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From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Spain in response to the Council Recommendation of 21 June 2013

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Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Spain in response to the Council Recommendation of 21 June 2013

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(8) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty, 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. The Stability and Growth Pact includes Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1], which was adopted in order to further the prompt correction of excessive general government deficits.

(3) The Council, acting upon a recommendation by the Commission, decided on 27 April 2009, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit existed in Spain and issued a recommendation to correct the excessive deficit by 2012 at the latest in accordance with Article 104(7) of that Treaty. Since then, the Council has issued three new recommendations to Spain (on 2 December 2009, 10 July 2012 and 21 June 2013) on the basis of Article 126(7) of the Treaty on the Functioning of the European Union, which extended the deadline for correcting the excessive deficit to 2013, 2014 and 2016 respectively. In all three recommendations the Council considered that Spain had taken effective action, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred[2].

(4) The latest Council Recommendation to Spain on the basis of Article 126(7) of the Treaty was issued on 21 June 2013. It recommended Spain to reach a headline deficit

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[1] OJ L 209, 2.8.1997, p. 6.

[2] All documents related to the excessive deficit procedure of Spain can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/spain_en.htm

target of 6.5% of GDP in 2013, 5.8% of GDP in 2014, 4.2% of GDP in 2015, and 2.8% of GDP in 2016, which was consistent with an improvement of the structural balance of 1.1%, 0.8%, 0.8%, and 1.2% of GDP in the years 2013-2016, respectively, based on the Commission 2013 spring forecast extended to 2016. To achieve that improvement, Spain was asked to implement additional measures amounting to 2%, 1% and 1.5% of GDP in 2014, 2015 and 2016, respectively. Furthermore, Spain was requested (i) to strengthen the effectiveness of the institutional framework by raising further the transparency in implementation of the Budgetary Stability Law as well as by establishing an independent fiscal council to provide analysis, advice and monitor compliance of fiscal policy with national and Union fiscal rules, (ii) to undertake concrete steps to rein in the increasing structural deficit in the social security system, and (iii) to give greater emphasis to the growth-friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system. Finally, to ensure the success of the fiscal consolidation strategy, the recommendation also pointed out that it was important to back the fiscal consolidation with comprehensive structural reforms, in line with the Council Recommendations addressed to Spain in the context of the European Semester and the Macroeconomic Imbalances Procedure.

(5) The Commission 2013 spring forecast, extended to 2016, which underpinned the Council Recommendation of 21 June 2013, projected that the Spanish economy would contract by 1.5% in 2013 before growing by 0.9%, 1.4% and 1.9%, respectively, in the three subsequent years. Nominal GDP growth was forecast at 0.1% and 2.0% in 2013 and 2014, respectively, and at 2.6% and 3.2% in the two following years.

(6) In its recommendation, the Council established a deadline of 1 October 2013 for effective action to be taken in line with the provisions of Article 3(4) of Regulation (EC) No 1467/97. On 15 November 2013, based on the Commission 2013 autumn forecast, the Commission concluded that Spain had taken effective action in compliance with the Council Recommendation of 21 June 2013, although it pointed to risks of non-compliance in 2014. On that basis, the Commission considered that no additional steps in the excessive deficit procedure were necessary at that point in time. Since then the excessive deficit procedure has been held in abeyance.

(7) Risks of non-compliance with the Council Recommendation of 21 June 2013 were highlighted again in subsequent assessments. In July 2014 the Council concluded that the measures underpinning the budgetary strategy set out in the 2014 Stability Programme needed to be specified further and that additional efforts were needed to fully comply with the Council Recommendation of 21 June 2013. Based on its assessment of the 2015 Stability Programme, the Council in July 2015 concluded that there was a risk that Spain would not comply with the provisions of the Stability and Growth Pact. Similarly, the Commission's Opinions on Spain's Draft Budget Plans for 2014, 2015 and 2016, have all concluded that Spain was at risk of not complying with the rules of the Stability and Growth Pact. In particular, the Commission pointed out risks related to the structural effort in the plans being lower than those recommended by the Council. Moreover, the Commission pointed out risks to the achievement of the headline deficit targets.

(8) On 9 March 2016, based on the Commission 2016 winter forecast, the Commission also concluded that there was a risk of non-compliance with the deadline to correct the excessive deficit, given the still significant expected excess over the 4.2% of GDP

intermediate headline balance target for 2015 and the fact that the fiscal effort achieved until then fell well short the recommended one. On that basis, the Commission issued a recommendation to Spain to step up efforts to ensure compliance with the Council Recommendation of 21 June 2013. To that end, Spain was recommended (i) to take measures to ensure a timely and durable correction of the excessive deficit, including by making full use as appropriate of the preventive and corrective tools set out in Spain's Stability law to control for slippages at the sub-central government level from the respective deficit, debt and expenditure rule targets; and (ii) to report to the Commission on measures in response to the Commission Recommendation in its updated 2016 draft budgetary plan or, at the latest, in a dedicated section of its forthcoming 2016 Stability Programme.

(9) A new assessment of the action taken by Spain to correct the excessive deficit by 2016 in response to the Council Recommendation of 21 June 2013leads to the following conclusions:

– Based on the data notified by Spain in spring 2016 and validated by the Commission (Eurostat) on 21 April 2016, the general government deficit was 5.9% of GDP in 2014 and 5.1% of GDP in 2015, above the intermediate targets set by the Council of 5.8% and 4.2% of GDP, respectively. The 2014 deficit outcome suffered from a downward revision of nominal GDP carried out at the time of the second EDP notification in October 2015 as well as deficit-increasing financial sector opearations worth 0.1% of GDP. The relaxation of fiscal policy in 2015 had a large impact on the fiscal outcome.

– Based on the Commission 2016 spring forecast, the change in the structural balance in 2015 is estimated at -1.0% of GDP, significantly less than the 0.8% of GDP recommended by the Council. The cumulative change in the structural balance over the 2013-2015 period amounted to 0.6% of GDP, thus falling significantly short of the 2.7% of GDP recommended by the Council. Moreover, when adjusted for the effects of revised potential output growth and revenue windfalls or shortfalls compared to the baseline scenario underpinning the recommendation, the structural effort amounts to -0.7% of GDP in 2015 and -0.2% of GDP over 2013-2015, which is well below the recommended effort. When measured according to the bottom-up method, the fiscal effort amounts to -0.5% of GDP in 2015 and there appears to have been no effort over the 2013-2015 period, against recommended efforts of 1% and 3% of GDP, respectively. Consolidation measures, for instance in the context of the reforms of the public administration and the pension system, were insufficient to offset the impact of some expansionary measures implemented in 2015, such as personal and corporate income tax reductions and a partial pay-back of previously foregone Christmas bonuses, and the upward trend in expenditure linked to population ageing.

– Over 2013-2015, Spanish inflation (as measured by the GDP deflator) was well below that in the baseline macroeconomic scenario underpinning the recommendation (it was even negative in 2014, at -0.4%), making the achievement of the fiscal targets more difficult. However, the negative impact of low or even negative inflation on Spain's fiscal outcomes was largely offset by higher-than-expected real GDP growth. Despite a less dynamic evolution of the GDP deflator, the level of nominal GDP in 2015 turned out only 1% lower than foreseen in the baseline scenario, as real GDP expanded much faster over the same period. Furthermore, fast job creation and a tax-rich composition of growth further benefitted the deficit reduction.

– Overall, throughout 2014 and 2015, a low interest rate environment and a stronger-than-expected economic recovery, also thanks to reforms undertaken in response to the crisis, the successful completion of the financial assistance programme and favourable labour market developments, helped Spain to reduce its general government deficit. At the same time, the fiscal consolidation process was hampered by a negative inflation surprise relative to the macroeconomic scenario underpinning the Council Recommendation of 21 June 2013. However, windfall gains, especially in 2015, were not used to accelerate the deficit reduction. Instead, fiscal policy was relaxed , in particular through the tax reform and dynamic expenditure growth.

(10) The Commission 2016 spring forecast projects a general government deficit of 3.9% of GDP in 2016 and 3.1% of GDP in 2017. The 2016 Stability Programme targets a deficit at 3.6% and 2.9% of GDP in 2016 and 2017, respectively. Therefore Spain is not set to achieve a timely and durable correction of its excessive deficit in 2016. The public-debt-to-GDP ratio declined slightly from 99.3% in 2014 to 99.2% in 2015, thanks to net sales of financial assets more than offsetting the impact of the deficit growing faster than nominal GDP growth. According to the Commission 2016 spring forecast, the debt ratio is expected to rise again in 2016 to 100.3% and to decline thereafter.

(11) Since 2012, Spain's fiscal framework has been strengthened in order to, among other things, prevent deviations and ensure compliance by all government levels with their respective deficit, debt and expenditure rule targets. Since the Council Recommendation of 21 June 2013, Spain has further strengthened its domestic fiscal framework by amending the 2012 Stability Law to provide incentives for public administrations to reduce public sector arrears to commercial suppliers and by creating in November 2013 an independent fiscal institution (AIReF). However, while Spain's Stability Law includes tools to prevent and correct deviations from the domestic fiscal targets, the experience over 2014 and 2015 shows that they could have been used to a greater extent. Following the March 2016 Commission Recommendation, the Spanish government has started to enforce corrective provisions in the Stability Law that had not previously been implemented.

(12) In December 2013 Spain adopted a reform revising pension indexation and introducing as from 2019 an automatic adjustment of future retirees' new pensions to take account of changes in life expectancy. Moreover, starting in June 2013, it has been implementing a public administration reform, with a view to reaping efficiency gains. At the same time, in 2014 Spain adopted a corporate and personal income tax reform, which had some positive features but was not fully funded.

(13) This leads to the conclusion that the response of Spain to the Council Recommendation of 21 June 2013 has been insufficient. Spain did not reach the intermediate target for the headline deficit in 2015 and is not forecast to put an end to its excessive deficit by 2016. The fiscal effort falls significantly short of what was recommended by the Council, and the fiscal stance was even relaxed in 2015,

HAS ADOPTED THIS DECISION:

Article 1

Spain has not taken effective action in response to the Council Recommendation of 21 June 2013.

Article 2

This Decision is addressed to the Kingdom of Spain.

Done at Brussels,

For the Council
The President