I

(Resolutions, recommendations and opinions)

RECOMMENDATIONS

COUNCIL

COUNCIL RECOMMENDATION

of 12 July 2011

on the National Reform Programme 2011 of Spain and delivering a Council opinion on the updated Stability Programme of Spain, 2011-2014

(2011/C 212/01)

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 [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission,

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 jobs and growth, 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 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 [2], 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 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of *ex ante* and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.

[1] OJ L 209, 2.8.1997, p. 1.

[2] Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011 on guidelines for the employment policies of the Member States (OJ L 138, 26.5.2011, p. 56).

(6) On 29 April 2011, Spain submitted its 2011 Stability Programme update covering the period 2011-2014 and its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) The Spanish economy was severely hit by the crisis and went through a sharp adjustment in 2008-2009. Real GDP fell by 4,3 % between the beginning of 2008 and the end of 2010, and employment declined by over 10 %. As a consequence, the unemployment rate rose to 20,1 % at the end of 2010, the highest in the EU. Young people (41,6 % unemployment rate) and less educated workers (26,4 % unemployment rate) bore much of the brunt of the Spanish recession. Sovereign debt yields increased in the context of adverse public debt developments in the euro area and the banking system, in particular savings banks, came under pressure with the burst of the housing bubble and the sharp contraction of the construction sector. The ongoing process of absorbing large macroeconomic imbalances built up during the boom period will continue for some time. In response to these challenges, the Spanish government has embarked on an ambitious reform agenda covering fiscal consolidation, public pension reform, savings bank restructuring and labour and product market reforms.

(8) Based on the assessment of the updated Stability Programme pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the Stability Programme is favourable in 2011 and 2012. The Stability Programme plans to bring the budget deficit below the 3 % reference value by 2013, in line with the Council recommendations of April 2009, and reduce the deficit further to 2,1 % of GDP in 2014. The Stability Programme does not foresee the achievement of the medium-term objective, which remains a balanced budget, in the Stability Programme horizon. This adjustment path is appropriate. The annual average improvement of the structural balance is 1,5 % of GDP on average for 2010-2013, in line with the Council recommendation, and an additional 0,3 % of GDP in 2014. The debt-to-GDP ratio is projected to rise from 60,1 % of GDP in 2010 to 69,3 % in 2013 and decline slightly in 2014. There are downside risks to the consolidation path related to the underlying macroeconomic assumptions and to the respect of budgetary targets at the regional level. Regions account for a large share of total public expenditure and 9 out of 17 exceeded their fiscal objectives in 2010. However, deficit and debt control mechanisms for regional governments have already been strengthened and the Spanish government has committed to take additional measures, if needed to meet the budgetary targets.

(9) Achieving the foreseen fiscal consolidation in 2011 and 2012 requires strict application of the deficit and debt control mechanisms that have been put in place for regional governments. Achieving the budgetary targets in the event that macroeconomic and budgetary developments turn out worse than expected in 2011 and 2012, will require additional measures that the Spanish government has committed itself to taking. For 2013, the Expenditure Revision Plan identifies a few measures to underpin the budgetary targets. According to the Commission's latest assessment, the risks with regards to long term-sustainability of public finances appear to be high.

(10) The medium-term budgetary framework in Spain has been instrumental in promoting multi-annual fiscal planning and overall shows a good track record. However, the crisis has put this framework to the test and showed the need to strengthen further fiscal stability and the preventive aspect of fiscal policy. This would be enhanced by introducing a spending rule based on medium-term nominal GDP growth in line with the new EU economic governance framework. The rule, put forward by the Spanish authorities in the Stability Programme, would automatically bind the central government and local governments. The government also plans to seek consensus within the Council for Fiscal and Financial Policy on applying the rule to the Autonomous Communities.

(11) In the absence of reform, the likely long-term impact of ageing on the Spanish public budget would be higher than the EU average. This is primarily because of the substantial increase in pension expenditure as a share of GDP that is projected for the coming decades. In the long run, ageing will lead to a significant increase in the ratio of retirees per worker. The Spanish government's proposal for a pension reform, agreed with social partners, will significantly improve fiscal sustainability and raise incentives for labour market participation. However, the reform still needs to be approved by Parliament and may still be subject to minor changes.

(12) Spain has taken important steps to strengthen its banking system by providing public support and taking measures to restructure savings banks, reinforce banks' solvency, and improve transparency of their balance sheets. The sector has undergone a noticeable consolidation as a result, and specially among savings banks, with positive consequences in terms of average size of the institutions, reduction of excess capacity in terms of branches and employment, strengthening balance sheets, recapitalization and improvement in efficiency and profitability. Recent legislation has addressed the problems created by the role of local authorities in the governance of savings banks, as most of them transfer their assets and liabilities to commercial banks. The Spanish government has undertaken to finalise the bulk

of the restructuring process by the end of September 2011. Coverage of the next round of stress tests will be again amongst the highest of the EU.

(13) The ongoing labour market reform in Spain needs to be complemented by an overhaul of the current unwieldy collective bargaining system. The predominance of provincial and industry agreements leaves little room for negotiations at firm level. The automatic extension of collective agreements, the validity of non-renewed contracts and the use of *ex post* inflation indexation clauses contribute to wage-inertia, preventing the wage flexibility needed to speed up economic adjustment and restore competitiveness. The Spanish government has requested social partners to agree on a reform of the collective bargaining system during spring 2011. In the absence of an agreement, on 10 June, the government has approved a Royal Decree which has immediately entered into force but will have to be validated by the parliament.

(14) Against the background of very high unemployment, Spain launched a reform of its labour market with the law of September 2010. The law aims to reduce labour market duality and youth unemployment, increase the employability of vulnerable groups and increase flexibility at company level and improve the efficiency of the intermediation in the market. Reform of the active labour market policies was adopted in February 2011, which also included measures to strengthen the advisory and guiding role of employment services and their coordination at national and regional levels. At this stage, it is too early to fully assess whether the reform is sufficient to reduce segmentation and reduce youth and long-term unemployment since some measures are not operational yet. The Spanish government has committed itself to taking further steps by October 2011.

(15) Spain has experienced a loss of price and cost competitiveness, although showing relative good performance in terms of export market shares, that has been reinforced during and after the crisis. Higher wage growth coupled with lower productivity growth than in the euro area and lack of competition in some product markets contributed to persistently higher inflation in Spain. Finding room to improve the tax efficiency could help to boost competitiveness. Further strengthening competition in product markets and adopting a reform of the collective bargaining system to ensure that wage growth better reflects productivity developments at the firm level will help boost competitiveness.

(16) The high level of early school leaving in Spain (31,2 % in 2009) is particularly worrying, as it undermines the size of the skilled work force, affects the job prospects of the concerned individuals and reduces potential growth. The Law on Sustainable Economy, adopted on 15 February 2011, includes measures aiming at increasing the quality and quantity of human capital through education and vocational training. However, the effectiveness of the new measures to combat early school leaving and to improve vocational training is uncertain and implementation at all levels of government may prove difficult.

(17) Spain has made significant progress in improving the conditions for competition in product and service markets, addressing one of the causes of slow productivity growth. The transposition of the Services Directive into law is well advanced and ambitious in Spain, although further opening up of professional services is needed. The Law on Sustainable Economy includes a wide array of measures to improve the business environment, strengthen competition and promote environmental sustainability. An effective implementation calls for further efforts by all levels of government and appropriate coordination

(18) Spain has made a number of commitments under the Euro Plus Pact. On the fiscal side, Spain commits itself to establishing an expenditure rule to enhance fiscal stability and thus sustainability of public finances. To reinforce financial stability, Spain committed itself to completing, before 30 September, the restructuring process of the financial sector. Employment measures focus on implementing acts on active labour market policies and provisions in the field of vocational training, as well as on addressing informal employment. The competitiveness measures focus on reforming the collective bargaining system, regulated professions, setting up an Advisory Committee on Competitiveness and a reform of bankruptcy law. The above commitments refer to all four areas of the Pact. They represent a continuity of the ongoing reform agenda, adding a firm timeframe for the implementation of certain reforms and ensuring full implementation of reforms that have already been carried out. These commitments have been assessed and taken into account in the recommendations.

(19) The Commission has assessed the Stability Programme and National Reform Programme, including the Euro Plus Pact commitments. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Spain but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the EU by providing EU level input into future national decisions. In this light, the Commission considers that the Spanish government has established fiscal consolidation plans consistent with the required targets, but that some downside risks remain. Public expenditure growth should be kept below the rate of medium-term GDP growth and the pension reform needs to be adopted. Further steps in 2011-2012 should focus on ensuring the stability of the financial system (through the finalisation of the restructuring and consolidation of the savings banks) and the strengthening of domestic sources for growth, by addressing the current surge in unemployment in particular through the reform of collective bargaining and continued implementation of the ongoing reforms in the labour market, with a close monitoring and evaluation of their effectiveness. The

services sector, trades and professions should be opened up to greater competition, and the administrative burden for enterprises should be reduced.

(20) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) Treaty on the Functioning of the European Union of 2 June 2010, the Council has examined the 2011 update of the Stability Programme of Spain and its opinion [1] is reflected in particular in its recommendation (1) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Spain,

HEREBY RECOMMENDS that Spain take action within the period 2011-2012 to:

1. Implement the budgetary strategy in 2011 and 2012 and correct the excessive deficit in the year 2013 in line with the Council recommendation under the EDP, ensuring the achievement of deficit targets at all levels of government, including by strictly applying the existing deficit and debt control mechanisms for regional governments; adopt further measures in case budgetary and economic developments do not turn out as expected; take any opportunity including from better economic conditions to accelerate the deficit reduction; set out concrete measures to fully underpin the targets for 2013 and 2014 which should bring the high public debt ratio on a downward path and ensure adequate progress towards the medium-term objective. Keep public expenditure growth below the rate of medium-term GDP growth, by introducing a binding expenditure rule at all levels of government, as envisaged. Further improve the provision of information in relation to regional and local government budgets and their execution.

2. Adopt the proposed pension reform to extend the statutory retirement age and increase the number of working years for the calculation of pensions as planned; regularly review pension parameters in line with changes to life expectancy, as planned, and develop further measures to improve lifelong learning for older workers.

3. Monitor closely the ongoing restructuring of the financial sector, in particular as regards savings banks, with a view to finalising it by 30 September 2011 as envisaged.

4. Explore the scope for improving the efficiency of the tax system, for example through a move away from labour towards consumption and environmental taxes while ensuring fiscal consolidation plans.

5. Following consultation with social partners and in accordance with national practice, complete the adoption and proceed with the implementation of a comprehensive reform of the collective bargaining process and the wage indexation system to ensure that wage growth better reflects productivity developments as well as local- and firm-level conditions and to grant firms enough flexibility to internally adapt working conditions to changes in the economic environment.

6. Assess, by the end of 2011, the impacts of the labour market reforms of September 2010 and of the reform of active labour market policies of February 2011, accompanied, if necessary, by proposals for further reforms to reduce labour market segmentation, and to improve employment opportunities for young people; ensure a close monitoring of the effectiveness of the measures set out in the National Reform Programme to reduce early school leaving, including through prevention policies, and facilitate the transition to vocational education and training.

7. Further open up professional services and enact the planned legislation in order to redesign the regulatory framework and eliminate current restrictions to competition, efficiency and innovation; implement the Law on Sustainable Economy, notably measures aimed at improving the business environment and enhancing competition in the product and service markets, at all levels of government; and improve coordination between regional and national administrations to reduce the administrative burden for enterprises.

Done at Brussels, 12 July 2011.

For the Council

The President

J. VINCENT-ROSTOWSKI

[1] Foreseen in Article 5(3) of Regulation (EC) No 1466/97.