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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 2019 National Reform Programme of Spain and delivering a Council opinion on the 2019 Stability Programme of Spain |

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Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2019) 509 final.

## COUNCIL RECOMMENDATION

of ...

### **on the 2019 National Reform Programme of Spain and delivering a Council opinion on the 2019 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<sup>1</sup>, 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<sup>2</sup>, 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,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area<sup>3</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (4) below. In particular, measures to improve productivity will help address the first euro-area recommendation as regards productivity improvements for euro area rebalancing, using windfall gains to reduce public debt and focusing economic policy related to investment in the specified areas will help address the second euro-area recommendation as regards rebuilding buffers and supporting investment, and measures to improve skills and employability will help address the third euro-area recommendation as regards the functioning of the labour market.

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<sup>3</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Spain was published on 27 February 2019. It assessed Spain's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018<sup>4</sup>, 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 27 February 2019. The Commission's analysis led it to conclude that Spain is experiencing macroeconomic imbalances. A large stock of internal and external debt, both public and private, and high unemployment, in the context of weak productivity growth, are still vulnerabilities with a cross-border relevance. The reduction of private-sector debt is progressing, but deleveraging needs remain sizeable. Despite continued robust gross domestic product (GDP) growth, the government debt as a share of GDP remains high. The unemployment rate has continued its rapid decline, but remains very high and the high degree of labour market segmentation between temporary and open-ended contracts impedes faster labour productivity growth. After a strong reform momentum between 2012 and 2015, an evolving political context over the past year has contributed to another year of limited progress in implementing country-specific recommendations of previous years. The present favourable economic situation provides a window of opportunity to address pending reform needs with a view to making the Spanish economy more resilient and raising its productivity growth.
- (4) On 30 April 2019, Spain submitted its 2019 National Reform Programme and its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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<sup>4</sup> OJ C 320, 10.9.2018, p. 33.

- (5) The 2019 Stability Programme reports on actions taken to implement the preventive and corrective tools set out in Spain's Stability Law. However, it does not set out plans to make the enforcement of these tools automatic and to review the Stability Law's expenditure rule, with a view to strengthening its contribution to fiscal consolidation, especially during economic upturns. In the area of public procurement, to improve the efficiency of public spending as well as to help prevent irregularities, the ambitious implementation of the Law on public-sector contracts adopted in 2017 will be instrumental. In particular, it is important that the new governing structure, in particular the Independent Office for Regulation and Supervision, can effectively perform the tasks allocated to it, and that the comprehensive National Public Procurement Strategy be swiftly adopted — with the active involvement of contracting authorities and entities at national, regional and local levels. Finally, a number of spending reviews are due in 2019 and the implementation of the recommendations stemming from them should help increase the efficiency of public spending.
- (6) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for 2014-2020. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council<sup>5</sup>, 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.

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<sup>5</sup> 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).

- (7) Following the timely and durable correction of the excessive deficit and Council Decision (EU) 2019/1001<sup>6</sup> to abrogate the excessive deficit procedure, Spain is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. It projects the general government balance to increase from -2,5 % of GDP in 2018 to -2,0 % of GDP in 2019 and to reach a balanced budget in 2022. Based on the recalculated structural balance<sup>7</sup>, the medium-term budgetary objective of a balanced budgetary position in structural terms is not planned to be achieved over the time horizon of the 2019 Stability Programme. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 97,1 % in 2018 to 95,8 % in 2019, before reaching 88,7 % in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of the fiscal targets set in the 2019 Stability Programme mostly pertain to the revenue side, where there is large uncertainty about the yield or chances of adoption of many of the revenue measures.
- (8) On 13 July 2018, the Council recommended Spain to ensure that the nominal growth rate of net primary government expenditure<sup>8</sup> does not exceed 0,6 % in 2019, corresponding to an annual structural adjustment of 0,65 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.

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<sup>6</sup> Council Decision (EU) 2019/1001 of 14 June 2019 abrogating Decision 2009/417/EC on the existence of an excessive deficit in Spain (OJ L 163, 20.6.2019, p. 59).

<sup>7</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

<sup>8</sup> 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.

- (9) In 2020, in view of Spain's general government debt-to-GDP ratio, which is above the 60 % of-GDP Treaty reference value, and projected positive output gap of 2,0 % of GDP, nominal net primary government expenditure should not grow in 2020, 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, with inflation projected to stay below 2 % in 2019 and 2020 and remaining slack in the labour market (high unemployment rate and a very high share of involuntary part-time work, temporary employees as well as in-work poverty). In addition, the plausibility tool also indicates that there is a high degree of uncertainty surrounding the output gap estimates based on the common methodology. On that basis, an annual structural adjustment of 0,65 % of GDP, corresponding to a maximum growth rate of net primary government expenditure of 0,9 %, appears appropriate. According to the Commission 2019 spring forecast, under unchanged policies, there is a risk of a significant deviation from the required fiscal adjustment in 2020. In addition, Spain is not projected to comply with the requirements of the transitional debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio.
- (10) Employment growth remains robust in Spain. Unemployment continues to fall but it remains well above the Union average, especially for young people and for the low-skilled people. Gender gaps in employment and in the length of working careers remain wide. These represent untapped potential not least given the rapidly ageing population.

- (11) While progressively reduced, the still widespread use of temporary contracts, including in sectors less prone to seasonal or cyclical activity, ranks amongst the highest in Europe and may hinder Spain's growth potential and social cohesion. Young people, the low-skilled and third-country nationals are those most affected, often suffering from lower entitlements to social benefits and higher poverty risks. Temporary contracts are often very short and provide weak incentives for both workers and employers to invest in training, which in turn hinders productivity growth. Moving from a temporary contract to a permanent one remains difficult and, barriers to mobility of labour reduce opportunities for jobseekers and hamper its efficient allocation across the country.
- (12) Spain has strengthened the support to the long-term unemployed, who still represented 6,4 % of the active population in 2018. Recent initiatives seek to make young people employable through counselling and career guidance, but public employment services still handle a low share of job vacancies and further efforts are needed to improve their use in job search and placement. In particular, in some regions, engagement with employers is weak and profiling tools to better match jobseekers with employers' needs are still in an initial phase. Partnerships between public employment services and social services are progressing, but cooperation is still limited in some regions. Increased investment in modern public employment services together with support to labour mobility could contribute to improve the employability and adaptability of workers and smoothens labour market transitions, thus improving Spain's productivity and long-term inclusive growth.



(13) Efforts to reinforce labour inspectorates in order to fight against the abuse of temporary contracts are bearing some fruit and the share of open-ended contracts in net employment growth is increasing. However, employers continue to make an extensive use of short-term contracts. Past evidence shows that the numerous incentives to support job creation are having limited effects in promoting quality employment. Spain launched a new evaluation with the view to simplifying the system, but results are not available yet. Recruitment competitions to reduce the share of fixed-term employment in the public sector at all levels of government need to be speed up to reach the target of 8 % by the end of the 2020 recruitment competitions. While the setting-up of tripartite round tables is a good step towards greater involvement by the social partners in policy design, there is room for deeper and more timely consultations.

(14) Though decreasing, the proportion of people at risk of poverty and social exclusion as well as income inequality remains above the Union average. In-work poverty rates are high amongst temporary or low-skilled workers, or non-EU-born. The child poverty rate, although declining, remains very high. The capacity of social transfers other than pensions to reduce poverty remains among the lowest in the Union, especially for children. Social spending as a share of GDP in Spain for households with children in Spain is one of the lowest in the Union and is poorly targeted, despite a recent small increase in the means-tested child allowance. Despite a positive trend, there are still significant gaps in the coverage of people with severe and moderate dependency. National unemployment assistance remains fragmented, with multiple schemes that target different groups of jobseekers. Recent measures improving the coverage and protection of income assistance for older long-term unemployed (aged 52 or above) may, at the same time, weaken incentives to work within this particular group. Meanwhile, regional minimum income schemes present wide disparities in access conditions, coverage and adequacy across regions and their limited portability between regions reduces incentives for labour mobility. As a result, a number of people in need do not receive support. The launch of the Universal Social Card system will make the social benefits system more transparent and thus allow for a better targeting. While the economic recovery continues to curb poverty, the situation calls for investment in social inclusion policies and social infrastructure (e.g. social housing) in order to attain inclusive growth. In addition, Spain faces specific territorial cohesion challenges, such as acute depopulation and ageing in certain rural areas. Actions promoting entrepreneurship, digitalisation and the social economy can help respond to those challenges, as part of integrated territorial development strategies.

- (15) During the crisis, the Spanish pension system played an important role in maintaining the living standards of the elderly, who face a lower risk of poverty. Projections in the 2018 Ageing Report and Pension Adequacy Report indicate that the 2011 and 2013 reforms helped to ensure the sustainability and relative adequacy of pensions in the long term. However, a continuation of the relinking of pension increases to inflation (as decided in 2018 and 2019) and the postponement of the sustainability factor would require compensatory measures to ensure the sustainability of the pension system in the medium to long term. Moreover, action would be needed to address both the main challenge of the adequacy of future retirees' incomes and the length and completeness of their working careers in a context of high unemployment and widespread use of temporary contracts and part-time employment.
- (16) Spain's innovation performance and productivity growth are hampered by subdued levels of investment in research and development and by skills mismatches. Research and development expenditure in the business sector in Spain is only half the level of the Union average, particularly for large firms, with significant regional disparities. That divergence is reinforced by the low and falling execution rate of the public budget for research and development, particularly of loans. Skills shortages and mismatches are another important barrier to the development and use of advanced technologies, in particular by small and medium-sized firms. Employment in high technology sectors and knowledge intensive services is well below the Union average in many Spanish regions. While regional innovation strategies for smart specialisation are being developed and the governance of national research and innovation policy is being streamlined, national-regional coordination in the design, implementation and evaluation of policy remains weak. Improving Spain's innovation performance requires significant investments to foster entrepreneurship and start-ups and help them grow and to promote the competitiveness of all firms and their adaptation – including through digitalisation – to higher added-value activities with the aim of expanding their presence in international markets. It also requires a stronger focus on public-private partnerships, cooperation between academia and business and technology transfer, particularly in favour of small and medium-sized companies, a strengthened governance of research and innovation policy across government levels, and a closer alignment of research and development infrastructure and projects to regional and national innovation strategies.

- (17) Although improving, the early school leaving rate remains very high in Spain, with significant regional disparities. There is scope to improve educational outcomes which vary greatly across regions. Both factors negatively affect the long-term potential for productivity growth. Efforts to reform the education system have stalled. Firms report difficulty in finding the skills needed to embrace innovation, in particular as regards specialists in information and communication technologies. Spain approved measures to upgrade the dual vocational education and training system, which could play a key role in providing the skills and qualifications required to absorb innovation, but enrolment in those systems remains moderate. Spain's rate of tertiary education attainment is above the Union average but tertiary graduates face difficulties in finding adequate jobs. Developing human capital through all levels of education and training, including higher education and vocational training, and greater cooperation between education and business with a view to mitigating existing skills mismatches, could boost labour market access of young graduates. It could also provide firms with the skills and qualifications required to enhance their innovation capacity and to take full advantage of the growth potential offered by digitalisation. Retraining workers in digital skills would also allow Spanish companies to remain competitive in an increasingly digitised economy. All those actions would contribute to the reduction of regional disparities.
- (18) The restrictiveness and fragmentation of regulation within Spain are preventing firms from benefiting from economies of scale and is holding back productivity. The Law on Market Unity remains an important tool to address these issues. Implementing that Law more decisively and removing identified restrictions on services in particular for certain professional services, such as civil engineers, architects and legal services, would improve growth opportunities and competition. As in other fields where regions are key actors for the successful implementation of reforms, a stronger and sustained coordination between national and regional authorities could make policies in this area more effective.

- (19) Incomplete connections for freight transport by rail and limited integration with the Union's electricity and gas markets prevent Spain from fully benefitting from the Union Single Market. For this reason, Spain also needs to invest further in electricity interconnections with the rest of the Union to achieve the target of at least 10 % of its installed electricity production capacity by 2020. Investment is also needed to allow for greater use of rail for freight transport, including cross-border connections with France and Portugal and connections to ports and logistic hubs.
- (20) Significant investment gaps also remain in the area of natural resources management to ensure a more sustainable development model. Reducing energy consumption in buildings, and developing smart grids and renewable electricity storage would help to better manage the demand. Additional efforts should promote sustainable transport and the circular economy. Certain areas of Spain are amongst the most exposed in Europe to climate change, with the existing water resources under pressure and requiring further infrastructure investments to improve water management, such as wastewater treatment, addressing leaks in the networks and water supply. In spite of a steady progress in recent years, Spain still needs to fulfil certain requirements of the Union's water law. Progress in meeting all these objectives would bring environmental, economic and social benefits to Spain.
- (21) For all identified investment gaps, account should be taken of specific regional disparities in investment needs. Territorial disparities in GDP per head are moderate but they remain wider than before the crisis, mostly due to the asymmetric impact of labour shedding across regions. The widest regional disparities are currently identified in labour and social outcome indicators, where most Spanish regions underperform relative to the Union average. Other socioeconomic indicators present wide territorial disparities, such as innovation, entrepreneurship, and competitiveness. Economic policy related to investment should take due account of regional disparities in investment needs.

- (22) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Spain to make the best use of those funds in respect of the identified sectors, taking into account regional disparities and the special situation of the outermost region of the Canary Islands. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Spain's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 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 their compliance 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.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion<sup>9</sup> is reflected in particular in recommendation (1) below.
- (25) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first, second and third euro-area recommendations. Fiscal policies referred to in recommendation (1) contribute inter-alia to address imbalances linked to high government debt,

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<sup>9</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Spain take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 0,9 % in 2020, corresponding to an annual structural adjustment of 0,65 % of GDP. Take measures to strengthen the fiscal and public procurement frameworks at all levels of government. Preserve the sustainability of the pension system. 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. Foster transitions towards open-ended contracts, including by simplifying the system of hiring incentives. Improve support for families, reduce fragmentation of national unemployment assistance and address coverage gaps in regional minimum income schemes. Reduce early school leaving and improve educational outcomes, taking into account regional disparities. Increase cooperation between education and businesses with a view to improving the provision of labour market relevant skills and qualifications, in particular for information and communication technologies.
3. Focus investment-related economic policy on fostering innovation, resource and energy efficiency, upgrading rail freight infrastructure and extending electricity interconnections with the rest of the Union, taking into account regional disparities. Enhance the effectiveness of policies supporting research and innovation.
4. 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 the principles of that Law and by improving cooperation between administrations.

Done at Brussels,

*For the Council*

*The President*

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