

Promoting stronger and more sustainable growth for all people across Spain

Category: Climate, Spain, Tax

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Before the COVID-19 pandemic, the Spanish economy experienced a period of sustained and more balanced economic growth, less dependent on the construction sector, and with a healthier financial system. The pandemic and Russia's war of aggression against Ukraine were successive shocks that required strong government support to protect businesses and households, as noted in the 2023 Economic Survey of Spain. Output has recovered to its pre-pandemic level, and growth has held up well since the second half of 2022 and it is expected to remain solid in 2024.

The recovery from the pandemic has been steady following the large fall of GDP in 2020

Gross Domestic Product, Volume, base 2019Q4 = 100

Spain has also introduced several major reforms to address longstanding labour market issues, promote business growth and innovation, ensure pensions' sustainability, and boost vocational education. However, structural weaknesses remain that weigh down Spain's growth potential. The 2023 Economic Survey discusses policy options to tackle these issues in four areas.

Addressing fiscal challenges

Government action was decisive for the recovery, but it was costly. Public debt, which was already high before the pandemic, has increased by 13 percent points of GDP since 2019. Sustained fiscal consolidation is required to keep debt on a downward path and to make room for ageing-related spending and growth-enhancing items, like education and green transition. This consolidation should rely on both mobilising additional revenues and on enhancing spending efficiency.

Increasing the relatively low tax intake should encompass gradually broadening the value added tax base and raising environment-related taxes, but also reducing tax avoidance and enhancing tax collection. Spending reviews should continue to be used to define growth-enhancing spending priorities, and evaluation of public policies should become the norm.

Public debt remains high

Public debt, Maastricht definition, % of GDP

Raising productivity

Low investment in R&D, inefficient public spending on education and training, and an insufficient stock of ICT capital have dragged down productivity growth, which in the last decade has averaged 0.6% per year compared to 0.9% for the OECD. The share of innovative companies is also comparatively low. All this weighs on potential growth, which with rapid population ageing is expected to weaken even more.

Promoting collaboration and knowledge transfer between businesses and universities, fostering entrepreneurship, reducing regulatory barriers, and improving regulation can increase innovation and business growth. Continuing with an effective implementation of the investment and reforms under the national Recovery, Transformation and Resilience Plan should remain a priority, as it can help overcome structural deficiencies and boost productivity.

Promoting opportunities for all people across Spain

Despite recent improvements, income inequalities remain significant. Poverty is high compared to the OECD, and Spain has the highest child poverty rate in Western Europe, at 22%. This makes it urgent ensuring that public assistance is sufficient and reaches those who need it more. The survey recommends improving the targeting of social benefits, particularly towards poor families with children, boosting the take-up of the minimum income guarantee, and reducing administrative burdens for users.

Young people in Spain face a challenging transition to an independent, productive, and happy adult life. The risk of poverty among them is particularly high, although it has fallen. That is why the special topic of this survey is how

can Spain increase opportunities for its young.

Educational and labour market outcomes have improved, but many young people still leave the education system with low education levels or skills, and youth labour-market integration remains difficult. The share of temporary contracts has decreased after the 2021 labour market reform, but it is still high. The survey recommends training teachers to identify and assist students at risk and maintaining support for students to enrol in vocational education, including by fostering the participation of SMEs to offer places. Furthermore, to ease school-to-work transitions it encourages greater employer involvement in the design of university curricula, and improving access to financing for young entrepreneurs.

Housing is a pressing concern for many people in Spain, especially the young. To increase housing supply, the survey recommends expanding the very low stock of social rental housing and relaxing stringent rent controls.

Young people face high poverty risks

Risk of poverty or social exclusion, %

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

Source: INE.

Addressing environmental challenges

Spain has made progress in the fight against climate change, as environmental protection expenditure has increased and renewable energies are becoming more prevalent in the energy mix. To keep reducing its dependence on fossil fuels, Spain should accelerate the shift towards greener transportation,

improve storage and grid interconnections, and continue promoting renewable energies.

A more environment-friendly tax regime is also needed, as environmental tax revenue as a share of GDP is low compared to most OECD European countries. The base for environment-related taxation can be broadened, including by phasing out exemptions and gradually increasing the tax rate on emissions, while compensating partially and temporarily the most vulnerable.

Persistent drought in some regions has lowered water availability, and intense agriculture production has affected water quality. These problems could be addressed through more efficient irrigation, reuse and recycling of waters, and a more sensible use of fertilizers.

Improving water availability and quality is urgent

Groundwater stations with poor quality standards, %

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Note: Groundwater stations failing to meet the drinking water standard under the EU Nitrates Directive

Source: European Environment Agency (EEA).

Government action helped Spain to overcome two major successive shocks. Evidence-based public policies can also help to solve Spain's longstanding structural weaknesses to increase growth and raise wellbeing for all people across Spain.

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How Climate Policies Shape Borrowing Costs and Investment through the Banking Channel

Category: Climate, Uncategorized
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More stringent climate policies means that firms' environmental performance affects their costs of debt as (sophisticated) investors price transition risks

Decarbonising the Housing Sector: Pathways to Net-Zero Emissions by 2050

Category: Climate

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Reducing carbon emissions from the building and use of homes is complex and requires a dedicated policy mix, including carbon pricing, subsidised investments and regulations.

Different paths to net-zero: Assessing the effectiveness of diverse climate mitigation approaches

Category: Climate

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Achieving Paris Agreement goals demands a step change in the assessment and comparison of mitigation policies to bolster trust and international policy coordination.

Towards net zero emissions in Denmark

Category: Climate, Denmark

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By Andrew Barker, H el ene Blake and Patrick Lenain, OECD Economics Department

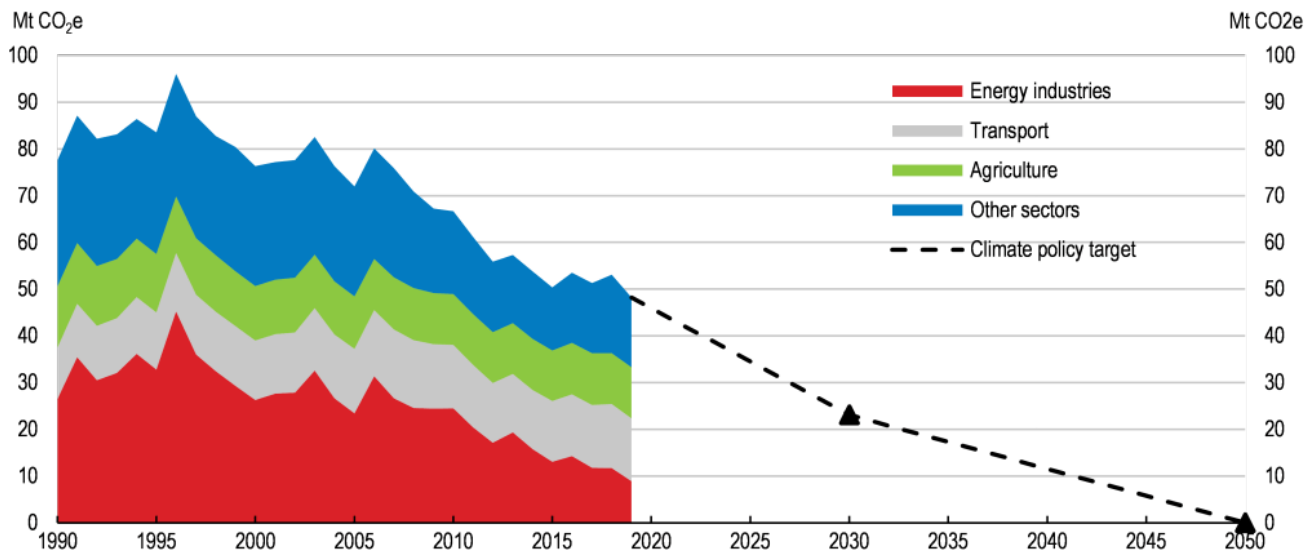


Denmark has embarked on an impressive climate policy agenda with ambitious emissions targets, carbon pricing, innovation, public investment and regulatory policies. The share of renewables in electricity generation has grown from less than 10% in the mid-1990s to over 80% in 2020. This has been the key driver behind the sharp cuts in greenhouse gas emissions by 36% between 1990 and 2019, making Denmark one of the least carbon-intensive countries in the OECD. Emission cuts have been achieved without compromising economic or jobs growth, with progress in wind generation in particular contributing to the development of an important export industry.

Denmark intends to go further with a a legally-binding commitment to cut emissions by 70% by 2030 from 1990 (Figure 1). This will require halving emissions from 2019 levels – a similar reduction in the next decade as has been achieved in the past 30 years. Cutting emissions at such a fast pace will be challenging, with substantial disruptions and socioeconomic challenges. Radical technological changes and vast resource reallocation will take place throughout the economy, similar to the transformational change in the Danish electricity sector since the mid-1990s. Greater certainty on policy measures to meet these targets will be important to send strong signals to investors. Additional investment in the order of 1% to 2% of GDP will be needed, which could largely come from the private sector with the right incentives.

Job losses to date in high-carbon activities have been offset by new opportunities in green industries – workers with skills in offshore oil and gas have for instance retrained to work in offshore wind. The successful Danish “flexicurity” system, which combines a safety net with support for skill building and job search, will continue to play a key role to facilitate this sizeable transformation.

Figure 1. Meeting targets will require further progress in all sectors

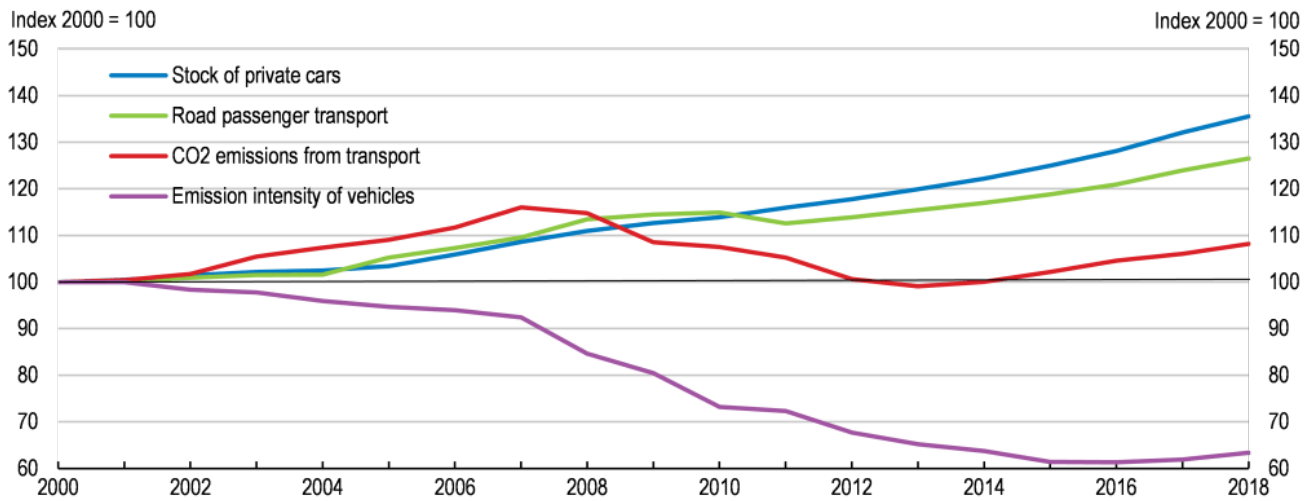


Source: UNFCCC GHG Data Interface; Danish Climate Law.

The energy sector must continue its transition towards renewable sources. Scarce supplies of sustainable woody biomass, on which Denmark has relied for low-emissions district heating, will need to be freed up for the difficult-to-decarbonise sectors, while continuing to protect security of supply as wind generation expands. A low-carbon economy will rely heavily on renewable energy, which can be promoted by further decreases in taxes on renewable electricity, as well as technological breakthroughs allowing large-scale conversion of electricity into sustainable fuels such as hydrogen, methane or ammonia.

Progress in reducing transport emissions has been slow to date, despite more environmentally-friendly vehicles, as the number of cars has continued to increase as well as the reliance on road transport (Figure 2). Agriculture is also a major and growing source of greenhouse gases. Low-hanging fruit such as rewetting of peatlands and improved manure management are available to cut emissions with limited impact on activity, while also reducing other environmental damages. Denmark needs to work with other EU member states towards further reform to green the Common Agriculture Policy, as agriculture is highly exposed to international trade and emissions could increase elsewhere if Denmark proceeds without international cooperation.

Figure 2. Increasing car use has pushed up transport emissions despite greener vehicles



Source: OECD estimation based on EEA; Statistics Denmark; ITF. The Danish government has made substantial progress to overcome many of the challenges linked to deep emission cuts. In the past year and a half, for example, the government has removed restrictions in district heating to support a move away from biomass, agreed measures to reduce greenhouse gas emissions in agriculture, and increased support for green vehicles and electric charging infrastructure. Further policy actions are being discussed among various stakeholders, including more uniform emission pricing. Denmark's past and planned efforts to decarbonise quickly and achieve net zero in 2050 are an inspiring example for other countries, as highlighted in the 2021 OECD Economic Survey of Denmark.

At the cross-roads of a low-carbon transition: what can

we learn from the current energy crisis?

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When it rains it pours. The energy crisis we face today is the result of a confluence of several forces at play: persistent underinvestment in the energy sector and fragile market regulation coupled with unfavourable weather events and insufficient buffers (Figure 1A) (IEA, 2021b). Together with the strong COVID-related demand recovery, they created an unsettling mismatch in our global energy markets leading to skyrocketing energy prices, in particular in Europe (Figure 1B). The crisis has brought to bear the multiple sources of tension that could threaten the stability and reliability of our energy system. It has also triggered a multiplicity of emergency measures to contain costs for households and firms at a time when the energy transition is set to accelerate. As countries embark on what promises to be the most ambitious energy transformation of our times, the current events show how transition to a climate neutral world needs to minimise the risk of such disruptions while securing public support.

Figure 1A. EU Gas Storage Use
Monthly average of filling level percentage

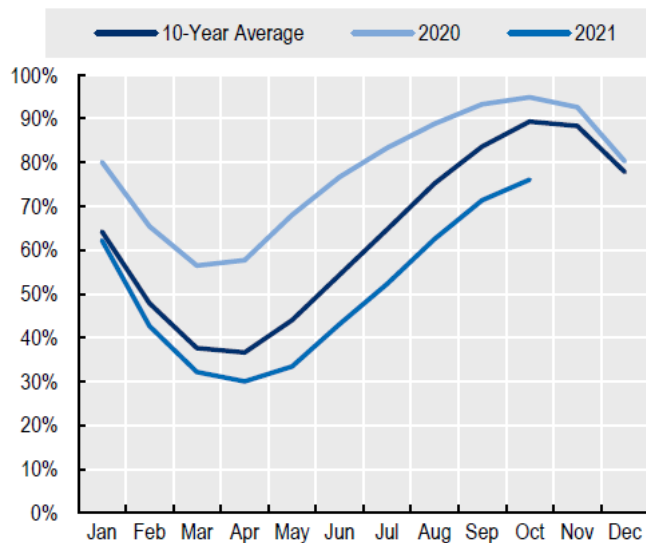


Figure 1B. European Natural Gas Prices
Oct 2007-Oct 2021
Eur/MWh



Note: Panel A shows the filling rate of European natural gas storage over 2020, 2021 and the 10 year average filling rate. Panel B uses the EEX EGIX THE Index (European Energy Exchange European Gas Index) as the reference price for natural gas for one month ahead contracts. It is based on exchange trades which are concluded in the respective current front month contracts (THE). The EGIX corresponds to the current market price for gas deliveries in the next month at any time.

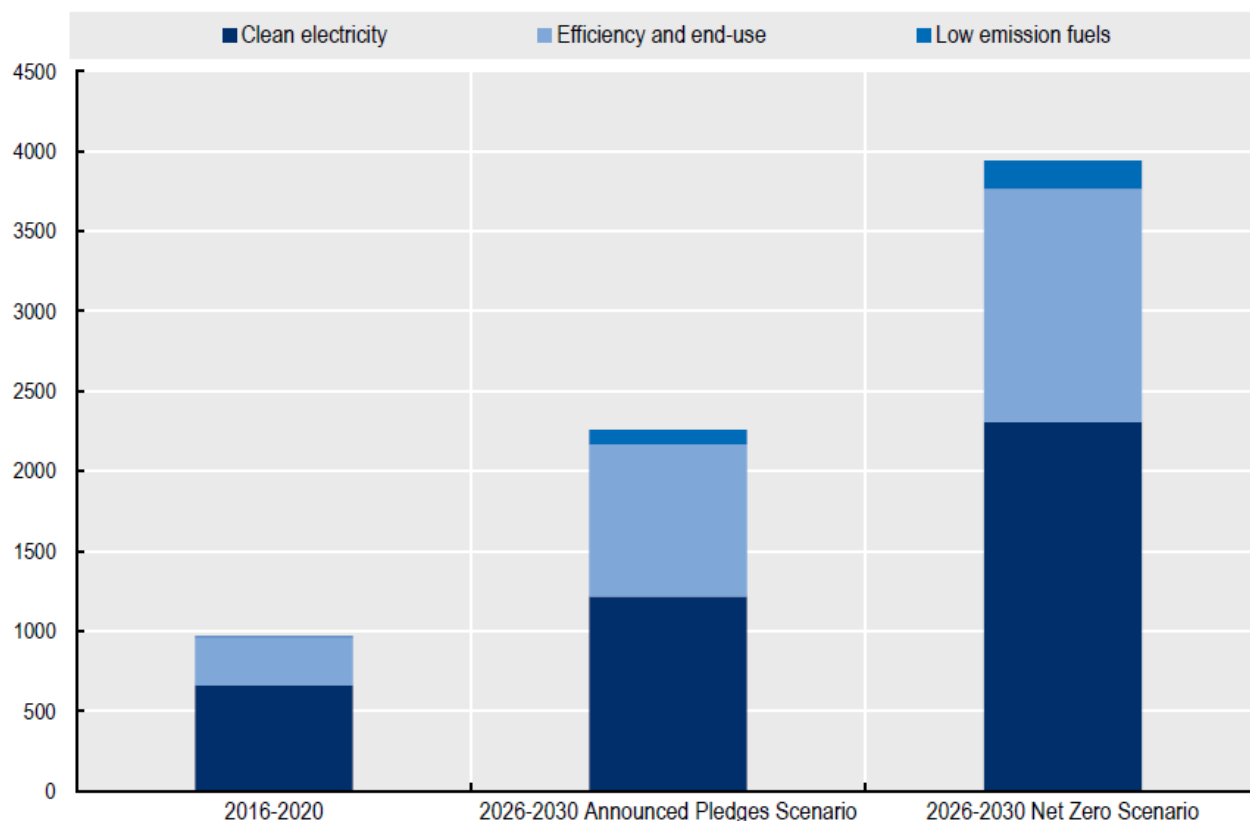
Source: Panel A: Aggregated Gas Storage Inventory, AGSI+ (gie.eu). Panel B: Refinitiv.

Between calls for greater energy security and energy affordability, particularly at a time when mounting inflation pressures are already raising concerns about people's purchasing power (OECD, 2021c), this crisis is very much exposing difficulties governments will face to stay on course towards a climate neutral world. Countries representing around 70% of the world's global carbon emissions have already announced climate neutrality targets by mid-century (IEA, 2021a), which necessitates a rapid and unprecedented transformation of the way we produce and consume our goods and services. Yet the steps to achieving this transformation remain unclear in many jurisdictions.

According to the recently published IEA World Energy Outlook, a net-zero emissions world requires accelerating clean

electrification of many energy uses, improving energy efficiency, substantially reducing methane emissions and boosting innovation (IEA, 2021c). This requires a major shift in investment (Figure 2), R&D, regulation and carbon pricing.

Figure 2. Annual average clean energy investment by technology in the Announced Pledges and Net Zero Scenarios 2016-2030



Note: The scenarios are from the IEA World Energy Outlook 2021. The Announced Pledges Scenario maps out a path in which the net zero emissions pledges announced by governments so far are implemented in time and in full. The Net Zero Emissions Scenario sets out what needs to be done to move beyond these announced pledges towards a trajectory that would reach net zero emissions globally by mid-century, which is consistent with limiting global warming to 1.5 °C.

Source: (IEA, 2021c).

Reasons for the current shortages are multiple, but some of them reflect future challenges that could be linked to decarbonisation. The post-Covid demand surge is partly responsible for a global shortage of energy, but it coincides with an undersupply due to a lack of investment in clean energy at a time when investment in brown energy has been

receding over the past decades (IEA, 2021b) .

In short, the current situation should provide lessons to prepare better for the transition to a climate neutral world through strengthening our energy systems as our energy infrastructure morphs into one that relies much more on variable renewable energy sources. Policy makers thus need not only steer incentives towards clean energy but they should also ensure that as energy systems become cleaner they remain reliable and affordable. This requires larger and more timely investment, a focus on electricity system flexibility, and better pricing systems. The IEA estimates that investment in clean energy projects and infrastructure needs to more than triple over the next decade to reach net-zero emissions (Figure 2).

Failure to better prepare our energy system would only exacerbate public finances pressure while weakening the price signals. Countries are currently scrambling to provide aid to their citizens to soften the blow from rising energy prices at the cost of higher emissions. Interventions range from means-tested transfers to low-income households, energy tax cuts, caps on energy prices, and excess profit taxes on energy companies (Table 1). While protecting vulnerable households is necessary, it is important that such measures remain time limited and not undermine incentives for clean energy.

The OECD has long since highlighted the importance of policy alignment and how a comprehensive, inclusive and cost-effective strategy to address climate change will require bringing in complementary policy areas and exploiting synergies among them (OECD, 2015e) (OECD, 2021a). The current episode highlights this further, especially since higher energy prices could render already contentious policies, such as carbon taxes, even less palatable and politically tenable (Politico, 2021). To this end, governments need to strengthen targeted social support to vulnerable populations, including through well-designed revenue-recycling schemes, and to

bolster active labour market support to help workers and encourage a more efficient reallocation of labour (OECD, 2021d) (Vona, forthcoming). They need to upgrade market regulation to ensure greater stability as well as competition, and to encourage investment in energy system flexibility. Reforming financial sector regulation is also key, such as requiring greater disclosure in financial markets to better account for climate risk and mobilise private funds (OECD, 2021b). Lastly, transparency, better communication and carefully assessing compensation packages would be necessary for garnering public support so as to not derail the energy transition.

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