



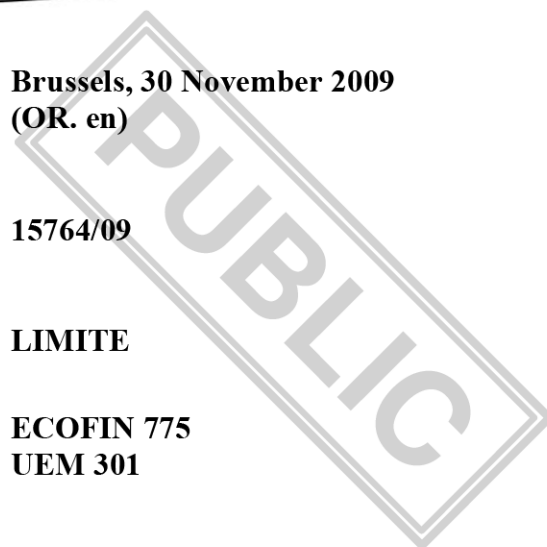
**COUNCIL OF
THE EUROPEAN UNION**

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject: COUNCIL RECOMMENDATION to Spain with a view to bringing an
end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION

of

to Spain

**with a view to bringing an end to the situation
of an excessive government deficit**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) in conjunction with Article 126(13) and Article 136 thereof;

Having regard to the recommendation from the Commission;

Whereas:

- (1) According to Article 126(1) of the Treaty on the Functioning of the European Union Member States shall avoid excessive government deficits.
- (2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.
- (3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the excessive deficit procedure (EDP). In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

- (4) On 27 April 2009 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit exists in Spain and issued recommendations to correct the excessive deficit by 2012 at the latest, in accordance with Article 104(7) of the Treaty establishing the European Community and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure¹. This would imply an average annual fiscal effort of 1¼ % of GDP over the period 2010-2013. The Council also established a deadline of 27 October 2009 for effective action to be taken.
- (5) The Council agreed on 20 October 2009 that, provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

¹ OJ L 209, 2.8.1997, p. 6.

- (6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 104 of the Treaty establishing the European Community, which has become Article 126 of the Treaty on the Functioning of the European Union. According to Article 3(5) of Regulation (EC) No 1467/97, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission and before taking into account the relevant factors mentioned in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 126 (7) of the Treaty on the Functioning of the European Union.

- (7) According to the Commission services' January 2009 interim forecast, which was underlying the Council recommendation under Article 104(7) of the Treaty establishing the European Community, Spain's GDP was projected to decline in 2009 by 2 % in volume terms and again in 2010 by 0,2 %. However, the recessive economic outlook has aggravated quickly in the course of 2009 and the Commission services' autumn 2009 forecast is now projecting GDP to decline by 3,7 % and 0,8 % in 2009 and 2010 respectively. The downward revision of the change of GDP in nominal terms is even stronger. Spain's fiscal outlook also worsened in the course of 2009 reflecting the sharper-than-expected fall in economic activity. Notably, the 2009 general government deficit is projected at 11,2 % of GDP in the Commission autumn forecast, compared with a deficit of 6,2 % projected in the January interim forecast. In particular, revenue has fallen sharply more than expected, as the result of the stronger-than-assumed fall in activity and of the fact that tax proceeds are reflecting falling activity in a much sharper way than the consideration of long-term tax elasticities would suggest.

At the same time, the plans for government expenditure foreseen in the January 2009 update of the Spanish stability programme have been broadly observed but the expenditure-to-GDP ratio has increased on account of a lower-than-expected nominal GDP level. The worsening 2009 fiscal outlook is expected to slip into 2010. The discretionary fiscal measures adopted after January 2009 have played no role in the fiscal outlook deterioration between then and now. In view of the above, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after adoption of the Council recommendation under Article 104(7) of the Treaty establishing the European Community.

- (8) The fiscal plans outlined in the January 2009 update of the stability programme, which the Council recommended to implement, included sizeable deficit-increasing stimulus measures adopted in the course of 2008 in the context of the progressively acute deterioration in economic conditions. Discretionary measures adopted after the publication of the stability programme and the Council recommendation under Article 104(7) of the Treaty establishing the European Community improve the 2009 fiscal balance by less than 0,1 % of GDP. Thus, the worse-than-expected fiscal deterioration in 2009 is not due to the adoption of sizeable discretionary measures after the issuance of the Council recommendation to end the situation of an excessive government deficit, but to the economic downturn, which has been sharper than expected in the Commission services' January 2009 interim forecast and has affected heavily Spanish public finances. In particular, tax revenue is now projected to fall by some 11½ % in nominal terms, which is worse than the fall in the major tax bases (e.g., nominal GDP or private consumption).

In turn, the level of nominal government expenditure foreseen in the Commission services' autumn 2009 forecast largely corresponds to the level implicit in the January 2009 update of the Spanish stability programme. As for 2010, the draft 2010 Budget Law published in late September 2009 targets a general government deficit of 8,1 % of GDP in 2010. Overall, the combined impact of the withdrawal of the temporary stimulus measures, on the one hand, and of the new discretionary measures presented in the draft 2010 Budget Law, on the other, could yield a significant improvement of the fiscal balance by some 1¾ % of GDP in 2010, with some of the latter measures helping an additional budgetary correction in 2011, yet by a much lower margin. In parallel, expenditure moderation is expected to come from annual updates of wages and pensions in 2010 which are announced to be lower than those recorded in recent years. In structural terms, the government balance would improve by around ¾ % of GDP next year against the backdrop of a rising interest burden and economic developments that are expected to continue to be more adverse than assumed at the time the Council issued its original recommendation. In view of the above, the Spanish authorities can be considered to have taken effective action towards the correction of the excessive government deficit.

- (9) Since the Spanish authorities are considered to have taken effective action in compliance with the Council recommendations of 27 April 2009 under Article 104(7) of the Treaty establishing the European Community and unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in Spain, a revised recommendation for Spain is justified.

- (10) The substantial deterioration in the budgetary position resulting from the worse-than-expected economic downturn, and the weaker overall position of the economy than envisaged when the earlier Council recommendation was framed suggest that a new deadline for correction of the excessive deficit in Spain by 2013 is appropriate. Given the marked deterioration in the fiscal outlook since the original Council recommendation under Article 104(7) of the Treaty establishing the European Community an average annual fiscal effort in excess of the originally recommended of at least 1¼ % of GDP is needed between 2010 and 2013 in order to bring the headline government deficit below the 3 % of GDP reference value by 2013. This correction would represent an average annual fiscal effort of above 1,5 % of GDP over the period 2010-2013¹.

¹ In line with the initial recommendations under Article 104(7) of the Treaty establishing the European Community issued by the Council on 27 April 2009, where due consideration was given to the special circumstances and the EERP framework, an average annual fiscal effort is recommended. As in the initial recommendations the required fiscal effort should take into account all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In particular, in the case of Spain due consideration was given to the size of the required budgetary correction, the expected change in age-related expenditure and the large external imbalances. In calculating the average annual fiscal effort, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total fiscal effort needed to reach the nominal deficit target of 3 % by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

- (11) After recording surpluses between 2005 and 2007, the general government balance deteriorated markedly in 2008, with the record of a deficit of 4,1 % of GDP. According to the Commission services' autumn 2009 forecast, the government deficit is projected at 11,2 % of GDP in 2009 and at 10,1 % of GDP in 2010. On the basis of unchanged policies, and with GDP growing already by 1 % in volume in 2011, the deficit is expected to come at 9,8 % of GDP in that year. In structural terms, this would represent deficits of around 9¼ % and 8½ % and 8 % of GDP in 2009, 2010 and 2011 respectively. Thus, a credible and sustained adjustment path would require the Spanish authorities to implement the budgetary plans outlined in the draft 2010 Budget Law; ensure an average annual fiscal effort of above 1,5 % of GDP over the period 2010-2013; specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

- (12) According to the Commission services' autumn 2009 forecast, the general government debt is projected to come at 54,3 % of GDP in 2009 after 39,7 % in 2008. Although it is currently still below the 60 % of GDP reference value, it is expected to increase further in 2010 and 2011 to 66 % and 74 % of GDP respectively. The correction of the excessive deficit should also contribute to halting the rapid rise in the gross government debt ratio.
- (13) The long-term budgetary impact of ageing in Spain is well above the EU average mainly as the result of a projected high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. Improving the primary balance over the medium term and further reforms to its old-age pension and health-care systems would contribute to reducing the risk to the long-term sustainability of public finances as defined by the Commission Communication¹ on "Long-term sustainability of public finances for a recovering economy" and discussed by the ECOFIN Council² on 10 November 2009 .

¹ Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

² Available at:
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

- (14) Enhanced surveillance under the EDP, which seems necessary in view also of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the Spanish stability programme which will be prepared between now and 2013 could usefully be devoted to this issue.
- (15) In general, budgetary consolidation measures during the period 2010-2013 should contribute to secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances, for instance to enhance the efficiency and effectiveness of public spending. In addition, Spain should reinforce the growth potential of the economy.

- (16) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Spain should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit will have been corrected.

HEREBY RECOMMENDS:

- (1) Recognising that Spain's budgetary position in 2009 resulted from measures amounting to slightly above 2 % of GDP, which were an adequate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the Spanish authorities should put an end to the present excessive deficit situation by 2013.
- (2) The Spanish authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. To this end, the Spanish authorities should:
 - (a) implement the significant deficit reducing measures in 2010 planned in the draft 2010 Budget Law;
 - (b) ensure an average annual fiscal effort of above 1,5 % of GDP over the period 2010-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, which is forecast to breach the reference value;
 - (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

- (3) The Council establishes the deadline of 2 June 2010 for the Spanish government to take effective action to implement the deficit reducing measures in 2010 planned in the draft 2010 Budget Law and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Spanish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

Furthermore, the Council invites Spain to stick to the enforceable nature of its medium-term budgetary framework, extending its horizon if needed, as well as closely monitor adherence to the budgetary targets throughout the year for all the levels of the general government sector. Moreover, the Council invites the Spanish authorities to improve the long-term sustainability of public finances by implementing further old-age pension and health care reform measures. In addition, the Council invites the Spanish authorities to implement reforms with a view to raising potential GDP growth. This includes reforms conducive to enhancing the quality of public finances, for instance to enhance the efficiency and effectiveness of public spending.

This Recommendation is addressed to the Kingdom of Spain.

Done at Brussels,

For the Council

The President
