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Spain's Crisis: The State of Play

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Introduction

Spain is at the centre of the euro zone crisis. There is hardly a glimmer of light in the country's long tunnel of recession, very high unemployment and rising bad debts in the banking sector. This Working Paper looks at the current situation, the progress that has been made and the challenges ahead.

Macroeconomic Situation

Spain has been in a severe recession since 2009, apart from anaemic growth in 2011, and will not come out of it until 2014 and then only weakly. Its economic crisis has been longer and deeper (see Figure 1) due to a lopsided and unsustainable economic model, excessively based on a housing and construction boom which burst, and high levels of indebtedness, particularly among households and the private corporate sector. Economic output in the third quarter of 2012 was 5.6% below the all-time high in the first quarter of

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2008 and the fall was larger than this if it is taken into account how much the economy would have grown had there been no crisis.

Figure 1. Macroeconomic Indicators, Spain and the Euro Zone, 2009-13

	2009	2010	2011	2012F	2013F
Spain GDP growth (%)	-3.7	-0.1	+0.7	-1.5	-1.4
Euro zone GDP growth (%)	-4.4	+2.0	+1.4	-0.3	+1.0
Spain average inflation (%)	-0.3	+1.8	+3.2	+2.5	+2.7
Euro zone average inflation (%)	0.3	1.6	2.7	2.5	1.8
Spain jobless rate (%)	18.4	20.5	22.2	25.8 (1)	25.7
Euro zone jobless rate (%)	9.8	10.3	10.4	10.7 (1)	11.8

F= forecast.

(1) September.

Source: Eurostat, INE and Santander Research Department.

The government's strategy to get the economy back on its feet consists of tough adjustment measures and structural reforms. Personal income tax and VAT rates have been increased, unemployment benefits reduced, public sector salaries frozen (between 2011 and 2013) and public spending slashed in order to cut the general government budget deficit from 11.1% of GDP in 2009 to below 3% as of 2014.

The seasonally-adjusted unemployment rate has relentlessly climbed from 8% in 2007 to over 25% for the first time in the country's modern history (more than double the EU average) and shows no signs of abating. The number of jobless officially reached 5.7 million at the end of September and there were 1.7 million households in which every member was out of work. The real jobless level, however, is widely considered to be lower, though still very high, due to a black economy estimated to account for up to 25% of GDP and family support networks.

Living standards have been depressed. Per capita income in purchasing power standards dropped in 2011 to below the EU average for the first time since 2001 (see Figure 2). Income inequality has become more skewed as measured by the Gini coefficient, where zero is perfect equality and 100 absolute inequality (see Figure 3). The population at risk of poverty reached 27% in 2011 (see Figure 4).

Figure 2. Per Capita Income in Purchasing Power Standards(EU-27 = 100)

	2001	2006	2011
France	115	108	107
Germany	116	116	120
Italy	118	105	101
Spain	98	105	101
UK	120	120	108

Source: Eurostat.



Figure 3. Gini Coefficient of Selected EU Countries (1)

	2005	2011
Austria	26.2	26.3
Czech Republic	26.0	25.2
Germany	26.1	29.0
Poland	35.6	31.1
Spain	31.8	34.0
Sweden	23.4	24.4

(1) The Gini coefficient is defined as the relationship of cumulative shares of the population arranged according to the level of equivalised disposable income, to the cumulative share of the equivalised total disposable income received by them. Source: Eurostat.

Figure 4. EU Population at Risk of Poverty, 2011

	%
Bulgaria	49.1
Ireland	29.9 (1)
Greece	27.7 (1)
Spain	27.0
Italy	24.5 (1)
Germany	19.9

(1) 2010.

Source: Eurostat.

Deleveraging of companies and households continues. The indebtedness of non-financial companies and households fell from 227% of GDP in 2009 to 218% in 2011 (it is at 164% in the euro zone as a whole).

House prices are also falling, but need to decline further in order to stimulate the sale of a stock of close to 700,000 new and unsold homes at the end of 2011. There are also several white-elephant airports. The Development Ministry forecasts a stock of below 375,000 in 2014. Spanish house prices in September 2012 had declined on average by 32% since their peak in the first quarter of 2008 (a smaller fall than Ireland and the US, but more than the UK). The number of housing starts has plummeted from 762,214 in 2006 (more than Germany, Italy and France combined) to an estimated 50,000 in 2012, the lowest figure in 40 years.

The external adjustment has been more successful and politically much easier to achieve than the domestic one, as one would expect. Stronger exports (see below), much lower imports and buoyant tourism revenues have lowered the current account deficit from 10% of GDP in 2007 (one of the highest in the world in relative terms) to an estimated deficit of 2.4% this year and a surplus as of 2014. This is a considerable reduction and has been achieved without resorting to a currency devaluation, which, as a euro zone country, Spain cannot do.

Fiscal Consolidation

The government is struggling to reduce the budget deficit to 6.3% of GDP in 2012 from the recently upwardly-revised figure of 9.4% in 2011. The revision was due to several factors: inclusion of unpaid bills, financial assistance to the banking sector and downward

revisions to GDP. The aid to the banking sector accounts for the bulk of that figures and is a one-off, which does not affect Spain's commitments under the excessive-deficit procedure. But the unpaid bills and the GDP revision do count, making the comparable deficit around 9.0%. Assuming that this year's deficit comes in at closer to 7.0% of GDP, which is what most analysts believe, then the target of 6.3% would imply an adjustment of around 2 to 2.5 percentage points between 2011 and 2012 in an economy that is still in recession.

If the government meets the budget deficit target for 2012, the adjustment will be even higher. But this is far from certain. According to the International Monetary Fund (IMF), Spain's budget balance deteriorated this year the most between the IMF's April and October forecasts out of 30 advanced economies, while the upward revision for gross public debt was second only to that of Greece, mainly because of the cost of bank rescues. Gross debt is now forecast at 90.7% of GDP by the end of 2013 (36.3% in 2007) compared with 83% in Germany.

The European Commission poured cold water on the government's economic projections. In its autumn forecast for 2013 it said Spain's budget deficit looked like overshooting the 4.5% of GDP agreed with Brussels and reaching 6% unless further austerity measures were implemented.

Economic Bailout

The prospect of Spain becoming the fourth EU country with an economic bailout, after Greece, Ireland and Portugal, seems to have receded, but this could be deceptive. Madrid's borrowing costs have come down and stabilised at more manageable but still relatively high levels. The 10-year government bond yield was 5.8% in early November, down from a peak of 7.5% in July (see Figure 5), and some large companies are able to tap the markets again for funds.

The yield reduction is due more to the markets' expectation that Spain will eventually enter a programme backed by the European Central Bank, following Mario Draghi's pledge in July to do 'whatever it takes' to preserve the euro and the unveiling in September of his 'outright monetary transactions' (OMT) programme, than any substantial improvement in Spain's financial situation. The better market conditions have put the Spanish Treasury in a position to sell longer-dated bonds instead of just shorter-dated bonds that are expected to benefit from any ECB purchases.



Figure 5. 10-Year Government Bond Yields (%) and Spreads over Germany's Bunds

	Yield (%) (1)	Spread over bunds
Germany	1.4	–
Greece	17.7	+16.3
Ireland	4.9	+3.4
Italy	5.0	+3.6
Portugal	8.6	+7.2
Spain	5.8	+4.3

(1) 5 November, 2012.

Source: ThomsonReuters.

The Spanish Treasury has already achieved 95% of its gross bond issuance target of €86 billion set for 2012. The average cost of funding Spanish debt has fallen from 3.9% in 2011 to 3.4% this year, according to calculations by UniCredit.

The major EU countries do not have a united position on what Spain should do, with particular resistance in Germany over a bailout, while Prime Minister Mariano Rajoy wants a clear idea of the 'conditionality' involved in a rescue, which, if it came, would be a political stigma for the PP.

Spain's financing needs in 2013 will remain high and its economy will still be in recession (to a greater extent than the government's forecasts, according to the European Commission's autumn forecast). The bond markets may be calmer towards Spain at the moment, but they can quickly become nervous and turn against Madrid if added problems, particularly the constitutional crisis sparked by Catalonia's determined push for independence, get out of hand or if the markets become convinced that the government's apparent gamble of playing for time in the hope that it can avoid a rescue is too risky.

Moody's Investors Service warned in October that Spain risked being downgraded to junk unless it requested financial aid. The nation's bonds are rated one step above non-investment grade with a negative outlook.

The private sector, in general, would welcome a bailout as it would end uncertainty.

Competitiveness

Between 1998 and 2009, when Spain lived beyond its means, unit labour costs rose by 38%, compared with 23% for the euro zone as a whole. In the past two years, they have come down by more than 4%. Wages are also falling in real terms, after rising rapidly during the first years of the single currency, and the real effective exchange rate has declined since 2008, which signifies an improvement in the competitive position (see Figure 6).



Figure 6. Real Effective Exchange Rate (index, 2005 = 100) (1)

	2004	2005	2006	2007	2008	2009	2010	2011
Euro area	100.9	100.0	99.7	104.1	109.9	110.7	103.4	102.4
Spain	96.5	100.0	103.1	108.7	113.5	110.3	109.0	109.0
Germany	103.4	100.0	96.6	97.4	101.3	102.1	99.8	98.2

(1) Defined as the ratio, in common currency, of the unit labour costs in the manufacturing sector to the weighted average of those of its industrial country trading partners, using 2004-06 trade weights.

Source: World Economic Outlook, IMF, April 2012.

All of this is restoring competitiveness, though Spain remained in 36th position in the World Economic Forum's latest global competitiveness index (see Figure 7).

Figure 7. Global Competitiveness Index 2012-2013, Selected Rankings (1)

Country ranking

1. Switzerland
2. Singapore
6. Germany
6. US
8. UK
21. France
29. China
- 36. Spain**
42. Italy

(1) Out of 144 countries.

Source: World Economic Forum.

Spain ranks high in criteria such as the quality of train infrastructure (the network is the fifth largest in the world) and business schools, but still low in labour market conditions, budget-deficit control and access to credit (see Figure 8).

Figure 8. Spain's Competitiveness Ranking by Various Criteria, 2012-2013

Criteria	Ranking out of 144 countries
Institutions	48
Infrastructure	10
Quality of train infrastructure	8
Macroeconomic environment	104
Control of budget deficit	135
Health and primary education	36
Life expectancy	7
Primary education	6
Higher education and vocational training	29
Secondary education	2
Business schools	4
Efficiency of goods market	55
Labour market	108
Flexibility of wages	129
Hiring and firing system	129
Productivity and remuneration	133
Financial system	82
Access to credit	122
Technology	26
Market size	14
Business development	32
Innovation	35

Source: World Economic Forum.

Exports¹

Enhanced competitiveness has helped boost exports, which in the last four years have been something of a success story. The recession has made many more companies sell their products and services abroad and pare down their profit margins. Between 2009 and 2011 exports of goods rose by €54.6 billion to €214.5 billion (20% of GDP), an improvement equivalent to 5.1% of GDP and a faster pace of growth than Germany, France and Italy, albeit from a smaller volume. Merchandise exports continued to grow in 2012 and accounted for around 22% of GDP, up from 18% a decade earlier.

Spain is the world's 18th largest exporter of goods, the same as India. Exports of goods rose from US\$118.9 billion in 2002 to US\$297 billion in 2011, according to the World Trade Organisation. While the US, the UK, Germany, France and Italy have all lost global market share to varying degrees over the last decade, mainly to China and other emerging countries, Spain's share of world merchandise exports has remained virtually unchanged at around 1.7% (see Figure 9). Spain only lost 0.4 pp of its global share since its peak of 2.0% in 2004, compared with Germany's 1.9 pp since 2004, the US's 4.0 pp since 2000, France's 1.6 pp since 2004 and Italy's 0.9 pp since 2004.

Figure 9. Ranking by Global Market Share of Merchandise Exports (%), 2002-11

Country ranking	2011	2010	2009	2002
1. China	10.4	10.4	10.1	5.1
2. US	8.1	8.4	8.5	10.8
3. Germany	8.1	8.3	9.0	9.5
6. France	3.3	3.4	3.9	5.1
8. Italy	2.9	2.9	3.2	3.9
11. UK	2.6	2.7	2.8	4.3
18. Spain	1.6	1.6	1.7	1.9

Source: World Trade Organisation.

In exports of commercial services, Spain has the eighth-largest global share, the same as Japan. They increased from US\$61.1 billion in 2002 to US\$141 billion in 2011. The global share has dropped by 0.6 pp since 2002 to 3.4%, a much smaller decline than all the other countries in Figure 10.

Figure 10. Ranking by Global Market Share of Exports of Commercial Services (%), 2002-11

Country ranking	2011	2010	2009	2002
1. US	13.9	14.1	14.2	17.4
2. UK	6.6	6.2	7.2	7.9
3. Germany	6.1	6.3	6.5	6.2
4. China	4.4	4.6	3.9	2.4
5. France	3.9	3.8	4.2	5.5
8. Spain	3.4	3.3	3.7	4.0
13. Italy	2.6	2.6	3.0	3.8

Source: World Trade Organisation.

¹ I deal with Spain's multinationals and exports in much greater detail at 'The Rise of Spain's International Presence'

http://www.realinstitutoelcano.org/wps/wcm/connect/aaf25a804d1679b8936bdbf2157e2fd8/Chislett_Atlas_Spain_Brand_Oct2012.pdf?MOD=AJPERES&CACHEID=aaf25a804d1679b8936bdbf2157e2fd8.

Partly thanks to higher exports, Spain recorded a current account surplus of €1.2 billion in August, the second monthly one since 1998 before Spain joined the euro. The trade deficit for January-August was €23.5 billion, 23.3% lower than in the first eight months of 2011 (the energy bill accounts for a big part of the deficit). This reduction, coupled with the higher surplus on the services account (including tourism) lowered the current account deficit for the first eight months to €16.1 billion from €26.5 billion in the same period of 2011. The new EU member states (as of 2004) are the only group of countries which have adjusted their current account positions more rapidly than Spain, but most of them do not belong to the euro zone and hence can reduce their deficits through exchange-rate policies.

Banking System

The collapse of many of Spain's savings banks, which accounted for 40% of total assets in 2007 before the onset of recession, as a result of their excessive exposure to the real estate sector and very poor and politically-influenced management, has given the whole of the country's banking system a bad name and a monumental headache for the government. Bad loans as a proportion of total lending by all banks rose from a mere 0.7% in 2006 to a record 10.5% in August 2012.

The number of *cajas*, as they are called, dropped from 46 to 12 between December 2008 and October 2012, mainly due to mergers forced through by the Bank of Spain. The biggest merger, which created Bankia in 2011, the fourth-largest lender and listed on the Madrid stock exchange, has been a disaster. It was nationalised this year. The bank's losses in the first nine months of 2012 amounted to €7 billion, compared with a pro-forma profit of €295 million in the same period of 2011.

César Molinas, a former investment banker at Merrill Lynch and the author of an upcoming book on Spain's political class, said the downfall of Bankia, was 'just the latest in a long series of cases that Congress has decided to treat as though they were natural disasters, like an earthquake, which has victims but no culprits'.²

Spain has been immersed in a process of deepening the provisioning and recapitalisation of its banking sector since 2009. Three main steps have been taken to strengthen the credibility of –and confidence in– the financial system:

- The requirement for more provisions for loans to the construction and real estate sectors, differentiated by the type of asset and situation, including those up to date with payments (Royal Decree Law 2/February 2012 and RDL 18/May 2012).

² César Molinas, 'Theory of Spain's political class', *El País*, 12/IX/2012
http://elpais.com/elpais/2012/09/12/inenglish/1347449744_053124.html.

- Expert and independent assessment of banks' balance sheets between May and September 2012.
- Request for financial assistance of up to €100 billion from European institutions to recapitalise those banks which require it.

The extra provisions and capital emanating from the two Royal Decrees amount to €84,000 million to cover possible losses from real-estate loans in the coming years. These requirements, which must be covered by the end of 2012, will raise the average coverage of loans to the real-estate sector from 18% at the end of 2011 to 45%. The property developments underway and land, both foreclosed and in doubtful situation, will increase their coverage levels to 65% and 80%, respectively.

The second step was an exercise of transparency, which expanded the analysis on the real-estate exposure to all lending to the private resident sector. This exercise was conducted on the 14 largest banks (90% of assets), and in two phases. The first one, a top-down analysis by the consultancies Oliver Wyman and Roland Berger, assessed the whole sector's capacity of resistance in 2012-14 under two scenarios to determine the global capital needs. One scenario was standard and the other adverse. The second phase was a bottom-up analysis of banks in order to classify, provision and measure credit risks. The individual capital needs were calculated under a baseline and an adverse scenario. The latter (probability of less than 1%) was based on a 6.5% shrinkage in GDP between 2012 and 2014, a further rise in unemployment (to 27.2% in 2014) and a big fall in real-estate prices. The scenario was the toughest of those applied in stress tests in Europe so far.

The results of the bottom-up analysis were:

- Total cumulative losses on the credit portfolio (loans in Spain) were €270,000 million in the adverse scenario and €183,300 in the baseline.
- After taking into account the banking system's absorption capacity (provisions already made, pre-provision profits, protection frameworks and the excess of capital vs. the capital required in the adverse scenario), the system's additional capital needs amount to €57,300 million in the adverse scenario and €24,000 million in the baseline scenario. This is below the €100 billion in rescue loans requested.

The four groups in which the Fund for the Orderly Restructuring of the Banking Sector (FROB) has a holding (15% of the system's total assets) account for 86% of the sector's capital needs. Another group of banks, without FROB involvement, which need more capital, account for 12% of total assets.

The picture, however, is not as bad as it seems. Seven banking groups, including Santander, BBVA and CaixaBank, the three largest, which together account for more than 60% of the system's total assets, have no extra capital needs. Even in the most adverse

scenario, Santander, the euro zone's largest bank by market capitalisation, would have a core capital of 10.8% in 2014, €25,297 million above the minimum requirement. The Financial Stability Board included Santander and BBVA in November in the updated list of global systemically important banks and in the lowest risk category.

Lastly, a 'bad bank' has been set up for the real-estate assets of troubled lenders with steep discounts that the government hopes will attract private investor funds. The Asset Management Company (Sareb) imposed in October an average write-down of 45.6% on the banks' property loans and an average of 63.1% on foreclosed properties held by lenders. The size of the discount attached to properties suggested there will be further price falls.

Foreign Direct Investment in Spain

Spain had the world's ninth-largest stock of inward foreign direct investment (FDI) at the end of 2011 and FDI continued to rise in the first half of 2012 (see Figure 11), although partly because of the recapitalisation by foreign parent banks of their affiliates, hit by the sovereign debt crisis, and not greenfield investment. The FDI inflow was US\$14.8 billion in the first six months, up from US\$3.1 billion in the same period of 2011 (see Figure 12). Italy saw a net divestment of US\$1.6 billion, compared with inflows of US\$13.9 billion in the first six months of 2011.

Among the latest investments in Spain was the decision by Investindustrial, the Italian private equity group, to take full control of PortAventura, Europe's third-largest theme park. The group will acquire the other 50% it does not already own at a cost of around €120 million.

Figure 11. Stock of Inward Foreign Direct Investment (US\$ million and % of world total), 2011

Country	Amount (US\$ million)	% of world total (1)	% of GDP
US	3,509,359	17.0	23.2
UK	1,198,870	5.8	49.8
Hong Kong, China	1,138,365	5.5	467.3
France	963,792	4.7	34.7
Belgium	957,836	4.6	186.7
Germany	713,706	3.5	20.0
China	711,802	3.5	10.1
Brazil	669,670	3.2	27.7
Spain	634,532	3.1	42.1
Sweden	338,484	1.6	63.4
Italy	332,664	1.6	15.2

(1) Figures rounded to nearest decimal.

Source: World Investment Report, 2012, UNCTAD.

Figure 12. Foreign Direct Investment Inflows, First Half of 2012 (US\$ billion)

Country	US\$ billion
China	59.1
US	57.4
Hong Kong, China	40.8
France	34.7
UK	30.8
Germany	10.0
Spain	14.8
Ireland	14.7
Portugal	7.8
Italy	-1.6

Source: Global Investment Trend Monitor, 23 October 2012, UNCTAD.

The 2012 business climate barometer from the standpoint of foreign investors, released at the end of October and drawn up by the IESE business school and the government-run Invest in Spain, is only slightly lower than in 2011 (2.7 out of 5 as against 2.9). The survey of over 250 companies was conducted in June and does not reflect some of the structural changes since then.

According to the report, Spain's main strengths are the availability of:

- Infrastructure (airports, high-speed trains and roads).
- Skilled and non-skilled labour force.
- Culture and leisure environment.

Its main weaknesses are:

- A scarcity of bank financing and its high cost and of other financing sources.
- An excessive bureaucratic burden in establishing and operating a company.
- The need for further flexibility and lower labour costs.
- The need for more investment incentives for R+D+i.

Compared to the 2011 barometer:

- The regulatory framework was the only area that received (slightly) better marks.
- The rise in 'general costs' was seen as the highest deterioration year-on-year, followed by financing and market size.
- The rest of the surveyed areas (labour market, taxation, infrastructures, labour force, innovation and quality of life) received slightly lower marks.

The forecast for 2012:

- In general, companies perceived the economic situation as worse than a year ago. But a majority expected their own company to perform the same or better in 2012 than in 2011.

- 88% of respondents (95% in 2011) expected to maintain or improve their exports from Spain in 2012.
- 70% (80% in 2011) expected to maintain or increase their investment and their number of employees.
- 63% (88% in 2011) expected to maintain or increase their turnover.

Spain's position in the World Bank's latest annual ranking on the ease of doing business remained unchanged at 44th, but it slipped two places to 136th out of 185 countries for starting a business (see Figure 13). It takes an average of 28 days to start a business in Spain (OECD average of 12) and 10 procedures (double the OECD average).

Figure 13. Ranking on the Ease of Doing Business 2013, Selected Countries (1)

	Number of procedures	Times (number of days)
1. Singapore	3	3
4. US	6	6
7. UK	6	13
20. Germany	9	15
34. France	5	7
43. Peru	5	26
44. Spain	10	28

(1) Out of 185.

Source: World Bank.

Spanish Direct Investment Abroad and Multinationals

Spain's stock of outward investment stood at US\$640.3 billion at the end of 2011, the 10th largest in the world and higher than Italy's in relative and absolute terms (see Figure 14). Most of this investment was made in the last 20 years, and with it the creation of a core group of multinationals with significant positions in the global market (see Figure 15). These companies comprise the most dynamic part of the economy. Two of them, Zara, the fashion retailer and the flagship of Inditex, and Santander, the euro zone's largest bank by market capitalisation, are among the world's 100 most valuable brands, according to Interbrand.

Figure 14. Stock of Outward Foreign Direct Investment (US\$ million and % of world total), 2011

Country	Amount (US\$ million)	% of world total (1)	% of GDP
US	4,499,962	21.2	29.8
UK	1,731,095	8.2	71.9
Germany	1,441,611	6.8	40.4
France	1,372,676	6.5	49.4
Hong Kong, China	1,045,920	4.7	429.3
Switzerland	991,966	4.7	154.1
Japan	962,790	4.5	16.5
Belgium	944,056	4.4	184.0
Netherlands	943,086	4.4	112.4
Canada	670,417	3.2	38.6
Spain	634,532	2.9	42.5
Italy	512,201	2.4	23.2

(1) Figures rounded to nearest decimal.

Source: World Investment Report 2012, UNCTAD.



Figure 15. Spanish Multinationals with the Largest Global Market Positions (1)

Company	Industry	Global market position
Ebro Puleva	Food processing	#1 producer of rice, and 2 nd of pasta
Grupo SOS	Food processing	#1 producer of olive oil
Viscofán	Food processing	#1 producer of artificial casings for the meat industry
Freixenet	Sparkling wine	#1 producer of sparkling wine
Tavex	Textiles	#1 producer of denim
Inditex	Clothing	#1 fashion retailer by sales
Pronovias	Clothing	#1 maker of bridal wear
Acerinox	Steel	#3 producer of stainless steel
Repsol	Energy	#3 privately-owned shipper of liquefied gas
Roca	Sanitary equipment	#1 maker of sanitary equipment
Grupo Antolín	Automobile components	#1 producer of interior linings
Zanini	Automobile components	#1 producer of wheel trims
Gamesa	Machinery	#4 manufacturer of wind turbines
Indo	Optical equipment	#3 manufacturer of lenses
Mondragón	Diversified	#1 worker-owned cooperative group
Iberdrola	Electricity	#1 wind farm operator
Grupo Ferrovial	Infrastructure	#4 developer & manager of transportation infrastructure (Public Works Financing 2011) (2)
ACS/Hochtief	Infrastructure	#1 developer & manager of transportation infrastructure (Public Works Financing 2011) (2)
Acciona	Infrastructure, renewable energy and water	#6 in wind energy and #7 in renewables (Bloomberg New Energy Finance)
Abertis	Infrastructure	#3 developer & manager of transportation infrastructure (Public Works Financing 2011) (2)
Telefónica	Telecom	#5 telecom operator by total customers (3)
Santander	Banking	#4 most valuable bank brand (BrandFinance 2011), largest bank by market capitalisation in the euro zone, and #1 franchise in Latin America (double that of its nearest competitor)
Prosegur	Security	#3 company by sales
Sol Meliá	Hotels	#17 Sol Meliá hotels by number of beds
Real Madrid	Sports	#1 football club by revenue

(1) 2011 or latest available.

(2) Ranked by number of road, bridge, tunnel, rail, port and airport concessions over US\$50 million investment value put under construction or operation as of October 1, 2011.

(3) Three of the four companies ahead of Telefónica are Chinese.

Source: compiled by William Chislett, Esteban García-Canal and Mauro F. Guillén from various sources.

The internationalisation of companies has significantly increased the proportion of revenues generated abroad. The companies that form the Ibex 35, the benchmark index of the Madrid stock market, earned, as a whole, 60% of their total revenues abroad in the first half of 2012 (see Figure 16). Acerinox (stainless steel) generated 92% of its revenues abroad, ACS (construction) 81% and Santander (banking) 79%.

Figure 16. International revenues of Ibx 35 companies, First Half of 2012 (€billion and % of total) (1)

Company	Sector	Total revenues (€bn)	International (% of total)
Abengoa	Technology	3.7	72.3
Abertis	Motorways	1.8	55.5
Acciona	Construction	3.3	39.6
Acerinox	Metals	2.4	91.6
ACS	Construction & services	18.8	81.3
Amadeus IT Holding	Travel technology	1.5	6.6
Banco Popular	Banking	2.7	8.8
Banco Sabadell	Banking	1.9	5.2
Banco Santander	Banking	30.5	79.5
Bankinter	Banking	0.0	0.0
BBVA	Banking	12.7	63.7
Dia	Supermarket chain	5.0	48.8
Enagás	Electricity	0.5	0.0
Endesa	Electricity	15.8	38.0
FCC	Construction	5.3	56.2
Ferrovial	Construction	3.6	61.6
Gamesa	Wind turbines	1.6	85.2
Gas Natural	Gas	12.4	44.0
Grifols	Pharmaceutical	1.3	91.5
IAG	Airlines	7.8	86.6
Iberdrola	Electricity	16.9	52.4
Inditex	Fashion retailer	7.2	77.5
Indra	Electronics	1.4	53.6
Mapfre	Insurance	9.1	58.7
Mediaset (Telecinco)	Media	1.7	71.7
OHL	Construction	2.5	74.4
Red Eléctrica	Electricity	0.8	2.4
Repsol	Oil	28.7	47.0
Sacyr-Vallehermoso	Construction	1.7	43.0
Técnicas Reunidas	Engineering	1.3	96.0
Telefónica	Telecoms	30.9	75.0
Total		239.8	60.4

(1) Figures rounded to nearest decimal point.

Source: Based on figures from the National Securities Market Commission.

The pace of investing abroad has slowed down enormously since the peak of US\$137 billion in 2007, the year before the onset of Spain's crisis, but some significant investments continued to be made this year. Santander, for example, took over Poland's Kredyt Bank in February and is merging it with Bank Zachodni, which it acquired in 2010, to make it the country's third-largest bank. Poland, the largest of the countries that joined the EU in 2004, has escaped the recession that has hit virtually all EU countries and in the first nine months of 2012 contributed 5% of Santander's recurring attributable profit (16% in Spain).

Immigration and Emigration

Very few countries have received such an influx of immigrants in a decade and absorbed them remarkably well. Between 2003 and 2012 Spain's foreign population (EU and non-EU citizens) increased from 2.6 million to 5.7 million (see Figure 17). Immigrants, whose unemployment rate is more than 30%, are returning home in increasing numbers, particularly Latin Americans, and more and more Spaniards are emigrating. As a result, Spain has stopped being a net importer of people.

Figure 17. Spain's Population and Foreigners' Share, 2003-12

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Population (mn)	42.7	43.2	44.1	44.7	45.2	46.1	46.6	46.9	47.1	47.2
Foreigners' share (%)	6.2	7.0	8.4	9.3	10.0	11.4	12.0	12.2	12.2	12.1

Note: the figures at 1 January of each year are based on those registered with local town halls. Foreigners have an incentive to do this as it entitles them to public health care and education, although not everyone does so. Failure to register leaves individuals with no legal recourse and no access to state services or aid.

Source: INE (National Statistics Office).

Close to 55,000 Spaniards emigrated in the first nine months of 2012, 21.6% more than in the same period of 2011. The total number who left the country was 420,150 (+9.8%). Since January 2011, 927,890 foreigners, mainly from non-EU countries, and 117,523 Spaniards have voted with their feet, largely in search of a better life. As a result, Spain's population is beginning to decline after relentlessly rising.

While the pace of emigration has quickened, that of immigration has slowed down. A total of 282,520 people arrived in the first nine months of 2012 (29,373 of them Spaniards), down from 345,890 in the same period of 2011. Net migration (the difference between the number of emigrants and immigrants) was 137,630, compared with 36,720 in 2011.

International Presence

Spain has taken a battering in the last four years, but it has not affected its international presence. The country has remained in 11th position in Elcano's Global Presence Index since 2000 (see Figure 18). The index measures the international positioning of countries on the basis of three categories: economic, military and 'soft' presence.

Figure 18. World Ranking in Elcano's Global Presence Index

2011	2010	2005	2000	1995	1990
1. US	US	US	US	US	US
2. Germany	Germany	Germany	Germany	Germany	Russia
3. UK	UK	UK	France	France	Germany
4. France	France	France	UK	Japan	France
5. China	China	Japan	Japan	UK	UK
6. Japan	Japan	Russia	Russia	Russia	Japan
7. Russia	Russia	China	Canada	Italy	Italy
8. Netherlands	Netherlands	Canada	Italy	Canada	Canada
9. Canada	Canada	Italy	Netherlands	Netherlands	Netherlands
10. Italy	Italy	Netherlands	China	Spain	Spain
11. Spain	Spain	Spain	Spain	China	Belgium

Source: www.iepg.es.

The economic presence is made up of the exports of primary goods, energy, manufactures, services and outward foreign direct investment. The military presence is measured by the number of troops actually deployed abroad and the equipment that enables their deployment overseas. The 'soft' presence includes immigrant population, tourist arrivals, results in major sport competitions, exports of audiovisual activities, international dissemination of information via the Internet, volume of foreign-oriented patents, international activity of its academic-university system (both in terms of research,

through academic publications, and teaching, as measured by the number of foreign students) and development aid.

The Challenges

Job Creation

The main challenge on the economic front and the most pressing socially is to create jobs to soak up the enormous pool of unemployed and satisfy the aspirations of those entering the labour market. The size of Spain's unemployment problem is such that the country, with 11% of the euro zone's GDP and a population of 47 million, officially accounted in September 2012 for 31% of the zone's 18.5 million total jobless (5.7 million), whereas Germany (population 82 million and 30% of the GDP) accounted for only 15% of the unemployed (2.8 million). Spain's seasonally-adjusted jobless rate of 25.8% was the highest in 30 years and almost five times that of Germany's rate of 5.4%, the lowest since reunification in 1991. This disproportionate difference cannot be explained away by Germany's *kurzarbeit* system, under which companies agree to avoid laying off workers and instead reduce their working hours with the government making up some of the employees' lost income, or by Spain's labour market rules.

Spain's youth unemployment for those aged 16 to 25 is even more dramatic, at more than 50%. This staggering figure is often misunderstood to mean that half of young people are jobless, which is not the case. The figure includes those in education or not seeking work. The 'real' unemployment rate for this age bracket, based on the methodology employed by EU countries to calculate those without work, looking for it and not in education or another form of activity, is still high, however, at 23%.

Labour market reforms in February brought the level of Spain's severance payments closer to the euro zone's (a maximum of 33 days up to 24 months as against the previous maximum of 45 days and 44 months for those on permanent contracts), but have so far had a negligible impact on job creation. Equally significant, collective wage bargaining agreements can now take more account of companies' individual circumstances and are not automatically binding for the whole sector, regardless of the state of a firm's finances. Companies say the reforms have already positively changed the dynamics of wage negotiations (real wages rose by 3.2% in 2009 even though the economy shrank by 3.7%).

While the labour market reforms should facilitate job creation once the economy gets moving again, they are not a panacea. Spain's problem is its economic model, which, excessively based on the real estate and construction sectors, showed itself to be incapable of creating jobs on a sustained basis during the 13-year boom. The majority of the more than 3 million people who lost their jobs over the last four years worked in these labour-intensive sectors and those related to them such as manufacturers of doors, windows, furniture, tiles, cement and bricks, and real estate agencies, etc.

Spain needs to change its economic model. New jobs will not come, as they did in the past, from the construction sector or the public sector (central, regional and local governments), which this year has been shedding jobs on an unprecedented scale.

Given the state of the education system and the large pool of unskilled workers, it will be very difficult to change the model. One in every four people in Spain between the ages of 18 and 24 were early school-leavers in 2011, double the EU average but down from a peak of one-third during the economic boom, when students dropped out of school and flocked in droves to work in the construction sector (see Figure 19). Results in the OECD's Pisa tests in reading, mathematics and scientific knowledge are poor, there is no university in the world's top 200 in the main academic rankings (up to 35% of students drop out before graduation and only a third complete their studies on time) and research and development and innovation spending, at 1.4% of GDP, is way below that of other developed economies.

Figure 19. Early School Leavers (% of those Aged between 18 and 24 who Left School after their Compulsory Education)

	2007	2011
Malta	38.3	33.5
Spain	31.0	26.5
Portugal	36.9	23.2
Italy	19.7	18.2
EU-27	15.1	13.5
France	12.6	12.0
Germany	12.5	11.5
Slovenia	4.1	4.2

Source: Eurostat.

More worrying still is that more than 25% of those aged between 15 and 29 are not in employment, education or training (known as NEETs), around 10 points above the OECD average. These people form a 'lost generation' which is tangibly frustrated and bitter. Experience shows that if a young person is not on the job ladder by 24 they are likely to suffer the consequences for the rest of their lives.

Politics

Spain has been ruled for most of the time since democracy was restored after the end of the Franco dictatorship by the Socialists or the conservative Popular Party (PP), in what is essentially a two-party system (see Figure 20), with the governing party if it does not have a parliamentary majority relying on regional parties for support.

Figure 20. Results of General Elections, 1977-2011 (% of total votes)

	1977	1979	1982	1986	1989	1993	1996	2000	2004	2008	2011
UCD (centrist)	34.5	35.0	–	–	–	–	–	–	–	–	–
Socialists	29.4	30.5	48.3	44.1	39.6	38.8	37.6	34.7	42.6	43.6	28.7
Communists (1)	9.4	10.8	4.0	4.6	9.1	9.6	10.5	5.5	4.9	3.8	5.4
Conservatives (2)	8.2	6.0	26.5	26.0	25.8	34.8	38.8	45.2	37.6	40.1	44.6
Catalan (3)	2.8	2.7	3.7	5.0	5.0	4.9	4.6	4.2	3.2	3.0	4.1
Basque (4)	1.6	1.5	1.9	1.5	1.2	1.2	1.3	1.5	1.6	1.2	1.3
Other	14.1	13.5	15.6	18.8	19.3	10.7	7.2	8.9	10.1	8.3	15.9

(1) Spanish Communist Party, known as United Left as of the 1986 election.

(2) Popular Alliance, known as the Popular Party as of the 1989 election.

(3) Centre-right Democratic Agreement for Catalonia, known as Convergence and Union as of the 1979 election.

(4) Centre-right Basque Nationalist Party.

UCD = Union of the Democratic Centre.

Source: Interior Ministry.

The political system worked reasonably well until the onset of the crisis in 2008. Today, however, politicians are viewed by a significant segment of the adult population as part of the problem and not the solution. A survey in October by the government-funded Centre for Sociological Research (CIS) showed the political class as the country's third most serious problem (one in four respondents, the highest level ever) after unemployment and other economic problems (see Figure 21).

Figure 21. What are Spain's Main Problems?

	% of respondents
Unemployment	79.3
Other economic problems	49.4
The political class	26.9
Healthcare	9.1
Corruption and fraud	8.5

Source: CIS, October 2012.

Spaniards blame politicians for creating the property bubble, the bursting of which has produced in relative terms much greater unemployment than in any other country with a housing boom and bust, the collapse of banks and *en route* many corruption scandals involving regional and local politicians. Relations between politicians and the regionally-based and unlisted savings banks –whose exposure to the real-estate sector has shaken the financial system– became particularly incestuous.

Generally speaking, Spaniards view the political elite as a self-serving caste that puts its own interests before those of the nation. Surveys also show support for much greater consensus between the two main parties, as existed during the transition to democracy.

Support for the ruling Popular Party since it returned to power last November with a sweeping victory has inevitably plummeted because of its unpopular measures, but the Socialists have not advanced. Rather like the Labour Party in the UK (defeated by David Cameron's Conservatives in the 2010 election), the Socialists have not yet been able to escape their past and the awful economic legacy they left the PP. Furthermore, the Socialists are fragmenting as a national party, particularly in Catalonia over the independence issue.

If there were elections now, the PP would gain 29.9% of the vote, down from 44.6% in November 2011 when it won the election, and the Socialists 23.9% (28.7%), according to a poll by Metroscopia in October.

Conclusion: The Spain Brand and Image

Spain's image and by association the Spain brand have taken a knocking as one would expect as there is a lot more negative news about the country. This was most forcefully displayed in a front page story in the *New York Times* in September titled 'Hunger and Austerity' and illustrated by a photo of a man scrounging for food in a rubbish container and other stark pictures in black and white on the NYT website. Such a story, which coincided with a visit to New York by King Juan Carlos and Mariano Rajoy, the Prime Minister, in a bid to counter the country's deteriorated image, could have been written about many other EU countries, let alone the US, and was far from unique to Spain.

The image is out of sync with the country's reality, depressed though it is and as this Working Paper has tried to show. It will not be easy to change perceptions. The PP administration is more assertive than the previous Socialist government and has created the post of High Commissioner for the Spain Brand with the rank of Secretary of State (under the wing of the Foreign Ministry) and is making foreign policy more commercially focused. José Luis Rodríguez Zapatero, the last Prime Minister (2004-11), promised to set up and head a Public Diplomacy Commission (in June 2008) along the lines of other countries, such as Germany, Finland and the UK, which successfully re-branded themselves, but did not get it off the ground.

Perhaps the best sign that all is not as bad as it is sometimes painted is that tourists continue to flock to Spain. This year looks like surpassing 2011's bumper figure of 56.7 million foreign visitors.

Appendix 1: A Snapshot of Spain Today

Figure 22. A Snapshot of Spain Today (1)

Global Ranking	Description
Top 15	13 th largest economy in purchasing power parity terms
Top 25	25 th in the Democracy Index of the Economist Intelligence Unit, ahead of France
Top 10	9 th largest stock of inward foreign direct investment, ahead of Italy
Top 10	11 th largest stock of outward direct investment, ahead of Italy
Top 25	23 rd in the United Nations' Human Development Index out of 177 countries
Top 10	9 th longest life expectancy at birth
Top 5	4 th largest tourist destination in terms of visitors
Top 10	9 th producer of cars
Top 5	Largest installed capacity of solar energy
Top 5	Largest international manager of infrastructure
Top 5	Biggest producer of olive oil
Top 5	Biggest producer of sparkling wine (<i>cava</i>)

(1) The figures were the latest available at October 2012.

Source: IMF, Economist Intelligence Unit, UN Human Development Report 2011, World Investment Report 2011 (UNCTAD), ANFAC, the World Tourism Organization and the Spanish Foreign Ministry.

Appendix 2: Basic Socio-Economic Statistics, 1975-2011

Figure 23. Basic Socio-Economic Statistics, 1975-2011

	1975 (1)	2011 (1)
Population (mn)	36.0	47.2 (2012)
Foreign population	165,000	5.7 mn (2012)
Foreign population (% of total)	0.4	12.1 (2012)
Unemployment rate (%)	4.7	25.8 (2)
GDP (current prices, US\$ mn)	111,442	1,450,517
Per capita GDP (US\$)	3,186	32,360
GDP structure (% of total)		
Agriculture	9.0	2.4
Industry	39.0	2.0
Services	52.0	63.4
Employment by sectors (% of the active population)		
Agriculture	21.8	4.8
Industry and construction	37.8	22.6
Services	40.4	72.6
Exports of goods and services (% of GDP)	10.4	30.1
Imports of goods and services (% of GDP)	11.9	30.7
Number of tourists (million)	27.3	56.9
Consumer price inflation (%)	17.2	3.2
	(av. ann. incr.1972-77)	
Gross national saving (% of GDP)	25.5	18.0
Government debt (% of GDP)	42.3(1985)	68.5
Government spending (% of GDP)	30.4 (average 1974-85)	43.6
Government revenue (% of GDP)	18.4	35.1
Inward stock of foreign direct investment (US\$ bn)	5.1 (1980)	634.5
Outward stock of Spanish investment (US\$ bn)	1.9 (1980)	640.3
Spending on R&D (% of GDP)	0.35	1.4(2010)
Passenger cars per 1,000 population	123	478 (2009)
Average number of children per woman	2.8	1.3
Proportion of births outside marriage (%)	1.4 (1970)	32 (2009)
UN human development index	0.680 (1980) (3)	0.878 (3)
Average life expectancy at birth (years)	73.3	81.4
Percentage of population under the age of 15	27.8 (1970)	15.0
Percentage of population over the age of 65	9.7 (1970)	16.8
Early abandonment of education (4)	17.7	26.5

(1) Unless otherwise stated.

(2) September 2012, seasonally adjusted.

(3) The maximum value is one. The index is based on life expectancy at birth, mean years of schooling, expected years of schooling and per capita income.

(4) The proportion of the population between 18 and 24 who left school after receiving their compulsory education.

Source: Eurostat, National Statistics Office of Spain (INE), World Bank, United Nations Conference on Trade and Development (UNCTAD), BBVA Foundation and Santander Research Department.