# OECD Economic Surveys: Spain 2023

Report

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## Abstract

Spain implemented notable measures to cushion the impact of the pandemic and the inflationary shock after Russia's war of aggression against Ukraine. The economy has held up well, but public debt, which was already high, has increased significantly and is now on a path that is not sustainable in the absence of fiscal consolidation. Public policy should continue to address Spain's structural weaknesses. Growth potential is low and will remain so with the rapid ageing of the population. Productivity growth has been disappointing for years and will require a strong and broad commitment in favour of a cleaner energy mix and a more environment-friendly tax regime. Unemployment remains the highest in the OECD area and inclusiveness of the labour market and education systems is challenging, although recent reforms have reduced the high share of temporary contracts, improving educational and labour market outcomes among the disadvantaged. Further reforms are needed to improve the functioning of the labour market and the labour market, supporting students at risk of falling behind, improving career counselling, and providing a more efficient public employment service. Further reforms are also needed to improve the business environment, improve access to affordable financial and educational support, foster innovation in unrosed small-scale activities, and boost access to housing for young people.

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## Executive summary

### The economy is proving resilient

**In a context of high inflation and an uncertain outlook due to Russia's war of aggression against Ukraine, the Spanish economy has held up well. The recovery from the pandemic has been strong, but inflation is high.**

With higher inflation, lower natural disasters and less uncertainty, GDP growth has proved resilient (Figure 1). Supply shortages and a sharp rebound in demand have contributed to high inflation, which has been more persistent than in the euro area, but is expected to fall gradually to pre-crisis levels. Spain's direct exposure to the war of aggression against Ukraine, headline inflation significantly eased in 2023 with lower energy prices, but it has slightly increased since and core inflation remains high.

Figure 1. GDP growth has been sustained

Real GDP, 2019Q4=100

Source: OECD Economic Outlook.

Excel file

Table 1. Economic growth is resilient

Annual growth rates, % unless specified

| | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|
| Gross domestic product | 6.4 | 5.8 | 2.5 | 1.5 |
| Private consumption | 7.1 | 4.7 | 1.7 | 1.6 |
| Unemployment rate (%) | 14.8 | 12.9 | 11.6 | 11.5 |
| Consumer price index | 1.9 | 8.3 | 3.5 | 3.7 |
| Fiscal balance (% of GDP) | -6.7 | -4.7 | -3.8 | -3.5 |
| Public debt (Maastricht definition, % of GDP) | 118.4 | 111.6 | 109.4 | 110.0 |

Source: OECD Economic Outlook.

GDP growth is projected to slow down but to remain resilient supported by consumption and investment (Table 1). Growth will also be supported by cohesion funds of Next Generation EU funds.

**Employment growth has been robust, and the OECD labour market reform is being implemented successfully. Nevertheless, the share of temporary permanent contracts, especially for the young.** The unemployment rate has come down but remains the OECD's highest. Pervasive joblessness reflects structural weaknesses, including a mismatch of skills and jobs, and insufficient incentives to work. Key contributions of the labour market reform have enhanced active labour market policies and increase incentives to return to work following unemployment. Improving remoteness and especially mothers' labour participation would further boost labour market outcomes.

**The financial sector remains resilient but rising interest rates could increase non-performing loans.** Spanish households are highly exposed to rising interest rates, with 70% of the stock of mortgages at variable rates, although most new mortgages have been extended at fixed interest rates. Banks should maintain prudent provisioning and capital policies.

### Public debt must be further reduced

**As a result of the COVID-19 pandemic, public debt, which was already high, increased considerably in 2020, even though it has been reduced in the years following. The fiscal stance should remain prudent and consolidation needed to normalise debt at a downward path and to create space for ageing-related and growth-oriented spending.**

Sizable public support helped to mitigate the inflationary shock on businesses and households, but it should be phased out.

**Pension and health-related outlays are set to rise in the longer term, substantial investments are needed to accelerate the green transition, and the government has committed to boosting defence spending.** To make spending more growth-friendly, it should be reoriented towards more growth-enhancing additional revenues and enhancing spending efficiency based on spending reviews. There is room to raise VAT, environmental-related taxes and property taxes, and to broaden the tax base. Spain's VAT revenue is well below the standard VAT rate of the items that are subject to a reduced rate and benefit mainly higher-income households would fully. Excises on alcohol and tobacco could be raised. But at the same time labour and some capital taxes could be cut.

Figure 2. Public debt has increased sharply

Annual government, % of GDP, 2000-2022

Source: OECD Economic Outlook, National Accounts database.

Excel file

The recent pension reform increased minimum and non-contributory pensions and indexed benefits to consumer prices. Despite accompanying measures to encourage longer working lives, the reform implies that there will be a considerable increase in overall pension expenditure. Nevertheless, pension spending is expected to decline gradually from the peak in the 2040s, as the generations born in the Franco years retire. The government requires by the Fiscal Council, if it concludes that there is a deviation from the benchmark defined by the law, the government will need to take corrective measures. Pension reform, if it is not accompanied by consolidation, will lead to, for, it would be profitable to link the outgoing retirement age to life expectancy at retirement and to cut pension accrual rates.

**Despite recent small declines in inequality and poverty, one quarter of the Spanish population was poor or at risk of poverty and social exclusion in 2022, the second highest in the OECD area.** Poverty among children is of concern as the resilient, notably poor families with children. Ensuring the adequate transferability of social and housing rights would make the system more efficient and fairer. Extending the minimum income scheme to people aged under 23 and the minimum income guarantee could be improved by further enhancing communication with eligible households.

### Growth needs to be stronger and more sustainable

**Population ageing, sluggish productivity growth and low investment weigh on potential growth in the medium term. Boosting the growth potential of the past decade has been strongly lifting growth more sustainable will require greater efforts to lower fossil fuel dependence and to improve the business environment and innovation.**

**Spain is making progress on its reform agenda and the implementation of the Recovery, Transformation and Resilience Plan.** Harmonising regulations and boosting the scale of small and medium-sized enterprises (SMEs) and fostering partnerships between public research institutions and firms would bolster their currently low capacity to innovate.

**Strengthening the prevention of corruption in the public administration would enhance the quality of public investment and lower fiscal costs.** More transparency in the allocation of public procurement, including in the Recovery Help, would continuing the implementation of the OECD Anti-Bribery Convention.

**To achieve its climate-change objectives Spain will have to step up its actions.** Despite improvements, Spain remains heavily reliant on fossil fuels, and greenhouse gas emissions are still high in transport, industry, agriculture and fishing. Carbon prices are too compressed to incentivise best practice. Alternative measures applied to sectors outside the EU ETS until the one-year-ahead carbon price reaches the EU ETS price level, and then, in the longer-term, as well as phasing out fossil fuels, would help to lower early housing. Support for environment in vocational education should continue because it equips students with the skills needed for the green transition in industries such as energy, agriculture, fishing, construction, and other administrative clusters, as the new law on vocational education foresees, can bring more SMEs into the vocational education and training system. Spain should also continue its leadership initiative in this direction. Greater employer involvement in the design of university curricula and improvements in existing tools that offer information on future market placements would help to better align studies and labour market needs.

Figure 3. The concentration of nitrates in drinking water is problematic

Groundwater nitrates failing to meet the drinking water standard under the Nitrates Directive, %

Source: European Environment Agency (EEA).

Excel file

### Spain must increase opportunities for youth

**Enhancing education, facilitating youth labour market participation, improving entrepreneurship, and boosting access to housing are also key to reducing the high share of young people who are at risk of poverty among young people (Figure 4).**

**Many young people in Spain leave the education system with low skills, limiting their job prospects.** Sizable expansion and early school-leaving rates have significantly declined, from 17.9% in 2016 to 13.9% in 2022 for the latter, a target set by the government for 2030. Nevertheless, the proportion remains far off, so students at risk of falling behind could help to lower early leaving. Support for enrolment in vocational education should continue because it equips students with the skills needed for the green transition in industries such as energy, apprenticeships, supply teachers or share administrative clusters, as the new law on vocational education foresees, can bring more SMEs into the vocational education and training system. Spain should also continue its leadership initiative in this direction. Greater employer involvement in the design of university curricula and improvements in existing tools that offer information on future market placements would help to better align studies and labour market needs.

Figure 4. Young people face high poverty risks

Risk of poverty or social exclusion, %

Source: OECD Energy Statistics (Spain's countries and outside Europe).

Source: EU.

Excel file

**Youth labour market integration is difficult.** The unemployment rate of people under 25 at 29% is the highest in the OECD. Poor job quality among the young is pervasive although the recent labour market reform helped to reduce temporary contracts among the young. Promoting permanent contracts would considerably since 2018, increasing earnings and reducing inequality for young people. However, such large increases can harm employment prospects of the young. Nevertheless, the labour market reform stages changes should be in line with labour market conditions and productivity. Youth entrepreneurship should also be fostered through better mentoring, training and access to financing.

**Over 60% of Spanish people under 34 live with their parents, mainly due to unaffordable housing and insufficient income.** Housing support for young people in rural areas would be beneficial, as potentially for government. A shift away from taxes on labour and towards taxes on housing, property, which may reduce already low rental supply and increase rents in the short run.

### Main findings and key recommendations

| MAIN FINDINGS | KEY RECOMMENDATIONS |
|---|---|
| **Addressing inadequate social protection** | |
| Support measures to alleviate the impact of high energy and food prices have been sizeable and only partly targeted towards the most vulnerable. | Make a medium-term fiscal plan, step up the pace of fiscal consolidation, and lower the share of public spending in fiscal balances and GDP. |
| Spending in Most towards social spending, mainly pensions, and investment in the green transition, which is important, is growth-enhancing. Spending on health and education, on the contrary, is not growth-enhancing and spending that aims. | Based on spending reviews and social cost-benefit analysis, reorient spending towards more growth-enhancing additional revenues and enhancing items, thereby enhancing spending efficiency. |
| Tax revenues are low by EU standards, and there is room to improve the design of the tax system. Tax evasion and fraud are high, and tax compliance costs are high. Tax revenues are mainly drawn from labour and consumption taxes, while taxes on property and property are growing and property. | Broaden the tax base for environmental-related taxes, property taxes, and consumption taxes, and lower taxes on labour and capital. Broaden the tax base for environmental-related taxes, property taxes, and consumption taxes, and lower taxes on labour and capital. |
| Spain's public pension system is sustainable, but the recent pension reform will lead to a considerable increase in overall pension expenditure. | Reorient the pension system towards more growth-enhancing, fiscal-neutral measures. |
| Spain's public pension system is sustainable, but the recent pension reform will lead to a considerable increase in overall pension expenditure. | Increase the amount and coverage of cash benefits for poor families with children. |
| **Promoting strong, inclusive and sustainable growth, productivity and the green transition** | |
| Social expenditure is distributed unevenly towards housing people with a job and a stable financial situation. Social assistance programmes do not provide adequate protection against poverty. Poverty is high. | Continue efforts to reduce corruption in the public sector. |
| The legal framework to fight corruption has been improved, but the risk of fraud in public procurement is still prevalent and high by others. | Broaden the base for environmental-related taxes, property taxes, and consumption taxes, and lower taxes on labour and capital. Broaden the base for environmental-related taxes, property taxes, and consumption taxes, and lower taxes on labour and capital. |
| Despite improvements, Spain remains heavily reliant on fossil fuels, and greenhouse gas emissions are high. Taxes and unaddressable subsidies on agriculture and fishing. | Broaden the base for environmental-related taxes, property taxes, and consumption taxes, and lower taxes on labour and capital. |
| Current policy efforts are unlikely to be sufficient to meet national goals, notably net zero carbon emissions by 2050 and the 2030 target for greenhouse gas emissions. | Install more electric vehicle charging points and provide more support for the retrofitting of buildings. |
| Water quality is good with low levels of nitrate concentration spreading because of intensive agriculture. Nitrate pollution is a problem in groundwater, which is part of the country's difficult groundwater drought. | Promote a more efficient use of fertilisers by increasing taxes or improving their regulation. |
| **Tackling difficulties facing people in the labour market, education, entrepreneurship and housing** | |
| Expanding access to early childhood education has been a priority and has been effective. The share of children in early childhood education is lower than in other OECD countries, and participation is low for children from early childhood education and care, while access to early childhood education and care, while access to early childhood education and care, while access to early childhood education and care, while access to early childhood education and care, while access to participation. | Continue expanding access to quality early childhood education and care, particularly for children from the age of three and promoting disadvantaged children. |
| Early school-leaving and repetition rates in compulsory education are very high. Lifelong education participation is low. | Support students at risk of falling behind, such as students with a low socio-economic background. |
| Enrolment in vocational education and training programmes is growing but remains comparatively low. Apprenticeships are underdeveloped. | Improve collaboration between SMEs to provide opportunities to students training in number of apprenticeships. |
| Despite recent efforts to reform vocational education and training, self-employment, manager, school-leaver, trainees, Close to 40% of 15-29-year-olds report that they are neither in employment, education or training. Current pay, one of the highest rates in the European Union. | Encourage collaboration between education institutions and employers to assist in internships and apprenticeships, and provide more information on productivity and ensure their access to labor. |
| Recent rises in minimum wages have been rapid and large, which could have negative consequences for vulnerable groups. | Make the recently established Spanish commission responsible for wages in relation to minimum wages, taking into account the impact on productivity and ensure their access to labor. |
| Entrepreneurship is low and Spanish entrepreneurs are training on how to start a business and on financial management. | Promote entrepreneurship education in more young people who are out of the formal education system. |
| Rental housing is expensive. The share of social rental housing is stagnant and, at 1%, one of the lowest in the OECD area. Housing support for young people is fragmented, and current regulations are among the most stringent in the OECD and further increases would risk curtailing housing supply. | Encourage wholesale supply of rentable stock in rural areas by increasing the share of social rental housing, relaxing rent control regulations, and improving housing support for young people, notably rural regions and improving property transfer taxes. |

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