

Inside Spain 62

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Foreign Policy

Spain Seeks to Reinvigorate the Lisbon Strategy during its EU Presidency

Spain will use its Presidency of the EU in the first half of 2010 to make the recently-approved Lisbon Treaty function and push the ailing Lisbon Strategy. It will be the first country to assume the Presidency with the newly established institutional architecture, including the new bodies of the President of the European Council, the Foreign Affairs Chief and the European External Action Service.

The Lisbon Strategy, approved in March 2000, is aimed at making the EU the ‘most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment by 2010’. Very little has been achieved in 10 years. Prime Minister José Luis Rodríguez Zapatero called at a conference last month organised by *The Economist* for less rhetoric and more action and better coordination between countries.

On the foreign policy front, the International Court of Justice, the top court of the United Nations, is expected to issue its non-binding advisory opinion on the legality of Kosovo’s independence during Spain’s Presidency. Kosovo unilaterally declared independence from Serbia in February 2008. Spain is one of only three EU countries that refused to recognise its independence and this month gave anti-Kosovo depositions at the court in The Hague along with Rumania and Cyprus. Some 60 countries recognise the sovereignty of Kosovo, including the US. Madrid regards Kosovo’s independence as contrary to international law and does not want to give ammunition to separatist movements in the Basque Country and Catalonia.

The Spanish Presidency will also have to handle the problem of Cyprus, invaded and occupied by Turkey since 1974.¹ The Greek and Turkish Cypriot leaders are currently in the delicate stage of negotiating a deal to reunify the island (the only divided country in Europe after the fall of the Berlin Wall). The Greek Cypriot part has been an EU member since 2004, while the *acquis communautaire* are still suspended in the internationally unrecognised Turkish Republic of Northern Cyprus (TRNC). Both sides are hoping to agree a deal which would be put to referendums before the unofficial deadline of April when Mehmet Talat, the pro-settlement Turkish Cypriot President, could lose to the hard-line Dervis Eroglu (who favours a two-state solution), in elections.

Miguel Ángel Moratinos, Spain’s Foreign Minister, who knows Cyprus very well (he

¹ See the author’s Paper on Cyprus at www.realinstitutoelcano.org/wps/portal/rielcano_eng/Content?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/dt61-2009.

was based there between 1996 and 2003 while he was the EU's Special Representative for the Middle East peace process), is expected to do his utmost to encourage both sides to reach a reunification agreement. It is far from certain, however, that Greek Cypriots, as opposed to Turkish Cypriots, would ratify a deal in their referendum, having rejected it massively in 2004.

A 'yes' vote by both sides would help put Turkey's sluggish EU negotiations back on track. Madrid actively supports the full EU membership of Turkey (earlier this year it joined six other countries with whom Spain has an annual government summit). Ankara's refusal to recognise the Greek-Cypriot side of the island (something separate from reunification) until the EU does something to fulfil a promise to ease the isolation of the TRNC, led to the freezing three years ago of eight of the chapters that Turkey needs to negotiate.

A resolution of the Cyprus problem would also enhance relations between the EU (Cyprus is a member, but not Turkey) and NATO (Turkey is a member, but not Cyprus).

Civil Guard and UK Royal Navy Spat over Gibraltar

The Foreign Ministry complained to the UK authorities after a Royal Navy patrol boat used a buoy bearing a marker in the same red-yellow-red as the Spanish flag for target practice in waters near Gibraltar, the British overseas territory long claimed by Spain. The marker was actually the Nato Maritime Signal Flag for nr 1 and not the Spanish flag.

The incident –for which the newly arrived British Ambassador, Giles Paxman, apologised– highlighted the tensions between the two countries over disputed waters surrounding the Rock (see *Inside Spain*, Newsletter 58, 21 July 2009). According to Spanish press reports, a Scimitar-class patrol boat withdrew hastily when a Civil Guard boat approached.

The Civil Guard, on the one side, and the Royal Navy and the Gibraltar police, on the other, accuse each other of harassment. Last year Madrid successfully requested the demarcation of part of the waters near Gibraltar as Spanish under EU environmental protection laws. The governments of Gibraltar and the UK do not recognise the validity of the adopted site. Gibraltar has lodged an appeal in the European Court in Luxembourg to have the decision reversed.

Spain ceded Gibraltar to Britain under the Treaty of Utrecht in 1713, but claims the waters around the Rock.

In a another incident, Gibraltar police arrested four Civil Guards officers who pursued a speedboat suspected of drug smuggling to the Rock's shore. Alfredo Pérez Rubalcaba, Spain's Interior Minister, apologised to Peter Caruana, Gibraltar's Chief Minister, for the 'mistaken operation'.

Spain, the UK and Gibraltar established a tripartite forum in 2004 to air their grievances which has established a *modus vivendi*. The conservative Popular Party accuses the Socialists of being soft on the issue of Gibraltar's sovereignty.

Spain 'Unlikely to Meet 2012 Official Development Assistance Goal'

The government's goal of dedicating by 2012 0.7% of GDP to official development assistance, the target set by the United Nations for developed countries, is unlikely to be met because of the need to reduce public spending, according to Soraya Rodríguez, the Secretary of State for Co-operation. She said this year's figure would reach 0.5% and 0.7% would be impossible without higher budgets.

Fifty-one percent of Spanish respondents in the latest Transatlantic Trend survey by the German Marshall Fund of the US said the most effective way to reduce immigration was by increasing development aid (see related item below). This was the highest level among the six European countries plus the US and Canada which were surveyed.

Domestic Scene

Catalan Parties Rally Around their Challenged Autonomy Statute

The great majority of political parties represented in the Catalan parliament would not accept a decision by the Constitutional Court, which could be imminent, that the region's new autonomy statute, approved by parliament and ratified in a referendum in 2006, is unconstitutional. The main exception is the conservative Popular Party (PP) which took the issue to the court.

In two related moves, 12 Catalan newspapers carried a joint editorial, titled 'The Dignity of Catalonia', which said that what was at stake was the 'spirit of 1977 which made the peaceful transition (to democracy after the end of the Franco dictatorship) possible', and 166 municipalities in Catalonia voted on independence from Spain in unofficial referendums. The votes have no constitutional or legal force. Only 27.2% of the 700,000 voters cast their votes and of them 94% were in favour of independence. The level of participation was 22 points below that in the referendum in 2006 on Catalonia's new statute.

The 10 members of the court have been examining Catalonia's charter for three years and have failed to reach any agreement supported by a majority of them. According to press reports, there is agreement on the need to change various articles of the statute but not on how to do this. The members of the court are equally divided between Socialist and PP appointees.

The most controversial parts of the charter concern the concept of 'nation', which is used to describe Catalonia in the preamble, and the reference to national symbols (the region's flag, hymn and national day), the Catalan language and the creation of a body to govern the region's justice system. Article 2 of the Spain's 1978 Constitution states that the constitution 'is based in the indissoluble unity of the Spanish Nation' while also referring to the 'right to autonomy of nationalities and regions'. Catalonia is a nationality.

Catalonia is governed by a Socialist-led coalition of three parties (one green and the other pro-independence). The centre-right nationalist party Convergence and Union (CiU) won the most seats in the 2006 election, but not enough to govern on its own. Artur Mas, the CiU leader, said the Constitutional Court should refrain from pronouncing on the issue 'because the statute is a political pact endorsed by the people'. If the court changed the charter, it would be difficult for the CiU to support the central government in Madrid in the future as it has done in the past.

Joan Ridaó, the spokesman in parliament for the Catalan Republican Left (ERC), said changes to the charter would be a ‘machine for producing people in favour of independence’.

Eight out of 10 Spaniards (84%) believe parts of the constitution should be reformed and that it should not be set in stone, according to an opinion poll conducted by Metroscopia and published in *El País*, the leading daily. Seventy-nine per cent of respondents said Catalonia was not a nation and 71% said the term should not be applied to define a region.

Population Growth Set to Decline Substantially

The pace of growth in Spain’s population is set to slow down substantially over the next decade, largely due to a sharp fall in immigrants. Between 2009 and 2019 the population will rise by 1.12 million to almost 47 million compared with 4.86 million between 2002 and this year, according to the latest forecasts by the National Institute of Statistics (INE).

The annual growth rate will decline from a peak of 1.82% in 2008, when the population increased by 808,628, to 0.41% this year and a stabilised rate of below 0.3% as of 2010 (see Figure 1).

Figure 1. Spain’s Population, 2002-19, Selected Years (1)

Year	Population (million)
2002	40.96
2005	43.03
2007	44.47
2009	45.82
2012	46.25
2015	46.56
2017	46.76
2019	46.95

(1) The figures for 2009-19 are forecasts.
Source: National Institute of Statistics (INE).

Immigrants accounted for between 76% and 93% of the annual growth in population between 2002 and 2008. The annual number of immigrants arriving in Spain is forecast to drop from a high of 958,000 in 2007 to 345,000 in 2010, while the fertility rate will increase from 1.46 to 1.54. Immigrant women are having more children than Spanish females.

The population will continue to age. The number of people over the age of 64 will rise by 1.29 million over the next decade and will account for 19% of the total population in 2019, up from 16.6% today. The dependency rate (the population under the age of 16 and above 64 as a percentage of the population aged 16 to 64) will climb from 47% to around 55%. This will put a strain on the state pension system unless there are reforms.

Government ‘Mismanaging Immigration’

Two-thirds of Spaniards believe the government is mishandling immigration, the second highest figure after the UK among the eight countries surveyed by the German Marshall Fund (see Figure 2).²

² See www.gmfus.org/trends/immigration/doc/TTI_2009_Key.pdf.

Figure 2.



Spain has experienced very fast growth in immigration since the late 1990s from new member EU states, Latin America and North Africa. At the end of 2007 it had 5.9 million immigrants, 13.4% of the overall population, according to the latest comparative figures by the OECD (see Figure 3).

Figure 3. Immigrant Population and Share of Overall Population (1)

	Population (million)	Share of the overall population (%)
Canada	6.33	20.1
France	5.22	8.5
Germany (2003)	10.62	12.9
Italy (2009)	3.89	6.5
Netherlands	1.75	10.7
Spain	5.99	13.4
UK	6.19	10.7
US	41.09	13.6

(1) All figures 2007 unless stated otherwise.

Source: OECD International Migration Outlook, 2009.

Abortion Bill Wins Backing in First Test in Parliament

The government's bill to make abortion easier won enough backing to defeat amendments by the conservative Popular Party (PP) that would have totally blocked the proposed law. The Socialists gained backing from small parties after offering to negotiate the bill's most controversial point: allowing 16-year-olds to get an abortion without parental consent.

Abortion was decriminalised in 1985, but only in matters of rape, or when the health of the child or mother is at risk. The number of abortions has doubled in the past decade from nearly 54,000 in 1998 to 112,000 in 2007, the most recent year for available data, according to the Ministry of Health.

The bill has provoked fierce opposition from the PP and the Roman Catholic Church. If it becomes law it would permit abortions through 14 weeks of pregnancy, with few questions asked, even allowing 16-year-olds to get an abortion without prior knowledge or consent from their parents. The Socialists sought a formula on this point.

Tens of thousands of people marched in Madrid in October against the bill, under the theme 'each life is important'. Many leading PP politicians attended, including the former Prime Minister, Jose María Aznar.

The Church hierarchy warned that 'anyone supporting, voting for or promoting' the bill 'is in mortal sin and cannot be admitted to holy communion'. José Bono, a former Socialist President of the Congress and a practising Catholic, who supports the bill, criticised the Church for regarding him as an 'assassin' whereas General Pinochet, the Chilean dictator, was a 'cruel assassin', he said, who was 'outrageously given communion'.

More than Half of Spain's Parishes Without a Priest

Priests are dwindling in numbers, leaving more than half of parishes without a resident incumbent. Cardinal Antonio María Rouco, the Archbishop of Madrid, said 10,615 of the 23,286 parishes did not have a resident priest in 2007 and the situation was worsening. The average age of priests was 63.3 years.

The Economy

Government Announces Measures to Create a More Sustainable Economy, S&P Negative on the Economy's Outlook

Eighteen months after entering recession and with an unemployment rate close to 20%, the government unveiled its long awaited 'sustainable economy' bill designed to get the economy moving and lay the foundations for a more solid economic model based on high technology and green energy.

In a separate move, Standard & Poor's (S&P), the credit rating agency, revised the outlook for the Spanish economy from 'stable' to 'negative' because of the deterioration of public finances. S&P stripped Spain of its triple A sovereign credit rating in January, but left the current ratings unchanged. S&P criticised the government indirectly for failing to deal with its budget deficit. The deficit is forecast to reach more than 10% of GDP this year and next and public debt 66% of GDP –less than half that, however, of Greece, the worst performing economy–. José Luis Rodríguez Zapatero, the Prime Minister, reaffirmed his commitment to cut the deficit to 3% in 2013 and meet the limit set in the EU stability pact (see Figure 4).

Figure 4. Public Finances in Selected EU Countries (1)

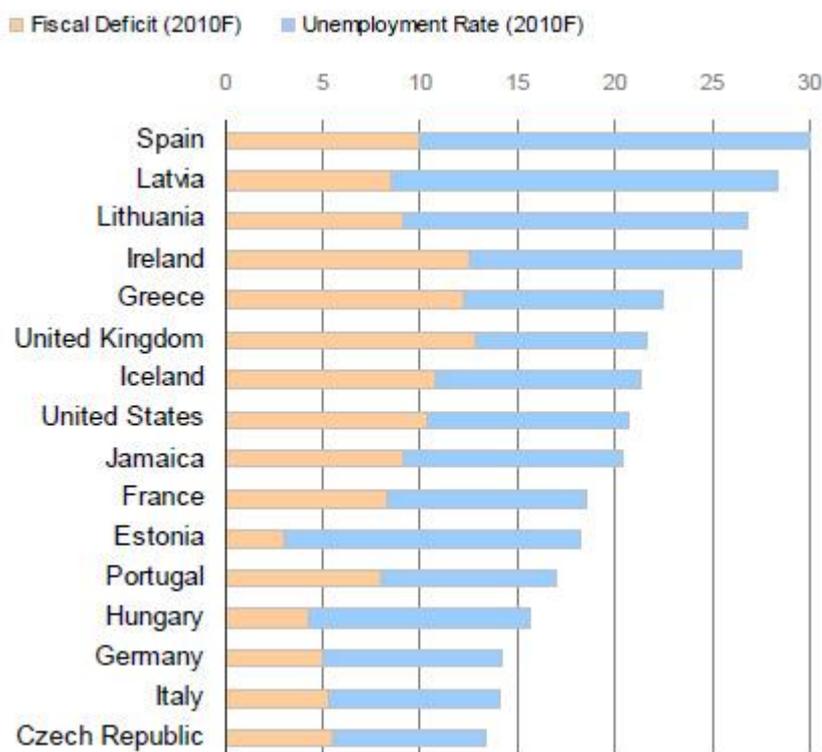
	Budget deficit (% of GDP)	Public debt (% of GDP)	10-year govt. bond yields (%)
France	8.2	82.5	3.49 (+0.23 pp)
Germany	5.0	76.7	3.25
Greece	12.2	124.9	5.76 (+2.51 pp)
Italy	5.3	116.7	4.03 (+0.78 pp)
Spain	10.1	66.3	3.85 (+0.61 pp)
UK	12.9	80.3	3.89 (+0.65 pp)

(1) 2010 for deficit and debt and 15 December for bond yields. Spread over the German bund in brackets.

Source: European Commission and Bloomberg.

Moody's, another credit rating agency, put Spain at the top of its new 'misery index', based on the jobless rate and the budget deficit (see Figure 5). The very low interest rates (and lower mortgage payments), combined with the welfare system, have so far enabled many Spaniards to survive.

Figure 5. Moody's 'Misery Index'



Some 900,000 of the 1.5 million jobs lost since Rodríguez Zapatero was re-elected in the March 2008 election have been in the construction sector. The sustainable economy measures include:

- A €20 billion fund to finance projects in 'sustainable tourism', energy efficiency improvements, biotechnology, aerospace and health, and to provide cash and guarantees to credit-starved companies.
- Creation of companies in a maximum of five days compared with the current estimated average of 47 days and an OECD average of 13 days.
- Public administrations will make their payments within 60 days. Small companies, unable to obtain loans because of the credit crunch, are going out of business because of late or non-payment by administrations.
- Tax deduction for restoring homes in certain conditions.

- The pay of directors of quoted companies will be made public and put to the vote at the annual meeting of shareholders.

The reforms do not include the education system, a key area for creating an economy based on knowledge rather than bricks and mortar. Spain's education system is one of the most equitable among industrialised countries, but the following indicators show it has serious problems:

- Almost one in three people between the ages of 18 and 24 in 2007 (the latest year available) were early school leavers as they did not complete their upper secondary education. This is twice the EU average. The trend is improving because young people, who abandoned their studies for a job which they have now lost, are completing their education or those at school see no prospect of finding employment and so are continuing their education.
- Spain scores badly in the PISA tests for 15 year olds on reading, mathematical and scientific literacy conducted by the Paris-based Organisation for Economic Co-operation and Development (OECD).
- Between 25% and 35% of students in most universities drop out before graduation.
- No Spanish university is in the top 150 of the *Times Higher Education Supplement* ranking or in that of Shanghai's Jiao Tong University.
- Spain has a very low number of patents per one million inhabitants, as registered with the European Office of Patents. On the basis of the trend between 1995 and 2005, a relatively dynamic period, Spain would reach the UK's current level in 100 years, France's in 150 years and Germany's in 300 years.
- R&D investment represents 1.35% of GDP compared with an EU average of close to 2% and way below the best countries. Spaniards spend much more on gambling and lotteries every year than on R&D.

The need for a more qualified workforce is borne out by the latest figures from Eurostat which show that employment among Spain's low qualified workers dropped by more than 11% between March 2008 and March 2009 compared with an EU-27 average of almost 5% (see Figure 6).

Figure 6. Changes in Employment by Education Levels

	Low qualified	Medium qualified	Highly qualified
France	-3.1	-2.6	5.1
Germany	-2.3	-1.2	5.9
Italy	-4.6	0.3	0.2
Spain	-11.6	-5.9	-2.6
UK	-6.9	-4.2	3.3
EU-27	-4.9	-2.6	3.0

Source: Eurostat.

Spain is ranked 16th out of 17 countries in the latest innovation league by the German Institute for Economic Research (see Figure 7). The ranking is based on more than 150 partial indicators including the quality of education and vocational training and the level of R&D.

Figure 7. Innovation Capacity of the Leading Industrialised Nations (1)

Country ranking and score			
1. US	7.00	10. UK	4.78
2. Switzerland	6.93	11. South Korea	4.47
3. Sweden	6.76	12. France	4.25
4. Finland	6.26	13. Austria	4.15
5. Denmark	6.14	14. Belgium	4.14
6. Canada	5.24	15. Ireland	3.77
7. Japan	5.22	16. Spain	1.79
8. Netherlands	5.03	17. Italy	1.00
9. Germany	5.01		

(1) The highest score is seven and the lowest one.

Source: German Institute for Economic Research.

The government is seeking an all-party consensus on education reforms and says it will not unilaterally push through reforms in the two-tier labour market as it wants an agreement which includes trade unions and the employers' organisation. This has so far proved impossible. Those on permanent contracts are costly to fire and those on short-term contracts (up to one-third of total employees) live in permanent insecurity. Employers want lower firing costs for those on permanent contracts, but the Socialist government, backed by trade unions, regards this as a red line it is not prepared to cross. It is seeking a German-style system under which workers are paid to work fewer hours. There are various mechanisms for this including a tax credit for employers. Germany's unemployment rate is less than half that of Spain's and not much higher than it was before the recession.

Meanwhile, year-on-year consumer price inflation in November was 0.3%, ending eight months of negative rates and the fear of deflation. In October it was 0.7% negative. Those receiving pensions from the state have benefited significantly this year as pensions were increased by 2% in January (minimum pensions rose by up to 7.3%).

The government aims to double renewable energy's share of total energy consumption to 20% by 2020 (see Figure 8) and cut primary energy demand by a fifth in the same period.

Figure 8. Renewable Energy Targets (% of total energy consumption)

	2005	2020
France	10	23
Germany	6	18
Italy	5	17
Spain	9	20
Sweden	40	49
UK	1	15

Source: International Energy Agency.

The OECD's latest projections see positive growth returning to Spain in 2011 (see Figure 9), but the jobless rate will remain very high. The pace of the rise in unemployment continued to decelerate in November. The number of jobless registered in the INEM offices rose by 60,593 over October to 3.8 million. The increase was much lower than a year earlier (+171,243).

Figure 9. Macroeconomic Scenario (forecasts for 2009-11)

	2008	2009	2010	2011
GDP at market prices (% change)	0.9	-3.6	-0.3	0.9
Exports of goods and services (% change)	-1.0	-13.5	5.5	7.8
Imports of goods and services (% change)	-4.9	-20.1	-0.4	5.4
Net exports (1)	1.4	2.9	1.4	0.6
Harmonised index of consumer prices (%)	4.1	-0.4	0.8	-0.1
Unemployment rate (%)	11.3	18.1	19.3	19.0
Household saving ratio (2)	13.4	17.8	17.9	17.9
General government balance (% of GDP)	-4.1	-9.6	-8.5	-7.7
Current account balance (% of GDP)	-9.6	-5.3	-3.8	-3.0

(1) Contributions to changes in real GDP.

(2) As a percentage of disposable income.

Source: OECD.

Downturn Takes its Toll on Spain's Tax Receipts, Pushes up Public Spending

Spain's tax burden registered the second-largest drop in 2008 among the 30 OECD countries after Iceland, falling from 37.2% to 33.0% of GDP (see Figure 10). Direct and indirect tax receipts and social security contributions plummeted because of the impact of much lower economic growth, the steep rise in unemployment and lower income tax rates.

Figure 10. Total Tax Revenue (% of GDP)

	1975	2000	2006	2007	2008 (1)	07/08 chg (pp)
France	35.4	44.4	44.0	43.5	43.1	-0.4
Germany	34.3	37.2	35.6	36.2	36.4	-0.4
Iceland	30.0	37.2	41.5	40.9	36.0	-4.9
Italy	25.4	42.3	42.3	43.5	43.2	-0.3
Spain	18.4	34.2	36.7	37.2	33.0	-4.2
UK	34.9	36.4	36.6	36.1	35.7	-0.4
US	25.6	29.9	28.2	28.3	26.9	-1.4

(1) Provisional.

Source: OECD.

The tax burden is likely to fall further this year as economic growth will be 3.6% negative, according to the latest OECD projections, compared with 0.9 positive in 2008. Tax rates have been raised for 2010, particularly VAT.

While the tax burden has dropped, public spending, as one would expect, has risen steeply in order to make up some of the shortfall. This year, according to the OECD, Spain's public expenditure will grow by 5.2 pp to 45.7% and be higher than the OECD average for the first time since the year 2000 (see Figure 11). Its rise is the second largest after Iceland, whose economy has suffered the biggest meltdown, in proportional terms, in the world.

Figure 11. Public Spending (% of GDP)

	2000	2008	2009 (1)	08/09 chg (pp)
France	51.6	52.7	55.4	+2.7
Germany	45.1	44.0	47.7	+3.7
Ireland	31.5	41.0	46.8	+5.8
Italy	46.1	48.7	51.7	+3.0
Spain	39.1	40.5	45.7	+5.2
Sweden	57.0	51.9	57.0	+5.1
UK	36.6	48.1	52.4	+4.3
OECD average	38.9	41.5	44.8	+3.3

(1) Forecast.

Source: OECD.

Salgado Calls for Retirement Age to be Extended

Elena Salgado, the Economy and Finance Minister, has proposed gradually extending the legal retirement age in order to ease the impact on general government accounts of an ageing population.

The current retirement age is 65, but in practice people are retiring at around 62 (see Figure 12). Salgado did not mention what would be the new age, but she did refer to that in the Netherlands (67). Trade unions oppose the idea.

Figure 12. Retirement Ages in Europe

	Real age (2008)	Legal retirement age
France	59.3	Between 60 and 65
Germany	61.7	67
Italy	60.8	65 for men and 60 for women
Spain	62.6	65
Sweden	63.8	Between 61 and 67
UK	63.1	65 for men and 60 for women

Source: Eurostat.

BBVA Lifts its Stake in Chinese Bank to 15%

BBVA, Spain's largest bank, exercised its option to increase its stake in China Citic Bank (CCB) to 15%, after acquiring an extra 4.93% for around €1 billion. This makes it well placed to expand in a dynamic part of the world.

BBVA invested in CCB in 2006, before the global recession. While troubled international banks, such as Royal Bank of Scotland, UBS and Bank of America, have retreated from China, BBVA, which is relatively unscathed, has pushed ahead with its plans.

The agreement with CCB prevents BBVA from opening its own branches in China. Instead, it is focusing on wholesale banking.

Spain's Business Schools Move up the Financial Times Ranking

Spain's three business schools are in the top 10 of the latest ranking of the *Financial Times* European Business Schools, and two of them are classified higher than in 2008 (see Figure 13).

IE Business school is ranked 5th (4th in 2008), Iese 6th (7th in 2008) and Esade 8th (11th in 2008).

Figure 13. The Top 10 Graduate Business Schools in Europe (*)

Rank 2009
1. HEC Paris (1)
2. London Business School (2)
3. Insead (3)
4. IMD (4)
5. IE Business School (4)
6. Iese Business School (7)
7. Rotterdam School of Management, Erasmus University (8)
8. EM Lyon Business School
8. Esade Business School (11)
10. Vlerick Leuven Gent Management School (10)

(*) Out of 70. 2008 rank in brackets.

Source: *Financial Times*.