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SEPTEMBER 2014

OVERVIEW



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Executive summary

- *Main findings*
- *Key recommendations*

Main findings

The Spanish economy has returned to moderate growth following a protracted recession and, crucially, sovereign spreads have fallen sharply. This major turnaround reflects decisive reforms to strengthen the banking sector (including a financial sector programme), the European Central Bank's actions, the improvement of public finance sustainability, with a now somewhat slower pace of fiscal consolidation, and reforms to enhance product and labour markets. Nevertheless, the key challenge now is to build on these achievements to enhance growth and reduce unemployment significantly through sustained gains in productivity and competitiveness and to reduce external debt. This will require orderly reduction of public and private sector debt, improvements in labour market institutions and policies to reduce the very high unemployment rate (which is itself a key driver of inequality), and reforms to the business sector environment to promote the entry and growth of firms.

Reducing debt and increasing competitiveness. The current consolidation path should allow public debt to decline eventually. The tax base is too narrow and over reliant on labour taxes, which are among the most detrimental to activity. Credit continues to be tighter than in other euro area countries. Major reforms have been undertaken in the financial sector and the banks have been recapitalised. However, bank profitability is low, non-performing loans are high and the private sector remains highly indebted. International experience suggests that in these circumstances credit growth will remain modest for an extended period. Existing insolvency regimes for most individuals are narrow in scope and allow for only limited debt discharge. A new fresh start was introduced in 2013 but it is too stringent to facilitate orderly restructuring of personal debts.

Sustainably boosting medium-term growth and jobs. Trend GDP growth is estimated to be just 1%, although there has been a recent cyclical upswing in productivity due to heavy job shedding. Innovation capability has expanded but remains behind peers in Europe. Universities are not specialised enough and business research and development is low. Despite improvements in the labour market, the shares of long-term and poorly qualified unemployed remain high and there is significant room for improvement of activation policies. Tackling unemployment is crucial to reduce poverty and inequality. Spain has made good progress towards making growth more environmentally sustainable, and continued good policy in this domain holds the promise of a new engine of growth in the years ahead.

Towards a higher performing business sector. The Spanish business sector is too fragmented, with many low-productivity small enterprises and few medium size and large companies. Most exporting is done by a tiny fraction of firms, small and medium-sized enterprises (SMEs) export little and exports are very concentrated in European destinations. Starting a business is perceived to be more difficult in Spain than in other OECD economies and framework conditions, such as size-dependent regulations, are not favourable to firms' growth. Firms also suffer from a regionally and locally fragmented regulatory framework, a challenge that the Market Unity Law is trying to address. Firms, especially SMEs are over-reliant on bank-lending. Nevertheless non-bank financial alternatives are starting to emerge. Some markets, especially in the service sector, have high entry requirements.

Key recommendations

Reducing debt and increasing competitiveness

- As specified in the government's medium-term fiscal plan, return to a cyclically-adjusted fiscal balance by 2017.
- Shift the balance from labour to indirect taxes by cutting employer social security contributions for low-skilled workers, increasing environmental and real estate taxes, and narrowing exemptions to value-added tax, corporation and income taxes.
- Continue to improve in-court insolvency procedures, increase incentives for the use of both in-court and out-of-court insolvency procedures by SMEs and introduce a new out-of-court negotiated personal insolvency regime.

Sustainably boosting medium-term growth and jobs

- Strengthen active labour market policies by improving vocational training, strengthening the capacities and efficiency of the public employment services, and enhancing coordination between the different levels of administration.
- Raise the quality of innovation and strengthen competitiveness by encouraging greater scale and specialisation of universities and research organisations, by extending performance based resources allocation and the application of international peer review and by providing more career opportunities for highly qualified researchers.
- Equalise pricing of greenhouse gas emissions across sources to contain carbon emissions and thereby promote green industry and jobs.

Towards a higher performing business sector

- Broaden the corporate tax base, lower the rate and eliminate special regimes for small and medium-sized enterprises.
- Continue to promote diversified financing sources for firms, revamp the licence and permits system and reduce regulatory fragmentation by implementing the market unity law.
- Reduce the number of professions requiring membership of a professional body and the cost of membership.

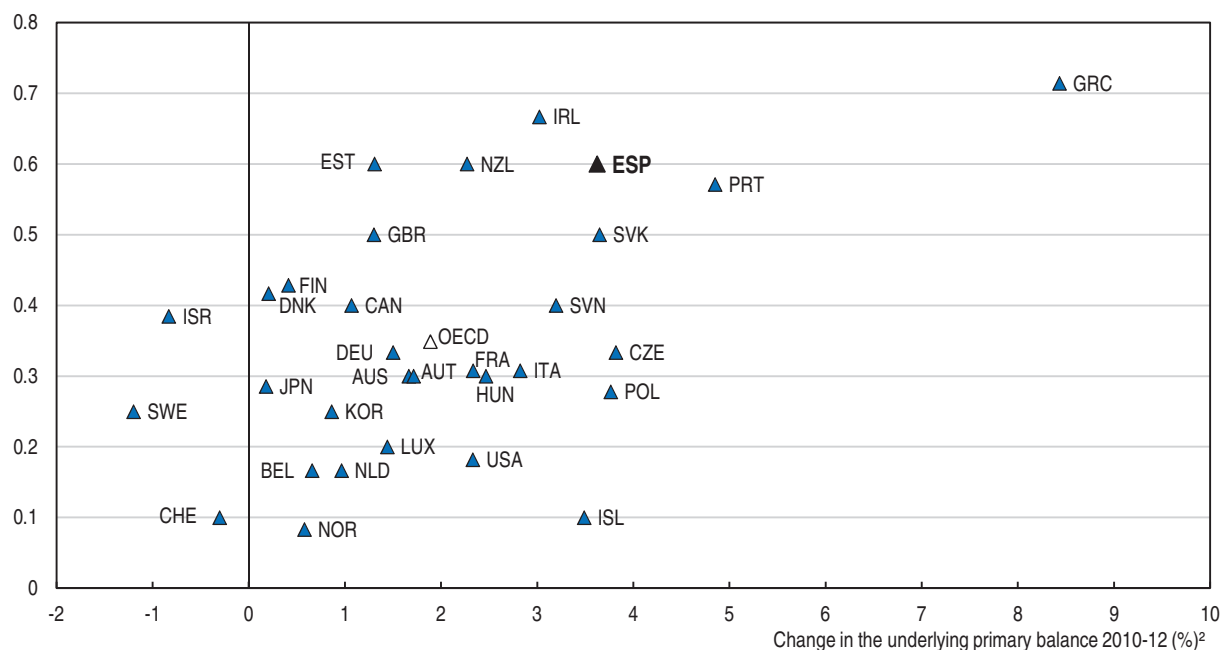
Assessment and recommendations

- *Macroeconomic performance and risks*
- *Fiscal policy*
- *The financial sector*
- *Sustainably boosting wellbeing, medium-term growth and jobs*
- *Business sector performance*

Following a long double-dip recession caused initially by large imbalances that the Spanish economy accumulated during the boom prior to the global financial crisis, and subsequently by banking and sovereign debt crises, economic growth turned positive at the end of 2013, unemployment has begun to decline and strong exports have significantly reduced the structural current account deficit. Decisive government actions have substantially improved the banking sector and the fiscal deficit is on a downward trajectory. The government introduced an impressive range of reforms to improve the labour market, enhance the fiscal framework, tackle long-standing education and housing issues, and improve the business environment (Figure 1; Annex). These reforms, together with a stronger commitment of euro area countries to solidify the common currency, have resulted in a dramatic fall in sovereign bond spreads.

Figure 1. **Fiscal consolidation and structural reform efforts**

Structural reform responsiveness rate, 2012-13¹



1. The reform responsiveness indicator is a measure of the extent to which countries have followed up on recommendations for structural reforms as given in past *Going for Growth* reports. It does not aim to assess overall reform intensity per se. The indicator is based on a scoring system in which recommendations set in the previous edition of *Going for Growth* take the value of one if "significant" action is taken and zero if not. A priority may entail more than one specific recommendation; the scoring is often based on more than one reform opportunity per priority. For more details see OECD (2010), *Economic Policy Reforms 2010: Going for Growth*.
2. Underlying government primary balance in per cent of potential GDP.

Source: OECD (2014), *Economic Policy Reforms 2014: Going for Growth Interim Report and Economic Outlook: Statistics and Projections* (database), July.

However, the economy remains fragile and the main economic policy challenge in the years ahead is to ensure strong and sustained growth of productivity and employment. The crisis has left a legacy of high public and private indebtedness as well as one of the highest unemployment rates in the OECD and increased inequality and poverty. To solidify the recovery and raise living standards, further measures are needed to boost competitiveness and growth and to ensure the fruits of the recovery are enjoyed by all. It is important to take into account the economic cycle when sequencing structural reforms. The first chapter of the *Survey* focuses on measures to increase medium-term growth, notably by reducing the large pool of unemployed, which is the best antidote to poverty and inequality, while the second chapter focuses on business sector performance.

Macroeconomic performance and risks

Recovery will be gradual and moderate

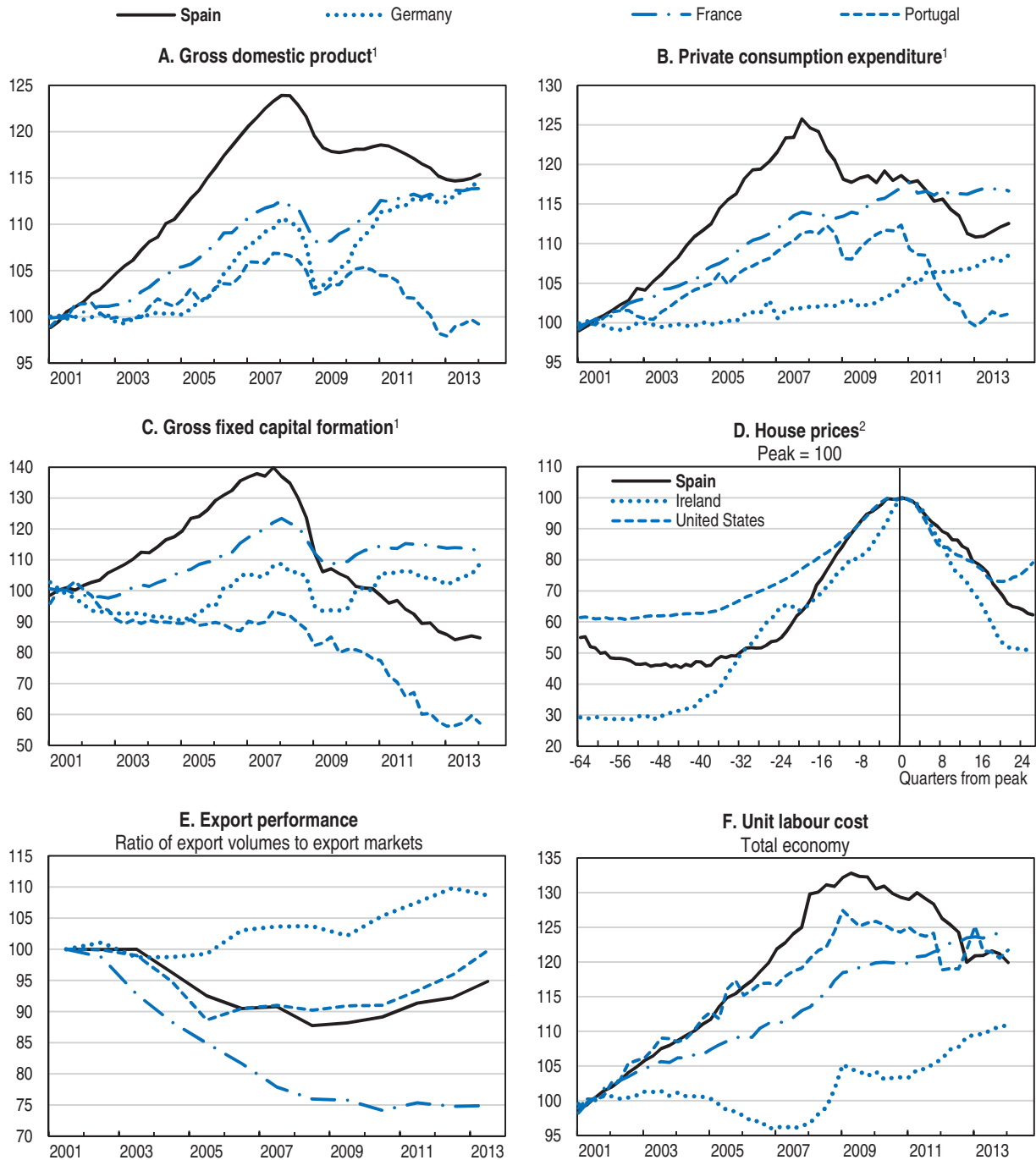
The Spanish economy returned to positive growth in the second half of 2013 (Figure 2, Panel A) on the back of a reduction of financial tensions, notably thanks to the announcement of outright monetary transactions (OMT) by the President of the European Central Bank (ECB), and the increase in confidence that followed the adoption of key reforms and measures in Spain from 2012 onwards. The turnaround in the economy has been led by exports (Figure 2, Panel E), with a gradual pick-up in consumption (Figure 2, Panel B) and a stabilisation in investment (Figure 2, Panel C). Unit labour costs have fallen (Figure 2, Panel F), reflecting high unemployment and wage moderation, and inflation is low.

The recovery is projected to gradually accelerate over the next two years with domestic demand making an increasing contribution (Table 1). The improving labour market and stronger confidence will aid private consumption, while better economic prospects and the strength of exports should boost investment. However, fiscal consolidation, private-sector deleveraging, and tight financing conditions will continue to restrain activity. The unemployment rate is projected to decline gradually, but will remain high. House prices have been falling for six years (Figure 2, Panel D) and may continue to fall on average, although at a moderating pace. Likewise, residential investment will decrease further but at a slower pace, reducing the drag on growth.

Some downside risks remain. Spain, and especially its banks, depends crucially on financial stability, which could be solidified by more decisive actions in Europe (OECD, 2014a). High public debt is an important source of vulnerability to potential renewed turmoil in sovereign debt markets. Given significant remaining slack in the economy, there is a risk of deflation. On the one hand low inflation helps competitiveness. On the other hand it makes deleveraging more difficult in case it is not accompanied by stronger real GDP growth. Lower growth in Spain's main trading partners would hurt exports and dampen the recovery. There are also upside risks including better financing conditions, which would boost investment further, and the improving labour market, which could support a stronger rebound in consumption. House prices may not fall as much as assumed, which would help to sustain consumption and preserve the quality of banking assets. Recent structural reforms may boost activity more than anticipated. A more supportive monetary policy and progress towards banking union would reduce fragmentation and improve monetary policy transmission.

Figure 2. **Macro indicators**

Index, 2001 = 100



1. Volume.

2. Real house prices seasonally adjusted. The peak occurs in Q1 2007 for Ireland, Q3 2007 for Spain and Q4 2006 for the United States. Source: OECD (2014), OECD Economic Outlook: Statistics and Projections (database) and Housing Prices Database, July.

Table 1. Macroeconomic indicators and projections

Annual percentage change, volume (2005 prices)

	2010 Current prices (billion EUR)	2011	2012	2013	2014	2015
Gross domestic product (GDP)	1 046	0.1	-1.6	-1.2	1.2	1.6
Private consumption	605	-1.2	-2.8	-2.1	2.1	1.8
Government consumption	225	-0.5	-4.8	-2.3	-0.3	-1.5
Gross fixed capital formation	232	-5.4	-7.0	-5.1	0.6	2.9
Housing	76	-12.5	-8.7	-8.0	-4.1	-1.0
Final domestic demand	1 062	-2.0	-4.1	-2.7	1.3	1.3
Stockbuilding ¹	6	-0.1	0.0	0.0	0.0	0.0
Total domestic demand	1 068	-2.0	-4.1	-2.7	1.4	1.3
Exports of goods and services	286	7.6	2.1	4.9	3.7	5.9
Imports of goods and services	309	-0.1	-5.7	0.4	4.3	5.2
Net exports ¹	-23	2.1	2.5	1.5	-0.1	0.4
Other indicators (growth rates, unless specified)						
Potential GDP	..	0.2	0.1	0.3	0.7	1.1
Output gap ²	..	-2.4	-4.1	-5.6	-5.1	-4.6
Employment	..	-1.6	-4.3	-2.8	0.8	1.1
Unemployment rate	..	21.4	24.8	26.1	24.6	23.6
GDP deflator	..	0.0	0.0	0.6	0.0	0.5
Consumer price index (harmonised)	..	3.1	2.4	1.5	0.1	0.5
Core consumer prices (harmonised)	..	1.2	1.3	1.3	0.1	0.5
Household saving ratio, net ³	..	6.8	4.4	4.7	4.4	4.5
Trade balance ⁴	..	-9.8	-36.0	-58.1
Current account balance ⁴	..	-3.7	-1.2	0.8	0.6	0.7
General government fiscal balance ⁴	..	-9.6	-10.6	-7.1	-5.5	-4.5
Underlying general government fiscal balance ²	..	-7.9	-5.4	-4.5	-4.2	-3.5
Underlying government primary fiscal balance ²	..	-5.9	-3.0	-1.7	-1.2	-0.4
General government gross debt (Maastricht) ⁴	..	70.5	86.0	93.9	98.4	101.4
General government net debt ⁴	..	48.2	59.6	67.0	71.7	74.7
Three-month money market rate, average	..	1.4	0.6	0.2	0.2	0.1
Ten-year government bond yield, average	..	5.4	5.8	4.6	3.3	3.3

1. Contribution to changes in real GDP.

2. As a percentage of potential GDP.

3. As a percentage of household disposable income.

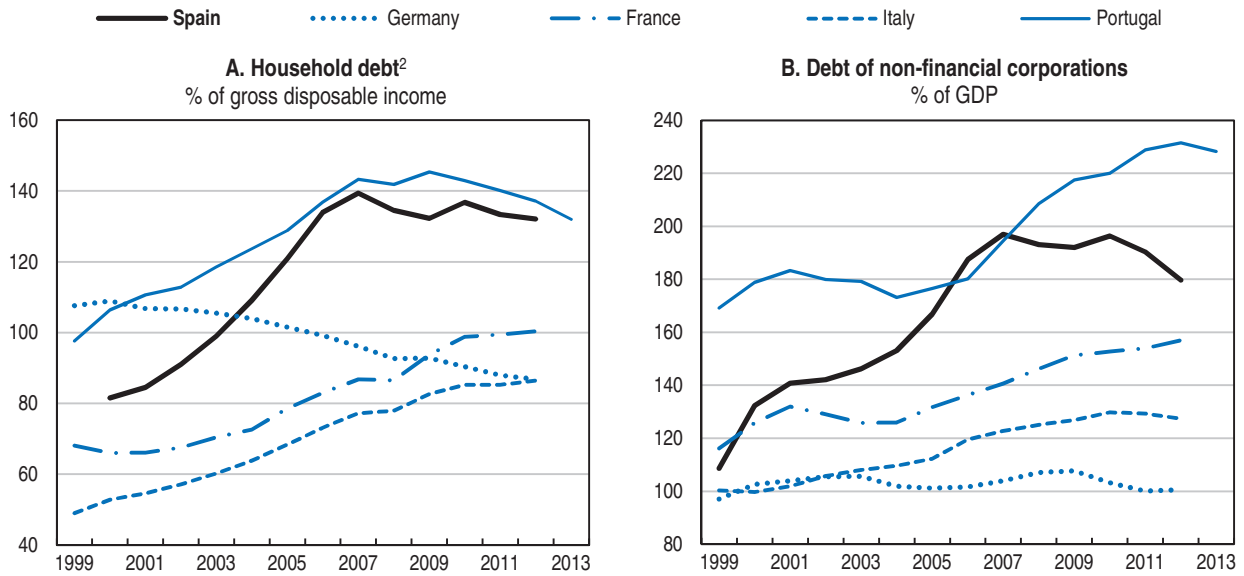
4. As a percentage of GDP.

Source: OECD (2014), *OECD Economic Outlook*, No. 95, Vol. 2014/1, updated and INE (2014), "Contabilidad nacional de España", INEbase, Instituto Nacional de Estadística.

Helping the private sector to reduce its indebtedness

Households' and firms' debt levels are declining but are still high (Figure 3). Firms are more heavily indebted, relative to earnings, than in most European countries (Figure 4). To reinforce the economic recovery and clean-up bank balance sheets, which are burdened by non-performing loans, greater action is needed to rehabilitate viable firms and close down unviable ones. Efficient insolvency and debt restructuring procedures could facilitate deleveraging and reduce its drag on growth. Spanish insolvency law had been complex and long (Mora-Sanguinetti and Fuentes, 2012). The government has recently reviewed corporate insolvency procedures to make it easier to get prior agreements on write-offs, maturity extensions and debt-for-equity swaps. These changes go in the right direction, especially for larger companies, but their effectiveness remains to be tested and more could be done to make them more effective, particularly concerning liabilities with tax and social security authorities, which account for a very significant part of the debt. Clear guidelines for the participation of both authorities in the restructuring process should be established.

Figure 3. Debt reduction¹



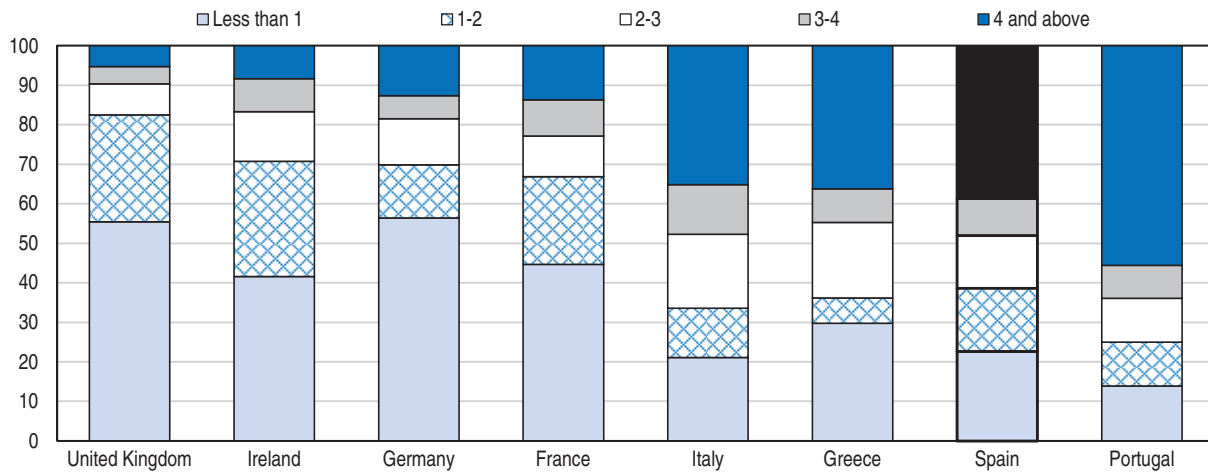
1. Debt is calculated as the sum of the following liability categories, whenever available/applicable: currency and deposits, securities other than shares (except financial derivatives), loans, insurance technical reserves and other accounts payable.
2. Including non-profit institutions serving households.

Source: OECD (2014), "Financial Dashboard", OECD National Accounts Statistics (database), July.

StatLink <http://dx.doi.org/10.1787/888933127947>

Figure 4. Debt-to-earnings ratio of firms

Per cent of firms with various debt-to-earnings ratios¹



1. Earnings before interest, taxes, depreciation and amortisation. Data for Greece, Ireland and Portugal covers a limited number of firms compared to the other countries.

Source: RBS (2014), "The Revolver", Royal Bank of Scotland, 22 May.

Given the limited capacity of the judicial system, promoting and facilitating voluntary out-of-court restructurings for corporate debt could provide a cost-effective alternative to court supervised proceedings. New out-of-court pre-insolvency payment procedures (*acuerdo extrajudicial de pagos*) have been introduced for small and medium-sized enterprises (SMEs). Their use could be further encouraged by permitting

the debt haircut to go above the current 25% maximum and the payment moratorium beyond the current three year maximum. Its effectiveness would also be increased by permitting outstanding debt with tax and social security authorities to be subject to a haircut.

The government has put in place a voluntary mechanism that allows banks to use out-of-court workouts for residential mortgage debtors, the so called “Code of Good Practices”. This code aims at avoiding hardship to the most vulnerable households facing unsustainable debt. However, the code does not allow individuals to fully discharge their obligations as they can in other European Union (EU) countries. Other existing alternatives are too narrow in scope and too stringent in their requirements to be broadly used or to have a significant impact. A new simplified personal insolvency procedure, allowing for a “fresh start”, under well-defined conditions, would provide a clear institutional framework for loss recognition and would support individuals’ efforts to reduce their debt. It would make the process of recognition of losses that would eventually occur anyway shorter, more predictable and less costly.

The stock of credit is still falling

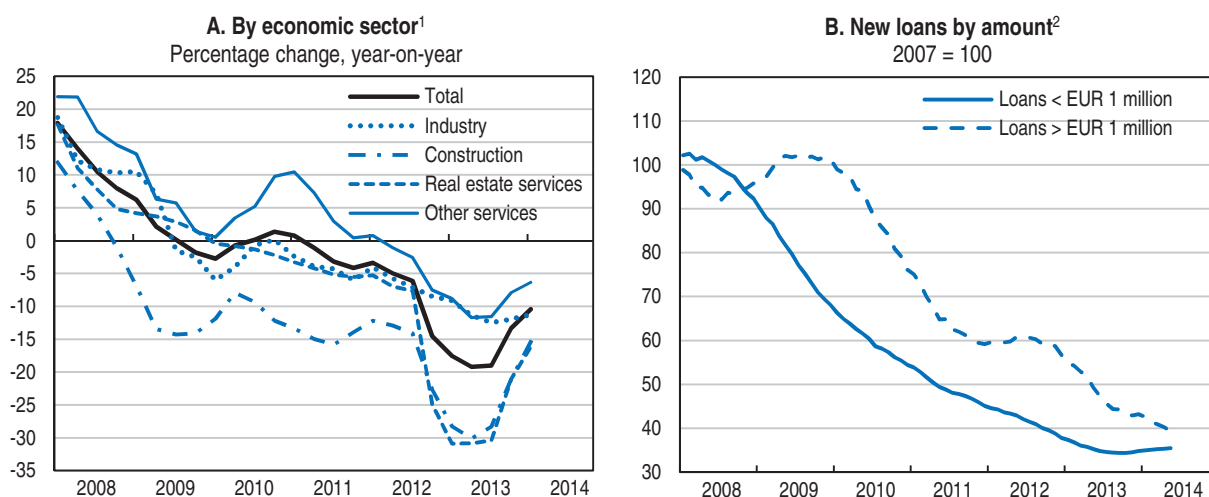
With the onset of the crisis, credit to firms began to contract (Figure 5, Panel A), affecting all economic sectors and both large and small firms. Borrowing demand fell as output contracted and has remained weak as firms and households have been reducing their indebtedness. Despite progress, this process is not yet complete, and is expected to affect demand for credit in the years ahead. On the supply side, some financial institutions have had difficulties attracting funds for credit and some have failed. Moreover, a still large portfolio of non-performing loans limits banks’ appetite for more lending. Firms suffering from loan supply restrictions were unable to completely offset them by turning to other banks (Jiménez et al., 2012). Indeed, firms whose credit came from weaker banks suffered additional employment drops of between 3 and 13.5 percentage points (Bentolila et al., 2013). The cost of borrowing remains high, especially for smaller loans predominately used by SMEs (Figure 6). In recent months, the fall in the stock of credit has been accompanied by positive year-on-year growth rates in new loans of less than EUR 1 million (Figure 5, Panel B) and lending to households (both real estate and consumer financing). This may be an indication that new lending may be turning up, although Spanish statistics on new loans include also loans whose terms and conditions have changed and available data do not allow for an estimation of how much of the new lending could be linked to ever-greening effects.

The current account moved to surplus but the stock of accumulated imbalances remains large

The current account balance moved from a 10% of GDP deficit in 2007 to a 0.8% of GDP surplus in 2013 (Figure 7, Panel A). Estimates suggest that around five percentage points of this shift is structural (La Caixa, 2014; BBVA, 2013), mainly reflecting good export performance. The remainder is attributable to temporarily weaker domestic demand, so as the economy recovers the current account deficit will re-appear, suggesting the need for further competitiveness improvements to stabilise external debt (see below).

In response to the crisis and the fall in domestic demand, Spanish firms have intensified their internationalisation efforts. The total number of Spanish exporters has increased but exports remain highly concentrated in a small number of firms. Lifting

Figure 5. **Lending to non-financial corporations**

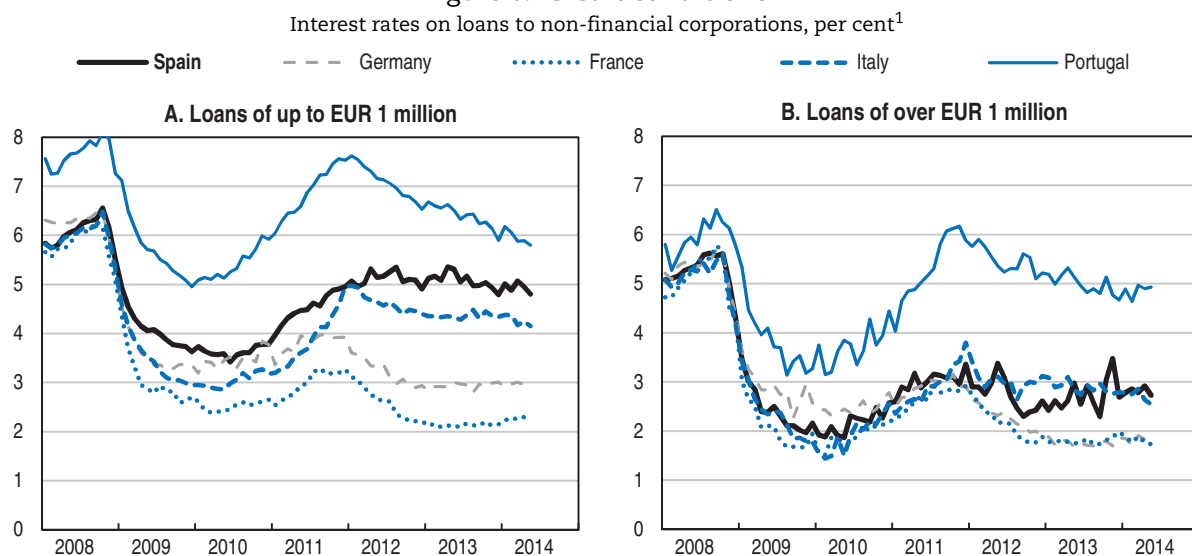


1. Lending by credit institutions to finance productive activities.

2. Twelve-month moving average.

Source: Banco de España (2013), *Boletín Económico*, October and (2014), *Boletín Estadístico* (database), July.

Figure 6. **Credit conditions**



1. Narrowly defined effective rates (NDER) for operations with an initial rate fixation period of less than one year.

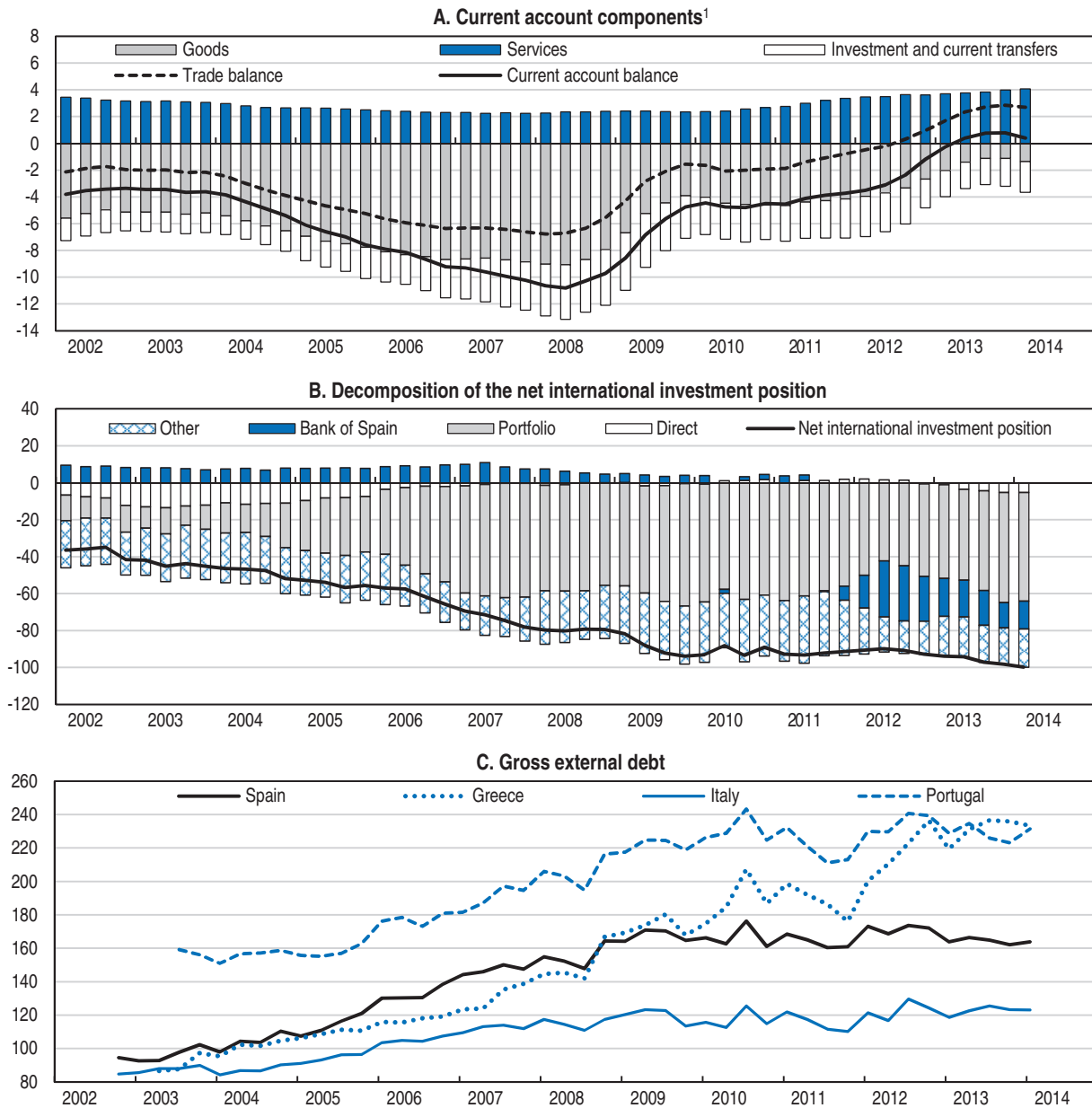
Source: ECB (2014), "MFI Interest Rates", *Statistical Data Warehouse*, European Central Bank, July.

business innovation rates (discussed below) would help to boost the number of exporting firms as innovation has a positive effect on the probability of participation in export markets (Caldera, 2010). It would also contribute to increase the technology content of exports, which is low in comparison with other advanced European countries.

The large past current account deficits left the negative net international investment position at close to 100% of GDP at end-2013 (Figure 7, Panel B). This position takes mainly the form of net portfolio investment liabilities but also liabilities resulting from Spanish banks' reliance on ECB financing. In terms of composition, most of the liabilities take the

Figure 7. **External imbalances**

Per cent of GDP



1. Balance of payments basis, four-quarter moving average.

Source: Banco de España (2014), *Boletín Económico* and *Boletín Estadístico* (databases), July and World Bank (2014), "Quarterly External Debt Statistics/SDDS", *World DataBank*, July.

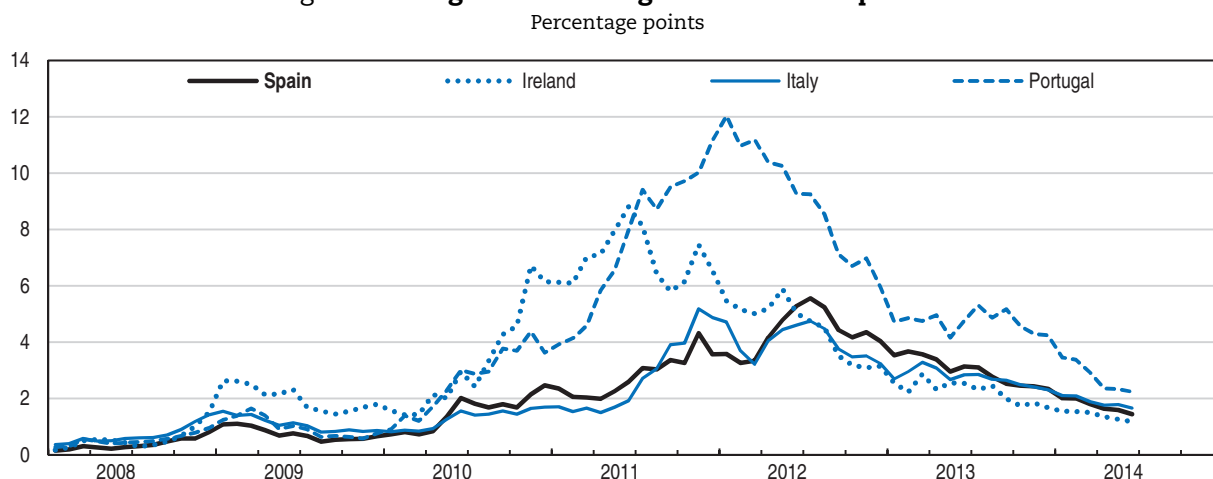
form of loans and bonds, which reflects a debt bias in the corporate sector and increases vulnerability to external shocks. Further improvement in the current account balance will be needed to put external debt on a firmly declining path: assuming nominal potential growth at about 3%, the structural current account deficit should not be bigger than 3% to stabilise debt at 100% of GDP, requiring either a permanent reduction of domestic absorption or further strengthening of competitiveness.

Fiscal policy

Medium-term fiscal sustainability is improving

Sovereign spreads have fallen significantly since July 2012 to levels not seen since May 2010, allowing Spain to service its debt at declining costs (Figure 8). The budget deficit was 6.6% of GDP in 2013 (Figure 9), excluding support to the financial sector, marginally above the excessive deficit procedure (EDP) target and 0.2% below the 2012 deficit. The consolidation effort was frontloaded in 2012-13, when measures were adopted amounting to 7.5% of GDP (53% on the expenditure side). Fiscal consolidation will continue in 2014 and 2015 (Table 2), when, according to government fiscal plans, the deficit is projected to fall to 5.5% and 4.2% of GDP respectively. The fiscal strategy set-up in the latest Stability program aims at bringing the fiscal deficit below 3% of GDP in 2016 and to reach the medium-term objective of a balanced budgetary position in structural terms in 2017.

Figure 8. Long-term sovereign interest rate spreads¹

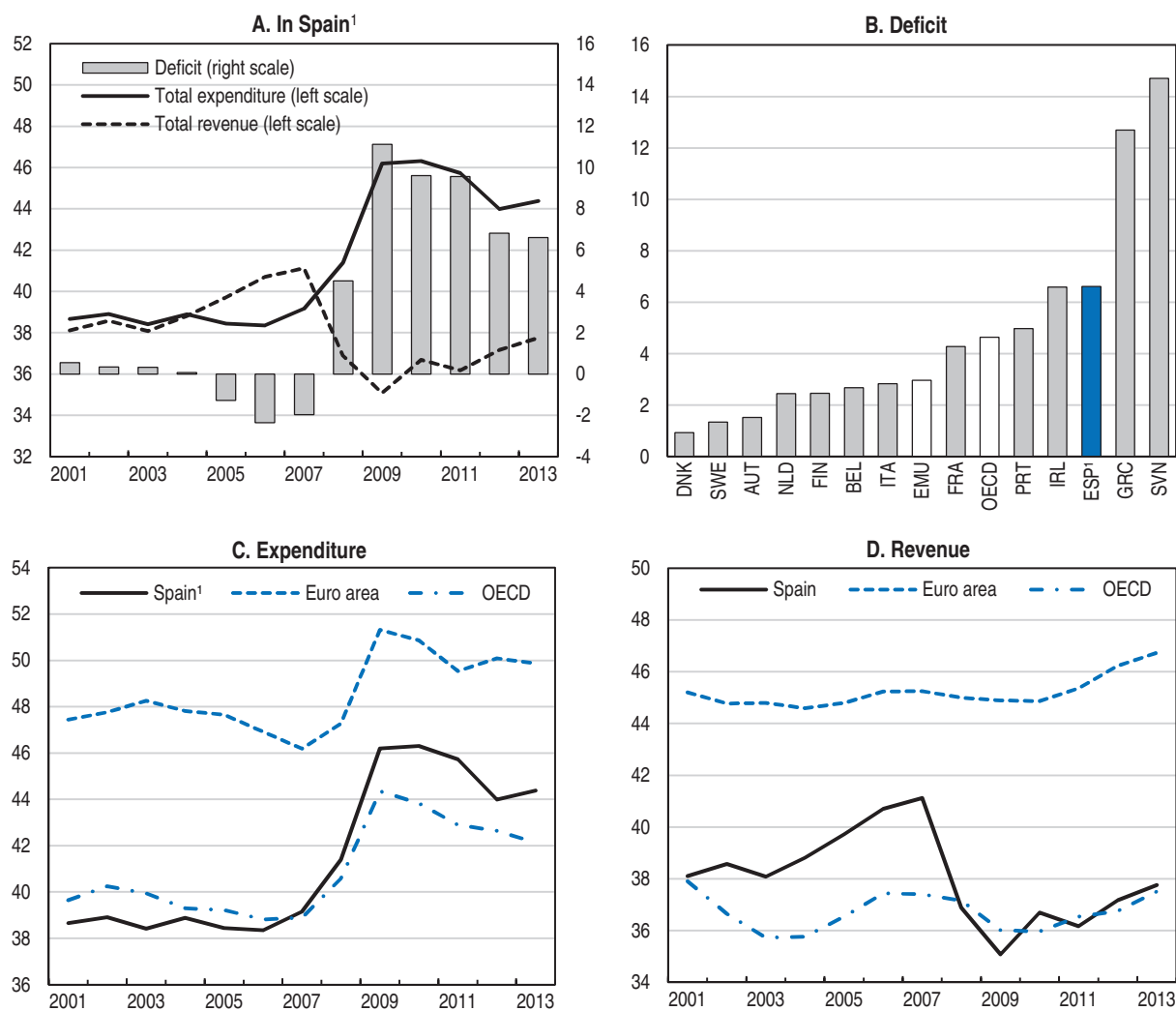


1. Ten-year national currency-denominated government bond spreads relative to the German rate.
Source: OECD (2014), *Main Economic Indicators* (database), July.

The fiscal framework has been progressively enhanced over the past few years with the introduction of new budget rules, including stricter control of regional government budget policies and new requirements on the publication of regional government budget outcomes, which should facilitate consistency between regional and central budget achievement and European requirements. Finally the Independent Authority for Fiscal Responsibility (AIReF) was established in November 2013. AIReF, which is not yet operational, has a broad remit. It will monitor sub-national level governments and analyse a very broad range of fiscal related issues including the sustainability of the pension system. It will play a critical role in ensuring fiscal sustainability and credibility in Spain by monitoring whether central, regional, municipal governments and the social security system are complying with fiscal rules. AIReF will issue “comply or explain” rulings, which the central government will enforce with the regions, and the regions will enforce with the municipalities.

Figure 9. **Fiscal situation**

Per cent of GDP



1. Excluding bank recapitalisation of 3.8% in 2012 and 0.46% in 2013.

Source: OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), July.

Table 2. **Medium-term fiscal plan**

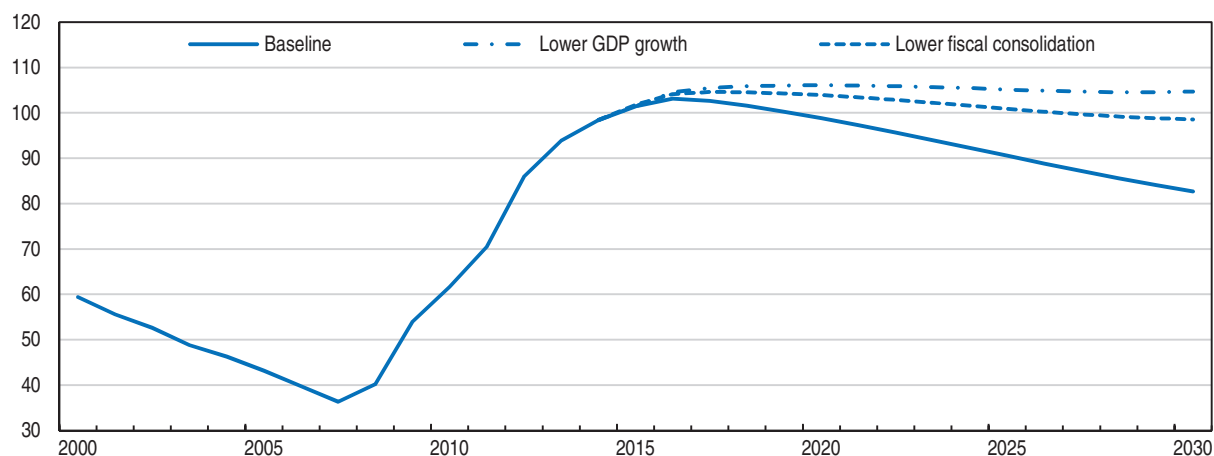
Per cent of GDP

	2014	2015	2016	2017
General government financial balance	-5.5	-4.2	-2.8	-1.1
Central government	-3.5	-2.9	-2.2	-1.1
Autonomous regions	-1.0	-0.7	-0.3	0.0
Local government	0.0	0.0	0.0	0.0
Social security administration	-1.0	-0.6	-0.3	0.0

Source: Government of Spain (2014), *Actualización del Programa de Estabilidad 2014-17* (Stability Programme Update).

The still high fiscal deficits will push public debt over 100% of GDP in 2015. Under the assumptions of fiscal consolidation continuing up to equilibrium of the cyclically-adjusted fiscal balance by 2017, as specified in government medium-term fiscal plans, and of a quick pick-up in real GDP, debt would decline gradually (Figure 10). However, weaker growth or less fiscal consolidation could result in a rising debt-to-GDP ratio. This highlights that it is critical to adhere to the medium-term fiscal plan up to the equilibrium of the cyclically-adjusted fiscal balance. In the same vein, the planned neutral fiscal reform (see below) should be implemented carefully as it is difficult to rely entirely on expenditure cuts for fiscal consolidation; and some caution is required in the implementation of the tax shift since losses following tax cuts could be bigger than expected, while new revenues could surprise on the downside. If growth turns out temporarily weaker than anticipated, the automatic stabilisers should be allowed to operate to avoid hurting growth in the short-term, but the consolidation measures need to be implemented to avoid more costly adjustments in the future.

Figure 10. **Illustrative public debt paths**¹
General government debt, Maastricht definition, per cent of GDP



1. The baseline consists of the projections for the *Economic Outlook No. 95* until 2015 and a strong cyclical pick-up afterwards, with real GDP growth averaging 2.2% and inflation 1.8% in the period 2016-30. It assumes government fiscal consolidation plans up to 2017, according to which the excessive deficit would be corrected by 2016 and the medium-term objective of a balanced budgetary position in structural terms reached in 2017. From 2017 onwards a neutral fiscal stance (constant structural primary budget balance) is assumed. The “lower GDP growth” scenario assumes lower nominal GDP growth by 1.5 percentage points per year over the period. The “lower fiscal consolidation” scenario assumes that fiscal consolidation is 1% of GDP lower spread over 2015-17.

Source: OECD calculations based on OECD (2014), *OECD Economic Outlook No. 95*, *OECD Economic Outlook: Statistics and Projections* (database).

The central government also has contingent liabilities amounting to EUR 83.6 billion (8.3% of GDP, Table 3). The more important sources of contingent liabilities have been guarantees associated with bank recapitalisation. The new regulation to allow deferred tax assets to become state-backed tax credits that banks can count as core capital (Banco de España, 2013) could also originate additional contingent liabilities of up to EUR 30 billion.

Significant liabilities have also originated from the so-called electricity tariff deficit. The electricity tariff deficit is the gap between the regulated access tariffs paid by consumers and system costs (including distribution costs and subsidies for renewable energy production). Costs escalated since the mid-2000s due to incorrect demand projections and high investment in renewables, which enjoyed the largest support in

Table 3. **Contingent liabilities**

31 March 2014

	Billion EUR	% of GDP
Asset management company (SAREB) guarantees	48.4	4.7
Guarantees on account of bonds issued by credit institutions	32.9	3.2
Programme to issue bonds backed by loans to small and medium-sized enterprises (FTPYMES)	1.7	0.2
Other non-classified guarantees	0.6	0.1
Total	83.6	8.0
<i>Other contingent liabilities already recognised as public debt</i>		
European financial stability facility (EFSF) guarantees	34.7	3.3
Programme to securitise the electricity-tariff deficit (FADE)	22.5	2.2
Banking bailout fund (FROB)	5.8	0.6

Source: Government of Spain (2013), *Actualización del Programa de Estabilidad 2014-17* (Stability Programme Update).

Europe (CEER, 2013), resulting in a large excess capacity in international comparison. Consequently, the cumulated tariff deficit up to 2012 is around EUR 27 billion (3% of GDP), which is guaranteed by the government via a fund.

The government introduced several measures in the electricity sector in 2012 and 2013 to prevent further debt accumulation but a gap between revenues and costs persisted, resulting in a EUR 3.1 billion deficit in 2013. Parliament passed legislation at the end of 2013 with the aim of achieving the long-term financial stability of the electricity system by reducing regulated costs associated with renewables, among other measures. This included setting a limit to temporary gaps between costs and revenues in a given fiscal year, and an obligation to increase fees automatically to keep the system balanced. No new costs can be introduced into the electric power system without an equivalent revenue increase or cost reduction, and 2013's deficit will be passed on to electricity prices over a 15-year span. System costs, such as the remuneration of transmission and distribution activities, capacity payments, and subsidies for renewable energies were reviewed. A new methodology for setting electricity prices for domestic consumers was introduced, under which the price will no longer be determined *ex ante* in a quarterly electricity auction but instead will reflect *ex post* the average wholesale market price. For a successful outcome of the reform, the rule "no new cost without a revenue increase" should be strictly enforced. The regulator should apply transparent cost models in determining prices that need to be regulated in the electricity system such as for using the grid. Standards and compensation schemes should be regularly monitored and reviewed to ensure consistency with market conditions and the economic situation.

The debt of state owned enterprises (SOEs), encompassing all levels of the administration, not included in public debt has also increased since the onset of the crisis. It amounted to EUR 51 billion (5% of GDP) at end-2013, against 3.1% of GDP in 2007. The rail traffic infrastructure administrator (ADIF) and the airports operator (AENA) have accumulated large debts (Table 4). ADIF's large debt reflects to a major extent the significant investment undertaken in high-speed railway lines to address previous infrastructure deficits. In the case of AENA its debt grew markedly due to the construction of new airport terminals in Madrid and Barcelona. New infrastructure projects need to be assessed in a more transparent way and be based on more robust cost-benefit analysis to avoid further over-investment. The government plans to set up an independent advisory body with that aim, which is welcome.

Table 4. **Performance of state-owned enterprises**

	Debt (2013)		Profit (million EUR, forecast for 2014)
	Million EUR	% of GDP	
From central government	35 199	3.4	..
ADIF – Railway infrastructure	11 844	1.2	-297
AENA – Airports	11 728	1.1	436
SEPI – Industrial shareholding	149	0.0	245
RENFE – Railway	4 927	0.5	-202
Other	6 551	0.6	..
From autonomous regions	9 004	0.9	..
From local corporations	7 407	0.7	..
TOTAL	51 610	5.0	1 894

Source: Bank of Spain and Ministerio de Hacienda y Administraciones Públicas (2014), *Presupuestos Generales del Estado 2014* (State Budget).

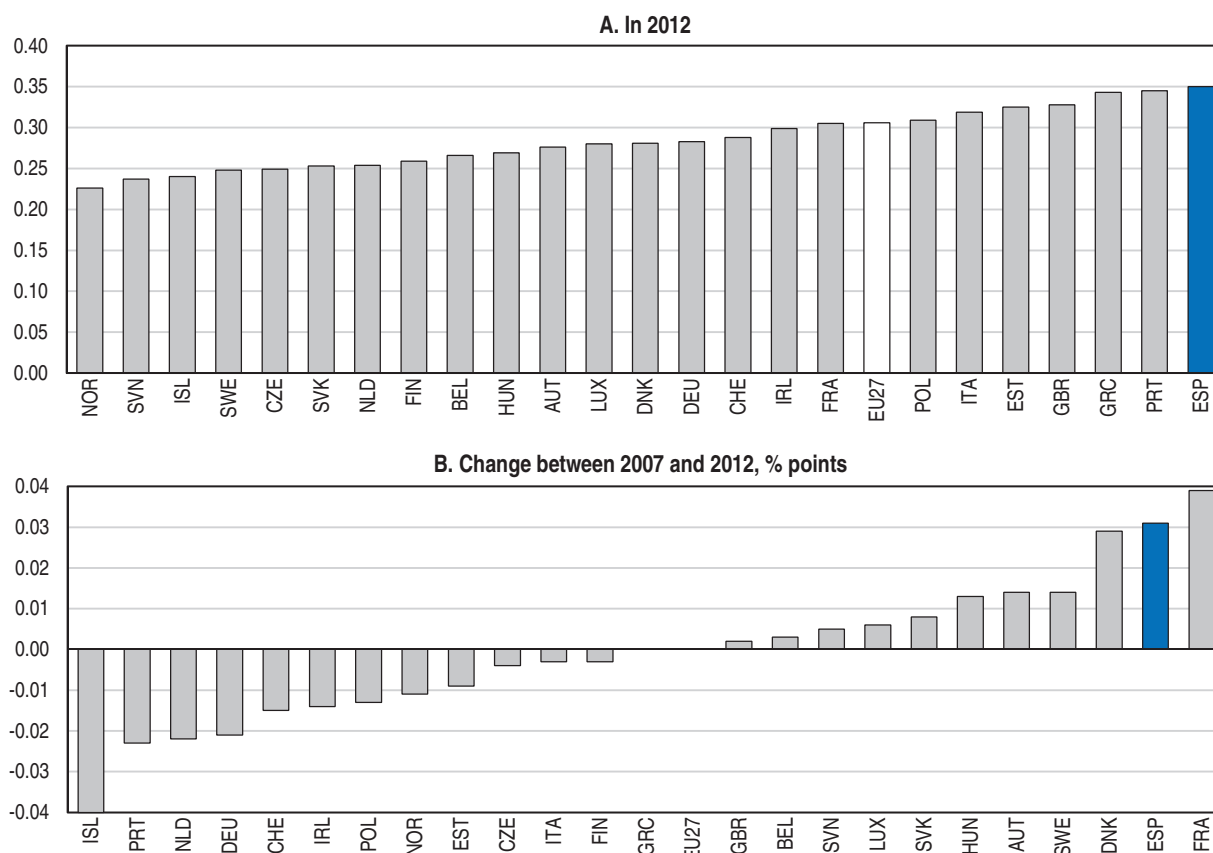
Significant progress has also been made recently in improving the operational performance and viability of most SOEs. AENA recorded profits for the first time in 2013, and profits are also expected for 2014, thanks to a reduction of routes to low-traffic airports, a staff reduction and increasing efficiency in its commercial activities. Efforts to improve AENA's operational performance should continue, including by adapting regional airport costs to the current level of demand and by improving slot coordination. Ultimately this may require either boosting traffic or severely reducing operations at those regional airports that remain unprofitable. ADIF has been split into two companies, one responsible for the high speed network ("ADIF high speed") and the other for the routes used by conventional services. The creation of a separate high speed company is expected to improve efficiency as passenger services are opened to competition, and it also complies with new EU accounting regulations that are due to be implemented as of September 2014. Taking on debt relating to the construction of high speed lines, ADIF high speed will be responsible for new projects, deriving its funding mainly from access charges. The company responsible for conventional services (i.e. non-high speed ones) has already being integrated in general government accounts. This will provide a more transparent subsidisation of government services and it is preferable to continuing to build up off balance sheet liabilities.

Before the crisis, Spain was the second largest user of public-private partnerships (PPP) in Europe, after the United Kingdom (Kappeler and Nemoz, 2010). Payment obligations derived from those PPP contracts have to a large extent been recognised in public debt, with the exception of private concessions. The largest private concessions are those granted to build and operate the so-called radial toll roads. Private companies with concessions for those roads enjoy public guarantees of a maximum of EUR 2.4 billion that would be executed if they were liquidated. Higher than foreseen expropriation costs and lower than estimated traffic make this a real possibility. An observatory for transport and logistics has already been created as a tool to better diagnose the sector. Its first report was published in February. The framework for the design of private concessions needs to be further reinforced, including by involving the independent infrastructure advisory body in its cost-benefit analysis and allowing it to vet proposals. Similar arrangements are common in other OECD countries (OECD, 2012a), whose finance ministries have units specialised on PPP contracts with veto power.

Fiscal consolidation, inequality and growth

The sustainability of fiscal consolidation will also depend on political support. For this, it is crucial that the burden of fiscal consolidation is considered to be fairly spread. The transfer and tax system in Spain significantly reduces both inequality and poverty (OECD, 2014b) and from 2008 to 2012 fiscal consolidation appears to have been progressive with a higher burden falling on higher incomes (IMF, 2014). In a context of tight fiscal constraints total spending on social protection increased from 59.1% of total expenditure in 2007 to 64.5% in 2012. Strongly related to the rise in unemployment, there was a large increase in inequality between 2007 and 2012 to the highest level in the European Union (Figure 11), before starting to fall in 2013. Relative poverty (the share of people with less than half the median income) rose to one of the higher rates in the OECD. However, according to Eurostat data, the number of people at risk of poverty fell by around half a million between 2012 and 2013 (Eurostat, 2014). As in many countries, pensions were not cut in order to protect the incomes of lower income elderly leading to a fall in relative poverty in this group (OECD, 2014b). The crisis also resulted in one of the largest increases in the OECD in the “anchored” poverty rate (where income is benchmarked against half real median incomes in 2005) (Figure 12).

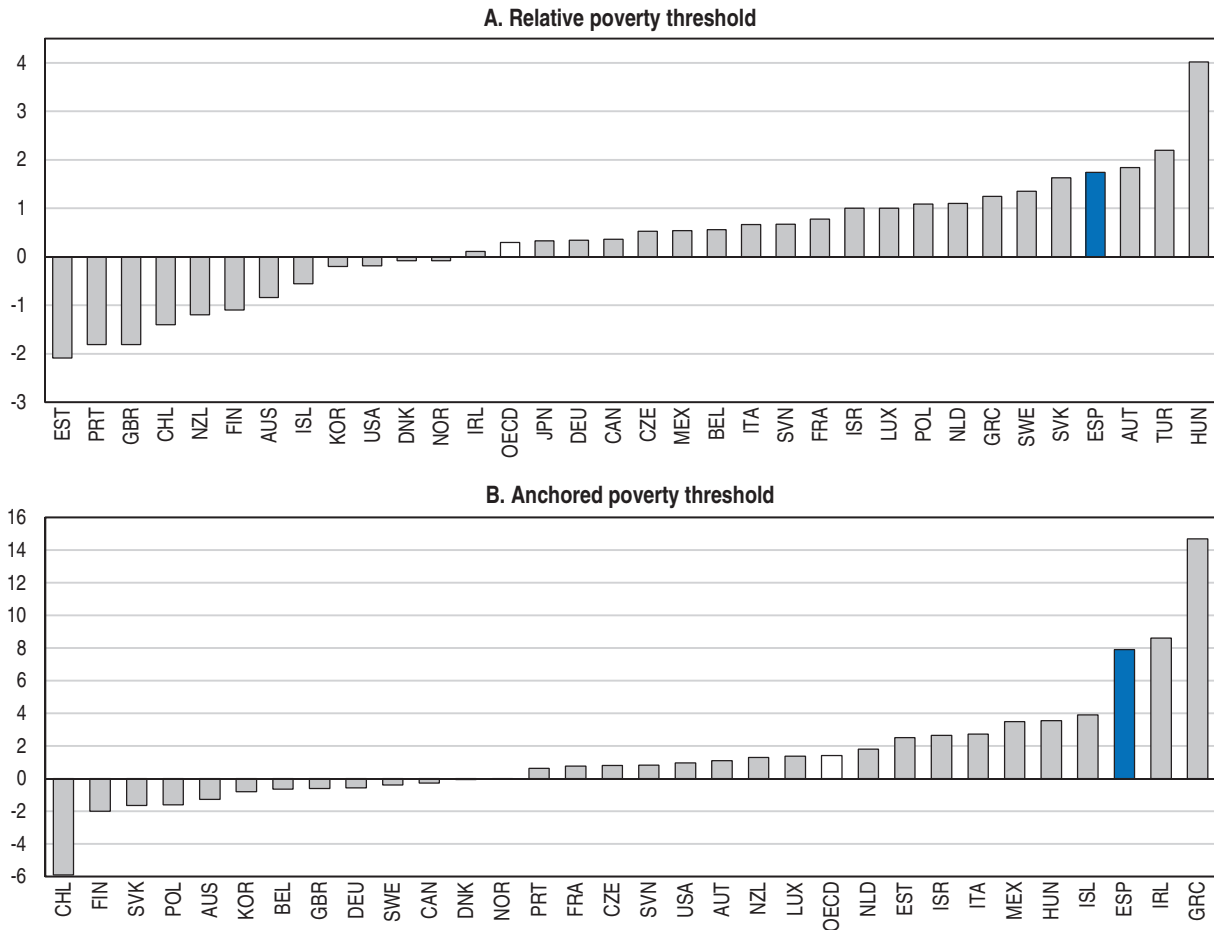
Figure 11. **Inequality: Gini coefficient of household disposable income¹**



1. 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. Disposable income is obtained by subtracting income tax and employees' social security contributions from gross income and is adjusted to reflect differences in household needs depending on the number of persons in the household.

Source: Eurostat (2014), "Income Distribution and Monetary Poverty", Eurostat Database, July.

Figure 12. **Poverty rates**¹
Percentage point change between 2007 and 2011



1. Relative income poverty is the share of people living with less than 50% of the median equivalised household disposable income. The “anchored” poverty rate is a benchmark “anchored” to half the median real incomes observed in 2005 (i.e. keeping constant the value of the 2005 poverty line).

Source: OECD (2014), *OECD Income Distribution Database*, June, www.oecd.org/social/income-distribution-database.htm.

How to read this figure: People are classified as poor when their equivalised household disposable income is less than 50% of the median household disposable income prevailing in each country, which is why this poverty concept is considered as “relative”. Changes in relative poverty can be difficult to interpret during recessions as the current median income is usually going down, which could hide an increase in absolute poverty. To take this into account, more “absolute” poverty indices, linked to past living standards, are needed to complement the picture provided by relative income poverty. Therefore changes in poverty are presented in this figure using an indicator which measures poverty against a benchmark “anchored” to half the median real incomes observed in 2005. While relative poverty has increased in Spain, poverty defined as an absolute level has increased even more.

Fiscal measures often involve trade-offs between growth and equity. The government has introduced a national action plan for social inclusion with a budget of EUR 1.4 billion for the period 2013-16. Consolidation measures for 2015 and beyond should be chosen carefully to minimise as much as possible harm to both growth and equity (Cournede et al., 2013). Spending cuts in education and health tend to reduce both equity and growth, and the focus here should therefore be on improving efficiency, and not reducing services (Cournède et al., 2013). International benchmarking shows that Spain’s health care sector is relatively efficient (Journard et al., 2010) although measures that can lower costs without comprising quality such as substituting branded pharmaceuticals with generics should be

pursued. Potential savings from moving all schools towards the efficiency frontier are significant (Sutherland et al., 2007). Continuing to ensure access to education and health services for lower-income groups should remain a priority for improving equity and can be achieved in a budget neutral way by greater use of means testing (IMF, 2014).

The reform of the Spanish Public Administrations (CORA, 2013), has the potential to both increase public-sector efficiency and reinforce public trust in government institutions (OECD, 2014c), which has deteriorated (Eurobarometer, 2013). The benefits in terms of greater efficiencies and improved services will depend on full implementation of the reforms.

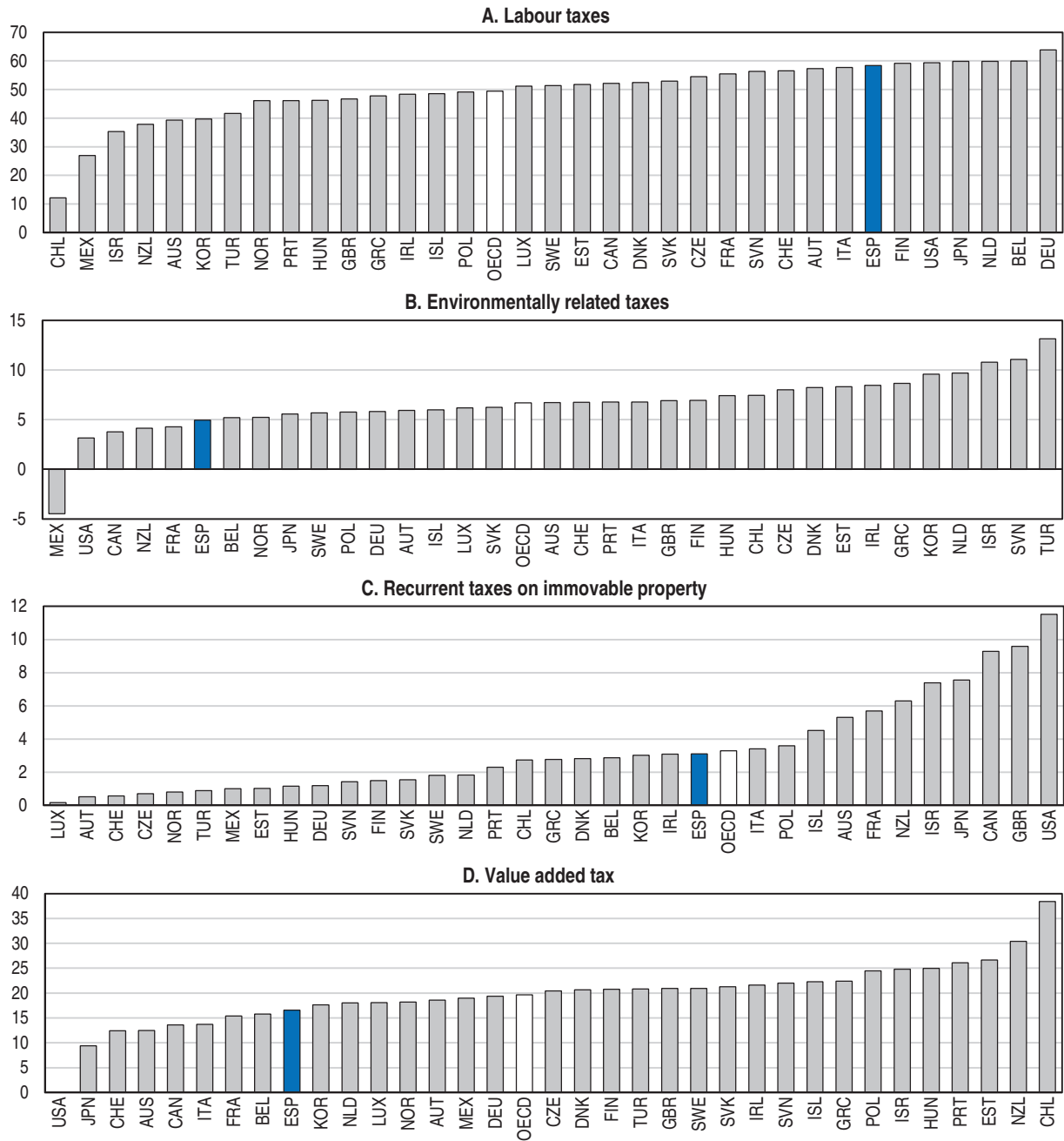
Reducing inequality also requires policies to improve the labour market and to get the unemployed back into work as well as to improve access to education and lower the secondary school drop-out rate of children from low-income households. The European Union Income and Living Conditions survey shows that the dropout rate for the poorest household income quintile was more than three times larger (35%) than for the highest income quintile (10%) in 2010.

Tax reform to boost growth and employment

Tax reform is a major part of the government's 2014 reform programme. A Fiscal Experts Commission reported in March on a comprehensive revenue-neutral tax reform, when totally implemented. The report's main thrust to broaden tax bases and rebalance taxation from labour to indirect taxes is in line with previous OECD advice. The government released a proposal in June that focuses on personal and corporate income taxes at this stage. The government considers that the reduction in the tax burden will have a cost in terms of revenue of a magnitude similar to that included in the Stability Programme (around 0.6% of GDP till 2016) and an expansionary impact on activity in the coming years that will offset part of the forgone revenue that the lower taxes will entail (Banco de España, 2014). The main components of the government proposal are a cut in both income and corporate tax rates to be implemented in 2015 and 2016. For personal income the proposal involves reducing the number of brackets and rates, with a focus on reducing taxation on the lower-income, as well as increasing tax benefits for large families and households with disabled members. On the corporate side, the measures involve broadening the base, eliminating tax credits, reducing the standard corporate tax rates and eliminating the preferential rate for SMEs. It also introduces a deduction in the tax base for earnings retained for at least five years to reduce debt bias. Overall, this reform goes in the right direction to boost labour supply and investment.

However, more could be done to prioritise employment, while maintaining a fair distribution of the tax burden. Revenue currently depends heavily on labour taxes (Figure 13), which are less growth and employment friendly than indirect taxes (Arnold, 2008). In March 2014, the government introduced a cut in employer social security contributions to a flat rate of EUR 100 per month for two years on all permanent contracts signed until the end of the year. While the tax has been reduced across the board, the flat rate is regressive and is highest on the low-paid. In any case, temporary measures cannot be expected to fully stimulate long-term hiring or investment plans. The recent cut in personal income tax is higher on lower income brackets. Nevertheless, at the heart of the future tax reform should be a permanent cut in employer social security contributions focussed on lower-paid workers, where the need to stimulate labour demand is the most acute and where labour demand elasticity to wage is the highest. This would require

Figure 13. **Taxation**
Per cent of total tax revenue, 2012¹



1. 2011 for Australia, Greece, Japan, Mexico, Netherlands, Poland and the OECD average. In Panel D 2011 also for Ireland and 2010 for Korea. Source: OECD (2014), OECD Tax Statistics, Environment Statistics and National Accounts Statistics (databases), July.

funding social security in part from general revenue. Simulations conducted for the Fiscal Expert's Commission show a significant effect on GDP from cutting social security contributions and personal income tax, marginally higher for the first one. Other work carried out by the Ministry of Economy and Competitiveness indicates that both personal income tax and social security contributions cuts would have a substantial impact on GDP, while the long-term impact on employment is only marginally larger if cutting social security contributions. In the short-term, measures to boost labour demand, such as a cut in social security contributions, tend to be more effective than policies increasing labour supply, whose effects take longer to materialise (IMF, 2012). Moreover, the cut tends to be more effective if targeted at the low-paid (OECD, 2011). Hence, the government should complement personal income cuts with cuts in social security contributions targeted at lower-paid.

The value-added tax (VAT) base was broadened in 2012 but remains one of the narrowest in the OECD (OECD, 2012b). The recent tax reform proposal foresees moving some medical related goods to the standard rate, according to EU regulations. From an economic point of view, the first best option would be to apply the standard VAT rate to the widest base possible. However, as VAT is regressive measures could be taken to mitigate the impact on lower incomes by enhancing the social safety net or exempting necessities such as food, although this would partially reduce the effectiveness of the reform. A key concern is that eliminating special VAT rates would hurt the important tourism industry *vis-à-vis* other competitors (Alvarez et al., 2007). However, if at the same time social security contributions were cut this could potentially compensate for the rise in the VAT rate, especially if those cuts were targeted at lower-paid workers, which are heavily employed in the industry.

A number of other reforms would also make the tax system more growth friendly. Taxes should also be raised on environmentally damaging activities and on real estate. Neither of these are very high in Spain, and taxes on energy are relatively low (OECD, 2013a). Such taxes are less damaging to growth and in the case of environmental taxation can raise welfare.

Broadening the corporate tax base, as discussed below, can also make the tax system more growth friendly. Fighting fraud is also an efficient way to broaden the base and improve public acceptance, trust and compliance with the system. It also supports equity. The government's efforts to reduce tax and social security fraud, including putting limits on cash transactions by firms, were estimated to have raised EUR 11.5 billion (1.2% of GDP) in 2012 (Government of Spain, 2013).

Broadening the income tax base would in many cases make it more equitable and less distorting. The proposed tax reform has a number of measures to broaden the tax base, such as the elimination of dividends exemptions and limits to severance payments exemptions. The government proposes to shift the way medium-term savings are incentivised through the tax system by reducing the limit on deductions for contributions to personal pension plans, creating other long-term saving plans and equalising the treatment of capital gains, deposits and other capital yields. The government should carefully monitor these incentives since they tend to benefit higher income households and in any case may just cause substitution from one instrument to another, instead of increasing the total amount of savings (Engen et al., 1996; Attanasio et al., 2004; Chetty et al., 2012). The government should also eliminate the tax deductibility of mortgage

payments for those who bought their house prior to January 2013. This credit is expected to cost EUR 1.8 billion in 2014 and benefits one group of households. Equity and investment neutrality could be further enhanced by taxing all household income, both capital (whether dividend, capital gain or interest) or labour at the same marginal income tax rate. The government should also consider reviewing the treatment of collective investment schemes and in particular SICAVs (*sociedad de inversión de capital variable*) in conjunction with other EU countries, which pay corporate tax at a rate of just 1%, and should reinforce controls to guarantee that this instrument is correctly used so as not avoid taxation.

The financial sector

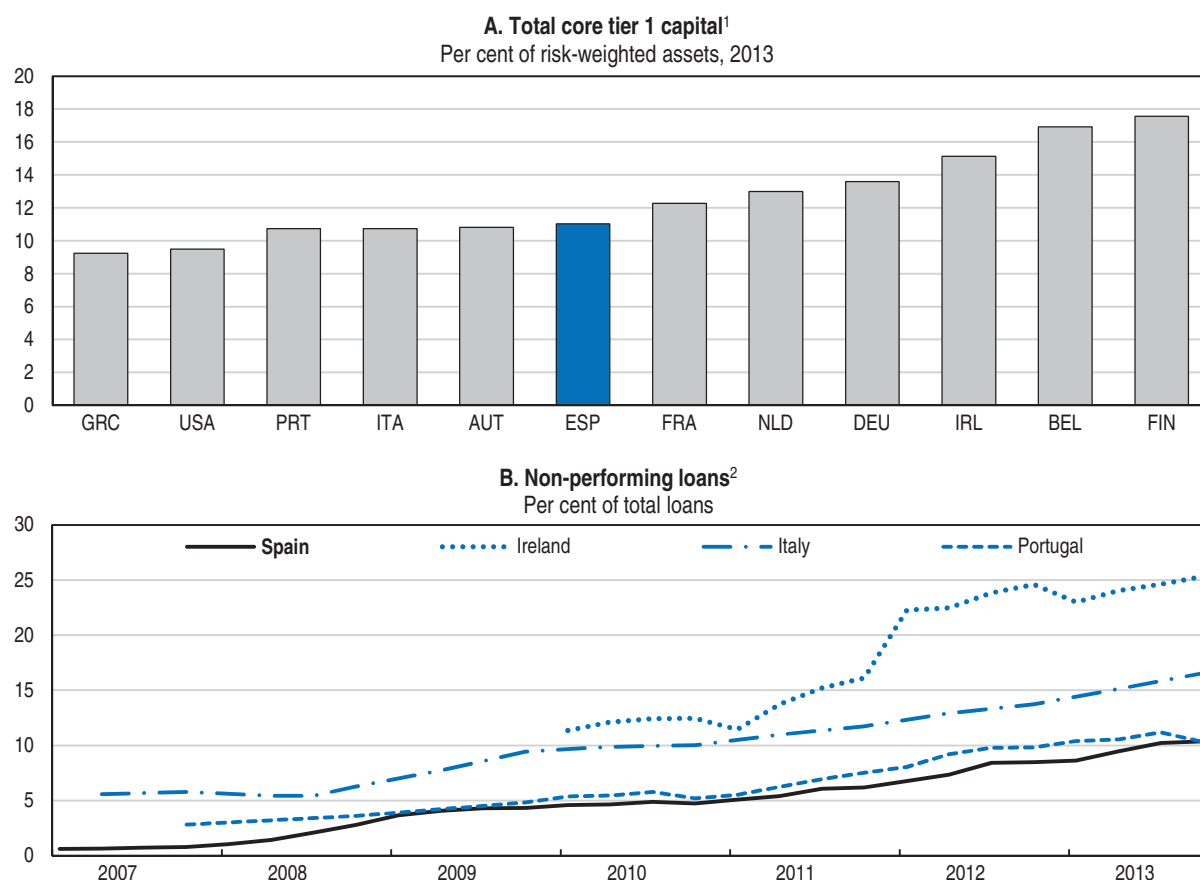
To restore financial stability, the authorities launched a reform program with the support of the EU, including a EUR 100 billion loan facility, of which only EUR 40 billion was used. The program identified weaker banks via a stress test, forced them to address capital shortfalls (restructuring them if needed), and called for the segregation of all those real estate assets that met specific valuation conditions from banks' balance sheets into a new asset management company (SAREB). The program also reinforced financial sector regulation, supervision and resolution and came to an end in January 2014. The banking system capital and liquidity positions have strengthened and market funding costs have also decreased. However, banks' reliance on ECB financing remains high and they hold an important volume of public debt on their books. Remaining risks are mostly related to the evolution of non-performing loans, in particular in case of a lower than expected recovery both in Spain and the EU.

Having recently been through a similar exercise, Spanish banks are perceived to be well positioned for the ECB's Assets Quality Review and subsequent stress tests. Remaining macroeconomic imbalances, such as high debt and unemployment levels, may weigh heavily on them in the more stressed scenarios though.

SAREB faces the challenge of divesting its asset portfolio while maximising value. The government owns 45% of SAREB's equity and it also has contingent liabilities amounting to EUR 50 billion (5% of GDP), in the form of the guarantees of SAREB's bonds. SAREB recorded a higher loss in 2013 than foreseen in its business plans, mainly due to higher than expected provisioning needs, but also to the slow pace of property sales and narrower profit margins on wholesale deals. In 2014 SAREB is expected to increase sales but profitability will depend heavily on house price dynamics.

The main challenges for banks appear to be weak core profits, due to falling volumes of intermediation and low margins, and still deteriorating asset quality. Profitability rose in 2013, driven by lower provisions requirements in comparison with 2012, and to a lesser extent by one-off factors and carry-trade operations. Non-performing loans remain high (Figure 14), and loan books, especially mortgages, will likely continue to deteriorate as long as unemployment stays high. This calls for close monitoring and maintaining suitable provisioning levels and capital buffers. Solvency ratios have recently increased and Spanish banks have higher leverage ratios than those in other European countries and risk-weighted capital is above 11% (core tier 1 capital). To ensure that banks remain sufficiently capitalised to support the recovery and to avoid excessive reliance on credit contraction to support capital ratios, it will be important to favour supervisory actions to boost banks' capital. Thus, the recommendation to limit dividend distribution should be reinforced and extended beyond 2014 and, if buoyant market conditions prevail, banks should also be encouraged to increase share issuance.

Figure 14. **Capital ratios and non-performing loans**



1. Actual amount of core common capital as defined by regulatory guidelines. Total risk-weighted assets are reported according to appropriate accounting or regulatory standards. Data shown is an average weighted by individual banks' total assets.
2. For Spain the data cover arrears in per cent of private domestic loans; arrears include non-performing doubtful loans (some amount of principal, interest or other contractually agreed expense is more than three months past-due or exceeds 25% of total debt). For other countries the data cover gross value of loans on which payments of principal and interest is past due by 90 days or more as a percentage of the total value of the loan portfolio (including non-performing loans, and before the deduction of specific loan loss provisions). Data are not strictly comparable across countries.

Source: OECD (2014), *OECD Economic Surveys: Euro Area 2014*; Banco de España (2014), *Boletín Estadístico* (database) and IMF (2014), *Financial Soundness Indicators* (database), July.

Recommendations to reduce debt and increase competitiveness

Key recommendations

- As specified in the government's medium-term fiscal plan, return to a cyclically-adjusted fiscal balance by 2017.
- Shift the tax burden from labour to indirect taxes by cutting employer social security contributions for low-skilled workers, increasing environmental and real estate taxes and narrowing exemptions to value-added tax, corporation and income taxes.
- Continue to improve in-court insolvency procedures, increase incentives for the use of both in-court and out-of-court insolvency procedures by small and medium-sized enterprises and introduce a new out-of-court negotiated personal insolvency regime.

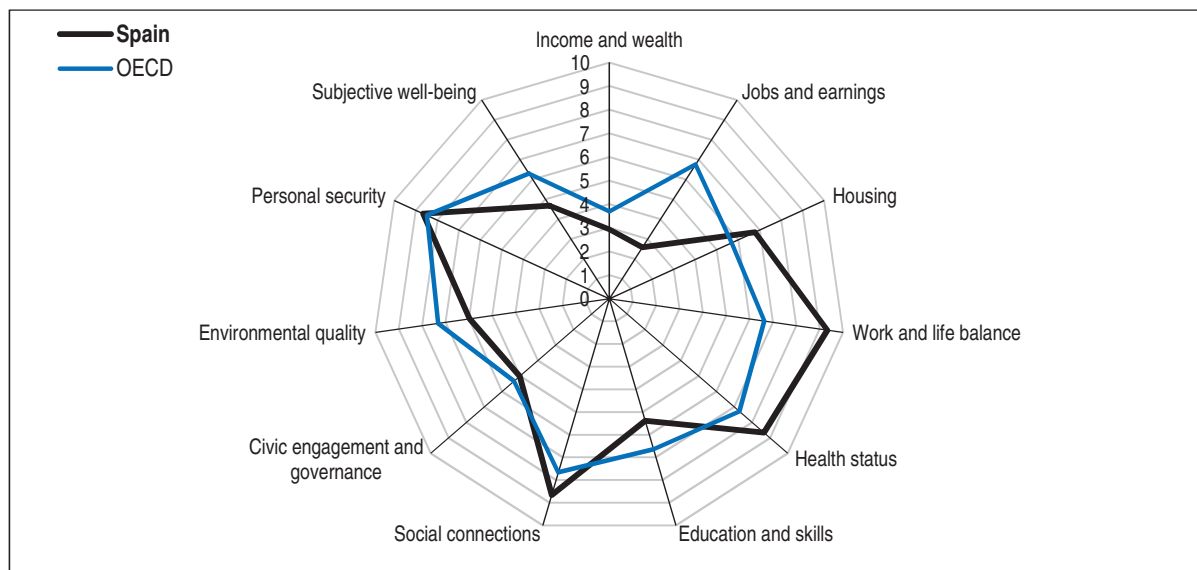
Other recommendation

- To reduce expenditure in a growth and equity friendly way, focus expenditure adjustment on public sector efficiency improvements.

Sustainably boosting wellbeing, medium-term growth and jobs

The OECD's *Better Life Index 2014* shows that Spain's indicators of wellbeing are mixed (Figure 15). Spain ranks 20 out of 21 in the jobs domain and below the OECD average in terms of income and wealth, education and skills and subjective wellbeing. By contrast it ranks relatively highly in terms of housing quality (rank 4/21), health status (3/21) and work life balance (2/31).

Figure 15. **Well-being outcomes: Better Life Index**
2014¹



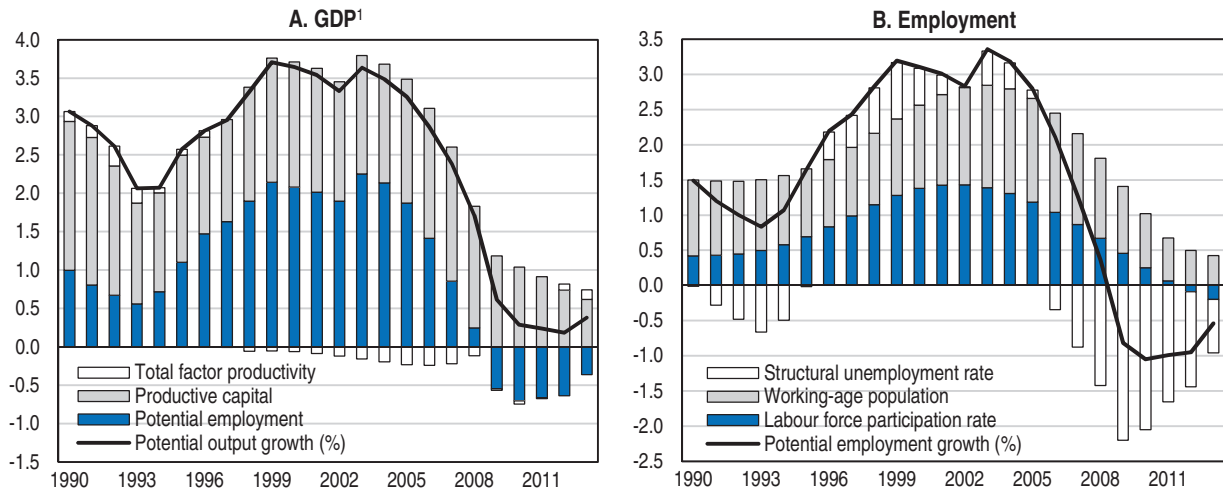
1. Each well-being dimension is measured by one to four indicators from the OECD Better Life indicator set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between ten (best) and zero according to the following formula: $(\text{indicator value} - \text{minimum value}) / (\text{maximum value} - \text{minimum value}) \times 10$.

Source: OECD (2014), *OECD Better Life Index*, www.oecdbetterlifeindex.org.

In the wake of the crisis overall trend and productivity growth are estimated at only around 1% and 0% respectively (Figure 16). An inflexible and dualistic labour market and an inadequate regulatory environment for business have contributed to the low productivity growth rate in the past (Dolado et al., 2011; Mora-Sanguinetti and Fuentes, 2012) and still do. Despite significant labour and product market reforms there is room for improvement. Productivity is still held back by the dualistic labour market, with high protection for permanent versus temporary contracts, low business innovation, skills mismatches, and still high barriers to starting and growing a business. Raising trend growth, particularly via productivity increases, is Spain's most fundamental medium-term economic policy challenge.

Spain needs growth driven by skills and innovation to sustainably lift productivity, wages and wellbeing. This involves tackling several challenges including: up-skilling and activating the huge pool of unemployed, most of whom are ill-equipped for the post-crisis economy; tackling long-standing education issues that have impeded the contribution of human capital to growth and lifting innovation capability and its impact on the economy to raise trend productivity growth; and encouraging the use of more environmentally friendly technologies to underpin more sustainable growth.

Figure 16. **Potential growth**
Contributions to growth, percentage points



1. Contributions to growth are calculated using a weight of 0.67 for potential employment and 0.33 for productive capital; total factor productivity is calculated as a residual. Productive capital excludes investment in housing, while potential employment abstracts from cyclical variations in the labour force and unemployment.

Source: OECD (2014), "OECD Economic Outlook No. 95", OECD Economic Outlook: Statistics and Projections (database).

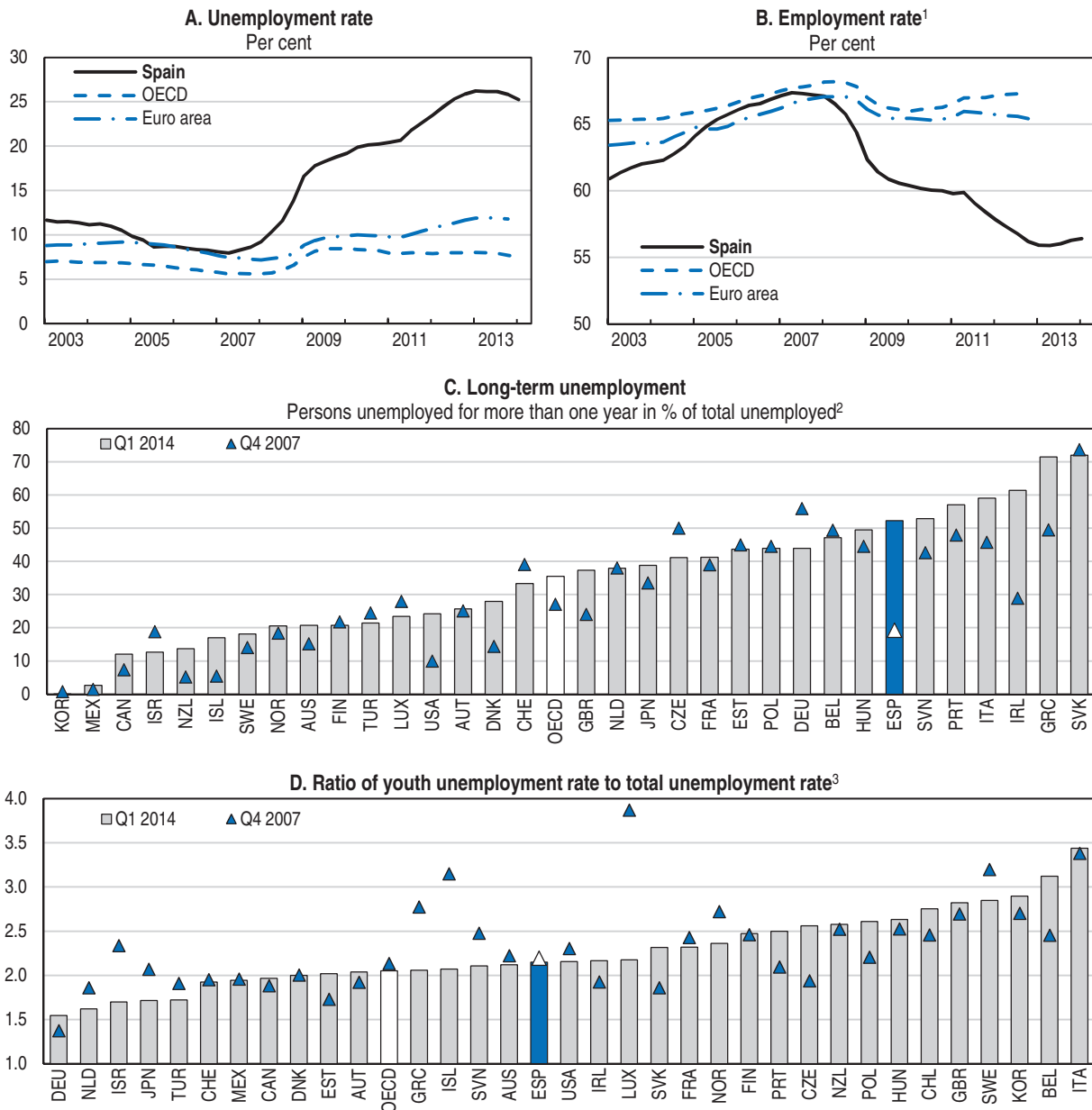
Towards a better performing labour market

Tackling very high unemployment is one of the main challenges for Spain. At around 25%, Spain's unemployment rate is the second highest in the OECD, after Greece (Figure 17). The youth unemployment rate is also extremely high at 55% and reducing it is a key policy challenge and has triggered initiatives at national and EU level to establish a Youth Guarantee Scheme and the OECD's Action Plan to Tackle Youth Joblessness.

In addition to programmes aimed at youth, policies will need to improve the whole labour market. High unemployment, of youth and others, is the result of weak demand but is also the legacy of structural problems, including an inadequate activation regime, insufficient responsiveness of wages to economic conditions and high protection for permanent versus temporary contracts. Participation rates are relatively high; however, due to high unemployment, the employment ratio is low. Recent developments are, nevertheless, quite encouraging. In the second quarter of 2014, employment recorded positive year-on-year growth for the first time in six years (an increase of 192 400), there was a quarterly reduction in unemployment of 310 400 people (the highest in the homogeneous series) and the unemployment rate dropped to 24.5%.

More than half of the nearly six million unemployed in Spain have been unemployed for more than one year. Around half of the unemployed have attained lower secondary education or less. In addition, up to $\frac{3}{4}$ million of the unemployed formerly worked in the construction industry. These groups are highly vulnerable to becoming structurally unemployed, and many of them do not have skills for the types of employment that Spain will likely generate in coming years. Getting the unemployed back into work by improving the functioning of the labour market, and by reducing impediments to growth and labour demand, is the most pressing economic challenge Spain now faces.

Figure 17. **The labour market situation is difficult**



1. Employment in per cent of working-age population. The OECD aggregate is an average of the country rates.
 2. Data are smoothed using three-quarter moving averages and include adjustments for breaks in series. Q4 2013 instead of Q1 2014 for Israel.
 3. Instead of Q4 data for 2007 data cover Q2 for Switzerland.
 Source: OECD (2014), *OECD Economic Outlook: Statistics and Projections* and *OECD Employment and Labour Market Statistics* (databases), July; and Online OECD Employment Database, July, www.oecd.org/employment/emp/onlineoecdemploymentdatabase.htm.

Avoiding a rise in structural unemployment

Despite being kept as a budget priority, spending on active labour market policies (ALMPs) has increased by only 10% since 2007, although the number of unemployed has more than doubled. There is room for improving the efficiency of the public employment services and public spending is skewed towards passive measures. Spending on job search assistance is low by international standards, and, on average, one employee of the public employment services

(PES) is responsible for more than 250 jobseekers, which is at the higher end of the range for European countries (Table 5). Modern activation tools, such as profiling the unemployed to select them into low or more intense assistance groups, are only starting to be developed.

Table 5. **Average caseload in the public employment service**
2011¹

	Registered job seekers (thousand) ²	Public employment service (PES) staff (thousand) ³	Job seekers per PES staff member
Spain	5 745.3	21.4	269
Austria	258.6	4.9	53
Belgium	547.4	10.0	54
Czech Republic	509.2	7.3	70
Denmark	207.7	5.8	36
Estonia	53.2	0.5	108
Finland	470.4	3.9	120
Germany	5 207.6	110.0	47
Greece	576.6	3.4	169
Ireland	444.9	0.6	778
Netherlands	625.6	5.0	125
Poland	2 011.2	23.8	84
Portugal	639.7	3.6	177
Slovak Republic	401.5	2.3	172
Slovenia	110.7	1.0	112
Sweden	679.0	10.8	63
United Kingdom	1 571.7	72.9	22

1. 2010 for job seekers for Greece.
2. Data on the total number of jobseekers registered with the PES are broken down into those considered as registered unemployed according to national definitions and other registered jobseekers.
3. Latest data available from the country fiches of the European Commission website, 2010 or 2011 in most cases but 2012 for Spain. The remit of the PES varies across countries in terms of groups covered (e.g. disabled, employed jobseekers) and services provided (e.g. career guidance, in-house training). For more details see the “PES Business Models” study by Mobility Lab available from the European Commission website (link below).

Source: Registered job seekers from Eurostat (2014), “Labour Market Policy”, *Eurostat Database*, May; PES staff numbers for Spain provided by the Ministry of Employment and Social Security; other PES staff numbers from European Commission, Employment, Social Affairs and Inclusion, Public Employment Services, <http://ec.europa.eu/social/main.jsp?catId=105&langId=en>, accessed April 2014.

Effective ALMPs are based on mutual obligation: the unemployed receive income and employment support and in return are required to participate actively in job-search or training (Martin, 2000; Kluge 2006). In Spain, the unemployed must accept an adequate job offer but definitional uncertainty of what is “adequate” facilitates refusal and makes enforcement difficult. There are no systematic job search obligations. Implementing the mutual obligations principle is challenging in Spain because activation is the responsibility of the regions, while the central government pays unemployment benefits. The central government is trying to counter this by building a new activation strategy 2014-16 with different components (profiling, a single nationwide portal for searching for job offers, stronger collaboration on placement with private agencies). A set of impact measurements are being used to allocate central government funding to the regions for activation.

These changes appear to be going in the right direction but implementation at the regional level is crucial and has been slow. In particular, the PES has been too slow to develop activation assistance to the unemployed based on modern practice, operating largely in a passive way. Resources need to be shifted to activation from other government expenditure areas. The first priority should be to improve PES efficiency by increasing the range of tools and

improving the institutional framework. This will require strengthening the capacities of the PES including retraining and specialisation of their caseworkers and reallocation of staff to value-added services. Once efficiency has increased it may be necessary to increase the number of caseworkers at the PES, although this will be costly. The policy aim should be to have a regularly monitored individual assistance and obligations plan for all unemployed shortly after their registration. Part of an enhanced obligations approach should be to define more clearly an adequate job offer using objective criteria such as the minimum pay premium the job must offer over unemployment assistance or the length of the unemployment period.

Major up-skilling of the unemployed group is required. The recent OECD Survey of Adult Skills (PIACC) found that Spain has the worst numeracy and second-worst literacy skills of the 23 countries and regions surveyed. To increase the labour market relevance of training for the unemployed the regions should introduce systematic evaluation of training outcomes and reallocate funding towards those schemes that are the most effective in increasing employability. The reform of the institutional framework should enhance the value added of training in terms of market relevance of its contents and increase efficiency in the use of public funds. Continuing education at the upper secondary vocational education and training (VET) level has a large role to play. The strengthened vocational education track with a higher practical component and greater labour market relevance being introduced at secondary school (discussed below) should be made available in parallel to the adult unemployed. International experience suggests that increasing work-based training opportunities such as apprenticeships and internships is likely to pay-off as they facilitate labour market entry, particularly of youth (OECD, 2009).

Significant reforms to both the wage bargaining and employment protection regimes were implemented in 2012. The reforms allow firms to opt-out of sectoral agreements, limit the period of automatic extension of sectoral agreements to one year, reduce severance pay for unjustified dismissal and define more clearly the economic reasons that would justify a dismissal. A recent OECD review of the reforms, which used statistical techniques to distinguish policy from other effects, found that they had contributed to wage moderation and increased hiring on permanent contracts (OECD, 2013b). However, further time will be required to fully evaluate the effect of the reform as it is hard to distinguish between cyclical and policy effects in an economy emerging from recession.

Depending on the outcome of such evaluation the government could consider a number of avenues for further reform. As a first option, gradually increasing representation requirements for both unions and firms for sectoral collective agreements would make the bargaining process more inclusive. As a second option, requiring firms to “opt-in” rather than allowing them to “opt-out” of sectoral collective agreements would increase the responsiveness of wages and allow new and innovative firms to enter (Chapter 2). The proportion of fair dismissals has increased from 30% in 2010 to nearly 60% of total dismissals, but if progress stalls the legal distinction between “justified” and “unjustified” dismissals may have to be further clarified.

Increasing the contribution of education and innovation to growth

Spain has made progress in raising the overall education level over the past decade, and the share of the population with upper secondary school and especially tertiary qualifications has increased. The education system faces several challenges: increasing performance and graduation rates at secondary school; and increasing the labour market relevance of university education.

The government is introducing a major reform to tackle these problems. In 2012 it introduced a new dual VET (simultaneous school and firm training) that has a high work-based component. A new two-year basic VET programme is being introduced from the autumn of 2014, which will lead to a qualification of both academic and professional value, and be a gateway to intermediate VET at the upper secondary school level. These changes are promising. The high share of small firms in Spain makes building a dual VET system challenging, as their capacity to participate in such a system is limited. The VET reform should also increase the practical work-based component of Spain's existing mostly school-based VET system, where 70% of the "practical" component is at present school based, particularly by increasing the time spent with companies from the current level of around 20% of total programme time.

At the university level, the government is planning from 2014 to publish information on labour market outcomes of graduates by degree and institution. This is a welcome reform that can help create demand-side pressure for greater specialisation in Spanish universities, which are too homogenous and offer an excessively wide range of degrees. The government should ensure that this information is widely communicated and the responsibility for its collection and dissemination transferred to the National Statistics Office to ensure the data remains in the public domain. To facilitate greater specialisation, the government should also ease the compulsory requirements to offer a minimum number of degree courses at undergraduate level.

Boosting innovation capacity and knowledge transfer

Spain has also made progress in expanding the innovation system; increasing the number of researchers, research and development (R&D) spending and output of scientific articles. However, it still lags behind the OECD and other large country peers in Europe and the effects of public spending cuts in the crisis are yet to show through on research outputs due to lags in the research process. Total spending on R&D remains significantly below the OECD average due mainly to low business spending on R&D. Spain faces two inter-related challenges: continue increasing the capacity and quality of its research base and the impact of innovation on the economy.

An important tool to tackle both challenges is to increase both the size and the specialisation of universities and research centres. Scale and specialisation are not only important for improving quality but also leveraging Spain's R&D spending by attracting EU Horizon 2020 funds. Larger research organisations are also in a better position to have support divisions to handle commercialisation, thereby increasing collaboration with enterprises. The central government should expand the use of performance based funding, such as the "centre of research excellence" programme, which provides a designation as well as extra funding to institutions evaluated as top research performers from an international perspective. This should be done by providing extra direct research funding to institutions that amalgamate, or network with existing high performing research groups or institutions and/or specialise. It is important to allocate funding to proven performers to increase both efficiency and impact.

The government could also better foster the innovation base through improvements to innovation funding mechanisms and framework conditions (Chapter 2); business R&D remains low, suggesting it is not effective. It should reduce the volatility of its total financial support to R&D; innovation is a long-term investment so funding stability is at a premium. The government should continue to balance direct innovation support with a

R&D tax credit, as each has advantages. The credit, while apparently generous, is not widely used, particularly by smaller firms. One potential problem is that firms are required to apply for certification from the government to claim the credit, which may be too cumbersome. The authorities should streamline the process. In addition to grants, loans and fiscal incentives, the authorities should continue boosting and extending the use of other instruments such as venture capital. In spite of the existing constraints, the government should continue to promote stable R&D spending.

Towards a green economy

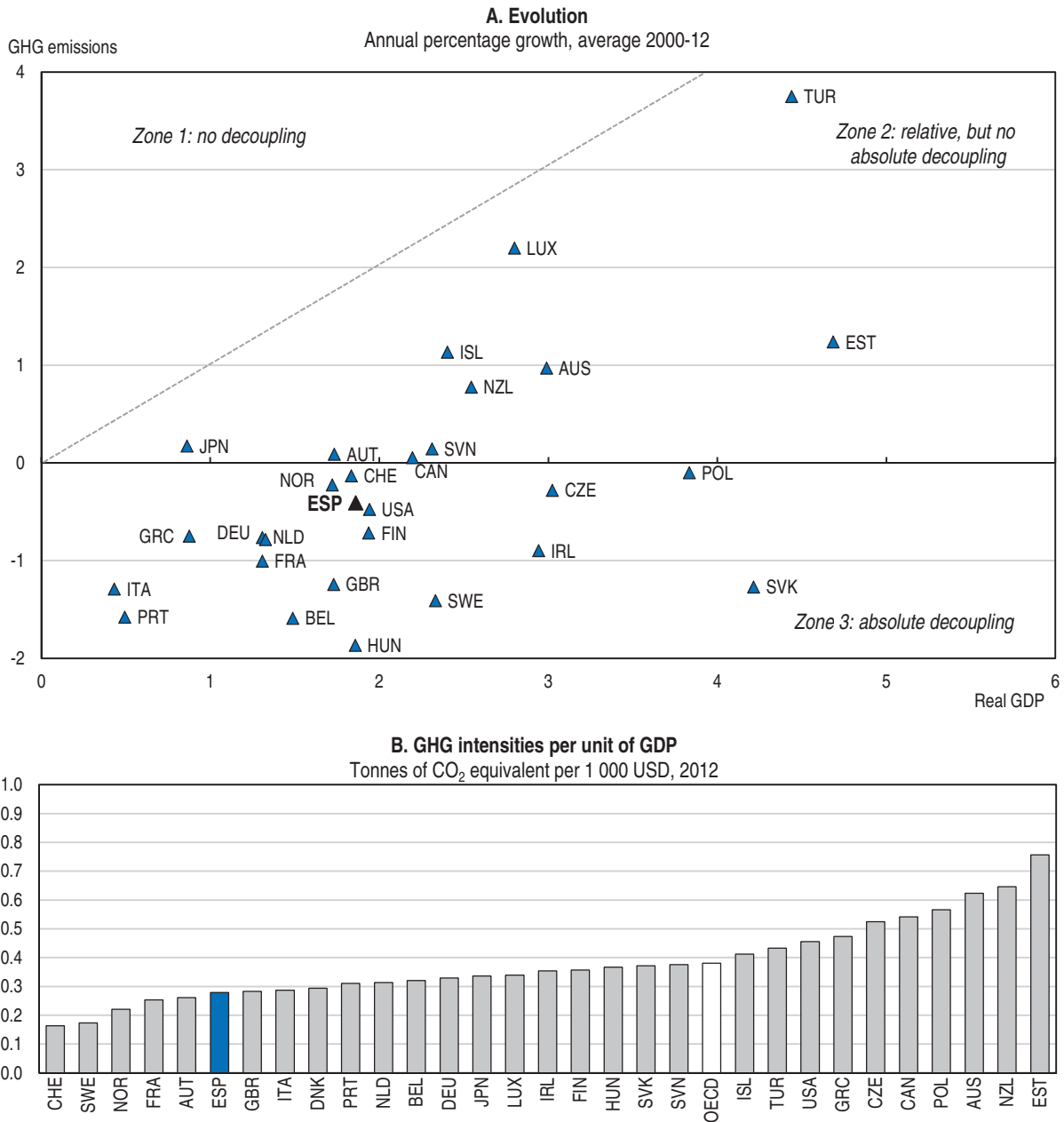
Developing environmentally sounder technologies, products and services is potentially an important opportunity for the business sector in Spain. It can generate new sales, added value and jobs across green value chains, and position Spain better for a future where environmental costs and benefits will likely feature more heavily in economic regulation and consumer choice across the OECD. Spain has developed a degree of leadership in some green technologies, but risks losing it as others move into the industry. Policies need to encourage green innovation and adoption. To a large extent, these policies are the same as encouraging innovation and firm growth more broadly, policies which are discussed more in detail in Chapters 1 and 2 of this Survey. However, environmental policies themselves, if properly designed, can provide critical incentives to green industries and green employment.

In a promising sign there was a large increase in green patent applications filed by Spain from 1999-2008, especially those related to renewable energy sources, particularly solar energy. There has been a steady growth in primary and final consumption of renewable energy in Spain, mainly driven by biofuels and waste, and solar and wind energy (IEA, 2013a). The share of renewable energy in the total primary energy supply increased from 7% in 1990 to 12% in 2012 and from 17.2% in 1990 to 29.5% in 2012 in electricity generation (IEA, 2013b). This contributed to a decoupling of GDP from greenhouse gas (GHG) emissions. As a result, Spain has one of the lowest emissions intensity economies in the OECD (Figure 18). Nonetheless, despite the increase in renewable energy generation and the replacement of coal by natural gas, fossil fuels still account for 76% of the country's energy supply.

Policies should be carefully designed to maximise effectiveness and minimise costs, including fiscal costs. In general terms, such considerations argue for the use of market-based instruments as the primary policy tools; although regulation and other policies also have a role. The government should continue to foster the entry of new firms with greener technologies by better using taxation, subsidy and other instruments to ensure market prices better reflect the environmental costs and benefits of different activities. Tighter regulatory standards can also play a role.

Policies should also be designed to attract private investment, by providing stable domestic policy frameworks for low-carbon investment. A rapid increase in the share of renewables in electricity generation has resulted from feed-in tariffs (guaranteed minimum prices paid to producers) and from 2004 feed-in tariff premiums (guaranteed mark-ups over the market price). However, feed-in tariffs and premiums can be an expensive way to reduce emissions compared with the EU's Emissions Trading Scheme (ETS) (OECD, 2013c). In Spain, the cost of these feed-in tariffs and premiums, as well as other regulated costs, were not fully passed onto consumers, blunting incentives and resulting in a significant build-up in tariff debt owed to producers (see above). The recent changes to feed-in tariffs and reforms of renewable energy incentives in Spain intend to ensure the sustainability of the system, although it has triggered some litigation with investors in renewable energy projects.

Figure 18. **Green growth**
Greenhouse gas emissions in CO₂ equivalent and real GDP¹



1. Greenhouse gas emissions (GHG) measured in carbon dioxide (CO₂) equivalent excluding land use, land-use change and forestry. Real GDP in national currency in Panel A, in USD at 2005 prices and purchasing power parities in Panel B.

Source: UNFCCC (2014), GHG Data, United Nations Framework Convention on Climate Change, July and OECD (2014), National Accounts Statistics (database), July.

Setting predictable incentives is critical to attract investment in renewable energy. In addition, around 40% of Spain's GHG emissions are already regulated by the ETS, including those related to energy generation and production as well as emission-intensive industries. Depending on the ETS price and developments in the costs of renewables, Spain might need to introduce other policy measures to meet its renewable targets. The costs of such measures

should be fully passed onto consumers and minimise fiscal costs. Increasing the interconnection capacities with neighbouring countries will help to mitigate these costs. Spain is an energy island and because of that the system has to bear an extra cost to accommodate higher penetration of renewables. Greater interconnection capacity between the Iberian Peninsula and the rest of Europe can help to make more compatible ambitious renewable objectives with the need to ensure affordable energy prices and a stable energy system. This is also part of a wider approach of the EU in the security of supply and meeting EU energy and climate change objectives that will be defined in the next 2030 strategy.

Under the Kyoto Protocol, Spain pledged to limit its GHG emissions for the 2008-12 commitment period to 15% above its 1990 levels. It has also established binding annual GHG emission targets for most sectors not included in the EU ETS, such as transport (except aviation), buildings, agriculture and waste. Spain is on track to meet its target using the flexible mechanisms under the Kyoto protocol (for example, promoting development of national carbon sinks, such as forest, or buying emissions rights) to compensate for GHG emissions that exceeded the target by a small amount (20% higher than in 1990, versus a target of 15% higher). In addition, Spain has committed to reduce its GHG emissions by 10% in 2020 compared to the 2005 level under the EU Effort Sharing Decision (European Parliament, 2009).

To encourage the least-cost reduction in emissions in non-ETS sectors, Spain should, as a first step, move towards equalisation of the price of GHG emissions across the economy. The private vehicle fleet is dominated by diesel vehicles, which produce less carbon dioxide (CO₂) emissions per kilometre but more per litre and it also produces higher health-damaging fine particulate matter per litre than petrol. Despite this, taxation per litre is lower for diesel than for petrol. The government should increase taxation per litre on diesel to more than taxation per litre on petrol to equalise its carbon price with that of petrol. More generally the government should try to harmonise the price of emissions across sources using taxes and fees.

Recommendations to sustainably boost medium-term growth and jobs

Key recommendations

- Strengthen active labour market policies by improving vocational training, strengthening the capacities and efficiency at the public employment services, and enhancing coordination between the different levels of administration.
- Raise the quality of innovation and strengthen competitiveness by encouraging greater scale and specialisation of universities and research organisations, by extending performance based resources allocation and the application of international peer review and by providing more career opportunities for highly qualified researchers.
- Equalise pricing of greenhouse gas emissions across sources to contain carbon emissions and thereby promote green industry and jobs.

Further recommendations

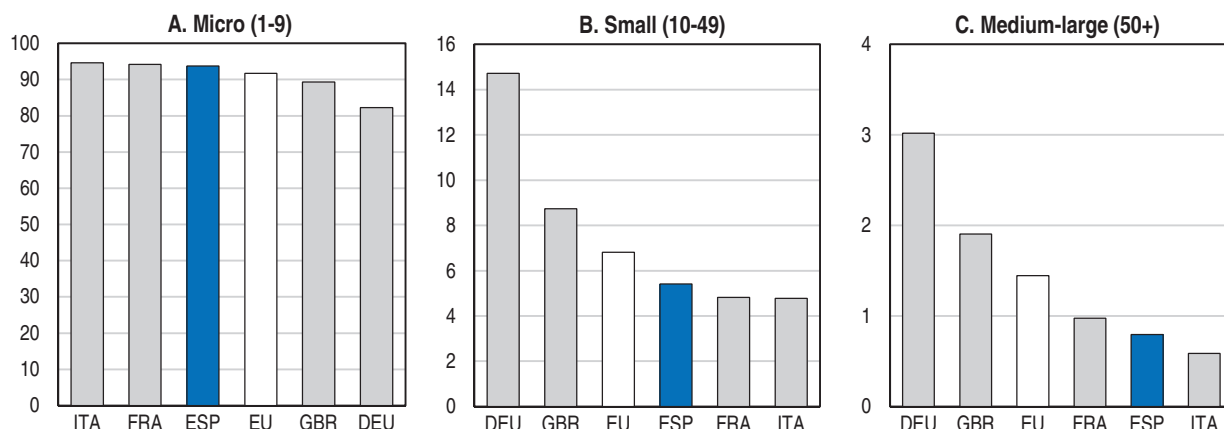
- Retain and review the research and development tax credit and cooperate with larger research organisations to promote its use among younger firms.
- Increase the work-based component of existing school-based vocational education and training.
- Ensure predictable and sustainable policy support to low-carbon technologies.

Business sector performance

The Spanish business sector is more dualistic than other OECD countries (Figure 19). A large number of very small locally focussed firms with low productivity coexist with a few large and productive firms, successful in international markets (Figure 20).

Figure 19. **Distribution of firms by size class**

Based on the number of persons employed, per cent of total, 2010¹

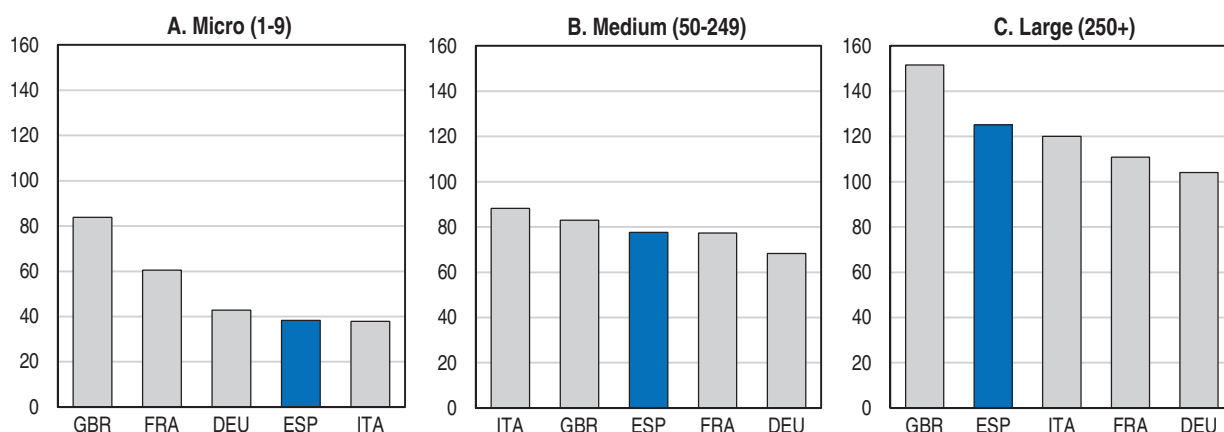


1. The sector covered is the total business economy (including repair of computers, personal and household goods; excluding financial and insurance activities). The EU aggregate is an unweighted average of shares for 23 countries.

Source: OECD (2013), *Entrepreneurship at a Glance 2013*.

Figure 20. **Productivity of firms in the manufacturing sector by firm size class¹**

Value added at factor cost, thousand USD per person employed, 2010



1. Firm size classes based on the number of persons employed.

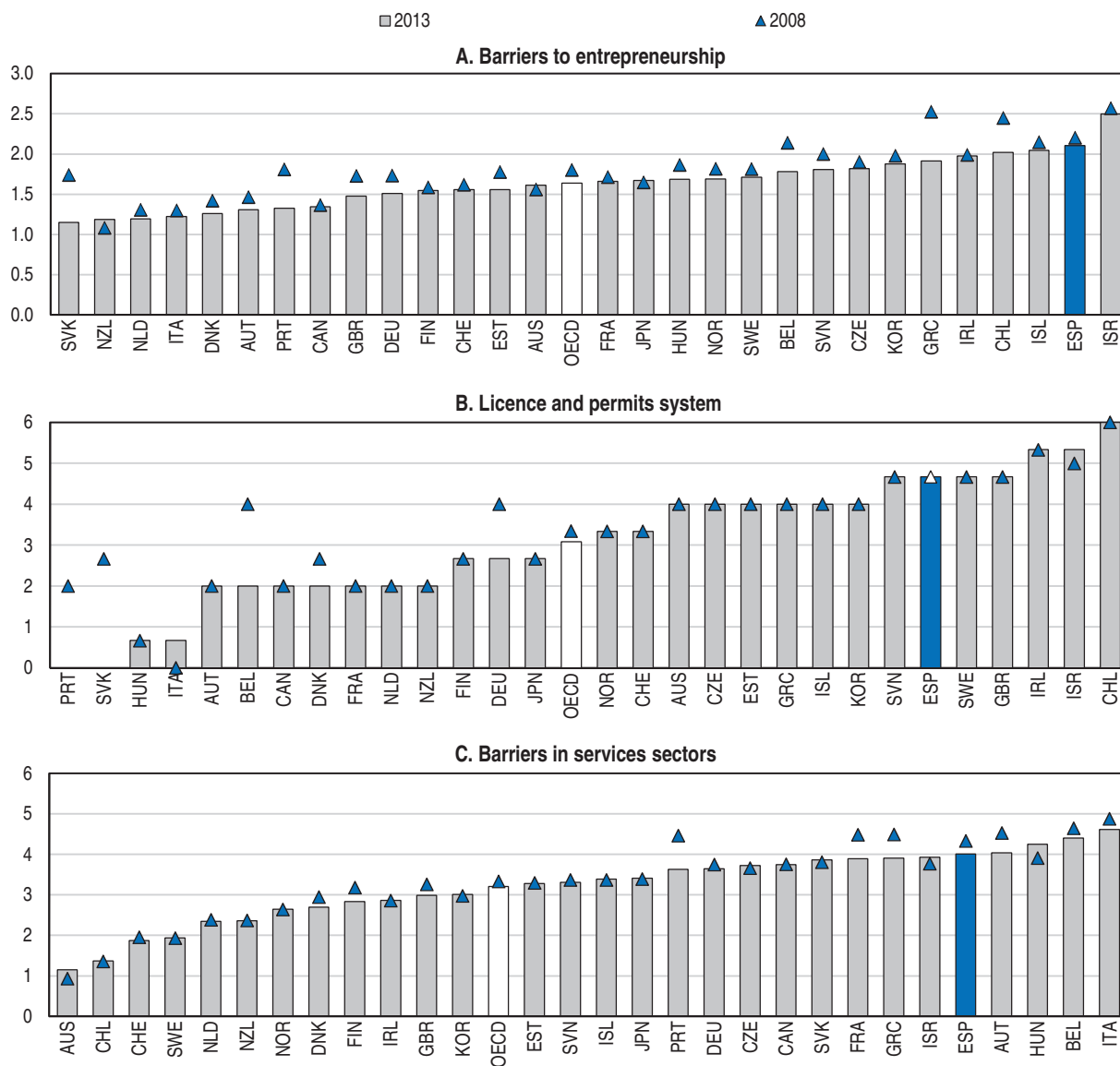
Source: OECD (2013), *Entrepreneurship at a Glance 2013*.

Favouring start-ups and firm expansion

Spain ranks 142nd (out of 185) with respect to the ease of starting a business (World Bank and IFC, 2014) and has the second highest barriers to entrepreneurship in the OECD (OECD, 2014d). Obtaining licences and permits is more difficult in Spain than in most OECD countries (Figure 21). Contrary to best practice, there are no standard procedures to use the “silence is consent” rule for issuing the licences required to open up a business, and

Figure 21. **Product market regulation indicators: Barriers to entrepreneurship**

Index scale of 0-6 from least to most restrictive¹



1. The OECD aggregate is an average of the data shown.

Source: OECD (2013), *Product Market Regulation Database*, www.oecd.org/economy/pmr.

there are not yet single contact points for issuing or accepting all notifications and licenses that are required to open up a business. However, with the aim to address this obstacle the law on entrepreneurship creates entrepreneurial support point networks as a single window through which to support business start-up. Progress has been made in reducing administrative burdens for sole proprietor firms, but they are still higher than the OECD average.

Firms also suffer the inconveniences of a regulatory framework that is fragmented by regional or local administrations. To tackle this and move towards a truly single market, the government has introduced the Market Unity Law to simplify business licensing requirements by increasing the use of notification procedures, reducing the need for prior

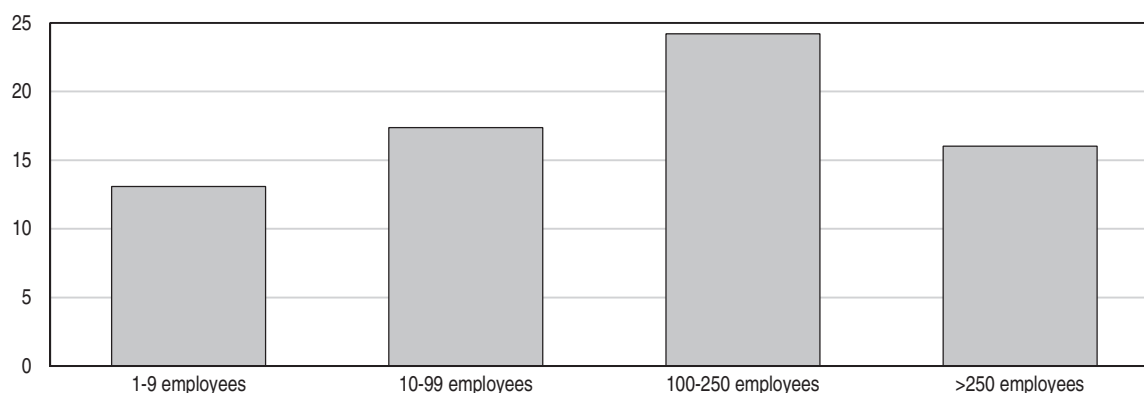
authorisations, and by ensuring that permits issued in one region will automatically be valid for the others. According to the law, all legal texts enacted at local, regional and central government level that may be considered inconsistent with the market unity law will have to be amended in the following six months. So far 2 700 regulatory barriers have been identified as inconsistent with market unity. This process is to be supported by enhancing administrative cooperation, and by setting up a procedure for responding quickly to complaints about obstacles to the single market. A swift implementation of the law, while challenging due to the technical complexity of dealing with a large body of regulation and the involvement of all levels of the government, will be crucial to boost the performance of the Spanish business sector.

Besides the Market Unity Law, Spain is currently embarking on other projects to improve the overall business climate. *Emprende en tres* is the electronic one-stop-shop designed to present declarations of responsibility required for entrepreneurs to start up a new economic activity. Spain will carry out an annual review of the business regulatory framework to detect and remove obstacles to businesses. Also, an agreement has been signed with the World Bank for the elaboration of a report on *Doing Business* at the subnational level in Spain during 2014 and 2015.

Some parts of the corporate tax system are not favourable for firms' growth. The standard corporate tax rate is 30%. The corporate rate for SMEs – defined as firms with an annual turnover below EUR 10 million – is 25% on profits up to EUR 300 000 and 30% above that. The rate is 20% for SMEs with net revenues below EUR 5 million and fewer than 25 employees who have not decreased the number of workers they employ. Despite these preferential rates for SMEs, larger firms can optimise deductions, resulting in differences between statutory rates and effective rates that widen as turnover increases. The result is a humped-shape effective tax rate that discourages growth up to about 100 employees (Figure 22). Broadening the tax base by reducing tax deductions, and using that fiscal space to establish a unique and lower corporate tax rate for all firms would reduce the capacity of larger firms to avoid taxation and provide better incentives for firm's growth and better align corporate taxation with the EU average.

Figure 22. **Effective corporate tax rates by firm size**

Per cent, 2011¹



1. Since 2011 several measures have been adopted to broaden the corporate tax base.

Source: La Agencia Tributaria, Ministerio de Hacienda y Administraciones Públicas.

Towards more diversified financing

Bank lending has traditionally been the predominant financing source in Spain. With the crisis, larger companies have raised capital directly from the markets, although less than in other European countries. By contrast, SMEs remain largely reliant on short-term bank loans. Compared with other large European countries, fewer alternatives to bank finance are available to Spanish firms, which affect business birth rates and growth (European Commission, 2013). Recent government initiatives (notably the strategy to promote non-bank financial intermediation under the Memorandum of Understanding agreed with European authorities) attempt to fill these gaps, with a special focus on SMEs and start-ups. They include a new securities market aimed at medium-sized companies and efforts to develop venture capital funding structures (especially FOND ICO Global, a public fund of funds) and to strengthen incentives to finance young technology companies (e.g. via better fiscal incentives for business angels).

While these initiatives have the potential to create a new landscape of financing alternatives, it will take some time until they are operating at their full potential. In the interim, strengthening some existing alternatives would help to improve the availability of bank financing. This includes the Official Credit Institute (ICO) intermediation facilities and mutual guarantee schemes (MGS). Through its intermediation facilities, ICO provides funds to banks on the condition that the funds are lent for a certain kind of activity (e.g. internationalisation) or to a certain type of firms such as SMEs (Ayuso, 2013; García-Vaquero, 2013). A more extended use of MGS would also contribute to further diversify and guarantee SME's risks, such as those adopted by CDTI (Centre for Industrial and Technological Development).

In addition to ICO there are numerous agencies and institutions providing financing support to Spanish companies. In some cases these institutions have cross-shareholdings and the instruments they offer are very similar (Ayuso, 2013). Simplification and consolidation may increase the effectiveness and cost-efficiency of the system, avoid duplications, and make it easier to access for firms, especially for SMEs that may have more difficulties to absorb information and navigate a complex system.

Strengthening competition

Spain undertook several reforms in 2012 and 2013, such as introducing more flexible shop opening hours and simplification of licensing procedures for small retail outlets (Mineco, 2013), to foster competition in goods and services markets. Profit margins have moderated during the recession but have grown faster than in other euro area countries (BBVA, 2014). This partly relates to the need for firms to rebuild their finances in the context of tight credit conditions, but it also signals weaknesses in effective competition in some markets (Montero and Urtasun, 2014). Margins are currently being used by firms to reduce debt and finance new investment projects. As the recovery strengthens and external financing becomes available, it is essential to continue to foster competition in goods and services markets to maximise the impact of other reforms, such as those in the labour market, on job creation.

A key unfinished initiative is the law on professional services and associations, whose approval is suffering a long delay. Barriers to entry in professional services remain high in international perspective, especially concerning access to the legal, architect and engineering professions. It will be crucial that the final content of law remain as ambitious

as initially foreseen in order to eliminate existing restrictions (CNC, 2012). There is also scope for improving competition in the electricity market. The sector is to a large extent vertically integrated. Strengthening competition between incumbents and improving entry possibilities are important for ensuring that the recent electricity reform really facilitates more price competitive dynamics in the sector.

Recommendations to boost business sector performance

Key recommendations

- Broaden the corporate tax base, lower the rate and eliminate regimes for small and medium-sized enterprises.
- Continue to promote diversified financing sources for firms, revamp the licence and permits system and reduce regulatory fragmentation by implementing the market unity law.
- Reduce the number of professions requiring membership of a professional body and the cost of membership.

Further recommendations

- Consider reducing the number of government agencies involved in providing financing support to firms.
- Adjust Official Credit Institute intermediation facilities to demand and make further use of mutual guarantee schemes.

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ANNEX

Progress in structural reform

This annex reviews action taken on recommendations from previous Surveys. Recommendations that are new in this Survey are listed in the relevant chapter.

Banking policies

Recommendations in previous <i>Surveys</i>	Actions taken
<p>Viable banks with capital needs should be recapitalised promptly and non-viable banks should be resolved in an orderly manner as soon as possible, as foreseen in the Memorandum of Understanding.</p>	<p>On the basis of independent stress test results and the subsequent bank plans to address potentially identified capital shortfalls, all banks requiring fresh capital were recapitalised. Some banks relied solely on private sources, while others were restructured and received state funds. As a result of this process and previous injections of public capital, the state (via the Spanish Fund for the Orderly Restructuring of Banks, FROB) became the controlling owner of a significant part of the banking sector (holding an estimated 18% of system loans). The FROB will be gradually divesting itself of this ownership interest. Most illiquid and difficult-to-value assets (mainly real estate, including land, and related loans) were segregated from state-aided banks and transferred to a newly created asset management company (SAREB).</p>
<p>Holders of subordinated debt and lower-ranked hybrid capital instruments should absorb losses of banks which are resolved or are restructured, as foreseen in the Memorandum of Understanding.</p>	<p>From the total of EUR 56 billion (5.5% of GDP) in capital shortfalls identified by the stress test, 70% was met by public capital injections, 23% by bailing-in junior debt and 6% by private capital injections.</p>

Public finance

Recommendations in previous <i>Surveys</i>	Actions taken
<p>The government should aim at meeting its new headline deficit targets, unless growth is far lower than expected, in which case the automatic stabilisers should be allowed to operate, at least partially.</p>	<p>Growth was lower than anticipated and as a result headline deficit targets were relaxed but the structural effort was maintained. The deadline for complying with the European Commission criterion of 3% of GDP was postponed by two years to 2016.</p>
<p>The consolidation measures needed to reach the deficit target in 2014 should be spelt out. Their regressive impact, if any, should be minimised, to foster the social consensus around consolidation needs.</p>	<p>Consolidation measures to reach the 2014 deficit target were specified in Budget 2014 and in the Stability Program Update. Two thirds of the fiscal consolidation measures are revenue-based, including higher revenues raised by regional administrations and higher corporate tax revenues. On the expenditure side, measures include reducing spending on personnel and labour market policies, less spending by regional administrations and a programme to increase efficiency in the public administration.</p>
<p>To improve the fiscal framework, establish a fiscal council with a strong mandate. Strictly implement control of regional government budget policies and the new requirements on the publication of regional government budget outcomes.</p>	<p>The Independent Authority for Fiscal Responsibility was established in November 2013 and it became operational in July 2014. The Authority will monitor and report on compliance of all levels of government including regional and municipal. 11 out of 17 regional governments complied with their deficit targets for 2013. Budgetary reporting at central, regional, and social security levels is now all published monthly on a national accounts basis. Local governments have quarterly budgetary reporting on a national accounts basis.</p>
<p>Raise taxes on environmental externalities, including on transport fuels. Apply the standard value-added tax (VAT) rate to more goods and services. Make increases in the taxation of real estate values permanent and reduce taxation of housing transactions.</p>	<p>No action on transport fuels. A tax reform proposal foresees moving medical goods to the standard VAT rate. New environmental taxes on the sale of electricity energy, on the production of radioactive waste and on the storage of radioactive waste were introduced in 2013. Moreover, a new tax on fluorinated greenhouse gases has been introduced in 2014. No action on taxation of real estate values and housing transactions.</p>

Labour market and education reform

Recommendations in previous <i>Surveys</i>	Actions taken
Further reduce compensation for unjustified dismissal. If the reform does not prove to be effective, a single contract with initially low but gradually increasing severance payments would reduce the still large difference in dismissal costs between temporary and permanent contracts. This would help reduce duality effectively.	No action.
An option to improve the flexibility to adapt to economic conditions is to abolish legal extension of higher level collective bargaining agreements or replace it by an opt-in system, where employers decide whether to be represented in sectoral wage bargaining.	No action.
Extend access to training and job-search assistance for unemployed youth. Introduce comprehensive monitoring and benchmarking of placement services and active labour market policy (ALMP) implementation at regional level.	In February 2013 a comprehensive strategy based on talks with social partners included 100 measures in the education and training spheres to tackle youth unemployment. A youth guarantee plan was presented in December 2013. The infrastructure (information systems, profiling tools, application procedure) is being developed in 2014. The new Activation Strategy for Employment Strategy 2014-16 includes a regional ALMP performance model of 22 indicators. In 2013 and 2014, 15% and 40% respectively of ALMP funds were allocated by the central government to the regions based on the model. In 2015 it will be 60%.
Widen access to upper secondary education by narrowing criteria for grade advancement in lower secondary education to core competencies. Combine the school-based vocational education system and training contracts into one single scheme.	A new assessment system with standardised external exams will be implemented at the secondary level from the 2015/16 school year. The requirements to sit the lower secondary exam have been narrowed – a pass in Spanish and mathematics and the failure of no more than two subjects in internal assessment rather than an internally assessed pass in all subjects. The dual VET regulation (Royal Decree 1529/2012) brings together the basic rules for vocational education and training contracts.

Product market reform

Recommendations in previous <i>Surveys</i>	Actions taken
Further reduce the costs and procedures necessary to create businesses and eliminate sector-specific entry barriers, including for professional services as well as rail and road transport.	The Market Unity Law foresees broader use of the declaration and notice systems (with <i>ex post</i> controls) to simplify licensing procedures. The new system will be based on mutual recognition by all regions of approval in one region rather than requiring individual approvals from every region in which a business operates. There are plans to open the national rail market for passengers to private operators in 2014. In road transport a modification of the Land Transportation Law was approved in 2013, including measures to reduce the number of licences required, reduce administrative burden and make contractual resolution easier. A law on professional services and professional bodies, aiming at opening up professional services and highly regulated professions, has been prepared but its approval has been delayed.
Entry barriers for large-surface retail outlets imposed by regional governments should be lowered, and shop opening hours should be liberalised in those regions where restrictions remain. Raise the national minimum limit on hours that regions have to apply when regulating shop opening hours.	The 2012 simplification of licensing for small retail outlets (express license) was extended both in time and scope, covering larger outlets (up to 750 square meters) and activities beyond the retail trade. A Royal Decree was approved to liberalise opening hours in areas declared as of tourism interest. The number of festive days when opening is allowed has increased to 16 days per year. Application of these new regulations varies across regions. Royal Decree Law 8/2014 extends the list of Spanish cities that must include a Touristic Zone within their boundaries (<i>Zona de Gran Afluencia Turística</i>). These zones benefit from greater freedom on opening hours. This law also institutes as a general rule that the setting up, move or enlargement of commercial establishments does not require authorisation. It also diminishes the associated administrative burden and time associated with processing the authorisation.

Chapter Summaries

Chapter 1

Better harnessing talent and knowledge to boost sustainable medium-term growth in Spain

Structural transformation towards a more knowledge-based economy will strengthen Spain's medium-term growth prospects. To deal with long standing impediments to higher growth the government has a substantial structural reform programme touching on education, the labour market and the business environment. Areas of particular weakness to be tackled include the high number of poorly qualified long-term unemployed, skills mismatches and a high school drop-out rate, and insufficient innovation. Spain has done well in reducing the carbon emissions intensity of GDP growth but will need to do more to meet future targets and manage its scarce water resources. The resolution of acute banking and fiscal problems, and the cyclical upswing, provide a more solid platform for sustained growth. Raising trend growth will boost job creation, which is the most effective antidote to the strong rise in poverty and inequality that accompanied the sharp deterioration in the labour market during the crisis.

Chapter 2

Moving towards a more dynamic business sector in Spain

Policy efforts to revitalise entrepreneurship and investment in Spain are key to generating growth and new jobs. The government has a substantial reform program to make it easier to do business in Spain, which should in some cases be deepened. Boosting economic growth requires a new generation of high-growth companies and that resources flow towards the most productive firms. For this to happen, barriers to business growth have to be reduced by streamlining regulations and licencing procedures, internationalisation needs to be fostered, and competition strengthened. In addition, the negative impact of the crisis on companies, notably the high level of indebtedness and difficulties to obtain financing faced by some firms, has to be relieved. This would be facilitated by more efficient insolvency procedures and further development of non-bank financing.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Spain were reviewed by the Committee on 10 July 2014. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 28 July 2014.

The Secretariat's draft report was prepared for the Committee by David Haugh and Alberto Gonzalez Pandiella under the supervision of Pierre Beynet. Research assistance was provided by Desney Erb.

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