Spain’s recovery plan: strengths and challenges

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Spain is one of the countries which has most to gain from *Next Generation EU*, the key European-wide blueprint intended to kick-start the recovery from the COVID-19 crisis. For decades, particularly since the debt crisis of 2010, many demanded a comprehensive reform package to modernise the economy. Such a plan is now available and was endorsed by the European Commission on 16 June.

Yet making this historic opportunity to transform the economy a reality will be a titanic challenge, in terms of both Spanish and European policymaking.

No doubt Brussels’ approval of the Spanish recovery plan, entitled *Spain can* –the first to be given the green light along with the Portuguese programme– is an impressive outcome that underlines the adequacy of the proposal in terms of the European goals of making the economy greener, fit for the digital age and more socially inclusive, and at the same time tackle some of Spain’s structural weaknesses.

The plan comprises nearly €70 billion in transfers (plus another potential €70 billion in the form of loans, not yet requested) committed over the next three years, to be disbursed subject to meeting around 200 investment targets and implementing over 100 reforms in 10 key policy-areas, ranging from a ‘a fair and inclusive energy transition’ and ‘industry and SME modernisation and digitisation’ to ‘education and knowledge, lifelong learning and capacity building’.

Not since the structural and cohesion funds received in the 1980s, and the reforms enacted at the time as part of the country’s entry to the European single market, has Spain envisioned such a comprehensive project. The challenge now is to convert it into effective policy action.

The Spanish plan includes a comprehensive mix of investments and reforms…

The mix of investment and reforms goes in the right direction in terms of the country's own needs. The Spanish economy has been one of the most heavily hit by the crisis, with a precipitous 10.8% fall in GDP in 2020, almost five points above the EU average, due to an over-reliance on services, especially tourism. Investment has been disproportionately affected, threatening to reduce long-term productive capacity. So the emphasis on (physical and especially human) capital accumulation in the plan is welcome.

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Importantly, the planned investment targets accurately touch upon the key areas where the Spanish economy needs to make progress in order to seize the opportunities of the digital and green transformations. This includes, among others: investing in renewable sources of energy, including green hydrogen, solar and wind energy projects that draw upon the country's comparative advantage; a plan to expand its electric car capacity with a value chain approach; various measures to boost the transition from a myriad of low-productivity small businesses to digitalised medium-sized companies and efforts to modernise the public administration. Crucially, investment in human capital runs through most of the targets, which is most appropriate given the existing gaps in this area. Spain is the EU country with the highest incidence of early school leavers after Malta.

A broad range of reforms accompany the investment plans. This echoes most of the recommendations put forward by the Commission in recent years through the European Semester, notably as regards reducing duality in the labour market, improving re-employment services for jobseekers and addressing chronic fiscal imbalances through changes in pension systems and taxation. The reform agenda goes further and includes changes in education and training, making product and energy markets more competitive and unified throughout all regions, and enhancing the effectiveness of the judiciary, among others. Greater gender equality, which is one of the four general objectives, alongside the green transition, digital transformation and social and territorial cohesion, is another salient, much needed, expected outcome.

… but implementing the programme raises titanic challenges…

While the programme is an ambitious attempt to tackle the key obstacles to inclusive growth that have plagued Spain for decades, the question arises as to whether it is achievable, and if so how.

If the past decade is any guide, there are reasons to be sceptical. During the previous EU budgetary period, less than 40% of the total funds available to the country had been executed (which does not bode well in view of the significant increase in the level of resources for the current budget). This is the lowest achievement rate in the EU, which points to major administrative bottlenecks. As to reforms, some of the most prominent ones –such as labour markets, pensions, education, public administration and the domestic single market– have been on the agenda of successive governments, without much policy action seeing the light of day. Furthermore, the current political polarisation is not the ideal context to reach the long-lasting, multiannual compromises that are called for.

Breaking with past inefficiencies and inertias involves, first of all, improving the management of the funds. One huge stumbling block here concerns the articulation between the central and regional levels of government –the latter are expected to manage around half the funds, and have full autonomy in areas such as health, education and active labour market policies–. Another is to set up mechanisms for allocating the funds that are both quick in terms of ensuring that the ambitious timetable is met, and efficient in the implementation and monitoring phases so that the money is well spent. The latter is crucial for maximising the economic impact of the plan, because it is no good to support projects that would have been undertaken by the private sector even without the transfers (entailing a deadweight loss). Also, the most competitive providers should be selected under a fair and transparent selection process that is appropriately communicated to everyone interested in receiving funds.

The plan innovates by introducing strategic private-public partnerships (the so-called PERTEs), which are the Spanish equivalent of the Important Projects of Common European Interest (IPCEIs) at the European level. But as it turns out, PERTEs are small in number and cover only a limited proportion of the grants. Furthermore, unfortunately, at first sight the plan devotes only €500 million to the integration of Spanish firms in pan-European cross-border IPCEIs in hydrogen, automotive batteries, submarine cables, the cloud, edge computing, microprocessors and secure satellite communications, among others. This is just 0.7% of the €70 billion. This is perhaps one of the greatest shortcomings of the EU Next Generation exercise, which was not designed to boost cross-European cooperation. It is regrettable that the first joint issue of EU debt (the much-needed Eurobonds) is devoted to compartmentalised national plans, without considering the strategic importance of pan-European projects that have the potential of becoming European public goods. True convergence cannot be achieved by strengthening the individual parts of the Union alone. Indeed, connecting and integrating economies is of paramount importance especially in the face of stiff global competition.

Secondly, launching the type of reforms that are foreseen in the plan will require major persuasion efforts in the direction of social partners, the political spectrum and society at large. Some reforms are particularly controversial, notably as regards labour markets, pensions, taxation and public administration. The Plan is specific concerning those elements which are most likely to be widely accepted, such as narrowing the range of contractual arrangements, widening funding sources for pensions, raising green taxes (although, here too, future disagreements are likely) and digitising the public administration. But the Plan is either vague or mute on other, often more fundamental matters, such as the protection of permanent employment contracts (a divisive matter between employers and workers' representatives), reducing the pension deficit, making taxes more progressive (questions that divide political parties and are highly sensitive to public opinion) and whether the entry mechanisms to public service should be revised (30% of all public jobs in Spain are temporary). And yet the timetable is for major overhauls over the next year or so.

There is also a tension between the Commission's insistence on retaining the main achievements of the labour and pension reforms carried out during the austerity period in the aftermath of the previous crisis, and the government's intention to undo some of them.

… that may or may not be met, depending, first, on the awareness of Spanish stakeholders that this is a historic opportunity not to be lost…

Given the many implementation hurdles, Spain will probably not meet all the plan's investment milestones in time. Indeed, some significant delays are likely, especially at the start given that the details of the concrete allocation of resources are still missing. Yet major progress is expected to be made on spending the funds: the stakes are simply too high and there is a broad awareness of the historic opportunity not to miss this modernisation train. The comprehensiveness of the investment package and the heavy implication of enterprises and social partners in its preparation bears testimony to this. Already in December 2020 the Spanish Government approved a royal decree to streamline the Spanish administration and facilitate the bureaucratic process to effectively implement the allocation of investment projects. Among other things the decree improved the public governance and oversight structures and the frameworks necessary for a better cooperation between the public and private sectors.

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Moving ahead with the reform agenda is an entirely different matter. Critics have suggested that the reform ambitions are too vague, and that leaving the ultimate decision to the 'social partners' is a delegation of responsibility by the Government. That said, if we have learned something from the mistakes of the 2010-12 crisis –and fortunately *Next Generation EU* seems to have incorporated these lessons– it is that reforms cannot be imposed top-down by Brussels, nor should they be enforced by the Government without a broad consensus among the main stakeholders. Ownership of the reforms is key. Thus, the European Commission seems to have converged towards the Spanish Government's argument that reforms should as much as possible be subject to social dialogue with employers and unions, for them to be long-lasting. In other words, the compromise needs to strike the right balance between flexibility and security so that it can be accepted by all stakeholders. In the absence of such a compromise, there may be difficulties for the disbursement of the next tranches of the Spanish recovery plan. It must be said that in the current context of strong political polarisation, social dialogue between employers and unions has been one of the few spaces of compromise and agreements throughout the pandemic.

The most important concern is with the boldness of the reform plan. Indeed, if the big reforms do not happen now, when there is a sense of urgency, and money is available, then they may be indefinitely postponed. In the current context of political fragmentation and polarisation, a 'big bang' moment of reforms is unlikely. Vested interests are difficult to break. Not to mention the fact that the next general elections will take place in 2023 at the latest.

The bottom line is that a piecemeal strategy is more likely and though not ideal this is better than inaction as long as the direction is the correct one. However, a critical mass of changes will have to be made in a short period of time for the plan to lead to a long-lasting expansionary period.

For many years, the biggest EU member states have been urged to enter into a dynamic where solidarity is met with reforms. If Spain undertakes the key reforms envisioned in the plan, and the pressure is certainly there if only because the next instalments of EU funds are dependent on this (a key innovation of Next Generation EU), the economy will become more resilient and socially inclusive. Much hinges, therefore, on the awareness of the Spanish stakeholders (both in the public and private sectors) regarding what is at stake, and in broad terms we believe the awareness is there.

… and, secondly, on major reforms in EU policymaking

That said, experience so far suggests that reform efforts should not be borne by Spain, or indeed other individual countries, alone. Europe should also engage in a deepening of the turn it has taken when agreeing on *Next Generation EU*. If the dynamic of investment-cum-reforms works, but the recovery and resilience plan is only a one-off event, the structural tensions in the EU will remain.

The EU, and more specifically the European Monetary Union, is simply not sustainable without a genuine counter-cyclical fiscal capacity. Already, as highlighted by Blanchard & Pisani-Ferry, the fiscal impulse provided by the plan is not enough in order to tackle the output and employment gaps provoked by the pandemic. So, if no continuity was given to this effort, Europe would be ill-prepared to respond to future recessions. Moreover, *Next Generation EU* can be regarded as a tool to facilitate reforms, rather than a rapid macroeconomic stabilisation mechanism.

Related to this, will the Union be able to compete with the US and China in a scenario of aggravated power rivalry, without having a bigger budget to strengthen its strategic autonomy? The answer must surely be no. Here we agree with the assessment of Andrea Capussela and we underline the idea that the success of the plans must be a joint exercise between the member states, the Commission and also European public opinion at large, which has a vested interest in making the plans work. In this regard, it is very positive to hear that some of the main political parties likely to be in the next German Government, especially the Greens, unequivocally defend the necessity of a fiscal union funded by the Union's own resources.

Next Generation EU, if it really wants to be the basis for a better future for the next generation of Europeans, hence a vision for 30 years and not just the current multiannual financial framework, should become permanent in some form or other. In its next phase it should also focus much more on transnational projects that can make the EU more competitive and resilient. As the latest review of the Commission's 'New Industrial Strategy' shows, and the debate around the production of the next generation of semiconductors demonstrates, the EU will need to invest enormous amounts of resources to catch up in key new technologies to avoid dependencies and vulnerabilities, notably with respect to the US and China. For this there needs to be more strategic thinking in Brussels and the national capitals and this starts by using the 'exorbitant privilege' that comes with issuing the second most international currency in the world. The high demand for euro-denominated debt, which was confirmed in the first issue of EU funds, not only ensures favourable funding conditions but also provides a solid basis for making Europe more resilient and prosperous.