

Inside Spain Nr 154

26 September - 23 October 2018

William Chislett

Summary

Spain and UK 'close to agreement' on post-Brexit deal for Gibraltar.
Andalucía in snap election in December.
Socialists pave way for 2019 budget approval in deal with far-left Podemos.
Economy losing steam, IMF warns on pensions, questions deficit reduction
Saudi Arabia opens Spain-built high-speed rail linking Mecca and Medina.

Foreign Policy

Spain and UK 'close to agreement' on post-Brexit deal for Gibraltar

Gibraltar, the UK overseas territory long claimed by Spain, will not be an obstacle to Britain and the EU reaching a withdrawal agreement, unlike the thorny and still unresolved issue of the border between Northern Ireland and the Republic of Ireland, which threatens to derail the broader agreement.

Prime Minister Pedro Sánchez said at the EU summit earlier this month that a protocol on Gibraltar to be included in the agreement was 'already closed with the British government'. Fabian Picardo, Gibraltar's Chief Minister, said there was a 'fairly final' protocol.

Spain has a veto over the provisions of any Brexit deal that would apply to Gibraltar, which could have been used to step up its claim on the Rock and put a spanner in the Brexit agreement.

The minority Socialist government is continuing the pragmatic policy of the previous Popular Party (PP) government and is not using Brexit to pursue sovereignty. Madrid has also decided not to press for joint use of Gibraltar's airport, which it says is built on Spanish land.

'Given that what we want above all is an agreement and to give stability, elements where we are light years away from reaching an agreement with United Kingdom, like the shared use of the airport or sovereignty over the Rock have been left out', said Sánchez.

More than 10,000 people cross the border every day to work in Gibraltar, most of them Spaniards. Franco's closure of the border with Gibraltar in 1969, which lasted 13 years, left 5,057 Spanish workers without a job in the territory.

Gibraltar voted 96% in favour of remaining in the EU. As well as the special protocol, whose detail has not yet been released, Spain and the UK are working out several bilateral agreements regarding taxes, the environment, tobacco smuggling and citizen's rights. If not agreed in the coming months, they would not derail a Brexit agreement and would be left for the transition period.

Diplomatic status of Flemish delegate removed

The government responded to the repeated support of the speaker of the Flemish parliament for an independent Catalonia by withdrawing the diplomatic status of the delegate for Flanders in Spain.

André Hennelinck represents the Flemish-speaking northern part of Belgium and forms part of Belgium's diplomatic representation in Madrid. He can continue to work in Spain but no longer enjoys diplomatic privileges.

Josep Borrell, Spain's Foreign Minister, has become increasingly outraged at the declarations of Jan Peumans, the speaker, who, among other things, called the nine jailed Catalan leaders 'political prisoners' and said Spain was 'incapable of complying with the conditions to be part of a democratic Europe.'

'Spain cannot allow that time and again the President of a parliament says that we are a country that should be expelled from the EU', said Borrell.

The Spanish Foreign Ministry has summoned Belgium's Ambassador to Madrid three times in a month to protest about Peumans, a member of the conservative New Flemish Alliance which is in favour of independence for Flanders.

Domestic scene

Andalucía in snap election in December

Andalucía, the Socialists' fiefdom for the last 40 years, will go to the polls on 2 December in the first electoral test since Prime Minister Pedro Sánchez came to power in a minority Socialist national government, and kicking off a wave of regional, municipal and European Parliament elections in 2019.

Susana Díaz, the region's Premier, called the early election after the liberal Ciudadanos (Cs) withdrew its support, leaving the Socialists with a 47-seat minority of the 109 seats in the parliament, eight seats short of a majority.

The results will be closely watched as an indicator of whether Sánchez decides to go to the polls early or sees out his term in office with general elections in July 2020.

Sánchez ousted the Popular Party (PP) in June half way through its term in office with a censure motion, supported by the far-left Podemos and Catalan and Basque nationalists, after a court convicted several PP members of corruption.

The election in Andalucía (population 8 million) will also be a first test for Pablo Casado, who replaced Mariano Rajoy as leader of the party, after he quit. The PP has 33 seats in the regional parliament and is in a duel with Cs (nine seats) at the national level for the centre-right ground.

Cs emerged, to the surprise of many, as the largest party in the Catalan parliament in that region's election last December and hopes to build on its groundswell of support.

Supreme Court upholds prison sentence against former deputy PM Rodrigo Rato

The Supreme Court upheld the four-and-a-half year prison sentence for embezzlement against Rodrigo Rato, the Popular Party Deputy Prime Minister (2003-04), International Monetary Fund chief (2004-07) and Chairman of Bankia (2010-12).

Rato was found guilty last year in a case involving corporate credit cards used by top executives at Caja Madrid and Bankia (created in 2010 from the merger of Caja Madrid and six other ailing savings banks and nationalised in 2012). More than 60 executives and board members received varying sentences after it emerged they had spent a total of €12.5 million between 2003 and 2012 on personal expenses ranging from holidays and jewellery to expensive meals in restaurants.

The longest jail terms went to Miguel Blesa, the former Caja Madrid Chairman, who spent €436,688 and was sentenced to six years, and his successor Rato (€99,055). Blesa committed suicide in 2017.

The Supreme Court said Rato maintained a system of secret bonuses for executives. The 36 people who returned before the trial the money they had spent have not gone to prison, except for Rato. Among those who received jail terms are several trade unionists from the Workers Commissions and UGT and representatives of the Popular Party, the Socialists and United Left (one of whom spent €456,522).

Rato could appeal to the Constitutional Court, which would put his sentence on hold until the case is reviewed.

The scandal broke at a time when Spain was in the depths of a long recession and provoked much public anger. The executive claimed the credit cards were a bonus on top of their salaries, something not written into their job contracts. The extra income was also not declared to the tax authorities.

In another banking development, the trial began in Barcelona against Narcís Serra, the Socialist Deputy Prime Minister (1991-95) and the former Chairman of CatalunyaCaixa (2005-10), and other executives for allegedly agreeing 'disproportionate' salary increases in 2010, shortly before the state came to the rescue and injected €1.25 billion into the institution.

Cracks appear in Catalan independence movement

Republican Left of Catalonia (ERC) voted against its independence ally, Together for Catalonia (JxCat), and by teaming up with the Socialists in the regional parliament defeated a proposal of JxCat to allow MPs in self-imposed exile or jailed for organising the illegal referendum on secession to vote in the parliament.

Imprisoned ERC leader Oriol Junqueras and Raul Romeva, another jailed ERC member, had previously agreed to transfer their votes to a member of their party, in line with a Supreme Court ruling.

This was the first time in three years that the two main Catalan independence parties voted against each other in the regional parliament.

In another development, the European Court of Human Rights ruled that the fines imposed by Spain's Constitutional Court on members of the electoral board that oversaw the illegal referendum on Catalan independence in 2017 did not breach human-rights law.

The Constitutional Court declared the referendum unlawful and imposed a coercive day-fine of a minimum of €6,000 on all members of the electoral boards. Montserrat Aumatell i Arnau, who brought the case, was informed of that decision via the Official Gazette. She resigned from her post on the same day. In a subsequent decision the Constitutional Court lifted the fines imposed on the members of the electoral boards in view of all the resignations.

The European Court said the failure to serve notice of the Constitutional Court's decision personally on Aumatell i Arnau had not prevented her from having knowledge of it or from making submissions to that court. It declared her application inadmissible.

Parliament to debate euthanasia bill

Parliament is to debate a bill that would regulate euthanasia, which a majority of Spaniards are in favour of, according to a study published earlier this year.

The decision follows a move by the conservative Popular Party (PP) to unblock a bill on the issue that was introduced by the Socialists when they were in the opposition.

Now that they are in government, the Socialists want to press ahead with a bill which views euthanasia as an individual right available to people suffering from 'a serious and incurable disease with a limited life prognosis' or 'a serious, chronic and irreversible disability that causes them unbearable suffering'.

The PP's change of heart does not mean it supports the bill. Pablo Casado, the party's leader, will present an alternative proposal.

The Socialists, however, have enough support for their bill as it is backed by a slim majority of lawmakers.

A survey published in *La Revista Española de Sociología* showed 58% support for euthanasia.

Spain scores slightly higher in quality of democracy index

Spain remained in 25th position out of 41 countries in the latest quality of democracy SGI ranking of the Bertelsmann Foundation, but with a slightly higher score than in 2017 (7.11 out of 10, as against 7.07, see Figure 1). Since 2014, it has moved up two places (score of 6.95).

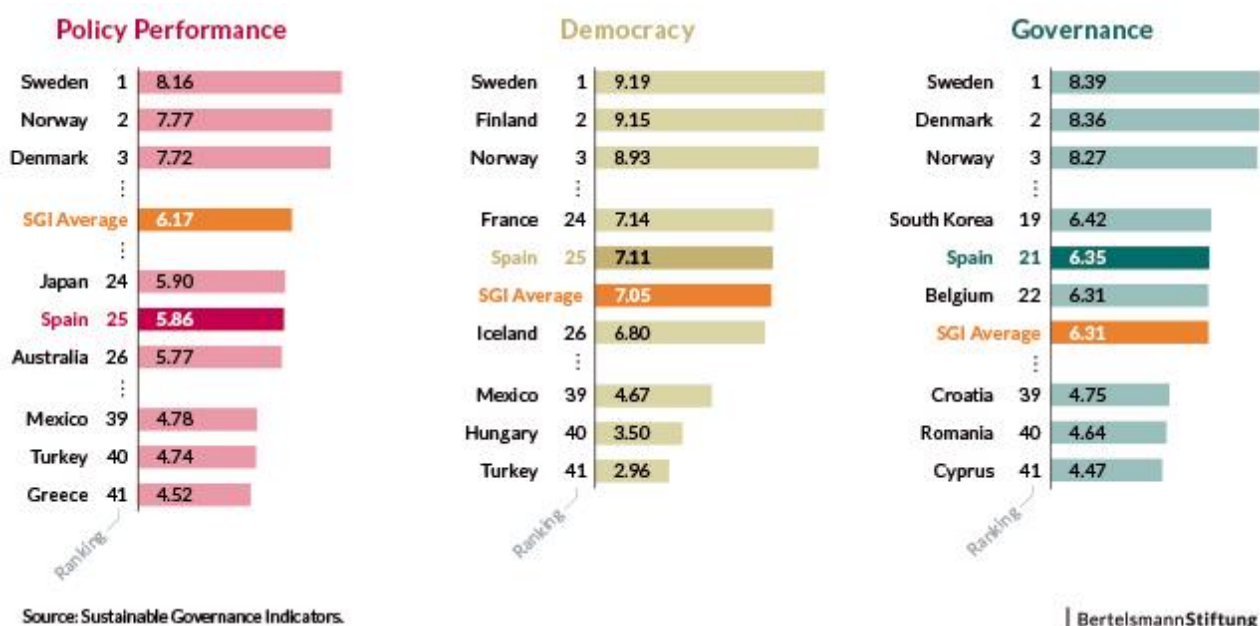
Figure 1. Quality of democracy, sustainable governance indicators (SGI), 2018 ranking

Ranking out of 41 countries	Score out of 10
1. Sweden	9.19
2. Finland	9.15
5. Germany	8.70
16. UK	7.46
18. US	7.41
21. Italy	7.30
24. France	7.14
25. Spain	7.11

Source: BertelsmannStiftung.

The report examines 41 countries in terms of their democratic standards, quality of governance and policy outcomes in the areas of economics, social affairs and the environment. Spain was below the SGI average in policy performance and above in democracy and governance (see Figure 2).

Figure 2. Spain's performance in SGI



Source: *Sustainable Governance Indicators 2018 Overview: Policy Performance and Governance Capacities in the OECD and EU, Spain - Country Profile SGI 2018*, Bertelsman Stiftung, http://www.sgi-network.org/docs/2018/basics/SGI2018_Overview.pdf.

Note: the policy performance index aggregates all the data compiled on policy outcomes in 16 areas that address the three dimensions of sustainability (economic development, environmental protection and social policies). This allows for a strengths-and-weaknesses profile of each country as it underscores their specific reform needs. The democracy index is based on the thorough analysis of each country's democratic order and the rule of law on which it is based. In assessing the quality of democratic institutions and processes, the index looks at the substantive and procedural features of a system that enable long-term oriented governance. The governance index assesses a government's capacity to steer and implement policies, as well as its capacity for institutional learning. It also takes a close look at the participatory and monitoring competencies of actors in society, thereby accounting for a political system's capacity for reform.

The authors noted that, along with France and Greece, Spain's political-party system has become more polarised, as a result of the shift from a two-party to a multiparty system with the nascent leftist Podemos and the liberal Ciudadanos.

Spain was one of the countries that recorded the biggest rise in overall policy performance since 2014, albeit from a low level. As a result of the reforms implemented the country 'is no longer viewed as the euro zone member whose troubles are most likely to put the single currency in peril'.

The Economy

Socialists pave the way for 2019 budget approval in deal with far-left Podemos

Socialist Prime Minister Pedro Sánchez and Pablo Iglesias, leader of the far-left Podemos, agreed a pact that could lead to parliament approving the 2019 draft budget

and with it enhance the chances of the minority government staying in office until the due date for elections in July 2020.

The deal, however, needs the support of Basque and Catalan nationalists. Quim Torra, the Catalan Premier, issued an ultimatum to the national government saying it would withdraw its political support unless there was an agreement on holding an independence referendum. This would probably trigger an early election. The independence movement, however, is split over strategy and Torra's ultimatum drew criticism.

The fiscal pact also requires the approval of the European Commission which has asked for more information on the spending plans. Spain has been under the excessive deficit procedure for the past decade as its fiscal deficit has been above the threshold of 3% of GDP. The aim this year is to lower the deficit to 2.7% and to 1.8% in 2019, which would release Spain from the greater oversight of its finances.

The projected deficit next year is higher than the 1.3% targeted at the start of the year by the previous Popular Party administration. The cut in the structural deficit, adjusted to take the economic cycle and one-off payments into account, of 0.4 percentage points is below the Commission's recommendation of 0.65 pp set out in July.

The monthly minimum wage will rise from €736 to €900 (14 payments), by far the largest ever annual increase in real terms. Juan Rosell, the head of the CEOE employers' association, criticised the 'unilateral' decision. Economists warned that the sharp rise will discourage hiring and if so will hinder a further reduction in the unemployment rate, which is still very high at 15%.

The increase coincided with publication of a report which showed that the average remuneration of top executives at companies forming the Ibex-35, the benchmark index of the Madrid Stock Exchange, rose 43% between 2013 and 2017.

Revenue measures include a rise in income for those earning more than €130,000 a year and a new tax, dubbed the 'Google tax', levied on big Internet companies with annual revenue of €750 million worldwide, and at least €3 million in Spain.

'It's urgent to reverse the scars of austerity, sew the social divide, reduce inequality, job precariousness and poverty', says the text of the 50-page agreement which blames the previous Popular Party government for 'seven years of cutbacks and suffocation'.

The Popular Party attacked the deal as 'impossible, irresponsible and suicidal'. 'Either the European Commission takes down this budget or this budget will take down Spain', said party leader Pablo Casado.

The budget wrangling comes when Italy is confronting the EU over its plans to raise spending. Despite having a deficit higher than Italy's, Spain's economy is in better shape and can support a slight relaxing of austerity. Spain's 10-year government bond yield

has risen but is much lower than Italy's, underscoring greater market confidence in Madrid than in Rome (see Figure 3).

Figure 3. 10-year government bond spreads

	Yield on 22 November (%)	Spread vs bund
France	0.82	+0.37
Germany	0.45	-
Italy	3.53	+3.09
Spain	1.73	+1.28
UK	1.52	+1.08

Source: Financial Times.

In its latest forecasts, the IMF cast doubt on government's capacity to reduce the budget deficit to below 2% of GDP in 2019, claiming that this would not happen during the 2018-23 period under study (see Figure 4).

Figure 4. IMF forecasts for Spain, 2018-23

	2018	2019	2020	2021	2022	2023
GDP growth (%)	2.65	2.20	1.85	1.71	1.65	1.65
Inflation (%)	2.17	1.71	1.67	1.90	1.95	1.94
Unemployment (%)	15.57	14.68	14.26	14.05	13.88	13.85
Fiscal deficit (% of GDP)	2.68	2.34	2.37	2.47	2.56	2.73
Public debt (% of GDP)	97.15	95.79	94.65	93.79	93.01	92.56

Source: IMF.

Economy losing steam, IMF warns on pensions

The economy continues to grow relatively strongly but is beginning to slow down because of a less favourable external environment and weakening domestic demand. The latest IMF forecast puts growth at 2.7% this year (3% in 2017) and 2.2% in 2019.

'The recovery of the Spanish economy may have passed its cyclical peak and downside risks have emerged', said Luis de Guindos, the former Popular Party Economy Minister and now Vice-President of the European Central Bank.

The number of tourists in August (10.2 million) was slightly lower than in the same month of 2017 and the first decline that month since 2009. Spending, however, was a little higher.

The trade deficit in the first eight months was 27.3% higher at €20.9 billion than in the same period of 2017. Exports grew 4.2% to €189.9 billion and imports were up 6.1% at €210.8 billion.

The IMF issued a veiled criticism of the previous minority Popular Party government's decision in April, before it left office, to restore purchasing power to pensions through indexing payments to inflation, in exchange for parliamentary support for its 2018 budget.

Indexation was ended in 2014 when rises were limited to a below-inflation 0.25% per year, in a move to make the pension system more sustainable. Inflation is running at around 2%.

Spaniards today live on average 83.2 years, almost 10 more than in 1978. The rapidly ageing population and the still very high unemployment rate (15%), with the number of social security contributors around one million below the peak in 2008, is putting the pension system under considerable strain.

People in Spain are forecast to have the longest life expectancy in the world by 2040 (85.8 years), ahead of Japan, according to a report by the Institute for Health Metrics and Evaluation in Seattle, US.

In a major demographic change, deaths have outstripped births since 2015. The fertility rate of 1.3 children per woman (2.5 in 1978) is one of the world's lowest. In 2050, Spain will have 77 retired people per 100 people working compared with around 30 at the moment and just 19 in 1975. The higher the old-age dependency rate, the smaller the proportion of the population in a position to work and contribute to the social security system. The number of pensioners is forecast to rise from 8.7 million to 15 million in 2050.

The National Statistics Office (INE) forecast that one-quarter of the 49 million population in 2033 will be over the age of 65, up from 19% now, based on current demographic trends.

According to BBVA Research, the average pension has risen from 50% of the average salary in 2007 to 63.4%, as a result of a 48% rise in the average pension and a 19% increase in salaries. Spain's pensions are the third most generous on this basis after Greece (80%) and Cyprus (70%).

The Independent Authority for Fiscal Responsibility forecasts that Spain will need up to 10 million immigrants by 2050 to help ease the pension problem as of 2023 when baby boomers retire.

The multi-party commission that controls pension spending reaffirmed the inflation indexation after the Socialists took office in June. The IMF said 'relinking pension increases to an indicator of purchasing power should not be translated into legislation without a comprehensive package. Ad hoc adjustments to pension benefits could put the system's financial sustainability at risk'.

Measures to offset indexation include increasing the minimum contribution for the self-employed and linking the statutory retirement age directly to life expectancy.

The IMF urged the government to 'take full advantage of the still strong economic conditions to bring down faster the high level of public debt'. Debt has trebled over the last decade to 98% of GDP and has only come down marginally in the last few years. If this does not happen and there is a future shock, the government would have to undertake a fiscal tightening.

As regards the banking system, parts of which had to be bailed out by the EU in 2012 after the bursting of a massive property bubble, the IMF said 'vigilance is needed as housing-related new loans and especially consumer lending continue to pick up'. It said the Bank of Spain's armoury 'should be swiftly expanded to include borrower-based tools such as limits on loan-to-value and debt service-to-income ratios'.

Corporate scene

Saudi Arabia opens Spain-built high-speed rail linking Mecca and Medina

King Salman inaugurated the 450km high-speed rail service between the two holiest cities in Islam, built by a Spanish-led consortium, that halves the travel time.

Pilgrims account for a large part of Saudi Arabia's 20 million tourists a year. The government aims to increase the number of umrah and hajj pilgrims to 15 million and five million respectively by 2020, and double the umrah number again to 30 million by 2030.

Iberdrola to sell Scottish Power Generation

Iberdrola, the world's leading producer of wind power, is to sell 100% of Scottish Power Generation, which it bought in 2006, to Drax Group for €801 million.

Court to investigate Caixabank's purchase of Portuguese bank

The High Court is to probe Caixabank's allegedly irregular purchase in 2017 of Portugal's Banco BPI, following a lawsuit brought against the bank by two shareholders.

The takeover took nearly two years to complete. Magistrates will decide whether there is a case before opening any trial.

Inditex and Santander in 'Fortune Change the World' list

Inditex, the world's leading fashion retailer, and Santander, the euro zone's largest bank by market capitalisation, are included in the latest 'Fortune Change the World' list which showcases 57 companies that are doing well by doing good.

The companies were chosen on the basis of their measurable social impact, business results, and degree of innovation.

Inditex is ranked 4th after Reliance Jio (telecoms), Merck (pharmaceuticals) and Bank of America and Santander 56th. Santander is the only European bank to make the list.