

Inside Spain Nr 125

20 January - 22 February 2016

William Chislett

Summary

Spain to contribute €153 million to migration fund for Turkey.
 Countdown to the investiture of a Socialist Prime Minister.
 Spain records its worst score in corruption index, Popular Party hit by more scandals.
 New government, whenever there is one, faces big budget hole.
 CAF wins £490 million rolling-stock contract in UK.

Foreign Policy

Spain to contribute €153 million to migration fund for Turkey...

Spain's share of the EU's €3 billion refugee facility for Turkey is €152.8 million, the fifth-largest contribution and based on its share of the EU economy.

The deal hammered out among the 28 member states puts into practice the commitment made by the EU at its summit with Turkey last November to provide €3 billion of funds to help Ankara stem the flow of migrants to Europe. Countries will provide €2 billion (see Figure 1) and the other €1 billion will come from the EU budget.

Figure 1. Main national contributions for the Turkey Refugee Facility (€ million) (1) (2)

EU member state	€ million
Germany	427.5
UK	327.6
France	309.2
Italy	224.9
Spain	152.8
Netherlands	93.9
Belgium	57.6
Poland	57.0

(1) Contributions made by member states could be adjusted downwards in 2017 according to the final contribution from the EU budget, without prejudice to the total amount planned for the instrument and without prejudice to the prerogatives of the budgetary authority.

(2) National contributions for the Facility will not be taken into account for the calculation of a member state's deficit under the Stability and Growth Pact.

Source: Council of the European Union.

The funds will go straight to the refugees, providing them with education, health and food. Brussels hopes it will help lower the number of arrivals after more than a million people reached the continent last year. Figures show few signs of falling so far this year.

... while spending on international military missions surpasses €1 billion

Spain spent just over €1 billion in 2015 on international military missions, 37% more than in 2014.

Half of this amount was for NATO-related missions such as the Response Force (based in Spain), Resolute Support (Afghanistan) and Operation Active Endeavour (Mediterranean). Other missions include the United Nations Interim Force (UNIFIL) in Lebanon.

Domestic Scene

Countdown to the investiture of a Socialist Prime Minister

The clock is now ticking to appoint the Socialist Pedro Sánchez the new Prime Minister. If he fails to gain an absolute majority in parliament on March 2 or a simple one on March 5 then Spain is headed towards a new election in June (see Figure 2).

Figure 2. Calendar for the investiture vote of Pedro Sánchez

Date	Action
February 2	King Felipe asked the Socialist Pedro Sánchez to form a government.
March 1	Investiture debate in parliament.
March 2	First vote. To be elected Sánchez needs an absolute majority.
March 5	Second vote. To be elected Sánchez needs a simple majority (1). If he is not elected the King can propose another candidate.
May 3	The hypothetical date for dissolving parliament if by then a new Prime Minister has not been elected.
June 26	Possible date for new parliamentary election.

(1) A majority in which the highest number of votes cast for a candidate exceeds the second-highest number, while not constituting an absolute majority.

Source: *El País*.

King Felipe VI entrusted Sánchez (from the Socialist party, the PSOE) on 3 February with the task of forming a new government, after Mariano Rajoy, the incumbent Popular Party (PP) Prime Minister, turned down the offer to start coalition talks. Rajoy, who won the 20 December election but lost his absolute majority, said he saw no chance of winning sufficient support, but left open the possibility of presenting himself if Sánchez fails.

Rajoy said his party would vote against Sánchez at the two investitures. If the PP abstains on 5 March Sánchez could emerge as the new Prime Minister.

A fresh election looks like repeating to a large degree the inconclusive results of last December's election with still no party obtaining anywhere near an absolute majority (see Figure 3). The centrist Ciudadanos, according to a Sigma Dos poll, would be the main beneficiary in terms of the largest increase in the number of seats (from 40 to 50). These seats combined with those of the PP (for a total of 169 out of 350) would be seven seats short of the 'magic' number of 176 for a stable government.

Figure 3. Voter intention (% of valid votes and number of parliamentary seats)

	2011 election	2015 election	February 2016
Popular Party (PP)	44.6 (186)	28.7 (123)	27.8 (119)
Socialists (PSOE)	28.8 (110)	22.0 (90)	23.1 (93)
Podemos	–	20.7 (69)	18.8 (60)
Ciudadanos	–	13.9 (40)	15.3 (50)

Source: Sigma Dos.

Spain is one of the very few EU countries not to have had a coalition government in the last 40 years. And neither has the political class forged a culture of compromises and pacts, which the election results show is what Spaniards want, but which the political parties, stuck in megaphone diplomacy and 'red lines', have so far failed to deliver. That said, Belgium took almost 600 days to form a government (announced in 2011) and the economy did not collapse.

Sánchez is much more advanced in his negotiations with the centrist Ciudadanos, led by Albert Rivera, than with the anti-austerity Podemos, headed by Pablo Iglesias, and other leftist parties. Sánchez and Rivera agree, for example, on asking the European Commission for another year in order to meet the benchmark budget deficit target of 3% of GDP (see the item in the Economy section).

Iglesias's strategy seems to be aimed at forcing a new election by offering conditions that are impossible for the Socialists to accept. Podemos trod closely on the heels of the Socialists in the December election (20.7% of the vote compared with the Socialists' 22%).

Iglesias is demanding a referendum on independence for Catalonia, a very heated issue that the Socialists as well as the PP and Ciudadanos (which between them won 65% of the vote last December) reject outright. Iglesias is somewhat of a hostage on this issue to his Catalan allies as they have 12 seats in parliament.

On some economic matters, the Socialists and Podemos are not that far apart. For example, both parties want to reform and beef up the Tax Agency, repeal the 2012 labour reforms and substantially increase the minimum wage.

Luis Garicano, a professor at the London School of Economics and the chief economic advisor of Ciudadanos, described Podemos' economic programme, particularly in public spending matters, as 'magical realism without realism' in reference to a literary genre associated particularly with Latin America.

A minority Socialist/Ciudadanos government (130 of the 350 seats), with the support or abstention of other parties on 3 or 5 March in order for it to pass muster, is what just over half of respondents in a Metroscopia poll said they wanted, compared with 37% for a leftist coalition comprising the Socialists, Podemos and the anti-capitalist Popular Unity, which would only have 134 seats (see Figure 4).

Figure 4. Possible coalitions for Pedro Sánchez to form a government

Combination	Good	Bad	Balance
Socialists+Ciudadanos+support or abstention of other parties	51	42	+9
Socialists on their own+ad hoc pacts with other parties	43	49	-6
Transition gov. comprising independent figures and members of other parties, headed by Sánchez	43	49	-6
Socialists+Popular Party+Ciudadanos, headed by Sánchez and Mariano Rajoy as deputy PM	42	53	-11
Socialists+Podemos+Popular Unity+ support or abstention of other parties	37	58	-21

Source: Metroscopia.

Ciudadanos does not want to enter a government with the Socialists, though it is prepared to agree the main lines of a programme. Ciudadanos sees an opportunity to outflank the PP, discredited by the toxic issue of a string of corruption scandals (see the next item), as the main centre-right party and believes it would run the risk of burning itself if it formally entered government.

A Socialist government on its own would be a weak one (only 25% of parliamentary seats) and subject to continuous ad hoc pacts, but by holding an essentially central position (as a social-democratic party) would have more flexibility than the other parties in reaching agreements with parties to its left and right.

On one particular issue there are no disagreements between the Socialists, Ciudadanos and Podemos, and that is that none of them want to get into bed with the PP because it is so tainted by corruption that it is perceived as having zero credibility to champion the much needed fight against it.

Rajoy is pushing for a coalition with the Socialists and Ciudadanos, and firmed this up by offering Sánchez and Rivera the posts of Deputy Prime Minister.

Spain records its worst score in corruption index, Popular Party hit by more scandals

Spain dropped one place in Transparency International's annual corruption perception index to 36th out of 168 countries and its score of 58 out of 100 (the nearer to 100 the cleaner the country) was its lowest since the ranking began in 1995 (see Figure 5).

Figure 5. Corruption Perception Index 2015 (1)

2015 rank	2015 score	2014 score	2013 score	2012 score
1. Denmark	91	92	91	90
5. Netherlands	87	83	83	84
10. Germany	81	79	79	79
23. France	70	69	69	71
36. Spain	58	60	60	65
61. Italy	44	43	43	42

(1) The nearer to 100, the cleaner the country.

Source: Transparency International.

Along with Australia, Libya, Brazil and Turkey, Spain is one of the five countries whose score has fallen the most in the last four years.

The country is awash in corruption cases, almost all of which took place before the PP took office at the end of 2011 but which have come to light since then and involve the party. These cases are mainly confined to municipal and regional politicians and their involvement in the awarding of public contracts and permits.

The number of corruption probes by the judiciary trebled between 2010 and 2015 to 1,108, according to the Interior Ministry, and the number of people detained increased from 389 to 2,442 (see Figure 6).

Figure 6. Corruption related crimes, 2012-15 (number and % of total)

Type of crime	Number (%)
Social security	530 (16.3)
Bribery	407 (12.5)
Administrative malfeasance	320 (9.8)
Embezzlement	266 (8.2)
Crimes against the public Treasury	263 (8.1)
Falsehood in subsidies	174 (5.3)
Corporate crime	151 (4.6)
Money laundering	138 (4.2)
Trafficking of influences	85 (2.6)
Urban re-zoning malfeasance	77 (2.4)
Other crimes	844 (25.9)
Total	3,255

Source: Interior Ministry.

In Valencia, ground zero of Spain's real-estate bubble, epicentre of a string of corruption cases and fiefdom of the PP, close to 50 people working for or involved in the city's government, including nine out of 10 PP councillors, are the target of a judicial probe for awarding contracts in return for commissions. Among those summoned to appear before a judge to answer accusations in the case known as Taula was Alfonso Rus, the former Chairman of the Valencia provincial council and the PP's leader in the province. Alfonso Grau, a former PP Deputy Mayor of Valencia, was arrested for alleged bribery.

Rita Barberá, the PP Mayor of Valencia between 1991 and 2015 and known as the 'mayor of Spain', denied any knowledge of the irregularities and refused calls for her to resign as a member of the Senate. She became a Senator last year after elections in Valencia (the 17 regions appoint 58 of the 266 Senators) and at a time when she was stained by other alleged corruption cases.

The PP controversially appointed her this month a member of the Senate's permanent council which means that if there are new elections, which is on the cards, she would continue to be *aforado*. This means she could only be tried in the first instance by the Supreme Court or by the highest court in a region, rather than by a lower court. The system applies to some 2,000 politicians in Spain; in Germany, it only applies to one: the President.

Isabel Bonig, the PP's President in Valencia, said the party's situation was so 'diabolical' in the region that it needed to be re-established and possibly change its name.

The Púnica case into corruption in a dozen city and town halls including Valencia and Madrid, ongoing since 2014 and involving a bid-rigging scheme for public contracts, claimed its first high profile victim this month when Esperanza Aguirre, the PP's President in Madrid, resigned after the police raided the PP's headquarters. Aguirre, a former President of the Madrid region, President of the Senate and Education Minister, said she 'assumed her political responsibility' but denied any wrongdoing. 'Corruption is killing us', Aguirre told a news conference.

In another case, 13 people were arrested last month following an investigation into the allegedly fraudulent awarding of contracts by the state company Acuamed for hydraulic and environmental works between 2007 and 2014. The arrests prompted the resignation of Federico Ramos de Armas, Deputy Minister of the Presidency, who was the Deputy Minister of the Environment and chairman of Acuamed when the contracts were awarded.

According to Rafael Doménech, BBVA's chief economist, corruption reduces Spain's annual GDP growth by 0.5 percentage points.

Meanwhile it was announced that Rodrigo Rato, a former head of the International Monetary Fund (IMF) and the PP's Economy Minister between 1996 and 2004, is to stand trial for misusing funds when he was Chairman of Caja Madrid and then of Bankia. That bank's collapse in 2012 less than one year after being listed on the stock exchange sparked a EU bail out of parts of Spain's financial sector. Bankia alone needed €22 billion in fresh capital to stay afloat.

Rato is one of 66 accused of benefiting from undeclared credit cards used for personal expenses between 1999 and 2012 at Caja Madrid, one of six savings banks which merged in 2010 to form Bankia, Spain's fourth-largest bank. A total of €15.5 million was spent. Rato is accused of racking up €44,217 on his account and if found guilty faces a prison sentence of four and a half years.

The Infanta Cristina loses appeal and testifies in court

The Infanta Cristina, the eldest sister of King Felipe VI, lost her appeal against tax fraud charges and testified in court this month in a case involving her husband, Iñaki Urdangarín, and 16 other defendants.

Her lawyers based their case on the so-called 'Botín doctrine', named after a case dropped against Emilio Botín, the former Chairman of Banco Santander, in 2007 because it was not supported by public prosecutors. The accusations against Cristina were made privately, by anti-corruption group *Manos Limpias* ('Clean Hands'). The tax authorities said they had no case against her.

She faces two counts of tax fraud, carrying a maximum prison sentence of eight years, for allegedly failing to declare taxes on personal expenses paid by a property company she owned with her husband.

Urdangarín, accused of embezzlement and money laundering, faces 19 years and six months. The case relates to his supposedly non-profit Noos Institute sports foundation, which was allegedly used as a vehicle to win falsely inflated contracts from regional government bodies, before channelling the money to personal accounts via tax havens.

The Economy

New government, whenever there is one, faces big budget hole

Spain failed last year to meet the budget-deficit target agreed with the European Commission (4.2% of GDP) and it looks as if the same will happen this year (2.8%), according to the Commission's latest forecasts, which put the respective figures at 4.8% and 3.6%, both well above the targets.

This means that the Eurozone's fourth-largest economy will still be in breach of the EU's 3% deficit ceiling. Pedro Sánchez, the Socialists' leader who is trying to form a new government, and the Ciudadanos' leader Albert Rivera, want to postpone the 3% target until 2017, a proposal that would not go down well in Brussels, as it was originally set for 2013. No other country in the Eurozone has been so far off its budgetary course as Spain.

'Whatever the new government, it must make adjustments', said Pierre Moscovici, the European Commissioner for Economic and Financial Affairs. The new government will have to make deeper spending cuts or raise more revenue through tax increases. The problem is this might not happen for months.

The PP controversially rushed through the 2016 budget last September, as it was crystal clear that no party would win the December election, and the government wanted the Commission's approval before the polls. As it turned out, the budget fell short of the EU's spending rules and the government was rebuked, but it rejected the request for stricter execution of the 2015 budget and cuts to ensure the 2016 budget was compliant, leaving the latter to the new government.

Another pressing issue facing the next government is the emerging crisis in the social security system. The greying population and a low fertility rate, combined with the very high unemployment (the number of social-security contributors is still 2 million less than the peak in 2007), has pushed up the dependency ratio (the inactive elderly as a percentage of the working-age population) and raised serious questions about the sustainability of the pay-as-you-go pension system.

Just as the incumbent government is not in a position to make changes to the budget so, too, it is powerless to do anything about the emerging social security crisis and the need to reform the Toledo Pact (first approved by parliament in 1995) to guarantee the system's future.

In order to pay pensions without putting the budget under more pressure, the government raided the reserve fund built up during the boom years, reducing it from a peak of €66.8 billion in 2011 (the PP took office at the end of that year) to €32.4 billion at the end of 2015. If this pace of drawing down the reserve continues and no measures are taken, the reserve will run out in 2019.

Moody's changed the outlook to stable from positive on Spain's government credit ratings. This revision was due to three factors:

- The institutional improvements that the government legislated in recent years, including greater controls over regional finances and pension reform, have had a smaller impact than Moody's had anticipated when it assigned the positive outlook back in 2014. This less favourable outcome limits the potential for improvement in Spain's future fiscal position and its growth trajectory.
- As a result, Spain's track record of meeting fiscal targets in the last few years has been mixed. Moody's expects the government to report above-target deficits this year and beyond, preventing any material reduction in the debt burden after peaking at around 100% of GDP in the near future.
- Moody's also believes that additional material structural reforms that would be supportive of growth are unlikely to be forthcoming over the coming three to four years, irrespective of the composition of the next government.

Moody's affirmed Spain's long-term debt and issuer ratings at Baa2 (see Figure 7).

Figure 7. Moody's rating of long-term sovereign bonds

	Rating
Germany	Aaa
France	Aa2
Spain	Baa2
Italy	Baa2
Portugal	Ba1

Aaa: minimum risk.
 Baa: moderate risk.
 Ba: significant risk.

Source: Moody's.

There was some good news, however, in the Commission's assessment as GDP growth for 2016 was again upgraded, to 2.8% though lower than last year (see Figure 8).

Figure 8. European Commission's forecasts for Spain, 2015-17 (annual % change)

	2015	2016	2017
Private consumption	3.1	3.4	2.3
Public consumption	2.2	0.6	0.6
Contribution to GDP growth:			
Domestic demand	3.5	3.0	2.4
Inventories	0.1	0.0	0.0
Net exports	-0.4	-0.2	0.1
Unemployment rate (% of labour force)	22.3	20.4	18.9
Current account balance (% of GDP)	1.5	1.4	1.3
General government balance (% of GDP)	-4.8	-3.6	-2.6
General government gross debt (% of GDP)	100.7	101.2	100.1

Source: European Commission.

Growth in 2015 was the strongest since 2008. GDP, however, was still below the pre-crisis level. The stated number of unemployed fell by 678,200 to just below 4.8 million, but this sharp drop hardly dented the jobless rate, which is still more than 20%. The average duration of contracts signed last year was 53 days, down from 79 in 2006, and 92% of the 18.6 million contracts signed were temporary. Seven out of every 10 people without a job received no type of subsidy from the Employment Ministry.

Inflation was zero, a record 68.1 million tourists visited the country (3 million more than in 2014), exports of goods were at an all-time high (€250.2 billion, +4.3%), the current account was in surplus (around 1% of GDP) and banks' earnings were much improved, following an EU bail-out of part of the financial system.

The trade deficit of €24.2 billion was 1.2% below 2014 and the second lowest since 1998. Thanks to much lower oil prices, the energy deficit (imports less exports) was down 31.5% at €26 billion. The automotive sector generated exports of €42.5 billion, 19.6% more than in 2014 and 17% of the total.

The Tax Agency notched up a record €15.6 billion (1.5% of GDP) last year in its fight against fraud and evasion, 27% more than in 2014.

Bankia to fully compensate retail investors hit by listing

Bankia, whose collapse in 2012 sparked an EU bail out of part of Spain's financial sector, is to compensate in full tens of thousands of small investors who participated in the bank's ill-fated initial public offering (IPO) in 2011.

Investors who bought shares will receive 100% of their investment, plus 1% annual interest. Those who have already sold the shares will be compensated for their loss, if any, plus interest. Bankia, 64% owned by the government, estimates retail investors put €1.855 billion into the IPO.

'This process is positive for various reasons', said José Sevilla, Bankia's CEO. 'First, it gives investors a quick exit as they will recover their money in a period we believe will not exceed 15 days from when they apply; second, it will save money by avoiding judicial processes or reducing those already begun; and third, it protects the patrimony of Bankia'.

The move came after the Supreme Court ordered Bankia to reimburse two small investors for misleading them during the IPO.

Crisis intensifies Spain's wealth inequality

The richest 1% of the population has almost as much wealth as the poorest 80%, according to a report by the NGO Oxfam Intermón which shows that Spain's economic crisis since 2007 widened the gap between rich and poor.

Spain's Gini coefficient, the most commonly used measure of inequality, where zero is perfect equality and 100 perfect inequality, rose the most among EU countries after Cyprus between 2007 and 2014 (see Figure 9).

Figure 9. Change in Gini coefficient, 2007-14

	2007	2014	Change in basis points
Cyprus	29.8	34.8	+5.0
Spain	31.9	34.7	+2.8
France	26.6	29.2	+2.6
Italy	32.0	32.4	+0.4
Germany	30.4	30.7	+0.3
Greece	34.3	34.5	+0.2
Portugal	36.8	34.5	-2.3

Source: Oxfam Intermón.

The average monthly gross salary of the top 10% of workers was €6,640 in 2014, 18 times higher than the bottom 10% (€365). The average salary fell 22.2% between 2007 and 2014.

On the tax front, the revenue from corporate income tax fell by 58% between 2007 and 2014 but total profits were only down 1%. Oxfam Intermón said its analysis of the companies that form the Ibex 35, the benchmark index of the Madrid stock exchange, revealed a 44% rise in the number of subsidiaries in tax havens in 2014, and 17 of the 35 companies did not pay any tax in Spain. Investment in tax paradises soared 2,000% (8,796% to the Cayman Islands).

Corporate scene

CAF wins £490 million rolling stock contract in UK

Rolling stock manufacturer CAF is to supply 281 new vehicles worth £490 million for the next Northern franchise in the UK.

The order consists of 31 three-car and 12 four-car electric multiple-units, and 25 two-car and 30 three-car diesel multiple-units.

Court backs Spain in dispute over renewable energy cuts

An arbitration court in Luxembourg dismissed the claims of two foreign investors against Spain's cuts in renewable energy subsidies in 2010, setting a potential precedent for other pending lawsuits.

The court said the photovoltaic subsidy cuts did not violate any expectations they might have had under energy treaties.

Spain faces around 20 claims filed by investors who say they were penalised by the cuts.