

2016
General State Budget:
**possible,
but we need
more reforms to
strengthen growth.**

September 2015

DOCUMENTOS
CÍRCULO



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CHAPTER I: Executive summary

Recent improvements in GDP and employment confirm that Spain's **recovery and economic dynamism continue to be strengthened**. **Internally**, the **reforms** that have been carried out **and the efforts** in the **private sector** have **corrected some of our macroeconomic imbalances**. This has led to improvements in the labor market, the external sector, investment and access to credit. Additionally, the Spanish economy has benefitted from

the positive effects of the ECB monetary policy, the depreciation of the euro, and the drop in the price of raw materials.

Nevertheless, **faster and more consolidated growth still requires new efforts** in economic policy, because Spain **continues to show structural weaknesses**. Among them: the high levels of public deficit and debt,



persistently high unemployment, an unviable pension system, the small average size of our companies, an educational system that clearly needs improving, the necessary reform of the Public Administration, the deficient administration of justice, and the low levels of innovation.

The advance of the 2016 General State Budget shows that the government wants to stabilize the Spanish economy and meet its obligations to the EU. And all this even though the government that emerges from the coming election may change this budget, as long as it continues on the path toward fiscal consolidation.

The 2016 Budget shows **little interest** in accelerating and achieving **fiscal consolidation** because it hopes to reduce the deficit by augmenting taxes and through a drop in financial spending and unemployment benefits. Nevertheless it does not take on the **necessary structural reform of the tax system** so as to make our tax revenue closer to the EU average, thus broadening the tax bases though without raising or creating new taxes and fees. Neither has the government considered the urgent need for **reforming the Public Administrations** so as to use resources more efficiently. Both reforms would make it possible to lower taxes on work and capital –especially a substantial cut in social security contributions by companies– so as to consolidate the economic recovery, accelerate the creation of employment and improve social wellbeing.

Our calling is to generate **ideas for growth**, and as we have stated in previous documents and public events, we propose a series of reforms that will generate more growth, more employment and more social welfare.

- It is necessary to **increase the estimated primary surplus and put a brake on the growth of public debt, as well as to carry out a structural reform of the Public Administrations** that will make it possible to use resources more efficiently, thus guaranteeing the sustainability of the Welfare State.
- **Further tax reform is necessary**, introducing new measures to reduce **fiscal pressure on labor and capital**. There must be a special **fight against fraud**, with measures to make people better **educated** and more aware as **taxpayers**.
- There are serious concerns about the Reserve Fund, which could run out in 2019, while the problem of an ageing Spanish population requires an urgent overhauling of the pension system.
- In the **labor market**, it would be a good idea to design new measures to correct **duality** in the market and create jobs and promote greater **employability** among the working population, especially **young people and people who have been out of work for long periods of time**.
- It is necessary to improve the quality of our educational system through a stable, long-range and consensus-based reform. Education should promote entrepreneurship and dual vocational training, design a system of scholarships and assistance that does not limit the academic development of gifted students, and dignify the work of the teachers.
- Finally, to make the Spanish economy **more dynamic** it is necessary to guarantee **legal certainty**; provide new mechanisms for company **financing** and increase **average company size**; eliminate **bureaucratic, fiscal and labor barriers**; and help our **businessmen** grow and become more professional.



Just as occurred in the very successful transition to democracy, we feel that the political parties and civil society must make an effort toward a **greater national structuring**. In a responsible way they must change the rules of the game, taking into account that, in this case, we are in a setting of global competition: it poses threats, but also provides opportunities to **develop a system of production** that will preserve our **Welfare State**. If we are up to the job, Spain will gain in **competitiveness, the quality of its institutions and wellbeing**.

To conclude: the Spanish economy continues to require **new structural reform** so as to consolidate the economic recovery, create and maintain jobs, and complete fiscal consolidation. It would be desirable that these reforms enjoy the **greatest possible agreement of the different political forces**, and a **high level of participation by civil society**. This would make it possible to work toward a single **national project** based on a modern economy and the quality and stability of the institutions. In any case, whatever the political situation that emerges from the coming elections, it should make possible an ample majority that will agree on the reforms that are necessary to carry out those objectives. Given the fact that the new Parliament will probably be fragmented, it would be beneficial to have a government with a big majority, one that could take on the big challenges to Spain and carry out the important structural reforms with the necessary consensus.



CHAPTER II: Progress and weakness of the Spanish economy

The recovery, the creation of employment and the dynamism of the Spanish economy all continue to take hold. This is confirmed by the upward predictions by the principal economic institutions, both domestic (Bank of Spain, FUNCAS...) and international (IMF, OECD...). This improved growth is based on the reduction of some of our macroeconomic imbalances and on the positive effects of the ECB monetary policy, the depreciation of the euro, and the drop in the price of raw materials.

Nevertheless, the crisis has left us with some high levels of debt and unemployment that, to be corrected, require new efforts in economic policy to strengthen and consolidate the bases of the recovery.

Before analyzing the 2016 Budget, we present the main progress and weaknesses that we see in the Spanish economy.

2.1 Progress

- **Labor market.**

Since the middle of 2013 there has been a change in the labor market. The number of Social Security affiliates has grown by nearly a million workers, from 16,426,756 (July 2013) to 17,315,188 (July 2015), although this is still far below the levels of 2007.

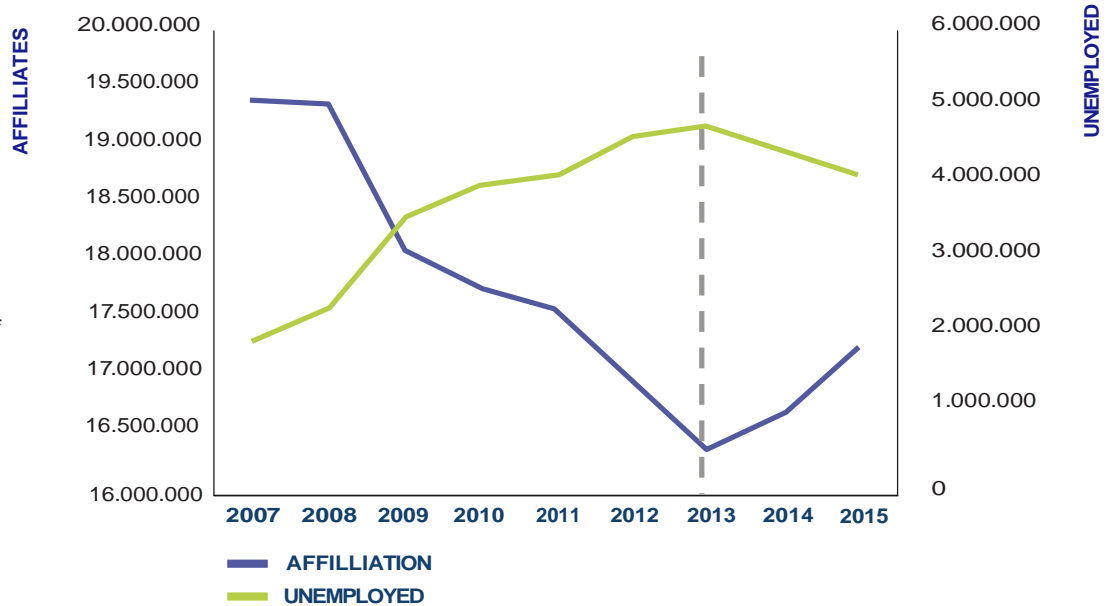
Meanwhile unemployment, while still very high, has dropped by more than a million persons in two years. According to the Survey of Active Population (EPA in Spanish), in the second quarter of 2015 there were 5.1 million unemployed in Spain, which was 1.2 million fewer than the maximum, which was reached in the first quarter of 2013 (6.3 million).



Evolution of affiliation to Social Security and registered unemployment

Persons

Source:
Ministry of
Employment and
Social Security.
August 2015



• **Successes in the exterior sector.**

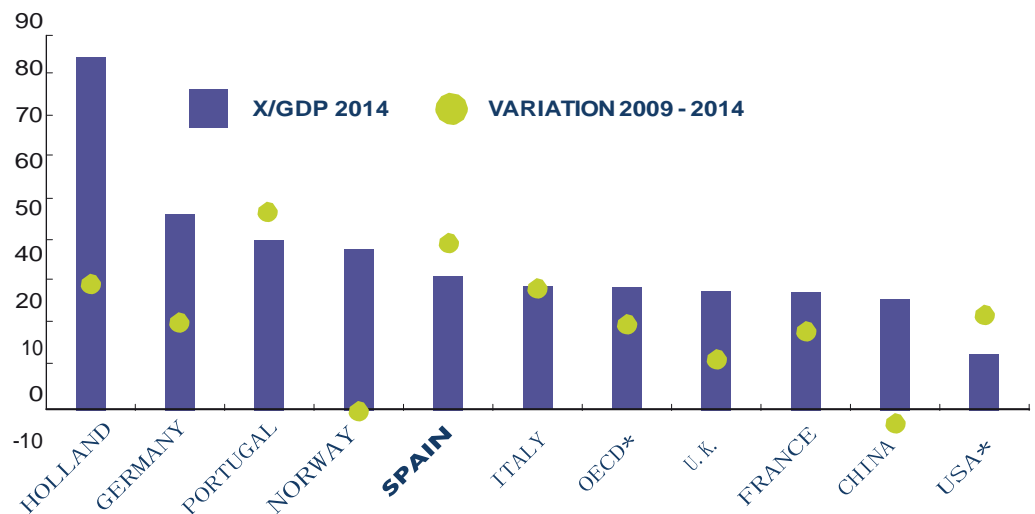
The exterior sector has been essential for the Spanish economy during the crisis years, a period in which the contribution to GDP by exports increased from 22.7% in 2009 to 32.6% in 2014.

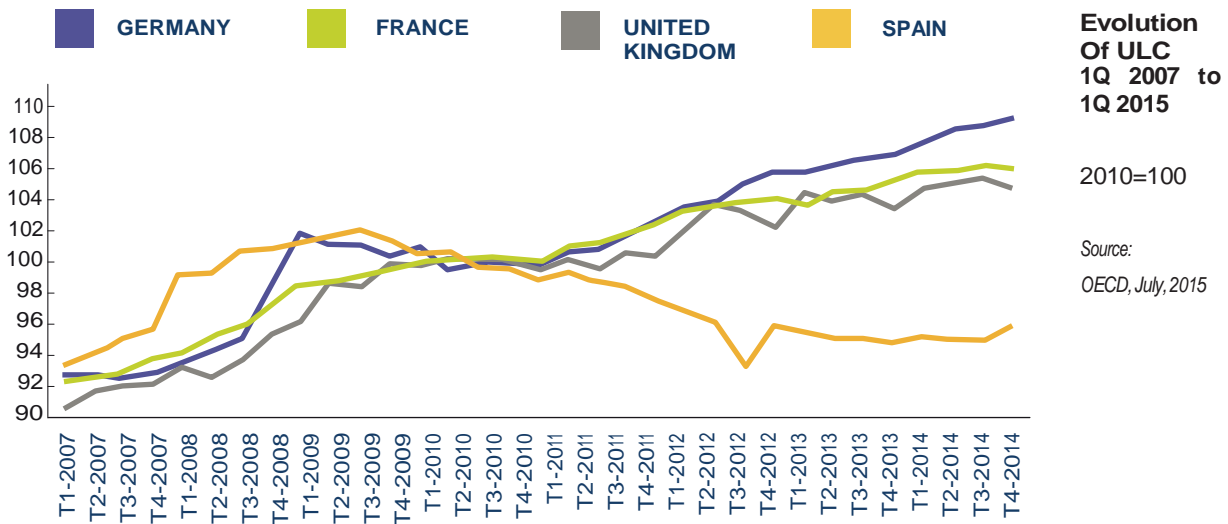
According to the latest estimates by the OECD, in 2016 there will be an increase of 6.1% in the export of Spanish goods and services –as against the 5.4% of 2015– thus making Spain the world’s ninth exporting country.

Exports as share of GDP

Source:
OECD. July, 2015

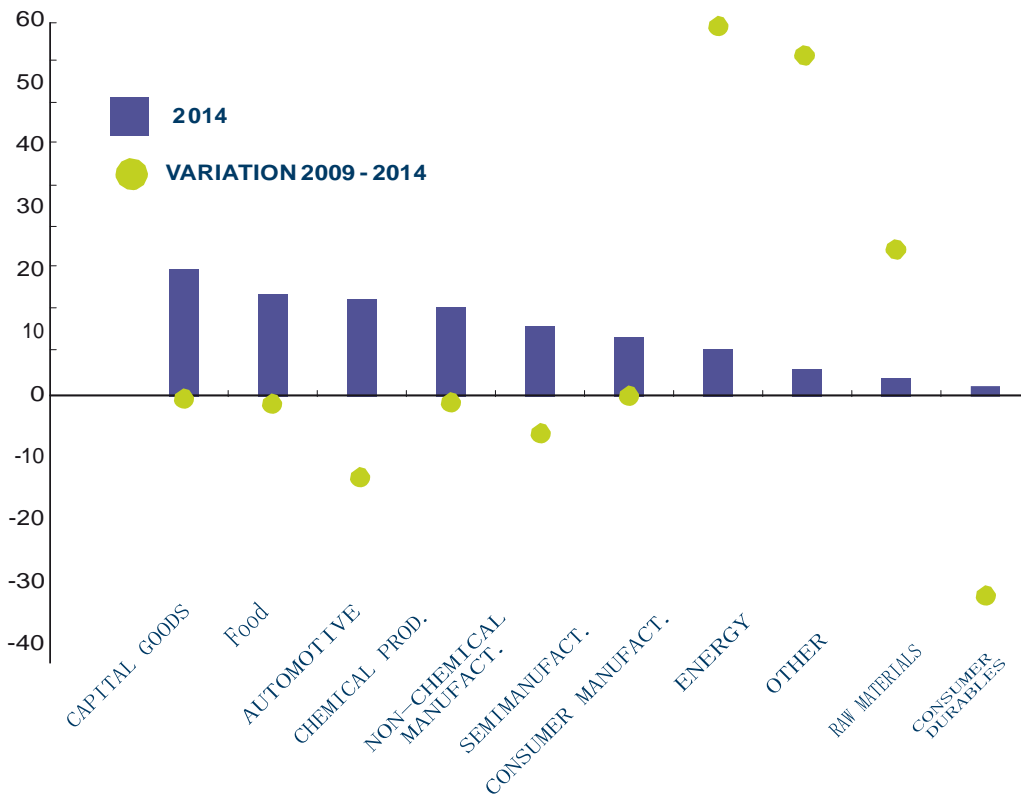
* 2013





Gains in the competitiveness of the Spanish economy can be explained by a drop since 2011 in unit labor costs (ULC), reversing the trend in –and widening the gap with– the UK, France and Germany, where these costs have grown..

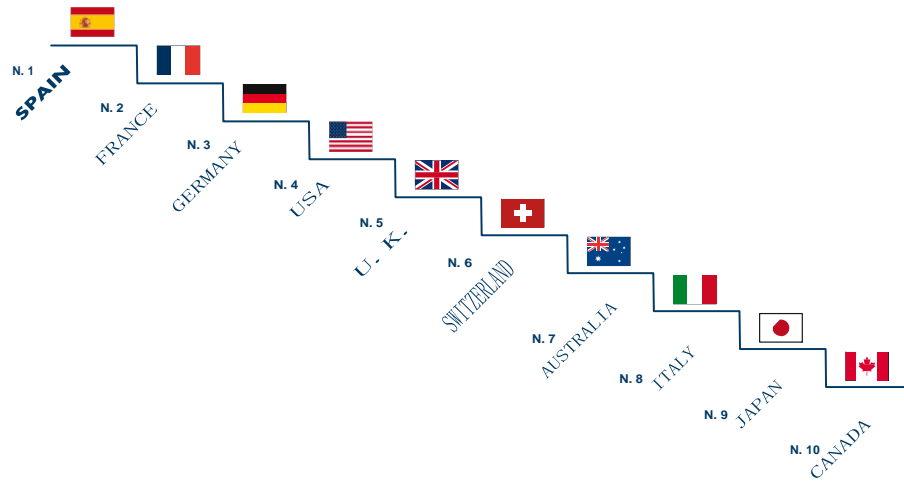
There is a noteworthy diversification in Spanish exports of greater added value products. The principal exporting sectors are capital goods, food and agriculture, and automobiles. In 2014 this latter sector (when added to the components industry) reached its annual maximum for the period analyzed (35,613 million euros).





Classification of the Travel & Tourism Competitiveness Index 2015

Source: World Economic Forum, 2015



Another Spanish sector that is outstanding for its competitiveness is tourism. For the first time, Spain leads the ranking in the World Economic Forum's Travel & Tourism Competitiveness Report. It jumps up eight positions from 2011, which is basically explained by the quality of its infrastructures, its cultural heritage, and its adaptation to the habits of digital consumers.

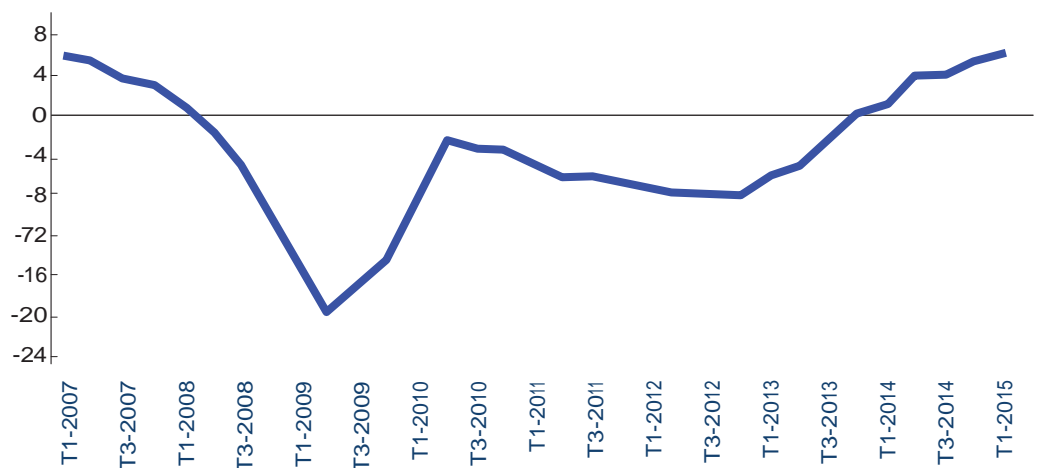
• **Gross capital formation.**

The formation of fixed capital has returned to the levels of interannual growth from before the crisis, thanks to the improvement of financial determinants and a context of favorable perspectives for greater internal demand, which encourage the adoption of new investment projects.

In 2016, Spain will be the fourth OECD country with the greatest growth in investment, some 6.3% interannual, above the 5.4% predicted for 2015. Spain is surpassed by only Iceland (14.5%), Ireland (9.6%) and India (7.7%).

Gross Capital Formation, 2007-2015

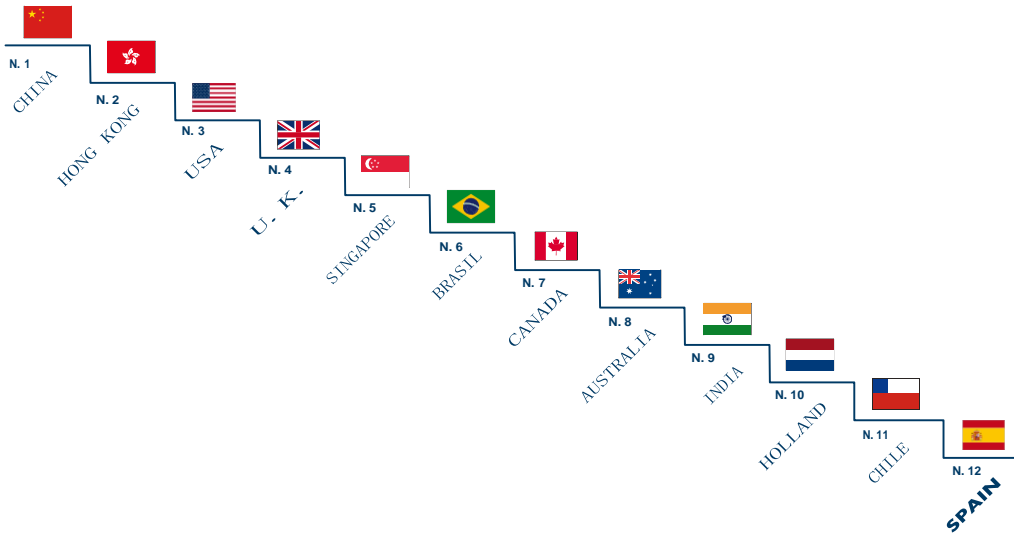
Source: INE, 2015





Classification of Foreign Direct Investment, 2014

Source:
World Investment Report,
UNCTAD 2015



• Foreign Direct Investment (FDI)

Spain is currently the world's 12th recipient of FDI, according to the ranking of the World Investment Report (WIR) 2015.

Spain's principal attraction for foreign investors is its large market, which is characterized by a sophisticated demand and high purchasing power. Likewise, there has been a steady growth in the importance of sectors of high valued added and technology, with a high degree of quality, differentiation, R+D and innovation, and design. In addition, Spain has become a platform to access other markets, such as Latin America and the EMEA region (Europe, the Middle East and Africa), both because of cultural and political factors and for the strategic opportunities offered by Spanish companies that are already operating there. And Spain has consolidated a model to attract FDI, one that is common in the most advanced economies, in which the bulk of the investment received is through fusion and acquisition.

The 2015 European Attractiveness Survey named Spain as the fourth most attractive

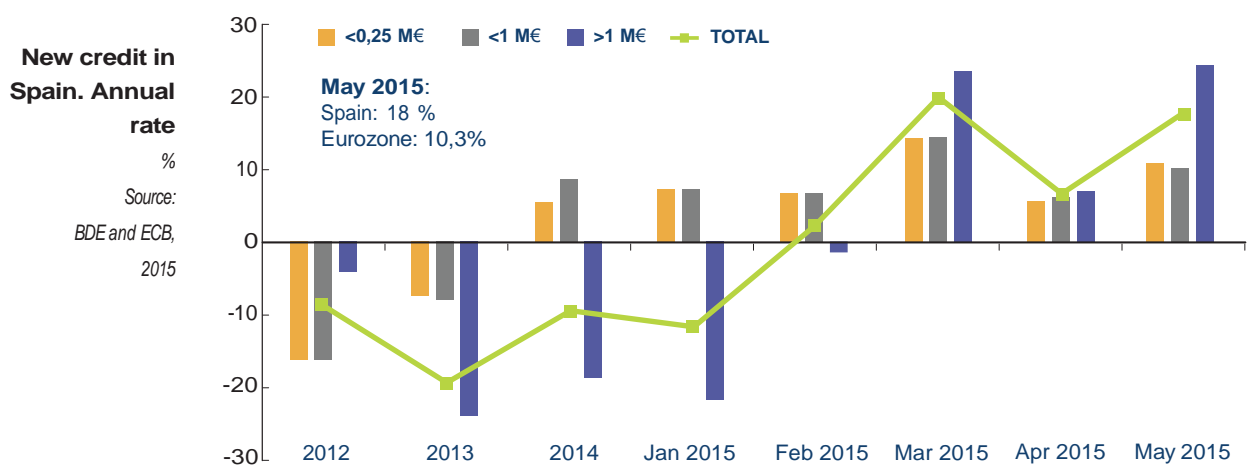
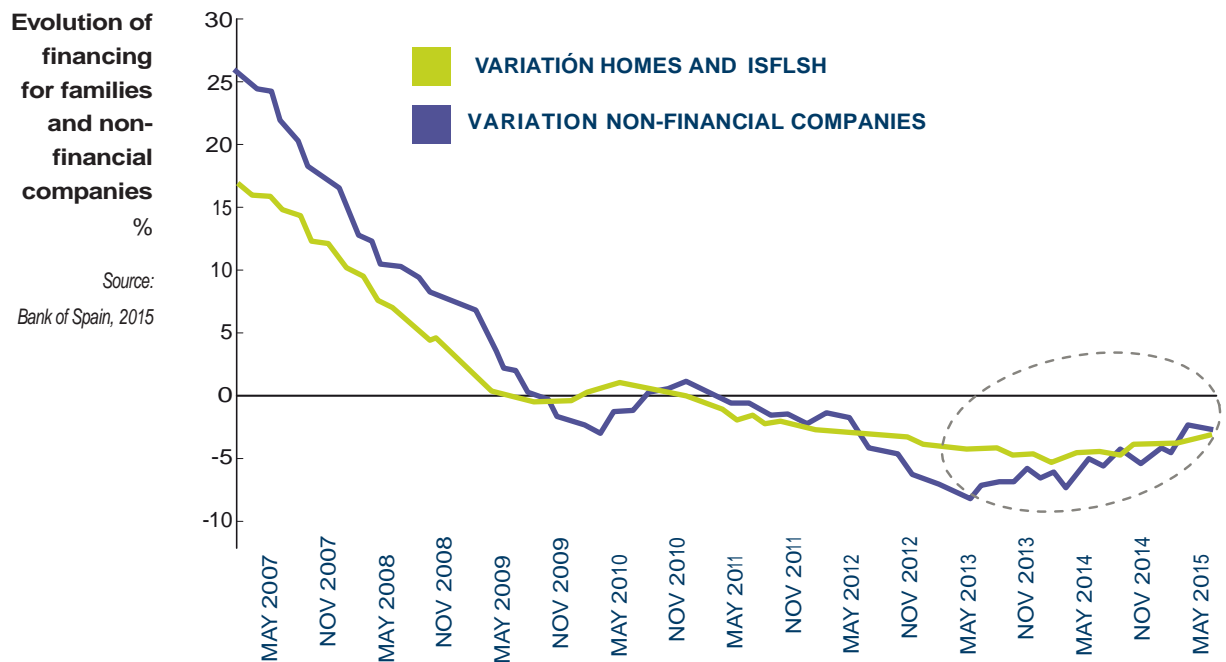
European destination for investment in 2014, behind the UK, Germany and France.

• Financing.

The financial crisis made it harder for Spanish companies to get bank loans as reflected in the negative growth rates due to company deleveraging, the restrictions of offers of credit, and the fragmentation of the European financial market, with effects in the greater cost of financing, especially for the countries on the periphery of the Eurozone.

At present Spanish companies have greater access to bank financing, thus interrupting the trend of recent years. Among the contributing factors: advances toward banking union (which reduces the differences between countries in cost of financing), the measures of the ECB (which reduce the cost and increase the availability of credit), the restructuring of the Spanish banking sector (which allows banks to lend more, on better terms), and the economic recovery (which benefits the solvent demand for credit).

Credit flow is still restricted but not as much as before, and credit for new operations is growing.



During the crisis Spanish companies, especially the small and medium-sized ones, have reduced their dependence on bank financing. This has gone from 80% of the total financing to levels of nearly 70% (Círculo de Empresarios and Foundation of Financial Studies, 2015), thus favoring the development of other sources (markets, crowd funding, risk capital...)

2.2 Weaknesses

• Public deficit

The public deficit continues to be a drag on the growth and competitiveness of the Spanish economy. According to the objectives of fiscal stability for the



Public Administrations, the maximum deficit predicted is 4.2% of the GDP for 2015; 2.8% for 2016; 1.4% for 2017, and 0.3% for 2018.

There are worrisome concerns for meeting and surpassing these aims: the primary balance, the deficits being run by the Autonomous Communities and the Social Security system

the spending in the Public Administrations, the public debt and unemployment.

The primary deficit for the Public Administrations as a whole, which discounts servicing of public debt, was -2.5% of the GDP in 2014 (ECB, 2015), with a forecast in

	2011*	2014**	2015	2016	2017	2018
Central Administration	-5,10	-3,50	-2,90	-2,20	-1,10	-0,20
Social Security	-0,10	-1,06	-0,60	-0,30	-0,20	-0,10
Auton. Communities	-3,84	-1,66	-0,70	-0,30	-0,10	0,00
Town Halls	-0,40	0,53	0,00	0,00	0,00	0,00
Total Pub.Admin	-8,94	-5,69	-4,20	-2,80	-1,40	-0,30

Budget Balance % GDP

* Before negative liquidations; excludes financial assistance of 0,48 pp in 2011

** Excluded financial assistance of 0.11 pp in 2014

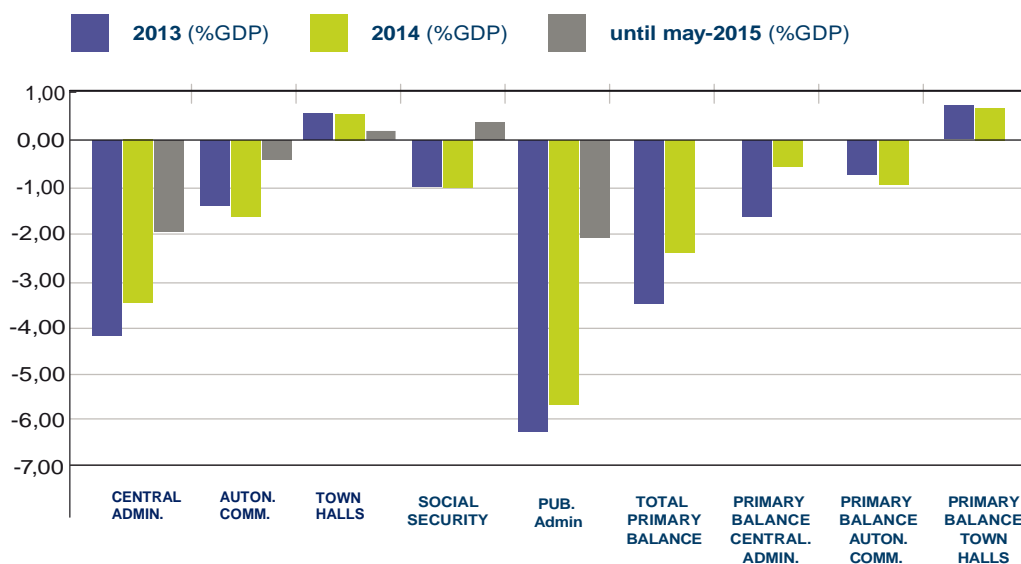
Source: Treasury Department, 2015

2016 Budget of +0,35%, far from the recommendations of the OECD, which considers that to accelerate the rhythm of fiscal consolidation it is necessary to generate a stable, continued primary surplus of at least 1%.

- Independent Authority on Fiscal Responsibility has recently expressed its doubts about compliance of the deficit target

in 2015 (4.2% of the GDP), principally because of the negative development of Social Security –with a deficit of 1.06%, rather than the objective of 0.6%– and for the failure to comply on the part of the Autonomous Communities, which have a predicted negative balance of more than 1%.

Capacity (+) or Need for Financing (-) of the Spanish Public Administrations



* Not taking into account in the Central Admin. the banking rescue.

Source: Treasury Department and Public Administrations, 2015



Nevertheless, the expected tax revenue, driven by the economic dynamism, makes it likely that the Central Administration will reach its goal of a deficit of 2.9% of the GDP for 2015. For their part, the Local Entities will balance their budgets.

- Following approval of the report by the Commission for the Reform of the Public Administrations (CORA) in 2012, exactly 76.13% of the 222 proposed measures have been implemented to lower spending by the Public Administrations (2Q 2015), which represents only 57.9% of the total estimated saving of the Public Administrations (37,620 million euros between 2012 and 2015).

In addition, in 2014 public spending exceeded income by almost 6 percentage points, which makes it difficult to adjust the deficit.

The negative evolution of tax income has played an important role in both the deterioration of the budget situation in Spain during the crisis, and in the process of fiscal consolidation. The drop in Government revenue explains an almost 50% increase in the public deficit between 2007 and 2009. Later, the reduction in the public deficit between 2009 and 2013, which was 4.2 points of GDP, was 60% the result of an increase in revenues –which grew 2.7 points of GDP in

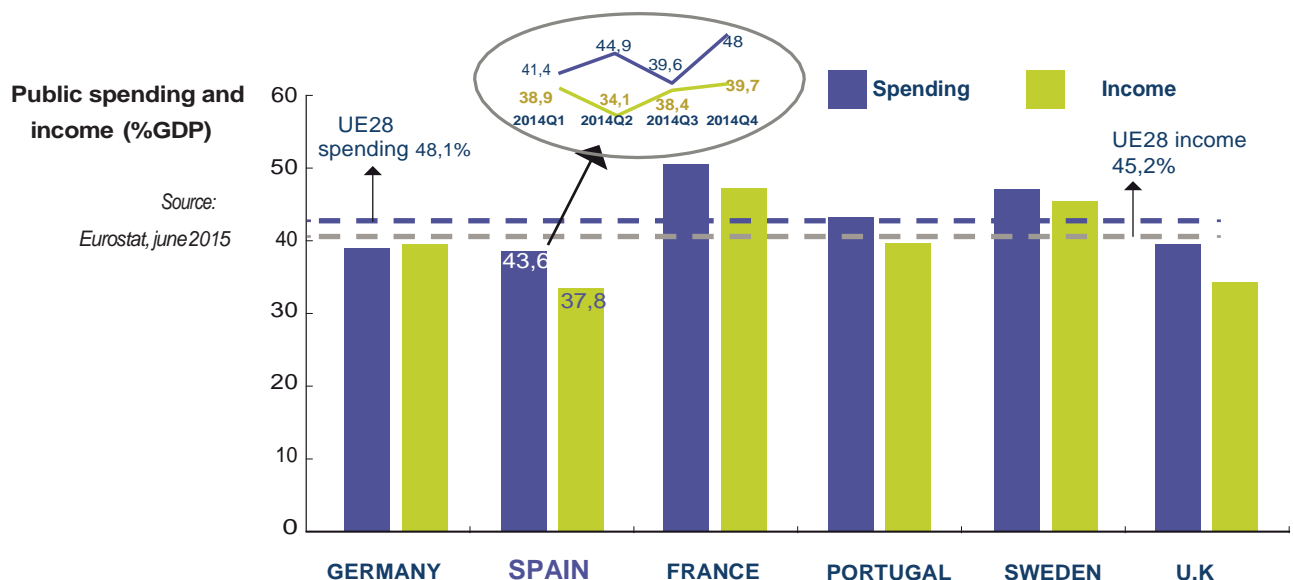
the same period– and 40% the result of lowered spending, which was reduced by 1.5 points of the GDP.

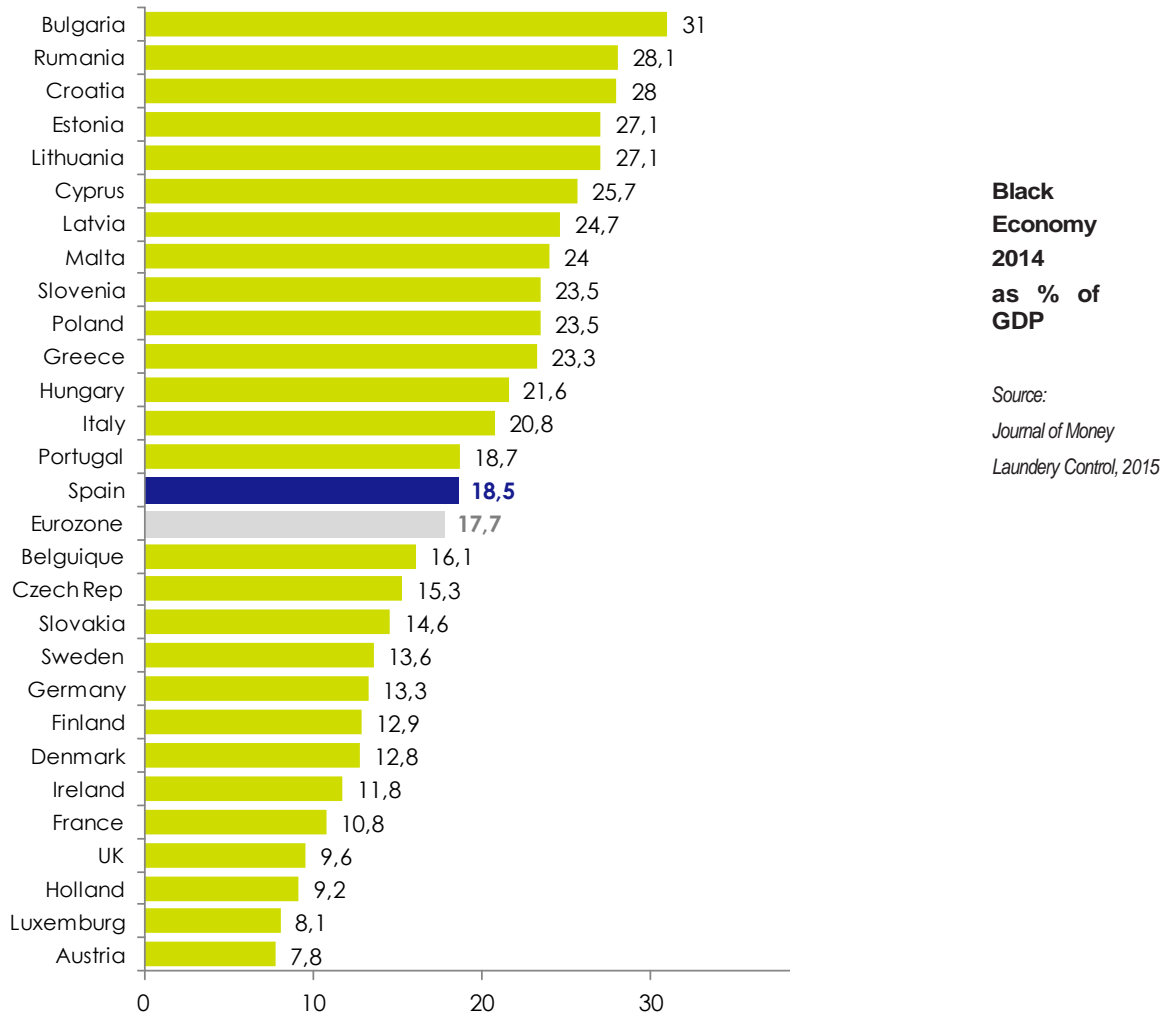
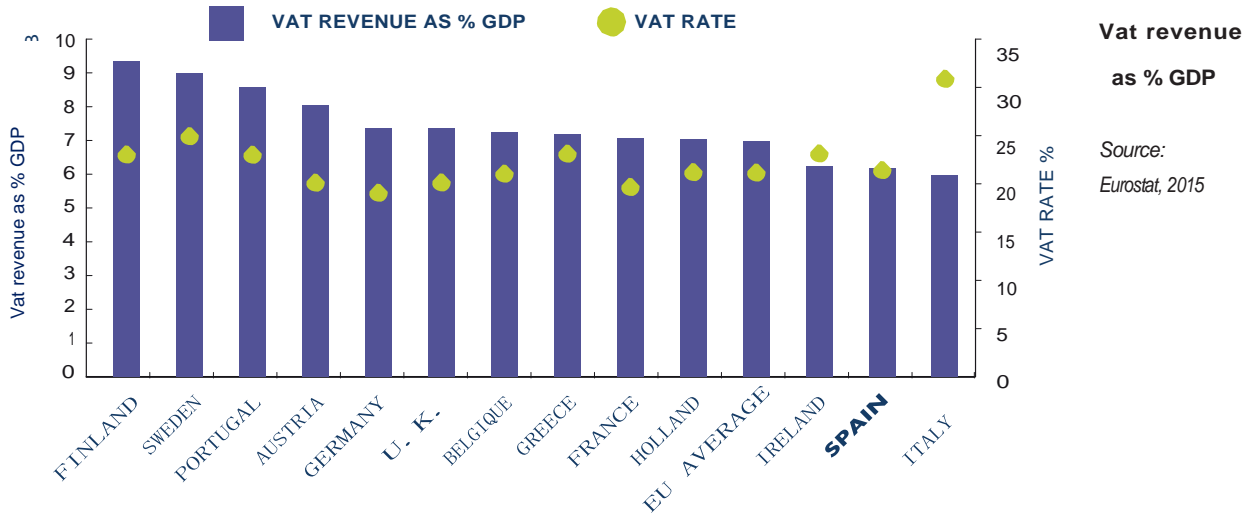
The Spanish tax system has an asymmetric structure for fiscal income, with lower collection than in the Eurozone. In terms of GDP, the lower total collection of taxes in Spain is principally the result of the behavior of indirect taxation, with lower VAT and Special Taxes. VAT collection in Spain is 6.1% of the GDP, slightly surpassing Italy (6%), and a far cry from most European countries such as Finland (9.3%), Sweden (9%) or Portugal (8.5%).

These lower revenues via VAT are explained in part by the black economy and fraud. In 2014 in Spain fraud reached 18.5% of the GDP, slightly above the average in the Eurozone (17.7%), and far above Germany, France, Holland and Austria. Other underlying causes are unemployment and self-employment, deficient design of our tax system, and the fact that people have not been educated in the culture of taxation and its obligations.

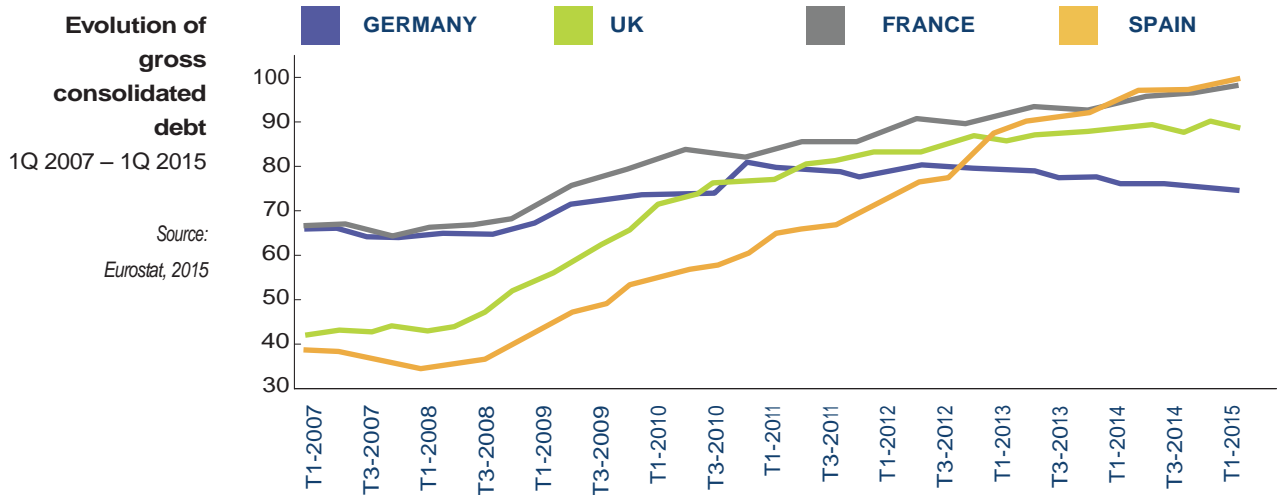
• The growing debt

Since the beginning of the crisis, Spain's public debt has tripled, reaching almost 98.5% of GDP in June of 2015 (approaching the objective set in the budget for





Source: Journal of money Laundering Control, 2015



2015 of 98.7%), which represents 1,053,000 million euros, or 4% more year-on-year. By contrast, since 2011 Germany has reduced the weight of its public debt.

The increase in public debt from 2007 to June of 2015 (669,000 million euros) contrasts with the deleveraging of the non-financial private sector by 50 points of the GDP (500,000 million), with Spain being the EU country that has most reduced its private debt in this period. On one side, Spanish companies have reduced their debt by 33 points from its maximum in 2009 (1,270,000 million) to 936,521 million euros in June of 2015 (93% of GDP). This development is explained principally by the credit squeeze, the urgency of reducing dependence on outside financing, and less need for credit because business volume had fallen. On the other side, since their maximums of 2008, homes have reduced their debt by 27 points of GDP (close to 170,000 million euros) down to 741,800 million in June of this year (74% of GDP).

Between 2007 and 2014, according to the IMF, the volume of total debt (public, families, companies and financial entities) has risen from 235% to 334% de GDP, essentially through the increase in debt by the Public Administrations.

• **Labor market**

In spite of the creation of more than 400,000 jobs in 2014, and with another 600,000 expected in 2015, Spain's unemployment rate continues to be unsustainable: 22.37% of the workforce. At the end of 2016 unemployment will be triple the OECD average (6.5%), at slightly below 20%. The situation is especially worrisome among the young, among people who have been out of work for long periods of time; even after the reforms there is a duality in the labor market. All this demands active policies to fight unemployment and changes in labor regulations

• During the second quarter of 2015, the unemployment rate in Spain among people younger than 25 was 49.2% (INE statistics): one of every two young people does not have a job. This is some 40 percentage points higher than in Germany, Denmark and Austria (with rates of between 7% and 10%) and exceeded only by Greece (Eurostat, May 2015).

According to the Survey of Active Population (EPA), unemployment is most severe among those young people with little training, especially those who only completed primary education. This situation is explained by the high rates of academic failure: even though it has been



Youth unemployment (< age 25)
as % of workforce of that age

*May 2015, except for Spain: EPA 2T2015(INE)

Source: Eurostat, 2015

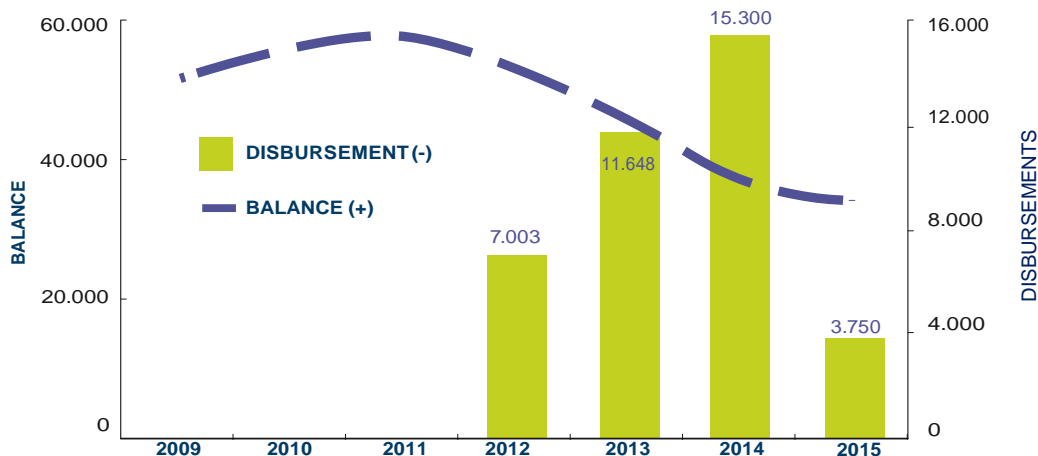
reduced more than 10 percentage points in the over the past decade, it is still above the EU average.

- Some 62% of those unemployed (more than 3.2 million people) have been out of work for long periods of time (more than a year), and of these, 70% have been without employment for a very long time (more than two years), and their prospects are dim
- In the second quarter of 2015, exactly 83.5% of new contracts were temporary contracts, which has a negative effect on economic growth, productivity, internal demand, savings, geographic mobility and the continuing education of the workforce.

• **Sustainability of Social Security.**

The sustainability of the Social Security system is conditioned by, among other factors, demographic structure. In a society like Spain's, with an increasingly aging population, spending on pensions is rising at an alarming rate, thus endangering the Welfare State.

The ratio of pensioners to the number of Social Security contributors has dropped continually since the beginning of the crisis – from 2.71 to 2.26 in June of 2015– while the quantity of the average pension has increased year by year, more than 30% since 2008.



Reserve Fund

2009- July 2015
Millions euros

Source: Social Security June 2015



Increased spending on pensions, along with insufficient income makes it necessary to finance the system by using resources from the Reserve Fund. Since 2012, some 37,701 million euros have been withdrawn from this fund to pay for pensions. As a result, its balance is now 39,520.46 million (3.71% of GDP). If this pace continues, and countermeasures are not taken, the Reserve Fund will be exhausted in 2019.

• **Company structure.**

The crisis has accentuated the fact that Spain has so many small companies, in part through the greater number of micro-enterprises: they grew in number from being 93.8% of all companies in 2009 to 94.5% in 2014. At present, 99.3% of Spanish companies are micro-enterprises and small companies (fewer than 50 employees) and 0.6% are medium-sized (between 50 and 250 workers). These figures contrast with Germany and the UK, where the micro-enterprises are less important than the small and medium-sized firms.

The largest companies make a positive contribution to the growth and economic stability of a country thanks to their higher productivity, capacity for innovation and internationalization, and their less volatile employment situation.

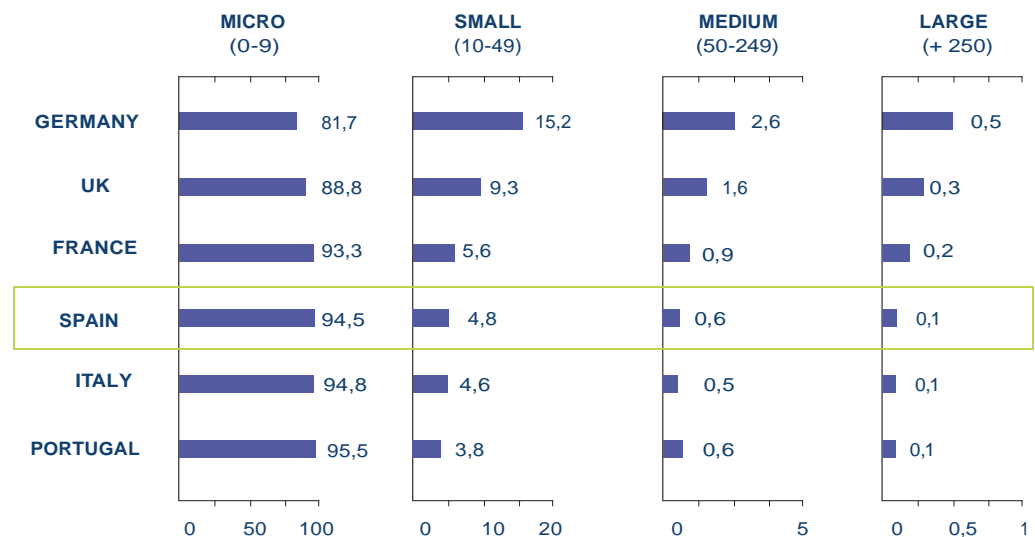
Although in 2015 Spain will recover its GDP level of 2007, there will not be a similar recovery in employment. In part, an employment recovery is conditioned by the size of Spanish companies. During the 2009-2015 period, staff reduction was the greatest at the smaller firms, where employment was reduced by 25%, as against the 20% in the medium-sized companies and the 6% in the large ones. Indeed, if Spanish companies were the size of the ones in the UK, more than 500,000 jobs could have been saved during the crisis. In addition, if Spain could achieve the average size of companies in Germany, our aggregate productivity would increase by 13%, which would create 15,000 new companies (12,000 of them medium-sized) and 400,000 new jobs (Círculo de Empresarios, 2014).

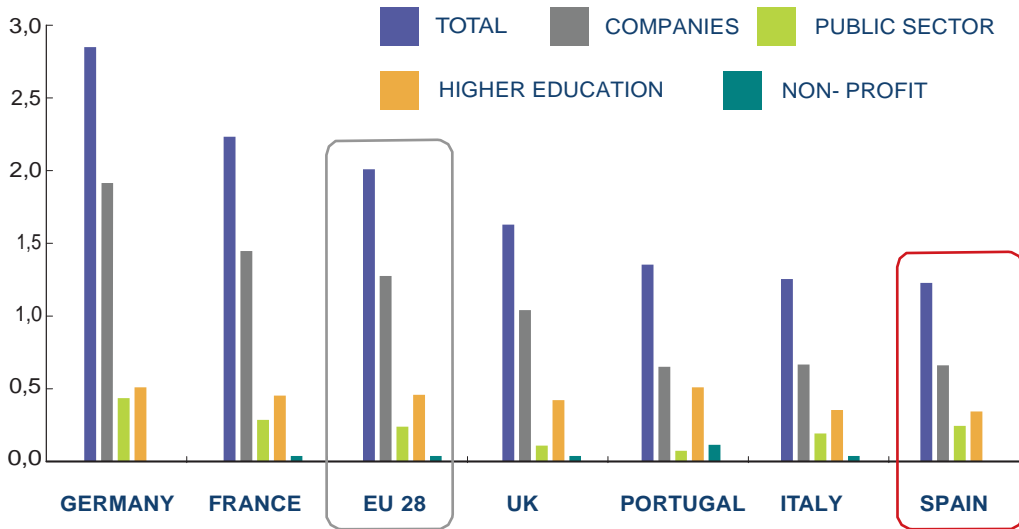
The small average size of our companies also affects the future development of the overseas sector, since it is the larger companies that export the most. In the Spanish economy, 80% of the medium-sized companies and 90% of the large ones export, while only 30% of the companies with fewer than 50 employees do so. (ICEX, 2014).

By contrast, the unit labor costs have increased

Distribution of companies by size
(as % of total)

Source: Eurostat and OECD, 2015





Spending on R+D, 2013 (as % GDP)

Source: Eurostat, 2015

the productivity of the Spanish economy, which should favor the development of a new production model and make our workforce more employable.

As for innovation, the big companies are more important, since 41% of them carry out activities regarding technological innovation, as against the 22.8% of the medium sized firms and the 8.6% of the small ones.

and development (R+D) returned to the levels of 2006, to 1.24% of GDP, which was still far below the EU-28 average of 2.1%.

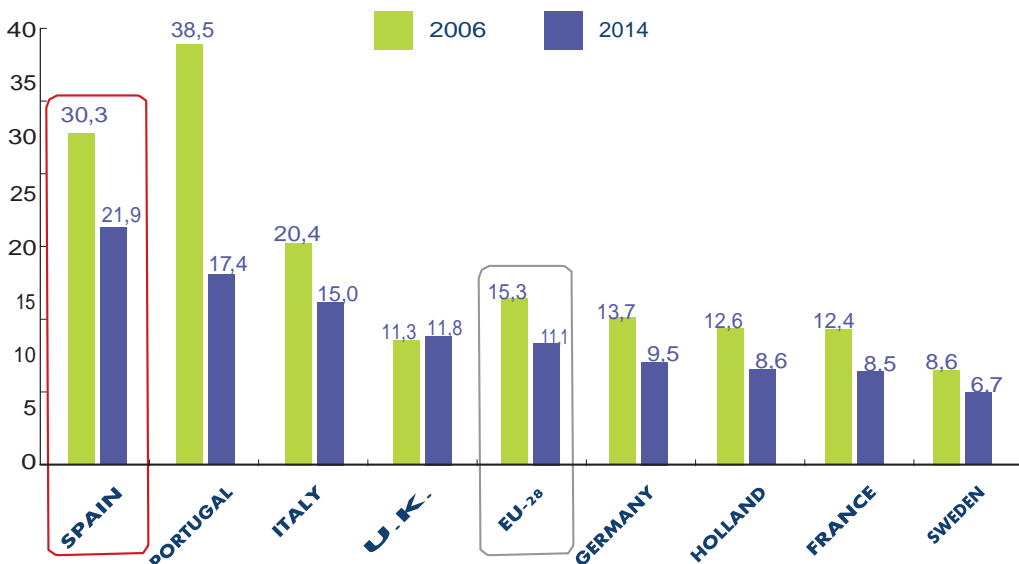
Las empresas españolas representan un 53,1% del gasto en I+D total, aunque su inversión sobre el PIB (0,66%) sigue siendo la mitad de la media europea (1,28%). Por su parte, el sector público invierte un 18,7% del total y el sector de enseñanza superior el 28%.

• **Research and development**

In 2013, after three consecutive years of being cut back, total spending on research and

• **Education**

The deficiencies in our educational system have an effect on Spain's society



Early school dropout, Rate

Young people from 18 to 24 years of age

Source: Eurostat, 2015



and economy. Education is characterized by inefficient spending, the high rate of students who repeat a year's study, the scant development of dual training, a lack of foreign language skills, little attention to teaching entrepreneurial abilities, and the poor performance of students in international testing.

Spain leads the European Union in academic failure: 21.9% of the people between the ages of 18 and 24 left the educational system prematurely, completing only the first cycle of primary education. This percentage is double that of the European average (11.1%), and far from the Spanish aim of reducing the dropout rate to 15% by 2020 (Eurostat).

In recent years Spain was able to bring down this rate from the 30.3% of 2006 to 23.6% in 2013 and to 21.9% in 2014. Academic failure is higher among males (25.6%) than among females (18.1%).

The high level of youth unemployment in Spain makes it imperative to accelerate the rhythm of dual training.

According to the International Labor Organization, dual professional training in the educational systems of Germany, Austria, Denmark and Switzerland explains the low levels of youth unemployment there and gives their young people the aptitudes and skills demanded by the labor market. In 2014, some 18,000 Spanish students enrolled in dual professional training (some 2% of the student population), whereas in 2013 there were 9,550. But in spite of this doubled interest, the figures are of little relevance when compared with Germany, where 60% of the students are enrolled.

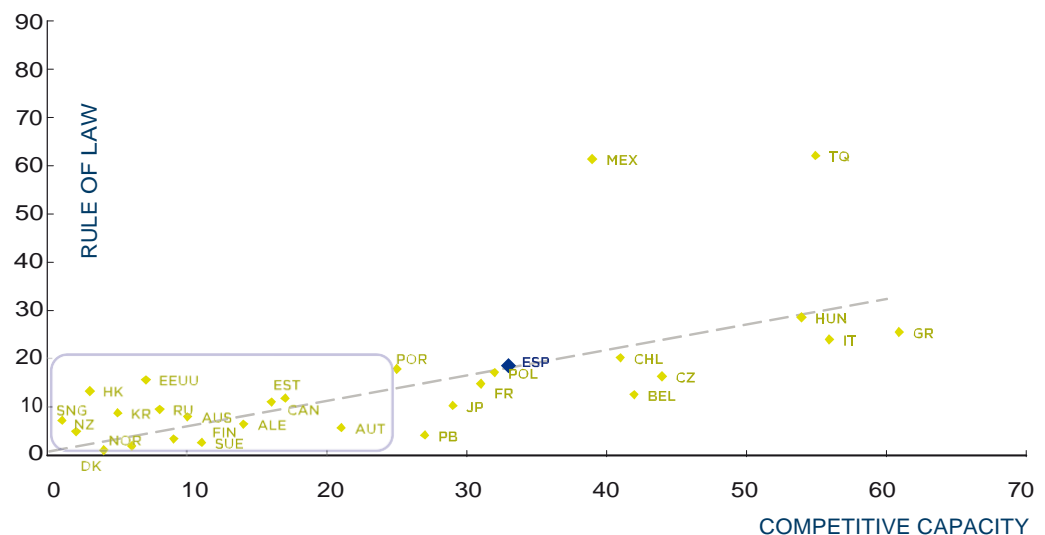
• **Justice.**

The Spanish justice system is inefficient and slow, with too much litigation. This can be explained by insufficient personnel and material, and by a lack of procedural, organizational and informatics resources, along with some laws that have not been adapted to the present.

The countries with the highest levels of competitiveness are also the ones with, among other things, the most efficient judicial systems.

Correlation between competitive capacity and - Rule of Law

Source: *Doing Business, 2015* (World Bank) *And Rule of Law Index 2017* (World Justice Project)





- **Geopolitical risks. Political and institutional uncertainty.**

Greater momentum and dynamism in the Spanish economy will depend in part on how the geopolitical risks to the international economy play out. Among these risks:

- Uncertainty about what will happen in the emerging economies (China, Brazil, Russia and Turkey) because of structural crises, the effects of the expected changes in monetary policy in the United States, and above all the marked decline in the price of hydrocarbons and raw materials.
- Greater political uncertainty in the Middle East, Russia, Central Europe, the Far East and in certain Latin American countries.
- The implementation, in the Eurogroup, of the agreement with Greece for its third rescue operation.
- Political uncertainties in Spain over the outcome of the regional election in Catalonia and the possible post-electoral pacts that might affect Spain's general election.



CHAPTER IV: Proposals Of the Círculo de Empresarios: Ideas for growth

We at the Círculo de Empresarios consider that it will only be possible to accelerate growth, create employment and consolidate recovery by increasing the level of competitiveness of the Spanish economy. Greater dynamism will not only guarantee the sustainability of the Welfare State and thus the Social Security system, but will also help meet the new challenges of the global economy.

We thus think that the principal aim of the 2016 Budget should be to accelerate fiscal consolidation through greater efficiency in public spending and an increase in tax revenues. This increase in tax income, without detriment to legal certainty, should be achieved without creating new taxes or increasing the already existing ones.

Thus the 2016 Budget, as an annual political instrument, should assure the fiscal consolidation that is necessary to lay the economic foundations that will make it possible to carry out the new structural reforms that Spain requires to gain in competitiveness and dynamism.

In our job of generating **ideas for growth**, and as we have done in previous documents and public presentations, we thus propose a series of reforms that would generate more growth, employment and social wellbeing:



- **Increase the expected primary surplus and put a brake on growing public debt.** The Government should set in motion new structural reforms to place the primary surplus around **1% of GDP**, in line with the recommendation of the OECD. This would have positive effects on the evolution of the public debt and on the conditions for financing both the public and private sectors.

- **Reforms of the Public Administrations.** Spain needs an Administration that is at the service of the taxpayers and that guarantees the present **Welfare State**, using resources with greater efficiency and quality.
 - In addition to accelerating the savings from the measures included in the CORA (Commission for Reforming the Public Administrations) program, it is necessary to carry out a structural reform of the Public Administrations, with actions like the following:
 - ∅ Increase the participation of civil society in the CORA.
 - ∅ Service to citizens must be based on the criteria of zero budgeting.
 - ∅ Reformulate the structure of the territorial Administration (Provincial Councils and Town Halls).
 - Externalize those functions of the Public Administrations that can be carried out jointly with the private sector, achieving greater efficiency in the costs and quality of services, along with greater flexibility and agility so as to adapt to the changes that are going to come in Spanish society.
 - Introduce greater transparency and accountability in not only the Central Administration but also the Autonomous Communities and the Town Halls.
 - Reformulate the model for paying public employees to make it more similar to one used in the private sector, establishing a variable scale of public salaries.
 - Make public accounting more transparent by means of a report that will consolidate all the income and expenses of the Public Administrations.

- **Go more deeply into fiscal reform.** Increased tax revenues cannot rely only on economic recovery and on maintaining elevated tax pressure on labor and capital. From the Círculo de Empresarios we propose broadening the tax bases by introducing the following improvements to the tax reform approved in 2014 and 2015:
 - **Intensify the fight against fraud.** On one side, the Tax Agency should have greater resources for making inspections, speeding up procedures, providing tax incentives for bringing to light illegal practices, and imposing stiffer sanctions, as in Norway and Holland. On the other, measures should be adopted to permit payment by



- electronic means, as in the Scandinavian countries.

 - **Promote fiscal education** to make people more aware of their shared responsibilities to the Welfare State. They must know the costs of public services and benefits, and the challenges to sustainability posed by an aging population, instead of permanently receiving the erroneous message that our system of pensions is assured.

 - **Simplify and clarify fiscal regulations** and, at the same time, modify the system of remuneration for inspectors: instead of being paid for initiating inspection processes, they should be paid when companies have been sanctioned.

 - **Promote cooperation** between taxpayers and the Tax Administration, following the experience of the UK and Belgium.

 - **Make fiscal pressures** on companies more similar to those in the more competitive countries of the OECD, establishing a flat **20%** rate of Corporation Tax and lowering by at least two points the employer contributions to workers' Social Security accounts, which are currently the highest in EU.

 - **Reconsider the exit tax**, which has been in force since January 1, 2015, because it is a disincentive to innovation and to entrepreneurs of technological startups, as well as to all those foreigners who are considering taking up residence in Spain for professional or personal reasons.

 - Get rid of the obligation of foreign residents in Spain to **declare their overseas assets**.
- **Pensions.** There has been a considerable increase in spending on pensions because of an aging population and longer life expectancy, and an increase in the quantity of these pensions. This, along with a drop in Social Security affiliates, makes it necessary to take new measures. Not only is spending on pensions increasing, but the reduced income to Social Security has made it necessary to finance the system using the resources of the Reserve Fund. Following the Fund's latest outlay of 3,750 million euros on July 1, it now has a balance of 39,520.46 million. **If this pace continues, the Reserve Fund will run out in 2019.**

The aging population, a low birthrate and the constant increase in the dependency ratios make it necessary to carry out a **structural reform of the pension system**. Parametric reforms (raising the retirement age, requiring more years of contributions for calculating pensions, etc.), although they can help make the system more sustainable, do not guarantee its future and only delay solving the problem.

To guarantee adequate pensions over the long term, there must be a reform that progressively changes the current system into a **mixed system** based on three supports: sharing out, mandatory funding, and voluntary funding.

At the same time, following the experience of Norway, to guarantee **survival** of the system and increase the **profitability** of the **Reserve Fund**, its investments should be diversified to



include the public revenue of other countries as well as corporate debt securities, initially with a residual rate that could rise progressively to also end up including a percentage of equities.

• **Labor market.** The Spanish economy, and the wellbeing of society in general, are affected negatively by the high rates of unemployment (22.37% overall and 49.2% among youths) and the dim outlook on structural unemployment, which is around 18%. For this reason we feel that new regulatory measures should be adopted to create jobs and stimulate employability among the workforce. There must be a new labor reform that contains clearer and simpler regulations that will reduce the scope for interpretation of judges. It should develop along the following lines:

- Rationalize and simplify the hiring system by means of **three kinds of contracts**, whether for part-time or full-time work: a permanent contract; a contract depending on business requirements (of a set duration); and a youth contract (for on-the job training).
- **Indemnity** after the termination of the temporary and permanent contracts must be the same, and **converge** towards 18 days remuneration for each year of work, as in the UK, Portugal, Germany and Sweden.
- Reformulate **active policies** through compliance with the commitment to activity obligations of unemployed workers, and by promoting employability through greater public-private collaboration and effective **professional retraining** that will allow unemployed people, in conjunction with the companies, to join the sectors that need workers.
- Support people who have been **unemployed for long periods** of time and young people who are out of work by lengthening the period during which they can be on welfare and receive unemployment subsidies, but making it dependent upon them accepting job offers.
- The companies should have a greater role in designing, managing and financing the **training programs**, as is the case in Germany, Denmark and the UK.
- Adopt specific measures to promote **youth employment**, many of which are already applied in Germany, Australia, Holland and the UK.
 - ∅ Make young people more employable through **dual training** programs, both professionally and university-based. These programs should be designed and developed in a coordinated way by the different parties and in a common framework.
 - ∅ Encourage **non-labor practices** in companies by facilitating agreements between companies and the Public Service of State Employment. These agreements would find wider use if they were made through private employment agencies.
 - ∅ Develop programs and take steps to **guide** and qualify young professionals.



∅ Establish a specific guaranteed minimum wage linked to the training of young people who have few qualifications, something similar to the systems in the UK, Germany, etc.

- **Link salaries to productivity**, encouraging the negotiation of wage agreements on the company level.

- Encourage **internal flexibility** in labor relations, as has been done with great success in the automotive sector: it should be easier for workers –and even different professional groups– to move from one task to another, thus promoting versatility and reducing the need for official approvals and administrative requirements.

• **Educational reform.** Spain's high levels of academic failure and youth unemployment, along with changes in attitude toward traditional employment and professional skills and abilities, demand a **consensual educational reform**. It must be stable and long-range, and include education in values, merit, effort, creativity, communications skills and foreign languages.

- Encourage the **entrepreneurial spirit** at all educational levels, stressing the social value of the businessman, social responsibility, and the acceptance of failure as part of the learning process. Students should be taught more about economics and finance.

- Develop the **system of scholarships and financial aid** depending on the economic needs of the students' families. In this way there will be no economic or financial limits to the academic advancement of gifted students, thus avoiding the problem of unequal opportunities.

- Promote **dual vocational training**, following the leads of Germany, Austria and Switzerland, with more resources spent on creating an efficient system of scholarships and/or training loans, and with the companies playing a larger role in **the educational system**.

- Consider the **needs of the companies** when designing the study plans.

- Invest in the **continuing training of teachers** to prepare them for the market's new technological and professional requirements.

- **Dignify the work of the teachers** and recognize their importance in improving society's competitiveness and wellbeing, by pegging their salaries to their dedication and the quality of their teaching.

- Promote the **knowledge of foreign languages**, especially English. All students should have a command of it.

• **Financing.** Access to financing is one of the major problems of Spanish companies. They depend too heavily on bank credits –**some 70%** of their total financing– and they have high levels of debt, accumulated during the boom years.



- Promote and develop **new sources** of company financing that will improve the levels of **capitalization** and competitiveness of the companies through corporate debt issue, alternative markets, stock markets, corporate credits, structured financing, risk capital funds and crowd funding.
 - **Revise banking regulations** with regard to company financing so as not penalize the loans to small and medium-sized companies. When credit is given, there should be an **evaluation of the solvency and credit standing of the companies**, based on their carefully audited accounts, in abbreviated form if the case merits this. In addition, the stress tests to banks must be always be applied with the same criteria.
 - Enforce further **compliance of the payment periods** law by the Public Administrations, especially the Autonomous Communities, as well as by companies to the suppliers.
- **Increasing the average size of companies** would help improve competitiveness through greater productivity and innovation, generate more and better jobs, attract and retain talent, and strengthen the internationalization process of Spanish companies. For this reason we think it is essential to adopt reforms that make our companies larger.
 - Create an **optimum regulatory framework**, one that is unified and stable, to reduce payment periods and managing expenses and the legal uncertainty for companies. It is necessary to develop a coordinated program for all the Public Administrations, including the Autonomous Communities and town halls, to make it faster and easier to obtain permissions and licenses for economic activities, by promoting the measures in the **Market Unity Law** and assuring that it be applied uniformly and effectively so as to avoid the often contradictory decisions by the different administrations.
 - **Increase threshold effect measures** in the labor, fiscal and regulatory spheres so as to discourage the appearance of new middle-sized companies.
 - ∅ **Fiscal.** Set the new billing threshold in installment payment of the Corporation Tax and VAT, as well as that of integration in the Unit of Large Taxpayers, from **6 to 20 million euros**, taking as a reference the lower billing figure of companies that make up what is known in Europe as the *mid-market*.
 - ∅ **Labor.** To form the works committee, there should be some 100 employees, as in Sweden and Belgium. However this does not prevent there being other legal or trade unions representative bodies in smaller companies (such as staff representatives).

Flexible working hours could be agreed upon by the companies and representatives of the workers depending on the needs and conditions in each firm, without the need for them to be established through legal procedures.
 - ∅ **Regulatory.** Establish a new “abbreviated” audit for companies that satisfy two of the following three requirements: assets of between 2.85 and 4 million euros;



net turnover of between 5.7 and 8 million euros; fewer than 50 workers.

- **Innovation.** To compete in the global economy there must be an investment in knowledge and innovation. In Spain there is room for improvement: the country is out of the Top 20 world economies in these departments.
 - Promote **applied research** according to company needs, with public-private financing of projects, which requires a greater connection between companies, universities and R+D centers.
 - Make it **easier** for **technological SMEs** to receive resources and aid for R+D, so that they can develop and offer technological solutions to the large companies.
 - Promote fiscal, labor and regulatory measures that will attract the specialized innovation centers of the multinationals.
 - Develop **programs to attract and retain talented** researchers.
- To improve business, as a lever for growth, it is necessary to **improve legal certainty** and the **functioning of the Spanish justice system**; there must be a **regulatory framework** with clear, simple norms that eliminate duplications. This would allow Spain to become a **platform for investment** and would attract **foreign companies**. We should exploit our excellent geographic location, our qualified work force and infrastructures, our cultural links with Latin America, and the advantages of the European Economic Area to develop our overseas possibilities and face the new challenges of the world economy.

We believe that just as in Spain's transition from dictatorship to democracy, the **political parties** and **civil society** must be strengthened. In a responsible way they must change the rules of the game, taking into account that, in this case, we are in a setting of global competition: it poses threats, but also provides opportunities to develop a system of production that will preserve our Welfare State. If we are up to the job, Spain will gain in **competitiveness, the quality of its institutions and wellbeing**.

To conclude: the Spanish economy continues to require **new structural reform** so as to consolidate the economic recovery, create and maintain jobs, and complete fiscal consolidation. It would be desirable that these reforms have the **greatest possible agreement** of the different **political forces**, and that they enjoy a high level of **participation by civil society**. This would make it possible to work toward a **single national project** based on a modern economy and the quality and stability of the institutions. In any case, whatever the political situation that emerges from the coming elections, it should make possible an ample majority that will agree on the reforms that are necessary to carry out those objectives. Because the new Parliament will probably be fragmented, it would be beneficial to have a **government with a large majority**, one that could take on the **big challenges** to Spain and carry out the important structural reforms with the necessary consensus.



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