

## Inside Spain Nr 127

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### Summary

Heading towards a new election.  
Panama Papers claim the head of Industry Minister.  
Spain ranked above UK and US in press-freedom index.  
Spain to be given more time to meet EU's budget deficit threshold.

### Domestic Scene

#### Heading towards a new election

Barring a last minute change of tactic by the conservative Popular Party (PP) or the anti-austerity Podemos, Spaniards will go to the polls in June for the second time in six months, and with the likelihood of another fragmented parliament.

The pact between the Socialists (with 90 seats) and the centrist Ciudadanos (40) to form a government, sealed in February, is the only achievement of the ongoing wrangling that followed December's inconclusive election. But their combined seats are far from a majority in the 350-seat parliament and to succeed they need the support or abstention of Podemos or the PP in parliamentary investiture votes.

Both parties, for very different reasons, decided not to back the pact. If parliament fails to elect a new Prime Minister by 2 May, King Felipe will officially call a new election probably for 26 June.

Podemos's leader, Pablo Iglesias, put support for the Socialists and Ciudadanos deal to the vote of party members after the leadership denounced it. He urged the Socialists to join with them instead in a coalition government including regional parties. That line was backed by 88% of Podemos's members who voted, making it impossible for the party's 69 MPs (27 of whom are from allied groupings that ran under other names in Catalonia, Valencia and Galicia) to get a minority government led by the Socialist leader Pedro Sánchez agreed in parliament.

Sporadic talks between the Socialists and Podemos made little progress. Podemos's economic programme is much more radical than the one agreed between the Socialists and Ciudadanos, and Podemos (12 of its MPs are from Catalonia) insists on a referendum in Catalonia on independence, a 'red line' for the Socialists.

The PP (with 123 seats, the largest number but far from its 186 in the 2011 election) made it very clear from the start that it would not support any deal that did not involve it.

Its strategy has been to push for a German-style grand coalition with the Socialists and Ciudadanos, but neither of these parties wants to get into bed with a PP still led by Mariano Rajoy and very tainted by numerous corruption cases. Rajoy turned down the King's offer in January to have the first shot at forming a government in the knowledge that no one would support him. In the latest case to affect the PP, José Torres Hurtado, the Mayor of Granada for 12 years, resigned after he was arrested for alleged corruption in the building of a discotheque and leisure centres in an urban green space.

The failure to form a government looked like leading inevitably to a repeat election unless there was a last minute surprise. As we went to press the King met party leaders in a last-ditch bid to see whether a government could be formed.

According to a Metroscopia poll, the PP would win a slightly higher share of the votes in a new election, despite the corruption scandals, while the other three parties would drop (see Figure 1). The PP's voters are the most loyal and the party would benefit from a lower turnout if fewer Spaniards, fed up with the blame game among all parties, decide not to cast their vote. If the vote for Ciudadanos and PP rises a centre-right government could be formed and the Socialists could be drawn into a grand coalition, leaving Podemos as the main opposition, although this would put the Socialists in an uncomfortable position.

**Figure 1. Voter intention (% of valid votes and with voter turnout of 73%)**

	2011 election	2015 election	Jan 2016	Feb. 2016	March	April
PP	44.6	28.7	29.0	24.0	26.0	27.7
Socialists	28.8	22.0	21.1	23.3	23.1	21.0
Podemos	–	20.7	22.5	19.9	16.8	15.9
Ciudadanos	–	13.9	16.6	18.5	19.5	18.8

Source: Metroscopia.

A potential game-changer would be Podemos and United Left (IU), the revamped Communist Party, running on a joint platform. Talks were underway for a tie-up. Podemos won 20.6% of the vote in December's election, slightly below the Socialists' 22.0% but 21 fewer seats because of the electoral system, and United Left 3.7%. Together they could overtake the Socialists in a new election.

Opinion polls show that Spaniards' support for a four-party system as opposed to the essentially two-party one at the national level between 1982 and 2015 has not been dented by the failure over the last four months to form a new government.

According to a poll by Llorente y Cuenca, the Socialists made the greatest effort to form a government (42.2% of respondents compared with 6% for the PP), but they were also mainly blamed for the failure to reach an agreement (31.2%, followed by Podemos with 28.7%).

The greater pluralism is one of the factors behind Spain’s notable rise in the Economist Intelligence Unit’s latest democracy index, from 22<sup>nd</sup> place in 2014 to 17<sup>th</sup> in 2015, with a score of 8.30 out of 10, up from 8.05, although the country is among the lowest-scoring nations in the ‘full democracy’ category (see Figure 2). Spain, however, is above Italy and France.

**Figure 2. The Economist Intelligence Unit’s Democracy Index 2015 (1)**

Rank	Score	Electoral process and pluralism	Functioning of government	Political participation	Political culture	Civil liberties
1. Norway	9.93	10.00	9.64	10.00	10.00	10.00
13. Germany	8.64	9.58	8.57	7.78	8.13	9.12
16. UK	8.31	9.58	7.14	6.67	8.75	9.41
17. Spain	8.30	9.58	7.14	7.22	8.13	9.41
20. US	8.05	9.17	7.50	7.22	8.13	8.24
21. Italy (2)	7.98	9.58	6.43	7.22	8.13	8.53
27. France (2)	7.92	9.58	7.14	7.78	6.25	8.82

(1) The index, on a 0 to 10 scale, is based on the ratings for 60 indicators grouped in five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. Each category has a rating on a 0 to 10 scale, and the overall index of democracy is the simple average of the five category indexes.

(2) Italy and France are termed flawed democracies and the countries ranked above them full democracies.

Source: EIU.

The EIU said Spain’s relatively strong position owes much to its high scores in the categories for electoral process and pluralism and civil liberties (9.58 and 9.41, respectively) The improvement in Spain’s overall ranking follows a sharp fall of 10 places between 2008 and 2011, largely due to a decline in the public’s trust in government and political parties.

The lower score (7.14) in the functioning of government category reflects the weakness that, once elected, the government is subject to less stringent parliamentary controls than in most other Western-European democracies, and these can be avoided by the use of decree powers (used to a large extent by the last PP government).

### Panama Papers claim the head of Industry Minister

José Manuel Soria, the Industry, Energy and Tourism Minister, resigned after he was named in the Panama Papers, the leak of 11.5 million documents from Mossack Fonseca, the Panamanian law firm that specialises in setting up offshore companies in tax havens.

Soria initially denied in a confusing explanation that he had briefly been the director of a Panama-based shell company more than 20 years ago, but had to reverse course after the newspaper *El Mundo* revealed that he had served as the director of a Jersey-based company in 2002.

'No one who's operated in tax havens can be in the government', said Cristóbal Montoro, the acting Finance Minister. Soria said the Tax Agency would find no wrongdoing if they investigated him. He blamed his inaccuracies on 'the lack of precise information' on events that occurred a long time ago and said his business interests were not linked in any way to his political life.

Soria also resigned his seat in parliament and gave up his role as President of the Popular Party in the Canary Islands.

The caretaker government of Mariano Rajoy, swamped by corruption scandals and with fresh elections on the cards in June, had no option but to let Soria go.

#### Anti-corruption crusader arrested for extortion in royal court case

Miguel Bernad, head of *Manos Limpias* (Clean Hands), a far-right organisation which brought a private prosecution against the *Infanta* Cristina, the sister of King Felipe, for tax fraud in the ongoing *Nóos* case, was arrested and jailed for allegedly offering to withdraw the case in return for a €3 million payment.

The offer was made to Banco Sabadell and La Caixa (Cristina works for this bank), according to High Court sources.

Cristina's husband, Iñaki Urdangarín, is at the centre of the *Nóos* case involving alleged tax fraud, embezzlement and money laundering when he was co-head of a charitable sports foundation that organised events for local and regional governments. The prosecution has asked for a 19-year jail sentence if he is convicted.

A court in Palma de Mallorca upheld in 2014 the tax fraud accusation against Cristina but dropped the money-laundering charge. Public prosecutors, however, do not believe she committed any wrongdoing. The investigation into *Manos Limpias* does not necessarily mean that the case against Cristina will be dropped, but it would be if *Manos Limpias* itself withdraws it.

The offer to withdraw the case in return for money was allegedly made on Bernad's behalf by Luis Pineda, the President of Ausbanc, a financial consumer association with a murky past, who knows the banking world (see item in the section below). He was also arrested and jailed.

*Manos Limpias* has presented many cases including suing high court judge Baltasar Garzón in 2009 over his probe into Franco-era crimes. Garzón was cleared of this charge but barred from the bench as a result of a separate case.

### Spain ranked above UK and US in press-freedom index

Spain was ranked 34<sup>th</sup> out of 180 countries in the 2016 World Press Freedom Index produced by Reporters without Borders, down one place, but still above the UK and the US (see Figure 3).

**Figure 3. 2016 World Press Freedom Index ranking and score (1)**

Ranking out of 180 countries	Score
1. Finland	8.59
8. Sweden	12.33
16. Germany	14.80
31. Chile	19.23
34. Spain	19.92
38. UK	21.70
41. US	22.49

(1) 0 is the best score and 100 the worst.

Source: Reporters without Borders.

The score is based on seven categories: pluralism, media independence, environment and self-censorship, legislative framework, transparency, infrastructure and abuses.

Spain's score of 19.92 was slightly lower than 19.95 in 2015. Reporters without Borders said Spain was 'going backwards' because of a 'new information law (known as the 'transparency' law) that took effect in late 2014 that does not treat access to information as a fundamental right, exempts certain kinds of government information (such as internal communications) and has created a monitoring entity whose independence is not guaranteed'. The economic crisis has hit the media hard: 354 media outlets closed between 2008 and 2014 and 11,875 journalists lost their jobs.

### 'Ghost' airport finally sold after four years

The short-lived airport at Ciudad Real, one of the symbols of the excesses of Spain's ill-fated construction and property boom and built at a total cost estimated at around €1 billion, was finally sold for €56.2 million.

Initially touted as an alternative to Madrid's airport, the airport at Ciudad Real (240km from the capital and with a planned rail link) was opened in 2008 by the then Socialist government of the Castilla-la Mancha region with a capacity of 2.5 million passengers per year. It has a 4km runway capable of taking an Airbus A380m, the world's largest passenger jet. But the venture went bankrupt in 2010, due to a lack of flights, and was closed in 2012.

Caja Castilla-La Mancha (CCM), a savings bank controlled by the regional government, financed the airport with a loan of €337 million. The bank teetered on the edge of collapse and was the first one taken over by the Bank of Spain in 2009. Its Chairman and Director General were sentenced to two years in jail in March for falsifying the accounts.

A trade tribunal rejected an offer of €10,000 for the airport made last year by a Chinese investment fund at an auction. The new buyer was named as CR International.

Ciudad Real is one of several ‘ghost’ airports. The one at Castellón has had since last September just one scheduled flight –the first in four years–.

## The Economy

### Spain to be given more time to meet EU’s budget deficit threshold

The European Commission agreed to put back yet again the date by when the general government budget deficit must be down to 3% of GDP, the EU’s threshold, following a significant overshoot in 2015.

The deficit came in at 5%, well above the target of 4.2%, the second highest in GDP terms in the euro zone after Greece (-7.2%) and compared with deficits of 4.4% in the UK, 3.5% in France and a surplus of 0.7% in Germany.

This makes the goal of 2.8% this year a Herculean task. With slower growth this year than last year’s 3.2%, an unemployment rate still at more than 20% and a caretaker government since last December, as a result of the inconclusive election, which is restricted it what it can do, the Commission had no option but to bow to Madrid’s request.

The government’s latest forecasts put this year’s deficit at 3.6% and next year’s at 2.9% and GDP growth at 2.7%, down from 2.9% but still a faster pace than Germany, France, Italy and the UK (see Figure 4). Spain will not recover its pre-crisis (2007) GDP level until next year.

**Figure 4. Forecasts for main EU economies, 2016**

	Real GDP growth (%)	Jobless rate (%)	Fiscal balance (% of GDP)	Gross public debt (% of GDP)
France	1.1	10.1	-3.4	98.2
Germany	1.5	4.4	+0.1	68.2
Italy	1.0	11.4	-2.7	133.0
Spain	2.7	19.9	-3.6 (1)	99.1
UK	1.9	5.0	-3.2	89.1

(1) Including financial sector support.

Source: Economy Ministry for Spain and IMF, World Economic Outlook, April 2016, for the other countries.

The main culprits for last year's budget failure were 14 of the 17 regional governments and the social security system. The regional deficit was 1.66%, more than double the 0.7% target, and the social security's 1.26%, twice the 0.6% target (see Figure 5 and Figure 6).

**Figure 5. Public administrations' budgetary balances (% of GDP) (1)**

	2011	2012	2013	2014	2015
Central government	-5.60	-7.92	-4.77	-3.67	-2.53
Regional governments	-3.35	-1.86	-1.57	-1.75	-1.66
Local governments	-0.40	+0.32	+0.55	+0.57	+0.44
Social Security	-0.10	-0.98	-1.12	-1.04	-1.26
Total	-9.13	-6.77	-6.62	-5.79	-5.01

(1) Excluding financial aid to banks.

Source: Finance Ministry.

**Figure 6. Regional governments' budget deficits (% of regional GDP)**

Region	% of GDP	Region	% of GDP
Andalusia	1.13	Extremadura	2.64
Aragón	2.13	Galicia	0.57
Asturias	1.53	La Rioja	1.13
Basque Country	0.69	Madrid	1.36
Canary Islands	0.54	Murcia	2.52
Cantabria	1.38	Navarre	1.28
Castilla y León	1.33	Valencia	2.51
Castilla La Mancha	1.67	Total	1.66
Catalonia	2.70		

Source: Finance Ministry.

The Popular Party (PP) government also reduced income and corporate tax rates in 2015, an electoral year. Spain's tax wedge declined by 1.1 points in 2015 to 39.6%, the second largest decline after Greece among the 34 OECD countries (see Figure 7).

**Figure 7. Total tax wedge as % of labour costs (1)**

	2015	2014
France	48.5	48.4
Germany	49.4	49.3
Italy	49.0	48.2
Spain	39.6	40.7
UK	30.8	31.0
OECD average	35.9	35.9

(1) Tax wedge is defined as the ratio between the amount of taxes paid by an average single worker (a single person at 100% of average earnings) without children and the corresponding total labour cost for the employer. The average tax wedge measures the extent to which tax on labour income discourages employment. This indicator is measured in percentage of labour costs.

Source: OECD.

Warnings from the Commission and from Spain's Independent Fiscal Authority (Airef) that the budget target would be breached which were blithely ignored. José Manuel García-Margallo, the Foreign Minister, said the 'only thing the predictions do is legitimise astrology'.

The government was meant to reach the 3% EU ceiling by 2013, but the dire situation the PP inherited from the Socialist government when it won the 2011 election made this impossible. The deadline was extended by a year, but in 2014 so little progress had been made that the PP won a further two-year extension to 2016.

Brussels has not hidden its disappointment at the PP's failure, which has eroded its hard-won credibility. Giving the central government more time will come at the cost of getting to grips much more rigorously with regional government finances and greater supervision by Brussels. The state pension system also needs a new overhaul.

Despite negative inflation of 0.5% in 2015, this year's pensions were increased by 0.25%, the minimum annual rise laid down in the pension reform which took effect in 2014. No one at that time thought Spain would have deflation.

The acting government announced €2 billion of central government spending cuts, but did not specify where they will be made. Regional governments gave short shrift to Cristóbal Montoro, the acting Finance Minister, when he sent them a letter proposing a freeze on spending. Airef, which has been right in the past, said the government needed to cut €4 billion in order to reduce the deficit to 3.6% of GDP.

In an unprecedented move, two regions, Extremadura and Aragón, with a poor record of paying their suppliers, can no longer directly access funds available to them.

In a separate development, the European Commission gave Spain until March 2017 to unblock €1.12 billion of regional EU funds held up because of irregularities and



deficiencies detected in 22 out of 23 projects. If Madrid does not respond adequately, some or all of this money could be lost.

### Santander fires starting pistol on more bank restructuring...

Santander, the euro zone's largest bank by market capitalisation, announced it would close 450 branches in Spain (13% of its network) and shed around 1,200 employees in response to the rapid shift towards online and digital banking. The bank's digital clients rose by 2.6 million in the year to March to 17.8 million (+17%).

Carlos Torres, the CEO of BBVA, Spain's second-largest bank, told the news agency Bloomberg that when digital banking was in full swing the bank would probably need around 1,000 branches and not the current 3,800.

In another move, Banco Ceiss, the result of the merger of two savings banks during Spain's banking crisis, plans to shed 1,120 jobs.

The sector suffered a bruising crisis between 2009 and 2012 when Bankia, the fourth-largest lender, which had been created in 2010 from the merger of seven ailing savings banks, almost collapsed.

It and several other banks were brought down by reckless and often politically influenced over-exposure to a property sector whose bubble burst; they were rescued with the help of a €41.3 billion EU bail-out programme (exited in January 2014). A 'bad bank' was also created to absorb and sell soured property assets.

Close to one-third of branches were closed during this period, 25% of employees were shed and the clean-up bill was the equivalent of 27% of GDP. In 2009 Spain had twice the number of bank branches per inhabitant than the euro zone average. The number of savings banks was reduced from 45 to two (and seven of those became banks).

Reforms and greater oversight have made banks stronger, as evidenced by the generally good results of EU stress tests conducted by the European Banking Authority (EBA), but non-performing loans still represent around 10% of total lending and there are new challenges on the horizon.

The advance of digital and online banking is making banks overstaffed. Another factor is the overlapping of branches as a result of mergers. The total number of bank employees dropped from 233,282 in 1995 to 175,520 last year, but this is considered too many (see Figure 8).

**Figure 8. Bank employees, 1975-2015**

	1975	1985	1995	2005	2015
Savings banks	43,172	71,042	84,336	118,072	78,738
Commercial banks	155,015	161,621	148,946	111,298	96,782
Total	198,187	232,663	233,282	229,370	175,520

Source: Workers' Commissions.

Meanwhile, eight former senior executives of Caja de Ahorros del Mediterráneo (CAM), whose administration was taken over by the Bank of Spain in 2011, are to go on trial for fraud and falsifying accounts including Modesto Crespo, the former Chairman. Miguel Ángel Fernández Ordóñez, the former central bank Governor, called CAM 'the worst of the worst'.

In a separate development, the EBA said 119 bankers in Spain earned more than €1 million in 2014, the fifth-largest number in the EU after the UK, Germany, France and Italy. Their average earnings were €2.39 million compared with the €3.3 million earned by 2,296 bankers in the UK.

### ... Former Banesto chief Mario Conde back in prison...

Mario Conde, the former Chairman of Banesto, who served 11 years of a 20-year sentence related to misappropriation of funds and fraud, was back in prison on suspicion of money-laundering €13 million.

He and six other people, including his daughter and son-in-law, were arrested after a probe into a network of companies set up abroad which he allegedly used to help disguise money he had taken from Banesto before its state rescue.

The Bank of Spain bailed out Banesto in 1993 after a shortfall of €3.6 billion was discovered. The bank was later bought by Banco Santander, which helped turn it into Spain's largest financial institution.

Conde (67), released from prison in 2005, symbolised Spain's get-rich-quick culture known as the *pelotazo*.

Judge Santiago Pedraz remanded Conde in prison, with no bail granted, until the start of his trial. He is also accused of eight counts of tax fraud and belonging to a criminal organisation.

### ... Ausbanc financial consumer association leader on extortion charges

The lawyer Luis Pineda, President of Ausbanc, the leading financial consumer association, was arrested and sent to prison accused of extorting money from banks in return for not publishing articles in the entity's magazines which criticised them.

Many banks submitted to the threats but did not denounce Ausbanc. Only the former Caja Madrid, part of Bankia since 2012, and BBVA refused to go along with the system and they blew the whistle. As soon as the news broke, banks stopped advertising in Ausbanc.

Ausbanc won a case brought against banks for ‘rounding up’ interest rates. Pineda’s wife, María Teresa Cuadrado, a former head of the Madrid regional government’s consumer office, was also detained.

Elvira Rodríguez, the Chairman of the National Securities Market Commission (CNMV), said she was not surprised by Pineda’s arrest as she had always wondered how Ausbanc made a living. She added that it was not the CNMV’s responsibility to investigate Ausbanc: none of the banks extorted had denounced the situation to her.

### Youth unemployment drops below 50%...

The jobless rate among those aged between 15 and 24 fell below 50% last year but at 48.3% was still more than double the EU average (see Figure 9).

**Figure 9. Youth unemployment in EU countries, 2015 and 2014 (%)**

	2015	2014
Greece	49.7	52.4
Spain	48.3	53.2
Italy	40.3	42.7
France	24.7	24.2
EU-28	20.2	22.0
UK	14.6	16.9
Germany	7.2	7.7

Source: Eurostat.

### ... Per capita income still below 2008 peak

Spain’s per capita income in 2015 (€23,290) was still below the peak of €23,858 in 2008 at the height of the economic boom, and with a wide divide by regions, according to provisional figures from the National Statistics Office (INE).

*Madriileños* earned on average €31,812 compared with €16,166 for those who live in Extremadura (see Figure 10).

**Figure 10. Per capita income by region, 2015 (€)**

	€		€
Madrid	31,812	Cantabria	20,847
Basque Country	30,459	Asturias	20,675
Navarre	28,682	Valencia	20,586
Catalonia	27,663	Galicia	20,431
Aragón	25,552	Canary Islands	19,900
La Rioja	25,507	Murcia	18,929
Balearic Islands	24,394	Castilla La Mancha	18,354
Spain	23,290	Andalusia	17,263
Castilla y León	21,992	Extremadura	16,166

Source: INE.

### Bullfighting 'contributed US\$1.6bn' to the economy

Bullfighting, under pressure from animal-rights lobbies, generated US\$1.6 billion in 2013 (the latest year available) and accounted for more than 200,000 jobs, according to the National Association of Bullfighting Events (Anoet).

Anoet released the information in response to claims that bullfighting's survival depends on €600 million of subsidies from local and regional governments. It said the subsidies amounted to €25.5 million.

### Corporate scene

#### Iberdrola wins €350 million Mexico contract

Iberdrola, Spain's largest electricity company and the world leader in the production of wind power, won a €350 million contract to build a combined cycle power plant in the Mexican state of Sinaloa.

By the time it is commissioned in January 2019, the Noroeste plant will produce enough electricity to meet the consumption needs of over 3 million Mexicans.

Iberdrola has been operating in Mexico for 18 years, and is the leading private electricity producer, with over 5,400 MW in operation. The Noroeste plant brings the capacity under construction up to 2,500 MW.