

- fiscal drag has helped Spain's government consolidate its finances, but there will be an economic and political cost;

What a fiscal drag

France and Germany are both having their arguments over taxes: whether to increase them, and where they should come from. But there is a third option out there: just do nothing, don't adjust tax bands periodically, and let nominal wage growth from inflation do the rest. In Spain, this phenomenon, fiscal drag, has been an important component of revenue growth. But, politically expedient as it may be, if you fiscally consolidate by taking more taxes in real terms and keeping spending at planned levels, you achieve a similar effect economically to the tax rises. Without solid real wage growth, voters will eventually notice too, and the insidious malaise of hidden tax increases might be worse in the long run.

Both countries have relied heavily on keeping thresholds where they are to balance the books. In Spain, analysis from the Banco de España found that fiscal drag accounted for half of the personal income tax-to-GDP ratio growth that occurred from 2019 to 2023. It has also said that, should nothing change, this ratio will be 29% higher this year than it was in 2019.

In Spain, fiscal drag has mostly affected high and middle-earners, reducing income inequality overall. But now it might affect those on the minimum wage soon. According to reporting from [El Diario](#), a commission set up to advise the government on minimum wage increases said that, absent of an adjustment in minimum tax rates, their suggested increases would cause these earners to pay tax for the first time. Spain's treasury has not said whether it will raise this exempt minimum level again or not.

The great thing about fiscal drag, if you are a government trying to raise money, is that you can do it pretty quietly. In Spanish politics, there are lots of very contentious topics that cause heated debate. Despite the huge rise in personal taxes proportional to GDP, taxes themselves are usually not one of them.

What you cannot do, however, is avoid the macroeconomic impact of the tax rise that you are effectively causing. Taking more of peoples' incomes in tax, all other things being equal, will reduce their spending, though this short-term effect will be dampened if higher earners bear more of the brunt. This has not really stopped Spain from continuing to grow economically at a very strong rate, thanks to immigration and labour

market strength. But fiscal drag will be an economic drag like any tax rise without commensurate spending increases is.

Politically, there will also be an impact. If you are reducing how much people take home in real terms, and therefore how much they can actually buy, this is going to happen sooner or later. Instead of having a specific object of frustration, however, these voters might think it shows something more generally wrong with the state of things. This is not great territory to be in for any government.