial and economic meltdown, has been much slower than its bigger competitor to seize opportunities arising from the crisis. In the last 18 months Santander bought at a knockdown price the 75% of Philadelphia-based Sovereign Bancorp that it did not already control, acquired in the UK Alliance and Leicester and parts of Bradford and Bingley and was the sole beneficiary of the ill-fated three-way take-over of ABN Amro.

### *Santander Floats Part of its Brazilian Bank*

Santander, the euro zone's largest bank by market capitalisation, is to sell 16% of its

bank in Brazil in an initial public offering (IPO), and use the proceeds of as much as US\$5.6 billion to expand its network of branches and ATMs in Latin America's largest market.

It acquired Banco Real as part of its participation in the €72 billion purchase and break-up of ABN Amro in 2007 and 2008, doubling the size of its operation in Brazil and becoming the fourth-largest bank in the country, with a 10.2% market share of assets. Brazil contributed 18% of Santander's global attributable profit in the first half of 2009.

Santander plans to add 600 branches by 2013 to its current network in Brazil of 2,019 branches.

#### *Sabadell Acquires Another Bank in Florida*

Banco Sabadell, based in Catalonia, bought its second bank in Florida, Mellon United National Bank (MUNB), for €101 million. This small bank will be merged with its previous purchase, Trans Atlantic Bank, to create the sixth-largest bank in Florida with deposits of around €1.75 billion.