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From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2018 National Reform Programme of Spain and delivering a Council opinion on the 2018 Stability Programme of Spain

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2018) 408 final.

COUNCIL RECOMMENDATION

of …

on the 2018 National Reform Programme of Spain

and delivering a Council opinion on the 2018 Stability Programme of Spain

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(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[2], and in particular Article 6(1) thereof

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

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,

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[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Spain as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area[3] ('Recommendation for the euro area').

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Spain should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (3) below.

[3] OJ C 179, 25.5 2018, p. 1.

(3) The 2018 country report for Spain was published on 7 March 2018. It assessed Spain's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017[4], the follow-up given to the country-specific recommendations adopted in previous years and Spain's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that Spain is experiencing macroeconomic imbalances. In particular, large stocks of external and internal debt, both public and private, in a context of high unemployment, continue to constitute vulnerabilities with cross-border relevance. The external rebalancing is advancing, thanks to the current account surpluses recorded since 2013, which are underpinned by structural improvements in trade performance. However, net external liabilities remain high. Private sector debt reduction is also progressing, supported by favourable growth conditions, but deleveraging needs persist. A healthier financial sector is supporting economic activity. Despite the strong nominal GDP growth, government debt as a share of GDP is only slowly decreasing. The unemployment rate has continued its rapid decline, but remains very high and the high degree of labour market segmentation impedes faster labour productivity growth. Following the strong reform momentum between 2012 and 2015, progress on the implementation of recommendations has become more limited. The present economic situation provides a window of opportunity to address pending reform needs with a view to making the Spanish economy more resilient and raising productivity growth.

[4] OJ C 261, 9.8.2017, p. 1.

(4) Spain is currently in the corrective arm of the Stability and Growth Pact. In its 2018 Stability Programme, Spain plans to correct the excessive deficit by 2018, in line with Council Decision (EU) 2017/984 giving notice to Spain to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit[5]. The general government balance is planned to continue improving and to reach a 0,1 % of GDP surplus in 2021. The 2018 Stability Programme incorporates all the measures included in the draft budget law submitted to Parliament on 3 April 2018 as well as additional measures announced by late April 2018. The medium-term budgetary objective of a balanced budgetary position in structural terms is not planned to be reached within the time horizon of the 2018 Stability Programme. The 2018 Stability Programme projects the government debt-to-GDP ratio to decline to 97,0 % in 2018, 95,2 % in 2019, and 89,1 % in 2021. The 2018 Stability Programme's macroeconomic assumptions are plausible. Overall, the planned achievement of the headline deficit targets continues to rely on the strong economic outlook and on government expenditure growing by less than nominal GDP. Risks to the achievement of the fiscal targets relate to both stronger revenue growth and more contained expenditure increases than those projected in the Commission 2018 spring forecast, and to the possible materialisation of further contingent liabilities.

[5] OJ L 148, 10.6.2017, p. 38.

(5) In Decision (EU) 2017/984, the Council requested Spain to put an end to the excessive deficit situation by 2018 and, in particular, to reduce the general government deficit to 4,6 % of GDP in 2016, 3,1 % of GDP in 2017 and 2,2 % of GDP in 2018. This improvement in the general government balance was deemed consistent with a deterioration of the structural balance by 0,4 % of GDP in 2016, and a 0,5 % of GDP improvement in both 2017 and 2018, based on the updated Commission 2016 spring forecast. Spain reached a headline deficit of 3,1 % of GDP in 2017, as required in Council Decision (EU) 2017/984. The Commission 2018 spring forecast projects the headline deficit to decline to 2,6 % of GDP in 2018, 0,4 % of GDP above the headline deficit target in the 2018 Stability Programme and that set by the Council. Compared to the 2018 Stability Programme, the Commission 2018 spring forecast projects lower growth in government revenues and somewhat higher expenditure. In the Commission 2018 spring forecast, the structural balance is forecast to deteriorate by 0,3 % of GDP in 2018, against the backdrop of deficit-increasing measures included in the draft budget law for 2018 that reached Parliament on 3 April 2018, and to improve only slightly in 2019. Hence, the fiscal effort in 2018 as well as cumulated over 2016-2018 is not expected to be ensured. While the economic expansion is supporting the deficit reduction, it is not being used to structurally strengthen the public finances. Accordingly, in its Opinion on the updated 2018 Draft Budgetary Plan of Spain, the Commission concludes that the Plan is broadly compliant with the provisions of the Stability and Growth Pact, as the Commission 2018 spring forecast projects that the excessive deficit will be corrected in a timely manner, but is expansionary.

(6) For 2019, should a timely and durable correction of the excessive deficit be achieved, Spain would be subject to the preventive arm of the Stability and Growth Pact and to the transitional debt rule. In view of Spain's general government debt ratio above 60 % of GDP and projected positive output gap of 2,3 % of GDP, nominal net primary government expenditure[6] should fall by at least 0,3 % in 2019, in line with the structural adjustment of 1,0 % of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. At the same time, there are signs that idle capacity in the economy is underestimated. In 2019, Spain is still expected to record one of the highest unemployment rates in the Union, which is set to contain wage pressures, especially in the private sector, and in turn inflation is expected to remain well below 2 %. This points to remaining slack in the labour market. In addition, even if the Commission's assessment of the plausibility of the output gap does not flag the output- gap estimates based on the commonly agreed methodology as implausible, it indicates a rather wide range of plausible output-gap estimates for Spain. On this basis, an annual structural adjustment of 0,65 % of GDP, corresponding to a maximum growth rate of net primary government expenditure of 0,6 %, appears appropriate. According to the Commission 2018 spring forecast, under unchanged policies, there is a risk of a significant deviation from the required fiscal adjustment in 2019. In addition, Spain is not projected to comply with the requirements of the transitional debt rule in 2019. Overall, the Council is of the opinion that Spain needs to stand ready to take further measures to ensure compliance in 2018 and that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

6 Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

(7) In addition, in Decision (EU) 2017/984, the Council also requested Spain to take measures to improve its fiscal framework, with a view to increasing the automaticity of mechanisms to prevent and correct deviations from the fiscal targets and to strengthening the contribution of the Stability Law's spending rule to fiscal consolidation. However, the 2018 Stability Programme does not report plans to reinforce the domestic spending rule. Neither does it report measures to increase in the law the automaticity of the corrective and preventive mechanisms. The Council also requested Spain to take measures to improve its public procurement policy framework. Spain has made progress with the adoption of a new law on public sector contracts in November 2017. However, the new legislation can only improve the efficiency and transparency of public procurement if it is swiftly and ambitiously implemented by setting up the new governance structure and enhancing control mechanisms of procurement procedures at all levels of government. In particular, the forthcoming National Public Procurement Strategy should specify the ex-ante and ex-post controls to be carried out by the new structures. In June 2017, the Government commissioned the independent fiscal authority to carry out a spending review on selected public sector subsidies. The Commission monitors the implementation of the review, which is expected to be completed by early 2019.

(8) On 27 April 2018, Spain submitted its 2018 National Reform Programme and its 2018 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[7], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(10) Employment has continued to grow at a robust pace in Spain, supported by the effects of past labour market reforms and wage moderation. The unemployment rate continues to fall, but it remains well above the country's pre-crisis levels and ranks among the highest in the Union. This entails considerable untapped skills potential, in particular for young unemployed people. The proportion of unemployed people who have been without a job for more than a year is decreasing but still accounts for 44,5 % of all unemployed people. Spain adopted a set of policy initiatives to extend the individual support to the long-term unemployed and to help young people enter the labour market and improve their employability, in particular by increasing the number of Youth Guarantee beneficiaries. The effectiveness of these measures also depends on the capacity of regional public employment and social services to deliver personalised support to jobseekers, which is only slowly improving. There is also scope for greater cooperation with employers, in particular by increasing the percentage of vacancies handled by the employment services and by better profiling and matching of jobseekers with employers' needs. At the same time, efforts to improve the coordination between employment and social services, which has seen some progress in 2017, should be maintained.

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7 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(11) The proportion of employees on temporary contracts is among the highest in the Union, and mostly comprises young and low-skilled workers. Temporary contracts are often short term and rarely serve as a stepping stone to a permanent contract. Their widespread use, including in sectors less prone to seasonal or cyclical activity, may impede faster productivity growth and is often associated with lower entitlements to social benefits and higher risks of poverty. While open-ended contracts have increased as a percentage of net employment growth in the last two years, further action is needed to incentivise transitions from temporary contracts into open-ended ones. The system of recruitment incentives remains fragmented and does not effectively aim to promote open-ended employment. Spain adopted a plan to reduce the reliance on fixed-term employment in the public sector, but its implementation is just beginning and needs to speed up to meet the 8 % target set for 2019. Labour inspectorates' greater capacity and effectiveness in fighting the abuse of temporary contracts has resulted in an increased number of them being converted into permanent contracts, but does not seem to discourage employers from continuing to use them extensively. The tripartite round table set up at the beginning of 2017 to discuss quality of employment has not yet made specific proposals. The involvement of social partners in policy design has increased recently but there is still room for further improvement.

(12) Economic growth and job creation are helping to reduce the share of people at risk of poverty and social exclusion, which nevertheless remains above the Union average, as well as income inequality. In-work poverty is a concern especially amongst households with members employed on temporary or part-time contracts. The child poverty rate, although declining, remains very high. The impact of social transfers other than pensions on reducing poverty is below the Union average and decreasing. Income guarantee schemes are marked by large disparities in access conditions across regions, and by the fragmentation of multiple national schemes that target different groups of jobseekers and are managed by different administrations. As a result, a number of people in need do not receive support. Further to the recent study assessing the effectiveness of the national and regional income guarantee schemes, no action plan has been agreed yet. The launch of a Universal Social Card system should make the social benefits granted more transparent and facilitate participation in associated activation measures, although it will not directly address the weaknesses of the existing schemes. The effectiveness of family benefits is also low and coverage is uneven. The Spanish pension system plays an important role in maintaining the quality of life of older people, who as a result face a significantly lower risk of poverty than younger generations. Relative to wages, current pensions are among the highest in the Union. Projections in the forthcoming 2018 Ageing Report and Pension Adequacy Report[8] indicate that the 2011 and 2013 reforms helped to ensure sustainability and relative adequacy of pensions in the long term. However, the increases in pensions and the postponement of the sustainability factor proposed during the adoption process of the draft 2018 budget call into question the commitment to these reforms. At the same time, they do not address the main challenge to income adequacy of future retirees, which is rather related to high unemployment and segmentation in the labour market.

8 European Commission (2018), The 2018 Pension Adequacy Report: current and future income adequacy in old age in the EU, Volume I and Volume II Joint Report prepared by the Social Protection Committee (SPC) and the European Commission (DG EMPL), Publications Office of the European Union, Luxembourg, 2018.

(13) Addressing weaknesses in Spanish firms' innovation capacity could improve their productivity. Innovation performance and productivity growth are hampered by persistently subdued levels of investment in research and development, which make reaching the national Europe 2020 research and development intensity target of 2 % very unlikely. This trend is reinforced by the low and falling execution rate of the public budget for research and development. While governance of national research and innovation policy is being streamlined, partly through the new State Agency for Research, national-regional coordination in the design, implementation and evaluation of policy remains weak. Developing an evaluation culture to systematically assess the effectiveness of support programmes and policies would allow policy learning and create synergies across levels of government.

(14) The limited innovation capacity of Spanish firms is also explained by skills mismatches, which negatively affect the long-term potential for productivity growth. Under-qualification and over-qualification at work are widespread in Spain. Despite having improved markedly over the last decade, early-school-leaving rates are well above the Union average. Together with educational outcomes, they vary greatly across regions and may affect equality of opportunities. Targeted programmes to address these disparities have so far only had limited effects. The National Social and Political Pact on Education, aimed at an in-depth reform of the education system, is still in the negotiation phase. In the meantime, the professional development of teachers is to be supported by reducing temporary employment contracts and increased resources for their training. At the same time, tertiary graduates in particular face difficulties in finding adequate, stable jobs in the labour market. Greater cooperation between education and business could boost labour market access of young graduates, while providing firms with the skills required to enhance their innovation capacity. In this context, the proposal for a new national digital strategy acknowledges the need to improve digital skills. Challenges relate to the low number of specialists in information and communication technologies, as well as to promoting the role of the education system in advancing digital skills. Retraining workers in digital skills would also allow Spanish companies to remain competitive in an increasingly digitised economy.

(15) Regulatory disparities in the business environment also play a role in keeping productivity growth restrained. In the current context, regulatory disparities and restrictions in the business environment contribute to keeping mark-ups high, reducing the geographical mobility of companies and workers, and restraining productivity growth. The Law on Market Unity, which aimed to meet this challenge, has been implemented only in part. The monitoring of the implementation of that Law at regional and local level must be improved and the role of the sectoral conferences strengthened. That Law introduced the principle that compliance with certain requirements in one part of the territory would allow businesses to operate in the whole territory. In several judgments published in 2017, the Constitutional Court held that this principle is void in the absence of common or equivalent minimum standards for access to or exercise of an economic activity. In light of these judgments, establishing consistent common or equivalent standards throughout the territory could help fulfil the objectives of that Law. In addition, cooperation between the different levels of government should be improved at all stages of the implementation to more effectively tackle the adverse effects of fragmentation on businesses. The work of the Committee for Better Regulation, which was set up to ensure that the legislation was aligned with the Union *acquis* on services, should be accelerated. Restrictions affecting certain regulated professions such as civil engineers and architects were also highlighted in the Services Package adopted in January 2017, and no specific measures to address them have been taken so far.

(16) More generally, improvements in the quality of institutions could boost trust in the Spanish economy and amplify the gains from measures adopted to increase productivity growth. Progress has been made in the transparency of party financing, and disclosure of assets and conflicts of interest. The business environment has also benefited from progress in the fight against corruption, although concerns still remain in this area. Perceptions of the independence of the justice system have also improved amongst citizens and businesses. Efforts to further improve the effectiveness of the justice system are under way and should be continued. Though some progress has been made in this broad area, the challenge of fostering trust in institutions across all levels of government remains.

(17) Further enhancing the transport, energy and water infrastructure would foster territorial cohesion, better integration in the common market and productivity growth. Cross-border transport and energy connections, as well as the water infrastructure, face investment gaps. Better use could be made of passenger and freight rail infrastructures. The different gauges coexisting in Spain, Portugal and France are a critical barrier to better rail connectivity, although new sections using the internationally prevalent standard gauge have been completed recently. Shortcomings are also found in freight railway connections between the main harbours on the Atlantic and Mediterranean coasts and in-land industrial areas. Insufficient connectivity also impedes closer integration in the Union electricity and gas markets. Further infrastructure investment is needed to improve water management, for example to treat wastewater, reduce leaks in the networks and improve water supply. This would bring environmental, economic and social benefits to Spain.

(18) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Spain's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Spain in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Spain but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion[9] 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 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below,

[9] Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Spain take action in 2018 and 2019 to:

1. Ensure compliance with Council Decision (EU) 2017/984 giving notice under the excessive deficit procedure, including through measures to enforce the fiscal and public procurement frameworks at all levels of government. Thereafter, ensure that the nominal growth rate of net primary government expenditure does not exceed 0,6 % in 2019, corresponding to an annual structural adjustment of 0,65 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.

2. Ensure that employment and social services have the capacity to provide effective support for jobseekers, including through better cooperation with employers. Foster transitions towards open-ended contracts. Improve family support and increase the effectiveness of income guarantee schemes, by addressing coverage gaps, simplifying the system of national schemes and reducing disparities in access conditions to regional ones. Reduce early school leaving and regional disparities in educational outcomes, in particular by better supporting students and teachers.

3. Increase public investment in research and innovation and systematically carry out evaluations of support policies in this area to ensure their effectiveness. Increase cooperation between education and businesses with a view to mitigating existing skills mismatches. Further the implementation of the Law on Market Unity by ensuring that, at all levels of government, rules governing access to and exercise of economic activities, in particular for services, are in line with principles of that Law and by improving cooperation between administrations.

Done at Brussels,

For the Council

The President