

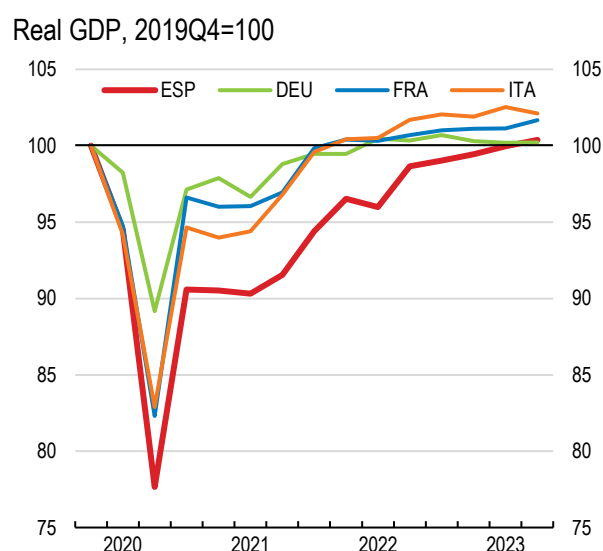
# Executive summary

## The economy is proving resilient

In a context of high inflation and an uncertain outlook due to Russia's war of aggression against Ukraine, the Spanish economy has held up well. The cost of living has increased, spurred by rising food and energy prices.

With higher inflation, lower external demand, and rising interest rates, activity has proved resilient (Figure 1). Supply shortages and a sharp rebound in demand led to a pick-up in inflation from early 2021, as in most OECD countries, which was then amplified by surging energy prices in early 2022 due to Russia's war of aggression against Ukraine. Headline inflation significantly eased in 2023 with lower energy prices, but it has slightly rebounded since June, and core inflation remains high.

Figure 1. GDP growth has been sustained



Source: OECD Economic Outlook.


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Table 1. Economic growth is resilient

Annual growth rates, %, unless specified

	2021	2022	2023	2024
Gross domestic product	6.4	5.8	2.5	1.5
Private consumption	7.1	4.7	1.7	1.6
Unemployment rate (%)	14.8	12.9	11.9	11.5
Consumer price index	3.0	8.3	3.5	3.7
Fiscal balance (% of GDP)	-6.7	-4.7	-3.8	-3.5
Public debt (Maastricht definition, % of GDP)	116.8	111.6	109.4	110.0

Source: OECD Economic Outlook.

GDP growth is projected to slow down but to remain resilient supported by domestic demand (Table 1). Growth will also be supported by sizeable inflows of Next Generation EU funds.

Employment growth has been robust, and the 2021 labour market reform is showing promising results in shifting workers from temporary to permanent contracts, especially for the young. The unemployment rate has come down but remains the OECD's highest. Pervasive joblessness reflects structural issues that need the continuation of on-going reform efforts to address skill mismatches, keep reducing the share of temporary workers, enhance active labour market policies and increase incentives to return to work following unemployment. Improving women's and especially mothers' labour market integration should also remain a priority.

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

## Public debt must be further reduced

As a result of the COVID-19 pandemic, public debt, which was already high, increased considerably in 2020, even though it has been reduced in the following years (Figure 2). Stronger and sustained fiscal consolidation is needed to maintain debt on a downward path and to create space for ageing-related and growth-oriented spending.

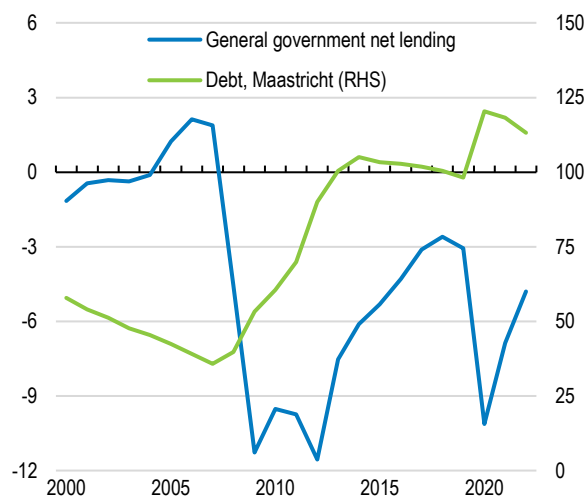
Sizeable public support helped to mitigate the inflationary shock on businesses and households. These measures should now end.

Pension and health-related outlays are set to rise in the longer term, substantial investments are needed to accelerate the green transition, and the government has committed to boosting defence spending. To make space for these future spending pressures, fiscal consolidation should rely on mobilising additional revenues and enhancing spending efficiency based on spending reviews. There is room to raise VAT, environment-related taxes and other excise duties, which are


lower than the EU average. A gradual alignment to the standard VAT rate of the items that are subject to a reduced rate and that benefit mainly higher-income households would help. Excises on alcohol and tobacco could be raised. But at the same time labour and some capital taxes could be cut.

## Figure 2. Public debt has increased sharply

General government, % of GDP, 2000-2022



Source: OECD (2022), National Accounts database.

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**The recent pension reform increased minimum and non-contributory pensions and indexed benefits to consumer prices. Despite accompanying revenue-raising measures and changes to encourage delayed retirement, there will be a considerable increase in overall pension expenditure. Nevertheless, pension spending is expected to decline gradually from the late 2040s onwards.** The sustainability of the new pension system will be re-examined regularly by the Fiscal Council. If it concludes that there is a deviation from the benchmark defined by the law, the government will need to take measures to compensate it or else an automatic increase of social contributions will kick in. Yet, it would be preferable to link the statutory retirement age to life expectancy at retirement and to cut pension accrual rates.

**Despite recent small declines in inequality and poverty, one quarter of the Spanish population was poor or at risk of poverty and social exclusion in 2022, and child poverty remains**

**high.** Social benefits should be better targeted at the neediest, notably poor families with children. Ensuring the regional transferability of social and housing rights would make the system more efficient and allow people to take advantage of more distant job opportunities. Take-up of the minimum income guarantee could be improved by further enhancing communication with eligible households.

## Growth needs to be stronger and more sustainable

**Population ageing, sluggish productivity growth and low investment weigh on Spain's growth potential. At about half of the OECD average, productivity growth over the past decade has been meagre. Making growth more sustainable will require greater efforts to lower fossil-fuel dependence and fight climate change and to address water problems.**

**Spain is making progress on its reform agenda and the implementation of its Recovery, Transformation and Resilience Plan.** Harmonising regulations across the country would support business growth, especially for SMEs. Fostering partnerships between public research institutions and firms would bolster their currently low capacity to innovate.

**Strengthening the prevention of corruption in the public administration would enhance the quality of public investment and lower fiscal costs.** More systematic use of electronic contracting in public procurement procedures could help, as would continuing the implementation of the OECD Anti-Bribery Convention.

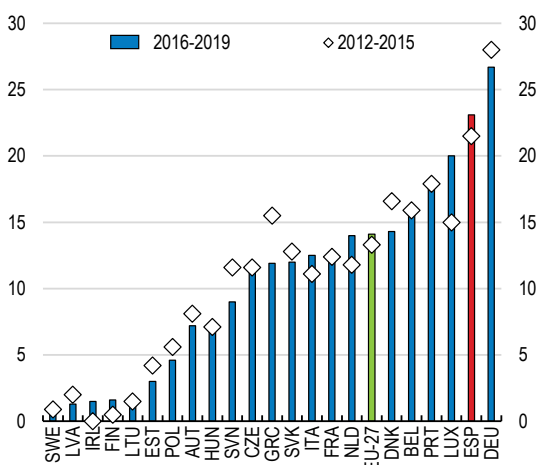
**To achieve its climate-change objectives Spain will have to step up its actions.** Despite improvements, Spain remains heavily reliant on fossil fuels, favoured by tax exemptions, modest fuel taxes and considerable subsidies in agriculture and fishing. Carbon prices are low compared to international best practice. Alternative measures applied to sectors outside the EU-ETS until the so-called EU-ETS2 takes effect would help reduce emissions. Stepping up the shift towards low/non-emitting transport modes can help reduce high transport-sector emissions. Continued efforts to overcome fossil-fuel dependence will be

necessary, including by promoting renewable energy, and seeking better storage and grid interconnections. The Recovery, Transformation and Resilience Plan, which devotes 40% of its resources to the green transition, will bring key support in this regard.

**Drought associated with climate change and the expansion of irrigation of cropland are impacting water availability and quality.** Actions should be promoted that focus on demand management, improving the efficiency of its use, through greater recourse to water reuse and the environmental recovery of water bodies. The price of water should better reflect its scarcity, in particular for agricultural purposes. Pollution from fertilisers should be addressed by adjusting taxation or regulating their use (Figure 3).

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

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



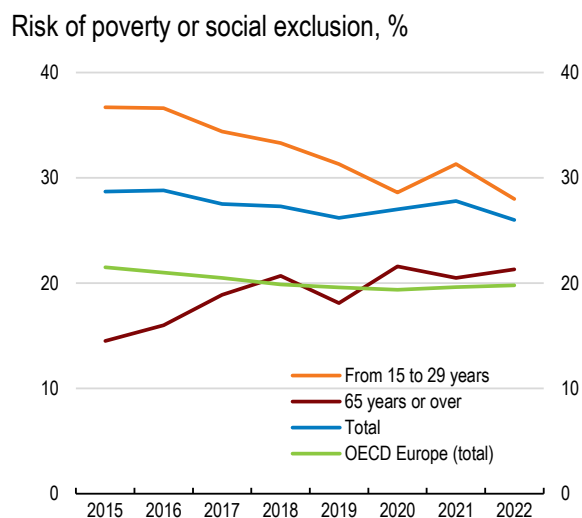
Source: European Environment Agency (EEA).  
StatLink <https://stat.link/kzumah>

### Spain must increase opportunities for youth

**Enhancing education, facilitating youth labour market participation, improving entrepreneurship, and boosting access to housing are also crucial to fully realise Spain’s growth potential and reduce the risk of poverty among young people (Figure 4).**

**Many young people in Spain leave the education system with low skills, limiting their job prospects.** Grade-repetition and early-school-leaving rates have significantly declined, from 17.9% in 2018 to 13.9% in 2022 for the latter, a progress that needs to continue. Early-warning indicators and tailored support for students at risk of falling behind could help to lower early leaving. Support for enrolment in vocational education should continue because it equips students with skills in high demand. Promoting collaboration among firms to offer apprenticeships, supply teachers or share administrative burdens, as the new law on vocational education foresees, can bring more SMEs into the vocational education and training system. The Alliance for Vocational Training is a welcome initiative in this direction. Greater employer involvement in the design of university curricula and improvement on existing tools that offer information on labour market placements would help to better align studies and labour market needs.

**Figure 4. Young people face high poverty risks**



Note: OECD Europe includes European OECD countries and excludes Türkiye.  
Source: INE.

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**Youth labour-market integration is difficult.** The unemployment rate of people under 25, at 27%, is one of the highest in the OECD. Poor job quality among the young is pervasive although the recent labour market reform helped to significantly reduce temporary employment. The minimum wage has

been raised considerably since 2018, increasing earnings and reducing wage inequality for young people. However, such large increases can harm employment for some groups, especially young people. Future minimum wage changes should be in line with labour market conditions and productivity. Youth entrepreneurship should also be fostered through better mentoring, training and access to financing.

**Over 60% of Spanish people under 34 live with their parents, mainly due to insufficient earnings and job instability.** Gradually increasing the stock of social rental housing should be a priority, as planned by the government. A draft law foresees temporary rent caps in stressed housing markets, which may reduce already low rental supply and increase rents in the longer run.

## Main findings and key recommendations

MAIN FINDINGS	KEY RECOMMENDATIONS
<b>Addressing medium-term fiscal challenges</b>	
Support measures to alleviate the impact of high energy and food prices have been sizeable and only partly targeted towards the most vulnerable.	End the support measures that were put in place to alleviate the impact of high energy and food prices.
Public debt, at 113% of GDP is high, the fiscal deficit is still sizeable and pension and health-related expenditures are set to rise in the longer term.	Adopt a medium-term fiscal plan, step up the pace of deficit reduction from 2024, and ensure all extra spending is fully financed over the medium term.
Spending is tilted towards social spending, mostly pensions and unemployment benefits, with too little allocated to growth-enhancing items including education and training. Young people benefit less from public spending than others.	Based on spending reviews and sound cost-benefit analysis, set longer-term spending priorities more geared to growth-enhancing items, notably skill-building measures such as education.
Tax revenues are low by EU standards, and there is scope to improve the design of the tax system: the value added tax base is narrow; marginal personal income tax rates climb quickly already at modest levels of income, discouraging labour supply; and the tax system is not well geared to achieving environmental goals.	Mobilise additional tax revenues by gradually broadening the value added tax base, imposing higher excise duties on alcohol and tobacco and raising environment-related taxes, while reducing some capital taxes and the tax burden on labour for low-income households with children.
<b>Promoting strong, inclusive and sustainable growth, and pursuing efforts to raise productivity and fight corruption</b>	
Social expenditure is tilted towards contributory benefits favouring people with a job and a stable financial situation. Social assistance programmes do not adequately protect vulnerable groups. Child poverty is high.	Increase the amount and coverage of cash benefits for poor families with children.
The legal framework to fight corruption has been enhanced over the past decade, but the level of corruption is still perceived as rather high by citizens.	Continue efforts to reduce corruption in the public sector.
Despite improvements, Spain remains heavily reliant on fossil fuels, favoured by tax-exemptions, modest fuel taxes and considerable subsidies in agriculture and fishing.	Broaden the base for environment-related taxation including by phasing out exemptions and gradually increasing the tax rate on non-ETS emissions, and compensate partially and temporarily the most vulnerable.
Current policy efforts are unlikely to be sufficient to reach stated goals, notably net zero carbon emissions by 2050 and a cleaner energy mix through greater renewables.	Install more electric vehicle charging points and provide more support for the retrofitting of buildings.
Water quality is poor with toxic levels of nitrates concentration spreading because of intensive agriculture production. Securing water is also a worsening problem in parts of the country afflicted by persistent drought.	Promote a more efficient use of fertilizers by increasing taxes or improving their regulation. Encourage a better use of water through more efficient irrigation, reusing and recycling water or increasing water pricing for irrigation.
<b>Tackling difficulties facing youth in the labour market, education, entrepreneurship and housing</b>	
Expanding access to early childhood education has been a government priority since 2021, but expenditure on early childhood education is lower than in other OECD countries and poorer families face challenges to access early childhood education and care, while access to childcare seems a barrier to female labour force participation.	Continue expanding access to quality early childhood education and care to children under the age of three prioritizing disadvantaged children.
Early school-leaving and repetition rates in compulsory education are very high, curbing educational advancement and job prospects.	Train teachers to identify and support students at risk of leaving education early and address their learning needs.
Enrolment in vocational education and training programmes is growing but remains comparatively low, despite graduates' good labour market outcomes.	Foster collaboration between SMEs to provide apprenticeships to students, training to teachers or share managerial duties.
Despite recent efforts to reform vocational education and training, skill mismatches hamper school-to-work transitions. Close to 40% of 15–34-year-olds report that their highest level of education did not help them in their current job, one of the highest rates in the European Union.	Encourage collaboration between education institutions and businesses in designing and updating university degrees and in student counselling to promote a better alignment between studies and labour market needs. Publicise data on the success of students' labour market placements.
Recent rises in minimum wages have been rapid and large, which could potentially lower employment for vulnerable groups.	Make the recently established expert commission independent with a mandate to advice on minimum wage changes in line with labour market conditions and productivity and ensure their access to data.
Entrepreneurship is low, and Spanish entrepreneurs lack training on how to start a business and on financial literacy more generally.	Extend entrepreneurship education to more young people who are out of the formal education system.
Rental housing is expensive. The stock of social rental housing is stagnant and, at 1%, one of the lowest in the OECD. Many young people involuntarily delay living independently. Rent control regulations are among the most stringent in the OECD and further increases would risk curbing housing supply.	Encourage additional rental supply in stressed areas by increasing the stock of social rental housing, relaxing rent controls, and making taxation less distortive (e.g. by updating property values more regularly and reducing property transfer taxes).



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