



EUROPEAN COMMISSION

Brussels, 7.6.2011  
SEC(2011) 718 final

**COMMISSION STAFF WORKING PAPER**

**Assessment of the 2011 national reform programme and stability programme for SPAIN**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**on the National Reform Programme 2011 of Spain and delivering a Council Opinion on the updated stability programme of Spain, 2011-2014**

{SEC(2011) 817 final}

## **1. INTRODUCTION**

The Spanish economy was severely hit by the crisis and went through a sharp adjustment in 2008-2009. During 2010 Spain experienced market pressure in the context of the euro area sovereign debt stress. In response, the Government accelerated and expanded its fiscal consolidation and structural reform agenda and started to tackle long-standing policy challenges. The reform determination of the government is confirmed in the National Reform Programme (NRP) and the Stability Programme (SP) submitted to the Commission on 29 April 2011. These documents also reflect the short-term commitments that Spain presented on 25 March 2011 under the Euro Plus Pact with the objectives of improving Spain's competitiveness and contributing to a higher degree of convergence in the euro area.

## **2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK**

### **2.1 RECENT ECONOMIC DEVELOPMENTS**

The Spanish economy experienced a long period of housing and credit boom prior to the financial and economic crisis, resulting in the build-up of large internal and external imbalances. These included an excessive allocation of resources to the construction sector, high indebtedness, of both households and corporations, a large current account deficit, and growing external debt.

A correction began in early 2007 and was accelerated by the international financial crisis. As a result, the share of GDP coming from the construction sector declined by 2010 to pre-boom levels. Households and corporations became net lenders and reduced their indebtedness. Net external borrowing fell to 3.9% of GDP from 9.6% in 2007. Labour productivity increased significantly, driven by the lower weight of the construction sector and a reduction in employment. Together with a moderation in wage growth, this led to some improvement in price and cost competitiveness, which had deteriorated considerably during the boom.

Nevertheless, significant imbalances remain. Real GDP fell by 4.3% between the first quarter of 2008 and the final quarter of 2010 and employment declined by over 10%. As a consequence, the unemployment rate rose above 20% by the end of 2010, the highest rate in the EU. While the adjustment of the construction sector is almost complete, the housing market is still adversely affected by a large stock of unsold dwellings (see Box 3 in section 4.2.1.3). House prices, which have already fallen by 15.4% in nominal terms by the first quarter of 2011, are therefore likely to adjust further. The banking sector was initially relatively unaffected by the international financial crisis, but came under pressure with the bursting of the housing bubble and the sharp increase of unemployment. As a result, substantial public support was required, although this was lower than in other countries.

### **2.2 OUTLOOK**

The Commission services project that real GDP will expand by 0.8% this year and by 1.5% in 2012. As in 2010, net exports are set to be the main driver of growth, especially in 2011. Exports are projected to grow strongly due to a positive impact of the recovery in world trade and the improving competitiveness of the Spanish economy. Domestic demand is being held back by high unemployment, ongoing deleveraging in the private sector, and fiscal consolidation.

Inflation was slightly above the euro-area average in 2010 and has increased further in the first quarter of this year. This reflects not only higher oil and commodity prices but also an increase of VAT, other indirect taxes, and administered prices. Core inflation is projected to

remain contained at around 1.7% on average in 2011 on the back of weak domestic demand and declining unit labour costs. Headline inflation is forecast to fall to around 1.5% in 2012 due to a foreseen stabilisation of oil prices and weak domestic demand. The moderation in wage growth observed in 2010 is expected to continue in 2011, mainly as a result of public sector wage cuts. Unit labour costs fell by 1.5% in 2010 and are projected to broadly stagnate in 2011 before growing moderately by around 0.7% in 2012. The lagged response of wages to the crisis contributed to the surge in unemployment. The unemployment rate averaged close to 20% in 2010 and is expected to reach a peak in 2011 at just above 20.5% before diminishing slightly in 2012.

Buoyant exports and weak domestic demand should support a further correction of the current account deficit in 2011 and in 2012. However, the long period of large external deficits led to an accumulation of high net external liabilities and the servicing of these liabilities is putting a burden on the current account balance with the primary income deficit, including net current transfers, projected to rise to almost 3% of GDP by 2012.

To sum up, the Spanish economy has been stabilising since 2010, but the correction of macro-economic imbalances implies a protracted recovery. Important measures in the areas of fiscal consolidation, savings-bank restructuring and labour and product market reforms have been taken. Nevertheless, challenges include further strengthening market confidence, reducing domestic and external vulnerabilities and underpinning medium-term growth and employment.

### **3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE**

In the light of the economic situation described above, Spain embarked on an ambitious reform agenda, reflected in the National Reform Programme (NRP) and the Stability Programme (SP), and in the short-term commitments made by Spain under the Euro Plus Pact. These commitments concentrate on three areas: fostering competitiveness, fostering employment and enhancing the sustainability of public finances.

Spain has ensured coherence between its National Reform Programme and Stability Programme, outlining in an integrated manner rigorous fiscal consolidation efforts on the one hand and key structural reforms on the other. The NRP reflects well both short-term priorities and the Euro Plus Pact commitments. It addresses long-term challenges to modernise the Spanish economy, and places imminent reform priorities in a wider context. This longer-term strategy is underpinned by the 2020 targets, with national targets set in the fields of employment, R&D, education, energy and climate change and poverty reduction for 2014 and 2020. The SP sets out the budgetary strategy to correct the excessive deficit by 2013 and make further progress with consolidation thereafter. The National Reform Programme was prepared in cooperation and consultation with social partners and civil society and with the Autonomous Communities and local authorities reflecting the multi-level governance structure of the country and regional competences in several of the areas of Europe 2020. The national targets will further be translated into targets at regional level. The Parliament was also involved in the process.

**Table 1: Spanish Europe 2020 targets**

Europe 2020 targets	Current situation in Spain <sup>1</sup>	Spanish Europe 2020 target in the NRP
R&D investment (% of GDP)	1.4%	3% (2/3 private)
Employment rate (%)	62.5%	74%
Early school leaving (%)	31.2%	15%
Tertiary education attainment (%)	39.4%	44%
Reduction of number of people in or at risk of poverty or exclusion	10,6 million (23,4% of the total population)	1,4 – 1,5 million
Energy efficiency – reduction of energy consumption in Mtoe <sup>2</sup>		Reduction in primary energy consumption: - 25.2 Mtoe
Greenhouse gas emissions (from sources not covered by the Emission Trading System)	0% <sup>3</sup>	-10% <sup>4</sup>
Renewable energy (% of total energy use)	11%	20% of energy from renewable sources in gross final consumption of energy

#### 4. POLICY CHALLENGES AND ASSESSMENT OF POLICY AGENDA

##### 4.1 CHALLENGES

The main policy challenge in the very short term is to further regain market confidence. It is also key to secure the sustainability of its public finances, stabilise the macro-economic situation, strengthen medium-term growth and reduce the very high rate of unemployment. In particular, both the ECOFIN Council<sup>5</sup> and the Spanish NRP shared the major challenges for Spain are to:

- (1) Reduce the high structural deficit and improve the long-term sustainability of public finances. A consolidation of public finances is essential to halt the rapid increase in government debt and to restore market confidence. The shift to a less tax-rich economy requires an adjustment of both expenditures and revenues at all levels of government. Dealing with the effects of an ageing population, including higher health-care costs and a significant increase in the ratio of retirees per worker, is an important challenge.
- (2) Stabilise the real estate sector and ensure a well-functioning and stable financial sector. Securing confidence in the stability of the financial sector, and in particular, the solvency of savings banks is a key challenge. This requires finalisation of the consolidation and downsizing of the sector. The high share of real estate loans in total loans is a risk factor, also in view of the high degree of indebtedness of the private sector. Guarding against the emergence of asset prices bubbles and putting in place measures to contain household and

<sup>1</sup> Eurostat figures

<sup>2</sup> As estimated by the Commission. Mtoe = Million tonnes of oil equivalent.

<sup>3</sup> This quantity corresponds to the 2005-2008 evolution of the emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

<sup>4</sup> The national emissions limitation target defined in Decision 2009/406/EC (or "Effort Sharing Decision") concerns the emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels

<sup>5</sup> Council conclusions on European 2020 Strategy, 8 June 2010.

corporate indebtedness would help ensure that similar imbalances do not recur in the future.

- (3) Facilitate wage and price adjustments and enhance productivity to regain and sustain competitiveness. Price and wage rigidities, a lack of competitions in certain sectors (which are associated with persistent inflation differentials vis-à-vis the euro-area average), and low productivity growth hamper structural adjustment towards higher value-added activities and reduce competitiveness. Stronger competition in product and service markets, an improved business environment and enhanced efficiency of investment in education and innovation would facilitate the reallocation of resources and to boost growth.
- (4) Improve the functioning of the labour market in particular as regards labour market segmentation and wage bargaining. A complex collective bargaining system inhibits the adaptation of wages to economic and labour market conditions. Inflation adjustment clauses are not in line with price-stability-oriented policies and also undermine competitiveness. High segmentation in the labour market reduces incentives to invest in education and training, and implies lower productivity and large cyclical swings in employment.
- (5) Ensure a stronger contribution of the education and training system at all levels to human capital formation. Low levels of educational achievement at secondary level, in particular a high early school leaving rate and weaknesses in the vocational education and training system, contribute to low productivity growth and reduce the employability of the workforce.

### **Box 1 – Commitments and actions taken by Spain under the Euro plus pact of 25 March 2011**

#### ***Commitments to foster competitiveness***

- *Reform the collective bargaining system by April 2011.*
- *Reform professional services.*
- *Setup of an Advisory Commission on Competitiveness.*
- *Speed up bankruptcy procedures by reforming the bankruptcy law.*

#### ***Commitments to foster employment***

- *Adopt implementing acts in compliance with the Royal Decree Law on active labour policies of February 18 in view of designing a Strategy for Employment.*
- *Adopt Decree laws to develop provisions in the Law on Sustainable Economy in the field of vocational training.*
- *Implement a programme to promote the reduction of informal employment.*

#### ***Commitments to enhance the sustainability of public finances***

- *Reform of the Fiscal Stability Law in order to promote the establishment of an expenditure rule, taking into account nominal GDP growth in the medium term.*

### ***Commitments to reinforce financial stability***

- *Complete before 30 September 2011, the restructuring process of the financial sector in order to adapt it, in particular for saving banks, to the reinforced capital requirements approved in February 18.*

The Spanish commitments broadly correspond to the macroeconomic bottlenecks endorsed by the ECOFIN in June 2010 in the context of the "Europe 2020-Strategy". While they mostly confirm previously announced plans, they also include additional commitments on the time frame within which certain reforms will be implemented (i.e. the reform of Active Labour Policies and the Law on Sustainable Economy). The commitments under the Euro Plus Pact highlight areas that the Government considers crucial for improving Spanish competitiveness and are thus helpful in sustaining the momentum for structural reform.

## **4.2 ASSESSMENT OF THE POLICY AGENDA**

### **4.2.1 Macroeconomic policies**

#### **4.2.1.1 Public finances**

Both the SP and NRP expect real GDP to pick up in 2011, advancing by 1.3%, to accelerate noticeably to 2.3% in 2012, and to increase further to around 2.5% per year in 2013 and 2014. This is a more favourable GDP growth scenario than the Commission service's 2011 spring forecast (see Table II in the annex). The SP projection for 2013 and 2014 are also above the Commission services' medium-term potential growth projections. The SP's growth outlook is, however, expected to be supported by the positive effect of structural reforms<sup>6</sup>. In terms of growth composition, the SP is more optimistic with respect to domestic demand than the Commission service's 2011 Spring Forecast, which projected that the high indebtedness of the private sector and the high unemployment rate will weigh more heavily on domestic demand and in particular private consumption. Moreover, the SP also contains a more favourable employment and unemployment scenario. According to the SP, the growth in the compensation for employees is projected to be subdued, with a moderate increase of 0.5%. This compares to 0.9% in the Commission services' forecast, due to higher wage growth in the private sector. Towards the end of the programme period, wage growth is expected to surge to around 2%. The SP also predicts somewhat higher inflation over the forecast horizon (as measured by the GDP deflator). Therefore, the macro-economic scenario of the programme is based on favourable assumptions in 2011 and markedly favourable assumptions in 2012. The output gap, as recalculated by Commission services based on the information in the programme and following the commonly agreed methodology, is expected to remain negative until 2013. The Commission projections for 2011 and 2012 also show negative output gap figures, but they display a somewhat larger gap in absolute terms. The SP expects the (recalculated) output gap to decrease progressively from -4.4% of GDP in 2011 to 0% of GDP 2014, bridging the gap with potential GDP growth in this final year of the programme.

The deficit outturn in 2010 was marginally better than planned in the previous programme. The deficit fell to 9.2% of GDP in 2010, thanks to the over-performance at the central government level, which offset slippages mainly by the regions and in social security. The improvement in the budget balance compared to 2009 was driven by both cuts in total

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<sup>6</sup> The Spanish government submitted as an annex to the National Reform Programme additional reports with simulations of the effects of the implementation of the labour market reform, the Law on Sustainable Economy and the services directive. Please see section 4.2.2 and 4.2.3 for further details.

expenditure and an increase in total revenues, mainly as a result of discretionary measures. On the expenditure side, the May 2010 measures, such as cuts in public sector wages and public sector hiring, and cuts in public investment, contributed to about 1% of the budget improvement, whereas the phasing-out of temporary stimulus measures accounted for an additional 0.5% of GDP (for details of all measures, see box 2). As regards revenues, discretionary measures included hikes in VAT rates, an increase in excise duties, the withdrawal of a EUR 400 personal-income-tax credit and the phasing out of child-related tax deductions.

For 2011, the SP projects a general government deficit of 6% of GDP, 0.3% below the Commission's estimate. The differences in budgetary projections are primarily due to differences in the underlying macroeconomic scenarios. In line with the stronger macroeconomic assumptions, the programme projects higher government revenue, in particular higher social contributions, and less expenditure in social transfers than the Commission services' 2011 Spring Forecast. The government has, however, committed itself to implementing additional measures should deviations from the expected budgetary execution be observed.

The SP plans to bring the budget deficit below the 3% reference value by 2013, in line with the Council recommendations of April 2009, and reduce it further to 2.1% of GDP in 2014. This adjustment path is broadly appropriate. The SP does not foresee the achievement of the Medium Term Objective (MTO), which remains a balanced budget, within the lifetime of the programme. When assessed against the projected rate of medium-term potential output growth, and taking into account discretionary revenue measures, expenditure projections seem to ensure an appropriate adjustment path towards the MTO. The annual average improvement of the structural balance is 1.5% of GDP on average for 2010-13, in line with the Council recommendation, and an additional 0.3% of GDP in 2014. The SP expects a sizeable improvement in the primary balance from a deficit of 7% in 2010 to a surplus of 0.8% of GDP in 2014. This comes alongside an increase of 1 percentage point (pp) of GDP in interest expenditure over the programme horizon. The fiscal consolidation plan is frontloaded with around 60% of the total fiscal adjustment required to comply with the 3% of GDP deficit target by 2013 to be delivered between 2010 and 2011. According to the SP, the cumulative reduction of the deficit amounts to 7.1 pp of GDP up to 2014 and is mainly expenditure-based. The significant expenditure reduction is helped by the central government's 2011-2013 Expenditure Review Plan approved by the Council of Ministers on 20 May 2010. Expenditure cuts will be particularly steep for central government departments, but regional governments will also have to deliver significant spending cuts. The budgetary stability target for the regional governments for the period 2012-2014 maintains the maximum deficit limits of 1.3% and 1.1% already defined for 2012 and 2013, respectively, while a new deficit target of 1% of GDP has been established for 2014.

The budgetary outcomes could be worse than projected in the SP if favourable macroeconomic assumptions do not hold. These risks appear relatively minor in 2011, but are substantially more important for the year 2012 and beyond. Uncertainty also surrounds the anticipated consolidation measures from 2013 onwards, which are not yet fully specified.

## Box 2. Main measures

The 2011 budget entails a significant consolidation, mostly from the expenditure side, but also with some contributions from revenue-increasing measures. The main expenditure-related consolidation measures includes a freeze in government nominal wages, cuts in public investment, a freeze on pensions and some cuts in social benefits. Besides the remaining impact of the 1 July 2010 increase in VAT rates, the overall impact of revenue-increasing discretionary measures is expected to be small. These include an increase in the maximum marginal rate of the personal income tax, the elimination of the housing investment deduction of mortgage interest payments in the personal income tax calculations for higher incomes, some changes to corporate taxation for SMEs and capital income taxes, and an increase in excise duties. On 3 December 2010, the government approved plans for the partial privatization of the National Lottery and Gaming Entity and of the agency controlling Spanish airports. The SP indicates that successive future budgets will be drafted taking into account the fiscal consolidation strategy described in the SP for the period 2012-2014.

### Main budgetary measures (% of GDP)

Revenue	Expenditure
<b>2011</b>	
<ul style="list-style-type: none"> <li>• Increase in VAT rates (0.3%)</li> <li>• Increase in excise taxes in the 2011 budget (0.1% )</li> <li>• Withdrawal of a personal income tax credit of 400 euro, residual impact (0.1% of GDP).</li> </ul>	<ul style="list-style-type: none"> <li>• May 2010 cuts in expenditure, including a reduction in public investment and a freeze in public sector wages (-1%).</li> <li>• Withdrawal of National Fund for Employment and Local Sustainability (-0.5%).</li> <li>• Phasing out of subsidies, including housing subsidies. (-0.1%).</li> </ul>
<b>2012-2013</b>	
N.a.	<ul style="list-style-type: none"> <li>• Implementation of a 10% replacement rate for staff in the overall Public Administration (-0.3%).</li> <li>• Public sector wage moderation (0.2%)</li> <li>• Phasing out of subsidies, including housing subsidies (-0.1%).</li> <li>• Further cuts in public investment (-0.2 %).</li> <li>• Cuts on health expenditure (-0.2%)</li> </ul>
<p><u>Note:</u> The budgetary impact in the table is the impact reported in the Programme (SP or NRP), i.e. by the national authorities. A positive sign implies that revenue/expenditure increases as a consequence of the measure.</p>	

An additional risk stems from the budgetary performance of the regional governments and in particular whether they can fully deliver their share of the adjustment. Some slippages already



took place in 2010 and the regional deficit target of 2.4% of GDP for 2010 was breached by many regions, including Catalonia (Spain's largest region in terms of GDP).

These risks could be mitigated by the commitments of the government in its Expenditure Review Plan 2011-2013. First, in the event of deviations (or risks thereof) in budgetary execution, for instance due to the macroeconomic scenario, the Government plans to take additional extraordinary measures on both revenue and expenditure sides to bring the deficit back on track. Second, the adoption of any new expenditure measure will be subject to full compliance with the stated objective of reducing overall expenditure. Third, revenue increases beyond the initial estimates will be used in full to reduce the government deficit, and may not be used to finance increases in expenditure.

According to the SP, public debt should increase from 60.1% of GDP in 2010 to 67.3% of GDP in 2011. The figure for 2010 exceeds the Treaty reference value for the first time in Spain since the creation of the euro area. Debt would increase by further 8.8 pps. over the programme period, according to the update; this is mainly driven by greater interest payments (10.2 pp.) and to a less extent by the primary deficit (5.2 pp) and other factors such as stock-flow adjustments (increasing debt by 3.0 pp).

The evolution of the debt ratio may be less favourable than projected in the update, in view of the risks attached to the macroeconomic scenario and the budgetary targets, and, to a lesser extent, the uncertainty about the impact of the refinancing needs of the financial sector. The Commission services' 2011 spring forecast projects a surge in public debt to 68.1% of GDP in 2011, and further to 71.0% in 2012, based on a no-policy change scenario.

Spain is at high risk with regard to the long-term sustainability of public finances. The long-term cost of ageing is clearly above the EU average. The current budgetary position compounds the cost of ageing. Based on the current fiscal position, debt would increase to 112% of GDP by 2020. However, the full implementation of the SP would be enough to put debt on a downward path by 2020, although it would still be above 60%. Ensuring sufficient primary surpluses over the medium-term and further reforming the Spanish social security system, in particular reforming the pension system, as currently planned by the Spanish authorities, so as to curb the projected substantial increase in age-related expenditure, would improve the sustainability of public finances while encouraging longer working lives.

Spain has taken steps to improve the long-term sustainability of public finances. In order to face in particular the ageing challenge, in February 2011 the government proposed a pension reform to Parliament, the primary elements of which are an extension of the retirement age from 65 to 67 phased in over 15 years, the introduction of a sustainability factor thereafter linked to changes in life expectancy, an increase in the number of working years for the calculations of pensions from 15 to 25, and tougher early retirement conditions. Overall, this reform represents a relevant positive step in the right direction and its speedy entry into force would be important and in line with the policy invitations made by the Commission and the Council. According to government estimates, the measures are to reduce pension expenditure by 1.4% of GDP by 2030, 2.8% of GDP by 2040 and 3.5% of GDP by 2050, which would be about half of the projected increase in pension outlays.

Given the decentralised nature of Spain's public finances, a strong institutional framework is essential for the achievement of fiscal consolidation. The medium-term budgetary framework has a good track record overall, but the crisis has put Spain's fiscal institutions under strain and exposed a need to tighten the control on regional and local authorities' budgets in order to reduce the risk of non-compliance. This is particularly important bearing in mind the fact that the regional authorities are responsible for more than 60% of public consumption (notably in areas such as health care and education) and 36% of public investment, and the full entry into

force in 2010 of the new financing system, which has considerably increased the regions' share of revenues from personal income tax, VAT and excise duties.

The fiscal framework was strengthened in 2010, improving budgetary discipline and transparency at regional level. The following deficit limits were set: 1.3% of GDP for 2011 and 2012, 1.1% of GDP for 2013 and 1% of GDP for 2014. Regions that do not comply with these targets have to submit a fiscal consolidation plan, which needs to be approved by the Ministry of Finance in order to obtain authorisation to issue new debt. Moreover, in order to further improve transparency of budget execution at lower levels of government, the Ministry of Finance reached an agreement with regional governments on 24 November 2010 to publish standardized economic and budgetary execution data on a quarterly basis. Information on the budget execution in the third quarter of 2010 was published for the first time by all Autonomous Communities on 20 December 2010. The fiscal risks could also be mitigated by adopting further reforms in fiscal governance. The adoption of expenditure rule to limit expenditure growth below the rate of the medium-term GDP at all levels of government, as envisaged in the SP, would significantly help to achieve budgetary targets.

#### **4.2.1.2 Financial sector**

Spanish banks were initially relatively unaffected by the international financial crisis due to their retail banking model, sizeable provisioning buffers as a result of countercyclical loan-loss provisioning rules, and the absence of off-balance-sheet investment vehicles. However, the banking sector came under pressure with the bursting of the housing bubble and the sharp contraction of the construction sector. Sizeable public support of around 9% of GDP was provided<sup>7</sup>. The Fund for Orderly Bank Restructuring (FROB) was created as a temporary mechanism in June 2009 with up to a maximum of €9 billion (9.4% of GDP). It was designed to manage the restructuring processes of credit institutions and assist in the enhancement of their equity base. The FROB has a mixed funding, with an initial budget of €9 billion, 75% coming from the Treasury and 25% from the contributions of the three Deposit Guarantee Schemes. In addition, the FROB may secure funding by issuing fixed income securities; it can also receive loans, apply to open credit facilities or undertake other borrowing transactions. Its main purpose was two-fold: firstly, to pave the way for integration processes involving viable institutions; secondly, to provide a quick and effective solution for non-viable credit institutions. . So far, FROB has provided capital injections to banks amounting to €1.56 billion, or about 1.1% of GDP. In the 2010 EU wide stress test, Spain increased the transparency of the exercise by expanding the sample of banks far beyond the agreed 50% coverage level and by offering additional detailed information on the sector. Additional capital support was provided to five banks that had failed to pass the test. The exact sample of banks that will be included in the European Banking Authority's 2011 stress test is being finalised but the coverage will be similar to last year.

Spanish authorities have adopted several measures aimed at restructuring savings banks, reinforcing banking sector solvency, reducing exposure to the real estate sector and improving transparency. The main reforms introduced were the following:

- Savings banks restructuring. Amendments to the legal framework governing the savings banks enable Spanish savings banks to raise equity capital in markets. In addition, new rules to improve the governance and management structures of savings banks were introduced.

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<sup>7</sup> Out of the total public support to the banking system, 1.1% of GDP was provided in capital injections, 5.7% in guarantees on bank liabilities and 2.1% in liquidity support and impaired asset relief.

- Reducing exposure to the real estate and construction sector. The Bank of Spain introduced new accounting rules to accelerate the process of deleveraging and loss recognition and to improve the level of coverage of loan losses.
- Improving transparency. The Bank of Spain strengthened the disclosure requirements of the banking sector. Banks were required to provide to the market specific information on land, construction and residential mortgage portfolios.
- Strengthening of banking sector solvency: The Spanish authorities introduced new minimum capital requirements to strengthen the banks' capital position. All banks will have to comply with a minimum "capital principal" ratio of 8%, with the minimum raised to 10% for those banks that have over 20% wholesale funding and less than 20% of their capital owned by third parties. The new capital levels are to be reached by September 2011. Credit institutions failing to meet the new capital standards on time will have to request capital support from the FROB. At the same time, they will have to submit recapitalisation plans, including a business plan that sets targets for efficiency, profitability, leverage levels, and liquidity.

In spite of the action taken or planned, and the Government's commitment under the Euro Plus Pact to finalise the restructuring of the sector by the end of September 2011, a number of issues are still outstanding. The reform of the savings bank law does not fully address the problems created by the involvement of local authorities in the governance of savings banks, although the ceiling on the voting shares for public entities has been reduced from 50% to 40%. The fact that consolidation of savings banks has occurred to a large extent via so-called cold mergers<sup>8</sup>, rather than full mergers, gives rise to some uncertainty regarding their rapid and efficient restructuring. Raising capital to meet the new solvency requirements may prove challenging especially for some savings banks. The introduction of more flexible deadlines increases the likelihood of recapitalisation taking place through a market solution and thus limiting the cost for public finances. Finally, funding liquidity risk is still high, especially for smaller and weaker institutions, although Spanish credit institutions have significantly increased their repo financing through central counterparties since August 2010.

#### **4.2.1.3 Other macro-economic issues**

The protracted demand boom over the last decade resulted in a large current account deficit and in growing net external liabilities. The rising current account deficit was driven by cyclical as well as structural factors, associated with strong capital inflows, persistent inflation differentials between Spain and the euro area, low productivity growth and a deterioration in competitiveness. Spain has had the highest appreciation of the real effective exchange rate vis-à-vis the rest of the euro area, based on unit labour costs (ULC), in the total economy since the creation of the euro area in 1999. Nevertheless, Spain was able to maintain its world export market share, suggesting the presence of some relatively more competitive sectors and companies within the economy and the importance of non-price factors. Since the adjustment began in 2008, ULC have fallen steadily as a result of wage growth moderation and rising productivity. However, remaining weaknesses in the functioning of the labour market, notably related to the current system of collective wage bargaining, (see Section 4.2.2) and in other areas such as the functioning of the markets for goods and services and in the area of

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<sup>8</sup> Under a "cold merger" each bank keeps its own brand, workforce, balance sheet and branch network, while some central functions such as the monitoring of liquidity are combined under a single management. This form of merger contrasts with a full-scale merger involving the takeover of weaker lenders by their stronger peers.

education (Section 4.2.3), not only hamper further improvements in competitiveness, but also put recent gains at risk.

High employers' social contributions<sup>9</sup> feeding non-wage labour costs and, in turn unit labour costs, also hamper competitiveness, and also distort the tax system via higher consumer prices and lower gross operating surplus for firms. Reducing the level of social contributions would in principle boost in competitiveness, not only in external markets, but also in the domestic market via lower domestic prices relative to imports prices, potentially allowing for further corrections of external imbalances. Given the relatively low indirect taxes and low taxes on oil products<sup>10</sup>, and in view to ensure fiscal consolidation, there is scope for compensating lower social contributions with increases in indirect taxes and excise duties, also reducing further distortions in the tax system. If this were to take place, the interaction with the extensively used system of targeted rebates on employers' social security contributions as means hiring of vulnerable groups (see Section 4.2.2) would need to be closely analysed.

A strong contraction of domestic demand in 2009-2010 led to a pronounced drop in imports, which, combined with strong export growth, resulted in a reduction in the trade deficit. Sustaining strong export growth, including facilitating a reallocation of resources from the non-tradable sector to the tradable sector, would support a further reduction in the external deficit. The on-going fiscal consolidation (see Section 4.2.1.1) and structural reforms, some of which are already implemented and others planned or committed under the Euro Plus Pact, go in the right direction.

The bursting of the Spanish housing and credit bubble was followed by a rebalancing in the housing sector, and left the private sector with a large stock of outstanding debt. This on-going adjustment has been reflected in rapidly falling construction activity, a drop in house prices and a sharp increase of unemployment within this sector. Construction has shrunk over recent years, while house prices have fallen significantly in nominal terms (see section 2.1) and are expected to continue to fall – something that may pose a challenge for the Spanish banking system and could weaken household balance sheets. Private sector balance sheets are undergoing a significant consolidation, as reflected by a sharp increase in the savings rate. The level of debt, of both households and corporations, has broadly stabilised since the beginning of 2008, but remain high. The current very low level of interest rates is helping facilitate the servicing of debt, given most lending is variable rates. To reduce vulnerability of the private sector, deleveraging will have to continue in the coming years and is likely to be a lengthy process.

Some policy measures have been implemented to prevent bubbles from re-occurring in the future. Notable examples include abolishing in 2011 fiscal incentives<sup>11</sup> that encouraged investment in real estate over renting or investing in other assets. Alongside this, a National Housing and Rehabilitation Programme designed to encourage renovation of the existing housing stock rather than new house construction, has been implemented, and rental housing is being promoted through changes in tax treatment and the creation of the National Rental Company. Furthermore, the government implemented fiscal incentives in mid-2010 aimed at encouraging home refurbishment to enhance energy efficiency. The Law on Sustainable Economy includes additional provisions in this area, such as the promotion and facilitation of

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<sup>9</sup> In 2009, employers' social contributions in Spain represented 23% for the average-wage worker, which is amongst the highest in the euro area.

<sup>10</sup> ES is amongst the euro area members with the lowest taxes on oil products. Implicit tax rates on energy fell in Spain by 23.2% during 2000-2008 (source: Taxation trends in European Union, Eurostat, 2010).

<sup>11</sup> E.g., the personal income tax credit for first home investments for taxpayers earning over 24,107 euro per year.

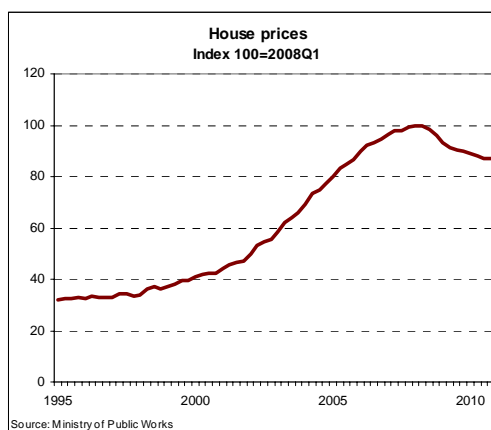
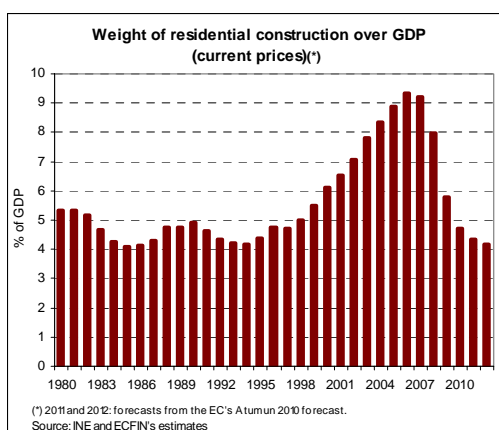
refurbishment and urban renewal. These measures seem to be steps in the right direction, although at this stage, it is too early to assess their effectiveness.

### Box 3 - Housing market and residential building activity

Low interest rates, easy credit conditions, a large inflow of immigration, structural changes of family composition, and strong economic and employment growth paved the way for a housing boom in Spain. House prices increased by 200% between the beginning of 1995 and the peak in 2008. Around 6.7 million dwellings were completed between 1996 and 2009 (480,000 per year on average). The end of the boom coincided with the onset of the world financial crisis, which turned the "soft-landing" adjustment that began in 2007 into a hard landing. This deeper adjustment has taken place primarily via volumes, as described below.

The deep adjustment in residential construction activity has displaced about 1 million workers, as construction activity moved from 760,000 dwelling starts in 2006 to less than 130,000 in 2010. Despite this the stock of unsold homes remains very high, at close to 1 million. Indeed, the lag between the initialisation of a dwelling and its finalisation (around 21 months) means that new dwellings started during the period of high activity are still entering the housing market. The weakness of housing demand is related to the high incidence of household indebtedness, a high level of unemployment and the relatively modest adjustment of house prices. Assessments of house valuation based on different indicators point towards a broad imbalance in house prices building up in the years up to 2007, with some correction more recently. The degree of overvaluation of house prices at the end of 2010 is estimated to lie in the range of 15-20%, depending on the indicator and the model used. The quantitative results must be treated with caution, as uncertainty is large.

The sharp contraction has reduced the weight of residential investment in GDP to the level prevailing before the housing boom. Despite the high volume of unsold properties, new housing projects are continuing. Indeed, a non-negligible part of this stock is the result of temporal misalignments between supply of and demand for dwellings. Furthermore, the existence of an overall unsold stock does not necessarily involve an excess of dwelling supply across the country. The bulk of unsold stock is concentrated on the Mediterranean coast and on some islands, while the main economic nuclei (Madrid, Barcelona and the Basque country) do not seem to have large unsold stocks.



#### 4.2.2 Labour market policies

Employment took a big hit during the crisis, while wages reacted only with a lag. As a result, unemployment recorded the highest rate in the euro area. From a low of 8.25% in 2007, the unemployment rate reached a record high of 21.25% in the first quarter of 2011, in spite of a fall in GDP during the crisis less severe than in other euro area member States. The young<sup>12</sup>, the less qualified, and less experienced workers, many of them on temporary contracts, took the brunt of the recession. Youth unemployment reached 41.6% in 2010. Men were more

<sup>12</sup> In 2010, the unemployment rate reached 37.1% for those aged 20-24 years old, and 24.6% for those aged 25-29 years old.

affected than women. However, the gap between the activity and employment rates of men and women remains important, as recognised in the NRP. The construction sector suffered the largest employment losses, with more than half of the overall increase in unemployment coming from this sector. This major sectoral reallocation of employment poses a risk of skill mismatches. Labour shedding affected workers with temporary contracts to a greater degree. While representing about one quarter of total employees, temporary employment accounted for about 90% of the net reduction in total employment between 2007 Q1 and 2010 Q4.

The labour force participation rate increased during the crisis. Previously inactive individuals (e.g. secondary members of the household) entered the labour force and others delayed their retirement because of family wealth losses. However, despite a thorough growth in the last decade, the female employment rate is still among the lowest in the European Union (55.8% in 2010, compared to 62.1% for the EU). This low participation rate can be partly explained by the interplay between labour market conditions, social protection and taxation. The lack of affordable care services is a significant factor causing inactivity or involuntary part-time work, and thereby influencing child poverty.

### **Labour market segmentation**

The high employment volatility created by the dual labour market generates strong job creation in booms, albeit concentrated in low-productive industries, and exacerbates job destruction during recessions. The generalised use of fixed-term contracts, coupled with a high turnover rate in temporary jobs and low conversion rates from temporary to permanent contracts, also means few of the people employment under these contracts have the opportunity to increase their skills. The low rates of transition rates from temporary to permanent contracts therefore risks leaving a long-lasting legacy on the employment, career and earnings prospects of these individuals (also affecting future pension rights). Intermittent periods in work, alongside periods of unemployment and temporary employment are also an important determinant of the high rate of in-work poverty in Spain<sup>13</sup>.

The September 2010 labour market reform aims at reducing labour market duality, strengthening internal flexibility and improving employment opportunities for unemployed. The main measures include: (i) a broader definition of justified dismissals; (ii) greater possibilities for concluding permanent contracts with reduced severance payments for new recruitments; (iii) a temporary, partial, reduction of the cost of termination in the case of objective dismissals, funded by the wage guarantee fund; (iv) wider use of the so-called "training contracts" ("contratos de formación") for younger workers and internship contract ("contrato de prácticas"); (v) stricter limitations on the use of temporary contracts, notably on the duration and renewals; (vi) higher severance payments in the case of temporary contracts; and (vii) a better targeting of social security rebates to promote the integration of unskilled or long-term unemployed in the labour market. The law also announced the introduction of a permanent capitalisation fund to be used in the case of dismissal, geographic mobility, training or retirement. The September package also included steps to ease the use of the opt-out clause in collective agreements, and widens the scope for changes to working conditions, inter alia on working time, at company level. It is too early to draw conclusions on the effectiveness of the reform. According to official estimates<sup>14</sup>, the impact of the reform can be very significant in the long term, with increases of between 3% and 4% in potential output

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<sup>13</sup> 11.4% of all employed are at risk of poverty in Spain. This risk is higher for people in temporary employment (12.6%) as compared to those in permanent contracts (5.3%).

<sup>14</sup> The central government submitted an evaluation of the long-term effects of labour reform as an annex to the National Reform Programme.

and a reduction of between two and three percentage points in the structural unemployment rate.

Even with these reforms, several structural issues are still outstanding in the Spanish labour market. For instance, the reform allows for different kinds of permanent contracts to co-exist, with different firing costs for unjustified dismissals. The effects of the reform, on youth unemployment, female employment rates and low-income second earners as well as indirectly on reducing poverty, are still uncertain. Indeed, the impact of the reform will also depend on the judicial interpretation of the new rules and on the extent to which companies are actually able to use the additional flexibility offered on working time arrangements and opt-out clauses. In addition, some measures have not yet been implemented, including incentives to reduce temporary contracts and the capitalization fund (they are expected to be operational at the beginning of 2012).

### **Collective wage bargaining**

The 2010 September labour market reform is due to be complemented by an overhaul of the collective bargaining system (see Box 4), which is currently under discussion, to ensure that wages are more responsive to conditions in each firm. The agreement of 2 February 2011 ('Acuerdo Economico y Social') among the social partners established the principle that wages and working conditions should take greater account of the needs of specific firms and represented a starting point for negotiations on the reform of collective bargaining. The government had asked Social Partners to reach an agreement on this issue by 19 March 2011 and the deadline was subsequently extended in view of the difficult negotiations. The current wage bargaining system has significantly contributed towards keeping wage growth rates relatively high compared to low productivity growth, in turn has feeding high and persistent inflation differentials with the euro area. Therefore, a reform of the wage bargaining system seems particularly important not only to ensure that wage developments respond better to labour market conditions and productivity developments, but also to boost competitiveness.

### **Active labour market policies, education and skills**

The 'Acuerdo Economico y Social' was also translated into a reform of active labour market policies (ALMP) in February 2011 (Royal Decree Law 3/2011 on urgent measures for enhancing employability and reforming active labour market policies). The reform promotes the development of individual job action plans between the unemployed and the public employment service, under which the unemployed commit to take effective actions to improve their employability, to search for a job or define a project to set up a business. The Public Employment Services are also being strengthened in terms of human resources, and financial resources are being reallocated toward training for the unemployed and away from rebates in social security contributions (Decree-Act 1/2011 of 11 February). The reform also announced a strategy for the employment of older workers (subject to an agreement with social partners and Autonomous Communities), and the development of an Employment Strategy before 31 October 2011. Additionally, the reform allows for the setting-up of labour market intermediaries (such as private, for-profit agencies). The success of these reforms will very much depend on a clear specification of the instruments that will be used to ensure an effective co-ordination at different levels of government.

The effectiveness and efficiency of available resources can be improved by focusing on investment in human capital. It is important to improve social cohesion while helping the unemployed, and young people and women in particular, and thus preventing an increase in structural unemployment. There are two good examples of how this can be done. One is PREPARA programme (already in place under the Decree-Act 1/2011 of 11 February), which combines retraining measures and professional reinsertion programmes with financial



support. The other is the Training and Work Experience Plan for Young People, which provides internships for training of low-skilled, unemployed young people in a way that is compatible with classroom training. The government has committed itself under the Euro Plus Pact to implement, during the next semester, elements of the recently-approved Law on Sustainable Economy that fall in the area of vocational training is to be welcomed. In particular, the government is committed to including amendments to the Education Organic Act and the Organic Act on Qualifications and Vocational Training in order to facilitate access to vocational education, increase the stay in the education system and improve the quality of education. These measures will be in force in the 2012-2013 academic year, although the Autonomous Communities may decide to implement them during the 2011-2012 academic year.

Combating the worrying high levels of early school leaving, as rightly recognised by Spain in its NRP, is a precondition for addressing high unemployment rates of the young people and reducing the risk of social exclusion. The very high rate of early school leaving (31.2%, more than double of the European average) sharply contrasts with very high tertiary educational attainment (39.4%). The Spanish NRP recalls specific programs to reduce early school leaving that have already been introduced with the objective of motivating young people to stay in the education system at least until obtaining the compulsory education certificate. The measures mainly consist of reinforcement, guidance and support programmes (PROA) and Initial Professional Qualification Programmes (PCPI). They are reinforced by the Action Plan 2010-2011 from the Ministry of Education and are implemented in cooperation with the Autonomous Communities through a specific programme to reduce early school leaving. Measures to promote vocational training lead to an increase in the number of places and new options in vocational training programmes. 2011 will show first results of the application of these measures. It is essential that the commitments for reducing early school leaving are sustained and follow a comprehensive perspective.

Another key factor to improve the functioning of the labour market is to turn undeclared jobs into official jobs. According to World-Bank estimates, the informal economy constituted over 20% to Spanish GDP over the period 2005 to 2008, employing more than four million people. In this respect, as part of its Euro Plus Pact commitments, the central government launched an action plan specifically aimed at regularising undeclared employment, combined with enhanced oversight system. There will be an initial period for voluntary regularisation, to be completed by the end of July 2011, in which employers can register employees who are currently in an irregular situation. The administration expects to negotiate a fine with firms involved in the hiring of illegal workers. After that period, the government will apply a harsh system of penalties for the remaining undeclared employment. These measures could help eliminate distortions in the corporate sector and create a level playing field for firms.

### **Poverty and Social Inclusion**

In 2009, some 23.4% of the population were at risk of poverty or exclusion. This rate that has remained stable in recent years, with the exception of for older people whereby the rate has decreased consistently, from 30.7% in 2006 to 25.2% in 2009. Due to high levels of unemployment, Spain spends a larger share of GDP on unemployment benefits than the EU average (3% against 1.3% at EU level), while expenditure on family benefits (1.5% of GDP against 2% at EU level) is well below the EU average. In order to tackle poverty and promote social inclusion Spain has increased income support through various measures, including increasing the level of minimum income or minimum wage, minimum pensions, extending the coverage or duration of unemployment benefits, reinforcing other social benefits, and introducing tax rebates or tax exemptions for specific groups. In addition, concrete measures are also being implemented in order to address the challenges facing certain population

groups, such as the Roma ("Plan de Acción para el Desarrollo de la Población Gitana 2010-2012"), children and youth ("II Plan Estratégico de Infancia y Adolescencia 2010-2013").

#### **Box 4. Collective bargaining**

In Spain, collective bargaining takes place mainly at industry and provincial levels. More than 85% of workers are covered by industry agreements at various territorial levels. Provincial industry agreements prevail in construction, trade and hotels and restaurant; company level predominates in large firms and in energy and transport; national agreements prevail in finance. According to data reported by the European Industrial Relations Observatory (EIRO), provincial industry agreements represented 20% of all agreements in 2008 and affected more than half the workers covered by collective bargaining; company agreements represented about 75% but covered only about 13% of the workers. National sectoral agreements accounted for 10% of all workers. Empirical evidence (Izquierdo, Moral and Urtasun, 2003) suggests that wage increases tend to be higher at the provincial industry level than at the national and company levels, while the wage distribution is more compressed compared to fully centralised or fully decentralised levels.

The predominance of provincial and industry agreements leaves little room for negotiations at the level of the individual firm, while the lack of a clear structure among collective contracts implies weak coordination among bargaining units. There is no clear hierarchy across bargaining levels. Collective agreements may occur at the firm level and at different territorial levels. The higher or lower territorial scope of application does not necessarily imply a higher or lower ranking of the collective agreement. The general criterion, which determines the agreement to be enforced, is a temporal one: the collective agreement that came into force first prevails over the later ones. However, agreements signed at the national or regional level by the most representative unions and employers associations may regulate the structure of collective bargaining and thus have a higher ranking status, inter alia setting the principles of complementarity of different bargaining units and the matters which can be dealt with by lower ranked collective agreements (Art. 83.2 of Workers' Statute).

Collective contracts already expired are automatically prolonged. Any agreement remains valid after its expiry, if it has not been renewed (the so-called "ultra-actividad"); this potentially reduces the opportunities for renewing a contract without improving its conditions. Wage indexation is in practice present in most collective agreements, although it is not prescribed by law. Both "ultra-actividad" and wage indexation contribute to wage inertia and to lags in the adjustment of price competitiveness. These characteristics increase the risk of wage developments that are not consistent with the macroeconomic situation.

Collective bargaining might play a role also in the highly persistent regional disparities in the Spanish labour market. The magnitude of regional disparities is at least as large as the unemployment rate differentials across EU countries. The highest temporary employment rates in the period 2005-2007 were found in Andalucía (45%), Extremadura (42%), Murcia (41%), whereas the lowest rates were in Madrid (27%) and Catalonia (25%). Regional disparities in unemployment rates are only weakly associated with differences in the real unit labour costs. Provincial sectoral bargaining generates limited wage differentiation between different occupations. By contrast, industry bargaining gives rise to relevant effects on the average wages, higher than at the national and company levels, and a more compressed distribution of wages across job/skill categories than at the centralised and decentralised levels (Izquierdo, Moral and Urtasun, 2003). The general validity of collective agreements, combined with a segmented labour market with a remarkable geographical bias, reinforces the divide between two groups of workers: a protected group with significant bargaining power and an unprotected group with no or limited participation in union elections.

### 4.2.3 Growth-enhancing structural measures

#### The business environment and competition

Spain has already undertaken major efforts in the area of services, including the setting up of Points of Single Contact<sup>15</sup>. In particular, it has transposed the Services Directive into national law by means of (for example) Laws 17/2009 and 25/2009. The Law on Sustainable Economy, adopted on 15 February 2011, also included a set of measures to improve the business environment, strengthen competition and promote environmental sustainability. Ensuring the full implementation of the new rules and regulations adopted, in particular at regional and local level is key to improving business environment and to enhance competition in service markets.

A substantial number of Spanish professional services are subject to access restrictions not covered by the EU Services Directive<sup>16</sup>. The strict regulation of these professions, which often includes membership to a professional association ("colegio profesional"), introduces important distortions in the services market. According to official estimates presented in the NRP, professional services account for 8.5% of GDP. Liberalising these services by both reducing access restrictions and limiting membership obligations would introduce more competition in the sector and would, in turn, reduce prices, improve the quality of the services, add transparency, and provide more opportunities for employment. According to official estimates, a reform in this area could increase potential GDP by 0.7%<sup>17</sup>. Spain committed itself under the Euro Plus Pact to present a new law on Professional Services before the summer of 2011. This law plans to limit more stringent requirements to either services performed in the general interest or those requiring maximum protection of the citizen (i.e. health profession). However, the scope of the Law remains unclear and some professions such as notaries and registrars do not seem to be addressed.

Since the adoption of the Action Plan for Administrative Burden Reduction in 2008, the central government in co-operation with business associations has intensified its efforts to reduce existing administrative burden for enterprises and red tape. Recent examples of this are measures under the broad Law on Sustainable Economy reforming the product and service markets, the Bankruptcy Act or the Royal Decree 13/2010, the latter reducing lead-times and costs of start-ups. These efforts are, however, offset in part by regulation emerging at the regional and local level. A lack of coordination among the different layers of the Spanish administration (local authorities, provinces, Autonomous Communities and the central government) can result in an excessive level of regulatory burden. Indeed, since there is no mechanism for overseeing the complete process of law implementation from legislation to delivery at all administrative levels, there can be overlaps between layers of the administration, and multi-level legislative gold-plating. Consequently legislation may vary substantially from one region to another. In some cases, there can be both a lack of horizontal co-ordination (between authorities at the same decision level) and a lack of vertical co-ordination (lower levels with higher levels). The former means that entities operating in several regions have to comply with different criteria and have to submit the same

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<sup>15</sup> [www.eugo.es](http://www.eugo.es)

<sup>16</sup> According to the Regulated Professions Database managed by the Commission and fed-in with information from the Member States, Spain has 174 regulated professions (EU average 152) of which 17 are not regulated in any other Member State (situation on 28.04.11). The central government has identified 192 professional services with reserves of activity.

<sup>17</sup> The Spanish government submitted a simulation of the effects of the implementation of Services Directive for Spain as an annex to the National Reform Programme. According to these estimates, the reform would increase output growth by about 1% combined with a permanent increase of productivity of 0.65-1%.

information several times. The latter inhibits oversight of the same standards for the implementation of rules and regulations (usually carried out at other levels), so that implementation is ineffective and uncoordinated. According to recent studies<sup>18</sup>, the increasing regulation of Autonomous Communities in Spain is translating into increasing barriers to entry in various economic sectors and reduced competition in these sectors is associated with lower productivity and fewer incentives to innovate. The NRP recognises this issue and commits the authorities to action on different aspects, for example regarding the implementation of the new Industrial Policy Plan, but a systematic approach does not seem to be planned.

The ongoing vulnerability of the banking sector has adverse consequences for business access to finance. Although banking sector reform is an immediate priority, there seems to be scope for more extensive use of non-banking and non-traditional funding mechanisms. As a result of the crisis new extraordinary credit lines, targeting SMEs, have been introduced by the Official Credit Institute (ICO). These include help for the liquidity of SMEs. However, these measures have so far had limited impact. Further measures are being developed to foster non-traditional funding mechanisms like venture capital and business angels, measures that will require some time to change the financing culture and produce results. There is also scope for exchanging best practice among regions, given that the system of Guarantees is effectively facilitating SMEs' access to finance in some Autonomous Communities but is still far from its potential in others. An efficient use of the EU funding resources (Structural Funds and Framework Programmes) could further support the facilitation of finance for SMEs and more generally support the growth-enhancing measures. Further development of financial engineering instruments (JEREMIE and JESSICA), in order to increase public private partnership would also help to attract more private capital and leverage the effect of public financing. Given that the burden of long delays in payments by public authorities falls disproportionately on SMEs, the recent law on late payments (Law 15/2010), once fully implemented at local level, would help to address this issue.

### **Research and innovation**

While Spain has substantially increased its R&D intensity over the last decade (from 0.91% in 2000 to 1.38% in 2009 one of the highest increases in the EU), structural change towards a more sustainable and knowledge-intensive economy still has some way to go. The Spanish research and innovation policy is undergoing comprehensive reforms with a new Law of Science, approved in 2011, a recent national Innovation Strategy (e2i) with an Action Plan for 2010-2015, the 2015 University strategy and the 2020 Industrial Policy Plan. The new Law of Science and the 2015 University strategy are moves towards reinforcing scientific excellence in research institutions, including modifications of the status of university professors to allow them to engage in start-up firms, further internationalisation and increase universities' excellence. Building on the positive experiences of many other Member States, Spain could link striving for excellence in research and innovation with the public funding of research institutions based on performance. More specifically, excellence in Spanish universities and other organisations performing public research can be improved by introducing performance-based public funding rules (using criteria such as scientific excellence, level of

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<sup>18</sup> Marcos, Santaló & Sánchez-Graells have screened the regulatory intensity of Spanish Autonomous Communities since 1978 in their study *Measuring regulatory intensity by the Spanish Regions (1978-2009)*. The same authors further analyse the impact of the increasing regulation stemming from the regions since 1998 on the productivity and innovation of the Spanish economy. It is estimated that a 100% increase in the number of regional regulations has been associated with a reduction of the annual growth rate of total factor productivity of 3.5% and an annual reduction of 80% in the number of applications for patent.

internationalisation, public-private cooperation and the matching of scientific priorities with business and societal demand).

Given that current R&D investment largely come from public sources, the role of the private sector is key in achieving the Spanish R&D target of 3% for 2020<sup>19</sup>. The new Spanish Innovation Strategy (e2i) addresses the need to stimulate private sector research and innovation. In parallel, the 2020 Industrial Policy Plan has identified areas where Spanish industry is strong and in which activity could therefore be promoted with the objective to further diversify the economy. However, on-going reforms cannot fully contribute to boosting business sector research and knowledge creation unless the full implementation at regional and local levels is ensured through a stringent and timely monitoring system. This would also improve coordination among different layers of the administration, avoiding overlapping and increasing synergies, thereby raising the effectiveness of R&D and innovation expenditures.

### **Climate and energy**

In spite of comprehensive efforts over the last two decades limited competition in the energy markets, high energy dependence and vulnerability to energy price shocks still represent major challenges for Spain. The drivers of these challenges are an incomplete implementation of the internal energy market legislation and insufficient interconnections with other countries.

The NRP indicates a determination to continue promoting the enlargement of the gas and electricity interconnections with France. Regarding the market for electricity, the evolution of concentration levels over the last few years of the liberalisation process has been clearly pro-competitive and good progress has been made in implementing the second package. This evolution was not entirely followed in the gas market, with room for improving the competitive environment in both markets. The transposition and implementation of the third package is a decisive step in the completion of the internal market, in particular the provisions aimed at increasing the independence and enhancing the powers of the Energy Regulator in fields like the setting of fines and the regulatory framework for price fixing. Regarding renewable energy, the recent adjustments in the feed-in tariffs aimed at providing an incentive to reduce costs raise questions concerning their impact on existing investments. In addition, there seem to be delays and uncertainty surrounding planning, authorisation and certification procedures and the inadequacies regarding transparency of administrative requirements and grid connection charges for renewable energy producers.

Spain has a relatively ambitious objective to reduce energy intensity by 2020, with numerous innovative elements indicated within the NRP. However, at this stage, it is possible to fully evaluate whether these measures are sufficient to reach the 2020 objective, and whether they will allow achieving the objective in a cost effective manner. The second National Energy Efficiency Plan that Spain should adopt by 30 June 2011 should allow such an evaluation. This plan should strengthen Spain's energy efficiency strategy and energy efficiency measures, giving priority to cost-effectiveness. In particular it will assign responsibilities for relevant ministries/services and identify related budgets for the implementation of different measures (including the identification of needs for EU Cohesion Policy Funds). There remains wide scope for fostering energy savings both in end-use consumption (through renovation of housing, public buildings, transport) as well as transmission, distribution and energy generation.

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<sup>19</sup> Private investment would need to grow from the current 0,76 % GDP (Eurostat) to almost 2% given that Spain has a target of two thirds of R&D spending to come from private sources.

In spite of the influence of the economic crisis, the recent trend in greenhouse gas emissions does not appear, at this stage, in line with the 2020 national target defined at the European level for the period 2013-2020. This means that additional emissions reduction measures and/or the use of flexibility mechanisms may be needed, especially in the road transportation sector given its weight in the national emissions and its current trend.

## **5. SUMMARY**

Spain is committed to implementing the strategy for exiting from the crisis as outlined in the previous Stability Programme (SP) Update 2009-2013. The current programme builds on this ambitious reform agenda including fiscal consolidation and structural measures in both factor and product markets. It plans to bring the budget deficit below the 3% reference value by 2013 and to reduce the deficit further to 2.1% of GDP in 2014. There are downside risks to the consolidation path related to favourable macroeconomic assumptions and to the need to respect budgetary targets at all levels of government. Regions account for a large share of total public expenditure and many exceeded their fiscal objectives in 2010. However, the Spanish government has committed to take additional measures, if budgetary slippages emerge.

The Spanish National Reform Program (NRP) 2011 addresses the macroeconomic and structural challenges that the Spanish economy faces. In particular, Spain has taken concrete steps to strengthen its banking system, reform the labour market, increase the quantity and quality of human capital, and improve the conditions for effective competition in product and service markets. However, several issues remain.

The ongoing labour market reform tackles key issues, including reducing labour market duality and youth unemployment, increasing the employability of vulnerable groups, increasing flexibility at company level, and improving active labour market policies. Given the recent adoption of these reforms it is too early to assess their impact. The current collective bargaining system has prevented wages from adjusting to economic and labour market conditions and contributed to the surge in unemployment. The Government asked for social partners to agree on a reform of the collective wage bargaining system during the spring 2011 and has subsequently committed legislation. The problems created by the role of local authorities in the governance of savings banks have not been fully addressed and the form of savings banks' consolidation via so-called 'cold mergers' gives rise to some uncertainty regarding the effective reorganisation and downsizing of the banks. Spain is well advanced in the transposition of the Services Directive into law and has already adopted the Law on Sustainable Economy, which includes measures to improve business environment, strengthen competition and promote environmental sustainability. However, overlapping competencies between layers of the administration, mean that administrative procedures remain complex. Competition in professional services remains limited by entry barriers.

# STATISTICAL ANNEX

## Table I. Macro-economic indicators

	1995- 1999	2000- 2004	2005- 2008	2009	2010	2011	2012
<b>Core indicators</b>							
GDP growth rate	3.7	3.6	3.0	-3.7	-0.1	0.8	1.5
Output gap <sup>1</sup>	-1.0	1.4	0.7	-4.5	-5.2	-4.7	-3.3
HICP (annual % change)	2.8	3.2	3.5	-0.2	2.0	3.0	1.4
Domestic demand (annual % change) <sup>2</sup>	4.2	4.2	3.5	-6.0	-1.1	-0.6	1.0
Unemployment rate (% of labour force) <sup>3</sup>	16.1	10.8	9.3	18.0	20.1	20.6	20.2
Gross fixed capital formation (% of GDP)	22.5	26.7	29.8	24.0	22.5	21.8	22.2
Gross national saving (% of GDP)	22.0	22.6	21.1	18.9	18.5	18.2	18.6
<b>General Government (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>-3.9</b>	<b>-0.5</b>	<b>0.2</b>	<b>-11.1</b>	<b>-9.2</b>	<b>-6.3</b>	<b>-5.3</b>
Gross debt	<b>64.7</b>	<b>52.5</b>	<b>39.6</b>	<b>53.3</b>	<b>60.1</b>	<b>68.1</b>	<b>71.0</b>
Net financial assets	<b>-52.5</b>	<b>-39.5</b>	<b>-23.7</b>	<b>-34.4</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	38.2	38.2	39.5	34.7	35.7	36.5	36.7
Total expenditure	42.0	38.8	39.3	45.8	45.0	42.9	42.0
of which: Interest	4.5	2.7	1.7	1.8	1.9	2.2	2.5
<b>Corporations (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>0.2</b>	<b>-3.3</b>	<b>-7.5</b>	<b>-0.6</b>	<b>1.4</b>	<b>-0.1</b>	<b>-1.2</b>
Net financial assets; non-financial corporations	<b>-89.3</b>	<b>-104.3</b>	<b>-141.3</b>	<b>-142.1</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net financial assets; financial corporations	<b>0.4</b>	<b>3.1</b>	<b>4.2</b>	<b>10.5</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	13.6	15.5	16.9	13.6	13.7	14.4	15.1
Gross operating surplus	20.6	19.4	18.8	21.1	20.8	20.6	20.5
<b>Households and NPISH (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>4.0</b>	<b>0.4</b>	<b>-1.1</b>	<b>6.6</b>	<b>4.0</b>	<b>2.9</b>	<b>3.0</b>
Net financial assets	<b>114.4</b>	<b>100.9</b>	<b>91.0</b>	<b>77.4</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	39.2	38.0	37.1	38.3	37.4	36.9	36.7
Net property income	3.8	4.0	3.6	4.2	3.2	3.2	3.2
Current transfers received	20.8	19.7	19.1	21.9	22.5	22.4	22.1
Gross saving	8.9	7.5	7.6	12.5	8.8	7.3	7.3
<b>Rest of the world (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>0.2</b>	<b>-3.4</b>	<b>-8.4</b>	<b>-5.1</b>	<b>-3.9</b>	<b>-3.6</b>	<b>-3.5</b>
Net financial assets	<b>27.7</b>	<b>40.7</b>	<b>70.3</b>	<b>89.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-0.1	-2.8	-6.0	-2.2	-2.2	-1.6	-1.3
Net primary income from the rest of the world	-0.9	-1.3	-2.1	-2.3	-1.3	-1.5	-1.8
Net capital transactions	1.1	1.0	0.6	0.4	0.7	0.6	0.5
Tradable sector	48.6	44.9	40.7	39.6	39.9	n.a	n.a
Non tradable sector	42.9	45.6	49.3	53.4	51.6	n.a	n.a
of which: Building and construction sector	6.8	8.5	10.5	10.0	9.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	104.7	104.7	117.0	120.5	115.9	115.0	114.5
Terms of trade goods and services (index, 2000=100)	102.1	103.8	106.3	109.2	105.3	102.7	101.8
Market performance of exports (index, 2000=100)	99.1	102.6	97.9	97.2	97.8	100.1	100.7
<b>Notes:</b>							
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
<sup>2</sup> The indicator on domestic demand includes stocks.							
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.							
Source :							
Commission services' spring 2011 forecast							

**Table II. Macro economic scenario for the budgetary projections**

	2010		2011		2012		2013	2014
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	-0.1	-0.1	0.8	1.3	1.5	2.3	2.4	2.6
Private consumption (% change)	1.2	1.2	0.8	0.9	1.1	1.4	1.6	1.9
Gross fixed capital formation (% change)	-7.6	-7.6	-3.4	-1.3	1.8	2.7	3.7	4.5
Exports of goods and services (% change)	10.3	10.3	7.0	8.3	5.8	7.9	7.2	7.1
Imports of goods and services (% change)	5.4	5.4	1.7	3.0	3.8	4.1	4.7	5.2
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	-1.3	-1.3	-0.6	0.0	1.0	1.3	1.7	2.0
- Change in inventories	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.0	1.1	1.4	1.3	0.5	1.0	0.7	0.6
Output gap <sup>1</sup>	-5.2	-5.4	-4.7	-4.4	-3.3	-2.8	-1.4	0.0
Employment (% change)	-2.3	-2.3	-0.6	0.4	0.8	1.5	1.6	1.8
Unemployment rate (%)	20.1	20.1	20.6	19.8	20.2	18.5	17.3	16.0
Labour productivity (% change)	2.3	2.2	1.4	0.9	0.6	0.8	0.8	0.8
HICP inflation (%)	2.0	optional	3.0	optional	1.4	optional	optional	optional
GDP deflator (% change)	1.0	1.0	1.0	1.2	1.1	1.5	1.7	1.8
Comp. of employees (per head, % change)	0.7	0.7	0.9	0.5	1.2	1.4	1.9	2.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-3.9	-3.9	-3.6	-3.4	-3.5	-2.7	-2.3	-2.0
<p><u>Note:</u>  <sup>1</sup>In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.</p> <p><u>Source:</u>  Commission services' spring 2011 forecasts (COM); Stability programme (SP).</p>								



**Table III. Composition of the budgetary adjustment**

(% of GDP)	2010	2011		2012		2013	2014	Change: 2010-2014
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>35.7</b>	<b>36.5</b>	<b>36.7</b>	<b>36.7</b>	<b>37.0</b>	<b>37.5</b>	<b>37.6</b>	<b>1.9</b>
<i>of which:</i>								
- Taxes on production and imports	10.1	10.6	10.6	10.6	10.6	10.6	10.7	0.6
- Current taxes on income, wealth, etc.	9.4	9.7	9.7	9.9	9.9	10.2	10.3	0.9
- Social contributions	13.2	13.0	13.1	12.9	13.1	13.2	13.2	0.0
- Other (residual)	3.0	3.2	3.3	3.2	3.4	3.5	3.4	0.4
<b>Expenditure</b>	<b>45.0</b>	<b>42.9</b>	<b>42.7</b>	<b>42.0</b>	<b>41.4</b>	<b>40.5</b>	<b>39.7</b>	<b>-5.3</b>
<i>of which:</i>								
- Primary expenditure	43.0	40.7	40.5	39.5	38.9	37.8	36.8	-6.2
<i>of which:</i>								
Compensation of employees	11.7	11.2	11.2	10.9	10.7	10.2	9.7	-2.0
Intermediate consumption	5.5	5.1	5.1	4.9	4.9	4.7	4.6	-0.9
Social payments	18.1	18.1	17.9	17.7	17.6	17.3	17.2	-0.9
Subsidies	1.1	0.9	1.0	0.9	0.9	0.8	0.8	-0.3
Gross fixed capital formation	3.7	2.9	2.9	2.7	2.7	2.6	2.6	-1.1
Other (residual)	2.9	2.5	2.5	2.5	2.2	2.1	2.0	-0.9
- Interest expenditure	1.9	2.2	2.2	2.5	2.5	2.7	2.9	1.0
<b>General government balance (GGB)</b>	<b>-9.2</b>	<b>-6.3</b>	<b>-6.0</b>	<b>-5.3</b>	<b>-4.4</b>	<b>-3.0</b>	<b>-2.1</b>	<b>7.1</b>
<b>Primary balance</b>	<b>-7.3</b>	<b>-4.1</b>	<b>-3.8</b>	<b>-2.9</b>	<b>-1.9</b>	<b>-0.3</b>	<b>0.8</b>	<b>8.1</b>
One-off and other temporary measures	0.0	0.0	n.a.	0.0	n.a.	n.a.	n.a.	n.a.
<b>GGB excl. one-offs</b>	<b>-9.2</b>	<b>-6.3</b>	<b>n.a.</b>	<b>-5.3</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>
Output gap <sup>2</sup>	-5.2	-4.7	-4.4	-3.3	-2.8	-1.4	0.0	5.2
Cyclically-adjusted balance <sup>2</sup>	-7.0	-4.3	-4.1	-3.9	-3.2	-2.4	-2.1	4.9
<b>Structural balance<sup>3</sup></b>	<b>-7.0</b>	<b>-4.3</b>	<b>-4.1</b>	<b>-3.9</b>	<b>-3.2</b>	<b>-2.4</b>	<b>-2.1</b>	<b>4.9</b>
<i>Change in structural balance</i>		2.7	2.9	0.4	0.9	0.8	0.3	
Structural primary balance <sup>3</sup>	-5.1	-2.1	-1.9	-1.4	-0.7	0.3	0.8	5.9
<i>Change in structural primary balance</i>		3.0	3.2	0.7	1.2	1.0	0.5	
<b>Notes:</b>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<b>Source:</b>								
Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations								

**Table IV. Debt dynamics**

(% of GDP)	average 2005-09	2010	2011		2012		2013	2014
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>42.4</b>	<b>60.1</b>	<b>68.1</b>	<b>67.3</b>	<b>71.0</b>	<b>68.5</b>	<b>69.3</b>	<b>68.9</b>
Change in the ratio	1.4	6.9	8.0	7.2	2.9	1.2	0.8	-0.4
<i>Contributions<sup>2</sup>:</i>								
<b>1. Primary balance</b>	<b>0.4</b>	<b>7.3</b>	<b>4.1</b>	<b>3.8</b>	<b>2.9</b>	<b>1.9</b>	<b>0.3</b>	<b>-0.8</b>
<b>2. “Snow-ball” effect</b>	<b>-0.1</b>	<b>1.5</b>	<b>1.1</b>	<b>0.7</b>	<b>0.8</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.1</b>
<i>Of which:</i>								
Interest expenditure	1.7	1.9	2.2	2.2	2.5	2.5	2.7	2.9
Growth effect	-0.6	0.1	-0.5	-0.8	-1.0	-1.5	-1.6	-1.7
Inflation effect	-1.2	-0.5	-0.6	-0.8	-0.7	-1.0	-1.1	-1.2
<b>3. Stock-flow adjustment</b>	<b>1.2</b>	<b>-2.0</b>	<b>2.7</b>	<b>2.7</b>	<b>-0.7</b>	<b>-0.7</b>	<b>0.5</b>	<b>0.5</b>
<i>Of which:</i>								
Cash/accruals diff.	-0.8	-0.4						
Acc. financial assets	2.0	-1.5						
<i>Privatisation</i>	n.a.	n.a.						
Val. effect & residual	0.0	0.0						

Notes:  
<sup>1</sup>End of period.  
<sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other

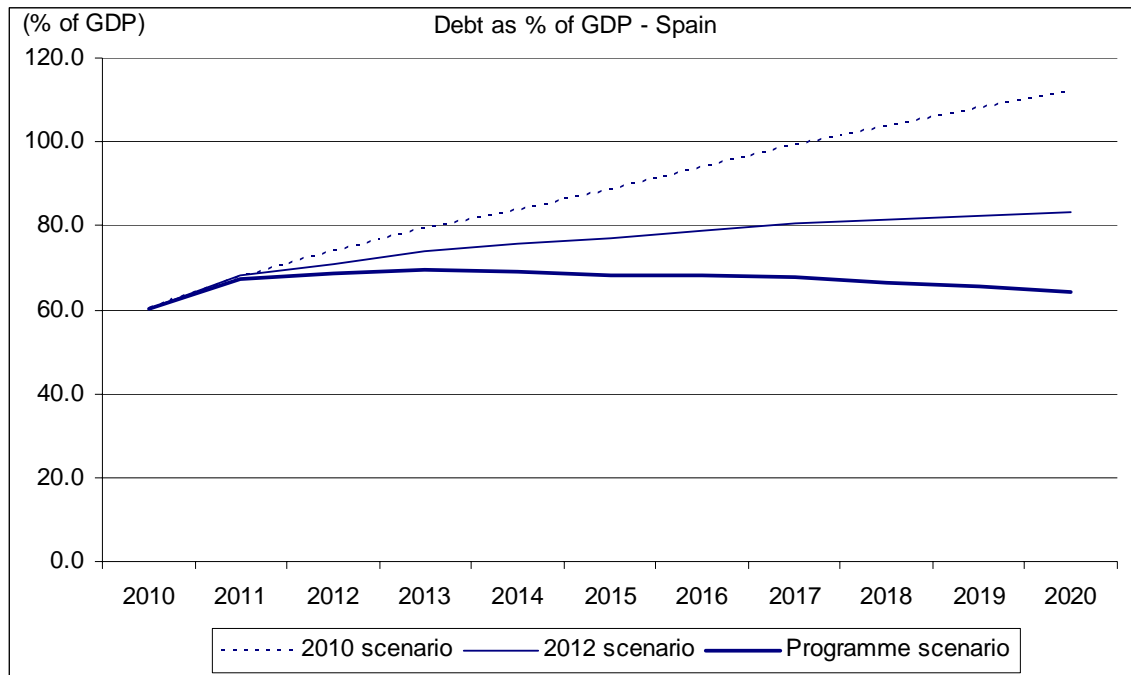
Source:  
*Stability programme (SP); Commission services’ spring 2011 forecasts (COM); Commission services’ calculations*

**Table V. Long-term sustainability indicators**

Spain	Baseline scenario (2010)			Programme scenario		
	S1	S2		S1	S2	
Value	10.2	12.0		4.0	6.0	
<i>of which:</i>						
Initial budgetary position (IBP)	6.2	6.4		0.3	0.4	
Debt requirement in 2060 (DR)	0.4	-		0.1	-	
Long-term change in the primary balance (LTC)	3.6	5.6		3.6	5.6	
	2010	2015	2020	2010	2015	2020
Debt as % of GDP	60.1	88.4	112.1	60.1	68.2	64.1

*Note:* The 'baseline' scenario (2010) depicts the sustainability gap under the assumption that the 2010 budgetary position remains unchanged over the medium-term (until the end of the period covered by the programme). The 'programme' scenario depicts the sustainability gap under the assumption that the budgetary plans of the programme are fully implemented.

**Figure. Medium term debt projections for Spain**



**Table VI. Financial market indicators**

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	239,2	261,8	295,3	326,1	327,0
Share of assets of the five largest banks (% of total assets)	40,4	41,0	42,4	43,3	...
Foreign ownership of banking system (% of total assets)	11,3	11,4	10,6	10,2	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	0,7	0,9	2,8	4,1	4,3
- capital adequacy ratio (%) <sup>1),2)</sup>	11,9	11,4	11,3	12,2	11,8
- profitability - return on equity (%) <sup>1),3)</sup>	19,8	19,6	12,6	9,2	9,4
Private credit growth (annual % change)	26,8	21,1	10,9	1,6	-0,8
Residential property prices (y-o-y % change)	...	...	-1,5	-6,7	-2,0
Exposure to countries receiving/repaying official financial assistance (% of GDP) <sup>4)</sup>	6,8	6,8	6,7	6,7	7,0
Private debt (% of GDP)	156,4	170,3	175,7	178,8	178,8
Gross external debt (% of GDP)					
- Public	22,4	19,1	22,7	27,6	27,8
- Private	55,2	61,6	61,9	58,8	58,3
Long term interest rates spread versus Bund (basis points)*	2,3	9,1	38,2	75,7	150,8
Credit default swap spreads for sovereign securities (5-year)*	...	...	59,2	92,9	203,4

**Notes:**

<sup>1)</sup> Latest available June 2010.

<sup>2)</sup> The capital adequacy ratio is defined as total capital divided by risk weighted assets.

<sup>3)</sup> Net income to equity ratio. After extraordinary items and taxes.

<sup>4)</sup> Covered countries are IE, EL, PT, RO, LV and HU.

\* Measured in basis points.

**Source:**

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).

**Table VII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Employment rate (% of population aged 20 - 64)	67.2	68.7	69.5	68.3	63.7	62.5
Employment growth (% change from previous year)	4.1	3.9	3.0	-0.4	-6.6	-2.3
Employment rate of women (% of female population aged 20 - 64)	54.4	56.4	58.0	58.3	56.3	55.8
Employment rate of men (% of male population aged 20 - 64)	79.9	80.7	80.7	78.1	71.0	69.1
Employment rate of older workers (% of population aged 55 - 64)	43.1	44.1	44.6	45.6	44.1	43.6
Part-time employment (% of total employment)	12.4	12.0	11.8	12.0	12.8	13.3
Fixed term employment (% of employees with a fixed term contract)	33.3	34.0	31.7	29.3	25.4	24.9
Unemployment rate <sup>1</sup> (% of labour force)	9.2	8.5	8.3	11.3	18.0	20.1
Long-term unemployment <sup>2</sup> (% of labour force)	2.2	1.8	1.7	2.0	4.3	7.3
Youth unemployment rate (% of youth labour force aged 15-24)	19.7	17.9	18.2	24.6	37.8	41.6
Youth NEET <sup>3</sup> rate (% of population aged 15-24)	13.0	12.0	12.2	14.4	18.3	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	30.8	30.5	31.0	31.9	31.2	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	38.6	38.1	39.5	39.8	39.4	:
Labour productivity per person employed (annual % change)	1.3	1.2	0.8	-0.5	-1.4	1.5
Hours worked per person employed (annual % change)	-0.3	-1.3	1.3	0.3	-0.1	-0.3
Labour productivity per hour worked (annual % change; constant prices)	1.6	2.6	-0.4	-0.6	-1.3	1.8
Compensation per employee (annual % change; constant prices)	1.0	0.8	-0.2	-0.2	1.0	1.8
Nominal unit labour cost growth (annual % change)	3.3	3.2	4.0	4.9	0.8	-1.5
Real unit labour cost growth (annual % change)	-0.9	-0.9	0.7	2.4	0.2	-2.5
<b>Notes:</b>						
<sup>1</sup> According to ILO definition, age group 15-74)						
<sup>2</sup> Share of persons in the labour force who have been unemployed for at least 12 months.						
<sup>3</sup> NEET are persons that are neither in employment nor in any education or training.						
<b>Sources:</b>						
Commission services (EU Labour Force Survey and European National Accounts)						

**Table VII. Labour market and social indicators (continued)**

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Sickness/Health care	6.26	6.30	6.34	6.39	6.84
Invalidity	1.50	1.53	1.52	1.53	1.59
Old age and survivors	8.51	8.51	8.43	8.49	8.79
Family/Children	1.11	1.18	1.20	1.26	1.50
Unemployment	2.50	2.53	2.44	2.39	3.01
Housing and Social exclusion n.e.c.	0.34	0.39	0.41	0.44	0.47
<b>Total</b>	<b>20.2</b>	<b>20.4</b>	<b>20.3</b>	<b>20.5</b>	<b>22.2</b>
of which: Means tested benefits	2.53	2.73	2.77	2.79	3.01
<b>Social inclusion indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Risk-of-poverty or exclusion <sup>1</sup> (% of total population)	23.4	23.3	23.1	22.9	23.4
Risk-of-poverty or exclusion of children (% of people aged 0-17)	26.6	26.5	26.4	26.3	26.2
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	30.4	32.4	29.7	28.2	26.1
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	19.7	19.9	19.7	19.6	19.5
Value of relative poverty threshold (single HH per year) - in PPS	6996	7560	7872	8364	8388
Severe Material Deprivation <sup>3</sup> (% of total population)	3.4	3.4	3.0	2.5	3.5
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59 not student)	6.5	6.0	6.3	6.2	7.0
In-work at-risk-of poverty rate (% of persons employed)	10.4	9.9	10.7	10.6	11.4
<b>Notes:</b>					
<sup>1</sup> People at-risk-of poverty or social exclusion (AROP): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
<sup>2</sup> At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.					
<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone					
<sup>4</sup> People living in households with very low work intensity: Share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.					
<b>Sources:</b>					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					

**Table VIII. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	-0.2	0.1	0.9	1.5	3.4	2.1
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	0.2	2.1	1.5	-1.3	1.2	n.a.
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	1.4	0.0	-1.2	8.4	-9.0	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	0.1	-1.2	-2.9	9.6	21.0	6.6
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	0.9	0.9	0.5	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Enforcing contracts <sup>3</sup> (days)	n.a.	515	515	515	515	515
Time to start a business <sup>3</sup> (days)	n.a.	47	47	47	47	47
R&D expenditure (% of GDP)	1.0	1.2	1.3	1.4	1.4	n.a.
Tertiary educational attainment (% of 30-34 years old population)	34.6	38.1	39.5	39.8	39.4	n.a.
Total public expenditure on education (% of GDP)	4.2	4.3	4.4	4.6	n.a.	n.a.
	<b>2003</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	1.7	n.a.	n.a.	1.0	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	3.4	n.a.	n.a.	2.7	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>6</sup> (Index; 0=not regulated; 6=most regulated)	2.0	1.6	1.6	1.6*	n.a.	n.a.
<b>Notes:</b>						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications designated to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, of this indicator is presented in detail at the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the Product market regulation indicators are presented in detail at the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html</a> . The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.						
<sup>6</sup> Aggregate ETCR.						
*figure for 2007.						
<b>Source :</b>						
Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						