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Recommendation for a

**COUNCIL RECOMMENDATION**

**on the 2017 National Reform Programme of Spain**

**and delivering a Council opinion on the 2017 Stability Programme of Spain**

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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,[3]

Having regard to the resolutions of the European Parliament,[4]

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,

Whereas:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey,[5] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,[6] in which it identified Spain as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] COM(2017) xxx.
[4] P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
[5] COM(2016) 725 final.
[6] COM(2016) 728 final.

Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March 2017.[7]

(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 which is reflected in recommendations 1 to 3 below.

(3) The 2017 country report for Spain[8] was published on 22 February 2017. It assessed Spain's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the 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 22 February 2017.[9] The Commission's analysis leads it to conclude that Spain is experiencing macroeconomic imbalances which have cross-border relevance. In particular, the current account surpluses are translating into a reduction of Spain's net external liabilities, which nonetheless remain sizeable and expose the country to shifts in market sentiment. Private sector debt has decreased significantly, especially for corporations, but household debt remains high. Economic growth has become the main driver of debt reduction, but fiscal sustainability risks remain high in the medium term. The need for action to reduce the risk of adverse effects of imbalances on the Spanish economy and, given its size and cross-border relevance, on the economic and monetary union, is particularly important. The financial sector has continued to show a high degree of stability, supported by its ongoing restructuring, low funding costs and the economic recovery. Job creation has been strong in recent years and unemployment has decreased rapidly, but remains very high. Labour market reforms and wage moderation have been important drivers of strong job creation and competitiveness gains in recent years.

(4) On 28 April 2017, Spain submitted its 2017 National Reform Programme and on 29 April 2017 Spain submitted its 2017 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[10] where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review

[7] OJ C92/01, 24.3.2017, p. 1.

[8] SWD(2017) 74 final.

[9] COM(2017) 90 final.

[10] Article 23 of 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.

and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[11]

(6) Spain is currently in the corrective arm of the Stability and Growth Pact. In its 2017 Stability Programme, Spain plans to correct the excessive deficit by 2018, in line with the Council notice of 8 August 2016. The headline deficit is planned to continue declining to 0.5% of GDP in 2020. The expenditure projections in the programme incorporate the materialisation of contingent liabilities related to the motorways and the financial sector, amounting to close to 0.4% and 0.2% of GDP in 2017 and 2018, respectively. 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 Stability Programme. The recalculated structural balance[12] is projected to reach -1.9% of GDP in 2020. The Stability Programme projects the government debt-to-GDP ratio to decline to 98.8% in 2017, 97.6% in 2018, and 92.5% in 2020. The programme's macroeconomic assumptions are plausible until 2018 and turn somewhat favourable thereafter. Overall, the planned achievement of the targets continues to rely on the strong economic outlook, which is nevertheless subject to risks. Other risks to the achievement of the fiscal targets relate to uncertainty regarding the impact of the recent tax measures. Moreover, taking into account the assumed materialisation of contingent liabilities (which are not included in the Commission forecast), the programme relies on considerably higher expenditure restraint than projected in the Commission forecast in 2017 and 2018. Finally, the measures needed to support the planned deficit targets for 2018 have not yet been specified.

(7) On 8 August 2016, 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 4.5% of GDP in 2016, slightly below the target set by the Council. The Commission 2017 spring forecast projects the headline deficit to decline to 3.2% of GDP in 2017 and further to 2.6% of GDP in 2018 on a no-policy-change basis, 0.1% and 0.4% of GDP above the headline deficit targets in the Stability Programme and those set by the Council. Unlike the Stability Programme, the forecast does not assume the materialisation of the above-mentioned contingent liabilities. The cumulative fiscal effort over 2016-2017 is expected to be narrowly ensured, while in 2018, on a no-policy-change basis, the fiscal effort is forecast to fall short of what was requested by the Council. In addition, in August 2016, the Council requested Spain to take measures to improve its fiscal framework, but the Stability Programme does not report plans to strengthen the contribution of the Stability Law's spending rule to the sustainability of public finance. Overall, the Council is of the opinion that further measures will be needed, notably in 2018, to comply with the provisions of the Stability and Growth Pact and in particular with the terms of the Council notice of 8 August 2016.

[11] COM(2014) 494 final.

[12] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(8) Spain still lacks a clear and consistent public procurement policy framework that ensures legal compliance, a high level of competition and economic efficiency, namely through effective *ex ante* and *ex post* control mechanisms, enhanced transparency and coordination across contracting authorities and entities at all government levels. The government has put forward some measures in 2017 that would improve the procurement supervision system and are currently awaiting parliamentary approval.

(9) Spain has made progress in the fight against corruption, in particular regarding transparency of administrative decision-making, and more concretely on enacting legislation on transparency of party financing, asset disclosure and conflicts of interest. The focus now shifts to the implementation of these measures. However, despite a surge in corruption investigations involving cases at the local and regional levels, no tailor-made preventive strategies to mitigate corruption risks have been developed at those government levels nor is there a shared preventive strategy across government levels. Other shortcomings such as the lack of legislation to protect whistle-blowers, the degree of independence of the recently established Office of Conflicts of Interest and the lack of regulation of lobbying have not been the object of a specific follow up yet. Another issue concerns the protracted judicial procedure for corruption cases. While the Criminal Procedure law was amended in 2015 to limit the time allocated to investigations and reduce undue delays in criminal procedures, this measure could result in impunity in complex corruption cases for which the time limits would not be sufficient for building cases.

(10) Despite a standard VAT rate in line with the EU average, Spain has relatively low VAT revenues. This is mainly due to Spain extensively applying exemptions or reduced rates on various products and services. As a result, Spain recorded the largest policy gap in the EU in 2014 (59 % compared to the EU average of about 44 %). Similarly, Spain's revenues from environmentally related taxes are among the lowest in the EU, despite some measures taken in recent years, mainly in the energy sector. Taxing pollution and resource use can generate increased revenue and bring important social and environmental benefits. There is also normative dispersion resulting in a heterogeneous approach to certain environmental taxes at the regional level. Regarding expenditure, the government has commissioned AIReF, Spain's independent fiscal institution, to carry out a spending review covering all levels of general government. The review can help identify areas where spending needs can be met with a more efficient use of resources.

(11) Job creation has been strong in recent years, supported by labour market reforms and wage moderation. Unemployment has decreased rapidly, but remains among the highest in the EU, in particular among young and low skilled people, entailing risks of disengagement from the labour market. Almost half of the unemployed have been without a job for more than a year. Spain is taking measures to support young people, notably by extending the Youth Guarantee eligibility criteria, and to strengthen individual support to the long-term unemployed. Their effectiveness depends also on the performance of the regional public employment services. There is scope to enhance their cooperation with social services, so as to improve the provision of extended services to jobseekers, in particular the long-term unemployed and beneficiaries of income guarantee schemes. At the same time, cooperation of public employment services with employers could be enhanced, notably by increasing the share of vacancies handled by the employment services.

(12) Spain has one of the highest shares of temporary employment in the EU, and many temporary contracts are of very short duration. Transition rates from temporary to permanent contracts are very low in comparison to the EU average. The widespread use of temporary contracts is associated with lower productivity growth (including through lower on-the-job training opportunities), poorer working conditions and higher poverty risks. The recent labour market reforms seem to have had a mildly positive effect in reducing segmentation between permanent and temporary contracts, and the ongoing reinforcement of labour inspections is showing positive results in addressing the abuse of temporary contracts. However, some features of the Spanish labour market may still discourage hiring on permanent contracts, including uncertainty in case of legal dispute following a dismissal, along with comparatively high severance payments for workers on permanent contracts. Moreover, the system of hiring incentives remains scattered and not effectively targeted at the promotion of open-ended employment. Although it has recently established a working group on the quality of employment, Spain has not yet developed a comprehensive plan for fighting labour market segmentation, following the 2014 agreement between the government and social partners.

(13) Disparities persist in the eligibility conditions of income guarantee schemes and in the link between activation and protection across regions and schemes. Certain categories of vulnerable households are left out of the income guarantee arrangements. The limited effectiveness of the schemes is partly explained by large disparities in adequacy and access conditions of the regional minimum income schemes and by the fragmentation of the national benefit system into multiple schemes addressing various categories of jobseekers and managed by different administrations. Fragmentation introduces discontinuity in the support given to those in need of it and hampers the delivery of integrated pathways. In response to the multiple challenges, an ongoing study aims at assessing the effectiveness of the national and regional income support schemes. Family benefits are poorly targeted. Moreover, when taking into account the impact of tax credits, the tax-benefit system is overall slightly regressive. In addition, childcare use strongly increases with family income, suggesting barriers to access for low-income parents. The provision of long-term care services is improving, but it differs across regions and current needs are still not met.

(14) Weak education outcomes negatively affect the longer-term potential for productivity growth in Spain. Despite significant improvements over the past years, the early school leaving rate remains among the highest in the EU. There are wide regional disparities in early school leaving and students' performance, in particular regarding basic skills. Teachers' training and individual students' support are among the drivers of successful school education in well performing regions. Spain has the second highest grade repetition rate in the EU, which increases the risk of school drop-out, lowers attainment expectations and weighs on education costs. Employability of tertiary graduates remains comparatively low. The reduced mobility of students and academic staff, limited traineeships' opportunities, lack of incentives and the rigidity of university governance remain obstacles to cooperation with business on education or research.

(15) To strengthen productivity and competitiveness, Spain would benefit from further promoting research and innovation. Yet, innovation performance has been declining and is now at a lower level than in 2007, while the country's gap to the EU average has increased over time. Low innovation performance coincides with declining

private R&D expenditure and points to weaknesses in the research and innovation governance framework. The State Agency for Research responsible for managing central government research and innovation funding has become operational in early 2017. Until now, there is no systematic multiannual planning of support programme budgets. Also, the effectiveness of support programmes is not systematically evaluated to enhance their design and implementation. Due to a lack of incentives and the rigidity of university governance, public-private cooperation also remains weak and the mobility of researchers between public and private sector is low. Coordination across government levels is not optimal, and as a result national and regional policies do not operate in full synergy.

(16) Spanish small firms tend to have significantly lower productivity than their peers in other large EU Member States. Given the prevalence of small firms in Spain, this has a significant impact on productivity in the economy as a whole. Easing the barriers for businesses to be created, operate and grow, would therefore result in increased investment and productivity. The Spanish government adopted several measures in recent years aimed at facilitating business creation and growth. The consolidation and full implementation of these reforms is essential to fully reap their benefits. The law on market unity adopted in 2013 has contributed to tackling the additional costs for entrepreneurs caused by the substantial differences and overlaps in business regulations across regions. The increasing use by businesses of the complaint mechanism foreseen in this law to seek redress on market access barriers hint at a possible need to further simplify licensing procedures. Coordination between relevant public administrations, including at sectoral conference level, requires more efforts. This is essential to ensure that existing and forthcoming legislation at all levels effectively tackles unnecessary market entry barriers, including for new business models in the collaborative economy. In the retail sector, dual authorisations for retail establishment continue to unnecessarily restrict market entry. Market access requirements foreseen in the vehicle-with-drivers services sector legislation and the short-term rental accommodation services legislation at regional level may unnecessarily hamper the balanced development of the collaborative economy. Spain has taken steps in the first months of 2017 to leverage the market unity law, an example being the recently adopted guide on its implementation and the published catalogue of good and bad practices in applying it.

(17) Regulation of professional services remains comparatively restrictive. Protectionist rights (‘reserved activities’) are granted selectively to some service providers, excluding others with relevant similar qualifications. In a large number of professions there is a mandatory membership requirement in a professional association. The level of restrictiveness is higher in Spain than the EU-weighted average for civil engineers, architects and tourist guides. It is lower than the EU average for patent agents and lawyers, although access to the latter profession is more tightly restricted than for any other profession in Spain. [13] The draft professional services law envisaging, among other things, rationalisation of professional association membership has still not been adopted. This reform also defines increased transparency and accountability of professional bodies, opening up unjustified reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain.

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[13] COM(2016) 436 final.

(18) In the context of the European Semester the Commission has carried out a comprehensive analysis of Spain's economic policy and published it in the 2017 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Spain in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Spain, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the Stability Programme and its opinion[14] 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 National Reform Programme and the Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 to 3 below,

HEREBY RECOMMENDS that Spain take action in 2017 and 2018 to:

1. Ensure compliance with the Council decision of 8 August 2016 giving notice under the excessive deficit procedure, including also measures to strengthen the fiscal and public procurement frameworks. Undertake a comprehensive expenditure review in order to identify possible areas for improving spending efficiency.

2. Reinforce the coordination between regional employment services, social services and employers, to better respond to jobseekers' and employers' needs. Take measures to promote hiring on open-ended contracts. Address regional disparities and fragmentation in income guarantee schemes and improve family support, including access to quality childcare. Increase labour market relevance of tertiary education. Address regional disparities in educational outcomes, notably by strengthening teachers' training and individual students' support.

3. Ensure adequate and sustained investment in research and innovation and strengthen its governance across government levels. Ensure a thorough and timely implementation of the law on market unity for existing and forthcoming legislation.

Done at Brussels,

*For the Council*
*The President*

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