

CATALONIA: OUT OF BUSINESS?

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Catalonia is located at the North-Eastern extremity of Spain bordering with France. The region is similar in size to Belgium, boasts a population of 7.5 million and amounts to 19% of the country's GDP. The capital and largest city is Barcelona, the second-most populated municipality in Spain and seventh-most populous urban area in the European Union. Voters have been called upon by the Catalanian parliament to vote on October 1st and express their willingness to become an independent state outside of Spain. The Spanish Government is blocking the process from all sides, creating an institutional and political gridlock with an unclear outcome for Spain's largest economy. Facing such uncertainties, many private companies are considering relocating to Madrid. Business, investors and other public and private institutions are worried about similar situations developing in other EU regions as well as the implications for nationwide politics in Spain.

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Spain's powerhouse

Catalonia is an important contributor to the Spanish economy. Its economy is based on a long-standing industrial tradition with the active presence of large multinational corporations, including those in the biomedical, agro food, automobile and telecommunication sectors. According to OECD figures, 66.8% of employment is in the tertiary sector, 26% in manufacturing, 10.2% in construction and 2.2% in agriculture. Moreover, it contributes nearly 19% to

Spain's GDP as well as being home to 22.5% of Spain's most innovative firms, a far greater share than other regions. Given its scale and performance, Catalonia is often the largest or second largest recipient region of R&D and innovation-related programme funds from the Spanish government and the European Union (EU) Framework Programme.

How we got here

The current political situation between the Spanish central government and the government of Catalonia has created an uncertain climate for business and investment decisions. On October 1st, Spain will undergo one of the greatest challenges it has faced in its 33 years as a democratic country; one that will undoubtedly decide the future of the Government of Catalonia, as well as the stability of the Spanish Government.

The history between the Spanish Central Government and the Catalanian Government is an important element for understanding the current constitutional crisis. In 2010, the Spanish Constitutional Court, after 4 years of deliberations, issued the decision on the Statute of Catalonia. The Court ruled that 4 out of 223 articles from the Statute were unconstitutional, which was approved by the Catalan Parliament on 30 September 2005 with 88.8% of votes and by the Spanish Congress on March 2006 with 54.8% of votes.

Importantly the ruling by the Spanish Constitutional Court came at the same time as Spain was trying to gain control over the regional governments' increasing debts. Catalonia's debts grew 28% in the first quarter of 2010 alone. If Catalonia becomes independent its public debt will quadruple to 118% of its GDP.

In the autumn of 2010, political parties in Catalonia started to campaign for regional elections on taxes and public services, as well as the right to have greater autonomy from the Spanish state. In view of the three election campaigns that Catalonia has had since 2010, companies and rating agencies have started to question the economic viability of a Catalonia outside Spain. Due to such political instability, some companies, such as Moody, have downgraded Catalonia's economic outlook. Additionally, the Societat Civil Catalana argues that secession would lead to the loss of up to 447,000 jobs, 34.4% unemployment, and a loss of €20 billion in foreign direct investment.

Although it is unlikely that Catalonia will leave Spain in the near future, if independent, the official EU stance is that Catalonia would be a "third country" with regards to the EU, and thus have to go through the full process of accession. Outside the EU, Catalonia's main partner is Switzerland. To provide context, Catalonia currently exports less to Switzerland than to Castilla y León, which ranks 7th among Catalonia's export destinations within Spain.

The EU and International Perspective

Catalan separatism has grown in recent years, gaining political momentum during the financial crisis. In fact, in 2009 opinion polls generally showed that support for independence in Catalonia was hovering around 20%—a figure that had doubled to the mid-40's by 2015 and almost 50% by 2017. Today around 80% of Catalans are in favour of holding a referendum on the issue of further autonomy.

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The increasing support for independence in Catalonia triggers the questions of whether and how Catalonia could join the EU if it became an independent country. Whilst the two differ in a number of ways, the media often outline the similarities between Scotland and Catalonia in this regard.

In both Scotland and Catalonia a significant percentage of the population supports the right to hold a referendum and both pro-independence governments have managed to mobilise large parts of society. However, the big difference between the two countries is that whilst the Scottish referendum was agreed with the central government in London, in Catalonia it has been blocked as it is considered unconstitutional. The desire of other regions in Europe to fully control their own affairs is part of European history, but it could lead to a more fragmented Union.

The N-VA in Belgium is another example of a regionalist party; previously the main driver for maximum regional autonomy they are now part of the federal Government and their message on greater autonomy for the Flemish region has been cautiously adapted to better suit the Belgian citizens.

EU on the side-lines

There have also been several heated debates in the European Parliament concerning the Catalanian referendum. However, the European Commission has kept a low profile throughout the process. Only when directly

asked by a Spanish Member of the European Parliament, Mr Juncker, President of the European Commission, said: *"It is not for the Commission to express a position on questions of internal organisation related to the constitutional arrangements of a particular Member State."* The European Commission is careful to avoid any legal analysis of the consequences of an independent Catalonia. However Margaritis Schinas, EC Spokesperson, has mentioned a few times that *"if a part of a Member State ceases to be a part of that state as a result of an independence process, the new region will become a third country and may apply to become a member of the EU"*.

The process for applying to the EU is not an easy one. According to Article 49 of the Treaty on European Union any *"European State which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union. The Applicant State shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the consent of the European Parliament, which shall act by a majority of its component members"*. Therefore the application from a third country to be part of the EU bloc could likely be vetoed not only by Spain, but by any other country which believes that growing internal nationalism could create instability for their own country. Nevertheless, it is very difficult to forecast how EU Institutions would react to the unlikely event of Catalonia's independence. The European Ombudsman, Emily O'Reilly, made clear that *"any declaration made by members of the EU institutions" regarding Catalonia's independence "would be reflecting their personal view and not the official position of the institution"*.

Meanwhile the Spanish Government is trying to obtain additional international endorsement outside the EU. Notably, Catalonia will be on the agenda of Prime Minister Rajoy's meeting with President Trump on 26th September. Spanish diplomacy is doing its best to provoke a strong statement from President Trump.

Economic and business impact

It is very difficult to assess what the economic impact of Catalonia leaving Spain could be. It is simply too soon to understand the political consequences or even the political and legal process on both sides. What is known however, is that rating agencies such as Standard & Poor's have downgraded Catalonia into junk bond territory, expressing less confidence than before in its financial management and economic relationship with the central government in Madrid. Another credit agency, Moody, anticipates continued political tension between Catalonia and the central government during the months ahead. The rating

agency will closely monitor any impact that these political tensions might have on Catalonia's credit profile, particularly if it appears that it may affect the liquidity support the region receives from the central government. The agency also notes that Catalonia, which accounted for 19% of the Spanish GDP in 2015, is a key beneficiary of Spain's growing economy. Standard & Poor's has predicted that Catalonia will not become independent and has considered that the "process" will not influence Spain's overall rating, which is becoming increasingly stable as it recovers from the financial crisis.

On the other hand, Spanish companies polled by *El País* are less optimistic. Three out of four Spanish executives (74%) said that Catalan succession would be detrimental to the Spanish economy. Within Catalonia that figure is 43%. Catalan entrepreneurs have already made publicly clear their discomfort with the independence movement on several occasions. A few companies are even planning to relocate to Madrid. Consequently, if political tensions with the central Government continue to escalate in the coming months, more companies could look to move their headquarters outside of Catalonia.

The question of Catalonia's Eurozone membership is equally complicated; Spanish central bank governor (Luis María Linde de Castro) has publically said that Catalonia will be automatically ejected from the Eurozone and its banking system brought to collapse should succession occur. Moreover, banks would "stop having access to the European Central Bank's facilities". Banking associations have also warned that a lack of predictability will affect investor's confidence. So, although Catalonia could still use the Euro as its currency without being a Eurozone member, it won't be able to control its monetary policy until it creates a new central bank.

Different scenarios moving forward

The lack of a legal basis and the absence of a minimum participation base would call into question the legitimacy of any referendum.

The Spanish government and Spanish Constitutional Court are confident that a referendum can be stopped from happening in the first place. Both have the power to invoke article 155 of the constitution, which would allow drastic steps to immediately suspend the regional autonomy of Catalonia. But it seems very unlikely that the Government will take such drastic measures, unless Mr. Puigdemont's government declares independence unilaterally. Instead, the Spanish Government is focusing on law-enforcement agencies taking forcible possession of all material that would be necessary to hold the vote,

making it difficult to hold a referendum. Equally some Catalanian high-level officials have been arrested for their involvement in the preparation of the referendum.

Regardless of what happens on October 1st, what will matter is the manner in which it occurs, as well as what happens the day after. The most likely scenario moving forward would be new elections in Catalonia. This would help the Catalanian Government to campaign explicitly for a legally binding referendum and would put pressure on the Spanish Government to reform the constitution. However this scenario would not help to alleviate the increasing tensions between both governments in the long term.

Another possibility is that political parties may call for a reform of the Spanish Constitution in order to reform the legal status of the autonomous regions within Spain. This is already an option preferred by some parties like the Centre Right Nationalist party from the Basque country (PNV). Some parties are likely to condition their support for the general budget on the Spanish Governments' willingness to grant more autonomy for some regions such as Catalonia and the Basque country.

What the central Government is trying to prevent is a situation that would bring Spain once again into early elections. Bearing in mind the political deadlock that Spain suffered a year ago, Mariano Rajoy and his minority government need to prove that they can bring economic reform, as well as constitutional stability, to the country. The fact that opposition parties are divided and struggling to coordinate or radically change policy in Spain could prove helpful for the current government.

As reported by the international press; perhaps the best outcome for Spain would be to accommodate some of the demands from the Catalonians, and for the Catalonians to ultimately reject independence. Otherwise, Madrid and Barcelona's intransigency will only continue to create further tensions leading to a point of no return.

How FTI Consulting could help

The process is likely to be lengthy, complex and emotionally charged. Businesses must be ready to hit the ground running having assessed their exposure to this political uncertainty and developed a strategy to protect their interests. Stakeholders will expect to be informed of the impact that this process may have on their business and they want to have assurances that plans are in place for the possible scenarios. Business will also need to explain how Catalonia's independence could affect the people they employ and the skills they bring.

We can work with you to manage this process; our dedicated teams in Spain and Brussels have intimate knowledge of the institutions and parties on both sides of the spectrum. The team is complemented by a comprehensive European network with offices in the capitals of all major Member State and dedicated cross sector teams in other global commercial and political centres, located on every continent.

Our services include: Regular updates and intelligence reports for strategic planning, support in corporate relocation, development and implementation of communications strategies, c-suite media engagement, crisis and issue planning and conducting risk assessments.,

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