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Foreign Policy

Madrid Seeks to Limit the Foreign Policy Activities of Regional Governments

Spain's new foreign-service action law aims to restrict the foreign policy moves of the country's 17 regional governments, in particular those of the Catalan government which says it will internationalise its conflict with the central government if it is barred, as seems very likely, from holding a referendum on independence.

The ruling Popular Party has already declared the referendum illegal. Most of the Socialist leadership is also against the referendum, though there are splits in the party's Catalan branch. The Spanish Constitution gives the central government 'exclusive competence' on the authorisation of referendums. The only legal way to trigger this process and end the impasse is through a constitutional amendment. This would require a large majority in the Spanish parliament, new elections and approval in a referendum held throughout the country.

According to newspaper reports, the heads of regional governments will have to inform the Foreign Ministry of the trips they make abroad in their official capacity and the actions they intend to take in order to determine whether they are in line with the central government's policy objectives.

Artur Mas, the premier of Catalonia, made trips to Moscow and Brussels last November, shortly before the region's parliamentary elections, to promote his cause.

He called José Manuel García-Margallo, the Foreign Minister, a 'dyed-in-the wool nationalist'. García-Margallo, who is a particularly vocal critic of the pro-independence movement in Catalonia, said the new law was not asking regional governments to do anything different to what the central government was already doing.

The government has also sought to reduce the number of representative offices abroad of regional governments, as part of the public spending cuts. The regions still have 166 offices abroad. Catalonia has the most (41, three of which are in China and four in the US). Some regions, such as La Rioja, Valencia, Galicia and Asturias, have agreed to integrate their offices into Spain's embassies and consulates.

Between 2008 and 2012, Catalan and Andalusian government officials made 287and 141 trips abroad, respectively, on behalf of their regions, according to the Foreign Ministry.

Domestic Scene

Popular Party's Secret Slush Fund Scandal Refuses to Go Away

Prime Minister Mariano Rajoy's publication of his tax returns over the last 10 years did nothing to quell the growing scandal surrounding allegations that his ruling Popular Party (PP) benefited from a secret slush fund.

Luis Bárcenas, the PP's former treasurer and senator, is under investigation after €22 million was discovered in Swiss bank accounts held by him. Parts of a handwritten accounting book published in *El País*, the leading daily, showed payments in cash to PP leaders including Rajoy (€322,231 between 1998 and 2008) and donations from companies, mainly construction firms.

Rajoy denied he had received any money, while Bárcenas said the publication of the accounts was a 'set-up' and the handwriting was not his. However, Jorge Trías, a former PP member of parliament, told anti-corruption officials that Bárcenas had showed him the same accounts as those published in *El País,* and handwriting experts said the writing in the ledger appeared to be Bárcenas's.

It is widely acknowledged that the release of Rajoy's tax returns has done nothing to resolve the slush fund allegations. According to a Metroscopia survey, 76% of respondents said the explanations given by PP people named in the ledger were not credible or convincing (89% of these respondents said they were Socialist voters and 67% PP).

Alfredo Pérez Rubalcaba, the leader of the Socialist party (PSOE), called for Rajoy to resign, but stopped short of demanding an early general election (not due until 2015), implicitly recognising that his party was not in a position to be an alternative to the PP and win a majority of seats in the parliament.

Another Metroscopia survey showed that neither the PP nor the Socialists would win an election on their own. The PP would obtain 23.9% of votes (down from the 44.6% it received in the November 2011 election when it won a sweeping majority) and the Socialists 23.5% (28.7% in 2011). The more radical United Left (IU) party would more than double its share of the vote to 15.3% and the centrist Union for Progress and Democracy (UPyD) would almost treble its slice to 13.6%.

Rubalcaba's call echoed the PP's slogan of *váyase, señor González* ('Go away, Mr González') repeated endlessly during the fourth Socialist government of Felipe González (1993-96), which was hit by its own corruption scandals and forced to go to the polls early, when it lost to the PP.

The scandal is being investigated by the anti-corruption unit, which must decide whether there is a case to answer. It has requested from the Tax Agency information in the payments declared by the PP since 2000. The PP rejected a parliamentary inquiry into the affair.

Meanwhile, the long-running judicial investigation into the corruption scandal known as Gürtel involving PP politicians and businessmen, mainly in Valencia, proceeds and would further damage the PP's standing if the investigating magistrate managed to incorporate the slush fund allegations into it by establishing a clear link between the two cases.

The only head to roll so far in the Bárcenas case is that of Jesús Sepúlveda, the former husband of Ana Mato, the Health Minister, and ex-mayor of Pozuelo (just outside Madrid), who was indicted in 2009 in the Gürtel case and fired from his post in the PP earlier this month after fresh allegations emerged. Before becoming mayor, Sepúlveda ran PP's electoral affairs between 1993 and 2003. Despite being indicted in the Gürtel case he continued to be on the PP's payroll.

The Bárcenas affair has exposed the ineffectiveness of the Audit Court, responsible for supervising public sector accounts including the budgets of political parties represented in Parliament and the money spent on electoral processes (political parties receive state funding). The Court has 800 employees and its 12-person governing body is appointed by political parties, which undermines its independence. Eight of the current 12 members were appointed by the PP, three by the Socialists and one by the Socialists and United Left.

The Supreme Court recently rejected two of the governing body's appointments to the Audit Court and called for it to employ more career bureaucrats and appoint fewer people itself. The Audit Court is notoriously slow in reviewing accounts. The last audited year was 2007.

In his state-of-the-nation address, Rajoy promised a new draft law that would tighten oversight of parties' finances.

Public Pressure Forces the Government to Debate Mortgage Law Reform

The ruling Popular Party reversed its stance and admitted to parliament a petition signed by close to 1.5 million people calling for mortgage law reforms. The PP had previously said it would vote against it.

The move followed several suicides by people facing eviction for non-payment of their mortgages. It is estimated that since the onset of Spain's crisis in 2008 banks have repossessed some 400,000 properties.

A grass roots movement, known as the Platform of those Affected by Mortgages, has spent the last four years campaigning for a mortgage law more in line with that in the rest of Europe which allows homeowners unable to meet their payments to return their properties in lieu of payment.

Spain's mortgage law is particularly harsh. Homeowners remain liable for what they owe on their mortgage loan even after returning the house to the bank, if the sale of the property does not cancel out the entire debt.

Early School Leaving Rate Continues to Improve

Spain's very high unemployment rate continued to have a positive impact on the country's level of educational attainment in 2012. The early school leaving rate dropped for the fourth year running(to 24.9% of those aged between 18 and 24 with only lower secondary education qualifications at best), according to trade union estimates, from a peak of 32% in 2004 (see Figure 1).

Figure 1. Early School Leaving Rates, 2004-2012 (1)

2004	2005	2006	2007	2008	2009	2010	2011	2012
32.0	30.8	30.5	31.0	31.9	31.2	28.4	26.5	24.9*

(1) Estimate made by the Workers' Commissions. Percentage of 18-24 year olds with only lower secondary education qualifications at best and not in training courses.

The rate, however, is still almost double the EU average. The European Commission has set a target of 10% for 2020.

Education experts say the situation is not as bad as that painted by the statistics as Spain sets a higher standard for passing the school-leaving exams.[1] This means, for example, that France passes students that Spain does not (see Figure 2).This would explain, to some extent, why France's early school leaving rate is less than half that of Spain's. Also, it is harder to pass in some of Spain's regions than in others as there is no consistency in marking. Successive governments in Spain have failed to point out these factors.

Figure 2. Percentage of Students in the Two Lowest Levels (PISA) and Early School Leaving Rates

	Reading	Mathematics	Science	Early school leaving rate (2011)
Spain	19.5	23.7	18.2	26.5
France	19.7	22.6	19.3	12.0
Italy	21.0	25.0	20.6	18.2
Belgium	17.7	19.0	18.1	12.3

Source: PISA 2009 and Eurostat 2011.

The reduction in the rate is due more to youth unemployment of 55% than to reforms. During Spain's 13-year long economic boom, which ended in 2008, tens of thousands of students left school as soon as their compulsory education finished at the age of 16 to work mainly in the construction and tourism sectors. Now, students have no option but to continue studying.

The union Comisiones Obreras (CCOO) estimated that of the 800,000 people between the ages of 18 and 24 who have left school early, around 400,000 are unemployed, 310,000 have a job and 130,000 are inactive.

The great majority of these people are very poorly qualified and with a scant chance of finding a job in an economy in its fifth year of recession and with an economic model excessively based on a construction sector now in the doldrums.

[1]This is well explained by Carmen González Enríquez, Elcano's analyst for demography,population and international migrations in the following Spanish text: http://www.realinstitutoelcano.org/wps/portal/rielcano/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/demografia+y+poblacion/comentario-gonzalezenriquez-fracaso-escolar-espana.

Opportunities for them, however, will be provided by the building of the Eurovegas mega casino project (see the item in the section below).

The Economy

Madrid Secures the Eurovegas Gambling Complex
The crisis-hit construction sector received a big boost this month when the US Las Vegas Sands corporation of multibillionaire Sheldon Adelson confirmed it would go ahead with building on the outskirts of Madrid Europe's largest complex of casinos, hotels, conference and leisure centres, golf courses, shopping malls and a recreation of New York's Times Square.

More than one million workers have lost their jobs in construction since the onset of the crisis in 2008. It is estimated that the entire complex will create around 240,000 direct and indirect jobs by the time it is finished in 18 years time.

Las Vegas Sands chose Madrid over Barcelona and announced it would start the first phase of building late this year as it had obtained the €9.8 billion financing and planned to open the complex in 2017.

The project has raised concerns that it will encourage gambling addiction, prostitution and organised crime. It also reinforces Spain's lopsided construction-centred economic model, which is very labour intensive when the economy is growing and sheds many jobs as soon as there is a downturn.

Las Vegas Sands, which has similar complexes in Singapore and the US, appeared to have won all the concessions it had asked for including tax changes and exemptions to no-smoking laws.

Protesters accused the government of creating a low-tax enclave for Las Vegas Sands.

Spain to Remain a Net Recipient of EU Funds in 2014-20
Contrary to expectations, Spain will not become, for the first time since joining the EU in 1986, a net contributor to the EU budget in 2014-20.

According to the first estimations by the European Commission, Spain will receive 0.20% of GDP of the community budget. On the basis of the growth forecasts for Spain, that figure could be around €15 billion.

This result is particularly relevant when considering that the two main sources of European funding for Spain (CAP and Cohesion policy) suffered cuts in relation to the spending in the 2007-13 multiannual financial framework.[2]

[2] Spain's deal is explained in greater detail in a forthcoming analysis by Dr Mario Kölling and Dr Cristina Serrano Leal to be published by the Elcano Royal Institute.

Prime Minister Mariano Rajoy regards the new budgetary deal as a victory for Spain. His quest for a better deal was helped by the fact that Spain is poorer today than it was when the current arrangement was negotiated, because of its five-year recession, and the EU budget was reduced for the first time, which puts Spain's deal in a better light.

Spain's per capita GDP in purchasing power standards dropped in 2010 below the EU average for the first time since 2002 (see Figure 3).

Figure 3. GDP Per Capita in PPS (EU-27 = 100)

	2002	2011
France	116	108
Germany	115	121
Italy	112	100
Spain	**100**	**98**

Source: Eurostat.

Public Debt Reaches a Record 84% of GDP, Trade Deficit 34% Lower

Public debt rose by €145.8 billion in 2012 to €882.3 billion (84% of GDP), the highest figure in relative terms in more than a century, according to the Bank of Spain (see Figure 4). This was the largest annual rise ever (roughly €400 million a day).

Figure 4. The Rise and Fall of Spain's Public Debt (% of GDP), 1975-2012

1975	1980	1985	1991	1996	2003	2007	2010	2012
7.3	22.2	43.3	45.4	67.5	46.3	36.3	68.5	84.0 (1)

(1) Based on an estimated GDP of €882.3 billion.
Source: Bank of Spain.

The debt level is still below the euro zone average, which in the third quarter of 2012 was 90.1%. Since 2007, Spain's debt to GDP has more than doubled.

Most of the growth in debt was due to the need to finance the budget deficit, which was still very high in 2012 at around 7% of GDP. Another factor was the one-off funds to recapitalise ailing banks.

The trade deficit in 2012 was 33.6% lower at €30.8 billion and one third of the peak in 2007 (€98.9 billion). Exports grew 3.8% to €222.6 billion, the highest figure ever, and imports fell 2.8% to €253.4 billion (see Figure 5). Exports covered 87.8% of imports, also a record.

Figure 5. Spain's Exports in 2012 by Economic Sectors (% of total and change in volume over 2011)

	% of total	% change over 2011
Capital goods	19.6	1.6
Food	15.3	11.7
Chemicals	14.1	6.4
Motor industry	13.7	-7.6
Semi-manufactured goods	11.5	-2.1
Consumer manufactures	8.4	6.8
Energy products	7.4	3.5
Other goods	5.8	35.7
Raw materials	2.6	0.6
Consumer durables	1.6	-1.9

Source: Customs.

The number of companies that exported in the first 11 months of 2012 was 12% higher year-on-year at 130,247. The drive in exports, in the face of the very depressed home market, has enabled many companies to survive.

Spain's trade surplus with the EU was three times higher than in 2011 at €12.5 billion and exports to Africa and Latin America (from relatively low bases) grew 30.6% and 14.9%, respectively (see Figure 6). The energy import bill, however, continued to weigh on the trade deficit.

Figure 6. Geographical Distribution of Exports (% of total and change in volume over 2011)

	% of total	Change/2011 (%)
EU	62.8	-1.3
Rest of Europe	7.8	6.7
North America	4.6	13.5
Latin America	6.2	14.9
Asia	8.5	11.9
Africa	6.8	30.6
Middle East	2.8	7.3
Total	100.0	3.8

Source: Customs.

The budget deficit in 2012 was below 7% of GDP, down from 9.4% in 2011, according to Prime Minister Mariano Rajoy, who did not offer any further details. With an economy still in recession this was an achievement, although the figure was higher than the European Commission's target of 6.3%. It could lead to Brussels easing this year's very demanding target of 4.5%.

Meanwhile, the number of Social Security contributors dropped to 16.17 million at the end of January, roughly the same number as in 2002, because of continued job losses. The pensions deficit (the difference between payments and revenues) in 2012 was estimated at €5.8 billion (€534 million deficit in 2011) and the total Social Security deficit around €10.5 billion.

Banks' Non-Performing Loans Fall for First Time since March 2011

The NPLs of the banking sector fell to 10.34% of their total loans at the end of 2012, almost one point below November's figure.

This fall, however, was due to the toxic assets now placed in Sareb, the 'bad bank' recently set up as part of the government's deal with the EU last year when some €40 billion of recapitalisation funds were received. Sareb is not covered by the NPL statistics.

Catalonia Requests a Further €9 billion from Regional Rescue Fund

The heavily indebted region of Catalonia, whose government is seeking a referendum on independence, has asked the central government for a further €9.1 billion from its liquidity fund. Last year, Catalonia sought €5.4 billion.

Of the €9.1 billion, €7.7 billion would be used to fund bond payments and the rest go towards meeting the region's deficit reduction target of 0.7% of GDP.

The government of Valencia has asked for €2.3 billion from the €23 billion fund. The fund had a budget of €18 billion in 2012, when nine regions requested aid.

One Year of Labour Market Reforms Makes No Dent in Unemployment
The Popular Party government's labour reforms were one year old this month and have not stopped the relentless rise in unemployment.

Since they came into effect the number of registered unemployed has risen by 380,000 to almost 5 million and the number of stated jobless (household surveys) by almost 700,000 to close to 6 million, although the period for the latter figure does not coincide exactly with the duration of the reforms.

The reforms cut the severance pay for workers on new permanent contracts from 45 days' salary for each year of employment (high by European standards) to 33 days and reduced the maximum payment possible from 42 months pay to 24 months.

Companies facing difficulties are allowed to reduce employees' working hours and collective wage bargaining agreements can take more account of companies' individual circumstances and are not automatically binding for the whole sector. This latter measure has probably saved jobs from being destroyed.

The reforms, however, have done little to narrow the enormous divide between permanent (and well-protected) and precarious temporary workers (around one-quarter of employees compared with one-third in 2007, the last year of the economic boom).

The reforms have not achieved what they set out to do –facilitate hiring and reduce firing– but this is more the fault of Spain's (expired) economic model, excessively based on a construction sector (a whopping 17.9% of GDP and 20% of employment in 2006) which collapsed as of 2008, than the measures being adopted at a time of recession. Indeed, Spain's labour market is still regarded as too rigid by European standards, and a 'new' economic model has yet to emerge.

Companies have used the reforms to slim down their work force and improve productivity. Had the reforms not been introduced, it is unlikely that the unemployment situation today would be radically different.

The government believes that when the economy begins to grow again as of 2014 the reforms will boost job creation.

An opinion poll by Metroscopia this month showed that most voters, including those supporting the PP, regard the reforms as unjust. When the reforms were approved in February 2012 59% of respondents supporting the PP welcomed them and 64% said they were just. Today, those figures are 49% and 52%, respectively.

Meanwhile, remarks by Juan Rosell, the head of the CEOE employers' association, who said he did not believe Spain really had 6 million unemployed, according to the EPA survey conducted every quarter by the National Statistics Office (INE), sparked an acrimonious public debate on whether the registered figure (announced every month) of 5 million was closer to reality.

The two sources use different definitions. INE defended its methodology as it is the same as that used by all EU countries and its unemployment figure is the one used by Eurostat, the EU's statistical arm. Around 15% of EPA unemployed are not registered in the government's employment offices for a variety of reasons including using other means to find a job and not the official service provided.

Short-Selling Ban on Shares Ends, Market Turns Bearish
The National Securities Market Commission ended on 31 January the ban on short-selling of shares imposed last July because of 'extreme volatility which may cause European securities markets to have a disorderly functioning'.

Short-sellers sell borrowed shares with plans to buy them back later at a lower price.

The Ibex-35, the benchmark index of the Madrid stock market, surged 40% between last year's low on 24 July and the end of January 2013. The market then suffered its worst week in February since last September. The Ibex-35 dropped 5.7%, virtually wiping out all the gains since the beginning of 2013 when the market rallied (see Figure 7), due to poor bank results for 2012 (see the corporate section) and the Popular Party's slush fund scandal.

Figure 7. Main Stock Market Indices (% change), 1 January-20 February 2013

Index	1 January-20 February 2013
Ibex-35 Spain)	**-0.06**
Dax (Frankfurt)	+1.53
FTSE 100 (London)	+8.44
Euro Stoxx 50	+0.17
Dow Jones	+6.28
Nikkei (Tokyo)	+10.32

Source: Markets.

Government Puts R&D Spending Target Back by a Decade
Spain's science and technology sector suffered a setback when the cash-strapped government announced that the target of spending 2% of GDP on research and development (R&D) had been put back to 2020.

The previous Socialist government (2004-11) had set 2010 as the year when R&D spending would reach 2% of GDP. In 2011 (latest figure), it stood at 1.33% (see Figure 8).

Figure 8. R&D Spending, 2004 and 2011 (% of GDP)

	2004	2011
Sweden	3.58	3.3
France	2.16	1.9
Germany	2.50	2.3
Italy	1.09	1.1
Spain	**1.06**	**1.3**
UK	1.68	1.7

Private sector spending on R&D, according to the 2013-20 strategy for science, technology and innovation, is forecast to double to 1.20% of GDP and the rest would come from state expenditure.

Corporate Scene

Nissan to Invest €130 million in New Car at its Barcelona Plant
Japan's Nissan Motor is to invest €130 million at its factory in Barcelona which has been chosen as the site for a new model. This represents a much-needed shot in the arm to Spain's motor industry and a vote of returning confidence in the country's improved competitiveness.

Nissan will produce 80,000 of a new compact family car per year as of 2014 and also manufacture 24,000 of its one tonne Pick Up model a year, as well as gearboxes for its electric LEAF and eNV200 models.

This investment follows expanded production agreements by Ford, Renault and Volkswagen in Spain and reflects, to some extent, the country's improved productivity since 2008, which has made it more attractive for foreign investors.

A large part of Nissan's new output will be exported. The company, like other car producers in Spain, exports most of its production. The level of exports is particularly high (80% in the case of Nissan) when the Spanish car market is in the doldrums, as at present.

Property Slump Claims Another Big Victim
Reyal Urbis filed for insolvency in the country's second-biggest corporate crash after banks pulled the plug on the real-estate giant after failing to reach a deal on renegotiating €3.6 billion of debts.

Martinsa Fadesa became Spain's biggest insolvency in 2008 when it defaulted on €7 billion of debt.

Sareb, the 'bad bank' set up recently to take the toxic assets from banks rescued by the EU, is Reyal Urbis's largest creditor.

Bolivia Nationalises More Spanish Companies
The Bolivian government took over three Spanish-owned airports in its third expropriation in less than a year.

Sabsa, jointly owned by Abertis and Aena, Spain's airport authority, ran the airports in La Paz, Santa Cruz and Cochabamba. Sabsa's contract was not due to expire until 2025.

Last December, the leftist President Evo Morales brought two Spanish-owned electricity supply companies under state control.

Banks' Earnings Dragged Down by Provisions for Soured Property Loans

Last year was *annus horribilis* for Spain's banking sector, including the two largest banks, Santander, the euro zone's largest bank by market value, and BBVA, because the provisions set aside against soured real estate loans dragged down their profits to the lowest levels in more than a decade.

Santander's net profits fell 59% in 2012 to €2.20 billion compared with €9.06 billion in 2008, before the onset of Spain's recession and the bursting of the property bubble, and €2.25 billion in 2000, while BBVA's dropped 44% to €1.67 billion. Banco Popular turned a profit of €480 million in 2011 into a net loss of €2.46 billion in 2012 and Caixbank's profit plummeted 78.3% to €229 million.

The scale of the problem can be gauged from Santander. Its profit before provisions was €23.55 billion, one of the highest in the world, but mainly as a result of €18 billion of provisions for Spain and other countries the net profit was reduced to €2.2 billion. Santander sold 33,500 of foreclosed and real estate developers' properties last year, which probably made it the country's largest real estate agency. Once provisions return to a 'normal' level, Santander's profits should rise considerably.

Most of the profits continued to be generated outside Spain, although these too were less buoyant (see Figure 9).

Figure 9. Geographical Distribution of Santander's Ordinary Attributable Profit (% of total)

	%
Brazil	26
Spain	**15**
UK	13
Mexico	12
US	10
Chile	6
Poland	5
Germany	4
Rest of Latin America	6
Rest of Europe	2
Portugal	1

Source: Santander.