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

The economic situation and policies of the Spain were reviewed by the Committee on 19 January 2017. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 30 January 2017.

The Secretariat's draft report was prepared for the Committee by Aida Caldera Sánchez, David Haugh, Yosuke Jin and Pilar García Perea under the supervision of Pierre Beynet. Müge Adalet McGowan and Dan Andrews also contributed. Research assistance was provided by Gabor Fulop and secretarial assistance was provided by Sylvie Ricordeau.

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BASIC STATISTICS OF SPAIN, 2015

(Numbers in parentheses refer to the OECD average)[a]

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	46.4		Population density per km^2	92.5	(37.0)
Under 15 (%)	15.1	(18.0)	Life expectancy (years, 2014)	83.3	(80.6)
Over 65 (%)	18.6	(16.3)	Men	80.4	(77.9)
Foreign-born (%, 2014)	13.2		Women	86.2	(83.3)
Latest 5-year average growth (%)	-0.1	(0.6)	Latest general election	June 2016	
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	1 193.0		Primary sector	2.6	(2.5)
In current prices (billion EUR)	1 075.6		Industry including construction	23.6	(27.0)
Latest 5-year average real growth (%)	-0.2	(1.9)	Services	73.8	(70.6)
Per capita (000 USD PPP)	34.7	(40.8)			
GENERAL GOVERNMENT Per cent of GDP					
Expenditure	43.8	(40.5)	Gross financial debt	116.8	(114.0)
Revenue	38.6	(37.9)	Net financial debt	82.0	(72.7)
EXTERNAL ACCOUNTS					
Exchange rate (EUR per USD)	0.901		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.667		Machinery and transport equipment	33.9	
In per cent of GDP			Manufactured goods	15.4	
Exports of goods and services	33.2	(54.8)	Chemicals and related products, n.e.s.	13.5	
Imports of goods and services	30.7	(50.2)	Main imports (% of total merchandise imports)		
Current account balance	1.4	(0.2)	Machinery and transport equipment	31.1	
Net international investment position (2014)	-87.9		Chemicals and related products, n.e.s.	14.8	
			Miscellaneous manufactured articles	14.1	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate for 15-64 year-olds (%)	57.8	(66.2)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	22.1	(6.8)
Men	62.9	(74.1)	Youth (age 15-24, %)	48.4	(13.9)
Women	52.7	(58.5)	Long-term unemployed (1 year and over, %)	11.4	(2.2)
Participation rate for 15-64 year-olds (%)	75.5	(71.3)	Tertiary educational attainment 25-64 year-olds (%)	35.1	(35.0)
Average hours worked per year	1 691	(1 766)	Gross domestic expenditure on R&D (% of GDP)	1.2	(2.4)
ENVIRONMENT					
Total primary energy supply per capita (toe)	2.6	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes, 2014)	5.0	(9.4)
Renewables (%)	14.4	(9.6)	Water abstractions per capita (1 000 m^3, 2012)	0.8	
Exposure to air pollution (more than 10 μg/m^3 of $PM_{2.5}$, % of population, 2013)	70.2	(72.3)	Municipal waste per capita (tonnes, 2014)	0.4	(0.5)
SOCIETY					
Income inequality (Gini coefficient, 2013)	0.346	(0.311)	Education outcomes (PISA score, 2015)		
Relative poverty rate (%, 2013)	15.9	(11.1)	Reading	496	(493)
Median disposable household income (000 USD PPP, 2013)	19.2	(22.0)	Mathematics	486	(490)
Public and private spending (% of GDP)			Science	493	(493)
Health care	9.0	(9.0)	Share of women in parliament (%)	41.1	(28.6)
Pensions (2013)	12.0	(9.1)	Net official development assistance (% of GNI)	0.12	(0.37)
Education (primary, secondary, post sec. non tertiary, 2013)	3.0	(3.7)			

Better life index: *www.oecdbetterlifeindex.org*

a) Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

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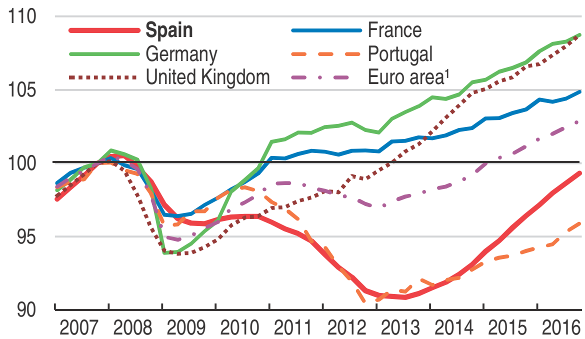
Executive summary

- *The recovery is underway but making growth more inclusive remains a challenge*
- *Fostering innovative business investment is crucial to unlock productivity growth*
- *Reducing unemployment and improving job quality can make growth more inclusive*

The recovery is underway but making growth more inclusive remains a challenge

Growth is gathering pace

Real GDP, index Q4 2007 = 100[1]



1. Euro area member countries that are also members of the OECD (16 countries).

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), March.

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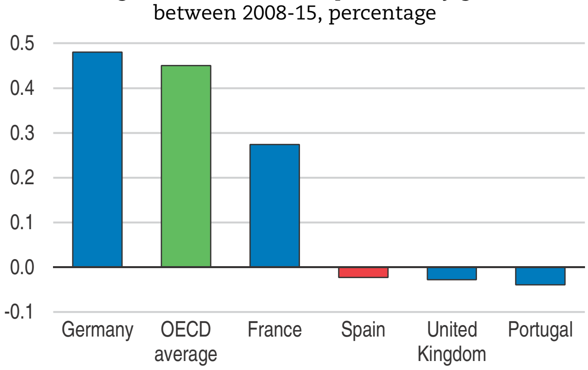
Spain is enjoying a robust recovery from a deep recession, with GDP growth averaging 2.5% over the past three years. A wide range of structural reforms has contributed to sustainable rises in living standards. Highly accommodative euro area monetary policy, low oil prices and, more recently, expansionary fiscal policy have all supported domestic demand. Exports have been a particular bright spot, as Spain has resisted the slowdown in global export growth. However, raising well-being and GDP per capita, particularly via productivity increases, and making growth more inclusive remains a challenge.

Fostering innovative business investment is crucial to unlock productivity growth

Spanish productivity growth is low

Average annual multifactor productivity growth between 2008-15, percentage



Source: OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November.

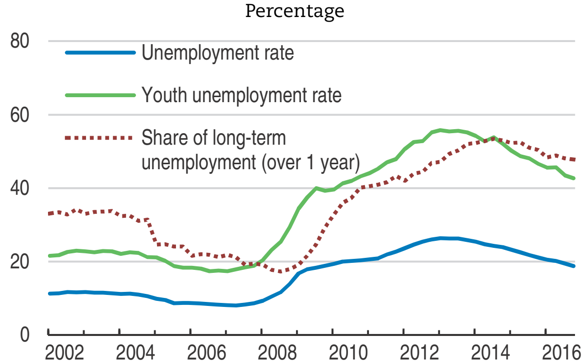
StatLink http://dx.doi.org/10.1787/888933458808

Spain has long suffered from very low productivity growth, which has restrained increases in living standards. Misallocation of capital towards low productivity firms and underinvestment in innovation have dragged down productivity, although more recently capital allocation has been improving. Policies to foster a better allocation of capital and higher productivity include reducing regulatory barriers in product markets that are holding back competition, encouraging higher investment in R&D and innovation and ensuring that capital goes to a wider set of innovative firms. Reducing entry barriers and improving framework conditions would also help to foster green investment.

Reducing unemployment and improving job quality can make growth more inclusive

Unemployment remains very high

Percentage



Source: OECD (2017), *OECD Employment and Labour Market Statistics* (database), February and Eurostat (2017), "Employment and unemployment (Labour Force Survey)", *Eurostat Database*, February.

StatLink http://dx.doi.org/10.1787/888933458814

The unemployment rate is gradually falling down thanks to stronger growth, but it remains very high, particularly among the young and long-term unemployed. The high share of long-term unemployed risks loss of skills, disaffection and alienation. Poverty has also risen, mainly due to lack of quality jobs that provide enough hours of paid work to support decent incomes. Part of the answer is continued strong economic growth, but strengthening training and job placement and better minimum income support are crucial.

MAIN FINDINGS	KEY RECOMMENDATIONS
Macroeconomic policies	
In addition to other factors, structural reforms have contributed to the economic recovery and improved competitiveness.	Continue to undertake structural reforms towards solid and balanced growth.
Public debt is high and there are risks around its future decline.	Stick to medium-term fiscal targets to ensure a gradual reduction of public debt.
The tax system is characterised by loopholes that undermine the tax base. Environmental tax revenue has declined in real terms since 2000.	Enhance the efficiency of the tax system by: • Abolishing poorly-targeted personal income tax exemptions. • Abolishing regressive reduced value-added tax (VAT) rates. • Increasing environmental taxes.
Reducing unemployment and making growth more inclusive	
Poverty and child poverty remain high and small and poorly targeted cash transfers do little to reduce poverty.	Increase the amount and coverage of the regional minimum income support programmes and of cash benefits for families with children.
The unemployment rate is decreasing, but at nearly 19% remains very high. Close to half of all unemployed have been unemployed for more than one year.	Increase the efficiency of regional public employment services by: • Employing profiling tools and specialisation of counsellors. • Increasing resources and staff-to-job seeker ratios. • Improving co-ordination to provide integrated support for jobseekers via a single point of contact for social and employment services and assistance.
Wage and employment conditions imposed by extensions of collective agreements can be too stringent for new firms to effectively compete with established firms.	Request gradually increased representativeness of business associations when allowing the extension of collective agreements.
High employer social security contributions raise the tax on labour, discouraging employment.	Reduce employer social security contributions for low-wage workers on permanent contracts.
Adult skills are poor dragging down productivity growth. The early school leaving rate is falling, but remains high.	Improve the quality of teaching through better university and on-the-job training for teachers.
About 40% of youth are unemployed, and many of them have low-skills.	Continue the development and modernisation of vocational education and training (VET). Expand dual VET and ensure skills meet firms' needs by fostering a greater role of employers in training students and designing curricula. Promote the VET system and adult education programmes to help the unemployed and those in need to gain relevant skills.
Fostering innovative business investment	
Structural bottlenecks are holding back competition.	Continue to implement the Market Unity Law and adopt the professional services reform.
Under-investment in knowledge-based capital is holding down productivity growth. Research and development (R&D) spending by firms is low and there is a high brain drain of talented researchers.	Partially reallocate funds from loans to R&D grants to projects and researchers based on performance and international peer review.
Misallocation of capital to low productivity firms within sectors is holding down productivity growth.	In cases when debt forgiveness is not automatic, reduce the period during which bankrupt entrepreneurs are required to repay past debt from future earnings. Set up small and medium-sized enterprises (SME) bond funds with guarantees provided both by government and SME companies. Increase public and private funding for innovative firms at the seed and early start-up phases.

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Assessment and recommendations

- *The economic recovery is set to continue at a healthy pace*
- *Bolstering the financial sector to raise credit growth*
- *Fiscal policy*
- *Making growth more inclusive by reducing unemployment and improving job quality*
- *Improving medium-term sustainable growth*

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Spain's economic recovery, underway since 2013, has been one of the strongest in the OECD thanks to a wide-ranging agenda of structural reform (Box 1), highly expansionary euro area monetary policy, easier fiscal policy, and significant repair of the banking system. Dynamic growth and wage moderation have led to strong employment gains, bringing down unemployment from very high levels and providing consumers with more income. Exports have grown strongly despite weak global markets, reflecting improving wage competitiveness and have helped turn a current account deficit into a surplus. Further economic growth at a pace above 2% annually is likely in the short term.

Looking ahead, maintaining the current pace of growth and increasing living standards will require continued reforms to consolidate the recovery of the economy and to improve the economy's growth potential, which has fallen substantially. With public debt around 100% of gross domestic product (GDP) and with the deficit still close to 5% the scope for fiscal expansion is limited, which means that new spending measures should be as fiscally neutral as possible. It is nevertheless important to stimulate growth and productivity by shifting spending towards growth enhancing items, such as education, active labour market policies and research and development (R&D) which are all below

Box 1. **Overview of Spain's most recent reforms**

Banking sector

To restore financial stability, the authorities launched a reform programme with the support of the European Union (EU) in 2012, including a EUR 100 billion loan facility (of which only EUR 40 billion was used). The programme identified weak banks via a comprehensive asset quality review and independent stress tests, required banks to address their capital shortfalls (restructuring them if needed), and shifted state-aided banks' real estate loans to a newly created asset management company (SAREB). The assets transferred to SAREB accounted for 10% of GDP and 3% of banking assets (Medina Cas and Peresa, 2016) and reduced the aggregated banks' non-performing loan (NPL) ratio by around 1 percentage point. The programme also reinforced financial sector regulation, supervision and bank resolution to facilitate a more orderly clean-up and better promote financial stability.

Labour market

The 2012 labour market reform reduced the stringency of job protection legislation for permanent workers. It aimed to define more clearly the criteria justifying fair dismissal and reduced the amount of compensation following unfair dismissal. The 2012 reform gave priority to firm-level collective agreements over collective agreements at higher levels and relaxed the conditions for firms to opt-out more easily from higher level collective agreements (OECD, 2014a).

Product market

The Market Unity Law, adopted in 2013, aims to harmonise business regulation across all regions and create a truly single market. It simplifies business licensing requirements by increasing the use of notification procedures, reducing the need for prior authorisations, and ensuring that permits issued in one region will automatically be valid for other regions (OECD, 2014a).

Box 1. **Overview of Spain's most recent reforms** *(cont.)*

Education

The Organic Law for Improvement of the Quality of Education (LOMCE), approved in 2013 and gradually implemented since the school year 2014/15, aims to reduce early school leaving and improve educational outcomes. It adopts new national external assessments of students; grants greater autonomy to schools in exchange for accountability, and modernises and develops the Vocational Education and Training (VET) system. In 2012, a new dual VET system was introduced which develops a model for certificates from the Ministry of Labour and another model for a degree from the Ministry of Education. National standardised exams have two positive goals: in primary education the aim is to identify students that face difficulties in order to provide additional support. At the end of compulsory education and upper secondary, the aim is to define the standards that students have to achieve in order to obtain a national degree.

Tax

The 2014 tax reform reduced the statutory income tax rates, in particular, for low-paid workers and simplified different deductions on labour earnings, reducing the tax wedge and the tax burden on labour. It eliminated distortive income tax benefits, like the house buying tax exemption. Also, it reduced the general corporate income tax rate from 30% to 25%. A tax on fluorinated gases was introduced in 2014. Some changes to the reform of the corporate income tax were approved in December 2016, as discussed below.

Pension

The 2011 and 2013 reforms raised the retirement age and reduced the replacement rate. Following the reforms, the pensionable earnings reference was revised and the amount of pension benefits will be linked to life expectancy in the future (OECD, 2015a).

Public administration

The commission on the Reform of the Spanish Public Administration (CORA) was established in 2012, to improve public-sector efficiency at all levels – central, regional and local – (OECD, 2014b). The reform, together with the Law for Rationalisation and Sustainability of the Local Administration in 2013, led to a large-scale drive to clarify the allocation of responsibilities across levels of government, reduce duplication and overlap across jurisdictions and limit the creation of new public entities or agencies at local level. The number of agencies (i.e. *Entidades Dependientes del Sector Público*) in the regional administration has been reduced by 34% between 2012 and 2016. A recent OECD report suggests that Spain has made progress in implementing the OECD recommendations from the first OECD Public Governance Review on the CORA (OECD, 2016a).

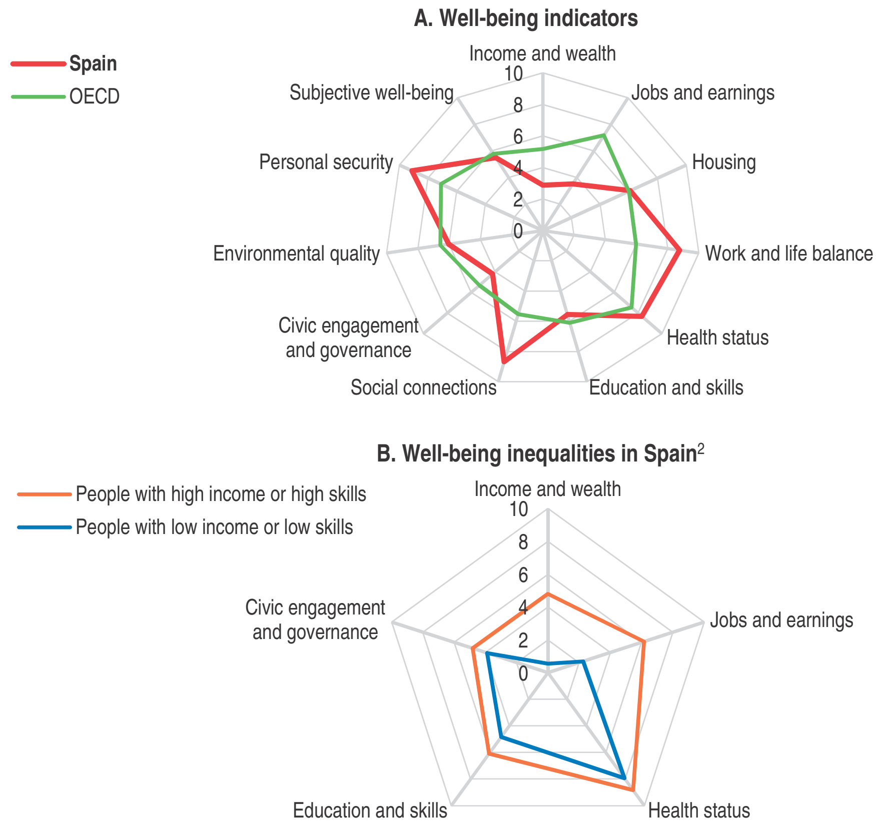
peer countries and have substantially fallen since the crisis. Productivity gains, if shared via higher wages, will be instrumental for improving the well-being of all Spanish citizens and to make growth more inclusive.

Spanish people enjoy very good social connections, good work-life balance, personal security and health conditions (Figure 1, Panel A). However, there are wider gaps in well-being relative to other countries in key areas including income, jobs, and education. Behind these averages there is also substantial heterogeneity with some groups of the population fairing considerably worse than others, especially in key areas including income and jobs (Figure 1, Panel B).

The crisis has left scars that hurt well-being, the most visible being still very high unemployment, poverty and inequality. Bringing more people back to work is crucial, but Spain has also to focus on the quality of jobs created to ensure that the benefits of growth are more widely shared and to create better opportunities for new generations. The labour

Figure 1. **How's life in Spain?**

Better Life Index, 2016[1]



1. Each well-being dimension is measured by one to four indicators from the OECD Better Life Index set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between 10 (best) and 0 (worst) according to the following formula: (indicator value – minimum value)/(maximum value – minimum value) × 10.
2. The panel shows well-being outcomes in various dimensions for people in Spain with different socio-economic background. In the dimensions of "income and wealth", "health" and "civic engagement and governance" data refer to people with an income belonging to the top (/bottom) quintile of the income distribution. In "jobs and earnings" data refer to people with the highest (/lowest) educational attainment (i.e. ISCED 5/6 versus ISCED 0/1/2) or with gross earnings belonging to the top (/bottom) quintile of the distribution. In "education and skills" data refer to people with a score belonging to the top (/bottom) quintile of the PISA index of economic, social and cultural status. Outcomes are shown as normalised scores on a scale from 0 (worst condition) to 10 (best condition) computed over OECD countries, Brazil and the Russian Federation.

Source: OECD (2016), *OECD Better Life Index*, *www.oecdbetterlifeindex.org*.

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market is characterised by a high share of temporary workers, mostly youth and many with low wages. Youth and the low-skilled suffer especially from unemployment, and long-term unemployment is very high. These factors risk entrenching inequalities, hurting future growth and social cohesion.

Against this background the main messages of this *Survey* are:

- The Spanish recovery has taken hold, but further sustained rises in living standards will depend on improving investment, skills, and productivity. Policies need to ensure that the benefits of the recovery are enjoyed by all, and the reform momentum should continue to achieve that goal.
- Low productivity reflects in part poor skills, overreliance on temporary workers, low business innovation, inefficient allocation of capital to low productivity firms, and high barriers to starting and growing a business.

- The crisis and the ensuing high unemployment have resulted in poverty and income disparities. Making growth more inclusive will require further reducing unemployment, better policies to reduce poverty and improving the quality of jobs via better skills, training and job matching.

The economic recovery is set to continue at a healthy pace

Spain recorded very robust GDP growth of 3.2% in 2015, up from 1.4% in 2014, supported by expansionary monetary policy, low oil prices, a looser fiscal stance and the depreciation of the euro. The banking sector reform helped to stabilise the financial sector contributing to a pick-up in credit growth by improving banks access to market funding and by avoiding a disruptive and disorderly unwind of a significant part of the financial sector (Box 1). A relaxation of the fiscal stance in 2015-16 supported demand.

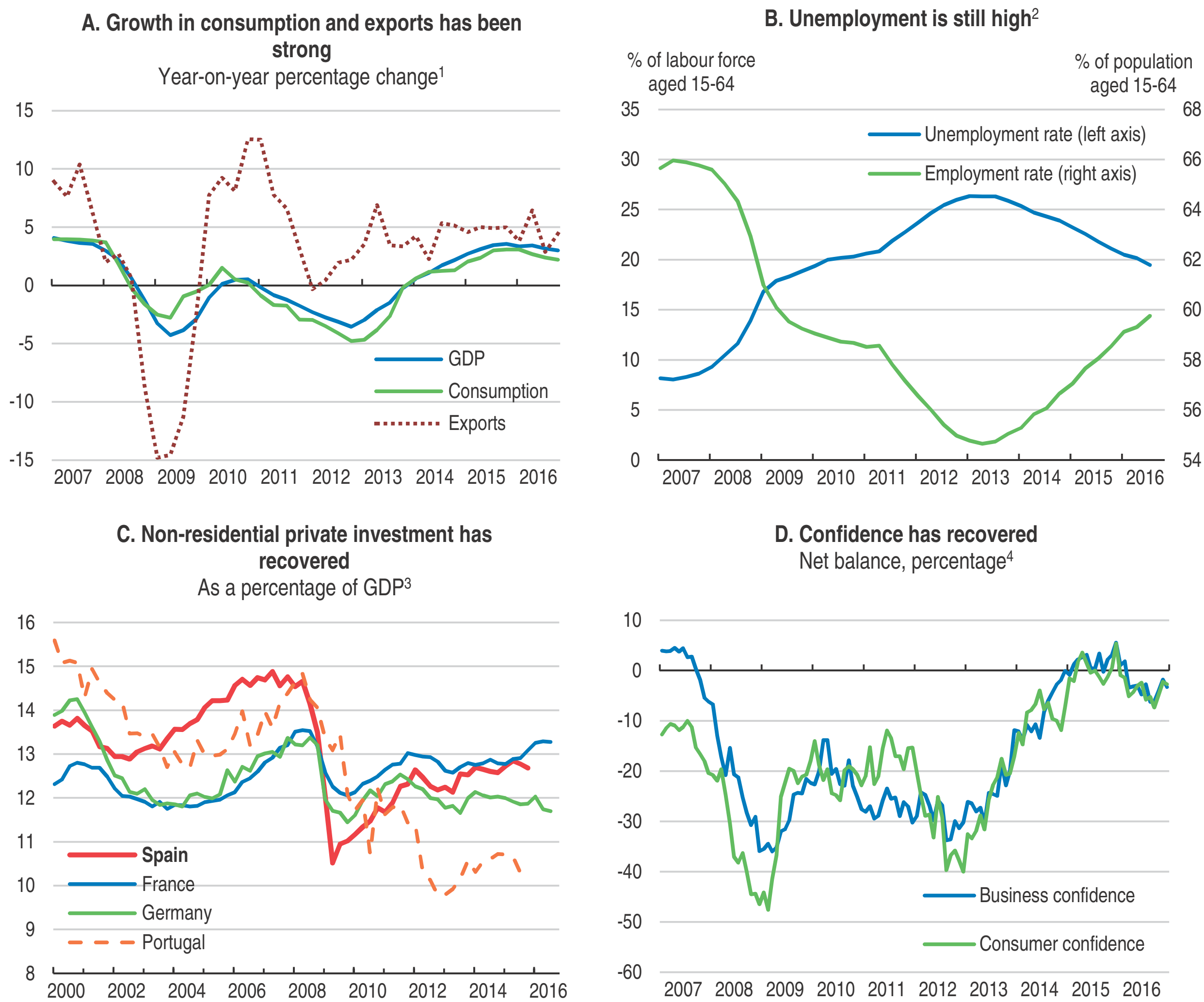
Consumption has been particularly strong, boosted by rising real disposable incomes, led by employment gains, tax reductions, falling prices, low oil prices and easy financial conditions (Figure 2, Panels A and B). Investment has picked up as financing conditions have kept improving and confidence strengthened (Figure 2, Panels C and D). Although total investment remains below pre-crisis levels, it is mainly due to a substantial fall in construction investment and to a lesser extent falls in public investment (Figure 3). On the other hand, equipment investment has been very dynamic in recent years and is already very close to pre-crisis levels. Exports are benefitting from gains in international competitiveness.

The job market was devastated during the crisis, but is gradually recovering. Employment is rising at about 3% a year. The unemployment rate has come down substantially from its peak of 26% in 2013, but it remains high at nearly 19%; youth unemployment is double than that (42.7%). Long-term unemployment has also come down rapidly from its 2014 peak, but is still high. Persistent unemployment may be eroding skills and increasing social alienation. The labour market is characterised by a high share of temporary workers (25.7% in 2015) and part-time work increased during the crisis and currently stands at 15.2%, more than half of it being involuntary. Temporary and part-time workers suffer from periods of unemployment and under employment, which reduces their incomes and raises poverty (OECD, 2015b).

Economic growth is projected to reach 3.2% in 2016 and then continue at an annual pace above 2% in 2017 and 2018 (Table 1). Domestic demand will continue leading the recovery. Private consumption is set to remain strong on the back of further employment gains, as the reforms from previous years continue to bear fruit. Continued favourable financing conditions will extend the nascent pick up in business and housing investment. Inflation will pick up but pressures should remain moderate due to still high unemployment. Growth is set to somewhat slow in 2017 and 2018 as the pace of growth of domestic demand eases, and some factors that have contributed to boost consumption, such as low oil prices and lower taxes, recede. Export growth is expected to somewhat moderate due to weak demand in export markets and anaemic world trade.

Risks stem from internal and external factors. Domestically, it may be difficult for the minority government to legislate further bold reforms needed to boost growth sustainably. Slowing global trade growth (Haugh et al., 2016) could further undermine exports, which have been an important driver of the economic recovery, especially if Spain's international competitiveness were to erode. Renewed turbulence in international financial markets

Figure 2. **Economic developments**



1. In real terms.
2. Data refer to population aged between 15 and 64.
3. Data refer to total investment minus government and housing investment. Since data for housing investment for Spain and Portugal may also include government housing, the series for non-residential private investment may be underestimated.
4. Net balance of answers to surveys taking the value between -100% (unfavourable) and +100% (favourable). Business confidence is calculated as an unweighted average of the confidence indicators for manufacturing, construction, retail trade and services (excluding retail trade).

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; OECD (2017), *OECD Employment and Labour Market Statistics* (database), February; and OECD (2017), *Main Economic Indicators* (database), February.

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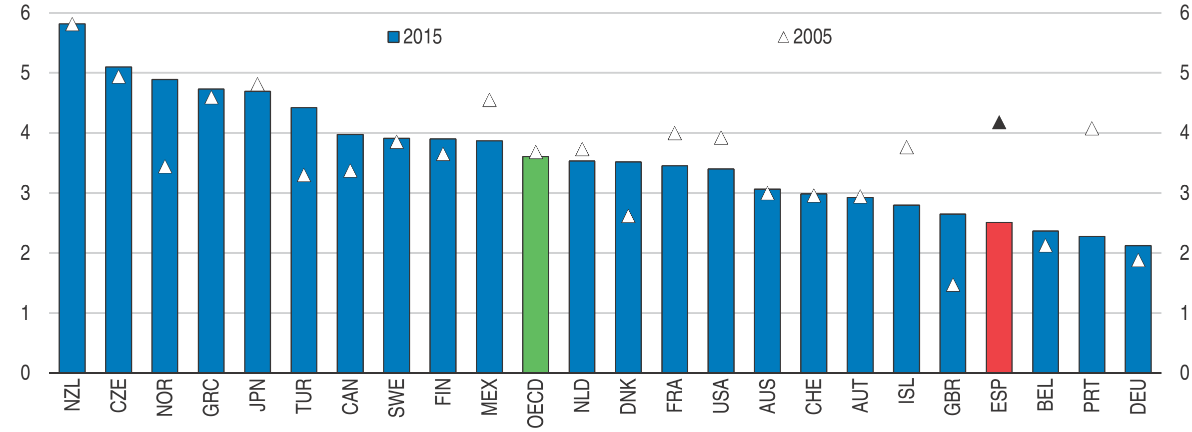
could damp private sector confidence and raise the cost of public-debt servicing. Spain exposure to "Brexit" (i.e. the exit of the United Kingdom from the EU) is estimated to be moderate (OECD, 2016b). Stronger demand from Europe, Spain's main export destination, could boost growth more than projected, as could higher construction investment, which has so far been tepid in the wake of the housing collapse. Economic prospects are also subject to medium-term uncertainties, the probabilities and consequences of which are difficult to quantify in terms of risks to the projections (Box 2).

Figure 3. **Public investment is low**

Government gross fixed capital formation, as a percentage of GDP, 2015[1]



1. The OECD aggregate is calculated as the unweighted average of the data shown.

Source: OECD (2016), *OECD Economic Outlook: Statistics and Projections* (database), December.

StatLink http://dx.doi.org/10.1787/888933458844

Table 1. **Macroeconomic indicators and projections**

Annual percentage change, volume (2010 prices)

	2013 Current prices (billion EUR)	2014	2015	2016	2017	2018
Gross domestic product (GDP)	**1 025.6**	**1.4**	**3.2**	**3.2**	**2.5**	**2.2**
Private consumption	598.5	1.6	2.9	3.2	2.2	1.6
Government consumption	201.8	-0.3	2.0	0.8	0.9	1.2
Gross fixed capital formation	192.4	3.8	6.0	3.1	3.6	4.7
Housing	42.5	6.2	3.1	3.7	3.7	2.9
Final domestic demand	992.7	1.6	3.3	2.7	2.2	2.2
Stockbuilding[1]	-0.5	0.3	0.1	0.1	0.1	0.0
Total domestic demand	992.2	1.9	3.4	2.9	2.3	2.2
Exports of goods and services	330.5	4.2	4.9	4.4	4.3	4.4
Imports of goods and services	297.1	6.5	5.6	3.3	3.7	4.5
Net exports[1]	33.4	-0.5	-0.1	0.5	0.3	0.1
Other indicators (growth rates, unless specified)						
Potential GDP	. .	0.4	0.5	0.6	0.7	0.8
Output gap[2]	. .	-10.0	-7.6	-5.1	-3.4	-2.1
Employment	. .	1.2	3.0	2.7	2.4	1.9
Unemployment rate	. .	24.4	22.1	19.6	17.5	16.1
GDP deflator	. .	-0.3	0.5	0.3	1.3	1.4
Consumer price index (harmonised)	. .	-0.2	-0.6	-0.3	1.9	1.8
Core consumer prices (harmonised)	. .	-0.1	0.3	0.7	1.1	1.5
Household saving ratio, net[3]	. .	3.2	2.3	2.0	2.0	2.1
Current account balance[4]	. .	1.1	1.4	2.1	2.2	2.2
General government fiscal balance[4]	. .	-6.0	-5.1	-4.6	-3.4	-2.8
Underlying general government fiscal balance[2]	. .	0.6	-0.1	-1.2	-1.2	-1.5
Underlying government primary fiscal balance[2]	. .	3.3	2.4	1.1	0.8	0.3
General government gross debt (Maastricht)[4]	. .	100.4	99.8	99.3	99.6	99.4
General government net debt[4]	. .	82.3	82.0	83.8	84.2	83.9
Three-month money market rate, average	. .	0.2	0.0	-0.3	-0.3	-0.3
Ten-year government bond yield, average	. .	2.7	1.7	1.4	1.0	1.0

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

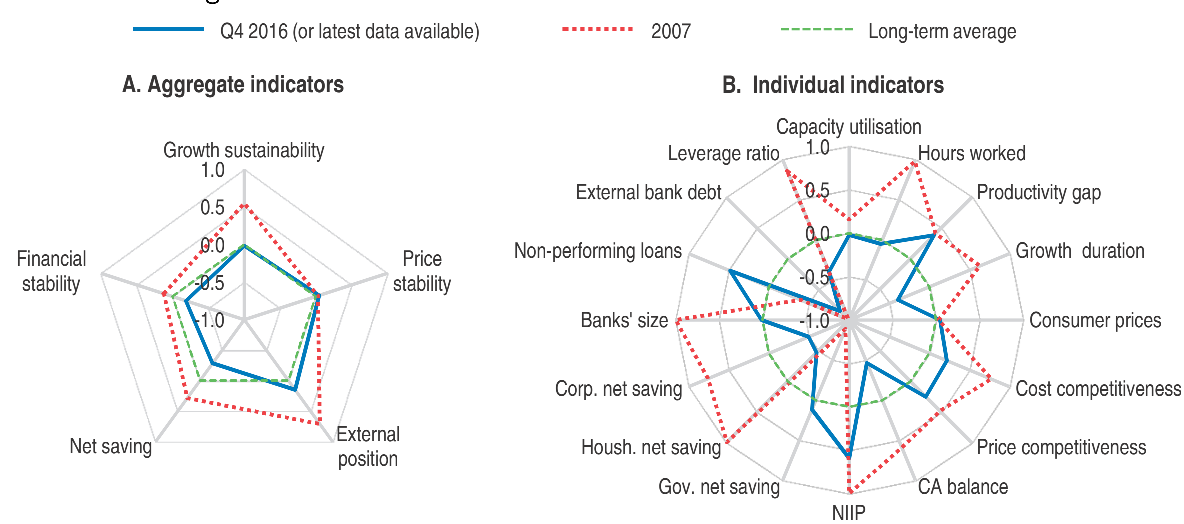
Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), March, projections revised as of 3 March 2017.

Box 2. **Medium-term uncertainties about the Spanish economy's growth prospects**

Uncertainty	Possible outcome
Global trade wars and a disorderly exit of the UK from the EU	Affect Spanish export growth, foreign investment and confidence.
A deterioration of the European banking system's financial health	A deterioration of banks' financial health in some European countries could have ripple effects across the EU and beyond, engendering financial turmoil and higher interest rates for the sovereign and the corporate sector.

Macro-financial vulnerabilities have decreased since 2007 (Figure 4). The banking sector has become significantly stronger and private sector indebtedness is declining (Figure 5, Panel A). However, Spain faces high public and external debt (Figure 5, Panels B and C). In particular, Spain's negative net international investment position at nearly 90% of GDP is large in historical and international perspective (Banco de España, 2016a). The bulk of the external liabilities is public debt and central bank borrowing, but risks are mitigated as public debt is mainly long-maturity (Figure 5, Panel D).

Figure 4. **Evolution of macro-financial vulnerabilities since 2007**



1. Each aggregate macro-financial vulnerability indicator is calculated by aggregating (simple average) normalised individual indicators. Growth sustainability includes: capacity utilisation of the manufacturing sector, total hours worked as a proportion of the working-age population (hours worked), difference between GDP growth and productivity growth (productivity gap), and an indicator combining the length and strength of expansion from the previous trough (growth duration). Price stability includes headline and core inflation (consumer prices), and it is calculated by the following formula: absolute value of (core inflation minus inflation target) + (headline inflation minus core inflation). External position includes: the average of unit labour cost based real effective exchange rate (REER), and consumer price based REER (cost competitiveness), relative prices of exported goods and services (price competitiveness), current account (CA) balance as a percentage of GDP and net international investment position (NIIP) as a percentage of GDP. Net saving includes: government, household and corporate net saving, all expressed as a percentage of GDP. Financial stability includes: banks' size as a percentage of GDP, the share of non-performing loans in total loans, external bank debt as percentage of total banks' liabilities, and capital and reserves as a proportion of total liabilities (leverage ratio).

Source: OECD calculations based on OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; OECD (2017), *Main Economic Indicators* (database), February; OECD (2017), *OECD National Accounts Statistics* (database), February; Banco de España (2017), "Statistical Bulletin, 01/2017", January; and Thomson Reuters Datastream.

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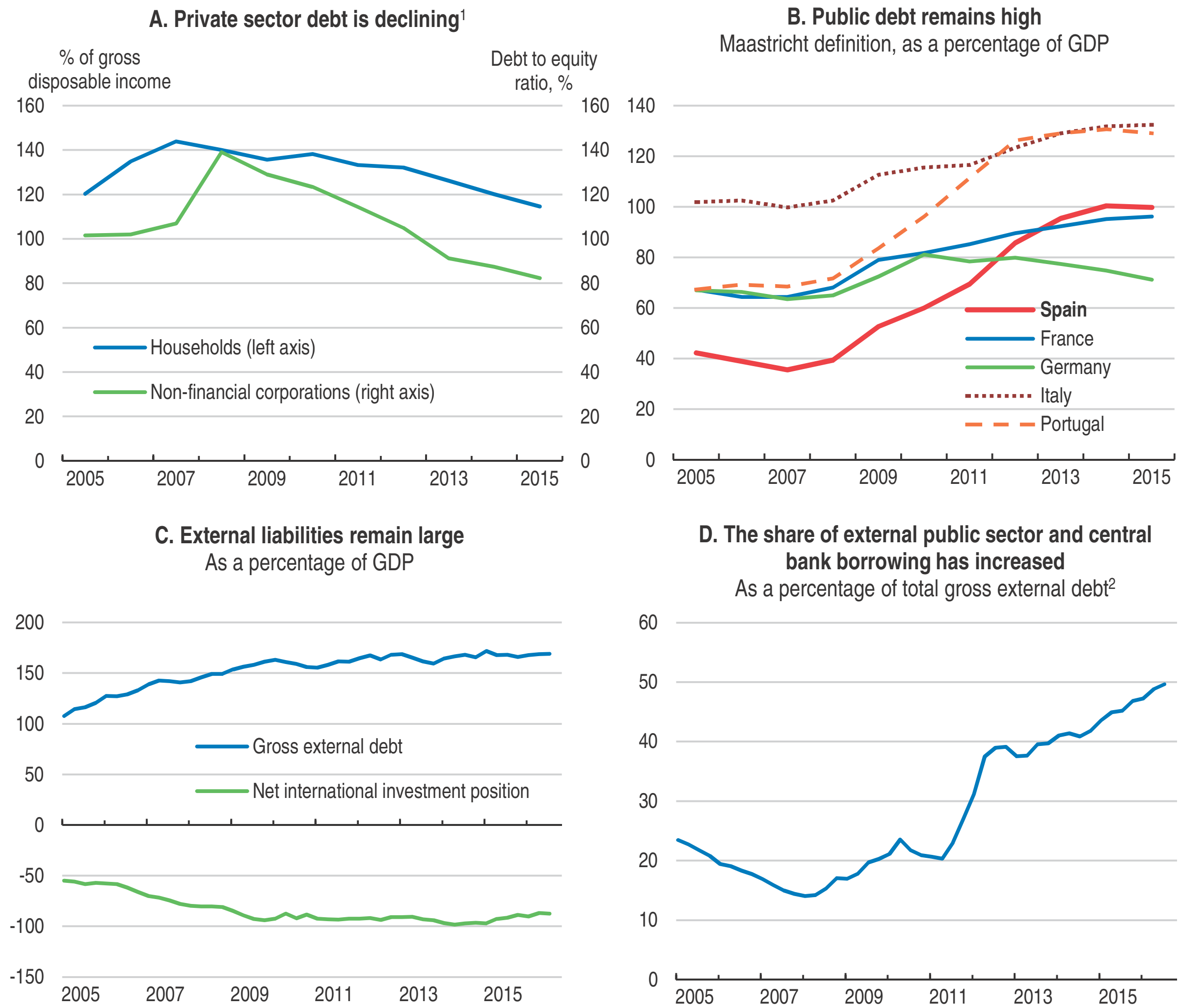
Figure 5. **Macroeconomic and financial vulnerabilities**



1. Debt is calculated as the sum of the following liability categories, whenever available/applicable: currency and deposits, securities other than shares (except financial derivatives), loans, insurance technical reserves and other accounts payable. Households also include non-profit institutions serving households.
2. Public sector borrowing refers to general government debt.

Source: OECD (2017), "Financial Dashboard", *OECD National Accounts Statistics* (database), February; OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; and Banco de España (2017), "Statistical Bulletin, 01/2017", January.

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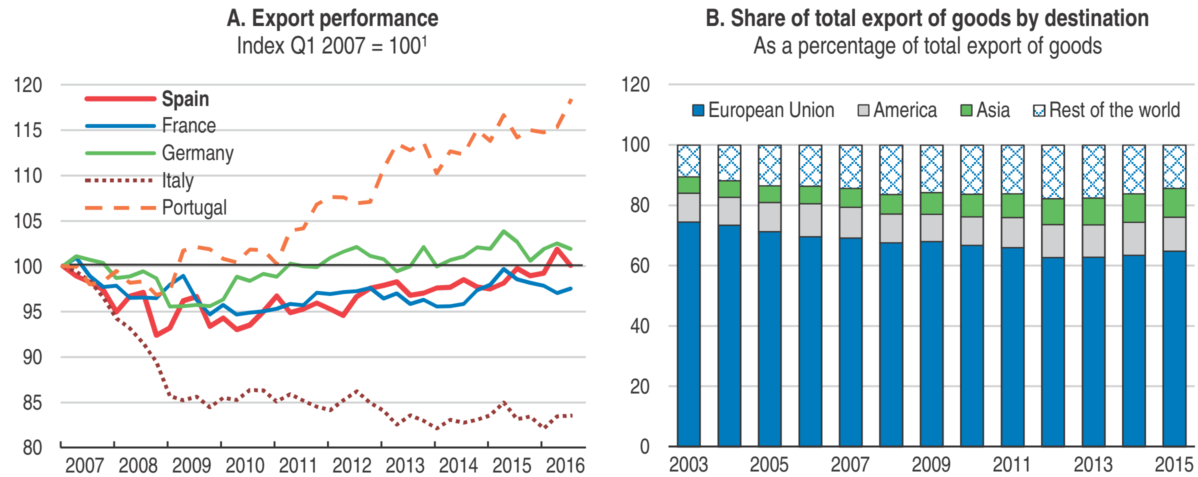
The current account improvement in recent years is in part structural, due to improved competitiveness, a greater internationalisation of Spanish firms and wider geographical diversification of exports (Figure 6), but is also due to temporary factors, such as depressed domestic demand in the recession, especially investment and lower oil prices (Banco de España, 2016a; European Commission, 2016a). Moreover, there has been a reduction in the net international debt position as a share of GDP, albeit moderate, due to an increase in the market price of external liabilities. A prolonged period of large current account surpluses will be needed to put it on a firmly declining path. This adjustment will depend on sustained competiveness gains stemming from faster productivity growth, innovation and attracting more foreign direct investment (Chapter 2).

Figure 6. **External developments**



1. Export performance is the ratio of export volumes to export markets for total goods and services.
Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; and INE (2017), "Main foreign trade results", *INEbase*, National Statistics Institute, January.

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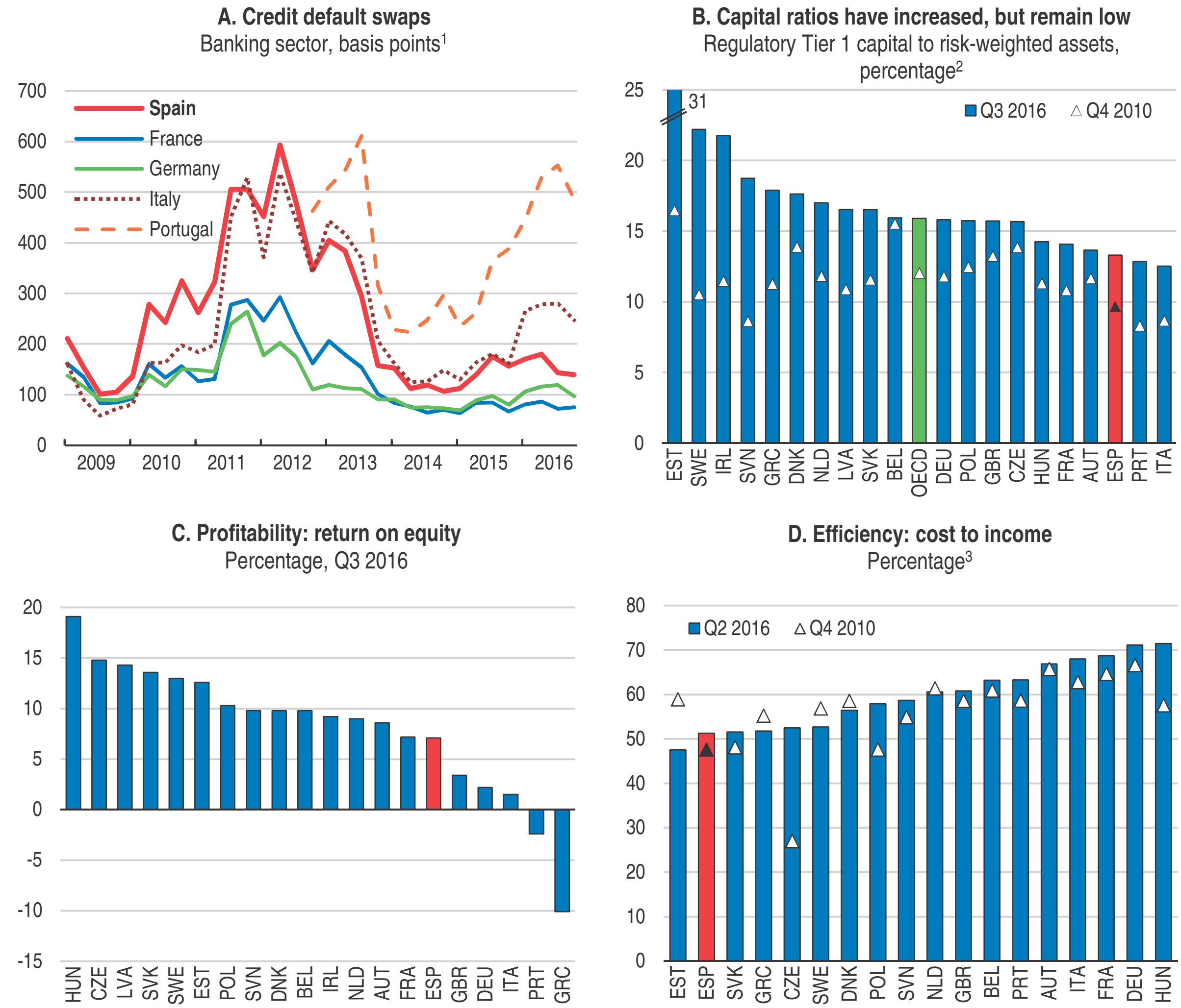
Bolstering the financial sector to raise credit growth

The banking system is stronger, but some challenges remain

Substantial restructuring and the economic recovery have materially strengthened the banking system. In the European Banking Authority (EBA) stress tests of July 2016 the six largest Spanish banking groups comfortably met capital requirements. Credit default swaps have fallen sharply since the peak, but are above those in France and slightly above those in Germany; capital ratios have risen, but are still below OECD average; and profitability is low as in the other euro area countries (Figure 7, Panels A, B and C). Cost-to-income ratios are low and have fallen, following the downsizing of infrastructure and staff (Figure 7, Panel D), but there is still scope for some consolidation to support profitability. Spanish banks still have a large number of bank branches (Figure 8).

Non-performing loans (NPLs) have been declining as a share of total loans (Figure 9, Panel A), but are still somewhat above the OECD average. NPLs net of provisions amount to 30% of banks' capital (Figure 9, Panel B) which is above the OECD average. Foreclosed assets, mostly also from the construction sector as a legacy of the crisis, still weigh on banks' balance sheets and have slightly declined since 2012 (Banco de España, 2016b). The government and the Bank of Spain have put in place a number of measures to reduce non-productive assets from banks' balance sheets, including transfer of NPLs to an asset management agency (OECD, 2014a and Box 1). They also increased provisioning requirements, imposed stricter criteria on forbearance and reformed the insolvency framework. Reforms in 2014 and 2015 to facilitate the restructuring of corporate and household debt (see below) should help to reduce further these unproductive assets in the medium term. NPLs are likely to continue to decline, but if they don't further action may be needed to strengthen banks' balance sheets.

Figure 7. **Banking sector indicators are still below par**



1. Five-year senior debt, mid-rate spreads between the entity and the relevant benchmark curve; end of quarter data. For Spain the series shown is an average of three banks – Banco Popular Español, Banco Santander and BBVA; for other countries the number of banks used in the calculation depend on data available.
2. Q2 2016 instead of Q3 2016 for France, Greece, Italy and the United Kingdom. The OECD aggregate is an unweighted average of the latest data available for 33 OECD countries.
3. Data refer to domestic banking groups and stand-alone banks.

Source: Thomson Reuters Datastream; IMF (2017), *Financial Soundness Indicator* (database), International Monetary Fund, February; EBA (2017), "Risk Dashboard: Data as of Q3 2016", European Banking Authority, January; and ECB (2017), "Supervisory and prudential statistics: Consolidated banking data", *Statistical Data Warehouse*, European Central Bank, February.

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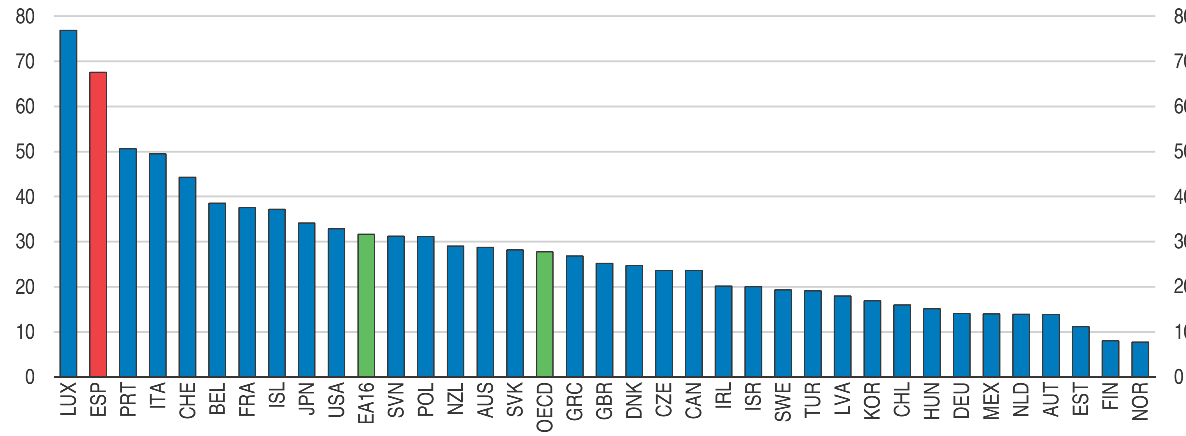
Credit growth is still weak

Lending to the domestic private sector fell substantially during the crisis and continued declining during the recovery, but it is now recovering (Figure 10, Panel A). Lending rates for all loan categories have fallen too (Figure 10, Panel B). Gross credit flows have shown positive growth rates in most segments since early 2014. One exception is new lending to large companies, which has declined recently. This reflects that large companies rely now more on market financing as the cost of market-based debt has declined more significantly than the cost of bank lending, in part thanks to the ECB asset purchase programme.

Figure 8. **There is scope for reducing operating expenses in the Spanish banking system**

Number of commercial bank branches per 100 000 adults, 2015[1]



1. 2013 for the United Kingdom. The euro area aggregate (EA16) refers to euro area countries that are also OECD members and it is calculated as an unweighted average. The OECD aggregate is calculated as an unweighted average of the data shown.

Source: World Bank (2017), *World Development Indicators* (database), February.

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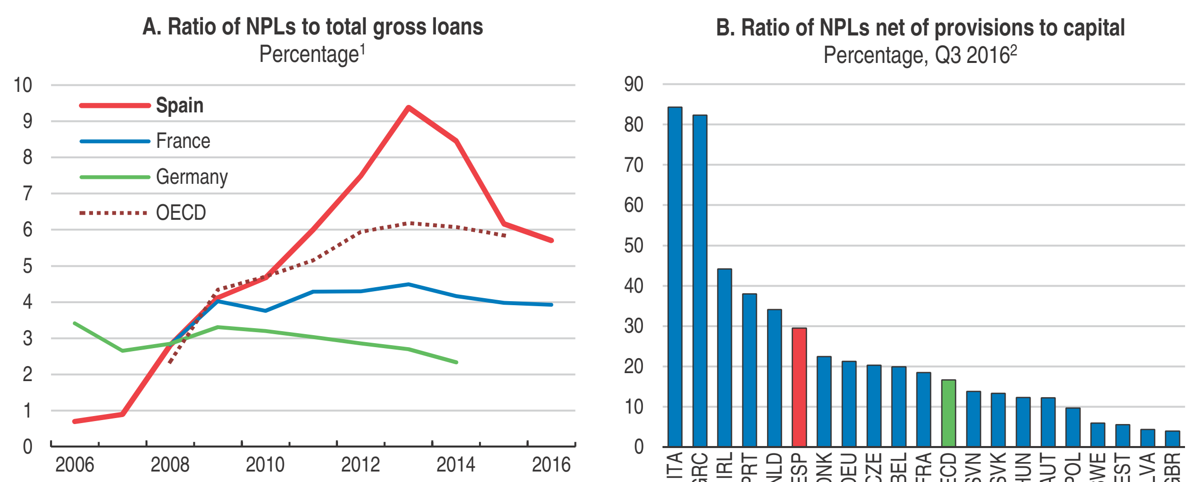
Figure 9. **Non-performing loans (NPLs) are falling, but are still high**



1. Data for 2016 refer to Q3 2016 for Spain and Q2 2016 for France. As the OECD aggregate is an unweighted average of the data available at each data point, the countries included in the OECD aggregate vary over time.
2. Q2 2016 for France, Greece, Italy and the United Kingdom. 2014 for Germany. The OECD aggregate is an unweighted average of the latest data available for 33 OECD countries.

Source: IMF (2017), *Financial Soundness Indicators* (database), International Monetary Fund, February.

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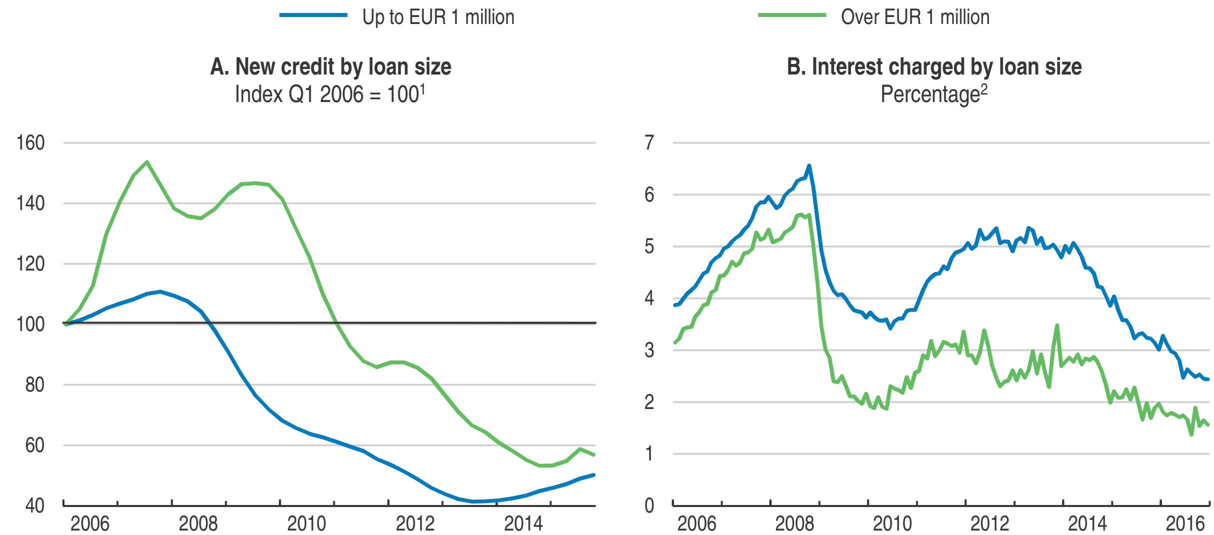
While access to finance for small and medium-sized enterprises (SMEs) has eased significantly since 2013 both in terms of costs and the availability of funds as indicated by surveys on the access to finance by enterprises (ECB, 2016a), new loans to SMEs remain well below historical averages. Evidence from the Bank of Spain suggests lending is flowing to a greater extent than it did before the crisis to financially sounder and more productive firms (Banco de España, 2015; European Investment Bank, 2016). This is a welcome development. To strengthen future productivity lending needs to flow to newer, innovative and fast growing companies that often face additional constraints in accessing lending because of their lack of collateral or track record.

Figure 10. **Credit flows have stabilised and lending rates are declining**

Lending to non-financial corporations



1. Quarterly figures are calculated as 12-month moving average of monthly data.
2. Data refer to new business loans other than revolving loans and overdrafts, convenience and extended credit card debt.

Source: Banco de España; and ECB (2017), "Financial markets and interest rates: Bank interest rates", *Statistical Data Warehouse*, European Central Bank, February.

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The Law on the Promotion of Business Financing adopted in 2015 aims to improve access to bank credit for SMEs and to develop alternatives to bank funding. As regards bank financing, the law seeks to strengthen the position of SMEs towards banks and to improve the regime of mutual guarantee funds. To mitigate information asymmetries, from now on banks have to notify SMEs at least three months in advance if a credit line is going to be cancelled or significantly reduced, as well as provide an assessment of the financial position of the SME and its creditworthiness to facilitate their search for alternative sources of financing. SMEs have also the right to request a credit assessment from their lenders. The law also intends to improve access to capital markets, principally the alternative stock market (MAB) and the alternative fixed-income securities market (MARF), which is welcome. Other measures to broaden the role of capital markets and help the banking and capital markets work more in tandem, as discussed below, could also help to improve the flow of credit to firms of all sizes and stages of development.

Access to credit by SMEs would be further improved by facilitating the assessment of their creditworthiness. In the context of the Law on the Promotion of Business Financing, the Bank of Spain has developed a standardised credit assessment for SMEs, as recommended in the *2014 OECD Economic Survey*, which commercial banks are required to use when making their assessment of SMEs creditworthiness. In addition, SMEs have the right to demand this assessment. Commercial banks should be required to publish prominently that SMEs have the right to demand this assessment. These measures will allow SMEs to provide relevant standardised credit information to alternative lenders, reducing information asymmetries, and will facilitate their access to alternative sources of financing.

Fiscal policy

Managing limited fiscal space

Spain has made a considerable effort to reduce public deficits from 2012, when the deficit peaked at 10.5% of GDP, including financial assistance. This has resulted in substantial progress. The budget deficit is expected to decline to 4.6% of GDP in 2016 from 5.1% in 2015. The deficit reduction was driven by dynamic growth and some consolidation measures, including expenditure cuts for the central and regional government and recent amendments to the corporate income tax to make up for a loss in revenue. On the basis of current government plans, the fiscal deficit will be reduced below 3% by 2018. This fiscal path will provide modest support in 2017 and 2018 and debt will stabilise at around 100% by end-2018. While more demand is needed to raise growth further and reduce unemployment significantly, high debt and deficits limit the scope for further fiscal expansion.

Table 2. **Fiscal indicators**

As a percentage of GDP

	2013	2014	2015	2016[1]	2017[1]	2018[1]
Spending and revenue						
Total revenue	38.6	38.9	38.6	38.4	38.4	37.9
Total expenditure	45.6	44.9	43.8	43.0	41.8	40.6
Net interest payments	2.9	3.0	2.7	2.4	2.1	1.8
Budget balance						
Fiscal balance	-7.0	-6.0	-5.1	-4.6	-3.4	-2.8
Primary fiscal balance	-4.1	-3.0	-2.4	-2.2	-1.4	-1.0
Cyclically adjusted fiscal balance[2]	0.4	0.8	-0.1	-1.2	-1.2	-1.5
Underlying fiscal balance[2]	0.7	0.6	-0.1	-1.2	-1.2	-1.5
Underlying primary fiscal balance[2]	3.3	3.3	2.4	1.1	0.8	0.3
Public debt						
Gross debt (Maastricht definition)	95.4	100.4	99.8	99.3	99.6	99.4
Net debt	69.7	82.3	82.0	83.8	84.2	83.9

1. Projections.
2. As a percentage of potential GDP. The underlying balances are adjusted for the cycle and for one-offs. For more details, see OECD Economic Outlook Sources and Methods.

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), March, projections revised as of 3 March 2017.

Prudent fiscal management should be combined with reforms of the tax structure that raise long-term growth. There is room to improve the tax mix, as the structure of taxation remains tilted towards labour income which penalises growth and employment, as discussed below. Greater expenditure efficiency, as the government has recently committed to would also be welcome. The fiscal council will carry out a review of the general government spending in 2017. Moreover, a new public administration reform programme would yield EUR 900 million in savings over 2017-19. These measures could help to finance current spending needs, such as labour market programmes to effectively fight youth and long term unemployment.

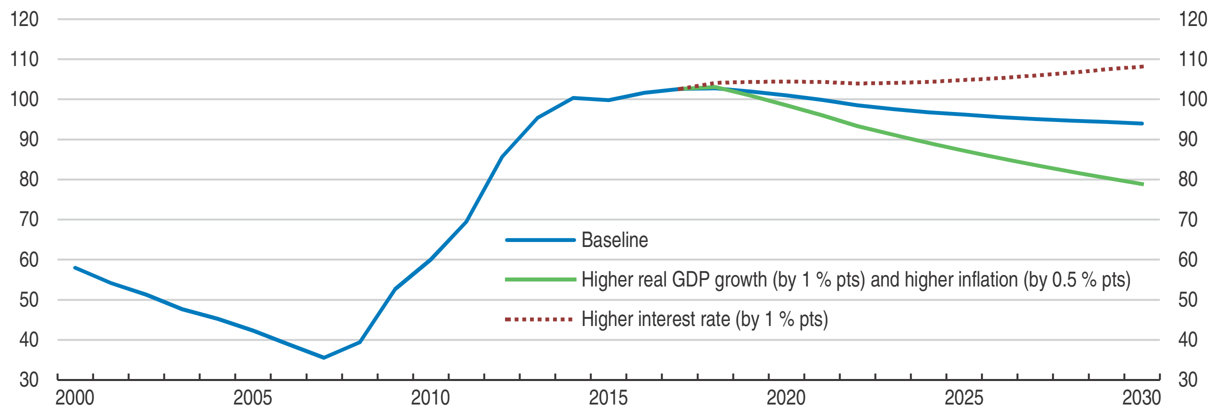
The new government should stick to its medium-term fiscal targets to allow a steady reduction of the debt ratio. Under current government plans, which assume medium-term nominal GDP growth of 3% a year from 2018 onwards and a primary surplus of 0.9% of GDP by 2022, public debt is projected to decline very slowly to 94% of GDP by 2030 (the baseline

Table 3. **Past OECD recommendations on fiscal policy**

Recommendations in 2014 *Economic Survey*	Actions taken since 2014
As specified in the government's medium-term fiscal plan, return to a cyclically-adjusted primary fiscal balance by 2017.	Despite some slippage with respect to targets, Spain has made substantial progress in reducing public deficits since 2012.
Shift the balance from labour to indirect taxes by cutting employer social security contributions for low-skilled workers, increasing environmental and real estate taxes, and narrowing exemptions to value-added tax, corporation and income taxes.	Between February 2015 and August 2016 social security contributions for employers were reduced, by exempting the first EUR 500 of workers' salaries employed on all new permanent contracts for two years. The 2014 fiscal reform has reduced the tax wedge and the tax burden on labour. Deductions for contributions to personal pension plans were tightened in 2015. A number of measures were introduced in December 2016 to broaden the corporate income tax base.
Broaden the corporate income tax base, lower the rate and eliminate special regimes for small and medium-sized enterprises.	The standard corporate income tax rate was lowered to 25% in 2016 from 28% in 2015 and 30% in 2014. The special regime for SMEs has been eliminated. Some measures were taken to broaden the corporate income tax base.

Figure 11. **Illustrative public debt paths**

General government debt, Maastricht definition, as a percentage of GDP[1]



1. The baseline consists of the projections for the Economic Outlook No. 100 until 2018. Thereafter assumptions are: real GDP growth progressively closing the output gap and from 2023 growing by 0.9% corresponding to the potential growth rate; a primary balance gradually reaching a surplus of 0.9% of GDP by 2022 as set out in the national reform programme and remaining constant thereafter; inflation rising progressively to 2% by 2030 and an average effective interest rate of 2.7% from 2018. The "higher inflation and higher GDP growth" scenario assumes higher inflation by 0.5 percentage point and higher real GDP growth by 1 percentage point per year, both from 2019. The "higher interest rate" scenario assumes higher interest rate by 1 percentage point from 2019.

Source: Calculations based on OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November.

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in Figure 11). In a positive scenario of higher growth, the debt ratio would fall further to 79% of GDP. However, the decline in public debt would not materialise and debt could reach close to 110% by 2030 (Figure 11) in an adverse alternative scenario where interest rates were one percentage point higher than the baseline assumptions. As noted above, renewed turbulence in international financial markets could damp private sector confidence and conceivably raise the cost of public-debt servicing.

The 2012 Law on Budgetary Stability and Financial Sustainability strengthened the fiscal framework by putting in place explicit deficits, debt and expenditure targets for each level of government and setting up procedures for annual budgetary objectives, monitoring and sanctions in case of non-compliance. These mechanisms have been bolstered by the creation of a fiscal council in 2013. The implementation of the stability law has faced some challenges with deficit and spending targets often missed. In 2016 additional corrective measures were applied, such as additional conditionality when accessing liquidity and budget appropriation cuts of EUR 1.5 billion to meet the deficit targets.

The additional conditionality on accessing liquidity is welcome since regional liquidity mechanisms in the form of conditional loans at low interest rates from the central government have helped regions, but could lead also to risky fiscal behaviour (Banco de España, 2016a; IMF, 2015; Cuenca and Ruiz Almedral, 2014). Transparency has improved with the monthly publication since 2016 of the actions to comply with the expenditure rule, which has been missed by all levels of government in the past, and regions adjustment plans to meet their targets.

Dealing with spending pressures due to aging

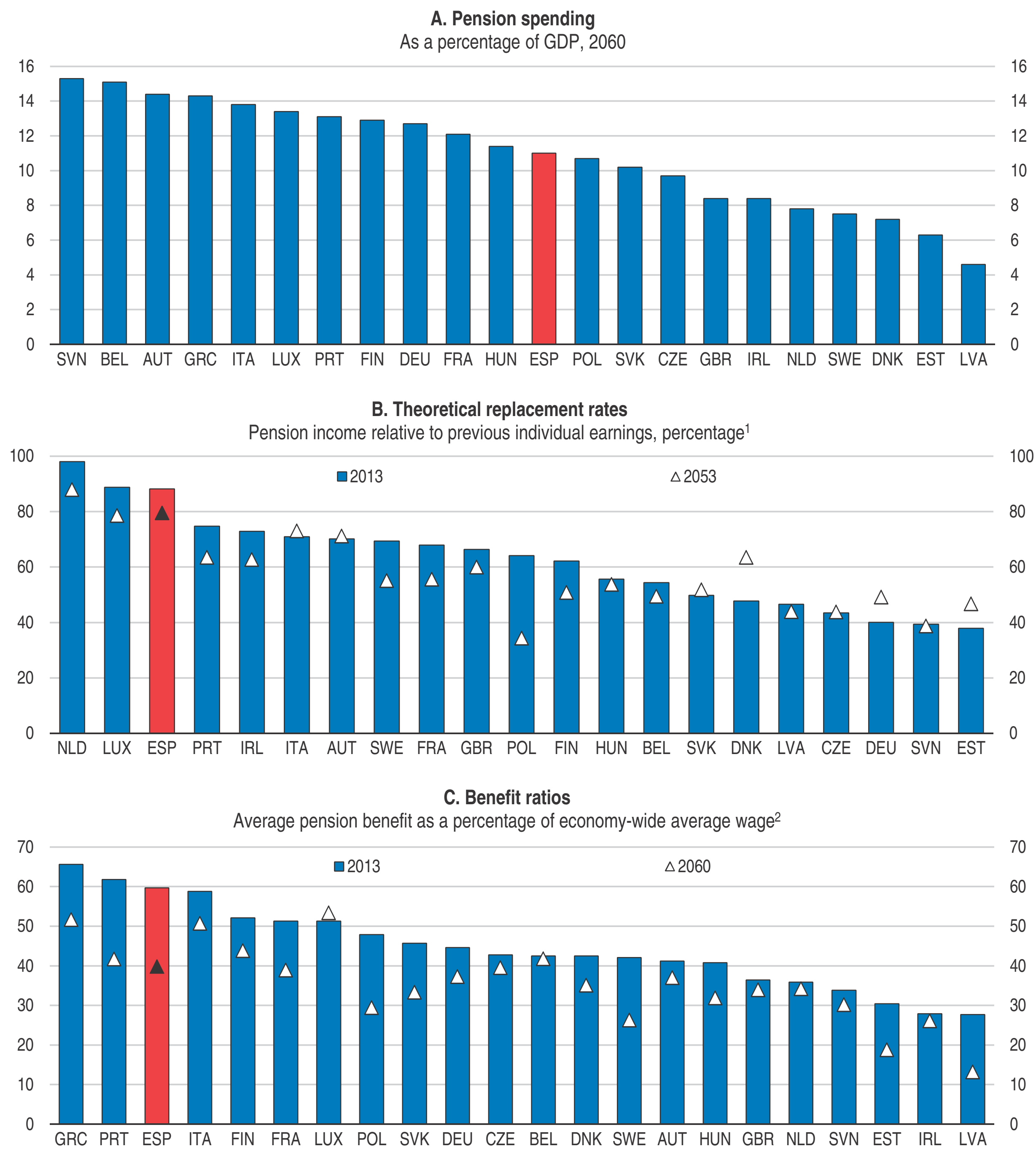
Fiscal sustainability could also be negatively impacted by contingent liability risks, such as high pension spending. Spain's social security regime faces the impact of population ageing and the legacy of the crisis, which has cut revenues. The problem has been crystallised in the public debate by the prediction that the pension Reserve Fund will be exhausted by end-2017. Important pension reforms in 2011 and 2013 (Box 1) will help dampen the increase in aging-related spending in the longer-term. The government estimates that these reforms will result in 2.5% of GDP lower spending by 2060 (Government of Spain, 2016). As a result pension spending is expected to be 11% of GDP in 2060 (Figure 12, Panel A), slightly decreasing from 11.8% of GDP in 2013 (European Commission, 2015). These projections suggest that the reforms substantially reduce fiscal sustainability risks in the long-term (European Commission, 2015).

Such projections are subject to considerable uncertainty, though, which may require further reforms. Social security contributions are already high (28% of labour costs compared with an OECD average of 22.4%) and increasing them further to pay for pensions could undermine employment and international competitiveness. Instead, pension financing should be considered in the context of a broader tax reform (see next section), with a view to raising any needed funds in the most efficient way. The theoretical replacement ratio for those with a full career remains very high even after the reform (Figure 12, Panel B). This contrasts with one of the largest reductions in the benefit ratio – the average benefit among all pensioners – among European countries as of 2060 (Figure 12, Panel C). This reflects the effect of shorter contribution periods that is comparatively higher in Spain relative to other EU countries (European Commission, 2015) because of long unemployment spells. The reduction in the benefit ratio calls for reducing unemployment and temporary jobs further (as discussed below) to ensure the adequacy of pensions for as many people as possible. Finally, survivors' pension benefits could be limited to cases of need, as recommended in previous OECD *Surveys* (OECD, 2010).

Tax reform to promote growth, employment and environmental quality

Spain implemented a reform in 2015 and 2016 to make the tax system more redistributive and conducive to growth, including by reducing the tax wedge on labour (OECD, 2014a, Box 1). The share of labour taxation has declined. However, the structure of taxation remains tilted towards labour income which penalises growth and employment (Johansson et al., 2008). In contrast, less distortive recurrent taxes on residential immovable property, value-added tax (VAT) and environmentally-related taxes are somewhat under-exploited (Figure 13). Also, narrow tax bases, in particular for the VAT and the corporate income tax, generate distortions and complexity at the same time as they reduce revenues.

Figure 12. **Spain's pension outlook**



1. Level of pension income in the first year after retirement as a percentage of individual earnings at the moment of retirement. Data refer to those men who contributed to the pension system for 40 years up to the standard pensionable age.
2. The average pension is calculated as the ratio of public pension spending relative to the number of pensioners, whereas the average wage is proxied by the change in the GDP per hours worked. The ratio of these two indicators is intended to provide an estimate of the overall generosity of pension systems.

Source: European Commission (2015), "The 2015 Ageing Report", Directorate-General for Economic and Financial Affairs, March; and European Commission (2015), "The 2015 Pension Adequacy Report", Directorate-General for Employment, Social Affairs and Inclusion, October.

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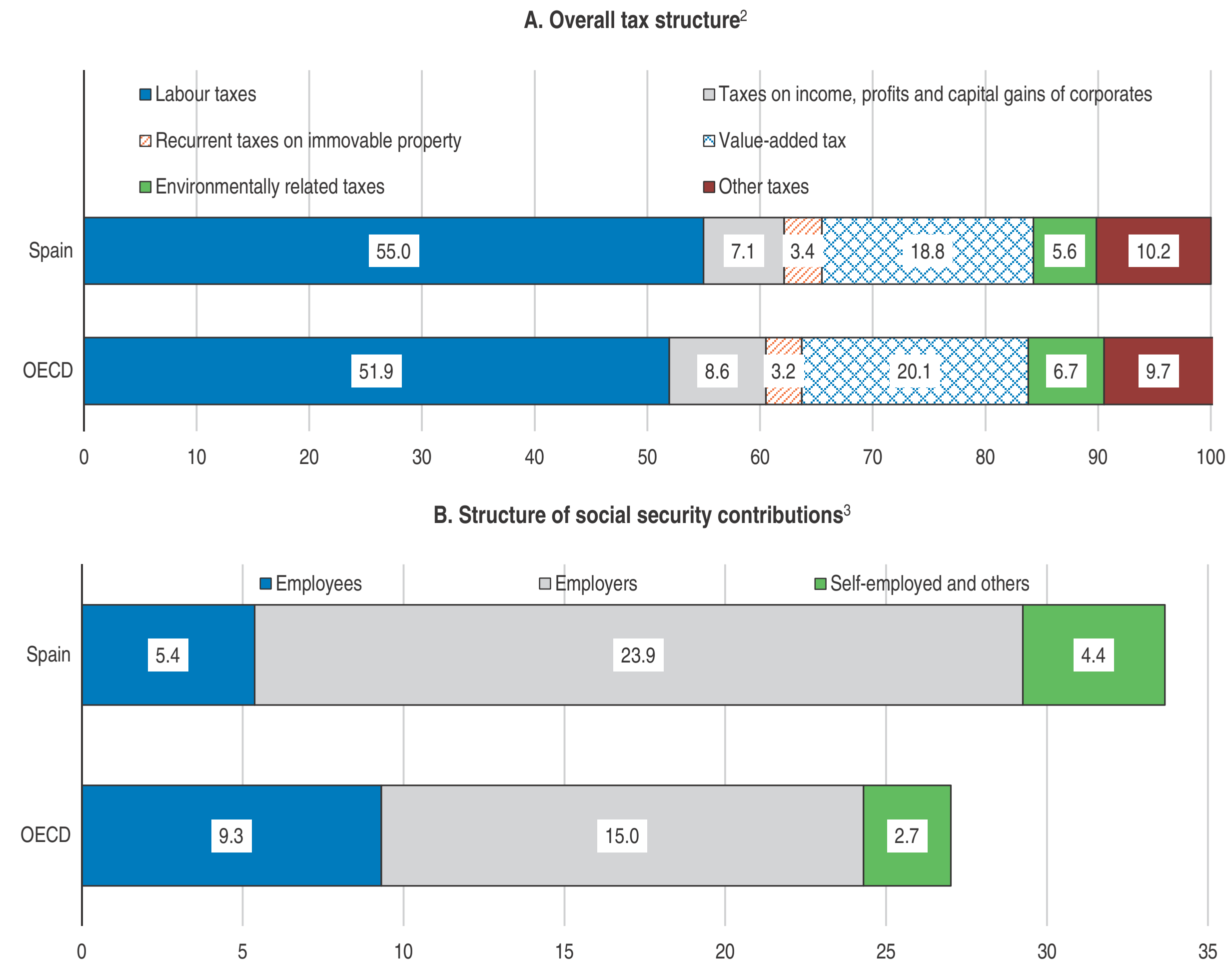
Figure 13. **The tax structure is tilted towards labour taxes**

Tax revenues as a percentage of total tax revenue, 2015[1]



1. The OECD aggregate is calculated as an unweighted average and due to data availability it does not include Australia, Greece, Japan, Latvia, Mexico and Poland.
2. Labour taxes are calculated as the sum of taxes on income, profits and capital gains of individuals, social security contributions and taxes on payroll and workforce. Other taxes include all other taxes on property except for recurrent taxes on immovable property, such as recurrent taxes on net wealth, estate, inheritance and gift taxes, taxes on financial and capital transactions and other recurrent and non-recurrent taxes on property as well as all other taxes on goods and services except for value-added tax.
3. Self-employed and others include social security contributions of self-employed and other tax revenues that are unallocable between employees, employers and self-employed.

Source: OECD (2016), "Revenue Statistics: Comparative tables", *OECD Tax Statistics* (database), December; and OECD (2016), "Green Growth Indicators", *OECD Environment Statistics* (database), December.

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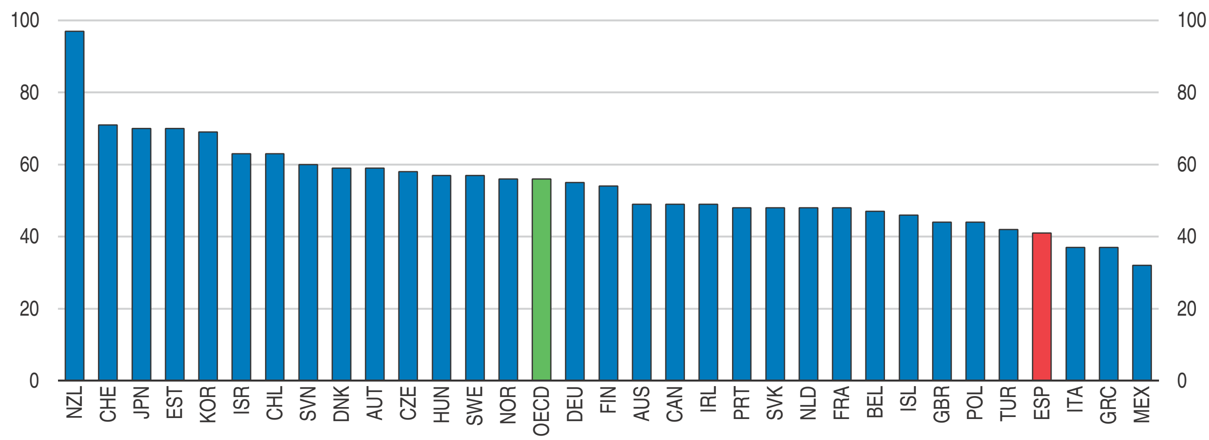
The 2014 personal income tax reform reduced the tax wedge by exempting income up to EUR 12 000 and lowering personal income tax rates, likely contributing to boost labour supply, especially among those with low skills. However, the main focus should remain on creating permanent and quality jobs. A temporary measure to boost permanent jobs between February 2015 and August 2016 temporarily reduced social security contributions (SSCs) for employers by exempting the first EUR 500 of workers' salaries employed on all new permanent contracts for two years. To further support job creation, the government should build on this cut in employer SSCs, making it permanent and also restricting it to low-wage workers. This will have more long lasting positive effects on employment among low-skilled workers, where the need to stimulate labour demand is largest. Such a reduction in employer SSCs should be considered in the context of a broader tax reform to improve the tax structure which is currently titled towards labour income which penalises growth and employment.

Exemptions and reduced rates significantly reduce VAT revenue and are the main factor behind Spain's poor efficiency in VAT collection (Figure 14). Reduced rates on fresh food and other basic necessities are generally redistributive, albeit poorly targeted, but other reduced rates tend to benefit richer households the most (OECD, 2014c). The authorities should reassess the merits of reduced VAT rates and eliminate those which mainly benefit the rich.

Figure 14. **The yield of the value-added tax is relatively low**

Value-added tax revenue ratio, percentage, 2014[1]



1. The VAT revenue ratio (VRR) is defined as the ratio between the actual value-added tax (VAT) revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. This ratio gives an indication of the efficiency of the VAT regime in a country compared to a standard norm. It is estimated by the following formula: VRR = VAT revenue/[(consumption – VAT revenue) × standard VAT rate]. VAT rates used are standard rates applicable as at 1 January of each year. The fact that public consumption is VAT-exempt under EU rules places an upper bound on the attainable VRR, especially in countries with a large public sector, such as Spain. For Canada, the VRR calculation includes federal VAT only. For Japan, given the substantial VAT rate hike on 1 April 2014, an average VAT rate was used to calculate the VRR for 2014. The OECD aggregate is calculated as an unweighted average of the data shown.

Source: OECD (2016), *Consumption Tax Trends 2016: VAT/GST and excise rates, trends and policy issues.*

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There is also scope to improve VAT revenues via better administration and enforcement. Early detection of organised VAT fraud was reinforced in 2015. A new electronic VAT filing system for invoices is foreseen for 2017. The government should continue these efforts. Addressing non-compliance will help to broaden the VAT base and improve public acceptance and trust in the tax system. Excise duties on tobacco and alcohol were recently raised but are still below EU average and could be increased further. In this respect, new measures taken by the government in December 2016 to increase taxes on alcohol, tobacco, as well as creating a new tax on sugary drinks are welcome.

The personal income tax base is eroded by generous deductions and exemptions. Besides lowering revenue, these items make the tax system more complex to manage. As discussed in Haugh and Martínez Toledano (2017), a number of tax exemptions are particularly regressive, including the exemptions on the interest from investing in the primary residence, on renting the primary residence and the deductions for contributions to personal pension plans. Deductions for contributions to personal pension plans were tightened in 2015. While the tax deduction for investing in the primary residence was recently eliminated, the transitory regime is still benefitting all those who purchased their house before 2013. This credit is expected to cost EUR 1.2 billion in 2016 (Ministerio de Hacienda y Administraciones Públicas, 2016) and tends to benefit higher income households. Removing these exemptions provides an opportunity to improve the equity and efficiency of the tax system.

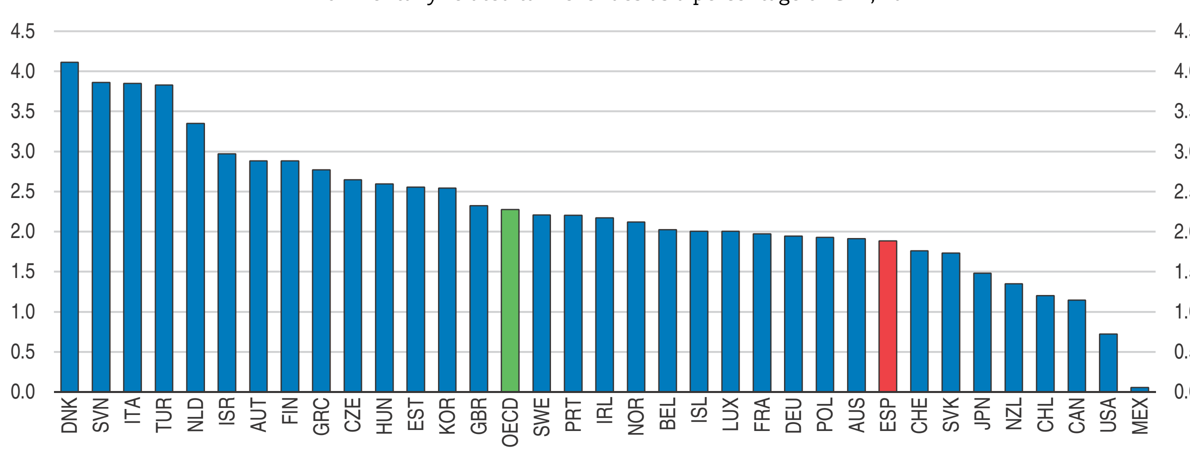
The recent reduction in the standard corporate income tax rate from 30% in 2014 to 25% in 2016 – aligning the tax rate for all firms – is welcome, as evidence suggests that high corporate taxes are relatively harmful for growth (Johansson et al., 2008). However, more could be done to broaden the corporate income tax base. For instance, making depreciation allowances more neutral across asset types and businesses by aligning tax depreciation with the economic depreciation of assets could also contribute to broaden the base and help reduce distortions to capital allocation (OECD, 2014d).

The government has introduced in December 2016 a number of measures to broaden the corporate income tax base affecting large companies that is expected to raise EUR 4.6 billion. Most notably, the measures include limiting how much companies can deduct past losses (25% for companies with net revenues above EUR 60 million and 50% for companies with net revenues between EUR 20 and EUR 60 million). It also further limits the deductibility of impairment losses – i.e. losses that arise because tangible or intangible goods loose value. The government should carefully monitor the impact of these measures. Given the deep economic downturn many businesses have made losses, which they will now partly loose. Such measures might reduce firms' incentives to take risks in the future and could also significantly reduce the attractiveness of Spain as a location for investment.

Spain has considerable scope to make the tax system more environmentally friendly, as environmental tax revenue as a share of GDP is low compared to most OECD countries (Figure 15). There is scope to raise tax rates on fuel for road transport, which are below OECD average. Moreover, diesel is under-taxed relative to gasoline encouraging consumers

Figure 15. **There is room to make the Spanish tax system more environmentally friendly**

Environmentally related tax revenues as a percentage of GDP, 2014[1]



1. 2013 for Poland. The OECD aggregate is calculated as an unweighted average of the data shown.

Source: OECD (2016), "Green Growth Indicators", *OECD Environment Statistics* (database), December.

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to buy diesel cars despite diesel cars produce more CO_2 emissions per litre than gasoline, and diesel cars emit more health damaging air pollutants per kilometre driven. The government should increase taxation per litre of diesel to at least the level of taxes on gasoline, and should increase diesel prices further if differences in local pollution costs are to be reflected in fuel prices. Simulations suggest that additional EUR 4 billion of revenues could be raised by taxing diesel at the same rate in energy terms as gasoline (OECD, 2014d). OECD research shows that carbon prices are not likely to change the competitiveness of affected firms; higher energy prices also do not raise particularly strong distributional concerns (Flues and Thomas, 2015; OECD, 2016c). There is also scope to reduce exemptions to broaden the environmental tax base, as some users in agriculture, mining, aviation, navigation and railway transport are exempted from fuel tax or the excise duty on electricity (OECD, 2015c).

Making growth more inclusive by reducing unemployment and improving job quality

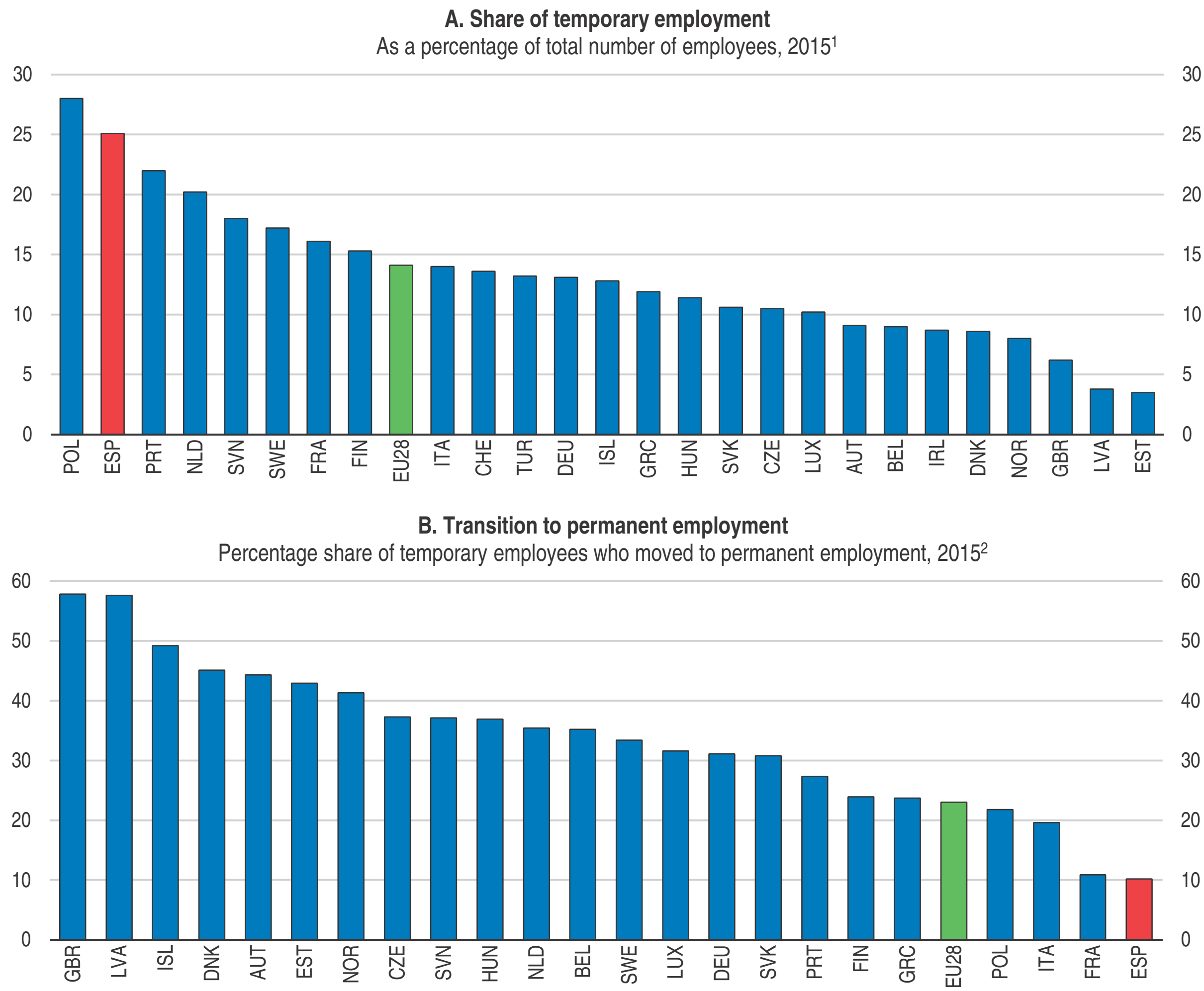
Improving the functioning of the labour market and strengthening the skills of Spanish workers will be paramount to make growth more inclusive and raise well-being. The labour market faces several problems, the most important of them being very high unemployment, a low level of skills, and the high share of long-term unemployed (47.8% of all unemployed in the fourth quarter of 2016).

Moreover, job quality, which deteriorated in the wake of the crisis, needs to improve to make growth inclusive. Job quality, in the form of earnings, labour market security and the quality of the working environment, is important for well-being and productivity (OECD, 2014e; Cazes et al., 2015). Spanish workers faced the highest probability of becoming unemployed in the OECD in 2013, mainly as a result of massive job separation from temporary contracts. Once unemployed, the expected length of unemployment spells was also very high by OECD standards. This is likely to have improved somewhat since then given the labour market recovery, as outflows to unemployment have fallen. However, one quarter of all employees is on temporary jobs, the highest share in the OECD after Poland (Figure 16, Panel A). In addition, Spain also shows the lowest rate of transition from temporary workers into permanent employment (Figure 16, Panel B). Average earnings are also comparatively low reflecting weak worker skills and poor firm productivity (Chapter 1). Finally, job demands on workers such as time pressure or physical health risks are excessive compared to the resources they have, including weak access to training.

The steep rise in joblessness in the wake of the crisis and, to a lesser extent, higher disparity in annual earnings, raised income inequality (Figure 17, Panel A). Jobless people and temporary workers are at the bottom of the income distribution. The poverty rate – measured by the share of households living with less than 50% of the median household disposable income – remains high (Figure 17, Panel B), despite declining somewhat in 2014, and it is likely to have continued declining since given the improvement in the labour market. Poverty is particularly high among jobless households, especially those with children, as reflected by a high child poverty rate of 23.4% compared to an OECD average of 13.3% in 2013.

The tax and transfer system does help to reduce income inequality and poverty (Figure 18) and there is some evidence that suggests that the 2014 tax reform might have contributed to lowering inequality (Instituto de Estudios Fiscales, 2015), but more can be done. Transfers help to reduce poverty, but are low and benefit the better-off (Figure 19).

Figure 16. **Temporary employment remains high**



1. Data refer to those aged 15 years and over.
2. 2014 for Germany, Greece, the United Kingdom and the European Union (EU28) aggregate.

Source: Eurostat (2016), "Employment and unemployment (Labour Force Survey)", *Eurostat Database*, December.

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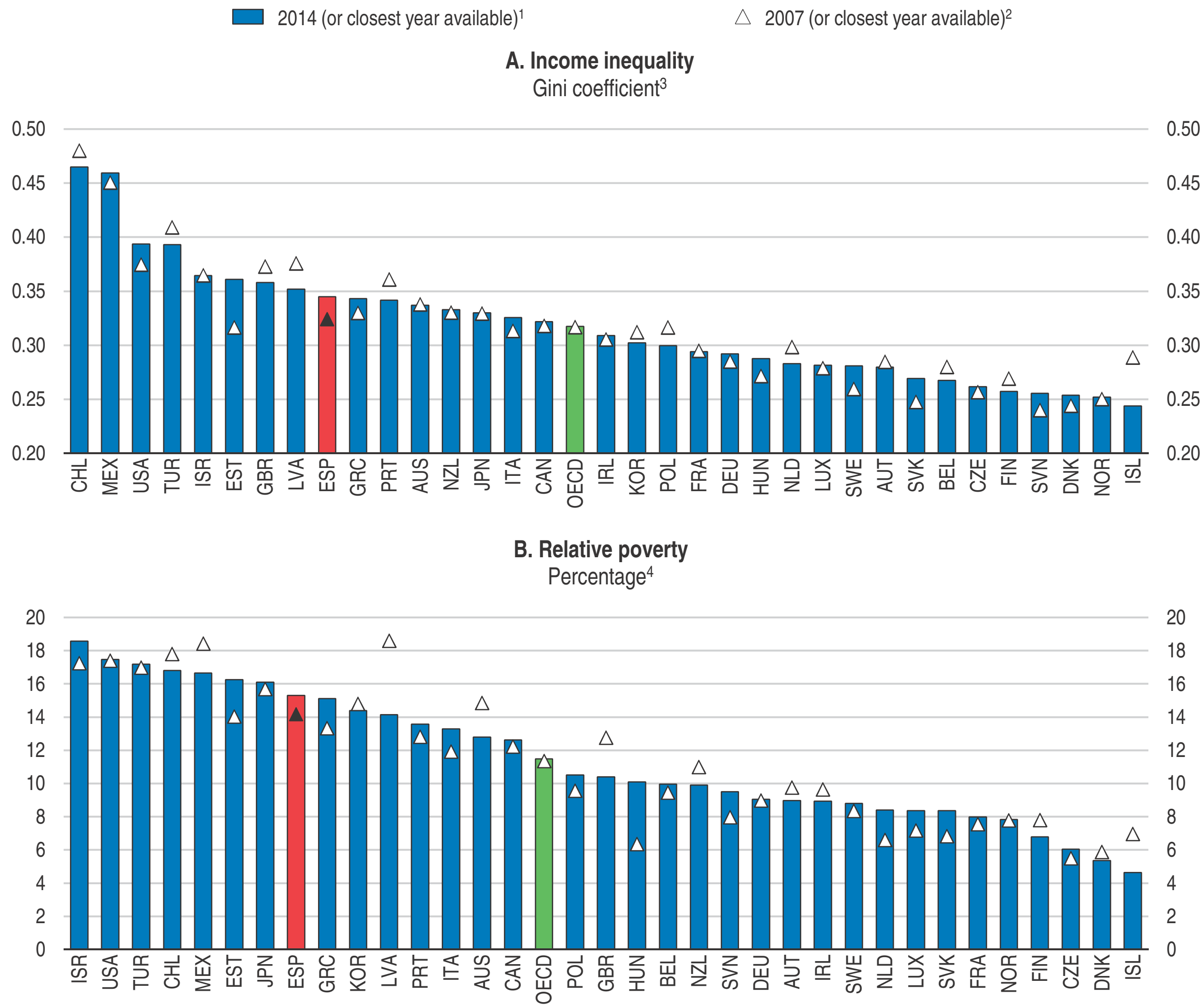
Public support for families is weak in general. Social spending per child is below the OECD average and is particularly low for early childhood, resulting from low spending on family cash benefits and on public childcare services. Family cash benefits accounted for only 0.5% of GDP in 2013, much below the OECD average of 1.2%, and can be enhanced given the high child poverty rate. Reinforcing public childcare services will not only help to alleviate child poverty by reducing childcare costs for poor households, but will also help reconcile work and family life, supporting female labour force participation and encouraging early childhood education – whose benefits in terms of subsequent school attainment are well documented (OECD, 2011; Heckman et al., 2010).

Strengthening social support and getting more people into good jobs

Many unemployed people have exhausted their benefits and thus are at risk of poverty and social exclusion. Social protection for those of working age in Spain consists not only of unemployment insurances and other programmes managed by the central government, but also of minimum income supports schemes run by regional authorities. The regional

Figure 17. **Income inequality and poverty increased during the crisis**



1. Data refer to 2014 for Australia, Finland, Hungary, Israel, Korea, Mexico, the Netherlands, Spain and the United States; to 2012 for Japan and New Zealand; and to 2013 for all other countries.
2. Data refer to 2008 for Australia, France, Germany, Israel, Mexico, New Zealand, Norway, Sweden and the United States; to 2006 for Japan; and to 2009 for Chile; and to 2007 for all other countries.
3. The Gini coefficient is calculated for household disposable income after taxes and transfers, adjusted for differences in household size and it has a range from zero (when everybody has identical incomes) to one (when all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income. The OECD aggregate is calculated as an unweighted average of the data shown.
4. The relative poverty rate is defined as the share of people living with less than 50% of the median disposable income (adjusted for family size and after taxes and transfers) of the entire population. The OECD aggregate is calculated as an unweighted average of the data shown.

Source: Provisional data from the *OECD Income Distribution Database*.

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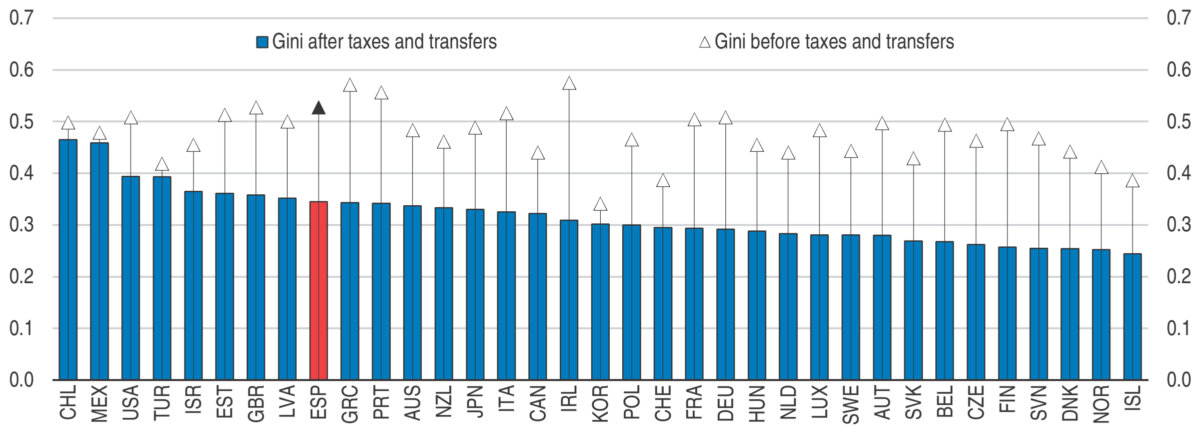
minimum income schemes are generally weak and with limited coverage and effectiveness. Only 1.5% of households received minimum income support in 2014 from the regional schemes. The *Renta Mínima de Inserción* (RMI) is the most common income support scheme for those who are not eligible for unemployment benefits. However, potential beneficiaries of the *Renta Mínima de Inserción* usually need to go through long and cumbersome procedures to qualify. Simplifying these procedures should help improve access and coverage for those eligible.

Figure 18. **Taxation and transfers reduce inequality in household disposable income**

Changes in the Gini coefficient due to taxation and transfers, 2014 or closest year available[1]



1. Data refer to 2014 for Australia, Finland, Hungary, Israel, Korea, Mexico, the Netherlands, Spain and the United States; to 2012 for Japan and New Zealand; and to 2013 for all other countries. The Gini coefficient has a range from zero (when everybody has identical incomes) to one (when all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income.

Source: Provisional data from the *OECD Income Distribution Database*.

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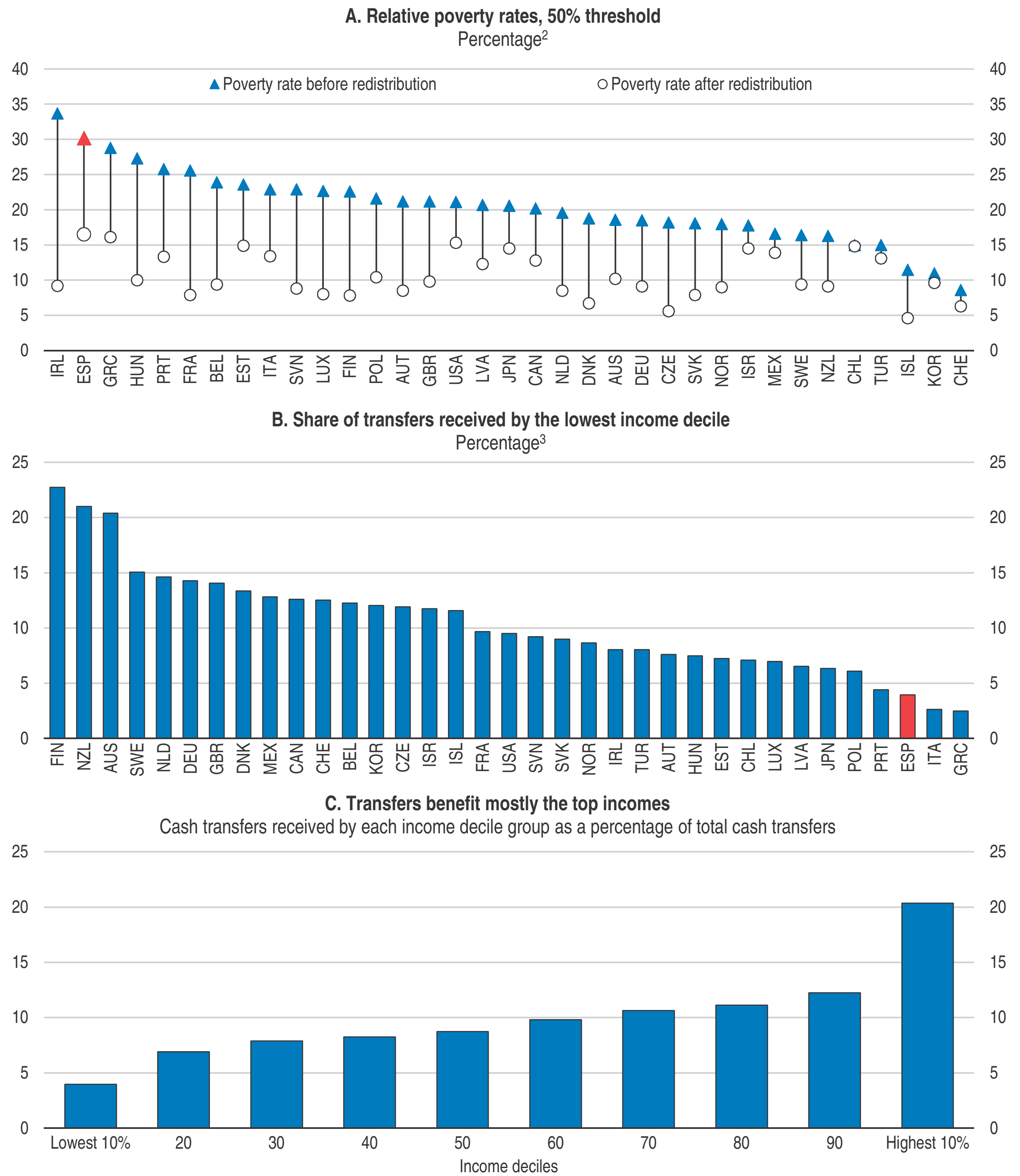
Basic support programmes to address poverty should be rethought. The schemes should be streamlined, and coverage and the amount of support should be raised, especially for families with children. Importantly, the social benefits for jobless people should be strictly conditional on active job search which helps the beneficiaries to stay connected to the labour market through public employment services. Finding a job is the best way to get out of poverty durably. The income support system should also be better co-ordinated with public employment services so that stronger links between protection and activation are built into the system. The benefit should also be withdrawn more gradually as earned income rises, instead of one-for-one reductions in the benefit as it is the case currently, in order not to blunt financial incentives to work.

Policies to get people back into jobs are also critical. Spending on active labour market measures – such as training and job placement – has increased (Table 4). Also, funding from the central government is increasingly conditional on the performance in moving people into work at the regional level, where the programmes are administered. However, spending remains low (Figure 20) and public employment services still struggle to be effective in finding jobs for the unemployed. Recent initiatives have been developed to better profile and serve job seekers and to employ more specialised counsellors. However, the sheer number of unemployed and the multiple barriers they face require more targeting, more efficient use of resources and lower caseloads for staff. In providing support to the long-term unemployed, the regional public employment services should upgrade their services by improving their profiling tools and the co-ordination with social services in providing support. Greater digitalisation could help to improve performance in particular by streamlining processes whilst keeping costs down.

The long-term unemployed need better targeted and more effective programmes. The existing programmes, *Renta Activa de Inserción* (RAI), *Programa de Recualificación Profesional* (PREPARA) and *Programa de Activación para el Empleo*, (PAE) launched at different stages and with different targets could be better co-ordinated or streamlined to become more effective. The PAE – a major package of income support and training targeted at the

Figure 19. **The transfer system can do more to relieve poverty**

Working-age population, 2013[1]



1. 2014 for Australia, Hungary and Mexico. 2012 for Japan and New Zealand.
2. The relative poverty rate is defined as the share of people living with less than 50% of the median disposable income (adjusted for family size) of the entire population.
3. Current transfers received from public social security.

Source: Calculations based on the *OECD Income Distribution Database*.

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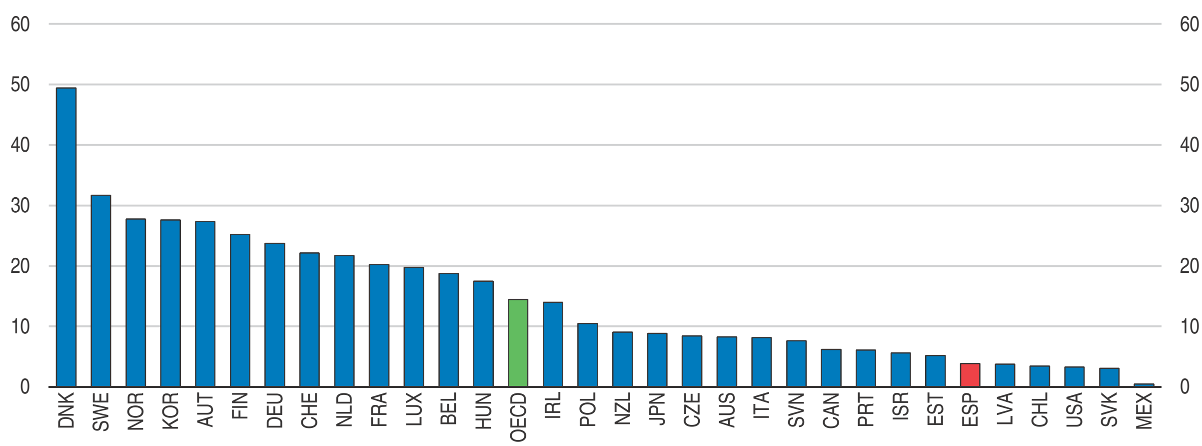
Table 4. **Past OECD recommendations on labour market policies**

Recommendations in 2014 *Economic Survey*	Actions taken since 2014
Strengthen active labour market policies by improving vocational training, increasing the number of staff and efficiency of the public employment service, and enhancing co-ordination between the different levels of administration.	The Activation for Employment Strategy was adopted in September 2014 to enhance co-ordination with regional Public Employment Services (PES). The budget for active labour market programmes has increased (at least by 16% between 2015 and 2016) and funding to regions has been made conditional on regional PES' performance.
To further increase the flexibility of wage bargaining require firms to "opt-in" rather than "opt-out" of sectorial collective agreements, abolish automatic extension of sectorial agreements and impose representation requirements for remaining sectorial collective agreements.	No action.
Further reduce compensation for unjustified dismissal. If the reform does not prove to be effective, a single contract with initially low but gradually increasing severance payments would reduce the still large difference in dismissal costs between temporary and permanent contracts. This would help reduce duality effectively.	No action.

Figure 20. **Spending on active labour market programmes per unemployed workers is low in Spain**

As a percentage of GDP per capita, 2013[1]



1. The OECD aggregate is calculated as an unweighted average of the data shown.
Source: OECD (2016), "Labour market programmes: expenditure and participants", *OECD Employment and Labour Market Statistics* (database), December.

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long-term unemployed with dependants – has helped 15% of its participants find work, which is relatively successful compared with similar programmes in other countries (Card et al., 2015). The experience with this programme on intensified assistance and strict requirements for active job search could be extended more generally. Besides, the financial support of the existing programmes – currently around EUR 400 per month – could be increased, as far as the budget allows, making the programme more effective.

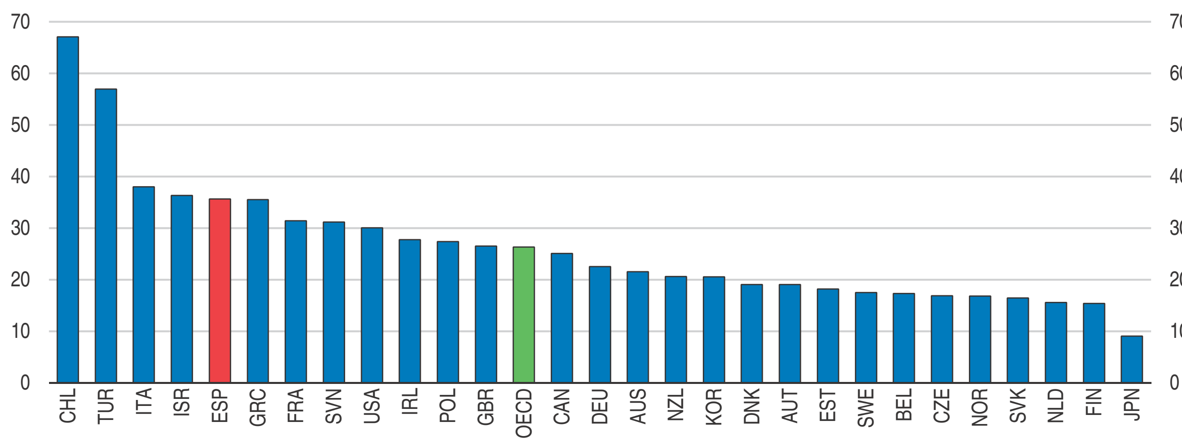
Job search requirements attached to unemployment benefits are an important tool to get people back to work (OECD, 2015b). These exist but the criteria on active job search are not necessarily clear, including those on a suitable job offer which jobseekers have to accept (OECD, 2014a). Moreover, the sanction on non-fulfilment rarely applies. Greater co-ordination between the central government responsible for unemployment benefits and regional authorities in charge of local public employment services is needed, since conditionality of active job search needs to be applied. Progress towards a more integrated support for jobseekers, particularly for the long term unemployed, including a single point of contact for all services and assistance, could help.

Strengthening skills

Strengthening the relatively poor skills of the Spanish workforce will be crucial to get them into good jobs and to boost Spain's growth potential (Figure 21 and Table 5). Monetary support in the programmes for the long-term unemployed should be coupled more closely to re-training in collaboration with vocational education and training (VET) schools or "Adult Education" programmes. Most of the long-term unemployed lack basic skills and recognisable diplomas and substantive retraining could help them gain relevant skills to find new jobs. Spain has a relatively extensive offer of "Adult Education" programmes and these programmes could be reoriented towards work-based training for the long-term unemployed.

Figure 21. **The proportion of low performer adults is high in Spain**

Percentage of adults who score at or below Level 1 in literacy and/or numeracy, 2012[1]



1. 2015 for Chile, Greece, Israel, New Zealand, Slovenia and Turkey. Low-performing adults are defined as those who score at or below Level 1 in either literacy or numeracy. The OECD aggregate refers to the unweighted average of the 28 OECD countries that participated in the OECD Programme for the International Assessment of Adult Competencies (PIAAC). Data for Belgium refers to Flanders. Data for the United Kingdom refer to England.

Source: OECD (2016), *Skills Matter: Further Results from the Survey of Adult Skills*.

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Table 5. **Past OECD recommendations on education policies**

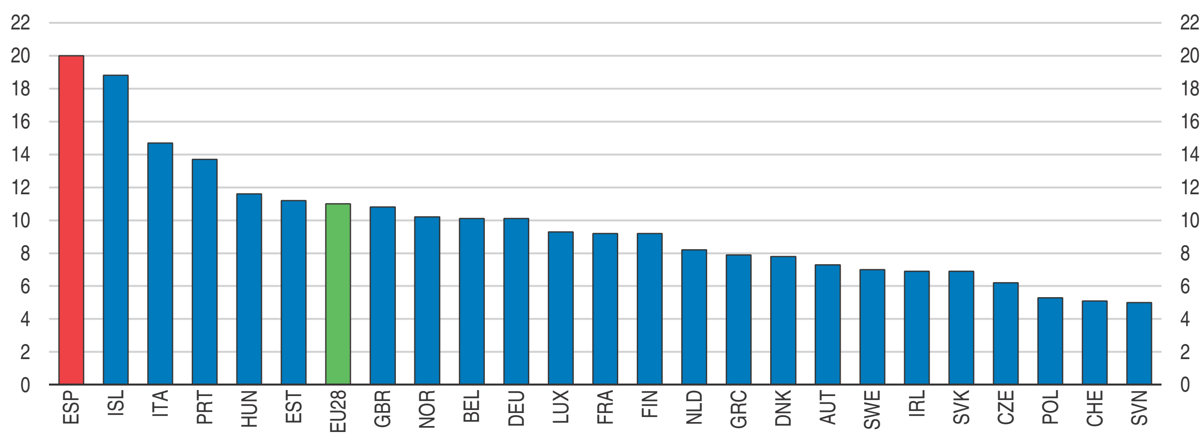
Recommendations in 2014 *Economic Survey*	Actions taken since 2014
Increase the practical component of existing school-based vocational education and training completed at firms.	In secondary VET, the time spent on practical training was increased to at least 60% for all the students. Training takes place either in the education centre or in a firm.
Encourage greater scale and specialisation of universities and research organisations to raise the quality of innovation and strengthen competitiveness.	Since 2015 new regulations reduce the number of university degrees to encourage specialisation.

The Youth Guarantee scheme is meant to promote vocational guidance, labour information and assistance in job seeking, and hiring, notably. However, although Spain has received the highest share in the total funding by the European Union to implement the guarantee, the programme had a slow start and is not reaching yet as many youth "not in education, employment, or training" (NEETs) as it should. Recent measures adopted in December 2016 that imply that youth registered with the public employment services will automatically be registered with the youth guarantee system may help boosting registration and increase the number of NEETs receiving help.

There is also a need to improve compulsory education. The incidence of early school leave has significantly fallen in recent years (from 26.3% in 2011 to 19.9% in 2015). Nevertheless, Spain still has the highest incidence of early school leave in the EU (Figure 22) and educational outcomes are poor (OECD, 2015d). This is explained by a number of factors: good employment opportunities for low qualified youth in some regions, reduced number of pathways to upper-level secondary education or the perceived lower labour market value of some secondary vocational education and training (VET) degrees. The Organic Law for the Improvement of Educational Quality (LOMCE) has been gradually rolled out since 2014 with one of its aims being to tackle early drop-out rates (OECD, 2014a, Box 1). For example, the law created a new Basic VET that will provide a new path to upper secondary education and provides some tools for improving upper secondary VET degrees by regions and schools. While it is too early to evaluate the impact of the law, given its broad scope and uneven implementation across regions, its objectives go in the right direction, with an increased focus on competencies and skills.

Figure 22. **Early school-leaving rates are high**

Percentage of the population aged 18 to 24 having attained at most lower secondary education and not being involved in further education or training, 2015



Source: Eurostat (2016), "Early leavers from education and training", *Eurostat Database*, December.

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However, more needs to be done to improve teaching quality and educational outcomes. OECD evidence shows that Spanish teachers are less likely to benefit from on the job support programmes than teachers in other OECD countries, and that the support they receive is not very effective (OECD, 2015d). Teachers also lack incentives and support to participate in development activities. To effectively implement the new pedagogical approaches in the law and help low achievers, teachers need better training and guidance if the reform is to improve educational outcomes and reduce early drop-outs. Measures to enhance the quality of teaching include improving university training, a better selection process, and effective on-the-job training. Moreover, regions should evaluate how their spending is currently being allocated in order to more effectively reduce early drop-out rates.

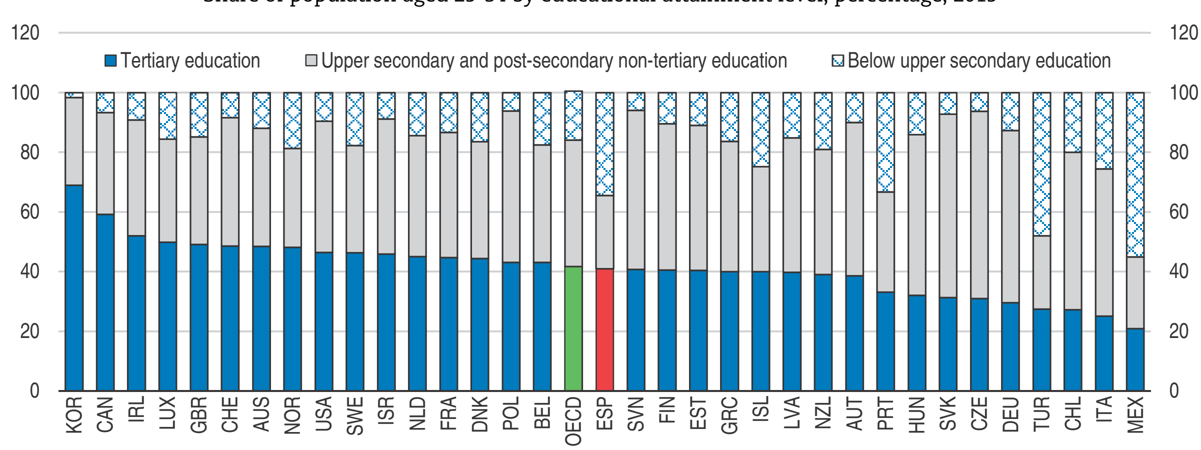
Vocational education and training (VET) can facilitate the transition from school to work. The Organic Law for the Improvement of Educational Quality introduced the new Basic VET, a fall-back programme for the least performing students which leads them to obtaining a certificate recognised by the European Union, which apparently has helped to reduce the early school leave rate. The Organic Law, in its primal objective for the VET reform, made the upper-secondary VET more attractive to students and employers: by redesigning upper-secondary VET courses to adapt them to labour market needs, increasing training at the work-place, strengthening the teaching of foundation skills and making the transition between upper secondary and tertiary VET easier. More funding has also been allocated. Despite this progress, few students are enrolled in secondary-level VET, although graduation rates have increased, and these programmes remain not sufficiently work-oriented and generally do not lead to tertiary-level VET.

More efforts are needed to consolidate the dual VET system, which combines work and school learning. The use of apprenticeship and training contracts has grown substantially since 2012, but only 2% of students in upper-secondary school are enrolled. A major challenge to expanding it further is securing commitment from firms to provide training: most firms in Spain are micro-enterprises that do not have sufficient financial and human resources to collaborate with VET programmes. Against such constraints, the authorities are trying to develop wider co-operation among stakeholders. The Chambers of Commerce, in co-operation with the business and labour unions take an important role to support collaboration between firms and educational institutions. Such co-operation could be further facilitated by building on the experience of some regions where clusters of firms with a shared need for workers with certain VET qualifications work together (as *Grupo de Iniciativas Regionales de Automoción* in Cantabria, Northern Spain). A more active role of employers in designing the curricula by ensuring that the skills being developed meet companies' skill needs would help strengthen co-operation.

While upper secondary education attainment is well below the OECD average (Figure 23), tertiary educational attainment is now on a par with many other OECD countries. However, the skills of tertiary graduates are among the lowest in the OECD suggesting a low quality of university education (OECD, 2015d) compounded with a deterioration of skills once in the labour market. A complex set of factors explain the low skills Spanish students acquire at university (OECD, 2014a), including funding formulas based almost exclusively on the number of students, governance systems with insufficient external accountability, selection procedures that promote inbreeding and very low mobility of students and teachers.

Figure 23. **Tertiary education attainment in young generations is close to the OECD average**

Share of population aged 25-34 by educational attainment level, percentage, 2015[1]



1. 2013 for Chile. 2014 for France.

Source: OECD (2016), "Education at a glance: Educational attainment and labour-force status", *OECD Education Statistics* (database), December.

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Reducing labour market duality

More needs to be done to reduce labour market duality to improve job quality. Temporary workers particularly suffer from labour market insecurity, which reduces their earnings (sometimes putting them at risk of poverty), the possibility of training and future job prospects. The 2012 labour market reform reduced severance payments for permanent contracts, provided hiring subsidies for new permanent workers and reinstated statutory limitations on the use of temporary contracts. The reform also aimed to define more clearly the criteria under which dismissals would be considered fair, with the aim of reducing firms' costs of firing and, therefore, facilitate hiring (OECD, 2014g; García-Pérez, 2016). However, uncertainty regarding labour court decisions remains high and many firms still continue to opt for accepting up front that the dismissal may be considered unfair although it is more costly. Despite the reform, the share of temporary jobs in overall employment remains steady at around 25% and the duration of contracts is often very short.

Out-of-court procedures, such as conciliation, mediation and arbitration to settle disputes about dismissals could help to further reduce uncertainty. The use of conciliation procedures has been on the rise over the past four years, which could be developed further to enhance dialogue and provide a quicker and more effective response to litigation. Finally, the costs of dismissing a permanent worker are still substantially higher than those for a temporary one. As recommended in the *2014 OECD Economic Survey*, greater convergence of termination costs between permanent and temporary contracts could further help to reduce duality.

Improving medium-term sustainable growth

Fostering productivity

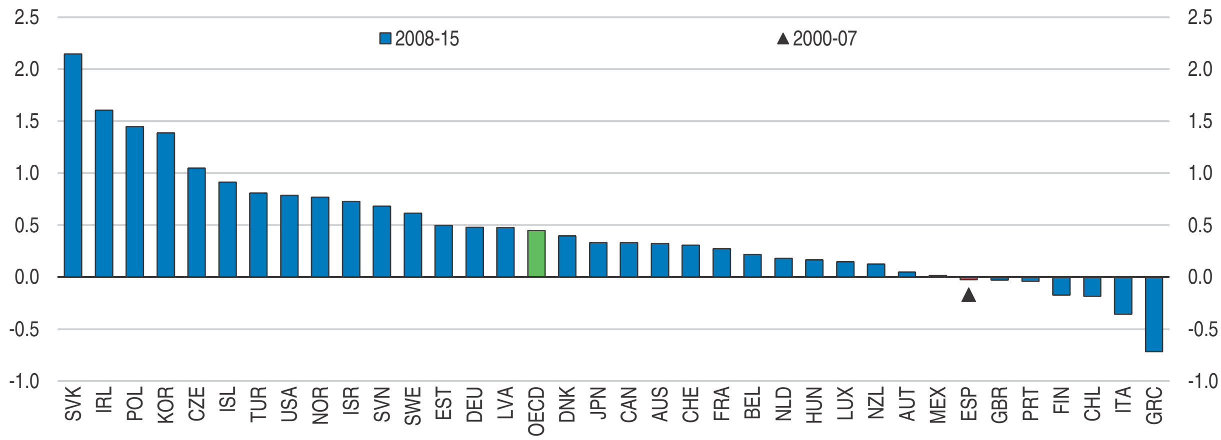
As previous OECD *Surveys* have noted, raising per capita GDP and wellbeing, particularly via productivity increases, is Spain's most fundamental medium-term economic challenge (Table 6). Productivity growth has improved slightly post-crisis, in part due to the reduced share of the low productivity construction sector, but it remains low, averaging around 0% from 2008 to 2015 (Figure 24, Panel A). The business sector is characterised by a high share of low productivity micro-enterprises (1-9 employees) and small enterprises (Chapter 2 and Figure 24, Panel B).

Table 6. **Past OECD recommendations on improving the business climate and boosting productivity**

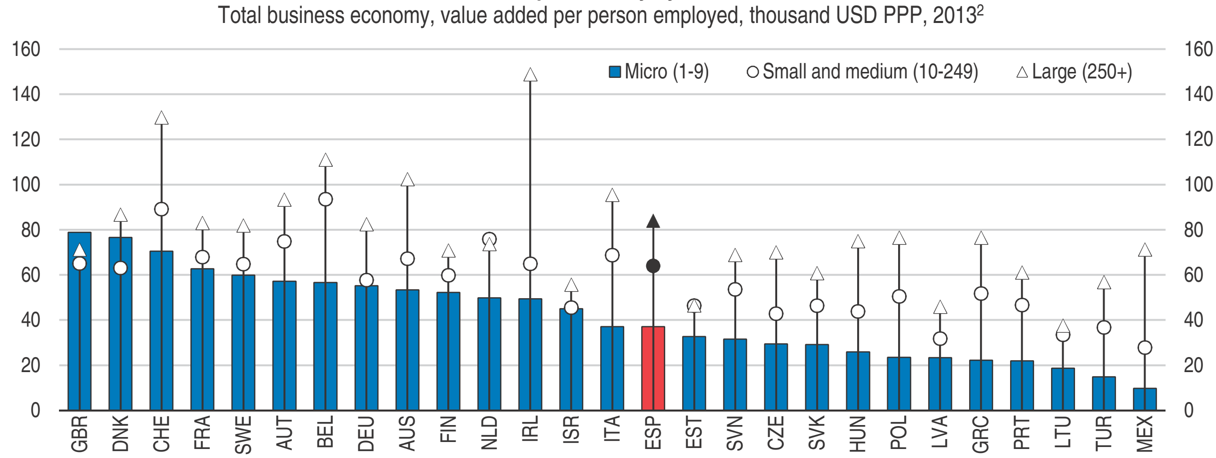
Recommendations in 2014 *Economic Survey*	Actions taken since 2014
Promote diversified financing sources for firms, revamp the licence and permits system and reduce regulatory fragmentation by implementing the market unity law.	The implementation of the Market Unity Law has continued. Law 5/2015 includes a series of measures to facilitate SMEs access to bank credit and sets the ground for the development of alternative sources of financing.
Increase incentives for the use of out-of-court pre-insolvency procedures by SMEs and introduce a new out-of-court negotiated personal insolvency regime.	Law 25/2015 introduces a fresh start for individuals and facilitates the implementation of out-of-court workouts for entrepreneurs and SMEs.
Retain and review the research and development tax credit and co-operate with larger research organisations to promote its use among younger firms.	A new regulation was adopted in June 2015 to simplify bureaucratic procedures when applying for R&D fiscal incentives.
Reduce the number of professions requiring membership of a professional body and the cost of membership.	No action.
Reduce the number of government agencies involved in providing financing support to firms.	No action.

Figure 24. **Productivity is low**

A. Average annual multifactor productivity growth
Percentage[1]



B. Labour productivity by firm size
Total business economy, value added per person employed, thousand USD PPP, 2013[2]



1. The OECD aggregate is calculated as the unweighted average of the data shown.
2. 2014 for Mexico. 2012 for Israel. 2011 for Ireland. Firm size classes based on the number of persons employed. For Australia, the size class "1-9" refers to "1-19", "10-249" refers to "20-199" and "250+" refers to "200+". For Mexico, "1-9" refers to "1-10", "10-249" refers to "11-250" and "250+" refers to "251+". For Turkey "1-9" refers to "1-19" and "10-249" refers to "20-249". Data for Switzerland and the United States refer to employees. Data for Mexico are based on establishments and not on enterprises. Data for the United Kingdom exclude an estimate of 2.6 million small unregistered businesses; these are businesses below the thresholds of the value-added tax regime and/or the "pay as you earn (PAYE)" (for employing firms) regime. Data for the United Kingdom exclude an estimate of 2.6 million small unregistered businesses; these are businesses below the thresholds of the value-added tax regime and/or the "pay as you earn (PAYE)" (for employing firms) regime. PPP: purchasing power parities.

Source: OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November; and OECD (2016), *Entrepreneurship at a Glance 2016*.

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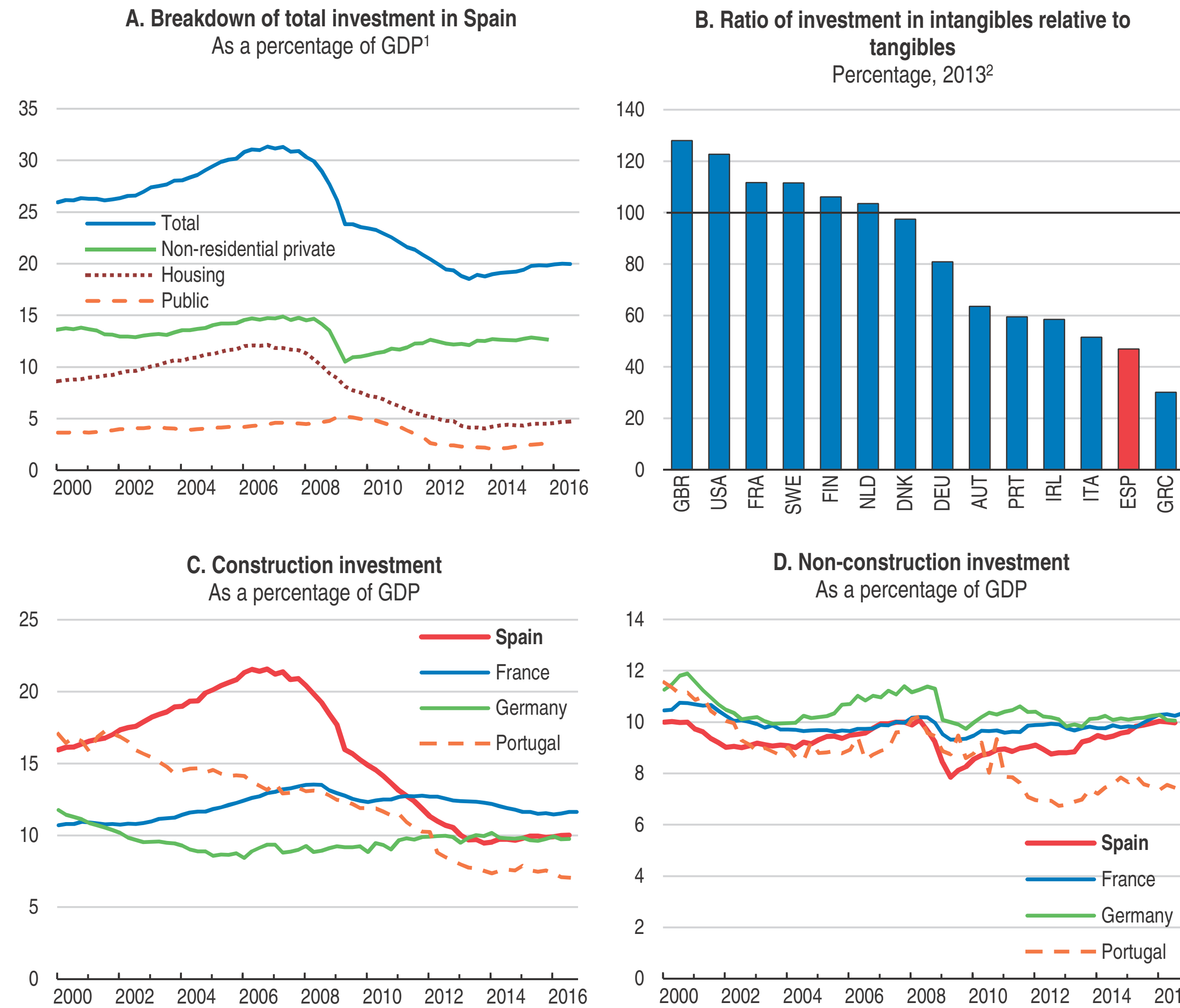
Productivity is held back by high barriers to starting and growing a business, low business innovation and high skill mismatch among others (OECD, 2014a; Haugh and Westmore, 2014; Mora-Sanguinetti and Fuentes, 2012). Increasing productivity involves tackling several challenges. Upskilling and activating the huge pool of unemployed and improving the quality of education that has impeded a greater contribution of human capital to growth, as discussed above, will be essential. Reducing regulatory barriers that restrain competition, encouraging innovation, and ensuring that capital goes to a wider set of innovative firms will also help to boost productivity. Indeed, there is a growing body of evidence that an important contributor to low productivity in Spain is misallocation of capital to low productivity firms within all sectors and under-investment in knowledge-based capital (Figure 25, Chapter 2), while misallocation of capital across sectors plays a more minor role (Mora-Sanguinetti and Fuentes, 2012; García-Santana et al., 2016).

Figure 25. **Innovative investment is low**



1. Data for non-residential private investment refer to total investment (i.e. total gross fixed capital formation) minus government and housing investment. Since data for housing investment for Spain and Portugal may also include government housing, the series for non-residential private investment may be underestimated.
2. Data refer to business sector excluding real estate [i.e. all activities except for real estate activities (L), public administration and defence, compulsory social security (O), education (P) and human health and social work activities (Q)]. Investment refers to gross fixed capital formation. Investment in intangibles refers to all knowledge-based capital (KBC) assets. KBC assets that are consistent with the definition in the System of National Accounts (SNA) 2008 include: software, R&D, entertainment, literary and artistic originals, and mineral exploration. Other KBC assets include: design, new product developments in the financial industry, brands, firm-specific training and organisational capital. Investment in tangibles refers to gross fixed capital formation in construction and machinery and equipment.

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; OECD (2017), *OECD National Accounts Statistics* (database), February; OECD (2015), *OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society*; Corrado, C., J. Haskel, C. Jona-Lasinio and M. Iommi, (2012), "Intangible Capital and Growth in Advanced Economies: Measurement Methods and Comparative Results", *Working Paper*, June (available at *www.intan-invest.net*).

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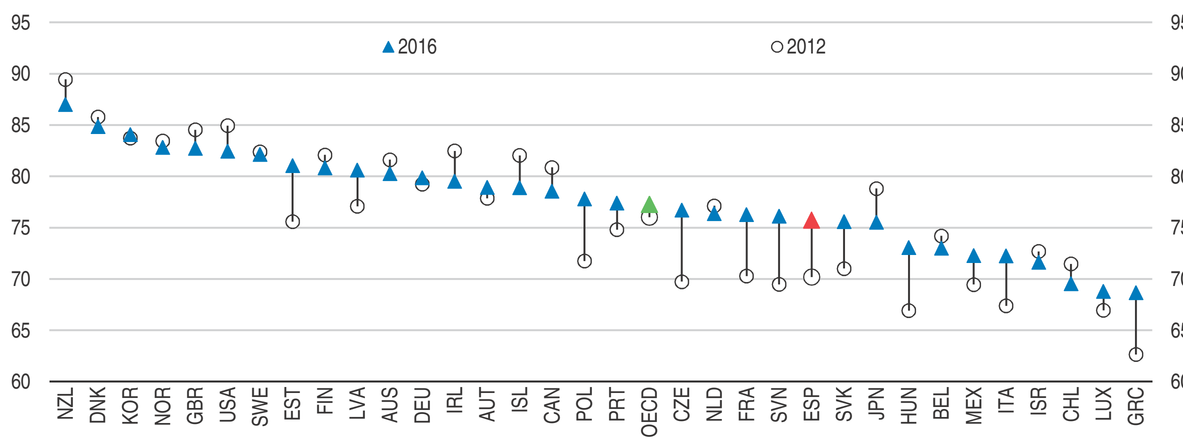
Reducing regulatory barriers that restrain competition

An efficient regulatory framework that supports competition and innovation is crucial to boost productivity. The country has made progress in improving product market regulations and converging towards best practices, which is a significant incentive for firms to innovate and become more productive. The government continues to make progress in implementing the 2013 Market Unity Law to improve business regulations across the 17 regions and thereby create a truly single market in Spain. An important step in this direction has been setting up a process where the government promptly considers complaints from anyone about new laws and regulations inconsistent with the Market Unity Law. However, doing business is still perceived to be more difficult in Spain than in other OECD economies (Figure 26). The central government and the regions reached an agreement in January 2017 to foster greater co-operation on ensuring market unity and implementing better-regulation principles. This is a welcome move and the central government and the regions should continue to maintain momentum in implementing the Market Unity Law to ensure that the obstacles businesses face keep falling and that regulatory reform has visible effects on productivity.

Figure 26. **Doing business has become easier, but there is scope for improvement**

Distance to best practice frontier, from 0 (worst performance) to 100 (best performance)[1]



1. The distance to best practice frontier score helps assess the absolute level of regulatory performance over time. It measures the distance of each economy to the "frontier", which represents the best performance observed on each of the indicators across all economies in the Doing Business sample since 2005.

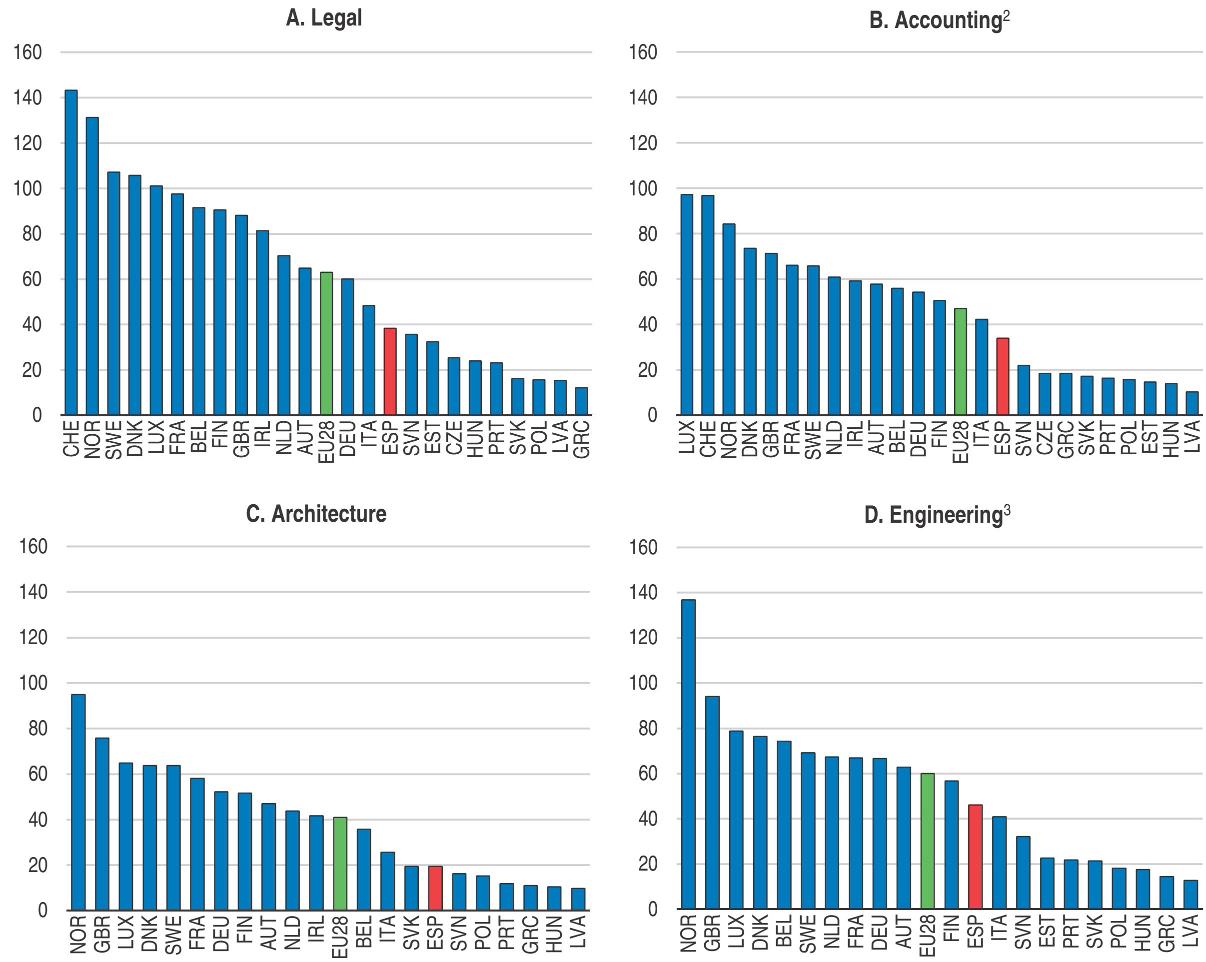
Source: World Bank (2016), *Doing Business 2017: Equal Opportunity for All.*

StatLink http://dx.doi.org/10.1787/888933459078

Competition is still rather weak in sectors that supply inputs to the business sector, most notably in the professional service sector. Professional services – which account for 75% of business services – are markedly less productive in Spain than in other European economies (González Pandiella, 2014 and Figure 27). Professional services are subject to entry requirements in Spain that are higher than those in most other OECD countries (Figure 28). Opening up these services to competition would increase productivity, reduce prices, improve the quality of services and provide more job opportunities. The authorities should adopt the reform of the liberalisation of professional services that has been planned for some time, but is still pending, that would facilitate access to and the exercise of professional services, as well as increase the accountability of professional bodies.

Figure 27. **Productivity in professional services is low**

Apparent labour productivity, gross value added in thousand EUR per person employed, 2014[1]



1. 2012 for Ireland.
2. Accounting, bookkeeping and auditing; tax consultancy.
3. Including related technical consultancy.

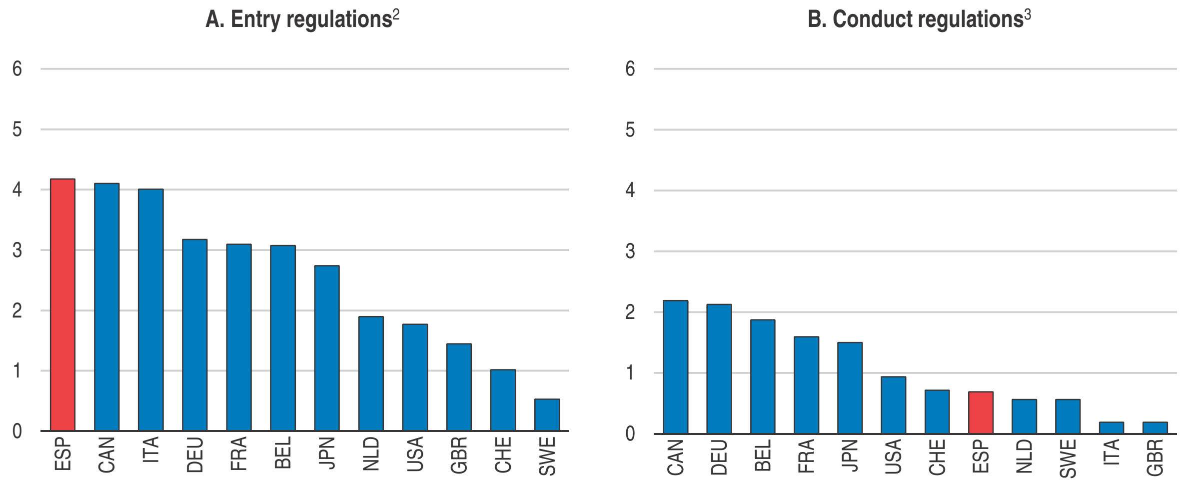
Source: Eurostat (2017), "Structural business Statistics – Services", *Eurostat Database*, February.

StatLink http://dx.doi.org/10.1787/888933459084

The Spanish wage bargaining system has been essentially characterised by collective bargaining at the sector level for long time. The extension of collective agreements at the sector level is automatic across the country, regardless of the representativeness of parties involved in collective bargaining. Such collective agreements then bind not only wages but also other employment conditions such as working time and shifts, unless firm-level agreements exist. The 2012 reform gave priority to firm-level collective agreements and relaxed the conditions for firms to opt-out (OECD, 2014g). The reform contributed to wage moderation (OECD, 2014g; Doménech et al., 2016; García-Pérez, 2016), but firm-level agreements have been concluded essentially only in large firms, and less than five per cent of all firms, many large ones, have opted-out. The authorities should reconsider the conditions under which the statutory collective agreements are extended, in particular, by gradually requiring higher and stricter representativeness of business associations and by checking that such representativeness applies. This would help avoid the situation that collective agreements are driven excessively by a limited number of the best performing firms.

Figure 28. **Entry barriers to professional services are high**

Indicator of regulation in professional services, index scale of 0-6 from least to most restrictive, 2013[1]



1. Professional services cover four sectors: accounting services, legal services, engineering services and architectural services. For further details see Koske, I., I. Wanner, R. Bitetti and O. Barbiero (2015), "The 2013 update of the OECD product market regulation indicators: policy insights for OECD and non-OECD countries", *OECD Economics Department Working Papers*, No. 1200.
2. Entry regulations cover exclusive or shared exclusive rights, education requirements, compulsory chamber membership and quotas.
3. Conduct regulations cover regulations on prices and fees, regulations on advertising, regulations on the form of business and inter-professional co-operation.

Source: OECD (2013), *OECD Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888933459098

Strong contract enforcement, efficient civil justice and timely bankruptcy procedures are important to encourage the growth of productive start-ups that generate a high share of new employment (OECD, 2016d). An efficient insolvency regime encourages entrepreneurs to take the risk to start a new business and is positively associated with entrepreneurship development and productivity growth (de Serres, 2006; OECD, 2016d). It also allows entrepreneurs to move on quickly to try again if they fail. The efficiency of both personal and corporate insolvency regimes has increased with reforms in 2014 and 2015, but there is room for improvement. Spain has introduced a "fresh start": the exemption of future earnings from obligations to repay past debt following bankruptcy. If certain conditions, including the repayment of a certain percentage of debt, are fulfilled entrepreneurs are immediately exempt from repaying debt from future earnings. However, when this payment threshold is not met, the debtor has to commit to a five year payment plan for the debt exempt from immediate discharge, which remains high in international perspective (Carcea et al., 2015). In cases when debt forgiveness is not automatic, reducing the period during which bankrupt entrepreneurs are required to repay past debt would make it possible for entrepreneurs to start over and begin hiring and producing sooner.

Boosting innovation, and ensuring that capital goes to a wider set of innovative firms

Spanish firms invest little in knowledge assets, not only R&D but also other innovation and business capabilities that matter for innovation (OECD, 2015e). The state provides dedicated public financing for innovation investments in the business sector via R&D tax credits and government direct funding programmes. Spain's R&D tax credit system is generous in international comparison, but few firms use the system in part because of complex procedural requirements. To boost take up, the procedures should be simplified and well publicised. Moreover, in the past few years, a significant part of the government budget for innovation was not spent because it was allocated to loans to firms for R&D but the loans were not taken up. To improve the effectiveness of R&D support, the government should favour the financing of performance based grants and public-private collaborative projects to increase firms' R&D and to slow the very high brain drain of talented researchers over the financing of repayable loans.

To foster firm productivity it will be important to ensure that financing goes to the most promising projects. The successful recapitalisation of the banking system following the crisis has laid the foundations for a better allocation of capital in Spain. The authorities have also taken measures to expand capital market finance, introducing an alternative fixed-income securities market, MARF, and an alternative stock market, MAB. Both are expanding, but to gain access to the market a firm still has to be reasonably large with an average bond issue size on the MARF of EUR 20 million (Guijarro and Mañueco, 2013).

Improving the flow of capital to a wider class of new innovative firms requires more education for entrepreneurs on how to access finance. It also requires making banking and capital markets work more in tandem to combine banks' in-depth knowledge of individual clients with the capacity of capital markets to spread risk widely. This is especially important for SMEs, which have more difficulties than large firms accessing either of these channels because their high riskiness impedes their access to bank finance and a lack of information and their size impedes them from accessing capital markets.

To increase the flow of funds to SMEs more can be done to tailor securitisation and mutual guarantee schemes to make it more attractive to list and buy securitised SME debt on MARF or MAB. The government could introduce risk sharing mechanisms, such as providing guarantees to SME bond funds that purchase either loans securitised by banks or smaller bonds issued directly by small firms. To reduce financial risks, the banks originating the loans should be required to retain a stake and the loans should be mutually guaranteed by the banks themselves, as is done in France with bond issues as low as EUR 500 000 (OECD, 2015f).

State funding for firms can be better prioritised. The state-owned bank Instituto de Crédito Oficial (ICO) provides second-floor facilities funds to SMEs where commercial banks assume the credit risk of the loan. In addition ICO provides direct financing activities directed to large projects in different economic sectors. ICO should encourage banks to focus more on lending to innovative companies. ICO also provides equity capital via several instruments. One of these is a "fund of funds" public venture capital fund, Fond-ICO Global, introduced in 2013. Fond-ICO Global should put emphasis at the early and late stages of the venture capital cycle, where there is less provision of private capital.

The public national innovation company (ENISA) helps to finance early stage start-ups, allowing them to establish a long enough track record to convince private venture capitalists to invest. ENISA's funding is very modest, though has increased recently. The government should consider further increasing ENISA's funding subject to the overall expenditure review because it plays a complementary role to market finance. It funds early stage start-ups that would not be financed by the private sector, allowing these firms to establish a long enough track record to convince private venture capitalists to invest.

Centro de Desarrollo Tecnológico Industrial (CDTI) is the main public actor funding business R&D and innovation projects in Spain. The "Innvierte" programme of CDTI aims to promote business innovation by supporting venture capital investment in technology based and innovative companies and to foster the entry of private venture capital to support their technological activities and internationalisation. The CDTI's share of funding available for grants has declined over time and there should be a partial shift of loan funding towards grants, especially to SMEs with technological and innovative development projects.

Making growth greener

Over the past decade, Spain reduced the carbon, energy and resource intensity of its economy despite the financial crisis and following recession and significantly expanded protected natural areas (OECD, 2015f). Yet, important environmental pressures remain (Figure 29). Spain is committed to fulfil jointly with other EU member states the 2020 target of reducing GHG emissions by 20% from 1990 levels. Moreover, Spain aims to reduce its non-ETS GHG emissions by 10% from 2005 levels by 2020. Making the tax system more environmentally friendly, on which there has been little progress recently (Table 7), would help to reach that goal. Spain remains less successful than many countries in making use of waste either by recycling or recovering energy in incineration; landfill remains the main treatment method for municipal waste and its share has increased in recent years.

Spain has one of the highest levels of water stress in the OECD (Figure 30), partly due to large use of water for agricultural irrigation (OECD, 2015g). In some regions, especially in southern parts where irrigated agriculture is a key industry, a substantial share of groundwater resources is at risk of being overexploited and agriculture run-offs are hurting groundwater quality contributing to the degradation of ecosystems, including important wetlands. Moreover, low prices of water in Spain have encouraged capital misallocation to water intensive, low productivity uses in the agricultural sector, weighing down on productivity (Chapter 2). Greater use of water price signals, including cost-effective water pricing and water trading as advised in the 2010 *Economic Survey* would help to generate incentives to use water-saving technology more extensively in agricultural production. Recent temporary measures introduced by decree law in 2015 in response to the drought, including allowing the sale of water rights to a wider set of users and selling water rights not used in the previous year, go in the right direction and should be made permanent. Better pricing of water that more fully reflects all costs involved in the provision of water services would further help to improve the efficiency in water use.

Spain's investment and research in improving environmental performance is relatively low. To a large extent policies to encourage green innovation and adoption are the same as those to foster innovation and firm growth more generally. However, environmental policies themselves, if properly designed, can provide critical incentives to green industries and to spur investment in low-carbon technologies (OECD, 2014a and Table 7). The government should continue to foster the entry of new firms with greener technologies by reducing entry barriers and improving framework conditions for green investment (OECD, 2015e). Tighter regulatory standards can also play a role.

Figure 29. **Green growth indicators: Spain**

Source: OECD (2016), *Green Growth Indicators* (database). For detailed metadata, see *http://stats.oecd.org/wbos/fileview2.aspx?IDFile=02a134e1-c3ec-4c5c-9a05-4ebb41a60539.*

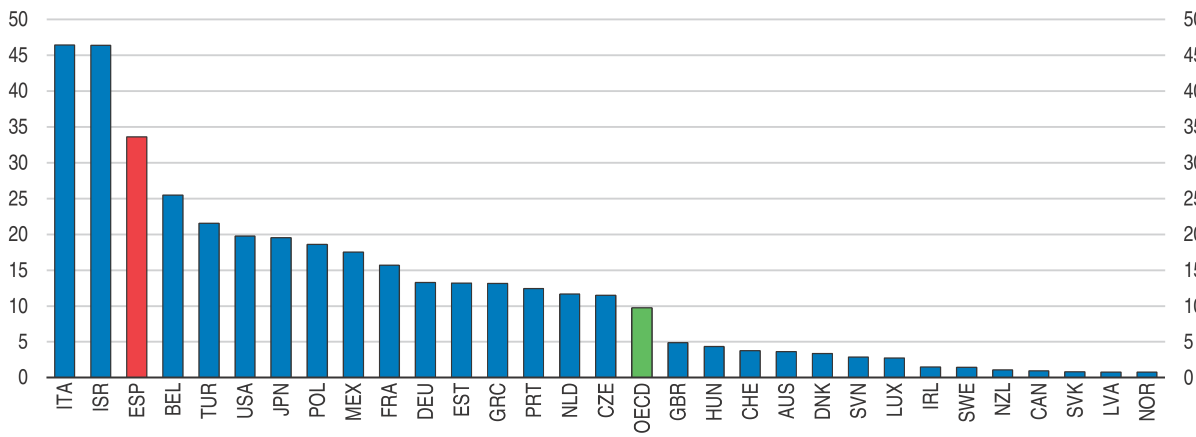
StatLink http://dx.doi.org/10.1787/888933459108

Table 7. **Past OECD recommendations on environmental sustainability**

Recommendations in 2014 *Economic Survey*	Actions taken since 2014
Equalise pricing of greenhouse gas emissions across sources to contain carbon emissions and thereby promote green industry and jobs.	No action has been taken to increase taxation per litre of diesel to equalise its carbon price with that of gasoline.
Ensure predictable policy support to low-carbon technologies.	In July 2014, new mechanisms to gradually eliminate the accumulated tariff deficit in the gas sector were put in place. It remains to be seen whether the government will maintain its strong long-term commitment to balancing the costs and revenues in the gas sector.

Figure 30. **Water stress is one of the highest among OECD countries**

Total freshwater abstraction as a percentage of total available renewable resources, 2012[1]



1. 2013 for Germany. 2011 for Australia, Belgium, Canada and Japan. 2010 for New Zealand, Sweden and the United States. 2009 for Ireland. 2008 for Italy. 2007 for Greece, Norway and Portugal.

Source: OECD (2017), "Green Growth Indicators", *OECD Environment Statistics* (database), February.

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ANNEX

Progress in main structural reforms

This annex reviews action taken on recommendations from previous Surveys *since the July 2014* Survey.

Recommendations in previous *Surveys*	Actions taken
A. Public Finance	
As specified in the government's medium-term fiscal plan, return to a cyclically-adjusted primary fiscal balance by 2017.	Despite some slippage with respect to targets, Spain has made progress in reducing public deficits since 2012. The fiscal deficit continued to be reduced in 2015 but the pace of consolidation slowed with the general government deficit reaching 5.1% of GDP in 2015, above the excessive deficit procedure target of 4.2%. The 2017 Budget aims at bringing the general government fiscal deficit to 3.1% of GDP.
Shift the balance from labour to indirect taxes by cutting employer social security contributions for low-skilled workers, increasing environmental and real estate taxes, and narrowing exemptions to value-added tax, corporation and income taxes.	A temporary measure to boost permanent jobs between February 2015 and August 2016 temporarily reduced social security contributions (SSCs) for employers (deduction of the first EUR 500). It was limited to newly-hired permanent workers and targets, in particular, those at low earnings levels. The 2014 tax reform reduced the statutory income tax rates, in particular, for low-paid workers and simplified different deductions on labour earnings. The reform also eliminated several tax benefits: the former EUR 1 500 dividend tax exemption; the tax benefits for the land lord renting; the exemption for severance payments and the corrective coefficients when computing capital gains.
Broaden the corporate tax base, lower the rate and eliminate special regimes for small and medium-sized enterprises (SMEs).	The 2014 tax reform reduced the general corporate income tax rate from 30% in 2014 to 25% in 2016 by aligning it to that which had applied for the SMEs special regime. Some measures were taken to broaden the corporate income tax base: further limits on the tax deductibility of financial expenses; simplification of amortisation; non-deductibility of impairment losses; limitation to the compensation of previous negative tax bases to 60% without temporal limit; and limitation of the deductibility of representation expenses. In December 2016, a number of measures to broaden the corporate income tax base affecting large companies were introduced. Most notably, the measures include limiting how much companies can deduct past losses (25% for companies with net revenues above EUR 60 million and 50% for companies with net revenues between EUR 20 and EUR 60 million). It also further limits the deductibility of impairment losses – i.e. losses that arise because tangible or intangible goods loose value because of damage- due to equity holdings or participations.
B. Labour market and education reform	
Strengthen active labour market policies by improving vocational training, increasing the number of staff and efficiency of the public employment service, and enhancing co-ordination between the different levels of administration.	The Activation for Employment Strategy was adopted in September 2014, aiming to enhance co-ordination with regional Public Employment Services (PES). The budget for active labour market programmes has been increased and funding to regions has been made conditional on regional PESs' results based on a wide range of performance indicators. A Common Catalogue of Services was adopted in February 2015, to ensure minimum quality standards in PESs. A comprehensive reform of the professional training system for workers and jobseekers was adopted in September 2015.
Encourage greater scale and specialisation of universities and research organisations to raise the quality of innovation and strengthen competitiveness.	Since 2015 new regulations reduce the number of university degrees to encourage specialisation.
Increase the practical component of existing school-based vocational education and training (VET) completed at firms.	In secondary VET, the time spent on practical training was increased to 60% for all the students. Training takes place either in the education centre or in a firm.
Further reduce compensation for unjustified dismissal. If the reform does not prove to be effective, a single contract with initially low but gradually increasing severance payments would reduce the still large difference in dismissal costs between temporary and permanent contracts. This would help reduce duality effectively.	No action.
To further increase the flexibility of wage bargaining require firms to "opt-in" rather than "opt-out" of sectorial collective agreements, abolish automatic extension of sectorial agreements and impose representation requirements for remaining sectorial collective agreements.	No action.
To improve the rental housing market and labour mobility, introduce a network of local arbitration bodies to handle landlord-tenant disputes, introduce periodic rolling leases and shift some funding from social housing to means tested housing benefits.	The State Plan for promotion of housing renting, the building rehabilitation and regeneration and urban renewal 2013-16 contains an aid programme to promote a public park to facilitate rental housing.

Recommendations in previous *Surveys*	Actions taken
C. Boost the performance of the business sector	
Promote diversified financing sources for firms, revamp the licence and permits system and reduce regulatory fragmentation by implementing the market unity law.	The implementation of the market unity law has continued. Law 22/2014 revises the legal framework for risk capital to channel resources to companies in the first stages of development. Law 5/2015 includes a series of measures to facilitate SMEs access to banking credit in the short term. It sets the ground for the development of alternative sources of financing, establishing regulation on crowd-funding, revising the regulatory framework of securitisations and facilitating access to capital markets for all types of companies.
Increase incentives for the use of out-of-court pre-insolvency procedures by SMEs and introduce a new out-of-court negotiated personal insolvency regime.	Law 25/2015 includes the so-called "fresh start" for individuals, as a second opportunity mechanism. Law 17/2014 promotes the adoption of creditors' agreements after the debtor detects any early warning of insolvency risk.
Retain and review the research and development tax credit and co-operate with larger research organisations to promote its use among younger firms.	A new regulation was adopted in June 2015 to simplify bureaucratic procedures when applying for R&D fiscal incentives. As a part of the corporate income tax reform reform (1 January 2015), companies allocating more than 10% of their turnover to R&D activities are allowed to further benefit from the R&D+I tax credit for an additional amount of EUR 2 million.
Reduce the number of government agencies involved in providing financing support to firms.	No action.
Pursue efforts to diversify the financing mix. In the short-term, strengthen Official Credit Institute (ICO) intermediation facilities and mutual guarantee schemes.	Law 5/2015 aims to facilitate bank credit to SMEs and to foster alternatives to bank financing, such as financing platforms. It also introduced legal changes with regard to the counter-guarantee provided to mutual guarantee societies by CERSA, a public company. ICO has continued to support SMEs by granting over EUR 30 billion in 2014 and 2015 through second floor facilities. At the same time, ICO, through FONDICO Global, aimed to enhance capitalisation of Spanish entrepreneurs, SMEs and midcaps through private funds, thus promoting the venture capital industry. CDTI Innvierte Program has increased its venture capital activities together with private investors to support technology based and innovative firms, especially SMEs.
Establish a comprehensive credit registry for SMEs along the Banque de France model, including information on payment performance, financial transactions and balance sheet positions. Make that information available to all banks.	Law 5/2015 introduced the "SME credit information" report including the credit history of the SME, a chronological list of defaults and bank's internal scoring. This information is standardised by the Bank of Spain, The credit information is available on demand.
D. Product market reform	
Further reduce the costs and procedures necessary to create businesses and eliminate sector-specific entry barriers, including for professional services as well as rail and road transport.	The Market Unity Law intends to replace prior authorisation schemes and requirements with less restrictive means of *ex post* control in order to simplify licensing procedures. A draft law, opening up professional services and clarifying the legal regime of professional bodies, has been prepared. Law 37/2015 on roads promotes competition in the service areas. Law 38/2015 on railways transposed EU Directive 2012/34/EU, establishing a single European railway area.
Reduce the number of professions requiring membership of a professional body and the cost of membership.	No action.
E. Environmental sustainability	
Equalise pricing of greenhouse gas emissions across sources to contain carbon emissions and thereby promote green industry and jobs.	No action has been taken to increase taxation per litre of diesel to equalise its carbon price with that of gasoline.
Ensure predictable policy support to low-carbon technologies.	In July 2014, new mechanisms to gradually eliminate the accumulated tariff deficit in the gas sector were put in place. It remains to be seen whether the government, will maintain its strong long- term commitment to balancing the costs and revenues in the gas sector. In 2014, the government approved a new regulatory framework for renewable energy source regulating production of electricity from renewable energy sources, cogeneration and waste. In 2015, the legal framework for self-consumption of electricity was approved (Royal Decree 900/2015, of 9 October). The government also approved in 2015 a new regulatory framework establishing targets for biofuels until 2020 (Royal Decree 1085/2015, of 4 December).

Thematic chapters

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Chapter 1

Reforms for more and better quality jobs in Spain

The Spanish economy is growing strongly, but there is a risk that many people are being left behind. Unemployment, especially among young people and the low-skilled, remains very high. About half of all the unemployed have been unemployed for over a year and one third for more than two years. A quarter of all those who are employed are on temporary jobs. Since the global economic crisis, poverty and inequality have increased. An immediate priority is to ensure adequate income support for those most in need. Getting more people into better jobs is crucial to raise living standards and to reduce poverty. In terms of structural policies, this requires continuing to improve activation policies, such as training and job placement, re-skilling and up-skilling the unemployed, preventing youth from leaving the education system under-qualified and better on-the-job-training. More can be done to foster the creation of better quality jobs by reducing barriers to hiring and addressing labour market duality.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

The labour market situation in Spain has continuously improved since the beginning of 2014 and job creation has been strong. A wide-ranging agenda of structural reform (Box 1 in the "Assessment and recommendations"), highly expansionary euro area monetary policy and, more recently, easier fiscal policy have supported demand and job creation during the recovery. Evidence suggests that the 2012 labour market reform has contributed to significant wage moderation, lower job destruction and a reduction in the duration of unemployment spells (Box 1.1). The significant reform of the banking sector in 2012 was an important complement to the labour market reform. It helped to address the deep dysfunctions in the financial sector and facilitated that new credit started to flow again to firms supporting hiring and investment.

These are all important achievements and Spain has a stronger base to keep tackling the labour market challenges it still faces. The unemployment rate is gradually decreasing, but remains very high and many people have been jobless for a very long-time. Long periods of unemployment are associated with discouragement and the loss of human capital, making labour market reintegration very difficult. Moreover, job quality deteriorated during the crisis. Spain performs relatively poorly compared to other OECD countries in terms of earnings, labour market security and the quality of the working environment, which are all important elements for well-being and productivity (OECD, 2014b, Cazes et al., 2015). A lack of skilled workers and managers drags productivity down, and with it the economy's growth potential.

The chapter discusses a wide range of policy measures to further reduce unemployment and make growth more inclusive in line with the flexicurity concept that emphasises the flexibility of labour markets at the same time as ensuring secure transitions for employees from one job to another. Along with the effective implementation of the 2012 labour market reform, the chapter discusses policies to improve on-the-job training, job placement and the minimum income support system. Productivity enhancing reforms, such as reducing regulatory barriers to entry in service sectors, can help to support business expansion and employment and lay the foundations for more and better quality jobs (Chapter 2). Lifting productivity will also require improving the quality of teaching in schools, continuing the development and modernisation of the vocational education and training system and better aligning tertiary education with labour market needs. The business sector has an important role to play in these endeavours through its input into university training design, providing on-the-job training opportunities as part of vocational education and training (VET) programmes, and improving training for its workers.

Box 1.1. **What does the evidence say about the impact of the 2012 Labour Market Reform?**

In February 2012 the Spanish government approved a comprehensive reform of the labour market that modified several aspects of the Spanish labour market regulation, including changes to collective bargaining rules and collective and individual redundancy procedures and costs (see OECD, 2012 for a description of the reform). Since then evidence has started to build up on the impact of the reform. This body of evidence suggests the following main results.

- **Wage moderation:** The reform contributed to significant wage moderation in the first year and a half after the reform. OECD evidence suggests that between the fourth quarter of 2011 and the second quarter of 2013 business sector unit labour costs (excluding non-wage components) declined by 3.2%, with more than a half of this drop attributed to the 2012 reform (OECD, 2014a). These results are consistent with econometric evidence by the Bank of Spain (Izquierdo et al., 2013) and qualitative evidence (BBVA, 2013; Ministerio de Empleo y Seguridad Social, 2013). More recent analysis by Doménech et al. (2016) suggests that greater wage moderation stems not only from the 2012 labour market reform, but also from the 2012 II Agreement of Social Partners on Employment and Collective Bargaining to moderate wage growth, which has been extended in the following years. Such wage moderation has contributed to improve Spain's competitiveness.
- **Employment growth:** Net employment contraction following the reform was below expectations, suggesting therefore a positive impact of the reform on employment growth (Ministerio de Empleo y Seguridad Social, 2013; Izquierdo et al., 2013). More recent analysis by Doménech et al. (2016) further suggests that the reduction in employment during the 2012-13 recession was milder than one could expect given the tight fiscal and financial conditions, which suggests that the labour market reform increased the resilience of the labour market to face negative shocks.
- **Duality and hiring rates:** OECD evidence (OECD, 2016a) finds that the reform is estimated to have increased the share of hirings with open-ended contracts by 46%, all else equal, during the two years following the reform. A more detailed analysis by firm size suggests that the effects were concentrated in firms smaller than 50 employees (OECD, 2014a). A recent study also shows a positive although small effect of the reform in reducing the duality of the Spanish labour market (García-Pérez, 2016).
- **Separation rates:** The overall effect of the reform on separation rates is less obvious, as the reform eased firing procedures and reduced its costs, but at the same time raised the incentives to adopt internal-flexibility measures within firms. OECD evidence (OECD, 2014a) suggests that separations decreased after the reform, especially for temporary contracts, possibly resulting from the greater use of internal flexibility measures as an alternative to contract termination.
- **Transitions from unemployment to employment:** OECD estimates that the 2012 reform increased the probability of leaving unemployment and entering employment for any unemployment duration (OECD, 2014a). Furthermore, the reform also contributed to containing the duration of unemployment spells, in particular due to faster transitions into permanent contracts for those workers entering unemployment after a temporary job. More recent evidence by García-Pérez (2016) confirms this evidence and finds that the reform increased the probability of exiting unemployment towards permanent employment, especially for young people.

Spain faces challenges to develop more and better quality jobs

Employment growth has been strong, but unemployment remains high

A bright side of the recovery has been robust job creation. Strong gross domestic product (GDP) growth has resulted in significant job creation, with the total number of employed increasing by 10.5% since the beginning of 2014. Job creation has been particularly strong in the tourism sector and relatively modest in other sectors which traditionally had created a large number of jobs, such as wholesale and retail as well as manufacturing. In contrast, employment remains subdued in the construction sector, an important source of jobs before the crisis. Overall, employment ratios remain below pre-crisis levels and the OECD average of 66% (Table 1.1). The unemployment rate has come down substantially from its peak (26.1% in 2013), but at close to 19% in late 2016, remains extremely high and well above pre-crisis levels and the OECD average (Figure 1.1).

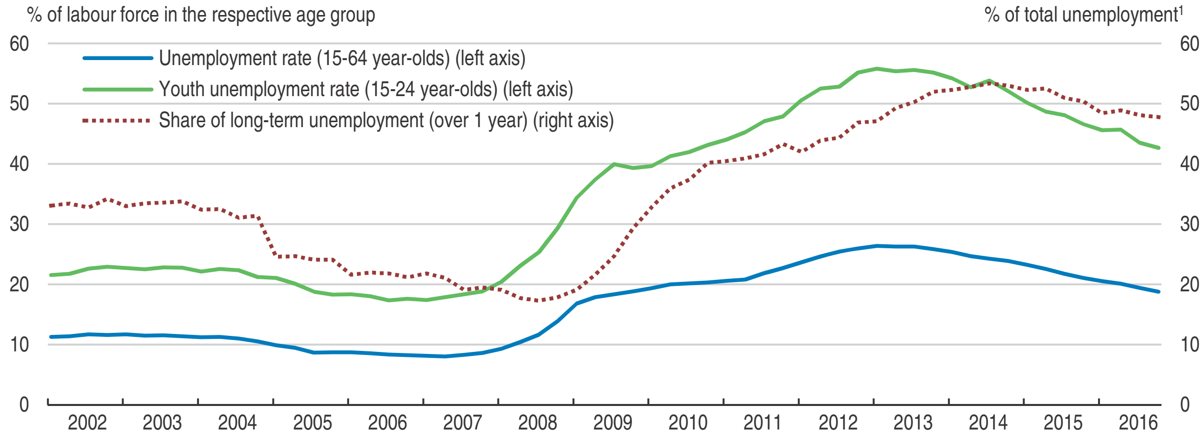
The low-skilled face a higher risk of being left behind and such a risk is disproportionately high among youth. The unemployment rate is markedly high among the less-well educated, and this holds true across different age groups (Table 1.1). Unemployment is more frequent among the youth, in many instances associated with termination of temporary contracts. The low-skilled youth face much more significant risk of unemployment, and the ratio of those who are "not in education, employment or training" (NEET), although falling, is high by OECD standards (Table 1.1), with many of them being early school leavers. Long-term unemployment, although declining, persists and still accounts for almost half of total unemployment (Table 1.1), with such risks concentrated on the less-well educated (Jansen et al., 2016).

Table 1.1. **Labour market indicators**

	Spain		OECD	
	2007	2015	2007	2015
Employment/population ratio	66.8	58.7	66.5	66.3
Labour force participation rate	72.8	75.5	70.5	71.3
Unemployment rate	8.3	22.2	5.8	7.0
of which: Long-term unemployment (> 1 year)	20.4	51.6	28.4	33.8
Youth (15-24)	18.1	48.3	12.0	14.0
Prime age (25-54)	7.2	20.6	4.9	6.2
Older population (55-64)	6.0	18.6	4.0	4.9
Men	6.5	23.7	5.6	7.5
Women	10.7	25.5	6.1	7.6
Lower secondary or less	10.5	31.0		
Upper secondary and post-secondary non-tertiary	8.1	21.6		
Tertiary	5.3	13.2		
Youth:				
Lower secondary or less	20.4	56.3		
Upper secondary and post-secondary non-tertiary	16.5	45.0		
Tertiary	13.4	35.9		
Youth "not in education, employment, or training" NEET rate (15-29)[1]	15.9	22.7	13.5	14.6

1. Unweighted OECD average for the Youth NEET rate, instead of the OECD total.
Source: OECD Labour Force Statistics (database) and Eurostat Labour Force Survey.

Figure 1.1. **Unemployment remains very high**



1. Data for the share of long-term unemployment refer to population aged between 15 and 64.

Source: OECD (2017), *OECD Employment and Labour Market Statistics* (database), February; and Eurostat (2017), "Employment and unemployment (Labour Force Survey)", *Eurostat Database*, February.

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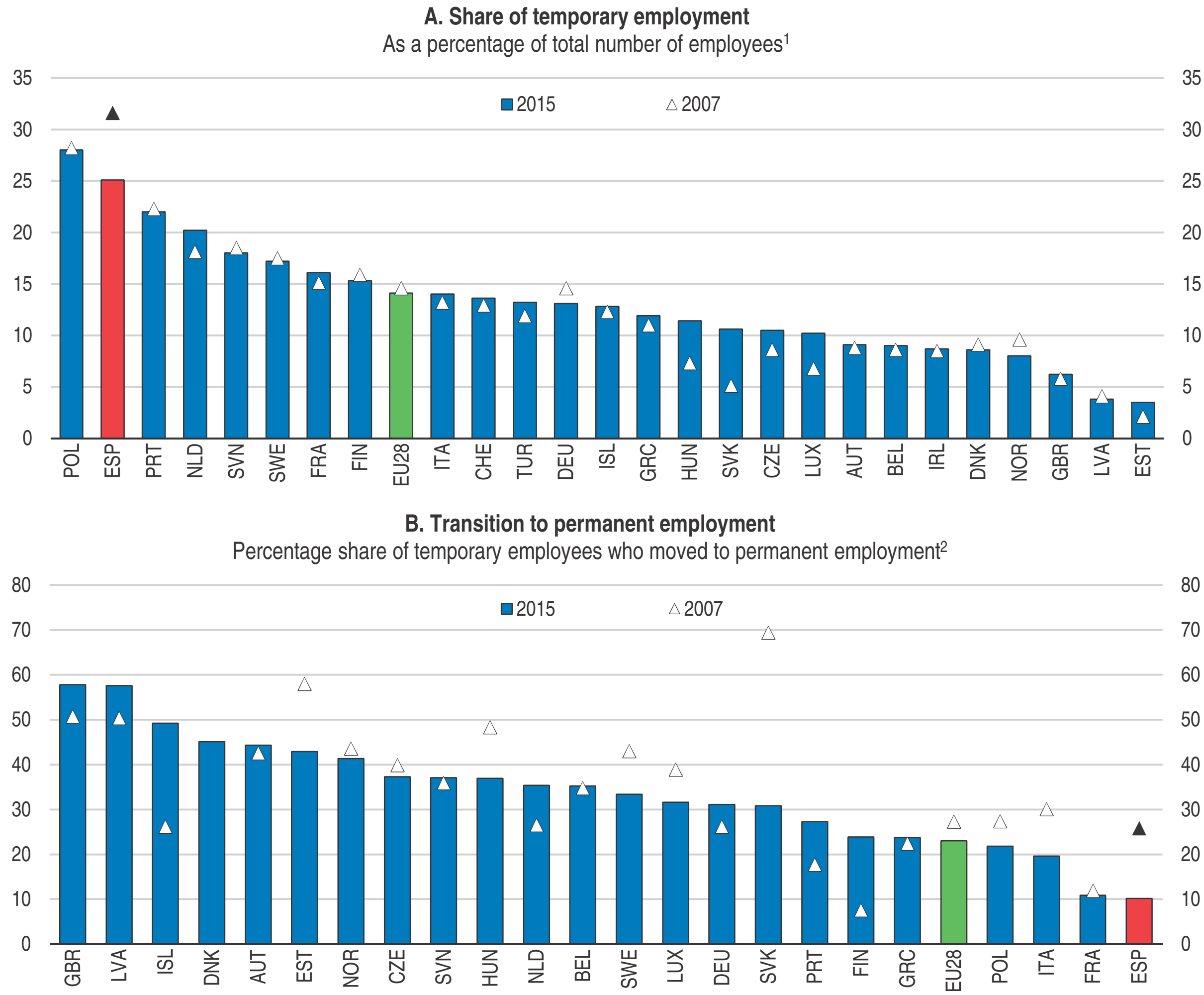
With 25% of all workers on a temporary contract, the share of temporary workers is the second highest in the OECD (Figure 1.2). About 10% of the working age population had a low work-intensity, defined as the share of workers that work no more than 45% of the year in 2013 (Fernández et al., 2016). Many temporary workers do not work all year long as they move from one temporary job to another interspersed by unemployment spells. As in many other OECD countries, part-time work also increased during the crisis, and stalled at 15.2% in the fourth quarter of 2016. In particular, more than half of part-time work is involuntary (63% against the OECD average of 17.4% in 2015), meaning that these people work part-time because they cannot find a full-time job, a significant increase during the crisis that is receding only slowly. Temporary work and part-time work are both strongly associated with low annual incomes and low long-term earnings.

Labour market insecurity in Spain was among the highest in the OECD in 2013 (Figure 1.3). Labour market insecurity captures not only the risk of job loss, but also the duration of unemployment and earning losses after accounting for the generosity and coverage of unemployment insurance. High unemployment risk and weak income support for jobless people (see below) jointly explain high labour market insecurity in Spain.

Job security is a major determinant of individuals' well-being. The detrimental effects of labour market insecurity go beyond the well-being of workers. It affects firms' profits by reducing worker retention rates, investment in firm-specific skills and productivity (Cazes et al., 2015). Moreover, persistent unemployment reduces the probability of finding a job as jobseekers become less motivated and their skills depreciate, and firms tend to avoid hiring those who have remained unemployed for a long time (Jansen et al., 2016).

Low-skilled workers and the youth face the highest labour market insecurity. Low-skilled workers were the most vulnerable to unemployment risk, compared to their peers in other OECD countries in 2013 (Figure 1.4). On average, they were estimated to spend more than half of the year in unemployment (Figure 1.4), though the recovery is likely to have improved the situation since then. The probability of becoming unemployed among the Spanish youth was also one of the highest in the OECD in 2013, after having

Figure 1.2. **The Spanish labour market remains characterised by its duality**



1. Data refer to those aged 15 years and over.
2. 2014 instead of 2015 for Germany, Greece, the United Kingdom and the European Union (EU28) aggregate. The 2007 data for the EU28 aggregate refer to EU27.

Source: Eurostat (2016), "Employment and unemployment (Labour Force Survey)", *Eurostat Database*, December.

StatLink http://dx.doi.org/10.1787/888933459130

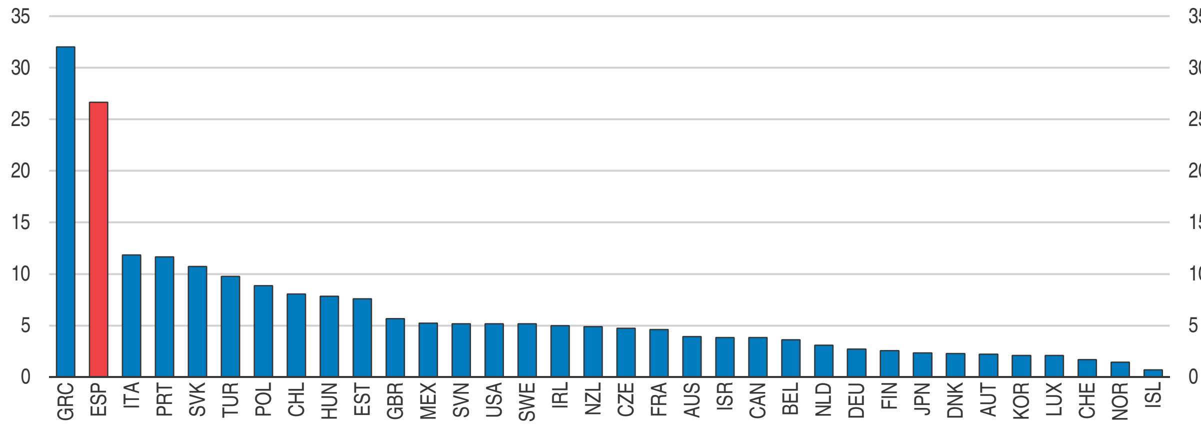
risen sharply during the crisis. For young people with no prior work experience the situation was estimated to be even worse given their additional barriers to find a job (Jansen et al., 2016).

Average earnings are low

Average earnings were low compared to other OECD countries in 2012 (Figure 1.5). This reflects low worker skills but also weak firm productivity. Evidence from firm-level data suggests that productivity and labour earnings are very weak in the vast majority of Spanish firms compared to their peers in other European Union (EU) countries (Figure 1.6).

Figure 1.3. **Labour market insecurity, among the highest in the OECD**

Risk of becoming unemployed and its expected cost as a share of previous earnings, percentage, 2013[1]



1. 2011 for Chile.

Source: OECD (2016), "Job quality", *OECD Employment and Labour Market Statistics* (database), December.

How to read this figure: In the OECD Job Quality framework, the headline indicator of "labour market insecurity" is the product of unemployment risk and unemployment insurance and measures the expected earnings loss associated with unemployment. Unemployment risk encompasses both the probability of becoming unemployed and the average expected duration of unemployment spells. It gives an indication of the expected amount of time a person is likely to spend in unemployment in a given year. Unemployment insurance is measured by the coverage of unemployment insurance and the replacement rates of public transfers received by the unemployed. For more details see OECD (2014), OECD Employment Outlook 2014, OECD Publishing, Paris.

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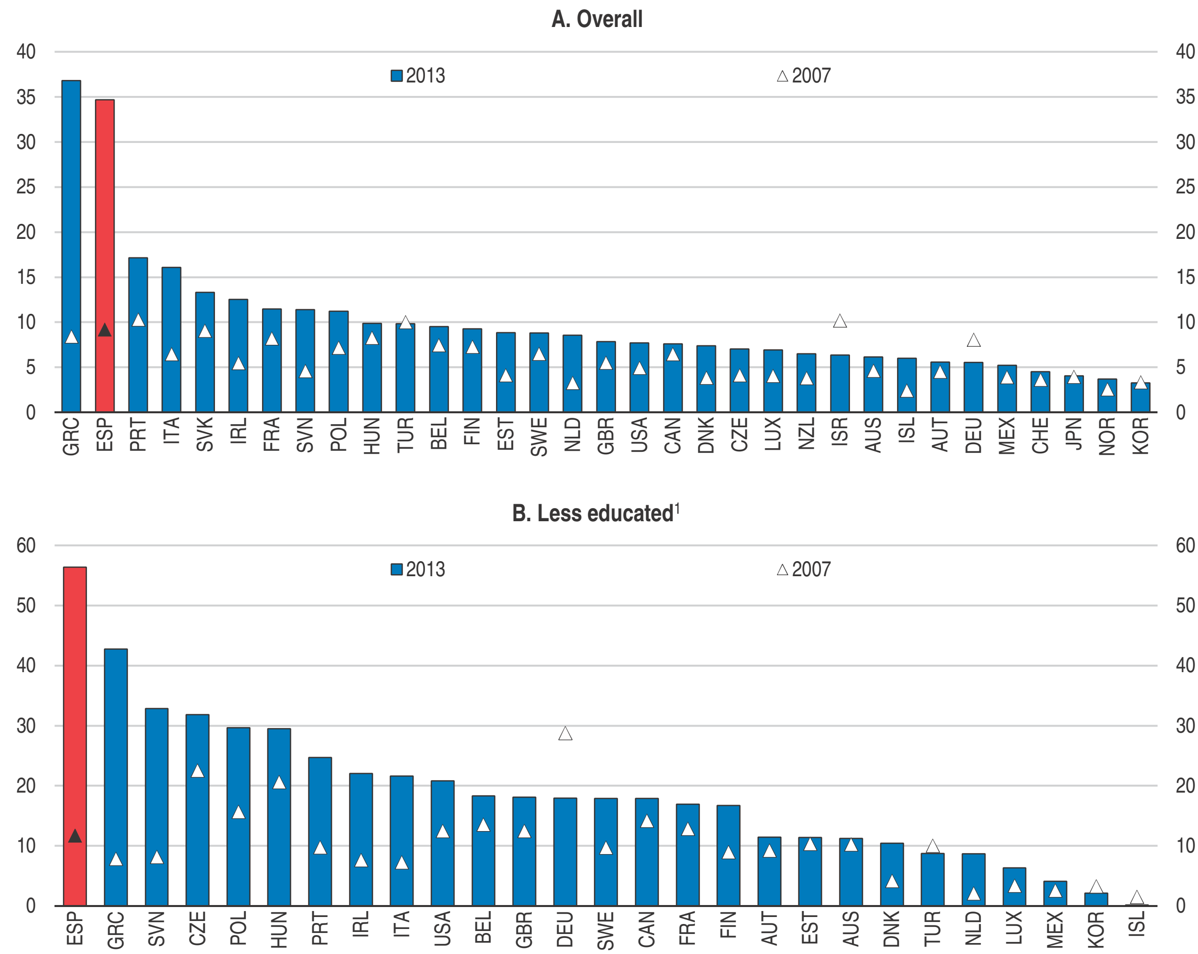
Low skills are in part associated with the occupational structure in Spain, which is biased towards low-wage occupations. It is characterised by a relatively smaller share of highly-skilled ("abstract") occupations (around 30% of all occupations, compared to over 40% in the EU15) and a larger share of low-skilled ("in-person service") occupations (Figure 1.7, Panel A). The significant job destruction during the crisis substantially reduced the share of "routine" occupations (Figure 1.7, Panel B).

The quality of the working environment is low

More than half of all workers suffer from job strain in Spain (Figure 1.8). This means that these workers are exposed to excessive job demands, such as time pressure or physical health risks, compared to the resources they have at hand to fulfil their work duties. For instance, job resources such as work autonomy and on-the-job learning opportunities are less frequent in Spain than in other EU countries (Figure 1.9). This is in part related to the low level of workers' skills, as low-skilled workers typically have fewer job resources available and face higher job demands than the average worker (Cazes et al., 2015). Fewer learning opportunities in Spain are also related to the high incidence of temporary jobs. Evidence suggests that firms often do not train their temporary workers as they stay only for short periods (Cabrales et al., 2012). Such low investment contributes to temporary workers low productivity (Dolado et al., 2012).

Figure 1.4. **Unemployment risk, particularly high among the less well-educated**

Proportion of time that a worker is expected to spend on average in unemployment, percentage



1. 2012 for Australia, Korea, Mexico and the United States. Less-educated: lower secondary diploma or less.

Source: OECD (2016), "Job quality", *OECD Employment and Labour Market Statistics* (database), December.

How to read this figure: Unemployment risk encompasses both the probability of becoming unemployed and the average expected duration of unemployment spells. As such it gives an indication of the expected amount of time a person is likely to spend in unemployment in a given year. It is calculated by multiplying the monthly probability of becoming unemployed by the average expected duration of unemployment spells in months. For more details see OECD (2014), OECD Employment Outlook 2014, OECD Publishing, Paris.

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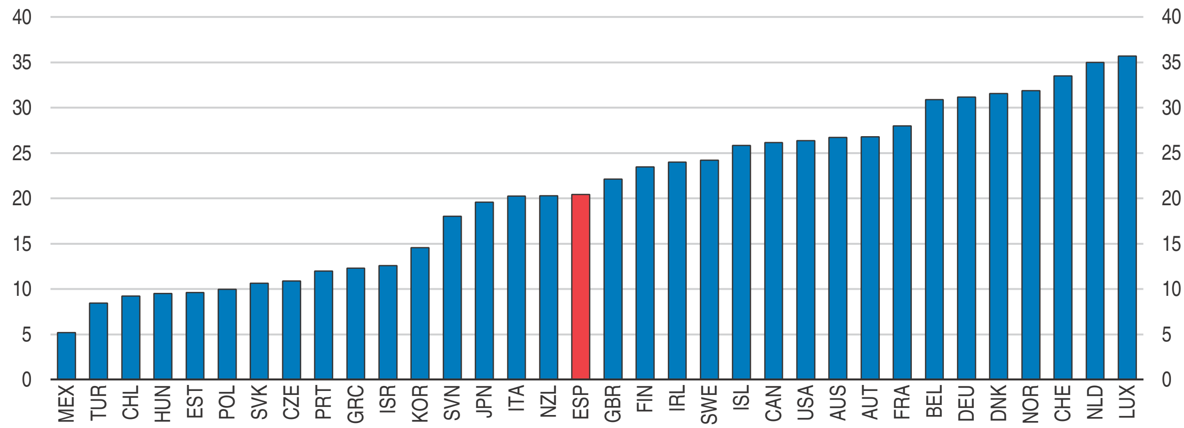
Ensuring adequate support for the most vulnerable

In the wake of the crisis, market income inequality rose (Figure 1.10, Panel A), essentially due to a steep rise in joblessness and, to a lesser extent, higher disparity in annual earnings. While inequality slightly declined in 2014 thanks to the improvement in the labour market, the level of inequality remained high. High inequality owed largely to low earnings at the bottom of the income distribution: the gap between the median and the bottom 10% income group was larger than the OECD average. In particular, the extent to which joblessness and temporary jobs contribute to overall inequality was among the largest in the OECD (Figure 1.10, Panel B).

Figure 1.5. **Low average earnings in Spain**

Average gross hourly earnings per worker in constant USD PPP, 2012[1]



1. 2013 for all countries unless otherwise mentioned in the following: 2012 for France, Italy, Poland, Spain, Sweden and Switzerland. 2011 for Israel. 2010 for Estonia, Luxembourg, the Netherlands, Slovenia and Turkey. PPP: purchasing power parities.

Source: OECD (2016), "Job quality", *OECD Employment and Labour Market Statistics* (database), December.

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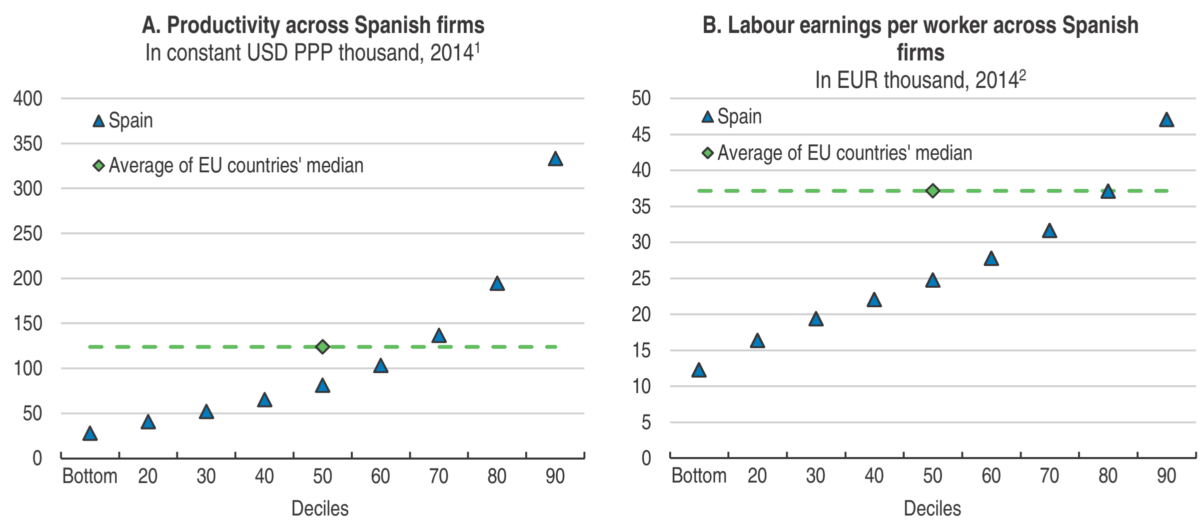
Figure 1.6. **Productivity and labour earnings are weak in the vast majority of Spanish firms**



1. Gross output based labour productivity. Industry-level purchasing power parities (PPP). European Union (EU) countries refer to 20 EU member countries that are available in the *ORBIS Database*.
2. Labour earnings per worker refer to total costs of employees (including employers' social security contributions) per number of employees. EU countries refer to 18 EU member countries that are available in the *ORBIS Database*.

Source: Calculations based on the *ORBIS Database*.

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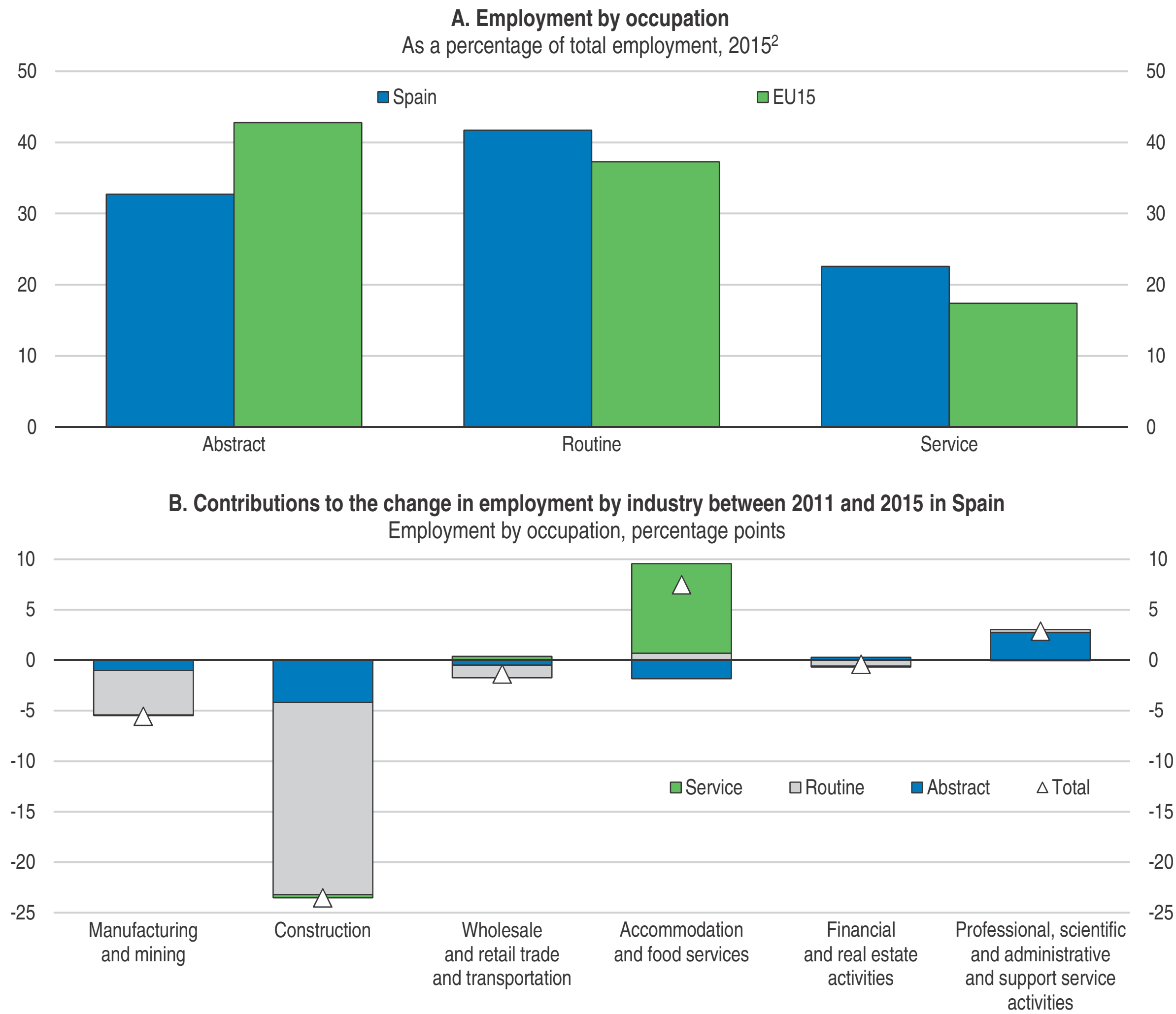
Poverty remained also high by OECD standards in 2014, after having significantly risen during the crisis (Figure 1.11). The poverty rate – measured by the share of households living with less than 50% of the median household disposable income (the poverty line) – was high in 2014 (Figure 1.11), although it started to decline (owing to the job recovery, thus it is expected to have declined further in 2015 and 2016). The risk of poverty is likely to remain particularly high among jobless households and households with only temporary

Figure 1.7. **Firms' skill requirements are low in Spain**[1]



1. Occupations are classified into the three categories "abstract", "routine" and "service" based on the International Standard Classification of Occupations (ISCO) 08 at 1-digit level. "Abstract" occupations require non-routine analytical skills which gained more importance on the back of the use of information and communication technology (ICT). "Abstract" occupations include managers (ISCO-1), professionals (ISCO-2), technicians and associate professionals (ISCO-3). Tasks in "routine" occupations can be relatively easily codified into some defined rules and thus more easily substitutable by technologies and offshored inputs. "Routine" occupations include clerical support workers (ISCO-4), craft and related trades workers (ISCO-7), plant and machine operators and assemblers (ISCO-8) and elementary occupations (ISCO-9). "Service" occupations do not necessarily require high skills but they are not easily offshored since their tasks should be made in the same place as the customers, typically in-person services. "Service" occupations include service and sales workers (ISCO-5). Data refer to the population aged between 15 and 64.
2. The EU15 aggregate refers to Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom.

Source: Eurostat (2016), "Employment and unemployment (Labour Force Survey)", *Eurostat Database*, December

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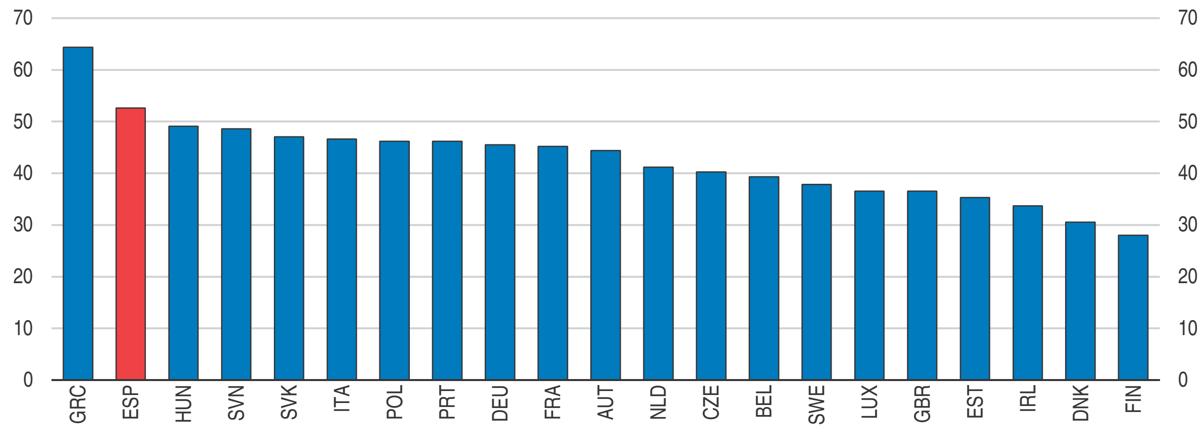
workers and especially so if they have children (Figure 1.12). The child poverty rate was relatively high in 2013, at 23.4% compared to an OECD average of 13.3%. On the other hand, the elderly and pensioners have been much better protected from the impact of the crisis, with relative poverty among the elderly falling by 14 percentage points to 6%, thanks to the pension system (OECD, 2014c).

Figure 1.8. **The quality of the working environment is low and job strain is high in Spain**

Incidence of job strain (excessive job demands against job resources available) among workers, percentage, 2015[1]



1. "Quality of the working environment" is measured by job strain – discrepancy between job demands and job resources to accomplish tasks. Two types of job demands are considered: i) time pressure; and ii) physical health risk factors. Two types of job resources are considered: i) work autonomy and learning opportunities; and ii) workplace relationships. The headline indicator "Job strain" refers to those jobs where the workers face one demand but have no resources or face two demands but have one or no resource.

Source: OECD (2016), "Job quality", *OECD Employment and Labour Market Statistics* (database), December.

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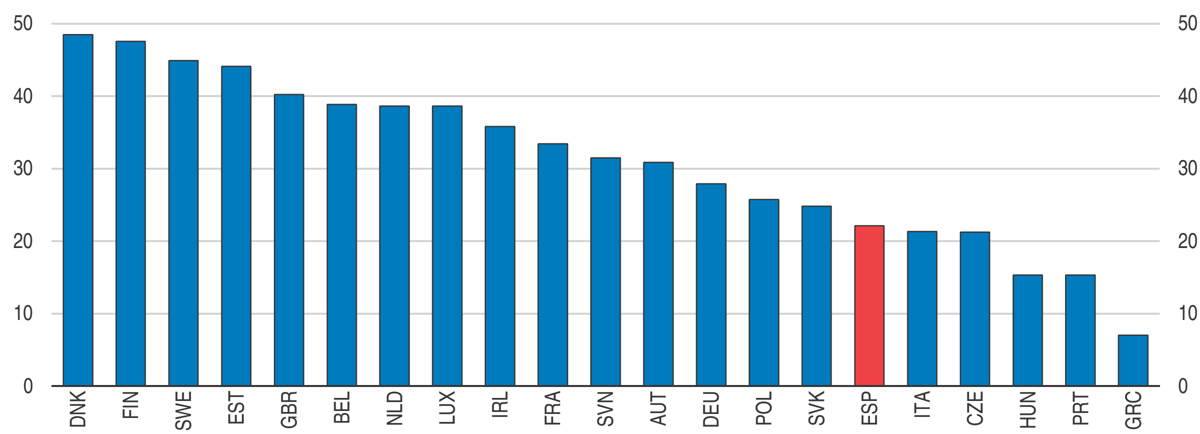
Figure 1.9. **Work autonomy and learning opportunities are scarce in Spain**

Percentage share of workers with work autonomy and/or learning opportunities, 2015[1]



1. Under the headline indicator of "job strain" of "quality of the working environment" one type of job resource considered is work autonomy and learning opportunities. Work autonomy refers to the ability of employees to influence the way they carry out their immediate work activities such as the order of tasks and the methods of work. Learning opportunities capture both informal learning at work by doing the job and formal training opportunities provided by the employer or during work hours.

Source: OECD (2016), "Job quality", *OECD Employment and Labour Market Statistics* (database), December.

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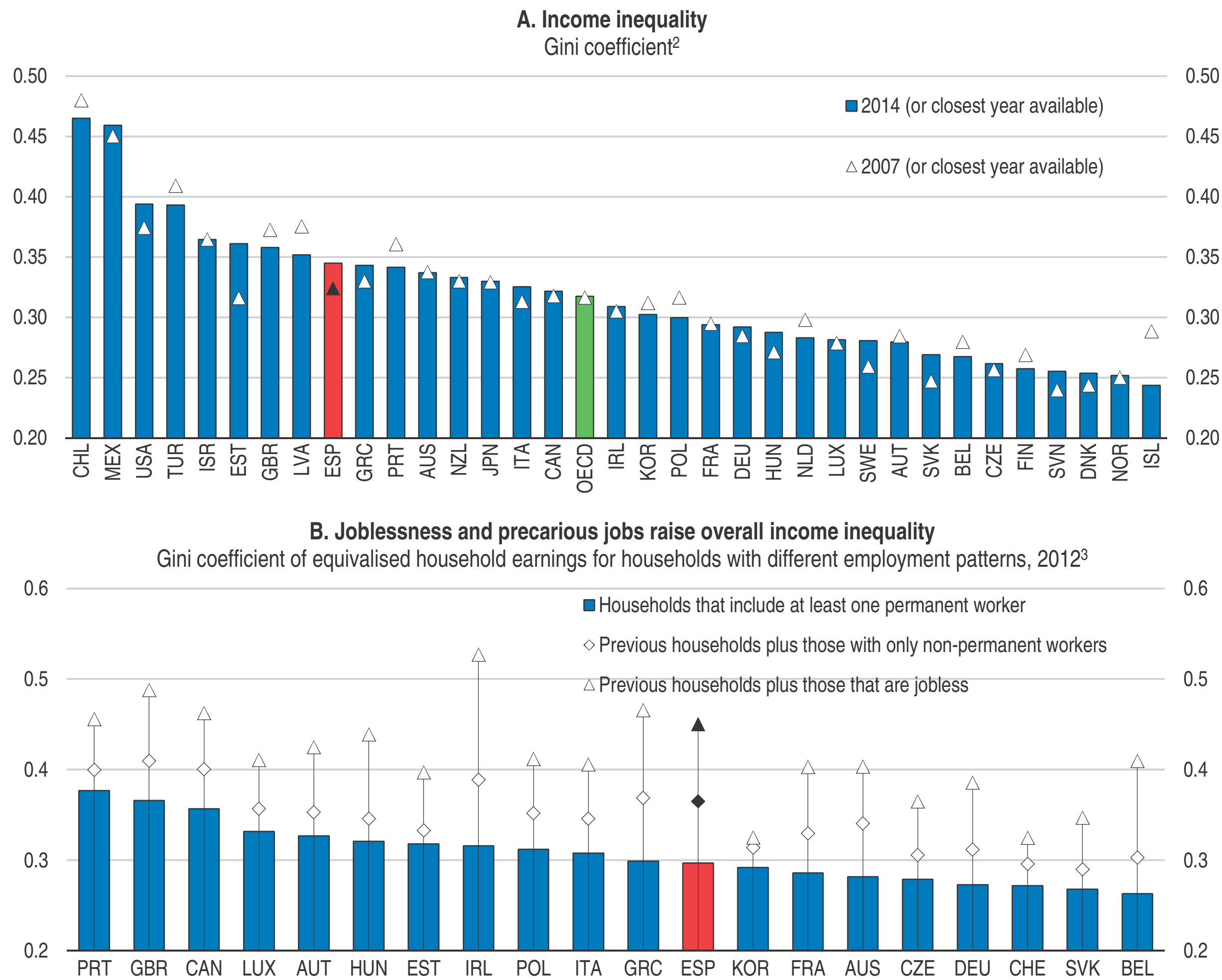
Social benefits are weak and poorly targeted

The tax and transfer system could do more to relieve poverty. Total social spending as a percentage of GDP is higher in Spain than the OECD average, which helped to partly cushion the negative effects of the steep rise in unemployment following the crisis. However, social benefits are poorly targeted with relatively well-off households benefiting

Figure 1.10. **Income inequality increased during the crisis**[1]



1. The Gini coefficient is calculated for household disposable income after taxes and transfers, adjusted for differences in household size and it has a range from zero (when everybody has identical incomes) to one (when all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income.
2. 2012 instead of 2014 for Japan and New Zealand. 2013 instead of 2014 for all other countries except for Australia, Finland, Hungary, Israel, Korea, Mexico, the Netherlands, Spain and the United States. 2006 instead of 2007 for Japan. 2008 instead of 2007 for Australia, France, Germany, Israel, Mexico, New Zealand, Norway, Sweden and the United States. 2009 instead of 2007 for Chile. The OECD aggregate is calculated as an unweighted average of the data shown.
3. Or most recent year available.

Source: Provisional data from the *OECD Income Distribution Database*; and OECD (2015), *In It Together: Why Less Inequality Benefits All*.

How to read Panel B of this figure: In Spain, the Gini coefficient is 0.30 when taking account of households with at least one permanent worker. It rises to 0.37 when including also households where all adult members in work are on a temporary contract or other precarious jobs. It rises further to 0.45 when including households where no adult member is in work.

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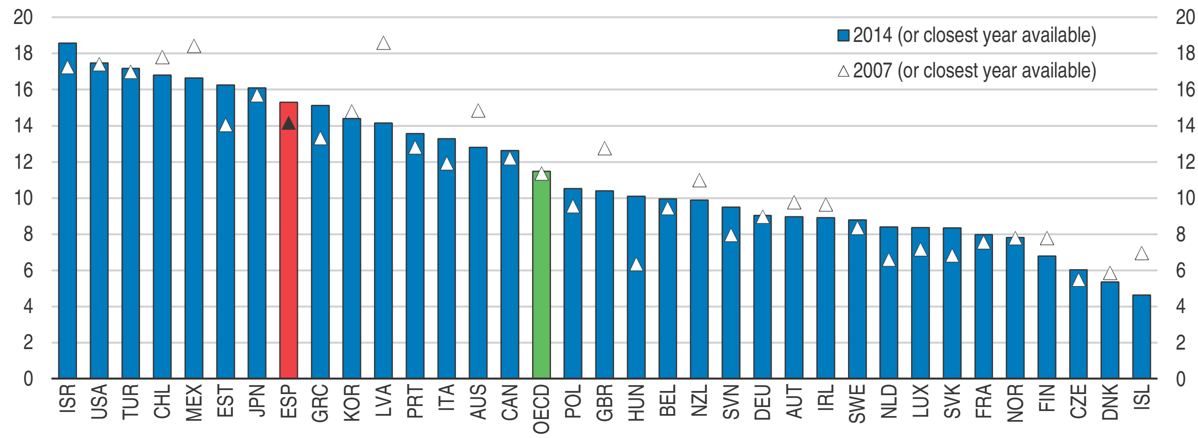
more than the poor (Figure 1.13). Income support to low-income households is also very weak. Among the working age population, the bottom 10% receives less than a quarter of the support that goes to the top 10% (Figure 1.13). Cash transfers are particularly low at the bottom 20% of the income distribution.

Figure 1.11. **Poverty increased during the crisis**

Relative poverty, percentage[1]



1. The relative poverty rate is defined as the share of people living with less than 50% of the median disposable income (adjusted for family size and after taxes and transfers) of the entire population. 2012 instead of 2014 for Japan and New Zealand. 2013 instead of 2014 for all other countries except for Australia, Finland, Hungary, Israel, Korea, Mexico, the Netherlands, Spain and the United States. 2006 instead of 2007 for Japan. 2008 instead of 2007 for Australia, France, Germany, Israel, Mexico, New Zealand, Norway, Sweden and the United States. 2009 instead of 2007 for Chile. The OECD aggregate is calculated as an unweighted average of the data shown.

Source: Provisional data from the *OECD Income Distribution Database*.

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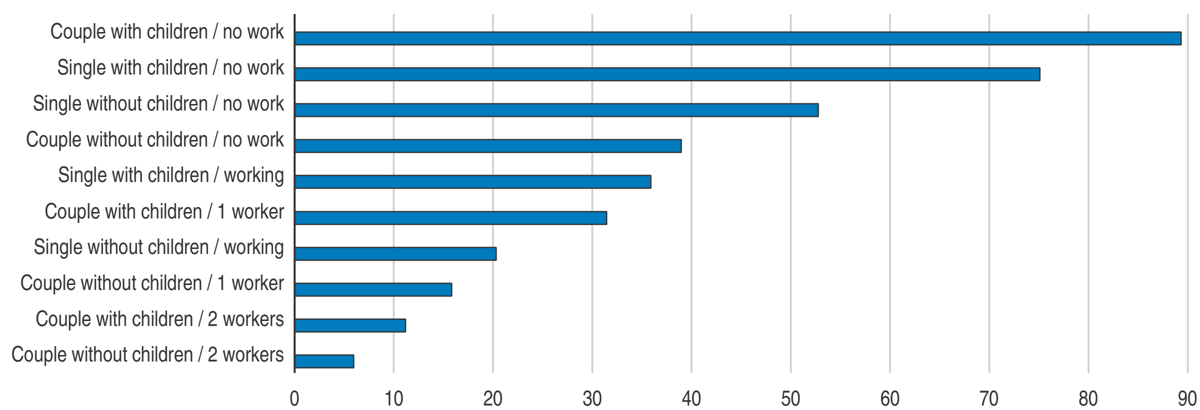
Figure 1.12. **Poverty risks are high for families with children or with unemployed family members**

Poverty rate across different employment status and household structure, percentage, 2013



Source: Calculations based on the *OECD Income Distribution Database*.

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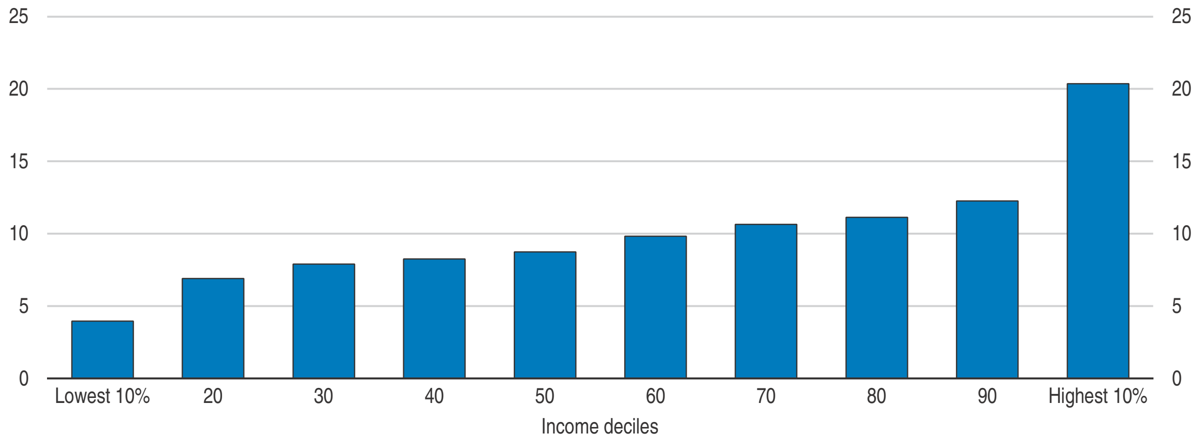
The minimum income support provided by safety nets is weak and its coverage is very limited. Social protection in Spain consists not only of the unemployment insurance system managed by the central government, but also of minimum income support schemes run by the central and regional authorities (Box 1.2). Only 1.5% of households received minimum income support in 2014 from the regional schemes. The *Renta Mínima de Inserción* (RMI) is the most common income support scheme for those who are not eligible for unemployment benefits, aimed at alleviating poverty by means of cash benefits for

Figure 1.13. **Transfers benefit mostly the top incomes**

Cash transfers received by each income decile group as a percentage of total cash transfers, working-age population, 2013



Source: Calculations based on the OECD *Income Distribution Database*.

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Box 1.2. **The structure of responsibilities at different government levels in Spain**

In Spain, the structure of responsibilities for employment services and social assistance is complex, involving authorities at three different levels: the central government (*Administración General*), regional authorities (*Comunidades Autónomas*) and local authorities which consist of provincial, sub-provincial and municipal entities. Regional and local authorities fund their expenditure via two major sources of revenue: i) transfer payments, most often unconditional, from the central government; and ii) their own taxes.

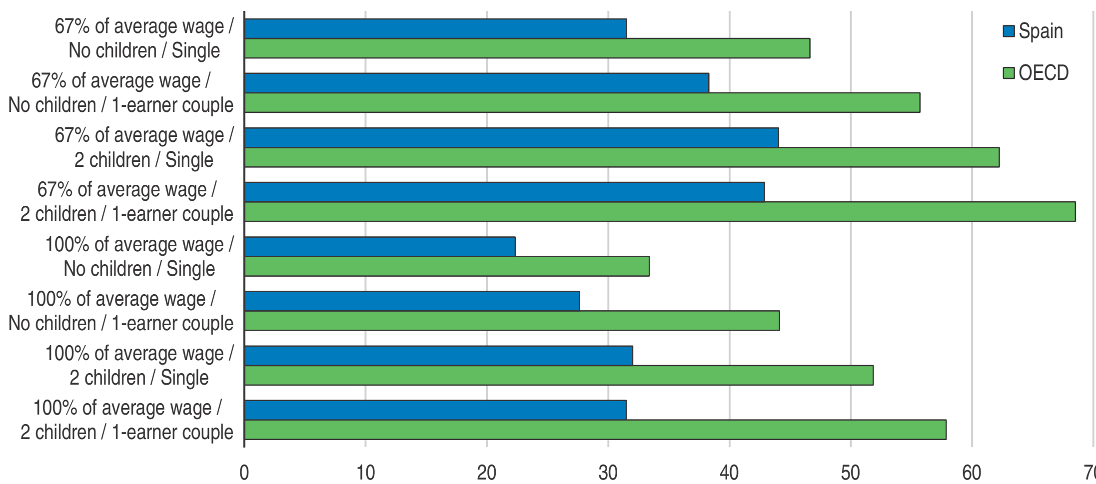
In some policy areas, the responsibilities are distributed between two or even three levels of government. For example, in the case of active labour market policies the central government is responsible for designing the policies while regional authorities are responsible for their implementation. For unemployment insurance, which is closely related to active labour market policies, the central government is responsible for its management. An effective activation policy, combining adequately unemployment benefits and active labour market programmes for the unemployed, would require intensive co-operation between the central government and regional authorities. Beyond that, providing effective support to the long-term unemployed who have exhausted their unemployment benefits and need social assistance, calls for an effective co-operation between employment and social services, for which both regional and local authorities are responsible.

There are already in place mechanisms to enhance co-operation across the authorities at different levels. The Sectoral Conferences that bring together the national and regional administrations by policy area are a notable example. Further co-operation could be achieved by exchanging best practices between regional authorities, setting up common action plans and electronic single points of contact. Information sharing on policies and beneficiaries in a timely manner, including setting up a shared information system, is an important element for enhanced co-operation.

basic living needs. For those who do receive the RMI, the net replacement ratio is low compared with similar social assistance in other OECD countries, in particular for those with children (Figure 1.14). There are also large disparities across regions in coverage and support that do not reflect regional differences in levels of poverty (European Commission, 2016). Moreover, social assistance beneficiaries often need to go through long and cumbersome procedures to access benefits and benefits are rapidly withdrawn when beneficiaries return to work, eroding their work incentives. Simplifying the procedures to access basic support would help improve access and coverage for those eligible.

Figure 1.14. **Income support for jobless households is weak**

Net replacement rates for long-term unemployed by previous earnings level and household structure, percentage, 2014[1]



1. Net replacement rates show after-tax benefits as a proportion of the previous earnings. These benefits include social assistance, family and housing benefits in the 60th month after job loss. For married couples the percentage of average wage relates to the previous earnings of the "unemployed" spouse only; the second spouse is assumed to be "inactive" with no earnings and no recent employment history.

Source: OECD Tax-Benefit Models.

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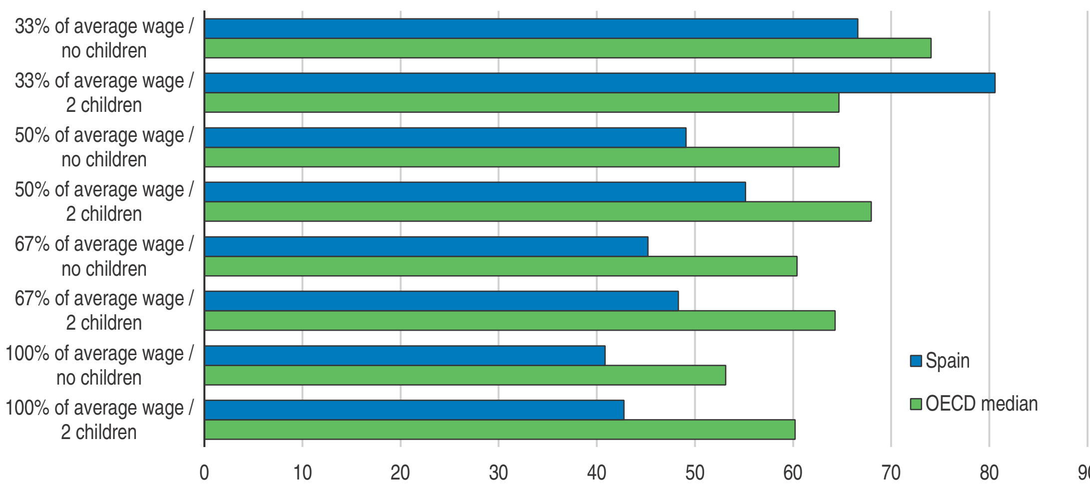
Both national and regional support programmes to address poverty should be rethought. The national and regional authorities are working closely to assess the effectiveness of the income support schemes. These consist of some targeted employment programmes [*Renta Activa de Inserción* (RAI), *Programa de Recualificación Profesional* (PREPARA), and *Programa de Activación para el Empleo* (PAE), see below]; specific schemes in the social security system, such as the minimum income for pensioners ("*Complemento a mínimos*"), non-contributory schemes for families ("*Pensiones no contributivas por hijo a cargo*"), and minimum income support systems run by regional authorities (such as the RMI). This complex system of social support could benefit from streamlining and better co-ordination across different government levels so that its effectiveness and targeting is improved. The coverage and amount of supports of the regional schemes should be raised, especially for families with children. Income support for low-income households with children is particularly poor, due to weak top-ups for children, and should be raised, given the particularly high poverty rate among households with children (Figure 1.12). Importantly, the benefits should be strictly conditional on active job search. This would not only provide immediate income support but also allow benefit recipients to stay connected to the labour market, as long as relevant activation and employment support measures are put in place.

When strengthening the minimum income support system the authorities should also consider the potential effects on work incentives such system may have. Currently, social benefits received while out of work are rapidly withdrawn, as reflected in high participation tax rates (the fraction of income which is taxed away by the combined effect of taxes and benefit withdrawals when returning to work) (Figure 1.15). To strengthen the financial incentives to return to work, social benefits for jobless people should be phased-out more gradually after they return to work and as they earn higher wages, instead of one-for-one reductions in the benefit as it is the case currently. Many other countries gradually phase-out benefits as earned income rises, as for instance in France (the *Revenu de Solidarité Active*). This may have a larger budgetary cost, but it ensures that incentives to return to work are not compromised.

Figure 1.15. **Financial incentives to return to work are low at low earning levels**

Participation tax rates by earnings level and household structure, percentage, 2014[1]



1. Data refer to the average of single person and one-earner married couple household structure. Participation tax rate refers to average effective tax rates measuring the extent to which taxes and benefits reduce the financial gain of moving into work. The estimates here relate to the situation of a person who is not entitled to unemployment benefits (e.g. because they entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. The percentage of average wage relates to the earnings from full-time employment of the individual moving into work.

Source: OECD Tax-Benefit Models.

StatLink http://dx.doi.org/10.1787/888933459261

Public support for families is weak in general. Social spending per child is below the OECD average and is particularly low for early childhood, resulting from low spending on family cash benefits and on public childcare services. Family cash benefits accounted for only 0.5% of GDP in 2013, much below the OECD average of 1.2%. Family cash benefits are found to reduce income inequality (Fournier and Johansson, 2016) and can be enhanced given the high child poverty rate. Reinforcing public childcare services will not only help to alleviate child poverty by reducing childcare costs for poor households, but will also help reconcile work and family life, supporting female labour force participation, which also contributes to GDP growth in the long run (Thévenon et al., 2012).

Improving the coverage of unemployment insurance

A substantial share of the unemployed has exhausted its benefits and is at risk of poverty and social exclusion. While the replacement ratio of the standard unemployment benefit is not particularly low, its coverage has been put under strain by the high numbers of long-term unemployed. The standard unemployment benefit covered only 24% of the unemployed in 2012, well below the OECD average. In addition, a substantial number of those who separate from temporary contracts are not entitled to the standard unemployment benefit or quickly lose their entitlement as a result of very short contribution periods in the social security system.

Strengthening the unemployment insurance system, as part of making employment policies oriented more towards activation, would help vulnerable jobseekers improve their employment prospects. Many of those who were on temporary contracts cannot meet the minimum contribution period of 360 days in the preceding six years, which is required for the standard unemployment benefit. Some of these jobseekers rely on other type of benefits, such as unemployment assistance benefits (*prestación por desempleo de nivel asistencial*), but the amount and coverage of these benefits are low. Instead, the standard unemployment benefit should extend its coverage to vulnerable jobseekers. Precisely speaking, its minimum required contribution period should be reduced to six months or shorter as in many other EU countries. Other countries which had similar requirements such as Italy made this requirement more flexible (OECD, 2015a). Improved coverage should be coupled with stronger incentives to remain in contact with public employment services.

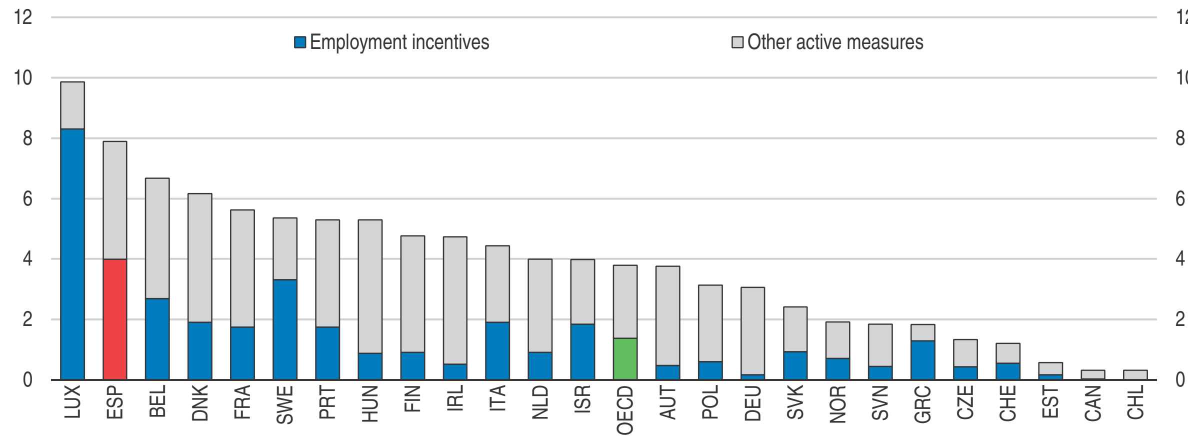
Improving the effectiveness of active labour market policies to get more people into jobs

Spain has continued making progress towards improving activation policies in the past few years. As part of its 2014-16 Activation for Employment Strategy, the government has started to introduce for the first time modern activation tools such as profiling systems to better target groups at greater risk of long-term unemployment. This is welcome, as profiling tools are essential to identify barriers impeding a quick return to work for the large number of long-term unemployed. However, implementation of recent reforms remains uneven across regions given insufficient and poorly targeted resources in many regions, besides high levels of bureaucracy and lack of effective mechanisms to reach the most vulnerable among the unemployed.

Spain spends still considerably less on active labour market policies (ALMPs) per unemployed person than in other OECD countries. The spending effort, measured as ALMP spending per unemployed person as a ratio to GDP per capita, was among the lowest in the OECD (3.9% for Spain against the OECD average of 14.5% in 2013). Possibly more importantly, the balance of spending on labour market programmes has been heavily skewed towards employment incentives (Figure 1.16), mostly hiring subsidies for the unemployed. Hiring subsidies can help to avoid workers losing contact with the labour market during a recession (de Serres and Murtin, 2013). However, now that the recovery is taking hold, the widespread use of hiring subsidies is inefficient. Previous experience has shown that these measures generate substantial deadweight losses and undesirable substitution effects, yielding at most small employment gains (Dolado et al., 2013; Crépon et al., 2013). Subsidies should be phased out or targeted solely on the most disadvantaged or difficult to place workers, such as older workers that have been unemployed for over a year. Moreover, greater efforts are needed to improve the efficiency of spending on labour market programmes. For that it is essential that evaluation mechanisms, which are very uncommon in Spain not only for labour market programmes but also in other policy areas, are put in place to assess what works and what does not and to reallocate resources towards effective schemes and to shut down ineffective ones.

Figure 1.16. **Active labour market policies are concentrated in employment incentives**

Participants in active labour market policies as a percentage of the labour force, 2014[1]



1. Active labour market programmes include all social expenditure (other than education) which is aimed at the improvement of the beneficiaries' prospect of finding gainful employment or to otherwise increase their earnings capacity. This category includes spending on public employment services and administration, labour market training, special programmes for youth when in transition from school to work, labour market programmes to provide or promote employment for unemployed and other persons (excluding young and disabled persons) and special programmes for the disabled. Employment incentives consist of job rotation and job sharing schemes as well as programmes making payments for a limited period only to facilitate the recruitment, or continuing employment in the case of restructuring, of unemployed persons and other target groups into jobs where the majority of the labour cost is covered by the employer. Due to data availability other active measures exclude programmes related to public employment services. 2013 for Ireland, Poland and Spain. 2010 for Greece.

Source: OECD (2016), "Labour market programmes: expenditure and participants", *OECD Employment and Labour Market Statistics* (database), December.

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Co-ordination between the central and regional government in job placement has been an issue for long time. In Spain, the central government manages unemployment benefits, while regions are in charge of managing placement services and ALMPs in general (Box 1.2). In the past regions received funding for ALMPs according to the number of unemployed, which distorted incentives for regional employment offices, as regions that succeed in placing more unemployed did not receive additional funding for their performance. To address this incentive problem, in 2013 the government started to gradually allocate funds to regions on the basis of quantitative indicators of performance. In 2016, 70% of funding is subject to the attainment of objectives agreed by the central government and regional authorities, up from 60% in 2015. A common catalogue of services has also been created to increase co-ordination and ensure a guaranteed minimum level of quality in job placement and job search support across regions. These measures go in the right direction, but change has been slow.

To further improve co-ordination and the quality of employment services, the authorities should consider setting up a single point of contact for all social and employment services and assistance. This could generate greater efficiency and ensure effectiveness through a more co-ordinated service delivery. It would also facilitate the sharing of expertise and information across regions.

The implementation of the new activation strategy is also held back by the limited capacity of public employment services to provide effective, individualised counselling. The number of jobseekers that each caseworker in the public employment service (PES) oversees is high, with one employee of public employment services in charge of more than 250 unemployed. Moreover, there is evidence that caseworkers spend a large proportion of their time on administrative tasks instead of counselling (OECD, 2015b). The public employment services need qualified staff and higher staff-to-job seeker ratios to properly implement the new activation strategy. Appropriate training is needed to help caseworkers use the new profiling tools and in particular to provide individualised counselling to hard-to-place jobseekers, such as the long-term unemployed, the low-skilled and youth. On this front, the recent programme *Programa de Activación para el Empleo* (see below) is going in the right direction, as it focuses on tailored assistance for jobseekers and reduces the number of jobseekers per caseworker by close to half.

Better targeting support to the most disadvantaged groups

In an effort to improve the matching between job openings and jobseekers and reduce very high unemployment, a single Spain-wide job portal was put in place in 2014. While the number of vacancies uploaded in the single job portal has steadily increased, it remains low and the quality of job postings is uneven with some providing only minimal information about the job requirements and a majority only providing a link to the website where the vacancy was originally posted. Experience from other OECD countries suggests that digitisation and new technologies can help improve job search assistance and reduce operating costs (Box 1.3). E-services are often useful to help the more educated and ready-to-work jobseekers find a job and can potentially enhance mobility of workers, which is low in Spain, by reducing information barriers and facilitating the co-ordination of unemployment services across regions. However, digitisation may be less of an answer to help harder-to-place jobseekers, such as the long-term unemployed or first-time job seekers. These often need personalised and specialised job counselling that is best provided and is most effective via face-to-face counselling, as recent rigorous evaluations from Denmark, Germany and Switzerland show.

To further improve efficiency public employment services have started to contract-out intermediation services to the private sector. A new framework agreement was introduced in 2014 to develop public-private partnerships between regional public employment services and private placement agencies under a common set of rules for all regions

Box 1.3. **Digitisation and new technologies are transforming the way public employment services operate**

In some countries public employment services are investing in user-friendly digital services aiming to increase service availability and accessibility and improve performance whilst keeping costs down. For instance, the Netherlands redesigned in 2010 their PES services (OECD, 2015c) to make a greater use of digitisation. Each jobseeker fills in an electronic questionnaire that helps determine whether or not the jobseeker is entitled to intensive support and the kind of support that is necessary. Moreover, jobseekers have an online account and automatically receive action plans and matched vacancies. All activities are monitored automatically and reminders and directions are given as necessary. If the required tasks are not fulfilled, such as applying for a job vacancy, personal interviews are used to follow-up and continued non-compliance may lead to sanctions. The Netherlands treats 90% of the unemployed benefit recipients through e-services and only those facing the greatest employment difficulties (about 10%) receiving face-to-face services. Finland is moving in the same direction to cut costs and better target its resources to the most disadvantaged jobseekers.

funded by the national employment service. Compensation to private agencies depends on verified full-time employment lasting at least six months, with higher compensation for placing the long-term unemployed. Such co-operation is only starting and only some regions participate. Around 200 000 jobseekers are being assisted by private agencies and only about 10 200 jobseekers have found a job thanks to the new private-public partnerships, according to the Labour Ministry.

OECD experience suggests that contracting-out to the private sector can help the public employment services improve service quality by exploiting the expertise and the know-how of external providers. However, for external provision to work the incentive structure of private employment partnership needs to be carefully designed and monitored to create the right incentives (OECD 2015c). The authorities should be careful, as there is a risk that private placement agencies place the unemployed who are easiest to employ, leaving aside the hardest to place unemployed who need more help. Experience from a number of OECD countries suggests that for these initiatives to work, the relevant authorities should define the target population that private providers should focus on and design a system of fees for private agencies that rewards performance in achieving sustainable job placements for this target population. It is also crucial to put in place good auditing and performance monitoring systems so the public employment service can evaluate whether contracting out has indeed led to sustained job placements and public money is effectively spent.

Experience in Australia – a country that has successfully involved private providers in job placement – shows that this is not easy and can be expensive (OECD, 2013). Therefore, it would be wise for Spain to start by testing the usefulness of contracting out activation to private providers through pilot studies for a target population, for instance the long-term unemployed who are in most need of specialised support that the PES cannot currently provide. Such a small scale approach would ensure the system is properly designed, including by developing proper schemes to monitor outcomes which Spain lacks at the moment, before scaling it up more widely. It would also be more cost-effective than the current approach of targeting all the unemployed, despite the fact that some of them may not need the help of private agencies to find a job.

Helping the long-term unemployed

One of the most worrying legacies of the crisis is the large number of very long term unemployed. About half of all unemployed have been unemployed for over a year – down from a peak 53% in 2014 – and among this group about seventy per cent has been unemployed for more than two years. What is most worrying is a strong concentration of the longest unemployment spells among disadvantaged groups, such the low educated, older workers above fifty years old and workers from the construction sector (Jansen et al., 2016). Nearly 60% of very long-term unemployed have no more than mandatory education and many of them used to work in the construction sector, which is unlikely to become such a large source of jobs as in the past. The recovery has led to a significant improvement in the job finding rates of the short-term unemployed, however, a similar improvement has not been observed for the long-term unemployed (Jansen et al., 2016).

The long-term unemployed need better targeted and more effective programmes. The existing programmes, *Renta Activa de Inserción* (RAI), *Programa de Recualificación Profesional* (PREPARA), and *Programa de Activación para el Empleo* (PAE) launched since the beginning of the crisis and with different target populations, could be better co-ordinated or streamlined to become more effective. The PAE is a major package of income support and training launched in early 2015. The programme has helped 15% of its participants find work, which is relatively successful compared with similar programmes in other countries (Card et al., 2015). The programme aims at upskilling the unemployed and includes the support of a personal tutor to help the person back into employment. These are steps in the right direction, however, the programme provides weak income support – around EUR 400 per month (which is slightly lower than the basic amount of the minimum income support – *Renta Mínima de Inserción*) during six months non-renewable. Accessing the benefit is also difficult given demanding requirements to provide evidence of active job search. This may explain why out of the EUR 1.2 billion allocated to the programme, only EUR 182 million were spent in 2015 and only some 100 000 people have benefited from the programme, much below the number of potential beneficiaries initially estimated.

A joint action plan to improve assistance to the long-term unemployed, primarily for those aged 30-55, was agreed with the regions and introduced in December 2016. It aims at improving the capacity of the public employment services to provide personalised assistance to the long-term unemployed by retraining staff, hiring new staff, strengthening collaborations with private agencies and improving information systems by developing profiling tools among others. Funding will be conditional on regional public employment services performance in providing personalised assistance to the long-term unemployed, the quality of that assistance, and the insertion rate of the long-term unemployed into stable employment. These efforts to improve the capacity of the public employment services are welcome, but it will also be important to strengthen the links with education policies.

A majority of the long-term unemployed lack basic literacy, numeracy and digital skills and recognisable diplomas and substantive re-training could be provided in collaboration with vocational education and training (VET) institutions. Spain also has relatively extensive offer of academically oriented "Adult Education" programmes and some of the resources of these programmes could be reoriented towards work-based training for the long-term unemployed.

Ensuring youth are not left behind

Youth unemployment is very high, and underscores the risks of a lost generation of youth who are missing out opportunities to build their careers. Youth unemployment doubles the overall unemployment rate. While the level of education is a key determinant of youth labour market success, the fact that even young university graduates suffer unemployment rates close to 36% (Table 1.1) signals the grim labour market prospects Spanish youth face.

Young people who are "not in education, employment or training" (NEETs) is a particularly vulnerable group for whom the risk of being left permanently behind is high. Although the NEET rate has fallen since 2013 to below 20%, it is worrying that the share of young people remaining NEETs for more than one year is large by OECD standards (OECD, 2016b). This risk is particularly high for low-skilled NEETs, who have not finished upper secondary schooling. At 12.9%, the share of young people in Spain who are low-skilled NEETs was one of the highest among OECD countries in 2015, remaining 3.4 percentage points above its pre-crisis level. Almost half of this group live in households without any employed adults, suggesting that they are also at risk of poverty (OECD, 2016a).

The Youth Guarantee scheme is meant to help young NEETs by promoting vocational guidance, labour information and assistance in job seeking, employability and hiring as well as entrepreneurship support. Spain has received the highest share of European funding to implement the guarantee and to provide assistance to youth, but the implementation of the scheme started slowly and has not yet reached as many youth as it should. As the European funding is being complemented with national funds, the number of registered youth has increased to around 400 000 as of November 2016. Apart from funding, some challenges remain to be addressed. It is still difficult to reach out unregistered youth NEETs who are farthest away from the labour market.

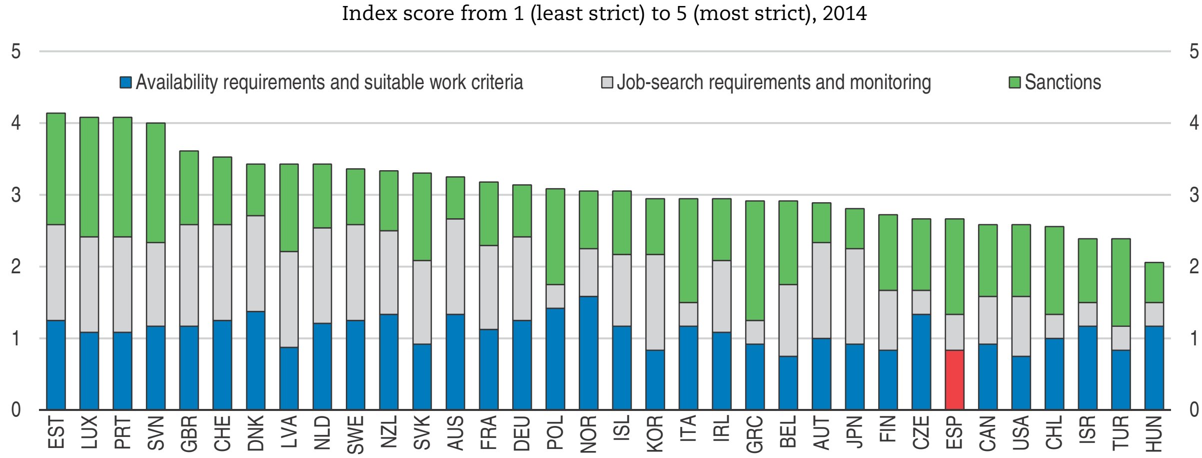
The registration to the Youth Guarantee programme was simplified in late 2016, facilitating regional authorities to provide assistance to youth NEETs. The government is also working with the regional and national PES to enhance attention to the registered youth and to increase the number of youth NEETs that are registered. The on-going co-operation with the Chambers of Commerce and the National Institute of Youth has been positive, and the authorities are considering new agreements with other partners (such as the Red Cross, Fundación ONCE and second chance schools, among others) to reach out to youth, disseminate information, encourage registration and provide basic training for the youth NEETs. These efforts are welcome and should be coupled with better education policies geared towards improving the skills of Spanish youth, as discussed below.

Effective implementation of conditionality is needed

An important part of best practice active labour market policies is to enforce requirements that the unemployed who receive income and employment support must participate actively in job search and/or training. Such conditionality keeps beneficiaries closer to the labour market, making it more likely that they will return to work. In Spain, job search requirements to receive unemployment benefits exist and the unemployed must renew their registration with the public employments services (PES) every three months to keep receiving benefits. However, monitoring of job search activities by PES, while it has been strengthened recently, is still low (Figure 1.17). Moreover, benefit recipients are in general not legally required to report their independent job-search efforts to the PES (Figure 1.18), in

Figure 1.17. **Job search requirements for the unemployed are low by international standards**

Index score from 1 (least strict) to 5 (most strict), 2014



Source: Langenbucher, K. (2015), “How demanding are eligibility criteria for unemployment benefits, quantitative indicators for OECD and EU countries”, *OECD Social, Employment and Migration Working Papers*, No. 166, OECD Publishing, Paris.

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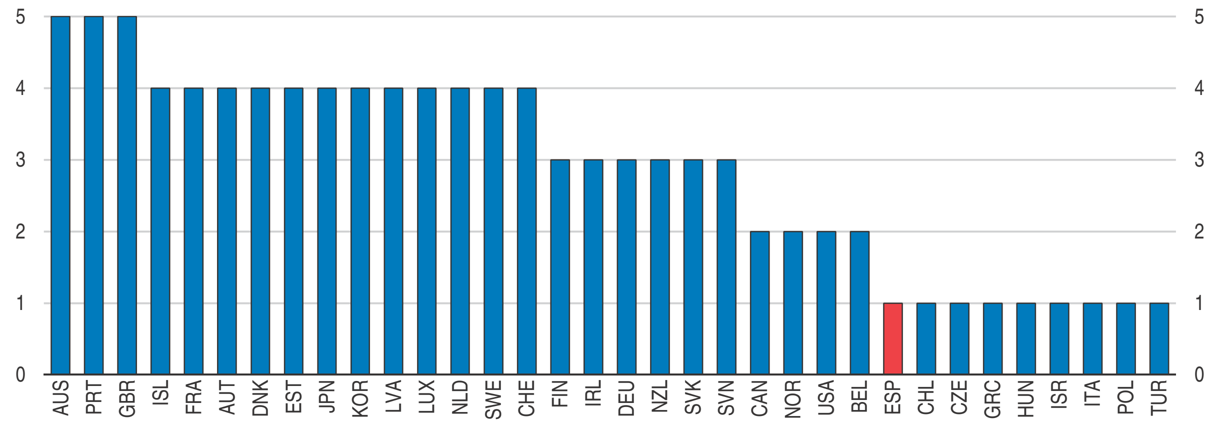
Figure 1.18. **Job-search monitoring is low**

Frequency of monitoring, index score from 1 (least strict) to 5 (most strict), 2014



Source: Langenbucher, K. (2015), "How demanding are eligibility criteria for unemployment benefits, quantitative indicators for OECD and EU countries", *OECD Social, Employment and Migration Working Papers*, No. 166, OECD Publishing, Paris.

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contrast to what happens in other OECD countries (Langenbucher, 2015). The only exception is the *Programa de Activación para el Empleo* (PAE) which requires active job search as a condition to access the programme. Since 2012, regional PES offices have the legal right to set up regular monitoring to ensure jobseekers are actively looking for employment. The regional PES offices should use this new capacity to strengthen monitoring and to guide jobseekers in their search towards the type of jobs that match their skills or towards training opportunities that can enhance their job capabilities.

As the economy recovers and more jobs become available jobseekers obligations in return for training and support provided by the public employment services should be strictly enforced, in line with recommendations in earlier *OECD Economic Surveys* (OECD, 2014c, 2012, 2010). This mutual obligation approach should be even more strictly applied when beneficiaries of unemployment benefits have also received a generous severance pay. At the same time, while increasing jobseeker obligations may be successful to activate new entrants to unemployment, it is not enough for the long-term unemployed who need individualised support and help to get re-skilled.

Regional authorities in charge of local public employment services should be more effectively involved, in order to enhance the mutual obligation approach for those who do not fulfil the obligations of active job search. As discussed above, to this end, the authorities should progress towards a more integrated support for jobseekers, including by setting-up a single point of contact responsible for both placement services and social assistance.

Strengthening skills

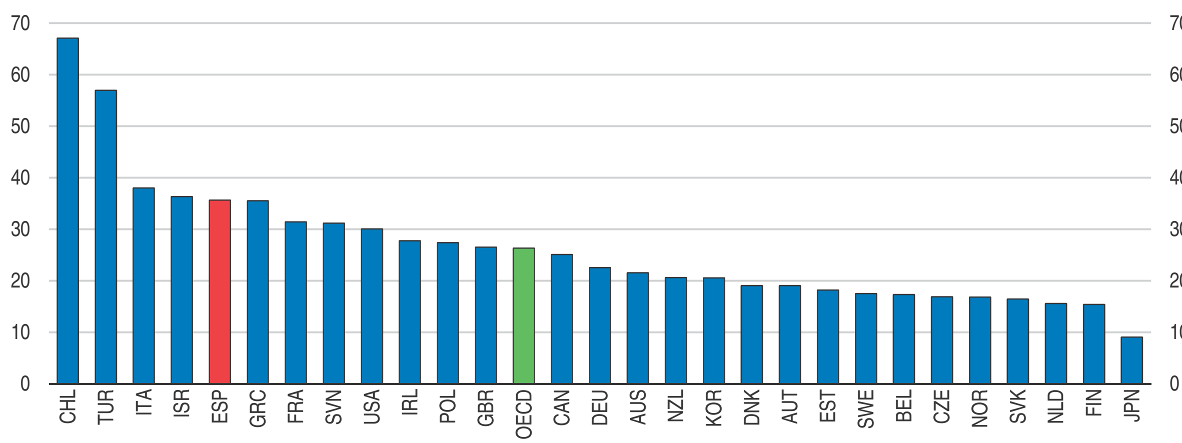
Strengthening the relatively poor skills of the Spanish workforce will be crucial for helping the unemployed find jobs and to better equip young generations for a changing labour market. More than half the unemployed have no more than mandatory secondary education (Jansen et al., 2016). The unemployment rates of these low-educated workers tripled between 2007 and 2015, reaching about 30% (Table 1.1). A key factor behind this development was the collapse of the construction sector and related real estate services.

Before the crisis the construction sector accounted for over 13% of total employment, and this share had fallen to 6% by 2015. Many of these construction jobs were held by low-educated men, including many immigrants. Given the good employment opportunities and the relatively high wage in the construction sector, many young males dropped out of education at an early age to work in construction, but when the housing bubble burst they lost their jobs. While employment has grown strongly recently, it is unlikely that future employment growth will be enough to absorb these low-educated workers without substantial re-skilling.

Moreover, the average level of educational attainment among Spanish people is low by OECD standards, although it has risen in the younger generations. Upper secondary education attainment is well below the OECD average, while tertiary educational attainment is now on a par with many other OECD countries. Such poor educational attainment partly explains that skills proficiency is among the lowest across OECD countries (Figure 1.19).

Figure 1.19. **The proportion of low performer adults is high in Spain**

Percentage of adults who score at or below Level 1 in literacy and/or numeracy, 2012[1]



1. 2015 for Chile, Greece, Israel, New Zealand, Slovenia and Turkey. Low-performing adults are defined as those who score at or below Level 1 in either literacy or numeracy. The OECD aggregate refers to the unweighted average of the 28 OECD countries that participated in the OECD Programme for the International Assessment of Adult Competencies (PIAAC). Data for Belgium refers to Flanders. Data for the United Kingdom refer to England.

Source: OECD (2016), *Skills Matter: Further Results from the Survey of Adult Skills.*

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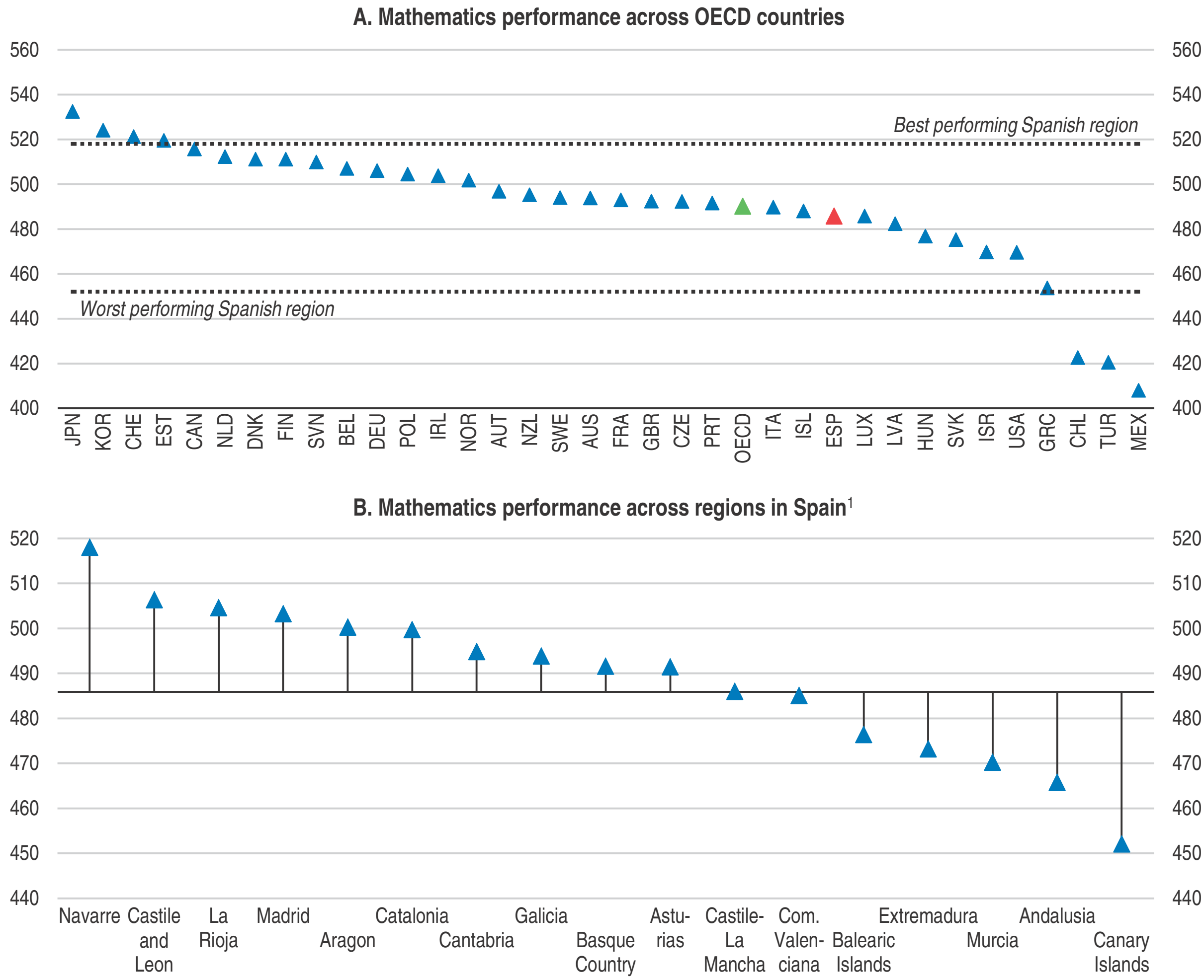
Compulsory education

A good place to start is to improve compulsory education. School performance is poor (Figure 1.20) and early school leaving is the highest in the EU (Figure 1.21), despite a significant improvement in recent years, falling from 26.3% in 2011 to 19.9% in 2015. This is explained by a number of factors including employment opportunities for low qualified youth in certain regions, reduced number of pathways to upper-level secondary education or the perceived lower labour market value of some secondary vocational education and training (VET) degrees.

There are also large differences in educational outcomes across regions, with the best performing region at the same level as the fourth best performing OECD country (Estonia) and the worst performing at the same level as Greece (Figure 1.20). Regional disparities are largely accounted for by socio-economic factors such as economic prospects in the location

Figure 1.20. **School performance is low on average with large regional disparities**

Mean PISA score, 2015



1. The horizontal axis is drawn at the national level of mean PISA score in Spain.

Source: OECD (2016), *PISA 2015 Results (Volume I): Excellence and Equity in Education.*

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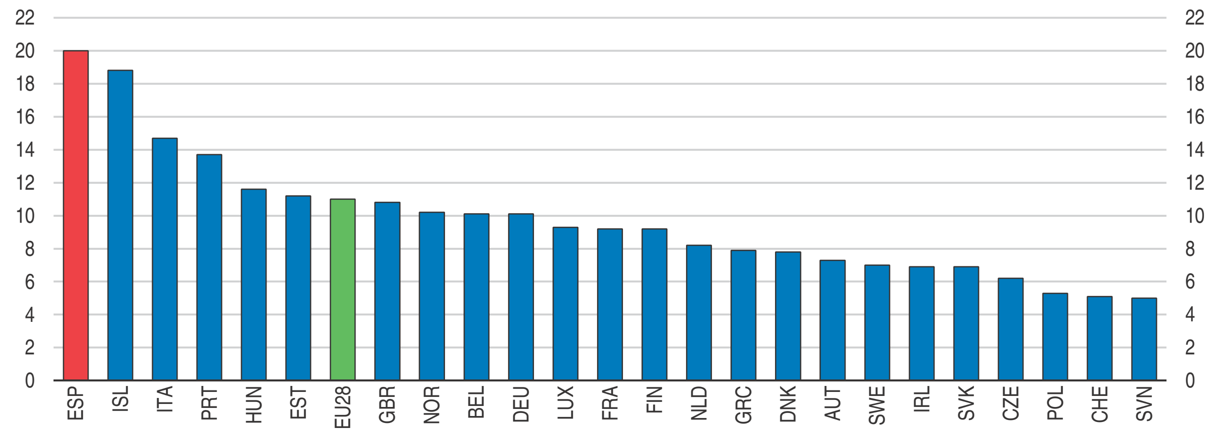
of schools, parents' educational attainment and resources, and migration backgrounds (Cordero et al., 2014). However, the characteristics of schools in terms of autonomy and accountability also affect educational outcomes (Hanushek and Woessmann, 2011). Moreover, in Spain factors likely to affect student performance, such as autonomy in hiring teachers and formulating budget, monitoring of teachers and teacher peer review, as well as standardised exams for orientation of students (OECD, 2016c), also differ across regions.

The Organic Law for Improvement of the Quality of Education (LOMCE), approved in 2013 and gradually implemented since the school year 2014/15, aims to reduce early school leaving and improve educational outcomes. The main pillars of the law are the development and modernisation of vocational education and training (VET), new national external assessment for students, more school autonomy in exchange for accountability and new roles for the regional government in the definition of curricula. While it is too early to evaluate the impact of the law given its broad scope and uneven implementation across regions, its objectives go in the right direction with an increased focus on

Figure 1.21. **Early school-leaving rates are high**

Percentage of the population aged 18 to 24 having attained at most lower secondary education and not being involved in further education or training, 2015



Source: Eurostat (2016), "Early leavers from education and training", *Eurostat Database*, December.

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competencies and skills. Greater school autonomy and better management skills of school leaders are needed and should be accompanied by a well-designed evaluation and assessment framework.

The LOMCE introduced new national standardised assessments. The standardised assessments in primary school have already been implemented for diagnostic purposes, helping to identify students facing learning difficulties in order to provide additional support. Such information should be shared with social and employment services allowing them to reach out to youth with a high risk of falling through the cracks of social and employment support, following the example of Norway (OECD, 2016b). The LOMCE also plans to implement standardised assessments in secondary education from this school year, to define the standards that the students have to achieve in order to obtain a national degree.

There is now widespread recognition that evaluation and assessments are key to improving educational practices and student learning (OECD, 2015d). Empirical evidence also suggests that standardised tests help improve student performance (Hanushek and Woessmann, 2011). Following the example of other OECD countries – five out of six countries surveyed by the OECD Programme for International Students Assessment (PISA) conduct standardised compulsory assessments at least once a year (OECD, 2016c) – Spain also should ensure frequent implementation of national standardised assessments. Such assessments are instrumental in recognising and rewarding the work of educational practitioners and in certifying the achievements of students. Among decentralised systems, national evaluations can help to set common standards and avoid major differences in performance between regions.

Improving the quality of teaching, by providing adequate training to teachers before starting to teach and on-the-job training is needed to further improve educational outcomes and ensure an effective implementation of the law. OECD survey evidence shows that Spanish teachers are less likely to benefit from on the job support programmes than teachers in other OECD countries, and that the support they receive is not very effective (OECD, 2015b). Teacher support and development activities consist mainly of participation in courses, with little positive impact on performance. Measures to enhance the quality of teaching include improving teacher training at university, a better selection process, and improved teacher and training support once they become teachers. For instance, new forms of professional development could be implemented, including collaborative development between teachers. Finally, regions should evaluate how their spending is currently being allocated in order to more effectively reduce early drop-out rates.

Vocational education and training

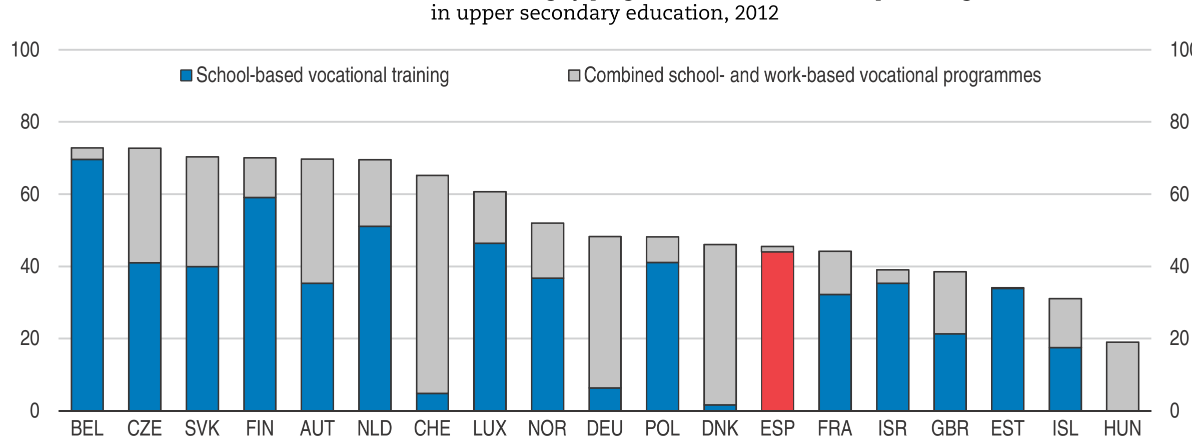
High quality vocational education and training (VET) can help facilitate a smoother school-to-work transition by providing work-related skills. The LOMCE introduced the new Basic VET, a fall-back programme for students lagging behind whose educational team consider as the best way for them to be kept in the educational system. The programme leads them to obtaining a certificate recognised by the European Union, and according to the authorities it has helped to reduce the early school leave rate. The LOMCE, in its primal objective for the VET reform, made the upper-secondary VET more attractive to students and employers: by redesigning courses to adapt them to labour market needs, increasing training at the workplace, strengthening foundation skills and making the transition between upper secondary and tertiary VET easier. More funding has also been allocated to finance new optional subjects in school-based VET, among others.

Despite this progress, the number of students enrolled in school-based VET remains limited, although it has increased in recent years. Students are older than is expected in those educational levels on average, which suggests that school-based VET is being used also as a way for early school leavers to re-enter education (European Commission, 2016). This is a welcome development, as it is a way for early school leavers to re-enter education and strengthen their work-related skills.

OECD experience suggests that practical training in VET is efficient to enhance rapid school-to-work transitions than school-based training. To that extent, recent steps to increase practical training in the workplace as part of VET education are welcome. However, most of the vocational training is still school-based vocational training, as opposed to some other countries that have succeeded in developing effective dual VET systems such as Denmark, Germany or Switzerland (Figure 1.22). Further increasing the

Figure 1.22. **Most of the vocational training is school-based**

Share of students enrolled in vocational training by programme orientation, as a percentage of all students in upper secondary education, 2012



Source: OECD (2014), *Education at a Glance 2014: OECD Indicators.*

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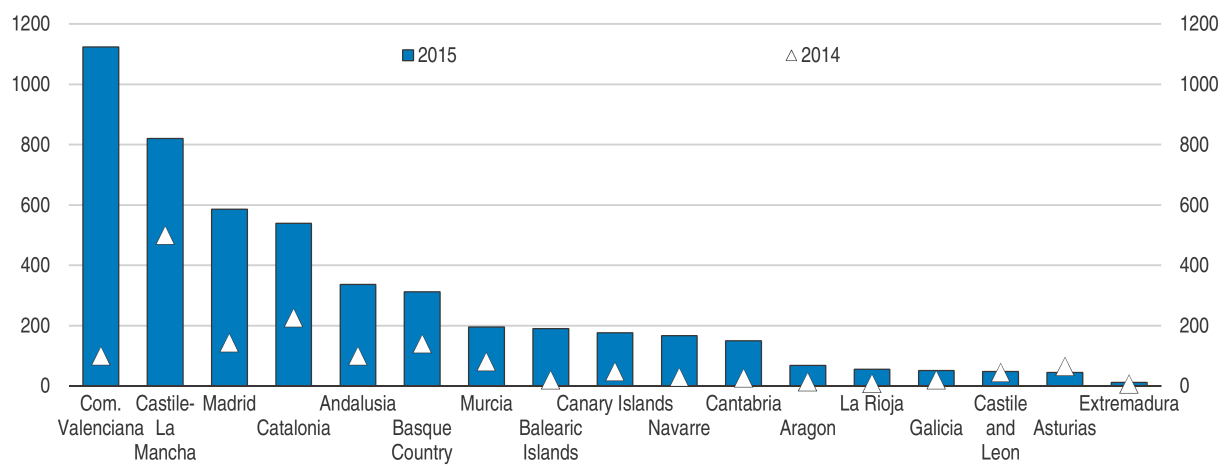
share of mandatory workplace training, as recommended in the 2014 *Economic Survey*, would be desirable not only because of the value the workplace has as a learning environment, but also because it could also help align more closely training with the needs of employers.

Dual VET

The dual VET system, which provides students with school-based training and practical training in a company simultaneously, remains underdeveloped and more efforts are needed to consolidate it. Since 2012, the dual VET system has grown substantially, with dual VET programmes starting up in all autonomous communities, the number of students enrolled quadrupling and the number of participating educational institutions and companies rising markedly (Figure 1.23). The number of students enrolled in dual VET (15 304 in 2015-16) still represents a small proportion of all VET students and the number of companies participating in dual VET is a tiny share of all firms (about 0.2%).

Figure 1.23. **Involvement of companies providing dual VET is low**

Number of companies providing dual vocational education and training (VET) by region



Source: OECD (2015), *OECD Skills Strategy Diagnostic Report: Spain 2015*; and Ministerio de Educación, Cultura y Deporte (MECD) (2014), "Datos de la Formación Profesional Dual del curso 2013-2014".

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More efforts are needed to expand the dual VET system further. A first step is to secure commitment from more firms to provide students with practical training opportunities. The number of companies providing training for dual VET has multiplied by ten, from 513 in 2012-13 to 5 665 in 2015-16. To further increase the incentives and attractiveness for firms to participate in dual vocational education, it is necessary to ensure that the skills being developed are in line with firms' needs and that they are adapted to the rapidly changing nature of jobs (OECD, 2014c; 2014d). This requires greater influence by employers in designing the curricula and improving trainers' skills.

A second step is to facilitate small and medium-sized enterprises (SMEs) participation in VET. About 90% of all Spanish firms have five employees or less. Such a small size makes it difficult for most companies to provide a training tutor, which is a requirement in most VET programmes. This may explain why so far most of the collaborations in dual VET are with large firms. Against such constraints, the authorities are trying to help develop wider co-operation between firms and VET educational centres in partnership with the Chambers of Commerce, the business and labour unions. Greater co-operation could be further facilitated by building on the experience of some regions where clusters of firms with a shared need for workers with certain VET qualifications have gotten together (e.g. *Grupo de Iniciativas Regionales de Automoción* in Cantabria, Northern Spain). Collaboration between SMEs can help to share costs and enhance students experience by providing opportunities to acquire skills on different jobs (Box 1.4).

Box 1.4. **Better engaging firms in providing apprenticeships: The case of Australia**

In Australia, the system of Group Training Organisation (GTO) was established in the early 1970s and there are now approximately 190 companies associated with the system. GTOs recruit apprentices and sign the apprenticeship contract and place apprentices into host employers. It is attractive to SMEs as the administrative costs are reduced. GTOs also provide additional services such as broking vacancies for apprenticeship and candidates, reviewing the quality of training, and providing career guidance to youth. Some GTOs are specialised in a particular industry while others provide services for a region covering many industries (OECD, 2016d).

Finally, another target for policy action to build good quality dual VET, and VET more generally, is the lack of qualified teachers and training tutors in companies. Currently, to become a teacher in the VET system one needs to have a university degree in the field of work, but no practical work experience in the field of teaching is needed. Further facilitating access to teaching in vocational schools to practitioners, as well as easing requirements for firm tutors, could help to increase the pool of qualified teachers and training opportunities. Greater participation in the Erasmus+ programme – an EU Programme that facilitates that tutors and teachers learn in countries with long lasting experience in VET – could also help to improve the skills of teachers and tutors.

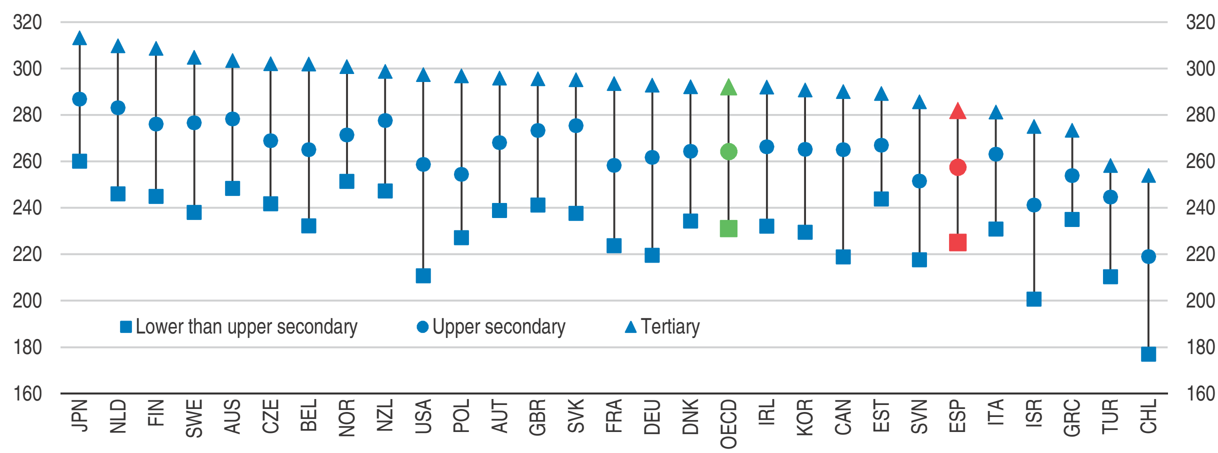
University education

In Spain, literacy proficiency among tertiary graduates is among the lowest in the OECD (Figure 1.24), with the skills of tertiary graduates similar to the level of skills of students who finish secondary education in other countries. The recent OECD Skills Strategy for Spain shows that a complex set of factors explain the low set of skills Spanish students acquire at university (OECD, 2015b), including the funding formulas based almost exclusively on the number of students, governance systems with insufficient external accountability, selection procedures that promote inbreeding and very low mobility of students and teachers.

At the same time, Spain seems to be underutilising the skills that do exist, with a high proportion of university graduates in occupations which do not require a university diploma. A survey by the Spanish statistical institute shows that only three out of four university graduates were carrying out tasks requiring a university diploma four years after their graduation in 2014 (INE, 2015). This reflects in part an important misalignment between university education and labour market needs. The low demand for high skills among Spanish firms is another factor explaining this outcome, as discussed above.

Figure 1.24. **Foundation skills are low on average**

Mean literacy proficiency score, 2012[1]



1. 2015 for Chile, Greece, Israel, New Zealand, Slovenia and Turkey. The OECD aggregate refers to the unweighted average of the 28 OECD countries that participated in the OECD Programme for the International Assessment of Adult Competencies (PIAAC). Data for Belgium refers to Flanders. Data for the United Kingdom refer to England.

Source: OECD (2016), *Skills Matter: Further Results from the Survey of Adult Skills.*

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Recent government initiatives aim at improving the modernisation and internationalisation of university education. A 2015 Royal Decree aims at making study programmes and funding more flexible and to enhance co-operation with the business sector to adapt programmes to labour market needs and to facilitate the development of joint research and development (R&D). The proposal to restructure governing boards so that representatives from the private sector and civil society sit on the board and influence university decision-making could help to better align university education with labour market needs.

On-the-job training

Education and training policy needs to reach out to the numerous adults who left education with poor skills. As noted above, on-the-job learning opportunities are less frequent in Spain than in other EU countries and a substantial share of workers is poorly skilled.

Recent government initiatives aim at improving on-the-job training. The new training-for-employment model, adopted in September 2015, is based on the principle of greater transparency and control in the management of public resources, greater competition in the provision of training courses, and better assessment of training quality. By using more information on workers' skill needs it aims at closing the gap between skills demand and supply. Information on skill needs is gathered by the public employment offices in co-operation with social partners.

A 2015 Royal Decree establishes an evaluation and monitoring system to ensure training quality, a multi-annual strategic planning, open and transparent tendering processes for private training providers, and an anti-fraud unit (OECD, 2015b). The new system enhances the involvement of employers in choosing the training courses although efforts are still needed to adapt the courses to labour market needs.

Supporting more and better quality jobs

Reducing barriers to hiring low-skilled workers

Spain implemented in 2015 and 2016 a reform to make the tax system more conductive to growth (OECD, 2014c). Even after the reform, however, the structure of taxation remains tilted towards labour income which penalises growth and employment (Johansson et al., 2008). Reducing the tax wedge on labour, which is high by international standards (Figure 1.25), could further support employment. The 2014 personal income tax reform reduced the tax wedge by exempting income up to EUR 12 000 and lowering personal income tax rates, likely contributing to boost labour supply, especially among those with low skills. A temporary measure to boost permanent jobs between February 2015 and August 2016 reduced social security contributions (SSCs) for employers, by exempting the first EUR 500 of workers' salaries employed on all new permanent contracts for two years. This measure is more progressive and better targeted at low wage earners than the 2014 flat SSCs fee for all new permanent hires that generated stronger incentives to hire high-wage workers (OECD, 2014c).

Figure 1.25. **Tax wedge is high due to high employer social security contributions**

Tax wedge for the average of four different household types by earnings level, as a percentage of total labour costs, 2015[1]

1. The four different household types include: single person without children, one-earner married couple without children, single parent with 2 children and one-earner married couple with 2 children.

Source: OECD (2016), "Taxing Wages: Tax wedge decomposition", *OECD Tax Statistics* (database), December.

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To further support job creation, the government should build on this cut in employer SSCs, by making it permanent and restricting it to low-wage workers. This will have long lasting positive effects on employment among low-skilled workers, where the need to stimulate labour demand is largest, and evidence suggests that reductions in non-wage labour costs are effective (OECD, 2011). OECD estimates suggest that such a measure could increase employment by around 70 000 jobs and GDP by ¼ percentage point over the next five years (Gal and Theising, 2015). Such a reduction in employer SSCs should be considered in the context of a broader tax reform to improve the tax structure which is currently titled towards labour income which penalises growth and employment (see "Assessment and recommendations").

Further reducing labour market duality

The Spanish labour market remains characterised by a strong duality between permanent and temporary workers. While the share of temporary workers has significantly declined since 2007 (when it reached 32%), 25% of all workers have a temporary contract, the second highest share in the OECD (Figure 1.2, Panel A). The 2012 Spanish labour market reform has helped to tackle deeply entrenched labour market segmentation by strengthening the incentives for employers to hire on open-ended contracts (Box 1.1). OECD analysis suggests that the reform increased the share of open-ended contracts in new hires. However, over 60% of net employment growth has taken the form of temporary contracts since early 2014, according to the Labour Force Survey data. Young people, including the highly-educated, are the main group affected by temporary contracts. Transitions from temporary to permanent status are very limited and have significantly worsened since 2007 (Figure 1.2, Panel B).

Job quality among temporary workers is particularly poor. Labour market insecurity for temporary workers during the crisis was significant and found to be three times as high as for permanent workers (OECD, 2014b), due to the fact that labour adjustments affected disproportionately temporary workers. Temporary workers earn some 30% lower hourly wages in Spain, with around half of which (15 percentage points) is estimated to be a wage penalty (attributed to the type of contract all else equal, OECD, 2015e). Over time, temporary workers tend to experience unstable employment careers and low wages subsequently ("scarring effects", see García-Pérez et al., 2016).

Many temporary workers do not work all year long. According to EU-SILC data, the share of individuals with low work intensity in Spain was high at 11% of the working age population in 2013 (working no more than 45% of the standard worker, in line with Eurostat definition) and many of them report "short-term unemployed" as a main activity of the reference year (Fernández et al., 2016). This suggests that many of them move from one temporary contract to another, interspersed by unemployment spells. On top of lower hourly wages, such low work intensity significantly reduces their overall annual earnings.

There is still a large gap in protection levels and dismissal costs between temporary and permanent contracts. If needed, on the basis of further evaluation of recent reforms, additional reform pursuing a greater convergence of termination costs between permanent contracts and temporary contracts, as recommended in the 2014 *Economic Survey*, could help to reduce duality further and reduce the precariousness of employment. The government may have to reconsider severance payment for temporary workers, due to the European Union Court of Justice ruling on the employment conditions for temporary workers. In broad terms, according to this ruling, severance payment for both temporary and permanent workers should be calculated in the same way. The government has asked a group of experts to examine the implications of the ruling and they will soon present their assessment, which may become a trigger for reviewing again the differences between temporary and permanent work contracts.

The 2012 labour market reform aimed to define more clearly the criteria justifying fair dismissals, with the aim of reducing firms' costs of firing and, therefore, hiring. More precisely, a persistent decline in revenues or income over three consecutive quarters within a firm is considered to be a season for fair dismissal. The law also states that court intervention should be limited to verifying facts asserted by the employer. The number of cases classified as fair dismissal has risen as a ratio to those as unfair dismissal in the years after the reform. However, the law still leaves discretion for labour courts to interpret the definition of fair dismissal (Durán López, 2015; Gómez Abelleira, 2012; Jimeno et al., 2015). As a result, many firms opt for accepting upfront that a dismissal may be considered unfair by the courts, which is more costly but judicially more certain. The authorities should once again try to revise the law to increase judicial certainty regarding fair dismissal, although the experience of the previous reform illustrates the difficulties involved.

Out-of-court procedures, such as conciliation, mediation and arbitration to settle labour disputes could help to further reduce uncertainty. The use of conciliation procedures has been on the rise over the past four years. Such out-of-court procedures could be developed further to enhance dialogue and provide a quicker and more effective response to litigation.

Promoting job creation through more flexible adjustment of wages

Spain has a complex collective bargaining system that traditionally provided limited leeway for firms to adjust working conditions to external and internal conditions even when unemployment was very high. The 2012 labour market reform significantly changed Spain's collective bargaining system. The objective was to restore competitiveness by aligning labour costs more closely with productivity and to allow employers to exploit more easily internal flexibility measures as an alternative to dismissals in the presence of adverse shocks (OECD, 2014c). The reform gave priority to collective bargaining agreements at the firm-level over those at sector or regional level. The reform also enhanced the possibility for employers to opt-out from sector or regional collective bargaining agreements and pursue internal flexibility measures.

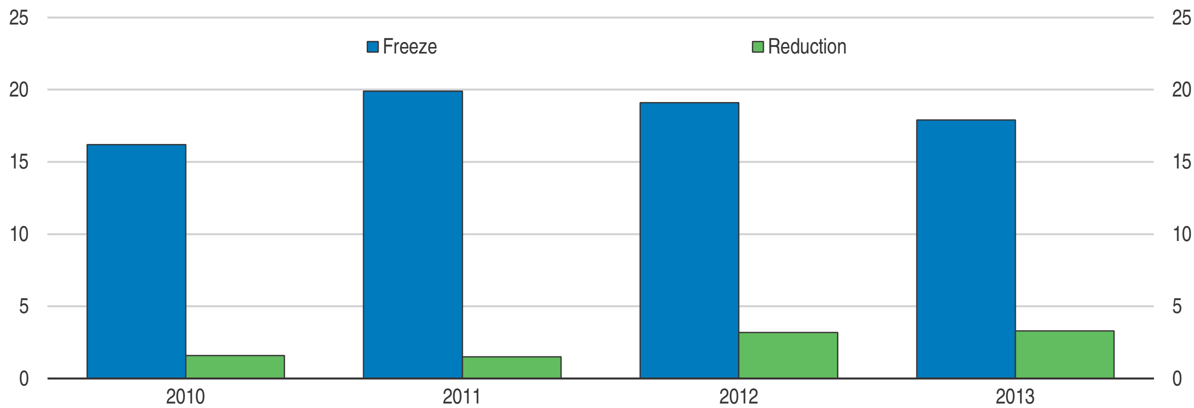
Evidence suggests that the reform has contributed to wage moderation (OECD, 2014a; Doménech et al., 2016; García-Pérez, 2016 and Box 1.1), which has helped employment performance and helped to restore competitiveness helping the export sector to lead the recovery. Nevertheless, it is difficult to disentangle whether salary moderation is a consequence of the labour market reform or a consequence of the successive Agreements for Employment and Social Dialogue signed by the social partners since 2012, which recommended salary restrain. Moreover, evidence suggests that despite the progress, firms still adjust employment in the presence of a fall in demand much more than wages or hours per employee (Izquierdo and Jimeno, 2015). The share of companies applying flexibility measures to working conditions increased after the 2012 reform (Figure 1.26).

The new bargaining regime allows firms to opt out of the terms and conditions contained in collective agreements at the sectoral, regional or national level. Less than five per cent of all firms have opted-out from higher level collective agreements (Izquierdo and Jimeno, 2015). The reform also gave priority to firm-level agreements over those at sector or regional level. This has provided certainty for firm-level agreements, which are on the rise, although remaining rare and have been essentially concluded in large firms. Overall this evidence suggest that large companies seem to be benefiting most from the reforms as it is easier for them to negotiate firm-level agreements or resort to the internal flexibility to change the terms and conditions in collective agreements. Therefore there is still scope to facilitate flexible wage adjustments that promotes job creation.

The extension of collective agreements at the sector level is automatic across the country, regardless of the representativeness of parties involved in collective bargaining. Such collective agreements then bind not only wages but also other employment

Figure 1.26. **The share of companies applying salary freezes and reductions is low**

As a percentage of all companies[1]



1. Figures are based on the Bank of Spain's 2014 Survey on Salary Formation.

Source: Durán, J. (2016), "Spain: Impact of crisis on labour costs and employment levels in companies", European Observatory of Working Life (EurWORK), April.

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conditions such as working time and shifts, unless firm-level agreements exist. The authorities should reconsider the conditions under which the statutory collective agreements are extended, in particular, by gradually requiring higher and stricter representativeness of business associations and by checking that such representativeness applies. This should avoid the situation that collective agreements are driven excessively by a limited number of the best performing firms. Alternatively, firm-level agreements and the opting-out system could be developed further, which requires strengthening worker representation in the firm. To that aim financial incentives can be provided for firm-level bargaining, as was introduced recently in Italy (OECD, 2017).

Policy recommendations for more and better quality jobs in Spain

Ensuring basic support for the most vulnerable

Key recommendations

- Increase the amount and coverage of the regional minimum income support programmes and of cash benefits for families with children.

Other recommendations

- Revise and streamline different social benefits at national and regional levels to improve their targeting and effectiveness.
- Phase out slowly the Renta Mínima de Inserción, the most common income support scheme, when beneficiaries return back to work and earn wages.
- Extend the coverage of the standard unemployment benefit to precarious workers, reducing the minimum required contribution periods.

Policy recommendations for more and better quality jobs in Spain *(cont.)*

Making active labour market policies more effective

Key recommendations

- Increase the efficiency of regional public employment services by: i) employing profiling tools and specialisation of counsellors; ii) increasing resources and staff-to-job seeker ratios; and iii) improving co-ordination to provide integrated support for jobseekers via a single point of contact for social and employment services and assistance.
- Promote the VET system and adult education programmes to help the unemployed and those in need to gain relevant skills.

Other recommendations

- Make better use of digitisation to improve job search assistance for ready-to-work jobseekers, reducing operating costs and targeting better resources to the most disadvantaged jobseekers.

Improving the skills of Spanish youth for getting them into jobs

Key recommendations

- Improve the quality of teaching through better university and on-the-job training for teachers.
- Continue the development and modernisation of vocational education and training (VET). Expand dual VET and ensure skills meet firms' needs by fostering a greater role of employers in training students and designing curricula.

Other recommendations

- Use national standardised tests widely in primary and secondary education.
- Improve attractiveness of basic and secondary VET by increasing the share of mandatory workplace training and facilitating pathways to dual and higher level VET.

Reducing demand side barriers to job creation

Key recommendations

- Reduce employer social security contributions for low-wage workers on permanent contracts.
- Request gradually increased representativeness of business associations when allowing the extension of collective agreements.

Other recommendations

- To further reduce duality, if necessary, pursue a greater convergence of termination costs between permanent contracts and temporary contracts.

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Thévenon, O., N. Ali, W. Adema and A. Salvi del Pero (2012), “Effects of Reducing Gender Gaps in Education and Labour Force Participation on Economic Growth in the OECD”, *OECD Social, Employment and MigrationWorking Papers*, No. 138, OECD Publishing, Paris, *http://dx.doi.org/10.1787/5k8xb722w928-en*.

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Chapter 2

Fostering innovative business investment in Spain

Spain has chronically low productivity growth, which undermines its ability to generate higher living standards. Important contributors to low productivity growth are the misallocation of capital to low productivity firms and under-investment in knowledge-based capital. To foster a better allocation of capital a first priority is to better tune bank, capital market and government financing to the needs of new innovative firms. This could be done through better small and medium-sized enterprises (SMEs) bond and loan securitisation tools, reallocating public financing to early stage finance and making it easier for firms to access public innovation funding by shifting some funding from loans to grants for research and development (R&D) projects. Attracting more foreign capital and improving the regulatory framework to increase the return on investment would also help. This could be done by reducing regulatory barriers that hold back competition, improving the neutrality of the tax system, improving pricing signals and reforming insolvency laws.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Poor business investment allocation is hampering productivity growth

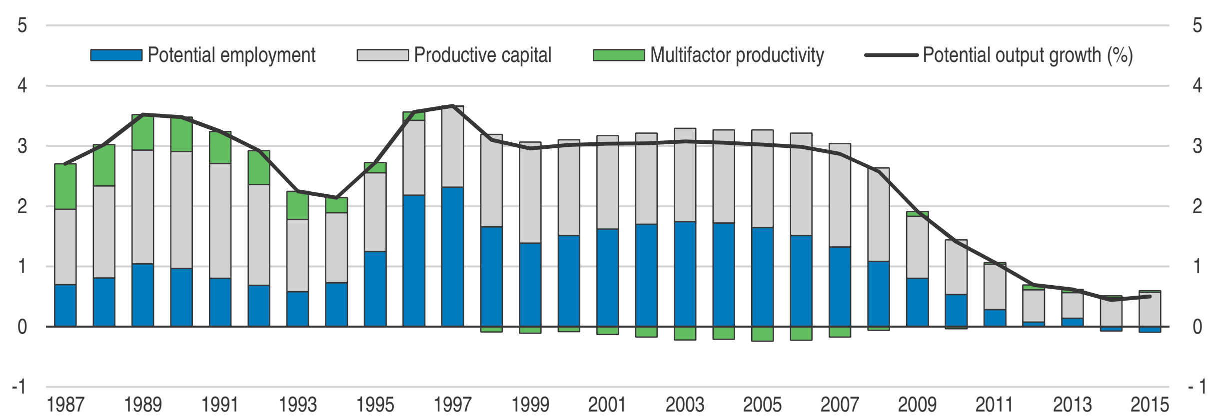
Investment is recovering but capital misallocation remains strong

Spain's trend growth rate has fallen to around only 0.5% per annum in the current recovery between 2013 and 2015 (Figure 2.1) constraining sustainable growth in living standards (Chapter 1). The contribution from labour utilisation and capital deepening has declined, exposing chronically low productivity growth by international standards (Figure 2.2). The current decline in unemployment will help to increase the contribution from labour to growth in the short-term. However, with an ageing population, raising trend growth in the medium-term requires boosting the quality of investment and productivity growth. Boosting the quality of investment will help to generate higher quality jobs that are needed to spread the benefits of growth wider. However, higher quality investment should be complemented by policies to raise skills and labour market participation so these jobs can be filled (Chapter 1).

Following the end of the pre-crisis construction boom, investment as a share of the economy has declined from 29% of gross domestic product (GDP) in 2008 to 20% of GDP in the third quarter of 2016 (Figure 2.3, Panel A). This was due to falls in both public and private investment (Figure 2.3, Panels B and C), but especially residential investment (Figure 2.3, Panel B). Non-residential investment also fell substantially but has started to recover (Figure 2.3, Panel D), investment in equipment has been very dynamic in recent years and is already very close to pre-crisis levels.

Figure 2.1. **Spain's growth potential has declined**

Potential output growth with contributions, percentage points[1]



1. Contributions to growth are calculated using a weight of 0.67 for potential employment and 0.33 for productive capital; multifactor productivity is calculated as a residual. Productive capital excludes investment in housing.

Source: OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November.

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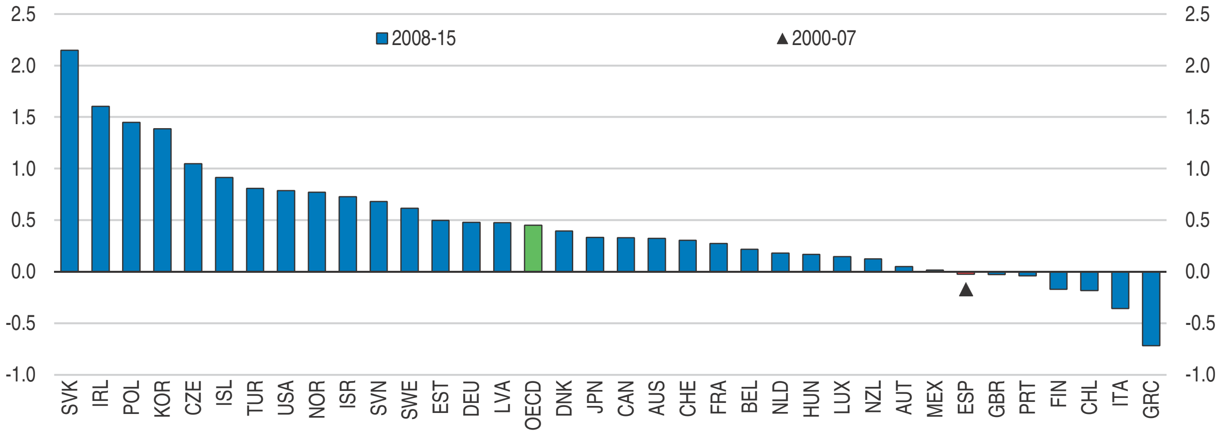
Figure 2.2. **Spanish productivity growth is low**

Average annual multifactor productivity growth, percentage[1]



1. The OECD aggregate is calculated as the unweighted average of the data shown.

Source: OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November.

StatLink http://dx.doi.org/10.1787/888933459376

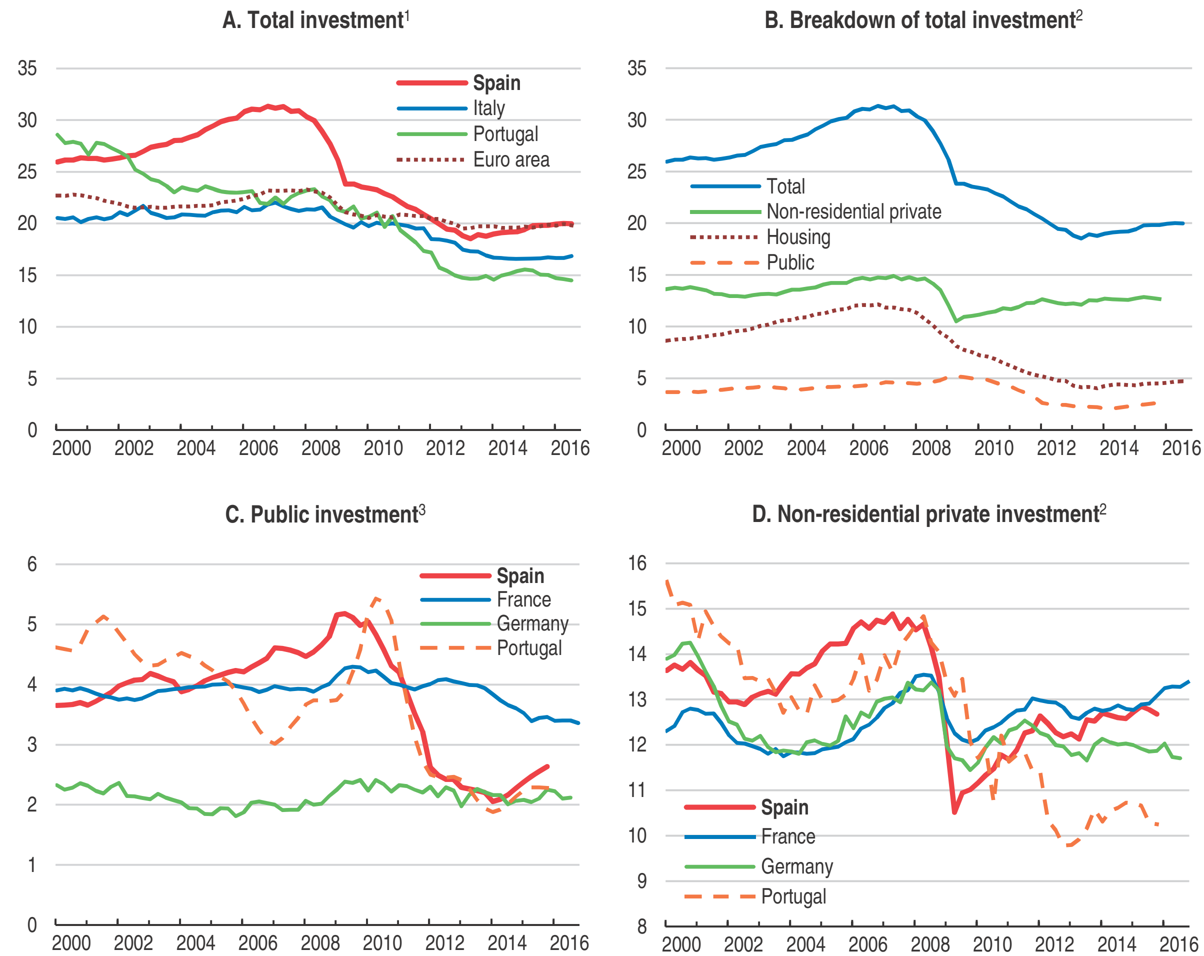
However, despite these declines, a low level of investment does not appear to be the cause of low productivity, as total investment flows have been around the OECD average (Figure 2.4, Panel A). Public investment is below the OECD average but similar to other large European countries, including Germany and the United Kingdom. Although it has fallen, total business sector investment appears to be on the higher side of a sample of the United States and European countries. Solid growth in demand and profits of non-financial corporations, as well as easier access to finance, will all help to underpin total investment growth. The capital stock per worker that has resulted from these investment flows is a bit below the OECD median but the required level depends on the production structure (Figure 2.4, Panel B). Services are the dominant activity in the Spanish economy and these tend to be less capital intensive.

However, Spain appears to have under-performed in capital allocation by under-investing in assets with high productivity returns, such as information and communication technology (ICT) (Figure 2.5). Recent empirical work suggests improving capital allocation and productivity are inter-linked challenges. Capital misallocation across sectors, especially an excessive flow of capital to the construction sector, appears to be a relatively minor explanation for Spain's poor productivity performance (Mora-Sanguinetti and Fuentes, 2012; García-Santana et al., 2016). Rather, capital appears to be misallocated in Spain due to underinvesting in some asset types, especially knowledge-based capital, and misallocation within all sectors to low productivity firms (Andrews and Criscuolo, 2013; Gopinath et al., 2015; García-Santana et al., 2016).

García-Santa et al. (2016) estimate that during the economic and credit boom between 1995 and 2007, cross sector and within sector capital misallocation together lowered productivity growth by around 1¾% per annum. In other words, if capital misallocation had not worsened over 1995 and 2007, Spanish productivity growth would have been close to 2% and among the best performers in the OECD. Low productivity growth has been correlated with a declining ability of more productive firms to attract capital and grow. From 2000 through to 2008 the positive difference in the amount of capital going to high and low productivity firms halved, correlating with the decline in total factor productivity (TFP) at an aggregate level (Figure 2.6).

Figure 2.3. **Total investment remains below pre-crisis level, but non-residential private investment has recovered**

Gross fixed capital formation, as a percentage of GDP



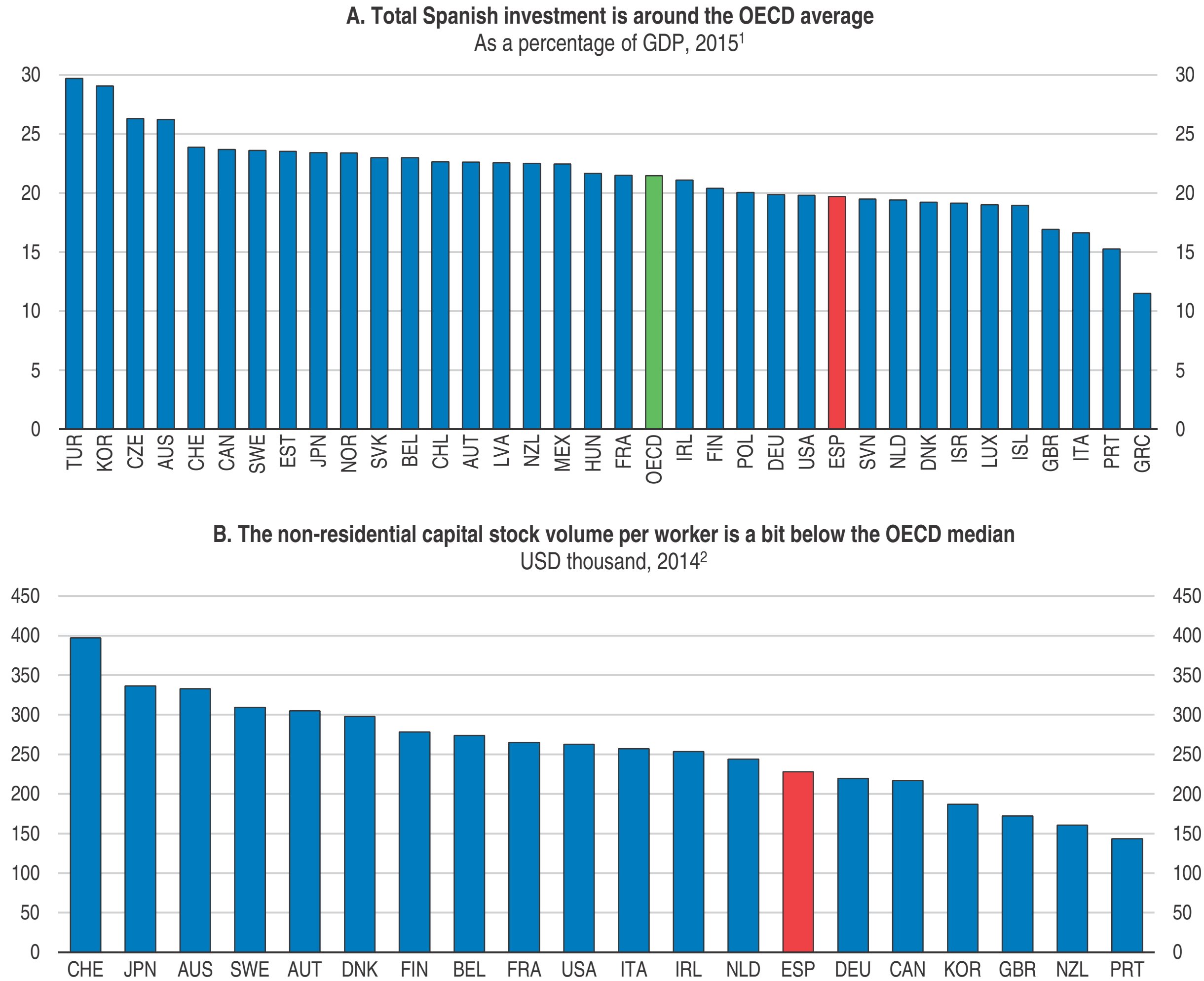
1. The euro area aggregate refers to euro area countries that are also OECD members.
2. Data for non-residential private investment refer to total investment minus government and housing investment. Since data for housing investment for Spain and Portugal may also include government housing, the series for non-residential private investment may be underestimated.
3. Data refer to government gross fixed capital formation.

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February.

StatLink http://dx.doi.org/10.1787/888933459388

Capital misallocation can also indicate that weak firms that would typically exit in a competitive market are surviving. Recent OECD research indicates that the prevalence of "zombie" firms – defined as old firms that have persistent problems meeting their interest payments – and the resources sunk in these firms have significantly risen in Spain since the mid-2000s, implying the increasing survival of low productivity firms (Adalet McGowan, Andrews and Millot, 2016; and Figure 2.7). For example, in 2013, 10% of firms were classified as zombie firms, while the share of capital stock and employment sunk in zombie firms was 13% and 11%, respectively. This share diminished from 2014 onwards (see Banco de España, 2016a).

Figure 2.4. **Investment and capital stock per worker**



1. Total investment refers to total gross fixed capital formation. The OECD aggregate is calculated as the unweighted average of the data shown.
2. 2013 for Portugal and Spain.

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February.

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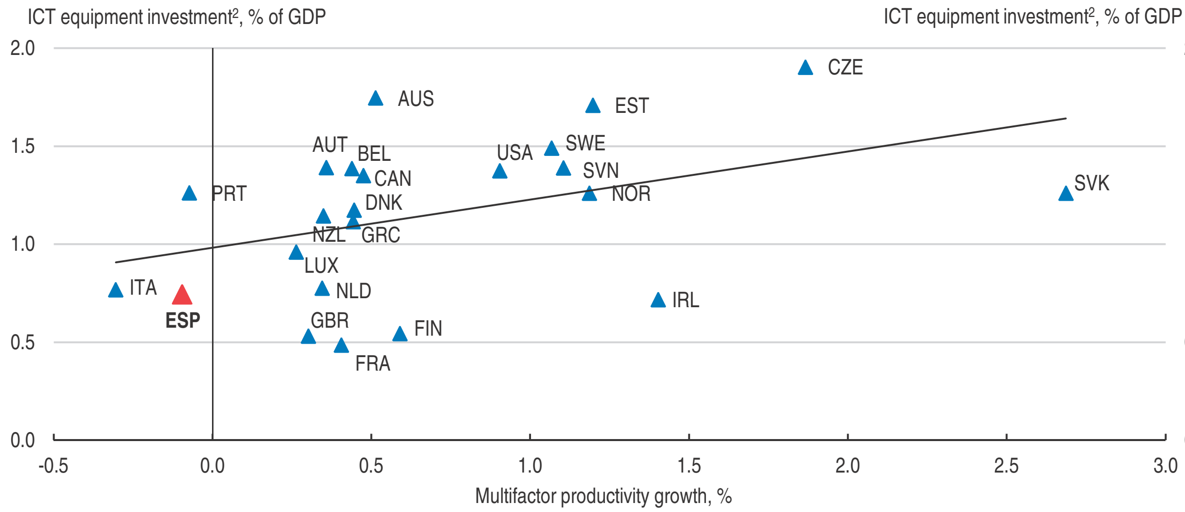
On top of being not very productive themselves, zombie firms also constrain the growth of other more productive firms. OECD evidence extending the empirical evidence provided by Caballero et al. (2008) for Japan to a broader sample of OECD countries, among them Spain, shows that a higher share of industry capital sunk in zombie firms is associated with lower investment and employment growth of a typical non-zombie firm. The results imply that the rise of zombie firms in Spain between 2008 and 2013 imposed a significant drag on labour productivity growth: business investment by the typical non-zombie firm would have been about 3% higher in 2013, on average, had the zombie share not risen from pre-crisis levels (Figure 2.8).

Spain's investment is not oriented enough towards innovative firms

Spain's investment is not directed enough towards innovation as evidenced by a low share of investment in intangibles (Figure 2.9, Panel A). Investment in construction even post-crisis is high (Figure 2.9, Panel B). Encouragingly, given its link with higher labour

Figure 2.5. **Capital allocation to ICT matters for productivity**

Annual average 2000-15[1]



1. Data for multifactor productivity growth for Estonia refer to 2001-15 average.
2. Gross fixed capital formation in information and communication technology (ICT) equipment.

Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), February; and OECD (2017), *OECD National Accounts Statistics* (database), February.

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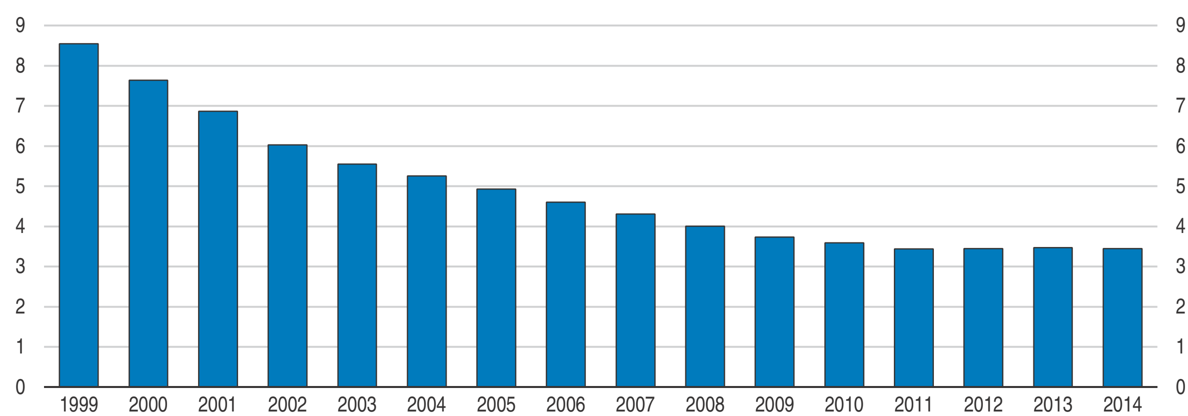
Figure 2.6. **The efficiency of capital allocation deteriorated in the boom**

Percentage point difference in capital stock growth of high and low productivity firms[1]



1. High(/low) productivity firms are defined by being one standard deviation above(/below) the industry mean multifactor productivity (MFP). The chart shows the sensitivity of firm capital growth to the lagged level of MFP, based on a firm level regression of the growth in the real capital stock on the lagged deviation of firm MFP from its industry-year average, interacted with time trends (trend and trend-squared). The regression also controls for firm age, firm size classes, industry and year fixed effects.

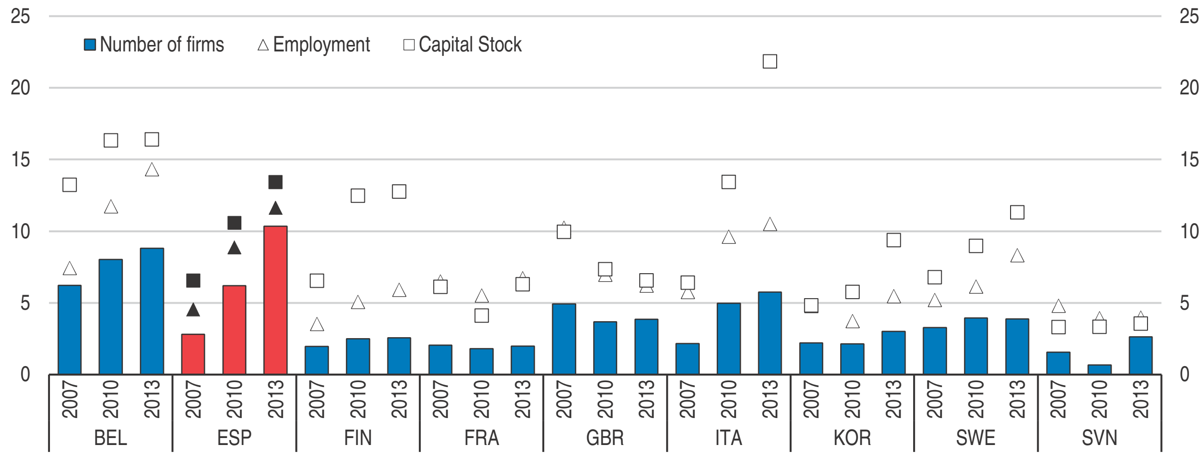
Source: Adalet McGowan, M. and D. Andrews (2017), "Productivity and Policies: Dynamic Resource Allocation in OECD Countries", *OECD Economics Department Working Paper*, forthcoming.

StatLink http://dx.doi.org/10.1787/888933459417

productivity growth, machinery and equipment investment is also above the median (Figure 2.9, Panel C). The still strong focus on tangibles investment is not obviously related to strong physical capital shortfalls in terms of underdeveloped infrastructure or other needs. Spain has high quality infrastructure and is ranked 9th in the world in this domain (WEF, 2015). Indeed, in some areas, such as regional airports, there is over-capacity.

Figure 2.7. **The rise of the zombie firms**

Percentage of firms over 10 years old and with interest costs exceeding operating income for at least three consecutive years[1]



1. Capital stock and employment refer to the share of capital and labour sunk in zombie firms.

Source: Adalet McGowan, M., D. Andrews and V. Millot (2017), "The Walking Dead? Zombie Firms and Productivity Performance in OECD Countries", *OECD Economics Department Working Papers*, No. 1372, OECD Publishing, Paris.

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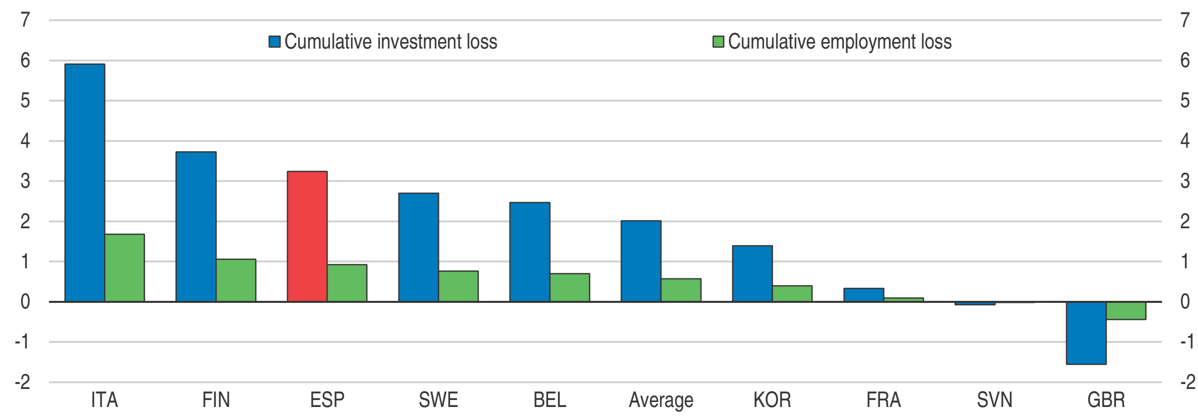
Figure 2.8. **Impact of zombie firms on non-zombie firm performance**

Cumulative investment and employment loss of a typical non-zombie firm due to a rise in the zombie share after 2007, percentage[1]



1. This figure shows the cumulative investment and employment loss between 2008 and 2013 due to the presence of zombie firms. The counterfactual is to keep the zombie shares at their 2007 level for the period 2008 to 2013. The average refers to the unweighted average of the data shown.

Source: Adalet McGowan, M., D. Andrews and V. Millot (2017), "The Walking Dead? Zombie Firms and Productivity Performance in OECD Countries", *OECD Economics Department Working Papers*, No. 1372, OECD Publishing, Paris.

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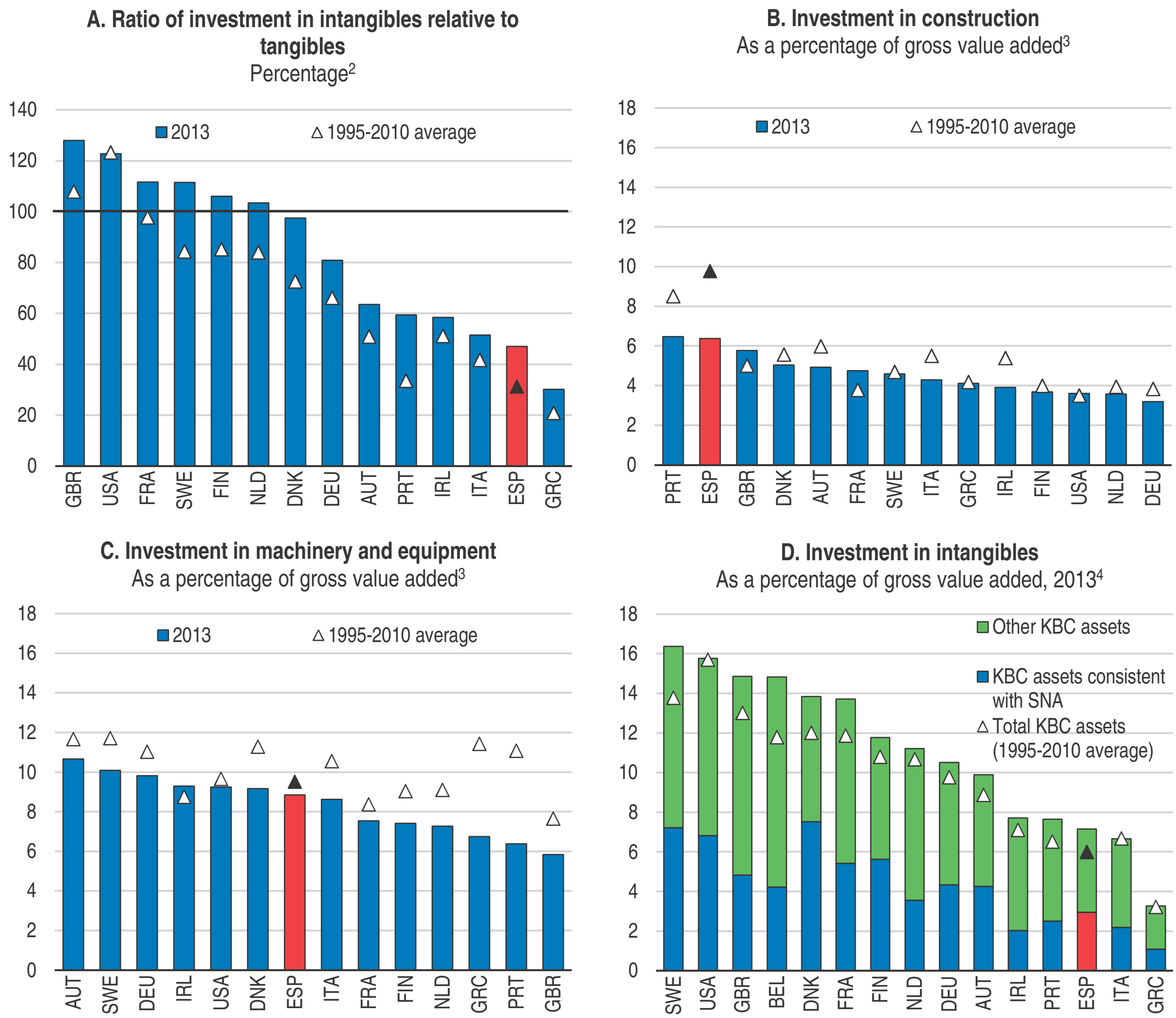
Of most concern is that the level of investment in knowledge-based capital (KBC) – a broad measure of investment in knowledge, which includes computerised information, innovative intellectual property and economic competencies – remains low. It is less than half than in countries such as the United States and France with stronger productivity growth, and similar to those with poor trend productivity and growth problems, such as Greece, Italy and Portugal (Figure 2.9, Panel D). Investment in KBC has higher potential returns than tangible capital because of its characteristics that generate economies of scale. For example, fixed costs of investment in knowledge such as R&D can be recombined with many other inputs in multiple applications giving rise to increasing returns. In

Figure 2.9. **Investment in intangibles is too low**

Business sector excluding real estate[1]



1. Data refer to business sector excluding real estate [i.e. all activities except for real estate activities (L), public administration and defence, compulsory social security (O), education (P) and human health and social work activities (Q)]. Investment refers to gross fixed capital formation. Investment in intangibles refers to all knowledge-based capital (KBC) assets. KBC assets that are consistent with the definition in the System of National Accounts (SNA) 2008 include: software, R&D, entertainment, literary and artistic originals, and mineral exploration. Other KBC assets include: design, new product developments in the financial industry, brands, firm-specific training and organisational capital. Investment in tangibles refers to gross fixed capital formation in construction and machinery and equipment.
2. 1997-2010 average instead of 1995-2010 average for the United Kingdom.
3. 1997-2010 average instead of 1995-2010 average for the United Kingdom and the United States.
4. 1997-2010 average instead of 1995-2010 average for the United States.

Source: OECD (2017), *OECD National Accounts Statistics* (database), February; and OECD (2015), *OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society*; Corrado, C., J. Haskel, C. Jona-Lasinio and M. Iommi, (2012), "Intangible Capital and Growth in Advanced Economies: Measurement Methods and Comparative Results", *Working Paper*, June (available at *www.intan-invest.net*).

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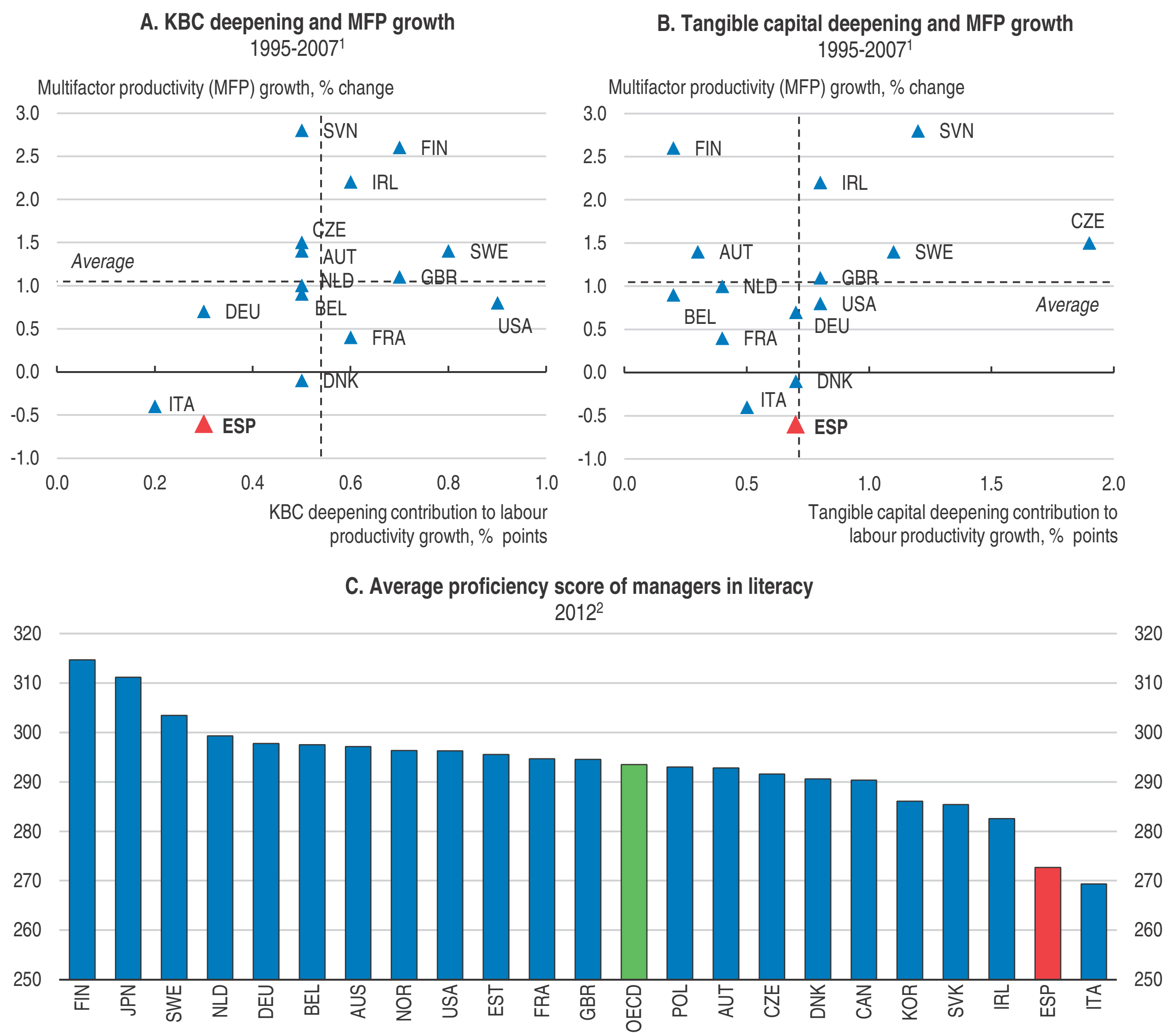
addition, knowledge is often only partially excludable resulting in spill-overs for other firms, i.e. the more knowledge is diffused, the more it gives rise to new ideas. OECD empirical work shows that investing in innovation is strongly linked with increasing productivity and growth (Box, 2009). Indeed, investment in KBC does appear to be more correlated with higher productivity growth than in tangible assets providing crude evidence of this type of spill over effects (Andrews and de Serres, 2012; OECD, 2013a; Figure 2.10, Panels A and B).

Figure 2.10. **Investment in knowledge-based capital (KBC) pays higher returns**



1. Labour productivity (i.e. output per hour) growth can be decomposed into the contribution of capital deepening and the contribution of multifactor productivity. The average refers to the unweighted average of the data shown.
2. Average proficiency scores of managers in literacy refer to the unweighted average of the proficiency scores of managers in each country across all industries. The OECD aggregate is calculated as an unweighted average of the scores of managers in the 22 OECD countries available in the PIAAC sample.

Source: Andrews, D. and C. Criscuolo (2013), "Knowledge-Based Capital, Innovation and Resource Allocation", *OECD Economics Department Working Papers*, No. 1046, OECD Publishing, Paris; and Adalet McGowan, M. and D. Andrews (2015), "Labour Market Mismatch and Labour Productivity: Evidence from PIAAC Data", *OECD Economics Department Working Papers*, No. 1209, OECD Publishing, Paris.

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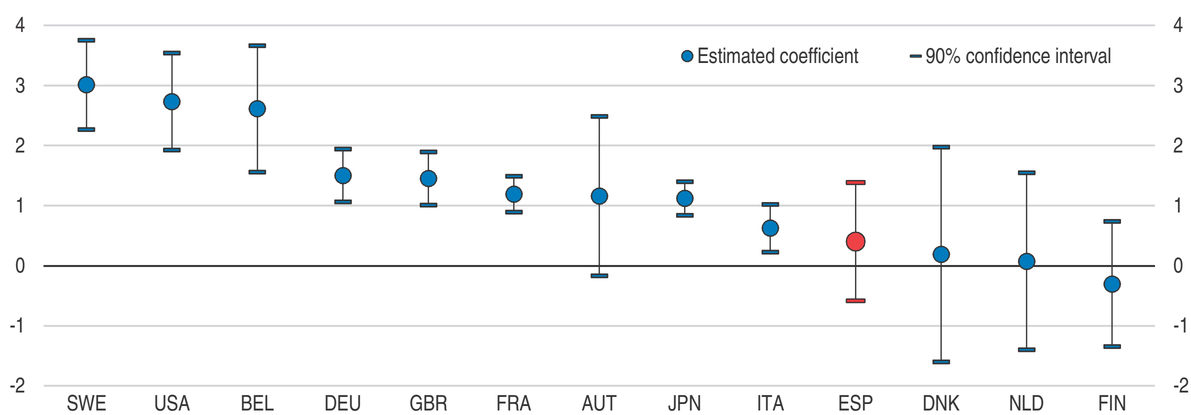
There are also important complementarities between managerial capital and ICT capital investment (Bloom et al., 2012). In order to extract the maximum benefit from ICT, firms typically need to adopt ICT as part of a "system" of mutually reinforcing organisational changes (Brynjolfsson et al., 1997), which will be easier to accommodate in firms with better organisational capital. Unfortunately, managerial quality is very low in Spain by OECD standards, both in terms of the use of cutting edge managerial practices in manufacturing (Bloom et al., 2014) and the skills of managers as measured by proficiency scores in the OECD Survey of Adult Skills across the broader economy (Figure 2.10, Panel C). This is likely to reduce returns to investing in ICT, which may explain Spain's poor performance in this area.

Existing financing channels do not favour enough innovation and risk

There is evidence that resource reallocation to innovative firms is relatively weak in Spain, especially in the case of capital (Andrews, Criscuolo and Menon, 2014). Firms in Spain that increase their knowledge stock (measured as patents) do not attract as much capital as their counterparts in other countries with stronger productivity performance such as Germany and the United States (Figure 2.11).

Figure 2.11. **Capital is not flowing to innovative firms**

Percentage change in a firm's capital stock following a 10% increase in its patent stock, 2002-10[1]



1. The confidence intervals vary across countries due to differences in the number of observations.

Source: Andrews, D. and C. Criscuolo (2013), "Knowledge-Based Capital, Innovation and Resource Allocation", *OECD Economics Department Working Papers*, No. 1046, OECD Publishing, Paris.

How to read this figure: The chart shows the average percentage change in a firm's capital stock following an increase in the firm's patent stock by 10%. For example, a firm that increases its patent stock by 10% in Spain will on average only increase its total capital by 0.5%.

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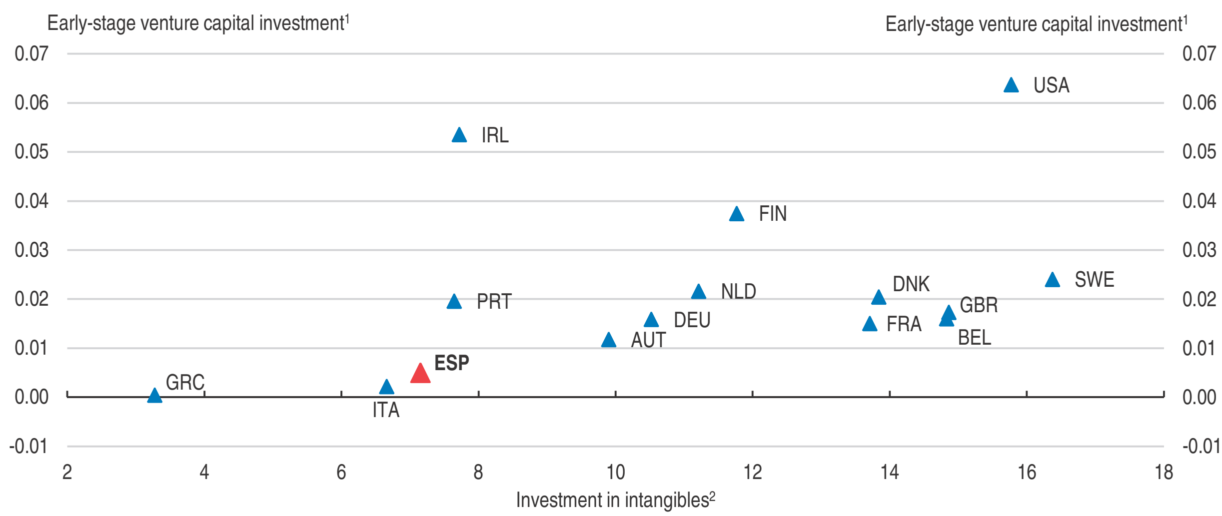
In this context, wider and deeper range of financing channels, both bank and capital market, are required if Spain is to better allocate capital to innovative investments on a large scale. This requires ensuring the financial system addresses the needs of firms across their life cycle from an idea to mature multinationals. In Spain, despite reform progress, the strongest priorities for improving capital allocation and productivity should be on further deepening financial markets, especially by improving the functioning of capital markets including venture capital, and further improving the insolvency law.

A first important complement to bank finance is capital markets that provide financing options to firms of all sizes and stages of development. The role of capital markets is particularly crucial for funding innovative firms because these markets help to match innovators and new firms with investors with a higher risk appetite and expertise in bringing new products and services to markets. They also provide an important conduit for foreign investment. Making improvements in capital markets, for example in the securitisation of SME debt, can also help to improve the flow of bank credit (Nassr and Wehinger, 2015).

Spain has significant potential to further develop capital markets, including venture capital, equity and bonds, especially for new and innovating firms. More developed seed and early stage venture capital markets increase financing flows to young innovative firms (Andrews et al., 2014) and are linked with higher investment in intangibles (Corrado et al., 2012) (Figure 2.12).

Figure 2.12. **Intangible investment and early-stage venture capital**

As a percentage of GDP, 2013



1. Venture capital is a subset of private equity (i.e. equity capital provided to enterprises not quoted on a stock market) and refers to equity investments made to support the pre-launch, launch and early stage development phases of a business. Early-stage venture capital investment includes pre-seed, seed, start-up and other early stage venture capital.
2. Data refer to business sector excluding real estate [i.e. all activities except for real estate activities (L), public administration and defence, compulsory social security (O), education (P) and human health and social work activities (Q)]. Investment in intangibles refers to knowledge-based capital (KBC) assets that are consistent with the definition in the System of National Accounts (SNA) 2008 (including software, R&D, entertainment, literary and artistic originals, and mineral exploration) and other KBC assets (including design, new product developments in the financial industry, brands, firm-specific training and organisational capital).

Source: OECD (2014), *Entrepreneurship at a Glance 2014*; and OECD (2015), *OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society*.

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A well-functioning stock market with robust Initial Public Offering (IPO) activity is an important complement to earlier stage equity finance, allowing venture capitalists to exit and recycle their funds into new companies (OECD, 2014a). It also provides an important channel for existing companies to raise new capital and increases the transparency and visibility of companies that are listed and helps to enhance the supporting financial ecosystem (equity research, market making, etc.), with positive repercussions (Nassr and Wehinger, 2016). There is also empirical evidence that shifting the composition of finance towards more stock market financing increases growth (Cournède et al., 2015).

Finally, the government has a role to play in facilitating capital flows to innovative firms because capital market imperfections tend to be more acute for new and innovative firms: asymmetric information problems are stronger and firms investing in knowledge based capital often lack traditional tangible capital that is easily priced (Andrews and Criscuolo, 2013). Government intervention is also justified by the high growth spill-overs from facilitating capital flows to new innovative firms (OECD, 2014a).

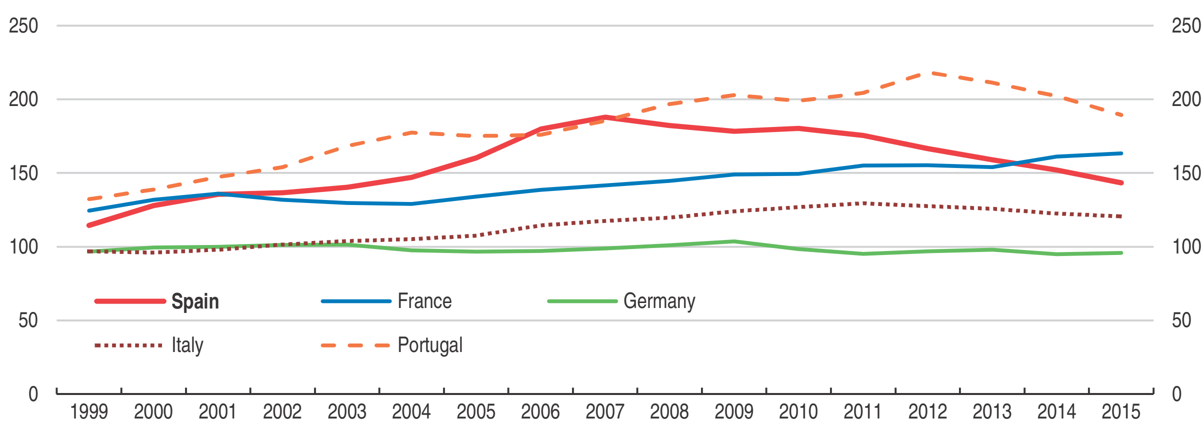
The remainder of this chapter will focus on two key policy issues to boost innovative business investment. The first is how to release financing constraints when firms want to invest but cannot finance their projects, in particular for innovative investment. The second is how to increase expected returns on investment so that firms that do not have financing constraints but are unsure about the benefit of investing do so.

Financing innovative investments

The level of corporate indebtedness in Spain has decreased (Figure 2.13) and is currently around the euro area average. Consequently the level of corporate indebtedness is a smaller obstacle for investment decisions than during the crisis. Recent research suggests that debt overhang explained about a third of the decline in investment observed during the crisis in the euro area (Kalemli-Ozcan et al., 2015) and financial constraints adversely affected investment, particularly for Italy, Portugal, and Spain (Barkbu et al., 2015).

Figure 2.13. **Corporate non-financial sector debt has declined from high levels**

As a percentage of GDP[1]



1. Debt is calculated as the sum of the following liability categories, whenever available/applicable: special drawing rights; currency and deposits; debt securities; loans; insurance, pension, and standardised guarantees; and other accounts payable.

Source: OECD (2017), "Financial Dashboard", *OECD National Accounts Statistics* (database), February.

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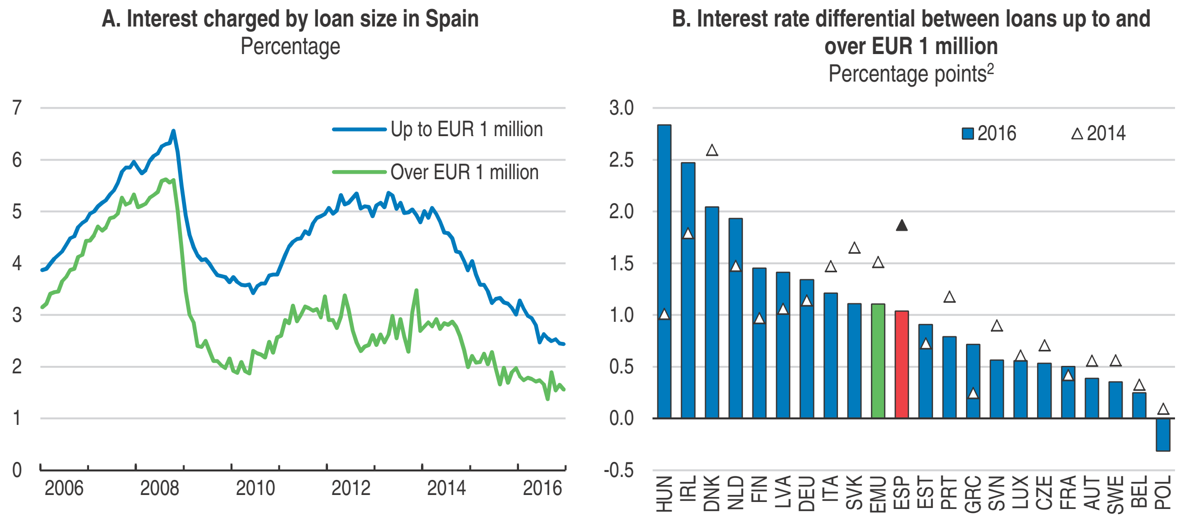
Lending to SMEs has significantly improved but obstacles remain

The European Central Bank's (ECB) non-standard monetary policy has helped to reduce bank lending rates significantly (Banco de España, 2016b; ECB, 2016). This has reduced fragmentation of Spanish bank lending markets from the core euro area countries, with lending rates spreads between different categories of borrowers converging to those in the core (Figure 2.14). There has also been compression on lending rates for all loan categories, including a decline in loan rejection rates.

Figure 2.14. **Differences in interest rates on new loans between small and large companies are decreasing**[1]



1. At floating rate and up to 1 year initial rate fixation.
2. Data refer to 12-month average. EMU: euro area.

Source: ECB (2017), "Financial markets and interest rates: Bank interest rates", *Statistical Data Warehouse*, European Central Bank, February.

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Lending to the domestic private sector fell substantially during the crisis and continued declining during the recovery, but the speed of contraction is moderating. Gross credit flows have shown positive growth rates in most segments since early 2014. One exception is new lending to large companies, which has declined recently. This reflects that large companies rely now more on market financing as the cost of market-based debt has declined more significantly than the cost of bank lending, in part thanks to the ECB asset purchase programme.

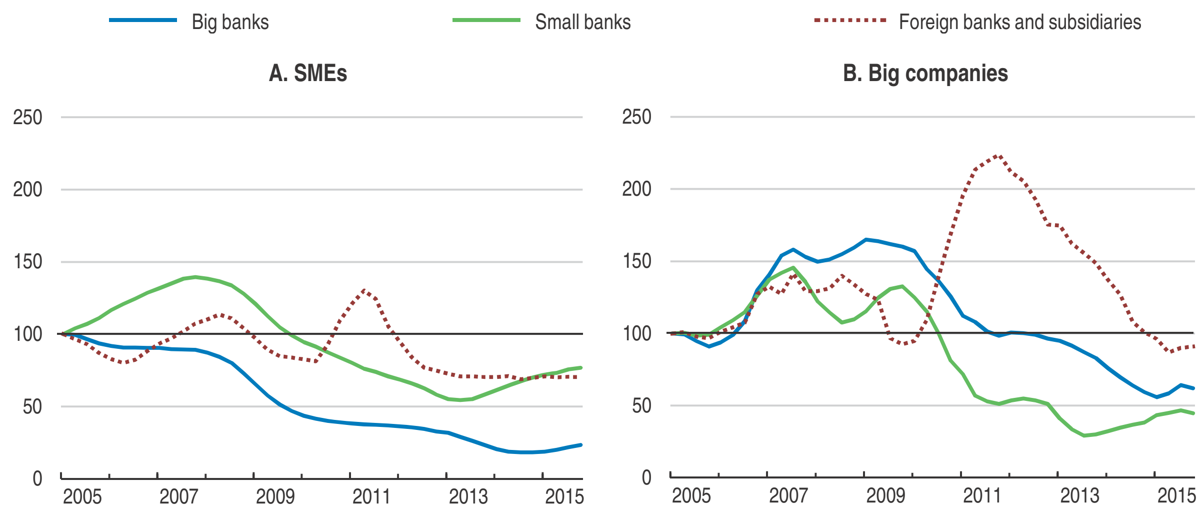
Access to finance for SMEs has eased significantly since 2013 both in terms of costs and the availability of funds as indicated by surveys on the access to finance by enterprises (ECB, 2016). In the beginning of the recovery only small banks increased the flow of new loans to SMEs, while large banks have been significantly reducing the flow of loans to SMEs, a tendency that has changed only recently (Figure 2.15). There has also been an increase of credit to SME companies that export, helping to boost Spain's export performance. Evidence from the Bank of Spain further suggests lending is flowing to a greater extent than it did before the crisis to financially sounder and more productive firms (Banco de España, 2015; European Investment Bank, 2016). This is a welcome development. To strengthen future productivity lending needs to flow to newer, innovative and fast growing companies that often face additional constraints in accessing lending because of their lack of collateral or track record.

Developing tools to facilitate SMEs' access to lending

Improving access of SMEs to lending should be a priority given the high share of employment accounted for by SMEs in the Spanish economy and their poor productivity performance compared to peers elsewhere (Figure 2.16). One of the main challenges for financial institutions is to assess the credit quality of businesses in a way that minimises the credit-rationed to productive and innovative business, generally new SMEs with an innovative project (OECD, 2006, 2013). To help tackle these issues the government has

Figure 2.15. **New lending is weak and mainly driven by small banks**

Index Q1 2005 = 100[1]



1. Credit to small and medium-sized enterprises (SMEs) is defined as credit below EUR 1 million, while credit to big companies refers to credit above EUR 1 million. Quarterly figures are calculated as 12-month moving average of monthly data.

Source: Banco de España.

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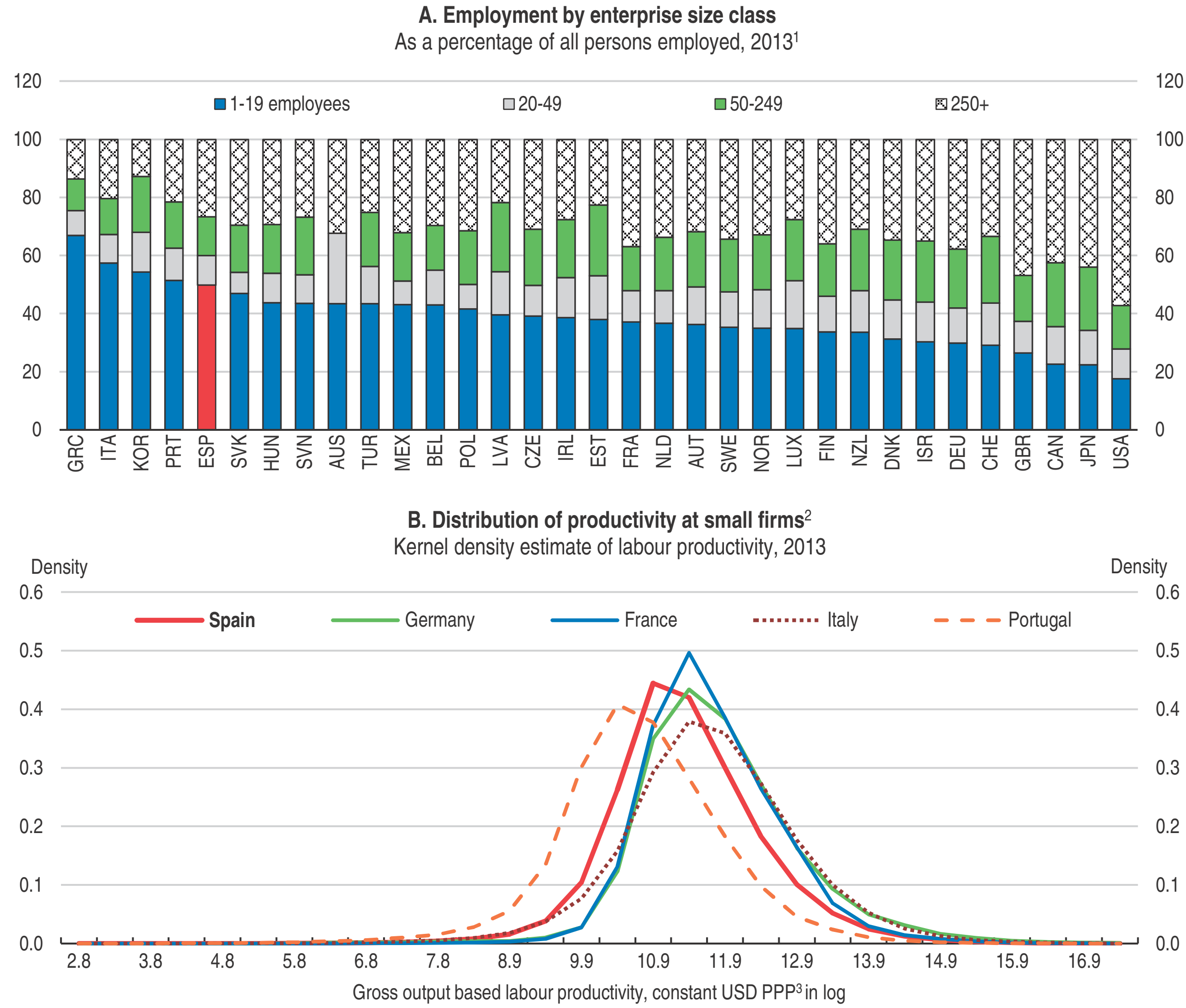
implemented the *Law on the Promotion Business Financing* adopted in April 2015, devoted to improving access to bank credit and developing non-bank financial intermediation (discussed below). The law strengthens the position of SMEs *vis-à-vis* banks. Specifically, if an SME's credit line is going to be cancelled or significantly reduced the credit institution must notify the firm at least three months in advance. To improve transparency of information if a credit line is going to be cancelled or significantly reduced the banks are required to provide SMEs with an assessment of their financial position and creditworthiness, including payment history and credit scores. In this context the Bank of Spain has developed a standardised SME credit assessment framework for SMEs, as recommended in the *2014 OECD Economic Survey of Spain*, which the commercial banks are required to use in making their assessment. In addition, SMEs have the right to demand this assessment. This process aims at facilitating the search by SMEs for alternative sources of financing, if need be. The banks should be obliged to publicise that SMEs have this right.

A rating for SMEs will lower information costs and increase transparency reducing banks' reliance on subjective information and helping to reduce the perceived riskiness when approaching SME finance. This measure should help to encourage – specifically in large banks – granting loans to viable SMEs on the basis of their expected future cash flow. One way to do this would be to favour instruments like equity loans, a financial innovative loan where the interest incurred depends on the profit made by the company and with the main advantage that it is granted without collateral depending only on the viability of the project being financed.

Securitisation, if carried out prudently, can also facilitate credit risk management by banks and help revive credit, including towards SMEs. Combining the client knowledge of banks with the risk spreading capabilities of bond markets securitisation can overcome the information asymmetry that hinders greater financial flows to small innovative firms. This can be achieved by the securitisation of bank credit and listing in bond markets. A step in the right direction is the new European framework for securitisation in the *EU Action Plan*

Figure 2.16. **The importance of small firms in overall employment and productivity**



1. 2014 for Canada, Israel, Korea and Mexico. 2012 for Japan. 2011 for Ireland. Data refer to total business economy. All countries present information using the enterprise as the statistical unit except Korea and Mexico, which use establishments. Data for Canada, Israel, Japan, Korea, Switzerland and the United States do not include non-employer enterprise counts. The size class "20-49" refers to "20-199" and the one with "250+" employees refers to "200+" for Australia. The size class "50-249" refers to "50-299" and the one with "250+" employees refers to "300+" for Canada, Japan and Korea.
2. Small firms are defined as those with less than 50 employees.
3. Industry-level purchasing power parities (PPP).

Source: OECD (2016), *Entrepreneurship at a Glance 2016*; and calculations based on the *ORBIS Database*.

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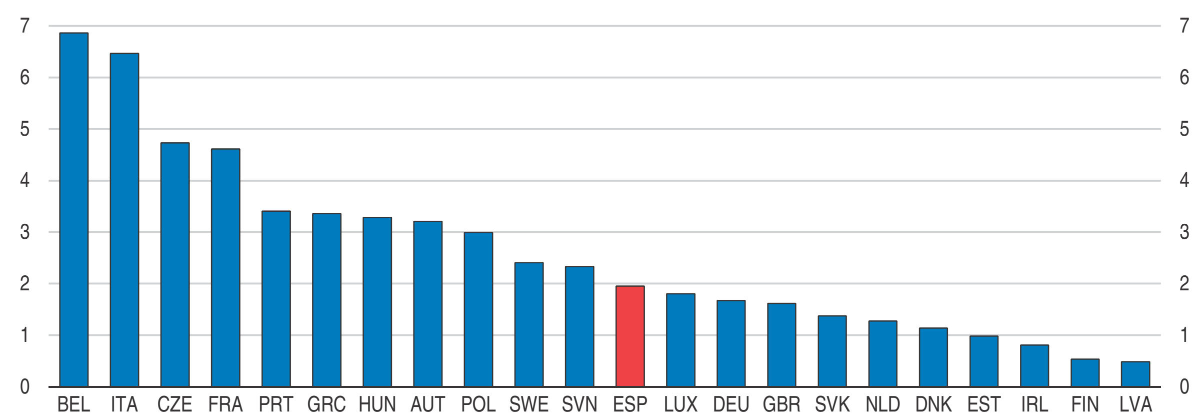
on Building a Capital Markets Union (EC, 2015). This should help facilitate SME lending by providing differentiated prudential treatment for "simple, transparent and standardised" (STS) securitisation, including reduced bank capital charges and would take advantage of ECB measures to broaden the eligibility of SME-backed securities as collateral.

Securitisation of SME debt could be further encouraged by the government providing guarantees to SME bond funds that are also mutually guaranteed by the debt issuing companies. This type of arrangement has been used in France for a bond fund (GIAC) that purchases firm issued bonds as low as EUR 500 000 (OECD, 2015b). Such a fund could also purchase securitised SME bank lending. However, to avoid moral hazard it would be important that the originating banks retained a stake in the securitised assets or the bond fund itself, in particular a first loss. The debt repayment risk would be spread across the originating banks, SME bond fund purchasers, the government and the borrowing firms, which would help to encourage banks to lend more to SMEs. It would also be important that before taking such steps, evaluation practices of publicly supported credit guarantee arrangements are improved. Recent OECD work assessing evaluation practices of publicly supported credit guarantee schemes for SMEs suggests that evaluation of the costs and benefits of such schemes lag behind those in other countries (OECD, 2016).

Mutual Guarantee Schemes (MGS) are a limited liability society owned by SMEs as well as local authorities, banks and chambers of commerce that guarantee bank loans. They can also play a role in facilitating SME lending by spreading risk. If well-designed they can help to revitalise the credit channel to SMEs by expanding joint risk-sharing financial instruments. In Spain MGS are spread throughout the territory but with a very low volume of outstanding guarantees (Figure 2.17) and there is scope for consolidation of the industry.

Figure 2.17. **The Spanish guarantee schemes are underdeveloped**

Financial guarantees given as a percentage of total assets, 2015[1]



1. Data refer to domestic banking groups and stand-alone banks.

Source: ECB (2016), “Supervisory and prudential statistics: Consolidated banking data”, *Statistical Data Warehouse*, European Central Bank, December.

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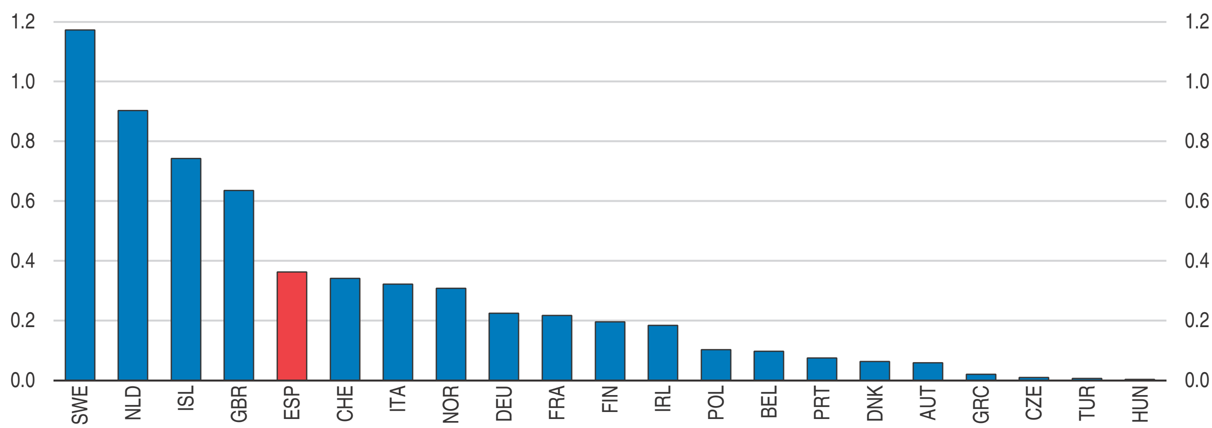
Improvements are foreseen in the 2015 *Law on the Promotion of Business Financing* to strengthen and improve the corporate governance of the private MGS entities and reinforce the public-guarantee by further increasing the resources of the government company CERSA. There is a trade-off between efficient scale and proximity to borrowers. Local MGS know their SME members well, which historically has been MGS competitive advantage, but they are small, which boost their costs. Spain has seen a proliferation of local MGS and appears that an increase in scale through mergers or consolidation to help reduce the relative cost of the service is justified. The SME Initiative is a further and welcome guarantee scheme. It is co-financed by the European Regional Development Fund, and entails the issuance of uncapped guarantees for the benefit of lenders to cover portfolio credit risk of new SME loans (EIF, 2015).

Facilitating access to capital markets, notably for SMEs

Improving access to public equity markets, notably for smaller firms, can help fill the financing gap for small fast growing and innovative companies, which tend to lack property collateral and find it more difficult to raise finance from the banking system (OECD, 2012; OECD, 2013b). Smaller companies that want to tap public equity markets are also facing a number of important impediments, such as admission cost, listing requirements and a lack of liquidity. Therefore creating dedicated stock market segments with more flexible listing criteria, eased disclosure requirements and comparatively low admission costs for SMEs, especially for high growth companies, should have benefits that extend beyond initial access to capital (IPO) (Nassr and Wehinger, 2016). Nevertheless, proper investor protection should always be ensured. Equity markets also give access to a large potential funding pool if they are open to retail and institutional investors worldwide. In a welcome sign total IPO activity was strong in international comparison in 2015 (Figure 2.18). An alternative stock market, *Mercado Alternativo Bursátil* (MAB), was set up in 2008 to provide a vehicle for smaller companies to list with less onerous listing requirements. However, growth in company IPOs and secondary capital raising on the MAB are a small percentage of total Spanish stock-market financial flows but in a promising sign grew fast in 2014 (BME, 2015). A reduction in the minimum estimated free float below EUR 2 million could be carried out to increase the number of eligible SMEs for listing (OECD, 2014b).

Figure 2.18. **IPO activity has been strong recently**

As a percentage of GDP, 2015[1]



1. 2014 for Austria, the Czech Republic, Greece, Hungary and Portugal. IPO: Initial public offering.

Source: PwC (2015), *IPO Watch Europe 2015 annual review*, Price Waterhouse Coopers.

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Important barriers to the expansion of stock market financing are illiquidity of SME equity markets and information asymmetry. To tackle illiquidity and asymmetry, there needs to be a strong supporting "eco-system" of equity research, market makers (firms that stand ready to buy and sell at a publicly quoted price) and broker/dealers specialising in SMEs (Nasser and Wehinger, 2016). To improve liquidity, the government should study whether the stock exchange should incentivise greater market making by requiring a compulsory market maker and lowering trading fees for them as has been done in Poland, which after less than 10 years in operation has the second largest secondary market in Europe by listing numbers after the United Kingdom's (Harwood and Konidaris, 2015). This could be usefully complemented by increasing investor flow of funds to SME equities by encouraging the formation of Exchange Traded Funds (ETFs) and mutual funds specialised in SME funds.

Another fundamental regulatory barrier to equity finance is asymmetric tax treatment of debt and equity. In particular tax deductibility of interest payments on debt from taxable income in Spain as in many countries, puts equity financing at a disadvantage (Nasser and Wehinger, 2016). This in turn favours certain business types that are more suited to debt than equity financing, in turn biasing capital allocation away from innovative new investments in knowledge. Firms with property assets as collateral will find it easier to raise debt and thereby gain the tax advantage relative to innovative new firms whose main asset is knowledge capital. There is also evidence that this bias increases corporate leverage and thereby raises the risk of financial instability (CTPA, 2015). In addition fostering a greater share of equity financing would help to promote growth (Cournède et al., 2015). It would also reduce the risk of over-leveraging, bad loans and financial instability created by an over reliance on debt finance by corporations.

Spain should consider further limiting the deductibility of interest from its corporate tax base. Action 4 of the Base Erosion and Profit Shifting (BEPS) project (OECD, 2015a) recommends a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its Earnings before Interest Tax Depreciation and Amortisation (EBITDA). The recommended approach includes a corridor of possible ratios between 10% and 30%. As a minimum this should apply to entities in multinational groups, but countries could apply the same rule to third party financing, as is the case in Spain. The approach can be supplemented by a worldwide group ratio rule which allows an entity to exceed this limit in certain circumstances. Action 4 of the BEPS report also includes factors that countries should take into account in setting their fixed ratio within this corridor.

Spain currently limits interest deductibility by applying a maximum deduction of 30% of EBITDA, although the EBITDA definition which Spain applies, which includes dividend income that qualifies for the participation exemption, differs from the definition under Action 4 of the BEPS project. This difference in the definition should be resolved. Given the country's history of excessive corporate debt and poor capital allocation, Spain could consider lowering the ratio of 30% in order to further reduce the tax-induced incentives for excessive leverage.

Some countries, including Belgium and Italy, grant deductibility to both debt and equity by applying an Allowance for Corporate Equity (ACE). This provides a deductible allowance for corporate equity in computing the corporation's taxable profits but the disadvantage is that it narrows the tax base and in order to raise the same amount of corporate tax revenue could result in a higher corporate tax rate (CTP, 2014). Unless it is applied only on new equity, it could lead to windfall gains for the investment undertaken before the introduction of the ACE. The ACE could also lead to strategic tax planning if not designed adequately and accompanied by specific anti-avoidance measures. In recent international policy debates, it has been advocated that countries could use a combination of both a partial ACE and limits to the interest deductibility (European Commission, 2015).

More public support is needed for innovative start-ups

Government programmes to support finance to firms should prioritise providing seed capital and early-stage financing of the small innovative start-ups that typically rely on intangible assets and where the gap in private financing is higher. As traditional debt finance offers moderate returns for lenders, it is particularly ill-suited for these types of companies, which have a higher risk-return profile but are at the forefront in job creation and are especially relevant for expanding the technology frontier (OECD, 2015b).

One potential way to increase funding to innovative start-ups is through the Centre for the Development of Industrial Technology (CDTI), the largest public innovation funding agency in Spain. CDTI is a public business entity that seeks to foster the technological and innovative capabilities of Spanish firms, including SMEs, and their internationalisation. It channels funding and provides loans to R&D projects. The CDTI Innvierte programme provides venture capital and seed capital together with private investors and CDTI also provides direct grant support to start ups (Neotec programme).

Empresa Nacional de Innovación, SA (ENISA) is a public national innovation company that is granting funding to SME business projects that typically have an innovative component and high potential growth. Private investors report that ENISA plays a complementary co-financing role to the private sector, helping to provide finance to start-ups at an early stage and allowing them to have a long enough track record to convince private investors and venture capitalists to invest more. This is a welcome initiative but ENISA's funding is very limited and should be reinforced, subject to the government's overall expenditure review.

The stated owned bank, Instituto de Crédito (ICO), provides second floor facilities funds to SMEs where commercial banks assume credit risks of the loan. ICO should encourage banks to focus more on lending to innovative companies. ICO also provides equity capital via several instruments. One of these is a "fund of funds" public venture capital fund, Fond ICO Global, introduced in 2013. Fond ICO Global should put emphasis at the early and late stages of the venture capital cycle, where there is less provision of private capital.

Broadening the role of venture capital

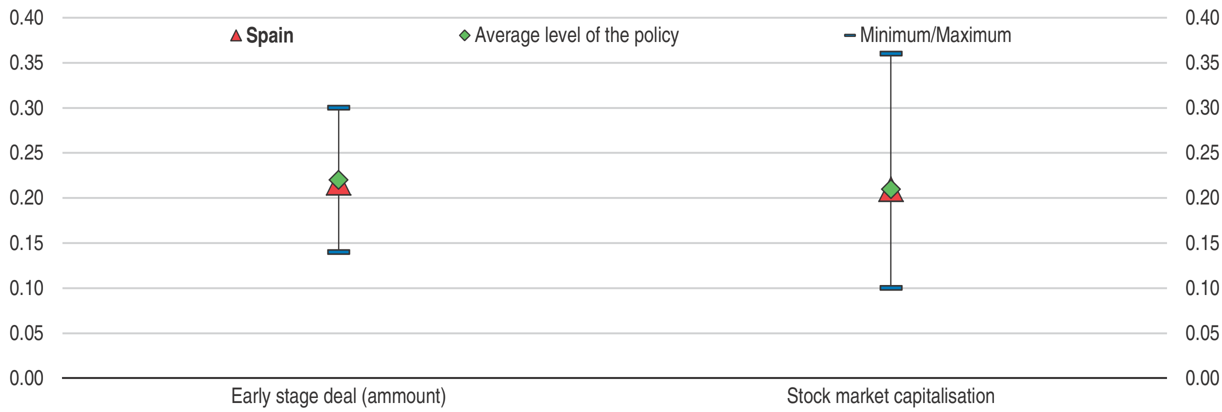
Better developed capital markets would increase technology absorption from the best productivity performers, thereby helping to boost overall productivity (Figure 2.19). Spain appears to be around the average in terms of the amount of early stage venture capital and stock market capitalisation, but government policy programmes to support development of the financial sector can be further fine-tuned.

Venture capital investment was hard hit in the crisis falling from EUR 3.6 billion in 2010 to EUR 1.4 billion in 2013, but has subsequently increased again as the economy has recovered (OECD, 2016a; ASCRI, 2015). The market is still small by international standards (Figure 2.20) but encouragingly funds are dispersed quite widely, over 80% of transactions are under EUR 5 million. In common with many OECD countries, the government has introduced a number of supply side policy initiatives to foster growth of the market, including a 1% corporate tax rate for venture capital companies registered with the Competition Authority (CNMV), and in July 2011 introduced exemptions from capital gains in smaller, younger, unlisted companies (OECD, 2016a).

In addition, in May 2013, the government set up a "fund of funds" public venture capital fund, Fond-ICO Global, to catalyse private venture capital by co-investing in private venture capital funds. Fond-ICO Global's commitment to being a minority investor in these private funds is sound as government venture capital efforts tend to have a positive effect when they are in the minority position and managed by private investors (OECD, 2014a). This approach also increases diversification of risk, which is particularly important as risk levels with this kind of investment are high.

Figure 2.19. **Financial markets and productivity growth**

Estimated annual frontier spillover associated with 2% points increase in MFP growth at the global frontier by different levels of public policy settings, percentage points[1]



1. The chart shows how the sensitivity of multifactor productivity (MFP) growth to changes in the frontier leader growth varies with different levels of framework policies and institutional environment. The diamond refers to the estimated frontier spillover effect associated with a 2% MFP growth at the frontier around the average level of the policy. The label "Minimum/Maximum" indicates the country with the lowest/highest value for the given policy indicator in a given reference year.

Source: Saia, A., D. Andrews and S. Albrizio (2015), "Productivity Spillovers from the Global Frontier and Public Policy: Industry-Level Evidence", *OECD Economics Department Working Papers*, No. 1238, OECD Publishing, Paris.

How to read this figure: This chart shows the increase in productivity Spain will experience if the global productivity frontier increases by 2%, which depends on characteristics of Spain's financial markets. For example, Spain's stock market capitalisation is around the average and so productivity would increase by around 0.2 percentage points in response to an increase in the global frontier of 2%.

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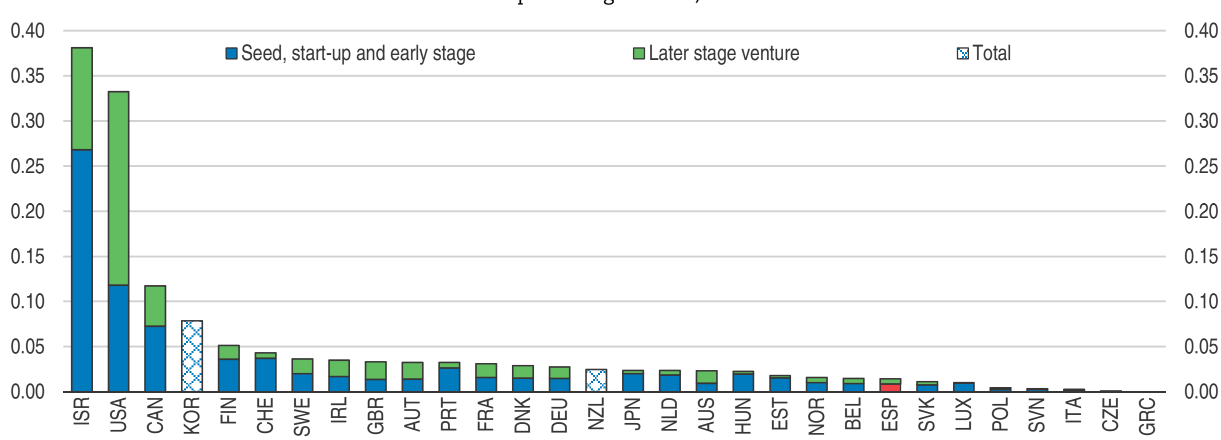
Figure 2.20. **Venture capital investment**

As a percentage of GDP, 2015[1]



1. 2014 for Israel and Japan. Venture capital is made up of the sum of early stage (including pre-seed, seed, start-up and other early stage) and later stage venture capital. For Korea and New Zealand only the total venture capital investment is shown since there is no internationally comparable data available for the breakdown of venture capital by stage.

Source: OECD (2016), *Entrepreneurship at a Glance 2016*.

StatLink http://dx.doi.org/10.1787/888933459557

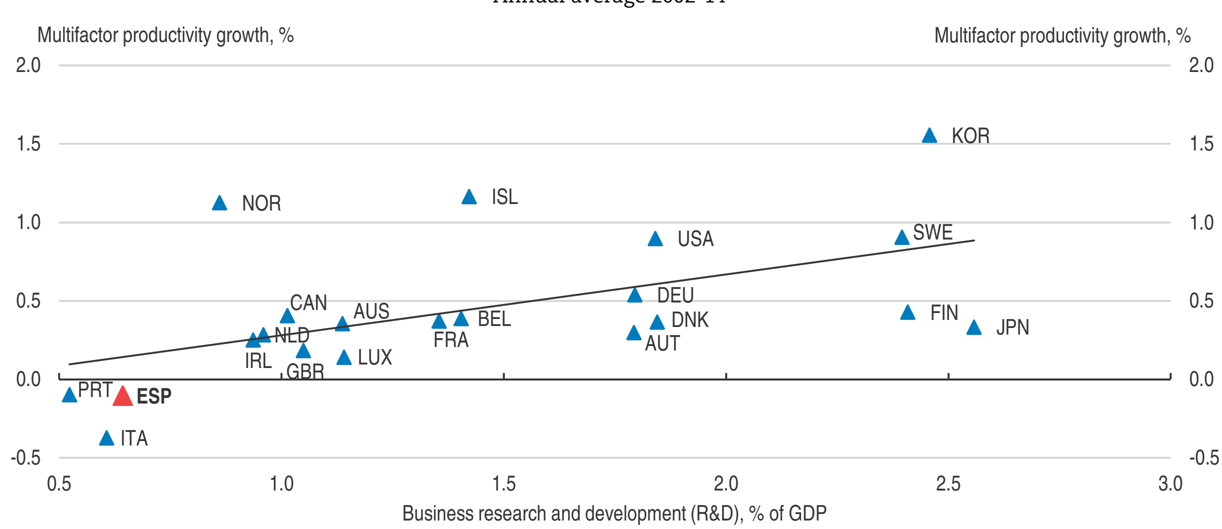
The Fond-ICO's total budget of EUR 1.2 billion combined with EUR 100 million from CDTI *Innvierte*, the Ministry of Economy's fund to promote business innovation by making equity investments in innovative companies, appears small in international comparison. It is similar to public venture capital available in Ireland, for example (OECD, 2013c). However, public funds are being rapidly injected into what is a very small market. To avoid the risk of crowding out private-sector lenders, the government needs to study carefully in consultation with the private sector where there are gaps in supply of the private sector in the spectrum from early stage to later stage venture capital. Where gaps are identified the government should reduce regulatory impediments to private sector capital flow and target its funding to fill the remaining gaps. There is evidence that there is a role for the government to act as co-investor with the private sector at the lower and higher end of the scales. The private sector reports that initial financing of firms by ENISA is complementary to their activities helping new firms to develop to a point where they are ready for private venture capital but ENISA has very few funds available. At later stages, there also seems to be a gap: obtaining more than EUR 2 million from private venture capital to expand a promising ICT company is not possible in Spain because at this scale, the risk is too great for individual private investors.

Public financing of business innovation investments

Despite apparently high returns from R&D Spain appears to under-invest in innovation (Figure 2.21). Business R&D investment is below the OECD median and shows signs of weakness, including low R&D even by large corporates, and low innovation outputs in terms of patents and trademarks by international comparison (OECD, 2014b). Spain provides dedicated public financing for innovation investments in the business sector in the form of both R&D Tax Credits and government direct funding programmes. This mixed system of support is appropriate given that both types of support have advantages. R&D tax credits have the advantage that they avoid the "picking winners" problem associated

Figure 2.21. **Business R&D and multifactor productivity growth**

Annual average 2002-14[1]



1. 2002-11 for Australia and Iceland. 2003-14 for Luxembourg and Sweden. 2002-13 for the United States.

Source: OECD (2016), "OECD Economic Outlook No. 100, Volume 2016 Issue 2", *OECD Economic Outlook: Statistics and Projections* (database), November; and OECD (2017), "OECD Science, Technology and Industry Outlook 2014", *OECD Science, Technology and R&D Statistics* (database), February.

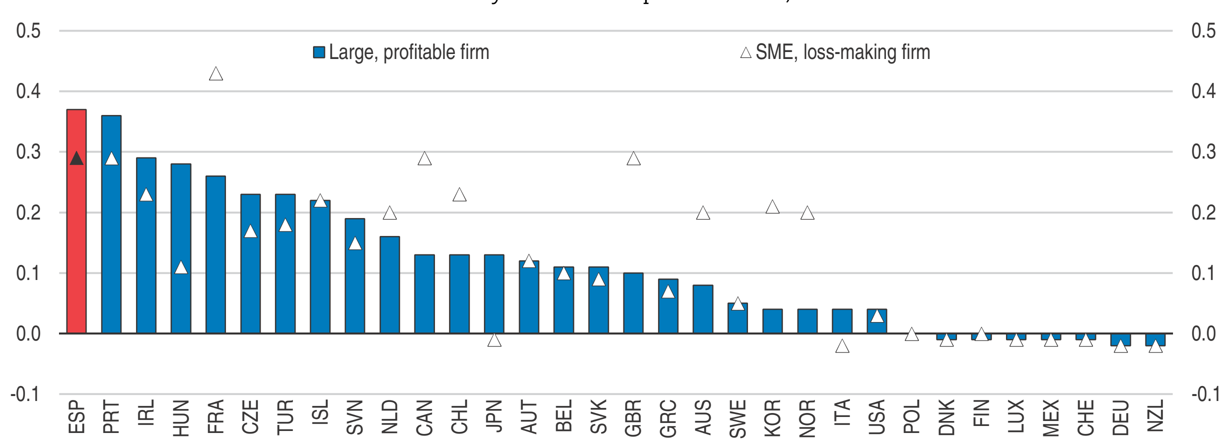
StatLink http://dx.doi.org/10.1787/888933459565 with direct grants. They also should require fewer administrative resources to operate than direct grants. However, R&D tax incentives can protect incumbents to the detriment of new entrants (Bravo-Biosca et al., 2013). In particular, income based R&D tax incentives that provide tax relief on R&D related incomes (for example, patent boxes) tend to benefit large firms disproportionally, and have a higher risk of being used for tax avoidance and purposes other than supporting innovation (OECD, 2016b). On the more traditional expenditure R&D tax incentives side, it is important that they include carry forward provisions, cash refunds or reductions in social security and payroll taxes, so that small and young firms and basic research projects can benefit (Appelt et al., 2016). Direct support makes SMEs more likely to carry out R&D (Czarnitski and Ebersberger, 2010). Even if R&D tax incentives contain carry-over provisions and refunds, young firms may not fully benefit from the schemes if they lack the upfront funds to start an innovative project, and in these cases public funding may be more beneficial (Busom et al., 2014).

Spain's R&D tax credit system is generous in international comparison (the R&D tax subsidy rate is above 35%), although it is less so for new loss making firms, even after the government made the scheme more attractive for younger less profitable firms by allowing the credits to be partly refundable and carried forward (Figure 2.22). However, firms make limited use of the system and as result most public support to business innovation is direct. One impediment is that the system is complex. The government should continue to streamline the system and publicise how to apply for credits.

During the recession, public funding for business innovation spending was reduced. In addition a significant part of the government budget for innovation was never spent because it was allocated to loans to firms for R&D but the loans were not taken up. The government should ensure that support to R&D is at least maintained as a percentage of GDP now that economy is recovering. The net outflow of scientific authors from Spain was

Figure 2.22. **Tax subsidy rates on R&D expenditures**

1-B-Index by firm size and profit scenario, 2015[1]



1. The tax subsidy rate is calculated as 1 minus the B-index, a measure of the before-tax income needed to break even on USD 1 of research and development (R&D) outlays. It is based on responses from national finance/tax/innovation authorities and R&D statistical agencies to the OECD questionnaire on R&D tax incentives and also draws on other publicly available information. As a measure of the marginal cost of R&D to users, the B-index is estimated based on marginal tax credit (allowance) rates. This is an experimental indicator based on quantitative and qualitative information representing a notional level of tax subsidy rate under different scenarios. It requires a number of assumptions and calculations specific to each country. International comparability may be limited. For more details and country specific information, see Figure 4.8.3 in OECD (2015), *OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society*. SME: small and medium-sized enterprise.

Source: OECD (2015), *OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society*.

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more than 2.5 times higher between 2009 and 2013 than over the period 1999-2013. The government should shift funds available via loans to a direct grant fund, where funds to firms and researchers would be granted based on performance and international peer review to increase firms' R&D and to slow the very high brain drain of talented researchers.

Enhancing financial education and networking

Consistent with past OECD recommendations Spain has recently introduced financial education in the school curriculum, with positive results (Hospido et al., 2015). However, current entrepreneurs' financial literacy and skills can also be improved by specific programmes such as training, mentoring and coaching tailored to the needs and to the different stages in the SME business cycle. This could be done by expanding the Valnalón entrepreneurship training programmes of the regional government of Asturias to other regions of Spain. To increase SME demand for equity finance, the government could further promote financial education of SMEs' entrepreneurs on options and processes for raising equity finance. Another way is to favour private venture capital investment proposals that involve not just capital contributions but also management and expertise in bringing new products and services to markets. The government should also expand initiatives to increase the knowledge of entrepreneurs on how to access finance and present to investors. There is evidence that supports to increase the skills in financing, can improve the survival and growth of new and small firms (OECD, 2015c).

Increasing linkages between investors, entrepreneurs, smaller and larger firms is also required to develop a stronger venture capital market. Stronger social networks appear to be more important than physical infrastructure (e.g. office spaces) for achieving this. Several OECD countries provide policy support for social network problems such as business angel networks, which act as an access point for entrepreneurs, and business accelerators that provide specialised mentoring to entrepreneurial teams rather than a sole entrepreneur (OECD, 2014a). The government should provide support to private sector initiatives in this area, particularly to expand those with an established track record more widely across Spain. Welcome initiatives in this direction include ENISA's "Colabora para crecer" project, a private network of investors and firms with a loan granted by ENISA to interact and possibly develop joint projects, as well as the European Commission "Enterprise Europe Network" initiative that tries to address SMEs' education and information gaps providing extensive advice and assistance to SMEs on accessing finance.

Raising the expected returns on innovative investment

Beyond policies to improve access to finance, increasing innovative investment also requires that firms expect sufficient returns on the project. Otherwise, even non-financially constrained firms could delay investment. Raising the expected return on investment could be achieved through a range of reforms including: facilitating foreign direct investment; reducing administrative barriers to firm entry as well as the restrictiveness of product and labour market regulations; improving the insolvency regime and judicial efficiency; and reducing price distortions to investment decisions (Andrews and de Serres, 2012; Andrews, Criscuolo and Menon, 2014).

Attracting more foreign investment

More foreign direct investment (FDI) is an important potential source of innovative investment. It has the advantage of providing new production processes and products, increasing competition in the economy and potentially generating technology and other spill-overs to domestic firms. The total stock of foreign direct investment as a share of GDP in Spain is above the OECD average and larger than in other large European countries including France and Germany (Figure 2.23). Excluding the very high share, 20% of the stock, that is private real estate investment, it would be around the OECD average. The flow of FDI to Spain as a percentage of GDP is considerably higher than in France, Germany and Italy and has been picking up recently in line with the recovery.

Spain appears to have a lower share of foreign investment than other large EU countries in the services sector, where the productivity benefits of greater competition from FDI are likely to be stronger due to facing less direct competition through international trade than manufacturing. In addition, services sector investment tends to be more employment intensive than manufacturing and therefore more likely to contribute to reducing unemployment. Greater competition and productivity in the services sector would also boost manufacturing sector exports, which rely more heavily on intermediate services inputs in Spain than many other countries.

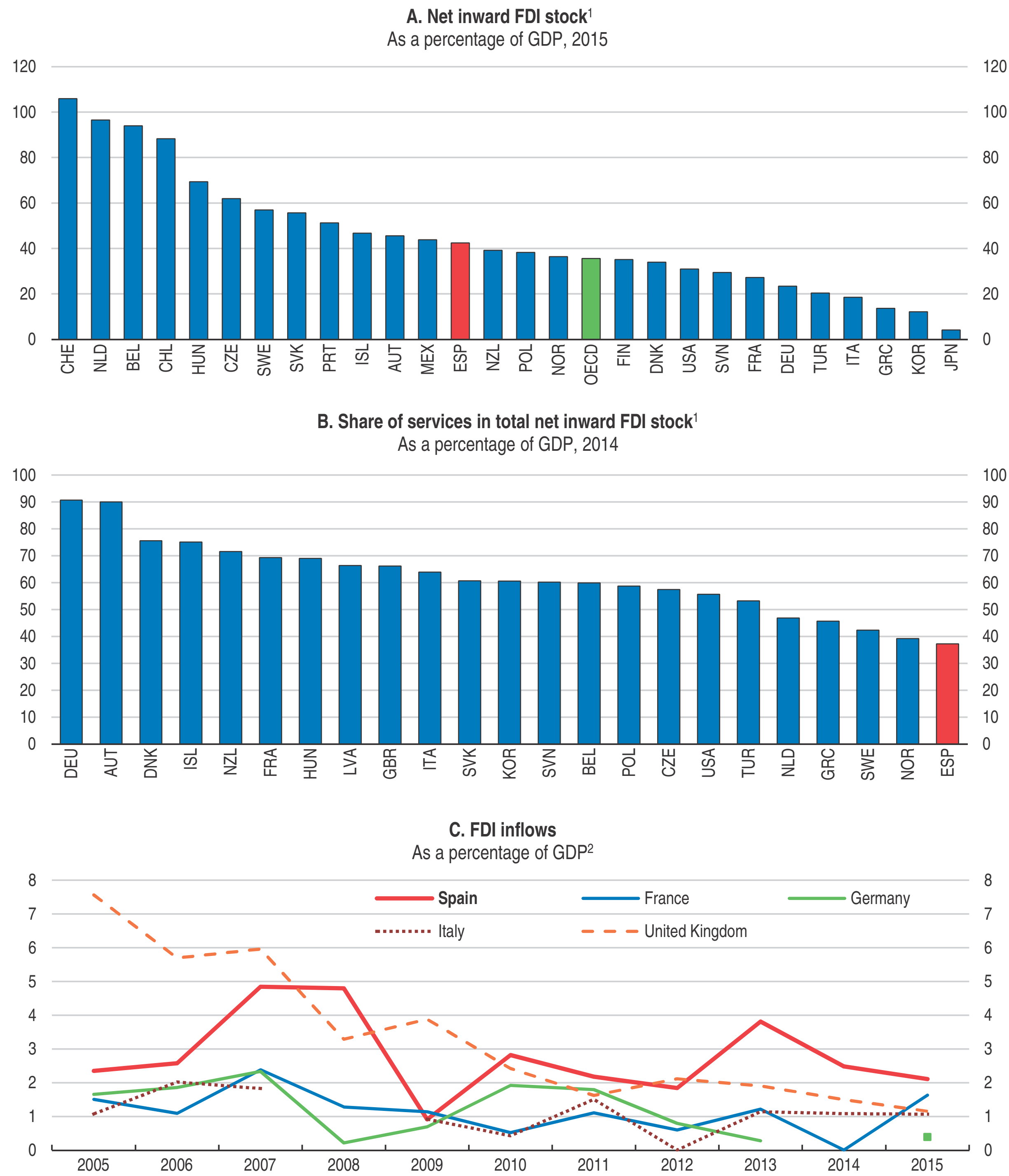
Formal barriers to services trade and investment are generally very low. The OECD's *Services Trade Restrictiveness Index* is lower in Spain than the sample average in 19 out 22 sectors covered. Nevertheless, there is still room for improvement, especially in air transport, auditing and legal services. In air transport, competition is restricted by the allocation of landing and take-off slots on a historical basis and a ban on commercial trading of these slots. A licence to practise auditing and legal services requires EU nationality and the majority of shares and voting rights of firms providing auditing and domestic legal services firms must be owned by locally licensed auditors and lawyers (OECD, 2015c). These results are confirmed by the OECD's *FDI Regulatory Restrictiveness Index*, which also shows that Spain's barriers to FDI are generally very low with the exception of air transport, radio and TV, media and particularly legal services, where Spain has the 4th most restrictive regulation in the OECD.

The main barriers to services sector FDI are problems faced by all firms in Spain: regulatory fragmentation across Spain's regions, difficulties of establishment in the internal market and overly restrictive labour market regulation (Chapter 1). These barriers are particularly relevant for services, where the internal market is a stronger pull factor than for manufacturing investment, which appears to be often motivated by exporting and particularly sensitive to international cost competitiveness (Rodriguez and Pallas, 2008).

Spain's agency responsible for promoting both the internationalisation of Spanish companies and attracting foreign investment, *ICEX- Spain Trade and Investment*, has a wide range of activities including matching foreign investors with Spanish companies requiring financing. In attracting foreign investment, it targets both sectors and key companies. The list of strategic sectors (aerospace, automotive, biotechnology, pharmaceuticals and ICT) appears similar to those other countries would target and is heavily industrially focussed. More effort could be put into targeting "anchor" FDI investors regardless of sector. This avoids picking sectors and has the advantage of gravity effects of FDI – in Ireland, the presence of leading international firms has tended to attract others (Barry et al., 2003; Worrall, 2014).

Corporate tax rates play a role in attracting foreign investment, with some industries such as financial services and pharmaceuticals tending to be particularly sensitive to the tax rate (Gorter and Parikh, 2003; Silva and Lagoa, 2011; Lawless et al., 2015). An increase in the corporate tax rate appears to have a stronger negative effect on FDI, the higher the level

Figure 2.23. **Foreign direct investment (FDI)**



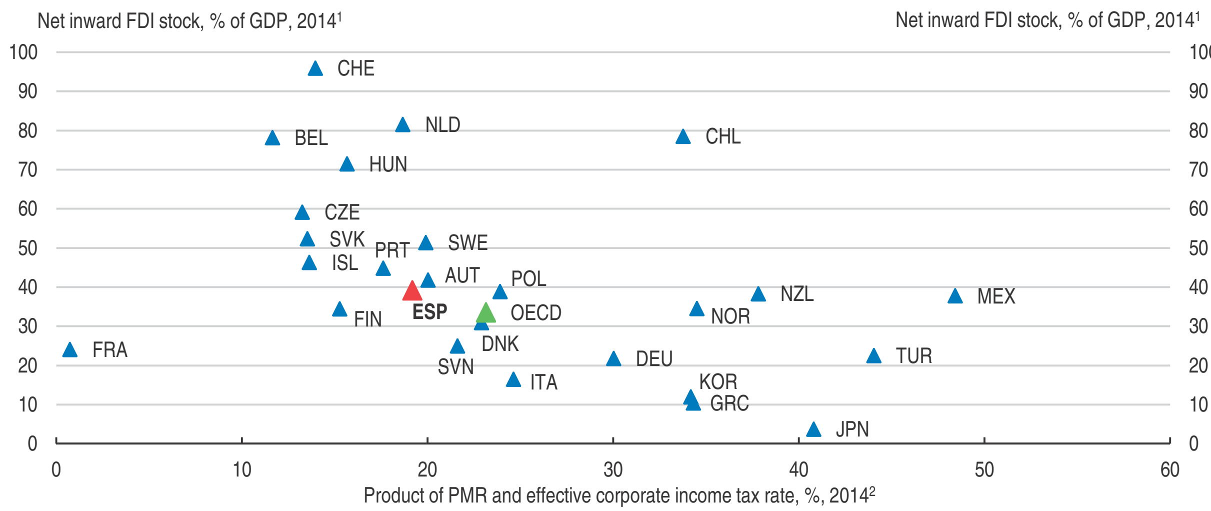
1. Data refer to resident operating unites excluding special purpose entities (SPEs).
2. There are gaps in the data for Germany and Italy in 2014 and 2008 respectively.

Source: OECD (2017), "Benchmark definition, 4th edition (BMD4): Foreign direct investment: positions, main aggregates", *OECD International Direct Investment Statistics* (database), February.

StatLink http://dx.doi.org/10.1787/888933459582

of product market regulation (Figure 2.24). Spain has recently cut the standard corporate tax rate from 28% to 25% in 2016, which puts the rate at about the OECD average (24.7% in 2015) and has aligned the tax rate for all firms, supressing the preferential rate for SMEs. The reduced rate for start-ups, introduced in 2013 has been maintained. The reduction in the tax rate is going in the right direction for attracting greater foreign investment but more could be done to broaden the tax base, as discussed in the "Assessment and recommendations".

Figure 2.24. **FDI and corporate income tax rates**



1. Data refer to resident operating unites excluding special purpose entities (SPEs). FDI: foreign direct investment.
2. The product market regulation (PMR) data used for the interaction term refer to 2013. The OECD aggregate is calculated as an unweighted average. Data for Japan and Mexico refer to Tokyo and Mexico City respectively.

Source: OECD (2017), "Benchmark definition, 4th edition (BMD4): Foreign direct investment: positions, main aggregates", *OECD International Direct Investment Statistics* (database), February; OECD (2013), *OECD Product Market Regulation Database*; and World Bank (2015), *Doing Business 2016: Measuring Regulatory Quality and Efficiency*.

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Size-dependant fiscal regulations, notably different levels of tax monitoring and enforcement, might also be acting as a break on the expansion of firms. In Spain, firms with more than EUR 6 million in annual operating revenue are monitored by the large taxpayers' unit. While all firms face the same tax schedule and compliance procedures, firms above that revenue threshold are more often exposed to tax audits and information requirements than smaller firms. There is evidence that firms react to avoid being under stricter tax enforcement by reducing their reported revenue just below (Almunia and Lopez, 2015). This is particularly the case in sectors with a low percentage of sales to final consumers, such as manufacturing and wholesale, where information trails are easier to verify. There is also evidence that firms locating below the threshold misreport their material and labour inputs costs to evade taxes. Such size-dependent policies should be carefully designed to avoid they become unintended barriers to firm growth.

Removing entry and expansion barriers and facilitating firm exit

Encouraging competition by reducing regulatory barriers to entry is an important tool for boosting profit prospects and therefore the incentive to invest for new innovative firms. In a welcome move to reduce barriers to entry, Spain introduced in 2013 the Market Unity Law to improve business regulation across all regions and thereby create a truly single market in Spain (OECD, 2014a). The government continues to make progress in implementing the Market Unity Law. An important step in this direction has been setting up a process where the government promptly considers complaints from anyone about new laws and regulations inconsistent with the Market Unity Law. Despite this, advances in reducing regulatory barriers have not yet been fully reflected on the ground. Doing business is still perceived to be more difficult in Spain than in other OECD economies (see "Assessment and recommendations"). The government and the regions should continue implementing the Market Unity Law to ensure that the obstacles businesses face keep falling and that regulatory reform has visible effects on productivity. Complementary to this would be to reduce barriers to firm expansion following entry by reforming tax and labour market regulations so that don't tighten with firm size (Gonzalez Pandiella, 2014).

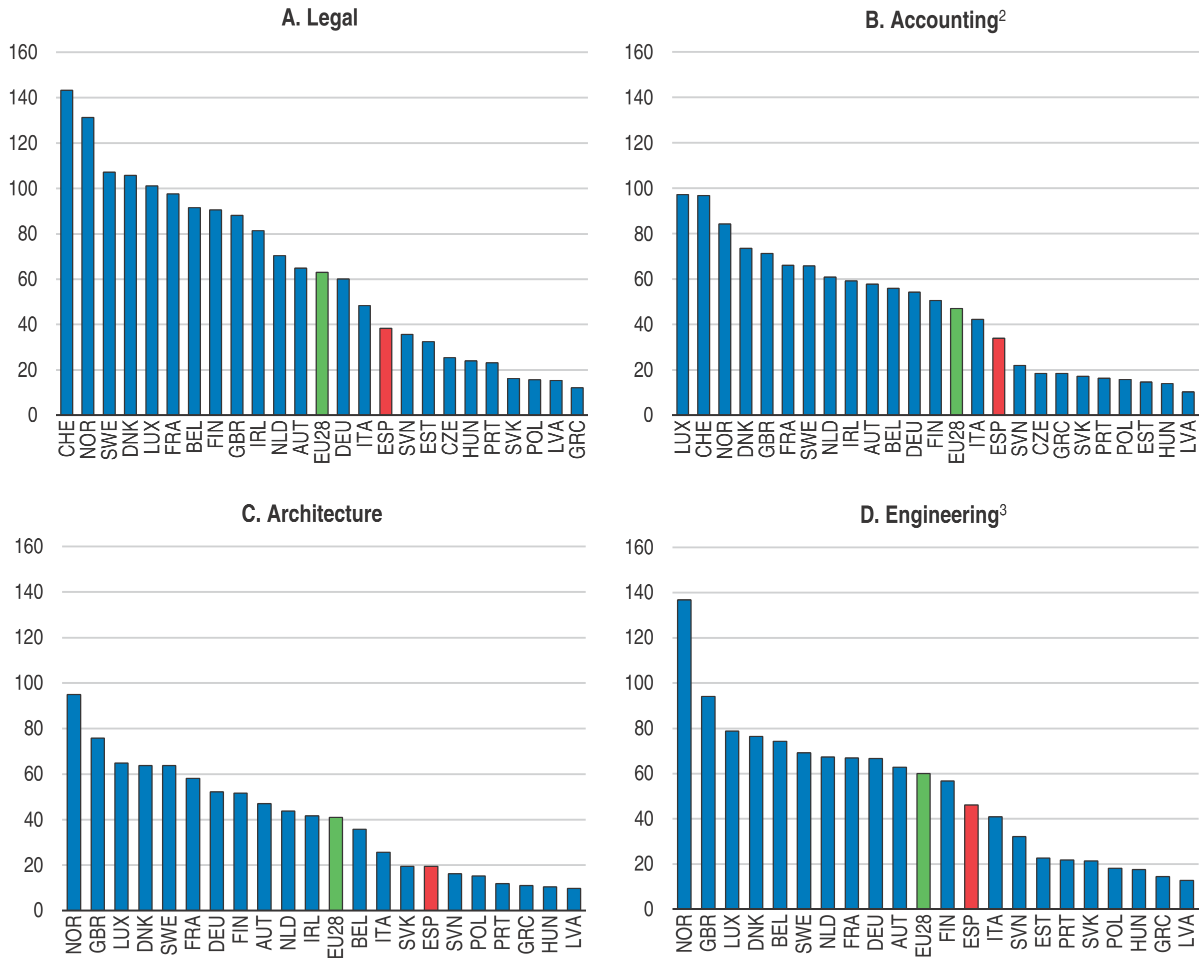
Competition remains weak in sectors that supply inputs to the whole business sector, particularly the professional service sector. This pushes up prices and again reduces potential profits from new investments as well as reducing their competitiveness in international markets. Professional services – which account for 75% of business services – are markedly less productive in Spain than in other European economies (González Pandiella, 2014 and Figure 2.25). They are subject to entry requirements in Spain that are much above those in other OECD countries, especially in the legal, architect and engineering professions. The authorities should implement the proposed reform of the liberalisation of professional services. The objective of the reform is two-fold. First: to improve the functioning and governance of professional bodies. Second: to benefit final customers, by eliminating disproportionate barriers to access or activity of professional services thus allowing increased competition, higher quality, lower prices and improved customer protection. There is also scope to lower costs and improve the quality of other inputs used by the whole business sector by boosting competition in the electricity, ports, sea and water transport and oil distribution sectors. (González Pandiella, 2014).

Sectorial wage agreements between incumbent firms and unions help protect insider firms by limiting the scope for new firms to try new business methods and organisation. The 2012 reform gave priority to firm-level collective agreements and relaxed the conditions for firms to opt-out. The reform contributed to wage moderation (see Chapter 1), but firm-level agreements have been concluded essentially only in large firms, and less than five per cent of all firms, mostly large ones, have opted-out. Reconsidering the conditions under which the statutory collective agreements are extended as discussed in Chapter 1, in particular, requiring a higher representativeness of business associations could help avoid that collective agreements are driven excessively by a limited number of the best performing firms.

Strong contract enforcement and efficient civil justice and timely bankruptcy procedures are important to encourage the growth of start-ups, especially as inefficient regulation in these areas has stronger negative effects on the growth of start-ups than incumbents (OECD, 2016c). Fostering the entry of new firms requires facilitating the exit of the less productive firms, which would free capital and labour resources towards the most innovative companies. The reform on the insolvency regime is a key aspect. The impact of reforms to insolvency regimes on aggregate productivity will also depend on the extent to which policy distortions in other areas constrain the exit of low productivity firms (Adalet McGowan and Andrews, 2016). Less stringent bankruptcy regimes, characterised by strong exit mechanisms and that do not excessively penalise business failure, can foster the development of seed and early stage venture capital (Armour and Cumming, 2006).

Figure 2.25. **Productivity in professional services is low**

Apparent labour productivity, gross value added in thousand EUR per person employed, 2014[1]



1. 2012 for Ireland.
2. Accounting, bookkeeping and auditing; tax consultancy.
3. Including related technical consultancy.

Source: Eurostat (2017), "Structural business Statistics – Services", *Eurostat Database*, February.

StatLink http://dx.doi.org/10.1787/888933459084

Efficient insolvency regimes can help address the issues associated with high levels of debt and non-performing loans (NPLs) by freeing up resources from unproductive uses. The effectiveness of insolvency law will also depend on framework conditions affecting firm exit, including judicial efficiency, regulatory and tax policies. There is some evidence that judicial efficiency is positively associated with entrepreneurship in Spain (García-Posada and Mora-Sanguinetti, 2014a). Until recently, the design of the Spanish insolvency regime has led to costly and lengthy insolvency proceedings (OECD, 2014b). In Spain, bankruptcy procedures took around 24 months and up to 36 months during the crisis, compared to around a year in France and the United Kingdom (García-Posada and Mora-Sanguinetti, 2012). This meant that secured creditors typically foreclosed on loans and seized collateral, providing few opportunities for marginal firms to restructure through formal insolvency procedures (García-Posada and Mora-Sanguinetti, 2014b).

Reforms in 2014 and 2015 to facilitate the restructuring of corporate and household debt should improve the efficiency of the insolvency regime. These reforms include measures to: i) improve out-of-court work-outs; ii) ease in-court procedures; iii) encourage the sale of firms as a going concern during liquidation; and iv) provide a "fresh start" – i.e. the exemption of future earnings from obligations to repay past debt due to liquidation bankruptcy. While tentative evidence suggests that these reforms have reduced the length of the insolvency process and the share of firms in liquidation (García-Posada and Vegas, 2016), some design features could be improved further to promote investment and productivity.

Out-of-court agreement on payments (OCAP) aimed at SMEs, which were introduced in 2013, were further improved in 2015, in line with the recommendations in the *2014 OECD Economic Survey of Spain*. The limitations of a 25% debt write-down and three year moratorium on debt extensions were relaxed. Moreover, the possibility to impose a restructuring plan on dissenting creditors, including secured creditors – a key feature of efficient insolvent regimes – was introduced. Finally, procedures have been streamlined to be made more accessible and faster by an improved system of mediators. Public creditors continue to be excluded from out-of-court restructuring processes, which reduces their effectiveness since a significant part of SMEs' debts are liabilities with tax and social security authorities (IMF, 2015; OECD, 2014b). The authorities claim that a flexible approach is taken to tax debts and they already negotiate separately with businesses. This suggests non-inclusion may not be as large a problem as at first sight, although this is not as efficient as including all debts in one negotiation because the public administration sometimes takes a long time to propose rescheduling.

Many advances to in-court procedures have been put in place, including the removal of limitations on debt write-downs, rescheduling of payments and the possibility to impose a restructuring plan on dissenting creditors. The introduction of the possibility of "cram-down" is welcome since it can boost aggregate productivity growth by promoting the timely restructuring of viable firms that encounter temporary financial difficulties. In order to prevent its potential adverse effects on credit supply, it is important that the interests of dissenting creditors are protected by ensuring that dissenting creditors would receive at least as much under the restructuring plan as they would receive under liquidation (Adalet McGowan and Andrews, 2016).

The introduction of a "fresh start" for entrepreneurs, as recommended in the *2014 OECD Economic Survey of Spain*, is welcome. The availability of a "fresh start" can reduce the costs and the stigma of failure associated with insolvency, and increase productivity by making it more likely that non-viable firms exit the market in a timely fashion and thereby free-up scarce resources to be recycled by more productive firms (Burchell and Hughes, 2006; Eberhart et al., 2014). With the introduction of a "fresh start" for entrepreneurs in 2015, the period over which the entrepreneur is legally required to repay debt (the discharge period) became immediate for some types of debt (unsecured and subordinated debt), if certain conditions, including the repayment of a certain percentage of debt, is fulfilled. When this payment threshold is not met, the debtor has to commit to a five year payment plan for the debt exempt from immediate discharge, which remains high in international perspective (Carcea et al., 2015).

A number of improvements could maximise the benefits associated with a "fresh start". In November 2016, the European Commission introduced a proposal to limit the full discharge period to three years for honest insolvent entrepreneurs (European Commission, 2016), which would improve the efficiency of the Spanish system. At the same time, it is important to address potential problems of abuse of more lenient personal insolvency regimes by fraudulent entrepreneurs and moral hazard. The benefits of the reform could also be maximised by increasing the certainty for the debtor by improving the clarity and conditions of the payment plan. Moreover, public creditors are excluded from this reform, which could: i) leave entrepreneurs with significant residual debt after discharge, decreasing their ability to start a new business; and ii) prevent them from dedicating their income to fulfil the payment plan in order to achieve a final discharge. To resolve this, the authorities should negotiate with entrepreneurs promptly on tax debts following discharge.

Environmental regulation and taxation and capital allocation

Environmental regulation, subsidies and taxation have a central role to play in improving private investment decisions. They can have direct effects on capital allocation and productivity by changing input costs and incentives to innovate. The dramatic increase in the share of renewables (wind and solar) in electricity generation in Spain over the past 15 years demonstrates how core environmental subsidies are to private sector investment choices.

If resources are under-priced relative to their full economic and environmental cost firms will over-invest in inefficient production processes and activities resulting in poor productivity performance, especially once environmental damage is taken into account. For example, low prices for water in Spain have encouraged capital misallocation to water intensive, low productivity purposes in a country with the third highest level of water stress of the 29 OECD countries with available data. Over 30% of irrigated water was being used for low value cereal and rice crops in 2015 (Magrama, 2015). Greater use of water pricing signals should be made to more efficiently allocate water (Fuentes, 2011). Barriers including restrictions on who can buy and what rights can be sold are impediments to the efficient reallocation of water rights to their highest value uses. Recent temporary measures introduced by decree law in 2015 in response to the drought, including allowing the sale of water rights to a wider set of users and selling water rights not used in the previous year, go in this direction and should be made permanent.

Environmental tax revenue in Spain has declined in real terms since 2000 from above the OECD average to around the OECD average as a share of GDP. The share of environmental taxes in total revenue is lower than the OECD average (OECD, 2015d). Taxation applies to all fossil fuels used for transport as well as fuel for heating and industrial purposes as well as electricity output but there are exemptions. Some users in agriculture, mining, aviation, navigation and railway transport are exempted from fuel tax or the excise duty on electricity, or receive refunds or reductions related to the use of diesel (OECD, 2015d). The design of environmentally-related taxes can be improved to better reflect environmental costs, so providing an incentive for the use of more environmentally friendly technologies. Over-investment in environmentally polluting industries makes the economy more vulnerable to shocks in regulations elsewhere and to changes in consumer preferences.

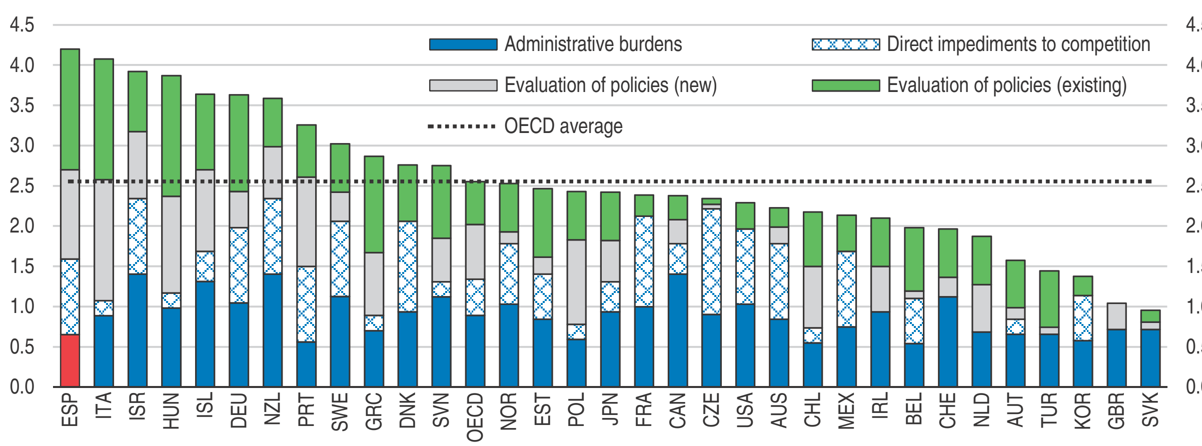
Price signals in the economy are an important influence on firm investment decisions because they affect input prices as well consumer demand. Diesel is under-taxed relative to petrol (diesel has lower taxes per litre than petrol despite having higher emissions) lowering the retail price of diesel relative to petrol and encouraging consumers to buy diesel cars. Spain has one of the highest shares of diesel powered passenger cars in Europe (Eurostat, 2015a).

Taxation of natural gas and coal used in electricity generation is based on energy used rather than emissions and in the case of commercial heating natural gas is even taxed more than coal by emissions. In addition, since 2011 some electricity generators are mandated to purchase coal. Coal production is also subsidised although subsidies are being phased out (OECD, 2015e). The government should reform taxation of transport fuels and fossil fuels used in electricity generation and heating so that the per-unit tax is based on the amount of CO_2 emissions and other pollutants per unit. This would encourage better allocation of capital and investment decisions by better aligning of pricing signals with environmental costs.

Increasing the stringency of environmental regulation can also improve capital allocation. More stringent policies tend to raise productivity growth in the most productive firms. The least technologically advanced firms tend to see a temporary fall in their productivity (Albrizio et al., 2016). Still, more stringent policies may have (small) negative impacts on domestic investment (Koźluk, Dlugosch and Garsous, 2016). In this context, it is even more important that environmental regulation is not just stringent but efficient and does not overly impede firm entry, competition and productivity. Encouragingly Spain has taken steps to reduce barriers to firm entry caused by environmental regulation, which a partial indicator suggested were the highest in the OECD (Figure 2.26).

Figure 2.26. **OECD indicator of barriers to entry due to environmental policies (BEEP)**

Index scale of 0-6 from least to highest burdens to entry and competition



Source: Koźluk, T. (2014), "The Indicators of the Economic Burdens of Environmental Policy Design: Results from the OECD Questionnaire", *OECD Economics Department Working Papers*, No. 1178, OECD Publishing, Paris.

StatLink http://dx.doi.org/10.1787/888933459600

The OECD's *Environmental Performance Review of Spain 2015* found that obtaining an Environmental Impact Assessment (EIA) report was slow, uncertain and subject to regulatory fragmentation. To tackle these problems at the end of 2013 a new law (Law on Environmental Assessments, 21/2013) was passed. The new law provides more details about the requirements for EIA removing the necessity for the regions to regulate, which should help reduce fragmentation. It's important that the law is fully implemented and deadlines (maximum four months for EIA assessments) are respected. The Market Unity Law complaint process should be used to remove any remaining regulatory fragmentation.

Main recommendations on boosting innovative investment

Increasing the flow of bank credit to smaller firms

Key recommendations

- Set up SME bond funds with guarantees provided both by government and SME companies.

Other recommendations

- Introduce a simple standardised framework for securitising SME debt to foster bank lending to SMEs.
- Require commercial banks to publish prominently the right of SMEs to demand a standardised credit assessment.

Better supporting innovative business investment

Key recommendations

- Increase public and private funding for innovative firms at the seed and early start-up phases.
- Partially reallocate funds from loans to R&D grants to projects and researchers based on performance and international peer review.

Other recommendations

- Increase the emphasis of the state-owned bank, ICO, on providing funding through second-floor facilities for commercial bank loans to new and innovative companies.
- Provide more specific programmes to entrepreneurs, such as financial education of SMEs' entrepreneurs on options and processes for raising equity finance.
- Shift public funding for venture capital towards the initial and higher ends of the venture capital scale.

Enhancing incentives to invest

Key recommendations

- Continue to implement the Market Unity Law and adopt the professional services reform.
- In cases when debt forgiveness is not automatic, reduce the period during which bankrupt entrepreneurs are required to repay past debt from future earnings.

Other recommendations

- Establish clear guidelines for the participation of public creditors in corporate debt restructuring processes to make them more effective.
- Refocus ICEX, Spain agency to promote FDI, on targeting key investors rather than investment in specific sectors.
- To encourage better allocation of capital and investment decisions by improving pricing signals reform taxation of fuels so that the tax per unit is based on the amount of emissions and other pollutants per unit.

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