



**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 TO SPAIN

of

**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 establishing the European Community, and in particular Article 104(7) thereof,

Having regard to the recommendation from the Commission,

Whereas:

- (1) According to Article 104 of the Treaty Member States are to 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 fully into account in all steps in the 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) The Council has decided on 27 April 2009, based on data notified by the Spanish authorities for 2008 and in accordance with Article 104(6), that an excessive deficit exists in Spain.

- (5) In accordance with Article 104(7) of the Treaty 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 (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances, and request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0,5 % of GDP as a benchmark. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

¹ OJ L 209, 2.8.1997, p. 6.

- (6) In line with the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, special circumstances are deemed to exist in the case of Spain, notably on account of both the current sharp economic downturn and the size of the required budgetary correction. In particular, the rate of economic growth has decreased sharply in 2008 to 1,2 % from 3,7 % in 2007 and, according to the Commission services' January 2009 interim forecast, GDP is expected to decline by 2 % in 2009 and by 0,2 % in 2010. This downturn in economic activity seems to be accompanied by a decline also in potential output growth on account of a series of mutually reinforcing structural factors, which entail a medium-term growth rate well below that observed in the years preceding the recession. With potential GDP growth projected to average around 1 % in 2009/2010 in the Commission services' January 2009 interim forecast, the output gap is projected to fall to -3 % on average over the same period. The government deficit is projected to further widen in 2009, to 6,2 % of GDP, before improving moderately in 2010 to reach 5,7 % of GDP. Bringing the government deficit below the 3 % of GDP reference value in 2010 would require an improvement of the headline deficit by over 3 % of GDP from 2009. All in all, in view of the current sharp economic downturn and the size of the required budgetary correction special circumstances within the meaning of the Stability and Growth Pact exist.

- (7) The budgetary strategy outlined in the January 2009 update of the stability programme of Spain aims at gradually reducing the government deficit in 2010 and 2011 after a fiscal expansion in 2009 as a response to the economic downturn and in line with the European Economic Recovery Plan. However, the deficit would remain above the 3 % of GDP reference value by the end of the programme period in 2011. Specifically, the programme targets government deficits of 5,8 % of GDP in 2009, 4,8 % in 2010 and 3,9 % of GDP in 2011. This fiscal path is assumed to be achieved against a macroeconomic scenario where GDP contracts by 1,6 % in volume terms in 2009 and grows by 1,2 % and 2,6 % in 2010 and 2011 respectively. In structural terms, this would imply a fiscal expansion in 2009, which would be completely reversed in 2010, and an improvement in the cyclically-adjusted balance net of one-off and temporary measures slightly over ½ % of GDP in 2011. In its opinion of 10 March 2009 on the Spanish stability programme, the Council stated that the budgetary targets are subject to downside risks throughout the programme period. First, downside risks pertain to the growth assumption in the underlying macroeconomic scenario, which appears to be favourable. Second, the adjustment path in the programme is not fully backed up with concrete measures. Besides the risks to the fiscal targets highlighted by the Council, delaying much fiscal consolidation would affect negatively the government debt ratio, which even if still below 60 % of GDP is foreseen to increase markedly in the coming years, adding to the high risks to the long-term sustainability of public finances.

- (8) It is appropriate to consider the correction of the excessive deficit in a medium-term framework in accordance with the path for deficit reduction as specified in the January 2009 stability programme – on which the Council gave its opinion on 10 March 2009 – with a deadline for the correction of 2012. A credible adjustment path would require the Spanish authorities to stick to the fiscal efforts as spelled out in the January 2009 update of the stability programme of Spain up to 2011. This means, first, implementing rigorously the plans for fiscal policy for 2009 as outlined in the January 2009 update of the stability programme, which reflects also the fiscal impulse package presented in the context of the European Economic Recovery Plan. Second, additional annual fiscal efforts might be necessary if downside risks to the budgetary targets were to materialize. Finally, it will require ensuring the additional effort in 2012 so as to achieve a government deficit below 3 % of GDP in that year in a credible and sustainable manner. This adjustment path would be consistent with Article 3(4) of Regulation (EC) No 1467/97.
- (9) In order to limit risks to the medium-term fiscal adjustment, Spain should stick to the binding nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets for the various levels of the government sector throughout the year.
- (10) 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 2009 and 2012 could usefully be devoted to this issue.

- (11) According to the Commission services' January 2009 interim forecast, the general government debt ratio became at 39,8 % after 36,2 % in 2007. Although remaining below the 60 % of GDP reference value, it is expected to increase further in 2009 and 2010.
- (12) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy,

HEREBY RECOMMENDS:

- (1) On the basis of the macroeconomic outlook of the Commission services' January interim forecast, the Spanish authorities should put an end to the present excessive deficit situation by 2012.
- (2) The Spanish authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in its medium-term framework, in accordance with the path for deficit reduction as specified in the January 2009 update of the stability programme of Spain on which the Council gave its opinion on 10 March 2009. Specifically, to this end, the Spanish authorities should:
 - (a) after implementing rigorously the budgetary plans outlined in the January 2009 update of the stability programme, implement the necessary efforts to bring the deficit below the reference value by 2012;
 - (b) to this end, implement an average annual fiscal effort of at least 1¼ % of GDP, as planned in the January 2009 update of the stability programme, starting consolidation in 2010.
- (3) To limit risks to the adjustment, Spain should stick to the binding nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets for the various levels of the government sector throughout the year.
- (4) The Council establishes the deadline of 27 October 2009 for the Spanish government to take effective action to implement the measures 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' January 2009 interim forecast.

- (5) The Spanish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the Spanish stability programme which will be prepared between 2009 and 2012.

In addition, the Council highlights the importance of achieving the medium-term objective (MTO) for appropriate budgetary management of economic downturns. It therefore invites the Spanish authorities to ensure that budgetary consolidation towards the MTO – in balance in structural terms – is sustained after the excessive deficit has been corrected. This consolidation is geared towards enhancing the quality of the public finances with a view to underpinning a smooth adjustment of the economy in the light of the external imbalances and the need to enhance potential growth in a protracted downturn. Moreover, the Council invites the Spanish authorities to improve the long-term sustainability of public finances by implementing further pension reform measures.

This Recommendation is addressed to the Kingdom of Spain.

Done at Brussels,

For the Council

The President
