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Recommendation for a

COUNCIL RECOMMENDATION

on Spain's 2013 national reform programme

and delivering a Council opinion on Spain's stability programme for 2012-2016

{SWD(2013) 359 final}

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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 policies¹, 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 imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission³,

Having regard to the resolutions of the European Parliament,⁴

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial 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, on the basis of the Commission's proposals, the Council 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 States⁵, which together form 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 and 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

¹ OJ L 209, 02.08.1997, p. 1

² OJ L 306, 23.11.2011, p. 25.

³ COM(2013) 359 final

⁴ P7_TA(2013)0052 and P7_TA(2013)0053.

⁵ Council Decision 2013/208/EU of 22 April 2013.

to be taken at the level of the Member States, in particular expressing full commitment to achieve the objectives of the Europe 2020 Strategy and to implement the country-specific recommendations.

- (4) On 6 July 2012, the Council adopted a recommendation on Spain's national reform programme for 2012 and delivered its opinion on Spain's updated stability programme for 2011-2015.
- (5) On 28 November 2012, the Commission adopted the Annual Growth Survey⁶, marking the start of the 2013 European Semester of economic policy coordination. On 28 November 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report⁷, in which it identified Spain as one of the Member States for which an in-depth review would be carried out.
- (6) On 14 March 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 10 April 2013, the Commission published the results of its in-depth review⁸ for Spain, under Article 5 of Regulation (EU) no 1176/2011. The Commission's analysis lead it to conclude that Spain is experiencing excessive macroeconomic imbalances. In particular, very high domestic and external debt levels continue to pose risks for growth and financial stability; the banking sector is undergoing a process of recapitalisation and restructuring, including with public money; rigidities in product and labour markets contribute to high and rising unemployment, and more generally hinder the adjustment of the economy. Although adjustment is taking place, the magnitude of the necessary correction requires continuous strong policy action, in the areas of product and service markets, labour market, financial sector, and public finances.
- (8) On 30 April 2013, Spain submitted its 2013 stability programme covering the period 2012-2016 and its 2013 national reform programme (NRP). In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (9) Based on the assessment of the 2013 stability programme pursuant to Article 5(1) of Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible for 2013 and subject to some downside risks in 2014 and beyond compared with the Commission's 2013 spring forecast. Although the programme projects growth to be lower over the 2014-16 period compared to the Commission's 2013 spring forecast, the latter is based on a no-policy-change assumption and hence does not take into account the fiscal consolidation that will be needed to attain the budgetary targets in the programme. The objective of the budgetary strategy outlined in the programme is to bring the general government deficit below the 3% of GDP reference value by 2016. The consolidation relies mainly on expenditure restraint with the expenditure ratio decreasing by 3.7 percentage points over the 2012-16 period, but also on some revenue-increasing measures. Based on the (recalculated) structural

⁶ COM(2012)750 final

⁷ COM(2012)751 final

⁸ SWD(2013) 116 final

balance⁹ the annual improvement of the structural deficit planned in the programme is 1.2%, 0.4%, 0.9% and 0.9% of GDP for the years 2013 to 2016. Following the correction of the excessive deficit, the programme confirms the medium-term objective (MTO) of a balanced budgetary position in structural terms, which would be achieved by 2018. The MTO is more ambitious than required by the Stability and Growth Pact. The envisaged pace of adjustment in structural terms in 2017-18 represents sufficient progress towards the MTO. The programme projects the government debt ratio to peak in 2016 and to start declining thereafter. The deficit and debt adjustment paths are subject to downside risks. Measures to support the deficit targets are not sufficiently specified, especially at regional level. For 2016 the programme does not present any measures and previous temporary measures are extended only to 2014. Planned savings from the local government reform are subject to significant implementation risks. Moreover, there are uncertainties surrounding the economic, labour market and financial situation as well as revenue developments in the context of persisting large macroeconomic imbalances. Fully implementing the adopted early retirement reform and reaching an agreement on the sustainability factor would mitigate risks in the social security system. A further risk stems from contingent liabilities linked with asset protection schemes/guarantees. There were major progress in the reporting of budgetary execution, but there is scope for a more transparent and timely implementation of the Budgetary Stability Law's preventive and corrective mechanisms. Systematic and timely reporting on government arrears, whose large outstanding stock required an ad-hoc repayment scheme, is missing. The establishment of an independent fiscal council has been lagging behind schedule. A proposed revision of indexation rules for all public revenues and expenditures would bring budgetary savings and a higher responsiveness of prices to economic conditions. The NRP also acknowledges the need to further improve cost-effectiveness in healthcare and pharmaceutical expenditure, e.g. by revising reference prices and centralising purchasing of pharmaceutical products, or extending co-payments.

- (10) While significant rebalancing of the relative tax burden towards consumption and environmental taxes took place in 2012, the Spanish tax-to-GDP ratio remains among the lowest in the EU. The efficiency of the tax system can be improved further by increasing the share of more growth-friendly indirect taxes and by tackling tax fraud and evasion, in line with the fiscal consolidation efforts. Spain took some measures to address the debt bias in corporate taxation, but further efforts are necessary in the context of high private indebtedness.
- (11) The financial sector adjustment programme is on track. In particular, the necessary recapitalisations have been carried out, and the asset management company Sareb has been set up. The restructuring of banks, in accordance to the decisions under state aid rules, will require continued attention in the coming years. To alleviate the funding and liquidity constraints on companies Spain implemented in 2012 a large plan of payment of State commercial debt to companies (EUR 27.3 bn) and launched various initiatives to widen the financing options for firms. An extension of the plan to repay State commercial debt is foreseen for 2013.
- (12) The situation on the labour market remains critical. The readjustment of the economy away from domestic demand and construction in a context of market rigidities and skills mismatch, among others, have contributed to the increase in the unemployment

⁹ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

rate to 27% in early 2013. Of particular concern is the marked increase of the youth unemployment rate to 56% and the rise of long-term unemployment to 44.4% of total unemployment at the end of 2012. Available data suggest that the 2012 labour market reform has started to lead to higher internal (within the firm) flexibility, to some reduction of dismissal costs and to increasing wage moderation. An official assessment of the reform against its stated objectives, with a view to complement it where needed, has been announced in the NRP for July 2013. Reforms in the field of active labour market policies have lagged behind and actions to modernise and reinforce the Public Employment Service itself are still needed and the recently adopted opening for private placement agencies remains to be made fully operational as well as the co-operation between national and regional public employment services (Single Job Portal).

- (13) A high share of unemployed without formal qualifications (35%) and inadequate labour market relevance of education and training contribute to the high youth unemployment rate, as well as to long term unemployment. The national Youth Employment and Entrepreneurship Strategy 2013-2016, presented in March 2013, incorporates a range of short- and longer-term measures intended to improve employment opportunities for young people. At the same time, dual vocational training has been introduced and pilot projects have already started in 2012. The 2013 NRP also highlights the importance of a swift implementation of the reform of the educational system and improving the overall quality of education and training.
- (14) Mainly as a result of the labour market situation, but also due limited effectiveness of social protection in reducing poverty, Spain is below the EU average in the main key indicators measuring poverty and social exclusion, with children being particularly exposed. Overall, no major improvements were registered in the development of new policy measures. The NRP does not include information on the content or the timeframe for the approval of the National Action Plan on Social Inclusion 2013-2016. The key challenges lie in the need to rationalise targets and resources under an adequate policy framework, improve governance and inter-institutional coordination at national, regional and local level, simplify procedures for social assistance claimants and review mobility barriers. Some progress was registered in measures to tackle child poverty and improve the efficiency of family support services.
- (15) Weaknesses in the business environment such as segmentation of the domestic market or entry barriers in services' industries, hold back job creation and reform progress in this area is taking longer than envisaged in the September 2012 reform plan. The first draft of the Law on market unity was adopted by the government in January 2013 and its final approval by Parliament is foreseen by end-2013. The reiterated commitments in the 2013 NRP foresee a first draft of the law on professional services by the end of June 2013 and final adoption of the Law on entrepreneurship and on company internationalization before the end of 2013. In spite of the expected effects of these reforms, there is still scope to further ease market entry and exit conditions, in particular by reducing the time needed for business licencing and by reviewing the insolvency framework. Moreover, regulatory and other barriers to firms' growth should be tackled. In spite of recent reforms, barriers to entry for large-surface outlets continue to limit competition in the retail sector. In September 2012 the government adopted a draft law to merge the national competition authority with supervisory and regulatory authorities in six sectors, thus creating a single body — the National Commission for Markets and Competition (CNMC). This reform aims at a consistent application of competition principles across the various economic sectors. Removing

the tax deductibility of mortgage interest payments and re-payments in 2012 was essential to shifting incentives away from home ownership, but efforts to create a larger and more efficient rental market, which would also support labour mobility, are still at an early stage.

- (16) The electricity tariff deficit, which implies a potentially sizeable contingent liability for the budget and non-negligible macroeconomic risks, has not yet been tackled conclusively, as the measures presented during 2012 and in early 2013 have been insufficient. In the 2013 NRP, the government announced that a draft law further reforming the electricity sector will be presented by the end of June 2013. There is scope for further improving competition in the retail electricity market. The transport infrastructure is abundant but there is scope to make the selection of investment more stringent and prioritise efficient maintenance of existing networks. Setting up an independent observatory, as planned, would help in this respect. At the same time, technical and legal obstacles prevent competition in railway freight and passenger transport.
- (17) The highly decentralised setting calls for an enhanced coordination between the various public administrations, both to reduce costs and to limit the administrative burden on companies and households. To this end, several initiatives have been undertaken or are on-going. In particular in February 2013 the government presented a draft Law on local administration reform (to be adopted by Parliament before end-2013) and a committee for the reform of the public administration was established. It shall present proposals for a reform of the Spanish public administration by the end of June 2013. Reforms to improve the working of the judicial system are on-going, although some measures are cumulating delays and scope to improve the efficiency of the Spanish judiciary remains.
- (18) 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 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 (10) below.
- (19) In the light of this assessment, the Council has examined Spain's stability programme, and its opinion¹⁰ is reflected in particular in recommendation (1) below,
- (20) 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. The assessment concludes that the proposed reform agenda is comprehensive and goes in the right direction. At the same time, the assessment underscores the urgency of adopting and effectively implementing the missing reforms so that they can start deploying the expected positive effects. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1), (2), (3), (4), (5), (7), (8) and (9) below.
- (21) 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 this basis the Council has issued specific recommendations addressed to the Member States whose currency

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

is the euro. Spain should also ensure the full and timely implementation of these recommendations.

HEREBY RECOMMENDS that Spain should take action within the period 2013-2014 to:

1. Deliver the structural fiscal effort as required by the Council recommendation under the EDP to ensure correction of the excessive deficit by 2016. To this end, implement the measures adopted in the 2013 budget plans at all levels of government, reinforce the medium-term budgetary strategy with sufficiently specified structural measures for the years 2014-16. A durable correction of the fiscal imbalances is predicated upon the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth and employment. After achieving the correction of the excessive deficit, pursue the structural adjustment at an appropriate pace so as to reach the medium term objective by 2018. Ensure a strict and transparent enforcement of the preventive and corrective measures provided for in the Budgetary Stability Organic Law. Establish an independent fiscal authority before the end of 2013 to provide analysis, advice and monitor compliance of fiscal policy with national and EU fiscal rules. Improve the efficiency and quality of public expenditure at all levels of government, and conduct a systematic review of major spending items by March 2014. Increase the cost-effectiveness of the health-care sector, while maintaining accessibility for vulnerable groups, for example by reducing hospital pharmaceutical spending, strengthening coordination across types of care and improving incentives for an efficient use of resources. Take measures to reduce the outstanding amount of government arrears, avoid their further accumulation and regularly publish data on outstanding amounts. Adopt the dis-indexation law to reduce the degree of price inertia in public expenditures and revenues, in time to have it in force by the beginning of 2014 and consider additional steps to limit the application of indexation clauses. Finalise by end-2013 the regulation of the sustainability factor so as to ensure the long-term financial stability of the pension system, including by providing that the retirement age will rise in line with gains in life expectancy.
2. Conduct a systematic review of the tax system by March 2014. Consider further limiting tax expenditure in direct taxation, explore the scope to further limit the application of the reduced VAT rates and take additional steps in environmental taxation, notably as regards fuel taxes. Take further measures to address the debt bias in corporate taxation. Intensify the fight against the shadow economy and undeclared work.
3. Implement the financial sector programme for the recapitalisation of the financial institutions, including the measures promoting non-bank intermediation adopted in November 2012.
4. Finalise the evaluation of the 2012 labour market reform covering the full range of its objectives and measures by July 2013, and present amendments, if necessary, by September 2013. Adopt the 2013 national Employment Plan by July 2013 and enact swiftly a result-oriented reform of active labour market policies, including by strengthening the targeting and efficiency of guidance. Reinforce and modernise public employment services to ensure effective individualised assistance to the unemployed according to their profiles and training needs. Reinforce the effectiveness of re-skilling training programmes for older and low-skilled workers. Fully operationalize the Single Job Portal and speed up the implementation of public-

private cooperation in placement services to ensure its effective application already in 2013.

5. Implement and monitor closely the effectiveness of the measures to fight youth unemployment set out in the Youth Entrepreneurship and Employment Strategy 2013-2016, for example through a Youth Guarantee. Continue with efforts to increase the labour market relevance of education and training, to reduce early school leaving and to enhance life-long learning, namely by expanding the application of dual vocational training beyond the current pilot phase and by introducing a comprehensive monitoring system of pupils' performance by the end of 2013.
6. Adopt and implement the necessary measures to reduce the number of people at risk of poverty and/or social exclusion by reinforcing active labour market policies to improve employability of people further away from the labour market and by improving the targeting and increasing efficiency and effectiveness of support measures including quality family support services.
7. Urgently adopt and implement the draft Law on Market Unity and speed up all complementary actions needed for its swift implementation. Ensure the effectiveness, autonomy and independence of the newly created regulatory authority. By the end of 2013, adopt and implement the Law on professional associations and services and the Law on Entrepreneurship. Regroup and concentrate support schemes for the internationalisation of firms. Reduce the number and shorten licensing procedures, including for industrial activities, and spread the use of the "express licence" approach to activities other than retail. Review insolvency frameworks for companies and individuals, including through limiting personal liability of entrepreneurs and easing second chances for failed businesses. Remove unjustifiable restrictions to the establishment of large-scale retail premises. By March 2014, review the effectiveness of the regulatory framework to support the development of the housing rental market.
8. Tackle the electricity tariff deficit by adopting and implementing a structural reform of the electricity sector by the end of 2013. Intensify efforts to complete the electricity and gas interconnections with neighbouring countries. Reduce the contingent liability for public finances stemming from unprofitable transport infrastructure. Provide for an independent national assessment of future major infrastructure projects. Take measures to ensure effective competition in freight and passenger rail services.
9. Adopt in line with the presented timetable the reform of the local administration and define by October 2013 a plan to enhance the efficiency of the overall public administration. Adopt and implement the on-going reforms to enhance the efficiency of the judicial system.

Done at Brussels,

*For the Council
The President*