



Brussels, 27.2.2019
SWD(2019) 1008 final

COMMISSION STAFF WORKING DOCUMENT

**Country Report Spain 2019
Including an In-Depth Review on the prevention and correction of macroeconomic
imbalances**

Accompanying the document

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN
CENTRAL BANK AND THE EUROGROUP**

**2019 European Semester: Assessment of progress on structural reforms, prevention and
correction of macroeconomic imbalances, and results of in-depth reviews under
Regulation (EU) No 1176/2011**

{COM(2019) 150 final}

CONTENTS

Executive summary	4
1. Economic situation and outlook	8
2. Progress with country-specific recommendations	15
3. Summary of the main findings from the MIP in-depth review	19
4. Reform priorities	28
4.1. Public finances and taxation	28
4.2. Financial sector	34
4.3. Labour market, education and social policies	43
4.4. Competitiveness, reforms, and investment	57
Annex A: Overview table	74
Annex B: Commission Debt Sustainability Analysis and fiscal risks	80
Annex C: Standard tables	81
Annex D: Investment guidance on cohesion policy funding 2021-2027 for Spain	87
References	94

LIST OF TABLES

Table 1.1:	Key economic and financial indicators - Spain	14
Table 2.1:	Overall assessment of progress with 2018 CSRs	18
Table 3.1:	Outward spill-over heat map for Spain	20
Table 3.2:	Current account balance and net international investment position sensitivity analysis	22
Table 3.3:	MIP matrix	26
Table 4.2.1:	Financial soundness indicators, all banks in Spain	35
Table C.1:	Financial market indicators	81
Table C.2:	Headline Social Scoreboard indicators	82
Table C.3:	Labour market and education indicators	83
Table C.4:	Social inclusion and health indicators	84
Table C.5:	Product market performance and policy indicators	85
Table C.6:	Green growth	86

LIST OF GRAPHS

Graph 1.1:	Composition of GDP growth	8
Graph 1.2:	Contributions to potential growth	8
Graph 1.3:	Investment rate, 2010 prices	9
Graph 1.4:	Capital intensity and capital productivity	9
Graph 1.5:	Net lending / borrowing by sector	10
Graph 1.6:	Analysis of unit labour costs	11
Graph 1.7:	Activity, unemployment, long-term unemployment, youth unemployment, NEET	11
Graph 1.8:	Regional disparities on selected indicators	13
Graph 2.1:	Overall multiannual implementation of 2011-2018 CSRs by February 2019	15
Graph 3.1:	Current account and net international investment position	21
Graph 3.2:	Analysis of the rate of change of net international investment position— Spain	21
Graph 3.3:	Gross external debt by sector-type of financial assets	22
Graph 4.1.1.1:	Evolution of pension expenditure under the 2018 Ageing Report baseline and alternative scenarios	29
Graph 4.1.2.1:	Gross government debt — Spain	32
Graph 4.2.1:	Overvaluation gap with respect to price/income, price/rent and fundamental model-based valuation gaps	35
Graph 4.2.2:	Loans to the private sector	35
Graph 4.2.3:	Sources of financing of the Spanish economy	36
Graph 4.2.4:	Composition of debt — Spain	37
Graph 4.2.5:	Decomposition of y-o-y changes in debt-to-GDP ratios, households	37
Graph 4.2.6:	Gap to the fundamental-based and prudential benchmarks for household and NFC debt	38
Graph 4.2.1.1:	Determinants of private consumption (1), model forecasts for consumption (2) and savings' rate (3)	39
Graph 4.2.1.2:	Evolution of consumption by quintile, 2007-17 % change (left); and growth in consumption of durable goods by income level (right), 2008-17 % change	40
Graph 4.2.1.3:	Change in household financial balance sheets, 2008-17 % change (left), and change in income by income decile, 2008-17 % change (right)	40
Graph 4.2.7:	Decomposition of year-on-year changes in debt-to-GDP ratios, quarterly non-consolidated data, non-financial corporations	41
Graph 4.3.1:	The minimum wage as a percentage of average and median wage: the effect of planned increases in Spain	45
Graph 4.3.2:	Projected ratio of minimum to average wage in 2019 rate v. unemployment rate by region, 2017	46
Graph 4.3.3:	Newly signed temporary and permanent contracts	48
Graph 4.3.4:	At-risk-of-poverty or social exclusion rate and its components	52
Graph 4.3.5:	At-risk-of-poverty or social exclusion rate by age group	53
Graph 4.3.6:	In-work poverty	53
Graph 4.4.1:	Productivity gap, ES v. EA-3 in current prices	57

Graph 4.4.2: REER based on unit labour costs	58
Graph 4.4.3: Exports by total exported value by company	58
Graph 4.4.4: Evolution of business R&D intensity and public R&D intensity 2000-2017	62
Graph 4.4.5: Regional convergence in GDP per head to the EU average – 2014-2017	68
Graph 4.4.6: Weighted dispersion in GDP per head across Spanish regions (1)	68
Graph 4.4.7: RCI and regional R&D expenditure	69
Graph 4.4.8: Disparities in the Regional Competitiveness Index by sub-pillar, across regions and compared to EU-average (1)	70

LIST OF BOXES

Box 2.1: EU funds and programmes contribute to addressing structural challenges and to fostering growth and competitiveness in Spain	17
Box 3.1: Outward spill-overs	25
Box 4.1.1: Long-term sustainability implications of changes to the pension system and to health care policies	29
Box 4.1.2: Medium-term projections for government debt	32
Box 4.2.1: Determinants of private consumption	39
Box 4.3.1: Monitoring performance in light of the European Pillar of Social Rights	44
Box 4.4.1: Global Value Chains: the role of Spain	60
Box 4.4.2: Investment challenges and reforms in Spain	65

EXECUTIVE SUMMARY

Spain has continued to record strong economic growth and rapid job creation, but important challenges remain. Debt has been further reduced, but still represents a source of vulnerability. Unemployment is falling rapidly, in turn leading to a slight fall in poverty and social exclusion, but too many people remain without a job or work on temporary contracts and income inequality is marked. Productivity is growing in line with the euro area average. However, structural impediments to the free flow of productive resources, ranging from low innovation performance and skill gaps to fragmented product and service market regulation, are key drivers of Spain's productivity gap to the EU average. ⁽¹⁾ An evolving political context over the past year, with a change of government in June 2018 and new elections due in April 2019, has been reflected in general slow progress on reforms.

2018 marked the fifth year of robust economic growth for Spain, despite some deceleration. Real GDP grew by 2.5%, 0.5 percentage points less than in 2017. Economic activity was driven by consumer spending and capital formation, also helped by the expansionary measures in the 2018 budget. Growth is forecast to slow to 2.1 % in 2019 and 1.9 % in 2020, remaining well above the euro area average. Job creation is also expected to moderate, though unemployment will continue to fall to 13.3 % in 2020.

Due to its size, the positive impact of economic reforms in Spain has the potential to spill over to other countries. Simulations show that ambitiously removing barriers in market regulation, helping unemployed or inactive people to find work or training, making the taxation structure more growth-friendly and increasing

⁽¹⁾ This report assesses Spain's economy in light of the European Commission's Annual Growth Survey published on 21 November 2018. In the survey, the Commission calls on EU Member States to implement reforms to make the European economy more productive, resilient and inclusive. In so doing, Member States should focus their efforts on the three elements of the virtuous triangle of economic policy — delivering high-quality investment, focusing reform efforts on productivity growth, inclusiveness and institutional quality and ensuring macroeconomic stability and sound public finance. At the same time, the Commission published the Alert Mechanism Report (AMR) that initiated the eighth round of the macroeconomic imbalance procedure. The AMR found that Spain warranted an in-depth review, which is presented in this report.

R&D subsidies would have a small, but positive impact on other euro area countries.

Supporting Spain's sustainable growth requires investments to foster innovation and resource efficiency, to promote skills and employability, to upgrade rail infrastructure for transporting goods, extend energy connections with Europe, as well as to promote job quality and social inclusion. Capital formation in Spain rebounded after the crisis, though mainly in the private sector. Further investment on public and private research and investment, including for small and medium-sized companies, as well as on digitisation and resource efficiency, would bolster competitiveness and the innovation capacity of the economy, if acting in synergy with investment on skills. Improvements to electricity connections and to rail transport for goods are needed to improve access to markets in Spain and in Europe. Resources supporting employability and social inclusion are key to address the existing labour market challenges and make growth more inclusive. In all these areas, investment should be targeted at addressing the specific regional needs. Annex D identifies key priorities for support by the European Regional Development Fund and the European Social Fund Plus over 2021-2027, building on the analysis of investment needs and challenges outlined in this report.

Spain has made limited ⁽²⁾ progress on the 2018 country specific recommendations (CSRs):

There has been some progress in the following areas:

- **Measures were taken to modernise the public employment services and improve their cooperation with social services, but their capacity to support jobseekers and meet employers' needs remains limited.** There were efforts to reduce the use of temporary contracts in the public sector. Action to fight their abuse in the private sector is bearing some fruit but the impact of hiring incentives remains limited.

⁽²⁾ Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the overview table in the Annex.

There has been limited progress in the following areas:

- The institutional framework governing the prudent management of the public finances was not strengthened. A new governance structure for public procurement is being set up, but a nation-wide public procurement strategy has still not been put in place.
- The implementation of the Law on Market Unity is an important tool to promote market unity and better regulation but its implementation is proceeding slowly.
- Advances in the funding and governance of the research, development and innovation system have been modest, despite some positive steps. Cooperation between universities and businesses remains weak.
- Efforts to better match initial vocational education and training and tertiary education to employers' needs mostly focused on fostering dialogue between stakeholders. Regional disparities in educational outcomes persist.
- National unemployment assistance schemes are fragmented and there are gaps in the coverage of many regional income guarantee schemes. There has been little improvement in support to families, especially those most in need.

On progress in reaching the national targets under the Europe 2020 Strategy, Spain is on track to reduce greenhouse emissions and to achieve its renewable energy and tertiary education attainment targets. Sizeable gaps remain on the employment and early school leaving rates, even though they are steadily improving. By contrast, there was little progress towards the targets for R&D investment and reducing poverty risk.

The indicators of the Social Scoreboard supporting the European Pillar of Social Rights point to a number of challenges. Although improving, the employment rate remains low, including for women, who are still at a disadvantage to men in the jobs market. The proportion of people leaving education and training early is still high, and deep income and opportunities inequalities persist. The risk of

poverty or social exclusion remains high, particularly for children, and social transfers (other than pensions) have a weak impact in its reduction.

The main findings of the in-depth review contained in this report and the related policy challenges are as follows:

- **Risks to the sustainability of government finances remain significant in the medium to long term.** Public debt is expected to have further declined slightly in 2018, to 96.9 % of GDP. Further declines are projected until 2020, supported by economic growth and a small primary surplus as from 2019. However, when adjusted by the impact of the economic cycle, Spain's government deficit remains stubbornly high, as the level of taxation is low in relation to expenditure. On pensions, recent temporary departures from the 2013 reform and plans to re-establish the link of pensions to the consumer price index are likely to significantly increase expenditure in the medium and long run, unless compensating measures are taken.
- **Reduction of private debt has continued but it remains high.** Total private debt of households and non-financial corporations is projected to have fallen further over the twelve months to June 2018. As net lending from Spanish banks has resumed, the pace of debt reduction has slowed. Household debt has even stopped decreasing in 2018, largely due to growth in new consumer credit.
- **Spain's net external debt declined further but remains sizeable.** The current account balance is expected to remain in surplus until 2020, despite some weakening. Together with still high GDP growth, this should continue supporting the improvement of Spain's net international investment position.
- **Unemployment continues to fall but it remains well above the EU average, especially for young people.** Continued dynamic job creation has led to a significant reduction of the unemployment rate, which however remains very high. The increase in the minimum wage by 22.3 % in 2019 could help reduce in-work poverty but also have adverse

effects on job opportunities for young and low-skilled workers.

Other key structural issues analysed in this country report, which point to particular challenges for Spain's economy, are the following:

- **The widespread use of temporary contracts holds back Spain's growth potential and social cohesion.** Moving from a temporary contract to a permanent one remains difficult. Barriers to mobility of labour reduce opportunities for jobseekers and hamper its efficient allocation across the country. Incomplete and broken careers for many result in low entitlements to social protection and weigh on the adequacy and sustainability of the pension system. They also leave a large untapped pool of workers in the face of fast population ageing and low productivity growth.
- **The proportion of people at risk of poverty or social exclusion decreased slightly in 2017 but remains high, particularly among children.** Temporary workers, the low-skilled and those not born in the EU face one of the highest in-work poverty risks in the EU. Public spending on family benefits, which is half of the EU average, remains poorly targeted at low-income families. Healthcare delivery could better respond to emerging challenges related to population ageing, disabilities and chronic conditions.
- **Skills mismatches and shortages weigh on productivity growth, especially in some regions.** The proportion of people leaving education and training early without a qualification remains high and displays large regional variation, as do educational outcomes. The take up of vocational education and training by young students is still low, as is participation in adult learning. New tertiary graduates still face challenges finding suitable work.
- **Innovation is hampered by a number of factors and this also affects productivity.** Spain is a "moderate innovator" in the EU. The innovation performance of the country suffers from underinvestment in public and private R&D, but also from weak coordination across all levels of government and insufficient reliance on policy evaluation. Skills shortages and mismatches are another important barrier to the development and use of advanced technologies. Stronger cooperation between academia and businesses could contribute to the diffusion of knowledge and help increase the presence of innovative firms. All these factors underlie Spain's low performance in terms of knowledge-intensive exports, particularly services.
- **Spain is making progress on digitisation, but still does not fully exploit the growth potential offered by it.** Spain is among the best EU performers in terms of provision of digital public services, but there is still room for further efforts. Despite significant improvement in infrastructure, the take-up of ultrafast broadband remains low. Businesses, especially small and medium-sized enterprises, often refer to shortage of information and communication technology's specialists as a constraining factor in production.
- **The restrictiveness and fragmentation of regulation within Spain prevents companies from benefiting from economies of scale.** Implementing more decisively the Law on Market Unity and removing identified restrictions for professional services would improve growth opportunities and competition in many services sectors. The large presence of small companies in the economy also explains Spain's productivity gap, as their productivity lags significantly behind that of larger firms. Small and medium-sized firms account for around half of R&D investment by firms, but are less able to absorb knowledge and technology.
- **Incomplete connections for goods transport by rail and limited integration with the EU electricity and gas markets also prevent Spain from fully benefitting from the EU single market.** Spain needs to invest further in electricity interconnections to achieve the target of at least 10% of its installed electricity production capacity by 2020. Investment is also needed to allow for greater use of rail for freight transport, including cross-border

connections with France and Portugal and connections to ports and logistic hubs.

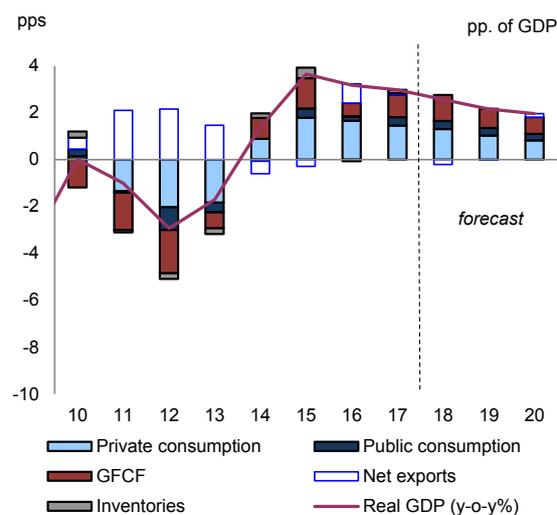
- **Increasing the share of energy from renewables and energy efficiency for buildings would be conducive to more sustainable growth.** Latest figures show an increase in final and in primary energy consumption and the latter now exceeds the indicative 2020 threshold. With a 17.5 % energy share of renewables in 2017, Spain is progressing well to meet its 20% 2020 target, but filling the gap to that target is still demanding. As CO₂ emissions from transport are rising, further action is also needed to enhance the transition to a clean and sustainable mobility.
- **Spain faces specific territorial cohesion challenges,** such as depopulation and ageing in rural areas, on the one hand, and demographic pressure in some urban areas, on the other. Certain areas of Spain are amongst the most exposed in Europe to climate change and there are significant challenges in managing water and wastewater.
- **Stronger and sustained coordination between national and regional authorities could make policies more effective.** Spain's high degree of decentralisation makes regions key actors for the successful implementation of policies and reforms. In policy areas where both national and regional levels of government are involved in reform implementation, coordination and accountability remain a challenge.

1. ECONOMIC SITUATION AND OUTLOOK

Economic growth

Spain has continued to record robust growth, but the economy has started to show signs of deceleration. The ongoing expansion is underpinned by a more balanced growth pattern than before the crisis, also reflecting the impact of the structural reforms implemented in the aftermath of the crisis. 2018 marked the fifth year of expansion of Spain's economic activity, with real GDP growing by 2.5 %, 0.5 percentage points less than in 2017 but still well above the EU average. ⁽³⁾ Supported by the expansionary measures in the 2018 budget, private consumption and investment were the main growth drivers, while net exports detracted 0.4 pps. from growth (Graph 1.1).

Graph 1.1: Composition of GDP growth



Source: European Economic Forecast, autumn 2018

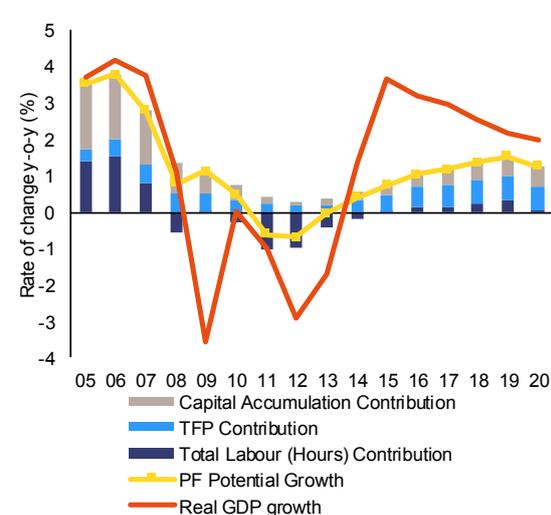
Economic activity is expected to moderate further in 2019 and 2020 as the cycle matures. Growth is expected to decelerate to 2.1 % in 2019 and 1.9 % in 2020. The deceleration would mainly be driven by a slowdown in private consumption, as pent-up demand is absorbed and households set aside part of their disposable income. The household saving rate is thus projected to rebound in 2019 from the historic low recorded in 2018 and

⁽³⁾ GDP growth and inflation forecasts are based on the European Commission 2019 winter forecast (which only takes into consideration data released until 31st January 2019). All other variables and GDP components are based on the Commission 2018 autumn forecast

increase slightly further in 2020. Job creation is forecast to ease, also due to the expected dampening impact of the increase in the minimum wage. Still, employment growth is set to remain robust and allow for further reductions in the unemployment rate. After years of buoyant growth, investment is also expected to moderate in 2019 and 2020 but continue growing above final demand, both in equipment and construction.

Risks to the growth outlook mainly relate to the global environment. Most downside risks identified in the first half of 2018, including lower than expected global and EU growth and trade tensions, have materialized. This resulted in lower than expected growth of exports in 2018 and translated into small downward revisions of the growth forecast for 2019 and 2020. ⁽⁴⁾ Remaining downside risks to the global environment and increased uncertainty could further constrain growth over the two years.

Graph 1.2: Contributions to potential growth



Source: European Commission.

Potential growth is projected to continue increasing. After plummeting during the crisis years, potential output growth has continued to increase, and is estimated to reach 1.5 % in 2020, converging towards the euro area average (1.6 %) (Graph 1.2). More than half of this increase comes

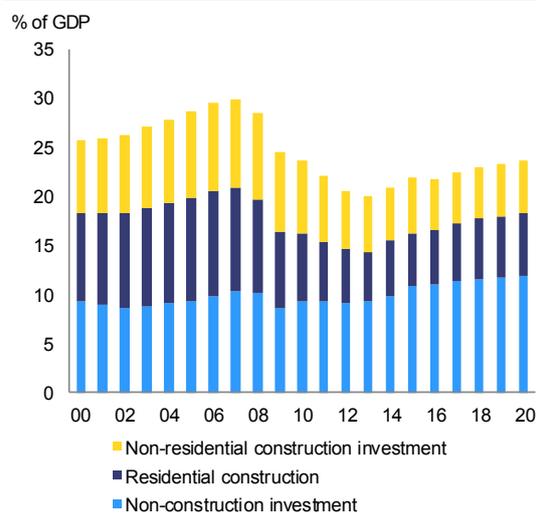
⁽⁴⁾ Compared to the Commission 2018 spring forecast, the growth forecasts for Spain were revised down in autumn 2018 by 0.2 pps. for both 2018 and 2019, and by 0.1 pps. in both 2019 and 2020 in winter 2019.

from labour, mostly due to the fall of the structural unemployment rate (as proxied by the NAWRU), which nevertheless remains much higher than the EU average; and, as of 2016, positive migration flows. The contribution of capital and total factor productivity (TFP) to potential output is now in line with the euro area average, after having increased since the crisis. The output gap is expected to have become positive in 2018 for the first time since 2008, and slowly widen until 2020, when it will reach 2.2 %.

Investment

Non-construction investment now exceeds its pre-crisis peak. After reaching almost 30 % of GDP in the pre-crisis peak in 2007 (two thirds of which was construction), the rate of capital formation fell to 19 % in 2013, driven by the collapse in residential investment. Construction investment has started again to increase its weight in GDP but at 11 % of GDP in 2018, it remains far from its pre-crisis level. By contrast, non-construction (mainly equipment) investment now stands at a record-high of 11.5 % of GDP.

Graph 1.3: Investment rate, 2010 prices

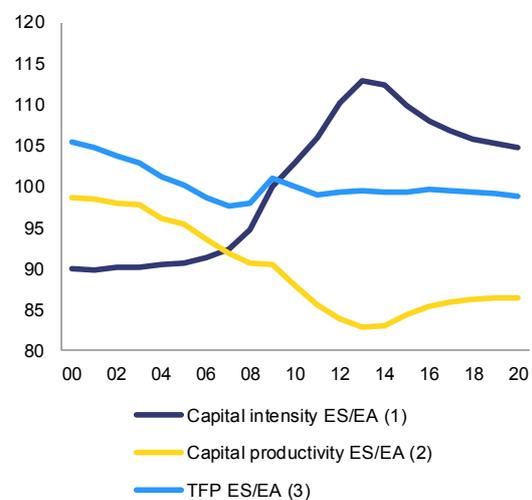


Source: AMECO.

Capital intensity in Spain is above the euro area average, but its productivity is still below, despite having improved. In the pre-crisis period investment flowed to non-tradable sectors, and in particular, construction, which at the time had high profitability but low productivity. This resulted in high capital intensity, but low productivity of

capital (Graph 1.4). This trend was reverted during the recovery, as strong job creation resulted in a decline in capital intensity and an increase in its productivity relative to the euro area, suggesting that capital allocation has improved in recent years. The increase in total factor productivity growth relative to the euro area also points in this direction, suggesting a structural improvement in the quality of investment.

Graph 1.4: Capital intensity and capital productivity



(1) Capital intensity: net capital stock at 2010 prices per person employed; total economy, relative to EA
 (2) Capital productivity: gross domestic product at 2010 reference levels per unit of net capital stock; total economy, relative to EA
 (3) Total factor productivity relative to the euro area, 2010=100

Source: AMECO.

External position

The contribution of net exports to growth is expected to improve over the Commission's forecast horizon. The contribution of the external sector to growth is projected to remain negative but improve in 2019, and turn neutral in 2020. Despite weak growth in global trade, exports are forecast to accelerate slightly in 2019 and 2020, as they recover some of the market shares lost in 2018. At the same time, imports are expected to decelerate broadly in line with final demand.

The current account balance has declined, but is expected to remain in surplus. The current account surplus declined in 2017 and is expected to weaken further in 2018, due to the worse-than expected trade performance and a deterioration of

terms of trade. It will then remain broadly stable at around 1 % of GDP over the period 2019-2020, as swings in terms of trade compound changes in export and import volumes. In cyclically-adjusted terms, and after years of improvement, the current account balance is expected to have declined slightly in 2018 to 1.5 % of GDP.

Persistent current account surpluses are slowly translating into a reduction of Spain's net external liabilities. Despite the current account surpluses registered since 2013, negative valuation effects (partly reflecting improvements in confidence and higher value of Spanish assets) have limited the improvements in the net international investment position (NIIP). Still, the net international investment position has narrowed by more than 19 pps. of GDP since its peak, but at -80.6 % of GDP in Q3-2018, it remains very negative. Continued current account surpluses and high nominal GDP growth projected until 2020 are expected to facilitate a further improvement of the net international investment position (see Section 3). Across sectors, the net lending position of the private sector since 2009 (to a large extent due to the corporate sector) has been partly offset with the borrowing position of the general government sector (Graph 1.5).

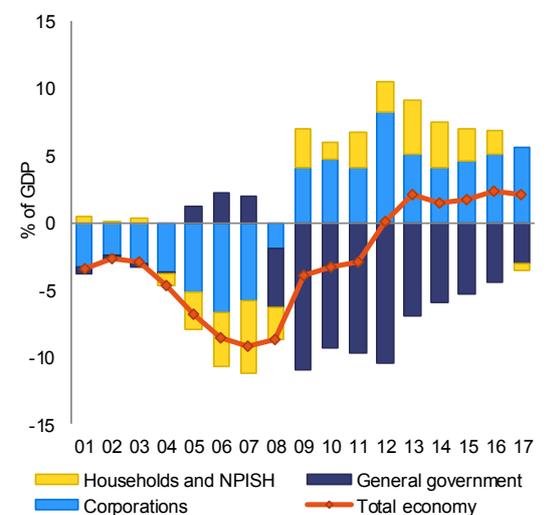
Private and public debt

The stock of private debt has continued declining despite resumed growth of new credit, but deleveraging needs persist. Despite rapid substantial deleveraging by both households and corporates, private sector debt remains high. The debt level of the corporate sector has continued declining throughout 2018 despite the increase in new credit, driven by robust GDP growth. By contrast, the total stock of household debt has stopped declining in 2018 due to significant growth in new credit to finance durable consumer spending, as well as growth in lending for house purchases and a reduction in the repayment of mortgages. Deleveraging needs persist, particularly for some over-indebted households that are particularly vulnerable to changes in the economic and financial situation (such as low-income households) (see Sections 3 and 4.2).

After the sharp adjustment that followed the crisis, the housing market and construction sector are recovering. Despite sustained increases

in recent years, housing prices remain far from the pre-crisis maximum levels both in nominal and real terms. House price developments vary greatly across regions, with larger increases in areas where the stock of unsold houses is lower. Despite the pickup in housing investment in recent years, its volume in 2018-Q3 was still at less than half of the pre-crisis peak (see Section 4.2).

Graph 1.5: Net lending / borrowing by sector

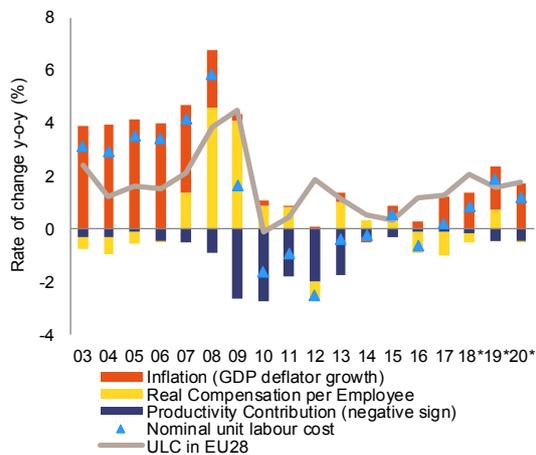


Source: INE.

The public debt ratio is set to continue its slow fall but remain high over the forecast horizon.

The general government debt ratio is expected to decline slowly from 98.1 % in 2017 to 95.4 % of GDP in 2020, as strong nominal GDP growth, and – as from 2019 – a small primary surplus, more than offset the impact of interest expenditure and debt-increasing stock-flow adjustments over the forecast period. After reaching 3.1 % of GDP in 2017, the general government deficit is expected to decline further to 2.7 % of GDP in 2018, as still robust economic growth largely offsets the impact of the expansionary measures in the 2018 budget. According to the Commission 2018 autumn forecast, the headline deficit is then set to decline to 2.1 % of GDP in 2019 and to narrow to 1.9 % of GDP in 2020, on the back of continued firm economic growth and the net impact of the measures that had been announced in the 2019 Draft Budgetary Plan. The structural deficit is expected to worsen slightly to 3.1 % of GDP in 2018 and to remain almost unchanged over the following two years with unchanged policies. While some of the new expenditure mentioned in

Graph 1.6: Analysis of unit labour costs



Source: AMECO, European Commission

the Draft Budgetary Plan has already been adopted (notably, the increase of the minimum salary, the increase in pensions and the increase of the wage of public employees), the draft Budget Law for 2019 submitted to Parliament on 14 January 2019 was rejected on 13 February 2019. General elections shall be held on 28 April 2019. The situation of the general government deficit shall be reassessed in light of evolving circumstances in the forthcoming Commission 2019 spring forecast.

Inflation

Core inflation is expected to increase gradually, as the output gap widens. Headline inflation reached 1.7% in 2018 and is forecast to decline to 1.2% in 2019 due to base effects as oil prices stabilise. It is then set to increase to 1.5% in 2020, driven by a gradual pick-up in core inflation, as wages increase, especially in 2019 under the impact of the increase in the minimum wage, and the positive output gap widens.

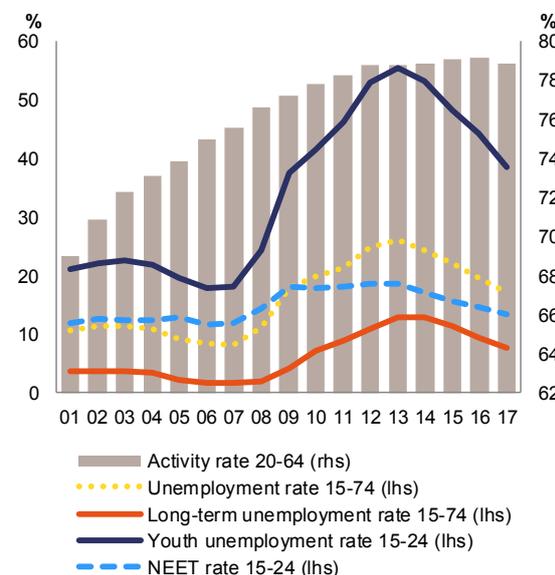
Labour market

Unemployment is set to continue falling, despite an expected slowdown in job creation. The economic expansion has been accompanied by strong job creation, supported by the impact of the previous labour market reforms and wage moderation. In net terms, more than 2.4 million jobs have been created since the recovery started in Q1-2014, bringing the unemployment rate to 14.5 % in Q4-2018 (seasonally adjusted).

Employment growth started to slow down in 2018, but at 2.5%, it remained robust. Job creation is forecast to slow down further in 2019 and 2020 as a consequence of lower growth of final demand, as well as the expected dampening impact of the increase in the minimum wage in 2019. The unemployment rate is set to continue falling, to 13.3 % in 2020 (the lowest since 2008).

Nominal wages have started to grow again, and are expected to exceed inflation over the forecast horizon. After years of very moderate or negative growth, wages increased by 1 % in 2018. Wage growth is projected to peak at 2.4 % in 2019, also under the impact of the increase in the minimum wage, and then moderate but still be above inflation in 2020. As labour productivity is forecast to grow moderately over the forecast horizon, this will lead to increases in nominal unit labour costs (Graph 1.6). In 2019, these are expected to grow above the euro area average, but in 2020 Spain would continue to record cost competitiveness gains.

Graph 1.7: Activity, unemployment, long-term unemployment, youth unemployment, NEET



(1) Activity rate (% of population), ages 20-64. (2) Unemployment rate and long-term unemployment rate (% of labour force), ages 15-74. (3) Youth unemployment rate (% of labour force), ages 15-24. (4) NEET: Not in employment, education or training (% of population), total, ages 15-24
Source: Eurostat, LFS.

A high level of labour market segmentation, long-term unemployment, and population

ageing weigh on potential growth. The youth unemployment rate has decreased progressively, from 53 % in 2014 to 33.1 % in Q4-2018, as did the long-term unemployment rate (from 12.9 % in 2014 to 6.3 % in Q4-2018) (Graph 1.7). However, both rates continue to be among the highest in the EU. Although open-ended contracts represent an increasing share of job creation, this has not been sufficient to reduce the share of workers on temporary contracts (26.9 % in Q3-2018), which remains among the largest in the EU. Activity rates are stagnant since 2012 and slightly decreased in 2017. Population ageing is affecting the composition of the active population, and calls for increasing labour supply and the duration of working careers. A highly segmented labour market, population ageing and skills gaps and mismatches act as a brake on potential growth and productivity.

Poverty, inequality and social inclusion

Improvements in the social situation reflect progress in labour market conditions but poverty indicators remain above their pre-crisis levels. Since the peak of 2014, around 1.2 million people stopped being at risk of poverty or social exclusion. The proportion of people at risk of poverty or social exclusion (AROPE) has declined mostly thanks to a reduction in the share of people living in low work-intensity households. In 2017, the proportion of people at-risk-of-poverty, a measure of relative poverty, was 21.6 %, above the EU average (16.9 %) and its pre-crisis level (19.8 % in 2008). At the same time, the share of people experiencing severe material deprivation, a measure of absolute poverty, stood at 5.1 % in 2017 (below the EU average of 6.6%). As highlighted in the Social Scoreboard accompanying the European Pillar of Social Rights (see Section 4.3.3), the poverty-reducing impact of the benefits system remains below the EU average and is particularly low for children.

Income inequalities remain high, while showing slight signs of improvement. In 2017 ⁽⁵⁾, the relative income of the top 20 % of households was unchanged at 6.6 times that of the poorest 20 %, above the EU average (5.1). Flash estimates ⁽⁶⁾

point to a slight improvement in 2018 (income year 2017). Likewise, the Gini coefficient ⁽⁷⁾ decreased slightly from 34.5 in 2016 to 34.1 in 2017, while remaining above the EU average (30.3) and its pre-crisis level (32.4). In addition, the high proportion of children at risk of poverty or social exclusion (31.3 % in 2017) and high rate of early school leaving suggests many young people face a disadvantaged start in life, with low prospects for upward social mobility (OECD, 2018a).

Regional disparities

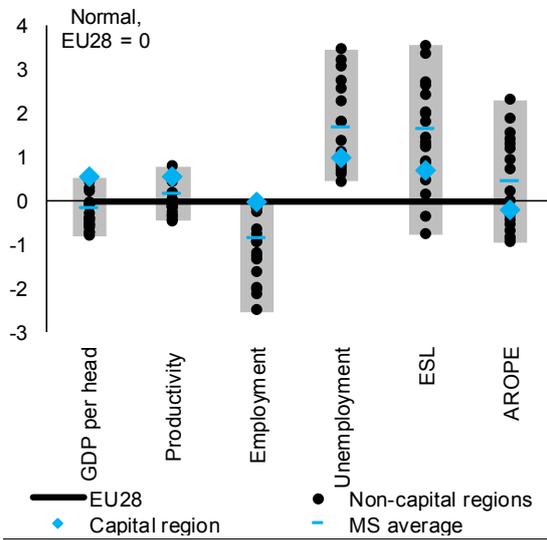
Significant regional socio-economic disparities persist in Spain. Regional disparities in terms of GDP per head have been closely linked to labour market developments, and in particular, the employment rate (European Commission 2018a, p. 9-10). Disparities in GDP per head increased after 2008 due to the asymmetric impact of labour shedding across regions, and started to decline only slightly after 2015 in parallel with the recovery of the labour market, but remain larger than in the pre-crisis period. Beyond GDP, many socio-economic indicators continue to present wide territorial disparities at regional level, such as innovation, entrepreneurship, competitiveness of small and medium-sized companies. Regional disparities are the widest in labour and social outcome indicators, where most regions underperform relative to the EU-average (see Section 4.3 and 4.4.3 and Graph 1.8).

⁽⁷⁾ The Gini coefficient ranges between 0 and 1. Lower values indicate higher equality. To take into account differences in household size and composition, the total disposable household income is "equivalised".

⁽⁵⁾ EU-SILC survey, income year 2016

⁽⁶⁾ Experimental flash estimates produced by Eurostat for income year 2017.

Graph 1.8: Regional disparities on selected indicators



(1) GDP in PPS per head (2016), Labour Productivity in PPS (2016), Employment rates (20-64) (2017), Unemployment rate (15-74) (2017), ESL: Early School Leavers (2017); AROPE: at-risk-of poverty or social exclusion rate (2017).

Source: Eurostat, European Commission calculations

Table 1.1: Key economic and financial indicators - Spain

	2004-07	2008-12	2013-15	2016	2017	forecast		
						2018	2019	2020
Real GDP (y-o-y)	3,7	-1,3	1,1	3,2	3,0	2,5	2,1	1,9
Potential growth (y-o-y)	3,6	0,9	-0,1	0,7	1,0	1,2	1,4	1,5
Private consumption (y-o-y)	3,8	-2,0	0,5	2,9	2,5	.	.	.
Public consumption (y-o-y)	5,8	1,3	-0,2	1,0	1,9	.	.	.
Gross fixed capital formation (y-o-y)	6,1	-8,4	2,5	2,9	4,8	.	.	.
Exports of goods and services (y-o-y)	4,8	0,9	4,2	5,2	5,2	.	.	.
Imports of goods and services (y-o-y)	8,5	-5,2	3,8	2,9	5,6	.	.	.
Contribution to GDP growth:								
Domestic demand (y-o-y)	4,9	-3,1	0,7	2,4	2,8	.	.	.
Inventories (y-o-y)	0,0	0,0	0,1	-0,1	0,1	.	.	.
Net exports (y-o-y)	-1,3	1,8	0,2	0,8	0,1	.	.	.
Contribution to potential GDP growth:								
Total Labour (hours) (y-o-y)	1,6	-0,2	-0,5	0,0	0,2	0,2	0,2	0,3
Capital accumulation (y-o-y)	1,7	0,7	0,2	0,3	0,3	0,4	0,5	0,5
Total factor productivity (y-o-y)	0,3	0,4	0,2	0,5	0,6	0,6	0,6	0,7
Output gap	2,5	-4,0	-7,0	-2,2	-0,4	1,0	1,8	2,2
Unemployment rate	9,2	19,1	24,2	19,6	17,2	15,6	14,4	13,3
GDP deflator (y-o-y)	3,8	0,5	0,2	0,3	1,2	1,4	1,6	1,7
Harmonised index of consumer prices (HICP, y-o-y)	3,2	2,3	0,2	-0,3	2,0	1,7	1,2	1,5
Nominal compensation per employee (y-o-y)	3,9	2,5	0,8	-0,5	0,3	1,0	2,4	1,7
Labour productivity (real, person employed, y-o-y)	-0,2	1,7	0,7	0,6	0,4	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	3,5	0,4	0,0	-0,6	0,2	0,9	1,9	1,2
Real unit labour costs (y-o-y)	-0,3	-0,1	-0,3	-0,9	-1,0	-0,5	0,3	-0,5
Real effective exchange rate (ULC, y-o-y)	2,6	-1,7	-1,1	-0,8	0,5	0,6	-0,4	-0,9
Real effective exchange rate (HICP, y-o-y)	1,2	-0,5	-1,0	0,8	1,4	2,0	-1,2	-0,8
Net savings rate of households (net saving as percentage of net disposable income)	2,2	3,9	3,4	1,8	-0,8	.	.	.
Private credit flow, consolidated (% of GDP)	26,9	-0,7	-6,2	-1,1	0,4	.	.	.
Private sector debt, consolidated (% of GDP)	165,3	196,5	166,1	147,1	139,3	.	.	.
of which household debt, consolidated (% of GDP)	73,2	82,6	72,7	64,5	61,1	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	92,1	113,9	93,4	82,7	78,2	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	4,4	6,6	4,8	3,8	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-5,4	3,9	4,6	5,1	5,6	5,4	4,5	4,5
Corporations, gross operating surplus (% of GDP)	20,5	23,9	24,0	24,7	25,3	25,5	25,2	25,5
Households, net lending (+) or net borrowing (-) (% of GDP)	-3,3	1,3	3,2	1,7	-0,4	-1,3	-1,1	-1,1
Deflated house price index (y-o-y)	9,6	-8,3	-2,2	4,6	4,5	.	.	.
Residential investment (% of GDP)	11,6	7,2	4,3	4,8	5,2	.	.	.
Current account balance (% of GDP), balance of payments	-7,9	-4,2	1,3	2,3	1,8	1,1	0,9	1,0
Trade balance (% of GDP), balance of payments	-5,2	-1,2	2,7	3,2	2,9	.	.	.
Terms of trade of goods and services (y-o-y)	0,3	-1,1	0,4	0,5	-0,8	-1,4	-0,5	0,0
Capital account balance (% of GDP)	0,7	0,4	0,6	0,2	0,2	.	.	.
Net international investment position (% of GDP)	-65,5	-88,8	-94,2	-85,3	-83,8	.	.	.
NIIP excluding non-defaultable instruments (% of GDP) (1)	.	.	-69,5	-62,4	-58,1	.	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	115,8	150,6	155,8	157,0	155,9	.	.	.
Export performance vs. advanced countries (% change over 5 years)	7,1	-3,8	-4,7	-0,7	4,8	.	.	.
Export market share, goods and services (y-o-y)	.	.	1,1	5,8	0,4	.	.	.
Net FDI flows (% of GDP)	3,9	-0,3	0,4	1,3	1,4	.	.	.
General government balance (% of GDP)	1,3	-9,0	-6,1	-4,5	-3,1	-2,7	-2,1	-1,9
Structural budget balance (% of GDP)	.	.	-1,5	-3,1	-2,9	-3,2	-3,2	-3,3
General government gross debt (% of GDP)	40,5	61,5	98,4	99,0	98,1	96,9	96,2	95,4
Tax-to-GDP ratio (%) (3)	36,2	32,1	34,3	34,1	34,5	34,9	35,3	35,3
Tax rate for a single person earning the average wage (%)	20,4	21,1	22,4	21,4
Tax rate for a single person earning 50% of the average wage (%)	10,6	9,5	11,2	10,2

(1) NIIP excluding direct investment and portfolio equity shares

(2) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.

(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation

Source: Eurostat and ECB as of 31-1-2019, where available; European Commission for forecast figures (Winter forecast 2019 for real GDP and HICP, Autumn forecast 2018 otherwise).

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

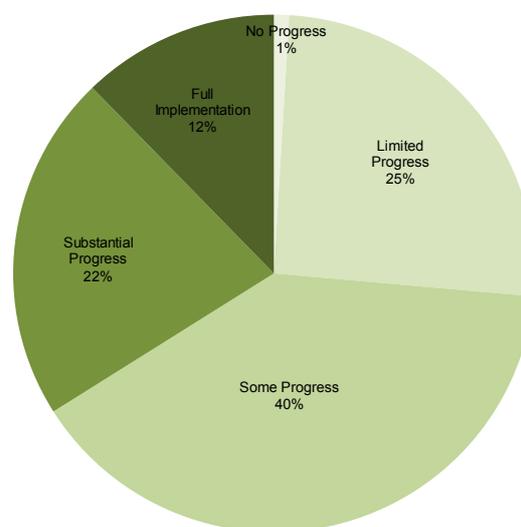
Since the start of the European Semester in 2011, 74 % of all country-specific recommendations addressed to Spain have recorded at least 'some progress'.⁽⁸⁾ 26 % of the country-specific recommendations (CSRs) recorded 'limited' or 'no progress' (Graph 2.1). The reforms carried out during and in the years after the economic and financial crisis have contributed to the Spanish economy's strong performance in the last years. The speed of implementation has, however, slowed somewhat since 2014 and there has been some reform backtracking, namely in the area of pensions. In several policy areas subject to CSRs, both the national and regional levels of government are involved. In those areas, coordination and unclear accountability remain challenges to a successful reform implementation.

Recommendations concerning the financial sector and insolvency framework have to a large extent been addressed, but the sustainability of public finances is still not ensured. The restructuring of banks that had received state aid has been accomplished and confidence in the resilience of the Spanish banking sector as a whole has been restored. The reform of the corporate and personal insolvency frameworks has facilitated private debt reduction and made company defaults less onerous. The 2011 and 2013 pension reforms made public finances more sustainable in the long term. However, the decision to temporarily depart from the index for pension revaluation in 2018 and 2019 will be costly. A more permanent relinking of pensions to the Consumer Price Index as from 2020 that is currently being discussed would further raise long-term spending on pensions, unless offset by other measures. The fiscal framework has seen various improvements since 2012, but the automatic implementation of the Stability Law's mechanisms is not ensured.

In labour market and social policy, significant gaps remain despite substantial progress in recent years. The past reforms of the labour market have supported strong employment gains, by increasing its responsiveness to economic growth. Still, unemployment and long-term unemployment remain high, especially among

young and low skilled workers. Some steps have been taken to address the widespread use of temporary contracts, often of short duration. However, their impact has so far been modest. Progress has been less prominent in social policies, notably concerning income support schemes and family policies, as well as in education.

Graph 2.1: Overall multiannual implementation of 2011-2018 CSRs by February 2019



- (1) The multiannual assessment looks at the implementation progress since a CSR was first adopted until February 2019.
(2) The assessment of CSRs related to fiscal policy excludes compliance with the Stability and Growth Pact.
(3) Assessment categories in 2011-2012 differed from those in the following years.

Source: European Commission

Limited progress has been achieved in implementing product market reforms and improving research and innovation in recent years. In the past few years, Spain has received recommendations to address regulatory fragmentation in its internal market and to strengthen research and innovation, a prerequisite for sustainable productivity growth. The Law on Market Unity has been in force for five years, and while it is being applied its impact is still limited. The lack of strong cooperation at all levels of government on market unity has so far translated into few tangible results. No policy measures have been taken to remove restrictions to firm growth or those affecting professional services, which had been the subject of previous years' CSRs. Public support for R&D remains low. There were a few advances in innovation governance and public-

⁽⁸⁾ For the assessment of other reforms implemented in the past, see in particular section 4.1, 4.2, 4.3 and 4.4.

private cooperation in research and tertiary education, but some of the measures taken may need some time before they have a measurable impact.

Overall, Spain has made limited progress in addressing the 2018 Country-specific Recommendations (see Table 2.1 and Annex A).

While the strengthening of the public procurement framework saw limited advances, no progress has been recorded to strengthen the fiscal framework (CSR 1), and therefore in addressing the Council Recommendations for the Euro Area to ensure sustainable public finances and remove investment bottlenecks. In labour market, social and education policy (CSR 2), some regions have advanced towards better coordination between public

employment and social services, and efforts have been undertaken to fight the abuse of temporary contracts and to reduce their number in the public sector. However, overall progress has been limited for CSR 2. The level of public investment in R&D remains unchanged in the absence of a new Budget Law for 2019 and there have been limited steps to enhance the evaluation culture for innovation policies. National courts are applying the Law on Market Unity. However, the few measures taken to help its implementation (work in sectorial conferences, trainings), have not had a visible impact yet. Overall, progress has also been limited on CSR 3.

Box 2.1: EU funds and programmes contribute to addressing structural challenges and to fostering growth and competitiveness in Spain

Spain is one of the largest beneficiaries of EU funds, concentrated in areas of highest EU value-added and on existing challenges and opportunities. The European Structural and Investment Funds (ESI Funds) deliver a critical mass of investments to support Spain in fostering lasting socio-economic convergence, resilience and territorial cohesion. A total amount of EUR 39.9 billion was allocated to Spain for the 2014-2020 Multiannual Financial Framework, potentially representing around 0.5 % of the country's current GDP. By the end of 2018, some EUR 24 billion were allocated to specific projects, representing about half of the total budget available for the 2014-2020 period (including the national contribution). In addition, around EUR 600 million were allocated to projects on strategic energy infrastructure and cross-border interconnections through the Connecting Europe Facility EU funding instrument. Spanish research institutions, innovative firms, researchers and academics benefitted also from Horizon 2020 EU funding instrument with EUR 3.3 billion disbursed so far.

European Structural and Investment Funds support the implementation of the Country-specific Recommendations and structural reforms in Spain. Actions financed include closer collaboration between businesses and research institutions, thus boosting the research and innovation system. As a result, European Structural and Investment Funds helped more than 3 000 enterprises in building cooperation with research institutions and about 450 firms in introducing new products on the markets in 2017. European Structural and Investment Funds are also promoting access and adaptation to the labour market, investing in education and training, and combatting poverty, discrimination and social exclusion, with a strong focus on youth, in line with the principles of the European Pillar of Social Rights. So far, the European Social Fund and the Youth Employment Initiative have supported more than 3 million activities, among others, employment subsidies, traineeships, apprenticeships, counselling, training courses, dual Vocational Education and Training and social services targeting participants of different ages and backgrounds.

EU funding contributes to mobilising significant private investment. EUR 1.4 billion of European Structural and Investment Funds (including the EUR 800 million for the SMEs Initiative) has been allocated to leverage additional private capital in the form of loans, guarantees and equity. The SMEs Initiative has already offered guarantees allowing 43 500 enterprises to receive loans and pursue their investments in the development of the companies.

In addition, the Commission can provide tailor-made technical support upon a Member State's request via the Structural Reform Support Programme to help implement growth-sustaining reforms to address challenges identified in the European Semester process or other national reforms. In Spain, work has started, for example, on assisting the Ministry of Justice to enhance the implementation of e-justice, on carrying out an expenditure review to identify possible areas for improving spending efficiency, and on improving the management capacity of the European Maritime and Fisheries Funds.

The overall volume of approved operations by the European Investment Bank, with the European Fund for Structural Investment (EFSI) backing, amounts to EUR 8.3 billion, which is set to trigger a total of EUR 45.4 billion in additional private and public investments (February 2019). Spain ranks amongst the highest in the EU in overall volume of approved operations as a share of GDP. 86 projects involving Spain were approved under the infrastructure and innovation window of the European Fund for Structural Investment; amounting to EUR 7 billion which should, in turn, generate EUR 30.7 billion of investments. Under the SME component, 27 agreements with intermediary banks were approved for a total of EUR 1.3 billion, which should mobilise close to EUR 15.5 billion of total financing. This support is expected to benefit 129 854 small and medium-sized enterprises and mid-cap companies. As an example of project supported by the European Investment Bank, the Empresa Municipal de Transportes of Palma de Mallorca is receiving EUR 30 million to replace the company's existing urban buses with new cleaner vehicles powered by compressed natural gas.

EU action contributes to strengthen national, regional and local authorities as well as the civil society. More than EUR 700 million have been allocated for strengthening capacity of public administrations at different levels and prompting close cooperation with stakeholders.

There are also other Commission initiatives contributing to boost the structural transformation of the economy. The pilot action on Industrial Transition helps to develop a comprehensive strategy for regional economic transformation building on their smart specialization strategy, clusters and digitization of industry plans. The action encourages interregional cooperation and the creation of value chains across European regions, identifies collaboration and funding opportunities at European, national and regional level, promotes regional and cluster partnerships focusing on mutual learning and sharing of good practices in innovation policies.

More information at: <https://cohesiondata.ec.europa.eu/countries/ES>

Table 2.1: Overall assessment of progress with 2018 CSRs

Spain - 2018 CSRs	Overall assessment of progress: Limited
<p>CSR 1: <i>Ensure compliance with Council Decision (EU) 2017/984 giving notice under the excessive deficit procedure, including through measures to enforce the fiscal and public procurement frameworks at all levels of government. Thereafter, ensure that the nominal growth rate of net primary government expenditure does not exceed 0,6 % in 2019, corresponding to an annual structural adjustment of 0,65 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. (MIP relevant)</i></p>	<p>Limited progress</p> <ul style="list-style-type: none"> • No progress in strengthening the fiscal framework • Limited progress in strengthening the public procurement framework • The compliance assessment with the Stability and Growth Pact will be included in Spring when final data for 2018 will be available
<p>CSR 2: <i>Ensure that employment and social services have the capacity to provide effective support for jobseekers, including through better cooperation with employers. Foster transitions towards open-ended contracts. Improve family support and increase the effectiveness of income guarantee schemes, by addressing coverage gaps, simplifying the system of national schemes and reducing disparities in access conditions to regional ones. Reduce early school leaving and regional disparities in educational outcomes, in particular by better supporting students and teachers. (MIP-relevant)</i></p>	<p>Limited progress</p> <ul style="list-style-type: none"> • Some progress in reinforcing coordination between employment services, social services and employers • Some progress in fostering transition towards open-ended contracts • Limited progress in addressing fragmentation in income guarantee schemes and improving family support • Limited progress in addressing early school leaving and regional disparities in educational outcomes
<p>CSR 3: <i>Increase public investment in research and innovation and systematically carry out evaluations of support policies in this area to ensure their effectiveness. Increase cooperation between education and businesses with a view to mitigating existing skills mismatches. Further the implementation of the Law on Market Unity by ensuring that, at all levels of government, rules governing access to and exercise of economic activities, in particular for services, are in line with principles of that Law and by improving cooperation between administrations. (MIP-relevant)</i></p>	<p>Limited progress</p> <ul style="list-style-type: none"> • Limited progress in enhancing the evaluation culture for innovation policies and no progress on the level of public investment for research and innovation. • Limited progress in increasing the labour market relevance of tertiary education • Limited progress in implementing the Law on Market Unity

(1) The overall assessment of CSR1 does not include an assessment of compliance with the Stability and Growth Pact.
Source: European Commission

3. SUMMARY OF THE MAIN FINDINGS FROM THE MIP IN-DEPTH REVIEW

3.1. INTRODUCTION

In spring 2018, Spain was identified as having macroeconomic imbalances (European Commission, 2018n). These imbalances related, in particular, to external sustainability, private and public debt and labour market adjustment, in the context of weak productivity growth. The 2019 Alert Mechanism Report concluded that a new in-depth review should be undertaken for Spain to assess the persistence or unwinding of the imbalances (European Commission, 2018b). This chapter summarises the findings of the analyses carried out as part of the macro-economic imbalances procedure (MIP) in-depth review that is contained in various sections in this report. ⁽⁹⁾

3.2. IMBALANCES AND THEIR GRAVITY

Spain's net international investment position (NIIP) remains very negative. The large stock of net external liabilities (-80.7 % of GDP in Q3-2018) leaves the country exposed to adverse shocks or shifts in market confidence, which could result in a tightening of credit conditions and international capital outflows. Favourable changes in the composition of external liabilities have somewhat mitigated the associated vulnerabilities.

Private-sector deleveraging needs remain sizeable, despite a significant reduction of debt. Private sector debt, in consolidated terms, amounted to 134.6 % of GDP in Q3-2018 (of which 59.7 % of GDP was household debt and 75.0 % of GDP non-financial corporate debt). Despite a sharp reduction, debt levels are above their prudential and fundamentals-based benchmarks, for both households and non-financial corporations, suggesting that deleveraging needs persist for both segments (see Section 4.2.3). The still high level of private sector debt makes agents vulnerable to interest rate shocks, and its associated financial burden may still constrain consumption and investment of some agents.

The general government debt ratio is expected to have slightly further decreased in 2018, but remains high. The Commission 2018 autumn forecast projects a decrease by 1.2 percentage points (pps.) in 2018, to 96.9 % of GDP. Despite being on a downward trend, the high stock of public debt continues to be a source of vulnerability for the economy in the face of potential changes in market sentiment.

Unemployment is still very high, despite its rapid decline. Unemployment stood at 14.5 % in Q4-2018, after falling by about 12 pps. since its peak in 2013. Long-term and, especially, youth unemployment saw a similarly steep fall during this period, but more than one third of the active population under 25 was still without a job in Q3-2018. Moreover, the share of temporary contracts (26.9 % in Q3-2018) has not decreased during the last year. This could have a negative impact on potential growth, productivity, and social cohesion.

The Spanish economy could provide significant spill-over effects to the rest of the EU. This stems from its relatively large size and its high degree of integration with other Member States, especially those with which Spain has significant trade links as well as financial and/or banking linkages (See Table 3.1). In particular, Portugal has a high trade exposure to Spain. Box 3.1 illustrates how structural reforms in Spain can boost economic growth in the country, with potential spill-over effects on other Member States. In particular, closing half of the gap with the best performers in a number of policy areas could boost GDP by 6 % over 10 years, with positive, albeit small, spill-over effects for the rest of the euro area. For Spain, the areas where the gap with the best performers are larger concern the business environment, taxation, skills and active labour market policies, as well as research and innovation. The simulations presented therein follow the spirit of the 2019 Council Recommendations for the euro area.

⁽⁹⁾ Analyses relevant for the in-depth review can be found in the following sections: Public finances (Section 4.1.1); Financial sector and private sector debt (Sections 4.2.1 and 4.2.3); Labour market (Section 4.3.1); and Investment (Section 4.4.1). These sections are marked with a *.

Table 3.1: Outward spill-over heat map for Spain

	EU partner																											
	AT	BE	BG	HR	CY	CZ	DK	EE	FI	FR	DE	EL	HU	IE	IT	LV	LT	LU	MT	NL	PL	PT	RO	SK	SI	ES	SE	UK
Imports	0.7	2.1	1.4	0.2	0.4	2.4	0.8	0.5	0.6	1.7	1.4	0.4	2.5	2.1	1.2	0.5	0.8	2.9	3.3	2.1	1.3	6.7	1.1	2.6	1.1		0.6	0.9
Imports (in value added)	0.6	1.1	3.1	0.6	1.4	1.0	0.6	0.6	0.5	1.5	0.9	1.2	0.9	0.8	1.0	0.6	0.9	0.7	1.1	0.8	0.9	8.1	0.8	0.7	1.2		0.5	0.7
Financial liabilities	5.2	10	0.4	1.3	1	0.3	3.9	0.7	2.6	13	8.8	4.5	0.8	27	5.5	0.4	0.1	332.7	16.1	29	2	19	0.1	1.6	2.6		3.2	7.8
Financial assets	1.9	6.2	2.8	0.1	1.2	0.7	1.9	0.3	1.6	6.1	1.4	2.5	0.8	15.3	8.2	0.1	0.0	237.0	1.4	30.9	1.1	26.2	1.8	0.8	0.5		2.1	5.3
Liabilities (to banks)	0.8	1.1							0	2.9	1.5	0.5		0.8	3.1				4.5		7.5						0.1	0.8
Bank claims	1.2	1.2	0.1	0.1	0.4	0.1	1.4	0.1	1.5	2.2	1.6	0.3	0.1	4.5	3.3	0	0	19.4	8.9	1.9	8	47	1.3	0.2	0.1		1	15

Note: cross-border figures for Spain, expressed as a % of the GDP of the partner country. The darkest shade of red corresponds to percentile 95 and the darkest shade of green to percentile 5. The percentiles were calculated for each variable based on the full available sample of bilateral exposures among EU countries. The blank spaces represent missing data. Data refer to: Imports - 2016, Imports (in value added) - 2014, Financial liabilities - 2015, Financial assets - 2015, Liabilities (to banks) - 2018-Q2, Bank Claims - 2018-Q2.

Source: UN, OECD, WIOD, BIS and Commission services.

3.3. EVOLUTION, PROSPECTS, AND POLICY RESPONSES

External sustainability and competitiveness

The current account surplus decreased in 2018 as a consequence of both cyclical and transitory factors. After remaining relatively stable at almost 2 % of GDP in 2016 and 2017, Spain's current account surplus weakened in 2018, to slightly above 1.0 % of GDP. Spain's net lending capacity also declined to 1.5 % of GDP. Cyclical and transitory factors, such as the increase in import prices, in particular oil prices, the slowdown in Spain's main export markets and the euro appreciation, have driven this decline. In addition, the composition of final demand has been skewed towards components with large import content (such as investment in capital goods and consumption of durables or exports in sectors with vertically integrated activities). Against this background, both the energy and non-energy trade balance contributed to weaken the current account surplus in 2018. In particular, the non-energy trade balance registered a deficit for the first time since 2011. In cyclically-adjusted terms, the decrease in the current account surplus has been limited (Graph 3.1).

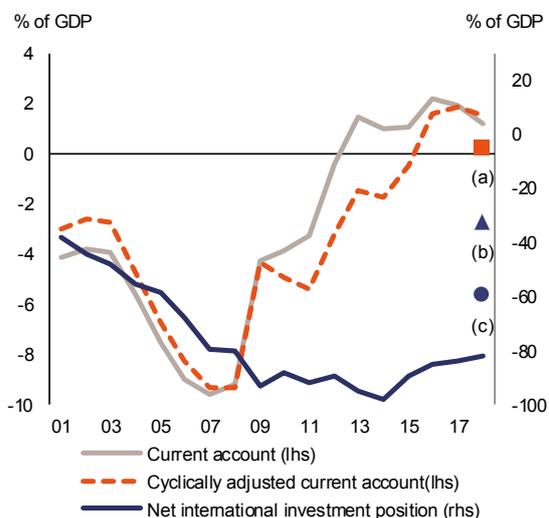
Structural factors are playing an important role in preserving the external trade surplus. A reduction in the import elasticity to final demand, as well as the increasing internationalisation of Spanish firms, suggest that a structural change has taken place in the Spanish economy (see (European Commission, 2018a). Accordingly, the cyclically adjusted current account balance (estimated at 1.5 % of GDP in 2018) has improved in recent years, and now exceeds the level required

to reach a prudential level of the net international investment position (NIIP), and also the more demanding current account norm (that is, the one explained by fundamentals, at about 0.5 % of GDP in 2018) (Graph 3.1). ⁽¹⁰⁾ ⁽¹¹⁾

⁽¹⁰⁾ The current account 'norm' benchmark is derived from regressions capturing the main fundamental determinants of the saving-investment balance (e.g. demographics, resources), as well as policy factors and global financial conditions. See also European Commission, 2017, 'Empirical current account benchmarks: modelling the impact of demographic variables', LIME Working Group, 24 April 2017.

⁽¹¹⁾ The current account balance required to reach, in ten years, the prudential net international investment position (about -60 % of GDP in 2027) is estimated to be around 0.2 % of GDP.

Graph 3.1: **Current account and net international investment position**



(a) Current account required to stabilize the net international investment position at the prudential benchmark by 2027 (lhs): 0.2 % of GDP
 (b) Fundamentally explained net international investment position benchmark: -33 % of GDP in 2017
 (c) Prudential net international investment position benchmark: -60% of GDP in 2017

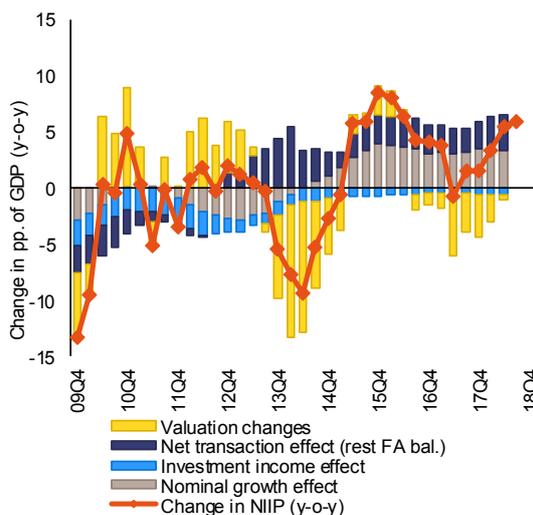
Source: Eurostat and own calculations.

Persistent current account surpluses are slowly translating into a narrowing of Spain’s net debtor international investment position. In addition to high nominal GDP growth, continued external surpluses have driven a slow but steady narrowing of Spain's negative net international investment position (Graph 3.2) ⁽¹²⁾. Negative valuation effects, mainly due to the appreciation of the euro, prevented a larger improvement in 2017 and 2018. Continued current account surpluses and high nominal GDP growth projected until 2020 are expected to result in further improvements in the net international investment position.

The composition of Spain’s external liabilities helps to mitigate some of the vulnerabilities. Since 2013, the proportion of equity instruments in total external liabilities has been increasing, although from a very low level. Equity does not carry the same risks as debt for external sustainability, as, contrary to debt, its remuneration (e.g. dividend payments) can be adjusted during economic downturns. Against this background, the net international investment position excluding non-defaultable instruments (NENDI), which

represents the net international investment position excluding equity, has improved faster than the overall net international investment position, crossing the prudential threshold for the first time in 2017 (falling to -56 % of GDP vs. a prudential threshold of -60 % of GDP). This is a reduction of 15 pps of GDP since 2012, against a decline of 6 pps of GDP of the net international investment position, partly reflecting an improvement in the net foreign direct investment (FDI) position. In addition, most of the external debt has maturities of one year or more (about 76 % of general government and private sector external debt, excluding intercompany loans), and has been increasing in recent years, reducing risks. In addition, a non-negligible part of the external debt are central bank liabilities stemming from monetary operations of the eurosystem (Graph 3.3).

Graph 3.2: **Analysis of the rate of change of net international investment position— Spain**



Source: Eurostat.

⁽¹²⁾ The Target 2 balances mainly reflect the impact of the Public Sector Purchase Programme (PSPP).

Table 3.2: Current account balance and net international investment position sensitivity analysis

	Low nominal GDP growth (2.1% avge. 2018-27)	Baseline scenario (3.1% avge. 2018-27)	High nominal GDP growth (4.1% avge. 2018-27)
NIIP Stabilisation	-2.0	-2.7	-3.6
NIIP at -75% of GDP	-1.0	-1.7	-2.5
NIIP at -60% of GDP	0.7	0.0	-0.7
NIIP at -33% of GDP	3.6	3.1	2.5

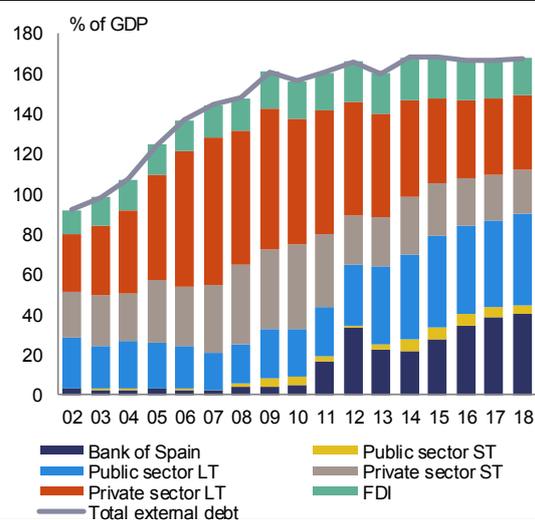
(1) The table above shows the average current account required to reach a certain NIIP by 2027, based on the different stated assumptions for nominal GDP growth, assuming no NIIP valuation effects on average, and a stable capital account balance at its median level over 2018-20 (0.2 % of GDP). See also European Commission, 2015, 'Refining the methodology for NIIP-based current account benchmarks', LIME Working Group 17 Jun 2015.

Source: Owns calculations.

Sustained current account surpluses would be needed for Spain to decisively reduce its still large external liabilities. While the current account surpluses recorded since 2013 have put the net international investment position onto a declining path, the amount of Spain's net external liabilities is still far from having achieved a level that could be considered prudential or in line with fundamentals (see Graph 3.1)⁽¹³⁾. Even under a relatively benign growth scenario, Spain would need to maintain current account surpluses over a long period of time in order to bring down the large net international investment position decisively (Table 3.2).

⁽¹³⁾ The country-specific prudential threshold for the net international investment position is derived from a univariate signalling approach that identifies at which net international investment position level an external crisis is likely to begin. The net international investment position level explained by fundamentals represents the net international investment position that would result if a country had run its current account in line with fundamentals since 1995. See Turrini, A, and Zeugner, S. (2018), 'Benchmarks for net international investment positions', European Commission Discussion Paper, forthcoming.

Graph 3.3: Gross external debt by sector-type of financial assets



(1) LT: Long-Term, ST: Short-Term

Source: Bank of Spain

Private indebtedness and deleveraging

Despite the growth in new credit, private sector deleveraging has advanced, reducing vulnerabilities. By Q3-2018, private sector debt - in consolidated terms - had been reduced by about 67.9 pps. of GDP since its peak in 2010. Most of this reduction is due to a decline in corporate debt (about 42.6 pps. of GDP), but progress in household debt reduction (over 25.3 pps. of GDP) has also been significant. The deleveraging process has reduced the exposure of both sectors to changes in interest rates⁽¹⁴⁾. The financial position

⁽¹⁴⁾ According to Bank of Spain estimates, the decline in the stock of household loans, along with the growing trend of their deposits, has contributed to substantially moderating the negative income effect associated with interest rate rises. This is also the case of firms, although, they are

of Spanish households has strengthened mainly thanks to improvements in the labour market. Furthermore, the financial burden of household debt has been reduced by the prevailing low interest rates.

Deleveraging needs remain for both corporations and households, but the stock of loans to households has started to increase again. According to prudential and fundamentals-based benchmarks, both household and non-financial corporations' debt remains high and deleveraging needs persist (see Section 4.2.3). The continued reduction of private sector debt is driven by non-financial corporations (NFCs), whereas the stock of total household debt stabilized in 2018 after being on a downward trend since 2010. Significant growth in new credit to finance durable consumer spending, as well as growth in lending for house purchases and a reduction in the repayment of mortgages (due to a reduction in housing debt) explain this change of trend. Even though consumer credit has contributed to the economic recovery in recent years by supporting domestic demand, its rapid increase increases agents' vulnerability to adverse shocks, especially if it goes to the most vulnerable households. On the corporate side, the debt reduction process has continued despite new credit flowing towards the less indebted and most productive firms, supporting investment (European Commission 2018a).

Amid rising house prices, the construction sector has started to grow, but houses are still undervalued for the country as a whole. House prices have risen for almost five years in a row, although there is a high degree of heterogeneity across regions, partly reflecting a still large stock of unsold houses in some areas and a buoyant rental housing market in others. On average for the whole of Spain, house prices remain below pre-crisis levels, and their recovery does not seem to imply potentially harmful dynamics, but price developments in some regions deserve attention. According to standard price valuation indicators, overall house prices are still undervalued in Spain, although some indicators suggest this gap is closing (see Section 4.2). Investment in residential

construction has been increasing since the last quarter of 2015, but remains below pre-crisis levels (5 % of GDP in 2017, compared to about 12 % of GDP in 2006).

The insolvency reforms over recent years have facilitated private debt reduction. In a context of strong economic growth and easing access to finance, the number of corporate insolvencies decreased by 2.6 % in annual terms in the first three quarters of 2018 (by 0.8 % in 2017). The proportion of insolvency proceedings that ends in an agreement between creditors and debtors increased in 2017, compared to the previous insolvency framework before the 2014 and 2015 reforms (see Section 4.2.2).

Public debt

The reduction of public sector debt is expected to continue, but at a moderate pace. After declining by 2.3 % of GDP between 2014 and 2017, it is expected to narrow slightly faster, by a further 2.7 pps., until 2020, helped by still strong nominal GDP growth. For the first time since 2007, debt reduction is also expected to be underpinned by a primary surplus as from 2019. While interest expenditure remains on a declining path as previous improvements in financing conditions filter through to lower debt servicing costs, debt-increasing stock-flow adjustments are preventing a slightly faster debt reduction in 2019 and 2020. While there appears to be no immediate risk of fiscal stress, risks to fiscal sustainability remain significant in the medium to long term (see Section 4.1.1).

Unemployment

Unemployment is set to continue falling, despite decelerating job creation. Employment growth is expected to slow down in 2019 and 2020, as a consequence of the slowdown in final demand, as well as the expected dampening impact of the increase in the minimum wage for 2019. Still, the unemployment rate is set to continue falling, to 13.3 % in 2020, which is still well above the EU average. Labour market segmentation has not declined despite the increasing share of permanent contracts among new jobs. A high level of labour market segmentation, long-term unemployment, and population ageing remain challenges for higher productivity and potential growth (see

comparatively more affected than households by these shocks owing to their higher net debt (see Bank of Spain, Economic Bulletin 2/2018).

Section 4.3).

After years of restraint, wages are set to increase, but cost-competitiveness gains will continue. Negotiated wage increases have been gradually recovering in recent years, reaching 1.7 % in October 2018. However, strong job creation has resulted in a negative wage drift, leading to very modest increases in nominal aggregate wage growth, or even negative in real terms in 2016-2018. This contained nominal unit labour costs (ULC) increases despite the low productivity growth during the period. Nominal wage growth is expected to peak in 2019 as a result of the increase of the minimum wage, and then to moderate, but remain above inflation in 2020. As labour productivity is forecast to grow only moderately over the forecast horizon, this will lead to increases in nominal unit labour costs. However, growth in nominal unit labour costs is expected to remain below the euro area, except for 2019, implying further gains in cost competitiveness.

The increase in the minimum wage could reduce in-work poverty, but could also hurt the employment prospects of young people and the low-skilled. Spain has implemented a steep increase in the minimum wage in 2019 (of 22.3 %), above expected inflation and productivity growth. The expected impact of the increase in the minimum wage on employment may vary significantly across regions, sectors, and categories of workers, depending on the coverage. Existing simulations specific to Spain estimate that the

recent increase in the minimum wage to EUR 900 would generate a negative employment effect of up to 0.8 % of total employment (some 125 000 net jobs). This negative effect would be greater for certain groups, such as women, young people, low-skilled workers and those on temporary contracts (see Section 4.3.1).

3.4. OVERALL ASSESSMENT

The reduction of macroeconomic imbalances in Spain has progressed further, but vulnerabilities remain. Private sector debt reduction has continued to advance, but deleveraging needs persist. Non-financial corporation debt has continued to decline, while the outstanding level of households' loans has increased slightly again after years of decline. Public sector debt has been slightly reduced, a process that is expected to accelerate somewhat as government deficits are forecast to narrow further. Despite a weakening of the external surplus in 2018, largely due to cyclical and transitory factors, structural factors continue supporting the growth of exports and limiting that of imports. Nevertheless, in order to bring down decisively its large stock of external liabilities, Spain will have to record current account surpluses over an extended period of time. Unemployment is set to continue falling, despite a deceleration in job creation. However, reducing long-term and youth unemployment, along with lowering the share of employees in temporary contracts, is critical to raise the growth potential of the Spanish economy.

Box 3.1: Outward spill-overs

Structural reforms in Spain could have spill-over effects on other countries due to the large size of the Spanish economy. While the demand effect (higher export demand for foreign products) leads to positive spillovers, reforms typically also improve a country's competitiveness and this can be at the (relative) expense of other countries. Whether the net effect is positive or negative depends on the relative strength of these two opposing channels and is likely to depend on the specific types of reforms.

In a model simulation exercise ⁽¹⁾, the impact of a comprehensive set of reforms is quantified for all EU Member States in a harmonised way (Varga and 't Veld, 2014). For a large set of structural indicators the benchmark is defined as the average of the three best performing countries, and then in the simulation these gaps are closed by half for all indicators together, for each country separately. An update of this exercise for Spain is shown in the table below, based on more recent indicators (but not capturing the reform measures introduced most recently). As the magnitude of the reform 'shocks' simulated here are based on a harmonized benchmarking exercise, they do not exactly correspond to past European Semester Country-specific recommendations, but they illustrate the potential impact that structural reforms can have on Member States' economies and their spill-overs.

The simulation for Spain shows that there may be a small but positive net spill-over to the rest of the euro area from structural reforms. The simulated reforms cover all areas: product market regulation and entry costs, labour market participation, taxation structure and R&D subsidies. For Spain, the largest 'reform gaps' identified are in the tax wedge (as captured by the relative share of labour tax revenues compared to consumption tax revenues) and product market regulation (services sector markups and entry costs). All together, this ambitious reform package can boost GDP by 6 % after 10 years, and 9 ¾ % after 20 years. The reforms raise competitiveness and boost exports, but imports also increase as a result of higher demand. As the terms of trade fall by about 3 % after 10 years, the trade balance to GDP ratio actually falls slightly by 0.3 pps. The net spillover to the rest of the EA is small but positive, and total EA GDP increases by 0.3 % after 10 years.

Table 1. Spillover effects of structural reforms – Spain closing half of the structural reform gaps

Spain	1	2	3	4	5	10	20
GDP	0.60	1.03	1.61	2.21	2.80	5.84	9.88
REER	-1.10	-1.53	-1.26	-0.69	0.00	2.72	6.52
Trade balance (% GDP)	-0.71	-1.13	-1.08	-0.90	-0.71	-0.33	-0.13
Rest of EA GDP	-0.02	-0.01	0.01	0.02	0.02	0.02	0.01
EA GDP	0.01	0.05	0.10	0.14	0.18	0.34	0.56

Note: increase in REER is a depreciation.

⁽¹⁾ Detailed information on the QUEST model and applications is available at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/economic-research/macroeconomic-models_en.

Table 3.3: MIP matrix

	Gravity of the challenge	Evolution and prospects	Policy response
Imbalances (unsustainable trends, vulnerabilities and associated risks)			
External position	Spain has a high, but declining, stock of net external liabilities, amounting to -80.7 % of GDP in Q3-2018, mainly composed of debt instruments. By institutional sector, the external debt of mainly the non-financial private sector, but also the public sector (mostly long-term securities), has declined.	<p>The current account surplus is expected to decline from 1.9% of GDP in 2017 to 1.2 % in 2018, and remain broadly stable around 1.0 % of GDP until 2020. This deterioration is a consequence of both cyclical and transitory factors, such as the increase in oil prices, the appreciation of the euro, as well as weaker than expected global trade. However, a structural improvement in Spain's trade performance, as confirmed by the increase in the number of regular exporters, and as well as a reduction in the elasticity of imports to final demand, play a role in preserving Spain's external surplus. This is corroborated by the cyclically-adjusted current account balance, which has been in surplus since 2016.</p> <p>The negative NIIP, which improved in 2017 by 3.2 pps, to -80.7 % of GDP, also helped by high nominal growth. The appreciation of the euro resulted into negative valuation effects, preventing an even greater improvement of the NIIP in 2018. Continued current account surpluses and high nominal GDP growth projected until 2020 are expected to facilitate further improvements of the NIIP.</p>	<p>Restrained wage growth has largely contributed to restoring cost competitiveness.</p> <p>After years of moderation, nominal wage growth has resumed, and is expected to reach 1 % in 2018. Wage growth is then expected to peak in 2019 at 2.4 %, under the impact of the increase of the minimum wage, and moderate but still grow at a rate above inflation in 2020. As labour productivity is forecast to grow moderately over 2018-2020, this will lead to increases in nominal unit labour costs. However, ULC are expected to grow above the euro area only in 2019, implying cost-competitiveness gains in the rest of the period.</p> <p>Measures to raise non-cost competitiveness (through investment in research and innovation, as well as improving labour skills) have been modest so far (see Sections 4.3 and 4.4).</p>
Public debt	<p>Spain has a high level of public debt, which was estimated at 96.9 % of GDP in 2018.</p> <p>While Spain does not appear to face fiscal sustainability risks in the short run, fiscal sustainability risks in the medium term are estimated to be high, primarily due to the initial level of government debt and budgetary position. (see Section 4.1.1).</p>	<p>Despite strong nominal GDP growth in recent years, the debt ratio has been declining relatively slowly (from a peak of 100.4 % in 2014 to 96.9 % in 2018), as a result of still high headline deficits.</p> <p>While the deficit is forecast to continue narrowing in 2019 and 2020 (to 2.1 % and 1.9 % of GDP, respectively) and nominal GDP growth to remain relatively strong, the debt ratio is forecast to decrease only modestly to 95.4 % of GDP in 2020, as a result of debt-increasing stock-flow adjustments.</p>	<p>The Commission concluded that the 2019 Draft Budgetary Plan of Spain is "at risk of non-compliance" with the provisions of the Stability and Growth Pact. Although Spain is expected to correct its excessive deficit in a durable manner in 2018, the Commission projects a risk of significant deviation from the required adjustment path to the medium-term budgetary objective. Moreover, Spain is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019.</p>
Private debt	<p>The total stock of private non-financial sector debt stood at 136.1 % of GDP (in consolidated terms) in Q2-2018. Of this amount, 60.8 % of GDP corresponds to household debt, while corporate debt now stands at 75.4 % of GDP in consolidated terms (94.9 % non-consolidated).</p> <p>The deleveraging process is taking place at the same time as new credit towards households and companies as well as issuance of debt securities by NFCs are increasing. Real GDP growth has thus become the main driver of private sector deleveraging.</p>	<p>The debt stock of the private sector has been reduced by about 66.5 pps of GDP since its peak. Most of it is attributable to non-financial corporations (about 42.3 pps. of GDP), but progress in households' deleveraging (by about 24.1 pps.) was also remarkable.</p> <p>In Q2-2018, the pace of debt reduction slowed down for NFCs, while the total stock of debt increased for households for the first time since 2010. Significant growth in new credit for durable consumer spending, as well as the slowdown in the reduction in the outstanding volume of mortgage loans, explain the modest increase in household debt.</p>	<p>The reforms of the insolvency framework in 2014/2015 have facilitated debt restructuring and made insolvencies less onerous.</p>

(Continued on the next page)

Table (continued)

		<p>The projected recovery of a historically low savings' rate could help to resume the deleveraging process going forward.</p> <p>Banks have restructured their activity and cleaned up their balance sheets, and the non-performing loans ratio for business in Spain has continued to decrease, from 8.4 % in 2017-Q2, to 6.4 in 2018Q-2. The NPL for consolidated business of Spanish bank (4.2 % in June 2018) is close to the EU average.</p>
Adjustment issues		
Unemployment	<p>Total employment is still almost 10 % below its pre-crisis peak. The unemployment rate stood at 14.5 % in Q4-2018, of which 39.7% was long-term unemployment, and youth unemployment stood at 33.1 %.</p> <p>Both rates are among the highest in the EU (see Section 3.3). Persistently high unemployment hampers the adjustment process.</p>	<p>Unemployment has been declining rapidly, but it remains very high, especially for youth and the long-term unemployed. The unemployment rate is expected to fall to about 13 % by 2020. High levels of labour market segmentation (permanent vs. temporary employment) persist.</p> <p>The government has proposed to increase the minimum wage by 22.3 % in 2019. Given the large magnitude of the increase, and the high share of workers potentially affected, the potential impact of this increase should be analysed further and its implementation should be carefully monitored.</p> <p>Incentives to reduce labour market segmentation have not had substantial impact so far, but the government is implementing additional measures, such as the Plan for Decent Work 2018-2020 to fight against abuse of temporary contracts through more targeted labour inspections.</p>
Conclusions from IDR analysis		
	<ul style="list-style-type: none"> Spain is characterised by a combination of still large, but declining, stock of external and internal debt, both public and private. This leaves the country exposed to adverse shocks or shifts in market confidence, which translate into a tightening of credit conditions on the international markets, which would have harmful implications for the real economy, especially given the still high level of unemployment. The current account balance surplus weakened in 2018, reflecting the negative impact of transitory factors, while structural factors continued being supportive. The external surplus continued supporting a slow decline in net external liabilities. Progress continues to be made on NFCs debt reduction, while an interruption in households deleveraging was observed in the second half of 2018. Public debt has decreased slightly, with deficits forecast to narrow in the future. Unemployment remains very high, despite a substantial reduction. <p>Policy progress regarding the implementation of recommendations has been limited in fields such as the fiscal framework, removing unnecessary regulatory burden on firms, reforming regulated professions, addressing the segmentation of the labour market.</p>	
<p>(*) first column summarises 'gravity' issues, aiming to put the imbalances in order of magnitude. The second column reports findings concerning the 'evolution and prospects' of these imbalances. The third column reports recent and planned measures. Findings are reported for each source of imbalance and adjustment issue. The final three paragraphs summarise the overall issues, in terms of their gravity, developments and prospects and the policy response to them.</p> <p>Source: European Commission.</p>		

4. REFORM PRIORITIES

4.1. PUBLIC FINANCES AND TAXATION

4.1.1. DEBT SUSTAINABILITY AND FISCAL RISKS*

Although slowly decreasing, Spain's general government debt ratio remains high. After rising sharply in the years following the financial crisis, the general government debt ratio peaked at slightly over 100 % of GDP in 2014, about 65 percentage points above its low point of 2007. The Commission 2018 autumn forecast projects that the debt ratio will decrease from 96.9 % of GDP in 2018 to 95.4 % of GDP in 2020. This decrease follows from both favourable interest rate-growth rate differentials and – as from 2019 – primary surpluses more than offsetting debt-increasing stock-flow adjustments. As the private debt ratio has declined faster than the government debt ratio, general government debt now makes up a much larger share of the total indebtedness of the economy – at around 41 % in 2017 relative to around 20 % in 2010, the year in which private debt peaked (See Graph 4.2.4).

The average life of outstanding debt has increased in recent years. As the Spanish Treasury took advantage of the lower interest rates to extend maturities, average life of outstanding debt has increased to slightly below 7.5 years. While the cost at issuance has risen slightly from a low of 0.61 % in 2016 to 0.65 % by 15 January 2019, it remains significantly below the cost of debt outstanding, which stood at 2.39 % on that same date (in 2011, both stood at around 4.0 %). This implies that there is still some margin to further reduce the average cost of debt in the near future.

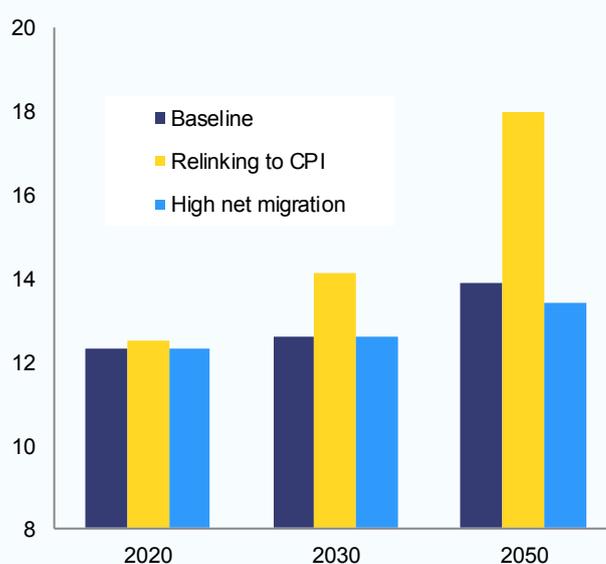
Spain does not appear to face immediate risks of 'fiscal stress', but sustainability risks are high in the medium and long term ⁽¹⁵⁾. The value of the early-detection indicator of fiscal stress, the S0 indicator, is below its critical threshold. However, some fiscal variables point to possible short-term challenges, especially if financial markets' perceptions were to rapidly change. Among the variables with a value above their critical threshold are the gross financing needs, the cyclically-adjusted deficit and net government debt. Financial markets' perceptions of Spain's sovereign risk seem to have improved over the last year, with upgrades from all major rating agencies in the first half of 2018. Since then, they have remained 'A- stable' or equivalent. The 10-year sovereign yield spread against the 10-year German bund is only slightly higher than a year ago. According to the Commission 2018 autumn forecast, Spain is still forecast to have a structural government deficit of 3.1% in both 2019 and 2020, reflecting a relatively low level of taxation in relation to expenditure. This is still some way from the medium-term objective of having a zero structural balance.

⁽¹⁵⁾ For details on the European Commission's assessment of fiscal sustainability risks in the short, medium and long term, see European Commission (2019), 'Fiscal Sustainability Report 2018' Directorate-General for Economic and Financial Affairs, *European Economy*, Institutional Paper 094/2019. In this year's Country Report, long-term sustainability risks are assessed by the S2 indicator in conjunction with the debt sustainability assessment. See also Annex B for an overview.

Box 4.1.1: Long-term sustainability implications of changes to the pension system and to health care policies

The adoption of the 2018 budget implied a departure from two key elements of the 2013 pension reform. These consist of, first, a temporary suspension of the annual revaluation mechanism during 2018 and 2019 and, second, a postponement from 2019 to 2023 of the entry into force of the so called sustainability factor, a mechanism by which the initial pension level is adjusted to changes in life expectancy. Regarding the former, the 2018 Budget Law contained a pension revaluation of 1.6 % in 2018 (compared to 0.25 % implied by the Index for Pension Revaluation (IPR)). In addition, the Government agreed to raise the minimum pension by 3 % in 2018 and to raise survivor pensions in both 2018 and 2019. The latter was already foreseen in the 2011 pension reform, but had been put on hold during the crisis years. The 2019 Draft Budgetary Plan submitted in October 2018 also announced a further top-up of the 2018 pensions to compensate for inflation being expected to overshoot 1.6 % in 2018. It also envisaged a further hike of minimum pensions of 3 % in 2019 and confirmed the intention to raise pensions in 2019 by the Consumer Price Index (CPI). All these measures were incorporated into the Commission 2018 autumn forecast. To ensure that they took effect on 1 January 2019 despite the absence of an adopted 2019 Budget Law, these changes were implemented through a Royal Decree Law adopted by the Government in December 2018.

Graph 4.1.1.1: Evolution of pension expenditure under the 2018 Ageing Report baseline and alternative scenarios



(1) The delayed implementation of the sustainability factor is not reflected in any of these projection scenarios. In the three scenarios all underlying assumptions are those of the Ageing Report 2018 (1).

(2) In the relinking to CPI scenario, old age and early pensions in payment are indexed to CPI instead of the Index for Pension Revaluation (IPR) as of 2018 in "structural terms", i.e. without any time limit. Concretely, this entails a much higher indexation of pensions, by 2 % per year instead of 0.25 % per year over almost the entire projection period, until 2047.

Source: Ageing Report 2018 (European Commission, 2018d) and Commission services calculations

Taking all these short-term legislated measures into account, total pension expenditure would be considerably higher compared with the 2018 Ageing Report baseline scenario, which reflects the pre-reform-reversal situation. In particular, adjusting pensions to the Consumer Price Index instead of the Index for Pension Revaluation in 2018-19 could lead to a cumulated increase in pension expenditure of 0.2 % of GDP by 2019 compared with the baseline scenario.

The permanent full relinking of pensions to inflation that is currently being discussed would lead to a

significant increase in pension expenditure over the long term, unless compensating measures are undertaken. In September 2018, the parliamentary committee dealing with pension issues, the so-called Toledo Pact Committee, issued a recommendation to link pensions to inflation. This recommendation, which enjoys broad political support, is not binding. The recent Royal Decree Law requires that the indexing of pensions be implemented in such a way so as to ensure the social and financial sustainability of the system. According to preliminary projections by the Commission services, a straight relinking to the Consumer Price Index rather than the Index for Pension Revaluation would lead pension expenditure to be about 4 % of GDP higher by 2050 compared to the baseline scenario (See Graph 4.1.1.1). This is close to the projections made by other institutions, such as Bank of Spain, the IMF and the think tank FEDEA (2018). The independent fiscal authority, AIReF, estimates the impact to be less (2% of GDP) based on different assumptions.

The sensitivity of the pension projections to changes in the assumptions regarding net migration is rather limited. The national statistical office (INE) has recently updated its demographic projections and AIReF has published a set of demographic forecasts for the first time. Both include net migration inflows that are higher than those included in the Commission 2018 Ageing Report. To gauge the importance of the demographic assumptions on the pension projections, the 2018 Ageing Report includes a high-migration sensitivity scenario (See Graph 4.1.1.1). It assumes that net migration flows are 33 % higher than in the baseline scenario throughout the projection period. While this scenario is expected to lead to a reduction in the weight of pension expenditure by about 0.5 % of GDP by 2050 as employment grows faster, by 2070 this reduction should have narrowed to 0.2 % of GDP, as migrants start drawing a pension after their working career.

As concerns adequacy, the current net theoretical replacement rate (measured as the first pension benefit relative to the last wage before retirement, on the assumption of a 40-year career, average earnings and retirement at the age of 65) of Spanish public pensions are among the highest in the EU (96.8 %). In 2017, people aged 65 and over faced a much lower risk of poverty than other age groups, notably children (14.8% against 28.3 %). According to the 2018 Pension Adequacy Report, the theoretical replacement rate in Spain is set to decline in the long run (86.5 % in 2056), but would remain above the EU average also in a scenario where the 2013 reform is left intact. Further improving the duration and completeness of working careers would improve the adequacy and sustainability of future pensions.

Also in the health care area, the Spanish authorities have recently implemented a new measure. In July 2018, the Spanish Government adopted a Royal Decree-Law extending health care coverage to undocumented and illegal immigrants (See Section 4.3.3). This Decree-Law was validated by Parliament in September 2018, establishing a legal right to health care.

Spain faces high fiscal sustainability risks in the medium term. This conclusion stems from both the sustainability gap indicator (S1) and from a debt sustainability analysis perspective. The former indicates that Spain's structural primary balance would need to improve by 5.2 % of GDP in cumulative terms over the five-year period to 2025 relative to the baseline 'no-fiscal policy change' scenario to bring the debt-to-GDP ratio to the reference value of 60 % by 2033. This would require an ambitious structural primary balance by European standards ⁽¹⁶⁾. About half of the very significant S1 value is due to the distance of the debt ratio from the 60 % reference value and, to a somewhat lesser extent, the unfavourable initial

budgetary position, but only to a limited extent the projected age-related public spending. However, these numbers are based on the same policy assumptions as those underlying the 2018 Ageing Report (European Commission, 2018d). The recent policy debate on pensions indicates that changes to the mechanism by which pensions are revalued may undergo changes in the near future. In particular, a relinking of pensions to inflation would lead to a significant increase in pension expenditure in the medium to long term (See Box 4.1.1). Debt sustainability analysis shows that under normal economic conditions and assuming a constant structural primary balance after the last Commission forecast year (2020), the Spanish general government debt is expected to reach more than 107 % of GDP by 2029 (last projection year). This projection is driven by a gradual worsening of

⁽¹⁶⁾ Only 10 % of the structural primary balances recorded for the EU countries over 1980-2018 were greater than this value.

the primary balance in the 2020-2024 period being compounded by an unfavourable and increasing interest rate-growth rate differential in the last part of the next decade. The analysis also shows that the level of the debt ratio is highly sensitive to shocks (see Box 4.1.2).

In the long term, Spain is deemed at high fiscal sustainability risk. This conclusion stems from combining the sustainability gap indicator (S2) with a debt sustainability analysis perspective described above. The former shows a gap of 2.3% of GDP that needs to be closed to stabilise debt over the long-term. The gap is mainly due the unfavourable initial budgetary position, but to a limited extent also to the projected ageing costs. As was the case for the S1 indicator, the S2 indicator is also based on assumptions regarding pension expenditure that may prove too low, if the announced reversals of some of the pension reforms materialises. Under the more adverse Ageing Working Group risk scenario (whereby healthcare and long-term care costs would exceed those expected from purely demographic factors due to non-demographic drivers such as technological changes and catching-up effects), the S2 indicator would double, to 4.4 % of GDP.

4.1.2. FISCAL FRAMEWORK

Some steps have been taken to improve public procurement and assess the efficiency of public spending. The implementation of the new governance structure for public procurement in Spain is ongoing, but the elaboration of the procurement strategy is still pending. The effectiveness of the new law will crucially depend on the degree of ownership at all levels of government (see Section 4.4.4). With support from the European Commission, the expenditure reviews, carried out by the Spanish Independent Authority for Fiscal Responsibility (AIReF) in 2018 and approved for 2019, have the potential to

lead to improvements in the efficiency and effectiveness of public spending in selected areas⁽¹⁷⁾. Some provisions adopted through a Royal Decree in March 2018 further enhanced the functions and the role of the Independent Authority for Fiscal Responsibility (AIReF). Spain's fiscal framework can be further strengthened, among other things, by pursuing a more automatic activation of measures to prevent and correct deviations from fiscal targets at the local level and by enhancing the contribution of the domestic spending rule to the sustainability of public spending (see European Commission 2018a, p.28-29, and European Commission 2018c).

4.1.3. TAXATION

Spain has a low tax-to-GDP ratio compared to other EU Member States. In 2017, its tax revenues amounted to 33.8 % of GDP, compared with EU and euro area averages of, respectively, 39.0 % and 40.2 %. The share of consumption taxes is very low, at 9.4 % of GDP, also reflected in a relatively low implicit tax rate on consumption of 15.9 %, below the EU/euro area average of 20.7 % and 20.6 %. At 16.3 % of GDP, the share of taxes on labour also remained below the EU average of 19.4 %, with an implicit tax rate of 32.0 % in 2017. In addition, the redistributive effect of household direct taxation is much below the EU average⁽¹⁸⁾.

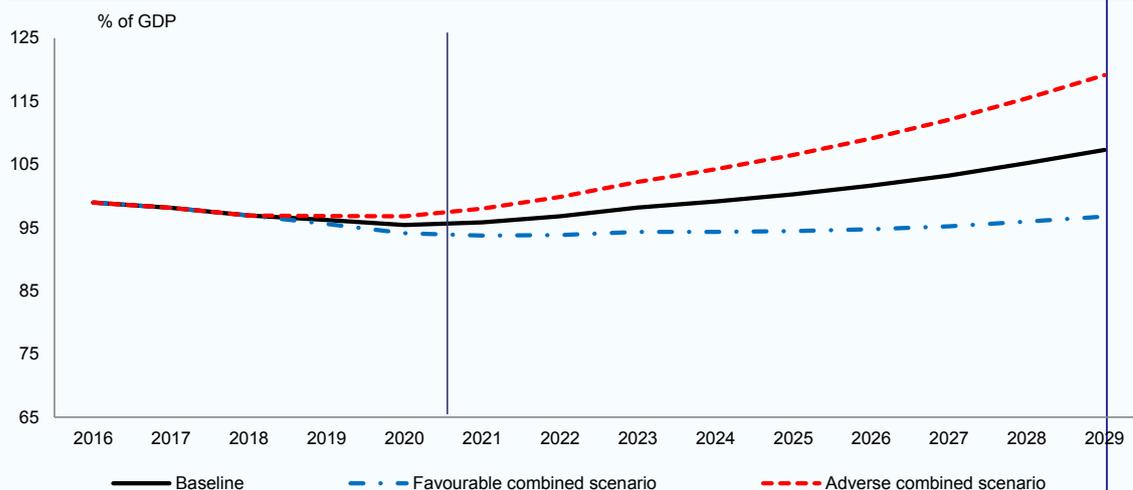
⁽¹⁷⁾ The 2018 reviews comprise seven evaluations of subsidies in the following areas: prescription drugs, active labour market policies, university education scholarships, promotion of talent and employability in R&D and innovation (pre- and post-doctoral aid programmes), the re-industrialisation and industrial competitiveness programme (RIC), the Spanish national post service and finally an overall evaluation of the strategy and procedures in granting subsidies. The 2019 reviews comprise the evaluation of the following expenditure items: expenditure in hospitals, investments in public infrastructure, tax benefits and hiring incentives.

⁽¹⁸⁾ Direct household taxation reduces the S80/S20 by 8.6% in Spain in 2016, against 12.4 % in the EU.

Box 4.1.2: Medium-term projections for government debt

The government debt trajectory has been simulated under different scenarios. Under the baseline scenario, the general government debt is forecast to decrease slightly until 2020, before rising again until the end of the projection period in 2029, when it reaches about 107.3 % of GDP. The baseline has been derived from the Commission 2018 autumn forecast, consistent with the forecast implicit interest rate and the shares of short-term and long-term public debt. It makes a number of technical assumptions. First, over the post-forecast period, the structural primary balance (before cost of ageing) is set constant at the value projected for 2020, at -1.0% of GDP, hence assuming that no further structural adjustment is made. The cyclical component of the primary balance is calculated using (country-specific) budget balance sensitivities over the period until output gap closure is assumed (2023). Second, the long-term interest rate on new and rolled-over debt is assumed to be 3.0 % in real terms by the end of the projection period, while the short-term real interest rate reaches an end-of-projection value that is consistent with the 3.0 % long-term real interest rate and the value of the euro area yield curve. Third, the GDP deflator is assumed to change linearly until it reaches 2.0 % in 2023 and remain constant thereafter. Fourth, the stock-flow adjustment is set to zero after 2020. Finally, medium-term real GDP growth projections are based on the T+10 methodology agreed with the Economic Policy Committee and implies that medium-term real GDP growth is assumed to average 1.3 % in 2018-2023 and to slow to 1.0 % on average in 2024-2029.

Graph 4.1.2.1: Gross government debt — Spain



(1) Combined negative/positive shock on interest rates and nominal GDP growth: +1p.p./-1p.p. on short- and long-term interest rates on new and rolled over debt and -0.5/+0.5 p.p. on nominal GDP growth over the whole projection period, 2019-29.

Source: European Commission.

More favourable assumptions on real growth and interest rates would lead the debt ratio to follow a lower path to reach 96.8 % of GDP in 2029. By contrast, under more unfavourable assumptions on these variables, the debt ratio would increase to 119.1 % of GDP by 2029.

The total tax revenue ratio to GDP has regained the level prior to the boom and bust episode of a decade ago. After peaking at 36.4 % of GDP in 2007 and bottoming out at 29.8 % of GDP in 2009, total tax revenues have gradually recovered and, as indicated, reached, 33.8 % of GDP in 2017, slightly above the 200-2017 average. While indirect taxes, such as Value Added Tax, are now clearly above its 2005-2017 average (+0.7 pps)

and personal income taxes are somewhat above (+0.2 pps.), social contributions (-0.2 pps.) and, in particular, corporate income taxes (-0.4 pps.) still fall short of that level. The 2019 Draft Budgetary Plan contained tax measures that the authorities estimated would yield about 0.6 % of GDP in additional revenue. These included planned increases in corporate and personal income taxes, environmental taxes and wealth taxes and the

introduction of new taxes on the digital economy and on financial transactions (see European Commission, 2018c) ⁽¹⁹⁾. According to the Commission 2018 autumn forecast, Spain is still forecast to have a structural government deficit of 3.1% in both 2019 and 2020, reflecting a relatively low level of taxation in relation to expenditure. The situation should be reassessed in light of evolving circumstances in the forthcoming Commission 2019 spring forecast.

Despite a standard Value Added Tax (VAT) rate in line with the EU average (21 % vs an EU average of 21.6 %), Spain collects relatively little Value Added Tax revenues. This is due to extensive use of reduced and super reduced rates, resulting in a large Value Added Tax policy gap. In 2016, it stood at 12.81 %, above the EU average of 9.95 % (European Commission 2018e). While, on average, the reduced rates in Spain have some progressive effect, which is almost entirely due to foodstuff, for many items they have a regressive effect. For instance, this is the case of the reduced rate for restaurants and hotels.

The Value Added Tax compliance gap continued to decrease. The gap – calculated as the difference between the theoretical Value Added Tax liability and the revenue actually received as a percent of the former – amounted to 2.7 % in 2016 (down from a peak of 11.8 % in 2013). This is significantly below the EU average of 12.3 %. Spain has taken steps to reduce Value Added Tax fraud by increasing taxpayer reporting requirements through the Immediate Supply of Information system. The new system has produced a more automated environment, reducing the time to comply with Value Added Tax obligations from 35 to 30.5 hours per company and year.

Environmental taxes are still below the EU average, despite increases in recent years. Environmental taxes in Spain amounted to about 1.8 % of GDP in 2017, compared to an EU average of about 2.4 % of GDP. In particular, energy taxes (including transport fuel taxes) yielded little revenue and amounted to about 1.5 % of GDP in 2016, compared to an EU average of about 1.8 %.

⁽¹⁹⁾ These measures were subsequently submitted to Parliament for approval through the draft Budget Law that was rejected on 13 February 2019 or, in the case of the new taxes, separate draft laws.

Taxes on transport, such as vehicle taxes, only yield half as much revenue in Spain as the EU average (0.2 % compared with 0.5 % of GDP). Also, diesel is taxed relatively less than petrol in Spain, with a ratio of 0.73 in 2018 compared with an EU average of 0.81.

Spain relies to a relatively low extent on recurrent property taxes. Recurrent property taxes are considered among the taxes least detrimental to growth and are preferable to transaction taxes, as the former allow a more efficient allocation of assets and higher labour mobility. While revenues from property taxation in Spain are slightly above the EU average (2.7 % compared with 2.6 % of GDP in 2017), the recurrent element is below the EU average (1.2 % of GDP compared with 1.6 % in 2017), while transaction taxes exceed the EU average (1.5 % compared with 1.0 % of GDP in 2016).

The R&D tax credit is one of the most generous and generic in the EU. However, it does not seem to lead to a significant increase in private R&D investment. The uptake in tax incentives for R&D might be fostered by removing administrative barriers limiting their implementation (Cordón and Gutiérrez Lousa, 2010; Busom, Corchuelo and Martínez Ros, 2014). Evidence shows that the probability of using tax incentives decreases when firms, in particular small and medium-sized businesses, face financial constraints (Busom, Corchuelo and Martínez Ros, 2014).

High compliance costs and an ageing workforce at the tax authority are two areas of concern. Tax compliance costs are relatively high in Spain due to the high ratio of direct tax obligations to turnover (2.6 %). Moreover, OECD data on human resources of the Spanish Tax Administration (Agencia Estatal de Administración Tributaria) shows a high degree of ageing staff, where less than 20 % were below the age of 45 in 2015. This figure has to be read in conjunction with 2015 data showing that Spain has the lowest number of tax agents per citizen among EU Member States that are OECD members (OECD, 2017b). This points to possible future human resource bottlenecks. Procedures have been initiated to hire 1300 civil servants in 2019 (tax inspectors, tax technicians, tax agents, custom police agents and auxiliary officials).

4.2. FINANCIAL SECTOR

The solvency and liquidity of Spanish banks is satisfactory amid positive credit flows to the private sector and continued debt reduction.

Bank profitability has also improved, despite persistently low interest rates and high litigation costs. The non-performing loans ratio of Spanish banks, including their international activity, has continued to decline to just above the EU average and slightly below the euro area average. The ongoing restructuring and consolidation of the banking sector allows it to continue to optimise its business model and to lower its costs. The outstanding level of loans to the Spanish private sector has declined further, driven by non-financial corporations, but deleveraging needs persist.

4.2.1. FINANCIAL SECTOR *

Improved profitability allows Spanish banks to remain well capitalized, although the capital ratio is still below the EU average.

On the back of the favourable economic environment, Spanish banks recorded a domestic return on equity (ROE) of 6.2 % in June 2018, up from 5.9 % a year earlier. The consolidated business recorded a more favourable return on equity of 8.9 % in June 2018 (8.2 % a year earlier). According to European Banking Authority data, the fully loaded common equity tier 1 (CET 1) ratio was 11.1 % at the end of June 2018, still more than 3 percentage points below the EU average (14.3 %). However, the results of the 2018 EU wide stress test exercise published on 2 November 2018 showed resilience of the four stress-tested banks in the event of a potential adverse scenario.

The percentage of non-performing loans (NPLs) in the banking sector has decreased further.

The total stock of non-performing loans for the corporate and household segments in Spain decreased to 6.4 % in June 2018, 2 pp. lower than a year earlier. When the foreign activity of Spanish banks is taken into account, the share of non-performing loans is even lower, at 4.1 % in H1 2018, close to the euro area average (4.2 %) and slightly above the EU average of 3.4 % (see Table 4.2.1). The progress achieved in the reduction of legacy assets was primarily due to the sales of non-performing loans portfolios, and to a lesser extent to recoveries and write-offs. By contrast, the divestment of SAREB's assets in the first half of 2018 – both loans and real estate – was

slower than planned and the company continued posting losses in the first half of 2018. This is related to the lower quality of its remaining portfolio compared to what has already been liquidated and the fact that the majority of SAREB's real estate assets are concentrated in areas where prices are recovering slowly.

The housing market has consolidated its recovery, supporting the clean-up of banks' legacy assets.

The housing market and construction sector continued to recover from the sharp adjustment that followed the crisis. Unsubsidised house prices increased by 7.2 % year-on-year in the third quarter of 2018. Prices of new dwellings went up by 6.1 % and those of used dwellings by 7.3 %. Despite this increase, house prices remain below the pre-crisis peaks, in both nominal and real terms (by around 22 % and 32 %, respectively). According to standard price valuation indicators, house prices are still undervalued in Spain, but some indicators suggest the gap is closing (see Graph 4.2.1).⁽²⁰⁾

Price increases, however, differed substantially across autonomous regions.

In Q3-2018, price growth ranged between about 2.2 % year-on-year in Extremadura and more than 11 % in the Madrid region, which together with Catalonia and the Balearic Islands recorded the largest increases. Regarding the volume of transactions, during the three-month period ending in October 2018, house purchases continued to increase at a strong, but declining, rate (10.8 % year-on-year compared to 18 % a year earlier)⁽²¹⁾. Residential investment is also increasing (to 5 % of GDP in 2017), although still at a much lower pace than before the crisis, and the stock of unsold houses remains high in some regions. This helps explain the above-

⁽²⁰⁾ The analysis of price valuations is based on an average of three metrics: (i) affordability gap (price-to-income deviation with respect to its long-term average); (ii) dividend gap (price-to-rent deviation from its long-term average); and (iii) estimates of deviations of house prices from equilibrium values justified by housing demand and supply fundamentals. See Philipponnet and Turrini, 2017. Apart from these indicators, the European Commission has recently used housing price in levels to compute the number of years of income per-capita required to buy a 100 m² dwelling. This price-to-income ratio in levels reached 9.9 years in Spain on average between 2014 and 2017, slightly below 10 years, the threshold that reflects a higher probability of overvaluation in the housing market

⁽²¹⁾ Source: Instituto Nacional de Estadística (INE).

Table 4.2.1: Financial soundness indicators, all banks in Spain

	2014q4	2015q4	2016q2	2016q3	2016q4	2017q1	2017q2	2017q3	2017q4	2018q1	2018q2
Non-performing loans	8.1	6.3	5.9	5.8	5.7	5.4	5.3	4.7	4.4	4.4	4.1
o/w foreign entities	10.4	8.1	5.6	5.5	5.0	4.1	3.7	3.7	3.2	3.1	2.8
o/w NFC & HH sectors	10.1	8.1	7.7	7.5	7.3	7.3	7.1	6.3	6.1	-	5.6
o/w NFC sector	16.4	12.8	12.0	11.6	10.9	10.3	10.0	8.3	7.9	7.4	6.8
o/w HH sector	5.3	4.5	4.5	4.5	4.5	4.6	4.5	4.5	4.4	4.4	4.3
Coverage ratio	46.4	46.8	46.2	45.8	45.0	43.9	44.9	42.4	42.7	45.2	44.7
Return on equity⁽¹⁾	6.7	6.6	6.8	6.9	5.0	7.9	8.2	7.6	7.0	9.6	8.9
Return on assets⁽¹⁾	0.5	0.5	0.5	0.5	0.4	0.6	0.6	0.6	0.5	0.7	0.7
Total capital ratio	13.6	14.5	14.6	15.0	14.7	14.6	14.4	15.3	15.4	15.1	15.1
CET 1 ratio	11.8	12.7	12.6	12.9	12.8	12.2	11.8	12.6	12.6	12.0	11.8
Tier 1 ratio	11.8	12.7	12.7	13.1	13.0	12.6	12.3	13.1	13.2	13.2	13.2
Loan to deposit ratio	90.3	91.7	93.2	93.6	92.5	91.4	90.8	89.6	89.3	89.8	89.9

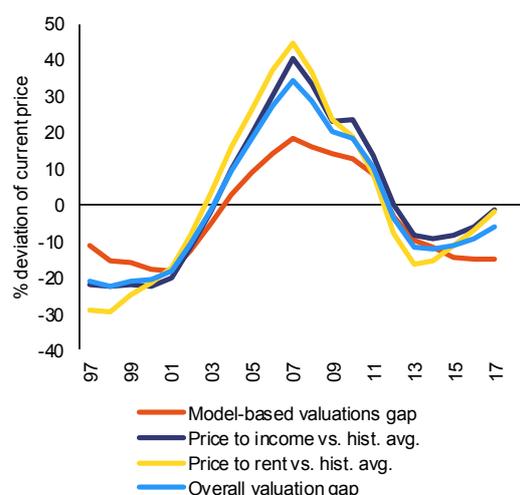
(1) Annualized data.

(2) Domestic banking groups and standalone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches

Source: ECB - CBD2 - Consolidated Banking data; own calculations.

mentioned regional differences in house price developments.

Graph 4.2.1: Overvaluation gap with respect to price/income, price/rent and fundamental model-based valuation gaps



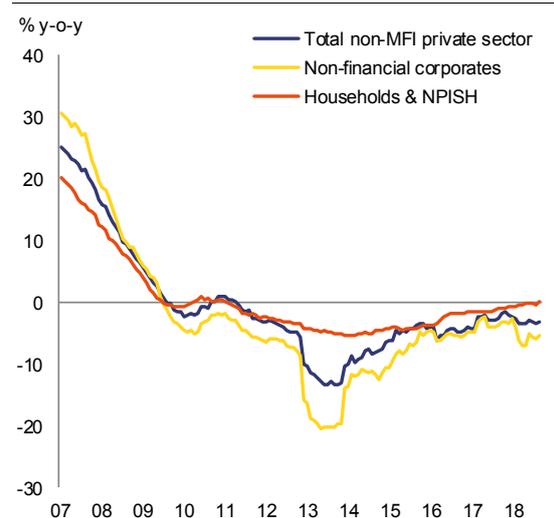
(1) Philipponnet and Turrini (2017)

Source: Own calculations

The outstanding volume of credit to the private sector is still decreasing. In August 2018, the pace of reduction of banks' domestic assets declined further to about 1 % year-on-year, in line with the overall decline of the stock of domestic private credit. The decline was driven by credit to non-financial corporations (NFCs), which in August 2018 was 4.5 % lower than a year earlier (Graph 4.2.2). The strong reduction of credit to non-financial corporates mainly reflects the clean-up of non-performing portfolios linked to the construction and real estate sector. But even excluding this effect, non-financial corporations

lending still registered a slight decrease. By contrast, the volume of outstanding bank loans to households increased by 0.3 % year-on-year in August 2018, prolonging the positive growth that started last June, for the first time since 2010. In the first half of 2018, according to the Bank Lending Survey (Bank of Spain, 2018c), credit conditions eased for both company loans and household lending. For the latter, this concerns both mortgage and, most notably, consumer lending. Although the volume of consumer credit in Spanish banks' portfolios remains small, its large increase requires careful monitoring.

Graph 4.2.2: Loans to the private sector



Source: Bank of Spain, own calculations

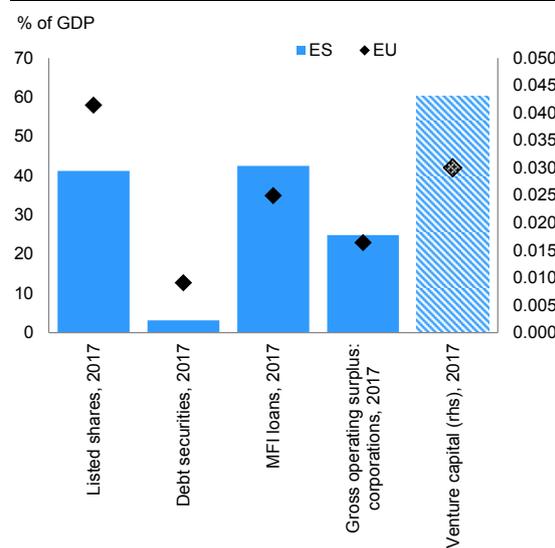
4.2.2. ACCESS TO FINANCE

While the banking system remains the biggest source of finance, other sources have emerged.

In 2017, total bank loans in the economy reached a level equivalent to about 42 % of GDP, almost 3 pp lower than the previous year, but still above the EU average of around 35 % of GDP (see Graph 4.2.3). Non-bank financial intermediation through equity markets and debt issuance is below the EU average. The number of Spanish firms that raise funds through debt securities has increased notably in recent years (by 40 % between 2014 and 2017), as has the number of issuances by small-sized and medium-sized firms (less than EUR 100 million), which accounted for around 50 % of total issuances in 2017 compared to 40 % in 2014. The increasing number of issuances is in part associated with smaller firms that traditionally had not used this financing channel. While remaining a niche option compared to traditional financing sources, finance through venture capital is particularly important for higher risk and innovative projects and companies. In 2017, the volume of venture capital funding to Spanish firms was above the EU average. Finally, funds channelled through crowdfunding platforms, regulated in Spain in 2015, are growing rapidly, but remain marginal (see Bank of Spain, 2018c).

Access to finance and availability of bank credit is no longer considered the most pressing problem by Spanish small and medium-sized enterprises. Overall, small companies heavily rely on bank financing and the availability of alternative financing is underdeveloped. On a positive note, Spanish banks are now far more willing to provide loans to small and medium-sized companies than in 2013 and this is continuing to improve. Similarly, the percentage share of rejected loan applications continues to fall — dropping by around 15 pps between 2012 and September 2018 (European Central Bank survey on the access to finance of enterprise, SAFE, April 2018 – September 2018).

Graph 4.2.3: Sources of financing of the Spanish economy



Source: Ameco, ECB, Invest Europe.

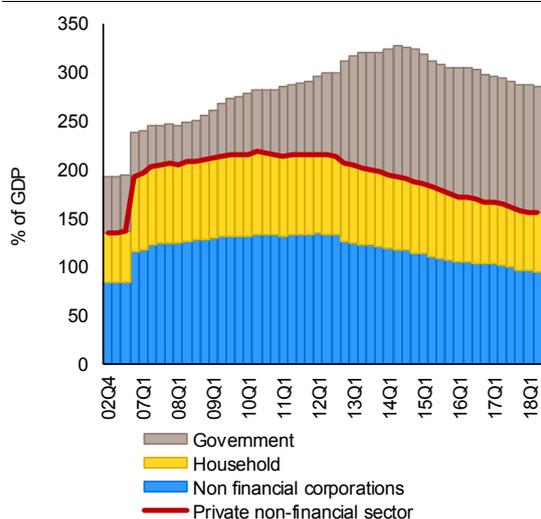
New measures have recently been implemented to ease access to non-bank financing for small and medium-sized enterprises. Access to such funding is easier at the start-up phase, but much less so at the scale-up phase, when small and medium-sized companies seek to expand. During 2017 and the first quarter of 2018, several new measures were introduced to fill this gap, such as: a) the ‘ENISA growth’ (ENISA crecimiento) provides financial support to small and medium-sized companies to grow and improve competitiveness, b) the ‘ICO line FOND-ICOSME’ (línea ICO FOND-ICOPYME) also provides financial support to small and medium-sized companies to put a long-term growth plan in place. Funding is available either in the form of equity financing or through participative loans, c) the ‘Financing Industry’ (Financia Industria) provides personalised advisory services to industrial companies on how to access public financing, d) ‘With a Guarantee, Yes’ (Con Aval Sí) is an electronic platform that aims to facilitate small and medium-sized company financing through mutual guarantee societies.

4.2.3. PRIVATE SECTOR DELEVERAGING *

Private sector indebtedness continues to fall, although the stock of loans to households has stopped declining. In Q3-2018, the outstanding volume of private non-financial sector debt

amounted to 134.6 % of GDP in consolidated terms, of which 59.7 % of GDP was held by households and 75.0 % by non-financial corporations. This is about 67.9 % of GDP lower than at its peak in Q3-2010 (Graph 4.2.4). Prudential and fundamentals-based benchmarks for private debt indicate that Spain still faces deleveraging needs ⁽²²⁾, but overall the deleveraging pace appears appropriate to allow private debt to converge to its fundamentals-based benchmark.

Graph 4.2.4: Composition of debt — Spain

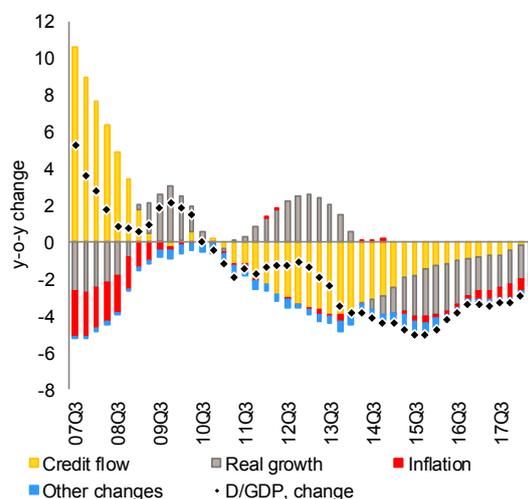


Source: Eurostat

The increase in new credit to households interrupted their deleveraging process in 2018. Household debt reduction was initially driven by negative credit flows, but GDP growth has progressively become the main contributor. However, since June 2018, nominal GDP growth has no longer been sufficient to offset the increase in net credit flows (Graph 4.2.5).

⁽²²⁾ Fundamentals-based benchmarks are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt threshold beyond which the probability of a banking crisis is high, minimising the probability of missed crisis and that of false alerts, see European Commission (2017a). Spanish private debt exceeded the benchmark based on fundamentals by about 27 % of GDP and the prudential threshold by about 39 % in 2017.

Graph 4.2.5: Decomposition of y-o-y changes in debt-to-GDP ratios, households



Source: Eurostat.

Growth in new credit to households is driven by both loans for house purchases and consumer credit. The pace of decline in the stock of mortgage loans slowed down to around 1.2 % year-on-year in November 2018, while the stock of consumer credit increased by more than 13 % year-on-year. New loans for house purchases and consumer credit continued increasing by respectively 10.7 % and 6.2 % year-on-year in November 2018. Between the trough reached in April 2015 and August 2018, the stock of consumer credit has increased by 50 %, accounting for about 10 % of total households' loans. Consumer credit deserves careful monitoring as it poses risks that can materialize quickly if economic conditions become less favourable, impacting negatively on the most vulnerable agents (such as low-income households) ⁽²³⁾.

The outstanding level of household debt has stabilised, despite remaining deleveraging needs (Graph 4.2.6) ⁽²⁴⁾. Although in 2017, the

⁽²³⁾ Nevertheless, the Bank of Spain estimates, the considerable household and non-financial corporations (NFC) deleveraging in recent years has contributed to moderate the negative income effect associated with interest rate rises (See box 7: "Sensitivity of the income of Spanish general government, non-financial corporations and households to interest rate rises", Economic Bulletin, 2/2018).

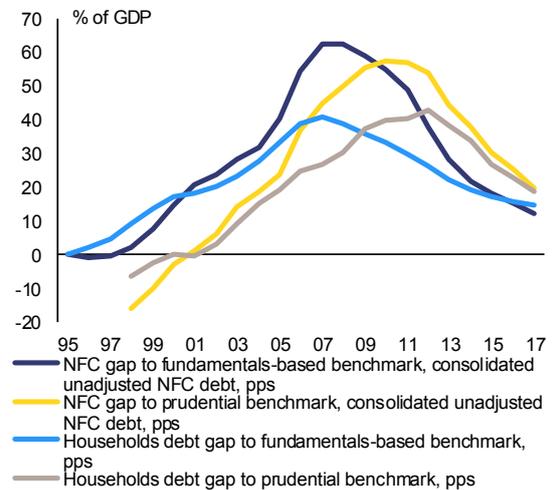
⁽²⁴⁾ In 2017, fundamentals-based benchmarks are estimated at 66 % of GDP in the case of non-financial corporations and

adjustment was faster than suggested by fundamentals, indicating a sufficient deleveraging speed, the household saving ratio is too low to guarantee household debt's sustainability at aggregate level⁽²⁵⁾. What is more, debt is unevenly distributed across households, and some over-indebted households – often living on low-income or jobless - are particularly vulnerable to changes in the economic and financial environment (Box 4.2.1).

46 % of GDP for households, while the prudential ones are estimated at 58 % and 42 % of GDP, respectively.

⁽²⁵⁾ Debt sustainability indicators correspond to the permanent adjustment in the savings rate to (i) reach the fundamental benchmark for debt within 15 years (S1) and (ii) ensure that net financial liabilities are eventually reimbursed (S2). See European Commission, 2017.

Graph 4.2.6: **Gap to the fundamental-based and prudential benchmarks for household and NFC debt**



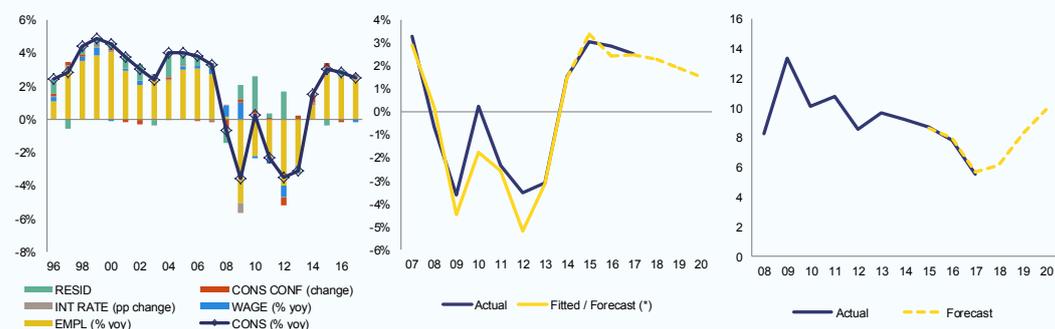
(1) Gap based on the consolidated debt ratio by sector. A positive value means that deleveraging needs persist

Source: European Commission.

Box 4.2.1: Determinants of private consumption

Since the recovery started in 2013, real private consumption in Spain has been growing faster than real household disposable income, bringing the savings rate to a historic low, which, together with strong investment, has resulted in households becoming net borrowers again. In this respect, the role of pent-up demand, mainly for durable goods, that built-up during the crisis due to the decrease in household income, the rise in precautionary savings, and credit restrictions, is well documented (Bank of Spain, 2018d). The economic theory suggests that consumption evolves in line with household disposable income, consumer confidence, interest rates, and household wealth. In addition, a higher propensity to consume can be expected when increases in disposable income arise from employment growth compared to when it arises from increases in the wage per head, as it has been the case in recent years. In order to investigate whether these macroeconomic determinants can explain the strength of household expenditure in recent years, a private consumption equation is estimated ⁽¹⁾. The results from this estimation suggest that consumption has evolved in recent years in line with fundamentals, and that the model would predict a pick-up of the saving's rate in the coming years (Graph 4.2.1.1). The results also suggest that growth in disposable income arising from job creation results in a higher propensity to consume than when it arises from increases in the wage per head. In particular, the model predicts that a 1% increase arising from employment growth would result in a 0.83% increase in consumption, compared to 0.19% arising from an increase in the wage per head. Additionally, the results of the estimation also show that high consumer confidence and low real interest rates have also played a positive but smaller role in explaining consumption growth in recent years. Finally, net wealth does not appear to have played a role in explaining the evolution of consumption in our model. ⁽²⁾

Graph 4.2.1.1: Determinants of private consumption (1), model forecasts for consumption (2) and savings' rate (3)



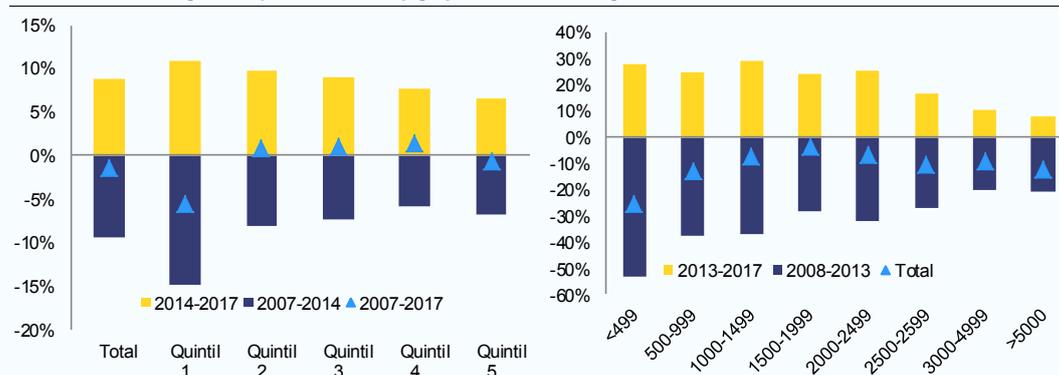
Source: AMECO, European Commission own calculations. (*) Forecasts start in 2015 using the estimated model

At the same time, the decline in the savings rate in recent years has been accompanied by a substantial increase in household net financial wealth, reducing the macroeconomic vulnerabilities associated to a low savings rate in the event of a negative shock, as agents would be better placed to smooth their consumption and investment pattern over the cycle. This improvement has taken place both due to an increase in financial assets and a crucially substantial decline in financial liabilities, especially long-term debt. However, it must be noted that part of the increase in financial assets has been not only motivated by net savings, but also to a large extent by valuation effects (in particular in equity) (Graph 4.2.1.3 left).

Although consumption per capita in both nominal and real terms is still below its 2008 level, a more granular approach to the evolution of consumption by household type, reveals that most of the fall and subsequent recovery of consumption has taken place in the lowest income quintiles (Graph 4.2.1.2 left). In fact, consumption level is still substantially below the pre-crisis level in nominal terms only among the lowest income quintile group, which was also hit hardest by the crisis. In particular, the rise in the consumption of durable goods has been stronger among lower income groups than among the overall population, but nevertheless they remain well below their pre-crisis levels (Graph 4.2.1.2 right). Although lower income groups represent a small share of total expenditure, this could imply that consumption and savings' patterns have differed substantially among income groups. In particular, the lowest income deciles have experienced the strongest growth in consumption since crisis, despite lower income growth than the average (Graph 4.2.1.3 right), suggesting a larger fall in the savings rate among low-income groups (which

in some cases, could be negative). This could be an indication of higher vulnerability of lower income households to changes in economic and financial conditions.

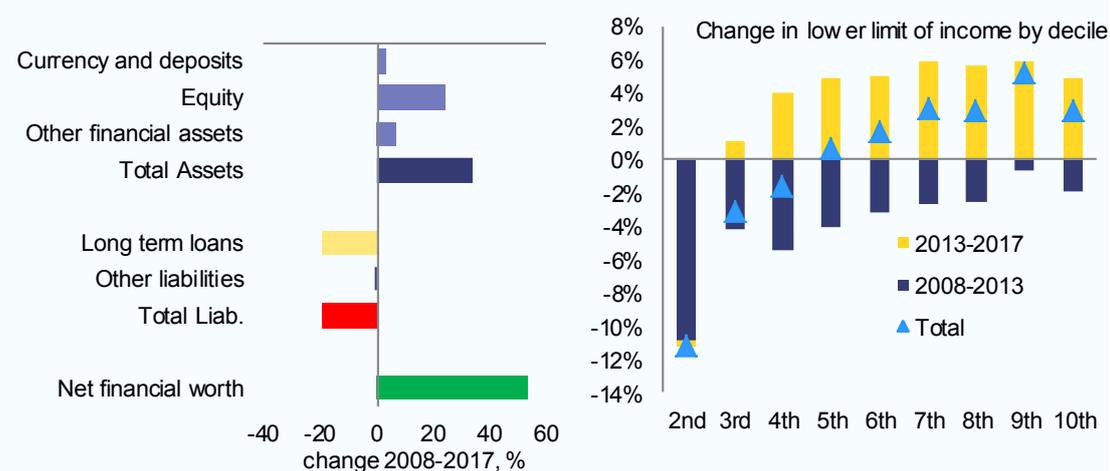
Graph 4.2.1.2: Evolution of consumption by quintile, 2007-17 % change (left); and growth in consumption of durable goods by income level (right), 2008-17 % change



Source: INE, European Commission own calculations.

The conclusion would be that, at an aggregate level, the strength of consumption in recent years can be explained by fundamentals, in particular, by strong job creation, and that a recovery in the savings rate could be expected over the near term. Besides, at an aggregate level, the low savings rate has been accompanied by an improvement in the financial position of families, and therefore the associated macroeconomic vulnerabilities are lower than in the pre-crisis period. However, a more granular approach suggests that income and consumption patterns have varied greatly across income levels and labour market status, and that low-income households may have seen an increase in their vulnerability in recent years.

Graph 4.2.1.3: Change in household financial balance sheets, 2008-17 % change (left), and change in income by income decile, 2008-17 % change (right)



Source: INE, Eurostat, European Commission own calculations.

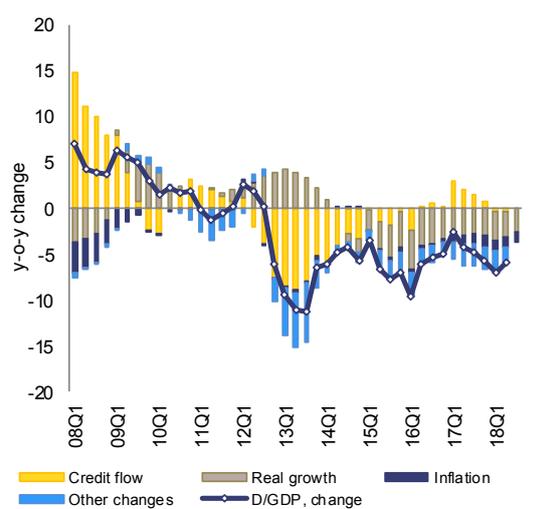
- (1) The estimation is conducted in two steps: in the first step, consumption is estimated as a function of employment growth and wage growth, and in the second step the residuals from this regression are estimated as a function of real interest rates, consumer confidence, and net wealth, following the methodology used in Caixabank Research, 2018.
- (2) Past research also found that wealth effects have had a limited role in explaining consumption decisions in Spain (Bank of Spain).

The financial burden of Spanish households continued falling in 2018, although at a declining pace. With low interest rates and variable rate loans prevailing in the Spanish mortgage market, the financial burden borne by households to service their debt has been falling rapidly. Nevertheless, in the first half of 2018, the debt servicing burden of households relative to disposable income remained broadly stable⁽²⁶⁾, reflecting the increase in households' debt. The continued decline of the share of new mortgages with variable rates reduced households' exposure to interest rate changes. Labour market improvements and growing gross disposable income have allowed the share of non-performing loans in household debt to continue declining to 5.2 % in the second quarter of 2018, compared to 5.4 % at the end of 2017.

Debt reduction in the corporate sector as a whole is taking place simultaneously with new borrowing. Between 2012 and 2016, negative net credit flows were the main driver of the fall in the corporate debt-to-GDP ratio. Since then, deleveraging has been mainly driven by GDP growth, as the recovery of capital investment amid favourable financing conditions has resulted in an increase in new credit. New lending to both small and medium-sized firms (proxied by loans under EUR 1 million) and bigger firms continued to rise in the first eight months of 2018, by 6.2 % and 10.3 % year-on-year, respectively. As a result, the deleveraging process slowed down during the first half of 2018⁽²⁷⁾. According to the Bank of Spain's Central Credit Register, while the total stock of outstanding credit to non-financial corporations decreased between 2012 and 2016, the proportion of firms that increased or maintained their borrowing levels rose (Bank of Spain, 2018b). In addition, the slowdown in the pace of decline of non-financial corporations' debt was even more marked when including external borrowing and issuance of bonds (-2.6 % year-on-year in August 2018 vs -4.5 % only taking account of bank

credit). As in the case of households, corporate indebtedness remains above the prudential and fundamentals-based benchmark (Graph 4.2.7), but deleveraging is progressing at a sufficient pace.

Graph 4.2.7: **Decomposition of year-on-year changes in debt-to-GDP ratios, quarterly non-consolidated data, non-financial corporations**



Source: Eurostat.

The financial position of the corporate sector has continued to improve in the first half of 2018. While remaining negative, the net financial wealth of firms increased for a fifth consecutive year, from -134.3 % of GDP in 2013 to a -117.8 % in the second half of 2018. This improvement was driven by reductions on the liabilities side and, to a lesser extent, a modest increase on the assets side. While the latter was concentrated on equity asset classes, the former was mostly driven by reductions in long-term loans.

Reforms to the insolvency regulation framework in 2014 and 2015 have facilitated debt restructuring and shortened procedures. In a context of strong economic growth and improved access to finance, the number of corporate insolvency proceedings decreased by 2.6 % in annual terms in the first three quarters of 2018 (vs. 0.8 % in 2017). According to Spain's association of registrars, in 2017, the proportion of insolvency proceedings ending up in an agreement between creditors and debtors stood at 8.2 %. This is below the 10.5 % recorded in the two preceding years, although above the proportion reached before the insolvency reforms (7.2 % over 2013 and 2012).

⁽²⁶⁾ The interest burden is the ratio of interest payments to gross disposable income.

⁽²⁷⁾ In April and May, the stock of loans granted by resident banks briefly intensified its decline due to the higher repayments in the last three months, possibly related, to the end (in January) of the calculation period for setting the interest rate on loans drawn by institutions under the ECB's LITRO II. The interest rate on these operations was set so as to encourage lending and depend on the credit balance at January 2018.

More importantly, the proportion of companies being wound down among companies in a failed restructuring agreement situation stood at 7 % in 2017. This is much lower than the two digit figure recorded before 2012 (around 20 %). It suggests that the insolvency framework has become more conducive to debt reduction and has facilitated the liquidation of non-viable companies. In addition, the median duration of proceedings with an anticipated insolvency plan was lower in 2017 compared to 2015 (215 days and 247 days, respectively), though still quite long. This is also the case of ordinary insolvency procedures, the duration of which declined to 440 days in 2017, from 471 days in 2015 ⁽²⁸⁾.

⁽²⁸⁾ 'Anuario Concursal' of the Spanish Official Body of Registrars, 2017.

4.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

4.3.1. LABOUR MARKET *

The economic recovery continues to uphold job creation, but high unemployment and segmentation remain important structural challenges. In Q3-2018 the employment rate (20-64) reached 67.1 % (seasonally adjusted), and unemployment continued to decline steadily to 14.5 % in Q4-2018. Both indicators are still far from their pre-crisis levels and worse than the EU averages (Box 4.3.1). In four regions, the unemployment rate is almost three times the lowest rate. The share of open-ended contracts in net employment growth kept increasing in the first three quarters of 2018, up to an average of 78 %⁽²⁹⁾. However, this was not sufficient to reduce the proportion of workers (aged 15-64) on temporary contracts, which remains one of the highest in the EU (26.9% on average in the first three quarters of 2018). Labour market slack (a measure that includes the unemployed, those marginally attached to the labour market and the underemployed) is declining but still high (24.5% in Q3-2018).

Activity rates remain stagnant and certain groups still face labour market exclusion. While still above the EU average, labour market participation has remained stable since 2012 and declined slightly in 2017, contrary to the growing trend observed in most EU countries. The young (15-24 years old), low-skilled⁽³⁰⁾ and non-EU-born residents struggle to get jobs and thrive on the labour market. In Q3-2018, their unemployment rates were 34.3 %, 22.2 % and 24.5 %, respectively. Long-term unemployment is decreasing, but still accounts for 6.3 % of the active population (1.4 million people, or 41.9 % of all unemployed in Q3-2018). These differences might be explained by factors other than regional labour market dynamics, such as higher participation of the youth in education. Investments supporting increased employment rates and the full mobilisation of the labour force, including of women and older workers, could help

⁽²⁹⁾ Eurostat. LFS. Employment (thousand) by type of contract, year-on-year change based on non-seasonally adjusted data.

⁽³⁰⁾ Level of qualification ranging from (pre-) primary to lower secondary education (ISCED 0-2).

addressing the challenges caused by population ageing and technological and societal change.

Gender disparities in access to the labour market and in working careers remain significant. The female activity rate (15-64 years old) stabilised at 68.8 % in 2017, just above the EU average. Both activity and employment rates of women remain well below those of men (-10.1 pps. and -10.8 pps. in 2017, respectively) with no signs of convergence. In 2017, the average duration of working careers was significantly shorter for women than for men (4.5 years), in spite of a recent decrease in this gap, with temporary and involuntary part-time contracts explaining part of it (Jansen and Troncoso-Ponce, 2018). Gender differences in both occupations and sectors remains above the EU average.⁽³¹⁾ The (unadjusted) gender pay gap held stable at 14.2 % in 2016, 2 pps. below the EU average, but still significant. The Government announced new measures to reduce gender gaps and promote equal opportunities for all. These include wage audits for large firms and measures to encourage work and family life conciliation and co-responsibility. Parental leave was extended from 4 to 5 weeks in July 2018.

Labour market attachment of older people is high, but population ageing poses rising challenges. Participation and employment rates of older workers (aged 50-64 years) increased in recent years, also linked to pension reforms,⁽³²⁾ to above the EU average. However, women above 55 years old still have a low employment rate (43.5 %, 15.6 pps. below men in Q3-2018). Following the implementation of the Strategy 55+ for 2012-2014, no additional policy measures have been taken to improve working conditions for this group of workers, including in relation to health and safety at work, and to incentivise employers to retain older workers.

⁽³¹⁾ Average national share of employment for women and men applied to each occupation and sector (NACE classification).

⁽³²⁾ In 2016, the average real retirement age was 64.1 years; 51 % of workers retire at the legal age of retirement, 44 % retire early, and only 5 % work after reaching the legal age. Source: Ministry of Labour, Migrations and Social Security, and European Commission, 2018d.

Box 4.3.1: Monitoring performance in light of the European Pillar of Social Rights

The European Pillar of Social Rights is designed as a compass for a renewed process of upward convergence towards better working and living conditions in the European Union.⁽¹⁾ It sets out twenty essential principles and rights in the areas of equal opportunities and access to the labour market; fair working conditions; and social protection and inclusion.

SOCIAL SCOREBOARD FOR SPAIN		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Critical Situation
	Gender employment gap	On average
	Income quintile ratio (S80/S20)	Critical Situation
	At risk of poverty or social exclusion (in %)	To watch
	Youth NEET (% of total population aged 15-24)	To watch
Dynamic labour markets and fair working conditions	Employment rate (% population aged 20-64)	Critical Situation
	Unemployment rate (% population aged 15-74)	Weak but improving
	Long-term unemployment rate (population aged 15-74)	Weak but improving
	GDHI per capita growth	To watch
	Net earnings of a full-time single worker earning AW	On average
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	To watch
	Children aged less than 3 years in formal childcare	Better than average
	Self-reported unmet need for medical care	Better than average
	Individuals' level of digital skills	On average

Members States are classified according to a statistical methodology agreed with the EMCO and SPC Committees. The methodology looks jointly at levels and changes of the indicators in comparison with the respective EU averages and classifies Member States in seven categories (from "best performers" to "critical situation"). For instance, a country can be flagged as "better than average" if the level of the indicator is close to EU average, but it is improving fast. For methodological details, please consult the draft Joint Employment Report 2019, COM (2018)761 final.
NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

The Social Scoreboard supporting the European Pillar of Social Rights continues to point to a number of challenges in Spain. The strong economic recovery and job creation contributed to a faster than average improvement in the overall and long-term unemployment rates. Yet, the employment rate remains way below that of the EU and its pre-crisis level. High labour market segmentation and stagnating incomes, notably in the lower part of the distribution, contribute to the high level of income inequality as well as in-work poverty. The capacity of social transfers (excluding pensions) to reduce poverty remains limited. On the positive side, Spain performs better than the EU average in providing access to childcare and to health care services. However, disparities in access and quality persist across the territory.

Young people still struggle to find jobs but remain more in education and training. The youth unemployment rate continues to decline, but remains almost twice as high than before the crisis. The share of young people neither in employment nor in education or training (NEET) and of early school leavers are gradually falling but remain high (respectively 13.3 % and 18.3 % in 2017) as highlighted by the Social Scoreboard. Low education levels greatly increase the risk of future poverty and social exclusion.

With the support of the European Social Fund, EOI (Industrial Organisation School), in collaboration with Google, provides digital training to young unemployed across Spain. Through Massive Open Online Courses (MOOC) trainings, individual tutoring and hiring subsidies, this initiative enables young people to specialise in digital fields that are highly demanded on the labour market (e.g. web/mobile development, big data, artificial intelligence, robotics and cybersecurity). In 2017, 1 131 people received a MOOC certificate, 200 were admitted to a tutoring activity and 61 attended a classroom course. 95 % of them found a job or resumed studies thanks to the programme.

⁽¹⁾ The European Pillar of Social Rights was proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission: https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights/european-pillar-social-rights-20-principles_en

Labour market participation of persons with disabilities lags behind. The employment rate of persons with disabilities (40.5 % in 2016) lags behind the EU average (48.1%) ⁽³³⁾. In 2016, 43 % of persons aged 50-69 who retired due to work

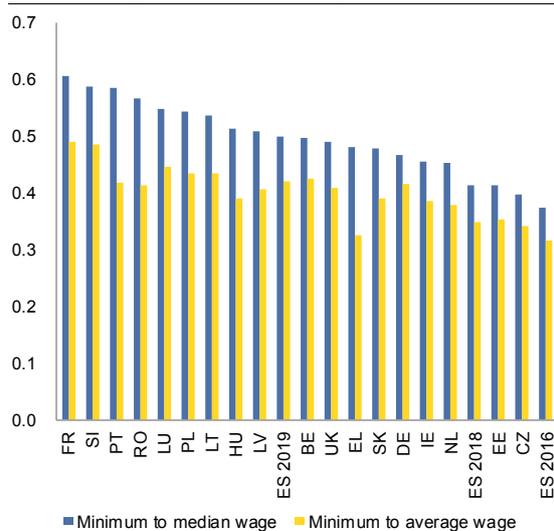
incapacity wished to have worked longer. Some measures were taken to improve the employability of people with disabilities, but relying largely on sheltered employment, which does not seem to facilitate access to the regular labour market (European Commission, 2016).

⁽³³⁾Source: EU-SILC

The employment gap of migrants is well below the EU average but has worsened during the crisis. In 2017, non-EU born people accounted for 8.8 % of the Spanish resident population, above the EU average (7.2 %). The employment gap between non-EU born and EU-born is well below the EU average (4.4 pps. compared to 10 pps.). Yet, between 2008 and 2017, the employment rate of the non-EU born decreased even more abruptly than for the overall population from 70.5% in 2008 to 61.6 % in 2017.

Nominal wage growth has been stagnant in recent years, but is picking up (see Section 1). After several years of very slow growth, negotiated wages continue to grow moderately (1.7 % on average in 2018 compared to 1.5 % in 2017). Sizeable labour market slack, together with persistently low inflation, can explain the moderate wage growth (Bank of Spain, 2018a). A collective inter-professional agreement signed in July 2018 by the main social partners envisaged an increase in negotiated wages by 2 % in 2018, 2019 and 2020, plus an additional 1 % conditional upon productivity growth. It also sets a floor of EUR 14 000 a year for negotiated wages, to be reached by 2021. However, it remains to be seen if it will be implemented.

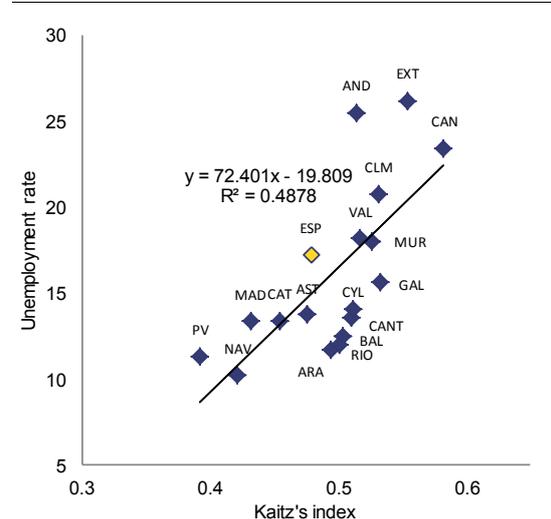
Graph 4.3.1: **The minimum wage as a percentage of average and median wage: the effect of planned increases in Spain**



(1) Calculations are based on the assumption that average and median wages grow at the same rate as compensation per employee (Commission Autumn 2018 Forecast).
Source: OECD, European Commission calculations..

Spain has recently approved a steep increase in the minimum wage for 2019. Following more moderate increases in 2017 and 2018, the minimum wage was raised by 22.3%, to EUR 900 per month. This initiative disregarded the more gradual trajectory agreed with the social partners in December 2017. The stipulated increase outpaces the expected moderate acceleration in consumer prices and labour productivity for 2019 and moves Spain's ratio of minimum to median and average wages close to the EU average, up from one of the lowest such ratio in 2016.

Graph 4.3.2: **Projected ratio of minimum to average wage in 2019 rate v. unemployment rate by region, 2017**



(*)Minimum wage is derived from the government proposal, and amounts to 12600 EUR / year, based on wage per hour.
Source: National Statistical Office, European Commission.

The potential impact of the minimum wage increase on employment may vary significantly across regions and categories of workers, depending on the coverage. Commission calculations based on microdata from EU-SILC⁽³⁴⁾ suggest that approximately 11 % of workers would receive the new minimum wage, in 2019, compared to 4% with the minimum wage in force in 2017. Coverage would range from 3 % in Navarre or 6 % in Rioja, through 10 % in the Madrid region and Catalonia, to 15 % in Andalusia or 18 % in Valencia. On average, it would be higher in regions with higher unemployment (Graph 4.3.2). Across sectors, coverage would

(34) Source: Eurostat. EU-SILC data based on 2015 incomes. Analysis restricted to individuals working full-year, full-time, in the income reference period.

range from below 5 % in the public sector, 8 % in industry, to about 30 % in agriculture and in certain activities within the accommodation and food services. Bank of Spain estimates that the increase in the minimum wage to EUR 900 in 2019 would affect 6.2 % of employees aged 16-64, with a negative employment effect of 0.8 % of total employment (Bank of Spain, 2019a). The potential negative effect on employment would be greater for low-wage workers, that prevail among new entrants (coverage of 24.5% of workers aged 16-24), former long-term unemployed (17%), the low-skilled (16.8%) and those working on temporary contracts (14,4%)⁽³⁵⁾.

In spite of increased outreach efforts, the employability of young people remains low. The share of young people neither in employment, nor in education or training (NEET) keeps falling (13.3 % in 2017), but it remains high and varies greatly across regions.⁽³⁶⁾ Registrations in the Youth Guarantee reached to 56 % for the young people neither in employment, nor in education or training aged 15-24 in 2017 (compared to 34 % in 2016) and to 27.4 % for those aged 25-29. The share of people still in employment, education or training six months after leaving the Youth Guarantee rose further to 60 % in 2017 for those aged 18-24 and to 65 % for those aged 25-29. However, the most vulnerable young people neither in employment, nor in education or training tend to be under-represented among beneficiaries and there is still room for greater cooperation with employers to improve engagement towards those furthest away from the labour market.

Additional resources have been allocated to a new Plan for Youth Employment to be implemented by the regions. Evidence suggests that past hiring subsidies for youth employment have had limited success and failed to promote quality employment. Between 2010 and 2016, only 2.3 % of all contracts were subsidised and just 7 % of all contracts signed by young workers were open-ended. (FUNCAS, 2018). In addition, young

workers on subsidised open-ended contracts were more likely to exit employment within two years than those employed on non-subsidised ones, casting doubts on the effectiveness of these subsidies. Jansen and Troncoso-Ponce (2018) suggest that subsidised training contracts that are of too short duration do not support skills transferability. The newly adopted Plan for Youth Employment 2019-2021 includes an increase in the number of counsellors for young jobseekers (+3 000), a review of the existing hiring incentives and measures covering guidance, training and actions to foster entrepreneurship and equal opportunities. The plan also envisages a review of the Youth Guarantee system and measures to enhance skills acquisition, including digital, and to support jobs in rural areas, in line with the demographic challenge outlined in Section 4.4. The EUR 660 million yearly budget allocated to the plan is still provisional and partly based on pre-existing resources. The implementation of the Plan, on a voluntary basis, is the competence of the regions.

Measures for the long-term unemployed have been updated and extended, but support remains fragmented and effectiveness limited.

The 2016 Joint Action Plan for the Long-term Unemployed (LTU) (see European Commission 2017a, pp. 36 and 60) is producing results. The share of long-term unemployed registered with the public employment services (PES) was 85.5 % in 2017 and the share participating in education and training reached 10.4 %, both above the EU average. At the same time, less than one quarter of all long-term unemployed received individualised support through a Job Integration Agreement at the public employment services in 2017, still half of the target for 2018 and well below the EU average (82.6 %). Among them, the share of those who regained employment keeps improving (19.4 % in 2017, compared to 10.7 % in 2015), but is still below the EU average (23 %). These figures indicate that investment to reinforce the effectiveness of active labour market measures is needed. Income support to the long-term unemployed remains fragmented. The extraordinary unemployment benefit of EUR 460 per month replaces the previous PREPARA and PAE schemes. It was approved in July 2018 and made permanent in December. Plans to integrate existing non-contributory national schemes are

⁽³⁵⁾ Minimum wage (MW) increases could reduce in-work poverty (Matsaganis, 2015) if not outpaced by negative employment effects. However, the simulations by the Bank of Spain (2019) estimate the overall impact on income to be neutral, as wage increases would be offset with employment losses. The latter may as well produce an increase in inequality, estimated at 0.2 % in the Gini index.

⁽³⁶⁾ Eurostat Database (2019)

under discussion, with no concrete proposals put forward yet.

Efforts to reinforce the design of the national employment system continue, but public employment services still play a limited role as intermediaries in the labour market. In 2018, Spain carried on with the modernisation of the public employment services. Performance is uneven across regions in providing individualised assistance for jobseekers and job changers.⁽³⁷⁾ Total expenditure in the public employment services remains 30 % below the level of 2015. Besides, still too few unemployed seek a job through the public employment services (24.6 % in Spain against 46.2 % in the EU in 2017). Investment needs remain in terms of services to employers, including profiling and matching of jobseekers' with employers' needs, establishing partnerships with social services, and providing pre- and post-hiring personalised services. While there is some progress on implementing the single points of contact across regions and the use of the web portal (*Empléate*) is gaining momentum, the share of total vacancies managed by the public employment services was at 3.1 % in 2017 vs 10 % on average in the EU. Cooperation with social services is improving in some regions, notably through joint staff trainings and exchange of best practices in the context of the Social Inclusion Network.

Labour mobility is comparatively low in Spain, with limited incentives and persisting barriers. Albeit increasing since the beginning of the recovery, labour mobility between regions remains low.⁽³⁸⁾ The bulk of internal migration occurs to or from Catalonia, Madrid and Andalusia, while in other regions (e.g., Aragon and Extremadura) outflows largely outpace inflows (International Monetary Fund, 2018). High home ownership, labour market segmentation, limited effectiveness

of active labour market policies and limited transferability of regional social benefits provide weak incentives for people to move, which in turn tend to feed disparities (see Section 4.4).

Albeit stabilising, the proportion of temporary contracts remain high. The share of employees in temporary contracts (15-64) increased during the recovery to reach 26.8 % in 2017 and has stabilised in 2018. At the same time, the share of open-ended contracts among the new hirings kept increasing in the first three quarters of 2018 up to an average of 78 %. While the share of part-time employment (14.6 % in 2017) remains 4 pps. below the EU average, involuntary part-time is very high (61.1 % in 2017 vs 26.4 % in the EU-28), in spite of recent improvements (64% in 2014). Temporary contracts are often of very short durations; 32.6 % of temporary employees have a contract shorter than 6 months, and 17.3 % shorter than 1 month. This implies limited access to job-specific training and difficulties to reach entitlements to unemployment benefits. 23.1 % of temporary workers were at risk of poverty in Spain in 2017, compared to 7.3 % of permanent workers. In addition, transition rates are low, since only 14.6% of temporary workers in Spain moved to a permanent contract in 2017, against 24 % in the EU (2017)⁽³⁹⁾. Young (aged 15-29), low-skilled workers and third country nationals continue to be the groups mostly affected by temporary employment.⁽⁴⁰⁾

Increased efforts to fight the abuse of temporary contracts and undeclared work are bearing fruit. Extensive use of these contracts is made in all sectors (Graph 4.3.3), including those with little seasonal or cyclical activity (European Commission, 2018a). A major aspect of the new Action Plan for Decent Work 2018-2020 is to further strengthen the legal framework and capacity of labour inspectorates to promote quality of jobs and fight against labour fraud. Until October 2018, labour inspections led to transforming 169 161 fixed-term contracts that did not abide by the law into open-ended, representing according to the Ministry of Employment and Social Security an increase of 82% compared to 2017 (92 900). There is still no evaluation of the

⁽³⁷⁾ The benchmarking evaluation program (*EVADES*) shows on-going efforts in some regional PES to incorporate statistical and holistic profiling tools, although at different stages of implementation and often without an integrated approach. Challenges remain to better assess skills of the labour force, target services for job entry and improve results evaluation.

⁽³⁸⁾ The share of working-age population who moved from one NUTS-II region to another in Spain was 0.2 % in 2013 vs. 1.2 % on average in the EU and still higher rates for France and Germany. This rate has increased in Spain to about 0.6 % by 2016. Source: European Commission calculations based on the Labour Force Survey.

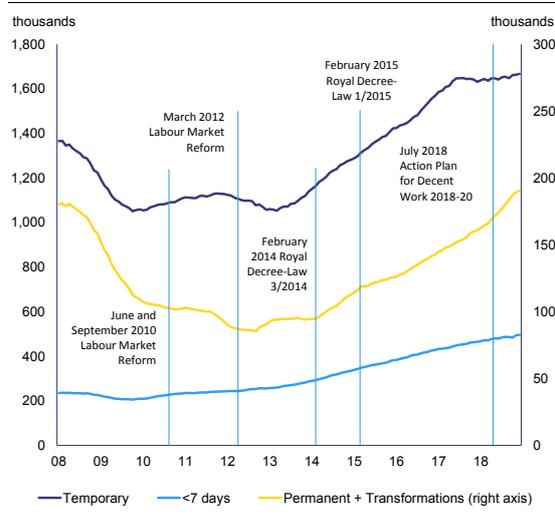
⁽³⁹⁾ Source: Eurostat, Labour transitions by type of contract

⁽⁴⁰⁾ Respectively 56.3 %, 31.4 % and 37.1 % (source: Eurostat database, latest quarterly or annual results).

effectiveness of the numerous national and regional hiring incentives in the private sector.

The Government reached an agreement with social partners to increase wages and improve working conditions of public employees. The agreement number II signed in March 2018 includes a fixed and accumulated wage increase for public employees of 6 % for 2018-2020 (1.75 % in 2018, 2.25 % in 2019 and 2 % in 2020). The Pact also foresees the replacement of all retirements and includes work-life balance measures. Recruitment competitions to reduce fixed-term employment in the Spanish public sector continue, mainly at the regional level. The Government confirmed the target to reduce the share of temporary employees down to 8 % by 2019. However, the current share of temporary employees in the public sector is still at 25.9 % in Q3-2018; (INE, 2019).

Graph 4.3.3: **Newly signed temporary and permanent contracts**



(1)

Source: SEPE, Registro de contratos.

Measures to support the self-employed are starting to bear fruit, even if few are opting for higher social protection. In the first half of 2018 the number of newly registered self-employed increased by 8 % compared to the same period in 2017 (Ministry of Labour, Migrations and Social Security, 2018a). This may reflect a limited impact of the extension of the flat rate of EUR 50/ month in social security contributions, that was expected to have benefitted another 140 500 new self-

employed workers in 2018⁽⁴¹⁾. However, the number of young self-employed aged 15-24 continued to decrease in 2017 (1.3 % less compared to 2016). Besides, the measure to adapt contribution bases (up to four times a year) of self-employed workers to changes in the billing cycle has not so far promoted higher contributions. Around 86 % of self-employed workers without employees and 81 % of those with employees contributed for the minimum base (EUR 279 a month in 2018). Lower contributions imply lower levels of protection and, ultimately, lower pensions, with an increased risk of poverty.⁽⁴²⁾ Nevertheless, social protection and social security contributions for practically all self-employed have been recently increased. Challenges exist to avoid that billing and associated work cooperatives meant to facilitate administrative procedures (often in the form of online platforms), become potential umbrellas for bogus self-employment.

The development of the social economy may attract further investment in support of sustainable job creation and entrepreneurship.

The sector counts around 43 500 firms (21 000 of them cooperatives) directly employing 2.3 million workers, in a context of still strong predominance of the agricultural sector (1.2 million farmers) (Ministry of Labour, Migrations and Social Security, 2018b). The Social Economy Strategy 2017-2020 launched in March 2018 aims at favouring the creation and consolidation of social economy enterprises⁽⁴³⁾. The Strategy also supports self-employed workers (currently around 338 000 in the social economy), firms creating new employment through social entrepreneurship and job opportunities for people with disabilities (some 197 000 employees in this sector) through programmes, projects and funds.

⁽⁴¹⁾ Since 2013, the monthly flat rate of EUR 50 per month in social security contributions has benefitted some 1 307 000 self-employed workers, being Andalusia (245000), Catalonia (219000), Madrid (182000) and Valencia (149000) the regions with the most beneficiaries. The flat rate increased in 2019 to EUR 60/ month. Source: Ministry of Labour.

⁽⁴²⁾ In 2017, the self-employed received an average monthly pension of EUR 711 compared to EUR 1212 for employees under the General Social Security Scheme. Source: Social Security database.

⁽⁴³⁾ Enterprises (cooperatives, mutual societies, non-profit associations, foundations, social enterprises, etc) that apply commercial methods intended to make profits for people other than investors or owners.

The involvement of social partners has improved recently, but there is scope for greater participation and more structured consultation in certain areas. Efforts have been made in recent years to improve the participation of social partners in the European Semester process, although there is scope for a more timely and targeted consultations. The tripartite roundtables launched in February 2017 resumed their work in July 2018. Their aim is to discuss policy initiatives around five key areas, but the intensity of their discussions remains so far uneven and still not fully exploiting the existing institutional framework for social dialogue. Moreover, relevant policy initiatives (e.g., increase in the minimum wage) overlooked agreements concluded with social partners without any prior involvement of those partners in the preparation of the measure. At the bipartite level, the inter-professional wage agreement of July 2018 can improve the collective bargaining process, but results for both firms and employees remain to be seen.

4.3.2. EDUCATION AND SKILLS

Spending on education remains low and efforts to agree on long-lasting reforms stalled against a background of low educational performance. High early-school leaving and a high share of low-skilled in the population still represent major challenges for Spain. However, in 2016, general government expenditure on education increased slightly, to 9.5 % of total spending, but remains below the EU average (10.2 %) and its 2009 peak as a share of GDP (4 % vs 4.6 % in 2009) ⁽⁴⁴⁾. Education expenses incurred by families ⁽⁴⁵⁾ increased by 34 % between 2009 and 2016 (INE, 2017b). This may be an issue for low-income families, especially given the overall low level of income support they receive. In addition, political disagreements including on the level of spending contributed to close the negotiations on a broad-ranging education reform that had started in 2016. The Government then focused on reforming specific aspects of the education system, including vocational education and training, and higher

education, but these plans have not materialised yet.

Participation in early childhood education and care is above the EU average, but disparities in access exist between regions. More than 95 % of children aged 3-6 are enrolled in pre-primary education, 67.4 % of them attending public centres. Pre-primary education for children aged 3-6 is free of charge and includes a national curriculum taught by graduate teachers. The share of children aged 0-3 enrolled in formal childcare was above the EU average in 2017 (45.8 % vs 34. %). Half of them attended public centres. Childcare expenses for those below three are tax deductible, which benefits mainly to households paying taxes ⁽⁴⁶⁾. However, the enrolment rate varies strongly across regions, being for instance almost four times higher in the Basque region compared to Ceuta ⁽⁴⁷⁾. This reflects differences in participation rates across regions, especially of women. The supply of publicly funded childcare places varies significantly across regions, ranging from almost 30 % in the Canary Islands to almost 90 % in Extremadura. The Government will allow municipalities to spend additional EUR 330 million in 2019 for building and upgrading public early childhood education and care facilities.

Large regional disparities persist in education and training outcomes. The rate of early school leaving stood at 18.3 % in 2017, 6.3 pps. below its level in 2013, but still among the highest in the EU as also highlighted by the Social Scoreboard accompanying the European Pillar of Social Rights (see Box 4.3.1). The indicator varies greatly across regions (from 7 % to 26.5 %). It is especially high for students with disabilities and non-EU born residents (see Section 4.3.3). Grade repetition rates remain high thus increasing the risk of drop-out, but dropping (8.8-11.4 % in secondary school courses). Students' performance in basic skills is stable at around the EU average (OECD, 2016), but wide regional disparities persist (see European Commission 2018a). The Government has upgraded the territorial cooperation Programme for Guidance and Reinforcement, with a higher

⁽⁴⁴⁾ Source: General government expenditure by function (COFOG).

⁽⁴⁵⁾ Spending mainly on foreign languages, education support and reinforcement classes provided inside and outside school premises.

⁽⁴⁶⁾ In 2018, the central government introduced a tax deduction (up to EUR 1000) for expenses in formal childcare. Some regions top up this deduction with additional schemes.

⁽⁴⁷⁾ Ministry of Education and Vocational Training. Number of children attending a recognised childcare institution divided by the number of children in the same age range.

budgetary allocation for 2019; new measures to promote dual vocational education and training (VET) studies and teachers' training to tackle this challenge. Efforts to tackle factors behind grade repetition have so far taken the form of ad hoc interventions with limited results, in particular in schools with high dropout rates. Further investment backed by an integrated strategy may be required.

Efforts to hire more teaching staff and to improve their working conditions continue. In 2016-2017, 24.7 % of teachers worked on temporary contracts, with regional rates ranging from 14.6 % to 39.2 %. In 2018, teacher recruitment competitions were held to fill around 20 000 posts in schools at International Standard Classification of Education (ISCED) levels 3-5 as part of a plan to increase the overall number of permanent teachers by 200 000 by 2022 (yet an average of 10 % of them remained vacant after the competitions). Some 10 000 new teachers in ISCED levels 0-2 were hired in 2018 and more competitions will take place in 2019. The plan to reduce the overall proportion of temporary workers in the public sector is ongoing (see Section 4.3.1).

Spain approved measures to support teachers' training and boost their mobility. The Government has approved new training and geographical mobility initiatives and plans to introduce a teacher appraisal system. However, the effectiveness of these measures may depend on the level of funding available to support implementation. As reported in the OECD Teaching and Learning International Survey 2013 (OECD, 2014), 36 % of teachers never received formal appraisal and 14 % of those in lower secondary education expressed a high need for professional development in information and communication technologies' skills (against an OECD average of 18.9%). In this survey, 21.8 % of them indicated training needs for teaching students with special education needs (below the 22.3% OECD average). In 2017, the Government adopted the *Spanish Digital Competence Framework for Teachers* to improve teaching skills in information and communication technology and designed a Digital Competence Portfolio to improve teachers' digital competences.

Matching initial vocational education and training (VET) with labour market needs is still

a challenge in Spain. In 2016, the proportion of initial vocational education and training (secondary education) students was still well below the EU average. In 2017, the employment rate of vocational education and training graduates (20-34 years old) stood at 58.5 % vs 76.6 % in the EU. Around 26 % of young people aged 15-34 holding a vocational education and training qualification in 2016 reported to have benefited from work-based learning during their studies, underperforming the EU average. In addition, cooperation between vocational education and training providers and local employers appears insufficient to increase the contribution of vocational education and training to local economic development. Recent initiatives seek to improve the matching between initial vocational education and training and labour market needs through a higher involvement of the business sector and a review of the qualifications framework. The Government approved measures in coordination with the regions, social partners and other stakeholders to further develop and upgrade the dual vocational education and training system, promote work-based learning and raise the attractiveness of the system. Further coordination may ensure that all regional models comply with key standards for dual vocational education and training (OECD, 2018b).

Despite high tertiary education attainment, skills supply is not sufficiently aligned with labour market needs. In 2017 Spain's rate of tertiary education attainment (41.2 % of people aged 30-34) was above the EU average (39.9 %), but moving away from its Europe 2020 target (44 %). However, the employment rate of recent tertiary graduates (76.6 %) is well below the EU average (84.9 %). At the same time, some high-value added sectors (such as information and communication technology and high value-added manufacturing) have difficulties to find young graduates with the relevant skills. Regional disparities exist both in higher education attainment and in the employment rate of recent graduates. The tertiary attainment rate (30-34 years old) ranges from 27 % in Ceuta to 55 % in the Basque Country (2017).

Cooperation between universities and businesses remains weak, but some new initiatives appear promising. The Spanish universities association and the conference of

business organisations jointly agreed to increase business participation in the universities' decisions on curricula and teaching methods, with the aim of increasing employability of university graduates⁽⁴⁸⁾. The Government supported the creation of the CERVERA Network to boost knowledge transfer. However, the mobility of students and academic staff is still limited, academic staff lack training opportunities, the university governance is still rigid and the Offices for the Transfer of Research Outcomes face a high administrative burden.

Enrolment in adult learning remains moderate with limited access. Participation in adult learning in Spain has recently improved (9.9 % in 2017 compared to 9.4 % in 2016), although it is still below the EU average (10.9 %) and far from the EU target of 15 % by 2020. As highlighted by the benchmarking exercise on adult learning and skills⁽⁴⁹⁾, the participation of the low skilled in adult learning stands at 3.5 % for 2017, recovering from a downward trend since 2010 (4.9 %), and is below the EU average (4.3 %). Nevertheless, the share of adults receiving guidance on learning opportunities is in line with the EU average (26 % vs 24 % in the EU in 2016). There are still no concrete proposals to improve the evaluation and validation of professional skills. The Spanish qualifications framework was recently updated but the training of in-company mentors involved in dual vocational educational and training could be further developed (Cedefop, 2018).

Significant skills mismatches persist, both in terms of qualifications and field of study. In 2015, 19 % of Spanish workers were underqualified for their jobs, 22 % were overqualified. Specialisation in fields with little labour market demand often leads to people accepting a job below their qualification level in an area unrelated to their studies (OECD, 2017). The Government and the regions are implementing specific programmes to develop dual vocational education and training, but further investments may help to ensure that vocational education and training promotes quality and high skills career pathways.

⁽⁴⁸⁾ See, the joint agreement between the Spanish Universities Association (CREU) and the Conference of Spanish Business Organisations (CEOE).

⁽⁴⁹⁾ See European Commission 2018i for more details.

Efforts to address regional disparities in education and training outcomes have not yet resulted in significant improvements. The Sectorial Conference on Education, which gathers representatives from the central government and the regions, provides a framework for policy coordination through the exchange of best practices and peer review among regions. However, it has not met often in recent years. Besides, targeted measures to help regions improve educational outcomes have so far only had small effects in improving the situation in the lagging regions (European Commission, 2018a).

Basic and advanced digital skills levels remain below the EU average. Despite an increasing number of Spaniards going online, the share of individuals aged 16-74 with basic digital skills, at 55 % in 2017, is still below the EU average (57 %) (Digital Scoreboard, 2019). Some regions have implemented the Digital Competence Framework and recognised the level of digital skills of citizens. Digital inclusion seems to be highly linked to income levels, as only 2 % of the high-income households have never used internet, compared to some 30 % of low-income households. While the number of science, technology, engineering and mathematics (STEM) graduates is on the rise (21.6 higher education graduates per thousand inhabitants aged 20-29, against 19.1 in the EU, but with a significant gender gap), information and communication technology specialists still represent a low share of the workforce (2.9 % vs 3.7 % in the EU). In 2018, the Government launched a Training Plan in Digital and Technological Competencies to help science, technology, engineering and mathematics graduates better meet employers' demand for information and communication technology specialists. The Government has also launched initiatives to increase the number of these graduates, with a focus on computer programming and the aim to achieve a higher involvement of schoolgirls in this field⁽⁵⁰⁾.

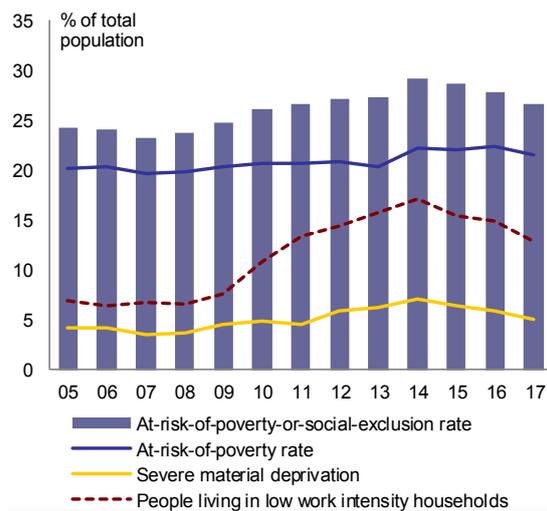
4.3.3. SOCIAL POLICIES

The economic recovery continues to curb poverty, which however remains high. In the last three years, the share of people at-risk-of-poverty

⁽⁵⁰⁾ Escuelas de Pensamiento Computacional.

or social exclusion (AROPE) decreased by 2.6 pps., down to 26.6 % in 2017 (income year 2016). It remained, however, well above the 2008 rate and EU average. The decline in AROPE is mainly driven by the significant 2 pps. drop in people living in quasi-jobless households down to 12.8 % in 2017. Severe material deprivation and the at-risk of poverty rate decreased by a more modest 0.7 pps. (Graph 4.3.4). The AROPE rate varies significantly across Spain. More than one third of the population in Extremadura, the Canary Islands and Andalusia are at risk of poverty and social exclusion, while the rate is below 15 % in Navarra and Rioja (EU-SILC, Eurostat).

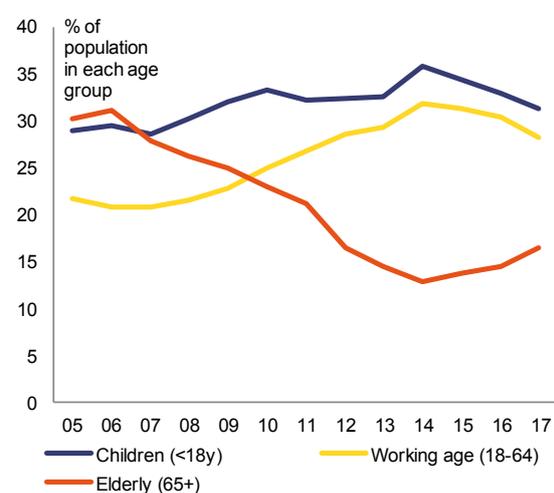
Graph 4.3.4: At-risk-of-poverty or social exclusion rate and its components



Source: Eurostat, EU-SILC.

Disposable income inequalities remained high, even as low-income people moved back to work. In 2017, the income share of the richest 20% was 6.6 times higher than that of the 20% poorest households. This ratio is one of the highest in the EU and did not improve in comparison to 2016. At the same time, income inequalities before taxes and transfers, but including pensions was also among the highest in the EU but significantly improved from 14.9 times in 2014 to 12.2 in 2017, as a result of falling unemployment. The improvement of inequalities before redistribution thanks to better labour market conditions is therefore not reflected in the evolution of inequalities after redistribution.

Graph 4.3.5: At-risk-of-poverty or social exclusion rate by age group



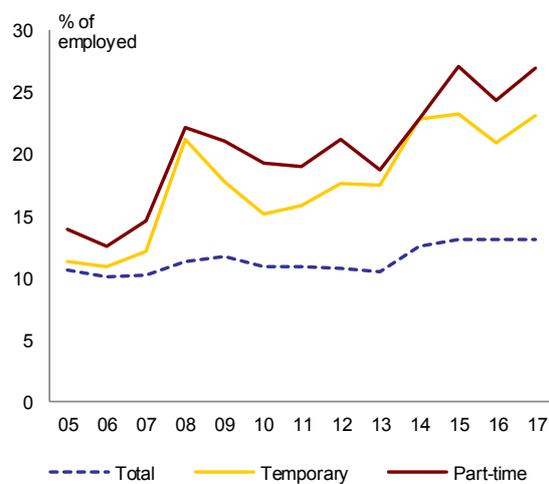
Source: Eurostat, EU-SILC.

Labour market improvements have benefitted working age adults, but in-work poverty remains high. The rate of people at-risk-of-poverty or social exclusion for working age adults decreased as unemployment declined further. However, at 28.2 % in 2017, it was still much above the pre-crisis level. It was also nearly 12 pps. above the rate for the elderly, who, unlike their younger peers, preserved their main source of income (pensions, see Section 4.1) during the crisis (see Graph 4.3.5). In 2017, in-work poverty remained unchanged at 13.1 %, among the highest rates in the EU. It actually increased by 1.4 pps. for employees, a large share of whom work on temporary contracts (see Section 4.3.1 and Graph 4.3.6). This increase was offset by the strong decrease among the self-employed. In-work poverty was especially high and rising for temporary workers (23.1 %), the non-EU-born residents (34.2 %), lone parents (27.8 %) and the low skilled (21.4 %) (EU-SILC, Eurostat). The measures to fight labour market segmentation and to increase the minimum wage may help reduce in-work poverty, but their impact on employment and incomes remains to be seen.

The capacity of social transfers (other than pensions) to reduce poverty remains among the lowest in the EU, especially for children. As highlighted in the Social Scoreboard accompanying the European Pillar of Social Rights (Box 4.3.1), social transfers reduced the risk of poverty by 23.9 % in Spain in 2017, 8.5 pps. below

the EU average, and by 17.7 % for children, i.e. 20.4 pps. below the EU average. This partly reflects the low coverage and adequacy of income guarantee schemes and family benefits. In 2016, the share of poor working age people living in a jobless household ⁽⁵¹⁾ in receipt of benefits was among the lowest in the EU and more than 15 pps. below the EU average.

Graph 4.3.6: In-work poverty



(1) Employed people with an equivalised disposable income below 60 % of the national equivalised median income.

Source: Eurostat, EU-SILC.

The scope of the announced measures to improve the effectiveness of the national income guarantee schemes remains limited. The 2018 Budget Law established that common criteria for activation should apply to all non-contributory unemployment benefits and clarified that unemployment benefits can be topped up by minimum income schemes. The Universal Social Card came into force in October 2018 and is intended to collect information on all benefits received by individuals from the national and regional governments. The resulting increased transparency can help the administrations better target social benefits to those in need, as well as to monitor performance and extend better practices.

More regions are setting a subjective right to a means-tested regional minimum income, but the portability of benefits between regions remains

⁽⁵¹⁾ Share of working age individuals (aged 18-59) receiving any benefits (other than old age or survivors' benefits) among people at-risk-of poverty and living in households with very low work intensity. Social Protection Committee

limited. Eligibility for regional minimum income is linked to residence, and moving to another region implies loss of the support. Six regions established the possibility to conclude agreements with other regions to ensure the transfer of rights in their legislation, but so far only two regions started to negotiate such an agreement. While benefit levels increased in most regions, large variations remain in their adequacy (Ministry of Health, Consumption and Social Welfare, 2017). According to EUROMOD ⁽⁵²⁾ simulations performed by the European Commission Joint Research Centre, one out of five potentially eligible beneficiaries actually receive regional minimum income schemes, with large variations across regions (from less than 10 % in some regions to near full coverage in others). Simulations suggest that full coverage in all regions would reduce the poverty gap ⁽⁵³⁾ by 4 pps. down to 27 %, 3 pps. above the EU average. An increase in the amount of benefits would be needed to further reduce the poverty gap (particularly in some regions).

Children face one of the highest rates of risk-of-poverty or social exclusion in the EU, well above other age groups. The risk of poverty or social exclusion for children (0-18) fell to 31.3 % in 2017, but remains very high. Children with a migrant background or with a lone parent face the highest risks of monetary poverty, above 40 %. Even when parents are working, children face a 12.5 % risk of poverty, well above the EU average (8.3 %) and rising since 2013 (EU-SILC, Eurostat). A newly appointed High Commissioner to fight child poverty has been tasked to evaluate and monitor policies and promote overarching strategies and national plans to fight child poverty are under discussion. The VECA program launched in the summer of 2018 sets subsidies for school meals, leisure and culture during school holidays for vulnerable children.

⁽⁵²⁾ EUROMOD is the tax-benefit microsimulation model for the EU. It simulates individuals' and households' benefit entitlements and tax liabilities (including social security contributions) according to the rules in place in each Member State. Simulations are based on representative survey data from the 2016 European Statistics on Income and Living Conditions (EU-SILC) and cover the main elements of direct taxation, social contributions and non-contributory benefits. Incomes reported in the EU-SILC of 2016 refer to 2015.

⁽⁵³⁾ The at-risk of poverty gap is the difference between the median equivalised disposable income of people below the at-risk-of-poverty threshold and the threshold itself.

Social spending for families with children is poorly targeted and remains among the lowest in the EU, resulting in very low effectiveness. In 2016, public spending on family benefits was almost half of the EU average (1.3 % of GDP vs 2.4 %). Per capita spending is also low (EUR 336 vs EUR 690 in Purchasing Power Standards) and declining. In 2017, 16.4 % of children (0-17) received the national means-tested child allowance. This is only half of the children recorded as being at risk of poverty or exclusion. In 2017, 25.7 % of households with children (0-18) at risk of poverty reported having great difficulty in paying for costs associated to formal education, against 17.2% at EU level ⁽⁵⁴⁾. In 2018, the Government introduced new tax credits for families and increased the minimum threshold for taxable gross salaries. However, tax reliefs for families do not benefit the poorest households.

Older adults maintained their living standards during the crisis. The at-risk-of poverty and social exclusion rate of people over 65 is increasing but, at 16.4 % in 2017, it remains 10 pps. below the 2008 level. The ratio between pension and late-career work income increased from 0.42 to 0.69 between 2008 and 2017 and remained well above the EU average ⁽⁵⁵⁾. However, the at-risk-of poverty gap for older adults increased for the first time since 2008, from 13.9 in 2016 to 20.2 in 2017 and is now above the EU level (16.7). This is because income for pensioners with lower pensions moved further away from the increasing relative poverty line. The level of retirement pension is on average lower for the self-employed and women, as in the EU (European Commission 2018h, and Box 4.1.1).

Social support for people with disabilities is effective in reducing their exposure to the risk of poverty. Despite relatively low employment rates, their at-risk-of-poverty or social exclusion rate is close to EU level at 30.9 % (0.8 pps. above the EU), and the gap between people with and without disabilities is one of the lowest in the EU at 4.8 pps. In 2016, the poverty-reducing impact of

social transfers (other than pensions) for persons with disabilities was 33.5 %, 2.4 pps. above the EU average. However, children with disabilities have a much higher risk of leaving school without a diploma than children without disabilities, among the highest gap in the EU (ANED, 2018). The provision of services for persons with disabilities also varies between regions, including for inclusive education programmes (Huete, 2017), and for job search assistance (OED, 2018). The mid-term evaluation of the National Disability Strategy (2014-2020) showed limited progress, mostly in the area of employment (OED, 2016).

The social integration of non-EU born migrants and of the Roma lags behind. People born outside the EU (8.8% of the population in 2017) face a much higher risk of poverty or exclusion (42.9%) than the native born, a much larger gap than in average in the EU (25.7 pps. vs 15.5 pps.) (EU-SILC, Eurostat). Despite an employment rate close to that of the native population, they face a much higher risk of in-work poverty. The gap in early school leaving between native and children with a migrant background is also one the highest in the EU. Spain has one of the largest Roma community in the EU (750 000 people, or 1.6% of the population). While overall they tend to have better education and health outcomes than other Roma communities in the EU, they face a very high and rising risk of poverty and significant gaps in social outcomes vis à vis the rest of the population in Spain (Roma Integration Indicators Scoreboard, 2011-2016). The National Roma Integration Strategy 2012-2020 sets a political framework to address these challenges.

Affordable housing is a challenge for tenants, low-income households with children, and non-EU-born people. The housing costs overburden rate ⁽⁵⁶⁾ is above the EU level for low-income households (38.4 % vs 34.3 %), households with children (11.4 % vs 8.1 %), including those with a lone-parent (30.6 % vs 18.4 %). Tenant eviction orders increased by 4.3 % in 2017 and a further 7.9 % year-on-year in Q3-2018 (General Council for the Judiciary, 2018), in a context of increasing rents. The new State Housing Plan (2018 – 2021)

⁽⁵⁴⁾ EU-SILC, Eurostat, costs of formal education include tuition and exam fees, books, school trips, cost of canteen and others.

⁽⁵⁵⁾ Aggregate Replacement Ratio (ARR) as the ratio of the median individual gross pensions of 65-74 age category relative to median individual gross earnings of 50-59 age category, excluding other social benefits.

⁽⁵⁶⁾ Share of people living in households where total housing costs make up over 40 % of the total disposable household income (both figures net of housing allowances). Source: EU-SILC.

includes rent subsidies targeted at vulnerable groups, promotion of public housing and housing renovation. The most recent survey on homelessness shows that between 2014 and 2016 the number of people hosted in a shelter increased by 20.5 % (INE, 2017a).

Energy poverty fell in 2017, and take-up of the new social tariff is slow. In 2017, the share of people at risk of poverty who are unable to keep their homes adequately warm decreased by 3.8 pps. to 19.4 %, reaching the EU average but remaining above the 2008 level (4.2 pps.) (EU-SILC, Eurostat). Following the reform of the social tariff for electricity in 2017, less than half of former beneficiaries renewed their application in 2018, despite measures taken to broaden coverage in October 2018. The complexity of the procedure may have deterred potential recipients. A social tariff to cover heating expenses during the winter was also introduced and is automatically granted to beneficiaries of the social tariff for electricity. A new national strategy against energy poverty under preparation has already been subject to public consultation.

Coverage of long-term care services increased, including amongst those with lower levels of dependency. In 2016, public spending on long-term care as a share of GDP was less than half than the EU average (0.8% vs 1.8%). In 2018, the coverage of people with severe dependency increased to 87.2% (+3.0 pps. in one year) (SAAD, 2018). The coverage of people with moderate dependency increased by 15 pps. to 60.8 %, thanks to the increased availability of complementary benefits (such as telecare) (CES, 2018b). All regions reduced their waiting lists to different degrees, but the number of requests and beneficiaries varies greatly. Since 2014, the number of formal long-term care workers increased but their share for population over 65 years old remains below the OECD average. A 2017 evaluation recommended to ensure sufficient funding, improve data collection and assess the gender impact of care provision (Commission for the Analysis of the Situation of Dependency, 2017).

Inequality of access to medical care is low on average, with exceptions and some variation between regions. In 2017, self-reported unmet need for care was lower than in the EU and with

little variation by income groups ⁽⁵⁷⁾. The extension of access to health care to undocumented migrants in 2018 filled one remaining gap in this area. However, the gap for unmet dental care needs between those in the lowest and highest income quintile was 9.3 pps. vs 5.3 pps. at EU level. In addition, regional disparities in care delivery persist, notably in the use of evidence-based procedures in secondary care and in the rational use of medicines (Bernal et al, 2018). There are increasing shortages of nurses and general physicians in primary care and long-term care services, especially in some regions. The widespread use of part-time and temporary contracts and the decline in salaries may have contributed to the outflow of doctors and nurses seeking employment abroad. These shortages are likely to further increase, as almost one third of the doctors are expected to retire within the next 10 to 15 years, in particular general practitioners.

Rapid population ageing and growing long-standing disability and chronic conditions challenge current healthcare delivery. Despite the increasing pressure on primary care, public spending on hospitals represents an increasing share of total public spending to the expense of primary care. The relatively high share of avoidable hospital admissions in Spain (6.3 vs 5.5 EU average), also illustrates the potential to increase the role of primary care in the prevention and management of acute chronic conditions ⁽⁵⁸⁾ (OECD and the European Union 2018). Other challenges for primary care include the growing care needs associated to lifestyle risk factors and chronic conditions; and the need to ensure continuity of care across care providers (Bernal et al, 2018). The lack of interoperability of electronic systems hampers the efficient use of available e-health solutions, as well as the coordination and continuity of care, especially in some regions (Oderkirk, 2017).

⁽⁵⁷⁾ The benchmarking exercise in the area of minimum income also shows that the gap in unmet needs for medical care between people 18-59 at risk of poverty from very low work intensity households and the rest of the population aged 18-59 is among the lowest in the EU. For details, see European Commission 2018i.

⁽⁵⁸⁾ Including diabetes, hypertension, heart failure, COPD and bronchiectasis, and asthma.

Investment needs

Increased investment in education and training, employment services and social inclusion policies is important for improving Spain's productivity and long-term inclusive growth. Promoting better access to quality and inclusive education is key to employability and social mobility. Investment in modern public employment services is a driver of quality jobs and smoother labour market transitions. High at-risk-of-poverty or social exclusion rates, in particular for children, call for investment in active inclusion policies and social infrastructure (e.g. social housing). Actions promoting labour mobility, entrepreneurship and the social economy can respond to depopulation in some inland regions. Integrating the different strands of healthcare services, while strengthening primary care may help adapt care delivery to population ageing, disability and chronic conditions. Investment should respond to regional needs and disparities in the availability and effectiveness of public services.

4.4. COMPETITIVENESS, REFORMS, AND INVESTMENT

4.4.1. PRODUCTIVITY, COMPETITIVENESS, AND INVESTMENT *

Supporting Spain's long-term sustainable growth requires investments to foster and help absorb innovation, including in small and medium-sized enterprises, as well as to promote resource efficiency, upgrade rail infrastructure for freight transport and extend energy connections with Europe. Further investment in both public and private R&D, as well as digitisation and digital skills, would bolster the innovation capacity of the economy, if acting in synergy with investment on education and labour market policies (see Section 4.3). The improvement of rail connections and logistic hubs allowing for freight transport with ports and the completion of the Trans-European Networks for Transport, as well as of energy interconnections with Europe are crucial to improve Spain's access to markets, both within the country and with the rest of Europe. In allocating investment, due attention has to be given to regional disparities and regions' specific characteristics, including the specific needs of rural areas.

Productivity and competitiveness

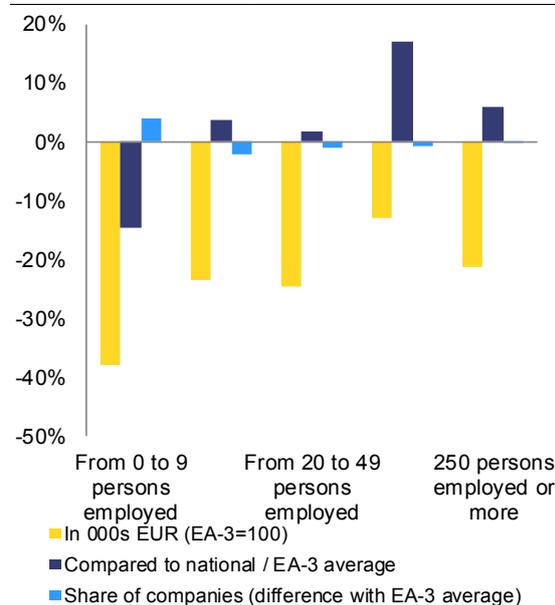
Productivity in Spain remains below that of other large euro area countries. During the crisis, growth in labour productivity, measured as Gross Value Added or GDP per employee, picked up, but largely as a result of labour shedding. Productivity has been growing more moderately since then, broadly in line with the euro area, and simultaneously with employment growth, underscoring genuine improvements in the efficiency of production. The improvement in the quality of investment supported these positive developments (Section 1). However, Spain's productivity is still comparatively low, though it displays some regional variation and large sectoral disparities. ⁽⁵⁹⁾ In sectors such as agriculture, construction, accommodation, food services and telecommunications, labour productivity is higher in Spain than in some other large euro area countries (see European Commission, 2018a, pp. 50). In terms of growth, labour productivity has grown faster in manufacturing than in services.

⁽⁵⁹⁾ Apparent labour productivity by hour worked is about 12% lower than the EU-15 average in PPS and 21% lower in nominal terms

Again, there is quite large variation within sectors, and some service sectors such as information and communication technologies have also seen strong productivity growth.

The large presence of small companies in the economy and a low innovation capacity largely explain Spain's productivity gap. Small companies tend to record lower productivity than large ones, mainly due to scale effects and limits to their absorptive capacity for innovation. In Spain, the productivity gap between small and large companies is greater than in other large Member States. The gap is more salient in sectors such as professional services, and smaller in manufacturing-related activities (see Graph 4.4.1 and European Commission 2018a). This is compounded by the fact that companies tend to be less productive than their counterparts in other large Member States at all size levels, and is reflected in Spain's comparatively low share of innovative firms across sectors, as measured by the 2018 European Innovation Scoreboard.

Graph 4.4.1: Productivity gap, ES v. EA-3 in current prices



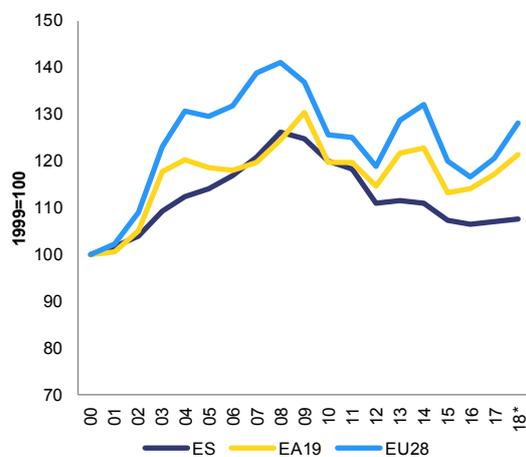
EA-3: unweighted average of DE, FR, IT.

Source: Eurostat.

Regained cost-competitiveness and some structural improvements are supporting Spanish exports, but the small average firm size limits export capacity. The increase in exports of both goods and services since the crisis (see Section 3) has been broad-based across sectors,

including some professional services (European Commission 2018a), and while the EU still accounts for the bulk of Spanish exports, there has been a process of geographical diversification to the US, Asia, Africa and Latin America (Bank of Spain 2019b). From 2009 to 2018, Spain's cost competitiveness against the EU – as measured by the real effective exchange rate - improved by around 14 % based on unit labour costs and around 5 % based on export prices (Graph 4.4.2). At the same time, the number of regular exporters has continued to increase during 2018, and is now 28 % above its 2010 level, with an increased number of exporting small and medium-sized companies. Still, much of the increase in exported value in recent years was realised by very large exporters (Graph 4.4.3). These are normally large companies, which have on average recorded more favourable unit labour cost developments than smaller ones due to higher productivity growth (see below and European Commission, 2017a and 2016b).

Graph 4.4.2: REER based on unit labour costs

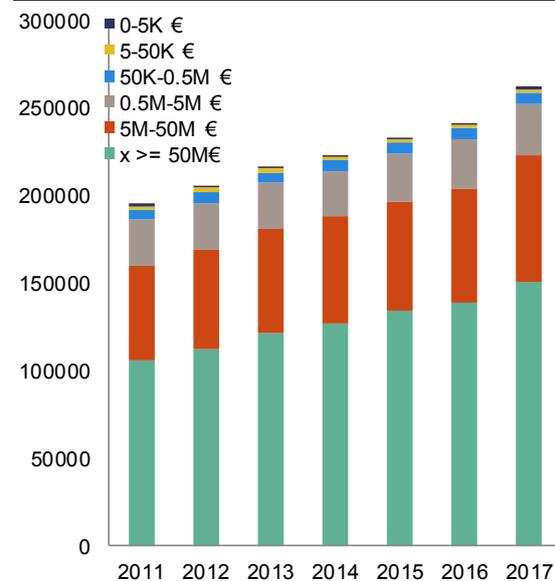


Source: Ameco

Spanish exports are concentrated in goods that compete mainly on price, although there are signs of improvements in non-cost competitiveness. Exports are concentrated in medium-high technology and medium-low quality products that compete mainly on price (European Commission, 2017a). However, there are signs of that Spanish exports become somewhat less sensitive to price competition in recent years (European Commission, 2018a). Apart from a large share of food and primary products, Spanish

goods exports consist mainly of intermediate goods, especially chemical products and equipment goods, and motor vehicles (the latter accounting for around 17 % of total exports). Although some of these products are characterised by medium to medium-high technological content, Spanish exporters have tended to specialise in medium-low quality goods (Bank of Spain, 2019b) with high price-elasticity (European Commission, 2017a and 2016b). In addition, contrary to other large euro area Member States, Spain is becoming more present in the downstream part of global value chains, which is more exposed to competition from emerging economies (see Box 4.4.1).

Graph 4.4.3: Exports by total exported value by company



Source: ICEX

Maintaining external competitiveness is likely to be a challenge unless productivity growth and non-cost competitiveness can be improved. Spain's competitiveness gains in recent years have largely relied on wage restraint, but maintaining external competitiveness could become a challenge unless it is supported by improved allocative efficiency and productivity growth. Structural impediments to the free flow of the factors of production and improved efficiency of production, ranging from skill gaps to the low innovation performance and fragmented product and service market regulation are key drivers of Spain's relatively low score in allocative efficiency and productivity. Against this backdrop, the set-up of a

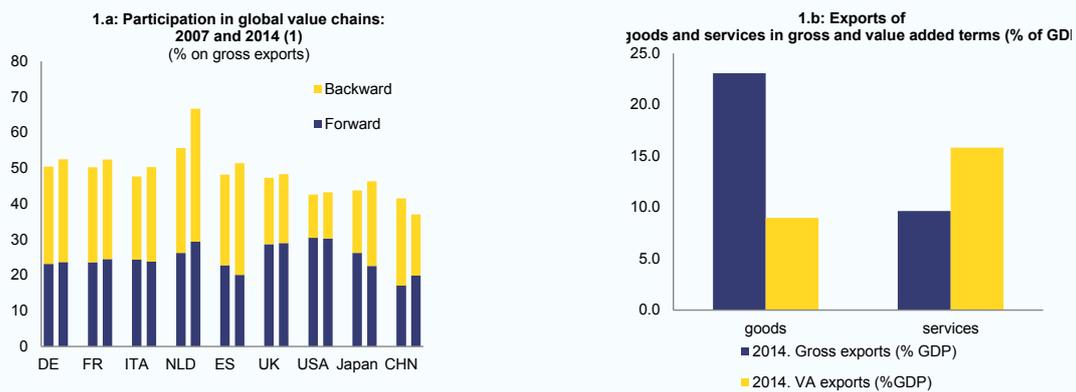
national Productivity Board, as recommended by the European Council (European Council, 2016), will help design and implement policies to comprehensively address the complex productivity drivers. Furthermore, in order to ensure a further structural positive contribution of the external sector to economic growth, the “Strategy for the

internationalization of the Spanish economy 2017-2027” aims to enhance the presence of Spanish companies abroad, notably small and medium-sized companies. The strategy is implemented through biennial action plans, the first of which (2017-18) has just been completed.

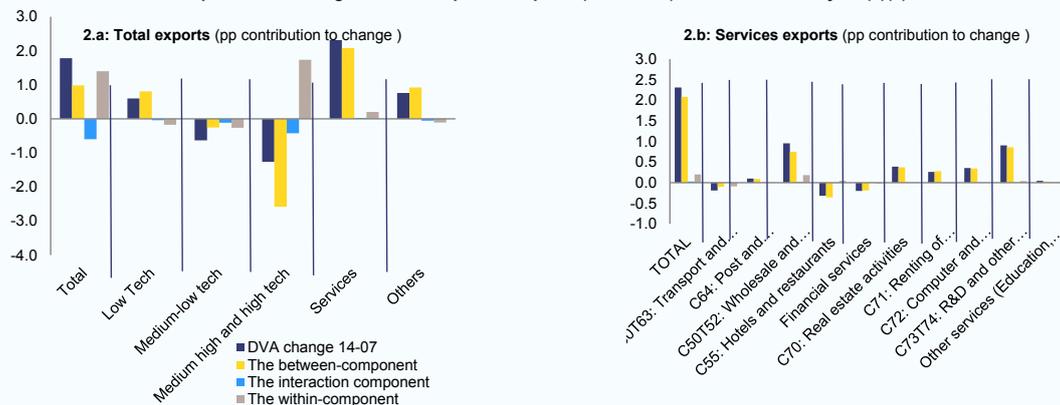
Box 4.4.1: Global Value Chains: the role of Spain

The production of goods and services is increasingly taking place across the globe, with the different stages of the production process being located across several countries. Such increased fragmentation entails an increased volume of trade in intermediate goods and services and increased divergence between what a country sells abroad and what a country produces and adds in its exports.

Graph 4.4.1.1: Global value chains indicators



Graph 4.4.1.2: Change in DVA of Spanish exports (2014-2007): a shift share analysis (2)(3)



(1) The participation index is defined as the sum of backward and forward participation. The backward participation refers to the FVA in a country's exports and the forward one is the DVA of a country's exports that are re-exported to a third country. (2) The shift share analysis allows to breakdown DVA changes in three components: i) changes in exports's composition (the between-component); ii) variations in the domestic value added of each sector's exports (the within-component); and, iii) the interaction or residual component. (3) Classification of exports according to its skilled content followed the International Standard Industrial Classification (ISIC rev. 3 a).

Source: INE, ITiva-OECD and own calculations.

The analysis in this box looks at Spain's participation in Global Value Chains (GVCs), based on Trade in Value Added (TiVA) indicators developed by the OECD ⁽¹⁾, which provide a more accurate picture of the flows of goods and services within GVCs than conventional measures of international trade. Measured on the basis of the aggregate indicator developed by Koopman et al. (2010) ⁽²⁾, Spain's integration in GVCs increased between 2009 and 2014, but remains below the pre-crisis level. The largest European countries have followed a similar path. However, unlike for the other largest EU countries, the decomposition of the index by source shows that Spain tends to be positioned in the downstream part of GVCs – that is, it is taking a backward position, whereby the import content of their exports is high (often as a result of assembly activities as in the automotive industry) (Graph 4.4.1.1.a). Such import content of exports – or the Foreign Value Added (FVA) embodied in exports – was at 27 % of total gross exports in 2014, down from 29 % in 2007. (Graph 4.4.1.1.a).

A sectoral breakdown shows that a significant share of the domestic value added (DVA) in total exports comes from the services sector (Graph 4.4.1.1.b). In gross terms, exports of services barely accounted for

40 % in 2014 of total Spanish exports; however, when international trade is measured in value added terms, services account for almost 50 % of total exports, or 24.8 % of GDP. These shares increased substantially between 2004 and 2017 (by 6.6 % of GDP), more than in Germany, France or Italy. The domestic value added of services in Spanish exports is to a large extent indirect: in 2014, around 30 % of services' value added was embodied in the exports of other sectors (i.e. manufacturing).

A shift share analysis shows that the increase in the domestic value added content of gross exports is mainly explained by an increase in the domestic value added in each individual sectors' exports, but also to some extent to changes in the composition of Spanish exports towards high domestic value added sectors. The services sector has contributed the most to the increase in the domestic value added content of total exports, mainly driven by wholesale and retail trade, as well as R&D services and Other business activities. Within manufacturing, only the low-tech industries have had a positive impact on the domestic value added content of Spanish exports.

(^l) This box is based on the 2016 edition of TiVA indicators. On December 2018 the OECD published the 2018 edition, although the level of some of the indicators has changed, the qualitative messages remain unchanged.

(²) *Koopman et al.* (2010): "Give credit where credit is due: tracing value added in global production chains". NBER working paper.

Research, innovation and digital economy

In an EU comparison, Spain is a moderate innovator. In 2017, Spain's innovation performance measured on the basis of the 2018 European Innovation Scoreboard increased relative to the EU average in 2010, but remains below the EU average. The summary innovation index incorporates a particularly low score on firm investments in innovation expenditures; linkages between innovative small and medium-sized companies and between academia and businesses; and share of innovative firms. Spain also underperforms the EU average in terms of knowledge-intensive services.

Spain's innovation and productivity performance is hampered by a lack of stable investment in R&D and innovation. The investment gap in intangible assets compared to the EU, notably for private R&D investment, has been widening in recent years, when both public and private R&D intensity in Spain have been on a declining trend (Graph 4.4.4). Overall R&D expenditure accounted for 1.20 % of GDP in 2017, and the national 2 % R&D intensity target for 2020 will not be reached unless these trends are drastically reversed. The size of the innovation fabric in Spain is small compared to the size of its economy, and this hampers the structural change towards a knowledge-based economy. Spain is below the EU average both in employment and

share of value added of knowledge intensive activities (⁶⁰).

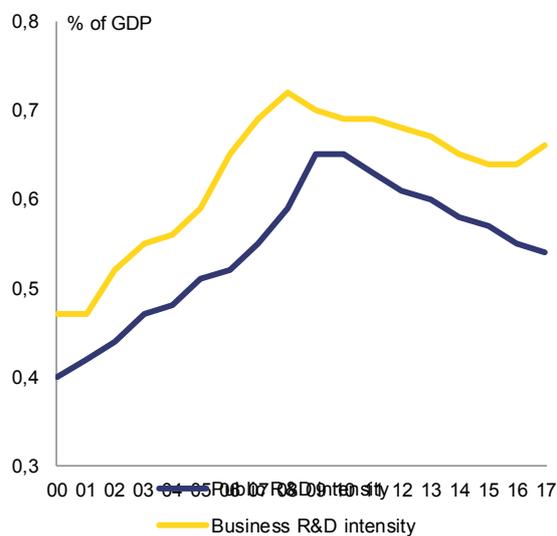
Business innovation capacity is constrained by low R&D investment by large firms, and low absorption capacity by small firms. The Spanish small and medium-sized enterprises (SMEs) account for around 50 % of the R&D investment done by firms, higher than the EU average (22.7 %) (⁶¹). However, small and medium-sized companies have less financial and human resources, and more limited absorptive capacity for knowledge and technology than large firms. At the same time, large firms in Spain have lower innovation investment than their European counterparts. Weak knowledge flows among stakeholders could be linked to lower investment.

The public research and innovation system suffers from underinvestment and a low take-up of public funds available. Public R&D investment is the lowest in almost a decade (Graph 4.4.4). Furthermore, the execution of the dedicated public research and innovation budget lines was very low, at around 30 %, in 2017, due to high reliance on credit-based financial instruments that have had low take-up. The level of public investment for R&D remains unchanged in the absence of a new Budget Law for 2019.

(⁶⁰) Share of value added in high tech knowledge intensive services is 4.4% compared to 5.1 % in EU. It is 4.6 % in medium-high-tech manufacturing, compared to 5.8% in the EU (OECD, 2017).

(⁶¹) Eurostat: BERD performed by SMEs in % of GDP/BERD in % of GDP

Graph 4.4.4: Evolution of business R&D intensity and public R&D intensity 2000-2017



(1) Business R&D intensity: business enterprise expenditure on R&D (BERD) as % of GDP.

(2) Public R&D intensity: government intramural expenditure on R&D (GOVERD) plus higher education expenditure on R&D (HERD) as % of GDP.

(3) Business R&D intensity: breaks in series between 2002 and the previous years and between 2008 and the previous years.

Source: Eurostat.

Human resources remain a crucial challenge for the Spanish research and innovation system.

Despite Spain's high number of science and technology graduates and the relatively high share of the population with tertiary education (see Section 4.3.2 on education), the number of researchers in Spain is below the EU average (2.8 % vs 3.9 % of the labour force in 2016), and decreasing. The share of researchers employed in the private sector is also lower than the EU average (37 % vs. 49 % in 2016) and the cooperation between business and science is very limited. In the public sector, the number of researchers has also decreased, and their average age has increased (European Commission, 2017c). Recent measures were put in place to address this, notably the obligation not to let the number of researchers decline further in the public sector and increasing the number of grants in post-doctoral programmes. Steps to reduce the number of temporary contracts in public research organisations have been taken in early 2019. However, reforms to consolidate careers in research through a 'tenure track' system in universities and public research organisations are

still pending. Finally, there are no policies to direct students towards intermediate technical fields, where there is a lack of qualified personnel.

The quality and structure of the Spanish R&D system is being improved, but the coordination and synergies between national and regional policies need to be reinforced.

The recently created Ministry of Science, Innovation and Universities now covers previously split competences, allowing for a more comprehensive vision of policy needs and synergies in policy-making. There has been steady growth over the past decade in Spain's scientific quality – measured by the share of domestic publications that are among the top 10% most cited scientific publications worldwide - and in the openness of the Spanish research system - as measured by the share of international co-publications in total publications, where Spain now is above EU average ⁽⁶²⁾. Finally, the Spanish Research Agency, created in 2015, is now operational and manages public research grants. Efforts to improve coordination between national and regional initiatives in research and innovation policies will need time to show an impact (Section 4.4.3).

There have been limited steps to develop an evaluation culture for public research and innovation policy.

The Spanish Innovation Agency (CDTI) has commissioned an impact evaluation of the innovation programmes, but most of the public research and innovation initiatives lack systematic assessments of quality, impact and efficiency using comparable methodologies. The Government is developing a more ambitious information system on science, technology and innovation intended to facilitate monitoring and evaluation. The system will include regional data and will be open to regional administrations.

Spain does not fully exploit the growth potential offered by digitisation, but is taking some positive steps.

Spain has a lower number of information and communication technology specialists in the work force than the EU average (2.9 % vs. 3.7 %), and one in five Spanish companies (both large and small and medium-sized enterprises) report serious difficulties in hiring these specialists. In addition, small and

⁽⁶²⁾ International publications as a % of total number of publications (56 % in Spain vs. 49 % in the EU), Eurostat

medium-sized enterprises lag behind big companies in digitisation, with lack of knowledge and technical skills among employees representing main barriers. In response, the strategy ‘Industria Conectada 4.0’, adopted in 2015, has launched several actions to boost digitalisation among companies⁽⁶³⁾. The Spanish Digital Agenda dates from 2013 and plans to update it focus on specific issues. The Government is currently working on the Strategy “Spain Start-Up Nation”, an overarching strategy to embed innovation and digitalisation in all aspects of economy and society. This strategy would include a new plan for the deployment of digital infrastructure; investment in enabling digital technologies; programs to promote skills and talent, or a national strategy on Artificial Intelligence⁽⁶⁴⁾. Spain is also committed to the advancement of new digital technologies via EU-coordinated programmes⁽⁶⁵⁾.

Despite significant investments in infrastructure, the take-up of high-speed connections remains low, as only 30 % of Spanish households subscribe to ultrafast broadband. On the other hand, fibre-to-home subscriptions have overcome other technologies (cable and DSL). Regarding 5G deployment, operators as well as public authorities are preparing the ground with pilot projects. 3,4-3,8 GHz band is already assigned and free for providing 5G services and a 700 MHz auction is expected in early 2020.

Sustainable growth

Spain is on track towards its Europe 2020 CO2 emissions targets. Emissions from sectors not covered by the EU Emission Trading System were reduced by 15.3 % between 2005 and 2017, which is above its 10 % reduction target. According to the latest national projections, the 2020 target is expected to be exceeded by a margin of 9.9 pps. The 2030 target of -26 %, however, is expected to be missed by 9.9 pps. if no further action is taken.

⁽⁶³⁾ Such as a self-assessment tool for enterprises (<https://hada.industriaconectada40.gob.es/hada/register>)

⁽⁶⁴⁾ In addition, new initiatives such as the announced Retail Modernisation Plan 2019-2020 or a foreseen “Strategy for sustainable tourism” will promote innovation and digitisation specific economic sectors.

⁽⁶⁵⁾ Euro HPC Joint Undertaking, European Blockchain Partnership, declaration on cooperation on Artificial Intelligence

After their temporary reduction during the financial crisis, CO2 emissions from transport are on the rise and they are projected to reach pre-crisis levels by 2030. This sector is currently the largest single source of these emissions. A transition to cleaner and more effective modes of transport requires in particular a more ambitious network of charging points for electric vehicles, integrated urban transport systems and the deployment of Intelligent Transport Systems’ technologies. Since the end of 2017, new initiatives on alternative energy vehicles have been taken, including incentives to the purchase of vehicles and investment support for the provision of new charging points.

Attracting investment into renewable energy and energy efficiency is crucial to meet Spain’s 2020 targets. With a renewable energy share in total energy consumption of 17.5 % in 2017, Spain is above its indicative trajectory to meet its 2020 binding renewables target (20 %). However, further investments will be needed to fully achieve that target, in particular considering that the trajectory becomes steeper in the last years of the decade. As regards energy efficiency, latest data show consecutive annual increases of primary and final energy consumption in Spain, putting at risk the achievement of the national energy efficiency targets. 75 % of the estimated additional investments needs in energy efficiency lie in buildings, and in particular the residential segment (High-Level Expert Group on Sustainable Finance, 2018, pp. 59).

In its forthcoming National Energy and Climate Plan⁽⁶⁶⁾, Spain will provide an overview of its investment needs until 2030 for the different dimensions of the Energy Union, including renewable energy, energy efficiency, security of supply and climate mitigation. The information to be provided, including in the forthcoming draft plan, should further contribute to the identification and assessment of energy and climate-related investment needs for Spain. The Government also announced its intention to propose a new Law on Climate Change and Energy Transition in the first half of 2019, which would establish the legal

⁽⁶⁶⁾ To be adopted by 31 December 2019 in line with the Regulation on the Governance of the Energy Union and Climate Action [Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018]

framework of the energy transition and the main targets and goals in this field.

The circular economy is also receiving greater policy attention in Spain. A national strategy is

being adopted, regional strategies exist or are in the pipeline and a pact on circular economy was signed in 2017 by more than 300 stakeholders.

Box 4.4.2: Investment challenges and reforms in Spain

1. Macroeconomic perspective

After a sharp reduction during the crisis, led by the collapse of the construction sector in Spain, investment has rebounded strongly in recent years, led by business investment, and is now slightly above the euro area average. Non-construction investment (11 % of GDP in 2018) now represents a higher share of GDP than at any time before, led by the strength of equipment investment. However, investment in intangibles remains below the euro area average, despite steady growth even during the crisis. Construction investment has been growing strongly since 2014 but from very low levels, and, is still only at 61% of its 2007 pre-crisis peak volume. Only public investment did not contribute to the overall rebound in investment, and has instead kept declining during the recovery. It now stands at 2.2 % of GDP, less than half its pre-crisis peak level.

2. Selected barriers to investment and ongoing of reforms

Public administration/ Business environment	Regulatory/ administrative burden	CSR	Financial Sector / Taxation	Taxation		
	Public administration			Access to finance		
	Public procurement / PPPs			R&D&I	Cooperation btw academia, research and business	CSR
	Judicial system				Financing of R&D&I	
	Insolvency framework			Sector specific regulation	Business services / Regulated professions	
	Competition and regulatory framework				Retail	
Labour market/ Education	EPL & framework for labour contracts	CSR	Construction			
	Wages & wage setting		Digital Economy / Telecom			
	Education	CSR	Energy			
			Transport			
Legend:				Some progress		
	No barrier to investment identified			Substantial progress		
CSR	Investment barriers that are also subject to a CSR			Fully addressed		
	No progress			Not assessed		
	Limited progress					

Major barriers to investment in Spain are reported to be general uncertainty (81 %), and business regulations (79 %), both above the EU average. ⁽¹⁾ Energy costs (72 %) and availability of skilled staff (64 %) are reported to be important barriers, but the latter less so than in the EU. Labour market regulations are more likely to be barriers for SMEs. The satisfaction with the level of external finance by Spanish firms is similar to the EU, and they tend to rely less on external finance. In Spain, both Instituto Oficial de Crédito (ICO) and the regional development banks act as both as public bank and provide public financing of particular activities, such as the promotion of exports.

Selected investment barriers

1. Skills mismatches constrain productivity growth and innovation (see Sections 4.3.1, 4.3.2, and 4.4.1). The high share of temporary employment reduces both workers' and employers' incentives to invest in training and improving job-specific skills. Labour market relevance of tertiary education in particular is weak, because of lack of cooperation between universities and because small and medium-sized companies have a limited capacity to engage with the higher education system and invest in training. Whereas secondary vocational educational training is being strengthened and promoted, enrolment rates are still low.

2. Restrictive regulations continue to discourage investment (see Section 4.4.4). Regulatory fragmentation across regions hampers economic activity and the commitment to implement the Law on Market Unity has produced few tangible results. No proposals to reform professional services have been presented, keeping mark-ups and entry barriers high in economically important professions. Measures to eliminate unnecessary size-contingent regulations that prevent firms from growing are being studied, but no concrete actions have been taken. Policies designed to support R&I investment have a limited impact, and public-private cooperation remains insufficient.

¹ EIB Investment Survey, Spain (2018).

4.4.2. MARKET INTEGRATION FOR PRODUCTS AND SERVICES

Regulatory framework

Restrictiveness and the fragmentation of regulation within Spain prevent companies from benefiting from economies of scale.

According to the OECD Intra EEA Services Trade Restrictiveness Index (OECD 2019), the level of regulatory restrictiveness in Spain is higher than the Single Market average in sectors such as architecture, engineering, legal and computer services. Barriers, often originating from the fragmentation of the Spanish market, restrain economic dynamism, in turn limiting the competitiveness of the economy. According to 2015 data, churn rates (that is, the sum of the birth and death rates of enterprises) remain low in sectors such as legal, accounting, architecture, and real estate activities. Recently introduced legislation on private-hire vehicles, granting regional and local authorities normative power to regulate these services, provides an illustration of regulatory fragmentation potentially leading to restrictions in the provision of services.

The Law on Market Unity remains an important tool to facilitate the free movement of goods and services and the establishment of economic operators throughout Spain, while further work on its implementation is needed.

The 2017 rulings of the Constitutional Court declared null and void certain provisions giving nation-wide effectiveness to licenses and prior declarations granted by or submitted to any given region. However, recent court practice in assessing cases introduced by the Competition Authority suggests that the Law on Market Unity was not substantially weakened by those rulings. In 2018, the Competition Authority introduced four new judicial appeals referring to regulations on professional activities, taxi activity, and activities in public procurement, the outcome of which is pending. The administrative tools foreseen by the Law to protect economic operators are also being used (40 claims have been handled by the Secretariat of the Council for Market Unity in 2018), but their effectiveness is undermined by the length of those procedures that require reaching a solution and the difficulties in ensuring that their outcome is transposed in legislation.

Stronger and sustained cooperation between the national and regional governments would improve the implementation of the Law on Market Unity. The role of inter-sectoral conferences is slowly being reinforced, but stronger and sustained cooperation between national and regional governments is needed to improve the implementation of this law.

Restrictions in retail services remain high. The autonomous communities regulate the retail sector and there are differences in their regulatory approaches. According to the Retail Restrictiveness Indicator (European Commission 2018f), Spain is among the ten most restrictive Member States for setting up retail premises. Administrative simplification to remove the double authorisation that is still in force – in law or practice – in certain regions could make authorisation procedures more efficient. Spain is also one of the most restrictive Member States when it comes to operational restrictions, such as shop-opening hours and sales promotions. In addition, a retail specific tax based on the selling space imposed on large retailers in some regions affects the competitiveness of brick and mortar retailers vis-à-vis e-commerce, which is gaining ground in Spain.

Unnecessary barriers in the regulation of professional services are still in place.

While the statutes of several professional services were revised (e.g. architects, engineers) or are about to be revised (e.g. real estate agents), the draft bill on professional services sent to Parliament in 2012 was withdrawn in 2015 and there are no proposals to relaunch this reform. The restrictiveness of regulation for certain professions continues to exceed the EU average, with persistent high barriers of entry to some professional activities, such as different regional requirements on membership to a professional association. These restrictions limit competition and hamper the mobility of professionals as well as an efficient allocation of the resources.

Challenges remain for the regulation of short term-rental of accommodation in several areas, potentially leading to regulatory fragmentation.

A recent Eurobarometer survey (April 2018) indicates that 24 % of respondents from Spain have used a service offered via collaborative platforms, most frequently for accommodation

(69 %, the highest score in EU). Only 7 % of respondents from Spain have ever offered services through collaborative platforms, but 19 % of respondents indicated that they would consider offering services occasionally. In its 2016 Communication on the collaborative economy, the European Commission looked into how to encourage the development of new and innovative services, and the temporary use of assets, while ensuring adequate consumer and social protection (see European Commission 2016c). However, local authorities have adopted or intend to adopt more burdensome regimes for the short-term rental of accommodation. Some of the new regulations, concerning urban planning in Bilbao, Madrid and San Sebastián, have been appealed by the Competition Authority as distorting competition. The Spanish authorities are assessing the need to amend the existing legal framework at national level.

Integration in the EU single market for energy

Limited integration with the EU single market prevents Spain from fully benefitting from the EU electricity and gas markets. The retail and wholesale energy markets remain competitive, with a very high switching ratio in both electricity and gas markets. The energy component of the retail electricity price continues to decrease due to progressive liberalisation and decreasing concentration of the market. However, with the increase in non-contestable charges, average household electricity retail prices have increased more than 50 % in the last 10 years⁽⁶⁷⁾. The energy component of the retail gas price was more stable than for electricity, but the final retail gas price has also increased substantially and more than the EU average, reflecting the still limited interconnection of the Iberian Peninsula with other EU pipelines.

Spain's electricity interconnection level reached 6 % in 2017, but further investments would be needed to reach the target of 10 % by 2020. However, in 2018 important progress was made with a grant agreement under the Connecting Europe Facility for a new power line crossing the Bay of Biscay totalling EUR 578 million which

will double the exchange capacity between France and Spain by 2025 (from 2800 to 5000 MW). A further project on two Pyrenean crossings has been granted Project of Common Interest status and should further increase the electricity interconnection capacity between Spain and France.

With the completion of the Val de Saône gas pipeline in France in October 2018, Spain has improved its access to the internal market. Additional gas interconnections ('Midcat' and 'STEP' as well as a third interconnection point between Spain and Portugal) have received the status of Projects of Common Interest and are being assessed.

Transport and connectivity

In transport, the improvement of multimodal connections in rail, including for freight transport, the completion of cross-border connections and road maintenance will support Spain's connectivity. Spain has developed an extensive and modern network of infrastructures for all transport modes. However, some Spanish transport infrastructures (ports, high speed rail connections and airports) operate well below their capacity, and the share of freight transported by rail remains low, at 5.1 % in 2016. Road transport remains prominent for both passengers and freight. In the rail segment, there remain gaps in multi-modal connections with ports and logistic hubs. The Trans-European Transport Network (TEN-T) Atlantic and Mediterranean corridors remain incomplete. Addressing these challenges through infrastructure investment would contribute importantly to connectivity of the Spanish territory, in particular with France, and to the competitiveness of its economy. Attention also needs to be paid to the maintenance of the extensive road network in order to keep the existing high level of road safety standards and ensuring connectivity.

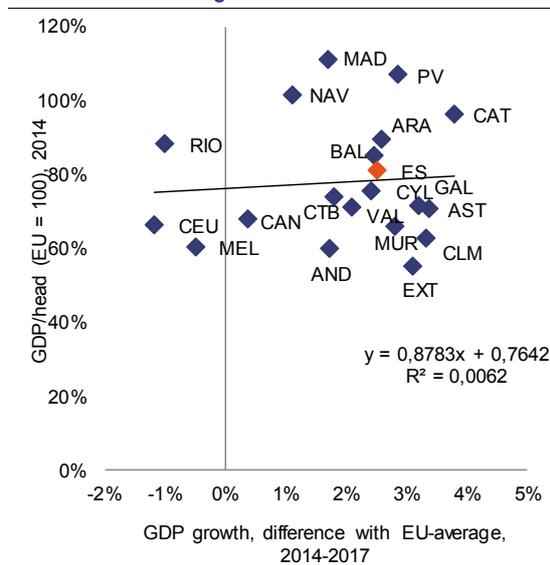
4.4.3. THE REGIONAL DIMENSION

In an EU context, divergences in GDP per head in Spain are moderate, but remain higher than before the crisis. Following a decade of convergence, regional disparities in GDP per head increased in the aftermath of the crisis. They

⁽⁶⁷⁾ See <https://www.acer.europa.eu/en/Electricity/Market%20monitoring/Pages/Current-edition.aspx> at

started decreasing again in 2014. However, convergence has been somewhat uneven, and in some cases, poorer regions have converged more slowly than richer ones towards the EU average in GDP per head (Graph 4.4.5). In 2017, when measured by the coefficient of variation, disparities were still significantly higher than in the pre-crisis period, at a level comparable to that in the early 2000s, but below the median of the EU. GDP per head in the best performing region was around twice as high as in the worst performing one – a ratio broadly in line with the median of the EU.

Graph 4.4.5: Regional convergence in GDP per head to the EU average – 2014-2017



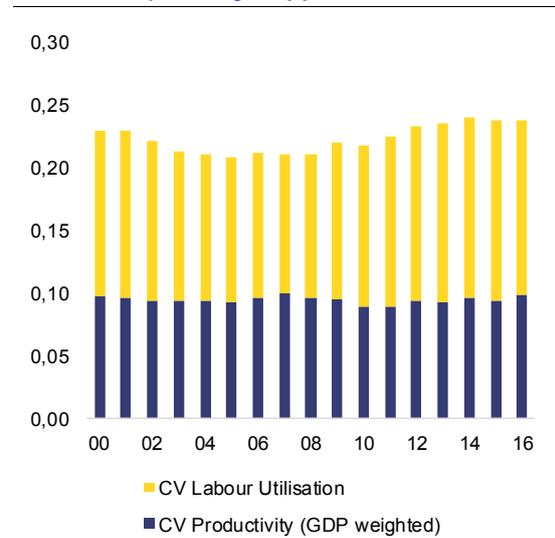
Source: INE, Eurostat, own calculations

The evolution of divergences in income per capita is mostly explained by the dramatic changes in labour utilisation, and in particular in the unemployment rate (See European Commission 2018a). By contrast, the role of productivity has remained broadly stable, and lower than in other Member States, with only slightly faster growth in the most productive regions (Graph 4.4.6) which increased somewhat the productivity gap between the richest and poorest regions.

Most Spanish regions rank below the EU average in most indicators of the 2016 Regional Competitiveness Index. Most Spanish regions are below the EU average in most of the components of the Regional Competitiveness Index, except for

health and basic education. The largest gaps with respect to the EU are found in labour market efficiency. The latter – which is an aggregate of the main labour market indicators – is also the dimension where Spain displays the largest divergences across regions (see Section 4.3), together with infrastructure, business sophistication, and innovation.

Graph 4.4.6: Weighted dispersion in GDP per head across Spanish regions (1)



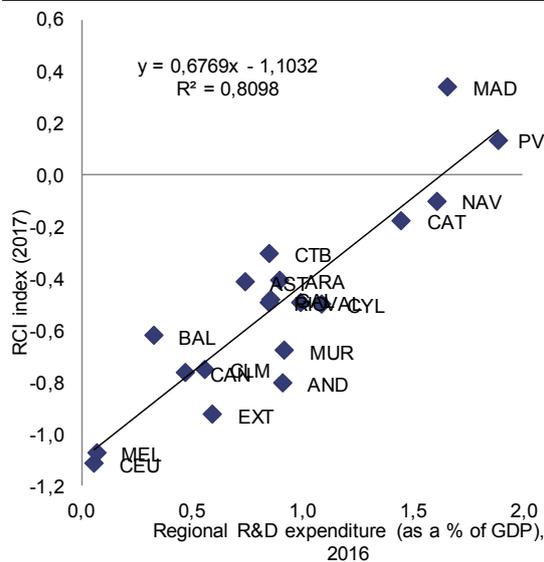
(1) Coefficient of Variation (CV) based on a Thiel's (0) decomposition, weighted by GDP/head

Source: INE, own calculations

Innovation performance is below the EU average in most Spanish regions, with the exception of the Basque Country, which is considered a strong innovator (Regional Innovation Scoreboard, 2017). The majority of Spanish regions fall within the group of moderate innovators (performance between 50 % and 90 % of the EU average). Regional competitiveness is highly correlated with the level of regional R&D investment (Graph 4.4.7), which is concentrated in the four regions with the highest GDP per capita (Madrid, the Basque Country, Navarre, and Catalonia). In addition, with the exception of Navarre, Madrid, and Catalonia, all other Spanish regions are below the EU average on public-private scientific co-publications and none are within the high performing group. Moreover, cooperation between small and medium-sized enterprises remains low, affecting the dissemination of technologies and innovations

from national best performing firms and regions to laggards.

Graph 4.4.7: RCI and regional R&D expenditure



(1)

Source: Regional Competitive Index, DG REGIO, Eurostat

Through the development of Smart Specialisation Strategies, Spain has taken initiatives to boost its innovation potential⁽⁶⁸⁾, but coordination between national and regional levels in research and innovation remains weak.

Reinforced and more focused smart specialisation strategies together with stronger monitoring and evaluation can help to improve innovation performance in all Spanish regions. In particular, smart specialisation may boost industrial transition in the regions that face specific challenges for economic transformation. Recent efforts to improve coordination between national and regional initiatives to exploit synergies between national and regional research and innovation policies and support schemes will need time to show an impact⁽⁶⁹⁾.

The digital divide between urban and rural households persists. Fast broadband only covers 37.4 % of rural households, while the deployment of fibre networks (fibre to the premises or FTTP)

is only 20.9 % of households in the less populated rural areas, compared to 71.4 % at national level, reinforcing the digital divide, one of the largest differences between total and rural fibre to the premises coverage figures among all EU Member States. When it comes to the fixed ultra-fast network (>100Mbps) the average coverage has been growing fast (83.6 %), but significant regional disparities persist. The acquisition of digital skills could play a role in bridging this digital gap between urban and rural areas.

Urbanisation and demographic pressure in some urban areas, on the one hand, and depopulation and ageing in rural areas, on the other hand, pose challenges. Most of the bigger urban areas have experienced rapid population growth, leading to challenges related to urban sprawl, poverty, traffic congestion, and bad air quality.

At the same time, depopulation and acute ageing processes are taking place in certain rural and smaller urban areas, making them less attractive for doing business and increasing the cost of providing public services. There are 14 provinces heavily affected by demographic decline, with more than 25 % of their population aged 65 or older. This represents an additional challenge for the provision of healthcare and long-term care services.

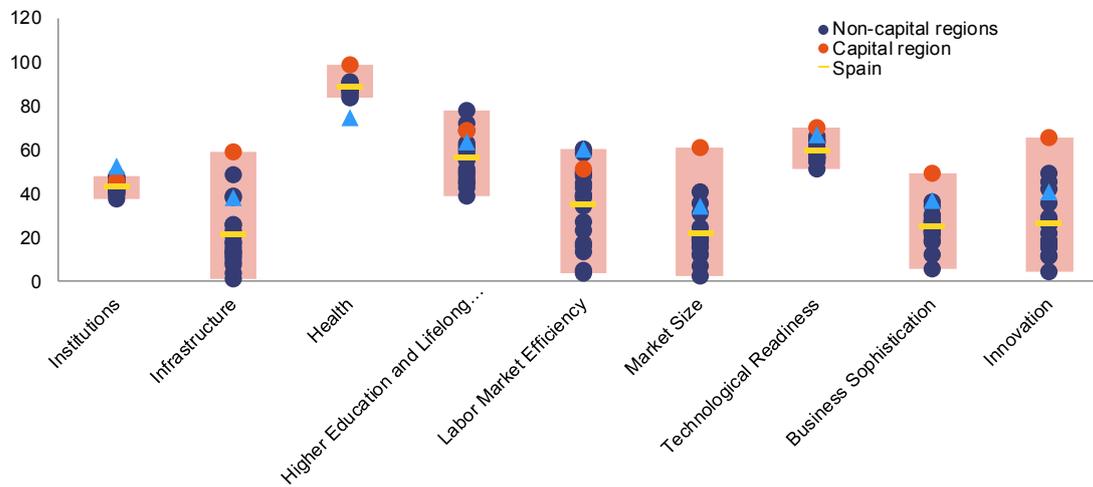
Certain areas are amongst Europe's most vulnerable to climate change. The Mediterranean regions face large increases in heat extremes and decreases in precipitation and river flows, which have heightened the risk of droughts, biodiversity loss and forest fires. The northern regions are more exposed to river and coastal flooding, and eastern regions face severe damages by heavy rains. This requires careful policies to prevent risks and adapt.

Significant environmental challenges exist in the area of water and wastewater management, where the quality of infrastructure is uneven across the country. Certain areas in Spain are water-stressed, due to climate reasons, but also shortcomings in water infrastructure combined with heavy consumption of water by certain economic sectors (e.g. agriculture, but also energy and tourism). Pressure on water resources includes abstractions, point-source pollution, diffuse pollution and morphological alterations. Hundreds of agglomerations in Spain do not yet comply with the Urban Waste Water Treatment Directive, and

⁽⁶⁸⁾ Valoración del proceso RIS3 (estrategias de especialización inteligente) en España. February 2018.

⁽⁶⁹⁾ E.g. the Spanish Council for Scientific, Technological and Innovation Policy; the Network on Public Policies for research, development and innovation – REDIDI; and the new Ministry of Science, Innovation and Universities.

Graph 4.4.8: Disparities in the Regional Competitiveness Index by sub-pillar, across regions and compared to EU-average (1)



(1) Dispersion based on Max-min scores by region normalised
Source: European Commission, Regional Competitiveness Index (DG REGIO)

the domestic institutional framework for water management is complex and fragmented. The lack of a dedicated body to regulate the provision of water and wastewater services (notably to harmonize tariff-setting mechanisms) contributes to this picture. Low tariffs have contributed to a sharp decrease in public expenditures in wastewater infrastructure.

While performing better than the EU average in resource productivity, Spain also faces considerable environmental challenges on air quality and biodiversity. Spain hosts a very rich biodiversity and contributes the largest territorial surface to the EU Natura 2000 network, covering around 27 % of the Spanish territory. Some urban areas have air quality problems, especially related to exceedances of NO₂ limit values, closely linked to traffic. In terms of resource productivity ⁽⁷⁰⁾, Spain performs better than EU-average in the EU (2.80 EUR/kg vs 2.04 in the EU in 2017). However, the high level of landfilled waste is preventing the full transition to a circular economy. Thus, recycling rates range from 10 % in the Canary Islands to above 50 % in Rioja and ten Spanish regions are at risk of missing the EU2020 recycling target for municipal waste.

⁽⁷⁰⁾ Resource productivity measures how efficiently the economy uses material resources and is defined as the ratio between GDP and domestic material consumption.

The Canary Islands ⁽⁷¹⁾, the Balearic Islands and the autonomous cities of Ceuta and Melilla face specific challenges. Their remote and isolated location and small size impose higher transport and communication costs, generate limited economies of scale and dependence on a few economic activities, which constrain their socio-economic growth and convergence with national indicators in several economic areas.

4.4.4. GOVERNANCE AND INSTITUTIONAL QUALITY

Effective coordination between and across various levels of government is crucial for making the Spanish economy more competitive. Spain is a highly decentralised country. Autonomous communities manage a high share of Spain's resources and hold extensive normative powers, making them play an important role in shaping policies in Spain.

Digital public services

Spain ranks amongst the EU best performers in terms of provision of digital public services. The country's investment in the area of open government data is noteworthy. The largest part of

⁽⁷¹⁾ As outermost region as defined in the Article 349 of TFEU

the 'digital-by-default strategy' ⁽⁷²⁾ - is already in place. However, adapting administrative procedures to the new paradigm across public administrations (at national, regional and local level as well as other entities like public universities) requires further public investment to implement the required technological and organizational changes. It also requires finding an agreement amongst the competent public administrations to ensure the full interoperability of all the different systems and platforms within the scope of their respective competences. Difficulties in reaching this agreement have led to the delay of full implementation of the complete targets of the national Information and Communication Technology Plan by two years. There are however margins for improvement when it comes to the take-up rates of digital public services by end-users which only reach 76%. In this context, the National Security Strategy 2017 seeks to strengthen the capacity of prevention, detection and response to cyber-attacks with a view to promoting a secure and reliable cyberspace for citizens, the public, and strategic sectors ⁽⁷³⁾.

Public sector innovation is also promoted through the Observatory for Public Sector Innovation. It is aimed at promoting the dissemination and reuse of public sector information data amongst government, citizens and businesses (amongst which census, directories and images) ⁽⁷⁴⁾.

Public procurement

The success of the new law on public procurement will to a large extent depend on the level of ambition in its implementation. The law, which came into force in March 2018, aims to enhance competition and ensure transparency and effective control mechanisms in public procurement. It sets out a new structure governing Spain's public procurement and an obligation to develop a nation-wide public procurement strategy

⁽⁷²⁾ Plan de Transformación digital de la Administración General del Estado y sus Organismos Públicos http://administracionelectronica.gob.es/pae_Home/pae_Estrategias/Estrategia-TIC-AGE.html#_Vuklmf4UV9A

⁽⁷³⁾ <http://www.dsn.gob.es/es/estrategias-publicaciones/estrategias/estrategia-seguridad-nacional-2017>

⁽⁷⁴⁾ see more information at: <https://www.oecd.org/governance/observatory-public-sector-innovation/countryprofiles/spain/>

to, among other things, combat corruption, improve professionalization and promote economic efficiency.

The new governance structure established under the law is being set up. The Cooperation Committee, tasked to ensure cooperation of central, regional and local authorities on procurement matters, was established in February 2018. The new Independent Office for Regulation and Supervision is being set up. Its President was appointed in July 2018. The Office enjoys functional independence guaranteed by law, but at present it lacks sufficient resources for the effective performance of its objectives and is short of a prominent position. This could undermine its role as a supervision authority in relation to other institutions and bodies.

The elaboration and adoption of the Procurement Strategy is still pending. The law stipulates that the Strategy has to be prepared by the Cooperation Committee, where all government levels and the independent office are represented. The action proposed in the Strategy needs to be based on sound analysis of the various problems identified during supervision. Moreover, active involvement in the preparation of the Strategy and its ownership by all government levels is key to improve public procurement across Spain.

Justice system

New challenges for the Spanish justice system are emerging. According to the 2019 EU Justice Scoreboard, the length of proceedings in first instance civil and commercial litigious cases increased. Spain now ranks in the bottom third of Member States in this category (European Commission 2019b). In addition, the positive trend observed over the past few years in the clearance rate at first instance - i.e. the ratio of resolved litigious civil and commercial cases to incoming cases - has been reversed in 2017, when it fell back under 100 %. This means that as more cases come to the courts than are resolved, the case backlog increases. This reversal could be explained by an increase in civil claims prompted by the issuing of several rulings of the European Court of Justice in relation to mortgage credit directives mentioned below. To help improve the court system's efficiency, the new Judicial Office has been set-up in several regions to support judges in their

procedural and everyday work. Its development continues but its real impact on the efficiency of justice cannot be assessed at this stage.

The improving trend on perceived independence of the judiciary has not continued. Although adequate structural safeguards for judicial independence seem to be in place, the forthcoming 2019 EU Justice Scoreboard reports that the independence of justice among both the general public and companies is perceived more critically. In 2018, more citizens perceive the independence as bad, compared to the previous year (up by 6 pps.) and fewer companies perceive the independence as good (down by 5 pps.).

Spain continues to perform rather well as regards various dimensions of the quality of justice. This concerns in particular aspects such as the availability of information technologies for court management and administration (European Commission 2019b). In 2018, the implementation of the "Justicia Digital" project allowing electronic treatment of information by judicial offices was further deployed. It is now applied in all the provincial courts and high courts of justice, in all unipersonal courts and in 55 % of the central courts.

In the financial sector, the European Court of Justice has issued several landmark rulings in preliminary questions related to unfair contract terms in mortgage credit directives in Spain ⁽⁷⁵⁾. A large number of cases before the Spanish courts as well as several requests for preliminary rulings submitted by Spanish courts are still pending. According to the latest Consumer Scoreboard data ⁽⁷⁶⁾, the exposure of consumers to unfair commercial practices from domestic retailers remains among the highest compared to other EU countries (although it is marginally better than two years ago).

Fight against corruption

Spain's scores on anti-corruption indices have remained relatively stable over recent years, but there are wide regional variations in the

quality of governance. Spain scores 57/100 on the incidence of corruption index in the 2018 Global Competitiveness Report, but there is growing divergence on regional performance. Spain has one of the highest regional variation on the 2017 European Quality of Governance Index ⁽⁷⁷⁾, which captures citizens' perceptions and experiences with corruption and the extent to which they rate their public services as impartial and of good quality in their region of residence. Spain does not have a national strategy for preventing corruption yet, but prevention plans and anti-corruption agencies have been established by some regions or municipalities ⁽⁷⁸⁾.

The implementation of the 2015 reforms on transparency, political party financing, asset disclosure and conflict of interests is advancing and plans have been put forward to cover other remaining gaps. The Transparency Council is handling a substantial amount of complaints regarding access to information, despite having limited human resources ⁽⁷⁹⁾. The Parliament finally appointed a Director for the Office of Conflicts of Interest in September 2018. The Office has been cooperating with similar bodies at regional level, despite the absence of formal mechanisms or tools for such cooperation. All asset declarations of officials in the scope of the law on high-ranking officials have now been published for the period 2014-2018. For other categories of officials at central, regional and local levels, rules on asset disclosure and conflict of interests still lack similar obligations and are not streamlined across levels. Certain regions have modernised their conflict of interest regulations in the past two years ⁽⁸⁰⁾. Furthermore, an anti-corruption omnibus bill is being debated in parliament, covering several aspects including whistle-blower protection, the criminalization of illicit enrichment and a possible derogation from the restrictive time limits under Article 324 of the Criminal Procedure Code.

⁽⁷⁵⁾ https://qog.pol.gu.se/digitalAssets/1684/1684749_2018_1_charron_lapuente_2.docx.pdf.

⁽⁷⁸⁾ For example in the Valencia region or the municipality of Madrid.

⁽⁷⁹⁾ Since 2015 until August 2018, 15 392 requests registered on the transparency portal. The Council admitted 58% of the complaints and lodged a total of 95 proceedings: www.consejodetransparencia.es.

⁽⁸⁰⁾ Valencia (2016), Navarre (2018) and Aragon (2017).

⁽⁷⁵⁾ See for instance judgment of the European Court of Justice in joined cases C-154/15, C-307/15 and C-308/15

⁽⁷⁶⁾ Forthcoming Consumer Conditions Scoreboard (2019)

ANNEX A: OVERVIEW TABLE

Commitments	Summary assessment (1)
2018 country-specific recommendations (CSRs)	
<p>CSR 1: Ensure compliance with Council Decision (EU) 2017/984 giving notice under the excessive deficit procedure, including through measures to enforce the fiscal and public procurement frameworks at all levels of government. Thereafter, ensure that the nominal growth rate of net primary government expenditure does not exceed 0.6 % in 2019, corresponding to an annual structural adjustment of 0.65 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.</p> <ul style="list-style-type: none"> • Ensure compliance with Council Decision (EU) 2017/984 giving notice under the excessive deficit procedure, • including through measures to enforce the fiscal • and public procurement frameworks at all levels of government. • Thereafter, ensure that the nominal growth rate of net primary government expenditure does not exceed 0.6 % in 2019, corresponding to an annual structural adjustment of 0.65 % of GDP. • Use windfall gains to accelerate the reduction of the general government debt ratio. 	<p>Spain has made Limited Progress in addressing CSR 1 (this overall assessment of compliance with CSR 1 does not include an assessment of compliance with the Stability and Growth Pact)</p> <ul style="list-style-type: none"> • The compliance assessment with the Stability and Growth Pact will be included in Spring when final data for 2018 will be available • No Progress. • Limited Progress A new law on public procurement introducing measures to enhance competition and ensure transparency and effective control mechanisms came into force on 9 March 2018. There are still not enough available data to allow a sound assessment of its impact yet. The set-up of the new governance structure, established under the new law, is ongoing. The elaboration of the Public and Procurement Strategy is still pending. • The compliance assessment with the Stability and Growth Pact will be included in Spring
<p>CSR 2: Ensure that employment and social services have the capacity to provide effective support for jobseekers, including through better cooperation with employers. Foster transitions towards open-ended contracts. Improve family support and increase the effectiveness of income guarantee schemes, by addressing coverage gaps, simplifying the system of national schemes and reducing disparities in access conditions to</p>	<p>Spain has made Limited Progress in addressing CSR 2</p>

<p>regional ones. Reduce early school leaving and regional disparities in educational outcomes, in particular by better supporting students and teachers</p> <ul style="list-style-type: none"> • Ensure that employment and social services have the capacity to provide effective support for jobseekers, including through better cooperation with employers. • Foster transitions towards open-ended contracts. • Improve family support and increase the effectiveness of income guarantee schemes, by addressing coverage gaps, simplifying the system of national schemes and reducing disparities in access conditions to regional ones. 	<ul style="list-style-type: none"> • Some progress. Spain has slightly but steadily increased the economic and human resources of regional public employment services since 2017 and approved a technical guidance to better provide services to jobseekers. The new government launched an Action Plan for Youth Employment that includes a budgetary allocation to hire 3 000 new staff to increase support and guidance for young unemployed. However, total public employment services staff and expenditure are still lower than before the crisis. The performance of the public employment services is uneven across regions. Measures to provide individualised services to jobseekers, including through profiling and IT tools, are still in an initial phase. Furthermore, Spain had in 2017 the lowest share in the EU of unemployed people using public employment services for job search. • Some progress. Spain approved in July 2018 an Action Plan to tackle the sources of labour market segmentation. In addition, the capacity of labour inspectorates to fight the abuse of temporary contacts and undeclared work was further strengthened. However, temporary contracts are still widely used and there are doubts about the effectiveness of existing incentives to promote open-ended employment. In the public sector, recruitment competitions are ongoing to reduce fixed-term employment down to 8 % in all sectors. However, estimates show still high shares of temporary employees in the public sector. • Limited Progress. The poverty-reducing impact of social transfers (other than pensions) remains one of the lowest in the EU, especially for children. Meanwhile, the share of poor working age people living in jobless households in receipt of benefits is well below the EU average and public spending on family benefits is almost half of the EU average. Fragmentation and disparities in access conditions across regions continue to undermine the effectiveness of the multiple income guarantee schemes. The new Universal
---	---

<ul style="list-style-type: none"> • Reduce early school leaving and regional disparities in educational outcomes, in particular by better supporting students and teachers 	<p>Social Card envisages collecting information from central, regional and local government on all benefits and recipients, but it will not directly address the weaknesses of the existing schemes.</p> <ul style="list-style-type: none"> • Limited Progress. Despite having improved, early school leaving rates are still high and regional disparities persist. The early school leaving rate is still well above the EU average and the national Europe 2020 target, with a difference of 20 pps. between the best performing and the worst performing regions. In the absence of effective policy measures, there is a risk that labour market improvements create negative incentives for young people to drop out of school prematurely. Existing coordination schemes between national and regional administrations are not sufficient to address regional disparities in education and training outcomes
<p>CSR 3: Increase public investment in research and innovation and systematically carry out evaluations of support policies in this area to ensure their effectiveness. Increase cooperation between education and businesses with a view to mitigating existing skills mismatches. Further the implementation of the Law on Market Unity by ensuring that, at all levels of government, rules governing access to and exercise of economic activities, in particular for services, are in line with principles of that Law and by improving cooperation between administrations.</p> <ul style="list-style-type: none"> • Increase public investment in research and innovation and systematically carry out evaluations of support policies in this area to ensure their effectiveness. • Increase cooperation between education and businesses with a view to mitigating existing skills mismatches. 	<p>Spain has made Limited Progress in addressing CSR 3</p> <ul style="list-style-type: none"> • Limited Progress Spain made limited progress in increasing public investment in research and innovation so far. The level of public investment in R&D remains unchanged in the absence of a new Budget Law for 2019. There have been limited steps to enhance the evaluation of research and innovation policies. • Limited Progress Cooperation between universities and businesses remains weak, albeit improving, with initiatives to increase business participation in the decision-making process. Despite the high tertiary education attainment, skills supply is not sufficiently aligned with labour market needs. Matching initial vocational education and training (VET) with labour market needs is still a challenge in

<ul style="list-style-type: none"> • Further the implementation of the Law on Market Unity by ensuring that, at all levels of government, rules governing access to and exercise of economic activities, in particular for services, are in line with principles of that Law and by improving cooperation between administrations. 	<p>Spain. Spain lacks enough skills for smart specialisation, industrial transition and entrepreneurship.</p> <ul style="list-style-type: none"> • Limited Progress. Some measures were taken to implement the Law on Market Unity with however limited effect. Measures include work on sectorial conference, training on the implementation of the law. Several favourable court rulings applying this Law were passed during this period.
Europe 2020 (national targets and progress)	
Employment rate target: 74 %.	The employment rate for 20-64 years old workers increased up to 65.5 % in the first three quarters of 2018, remaining 6.7 pps below the EU average (72.2 %) and 7.2 pps below the Europe 2020 target for Spain.
R&D target set in the NRP: 2 % of GDP	<p>With an overall R&D spending of 1.20 %, reaching the 2% national R&D intensity target in 2020 remains practically unattainable.</p> <p>In 2017, R&D intensity was composed of 55% private investment (0.66% of GDP) and 45% public investment (0.54% of GDP).</p>
National greenhouse gas (GHG) emissions target: - 10 % in 2020 compared with 2005 (in sectors not included in the EU emissions trading scheme)	Emissions from sectors not covered by the EU Emission trading scheme were reduced by 15.3 % between 2005 and 2017, which is above Spain's target of -10 % compared to 2005. Based on the latest national projections taking into account existing measures, the 2020 target is expected to be exceeded by a margin of 9.9 pps. However, Spain is expected to miss the 2030 target of -26 % by 9.9 pps.
2020 renewable energy target: 20 %	With a renewable energy share of 17.5 % (2017), Spain is above its indicative trajectory to reach the 2020 target, but this trajectory becomes steeper in the last years of this decade.
<p>Energy efficiency, 2020 energy consumption targets:</p> <ul style="list-style-type: none"> • Spain's 2020 energy efficiency target is 122.6 Mtoe expressed in primary energy consumption (87.23 Mtoe expressed in final energy consumption) 	Latest figures (2017) show an additional increase to 125.6 Mtoe primary energy consumption and 84.2 Mtoe final energy consumption. Whilst the figures for final energy consumption remain below the Spanish indicative 2020 target, primary energy consumption exceeds it. Spain should further intensify its commitment to energy efficiency in order to reverse this trend and make sure that demand remains below both targets during the next

	years.
Early school/training leaving target: 15 %.	The rate of early school leaving (ESL) (18-24 years old) stood at 18.3 % in 2017, still among the highest in the EU and still some way from the Spanish Europe 2020 target. The indicator varies greatly across regions (from 7 % to 26.5 %). It is especially high for students with disabilities and non-EU born background.
Tertiary education target: 44 % of population aged 30-34.	In 2017, the proportion of 30-34 year-old tertiary graduates increased slightly to 41.2 %. It is above the EU average (39.9 %), but still some way from the Europe 2020 national target of 44 %.
Target for reducing the number of people at risk of poverty or social exclusion, expressed as an absolute number of people: -1 400 000 compared to 2008	Although the number of people at risk of poverty or social exclusion is decreasing since 2014, in 2017 it was still 1 450 000 more than in 2008. The Europe 2020 target is therefore far from reach.

(1) The following categories are used to assess progress in implementing the country-specific recommendations (CSRs):

No progress: The Member State has not credibly announced nor adopted any measures to address the CSR. This category covers a number of typical situations to be interpreted on a case by case basis taking into account country-specific conditions. They include the following:

- no legal, administrative, or budgetary measures have been announced
- in the national reform programme,
- in any other official communication to the national Parliament/relevant parliamentary committees or the European Commission,
- publicly (e.g. in a press statement or on the government's website);
- no non-legislative acts have been presented by the governing or legislative body;
- the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures to be taken (unless the CSR explicitly asks for orientations or exploratory actions). However, it has not proposed any clearly-specified measure(s) to address the CSR.

Limited progress: The Member State has:

- announced certain measures but these address the CSR only to a limited extent; and/or
- presented legislative acts in the governing or legislative body but these have not been adopted yet and substantial further, non-legislative work is needed before the CSR is implemented;

- presented non-legislative acts, but has not followed these up with the implementation needed to address the CSR.

Some progress: The Member State has adopted measures

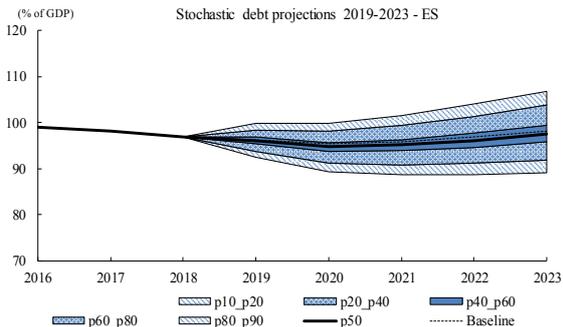
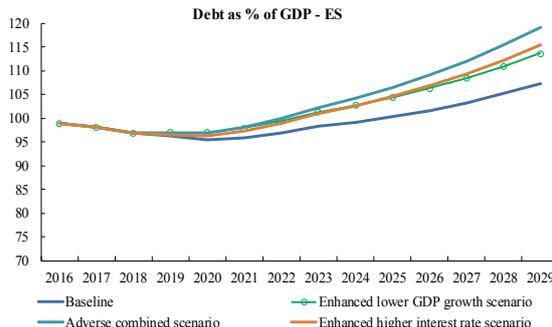
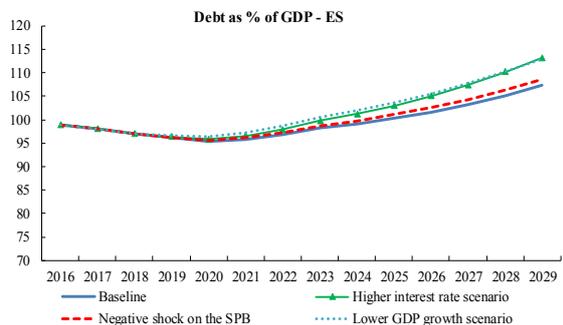
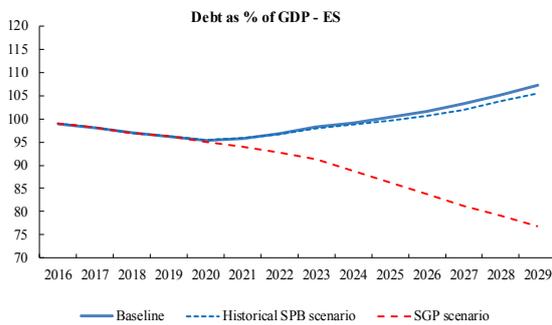
- that partly address the CSR; and/or
- that address the CSR, but a fair amount of work is still needed to fully address the CSR fully as only a few of the measures have been implemented. For instance, a measure or measures have been adopted by the national Parliament or by ministerial decision but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way towards addressing the CSR and most of them have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately.

ANNEX B: COMMISSION DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

General Government debt projections under baseline, alternative scenarios and sensitivity tests													
ES - Debt projections baseline scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Gross debt ratio	98.1	96.9	96.2	95.4	95.8	96.8	98.2	99.1	100.3	101.6	103.2	105.2	107.3
Changes in the ratio <small>(-1+2+3)</small>	-0.8	-1.2	-0.7	-0.8	0.4	0.9	1.4	0.9	1.1	1.4	1.6	2.0	2.1
of which													
(1) Primary balance <small>(1.1+1.2+1.3)</small>	-0.5	-0.3	0.1	0.2	-0.4	-0.8	-1.2	-1.3	-1.3	-1.3	-1.2	-1.3	-1.3
(1.1) Structural primary balance <small>(1.1.1-1.1.2+1.1.3)</small>	-0.3	-0.7	-0.8	-1.0	-1.2	-1.2	-1.2	-1.3	-1.3	-1.3	-1.2	-1.3	-1.3
<small>(1.1.1) Structural primary balance (bef. CoA)</small>	-0.3	-0.7	-0.8	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
<small>(1.1.2) Cost of ageing</small>					0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
<small>(1.1.3) Others (taxes and property incomes)</small>					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(1.2) Cyclical component	-0.2	0.5	1.0	1.2	0.8	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(1.3) One-off and other temporary measures	0.0	-0.1	0.0	0.0	0.0	0.0	0.0						
(2) Snowball effect <small>(2.1+2.2+2.3)</small>	-1.5	-1.4	-1.3	-1.2	0.1	0.1	0.2	-0.3	-0.1	0.1	0.4	0.7	0.8
<small>(2.1) Interest expenditure</small>	2.6	2.4	2.3	2.2	2.2	2.3	2.5	2.6	2.8	3.1	3.3	3.6	3.9
<small>(2.2) Growth effect</small>	-2.8	-2.4	-2.0	-1.8	-0.5	-0.4	-0.4	-1.0	-1.0	-1.0	-1.0	-0.9	-1.0
<small>(2.3) Inflation effect</small>	-1.2	-1.3	-1.6	-1.6	-1.7	-1.8	-1.9	-1.9	-1.9	-2.0	-2.0	-2.0	-2.1
(3) Stock-flow adjustments	0.1	-0.1	0.7	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0



Short term	Medium term	S1	Debt sustainability analysis (detail)						DSA	S2	Long term
			Baseline	Historical SPB	Lower GDP growth	Higher interest rate	Negative shock on SPB	Stochastic projections			
LOW (S0 = 0.4)	HIGH	HIGH (S1 = 5.2)	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	
			Debt level (2029)	107.3	105.5	112.9	113.2	108.6			
			Debt peak year	2029	2029	2029	2029	2029			
			Percentile rank	72.0%	70.0%						
			Probability debt higher					54.1%			
			Dif. between percentiles					17.6			

Note: For further information, see the European Commission Fiscal Sustainability Report (FSR) 2018.

[1] The first table presents the baseline no-fiscal policy change scenario projections. It shows the projected government debt dynamics and its decomposition between the primary balance, snowball effects and stock-flow adjustments. Snowball effects measure the net impact of the counteracting effects of interest rates, inflation, real GDP growth (and exchange rates in some countries). Stock-flow adjustments include differences in cash and accrual accounting, net accumulation of assets, as well as valuation and other residual effects.

[2] The charts present a series of sensitivity tests around the baseline scenario, as well as alternative policy scenarios, in particular: the historical structural primary balance (SPB) scenario (where the SPB is set at its historical average), the Stability and Growth Pact (SGP) scenario (where fiscal policy is assumed to evolve in line with the main provisions of the SGP), a higher interest rate scenario (+1 pp. compared to the baseline), a lower GDP growth scenario (-0.5 pp. compared to the baseline) and a negative shock on the SPB (calibrated on the basis of the forecasted change). An adverse combined scenario and enhanced sensitivity tests (on the interest rate and growth) are also included, as well as stochastic projections. Detailed information on the design of these projections can be found in the FSR 2018.

[3] The second table presents the overall fiscal risk classification over the short, medium and long-term.

a. For the short-term, the risk category (low/high) is based on the S0 indicator. S0 is an early-detection indicator of fiscal stress in the upcoming year, based on 25 fiscal and financial-competitiveness variables that have proven in the past to be leading indicators of fiscal stress. The critical threshold beyond which fiscal distress is signalled is 0.46.

b. For the medium-term, the risk category (low/medium/high) is based on the joint use of the S1 indicator and of the DSA results. The S1 indicator measures the fiscal adjustment required (cumulated over the 5 years following the forecast horizon and sustained thereafter) to bring the debt-to-GDP ratio to 60% by 2033. The critical values used are 0 and 2.5 pps. of GDP. The DSA classification is based on the results of 5 deterministic scenarios (baseline, historical SPB, higher interest rate, lower GDP growth and negative shock on the SPB scenarios) and the stochastic projections. Different criteria are used such as the projected debt level, the debt path, the realism of fiscal assumptions, the probability of debt stabilisation, and the size of uncertainties.

c. For the long-term, the risk category (low/medium/high) is based on the joint use of the S2 indicator and the DSA results. The S2 indicator measures the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical values used are 2 and 6 pps. of GDP. The DSA results are used to further qualify the long-term risk classification, in particular in cases when debt vulnerabilities are identified (a medium / high DSA risk category).

ANNEX C: STANDARD TABLES

Table C.1: **Financial market indicators**

	2013	2014	2015	2016	2017	2018
Total assets of the banking sector (% of GDP) ¹⁾	307.3	286.5	261.6	243.8	233.5	218.9
Share of assets of the five largest banks (% of total assets)	54.4	58.3	60.2	61.8	63.7	-
Foreign ownership of banking system (% of total assets) ²⁾	6.2	6.5	5.3	3.9	4.5	4.6
Financial soundness indicators: ²⁾						
- non-performing loans (% of total loans)	-	8.1	6.3	5.7	4.4	4.1
- capital adequacy ratio (%)	13.3	13.6	14.5	14.7	15.4	15.1
- return on equity (%) ³⁾	5.8	6.7	6.6	5.0	7.0	8.9
Bank loans to the private sector (year-on-year % change) ¹⁾	-8.6	-4.8	-2.3	-1.6	0.1	-1.0
Lending for house purchase (year-on-year % change) ¹⁾	-4.1	-3.7	-4.2	-2.8	-2.3	-1.4
Loan to deposit ratio ²⁾	-	90.3	91.7	92.5	89.3	89.9
Central Bank liquidity as % of liabilities ¹⁾	-	6.2	6.1	6.9	7.9	7.9
Private debt (% of GDP)	177.2	165.8	154.8	146.8	138.8	-
Gross external debt (% of GDP) ²⁾ - public	41.2	48.5	51.1	49.4	48.9	48.4
- private	52.4	53.2	49.1	46.6	41.8	40.9
Long-term interest rate spread versus Bund (basis points)*	299.2	156.0	123.9	130.3	123.8	100.6
Credit default swap spreads for sovereign securities (5-year)*	185.5	71.4	72.6	68.1	37.8	33.6

1) Latest data Q3 2018. Includes not only banks but all monetary financial institutions excluding central banks.

2) Latest data Q2 2018.

3) Quarterly values are annualised.

* Measured in basis points.

Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Headline Social Scoreboard indicators**

	2013	2014	2015	2016	2017	2018 ⁶
Equal opportunities and access to the labour market						
Early leavers from education and training (% of population aged 18-24)	23.6	21.9	20.0	19.0	18.3	:
Gender employment gap (pps)	9.6	10.2	11.2	11.5	11.9	12.1
Income inequality, measured as quintile share ratio (S80/S20)	6.3	6.8	6.9	6.6	6.6	:
At-risk-of-poverty or social exclusion rate ¹ (AROPE)	27.3	29.2	28.6	27.9	26.6	:
Young people neither in employment nor in education and training (% of population aged 15-24)	18.6	17.1	15.6	14.6	13.3	:
Dynamic labour markets and fair working conditions[†]						
Employment rate (20-64 years)	58.6	59.9	62.0	63.9	65.5	66.8
Unemployment rate ² (15-74 years)	26.1	24.5	22.1	19.6	17.2	15.3
Long-term unemployment rate ³ (as % of active population)	13.0	12.9	11.4	9.5	7.7	6.6
Gross disposable income of households in real terms per capita ⁴ (Index 2008=100)	89.2	90.3	92.7	94.3	94.2	:
Annual net earnings of a full-time single worker without children earning an average wage (levels in PPS, three-year average)	21522	21999	22584	23077	:	:
Annual net earnings of a full-time single worker without children earning an average wage (percentage change, real terms, three-year average)	-1.2	-0.8	1.1	1.9	:	:
Public support / Social protection and inclusion						
Impact of social transfers (excluding pensions) on poverty reduction ⁵	32.0	28.6	26.6	24.4	23.9	:
Children aged less than 3 years in formal childcare	35.0	36.9	39.7	39.3	45.8	:
Self-reported unmet need for medical care	0.8	0.6	0.6	0.5	0.1	:
Individuals who have basic or above basic overall digital skills (% of population aged 16-74)	:	:	54.0	53.0	55.0	:

1 People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).

2 Unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within two weeks.

3 Long-term unemployed are people who have been unemployed for at least 12 months.

4 Gross disposable household income is defined in unadjusted terms, according to the draft Joint Employment Report 2019.

5 Reduction in percentage of the risk of poverty rate, due to social transfers (calculated comparing at-risk-of-poverty rates before social transfers with those after transfers; pensions are not considered as social transfers in the calculation).

6 Average of first three quarters of 2018 for the employment rate, long-term unemployment rate and gender employment gap. Data for unemployment rate is seasonally adjusted (annual series, for EE, EL, HU, IT and UK data based on first three quarters of 2018).

Source: Eurostat.

Table C.3: Labour market and education indicators

Labour market indicators	2013	2014	2015	2016	2017	2018 ⁴
Activity rate (15-64)	74.3	74.2	74.3	74.2	73.9	:
Employment in current job by duration						
From 0 to 11 months	14.1	15.6	16.5	16.9	17.5	:
From 12 to 23 months	6.7	6.8	7.4	8.3	8.7	:
From 24 to 59 months	13.4	13.3	12.3	12.1	13.0	:
60 months or over	65.8	64.3	63.8	62.6	60.8	:
Employment growth*						
(% change from previous year)	-2.6	1.0	2.8	2.6	2.6	2.2
Employment rate of women						
(% of female population aged 20-64)	53.8	54.8	56.4	58.1	59.6	60.8
Employment rate of men						
(% of male population aged 20-64)	63.4	65.0	67.6	69.6	71.5	72.8
Employment rate of older workers*						
(% of population aged 55-64)	43.2	44.3	46.9	49.1	50.5	51.9
Part-time employment*						
(% of total employment, aged 15-64)	15.7	15.8	15.6	15.1	14.9	14.5
Fixed-term employment*						
(% of employees with a fixed term contract, aged 15-64)	23.2	24.0	25.2	26.1	26.8	26.9
Participation in activation labour market policies						
(per 100 persons wanting to work)	23.3	25.1	28.3	28.9	:	:
Transition rate from temporary to permanent employment						
(3-year average)	13.2	13.6	12.2	10.7	11.5	:
Youth unemployment rate						
(% active population aged 15-24)	55.5	53.2	48.3	44.4	38.6	34.3
Gender gap in part-time employment						
	17.5	17.8	17.3	16.5	16.9	17.2
Gender pay gap ¹ (in unadjusted form)						
	17.8	14.9	14.2	15.1	15.1	:
Education and training indicators	2013	2014	2015	2016	2017	2018
Adult participation in learning						
(% of people aged 25-64 participating in education and training)	11.4	10.1	9.9	9.4	9.9	:
Underachievement in education ²	:	:	22.2	:	:	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	42.3	42.3	40.9	40.1	41.2	:
Variation in performance explained by students' socio-economic status ³	:	:	13.4	:	:	:

* Non-scoreboard indicator

1 Difference between the average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees. It is defined as "unadjusted", as it does not correct for the distribution of individual characteristics (and thus gives an overall picture of gender inequalities in terms of pay). All employees working in firms with ten or more employees, without restrictions for age and hours worked, are included.

2 PISA (OECD) results for low achievement in mathematics for 15 year-olds.

3 Impact of socio-economic and cultural status on PISA (OECD) scores. Values for 2012 and 2015 refer respectively to mathematics and science.

4 Average of first three quarters of 2018. Data for youth unemployment rate is seasonally adjusted (annual series, for EE, EL, HU, IT and UK data based on first three quarters of 2018).

Source: Eurostat, OECD.

Table C.4: Social inclusion and health indicators

	2012	2013	2014	2015	2016	2017
Expenditure on social protection benefits* (% of GDP)						
<i>Sickness/healthcare</i>	6.6	6.5	6.5	6.6	6.6	:
<i>Disability</i>	1.8	1.9	1.8	1.7	1.7	:
<i>Old age and survivors</i>	11.4	12.0	12.3	12.0	12.0	:
<i>Family/children</i>	1.3	1.4	1.3	1.3	1.3	:
<i>Unemployment</i>	3.4	3.3	2.7	2.2	1.9	:
<i>Housing</i>	0.1	0.1	0.1	0.1	0.1	:
<i>Social exclusion n.e.c.</i>	0.2	0.2	0.2	0.2	0.2	:
Total	25.0	25.3	24.9	24.2	23.9	:
<i>of which: means-tested benefits</i>	3.7	3.7	3.5	3.2	3.1	:
General government expenditure by function (% of GDP, COFOG)						
<i>Social protection</i>	17.6	18.0	17.7	17.1	16.8	:
<i>Health</i>	6.2	6.2	6.1	6.2	6.0	:
<i>Education</i>	4.2	4.1	4.1	4.1	4.0	:
Out-of-pocket expenditure on healthcare (% of total health expenditure)	22.8	24.0	24.4	23.8	23.8	:
Children at risk of poverty or social exclusion (% of people aged 0-17)*	32.4	32.6	35.8	34.4	32.9	31.3
At-risk-of-poverty rate ¹ (% of total population)	20.8	20.4	22.2	22.1	22.3	21.6
In-work at-risk-of-poverty rate (% of persons employed)	10.8	10.5	12.5	13.1	13.1	13.1
Severe material deprivation rate ² (% of total population)	5.8	6.2	7.1	6.4	5.8	5.1
Severe housing deprivation rate ³ , by tenure status						
<i>Owner, with mortgage or loan</i>	1.0	1.0	0.9	1.0	0.7	0.3
<i>Tenant, rent at market price</i>	3.5	3.8	3.3	3.0	3.1	2.8
Proportion of people living in low work intensity households ⁴ (% of people aged 0-59)	14.3	15.7	17.1	15.4	14.9	12.8
Poverty thresholds, expressed in national currency at constant prices*	7407	7050	6813	6869	7084	7379
Healthy life years (at the age of 65)						
<i>Females</i>	9.0	9.0	9.4	8.9	10.4	:
<i>Males</i>	9.2	9.7	10.1	9.5	10.4	:
Aggregate replacement ratio for pensions ⁵ (at the age of 65)	0.6	0.6	0.6	0.7	0.7	0.7
Connectivity dimension of the Digital Economy and Society Index (DESI) ⁶	:	:	44.5	53.2	54.1	59.5
GINI coefficient before taxes and transfers*	50.8	51.5	52.7	52.9	52.8	52.1
GINI coefficient after taxes and transfers*	34.2	33.7	34.7	34.6	34.5	34.1

* Non-scoreboard indicator

1 At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.

2 Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.

3 Percentage of total population living in overcrowded dwellings and exhibiting housing deprivation.

4 People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.

5 Ratio of the median individual gross pensions of people aged 65-74 relative to the median individual gross earnings of people aged 50-59.

6 Fixed broadband take up (33%), mobile broadband take up (22%), speed (33%) and affordability (11%), from the Digital Scoreboard.

Source: Eurostat, OECD.

Table C.5: Product market performance and policy indicators

Performance indicators	2012	2013	2014	2015	2016	2017
Labour productivity per person ¹ growth (t/t-1) in %						
Labour productivity growth in industry	1.76	0.66	2.72	0.43	1.73	1.07
Labour productivity growth in construction	9.72	2.04	1.21	-1.79	1.95	0.23
Labour productivity growth in market services	2.18	1.67	0.17	-0.39	0.07	0.61
Unit Labour Cost (ULC) index ² growth (t/t-1) in %						
ULC growth in industry	-0.24	0.72	-2.41	-0.15	-1.38	-0.37
ULC growth in construction	-11.64	-4.00	-0.49	1.53	-0.56	0.05
ULC growth in market services	-3.04	-1.91	0.36	2.29	-0.12	1.22
Business environment	2012	2013	2014	2015	2016	2017
Time needed to enforce contracts ³ (days)	510	510	510	510	510	510
Time needed to start a business ³ (days)	30.0	24.0	14.0	14.0	13.0	13.0
Outcome of applications by SMEs for bank loans ⁴	1.15	0.98	0.97	0.66	0.56	0.49
Research and innovation	2012	2013	2014	2015	2016	2017
R&D intensity	1.29	1.27	1.24	1.22	1.19	:
General government expenditure on education as % of GDP	4.20	4.10	4.10	4.10	4.00	:
Employed people with tertiary education and/or people employed in science and technology as % of total employment	43	44	45	45	45	46
Population having completed tertiary education ⁵	30	31	32	32	33	33
Young people with upper secondary education ⁶	63	64	66	69	71	72
Trade balance of high technology products as % of GDP	-0.86	-0.70	-0.87	-1.06	-0.99	-1.07
Product and service markets and competition				2003	2008	2013
OECD product market regulation (PMR) ⁷ , overall				1.79	1.59	1.44
OECD PMR ⁷ , retail				3.67	3.48	2.88
OECD PMR ⁷ , professional services				2.92	2.74	2.43
OECD PMR ⁷ , network industries ⁸				2.27	1.65	1.59

1 Value added in constant prices divided by the number of persons employed.

2 Compensation of employees in current prices divided by value added in constant prices.

3 The methodologies, including the assumptions, for this indicator are shown in detail here:

<http://www.doingbusiness.org/methodology>.

4 Average of the answer to question Q7B_a. "[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?". Answers were codified as follows: zero if received everything, one if received 75% and above, two if received below 75%, three if refused or rejected and treated as missing values if the application is still pending or don't know.

5 Percentage population aged 15-64 having completed tertiary education.

6 Percentage population aged 20-24 having attained at least upper secondary education.

7 Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail here: <http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm>

8 Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).

Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans).

Table C.6: **Green growth**

Green growth performance		2012	2013	2014	2015	2016	2017
Macroeconomic							
Energy intensity	kgoe / €	0.12	0.12	0.11	0.11	0.11	0.11
Carbon intensity	kg / €	0.34	0.32	0.31	0.31	0.29	-
Resource intensity (reciprocal of resource productivity)	kg / €	0.40	0.38	0.38	0.38	0.36	0.36
Waste intensity	kg / €	0.11	-	0.11	-	0.12	-
Energy balance of trade	% GDP	-3.8	-3.4	-2.9	-2.0	-1.5	-1.8
Weighting of energy in HICP	%	11.6	12.4	12.3	12.4	11.7	10.9
Difference between energy price change and inflation	%	7.4	-1.9	2.6	-4.5	-10.2	7.2
Real unit of energy cost	% of value added	15.3	15.4	15.7	16.5	17.4	-
Ratio of environmental taxes to labour taxes	ratio	0.09	0.12	0.11	0.12	0.12	-
Environmental taxes	% GDP	1.6	1.9	1.9	1.9	1.9	1.8
Sectoral							
Industry energy intensity	kgoe / €	0.09	0.09	0.09	0.08	0.08	0.08
Real unit energy cost for manufacturing industry excl. refining	% of value added	20.0	19.2	18.7	19.5	20.4	-
Share of energy-intensive industries in the economy	% GDP	8.0	7.5	7.8	8.2	9.2	8.9
Electricity prices for medium-sized industrial users	€ / kWh	0.12	0.12	0.12	0.12	0.11	0.10
Gas prices for medium-sized industrial users	€ / kWh	0.04	0.04	0.04	0.03	0.03	0.03
Public R&D for energy	% GDP	0.01	0.01	0.01	0.01	0.02	0.01
Public R&D for environmental protection	% GDP	0.02	0.02	0.02	0.02	0.02	0.02
Municipal waste recycling rate	%	29.8	32.5	30.8	30.0	33.9	33.5
Share of GHG emissions covered by ETS*	%	40.8	37.8	38.3	40.5	38.4	-
Transport energy intensity	kgoe / €	0.76	0.78	0.75	0.76	0.80	0.79
Transport carbon intensity	kg / €	1.85	1.95	1.88	1.89	1.97	-
Security of energy supply							
Energy import dependency	%	73.0	70.2	72.7	72.9	71.5	73.9
Aggregated supplier concentration index	HHI	14.9	19.8	25.2	20.5	18.3	-
Diversification of energy mix	HHI	0.27	0.27	0.27	0.27	0.28	0.28

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2010 prices)

Energy intensity: gross inland energy consumption (Europe 2020-2030) (in kgoe) divided by GDP (in EUR)

Carbon intensity: greenhouse gas emissions (in kg CO₂ equivalents) divided by GDP (in EUR)

Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)

Real unit energy cost: real energy costs as % of total value added for the economy

Industry energy intensity: final energy use in industry (in kgoe) divided by gross value added of industry, including construction (in 2010 EUR)

Real unit energy costs for manufacturing industry excluding refining : real costs as % of value added for manufacturing sectors

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices for medium-sized industrial users: consumption band 500–20 000MWh and 10 000–100 000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste

Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP

Proportion of GHG emissions covered by EU emissions trading system (ETS) (excluding aviation): based on GHG emissions (excl land use, land use change and forestry) as reported by Member States to the European Environment Agency.

Transport energy intensity: final energy use in transport sector including international aviation, (in kgoe) divided by transport industry gross value added (in 2010 EUR)

Transport carbon intensity: GHG emissions in transport sector divided by gross value added of the transport activities

Energy import dependency: net energy imports divided by gross inland energy consumption plus consumption of international maritime bunkers

Aggregated supplier concentration index: Herfindahl-Hirschman index for net imports of crude oil and NGL, natural gas and hard coal. Smaller values indicate larger diversification and hence lower risk.

Diversification of the energy mix: Herfindahl-Hirschman index of the main energy products in the gross inland consumption of energy

* European Commission and European Environment Agency

Source: European Commission and European Environment Agency (Share of GHG emissions covered by ETS); European Commission (Environmental taxes over labour taxes); Eurostat (all other indicators).

ANNEX D: INVESTMENT GUIDANCE ON COHESION POLICY FUNDING 2021-2027 FOR SPAIN

Building on the Commission proposal for the next Multi-Annual Financial Framework for the period 2021-2027 of 2 May 2018 (COM (2018) 321), this Annex D presents the preliminary Commission services views on priority investment areas and framework conditions for effective delivery for the 2021-2027 Cohesion Policy. These priority investment areas are derived from the broader context of investment bottlenecks, investment needs and regional disparities assessed in the report. This Annex provides the basis for a dialogue between Spain and the Commission services in view of the programming of the Cohesion policy funds (European Regional Development Fund and European Social Fund Plus). ⁽⁸¹⁾ ⁽⁸²⁾

Policy Objective 1: A Smarter Europe – Innovative and smart industrial transformation

Spain remains a moderate innovator and the innovation capabilities of its public sector and companies are insufficient to increase their productivity. High priority investment needs⁽⁸³⁾ are therefore identified to **enhance research and innovation capabilities and the uptake of advanced technologies** within the framework of regional smart specialisation strategies identifying priority areas based on regional needs, in particular to:

- foster investment in research and innovation, in particular to increase the number of innovative firms in the Smart Specialisation Strategy sectors, including innovative public procurement and development of new products, processes and services;
- enhance technology transfer and market-oriented cooperation between businesses, research centres and universities, in particular through the development and use of innovation eco-systems and the increase of the capacity of firms to internalise external knowledge;
- stimulate interregional cooperation in new value chains, also with other Member States;
- increase synergies and complementarities between national and regional operational programmes through joint programming for a more efficient use of public resources.

In order to increase the uptake of new generation Information and Communication Technology by businesses and to improve the access to e-government and other public e-services, priority investment needs are identified to **reap the benefits of digitisation for citizens, companies and governmental bodies**, and in particular to:

- support the uptake of digital technologies and Information and Communication Technology based business models for SMEs, including infrastructures and services like digital innovation hubs, as well as promoting e-skilling and market-driven Information and Communication Technology skills in small and medium sized enterprises;
- develop and promote interoperable e-government and e-services (health, education and other public services), in particular in remote and outermost regions, and including joint provision of services in border areas.

⁽⁸¹⁾ This Annex is to be considered in conjunction with the Proposal for a Regulation of the European Parliament and of the Council on the European Regional Development Fund and on the Cohesion Fund COM(2018) 372 and the EC Proposal for a Regulation of the European Parliament and of the Council on the European Social Fund Plus COM(2018) 382, in particular as regards the requirements for thematic concentration and urban earmarking outlined in these proposals.

⁽⁸²⁾ Transnational cooperation, cross border cooperation and integration of the outermost region of the Canary Islands in its neighbouring environment could be supported in the framework of the Atlantic Strategy.

⁽⁸³⁾ The intensity of needs is classified in three categories in a descending order - high priority needs, priority needs, needs.

The reduced size of Spanish small and medium sized enterprises affects their innovation capacity and productivity. High priority investment needs are therefore identified to **enhance growth and competitiveness of** small and medium sized enterprises, and in particular to:

- promote entrepreneurship, growth of start-ups/scale-ups, incubators and accelerators, access to advanced business services, and new business models for small and medium sized enterprises, in particular through investment in intangibles;
- boost exports, by increasing the number of regular exporters, in particular of SMEs with a focus on developing the link between exporting and innovation;
- encourage entrepreneurial ecosystems by supporting networking, business transfer ecosystems, (industry-led) cluster development and deployment of joint interregional innovative projects, also cross-border.

Skill gaps and mismatches hinder productivity and technology diffusion, and affect the development of innovative competences in Spain. In this sense, priority investment needs are identified to **develop skills for smart specialisation, industrial transition and entrepreneurship**, and in particular to:

- stimulate innovation management, specific training and re-skilling in the areas of smart specialisation, industrial transition and entrepreneurship, in particular on key enabling technologies and emerging fields;
- integrate education institutions within national and regional innovation ecosystems to increase the commercial viability and market relevance of their research projects.

Policy Objective 2: A low carbon and greener Europe – Clean and fair energy transition, green and blue investment, circular economy, climate adaptation and risk prevention⁽⁸⁴⁾

The 2016 and 2017 figures show an increase in energy consumption, in particular in industry and buildings. High priority investment needs are therefore identified to **promote energy efficiency**, and in particular to:

- accelerate the energy efficient renovation of the building stock (including public buildings and small and medium-sized enterprises), prioritising the renovation of residential buildings and focusing on the energy poor;
- promote small-scale infrastructure and access to small grids with cross-border regions.

The electricity interconnection level of Spain was 6% in 2017. Priority investment needs are identified to **promote smart energy systems at local level** and in particular to:

- deploy smart electricity distribution grids and storage solutions – linked to demand and supply planning, also in a cross border-context.

⁽⁸⁴⁾ While outside of the scope of the ERDF and the Cohesion Fund (art. 6, paragraph 1(h), COM (2018)372), energy interconnectors could be financed by the Connecting Europe Facility in line with its objectives (art. 3, paragraphs 1 and 2 (b), COM(2018) 438).

The increase of the renewable energy share in Spain has visibly slowed down between 2014 and 2017. Priority investments needs are therefore identified to **promote renewable energy** and in particular :

- foster the deployment of small-scale renewable electricity capacities owned by energy communities, small and medium sized enterprises or individual energy consumers;
- promote the transition to renewables in heating and cooling;
- support renewable energy technologies that are close to market or not yet widely deployed.

Spain is one of the areas in Europe most vulnerable to climate change. Priority investment needs are therefore identified to **promote climate change adaptation, risk prevention and disaster resilience**, and in particular to:

- support prevention and climate-change adaptation measures based on an ecosystem restoration approach, also in a cross-border context;
- reinforce preparedness and response capacity, including in a cross-border/transnational context.

Certain areas in Spain are seriously water-stressed. High priority investment needs are identified to reach the objectives of **the Water Framework Directive and the Urban Waste Water Treatment Directive**, and in particular to:

- foster an efficient use of water resources throughout the whole water cycle by promoting water saving and re-use, as well as by supporting ecosystem-based measures;
- invest in the collection and treatment of wastewater in less developed regions and regions with specific needs, such as the islands.

In 2017, Spain's municipal waste recycling rate was 34%, while its landfilling rate was 54%, well above the EU average (24%). Biodiversity conservation is a challenge in Spain. Priority investment needs are therefore identified to **improve resource efficiency and waste management**, and to **enhance biodiversity and green infrastructures**, in particular to:

- foster a transition towards a circular economy, as well as shifting towards higher steps of the waste management hierarchy, by promoting separate collection systems and re-use centres, and by developing waste recycling and material recovery facilities for separately collected waste, also in a supra-regional context;
- protect and restore biodiversity by promoting green infrastructures, especially in urban areas.

Policy Objective 3: A more connected Europe – Mobility and regional Information and Communication Technology connectivity

Given Spain's peripheral position, a well-functioning and well-connected network infrastructure (especially rail) is essential to access the main EU markets, increase competitiveness and ensure territorial cohesion. Priority investment needs are therefore identified to **develop a sustainable, climate resilient, intelligent, secure and intermodal Trans-European Transport Network**, including **improved access to Trans-European Transport Network**, and in particular to:

- complete the core Trans-European Transport rail Network (Atlantic and Mediterranean corridors), including cross border links and better connectivity with ports and logistic platforms;
- foster digitisation for more intelligent, interoperable, intermodal and safer transport systems;
- promote clean mobility and related infrastructure, including alternative fuels' infrastructure;
- improve accessibility and interconnectivity of the Canary Islands as outermost region.

The transport sector is one of the biggest energy consuming sectors. Priority needs are therefore identified to **promote sustainable multimodal urban mobility**, and in particular to:

- promote more inclusive, sustainable and efficient urban transport systems and reduce the negative externalities of transport (congestion, emissions, air quality) based on sustainable urban mobility plans;
- enhance the deployment of intelligent transport systems.

Spain performs well in terms of broadband connectivity, but the digital divide between urban and rural areas persists – and between regions. Investment needs are therefore identified to **enhance digital connectivity**, and in particular:

- deploy very high capacity broadband networks for backward regions (including the outermost), providing speeds of at least 100 Mbps, and eliminate the urban-rural coverage gap;
- deploy or upgrade very high capacity network connections enabling access to 1Gbps for the main socio-economic drivers (schools, transport hubs, public service providers, digitally intensive enterprises, etc.) in all regions.

Policy Objective 4: A more social Europe – Implementing the European Pillar of Social Rights

Unemployment is high, in particular in some regions; employment rates are low especially for women, the young, low-skilled, people with disabilities and non-EU-born. The share of temporary contracts remains high. The capacity and performance of the public employment services remain limited, especially in some regions. High priority investment needs are therefore identified **to improve access to employment and promote adaptation of workers, enterprises and entrepreneurs to change; to modernise labour market institutions and services to assess and anticipate skills needs, and support labour market matching and transitions and mobility**, and in particular to:

- provide active and preventive labour market measures such as training, traineeships, apprenticeships, second chance programmes, and well-designed employment subsidies to promote open-ended employment; support entrepreneurship and social enterprises; support voluntary labour mobility across sectors and regions;
- support enterprises in developing and fully utilising the human capital in their firms, including by adopting new work organisation and reconciliation practices, Human Resources tools, and workforce training;
- strengthen the capacity of public employment services to i) provide services to jobseekers and job changers, including profiling, personalised services and guidance, up-skilling and re-skilling; ii) collaborate with and offer services to employers; iii) establish partnerships with social services, education and training institutions, and third sector; iv) support outreach measures.
- invest in infrastructure, equipment and technologies to strengthen the capacity of public employment services, including tools for profiling, skills matching and anticipation of skills demand.

Early school leaving remains high, educational and training outcomes are low especially in some regions, and substantial skills mismatches persist. High priority investment needs are therefore identified **to improve the quality and labour market relevance of education and training; to promote quality and inclusive education and training, in particular for disadvantaged groups, and lifelong learning opportunities for all**, and in particular to:

- increase access and completion at all levels of education and training, especially in regions with high early school leaving rates and/or low educational outcomes.
- support the acquisition of key competences, including digital skills.
- promote vocational education and training as a quality and high-skill career pathway, including through workplace learning and links with local innovation ecosystems.
- promote teachers' and trainers' career development and mobility.
- support investments in early childhood education and care, education and training infrastructures.

Poverty remains high, in particular for children and non-EU-born, as well as in-work poverty. Coverage and adequacy of benefits (different from pensions) are limited and some groups face barriers to access services. Care delivery is not adapted to population ageing, disability and chronic conditions. High priority investment needs are therefore identified to **foster active inclusion, promote the social integration of people at risk of poverty or social exclusion, including children, third country nationals and marginalised communities such as the Roma and enhance equal and timely access to quality services and social protection**; and in particular to:

- develop active inclusion policies, including a twin-track approach for persons with disabilities; adapt social protection to societal and labour market changes.
- promote social integration for people at risk of poverty and social exclusion, particularly children.
- fight discrimination, especially in access to education, labour market and social services. Support social housing infrastructure, jointly with education, employment and health interventions.
- strengthen primary care and integrated care, including through investments in infrastructure and e-health, in particular in regions lagging behind and with a view to reducing health inequalities.

Policy Objective 5 – A Europe closer to citizens by fostering the sustainable and integrated development of urban, rural and coastal areas and local initiatives

Rapid population growth in urban areas has increased the pressure on the natural resources and land use, with effects (inter alia) on mobility, pollution and access to services; while smaller urban areas face problems related to connectivity, access to services and attractiveness for business. Priority investment needs are therefore identified to **foster the integrated social, economic and environmental development, of the urban areas**, and tackle the urban-rural linkages, and in particular to:

- address urban challenges at functional area level taking into account the different needs, according to the size, specialisation and function of each area.

Depopulation and ageing in inner areas leads to a reduction in the quality of basic services. The islands face increased pressure on their ecosystems, confronted with the intensive development of tourism and related activities. Priority investment needs are therefore identified to **foster the integrated social, economic, cultural and environmental local development of the inner areas, areas affected by depopulation and low density, and of the islands**, and in particular to:

- improve access to basic services, innovation and business development, enhanced connectivity and mobility, renewable energies, water supply, water treatment and waste management;
- encourage joint actions with neighbouring regions and in sea-basin or functional areas with similar challenges; a better regional integration with third countries; and support to EU initiatives like Clean Energy for Islands and Coal Regions.

Factors for effective delivery of Cohesion policy

- improved administrative capacity of the managing authority, intermediate bodies and beneficiaries to implement EU funds in a transparent and coordinated manner, including (where relevant) a roadmap on administrative capacity building, and the supervision of the audit authority over regional bodies;
- simplified administrative procedures, while putting in place improved and more efficient measures to prevent and address conflicts of interest, fraud and corruption;
- stronger institutional coordination and collaboration mechanisms between and within the central, regional and local administrations, including the evaluation and assessment of the effectiveness of the policies;
- active involvement of social partners;
- improved performance of public procurement, including effective implementation of the new law on public sector contracts;
- broader use of financial instruments, as well as exploiting synergies with InvestEU for revenue-generating and cost-saving activities;
- lessons learnt through the implementation of the Commission pilot project on industrial transition, in particular about the impact of new technologies, decarbonisation and the promotion of inclusive growth.

REFERENCES

Anghel, B., Conde-Ruiz, J. I., & Marra de Artiñano, I. (2018), Brechas salariales de Género en España, Madrid, FEDEA, <http://documentos.fedea.net/pubs/eee/eee2018-06.pdf>

ANED, Academic Network of European Disability Experts (2018), Country report on the European Semester –Spain.

Bank of Spain (2019a), *Un Análisis del Impacto de las Subida del Salario Mínimo en 2017 sobre la Probabilidad de Perder el Empleo*, Aitor Lacuesta, Mario Izquierdo, Sergio Puente, Documentos Ocasionales, Number 1902, <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasional/es/19/Fich/do1902.pdf>

Bank of Spain (2019b), Exporting Spanish Firms. Stylized Facts and Trends, Gutiérrez Chacón E and Martín Machuca C, Documentos Ocasionales, Number 1903. <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasional/es/19/Files/do1902e.pdf>

Bank of Spain (2018a), La moderación salarial en España y en la UEM, Boletín Económico 4/2018.

Bank of Spain (2018b), Informe Anual 2017 <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesAnuales/InformesAnuales/17/Descargar/Fich/Inf2017.pdf>

Bank of Spain (2018c), Bank Lending Survey, <https://www.bde.es/webbde/en/estadis/infoest/epb.html>

Bank of Spain (2018d), Economic Bulletin, 2018/1. https://www.bde.es/bde/en/secciones/informes/boletines/Boletin_economic

Bernal-Delgado E, García-Armesto S, Oliva J, Sánchez Martínez FI, Repullo JR, PeñaLongobardo LM, Ridao-López M, Hernández-Quevedo C. (2018), *Spain: Health system review 2018. Health Systems in Transition*, <http://www.euro.who.int/en/about-us/partners/observatory/publications/health-system-reviews-hits/full-list-of-country-hits/spain-hit-2018>

Busom I, Corchuelo B, Martínez Ros E, 2014, Tax Incentives and Direct Support: What do Firms Use and Why?, Academia. https://www.academia.edu/7594119/Tax_incentives_and_direct_support_for_R_and_D_what_do_firms_use_and_why

CEDEFOP, 2018, Developments in vocational education and training policy in 2015-2018: Spain. Cedefop monitoring and analysis of VET policies, <http://www.cedefop.europa.eu/en/publications-and-resources/country-reports/vet-policy-developments-spain-2017>

Cordón T, Gutiérrez Lousa M, 2010, Los incentivos fiscales a la investigación, el desarrollo y la innovación tecnológica, Clm. economía, Num. 1

Commission for the Analysis of the Situation of Dependency (2017), Informe de la comisión para el análisis de la situación actual del sistema de la dependencia, de su sostenibilidad y de los actuales mecanismos de financiación, para evaluar su adecuación a las necesidades asociadas a la dependencia, http://www.dependencia.imserso.es/dependencia_01/evo_doc/co_si_dep/index.htm

CES, Consejo Económico y Social España (2018a). Memoria sobre la situación socioeconómica y laboral de España en 2017, <http://www.ces.es/memorias>

CES, Consejo Económico y Social España (2018b). Políticas públicas para combatir la pobreza en España, <http://www.ces.es/memorias>

CES, Consejo Económico y Social, (2018c) El medio rural y su vertebración social y territorial, España, <http://www.ces.es/documents/10180/5461461/Inf0118.pdf>

Digital Scoreboard, 2019, European Commission, <https://ec.europa.eu/digital-single-market/en/digital-scoreboard>

European Commission (2019a), 'Fiscal Sustainability Report 2018' Directorate-General for Economic and Financial Affairs, European Economy, Institutional Paper xx/2019.

European Commission (2019b), 2019 EU Justice Scoreboard, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions (forthcoming)

European Commission (2018a), "Country Report Spain 2018", SWD(2018)207 final, March 2018. https://ec.europa.eu/info/files/2018-european-semester-country-report-spain_en

European Commission (2018b), "Alert Mechanism Report 2019", COM(2018) 758 final, November 2018 https://ec.europa.eu/info/publications/2019-european-semester-alert-mechanism-report_en

European Commission (2018c), Commission Opinion on the Draft Budgetary Plan of Spain, COM (2018) 8015 final, November 2018 https://ec.europa.eu/info/sites/info/files/economy-finance/c_2018_8015_es_en.pdf

European Commission (2018d), "The 2018 Ageing Report. Economic and budgetary projections for the 28 EU Member States (2016-2070)", European Economy, Institutional Paper 079, May 2018

European Commission (2018e) and Centre for Social and Economic Research "Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report", Centre for Social and Economic Research, TAXUD/2015/CC/131 (2018)

European Commission (2018f), Commission Communication "A European retail sector fit for the 21st century" COM(2018) 219 final, and its Annex and accompanying Staff Working Document

European Commission (2018g), ECORYS, "Study on costs involved in accessing markets cross-border for provisions of construction services" https://ec.europa.eu/growth/content/study-costs-involved-accessing-markets-cross-border-provisions-construction-services_en

European Commission (2018h), *The 2018 Pension Adequacy Report: current and future income adequacy in old age in the EU. Volume II*, <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8085&furtherPubs=yes>

European Commission (2018i), Draft Joint Employment Report: Accompanying the Communication from the Commission on Annual Growth Survey 2018.

European Commission (2018j), SRIP report (Science, Research and Innovation Performance of the EU) https://ec.europa.eu/info/sites/info/files/rec-17-015-srip-report2018_mep-web-20180228.pdf

European Commission (2018k), Country Report Spain 2018, Digital Economy and Society Index <https://ec.europa.eu/digital-single-market/en/digital-scoreboard>

European Commission (2018l), Country Profile Spain 2018, Women in Digital Scoreboard <https://ec.europa.eu/digital-single-market/en/women-digital-scoreboard>

European Commission (2018m), *Employment and Social Developments in Europe – Annual Review 2018*, Luxembourg: Publications Office of the European Union, 2018

European Commission (2018n), European Semester Country Report Communication, COM(2018) 120 final, https://ec.europa.eu/info/publications/2018-european-semester-communication-country-reports-0_en

European Commission (2017a), “Country Report Spain 2017”, SWD(2017)74 final, February 2017 <https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-spain-en.pdf>

European Commission (2017b) "Communication on strengthening Europe's energy networks", COM(2017) 718 final

European Commission (2017c), RIO Country Report for Spain <https://rio.jrc.ec.europa.eu/en/library/rio-country-report-spain-2017>

European Commission (2016a). *Disability and labour market integration*. Directorate-General of Employment, Social Affairs and Inclusion. Publications Office of the European Union.

European Commission (2016b), “Country Report Spain 2016”, SWD(2016)78 final, February 2016 https://ec.europa.eu/info/sites/info/files/cr_spain_2016_en.pdf

European Commission (2016c), “A European Agenda for the Collaborative Economy”, COM (2016) 356 final.

European Commission, 2014, The EU Environmental Implementation Review Country Report – SPAIN. SWD(2017) 42 final

European Council 2016, Council Recommendation of 20 September 2016 on the establishment of National Productivity Boards, [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0924\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0924(01)&from=EN)

European Investment Bank, 2018, Investment Survey, Spain

European Innovation Scoreboard 2018: http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_en

[EU-SILC. European Union Statistics on Income and Living Conditions. Eurostat. European Commission. https://ec.europa.eu/eurostat/web/microdata/european-union-statistics-on-income-and-living-conditions](https://ec.europa.eu/eurostat/web/microdata/european-union-statistics-on-income-and-living-conditions)

Eurydice (2018), Early Childhood and School Education Funding: Spain, Chapter 3, Funding in Education (https://eacea.ec.europa.eu/national-policies/eurydice/content/early-childhood-and-school-education-funding-79_en)

Final report from the High-Level Expert Group on Sustainable Finance 2018, https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

FEDEA, Policy Papers - 2018/09, “¿Hacia una nueva reforma de las pensiones?”, Notas para el Pacto de Toledo, Angel de la Fuente (FEDEA e Instituto de Análisis Económico, CSIC), Miguel Angel García Díaz (Universidad Rey Juan Carlos y FEDEA) and Alfonso R. Sánchez (CUNEF y FEDEA)

Felgueroso, F., & Jansen, M. (2018), *Aumento del salario mínimo: datos para el debate*, No. 2018-02, FEDEA.

FUNCAS (2018), *Los problemas del mercado de trabajo y las reformas pendientes*, Papeles de Economía Española, n.º 156, 2018, ISSN: 0210-9107.

General Council for the Judiciary, 2018. <http://www.poderjudicial.es/cgpj/es/Temas/Estadistica-Judicial/Estadistica-por-temas/Datos-penales--civiles-y-laborales/Civil-y-laboral/Estadistica-sobre-Ejecuciones-Hipotecarias/>

Global Start-Ups Ecosystem Report 2018, <https://www.finnovista.com/update-fintech-radar-spain/?lang=en>

High-Level Expert Group on Sustainable Finance, Final Report 2018. https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

Huete García, A. (2017), Las personas con discapacidad en la escuela. Luces y sombras del proceso de inclusión educativa en España. *Panorama Social*. Vol 26, p. 93-108, <http://www.funcas.es/Publicaciones/Detalle.aspx?IdArt=23614>

IDAE, Energy efficiency trends and policies in Spain, 2015

INE (Instituto Nacional de Estadística), 2019. EPA www.ine.es

INE (Instituto Nacional de Estadística), 2017a. https://www.ine.es/dyngs/INEbase/es/operacion.htm?c=Estadistica_C&cid=1254736176925&menu=ultiDatos&idp=1254735976608

INE (Instituto Nacional de Estadística), 2017b. Encuesta de presupuestos familiares 2016. INE. (Survey on family budget 2016): http://www.ine.es/prensa/epf_2016.pdf

International Monetary Fund (2018), *Spain: 2018 Article IV Consultation-Press Release, Staff Report, and Statement by the Executive Director for Spain* (<https://www.imf.org/en/Publications/CR/Issues/2018/11/21/Spain-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-Executive-46381>)

Jansen, M., and Troncoso-Ponce, D. (2018), *El impacto de los contratos para la formación y el aprendizaje en la inserción laboral de los jóvenes*, Estudios sobre la Economía Española 2018/27, FEDEA.

Robert Koopman, William Powers, Zhi Wang, Shang-Jin Wei (2010), Give credit where credit is due: tracing value added in global production chains, Working Paper 16426, National Bureau of Economic Research, <http://www.nber.org/papers/w16426>

Matsaganis, M., Medgyesi, M., and Karakitsios, A. (2015), *The interaction between minimum wages, income support, and poverty*, European Commission, Research note 10/2015.

Ministry of Labour, Migrations and Social Security, 2018a, Afiliación a la Seguridad Social Junio 2018. <http://prensa.mitramiss.gob.es/WebPrensa/downloadFile.do?tipo=documento&id=3.316&idContenido=2.986>

Ministry of Labour, Migrations and Social Security, 2018b. http://www.mitramiss.gob.es/es/sec_trabajo/autonomos/economia-soc/EconomiaSocial/estadisticas/

Ministry of Labour and Migration (2011), *Plan Estratégico de Ciudadanía e Integración 2011-2014*, http://extranjeros.mitramiss.gob.es/es/Programas_Integracion/Plan_estrategico2011/pdf/PECI-2011-2014.pdf

Ministry of Health, Consumption and Social Welfare (2017), *Informe de rentas mínimas de inserción 2016*, <http://www.msbs.gob.es/ssi/familiasInfancia/ServiciosSociales/docs/Informe2016.pdf>

National Reform Programme of Spain, 2018: 31. https://ec.europa.eu/info/2018-european-semester-national-reform-programmes-and-stability-convergence-programmes_en

Resolución de 15 de marzo de 2018, de la Secretaría de Estado de Empleo, por la que se publica el Acuerdo del Consejo de Ministros de 29 de diciembre de 2017, por el que se aprueba la Estrategia Española de Economía Social 2017-2020.

Oderkirk, J. (2017), *Readiness of electronic health record systems to contribute to national health information and research*, OECD Health Working Papers, No. 99, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9e296bf3-en>

OECD (2019), Benz, S. and F. Gonzales (2019), “Intra-EEA STRI Database: Methodology and Results”, OECD Trade Policy Papers, No. 223, OECD Publishing, Paris

OECD (2018a), *Education Policy Outlook 2018: Putting Student Learning at the Centre*, OECD Publishing, Paris (<http://dx.doi.org/10.1787/9789264301528-en>)

OECD (2018b), Spain: Country Profile, Education GPS (<http://gpseducation.oecd.org/Helpers/GenerateHTML>)

OECD (2018c), *A Broken Social Elevator? How to Promote Social Mobility. How does Spain compare?*, OECD Publishing, Paris. <http://www.oecd.org/spain/social-mobility-2018-ESP-EN.pdf>

OECD, 2017a, *Economic Survey of Spain, 2017*, <http://www.oecd.org/eco/surveys/Spain-2017-OECD-economic-survey-overview.pdf>

OECD, 2017b, *Ageing staff – Tax Administration 2017*. <http://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-2017-summary.pdf>

OECD, 2016, *PISA 2015 Results (Volume 1): Excellence and Equity in Education*, PISA, OECD, Publishing, Paris <http://www.oecd.org/publications/pisa-2015-results-volume-i-9789264266490-en.htm>

OECD, 2014, *TALIS 2013 Results: An international perspective on Teaching and Learning*, TALIS, OECD Publishing. <http://www.oecd.org/education/school/talis-2013-results.htm>

OECD, 2013, *Tax Administration 2013: Comparative Information on OECD and Other Advanced and Emerging Economies*. <http://www.oecd.org/tax/administration/Tax-Administration-2013-Information.pdf>

OECD and the European Union, 2018, *Health at a Glance: Europe 2018: State of Health in the EU Cycle*, OECD Publishing, Paris. https://doi.org/10.1787/health_glance_eur-2018-en

OED, Observatorio Estatal de la Discapacidad (2018). *Informe Olivenza 2017, sobre la situación general de la discapacidad en España*. <https://www.observatoriodeladiscapacidad.info/category/documentos/observatorio/informe-olivenza-observatorio/>

OED, Observatorio Estatal de la Discapacidad (2016). Plan de Acción de la Estrategia Española sobre Discapacidad 2014-2020. Informe sobre aplicación de la primera fase del Plan (2014-2016) <https://www.observatoriodeladiscapacidad.info/aplicacion-de-la-primera-fase-del-plan-2014-2016/>

Special Eurobarometer 469: Integration of immigrants in the European Union, 2018. http://data.europa.eu/euodp/en/data/dataset/S2169_88_2_469_ENG

RIS - Social Inclusion Network (2018), *Grupo De Trabajo GT2 Sobre Transiciones Entre Ingresos Mínimos y Empleo. Informe De Resultados*, <http://redinclusion-social.es/wp-content/uploads/2018/10/INFORME-GT2.2-TRANSICIONES-FINAL-2.pdf>

SAAD - System for Autonomy and Care for Dependency (2018), Análisis explicativo de las estadísticas mensuales del Sistema para la autonomía y atención a la dependencia. Situación 30/09/2018, http://www.imserso.es/imserso_01/documentacion/estadisticas/info_d/estadisticas/est_inf/otros_inf/id/ind_ex.htm

Thum-Thysen, A., P. Voigt, B. Bilbao-Osorio, C. Maier and D. Ognyanova (2017), 'Unlocking investment in intangible assets', European Economy Discussion Paper 47, May 2015, Publications Office of the European Union, Luxembourg.

Varga, J, in 't Veld J. (2014), "The potential growth impact of structural reforms in the EU: a benchmarking exercise ", European Economy Economic Papers no. 541. http://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp541_en.pdf

World Bank, Doing Business project, <http://www.doingbusiness.org/en/doingbusiness>