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Spain

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OVERVIEW

This Overview is extracted from the Economic Survey of Spain. The Survey is published on the responsibility of the Economic and Development Review Committee (EDRC) of the OECD, which is charged with the examination of the economic situation of member countries.

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Executive Summary

- Spain has made a successful recovery
- The resilience of public finances should be increased to address medium-term challenges
- Bringing people back into employment and reducing regional disparities would make growth more inclusive
- Policies to improve competition and innovation will be key to boosting productivity growth and exports
Spain has made a successful recovery

The strong recovery continues (Figure A). Real GDP grew by around 3% in the past three years, outpacing most other euro area economies. Past structural reforms, robust employment growth, gains in competitiveness and favourable external and financial conditions have supported economic activity. Momentum for structural reform should be maintained to improve the resilience of the Spanish economy. Current account surpluses in recent years have contributed to the reduction in Spain’s external liabilities, which nevertheless remain high.

Figure A. Growth has been robust

![Graph showing growth in GDP and private consumption from 2007 to 2019.](https://doi.org/10.1787/888933873022)

Source: OECD, Economic Outlook (database).

Growth is set to continue, though at a slower pace (Table A). Growth, supported by low interest rates and robust job creation, will continue to be broad-based. The unemployment rate is expected to edge down to 12.5% in 2020, which would still be above that of the euro area and pre-crisis levels. Risks to the outlook remain sizeable. Slowing global trade growth could undermine exports. Turbulence in international markets and political uncertainty could lower private sector confidence, hampering domestic demand. On the other hand, domestic demand could prove more resilient than expected, if the slowdown in the pace of job creation is more moderate.

Table A: Economic growth is set to moderate

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic product (GDP)</td>
<td>2.6</td>
<td>2.2</td>
<td>1.9</td>
</tr>
<tr>
<td>Private consumption</td>
<td>2.4</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Government consumption</td>
<td>2.1</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>6.1</td>
<td>3.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>1.6</td>
<td>2.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>3.5</td>
<td>2.9</td>
<td>4.1</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>15.3</td>
<td>13.8</td>
<td>12.5</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>1.9</td>
<td>1.9</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Source: OECD, Economic Outlook (database).

The resilience of public finances should be increased to address medium-term challenges

The public debt to GDP ratio is falling, but is high at 98%. Recent improvements have been mostly due to favourable economic conditions. As the recovery continues, the government should stick to medium-term fiscal targets to ensure a durable reduction of public debt.

The old-age dependency ratio is set to more than double by 2050. Even with the recent pension reforms, pension replacement rates for those having a full career remain above the OECD average (Figure B). The current system creates disincentives to extend working lives after the attainment of required contribution periods and penalises some who continue to work while receiving a pension.

Figure B. Pension replacement rates remain high

![Graph showing net pension replacement rates for average earners from DEU, OECD, FRA, ESP, and ITA.](https://doi.org/10.1787/888933873041)

There is room to further improve the fiscal framework. The introduction of debt, deficit and expenditure rules for regions in 2012 has strengthened the fiscal framework. In practice, regions only apply the deficit rule, which tends to make their expenditures pro-cyclical and does not help them converge towards their debt targets. Rules should be reinforced by making the expenditure rule the main tool to achieve sustainability in public finances. Expenditure growth should be set to achieve a regular decrease in the debt ratio towards targets set by the Stability and Growth Pact.

Bringing people back into employment and reducing regional disparities would make growth more inclusive

Income inequality and poverty rates are high, with regional differences. Given the high degree of decentralisation, regional policies and institutions are key to the effective implementation of national labour market and education policies, which can help lower inequalities. More effective coordination and sharing of best practices across regions would help reduce regional disparities.

More effective use of taxes and transfers would lower inequalities. Taxation remains tilted towards labour income, which penalises growth and employment. There is room to utilise less distortive environmental taxes and value-added taxes (VAT). The income and VAT bases are eroded by various exemptions and reduced rates, which are poorly targeted tools in terms of reducing income inequality. Higher environmental taxes would also have the additional benefit of lowering emissions.

Unemployment is decreasing, but remains high, especially for the youth and the long-term unemployed (Figure C). The share of active labour market spending on training remains low, which can be a barrier to the up-skilling of the labour force. While it is important to guarantee the quality of training centres, competition is also needed. Regions favour local training providers by making requirements, such as permanent establishment, mandatory. Removing such barriers could improve the efficiency of ALMPs and decrease their cost. An effective evaluation system is also needed to ensure the quality of training.

**Figure C. Unemployment remains high in Spain**

<table>
<thead>
<tr>
<th>% of labour force in each age group, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worst performing region</td>
</tr>
<tr>
<td>Total unemployment</td>
</tr>
<tr>
<td>Youth unemployment</td>
</tr>
</tbody>
</table>

Source: OECD, Labour and Regional Statistics.

StatLink 2 [https://doi.org/10.1787/888933873060](https://doi.org/10.1787/888933873060)

Inter-regional migration remains low (Figure D). Lack of full portability of social and housing rights across regions, due to prior residency requirements, contributes to low labour mobility. Ensuring full portability of these benefits across regions, by providing temporary assistance either by the region of origin or the central government, should be considered. The structure of responsibilities of labour market and social policies are spread across different levels of government and regions. Introducing a single point of contact for employment and social services to provide integrated support for jobseekers would improve coordination and information sharing.

**Figure D. Regional migration rates are low**

Flows across TL3 regions, average 2013-2016, % of total population


StatLink 2 [https://doi.org/10.1787/888933873079](https://doi.org/10.1787/888933873079)
Regions differ considerably in their ability to develop, attract and retain skilled labour. Skills proficiency is among the lowest across OECD countries and should be improved to meet future skill needs. Increasing the adaptability of workers, via lifelong learning policies better targeting the participation of low-qualified adults, is essential. Early school leaving rates are declining, but remain high and display large regional differences (Figure E). Providing individualised support to students at the risk of failing at an early stage has contributed to lower early school leaving rates in some regions.

Figure E. Early school leaving rates are high in Spain

% of the population aged 18-24 with at most lower secondary education and not in further education or training, 2017

Source: Eurostat.
StatLink 2 https://doi.org/10.1787/888933873098

Policies to improve competition and innovation will be key to boosting productivity growth and exports

There is ample room for policy to boost productivity growth, including in the best performing regions and firms. Productivity growth remains subdued (Figure F). The large productivity gap between Spanish firms and the best performing global firms suggests that policies to increase the exposure of firms to competition and innovation are needed. In addition, firms in regions with higher trade intensity, R&D expenditures and share of highly educated workers tend to have higher productivity growth.

Barriers can prevent firms from reaping the benefits of economies of scale and exporting. There are a number of regulations that depend on the size of firms in terms of employment and turnover, which can limit firm post-entry growth, and should be eliminated, as needed. Regional regulatory differences also create barriers to achieving a truly single market and firm growth, contributing to regional productivity differences.

Central and regional governments can strengthen the implementation of the Market Unity Law. The principle of national effectiveness of the Market Unity Law, which ensures that firms will not be subject to any additional requirements in other regions than their own, could be included in regional legislation. Enhanced cooperation and coordination across different levels of government is also key.

Public R&D funding and innovation promotion are shared competences between the central and regional governments, which increases the importance of coordination for successful outcomes. Innovation support is fragmented, making it harder for innovative firms to navigate the system. Efforts should continue to improve national and regional cooperation in the design and implementation of innovation policies to avoid duplication. Innovation can be made more effective through more widespread ex-post evaluation of policies and moving towards performance based funding.
<table>
<thead>
<tr>
<th>MAIN FINDINGS</th>
<th>KEY RECOMMENDATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Framework and fiscal policies</strong></td>
<td></td>
</tr>
<tr>
<td>Structural reforms, notably in product and labour markets, have enhanced the competitiveness and resilience of the economy.</td>
<td>Maintain momentum for structural reforms enhancing productivity and job creation, together with continuous evaluation of reforms.</td>
</tr>
<tr>
<td>Public debt remains high, while the fiscal position has not improved as much as expected given the strength of economic activity.</td>
<td>Stick to medium-term fiscal targets to ensure a durable reduction of public debt. As the recovery continues, set a more ambitious fiscal consolidation path.</td>
</tr>
<tr>
<td>Taxation remains tilted towards labour, while value-added and environmental taxes are underutilised.</td>
<td>Abolish reduced value-added tax rates that are regressive. Increase taxation of fuels to better reflect emissions of CO2 and other pollutants.</td>
</tr>
<tr>
<td>The design of fiscal rules for regions does not ensure a clear path of reduction in debt to targets.</td>
<td>Make the expenditure rule the main rule and link it to the debt ratio targets.</td>
</tr>
<tr>
<td>Population ageing will continue to put pressure on public finances. Some people who combine work and pensions lose 50% of their pension payment, but do not accrue additional pension entitlements.</td>
<td>Further extend the pensionable earnings reference period and the number of years of contributions required to gain a full pension. To increase the flexibility of combining work and pensions, do not reduce pension payments and allow additional pension entitlements to be earned.</td>
</tr>
<tr>
<td><strong>Improving labour market and education outcomes for lower regional disparities</strong></td>
<td></td>
</tr>
<tr>
<td>Spending on training is low.</td>
<td>Increase spending on training and job-search assistance.</td>
</tr>
<tr>
<td>Regions limit the entry of training providers from other regions.</td>
<td>Remove barriers to competition of training centres across regions.</td>
</tr>
<tr>
<td>Lack of integrated support for jobseekers lowers the effectiveness of social and labour market policies.</td>
<td>Introduce a single point of contact for social and employment services.</td>
</tr>
<tr>
<td>Moving to another region implies the loss of social and housing benefits due to prior residency requirements, which restricts labour mobility. Lifelong learning is not always targeted to low-skilled workers and individual training accounts are not utilised effectively. Early school leaving and grade repetition rates are high and vary by socio-economic background.</td>
<td>Ensure full portability of social and housing benefits across regions, by providing temporary assistance either by the region of origin or the central government. Target existing financial incentives for lifelong learning opportunities to low-qualified workers and link them to individuals. Increase individualised support to students at the risk of failing at an early stage.</td>
</tr>
<tr>
<td><strong>Boosting productivity and internationalisation</strong></td>
<td></td>
</tr>
<tr>
<td>Regulations that depend on the size of firms can create barriers to firm growth. The national effectiveness principle of the Market Unity Law, which lowers barriers to firms operating across regions, can be effective if incorporated in regional legislation. Innovation support is fragmented, which makes it harder for firms to navigate the system and can lead to duplication. Innovation funding is often not tied to ex-post evaluation.</td>
<td>Eliminate the existing regulations that depend on the size of firms, as needed. Regions should include the principle of national effectiveness of the Market Unity Law in their legislation. Assess the compliance of new legislation at all levels of government with the principles of the Market Unity Law. Give the recently activated R&amp;D Public Policy Network a strong mandate to further increase coordination of regional and national innovation policies. Strengthen the ex-post evaluation framework of innovation support and consider increasing performance based funding.</td>
</tr>
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</table>
Key Policy Insights

- Recent macroeconomic development and short-term prospects
- Strengthening the financial system’s resilience to new challenges
- Fiscal policy to manage medium-term sustainability risks
- Addressing medium-term challenges to well-being
- Boosting productivity and trade
The Spanish economy continues its strong and balanced growth (Figure 1). Strong employment gains have reduced unemployment and provided support to households. A wide range of structural reforms (discussed in detail in the 2017 Economic Survey of Spain) has contributed to the recovery. The correction of imbalances continues steadily, with a higher share of trade in gross value added, lower private debt and a healthier financial system. Maintaining momentum for structural reforms, notably in labour and product markets, is key to improve the resilience of the Spanish economy to future shocks.

**Figure 1. The economy and employment have grown steadily**

![Graph A: GDP growth](https://doi.org/10.1787/888933871654)

![Graph B: Employment rates](https://doi.org/10.1787/888933871654)

However, the legacy of the crisis has not yet been fully overcome and imbalances remain. Despite large falls, the unemployment rate is still the second highest in the OECD (Figure 2, Panel A), which exacerbates inequalities and raises poverty. The labour market also remains highly segmented, with high rates of youth and long-term unemployment, and temporary contracts. After peaking at 100.4% of GDP in 2014, public debt has barely declined (Figure 2, Panel B). Population ageing implies a significant increase in age-related spending, potentially undermining fiscal sustainability. Current account surpluses in recent years have contributed to the reduction in Spain's external liabilities, but the negative net international investment position, at 80.9% of GDP in 2017, is still large in international perspective (Figure 2, Panel C).
Figure 2. High unemployment and debt levels represent vulnerabilities

**A. Unemployment rate**
Percentage of labour force

**B. Public debt**
Percentage of GDP

**C. External liabilities**
Percentage of GDP

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**Source:** OECD Economic Outlook (database), Eurostat.

[StatLink](https://doi.org/10.1787/888933871673)

The gap in GDP per capita relative to the most advanced OECD countries remains large, reflecting differences both in labour productivity and labour utilisation (Figure 3). Significant differences in labour productivity and employment also explain regional disparities in GDP per capita (Chapter 1). Hence, future growth and well-being will hinge on a higher employment rate and productivity gains.

Labour productivity has improved in the post-crisis period, reflecting capital deepening and the reallocation of labour to more productive firms and sectors. However, multifactor productivity growth, which is more closely related to innovation, remains flat and is low in international perspective (Figure 4, Panel A). Raising multi-factor productivity is needed to maintain sustainable and inclusive growth going forward. The productivity gap between Spanish firms and the best performing global firms remains large, suggesting that policies that can increase international spillovers are key. Investment in knowledge-based capital as a share of GDP, which has been linked to productivity growth, is also low (Figure 4,
Panel B). Policies to boost innovation, digitalisation and skills will be crucial to boost growth potential and reduce regional disparities (Chapter 1).

Figure 3. Lower labour productivity and labour utilisation both contribute to GDP per capita gaps

Percentage difference vis-à-vis the upper half of OECD countries, 2017

**Note:** Compared to the weighted average using population weights of the 18 OECD countries with highest GDP per capita in 2017 based on 2017 purchasing power parities (PPPs). Labour productivity is measured as GDP per hour worked. Labour resource utilisation is measured as the total number of hours worked per capita.

**Source:** OECD (2018), Going for Growth Database.

As the recovery continues, there is renewed opportunity to ensure the benefits of economic growth are widely enjoyed. Income inequality remains above the OECD average, partly driven by the fall in the share of income going to the poorest sections of the population and consecutive years of income moderation. Labour market inequalities, including high labour market duality, and regional disparities also create challenges for inclusiveness.
Figure 4. Boosting growth potential requires higher multifactor productivity growth

A. Multifactor productivity growth
Index 2000=100

B. Investment in knowledge-based capital
As a percentage of business sector’s gross value added, 2015

Note: KBC comprises computerised information, like software and databases; innovative property, including research and development (R&D) and new product development in financial services (among other things); and economic competencies, including firms’ human and structural resources such as firm-specific training, brand equity, and organisational capital.

Source: OECD, Productivity Indicators (database), and OECD (2017), Science, Technology and Industry Scoreboard 2017: The digital transformation.

StatLink https://doi.org/10.1787/888933871711

Spain is a highly decentralised country with regards to public spending, and many public services are provided at the regional level. Hence, the success of policy reforms will depend on the ability of regions to implement them, highlighting the importance of coordination and sharing of best practices across regions in various areas. Regional dispersion in well-being is high in a number of dimensions, in particular education, civic engagement, housing, income and access to jobs (Figure 5). Accordingly, the thematic chapter analyses productivity, labour markets, skills and education from a regional perspective.
Against this background, the Survey has three main messages:

- The robust recovery provides an opportunity to keep reducing macroeconomic and financial vulnerabilities, such as high public and external debt.
- Improving the labour market outcomes of vulnerable groups and reducing some regional disparities are key to addressing medium-term challenges to well-being.
Boosting productivity growth, which remains subdued, will require firms to be more exposed to competition and innovation.

The new Spanish government has recently outlined its economic priorities (Box 1), which should help address some of these challenges. The economic agenda focuses on combining fiscal sustainability with further promotion of inclusive growth and reducing inequalities, and the enhancement of structural reform efforts.

**Box 1. Economic priorities of the new government**

The economic priorities of the new government, which came to office in June 2018, are outlined as follows:

**Fiscal policy:** The government has revised upward the likely outcome of the 2018 fiscal deficit based on AIReF forecasts (from 2.2% to 2.7% of GDP), but expects consolidation efforts to remain close to initial plans in 2019, bringing the deficit down to 1.8% that year. The Draft Budgetary Plan 2019 sent to the European Commission in October 2018 plans to run a primary fiscal surplus and achieve a structural effort. This plan proposes a number of taxation changes, including the introduction of specific taxes on certain digital services and on financial transactions, and increases in income tax rates for high incomes and environmental excise duties. Another proposal is to redesign corporate taxation such that the effective rate on large businesses is close to the nominal rate (25%) and will not be below a certain threshold (15%).

**Labour markets:** Addressing youth unemployment and abuse of temporary contracts are top priorities. In July 2018, the government approved a roadmap plan for reducing job precariousness. The Draft Budgetary Plan 2019 proposes to extend early childhood education to children between 0 and 3 years old and extend father’s parental leave up to 8 weeks, with an aim to improve labour market participation of women. Another proposal is to raise the minimum wage to EUR 900 gross per month.

**Productivity and innovation:** The government plans to promote digitalisation and internationalisation via lower administrative barriers and new forms of financing. The Ministry of Science, Innovation and Universities was created to bring together science, innovation and higher education policies. The Draft Budgetary Plan 2019 proposes measures for improving the innovation ecosystem, boosting private-public collaborations and addressing the issue of limited demand by the private sector for R&D loans included in the public budget.

**Environment:** In June 2018, the Ministry of Ecological Transition was created to bring together environment and energy policies, and more ambitious goals were set in the European Winter Package. In October 2018, a package of measures to boost transition to a low-carbon economy and to address energy poverty was approved. The top priorities are the Climate Change and Energy Transition Bill, the National Integrated Climate and Energy Plan and the Fair Transition Plan.

**Education:** Education policies, with a focus on promoting principles of equal opportunities (e.g. scholarships for low-income students), improving teacher training, modifying the evaluation framework, enhancing lifelong learning and integrating the different VET systems, are also high on the government’s agenda.
Recent macroeconomic developments and short-term prospects

The recovery has been robust and balanced

The Spanish economy grew by around 3% in the past three years, outpacing most other euro area countries (Figure 1). Both external and domestic demand have contributed to growth, but the latter remains the main driver (Figure 6, Panel A). Private consumption has been particularly strong in the last few years, and employment creation and private consumption are strongly linked (Figure 6, Panel B). Business investment has picked up due to supportive financing conditions, lower corporate indebtedness and stronger confidence (Figure 6, Panel C).

Figure 6. The recovery has been strong

Source: OECD, Economic Outlook (database). StatLink 2 https://doi.org/10.1787/888933871749
Structural reform and wage moderation have led to gains in cost-competitiveness, boosting export performance (Figure 7, Panels A and B). The current account has been in surplus for five consecutive years. While all the components of the current account contributed, the improvement in the non-energy goods balance accounted for close to half of the change in the current account between 2008 and 2017 (Figure 7, Panel C). The increase in exports of non-tourist services, by 53% during 2009 and 2017, was also an important factor.

Figure 7. Export performance has been strong

Source: OECD, Economic Outlook (database) and OECD, Main Economic Indicators.

StatLink https://doi.org/10.1787/888933871768
Although transitory and cyclical factors have contributed to the improvement of the current account, structural factors have also played a role. For example, a decomposition of the changes in the current account between 2008 and 2015 suggests that approximately 60% of the cumulated change in the current account over the period can be explained by cyclical factors such as the output gap, oil balance and financial cycle, with the remaining 40% attributable to those of a more permanent nature (Figure 8). Structural factors which contributed positively to the adjustment, in order of importance, were the structural adjustment of the fiscal deficit, ageing of the population, lower interest rates and lower growth expectations (Moral-Benito and Viani, 2017).

Figure 8. Structural factors have contributed to the changes in the current account
Decomposition of the accumulated current account adjustment, 2008 to 2015

Note: Cyclical factors include the output gap, financial cycle and oil balance. Structural factors include unit labour costs, the old age dependency ratio, the institutional environment, long term interest rates, private credit, the fiscal balance and expected growth.

The structural improvement of export performance is also reflected in the increase in the number of regular exporting firms and the geographical diversification of exports. Spain has increased the geographical diversification of its exports, with 35.5% of merchandise exports and 27% of non-touristic service exports going to non-EU destinations in 2017, compared to 29.1% and 16.8%, respectively, in 2007 (Figure 9). The exports of machinery, manufactured and chemical goods have increased by 33%, on average, between 2009 and 2017. The number of regular exporters, firms that have exported for four consecutive years, has risen by 30% between 2006 and 2016. Bringing down the high external liabilities will require current account surpluses for an extended period of time. Hence, it will be important that policies foster an environment that continues to support exporting firms and increase the competitiveness of the Spanish economy.
**Growth is set to continue, but at a slower pace**

The current recovery is projected to continue, but growth will moderate to 2.6% in 2018, 2.2% in 2019 and 1.9% in 2020 (Table 1). Robust job creation and private consumption should continue to support each other. The unemployment rate is expected to edge down to 12.5% in 2020, which would still be above that of the euro area. Residential and business investment are set to ease gradually, but remain high. The current account will remain in surplus, but lower than in the past two years, as the contribution of external demand is expected to be neutral in 2019-20, in the context of a less favourable international environment. Despite a closing of the output gap at the end of the projection period, inflation will only slowly increase as the unemployment rate and the share of temporary employment remain high.
Table 1. Macroeconomic indicators and projections

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<tr>
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<td><strong>Gross domestic product (GDP)</strong></td>
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<td>1.9</td>
<td>1.8</td>
<td>1.7</td>
<td>1.6</td>
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<tr>
<td>Private consumption</td>
<td>626.0</td>
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<td>1.4</td>
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<tr>
<td>Government consumption</td>
<td>208.9</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>1.2</td>
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<tr>
<td>Gross fixed capital formation</td>
<td>214.7</td>
<td>3.8</td>
<td>3.8</td>
<td>3.8</td>
<td>3.8</td>
<td>3.8</td>
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<tr>
<td>Housing</td>
<td>48.1</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
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<tr>
<td>Final domestic demand</td>
<td>1,049.7</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
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<tr>
<td>Stockbuilding¹</td>
<td>6.3</td>
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<td>0.0</td>
<td>0.0</td>
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<td>Total domestic demand</td>
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<td>1.9</td>
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<td>Exports of goods and services</td>
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<td>4.0</td>
<td>4.0</td>
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<td>Imports of goods and services</td>
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<td>Net exports¹</td>
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<tr>
<td><strong>Other indicators (growth rates, unless specified)</strong></td>
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<td></td>
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<td>Potential GDP</td>
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<td>Output gap²</td>
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<td>1.8</td>
</tr>
<tr>
<td>Consumer price index (harmonised)</td>
<td>. .</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
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<tr>
<td>Core consumer prices (harmonised)</td>
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<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
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<td>Household saving ratio, net³</td>
<td>. .</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Current account balance¹</td>
<td>. .</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>General government fiscal balance¹</td>
<td>. .</td>
<td>-1.2</td>
<td>-1.2</td>
<td>-1.2</td>
<td>-1.2</td>
<td>-1.2</td>
</tr>
<tr>
<td>Underlying general government fiscal balance²</td>
<td>. .</td>
<td>-1.8</td>
<td>-1.8</td>
<td>-1.8</td>
<td>-1.8</td>
<td>-1.8</td>
</tr>
<tr>
<td>Underlying government primary fiscal balance²</td>
<td>. .</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>General government gross debt (Maastricht)³</td>
<td>. .</td>
<td>96.0</td>
<td>96.0</td>
<td>96.0</td>
<td>96.0</td>
<td>96.0</td>
</tr>
<tr>
<td>General government net debt⁴</td>
<td>. .</td>
<td>78.0</td>
<td>78.0</td>
<td>78.0</td>
<td>78.0</td>
<td>78.0</td>
</tr>
<tr>
<td>Three-month money market rate, average</td>
<td>. .</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Ten-year government bond yield, average</td>
<td>. .</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
</tr>
</tbody>
</table>

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP. Based on OECD estimates of cyclical elasticities of taxes and expenditures. For more details, see OECD Economic Outlook Sources and Methods.
3. As a percentage of household disposable income.
4. As a percentage of GDP.

In the short-term, this growth scenario is mainly exposed to well-known factors that could affect the Spanish economy both on the upside and downside, such as growth in Europe, its main export partner, and the evolution of the euro exchange rate. A more rapid than expected increase in interest rates by the European Central Bank (ECB) could hurt growth since the share of variable rates in mortgages is high. Turbulence in international markets could lower private sector confidence. A minority government could face difficulties in pushing the national reform agenda further, which could also lower growth prospects. An increase in oil prices would create pressures on inflation. On the upside, domestic demand could prove more resilient than expected, if the slowdown in the pace of job creation is
more moderate or residential investment is higher. In addition to these risks, the Spanish economy is exposed to major internal and external shocks, such as prolonged uncertainty in Catalonia or an increase in global protectionism and a stronger-than-projected impact of Brexit (Table 2).

Table 2. Shocks that could strongly impact the Spanish economy

<table>
<thead>
<tr>
<th>Shock</th>
<th>Possible impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prolonged political uncertainty in Catalonia.</td>
<td>Increased tensions could lower confidence and tourism. It could also divert attention from the reform process, lowering Spain’s medium-term growth prospects.</td>
</tr>
<tr>
<td>Disorderly exit of the UK from the EU.</td>
<td>Lower foreign trade and investment, harming productivity and growth.</td>
</tr>
<tr>
<td>Renewed tension in the euro area.</td>
<td>Lower confidence, hampering domestic demand.</td>
</tr>
<tr>
<td>Worldwide rise in protectionism.</td>
<td>Lower exports and fewer new firms, harming productivity and potential growth.</td>
</tr>
</tbody>
</table>

Strengthening the financial system's resilience to new challenges

Macro-financial vulnerabilities have decreased since 2007, as the financial system has gotten stronger and private sector debt has declined (Figure 10). However, vulnerabilities in terms of public and external debt have not materially diminished. Thanks to significant reforms, including the creation of an asset management company (SAREB), the restructuring of the banking sector, economic recovery and accommodative monetary policy, bank performance has improved and much progress has been made in reducing non-performing loans (NPLs) (IMF, 2017a). Large credit institutions in Spain are under the supervision of the ECB. The resolution of Banco Popular in June 2017, without negative spillovers on overall financial stability, exhibited the effective coordination between European and Spanish supervisors. It is important to continue addressing the legacies of the crisis and improve the resilience of the financial system to future challenges.

The profitability of Spanish banks has improved, and return on equity at 9.7% is now above the EU average of 6.8%, but it is still below pre-crisis levels (Figure 10). Low bank profitability remains one of the key challenges, as in other countries, driven by low interest rates and subdued lending activity, and the high level of non-productive assets on bank balance sheets (Bank of Spain, 2017 and 2018). Some banks have diversified their incomes via their international business to emerging markets, including Turkey. While such diversification is welcome and has benefited bank profitability during the crisis, the associated potential vulnerabilities from cross-border spillovers and exchange rate movements must be monitored closely, especially since bank capital ratios are still comparatively low (Figure 11).
Figure 10. Macro-financial vulnerabilities have decreased

Index scale of -1 to 1 from lowest to greatest potential vulnerability, where 0 refers to long-term average, calculated for the period since 2000

Note: Each aggregate macro-financial vulnerability dimension is calculated by aggregating (simple average) normalised individual indicators from the OECD Resilience Database. Individual indicators are normalised to range between -1 and 1, where -1 to 0 represents deviations with the observation being below long-term average since 2000 [positive deviation=>less vulnerability], 0 refers to long-term average since 2000 and 0 to 1 refers to deviations where the observation is above long-term average since 2000 [negative deviation=>more vulnerability]. Financial dimension includes: leverage ratio (inverted), capital ratio (regulatory capital) (inverted), return on assets (inverted) and loan-to-deposit ratio. Data for financial indicators is only available from Q4 2008 onwards.

Source: Calculations based on OECD (2017), OECD, Resilience Database, September.

StatLink 2 https://doi.org/10.1787/888933871825

Figure 11. Capital ratios have increased, but remain low

Regulatory Tier 1 capital to risk-weighted assets, percentage

Source: IMF, Financial Soundness Indicators.

StatLink 2 https://doi.org/10.1787/888933871844
Non-performing loans as a share of total loans continued to decline from their peak of 9.4% in 2013 and stood at 4.4% in the first quarter of 2018 (Figure 12, Panel A). In an extreme scenario where all NPLs are written off (and assuming no collaterals), Spanish banks would be adversely affected, suggested by comparatively high ratio of NPLs net of provisions to capital (Figure 12, Panel B). Furthermore, NPLs remain high for lending to small and medium-sized enterprises (SMEs), and to the construction and real estate sectors (Figure 12, Panel C). Consequently, full implementation of the ECB guidance on NPLs and additional provisioning, if needed, is key to complete the reduction of NPLs before the normalisation of monetary policy. To ensure the credibility of NPL reduction targets specified by banks and given the wide prevalence of NPLs in property-related sectors, the authorities should assess banks’ strategies by using their own risk-models, including projections of property prices (IMF, 2017a). Disclosure of progress with NPL reduction should be made mandatory and failure to comply with targets should trigger transparent prudential measures.

Figure 12. Non-performing loans are falling, but remain high

Note: Panels A and B: The precise definition and consolidation basis of non-performing loans may vary across countries. They are based on consolidated data for Spain. Panel C is based on only domestic exposures data. Source: IMF, Financial Soundness Indicators and Banco de España, Statistical Bulletin. 

StatLink 2 https://doi.org/10.1787/888933871863
The continued recovery in housing markets can also contribute to the reduction of NPLs. House prices increased by 4.3% in 2017, but there are large regional disparities in house price developments, suggesting that geographical exposure can also affect the speed and success of resolution of bad loans (Figure 13). The recent insolvency reform has brought Spain closer to international best practices and has supported debt restructuring (Adalet McGowan, Andrews and Millot, 2017). The remaining gaps should be addressed in line with the proposed EU directive on restructuring frameworks and second chance. The creation of an experts group to implement this forthcoming EU directive is welcome. Specifically, in cases when debt forgiveness is not automatic, the period during which bankrupt entrepreneurs are required to repay past debt from future earnings should be reduced, as recommended in the 2017 Economic Survey of Spain.

Figure 13. House prices are recovering slowly and unevenly

### A. House prices

Index 2010=100

### B. Regional differences in house price growth

Growth between 2013Q4 and 2018Q1, percentage

Source: OECD, Analytical House Prices Indicators (database), and INE.

StatLink [https://doi.org/10.1787/888933871882](https://doi.org/10.1787/888933871882)
SAREB continued the reduction of its assets, but progress has been slow, and its liabilities still stand at around 4% of GDP. It recorded negative financial results in 2017 due to slower than expected recovery of real estate prices (European Commission, 2018a). While SAREB has until 2027 to fully liquidate its assets, its projected performance is highly dependent on assumptions on real estate prices and sale volumes, and hence should be monitored closely.

The risk interdependency between banks and sovereign should be part of systemic surveillance, as there is room to improve diversification in banks’ portfolios, as in other euro area countries (OECD, 2018a). Indeed, the share of domestic sovereign bonds in banks’ portfolios of sovereign bonds by euro area countries is relatively high (Figure 14). Furthermore, bank exposure to the sovereign through the holding of government bonds and other claims has been declining since 2012, but remains at 11% of total assets at the end of 2016, higher than its pre-crisis levels in low single digits (IMF, 2017b). Another channel of contagion risk rises from the contingent liabilities of the sovereign in the financial sector via the guarantees provided during the crisis, including those to SAREB.

**Figure 14. Home bias in banks’ holdings of government bonds is still high**

<table>
<thead>
<tr>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
</tr>
<tr>
<td>90</td>
</tr>
<tr>
<td>80</td>
</tr>
<tr>
<td>70</td>
</tr>
<tr>
<td>60</td>
</tr>
<tr>
<td>50</td>
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<tr>
<td>40</td>
</tr>
<tr>
<td>30</td>
</tr>
<tr>
<td>20</td>
</tr>
<tr>
<td>10</td>
</tr>
</tbody>
</table>

**Note:** Share of domestic sovereign bonds in banks’ portfolios of sovereign bonds issued by Euro area countries. **Source:** OECD calculations based on ECB (2017), Statistical Data Warehouse. **StatLink** [https://doi.org/10.1787/888933871901](https://doi.org/10.1787/888933871901)

The institutional framework for financial supervision could be bolstered by the creation of a national macroprudential authority, as recommended by the European Systemic Risk Board and recently announced by the government. While the Bank of Spain is responsible for setting the countercyclical buffers, it does not have complete authority over macroprudential policies. A number of other institutions, including the National Securities Market Commission, the General Directorate of Insurance and Pensions and the Treasury, are also involved in financial supervision. While informal inter-agency coordination seems to work well, the creation of a national macroprudential authority, comprising all the different institutions and with a clear division of responsibilities, would address future potential risks. In this respect, the convening of the Financial Stability Committee in July 2018, to share information and views on the current financial outlook, was a good first step. The announcement of the creation of a national macroprudential authority in November 2018 is welcome.

The government is currently studying several initiatives to strengthen the institutional supervisory framework, such as the creation of an independent insurance and pension fund.
supervisory agency and an ombudsman for the protection of savers and financial investors. Reforms in this area would strengthen competition and financial supervision, and it is important to ensure that the new institutions are allocated the necessary resources.

Corporate and household debt have continued to decline (Figure 15). Weak credit demand and higher incomes thanks to improving macroeconomic conditions have contributed to household deleveraging. Nevertheless, deleveraging needs are higher for low-income households, making them vulnerable to changes in economic and financial conditions (IMF, 2017b). The outstanding volume of credit is still decreasing, but new lending to households and SMEs has picked up. According to the latest Bank Lending Surveys, access to finance in terms of availability and cost have been improving and are close to euro area averages. Furthermore, the gap in financing costs between small and large firms has been narrowing. While credit growth remains weak, the authorities should still put in place macro-prudential tools, such as limits on loan-to-value or debt service to income, to prepare for future risks.

Figure 15. Private sector debt is declining

<table>
<thead>
<tr>
<th>A. Household debt</th>
<th>B. Corporate debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of disposable income</td>
<td>Debt to equity ratio, percentage</td>
</tr>
</tbody>
</table>

Note: Debt includes currency and deposits, debt securities, loans, insurance, pension, and standardised guarantees and other accounts payable.
Source: OECD, National Accounts Statistics.

Fiscal policy to manage medium-term sustainability risks

Fiscal vulnerabilities need to be addressed

Spain has been under the Excessive Deficit Procedure (EDP) since 2009, and the authorities had to balance the need for boosting employment and growth with fiscal adjustment. The fiscal deficit has declined from its peak of 10.5% of GDP in 2012 to 3.1% in 2017, which was in line with targets set by the EDP. However, the Spanish fiscal council (AIReF) estimates that the fiscal deficit in 2018 is likely to be higher than the official target (AIReF, 2018a). Based on this assessment, the government has revised upwards its deficit targets to 2.7% in 2018 (which would allow Spain to exit the EDP) and to 1.8% in 2019, although it expects consolidation efforts in 2019 to be close to what was proposed initially in the Stability Programme. The details of these consolidation measures, as stated in the Draft Budgetary Plan 2019, are outlined in Box 1.
The plans for deficit reduction in the Stability Programme 2018-21 rely on favourable macroeconomic conditions. An evaluation by the fiscal council suggested that meeting the deficit targets will be difficult without further adjustment (AIReF, 2018b). Moreover, the medium-term objective of structural balance by 2020 under European and national rules is not projected to be met without further measures (Government of Spain, 2018). It will be important to structurally strengthen the public finances to increase resilience to shocks by continuing planned consolidation efforts.

The high public debt-to-GDP ratio, at 98.3% of GDP in 2017, poses risks for medium-term sustainability. According to a baseline scenario based on OECD and government projections, public debt will gradually decline to 79% of GDP by 2030 (Figure 16, Panel A). In a positive scenario of higher growth by 0.5 percentage points, the debt-to-GDP ratio would fall further to 74%. This highlights the importance of structural reforms to boost potential growth and fiscal sustainability. However, in an adverse scenario of higher interest rates, the public debt ratio would only decline to 88% of GDP by 2030.

**Figure 16. High pension costs highlight the importance of a durable reduction of public debt**

![Graph showing public debt paths and gross public pensions](https://doi.org/10.1787/888933871939)

*Note: Panel A: The baseline uses data from the EO103 projections until 2019 and the OECD long-term projections after 2019, except for the primary surplus which is kept constant at its surplus of 1% of GDP in 2019, according to the government projections (Government of Spain, 2018). The other assumptions for beyond 2019 are an average effective interest rate of 3.2%, inflation gradually stabilising at 2% by 2020 and real GDP growth by around 1% corresponding to the potential growth rate. The “higher GDP growth” scenario assumes higher real GDP growth by 0.5 percentage points per year after 2019. The “higher interest rate” scenario assumes higher interest rate by 1 percentage point from 2019. The baseline debt projections implicitly assume that the increase in pension spending presented in Panel B, which is based on data from May 2018, is offset by balancing measures.

The differences across the various scenarios suggest that, as the recovery continues, the government should stick to medium-term fiscal targets to ensure a durable reduction of public debt. In the case of higher growth than projected in the baseline scenarios, more ambitious fiscal targets should be achieved. For this purpose, all windfall revenues should be used to reduce the debt ratio. Despite recent reforms, aging pressures will increase the cost of pensions as a share of GDP, which is expected to peak in 2045 (Figure 16, Panel B). Hence, the implementation of the pension reform will be key for fiscal sustainability, as discussed below, and including additional revenues, if necessary.

Government expenditures as a share of GDP peaked at 48.1% in 2012, but have been declining steadily and stood at 41% of GDP in 2017, well below the euro area average of 47.2%. While the government’s focus on boosting expenditure efficiency is appropriate, new reforms on the revenue side would be welcome. Spain has a relatively low tax-to-GDP ratio and the tax system can be further reformed to promote growth and employment and reduce inequalities, which is discussed in detail below. Without offsetting measures, implementing some of the recommendations of this survey will have a slightly greater effect on expenditures than revenues, based on a back-of-the-envelope calculation of their quantitative impact (Box 2).

<table>
<thead>
<tr>
<th>Policy</th>
<th>Measure</th>
<th>Annual fiscal impact, % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Social Security Contributions</strong></td>
<td>Reduce employer social security contributions for low-wage workers hired on a permanent contract to enhance employment prospects.</td>
<td>0.10%</td>
</tr>
<tr>
<td><strong>Active Labour Market Policies</strong></td>
<td>Increase active labour market programme spending on training and job-search assistance. Remove regional barriers to competition of training centres.</td>
<td>0.05%</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>Increase spending on Education. Provide further individualised support to students at the risk of failing at an early stage. Increase evaluation of schools and teachers.</td>
<td>0.80%</td>
</tr>
<tr>
<td><strong>Value-Added Tax</strong></td>
<td>Increase VAT collection through abolishing some reduced rates.</td>
<td>0.40%</td>
</tr>
<tr>
<td><strong>Environment Tax</strong></td>
<td>Increase environmental taxes as a percentage of tax revenues to the average level of the OECD.</td>
<td>0.40%</td>
</tr>
</tbody>
</table>
The fiscal framework has been strengthened by the 2012 Law on Budgetary Stability and Financial Sustainability and the establishment of AIReF in 2013. However, there is room to improve the fiscal framework by improving the consistency of the deficit, debt and expenditure rules for regions (Chapter 1). AIReF is conducting a review of general government spending and assessing the consistency of spending with policy, impact and efficiency, with initial results expected at the end of 2018 (AIReF, 2017). This is a good step towards improving the evaluation of policies in Spain, which is not currently widespread in a number of areas. There is also an ongoing review to reform the regional financing system, which should help maximise the benefits of fiscal decentralisation (Chapter 1).

Table 4. Past OECD recommendations on fiscal sustainability

<table>
<thead>
<tr>
<th>Recommendations in 2017 Economic Survey</th>
<th>Actions taken since 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stick to medium-term fiscal targets to ensure a gradual reduction of public debt.</td>
<td>The government deficit declined to 3.1% of GDP in 2017, in line with targets.</td>
</tr>
</tbody>
</table>

Addressing spending pressures from demographic challenges is crucial

Spain faces a number of demographic challenges, which have the potential to significantly increase pressure on age-related spending, such as those related to health, long term care and pensions. In particular, population ageing is set to accelerate, with the old-age dependency ratio more than doubling between 2015 and 2050, making it the second highest projected dependency ratio in the OECD (Figure 17). Life expectancy is high and increasing, but the average age of exit from the labour market has stagnated and is more than two years below the OECD average.

While expenditures related to health and long term care are projected to increase over the coming decades, spending on pensions will remain the bulk of public age-related spending (European Commission, 2018b). Together, the pension reforms of 2011 and 2013 have the potential to help ensure the fiscal sustainability of the pension system in the long term. Changes adopted as part of the 2018 Budget may undo part of these reforms, increasing the costs of pensions somewhat, but at the same time will raise the living standards of retirees.
Notwithstanding these recent pension reforms, there remains room to: \( i) \) further enhance the sustainability of the pension system, \( ii) \) reduce incentives to retire early, and \( iii) \) better address the main challenges to income adequacy of those future retirees hardest hit by the crisis, which will rise due to a high and protracted period of unemployment, and labour market segmentation.

If fully implemented and sustained, the pension reforms of 2011 and 2013 will mitigate increases in public pension spending in the longer-term. Overall, the government estimates that together these reforms will result in 2.5% of GDP lower spending by 2060 than would otherwise be the case (Government of Spain, 2016). As a result, pension spending is expected to be 11.4% of GDP in 2060 (European Commission, 2018b).

The aim of the 2011 reform is to increase the effective retirement age, by raising the statutory retirement age by two years to 67. The retirement age increases by two months from 2019. The reference period used to calculate pensionable earnings will increase from 15 to 25 years in 2022. In addition, the number of years of contributions required to receive a full pension will increase from 35 to 37 and access to partial early retirement will become more difficult.

With the 2013 reform, the Sustainability Factor (SF) would gradually reduce replacement rates at the time of retirement, by automatically linking the value of new pensions to changes in life expectancy. Moreover, benefits during retirement are indexed to the Index for Pension Revaluation (IPR), which depends on the finances available for social protection, changes in the number of pensioners and changes in the average pension (in the absence of indexation).

**Figure 17. The old-age dependency ratio in Spain will more than double by 2050**

Number of people older than 65 years per 100 people working age (20-64)

*Note:* The data are based on UN data. According to Eurostat, the old-age dependency ratio (65+/20-64) would increase by 39 and 19 percentage points between 2015 and 2050 in Spain and Austria, respectively, against 47 and 29 points with UN data.


[StatLink](https://doi.org/10.1787/888933871958)
However, there are some tensions between fiscal sustainability and political feasibility, with the recent reforms leading to significant reductions in pensions over time, one of the largest projected reductions in the benefit ratio among European countries. The average benefit among all pensioners as a percentage of the average wage is projected to fall from approximately 58% in 2016 to 38% in 2070. This is due to, in particular, the 2013 pension reform and the relatively larger effect of shorter contribution periods due to long unemployment spells, compared to other EU countries (European Commission, 2018b). As part of the 2018 Budget, the introduction of the SF is now delayed until 2023 and the IPR, which would have likely limited growth in pension benefits to 0.25% per annum for several decades, will not apply in 2018 and 2019. Instead, pension benefits will increase in line with the consumer price index (CPI), or by more in the case of minimum and widowed pensions. In addition, those with monthly pensions of between EUR 600 and EUR 1200 will receive some additional support through tax credits and deductions. Pension issues, including linking indexation to CPI, wages and productivity, are currently being studied by a parliamentary committee (Toledo Pact).

The theoretical replacement rate at the time of retirement for those able to work throughout a full career would remain high, even after the implementation of the 2011 and 2013 reforms (Figure 18), suggesting further reforms may be eventually needed. To reduce incentives to retire early, a number of measures should be adopted. The system does not sufficiently acknowledge long contributory careers, penalises people with stable earnings throughout their working lives and does not incentivise extending working lives after the relevant periods of contributions have been attained. The pensionable earnings reference period should be extended further to a contributor’s full career, and the number of years of contributions required to gain a full pension should be lengthened. In addition, although the previous reforms raise the statutory retirement age over time by two years, this represents only the approximate improvement in life expectancy at age 65 since 2000. The statutory retirement age should therefore eventually be linked to changes in remaining life expectancy, for example, at 65.

There are also strong disincentives to continue working for some, while receiving a full pension in Spain. In particular, apart from the self-employed under certain circumstances, the pension payments of those who continue to work beyond the statutory retirement age are reduced by 50%, additional pension entitlements are not earned and a special ‘solidarity’ contribution of 8% must be paid. The effective marginal tax rate facing such people should be reduced significantly (OECD, 2017a).
Older people in Spain currently face a significantly lower risk of poverty than younger generations. Given the protracted period of high unemployment, growing income disparities between the young and old, and the strong relationship between inequality in earnings over one’s lifetime and old-age pensions in Spain, the risk of poverty in old-age is likely to increase in the future (OECD, 2015a). Enhancing labour market and education outcomes and improving productivity growth (as discussed elsewhere in this survey) can help address this issue.

In this context, care should also be taken to ensure that past pension reforms and the additional measures proposed above will not adversely affect those already hit hardest by the crisis. To this end, the minimum number of years of contributions required to qualify for a contributory pension (currently at 15) should be reduced or eliminated so that those with significantly shortened working lives may also benefit from contributory pensions (OECD, 2017b). Non-contributory pensions could also be enhanced to add a greater redistributive element to the pension system in Spain. In parallel, to offset costs and further promote labour market participation, the speed with which pension benefits are accrued during the early years of one’s career (currently 50% of pension benefits are earned during the first 15 years of work) should also be reduced.

With lower expected public pension entitlements for some in the future, those who are able will need to save more, if their standards of living in retirement are to remain similar. Higher levels of private saving would serve to mitigate risks associated with changes to public pensions in the future. The importance of one potential avenue for private saving, funded pension arrangements, has increased over time in the OECD, although some countries have moved in the other direction. Currently, as a proportion of GDP, Spain has relatively few assets invested in private pension funds, at approximately 14% of GDP in 2016. In addition, the expenses associated with saving through these vehicles are amongst the highest in the OECD (Figure 19).
Changes that would lower fees associated with private pension schemes were announced in 2018. At the same time, a decision was taken to allow the early withdrawal of funds after ten years of contributions from tax advantaged private pension schemes. While this decision will likely make private pension schemes a more attractive instrument for investors, it may also undermine long-term savings for retirement. Additional and alternative measures should be considered to boost private savings.

Greater transparency and understanding of the impact of reforms to public pensions could help facilitate behavioural change and lift private saving (Law, 2016; Talosaga and Vink, 2014). It may be beneficial, therefore, to develop retirement income calculators and to send regular letters to people providing information about their future public pension entitlements, as was envisaged as part of the 2013 pension reform. Indeed, there is evidence of an increase in private savings after the authorities began to send out annual letters detailing individual expected pension payments in Germany (Dolls et al., 2016). In addition, membership in private pension schemes could be increased by facilitating greater choice of providers and investment options available through employers.

Automatic enrolment in private pension schemes upon starting a new job with the ability to later opt-out, such as in New Zealand, is another possibility. However, care should be taken in the design of such schemes. For instance, automatic enrolment in private pension schemes may help to overcome inertia and short sighted savings behaviour. However, associated financial incentives may provide poor value for money and can be regressive, primarily benefitting the already well off, and therefore may induce little additional saving over and above a similarly designed unsubsidised scheme (Law, Meehan and Scobie, 2017; Chetty et al., 2014).

### Addressing medium-term challenges to well-being

The OECD's Better Life Index 2017 suggests that Spain's well-being performance is mixed (Figure 20, Panel A). Spain scores highly on a number of well-being indicators, including work-life balance and life expectancy, but problems with water quality and housing affordability are above the OECD average. Furthermore, Spain ranks amongst the lowest
in the categories of jobs and earnings (especially employment and long-term unemployment), and education and skills. Spain also faces a number of challenges to ensure inclusive growth according to the OECD Framework for Action on Inclusive Growth, which includes a selection of key indicators (OECD, 2018b). For example, poverty risk is significant with 15% of the population living in poor households in 2014, one percentage point more than in 2008 (Figure 20, Panel B). Child poverty is also significantly above the OECD average, as discussed below.

**Figure 20. Well-being performance is mixed**

Well-being inequalities also vary according to dimensions (OECD, 2017c). For example, the skill gap according to income, age and gender is not very high in international perspective. On the other hand, the gap in life satisfaction between high and low-income people is higher than in most OECD countries. Income inequality is high, with the richest 20% earning six times more than the poorest 20% in 2015 (Figure 20, Panel C), above the OECD average. Employment among young people in Spain is more than three times lower than for the middle-aged, which is much higher than for the OECD on average. Furthermore, people with a secondary education have 15% less chance of a job than people with a tertiary level of education, a larger gap than in two-thirds of OECD countries.

*Source: OECD, Better Life Index (database) and OECD (2018), Framework for Action on Inclusive Growth.*

*StatLink* [http://dx.doi.org/10.1787/888933872015](http://dx.doi.org/10.1787/888933872015)
Addressing well-being challenges and income inequality requires more efficient use of tax and transfer policies and policies to improve labour market and education outcomes. There is also room to better address environmental sustainability, as discussed below.

**Income and wealth inequality should be further reduced**

High income and wealth inequality can harm economic growth and productivity, and limit productive investment opportunities (OECD, 2015b; OECD, 2016a). Income inequality is relatively high in Spain and it increased during the crisis, as employment fell significantly and income disparity grew (Figure 21). While wealth inequality in Spain is higher than income inequality, it is relatively low in international perspective, reflecting high rates of home ownership. The top 10% of households still holds close to half of all wealth, compared to around one fifth for the bottom 60% of households (Figure 22). Given that wealth takes time to accumulate, the recent rise in income inequality and labour market trends may lead to an even more concentrated distribution of wealth over time.

**Figure 21. Income inequality is high**

Gini coefficient, 2015 or latest year available

![Gini coefficient chart](https://doi.org/10.1787/888933872034)

*Note:* The Gini coefficient has a range from zero (when everybody has identical incomes) to one (when all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income.

Figure 22. Wealth inequality is comparatively low

Top wealth deciles share of total wealth, 2014 or latest year available

Note: Despite efforts made to ensure common treatments and classifications across countries, the measures included in the OECD Wealth Distribution Database are affected by differences that may limit their comparability. These include: i) differences between countries in the year when data are collected; ii) differences in the degree of oversampling of rich households across countries, which may affect comparisons of both levels and concentrations of household wealth; and iii) differences in the income concept recorded. See Balestra and Tonkin (2018) for further details.


StatLink  
https://doi.org/10.1787/888933872053

New analysis using household survey data shows that wealth inequality increased in Spain between 2011 and 2014, following the rapid decline in house prices (Box 3). In addition, as in other countries, income and wealth mobility also exhibit some degree of persistence, which can exacerbate inequalities. Recent evidence suggests that an important driver of the change in wealth dispersion could be differences in the performance of financial and real assets (Anghel et al., 2018).

Box 3. Income and wealth mobility in Spain

New research, using household-level data (the Survey of Household Finances constructed by the Bank of Spain), examines the mobility of households within both the income and wealth distributions over the period 2002 to 2014 (Martinez Toledano et al., 2018). While wealth inequality is low in international perspective, the results suggest that wealth inequality is greater than income inequality in Spain. Furthermore, wealth inequality is shown to have increased by more than income inequality, particularly between 2011 and 2014. There is a degree of persistence in both income and wealth mobility, although this is more pronounced at the top and bottom of the distribution.
To test the determinants of the changes in nominal net wealth, we estimate the following model:

$$\Delta NW_{it} = \alpha + \beta_1 NW_{it-1} + \beta_2 Income_i + \beta_3 X_{it-1} + D_t + \epsilon$$

where NW refers to net wealth of the household to which person i belongs at time t; income is the average income during the two time periods; X includes a number of individual characteristics such as whether the person has a mortgage, owns a house or stocks, age and household size. The pooled specification also includes year dummies, denoted by D. The outlier observations are dropped. The results show that greater levels of net wealth accumulation are generally associated with higher levels of income, home and stock ownership (Table 5). Conversely, having a mortgage and a larger household size are associated with lower levels of net wealth accumulation.

Table 5. Factors associated with greater household wealth accumulation

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net wealth (start of period)</td>
<td>-0.619***</td>
<td>-0.480***</td>
<td>-0.481***</td>
<td>-0.369***</td>
<td>-0.572***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-33.31)</td>
<td>(-117.24)</td>
<td>(-36.36)</td>
<td>(-81.26)</td>
<td>(-54.03)</td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td>3.048***</td>
<td>3.122***</td>
<td>3.24***</td>
<td>1.972***</td>
<td>3.711***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(60.02)</td>
<td>(118.47)</td>
<td>(62.65)</td>
<td>(104.46)</td>
<td>(85.5)</td>
<td></td>
</tr>
<tr>
<td>Has mortgage</td>
<td>-61750.2***</td>
<td>-40448.6***</td>
<td>-63218.7***</td>
<td>-77735.7***</td>
<td>-75938.8***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-64.25)</td>
<td>(-62.71)</td>
<td>(-50.47)</td>
<td>(-142.62)</td>
<td>(-77.28)</td>
<td></td>
</tr>
<tr>
<td>Owns house</td>
<td>106842.1***</td>
<td>32399.2***</td>
<td>11842.6***</td>
<td>16501.2***</td>
<td>33370.6***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(49.88)</td>
<td>(35.74)</td>
<td>(5.1)</td>
<td>(21.47)</td>
<td>(16.82)</td>
<td></td>
</tr>
<tr>
<td>Owns stocks</td>
<td>14173.0***</td>
<td>38882.5***</td>
<td>6815.1***</td>
<td>17886.2***</td>
<td>46486.2***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.03)</td>
<td>(43.71)</td>
<td>(3.55)</td>
<td>(17.82)</td>
<td>(29.68)</td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>7730.6***</td>
<td>-1895.1***</td>
<td>2756.5***</td>
<td>-421.6***</td>
<td>-940.6***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(73.46)</td>
<td>(-22.18)</td>
<td>(29.08)</td>
<td>(-7.33)</td>
<td>(-10.06)</td>
<td></td>
</tr>
<tr>
<td>Age squared</td>
<td>-61.67***</td>
<td>36.62***</td>
<td>-10.83***</td>
<td>20.80***</td>
<td>24.50***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-76.27)</td>
<td>(47.88)</td>
<td>(-18.06)</td>
<td>(26.8)</td>
<td>(35.21)</td>
<td></td>
</tr>
<tr>
<td>Household size</td>
<td>-16633.1***</td>
<td>-16857.4***</td>
<td>-24564.9***</td>
<td>-1238.2***</td>
<td>-26807.3***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-47.06)</td>
<td>(-77.05)</td>
<td>(-95.99)</td>
<td>(-9.51)</td>
<td>(-126.77)</td>
<td></td>
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<tr>
<td>Constant</td>
<td>-201494.9***</td>
<td>5759.9*</td>
<td>-101620.1***</td>
<td>-42310.1***</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-58.76)</td>
<td>(2.5)</td>
<td>(-26.42)</td>
<td>(-18.69)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005 dummy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29037.1***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(8.08)</td>
</tr>
<tr>
<td>2008 dummy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-25167.2***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(-7.21)</td>
</tr>
<tr>
<td>2011 dummy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-48507.7***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td>(-12.89)</td>
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<tr>
<td>Observations</td>
<td>2577</td>
<td>3961</td>
<td>3710</td>
<td>3049</td>
<td>13297</td>
<td></td>
</tr>
</tbody>
</table>

Using the tax and transfer system more efficiently and progressively

Spain has relatively high social expenditures in a number of areas (Figure 23, Panel A). However, a recent cross-country study using household level micro-data suggests that transfers in Spain are relatively poorly targeted (Causa and Hermansen, 2017). Indeed, low-income households receive less cash transfers than higher-income ones, with those in the bottom 20% of the income distribution receiving only around 55% of the average payment across all families, compared to the top 20% receiving over 60% more than the average...
family (Figure 23, Panel B). Furthermore, a number of tax exemptions in Spain tend to be regressive (Haugh and Martinez-Toledano, 2017).

**Figure 23. Social expenditure is relatively high, but could be better targeted**

### A. Social expenditure by branch
Cash transfers, percentage of GDP, 2013

<table>
<thead>
<tr>
<th>Branch</th>
<th>Spain</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old age and Survivors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Family</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other social policy areas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### B. Transfers received by working-age individuals
Percentage of average cash transfer, 2013 or latest year available

A number of reforms were undertaken since 2014 with an aim to make the tax system more progressive and conducive to growth and job creation, including changes to corporate and labour taxes (Box 4). In 2013, the tax deduction for house purchases was removed. The tax wedge on labour was reduced by exempting income up to EUR 14 000 and lowering personal income tax on incomes between EUR 14 000 and EUR 17 000 in 2018. However, considerable room for improvement remains in terms of both redistribution and efficiency. Globalisation and digitalisation also bring new challenges in terms of tax policies (OECD, 2018c). In this context, Spain is engaging with other OECD governments in the OECD/G20 Base Erosion and Profit Shifting Project to discuss solutions to the tax challenges arising.
from digitalisation, as well as the European Union regarding its proposals from March 2018 for new directives in this area.

### Box 4. Selected tax reforms since 2014

- The 2014 tax reform reduced the statutory income tax rates, in particular, for low-paid workers and simplified different deductions on labour earnings, reducing the tax wedge and the tax burden on labour.
- Social security contributions for employers were temporarily reduced between February 2015 and August 2016, by exempting the first EUR 500 of the salaries of workers employed on new permanent contracts for two years.
- The standard corporate income rate was reduced from 30% in 2014 to 25% in 2016. In December 2016, a number of measures were introduced to broaden the corporate income tax base affecting large companies, including limiting the extent to which companies can deduct past losses.
- Excise taxes on tobacco and alcohol were increased in 2016.
- In 2017, a new electronic VAT filing system for invoices was introduced.
- The tax wedge on labour was reduced by exempting income up to EUR 14 000 and lowering personal income tax on incomes between EUR 14 000 and EUR 17 000 in 2018.

Taxation remains tilted towards labour income, which penalises growth and employment (Johansson et al., 2008), while environmentally-related taxes and value-added taxes (VAT), in particular, are somewhat underutilised (Figure 24). In order to encourage the hiring of low-wage workers on a permanent contract, reviewing existing incentives would be useful. For example, a reduction in employer social security contributions targeted toward low-wage workers hired on a permanent contract, as recommended in the 2017 *Economic Survey of Spain*, could be considered and would provide a win-win in terms of both inequality reduction and economic growth (Akgun, Courède and Fournier, 2017). The introduction of such a measure would benefit from an evaluation of its effectiveness, along with other measures that support hiring.
Figure 24. Taxation remains tilted towards labour

Taxes as a percentage of total tax revenues, 2016

A. Labour taxes

B. Environmentally related taxes

C. Recurrent taxes on immovable property

D. Value added tax

Note: OECD average is calculated as a simple average of the presented countries.

StatLink 1 https://doi.org/10.1787/888933872091
Value added tax bases in Spain are eroded by various deductions, exemptions and reduced rates, which are poorly targeted tools in terms of reducing income inequality and poverty. While some reduced rates on VAT, such as those on basic food and other necessities, benefit relatively poorer people, they remain insufficiently targeted, and other reduced VAT rates tend to benefit richer households instead (OECD, 2016b). The authorities should reassess the merits of such reduced VAT rates, particularly in the context of potentially more efficient and better targeted tools for income redistribution through the transfer system. Reduced VAT rates in Spain have supported the competitiveness of the tourism sector. However, Spain is now the most competitive tourism destination in the OECD (Figure 25), which suggests reduced VAT rates to promote tourism may no longer be necessary and that there is scope to raise tax revenues in other areas related to tourism.

**Figure 25. Spain is a competitive tourism destination**

Travel and tourism competitiveness index, 2017

With the growing importance of the sharing economy (including businesses such as AirBnB), it is important that businesses operating in this area are placed on an equal footing in terms of taxation and regulation, with more traditional ones. Between 2010 and 2014, the number of foreign tourists staying in rented homes increased by 59.7% to 7.4 million. However, Barcelona City Council identified a high rate of homes used for tourism that did not comply with the relevant laws, with potential consequences for tax collection in 2016. In 2018, tax regulations to place information commitments on digital platforms to clearly identify accommodation owners who use them were introduced. This is a welcome step and further efforts to ensure tax compliance within the sharing economy should be continued.

After the introduction of a 100% tax credit, effectively reducing all taxpayers’ wealth tax liabilities to zero in 2008, net wealth taxes were reinstated as a temporary fiscal consolidation measure, but have been maintained since then. These taxes raised revenues of approximately 0.2% of GDP in 2016 (OECD, 2018d). Net wealth taxes can be used to redistribute income from the wealthy, if they are based on total net wealth, and if they have
an exemption level that is high enough to exclude the savings of individuals undertaken to smooth consumption over their lifetimes (life-cycle saving) of everyone except the most wealthy. Wealth taxes can also encourage the productive use of capital and tax revenues that could have evaded income tax first.

At the same time, wealth taxes may be seen as a tax on income that has already been taxed and could discourage the savings of those people to whom they apply. In addition, they can be costly to administer, discourage residency and can distort portfolio choices when certain assets are exempt (OECD, 2018d). Hence, all the implications of resorting to wealth taxes should be carefully reconsidered.

Inheritance taxes are considered less distortionary since they are levied only once, a large part of inheritances are unplanned and the taxation of most life-cycle saving is avoided (OECD, 2014). Greater use of inheritance taxes have been found to be less distortive and detrimental to growth than other taxes (Akgun, Courède and Fournier, 2017). There is scope to enhance the role of inheritance taxes in some regions in Spain, particularly as wealth inequalities, though relatively low, have increased somewhat in recent years (Box 3).

While it makes sense to have tax allowances that avoid taxing the majority of people with small inheritances, some Spanish regions have substantially reduced the tax on transfers between spouses and descendants. For example, from 2018, children and spouses can each receive EUR 1 million free from inheritance tax in Andalusia. By contrast, in France, only EUR 100 000 are exempt from inheritance tax in the case of children (median wealth per adult in Spain falls significantly below this level). Tax allowances granted for inheritance taxes for the most wealthy should be reconsidered. To avoid a race to the bottom between regions and issues of “fictitious tax residence”, the central government could coordinate with regions to set minimum inheritance tax rates or a maximum exemption level.

**Addressing remaining challenges in labour markets**

Labour markets continue to improve, thanks to wage moderation and past labour market reform. The unemployment rate is gradually falling from its peak of 26% in 2013, but remains high at 15% in the third quarter of 2018 (Figure 26, Panel A). The unemployment rates of disadvantaged groups are all higher than those in the OECD on average (Figure 26, Panel B). Despite significant decreases, the youth unemployment rate (54% in 2014 to 38.6% in 2017) and the long-term unemployment rate (12.9% in 2014 to 7.7% in 2017) remain among the highest in the European Union. The still wide prevalence of temporary and part-time workers creates vulnerabilities and contributes to inequalities. The crisis also had an uneven effect on wages, with the strongest adjustment in the lowest deciles, exacerbating inequalities (Figure 27). The wages in the lowest deciles are benefiting from the recovery, but they are still below their pre-crisis levels. The reduction of income tax in the 2018 Budget, and the 4% and 5% rises in the minimum wages in 2018 and 2019, respectively, will also benefit workers with lower incomes.

The sharp increase of unemployment during the crisis had also a structural dimension (European Commission, 2016). For example, 31% of the decline in employment during the recession was due to lower labour matching (Boscá et al., 2017). Although there has been a structural improvement in the labour market since 2013, high long-term unemployment, skill mismatch and low labour mobility could prevent structural unemployment from falling to pre-crisis levels (Chapter 1).
High youth unemployment remains a key challenge in Spain. To address the low professional skills and lack of recent work experience of some unemployed youth, the Youth Employment and Entrepreneurship Strategy has provided financial incentives for firms and training. Furthermore, the Youth Guarantee was reformed in December 2016 to simplify the registration process, with positive results in terms of higher number of registrations. The share of young beneficiaries still in employment six months after has also increased from 38% to 51% (European Commission, 2018c).

The Budget for 2018 introduced a new wage complement of EUR 430 for those youth who sign training and learning contracts (Contrato de Formación y aprendizaje), allowing them to acquire working experience and training. Nevertheless, the number of youth who is not in education, employment or training remains high at 17.7% in 2017. An effective implementation of the measures targeted at youth, including the Youth Guarantee, requires
effective upskilling. To address this, the capacity of the Public Employment Services (PES) to develop and implement more personalised action plans should be enhanced.

**Figure 27. Wage declines disproportionately affected the lowest deciles during the crisis**

Contribution to wage growth by deciles, percentage

![Bar chart showing wage declines disproportionately affected the lowest deciles during the crisis](https://doi.org/10.1787/888933872148)

High long-term unemployment may be eroding skills and lowering social inclusion. Recent analysis finds that the long-term unemployed tend to be older and less educated, and have lower work experience. High job-searching time emerges as the main barrier to the transition from long-term unemployment to employment (Bentolila et al., 2017). Tailored active labour market policies have proven to be the most cost-effective measure to overcome barriers that hinder the re-employment of the long-term unemployed (Card, Kluve and Weber, 2015). In 2016, the Programa de Acción Conjunta para la Mejora en la Atención de Desempleados de Larga Duración, which includes additional funding for employment agencies to support this group, was introduced. Improving regional coordination of social and labour market policies and higher inter-regional mobility, would also help (Chapter 1).

In 2014, individuals who were inactive, unemployed or underemployed represented 45% of the working age population. The main barriers to moving into the labour market are low education or professional skills, total and current work experience and scarce job opportunities (Fernandez et al., 2018). Furthermore, these barriers are unequally distributed across groups or regions, suggesting that the correct identification of the needs of each unemployed person remains key. Hence, a profiling tool, as planned in the Activation Strategy 2017-20, should be implemented in order to adapt activation programs to the specific needs of the unemployed and abandon ‘one-size-fits-all’ formulas.

While the share of temporary workers is lower than its pre-crisis peaks, it remains high at 27% in 2017, notably higher than the EU average of 14%. The share of temporary contracts due to involuntary reasons, 91.4% in 2016, is also much higher than the EU average of 60.7% (Felgueroso et al., 2017). One way to reduce labour market duality is to pursue a greater convergence of termination costs between permanent and temporary contracts, as
recommended in the 2017 Economic Survey of Spain. Firms may also use temporary contracts to reduce severance payments and social security contributions, which necessitates good regulation and supervision to avoid abuse of temporary jobs. The recent measures, including the new legal framework for labour supervisors and increased resources, have delivered positive results. The number of temporary contracts under investigation increased by 21% between 2015 and 2016, resulting in 22% of them being transformed into indefinite contracts (European Commission, 2018c). The efforts to fight against the abuse of temporary contracts should continue. In July 2018, the new government approved an action plan for 2018-20, which increased the resources and staff for labour inspection, which is welcome.

Despite much progress in the last two decades, the gender gap still exists in a number of dimensions, including an average gender pay gap of around 11% and a high prevalence among women of temporary and involuntary part-time employment. The gender pay gap also varies with the level of education, reaching 25% for those with below upper secondary education, above the OECD average of 22% (Figure 28). The gender convergence in unemployment rates observed in recent years is due to the cyclical downturn disproportionately worsening male labour market outcomes and is unlikely to persist, except for the long-term unemployed (De La Rica and Rebollo Sanz, 2015).

**Figure 28. Gender pay gap decreases with education**

Gender gap (percentage) in mean full-time, full-year earnings, by levels of education, 25-64 year olds, 2015 or latest year

![Graph showing gender pay gap by education level](https://example.com/graph.png)

*Note:* Data for France and Italy refer to 2013, and for Canada, Finland, Luxembourg, the Netherlands, Poland, Spain and Lithuania to 2014.
*Source:* OECD, Family Database.

While the share of children aged 3 and over enrolled in formal childcare is around 90%, only around 34% of children under the age of 3 use formal childcare services, which is around the EU average (Conde-Ruiz and De Artiñano, 2016). As inequality in the division of domestic tasks is high in Spain, extending the length of early childhood education to children between 0 and 3 years old could improve the labour market participation of women. The Budget 2018 introduced an annual EUR 1 000 subsidy to working parents with children under the age of 3. Fostering flexible work arrangements, which are scarce
in Spain, via regional and firm-level agreements, would also contribute to the higher employment of women.

The 2012 labour market reform increased the flexibility of labour markets by introducing the priority of firm-level agreements over those at the sector and regional level. Firm-level agreements tend to have more clauses linking wage and productivity growth, compared to sectoral agreements. Such clauses can help prevent the re-emergence of a divergence of wages and productivity, which lowered competitiveness before the crisis. Recent OECD research suggests that this change moved Spain closer to an organised decentralised system, as in some other continental European countries. Such a system allows sector-level agreements to set broad framework conditions but leave detailed provisions to firm-level negotiations. Coordinated systems, including those characterised by organised decentralisation, should contribute to both higher labour market flexibility and employment growth than fully centralised and decentralised systems (OECD, 2018e). Maintaining this flexibility aspect of the reform is thus critical to avoid excessive firing of workers when the next crisis hits. The global financial crisis showed that countries using flexible arrangements within firms (e.g. including temporarily lower working hours or benefits), such as Germany, had a significantly less marked increase in unemployment, despite a similar fall in activity. In 2015, only 7% of workers were covered by firm-level agreements, slightly below the 2007 level and the use of such agreements is uneven across regions (Figure 29). One explanation for this could be that the cost of negotiating an agreement is more burdensome for smaller firms. Including such productivity clauses more in sectoral agreements could help overcome these high costs.

Figure 29. The share of workers covered by firm-level collective agreements is low

Source: Ministry of Employment and Social Security, “Estadistica de convenios colectivos de trabajo”.
StatLink: http://dx.doi.org/10.1787/888933872186
Improving education and skills

Higher educational attainment and skills can lead to better employment prospects and wages (OECD, 2014). In Spain, the gap between the unemployment rate of those with tertiary education and less than upper secondary education, at around 14%, is higher than the EU average of 10%. Furthermore, the quality of the workforce’s skills is low and skill mismatch is high, contributing to low productivity (Chapter 1). Policies should focus on improving the skills of workers via lifelong learning and providing skills matching future labour market needs (OECD, 2018f; OECD, 2015c). Improving the quality of teaching through better university and on-the-job training for teachers, as recommended in the 2017 Economic Survey of Spain, would also help boost skills.

Despite significant improvements over the past years, the early school leaving rate remains among the highest in the OECD, at 18.3% in 2017, and Spain has the second highest grade repetition rate in the European Union. The increased likelihood of grade repetition among disadvantaged students compared with their advantaged peers, and after taking performance into account, is amongst the highest in the OECD (OECD, 2016c). Furthermore, the percentage of variance in science performance explained by socio-economic background is relatively high (Figure 30). Recent OECD analysis also suggests that in terms of intergenerational social mobility, Spain performs poorly, particularly in terms of education (OECD, 2018g).

Figure 30. Education outcomes vary by socio-economic conditions

Percentage of variance in science performance explained by socio-economic background


StatLink: https://doi.org/10.1787/888933872205

Reducing inequality of opportunity in education would be one of the main drivers to improve inclusiveness and reduce intergenerational inequality, as discussed in detail in Chapter 1. Increasing individualised support to students at the risk of failing at an early stage would benefit especially disadvantaged students with parents with low levels of education. Enhancing incentives for the mobility of well-qualified teachers across schools and regions is another way to increase equality of opportunities in lagging regions (Chapter 1). Finally, increasing the provision of early childhood education for those between the
ages of 0 to 3 would not only boost labour participation of women (see above), but also improve future skill formation, especially for children from disadvantaged backgrounds.

**Reducing child poverty**

The rate of child poverty increased sharply in Spain during the financial crisis to 22%, significantly above the OECD average of 13% (Figure 31). The risk of poverty is especially high for children living in migrant and single parent families. In addition, 8 out of 10 school-age poor children suffer material deprivation in a number of areas, including housing and educational opportunities. Addressing high rates of material deprivation will require coordinated joint action in health, education and housing policies. A High Commissioner of Child Poverty was recently created and a Child Poverty Plan was launched to help reduce child poverty, which is a key objective of the new government.

Child poverty is closely related to the deterioration in parents’ employment conditions, with the proportion of poor children where one parent is not in work all year increasing from 34% in 2006 to 60% in 2014. Hence, employment policies to create conditions that are conducive to parents finding a job will be key to address child poverty. In this context, stronger coordination between employment and social services is needed to provide effective transitions between social support schemes and employment (Chapter 1). At the same time, the development of affordable after-school services for school-age children can help parents, especially mothers, to maintain employment (Thevenon et al., 2018). The share of school-age children covered by such services at 8% is well below the OECD average of 29%. Increasing the amount and coverage of cash benefits for families with children, as recommended in the 2017 Economic Survey of Spain, would also help.

**Figure 31. The rate of child poverty is high**

Percentage, 2015 or latest year

*Note: Share of children (0-17) with an equivalised post-tax and transfer income of less than 50% of the national annual average equivalised post-tax and transfer income.*

*Source: OECD, Income Distribution Database.*

[StatLink](https://doi.org/10.1787/888933872224)
Table 6. Past OECD recommendations on tax, social and labour market policies

<table>
<thead>
<tr>
<th>Recommendations in 2017 Economic Survey</th>
<th>Actions taken since 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase the amount and coverage of the regional minimum income support programmes and of cash benefits for families with children.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Increase the efficiency of regional public employment services by employing profiling tools and specialisation of counsellors, increasing resources and staff-to-job seeker ratios, and improving coordination to provide integrated support for jobseekers via a single point of contact for social and employment services and assistance.</td>
<td>Spanish Employment Activation Strategy 2017-2020 includes the implementation of profiling tools, but they have not been implemented yet. Additional funds for employment agencies is provided in the Programa de Acción Conjunta. Only the Basque Country has effectively created a single point of contact for social and employment services.</td>
</tr>
<tr>
<td>Request gradually increased representativeness of business associations when allowing the extension of collective agreements.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Reduce employer social security contributions for low-wage workers on permanent contracts.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Enhance the efficiency of the tax system by abolishing poorly-targeted personal income tax exemptions, regressive reduced value added (VAT) rates, and increasing environmental taxes.</td>
<td>Excise taxes on tobacco and alcohol were increased. The tax wedge on labour was reduced by exempting income up to EUR 14 000.</td>
</tr>
</tbody>
</table>

There is room to make growth greener

Spain's emissions of greenhouse gases (GHG) per unit of GDP remain below the OECD average, and are declining, but at a pace lower than that in the OECD. Furthermore, per capita emissions ceased to fall in 2014, as the economy began to recover. Performance in a number of areas has improved, with energy use and air pollution less than the OECD average (Figure 32). Spain was once a relatively poor performer in generation of household waste, but levels of waste have now been declining for some years, falling below the OECD average. However, Spain remains less successful than many countries in making use of waste either by recycling or recovering energy in incineration. In fact, landfill remains the main treatment method for municipal waste and its share has increased in recent years.
Spain has one of the highest levels of water stress in the OECD (OECD, 2017d). In particular, as per capita precipitation is relatively low, total water use as a share of available water is very high. As climate change proceeds, improving techniques for managing water
supply will become increasingly important. Greater use of water price signals, as recommended in the 2017 Economic Survey of Spain, would help to generate better incentives. This should be complemented by improved water governance by widening participation of stakeholders in river basin authorities to include more scientists and improving the efficiency of water supply and treatment services by benchmarking regulation of water utilities (Fuentes, 2011). Despite a high share of patents in environment-related technologies, patents tend to be concentrated on climate change mitigation, in line with the large recent increase in the use of renewables. Relatively few patents are related to water, compared to some other key water-scarce countries (Figure 33). This suggests that further investment and research in this area may be warranted.

Figure 33. Environment-related patents are not concentrated on water

Patent applications by technology domain as a share of environment-related applications, 2010-14 average


Spain continues to have considerable scope to make the tax system more environmentally friendly. In particular, Spain raises less revenue as a share of GDP and revenues from environment-related taxes than the OECD average (Figure 24 and Figure 32, Panel E). For example, there remains room to raise tax rates on fuel for road transport, particularly with respect to diesel. Despite having higher emissions, the tax rate on diesel is lower than the tax rate on petrol, which lowers its retail price relative to petrol and encourages consumers to buy diesel cars (OECD, 2017d). Taxation of fuels should be reformed to better reflect emissions of CO₂ and other pollutants.

Boosting productivity and trade

International trade, investment and participation in global value chains (GVCs) can contribute to higher productivity growth (Keller and Yeaple, 2009; Baldwin, 2011; Benkovskis et al., 2017; OECD, 2017e). As is the case in other countries, exporting firms consistently display higher productivity than non-exporting firms, with Spanish exporters enjoying a productivity premium of around 40% on average over the period 2001 to 2010 (Martin Machuca and Rodriguez Caloca, 2011; Berthou et al., 2015). Furthermore, there is evidence that Spanish exporters were more resilient than non-exporters to the effects of the recent crisis, faring better during and after the crisis on a number of dimensions, including output, productivity, wages and likelihood of survival (Eppinger et al., 2018).
There is room to increase internationalisation further

Exports as a share of GDP increased from 26% in 2007 to 33% in 2017, but remain below the average of euro area countries at 48%. Similarly, trade openness, defined as exports and imports as a share of GDP, at 65%, is well below the EU average of 90% (Figure 34, Panel A). Furthermore, Spain’s participation in GVCs, measured as the combination of backward and forward integration of its exports, is relatively low. That is, the extent to which imported inputs are used in exports, and exported goods and services of Spain are used as imported inputs to produce other countries exports, respectively, is low (Figure 34, Panel B).

1. The indicator provides the share of exported goods and services used as imported inputs to produce other countries’ exports.
2. The indicator measures the value of imported inputs in the overall exports of a country (the remainder being the domestic content of exports).

Source: OECD, National Accounts and International Trade Statistics.

StatLink 2 https://doi.org/10.1787/888933872281

Spain does not score well according to an indicator that measures countries’ potential to be part of global education, innovation and research networks, which can boost GVC participation and trade performance (OECD, 2017f) (Figure 35). Hence, the internationalisation strategy adopted in 2017, which encompasses a number of these
dimensions, is welcome. The Strategy also has some specific initiatives targeted at small and medium-sized enterprises (SMEs), since the share of exporting SMEs remains low, despite recent increases (Figure 36).

Figure 35. Spain can improve its participation in global networks in a number of dimensions

A synthetic indicator ranging from 0 to 3 (higher value indicates more integration)

Note: International co-operation for research and innovation, measured by international co-authorship, international co-inventions, and the international mobility of scientific authors. Foreign/international students and high-skilled workers, measured by the share of international and foreign students enrolled in tertiary education and the share of foreign-born doctorate holders. Funding incentives for international co-operation, measured by government expenditure on R&D, the share of government R&D expenditure financed from abroad, and the share of business R&D expenditure financed from abroad.

Source: OECD, Skills Outlook 2017 (database).

StatLink 2 https://doi.org/10.1787/888933872300

Figure 36. The share of exporting SMEs has increased, but remains relatively low

Note: Data for Belgium, Sweden, Turkey, the United Kingdom and the United States refer to 2014.


StatLink 2 https://doi.org/10.1787/888933872319
Removing barriers to firm growth will help increase internationalisation

SMEs in Spain constitute a large proportion of total firms and account for a relatively high share of total employment (Figure 37, Panel A). However, as in other countries, small firms in Spain tend to have much lower levels of productivity than large firms (Figure 37, Panel B). Furthermore, during the crisis, the average size of SMEs declined markedly. In 2016, for SMEs in the Spanish non-financial business economy, value added remained 22.8% below the pre-crisis level and employment 20.8% lower than in 2008.

Figure 37. Employment in SMEs is relatively high, but their productivity is low

While trade can facilitate spillovers, firms need to reach a sufficient scale in terms of size and productivity to compete in international markets and participate in GVCs (Criscuolo and Timmis, 2017). In Spain, post-entry growth of start-ups (after two years) is low in international perspective, which can be a reflection of barriers to firm growth.

StatLink https://doi.org/10.1787/88893872338
(OECD, 2017g). Improved access to finance by SMEs via better SME bond and loan securitisation, as recommended in the 2017 Economic Survey of Spain, would enable the upscaling of SMEs and improve productivity. For instance, the government could introduce risk sharing mechanisms, such as providing guarantees to SME bond funds that purchase either loans securitised by banks or smaller bonds issued directly by small firms. Policies that impede product and labour market flexibility can also restrict the ability of SMEs to grow by hampering the reallocation of resources.

**Boosting competition and reducing regulatory barriers**

A sound regulatory framework that supports efficient resource allocation and fosters competition, innovation and entrepreneurship is vital to increase productivity and promote firm growth. Improved corporate governance, simplified corporate taxes, bankruptcy reform and increased efficiency of the business registry have improved ease of doing business (Ministry of Economy, 2017). Spain's ranking increased from 33 in 2016 to 28 in 2017 according to the World Bank Doing Business Indicators. While the overall stringency of product market regulations is close to the OECD average, some barriers to entrepreneurship remain (Figure 38). OECD analysis of the impact of structural reforms suggests that reforms in these areas could improve performance and boost productivity (Box 5).

**Figure 38. Barriers to entrepreneurship are high**

Index scale of 0-6 from least to most restrictive, 2013

![Barriers to entrepreneurship](image-url)

Source: OECD, Product Market Regulation Database.

According to the 2015 Regional World Bank Doing Business indicators, there are also large regional differences in a number of areas, including barriers to starting a business. Indeed, regions where it is easier to start a business tend to have higher firm birth rates, suggesting that harmonising ease of entry could increase business dynamism. In this context, effective implementation of the Market Unity Law, which aims to improve business regulations across regions to create a truly single market, is key (Chapter 1).

Size-contingent regulations, that is, regulations which depend on the size of firms (often in terms of employment or turnover), can create barriers to post-entry growth (González
Pandiella, 2014). For example, such size-contingent labour laws in France are associated with significant distortions to the firm size distribution and deadweight losses of above 5% of GDP (Garicano, Lelarge and Reenen, 2013). Similar distortions to the firm size distribution were observed in Spain during the period 1999 to 2007 (Almunia and Lopez Rodriguez, 2014).

A recent review by the government of horizontal state regulations identified more than 130 size-contingent regulations relating to both employment and turnover levels, concentrated around 250, 50 and 10 workers, and EUR 10, 6 and 2 million, respectively. These thresholds should be phased out and eliminated, as needed, and the creation of new regulatory thresholds should be limited. In cases where this is not possible, it would be preferable that any threshold related instead to a firm’s age, with little rationale for assisting old small firms given the evidence that young as opposed to small firms are the most important for job creation (Haltiwanger, Jarmin and Miranda, 2013).

Box 5. Quantification of structural reforms

This box quantifies the effect of some structural reforms for Spain based on the OECD’s most recent quantification framework set out in (Égert and Gal, 2017). Some tax measures considered in Box 2, will also affect employment and output, but are not able to be quantified here. The effects are derived from a range of time-series cross-country reduced-form panel regressions on a sample of OECD countries. The estimated effects are allowed to vary across countries as a result of differences in factor shares, the level of the employment rate and a country’s demographic composition. The approach is illustrative and results should be interpreted with care. A breakdown of the effect on GDP per capita based on Égert and Gal (2017) suggests that these measures will raise employment by 0.9 percentage points over 10 years, which will have a positive impact on the budget balance (See Box 2).

<table>
<thead>
<tr>
<th>Total effect on GDP per capita</th>
<th>5 year effect</th>
<th>10 year effect</th>
<th>Long-term effect</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product market regulations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Barriers to entrepreneurship</td>
<td>1.2%</td>
<td>1.4%</td>
<td>1.4%</td>
</tr>
<tr>
<td><strong>Innovation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business R&amp;D</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.5%</td>
</tr>
<tr>
<td><strong>Labour market policies</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Active labour market policies</td>
<td>0.1%</td>
<td>0.3%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Increase support for childcare services</td>
<td>0.3%</td>
<td>0.5%</td>
<td>0.6%</td>
</tr>
<tr>
<td><strong>Trade openness</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher exports and imports as a % of GDP</td>
<td>0.4%</td>
<td>0.7%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

Note: Calculations are based on a 10% policy change scenario, which corresponds to lowering the PMR indicator for barriers to entrepreneurship from 2.1; increasing business R&D as a percent of GDP from 2.1%; increasing ALMP spending per unemployed as a share of GDP per capita from 19.2%, increasing spending on childcare as a share of GDP from 0.8% and increasing the share of exports and imports as a share of GDP from 32%. Trade openness can be enhanced via a higher skilled workforce and greater participation in global research and innovation network, which can't be quantified directly.
Some entry barriers in the legal, architect and engineering professions remain and professional services are significantly less productive in Spain than in other European countries (OECD, 2017d). This raises costs to other firms, including SMEs, reducing their returns on investment and expansion, as well as their competitiveness in international markets. Analysis for the European Union over the period 2008 to 2011 suggests that less strict regulations in professional services would improve allocative efficiency and reduce the observed larger-than-average profitability, and economic rents inherent in this sector, through intensified business dynamics (Canton, Ciriaci and Solera, 2014). The pending reform of the liberalisation of professional services has been delayed for some time, but should be adopted. The reform aims to improve the functioning and governance of professional bodies, and benefit final consumers through increased competition, higher quality, lower prices and improved customer protection.

**Improving public procurement**

Public procurement as a share of government expenditures and the number of businesses using electronic procurement systems are relatively low in Spain (Figure 39, Panels A and B). The share of public procurement with no call for tender has fallen from 12% in 2016, but remains high at 8% in 2017 (Figure 39, Panel C). Healthy competition in public procurement can reduce costs to the public and enhance incentives to innovate and the quality of goods and services. Indeed, evidence suggests that reported innovation rates are significantly larger for companies that are involved in procurement contracts, which can boost productivity (Appelt and Galindo-Rueda, 2016). Furthermore, in 2017, only 28% of contractors in public procurement were SMEs in Spain, well below the EU average of 52%. Hence, a level playing field in public procurement can foster the growth of SMEs and enhance the efficient allocation of resources.

The Public Procurement Law, which was passed in 2017 and came into effect in 2018, significantly improves the public procurement system in Spain. Procedures have been simplified for contracts below a certain size, which should facilitate greater participation from SMEs, and transparency has been enhanced. In line with the EU directive, an innovation partnership procedure has been introduced with the aim of developing new innovative products or work for subsequent purchases. Greater emphasis is placed on quality when awarding contracts, which is beneficial to firms offering innovative products and services that may initially have higher costs or longer pay back periods. Awarding bodies are given the power to present evidence of tender collusion to the National Commission on Markets and Competition, which should enhance competition in public procurement. In March 2018, electronic public procurement became mandatory. The share of procurement with no call for tender is also expected to be reduced.

The effective implementation of this reform will depend on continued improvement in a number of areas. Better training of procurement bodies and officials, and enhanced incentives for fulfilling efficient, open and competitive purchases would be beneficial, as these are currently limited. Governance could be improved by providing supervisory and regulatory bodies powers beyond making non-binding recommendations. Access to information about past tenders and losing bids would also be beneficial to make assessments and comparisons with current tenders. Budgeting of rewards or penalties linked to contract outcomes would improve incentives to firms. In addition, guidelines should be further developed on what constitutes evidence of collusion to ensure consistent application of this aspect of the new public procurement law and to avoid the possibility of unintentionally discouraging, or raising costs to participation in public procurement.
Figure 39. Public procurement could be better utilised

A. Public procurement spending as a percentage of total government expenditures
Percentage, 2017 or latest available

B. Businesses using electronic procurement systems
Percentage, 2013

C. Share of procurement procedures with no call for tender
Percentage, 2017 or latest available


StatLink  
https://doi.org/10.1787/888933872376
Fostering innovation

Innovation is key to foster MFP and remain internationally competitive in an increasingly globalised world, which requires strong investment in R&D and innovation. Gross domestic expenditures on R&D as a share of GDP is low in Spain, at around half the OECD average. As the economic recovery continues, it will be important to boost public R&D expenditures, which can have spillover effects on firm innovation. At the same time, higher coordination of regional and national innovation policies and wider use of evaluation, as discussed in detail in Chapter 1, would help enhance innovation performance.

Despite a generous R&D tax credit system, business R&D as a share of GDP is low in Spain at 0.6% in 2016, well below the OECD average of 1.6%. The marginal tax subsidy rate for profit-making firms at 0.33 is above the median OECD rate. While the rate for new loss making firms is lower, even after the government made the scheme more attractive for younger and less profitable firms by allowing the credits to be partly refundable and carried forward, it is also above the OECD median (OECD, 2018h).

Due to complex procedural requirements, however, firms make limited use of the system and consequently, most public support to business innovation is direct. While new firms are able to certify their activities, there is significant cost and time involved, which may be a particular disincentive for SMEs. The government should continue to streamline the system, lower associated costs and publicise how to apply for credits, as recommended in the 2017 Economic Survey of Spain.

Migration can facilitate trade

Through their ability to speak languages, navigate legal systems and draw on social and commercial networks in their countries of origin and destination, migrants can play an important role in facilitating trade by reducing the associated transaction costs (Gould, 1994; Rauch, 1999; Law, Genç and Bryant, 2013). To the extent that these transactions costs are fixed, they may be particularly difficult to overcome for SMEs, which can benefit most from migrants to boost their trade and productivity performance. A 10% increase in immigrants may be expected to increase the volume of trade by about 1% in Spain (Peri and Requena, 2009), with a similar positive relationship at the regional level (D’ambrosio and Montresor, 2017). In addition, migration, particularly of high-skilled individuals, may provide a more direct link to the global productivity frontier, enhancing knowledge diffusion and innovation.

Labour migration flows are currently relatively low, as the substantial immigration of pre-crisis years subsequently reversed, with net immigration of foreign nationals returning to positive figures for the first time only in 2015 (OECD, 2017h). Nevertheless, the stock of migrants living in Spain is now approximately six million people, originating mainly from Europe and Latin America. Migrants are less educated than the native-born population (Figure 40) and are overrepresented in terms of temporary employment. On the other hand, emigration flows increased after the crisis and have been greater than internal migration flows for a number of years. Consequently, the stock of Spanish emigrants living abroad is now over 1.3 million people, with available data suggesting recent emigrants are young, with relatively high levels of education (Arango, 2016).

The government already makes efforts to attract and integrate migrants in Spain, for example, through encouragement to learn Spanish and the development of education programs to facilitate the integration of students from a migrant background. Policies could be enhanced to better integrate past and future immigrants into Spanish society and the
labour market, as well as keeping in closer touch with the Spanish diaspora. Diaspora policy could be reviewed to ensure it can address the changing characteristics of recent emigrants.

**Figure 40. Spain has previously not attracted highly educated migrants**

Percentage of the highly educated among corresponding population, 15-64 year-olds, 2015 or latest year


Table 8. Past OECD recommendations on improving the business climate

<table>
<thead>
<tr>
<th>Recommendations in 2017 Economic Survey</th>
<th>Actions taken since 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continue to implement the Market Unity Law and adopt the professional services reform.</td>
<td>The ruling of the Constitutional court declared unconstitutional the principle of national effectiveness contained in the law, but the other principles remain intact and operational. The requirement to analyse the impact of new central legislation on the Market Unity Law was introduced. No action taken in relation to the professional services reform.</td>
</tr>
<tr>
<td>Partially reallocate funds from loans to R&amp;D grants to projects and researchers based on performance and international peer review.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>In cases when debt forgiveness is not automatic, reduce the period during which bankrupt entrepreneurs are required to repay past debt from future earnings.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Set up small and medium enterprises (SME) bond funds with guarantees provided both by government and SME companies.</td>
<td>The state-owned bank, ICO approved a new SME securitisation programme in June 2017.</td>
</tr>
</tbody>
</table>
Box 6. Other recommendations on macro and structural policies

Financial and fiscal policies

Financial stability
- Create a national macro-prudential authority, including the main supervisory institutions, with clear division of responsibilities.
- Introduce macro-prudential tools, such as limits on loan-to-value and debt service to income.

Taxation
- Reconsider tax allowances granted for inheritance taxes for the most wealthy.

Pensions
- Link the statutory retirement age to life expectancy at retirement.
- Facilitate greater choice of both pension scheme providers and investment options available through employers.

Structural policies

Labour and education
- In order to encourage the hiring of low-wage workers on a permanent contract, review existing incentives and consider reducing, for example, employer social security contributions for these workers.
- Introduce a profiling tool to adapt active labour market programmes to the needs of individual workers.
- Increase the provision of early childhood education to children between the ages of 0 and 3.
- Further develop affordable after-school services for school-age children in order to help parents maintain employment.

Competition and innovation
- Make greater use of rewards and penalties, linked to contract outcomes, to improve incentives to firms that participate in public procurement.
- Streamline the R&D tax credit system and publicise how to apply for credits.
References


AIReF (2017), Plan de Acción de la revisión del gasto en subvenciones del conjunto de las Administraciones Públicas, Madrid.


European Commission (2018a), *Statement by the staff of the European Commission and the European Central Bank following the ninth post-programme surveillance visit to Spain*, Brussels.


Annex. Progress in main structural reforms

This annex reviews action taken on recommendations from previous Surveys since the March 2017 Survey.
<table>
<thead>
<tr>
<th>Recommendations in previous Surveys</th>
<th>Actions taken</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Public Finance</strong></td>
<td></td>
</tr>
<tr>
<td>Stick to medium-term fiscal targets to ensure a gradual reduction of public debt.</td>
<td>The government deficit declined to 3.1% of GDP in 2017, in line with targets.</td>
</tr>
<tr>
<td>Enhance the efficiency of the tax system by abolishing poorly-targeted personal income tax exemptions, regressive reduced value added (VAT) rates, and increasing environmental taxes.</td>
<td>Excise taxes on tobacco and alcohol were increased. The tax wedge on labour was reduced by exempting income up to EUR 14 000.</td>
</tr>
<tr>
<td><strong>B. Labour market and social policies</strong></td>
<td></td>
</tr>
<tr>
<td>Increase the amount and coverage of the regional minimum income support programmes and of cash benefits for families with children.</td>
<td>In 2018, within the framework of the fight against child poverty, the government provided an additional credit of EUR 5.2 million to guarantee the basic right of food, leisure and culture of the children in cases of social vulnerability during school holidays and other non-school periods (VECA plan).</td>
</tr>
<tr>
<td>Increase the efficiency of regional public employment services by employing profiling tools and specialisation of counsellors, increasing resources and staff-to-job seeker ratios, and improving coordination to provide integrated support for jobseekers via a single point of contact for social and employment services and assistance.</td>
<td>The Spanish Employment Activation Strategy 2017-2020 includes the implementation of profiling tools, but they have not been implemented yet. Additional funds for employment agencies are provided in the Programa de Acción Conjunta. Only the Basque Country has effectively created a single point of contact for social and employment services.</td>
</tr>
<tr>
<td>Request gradually increased representativeness of business associations when allowing the extension of collective agreements.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Reduce employer social security contributions for low-wage workers on permanent contracts.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Revise and streamline different social benefits at national and regional levels to improve their targeting and effectiveness.</td>
<td>The Spanish Fiscal Council is conducting an analysis on the efficiency of subsidies as a first step to reform.</td>
</tr>
<tr>
<td>Phase out slowly the Renta Mínima de Inserción, the most common income support scheme, when beneficiaries return back to work and earn wages.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>To further reduce duality, if necessary, pursue a greater convergence of termination costs between permanent contracts and temporary contracts.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Extend the coverage of the standard unemployment benefit to precarious workers, reducing the minimum required contribution periods.</td>
<td>No action taken.</td>
</tr>
<tr>
<td><strong>C. Education reform</strong></td>
<td></td>
</tr>
<tr>
<td>Improve the quality of teaching through better university and on-the-job training for teachers.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Promote the VET system and adult education programmes to help the unemployed and those in need to gain relevant skills.</td>
<td>The Royal Decree 694/2017 extends and regulates in detail the main aspects of the Law 30/2015, focused on VET for employment.</td>
</tr>
<tr>
<td>Use national standardised tests widely in primary and secondary education.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Improve attractiveness of basic and secondary VET by increasing the share of mandatory workplace training and facilitating pathways to dual and higher level VET.</td>
<td>In recent years, the number of centers, students and firms engaged in VET have increased notably.</td>
</tr>
<tr>
<td>Continue the development and modernisation of Vocational Education and Training (VET). Expand dual VET and ensure skills meet firms’ needs by fostering a greater role of employers in training students and designing curricula.</td>
<td>The implementation of the 2013 reform of the education and training system (LOMCE), which aimed at more school autonomy and development of VET, has been completed in 2018, except for changes to the evaluation framework.</td>
</tr>
</tbody>
</table>
### D. Productivity and business climate

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Progress/Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continue to implement the Market Unity Law.</td>
<td>The ruling of the Constitutional court declared unconstitutional the principle of national effectiveness contained in the law, but the other principles remain intact and operational. The requirement to analyse the impact of new central legislation on the Market Unity Law was introduced.</td>
</tr>
<tr>
<td>Adopt the professional services reform.</td>
<td>No action taken in relation to the professional services reform.</td>
</tr>
<tr>
<td>Partially reallocate funds from loans to R&amp;D grants to projects and researchers based on performance and international peer review.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>In cases when debt forgiveness is not automatic, reduce the period during which bankrupt entrepreneurs are required to repay past debt from future earnings.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Set up small and medium enterprises (SME) bond funds with guarantees provided both by government and SME companies.</td>
<td>The state-owned bank, ICO approved a new SME securitisation programme in June 2017.</td>
</tr>
<tr>
<td>Increase public and private funding for innovative firms at the seed and early start-up phases.</td>
<td>In 2018, the contract with European Investment Fund, which was originally signed in 2016, to provide access to finance for innovative companies was extended for two years and the amount increased by 30%.</td>
</tr>
<tr>
<td>Require commercial banks to publish prominently the right of SMEs to demand a standardised credit assessment.</td>
<td>According to Law 5/2015, banks are obliged to inform their customers about the right to a credit assessment in loan contracts.</td>
</tr>
<tr>
<td>Increase the emphasis of the state-owned bank, ICO, on providing funding through second-floor facilities for commercial bank loans to new and innovative companies.</td>
<td>In 2017, in its new Strategic Plan, ICO expanded the scope of “FondICO Global” to pay special attention to technological innovation.</td>
</tr>
<tr>
<td>Provide more specific programmes to entrepreneurs, such as financial education of SMEs’ entrepreneurs on options and processes for raising equity finance.</td>
<td>The Spanish Institute for Foreign Trade, ICEX, extended its advisory financial services to companies in 2017.</td>
</tr>
<tr>
<td>Establish clear guidelines for the participation of public creditors in corporate debt restructuring processes to make them more effective.</td>
<td>No action taken.</td>
</tr>
<tr>
<td>Refocus ICEX, Spain agency to promote FDI, on targeting key investors rather than investment in specific sectors.</td>
<td>ICEX has started shifting their focus on financial investors, including sovereign wealth funds, venture capital firms or business angels.</td>
</tr>
</tbody>
</table>

### E. Environmental sustainability

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Progress/Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>To encourage better allocation of capital and investment decisions by improving pricing signals reform taxation of fuels so that the tax per unit is based on the amount of emissions and other pollutants per unit.</td>
<td>No action taken.</td>
</tr>
</tbody>
</table>