

**Inside Spain Nr 109**  
**(21 July-22 September)**  
*William Chislett*

**Summary**

EU dismisses Madrid's request to dismantle contentious reef created by Gibraltar.

House prices inch up for first time in six years, OECD lauds reforms and calls for more.

Catalan parliament defies Madrid and passes law on independence referendum.

Political parties discuss measures to 'regenerate' democracy.

**Foreign Policy**

*EU dismisses Madrid's request to dismantle contentious reef created by Gibraltar*

Gibraltar predictably lost its competitive football debut against Poland (0-7) in a Euro 16 qualifier, but the UK overseas territory was victorious when the European Commission dismissed Spanish demands that the Rock, whose sovereignty Madrid has long disputed, dismantle the artificial reef at the centre of a tense diplomatic spat with London.

Gibraltar dumped 72 concrete blocks into contested waters in July 2013 in order to create a small reef and regenerate depleted fish stocks. This move prompted Madrid to impose stringent controls at the border, which continue to create massive queues on either side during busy times. The checks are ostensibly a crackdown on tobacco smuggling, which is rife as prices are much lower in Gibraltar.

The Commission also dismissed the questions raised by Madrid on environmental grounds over bunkering activity and a number of reclamation projects. Karl Falkenberg, the head of the Commission's environmental department, said 'based on the evidence produced... we are unable to identify any breach of EU environmental legislation'.

Gibraltar became UEFA's 54th and smallest member in 2013 despite opposition from Spain. The long-running political tension over sovereignty means Gibraltar cannot play football in neighbouring Spain and will hold its home matches in the Portuguese town of Faro until a new stadium is completed.

Spain ceded Gibraltar to Britain in 1713 under the Treaty of Utrecht but has long argued that it should be returned to Spanish sovereignty.

The Spanish government, however, drew comfort from a report by the European Anti-Fraud Office (OLAF), which recommended that Madrid and Gibraltar launch legal action after it found that organised crime was behind a rise in cigarette smuggling.

‘The OLAF investigation has raised a number of concerns regarding the link between a significant increase in the size of the Gibraltar market for cigarettes over the past four years and the subsequent increase of cigarette smuggling across the frontier’, a spokesman for the anti-fraud office said.

Gibraltar Chief Minister Fabian Picardo welcomed the report and said the territory wanted to work together with Spain to investigate the cigarette smuggling.

The Spanish government said the report ‘justified’ its ‘work in the fight against fraud and the underground economy’. Cristobal Montoro, the Finance Minister, said 60% of the contraband cigarettes seized in Spain came from Gibraltar.

Íñigo Méndez de Vigo, Spain’s Secretary of State for the EU, claimed the Spanish government misses out on €1 billion of tax revenues each year as a result of Gibraltar’s tax regime. He called for the European Commission to investigate the Rock’s tax policies for possible illegal state aid.

The government of Gibraltar said the accusation has ‘no basis in fact and is no more than a financial flight of fantasy’. It pointed out that ‘of the 15,673 active companies (ie, those that are in good standing with the Registrar of Companies), there are only 102 Spanish nationals with a Spanish address holding one or more shares in a total of 66 companies’.

Gibraltar’s 2010 Income Tax Act was amended by the current government of Chief Minister Fabian Picardo and approved by the Code Group of the EU with only Spain not approving it.

Meanwhile, the several thousand Spaniards working in Gibraltar and far fewer Gibraltarians in Spain have shown little interest in applying for the pass from the Spanish authorities that offers fast-track crossing of the frontier. Those with the pass can use the red lane and avoid having to queue.

In Gibraltar the authorities complain that it is discriminatory and that everyone crossing the border should be treated the same. In Spain, many workers view it as a measure to collect personal data relating to employment status in Gibraltar. In order to obtain a pass, workers must first register with the Finance Ministry and provide extensive employment and personal details.

Madrid and London are edging towards holding *ad hoc* talks that would involve all interested parties. The Popular Party government pulled out of the tripartite forum for regular dialogue between the UK, Spain and Gibraltar in 2012 soon after taking office. The previous socialist government established this forum with all issues on the table except sovereignty.

In response to the House of Commons Foreign Affairs Committee report on Gibraltar in July urging tougher action, the UK coalition government said at the beginning of September that it remains ‘unreservedly resolute in its commitment never to enter into arrangements under which UK sovereignty over Gibraltar would pass to another state against the wishes of the people of Gibraltar’.<sup>1</sup>

The current tensions were partly the result of ‘regrettable decisions made in 2001-02 (by the previous Labour government) for joint sovereignty discussions, which raised expectations on the Spanish side’.

The Spanish ambassador to London was summoned to the Foreign Office more times between 2010 and May 2014 than the ambassador of any other country except Syria. Summoning is a serious form of diplomatic protest; the incidents were mostly related to maritime incursions in British Gibraltar Territorial Waters.

*Spain joins alliance against Islamic State, role yet to be specified*

Spain joined the alliance of 30 countries to combat the Islamic State (IS) jihadist insurgency in Iraq and Syria. Its role has yet to be specified.

José Manuel García-Margallo, Spain’s Foreign Minister, attended the conference in Paris on peace and security in Iraq where he urged a diplomatic solution and not just a military one. ‘All options are on the table’, he said.

Spain suffered a horrendous terrorist attack by Islamist militants in 2004 when bombs exploded in commuter trains killing 191 people and wounding more than 1,400. The Popular Party government at that time was an American ally in the war on Iraq.

Some of the foreign combatants fighting in support of the IS are of Spanish origin. The government is studying a change in the Penal Code that would make it a crime of terrorism to fight in such conflicts.

---

<sup>1</sup> The full document is available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/351172/42878\\_Cm\\_8917\\_Web\\_Accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/351172/42878_Cm_8917_Web_Accessible.pdf).

## **Domestic Scene**

### *Catalan parliament defies Madrid and passes law on independence referendum*

The Catalan parliament voted through a law by 106 to 28 that paves the way for holding a non-binding plebiscite on the region's independence. The government will challenge the law in the Constitutional Court as soon as it is enacted.

Madrid breathed a deep sigh of relief when Scotland voted decisively in its referendum on 18 September by a margin of 55% to 45% to remain part of the UK. A 'yes' vote would have emboldened the independence movement in Catalonia.

Prime Minister Mariano Rajoy described referendums like Scotland's as 'a torpedo below the waterline for European integration' and praised the decision of voters. 'They have avoided the grave economic, social, institutional and political consequences that would have happened in the case of separation from the UK and from Europe'.

Undeterred by the result of the Scottish referendum, Artur Mas, the Catalan president, said a vote was 'the only way to resolve differences and to resolve problems. The Catalan political process goes on'.

The Catalan referendum, planned for 9 November, is illegal as under Spain's constitution it requires the central government's blessing, whereas the UK parliament authorised the Scottish referendum as the British constitution is uncodified.

The ruling Popular Party and the Socialists, the main opposition, are united in their opposition to the Catalan referendum, though not in how the problem should be resolved. The Catalan Socialist Party, however, voted in favour of the referendum law.

The passing of the new law followed a massive turnout on 11 September, Catalonia's national day or *La Diada*, in favour of independence. Several hundred thousand people attended the gathering, which marks what is perceived as the day the territory lost its autonomy when Barcelona fell to Spanish and French forces in the War of Spanish Succession in 1714.

An opinion poll by Metroscopia showed that the preferred option, in the likely event of the Catalan referendum being declared unconstitutional, was for Mas to accept the decision and negotiate the calling of a plebiscite that is legal. Less than one quarter of respondents (23%) –the hardcore separatists who are mainly supporters of the Catalan Republican Left– said the Constitutional Court's decision should be ignored (see Figure 1).

**Figure 1. If the Constitutional Court rules that the referendum is unconstitutional what should Catalan president Artur Mas do? (% of respondents)**

|                         | <b>Ignore the Constitutional Court's ruling: 23%</b> | <b>Accept the decision and negotiate the calling of a new referendum that is legal: 45%</b> | <b>Seek another way out that does not require a referendum: 25%</b> |
|-------------------------|--|---|---|
| Potential voters of:    |  |   |   |
| Convergència i Unió     | 43   | 28  | 24  |
| Catalan Republican Left | 55   | 17  | 25  |
| Podemos                 | 22   | 43  | 30  |
| Catalan Socialists      | 5  | 69  | 22  |
| Popular Party           | 5  | 68  | 22  |

Source: Metroscopia.

Another survey showed that 44% of Catalans would, if given the option, vote for a third option of constitutional change involving the transfer of more powers from Madrid to Catalonia. The number voting for independence would, in this case, drop to 23% from 43% with just straight 'yes' and 'no' options.

Rajoy is against constitutional change unless there is a broad consensus among the political class, which does not exist. The Socialists favour a more federal system.

Meanwhile, Jordi Pujol Ferrusola, the eldest of the seven children of Jordi Pujol, the Catalan president for 23 years and the father of modern Catalan nationalism, testified before a judge over accusations of charging illegal commissions on contracts awarded by the regional government. He is also accused of money laundering and tax evasion. Several other members of the Pujol clan are also under investigation for illegal enrichment.

The 84-year-old Pujol revealed in July that he had kept millions of undeclared funds in bank accounts in Andorra for the past 34 years. He said the money was an inheritance from his father. It is widely believed that Pujol made the revelation, which stunned the Catalan establishment, in order to explain the wealth of his children.

*Political parties discuss measures to 'regenerate' democracy*

The government hopes to win approval from opposition parties for a battery of measures by the end of the year that would restore public confidence in the political class, discredited by corruption scandals, a lack of transparency and state institutions colonised by politicians.

The main political parties, particularly the Popular Party (PP) and the Socialists, which between them have ruled Spain for the last 30 years, and politicians as individuals regularly receive the lowest approval ratings (see Figure 2).

**Figure 2. Approval ratings of institutions and social groups (% approval)**

| Institution/social group         | % approval | Institution/social group | % approval |
|----------------------------------|------------|--------------------------|------------|
| Scientists                       | 89         | Lawyers                  | 51         |
| Public health doctors            | 85         | Judges                   | 41         |
| State school teachers            | 81         | Tax inspectors           | 39         |
| Roman Catholic Charity (Cáritas) | 75         | Parish priests           | 39         |
| Civil Guard                      | 72         | Parliament               | 29         |
| NGOs                             | 70         | Government               | 21         |
| Police                           | 69         | Employers                | 20         |
| King Felipe VI                   | 69         | Trade unions             | 17         |
| Universities                     | 61         | Banks                    | 10         |
| Armed forces                     | 59         | Political parties        | 10         |
| Newspapers                       | 51         | Politicians              | 10         |

Source: Metroscopia.

The institution that has most improved its rating over the last year is the monarchy: from 47% for former King Juan Carlos to 69% for King Felipe VI who took over from his father in June when he abdicated.

The depth of the discontent with the political status quo became clear in May's elections for the European Parliament when *Podemos* ('We can'), a new radical political grouping born out of the grassroots protest movement known as *los indignados* ('the indignant ones'), came from nowhere to win five seats and 1.2 million votes (8% of the total). *Podemos* took votes from all parties including 100,000 from the conservative PP.

Spain was ranked 40<sup>th</sup> out of 177 countries in the latest (2013) corruption perceptions ranking by the Berlin-based Transparency International, down from 30<sup>th</sup> place in 2012 and 20<sup>th</sup> in 2000 (see Figure 3). Its score of 59 was six points lower. The nearer to 100, the cleaner the country. Spain was the second-biggest loser of points, and only topped by war-torn Syria.

**Figure 3. Ranking of perceived levels of public sector corruption, selected countries (1)**

| Country ranking out of 177 nations | Score out of 100 |
|------------------------------------|------------------|
| 1. Denmark (2)                     | 91 (9.8)         |
| 3. Finland (1)                     | 89 (10)          |
| 12. Germany (17)                   | 78 (7.6)         |
| 14. UK (10)                        | 76 (8.7)         |
| 22. France (21)                    | 71 (6.7)         |
| <b>40. Spain (20)</b>              | <b>59 (7.0)</b>  |
| 69. Italy (39)                     | 43 (4.6)         |

(1) Ranking and score in 2000 in brackets. The score in the 2013 index is out of 100 and in the 2000 index out of 10.

Source: Transparency International.

Eduardo Torres-Dulce, the Director of Public Prosecutions, said, in the presence of King Felipe VI, that corruption was 'seriously damaging the image of public life and the government treasury' and 'undermining the credibility of the democratic system'.

The bulk of the more than 2,000 corruption cases under investigation are concentrated in the six regions where most of the construction and real-estate boom occurred and where the same political party has been in power for several decades.

The measures under discussion include incorporating the illegal financing of a political party into the Penal Code, tougher sentences for trafficking of influences and bribery, a ban on anonymous donations to political parties by companies, greater transparency on the salaries of those in public office and a more effective Court of Auditors that oversees the finances of political parties. These reforms follow the Transparency Law adopted last December, the first one since the end of the Franco regime in 1975.

The transparency law is a move in the right direction but it is lacking in a number of areas; for example, it is ranked 72<sup>nd</sup> out of 96 countries as regards access to information laws, according to the RTI ranking of the Centre for Law and Democracy. In spite of the pressing need to tackle corruption and secrecy, this law will not be in force at the national level until December, and not fully in force at the regional and local levels until December 2015. The scope of the access to information law is narrow and does not enshrine access to information as a fundamental right: information regarding national security, defence, foreign relations, public security or the prevention, investigation and sanction of illegal actions is not public, and one article limits the right of access to information that harms economic and monetary policy or the environment in such a general way that if interpreted widely reduces the access to a minimum. Furthermore, the access is only to public documents and not to information in general: for example, there is no access to reports and internal communications used to take decisions. Lastly, the agency responsible for guaranteeing the right of access is not independent as its head is appointed and dismissed by the government of the day. It is to be hoped that the regulations for implementing the law improve this situation.

The Spanish chapter of Transparency International has been gauging the transparency levels of political parties. The results are mixed (see Figure 4).

**Figure 4. Transparency level of the three main political parties**

|  | PP      | PSOE    | IU      |
|--|---------|---------|---------|
| Annual accounts (last two years)   | Yes     | No      | Yes     |
| Dates when accounts sent to the Court of Auditors  | No      | No      | Yes     |
| Latest report of the party's accounts issued by the Court of Auditors                              | Yes     | No      | Yes     |
| Annual budgets (last two years) with corresponding liquidation                                     | No      | Partial | Yes     |
| Basic data of entities linked to the party (foundations, etc)                                      | Yes     | Yes     | Yes     |
| Breakdown of spending, income and assets   | No      | No      | No      |
| Declaration in electoral lists of inexistence of those tried for corruption or under investigation | Partial | Partial | Partial |
| Breakdown of spending on elections and/or limits legally established for spending                  | No      | No      | No      |
| Description of control procedures and/or internal audit of party                                   | Yes     | No      | No      |
| Curriculum vitae of candidates on electoral lists (at least five lines)                            | No      | Yes     | Partial |
| Score  | 4.5     | 3       | 6       |

PP = Popular Party; PSOE = Socialists; IU = United Left.

Yes = 1 point; Partial = 0.5 points; No = 0 points.

Source: Transparency International Spain.

The PP's proposal to reform the electoral law that would enable in municipal elections the mayor to come from the most voted party, even if that party did not win the majority of votes, has been rejected by other parties as they believe it would mainly benefit the PP.

There is widespread agreement, however, on reducing the number of *aforados* (those with parliamentary immunity who can only be tried by the Supreme Court) from more than 17,000 to 22. Almost all the political class, judges, prosecutors and justices of the peace enjoy this privilege. In Germany, the UK and the US there are no *aforados* and in France only the president, prime minister and ministers.

A key issue for making political parties more internally democratic –replacing closed and blocked voting lists with open ones– is not on the agenda. With closed lists, people vote for a political party as a whole and have no influence on the party-supplied order. The higher up the list, the greater the chance of being elected.

Party leaders decide who gets on the list and in what position, not constituents. As a result, MPs have more incentive to be loyal to their party leaders than to their constituency –limiting MPs’ independent vote and deterring whistleblowing–. Closed and blocked voting lists also favour a system in which the party leaders maintain strong control over the representative bodies on the national, regional and local level.

#### *Surge in migrants crossing the Strait of Gibraltar*

In August the Spanish coast guard rescued close to 700 North African immigrants from 70 inflatable boats who were trying to make the perilous crossing to southern Spain. It happened just a day after 300 people were found on 31 rafts in the area. The number found was the highest that month since 2010.

In one case, an 11-month-old baby arrived in Tarifa without its parents after the father went to look for the mother before boarding an inflatable boat. By the time he returned, the boat had left.

#### *One in four Spaniards under 30 not in education, a job or training*

The collapse of the construction sector, the engine of the economy, and the consequent massive rise in unemployment continue to take a toll on 15-29 year-olds, one quarter of whom are neither employed nor in education or training, the second-highest level among the 34 OECD countries (see Figure 5).

These people, known as NEETs, make up what has become to be known as a ‘lost generation’. Many of them left school at 16 after completing their compulsory education to work in construction and related sectors.

King Felipe VI opened the school year at a college in Galicia, saying the education system has ‘very serious problems’ and there was an urgent need to improve the quality.



**Figure 5. Population among 15-29 year-olds who are neither employed nor in education or training (%) (1)**

|              | %           |
|--------------|-------------|
| Turkey       | 29.2        |
| <b>Spain</b> | <b>25.8</b> |
| Italy        | 24.6        |
| France       | 16.6        |
| Poland       | 16.0        |
| OECD average | 15.0        |
| Germany      | 9.9         |
| Netherlands  | 6.7         |

(1) Figures for 2012 and rounded up to nearest decimal point.  
Source: OECD.

According to the OECD's latest Education at a Glance report, published this month, the proportion of NEETs with below upper secondary education rose from 21% in 2008 to 31% in 2012 (OECD average from 14% to 15%), those with upper secondary education from 13% to 20% (OECD average from 13% to 16%) and those with tertiary education or professional training from 13% to 23% (OECD average from 11% to 13%).<sup>2</sup>

In response to the crisis, young adults in Spain are staying on at school longer. The early school leaving rate is slowly declining and was put at 22.7% in the first months of 2014, down from 26.5% in 2011, but is still almost double the EU average.

The percentage of young adults who enrol in formal education after finishing compulsory education has been growing in Spain at a faster pace than the OECD average. In 2008, some 81% of 15-19 year olds and 21% of 20-29 year-olds were enrolled in education; by 2012, these figures were 86% and 28%, respectively. By comparison, across OECD countries, the proportion of 15-19 year-olds enrolled in education increased from 81% to 84%, and the proportion of 20-29 year-olds from 25% to 28%.

The difference in unemployment rates by education attainment is particularly acute in Spain. In 2012, 31.2% of adults with below upper secondary education were unemployed (OECD average was 13.6%), 22% of those with upper secondary education (OECD average 7.8%) and 14% of tertiary education adults (OECD average 5%).

Spain's education system was ranked the 26<sup>th</sup> most efficient out of 30 OECD countries, according to a wide-ranging study by GEMS Education Solutions published this month (see Figure 6).<sup>3</sup> The ranking takes into account teachers' pay, class sizes and pupils' scores in the PISA international tests that rank 15-year-olds in core subjects every three years.

<sup>2</sup> <http://www.oecd.org/edu/Spain-EAG2014-Country-Note.pdf>.

<sup>3</sup> See <http://www.gemsedsolutions.com/efficiency-index>.

Spanish teachers, for example, earn only US\$1,560 less a year than teachers in Finland, the top country, and yet Spain's PISA results are much poorer. 'There are some inconvenient truths about education: spending explains less than a fifth of the performance differences among countries, ie, two countries with similar spending can produce very different educational results', said Andreas Schleicher, the OECD's director for education.

**Figure 6. Education efficiency ranking (out of 30) (1)**

|                   | PISA mathematics score, 2012<br>(2) | Average annual teachers' salary, 2011, US\$ at PPP (3) |
|-------------------|-------------------------------------|--|
| 1. Finland        | 519                                 | 42,810   |
| 2. South Korea    | 554                                 | 47,340   |
| 3. Czech Republic | 499                                 | 18,610   |
| 11. Britain       | 494                                 | 40,910   |
| 12. France        | 495                                 | 33,570   |
| 23. Italy         | 485                                 | 31,460   |
| 25. Germany       | 514                                 | 53,730   |
| <b>26. Spain</b>  | <b>484</b>                          | <b>41,520</b>  |

(1) Index of value for money, using cost and outcomes.

(2) OECD average = 494.

(3) After 15 years of teaching.

Source: GEMS Education Solutions.

Spanish universities also fared badly in the QS ranking of the world's top 800 released last week. Only 18 Spanish universities made it into the ranking, regarded as the most authoritative of its type. The first ranked is the University of Barcelona in 166<sup>th</sup> place (see Figure 7).

**Figure 7. Number of universities by country in the QS ranking of world universities**

|              | Number of universities | Ranking of first placed                          |
|--------------|------------------------|--|
| US           | 166                    | MIT 1 <sup>st</sup>                              |
| UK           | 73                     | Cambridge/Imperial College 2 <sup>nd</sup>       |
| Germany      | 44                     | Ruprecht-Karls, Heidelberg 49 <sup>th</sup>      |
| France       | 41                     | Ecole normale supérieure, Paris 24 <sup>th</sup> |
| Italy        | 26                     | University of Bologna 182 <sup>nd</sup>          |
| <b>Spain</b> | <b>18</b>              | <b>University of Barcelona 166<sup>th</sup></b>  |

Source: QS World University Rankings.

### *Spain slips in UN Human Development Index*

Spain fell from 23<sup>rd</sup> to 27<sup>th</sup> position out of 187 countries in the latest UN Human Development Index. Its overall index value (the maximum is one), calculated on the basis of several categories, dropped from a high of 0.955 in 2007 to 0.869 in 2013, close to the level in 1980 (see Figure 8). Spain's index value has steadily dropped since 2007, after rising continuously as of 1980 (see Figure 9).

**Figure 8. UN Human Development Index (HDI) for selected countries**

| Ranking (1)      | Human Development Index value 2013 (2) | Life expectancy at birth, 2013 (years) | Mean years of schooling (2012) | GNI per capita (2011 PPP US\$) 2013 |
|------------------|--|--|--------------------------------|-------------------------------------|
| 1. Norway        | 0.944                                  | 81.5                                   | 12.6                           | 63,909                              |
| 5. US            | 0.914                                  | 78.9                                   | 12.9                           | 52,308                              |
| 6. Germany       | 0.911                                  | 80.7                                   | 12.9                           | 43,049                              |
| 14. UK           | 0.892                                  | 80.5                                   | 12.3                           | 35,002                              |
| 20. France       | 0.884                                  | 81.8                                   | 11.1                           | 36,629                              |
| 26. Italy        | 0.872                                  | 82.4                                   | 10.1                           | 32,669                              |
| <b>27. Spain</b> | <b>0.869</b>                           | <b>82.1</b>                            | <b>9.6</b>                     | <b>30,561</b>                       |
| 35. Poland       | 0.834                                  | 76.4                                   | 11.8                           | 21,487                              |

(1) Out of 187 countries.

(2) The maximum value is one.

Source: United Nations Human Development Report, 2014.

**Figure 9. Change in UN Human Development Index for selected countries, 1980-2012 (1)**

|              | 1980         | 2007         | 2012         | 2013         |
|--------------|--------------|--------------|--------------|--------------|
| Ireland      | 0.840        | 0.965        | 0.906        | 0.899        |
| France       | 0.876        | 0.963        | 0.893        | 0.884        |
| <b>Spain</b> | <b>0.855</b> | <b>0.955</b> | <b>0.885</b> | <b>0.869</b> |
| Italy        | 0.857        | 0.951        | 0.881        | 0.872        |
| Germany      | 0.869        | 0.947        | 0.920        | 0.911        |
| Greece       | 0.844        | 0.942        | 0.860        | 0.853        |
| Portugal     | 0.768        | 0.909        | 0.816        | 0.822        |

(1) The maximum value is one.

Source: UN Human Development Reports.

## The Economy

*House prices inch up for first time in six years, OECD lauds reforms and calls for more*

Spain's housing prices, which have fallen on average by more than 35% since 2007, rose 0.8% in the second quarter year-on-year.

This was the first such increase since the first quarter of 2008 and was further evidence that the economic recovery is underway, following the bursting of a massive property bubble which plunged the country into recession, sparked a banking crisis and caused unemployment to skyrocket.<sup>4</sup> Foreign investors have been snapping up properties, often at bargain prices.

The announcement coincided with the publication earlier this month of a report on Spain by the Organisation for Economic Co-Operation and Development (OECD), which praised the government for its reforms and urged it to do more.<sup>5</sup>

'The courageous reforms enacted over the past two years are paying off', said Ángel Gurría, the OECD's Secretary-General. 'The economy is growing again, employment is rising, the banking sector has stabilised and financial markets' trust in Spain has increased'.

<sup>4</sup> See William Chislett's document on the recovery and the legacy of the crisis at [http://www.realinstitutoelcano.org/wps/portal/web/rielcano\\_en/contenido?WCM\\_GLOBAL\\_CO NTEXT=/elcano/elcano\\_in/zonas\\_in/wp9-2014-chislett-spain-turns-corner-but-legacy-from-crisis-persists#.VB2SvGS1bT4](http://www.realinstitutoelcano.org/wps/portal/web/rielcano_en/contenido?WCM_GLOBAL_CO NTEXT=/elcano/elcano_in/zonas_in/wp9-2014-chislett-spain-turns-corner-but-legacy-from-crisis-persists#.VB2SvGS1bT4).

<sup>5</sup> [http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-surveys-spain-2014\\_eco\\_surveys-esp-2014-en#page1](http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-surveys-spain-2014_eco_surveys-esp-2014-en#page1).

The main findings of the report are:

- Reforms have improved labour market performance even though the unemployment rate is still too high.
- Innovation, especially by business, is too low, and talent is under-utilised.
- In spite of recent competitiveness gains, barriers to entrepreneurship remain high.
- The banking sector has improved but credit is too low and firms need access to other sources of financing.

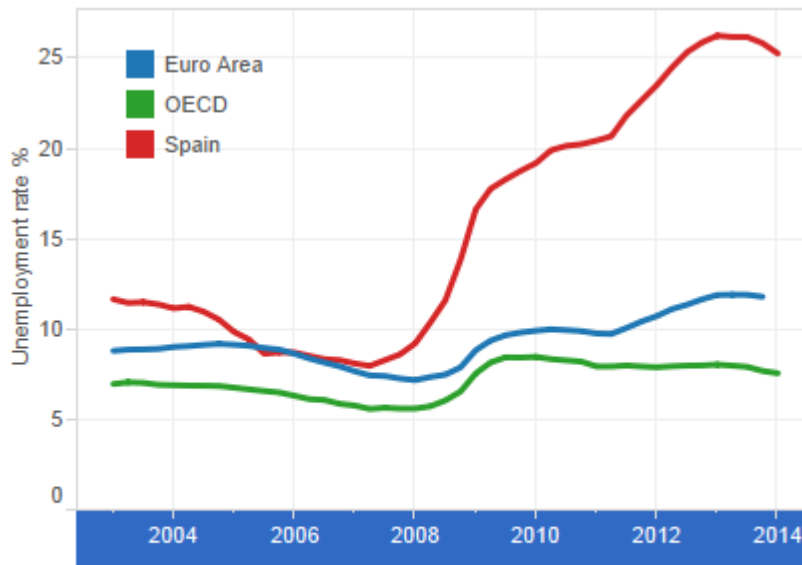
Its key recommendations are:

- Strengthen job search assistance and vocational training and improve the tax mix.
- Raise living standards by increasing innovation and enhancing skills.
- Streamline regulations and reduce barriers to start and grow firms.
- Improve insolvency procedures and promote diversified financing sources.

As regards unemployment, which stands at 24.5% (see Figure 10), according to the latest quarterly survey, and is falling very slowly the OECD recommends further reforms on top of those in 2012 which lowered severance costs for permanent contracts and give companies the upper hand, depending on their financial health, in collective wage bargaining agreements. The proposed measures are:

- Fiscal policy: cut employer social security contributions for low-skilled workers to stimulate labour demand.
- Wage bargaining options: firm and union representation requirements for collective agreements, 'opt-in' rather than opt-out to collective agreements.
- Employment protection options: converge termination costs for fixed-term and permanent contracts, further define conditions for fair dismissal.
- Housing and labour mobility: rolling periodic leases, means-tested housing benefits, simple arbitration for disputes.

**Figure 10. Unemployment rate**



Source: OECD (2014), OECD Economic Outlook: Statistics and Projections and OECD Employment and Labour Market Statistics (databases); and OECD Short-Term Labour Market Statistics Database <http://bit.ly/1lwkp3Z>

The collapse of the construction sector, with the loss of around 1.7 million jobs since 2007, pushed up the service sector's share of total employment from 68.5% in 2007 to 77.4% in 2013, the largest rise among EU countries after Ireland which also suffered a housing boom that burst and a banking crisis (see Figure 11).

**Figure 11. Employment in the services sector (% of total jobs), 2013 and 2007**

|              | 2013        | 2007        |
|--------------|-------------|-------------|
| UK           | 82.9        | 80.7        |
| France       | 78.7        | 77.0        |
| <b>Spain</b> | <b>77.4</b> | 68.5        |
| Ireland      | 76.0        | <b>68.1</b> |
| Germany      | 73.8        | <b>72.9</b> |
| EU-28        | 72.5        | 69.5        |
| Italy        | 70.6        | 67.4        |
| Poland       | 57.7        | 54.5        |

Source: Eurostat.

The OECD's macroeconomic forecasts for this year and next are broadly in line with the government's and those of other international institutions (see Figure 12).

**Figure 12. OECD's forecasts for Spain 2014 and 2015 (% annual growth unless otherwise stated)**

|                             | 2014 | 2015  |
|-----------------------------|------|-------|
| GDP                         | 1.2  | 1.6   |
| Private consumption         | 2.1  | 1.8   |
| Investment                  | 0.6  | 2.9   |
| Exports                     | 3.7  | 5.9   |
| Imports                     | 4.3  | 5.2   |
| Employment                  | 0.8  | 1.1   |
| Harmonised CPI              | 0.1  | 0.5   |
| Jobless rate (%)            | 24.6 | 23.6  |
| Current account balance (1) | 0.6  | 0.7   |
| Budget deficit (1)          | -5.5 | -4.5  |
| Public debt (1)             | 98.4 | 101.4 |

(1) % of GDP.

Source: OECD.

Reflecting Spain's improved fundamentals and the fall in its benchmark bond yields, the Treasury launched 50-year government bonds this month, selling €1 billion of the 4% securities due on October 2064. Yields on the 10-year debt dropped to 2.08% on 27 August, the lowest since 1993 (see Figure 13).

**Figure 13. 10-year government bond yields (%) and spreads over Germany's bund (pp)**

|              | Yield 22 September (%) | Spread over Germany (pp) |
|--------------|------------------------|--------------------------|
| Germany      | 1.02                   | –                        |
| Greece       | 5.90                   | +4.88                    |
| Ireland      | 1.74                   | +0.72                    |
| Italy        | 2.38                   | +1.36                    |
| Portugal     | 3.18                   | +2.16                    |
| <b>Spain</b> | <b>2.22</b>            | <b>+1.20</b>             |

Source: ThomsonReuters.

#### *Trade deficit doubles as domestic demand picks up*

The trade deficit more than doubled in the first seven months to €13.7 billion compared to the same period of 2013, as imports rose 6.5% to €154.5 billion, reflecting stronger domestic demand, and exports of goods 1.6% to €140.8 billion.

Spain's export growth, though lower in year-on-year terms, was still higher than that of France (-1.7%), the UK (-15.1%) and the euro zone as a whole (+0.9%).

#### *Record tourism month in August*

A record 9.1 million tourists came to Spain in August, 8.8% more than the same month of last year and the highest monthly figure ever. Close to one-quarter came from the UK (23.6%), followed by France (21.8%) and Germany (14.2%). The traditional 'beach and sun' industry is driving the recovery together with exports. The number of tourists in the first eight months of the year reached 45.4 million

## **Corporate Scene**

#### *CaixaBank acquires Barclays unit in Spain*

CaixaBank, Spain's third-largest lender, significantly strengthened its position in its domestic market with the acquisition for around €800 million of Barclays' ailing subsidiary.

The sale marked a major step in Barclays' retreat from European retail banking business. The bank, which will keep its investment banking division and credit card operations in Spain, entered the country in 1974 when it bought the branch network of a Spanish bank. It struggled in recent years to make a profit, forcing it to close branches and cut jobs. It has 271 branches, 103 of them in Madrid.

CaixaBank bought several regional savings banks bailed out by the government after the bursting of the property bubble and lost out to BBVA when it snapped up the state-owned Catalunya Banc. It is now the retail banking leader (see Figure 14).

**Figure 14. Market share in Spain of the four main banks (1)**

|                      | % share |
|----------------------|---------|
| CaixaBank + Barclays | 23      |
| BBVA                 | 14      |
| Bankia               | 11      |
| Santander            | 10      |

(1) Main bank of clients, December 2013.  
Source: Bank reports.

The foreign bank presence in Spain in retail business now mainly consists of Deutsche Bank as Citigroup sold most of its business to Banco Popular in June.

Caixabank is the second most exposed bank to real estate developers, with €16.7 billion of loans (9.3% of its total credit) and €14.4 billion of foreclosed properties on its books at the end of June, according to calculations made by the newspaper *El País* based on the information of 14 banks.

Despite the efforts of these banks to reduce their exposure to the real estate sector, the total amount of foreclosed properties and land increased by €6.1 billion to €90.2 billion between the end of 2013 and last June.

These assets together with doubtful and substandard loans constitute what the Bank of Spain regards as potentially problematic (ie, toxic) assets. They were only €300 million lower at the end of June at €159.3 billion (see Figure 15). Coverage of these assets was 48%.

**Figure 15. Banks and real estate risk (€ million and %)**

|                       | Exposure to<br>real estate<br>developers | % of total loans | Potentially<br>problematic<br>loans (1) | % of total loans |
|-----------------------|--|------------------|---|------------------|
| CaixaBank             | 16,732                                   | 9.3              | 24,924                                  | 13.9             |
| Banco Popular         | 19,424                                   | 21.6             | 28,253                                  | 31.4             |
| Banco Santander       | 10,997                                   | 6.8              | 20,182                                  | 12.4             |
| BBVA                  | 2,278                                    | 2.1              | 7,062                                   | 6.6              |
| Bankia                | 2,017                                    | 1.9              | 6,431                                   | 6.0              |
| Total banks 2013      | 101,872                                  | 9.5              | 159,650                                 | 14.9             |
| Total banks June 2014 | 92,685                                   | 8.8              | 159,316                                 | 15.1             |

(1) Doubtful and substandard loans and foreclosed properties.  
Source: *El País* based on banks' figures.



The non-performing loans of the banking system represented 13.2% of total lending at the end of July.

*Santander to acquire Canadian auto finance company*

Santander, Spain's biggest bank, agreed to buy Canadian car-financing company Carfinco Financial Group Inc. for around US\$269 million.

The Spanish bank will own about 95% of the new company that will be formed after the transaction is completed.