

# Inequality and social contract

Luis Ayala Cañón  
*Editor*

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## *Executive summary*



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# A snapshot of half a century of inequality in Spain

One of the most important socio-economic problems in Spain is the high level of income distribution inequality, which is significantly higher than in most European countries. One of the main reasons for this is the lower redistributive capacity of its tax and benefit system. This high level of inequality has persisted over time and has made the country more vulnerable to possible economic shocks, as it quickly increases during economic downturns and barely decreases during upswings. The intensity and duration of the crisis that began in 2008 led to a major increase in household income inequality, and this resulted in a significant fall in the share of the population with average incomes. This negative trend was not offset by the meagre, highly uneven economic growth since 2014, thereby leaving many households in a situation of considerable vulnerability when the covid-19 crisis hit. Poverty in Spain, historically characterised as recurrent but transitory, risks becoming chronic if this dynamic is not reversed, as this would lead to the effects of transitory shocks continuing over time.

Luis Ayala, UNED and Olga Cantó, University of Alcalá

1

Spain has been one of the most unequal countries in Europe in recent decades and was the fifth most unequal country in the EU-27 between 2015 and 2019.

2

The evolution of inequality is affected by economic cycles: income differences increase more during downturns than they shrink during upswings.

3

The lowest incomes have fared worst and the highest incomes best ever since the 2008 crisis. Spain is the EU country where the gap between the highest and lowest incomes has grown the most.

4

The growth of inequality in Spain in recent decades has been due to changes in labour and capital income and the limited redistributive capacity of taxes and benefits, which barely increased between 2015 and 2019.

5

The richest 20% of the population receives more than 43% of earned income. The higher share of this income in total revenue makes it the largest contributor to inequality.

6

The middle-income group of the population is shrinking. Its share is lower today than it was thirty years ago, and lower than it is in rich European countries.

7

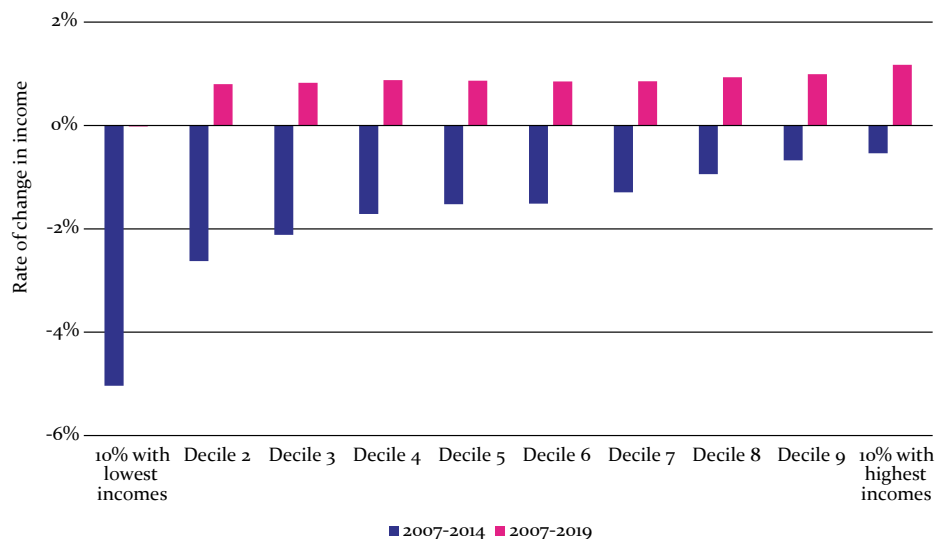
Poverty in Spain has become chronic since 2010, especially in younger households with dependent children. The percentage of children in jobless households has doubled over the past fifteen years.

8

Early evidence on the economic effects of the pandemic indicates a higher increase in inequality and poverty than in the rest of the EU-27.

## Income trends for poorest households have been the most adversely affected among the population as a whole since the onset of the crisis in 2008

*Average annual change in income per income decile as a %, 2007-2014 and 2007-2019*



Source: compiled by the authors based on "Living Conditions Survey".

# Inequality in employment

The economic recession that began in 2008 led to consequences that radically transformed socio-economic reality. The greatest impact of the recession in the case of Spain was on the labour market, with a significant increase in the unemployment rate, rising from 8.1% in 2008 to 26.1% in 2013. This study analyses the relationship between the labour market and income inequality in Spain, as well as the determinants of accessing employment and part-time work from an intergenerational perspective. The results show that part-time employment and unemployment are essential to understanding income inequality, and that these particularly affect women, young people and those with a low level of education.

Sara de la Rica, Lucía Gorjón and Gonzalo Romero, ISEAK Foundation

1

Income inequality in Spain is strongly connected to access to employment. In 2019, 70.6% of all people in the bottom 10% of income were unemployed.

2

Spain has one of the EU's highest unemployment rates, especially among young people. Its youth unemployment rate was 23.4% in 2018. It also has a high level of long-term unemployment.

3

Being young and having a low level of education impede access to employment and this negative impact has increased over time. Being a woman also reduces access to employment, although this negative impact has decreased over time.

4

Access to employment varies significantly according to autonomous community, and differences are exacerbated among young people: taking into account people aged 25-29, the probability of having a job in Navarre is 92% while in Andalusia it is 72%.

5

Income inequality is also related to hours worked. Part-time workers tend to be low-paid and most of them would like to work more hours.

6

Part-time employment predominantly affects young people and women. Up to a quarter of people in the lowest 20% of income earners are part-time employed women. The gender gap in this area increased by 55% between 1999 and 2019.

7

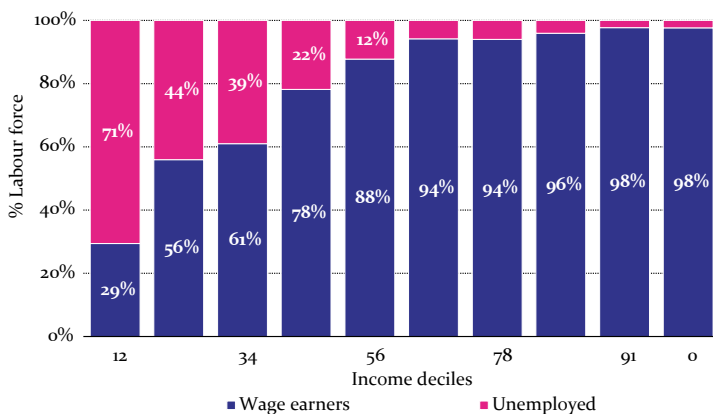
People employed in the service sector have a lower work intensity. The probability of working full-time if you are young is no more than 80% in health or hospitality and this figure is 55% in education.

8

The covid-19 pandemic has made it even more difficult for young people to access employment.

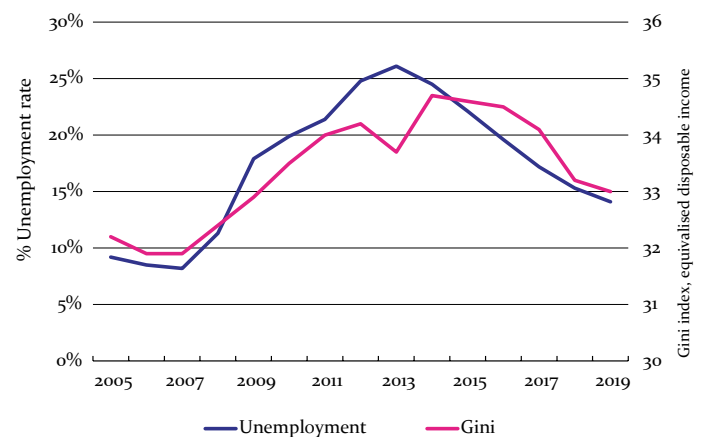
## Lack of employment affects mainly lower incomes

*Distribution of labour force (employed and unemployed) according to income deciles, 2019*



## Changes in inequality is positively related to a lack of employment

*Unemployment and inequality in Spain, 2005-2019*



Source: author's calculations based on data from the "Living Conditions Survey" (ECV) 2019, INE.

Source: Eurostat.

# Low labour intensity and the origins of inequality

Wage inequality in Spain grew in the years following the Great Recession of 2008, and this increase places Spain among the countries with the highest wage inequality in Europe. The main, although not only reason was the increase in temporary and part-time contracts among the lowest paid and youngest workers. The production structure of the Spanish economy is a determining factor, as the distribution of various types of contracts corresponds to the particularities of each sector. Finally, although technological change increases wage inequality, training reduces it.

Manuel Alejandro Hidalgo Pérez, *Pablo de Olavide University and ESADE EcPol*

1

Wage inequality in Spain has grown since the onset of the Great Recession, and this increase is mainly due to the rise in temporary and part-time contracts among people earning lower wages.

2

The lowest paid workers have experienced a reduction in their total working hours following the Great Recession, although no significant changes in hourly wages have been observed.

3

This increase in inequality was more pronounced between 2014 and 2018, driven by higher wage growth among the highest earners compared to the lowest earners.

4

The share of temporary and part-time employment accounts for most of the differences in inequality among sectors.

5

Inequality between younger and older workers grew between 2010 and 2018, as those aged 30 and over saw their average gross monthly wage increase by 1.5%, while those under 30 saw it fall by 8.1%.

6

High temporary employment is one of the reasons why inequality in Spain is among the highest in the European Union.

7

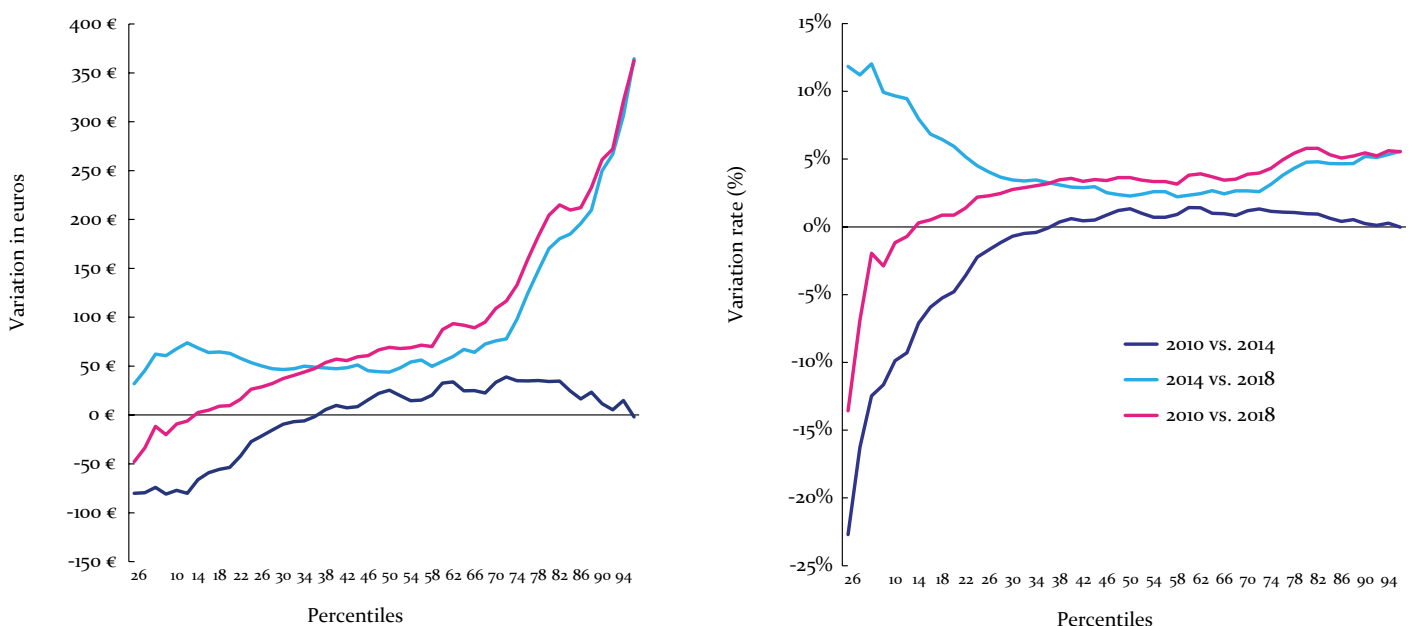
Technological change increases wage polarisation in the labour market, an effect on wage inequality that can be partially offset by training.

8

Covid-19 has apparently not led to a large increase in wage inequality, and this can be explained by two opposing trends that largely offset each other: temporary layoffs will have increased inequality, but rising unemployment will have reduced this.

## Inequality has increased as a result of lower wage growth in the lower percentiles

*Absolute change (euros) and rate of change (%) in gross monthly wage by wage distribution percentile, 2010, 2014 and 2018*



**Source:** compiled by the author based on data from the “Wage Structure Survey”, 2010, 2014 and 2018, INE.

# Instability and problems to access housing, an increasingly more prevalent reality

Changes in terms of access to and stability in Spain's residential system have been accentuated as a result of the economic crisis that began in 2008. What is new with respect to previous processes of changes to residential systems is that on this occasion they affect not only access to housing for young people, but also stability in more elderly people. Although the main problems are shared by the population as a whole, there are important elements of diversity and inequality that the covid-19 crisis will most likely not help to reduce.

Juan A. Módenes, *CED, UAB*

1

Spain has shifted away from the traditional Southern European residential model, based on high residential stability.

2

Rental share has increased in recent years at all socio-economic levels, not only in more modest households.

3

More than 60% of adults aged 45-49 live in market rent or owned with mortgage.

4

Less than 70% of people aged 30-34 have become independent, which is the main and perhaps most important residential problem in Spain.

5

Of those aged 30-34 who have become independent, 70% have done so through market rent or owned with mortgage.

6

Most young households in Catalonia and the Community of Madrid live in rental accommodation.

7

Spain is one of the European countries where young people have more financial problems related to housing.

8

Almost 50% of those aged under 35 living in rental accommodation experience a situation of financial overstretch in paying for their housing.

9

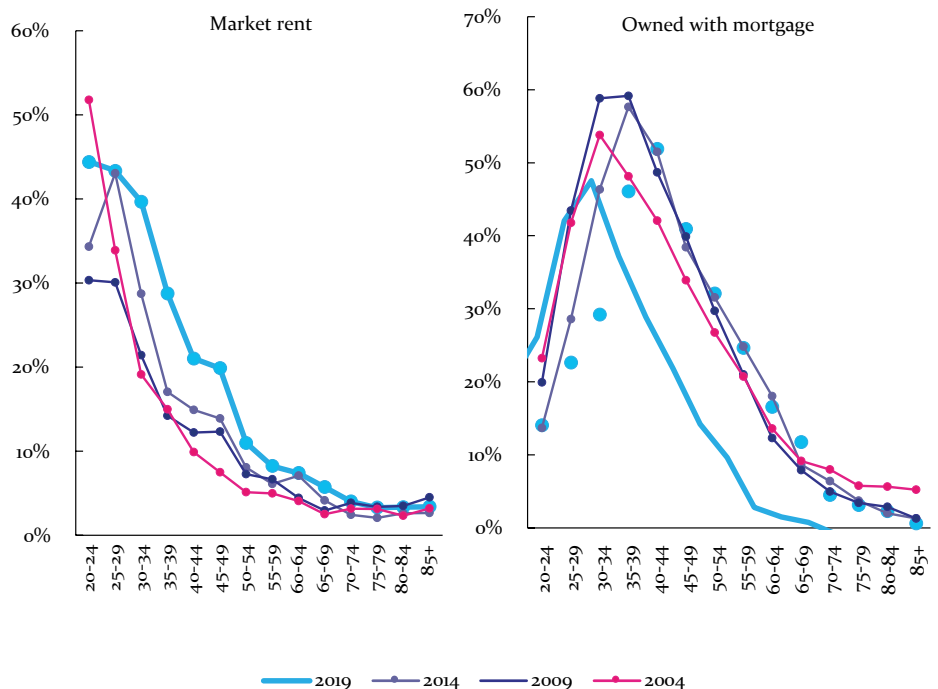
80% of households with lower incomes living in rental accommodation have to financially overstretch to pay for their housing.

10

The covid-19 crisis erupted in a country with more tenants with an older profile and, therefore, more residential insecurity.

## Market rent supplants owned with mortgage among young households and both supplant fully paid ownership in older age groups

*Proportion of persons responsible for a household living in market rent and owned with mortgage according to age and year*



Source: INE, "Living Conditions Survey", various years.



# The persistence of unequal opportunities following the expansion of education

Spain's education system has undergone a major expansion, particularly from the latter half of the last century onwards. This expansion has improved the educational level of younger generations, especially in the case of women. But although it has reduced educational inequalities, it has not eliminated them. There is still a clear link today between the socio-economic and cultural conditions of households and the likelihood of early childhood schooling, dropout rates and opportunity for children to pursue tertiary education. Particularly worrying is the situation of poorly educated, low-income groups in society, given that they face major difficulties in preventing their children from achieving unfavourable educational outcomes.

Miguel Requena and Leire Salazar, UNED

1

The historical disadvantage of women in education has been reversed at almost all educational levels. Whereas only one in three university graduates born before 1940 was a woman, these figures have been reversed among those born after 1980.

2

Almost 40% of children under the age of 3 are in school, which is above the European average. But there are striking differences between autonomous communities that decrease according to the age of children.

3

Households with greater educational or financial resources provide more schooling for children aged 0-3: young children from high-education households are up to 28% more likely to attend school than those from low-education households.

4

Both cultural and financial family resources are strongly related to early school leaving, and Spain leads the EU ranking in this, especially among boys.

5

Tertiary education enrolment is clearly linked to family resources: the higher the socio-economic status of parents, the greater the access of their children to tertiary education.

6

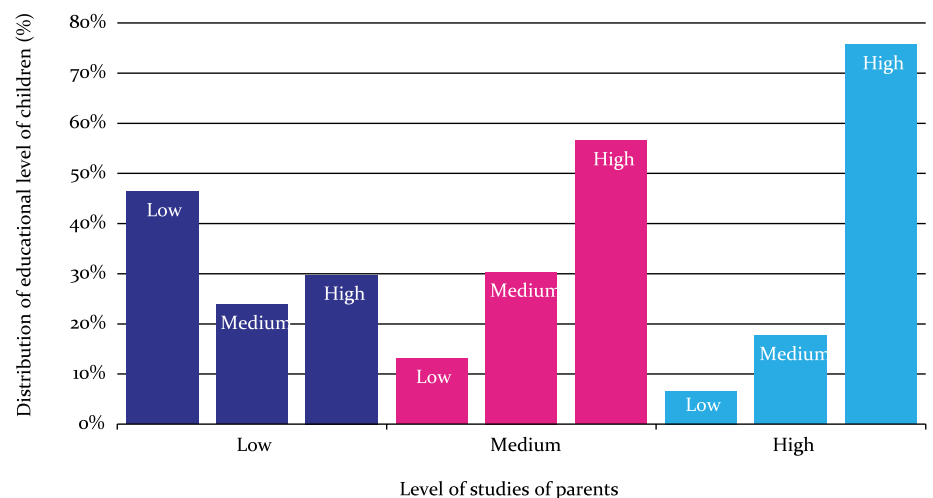
The expansion of the education system has produced much educational mobility, but it has failed to remove the obstacles to exceeding parental levels: almost half of the children of low-educated parents remain at that level.

7

Evidence suggests that remote school attendance during lockdowns caused by the covid-19 pandemic has intensified educational inequalities.

## Educational mobility depends on social background

*Percentage of the cohort of children with low, medium and high educational levels according to the educational level of parents, 2019*



**Note:** population aged 25-59 years only. Low level = first stage of secondary education or lower; medium level = second stage of secondary education; high level = tertiary education.

**Source:** compiled by the authors based on data from the "Living Conditions Survey" (ECV) 2019, INE.

# Demand for income redistribution in Spain

Income inequality prior to taxes, transfers and other public spending in Spain is in the middle ranking of the EU-28 and when compared to the baseline countries in this study. Nonetheless, final income inequality, i.e. after public sector action, tends to be among the upper reaches. The redistributive effect of taxes and cash transfers has been diminishing since 2008 until falling below the EU average, and it is the lowest of the countries under review. This result can to some extent be explained by the combination of a lower tax burden and a not very progressive tax system, in which taxation on consumption has been gaining ground since 2010. Nonetheless, Spanish citizens are in favour of the government taking measures to reduce inequality, a demand that is similarly high when compared to other countries and remains stable over time.

José María Durán and Alejandro Esteller, UB and IEB

1

Inequality in Spain prior to public sector intervention is lower than the EU-28 average and is in the middle ranking when compared to baseline countries (Denmark, France, Germany, Italy, Netherlands, Portugal, Sweden and United Kingdom).

2

Spain has been witnessing a decreasing redistributive impact of public sector action since 2008, especially redistribution stemming from taxes and cash transfers.

3

Income inequality following public sector intervention increased between 2004 and 2017, and it is now higher than the EU average. Spain is the most unequal country of all those considered, second only to Portugal.

4

The overall tax burden in Spain is far from the EU-28 average, thereby limiting its redistributive capacity.

5

The Spanish public sector has a low redistributive capacity compared to the baseline countries, and Spain has been the country with the lowest level of redistribution since 2013, well below the EU average.

6

The demand for redistribution in Spanish society is well above the EU-28 average, and this level has been very stable over time.

7

In short, redistribution in Spain is not in line with the demand from society. In other words, Spain redistributes less in comparison with the redistribution of baseline countries, despite the fact that social demand for redistribution is higher.

## The redistributive impact diminished from 2010 onwards, although the tax burden increased

*Relationship between overall tax burden level and percentage reduction of redistributive effect, 2004-2017*



**Note:** the redistributive effect is measured through the Reynolds-Smolensky index, which measures the difference between the Gini index before and after the action of the public sector.

**Source:** compiled by the authors based on the World Inequality Database and OECD tax statistics, 2004-2017.

# Reinforcing the redistributive capacity of the tax system

This report compares the redistributive effect of taxes in Spain with that of other countries in the European Union. Spain's lagging position seems to be primarily explained by the smaller size of its tax system. This smaller tax size also at least partly explains its serious public account imbalance. The revenue-raising capacity of Spain's tax system could be increased by combining the use of direct and indirect taxes in such a way as not to deteriorate the limited role of taxes and social contributions to correct income inequalities among Spanish households.

Julio López Laborda, *UZ and FEDEA*, Jorge Onrubia Fernández, *UCM-ICEI and FEDEA*, and María del Carmen Rodado Ruiz, *URJC*

1

The tax burden plays a dual role: to provide enough resources to finance the welfare state and to contribute to reducing inequality.

2

Spain is among the EU countries with the highest inequality in market income, gross income (i.e. after cash benefits) and disposable income (after direct and indirect benefits and taxes).

3

Like other European countries, Spain corrects existing inequalities in market income distribution more with cash benefits rather than with direct taxes and social contributions.

4

Spain is below the EU-28 average in terms of the redistributive effect of direct taxes and social contributions.

5

Spain is one of the few EU-28 countries where social contributions by workers and the self-employed act regressively, thereby increasing inequality by reducing the redistributive efforts of direct taxation.

6

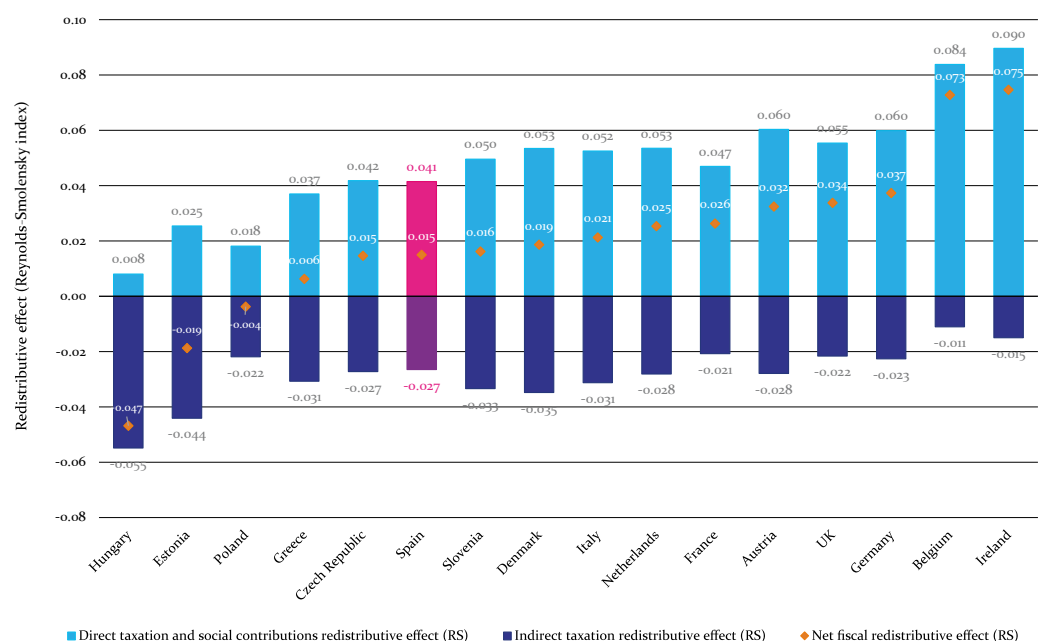
The regressivity of indirect taxes increases inequality and reduces the joint redistributive effect of contributions and direct taxes. This effect in Spain compared to other countries is offset by a lower collection share of indirect taxation.

7

Spain's lagging position in relation to other EU countries in terms of the redistributive effects of taxes is primarily explained by the smaller size of its tax system.

**All countries with a higher net fiscal redistributive effect than Spain also have a higher redistributive effect of their direct taxes and social contributions**

*Contribution to redistribution of direct taxation and social contributions, as well as indirect taxation (selected EU-28 countries)*



**Source:** compiled by the authors based on data from Euromod, Blasco, J.; Guillaud, E. and Zemmour, M. (2020) and Blasco, J.; Guillaud, E. and Zemmour, M. (2021).

# Tax fraud leads to inequality

This report provides estimates on the nature of personal income tax fraud in Spain and how this affects inequality. This tax has been highlighted for two reasons. First, because it is the tax that carries out most of the redistribution derived from taxes in the country, as it combines high revenue with a progressive nature. Second, it determines how the public view the fairness of the tax system as a whole because of its visibility. The key conclusion is that fraud, by being greater in the types of income received by higher earning taxpayers, predominantly financial income, is a major contributor to inequality. Similarly, indirect effects should be also added, such as a reduction in public spending of a redistributive nature. Furthermore, a growing rejection of fraud by the general public and apportioning blame to the tax administration may undermine the institutional trust required for achieving social contracts against inequality.

Sara Torregrosa Hetland, University of Lund

**1** Tax fraud leads to inequality: it is an affront to those who comply by those who do not.

**2** A significant part of self-employment or capital income is not declared in personal income tax. Although this represents 20% of the income declared in this tax, other measures suggest that the real weight in household income is 30%.

**3** Tax compliance is around 80% for self-employment and fixed capital income, but it falls to 50-60% for financial income. Fraud in the first two cases has been considerably reduced in recent decades.

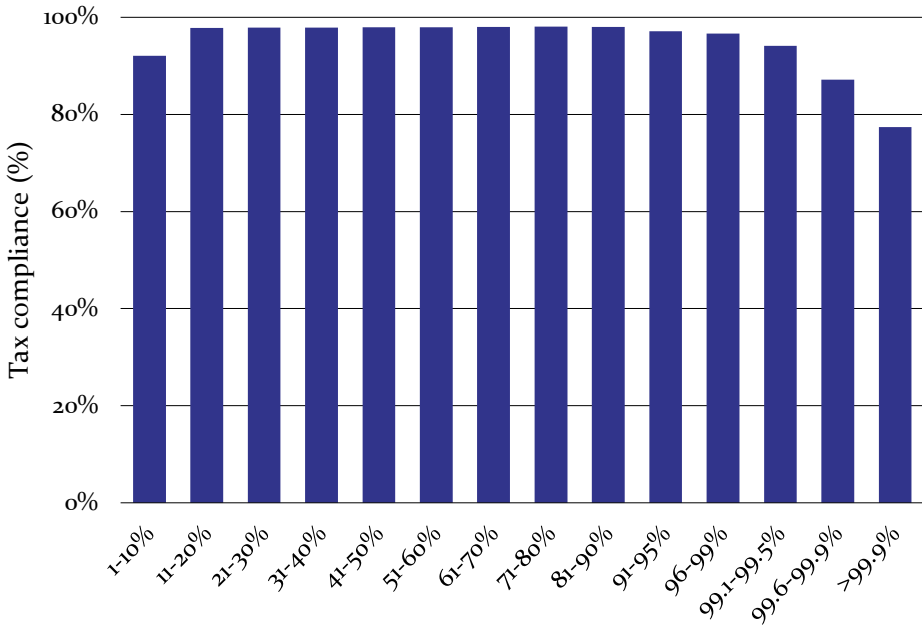
**4** Tax compliance is lower the higher up the income scale one goes, and this leads to inequality and significant reductions in tax revenue. The richest 0.1% conceals approximately 23% of their income.

**5** Up to 70% of the population considers fraud to be unjustifiable, compared with 50% in 1981. There is also a majority opinion that fraud mainly stems from the inefficiency of the tax administration.

**6** La comparación internacional muestra International comparison shows that applying withholding taxes and providing information by third parties are crucial. Income not subject to this control reaches a plateau compliance level of 60-70%.

## Tax fraud is greater at higher incomes, more so the higher the incomes, and is estimated at 23% for the richest 0.1% of personal income tax filers

*Estimated average compliance (declared income over actual income) in percentage at different income levels of the tax filer population, 2017*



Source: compiled by the author based on personal income tax microdata from 2017.

# Spanish society demands greater economic equality

The view that Spanish society is very unequal is firmly deep-rooted in public opinion. This view corresponds fairly closely to reality, as its actual level of inequality is high when compared to other European Union countries. There is very broad social support for public intervention in income redistribution, with no major differences among social groups. In terms of the means of achieving social welfare, the vast majority of the population believes in the need for taxation, although it also strongly distrusts the fairness of the tax system. There is also a perception of widespread tax fraud. Likewise, the population expresses broad, ongoing support over time for investment in health, pensions, education and unemployment policies. In this respect, there are no divisions among social groups either, although there are some differences when it comes to supporting specific measures. It can therefore be concluded that the main obstacle to reducing inequality is not so much in the preferences of the public, although the perception of tax fraud may hinder the use of taxes as a tool to increase public spending.

Inés Calzada, *Complutense University of Madrid*, Eloísa del Pino, *CSIC* and Antonio M. Jaime-Castillo, *UNED*

1

Nine out of ten people in Spain believe that income differences are too great. This view is in line with the reality in the country, where inequality is among the highest in Europe.

2

There is broad support for state intervention in income redistribution, with very few differences among social groups or by ideological stance.

3

The vast majority of citizens believe that taxes are needed and serve to make life better for all citizens, with very few differences by educational level, gender, age or occupation.

4

The population is highly suspicious of the fairness of the tax system and believes that widespread fraud exists.

5

Citizens express strong, ongoing support for public spending on health, pensions, education and unemployment, as opposed to more unstable and less intense support for other public policies.

6

Despite the broad consensus on the need for specific policies, major ideological differences emerge when looking in detail at areas such as housing, education and health.

7

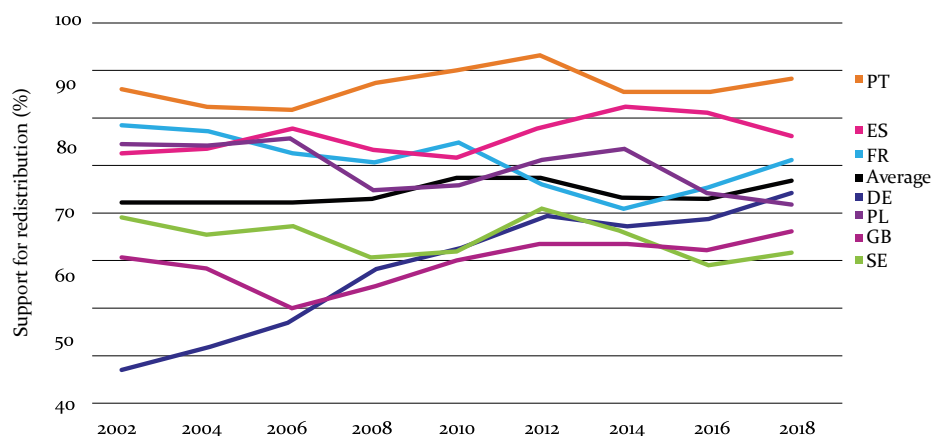
Although there is a widespread view of an unequal society in terms of both wealth distribution and opportunities, Spaniards tend to believe that their personal situation is an exception to the rule.

8

The strong support for a minimum living income may be partly tied to the context in which it was approved: the covid-19 pandemic.

## Spain is among the countries with the highest level of support for redistribution

*Percentage of support for income redistribution in selected European countries, 2002-2018*



**Note:** the average refers to that of the countries in this survey, including European countries inside and outside the European Union.

**Source:** European Social Survey, 2002-2018.

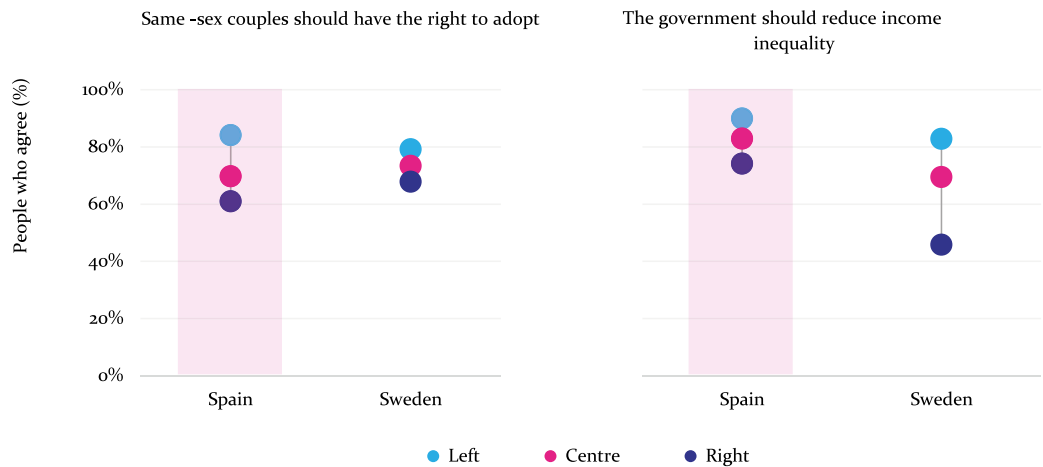
# A political culture unaccustomed to dialogue

Reaching lasting political agreements is vital for solving structural problems such as social inequality. There are several factors that can make it easier or more difficult for political parties, usually at odds with each other, to reach this type of consensus. In Spain, as in other southern European countries and in contrast to the north, there is greater polarisation on cultural or moral issues than on economic issues. Left-wing and right-wing parties have consequently reached agreements in areas such as taxation, unemployment, pensions or minimum incomes, which is something that could be repeated in the area of reducing inequality. On the other hand, polarisation on moral issues pushes in the opposite direction and makes it difficult to reach consensus on equality. Furthermore, divided public opinion and an institutional design that makes it easier to govern alone without any agreements also discourage pacts. Changing specific characteristics of parliamentary committees could in turn convert them into a space for negotiation in order to overcome these difficulties and reach positive social impact agreements.

Margarita León, Manuel Alvariño and Llorenç Soler, Autonomous University of Barcelona

- 1 Political competition in southern Europe revolves around moral rather than economic issues. For example, almost 85% of left-wing voters in Spain are in favour of adoption in same-sex marriages, while only 60% of right-wing voters are in favour of this.
- 2 Polarisation on moral issues makes it difficult to reach consensus on equal rights issues, such as, for example, divorce, same-sex marriage or abortion. Nonetheless, disagreement has not resulted in counter-reforms.
- 3 Far-reaching agreements to reduce inequality are possible even in areas where ideological differences remain. Indeed, ideological differences have failed to prevent agreements on tax policy and unemployment protection.
- 4 The combination of economic, moral and territorial conflicts maximises polarisation in the area of education, and this has led to constant counter-reforms.
- 5 Cohesive public opinion is associated with less polarisation and a higher likelihood of agreement, and vice versa. This would, for example, explain the agreements reached on gender equality.
- 6 Certain features of Spain's institutional design are not favourable to political pacts, especially legislation by decree laws, whose use doubled between 2005 and 2015.
- 7 A fragmented political scenario, such as that in Spain after 2015, favours coalition governments, which is an opportunity for agreement-based institutional learning.

**Southern Europe is more polarised on moral issues and northern Europe on economic issues**  
*Percentage of people in Spain and Sweden agreeing with each statement according to their ideological self-positioning, 2016*



# The inefficient state, the social contract's Achilles heel

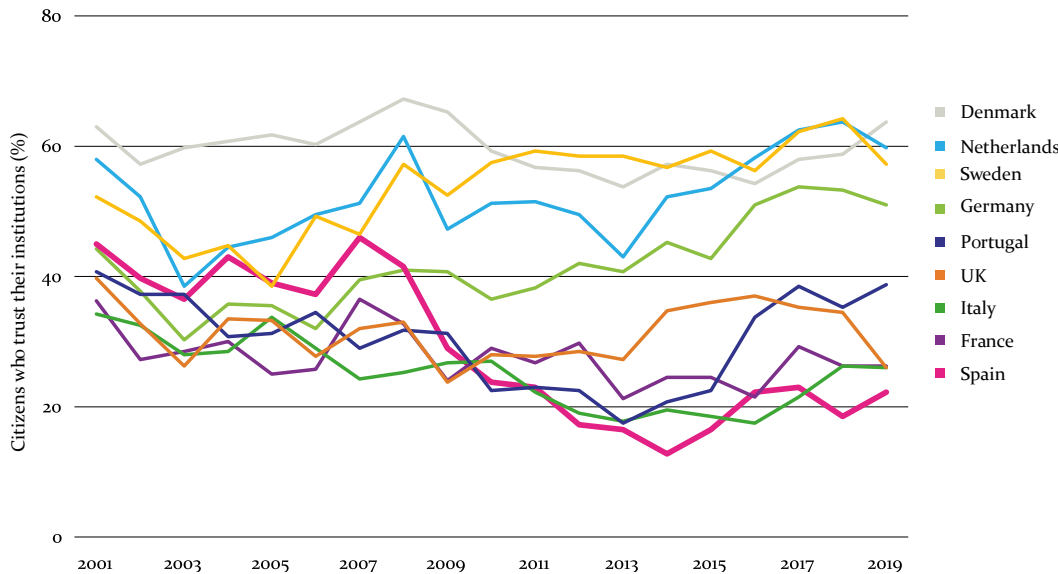
This study deals with the political culture of Spaniards and the quality of their institutions. Its main thesis is that both elements may hinder demands of redistribution to be translated into an effective social contract. In terms of culture, it demonstrates the low satisfaction of Spaniards with regard to the functioning of democracy, the major importance they attach to social justice in their concept of democracy, their greater propensity to protest in comparison with other countries and their notable support for technocracy. In terms of institutional quality, it addresses low government effectiveness in comparative terms, the limited strength of legislature in influencing public policies, the poor perception of the independence of the judiciary and the functioning of decentralisation, which could be improved in terms of horizontal cooperation.

Pablo Simón Cosano, *Carlos III University of Madrid*

- 1 Satisfaction with democracy and trust in institutions and system actors (government, political parties, parliament, legal and judicial system) plummeted following the Great Recession and have barely recovered in the case of Spain. This generally reinforces the preference of citizens for governments of experts.
- 2 Participation in demonstrations by Spaniards is high, while in contrast levels of institutional political participation and involvement in associations are low.
- 3 Although Spain is among the countries where most citizens favour small social differences, effective redistribution by the state is limited from a comparative perspective.
- 4 The importance that Spaniards attach to social justice is compatible with core ideas of liberal democracy, such as checks and balances of power or direct democracy.
- 5 With fewer resources, less technical capacity and independence of its public servants, Spain ranks at the bottom of southern European countries in terms of the quality of the institutions in charge of designing public policies.
- 6 The power of the Spanish parliament to appoint officials and politically control the executive is comparable to that of neighbouring parliaments, but it has few resources and little capacity to influence public policy directly.
- 7 Spaniards view the judicial system as not being very independent from political and economic powers, and they mainly attribute this to their system of governance.
- 8 Spain is characterised as a relatively decentralised country, but it lacks institutions of shared governance and horizontal coordination among its autonomous communities.

## Trust of Spaniards in their institutions hit rock bottom in 2014 and stabilised at low levels

*Percentage of citizens who say they trust their institutions, 2001-2019*



Source: Eurobarometer, 2001-2019.

