

# The cost of the Spanish scandal

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## Summary

Spanish politics have taken a dramatic turn in the last fortnight, and one that has not fully registered outside of Spain. Spain's biggest political scandal of the post-Franco era may yet bring down Spanish Prime Minister Mariano Rajoy. But the real cost of the 'Bárceñas Scandal' is as likely to be the compounding of a broader crisis of authority for the pre-crisis Spanish political mainstream. This is likely to have longer-term implications for the speed and depth of Spanish reforms.

The allegation by the *El País* newspaper that corporate donations were for over two decades channelled to senior figures in the ruling *Partido Popular* (PP), including Prime Minister Mariano Rajoy, is shaping up to be easily Spain's biggest political scandal of the post-Franco era. Rajoy went to Brussels last week for EU budget negotiations looking decidedly destabilised. But how unstable is he? To what extent should this sudden uncertainty in Madrid worry investors in Spain and observers of the wider state of the Eurozone?

Spanish 10 year bond yields have risen around 60 basis points since the scandal broke three weeks ago. They have fallen back since, and they are still far short of the levels that marked most of 2012. Does this mean that the market is pricing in the survival of Rajoy's government? Or that it sees the Draghi guarantee of Spanish debt cost sustainability as trumping even the risk of a change of government in Spain? Or that it simply doesn't know what to think about an economy whose stockmarket has risen 30% since the middle of last year even as Spain's macroeconomic prospects have continued to deteriorate? There is probably an element of all three.

But assuming that the PP government does survive (or at least defer its electoral punishment for a few years until 2015) - which looks probable on balance - this may be the wrong test of this

scandal's real impact. Current polls suggest that the corruption allegations have now pushed the Spanish political mainstream into a minority in Spain. The opposition *Partido Socialista Obrero Español* (PSOE) has received no apparent electoral dividend from the unpopularity of the government's austerity programme since its electoral defeat in 2011 and it is receiving no obvious dividend from this corruption scandal. The Bárceñas scandal is compounding a bigger crisis of authority for the Spanish political elite.

## The shrinking Spanish mainstream

The receipts in the possession of the *El País* newspaper appear to show corporate donations of more than €5 million between 1990 and 2008, most of which would be illegal under Spain's party financing laws which set strict limits on anonymous donations before 2007, when they were banned entirely. Along with a raft of senior PP figures, Rajoy himself is alleged to have received €25000 every year between 1997 and 2008.

The PP has defended the legality of its accounting practices, and rejected the accusations of undeclared payments. Rajoy has categorically denied any wrongdoing and published his tax returns on the internet. This attempt at transparency may in fact backfire, as it shows a much higher party salary than previously

disclosed, and a 30% salary rise from 2007 to 2011 when Rajoy was a vocal advocate of wage moderation.

It still looks unlikely that the scandal will unseat the Rajoy government. The PP have a sufficient majority in parliament to block any call for early elections, just as they have used it to block parliament from establishing its own investigative commission. Nevertheless anti-corruption prosecutors have begun investigating the allegations and more than 15 corporate donors - most of which are construction companies - who are listed in the receipts. A string of prosecutions is likely, but there is as yet no smoking gun for Rajoy. Even if he was to be fatally implicated in illegal activity and stood down, this would not in principle require fresh elections, although mid-term leadership replacements have never occurred at the national level in Spanish government.

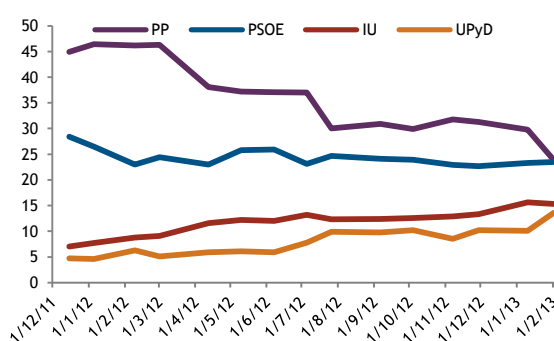


Fig 1: Metroscopia Spanish Polling February 2013

Source: Metroscopia

But for the real impact here we need to look more closely at the mechanics of Spanish politics. The impact on the credibility and standing of the PP and for Rajoy personally has been significant. In some polls the party has lost 6 percentage points in the last month, plummeting to a record low of 24%. Even the more generous Sigma Dos polling puts the PP down around 4% to 33%. Rajoy's personal approval ratings have plunged to 15%. The public backlash has been vocal and substantial, with protests springing up outside PP headquarters in Madrid and across the country. An online petition calling for the resignation of all PP

officials involved in the scandal reached 1 million signatures in just a few days.

The dispute has also opened up a tense debate inside the PP itself, between Aznar and Rajoy loyalists, and between the regions and the centre. Former PP Madrid regional president Esperanza Aguirre has launched an angry attack on the national leadership. She is tapping into a deep vein of suspicion and scepticism about the Spanish business and political elite and their perceived complicity in the failures of the last decade. At a time when Madrid is demanding harsh austerity of Spanish regional governments and centralisation as a remedy for fiscal laxity, the implication of political corruption at the centre will only add further tension to this critical relationship between the centre and the regions.

However, this fall in support for the PP has not delivered any dividend to the mainstream opposition PSOE. The PSOE remains narrowly behind the PP at 23.5%. Approval ratings for PSOE leader Alfredo Pérez Rubalcaba are even worse than Rajoy's, at 11%. Dragged down by its implication in the banking crisis of 2008, the PSOE has failed since 2010 to rebuild its standing with the Spanish electorate. The application of a harsh austerity programme and now this scandal has pulled the PP down to the same level of public disdain. To some degree, Spanish voters appear to be drawing a judgement on the Spanish mainstream political class as a whole.

The current beneficiaries are the minority parties. Polls suggest that support for the centrist *Unión Progreso y Democracia* (Union Progress and Democracy) could triple in a general election result to 13.6%. Its strong reformist and anti-corruption rhetoric has drawn many disenchanted voters from across the political spectrum. The PSOE may have picked up some voters from the PP, but not enough to compensate for its own former voters moving further to the left. Polls suggest that if an election was held now, the *Izquierda Unida* (United Left) would more than double its share of the votes, to reach 15.3%.

## The authority cost

The net effect of these shifts is that declared combined support for the two largest mainstream Spanish political parties is, for the first time ever, below 50%. If an election were held today, the only numerically and politically feasible option of government could well be a Greek-style grand coalition or a Dutch-style centrist coalition between the two mainstream parties (Fig 1). If the government did collapse, Spain would be left to piece together an unpopular coalition in a process that would inevitably test market nerves.

The most important point is that even if the scandal does not bring down the Rajoy administration, it will still levy a heavy cost on the government's moral authority and credibility. This will probably matter less in Brussels, where anything but the most politically fatal domestic politics is usually left at the door of the negotiating room. The pressure on Rajoy in Brussels will chiefly be to ensure that the scandal does not reawaken market fears at a time when the rest of the Eurozone is desperate to project a sense of calm. Merkel made a point of projecting an unworried front when Rajoy was in Berlin last week.

But at home, the cost of the scandal will be measured in the government's ability to implement structural reforms and Rajoy's ability to offer a source of credible leadership. The unprecedented grip of the PP on regional governments after the 2011 election looks like less of an advantage in a context when resentment of Madrid has reached chronic levels and PP regional governments can exploit the weakness of the centre to their advantage. Pressure by the centre over the Madrid regional authorities' healthcare plans, governed by the PP, has already been eased as a result of the scandal. We simply do not know the cost of this weakened leadership and authority on the pace and depth of the Spanish reform agenda. But there will be one, and it is likely to become clearer in the months ahead.

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