

# Annual Report: Digest

### Global and euro area activity

- The pandemic has caused a global health, social and economic crisis unprecedented in modern times.
- Economic activity shrank sharply worldwide in 2020 H1, owing to strict lockdowns. The recovery has since been incomplete, on a volatile path and governed by fresh outbreaks of the virus and by the lockdown measures adopted.
- The extraordinary economic (monetary, fiscal and financial) policy measures have helped mitigate the impact of the crisis and support the recovery. Following the first wave of the pandemic, the restrictions introduced to contain the spread of the virus have focused increasingly on the activities most exposed to social interaction. This has contributed to lessening the economic impact.
- Economic developments across countries have been uneven. Among the main world economies, the decline in output in 2020 was 3.5% in the United States and 6.7% in the euro area, while GDP grew by 2.3% in China. Among the emerging economies the impact was especially severe in Latin America, with a 7% fall in GDP
- The asymmetry in economic developments can also be seen in the euro area, with comparatively more unfavourable results in France, Italy and Spain.
- The buoyancy of international goods trade, which has picked up swiftly following the disruptions in the first half of 2020, is proving a significant lever for exiting the crisis. International tourism flows, by contrast, have remained weighed down by the restrictions on mobility.

### Activity in Spain: the impact of the crisis

- Spain has been one of the countries most acutely affected by the pandemic, particularly in the first wave.
- GDP contracted by 10.8% on average in 2020. In 2021 Q1, it still stood 9.4% below its end-2019 level. Among the advanced economies, Spanish GDP has moved on one of the most unfavourable trajectories since the start of the pandemic.
- The unevenness across sectors of the impact of COVID-19 is very high. The effects have been more pronounced in activities subject to a greater degree of social interaction. Gross value added in the retail, transport and hospitality, and artistic and recreational activities sectors thus stood, in 2021 Q1, 21.3% and 32.8% below their pre-crisis levels, respectively.
- The crisis also evidences high disparity in other respects. First, the impact on SMEs and the self-employed is greater than is the case for large corporations. From a regional standpoint, the island and Mediterranean arc provinces have been most affected. Finally, the downturn in the labour market has impacted temporary, younger and lower-income employees to a greater extent.
- All domestic demand components except government consumption fell forcefully in 2020. Household consumption declined by 12.4%. The similar-scale contraction in business investment was, however, less than might have been expected given the size of the decline in GDP.
- External demand contributed 2 pp to the decline in GDP in 2020. In nominal terms, foreign tourism receipts fell by 75.9%. As a result, there was a 1.4 pp reduction in the Spanish economy's net lending capacity to 1.1% of GDP.
- The public finances worsened most significantly last year. In 2020, the general government deficit increased by 8.1 pp to 11% of GDP and public debt by 24.5 pp to 120% of GDP. Around 85% of the increase in public spending was related to the pandemic.
- The impact of the crisis on consumer prices has so far been patently disinflationary. In early 2021, inflation has increased in a foreseeably temporary fashion owing to energy prices, although the core component has also risen slightly.

**Activity in Spain: sources of uncertainty and growth outlook**

- Headway in the vaccination process and the improved external environment have reduced the risks surrounding the economic outlook.
- But other sources of uncertainty remain active. These include the degree of implementation and effects of the European NGEU programme, the capacity of economic policies to adapt to the changing circumstances of the crisis and the scarring the pandemic may have caused to the productive system and the labour market.
- Economic developments in the coming quarters will be further influenced by the pace at which the reservoir of saving accumulated by Spanish households in 2020 diminishes and by the path of recovery of international tourism.
- The latest Banco de España projections (March 2021) point to a relatively robust recovery as from the second half of the year. However, the impact of the crisis on the level of GDP, employment and the public finances will be relatively persistent. Thus, for example, the end-2019 level of GDP would not be recouped, under the baseline scenario, until 2023.

**MAIN FACTORS OF UNCERTAINTY OVER THE FORECASTING HORIZON**



SOURCE: Banco de España.

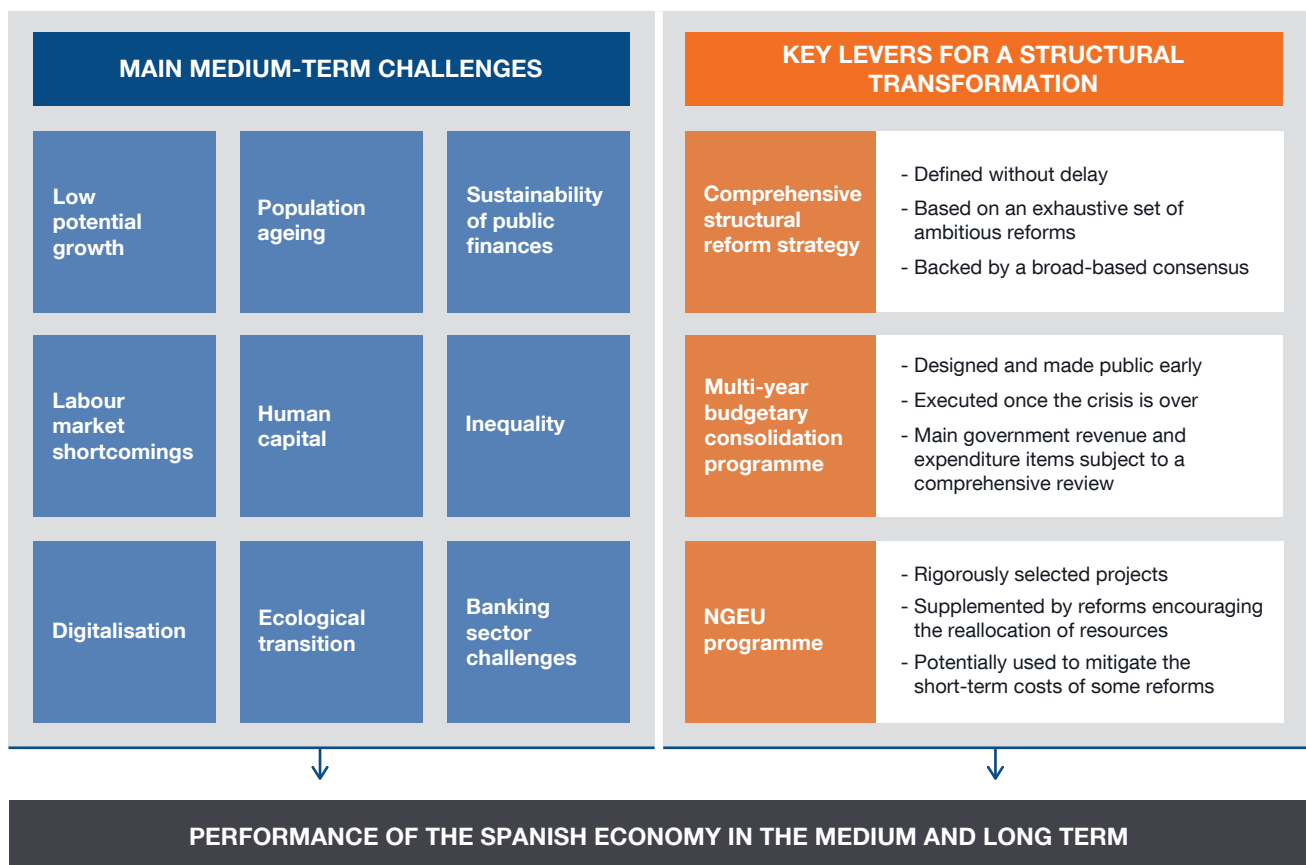
## Economic policies in the short term

- The persistence of the crisis is seeing the economic policy measures initially deployed maintained or extended, in a setting in which it is essential to prevent a premature withdrawal of the support lent.
- In the prudential realm, the international authorities have retained the recommendations made at the onset of the pandemic regarding the release of credit institutions' capital and liquidity buffers.
- The ECB response has been pivotal in ensuring favourable financing conditions in the euro area and preventing the financial fragmentation of the region. The flexibility of its pandemic emergency purchase programme (PEPP) is key in this respect. The PEPP has afforded fiscal authorities leeway to extend and maintain the measures supporting the economy.
- The fragility still marking the ongoing economic recovery and price dynamics in the euro area recommend maintaining a highly accommodative monetary policy in the coming quarters.
- On the domestic front, the economic policy response was swift and resolute in the early stages of the pandemic. The Spanish authorities provided the health system with greater resources and launched a range of measures aimed at protecting labour income, supporting the most vulnerable households and providing firms with liquidity.
- The ICO's public guarantee programmes were, at the start of the crisis, effective in providing financing for the liquidity needs of the self-employed and firms, especially smaller ones. Subsequently, the shift in concern to the problems of business viability and solvency led to the approval, in March 2021, of a new aid package.
- Furlough schemes have been an essential mechanism for protecting labour income and mitigating the increase in the unemployment rate. Looking ahead, the schemes must continue adapting to the changing economic and health circumstances. In that connection, increasingly focused arrangements are needed for the necessary reallocation of employment to more productive firms and sectors.

Main medium-term challenges and levers for a structural transformation

- The medium and long-term outlook for the Spanish economy hinges not only on overcoming the present health crisis, but also on addressing a series of key structural challenges.
- The pre-pandemic challenges included the need to increase growth potential, correct dysfunctions in several goods and factor markets, enhance the sustainability of public finances and address important challenges linked to population ageing, inequality and climate change.
- The pandemic has magnified some of these challenges and has also posed some new ones. In particular, this crisis has brought about certain changes in the behaviour patterns of households and firms, many of which are linked to greater digitalisation of economic activity. In addition, the international trade disruptions in the early stages of the pandemic could give rise to a series of profound changes in the trade globalisation process.
- The Spanish economy has three main levers with which to address these challenges:
  - The design and approval of an ambitious structural reform agenda.
  - The definition and execution of a multi-year budgetary consolidation programme once the present crisis is over.
  - The NGEU recovery programme.

THE MAIN MEDIUM-TERM CHALLENGES FACING THE SPANISH ECONOMY AND THE KEY LEVERS FOR ADDRESSING THEM



SOURCE: Banco de España.

### **Impact on households**

- Changes in households' daily activity patterns: mobility, remote working and consumption habits
  - Since the start of the pandemic, the Spanish population's mobility patterns have changed. Mobility has been lower during the working day thanks to the increase in working from home.
  - The increase in remote working could affect the recovery in demand for certain products, especially in the big cities (see Box 2.1).
  - However, Spain's relatively small cities, small firm size, high ratio of temporary employment and low intangible investment are all elements that could limit the growth of remote working in Spain.
  - E-commerce has surged as a result of the crisis, and it will likely continue to grow in the future as digital skills become more widespread. This should encourage competition among firms and reduce demand for the products of less competitive firms.
- Employment
  - The adverse impact of the pandemic on employment is being felt most acutely by the most vulnerable workers (employees with temporary contracts, younger workers and employees with a lower level of education). Should these labour market dynamics persist, they could heighten inequality in Spain and hamper economic growth potential.
  - The pandemic may quicken the process of automation of certain occupations and the need to reallocate workers to other tasks. This reallocation process could affect above all occupations that are currently primarily held by women and by workers with a low level of education.
- Education
  - School and university closures during the last term of the 2019/2020 academic year led face-to-face teaching to be replaced with digital online home learning. This change in teaching method may have had an adverse impact on academic achievement in the short term, especially among the most disadvantaged groups.
  - However, as yet it seems that the pandemic has not accelerated early school leaving in Spain.
- Health
  - The incidence of health problems among the older population varies considerably across European countries. These problems are more prevalent among women and among those with a lower level of education.
  - As a result of the pandemic, the incidence of mental health problems has increased for all population groups, owing, above all, to uncertainty about the future.
  - In some European countries there have been considerable restrictions on and delays in access to health care as a result of the pandemic; this may have long-term consequences for the health of the population.
- Inequality
  - After several years of declining labour income inequality, owing to the favourable employment performance in the last upturn, the outbreak of the pandemic triggered a fresh increase in this form of inequality.
  - The health crisis also appears to have increased uncertainty about future income. This primarily affects the younger population, employees with temporary contracts and lower income groups.

#### ***Impact on potential economic growth***

- The scale and persistence of the effects of the pandemic on potential output will crucially depend on the duration of the shock.
- The nature of the jobs lost as a result of the crisis suggests it could have an adverse effect on the labour input contribution to potential output by pushing up structural unemployment.
- The effects of the pandemic on capital stock in the long term are likely to be predominantly negative, although some public policies will help preserve and modernise the Spanish economy's productive capital.
- The channels through which the crisis could affect total factor productivity are numerous, although the net impact is uncertain. On the one hand, the pandemic appears to have accelerated the take-up of new technologies, and the projects associated with the NGEU programme should also generate productivity gains. On the other, a hypothetical brake on world trade could adversely affect productivity.

#### ***Banking sector***

- The economic crisis triggered by the COVID-19 pandemic and certain extraordinary adjustments drove the profitability of the Spanish banking system into negative territory in 2020. However, average solvency ratios rose.
- Overall, the prudential and accounting measures adopted by the different financial authorities appear to have helped sustain the momentum of the flow of credit to the private sector throughout 2020. Indeed, bank lending to the non-financial private sector picked up again in 2020 after more than a decade of gradual deleveraging.
- Credit risk is one of the major challenges for the banking system in the coming years. The low interest rate environment, the digitalisation of the economy and climate change will be the key challenges for deposit institutions in the longer term.

#### ***Public finances***

- Before the onset of the COVID-19 pandemic, the Spanish economy had managed to recover only part of its fiscal space, which had deteriorated sharply following the global financial crisis and the European sovereign debt crisis.
- Since the start of the health crisis, fiscal policy has remained clearly expansionary. Specifically, the impact of the measures approved in 2020 on the budget balance is estimated at around 4.5 pp of GDP.
- In 2021, the fiscal policy stance will remain expansionary and this will help shore up the still fragile recovery of the Spanish economy.
- As a consequence of the crisis, public finances have become more vulnerable and future fiscal space has decreased. A budgetary consolidation process will therefore be essential once the recovery takes hold.

#### ***Global impact***

- The disruptions to world trade caused by the pandemic could amplify some previous trends relating to the growing importance attached to national considerations in the solution of multilateral problems and to the partial questioning of the WTO rules-based international framework (see Box 2.2)
- A framework of shared multilateral rules is essential to address the long-term challenges facing national economies.
- Against this background, the European Union's Open Strategic Autonomy is designed as a framework for coordination of a broad set of policies to propel the external projection of the European Union, advocating trade openness and multilateralism and strengthening the region's economic and financial resilience.

## SOME EFFECTS OF THE PANDEMIC WITH POSSIBLE LASTING IMPLICATIONS

 <p><b>HOUSEHOLDS</b></p>	 <p><b>POTENTIAL GROWTH</b></p>	 <p><b>BANKING SECTOR</b></p>
<ul style="list-style-type: none"> <li>- The health crisis has affected households' mobility and consumption habits. This could have lasting implications for economic activity.</li> <li>- Despite the recent growth in remote working, certain structural factors could limit its future growth in Spain.</li> <li>- The pandemic has also posed new challenges associated with delays to health care, mental health problems, increased inequality and income uncertainty.</li> </ul>	<ul style="list-style-type: none"> <li>- The scale and persistence of the effects of the pandemic on potential output will depend on the duration of the shock.</li> <li>- A possible negative impact via an increase in structural unemployment and a decrease in capital stock is to be expected.</li> <li>- The effect of the pandemic on long-term productivity remains uncertain.</li> </ul>	<ul style="list-style-type: none"> <li>- The profitability of the Spanish banking system entered negative territory in 2020. However, average solvency ratios rose slightly.</li> <li>- The prudential and accounting measures appear to have added momentum to lending to the private sector, which picked up again in 2020.</li> <li>- Credit risk is one of the biggest challenges facing the banking system in the coming years.</li> </ul>
 <p><b>PUBLIC FINANCES</b></p>	 <p><b>GLOBAL IMPACT</b></p>	
<ul style="list-style-type: none"> <li>- Since the onset of the health crisis, the fiscal policy stance has been clearly expansionary. This has enabled the adverse economic effects of the pandemic to be mitigated.</li> <li>- However, as a result of the crisis, public finances are more vulnerable and there is less fiscal space available for the future.</li> </ul>	<ul style="list-style-type: none"> <li>- The pandemic has triggered some shocks to global trade. These could amplify certain pre-pandemic trends that called into question the multilateral framework.</li> <li>- Against this background, the European Union's Open Strategic Autonomy seeks to boost the region's projection abroad by committing to trade openness and multilateralism, while strengthening the Union's economic and financial resilience.</li> </ul>	

SOURCE: Banco de España.

### Tools available to the Spanish economy to undertake its structural transformation

#### Structural reforms

- The challenges the Spanish economy will have to face in the coming years are substantial and closely interrelated. Tackling them requires a comprehensive strategy of ambitious and lasting structural reforms.
- Within this overall growth strategy certain lines of action stand out. In particular, to boost productivity, policies should be rolled out that encourage both business growth and human and technological capital accumulation.
- In the Spanish labour market, the high duality between workers with temporary and permanent employment contracts must be corrected and an in-depth review of active labour market policies must be undertaken.
- The numerous economic implications of population ageing should be addressed with decisive action in various spheres, for example, promoting longer working lives for older workers and analysing the reasons for Spain's low fertility rate.



- The financial sustainability of the public pension system must also be reinforced, based on an assessment of the level of benefits to be provided by the system and the resources committed to fund them.
- Moreover, to mitigate the adverse effects of high levels of inequality, public policy measures across a wide range of areas must be rolled out and continuously assessed. These include regulatory reform of the labour market and of the education system, different fiscal measures regarding transfers and taxes, and measures to encourage a sustained increase in the supply of rental housing.
- Moving towards a more sustainable growth model and mitigating the effects of climate change will require a profound economic, social and technological transformation in Spain and globally. It is essential that the numerous implications of each economic policy initiative adopted be rigorously assessed and that the highest possible level of international coordination be sought.

#### ***Budgetary consolidation strategy***

- The much-needed expansionary fiscal policy stance during the current crisis should give way, once the recovery takes hold, to a restructuring of public finances that enables the rebuilding of fiscal space for future crises.
- Correcting the structural imbalance of public finances will require a firm commitment and a sustained effort over time.
- It would be desirable for the main details of the fiscal consolidation process to be defined and made public early to reinforce its credibility.
- The effectiveness and credibility of the budgetary rebalancing plan would also be enhanced if it were accompanied by the implementation of an ambitious structural reform package and involved all tiers of general government.
- The decision on how to distribute the fiscal adjustment among the different budget items should be based on a comprehensive review of all public expenditure and revenue items and a rigorous analysis of the implications of any fiscal policy action in terms of economic efficiency and fairness.
- On the expenditure side, priorities need to be set in the use of public resources and efficiency increased.
- On the revenue side, it would be advisable to undertake a comprehensive review of the Spanish tax system to ensure that tax revenue is sufficient to finance the desired level of spending.

#### ***The challenge of making the best possible use of the NGEU programme***

- The NGEU programme will help to make up for the lack of a common automatic fiscal stabilisation capacity, one of the main shortcomings in the EU's institutional architecture (see Box 2.3).
- NGEU financing through large-scale supranational debt issuance represents an unprecedented step that will contribute to reducing the relative scarcity of euro-denominated safe assets.
- To maximise the positive effects of this programme in Spain, the reforms contemplated in the Recovery, Transformation and Resilience Plan (RTRP) approved by the Spanish Government will have to be appropriately defined and decisively implemented, and the different expenditure projects carefully selected. In this respect, three aspects are particularly important:
  - First, the projects should be selected under an appropriate public procurement framework and according to an appropriate design of methodologies for assessment of the different initiatives.
  - Second, it should be ensured that there are no obstacles in the Spanish institutional framework to the reallocation of resources among firms and among sectors that will likely result from implementation of the programme. This could require, in particular, making it easier for firms to enter and leave the market, redesigning the incentives to encourage investment in R&D&I and reformulating active labour market policies.
  - Third, to encourage the introduction of certain structural reforms, it would be desirable to consider using part of the funds of the NGEU programme to ease the costs that these reforms, although beneficial in the medium and long term, may have for certain groups in the short term (see Box 2.4).

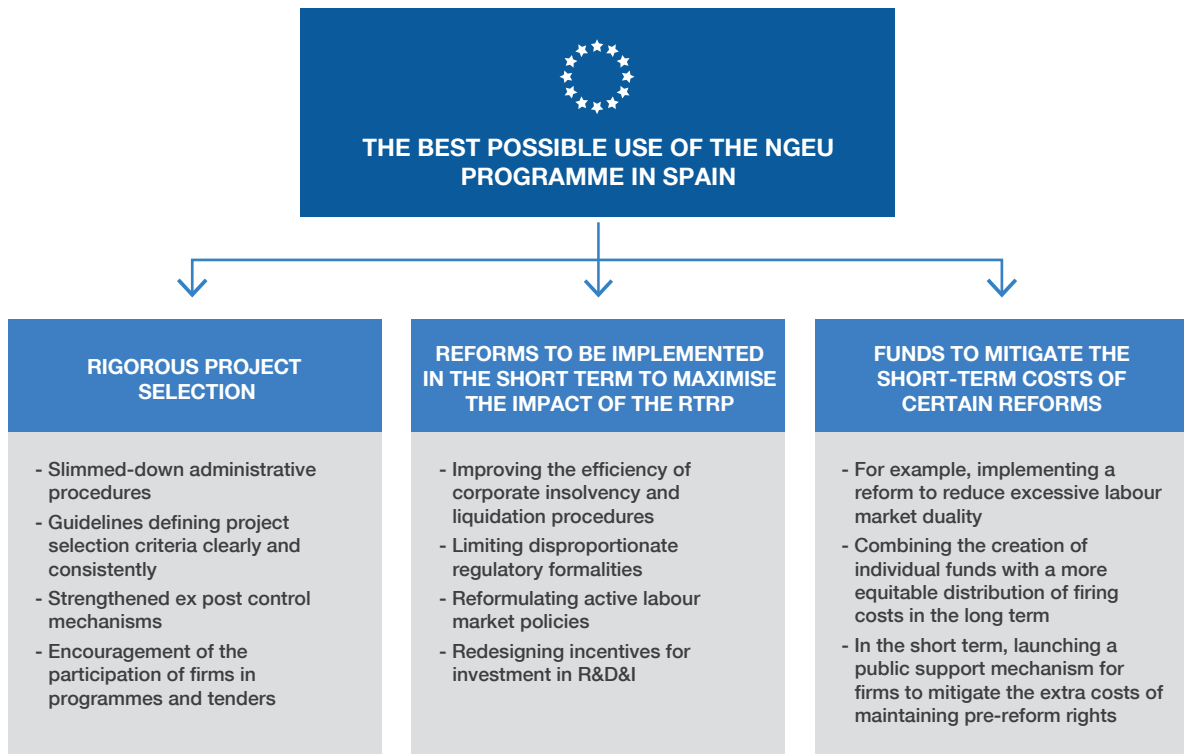
**COMPREHENSIVE STRUCTURAL REFORM STRATEGY**



SOURCE: Banco de España.

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## THE BEST POSSIBLE USE OF THE NGEU PROGRAMME IN SPAIN



SOURCE: Banco de España.

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Impact on liquidity situation

- Firms' revenues fell sharply in 2020 on account of the COVID-19 crisis, although changes were highly heterogeneous.
  - By sector, the largest falls were observed in those whose activity entails greater social interaction, e.g. entertainment, and in those that rely on personal mobility, such as transport and tourism services.
  - By size, the fall-off in turnover was sharper in smaller firms.
- The decline in firms' turnover increased the aggregate liquidity needs derived from a shortfall between revenues and payments associated with their operating activity (such as rents and salaries), the repayment of outstanding debt and, to a lesser extent, fixed asset investments.
- Firms' liquidity buffers (such as bank deposits and undrawn credit facilities) were, in many cases, insufficient to cover this liquidity shortfall.
- However, the credit support policies deployed by the tax, monetary and financial authorities smoothed the availability of financing; the public guarantee schemes for loans, managed by the Official Credit Institute (ICO, by its Spanish abbreviation), played a key part in this respect.
- Thus, many firms and sole proprietors were able to cover their liquidity shortfalls by resorting to debt, chiefly bank loans.
- Nevertheless, some firms had more limited access to credit and could have covered part of their shortfall by making use of their internal liquidity buffers.
- In 2021, some risks relating to the liquidity situation persist, especially for firms and sole proprietors in the sectors hit hardest by the pandemic and for which access to external financing is more difficult.

VULNERABILITY OF THE PRODUCTIVE SECTORS

VULNERABILITY OF THE PRODUCTIVE SECTORS: INDICATORS, ECONOMIC EFFECTS AND POLICIES

	Short term	Medium term
Indicators	<p><b>Liquidity risk</b> When firms' liquidity needs exceed their liquidity buffers (liquid assets and credit facilities)</p>	<p><b>Low profitability</b> When the return on assets is negative</p> <p><b>High indebtedness</b> When the ratio of net financial debt to ordinary earnings exceeds a certain threshold</p>
Economic and financial effects	<p><b>Bankruptcy</b>, which has an economic impact through:</p> <ol style="list-style-type: none"> <li>1 Loss of the productive system and employment</li> <li>2 Possible contraction in the supply of credit if debt defaults affect a notable portion of banks' credit portfolios</li> </ol>	<p><b>Obstacles to investment and hiring plans (debt overhang)</b></p>
Economic policies	<ol style="list-style-type: none"> <li>1 Income support (short-time work schemes)</li> <li>2 Payment deferrals (loan moratoria, Social Security contributions)</li> <li>3 Credit support:                             <ul style="list-style-type: none"> <li>– ICO guarantees</li> <li>– TLTRO III</li> </ul> </li> </ol>	<p>Income support (short-time work schemes)</p>

SOURCE: Banco de España.

## VULNERABILITY OF THE PRODUCTIVE SECTORS (cont'd)

### VULNERABILITY OF THE PRODUCTIVE SECTORS: INDICATORS, ECONOMIC EFFECTS AND POLICIES

#### Long term

#### Indicators

##### Viability

Firms with **viability risks** are those whose ordinary earnings are expected to be negative in 2023

##### Solvency

**Overindebted viable firms** are those whose ordinary earnings are expected to be positive in 2023 and whose ratio of expected net debt (in 2022) to ordinary earnings (in 2023) exceeds a certain threshold

#### Economic and financial effects

##### 1 Bankruptcy of non-viable firms

- Loss of the productive system and employment
- Possible contraction in the supply of credit if debt defaults affect a notable portion of banks' credit portfolios

##### 2 Survival of non-viable firms ("zombification")

- Inefficient allocation of resources, harming economic growth in the long term

##### 3 Inefficient liquidation of overindebted viable firms

- Loss of the productive system and employment
- Possible contraction in the supply of credit if debt defaults affect a notable portion of banks' credit portfolios

#### Economic policies

##### 1 Aimed at overindebted viable firms

- Income support (short-time work schemes)
- Direct assistance grants
- Recapitalisation
- Debt restructuring
- Improvements in restructuring procedures

##### 2 Aimed at non-viable firms

- Improvements in firm liquidation procedures

SOURCE: Banco de España.

#### Impact on profitability and indebtedness

- The fall in firms' turnover has substantially reduced their profitability. The simulations conducted by the Banco de España suggest that more than half of firms posted accounting losses in 2020.
- The proportion of firms with high debt levels also increased in 2020.
- The decline in profitability and the increase in debt appear to have been sharper among companies operating in the sectors hit hardest by the crisis and among smaller firms.
- Financial vulnerability in the productive sectors is expected to decline gradually from 2021 H2, in line with the projected recovery of economic activity.

### Effects on viability and solvency

- The simulations conducted by the Banco de España point towards a moderate increase in the proportion of firms at risk of becoming non-viable on account of the COVID-19 crisis (between 2 pp and 3 pp, depending on the course of economic activity).
- The proportion of firms that, while remaining viable, would become overindebted is also expected to rise moderately (between 3 pp and 4.7 pp). A firm is defined as being overindebted when it has difficulties in repaying its accumulated debt out of its future earnings expected in the medium term.

### Economic effects associated with financial vulnerability in productive sectors

- The greater financial vulnerability of firms and sole proprietors could hamper the economic recovery through various channels:
  - Firms that are more financially vulnerable find it more difficult to undertake investment plans and expand their workforce.
  - Some viable but overindebted firms could fail if they are unable to turn around their situation. This could adversely affect economic growth through two channels:
    - Loss of production capacity and employment.
    - Defaults on their debt having a negative impact on both financial and non-financial creditors; under extreme circumstances, this could limit the banking system's capacity to grant new loans.
  - The failure of firms that become non-viable as a result of the crisis would also trigger immediate losses in terms of production and bank defaults. However, these firms' exit from the market can benefit economic growth in the medium and long term, since their prolonged survival tends to result in an inefficient allocation of resources.
- The Spanish government has recently implemented several measures to support business solvency, aimed at preventing the failure of viable but overindebted firms. The effectiveness of these measures would benefit from a swift and flexible application, allowing for the possibility of their recalibration, if deemed necessary, in terms of both their volume and their allocation among the different tools envisaged.

### Impact on banks

- Thus far, there has been no increase in the volume of non-performing loans in bank credit to non-financial corporations and sole proprietors, despite the sharp decline in GDP in 2020 and these sectors' deteriorating financial position.
- This is largely explained by the public support measures, such as the guarantee schemes and loan moratoria, which appear to have eased some borrowers' debt repayment difficulties.
- In any event, loans to non-financial corporations and sole proprietors have shown some signs of credit quality deterioration, particularly in the sectors hardest hit by the crisis.
- In particular, Stage 2 loans (i.e. those whose credit default risk has increased significantly since they were granted, but not enough to be classified as non-performing) rose sharply in 2020 Q4.
- Further, in anticipation of a possible upsurge in defaults, banks generally built up reserves in the form of provisions in 2020, which had a negative impact on their profitability.
- Going forward, the quality of banks' credit portfolios could be affected if the crisis ultimately brings about persistent damage to corporate sector balance sheets.
- Under the more adverse scenarios, this could limit the supply of bank credit, with the consequent adverse impact on the prospects of economic recovery.
- In this context, close monitoring of firms' financial position is important so as to identify any signs of additional deterioration at an early juncture and to adopt the containment measures needed, should such deterioration occur.

### Rural depopulation in Spain

- The secular depopulation of Spanish rural areas is part of a global trend towards greater urbanisation, as a result of the process of economic development that has also been observed in many other advanced economies.
- However, compared with Europe, Spain is an exception since a very high percentage of its surface area is uninhabited and its population is more highly concentrated.
- Spanish urbanisation since 1950 is characterised by two distinct phases:
  - The first stage, dubbed the “rural exodus”, which ran from 1950 to 1991. During this stage, the percentage of urban population rose significantly, from 59% to 79%, as a result of the deagriculturalisation of the Spanish economy, with significant inter-regional migration.
  - The second, from 1991 onwards, in which the percentage of urban population grew at a much slower pace to stand slightly above 80%, mainly due to negative natural population growth in those rural municipalities that underwent negative migration during the rural exodus.
- There are more municipalities at risk of depopulation in Spain than in other European countries. Furthermore, they present significant shortcomings in terms of access to various services.
- The loss of momentum in smaller urban areas seems to have contributed to rural depopulation over recent decades in Spain.

### Population decline in small Spanish urban areas

- Younger adults migrating to a few big cities explains population decline in smaller urban areas.
- The decision to move from a small to a larger urban area is made by comparing costs and benefits:
  - Living in bigger cities is associated with advantages in the form of higher wages and greater professional opportunities, in addition to a wider range of public and private services.
  - However, it is also linked to disadvantages related to the various costs of congestion, such as higher house prices, increased exposure to pollution and longer commute times.
- The wage premium associated with working in big cities is higher for workers in high-skilled occupations. Indeed, when wages adjusted for differences in the cost of living between cities are considered, workers in low-skilled occupations do not earn higher wages in big cities.
- These differences in the wage premium between groups of workers explain why large Spanish urban areas have a negative net migration balance for workers in low-skilled occupations.
- These dynamics lead to an increase in the concentration of high-skilled employment in a few large urban areas, resulting in greater income disparity between urban areas.

### Economic policies

- Place-based public policies account for a significant share of public budgets: 33% of the EU budget goes to economic, social and territorial cohesion policies.
- As these policies seek to encourage development in more disadvantaged areas through public investment, subsidies, tax exemptions, etc., they may be considered redistributive policies since, by one means or another, they transfer public resources to households in more disadvantaged areas.
- In light of the evidence presented in this chapter, two types of redistributive policies to alleviate the effects of population concentration in big cities may be considered:
  - Adaptation policies to ensure that a certain level of services is available to inhabitants of rural municipalities.
  - Mitigation policies that seek to reverse the population dynamics in those municipalities with growth the possible comma given the circumstances and opportunities in their surroundings.

## Economic policies (cont'd)

- Some successful international experiences can serve as benchmarks. Upon review, some elements to be considered emerge, such as:
  - A comprehensive, lasting strategy built on broad political consensus.
  - Powers that are clearly distributed among the different tiers of government and collaboration between municipalities.
  - Clearly defined, measurable ex ante objectives and an ex post assessment.
- Lastly, any public policy should be assessed in depth, comparing the potential benefits in terms of greater regional equity with the costs it might incur for society as a whole in the form of efficiency losses and opportunity costs.

## THE SPATIAL DISTRIBUTION OF POPULATION IN SPAIN AND ITS ECONOMIC CONSEQUENCES

### CONCENTRATION OF POPULATION

Compared with Europe, the population in Spain is very highly concentrated in both urban and rural areas.

In Spain an abnormally high percentage of the territory is uninhabited and this anomaly is not due to geo-climatic factors.

Only 13% of the 1 km<sup>2</sup> cells in Spain are inhabited (red dots on the map).



### MUNICIPALITIES AT RISK OF DEPOPULATION

A total of 3,403 municipalities at risk of depopulation are identified (42% of municipalities in Spain). This is much higher than the figure for the euro area as a whole.

They display socioeconomic and orographic idiosyncrasies and have worse access to services than urban municipalities and other rural municipalities.

### CITIES AS A DRIVING FORCE

The provinces with a higher incidence of municipalities at risk of depopulation are those with a smaller provincial capital.

Rural municipalities neighbouring urban centres display greater momentum when commuting costs are lower.

Over recent decades, internal migration from smaller urban areas to big cities has contributed to the lower momentum of rural municipalities surrounding smaller urban areas.

### CONCENTRATION OF HIGH-SKILLED EMPLOYMENT IN BIG CITIES

The wage premium associated with city size is the main driver of migration towards large urban areas over the last two decades, particularly for workers in high-skilled occupations. This premium disappears for workers in low-skilled occupations when wages are adjusted to reflect purchasing power in each city.

Over the period 2005-2018, the largest urban areas recorded a net loss of workers in low-skilled occupations.

SOURCE: Banco de España.