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Recommendation for a

**COUNCIL RECOMMENDATION**

**on Spain's 2014 national reform programme**

**and delivering a Council opinion on Spain's 2014 stability programme**

{SWD(2014) 410 final}

Recommendation for a

## **COUNCIL RECOMMENDATION**

**on Spain's 2014 national reform programme**

**and delivering a Council opinion on Spain's 2014 stability programme**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances<sup>2</sup>, and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission<sup>3</sup>,

Having regard to the resolutions of the European Parliament<sup>4</sup>,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.
- (2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

<sup>3</sup> COM(2014) 410 final.

<sup>4</sup> P7\_TA(2014)0128 and P7\_TA(2014)0129.

the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

- (3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.
- (4) On 9 July 2013, the Council adopted a recommendation on Spain's national reform programme for 2013 and delivered its opinion on Spain's updated stability programme for 2012-2016. On 15 November 2013, in line with Regulation (EU) No 473/2013<sup>5</sup>, the Commission presented its opinion on Spain's draft budgetary plan for 2014<sup>6</sup>.
- (5) On 13 November 2013, the Commission adopted the Annual Growth Survey<sup>7</sup>, marking the start of the 2014 European Semester of economic policy coordination. On the same day, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report<sup>8</sup>, in which it identified Spain as one of the Member States for which an in-depth review would be carried out.
- (6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.
- (7) On 5 March 2014, the Commission published the results of its in-depth review for Spain<sup>9</sup>, under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Spain is experiencing macroeconomic imbalances which require specific monitoring and decisive policy action. In particular, in several areas, the adjustment of the imbalances identified last year as excessive has clearly advanced and the return to positive growth has reduced risks. However, the magnitude and inter-related nature of the imbalances, in particular high domestic and external debt levels and high unemployment, mean that vulnerabilities are still present.
- (8) On 30 April 2014, Spain submitted its 2014 national reform programme and its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (9) The objective of the budgetary strategy outlined in the 2014 Stability Programme is to correct the excessive deficit by 2016 and reach the medium-term objective in 2017. The programme confirms the medium-term objective of a balanced budgetary position in structural terms, which is more stringent than what the Stability and Growth Pact requires. The programme plans to bring the deficit below 3% of GDP in 2016, in line with the target set in the Council recommendation of 21 June 2013, but

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<sup>5</sup> OJ L 140, 27.5.2013, p.11.

<sup>6</sup> C(2013) 8003 final

<sup>7</sup> COM(2013) 800 final.

<sup>8</sup> COM(2013) 790 final.

<sup>9</sup> SWD(2014) 80 final.

the annual improvement of the (recalculated) structural balance planned in the programme falls below the recommended effort as of 2014. For 2017, the plan envisages sufficient progress towards the medium-term objective, although this may not be enough to reach it in the same year as declared in the programme. The programme projects the government debt ratio to peak in 2015 at 101.7% of GDP and to start declining thereafter. Overall, the budgetary strategy outlined in the programme is only partly in line with the requirements of the Stability and Growth Pact. The macroeconomic scenario underpinning the budgetary projections in the programme, which has not been produced or endorsed by an independent body, is broadly plausible for 2014 and subject to downside risks in 2015 when compared with the Commission 2014 spring forecast. For 2016-2017, the GDP growth rates in the programme seem somewhat optimistic when seen against current estimates of the potential growth rate of the economy and the remaining post-crisis economic adjustment needs. Therefore, the deficit and debt adjustment paths are also subject to downside risks. Moreover, concrete measures to support the headline deficit targets from 2015 onwards are not yet sufficiently specified, especially regarding the changes to tax legislation within the framework of the planned tax reform. Other risks relate to contingent liabilities and the yields of planned savings at local and regional level. Based on the Commission forecast, the fiscal effort over 2013-2014 falls short by 1.1 pp. in terms of (corrected) change in the structural balance (although this figure is inflated by recent changes in the methodology for the estimation of potential output) and by 0.4 pp. compared to the amount of measures estimated as necessary at the time of the recommendation under the Excessive Deficit Procedure. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the measures underpinning the budgetary strategy need to be specified further and that additional efforts are needed to fully comply with the Council recommendation under the Excessive Deficit Procedure.

- (10) On the fiscal structural side, there has been progress in the reporting of budgetary execution and in the application of corrective measures to non-compliant administrative bodies; however, there remains scope for implementing additional enforcement mechanisms, set out in Spain's Budgetary Stability Organic Law, for non-compliant regions. New measures have been taken to enforce an average period for payments to commercial suppliers of 30 days across all levels of government. An independent fiscal institution was set up by law in November 2013 and its president appointed in February 2014. However, the institution was not operational in time to assess the 2014 stability programme. The 2014 national reform programme also acknowledges the need to keep improving cost-effectiveness in healthcare and pharmaceutical expenditure, e.g. by centralising purchasing of pharmaceutical products, revising the basket of services, developing digital clinical records, or strengthening management of health establishments. With most of the fiscal consolidation ahead planned to come from expenditure savings, a systematic review of expenditure at all government levels, would help to identify areas where savings could be generated in a growth-friendly way while catering for the needs of the most vulnerable.
- (11) In 2013, Spain adopted new measures to address the debt bias in corporate taxation. During 2013, Spain also made some progress on improving tax compliance by intensifying the fight against tax fraud and undeclared work, but important challenges remain. In 2013 and 2014, Spain also introduced reductions in social security contributions for hiring young and new employees. Following the delivery

of a comprehensive report on tax reform by an Expert Committee commissioned by the government, the authorities plan to present concrete legislative proposals in the second quarter of 2014. According to the 2014 National Reform Programme, the proposals will aim at modernizing the tax system, reduce the bias against employment, foster revenue collection, favour economic development, ensure market unity and fiscal neutrality and enhance the competitiveness of the Spanish economy while contributing to fiscal consolidation. The design and implementation of this reform will be important to future economic prospects and public finances.

- (12) Financial stability has been bolstered by the recapitalisation and restructuring of the banking sector and the thorough implementation of the July 2012 ESM programme for the recapitalisation of financial institutions, completed on 22 January 2014. Yet, the financial sector in Spain is still faced with significant challenges that need to be carefully monitored and managed. Moreover, improvements in the funding conditions of banks are being passed only gradually to the financing of SMEs. Going forward, it is important to ensure that credit continues to flow to viable sectors of the economy as the deleveraging of the private sector continues. The authorities have taken several measures to improve access of firms to bank and non-bank financing and facilitate corporate debt restructuring, but further policy actions are needed.
- (13) The labour market is showing some signs of stabilisation and a mild recovery is expected in 2014 with growing employment and decreasing unemployment levels. However, with an annual average of 26.1% in 2013, the unemployment rate remains very high. Of particular concern are the high youth unemployment rate of 54.3%, and the significant peak of long-term unemployment at 49.7% of total unemployment in 2013, the latter with particularly high rates among older and the low-skilled workers. Available evaluations of the 2012 labour market reform conclude that the reform, together with the social partners' commitment to wage moderation in 2012-14, has helped to provide firms with greater internal flexibility and limit job losses, prioritising collective bargaining agreements at firm level and enhancing possibilities for firms to opt out of a collective agreement. The reform has also reduced the compensation costs for unfair dismissal and contributed to a lowering the number of dismissals challenged in court, and introduced new contract to promote stable hiring in SMEs. Further measures were introduced in 2013 and early 2014 to facilitate stable part-time employment, and reducing temporarily social security contributions on new indefinite contracts. However, segmentation remains an important challenge for the Spanish labour market, the number of contract types remains high and the gap between severance costs for fixed-term and indefinite contracts remains among the highest in the EU even after the reform. Progress has been made in the reform of active labour market policies, including the approval of the annual Employment Plan (PAPE). However, action to modernise and reinforce the public employment service seems to be lagging behind, which threatens to hinder the successful implementation of the new framework. The full operationalisation of the single job portal has suffered delays. Progress has been made in fostering cooperation with private placement agencies, but further efforts are needed.
- (14) The inadequate labour-market relevance of education and training and the high proportion of unemployed without formal qualifications (35.2%) contribute to the high youth unemployment rate, as well as to long term unemployment. The rate of young people not in employment, education or training remains higher than the EU average and has been increasing sharply. The proportion of pupils and students leaving education and training early, although decreasing, also remains very high

(23.5%). Tertiary attainment rates are sustained, but vocational education and training and apprenticeship schemes are still under-used and the proficiency of upper secondary vocational education and training graduates lags behind the EU average. Spain is also working on measures to encourage youth employment. The national 2013-2016 Youth Employment and Entrepreneurship Strategy, presented in March 2013 is now being implemented, although some measures have yet to be put in place. Building on the Strategy, Spain has undertaken steps to fight youth unemployment, in line with the objectives of a youth guarantee. Some progress has been registered in measures to fight early school leaving and to promote dual vocational education and training, but full implementation and efficient use of funding remain crucial. On dual vocational training, continued coordination among all stakeholders, including decision makers and training providers at all government levels and employers, is needed to streamline the system, favour a better match of training to labour demands and guarantee the compatibility of dual vocational education and training models across regions.

- (15) Mainly as a result of the labour market situation, but also due to the limited effectiveness of social protection in reducing poverty, Spain is below the EU average as regards the main indicators measuring poverty and social exclusion, with children and young adults being particularly exposed. As a result of the crisis, Spain also witnessed one of the highest falls in household disposable income and one of the highest levels of income inequality in the EU. The key challenges are to simplify procedures for social assistance claimants and improve governance and inter-institutional coordination at national, regional and local level. The 2013-2016 National Action Plan for Social Inclusion provides an appropriate policy framework for adapting active labour market policies to those further away from the labour market, tackling child poverty and improving the efficiency of family support services. Moreover, social assistance and benefits have limited redistributive effects across different groups at risk, suggesting poor targeting. In addition, limited coordination between employment and social services (including those at regional and local levels) and the administrative burden involved in accessing minimum income schemes hinders the smooth transition between social assistance and the reintegration into the labour market.
- (16) Spain made progress on structural reforms promoting growth and competitiveness broadly in line with the plans in the 2013 national reform programme. The law on the guarantee of market unity was adopted in December 2013 and its complex implementation is ongoing. The law on entrepreneurship adopted in autumn 2013, has also brought improvements to the framework for corporate insolvency and more flexible company forms, and as regards the rationalisation of support schemes for the internationalisation of firms. The use of the express licensing has been extended thus simplifying the opening of small-scale retail outlets, and other measures taken to facilitate business licensing. However, secondary legislation to allow private limited companies to be created through one-stop shops within the shorter deadlines set out in the September 2013 entrepreneurship law are still pending. Moreover, there is a case for the continuous review of regulatory barriers to company growth, including on taxation, given Spain's gap vis-à-vis other euro area countries as regards company size. The long-awaited reform of professional services has been cumulating delays and needs to be speeded up. No measures have been taken to remove restrictions to the establishment of large-scale retail premises. The Spanish R&I system needs to increase the quality of its scientific outputs, foster public-private co-operation and facilitate the conversion of research and innovation into commercial products. In

2013, the Spanish government adopted a national strategy for science, technology and innovation, which still needs to be backed by public funding. Moreover, the creation of the new State Research Agency, which is tasked with the efficient management of public R&D investment, is pending.

- (17) Significant steps have been taken to address the electricity tariff deficit, especially by reducing the system's costs, although the exact impact of the reform, in particular on renewables, is not yet fully clear. The government is exploring ways to minimise negative spillover effects on public finances from insolvent toll motorways. The authorities established a database containing economic, environmental, traffic-related and other indicators supporting analysis prior to investment in infrastructure, but have not yet set up an independent observatory to help assess future major infrastructure projects. Effective competition in railway passenger and freight services is still prevented by technical and legal obstacles, hampering the efficient use of the extensive infrastructure stock.
- (18) The reform of public administration is advancing. A reform of local public administration was passed in December 2013 and the implementation of the expert's committee on public administration reform is on-going and will continue throughout 2014-15. Judicial reform is at various stages of completion and/or implementation and needs to be completed. Recent efforts in the area of tackling corruption include the law on transparency, public access to information and good governance, adopted in December 2013, as well as two draft bills on supervision of party funding and accountability of high ranking officials. The 2012-2014 National Plan against Irregular Work and Social Security Fraud is being implemented. Spain has also extended its network of international agreements to exchange information relevant for tax assessments and launched a project with private firms to study potential improvements in the management of the benefits system.
- (19) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Spain's economic policy. It has assessed the stability programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Spain but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (8) below.
- (20) In the light of this assessment, the Council has examined Spain's stability programme, and its opinion<sup>10</sup> is reflected in particular in recommendation (1) below.
- (21) In the light of the Commission's in-depth review and this assessment, the Council has examined the national reform programme and the stability programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1), (2), (3), (4), (6), (7) and (8) below.
- (22) In the context of the European Semester the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations for the Member States whose currency is the euro. Spain should also ensure the full and timely implementation of these recommendations.

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<sup>10</sup> Under Article 5(2) of Council Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Spain take action within the period 2014-2015 to:

1. Reinforce the budgetary strategy as of 2014, in particular by fully specifying the underlying measures for the year 2015 and beyond, to ensure the correction of the excessive deficit in a sustainable manner by 2016 through achieving the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. After achieving the correction of the excessive deficit, pursue a structural adjustment towards the medium-term objective of at least 0.5% each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. Ensure that the new independent fiscal authority becomes fully operational as soon as possible and ensure a full implementation of the preventive, corrective and enforcement measures in the Budgetary Stability Organic Law at all levels of government, including on the elimination of public sector commercial arrears. Carry out by February 2015 a systematic review of expenditure at all levels of government to underpin the efficiency and quality of public spending going forward. Continue to increase the cost-effectiveness of the health-care sector, in particular by further rationalising pharmaceutical spending, including in hospitals and strengthening coordination across types of care, while maintaining accessibility for vulnerable groups. Adopt by the end of 2014 a comprehensive tax reform to make the tax system simpler and more conducive to growth and job creation, preservation of the environment and stability of revenues. To that end: shift revenues towards less distortive taxes, such as consumption, environmental (e.g. on motor fuels) and recurrent property taxes; remove inefficient personal and corporate income tax expenditures; consider lowering employers' social security contributions, in particular for low-wage jobs; continue to tackle the debt bias in corporate taxation; take measures to avoid that taxation hinders the smooth functioning of Spain's internal market. Step up the fight against tax evasion.
2. Complete the reform of the saving banks sector, as regards the adoption of secondary legislation and complete the restructuring of state-owned savings banks in order to accelerate their full recovery and facilitate their return to private ownership. Promote banks' efforts to sustain strong capital ratios, monitor Sareb's activity in order to ensure timely asset disposal while minimising the cost to the taxpayer. Complete the ongoing measures to widen SMEs access to finance, in particular by finalising the ongoing measures to improve non-bank financial intermediation. Remove remaining bottlenecks in the corporate insolvency framework, in particular by enhancing the expertise of insolvency administrators and the capacity of the judicial system to handle insolvency cases and develop a permanent framework for personal insolvency.
3. Pursue new measures to reduce labour market segmentation to favour sustainable, quality jobs, including through reducing the number of contract types and ensuring a balanced access to severance rights. Continue regular monitoring of the labour market reforms. Promote real wage developments consistent with the objective of creating jobs. Strengthen the job-search requirement in unemployment benefits. Enhance the effectiveness and targeting of active labour market policies, including hiring subsidies, particularly for those facing more difficulties in accessing employment. Reinforce the coordination between labour market and education and training policies. Accelerate the modernisation of public employment services to

ensure effective personalised counselling, adequate training and job-matching, with special focus on the long-term unemployed. Ensure the effective application of public-private cooperation in placement services before the end of 2014, and monitor the quality of services provided. Ensure the effective functioning of the Single Job Portal and combine it with further measures to support labour mobility.

4. Implement the 2013-2016 Youth Entrepreneurship and Employment Strategy and evaluate its effectiveness. Provide good quality offers of employment opportunities, apprenticeships and traineeships for young people and improve the outreach to non-registered unemployed young people, in line with the objectives of a youth guarantee. Effectively implement the new educational schemes to increase the quality of primary and secondary education. Enhance guidance and support for groups at risk of early school leaving. Increase the labour-market relevance of vocational education and training and of higher education, in particular by enhancing the cooperation with employers and supporting the training of trainers and tutors.
5. Implement the 2013-2016 National Action Plan on Social Inclusion and assess its effectiveness covering the full range of its objectives. Strengthen administrative capacity and coordination between employment and social services in order to provide integrated pathways to support those at risk, and streamline procedures to support transitions between minimum income schemes and the labour market. Improve the targeting of family support schemes and quality services favouring low-income households with children, to ensure the progressivity and effectiveness of social transfers.
6. Ensure an ambitious and swift implementation of Law No 20/1013 on Market Unity at all levels of administration. Adopt an ambitious reform of professional services and of professional associations by the end of 2014, defining the professions requiring registration in a professional organisation, and the transparency and accountability of professional bodies, opening up unjustifiably reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain. Further reduce the time, cost and number of procedures required for setting up an operating business. Address unjustified restrictions to the establishment of large-scale retail premises, notably through a revision of existing regional planning regulations. Identify sources of financing for the new national strategy for science, technology and innovation and make operational the new State Research Agency.
7. Following the reform of 2013, ensure the effective elimination of deficit in the electricity system as of 2014, including by taking further structural measures if needed. Address the problem of insolvent toll motorways so as to minimise costs for the State. Set up an independent observatory to contribute to the assessment of future major infrastructure projects by the end of 2014. Take measures to ensure effective competition in freight and passenger rail services.
8. Implement at all government levels the recommendations of the committee for the reform of the public administration. Strengthen control mechanisms and increase the transparency of administrative decisions, in particular at regional and local level. Complete and monitor closely the ongoing measures to fight against the shadow economy and undeclared work. Adopt pending reforms on the structure of the judiciary and on the judicial map and ensure implementation of adopted reforms.

Done at Brussels,

*For the Council  
The President*