

© OECD, 2002.

© Software: 1987-1996, Acrobat is a trademark of ADOBE.

All rights reserved. OECD grants you the right to use one copy of this Program for your personal use only. Unauthorised reproduction, lending, hiring, transmission or distribution of any data or software is prohibited. You must treat the Program and associated materials and any elements thereof like any other copyrighted material.

All requests should be made to:

Head of Publications Service,  
OECD Publications Service,  
2, rue André-Pascal,  
75775 Paris Cedex 16, France.

© OCDE, 2002.

© Logiciel, 1987-1996, Acrobat, marque déposée d'ADOBE.

Tous droits du producteur et du propriétaire de ce produit sont réservés. L'OCDE autorise la reproduction d'un seul exemplaire de ce programme pour usage personnel et non commercial uniquement. Sauf autorisation, la duplication, la location, le prêt, l'utilisation de ce produit pour exécution publique sont interdits. Ce programme, les données y afférentes et d'autres éléments doivent donc être traités comme toute autre documentation sur laquelle s'exerce la protection par le droit d'auteur.

Les demandes sont à adresser au :

Chef du Service des Publications,  
Service des Publications de l'OCDE,  
2, rue André-Pascal,  
75775 Paris Cedex 16, France.

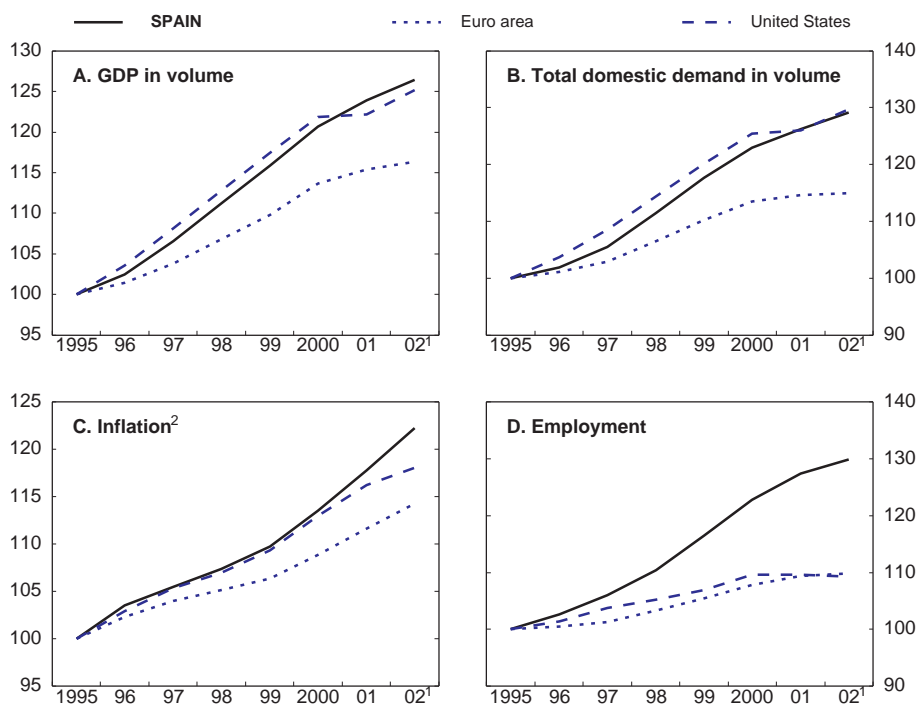
# I. Economic developments, the fiscal stance and prospects

## Overview

Spain has not escaped the international economic slowdown since 2000 but has fared better than most countries. Output growth for 2002 reached 2 per cent, which means that the positive growth differential with the euro area remained at 1¼ percentage points, its average level since 1996. This strong growth performance, which is similar to that of the United States since the mid-1990s (Figure 1), is due mainly to strong job creation which has boosted domestic demand, especially private consumption and residential investment. However, robust growth of employment did not prevent a cyclical rise in the unemployment rate to 11½ per cent in late 2002, the first increase since 1994, which is also due to the low sensitivity of the labour force to economic conditions and the steep rise in immigration. Despite an easing of labour market pressures and a slightly negative output gap, inflation has not slowed, partly because of exceptional factors such as the changeover to the euro. In February 2003, consumer prices were 3¾ per cent higher than a year earlier. The inflation differential with the euro area of about 1¼ percentage points since 1999 tends to erode the economy's international competitiveness.

Recent developments, while favourable overall, have revealed three main sources of strain that are essentially structural in nature. First, the inflation differential with the euro area constitutes a major threat to the continuance of good performance in the medium term. This problem is largely due to nominal wage rigidity and insufficient moderation of profit margins in the sheltered sector. Second, productivity gains have remained weak, even though uncertainties surround productivity estimates. Continuing sluggish productivity growth during the next few years will not pose a problem if real and nominal wage growth moderates. But if the present trend continues because of labour market rigidities, Spain's real convergence with the most developed countries will be compromised. A third notable characteristic has been the steep rise in house prices, which have amounted to some 40 per cent since 1999 and shows little sign of slowing. This has led some analysts to express concern about the emergence of a speculative

Figure 1. **Key indicators in international perspective**  
Index 1995 = 100



1. OECD estimates.

2. CPI for the United States and harmonised CPI for Spain and the euro area. The break of the Spanish harmonised CPI in 2001 has been adjusted using the national CPI as benchmark.

Source: INE, EUROSTAT and OECD.

bubble. Although a bubble is unlikely to exist at present, it is important not to underestimate the risks of a speculative spiral developing, given the large distortions in the real estate market.

Domestic liquidity conditions have become easier in recent years because the European Central Bank (ECB) has relaxed monetary policy. Monetary conditions remain accommodating in Spain despite the euro's appreciation since the second half of 2002. The expansionary effect has been limited, however, by fiscal tightening since 2000. This policy has continued the fiscal consolidation begun in the mid-1990s and eliminated the general government deficit. In 2003 the government aims again at a balanced budget on the basis of an official growth forecast of 3 per cent, close to potential, implying a neutral fiscal stance. According to the

OECD projections, gross domestic product (GDP) growth may be only marginally above 2 per cent in 2003 before reaching more than 3 per cent in 2004, maintaining the positive growth differential with the euro area. These projections imply the persistence of a negative output gap, and given the relaxed monetary conditions, a neutral fiscal stance is appropriate. This stance also seems appropriate in light of the risks to the economic outlook, which are mainly on the downside. In the short term, some fiscal slippage could be tolerated, notably if prospects deteriorate.

## Recent trends

### *Household consumption has remained relatively buoyant*

Private consumption slowed further in 2002, spending rising by less than 2 per cent, as against over 4½ per cent in 1998-99 (Table 1). With the economy more sluggish and consumer confidence turning down, there was a slight rise in the saving ratio, while wages increased less because of the slowdown in job creation. Households, whose lending capacity has fallen sharply since the mid-90s (Table 2), have adopted a more cautious attitude as a result of mounting uncertainty about the international situation and the increasingly gloomy outlook regarding their incomes. Furthermore, the euro changeover in early 2002 seems to have triggered the use of old notes to advance purchases of consumer durables, particularly cars, which underpinned consumption in late 2001

Table 1. **Demand and output**  
Year-on-year percentage changes (1995 prices)

	Average 1991-2000	1998	1999	2000	2001	2002	2002		
							Q2	Q3	Q4
Private consumption	2.4	4.4	4.7	3.9	2.5	1.9	1.8	1.5	1.8
Government consumption	3.2	3.7	4.2	5.0	3.1	3.8	3.8	3.7	4.0
Gross fixed investment	3.0	10.0	8.7	5.7	3.2	1.4	1.0	1.6	2.5
Construction	2.5	7.8	9.0	6.1	5.8	4.5	4.5	5.0	4.6
Machinery and equipment	3.6	12.6	8.4	5.1	0.3	-2.2	-3.0	-2.4	-0.2
Final domestic demand	2.7	5.5	5.6	4.5	2.8	2.1	1.9	1.9	2.3
Total domestic demand	2.6	5.7	5.6	4.4	2.7	2.2	1.9	1.9	2.7
Exports of goods and services	10.1	8.2	7.7	10.1	3.4	1.4	-1.6	4.2	6.0
Imports of goods and services	9.2	13.2	12.7	10.6	3.5	2.2	-1.7	4.2	7.4
Gross domestic product	2.7	4.3	4.2	4.2	2.7	2.0	2.0	1.8	2.1
GDP price deflator	4.1	2.4	2.7	3.5	4.2	4.4	4.2	4.5	4.8
Private consumption deflator	4.2	2.2	2.4	3.2	3.3	3.6	3.6	3.6	4.0
Industrial production	2.2	5.5	2.6	4.4	-1.4	0.3	-0.9	0.6	2.0
Household saving ratio (level)	12.7	12.2	11.1	10.6	10.2	10.4			

Source: INE.

Table 2. **Financial position of the economic sectors**

	Per cent of GDP					
	1996	1997	1998	1999	2000	2001
<b>Gross saving</b>						
Total economy	22.1	22.6	22.6	22.3	22.4	22.9
Financial corporations	1.6	1.3	1.4	1.0	1.4	1.8
General government	-1.2	0.4	1.2	2.9	3.3	3.9
Non-financial firms	11.8	11.7	11.8	11.3	11.2	10.7
Households <sup>1</sup>	9.9	9.1	8.2	7.2	6.5	6.5
<b>Capital transfers and investment</b>						
Total economy	-20.8	-21.0	-22.1	-23.4	-24.9	-24.9
Financial corporations	-0.6	-0.6	-0.5	-0.5	-0.7	-0.6
General government	-3.7	-3.6	-3.9	-4.0	-3.9	-4.0
Non-financial firms	-11.7	-12.0	-12.7	-13.3	-14.4	-14.3
Households <sup>1</sup>	-4.9	-4.8	-5.1	-5.5	-5.9	-6.0
<b>Net lending</b>						
Total economy	1.2	1.6	0.5	-1.1	-2.5	-2.0
Financial corporations	1.0	0.7	1.0	0.5	0.7	1.2
General government	-4.9	-3.2	-2.7	-1.1	-0.6	-0.1
Non-financial firms	0.2	-0.3	-0.9	-2.1	-3.2	-3.6
Households <sup>1</sup>	5.0	4.3	3.1	1.6	0.6	0.5
	2001			2002		
	Q2	Q3	Q4	Q1	Q2	Q3
<b>Net lending</b>						
Total economy	-1.9	-1.9	-1.8	-2.0	-1.7	-1.1
Financial corporations	1.6	1.2	1.0	1.8	1.3	1.6
General government	-0.4	0.6	-3.0	4.7	-2.2	2.5
Non-financial firms and households <sup>1</sup>	-3.1	-3.7	0.2	-8.4	-0.7	-5.2

1. Including non-profit institutions serving households.

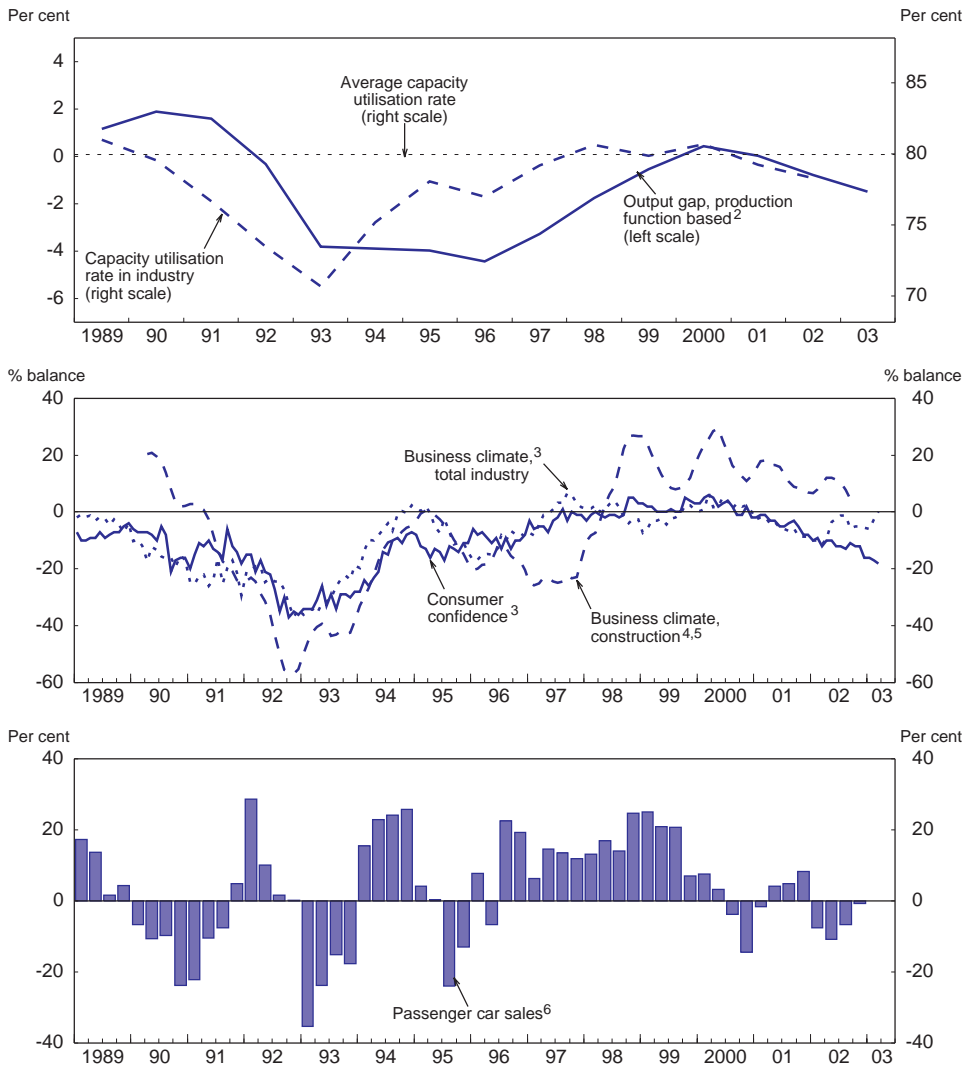
Source: Bank of Spain, *Financial accounts of the Spanish economy*.

(Figure 2),<sup>1</sup> but depressed consumption thereafter. On the other hand, the influence of the decline in financial wealth on the saving ratio following the stock market correction is likely to have been largely offset by rising house prices, which account for some 70 per cent of households' total assets.<sup>2</sup> Despite the deceleration, private consumption has remained more buoyant in Spain than in the rest of the euro area, with job creation continuing to be more robust and the rise in the saving ratio more limited.

### **Housing investment remains strong, while property prices rise briskly**

With growth of 4½ per cent in 2002, construction investment is the most dynamic demand component and confidence indicators for this sector have

Figure 2. Output gap<sup>1</sup> and economic activity indicators



1. Deviation of GDP from potential. Data for 2002-03 are OECD estimates and projections.
2. Estimate based on OECD method.
3. Balance of positive and negative responses.
4. Simple average of the level of the orders and the employment tendency in the construction industry.
5. Six-month moving average.
6. Year-on-year percentage change.

Source: INE, Ministry of Science and Technology and OECD, *Main Economic Indicators*.

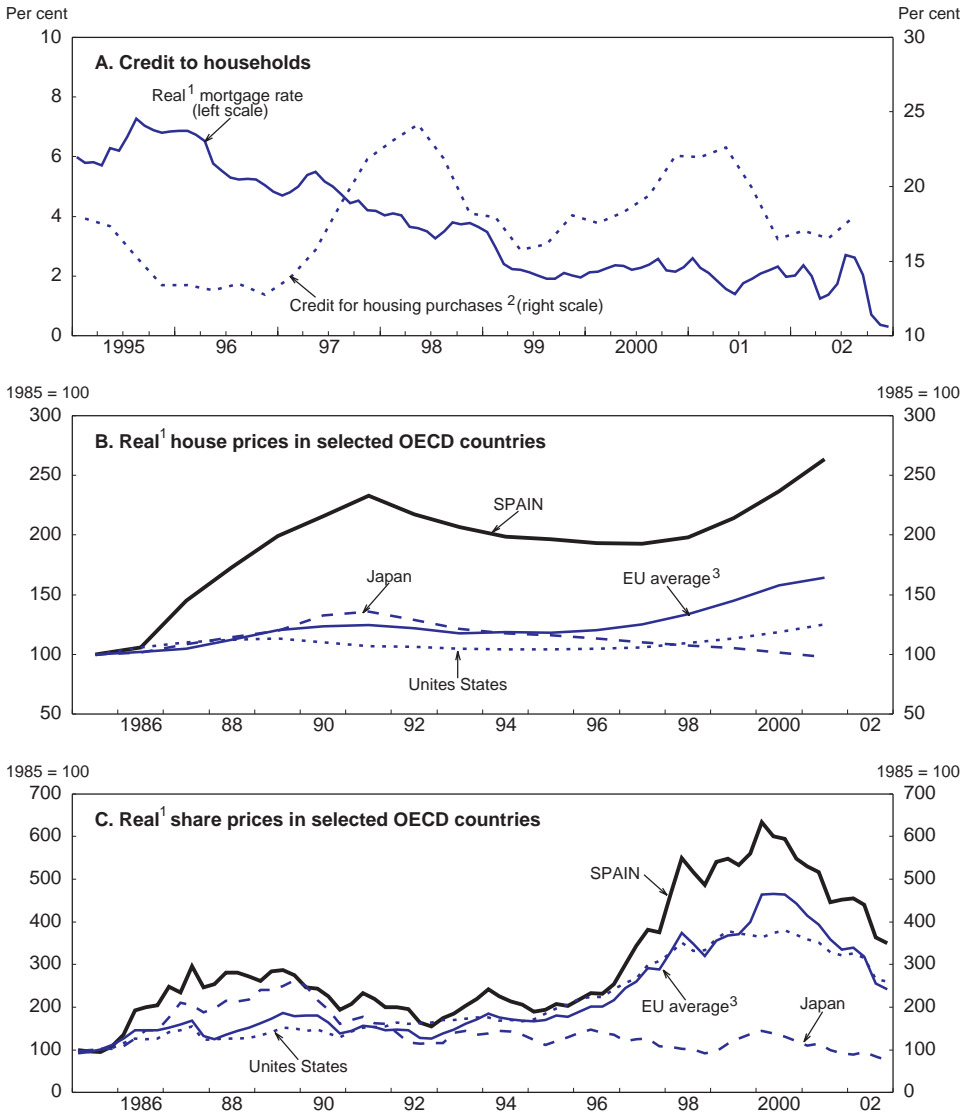
remained higher than those for industry and consumption (Figure 2). Activity in the civil engineering and residential construction sectors in particular has remained very buoyant, though it has weakened in the non-residential sector. Civil engineering, which accounts for nearly one third of total construction expenditure, increased by over 10 per cent in 2001, partly as a result of the implementation of the 2000-07 infrastructure plan. Growth in this sector has also benefited from increased local authority spending in the run-up to the 2003 municipal elections.

In contrast with private consumption, residential investment has lost little steam despite the slowdown in activity. Housing demand has remained well in excess of its long-term trend based on population factors, while at the same time the number of dwellings has increased strongly.<sup>3</sup> This is partly due to the continuing adjustment to the fall in real interest rates (Figure 3). Lower rates, coupled with the more extensive and flexible supply of mortgage loans, have enabled households to increase their debt to a level close to the euro area average (Figure 4). Housing expenditure also appears to have been stimulated by the euro changeover and by investment shifting from the financial sector to the real estate sector because of the stock market fall.<sup>4</sup> As a result, house price increases have outstripped rises in most OECD countries, prompting some analysts to worry about the risk of a speculative bubble. However, it is unlikely that such a bubble has already developed. Although real estate prices have reached historically high levels, a sizeable portion of the increase reflects the improvement in households' average incomes, due in particular to the increase in female employment. House prices relative to average household income are currently not higher than in 1991 (BBVA, 2002b).<sup>5</sup> Yet it is important to bear in mind the risk of triggering a speculative spiral in the present economic situation. This risk is accentuated by the distortions in the real estate market, which are restricting supply and stimulating housing demand (Chapter III). The distortions include, in particular, tax concessions for the purchase of the main residence, the scale of which (½ per cent of GDP per year) corresponds to a reduction in mortgage rates of some 1½ percentage points, making them negative in real terms.

### ***The downturn in equipment spending was fairly moderate***

With an international environment that had been deteriorating since 2000 amid mounting uncertainty, firms, unlike households, cut back investment appreciably. Particularly hard hit were purchases of machinery and equipment. Order books in industry fell to their lowest level since 1996, as did capacity utilisation (Figure 2). The negative impact of unfavourable demand prospects and the low capacity utilisation rate was accentuated by the increase in corporate debt since 1995. This increase in indebtedness partly reflects, as in

Figure 3. Credit to households and asset prices



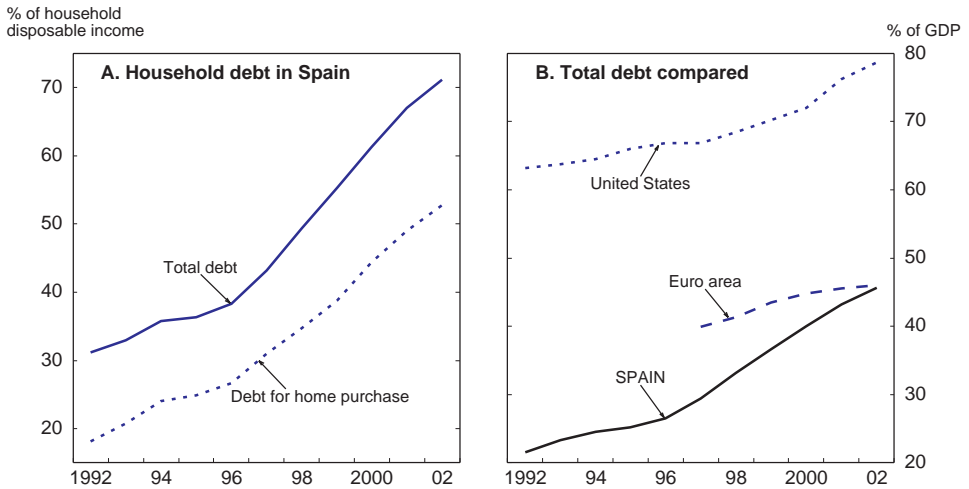
1. Deflated by the consumer price index.

2. Year-on-year percentage changes.

3. Non-weighted average of Denmark, France, Germany, Ireland, Italy, Netherlands, Sweden and the United Kingdom.

Source: Ministry of Economy and OECD, *Main Economic Indicators*.



Figure 4. Household indebtedness<sup>1</sup>

1. End-of-period data. For 2002, these are Q3 2002.

Source: Bank of Spain, Board of Governors of the Federal Reserve System and European Central Bank.

the case of households, a structural adjustment to lower interest rates, and served in some cases to finance investment in Latin America or in the telecommunications sector, which was not always profitable and generated substantial losses for a few big groups. The Bank of Spain survey shows that these losses resulted in a downturn in company results which became appreciably more marked in 2002 (Table 3). However, corporate profitability excluding exceptional provisions has remained relatively high, because of the steep fall in financial costs due to lower interest rates, which more than offset the debt increase. Labour costs also eased as wage payments grew more slowly. These developments had the effect of limiting the slowdown in machinery and equipment investment, which has been less pronounced since end-2000 than during previous episodes of soft demand (Figure A1, Annex I).

### **Exports falter due to weakening markets and competitiveness**

The marked weakening in exports is one of the main reasons for the cyclical slowdown. Foreign sales of both goods and services were affected by the deceleration. Tourism receipts fell in nominal terms in 2002, whereas they had risen uninterruptedly by over 10 per cent per year between 1994 and 2000. This fall reflects not only the decline in international tourism following the 11 September terrorist attacks, but is also attributable to certain traditional,

Table 3. **Financial performance of non-financial firms<sup>1</sup>**

	Per cent							
	Annual sample				Quarterly sample <sup>2</sup>			
	Average 1991-98	1999	2000	2001	2001		2002	
				S1	S2	S1	Q3	
Growth, annual rate								
Gross value added	5.2	4.7	7.5	3.9	4.2	3.9	2.2	3.0
Labour costs	4.1	6.4	7.5	5.4	5.5	4.5	3.7	3.8
Financial costs	-3.3	-2.2	26.3	12.0	29.6	9.4	-9.9	-9.5
Ordinary net result <sup>3</sup>	22.8	0.1	8.3	10.2	7.2	7.6	4.2	6.9
Net result <sup>4</sup>	17.4	-5.0	15.3	-3.1	-6.0	-11.5	-47.6	-34.4
Profitability ratios								
Return on net assets	7.1	7.5	7.4	7.6	7.7	8.2	8.3	8.5
Financial costs on total liabilities	9.2	5.0	5.0	5.0	5.5	5.3	4.6	4.6
Leverage ratio <sup>5</sup>	-2.1	2.5	2.3	2.5	2.2	2.9	3.7	3.9
Debt ratio	45.0	41.1	46.0	48.7	46.7	48.8	50.0	49.3

1. Data coverage is biased towards large, public and industrial enterprises.

2. For each period, growth rates are computed as the cumulative quarterly data since the beginning of the specified year over the same cumulative data of the previous year.

3. Gross economic results plus financial income less financial costs and amortisation allowances.

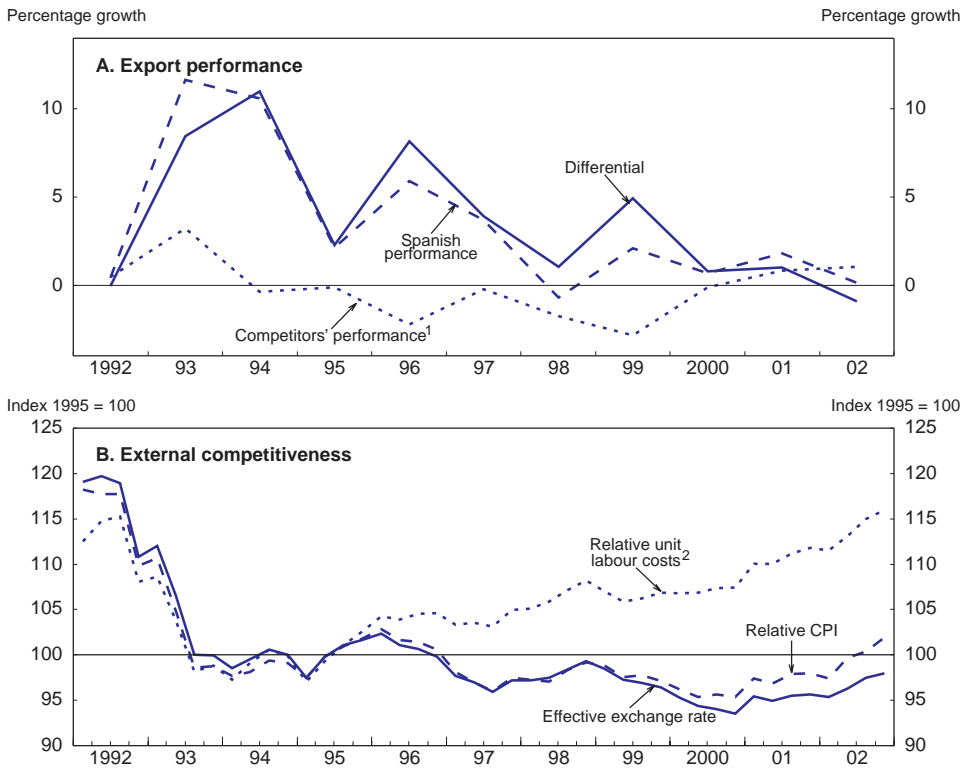
4. Resources less depreciation allowances.

5. Rate of return on assets less financial costs on total liabilities (in percentage points).

Source: Bank of Spain, *Statistical Bulletin*.

mainly German customers travelling less, no doubt because of the depressed state of their economy.<sup>6</sup> However, the competitiveness of Spanish tourism is also being eroded, with prices rising sharply in the hotel and catering trade<sup>7</sup> and, perhaps, too little use being made of new technologies: only 3 per cent of hotel reservations are made via the Internet, compared with nearly 40 per cent in the Nordic countries and 25 to 35 per cent in the United States and Canada (Canadian Tourism Commission, 2002). As with tourism, foreign sales of goods have also lost competitiveness, which has accentuated the effect of the slower growth of foreign markets on exports. The loss of competitiveness partly reflects the euro's appreciation against the dollar, which has reached some 20 per cent since the second half of 2000, but it is also due to prices and unit labour costs continuing to rise faster than in the rest of the euro area. Measured on the basis of prices, the loss of competitiveness has however only been perceptible since 2000, whereas in terms of labour costs it has been ongoing since the mid-1990s (Figure 5). The underlying decline in firms' financial costs as a result of lower interest rates, which has been larger than in other countries, has doubtless offset the effect of increasing labour costs on corporate profit margins. However, Spanish exporters, who steadily increased their market shares following the 1992 devaluation, are now finding it difficult to hold their position, particularly as they

Figure 5. Competitiveness indicators and export performance



1. Represented by Belgium, France, Germany, Italy and Portugal.

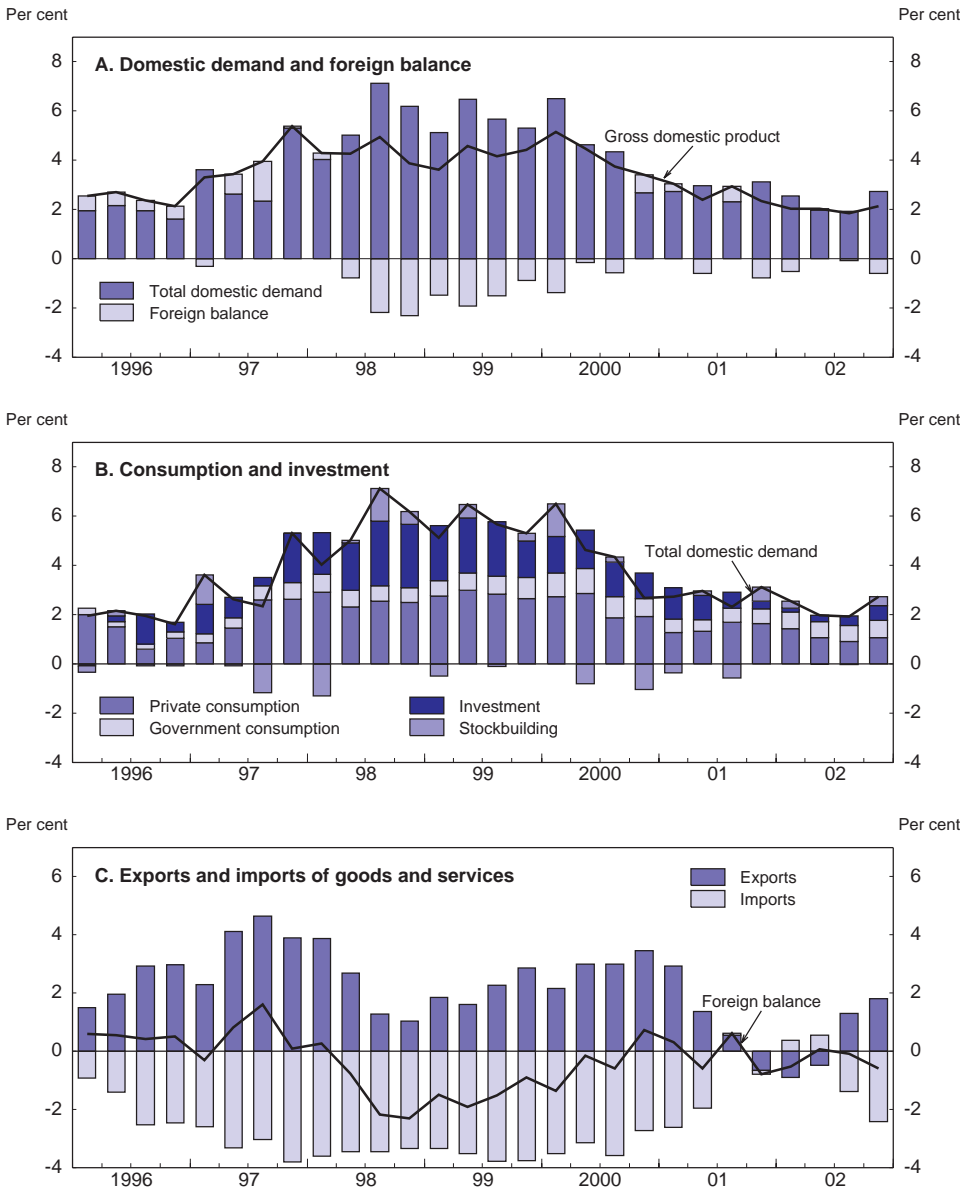
2. In manufacturing.

Source: OECD.

are also having to contend with increased competition from the Central European countries that are in the process of joining the Union (Figure 5).<sup>8</sup>

In 2002, weaker exports were partly offset by a similar trend in imports, so that the contribution of the foreign balance to activity was slightly negative (Figure 6). The improvement in the terms of trade, resulting from the oil price fall (expressed in United States dollars (USD)) of some 12 per cent since the second half of 2000, plus the 5 per cent nominal effective appreciation in the exchange rate over the same period, helped to reduce the negative current account balance from 3.3 to 2.7 per cent of GDP between 2000 and 2002, despite the slight increase of the investment income deficit (Table A1, Annex I).

Figure 6. Contributions to GDP growth<sup>1</sup>



1. Seasonally adjusted data.  
Source: OECD, Quarterly National Accounts.

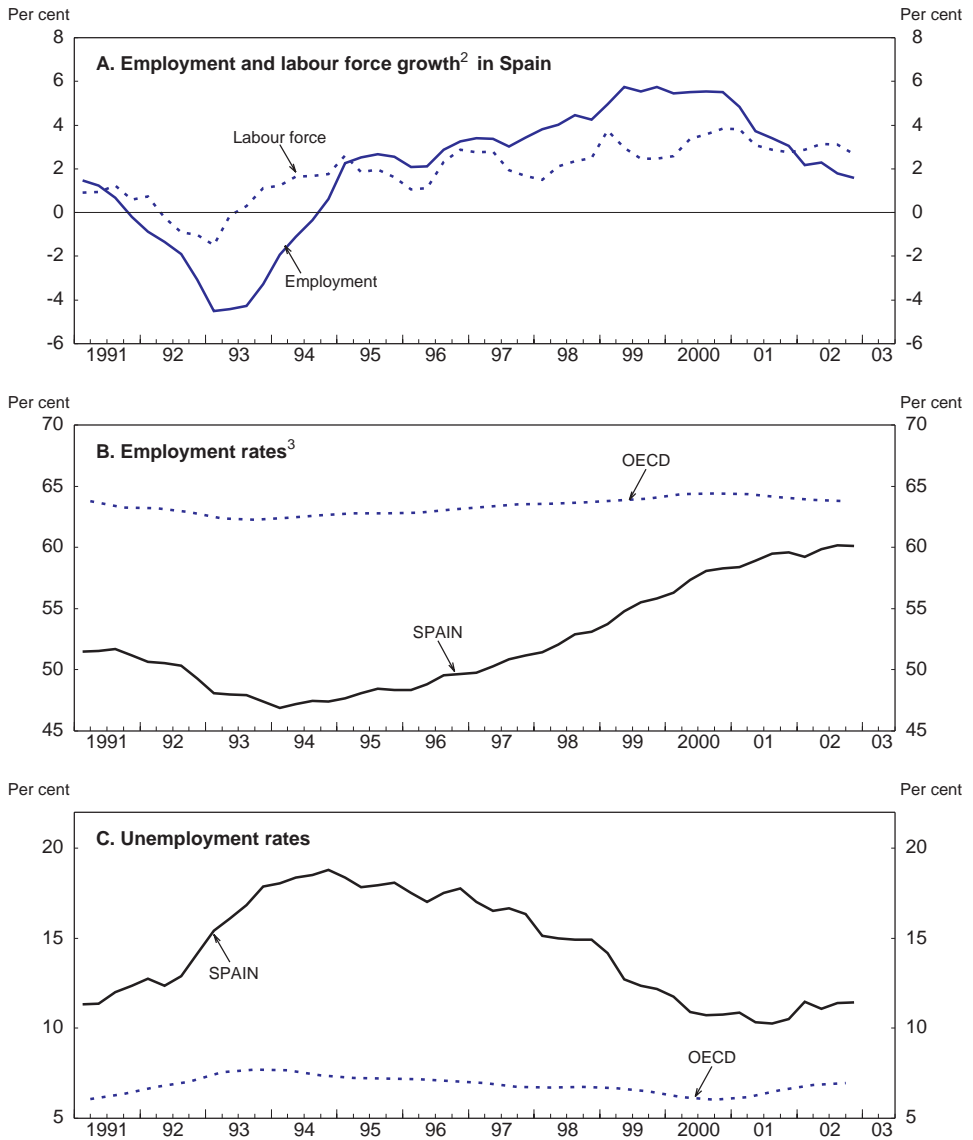
### **Job creation slows**

Employment growth has slowed with the slackening of activity since early 2001, but the scale of the slowdown is uncertain. According to the labour force survey, recruitment grew by some 2 per cent in 2002, which was about half the 2000 rate (Figure 7). Though fairly similar to that shown in the national accounts, this deceleration is less marked according to the social security figures. The latter show employment growth of about 3 per cent since the beginning of 2002, reflecting an especially sharp increase in the recruitment of foreign workers. A significant proportion of this increase could, however, be due to the regularisation of immigrants, who had already been recorded in the labour force and national accounts figures (Chapter IV). All indicators agree, however, that the slowdown in job creation has eased since spring 2002. From a sectoral standpoint, the downturn in recruitment in industry seems to be over, but meanwhile job creation in construction and in market services has also lost momentum. The employment figures also point to a pick-up in the number of indefinite contracts. This is a result of the March 2001 reform which extended and indefinitely prolonged the system of subsidies for workers hired on permanent contracts adopted in 1997 (OECD, 2001a). On the other hand, the introduction under this reform of redundancy costs, albeit at a reduce rate of eight days per year of work for the termination of temporary contracts has not resulted in a marked fall in the proportion of the latter in total employment. It stood at 30.7 per cent in the fourth quarter of 2002, *i.e.* 1 percentage point less than in 2000 and in 2001, and remained twice as high as in the other EU countries.<sup>9</sup> Nor did the measures in favour of part-time work, adopted in March 2001, stimulate this type of recruitment, whose share (7.9 per cent of total employment) is still smaller than in the other OECD countries, especially the European ones (where it accounts for 19 per cent of total employment).

### ***The persisting weakness of productivity gains partly reflects increased employment flexibility...***

Job creation decelerated less than activity. Labour productivity growth, which was already low, thus slowed to an annual rate of only  $\frac{1}{4}$  per cent since end-2000. This further slowdown is unusual, as productivity has usually accelerated during previous episodes of economic weakness (Table 4, Part A). The slowdown is probably little affected by labour hoarding because of the large share of temporary labour, for which the redundancy costs are low. Conversely, the persistence of low productivity growth could indicate greater flexibility than in the past – particularly as regards unskilled jobs – following the reforms of the mid-1990s. The economy has enjoyed an abundant and flexible supply of unskilled labour thanks to strong immigration in recent years, and this has contributed to the persisting buoyancy of employment growth in sectors such as retailing and construction, without generating excessive wage pressures. More generally, the moderation of real wages

Figure 7. **Employment and unemployment:<sup>1</sup> key features**



1. Labour force and unemployment data before 2001 have been estimated by the Bank of Spain.

2. Year-on-year percentage changes.

3. Employment as a per cent of population aged 16-64.

Source: Bank of Spain, INE and Ministry of Economy.

Table 4. **Productivity and real wage growth by sector**  
Per cent, average growth rate over the period

	Total	Agriculture, hunting, forestry and fishing	Industry and energy	Construction	Market services	Non-market services	
<b>A. Productivity<sup>1</sup> growth</b>							
<b>1981Q1-2002Q4</b>	1.5	5.1	2.2	1.1	0.6	0.8	
<b>1981Q1-1994Q4</b>	(1)	2.0	6.6	2.8	1.8	0.8	0.8
1982Q4-1985Q2	(1a)	3.4	8.3	3.6	6.6	3.1	0.2
1991Q4-1994Q4	(1b)	2.4	5.5	3.0	2.2	1.8	1.7
	(1a)-(1)	1.4	1.7	0.8	4.8	2.4	-0.6
	(1b)-(1)	0.5	-1.1	0.2	0.3	1.0	1.0
<b>1995Q1-2002Q4</b>	(2)	0.7	2.6	1.1	-0.2	0.3	0.7
2000Q3-2002Q4	(2a)	0.4	1.0	0.6	1.1	0.1	0.5
	(2a)-(2)	-0.3	-1.6	-0.5	1.3	-0.2	-0.2
	(2)-(1)	-1.3	-4.0	-1.7	-2.0	-0.5	0.0
<b>B. Real wage<sup>2</sup> growth</b>							
<b>1981Q1-2002Q4</b>	0.9	1.3	1.0	0.8	0.7	0.4	
<b>1981Q1-1994Q4</b>	(1)	1.4	2.1	1.7	1.4	1.1	0.6
1982Q4-1985Q2	(1a)	0.5	2.2	-0.4	0.2	1.3	-0.1
1991Q4-1994Q4	(1b)	2.3	1.4	3.2	3.7	1.6	1.2
	(1a)-(1)	-0.8	0.0	-2.1	-1.2	0.2	-0.7
	(1b)-(1)	1.0	-0.7	1.5	2.3	0.5	0.6
<b>1995Q1-2002Q4</b>	(2)	0.0	-0.2	-0.2	-0.2	0.0	0.0
2000Q3-2002Q4	(2a)	-0.2	-0.7	0.1	-0.2	-0.2	-0.9
	(2a)-(2)	-0.2	-0.5	0.3	0.1	-0.2	-0.9
	(2)-(1)	-1.4	-2.3	-1.9	-1.6	-1.0	-0.6

1. Real GDP of the sector divided by the number of full-time equivalent employment.

2. Nominal wage per full-time equivalent employee deflated by the GDP deflator.

Source: INE.

since 1995 (Table 4, Part B), which compared to expectations partly reflects negative inflation surprises, is evidence of the reduced real rigidities in the labour market. This has resulted in a somewhat higher labour intensity of production, as the slowdown in labour productivity in all branches of activity since 1995 suggests.<sup>10</sup>

**... but it could be problematic if this trend were to persist**

The deceleration in productivity gains is partly a natural consequence of the positive effects of past reforms, which have boosted job creation. The

scale of the slowdown is moreover uncertain since both the level of GDP and its growth have possibly been underestimated in recent years.<sup>11</sup> The slowdown has been accentuated by the concentration of job creation in less productive sectors.<sup>12</sup> The sectoral shift in employment towards low value-added branches is estimated to have reduced the growth of apparent labour productivity by an average of 0.2 percentage point per year between 1995 and 2002 (Chapter IV). Timid productivity growth for a few further years will not create difficulties as long as there is real and nominal wage moderation. If, however, the trend were to persist for longer, it would jeopardise real convergence with the other European countries. Moreover, even if productivity were to pick up again in the future spontaneously in the low value-added sectors, this sort of specialisation would perpetuate a standard of living differential with the other countries. As the Bank of Spain (2001) shows, the country's productivity lag compared with its European partners is attributable mainly to the production structure, which is concentrated in low value-added sectors.<sup>13</sup> This specialisation, which seems to have increased in recent years, could be related to the inadequate up-take of new technologies, notably because of the distortions in the way the labour and goods markets function (Chapter III).

### ***The recent increase in unemployment is mainly cyclical***

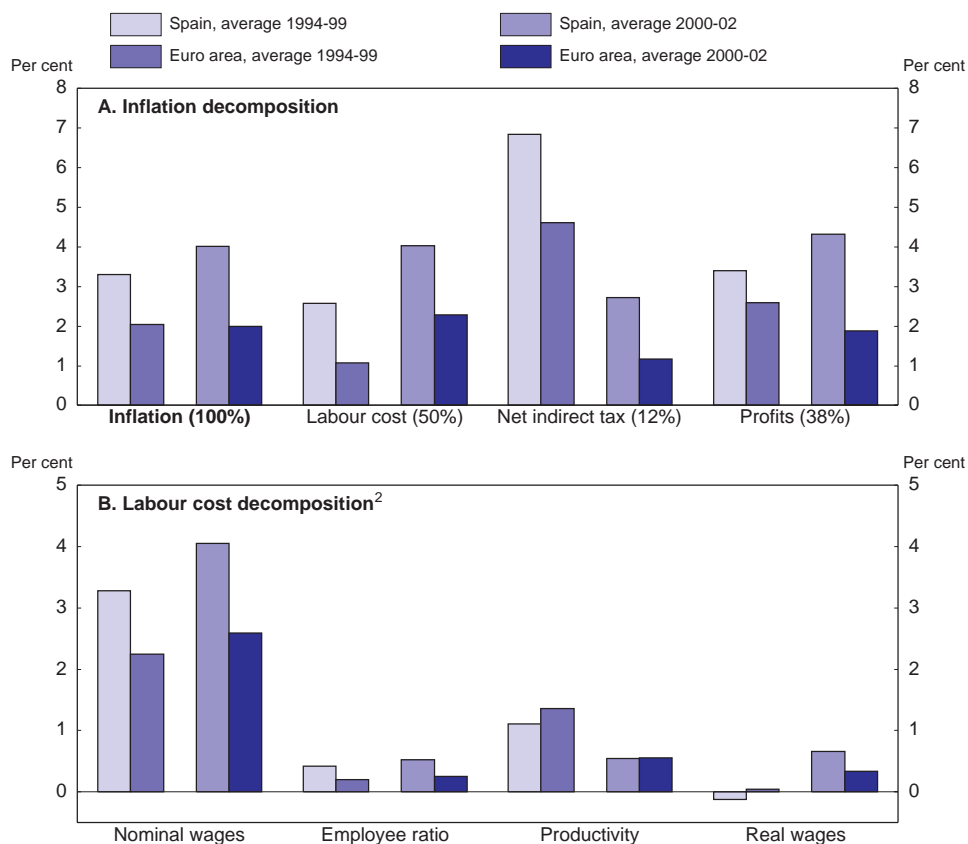
Labour force growth, which has accelerated since 1999 to an annual rate of 3 per cent, barely slowed with the deceleration in employment, with the result that the unemployment rate has risen for the first time since 1994. It was up to 11.5 per cent in the fourth quarter of 2002 (Figure 7, Part C). The labour force has in fact continued to be fairly insensitive to economic conditions. Its growth has been dominated by the increase in immigration and the continuous rise in female participation in the labour market, which mainly reflects the trend improvement in women's level of education (Álvarez-Llorente, 2002). The slight upturn in unemployment in 2002, which affected women more than men, and also young people seeking their first jobs, would appear to be mainly cyclical. Long-term unemployment, which accounted for 38.1 per cent of total unemployment in the fourth quarter of 2002, increased slightly recently, but is more than 13 percentage points lower than in 1998. Scrutiny of the way the employment and unemployment rates have moved over the long term reveals, moreover, the remarkable structural improvement in the labour market since the mid-1990s (Figure 7, Part B). Although there is still considerable progress to be made before Spain's performance will match the OECD average, the new INE statistics<sup>14</sup> show that the employment rate has risen by more than 10 percentage points since 1995 and the unemployment rate has fallen by 11 percentage points.



### ***Nominal wage rigidity partly explains the persisting inflation differential with the euro area***

Real wage moderation since the mid-1990s was accompanied by an acceleration in nominal wages as of 1999. According to national accounts data, the rise in wages per employee has reached 4 per cent on average since 2000, whereas it was limited to 2.6 per cent between 1997 and 1999. This acceleration was much more marked than in the other euro area countries (Figure 8). This was because the wage negotiation system in Spain is based on collective agreements often containing safeguard clauses that guarantee workers' purchasing power in the event of inflation surprises. Moreover, the proportion of workers covered by agreements incorporating such clauses rose from about 50 to nearly 75 per cent between 1998 and 2002. The existence of the clauses, which provide workers with an ex-post real income insurance, contributed to the adoption in 2002 of a national agreement on wage moderation negotiated on the basis of a 2 per cent inflation target. In fact, there has been a slight easing of nominal wage increases since the beginning of 2002, with collective wages rising by only 3 per cent, *i.e.* ½ percentage point less than in 2001. This moderation is likely, however, to be offset by the year-end activation of the catch-up clauses which, according to a first official estimate of the Ministry of Labour and Social Affairs, have increased wages by an extra 0.7 percentage points in 2002, instead of 0.4 per cent on average in recent years (Bank of Spain, 2002b). According to the national account data, compensation per employee growth decelerated by only 0.1 percentage points in 2002. The present system of negotiating compensation accentuates the nominal rigidity of wages, causing labour costs per worker to increase more than in the other euro area countries.<sup>15</sup> According to OECD estimates, this rise in per capita wage costs, coupled with slightly lower productivity growth, accounts for almost 60 per cent of the nearly 1½ percentage point inflation differential with the rest of the euro area between 1994 and 2002, as measured by the GDP deflator. The national wage moderation agreement has been renewed for 2003. It includes the same main features as the 2002 agreement. It contains again certain guarantees with regard to keeping permanent jobs in exchange for restraint on wages, which were set in accordance with Spain's official inflation target (2 per cent) and increases in productivity accruing either at the sectoral or firm level.

The indexation clauses frequently included in the collective agreements were in many cases retroactive so as to offset the impact of an inflation surprise. Such agreements pose two main problems. First, the social partners feel less responsible for inflation, whereas inflation (excluding energy and fresh food prices) is in the short term precisely the result of the interplay of their behaviour. While the authorities have stopped setting an official inflation forecast since the creation of European Monetary Union (EMU) and now refer only to an inflation target (2 per cent), the way the negotiations are organised results in the unions being

Figure 8. Inflation decomposition for Spain and the euro area<sup>1</sup>

1. The breakdown of inflation (measured by the GDP deflator) is obtained using the following accounting identity expressed in logarithm:

$$\frac{\text{GDP}}{\text{GDP volume}} = \frac{\text{Total compensation of employees}}{\text{GDP volume}} + \frac{\text{Net indirect taxes}}{\text{GDP volume}} + \frac{\text{Profits}}{\text{GDP volume}}$$

The first term represents unit labour cost of the whole economy, the second term represents the costs linked to net indirect taxes and the final term (defined as a residual of the identity) represents the contributions of profits and other revenues. Their weight in total inflation for the whole period is indicated in parentheses.

2. Labour cost (shown in panel A) is decomposed in panel B using the following identity expressed in logarithm:

$$\frac{\text{Total compensation of employees}}{\text{GDP volume}} = \frac{\text{Total compensation of employees}}{\text{Total employees}} + \frac{\text{Total employees}}{\text{Total employment}} + \frac{\text{GDP volume}}{\text{Total employment}}$$

The first term represents nominal wages, the second the employee ratio and the third productivity. Real wages are provided for information.

Source: OECD calculations based on national accounts data.

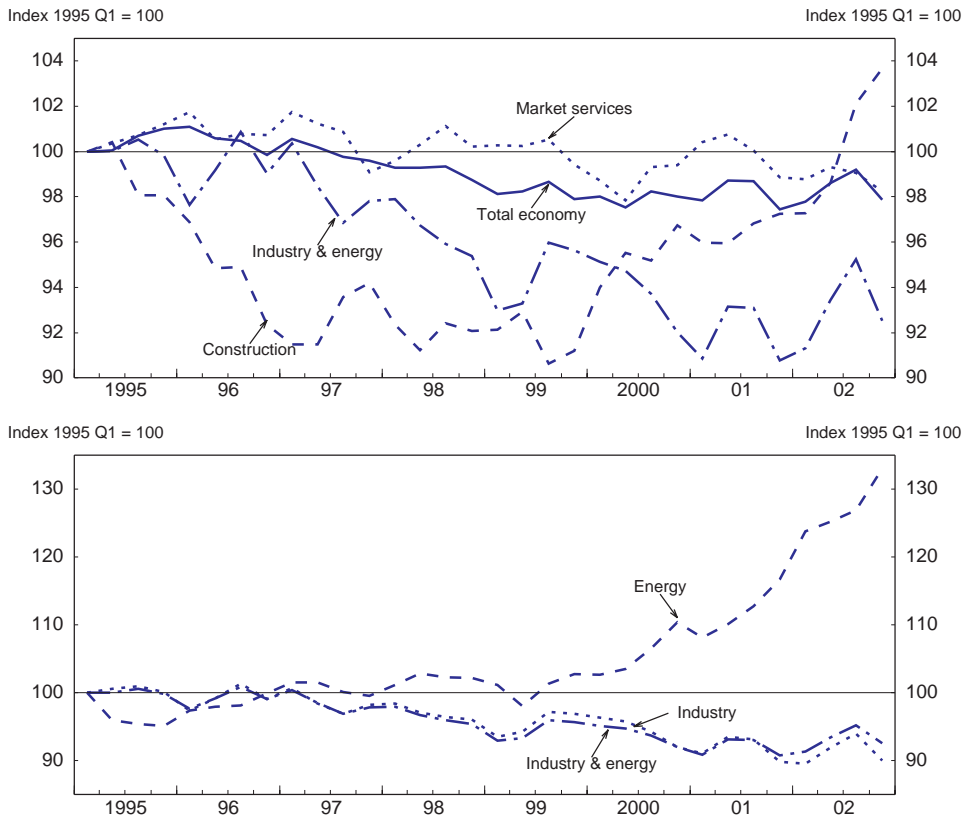
less concerned with nominal wage increases as long as they are guaranteed in real terms. Insofar as they are able to protect their profit margins – at least in the short term – by increasing prices, firms also seem to find such agreements satisfactory, even if in the longer term the impact on international competition, coupled with the lack of any possibility to adjust the exchange rate, will no doubt be prejudicial to them, especially in the exposed sector. Second, the present system of wage indexation depends on total rather than underlying inflation, which reduces the economy's ability to adjust to exogenous shocks such as an oil price shock. This form of indexation is moreover asymmetric, compensation not being adjusted in the event of price surprises that are favourable to wage earners. This lack of flexibility penalises Spain in relation to its main partners. In the current situation, a reform of the wage formation system is vital (Chapter III).

### ***Profit behaviour in certain sectors also keeps inflation high...***

Apart from wages, profit developments since the mid-1990s also partly explain the inflation differential between Spain and the euro area average. Profit margins, calculated on the basis of the gap between the GDP deflator and unit labour costs, account for approximately one-third of the differential. Although corporate profits have tended to decrease since 1995, that trend has been less marked than in the other euro area countries. Since 1995, in fact, profit margins have fallen markedly only in manufacturing, remaining stable in market services and picking up spectacularly in the construction and energy sector since 1999 (Figure 9).

A number of possible reasons have been put forward for the differences in profit margin behaviour across branches of activity. First, demand pressures differ between sectors, this having no doubt played a part in the construction industry and tourism in recent years. Second, several analysts have pointed to price convergence with the euro area countries, even though the empirical foundation for this hypothesis is fragile.<sup>16</sup> There can be a number of reasons for the existence of convergence, but some of them are improbable.<sup>17</sup> Amongst the possible causes, mention is sometimes made of the existence of a price adjustment phenomenon caused by Spain's entry into the euro area at an exchange rate that was undervalued in relation to its equilibrium value. However, while this sort of adjustment appears consistent with the fact that profit margins have held up better than in the other countries, it ought to happen mainly in sectors exposed to international competition, a low exchange rate enabling enterprises to raise their prices without running the risk of losing markets: this has happened in tourism. In the industrial sector, which is more exposed to foreign competition, Spanish margins developed as in the other euro area countries. All in all, the most likely explanation for profits increasing more steeply than in the other countries is the differential of demand while some analysts also have suggested in the past the possible inadequacy of competitive pressures in certain sectors of the economy (Chapter III). This lack of

Figure 9. Profit margins by sector



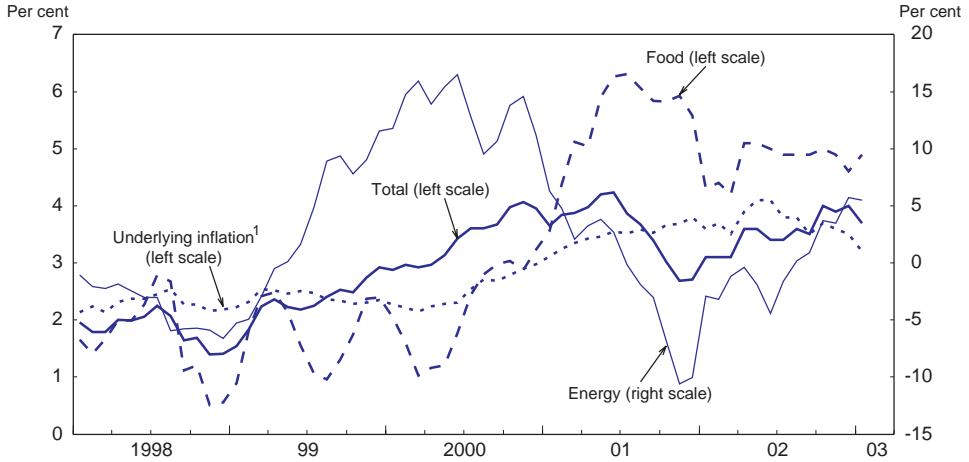
Source: INE.

competition, according to Estrada and López-Salido (2002) may have been a major cause for Spain's dual inflation problem in the 1990s. However, the increasing inflation differential in 2002 is mainly due to exceptional reasons such as the stronger than expected impact of the euro changeover, which may have added about  $\frac{1}{2}$  percentage point to consumer price inflation,<sup>18</sup> as well as other one-off factors.

### *... while certain specific factors have prevented greater price moderation*

The rise in the consumer price index reached  $3\frac{3}{4}$  per cent in February 2003 (year-on-year), which is twice the official inflation target, while underlying inflation was  $3\frac{1}{4}$  per cent (Figure 10). The lack of any disinflation

Figure 10. **Consumer prices**  
Year-on-year percentage changes



1. Excluding non-processed food and energy.  
Source: INE and EUROSTAT.

compared with 2001, despite lower import prices and the existence of a slightly negative output gap, was no doubt also affected by the euro changeover, the negative impact of weather on food prices and the rise in indirect taxes in early 2002, the impact of which is put at about  $\frac{1}{2}$  percentage point. Obtaining an accurate measurement of these specific effects, which are transitory in nature, is made more difficult by the change in method affecting the price index since 2002 (OECD, 2001a). In some sectors, the change has contributed to affect inflation measurement. With these particular factors disappearing in 2003 a more moderate increase in prices over the coming months is likely plus, perhaps, some narrowing of the inflation differential with the euro area, which has been some  $1\frac{1}{4}$  to  $1\frac{1}{2}$  percentage points since 1999 and a cumulative 6 to 7 percentage points since 1997 (Table 5).

### Fiscal policy in the short run

#### *Prudent fiscal policy has limited the expansionary effect of monetary conditions*

Monetary conditions have remained accommodating (Figure 11). With the easing of the ECB's monetary policy since end-2000 and inflation remaining higher than in the other euro area countries, the already low level of real interest

Table 5. **Inflation differential between Spain<sup>1</sup> and the euro area**  
Percentage points

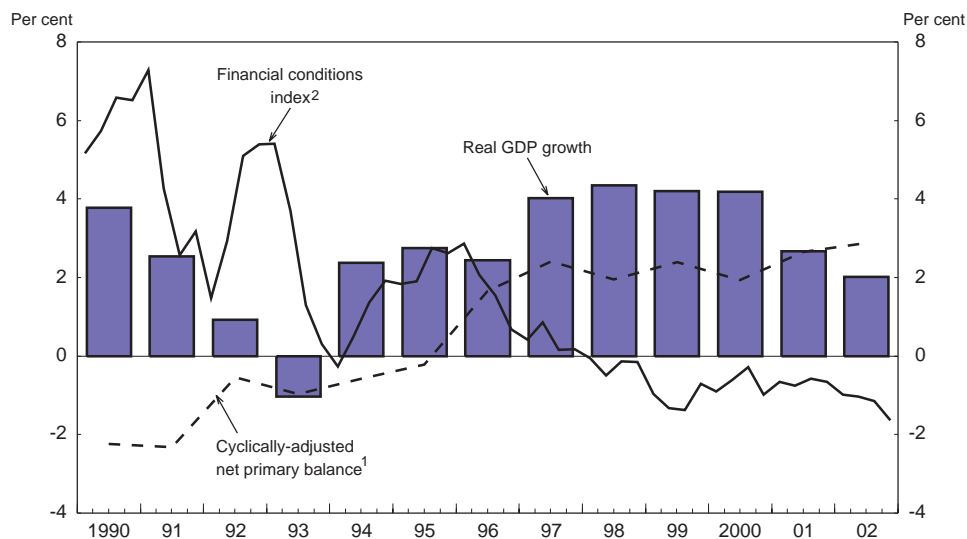
	Weight	1997	1998	1999	2000	2001	2002
Total	100.0	0.3	0.7	1.1	1.2	1.1	1.4
Energy	9.4	-0.3	-1.2	0.9	0.4	-3.3	0.5
Total excluding energy	90.6	0.4	0.7	1.2	1.7	1.7	1.5
Food	25.1	-1.5	-0.2	1.1	1.2	-0.2	1.9
Industrial goods	40.7	0.7	0.3	0.8	1.1	0.4	1.0
of which:							
Industrial goods excl. energy	38.1	1.0	0.5	0.9	1.5	1.7	1.2
Services	34.3	1.2	1.6	1.7	2.0	1.6	1.5
<i>Memorandum items:</i>							
Core inflation <sup>2</sup>	82.3	0.5	0.8	1.3	1.4	1.5	1.4
Producer prices		-0.1	0.1	1.1	-0.1	-0.5	0.8

1. The break of the Spanish harmonised CPI in 2001 has been adjusted using the national CPI as benchmark.

2. Total excluding unprocessed food and energy.

Source: INE and EUROSTAT.

Figure 11. **The macroeconomic policy stance**



1. As a per cent of potential output.

2. The financial conditions indicator is computed as the weighted average of the real short-term and long-term interest rate and the real effective exchange rate (based on unit labour costs in manufacturing). The interest rate variable has a unitary coefficient while the exchange rate coefficient is the ratio of exports to GDP.

Source: OECD.

rates dipped further, becoming negative for short rates. While the impact of this easing of conditions was to some extent offset by the appreciation of the euro against the dollar since the second half of 2002, domestic lending nevertheless continued to grow rapidly, reaching some 14 per cent during 2002. This indicates the ease of monetary conditions. Another indicator is provided by a Taylor rule, which suggests that three-month interest rates should currently be  $1\frac{3}{4}$ - $2\frac{1}{4}$  points higher.<sup>19</sup>

The easing of monetary policy throughout the euro area, which reflected the general weakening of the economic situation, was accompanied by a tightening of fiscal policy in Spain. The Spanish authorities quite rightly showed greater prudence than many other EU countries, even if the restrictive stance of fiscal policy has only partly offset the expansionary effect of monetary conditions on activity. It was also possible, thanks to this policy, to continue the consolidation of the government accounts that had begun in the mid-1990s by eliminating the public deficits.

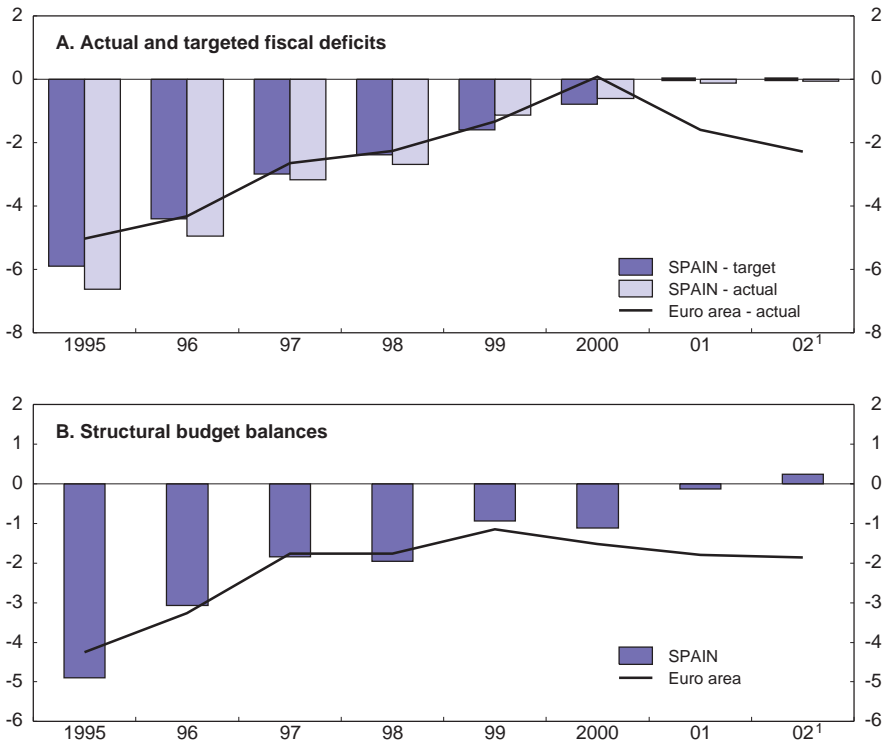
### ***Fiscal consolidation has been structural in recent years***

The fiscal consolidation begun in the mid-1990s has continued. The general government deficit, which stood at  $6\frac{1}{2}$  per cent in 1995, was eliminated in 2001 and a balanced budget was broadly maintained in 2002 (Figure 12). This performance, which is consistent with the official targets, was achieved despite the economic situation being less favourable than expected in 2001 and 2002. The structural improvement in the budget balance since 2000 has more than offset the negative effect of the cycle on public finances, in contrast with the euro area average. The consolidation process, which resulted in the general government primary structural balance improving by 1 per cent of GDP in the last two years, was based largely on better control of current expenditure, while the share of public investment in GDP has continued to increase since 1997 (Table 6). As a result, the reduction in the public debt/GDP ratio exceeded 12 percentage points between 1996 and 2002, falling to less than 56 per cent (Maastricht definition). Moody's has hence raised Spain's public debt rating and the long-term interest rate differential with Germany has practically disappeared.

### ***As in 2002, the 2003 Budget is designed to balance the accounts***

According to official estimates, the general government account recorded a slight deficit of 0.1 per cent of GDP in 2002. There are three main reasons for these favourable developments, despite an economic situation that is gloomier than initially forecast.<sup>20</sup> First, the budget was again prudent, the authorities indicating in particular that revenue projections had been based on historic elasticities (latest ten years) with respect to GDP that are notably lower with respect to

Figure 12. **Budget balances**  
As a percentage of GDP



1. Preliminary estimates.  
Source: OECD.

the elasticities of the latest five years. This surprise partly reflected past reforms aimed at simplifying tax collection and combating tax evasion. Second, despite the slowdown in activity, employment grew more than expected. As a result of the increase in contributions, the social security surplus and that of the public employment services (INEM) have systematically exceeded projections in recent years, despite unforeseen increases in retirement expenditure linked to adjustments in pensions, the purchasing power of which is guaranteed in the event of a surge in inflation.<sup>21</sup> The unexpected size of the surplus counterbalanced at least partly the overshoot on other government accounts – notably regional –



Table 6. The fiscal consolidation process

	1995	1997	2000	2002 <sup>1</sup>	2003 <sup>2</sup>	Change over period		
						1995-97	1997-2000	2000-02 <sup>1</sup>
<b>Per cent of GDP</b>								
Net lending	-6.6	-3.2	-0.6	-0.1	-0.4	3.5	2.6	0.5
Cyclical effects	-1.2	-0.8	0.5	0.1	-0.3	0.4	1.3	-0.4
Interest payments <sup>3</sup>	-5.2	-4.8	-3.3	-3.0	-2.9	0.5	1.5	0.3
<b>Per cent of potential GDP</b>								
Structural primary balance	-0.2	2.4	2.2	2.8	2.8	2.6	-0.2	0.6
Structural revenues	35.4	36.1	37.1	36.9	36.6	0.7	1.0	-0.2
Direct taxes	10.2	10.5	10.5	10.5	10.2	0.3	0.0	0.0
Indirect taxes	10.2	10.5	11.7	11.1	11.1	0.3	1.2	-0.6
Social security contributions	12.9	13.0	13.3	13.5	13.5	0.1	0.3	0.2
Other revenues	2.1	2.1	1.6	1.8	1.8	0.0	-0.5	0.2
Structural expenditure	35.8	33.8	35.1	34.2	33.9	-2.0	1.3	-0.9
Consumption	17.4	17.0	17.8	17.3	17.2	-0.4	0.8	-0.5
Investment	3.6	3.0	3.2	3.3	3.3	-0.6	0.2	0.1
Social security expenditure	13.3	12.8	12.5	12.1	12.0	-0.5	-0.3	-0.4
Other expenditure	1.5	1.0	1.6	1.5	1.4	-0.5	0.6	-0.1

1. Preliminary estimates.

2. OECD projections.

3. The fall in interest payments can be included among the structural factors as it reflects the permanent elimination of risk premiums on interest rates due to the sounder economic conditions achieved prior to joining the euro area.

Source: OECD.

in 2001 and 2002 (Table 7). Third, the rise in inflation helped to maintain brisk growth of nominal GDP and partially offset the effect of real growth falling short of the projection. In 2002, despite the increase in volume GDP perhaps falling 1 percentage point short of expectations, in nominal terms it will no doubt exceed the budget estimate.

A number of innovations affected the budget process in 2003. Drawn up on the basis of real GDP growth of 3 per cent, the aim of the budget is to keep the government accounts in balance, in accordance with the fiscal stability law which is being applied for the first time (Chapter II). This budget is also the first to be presented under the new process enacted by this law. A ceiling was thus placed on central government expenditure as early as March 2002 (with an increase restricted to 4.1 per cent above the 2002 spending projection). This ceiling includes a contingency fund equal to 2 per cent of expenditure, which has been established for unscheduled but non-discretionary expenditure inasmuch as it will no longer be possible to use end-of-year budget packages to finance unanticipated overruns. For instance, it will be used to cope with the aftermath of the

Table 7. **General government accounts**  
As a percentage of GDP

	1999	2000	2001	2002 <sup>1</sup>	2003 <sup>2</sup>
<b>Current receipts</b>	38.3	38.4	38.5	38.5	38.3
Direct taxes	10.2	10.5	10.5	10.9	10.5
Household	7.1	7.2	7.4	7.4	7.1
Business	3.1	3.3	3.1	3.5	3.5
Indirect taxes	11.7	11.7	11.4	11.2	11.2
Social security contributions	13.1	13.3	13.6	13.4	13.5
Other	3.3	2.9	3.1	3.1	3.1
<b>Current expenditure</b>	36.9	36.7	36.2	36.1	36.2
Government consumption	17.4	17.6	17.5	17.6	17.8
Subsidies	1.2	1.2	1.1	1.1	1.1
Social security outlays	12.4	12.3	12.2	12.2	12.2
Property income paid	3.5	3.3	3.1	3.0	3.0
Other	2.3	2.3	2.3	2.2	2.2
Net saving	1.4	1.7	2.3	2.4	2.1
Net capital outlays	2.5	2.3	2.5	2.5	2.5
<b>Net lending</b>	-1.1	-0.6	-0.1	-0.1	-0.4
<i>Memorandum items:</i>					
Net primary balance <sup>3</sup>	2.2	2.4	2.7	2.6	2.2
Net borrowing of:					
Central government	-1.1	-0.7	-0.5	-0.6	-0.5
Social security	0.2	0.5	0.8	0.8	0.5
Local and regional government	-0.2	-0.4	-0.5	-0.4	0.0

1. Preliminary estimates.

2. OECD projections.

3. Difference between the actual balance and net interest payments.

Source: Ministry of Finance and OECD.

Prestige oil tanker disaster, with budget costs initially estimated at around EUR 250 million. The 2003 Budget is, moreover, the first to be drawn up since the full implementation of the new financing agreement with the autonomous communities and the transfer to these regions of health spending, which changes the contours and responsibility of the main levels of government (Chapter II). However, these institutional changes make detailed comparisons of the government accounts with previous years difficult.<sup>22</sup> In the official documents, moreover, detailed accounts are provided only for central government (*i.e.* excluding regional and local government), which accounts for less than 55 per cent of the total budget.

On the revenue side, the main measure in the 2003 Budget concerns personal income tax cuts, which are officially estimated to amount *ex ante* to

EUR 3 billion in 2003 and EUR 0.6 billion in 2004 (making a total of ½ per cent of GDP). Coupled with the tax cut is a freeze on excise taxes on fuels and the abolition, for about 95 per cent of taxpayers, of the local tax on economic activities, which affects companies. Taken together, these measures explain why the 4.3 per cent increase in receipts is lower than the projection for nominal GDP growth (5.8 per cent). As already noted, the increase in State spending is capped at 4.1 per cent, with investment, spending on justice and security and social expenditure being given priority. When preparing the budget, an agreement was signed with public sector employees that provides for a 3.3 per cent increase in per capita wages in 2003, which includes a uniform 2.7 per cent adjustment and a productivity-linked increase of 0.6 per cent.<sup>23</sup> Against this background, it is planned to extend the opening hours of certain public services and to cut absenteeism by 20 per cent. The agreement also aims to put an end to the requirement that only one retiring civil servant in four be replaced, which has led to a sharp rise in temporary employment in the public sector. The intention in fact is to reduce the proportion of temporary jobs in the civil service from 22 to 8 per cent over the next few years.<sup>24</sup>

***In the present context, the neutral stance of fiscal policy is appropriate***

A number of criticisms have been levelled at the budget, the main one concerning the lack of transparency of some of the statistical information. This is probably a temporary problem deriving in particular from the ongoing process of decentralisation, but it is also due to sometimes not very homogeneous presentation of the government accounts.<sup>25</sup> Also, the macroeconomic projections look somewhat optimistic. The 3 per cent growth assumption, close to potential growth, which was made by the authorities in March 2002, when the central government spending ceiling was decided, is in fact ½ percentage point higher than the consensus forecast of March 2003. Moreover, consumers may save more of the tax cut than projected. According to the authorities, the net cost of the tax reform will be EUR 2 450 million in 2003, *i.e.* 80 per cent of the tax reduction estimated *ex ante*, because of the positive effect of the increase in activity on receipts. Since the tax cut takes place in a situation where government expenditure growth is subject to strict control, agents could however perceive it as permanent and therefore spend a sizeable part of the cut. Moreover, the social security budget appears to be based on prudent assumptions, bearing in mind the still brisk growth in employment and the continuing strong rise in nominal wages. A surplus in excess of the ½ per cent of GDP forecast for social security would again make it possible to offset a possible overrun on the regional accounts which are supposed to balance their budgets. All told, the budget could record a slight cyclical deficit in 2003 as the economy could be a little less robust than expected in the official projections. The neutral stance of fiscal policy

in 2003, following the restrictive policy pursued in 2001 and 2002, suits economic conditions, with growth remaining slightly short of potential and the output gap negative. Even though inflation developments remain worrying, the solution to this problem should come from structural reforms rather than fiscal policy.

## Prospects

According to the OECD's projections, presented in Table 8, economic activity should accelerate during the second half of 2003.<sup>26</sup> Conjunctural indicators at the beginning of the year do not suggest an imminent pick-up of activity. Industrial production has improved during the last months of 2002 as well as business confidence in January 2003, but consumer confidence weakened and car sales continued to fall. An export-led recovery in the second half of 2003 should be moderate due to the recent appreciation of the exchange rate and should pull equipment investment, while growth in the construction sector should ease slightly but still remain buoyant. In a context of a neutral fiscal policy overall, private consumption should strengthen, incomes being bolstered by income tax cuts, sustained employment growth and the wage catch-up pursuant to the indexation clauses activated following the inflation spurt in 2002. All told, GDP should grow marginally above 2 per cent in 2003, as in 2002, before accelerating to over 3 per cent in 2004, a rate higher than the euro area average. These figures are slightly below the March 2003 consensus projections and about 1 percentage point below the official forecast.

With the soft recovery and the continued strength of the labour force, unemployment rate might increase slightly in 2003 before edging down in 2004. Given a negative cyclical gap over the period, import prices remaining moderate with the exchange rate appreciation, and the absence of special factors like the euro changeover, inflation could fall back to less than 3 per cent in 2003 and below 2½ per cent in 2004. The decline in the inflation differential with the euro area is likely to be limited.

There are two major risks to this central scenario. The first relates to the strength of external demand which supports the recovery as from the second half of 2003. Although a sharper than expected acceleration in world economic activity cannot be ruled out, recent developments in the external environment point to the existence of downside risks, especially in some large European countries. A slower than expected international recovery would undoubtedly worsen the outlook. Business investment would also be lower if business confidence is not fully restored because of continuing international uncertainties or if new disturbances in Latin America further erode the profits of Spanish firms that have invested in that region. In such a context, a further loss of confidence on the part of consumers might cause them to reduce their spending and instead save most of the tax cut

**Table 8. Short-term prospects<sup>1</sup>**  
 Percentage changes from previous period<sup>2</sup>

	Current prices EUR billion 1999	2000	2001	2002	2003	2004
Private consumption	335.2	3.9	2.5	1.9	2.3	3.2
Government consumption	98.6	5.0	3.1	3.8	3.5	3.0
Gross fixed investment	136.1	5.7	3.2	1.4	2.6	4.1
Construction	72.4	6.1	5.8	4.5	3.3	3.3
Machinery and equipment	63.8	5.1	0.3	-2.2	1.8	5.0
Stockbuilding <sup>3</sup>	2.6	-0.1	-0.0	0.1	0.0	0.0
Total domestic demand	572.6	4.4	2.7	2.2	2.6	3.4
Exports of goods and services	155.5	10.1	3.4	1.4	3.9	5.8
Imports of goods and services	162.8	10.6	3.5	2.2	5.3	6.6
Foreign balance <sup>3</sup>	-7.4	-0.3	-0.1	-0.3	-0.5	-0.4
Gross domestic product	565.2	4.2	2.7	2.0	2.1	3.1
Household saving ratio (%) <sup>4</sup>		10.0	10.2	10.3	10.6	10.4
Employment <sup>5</sup>		5.5	3.7	2.0	1.4	2.1
Unemployment rate (%)		11.0	10.5	11.4	12.0	11.7
Private consumption deflator		3.2	3.3	3.6	2.9	2.4
GDP price deflator		3.5	4.2	4.4	3.0	2.4
Wage rate, total economy		3.7	4.1	4.3	3.7	3.5
Unit labour cost, total economy		3.7	4.2	4.3	3.2	2.6
Output gap (%) <sup>6</sup>		0.4	0.0	-0.8	-1.5	-1.2
As a % of GDP:						
Current account balance		-3.5	-2.6	-2.3	-2.4	-2.4
Net government lending		-0.6	-0.1	-0.1	-0.4	-0.2
Primary government balance		2.4	2.7	2.6	2.2	2.2

1. The projections are based on the following assumptions: oil prices are assumed to stay at USD 31 per barrel in the first half of 2003 before falling to USD 25 in the second half and remain there until the end of the projection period; exchange rates are fixed at their level of 7 February 2003 (1 EUR = 1.08 USD), implying an appreciation of the euro *vis-à-vis* the US dollar of 20 per cent since the first half of 2002.

2. At constant 1995 prices for GDP and its components.

3. Contribution to GDP growth.

4. Household saving as a percentage of household disposable income.

5. Labour force survey definition.

6. Deviations of actual GDP from potential GDP as a percentage of potential GDP.

Source: OECD.

granted in 2003. The materialisation of this risk, a quantification of which is provided in Box 1, would result in a cyclical deterioration of the budget balance, which could be accommodated, and a more marked reduction of inflation, although this would have little effect on the differential with the euro area. The second major risk concerns the evolution of the price of oil, which could pick up in case of a prolonged conflict in the middle-East, but could also be weaker in particular if the

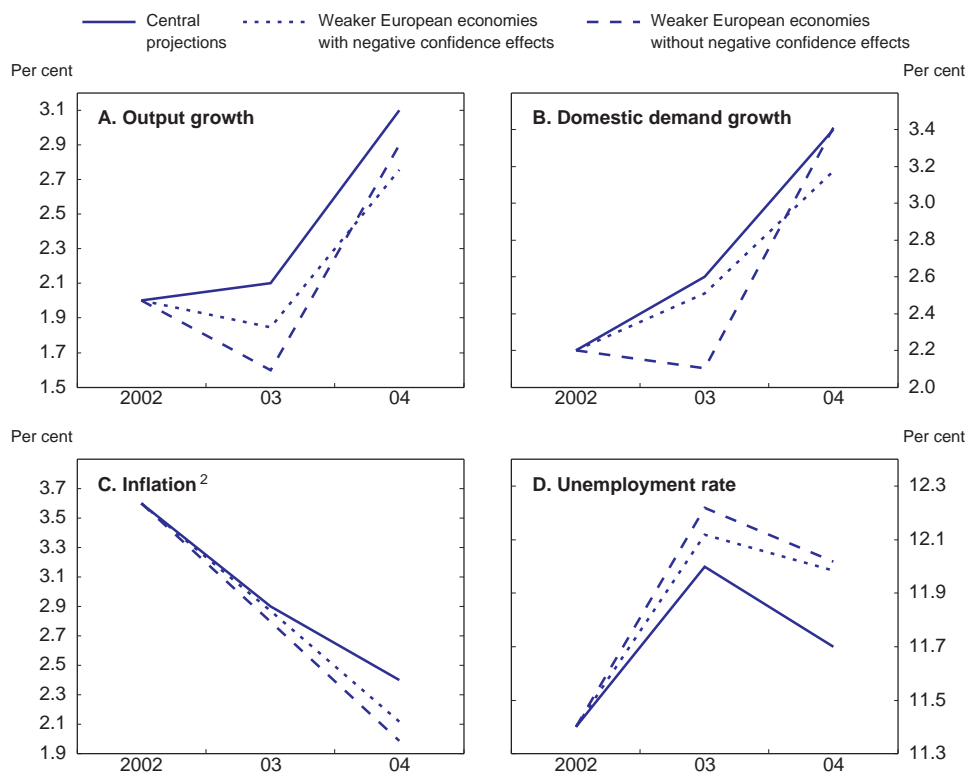
**Box 1. Risks to the outlook**

In order to evaluate the main risks surrounding the projections for 2003 and 2004, an alternative scenario has been drawn up with the OECD's Interlink model. It chiefly concerns possible developments in the international environment, but also the implications for households' behaviour.

The scenario quantifies the impact of a weaker than projected pickup of output ( $\frac{1}{2}$  percentage point) in 2003 and 2004 in the major European countries and their close neighbours, because of a less dynamic domestic demand.\* Activity would then also weaken in Spain by  $\frac{1}{4}$  percentage point this year and next relative to the baseline scenario, so that growth would amount to  $1\frac{3}{4}$  and below 3 per cent respectively in 2003 and 2004 (Figure 13). Inflation, which would show little change in 2003, would slow by almost  $\frac{1}{2}$  percentage point to around 2 per cent in 2004. In the alternative scenario, where the household saving ratio is virtually the same as in the baseline scenario, the slowdown in activity induces a rise in the unemployment rate, which does not fall below 12 per cent until 2004. A variant of this scenario evaluates the impact of a more prudent saving behaviour by households. It is assumed that in the event of a less favourable macroeconomic performance, households would increase their saving by an amount equivalent to half of the tax reduction granted to them *ex ante* in 2003 and 2004 (equivalent to  $\frac{1}{4}$  per cent of GDP bearing principally on 2003). In that case, GDP growth would amount to 1.6 and 2.9 per cent respectively in 2003 and 2004. With this variant, the budget would show a deficit of 0.6 per cent of GDP in 2003.

\* In the alternative scenario, as in the variant of it discussed a little later, nominal interest and exchange rates are the same as in the baseline scenario. The fiscal stance as measured by the structural primary balance is also unchanged. Given the linearity of the OECD's Interlink model, the simulations made can also be used (changing the sign of the impact) to evaluate the consequences of a stronger international upturn.

current crisis is resolved quickly. An oil-price shock would probably have much the same effect on short-term growth in Spain as in other European countries. According to the OECD's standard simulations, an oil-price hike (fall) of USD 10 per barrel in early 2003 would cut (raise) output growth by  $\frac{1}{4}$  percentage point in 2003. The rise (fall) in inflation might be roughly the same as in other European countries in 2003 ( $\frac{1}{2}$  percentage point) but steeper in 2004 owing to wage indexation. The result would be a widening (reduction) of the inflation differential. The gap, were it to persist, would erode the economy's competitiveness and in the medium term make it difficult to sustain the good performance recorded in recent years (Chapter III).

Figure 13. Risks of a weaker European recovery<sup>1</sup>

1. Represented by Belgium, Austria, France, Germany, Italy, Netherlands, Portugal and United Kingdom.

2. Change of the private consumption deflator over the previous year.

Source: OECD.

## Notes

1. As in the rest of the euro area, the introduction of the fiduciary euro resulted in a fall in demand for notes during the course of 2001, households being compelled to clear their cash reserves. That saving, put at 2½ per cent of GDP by the BBVA (2002a), seems to have been partly spent on consumer durables and housing in late 2001. This may have stimulated consumption by between ¼ and ½ percentage point in 2001, which would partly explain why it grew more slowly in early 2002 (Laborda, 2002).
2. According to Farré and Raymond (2002), the wealth effect on household behaviour is significant and of the same order of magnitude in Spain as in the other main OECD countries: a rise in total wealth by one euro results in a fall in the saving ratio by nearly 4 cents. These authors claim that the bulk of the reduction (by 4 percentage points) in the household saving ratio between 1995 and 2000 was due to the increase in wealth (over 40 per cent in real terms), itself stemming from the rise in the relative prices of financial assets and real estate. Since 2000, the continuing rise in house prices has offset the stock market fall.
3. The number of dwellings has increased on average by nearly 500 000 over the last four years, whereas the number of new households has risen by only 200 000 (Bank of Spain, 2002a).
4. According to Tinsa Real Estate Appraisals, approximately one-third of real estate purchases in autumn 2002 were for investment purposes. This investment, which takes the form of purchases of second homes or of property for children, is one of households' favourite ways of saving to protect themselves against the risk of inflation.
5. The proportion of households with both members working rose between 1992 and 2000 by 12 percentage points to 43 per cent, though this remains well below the European average (60 per cent). Measured against household income, the effort required to finance an average mortgage loan remains fairly moderate from an historical point of view, despite the recent rise in real estate prices (Bank of Spain, 2002a). A discussion of the risks of a speculative bubble is also provided by Balmaseda *et al.* (2002).
6. In the Balearic Islands, moreover, the introduction of a special green tax on tourism may have had an effect.
7. Prices of hotel and tourism services have climbed by an annual average of 9½ per cent since 1997, which is 6½ per cent more than in France and 4½ per cent more than in Italy.
8. For example, lower wage costs in countries such as the Slovak Republic prompted the car manufacturer Seat to transfer part of its production to that country during autumn 2002. According to Muñoz (2002a), foreign firms have been cutting back on their net investment in the industrial sector in Spain, though not in services. This



author argues, however, that this process has more to do with the restructuring by multinationals throughout Europe than with Spain losing its comparative advantage in terms of wage costs.

9. Temporary employment accounted for only 13.2 per cent of total employment in the EU in 2001. The reduced use made of temporary contracts in the private sector in Spain was partly offset by an increase in the public sector.
10. The capital-labour ratio has fallen in recent years and the share of salaries in value added, which went from 52.2 per cent in 1993 to 49.8 per cent in 1996, rose slightly to 50.1 per cent in 2001.
11. At end-2003, the National Statistical Institute (INE) will present the revised ESA 95 national accounts figures, calculated for the base year 2000. There are a number of indicators, such as the buoyancy of tax receipts and the steeper-than-expected population rise (revealed by the 2001 census) resulting from increased immigration, which suggest that GDP might be revised upwards.
12. Between 1995 and 1999 (the period for which detailed data are available), 70 per cent of jobs (measured in full-time equivalent) were created in sectors where productivity was lower than the national average. Over 50 per cent of jobs were created in sectors where apparent labour productivity was less than 75 per cent of the national average. See also Estrada and López-Salido (2001) on this subject.
13. According to a study carried out by the Bank of Spain (Estrada *et al.*, 2001a) for the period 1996-99, nearly three-quarters of Spain's productivity gap with the EU is due to a different production structure, whereas only a quarter of the gap derives from a lower level of sectoral productivity.
14. The statistical changes that the INE introduced in the labour force survey with effect from the first quarter of 2002 brought some major revisions in labour market statistics. As reported in the previous survey (OECD, 2001a), there have been three main changes: *i*) a revision of the labour force to take account of new immigration figures; *ii*) an adjustment in the system of reweighting the sample deriving from the labour force survey; *iii*) the way unemployment is calculated has been made consistent with Eurostat norms. For 2001, these changes meant revising employment upwards by 8 per cent and the labour force by 5 per cent, while the unemployment rate was reduced by 2½ percentage points.
15. According to the INE, the total cost of work, per worker and per month, has risen by some 5 per cent on average across the whole economy since early 2001. This is 1½ percentage points higher than in the euro area for which Eurostat publishes homogeneous statistics. In the case of Spain, the sharp rise in labour costs partly reflects a bigger increase in non-wage costs than in the other countries, this being due to the raising of the ceiling on social security contributions for the least skilled workers, which is now the same for all job categories. The rise in non-wage costs may also be partly attributable to the suspension of the subsidies, which certain contracts had hitherto benefited from.
16. Rogers (2001), for example, draws attention to the existence of a price convergence phenomenon in the case of Spain. The empirical findings presented in this study depend, however, on the specification of the equation estimated.
17. As indicated in the previous OECD survey (OECD, 2001a), for example, it is hardly likely that price convergence between Spain and the euro area is the result of rising wages in the service sector due to a catch-up in industrial productivity, as described by Balassa and Samuelson. Productivity growth has been lower in Spain than in the

other countries in recent years and the increase in prices of services is closely linked with the trend in profit margins in the latter sector.

18. According to the Spanish Government, the effect of the introduction of the euro on inflation in 2002 may have been slightly more marked than in the other countries because of the special difficulty of converting pesetas into euros.
19. Taylor rules typically relate short-term interest rates to the output gap and inflation developments relative to inflation target. Such rules, estimated on the basis of underlying inflation for the euro area but used for Spain, suggest that short-term interest rates should be around 5¼ per cent if a 1½ inflation target is assumed and around 4½ per cent in the case of a 2 per cent target. The three-month interest rate averaged only 2.85 per cent in early January 2003.
20. As in 2001, activity in 2002 turned out lower than forecast. The 2001 budget was initially based on an assumption of real GDP growth of 3.6 per cent, and of 2.9 per cent for the 2002 budget. In 2001, growth finally reached 2.7 per cent and was around 2 per cent in 2002.
21. In 2002, with inflation overshooting the initial target by nearly 2 percentage points, pensions expenditure again had to be increased by a total of EUR 2.1 billion, or 0.3 per cent of GDP, which is spread evenly over the 2002 and 2003 budgets.
22. Monitoring of the budget out-turn was also difficult in 2002 because of the ongoing process of decentralisation and the lack of information at the regional level. Discussions concerning the quarterly publication of government (including regional) accounts are under way with a view to improving the monitoring of the budget outturn. A new Eurostat regulation will effectively be in force as from 2003 whereby all levels of government will be obliged to report quarterly budget outturns. One of the obstacles to the implementation of this regulation is the difficulty of applying the ESA 95 methodology to lower levels of government.
23. The agreement in the public service also provides for a 3.2 per cent increase in 2004, of which 0.5 per cent represents a deferred wage increase in the form of a pension fund set up for civil servants.
24. Over the past 15 years, the number of civil servants has risen by 800 000, which is 3 per cent per year (Caixa, 2002). This sharp increase is attributable in particular to decentralisation and the development of the autonomous communities, where over 80 per cent of these jobs were created, whereas the number of central government public servants has declined. Despite having risen so rapidly, the proportion of government jobs, at 14.5 per cent of total employment, was not high in international comparison (OECD, 2001a). Recently, the restrictions on recruitment to the civil service have resulted in an appreciable increase in temporary jobs, especially at the regional and local level. The share of temporary employment in the public sector, for example, rose from 16.6 to 22 per cent between 1997 and 2002, whereas it fell from 38.8 to 34 per cent in the private sector.
25. Sometimes information on general government is presented with reference to the forecast end-2002 outturn, which is useful, but is usually made in comparison with the initial 2002 Budget, which is inadequate.
26. The projections are based on the following assumptions: oil prices are assumed to stay at USD 31 per barrel in the first half of 2003 before falling to USD 25 in the second half and remain there until the end of the projection period; exchange rates are fixed at their level of 7 February 2003 (1 EUR = 1.08 USD), implying an appreciation of the euro *vis-à-vis* the US dollar of 20 per cent since the first half of 2002.

27. The basket also includes the tax on electricity and on car registration and devolved taxes (on wealth, inheritance and donations, gambling and stamp duty).
28. The previous income tax reform lowered the top rate from 56 to 48 per cent, and the minimum rate from 20 to 18 per cent.
29. Revenues from mutual funds are considered as capital gains by the 1999 law, not capital income, so that they are taxed at a flat 15 per cent rate (instead of the marginal rate), if generated in more than one year.
30. Tax exemption for rental income, though good for the development of the market of rental housing and labour mobility will also subsidise the numerous holiday rentals.
31. Those businesses whose activity falls outside the geographic application of the tax (like exporters and importers) will not be allowed to pay tax under this regime.
32. After the 1999 reform, the tax brackets were modified in 2000 but not in 2001 and 2002.
33. According to the 1998 law, local authorities can only resort to fees if a direct link can be established with the cost of the service to be financed. According to Martinez (2000), the municipalities' lack of information in this area partly explains why little use is made of this source of finance.
34. Spending efficiency will be enhanced by management improvements. A recent example is the extension to the whole of Spain of a control system developed in Andalusia for prescriptions of anti-inflammatory drugs. More generally, the indicators could gauge the budgetary management of the regions and the central government. The publication of such information in other federal countries, coupled with the existence of local referenda, represents a powerful incentive to take account of the aspirations of the population and keep tighter control over public finance (OECD, 2002a).
35. Hospital reform has also been slowed by the completion of the decentralisation of health spending to the 10 communities that did not as yet have that responsibility in 2002. In late 2000, the government had suspended the reform process, pending the transfers of responsibility.
36. A 1998 Court of Auditors study on hospital activity showed that some hospitals were paying up to twice as much as others for the same drug. According to the body that managed non-decentralised health services up until 2002 (INSALUD), the rules governing tenders for procurement contracts relating to advertising and competition, as laid down by law, were not applied in half of these contracts.
37. Despite the budgetary restrictions, the number of doctors has increased since the mid-1990s, suggesting wage restraint.
38. According to official estimates, these measures had the effect of slowing the growth of public spending on prescription drugs by 7 percentage points between 1999 and 2002. However, over 40 per cent of this reduction was due to the narrowing of margins on drugs, the effect of which is temporary. Consumption of generic products rose to 3.4 per cent of pharmacy spending in value terms and was put at 6.7 per cent in real terms in May 2002.
39. In 2003, minimum pensions will be raised by 5½ per cent, *i.e.* 1½ per cent more than the inflation-linked adjustment, whilst survivors' pensions will be increased by some 8 per cent. The budgetary cost of these measures amounts to EUR 335 million.
40. The bulk of the 28-page report on Spain's national strategy by the Ministry for Social Affairs concerning the future of the pension system deals with the period 2000-15, whereas the pressures liable to emerge after that period are discussed in only three lines. An annex to the report contains an extrapolation of pension expenditure projections up

to 2040, *i.e.* 10 years before the demographic pressures peak. Also, the projected 3¼ per cent of GDP increase in pension payments between 2020 and 2040 seems very optimistic. The assumptions underlying this projection are, first, a decrease in the number of pensions for the population aged 65 and over – despite the rise in female labour force participation and the possibilities of combining retirement and survivors' pensions without means-testing – and, second, a decrease in pensions relative to productivity (and real wages), contrary to the trend during recent years. The Stability Programme 2002-06 (Ministry of Economy, 2002) includes also unofficial projections similar to those of the Ministry of Social Affairs until 2040. These projections are extended until 2050 and project an increase of public pension spending by 4½ per cent of GDP between 2020 and 2050.

41. The INE will publish at the end of 2003 new demographic projections based on the results of the 2001 census.
42. The uncertainties, which chiefly concern economic and demographic developments, are both positive and negative, and their implications are frequently subjected to sensitivity analyses (OECD, 2001a).
43. Since 1980 pensions have been growing on average by 1½ percentage points more than wages. Were this trend to continue, there would also be problems of income distribution, especially since, according to the authorities, the elderly are less subject to poverty than labour force participants and the unemployed in particular (Ministry of Labour and Social Affairs, 2002).
44. It would seem reasonable for persons who will be retiring at age 65 in 2015-20 to know at least by age 55, how their pensions will be calculated. This means that the reform has to be adopted between 2005 and 2010, *i.e.* during the next parliamentary term.
45. The INE will present at the end of 2003 revised national accounts, which will take into account, among other things, the new census for 2001.
46. The Bank of Spain periodically publishes several indicators of convergence with the European Union. For those on the stock of public and private capital, see Bank of Spain (2002b).
47. For an exhaustive account of such externalities, see OECD (1999) that follows Calmfors (1993).
48. However, the empirical evidence in favour of this hypothesis is not conclusive (OECD, 1997a).
49. For a background for these attempts, see Bentolila and Jimeno (2002).
50. Wage increases have been more moderate at the enterprise level than at the sectoral (provincial or national) level, although this is partly due to the fact that they are usually signed in larger firms, where wage levels are higher to start with, and workers receive higher non-wage benefits (Fina *et al.*, 2001).
51. Out of 18 OECD countries, it is longer only in the Netherlands, Denmark, France and Norway.
52. Countries like the United States and the United Kingdom do not have unemployment assistance after unemployment benefits have expired, while Australia and New Zealand do not have a UI system.
53. Out of 800 000 temporary workers in agriculture, 600 000 live in Andalusia and Extremadura.

54. Abuses of the system were reported in the past. In particular, some enterprises issued false certificates of days worked, while some municipalities did the same in public works. This type of abuse seems to have almost disappeared in recent years.
55. The May 2002 decree suppressed the PER completely for new entrants, *i.e.*, for those who have not received the subsidy during the last three years. The new, temporary subsidy for new entrants in the PER system will be limited to those who have been resident in the area for at least ten years, which will exclude most immigrant workers.
56. Individual dismissals may be “justified” by the law depending on different criteria, including economic reasons. In practice, most dismissals are declared “unjustified” by courts, carrying higher severance payments.
57. Those unemployed workers who take up co-operative work and handicapped workers who set up as self employed were already able to capitalise their benefits as initial investment and will now be able to use part of their benefits to pay social security contributions.
58. Such a measure should probably be accompanied by a simplification of the different types of temporary contracts. There are too many, which makes contract management difficult.
59. Quality of university education is very difficult to pin down and measure, though the literature on this subject points to several weaknesses. The Bricall *et al.* (2000) report, written by a group of experts prior to the most recent reform, points out that the structure of university institutions is somewhat old fashioned and teaching is focused to knowledge transmission rather than learning processes. Mora *et al.* (2000) stress that high unemployment rates among the young with university degrees reflects, among other factors, the lack of preparation of Spanish graduates to changing professions and skilled requirements, as the education system is too focused on professional education. Mora and García (1999) show that the cost per student of university education is relatively low because the number of services offered other than lectures is also limited.
60. 100 per cent of children aged 5 go to school, 98 per cent at age 4, and 75 per cent at age 3. Only France, Italy and Belgium have higher rates.
61. Enrolment rates are 1.3 per cent for under one-year-olds, 5.7 per cent for those aged 1 and 13.7 per cent for those aged 2.
62. In particular, schooling at this stage will be considered “assistential” as well as educational, implying that not all pedagogic staff will be required to hold university degrees.
63. Most private schools are financed by the State through special agreements (*concertos*) covering current expenses. Investment in private education is paid by the school, which can receive extra finance from students through fees. Private schools that receive public funds are obliged to follow official guidelines in their curricula and the same admission criteria apply as in public schools.
64. That is another flexible way to obtain the compulsory secondary education certificate and provides a link with the other post-compulsory formal education paths.
65. The new national tests (*Prueba General de Bachillerato*) will substitute a previous exam that was required only for those who wanted to access university.
66. See OECD (2002c).
67. The FORCEM has been renamed after the entry of the government in its management, as the *Tripartite Foundation for Training for Employment*.

68. The number of demands for training covered 4.7 million workers in 2000; about 80 per cent were approved and implemented.
69. Good indicators of university performance are not easy to find. One possible good indicator is a low drop-out rate (although, in this case, provisions would have to be made so as to ensure that universities do not minimise drop-out rates by accepting only the best students).
70. Spending on grants is 11 per cent of total public expenditure in tertiary education (against 12 per cent in the OECD), covering mostly fees, and in some cases some help for books and transport. The fact that grants do not cover the actual cost of living is also a factor behind the low mobility of students.
71. The OECD index of tax advantages for R&D expenditures reveals that, for each unit spent by large firms on R&D, one third is recovered in lower tax payments. This is the highest ratio out of 24 OECD countries reviewed, and almost double that of the second country ranked, Canada.
72. Annual employment growth for scientists and engineers was 8 per cent between 1995 and 1999, much higher than average employment growth and one of the highest in the OECD.
73. The rise in the birth rate between 1960 and 1975 increased households' residential investment owing to the higher rate of acquisition of housing by those aged 22 to 32 years (Eguía and Echevarría, 2001), *i.e.* at the time of getting married (Namkee, 2001).
74. House purchases by non-residents have increased sharply since 1993. The pressure exerted by foreign demand in tourist areas is also causing property price disparities to widen across the country. Up to 1991, tax incentives also encouraged Spanish residents to buy second homes.
75. Land prices have more or less doubled in Madrid since 1997 (Bank of Spain, 2002a).
76. These restrictions on the rental housing market were removed by the 1985 reform.
77. Leases dating from before 1985 could be extended indefinitely. Rents relating to contracts signed before 1964 were frozen, whereas those signed between 1964 and 1985 could be linked to inflation.
78. A study of the Economic and Social Council (CES, 2002) indicates that the proportion of youngsters between 20 and 34 that have left their parents' home has decreased from 44 to 33 per cent between 1977 and 2001. This phenomenon, which reflects longer time spent at studying and problems of unemployment and unstable employment for the young, seems to be more intense than in other countries, and has probably contributed to reducing fertility rates.
79. The object of this assistance is to facilitate the purchase of a home at reduced prices by means of loans at preferential rates and subsidies.
80. In Barcelona, for example, some 50 per cent of rental accommodation comes under rules imposing low rents and the renewal of contracts until the death of the tenant or the tenant's spouse (or until their children are 25 years old) (Trilla and Carreras, 2001).
81. According to Pareja and San Martín (2002), the rate of return on rental investment has been lower than that on public debt since 1984, although the gap has narrowed since 1998.
82. The competence of the municipalities and autonomous communities as regards land management was confirmed by the decision of the Constitutional Court to rescind the

measures taken by central government in June 2000 with the objective of restricting the communities' discretionary powers as regards issuing building permits.

83. Since the Act of 1998, an urban plot of land, *i.e.* land complying with certain technical characteristics, has been considered *a priori* to be developable, unless a decision to the contrary is taken and is properly argued. Under the communities' town planning rules, however, other conditions have been imposed which *de facto* prevent owners from exercising their right to build until they have obtained formal permission from the municipal or regional authorities. The process for disposing of land for construction are long (three years on average, sometimes much more), complex and uncertain.
84. Income from principal homes occupied by their owners (imputed rents) ceased to be taxed in 1999.
85. Comunidad Valenciana, Andalusia and the Basque Country.
86. In practice, most regional governments stick to the national minimum of 13 Sundays. The autonomous community of Madrid allows the largest number of Sunday openings, namely 21.
87. The association of hypermarkets claims that about 50 new shopping centres are on the waiting list for opening permits.
88. Telefónica's share of access lines was 95 per cent at the end of 2001, 82 per cent in the national long distance market (share of minutes) and 83 per cent in international traffic minutes.
89. The approved price cut was 2 per cent, as it was foreseen in the original price cap system, although the connection fee has been taken out of the price cap system and has been increased by 8 per cent, ending the tariff re-balancing process. Simultaneously, the regulator adopted some other measures to foster competition, like a new single invoicing mechanism for pre-assigned customers, and reinforced rules for public procurement of telecommunication services.
90. Telefónica lowered its investment in cable networks in 2000 when it focused its broadband strategy towards ADSL technologies. The main company in the cable business is Auna, which also owns Retevisión (the second fixed telephony operator) and Amena (the third mobile operator).
91. The government has pressed operators to accelerate its development, and could withdraw the deposits paid by the operators when the licences were given, since investments have been delayed. The government has recently liberated cable and radio-telephony operators from their investment agreements, but not UMTS operators.
92. Modernisation measures will only apply to older vessels (5 or more years old) and only for improving security, not efficiency of catches; construction will be linked to somewhat stricter decommissioning rules for old vessels; and exports to third countries in joint venture agreements will only be possible with those countries that have signed a fishing agreements with the European Union.
93. For instance, the legislation has allowed the recent merger of the clearing and settlement systems of all secondary markets, which has taken place as a result of this initiative. Although a *de facto* monopoly system, the law leaves the door open for other competing systems.
94. New regulations on the take over bid (OPA) regime in stock markets are also being prepared, following some episodes of sales of controlling stakes which were just at the limit that obliges the launch of an OPA, although they will depend on the corresponding European directive on the issue.

95. Venture capital investment is equivalent to 0.25 per cent in Italy, 0.38 per cent of GDP in France, 0.48 per cent in the Netherlands and 0.85 per cent of GDP in the United Kingdom.
96. To protect the initial stability of stock values, stock market regulations oblige the main owner of a firm to keep a participation for some time when it is publicly offered. Up to now, this resulted in the loss of any tax advantages for the venture capital entity, which prevented them from offering the participated firms in the stock markets. The new regime addresses this problem by extending tax advantages for two years after admission to trading on a regulated market.
97. In fact, saving banks have acquired very few and very small commercial banks. On the other hand saving banks reinforce competition in the market. The possibility of privatising saving banks is not on the politic agenda.
98. In a comparison by the Bank of Spain for the period June 2001 – June 2002, profits of Spanish banks fell by 10 per cent, whereas those of French banks fell by 20 per cent and those of German and Italian banks by more than 35 per cent.
99. The two largest Spanish banks, BBVA and Santander, invested heavily in Latin America in past years. Consolidated foreign claims of Spanish institutions in the area (which exclude loans of affiliates of Spanish banks in domestic currencies, that are less prone to devaluation risks) amounted to USD 48 billion in December 2001. Of these, 32 per cent originated in Argentina, 30 per cent in Mexico, 10 per cent in Brazil and 9 per cent in Chile. Claims on Argentina fell strongly during the first half of 2002 due to devaluation and to the partial reduction of positions in the country by Spanish banks.
100. In part because the Bank of Spain imposes stricter solvency ratios for Spanish banks.
101. These two alternative scenarios assume the same exchange and nominal interest rates as the baseline scenario. Furthermore, public spending is maintained stable in real terms with respect to the reference scenario.
102. Potential growth in the euro area, which is estimated at about 2 per cent between 2005 and 2008, tends to decline slightly due to the negative effect of ageing.
103. Council Decision (2002/358/EC) of 25 April 2002 concerning the approval, on behalf of the European Community, of the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the joint fulfilment of commitments thereunder.
104. Some co-generation facilities are ineligible for support as they fail to meet efficiency criteria.
105. In 2001, for example, the premium per kilowatt hour for renewable energy varied from EUR 0.03 for electricity generated from biomass to EUR 0.36 for small-scale solar energy electricity production (National Commission for Energy, 2002). Energy recovery from the incineration of waste also receives a feed-in premium. From 2007 this system will end support for larger co-generation facilities.
106. Support was granted for energy saving projects, the installation of co-generation capacity, and promoting the use of natural gas and renewable energy sources.
107. Some expansion of existing plants has been allowed.
108. Not only are emissions of carbon dioxide in this sector the highest per kilowatt hour of electricity generated, but the externalities due to other conventional pollutants are also substantially higher than for other major electricity generating sectors (CIEMAT, 1997). For example, the sulphur content of domestically produced coal is high (IEA, 2001).



109. The domestic coal industry is regionally concentrated and so appropriate, temporary assistance might be required for these regions. However, concerns over the security of supply of coal are less important (IEA, 2001).
110. For example, Capros and Mantzos (2000) estimate that marginal abatement costs of a sectoral approach with identical reduction targets would rise to EUR 348 per tonne of carbon from EUR 103 in the case of an optimal allocation of abatement efforts in Spain alone.
111. Almost three-quarters of the financing is expected to come from the European Community.
112. The expansion of gas powered electricity generation will also allow a further downsizing of support to the coal industry.
113. For emitters not participating in the EU trading scheme, carbon taxation could be usefully applied, if the implicit tax on carbon embedded in fuel taxation does not exceed the price of allowances. In particular, carbon taxation on the fuels used by small-scale combustion plants that will fall outside the EC emission trading scheme could help reduce the overall cost to the economy of achieving greenhouse gas targets.
114. Waste statistics in Spain have recently been reviewed. Reporting methodologies across autonomous communities have differed substantially over time making the determination of trends extremely difficult.
115. In particular, Directives 75/442/EEC on waste and 99/31/EC on the landfilling of waste. For this reason the European Commission has opened infringement proceedings against Spain on the grounds of several actions of illegal dumping with the view of bringing the Kingdom of Spain to the European Court of Justice.
116. *Normativa e instrumentos de gestion en materia de residuos.*
117. In reducing the amount of waste generated the government has required larger firms to prepare waste reduction strategies. In the case of packaging waste, the reduction is expressed in terms of packaging weight relative to the weight of the product.
118. These include Ecoembes (for general packaging waste), Ecovidrio (glass), and Sigre (pharmaceutical packaging). If companies do not join such a system, they are required to implement a deposit-refund scheme. Industrial packaging must be sent to an authorised operator for disposal.
119. The packaging law (following the EC directive) required that between 25 and 45 per cent of all packaging must be recycled, but that recycling of an individual packaging material need only reach 15 per cent.
120. Annual outlays have been above EUR 10 million in recent years, with remedial action taking place at 275 contaminated sites.
121. The EC Water Framework Directive will require full-cost recovery by 2011.
122. These prices refer to those charged in the Jucar and Almeria counties (Albiac-Murillo *et al.*, 2002).
123. Agricultural support policies may also be indirectly contributing to demand for irrigation water. See also Chapter IV.
124. These changes were introduced in the 1999 amendments to the Water Act. New irrigators would pay half the capital costs for new infrastructure and be required to cover operation and maintenance costs.
125. Such a policy would be equivalent to grand-fathering existing rights and allowing trading.
126. The national analysis uses a 50 year timeframe for the cost analysis with a real discount rate of 4 per cent.

127. Desalination costs vary considerably according to the size of plant and the amount of electricity that can be sold. A range of cost of between EUR 0.3 and 0.4 per m<sup>3</sup> is suggested by Uche *et al.* (2001).
128. Almost a third of the land under irrigation is based on systems over a century old (Ministry of Agriculture, Fishery and Food, 2002).
129. Public investment is limited to existing and uncompleted irrigation systems, though new irrigation schemes of a “social nature” may also receive funding.
130. Foreigners referred to in this chapter are foreign citizens, as Spain bases its statistics on nationality rather than place of birth.
131. For an analysis of ageing in Spain see OECD (2001a).
132. Up to 2003 EU citizens were obliged in principle to obtain a residence card. As from March 2003 this obligation no longer applies to those working or studying in Spain, following the implementation of the 28 July 2000 Marseille Declaration, although EU citizens must apply for a number of identification of foreigner (N.I.E), which is necessary for bank operation, etc.
133. The total number of undocumented foreigners is uncertain. In June 2001, Enrique Fernández-Miranda, the Delegate of the Government for Immigration, declared that Spain had about 1.2 million immigrants on its territory (*El Mundo*, 10 June 2001); the number of foreign residents officially-registered by the Ministry of the Interior on 31 December 2000 was around 896 000 and 1.1 million at end 2001.
134. There are no statistics on the return of foreigners to their country of origin or to any other country.
135. Besides, income distribution is generally wider in these countries, and has often worsened since the 1980s, which makes the incentives to migrate all the greater for low-income people.
136. This figure is in addition probably underestimated, since, as in most developing countries, informal activity is high and under-employment too.
137. See OECD (2002d).
138. The countries covered in this survey are the 22 members of the League of Arab States, which includes North African countries and Arab Middle-Eastern countries, with a population of 280 million in 2000.
139. Up to 1985, Spanish legislation characterised immigration-related issues as matters of “public order” (and therefore the exclusive responsibility of the Ministry of Interior) and issues related to settlement of foreign nationals in Spain were very weakly regulated. For a review of Spanish migration policy until 1999, see Moreno Fuentes (2000).
140. Rights to meeting and association were limited, although these aspects were softened on a number of occasions by the courts; family reunification rights were not recognised.
141. The Immigration Act is the result of two laws. The “*Ley de extranjería 2000/4*” was adopted in December 1999, after two years of negotiation between all political parties in a parliamentary commission, and put a strong focus on integration issues. It was reformed a few months later by the “*Ley de extranjería 2000/8*”, that put more emphasis on the control of immigration flows. One of the main points of disagreement was the introduction of a permanent possibility for undocumented foreigners to obtain a temporary residence permit if they could prove that they had stayed two years in Spain and had sufficient means of subsistence, which was denounced as providing incentives for immigrants to come illegally. The new Act extends the period of stay to five years.

142. Undocumented foreigners do not have the rights of meeting, association, unionisation and strike. Being in Spain without authorisation is a serious offence that can be punished by expulsion instead of a fine. Documented foreigners committing offences that can be punished by one to six years of jail can also be expelled.
143. The decision was published in early January, at the same time as the quota was announced, to restrict individual applications to specific categories of people, such as those for which looking at the national employment situation is not required (*e.g.* family members of foreign residents, students, Chilean and Peruvian nationals due to preferential international agreements).
144. The publication of the number of work permits granted has been recently interrupted, and figures are not available for the whole year of 2001.
145. The persons whose application was rejected (whose number is probably inferior to 210 000 because some may have applied in the two subsequent processes) were not expelled and are likely to remain on the territory.
146. This is under the assumption that all the persons whose application was rejected in the 2000 process did apply in the 2001 process.
147. See *El País*, 14 October 2001.
148. The government has proposed a 2003 budget for expulsions of EUR 8 million, almost three times higher than in 2002.
149. France, Italy, Portugal, Bulgaria, Poland, Slovakia, Estonia, Letonia, Lithuania and Rumania.
150. 90 000 is a minimum as it is the number of persons whose application was rejected in the 2001 process. 70 000 applications were also rejected in the 2000 process, but part of those rejected in the first process have certainly participated in the second. Those who did not apply, those who entered after the processes, and those who fell into illegality because their permit expired and could not be renewed since then due to lack of a work contract should also be added.
151. The government has also announced its intention to eliminate the permanent mechanism of regularisation "*por arraigo*" (*i.e.* for settlement reasons) included in the Immigration Act, which is allowing foreigners able to prove that they have been living in Spain for five years to obtain papers.
152. Besides, migration decisions of natives may also respond to labour immigration (Brücker *et al.*, 2001). For a critical analysis of this type of studies suggesting that immigration effects on the labour market may be underestimated see Borjas (2002).
153. Dolado *et al.* (1996) consider the number of work permits granted from 1990 to 1992. In 1991 and 1992 they are dominated by the regularisation process, so that it is not the effects of immigration on the labour market *per se* that are captured, but rather the effects of the legalisation of immigrants.
154. According to the labour force survey, non-OECD immigrants as a whole are better educated than Spanish nationals. Although the share of the second and third groups of workers referred to here cannot be exactly established (due to lack of data), the third group (*i.e.* low-skill jobs) is more important than the second (high-skilled jobs). To some extent, the fact that non-OECD workers are on average better educated than Spanish nationals may reflect under-utilisation of immigrants' human capital. However, this may also reflect the non-accuracy of the figures: as noted above, the labour force survey is not completely representative for foreigners, especially for non-OECD immi-

- grants, who are more likely to live in collective housing (not covered) and have temporary visas.
155. See Colectivo IOÉ (1998) for the construction sector, Colectivo IOÉ (1999) for hotels and restaurants, and Carrasco (1999). Mendoza (1997) provides information on African employment in agriculture and construction, and Martínez Veiga (1999) for employment in domestic services, agriculture and construction.
  156. 24 per cent of the immigrants surveyed by Carrasco (1999) were without contracts; in the construction sector, 62 per cent of the Poles and 19 per cent of the Moroccans surveyed by Colectivo IOÉ (1998) had no contracts, against 1.5 per cent of the Spaniards; in restaurants, 42 per cent of the Peruvians, 23 per cent of the Dominicans and Chinese, 12 per cent of the Moroccans and 6 per cent of the Philipinos and the Spanish had no contract.
  157. In the construction sector, 52 per cent of the Moroccans were working more than 40 hours a week, against 39 per cent of Spanish; overtime hours are more often paid at the normal rate for Moroccans than for Spanish and Polish workers (Colectivo IOÉ, 1998). Foreigners also tend to work longer hours in hotels and restaurants; more than two thirds of the Dominicans and Filipinos were not paid for extra-hours, against one third for Spanish and Moroccan workers (Colectivo IOÉ, 1999).
  158. At end-1997, it was one of the lowest in the European Union in PPP terms (OECD, 1998).
  159. For example, domestic employees can be fired without notice and do not have access to unemployment benefits.
  160. Comparing the situation of young natives and young non-EU immigrants both in Belgium and Spain at labour market entry based on the EU Labour Force Survey, Kalter and Kogan (2002) find that while differences in education levels explain the disadvantage that non-EU youth face compared with natives, it is not the case in Spain.
  161. It is also likely that there is more variability in their unemployment rate than for natives, *i.e.* that they play the role of cushioning the variations in activity. It is however not possible to verify this based on the labour force survey since data for foreigners are published only annually.
  162. EU foreigners, on the other hand, include a large number of pensioners.
  163. Employment data used here is the affiliation with the social security system, available for foreigners starting in December 1999.
  164. About 55 000 foreigners were registered under the domestic employee social security regime in June 2002. It is a sector where undeclared employment is common, so that overall domestic employment is higher.
  165. See OECD (2001f).
  166. See Álvarez-Llorente (2002) and Muñoz (2002b).
  167. The important increase in temporary jobs for natives may also have played a role. Unemployment dropped from about 18 per cent in 1995 to about 11 per cent in 2002, with new employment largely situated at the low-skilled, low-productivity end.
  168. Productivity here is measured as GDP divided by the number of workers affiliated with the social security system. The number of non-EU foreigners affiliated with the social security system is not available for 1995, so that the number of existing work permits was used instead, after checking that they were quite similar to the number of affiliations in the period where both are available.

169. In Almeria, income per capita was equivalent to 82 per cent of the national average in 1999, against 73 per cent in 1991. In Huelva, the Rioja and Castellon, income per capita was equivalent to 73, 119 and 117 per cent of the national average, respectively, against 69, 110 and 108 in 1991.
170. According to the 2000 Census, one out of three EU residents were aged more than 55.
171. Revenues from the VAT on consumption are not included.
172. According to de Ayala Cañón *et al.* (2001), 70 000 households or 180 000 individuals (0.5 per cent of total population) were benefiting from a minimum income.
173. According to the OECD database on social transfers, in 1998, the benefits provided to compensate for low income represented 0.07 per cent of GDP, family benefits and services to families 0.4 per cent of GDP, and housing benefits 0.07 per cent of GDP (excluding income tax relief granted for purchasing a main residence).
174. Aparicio and Tornos (2000) estimated that they were inferior to 2.8 per cent of the expenditure they estimated at the central level in 1998. They may have somewhat increased recently.
175. See Collado *et al.* (2002).
176. As shown by Samuelson (1958), in the steady-state the system's internal rate of return must be less than or equal to the real rate of output growth in order to keep the pension regime in equilibrium. Given the effect of immigration and under the assumption of a stable annual growth of 1¼ per cent of productivity, real output could rise on average by 1¼ per cent a year over the 2000-50 period, a rate much below the estimated level of the internal rate of return of the pension system.
177. Moroccan and Peruvian immigrants surveyed in the Madrid area by Aparicio and Tornos (2000) were sending on average one to two months of their salaries in remittances to their origin country in 1999.
178. The fruit and vegetable sector, which employs many immigrants, is not benefiting from direct subsidies from the CAP, but benefit from trade protection; other sectors including the olive oil sector enjoy both trade protection and production subsidies. The regime of EU subsidies to olive oil was significantly modified in November 1998. The main modification entailed replacing the intervention price system by a private storage aid, abolishing aid to consumption and introducing an overall cash ceiling on the amount of production subsidies (these changes are not definitive; they have been extended up to 2004/05). This ceiling is distributed across countries according to the national guaranteed production level. In the event that national production exceeds the quota, the subsidy per tonne is reduced proportionately.
179. The demand from Latin American countries for reduced protection of EU markets, in particular for agricultural products, was one of the most contentious points in the last Ibero-American summit in November 2002. In March 2002, the Spanish Secretary of State for Foreign Affairs defended (during a meeting of entrepreneurs from Spain and Maghreb countries on investment opportunities in the Maghreb) the view that free trade between the EU and Maghreb, including in agricultural products, should be sought by 2010 so as to help the development of these countries and slow immigration flows. The president of Catalonia also supported this view (see *Noticias Infoagro*, 22/03/2002). For an analysis of the impact of liberalisation of Euro-Mediterranean trade in agricultural products, see Lorca Corrons (2002).
180. According to a report by the Defensor del Pueblo Andaluz (2001), in western Almeria, at least 65 per cent of the immigrants did not live in decent housing. More than 50 per

cent had no access to drinkable water, and 25 per cent to electricity, and most had no sewage.

181. For example, in Madrid, rents can vary between EUR 150 and 240 per month for a bed in shared rooms. The immigrants are also often asked to provide a bank guarantee or are required to pay a number of monthly rents in advance, while the norm is one month (*El País*, 9 April 2002).
182. According to Trilla (2001), social housing accounts for 2 per cent of the housing stock, against 18 per cent on average in the EU.
183. See *El País*, 23 January 2003.

## Glossary of acronyms

<b>ADSL</b>	Asymmetric digital subscriber line
<b>ALMP</b>	Active labour market policy
<b>BBVA</b>	<i>Banco Bilbao Vizcaya Argentaria</i>
<b>BIS</b>	Bank for International Settlements
<b>CAP</b>	Common agricultural policy
<b>CES</b>	<i>Consejo Económico y Social</i> (Economic and social council)
<b>CLH</b>	Transportation monopoly
<b>CMT</b>	<i>Comisión del Mercado de las Telecomunicaciones</i> (telecommunications sector regulator)
<b>CPI</b>	Consumer price index
<b>EC</b>	European Commission
<b>ECB</b>	European Central Bank
<b>EMU</b>	European Monetary Union
<b>EPA</b>	Labour force survey
<b>ESA</b>	European System of Integrated Economic Accounts
<b>EU</b>	European Union
<b>EUR</b>	Euro
<b>Eurostat</b>	European Union Statistical Institute
<b>FAO</b>	Food and Agricultural Organisation
<b>FORCEM</b>	Foundation for the training of workers
<b>GDP</b>	Gross domestic product
<b>GHG</b>	Greenhouse gas
<b>GRECO</b>	<i>Programa Global de Regulación y Coordinación de la Extranjería y la Inmigración en España</i> (Global Programme to Regulate and Co-ordinate Foreign Residents' Affairs and Immigration in Spain)
<b>IAE</b>	<i>Impuesto de actividades económicas</i> (tax on business activities)
<b>IEA</b>	International Energy Agency
<b>IBI</b>	<i>Impuesto sobre bienes inmuebles</i> (real estate tax)
<b>ICAC</b>	<i>Instituto de Contabilidad y Auditoría de Cuentas</i> (Institute for Accounting and Auditing)
<b>ICES</b>	International Council for the Exploration of the Sea
<b>ICID</b>	International Commission on Irrigation and Drainage
<b>ICT</b>	Information and Communication Technology
<b>IMF</b>	International Monetary Fund
<b>IMSERSO</b>	<i>Instituto de Inmigración y Servicios Sociales</i> (national agency for migration and social services)
<b>INE</b>	<i>Instituto Nacional de Estadística</i> (National Statistics Institute)
<b>INEM</b>	<i>Instituto Nacional de Empleo</i> (National Agency for Employment)

<b>INSALUD</b>	<i>Instituto Nacional de la Salud</i> (National Health Institute)
<b>NAIRU</b>	Non-accelerating inflation rate of unemployment
<b>NGO</b>	Non-governmental organisation
<b>OPA</b>	<i>Oferta pública de adquisición</i> (take-over bid)
<b>PER</b>	<i>Plan de Empleo Rural</i> (special unemployment and investment regime for seasonal agricultural workers in Andalusia and Extremadura)
<b>PES</b>	Public employment service
<b>PISA</b>	Programme for International Student Assessment
<b>PPP</b>	Purchasing power parity
<b>R&amp;D</b>	Research and Development
<b>SCP</b>	Stability and Convergence Programmes
<b>SDC</b>	<i>Servicio de Defensa de la Competencia</i> (Competition Service)
<b>SME</b>	Small and medium-sized enterprise
<b>TDC</b>	<i>Tribunal de Defensa de la Competencia</i> (Competition Tribunal)
<b>UA</b>	Unemployment assistance
<b>UI</b>	Unemployment insurance
<b>UMTS</b>	Universal Mobile Telephone Systems (third generation mobile telephone systems)
<b>UNDP</b>	United Nations Development Programme
<b>UNFCCC</b>	United Nations Framework Convention on Climate Change
<b>USD</b>	United States dollar
<b>VAT</b>	Value added tax



## Bibliography

- Albiac-Murillo, J., J. Tapia-Barcones, A. Meyer, and J. Uche (2002),  
“Water Demand Mangement *versus* Water Supply Policy: the Ebro River Water Transfer”,  
*World Bank Water Forum*, May 6-8, Washington, D.C.
- Álvarez-Llorente, G. (2002),  
“Decisiones de fecundidad y participación laboral de la mujer en España”, *Investigaciones Económicas*, Vol. XXVI(1).
- Aparicio, R. and A. Tornos (2000),  
*La inmigración y la economía española*, Ministry of Labour and Social Affairs, Madrid.
- Balmaseda, M., I. San Martín and M. Sebastián (2002),  
“Una aproximación cuantitativa a la ‘burbuja’ inmobiliaria”, *Situación Inmobiliaria*, BBVA,  
December, Bilbao.
- BBVA (2002a),  
*Informe Económico 2001*.
- BBVA (2002b),  
*Situación Inmobiliaria*, July, Bilbao.
- Bank of Spain (2001),  
*Annual Report*.
- Bank of Spain (2002a),  
*Boletín Económico*, September.
- Bank of Spain (2002b),  
*Boletín Económico*, October.
- Bank of Spain (2002c),  
*Estabilidad Financiera*, No. 3, November.
- Beaufoy, G. (2000),  
“The Environmental Impact of Olive Oil Production in the European Union: Practical Options for Improving the Environmental Impact”, report of the European Forum on Nature Conservation and Pastoralism and the Asociación para el Análisis y Reforma de la Política Agro-rural.
- Bentolila, S. and J.F. Jimeno (2002),  
“La reforma de la negociación colectiva en España”, *Working Paper*, FEDEA, January.
- Blanchard, O. (2001),  
“Country Adjustments Within Euroland. Lessons After Two Years”, *Defining a Macroeconomic Framework for the Euro Area. Monitoring the European Central Bank 3*, Centre for Economic Policy Research (CEPR), London, March.

- Blondal, S., S. Field and N. Girouard (2002),  
“Investment in Human Capital Through Post-Compulsory Education and Training: Selected Efficiency and Equity Aspects”, *OECD Economics Department Working Papers*, No. 333.
- Borjas, G. (2002),  
“The Labor Demand Curve is Downward Sloping: Reexamining the Impact of Immigration on the Labor Market”, paper presented at the European Association of Labour Economics (EALE) Conference in Paris, 19-22 September.
- Bover, O., M. Arellano and S. Bentolila (1996),  
“Duración del desempleo, duración de las prestaciones y ciclo económico”, *Economic Studies*, No. 57, Bank of Spain.
- Bricall, J.M. *et al.* (2000),  
“Informe Universidad 2000”, report published by the Conferencia de Rectores de las Universidades Españolas (CRUE), March.
- Brücker, H. *et al.* (2001),  
“Managing Migration in the European Welfare State”, paper presented at the third European Conference of the Fondazione Rodolfo DeBenedetti in Trieste on 23 June.
- Caixa (2002),  
“Special Reports”, *The Spanish Economy: Monthly Report*, Caixa Research Department, October.
- Calmfors, L. (1993),  
“Centralisation of Wage Bargaining and Economic Performance: A Survey”, *OECD Economics Department Working Papers*, No. 131.
- Calmfors, L. and J. Driffil (1988),  
“Bargaining Structure, Corporatism and Macroeconomic Performance”, *Economic Policy*, Oxford, Blackwell Publishers, April.
- Canadian Tourism Commission (2002),  
*Role of the Internet in the Vacation Travel of North Americans – Summary of Findings*, Research Report, 2002-7.
- Capros, P. and L. Mantzos (2000),  
“The Economic Effects of EU-Wide Industry-Level Emission Trading to Reduce Greenhouse Gases: Results from the PRIMES Energy Systems Model”, National Technical University of Athens.
- Carrasco, C. (1999),  
*Mercados de trabajo: Los inmigrantes económicos*.
- CIEMAT (1997),  
*ExternE National Implementation: Spain*.
- CIHEAM (2001),  
*Development and Agri-Food Policies in the Mediterranean Region*, Annual Report.
- Colectivo IOÉ (1998),  
*Inmigración y trabajo – Trabajadores inmigrantes en el sector de la construcción*, Colección Observatorio Permanente de la Inmigración, Ministry of Labour and Social Affairs, Madrid.
- Colectivo IOÉ (1999),  
*Inmigración y trabajo en España – Trabajadores inmigrantes en el sector de la hostelería*, Colección Observatorio Permanente de la Inmigración, Ministry of Labour and Social Affairs, Madrid.

- Collado, D., I. Iturbe-Ormaetxe and G. Valera (2002),  
“Quantifying the Impact of Immigration on the Spanish State”, *IVIE Working Paper*,  
No. 2002-04, March.
- CES (2002),  
“La emancipación de los jóvenes y la situación de la vivienda en España”, *Colección  
Informes*, 3/2002, Economic and Social Council.
- Cuesta Azofra, M., C. M. S. Pardi Ruíz, T. Nuñez, I. Galvin and M. C. Martínez Alvarez (2000),  
“La escolarización de los hijos de inmigrantes en España”, *Cuadernos de Información  
Sindical*, CC. OO, November.
- De Ayala Cañón, L., R. Martínez López and J. Ruiz-Huerta (2001),  
“La descentralización territorial de las prestaciones asistenciales: efectos sobre la  
igualdad”, *Papeles de Trabajo del Instituto de Estudios Fiscales*, No. 16/01, [www.minhac.es/ief/  
publicaciones/papelest/01/pt\\_16\\_01.pdf](http://www.minhac.es/ief/publicaciones/papelest/01/pt_16_01.pdf)
- Defensor del Pueblo Andaluz (2001),  
“El alojamiento y la vivienda de los trabajadores inmigrantes en el poniente alme-  
riense y campo de Níjar”, *Informe especial al Parlamento de Andalucía*, February.
- Dolado, J. J. (2002),  
“Los nuevos fenómenos migratorios: retos y políticas”, mimeo, January.
- Dolado, J.J., C. García-Serrano and J.F. Jimeno (2001),  
“Drawing Lessons from the Boom of Temporary Jobs in Spain”, *Working Papers*, 2001-11,  
FEDEA, July.
- Dolado, J. J., J. F. Jimeno and R. Dulce (1996),  
“The Effects of Migration on the Relative Demand of Skilled Versus Unskilled Labour:  
Evidence from Spain”, *CEPR Discussion Paper*, No. 1476, September.
- Dustmann, C. and F. Fabbri (2000),  
“Language Proficiency and Labour Market Performance of Immigrants in the UK”, *IZA  
Discussion Papers*, 156, May.
- Eguía, B. and C.A. Echevarría (2001),  
“Estructura de edad poblacional e inversión residencial en España”, *Estudios sobre la  
Economía Española*, FEDEA, 119, November.
- Estrada, A. and J.D. López-Salido (2001a),  
“Accounting for Spanish Productivity Growth Using Sectoral Data: New Evidence”, *Work-  
ing Paper*, No. 0110, Bank of Spain.
- Estrada, A. and J.D. López-Salido (2001b),  
“Sectoral and Aggregate Technology Growth in Spain”, *Working Paper*, No. 0116, Bank of  
Spain.
- Estrada, A. and J.D. López-Salido (2002),  
“Understanding Spanish Dual Inflation”, *Working Paper*, No. 0205, Bank of Spain.
- Eunomia Research and Consulting (2002),  
“Economic Analysis of Options For Managing Biodegradable Municipal Waste” *Final  
Report to the European Commission*, Bristol UK.
- Euroconstruct (2001),  
*The Prospective Construction in Europe*.
- European Commission (2002),  
“Comments on the Strategic Environmental Assessment of the Ebro River Water Transfer”,  
ENV.B1/MMA/ip/D(2002).310613, mimeo, May.

- Faini, R. (2001),  
“Development, Trade and Migration”, June, mimeo.
- FAO (2000),  
“Land Resource Potential and Constraints at Regional and Country Levels, Rome.
- Farré, L. and J.L. Raymond (2002),  
“Riqueza y ahorro”, *Cuadernos de Información Económica*, No. 170, September-October.
- Feijoó, M., J. Franco, and J. Hernández (2002),  
“Global Warming and the Energy Efficiency of Spanish Industry”, *Energy Economics*, 24.
- Ferguson, C. (1999),  
“Assessing Risks from Contaminated Sites: Policy and Practice in 16 European Countries”,  
*Land Contamination and Reclamation*, 7(2).
- Fina, L., F. González de Lena and J.I. Pérez Infante (2001),  
“Negociación colectiva y salarios en España”, *Colección Estudios*, No. 110, Economic and Social Council.
- Garrido, A. (2001),  
“Transition to Full-Cost Pricing of Irrigation Water for Agriculture in OECD Countries”,  
OECD, Paris.
- Gonzalo, M. T. (2002),  
“A New Look at the UI Effect on Transitions from Unemployment into Wage Employment in Spain: the Limited Duration of the UI Benefits Entitlement”, *Applied Economics*,  
No. 34.
- Holdsworth, C. and M. Irazoqui Solda (2002),  
“First Housing Moves in Spain: An Analysis of Leaving Home and First Housing Acquisition”, *European Journal of Population*, 18.
- ICES (2002),  
“Report of the ICES Advisory Committee on Fisheries Management, Copenhagen.
- IEA (2001),  
“Energy Policies of IEA Countries: Spain 2001 Review, Paris.
- INE (2001),  
“Water Accounts in Spain” Joint ECE/Eurostat Work Session on Methodological Issues of Environment Statistics, Ottawa, October 1-4.
- Jimeno, J.F. (2002a),  
“Incentivos y desigualdad en el sistema español de pensiones contributivas de jubilación”,  
*Working Papers*, 2002-13, FEDEA, July.
- Jimeno, J.F. (2002b),  
“Demografía, empleo, salarios y pensiones”, *Working Papers*, 2002-04, FEDEA, January.
- Kalter, F. and I. Kogan (2002),  
“Ethnic Inequalities at Labour Market Entry in Belgium and Spain”, *Working Papers*,  
No. 49, Mannheimer Zentrum Für Europäische Sozialforschung (MZES).
- Laborda, Á. (2002),  
“Al final de un ciclo”, *Cuadernos de Información Económica*, No. 169, July-August.
- Lorca Corrons, A. (2000),  
“L'impact de la libéralisation commerciale euro-méditerranéenne dans les échanges agricoles”, FEMISE Research Programme, [www.femise.org/PDF/A\\_Corrns\\_09\\_00.pdf](http://www.femise.org/PDF/A_Corrns_09_00.pdf)

- Martínez, A. (2000),  
“El incremento de la financiación de los servicios públicos locales mediante tasas y precios”, *Análisis Local*, Número Extraordinario 1/2000, May-June.
- Martínez Veiga, U. (1999),  
“Immigrants in the Spanish Labour Market”, in *Immigrants and the Informal Economy in Southern Europe*, edited by M. Baldwin-Edwards and J. Arango, Frank Cass, London.
- Mendoza, C. (1997),  
“African Employment in Iberian Agriculture and Construction: a Cross-Border Comparative Approach”, *Occasional Paper*, King's College, London.
- Ministry of Agriculture, Fishery and Food (2002),  
*The Spanish Agrofood Sector and Rural Environment*, Madrid.
- Ministry of Economy (2001),  
“Stability Programme Update Kingdom of Spain 2001-2005”.
- Ministry of Economy (2002),  
“Stability Programme Update Kingdom of Spain 2002-2006”.
- Ministry of Environment (1998),  
*Libro blanco del agua en España: Documento de síntesis*, Madrid.
- Ministry of Environment (2002a),  
*Tercera comunicación nacional de España: Convención marco de las Naciones Unidas sobre cambio climático*, Madrid.
- Ministry of Environment (2002b),  
*Strategic Environmental Assessment of the National Hydrological Plan: Summary Document*, Madrid.
- Ministry of Labour and Social Affairs (2002),  
“Report on the Spanish National Strategy for the Future of the Pension System”, 12 September, Madrid.
- Monge Lozano, P. (2002),  
“La gestión en las empresas sanitarias españolas”, *Boletín Económico de ICE*, No. 2732, June.
- Mora, J.G. and A. Garcia (1999),  
“Private Costs of Higher Education in Spain”, *European Journal of Education*, Vol. 34, No. 1.
- Mora, J.G., J. García-Montalvo and A. García-Aracil (2000),  
“Higher Education and Graduate Employment in Spain”, *European Journal of Education*, Vol. 35, No. 2.
- Moreno Fuentes, F. J. (2000),  
“Immigration Policies in Spain: Between External Constraints and Domestic Demand for Unskilled Labour”, presented at the ECPR Joint Sessions of Workshop, 14-19 April.
- Muñoz, M. (2002a),  
“Deslocalización sectorial de la inversión directa extranjera en España”, *Boletín Económico de ICE*, No. 2744, October.
- Muñoz, M. (2002b),  
“Tasa de actividad femenina y fecundidad – Ser madre o ser activa?”, *Boletín Económico de ICE*, No. 2773, March.
- Namkee, A. (2001),  
“Age at First-Time HomeOwnership in Spain”, *Working Paper 2001-23*, FEDEA, December.

- National Commission for Energy (2002),  
*Informe sobre las compras de energía al régimen especial: Periodo año 2001.*
- OECD (1997a),  
*OECD Employment Outlook*, Paris.
- OECD (1997b),  
*Environmental Performance Reviews, Spain*, Paris.
- OECD (1998),  
*OECD Employment Outlook*, Paris.
- OECD (1999),  
*Education Policy Analysis*, Centre for Educational Research and Innovation, Paris.
- OECD (2000),  
*OECD Economic Surveys: Spain*, Paris.
- OECD (2001a),  
*OECD Economic Surveys: Spain*, Paris.
- OECD (2001b),  
"Tax and the Economy: A Comparative Assessment of OECD Countries", *OECD Tax Policy Studies*, No. 6.
- OECD (2001c),  
*OECD Science, Technology and Industry Scoreboard – Towards a Knowledge-Based Economy*, Paris.
- OECD (2001d),  
*Education at a Glance – OECD Indicators*, Paris.
- OECD (2001e),  
*Environmental Indicators for Agriculture: Methods and Results*, Vol. 3, Paris.
- OECD (2001f),  
*OECD Employment Outlook*, Paris.
- OECD (2002a),  
*OECD Economic Surveys: Switzerland*, Paris.
- OECD (2002b),  
*The New Economy: Beyond the Hype – The OECD Growth Project*, Paris.
- OECD (2002c),  
*Education at a Glance – OECD Indicators*, Paris.
- OECD (2002d),  
*African Economic Outlook*, Paris.
- Pareja, M. and I. San Martín (2002),  
"The Tenure Imbalance in Spain: The Need for Social Housing Policy", *Urban Studies*, Vol. 39, No. 2.
- Poveda, F. and A. Sánchez (2002),  
"La financiación impositiva municipal. Propuestas para su reforma", *Papeles de Economía Española*, 92/2002, Fundación de las Cajas de Ahorros Confederadas para la Investigación Económica y Social.
- Revenga, C., J. Brunner, N. Henninger, K. Kassem and R. Payne (2000),  
*Pilot Analysis of Global Ecosystems: Freshwater Systems*, World Resources Institute, Washington, D.C.

- Rogers, J. (2001),  
“Price Level Convergence, Relative Prices and Inflation in Europe”, *International Finance Discussion Papers*, No. 699, March.
- Sáez, F. *et al.* (2001),  
“Evaluación de la estrategia europea de empleo: España”, Report for the European Commission, mimeo.
- Samuelson, P. (1958),  
“An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money”, *The Journal of Political Economy*, Vol. 66, No. 6, The University of Chicago Press.
- San Martín, I. (2000),  
“Rent or Buy?”, *Real Estate Situation*, BBVA Research Service, October.
- Spiess, C.K. and U. Schneider (2002),  
“Midlife Caregiving and Employment – An Analysis of Adjustments in Work Hours and Informal Care for Female Employees in Europe”, *ENEPRI Working Paper*, No. 9.
- Trilla, C. (2001),  
“La política de vivienda en una perspectiva europea comparada”, *Estudios Sociales*, La Caixa, No. 9, [www.estudis.lacaixa.com/webes/estudis.nsf/wurl/pfes009cos\\_esp](http://www.estudis.lacaixa.com/webes/estudis.nsf/wurl/pfes009cos_esp)
- Trilla, C. and A. Carreras (2001),  
*Promoció Ciutat Vella*, S.A.
- Uche, J., L. Serra and A. Valero (2001),  
“Hybrid desalting systems for avoiding water shortage in Spain”, paper presented at the European Conference on Desalination and the Environment: Water Shortage, Lemesos, Cyprus, 28-31 May.
- UNDP (2002),  
*Arab Human Development Report*.

# Table of contents

<b>Assessment and recommendations</b>	9
<b>I. Economic developments, the fiscal stance and prospects</b>	21
Overview	21
Recent trends	23
Fiscal policy in the short run	40
Prospects	47
<b>II. Medium and long-term fiscal policy challenges</b>	51
Fiscal policy: being prudent, while ensuring flexibility	51
Increasing public sector efficiency has to remain a priority	55
The consequences of ageing: pension reform is more urgent than generally perceived	63
<b>III. Structural reforms to sustain a strong performance</b>	67
Labour markets	70
Education and R&D	80
Housing market	92
Competition policy	99
Financial markets	105
The benefits from deepening structural reforms	107
Sustainable development	108
<b>IV. The economic impact of migration</b>	127
Introduction	127
Migration stocks and flows	127
Migration policy: still in the making	134
Economic aspects of immigration	142
Integrating immigrants	154
Conclusions and recommendations	157
Notes	160
Glossary of acronyms	175
Bibliography	177





*Annexes*

I. Supporting material	184
II. The decentralisation and financing reform of autonomous communities and local authorities	188
III. Main measures of the personal income tax reform	192
IV. Rental supply and demand incentives	194
V. The effect of employment shifts on labour productivity growth and the contribution of immigration of non-EU foreigners	197
VI. Calendar of main economic events	200

**Boxes**

1. Risks to the outlook	49
2. Private rates of return from non-compulsory education	88
3. Analysis of rental supply and demand incentives	97
4. The integration of environmental concerns into government policy	110
5. EU-wide immigration policies	135
6. The new quota system for work permits	140
7. Projections of public pension expenditure	152
8. EU agricultural market access for South Mediterranean countries	154

**Tables**

1. Demand and output	23
2. Financial position of the economic sectors	24
3. Financial performance of non-financial firms	29
4. Productivity and real wage growth by sector	34
5. Inflation differential between Spain and the euro area	41
6. The fiscal consolidation process	44
7. General government accounts	45
8. Short-term prospects	48
9. Stability Programme 2002-06	52
10. Expenditure by level of government	53
11. Local government revenue in OECD countries with federal structure	57
12. Tax revenues in OECD countries	58
13. Evolution of health expenditure	61
14. Recommendations for further structural reforms	71
15. International comparison of unemployment benefits	75
16. Public expenditure on labour market policies	78
17. Educational attainment by age	81
18. Participation in education at typical ages	82
19. Student performance at age 15	83
20. Private rates of return on education	89
21. Household assets	94
22. Tenure and availability of housing	95
23. Main indicators: climate change	112
24. Performance indicators: waste	116
25. Treatment systems for waste in Spain	117

26.	Fees for extended producer responsibility schemes in Europe	118
27.	Recovery and recycling rates and targets	119
28.	Costs of composting in selected European countries	120
29.	Main indicators for water withdrawal and land degradation	121
30.	Immigration statistics in Spain	129
31.	Regularisation processes	136
32.	Annual quota for work permits in the 1990s	136
33.	Work permits	138
34.	Education level and type of employment: foreigners <i>versus</i> natives	143
35.	Workers affiliated with the social security system	145
36.	Unemployment rates of foreigners and natives	146
37.	Fiscal impact of non-EU immigrants	150

#### Annexes

A1.	Balance of payments	185
A2.	Inflation decomposition: comparison between Spain and the euro area	186
A3.	Greenhouse gas emissions and sectoral indicators	187
A4.	Local governments' expenditure by function	190
A5.	The effect of employment shifts on labour productivity growth and the contribution of immigration	199

#### Figures

1.	Key indicators in international perspective	22
2.	Output gap and economic activity indicators	25
3.	Credit to households and asset prices	27
4.	Household indebtedness	28
5.	Competitiveness indicators and export performance	30
6.	Contributions to GDP growth	31
7.	Employment and unemployment: key features	33
8.	Inflation decomposition for Spain and the euro area	37
9.	Profit margins by sector	39
10.	Consumer prices	40
11.	The macroeconomic policy stance	41
12.	Budget balances	43
13.	Risks of a weaker European recovery	50
14.	Decomposition of the business sector potential growth	68
15.	Real GDP growth by sector	69
16.	Public expenditure on active labour market policies and unemployment rates	79
17.	Annual educational expenditure per student, 1999	84
18.	Business R&D expenditure	90
19.	Internet infrastructure	91
20.	Housing market trends	93
21.	Wealth developments linked to housing purchase/rental	98
22.	Telecommunications prices	101
23.	Medium-term effects of structural reforms	109
24.	Greenhouse gas emissions	111
25.	Application of efficient irrigation methods	124
26.	Foreign population in selected OECD countries	128
27.	Foreign population by nationality for the top 15 source countries	130
28.	Length of stay of foreigners	131
29.	Income differentials	132

---

30. Population projections for Spain and selected source countries	133
31. Population of selected source countries/regions, aged 15-44	133
32. Workers' remittances	153
33. Disadvantage in reading of 15 year-old children	157

*Annexes*

A1. Investment cycles	184
A2. Wealth developments linked to housing purchase/rental	195

## BASIC STATISTICS OF SPAIN (2002)

### THE LAND

Area (1 000 km <sup>2</sup> ):		Major cities (thousand inhabitants):	
Total	506.0	Madrid	3 017
Cultivated (1998)	185.1	Barcelona	1 527
		Valencia	762
		Seville	704

### THE PEOPLE

In thousands:		Employment (thousands)	16 258
Population	41 838	Employment by sector (% of total):	
Net natural increase (2001)	45	Agriculture	5.9
Net migration (2001)	247	Industry	19.4
Number of inhabitants per km <sup>2</sup>	82.7	Construction	11.8
		Services	62.9

### PRODUCTION

Gross domestic product (GDP):		Gross fixed capital investment:	
Billion EUR	694	% of GDP	25.4
Per head (US\$)	15 631	Per head (US\$)	3 973

### THE GOVERNMENT

% of GDP:		Composition of Parliament	
Consumption	17.6	(No. of seats, March 2000):	350
Revenue	38.5	Popular Party (PP)	182
Deficit	-0.1	Spanish Labour Socialist Party (PSOE)	125
Fixed investment (% of gross fixed capital formation)	13.1	Convergence and Union (CIU)	15
		Izquierda Unida (IU)	8
		Basque Nationalist Party (PNV)	7
		Other	13
		Next general elections: March 2004	

### FOREIGN TRADE

Exports of goods and services (% of GDP)	28.5	Imports of goods and services (% of GDP)	30.0
Exports as a % of total goods exports:		Imports as a % of total goods imports:	
Foodstuffs	12.5	Foodstuffs	6.6
Other consumer goods	28.8	Other consumer goods	20.9
Energy	2.0	Energy	10.7
Other intermediate goods	44.6	Other intermediate goods	46.0
Capital goods	12.2	Capital goods	15.8

### THE CURRENCY

Monetary unit: Euro		Currency units per US\$, average of daily figures:	
		Year 2002	1.0611
		February 2003	0.9276

Note: An international comparison of certain basic statistics is given in an annex table.

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

•

*The economic situation and policies of Spain were reviewed by the Committee on 24 February 2003. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 27 March 2003.*

•

*The Secretariat's draft report was prepared for the Committee by Claude Giorno, Miguel Jimenez, Douglas Sutherland and Ann Vourc'h under the supervision of Peter Hoeller.*

•

*The previous Survey of Spain was issued in June 2001.*



**From:**  
**OECD Economic Surveys: Spain 2003**

**Access the complete publication at:**  
[https://doi.org/10.1787/eco\\_surveys-esp-2003-en](https://doi.org/10.1787/eco_surveys-esp-2003-en)

**Please cite this chapter as:**

OECD (2003), "Economic Developments, the Fiscal Stance and Prospects", in *OECD Economic Surveys: Spain 2003*, OECD Publishing, Paris.

DOI: [https://doi.org/10.1787/eco\\_surveys-esp-2003-3-en](https://doi.org/10.1787/eco_surveys-esp-2003-3-en)

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to [rights@oecd.org](mailto:rights@oecd.org). Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at [info@copyright.com](mailto:info@copyright.com) or the Centre français d'exploitation du droit de copie (CFC) at [contact@cfcopies.com](mailto:contact@cfcopies.com).