



## **Inside Spain 50**

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### **Foreign Policy**

#### *Zapatero Wins Bid to Attend G-20 Summit*

José Luis Rodríguez Zapatero, the Prime Minister, won his hard-fought battle to be invited to the G-20 summit in Washington on 14-15 November after Nicolas Sarkozy ceded one of the two seats his country qualifies for. France is a G-7 member and also currently holds the EU presidency.

‘It is difficult for me to justify that the world’s eighth-largest economy is not at the meeting’, Sarkozy said at the EU meeting in Brussels devoted to the global economic crisis.

Spain was far too underdeveloped to join the G-7 when it was formed in 1976, the year after General Franco died, and too developed to join the group that formed the G-20 between 1997 and 1999. Furthermore, George W Bush has kept Rodríguez Zapatero at arm’s length since he withdrew Spain’s peacekeeping troops from Iraq in 2004 (he is virtually the only EU head of government not to have set foot in the White House).

Rodríguez Zapatero gained the support of Gordon Brown, the UK’s Prime Minister, President Hu Jintao of China and President Luiz Inácio Lula da Silva of Brazil, among others, for attending the G-20 summit. His attendance at the world’s top table became a Spanish national obsession and a matter of pride. Even the opposition Popular Party, usually quick to seek political advantage whenever it can, supported Rodríguez Zapatero’s bid.

Not only has Spain become over the past 30 years the world’s eighth-largest economy in nominal terms, but its banking sector has been widely praised abroad for escaping the current crisis thanks to the exemplary supervision and regulation of the Bank of Spain and the sensible policies of the banks’ top management teams.

Rodríguez Zapatero hopes Spain’s presence at the G-20 summit will enhance its position in the groupings of countries that could emerge in a new global architecture.

#### *Barcelona to be Headquarters of new Union for the Mediterranean*

Barcelona is to house the headquarters of the new union between Europe and southern Mediterranean countries in the city’s historic Palace of Pedralbes. Spain was chosen over Tunis, Brussels and Valetta (Malta).

The Union for the Mediterranean, formerly known as Barcelona Process Union for the Mediterranean, in deference to the Barcelona Process, an existing EU initiative that began in 1995 but failed to deliver on expectations, consists of 43 countries (the EU-27

plus countries as diverse as Turkey, Israel and Syria). The Arab bloc will be able to attend all meetings but will not have voting rights because of objections by Israel, according to reports.

#### *Zapatero Accepts Invitation to Visit Cuba*

José Luis Rodríguez Zapatero, the Prime Minister, who played a key role in persuading the EU to lift diplomatic sanctions against Cuba, is expected to visit the island next year. The invitation was announced during a visit to Madrid by Felipe Pérez Roque, Cuba's Foreign Minister.

The EU imposed sanctions in 2003 after Fidel Castro jailed 75 dissidents, 55 of whom remain in prison. The measures were lifted in June. A total of more than 200 dissidents are still serving jail terms in Cuba.

Spain also agreed to fund a two-year €24.5 million programme to help Cuba rebuild homes, schools and infrastructure destroyed by hurricanes Gustav and Ike this summer and to restructure part of Cuba's €1.5 billion debt with the Spanish government, as well as open up a new line of credit worth up to €100 million. Spain turned off the credit tap in 2001 because of the debt.

Flanked by Miguel Ángel Moratinos, Spain's Foreign Minister, Pérez Roque said there were no prisoners in Cuba for 'thinking differently' and that journalists could 'work freely'. The government believes its pragmatic policy is the most constructive one for Cuba.

While Pérez Roque visited Madrid, the Popular Party (PP) organised a meeting at its headquarters of opponents of the Cuban regime who live in the city. The meeting was partly in response to the decision of the Spanish embassy in Havana not to invite dissidents to the 12 October national day celebration. Jorge Moragas, the PP's Secretary of International Relations, called on the government to end what he called its hypocritical policy.

#### *Defence Minister to Seek End to Ceiling on Troops Abroad, Two Soldiers Killed in Afghanistan*

Carme Chacón, Spain's Defence Minister, said she would ask Parliament to remove the limit on the number of Spanish peacekeeping troops that can be abroad at any one time. The ceiling was set at 3,000 in 2005.

In order to maintain current troop strengths abroad and come through with an offer to reinforce the EU's anti-pirate force off Africa, the ceiling needs to be removed or increased. Spain sent 90 soldiers and a P-3 Orion maritime patrol aircraft to the French base in Djibouti in September and has offered to send a frigate and more soldiers.

There are currently more than 1,000 Spanish troops in the Lebanon, 780 in Afghanistan, 585 in Kosovo, 378 in Bosnia and 88 in Chad.

Two Spanish soldiers were killed and four others injured after a suicide bomber rammed an explosives-laden van into a military convoy in Afghanistan. More than 20 Spanish troops have died in Afghanistan, including two in an explosion in September 2007 and 17 in a helicopter crash in August 2005. In May 2003, 62 Spanish peacekeeping troops

returning from Afghanistan and other nearby countries died when their plane crashed in Turkey.

## **Domestic Scene**

### *Court Orders Judge to Halt Exhumations of Mass Graves*

A court overruled the controversial decision of Judge Baltasar Garzón to exhume the mass graves of people killed by the supporters of General Franco during the 1936-39 civil war and the dictatorship that followed it. It also paralysed the judge's case against the Franco regime for crimes against humanity.

Garzón was challenged by the Attorney General's office which argued his case was the responsibility of the Supreme Court, as there had been an amnesty in 1977, two years after Franco's death, for crimes committed during the dictatorship and because international human rights laws do not apply to the civil war as Spain was not signed up to them at the time. Ten judges out of a panel of 15 at the National Court said Garzón's case could not resume until the court rules on whether he has jurisdiction.

Garzón's decision followed the presentation to him by associations representing families of the missing of a list of 133,708 disappeared people, 114,266 of whom the judge said were sent to their death by Franco's death squads, military courts and other tribunals between 17 July 1936 (the day before Franco's uprising against the democratically-elected left-wing government of the Republic) and December 1951 (12 years after the end of the civil war). He ordered the opening of 25 mass graves, including one near Granada that is believed to contain the remains of the poet Federico García Lorca, who was shot in 1936. Digging is well advanced on most of them.

Garzón believes he is on firm legal ground because where a person was detained and later disappeared, a crime of kidnapping is still being carried out today if the body has not been found. Thus anyone who took part in such a kidnapping can now be put on trial. Courts in Chile have used the same criteria to convict hundreds of those involved in the Pinochet regime. Garzón succeeded in having General Pinochet arrested in London in 1998 but failed to get him extradited to face trial in Spain for the disappearance of Spaniards in Chile.

While the Franco regime honoured its own dead after the civil war, tens of thousands of its opponents were buried in hundreds of unmarked graves across the country, according to victims' rights associations. Their cause received a boost in 2007 when Parliament approved the Law of Historical Memory which, for the first time, recognised the victims of the civil war and dictatorship and obliges local administrations to cooperate in the search for victims. Very few, if any, of the people responsible for the crimes on Franco's side are alive today, however.

### *Government Offers Spanish Nationality to Political and Economic Exiles*

The children and grandchildren of Spaniards who went into exile between the beginning of the Civil War in 1936 and 1955, the date established for the end of the 'immediate post-war', for political or economic reasons will be able to seek Spanish nationality.

The measure, approved by the cabinet, is part of the 2007 Law of Historical Memory. It is estimated that 500,000 people could benefit from the move.

*Poverty Levels ‘Remain Despite Strong Growth’ but Income Inequality Declines*

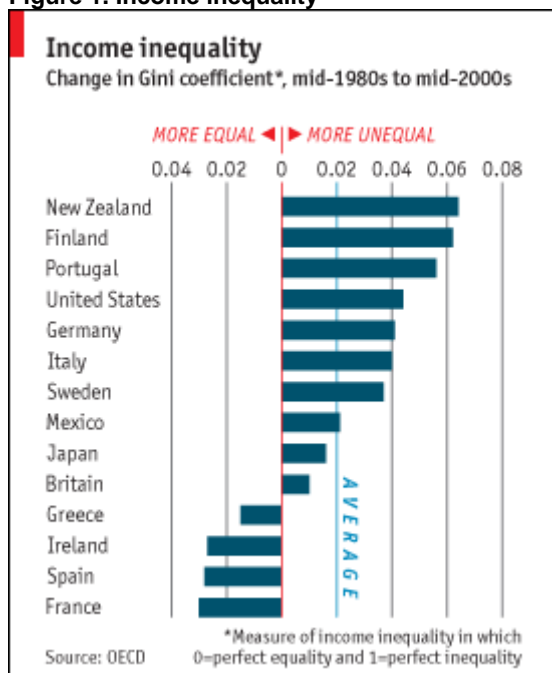
Spain has the same proportion of people living in poverty today as 10 years ago, despite a long period of strong economic growth.

According to a report by FOESSA, the monthly income of 8.5 million people (19.7% of the population) is less than €574. Its study, the seventh since 1965, uses the same figure as the National Statistics Office to define poverty –annual income of less than €6,895 (60% of the average net income)–. Another 1.5 million live in ‘extreme poverty’ (monthly income of less than €280).

‘Spain’s experience seems to contradict the stereotype that the best way to foster wellbeing is to achieve high rates of growth and strong job creation’, says the report.

Nevertheless, Spain (and France) recorded the largest falls in income inequality in rich countries between the mid-1980s and the middle of this decade, according to a report by the OECD (see Figure 1). The Gini coefficient, which measures the spread of income levels, rose by an average of 0.02 (or 7%) for the 24 countries that made data available. While the US and New Zealand saw large increases from an already unequal base, Spain’s income inequality declined by 0.03. Spain’s Gini coefficient is 0.32 (0 is perfect equality and 1 perfect inequality), the 16<sup>th</sup> highest out of 30 countries (see Figure 2).

**Figure 1. Income inequality**



**Figure 2. Gini Coefficient and Ranking of Selected Countries**

	Gini coefficient
1=. Denmark	0.23
1=. Sweden	0.23
13. France	0.28
15. Germany	0.30
<b>19. Spain</b>	<b>0.32</b>
23. UK	0.34
25. Italy	0.35
27. US	0.38
30. Mexico	0.47

Source: OECD report *Growing Unequal?*

## The Economy

### *Spain on the Verge of Recession*

Spain's long period of strong economic growth officially came to an end. The Bank of Spain estimated the economy shrank by 0.2% in the third quarter over the second quarter. This was the first quarterly contraction in 15 years. Technically speaking, Spain is not yet in recession as this requires two consecutive quarters of negative growth. Year-on-year growth dropped from 1.8% to 0.9%.

The Bank attributed the sharp slowdown mainly to an 'intense correction' in construction activity, until recently the engine of growth, and a fall in the value of manufactured goods, problems that have not been helped by the global credit squeeze.

'The persistence of instability in international financial markets... has aggravated a correction which began in preceding quarters, and has contributed to putting the brakes on growth in activity', the Bank said.

José Luis Rodríguez Zapatero, the Prime Minister, who until recently was playing down the depth of the crisis, said it would be 'very difficult' for Spain to grow.

The unemployment rate continued to climb and reached 11.5% at the end of October, the highest level since Rodríguez Zapatero first came to office in 2004. The number of registered jobless rose by 192,658 in October (the highest ever monthly increase) to 2.8 million (the largest number since April 1996), 37% (770,000) more than in October 2007. Between 1995 and 2007 Spain created more than 7 million jobs and 10% of them have been lost in a year. Immigrant workers, many of whom work in the construction sector, have been proportionately harder hit: the number of foreigners claiming unemployment benefits rose 46% in the year to October to 337,000.

In order to ease the pain, Rodríguez Zapatero announced a package of relief measures including a partial, two-year moratorium on mortgage payments by the unemployed.

New car registrations fell 24% in October year-on-year and even tourism suffered. The number of tourists in September, normally a good one, was almost 6% lower than a year earlier (-0.9% for the first nine months of 2008).

There was, however, one bit of good news. Thanks to lower oil and food prices, the annual rate of inflation in October dropped to 3.6% from 4.5% in September.

The European Commission forecast negative growth of 0.2% for Spain next year, the same figure as the IMF's latest projection (see Figure 3). The Euro zone as a whole will only grow 0.2% in 2009.

**Figure 3. Macroeconomic Forecasts for Spain**

	2007	2008 (1)	2009 (1)	2010 (1)
GDP growth (%)	3.7	1.3	-0.2	0.5
Jobless rate (%)	8.3	10.8	13.8	15.5
Inflation (%)	2.8	4.2	2.1	2.8
Gen. gov balance (% of GDP)	+2.2	-1.6	-2.9	-3.2
Public debt (% of GDP)	36.2	37.5	41.1	44.4

(1) Forecasts.

Source: European Commission.

### *Bank Mergers Urged, Profits of the Big Banks Continue to Rise*

Spain's relatively healthy banking system has escaped the worst affects of the international financial crisis, but it needs to prepare for mergers, according to José Luis Rodríguez Zapatero, the Prime Minister.

Rodríguez Zapatero did not specify which banks should merge, although he pointed towards the 42 savings banks which control just over half of the system's deposits. 'When there's a time of grave crisis like this, it's likely that there will be merger situations and restructurings not only in Spain but in other countries as well' Rodríguez Zapatero told parliament. Miguel Ángel Fernández Ordóñez, the Governor of the Bank of Spain, said the financial sector needed to restructure and reduce its costs, and mergers should be made on a voluntary basis.

The weakest banks in Spain are small savings banks over exposed to the construction sector, particularly to real estate developers, and to mortgage borrowers. This sector has slumped and its bad debts are rising rapidly.

Savings banks are controlled politically at local and regional government levels and as they do not have shares cannot, at least in theory, be bought by commercial banks. Thirty years ago there were more than 70 of them; their number slimmed down after Spain's banking crisis in the late 1970s.

The non-performing loans (NPLs) of savings and commercial banks stood at 2.5% of total lending at the end of August (latest figure), three times more than a year earlier and the highest level since 1998. It is mainly being pushed up by the bad debts of savings banks, but is well below the level during Spain's last banking crisis and relatively lower than in many other European countries.

The Bank of Spain has proved to be a tough and effective regulator and supervisor –it has inspectors permanently inside the main banks (26 in the case of Santander)– particularly since the year 2000 when countercyclical provisions were introduced. Provisions were accumulated during the decade-long boom and are now acting as a cushion against bad debts.

Meanwhile, the three largest banks reported significant rises in net profits excluding non-recurrent items in the first nine months, in marked contrast to many of their international peers (see Figure 4). The figure that bests reflects a bank's performance is the one based on ordinary activity (ie, recurrent) as this is its underlying business.

**Figure 4. Profits of Spain's Three-Largest Banks in First Nine Months (1)**

	€mn	% change over same period of 2007	NPL ratio
Santander	6,935	15.8	1.63
BBVA	4,321	9.1	1.54
La Caixa	1,773	18.9	1.69

(1) Excluding extraordinary income.

Source: Banks.

Santander, the Euro zone's largest bank by market capitalisation and the international bank with the most branches, increased its net profits by 15.8% to €6,935 million, excluding extraordinary income. Including it (mainly the sale of stakes in 2007) profits rose 5.5%. Santander has had no extraordinary income so far this year.

The bank's NPL rate, however, almost doubled to 1.63%, but this is below the sector's average and compares well with other international banks. The bullish Santander still expects to reach its profit target for the year –set in 2007 and remarkably not changed– of €10 billion. However, in order to boost its capital ratios, it announced a deeply discounted €7.2 billion rights issue which took the market by surprise as Santander had intimated it was in no hurry to do this. This raised speculation that further acquisitions might be in the pipeline.

Continental Europe generated 53% of Santander's net profits compared with 59% in the whole of 2004 when the bank moved into the UK and bought the mortgage lender Abbey, the UK's sixth-largest bank. The UK accounted for 14% of its profits and Latin America for 33% (41% in 2004), with Brazil providing 11%, Mexico 8% and Chile 6%.

BBVA's net profits excluding extraordinary income were 9.1% higher at €4,321 million and including them 5.4% lower, while La Caixa, the largest savings bank, reported an 18.9% rise in recurrent net profit to €1,773 million.

#### *Ryanair to Close its Base at Valencia*

The Irish budget airline Ryanair stopped flying from Valencia as a result of a disagreement with the regional government over the allocation of marketing funds. The airline had 70 weekly flights and moved around 750,000 passengers a year. It used its base at Valencia to fly to 10 European destinations.

#### *Tax Revenue Rises Strongly in Last Four Years*

Spain's tax revenue as a percentage of GDP rose significantly between 2004 and 2007 when it stood at 37.2%, higher than the average for all OECD countries (see Figure 5).

**Figure 5. Total Tax Revenue as Percentage of GDP, Selected Countries**

	1975	2007 (1)
France	35.4	43.6
Germany	34.3	36.2
Italy	25.4	43.3
<b>Spain</b>	<b>18.4</b>	<b>37.2</b>
UK	35.2	36.6
OECD total	29.4	35.9

(1) Provisional and 2006 for the OECD.

Source: OECD.

#### *Spain Moves Nearer to OECD Broadband Average*

Spain's broadband situation moved closer to the OECD average. Nearly 20 out of every 100 inhabitants have it (see Figure 6).

**Figure 6. Ranking of Broadband Subscribers per 100 Inhabitants, Selected Countries, June 2008**

	Subscribers
1. Denmark	36.7
8. Finland	30.7
11. UK	27.6
13. France	26.4
14. Germany	26.2
15. US	25.0
<b>20. Spain</b>	<b>19.8</b>
22. Italy	18.2
OECD total	21.3

Source: OECD.

### *Spain Continues to Top the Ranking of International Transportation Developers*

Spain once again led the ranking of the world's largest international transportation developers (see Figure 7). Five of its companies were in the top 10 produced every year by Public Works Financing.

**Figure 7. Top Transportation Developers, 2008**

	<b>Const./Operating (1)</b>	<b>Active Proposals</b>
<b>1. ACS/Iridium (Spain)</b>	<b>57</b>	<b>27</b>
<b>2. Macquarie group (Australia)</b>	<b>44</b>	<b>18</b>
<b>3. Sacyr/Itinere (Spain)</b>	<b>40</b>	<b>22</b>
<b>4. Ferrovial/Cintra (Spain)</b>	<b>38</b>	<b>30</b>
<b>5. Global Via (FCC-Caja Madrid) (Spain)</b>	<b>33</b>	<b>17</b>
6. Abertis (Spain)	32	7
<b>7. OHL (Spain)</b>	<b>28</b>	<b>33</b>
8. NWS Holdings (China)	24	2
9. Hochtief (Germany) (2)	23	11
10. Vinci/Cofiroute (France)	22	23

(1) Road, bridge, tunnel, rail, airport concessions; over US\$50 million in capital put under construction/operation since 1985.

(2) Spain's ACS is Hochtief's largest shareholder.

Source: Public Works Financing.