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The Spanish Recovery Strategy

Setting the course for a climate-neutral
and digital future?

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About this publication

Spain will be among the countries in the EU hardest hit by the pandemic, which has already grave impacts in all sectors of society and economy. The Spanish government was among the first to present its recovery plan to the public and to the EU in the fall 2020. The already detailed plan reinforces the intentions of the progressive coalition in power since January 2020 to heavily invest in social justice as well as in digital transition and ecological transformation modernizing the prevailing industrial model in Spain. The paper provides an assessment of the most salient parts of the program for recovery, transition and resilience in the broader context of challenges for the economic and social policy in Spain. It positively evaluates the intentions and highlights the need for more detailed strategies and mechanisms for the utilization of the European funds as well as the overall importance of good governance as guiding principle.

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INTRODUCTION: ECONOMIC DAMAGE AND INSTITUTIONAL PROBLEMS

Spain is suffering particularly badly from the devastating effects of the global pandemic. Following a first wave that put the health system under great pressure and required a very strict lockdown, the second wave hit Spain earlier than the rest of Europe. The contraction in 2020 will be among the most severe experienced by the advanced economies, due to the importance of sectors with the greatest exposure to disruption (such as tourism) and the vulnerability that is the product of a highly atomized business sector, dominated by small and medium-sized enterprises.¹ After an unprecedented fall in GDP of between 11% and 12%, we believe that economic activity will not return to pre-pandemic levels until well into 2022.

The social impact of the crisis will exacerbate inequality, as the destruction of jobs and the loss of income has been greatest among workers with fewer qualifications and more precarious employment. The female unemployment rate has risen to 18.4%. However, the stabilizing actions set out in the budget and the emergency measures to reduce the impact on employment, including a major role for social dialogue, have softened the blow.

The authorities' response to the health crisis has exacerbated the distrust in public institutions which had been growing since the economic crisis of 2009. Weaknesses in Spain's system of regionally devolved government have been revealed, and even the health system – perhaps the greatest focus of shared national pride – has shown that its performance rests on far more fragile foundations than might be hoped.

In the four years prior to the arrival of COVID-19, Spain held four general elections- and relations between Catalonia and the rest of Spain have been thrown into crisis by demands for independence. Numerous and far-reaching economic reforms between 2010 and 2015 were halted despite a strong recovery and the persistence of structural challenges, including low employment rates, an ageing population and weak productivity growth.

In this context, the scale and scope of the European response to the crisis is both a short-term boost and a great opportunity over the medium and long term. The lessons learned by the Eurosystem and the improved solvency of the banking system have largely neutralized the financial mechanisms that could have aggravated the crisis. On this occasion, European institutions have risen to the challenge with the concept of Next Generation EU (NGEU), an exceptional temporary budget to promote recovery and accelerate the green and digital transformation, funded by the issue of joint debt.

The Recovery, Transformation and Resilience Plan, presented in early October by the Spanish Prime Minister, Pedro Sánchez, offers a route map to implement the promise of NGEU in Spain, in accordance with four principles and ten policies to leverage reform. This is only the beginning, as success will require the energy and commitment of all, in a new national effort both to recover from this massive blow and to establish the foundations for a new period of economic and social progress. Social dialogue is essential if our attempts to meet this challenge are to be successful, and its newfound importance will act as a catalyst for reforms, rejecting maximalist positions in search of formulae that enable us to protect those hit hardest by the crisis while also promoting economic transformation.

GOVERNANCE AND THE DRIVE TO MODERNIZE

Following a series of gruelling meetings on the proposal put forward by the European Commission on 27 May, the European Council reached a political agreement in July, since when attention has focused on the huge scale of the resources that Spain will receive. This is understandable, given that the NGEU, according to the most recent estimates (Darvas, 2020),² could provide Spain with 72.5 billion euros in transfers (including guarantees) and 72.4 billion in loans during the period 2021–2024 (both figures at 2018 prices). Spain has extensive experience of accessing structural and cohesion funds from the European Union but never before has the volume been so large, representing 11% of GDP, over such a short time period, with the dual aim of fuelling recovery.

¹ The tourist industry accounts for 12% of Spanish GDP, according to the country's national statistical institute (INE), while exports of tourist services, prior to the pandemic, represented almost 6% of GDP.

² Darvas, Zsolt (2020): Next Generation EU payments across countries and years (21.11.2020); available at: <https://www.bruegel.org/2020/11/next-generation-eu-payments-across-countries-and-years/>

ery and supporting economic transformation. In the atmosphere of distrust and sadness that has characterized 2020, the initial euphoria has given way to fear that we are not up to the scale of the challenge. Indeed, it is often the case that when we achieve something we have been pursuing for a long time – in this case, coordinated European fiscal action, funded by joint debt – we forget the achievement and concentrate solely on the responsibility of implementing it.

The fiscal injection, funded by medium- and long-term European debt (whose repayment we will contribute to through the EU's own resources) complements the domestic fiscal expansion that we needed in the calamitous situation generated by the pandemic. But the moment requires perspective and a strategy, which must look beyond money and immediate needs (however pressing these undoubtedly are). We need to grasp the opportunity to make a major breakthrough in modernizing the country, combining regulatory and institutional reforms with public and private investment. Time is of the essence, but the key to success is not urgency but the manner in which we tackle this challenge. No doubt there will be some mistakes and it is very likely that we will fail to absorb all of the funds (in particular, the loans). But if the method is right, then we will be able to learn as we go and to correct our errors.

Among the principles that should be included in this method, we would highlight the following:

- **Political coordination.** Central government is responsible for directing the process, and it has set out its priorities in the first version of the Recovery, Transformation and Resilience Plan. However, if this is to be implemented successfully it will require the efforts of the whole country, and this means involving all political groupings and administrations at every level.
- **Close cooperation with the private sector.** The Plan envisages leveraging up to 500 billion euros of private investment. However, the figures are not the most important aspect here. Economic transformation can only happen with the knowledge, experience and investment opportunities provided by private companies. Business associations, the financial sector and individual companies are already mobilizing to contribute to the implementation of the plan. And clear channels for communication and participation need to be created, even though final decisions as to the use of public resources and their allocation to specific projects correspond to the government.
- **Rigorous project-selection criteria.** After several years of limited resources for public investment, it is important not simply to dust off old projects. Transport infrastructure, which has absorbed very significant amounts in the past, should no longer be a priority. Administrations and companies must strive to concentrate on the best projects; the abundance of emergency and European funding should not lead to hasty decision-making. In this respect, it is important to stress the need to apply principles that guide candidate

projects and investments towards areas such as the decarbonization of industrial activity and mobility, or towards greater digitalization both in companies and public administrations.

- **Sufficient attention to the medium and long term.** Restoring pre-pandemic activity and employment levels is a worthy objective. However, the opportunity provided by NGEU goes beyond that because it offers the chance to establish the foundations for a new phase of economic and social prosperity. The analysis of investment projects must take future benefits into account, and it is important to remember that, in a low interest rate environment such as today's, these have greater weight in current net value.
- **Think about implementation, evaluation and control from the outset.** The European Commission has already made it clear that it will disburse funds on the basis of project implementation milestones. But this is not just a requirement of European institutions. In an undertaking of this scale, citizens deserve a transparent system which ensures proper use of funds, accountability and impact assessment. This task cannot be postponed and must, instead, form an integral part of the preparation work that is already under way.

Another key element of the strategy is **renewing the reformist and modernizing drive**. Since the late 1950s, the Spanish economy and society have experienced two phases of intense modernization. The first was associated with opening up and liberalization during the 1960s and the first half of the 1970s. The second was marked by entry to the European Community, borne along by trade and financial liberalization and the construction of the welfare state during the 1980s and 1990s. We now need a third modernization, one which must again involve a domestic dynamic for change. Our institutional framework requires new reforms to address unresolved problems which have been closely studied and analysed both in and of themselves and in terms of the barrier they represent for our capacity for inclusive growth.

These reforms are identified in the plan presented by the government. Of particular importance are those relating to the operation of regional devolution, the labour market, pensions, the tax system, education and the health system. We have been suffering from our incapacity to join forces to deliver these essential changes to increase our employment rate, address the problem of precarious employment and the dual labour market, deliver high growth in productivity, and strengthen our public finances. We can no longer postpone this third modernization, and NGEU provides a favourable framework for such an undertaking.

For some of the most decisive changes on this agenda, agreement between different social agents is not just desirable but essential. Making progress towards greater job stability, increased employee participation in companies and, in general, closer cooperation between labour and capital, is essential if the investment in human and technological capital is to translate into greater growth in productivity.

At the same time, the Spanish strategy must pay particular attention to the two vectors of transformation on which the EU wishes to concentrate its efforts to combine short-term recovery with the establishment of more solid foundations for medium- and long-term growth: sustainability and digitalization.

THE GREEN TRANSITION

Spain is one of the European countries that is most exposed to the impact of climate change. Rising average temperatures (which we have already seen over recent years), extreme weather events, lower rainfall and rising sea levels will place pressure on water resources and will increase costs for sectors such as agriculture and tourism. At the same time, the Spanish economy imports almost all of the fossil fuels it consumes, while it has abundant renewable resources. According to *Carbon Monitor*, emissions of greenhouse gases fell by 15% for the period January to September 2020, due to the economic consequences of the pandemic. However, hitting the targets for 2030 will require a sustained increase in investment to decarbonize electricity generation, transport, industry and domestic use.

This starting position means that, for Spain, energy transition – understood as a dramatic shift in the composition of electricity generation, the electrification of a significant portion of demand, and improved energy efficiency – is an investment with very significant economic and social benefits. The multipliers of green investment in terms of employment and GDP are high, as we show in our study of climate change and sustainability in policies to support recovery from the pandemic³. Each euro invested in these projects will generate more than two euros of additional GDP, while the jobs created will tend to be skilled and permanent.

The Recovery Plan is based on detailed work to reform and promote public-private initiatives, which have been given form in the Integrated National Energy and Climate Plan (PNIEC) submitted to the European Commission in May 2020, in line with the European Green Deal announced by the Commission at the end of 2019. Moreover, Spain has a very powerful private sector, with extensive technological experience and financial capacity, which will play a fundamental role in implementing the necessary investments. Public support, however, is vital in defining a clear, stable legislative framework; the Climate Change and Energy Transition White Paper is designed to establish this framework, to support investment worth 200 billion euros until 2030, generating up to 300,000 jobs.

The public sector has to establish the obligations to adapt and provide the appropriate incentives for companies and families, facilitating the internalization of externalities, both negative (through taxes or limits on emissions) and positive

(with grants and financial incentives). And the state also has to promote investment in the development of technologies associated with energy transition, the circular economy and adaptation to climate change. Electricity storage and green hydrogen are examples of technologies in which public funds will have to complement private efforts if Spain is to capitalize on new production capacities in a low-carbon environment.

DIGITALIZATION AS A MEANS OF LEVERAGING PRODUCTIVITY

The Spanish economy has strong foundations with respect to digitalization, with good telecommunications infrastructure and digitalization of public services (with Spain being above the EU average in the European Commission Digital Economy and Society Index, DESI). However, there is still a great deal of work to be done to take advantage of the full potential of new technologies for training, health and productivity in companies, particularly in the micro-enterprises, which exist in such large numbers.

The pandemic has also led to a rise in the use of digital technology, which could boost use across the board: teleworking, access, education and e-commerce have helped to support 78% of jobs and 79% of gross value added (GVA) during the second quarter of 2020, when the impact on the economy was greatest.

The Recovery Plan defines two basic policies destined to promote digitalization in the public sector – *Una Administración para el siglo XXI* (An Administration for the 21st Century) and *Modernización y digitalización del tejido industrial y de la Pyme* (Modernization and Digitalization of Industrial Infrastructure and the SME sector) – to which 5% and 17.1% of the total transferred resources, respectively, will be allocated. However, digital technology is an issue that cuts across the vast majority of the ten key policies identified in the plan.

From a public perspective, the systematic use of data for public policies could help to mitigate the Spanish authorities' shortcomings in control and management capacity. Two clear examples are the tax system and the labour market. At the same time, digitalization could reduce compliance costs for firms and citizens, and make it easier to detect breaches, thus generating greater incentives. In this area, it will be important to facilitate cooperation and coordination between different branches of the administration, in order not to unnecessarily duplicate fixed costs and to promote learning and the development of best practices.

When applied to health, such technology makes a significant contribution to medical research and public health measures, which is particularly important in the current scenario. The much-needed consolidation of the national health system over the coming years should prioritize the use of data in decision-making and the development of digital skills in health professionals. Moreover, digitalization represents an opportunity to make health spending more efficient, in the context of growing pressure on public budgets.

³ Afi (2020): El clima y la sostenibilidad en las políticas de recuperación frente a la pandemia (Climate and sustainability in the recovery policies to fight against the pandemic) (09.2020); available at: <https://www.afi.es/webAfi/descargas/2018628/1252800/El-clima-y-la-sostenibilidad-en-las-politicas-de-recuperacion-frente-a-la-pandemia.pdf>

In an increasingly globalized world, the ability to compete in the marketplace is fundamental to the survival of companies, and of SMEs in particular. Digitalization has become a vital element of business competitiveness, through the intensive use of data, which is the basis of artificial intelligence technologies. E-commerce platforms make a significant contribution to companies' commercial strategies, offering key logistical and management advantages when it comes to penetrating international markets, without the restrictions on business size that were a feature of traditional exporting. In this respect, it is important to extend the support already available from public bodies such as ICEX (the Spanish Institute for Foreign Trade) in the use of these technological tools by companies, to enable business supply to meet public demand. At the same time, both Spain and the rest of Europe face major challenges in industrial value chains, which are increasingly influenced by relationships between global actors such as China and the USA. The pandemic has exposed the Spanish economy's vulnerability in this field, due to its dependence on certain digital technologies, reviving the debate about the role of industrial policy in ensuring that Spain and Europe have the necessary technological and industrial capacity and human capital to compete in the arena of the digital economy.

In particular, improving the quality of human digital capital is a necessary condition to achieve the goals set out above while also being the most difficult area in which to achieve progress, given the long timeframe over which reforms in education and training bear fruit. The objective of this strategy is none other than to adapt the skills and knowledge of citizens to the needs of the economy and our society, and to provide the productive sectors of the economy with the skilled professionals it currently lacks.

In the short term, it is essential for Spain to develop a policy of attracting foreign talent, particularly from Latin America. Our close cultural ties and the salary gap between these countries and Spain means that Latin American professionals are ideal candidates for such opportunities. The reduction of bureaucratic barriers in the issue of visas, and the promotion of tax advantages for IT specialists would help to attract human capital from abroad.

Recent months have exposed a digital gap in the education sector, linked to technological shortcomings – both in terms of equipment and broadband connections – of a large number of vulnerable families. Given that online education can represent a viable alternative in situations such as the present one, it is necessary to ensure internet access and the availability of equipment to those students who, for economic reasons, were cut off from teaching during the lockdown period.

Over the medium and long term, there must be reforms to the education and continuous training system designed to ensure that these keep up with the changing needs of the market. The number of university places in technological subjects should be increased to match rising demand from students. Over the last four academic years, demand for qualifications associated with digitalization has consistently

risen faster than supply, far exceeding the level of demand for qualifications in physics and mathematics.

There is also a need to develop a genuine continuous training policy in the digital sphere for older workers and the unemployed so that they can update their skills and knowledge to match the changing demands of the market. For example, the completion of digital skills courses might be a requirement for all applicants for the Basic Living Income.

Strengthening the EU's digital sovereignty is one of the Commission's key technological objectives. However, this concept of sovereignty should not be interpreted as a return to technological protectionism but rather as an expression of the need to consolidate innovation and human capital and to reduce barriers within the single market, and as a commitment to technological cooperation with the strategic partners of EU countries.

CONCLUSION: SPAIN CAN DO IT AGAIN

In the first two decades of the 21st century, Spain has already experienced two massive crises with a dramatic impact both on the economy and on the wider society. During the financial crisis, disruption both globally and, more specifically, within the eurozone, amplified the severity and the cost of problems that had been building up for years. The subsequent recovery was based on the business sector's capacity for resistance and on the welfare state, along with reforms adopted to facilitate the restructuring of the economy.

The impact on GDP in 2020 will be unprecedented but the nature both of the pandemic itself and of the European response mean we can have some confidence that it will be of limited duration. As a result, 2021 will be a year of recovery, but the future remains very uncertain and the path followed by the Spanish economy will depend to a large extent on our ability to make the most of NGEU.

In the context of the solidarity and clear-sightedness displayed by the EU, we must make sure we take the right measures and demonstrate that Spain is a trustworthy and credible partner. And this requires us not only to make intelligent use of the resources to which we will have access but also to adopt the regulatory and institutional changes necessary to address endemic problems and enable the transformations of the future. NGEU is a milestone in European economic integration. Whether it is doomed to be nothing more than a short-lived response to a crisis or if, instead, it becomes the embryo of the joint fiscal capacity that is vital to the future of monetary union will depend, in large measure, on whether countries such as Spain are able to take full advantage of it.

The political, logistical and administrative obstacles are numerous. But let us not forget that, in more challenging situations, and with fewer resources, Spain was able to pursue the path of modernization, as occurred during the years of the transition to democracy.

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IMPRINT

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Front cover: Yevhen – stock.adobe.com
Design concept: www.bergsee-blau.de
Layout: www.zumweissenroessl.de

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Recovery strategies in Europe

The restrictions imposed to combat the COVID-19 pandemic have led to a pronounced drop in production, a steep rise in unemployment and public debt. As a result, profound social distortions have arisen. Further, the pandemic has also revealed the strong dependence of Europe's economy from the production of vital products beyond the continent. Accordingly, national governments as the EU have had to devise wide-ranging programmes to support and revive the economy.

The development of these "recovery" programmes is taking place at a point in time when the European economies are at a crossroads. They are faced with meeting the immediate challenges stemming from social and ecological transformation and digitalization. As a result, there is significant pressure to ensure that the measures to implement economic revival do not lead to a restructure of the pre-pandemic status quo. Instead, the countries should seize the opportunity of massive public spending programmes to start the transformation of the economy and society towards climate neutrality and social equality.

A series of reports from several European countries analyse their respective national recovery plans and assess them in view of meeting the complex challenges. A synopsis offers a comparative perspective by interpreting and classifying the events and individual measures introduced in the individual countries. The aim is to develop policy recommendations that not only meet the long-term structural challenges faced by the EU-member states, but also to combat the immediate effects of the pandemic.