A New Course for Spain: Beyond the Crisis

William Chislett

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Photo: Ben Chislett

William Chislett is a writer who has lived in Madrid since 1986. He covered Spain's transition to democracy (1975-78) for *The Times* of London and was later based in Mexico City for the *Financial Times* (1978-84) covering Mexico, Central America and Cuba. He is an associate researcher at the Real Instituto Elcano, which has published three books of his on Spain. He writes a monthly essay on Spain for Elcano called *Inside Spain*. He has spoken on Spain at the universities of Harvard, Princeton, Chicago, Suffolk, Georgetown, Williams College, London School of Economics and Oxford, and at the literary festivals of Oxford and Gibraltar. He has been a visiting scholar at the King Juan Carlos I of Spain Centre, New York University, and at Bilkent University, Ankara. In 2013, Oxford University Press published his book *Spain: What everyone needs to know.*

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In memoriam Sir Raymond Carr (1919-2015) and Michael Jacobs (1952-2014)

'To see what is in front of one's nose needs a constant struggle'.
George Orwell

Prologue and acknowledgements

This is the fourth book on Spain that I have written for the Real Instituto Elcano since it was founded in 2001, and as in those books I view the country from an international perspective. Readers of these books will know that I have a penchant for the latest comparative statistics: there is no shortage of opinions in today's interconnected world, but too often a scant regard for facts. It is said that a picture is worth more than a thousand words as a complex idea can be conveyed with just a single image. The same can sometimes be said of figures, particularly when contrasted with those of other countries.

Spain has changed considerably since my first book, *The Internationalization of the Spanish Economy,* was published in 2002. The country at that time was in the middle of a more than decade-long economic boom and was riding high. It had finally reclaimed its seat at the table of world affairs after moving remarkably smoothly from the dictatorship of General Franco (1939-75), which was born out of a terrible Civil War (1936-39), to democracy and from autarky to a free-market economy. It had joined the European Economic Community in 1986 and was a founder member of the euro zone in 1999. It seemed that nothing could go wrong.

As we now all know, and some warned at the time, this was not the case. The global financial crisis of 2007-08, sparked by the sub-prime mortgage crisis in the US and the collapse of Lehman Brothers, which almost brought down the world's financial system and led to a credit crunch, took a heavy toll on Spain's vulnerable economy, excessively based on bricks and mortar. The spectacular collapse of the real estate and construction sectors caused the unemployment rate to skyrocket to 27% in 2013. This shook the country's economic, political, institutional and social foundations and produced a period of profound reflection about where the country had gone wrong.

The euro zone's fourth-largest economy became mired in uncharted territory, with a crisis on five fronts: economic (the need for a more sustainable economic model), financial (soaring budget deficit and public debt and a massive private sector debt burden), institutional (a major loss of confidence in the political elite and in many of the institutions), social (a jobless rate that left at one point more than 1.8 million households with no breadwinners) and constitutional (the illegal push in Catalonia for independence). The Spanish economy was still smaller, and the income of Spaniards was still lower, in 2015 than it was in 2007.

The depth and scale of the crisis was such that Spain could have gone under, but it has pulled through. There is now a glimmer of light in what has been a very long tunnel, thanks to some of the measures taken, the innate strengths of the country, particularly the extended family-based network, and the common sense of its people, something that I have witnessed after spending more than half my life in Spain.

I first came to the country as a young correspondent in 1974, the year before Franco died, and covered the transition until 1978 for *The Times* of London. I returned to Spain for good in 1986 after reporting from Mexico for the *Financial Times* and working in London. Since then I have moved regularly between Madrid and a village in Castile- La Mancha where my wife and I bought a house in 1976 and which has served as a microcosm of the tremendous changes that have taken place in the wider Spain.

This book seeks to explain how Spain moved from crisis to incipient recovery by looking at the reforms and the main sectors –macroeconomic fundamentals, exports, banking, investment abroad, foreign direct investment in Spain, etc–. It also looks at the challenges ahead including the new political situation with the erosion of the two-party system –the Popular Party and the Socialists– that has alternated in power since 1982 and the emergence of two new parties, the anti-austerity Podemos and centrist Ciudadanos. The book was completed shortly after the inconclusive general election on 20 December 2015, which ushered in a period of uncertainty and the possibility of fresh elections.

I would particularly like to thank Emilio Lamo de Espinosa, the Chairman of the Real Instituto Elcano (RIE), and Charles Powell, RIE's Director, for commissioning this book and continuing to put their faith in me. It has been a pleasure to work with them since the non-partisan Institute was founded in 2001 under the honorary presidency of King Felipe VI, and in such a convivial and intellectually stimulating atmosphere. I am honoured to have played a modest role in putting the RIE on the global think-tank map and, in particular, make Spain better known abroad for reasons other than the longstanding stereotypes of siesta, fiesta, flamenco and bullfighting that still distort the country's image.

I am also grateful to the following people: Simon Anholt, Rafael Arenas, Miguel de Avendaño (for careful copy-editing), María Dolores de Azategui, Tobias Buck, Esther Cases, Alicia Coronil, Professor Jim Davies, Guillermo de la Dehesa, Gabriel Elorriaga, Carlos Espinosa de los Monteros, Carmen González Enríquez, Gonzalo Escribano, Alfonso Galobart, José Carlos García de Quevedo Ruiz, Ian Gibson, Ferdi Grafe, Jorge Hay, the late Edward Hugh, Alejandra Kindelán, Manuel de Lope, María Mercedes Manjavacas Mínguez, Simon Manley, Amanda Mars, Lola Martínez Brioso, Ignacio Molina, Antonio Muñoz Molina, Valeriano Muñoz, Iliana Olivié, Andrés Ortega, Miguel Otero-Iglesias, Santiago Pantín, Paul Preston, Balbino Prieto, Bill Reinhardt, José Manuel Romero Moreno, María Romero Paniagua, Tomás Riestra Giner de los Ríos, Concepción Sanz Gómez, Eduardo Serra, María Solanas, Carlos Solchaga, Federico Steinberg, José Juan Toharia and Ana de Vicente Lancho, Last, but not least, my 'international brigade' of friends in the village of Buendía where I spend most weekends.

Madrid and Buendía, January 2016
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Preface

I first met William Chislett in 2002 when I read one of his pieces and it struck me that he could assist with the responsibilities I then had as director of the Elcano Royal Institute. I went on to commission the first of three books he wrote for us, *The Internationalisation of the Spanish Economy* (2002), which I believe was the first exhaustive study of a subject that was already important then, and has since acquired, as is now abundantly clear, a preeminent significance. The experience was positive (for both parties, I believe) and the following year saw the publication of an equally important work, *Spanish Investment in Latin America*, and later *Spain and the United States: The Quest for Mutual Rediscovery* (2005), just as Spanish foreign investment started to shift from Latin America to the US. Since then, William has continued to produce an uninterrupted and insightful stream of work for Elcano, in particular his monthly commentaries on the situation in Spain, *Inside Spain*, now numbering no fewer than 122, which have appeared regularly since 2004. I dare say (without fear of exaggeration) that this constitutes the best summary of the ins and outs of Spanish society and political and economic affairs aimed at a foreign audience. It should be superfluous to add that he is an associate researcher at the Institute; he has always worn his involvement with the Elcano as a badge of honour, a sentiment that is entirely reciprocated.

His research has not been confined exclusively to Spain: he also works on Turkey and Cyprus, countries in which he has particular expertise, and has written books on Portugal, Chile, Ecuador, Panama, Finland, El Salvador and Turkey, which were published in the UK.

William belongs to that group of Britons enamoured of Spain (not, as luck would have it, insubstantial in number,) who, not content with making it their country of residence, have cultivated a particularly creditable intellectual curiosity and yearning to extend their knowledge of the country. It is always a pleasure to recall that expatriate Briton, Gerald Brenan –don Gerardo or Gerardito to his neighbours in La Alpujarra– whose book *The Spanish Labyrinth* (1943) formed part of the intellectual and sentimental education of my generation. But I could add many British historians, especially Raymond Carr –whose Spain 1808-1975 is another of those books that helped to shape my generation's perception of Spain– but also John Elliott and Hugh Thomas, a tradition that has fortunately attracted followers and disciples both in the UK and Spain. A substantial proportion of the best Spanish historians today are devotees of these Britons, above all Carr, and it is no exaggeration to say that the history of Spain, at least our history of Spain, has

been written by them, and it is they who have most contributed to changing the perception that both natives and outsiders have of the country. It may be said that William is not a historian, but a journalist, which is true. But in the final analysis a historian is only a journalist of the long run. And vice versa: the journalist is a historian of the present. Both tell stories, albeit not of the fictitious variety. And the proof of this convergence is provided by William himself in his book *Spain: What Everyone needs to Know,* published in 2013 by Oxford University Press, an excellent summary of Spanish history for non-Spaniards, in which the journalist blends into a historian.

The success of this British school rests, I suspect, on a singular viewpoint that William exemplifies to perfection: a perception that is simultaneously internal and external. He describes himself as 'a writer who has lived in Madrid since 1986'. This is undoubtedly true. And it may be thought that he could just as well have lived anywhere else. This is by no means the case, but his self-description illustrates the very detachment from the here and now that I am trying to elucidate. By seeing us from the outside while being physically and mentally on the inside, he naturally occupies the position we sociologists regard as appropriate for conducting scientific research: that of the 'participant-observer', an individual who is both part of the action and on the inside, but also out of it, as an external observer. He lives among and with us, but his gaze originates from somewhere beyond, from a distinct cognitive space, virtually a different world. It is perhaps incidental, but despite the many years he has spent living among (and with) us, William's Spanish accent remains deplorable. It matters not at all. He expresses himself superbly, and this attribute forms part of the detachment with which he observes Spain, and lends him such great (and at times unbearable) objectivity.

He also embodies another very British phenomenon: that of objective and detached, one might almost say precision-engineered, journalism. He came to Spain in 1974 and was hired in 1975 to help cover the political transition to democracy for *The Times,* remaining here until 1978 before moving to Mexico, where he worked for the *Financial Times*. He is thus a member of that other longstanding tradition of British journalism, regarded as a model throughout the world and one that everyone seeks to emulate, albeit with limited success. When you read him you realise it is difficult to disagree with what he writes. He is concise, clear and precise, and his claims rarely go beyond what the facts sustain.

Apart from all this, I have still not mentioned the aspect of his work that impresses me most: his utterly spectacular command of facts, information and statistics. William always has at his disposal the most up-to-date statistics, the telling fact, whatever the subject may be, and what is more he has it before it has even been made public. I do not know how he does it, and I suspect that he may have spies and informants liberally scattered, but I swear it is the case, such that his output is compellingly exact. He is acquainted with, marshals, manages and presents data and statistics with skill, making reading a pleasurable experience. As he himself says, in today's interconnected world there is no shortage of opinions, but what is lacking sometimes is a greater appreciation of the facts. Pure empiricism, but of a high order.

If we take all this in conjunction (the detachment, the precision-engineered journalism, the compelling statistics) it may strike the reader that I am describing someone who is cold and distant. This is by no means the case. I have been fortunate enough to talk to William on many occasions and I am honoured to be his friend. And his Hispanism, which is clearly eclectic, does not exclude activism and initiatives, and is not confined simply to observations. To cite one example, some years ago William and a group of friends set out to restore the memory of that great writer Arturo Barea, the finest chronicler of the catastrophe of the Republic and the Spanish Civil War, who died in exile in England in 1957, in Oxfordshire, William's own county of birth. And thus in December 2010, along with other Spanish and British writers (Gabriel Jackson, Javier Marías, Antonio Muñoz Molina, Elvira Lindo, Santos Juliá, Michael Eaude, Barea's biographer Nigel Townson –editor of Barea's books–, Edwin Williamson and Jeremy Treglown), he organised the restoration of Barea's headstone in Faringdon and installed a plaque on the façade of The Volunteer, Barea's habitual pub. It is thus a committed sort of Hispanism, to use an old word that has almost been forgotten.

I have saved until last what strikes me as the most creditable aspect of this book, which in a sense is a sequel to his 'history of Spain for non-Spaniards'. I believe it was James Joyce who, overwhelmed by the 'Irish labyrinth' said that since we cannot change the world, let us at least change the conversation. We Spaniards have done both things: we have changed the world, our Spain, but also the conversation about Spain, the historical narrative of this reality. Between 1975 and 1998 (the centenary of the debacle of 1898, when Spain lost its last major colonies) we normalised reality, the events, in order to become a normal European country, one among many. But subsequently, once the reality changed, we changed the conversation, and young Spanish historians, taking a lead from their aforementioned British counterparts, turned on its head the regrettably exceptionalist view of Spain inherited from the Generation of '98 (and also from José Ortega y Gasset himself), that conception of Spanish history as 'a long decline' (to quote the philosopher), the country where what should have happened never did and where there was no bourgeoisie, no industry, no science, no State and no democracy.

Running counter to this view of an 'abnormal' country, and drawing on what is now a well-established tradition, William produced his 2013 book on Spain; this featured on its cover a bull, that stereotypical symbol that has dogged the Spanish for decades and was inevitably used in the front-page stories the world's newspapers and magazines published on the PIGS crisis and the end of the Spanish fiesta. 'The party's over' announced *The Economist* in a special report on the country in 2008, depicting in another issue a wounded bull in its death throes. This book is a continuation of its predecessor, and once again sets out to undermine the numerous stereotypes that haunt us: bulls and siestas, beaches, paella and flamenco, the old stereotype of a country of 'fiestas and frivolity'.

Is this a true reflection of Spain? This book tries to show that, while it is true that 'the party's over', neither the industry nor the industriousness of Spain are over; indeed, as I write these words, it is growing faster than any other EU country,

at a rate of more than 3% no less. Economic recovery is now an undeniable fact, something that this book and the Elcano Royal Institute both seek to highlight.

Will the recovery continue? The book was completed shortly after the election held on 20 December 2015, which heralded, or rather laid bare, a political crisis that had been years in the making but that the economic crisis had covered up. It is a political crisis with at least two facets: a notable deterioration in the legitimacy of politicians and parties, and an erosion of the political and institutional framework assembled during the transition to democracy, including, in all likelihood, its constitutional aspect. The emergence of new political figures, of new parties, undoubtedly represents a chance to start remedying the political crisis that the economic crisis has re-engendered. But the emergence of new figures seems to be leading us not so much to a post-transition as to a pre-transition, to moments of indeterminacy essential to the model of the country. This leads me to wonder whether we may not have gone too far in the effort to normalise the narrative about Spain. As William says in his much-cited book on Spain, 'not all the ghosts of the authoritarian past have vanished'. I fear that the shadow of the Civil War, recklessly intensified in some quarters, is going to haunt us for some years to come, almost like a biblical curse. I hope that I am mistaken.

Emilio Lamo de Espinosa
Chairman of the Elcano Royal Insitute

Chapter 1
Overview

1. How Spain Landed Itself in a Mess

The Spanish economy, the euro zone's fourth largest (10% of the bloc's GDP), grew by almost 30% between 2000 and 2008, much faster than the Organisation for Economic Co-operation and Development (OECD) average of less than 20%, but the boom was built on shaky foundations. These began to crumble after the first signs of a global credit crunch in August 2007, following the sub prime mortgage crisis in the US, and particularly after the September 2008 collapse of Lehman Brothers, which triggered the deepest downturn in the global economy since the Great Depression in the 1930s.

The more than decade-long period of what Spaniards called *las vacas gordas* (fat cows) was mainly fuelled by the labour-intensive and debt-fuelled construction and property sectors. The number of housing starts in 2006 was 865,000 –more than Germany, France and the UK combined–. Fully two-thirds of the properties built in Europe between 1999 and 2007 were built in Spain. Such frenetic building was only made possible by the influx of immigrants (3.6 million between 2000 and 2007) and created a lopsided economy. The housing stock increased by 5.7 million during the boom, the equivalent of almost 30% of the existing stock. The impact on employment was dramatic: between 1995 and 2007, 8 million jobs were created. The number of jobholders, which stood at 12 million in 1995 (roughly the same size as two decades earlier), increased to 20.5 million in 2007.

The boom period was also characterised by a very low rise in productivity. Total factor productivity (which measures the efficiency of all inputs to a production process) fell between 1995 and 2007. Instead of growing more because workers were more productive (the result of improved technology), the economy expended due to people working more, reflecting the incorporation of women to the labour force and the influx of immigrants.

The economy was going so well that José Luis Rodríguez Zapatero, the Socialist Prime Minister between 2004 and 2011, adopted a football metaphor and proclaimed in September 2007 that Spain 'has joined the Champions League'. That same year he also called Spain's economic model 'an international model of solvency and efficiency'. The truth is that Spain's boom was a false bonanza.

Building and consumption in general was spurred by the sharp drop in interest rates after Spain joined the euro as a founder member in 1999: average short- and long-term rates fell from 13.3% and 11.7%, respectively, in 1992, to 3.0% and 2.2% in 1999 and to 2.2% and 3.4% in 2005, encouraging borrowers to take out loans, particularly mortgages, and some banks, particularly Spain's *cajas de ahorros* (savings banks), to lend recklessly. Close to 80% of homes in Spain are owned compared with an EU average of 70%. Foreign banks were equally at fault: some of the frothiest lending was by German banks, whose exposure to Spain at the start of 2008 was €200 billion, according to the Bundesbank.

The European Central Bank's one-size-fits-all monetary policy produced asymmetric effects.[1] The policy was too loose for Spain and led to negative real interest rates. This distorted the rational behaviour of economic agents and promoted excessive indebtedness, the accumulation of imbalances and significant competitiveness losses.

Credit to Spain's private sector at the height of the boom increased at an annual average of 23% between 2004 and 2007: at one stage Spain accounted for one quarter of the euro zone's total lending and also for around one-quarter of the total number of 500 euro notes in circulation in the then 12 euro zone countries –much higher than what corresponded to the country's economic size (10%)–. Ordinary Spaniards referred to these notes, used in large informal economy transactions, as 'bin Ladens' (in reference to Osama bin Laden, the founder of al-Qaeda), because everyone knew they existed and what they looked like but had never seen them.

The gross debt of the private sector (households and non-financial corporations) doubled to a whopping 227.3% of GDP between 2000 and 2010, when this same ratio stood at around 165% both in the euro zone and in the US. This accumulation of debt by the private sector led to an increase in the Spanish net debit position vis-à-vis the rest of the world to 92% of GDP in 2011 compared with positions for countries such as France, Italy and the UK of between 10% and 20% of their GDP. The current account deficit reached 9.6% of GDP in 2007 (one of the highest in the developed world and the second largest in absolute terms after the US), underscoring the extent to which the economy had become overheated and uncompetitive, and the degree to which households and companies were living

beyond their means and on borrowed money. Most of the current account deficit was financed by foreign savings, mainly in euros.

The asymmetric effects of the European Central Bank's monetary policy were manifested in imbalances between euro zone countries, with an enormous generation of savings, particularly in Germany, and countries in need of savings, such as Spain. Germany's savings and those of other northern European countries financed a large part of Spain's economic fiesta.

The growth in credit was not balanced across the various sectors of the economy, but was excessively concentrated in the real estate sector. Mortgages rose sixfold to more than Spain's GDP. House prices rose 175% in nominal terms between 1998 and 2008 compared with an increase in inflation of 61.5%. A typical example of the property fiasco was the *Residencial Francisco Hernando* near Madrid, which was intended to treble the population of Seseña in the dry plains of Castile with 13,500 flats. Billed as the Manhattan of La Mancha, the home region of Don Quixote, the world famous novel of Miguel de Cervantes, only around 2,500 had been sold by the time the property bubble burst. The developer was as deluded as Don Quixote.

The construction frenzy was not only confined to the building of too many houses. Too many ghost airports were also built. The unlisted savings banks played a decisive role as an instrument for financing political interests. Take the emblematic cases of the airports at Castellón and Ciudad Real. The former was opened by Carlos Fabra, the longstanding Popular Party head of the Castellón provincial government, even though it did not have all the permits to operate. Amazing as it may sound, Fabra justified the opening on the grounds that 'anyone who wants to can visit the runway, the terminal and the control tower and walk around them, something they could not do if aircraft were taking off'. There is a 24-metre sculpture of Fabra outside the airport. In September 2015, Ryanair began to operate the first scheduled flights from Castellón in four years. The €1 billion airport at Ciudad Real (previously known as Don Quixote airport), meant to be an alternative to Madrid's airport –it has a 4km runway capable of taking an Airbus A380m, the world's largest passenger jet– was opened in 2008 by the region's then Socialist government. It went bankrupt in 2010 and was closed in 2012. Efforts to sell the airport in 2015 failed.

Public funds were also wasted in building pharaonic projects. The Popular Party Madrid regional government embarked in 2008 on the so-called City of Justice comprising 12 circular buildings near Barajas Airport which was due to be completed in 2014. The judicial complex covering all parts of the justice system, the biggest of its kind in the world, was due to be completed in 2014. Only one

building was finished, the Madrid Forensic Anatomical Institute, and that was lying idle and had to be cleared periodically of rabbits. According to documents obtained by *El País*, more than €27 million was spent on paying construction companies for work that was never carried out, a further €6.4 million went to compensate suppliers, while €11.4 million was paid in rescinded contracts, along with interest payments and other costs. The total public outlay was €130 million and the net worth of the complex when it was officially wound down in 2014 was €25 million.

Civil groups in the city of Valencia organise coach tours that follow the *ruta del despilfarro* ('the route of squandering'). Stops include the Formula 1 racing circuit, the City of Arts and Sciences (which includes a 4,000-seat opera house), the enlarged regional parliament building and, in stark contract to the artificial opulence, a school with classrooms made from containers.

Nothing was done to prevent the housing bubble, such as tightening the regulations on land use and urbanisation, and the very favourable interest payments deduction on personal income tax for first-home mortgages was maintained. The Bank of Spain had the powers to prevent the real estate bubble and if unsuccessful try and burst it later. While the European Central Bank controls interest rates, the Bank of Spain controls domestic banking regulations. The central bank, however, had limited supervisory competences over the regionally-based savings banks which accounted for around half the financial system. The supervision by regional governments was woefully inadequate. The central bank could and should have used its powers to restrict financing of the bubble by introducing limits to the amount to be lent as a proportion of the value of the property and/or the family income or/and the debt to capital ratio of promoters/ buyers. It could also have shortened or limited the maturity of mortgages and their grace periods and increased the provisions for mortgage loans. All these instruments properly and timely used could have prevented or burst the bubble. No one, however, wanted to be a party pooper, although Bank of Spain staff alerted about the formation of a real estate bubble between 2000 and 2006.

The Bank of Spain did, however, introduce 'dynamic provisioning' in 2000, which helped to soften the blow when the bubble burst. Banks set aside loan-loss reserves on their books during the boom years at the time of making loans as opposed to when bad loans were specifically identified. As a result, they built up a buffer provisions of more than €40 billion, which were an important cushion when the financial crisis hit and non-performing loans soared (from a negligible 0.7% of total credit in 2006 to a peak of 13.7% at the end of 2013). Yet the provisions were insufficient as banks did not report all their losses when they should have.

When the massive property bubble burst, house prices plummeted (by more than 35% between 2008 and 2014), some savings banks teetered on the brink of collapse (they were 'saved' by a €41 billion euro-zone bail-out, successfully exited in January 2014) and many property developers went to the wall. The economy shrank by 8.6% between 2008 and 2013. The unemployment rate surged to a peak of 26.7% in 2013 (from an historic low of 8% in 2007), while youth unemployment for those aged 16 to 24 jumped from 17.2% in 2007 to a high of 56% in 2014.[2] Even before the crisis, youth unemployment in Spain was around 20%.

The impact of the collapse of the construction sector on public finances, which were in good shape, was dramatic. Rapidly falling tax revenues (from €435 billion in 2007 to €368 billion in 2009) and rising spending (from €413 billion in 2007 to €485 billion in 2009), as a large part of it was allotted for essential services such as health and education, coupled with the burden of unemployment subsidies, turned a budget surplus of 2% of GDP in 2007 into a deficit of 11% in 2009. Gross public debt (low at 36.3% of GDP in 2007) also began to skyrocket. The tax burden peaked at 36.5% of GDP in 2007 and then plummeted to 29.8% in 2008.

Jobs began to be shed as of 2008 almost as quickly as they had been created during the boom. Between 2008 and 2013, the number of medium-sized companies fell by 56%.[3] Due to much lower firing costs, the first people to lose their job were those on temporary contracts, particularly males, in the construction sector, many of whom had left school at 16. Nowhere was this rifer than in Villacañas, which became the door-making capital of Spain. At the height of the boom, this town of 10,000 inhabitants had 10 door-manufacturing plants employing 6,000 people and producing 11 million doors a year, 60% of the national total. Hardly anyone stayed on at school. One bright lad, Manuel Huete, saw the writing on the wall and stopped working in one of the factories so he could complete his education. He did so well that he won a place at the London School of Economics and went on to work for the Bank of Spain.

The early school-leaving rate declined from a peak of 40% in 1992 to below 30% in 2001 and then increased to 31.2% in 2009,[4] more than double the EU average. It came down to 22% in 2014 as students had no option but to continue their education. Of the 2.5 million jobs shed between 2008 and September 2014, when Spain emerged from recession, 1.1 million came from the construction sector (see Figure 1.1). A large number of these lost jobs were held by people under the age of 30. These workers face a bleak future, as they are mostly unskilled. In Villacañas, some of those who lost their jobs went back to school, while others joined Huete in setting up a saffron cooperative.

Figure 1.1 Employment in Spain by Sectors, 2007-15 (million jobs) (1)

	2008	2010	2011	2012	2014	2015 (2)
Services	13.83	13.40	13.19	12.71	13.23	13.50
Industry	3.04	2.62	2.52	2.38	2.38	2.49
Construction	2.18	1.57	1.27	1.07	0.99	1.08
Agriculture	0.80	0.80	0.80	0.78	0.74	0.72
Total jobs	19.85	18.40	17.80	16.95	17.34	18.79

(1) Average figures for each year. (2) Average figures for January-September.
Source: INE, based on labour force survey.

Political factors were also at the root of Spain's crisis, particularly the degeneration of key institutions (the judiciary, parliament, regulatory bodies, the Court of Auditors, etc) that were colonised (along with savings banks) mainly by the two largest parties, the Popular Party and the Socialists, and consequently failed to fulfil their accountability role. In the process, these institutions were discredited and lost legitimacy and the political class was perceived as an extractive elite. An effective system of checks and balances would have gone a long way towards reducing the scale of crony capitalism and hence the crisis.

Spain's position in the World Economic Forum's ranking of public trust in politicians –part of the Global Competitiveness Index– dropped from 79th in the 2012-13 index to 101st in the 2013-14 index. In the World Justice Project's Rule of Law 2015 Index (which provides data on eight dimensions of the rule of law), Spain was ranked relatively low in constraints on government powers (26th), enforcing government regulations (26th) and absence of corruption (25th).

Lastly, the crisis can also be attributed to a passive society that failed to hold its politicians to account and even voted for politicians known to be corrupt. As long as the economic *fiesta* lasted and society was seen to be benefiting, few people rocked the boat and challenged the status quo. That all changed when the property bubble burst as of 2008. As a result, Spain has seen a huge and healthy change in public attitudes to corruption.

2. Austerity Measures: Pain and Gain

The first signs of the meltdown appeared in 2008, the year the Socialist Prime Minister José Luis Rodríguez Zapatero won a second term in office, but instead of tightening its belt the government launched a €12 billion Keynesian public works programme known as Plan E, equivalent to the New Deal US President Franklin D. Roosevelt devised in response to the Great Depression, aimed to kick-start the economy. Among the projects, the 17-metre monument to Christopher Columbus was moved 100 metres back to the same spot in central Madrid where it had stood for almost 100 years.

It was not until May 2010, by when the EU had agreed a bailout of the Greek economy in the hope that this would stem the euro zone's existential crisis, that Zapatero engineered a sharp U-turn in his economic policy and implemented austerity measures. By then the unemployment rate was fast rising to 20%, the budget deficit had ended 2009 at 11% of GDP (1.9% surplus in 2007), and public debt had risen from 35.5% of GDP in 2007 to 53%. The latter two factors scarred the markets and raised the prospect of a sovereign debt crisis: the risk premium –the spread between 10-year Spanish government bonds and the benchmark German equivalent (*bunds*)– rose from an average of 8 basis points in 2007 to 181 in early May 2010 and went on increasing until it peaked at 650 in July 2012. The yield on Spain's 10-year government bonds reached a level that had prompted bailouts for Greece, Portugal and Ireland.

The austerity measures included an average 5% cut in the salaries of 2.8 million public-sector workers (a freeze in 2011, 2012 and 2013), a freeze on payments for pensioners, the transition regime emanating from the 2007 law allowing for early retirement was abolished, the €2,500 'baby cheque' for every new-born (introduced in 2007 to boost Spain's low birth rate) was eliminated, overseas development aid was cut and public investment over the next two years reduced by €6 billion (in addition to the €5 billion for 2010). Value-added tax was raised from 16% to 18% (to 21% as of September 2012 after the Popular Party came to power at the end of 2011) and labour-market reforms were imposed by decree as employers and trade unions failed to reach agreement on a package of measures. Severance payments for workers on permanent contracts signed as of 2011 and dismissed for fair reasons were lowered from 45 days to 33 days of salary for each year worked, and temporary contracts were made less attractive. Trade unions called a general strike in September 2010 to protest the austerity measures.

As a result of these and other measures, per capita income fell to below the EU average in 2010 for the first time since 2001 (see Figure 1.2).

Figure 1.2. GDP per Capita in Purchasing Power Standards (EU-28 = 100)

	2002	2007	2010	2013	2014
France	116	107	107	107	107
Germany	115	116	119	122	124
Italy	113	105	104	99	97
Spain	**100**	**103**	**98**	**94**	**93**
UK	122	118	108	109	108

Source: Eurostat.

The European Central Bank was not happy with the government's policies and in August 2011 Jean-Claude Trichet, the Bank's President, and Miguel Fernández Ordóñez, the Governor of the Bank of Spain, against a background of the euro zone's growing sovereign debt crisis, sent a confidential letter to Rodríguez Zapatero urging him to go further by improving the functioning of the labour market, abolishing inflation-adjustment clauses, taking 'exceptional action' to encourage private sector moderation and ensuring the sustainability of public finances (see Appendix 1 for the full letter).

These proposals later served as something of a blueprint for the reforms of the Popular Party under Mariano Rajoy which swept to victory at the end of 2011, by when there was also a full-blown crisis among a swathe of savings banks which needed a €41 billion euro-zone bail out in 2012 (see Chapter 5). The Popular Party resorted to more emergency laws (as a percentage of total draft laws presented to parliament) to drive reforms than any other Spanish government, even though it enjoyed an absolute majority in parliament. By August 2015, it had issued 73 so-called royal decrees (33.8% of the total draft laws) compared with 56 (29%) by the previous Socialist government. Under the Spanish Constitution, governments are allowed to issue decrees only 'in cases of extraordinary and urgent need'. The parliament can reject the draft decree, but only under a procedure that leaves a maximum of 30 days to examine and debate the legislation.

The most pressing problem was to get to grips with the budget deficit the Popular Party inherited from the Socialists of 9.4% of GDP in 2011 (including aid for banks) and well beyond the 6% target originally agreed with Brussels and a commitment to reduce it to the EU threshold of 3% in 2013.[5] As expected, the 3% target was far too ambitious a wrench for an economy in recession and in July 2012 the government was given another year to meet the threshold. This, too, proved to be unrealistic and after missing targets in 2012 (the deficit came in at almost 7% of GDP and 10.3% including the aid to ailing banks) and struggling with the goals for 2013, due to a combination of weaker-than-expected revenues, some expenditure overruns and higher social spending resulting from massive unemployment, Brussels came to Madrid's rescue again in May 2013 and gave the government a further two years (until 2016) to meet the 3% reference (see Chapter 2).

Under a reform in September 2013, pension payments for more than 8 million pensioners under the pay-as-you-go system were no longer automatically indexed to annual inflation, something long demanded by the European Commission. This helped to contain long-term pressure on public spending. A complex formula known as the Pension Revaluation Index replaced pension indexation in order to calculate annual pension rises. This formula uses a series of criteria such as the number of pensioners, the financial situation of the social security system and

the level of pension payments over many years. From 2014 onwards, pension payments rose by a minimum of 0.25% every year, well below inflation rates expected to be between 1% and 2%, while maximum increases were capped at inflation rates plus a 0.25% top-up.

The retirement age was gradually increased from 65 (unchanged since first established in 1919) to 67 (fully in force as of 2027) for both men and women, and the number of years of contributions to qualify for the maximum pension raised from 35 to 37. As of 2019, the so-called sustainability factor will be introduced, consisting of an automatic adjustment of future retirees' new pensions to take account of the growth of the life expectancy of the new pensioners. Spain's life expectancy is among the highest in the world (see Figure 1.3).

Figure 1.3. Key Pension Indicators, 2014

	France	Germany	Spain	OECD
Average worker earnings (€)	37,427	45,952	**26,162**	33,036
Public pension spending (% of GDP)	13.8	10.6	**10.5**	7.9
Life expectancy at birth (years)	81.7	80.7	**82.0**	80.0
At age 65	21.0	19.4	**20.5**	19.3
Population over age of 65 (% of total)	18.7	21.4	**18.3**	16.2

Source: Pensions at a Glance, 2015, OECD.

3. The Dysfunctional Labour Market

Spain's crisis decimated jobs. The stated unemployment rate more than trebled between 2007 and its peak of 27.1% in early 2013, the second highest among euro-zone countries after Greece and more than double the zone's average. The number of unemployed rose by more than 4 million to 6.3 million and the total number of companies dropped from 3.7 million to 3.4 million. In September 2015, the unemployment number fell below 5 million (2.9 million of whom had been jobless for at least a year) for the first time in four years, spurred by the economic recovery and labour-market reforms. The more than one million fall in the number of jobless between 2013 and 2015 also reflected the shrinkage in the labour force of around 300,000. Much of the new employment, however, was precarious and the job creation was from an extremely low base. The jobless rate remained troublingly high and was not expected to fall below 20% until 2017.

The magnitude of Spain's unemployment could be judged by comparing it with Germany. Spain, with around 10% of the euro zone's GDP and a population of 46.4 million, accounted in the autumn of 2015 for 28% of the zone's 17.3 million jobless (4.9 million), whereas Germany (with a population of 82.5 million and accounting for close to 30% of GDP) accounted for only 11% of the unemployed (1.8 million).

Youth unemployment was also very high in the autumn of 2015 at 46.6%, though down from a peak of 55% in June 2009 (see item 2 in the notes). Many only find part-time work. One-quarter of those aged between 15 and 24 worked involuntary in part-time jobs in 2014, seven times higher than in 2000 (see Figure 1.4). Given the lack of jobs, many took any available employment if the alternative was no job at all.

Figure 1.4. Share of Involuntary Part-Timers in Total Employment of Youth (aged 15-24), 2000 and 2014

	2014	2000
France	11.9	9.5
Germany	2.3	1.9
Italy	25.0	5.8
Spain	**23.8**	**3.4**
UK	9.8	3.6
OECD	2.8	2.8

Source: OECD.

There was too a considerable regional divide in unemployment rates, varying between a high of 31.7% in Andalusia and a low of 13.6% in Navarre (see Figure 1.5).

Figure 1.5. Stated Unemployment Rates by Spain's Regions, 2015 (%) (1)

	%
Andalusia	31.7
Aragón	15.0
Asturias	17.0
Balearic Islands	13.9
Basque Country	13.8
Canary Islands	28.6
Cantabria	16.2
Castilla y León	16.6
Castilla-La Mancha	24.7
Catalonia	17.5
Extremadura	28.5
Galicia	17.7
La Rioja	13.6
Madrid	16.3
Murcia	23.5
Navarre	13.6
Valencia	22.4
Spain	21.2

(1) September
Source: INE.

Spain has two sets of unemployment figures, which creates confusion, particularly abroad. There is the quarterly labour force survey (EPA) figure, based on EU-wide methodology and the one that makes the headlines, which gives the stated jobless rate, and the monthly number of those registered as unemployed in government offices where the criteria to be registered is not the same for all countries. For example, Spain excludes part-time workers (those working a small number of hours) from the registered unemployed. To register as unemployed in Spain, a jobseeker has to be without work, be actively seeking and be available for a job. Two other groups of jobseekers are counted in the register: inactive jobseekers who are not working at all and employed jobseekers who have found a job, but stay registered to find a better one. The registered number of jobless (4.1 million) was around 700,000 lower than the stated EPA number at the end of 2015. The difference between the two figures reflected those who might have exhausted their right to unemployment benefits, were not on state training-programmes, were working in the shadow economy (see Figure 1.6) or had given up seeking a job. Spain has the lowest use among EU countries of the government's employment offices to find a job (around 30% compared with 80% in Germany and close to 60% in the UK), according to Eurostat.

Figure 1.6. Size of the Shadow Economy in Selected EU Countries, 2003-15 (% of official GDP)

	2003	2007	2010	2012	2015
France	14.7	11.8	11.3	10.8	12.3
Germany	17.1	14.7	13.9	12.9	12.2
Italy	26.1	22.3	21.8	21.6	20.6
Spain	**22.2**	**19.3**	**19.4**	**19.2**	**18.2**
UK	12.2	10.6	10.7	10.1	13.2
EU-28 unweighted average	22.6	20.3	19.9	19.3	18.3

Source: Friedrich Schneider, Johannes Kepler University, Linz, Austria.

Why is unemployment so stubbornly high? And it is not something new. Apart from the real estate bubble period (2002-08), Spain's jobless rate since 1980 was at least five percentage points above that in Germany, France, Italy, the UK and the US, 10 points higher in the early 1990s and 15 points in 2013 and 2014. Even in 2007, at the height of the economic boom, Spain's jobless rate was 8%, a disastrous level by the standards of countries such as Germany and the UK. Some companies complained during the boom they could not find suitable workers to fill posts. During its recession, Spain had the developed world's highest Okun coefficient (ie, the greatest sensitivity of employment to changes in the GDP).

'Spain is the most over-diagnosed country in the world in terms of the labour market,' Ramón Guzmán, the executive director for Spain, told a meeting of

the IMF's executive board in July 2010 when the Socialist government's labour reforms were discussed.[6] 'One could talk for hours and one could fill this room with labour law experts and economists, and they will have 150 solutions or 150,000 solutions for the troubles of the Spanish labour market. The Spanish labour market is a disaster in terms of efficiency. I have no trouble admitting this and neither do my authorities. It has produced a phenomenon that can be described in many ways, but basically, for the past 20 years, something between 40-50 per cent of the Spanish population has been either unemployed permanently or in precarious job conditions in fixed-term contracts'. This was quite an indictment of the Spanish system.

There were several reasons for the massive unemployment rate, which to a small extent was due to the statistical effect produced by the numerator remaining high while the denominator (the size of the labour force) declined, as a result of emigration abroad by native and naturalised Spaniards and immigrants returning to their country of origin. The most worrying factor was the large number of workers with low levels of education and hence a lack of basic skills, many of who left school early at 16 to work on building sites. Only 25% of those aged between 25 and 35 had completed their secondary education compared with 29% in Portugal, 40% in France, 45% in Greece, 50% in Italy and 77% in Austria. The share of construction-sector jobs in male employment increased from 14% to more than 20% between 1997 and 2006. In the same period, construction workers' wages moved from the 30th percentile (ie, 70% of earnings were higher than those in this sector) to the 40th percentile (60%) of the aggregate distribution.[7] With wages for unskilled work rising faster than those for skilled work, many young people, particularly males, concluded that education did not pay.[8] These low-skilled jobs in an economy excessively based on a labour-intensive but unsustainable sector (unlike tourism, which has continued to flourish although it, too, does not generate jobs on a permanent basis as it is a seasonal industry) were destroyed as soon as the economy ground to a halt and they may have vanished forever. Many of those who lost these construction jobs were on temporary contracts as they were cheaper to sack than those on permanent contracts. These poorly qualified young adults form a 'lost generation'.

The bursting of the property bubble hit those banks with large exposures to mortgages and property developers hard, particularly the savings banks whose number fell from 45 to two (and seven of those became banks), largely as a result of mergers. This led to the closure of more than 9,000 branches and over 60,000 job losses.

Another factor was the influx of immigrants. Spain's construction sector acted as a magnet for immigrants –their number soared from around 900,000 to more than 5 million in 2007–. In the decade before the crisis Spain received

more immigrants proportional to its population of any EU country. They were particularly needed in the construction and agricultural sectors, as there were not enough Spaniards to work in them or prepared to work in them. At the peak of the boom in 2007, more than half of the 3.3 million non-EU immigrants in Spain, mainly from Latin America and North Africa, worked in the construction sector. When the economy went into recession, immigrants bore a large part of the surge in unemployment. The jobless rate among immigrants in the autumn of 2015 was 29%, eight percentage points higher than that for Spaniards. Immigrants (including naturalised Spaniards) began to return to their countries in significant numbers in 2012. The resident foreign population fell by 800,000 between 2012 and July 2015.

The Popular Party tackled labour market reforms in February 2012, soon after coming into office. Fifty-two reforms were enacted between the 1980 Statute of Workers' Rights, which laid the foundations for post-Franco labour relations, and the end of 2015, a world record. The 2012 reforms were more ambitious than those in 2010 by the Socialist government (which led to a general strike) as they allowed companies to opt out of collective pay-setting agreements within industries and to make their own deals with workers. They also gave companies greater discretionary powers to adopt internal measures to limit job destruction. Dismissal regulations were also modified, redefining the conditions for fair dismissal and improving further on the greater clarity introduced by the 2010 reform, severance payments in the case of unfair dismissal for those on permanent contracts (from 45 days per year worked with a maximum of 42 months to 33 days per year with a maximum of 24 months) were reduced and the requirement of administrative authorisation in the case of collective redundancies eliminated. Compensation for permanent contract termination in the case of redundancies for objective reasons was set at 20 days per year worked with a maximum of 12 months. As a result, employment protection legislation (EPL) became less strict, though severance pay for permanent workers in relative terms remained among the highest in OECD countries, despite the significant reduction in compensation for unfair dismissal (see Figure 1.7).[9]

Figure 1.7. Strictness of Employment Protection Legislation (1)

	2013 scale 0-6	2008 scale 0-6
Portugal	3.01	4.17
Germany	2.72	2.72
France	2.60	2.67
Italy	2.41	2.60
OECD	2.04	2.15
Spain	**1.95**	**2.22**
US	0.49	0.49

(1) Synthetic indicator of the strictness of employment protection legislation (EPL) with a scale of 0-6 from most to least restrictive. The EPL shown in this figure incorporates three aspects of dismissal protection: procedural inconveniences that employers face when starting the process; notice periods and severance pay; and difficulty of dismissal.
Source: OECD (2014).

These measures helped to save and create jobs and contributed to wage moderation. The decline in unit labour costs (ULCs) since 2011 made Spanish goods more competitive on world markets, fuelling an export boom that pulled Spain out of recession in 2013. This was particularly the case of the automotive industry, whose growth in total labour costs per hour between 2008 and 2014 was 9.2% compared with 20.1% in Italy, 18.7% in France and 17.2% in Germany, according to the Spanish Association of Car and Lorry Producers (Anfac).

Productivity in the non-exporting sectors, however, would appear to have remained at a standstill, which hindered sustainable growth in the economy and employment.

As a euro-zone country Spain could no longer devalue its currency as a means to gain competitiveness. The 1992 crisis of the European Monetary System –the peseta became part of the wide band of the Exchange Rate Mechanism in 1989– led to three devaluations of the peseta. This could not be done this time but in less than three years Spain's internal devaluation almost reversed half of the price competitiveness loss vis-à-vis Germany in the years of the boom. Of the main EU economies, Spain's ULCs were the only ones that were lower in 2015 than in 2008 (see Figure 1.8).

Figure 1.8. Nominal Unit Labour Costs, 2008-15 (2010 = 100)

	2008	2009	2010	2011	2012	2013	2014	2015 (1)
France	97	100	100	102	104	105	106	106
Germany	98	101	100	101	105	107	109	110
Spain	**101**	**101**	**99**	**98**	**93**	**95**	**95**	**95**
UK	96	100	100	101	103	104	105	105

(1) Third quarter.
Source: Eurostat.

The Popular Party's reforms lowered the GDP growth rate needed to create jobs from around 2% to 1%-1.5%. The number of stated unemployed fell by 577,000 between September 2014 and September 2015, the biggest annual reduction since 2002, and close to 550,000 jobs were created. Rafael Domenech of the research department of BBVA, Spain's second-largest bank, estimated that if the reforms had been in place during the crisis, unemployment would have peaked at 20% instead of 27%, sparing a third of the rise in the jobless rate.

There was still a chasm between the conditions of temporary workers and those on permanent contracts. Temporary contracts were introduced in Spain in 1984 –when the unemployment rate was 20%– by the first Socialist government of Felipe González in order to make the labour market more flexible. Employers complained that the rigid labour market rules that continued after the end of the Franco regime in 1975 would put them at a disadvantage when Spain joined the European Community (1986) and became a free-market economy. Employers were quick to use them and by 1997 around one-third of jobholders held temporary contracts, three times the EU average and creating a two-tier system of insiders and outsiders. Yet the jobless rate in 1997 was not much changed from 1984 because liberalisation and later the unsustainable bricks-and-mortar economic model failed to generate stable employment. Just over one-quarter of employees in 2015 were on temporary contracts, the highest share across OECD countries except for Poland but lower than the pre-crisis levels as the recession took a disproportionate toll on temporary workers. The increase in wage earners on a temporary contract between the third quarter of 2014 and the same period of 2015 (from 24.6% to 26.2%), despite the recovery, underlined the persisting segmentation in the labour market. The proportion of jobholders on temporary contracts was particularly acute for those aged between 15 and 24 (70% compared with an EU average of 43%).

Successive reforms to tackle the duality problem have failed. Generally speaking, neither the trade unions nor employers are really interested in changing the situation. Temporary contracts suit employers as it gives workers limited protection, while trade unions defend the interests of insiders as they account for most of their members.

Another problem was the role of the labour courts or arbitration mechanisms in resolving labour conflicts. A large share of concluded proceedings concerning collective dismissals resulted in court rulings against the employer and in the reinstatement of the affected workers with back pay –a situation that hardly existed before the 2012 reform–. Spain was one of the few European countries that signed (in 1985) article 158 of the International Labour Organisation, which establishes that the causes for dismissals and substantial unilateral changes in

working conditions must be within the grounds recognised by law. The courts not only require just grounds for dismissals and changes but also must be convinced of the economic rationale behind the moves, and this can sometimes depend on the ideology of the judge. This judicial activism in the labour sphere emanates from the Franco regime when the state intervened in all labour conflicts.

The labour market duality could be addressed through the introduction of a single open-ended contract (the so-called equal opportunities contract, or EOC) at the same time that temporary contracts were abolished –with the exception of replacement contracts for maternity or sickness/disability leave–. Severance payments would increase with seniority, instead of having the same indemnity per year of service applying from the start of the contract. The rationale for gradually increasing severance pay is that the longer a worker stays in a company, the larger that person's loss of specific human capital. One of the main downsides of temporary contracts is that companies invariably invest less or nothing in training employees, which lowers productivity.

How did people survive in this dire situation? Spaniards get by thanks to what the sociologist Víctor Pérez-Díaz calls the 'society of four squares' after a children's game. People, especially the young, move between four points: a fixed-term, precarious job; the shadow economy; unemployment benefits; and, if they strike lucky, a permanent job.

4. Demographics: a Rapidly Changing and Greying Population

The face of Spain has changed considerably over the past 20 years due to an unprecedented influx of immigrants. Exceptionally for a developed country, the population rose from 39.6 million in 1996 to a peak of 46.8 million in 2012, an increase of 18%. Spain's migrant stock rose from 800,000 in 1990 to 6.5 million in 2013 (including intra-Community residents), 13.8% of the total population (2.1% in 1990) and the largest relative share of the main EU economies, according to the United Nations (see Figure 1.9).

Figure 1.9. International Migrant Stock, 1990 and 2013, (million and % of total population)

	Stock in 2013	% of population	Stock in 1990	% of population
Spain	**6.5**	**13.8**	**0.8**	**2.1**
UK	7.8	12.4	3.6	6.4
Germany	9.8	11.9	5.9	7.4
France	7.4	11.6	5.8	10.4
Italy	5.7	9.4	1.4	2.5

Source: UN Trends in International Migrant Stock.

Spain received more immigrants per capita over a 10-year period than any other country in the world except for the US. Whereas between 1960 and 1973 more than one million Spaniards emigrated as ‘guest workers’ (as the Germans called them), Spain during its boom became the favoured country in Europe for migrants in search of a better way of life. To Spain’s credit this did not produce any relevant xenophobic, far-right, populist parties, and violent attacks on immigrants were rare. Many families had relatives who migrated to Europe in the 1950s and 1960s, helping them to view today’s migrants with understanding and sympathy. According to the British think-tank Demos, Spain is the most tolerant EU country towards immigrants. This is beginning to change, however. According to a survey by the Pew Research Center conducted in May 2015, before the Syrian migrant crisis, 46% of Spaniards believed immigrants were a burden on their country, the third-highest proportion among the five largest EU economies (see Figure 1.10).

Figure 1.10. Views of immigrants in Europe: % who say immigrants today…

	Are a burden on our country because they take our jobs and social benefits	Make our country stronger because of their work and talents
Italy	69	19
France	52	45
Spain	**46**	**47**
UK	37	52
Germany	29	66

Source: Pew Research Center,

Immigration is a relatively new phenomenon in the history of Spain, traditionally an intolerant and dogma-obsessed country that for centuries drove its citizens into exile for religious, political or economic reasons. Between 1492, with the massive expulsion of Jews and Muslims (in 1609), and 1975, when the Franco dictatorship ended, around 3 million Spaniards left the country under political or economic pressure, without counting the very many others who formed part of a regular process of emigration. Spain, according to the eminent historian Henry Kamen, was the ‘only European country to have attempted to consolidate itself over the centuries not through offering shelter but through a policy of exclusion’.[10] All the more remarkable then was the country’s swift transformation, in less than two decades, from a net source of emigrants to a big recipient of immigrants and the creation of a much more heterogeneous and tolerant nation.

The foreign nationals’ share of the total population declined to below 10% in 2015, as a result of net emigration (see Figure 1.11). Fewer people emigrated to Spain and more foreigners, naturalised Spaniards and native Spaniards left the country because of the crisis.

Figure 1.11. Spain's Population and Foreign Nationals Share of it (million and %) (1)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Population	44.8	45.7	46.2	46.4	46.6	46.8	46.7	46.7	46.4
% foreigners	9.8	10.9	11.6	11.6	11.3	11.1	10.7	10.1	9.4

(1) Figures based on those registered with town halls at January 1 of each year.
Source: INE.

The largest foreign resident community in Spain are Rumanians. Their number surged from a 66,994 in 2002 to a high of 798,970 in 2012 before falling to 705,333 in July 2015, according to the National Statistics Office (INE). All the 10 largest communities except for Italy shrank between 2012 and 2015, as migrants returned to their home countries or moved elsewhere (see Figure 1.12). The resident foreign population fell by 810,000 in two and a half years.

Figure 1.12. Resident Foreign Population by the Top-10 Countries of Origin, 1996, 2012 and July 2015 (1)

	1996	2012	July 2015
Rumania	2,258	897,203	705,333
Morocco	111,043	788,563	680,120
UK	75,600	397,892	300,439
Italy	19,287	191,901	187,330
China	11,611	177,001	169,445
Ecuador	3,972	308,174	164,803
Germany	60,495	196,878	143,876
Colombia	9,997	246,345	139,336
Bulgaria	1,453	176,411	133,114
Portugal	35,960	138,682	103,422
Other countries	1,699,593	2,217,208	1,699,593
Total	637,085	5,736,258	4,426,811

(1) Ranked by 2015 figures which are provisional.
Source: INE.

Spaniards also emigrated in relatively significant numbers for a society that has been exceptionally immobile in the last 40 years until the 2008 economic crisis: 50,884 in the first half of 2015, up from 41,313 in the same period of 2014.

The immigration data is based on use of the municipal electronic register (known as the *padrón municipal*). This is reasonably accurate and provides data most EU countries do not have since it includes people in Spain illegally. It is very good at catching the upswing –since everyone needs to register if they want health care and to eventually regularise their situation– but is not so accurate during the downswing, since not everyone formally leaves the register. In an attempt to address this issue, non-Spanish nationals were asked to re-register in 2012/13 to confirm they were still in the country, and non-EU nationals have to re-register more frequently. This partly explained the size of the UK drop of

97,000 between 2012 and July 2015– people were no longer in Spain and the register records were out of date–.

The other weakness of the data is that it does not fully catch Spanish nationals who emigrate. Most young Spaniards working abroad had not taken their name off the municipal register. According to the OECD, Spain's share of the native population living abroad was only 2% in 2014 compared with 17.5% for Ireland (see Figure 1.13).

Figure 1.13. Over-15s Living Outside the Country of their Birth, 2014 (% of native-born population)

	%
Ireland	17.5
UK	6.8
Germany	4.5
Italy	4.3
France	2.6
Spain	**2.0**

Source: OECD.

Until the arrival of immigrants, which no one foresaw would happen in such large numbers, Spain's population was projected to decline steeply. In 1996 the United Nations forecast the population would sharply fall by 2050 from almost 40 million to around 28 million because Spanish women were not producing enough babies. Spain's fertility rate dropped from 2.80 children per woman in 1978 to 1.23 in 2000, the lowest in the EU. The Socialist government of José Luis Rodríguez Zapatero introduced the so-called *cheque bebé* (a €2,500 benefit for very newborn or adopted child) in July 2007 in an attempt to boost the low birth rate, but it was scrapped at the end of 2010 as part of budget cuts.

The fertility rate was 1.32 in 2010-2015; first-generation immigrant women tended to have more children than Spaniards, but it was still below the 'replacement rate' of 2.1 needed to maintain a stable population (see Figure 1.14). One factor behind the low fertility rate is a budgetary policy that has long been one of the least supportive of families in the EU: spending on families and children in Spain as a percentage of total government expenditure is the lowest in the EU after Greece (1.1% in 2013 compared with 8.8% in Denmark). The number of babies born in 2014 (426,303) rose, however, for the first time since 2008, albeit by a miniscule 0.1%. The fertility rate for Spanish women was 1.27 (1.31 in 2007) and for foreign women 1.61 (1.72 in 2007).

Figure 1.14. Fertility Rates in the EU, 1975-2020 (average number of children per woman)

	1975-80	1990-95	2005-10	2010-15
France	1.86	1.71	1.97	2.00
Germany	1.51	1.30	1.36	1.39
Italy	1.89	1.27	1.42	1.43
Spain	**2.55**	**1.28**	**1.39**	**1.32**
UK	1.73	1.78	1.88	1.92

Source: United Nations Population Division, the 2015 Revision.

Despite the influx of immigrants, Spain's population is forecast to be 200,000 lower in 2030 than in 2015 at 45.9 million and 1.3 million lower in 2050 at 44.8 million (a whopping 16.8 million higher than the projection made in 1996), according to the revision in 2015 by the United Nations Population Division (see Figure 1.15). In 2015, for the first time since 1944, there were more deaths in Spain than births. The forecasts of Spain's National Statistics Office (INE) were more severe: the population would fall from 46.4 million in 2015 to 45.4 million in 2029 and to 40.8 million in 2065.

Figure 1.15. Population of Main EU Countries, 1950-2050 (1) (million)

	1950	2015	2030	2050
France	41.8	64.3	68.0	71.1
Germany	69.7	80.6	79.2	74.5
Italy	46.6	59.8	59.1	56.5
Spain	**28.0**	**46.1**	**45.9**	**44.8**
UK	50.6	64.7	70.1	75.4

(1) Projections for 2030 and 2050.
Source: United Nations Population Division, the 2015 Revision.

Such forecasts are hazardous as they depend on three factors: life expectancy, fertility, and immigration. The first of these is –in theory– the easiest to forecast, since the trajectory is fairly well established. Fertility is harder, but the pattern is unlikely to change that much. The rate could settle in the 1.5/1.6 range in the medium term. With each generation, however, there are less children, so that 1.5 children per female is on an ever smaller base of females. The key factor was immigration, since it can make big shifts in population size, as happened in Spain between 2002 and 2007. Immigration depends on the state of the labour market, and the rate of job creation depends on the rate of economic growth. Spain continued to lose population in 2015 to emigration, but it was impossible to say with any degree of certainty what would happen 10 years ahead.

Spain's rising average life expectancy –from 77.4 years in 1990-95 to 83.2 in 2015-20, a testimony to the creation of a welfare state and Spaniards' healthier life style– and the low fertility rate are producing significant changes in the population pyramid. The share of the population over the age of 60 was forecast to increase from 24.4% in 2015 to 41.4% in 2050. This would sharply lift the old-age dependency ratio (the inactive elderly as a percentage of the working age population) and exert considerable pressure on the pension and public health systems to provide for a significantly older population.

The declining fertility was also resulting in a shrinking labour supply. The share of the population of working age in Spain has been falling since 2010. This could be good news for the unemployed, since as the economy recovers the declining labour supply should make it easier for them to find work, provided workers have the skills that match the required needs and regulations and tax policies do not create barriers to hiring. If not, employers might respond by off-shoring work to other countries.

5. A Resilient and Tolerant Society

Despite the potentially explosive mixture of a massive increase in unemployment and the consequent decline in living standards, a significant widening of the gap between rich and poor, a welfare state eroded by cuts in public spending and an influx of immigrants (until the onset of recession), Spain has held together remarkably well. In large measure this was due to the extended and cohesive family-based network that looks after its own at times of crisis. Many other countries, particularly in Northern Europe without such a network, would not have been able to withstand such dire circumstances without social unrest.

Spain's previous periods of low growth or recession (1975-85 and 1993-95) did not see the kind of growing social inequality that has characterised the latest crisis. At one extreme of the social spectrum, the share of the population at risk of poverty or social exclusion hit 29.2% (see Figure 1.16) in 2014,[11] according to Eurostat. This means that they were in at least one of the following three conditions: at-risk-of-poverty after social transfers (income poverty), severely materially deprived or living in households with very low work intensity. The Roman Catholic charity Caritas distributed food, clothes and help to 2.5 million people in 2014, one in 20 of the population.

Figure 1.16. People at Risk of Poverty or Social Exclusion in Selected Euro-Zone Countries, 2008-14

	% of total population		In millions	
	2008	2014	2008	2014
France	18.5	18.6	11.15	11.52
Germany	20.1	20.6	16.34	16.51
Greece	28.1	36.0	3.05	3.88
Italy	25.3	28.1	15.10	17.04
Spain	**24.5**	**29.2**	**11.12**	**13.40**

Source: Eurostat.

The severe material deprivation rate, one of the components of the 'at risk of poverty or social exclusion' rate, doubled between 2008 and 2014 (see Figure 1.17).

Figure 1.17. Persons Severely Materially Deprived (%) (1)

	2008	2014
France	5.4	4.8
Germany	5.5	5.0
Greece	11.2	21.5
Italy	7.5	11.5
Spain	**3.6**	**7.1**

(1) Severe material deprivation is defined as not being able to pay for at least four of the following nine items: mortgage or rent payments; one week's holiday away from home; a meal with meat, chicken, fish or vegetarian equivalent every second day; unexpected financial expenses; a telephone (including mobile telephone); a colour TV; a washing machine; a car; and heating to keep the home sufficiently warm.
Source: Eurostat.

Spain was ranked 23rd out of 28 countries in the 2015 EU social justice index (SJI). With a score of 4.73 out of 10, it ranked equal with Hungary (see Figure 1.18). Spain's performance in the SJI has gradually worsened since 2008. The country ranked among the bottom third of countries in four of the six dimensions, and among the bottom five in terms of labour market access. With regard to the SJI's focus in 2015 on children and youth, Spain ranked 25th with a score of 3.94 in this sub-index.

Figure 1.18. EU Social Justice Index, 2008-15

	2008	2011	2014	2015	Cha. 08/15
1. Sweden	7.54	7.34	7.44	7.23	-0.31
7. Germany	6.16	6.27	6.56	6.52	+0.37
12. France	6.26	6.15	6.12	6.18	-0.09
13. UK	5.95	5.96	5.96	5.97	+0.02
15. Poland	4.48	5.01	5.30	5.46	+0.98
23. Spain	**5.54**	**5.13**	**4.86**	**4.73**	**-0.82**
25. Italy	5.17	5.16	4.60	4.69	-0.48
28. Greece	4.46	4.44	3.57	3.61	-0.85

Source: BertelsmannStiftung.

The index is based on six dimensions: in poverty prevention Spain was ranked 21st, equitable education 20th, labour market access 27th, social cohesion and non-discrimination 18th, health 12th and inter-generational justice 22nd, which, in turn, are drawn up using many indicators.

At the other end, the number of Spaniards with net assets of at least US$1 million excluding their primary residence and consumables rose 40% between 2008 and 2014 to 178,000, according to the Capgemini World Wealth Report. The uneven distribution of the cost of the crisis fuelled considerable resentment. Spain's wealth distribution, however, is more even than in the other large EU countries. Two-thirds of adults in Spain had net wealth of between €10,000 and €100,000 in 2015, a much higher proportion than the other large EU economies, according to the Credit Suisse Global Wealth Databook 2015 (see Figure 1.19). The country's Gini, which measures the hot topic of wealth distribution, was 67.1%, far from the US's 85% (0 represents perfect equality and 100 perfect inequality).

Figure 1.19. Wealth Pattern Within Countries, 2015 (1): Distribution of Adults (%) by Wealth Range (US$)

	Under US$10,000	US$10,000-US$100,000	US$100,000-US$1 million	Over US$1 million	Gini[2] (%)
France	16.9	33.1	46.3	3.7	70.3
Germany	29.7	33.9	34.2	2.3	77.5
Italy	12.4	37.6	47.7	2.3	66.7
Spain	**12.1**	**62.8**	**24.1**	**1.0**	**67.1**
UK	10.0	33.9	51.3	4.9	67.8
US	28.1	32.9	32.6	6.4	85.0

(1) Wealth is defined as the value of assets minus debts including homes and consumer durables.
(2) The Gini coefficient is a measure of statistical dispersion intended to represent the income distribution of a nation's residents, and is the most commonly used measure of inequality. 0 represents perfect equality and 100 perfect inequality.
Source: Credit Suisse Global Wealth Databook 2015.

Spain's crisis occurred after an unprecedented period of advances in social and economic development, following membership of the EU in 1986 and the euro zone in 1999. This prosperity raised expectations that were then quickly dashed, particularly among the younger generation entering the labour market, a significant number of whom had to emigrate in search of a job. The situation for those aged between 15 and 24 is particularly worrying (see Figure 1.20).

Figure 1.20. Trends in Youth Unemployment Rate, NEET Rate, Temporary Employment Rate, Involuntary Part-Time Rate and Risk of Poverty or Social Exclusion, Selected EU Countries, Change between 2010 and 2014 (% points) (1)

	Growth in jobless rate	Growth in NEET rate	Growth in temporary employment rate	Growth in involuntary part-time employment rate	Growth in share of persons at risk of poverty of social exclusion
Greece	19.4	4.3	-0.8	15.2	14.3
Italy	-3.7	3.1	9.2	13.3	5.5
Spain	**11.7**	**-0.7**	**10.7**	**10.3**	**9.0**
EU-28	0.9	-0.3	0.9	1.0	3.1

(1) The temporary employment rate is the share of employees in temporary jobs in total paid (dependent) employment. Involuntary part-time employment is the share of youth working less than 30 hours who want to work full-time in total employment. 'Youth at risk of poverty or social exclusion' is among the EU Social Indicators. It is defined as persons with an equivalised disposable income below 60% of the national equivalised median income or living in households with very low work intensity as a share of the total population. The period measured is 2010–14 except for involuntary part-time employment and risk of poverty and social exclusion, which are 2010–13. The age group is 15-24, except for risk of poverty or social exclusion which measures youth as 16-24.
Source: Eurostat, database of the European Union Labour Force Survey, except for involuntary part-time which is OECD data.

The progress until the crisis can be seen in the improvement in the United Nations development index for Spain, which between 1980 and 2010 rose 23%, the fastest rate of the big four euro-zone countries albeit from the lowest starting point (see Figure 1.21). This index (maximum value one) is based on life expectancy at birth, mean years of schooling, expected years of schooling and gross national income per capita (see Figure 1.22).

Figure 1.21. Change in UN Human Development Index for Selected Countries, 1980-2014 (1)

	1980	1990	2000	2010	2012	2014	Change 1980-2014 (%)
France	0.722	0.779	0.848	0.879	0.884	0.888	22.9
Germany	0.739	0.782	0.854	0.904	0.911	0.916	23.9
Greece	0.713	0.749	0.798	0.856	0.854	0.865	21.3
Italy	0.718	0.763	0.825	0.869	0.872	0.873	21.6
Spain	**0.702**	**0.755**	**0.826**	**0.864**	**0.869**	**0.876**	**24.7**
US	0.825	0.858	0.883	0.908	0.912	0.915	10.9

(1) The maximum value is one.
Source: UN Human Development Reports.

Figure 1.22. UN Human Development Index for Selected Countries

Ranking (1)	Human Development Index value 2014	Life expectancy at birth 2014 (years)	Mean years of schooling 2014 (years)	GNI per capita (2011 PPP US$) 2014
1. Norway	0.944	81.6	12.6	64,992
6. Germany	0.916	80.9	13.1	43,919
8. US	0.915	79.1	12.9	52,947
14. UK	0.907	80.7	13.1	39,267
22. France	0.888	82.2	11.1	38,056
26. Spain	**0.876**	**82.6**	**9.6**	**32,045**
27. Italy	0.873	83.1	10.1	33,030
36. Poland	0.843	77.4	11.8	23,177

Note: the maximum value is one.
(1) Out of 188 countries.
Source: United Nations Human Development Report, 2015.

Spain telescoped modernisation into a much shorter period than many other countries, including the creation of a fully-fledged welfare state, the incorporation of women to the working population and urbanisation (77% of the population live in towns and cities compared with 61% in 1965). Per capita income fell from €23,900 in 2007 to €23,300 in 2015. This was the first sustained drop in GDP per head since the end of the 1950s. And for the poorest 10%, real income dropped by 13% per year from 2007 to 2011, compared with only 1.4% for the richest 10%, according to the Organization for Economic Co-operation and Development (OECD).

Despite the hardship, Spain moved up one place to 20th position out of 133 countries in the 2015 Social Progress Index (see Figure 1.23), published by the US Social Progress Imperative (SPI).

Figure 1.23. Social Progress Index, Ranking (1)

Rank out of 133 countries	Score out of 100
1. Norway	88.36
11. UK	84.68
14. Germany	84.04
16. US	82.85
20. Spain	**81.17**
21. France	80.82
31. Italy	73.38

(1) The SPI defines social progress as 'the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential'.
Source: Social Progress Imperative.

The index is based on three dimensions that incorporate 52 indicators (see Figure 1.24).

Figure 1.24. Spain's Position in the Social Progress Index Component-Level Framework

Basic human needs	Foundations of wellbeing	Opportunity
Water and sanitation: 19th	Access to basic knowledge: 2nd	Personal rights: 22nd
Nutrition & basic medical care: 10th	Access to information and communications: 26th	Tolerance and inclusion: 14th
Shelter: 23rd	Health and wellness: 11th	Personal freedom and choice: 28th
Personal safety: 23rd	Ecosystem sustainability: 100th	Access to advanced education: 18th

Source: Social Progress Imperative.

The crisis did not dent Spaniards' support for the EU and the euro zone, both of which brought the country an unprecedented period of prosperity, peaceful co-existence and modernisation. Among the big four euro-zone economies, Spaniards' support for the euro increased the most between 2012, at the height of the recession, and 2015 when it was on a par with that in Germany (see Figures 1.25 and 1.26).

Figure 1.25. Should Keep the Euro rather than Return to National Currency

	2012 (%)	2015 (%)	Change (p.p.)
Spain	**60**	**71**	**+11**
Germany	66	72	+6
Italy	52	56	+4
France	69	72	+3

Source: Pew Research Centre. Spring 2015 Global Attitudes Survey.

Figure 1.26. Very/Somewhat Favourable Opinion of the EU

	2013 (%)	2014 (%)	2015 (%)	2013-15 change	2014-15 change
Italy	58	46	64	+6	+18
Spain	**46**	**50**	**63**	**+17**	**+13**
France	41	54	55	+14	+1
UK	43	52	51	+8	-1
Germany	60	66	58	-2	-8

Source: Pew Research Centre. Spring 2015 Global Attitudes Survey.

Not only was there a surprising absence of social unrest, but crime figures were at an all-time low. As regards homicide deaths, Spain averaged 0.8 per 100,000 population in 2010-12, compared to 19.4 for black UK and 2.5 for white US. Why was this? A major factor was the existence of the extended family-based network, or 'inter-generational solidarity'. Some property owners who

were unable to meet their mortgage payments and lost their homes (Moody's Investor service estimated Spanish banks had around €100 billion of repossessed real-estate properties on their books) ended up living with their parents.[12] In 2013, 37.2% of people aged 25-34 in Spain lived with their parents, far higher than that in northern European countries (see Figure 1.27).

Figure 1.27. Share of 25-34-Year-Olds Living with Parents, Selected Countries (%) (1)

	%
Slovakia	56.6
Italy	46.6
Spain	**37.2**
Germany	17.3
UK	14.4
France	11.5
Denmark	1.8

(1) 2013 or latest.
Source: Eurostat, UK ONS.

In some cases, three generations lived under the same roof. Grandparents, in particular, played an important role, looking after grandchildren while their sons or daughters worked so that they did not have to pay for care and, in some cases, making over part of their pension to their unemployed children. In February 2010, 15% of those over the age of 65 told a *Simple Lógica* survey they supported at least one relative and this figure increased to 40% in 2012. The sizeable informal or shadow economy (18% of GDP) also acted as a social cushion, although it was no larger than the EU average in relative terms.

Many of the unemployed were immigrants from non-EU countries and most unlikely to protest, particularly those in an 'irregular' situation. There were good reasons for believing that Spain will not experience the kind of assimilation crisis that has hit France and the Netherlands. Around 2.5 million of the immigrants in Spain are Latin Americans, 1.24 million of whom since 2000 became naturalised Spaniards without losing their nationality of origin. Not only do they speak the same language as Spaniards, but they also have a religious, cultural and historical affinity, while some 700,000 immigrants are Romanians, who quickly pick up the language as it is similar to their own.

Immigrants have changed Spain's religious map and not just the face of the country. There are now around 1 million Muslims (the fourth-largest absolute number in the EU), 1.2 million evangelicals, 600,000 members of Orthodox Churches (Romania, Bulgaria and Russia) and 48,000 Jews (mainly from Latin America), according to the Registry of Religious Institutions. Although under the 1978 post-Franco constitution Roman Catholicism is no longer the official religion, the Church remains in a very powerful position, particularly in education.[13] In 2015 it was still the only faith that taxpayers could give money to via their annual income-tax return.

6. Education: a Lot to be Desired

Spain has made considerable progress in educational attainment in the last 40 years, particularly when it is borne in mind that it was not obligatory to attend school (between the ages of six and 14) until 1970, much later than most other developed countries. The country has also done better than many other European countries as regards educational mobility: about 40% of adults have a higher level of education than their parents.

Thanks to the rapid expansion of education over the last few decades, around two-thirds of 25-34 year olds had attained at least an upper secondary education compared with only 35% of 55-64 year-olds. Tertiary attainment had also grown rapidly and was at the OECD average. In 2014, the share of Spanish 25-34 year-olds with tertiary education was 41% compared with 21% among 55-64 year-olds. This 20-percentage point difference was surpassed in only six OECD countries. However, too few tertiary graduates were developing the high levels of skill needed for success in the economy and society. At the other end of the education spectrum, Spain had the fourth-largest percentage (36%) of 25-34 year old with an education level below upper secondary.[14] Most of these people were at risk of being undereducated for the rest of their lives and were particularly vulnerable to losing their jobs during times of economic downturn.

During the 1997-2008 economic boom, many teenagers came to the conclusion that education did not pay, and, sadly, they were right. They dropped out of school early at 16 (the age at which compulsory education ends) and flocked in droves to work in the construction and related sectors. Wages for unskilled work during this period rose faster than those for skilled work. Many of these students were demotivated: one in three of all students under the age of 15 repeated a year because they did not pass a sufficient number of exams, and when they reached 16 had no incentive to continue studying. This repeating of grades was estimated to represent 8% of education spending, money that could be much better spent tending to problem students.

The early school-leaving rate peaked at 31.2% in 2009, double the EU average, and dropped to 20% to 2015, still almost double the average and making the much desired idea of an economy based more on knowledge than on bricks and mortar a pipedream (see Figure 1.28). It would make eminent sense if Spain's school-leaving age was raised from 16 to 18, the same as in Germany, Belgium, England and the Netherlands (part time, full time or vocational education as of 16).

Figure 1.28. Early School-Leaving Rates, 2006 and 2014 (1)

	2006	2014
Portugal	38.5	17.4
Spain	**30.3**	**21.9**
Italy	20.4	15.0
EU-28	15.3	11.1
Germany	13.7	9.5
France	12.4	8.5
UK	11.3	11.8
Sweden	8.6	6.7

(1) The percentage of those aged between 18 and 24 who have only lower secondary education or less and are no longer in education or training.
Source: Eurostat.

There was a correlation between the real-estate boom and the early school-leaving rate. As the number of housing starts declined and jobs were shed as the recession deepened, so more students stayed at school beyond the age of 16 (see Figure 1.29).

Figure 1.29. Housing Starts and Early School-leaving Rate, 2006-14

	Housing starts	Early school leaving rate (%) (1)
2006	865,561	30.5
2007	598,087	31.0
2008	264,795	31.7
2009	110,849	30.9
2010	91,662	28.2
2011	78,286	26.3
2012	44,162	24.7
2013	34,288	23.6
2014	34,873	21.9

(1) People aged 18-24 who have only lower secondary education or less and are no longer in education or training.
Source: Ministry of Development and INE.

The better qualified the student, the better the chances of finding a job. The jobless rate for those in Spain without tertiary education was 31.4% in 2014 compared with 10.8% for those who went on studying after completing their secondary education. The latter rate was considerably below the overall unemployment rate of more than 23% (see Figure 1.30).

Figure 1.30. Unemployment Rates by Educational Attainment Level, 25-64 Year-Olds (%)

	Tertiary education	Upper secondary education and post-secondary non-tertiary education (levels 3 and 4)
Greece	19.1	27.6
Spain	**13.8**	**31.4**
Italy	7.6	15.2
France	5.8	24.8
EU-28	5.7	17.4
Germany	2.5	12.0

Source: Eurostat, July 2015.

As well as a still high early school leaving rate, a third of students repeated a grade, and almost a quarter completed school as much as two years later than the rest of their Spanish peers, according to the OECD. All three rates were considerably higher than the OECD average. Grade repetition alone was estimated to cost an amount equivalent to almost 8% of the total expenditure on primary and secondary education.

Concomitant with this, following the double-dip recession and the massive rise in unemployment, was the rise in the percentage of 15-29 year-olds not in education, training or employment (known as NEETs, see Figure 1.31). This increased from 12.8% in 2007, before the huge property bubble burst, to 25.8% in 2014, as many early school leavers were among the first to lose their jobs.

Figure 1.31. Percentage of 15-29 Year-Olds not in Employment, Education or Training, 2007 and 2014

	2007	2014
France	12.6	16.3
Germany	11.6	9.2
Italy	18.8	27.6
Spain	**12.8**	**25.8**
UK	12.9	14.4
OECD	12.5	15.5

Source: Education at a Glance 2015, OECD.

The quality of academic results leads a lot to be desired. Those in the OECD's international tests in reading, mathematics and scientific knowledge for 15-year-olds, known as the Programme for International Student Assessment (PISA), and for fourth-grade children in the TIMS and PIRLS tests, were generally not good. Spain scored below the OECD average in the latest (2012) PISA tests, but showed an improvement in its scores for reading, maths and science. The country was ranked 29th in science and 32nd in reading and maths out of 65 countries (see Figure 1.32). The PISA assessment is conducted every three years.

Figure 1.32. Pisa Report Assessing Competencies in Reading, Maths and Science, Selected Ranking of Countries (1)

Reading	Maths	Science
1.Shanghai, China (570; 556)	1. Shanghai, China (613; 600)	1. Shanghai, China (580; 575)
5. S. Korea (536; 539)	2. Singapore (573; 562)	5. Finland (545; 554)
6. Finland (524; 536)	5. S. Korea (554; 546)	7. S. Korea (538; 538)
9. Ireland (523; 496)	12. Finland (519; 541)	9. Poland (526; 508)
10. Poland (518; 500)	14. Poland (518; 495)	12. Germany (524; 520)
19. Germany (508; 500)	16. Germany (514; 513)	21. UK (514; 514)
21. France (505; 496)	25. France (495; 497)	22. Czech Republic (508; 508)
23. UK (499; 494)	26. UK (494; 487)	25. Latvia (502; 494)
OECD average (496; 493)	OECD average (494; 496)	OECD average (501)
28. Italy (490; 486)	28. Italy (490; 483)	26. France (499; 498)
31. Portugal (488; 489)	31. Portugal (487; 487)	28. US (497; 493)
32. Spain (488; 481)	**32. Spain (484; 483)**	**29. Spain (496; 488)**

(1) 2012 and 2009 scores in brackets. The results of the next report will not be known until the end of 2016.
Source: OECD.

Spain basically stood still over the last decade. In reading, Spain's score in 2012 of 488 was better than in 2009 (481) and 2006 (461) but lower than in 2000 (493). The maths score of 484 was marginally higher than in 2009 (483) and 2006 (480) but lower than in 2003 (485), while in science the score of 496 was above 2009 (488) and 2006 (487).

One of the reasons for the overall mediocre results, but with notable differences by regions, is that Spain has had to cope with a much larger influx of immigrants over the past 20 years than any other OECD country apart from the US. Other factors that held back results are a curriculum regarded as antiquated, the rote system of learning (as opposed to the Anglo-Saxon system of critical thinking), the quality of teachers and the large number of students who had to repeat a year. Education experts claimed that Spain set a higher standard for passing the school-leaving exams, which meant, for instance, that France passed students that Spain did not.[15] Students who repeated a year became demotivated and dropped out, though less so than in the recent past because of Spain's high unemployment rate.

The level of government spending on education was below the OECD average (see Figure 1.33), but in other areas, such as the ratio of 15-year-old students to computers (2.2 in Spain vs 4.7 for the average), class size (22 students compared with 21) and time spent on actual teaching Spain compared relatively well, according to the latest comparative figures (2012). Spain's teachers were also not poorly paid compared with other countries of similar or higher income levels. '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 and skills who runs PISA.

Teachers in Spain are appraised to access the profession but not regularly afterwards. In 11 other OECD countries, regular teacher appraisal affects teacher's pay, but it is not the case in Spain where the only consequence of underperformance noted in an appraisal is the failure to progress to registered or certified teacher status. However good or bad a teacher was, they earned the same. The lack of motivation could be one of the reasons for the mediocre results.

Figure 1.33. Total Public Expenditure on Education, 2000 and 2012 (% of GDP) (1)

	2000	2012
Finland	5.5	6.1
France	5.2	4.8
Italy	3.8	3.6
Poland	4.4	4.3
Spain	**3.8**	**3.7**
UK	5.0	5.4
OECD average	4.5	4.8

(1) Including public subsidies to households for living costs (scholarships and grants to students/households and students loans), which are not spent on educational institutions.
Source: Education at a Glance 2015, OECD.

Spain's education system was ranked the 26th most efficient out of 30 OECD countries, according to a wide-ranging study by GEMS Education Solution. The ranking takes into account teachers' pay, class sizes and pupils' scores in the PISA tests.

There has been a proliferation of universities in Spain (more than 70), but only 18 of them made it into the QS World University Rankings, regarded as the most authoritative of its type. The first ranked was the University of Barcelona in 166th place. The three main Spanish graduate business schools (IESE, IE and ESADE), however, were among the best in the world and regularly made the top rankings. IESE and IE were ranked 7th and 12th, respectively, in the *Financial Times'* 2015 Global MBA Ranking. The business schools' success is in stark contrast to that of Spanish universities. Faculties are heavily endogamic and the appointment and promotion system is widely perceived to be corrupt.

While Spanish universities were ranked low in the world's classifications, when the classification was made on the basis of faculties the picture told another story. The QS put seven of them in the Top 50 (see Figure 1.34).

Figure 1.34. Spanish University Faculties in the QS Top 50 (position in brackets)

Universidad Politécnica de Cataluña	Architecture and built environment (22nd)
	Civil and structural engineering (35th)
Universidad Autónoma de Cataluña	Veterinary science (23rd)
Universidad Pompeu Fabra	Economics and econometrics (23rd)
Universidad Ramón Llull (private)	Business and management studies (29th)
Universidad Carlos III	Economics and econometrics (38th)
Universidad de Barcelona	Philosophy (48th)
Universidad Complutense de Madrid	Dentistry (40th)
	Veterinary science (50th)

Source: QS.

Spain also came out relatively well in the Nature Index which tracks the affiliations of high quality scientific articles published in 68 science journals independently chosen by the scientific community as the journals scientists would most like to publish their best research in. The county was classified the 10th most prolific (see Figure 1.35).

Figure 1.35. Nature Index 2015 Global, Top 10 Countries by Research Articles

	Number of research articles
1. US	17,520
2. China	6,352
3. Germany	3,964
4. UK	3,236
5. Japan	3,066
6. France	2,150
7. Canada	1,441
8. Switzerland	1,218
9. South Korea	1,146
10. Spain	**1,061**

Source: Nature Publishing Group.

Spain's tertiary education attainment level among 25-34 year olds is higher than Germany's and almost double that of Italy's. Yet it is not uncommon to find graduates in jobs that required little or no qualifications. Four years after graduation about half of young graduates work in jobs that do not require their level of qualification. This problem is related to the lopsided economic model and a rebalanced one which has yet to emerge based more on knowledge. Spain has one of the highest levels of qualification mismatch in the EU. According to the European Centre for the Development of Vocational Training, 57% of employees in Spain in 2014 had few opportunities to find a job matching their skills and qualifications compared with 47% in the UK and 32% in Germany.

Spain has one of the lowest percentages of young people in vocational training (13% vs the EU average of 29%) as most prefer to go to university, despite a degree not guaranteeing a job or work that matches their skills. One reason for this is the social status acquired by going to university and the lack of social appreciation of vocational courses. The previous Popular Party government sought to strengthen the role of companies in training, in line with the German dual system, but this was held back by the predominance of SMEs (more than 40% of companies have fewer than nine employees) and their scant training culture.

Research and innovation also remained a weak area, as evidenced by the relatively poor ranking of universities, the low number of patents registered and the level of spending on R&D of 1.20% (2014) of GDP compared with an EU average of more than 2% (the Socialist government of José Luis Rodríguez Zapatero set an R&D target of 2% for 2010). Spain spends much more on gambling and lotteries than on R&D. The CSIC national research council warned in 2013 of a 'catastrophe' in its research centres if no extra money was found. Its budget had fallen by 30% from 2008 levels, and it only offered 35 permanent positions in 2014, compared with 263 in 2008. Half of all CSIC researchers were due to retire over the next five years. Many promising young scientific researchers went abroad in a brain drain the country could ill afford[16]. Since 2012 the seven public research entities including CSIC linked to the central government have been assigned a replacement rate of only 10% of retired scientists. The same restriction applied to public universities, resulting in more teaching obligations and consequently less time devoted to research. At the end of 2015, shortly before a general election, the Popular Party government finally made good on its promise to establish a national science funding agency (part of a 2011 science law). But the agency would not come with new money, as it would usurp existing research budgets.

There are, however, some striking successes; for instance, several Spanish companies were involved in the creation of Curiosity, the robot designed to find out whether there was or is life on Mars, and three out of every five flights worldwide are controlled using Spanish air navigation systems. This belies the fatalistic approach epitomised in the still much quoted phrase of the philosopher Miguel de Unamuno (1864-1936), 'Let them invent! The electric bulb illuminates here as much as where it was invented'. More pertinently, Unamuno also said, 'We should try to be the parents of our future rather than the offspring of our past'.

7. Spain's Global Presence: on the Rise

Spain has achieved in 30 years a notable global presence as a result of its strengthened economic, military and soft power dimensions, following European Community membership in 1986. The 2015 Elcano Global Presence Index (IEPG) ranked Spain 11th out of 80 countries, a position it has held since 2011 (see Figure 1.36).[17]

Figure 1.36. Elcano Global Presence Ranking and Scores

Ranking	Score
1. US	1,099.6
2. UK	404.9
3. Germany	400.5
4. China	363,5
5. France	321.3
6. Russia	295.0
7. Japan	257.7
8. Netherlands	231.2
9. Canada	205.4
10. Italy	176.0
11. Spain	**169.0**

Source: Real Instituto Elcano.

The index measures the ability of countries to project themselves beyond their borders and the extent to which they are participating in and shaping the process of globalisation. It is based on three main fields. First, it ranks a country's economic presence, including measures of exports, outward foreign direct investment, and other elements. Second, it assesses a country's military presence, which is determined by the number of troops deployed abroad and the equipment available for deployment, Third, the IEPG includes statistics on a country's soft presence, which is based on a wide number of factors including exports of cultural products, tourist arrivals and official development aid.

Since Spain's transition to democracy in the late 1970s, foreign policy has been very active in reasserting the country in the international community, and this coincided with the globalisation process. Spain's IEPG score quadrupled between 1990 and 2014 (see Figure 1.37).

Figure 1.37. Spain's Global Presence Index Absolute Values and % Share in the Index of the Economic, Military and Soft Presence Dimensions, 1990-2014

Variable	1990	2000	2005	2010	2011	2012	2013	2014
Economic presence	**11.3**	**24.8**	**45.7**	**62.5**	**66.6**	**78.3**	**75.7**	**79.6**
% of global presence	27.2	36.8	43.7	43.8	43.6	46.6	46.5	47.4
Energy	1.1	1.5	3.1	3.7	4.6	8.1	7.7	7.8
Primary goods	2.4	5.6	9.9	12.9	14.4	17.6	17.8	18.5
Manufactures	2.8	5.8	9.7	10.8	11.7	13.6	12.6	14.1
Services	4.8	9.1	16.5	21.4	21.6	24.9	23.9	25.4
Investments	0.4	3.0	7.1	14.6	15.3	15.3	14.9	15.0
Military presence	**2.5**	**2.7**	**3.2**	**3.5**	**3.7**	**3.7**	**3.7**	**2.4**
% of global presence	5.7	3.8	2.9	2.4	2.3	2.1	2.1	1.3
Troops	0.0	0.6	0.6	0.6	0.6	0.6	0.6	0.2
Military equipment	2.4	2.0	2.4	2.8	2.9	2.9	3.0	2.1
Soft presence	**28.2**	**40.7**	**56.8**	**78.1**	**84.0**	**87.4**	**84.8**	**87.1**
% of global presence	67.1	59.4	53.5	53.9	54.1	51.3	51.4	51.2
Migrations	0.8	1.7	4.4	6.1	6.2	6.1	6.1	6.1
Tourism	20.0	24.8	29.9	27.9	28.1	30.0	30.8	32.4
Sports	1.6	2.8	5.7	8.1	8.1	7.9	7.7	7.1
Culture	1.2	1.0	2.3	3.9	3.6	4.8	5.4	5.4
Information	0.0	0.1	1.0	8.6	14.6	17.2	17.2	17.2
Technology	0.6	1.0	1.4	1.7	1.6	1.2	1.2	1.2
Science	1.6	3.8	5.2	7.3	7.7	8.4	8.9	9.5
Education	0.8	3.4	1.5	4.0	4.6	5.2	4.6	4.6
Development cooperation	1.5	2.1	5.2	10.4	9.4	6.6	3.1	3.9
Global presence index value	**42.0**	**68.2**	**105.6**	**144.1**	**154.3**	**169.3**	**164.2**	**169.0**
Position in the index	10	11	11	10	11	11	11	11

Source: Real Instituto Elcano.

By comparing a state's presence with its actual power (or influence), it is possible to measure the extent to which it is punching above or below its weight. In Spain's case, it punches below its weight since it has more presence than influence.

The region that contributed the most to the country's global presence was Catalonia, at 21.59%, higher than its contribution to Spain's GDP (19.8%), followed by Madrid (19.5%), which is lower than its GDP contribution (19.8%).

Just over half of Spain's global presence was due to its soft dimension. Spain was ranked 14th in Portland's 2015 Soft Power 30. Described by Professor Joseph Nye, who developed the concept of soft power, as 'the clearest picture to date', this index was the first one to include the rising importance of digital assets and to use international polling to gauge national reputations across the world. Country rankings are based on a composite index measuring and comparing the sources of a country's soft power using 66 metrics across six categories: government, culture, education, global engagement, enterprise, and digital (see Figure 1.38).

Figure 1.38. The Soft Power 30, Ranking of Selected Countries

Rank	Country	Rank	Country
1.	UK	**14.**	**Spain**
2.	Germany	15.	Finland
3.	US	21.	Singapore
4.	France	26.	Israel
9.	Sweden	28.	Turkey
10.	Netherlands	29.	Mexico
12.	Italy	30.	China

Source: Portland.

8. The Growing Importance of the Spanish Language

Spanish is spoken by more than 560 million people and is the second language with the most native speakers in the world (more than 470 million) after Mandarin. It is the official language in 21 countries and the second most-used language in international communication. By 2030, according to Britannica World Data, Spanish will be spoken by 7.5% of the world's population, well above Russian (2.2%), French (1.4%) and German (1.2%).

There are already more Spanish speakers in the US than in Spain: 41 million native speakers and a further 11.6 million with limited proficiency (see Figure 1.39). The US will be the largest Spanish-speaking country in 2050 (around one-third of the population) as a result of the growth in the Hispanic population, according to the US Census Bureau. California became the second state as of July 2014 after New Mexico where Hispanics outnumbered the white population.

Figure 1.39. Main Countries where Spanish is Spoken (million)

	Native speakers	Limited proficiency
Mexico	117.0	
Colombia	47.6	
Spain	**42.9**	
Argentina	41.3	
US	41.3	11.6
Peru	26.9	
Venezuela	29.7	
Chile	17.2	
Ecuador	15.2	
EU (except Spain)	1.4	30.9

Source: Cervantes Institute, El español: una lengua viva.

The growing number of Spanish speakers is an economic as well as a cultural asset for Spain; the two of them are closely linked. For example, in 2014, 237,600 people came to Spain to study Spanish, while the culture industry in the broadest sense employs more than 480,000 people. Spanish publishing houses have 162 subsidiaries in 28 countries, mostly in Latin America.

In 2015 the Cervantes Institute launched the first and long overdue pan-Hispanic test in the Spanish language, which aspires to be globally recognised. English has long had its Cambridge-awarded assessments, French its DALF, German its Goethe-Zertifikat and now Spanish its Siele (International Service for Evaluation of the Spanish Language).

The Siele certificate brings together the varied forms of the language in use in different Spanish-speaking countries. It is available on five continents, but with a particular focus on Brazil, the US and China, where more than 15 million people are currently studying Spanish.

9. Spain's Image: Still out of Sync with Reality

For centuries the bull has been the supreme iconographic image of Spain, to the chagrin of many Spaniards desiring something more modern not associated with the 'national festival' of bullfighting. During the crisis, the international media excessively used the bull in creative metaphors to reflect Spain's situation. At the lowest point of the crisis when Spain looked as if it might have to be 'rescued' by the EU, *The Economist*, for instance, put on its cover a bull wounded by *banderillas* placed in pairs into the muscle on top of the bull's shoulders, and above it the word Spain with the S falling off so it read 'pain'. The same magazine illustrated an article on Spain's economic recovery in the summer of 2015 with a matador holding his cape and waiting to confront a bull. The Spanish press was also not immune to using the cliché of the bull. The daily *ABC* illustrated on its cover the sharp rise in Spain's risk premium (the difference between the yield on Germany's and Spain's 10-year government bonds) with a bull moving up a slope.[18]

With the economy firmly recovering since 2014 (and the 'bull' back on its feet), such stark images in the media were less prevalent, but Spain still struggles to rid itself of the noble beast (along with the siesta and flamenco) as the country's defining image. And attempts to do so were not helped by 15,848 *encierros populares* (the running of bulls through streets during local fiestas) in 2014, 2,000 more than in 2013.[19] When Prime Minister Mariano Rajoy visited China in 2014 and promised to shorten the time it takes to approve visas for Chinese tourists, the English-language *China Daily* illustrated this news item with a bull being fought by a 'flamenco dancer', which it seemed to confuse with a matador, or perhaps the strange combination was deliberate.

The economic recovery has enhanced Spain's reputation abroad, according to the 2015 Country RepTrak published by the Reputation Institute that classifies 55 countries. The study measures a country's perceptions exploring 16 attributes that include it being viewed as: a safe place to visit, a beautiful country, having friendly and welcoming residents, having progressive social and economic policies, being run by an effective government, and more. Spain moved up one place to 17th, ahead of France, with a score of 67.8 out of 100 compared with 64 in 2014 and 62 in 2013, its lowest score (see Figure 1.40).

Figure 1.40. 2015 Country Reptrak® Survey, Top 20

Country and rank	Score	Position vs. 2014
1. Canada	78.1	+1
2. Norway	77.1	+4
13. United Kingdom	69.5	+2
14. Italy	69.4	+2
15. Germany	69.0	-5
17. Spain	**67.8**	**+1**
20. Singapore	61.1	=

Source: Reputation Institute.

The improvement was clearly seen in the aspects most affected by the crisis. For example, the assessment of the economic environment improved by seven points. Spaniards, who have a worse perception of their own country than any other people, perverse though this may sound, also viewed their country more positively. The score they gave Spain increased from 53 to 63, narrowing the gap between the foreigners' and Spaniards' score from almost 11 points in 2014 to 4.8 in 2015. Spaniards' harsh view of their own country, which plummeted as of 2012, can be the result of ignorance of its strengths, which are generally better known abroad, though still not sufficiently, than at home (see Figure 1.41). Spain can hardly convince the world of its strengths if Spaniards are not convinced themselves.

Figure 1.41. Spain Today: Some Economic and Socioeconomic Realities

Global ranking	Description
Top 5	#1 international manager of transportation infrastructure
Top 5	#1 producer of olive oil
Top 5	#1 producer of sparkling wine (cava)
Top 5	#2 largest high-speed rail network after China
Top 5	#2 largest number of sites (44) in UNESCO's World Heritage List
Top 5	#3 largest tourist destination in terms of visitors
Top 5	#4 for studying a Master of Business Administration
Top 5	#4 largest producer of wind-generated power
Top 10	#7 longest life expectancy
Top 10	#7 in satellite manufacturing.
Top 10	#9 largest stock of inward foreign direct investment
Top 10	#10 largest stock of outward direct investment
Top 10	#10 best infrastructure
Top 15	#11 in the Elcano Global Presence Index (out of 80 countries)
Top 15	#9 largest producer of vehicles
Top 20	#16 largest economy in purchasing power parity terms
Top 25	#25 in the Democracy Index of the Economist Intelligence Unit (out of 165 independent states and two territories)
Top 30	#26 in the United Nations' Human Development Index (out of 187 countries)
Top 40	#37 least corrupt country out of 176 nations in Transparency International's ranking of perceived levels of public sector corruption

Note: the figures were the latest available in December 2015.
Source: The Lancet, IMF, Economist Intelligence Unit, UN Human Development Report 2015, World Investment Report 2015 (UNCTAD), ANFAC, the World Tourism Organisation, Transparency International, MBA City Monitor ESADE, Real Instituto Elcano, World Economic Forum and the Spanish Foreign Ministry.

Despite the improvement in the perception of Spain, the country's positive profile is still largely based on 'soft' attributes such as friendly and congenial people, lifestyle, the possibilities of leisure and entertainment than on 'hard' attributes like technology, recognised brands and economic environment. Flamenco, bullfighting and fiestas are fine to promote the tourism industry as it plays a vital role in the economy (generating around 11% of GDP and 12% of jobs). Close to 30% of Japanese respondents in a survey by the Elcano Royal Institute spontaneously associated the word 'Spain' with bulls and almost 20% with flamenco. This is not to say that Spain has a poor or a negative image, but rather one that is lopsided as it does not properly reflect nor is wholly concordant with the country's progress or is based disproportionately on stereotypes (which exist for all countries and are often beneficial). Spain needs a more 'serious' image in order to make the country known for other achievements and not just as a fun playground. An image that better reflects a country's reality enables it to attract more investments, better sell its goods and services abroad, access financial markets on more favourable terms (lower risk premium), attract more tourists and take a more active role in international decision-making forums.

Some countries have no image (Belgium and Paraguay, for example). Spain's image is one of the world's strongest and oldest, dating from the 16th century with the *conquistadores* who forged an empire in Latin America, the Armada that set sail for England and the negative stereotypes associated with the Inquisition of the all-pervasive Roman Catholic Church. The latter have led to the curious phenomenon of a self-perceived 'Black Legend', the conviction that there has historically been a concerted effort by Spain's enemies to denigrate it. Although essentially a late-19th and early-20th century phenomenon resulting from domestic squabbles between conservatives and progressives over the country's history, the belief that such a conspiracy exists has been remarkably resilient (helped in no uncertain way by the Franco regime's self-interested promotion of national paranoia) and, as suggested by the French historian Pierre Chaunu, is based on a 'double distortion', the 'reflection of a reflection': it is not so much what foreigners think about Spain but what Spaniards believe foreigners think about Spain.

The other and very different image of Spain originated in the 19th century and is a romantic one emanating from British, American and French travellers, known collectively as *los curiosos impertinentes*, who visited the country and wrote about it (see Figure 1.42). The 'exotic' primitive Spain was epitomised by the phrase coined by Alexandre Dumas (1802-70), 'Africa begins at the Pyrenees'.

Figure 1.42. Historic Stereotyped Images of Spain

18th Century	19th Century
Western, European	Verging on the oriental, exotic
Traditionalist	Anarchist, individualist
Intolerant, narrow minded	Very tolerant, open minded
Indolent, lazy	Hyperactive, energetic
Calculating, astute	Passionate, impulsive
Artificial, baroque	Natural
Mean	Generous
El Escorial[1]	Granada[1]
The gentleman, the inquisitor, the conqueror	The guerrilla, the bandit, Carmen[2]
Catholic	Pagan, non-believers
Very negative image …	Very positive image…
But we are like everyone else, civilised	But we are different, uncivilised

(1) El Escorial is the austere monastery near Madrid built by Philip II (1527-98). It has been called an expression in stone of Roman Catholicism in Spain. The floor plan of the building is in the form of a gridiron. The traditional belief is that the design was chosen in honour of St. Lawrence, who was martyred by being roasted to death on a grill. Granada, with its Alhambra, the residence of Muslim kings until the Christian reconquest of the city in 1492, epitomised the romantic image of Spain. (2) Carmen, a French opera by Georges Bizet premiered in 1875, is about a beautiful gypsy with a fiery temper who is responsible for the downfall of many men; it is still one of the most performed operas in the world.

Source: prepared by Emilio Lamo de Espinosa.

The forces representing the Imperial and Romantic images clashed in the 1936-39 Civil War (in the form of General Franco's Nationalists and the Republicans) and the image that emerged from the dictatorship established by Nationalists combined the self-perceived 'Black Legend' and the Romantic view. The transition to democracy, as of 1975, softened these two images, but they still persist and have not been wholly replaced by one that really reflects today's dynamic economy and society. Spain is still weighed down by her past. In 1996 the British economic historian David Ringrose published a major book in which he noted the following. 'In one generation economic modernization, democratization, and integration into Europe have abruptly transformed our perceptions of Spain. Dramatic as it seems, however, I suggest that this change is surprising, not because of Spain's actual history, but because of a longstanding historiographical tradition. That historiography is permeated with the assumption of failure – most versions of modern Spanish history assume (or assert) that Spain failed to attain one or another moral, religious, economic or political destiny. The nature of the failure depends on the ideology of the historian, but the assumption of her failure to live up to her potential is pervasive'.[20] Interestingly, the title of Ringrose's book in English is *Spain, Europe and the Spanish Miracle* while the version in Spanish is called *El Mito del Fracaso* (*The Myth of Failure*).

A study in 2015 by the Spain Image Observatory of the Elcano Royal Institute, based on surveys in the form of questions by the Reputation Institute in 55 countries, compared data on the reality of Spain to that corresponding to how it was perceived abroad. The results showed that in quite a few areas there was a significant gap between the image of something and the reality of it (see Figure 1.43). For example, Spain was placed 21st in the image (perception) ranking as a country in which it was recommended to invest in compared with 10th in reality on the basis of the stock of its inward foreign direct investment. The country's brands were also better recognised abroad than suggested by the image of them.

Figure 1.43. Image and Reality Rankings of Spain and the Distance between the Two

	A. Image abroad (1)	B. Reality	Distance A-B
Safe country	19th	4th (2)	+15
Recommendable to invest in	21st	10th (3)	+11
Developed infrastructure for business	25th	21st (4)	+4
Investment freedom	21st	10th (5)	+11
Attractiveness for foreign students	16th	13th (6)	+3
High quality universities	20th	12th (7)	+8
Recommendable to buy its products	19th	12th (8)	+7
Recommendable to attend events	18th	3rd (9)	+15
Recommendable to visit	11th	3rd (10)	+8
Recognised brands	17th	11th (11)	+6
Audiovisual production	10th	5th (12)	+5
Natural environment	13th	8th (13)	+5

(1) Perception rankings based on surveys by the Reputation Institute. (2) Violent deaths per 100,000 inhabitants, United Nations. If small countries with populations of less than three million are included, Spain is the safest country in the West. (3) UNCTAD, foreign direct investment. (4) World Fact Book, CIA. (5) Index of Economic Freedom. (6) UNESCO, number of foreign students. (7) Shanghai and Times Higher Education rankings. (8) UNCTAD, value of exports. (9) Figures of the International Congress and Convention Association. (10) Number of tourists, World Tourism Organisation. (11) Brand Directory, number of brands among the top 500. (12) Exports of audiovisual products, World Trade Organisation. (13) Number of UNESCO World Heritage sites.

These are areas where the public and private sectors need to concentrate their efforts in order for Spain to be viewed better abroad. In all of them, there is room to improve the perception as the reality is better than the image.

10. The *Marca España* (Spain Brand): Increasingly Recognised

In the increasingly globalised world, in which competition is getting tougher every year and price is not always the overriding factor, a brand, an intangible asset closely linked to a country's image and based on many elements including the reputation of its companies, is increasingly the way companies differentiate themselves and add value.

The previous Popular Party government (2011-15) fostered the *Marca España* more actively by creating the post of High Commissioner for *Marca España* within the Foreign Ministry and setting up a dedicated website (www.marcaespana.es/en). This followed the failed attempt of José Luis Rodríguez Zapatero, the Socialist Prime Minister from 2004 to 2011, to create a public diplomacy commission along the lines of other countries that successfully rebranded, such as the UK (with its Cool Britannia campaign) and Germany. One reason for the failure was that Spain needs to speak with one voice, a difficult task as some of its 17 autonomous regions pulled in different directions, most notably Catalonia in its push for independence. This created confusion abroad.

Spain was ranked 12th out of 50 countries in the Anholt-GfK Roper Nation Brands Index (NBI) in 2014, ahead of countries such as Belgium, Denmark and Norway (see Figure 1.44). The NBI is based on six elements –exports, governance, culture, people, tourism and immigration-investment– and is the only analytical ranking of the world's nation brands.

Figure 1.44. Ranking in the Anholt-GfK Roper Nation Brands IndexSM ®, 2014, Top 20

Country	Score	Country	Score
1. Germany	70.17	11. Netherlands	64.15
2. US	69.30	**12. Spain**	**63.73**
3. UK	68.53	13. Norway	62.55
4. France	68.39	14. Austria	62.37
5. Canada	67.58	15. New Zealand	62.16
6. Japan	66.68	16. Denmark	62.07
7. Italy	66.66	17. Scotland	61.81
8. Switzerland	66.53	18. Finland	61.11
9. Australia	66.07	19. Ireland	60.60
10. Sweden	65.56	20. Greece	58.73

Source: Anholt-GfK Roper Nation Brands IndexSM ®,

Spain's highest position was in the tourism ranking (5th). The branding strategy in tourism has been phenomenally successful. The first international campaign slogan, produced by the Franco regime in the 1960s, when mass tourism in Spain began, was 'Spain is different' (as the country certainly was at that time).[21] If there is a leitmotif running through Spain over the past 40 years it has been 'Spain is normal', but this has still not fully caught on in the outside world, even though a survey of Spain by the *Economist* magazine in 1999 concluded that Spain was now a 'fairly normal country'.

Very few countries are viewed as both 'cold' (efficient, rigorous and thus serious) and 'hot' (creative, passionate and hence not serious) or 'hard' and 'soft'. Germany and the UK are among the 'cold/hard' countries and Spain the 'hot/soft' ones. France, however, is successful both as a country for tourists (it receives more visitors than Spain) and as an exporter.

Chile was so determined to impress upon the world its 'coldness' (hence seriousness) and to distance itself from the 'hot' (in all senses of the word) countries of the rest of Latin America that it shipped a 60-tonne Antarctic iceberg to Seville and made it the centre piece of its pavilion at the six-month World's Fair (Expo) in 1992 in the Andalusian city. While environmentalists gave it an icy reception and protested that the Antarctic was already threatened enough without huge chunks of it being cut off and sent to one of Europe's hottest cities, the

iceberg left a deep impression on visitors to the Chilean pavilion –and perhaps changed their view, assuming they had one, of the country (which since then has become the most successful economy in Latin America)–.

Spain does not need to go to such lengths, even if it could. The efforts to make the Spain brand better known were beginning to bear fruit. The 2015 index of the strength of the *Marca España*, produced by the Mesias project (the Spanish acronym for *Marca España* for Applied Intelligence), which analyses the evolution of the Spain brand, showed it gaining ground.

Chapter 2
The New Mould of Politics

1. The Landmark 2015 Election

The general election on 20 December 2015 significantly changed the shape of Spanish politics, forged during the 1975-78 transition to democracy. Two upstart parties, the centrist Ciudadanos ('Citizens') and the anti-austerity Podemos ('We Can'), broke the hegemony of the conservative Popular Party (PP) and the centre-left Socialists, the two mainstream parties that have alternated in power since 1982.

But the results, which showed widespread support for change and consensual politics, failed to deliver an absolute majority for any of the parties and few coherent options to form a government. No agreement on a new government had been reached by early 2016. A fresh election looked inevitable if the parties were unable to bridge their considerable differences and form a stable and strong government which was what Spain needed and the markets required.

The PP won 123 of the 350 seats in parliament on close to 30% of the vote, way down on the absolute majority of 186 it obtained in the 2011 election (see Figure 2.1) and its lowest number (107) since 1989. The Socialists captured 90 seats, their worst performance since 1988 (118).

Figure 2.1. Results of General Elections, 2015 and 2011 (seats, millions of votes and % of votes)

	2015			2011		
	Seats	Votes	%	Seats	Votes	%
Popular Party	123	7.21	28.7	186	10.83	44.6
Socialists	90	5.53	22.0	110	6.97	28.7
Podemos (1)	69	5.18	20.6	–	–	–
Ciudadanos	40	3.50	13.9	–	–	–
Catalan Republican Left	9	0.59	2.4	3	0.25	1.0
Democracy and Freedom (2)	8	0.56	2.2	16	1.0	4.2
Basque Nationalist Party	6	0.30	1.2	5	0.32	1.3
Popular Unity (3)	2	0.92	3.7	11	1.68	6.9
EH Bildu (4)	2	0.21	0.9	7	0.33	1.37
Canarian Coalition	1	0.08	0.3	2	0.14	0.6

(1) The government upgraded growth to 3.3% in July 2015.
(2) In the 2011 election, the Catalan CiU alliance, which broke up in 2015.
(3) Ran as United Left in 2011.
(4) Amaiur in 2011.
Source: Interior Ministry.

The two parties were severely but far from mortally wounded: their combined share of the vote plummeted from 73.4% in 2011 (84% of the seats) to 50.7% (61% of the seats, see Figure 2.1). They held on to the Senate winning 171 of the 208 elected seats (58 are appointed by regional parliaments). The political establishment did not collapse as Greece's did in 2014/2015.

Figure 2.2. The Rise and Fall of Spain's Two-Party System in Municipal, General and European Elections, 1986-2015 (1)

	1986	1987	2003	2007	2008	2011	2014	2015
Municipal		54.5	69.1	70.5		65.3		52.0
General	70.1				83.8	73.4		50.7
Cleavage		63.8					49.1	

(1) Percentage of votes won by the Popular Party (Alianza Popular until 1989) and the Socialists.
Source: Interior Ministry.

Had Ciudadanos obtained as many seats as the opinion polls had predicted, it would probably have been the kingmaker and backed a minority PP government. But its 40 seats left the PP 13 seats short of the 'magic number' of 176. The combination of the Socialists and Podemos (159) was 17 short of an absolute majority, and was stymied by Podemos's apparent 'red line' of a referendum on Catalan independence, which was rejected by the Socialists. This coalition would also need the support of the Basque Nationalist Party and pro-independence Catalan parties.

The logical option was a German-style grand coalition between the PP and the Socialists, which would give the government a comfortable majority. But

the cleavage between left and right is particularly acute in Spain, going back to the country's 1936-39 civil war. Such a government could be seen as shoring up the creaking political establishment, which the new parties campaigned to regenerate. But this would not be the case if Ciudadanos were included in the coalition. Despite their differences, more unites these three parties than divides them: they oppose the independence of Catalonia (and a referendum on the issue), and to varying degrees support reforming the Constitution and the electoral law and believe in a free market economy.

Podemos and Ciudadanos channelled the anger at a long succession of corruption scandals and the economic and social impact of the recession. Spain experienced one of the steepest declines in confidence in national governments between 2007 and 2014, according to the OECD's Government at a Glance 2015 report. Confidence fell 27 percentage points to 21% compared to a decline in the OECD average from 45.2% to 41.8% (see Figure 2.3). Evidence shows that trust in government is negatively correlated with the perceived levels of corruption in government, the OECD noted. Misuse of public resources or inadequate behaviour by government representatives shape public opinion on the overall trustworthiness of government.

Figure 2.3. Confidence in National Governments in 2014 and its Change Since 2007

	% point change since 2007	% in 2014
Germany	+25	60
France	-10	26
Italy	+1	31
Spain	**-27**	**21**
UK	+6	42
OECD average	-3	42

Source: Government at a Glance 2015, OECD. Data collected by Gallup World Poll.

The most visible consequence of the disaffection with political elites was King Juan Carlos's abdication in June 2014. This was largely the result of two specific episodes: his elephant-hunting holiday in Botswana (April 2012) and the illicit activities of his son-in-law Iñaki Urdangarín, who was under investigation for alleged corruption of public officials and money laundering.[1] The abdication, which was performed impeccably, probably saved the monarchy, and his son Felipe VI enjoyed high approval ratings in 2015 (indeed far higher than those of any other public figure).

The growing irritation with the Popular Party and the Socialists came to a head in the May 2014 European elections when their combined vote was, for the first time, less than 50% of the total cast. That election saw the irruption of Podemos, which won 1.2 million votes (8% of the total) and five seats in the European

Parliament, stunning the political establishment and changing the mould of post-Franco politics. It should be noted, however, that European elections are highly unusual: the turnout, for instance, is much lower than in national elections (it was 43% in 2014 as against 73% in the 2015 general election).

Podemos and Ciudadanos were not the first new political actors who sought to end the domination at the national level of the traditional parties. Unión Progreso y Democracia (UPyD), founded in 2007, obtained five seats in parliament in the 2011 general election (4.7% of votes), but then became a spent force. In the 2015 election it was wiped out, winning no seats (0.6% of votes).

Podemos was born out of the grassroots movement of *los indignados* ('the indignant ones', also known as 15-M), which grabbed world headlines in May 2011 when thousands of mainly young people occupied the Puerta del Sol square in the heart of Madrid and set up camp for a month (and, incidentally, inspired the Occupy Wall Street movement). The movement took its name from *Sí, se puede*, the slogan of Spain's anti-eviction movement, though more generally associated with the US Democrats' 2008 campaign slogan. In the words of Pablo Iglesias, the pony-tailed 37-year-old leader of Podemos, the 15-M movement 'held up a mirror to the left, revealing its deficiencies' and 'put on the table the main components of a new common sense: rejection of the dominant political and economic elites, systematically signalled as corrupt.[2]' The party coined the expression '*la casta*' (the caste) to describe the political and business elite.

The most memorable slogan to come out of the 15-M movement was that shouted in front of Spain's parliament when protestors waved loaves of bread above their heads and screamed: 'There isn't enough bread for so many chorizos!'. A chorizo is a swindler or cheat and not just a spicy sausage, often sliced and served in a *bocadillo*.

Podemos began as a kind of offshoot of the United Socialist Party of Venezuela, founded by the late Hugo Chávez, the country's President for 11 years. In a U-turn following the leaders' realisation that many Podemos sympathisers viewed the party as far more radical than themselves, the party distanced itself from a country plagued by food shortages, the world's highest inflation rate and the regime's US-bashing ideology propagated by Chávez and his successor, Nicolás Maduro. Podemos presented itself as a Nordic-style social-democrat party, but it did not join with the other main Spanish political parties in signing a manifesto in support of democracy in Venezuela, in response to Maduro's diluting of the power of the opposition-led parliament after the government's 17-year grip on the legislature was broken in the 6 December 2015 election.

Spain's ideological self-placement scale have changed little over the last 20 years, rarely dropping below 4.5 where 5.0 is the centre (0 is extreme left and 10 extreme right). Given that much of Podemos' potential electorate consisted of civil servants and housewives, its move toward the centre was not entirely surprising.

Podemos's founders, Iglesias, Juan Carlos Monedero and Íñigo Errejón, lecturers at the faculty of political sciences (well known for its longstanding commitment to far-left ideology) at Madrid's Complutense University, served as advisers to the authoritarian Chávez regime, and received funding from it for their political project.[3]

Podemos rejected the traditional left-right axis of politics and engaged in transversal politics –trying to cross and possibly redraw borders that mark politicised differences–. In a phrase reminiscent of Karl Marx, Iglesias declaimed: 'Heaven is not taken by consensus, but by storm'. The party was on a roll until January 2015 when its support peaked at 28.2%, according to a Metroscopia voter-intention poll, ahead of both the Popular Party and the Socialists. Its rise from the political fringe paralleled that of Syriza, the leftist coalition that upset Greece's political establishment to win the country's parliamentary election in January 2015.

The more moderate and reformist Ciudadanos, which is situated between the Popular Party and the Socialists, also seized the political openings produced by the 2008 crisis and to some extent the irruption of Podemos. It started life in Catalonia in 2006 and won three seats in the region's parliament (25 in the snap 2015 Catalan election, making it the region's second largest). It was largely unknown in the rest of Spain and overshadowed by the media-savvy Podemos until it opposed the mock non-binding referendum on Catalan independence which took place in November 2014 in defiance of a ban by the Constitutional Court.

Ciudadanos then contested its first election outside its home region and presented candidates in the March 2015 election for the Andalusian parliament and won nine of the 109 seats on 9.3% of the vote. Podemos won 15 seats (14.9% of the vote). Despite winning fewer seats, Ciudadanos's results were positive as a party of Catalan origin is not a good sell in Andalusia, due to the tensions between the two regions resulting from the perception that the much richer Catalonia does not show sufficient 'solidarity' towards the much poorer Andalusia, and, moreover, was pushing for independence.

Ciudadanos followed this by running candidates throughout Spain in the May 2015 municipal and regional elections where it won 6.6% and 10% of the vote, respectively. Podemos captured 14% of the vote in the regional elections and instead of fielding candidates with the Podemos name in the local elections it teamed up with other leftist parties, residents' associations and social movements under a single candidature.

To a large extent, disaffection with the political establishment was accompanied by a demand for generational renewal: Albert Rivera, the Ciudadanos leader, was 36, Iglesias 37, while Pedro Sánchez, the Socialists' leader, was 43 (he replaced the 64-year-old Alfredo Pérez Rubalcaba in 2014) and the Popular Party's Mariano Rajoy was 60. The average age of the Popular Party's MPs was 51 and that of the Socialists 48, compared with 39 years for Podemos and 42 for Ciudadanos.

According to a survey by the Centre for Sociological Studies (CIS) before the election, Ciudadanos was the party least rejected by voters under the age of 24, while the PP had the largest share of votes of those over the age of 65. Close to two-thirds of voters aged between 25 and 34 (64.2%) said they would never vote for the PP and the same percentage of voters over the age of 65 said they would never vote for Podemos.

Spaniards do not want a break with the recent past, with what a Podemos ideologue called the 'regime of 1978' in reference to the transition and the democratic constitution of that year –which despite its defects engineered the best phase of Spain's history in terms of prosperity and peaceful co-existence–. In the distorted eyes of today's radicals (the grandchildren of those who lived through the transition), the consensus between the reformist right and the non-violent left that produced a smooth transition to democracy after the death of General Franco betrayed the Republican side that lost the 1936-39 Civil War, while the 1978 Constitution enabled the traditional powers to survive virtually untouched and King Juan Carlos to be little more than Franco's successor. Nevertheless, there is a sense of unfinished business.

What Spaniards want is for the political system to be reformed and to work fairly, without privileges and impunity and with an effective system of checks and balances. The political class became an extractive elite, to use the term popularised by Daron Acemoglu and James Robinson in their 2012 book *Why Nations Fail*. Spain's politicians were the main culprits of the real-estate bubble, the collapse of savings banks, the renewable-energy bubble and the infrastructure bubble. Not only did politicians become an extractive elite –defined as a system which allows, without creating new wealth, for the extraction of rent from a majority of the population for one's own benefit– but they turned themselves into a special interest group, like air traffic controllers, for example.[4]

Another problem was the general lack of business experience of politicians which would give them a better understanding of how the real world works; for instance, only 13 of the 54 ministers between 2004 and 2015 had done another job other than being a politician.

Spanish society as a whole was not more corrupt than other Western societies, although regular readers of the Spanish press could be forgiven for thinking corruption had reached African proportions. Graft was very rare among the police or judiciary, for example. Corruption among the political elites, however, was perceived as being fairly widespread, particularly in the interface between local politicians and construction companies. Spain's score in the Corruption Perceptions Index of the Berlin-based Transparency International dropped from 65 in 2012 to 60 in 2014 (the nearer to 100 the cleaner the country) when the country was ranked 37th out of 174 nations (see Figure 2.4). Spain, however, has a long way to fall before it reaches the position of Italy. Almost all companies in Spain, as well as in Greece and Italy, said corruption was widespread in their country, according to a Eurobarometer survey published in December 2015.

Figure 2.4. Corruption Perceptions Index (1)

Rank in 2014	2014 score	2013 score	2012 score	2011 score
1. Denmark	92	91	90	94
12. Germany	79	78	79	80
14. UK	78	76	74	78
17. US	74	73	73	71
26. France	69	71	71	70
37. Spain	**60**	**59**	**65**	**62**
69. Italy	43	43	42	39

(1) The nearer to 100 the cleaner the country.
Source: Transparency International.

This perception was borne out by a novel study by two US academics published in August 2015 by the *Journal of Comparative Economics*.[5] The authors found that Spain's billionaires owe 30% of their wealth to political connections, the highest level in Europe after Italy (see Figure 2.5).

Figure 2.5. How Much Wealth Comes from Political Connections (%)

	%
Colombia	84
India	66
Italy	41
Spain	**30**
Germany	6
France	4
US	1
UK	0

Source: Sutirtha Bagchi & Jan Svejnar.

Sutirtha Bagchi of Villanova University and Jan Svejnar of Columbia University found that when billionaires get their wealth because of political connections, that wealth inequality tends to drag on the broader economy. But when they obtain it through the market (ie, through business not related to the government) it does not. Wealth figures (a person's assets minus their debt as opposed to the much narrower definition of their income) are often hard to find so the researchers decided to use a well-known source –the *Forbes* magazine annual list of billionaires–. They added together the wealth of all these billionaires in a given country and then divided the total by a country's GDP, population or physical capital stock to normalise billionaire wealth for the country's size.

The researchers also used conservative criteria for classifying the billionaires as politically connected. Only when it was clear that their wealth was a product of government connections –as opposed to benefiting from a pro-business government– were they included in this group.

Spain was also ranked better than Italy, but far from Germany, France and the UK, in the 2015 World Justice Project Rule of Law Index which comprised eight categories including constraints on government powers and absence of corruption (see Figure 2.6.).

Figure 2.6. 2015 WJP Rule of Law Index, Global Rankings of Selected Countries

	Overall	CoGP	AoC	OG	FR	OS	RE	CJ	Cr.J
France	18	16	21	17	18	30	17	19	22
Germany	8	6	12	15	6	14	11	5	12
Italy	30	27	33	28	23	53	32	36	25
Spain	**24**	**26**	**25**	**26**	**19**	**33**	**26**	**24**	**26**
UK	12	11	15	8	14	19	12	13	11

(1) Out of 102 countries. CoGP, Constraints on government powers; AoC, absence of corruption; OG, open government; FR, fundamental rights; OS, order and security; RE, regulatory enforcement; CJ, civil justice; Cr.J, criminal justice.
Source: World Justice Project.

Another weak area was the relative lack of transparency in government. Spain was ranked 31st out of 97 countries in the 2014 Global Open Data Index, which measured and benchmarked the openness of data around the world, particularly open government data (see Figure 2.7).

Figure 2.7. Openness of Official Data, 2014 (%)

Ranking out of 97	Score (%)
1. UK	97
3. France	80
8. US	70
9. Germany	69
25. Italy	55
31. Spain	**52**

Source: Open Knowledge; Global Open Data Index.

It was not until December 2014 when a Transparency Law came into effect that Spain finally fell into line with the rest of the EU. The law –almost 40 years after the end of the Franco dictatorship– only operated at the state level until December 2015 when it was extended to municipal and regional levels, where most corruption occurs. Access to government information was still extremely difficult as a consequence of bureaucratic red tape and the rigid interpretation of exceptions and restrictions. Moreover, enforcement and appeal mechanisms (either to the administration itself, to the Ombudsman or to the courts) were largely ineffective.

In 2015 Spain was ranked 20th out of 19 EU countries and three EU institutions for the robustness of its lobbying transparency mechanisms, 20th for the inclusiveness of its public consultation mechanisms and the robustness of its advisory group composition rules and 11th for the robustness of its integrity mechanisms designed to promote ethical lobbying among lobbyists and decision-makers, according to a report by Transparency International.[6] Its overall score, based on an un-weighted average of results in the three sub-categories, was 21%, the fifth lowest but only slightly below Germany (see Figure 2.8).

Figure 2.8. How Strong are Safeguards against Undue Influence and Rules to Promote Ethical Lobbying in European Political Systems? (%) (1)

	Transparency	Integrity	Equality of access	Total score
France	24	30	27	27
Germany	13	25	30	23
Italy	11	27	22	20
Spain	**10**	**35**	**17**	**21**
UK	34	51	46	44
European Commission	48	49	63	53
European Parliament	45	46	21	37
Council of the EU	17	29	13	19
Average (2)	26	33	33	31

(1) The overall score is an un-weighted average of results in the three sub-categories. The overall score represents the strength of the overall system of regulatory safeguards against undue influence in lobbying and efforts to promote open and ethical lobbying.
(2) 19 countries and three EU institutions.
Source: Transparency International. Lobbying in Europe: Hidden Influence, Privileged Access, 2015.

2. The Need for Political Reform

The results of the December 2015 general election showed a widespread demand for political reform to regenerate the discredited system. The political class (including trade unions) colonised areas that are not the preserve of politics, such as the Constitutional Court, the Court of Auditors, the General Council of the Judiciary (the legal watchdog), savings banks and even, to a lesser extent, the Bank of Spain and the National Securities Market Commission. Not only did politicians invade new areas, but they abandoned their natural environment – parliament, one of whose functions is to demand accountability–.

Enchufismo (favouritism), *clientelismo* (patronage) and nepotism (the negative side of the otherwise admirable importance given to the family, and which has been the country's saviour) were, in varying degrees, rife. For example, Ramón Álvarez de Miranda, head of the Court of Auditors, had to explain himself to a parliamentary committee after it was discovered that around 100 of the 700 employees were related to the Court's current and former senior management and to its trade-union representatives, while José Luis Baltar, the Popular Party's head in the province of Ourense, was disqualified from public office for nine years (at a time when he had already retired) after he personally appointed 104 people to the Provincial Council (*Diputación Provincial*) which he headed for 25 years and managed to hand over to his son.

The Provincial Councils are a layer of administration that could be eliminated and their functions assumed by local and/or regional governments. The usefulness of the Senate, in its current form, is also widely questioned. Of its 266 members, 208 are elected by popular vote and 58 appointed by regional parliaments. It has limited powers (the Congress can override most Senate measures) and has become something of a retirement home for regional politicians. The Senate would serve a better purpose if it were converted into a body solely representing the regions (something which has been talked about for years), which would go hand in hand with advancing the federalisation of Spain. There are also too many municipalities –8,117, 6,802 of which have fewer than 5,000 inhabitants, compared with around 11,000 for Germany, whose population is 80% higher than Spain's–. The town halls, like the provincial councils, were the sources of most of the corruption. More than 800 municipal governments were under investigation.

The electoral system, designed to avoid the fragmentation of power (the end of the Franco dictatorship produced an alphabet soup of 70 political parties competing in the 1977 general election) and ensure political stability and governability, needed to be reformed. The D'Hondt method ensures that a national party that does not reach 25% of the vote is under-represented in

parliament, while regionalist parties are well if not over represented. The votes won in smaller, rural electoral districts were more valuable to parties than those won in urban areas. Both features emanated from Spain's turbulent history when parliament collapsed on several occasions due to the proliferation of smaller parties and regional tensions, and helped to explain the endurance of the two-party system until the 2015 election. Only the Popular Party obtained in the 2015 election more than 25% of the votes, while smaller nationwide parties, such as Popular Unity, were under-represented vis-à-vis nationalist parties in Catalonia, Galicia and the Basque Country. Popular Unity needed 461,319 votes to win a seat in parliament compared with 50,264 for the Basque Nationalist Party, 61,434 for the Socialists and 58,637 for the Popular Party.

It should be noted, however, that no electoral system is entirely fair: in the 2015 UK election, under the first-past-the post system, Ukip needed a staggering 3.8 million votes (13% of the vote) to win its one seat in parliament compared with 34,243 to elect a Conservative MP and 40,290 to elect a Labour MP. Had Spain's election been held under the UK's far more distorting system, the Popular Party would have won a thumping parliamentary majority.

As well as electoral reform, the way political parties operate needs to be more democratic. The closed as opposed to open list system in elections gives excessive power to a party's apparatus at the expense of accountability, and makes politicians sycophantic. Under this system, as opposed to the open list, people vote for the party, and not a particular candidate, and therefore the list as a whole. Candidates are elected in the order they appear on the list (as decided by the party) until all the seats are filled. Closed party lists parties stifle independent and minority opinion within the ranks. As all the power over who gets seats lies with the party machine, so too does the power to voice opinions. Closed party lists offer very little in the way of voter choice: all the power, save that of choosing a party for government, resides with the party. It would also be healthy for parties to hold primaries to elect their leader that are regulated by law and not by the parties themselves.

The system of known as *aforamiento*, under which Spain's more than 2,000 politicians can only be tried in the first instance by the Supreme Court or by the highest court in a region, rather than by a lower court, also needs to be reformed. In Germany, for instance, this system only applies to one politician: the President. The reasoning behind the system introduced by the 1978 Constitution was simple: it was meant to protect politicians from spurious attacks (Spain is a litigious society), while at the same time relieving lower courts from any potential pressure when dealing with high-profile figures. The system, however, is perceived to be unfair and privileged, particularly as Supreme Court judges are appointed by political parties which questions their impartiality.

The judiciary has become increasingly politicised, leading to what the distinguished lawyer Antonio Garrrigues calls a ‘politicisation of the judiciary and judicialisation of politics’. This deprives Spain of an effective system of checks and balances and leads to a considerable degree of impunity.

Principled political resignations are unknown. When Chris Huhne, the former British Energy Minister, resigned from the Cabinet and gave up his parliamentary seat, after he was accused and then found guilty of perverting the course of justice for asking his then wife to take three speeding points, Spaniards were amazed. Nothing remotely approaching that happens, and for far worse misdeeds.

The 20 members of the General Council of the Judiciary (CGPJ), the governing authority, are appointed by parliament and the Senate by a three-fifths supermajority vote, and with a tenure of five years. As a result, they are largely beholden to the parties that appointed them and to whom they feel they owe their allegiance. Similarly, the Constitutional Court consists of 12 members, four of whom are appointed by parliament on the basis of a supermajority of three-fifths of its members, and four by the Senate, requiring the same supermajority vote (following a selection process in which each of the 17 regional parliaments nominated two candidates). In addition, two members are directly appointed by the CGPJ. All 12 members have a tenure of nine years, with one third of the court’s membership renewed every three years in a highly politicised process. Lastly, the Supreme Court –the highest court for all issues except constitutional matters– has five different specialised chambers, and all its members (around 90) are appointed by the CGJP by a supermajority of three fifths.

Once appointed, the media quickly labels the members of these various bodies ‘conservative’ or ‘progressive’ depending on the party that pushed for their appointment. Government changes usually produced an ideological shift in the Constitutional Court and the CGPJ. Political allegiance could be reduced if not disappear altogether over time with the change of government by making life appointments, as occurs in the US for every Supreme Court Justice.

The legal system also functions at a snail’s pace, partly because of lack of resources and the opportunities for smart lawyers to drag out a court process. The system is still largely paper-based as it was in the 19th century; the computer systems in the 17 regional governments are mostly incompatible, making it impossible for a judge in one region to call up on his screen information from another region. A state lawyer tried to link up all the systems, but met so much resistance in regions zealous of their ‘independence’ that he gave up. In one of the most notorious cases, it took 10 years for Carlos Fabra, a prominent Popular

Party politician best known for the building of the ghost airport at Castellón, to come to trial on charges that included tax fraud. The backlog of cases was highlighted in the media with photos showing files piled up in court lavatories.

3. The Hot Topic of Catalan Independence

The government of Catalonia, a dynamic region (see Figure 2.9) with more inhabitants (7.4 million) than Denmark, Ireland, Finland and Luxembourg and a territory roughly the size of Switzerland, is locked in a struggle with the central government in Madrid to set up its own state and secede from Spain. Defusing the independence movement is one of the most complex challenges facing the country.

Figure 2.9. Catalonia at a Glance

	Catalonia
Population	7.4 million (16% of the total)
GDP	19%, making it Spain's economic powerhouse
Manufacturing	Around one quarter of the total
Exports	Close to 25% of the total
Tourism	The region attracts the largest number of tourists

Source: Government of Catalonia.

Tensions between Catalonia and the rest of Spain have existed for centuries. At the risk of oversimplification, a potted history of Catalonia goes something like this. The County of Barcelona and the Kingdom of Aragon to the east and south were brought together through a dynastic union in 1137. The two realms maintained their own institutions and laws and were ruled separately. The composite state was known as the Crown of Aragon. Catalonia was never a kingdom or an independent state. The *Generalitat* (government) of Catalonia was established in 1359, with a president and what is considered one of Europe's earliest parliaments. King Ferdinand of Aragon married Queen Isabella of Castile in 1469, uniting the two crowns. Catalonia retained considerable self-rule, with its own political institutions, courts and laws. A key event was the War of the Spanish Succession. After King Charles II 'the Bewitched' died childless in 1700, the crown passed to his chosen heir Philippe, Duke of Anjou, of the French House of Bourbon, who became Felipe V. Catalans, fearful of the consequences of a French king, plotted against Felipe and allied themselves with England, Holland and the Austrian empire, who opposed the Bourbon rule over Spain. Abandoned by its allies, following the 1713 Treaty of Utrecht (which ceded Gibraltar to Great Britain), Catalonia continued to fight but fell after the 14-month siege of Barcelona. The Decree of *Nueva Planta* abolished the *Generalitat* and

ended self-rule. The Catalan language was also discouraged. In 1931, Francesc Macià proclaimed a Republic of Catalonia, which was short-lived but led to the return of the *Generalitat* as a concession from Madrid. After the 1936-39 Civil War, the victorious General Franco had Lluís Companys, President of the Catalan government, executed in 1940. He was arrested in France by the Gestapo and extradited to Spain. Over the next 35 years, Catalan identity and language were severely repressed, and all political institutions abolished. Following Franco's death in 1975 and the transition to democracy, the *Generalitat* was re-established and varying degrees of autonomy were also granted for the rest of Spain's regions in a process known as '*café para todos*' (coffee for all).

Nationalists have twisted Catalonia's history into a narrative of *victimismo* (persecution), fomented by the *Generalitat* and its allies in a top-down movement to *catalanise* society through education, linguistic immersion and even sports policies that are perceived by unionists as anti-Spanish. This distorted view of history ignores among other things the significant influence of the Catalan bourgeoisie on the main lines of Spanish economic policy. On the language front, all classes in schools are taught in Catalan (Spanish is taught as a separate subject). The Catalan government opposed the Supreme Court ruling that those parents who wanted their children to be taught in Castilian have that right, as it is the common language of Spain, and postponed its implementation through legal manoeuvres. The Court ordered that 25% of instruction should be given in Spanish when the student or parents asked. It should be noted, however, that very few parents demanded this right; unionist politicians, particularly the Popular Party and Ciudadanos, said parents were scared of asking for tuition in Spanish.[7]

Tensions with Madrid came to a head in 2010 when the Constitutional Court struck down some of the articles of the region's new self-government charter including recognition of Catalan as the 'preferred language' after the Popular Party referred it to the court. Three-quarters of Catalan voters had approved the charter in a referendum, following its approval by the Catalan and national parliaments, against 21% who rejected it. The abstention rate, however, was high at 51%. Ernest Benach, the President of the Catalan parliament, claimed the court's ruling opened a 'crisis of state' because it 'ignores the will of Catalan citizens'.

The court's verdict marked a turning point as it convinced nationalists, including Jordi Pujol, President of the region's government from 1980 to 2003 and the preeminent nationalist leader, that Catalonia no longer belonged inside Spain. Pujol became a discredited figure after he admitted publicly in 2014 that he had offshore bank accounts with a considerable amount of money in Andorra, which he claimed was left to him by his father. He was stripped of his honorary privileges. Pujol and his wife Marta Ferrusola were subpoenaed to testify before a court in February 2016 in connection with a probe into money-laundering. They denied

that the money came from corrupt activities during his 23 years as Catalonia's regional Prime Minister. Several of their children were also under investigation.

Spain's economic crisis intensified the push for independence and led to an illegal non-binding referendum in November 2014 after the Spanish parliament rejected the Catalan parliament's request (299 votes to 47) and in defiance of the Constitutional Court. Catalan nationalists blamed the central government for the region's severe spending cuts, and demanded a new fiscal pact as they were aggrieved at transferring under the regional financing system of 'solidarity' what they regarded as a disproportionate share of their wealth to Madrid for distribution to the poorer regions. Pro-independence economists say Catalonia would claw back the equivalent of 8% of its GDP if it did not have to hand over its taxes to the national government.

The prevalence of toll roads in Catalonia also fuelled a sense of grievance among Catalans, who say this shows the national government has failed to invest enough in the region's infrastructure. Toll roads account for more than half the length of national highways running through Catalonia, more than twice the national average. The *Generalitat* oversees some toll roads, and most of the payments go to the Catalan company, Abertis.

Of the 2.3 million people who voted in the mock referendum (out of 6.3 million who were eligible), more than 80% were in favour of independence (29% of the possible votes). Artur Mas, the President of Catalonia and leader of the centre-right Convergence and Union (CiU) alliance, hailed the result as a victory and opponents said it was a failure. Mas followed this with a snap election in September 2015 billed as a *de facto* vote on secession which was won by a pro-independence movement called *Junts pel Sí* (Together for Yes), an unholy alliance between Mas's Democratic Convergence party (the more moderate and smaller Democratic Union of Josep Antoni Durán i Lleida, the other party in the CiU, had by then broken away in a disagreement over independence), the much more radical Republican Left of Catalonia (ERC) and grass-roots separatists. *Junts pel Sí* won 62 of the 135 seats in the Catalan parliament which, together with the 10 seats of the far left, anti-capitalist Popular Unity Candidacy (CUP), gave the pro-independence camp (an even more unholy alliance) 72 seats and 48% of the vote against 52% for parties opposed to independence.

Junts pel Sí claimed the results of the September election gave the pro-independence bloc the authority break away from Spain[8]. Less than half of the votes was far from a clear mandate, as defined by constitutional experts. The Catalan parliament adopted a resolution calling for the creation of a breakaway republic over the course of 18 months and declared that decisions taken by the Spanish state –including rulings by the Constitutional Court– were no longer valid within the region. The Court quickly struck down the resolution.

The bloc subsequently fractured: CUP repeatedly refused over the course of three months to back the incumbent Mas ahead of the deadline to form a new government. CUP viewed Mas as too business-friendly, and he was also damaged by a string of corruption scandals, particularly that of Pujol (Mas was his political heir). In a last minute deal to avert fresh regional elections in March 2016 (which would have been the fourth in five years), Mas stepped down on 9 January in favour of Carles Puigdemont, the Convergence mayor of Girona and an ardent defender of secession from Spain.

The Spanish constitution gives the central government 'exclusive competence' on the authorisation of referendums; it is highly unlikely that one will be granted, whatever the political colour of the government. Allowing a referendum would run the risk of opening a Pandora's Box of competing demands for plebiscites in other regions, most notably the Basque Country, which along with Galicia is the other 'historic' region of nationalism, and would not go down well in the European Commission which does not want a fragmented EU. The only way to trigger a process that resulted in the independence of any region is through a constitutional amendment, which requires a large majority in the Spanish parliament, new elections and approval in a referendum held throughout the country.

Opinion polls showed that a significant proportion of Catalans –more than those in favour of the options of independence or maintaining the current situation– favoured a so-called 'third way' under which Catalonia would remain part of Spain, but with new powers and special treatment in recognition of the region's 'unique' status (the so-called *hecho diferencial*). This possibility could be offered by modifying the regional government architecture as part of an overhaul of the Spanish Constitution which would then be put to a referendum in the whole of Spain, and if approved in Catalonia could be taken to mean that the region rejects independence. Only Podemos, among the four main parties, is in favour of a referendum on Catalan secession.

Dire warnings of the economic consequences of independence by business and bank leaders as Catalonia would no longer form part of the euro zone, the EU and of international institutions fell on deaf ears in the independence camp, but as time passes could well be taken more seriously as the impact sinks in, particularly among those who do not form the hard core of secessionists (estimated at 25% of Catalans). Luis Linde, the Governor of the Bank of Spain, warned that without the backing of the European Central Bank, capital controls on Catalan bank deposits could follow, while some Catalan companies began to re-locate outside the region.

Support for independence was strongest among young Catalans, according to a 2015 poll by the Catalan CEO institute. Asked whether they wanted the region to be independent, 50% of the total respondents said No and 43% said Yes. Of those aged 65 and above, close to 60% said they were against independence and 34% in favour. Among Catalans aged 18 to 24, 56% supported independence and 39% were against it. One factor behind the greater support among the young for independence is the Catalan education system, where instruction is given mainly in Catalan and which teaches an idiosyncratic version of Spanish and Catalan history, according to some notable historians. Also, young adults have less to lose than their parents or grandparents, many of whom moved to Catalonia from other regions and are more identified with Spain.

The previous Popular Party government challenged the independence movement at every step. Mas was called to court for his role in staging the mock referendum and accused of disobedience, abuse of power and embezzlement of public funds. The Constitution has two articles that could be wielded *in extremis*: Article 116 allows the national government to declare states of alarm, emergency and siege in a disobedient region and Article 155 to take coercive measures, following approval by an absolute majority in the Senate.

The Catalan problem is to some extent a story of shared political failure, with most of the responsibility falling on the Catalan government, and needs to be resolved politically and not through coercion. There is too much common history between Catalonia and the rest of Spain to establish a frontier between the two.

Chapter 3

The Economy: From Bust to 'Poster Boy'

Spain emerged from an unprecedented, extended double-dip recession during which the economy shrank 8.6% between 2008 and 2013, but output in 2015 was still below the pre-crisis level and the unemployment rate was more than 20%.

Reducing a massive budget deficit, restructuring the ailing banking sector, part of which was rescued by Spain's euro-zone partners, and structural reforms ushered in a new economic cycle of annual GDP growth forecast at around 3% until 2018, outpacing most of the country's euro-zone partners (see Figure 3.1).

Figure 3.1 Updated Stability Programme, 2015-18

	2014	2015	2016	2017	2018
GDP growth (%)	1.4	2.9	2.9 (1)	3.0	3.0
Unemployment rate (%)	24.4	22.1	19.8	17.7	15.6
Current account balance (% of GDP)	1.0	1.7	1.8	1.6	1.4
Budget deficit (% of GDP)	-5.7	-4.2	-2.8	-1.4	-0.3
Gross public debt (% of GDP)	97.7	98.9	98.5	96.5	93.2

(1) The government upgraded growth to 3.3% in July 2015.
Source: update by the Economy Ministry in April 2015 of the government's 2015-18 Stability Programme.

The recovery won Spain an upgrade from the rating agency Standard & Poor's (S&P), which lifted it in October 2015 to BBB+ from BBB and forecast a sustained economic expansion that would help improve the budget position (see Figure 3.2)

Figure 3.2. Ratings of Sovereign Debt (Long-Term Bonds) (1)

	Moody's	S&P	Fitch
France	Aa1	AA	AA
Germany	Aaa	AAA	AAA
Greece	Caa3	CCC+	CCC
Italy	Baa2	BBB-	BBB+
Spain	**Baa2**	**BBB+**	**BBB+**
US	Aaa	AA+	AAA

(1) Aaa/AAA: minimum risk; Aa/AA: very low risk; A/A: low risk; Baa/BBB moderate risk; B/B: high risk; Caa/CCC: very high risk. As of October 2015.
Source: rating agencies.

The pace of expansion began to accelerate as of 2014, the first full year of positive growth since 2009. The International Monetary Fund was particularly slow in recognising Spain's upturn and upgraded its growth forecasts for the country numerous times. 'One can compare the speed of our recovery only to the speed of our decline before', boasted Mariano Rajoy, the Popular Party Prime Minister between 2011 and 2015. 'Spain has passed from being a country on the brink of bankruptcy to a model of recovery that provides an example to other countries in the EU'. Domestic demand (consumption and investment), however, was still well below the pre-crisis peak.

The reforms and increasingly positive GDP growth forecasts produced a virtuous circle of a recovery in confidence in the economy and a degree of normalisation of financing conditions for households and companies. As a result of the quickening pace of growth (from a low base), euro-zone governments such as the fiscally-conservative Germany and international lenders hailed Spain as a poster child –cited as 'proof' that austerity and structural reforms work– in stark contrast to 'failed state' Greece which verged from orthodox measures. The German Chancellor, Angela Merkel, hailed Rajoy as 'the prime minister of one million jobs' at the European People's Party congress in Madrid in October 2015.

International factors played a significant part in Spain's upswing. The European Central Bank's low interest rates, the normalisation of the perception of risk in the Spanish economy, lower oil prices for a country heavily dependent on imported energy and the decline in the value of the euro, which spurred exports, helped put the economy back on its feet. The risk premium –the difference between the yield on benchmark 10-year German government bonds and that on Spain's equivalent bonds– came down from a peak of 650 basis points in 2012 to around 120 in December 2015. The 10-year Spanish yield reached 7.7% in July 2012, a level that triggered sovereign bailouts for Greece, Portugal and Ireland, and had fallen to around 1.80% in December 2015.

External demand played an important role in pulling Spain out of recession –exports rose by €80 billion between 2009 and 2014– and for a time it was the main net contributor to growth (see Chapter 5). The jump in exports and buoyant tourism helped turn a current-account deficit of 9.6% of GDP in 2007 into a surplus of 1.4% in 2013 and smaller surpluses in 2014 and 2015. The surplus in 2013 was the first since the current statistical series began in 1990. Despite the turnaround, the negative net international investment position (NIIP) was the highest among euro countries after Cyprus and Portugal (ie, Spain's foreign liabilities exceeded its foreign assets). It stood at 91% of GDP in June 2015, compared with a positive position for Germany of 42.3% (in 2014) and a much lower negative position for France (19.5%) and Italy (27.9%).

This was a cause of concern as it made Spain vulnerable to shocks or shifts in market confidence, but mitigated to some extent by the favourable maturity structure of Spanish liabilities, the low cost of debt and the geographical diversification of external assets and liabilities.

The origin of the high negative NIIP lay in the convergence of interest rates as a result of the creation of the euro zone, which supported persistently high current account deficits. According to the European Commission, even under relatively benign growth and inflation scenarios, Spain would still need to achieve a record current account surplus of 1.7 % of GDP on average over the 2014-24 period in order to halve its NIIP-to-GDP ratio by 2024.

Domestic demand began to rebound as of 2014 (see Figure 3.3), as evidenced by the pick-up in the housing market, the construction sector, private consumption and imports, making the recovery more broad-based.

Figure 3.3. Contribution of Domestic and External Demand to GDP Growth (% points)

	1995-2010	2011	2012	2013	2014	2015 (1)	2016 (1)
Domestic demand	3.1	-3.1	-4.7	-3.1	1.6	3.4	2.9
External demand	-0.3	2.1	2.1	1.4	-0.2	-0.2	-0.2

(1) Forecasts.
Source: INE and Afi.

Cutting the budget deficit, which was 10.3% of GDP in 2012 including the aid to banks, was the government's main priority. This involved a combination of spending cuts and direct and indirect tax increases to boost revenues. In 2014, for the first time since 2008, Spain met the deficit target agreed with the European Commission. It came in at 5.7% of GDP, slightly below the target of 5.8%, though most of the regional governments exceeded the goals set and the deficit was the biggest in the EU after tiny Cyprus (see Figure 3.4).

Figure 3.4. Public Deficit Targets by Type of Administration (% of GDP)

	2013	2014	2015	2016	2017	2018
Central government	-4.2	-3.5	-2.9	-2.2	-1.1	-0.2
Autonomous communities	-1.5	-1.7	-0.7	-0.3	-0.1	0.0
Local governments	0.5	0.5	0.0	0.0	0.0	0.0
Social Security	-1.1	-1.1	-0.6	-0.3	-0.2	-0.1
Total public administrations	-6.3	-5.7	-4.2	-2.8	-1.4	-0.3
Bank restructuring cost	-0.5	-0.1	0.0	0.0	0.0	0.0
Total (with banking)	-6.8	-5.8	-4.2	-2.8	-1.4	-0.3

Source: La Caixa Research Department and Finance Ministry.

The main reason why Spain struggled to cut its deficit was not especially due to uncontrolled spending, which in GDP terms was below the EU average,

but because of insufficient revenues (see Figure 3.5). Government revenue was 36% of GDP in 2011, eight percentage points less than the EU average, while the tax burden peaked at 36.5% of GDP in 2007, at the height of the boom, and plummeted to 29.8% in 2009, since when it has recovered (see Figure 3.6)

Figure 3.5. Spanish Government Revenue, Spending, Budget Deficit and Public Debt, 2011-14 (% of GDP)

	2011	2012	2013	2014
Spain				
Revenue	36.0	37.0	37.5	37.8
Spending	45.4	47.3	44.3	43.5
Deficit	-9.4 (1)	-10.3 (1)	-6.8 (1)	-5.7 (1)
Debt	69.2	84.4	92.1	97.7
EU-28				
Revenue	44.0	44.7	45.4	45.2
Spending	48.5	49.0	48.6	48.1
Deficit	-4.5	-4.2	-3.2	-2.9
Debt	80.9	83.7	85.5	86.8

(1) Including financial aid of 0.48 percentage points of GDP in 2011, 3.3 in 2012, 0.18 in 2013 and 0.11 in 2014.
Source: Eurostat.

Figure 3.6. Total Tax Revenue, 1975-2014 (% of GDP)

	1975	1985	1995	2000	2009	2014 (1)
France	34.9	41.9	41.9	43.1	41.3	45.2
Germany (2)	34.3	36.1	36.2	36.2	36.1	36.1
Italy	24.5	32.5	38.6	40.6	42.1	43.6
Spain	**18.0**	**26.8**	**31.3**	**33.4**	**29.8**	**33.2**
UK	34.2	35.1	31.9	34.7	32.3	32.6
OECD total	28.6	31.5	33.6	34.2	32.7	34.4

(1) Provisional.
(2) Unified Germany as of 1991.
Source: Revenue Statistics, OECD.

Tax rates are not lower in Spain than in most other countries; what is different is that the system is like a Gruyère cheese, as it is full of holes due to a plethora of exemptions, deductions and reduced special tax rates. The effective personal income tax rate in 2014 (after taking into account the money returned to taxpayers) was 16.7%. The standard VAT rate in Spain of 21% in 2015 was higher than the OECD average of 19.2%.

The VAT gap in 2013 (latest figure) was estimated at €12,094 million (€11,610 million in 2012), due to fraud, evasion, tax avoidance bankruptcies and financial insolvencies, as well as miscalculations, according to the latest report prepared for the European Commission by Poland's Centre for Social and Economic

Research (CASE).[1] The gap accounted for 16.5% of the total VAT liability of €73,444 million, higher than Germany's 11.2% but well below Italy's 33.6% (see Figure 3.7).

Figure 3.7. VAT Gap Estimates (€ mn and % of total VAT liability)

	VAT gap	% of total VAT liability
France	14,096	8.9
Germany	24,873	11.2
Italy	47,516	33.6
Spain	**12,094**	**16.5**
UK	15,431	9.8

Source: Eurostat (revenues) and calculations of CASE.

The Popular Party government (2011-15), however, had some success in combating tax fraud: it collected more than €40 billion between 2012 and June 2015 as a result of various measures including the introduction of the *Modelo* 720 form for declaring assets held abroad. Taxpayers reported total assets of €126.5 billion, of which €7.3 billion was in bank accounts in tax havens, according to Santiago Menéndez, the head of the Tax Agency (AEAT).

In a policy of name and shame, the Tax Agency published in December 2015 a list of individuals and companies who owed more than €1 million. The 15 largest company debtors were mainly construction firms. One of them, Reyal Urbis, owed €378.2 million. Among the 4,855 individual debtors was Mario Conde, the former Chairman of Banesto (1987-93), imprisoned for embezzlement and document forgery. He owed €9.9 million. The total amount owing was €15.6 billion.

AEAT has limited resources to combat tax fraud compared with other EU countries (see Figure 3.8).[2] In 2013, Spain had around the same number of tax employees in 2013 (27,000) as the Netherlands (28,000), a much smaller country.[3] While Belgium had 22 tax staff per 10,000 inhabitants, France 17.5 and the UK 11.7, Spain had only 5.8. The AEAT was hit by budget cuts: 980 employees left or retired from the AEAT in 2013 and only 383 were recruited. Close to 50% of tax employees were between the age of 50 and 59, compared with 33% in Germany and 42% in France.

Figure 3.8. Resources Dedicated to Fighting Tax Fraud

	Spain	France	Netherlands	Germany
Spending on combating tax fraud (€ mn)	**1,387**	4,513	1,984	7,360
Shadow economy (% of GDP)	**19.2**	10.8	9.3	12.9
Average number of inhabitants inspected by each tax agency employee	**1,958**	942	722	720

Source: Francisco de la Torre (2014), *¿Hacienda somos todos?*, Debate, with 2011 figures, and Friedrich Schneider for the shadow economy figures (2012).

The high level of computerisation in the Spanish tax system, however, went some way towards mitigating the impact of fewer employees. According to the World Bank's Doing Business report, Spain was among the countries that made the greatest advances in tax payment systems in 2014/15. The objective was to streamline and simplify tax compliance and reduce the effective tax burden on businesses. The new system, known as Cl@ve, an integrated online platform for the entire public administration sector, made accessing electronic services easier.

A Budgetary Stability and Financial Stability Law came into force in May 2012 in a bid to strengthen fiscal discipline across all levels of government.[4] It set three types of restrictions on general government conduct: they may not run a budget deficit in structural terms; public spending growth shall, at most, be that of the economy's nominal potential growth; and the public debt/GDP ratio may not exceed 60%. The law also introduced early warning and corrective mechanisms and sanctions in the event of non-compliance with fiscal targets. This followed the constitutional reform agreed in September 2011 between the then Socialist government and the Popular Party to change Article 135, which established the obligation of a balanced budget and required the state to give public debt payments priority over any other expenditure.

The new law stipulated a transition period running from its entry into force until 2020, the first year in which the structural deficit and public debt caps would be applicable. During that period, the reduction in the structural deficit shall be at least 0.8% of GDP in annual average terms (with the distribution between state and regional governments based on the structural deficit percentages recorded as at 1 January 2012). The public debt ratio shall be reduced at the rate necessary to place it below 60% in 2020. These limits would not be applicable in exceptional situations.

Had an expenditure rule been introduced during Spain's economic boom and before the onset of the crisis in 2008, along the lines of the European Commission's 2011 reforms (known as 'six pack'), Spain's public sector accounts would have been in much healthier shape (see Figure 3.9).[5]

Figure 3.9. Impact of Expenditure Rule on the Budget Balance (% of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007
Actual balance	-1.0	-0.7	-0.5	-0.2	-0.4	1.0	2.0	1.9
With rule in place	0.9	1.4	2.0	3.1	3.8	5.2	6.9	8.0

Source: Bank of Spain.

The most problematic link in the chain of public administrations are the 17 regional governments that control more than a third of public spending and are a big part of the country's financial problems. Like the regional savings banks, they were hard hit by the bursting of the massive property bubble. Their coffers were swelled during the boom by stamp duties on property sales, income tax paid by immigrants working on building sites and other taxes, and depleted when revenues collapsed. Regional governments' spending commitments, however, on health, education and social services, for which they are responsible as a result of decentralisation, remained, and some of them spent wildly on big infrastructure projects. The regional governments' collective budget deficit was 3.8% of GDP in 2011, more than one-third of the 8.9% total deficit (excluding financial aid) and well above the 1.3% target set for the regions by the central government.

Spain is one of the most highly decentralised countries in Europe, as more than 40% of taxes are ceded to or received by regional and local governments, the highest level of EU countries and well above the 10% average.[6] The regional finance system is asymmetrical: the *foral* system and the common system. The former was applied only to the Basque Country and Navarra and the latter to the other 15 regions. The *foral* system, which dates back to mediaeval times and in its current form to bilateral agreements established in 1978, provides significant tax autonomy. Under it these two regions are responsible for the design, administration, collection and inspection of all taxes accrued in their territory except for customs tariffs. They do not share any revenues with other regions or the central government, and only have to transfer back to Madrid the share of the central government budget associated with spending responsibilities that have not been devolved (mainly social security, national security and foreign relations). This amount, known as the *cupo* (Basque Country) or *aportación* (Navarra), is set by a formula that takes into account the region's economic size.

The common system dates back to 1980 and gives the other 15 regions less tax autonomy than the *foral* system. Since 1997, reforms have gradually increased regions' discretion over ceded taxes, allowing them to set tax rates and establish tax credit and allowances. These regions finance their own spending through a combination of own revenues, shared revenues and intergovernmental transfers. The regulatory power of these regions extends to just over half of the revenues, giving them a degree of tax autonomy comparable to that of Australia and Germany (see Figure 3.10).

Figure 3.10. Regulatory Power of Regional Governments over Devolved Taxes

Tax	Revenue (% shared)	Regulatory power
Wealth	100	Schedules, minimum income limits, deductions & credits
Estate & gift	100	Schedules, deductions and credit & management
Property transfers, legal acts (1)	100	Schedules, deductions and credit & management
Gambling	100	Exemptions, base, rate, charges, credit & accrual
Vehicle registration	100	Rates
Electricity	100	No power
Hydrocarbons	58	Rate of region share
Excises (2)	58	No power
Personal income tax	50	No power

(1) Includes real estate administrative concessions, personal property, notary public and documents. (2) Includes alcoholic beverages, tobacco and other intermediate manufacturing products.
Source: Tax reform expert committee, 2014.

The government also introduced regional liquidity mechanisms (RLMs) in 2012 to help fiscally-stressed regions during the crisis.[7] The RLMs included a fund to enable regions to pay for outstanding debt with private suppliers (known by its acronym as FFPP) and the regional liquidity fund (FLA). The FFPP and the FLA are financed by Treasury bonds under the central government financing programme. The regions benefiting from the FLA are subject to fiscal conditionality implemented through an adjustment programme. Regions participating in RLMs are also subject to financial prudence rules, under which all non-RLM loans are subject to prior approval by the Treasury and the Finance Ministry. The total amount of liquidity provided by the state to the regions between 2012 and 2015 was €179.9 billion, €52.9 billion (30%) of which went to Catalonia.

Budget execution became much more transparent as of May 2013 when the Ministry of Finance began to publish data for regions and social security on a monthly and national accounts basis. The law also provided for a suppliers' payment scheme enabling regional governments to pay commercial arrears. An independent authority for fiscal responsibility (AIReF), along the lines of the UK's Office for Budget Responsibility, was also established to provide analysis, advice and monitor fiscal policy. The body was much needed and required more funds in order to exercise all its functions: for example, in 2015 it only had one person to assess Spain's 8,122 municipalities.

The AIReF broadly endorsed the forecasts of the 2015-18 Stability Programme, although it viewed the target of cutting the budget deficit by 5.4 percentage points of GDP between 2014 and 2018 (from 5.7% to 0.3%) as ambitious. It said success would depend on rolling out a stringent policy, particularly for containing expenditure against a backdrop of cyclical economic recovery.

Spain, however, had a precedent: the tough fiscal adjustment between 1995 and 1999 when Spain needed to get itself in shape in order to be a founder member of the euro was similar to the latest adjustment (see Figure 3.11).

Figure 3.11. Comparison of Fiscal Consolidation in 1995-99 and 2014-18 (% of GDP)

	1995-99	2014-18
1. Budget deficit adjustment (1 = 2 + 5 + 6 + 7)	-5.7	-5.4
2. Cyclical component of revenue and expenditure (2 = 3 + 4)	-2.6	-1.9
3. Revenue	-1.3	-0.4
4. Spending on social benefits	-1.3	-1.6
5. Debt servicing	-1.5	-0.8
6. Investment expenditure	-1.2	-0.3
7. Government consumption and other expenditure (7 = 8 + 9 + 10 +11)	0.3	-2.5
8. Compensation per employee	-0.7	-1.3
9. Intermediate consumption	-0.3	-0.7
10. Social benefit payments in kind	0.2	-0.3
11. Other spending	0.5	-0.3
Memorandum items		
Real GDP growth (annual average)	3.7	3.0
Nominal GDP growth (annual average)	6.7	4.0
Change in output gap (cumulative)	4.4	8.0

Source: AIReF.

Despite the strengthening of budgetary practices at the regional level, regions’ fiscal non-compliance remained significant. The total regional government deficit target was systematically missed every year between 2010 and 2014 because so many regions missed their individual targets, and it looked as if the 2015 target would also not be met (see Figure 3.12). The European Commission forecast an overall general government budget deficit of 4.7% of GDP in 2015, above the target of 4.2% and still among the highest in the euro zone.

Figure 3.12. Deviations of Regions from Fiscal Targets, 2010-14 (% of regional GDP)

	2010	2011	2012	2013	2014
Andalucía	-0.7	-2.2	-0.6	0.1	-0.2
Aragon	-0.6	-1.3	0.0	-0.9	-0.7
Asturias	-0.3	-2.3	0.5	0.0	-0.3
Balearic Islands	-1.6	-2.9	-0.3	0.3	-0.7
Basque Country	0.0	-1.3	0.0	0.1	0.0
Canary Islands	0.1	-0.2	0.4	0.2	0.1
Cantabria	-0.5	-2.2	0.0	-0.1	-0.5
Castilla-La Mancha	-3.9	-7.1	-0.1	-0.8	-0.8
Castilla and León	0.1	-1.3	0.1	0.1	-0.1
Catalonia	-1.8	-3.3	-0.7	-0.4	-1.6
Extremadura	0.0	-3.4	0.5	0.1	-1.4
Galicia	0.0	-0.3	0.2	0.1	0.0
Madrid	0.0	-1.2	0.4	0.1	-0.3
Murcia	-2.5	-3.2	-1.6	-1.5	-1.7
Navarra	-0.6	-0.7	-0.2	-0.2	0.3
La Rioja	-0.7	-0.7	0.3	0.0	-0.2
Valencia	-1.2	-3.7	-2.2	-0.6	-1.4

Note: Negative/positive numbers indicate under (over)-compliance.
Source: IMF staff estimates.

Some of the new regional governments, which resulted from the May 2015 elections when the Popular Party lost its majority in several regional parliaments, such as Valencia, said they had found finances to be in such a sorry state that they would not be able to meet the deficit targets set by the central government.

The Council of the EU imposed on Spain a fine of €18.9 million in July 2015 for the concealment by the regional government of Valencia of part of its health spending between 1988 and 2011. The European Commission found serious negligence in the regional audit office, which led to incorrect reporting by Spain of its general government data in March 2012 to Eurostat. This was the first time a fine was imposed for data manipulation under a regulation adopted in 2011 as part of a strengthening of EU fiscal surveillance.

Another measure taken to reduce the budget deficit was to cut the number of public sector employees, which stood at a high of almost 2.7 million in 2010. By July 2015 the number was 155,841 lower at 2.54 million (see Figure 3.13). Regional governments eliminated 467 entities between January 2012 and July 2015 (from 2,245 to 1,778), the same number as those created between 2004 and 2011 during the boom. Some regions, notably the Socialists' fiefdom of Andalusia, hardly reduced the number of its entities (from 357 to 331), according to the Ministry of Finance and Public Administrations.

Figure 3.13. Employment by Public Administrations, January 2010-January 2015

	2010	2015	Change (2015/10)
Central government	591,559	531,443	-60,116
Regional governments	1,348,492	1,284,108	-64,384
Local governments	657,905	577,212	-80,693
Universities	100,672	150,024	+49,352
Total	2,698,628	2,542,787	-155,841

Source: Ministry of Finance and Public Administrations.

As well as the doubts over regional government finances and whether they are really on an even keel, another pressing budgetary policy challenge is the sustainability of the social security system, which has been in deficit since 2010 (1.1% of GDP in 2014). The greying population, as a result of longer life expectancy and a still low fertility rate, combined with very high unemployment for the foreseeable future, which has pushed up the dependency ratio (the inactive elderly as a percentage of the working age population), raised serious questions about the sustainability of the pay-as-you-go pension system. The independent authority for fiscal responsibility (AIReF) warned in September 2015 of a serious risk in 2016 of not meeting the target for the social security deficit, which it estimated at 1.5% of GDP, much higher than the government's 0.3%.

The number of social security contributors rose by 533,186 in 2015 to 17.3 million, but was still far from the peak of 19.5 million in 2007. The number of contributors for each pensioner dropped from a high of 2.71 in 2007 to 2.26 in 2015. The sharp fall in social security contributors led the Popular Party in 2012 to move pension financing from the general government budget, as part of its strategy to cut the massive deficit, to raiding the reserve fund created in 2000 and built up during the boom years. The reserve rose from €35.8 billion in 2006 to a peak of €66.8 billion in 2011 and then fell to €36.9 billion November 2015 (3.5% of GDP). If this pace of drawing down the reserve continues and no measures are taken, the reserve will run out in 2019.

'Instead of paying the pensions gap out of current income the government used a credit card issued by future pensions to keep up payments even though the situation was obviously getting worse', said the late British economist Edward Hugh, who closely followed the Spanish economy. Luis Linde, the Governor of the Bank of Spain, warned in 2015 that the demographic problem would lead to 'an inexorable reduction in pensions in the long term, unless they are combined with private savings. The current system does not guarantee the level of pensions that people expect'.

Private pension funds in Spain accounted for only 9.5% of GDP in 2014, well below the OECD average of 37.2%, but above France (0.5%), Germany (6.7%) and Italy (6.7%).

The economic recovery enabled the outgoing Popular Party government to loosen the purse strings a little in the 2016 budget. Some 3 million civil servants were given their first wage increase (1%) in five years, their bonus payments were restored and social expenditure was budgeted to be higher. As well as a commitment with Brussels to cut the budget deficit to 4.2% of GDP and below the EU threshold of 3% in 2017, Madrid was also committed to achieving a primary surplus (excluding the costs of servicing the debt). The surplus was forecast at 0.1% of GDP in 2016, the first in eight years.

Companies and households made headway in deleveraging. Their debts dropped from a peak of 216.4% of GDP in the second quarter of 2010 to 178.7% in June 2015 (70.6% of GDP household debt and 108% of GDP non-financial corporation debt), the lowest level since 2006 (see Figure 3.14).

Figure 3.14. Private, Public and Total Debt, 2008-14 (% of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015 (1)
Private	210.1	215.1	216.4	213.7	204.1	192.8	182.5	178.7
Public	39.4	52.7	60.1	69.2	84.4	92.1	97.7	97.8
Total	249.5	267.8	276.5	282.9	288.5	284.9	280.2	276.5

(1) June.
Source: FUNCAS, prepared by AFI.

The companies that comprise the Ibex 35, the benchmark index of the Spanish stock exchange, increased their profits 22% year-on-year in the first nine months of 2015 to €26.6 billion. The Ibex-35, however, was the worst performer in 2015 among the main indices (see Figure 3.15). The index ended 2015 at 9,544, down 7.1% and far from the more than 15,000 in 2007.

Figure 3.15. Main Stock Market Indices, 2015 (% change)

	% change
Ibex-35 Spain	**-7.1**
Dax (Frankfurt)	9.6
CAC 40 (Paris)	8.5
FTSE 100 (London)	-4.9
FTSE MIB (Milan)	12.7
Euro Stoxx 50	3.8
Dow Jones	-2.2
Nikkei (Tokyo)	9.1

Source: Markets.

Spain was still way off meeting in 2015 the five Europe 2020 targets, particularly in employment (see Figure 3.15). Hindering the much-vaunted ambition to foster a new model of economic growth based more on brainpower than on bricks and mortar were the still high early school-leaving rate and the low level of spending on R&D in GDP terms.

Figure 3.16. Evolution of the Five Europe 2020 Targets

	Spain's targets	Europe 2020 goal
Employment	74% of 20-64 year-olds to be employed	75%
R&D	2% of GDP to be invested in R&D	3%
Climate change/energy	Greenhouse gas emissions (-10% over 2005)	20% lower than 1990
	20% of energy from renewables	20%
	20% of increase in energy efficiency (primary energy consumption of 119.9 Mtoe)	20%, energy consumption has to be of no more than 1474 Mtoe of primary energy
Education	Reduce early school leaving rate to below 15%	10%
Poverty/social exclusion (1)	At least 1.4-1.5 million fewer people at risk of poverty or social exclusion	At least 20 million fewer at risk of poverty or social exclusion

(1) Poverty or social exclusion rate of the National Statistics Office (INE).
Source: European Commission and Spanish government.

Competitiveness improved as a result of internal devaluation. This was evidenced in the two main rankings of the world's most competitive economies in 2015. In the IMD ranking, Spain moved up to 37th position out of 61 countries from 39th in 2014 and 45th in 2013 (see Figure 3.17).

Figure 3.17. IMD World Competitiveness Ranking 2015, Selected Countries

Ranking	Change over position in 2014
1. US	–
3. Singapore	–
10. Germany	-4
19. UK	-3
20. Finland	-2
32. France	-5
37. Spain	**+2**
38. Italy	+8

Source: IMD.

The IMD defines competitiveness as the 'ability of a country to create added value and thus increase national wealth by managing assets and processes, attractiveness and aggressiveness, globality and proximity, and by integrating these relationships into an economic and social model'. The rankings are based on four input factors: economic performance, government efficiency, business efficiency and infrastructure, each with five sub-factors. The strongest improvement was in economic performance (see Figure 3.18).

Figure 3.18. Competitiveness Input Factors, Ranking in Each Category and Overall Ranking

	2011	2012	2013	2014	2015
Economic performance	47	51	53	51	39
Government efficiency	38	40	50	46	43
Business efficiency	38	46	50	42	46
Infrastructure	26	27	27	27	29
Overall ranking	35	39	45	39	37

Source: IMD World Competitiveness Yearbook 2015.

In the World Economic Forum (WEF) ranking, Spain also moved up two places –from 35th to 33rd out of 144 countries– (see Figure 3.19).

Figure 3.19. World Economic Forum Competitiveness Ranking 2015, Selected Countries (1)

Ranking	Score out of 7	Change in position over 2014
1. Switzerland	5.76	–
3. US	5.61	–
4. Germany	5.53	+1
10. UK	5.43	-1
22. France	5.13	+1
33. Spain	**4.59**	**+2**
43. Italy	4.46	+6

(1) Out of 144 countries in 2014 and 140 in 2015.
Source: The Global Competitiveness Report 2015-2016.

The WEF defines competitiveness as the set of institutions, policies and factors that determine the level of productivity of a country. Its competitiveness index is based on 12 pillars. The main improvement since 2011 was in labour market efficiency and the largest fall was in institutions (see Figure 3.20).

Figure 3.20. Ranking of the 12 Pillars of the WEF Global Competitiveness Index, 2011-15 (1)

	2011	2012	2013	2014	2015
Institutions	48	58	73	65	65
Infrastructure	10	10	9	10	10
Macro environment	104	116	121	116	116
Health, primary education	36	30	34	32	32
Higher education + training	29	26	29	30	30
Goods market efficiency	55	63	75	62	62
Labour market efficiency	108	115	100	92	92
Financial market development	82	97	91	77	77
Technological readiness	26	26	27	25	25
Market size	14	14	14	15	15
Business sophistication	32	33	38	31	31
Innovation	35	34	37	37	37
Overall ranking	36	36	35	35	33

(1) In 2015, 140 countries; in 2014 144; in 2013 148; in 2012 144; and in 2011 142.
Source: Global Competitiveness Reports.

The improvements in the economy and reforms helped to reverse in 2015 three straight years of declines in the Economic Freedom Index drawn up by the US Heritage Foundation. Spain was ranked the 49th freest economy in the 2015 Index with a score of 67.6 out of 100, slightly higher than in 2014. The Index rates economic freedom on 10 quantitative and qualitative factors that are based on four pillars of freedom: rule of law, limited government, regulatory efficiency and open markets (see Figure 3.21).

Figure 3.21. 2015 Economic Freedom Index: the 10 Freedoms

	Score out of 100	Rank	1-year change in score
Property rights	70.0	30th	0
Freedom from corruption	59.0	39th	-3.6
Fiscal freedom	53.1	172nd	-0.9
Government spending	39.8	153rd	+1.1
Business freedom	77.5	38th	+0.2
Labour freedom	52.6	127th	+0.4
Monetary freedom	81.3	34th	+1.4
Trade freedom	88.0	11th	+0.2
Investment freedom	85.0	13th	+5.0
Financial freedom	70.0	19th	0

Source: Heritage Foundation.

Spain's score change in the Index since 1995 has been considerable (see Figure 3.22).

Figure 3.22. Spain's Score Change in the Economic Freedom Index since 1995

	Score change
Property rights	0
Freedom from corruption	+9.0
Fiscal freedom	+7.9
Government spending	+3.0
Business freedom	+7.5
Labour freedom	+3.8
Monetary freedom	+5.5
Trade freedom	+10.2
Investment freedom	+15.0
Financial freedom	0

Source: Heritage Foundation.

Other pro-business moves were a lower corporate tax rate (reduced from 30% to 28% in 2015). This was still above the euro-zone average, but the lowest rate among the large countries (see Figure 3.23). The rate was further reduced to 25% in 2016.

Figure 3.23. Corporate Tax Rates, 2007-15

	2007	2014	2015
Germany	38.36	29.58	29.65
France	33.33	33.33	33.33
Italy	37.25	31.40	31.40
Spain	**32.50**	**30.00**	**28.00**
Euro zone	23.97	21.34	22.15

Source: KPMG.

Measures were also introduced in 2014 and 2015 to improve the insolvency law by facilitating the restructuring of corporate and household debt –a major problem for a significant number of companies and individuals– including a 'fresh start' for good-faith consumers and entrepreneurs. The reforms were designed to facilitate the ability of enterprises to reach restructuring agreements in courts, encourage the sale of businesses as going concerns in insolvency liquidation, improve the mediated out-of-court restructuring process for SMEs and extend it to include consumers and provide a 'fresh start' for consumers and individual entrepreneurs after their assets are liquidated in bankruptcy. The introduction of the fresh start was particularly important, as it might enable financially-distressed entrepreneurs and consumers to be discharged of unsustainable debt and so incentivise future entrepreneurial activity and consumption.[8]

The preferential treatment afforded to public creditors and labour, however, reduced the efficiency of the process. Public creditors continued to be excluded from out-of-court restructuring processes, there was no stay on the execution of public claims once the processes began and public creditors were left out of the collective creditor decision-making process.

According to IMF estimates, the impact of insolvency reform on banks' earnings and capital would be relatively small and unlikely to be a significant impediment to credit supply.[9] The largest banks had adequate capital and provisioning buffers as well as ample funding.

The single market law was also introduced, as a result of which a company that meets the requirements of a particular region had the right to do business in the rest of Spain and could not be asked for additional requirements. Some 2,700 regulatory barriers were identified, most at the regional level and resulting from disparities in central and sub-central government legislation regulating access to and exercise of economic activities. In one of the more absurd examples cited as a reason for the new measure, a company making slot machines had to manufacture 17 different models in order to meet the requirements of each regional government. Implementation of this law was behind schedule.

The economy was coming out of the woods, but, in the words of the IMF,[10] ‘deep structural problems limit Spain's growth potential going forward and vulnerabilities remain’, as shown in the macroeconomic imbalance procedure (MIP), the European Commission's surveillance mechanism that aimed to identify potential risks early on and correct the imbalance already in place (see Figures 3.24 and 3.25).

Figure 3.24. MIP Scoreboard 2015: External Imbalances and Competitiveness

	Current account balance -% of GDP (3 year average)	Net international investment position (% of GDP)	Real effective exchange rate – 42 trading partners, HICP deflator (3 year % change)	Export market share - % of world exports (5 year % change)	Nominal unit labour cost index (2010=100) (3 year % change)
Threshold	**-4/6**	**-35**	**+/-5**	**-6**	**9**
France	-1.0	-19.5	-1.2	-13.1	4.8
Germany	6.9	42.3	-0.3	-8.3	7.6
Italy	0.8	-27.9	0.2	-14.0	3.6
Spain	**0.7**	**-94.1**	**-1.0**	**-11.5**	**-4.1**

Source: European Commission, Eurostat and International Monetary Fund.

Figure 3.25. MIP Scoreboard 2015: Internal Imbalances

	House price index (2010 = 100), deflated (1 year % change)	Private sector credit flow, consolidated (% of GDP)	Private sector debt, consolidated (% of GDP)	General government gross debt (% of GDP)	Unemployment rate (3 year average) (%)	Total fin. sector liabil. non-consol (1 year % cha.)
Threshold	**6**	**14**	**133**	**60**	**10**	**16.5**
France	-1.6	3.3	143.2	95.6	10.1	
Germany	1.5 (1)	1.1	100.4	74.9	5.2	4.2
Italy	-4.6 (1)	-0.9	119.3	132.3	11.8	-0.7
Spain	**0.1**	**-7.1**	**165.8**	**99.3**	**26.1**	**-1.9**

(1) Provisional.
Source: European Commission, Eurostat and International Monetary Fund.

Unemployment will remain high for a long time, the economic model has not changed very much (it remained to be seen whether the success in exports was here to stay), public and private debt levels are still high, productivity is low and the negative net international position very high by cross-country and historical standards.

Chapter 4
Foreign Trade

1. Exports of Goods: a Success Story

Spain's striking export achievement played a significant role in pulling the economy out of recession and shifted the engine of GDP growth from overdependence on domestic demand, particularly the infrastructure and property sectors, to a more broadly based economic model. The sharp fall in domestic demand pushed companies to seek markets abroad. A typical case among many was a producer of water meters whose market dried up in Spain and who found success in Turkey. The key question for the future is whether this proves to be a lasting structural change or a temporary one that loses steam as domestic demand strengthens and the economy gathers pace.

Exports of goods increased from €185 billion in 2007 (17.5% of GDP) to €240 billion in 2014 (22.6%). Even allowing for the shrinkage in Spain's output, which made exports in GDP terms look better, this was still a significant achievement (see Figure 4.1). The other large EU economies increased their merchandise exports in GDP terms to a smaller extent: France from 20.7% to 20.9%, Italy from 22.1% to 23.9%, the UK from 15.0% to 16.2% and Germany from 36.9% to 38.5%. Exports continued to set new records in 2015 (€208.4 billion in the first 10 months).

Figure 4.1. Merchandise Exports, as a Percentage of GDP and Coverage, 2007-15 (€ bn and %)

	Exports (€ bn)	% of GDP	Coverage (%) (1)
2007	185.0	17.1	64.7
2008	189.2	16.9	66.8
2009	159.9	14.8	77.6
2010	186.8	17.3	77.8
2011	215.2	20.0	81.8
2012	226.1	21.4	87.7
2013	235.8	22.5	93.4
2014	240.0	22.7	90.7
2015 (2)	208.4	-	91.0

(1) Exports as a percentage of imports. (2) First ten months.
Source: INE, Bank of Spain and Customs.

Merchandise exports as a percentage of imports (coverage) increased from 77.6% to 91% during this period, albeit an indicator that benefited from the steep fall in imports. External demand was positive between 2011 and 2013, having been negative most of the time between 1995 and 2010, but turned negative again in 2014 and 2015 and probably in 2016. Exports including services in GDP terms converged towards Germany and in 2014 stood at 32.1%, up from 22.7% in 2007 and higher than France, Italy and the UK (see Figure 4.2). Exports of goods and services generated €340 billion in 2014, six and a half times more than tourism revenues. Despite the almost 10 percentage-point increase in its export-to-GDP ratio between 2009 and 2014 (a bigger rise than all the other large EU economies), there was still considerable scope for improvement.

Figure 4.2. Exports of Goods and Services, Main EU Countries, 2009-14 (% of GDP)

	2009	2010	2011	2012	2013	2014
Germany	37.8	42.3	44.8	45.9	45.6	45.7
Spain	**22.7**	**25.5**	**28.8**	**30.3**	**31.6**	**32.1**
France	24.1	26.0	27.8	28.1	28.3	28.4
Italy	22.5	25.2	27.0	28.6	28.8	29.4
UK	27.0	28.7	30.9	30.2	30.1	28.4

Source: Eurostat.

Export growth was spurred by restoring the eroded competitiveness of products through internal devaluation, as the policy option of devaluing the currency disappeared when Spain became a founder member of the euro in 1999. The sharp rise in unemployment led to a reduction in wages in real terms and productivity gains which lowered unit labour costs, while the 2012 labour market reforms enabled companies to negotiate wages and working conditions more flexibly. These factors, in turn, encouraged foreign direct investment (FDI) in Spain, some of which went to major exporting industries, notably automotive companies. Car plants boosted the number of models manufactured from 34 in 2011 to 45 in 2015. Spain's gross FDI inflows in 2014 of US$22.9 billion were higher than France's Germany's and Italy's, according to UNCTAD (see Chapter 8).

The decline in the trade deficit (from €94.1 billion in 2009 to €24.5 billion in 2014) helped turn a massive current account deficit of 9.6% of GDP in 2007 into a surplus in 2013, 2014 and 2015. This turnaround was unprecedented in modern Spanish economic history (see Figure 4.3).

Figure 4.3. Current Account Balances in Main Euro Zone Countries, 2007-15 (% of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015(1)
France	-0.3	-1.0	-0.8	-0.8	-1.0	-1.2	-0.8	-0.9	-0.2
Germany	6.7	5.6	5.7	5.6	6.1	6.8	6.4	7.4	8.5
Italy	-1.4	-2.8	-1.9	-3.5	-3.1	-0.4	0.9	1.9	2.0
Spain	**-9.6**	**-9.3**	**-4.3**	**-3.9**	**-3.2**	**-0.3**	**1.4**	**0.8**	**0.9**

(1) Estimate.
Source: IMF, World Economic Outlook, October 2015.

Spain experienced three current-account adjustments before the latest crisis (in 1977, 1983 and 1992) but they were all much less challenging. In these episodes, the current account deficits at the beginning of the respective crises were only between 2.6% and 4% of GDP.

The total number of exporters increased 37% to close to 148,000 between 2009 and 2014, while the number of companies regularly exporting (more than four consecutive years) rose 16% to 46,000 (see Figure 4.4). Just over half of the companies, however, exported goods worth less than €5,000 in 2014 (see Figure 4.5). The bulk of exports are concentrated in a small number of companies: the 50 largest companies account for one-third of total exports (see Figure 4.6).

Figure 4.4. Total and Regular Exporters of Goods, 2009-14

	2009	2010	2011	2012	2013	2014
Total	107,579	109,363	123,128	137,528	151,160	147,731
Regular (1)	39,320	38,763	37,253	38,373	41,168	45,842

(1) Four consecutive years.
Source: ICEX.

Figure 4.5. Concentration of Exports by Number of Companies and Volume of Exports, 2012-14 (€ 000)

	2012		2013		2014	
	Nr cos.	Exports	Nr cos.	Exports	Nr cos.	Exports
Less than €5,000	67,837	77,825	78,650	87,133	77,786	80,948
% of total	49.3	0.0	52.0	0.0	52.7	0.0
€5,000-€25,000	24,415	282,752	25,959	300,518	23,408	272,988
% of total	17.8	0.1	17.2	0.1	15.8	0.1
€25,000-€50,000	7,522	267,555	7,594	268,339	7,298	259,347
% of total	5.5	0.1	5.0	0.1	4.9	0.1
€50,000-€500,000	19,057	3,703,676	19,660	3,776,570	19,615	3,764,935
% of total	13.9	1.6	13.0	1.6	13.3	1.6
€500,000-€5 mn	13,868	23,186,997	14,317	23,801,181	14,524	24,354,981
% of total	10.1	10.3	9.5	10.1	9.8	10.1
€5 mn-€50 mn	4,258	60,947,379	4,407	63,398,462	4,511	64,366,484
% of total	3.1	27.0	2.9	26.9	3.1	2.
€50 mn-€250 mn	476	47,483,970	473	47,559,046	488	48,691,133
% of total	0.3	21.0	0.3	20.2	0.3	20.3
Over €250 mn	95	90,164,439	100	96,622,819	101	98,244,055
% of total	0.1	39.9	0.1	41.0	0.1	40.9

Source: ICEX.

Figure 4.6. Cumulative Percentage of Exports by Number of Companies, 2010-14 (% of total exports)

	2010	2011	2012	2013	2014
Five largest	9.5	9.0	10.0	10.1	9.8
10 largest	14.9	14.2	14.8	16.0	15.4
25 largest	22.7	23.2	23.5	25.3	25.0
50 largest	30.5	32.3	32.3	32.9	33.1
100 largest	38.1	40.3	40.4	41.0	40.8
500 largest	57.3	59.0	59.2	59.5	59.2
1,000 largest	66.6	68.0	68.1	68.1	67.9

Source: ICEX.

Not only had exports grown, but their composition by sectors and markets had also changed. The EU's share was virtually unchanged between 2007 and 2014 at around 70%, but the slice going to other destinations gained prominence. Exports to the emerging and growth-leading economies were the most dynamic, rising from 6.8% in 2007 to 8.2% in 2014. Exports to Asia increased from 6.2% of the total to 9.5% and Africa's from 4.5% to 6.8% (see Figure 4.7). China, however, still accounted for less than 2% of exports. This greater geographical distribution enabled Spain to benefit from the increase in world trade. Exports of eggs, for example, to non-EU countries such as Israel, Nigeria and Mexico rose 46% in 2014.

Figure 4.7. Merchandise Exports by Geographic Area, 2007 and 2014 (€ bn and % of total)

	2007 (exports €181.5bn)	2014 (exports €240bn)
EU	70.1	69.8
Euro zone	55.9	63.4
France	18.6	15.7
Germany	10.8	10.4
Italy	8.5	7.2
UK	7.5	6.9
North America	4.6	5.0
Latin America	4.9	5.8
Asia	6.2	9.5
China	1.1	1.7
Africa	4.5	6.8
Rest	9.7	3.1

Source: Economy Ministry.

Food, drinks and tobacco increased their share of total goods exports, while that of the automotive sector, traditionally high, declined (see Figure 4.8). Wine exports trebled between 1995 and in 2014, enabling Spain to overtake Italy as the world's biggest exporter by volume. Revenues, however, fell almost 3% in 2014. This success, however, was based on volume not quality, and in some cases at prices below what it cost to produce the wine. Some 55% of the exports

were unbranded bulk wine that was then often bottled and exported again by France and other European countries. Spain's wine industry underwent a quality revolution in the last 30 years; nevertheless, this change had not fully resonated in the international markets.

Figure 4.8. Merchandise Exports by Sector, 2007 and 2014 (% of total)

	2007 (exports €181.5bn)	2014 (exports €240bn)
Food, drinks and tobacco	13.7	15.5
Energy products	4.6	7.2
Raw materials	2.0	2.4
Semi-manufactured non-chemical products	13.1	10.7
Chemical products	13.1	14.2
Capital goods	21.6	20.1
Automotive industry	18.2	14.8
Consumer durables	3.1	1.4
Manufactured consumer goods	8.6	9.2
Other goods	2.0	4.4

Source: Economy Ministry.

The majority of Spanish exports were in intermediate, equipment, motor vehicles and food products, which tend to be more price sensitive and incorporate a high import content except food products. Some of these exports were part of an international supply chain that fed into other countries' final products. This wide range of exports belied the country's traditional image, which it had yet to shake off completely, of an exporter of mainly fruit and vegetables. In 2003, when Spain was producing around 2 million cars and was the eighth-largest manufacturer, José María Aznar, the then Prime Minister, visited the ranch in Texas of President George W. Bush and before seeing him chatted with one of his close advisors. The conversation went as follows: 'And what is the main product exported by Spain?'. 'Cars', replied Aznar. 'No, I am asking about the number-one product that Spain exports'. 'Cars', repeated Aznar. 'No, no, what I want to know is which Spanish product sells most successfully abroad'. 'Yes, cars, cars', repeated an exasperated Aznar.[1]

Since joining the European Economic Community in 1986, Spain has exported an increasingly diversified range of products, from oddities such as doughnuts to cars, information and air traffic control systems (Indra) and space navigation equipment (GMV). In several sectors, notably cement and ceramics, metallic structures, aeronautics and clothing, Spain's exports were among the top 10 globally in 2013 (see Figure 4.9).

Figure 4.9. Global Position of Spanish Merchandise Exports by Sectors, 2013

Sector	Global position
Cement and ceramics	4th
Metallic structures	6th
Aeronautics	7th
Clothing	8th
Machine tools	10th
Publications	10th
Electronic equipment	11th
Watches	12th
Electrical appliances	13th

Source: Based on the Atlas of Economic Complexity developed by César Hidalgo and Ricardo Hausmann.

The export success was such that Luis de Guindos, Spain's Economy Minister, let it be known in 2013 that he did not share the international criticism of Germany's huge trade and current account surpluses. Germany's export boom, he said, was a fillip for Spain because it exported a lot of intermediate goods to German multinationals who, in turn, boosted their exports to China and other non-European markets.

Spanish exports had a not insignificant 2.6% market share in Germany in 2014 and one-third in tiny Portugal (see Figure 4.10). The export success also made Spain an enthusiastic supporter of the free trade and investment agreement between the EU and the US, known as the Transatlantic Trade and Investment Partnership (TTIP).

Figure 4.10. Market Share of Spanish Merchandise Exports by Country, 2009-14 (%)

	2009	2010	2011	2012	2013	2014
Germany	2.7	2.5	2.4	2.4	2.5	2.6
France	6.7	6.5	6.4	6.5	6.6	6.5
Italy	4.4	4.5	4.5	4.5	4.5	4.8
Portugal	32.7	31.9	32.3	31.8	32.3	32.5
UK	2.9	2.6	2.6	2.6	2.9	3.1
EU-28	3.4	3.3	3.2	3.1	3.2	3.3

Source: Economy Ministry based on Eurostat and World Trade Organisation figures.

Exports with a high and medium-high technological component were low compared with France, Germany and the UK (see Figure 4.11). To some extent this reflects Spain's low R&D spending, which at 1.3% of GDP was well below the EU average (2%) and almost less than one-third that of high-tech countries such as Finland. Half the rise in goods exported between 2007 and 2014 came from fuels, food and raw materials. Spain needs to invest more in R&D, training and advertising in order to move up the value-chain.

Figure 4.11. Exports of High Technology Products, 2014 (% of total exports)

	% of total
France	20.6
UK	15.6
EU-28	15.6
Germany	14.2
Poland	7.7
Italy	6.7
Spain	**5.1**

Source: Eurostat.

Spain was the world's 18th largest exporter of goods in 2014, according to the World Trade Organisation. While Germany, France and Italy lost global market export share over the last decade, mainly to China and other emerging countries, Spain's held up well as its share of world merchandise exports remained virtually unchanged. It only decreased by 0.2 percentage points to 1.7% during 2000-14 in absolute terms, which was in line with the country's 1.8% share of the world's GDP (see Figure 4.12). Spain benefited from structural competitiveness gains due to wage and price moderation.

Figure 4.12. Global Market Share of Merchandise Exports by Country, 2010-14 (%)

	2010	2012	2013	2014	Diff. 10-14	Rank 2014
China	10.4	11.2	11.7	12.4	+2.0	1.
US	8.4	8.4	8.4	8.6	-0.2	2.
Germany	8.3	7.7	7.7	8.0	-0.7	3.
France	3.4	3.1	3.1	3.1	-0.3	4.
Italy	2.9	2.7	2.8	2.8	-0.1	8.
Spain	**1.6**	**1.6**	**1.7**	**1.7**	**-0.1**	**18.**

Source: World Trade Organisation.

The export base increased considerably since the onset of the crisis in 2008, but the size distribution of Spanish companies was skewed heavily towards micro companies. Ninety-four per cent of companies in Spain have fewer than 10 employees compared with 82% in Germany (see Figure 4.13), and these micro companies accounted for 40.5% of total employment compared with 18.7% in Germany (see Figure 4.14). The very large number of very small, low-productivity companies co-exist with a few large and highly productive firms. The small size of Spanish companies was an economy-wide problem and not just one in the export sector where there was a strong positive correlation between company size, productivity and export potential. According to a study by Fedea-McKinsey, Spain would have a 30% higher level of productivity than Germany if it maintained productivity levels, but changed its company-size mix to resemble that of Germany.

Figure 4.13. Size of Companies in Main EU Countries by Number of Employees (% of total companies)

	Micro (0-9)	Small (10-49)	Medium (50-249)	Large (over 250)
Spain	**94.5**	**4.8**	**0.6**	**0.1**
Germany	81.7	15.2	2.6	0.5
France	93.3	5.6	0.9	0.2
Italy	94.8	4.6	0.5	0.1
UK	88.8	9.3	1.6	0.3

Source: Eurostat and OECD.

Figure 4.14. Contribution to Employment by Company Size (% of total jobs in each country)

	Micro (0-9)	Small (10-49)	Medium (50-249)	Large (over 250)
Spain	**40.5**	**19.1**	**13.5**	**24.9**
Germany	18.7	23.8	20.8	36.7
France	27.9	19.6	15.1	37.4
Italy	45.7	20.9	13.0	20.4
UK	17.0	19.6	17.0	46.4

Source: Circulo de Empresarios based on Eurostat estimates.

One factor holding back the creation of more medium-sized companies (50-250 workers) was that size-related taxation thresholds created disincentives for companies to grow. Spain's corporate tax system did not provide incentives for companies to grow, as it allowed for lower corporate standard tax rates for SMEs with an annual turnover of below €10 million, and an even lower rate for those under €5 million and with fewer than 25 employees, combined with generous deductions for larger firms. The result was an effective tax rate that increased with firm size, discouraging the creation of a larger company. The 2015 tax reforms reduced some of the disincentives to company growth by eliminating the reduced rate for SMEs while cutting the deductions and tax benefits for big companies, in order to lower the tax gap between the actual and effective rate.

The creation of larger companies would increase the volume of exports per head of population, a yardstick where Spain lags behind its EU partners (see Figure 4.15).

Figure 4.15. Merchandise Exports per Head in Selected EU Countries, 2014 (€)

Country	Exports per person
Netherlands	25,744
Sweden	14,062
Germany	13,559
France	6,904
Italy	6,344
UK	5,700
Spain	**5,106**

Source: Eurostat for exports and the United Nations for population figures.

2. Exports of Services: Holding Firm

Exports of services also rose, although nowhere as much as that of goods (see Figure 4.16).

Figure 4.16. Exports of Services and as Percentage of GDP, 2007-15 (€ bn and %)

	€ bn	% of GDP
2007	87.3	8.1
2008	89.7	8.0
2009	80.7	7.5
2010	85.4	7.9
2011	93.9	8.7
2012	95.6	9.0
2013	97.0	9.2
2014	101.4	9.6

Source: INE, Bank of Spain and Customs.

The country's share of global exports of services, however, was significantly higher than its share of global merchandise exports (2.8% against 1.7% in 2014), mainly because of the buoyant tourism sector (see Figure 4.17). Spain has also expanded its world share of exports in other services, mainly linked to businesses such as software publishing, computer programming, consultancy and related activities, and engineering. Companies have also penetrated foreign markets more deeply in accounting, auditing, tax consultancy and management consultancy activities. Whereas the growth in export markets for goods mainly occurred in the emerging and growth-led markets, the expansion of service exports was concentrated in North America and the UK.

Figure 4.17. Global Market Share of Exports of Services by Country, 2010-14 (%)

	2010	2012	2013	2014	Diff. 10-14	Rank 2014
US	14.2	14.2	14.2	14.1	-0.1	1.
UK	7.0	6.9	6.8	6.8	-0.2	2.
Germany	5.8	5.3	5.5	5.5	-0.3	3.
France	5.2	5.3	5.4	5.4	+0.2	4.
China	4.5	4.9	4.4	4.6	+0.1	5.
Spain	**2.9**	**2.8**	**2.7**	**2.8**	**-0.1**	**9.**
Italy	2.6	2.4	2.4	2.3	-0.3	14.

Source: World Trade Organisation.

3. Imports: Recovering

Spain’s imports of goods plummeted from €285 billion in 2007 at the height of the economic boom (24.5% of GDP), to €201.1 billion in 2009 (18.6%), when the economy went into recession, a sharp drop of close to 30% and underscoring the fall in domestic demand. They then gradually rose to €265.5 billion in 2014 (the 16th largest in the world) and €228.9 billion in the first ten months of 2015, as the recovery in consumption gained momentum, pulled to some extent by exports that have a high import content.

Spanish industry is highly dependent on imports of intermediate and energy goods and on technology, particularly the automotive and chemical industries, two of the strongest export sectors and both in foreign hands. There is a positive relationship in Spain between foreign direct investment (FDI) and import intensity.

The main reason Spain has long run a trade deficit is because of the large share of energy products in total imports, particularly oil and gas (see Figure 4.18). The non-energy trade balance is usually in surplus.

Figure 4.18. Merchandise Imports by Sector, 2007 and 2014 (% of total)

	2007: €285bn	2014: €264.5bn
Food, drinks and tobacco	8.7	10.7
Energy products	14.8	20.9
Raw materials	3.6	3.6
Semi-manufactured non-chemical products	9.6	6.8
Chemical products	11.7	15.0
Capital goods	23.7	17.8
Automotive industry	14.7	11.6
Consumer durables	3.2	2.4
Manufactured consumer goods	9.6	11.0
Other goods	0.6	0.3

Source: Economy Ministry.

Just as a larger share of exports went to euro-zone countries between 2007 and 2014, so the bloc provided a greater slice of Spain's imports (see Figure 4.19). Outside the zone, Africa increased its share the most.

Figure 4.19. Merchandise Imports by Geographic Area, 2007 and 2014 (% of total)

	2007: €285bn	2014: €264.5bn
EU	59.1	59.9
Euro zone	49.3	53.3
France	12.2	11.0
Germany	15.2	12.1
Italy	8.7	5.9
UK	4.7	4.2
North America	3.9	4.3
Latin America	4.6	6.6
Asia	17.3	17.9
China	6.7	7.5
Africa	7.4	10.6
Rest	7.7	0.7

Source: Economy Ministry.

Spain's share of global imports dropped by the same amount between 2010 and 2014 as its share of exports, falling by 0.1 percentage points (see Figure 4.20). Its share of imports of commercial services, however, fell by a much sharper 0.9 points (see Figure 4.21).

Figure 4.20. Global Market Shares of Imports by Country, 2010-14 (%)

	2010	2012	2013	2014	Diff. 10-14	Rank 2014
US	12.8	12.6	12.3	12.7	-0.1	1.
China	9.1	9.8	10.3	10.3	+1.2	2.
Germany	6.9	6.3	6.3	6.4	-0.5	3.
UK	3.6	3.7	3.5	3.6	0.0	5.
France	3.9	3.6	3.6	3.6	-0.3	6.
Italy	3.1	2.6	2.5	2.5	-0.6	11.
Spain	**2.0**	**1.8**	**1.8**	**1.9**	**-0.1**	**16.**

Source: World Trade Organisation.

Figure 4.21. Leading Importers in World Trade in Commercial Services, 2010-14 (% global share)

	2010	2012	2013	2014	Diff. 10-14	Rank 2014
US	10.2	9.9	9.8	9.6	-0.6	1.
China	5.5	6.8	7.5	8.1	+2.6	2.
Germany	7.3	6.9	7.2	6.9	-0.4	3.
France	3.6	4.2	4.3	5.1	+1.5	4.
UK	4.5	4.3	4.0	4.0	-0.5	6.
Italy	3.1	2.6	2.4	2.4	-0.7	13.
Spain	**2.4**	**2.2**	**2.1**	**1.5**	**-0.9**	**20.**

Source: World Trade Organisation.

The big decline in imports since 2007 raised the question of whether goods made in Spain replaced to some extent those acquired abroad which, if the case, would be a significant structural change. Import substitution can be fostered by three factors: price competitiveness gains of domestically produced goods and services over imported ones, the increase in the sensitivity of domestic demand to the relative price of imports, and a country's reduced propensity to import. According to a study by BBVA's research department, 42% of the reduction in non-energy imports between 2008 and 2012 (€34.2 billion) was due to import substitution and the rest to the slump in demand.

As the economy gathered pace as of 2014, so imports increased. The challenge for Spain was to maintain the momentum in exports in order to have a sustainable trade deficit, otherwise it would store up problems and create new imbalances.

Chapter 5

Economic Sectors

The structure of the Spanish economy has changed considerably over the past 40 years, particularly since 1986 when the country joined the European Economic Community (see Figure 5.1). The bursting of the massive property bubble as of 2008 intensified the change. Industry's share of GDP including construction plummeted from 31.1% in 2007 to 23.1% in 2014, solely because of the collapse of the property sector (its slice of output fell from 13.7% to 5.6%). As a result, services generate three-quarters of GDP.

Figure 5.1. Structure of GDP (Current Prices) by Sectors and Employment (% of total)

	Agriculture		Industry		Construction		Services	
	Output	Employment	Output	Employment	Output	Employment	Output	Employment
1964	17.0	38.0	CZ31.0	25.0	7.0	8.0	44.0	29.0
1984	7.0	19.0	29.0	25.0	7.0	8.0	57.0	49.0
2014	2.5	4.2	17.5	13.7	5.6	5.7	74.4	76.3

Source: INE and J. Baiges, C. Molinas & M. Sebastián, La economía española 1964-85 (Instituto de Estudios Fiscales, 1987).

Spain has the world's second-largest tourism industry in terms of receipts and the third-largest by visitors, the largest bank in the euro zone by market capitalisation (Santander), the ninth-biggest motor-vehicle industry and a sizeable chemicals industry, to name but a few of the significant parts of the economy.

1. Agriculture: Small but Dynamic

Agriculture's importance in the economy has declined steeply over the last 50 years from generating close to 20% of GDP and about 40% of jobs to less than 3% and around 4%, respectively. Yet it is still at the heart of Spanish life. Most city dwellers have family connections with the countrywide (many have second homes) and professional people are often absentee landlords. The agri-food sector is a dynamic exporter (€37.2 billion in 2014, 15.5% of total exports). Spain is a world leader in exports of olive oil, citrus and seeded fruits and wine (see Figure 5.2). The Catalan companies Freixenet and Codorníu lead the world in the production of *cava* based on the *méthode champenoise*. In 2015 there were 700,000 people working in agriculture, 100,000 fewer than in 2008.

Figure 5.2. Volume and Value of Wine Exports, 2014

Volume	Million hectolitres	Value	€ mn
Spain	**22.56**	France	7,732
Italy	20.42	Italy	5,111
Chile	0.80	**Spain**	**2,511**
Australia	0.73	Chile	1,400
South Africa	0.47	Australia	1,263
US	0.40	US	1,106

Source: Observatorio Español del Mercado del Vino.

There has been a tremendous flight from the land over the past 40 years, as Spaniards migrated from villages to towns and cities or emigrated. Had it not been for the influx of immigrants from North Africa, Latin America and Eastern Europe, large parts of Spain's agriculture, particularly the picking and packing of fruit and produce, would have found it very hard to keep going.

The sector is characterised, at one end, by very efficient production of produce for export, mainly in the south and east of the country (often using droplet irrigation in hot-houses) and, at the other, largely in the north, tiny plots for subsistence farming by smallholders. More than 50% of Spanish farms have less than five hectares and less than 10% more than 50, according to official figures. Less than 15% of useful agricultural surface is irrigated, but it generates more than half of production. Lastly, there has been a surge in the land used for ecological agriculture, from 4,235 hectares in 1991 to more than 1.8 million, one of the largest in the EU and mainly used to grow organic products for export.

Spain has the widest range of agricultural products in the EU. In the Atlantic provinces of the north, between 65% and 90% of production comes from the livestock sector (mainly dairy products), and a similar proportion comes from horticulture in the Mediterranean coastal provinces. In the central plain the main products are cereals and wine. Jaén, in the south, has Europe's highest concentration of olive-oil production. By contrast, the main activity in Badajoz and Salamanca in the west, provinces that border Portugal, is meat production, while Lérida, in the north-east, is famous for pork and olive oil.

The great variety of products is due to the diversity of weather and terrain. Spain is criss-crossed with mountain ranges, and the altitude of nearly 60% of its territory exceeds 600 metres, making it the second most mountainous country in Europe after Switzerland. The climate varies from mild and wet conditions in the north, where the average yearly rainfall can be as much as 1,600 millimetres (the North Atlantic coastal area is known as 'Green Spain'), to the arid desert of Almería in the south-east, where as little as 100 millimetres of rain can fall a year. Almería and Huelva are focal points of the Spanish agricultural 'miracle'.

Investment in irrigation and in plastic greenhouses, based on technology used in Israel, has produced a surge in the area intensively cultivated for horticultural produce. Beans, peppers, papaya and, particularly, strawberries grow under miles of shimmering plastic.

2. Automotive Industry: Moving up a Gear

In 1963 Spain's motor industry was in its infancy, and the tiny Seat 600 (the not-so-elegant equivalent of the UK's Mini) was the most popular car. In 2014, the country was the world's ninth-largest producer of motor vehicles, and in Europe the second-largest car manufacturer and the largest manufacturer of industrial vehicles (see Figure 5.3).

Figure 5.3. Top 10 Motor-Vehicle Producers, 2014 and 2010 (million units)

Ranking	2014	2010
1. China	23.7	18.3
2. US	11.6	7.7
3. Japan	9.8	9.6
4. Germany	5.9	5.9
5. South Korea	4.5	4.3
6. India	3.8	3.5
7. Mexico	3.4	2.3
8. Brazil	3.1	3.4
9. Spain	**2.4**	**2.4**
10. Canada	2.4	2.0

Source: OICA.

Following the sale of Seat to Volkswagen in the 1980s, all the producers in Spain are owned by foreign multinationals (Ford, Nissan, General Motors, Peugeot Citroën, Mercedes Benz, Renault, Santana and Iveco). Since the crisis these companies have substantially increased their investment to boost output: average annual investment rose from €1.1 billion in 2009-11 to €1.7 billion in 2012-14. Thirteen new models were launched in Spanish plants between 2012 and 2015. Ford, for instance, manufactures the Mondeo Hybrid at its plant in Almussafes (which started operating in 1976). VW is to invest €4.2 billion in its plants at Martorell and Navarra between 2015 and 2019 in what was billed as 'the largest industrial investment ever made in Spain'. Of this amount €3.3 billion will support the launch of four new SEAT models. The first of them will be a compact SUV, the first-ever SUV to be built by SEAT.

The industry generates around 10% of GDP, directly employs 300,000 people (2 million jobs linked to the industry) and regularly exports more than 80% of

output (17.6% of total merchandise exports in 2014 including components, see Figure 5.4).

Figure 5.4. Output and Exports of Motor Vehicles, 2007-15 (million units)

	Output	Exports	Exports as a % of total output
2007	2.88	2.38	82.6
2008	2.54	2.18	85.8
2009	2.17	1.88	86.7
2010	2.38	2.97	87.0
2011	2.37	2.12	89.4
2012	1.97	1.72	87.4
2013	2.16	1.87	86.6
2014	2.40	2.03	w84.5
2015 (1)	2.60	2.15	82.6

(1) First 10 months.
Source: Anfac.

Part of the export success was due to the thriving world-class auto-parts sector, led by Grupo Antolín, which has grown in Spain in tandem with the expansion of the motor industry. The sector ranked 6th in the world in terms of turnover and it exports to 150 countries.

The crisis made the industry adopt more flexible work practices such as working more hours when a big order comes through, and then taking time off when assembly lines were idle. Twin-track salary scales were also introduced under which new workers were paid less for doing the same job as existing employees. For example, newly-hired workers at Antolín cost the company €16-€17 an hour, compared with €22-€23 for those hired under the old regime. As a result of these factors and wage restraint, the industry's labour costs increased 9.8% between 2008 and 2014, the third-lowest rise in the world's car industries according to Anfac, compared with 20.1% for Italy, 18.7% for France and 17.2% for Germany. The sale of new cars rose 21% in 2015 and exceeded one million for the first time since 2008.

3. Construction and Real Estate: Rising from the Rubble

No sector increased so quickly and plummeted so steeply as construction in the widest sense (real estate and infrastructure). At the height of the boom in 2006, the number of housing starts (865,561) was more than that of Germany, France and the UK combined. In 2015, this figure was down to around 42,000, while the number of unsold new homes (see Figure 5.5) was still more than 500,000 in 2015 (1.6 million including second-hand properties according to the Madrid consultancy R.R. de Acuña). The large number of empty homes was in stark

contrast to the 119,442 property foreclosures which took place in 2014, according to the National Statistics Institute (INE), because owners defaulted on their mortgage payments. Evictions were a big social problem. In Spain home-owners are liable for their mortgages, even after their properties have been repossessed.

Figure 5.5. Stock of Unsold New Homes, 2005-14

2005	2006	2007	2009	2010	2011	2012	2013	2014
195,184	273,363	413,642	9,780	642,793	626,670	583,453	563,908	535,734

Source: Development Ministry.

Construction's share of GDP dropped from 13.7% in 2007 to 5.7% in 2014, during which period more than 1.1 million jobs were shed in the sector. The magnitude of the crash was such that cement consumption in 2013 was at its lowest level since 1964, when Spain's population was much smaller. The share of residential investment exceeded 10% of GDP every year between 2003 and 2008, way above the euro zone average, and then fell from a peak of around 12.5% in 2006 to 4% in 2014. Nominal house prices declined by 35% from their peak in 2007 and reached a trough in 2014.

The sharp drop in house and land prices made the real-estate sector attractive for international investors who were drawn by the prospect of higher returns compared with the main European countries, the beginning of a new cycle in Spain and expected rental and occupancy increases. Blackstone, Starwood and Lone Star all closed private equity real-estate funds in excess of €5 billion in the first half of 2015.

A real-estate investment trust industry (REITs, known as Socimis in Spain) began to develop and raised €5 billion in 18 months. Their IPOs attracted significant interest from prominent hedge funds and opportunistic investors seeking to buy mispriced core assets. Socimis do not pay corporate income tax as long as they invest 80% of their funds in rentals and distribute most of their income as dividends, among other requirements. This is a relatively common vehicle traded on stock exchanges in countries such as France and the US but new in Spain. Merlin Properties acquired Testa Inmuebles from Sacyr in June 2015 for €1.79 billion, making it Spain's largest property company with assets of more than €5.5 billion and annual rental income of around €300 million. Merlin was the first Socimi to join the Ibex 35, the benchmark index of the Madrid stock exchange. Socimis accounted for 46% of the €10.8 billion investment in commercial properties in the first nine months of 2015, according to CBRE.

4. Energy: a Leader in Renewables

Spain is heavily dependent on energy imports, but thanks to the incentive-induced surge in renewable energy supply over the last decade energy imports fell from around 80% of supply in 2009 to about 70% in 2014.

The share of renewable energy in electricity supply doubled to 40% between 2004 and 2014, according to the International Energy Agency (IEA). Solar power output was 49 times higher in 2014 and wind power 233% higher. The combined share of wind and solar power, at around 25% of total generation, was one of the highest in the world (see Figure 5.6). Spain's installed wind capacity was the fourth largest in the world in 2014 (see Figure 5.7). Geothermal and biofuels and waste rose by 265% and 35.5%, respectively. Nuclear power remained the main source of electricity generation in 2014, but only marginally as its output has been declining.

Figure 5.6. Electricity Generation by Source, 2014 (%)

	%
Nuclear	20.9
Wind	19.1
Gas	17.2
Coal	16.3
Hydro	14.3
Oil	5.2
Solar	5.0
Biofuels and waste	2.0

Source: International Energy Agency.

Figure 5.7. Top Five Countries by Installed Wind Capacity, 2014 (Gigawatts)

	Gigawatts	% global share
1. China	114.6	31.0
2. US	65.8	17.8
3. Germany	39.2	10.6
4. Spain	**23.0**	**6.2**
5. India	22.5	6.1

Source: Global Wind Energy Council.

Spain imports oil from a broad range of countries and holds in its stocks far more than required under its obligations as an IEA member. In natural gas, it has pipelines from North Africa, France and Portugal and abundant LNG capacity (one-third of the EU total). Gas is imported from more than 10 countries, making Spain not very dependent on any one source. The largest importing companies may source only half of their annual total from any given country.

The energy dependence rate (net imports divided by gross consumption, and which shows the extent to which a country is dependent on energy imports) fell from 81.3% in 2008 to 70.5% in 2013, according to the latest comparative figures from Eurostat (see Figure 5.8).

Figure 5.8. Energy Dependence Rates in the EU, 2008-13 (%) (1)

	2013	2008
France	47.9	50.8
Germany	62.7	60.8
Italy	76.9	85.7
Spain	**70.5**	**81.3**
UK	46.4	26.2
EU-28	53.2	54.7

(1) Net imports divided by gross consumption and expressed as a percentage.
Source: Eurostat.

The boom in wind and solar power was driven by subsidies at a volume that was unsustainable and produced a fast rising multi-billion-euro tariff deficit. Electricity costs spiralled out of control –they increased by 221% between 2005 and 2013– and revenues rose by only 100%. As a result of the high level of costs, end-user prices in Spain were among the highest in IEA member countries. Electricity prices paid by families in Spain grew at a rate double the EU average between 2008 and 2014, according to a report by David Robinson of the Oxford Institute for Energy Studies.[1]

In 2012 the Popular Party government took draconian measures: subsidies for new installations were eliminated, remuneration for transmission and distribution network services reduced, access tariffs increased and a 7% tax on electricity generation (22% for hydropower) introduced. The deficit peaked at €29 billion in 2013.

Further reforms were introduced in 2013, which reduced the remuneration and compensation for electricity activities by several billion euros a year and created a new way of calculating compensation for renewable energy, waste and the combined production of heat and power. The reforms were largely in place by the middle of 2015 and the deficit was expected to gradually disappear by 2040, but at a cost as the measures sent a negative signal to investors and brought new investments to a halt. As a result, no one was willing to invest in renewable energy anymore and Spain faced legal battles with investors over what they perceived as an unfair retroactive change to the rules of the game. There were more than 20 cases in 2015 against Spain pending at the International Centre for Settlement of Investment Disputes (ICSID), the World Bank's arbitration agency.

Another problem, in the context of the creation of a single energy market covering electricity and natural gas in the EU, was Spain's low interconnection capacity at around 4% of installed capacity in 2014, although this began to change in early 2015 when the first new interconnection with France in almost 30 years was inaugurated.

The 65km link between Spain and France, the world's longest underground high-voltage cable, built at a cost of €700 million, increased Spain's interconnection capacity (including to Portugal and Morocco) to 6% of its generation capacity, but that was still short of an EU target of at least 10%. The power line doubled the existing electricity interconnection capacity between France and Spain, from 1,400 megawatts to 2,800 megawatts. A planned second cable to run underwater past the west side of the Pyrenees would lift French-Spanish interconnection capacity further. It was not expected to come online until after 2020.

5. Tourism: a Mainstay of the Economy

Tourism has long been a cornerstone of the Spanish economy. The number of visitors in 2014 was 65 million, the third highest in the world, and yet another record was set in 2015 (around 68 million). Receipts of US$65.2 billion in 2014 were the second largest and helped to keep the current account in surplus (see Figure 5.9).

Figure 5.9. World's Top-10 Tourism Destinations, 2014 (by Visitors and Receipts)

	Visitors (mn)	Receipts (US$ bn)
1. France	83.7	55.4
2. US	74.8	177.2
3. Spain	**65.0**	**65.2**
4. China	55.6	56.9
5. Italy	48.6	49.5
6. Turkey	39.8	29.6
7. Germany	33.0	43.3
8. UK	32.6	45.3
9. Russian Federation	29.8	11.7
10. Mexico	29.1	16.3

Source: World Trade Organisation.

The labour-intensive industry, which generated around 11% of GDP and a larger share of total jobs, played a key role in Spain's economic recovery. The number of tourists visiting Spain rose by 12.8 million between 2009 and 2014 compared with much smaller rises of 6.9 million for France, 6.2 million for

Germany and 5.4 million for Italy (see Figure 5.10). Growth was spurred by price competitiveness and the Arab revolutions, which made tourists switch their holidays from these countries (and Greece) to Spain.

Figure 5.10. Tourism Visitors (million) and Receipts (US$ bn), 2009-14

	2009	2010	2011	2012	2013	2014
Visitors (mn)	52.2	52.5	56.7	57.5	60.7	65.0
Receipts (US$ bn)	53.2	52.5	59.9	56.3	62.6	65.2

Source: World Trade Organisation.

Tourism is nothing new in Spain; the country pioneered mass tourism and package tours in the 1960s. It was blessed with hundreds of kilometres of virgin coastline that was quickly developed (and much of it eventually ravaged) with hotels and apartment blocks that were cheap by European standards. Benidorm, a sleepy village of fishermen and farmers on the Mediterranean coast in the 1960s, became the archetypal resort for mass tourism and package tours. Today, Benidorm has Europe's tallest hotel, the Gran Bali, with 52 floors and 776 rooms.

In addition to a plentiful supply of beaches, Spain has 44 UNESCO-declared World Heritage Sites, the most of any country after Italy and despite being a late joiner in 1984 and largely known abroad for little more than its beaches. The list is wide-ranging and testimony to Spain's situation as a cradle of different cultures and civilisations.[1] It takes in almost the entire history and geography of Spain, including Atapuerca near Burgos, where archaeologists discovered human bones in the late 1990s that date back 800,000 years, the Roman aqueduct in Segovia, the Alhambra Islamic palace in Granada and the Jacobean route to Santiago de Compostela, along which pilgrims began to walk in the Middle Ages to the Galician city's cathedral where tradition has it that the remains of the apostle St. James were buried.

Spain led the World Economic Forum's tourism competitiveness ranking in 2015, up from fourth place in the 2014 index and eighth in 2011 (see Figure 5.11). The ranking is divided into four indices which, in turn, cover 14 pillars. Spain excels in cultural and natural resources as well as in most of the infrastructures related to the tourist industry, but it was below the European average from a business perspective (ranked 100th out of a total of 141 countries in 2015 compared with 56th in 2008). Price competitiveness had also not improved over the last few years, which was surprising given Spain's wage restraint and moderate price rises. This was probably due to the incorporation into the report of new countries that are highly price-competitive rather than any standstill in Spain. The country has quickly adapted to digital consumer trends: there were reportedly more rooms available in 2014 via Airbnb-like rentals than through traditional hotels.

Figure 5.11. Travel and Tourism Competitiveness Index, 2015 Ranking

Country and ranking (out of 141)	Score (1-7)
1. Spain	**5.31**
2. France	5.24
3. Germany	5.22
4. US	5.12
5. UK	5.12
6. Switzerland	4.99
7. Australia	4.98
8. Italy	4.98
9. Japan	4.94
10. Canada	4.92

Source: World Economic Forum (2015), 'Travel and Tourism Competitiveness Report'.

The index is based on four sub-indexes, 14 pillars and 90 individual indicators. The low rank for business environment (100th) reflected the red tape related to construction permits and an inefficient legal framework, while the labour market (113th) was still assessed as somewhat rigid (see Figure 5.12).

Figure 5.12. Spain's Position in the Main Components Comprising the Travel and Tourism (T&T) Index

	Rank out of 141 countries	Score (1-7)
Enabling environment	**35**	**5.26**
Business environment	100	4.09
Safety and security	31	5.97
Health and hygiene	33	6.11
Human resources and labour market	34	4.87
ICT Readiness	31	5.26
T&T policy and enabling conditions	**8**	**4.66**
Prioritization of travel and tourism	6	5.89
International openness	41	3.93
Price competitiveness	105	4.22
Environmental sustainability	29	4.61
Infrastructure	**2**	**5.68**
Air transport infrastructure	12	4.91
Ground and port infrastructure	10	5.54
Tourist service infrastructure	4	6.58
Natural and cultural resources	**4**	**5.64**
Natural resources	14	4.59
Cultural resources and business travel	1	6.69

Source: World Economic Forum.

Despite its success, the share of Spain in world tourism decreased in the last decade (from 6.8% to 5.7%) as its model relied mainly on coastal seasonal tourism, which faced increasing competition from cheaper destinations such as Turkey. The latter attracted 23 million more tourists between 2004 and 2014, compared with Spain's rise of 12.6 million during the same period.

Spain was also beginning to suffer tourism fatigue. The authorities in Barcelona, Spain's most visited city, and the Canary Islands suggested in 2015 that the time had come to limit the influx of visitors before they become overrun and residents are driven out to live elsewhere. The city of Gaudí welcomed 1.7 million visitors in 1990, 3.1 million in 2000 and a staggering 7.5 million in 2014.

Chapter 6
Banks

1. What Led to the Banking Crisis?

Spanish banks were not exposed to the US subprime mortgage crisis, but they were heavily exposed to toxic real-estate assets following the bursting of a massive property bubble in 2008 which triggered a recession. By the end of the construction boom in 2008, the stock of loans to real-estate developers and builders was almost €500 billion (50% of Spain's GDP). The loan defaults of property developers and construction firms as a percentage of total bank lending to these two sectors (known as the non-performing loan, or NPL, ratio) surged from a mere 0.6% in 2007 to more than 25% in 2012. The total NPLs of Spain's banks peaked at 13.6% of lending to all sectors in 2013 (excluding the toxic loans placed in a specially created 'bad bank'), up from a mere 0.7% in 2006.

The banking crisis was concentrated in the regionally-based savings banks, known as *cajas,* which accounted for around half the domestic banking system. The origin of savings banks dates back to the old thrift institutions (*Montes de Piedad*) from the 18th century, whose main objective was to channel people's savings towards investments and to provide social services in their respective territories. The *cajas* were not limited companies and so did not have share capital. In the absence of shareholders, they were governed by a general assembly (representing the various stakeholders ranging from 'insiders' –employees and depositors– to 'outsiders' from local and regional governments), a board of directors packed with political appointees sometimes with little or no knowledge of banking and a control committee. Instead of paying dividends, the *cajas* channelled funds into community projects. The removal of restrictions in 1989 on establishing branches outside their home regions enabled the *cajas* to expand their universal banking activities around Spain, and they did so at an inexorable pace. The number of savings-bank branches rose from 13,642 in 1990 to a peak of 25,001 in September 2008, while the number of branches of the more prudent commercial banks –mainly Santander, BBVA and Popular– dropped over the same period from 16,917 to 15,657. As of end-2009, the more than 40,000 branches meant there was almost one branch for every 1,000 inhabitants in Spain, almost twice the density of the euro-area average. When the property bubble burst, the

cajas were hard hit by loan defaults, and this sparked a banking collapse similar in depth to that of the savings-and-loans crisis in the US in the late 1980s.

The culture of a large number of the *cajas* was one of greed, cronyism, nepotism and political meddling, and there was also a woeful lack of adequate supervision by regulatory bodies and an entrenched habit of looking the other way. The board members of the failed *cajas* included someone who subsequently admitted she knew little about financing as her background was in chemistry (she was made a member of the audit committee) and a ballet teacher with no financial knowledge. A study by two economists convincingly showed that *cajas* whose chairman was a political appointee had a very significantly worse loan performance.[1]

The first to fall was Caja Castilla La Mancha (CCM) in March 2009, when the Bank of Spain took over its administration. Among other reckless projects, CCM had provided finance to build the white-elephant airport at Ciudad Real. Two other *cajas*, CajaSur, mainly controlled by the Roman Catholic Church, and Caja de Ahorros del Mediterraneo (CAM), based in Valencia, ground zero of the property collapse, were also seized.

The most spectacular near collapse in May 2012 was that of Bankia, the fourth-largest lender, which had been created in December 2010 from the merger of seven ailing *cajas* including Caja Madrid and was headed by Rodrigo Rato, a former Managing Director of the International Monetary Fund (with the rank of Head of State) and Popular Party Economy Minister. Bankia had been floated on the Madrid stock exchange in July 2011. Officials hoped the creation of Bankia would resolve the crisis, but instead it sparked the biggest banking catastrophe in Spain's history, and this in a country with crises in the 1970s, 80s and 90s. This time, however, the crisis was mainly confined to savings and not commercial banks.

The more than 350,000 retail investors who bought preferred shares in Bankia in the belief they were a safe investment saw their savings virtually wiped out by a share price that plummeted 80% in the bank's first year (althought some could get their money back in the courts by proving they had been intentionally misled). The Popular Party government partly nationalised Bankia in order to avert a full-blown collapse that could have dragged down the whole financial system and forced Spain out of the euro. The government sweated in the summer of 2012 to stave off a sovereign bailout by the euro zone.

Bankia was the subject of a criminal investigation for alleged errors in the accounts underlying its initial public offering (IPO) in 2011, as well as to related lawsuits for damages. Dozens of bankers, politicians and trade-union officials

faced charges for using 'phantom' corporate cards issued by Caja Madrid between 2003 and 2012 to go on a €15 million spending spree. The cards were handled separately from regular corporate expenses, and were largely used for restaurants, hotels, clothes and other private whims.

In a decade, the standing and reputation of the Spanish banking system moved from that of an internationally-hailed model to one of disgrace. The Bank of Spain had pioneered in 2000 an innovative countercyclical provisioning policy, called dynamic provisioning, that created a cushion during the upward phases of the economic cycle in order to soften the impact of bad loans on banks' earnings during the periods of lower growth, when defaults are higher. The commercial banks, in particular, used this macro-prudential policy tool to build up a buffer of provisions that enabled them to withstand the crisis relatively well, although they proved to be insufficient as banks did not report all of their losses when they should have, dynamically or otherwise. The authorities failed to see the scale at which the crisis unfolded. The Socialist Prime Minister José Luis Rodríguez Zapatero told a meeting of Wall Street bankers in New York, nine days after the collapse of Lehman Brothers in September 2008, that 'Spain has perhaps the most sold financial system in the world. It has a standard of regulation and supervision recognised internationally for its quality and rigour'.

Luis Linde, who took over as Governor of the Bank of Spain in June 2012, told a parliamentary committee, 'In the real estate and financial bubble years there was a sort of euphoria which led to the risks that were accumulating to not be seen, or not wish to be seen. It was as if nobody wanted to forecast scenarios of recession, interest-rate rises or collapses in funding'.[1]

2. The Steps Taken to Resolve the Crisis

By taking decisive action, the authorities prevented the 'tumour' in the savings banks spreading to the whole financial system. There was only one really dramatic period and that was during the first half of 2012, after the Popular Party took office, when the growing lack of confidence in the Kingdom of Spain and in the banking system contaminated the big commercial banks and produced credit-rating downgrades and serious liquidity problems. The downgrades emanated from cutting the sovereign rating as a bank's rating cannot be more than one notch above this. As a result of the downgrading of Spanish government bonds, the banks' ratings also slipped.

The first step was to set up the Fund for the Orderly Restructuring of the Banking System (FROB) in June 2009 to promote with public aid a series of mergers, interventions and acquisitions between savings banks. The total number

of these institutions declined from 45 in 2007 to two in 2015 (Pollença and Ontinyent, both of which are tiny) in 2015. Between 2008 and 2014, the total number of bank employees fell by 25% to 208,000.

In a key move, seven former savings banks became commercial banks (three of them quoted), separating their banking business from their social activities and making them more transparent. Barcelona-based Caixabank is the only large savings bank that survived the crisis in pretty well the same form as it entered it, only bigger. Caixabank and the other two big lenders, Santander and BBVA, escaped the meltdown largely unscathed.

José Ignacio Goirigolzarri, a former chief executive of BBVA, replaced Rato as chairman of Bankia in May 2012 and requested €19 billion in emergency capital. In July, the Eurogroup approved financial assistance for Spain of up to €100 billion. In December the European Stability Mechanism disbursed a total of €41.3 billion for Spain's banks. Spain's total support for the recapitalisation of banks (€62 billion) was the fourth largest in the EU after the UK (€100 billion), Germany (€64 billion) and Ireland (€63 billion). Bankia (€22 billion) received the third-largest amount after RBS (€50 billion) and Anglo Irish Bank (€32 billion). Bankia restated its 2011 results to reflect a loss of €2.97 billion (the biggest ever in Spain's corporate history), having earlier declared a net profit of €309 million. This followed Deloitte's refusal to sign off on that year's accounts, although it had approved the financial statements for the July 2011 stock-market listing debut. In return for the rescue funds, Bankia had to cut around 6,000 jobs (28% of its staff) and close to 40% of its branches by 2015. Caja Madrid's magnificent historic headquarters in the centre of Spain's capital was up for sale in 2015 and the likely buyer was one of the big international hotel chains.

The government (through FROB) became the majority owner of a significant part of the banking sector (holding around 18% of system loans). The banks under EU-approved restructuring or resolution plans had to downsize and cut costs, and divest the government's ownership by no later than the end of 2017. The total number of bank branches was 31,412 in June 2015, down by more than 9,000 in seven years and with the loss of more than 60,000 jobs.

The government created a 'bad bank' (known by its Spanish acronym as Sareb) to absorb and eventually re-sell soured property assets. Just over €50 billion of assets were transferred from the bailed-out banks in two tranches in late 2012 and early 2013, most notably from Bankia. Sareb was given 15 years to sell off its assets. At the end of 2014, the assets had been whittled down to just over €44 billion. Sareb recorded a loss of €585 million in 2014, up from €261 million in 2013, on the back of provisions of €719 million on some of its assets after consultation with the Bank of Spain. Excluding the provisions, Sareb made a loss of €45 million, a significant reduction on 2013.

The six largest banks were estimated to hold around 65,000 residential properties on their books at the end of 2014, most of them on the Mediterranean coast in Valencia, Catalonia and Andalusia. Santander, for example, sold 26,600 units (its own sales, those of promoters and rentals) in 2013 and 2014.

Reforms were enacted under a Memorandum of Understanding (MoU) with the European Commission, the European Central Bank and the IMF on financial-sector policy conditionality, which set out the measures to reinforce financial stability. As well as adopting tougher measures regarding accounting for provisions and increasing banks' capital sector-wide, the treatment of foreclosed property and land and of real estate collateral was tightened. The increase in provisions for bad loans made by banks between 2007 and 2012 were the equivalent of more than 20% of Spanish GDP in 2011. The average coverage of loans to the real-estate sector increased from 18% at the end of 2011 to 45% a year later. The value of banks' assets was adjusted to better reflect market reality. A new minimum core capital ratio was set at 8% (10% for banks highly dependent on wholesale funding markets).

Injections of public sector capital, burden-sharing exercises, asset sales, private equity issuance and the requirement for all intervened banks to transfer their foreclosed assets and real-estate loans over a certain amount to Sareb, in exchange for government-guaranteed Sareb bonds to be used as collateral for European Central Bank financing, made the banking system, more solvent. Non-performing loans continued to rise and peaked at 13.6% (excluding the toxic assets in Sareb) of total lending in 2013 (see Figure 6.1).

Figure 6.1. Core Financial Soundness Indicators, 2007-15 (% or otherwise indicated) (1)

	2007	2010	2012	2013	2015
Solvency					
Regulatory capital to risk weighted assets	11.4	11.9	11.5	12.1	14.4 (2)
Tier 1 capital to risk weighted assets	7.9	9.7	9.9	10.9	12.6 (2)
Profitability					
Return on average assets	1.1	0.5	-1.4	0.4	0.7 (2)
Return on average equity	19.5	7.2	-21.5	7.4	10.3 (2)
Asset quality[1]					
Non-performing loans (€ bn)	16.3	107.2	167.5	191.0	141.3 (3)
Non-performing loans to total loans (%)	0.9	5.8	10.4	13.6	10.6 (3)

(1) Private sector, non-consolidated figures. (2) June. (3) October.
Source: Bank of Spain, European Central Bank, Bloomberg and the IMF.

EU-wide stress tests were conducted on banks in 2010, 2011, 2012 and 2014 in an exercise overseen by the European Banking Authority (EBA) to gauge the extent to which banks would survive recession scenarios of varying severity.

The quality of the first tests, however, proved to be inadequate for Spain, as practically nobody had foreseen that the country would still be in recession in 2012 and 2013. They were also undermined by the intensified deterioration of the euro-zone crisis. The Popular Party government requested an independent assessment of the degree of solvency of the banking system by Oliver Wyman, a consultancy. A bottom-up review of 14 banks showed in September 2012 they would need 'only' €40-€59 billion of bail-out money (around 5.5% of GDP) from European rescue funds in the event of a further serious downturn in the economy.

Spain's banks sailed through the asset-quality review by the European Central Bank in 2014 (see Figure 6.2). Only one bank failed (Liberbank) but it had already adopted capital-strengthening measures on a scale far exceeding that needed to cover the shortfall identified. In an overlapping review, the EBA released the results of a complementary set of stress tests that showed 24 failures for the whole of the EU, and none of them in Spain. The results vindicated the Bank of Spain's handling of the crisis. Spanish banks needed the least adjustment to their balance sheets of the analysed banks (less than 0.2% of their risk-weighted assets). Luis Linde, the prudent Governor of the Bank of Spain, warned, however, there was no cause for triumphalism as the assessment was a 'fixed photo and not a guarantee for the next 15 years'.

Figure 6.2. Results of Spanish Banks in the Asset Quality Review: Common Equity Tier 1 Capital Ratio (%)

	Lowest ratio in the adverse scenario (5.5% minimum) (1)	Lowest ratio in the baseline scenario (8% minimum) (1)	Adjusted for the asset quality review (8% minimum)
Kutxabank	11.82	12.36	12.03
Bankinter	10.80	11.63	11.67
BFA-Bankia	10.30	12.33	10.60
La Caixa	9.25	10.79	10.24
NCG Banco	9.14	11.50	10.18
BBVA	8.97	10.24	10.54
Banco Santander	8.95	11.05	10.34
Unicaja	8.89	11.12	10.88
Banco Sabadell	8.33	10.16	10.26
BMN	8.09	10.30	9.01
Catalunya Banc	8.02	11.76	12.21
Cajamar	7.99	10.17	9.95
Ibercaja	7.82	10.31	10.01
Banco Popular	7.56	10.20	10.06
LIberbank	5.62	8.51	7.82

(1) The scenarios covered 2014-16.
Source: European Central Bank.

Supervisory procedures were enhanced, including extending on-site continuous monitoring to all significant banks and the introduction of forward-looking exercises in order to regularly assess the solvency position. Unlike the stress tests, which were one-off exercises based on a pass-fail methodology, these exercises are intended as a permanent framework to help the Bank of Spain monitor banks' health and guide its supervisory decisions. The Bank of Spain also reorganised its Directorate General of Banking Supervision, creating a structure that mirrors that of the European Central Bank's Single Supervisory Mechanism. The ratios of the five largest banks, which account for 58% of the system's assets, were considerably better at the end of 2014 (see Figure 6.3).

Figure 6.3. Ratios of Spain's Top Five Banks, 2014 (%)

	BIS capital (total)	NPL (1) to total loans	Loans to assets	RWA (2) to assets	Cost to income
Santander	12.00	5.20	63.16	42.26	39.32
BBVA	15.10	5.80	59.78	55.52	47.02
La Caixa	16.10	9.70	59.77	41.26	51.85
Bankia	14.50	12.91	52.53	37.81	39.05
Popular	11.96	13.78	71.57	49.62	44.52

(1) Non-performing loans. (2) Risk-weighted assets.
Source: The Banker, July 2015.

Lastly, 'rogue' bankers were investigated and in a very few cases they were brought to trial and given prison sentences. Spain, however, was a long way from the situation in the City of London where nearly 6,000 bankers, brokers and financial advisers were sacked or suspended for misconduct since the start of the financial crisis in 2008, according to the Financial Conduct Authority.

3. The Results of the Reforms and Banks' Performance

Banks suffered a bruising crisis, which led to the closure of 31% of branches, the shedding of 25% of employees and a clean-up that was the equivalent of 27% of GDP. Spain exited its 18-month €41.3 billion bailout by the European Stability Mechanism in January 2014, and as of end-October 2015 it owed €35.7 billion. The European Commission said the repayment risks for the loan were 'very low'.

Bank earnings have gradually improved. Attributable profits increased by close to 34% in 2014, and those of the four largest banks (Santander, BBVA, Caixabank and Bankia) rose 16% year-on-year in the first nine months of 2015 to €8.7 billion. Bankia's profits surged 93% to €698 million, boosted by cost-cutting, capital gains from stake sales and lower provisions as bad loans came down.

It would seem from this that the good times have returned, but this was not yet the case as the improvement in profitability was largely due to declining funding costs, the reduced need to provision against loan losses, income generated by banks' fixed-income portfolios and, in some cases, to the incorporation of banks acquired and activity abroad (see Figure 6.4).

Figure 6.4. Consolidated Income Statement of Spain's Banks, 2015 (1)

	June 15		June 14	June 15
	€ mn	% chg. 15/14	% ATA (2)	% ATA (2)
Financial revenues	55,254	-1.5	3.32	3.14
Financial costs	21,064	-16.5	1.50	1.20
Net interest income	34,191	10.8	1.83	1.94
Return from capital instruments	806	-12.3	0.05	0.05
Share of profit or loss of entities accounted for by the equity method	2,175	29.7	0.10	0.12
Net commissions	11,643	4.2	0.66	0.66
Gains and losses on financial assets and liabilities	7,264	3.6	0.42	0.41
Other operating income	-409	-	-0.08	-0.02
Gross income	55,670	10.8	2.98	3.16
Operating expenses	25,686	7.3	1.42	1.46
Net operating income	29,983	13.9	1.56	1.70
Asset impairment losses (specific & general provisions)	12,260	-10.5	0.81	0.70
Provisioning expense (net)	2,619	87.6	0.08	0.15
Operating profit	15,104	34.6	0.67	0.86
Asset impairment losses (assets other than loans & credit)	2,282	0.6	0.13	0.13
Income from disposals (net)	2,149	-37.6	0.20	0.12
Profit before tax	14,972	20.7	0.73	0.85
Net income	12,594	37.1	0.54	0.72
Memorandum item				
Income attributable to the controlling entity	11,020	38.7	0.47	0.63

(1) First half. (2) ATA= average total assets.
Source: Bank of Spain.

Net interest income (the money a bank makes on its core lending activities) generated in Spain was up 4.2% in the first half of 2015 year-on-year to €12.73 billion, but this was due to a 35.6% drop in financial costs and a 17.1% fall in financial revenue (see Figure 6.5). Growth in loans in Spain was still sluggish and consumer demand low, while non-performing loans plus foreclosed assets amounted to a whopping €224 billion, 8.7% of the total assets of banks' business in Spain. These two types of assets do not generate revenue and reduce the capacity to generate profits. Return on equity in Spain was around 5%, below the cost of capital, estimated at 8%.

Figure 6.5. Income Statement of Spanish Banks' Business in Spain, 2015 (1)

	June 15		June 14	June 15
	€ mn	% chg. 15/14	% ATA (2)	% ATA (2)
Financial revenues	21,850	-17.1	2.10	1.73
Financial costs	9,114	-35.6	1.13	0.72
Net interest income	12,736	4.2	0.97	1.01
Net commissions	5,329	1.1	0.42	0.42
Gains and losses on financial assets & liabilities	4,727	-20.8	0.48	0.38
Gross income	27,248	-4.3	2.27	2.16
Operating expenses	12,408	1.0	0.98	0.98
Net operating income	14,840	-8.3	1.29	1.18
Asset impairment losses (specific & general provisions)	8,393	-17.2	0.81	0.67
Net income	5,748	3.2	0.44	0.72

(1) First half. (2) ATA = average total assets.
Source: Bank of Spain.

Spain's total impairment charges in 2014 represented 32.8% of total operating income, the sixth-largest proportion (see Figure 6.6). The non-performing loan ratio in 2015 was still high at more than 10%, though down from the peak of 13.6% at the end of 2013.

Figure 6.6. Top Countries for Total Impairment Charges, 2014

	Proportion of total operating income (%)
Ukraine	122.1
Greece	108.9
Portugal	53.4
Italy	43.3
Russia	39.7
Spain	**32.8**

Source: The Banker, July 2015.

The environment of very low interest rates and the large volume of non-productive assets will continue to bear down on banks' income statements. In the Bank of Spain's view, this makes it necessary for banks to create more sustainable business models, involving the application of new technologies, new activities and a branch and staffing structure better tailored to attaining this model.

Banks could also be hit by a European Commission recommendation in November 2015 that Spain's Supreme Court compensate in full customers whose mortgage contracts were found to have illegal interest rate floors. The sum involved could run into the billions of euros. In May 2013 the court ruled that the floors of three banks were null and void because the clauses were not clearly and

transparently explained. However, it said that the ruling could not be retroactive as this would imperil the financial system. The Commission's observation was not binding on the court.

The downturn in emerging economies such as Brazil also began to affect the big banks, whose wide geographical diversification over the past 20 years helped to mitigate the impact of the depressed market in Spain on business during the crisis period (see Figure 6.7).

Figure 6.7. Geographical Breakdown of Spanish Banks' Financial Assets Abroad, 2015

	%
UK	29.2
US	15.6
Mexico	9.8
Brazil	9.0
France	4.4
Portugal	4.3
Chile	3.8
Germany	3.7
Turkey	1.3
China	0.4
Rest of Europe	10.7
Rest of Latin America	4.6
Rest of the world	3.1

Source: Bank of Spain.

Santander, the second largest bank in the euro zone by market capitalisation and one of the world's 30 global systemically important banks ('too big to fail'), had four of the world's top 25 banks in 2014 on the basis of the pre-tax profits of foreign-owned subsidiaries, and BBVA one (see Figure 6.8). These two banks' foreign networks were respectively the second and third most profitable in the Top 1,000 World Banks ranking of *The Banker* magazine (see Figure 6.9). Santander delivered a profit every year since the crisis in 2008 and paid a dividend every quarter, but it was not expected to beat its overall profit record in 2009 (€8.9 billion) until 2017/18, according to some forecasts. Both Santander and BBVA were rated one notch above the sovereign's rating.

Figure 6.8. Top 25 Profits for Foreign-Owned Subsidiaries, 2014

Rank	Bank	Country	Pre-tax profits (US$ mn)	Parent country
1.	HSBC	Hong Kong	14,336	UK
2.	Santander USA	US	4,121	**Spain**
7.	Santander Brazil	Brazil	2,426	**Spain**
9.	Santander UK	UK	2,183	**Spain**
10.	BBVA Provincial	Venezuela	2,136	**Spain**
20.	Grupo Fin. Santander	Mexico	1,143	**Spain**

Source: The Banker, July 2015.

Figure 6.9. Top 5 Most Profitable Foreign Networks, 2014

	Pre-tax profits of foreign-owned subsidiaries (US$ mn)	Pre-tax profits of bank holding company (US$ mn)
HSBC Holdings	21,729	18,680
Santander	**12,739**	**12,928**
BBVA	**7,125**	**4,289**
Unicredit	5,937	4,830
BNP Paribas	5,061	3,822

Source: The Banker, July 2015.

Commercial banks, and not just the big ones, spent more than US$100 billion since 2007 on acquisitions, buying up ailing savings banks, acquiring the networks of foreign banks when they beat a retreat from the Iberian Peninsula and expanding further abroad. Bankinter bought Barclay's banking business in Portugal (in only its second deal abroad), Caixabank purchased Barclay's Spanish franchise –Banco Popular Citi's–, Banco Popular acquired 24.9% of Mexico's Grupo Financiero Ve por Más and Banco Sabadell TSB in the UK, which boosted its assets outside Spain to more than a fifth, up from 5% in 2014.

In a clear sign of the turnaround, only six Spanish banks had to undergo the EU-wide stress test in 2016 conducted by the European Banking Authority (EBA), compared with 15 at the last test in 2014. All banks met the Common Equity Tier 1 (CET1) ratio required by the European Central Bank in 2016. This key metric varied depending on a bank's assets, risk profile and systemic importance (see Figure 6.10)

Figure 6.10. Common Equity Tier 1 (CET1) Ratios of Main Spanish Banks (%)

	CET1 required (consolidated)	CET1 at 30/IX/2015
Caixabank	9.05	12.80
Bankia	10.31	13.60
Santander	9.75	12.39
BBVA	9.75	11.70

Source: National Securities Market Commission.

The banks are out of the woods, but face a new set of challenges resulting from the combination of increasing regulatory pressure, which requires higher capital, and the need to further improve efficiency. The latter will have to come from further cost-cutting as the room to boost revenues from core banking activities, such as lending (very competitive), is limited by interest rates that are expected to remain low for some time. This raises questions on the viability of the current retail banking model and the need for new business models. Further consolidation of the banking sector cannot be excluded.

Chapter 7
The Inexorable Rise of Spain's Multinationals

1. How the Multinationals were Formed

Anyone who had predicted 20 years ago that Spanish companies and banks would attain significant global positions would have been laughed at for being as deluded as Don Quixote. But this is precisely what happened. While the influx of immigrants has been the most significant inward development, the most important outward one has been the massive investment abroad by companies and the creation of a bevy of multinationals. Companies in sectors ranging from food processing to sparkling wine, clothing, sanitary equipment, wheel trims and wind farms, to mention just a few, are leaders in their fields, while Santander was the second largest bank in the euro zone in 2015 by market capitalisation and one of the world's systemically important banks, meaning that it was 'too big to fail' (see Figure 7.1).

Figure 7.1. Spanish Multinationals with the Largest Global Market Positions (1)

Company	Industry	Global market position
Ebro Foods	Food processing	#1 trader/miller of rice, & #2 producer of pasta
Grupo SOS	Food processing	#1 producer of olive oil
Viscofán	Food processing	#1 producer of artificial casings for the meat industry
Freixenet	Sparkling wine	#1 producer of sparkling wine
Tavex	Textiles	#1 producer of denim
Inditex	Clothing	#1 fashion retailer by sales
Pronovias	Clothing	#1 maker of bridal wear
Acerinox	Steel	#1 producer of stainless steel
Repsol	Energy	#15 largest publicly-listed oil & gas company by production
Roca	Sanitary equipment	#1 maker of sanitary equipment
Grupo Antolín	Automotive	#1 supplier of headliner substrates
Zanini	Automotive	#1 producer of wheel trims
Gamesa	Machinery	#4 manufacturer of wind turbines
Indo	Optical equipment	#3 manufacturer of lenses
Iberdrola Renovables	Electricity	#1 producer of wind power

Company	Industry	Global market position
Ferrovial/Cintra	Infrastructure	#6 developer & manager of transport infrastructure (2)
ACS/Hochtief	Infrastructure	#1 developer & manager of transport infrastructure (2)
Acciona Energy	Infrastructure, renewable energy & water	#5 wind farm owner-operator
Abertis	Infrastructure	#5 developer & manager of transport infrastructure (2)
Telefónica	Telecoms	#7 operator by total accesses
Santander	Banking	#1 by market capitalisation in the euro zone, & #1 franchise in Latin America
Prosegur	Security	#3 company by sales
Meliá International	Hotels	#1 holiday hotel chain by number of beds
Real Madrid	Sports	#1 football club by revenue

(1) Latest available. (2) Ranked by number of road, bridge, tunnel, rail, port and airport concessions over US$50 million investment value put under construction or operation as of 1 October 2015.
Source: compiled by William Chislett, Esteban García-Canal and Mauro F. Guillén from Interbrand, Public Works Financing, BrandFinance, Bloomberg, the Spanish Business Council for Competitiveness and company reports.

These companies are the most dynamic part of corporate Spain, and some of them are household names. The companies that comprised the Ibex-35 benchmark index of the Spanish stock exchange generated more than 60% of their revenues abroad in 2015 (see Figure 7.2). This was particularly important during Spain's long recession as it offset the steep decline in business in the home market.

Figure 7.2. International Revenues of Ibex-35 Companies, First Half of 2015 (€ mn and % of total revenues)

Company	Sector	Total revenues (€ mn)	International (% of total)
Abengoa	Engineering	3,390	86.4
Abertis	Motorways	2,047	71.4
Acciona	Construction	3,304	51.9
Acerinox	Stainless steel	2,315	90.3
ACS	Construction & services	17,860	81.6
Aena	Operator of airports	1,567	5.9
Amadeus	Travel technology	1,977	95.7
Banco Popular	Banking	1,836	8.6
Banco Sabadell	Banking	2,128	7.1
Santander	Banking	29,182	87.3
Bankia	Banking	1,911	4.1
Bankinter	Banking	657	0.0
BBVA	Banking	10,666	70.8
CaixaBank	Banking	4,573	0.1
Día	Supermarket chain	4,342	43.8
Enagás	Gas	580	0.4
Endesa	Electricity	9,783	8.9
FCC	Construction	3,162	47.4
Ferrovial	Construction	4,736	71.3

Company	Sector	Total revenues (€ mn)	International (% of total)
Gamesa	Engineering	1,651	92.9
Gas Natural Fenosa	Gas	13,685	55.8
Grifols	Pharmaceutical	1,901	94.2
IAG	Airline	9,624	85.0
Inditex	Fashion retailer	9,421	82.4
Iberdrola	Electricity	16,126	54.3
Indra	Electronics	1,409	56.4
Mapfre	Insurance	9,226	68.6
Mediaset	Media	474	2.0
OHL	Construction	1,976	79.5
Red Eléctrica	Electricity grid	973	2.0
Repsol	Oil	20,119	47.5
Sacyr	Construction	1,338	51.3
Técnicas Reunidas	Engineering	1,884	97.3
Telefónica	Telecoms	23,419	74.0
Total		219,237	63.6

Source: National Securities Market Commission (CNMV).

The first and very modest wave of outward direct investment occurred in the 1960s and early 1970s and accounted for a mere 0.1% of total international outflows of foreign direct investment (FDI). Spain at that time was opening its economy after moving away from the autarky that followed the country's 1936-39 Civil War. Spain's share in FDI flows increased to 0.3% in the 1970s when investment in Latin American and Caribbean countries accounted for more than half the country's total outflows. Financial and commercial activities accounted for around three-quarters of Spanish direct investment in Latin America. Latin America's external debt crisis, triggered by Mexico's default in 1982, plunged countries into recession and changed the course of Spain's investment abroad. By 1985 the region's share of total direct investment had fallen from more than 50% to 20%.

The catalyst for a much stronger drive in outward investment came from joining the European Economic Community (as it was then known) in 1986 and the 1992 Treaty of Maastricht which created the EU. The strategic focus of corporate Spain changed from one of defending the relatively developed home market to aggressively expanding abroad. The liberalisation of the domestic market as European single-market directives began to unfold made the big Spanish companies –particularly the state-run companies in oligopolistic sectors such as telecommunications (Telefónica), oil and natural gas (Repsol and Gas Natural) and electricity (Endesa), all of which were privatised and became cash rich– and the large private sector commercial banks conscious of the need to reposition themselves in the more competitive environment. The tougher environment was

underscored by the boom in foreign direct investment in Spain in the first years after EEC entry, when hardly a week passed without an acquisition and it seemed that Spain was up for sale.

Liberalisation gave Spanish companies and banks the chance to go on the offensive, and they seized the opportunity in the 1990s provided by the wave of privatisations in Latin America. Total outward investment surged from a yearly average of US$2.3 billion in 1985-95 to US$44.3 billion in 1999 and a peak of US$137 billion in 2007, the third highest amount in the EU after the UK and Germany and the fourth in the world including the US, according to UNCTAD (see Figure 7.3).

Figure 7.3 FDI Outflows by Country, 1990-2014 (US$ bn)

	1990	1995	2000	2007	2010	2014
France	38.3	15.7	161.9	110.6	48.1	42.9
Germany	24.2	39.0	56.5	169.3	125.4	112.2
Italy	7.6	5.7	6.7	96.2	32.6	23.4
Spain	**2.6**	**4.6**	**58.2**	**137.0**	**37.8**	**30.7**
UK	17.9	43.5	235.4	319.3	46.6	-59.6

Source: 2015 World Investment Report, UNCTAD.

Spain's stock of outward investment rose from US$15.6 billion in 1990 to US$674 billion in 2014, the 10th largest in the world, and in GDP terms from 15.6% to 48%, higher than Italy on an absolute and relative basis (see Figure 7.4). The stock rose 43-fold between 1990 and 2014, making Spain the fifth most-internationalised economy based on the volume of its foreign trade and direct investment. The country's share of the global stock of outward FDI at 2.6% was well above Spain's 1.8% share of the world's GDP, and as with inward FDI into the country punched above its weight (see Figure 7.5).

Figure 7.4. Outward Stock of Foreign Direct Investment of Main EU Countries, 1990-2014 (US$ bn and % of GDP)

	1990	% of GDP	2000	% of GDP	2014	% of GDP
France	119.8	9.4	365.9	26.7	1,279.0	44.9
Germany	308.7	19.4	541.9	27.7	1,583.3	41.0
Italy	60.2	5.3	169.9	14.8	548.4	25.5
Spain	**15.6**	**2.9**	**129.2**	**21.6**	**674.0**	**48.0**
UK	229.3	20.9	923.4	59.5	1,584.2	53.8

Source: 2015 World Investment Report, UNCTAD.

Figure 7.5. World Ranking of Outward Stocks of Foreign Direct Investment (US$ bn and % of the global total)

	US$ bn	% of global total
US	6,318.6	24.4
UK	1,584.2	6.1
Germany	1,583.3	6.1
Hong Kong, China	1,459.9	5.6
France	1,279.1	4.9
Japan	1,193.1	4.6
Switzerland	1,130.6	4.4
Netherlands	985.2	3.8
Canada	714.5	2.8
Spain	**674.0**	**2.6**

Source: 2015 World Investment Report, UNCTAD.

The major expansion abroad, as of the 1990s, came after a wave of mergers, restructurings and privatisations in Spain that increased the critical mass of companies and banks. Spain had eight companies in Fortune's Global 500 ranking of the world's largest companies published in July 2015 based on total revenues, two less than Italy but well below France's 31 and Germany's 28 (see Figures 7.6 and 7.7). In 1995, when the ranking started, the only Spanish companies in the list were INI, the state-owned industrial holding, and Repsol, the oil and gas group.

Figure 7.6 Spanish Companies in the Fortune Global 500 (US$ bn)

Ranking out of 500	Company	Sector	Revenue (US$ bn)
67.	Santander	Banking	100.7
140.	Telefónica	Telecommunications	66.8
188.	Repsol	Petroleum refining	54.7
203.	ACS	Engineering, construction	51.2
221.	BBVA	Banking	47.7
283.	Iberdrola	Utilities	39.8
370.	Gas Natural Fenosa	Energy	32.8
399.	Mapfre	Insurance	29.7

Ranked by total revenues for their respective fiscal years ended on or before 31 March, 2015.
Source: Fortune.

Figure 7.7 Fortune Global 500 by Country

Country	Number of companies
US	128
China	98
Japan	54
France	31
Germany	28
UK	28
South Korea	17
Netherlands	13
Canada	11
Spain	**8**

Source: Fortune.

Santander, BBVA, Telefónica, Iberdrola, Inditex and Repsol formed part of the Euro Stoxx 50 comprising the largest euro-zone stocks by market capitalisation, and some of these companies, such as Telefónica and Santander, were also part of the Dow Jones Sustainability World Index, based on long-term economic, environmental and social criteria (see Figure 7.8).

Figure 7.8. Dow Jones Sustainability World Index Companies by Country (1)

Country	Number of companies in the index
France	27
Germany	20
Italy	10
Spain	**16**
UK	47
US	51

(1) Effective as of 21 September 2015.
Source: S&P Dow Jones Indices.

Latin America was the natural first choice for Spanish companies wishing to expand abroad in the 1990s. Liberalisation and privatisation opened up sectors of the Latin American economy that were hitherto off limits, and there was an ongoing need for capital to develop the region's generally poor infrastructure. Other pull factors were the common language (Spanish) and the ease, as a result, with which management styles could be transferred. The macroeconomic fundamentals were better and democracy was taking root in an increasing number of countries. Spanish executives had also gained a lot of experience of how to compete in industries under deregulation in their own country.

Most of the Spanish investment in Latin America was in utilities, telecommunications, banking and infrastructure, sectors protected like Spain's once were and that began to be privatised and liberalised. The move into Latin

America was, as Professor Mauro Guillén has pointed out, the 'path of least resistance' for Spanish companies facing deregulation and take-over threats on their home ground. By 2005 Spanish companies had become the largest operators in telecommunications, electricity, water and financial services.

The shift away from Latin America and into Europe, particularly the UK, the US and Asia was marked by several emblematic investments: Santander's €12.5 billion purchase of the British bank Abbey in 2004, the acquisition by BBVA of two small banks in California and Texas, and Telefónica's purchase in 2005 of a stake in China Netcom and in 2006 of the O2 mobile telephony operator in the UK, Germany and Ireland for €26 billion –the largest Spanish acquisition of a foreign company after Repsol's purchase of the Argentine oil company YPF in 1999–.

Spain's direct investment in the US on a historical cost basis rose 24-fold between 1994 and 2014 to US$58.1 billion, almost three times higher than Italy's (see Figure 7.9). Despite this, only one dollar of every US$57 of foreign capital invested in the United States comes from Spanish companies.

Figure 7.9. Foreign Direct Investment in the US on a Historical Cost Basis, 1994-2014 (US$ mn)

	1994	2014
Total	480,667	2,901,059
Europe	294,035	1,977,215
France	32,950	223,164
Germany	39,630	224,114
Italy	2,904	21,824
Spain	**2,430**	**58,138**
UK	98,732	448,548
Rest	186,632	923,844

Source: US Bureau of Economic Analysis.

Spain's move away from investing in Latin America towards Europe and Asia was highlighted in UNCTAD's 2015 World Investment Report that showed that Spain's share of total investment flows to the region dropped from 17.1% in 1996-2003 to 8.5% in 2004-13. The combined share of the US and Spain, the two largest investors, in total FDI declined from 50.4% in 1996-2003 to 32.4% in 2004-13 (see Figure 7.10).

Figure 7.10. FDI to Latin America and the Caribbean by Main Home Countries (% shares of flows and stocks)

	Flows 1996-2003	Flows 2004-13	Stocks 2013
US	33.3	23.9	23.8
Netherlands	8.2	13.9	16.7
Spain	**17.1**	**8.5**	**10.6**
UK	3.3	4.2	3.7
France	4.1	3.2	3.1
Switzerland	1.3	3.7	2.4

Source: 2015 World Investment Report, UNCTAD.

The outward stock of investment dropped from €719.4 billion in 2013 to €673.9 billion in 2014, as a result of divestments for strategic reasons or in order to reduce debt burdens. Telefónica, for example, sold O2, the UK's second-largest mobile operator, to the Hong Kong conglomerate Hutchison Whampoa, the owner of the rival operator Three.

Companies started a new wave of acquisitions in 2014, following the recovery in the domestic economy and spurred by the building up of large cash reserves, interest rates at historically low levels, an abundance of liquidity in markets and stock markets with an appetite for those companies financing their purchases by increasing their capital. The largest investment was Repsol's purchase of Canada's Talisman Energy for €6.6 billion, which came more than two years after Argentina expropriated Repsol's majority stake in YPF (for which it received a US$5 billion settlement). In the banking sector, BBVA, Spain's second-largest bank, increased its stake in Turkey's Garanti Bank to almost 40% and Banco Sabadell, the fifth biggest, made its first significant foray abroad and acquired the 600 branches of the UK's TSB, which was spun out of Lloyds in 2014 after the latter was ordered to sell the business by European regulators as a condition of its £20.5 billion bailout during the 2007-09 financial crisis (see Figure 7.11). The purchase increased Sabadell's assets held outside Spain from 5% to 22%.

Figure 7.11. Spanish Acquisitions Abroad, 2014-15

	Sector	Company acquired and cost (€ mn)
Repsol	Oil and gas	100% of Canadian Talisman Energy, €6.6 bn plus debt
Gas Natural Fenosa	Gas	Chilean Compañía de Electricidad, €2.6 bn
CLH	Oil products pipeline	UK distribution network, €138 mn
BBVA	Banking	14.89% of Turkey's Garanti Bank, €1.8 bn
Banco Sabadell	Banking	Takeover of UK's TSB, €2.3 bn
Bankinter	Banking	Barclays retail & insurance business in Portugal for €175 mn
Abertis	Infrastructure	90% of Italy's Wind Galata, €693 mn
Vidrala	Container glass	UK's Encirc, €408 mn
NH	Hotels	Colombia's Royal, €66 mn
Tubacex	Stainless steel tubes	68% of India's Prakash & 65% of Italy's IBF, around €60 mn
Grifols	Pharmaceuticals	45% of US Alkatest,€38 mn
Enagas	Gas	Acquired with Belgium's Fluxys Swedegas for €200 mn
Grupo Antolín	Auto-parts	Acquired the car interior division of Magna for €490 mn

Source: Companies.

One of the most striking aspects of Spain's investment abroad is the extraordinary success of infrastructure and engineering companies. Anyone who has been coming to Spain over the last 30 years can testify to the striking transformation of the country's infrastructure, with the building of a network of world-class motorways, airports and a high-speed railway line, the second largest in the world after China. If any criticism can be made it is that excessive emphasis was placed on improving infrastructure and not enough on enhancing human capital, as the country's long economic crisis and high unemployment rate revealed. What is generally less well known is the success of Spanish companies in winning flagship infrastructure contracts abroad, including the building of the high-speed railway line between Mecca and Medina in Saudi Arabia and the widening of the Panama Canal, to name just a few (see Figure 7.12).

Figure 7.12. Major Infrastructure Works led by Spanish Companies

	Total value of the contract and details
Saudi Arabia	€6.73 bn. Design & construct the high-speed railway line between Mecca & Medina. Awarded to a Spanish-Saudi consortium (12 Spanish companies)
Saudi Arabia	€6.03 billion. Design & construct lines 4, 5 and 6 of the Riyadh underground railway (65 km of tracks, 25 stations and 24 viaducts). FCC leads the consortium
Peru	€3.9 bn. Lima underground railway. Awarded to a consortium led by ACS (25%) & FCC (19%)
Australia	€3.7 bn. East West Link in Melbourne, the largest civil works project in the country. Awarded to Acciona
Turkey	€2.5 bn. Tunnel under the Bosphorus & Istanbul-Ankara high-speed railway. Awarded to a consortium led by OHL
Panama Canal	€2.48 bn. Building new access channels & locks & widening the existing navigation channels. Awarded to a consortium led by Sacyr (48%)
China	€2.14 bn. Hotel and leisure resort in Macau (world's largest tourist hotel). Contract awarded to ACS
Qatar	€1.64 bn. Sidra hospital in Doha. OHL leads the consortium (55%)
Russia	€1.5 bn. Ural polar project. Awarded to OHL
Canada	€1.43 bn. CHUM hospital in Montreal. Awarded to consortium led by OHL (50%)
Scotland	€1.11 bn. Cable-stayed bridge over the Firth of Forth. Awarded to a consortium led by ACS
Australia	€1.11 bn. Sydney light rail project. Consortium including Acciona

Source: Ministry of Foreign Affairs and Co-operation and companies.

The origin of this success, which has helped the companies weather the severe downturn in Spain's once booming construction and infrastructure sector, could be dated back to the late 1960s and 70s when the process of using toll roads to build infrastructure began as the country's mass tourism industry was in the throes of being established. Unlike France and Italy, however, Spain did not choose the model of having state-owned companies develop roads and opted for a mainly private-sector model.

Another factor was that the roads began to be open to the public in the early 1970s before energy-dependent Spain was dealt a blow by the oil crisis. The government offered to buy back the shares in the under-used toll roads from companies, but they decided to hang on as the contracts for the concessions were long-term. When the crisis ended and the market improved, the roads proved to be profitable and the companies went from strength to strength.

The first toll-road concession in North America was gained by Cintra, a subsidiary of Ferrovial, in 1999 in conjunction with Australia's Macquaire Bank when it won the tender for Toronto's Highway 407 –a 99-year-contract and the largest privatisation in Canadian history–. The contract eased Cintra's path into the US where in 2004 it purchased the rights to improve and operate the Chicago Skyway, the city's only toll road, for US$1.83 billion, for the next 99 years.

There were more Spanish companies in the 2015 ranking of the world's top transport developers by the US publication *Public Works Financing* than any other country. Spain had five Spanish companies in the top 10 (see Figures 7.13) and four based on the amount of invested capital (see Figure 7.14). These companies and others continued to win big contracts abroad (see Figure 7.15).

Figure 7.13. Ranking of the World's 10 Largest Transport Developers (1)

	Operating or under construction	Of which: in the US	Of which: in Canada	Of which: in home country	All other
1. ACS Group/Hochtief (Spain)	**60**	**3**	**8**	**19**	**30**
2. Global Via-FCC-Bankia (Spain)	**43**	**0**	**1**	**28**	**14**
3. Macquarie (Australia)	43	4	1	1	37
4. Vinci (France)	42	1	3	15	23
5. Abertis (Spain)	**41**	**0**	**0**	**14**	**27**
6. Ferrovial/Cintra (Spain)	**40**	**6**	**3**	**11**	**20**
7. Sacyr (Spain)	**29**	**0**	**0**	**15**	**14**
8. Bouygues (France)	27	1	1	10	15
9. NWS Holdings (China)	26	0	0	26	0
10. EGIS (France)	26	0	1	5	20

(1) Developers are ranked by the number of road, rail, port and airport concessions over US$50 million in investment value that they have developed worldwide, alone or in joint venture, and are currently operating or have under construction as of 1 October 2015.
Source: Public Works Financing.

Figure 7.14. Developers Ranked by Invested Capital, 1985-2015

	Total invested capital (US$ mn) (1)	Total number of concessions, active, sold or expired
ACS (Iridium+Hochtief) (Spain)	**91,000**	**109**
Ferrovial (Cintra) (Spain)	**78,700**	**64**
Vinci (France)	76,000	48
Macquaire (Australia)	50,900	61
Bouygues (France)	40,200	31
John Laing (UK)	33,500	30
Egis (France)	27,700	27
Global Via (FCC+Bankia) (Spain)	**27,300**	**51**
Sacyr (Spain)	**27,200**	**49**
OHL (Spain)	**21,000**	**39**

(1) The sum of the original investment, in nominal dollars, of all of a company's transport P3 projects (highways, transit, ports, airports) that it has financed and put under construction and/or operation, or acquired and improved, from 1985 to 1 October 2015, for which it had a substantial developer role in financing, building and operating a publicly-owned asset, or in acquiring and improving/operating an asset for a set amount of time, under a long-term contract with government. To capture all of a firm's development experience, we include both active and sold projects in the calculations. Some of largest P3 projects are developed by a consortium of companies, which results in some double counting of projects between the firms listed here. It includes Ferrovial's 2006 acquisition, upgrade and management of BAA's UK airports, using a US$24.3 billion enterprise value.
Source: Public Works Financing.

Figure 7.15. Infrastructure Contracts Won by Spanish Companies in 2015

Spanish company	Country	Details
Duro Felguera	Brazil	€800 mn contract with General Electric to build two gas-fired thermoelectric plants
Sacyr	Colombia	€223 mn contract to build a 2.3km bridge over the Magdalena River, the country's longest
ACS	Canada	Part of a consortium that won a €4 bn turnkey contract to build the Eglinton Crosstown light rail project in Toronto
ACS	Canada	Part of a consortium that won a €1.8 bn turnkey contract to build a bridge in Montreal over the St Lawrence river
Acciona	Norway	Part of a consortium with Italy's Ghella to build twin tunnels 20km long linking Oslo & Ski
Ferrovial	UK	Part of a consortium that won a €1.05 bn contract to build part of a new London sewer system
FCC	Egypt	A consortium led by Aqualia won the contract worth €2.4 bn for the design, construction & operation of the Abu Rawash treatment plant in El Cairo
Iberdrola	Mexico	Combined cycle 850 MW power plant

Source: Companies.

The Spanish stock exchange plays a key role in the internationalisation of companies. Size, being listed and internationalisation feed off one another and form a virtuous circle. In terms of capitalisation, some of the Ibex companies were among the largest in the world in their respective sectors in 2015 (see Figure 7.16).

Figure 7.16. Capitalisation of Some of the Ibex-35 Companies (US$ mn and position in world and Europe)

	Capitalisation	Sector	World position	European position
Abertis	16,242	Motorways	2nd	2nd
Santander	106,102	Banking	8th	2nd
BBVA	63,886	Banking	18th	5th
Ferrovial	15,895	Construction & engineering	2nd	2nd
ACS	11,314	Construction & engineering	4th	4th
Iberdrola	41,561	Electricity	5th	3rd
Gas Natural	22,478	Gas	2nd	1st
Repsol	25,878	Oil & gas	12th	7th
Telefónica	70,831	Telecoms	4th	2nd
Inditex	100,017	Fashion retailer	1st	1st

Source: MDCI Blue Book, Developed Markets. Data at March 31, 2015.

2. A Cross-Section of the Main Spanish Multinationals

Santander

Santander's rise from a local note-issuing bank founded in 1857 in the province of the same name (now the Autonomous Community of Cantabria) to its position as the euro-zone's leading retail bank (and the second largest by market capitalisation) with the biggest financial franchise in Latin America and strong positions in the UK and the US is a remarkable one. Santander has almost become a household name outside Spain, epitomised by the anecdote about someone who when he said he was born in Santander was met with bemusement as he was understood to have been born in a bank as opposed to the city of the same name. In 2015, Santander was ranked 70th in Interbrand's 100 best global brands.

The product of the merger of three banks (Santander, Central and Hispano Americano) between 1991 and 1999, Santander operates around the world. The number of its customers soared from 750,000 in 1985 to more than 120 million today. Santander's reputation for business aggressiveness and innovation started in 1989, when it was the first Spanish bank to offer remunerated current accounts. This broke the rather cosy relationships between what were known as the Big Seven banks.

Long before its marriage to Central Hispano in 1999 (Hispano Americano, founded in 1900, and Central, established in 1919, merged in 1991), Santander was internationally-minded. One of its earliest functions was to finance foreign trade between the port city of Santander and Latin America. In 1947, it opened a representative office in Cuba, a Spanish colony until 1898, and in 1963 acquired its first bank in the Americas (Banco del Hogar Argentino). The big push into Latin America, a zone with a low level of 'bankarisation' and thus plenty of scope to develop business, took place between 1999 and 2001, when Santander bought Mexico's nationalised Serfin and Brazil's Banespa. Santander is the third-largest banking group in Mexico by business volume and the third-largest private sector bank in Brazil (the largest foreign bank) by assets. In Chile, Santander is the leading bank. By September 2015, the number of Santander branches in Latin America had grown from the one in 1947 (in Cuba) to 5,812.

As a result of its participation in the RBS-led consortium that won control of the Dutch bank ABN Amro in 2007, Santander substantially strengthened its presence in Brazil (and Italy) as it acquired Amro's subsidiary Banco Real.

Santander opened its first office in London in 1954, and in 1988 established an alliance with the Royal Bank of Scotland (RBS) that lasted 16 years. RBS helped Santander to acquire Banespa in Brazil and Santander aided RBS in its purchase of National Westminster. Following the 2007-08 financial crisis, the British

government took an 81% stake in the RBS Group. In 2000 Santander acquired Portugal's Totta Bank, the country's third-largest private-sector bank, and in 2004 it made its largest single investment when it bought Abbey, the UK's sixth-largest bank, for €12.6 billion. This purchase gave Santander a better geographic diversification among emerging, mature and stable economies, a major presence in one of Europe's most attractive and profitable banking markets and enabled it to be a player in the world's three main currencies (the US dollar, the euro and sterling). Santander stepped up its UK presence in 2008 when it bought Bradford & Bingley and Alliance & Leicester. Today, it is the fourth bank by loans.

Santander also operates in Continental Europe through its consumer finance arm, Santander Consumer Finance (SCF). In the US, Santander gained full control of Sovereign, the largest surviving US savings and loan, in 2008. As a result of these acquisitions, Santander earned a larger slice of its profits in 2015 in the UK than in Spain, though part of this was due to Spain's long recession which hit banking activity at home (see Figure 7.17).

Figure 7.17. Distribution of Santander's Attributable Profit by Geographical Business, 2015 (% of total) (1)

	% of total
UK	22
Brazil	19
Spain	**13**
Santander Consumer Finance	10
US	10
Mexico	7
Chile	6
Other Latin American countries	5
Poland	4
Portugal	3
Other European countries	1

(1) First nine months and excluding Spain's real estate activity.
Source: Santander.

Banco Bilbao Vizcaya Argentaria (BBVA)

Like Santander, BBVA, Spain's second-largest bank, was also founded in 1857 and was the result of the merger of three banks (Banco de Vizcaya, Banco de Bilbao and Argentaria), hard on the heels of Santander's merger. BBVA's roots were in the Basque Country.

It acquired a controlling stake in the nationalised Bancomer, Mexico's largest bank, in 2000, and also has banks in several South American countries. Partly as a result of Bancomer's presence in the US and its successful money-transfer service linking Mexican immigrants with Bancomer in Mexico, BBVA entered

the American market in 2004 with the purchase of Valley Bank of California. This was followed in 2005 by the acquisition of Laredo National Bancshares, in 2006 by the purchase of Texas Regional Bancshares and State National Bancshares and in 2007 by buying CompassBancshares, a franchise covering six states. The purchase of Texas Regional Bancshares and State National Bancshares made BBVA the largest regional bank based in Texas, while the acquisition of Compass gave it a leading position in the southern strip of the so-called Sun Belt and put BBVA among the 20 leading banks in the US.

In a bold move, BBVA was the first Spanish bank to break into China when it acquired in 2006 5% of China's Citic Bank and a 15% stake in Citic International Financial Holdings, its Hong Kong-based offshoot. The stake in Citic was increased and then reduced to 3.2% in June 2015. While BBVA reduced its Chinese presence, it stepped up its investment in Turkey's Garanti Bank, the market leader, which it entered in 2010 with the purchase of a 24.9% stake for €4.2 billion, and increased to almost 40% in 2015 at a cost of around €1.8 billion. Like Santander, BBVA's profit is widely generated (see Figure 7.18).

Figure 7.18. Distribution of BBVA's Attributable Profit by Geographical Business, 2015 (1)

	% of total
Mexico	41.7
Spain (2)	**19.1**
South America	19.1
US	11.3
Turkey	6.9
Rest of Eurasia	1.8

(1) First nine months. (2) Including real estate activity.
Source: BBVA.

Inditex

Inditex, founded in 1963 by Amancio Ortega as a dressmaker, is the world's largest fashion retailer, with more than 6,700 stores worldwide. In 1975, Zara, the group's flagship, opened its first store in La Coruña, Galicia, and in 1988 its first store outside Spain, in Oporto, Portugal, followed by New York, Paris, Mexico City, Athens, Bruges, Malta, Cyprus and many other countries. At the same time, Inditex added brands such as Bershka and Stradivarius and in 2001 its shares began trading on the Madrid Stock Exchange, making Ortega Spain's wealthiest person and the 4th in the world with US$64.5 billion, according to the 2015 Forbes list of billionaires. The 79-year-old Ortega briefly overtook Bill Gates on 23 October 2015 to become the world's richest individual as a result of a rise in the Inditex share price. Inditex operates in 88 markets in all five continents (see Figure 7.19). Zara was ranked 30th in 2015 in Interbrand's 100 best global brands.

Figure 7.19. Inditex's International Presence

	Number of stores
Zara	2,109
Pull & Bear	905
Massimo Dutti	716
Bershka	1,010
Stradivarius	919
Oysho	586
Zara Home	462
Uterqüe	70
Total	6,777

Figures at 31 July 2015.
Source: Inditex.

One of the key factors in Inditex's success is its just-in-time manufacturing capabilities and state-of-the-art IT systems, which enables it to keep low stocks in stores and respond very quickly to market trends and needs. The business model is based on a quick rotation of the offer. The US magazine *Business Week* commented in 2007: 'the faster the clothes change, the more often customers return to check out the new offering'.

Telefónica

Founded in 1924, Telefónica, the world's seventh-largest telecommunications company by total accesses, began to expand into Latin America in 1990 when it acquired stakes in, and then took over, CTC and ENTEL in Chile and Argentina's main operator (ENTEL). In 1994 it acquired CPT and ENTEL in Peru. In 1996 Telefónica entered Brazil as head of a consortium that bought 35% of the voting shares of CRT in the southern state of Río Grande do Sul, and in 1998 the Telefónica-led consortium won the tender to acquire Telesp in the state of São Paulo. In 2000 Telefónica purchased all the capital of its operators in Argentina, Brazil, Chile and Peru, and in 2001 acquired Motorola's cellular assets in Mexico.

By 2002, Telefónica had more fixed lines in Latin America (21.6 million) than in Spain (18.7 million) and more mobile telephone customers too (21.3 million versus 18.4 million). In 2003, Telefónica and Portugal Telecom, the country's incumbent in which Telefónica had a stake of 9.8%, set up a joint venture combining their mobile telephony assets in Brazil (under the name Vivo, Brazil's largest mobile operator). In 2004 Telefónica acquired BellSouth's interests in mobile operators in Argentina, Chile, Peru, Venezuela, Colombia, Ecuador, Uruguay, Guatemala, Nicaragua and Panama, consolidating its position as the leading mobile phone company in the region.

In 2005, when it became the first Spanish company to join the NY Dow Jones Global Titans 50 index, Telefónica moved into Asia and bought 5% of China Netcom, the country's second-largest fixed-line operator. This was followed in 2006 by its biggest acquisition: the assets of the O2 mobile operator in the UK, Germany and Ireland for €26 billion. In 2015 Telefónica agreed to sell the UK part of O2 to Hutchison Whampoa as part of its strategy to reduce its debt.

Iberdrola

Iberdrola, Spain's largest electricity group and the world leader in the production of wind power, operates in around 30 countries. It is the second-largest developer of wind projects in the US, the main private-sector generator of electricity in Mexico, one of the leading operators in the UK (as a result of buying Scottish Power in 2006 for €17.1 billion) and operates in Brazil.

In the US, Iberdrola delivers natural gas and electricity in New England and New York state, has more than 60 renewable energy projects in 24 states and is one of the leading independent gas storage operators and gas traders. Iberdola consolidated its position in Mexico in September 2015 when it won the contract to build an 850 MW combined cycle power plant in the state of Nuevo León.

ACS

ACS, the result of several mergers in 1997, is Spain's largest construction company and the second biggest in the world in 2014 on the basis of revenues. It has a majority stake in Germany's Hochtief (the fourth biggest company), and its activities ranged from the construction of motorways in Ireland and Greece, railway tunnels in New York and wind farms in Portugal to the refurbishing of three dams in the state of New York, motorway concessions in Chile, the UK and South Africa and transmission line concession projects in Brazil and Peru.

Ferrovial

Ferrovial started out building railways in Spain in the 1950s, and in 2006 led a consortium that purchased the UK airports operator BAA –the world's biggest private-sector airports business, which owned Heathrow, Gatwick and Stansted and six others– for €23.6 billion including debt. As a result of a ruling by the UK's competition watchdog, Ferrovial had to sell the airports at Gatwick, Edinburgh and Stansted. It also sold Swissport, the world's leading provider of ground services.

In 2014, Ferrovial and Australia's Macquaire bought Aberdeen, Glasgow and Southampton airports.

The company was no stranger to the UK when it acquired BAA, as it already operated Bristol airport with Macquarie, and in 2003 bought Amey, the services and project management group that runs and maintains three of London's underground railway lines (Jubilee, Northern and Piccadilly). In 2010, Amey sold its shares in Tube Lines to Transport for London, but continued to provide management and maintenance services on the three lines. Ferrovial Agroman and UK construction company Laing O'Rourke won the contract in 2014 to extend the Northern Line, which is expected to be completed by 2020.

Ferrovial also operates in the US where Cintra, its toll-road operator, won in 2005 a 99-year concession to run the Chicago Skyway, and in partnership with Macquarie a 75-year concession to operate the Indiana Toll Road. Ferrovial has motorway concessions in many other countries, including Canada, Chile, Ireland and Portugal.

OHL

OHL, the concessions and construction group dating back to 1911, operates in more than 30 countries. It entered the US in 2066, when it acquired Community Asphalt and the Tower Group. Community participated in the construction of the AirportLink, an elevated railway in the state of Florida with 22 stations. OHL also owned a construction firm in the Czech Republic, won major infrastructure projects in Mexico and Chile, and in Turkey won the Marmaray project to connect the railway lines that unite the European and Asian sides of Istanbul through an underwater tunnel in the Bosphorus Strait.

FCC

FCC was created in 1992 from mergers and operates in the construction, services and cement sectors. Its international activities included full-service water management in Argentina, Italy and Brazil, treatment and elimination of solid urban waste in the UK, US and Venezuela and the building of motorways in Romania, Costa Rica and Canada. In 2015 FCC and Brazil's Odebrecht won the €1.6 billion contract to build line 2 of the Panama City metro.

Sacyr

A consortium led by Sacyr won in 2009 the contract to build the third set of locks for the Panama Canal, the largest engineering project in the world and part of the project to expand the choked waterway's capacity. It was expected to be completed in 2016, later than originally scheduled because of a dispute over cost overruns. Sacyr operates in more than 20 countries.

Acciona

Acciona became a significant global player in the global wind energy market in October 2015 when it agreed to team up with Nordex. The German wind-turbine maker bought Acciona's windpower business for €785 million in cash and stock, and in return Acciona received a cash payment of €366.4 million and 16.1 million new shares of Nordex. Combined with shares acquired from other large shareholders after the deal, Acciona's stake in Nordex is around 30%.

The two companies are complementary. Acciona Windpower is strong in the Americas and emerging markets, mainly with large-scale wind-farms, while Nordex focuses on Europe. As well as renewable energy, Acciona is engaged in water services and infrastructure sectors. It built a big solar-energy plant in Nevada (US), wind-power parks in Australia and Canada, the largest aerogenerator plant in China and desalination plants in the US at Tampa, Florida and Carlsbad, California (slated as one of the world's biggest).

CAF

CAF is an international leader in the design, manufacture, maintenance and supply of equipment and components for railway systems. It won contracts for the Heathrow Express in the UK, the Hong Kong airport rail link, the New Delhi airport rail link, the Budapest tram and in Turkey for the high-speed train link between Istanbul and Ankara and a tram network in Antalya.

Grupo Antolín

Antolín is the world's largest manufacturer of interior liners for cars and a leading producer of seats, door locks and electrical devices for windows. Founded in 1959, when Spain's car industry was in its infancy (Seat started in 1950), more than two-thirds of its revenues are generated abroad. The first plants were set up close to Renault's assembly lines during the 1960s and in the 1970s near Ford's plant in Valencia. In the 1990s Antolín entered Germany, the UK, France, Portugal, US, Mexico, Turkey, the Czech Republic, Slovakia, Brazil, Argentina and China, among other countries. In August 2015, Antolín closed its US$525 million acquisition of Canada's Magna International's interiors operations in Europe, North America and Asia. This purchase doubled Antolín's size.

Ebro Puleva

Ebro Puleva is the world's largest trader/miller of rice and the second biggest producer of pasta. It acquired Riviana, the US's largest rice processor (with a 23% market share), in 2004 and with it the company's subsidiaries in Central America, Belgium and the UK. In 2006 it purchased Kraft Foods' Minute Rice brand in the US and Canada and New World Pasta (with a 23.4% market share in the US and a 43% market share in Canada).

Indra
Indra, Spain's leading information technology and defence-systems company, broke into the US market in 1994 when it was selected by the US Navy to supply full mission simulators, radar trainers and test programme sets for the AV-8B+ Harrier combat aircraft. It also won tenders to supply simulators and test programme sets for other aircraft used by the US Navy (the F-14 Tomcat, F-18 hornet and MH-60 Seahawk), and provided AS350, EC135 and EC145 helicopter simulators for police training, located at the American Eurocopter Centre in Dallas, Texas. Chatman Area Transit, the transport agency of Savannah, awarded Indra a contract to implement its Vehicle Tracking Management System (VTMS) to control the fleet of 80 buses and 29 vehicles adapted for the disabled (Paratransit).

The company is very strong in air-traffic control, particularly in Asia where it won contracts in China, Mongolia, Vietnam, Indonesia, the Philippines, Australia and India, and in information and control systems for transport. For example, it created the ticketing and access control systems for the St Louis subway (Missouri), for the Austin subway (Texas) and the tolling system for the Indiana Toll Road.

Mapfre
Mapfre, the leading insurer in Spain, is a global company with more than 27 million clients. It is the leader in non-life insurance in Latin America in terms of premium income and the second in total premiums after Brazil's Bradesco. In the US it is one of the 20 top automobile insurance companies. In 2007 Mapfre bought 80% of Sigorta, Turkey's sixth-largest insurance company, and 100% of the US's Commerce Group.

Roca
Roca is the world leader in bathroom installations. The Olympic Village in Beijing for the 2008 Games has some 15,000 Roca products. In 2006, the company spent more than €50 million acquiring Switzerland's JohnsonSuisse, which has activities in Malaysia, the Croatian and Romanian subsidiaries of Austrian group Lasselsberger and a 50% stake in India's Parryware. A year later it bought Russia's Keramkia.

Talgo
The innovative Talgo began in the 1920s when a Basque railway engineer, Alejandro Goicoechea, pioneered a new method for building railway cars. Instead of making them heavy enough to allow them to make turns at relatively high speeds, Goicoechea sought to minimise the equipment's weight by using lighter materials and reducing the cars' height. In addition, the wheels were mounted in pairs but not joined by an axle and were between rather than underneath the

individual coaches The first prototype was launched in 1943, at a time when Spain was internationally isolated. In 1974 the Talgo became the first high-speed sleeper train in the world (covering the Barcelona-Paris route). Another later feature is the suspension, which makes carriages tilt as they enter a curve and allows for higher speeds without passenger discomfort.

Talgo sold coaches to Germany in 1993 and in 1994 became the first European train with a regular commercial service in the US (between Seattle and Portland). This was followed in 1995 by Seattle-Vancouver. It entered Finland via an acquisition in 1999, where it designed, built and maintained various types of trains, and in 2003 began a service on the line between Almaty and Astana, the former and new Kazakh capitals. In June 2015 the line connecting Moscow and Nizhni Novgorod was opened using Talgo, while in August the government of India gave its approval for Talgo to conduct trial runs of its lighter and faster trains on the rail track between Mumbai and Delhi that could cut travel time from 17 hours to 12 without overhauling the ageing track.

In 2015, Spain had two companies, the fashion retailer Zara and the financial services group Santander, in Interbrand's top 100 global brands (see Figure 7.20).

Figure 7.20. The Top 100 Global Brands by Country, 2015

	Number in top 100	Highest ranked company, brand value (US$ mn) and position
US	52	Apple, 170,276, 1st
Germany	11	BMW, 37,212, 11th
France	7	Hermes, 10,944, 41st
Japan	6	Toyota, 49,048, 6th
UK	5	Burberry, 5,873, 73rd
South Korea	3	Samsung, 45,297, 7th
Netherlands	3	Shell, 5,530, 78th
Switzerland	2	Nescafé, 12,257, 36th
Italy	2	Gucci, 8,882, 50th
Spain	**2**	**Zara, 14,031, 30th**
	2	**Santander, 6,097, 70th**

Source: Interbrand.

Chapter 8

Foreign direct investment in Spain

Foreign direct investment (FDI) plays a prominent role in the Spanish economy, and it increased significantly during the country's 2009-13 recession, reflecting the improved macroeconomic fundamentals, reforms and the new opportunities created. The inward stock rose from US$589 billion in 2008, when the downturn began, to US$722 billion in 2014. In GDP terms (51%), Spain's stock was the second largest among the big EU economies (see Figure 8.1) and the 9th in the world in absolute terms with a global share of 2.8%, well above the country's 1.8% share of the world's GDP (see Figure 8.2)

Figure 8.1. Growth in Inward Stock of Foreign Direct Investment of Main EU Countries, 1990-2014 (US$ bn and % of GDP)

	1990	% of GDP	2000	% of GDP	2014	% of GDP
France	104	8.2	184	13.4	729	25.6
Germany	227	14.2	272	13.9	743	19.3
Italy	60	5.3	123	10.7	374	17.4
Spain	**66**	**12.3**	**156**	**26.2**	**722**	**51.3**
UK	204	18.6	463	29.8	1,663	56.5

Source: 2015 World Investment Report, UNCTAD.

Figure 8.2. Inward Stock of Foreign Direct Investment, Top-10 Countries, 2014 (US$ mn and % global share)

Ranking	US$ mn	Global share (%)
1.US	5,409,884	20.7
2.UK	1,662,858	6.7
3.HongKong	1,549,849	5.9
4.China	1,085,293	4.2
5.Singapore	912,355	3.5
6.Brazil	754,769	2.9
7.Germany	743,512	2.8
8.France	729,147	2.8
9.Spain	**721,879**	**2.8**
10.Switzerland	681,849	2.6

Source: UNCTAD, 2015 World Investment Report.

Barred from the post-World War II Marshall Fund, which benefited almost all European countries outside the Soviet bloc, because the Franco regime that won the 1936-39 Civil War sided with Hitler and Mussolini, it was not until the 1953 Pact of Madrid, which established US bases in Spain, that the country began to receive a trickle of foreign investment and aid (nearly all of it from America). Spain's missing out on the Marshall Plan was amusingly satirised in Luis García Berlanga's famous 1953 film *Bienvenido Mr Marshall*, whose subtleties escaped Franco's censors. One of the scenes shows a large American car carrying a Mr Marshall speeding through a village and passing crowds, leaving nothing in its trail but dust and dashed hopes.

The total amount of all types of US aid in the first decade after the 1953 agreement was around US$1.5 billion (half of what Italy received from the Marshall Plan). In the 1960s, the liberalisation and stabilisation measures of 1959 under an agreement with the IMF and the World Bank, which put an end to 20 years of autarky, opened the country to tourism and started to integrate the peseta into a transnational monetary system. A more liberal approach towards FDI was adopted. Complete freedom was granted for such investment as long as foreign ownership of individual enterprises did not exceed 50%. For investments involving over 50% ownership, applications had to be submitted to the cabinet for approval. FDI inflows jumped from US$12 million in 1958 to US$86 million in 1960.

Between 1961 and 1973, when the Spanish economy grew by 7% a year in real terms –the fastest growth among member states of the OECD apart from Japan– the US was the main source of inward FDI, accounting for some 40% of the total invested (and probably more if one includes investment by US subsidiaries in third countries such as Switzerland). Tiny Switzerland was the second-largest investor, followed by Germany, the UK and France. The punitive taxation of imports of industrial and consumer goods in a domestic market of considerable growth potential spurred inward FDI. During the 1960s and early 1970s, annual inward FDI inflows ranged between 0.15% and 0.59% of GDP, while outward investment stayed under 0.1% of GDP, ie, 25 to 30 times smaller than inward FDI. At the end of 1973, according to the Commerce Ministry, one in five jobs were financed by foreign investment, much of which was in chemicals, glass, food and printing. Of the 25 main private industrial companies in 1975, only one was completely Spanish-owned (the steel plant Altos Hornos de Vizcaya). The rest, particularly automotive and petrochemical industries, were almost entirely foreign-controlled.

Inward FDI surged after Spain joined the European Economic Community (EEC) in 1986; at times it seemed as if the country was up for sale (in 1991 FDI inflows represented 4.2% of GDP). Liberalisation opened up opportunities

for foreign companies in a country with a sizeable domestic market, growth potential and the possibilities of using Spain as a platform for exports, and was also facilitated by regulatory changes. These factors assumed as much if not more importance than wage levels, where the gap relative to the then EEC-15 had been narrowing fast until devaluations in 1992 and 1993 began to restore competitiveness.

Spain's automotive industry, the world's ninth -largest producer of cars, which generated 15% of merchandise exports in 2014, has been entirely owned by multinationals since 1986 when the bankrupt SEAT, founded in 1950 with Fiat's assistance, was sold to Volkswagen. The first car under the SEAT logo appeared in 1982 (the SEAT Ronda) and sparked a lawsuit from Fiat which claimed that it was too similar to its Ritmo model. The then President of SEAT, Juan Miguel Antoñanzas, showed a Ronda model to the press with all the parts different from the Ritmo painted in bright yellow, to highlight the differences. This ended the dispute. Rumour at the time had it that Fiat was angry because the Ronda re-styling was in fact too close to their own planned re-styling for the Fiat Ritmo, which they had to scrap.

Multinationals are also strong in other sectors that export such as cement (Portland and Lafarge Asland), an industry in the doldrums since 2008 as a result of the collapse of the property sector, steel (ArcelorMittal), electrical appliances (Sony, Philips and Electrolux), electronic components (Siemens and Robert Bosch), electronics (Philips and Honeywell), information technology (IBM and HP) and some consumer products (Unilever and Procter & Gamble). Mexican magnate Carlos Slim, one of the world's richest persons, owns 25.6% of the construction group FCC.

The foreign-bank presence in Spain is small. The financial system is dominated by Santander, BBVA, La Caixa (which acquired the 270 branches of the Spanish subsidiary of Barclays in 2014) and several other smaller commercial banks. Citibank and Deutsche Bank have networks, but their share of the market is tiny. The foreign presence in insurance (Allianz, Axa, Aviva and Generali) is larger than in banking. In retailing, the French Auchan (known in Spain as Alcampo) and Carrefour groups led a revolution in Spain, opening hypermarkets that lured customers away from traditional corner shops. Germany's Lidl supermarket also has a strong presence. Not even the wine industry was immune from foreign takeovers: in 1994 Allied-Lyons acquired Pedro Domecq, the leading spirits company in Spain, and in 2001 the renamed Allied Domecq bought Bodegas y Bebidas, Spain's largest wine producer. The more than 12,000 foreign affiliates in Spain provide over 1.1 million jobs (see Figure 8.3).

Figure 8.3. FDI in Spain: Stock, Accumulated Flows, Employment and Number of Companies, Top-10 Countries

Country	Total stock (€ bn) (1)	Total flows (€ bn) (2)	Jobs (1)	Number of companies (1)
US	61.1	93.8	156,241	1,341
Italy	37.8	30.4	39,138	484
France	34.2	40.1	235,280	1,313
Germany	33.0	29.4	155,450	1,312
UK	30.8	65.7	107,590	1,323
Mexico	22.4	21.8	5,726	165
Luxembourg	21.9	23.4	91,716	857
Netherlands	13.6	36.9	50,021	1,533
Brazil	11.9	6.1	4,163	71
Switzerland	11.1	8.7	72,648	520
Others	69.8	97.0	232,234	3,184
Total	347.6	453.3	1,150,207	12,103

(1) The stock, employment and company figures are 2013. (2) The accumulated flows are 1993-2015 (first two quarters). The companies are level 1 companies plus other Spanish subsidiaries or Spanish companies under their control (level 2 & 3). Of the €347.6 billion stock, €298.1 billion was productive investment (ie, excluding special purpose entities).
Source: Investment Register. Ministry of Economy.

The sector with the largest stock of foreign investment in 2013 was metals and manufacturing of other materials (see Figure 8.4).

Figure 8.4. FDI Stock in Spain by Top-10 Sectors (€ bn)

	Stock (1)
Metals & manufacturing of other materials	51.2
Energy	51.1
Financial services	36.2
Retail & Wholesale	29.6
Food & beverages	27.3
Real estate, building & infrastructure	25.9
Chemicals & petrochemicals	22.4
Automotive OEM & components	22.3
Information & communications technology	18.0
Pharmaceuticals, healthcare & biotech	11.1
Others	52.5
Total	347.6

(1) 2013. Latest figures.
Note: of the €347.6 million, €298.1 million is productive investment (ie, excluding special-purpose entities).
Source: Investment Register, Ministry of Economy.

In generation of value added, the foreign affiliates of countries such as Italy and France are particularly important. France, for instance, generated in 2013 (latest available year) close to 6% of the total value added generated by all companies resident in Spain in the commerce sector (see Figure 8.5).

Figure 8.5. Main Investor Countries by the Value Added Generated by their Affiliates, Selected Sectors

	Country	% of value added of each sector
Industry	France	5.5
Extractive industries, energy, water, waste	Italy	13.1
Food, drinks, tobacco	France	4.1
Chemicals & pharmaceuticals	US	16.6
Transport material	Germany	22.5
Commerce	France	5.8
Intermediaries	US	20.5
Services	France	3.2
Publishing, cinema, radio, TV, communications	UK	10.7
Real estate	Netherlands	4.0

Source: Investment Register, Ministry of Economy.

Spain was one of Europe's top five destinations for greenfield investment between 2012 and 2014 (see Figure 8.6), with ITC, consumer products, business and financial services and automotive (including components) accounting for close to 60% of the €32.5 billion of capital expenditure (see Figure 8.7).

Figure 8.6. Top Five Greenfield Destinations in Europe, 2012-14 (US$ bn)

	Capital expenditure	Projects	Jobs created
UK	113.9	2,974	225,971
Spain	**32.5**	**1,133**	**85,745**
Germany	30.5	2,139	84,884
Poland	27.1	782	153,645
France	25.7	1,221	66,010
Others	250.8	7,315	917,019
Total	480.5	5,564	1,533,274

Source: fDI Markets 2015.

Figure 8.7. Greenfield Projects in Spain by Sectors, Top Sectors, 2012-14 (US$ bn)

	Capital expenditure	Projects	Jobs created
ITC: communications, software & IT services	8.2	193	12,295
Consumer products, food, textiles & beverages	4.7	300	29,376
Business and financial services	3.2	186	5,249
Automotive OEM & components	3.2	46	8,269
Transportation & non-automotive transport OEM	3.0	82	3,630
Energy, environment & renewable energy	2.6	16	816
Real estate, building & construction materials	2.1	32	12,929
Chemicals, plastics & rubber	1.2	63	2,284
Logistics & warehousing	1.1	9	1,450
Other sectors	3.2	503	9,450
Total	32.5	1,133	85,745

Source: fDI Markets 2015.

A significant part of the increase in Spain's merchandise exports of €55 billion between 2007 and 2014 was due to foreign companies that sought to compensate for the depressed domestic market (see Figure 8.8).

Figure 8.8. Exports of Companies with Foreign Capital, Selected Sectors (% of total exports)

	2001-07	2008-11	2001-11
Food, drinks, tobacco	45.8	49.5	47.9
Textiles, clothes & leather	28.1	31.4	29.5
Paper	16.6	16.9	16.7
Wood, furniture & other manufactures	12.0	23.0	15.9
Metallic products	20.4	20.8	20.5
Metallurgy	46.1	38.9	42.6
Non-metallic mineral products	27.5	27.3	28.3
Rubber & plastics	75.6	80.9	78.6
Chemicals	39.1	29.9	34.7
Pharmaceutical products	46.4	57.6	49.7
Telecommunications	22.1	33.0	24.9
Total sectors (1)	64.2	56.9	61.9

(1) The sectors mentioned and some others not listed in the table.
Taken from the book *España en la inversion directa internacional*, chapter 5 by María Elisa Álvarez-López & Carlos M. Fernández-Otheo, published by Instituto de Estudios Económicos, 2015.
Source: Bank of Spain, Central Balance Sheet Office, information submitted voluntarily by non-financial companies.

The economy was growing again, labour costs were more competitive, as a result of internal devaluation, productivity was higher, the labour market was more flexible, due to reforms in 2012, corporate income tax was down to 25% in 2016, the single-market law made it less cumbersome to sell to different parts of Spain and a fast-track regime was in place for non-EU international investors to obtain residence permits and work visas. Of the five largest EU economies, Spain's hourly labour costs rose the least between 2008 and 2014 after the UK's (see Figure 8.9).

Figure 8.9. Hourly Labour Costs for the Whole Economy (€) (1)

	2004	2008	2012	2013	2014	Chg. 2008/14
France	28.2	31.2	34.3	34.3	34.6	+10.8
Germany	26.8	27.9	30.5	31.0	31.4	+12.5
Italy	22.4	25.2	27.7	28.1	28.3	+12.3
Spain	**16.5**	**19.4**	**21.1**	**21.2**	**21.3**	**+9.7**
UK	21.5	20.9	21.7	20.9	22.3	+6.7
EU-28	19.8	21.5	23.9	24.2	24.6	+14.4
Euro zone	23.0	25.3	28.3	28.7	29.0	+14.6

(1) Excluding agriculture and public administration.
Source: Eurostat.

Notable progress was also made in the time it takes to set up a business, which had long been a bane of employers. In 2015 starting a business took 14 days, down from more than 130 days in 2005 according to the 2016 edition of the World Bank's Doing Business report. While the improvement was considerable, the time to get licences and permits required to take up and perform a specific activity in Spain was still longer than that of most other EU countries, not to speak of New Zealand where a simple online procedure means that it takes only a few hours to set up a business. Spain was ranked 33rd out of 189 countries in the 2016 ease-of-doing-business ranking (see Figure 8.10).

Figure 8.10. Spain: Ease of Doing Business Rankings by Category

	Rank out of 189 countries
Starting a business	82
Dealing with construction permits	101
Getting electricity	74
Registering property	49
Getting credit	59
Protecting minority investors	29
Paying taxes	60
Trading across borders	1
Enforcing contracts	39
Resolving insolvency	25
Overall ranking	33

Source: World Bank, Doing Business 2016.

The country's distance-to-frontier score –which seeks to capture the actual distance it has to go to reach the frontier of 'best performance'– was 74.86 in 2015, almost the same as France (75.96), better than Italy (72.07) and not far from Germany (79.87).

Spain is one of the most decentralised countries in Europe: regional administrations manage around 50% of public spending and 77% of public employees. This gives people more direct access to government, but the downside is the lack of homogeneous regulations and overlaps. It is easier, for example, to start a business in Andalucía thanks to the absence of municipal fees and the higher use of the online start-up platform than in other regions and easier to obtain a construction permit in La Rioja because the construction-works licence is granted more quickly and at a lower cost and there are fewer pre-construction requirements. In Catalonia it is quicker to obtain electricity because of the simplified authorisation process and it is no longer necessary to obtain project approval from a professional association (see Figure 8.11).

Figure 8.11. Starting a Business in Spanish Regions

	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in minimum capital (% of income per capita)
Andalucía	7	14	3.4	13.8
Basque Country	10	17	4.6	13.8
Catalonia	10	14	4.5	13.8
Extremadura	9	14.5	3.4	13.8
Madrid	7	14	5.3	13.8
Navarra	12	20	6.6	13.8
Valencia	9	14	3.4	13.8

Source: World Bank, Doing Business in Spain 2015.

Cost competitiveness was one of the main attractions of the Spanish economy, according to the 2015 survey by the IMD business school (see Figure 8.12), while the unemployment rate, entrepreneurship and language skills were among the main weaknesses (see Figure 8.13).

Figure 8.12. Key Attractiveness Indicators of the Spanish Economy (1)

	% of responses per indicator
Skilled workforce	71.4
Cost competitiveness	67.9
Reliable infrastructure	63.4
Open & positive attitudes	52.7
High educational level	37.5
Dynamism of the economy	37.5
Business-friendly environment	30.4
Effective labour relations	23.2
Effective legal environment	20.5
Policy stability & predictability	20.5
Competitive tax regime	14.3
Access to financing	12.5
Competency of government	12.5
Strong R&D culture	9.8
Quality of corporate governance	6.3

(1) From a list of 15 indicators, respondents were asked to select five that they perceived as the key attractiveness factors of their economy. The chart shows the percentage of responses per indicator from the highest number of responses to the lowest.
Source: IMD Competitiveness Yearbook 2015.

Figure 8.13. Main Weaknesses by IMD's Competitiveness Input Factors

	Rank out of 61 countries
Economic performance	
Unemployment rate	59
Resilience of the economy	54
Government efficiency	
Parallel economy	59
Creation of firms	56
Business efficiency	
Entrepreneurship	59
Attracting and retaining talents	59
Infrastructure	
Fixed telephone tariffs	57
Language skills	57

Source: IMD Competitiveness Yearbook 2015.

One of the hottest sectors for FDI in 2015 was property. The price of homes fell on average by more than 35% since the bursting of the massive bubble in 2008 before stabilising in 2015, spurring international institutional investors to snatch up properties. In 2013, Goldman Sachs's private equity and the investment group Azora acquired 3,000 apartments from the regional government of Madrid for €201 million. This followed the sale of 1,860 rent-controlled properties by the Madrid city council to Blackstone for €125.5 million, and the first sale by the 'bad bank' Sareb of properties valued at €100 million to HIG Capital. Sareb, created in 2012, took over around €50 billion of properties and land from nationalised banks. Santander, Spain's and the euro zone's largest bank by market capitalisation, sold its real-estate management business Altamira to US private equity group Apollo Global Management in a deal worth around €700 million. Apollo took over the business that manages bad loans and properties owned by Santander (from foreclosures), but did not buy the property assets. The banks became major property owners. Santander, for instance, sold 5,200 properties in the first half of 2015 (6,300 in the same period of 2014). In 2014 George Soros and John Paulson, two of the world's best-known hedge-fund managers, bought into the public offering of real-estate company Hispania Activos Inmobiliarios. That same year Santander sold the 25-storey Edificio España in Madrid, one of the city's iconic buildings, to China's Wanda for €265 million. Wanda was reportedly negotiating in late 2015 the purchase of 75% of the Marina d'Or holiday complex in Oropesa del Mar.

Foreign buyers became the main driving force in the luxury end of the property market, aided by the government's 'Golden Visa' scheme, launched in September 2013, that offers residency permits to non-EU citizens who invest more than €500,000. Close to 500 visas were issued in 2014, mostly to Russians, Chinese and the rich from the Middle East.

A big share of investment in the commercial property sector also came from foreigners. GreenOak Real Estate bought eight shopping centres in 2014 for €160 million and Qatari funds acquired Barcelona's Renaissance and Madrid's InterContinental Hotels for €78.5 million and €60 million, respectively, while the 167-room Ritz in Madrid was sold in 2015 to Saudi Arabia's Olayan Group and the Singapore-listed Mandarin Oriental International for €130 million (valuing each room at close to €800,000).

According to CBRE Spain, half of the €10.2 billion invested in the commercial real-estate sector came from foreign funds in 2014 and another €2.5 billion from Socimis –real estate investments that can be traded like shares on financial exchanges, which are heavily funded by foreign investors–.

Chapter 9

The Shape of Things to Come

Spain had to tackle crises on three fronts that were superimposed on one another like Russian nesting dolls: economic, a lack of legitimacy emanating from a discredited political class and its endemic corruption, and institutional (a major loss of confidence and profound lack of trust in state institutions as a result of their colonisation by politicians).

The country came out of a long recession with the economy growing at more than 3%, one of the fastest rates in the EU, albeit with a jobless rate of more than 20%, and was more competitive. The general election on December 20 2015 broke the hegemony of the Popular Party and the Socialists, the two parties that have alternated in power since 1982, and catapulted two upstart parties into parliament, the centrist Ciudadanos and the anti-austerity Podemos. This was a healthy development as it reflected Spain's new political realities and hopefully will usher in consensual policy making after years of partisan bickering. The election results, however, made the process of forming a new government arduous as no party won an absolute majority, and the coalition government options were fragile. A fresh election could not be ruled out.

The institutional crisis is the one that remains to be fixed. First, however, some thoughts on the economic crisis. The European Commission's post-programme surveillance report published in December 2015, following Spain's exit in January 2014 from the €41.3 billion financial assistance programme for the recapitalisation of ailing banks, made clear the achievements but also the challenges ahead. The balance of the Popular Party's government between 2011 and 2015 was mixed (see Figure 9.1).

Figure 9.1. From Crisis to Fledgling Recovery during the Popular Party Government (2011-15) (1)

	2011	2015
GDP growth (%)	-1.0	3.1 (e)
Nominal GDP (€ trillion)	1.05	1.04 (e)
Per capita income (€)	23,900	23,300 (e)
Stated unemployment rate (% of labour force)	22.56	21.18 (2)
Temporary employment rate (%)	24.8	26.2
Number of social security contributors (million)	17.25	17.22 (3)
Social security reserve (€ billion)	66.8	34.2 (3)
General government budget deficit (% of GDP)	8.9	4.7 (e)
Gross public debt (% of GDP)	69.5	100.8 (e)
Inflation (%)	2.9	-0.2 (e)
Current account balance (% of GDP)	-3.3	0.4 (e)
Banks' assets (% of GDP)	338.3	264.2 (e)
Non-performing loans (% of total lending)	7.8	10.56 (4)
Number of sales of foreclosures of homes ordered by the courts	77,854	37,615 (5)
Ibex-35 stock market index	8,454.4 (6)	9,544.2 (7)
Early school-leaving rate	26.3	20.3 (8)

(e) Estimate.
(1) The 2011 election was held on November 20 and the 2015 one on December 20.
(2) Third quarter of each year.
(3) November of each year.
(4) October
(5) First half.
(6) 19 November.
(7) 31 December.
(8) September. The percentage of people aged 18-24 who have only lower secondary education or less and are no longer in education or training.
Source: INE, General Council of the Judiciary, Employment and Social Security Ministry, Bank of Spain, Bolsa de Madrid and Afi.

Economic conditions were improving, but significant imbalances remained. The general government budget deficit, for example, was still among the highest in the euro zone (between 4% and 5% of GDP in 2015). Private sector debt (households and non-financial companies) was reduced from close to 220% of GDP in the second quarter of 2010 to below 180%, and the current account balance was in surplus. Yet the net international investment position (NIIP) remained very negative (ie Spain's foreign liabilities exceed its foreign assets) at 91% of GDP (June 2015, latest figure), one of the highest in the EU. In order to lower it to around 35% in 2024 (Germany's NIIP was 42% positive in 2014), and in turn reduce concerns about external sustainability, Spain needed to generate large current account surpluses on a sustained basis.

The banks were also on the mend. Profitability was rising but was too reliant on declining funding costs, the reduced need to provision against loan losses, and income generated by banks' fixed-income portfolios. Further mergers cannot be excluded. Access to loans for companies and households was also picking up.

The reform of public administrations continued to advance. By the end of September 2015, 180 out of 220 planned measures had been adopted, delivering €6.2 billion of savings (excluding measures affecting employees), according to the central government. Some regional administrations, however, remain bloated, while the 49 provincial councils, nests of corruption and a layer of opaque administration, needed to be eliminated.

The high unemployment rate, the country's scourge, was down from a peak of 27% in 2013 and the youth unemployment rate for 15-24 year-olds decreased to below 50%. Similarly, the percentage of youth 'not in employment, education or training' (known as NEETs) fell to below 20%. Yet these rates are intolerable for a developed country. Job creation was at the expense of precarious employment contracts and increased duality between insiders (those on permanent contracts) and outsiders (those on temporary contracts). In the third quarter of 2015, 26.2% of all wage earners were on a temporary contract, up from 24.6% a year earlier. The incentives in the 2012 labour market reforms to permanent hires did not have a sizeable impact on increasing permanent employment. The number of workers on permanent contracts increased 1.6% in the 12 months to September 2015, while those on temporary contracts rose 10.2%. Introducing a single contract whereby workers would gain the same protection rights gradually, instead of the existing dual system with high and low levels of protection would be a move in the right direction.

The economic crisis put Spain's welfare state under considerable pressure. The last Popular Party government raided the reserve fund created in 2000 and built up during the boom years to pay pensions. The reserve was reduced from €66.8 billion in 2011 to €36.9 billion in November 2015 (3.5% of GDP). If this pace of drawing down the reserve continued and no measures were taken, it would run out in 2019. With an increasingly greying population and more than 2 million fewer social security contributors than in 2007, it is crystal clear that the pay-as-you-go pension system (reformed as of 2014) needs to be overhauled again.

Recent experience lamentably shows that governments in Spain only reform when the economic situation is bad and there is no other alternative (for example, the Socialists in 2010-11 and the Popular Party in 2012-13), instead of when the times are good and the economic winds are blowing in their favour (the Socialists in 2004-7).

The new government whatever its political colour has little leeway to relax the economic policies, without storing up problems for the future. Lowering the general government budget deficit to the EU threshold of 3% of GDP has already

been postponed twice. Public debt shot up from 70% of GDP in 2011 to 100% in 2015, and needs to begin to come down. Interest rates will one day stop being ultra low and become 'normal' and then the burden of such a high debt will be truly realised. A tight rein will have to be kept on spending and more tax revenues collected through a tougher crackdown on tax fraud and evasion. Spain's tax rates are not particularly low by EU standards.

The economic model is no longer excessively based on the construction sector (which collapsed as of 2008), and is unlikely to be so in the near future. Yet the temptation to return to that unsustainable model is bound to be strong because it is so labour intensive and produces short-term gains for the political class. Spain is stuck with a high unemployment for a long time, though not of the magnitude that the official figures suggest. Despite countless reforms since 1980, the labour market remains dysfunctional.

The productive model can only become more sustainable if it is more knowledge-based and export-focused. Exports have been something of a success –those of goods rose from 17.5% of GDP in 2007 to 22.4% in 2015, which even allowing for the shrinkage in GDP was still a notable achievement– and this momentum needs to be kept up. The risk is that as the domestic economy strengthens so some exporters will give up. The external sector's contribution to GDP growth was negative in 2015 for the second year running and looked like remaining so in 2016.

Exports are not the only success. The highly competitive tourism industry has gone from strength to strength, Spain continues to attract significant foreign direct investment, the infrastructure (roads, railways, airports, maritime transport) is excellent, more than 20 Spanish multinationals of varying sizes hold significant positions in the global economy and the influx of immigrants (net migration over the past 15 years was greater than to the UK) has not produced xenophobia or anti-immigrant/anti-Europe parties along the lines of Britain's UKIP. Spanish society, in which the extended family-based network continues to play an important role, is cohesive.

The education system remains a big problem, and one that needs to be resolved with a national pact between politicians. For far too long, education had been kicked around like a political football with each change of government. Instead of focusing on key problems such as the high drop out rate or the large number of students who repeat a course before they reach 15 (which, in turn, demotivates them and results in them leaving school at 16), the public debate is an ideological one about far less important issues such as whether to increase or decrease the amount of religious instruction or introduce or get rid of citizenship courses.

The early school-leaving rate peaked at 31.2% in 2009, double the EU average, when 16 year-olds dropped out of school in droves to work in the construction sector, and dropped to 20.3% in 2015, but it was still far too high. It would make eminent sense if Spain's school-leaving age was raised from 16 to 18, the same as in Germany, Belgium, England and the Netherlands (part time, full time or vocational education as of 16).

At one end of the education spectrum there is a 'lost generation' of unqualified workers who left school early and were among the first to be made unemployed when the economy crashed, and at the other end it is not uncommon to find graduates in jobs that require little or no qualifications. Four years after graduation about half of young graduates in Spain work in jobs that do not require their level of qualification. On top of this, Spain has one of the lowest percentages of young people in vocational training as most prefer to go to university, despite a degree not guaranteeing a job or work that matched their skills.

The proposals contained in the white book on education prepared for the last government by José Antonio Marina are a starting point. Among other things, Marina proposed that teachers be assessed more. Teachers in Spain are appraised to access the profession but not regularly afterwards. However good or bad a teacher is, they earn the same. The lack of motivation could be one of the reasons for the mediocre results in the PISA tests.

The results of the last general election left no room for doubt that Spaniards want a clean broom swept through the traditional political establishment, and some of the state's institutions colonized by politicians with a consequent loss of independence, such as the General Council of the Judiciary, the Court of Auditors and the Constitutional Court. Opinion polls before the election regularly showed that Spaniards had a low view of their political parties (perceived as self-serving machines) and of parliament. This was a worrying development in a democracy that had only existed for 40 years.

Spaniards clamoured for an end to the crony capitalism and corruption that flourished during the decade-long economic boom and which gave rise to scandals such as the massive fraudulent use of public money in Andalusia to lay off workers and run training courses, collusion between real estate promoters and town halls, the politicisation of savings banks, the building of airports for which there was no traffic demand and the payment of commissions to political parties in return for favours.

A reform of the 1978 Constitution is also finally on the table. The post-Franco constitution has served Spain well, giving the country its longest lasting and most stable democratic government. Since the 1812 Constitution, established by

the Cádiz Cortes, Spain's first national sovereign assembly, the country has had seven constitutions, two kings who were expelled, one imported, two republics, three Carlist wars, the Civil War (1936-39) and the dictatorship of General Franco (1939-75).

The 1978 Constitution is not something set in concrete. The Council of State, the government's highest advisory body, approved a report on constitutional reform in 2006 (since shelved). The urgency to do this is now greater, and in effect engineer a kind of second transition, in order to take account of new circumstances, not the least being an amendment to allow absolute cognatic primogeniture in order to enable the first-born to inherit the throne, whether the heir be male or female. Felipe, the youngest of King Juan Carlos's three children and who has two daughters, became king in June 2014, following the abdication of his father, as Spain uses the system of male-preference cognatic primogeniture.

The most contentious constitutional reform concerns the system of 17 autonomous communities. It is widely recognised that the system does not operate efficiently. Instead of resolving historical conflicts between the periphery and the centre, it exacerbates them, as evidenced, in particular, by the push for independence in Catalonia.

Uncontrolled spending and a general reluctance among regional governments to use the revenue-raising powers they have, through fear of losing votes, and instead go with a begging bowl to the central government were major factors behind the ballooning of the total budget deficit between 2007 and 2011, which is not yet under control. The high regional deficits undermined international confidence in the national government when Spain's economic crisis erupted, and could do so again.

The regions have become like mini states, with their parliaments, bureaucracies, plethora of official cars, 'ghost' airports in some cases and savings banks (under the thumb of politicians), many of which had to be bailed out under a euro zone programme or nationalised. The savings banks have been cleaned up –their number fell from 45 to two– but the finances of the regional governments are not yet on a sustainable path.

Under constitutional reforms, the Senate should be called to play a greater role. In the Council of State's view, the nature of the Senate as 'the chamber of territorial representation' should have effects on its functions, its composition, and its institutional position within the parliament. The report proposed to strengthen the Senate's participation in the legislative function by extending to four months the period the upper house has to veto or amend bills approved by parliament.

More specifically, the Council of State suggested that bills that particularly affect the autonomous communities should originate in the Senate.[1]

The composition of the Senate has always the most important issue in all debates on the Spanish upper house reform. The current composition does not correspond to Spain's regional structure. The Council of State sought to correct this 'mismatch' by enhancing the participation of the autonomous communities in the Senate. It used a combination of three criteria: equal distribution of senators among the 17 regions; distribution in proportion to each region's population; and distribution that takes into account the number of provinces in every region (Castile and León has nine provinces, while Madrid and four other regions have only one). Each region would elect six senators, plus an additional one or every one million inhabitants, and an additional senator per province. This would produce a chamber of 234 senators and their distribution among the regions would be significantly different from the existing one. The Council favours the election of senators by universal suffrage over their appointment by regional legislatures, as happens for a certain number who are elevated to the Senate as a kind of retirement home.

The revamping of the regional autonomy system could go some way toward meeting Catalan demands for a 'fairer' financing system by opening a third way between maintaining the status quo and independence (the only two options at the moment). The government of Catalonia, one of Spain's richest regions, claimed it transferred too much of its revenues to Madrid under the system of 'solidarity' with the poorer regions. Opinion polls showed that given the chance a significant number of Catalans wanted neither independence nor keeping the current system. A bilateral agreement with Catalonia is out of the question as it would be viewed as unfair by other regions and open up a Pandora's box of competing demands, particularly in the Basque Country.

Spain has come through a tough time, as it did during the transition to democracy, thanks to a marvellous collective effort. Another similar drive was needed to steer the country through uncharted territory.

Notes

Chapter 1: Overview

1. The flaws in the original design of European Monetary Union are well explained in *How to Fix the Euro: Strengthening Economic Governance in Europe*, a joint Chatham House, Elcano Royal Institute Elcano and AREL report, by Stephen Pickford, Federico Steinberg and Miguel Otero-Iglesias, published in May 2014 and available at http://www.realinstitutoelcano.org/wps/wcm/connect/48950100436dd836af88bf314d72f5eb/Pickford_Steinberg_OteroIglesias_How_to_fix_the_euro.pdf?MOD=AJPERES&CACHEID=48950100436dd836af88bf314d72f5eb. See also, in the appendix, the Popular Party government's contribution to discussion about governance of the European Monetary Union presented in Brussels in May 2015.

2. This staggering figure, based on the methodology employed by EU countries to calculate youth unemployment, is often misunderstood to mean that half of young people are jobless, as opposed to being in education or not seeking work, which is not the case. According to another way of calculating the figure on the basis of all young people, as opposed to those in the labour force (ie, actively employed or seeking employment), the figure, known as the unemployment ratio, is around 20%. See http://www.realinstitutoelcano.org/wps/portal/web/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/demography+population/commentary-gonzalezenriquez-youth-unemployment-spain#.VZy7z-2qqkp.

3. Law 14/2013 of 27 September on support for entrepreneurs and entrepreneur internationalisation.

4. Defined as the percentage of the population aged 18-24 with at most the lower secondary-education certificate (school-leaving certificate) and not in further education or training programmes.

5. The Socialist government's target for 2011 was 6% and the deficit came in at 8.5%. Eurostat, the EU's statistics office, then revised the figure upward to 9.4% to reflect state injections of capital into nationalised banks and also the deficit in 2010 from 9.3% to 9.7% to take account of a backlog of unpaid bills by public administrations.

6. Minutes of Executive Board Meeting 10/72-4, 3:45pm, 14/VII/2010.

7. See *Earnings inequality in Spain: evidence from social security data* by Stéphane Bonhomme & Laura Hospido, CEMFI, March, 2012, at http://www.cemfi.es/ftp/pdf/papers/pew/InequalitySpainMar2012.pdf.

8. In the US, pay for men with only a high-school diploma fell 21% in real terms between 1979 and 2013; for those who dropped out of high school it fell by 34%. Data taken from 'Men adrift', *The Economist*, 30/V/2015.

9. See the '2012 Labour Market Reform in Spain: a Preliminary Assessment', OECD, December 2013, at http://www.oecd.org/els/emp/SpainLabourMarketReform-ExecutiveSummary.pdf.

10. See the preface of *The Disinherited* by Henry Kamen, Allen Lane, 2007.

11. This meant that 13.6 million people were at least in one of the following conditions: at-risk-of-poverty after social transfers (income poverty), severely materially deprived or living in households with very low work intensity.

12. A positive result of so many foreclosed properties was that banks were keen to take them off their books at attractive prices and they also offered up to 100% financing to buy a foreclosure, compared with a maximum of 80% for a property not owned by a bank. This helped first-time buyers get on the property ladder.

13. The 1978 Constitution stated that 'there shall be no state religion', and Article 16:3 declared: 'the public authorities shall take the religious beliefs of Spanish society into account and shall in consequence maintain appropriate cooperation with the Catholic Church and other confessions'. No other religious group was mentioned by name. The Socialist Party saw this as introducing 'covert confessionality' and voted against it in the committee that drafted the text.

14. This section draws on the 'OECD Skills Strategy Diagnostic Report', September 2015, https://skills.oecd.org/developskills/documents/Spain_Diagnostic_Report.pdf.

15. This is well explained (in Spanish) by Carmen González Enríquez at http://www.realinstitutoelcano.org/wps/portal/rielcano/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/comentario-gonzalezenriquez-fracaso-escolar-espana.

16. See the angry open letter by Amaya Moro-Martín, a Spanish astrophysicist who left her country for a job in the US, denouncing the Popular Party's science policy.
http://www.theguardian.com/science/political-science/2015/dec/19/an-open-letter-to-mariano-rajoy-from-an-emigre-researcher

17. The 2015 Elcano Global Presence Report is available at http://www.realinstitutoelcano.org/wps/portal/web/rielcano_en/publication?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/publications/elcano-global-presence-report-2015.

18. The Elcano Royal Institute published an analysis in Spanish of this issue by María Morán: http://www.realinstitutoelcano.org/wps/wcm/connect/e16ab0004eb57268a719efb5284b5e68/OME9-2013-Moran-imagen-toro-Espana-medios-crisis.pdf?MOD=AJPERES&CACHEID=e16ab0004eb57268a719efb5284b5e68.

19. Twelve people died in the summer of 2015 after being gored by bulls during the *encierros*, sparking a debate about whether to ban them.

20. David Ringrose (1996), *Spain, Europe and the 'Spanish Miracle'*, Cambridge University Press, p. 3-28.

21. Julian Pitt-Rivers (1919-2001), the distinguished British social anthropologist and author of the classic *The People of the Sierra* (Weidenfeld & Nicolson, 1954), did nothing to dispel the 'Spain is different image' when he wrote, 'Being Spanish is the ultimate expression of the human condition. Spaniards in themselves are not so different from other human beings except that they are more… of everything. In other words, when they are jolly, they are jollier than anyone and a good time in Andalusia is better than a good time anywhere else... When they are sad, they more tragic and dignified in their tragedy. If they are charming, no one can be more charming and their charm penetrates like a laser beam. But if they are unpleasant, they are the most pompous and insensitive people imaginable. If they love, they love more deeply than anyone, if they hate, they hate more deeply too, but they know how to hide their hatred better than anyone'.

Chapter 2: The New Mould of Politics

1. Urdangarín and the Infanta Cristina were due to stand trial in early 2016.

2. Iglesias's thinking is set out in an illuminating article and interview in the May-June 2015 issue of the *New Left Review*, http://newleftreview.org/II/93/pablo-iglesias-understanding-podemos and http://newleftreview.org/II/93/pablo-iglesias-spain-on-edge.

3. Podemos's Venezuelan connection is well explained by David Roman in a report for the *Wall Street Journal*, http://www.wsj.com/articles/how-venezuelas-chavez-lives-on-in-spain-1425000737.

4. The best diagnosis of the roots of Spain's political problems was penned by César Molinas in an essay for *El País*. Available at http://elpais.com/elpais/2012/09/12/inenglish/1347449744_053124.html

5. The article is available at http://www.sciencedirect.com/science/article/pii/S0147596715000505 and explained by Ana Swanson at http://www.washingtonpost.com/news/wonkblog/wp/2015/08/20/why-some-billionaires-are-bad-for-growth-and-others-arent/.

6. See http://www.transparencyinternational.eu/wp-content/uploads/2015/04/Lobbying_web.pdf.

7. According to a detailed report on the lack of democracy in Catalonia by *Societat Civil Catalana*, families who ask for bilingual education are demonised and accused of 'politicising education'. See page 70 of the report available at https://societatcivilcatalana.cat/assets/documents/deficits-democraticos-ING.pdf.

8. See Mas's case for independence in an article published in *The Guardian* at http://www.theguardian.com/commentisfree/2015/oct/05/catalan-people-spanish-government-catalonia-independence-election-madrid.

Chapter 3: The Economy: From Bust to 'Poster Boy'

1. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf.

2. In a document AEAT staff said, 'It's not that AEAT does its work badly; it could do it better, if it was allowed. It's not that it collects little; it could collect more; it's not that it recovers few debts; it could recover more. In short, it's not that it combats fraud badly; it fights it less than we would like'.

3. Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies, OECD, 2015. http://www.oecd.org/ctp/administration/tax-administration-23077727.htm.

4. Explained by the Bank of Spain at http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/13/Abr/Files/art2e.pdf.

5. The expenditure benchmark is a rule that contains the growth rate of government spending at or below a country's medium-term potential economic growth rate, depending on the country's position with respect to the medium-term budgetary objective (MTO). Under the rule, spending increases beyond this rate must be matched by additional discretionary revenue measures. The expenditure benchmark complements the MTO by putting growth in net expenditure on a sustainable path and therefore helping to move towards or maintain the MTO itself.

6. See Pablo Hernández de Cos & David López Rodríguez (2014), *Tax structure and revenue-raising capacity in Spain: A comparative analysis with the EU*, Bank of Spain, http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasionales/14/Fich/do1406e.pdf.

7. Explained by the Economy Ministry at http://www.thespanisheconomy.com/stfls/tse/ficheros/2013/agosto/120713_Regional_Liquidity_Mechanism.pdf.

8. See the section on Spain's insolvency regime in the IMF's document published in August 2015 at http://www.imf.org/external/pubs/ft/scr/2015/cr15233.pdf.

9. *Ibid*.

10. See http://www.imf.org/external/np/sec/pr/2015/pr15378.htm.

Chapter 4: Foreign Trade

1. Cited in José Luis Barbería (2006), 'El valor de la "marca" España', *El País*, 19/VI/2006.

Chapter 5: Economic Sectors

1. 'Analysis of electricity prices in the European Union and the United States: A Spanish perspective'.

2. See the full list at http://whc.unesco.org/en/statesparties/es.

Chapter 6: Banks

1. Vicente Cuñat & Luis Garicano (2009), *Did good cajas extend bad loans? Governance, human capital and loan portfolios*, London School of Economics and CEPR, November, http://www.vicentecunat.com/cajas.pdf.

2. Testimony by Luis M. Linde, Governor of the Bank of Spain, before the Parliamentary Committee on Economic Affairs and Competitiveness, Madrid, 17 July 2012. See http://www.bis.org/review/r120718r.pdf

Chapter 9: The Shape of Things to Come

1. This section draws on an analysis by Leopoldo Calvo-Sotelo, a former Spanish prime minister at http://preview.ialsnet.org/meetings/constit/papers/Calvo-SoteloLeopoldo(Spain).pdf

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Appendix 1.

Letter sent to José Luis Rodríguez Zapatero by Jean-Claude Trichet, President of the European Central Bank, and Miguel Ángel Fernández Ordóñez, Governor of the Bank of Spain, in August 2011.

STRICTLY CONFIDENTIAL
Reclassifed for release on 19 December 20

Mr. José Luis Rodríguez Zapatero
Prime Minister
Presidente del Gobierno de España
Complejo de la Moncloa
Avenida de Puerta de Hierro, s/n
28071 Madrid
Spain

Frankfurt/Madrid, 5 August 2011

Dear Prime Minister.

The Governing Council of the European Central Bank discussed on 4 August 2011 the situation in Spain's government bond markets. The Governing Council considers that for Spain pressing action by the Spanish authorities is essential to restore the credibility of the sovereign's signature in capital markets.

We recall that the Euro area Heads of State or Government summit of 21 July 2011 concluded that "*all euro countries solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature and all their commitments to sustainable fiscal conditions and structural reforms*". The Governing Council considers that Spain needs to urgently underpin the standing of its sovereign signature and its commitment to fiscal sustainability and structural reforms with credible evidence.

At the current juncture, we consider the following measures to be essential:

1. We see a need for further significant measures to improve the **functioning of the labour market** with a view to making clear progress towards reducing the very high rate of unemployment.

a) The wage-bargaining reform bill adopted by the Spanish government on 10 June 2011 should more effectively strengthen the role of firm-level agreements, with a view to ensuring an effective decentralisation of wage negotiations. During the forthcoming parliamentary process, the law should be amended in order to reduce the possibility for industry-level agreements (at national or regional level) to limit the applicability of firm-level agreements.

b) Furthermore, we remain very concerned that the government has not taken any measures to abolish inflation-adjustment clauses. Such clauses are not an appropriate feature for labour markets inside a Monetary Union as they are a structural obstacle to the adjustment of labour costs and thereby contribute to hampering competitiveness and growth. We encourage the government to take bold and exceptional steps to exclude the use of such clauses in view of the current crisis.

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c) The government should also take exceptional action to encourage private sector wage moderation, following the significant cuts in public wages agreed last year. We invite the government to explore all possible avenues to this end.

d) We also suggest reviewing other labour market regulations at short notice, with a view to speeding up the reintegration of unemployed into the labour market. We see strong benefits in introducing an exceptional new labour contract with only very low severance payments, to be applied for a limited period of time. In addition, we suggest eliminating all restrictions for the roll-over of temporary contracts for a certain period of time.

In view of the severity of the financial market situation, we regard as crucial that action in the above fields be taken as soon as possible, but at the latest by end-August.

2. The government also needs to take bold measures to ensuring the **sustainability of public finances.**

a) The government should clearly demonstrate with actions its unconditional commitment to meeting its fiscal policy targets independent of the economic situation. To this end, we urge the government to announce already in August additional structural fiscal consolidation measures for the remainder of 2011 of above 0.5% of GDP as a minimum with a view to convincing markets that the 6% deficit target for 2011 will be reached under all circumstances. At the same time, strict implementation of the national fiscal rules to ensure control of regional and local government budgets (including the authorisation of regional government debt issuance) must continue and additional adjustments to regional and local government consolidation plans implemented swiftly when needed.

b) The recent publication of quarterly data on the budget execution of regional governments is an important step forward in terms of transparency; but it does not go far enough. The government should publish in the short term national accounts for each government sub-sector in conjunction with the publication of quarterly government finance statistics. In addition, in the medium-term, the government should encourage the publication of monthly national accounts data for other government sub-sectors with the same detail and timeliness as for central government.

c) The introduction of a new spending rule (limiting spending increases in normal times to the trend growth rate of GDP, unless financed by changes to tax legislation) is welcome. It is key that this rule applies in the future to all government sub-sectors.

3. Finally, we encourage the government to undertake further **product market reforms**. Several elements should be addressed here:

2

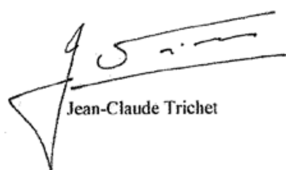
i) increasing competition in the energy sector, so that prices better reflect the cost of energy, as well as taking measures to reduce the high energy dependence of the Spanish economy;

ii) promoting the rental market for housing, by improving the regulation of contracts; and

iii) increasing competition in the services sector, by specifically addressing the regulation of professional services.

Overall, we trust that the Spanish government is aware of its very high responsibility for the smooth functioning of the euro area at the current juncture and will decisively undertake all necessary measures to regain market confidence in the sustainability of its policies again. Such actions, together with all measures underway to restructure and recapitalise the Spanish banking sector, should lead to high benefits not only for the Spanish economy but also for the euro area as a whole.

With best regards,



Jean-Claude Trichet

Miguel Fernández Ordoñez

Cc: Finance Minister Elena Salgado

3

Appendix 2.

Spanish contribution to discussion about governance of the European Monetary Union, presented in Brussels by the Popular Party government of Mariano Rajoy in May 2015.

The economic crisis confronted the Euro Area with its weaknesses. The crisis might not have been exclusive to the Eurozone, but specific factors prolonged and aggravated its effects:

Monetary unions are vulnerable to asymmetric shocks. As Member States cannot make use of currency devaluations to absorb economic shocks, the burden of the adjustment falls on internal flexibility and on factor mobility. And the Euro Area lacks efficient shock-absorbing mechanisms.

First of all, the Euro Area lacks adequate internal price and income flexibility. Indeed, in the years preceding the crisis, nominal and real rigidities at national level delayed the necessary adjustments in prices and wages. While inflation remained low at the aggregate level, differences in product and labour markets led to differences in inflation among Member States.

In these circumstances, the single monetary policy stance proved to be inadequate for certain Member States and generated asymmetric effects. In some countries, monetary policy resulted excessively loose, leading to negative real interest rates. Such financial conditions distorted rational behaviour of economic agents and promoted excessive indebtedness and the accumulation of imbalances. These developments also fostered significant competitiveness losses in certain Member States.

At the same time, the Euro Area lacks sufficient labour mobility (while capital movements are unrestricted). This combination has amplified the volatility of asymmetric shocks, and hampered an efficient adjustment inside the EMU: imbalances could not be absorbed by the relocation of workers among countries, but by adjustments in the number of employed and unemployed within each country. This, ultimately, led, in some countries, to dramatic increases in unemployment.

Another central condition for an efficient monetary union is the existence of a truly functioning internal market. Market fragmentation increases the divergences among countries in their cyclical situation, which is a source of instability for the single currency and makes a single monetary policy difficult to implement.

Consequences were especially acute in the financial sector. The EMU had a fragmented banking sector and, in particular, a fragmented retail banking sector.

This feature, which has still not been sufficiently addressed in the context of the banking union, aggravated the accumulation of imbalances. Debtors were concentrated in the banking sector of certain countries, while creditors were in others. As the financial crisis broke out, weak financial interconnections collapsed. This had two effects: (1) First, it triggered a severe banking crisis, as liquidity problems quickly turned into solvency problems; (2) Second, a financial crisis was rapidly transformed into a sovereign debt crisis. As confidence in banking sector solvency deteriorated, fears of a sovereign bail out, in a context of deteriorated fiscal accounts, shot up risk premia in countries under stress. At the same time, financial fragmentation along national borders restricted demand for sovereigns with high external imbalances.

One last feature of the 2008 financial crisis is that it also led to unforeseen fiscal deficits, caused, to a great extent, by a dramatic revenue plunge. Indeed, in low competiveness countries, fiscal revenues were excessively dependent on the artificial growth nurtured by negative real interest rates and on the accumulation of external deficits. The outbreak of the crisis provoked a sharp deterioration in their fiscal situation.

In the last years, significant progress has been achieved in relevant areas.

The Banking Union, the creation of financial sector support instruments in the framework of the ESM, and the liquidity measures adopted by the ECB have broken the feed-back loop between banks and national sovereigns.

Secondly, the creation of instruments (with adequate rules and conditionality) for debt market intervention, together with the setup of specific assistance programs helped, first, contain and, then, put an end to the sovereign debt crisis. Although the current situation cannot be qualified as of total normalization, countries that have exited Economic Adjustment Programs have returned to the market, and spreads differentials have moderated.

Thirdly, the macroeconomic adjustment and deep structural reforms put in place at national level have helped avert the external unbalances and reduce competitiveness differences among member states.

However, much remains to be done to strengthen the European Monetary Union, consolidate the economic recovery and prevent future crises and instabilities. In the medium and long term, five elements are needed to complete a sound and mature monetary union:

1. Eliminate real and nominal rigidities that hamper swift adjustment to economic shocks.

2. Reach sufficient levels of labour mobility
3. Achieve a sound Fiscal Union to complete and reinforce the Monetary Union. Such Fiscal Union should encompass three elements: (1) transfer of sovereignty to the Union on national revenue and expenditure policies; (2) a common Eurozone budget; (3) common debt instruments.
4. Complete the internal market. In particular, financial market fragmentation has to be tackled by ensuring adequate integration in the retail banking sector.
5. These advances will entail sovereignty transfers to the central level of the EMU, and thus need to be accompanied of enhanced democratic legitimacy and accountability.

The key issue now is how to progress to this medium and long term scenario. Bold measures need to be taken in the short term to anchor expectations and ensure the credibility of the process. At the same time, adequate incentives need to be put in place to promote balanced convergence and ensure sustainability.

The Government of Spain proposes a gradual approach, based on a transparent new convergence process enshrined in a clear and predictable roadmap. This gradual approach is similar in inspiration to the Maastricht convergence process that led to the adoption of the single currency. It would entail three stages, each of which will foster progress on each of the five elements identified as essential for the efficient functioning of the Monetary Union. Participation in the different stages will be conditional on Member States ensuring adequate fulfilment of newly defined convergence criteria. Such criteria have to be designed so as to promote fiscal and external balanced positions, as these are the two sources of instability for a monetary union.

I. First stage: 18 months (until 2017):

This is a preparatory stage. While engaging in deep analysis on the identified weaknesses, this stage will develop all the necessary work to design the convergence process, the convergence criteria and the policy coordination tools. Measures not requiring Treaty changes would be implemented at this stage to anchor the process.

The first and essential step is to streamline and reinforce policy coordination processes. Fiscal imbalances, as a source of instability in the EMU are already covered within the Stability and Growth Pact framework. However, more work needs to be done to prevent the negative spill-overs of external unbalanced positions. And these imbalances need to be identified and tackled at an early stage. Therefore, at this stage, an appropriate set of indicators needs to be identified and regularly monitored based on periodic publication, in order to timely correct

deviations. A process similar to the one foreseen for fiscal deviations within the Excessive Deficit Procedure should be set up. Member States would commit to take the necessary measures to swiftly correct identified imbalances. The design of specific correction policies, however, would remain a responsibility of Member States, in full respect of the subsidiarity principle.

Such indicators could be: inflation, real effective exchange rate, external deficit and differentials in unit labour costs. Inflation expectations measured by the evolution of interest rates could also be taken into account. An immediate option could be reintroducing, in the coordination process, nominal convergence rules of inflation established in the Maastricht Treaty. The paradox has been that fiscal criteria have been monitored after the creation of the single currency through the Stability and Growth Pact, while no similar treatment has been given to nominal convergence in inflation criteria.

The framework of imbalances identification and correction and policy coordination needs to be complemented by a more adequate formulation of monetary policy. In the years before and after the crisis, the ECB has maintained its definition of price stability essentially unchanged (a year-on-year increase in the Harmonized Index of Consumer Prices for the euro area of below, but close, to 2%). This definition must be adapted to take into account not only average inflation in the Euro area but also its variability across countries and the divergent conditions this variability creates.

Labour mobility: at this stage, the Commission would launch a green paper on a 'Labour Market Union'. This paper would serve as a first analysis of all elements needed to achieve maximum labour mobility: deepening current initiatives such as the foreseen labour mobility package (in particular measures enhancing coordination in social security systems), initiatives in the field of education and recognition of professional qualifications; language and/or cultural barriers... The aim of this process would be to ensure coherence in the multiple fields related to labour mobility, identify the legislative changes needed and send a strong signal of political determination to advance.

Fiscal Union: At this stage steps towards a fiscal union are meant to set strong foundations for deeper integration. These steps are to be taken in three areas:

- First: measures in the taxation area. Harmonization of budgetary frameworks and fiscal alignment is critical and constitutes a frequently forgotten feature of a prospective fiscal union. A first and urgent step is to ensure swift progress against aggressive tax planning, base erosion and profit shifting (BEPS). Action should be taken along the following lines:

- Approve new initiatives against aggressive tax planning, base erosion and profit shifting (BEPS). In particular, the EU should ensure swift implementation of proposals to favour the exchange of information and the widest possible scope of application for the automatic exchange principle.
- Protect internal markets from tax avoidance and engage in transversal and coordinated actions with other countries in the fight against tax havens.
- Take a close look in the fiscal treatment of hybrid instruments, the international fiscal rules, the rules against exit tax and so on. Introduce a European fiscal identification number that will facilitate the identification of tax payers that embark in cross-border operations.
- Enhance fiscal transparency including through enhanced cooperation and the application of counter-measures against non-complying jurisdictions. A Code of Good Practices will be a useful tool in this endeavour.

- Second: progress on the expenditure side, in particular on public investment within the framework of the European Investment Plan (Juncker Plan). The following measures could be considered:

- Include, in the framework of the SGP, a 'golden rule' for investment, to be applicable in the case of investments made in the interest of the EMU. Under this 'golden rule', Member States could temporarily and in a limited and small manner deviate from their adjustment path.
- Create a specific ESM facility to finance or 'guarantee' infrastructure projects in the interest of the Union. These projects should have a participation of the private sector and render market yields, in line with the projects considered under the Junker Plan.
- Allow for the EFSI to find additional leverage in the financial markets in order to increase the effects of the Junker investment Plan.

- Third: agree on a precise roadmap to achieve a full fiscal union. This roadmap needs to be simple and predictable, while incorporating adequate incentives and strict conditions to ensure the stability of the Union. The process should be based on the strengthened policy coordination process and its set of indicators, which will function as a continuous and dynamic monitoring and correction mechanism.

That is, not only accessing further phases of fiscal integration will be conditional on the fulfilment of established thresholds for fiscal and external sector indicators, but these thresholds will also be considered permanent requirements. By enshrining the convergence process in a stable policy coordination framework, the EMU guarantees that adequate monitoring will continue once the Fiscal Union is in place, triggering correction mechanisms if necessary.

Internal market: the process of completion of the internal market should be accelerated. The Commission has announced its intention to present an Internal Market Strategy. The Government of Spain considers that this could be a good opportunity to adopt a comprehensive and ambitious approach. The strategy should identify remaining shortcomings and propose the necessary legislative changes and specific measures. On the basis of this analysis, measures immediately applicable should be adopted already in phase one and a time-bounded roadmap developed to ensure completion of the process.

In this stage, the EMU should proceed to full implementation of the Banking Union. The Single Resolution Mechanism and the Single Resolution Fund will become operative as of January 2016. The banking union framework should be completed by further integration in the deposit guarantee area, with the creation of a Single Deposit Guarantee Scheme. Furthermore, work should proceed on the development of an adequate backstop for the Single Resolution Mechanism as committed by the ECOFIN Ministers in their statement of December 18th 2013.

Additionally a complete Banking Union requires an integrated retail banking sector. In this stage, a Green Paper on the integration of retail banking markets should be launched. Fifteen years after the introduction of the Euro, retail banking remains dominated by domestic banks in most EMU countries. It is very common to find Eurozone banks that have larger retail operations outside the EMU than in other EMU countries. The objective of this green paper would be to analyze the barriers to the establishment of pan-European retail banks. While the Banking Union should clearly help remove some of these barriers, there are particular areas where further liberalization of cross-border investments may be needed, looking at areas such as national supervisors' powers to block mergers, consumer protection regulations and cross-selling restrictions.

Political Union: Increased democratic accountability and greater cooperation among national parliaments is increasingly needed. It could take the form of biannual hearings of the Presidents of the Eurosummit, the Eurogroup and the ECB as well as of the Vice President of the Commission in charge of Euro matters and of the relevant Commissioners who will report on the economic situation and action taken to representatives of the economic Commissions of the European Parliament and national parliaments (applying the distribution key of countries representation in the European Parliament).

II. Second stage: 2017- end of current legislative period (2019):

In this stage, the focus should be set on implementation and legislative development, including changes in the EU Treaties, as needed.

Eliminating structural rigidities: As previously said, the new policy coordination and imbalances correction process will be permanent. It will foster real economic convergence and prevent the accumulation of imbalances. Sustained fulfilment of established thresholds will be required in this phase for Member States to access to the first stages of the Fiscal Union.

As countries aim for economic convergence in this stage, the ECB's mandate will be adapted to regulate the contribution of monetary policy to this objective. While price stability (under the revised definition envisaged previously) will remain the primary objective of the ECB, its contribution in the prevention of macroeconomic divergences and imbalances across countries will be made explicit.

Labour mobility: In this phase, legislative work identified in the Green Paper on labour mobility will be developed and approved, and other identified measures will be implemented.

Internal market: The EMU should complete all the legislative work required for the completion of a sound internal market, as established in stage one. This would include the approval of specific legislation to ensure sufficient integration in the retail banking sector.

Fiscal Union: The second phase of the fiscal union process involves the creation of a limited common fiscal capacity within the EMU. This fiscal capacity will be of a cyclical nature and linked to the financing of public investments. It will be financed by the EMU's own resources (to be defined) and will have limited borrowing capacity. To ensure its cyclical nature, debt emission will be subject to strict conditions and will be contingent on cyclical needs: debt issued in 'bad times' will have to be absorbed in 'good times' thus preventing unsustainable debt accumulation dynamics.

Another important feature of any fiscal union is common debt management. Currently the EMU is confronted to high stocks of public debt, both at the national level and in the EFSF/ESM framework. A reflection process, enshrined in a specific Green Paper, should be launched on the future of this debt within a fully-fledged fiscal union (third stage) with a view to preserve fiscal sustainability.

Political Union: Progress in economic integration has to be accompanied by deeper political integration. At this stage, an Authority responsible for economic policy in the Eurozone, sort of a Eurozone Minister of Finance, will be needed. This Authority would be responsible for the limited fiscal capacity already in place; would be in charge of the coordination and supervision of the convergence process; and will promote the analysis of public debt management. Furthermore, he or she would make recommendations to foster the deepening of the Internal Market and labour mobility. The Authority will be appointed by representatives of the European Parliament and national parliaments (applying the distribution key of countries representation in the European Parliament), acting on a proposal of the European Council.

III. Third stage: beyond 2020

This phase requires not only changes in the Treaties, but also institutional changes without a limited timeline (this timeline is to be decided during the second stage). Access will be conditional on sustained fulfilment of convergence fiscal and external sector criteria in the framework of the monitoring and correction procedure.

Eliminating structural rigidities: The EMU should have reached sufficient flexibility levels to ensure its smooth functioning. In any case, the monitoring and correction procedure for policy coordination will continue to function during the third stage, preventing divergences and accumulation of imbalances. The European level should be granted clear competences in fields most related with the reduction and elimination of structural rigidities.

Labour mobility: All competences related to labour mobility should be transferred to the European level, including, for example, matters related to social security, unemployment insurance, or professional qualifications.

Internal market: To ensure an efficient functioning of the internal market, responsibilities should be clearly assigned between the European level and Member States. The Government of Spain proposes an approach based on lists. The aim will be to order regulatory elements (either by topic or by their nature of primary law or implementing legislation). The highest level will correspond to legislation to be approved at the European level. Other norms will require a qualified majority of the Council, while a simple majority will suffice to approve lower categories.

Fiscal Union: Based on the analysis on public debt undertaken in stage II and once the budgetary responsibilities are clearly assigned between member

States and the European level, the limited fiscal capacity could be enhanced to create a true Fiscal Union encompassing the three central elements: (1) transfer of sovereignty on revenue and expenditure policies to the European level; (2) a common Eurozone budget; and (3) common debt instruments.

Participation in the Fiscal Union will be conditional to Member States achieving a significant degree of convergence, as demonstrated by sustained fulfilment of established criteria. Common debt instruments will be subject to controls and limits to ensure fiscal stability.

Political Union: The Authority responsible for economic policy in the Eurozone will assume full responsibility for the EMU fiscal policy and will be granted direct sanction powers towards national administrations.

Appendix 3.

Basic Socioeconomic Statistics, 1975 (the year that General Franco died) and 2015

	1975	2015 (1)
Population (mn)	36.0	46.4
Foreign-born population	165,000	4.4 mn
Unemployment rate (%)	4.7	21.2 (October)
Nominal GDP (US$ mn)	111,442	1,116,373
Per capita income US$)	3,186	24,041
GDP structure (% of total)		
Agriculture	9.0	2.5 (2014)
Industry and construction	39.0	17.5
Services	52.0	74.4
Employment by sectors (% of total)		
Agriculture	21.8	4.2 (2014)
Industry and construction	37.8	23.1
Services	40.4	74.4
Exports of goods and services (% of GDP)	10.4	33.3
Imports of goods and services (% of GDP)	11.9	30.9
Number of tourists (mn)	27.3	68.0
Consumer price inflation	17.2 (av. ann. incr. 1972-77)	-0.2
Public expenditure (% of GDP)	30.4 (av. 1974-85)	43.6 (2014)
Tax burden (% of GDP)	18.0	33.2 (2014)
Inward stock of foreign direct investment (US$ bn)	5.1 (1980)	722 (2014)
Outward stock of direct investment (US$ bn)	1.9 (1980)	674 (2014)
Spending on R&D (% of GDP)	0.35	1.20 (2014)
UN Human Development Index (2)	0.680 (1980)	0.869 (2014)
Average life expectancy at birth (years)	73.3	82.1
Percentage of population under age of 15	27.8 (1970)	14.9
Percentage of population over age of 65	10.0	18.0
Early abandonment of education (%) (3)	17.7	20.3

(1) Estimates or latest available figure. (2) The maximum value is one. The index is based on life expectancy at birth, mean years of schooling, expected years of schooling and per capita income. (3) The percentage of people aged 18-24 who have only lower secondary education or less and are no longer in education or training.
Source: National Statistics Office, Eurostat, UN Human Development Reports, UNCTAD, Economy Ministry and Afi.

Appendix 4.

Basic Socioeconomic Statistics, 2007 and 2015

	2007 (1)	2015 (2)
Population (million) (3)	44.8	46.4
Foreign-born population (% of total	9.8	10.0
Number of unemployed (labour force survey, mn)	1.9	4.8 (September)
Stated unemployment rate (%)	8.3	21.2 (September)
Number of registered unemployed (mn)	2.1	4.1 (November)
Nominal GDP (US$ trillion)	1.47	1.11
Per capita income (US$)	33,120	24,041
Per capita income (EU-28 = 100, PPS)	103	93 (2014)
Contribution to real GDP growth		
Final domestic demand	4.3	3.5
Net exports (contribution to GDP growth)	-0.8	-0.4
GDP structure (% of total)		
Agriculture	2.8	2.5 (2014)
Industry	17.4	17.5
Construction	13.7	5.6
Services	66.1	74.4
Employment by sectors (% of total)		
Agriculture	4.4	4.2 (2014)
Industry	16.0	13.7
Construction	13.1	5.7
Services	66.5	76.3
Exports of goods and services (% of GDP)	26.9	33.3
Exports as % of imports (coverage)	64.7	91.0 (October)
Imports of goods and services (% of GDP)	33.6	30.9
Current account balance (% of GDP)	-10.0	1.0
Number of tourists (mn)	59.2	68.0
Consumer price inflation (annual rate, %)	2.8	-0.2
Gross public debt (% of GDP)	36.2	100.8
Public expenditure (% of GDP)	39.2	43.6 (2014)
Tax burden (% of GDP)	36.5	33.2 (2014)
General government fiscal balance (% of GDP)	1.9	-4.7
Ibex-35 stock market index (Dec 1989 = 300)	15,182.30	9,544.2
Inward stock of foreign direct investment (US$ bn)	585.8	722 (2014)
Outward stock of direct investment (US$ bn)	582.0	674 (2014)
Stock of new and unsold homes	413,642	535,734 (2014)
Spending on R&D (% of GDP)	1.27	1.20 (2014)
UN Human Development Index (3)	0.955	0.869 (2014)
Early school leaving rate (4)	31.0	22.0 (2014)
Gini coefficient of income equality (5)	31.9	34.7 (2014)
Net official development assistance (% of GDP)	0.37	0.14 (2014)

(1) 2007 has been chosen as the reference year as it was the last year when the economy grew by more than 3% and marked the end of a boom period.
(2) Estimates or latest available figure.
(3) The maximum value is one. The index is based on life expectancy at birth, mean years of schooling, expected years of schooling and per capita income.
(4) The percentage of people aged 18-24 who have only lower secondary education or less and are no longer in education or training.
(5) Zero is perfect equality and 100 absolute inequality.
Source: National Statistics Office, Eurostat, UN Human Development Reports, UNCTAD, Economy Ministry, Madrid Stock Exchange and Afi.

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