

01|2020

# INFORME

## PUBLIC INVESTMENT IN SPAIN: CURRENT SITUATION AND STRATEGIC PRIORITIES

### CONCLUSIONS AND PROPOSALS



CONSEJO  
ECONÓMICO  
Y SOCIAL  
ESPAÑA

NÚMERO 01|2020

COLECCIÓN INFORMES

Ordinary session of the plenary assembly, 22 January 2020

# **INFORME** 01|2020 PUBLIC INVESTMENT IN SPAIN: CURRENT SITUATION AND STRATEGIC PRIORITIES

## CONCLUSIONS AND PROPOSALS

CONSEJO ECONÓMICO Y SOCIAL ESPAÑA  
PUBLICATIONS DEPARTMENT  
NICES: 794-2021

*Colección Informes*  
Número 01/2020  
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Consejo Económico y Social  
Huertas, 73  
28014 Madrid. Spain  
T 91 429 00 18  
F 91 429 42 57  
publicaciones@ces.es  
www.ces.es

During the initial years of the 21st century, public investment saw a very positive trend, in line with the cycle of growth in the Spanish economy that began in the mid-1990s and encouraged by structural funds from the European Union, which could have helped to build up a large stock of capital.

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*The fall in investment  
and loss of value of  
public capital*

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However, two circumstances affected the upward trend in this latest cycle of investment. First, its marked pro-cyclical nature which led at the time of the crisis to an abrupt cutback in investments that had been planned or were under way. Second, there were deficiencies in the selection and implementation of some large investment projects which meant that the total investment actually made did not lead to the improvements expected in efficiency of the economy, quality of life for citizens and structuring of the territory. The capital accumulated during this latest investment cycle, which was concentrated in certain physical infrastructures, also required the allocation of a large volume of resources to maintenance over the next few years as well as acceptance of a higher level of public expenditure resulting from the completion or early termination of concessions that turned out to be unfeasible for the concessionaires.

In 2010, fiscal policy in the European Union as a whole changed direction. A new period began for generalised and long-lasting processes of budgetary consolidation, forcing Member States to abruptly reduce their public expenditure. In Spain, this led to very large cutbacks in public investment, which fell to record low levels. These levels did not recover, remaining over recent years at 2 per cent of GDP (as opposed to 5.2 per cent in 2009), a percentage that did not even cover the depreciation in the large volume of public capital that had accumulated over recent decades.

This collapse in investment brought down the value of total accumulated public capital as from 2012, with a total negative variation of 6.8 per cent between 2011 and 2016 in real terms. This trend, not seen since at least the 1960s, shows how an intense reduction in public investment is already having far-reaching consequences. If this trend continues, that is, if depreciation in accumulated capital is not covered, such consequences are likely to be very serious, affecting the quality of the services provided to both the production fabric and citizens by the assets and elements that make up that public capital.

The majority of public investment still goes to infrastructure, especially transport infrastructure. The latter was probably the largest area of investment, which could be justified from a theoretical point of view by its impact on economic development and territorial cohesion and was largely supported by the European Union structural funds. The last great investment cycle, which developed the high-capacity road network, high-speed rail network, airports and ports, allowed Spain to significantly reduce its historic deficit in infrastructure and also to reduce regional disparities.

Observation of the main figures relating to regional public capitalisation weighted by population at three moments over a very long period is sufficient to point to two circumstances. First, Spain's Autonomous Communities made a huge leap forward when they started to receive European structural funds, as from the second half of the 1980s. Second, regional differences in these terms decreased visibly from then until 2005, a situation that remained the same until 2015. In 1985, the provision per inhabitant of the Autonomous Community with the highest capitalisation was almost three times that of the Community with the lowest capitalisation that same year. In 2005, this ratio had fallen to about double, and in 2015 it remained unchanged. This indicates that the structural funds had a noticeable positive effect on correction of disparities in the net provision of public wealth. This is a necessary, though not sufficient condition for reducing economic inequality in the territory.

However, with the crisis, this investment in infrastructure, especially in transport, decreased significantly, and did not recover in the later years of economic reactivation. Moreover, levels as high as those during the first decade of the twenty-first century are unlikely to return in the medium term, mainly because of the large stock established in transport infrastructure, but also for other reasons. These include the decrease in structural funds from the European Union and the fact that over-investment has been detected in some segments, which include high-speed rail, where excess capacity questions both the profitability and sustainability of many lines.

In addition, investment in social facilities, and specifically in health care which is particularly relevant for social wellbeing, showed similar behaviour to that of total public investment, with a significant increase as from 2000 and a sharp decrease after 2009-2010.

Investment processes that turned into accumulated public capital largely correspond to physical assets and, within them, infrastructure. In Spain, the drop in investment over recent years amounts to a very moderate drop in the value of capital of 4.7 per cent in real terms during the period 2011-2016. But physical assets in general comprising machinery, transport and equipment, especially hardware and communications, saw a considerable decrease (27.4 per cent over the same period), which in the medium term affected maintenance of the quality of services provided by public Administrations through these assets.

Although the degree of capitalisation is high and in almost all cases the assets are fairly young so have a long useful life, these data point to less potential for economic growth and a decline in quality of life for citizens.

In intangible assets, the drop was 24.9 per cent over the same period, in both R&D (four-fifths of the total of such assets) and software for public Administrations. This fact, together with a short average useful life, points yet again to the need to turn around the investment trend if we are to avoid serious decapitalisation in technological elements, not to mention the consequences of further delay in R&D.

The above indicates that, in spite of financial limitations stemming from compliance with the rules for fiscal stability and while it is still necessary to substantially improve assessment of the need for, and the efficiency of each specific project, at present public investment is necessary. Public investment is required for its own sake and as a lever to mobilise private resources in fields that are strategic for the future. In the context of the 2030 Agenda, these are digitisation on the one hand and, on the other, the move towards low-emission production and consumption models while also sustaining a fair transition towards such new models. Public investment activities also continue to depend on the existence of infrastructure and facilities in the fields of transport, water, health and education, among others. When these are appropriate and sufficient, they prevent bottlenecks in private activity and provide an optimal level of public services for all and throughout the territory.

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*Recover sufficient investment rhythm*

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The ESC considers it necessary to regain a sufficient rate of increase in public investment, in stable, agreed scenarios. Such strategic areas have to be faced, turning round the incipient decapitalisation in infrastructure and social facilities that is causing them to collapse, and improving the quality and sufficiency of public services, enhancing social cohesion and the territorial structure of our country.

In the opinion of the ESC, the current convention regarding what is considered public investment has serious limitations. On the one hand, regarding intangible fixed assets, human capital is not included, so expenditure on educational and health services is not considered investment, in spite of their evident economic benefits in the long term in terms of both productivity and social cohesion, especially in a context of growing technological intensity and complexity.

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*Broaden the concept of public investment*

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Nor does it consider the public expenditure on strengthening institutions, democratic quality and the Welfare State to be investment in intangibles. These are three fundamental pillars for the proper functioning of any society and are designed to last and to guarantee high levels of wellbeing for future generations.

Moreover, the current system of economic accounting only covers natural resources when they are considered to be economic assets, that is, goods on which property rights can be established and transferred and which may be subject to economic

exploitation at present or in the future, without regard for the fact that the future sustainability of the economic and social system depends on their preservation and rational use. This implies, firstly, that clean air, the water in rivers or the open sea, to take the most obvious examples, are left out of the calculation of natural wealth and are included in production processes as if supplies were unlimited, without taking into account the deterioration in them that results from such processes. Secondly, natural resources are valued for the benefits that can be obtained from their use rather than for the ecosystem services of many types that they provide.

Also, if in order to describe an investment as “public” we consider its purpose is for the common good or it has a collective value, we must take into account investments made by joint ventures, those that are channelled through formulae for collaboration between public and private agents, for profit or not-for-profit, those made by private agents with guidance, promotion and/or financial support from the public Administrations, through tax incentives or capital transfers, provided that they are in line with strategic priorities established through democratic channels and for which the collective profitability therefore goes beyond what is strictly private.

The ESC considers that this broader approach, which considers as public investment any expenditure leading to future collective benefits, should be adopted by public authorities when analysing investment processes, prioritising areas of action and laying down the corresponding public policies. It should also lead to reformulation of the economic accounting system and, in general, to reconsideration of the standard indicators and statistics to facilitate a sounder quantitative evaluation of this reality.

The fight against climate change, together with the necessary movement towards the environmental, demographic and digital transition, have marked the guidelines of the 2030 Agenda, taken on board by the European Commission’s new Green Pact, and include the general move towards decarbonisation. Also, the European Parliament has declared a climate emergency. In addition, the agreement reached at the Madrid climate summit (COP25) calls for more ambitious commitments in the fight against climate change, in line with the calendar set by the Paris Agreement.

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*Strategic priorities:  
ecological transition*

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The concept of a fair transition to a green economy, which involves the transformation of the economic model and a new social contract, will require large public and private investments. For this purpose, a Strategic Energy and Climate Framework has been drawn up, with three components: the bill of law for Climate Change and Energy Transition, the National Integrated Plan for Energy and Climate 2012-2030, and the Strategy for Fair Transition. In this respect, in 2018 the Spanish Government signed a strategic Agreement on collaboration in order to adopt the ILO guidelines on Fair Transition towards environmentally sustainable economies and societies, of which the National Strategy for Fair Transition is the first element. This strategy

aims to maximise opportunities and reduce the negative impact on employment, as well as other impacts stemming from gradual decarbonisation of the energy system up to 2050.

For all these reasons, the ESC is calling for fast development of regulatory and institutional tools and for sufficient public funding so that the programme of investment resulting from the National Strategy for Fair Transition can be adopted as a means of ensuring that the change towards an environmentally and socially sustainable economy will serve as an instrument for achieving better quality of employment, social justice and the eradication of poverty.

After 2010, the previous rise in public investment in R&D turned into a period of constant cutbacks in both current terms and in percentage of GDP during the crisis years, and during the current period of economic growth, the levels of investment prior to the crisis have not recovered. This trend differs from that in the European Union and especially in countries that devote a larger percentage of their GDP to public investment, such as Germany, Sweden and Austria, whose levels show a growing trend over time, when measured in current terms, that was not affected by the crisis.

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*Strategic priorities:  
R+D+i and  
digitalisation*

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The ESC considers it necessary to review priorities in general State budgets, with greater public support of R&D and guaranteeing that budget funds reach all public and private agents. A constant increase is needed over time in investment in R&D+I. Policies in this field should be stabilised over time, in both the public sphere, guaranteeing continuity in the funding of projects and stability for researchers' jobs, and the private sphere where, in particular, measures are needed to ensure that funds for R&D+I, especially European funds, are used better by firms. For this purpose, the regulatory framework for the incentive system should be improved and made more flexible, eliminating unjustified paperwork and improving processes for eligibility.

Regarding new areas, it should be stressed that Spain is not taking full advantage of the growth potential offered by digitisation, although some progress has been made. It is therefore necessary to efficiently improve digital connectivity. Unless there is firm public intervention, the risk is run that results will not be optimal, with fast broadband networks being concentrated in just a few high-density areas where entry costs and prices are high. Broadband should be considered a public service of interest to all so that it can be provided universally, and the possibility should be restored for the public Administrations to fund it where there is insufficient private investment. It should also be possible for part of the cost of the service to be covered for vulnerable consumers.

Investment to improve digital connectivity would improve social cohesion and help fight inequality in the framework of digital transformation. In order to achieve these goals, the ESC considers it necessary for Spain to adopt a strategy for far-reach-

ing digitisation, meeting in an integrated and cross-cutting way the challenges faced by society, that is, both citizens and businesses. This would help to reduce the digital gap which exists both territorially and among individuals for reasons of age, income, knowledge or skills and among firms, especially SMEs.

As part of this necessary reactivation of public investment and in line with sufficiently well-developed criteria for efficiency and systems of evaluation that can guarantee not only control of expenditure but also rational, efficient and effective investments, the needs of specific territories must be taken into account.

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*Territorial structuring  
and social cohesion*

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Such needs refer to both conventional infrastructure and new elements for connectivity and digitisation on the one hand, and for a fair transition to a decarbonised economy with a low environmental impact on the other.

In addition, differences in infrastructure and facilities mainly affect rural areas, especially what is known as the “emptied parts of Spain”. Specifically, there are shortcomings in the provision of road infrastructure, water and waste management facilities and access to health care and education services, among others, especially in areas of low, highly dispersed population. Such services are of special relevance for maintaining the population.

In its current form, the legal framework for budgetary stability in both the European Union and internally requires Spain to step up the process of fiscal adjustment until public debt, currently at almost 100 per cent of GDP, reaches 60 per cent. Consequently, the possibility of promoting ambitious projects for public investment over coming decades is very limited.

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*Fiscal rules and funding  
public investments*

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The ESC considers that the current reform of the European Union fiscal rules framework offers a great opportunity for including a “golden rule” for investment to provide a fiscal margin to the public sectors that are still on the side of prevention in the Pact for Stability and Growth so that it will be possible to use public debt to fund investments of proven social utility that are in line with the strategic priorities of the European Union.

In the current scenario of weak growth, low inflation and interest rates close to zero, the promotion of public investment projects funded with public debt would have a double dividend well in excess of their cost because of the very advantageous conditions for long-term financing of this debt. It would greatly increase aggregate demand and growth, especially considering that the multipliers of investment, which are higher than those of other areas of expenditure or of tax reductions, tend to be larger in this macroeconomic context. Also, the increase in public investment would have a positive impact on supply and on the growth potential of the Spanish economy, providing that it is focused on projects that are carefully selected for their high economic and social profitability in the long term.

The European Union makes a great contribution to regional growth and development in the Member States through its regional or cohesion policy, which is the main tool for investment on a European level and also plays an important anti-cyclical role by making up for the drop in public investment on a national level. In Spain, the European funds have been, and are still, an important source of funding for public investment; on average 13 per cent per annum over the last two decades and even more since the crisis and budgetary adjustments in Spain. In 2018, they amounted to 19 per cent of total public investment.

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*The European Union's contribution to the funding of Spanish public investment*

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For the period 2014-2020, funding from the European structural and investment funds in Spain amounted to 56.304 billion euros, 71 per cent of which came from the European Union, the remainder being the national contribution, with the EDFR providing more than half. By priorities served, over 50 per cent of the funds were allocated to elements that correspond a priori to investment in physical and technological capital. There are also other financial tools and specific lines of action such as the Investment Plan for Europe (Juncker Plan), from which Spain obtained 10.2 billion euros, and the Horizon 2020 programme (4.2 billion euros).

However, all this considerable provision of programmed resources contrasts with a low or very low degree of implementation, with a worrying minimum implementation ratio of 1.9 per cent of the resources allocated to R&D+I in Structural Funds. In addition, the current model for managing European funds has certain weaknesses that were signalled explicitly in the Partnership Agreement with Spain, relating to insufficient definition of shared objectives, common management models and coordination mechanisms. This fragmentation makes it difficult to coordinate fund interventions with other Union policies or instruments of the Union for public investment. Similarly, greater collaboration among ministries and with the private sector is needed to identify strategic projects in Spain in the framework of the Strategic Forum on important projects of shared European interest.

For the forthcoming period of programming for which there will be a new Multi-Year Budget Framework, the ESC considers that it would be appropriate to set up mechanisms to iron out these weaknesses and ensure that there are real synergies between the funds. There must also be greater coordination in management and in follow-up and evaluation procedures, and between private and public investment, and a single model for management and participation by private agents in the national part so that it is also possible to define strategic projects of shared European interest that might be eligible for European funding. All this will lead to a more ambitious, efficient and effective policy for public investment in Spain, aiming to meet, in an integrated way, the regional, national and community challenges.

Implementing projects for public investment is a complex process. It is necessary to define goals, responsibilities and procedures which often involves multiple agents with different competencies, functions and interests, requiring coordination to guarantee the project's feasibility and success.

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*The governance of public investment*

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So proper governance must be set up to develop public investment, considering the levels of participation of the various agents involved in the existing territorial and institutional structure but also that of private financing and including the possibilities of public-private collaboration. If appropriate tools for governance are available, it should be possible to make better use of public funds for investment and achieve a greater impact.

Moreover, the selection of investment projects must be aligned with strategic priorities established for public investment, in line with any needs, problems or opportunities detected and adopting economic criteria of equity, sustainability and efficiency.

For this purpose, it is important to include the OECD principles on “effective public investment across levels of government” relating to coordination between levels of government and policies, with the aim of pinpointing complementarities, strengthening skills for implementing projects and establishing a suitable framework as regards administrative structure, budget availability, purchasing and regulatory quality.

The process of defining and implementing public investment projects in Spain involves a set of stages, from actual project definition to completion and fulfilment of the contract and impact evaluation.

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*Selecting and evaluating projects*

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In order to efficiently undertake a public investment project, it is necessary to draw up proper strategic and financial planning and timing to ensure it is both economically and technically viable.

Definition of the project should be based on a need to be met, a problem to be solved or an opportunity to be taken up in line with economic criteria and starting out from cost-benefit and efficiency analysis aiming to achieve results and equity. In addition, the public investment should support sustainable growth in all its dimensions – economic, social and environmental – and should be framed in broader plans or strategies in accordance with existing strategic priorities for public investment on national, regional and local levels.

A full and systematic evaluation of an investment project at all levels is essential for guaranteeing its success. This must cover prior assessment to select the investment, intermediate assessment to test its implementation and minimise risks and negative effects, and final assessment to evaluate the closing of the project and achievement of its requirements and goals. Ex post, its social, environmental and economic impact

in the short and long term must be determined. All this must be done with the goal of making the investment effective.

The public interest behind the need to recover suitable levels of investment in Spain can be satisfied by both the public authorities and by private and joint initiatives. Such public-private partnerships (PPP), in a context of proper planning and implementation, amount to an alternative that has both pros and cons for public investment projects.

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*Improving public-private collaboration*

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Spain has a longstanding tradition of PPP-financed projects, which has allowed Spanish businesses to be present in the design, funding, construction and operation of large international infrastructure projects of various types (especially in the field of transport), strengthening its leadership position and becoming a reference on a global scale. However, unlike in Europe, in Spain the adoption of PPP-financed projects is not going well as a result of the crisis and budget cutbacks, but also because of excesses and problems of efficiency in some projects carried out during the previous phase of expansion, especially in the field of transport infrastructure. These ended up entailing considerable costs for the public treasury.

In fact, although PPPs have been widely used in Spain and in many Member States of the European Union, the debate on their benefits and costs has become particularly relevant over recent years.

Moreover, although certain public Administration bodies select investment projects to be implemented using a type of PPP more appropriately than others, there is no general strategy based on technical criteria that is accepted by them all to guide them in their decisions on whether a specific investment project would be more efficient if promoted by a PPP or directly by the Administration. In some cases, decisions have been based on the impact of the project on the public treasury rather than on its efficiency and economic and social benefits. Also, some contracts have been signed that aim to prevent the expense from being considered public for the purpose of calculation of the deficit of the Administration signing it. Such contracts have then been reviewed by Eurostat, leading to their re-classification. This implies that there are many contracts with risks that the private sector considers unacceptable or excessive, which makes them of less interest for a PPP.

This debate suggests that a new culture or model for governance for more efficient and effective PPPs is needed. This might include the promotion of more ex ante and ex post assessments of public investment projects based on PPPs and the regulation of common technical criteria that would indicate to the various Administration bodies what type of PPP would be most appropriate for a specific public investment project to make it more efficient and to ensure its value for money. And it must be remembered that PPPs must always be set up in a climate of legal certainty and trust.

The main challenges of PPP today are to achieve good governance over coming years following the lead of public institutions and based on certain basic elements such as legal certainty, agility, transparency and answerability, and complementarity between public and private efforts. In practice, this can probably be done by improving administrative practice and the regulatory framework of PPPs. It would therefore be necessary to have a sound legal framework covering above all the terms and conditions as well as correctly drawn-up contracts with correct risk allocation. It would also be advisable to analyse possible mechanisms for out-of-court conflict resolution for certain types of investment using PPPs with public sector entities that do not have award powers. This would enable the considerable litigation generated by PPP-based public investments to be resolved faster and at lower cost.

To close, the following is a summary of the main proposals made by the Economic and Social Council in this report.

## SUMMARY OF PROPOSALS

1. New impetus must be given to public investment to avoid economic stagnation, to strengthen social cohesion and territorial structure, to increase potential for long-term growth in citizens' wellbeing, and to mobilise and guide private investment towards the areas that are strategic for such purposes.

2. In order to finance this new cycle of investment, the public Administrations must broaden the narrow fiscal margin they have today by: enhancing the collection efficiency of the tax system; including a golden rule for investment in European regulations on budget stability that will allow the use of public debt to fund investments of proven social benefit that are in line with the strategic priorities of the European Union; and taking maximum benefit of opportunities offered by European funds and financial tools.

3. Public investment must be reoriented in order to bring about in a rational, balanced and fair way the systemic transformations required by technological and environmental challenges. This requires prioritisation of investment in intangible assets such as education, scientific research and technological development, as well as in decarbonisation of the economic system, the circular economy, decontamination, mitigation of the consequences of climate change and the recovery of ecosystems. All this must be done without affecting the investment required to maintain existing public capital and to construct the infrastructure and facilities needed to promote more balanced territorial development.

4. When analysing investment processes, prioritising areas of action and drafting the appropriate policies, public authorities should adopt a broad approach to public investment in order to avoid the reductionism of current economic and accounting conventions and to include investment in human capital, natural capital and institutional capital. Investment should also be made by the private sector in collaboration with the public sector which can bring much higher rates of return than the private sector.

5. It is important to continue working on improved governance of public investment processes, in order to increase the efficiency of the complex management tools that have to be used throughout the project cycle. These normally involve multiple public and private agents with different competencies and interests. More specifically, PPP regulation should be improved to make sure that PPPs are used properly. Such institutional strengthening requires strict ex ante and ex post evaluation of investments, based on the principles of effectiveness, efficiency and equity, a field in which there is plenty of room for improvement. Also, it is necessary to separate strategic investments from political and economic cycles.



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