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**COMMISSION STAFF WORKING DOCUMENT**

**Assessment of the 2014 national reform programme and stability programme for  
SPAIN**

*Accompanying the document*

**Recommendation for a COUNCIL RECOMMENDATION**

**on Spain's 2014 national reform programme and delivering a Council opinion on  
Spain's 2014 stability programme**

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## EXECUTIVE SUMMARY

**Progress on the adjustment of macroeconomic imbalances and advances in the policy reform agenda are helping to rebuild confidence on the Spanish economy.** Spain has taken measures to strengthen the financial sector, restore competitiveness and shore up public finances. The private sector is gradually reducing its debt, and the current account balance has turned into a small surplus. Amid recovering confidence, easing financing conditions (although still relatively onerous for smaller borrowers) and reduced economic uncertainty, the economy pulled out of a long recession in the third quarter of 2013 and employment stopped declining at the end of 2013. GDP is expected to grow by 1.1 % this year in the Commission 2014 spring forecast, as exports remain robust and domestic demand stops being a drag on growth.. Employment is expected to progressively gain some traction over 2014 and 2015, prompting a moderate fall in unemployment.

**However, the recovery of the Spanish economy is at an early stage and remains fragile.** High levels of private and public debt and external liabilities and very high unemployment make the economy vulnerable and constrain future growth prospects. The recovery can be sustained only if it does not result in a halt or reversal of the correction of imbalances and the economic adjustment process. This calls for a continuation of structural and fiscal policies that support an efficient reallocation of resources and macroeconomic stability, hence underpinning sustainable growth and employment going forward.

**Overall, Spain has made some progress in addressing the country-specific recommendations of 2013.** Fiscal consolidation continued in 2013 and the national reform agenda has advanced significantly, with many important reforms being passed into law, broadly in line with the plans in the 2013 Spanish national reform programme and stability programme. Notably, Spain has adopted reforms on pensions, healthcare, independent fiscal institution, public administration, internal market, financial sector, non-bank financial intermediation, labour market, corporate insolvency, liberalisation of the housing rental market, and to tackle the electricity tariff deficit. The implementation of many of these reforms required follow-up actions and is thus ongoing (in some cases it is still at an early stage), and not devoid of risks, including from the need of joint delivery by various tiers of government in many reforms. Moreover, some key reforms, e.g. regarding professional services and associations, have been delayed.

**The 2014 national reform programme confirms the reform agenda, providing further detail on reforms still to be adopted and focusing on implementation.** Building on the measures included in the 2012 and 2013 programmes in key areas such as business environment, the labour market and network industries, the 2014 programme aims at deepening the reforms, favouring economic recovery and job creation, and emphasises the need for a swift and full implementation of the measures already adopted. Amongst the key new measures are a far-reaching reform of the tax system, planned to be adopted in the second half of 2014, measures to promote democratic regeneration and fight against corruption, the reform of active labour market policies and to address social issues, and measures to improve access to bank and non-bank financing for small- and medium-sized enterprises. For most of these measures, however, a concrete timeline is missing.

**Despite the recent achievements, there are still important challenges to be addressed in several policy areas:**

- **Public finances:** Fiscal consolidation remains a priority to reduce the still high general government deficit (7.1 % of GDP in 2013, of which 0.5 % of GDP related to bank recapitalisations) and put the high general government debt (around 100 % of GDP) on a declining path. While in the stability programme the headline deficit is planned to be brought below 3% in 2016, which is the deadline set in the Council's recommendations in the context of the excessive deficit procedure, the planned fiscal efforts fall short of what recommended by the Council. Moreover, the deficit and debt adjustment paths are subject to downside risks in particular in 2015 and beyond, relating in particular to a somewhat optimistic macroeconomic scenario underpinning the budgetary projections and from the fact that concrete measures to reach the deficit targets from 2015 onwards are not yet sufficiently specified, notably regarding the changes to tax legislation within the framework of the planned tax reform. Spain is enhancing its public finance management, notably with measures taken to underpin the sustainability of the pension system, control healthcare expenditure, reform the public administration and avoid the emergence of new arrears in public administration payments to providers.
- **Financial sector:** Spain has successfully concluded a euro-area-backed programme to recapitalise its financial institutions. However, the sector still faces challenges and risks that need to be carefully monitored and managed, and it is important to ensure that credit keeps flowing to viable sectors of the economy as the deleveraging of the corporate sector continues, in particular by completing the recent and ongoing measures to widen access to finance for small and medium-sized enterprises. New legislation was adopted in March 2014 to facilitate corporate debt restructuring of viable firms. Nevertheless, there seems to be still scope to reinforce the efficiency of the insolvency framework for both corporate and individuals.
- **Labour market, education and training, and social policies:** Although slowly declining, unemployment is unbearably high. Moreover, the labour market remains fragmented, with a high share of temporary employment carrying risks for productivity and human capital development. As a result of the deterioration of the labour market and the strain on the capacity of social protection from growing demand, poverty, social exclusion and income inequality are on the rise. Early school leaving is falling, but the use of vocational training is still insufficient and the mismatch between education and labour market needs is a problem. Effective active labour market policies and labour market institutions, as well as flanking reforms in education, training and youth policies are key to reabsorb over time the very high number of unemployed. At the same time, it is also crucial to continue monitoring closely the effects of recent reforms and maintaining wage setting consistent with job creation and international competitiveness. More employment-friendly taxation and greater competition in product and services markets are also necessary to boost employment.
- **Product and service markets:** Competition in the domestic goods and services sectors would be further improved with the full implementation of ongoing reforms, such as the December law to secure market unity and adoption of the law on professional services, which has been further delayed. The parliamentary approval process for the dis-indexation law is ongoing, and some of its principles have already been implemented with the 2014 budget law. Efforts have been made to foster a more efficient rental housing market and steps have been taken to address the electricity tariff deficit, in particular by reducing the system costs, with the aim of eliminating the deficit as of 2014.

## 1. INTRODUCTION

In May 2013, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies for Spain. On the basis of these recommendations, the Council of the European Union adopted nine CSRs in July 2013. These CSRs concerned public finances, taxation, labour market, education and training, social policies, business environment, product and services markets, network industries, public administration and the judicial system. This staff working document (SWD) assesses the state of implementation of these recommendations in Spain.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2014 (AGS)<sup>1</sup> and the third annual Alert Mechanism Report (AMR),<sup>2</sup> which were published in November 2013. The AGS sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2014. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, Spain and 15 other Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014 along with a Commission Communication.<sup>3</sup>

Against the background of the 2013 Council Recommendations, the AGS, the AMR and the in-depth review, Spain presented its national reform programme and a stability programme on 30 April 2014. These programmes provide detailed information on progress made since July 2013 and on the plans of the government. The information contained in these programmes provides the basis for the assessment made in this staff working document.

The programmes submitted underwent a consultation process involving regional authorities and relevant stakeholders, such as social partners and representatives of the third sector, in the areas of their competence.

## 2. ECONOMIC SITUATION AND OUTLOOK

### Economic situation

**The correction of macroeconomic imbalances has progressed, allowing a return to positive economic growth and a stabilisation in the labour market.** A number of policy measures were taken to strengthen the financial sector, restore competitiveness and shore up public finances. The private sector is gradually reducing its debt, and the current account balance has turned into a small surplus. Amid recovering confidence and reduced economic uncertainty, the economy has pulled out of a long recession and employment rates have stopped their decline in the fourth quarter of 2013 (in quarterly terms). A return to positive

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<sup>1</sup> COM(2013) 800 final

<sup>2</sup> COM (2013) 790 final

<sup>3</sup> Apart from the 16 Member States identified in the AMR, Ireland was also covered by an in-depth review, following the conclusion by the Council that it should be fully integrated into the normal surveillance framework after the successful completion of its financial assistance programme.

GDP growth took place as domestic demand became less of a drag on growth amid recovering confidence and gradually easing financing conditions, in particular for larger borrowers. However, large deleveraging needs in the private and public sectors cap medium-term growth prospects and mean that the economy remains vulnerable to shocks. The recovery can be sustained only if it does not result in a halt or reversal of the adjustment process, as the ongoing correction of imbalances still has a long way to go.

## **Economic outlook**

**According to the Commission 2014 spring forecast, GDP is expected to grow by 1.1% in 2014.** The narrowing contribution from the external sector will be more than offset by the positive contribution from domestic demand, which is expected to gain momentum in the coming quarters. Private-sector investment in equipment is expected to benefit from the improved economic outlook and the relative strength of exports. Conversely, the adjustment of residential investment is set to reach its inflection point only in 2015. The unemployment rate is forecast to fall moderately to 25.5 %, <sup>4</sup> due to both the decline in the labour force and meagre employment growth. Although productivity growth is expected to slow, wage moderation should allow for further improvements in nominal unit labour costs and competitiveness gains.

**The macroeconomic scenario underlying the national reform programme and the stability programme appears somewhat optimistic for 2015 and the outer years.** For 2014, the GDP growth forecast of 1.2 % is similar to the outlook in the Commission 2014 spring forecast, albeit with a more even growth composition, with contributions of 0.7 pp. of domestic demand and 0.6 pp of net external demand (0.4 and 0.8 respectively in the Commission 2014 spring forecast). For the following years, the authorities forecast economic growth of 1.8 % in 2015, 2.3 % in 2016 and 3.0 % in 2017, compared to growth of 2.1% in 2015 in the Commission 2014 spring forecast. However, the Commission forecast is carried out under the customary no-policy change assumption, which does not factor in the consolidation plans underlying the official macroeconomic scenario. Specifically, the general government deficit projected for 2015 in the stability programme is 4.2% of GDP, against a deficit of 6.1 % of GDP forecast by the Commission. Had the Commission incorporated the fiscal adjustment to reach the 4.2% of GDP deficit, the resulting GDP growth forecast in 2015 would have most likely been below 1.5 %. Moreover, the GDP growth rates for 2016 and 2017 in the stability programme seem optimistic when seen against current estimates of the potential growth rate of the economy and the remaining economic adjustment needs.

## **3. CHALLENGES AND ASSESSMENT OF POLICY AGENDA**

### **3.1. Fiscal policy and taxation**

#### *Budgetary developments and debt dynamics*

**The main goal of the medium-term budgetary strategy outlined in the stability programme is to correct the excessive deficit by 2016 and reach the medium-term objective (MTO) in 2017.**<sup>5</sup> The stability programme confirms the medium-term objective

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<sup>4</sup> Unemployment figures in the Commission 2014 spring forecast are calculated with labour force survey figures at the time of the forecast, according to which the unemployment rate in 2013 Q4 was 26.0%. However, after the cut-off date of the forecast new figures have been released based on updated population estimates. According the new data, unemployment stood at 25.7% in the fourth quarter of 2013.

<sup>5</sup> However, according to the expected evolution of the structural balance, which is the cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided

(MTO) of a balanced budgetary position in structural terms, which is more stringent than what the Stability and Growth Pact requires. The stability programme broadly confirms the fiscal structural reform agenda included in the economic partnership programme presented in October 2013.

**Fiscal consolidation continued in 2013, although at a slower pace than in 2012.** The general government deficit net of capital transfers to banks (3.8 % of GDP in 2012 and 0.5 % of GDP in 2013), carried out in the framework of the financial sector programme and considered as one-off operations, narrowed to 6.6 % of GDP in 2013, from 6.8 % of GDP in 2012. This marginally exceeds the government and EDP target of 6.5 % of GDP.<sup>6</sup> By level of government, the main consolidation effort was achieved at the regional and local level, although the regions as a whole missed the deficit target of 1.3 % of GDP by slightly more than 0.2 pp., while the local governments over-performed their zero balance target, posting a surplus of 0.4 % of GDP. In contrast, the social security sector balance deteriorated by around 0.2 pp., resulting in a deficit of almost 1.2 % of GDP, which, however, was more than 0.2 pp. better than target. The deviation from the general government target set in the 2014 Draft Budgetary Plan was largely linked to weaker-than-expected current revenues, mainly as a result of lower-than-targeted taxes on income and wealth. On the expenditure side, slippages regarding social transfers in kind, other current expenditure and gross fixed capital formation were more than compensated by lower-than-expected social transfers other than in kind, subsidies and other capital expenditure.

**For 2014, the stability programme aims at accelerating the general government deficit reduction to 5.5 % of GDP, over-performing the headline target of 5.8 % set in the 2014 budget and in the June 2013 EDP recommendation.** The new more ambitious target largely reflects the positive budgetary impact from a significant upward adjustment of the macroeconomic scenario and labour market developments, which more than offset the slightly worse starting position in 2013. The planned narrowing of the deficit in 2014 would be achieved by a combination of higher revenues and expenditure restraint. The revenue-to-GDP ratio is forecast to increase by 0.8 pp., reflecting more buoyant revenues from both direct and indirect taxes due to the expected higher GDP growth and more tax-rich growth composition as well as to some additional consolidation measures adopted in response to the Commission Opinion on the 2014 Draft Budgetary Plan. The expenditure ratio is projected to fall by 0.4 pp. (excluding bank recapitalisation costs in 2013), reflecting mainly lower spending on compensation of employees, intermediate consumption and unemployment benefits, while the increase in nominal interest expenditure is decelerating thanks to improved market financing conditions. In total, the consolidation in the programme relies on adopted discretionary measures with a budgetary impact estimated by the government at 1.6 % of GDP. In its 2014 spring forecast, the Commission projects a marginally higher deficit of 5.6 % of GDP.

**In the stability programme the authorities confirm their commitment to advance with fiscal consolidation over the medium term.** The authorities target a headline deficit of 4.2 % of GDP in 2015, 2.8 % of GDP in 2016, and 1.1 % in 2017. The fiscal consolidation plan projects an increasing fiscal effort towards the end of the programme period, back-loading the fiscal adjustment. The current programme targets differ only marginally from those in the previous programme and are set in line with the budgetary plans presented in October 2013. According to the programme, the consolidation would be primarily achieved via expenditure

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in the programme using the commonly agreed methodology, the MTO would not be achieved within the programme period.

<sup>6</sup> The general government deficit targets of 6.3% of GDP in 2013 and 5.5% of GDP in 2014 in last year's stability programme were revised to 6.5% and 5.8% of GDP respectively, in the 2014 Draft Budgetary Plan presented in October 2013.

restraint. The expenditure-to-GDP ratio (net of bank recapitalisation costs in 2013) is projected to fall by 4.2 pp. between 2013 and 2017 while the revenue-to-GDP ratio is expected to increase by 1.3 pp. The planned expenditure savings mainly falls in the areas of compensation of employees and social transfers and less in intermediate consumption and other current expenditure. On the revenue side, higher revenue from both direct and indirect taxes, including due to measures in environmental taxation, is expected to more than offset a fall in social security contributions. The central government would reduce its deficit by 3.7 pp. between 2013 and 2017, the regional governments by 1.5 pp., and social security by 1.2 pp. The local government budgets are planned to be in balance from 2014 onwards.

**Concrete measures to support the headline deficit targets from 2015 onwards are not yet sufficiently specified, especially regarding the changes to tax legislation within the framework of the planned tax reform** (see Box 1). For 2015, the stability programme foresees the headline deficit to narrow by 1.3 pp., with decreasing expenditure contributing 1 pp. and a further 0.3 pp. stemming from higher revenues, primarily higher indirect taxes. The projection is based on consolidation measures with an incremental budgetary impact of only 0.97 % of GDP, of which 0.82 % on the expenditure side and 0.15 % on the revenue side. The programme does not clearly specify to what extent these measures have already been adopted or are to be adopted. However, the fact that the programme foresees a net consolidation effect of revenue measures of 0.15 % of GDP seems to indicate that those temporary revenue measures taken in previous years that were due to expire by the end of 2014 will either be extended, made permanent or replaced by other measures, including (still to be specified) revenue measures at regional level. According to the programme, a gradual reform of the tax system from 2015 onwards will be adopted based on the report of the committee of experts already presented in March, although concrete details on the planned measures and their estimated budgetary impact are not provided. On the expenditure side, the main discretionary measures with an incremental impact in 2015 are the continued freeze in public sector hiring, unspecified savings at regional level and savings under the public and local administration reform. The main consolidation efforts for 2016 presented in the programme concern planned savings at regional level and further savings from the public and local administration reform. For 2017 the programme does not specify any measures to underpin the envisaged further reduction in the deficit.

**Risks to the deficit adjustment path presented in the stability programme are tilted to the downside.** In particular, while the macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible for 2014, the budgetary targets for 2015 and beyond rely significantly on the underlying scenario of accelerating GDP growth. There is uncertainty regarding the revenue projections from 2015 onwards, as the source of additional regional revenues and the changes to the tax legislation in the framework of the planned tax reform are not sufficiently specified. The yield of planned savings from the local government reform and at the regional level is still uncertain and subject to significant implementation risks, which could be further heightened by the upcoming elections in 2015. Moreover, maintaining the public sector pay and hiring freeze may prove increasingly difficult the longer it has been in place. Other risks to the budgetary strategy are larger deficits in the social security system if employment growth falls short of expectations. Finally, contingent liabilities linked with asset protection schemes (guarantees) for financial institutions, the electricity tariff deficit and the financial health of toll road companies are significant.

**Although Spain plans to meet the headline EDP targets recommended by the Council in June 2013, the planned fiscal efforts falls short of the Council's recommendations.** After marginally missing the headline deficit target in 2013 (excluding the costs for bank recapitalisations within the framework of the financial sector programme) the headline deficit

target for 2014 (5.5 % of GDP) is more ambitious than the EDP target of 5.8 % of GDP while for 2015 and 2016 the programme targets are set in line with the EDP targets of 4.2 % and 2.8 % of GDP, respectively. However, in terms of the structural balance, the programme foresees an improvement in the (recalculated) structural deficit of 0.7 % of GDP in 2014, 0.2 % of GDP in 2015, 0.5 % of GDP in 2016 and 0.7 % of GDP in 2017. For 2014, the programme assumes deficit increasing one-off measures of 0.2 % of GDP related to the introduction of a temporary flat social security rate on new permanent employment contracts and to the European Court of Justice decision on illegally levied special taxes, '*centimo sanitario*', whereas in the Commission 2014 spring forecast only the latter measure is considered as a one-off measure to be excluded from the structural balance. Overall, the annual improvement in the structural balance falls below the structural effort recommended by the Council (see Box 2). For 2017, after the planned correction of the excessive deficit, the programme foresees adequate progress in structural terms, by 0.7 pp., towards achieving the MTO, which based on the (recalculated) structural balance, would not be reached within the programme period.

**In the Commission 2014 spring forecast, the general government deficit is forecast to decrease to 5.6 % of GDP in 2014, over-achieving the EDP target, and to rebound again to 6.1 % of GDP in 2015 (based a no-policy change assumption), above the EDP target.** While the improvement in the structural balance for 2013 is 0.2 pp. above the effort in the EDP recommendation, the cumulative change in the structural balance over 2013 and 2014 falls somewhat (0.2 pp.) short of the EDP recommended value. When corrected for revisions in potential output growth and for unexpected revenue windfalls/shortfalls, the cumulative change in the structural balance for 2013-14 falls short by 1.1 pp. of the recommended adjustment (although this figure is inflated by recent changes in the methodology for the estimation of potential output).<sup>7</sup> Over the same period, the fiscal efforts calculated according to the bottom-up methodology, which estimates the size of the additional effort on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the Commission's 2014 spring forecast, fall short by 0.4 pp. compared to the amount of measures estimated as necessary at the time of the EDP recommendation. For 2015, the structural deficit is projected to deteriorate by 1.1 pp. to 3.4 % of GDP based on a no-policy change assumption, in contrast to the programme which projects the structural deficit to improve by 0.2 pp. The no-policy-change assumption in the Commission's forecast implies among others that a sizeable amount of revenue measures of about 1.2 % of GDP, which were announced as temporary before the cut-off date of the forecast, are projected to expire in 2015, which significantly contributes to the deterioration in the deficit.<sup>8</sup>

**The general government debt-to-GDP ratio has been on a steep upward path since reaching a low of about 36 % of GDP in 2007.** In 2013, it rose further to almost 94 % of GDP. The debt ratio is projected to continue to increase over the programme period, peaking at close to 102 % in 2015, well above the Treaty reference value in all years. This increase in debt is mainly driven by high interest payments and to a lesser extent by the dynamics in the primary deficit, which is expected to turn into a surplus in 2016. According to the programme, the stock-flow adjustment contributes 1.7 pp. in 2014 and one additional percentage point

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<sup>7</sup> In the case of Spain, a significant part (estimated at about 0.3 pp. annually) of the difference between the uncorrected and corrected structural balance stems from methodological changes to the estimation of the NAWRU, which result in an upward revision in the potential growth estimates for 2013 and 2014 and associated slower closure of the output gap.

<sup>8</sup> The current stability programme was submitted on 30 April 2014 after the cut-off date of the Commission 2014 spring forecast which was 24 April and, therefore, the information provided in the programme was not taken into account in the Commission's forecast.

accumulated over 2015-17. The trend in the debt ratio may be more unfavourable than projected in the programme if risks related to the budgetary targets materialise.

**The stability programme foresees most of the consolidation over the 2013-17 period to take place on the expenditure side.** While this is consistent with keeping tax pressure low, it also calls for reviewing systematically expenditure at all government levels to identify areas where savings could be made and to ensure that these are generated in a growth-friendly way while catering for the needs of the most vulnerable. Key categories of spending have been reviewed recently on occasion of the health, education and public administration reforms, the implementation of which is ongoing. Looking forward, reviews could be extended to areas such as spending on active labour market policies, for instance to re-assess the efficiency and efficacy of current hiring subsidies (see section 3.3). Additional reviews on public administration spending could also take place, especially at sub-central government level.

<b>Box 1. Main measures</b>	
<p>After relying on a number of tax increases in 2012-14, such as personal and corporate income taxes, VAT and environmental taxes, the measures presented in the programme are more clearly tilted towards the expenditure side in the latter years of the programme. Notably, the programme relies on a continuation of the hiring freeze, deceleration of social transfers as a result of the pension indexation reform, and continued expenditure restraint at regional and local government level. The reform of local government and other savings at local level are expected to yield increasing savings, reaching 0.6% of GDP over 2015-2016. The table only includes measures that have been specified in sufficient detail. In addition, for the years 2015-2016, the programme also refers to a number of other unspecified measures, in particular on the revenue side.</p>	
<b>Main budgetary measures</b>	
<b>Revenue</b>	<b>Expenditure</b>
<b>2013</b>	
<ul style="list-style-type: none"> <li>• Income tax and taxes on non-residents (0.2 % of GDP)</li> <li>• Excise taxes and environmental taxes (0.3 % of GDP)</li> <li>• VAT (0.8 % of GDP)</li> <li>• Revenue measures at regional level (0.2 % of GDP)</li> <li>• Social contributions (0.2 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Christmas bonus reintroduction (-0.5 % of GDP)</li> <li>• Public employment (0.3 % of GDP)</li> <li>• Labour market policies (0.3 % of GDP)</li> <li>• Long-term care (0.1 % of GDP)</li> <li>• Regional measures, excl. public employment measures (0.7 % of GDP)</li> <li>• Local government reform and adjustment plans (0.1 % of GDP)</li> <li>• Other, incl. CORA (0.4 % of GDP)</li> </ul>
<b>2014</b>	
<ul style="list-style-type: none"> <li>• Corporate income tax (0.2 % of GDP)</li> <li>• Measures combatting fraud (0.1 % of GDP)</li> <li>• Revenue measures at regional level (0.3 % of GDP)</li> <li>• Environmental taxes (0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Public employment (0.2 % of GDP)</li> <li>• Labour market policies (0.1% of GDP)</li> <li>• Regional measures, excl. public employment measures (0.1 % of GDP)</li> <li>• Local government reform and adjustment plans (0.1 % of GDP)</li> </ul>

<ul style="list-style-type: none"> <li>• Social security (0.1% of GDP)</li> <li>• Local government measures (0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Social security (0.1 % of GDP)</li> </ul>
<b>2015</b>	
	<ul style="list-style-type: none"> <li>• Public employment (0.1 % of GDP)</li> <li>• Local government reform and adjustment plans (0.4 % of GDP)</li> <li>• Social security (0.1 % of GDP)</li> </ul>
<b>2016</b>	
	<ul style="list-style-type: none"> <li>• Public employment (0.1 % of GDP)</li> <li>• Local government reform and adjustment plans (0.3 % of GDP)</li> <li>• Social security (0.1 % of GDP)</li> </ul>
<p><u>Note:</u> The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A plus sign implies that revenue increases or expenditure decreases as a consequence of this measure.</p>	
<p>Macro-structural measures presented in the programme include, among others, measures on labour markets, insolvency procedures, regulation of electricity prices, local governments and to increase competition in railway and air transport (see Section 3.3). The aim of the measures is to improve the working of the labour market in order to reduce the high level of unemployment, sustain the deleveraging in the private sector, and boost competition.</p>	

## **Box 2. Excessive deficit procedure for Spain**

Spain is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the excessive deficit procedure for Spain on 27 April 2009, in accordance with Article 104(6) TEC. On 21 June 2013, the Council issued its most recent recommendation to correct the excessive deficit by 2016 in accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure.

To this end, the Council recommended that Spain should reach a headline deficit 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 is 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's 2013 spring forecast extended to 2016. Spain was also recommended to (a) implement the measures adopted in the 2013 budget plans at all levels of government and stand ready to take corrective action in case of deviations from budgetary plans; (b) reinforce the medium-term budgetary strategy with well-specified structural measures for the years 2014-16 that are necessary to achieve the correction of the excessive deficit by 2016; (c) 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 EU fiscal rules; (d) undertake concrete steps to rein in the increasing structural deficit in the social security system, and (e) give a greater emphasis to the growth friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system. In addition, to ensure the success of the fiscal consolidation strategy, the Council highlighted the importance of backing the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Spain in the context of the European Semester and the Macroeconomic Imbalances Procedure.

On 15 November 2013, the Commission concluded that, based on its 2013 Autumn Forecast, for 2013 Spain had taken effective action in compliance with the revised Council recommendation of 21 June 2013, provided that risks to the budgetary targets were dispelled. As regards 2014, the assessment pointed to risks of non-compliance. For 2015 and 2016, the budgetary adjustment still fell far short of the recommendation.

The year following the correction of the excessive deficit, Spain will be subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. As the debt ratio in 2016 is projected in the programme at 101.5% of GDP, exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit Spain will also be subject to the transitional arrangements as regards compliance with the debt criterion, during which it should ensure sufficient progress towards compliance.

An overview of the current state of excessive deficit procedures is available on: [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/deficit/countries/spain\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/spain_en.htm).

## *Fiscal framework*

**In 2013, the transparency of budget execution improved considerably.** This followed the publication of more systematic and higher-frequency regional and local government budgetary data, both in terms of cash and national accounts.<sup>9</sup> In addition, the Ministry of Finance issued detailed and comprehensive evaluation reports of regions' economic and financial plans. It has also requested regions at risk of non-compliance with the 2013 target to adopt corrective measures, and the content of these measures was disclosed for the first time. Specifically, in November 2013, Andalusia, Catalonia, Valencia and Murcia were required to take additional measures in order to reach their 2013 fiscal target. However, the full range of the enforcement mechanisms set out in Spain's budget stability organic law for non-compliant regions has not been fully utilised so far. Regional governments failed to meet the 2013 fiscal deficit target of 1.3% of regional GDP by a relatively small margin, but the overall budgetary outcome masks differences among them.

**Spain's independent fiscal institution (*Autoridad independiente de responsabilidad fiscal* or AIREF) was created in law in November 2013, its president appointed in February 2014 and its statutes published on 30 March 2014.** AIREF has an initial budget of around EUR 4 million for 2014. While the launch of the independent fiscal institution is welcome, it is coming after the 31 October 2013 deadline set out in EU law to have such monitoring institutions in place and too late for AIREF to be able to assess the 2014 stability programme. In line with the law, the AIREF will have to issue reports and opinions, including endorsing macroeconomic forecasts, and produce studies (resources permitting) upon the request of specific administrative bodies. The independence of the AIREF and its president is protected by several articles of the law, although this could have been further underpinned with regard to its administrative location (currently attached to the Ministry of Finance, instead of, for example, the Spanish Parliament or the Ministry of the Presidency as suggested by the Spanish Council of State).<sup>10</sup>

**Measures have been taken to reduce public-sector commercial arrears.**<sup>11</sup> Information available shows that Spain's public sector has relatively high payment duration (155 days in 2013, well above the EU average of 65 days, with only limited progress over time).<sup>12</sup> In particular, Organic Law 9/2013 on the control of the public sector's commercial debt aims to enforce an average payment period to commercial suppliers of 30 days across all general government levels. This is to be done by periodically publishing payment periods for each administrative body (this obligation had been followed up partially at the cut-off date of this report, as the implementing legislation had not been issued) and by strengthening the powers of the Ministry of Finance to enforce correction mechanisms and impose penalties on non-compliant administrations. These provisions follow the repayment of large public sector arrears deriving from regions and local entities' commercial debt: EUR 41.8 billion have been paid since 2012 through the three stages of the Suppliers' Payment Scheme. The new provisions can create incentives at all government levels to speed up payments to commercial

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<sup>9</sup> According to the 2014 NRP, during 2014, all budgetary and economic data on Spain's public administration will be centralised on the Ministry of Finance's new economic and financial database.

<sup>10</sup> See Council of State's opinion # 606/2013 on the draft law providing for the creation of an independent fiscal institution in Spain. [http://www.boe.es/buscar/doc.php?coleccion=consejo\\_estado&id=2013-606](http://www.boe.es/buscar/doc.php?coleccion=consejo_estado&id=2013-606)

<sup>11</sup> See Organic Law 9/2013 of 20 December, on the control of public sector commercial debt.

<sup>12</sup> 2013 Report by Intrum Justitia. Liquidity constraints associated with late payments by the public sector may contribute to put firms out of business. See European Economy – Economic Papers: The economic effects of late payments, European Commission, May 2014.

suppliers. However, reducing the payment period of Spain's administrative bodies to an average of 30 days is a challenge, in particular, at sub-central government level.

### *Long-term sustainability*

**Amongst the 2013 country-specific recommendations for Spain were the need to improve the long-term sustainability of the pension system and to increase the cost-effectiveness of the health-care sector, while maintaining accessibility for vulnerable groups.** The analysis in this SWD leads to the conclusion that Spain has made substantial progress on some aspects, and some progress on others (for the full CSR assessment see the overview table in Section 4).

**Spain appears to face high fiscal sustainability risks in the medium-term, primarily related to high level of government debt.** Government debt (93.9 % of GDP in 2013 and projected to rise to 103.8 % in 2015 in the Commission's spring 2014 forecast under a no-policy change assumption) is currently well above the 60 % of GDP Treaty threshold. While the debt ratio is projected to fall by 2030, it would remain above 60 %. However, the full implementation of the plans in the stability programme would put debt on a decreasing path and it would fall below the 60 % of GDP reference value by 2030. The medium-term sustainability gap, showing the adjustment effort up to 2020 required in the structural primary balance to bring debt ratios to 60 % of GDP in 2030, is at 2.6 % of GDP, relative to the 2015 primary balance in the Commission 2014 spring forecast. In the long-term, Spain appears to face low fiscal sustainability risks: the long-term sustainability gap, showing the adjustment effort in the structural primary balance needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 0.3 % of GDP. As a result of the recent pension reforms, the costs of ageing<sup>13</sup> (as a ratio to GDP) are projected to decrease by 1 pp. of GDP over the very long run, almost offsetting the impact of the initial budgetary position on the long-term sustainability. However, the contribution from health care expenditure is relatively large (the projected increase in expenditure is 1.2 pp). There is also a risk that the structural primary balance reverts to lower values observed in the past (e.g. the average for the period 2004-2013). It is therefore appropriate for Spain to reduce government debt and further contain age-related expenditure growth to contribute to the sustainability of public finances in the long term.

**An important reform of the pension system was approved on 23 December 2013.** Law 23/2013 revising pension indexation and regulating the pension sustainability factor complements the 2011 pension reforms and the measures to reduce access to early and partial retirement that were adopted in March 2013. The law changes the annual indexation of pensions as of 2014, by linking it to the financial balance of the system, with minimum (0.25 % in nominal terms) and maximum (0.5 % in real terms) thresholds. At the end of December, based on the new law, the government adopted a nominal indexation of pensions by 0.25 % for 2014. From 2019, the law also introduces the automatic adjustment of future retirees' new pensions to take account of changes in life expectancy. The reform will help to contain long-term pressure on pension expenditure. According to the latest projections, public pension expenditure in Spain will decline from 10 % of GDP in 2010 to 9.6 % in 2060, compared with a projected 13.7 % of GDP in 2060 before the reform. However, the sustainability factor formula does not link the statutory retirement age to life expectancy, heightening the challenge of pension adequacy for lower pensions.<sup>14</sup> High levels of inactivity, lengthy unemployment periods and gender disparities in employment and contributory

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<sup>13</sup> Ageing costs comprise long-term projections of public age-related expenditure on pension, health care, long-term care, education and unemployment benefits. See the 2012 Ageing Report for details.

<sup>14</sup> The replacement ratio at retirement is projected to drop sharply from 72.4 % to 52.1 % by 2030 (44.9 % by 2060).

periods may have a negative impact on future benefits. Minimum contribution periods for pensions were adjusted for part-time workers (who are mainly women), following a ruling of the European Court of Justice.

**A comprehensive regulatory framework has been developed since 2012 to increase the efficiency and control of health-care expenditure.** This includes: reviewing the services covered; introducing co-payments for some services; changing the reference pricing for pharmaceuticals; building a centralised purchasing platform for buying medicines, medical devices or services; developing digital clinical records and electronic prescriptions; and, preparing for the introduction of clinical management where physicians have more responsibility for their budgets in health establishments. A system of pharmaceutical expenditure control in hospitals has also been designed. The measures that have already been implemented have helped to reduce expenditure and to increase cost-effectiveness. While full implementation of the measures adopted continues, the impact of recent reforms will need to be monitored and evaluated to prevent unwarranted effects. As the system moved from a universal health system to a coverage approach, the number of complaints about restrictions on access grew. In addition, an increase in waiting lists has been noted, despite initiatives to guarantee accessibility for vulnerable groups. Measures to improve coordination of health and social services are also being developed to make the healthcare model more efficient in the long-term.

**The long-term care system has faced significant challenges.** The reduction in central budget contributions to financing the long-term care system has halted the gradual roll-out of the system and reduced the numbers of current and future beneficiaries. Spain is among the Member States with the highest proportion of informal carers, and care needs are likely to increase further due to the ageing population. As institutional care is considerably more expensive than home care, it seems sensible to find strategies to formalise support for informal carers, including by improving the quality of home- and community-based services.

### *Tax system*

**In 2013, Spain was recommended to review and reform its tax system in order to raise revenue in a way that is growth-friendly, contributes to employment and improves tax compliance.** Overall, the analysis in this SWD leads to the conclusion that Spain has made some progress to design the measures to be taken addressing this recommendation (for the full CSR assessment see the overview table in Section 4). The crisis revealed significant shortcomings in the Spanish tax system, adversely affecting economic efficiency and fiscal performance. The bursting of the construction and housing bubble and the ensuing recession led to a significant erosion of tax bases in Spain. In 2012, the tax-to-GDP ratio in Spain reached 32.5 %, much below the EU-28 average of 39.4 %, and below the national average over the last decade (33.9 %). Thanks to a number of discretionary tax increases and a stabilisation of output, the ratio bottomed out in 2013.

**In response to last year's country-specific recommendation to undertake a systematic review of the tax system by March 2014,** the government appointed an expert committee last July. On 13 March, it delivered its report (see Box 3), which focuses on simplifying the tax system and increasing its efficiency, *inter alia*, by lowering the relatively high statutory tax rates while broadening the tax bases, and suggests a revenue-neutral tax shift away from direct taxes towards indirect taxes. However, the committee's report lacks detail on the quantitative impact of specific measures and their effect on income distribution, making their relative importance difficult to assess. Following this report, the NRP undertakes the commitment to present a tax system reform by the second quarter of 2014. Its main objectives will be: modernizing the tax system, addressing its disincentives to employment – reducing

the tax wedge - and the low tax revenues, fostering economic development, guaranteeing market unity and tax neutrality and improving competitiveness.

### **Box 3. Report from the committee of experts on the reform of the Spanish tax system**

**The general direction of the proposals is to broaden tax bases to allow for a lowering of nominal and marginal tax rates and to move the burden of taxation away from direct taxation towards indirect taxation.** The committee, led by Prof. Manuel Lagares, preferred not to enter into a discussion on the optimal level of taxation and thus worked under the assumption of constant overall tax revenues in percent of GDP in the coming years. The experts also recommend actions to combat tax fraud and preserve market unity. These principles have guided the committee to make the following main recommendations:

**Personal income tax:** Maintain the dual system of a standard base and a savings base, but reduce progressivity in the taxation of the former and reduce the number of tax brackets. Tax the savings base at a single rate close to its current lowest rate. Broaden the tax base by eliminating or reducing exemptions and deductions.

**Corporate income tax:** Allow a gradual lowering of the nominal tax rate from 30% to 20% by eliminating deductions, so that the effective and legal tax rates converge. Eliminate the differentiation of tax rates according to firm size to improve incentives for firms to grow.

**Value added tax:** Raise the super-reduced and reduced rates to the general rate of 21% in the long run, but with the following exceptions and provisos: a) Only increase the super-reduced rate if compensatory benefits to those with the lowest incomes are introduced simultaneously; b) only consider bringing tourist services to the general rate if combined with a substantial reduction in social security contributions; c) do not raise the VAT rate for housing to the general rate for the time being, as it would complicate the unwinding of the significant stock of unsold houses in Spain; d) maintain the reduced rate for public transport services, given their positive environmental effects. To reduce fraud, eliminate the special retailers' regime and the simplified VAT regime.

**Excise duties and environmental taxes:** Periodically revise excise duties on alcohol and tobacco to maintain their weight on the consumer price and to gradually bring them in line with those in the rest of Europe. In environmental taxation, tax separately the carbon dioxide and energy content of products to ensure the neutrality of the tax system between various energy sources. To this effect, bring the tax on diesel fuel into line with that on petrol and change the rate and eliminate exemptions from the coal tax. Replace the tax on the invoiced amount of electricity sales with one based on kW/h consumed to encourage energy efficiency. Eliminate certain allegedly environmental taxes at regional level that hamper market functioning or simply do not achieve their purpose and replace them with national level taxes.

**Social contributions:** Eliminate non-discriminatory rebates in favour of more targeted rebates directed at particularly underprivileged groups that cannot be reached by other more efficient means.

**Combating tax fraud:** Implement the recommended reductions in tax rates to reduce incentives for fraud. Provide sufficient resources to tax authorities to enable them to fight fraud, notably through large-scale and coordinated processing of information.

**Decentralised taxation:** Given the relatively high level of decentralisation of revenue in Spain, the report puts forward key principles to avoid that decentralisation hamper the unity of

the internal Spanish market and economic neutrality. To this end, a mechanism of *ex ante* coordination for regional governments' taxation is also proposed.

**There remains scope to increase consumption taxes and improve their efficiency by broadening the VAT base.** In 2012, VAT rates were raised and the base of the reduced rate was narrowed. However, in January 2014, it was decided that imports and certain transactions regarding art, antiques and collectibles should be moved from the standard to the reduced rate. Excise taxes (levied at lump-sum rates) on alcohol and alcoholic drinks were increased, as of June 2013, by approximately 10 %, although this does not apply to beer or wine. Tobacco excise duties were also increased. Despite these increases, overall progress appears limited. The NRP does not foresee further measures to broaden the standard VAT rate base. Certain measures taken to foster entrepreneurial activity (such as the VAT special cash accounting scheme) are announced to remain in place.

**Revenues from environmental taxes, expressed as a percentage of GDP, remained among the lowest in the EU in 2012, with low revenues from energy and transport fuel taxes.** Following the package of taxes that entered into force on 1 January 2013, further progress includes a new tax on fluorinated greenhouse gases, applicable from 1 January 2014 and which according to the NRP should yield 400 million euros in 2014. No progress, however, seems to have been done on fuel taxes, expressly mentioned in the 2013 country-specific recommendations, and where there is scope to address the preferential treatment of diesel compared with petrol. The expert committee's report contains a number of proposals in this area which aim to rationalise and increase the weight of excise duties and environmental taxation. The NRP refers to further studies to increase environmental taxation while minimising the impact on competitiveness. The NRP also refers to certain progress made in this area at regional level, since several regions have created new environmental taxes or have increased the rates of existing environmental taxes.

**Limited progress has been made on reducing high tax expenditure in direct taxation, as proposed in the 2013 CSR.** There is scope to downscale tax expenditures by assessing their effectiveness and likelihood of achieving their goals. Despite the restriction in some deductions – depreciation rates, value depreciation of shares and financial goodwill, loss offsetting, recent trends show that new discretionary measures were created or extended. Altogether, tax expenditures set out in the 2014 budget amounted to around 2 % of GDP. In this respect, the expert committee also recommended eliminating exemptions and deductions, while lowering headline tax rates.

**In line with the 2013 CSRs, new measures to address the debt bias in corporate taxation were introduced, but with likely only indirect effects.** The measures adopted in 2013 include deductions for reinvested profits and for shares acquired in newly set up companies. However, these measures may only indirectly limit the debt bias and their effectiveness will have to be monitored over time, also as there are . It is difficult at this stage to ascertain whether and to what extent the measures adopted since 2012 might have contributed to the ongoing deleveraging in the corporate sector

**Property taxation is still to a large extent transaction-based.** Although revenues from recurrent property taxes increased in 2012 to 1.2 % of GDP, property transaction taxes still account for a large proportion of property taxation. To ensure a more stable tax base and in order not to hamper labour market mobility, property taxation could be further shifted towards recurrent taxes, as the NRP proposes to analyse further.

**A shift from taxes on labour to mainly indirect taxes could play a role in addressing Spain's unemployment challenges, although it is not a panacea as other structural**

**factors mostly explain the labour market outcome.**<sup>15</sup> Spanish labour tax rates are not high in comparison with other EU countries: the implicit tax rate on labour (33.5 %) and the proportion of an individual total wage paid as tax (37 %) are below the EU average. The announcement of the NRP to increase the exemption of labour income earners with income below EUR 12.000 should contribute to reduce the tax wedge of the low-skilled. While employees' social security contributions are relatively low, employers contributions are relatively high (8.4 % of GDP in 2012, accounting for 25.8 % of total taxation — the fourth highest value in the EU — and 70 % of the total contributions). Focusing cuts on employer's social security contributions (in particular for low-wage earners) may thus have a more immediate impact on employment than reducing the personal income tax rate. In 2013, Spain introduced reductions in social security contributions for hiring young people and in February 2014, the government also introduced a temporary low flat-rate social security contribution for new permanent contracts, in order to support employment and improve incentives to leave the informal sector (see also section 3.3 on the labour market). This measure increases incentives to hire permanent staff during the period of validity (until the end of 2014). There is a risk, however, that it may carry a non-negligible fiscal cost relative to its impact on net employment creation.

**In the fight against fraud, Spain has made efforts to tackle aggressive tax planning and organized crime, control electronic commerce and online gambling and extend its network of international agreements to exchange information relevant for tax assessments.** The returns from auditing and control activities and the improvement of the tax assessment yield about EUR 11 billion according to the NRP. The new reporting obligations regarding assets held abroad affected 131 000 taxpayers, who reported assets valued at EUR 87 billion. In 2014 a special plan to combat grey economy has been launched, which will provide for an increase of the staff's working hours to run e-audits. Spain also launched a project with private companies to study potential improvements in managing the benefits system. Still, the Spanish tax administration neither estimates nor monitors the tax gap. As the ceiling for cash payments – EUR 2 500 – is higher than in other Member States with similar challenges,<sup>16</sup> there seems to be scope to expand the use of electronic payments - a useful measure to reduce the underground economy. The implementation of the 2012-2014 national plan against irregular work and social security fraud continued, including strengthened monitoring and checks to combat sham companies, irregular employment and social security fraud, and undue benefit collection.<sup>17</sup> The intensification of social security checks resulted in a reported 30.6 % increase in identified infringements by employers who employed recipients of unemployment benefits or provided access to such benefits without cause, and a 28.9 % increase in identifying the illegal combination of unemployment benefit receipt and work.<sup>18</sup> As recommended by the experts' committee, Spain could also usefully consider – among other measures – expanding the use of data matching to detect tax evasion and fraud.<sup>19</sup>

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<sup>15</sup> See ECFIN country focus 'Assessing the impact of a revenue-neutral tax shift away from labour income in Spain', volume 11, issue 5, April 2014: [http://ec.europa.eu/economy\\_finance/publications/country\\_focus/2014/pdf/cf\\_vol11\\_issue5\\_en.pdf](http://ec.europa.eu/economy_finance/publications/country_focus/2014/pdf/cf_vol11_issue5_en.pdf), and references therein.

<sup>16</sup> For instance, the limit is set to EUR 1 000 in Italy and EUR 1 500 in Greece.

<sup>17</sup> According to official reports, 64 000 companies were closed, 130 500 irregular jobs were identified, and an estimated EU 3.2 billion savings were achieved between 2012 and mid-2013 as a result of checks on compliance with unemployment regulations.

<sup>18</sup> Unemployment benefits were withdrawn from around 60 000 beneficiaries (14.8 % more than in 2012, representing EUR 0.9 billion savings), due to non-compliance with access and maintenance requirements.

<sup>19</sup> See in particular recommendations 113 and 114.

#### **Box 4: Conclusions from the March 2014 in-depth review on Spain**

The third in-depth review (IDR) on Spain under the Macroeconomic Imbalances Procedure was published on 5 March 2014.<sup>20</sup> On the basis of the IDR, the Commission has concluded that Spain is experiencing macroeconomic imbalances which require specific monitoring and decisive policy action. In several aspects, the adjustment of the imbalances identified last year as excessive has clearly progressed and the return to positive growth has reduced risks. However, the magnitude and inter-related nature of the imbalances, in particular high domestic and external debt levels, mean that risks are still present. The main conclusions of the IDR, many elements of which are taken up and further developed in this staff working document, can be summarised as follows:

- The adjustment has been supported by decisive policy actions at the EU level and at national level. In particular, the recapitalisation and restructuring of weaker banks has dispelled systemic concerns about the financial sector and allowed a smooth conclusion to the financial assistance programme at the beginning of 2014. The current account has turned into surplus, as a result of import compression and strong exports, supported by competitiveness gains. The housing market has nearly stabilised. The pace of job losses appears to be coming to an end. The comprehensive agenda of structural reforms outlined in the 2013 national reform programme has been mostly completed, and attention is shifting to a challenging implementation phase. These positive developments have led to a strong return of confidence, shown by the fall in market risk premiums, the return of foreign capital inflows and the rise in business and consumer confidence.

- However, the adjustment is far from complete and vulnerabilities persist: the very high stock of private and public debt, both domestic and external, continues to pose risks for growth and financial stability; unemployment remains at alarming levels; maintaining the re-orientation of the system of production towards exporting sectors and recovery in international competitiveness is key to reducing the very large stock of external liabilities; the adjustment of private-sector balance sheets is advancing, although at a limited pace due to high unemployment and falling incomes, while non-financial corporations have reduced debt at a somewhat more sustained pace.

The IDR also discusses the policy challenges stemming from these imbalances and the possible ways to address these. A notable challenge will be ensuring that deleveraging goes hand-in-hand with positive credit flows to financially healthy borrowers, including by removing hindrances to the functioning of the product and financial markets and efficient insolvency procedures. Building on recent reforms to internal flexibility and wage setting, additional reforms could be envisaged to the labour market. Future reform of the tax system, still to be developed, could help make the tax system more growth-friendly and make tax revenues less volatile. Finally, significant revenue shortfalls, higher social expenditure and the costs of bank recapitalisation have led to substantial pressure on government deficits and a steep rise in government debt. Sustained fiscal efforts will be required to ensure a reduction in government debt in the medium term.

### **3.2. Financial sector**

**Spain has successfully concluded the financial sector programme for the recapitalisation of its financial institutions.** The 2013 CSR on implementing the financial sector programme in Spain has been fully addressed, and the conditionality included in the Memorandum of

<sup>20</sup>[http://ec.europa.eu/economy\\_finance/economic\\_governance/macroeconomic\\_imbalance\\_procedure/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/index_en.htm)

Understanding has been met, as confirmed by the final programme review in December 2013.<sup>21</sup> The programme contributed to improving the solvency and liquidity position of Spanish banks and to a strengthening of financial sector governance and regulatory and supervisory procedures. In particular, European Banking Authority core tier 1 ("capital principal") reached 11.5 % at the end of 2013. In addition, banks are shifting towards more stable funding sources like retail deposits, and thus reducing their reliance on the Eurosystem and on wholesale markets.

**However, the financial sector still faces with significant challenges and risks that need to be carefully monitored and managed.** Despite recent improvements, the broader economic environment has continued to weigh on the banking sector. The profitability of the banking sector will be subject to pressures stemming from asset quality developments and lower volumes of intermediation. In particular, high unemployment and the ongoing housing market adjustment have continued to put strains on asset quality. Non-performing loans have been on an upward trend until December 2013, when they reached 13.6 % of total loans, but have since then mildly declined to 13.4 % in March 2014.<sup>22</sup> The coverage ratio of non-performing loans is comfortable. Credit contraction has been the main channel of private-sector deleveraging, with bank lending on a declining path since 2007. Recent data shows some deceleration in this contraction and new credit to non-financial companies has started growing again.

**Spain is expected to ensure the full implementation of the policy measures initiated under the Memorandum of Understanding and to make further progress in stabilising the banking sector.** These include, in particular, completing the reform of the saving banks sector, implementing measures to improve non-bank financial intermediation, completing banks' restructuring plans and continued monitoring of Sareb's activity.<sup>23</sup>

**It is important to ensure that credit continues to flow to viable sectors of the economy, as the deleveraging of the corporate sector continues.** In spite of the improvements in the liquidity and financing of the financial sector, credit conditions for smaller borrowers are being eased only slowly and remain relatively onerous (although the latest data, such as the Bank Lending Survey for the first quarter of 2014 and the April 2014 ECB survey of SME, show a more marked relaxation of lending conditions for SMEs). Going forward, banks faced with a historically high level of non-performing loans may have become structurally more prudent in their lending and SMEs may be disproportionately affected by the ongoing bank restructuring, through weakened or broken long-term lender/borrower relations. Specifically, inadequate access to finance for fast-growing firms operating in innovative and knowledge-intensive sectors may hamper the creation and development of start-ups and technology-based SMEs, both critical for spurring long-term growth.

**Spain has taken policy actions to ease SMEs access to finance.** Access to non-bank finance is being improved, with the development of alternative capital and debt markets and venture capital. The first tender for allocating investment commitments in the venture and development capital funds of ICO<sup>24</sup> *Fondo Global* was awarded and three other tenders are

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<sup>21</sup> The Commission and ECB press release is available at: [http://europa.eu/rapid/press-release\\_MEMO-13-1153\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-1153_en.htm). See also Winter 2014 Review Report for more in-depth discussion.

<sup>22</sup> The increase in the non-performing loan ratio in 2013 was driven by the higher stock of impaired assets but also, increasingly, by the denominator effect, i.e. shrinking total loan portfolio as well as by the reclassification exercise of the restructured loans portfolio performed by banks on guidance from Banco de España.

<sup>23</sup> Sareb (*Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria*) was created in the context of the financial assistance programme to manage real estate and development assets transferred by the Spanish financial institutions, which benefitted from state aid.

<sup>24</sup> *Instituto de Crédito Oficial*.

planned for 2014. The alternative bond market for SMEs (MARF)<sup>25</sup> has become operational and the first issuance on this market took place in December 2013, while several others are in the pipeline. The volume of the ICO's on-lending programme for SMEs via commercial banks has increased significantly, to EUR 13.8 billion in 2013, and its funding rates to banks continued to decline, supported by funding deals with KfW and the European Investment Bank. A broad-based legislative package, which is currently being finalised, aims to facilitate access to finance for SMEs and other non-financial corporations by, *inter alia*, improving (i) access to financial information (banks are required to give prior notice and disclose their internal creditworthiness assessment of a company before restricting or cancelling its access to financing); (ii) the CERSA (*Compañía española de reafianzamiento, S.A.*) regime of mutual guarantees; (iii) the arrangements for securitisation; and (iv) the two-way transit between the traditional and the alternative stock markets. Further policy actions could be considered to improve the efficiency of the existing instruments and the allocation of the available resources, taking into account the possibilities offered by increased use of the European structural and investment funds to set up revolving funds. Facilitating companies' access to debt and equity markets and developing venture capital instruments should broaden the set of financial instruments available to Spanish companies in the long run.

**The corporate insolvency framework was reviewed in September 2013 and March 2014, but it is too early to assess the impact of these revisions.** Inefficiencies in personal and corporate insolvency procedures may delay private-sector deleveraging and the re-allocation of resources by impeding swift recognition and work-out of unsustainable private debt or by unnecessarily pushing viable firms into liquidation. Law 14/2013 on entrepreneurship has addressed some of the apparent shortcomings of the insolvency framework for corporations, by introducing a new debt refinancing procedure with the possibility of a partial debt discharge. The law has also created a limited liability company 'in formation' with lower capital requirements and narrowed personal liability of limited liability entrepreneurs. Increasing the efficiency of the pre-insolvency regime was the main focus of Royal Decree-Law 4/2014 of 7 March 2014, which facilitates further negotiation of refinancing agreements to accelerate the deleveraging process. It will be important to monitor the actual take-up of these broader options to gauge their effectiveness, including monitoring their effect on companies of different size. However, provisions giving second chance to entrepreneurs have not yet been fully developed in Spain, as debt discharges are not automatically applied after a certain period of time.<sup>26</sup> Both the pre-insolvency and insolvency proceedings available seem to offer insufficient incentives to their use by SMEs, as they often exclude some categories of creditors, or limit available options under restructuring plans.

**Dealing with the legacy debt of overly indebted individuals could be facilitated by developing a permanent framework for personal insolvency, with due regard for the stability of the financial sector.** Some gradual reforms have been introduced to reduce debt-related distress for residential mortgage debtors, but their scope still seems to be insufficient. The current legal framework does not generally allow for the possibility of debt discharge for financially responsible personal debtors. In May 2013, the Spanish Parliament adopted Law 1/2013 on strengthening protections for mortgage debtors, on debt restructuring and on social housing. The law builds on legal acts adopted in 2012, and has tightened conditions for launching foreclosures.<sup>27</sup> These emergency provisions tried to strike a balance between providing relief to over-indebted insolvent households and preserving financial stability.

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<sup>25</sup> *Mercado Alternativo de Renta Fija*, Alternative Fixed-Income Market

<sup>26</sup> See the Commission Recommendation on a new approach to business failure and insolvency of 12 March 2014, C(2014) 1500 final, available at: [http://ec.europa.eu/justice/civil/files/c\\_2014\\_1500\\_en.pdf](http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf).

<sup>27</sup> In particular, it has extended the application of debt restructurings, provided for a partial debt discharge after foreclosure on primary residences, and established a temporary two-year moratorium on evictions of very vulnerable debtors.

However, according to the available data, their take-up has been limited. A careful evaluation of the effectiveness of these temporary measures (including partial debt discharge) and measures to strengthen consumer protection (i.e. cap on the penalty interest rate) could help defining a medium- and long-term institutional and regulatory framework with due concern for balanced creditor/borrower rights, the stability of the financial sector and overall economic efficiency.

### 3.3. Labour market<sup>28</sup>, education and social policies

**Challenges regarding labour market, education and training, social inclusion and poverty remain considerable, notwithstanding the significant reforms, particularly in the labour market.** Almost 200 000 jobs were lost only in 2013; overall, 3.6 million have been lost since the crisis began. Following the incipient economic recovery and the unfolding effect of the reforms and measures put in place, the labour market is showing signs of stabilisation since the end of last year. The employment rate stopped its decline in the fourth quarter of 2013, and employment is expected to grow in 2014. Unemployment has been decreasing, initially due to a declining labour force, and is projected to continue falling in 2014. Nevertheless, the legacy of long-standing institutional failures in the labour market and of the financial crisis still weighs heavily on employment and social indicators: the employment rate remains well below the national target of 74 % by 2020, and unemployment remains high, particularly for the young people, the low-skilled and migrants. A large proportion of the unemployed has been jobless for more than a year, and is at risk of exclusion from the labour force, particularly those who are over 50. Gender<sup>29</sup> and regional differences in employment persist, further aggravated by a certain lack of adequate and affordable childcare facilities and insufficient geographical mobility. In 2013, wage moderation has come about as a result of the large slack in the labour market, the 2012-2014 inter-confederal agreement, public-sector wage cuts and changes in firms' internal flexibility. The rate of young people not in employment, education or training has remained high in 2013, at 18.6% for people under 25 years, and further increased to 29.5% for those aged between 25 and 29. Early leaving from education and training, although decreasing, remains very high. Vocational education and training and apprenticeship schemes, although rapidly expanding, are still insufficiently used.<sup>30</sup> Tertiary attainment rates remain constant. Finally, in 2012, Spain saw a further increase in the proportion of the population at risk of poverty or social exclusion, as well as the third largest fall in household disposable income in the EU, while income dispersion continued to increase, to one of the highest in the EU.

**In 2013, Spain received country-specific recommendations concerning the labour market, education and training and social inclusion.** The analysis in this SWD leads to the conclusion that Spain has made some progress on measures taken to address the recommendations on labour market and education and training, and on social inclusion. (For the full country-specific recommendations assessment, see the overview table in Section 4). The significance and urgency of the challenges in these fields makes it necessary to go further, in particular by fostering job creation, reducing labour market segmentation, enhancing the matching of education and training with labour market demands, reducing early school leaving, increasing participation in vocational education and training, tackling rising poverty and inequalities, and improving the coordination of institutions and policies in these fields.

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<sup>28</sup> For further details, see the 2014 Joint Employment Report, COM(2013)801, which includes a scoreboard of key employment and social indicators.

<sup>29</sup> The employment rate of women stands at 53.1 %, vs. 58.2% for men.

<sup>30</sup> In 2013, training and apprenticeship contracts increased by 75% y-o-y (totalling 106 100 contracts).

## *Labour market*

**Recent labour market improvements are likely to be partly the result of labour market reforms.** Evaluations of the 2012 comprehensive labour market reform conclude that this reform and the social partners' commitment to wage moderation from 2012 to 2014 have helped limit job losses.<sup>31</sup> The main mechanisms have been greater internal flexibility in companies, as the reforms prioritise collective bargaining agreements at company level over sectoral and regional level and increase possibilities for companies to opt out of a collective agreement, as well as wage moderation. The reform has also reduced the compensation costs for unfair dismissal and helped to lower the number of dismissals challenged in court. Other aspects of the reform, like the development of an individual right to training, are still under development.

**High labour market segmentation is still a key characteristic of the Spanish labour market.** Against the background of an uncertain economic outlook, the proportion of employees with fixed-term contracts in 2013 stood at 23.4 % (among the highest in the EU), and 84.9 % of the temporary jobs had a duration of less than 3 months. This, coupled with low levels of transition to stable jobs, raises concerns about, i.a., productivity, deterioration of job quality and low levels of training on the job, especially for young people and low-skilled workers.<sup>32</sup> The duration of probation periods is typically shorter than in some other EU Member States,<sup>33</sup> with the exception of people hired under the open-ended contract in support of small and medium enterprises introduced in 2012, which has a one-year probation period. Use of this type of contract is increasing, although at a slow pace. The simplification of contract templates, introduced in January 2014,<sup>34</sup> might further increase transparency of information on hiring options for employers. Yet, this administrative simplification is not accompanied by a streamlining of the high number of current contractual arrangements (currently 42). The gap in contract termination costs between permanent and temporary contracts remains above EU and OECD averages, although it is narrowing following the changes introduced by the 2012 reform and the gradual increases for fixed-term contracts introduced in 2010.<sup>35</sup>

**A number of new measures have been adopted since the 2012 reform, without introducing major amendments to labour market regulation.** In August 2013, Royal Decree-Law 11/2013 further clarified the collective dismissal procedure, made some modifications to the requirements for accessing unemployment benefits, and established a framework for cooperation between public employment services and private placement agencies. In December 2013, Royal Decree-Law 16/2013 introduced new measures and extended hiring incentives to facilitate stable part-time employment. The measure is driven by the relatively low number of part-time workers in Spain (16 % of total employment in 2013

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<sup>31</sup> In accordance with the 2013 Council Recommendation, the government published an evaluation of labour market reform in August 2013, while the OECD independent evaluation, commissioned by the Spanish authorities, was finalised in December 2013.

<sup>32</sup> See also the 2014 in-depth review for Spain, published on 5 March:

[http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2014/pdf/ocp176\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp176_en.pdf)

<sup>33</sup> In Spain, the maximum probation period for permanent contracts is set by the relevant collective agreement (if no such agreement exists, the periods are six months for employees with a degree and two months for other employees). Across the EU, maximum probation periods range from less than one month to twelve months; in a majority of Member States it is between three and six months.

<sup>34</sup> The new simplified online tool groups contract templates into four broad categories: permanent, temporary, training and apprenticeship, and internship. However, this administrative simplification has not been accompanied by a streamlining of the number of contractual arrangements (currently 42).

<sup>35</sup> For recent comparative data and description of the degree of stringency of EPL in OECD countries, see OECD Employment Outlook 2013 at

<http://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm>

versus the EU average of 19.9 %). However, a significant proportion of part-time employment in Spain is classed as involuntary (60.9 % in Spain versus 27.6 % in the EU). The same Royal Decree-Law introduced new rules concerning in-kind benefits for the calculation of employers' contributions to social security, which, eventually, might increase pension contribution bases but also have a small effect on labour costs. Another relevant measure, likely to have an effect on self-employment growth rates, is the extension of social security contributions rebates designed for young workers to newly self-employed people, included in the law on entrepreneurship passed last September. A new scheme for social security contributions was introduced at the end of February 2014, according to which a lump-sum contribution of EUR 100 per month is made for each new permanent contract signed before the end of 2014 and leading to net permanent employment creation over two years (with special provisions for companies of fewer than ten employees and part-time contracts). It would be expected to mostly have an impact on the choice of contracts, particularly for medium to high earners, as labour costs savings rise with income levels when such a lump-sum contribution is applied. In addition, a further streamlining of hiring subsidies under one piece of legislation has been also announced by the government. Lastly, reducing the gender differences in employment is one of the main objectives of the 2014-16 strategic plan for equal opportunities adopted on 7 March 2014. Swift implementation and close monitoring of the effectiveness and budgetary impact of these new measures will be necessary.

**The geographical and skills mismatch between labour demand and supply, aggravated by the ongoing transformation of the Spanish economy, calls for the intensification of active labour market policies, the improvement of public employment services and further extension of vocational education and training.** In line with the 2013 country-specific recommendations, national annual employment plans (*Plan Anual de Política de Empleo – PAPE*) were adopted in August 2013 and the first semester of 2014. The employment plans confirm the new results-based system to allocate funds to the Autonomous Regions for the development of employment policies,<sup>36</sup> and are likely to help improve coordination and information sharing among regional and national public employment services. However, the division of responsibilities regarding active labour market policies between the central government and the Autonomous Regions means that the move to the new model is likely to be gradual and to face implementation risks. The assessment against the 2013 performance indicators, finalised in spring 2014, is expected to contribute to the further fine-tuning of this framework, including strengthening the incentives (in 2015, it is planned to distribute 60% of the funds to the Autonomous Regions according to the results obtained), simplifying the system of indicators and eliminating potential overlaps between national and regional public employment services. The transition to an evaluation and outcome-oriented system will be corroborated in the forthcoming 2014-16 activation strategy, likely to be adopted by mid-2014. The new strategy will frame all the policy interventions and measures regarding active labour market policies and public employment services. Its strategic objectives are detailed in the 2014 national reform programme: improving youth employability and implementation of the Youth Guarantee, improving employability of older workers and long-term unemployed, stepping up the quality of occupational training, reinforcing the links between passive and active labour market policies and supporting entrepreneurship. The government is working on the several legislative instruments that will be required to implement the activation strategy, most notably a common catalogue of employment services, which, inter alia, will detail the minimum services to be provided by the public employment service. Also, measures to better link active and passive labour market policies, including improving incentives to work, are being developed. The national reform

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<sup>36</sup> The first distribution of funds under the new model took place in November 2013. In 2014, 40 % of the funds will be distributed according to the results achieved in 2013, 25 % according to strategic objectives (annual) and 15 % according to the structural objectives (long-term), set in the 2013 annual employment plan.

programme details also the future reform of the continuous professional training model for workers, currently under negotiation with the social partners, which will be developed based on the principles of transparency and open competition, and will be subject to a systematic evaluation of results.

**The swift implementation of the 2013-16 youth employment and entrepreneurship strategy, adopted in March 2013, should facilitate the entry of young workers into the labour market.** Pending the first annual evaluation of the strategy, expected in summer 2014, preliminary national data point to widespread use of short-term measures, such as employment hiring incentives and social security rebates for hiring young workers.<sup>37</sup> The national Youth Guarantee Implementation Plan, submitted to the Commission in December 2013, builds on the youth entrepreneurship and employment Strategy (see Box 5).

#### **Box 5: The delivery of a Youth Guarantee in Spain<sup>38</sup>**

The most important challenges to deliver a Youth Guarantee (YG) in Spain are:<sup>39</sup>

- Risk that not all young people under the age of 25 years who are unemployed or who have left formal education are considered as target population.
- Non-availability of comprehensive ex-ante evaluation of the effectiveness and adequacy of the proposed short-term trainings, hiring subsidies and social security reductions to facilitate the sustainable labour market integration of young people.
- Lack of sufficient resources in the Public Employment Services, foreseen as the main entry point for the YG initial assistance, to provide adequate personalised guidance and individual action planning based on the profiles established initially.
- Unclear outreach mechanisms for non-registered unemployed or inactive youngsters.
- Need for better targeting of the regional disparities and needs,<sup>40</sup> continuous monitoring and effective coordination between the central authorities and the autonomous regions that will be among the main responsible for the implementation of the YG.
- Lack of complementary national funding, which could undermine the implementation of the Youth Guarantee in the short- and long-term.

**Modernisation and strengthening measures for public employment services seem to be lagging behind, which could hinder the successful implementation of the new active labour market policies framework and the Youth Guarantee.** Work continues on a single job portal, which is expected to bring together all national and regional public employment services information for jobseekers and employers. Framework agreements for cooperation between the public employment services and private placement agencies were signed with 14

<sup>37</sup> National data point to 120 000 young persons benefitting from the strategy in 2013, of which 77 300 young self-employed workers and 34 400 traineeship contracts.

<sup>38</sup> Spain presented a Youth Guarantee implementation plan (*Plan Nacional de Implantación de la Garantía Juvenil en España*) in December 2013: <http://www.empleo.gob.es/es/estrategia-empleo-joven/index.htm>.

<sup>39</sup> Pursuant to the Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01): "ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within a period of four months of becoming unemployed or leaving formal education".

<sup>40</sup> The regions of Canary Islands (26, 1%), Andalusia (25,2%) and Extremadura (24%) have the highest ratio of NEET young population and Navarra (11.1%) and Basque Country (12,7%).

out of 17 regions<sup>41</sup> and a total of 81 private agencies have been finally selected. Implementation is now underway. However, no specific measures have been taken so far to modernise and strengthen the capacity of the public employment services themselves, allowing them to provide effective, individualised counselling and job search assistance to those looking for jobs. The 2014 national reform programme provides detail of the deployment of an inter-regional best practice exchange programme on employment services. The strengthening of public employment services is also key for the modernisation of national European Jobs Network (EURES) services, which can play a significant role in cross-border recruitment, matching and placement.

### ***Education and training***

**The 2013 organic law reforming education and training (LOMCE), adopted last November, aims to improve the quality of the Spanish education system and its links with the labour market.** The law aims to address three main challenges: (i) the high early school leaving rate (which has wide regional differences); (ii) the insufficient use of vocational education and training; and (iii) the need to improve educational outcomes.<sup>42</sup> New provisions are expected, if effectively implemented, to lead to tangible results on lowering early school leaving. These provisions include compulsory evaluation of students' performance after completing primary and secondary education and the adaptation of curricula (aimed at improving performance rates), increased flexibility in the certification path, and a new two-year vocational training module that upgrades the PCPI (*Programa de cualificación profesional inicial* – Initial professional qualification programme), and allows students to obtain initial professional qualifications paired with basic skills by providing an alternative path to the compulsory education diploma. However, the absence of any provision to continue the actions developed by the PROA (*Programa de refuerzo, orientación y apoyo* – Support and guidance programme) programme to address early leaving is a matter of concern. The LOMCE will enter into force gradually, between the 2014/15 and 2016/17 academic years, although there are implementation risks at regional level, mainly due to the lack of agreement between the Autonomous regions and the State on its funding and implementation of particular provisions.

**Some progress was made on implementing the dual vocational education and training system, but links between education and labour market policies could be further improved.** Over the past year, Spain has further developed various modalities of dual vocational education and training by strengthening work-based learning. Use of paid internships and of training and apprenticeship contracts is progressing, but requires further monitoring to evaluate its effectiveness as an adequate labour market integration tool. All Autonomous Regions are implementing dual vocational education and training in one of the proposed modalities, with more than 9 500 students, 375 learning centres and 1 500 companies involved. However, the involvement of the business community is low: firms have little training capacity, largely due to the lack of tutors, which leads to a limited availability of traineeships, and the use of dual vocational education and training is clearly geared to tertiary level (72 % of the total current programmes), and private sector adherence is still low at basic level. In addition, the implementation of different dual models across regions and the differences between the Ministry of Education and the Ministry of Labour certifications can lead to compatibility issues. To combat this, strengthening the national qualification system could be a key tool to ensure coherence and comparability at national level.

**Tertiary educational attainment continues to be relatively high, but the high unemployment and underemployment of university graduates remains a concern.** At

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<sup>41</sup> All Autonomous Regions except the Basque Country, Catalonia and Andalusia.

<sup>42</sup> Spain remains below the OECD average in mathematics, reading and science, according to the 2012 OECD Programme for International Student Assessment (PISA).

14 % in 2012, graduate unemployment in Spain is well above the EU average (5.6 %). Under-employment, which seems to have a strong structural component,<sup>43</sup> remains the biggest challenge for this group. Consideration could be given to creating a comprehensive national strategy to improve the efficiency of tertiary education and its capacity to adapt to labour market needs. This strategy could help address skills mismatches, promote company-based internships, address potential overlaps at regional level and restructure, anticipate and reorient training and education to better meet future demand, including for green jobs.

**So far, limited progress has been made on reinforcing the effectiveness of re-skilling training programmes for older and low-skilled workers, but the government and the regions are working on a common framework for the future lifelong learning plan.** The draft plan (expected to be finalised in 2014) is intended to identify common issues and best practice across the Autonomous Regions, in line with a single lifelong learning framework at national level. Some positive steps were taken in regulating e-learning professional certificates and updating the national catalogue of professional certificates. The 2012 labour market reform also envisaged the widening of supply for occupational and continuous training courses and the creation of a new training account for each individual worker, but implementation of those measures has not yet been completed.

### *Social policies*

**The prolonged crisis has had a heavy impact on the number of people at risk of poverty or social exclusion,<sup>44</sup> which reached 28.2 % of the Spanish population in 2012.<sup>45</sup>** The deterioration of the labour market and the sharp escalation in the number of households with low work intensity<sup>46</sup> have led to a rise in the rates of people at risk of poverty or social exclusion amongst the working-age population and large increases in poverty amongst both unemployed and employed people, with in-work poverty rates reaching the third-highest level in the EU (12.3 %) in 2012, mainly as a result of lower household work-intensity. Poverty levels among children (29.9 % amongst children aged up to 17) and young adults (28.4 % amongst people aged 18-24) were also very high. Various groups at particular risk, such as people with migrant background,<sup>47</sup> those with disabilities and Roma people, suffer disproportionately from poverty and/or social exclusion (and in most cases, this is further aggravated for women). Disparities more generally between these groups and the rest of the population have also increased over time.

**The social protection system faced difficulties in responding to growing social needs.** Within the EU, Spain is one of the Member States where social protection has had the least

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<sup>43</sup> Since 1996, fewer than 50% of graduates have reported finding a job matching their level or field of education.

<sup>44</sup> This indicator corresponds to the sum of people who are at risk of poverty, severely materially deprived or living in households with very low work intensity. People are counted only once even if they fall into several sub-indicators. Persons at risk of poverty have an equivalised disposable income below 60 % of the national median equivalised disposable income after social transfers. Material deprivation covers indicators relating to economic strain and durables. Persons are considered living in households with very low work intensity if they are aged 0-59 and the working age members in the household worked less than 20 % of their potential during the past year.

<sup>45</sup> The general fall in income in the years following the height of the crisis led to a significant drop in the level of the poverty line, indicating a sharp fall in the living standards of the poorest. Poverty figures are higher if the poverty line is set at the peak of the boom levels (2007 incomes).

<sup>46</sup> People living in households with very low work intensity are people aged 0-59 living in households where the adults work less than 20 % of their total work potential during the previous year.

<sup>47</sup> The proportion of migrants facing severe material deprivation was 17.9 % in 2012, compared to 5.8 % for the total population residing in Spain.

impact on reducing poverty, in particular child poverty.<sup>48</sup> Social assistance and benefits suffered from low coverage and effectiveness (with high levels of non-coverage rate for poor people with jobs),<sup>49</sup> with limited redistributive effects across different groups at risk. In addition, limited coordination between employment and social services (including those at regional and local levels) hampered the effectiveness of active labour market policies for those further away from the labour market. A complex administrative process for accessing minimum income schemes also hinders the smooth transition between social assistance and reintegration into the labour market. Access to long-term care and early childhood education and care was also limited.

**Newly adopted measures aim to address growing inequalities. These measures pay particular attention to the needs of disadvantaged population groups, but need to be promptly implemented and complemented by further actions.** Approval of the second strategic plan for childhood and adolescence (PENIA II) and the 2013-16 national action plan on social inclusion represented steps forward, but these plans still need to be complemented, at least, by the comprehensive plan for family support (PIAF), announced by the government. These plans, combined with the 2013 annual employment plan, also provided a relevant policy framework for promoting active inclusion, although they include a quite limited number of new measures. The 2014 national reform programme refers also to concrete plans to promote the social inclusion and labour market integration of other specific vulnerable groups, like people with disabilities or people dependent on drugs. The programme for professional requalification (PREPARA programme) also played an important role both in terms of activation and providing a last-resort safety net, yet the results show the need to improve its capacity for labour market reintegration.<sup>50</sup> Lastly, the national reform programme recalls the mainstreaming of social issues in other policy areas, such as energy (with specific clauses for small vulnerable energy consumers) and social housing (see section 3.4).

### **3.4. Structural measures promoting sustainable growth and competitiveness**

**Progress on structural reforms promoting growth and competitiveness continues, although this has been uneven across policy measures.** Removing obstacles to competition in product and services markets and barriers to the growth of firms is crucial to encourage productivity and employment creation and to foster the reallocation of resources towards more productive and sustainable sectors, including the tradable sector. Removing these obstacles may result in significant growth (see Box 6).

**In 2013, Spain received a country-specific recommendation concerning product and services markets, the business environment and network industries.** The analysis in this SWD leads to the conclusion that Spain has made some progress on measures taken to address these recommendations. Several reforms have progressed broadly in line with the plans in the 2013 national reform programme and with the 2013 country-specific recommendations. However, some key measures, such as the reform of professional services and associations,

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<sup>48</sup> The distribution of family benefits is unfavourable to the poorer quintiles of the population who receive proportionally less family benefits based on the number of children. Average spending per child increases with household income, while poor families with children receive lower benefits. This regressive distribution of benefits is partly due to the measures' focus on newborn babies and young children, who tend to be over-represented in higher income quintiles.

<sup>49</sup> The non-coverage rate of at-risk-of-poverty and unemployed people is 35.7%, being defined as the proportion of individuals aged 18–59 who live in a jobless household and who are at risk of poverty, but whose total benefits/allowances received is less than 10 % of their total net disposable household income. The net income of people on social assistance relative to median income is 31.0%

<sup>50</sup> See Royal Decree Law 1/2013 of 25 January.

continue to be delayed and implementation of other reforms remains at an early stage. Some progress has been made in the network industries, where the authorities took steps to address the electricity tariff deficit, and are studying ways to minimise the contingent liability for public finances stemming from unprofitable transport infrastructure. Given the wide scope to improve regulation and competition in product and services markets and network industries, it is crucial that the independence and autonomy of the competition authority and sectoral regulator is preserved.

### Box 6: Potential impact of structural reforms on growth – a benchmarking exercise

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as the degree of competition in the economy, skills of the workforce or labour market participation. Improvements on these indicators could raise Spain's GDP by about 6% in a 10-year period. Some reforms could have an effect even within a relatively short time horizon. The model simulations corroborate the analysis of Sections 3.3 and 3.4, according to which the largest gains would likely stem from reducing regulatory fragmentation, improving the average skill level of the working age population and increasing participation rates among women. Skill-enhancing measures could have a major impact on GDP, but only in the very long term. Over a 50-year horizon, such measures could raise GDP by about 7.8% (see note).

**Table: Structural indicators, targets and potential GDP effects** <sup>51</sup>

Reform areas		ES	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.23	0.13	2.3	3.2
Market regulation	Entry costs	4.70	0.13	0.0	0.1
Tax reform	Implicit consumption tax rate	14.0	28.6	0.6	0.9
Skill enhancing reforms*	Share of high-skilled	9.7	10.7	0.0	0.1
	Share of low-skilled	45.6	7.5	0.0	0.2
Labour market reforms	Female non-participation rate (25-54ys):			0.6	1.1
	- low-skilled	29.1	26.4		
	- medium-skilled	17.8	10.5		
	- high-skilled	10.8	4.3		
	Low-skilled male non-participation rate (25-54ys)	10.2	7.7	0.1	0.2
	Elderly non-participation rate (55-64ys):			0.0	0.1
	- low-skilled	15.0	13.4		
	- medium-skilled	5.4	4.8		
	- high-skilled	3.4	3.3		
	ALMP (% of GDP over unemployment share)	6.3	37.4	0.4	0.4
Benefit replacement rate**	47.2	52.6	0.0	0.0	
Total				4.2	6.3

Source: Commission services. Note: Simulations assume that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. If the country is above the benchmark for a given indicator, we do not simulate the impact of reform measures in that area; however, the Member State in question can still benefit from measures taken by other Member States.<sup>52</sup> \*The long-run effect of increasing the share of high-skilled population would be 0.5% of GDP and of decreasing the share of low-skilled would be 7.3%. \*\*EU average is set as the benchmark.

<sup>51</sup> Final goods sector mark-ups is the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme. For a detailed explanation of indicators see Annex.

<sup>52</sup> For a detailed explanation of the transmission mechanisms of the reform scenarios see: European Commission (2013), "The growth impact of structural reforms", Chapter 2 in QREA No. 4. December 2013. Brussels; [http://ec.europa.eu/economy\\_finance/publications/qr\\_euro\\_area/2013/pdf/qrea4\\_section\\_2\\_en.pdf](http://ec.europa.eu/economy_finance/publications/qr_euro_area/2013/pdf/qrea4_section_2_en.pdf)

### *Products and services markets*

**The law on the guarantee of market unity, which aims to address regulatory fragmentation in Spain internal market, came into force on 11 December 2013.** Its goal is to make it easier for operators to take advantage of economies of scale and scope in the market by providing unrestricted access to economic activities and the right to perform and expand these throughout Spain. Full implementation of the law is of utmost importance. To that end, effective coordination and cooperation among the different levels of government is critical, in particular when it comes to enforcing provisions on supervising economic operators and amending sector specific legislation to remove inconsistencies.<sup>53</sup> The law also sets out procedures to monitor the application of its provisions. These includes a catalogue of good and bad practices which may affect market unity (to be produced by the newly created secretariat of the Council for Market Unity), the planned dissemination of regulatory quality indicators, the new powers given to Spain's Competition Commission to file administrative appeals with regard to situations contrary to the law and, more generally, the outcome of the sectoral conferences where regional and central government representatives discuss and agree legislative amendments. In addition to measuring progress in implementing the law, these procedures would provide very valuable information, should further legislative action be required in the interest of freedom of establishment and movement and the simplification of burdens.

**The draft law on dis-indexation, submitted for parliamentary approval in December 2013, aims to discontinue current indexation schemes on fees and public sector contracts.** It prohibits automatic and periodic updating of prices based on general price indices. However, it permits periodic and non-periodic updates of those values on an exceptional basis, based on changes to specific costs. The draft law also provides for new indexation mechanisms to be applied on a voluntary basis on privately agreed prices, such as housing rents, which would yield lower price increases than indexation based on the consumer price index. Indexation schemes for collective bargaining, financial sector instruments and pensions are excluded from the scope of this reform, as some of them have their own dedicated legal instruments (e.g. pensions). The law needs to be accompanied by secondary legislation, however, to set out the details on periodic and non-periodic indexation. Nevertheless, the principles of the law have already come into effect on public sector contracts with the 2014 budget law.

**The adoption of the law on professional services continues to be delayed, as it faces resistance from interest groups.** In addition to the job creation potential, reforming professional services would lift the competitiveness of the overall economy, given that they are an input for other sectors. Although work started in the previous legislature, it was only in August 2013 that the first draft law (*anteproyecto de ley*) was approved by the government. The draft aims to set out the professions requiring registration with a professional organisation. It reviews the rules on membership fees, transparency and the accountability of professional bodies. It also safeguards the principle of market unity in the access to and exercise of professional services. The long-term impact of the reform was originally estimated by the government at 0.7 % of additional potential GDP and lower inflation of 0.24 % relative to the baseline. A bold approach in the various areas addressed by the proposal is needed for the reform to have these effects.

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<sup>53</sup> The 2014 National Reform Programme describes the planned amendments to sector specific legislation in areas such as railways, gambling, funeral services, social services, retail trade, urban planning, environment, industrial licensing, waste management, education services, temporary employment agencies, health and veterinary services, hunting and fishing and consumer protection.

**Barriers to competition in the postal services sector remain.** Although there are several postal operators competing in the Spanish market, the universal service provider *Correos* still holds close to 90 % of the postal market for letters. Access to the postal network for alternative operators is hindered by the Spanish postal system's use of discriminatory prices for some operators.

**Recent measures to improve the business environment aim to support company creation and growth and to reduce administrative burdens.** The law on entrepreneurship, adopted in September 2013, includes measures to support the internationalisation of businesses, reduce the cost and time of creation of private limited companies, simplify administrative burdens, promote SME participation in public tenders and allow partial debt discharge in the event of corporate insolvency. The law on environmental assessment, adopted in December 2013, aims to speed up licensing for environmental programmes, plans and projects. There has been further simplification in the requirements for opening small-scale retail outlets, removing the need for municipal permits for the premises or operation of small shops and, linked to this, the "*Emprende en Tres*" initiative to facilitate business licensing. These measures are steps in the right direction. They can however, be complemented by further action. To illustrate, there is need to issue implementing legislation so that private limited companies can be created through one stop shops within the shorter deadlines set out in the September 2013 entrepreneurship law. There is a case for continuous review of regulatory barriers to company growth given Spain's gap compared with other euro area countries on company size. This includes evaluating lock-in effects originating from corporate income tax, as suggested recently by the committee of experts on tax reform. Lastly, good cooperation with the regions is needed for successful implementation of the environmental assessment law, so that agreement can be reached at the environment sectoral conference on enforcing the shorter deadlines set out in this law, simplifying legislation and standardising procedures in the interest of efficiency and market unity.

**Barriers to entry for large-surface retail establishments continue to limit competition in the retail sector, despite recent measures.** While the transposition of the Services Directive largely eliminated the dual licensing system (i.e. licensing by both municipalities and regions) to set up large retail establishments, the revised rules authorise regional governments to create specific authorisation schemes. This allows the *de facto* continuation of the dual licensing system.<sup>54</sup> Against this backdrop, the government and the regions plan to explore ways to remove unjustified barriers to establishing retail outlets, including for large outlets, at the sectoral conferences on retail trade, held to discuss the implementation of the market unity law.

### ***Research, development and innovation***

**Spain's research and innovation system faces challenges and shortcomings.** The economic crisis has led to reductions in public-sector and private-sector R&D funding,<sup>55</sup> thus lowering the likelihood of reaching the 2 % R&D intensity target by 2020. Spain's public-sector R&D expenditure does not provide sufficient incentive for public-sector research organisations and universities to cooperate with the private sector. Insufficient finance for fast-growing and innovative firms at the height of the crisis has hampered the transformation of research and innovation into commercial products. The system's science base is not grounded on international peer review and the allocation of institutional research and innovation funding in Spain is, generally speaking, not based on performance criteria.

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<sup>54</sup> See CNC (2011), Report on the relations between manufacturers and retailers in the food sector.

<sup>55</sup> In 2012, Spain's R&D intensity stood at 1.30 %. Private R&D intensity fell by on average by 1.8 % over 2008-12 despite a shrinking GDP.

Innovation policy is devolved to regions, with a great need for more effective coordination between the central and regional level to avoid overlaps and to increase the impact of smart specialisation. These challenges and shortcomings have been compounded by a reduction in the number of technology-based innovative firms. Against this backdrop, in 2013, the Spanish government adopted a national strategy for science, technology and innovation and a plan to implement this, but the new strategy and plan still need to be backed by public funding. The funding needs to be sufficient to address the health, energy, transport and climate societal challenges set out, leverage private investment and make best use of available EU research and innovation funding programmes (such as Horizon 2020, European structural and investment funds, COSME and others). The creation of the new State Research Agency, which is tasked with the efficient management of public R&D investment, is also pending. The success of the Agency will require the use of best practice in fund allocation, including independent peer reviews of projects by international experts and evaluations based on the innovative capacity of projects.

### ***Rental market***

**Measures have been taken to create a larger and more efficient housing rental market.** Law 4/2013 on the promotion of the rental housing market brings about significant changes, strengthening the legal rights of owners but also providing greater flexibility in ending rental agreements. A more flexible and efficient rental market may help the adjustment process for the housing market and, together with the elimination of tax-deductible mortgage payment from the beginning of 2013, is expected to reduce the bias towards home-ownership. It will also support labour mobility and in the long run help reduce the volatility of house prices.

**Social housing is being appropriately redirected towards renting.** Social housing in Spain has been traditionally provided for owner-occupation. Recently, the policy has been directed more towards providing support to tenants, partly to address the negative social consequences of the housing crisis. Although it remains a very small percentage of the total, the number of repossessions of primary residences has increased in recent years. (According to Bank of Spain data, in both 2012 and 2013, around 39 000 primary residences were repossessed, out of about six million mortgaged; about half of these were voluntary repossessions, and about one third with dation in payment. As mentioned in the 2014 national reform programme, the Spanish authorities introduced a temporary moratorium on evictions for households that meet vulnerability criteria and reached an agreement with banks to establish a social housing scheme (*fondo social de vivienda*), where banks transfer a proportion of their housing stock into a social rental sector. Take-up rates have been relatively low, possibly due to restrictive eligibility criteria. Meanwhile, the percentage of the population living in households where total housing costs represent more than 40 % of disposable income increased, from 8.3 % in 2007 to 14.3 % in 2012.

### ***Energy***

**The authorities took significant measures to reduce the electricity tariff deficit, but the 2013 deficit remained large.** Energy policy choices in Spain over the last decade resulted in an increase in regulated costs of the electricity system. Substantial private investment in gas-fired and renewable generation and increases in support for developing renewable energy coincided with the economic crisis, leading to lower consumption and generation overcapacity. As access tariffs were fixed below the system's costs, the system has generated a large tariff deficit over recent years. Following a number of measures adopted in 2012 and

early 2013, a significant reform was initiated in July 2013.<sup>56</sup> The reform introduces the principle of budgetary balance, to be implemented from 2014, and envisages an overall reduction in regulated costs, such as the remuneration of transmission and distribution activities, capacity payments, and, in particular, subsidies for renewable energy. These changes have led to much regulatory uncertainty and legal challenges from energy companies. The tariff deficit is estimated to have exceeded EUR 3.6 billion (0.35 % of GDP) in 2013, in spite of the government's intention to have zero tariff deficit in that year. In November 2013, the government cancelled the use of the budgetary resources to cover the electricity tariff deficit, creating a funding gap. The five incumbent electricity companies will have to finance that deficit, receiving collection rights in exchange. The cumulative amount of tariff debt, not including the 2013 deficit, is estimated by the authorities at some EUR 26 billion (2.5 % of GDP).

**Competition in the electricity wholesale and retail market appears to be limited.** At various times, the competition authority has claimed that the degree of competition in the wholesale market is insufficient, with detrimental effects for electricity prices.<sup>57</sup> Consumers' overall assessment of retail electricity market is the second lowest in the EU and satisfaction with the choice of available suppliers is well below the EU average.<sup>58</sup> A new method for setting electricity prices for domestic consumers will start to be applied from July 2014, more closely linked to wholesale market prices. The new system could stimulate more competition between electricity suppliers, but may also result in higher price variations over time.

**Energy represents a major input cost for the economy that could be reduced by enhancing energy efficiency.** The new national energy efficiency action plan, to be submitted in the first half of 2014, details an ambitious energy efficiency strategy and reports significant progress in recent years. Spain is currently on track to achieve its 20 % renewable energy target by 2020, with 14.3 % of energy currently provided by renewable sources. This momentum needs to be maintained, as increased energy efficiency and a higher share of renewables would lower Spain's energy import dependency, currently one of the highest in the EU. In particular, renovation of the building stock could improve energy efficiency and stimulate job creation. Some recent measures, while necessary to reduce the very high overall electricity tariff deficit, may lead to closure of electricity plants. The planned access tariffs for self-consumption of electricity would primarily affect solar photovoltaic installations and risks making these uneconomical for households and small consumers. The recent reduction of support for cogeneration (where heat and power are produced simultaneously) may lead to cogeneration installations being shut down.

**Cross-border transmission capacity with France is being improved, but still falls short of that required for the Iberian Peninsula to be a part of the European energy market.** In 2015, a new electricity line is expected to be operational on the French border, doubling the interconnection capacity between France and Spain. This is currently provided by four lines, corresponding to 3 % of peak demand in Spain. The authorities are exploring further extensions to interconnection capacity, so that Spain and Portugal could be better integrated with the European electricity network. In the area of gas, the key challenge will be to create an Iberian gas hub to encourage wholesale and retail competition and market liquidity. Some progress has been seen on improving gas interconnection capacity with France, but developing interconnections further would allow more diversity of supply.

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<sup>56</sup> The Royal Decree Law 9/2013 of 12 July on urgent measures in the electricity sector. The law on the electricity sector (Law 24/2013), adopted on 26 December 2013.

<sup>57</sup> CNC, IPN 103/13 Anteproyecto de Ley del sector eléctrico.

<sup>58</sup> Consumer Markets Scoreboard (to be published in June 2014),

[http://ec.europa.eu/consumers/consumer\\_research](http://ec.europa.eu/consumers/consumer_research)

## ***Transport***

**An over-sized transport network is creating liabilities for public finances.** When selecting transport projects Spain seems to have given higher priority to increasing geographical cohesion, than improving efficiency, so that investment plans still include high-speed railway lines and motorways in areas with negligible traffic. Due to insufficient strategic planning at national level, port expansion projects potentially leading to overcapacity are being promoted, while improving railway connections with major ports has often been neglected and delayed. The authorities have not yet set up an independent observatory to help evaluate future major infrastructure projects, as recommended in the 2013 country-specific recommendations, although they have created a database containing economic, environmental, traffic-related and other indicators to support analysis prior to investment in infrastructure. In addition, it is not clear whether public-private partnership projects are subject to sufficient scrutiny to avoid overoptimistic traffic estimates with consequent potential risks for public finances. The 2014 national reform programme announces the setting up of an advisory council to appraise infrastructure projects.

**The government is exploring ways to minimise negative spillover effects on public finances from unprofitable motorways.** Operators of ten toll motorways which have low traffic flows are facing financial difficulties, with non-negligible contingent liabilities for the state. The majority of these operators have already been declared insolvent, and the government has injected funds to help them. A viable solution to this situation has not yet been found. It would have to address the structural low profitability and underutilisation of the toll motorway network, compared with toll-free motorways and high capacity roads running in parallel. The government proposed setting up a public company to take over the insolvent motorways and presented a restructuring plan to creditors. There are currently no plans to introduce user charges on the motorway network.

**Effective competition in the railway passenger and freight services is currently prevented by technical and legal obstacles, hampering the efficient use of the extensive infrastructure stock.** Low interoperability with the rest of the European railway network (e.g. different gauge, rolling stock, and technical requirements), poor connections to seaports, and preferential treatment given to the state-owned Spanish rail operator *Renfe* for transporting passengers and freight hinder new companies entering the market.<sup>59</sup> Some measures to promote competition in railway transport have been adopted, including splitting up *Renfe Operadora* into four entities, and reviewing infrastructure access charges.<sup>60</sup> The other measures planned to help strengthen competition in rail freight include a one-stop shop for administrative procedures, opening up freight terminals to new entrants and breaking *Renfe*'s quasi-monopoly on rolling stock. The railway passenger market has been opened, though only for touristic services.<sup>61</sup> Nevertheless, there is a clear economic justification for opening up access to high-speed lines, as they are currently underused. Moreover, the experience from other Member States shows that market opening in public service obligation could bring substantial savings. An opening up of high-speed lines and long distance services has been announced and is expected to take place in the first half of 2014.

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<sup>59</sup> *Informe sobre la competencia en el transporte de mercancías por ferrocarril en España*, CNC, 2013.

<sup>60</sup> Royal Decree-Law 1/2014.

<sup>61</sup> Royal Decree-Law 4/2013.

**Some obstacles to developing air and maritime transport have been identified.** The costs of airport services in individual airports operated by *Aena Aeropuertos* are not transparent. Some progress has been observed with the setting up of an independent regulator and a more independent slot coordinator,<sup>62</sup> but enforcement will be crucial. The existing arrangements for cargo handling companies in seaports restrict their freedom to employ workers, posing a barrier to attracting investment and creating job opportunities in ports.

### *Environment*

**Spain is expected to miss its 2020 greenhouse gas emission target.** Under the Europe 2020 Strategy, Spain committed to reducing its greenhouse gas emissions in the sectors not covered by the EU Emissions Trading System (ETS) by 10 % between 2005 and 2020. According to the latest national projections based on the existing measures, it is expected to miss this target.

**Spain also faces several other environmental challenges, including saving water through a better water pricing policy.** Despite serious water provision issues, water tariffs in Spain are among the lowest in the EU. Higher transparency of prices and subsidies is needed, to exert pressure on agricultural activities to improve water management in the sector, including better waste-water treatment. The main challenge in the waste sector is to increase levels of waste prevention and recycling. Flood prevention measures are sometimes disregarded, despite being cheaper than the costs of flood recovery.<sup>63</sup> Air pollution in the major cities is largely due to traffic congestion, as private transport use exacerbates seasonal problems with air quality. Addressing environmental issues could also potentially boost job creation, for instance by promoting sustainable tourism.<sup>64</sup>

### **3.5. Modernisation of public administration**

**In 2013, Spain received a country-specific recommendation concerning public administration and the judicial system.** The analysis in this SWD leads to the conclusion that Spain has made substantial progress on measures concerning public administration and some progress on measures in relation to the judicial system (for the full CSR assessment, see the overview table in Section 4). The law on local administration reform has been adopted, as has a plan to reform public administration, the implementation of which is ongoing. Reforms in the judicial sector have continued, with varying degrees of completion. Following approval of reforms, focus has moved to their implementation. Seamless coordination with the administrative bodies involved will be required for the reforms to bear fruit.

**Fiscal consolidation needs will remain significant over the next few years, and so will pressure on public administration reform to deliver efficiency gains and reduce operating costs.** In June 2013, a group of experts commissioned by the government published a set of 217 recommendations on reforming public administration, which rose to 221 subsequently. They aim to create efficiency gains and fiscal savings at all levels of government. They fall into four categories: i) recommendations to remove duplicate structures at central and regional level; ii) recommendations to reduce administrative burdens; iii) recommendations to improve the management of shared services and reduce overheads; and iv) recommendations to rationalise the central government institutional administration. These are currently being implemented. At the time of writing (i.e., mid-May 2014), 29 % of the measures had been adopted and the remaining 71 % had been launched.<sup>65</sup> The expectation in

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<sup>62</sup> Royal Decree-Law 1/2014.

<sup>63</sup> RPA (2014) Study on economic and social benefits for the European Semester, [http://ec.europa.eu/environment/integration/green\\_semester/pdf/RPA%20Final%20Report-annexes.pdf](http://ec.europa.eu/environment/integration/green_semester/pdf/RPA%20Final%20Report-annexes.pdf).

<sup>64</sup> <http://ec.europa.eu/environment/enveco/studies.htm#3>

<sup>65</sup> Some reform measures have been described in dedicated paragraphs, such as the law on the guarantee of market unity (see 3.4) or the local administration reform.

the 2014 National Reform Programme is that 50% of the measures could be completed before the end of the year. Flagship reforms (in terms of potential savings and/or efficiency gains) scheduled for 2014 include a new law on administrative procedure, amendments to the law on public grants, the centralisation of scattered public sector checking accounts and changes to the law on Spain's civil service, to cater for proper human resource planning, training and evaluation of public servant's performance. As in other policy areas, the cooperation of regional governments is crucial for the success of the reforms.

**There is scope for improvements in Spain's law-making process.** Despite progress made by the 2011 law on sustainable economy, the quality of the law-making process in Spain could be further improved by publishing impact assessments, pursuing a proper analysis of policy options linked to objectives and doing quality checks on impact assessments by independent bodies. More efforts could also be placed on the ex-post evaluation of enacted legislation. This is particularly important as attention shifts to implementing reforms that have been adopted recently.

**In December 2013, an ambitious local administration reform was passed.** It aims to clarify the powers of municipalities in order to: i) remove duplications with other government sub-sectors at local level; ii) streamline the number of local bodies; iii) rationalise the services provided at local level; and iv) make the cost of providing local public services more transparent. Implementing this law is expected to bring significant budgetary savings, the bulk of which will be concentrated in 2015 and 2016 (EUR 6.1 billion, 76 % of total savings according to government estimates). However, the reform is facing resistance from some municipalities and the final savings figures could differ, due to uncertainties surrounding the implementation of provisions on merging municipalities, on the coordination by provincial councils of 'essential' services provided by smaller municipalities, the gradual take up of municipal health and social services competencies by regions and the rationalisation of local entities' institutional administration.

**Public procurement policy can contribute to competition and fiscal savings.** Recent policy measures require all general entities to publish calls for tenders and their results on the public- sector procurement platform. Measures to develop centralised procurement are currently being adopted. Progress has been made, in particular on pooling purchases of health supplies. However, the current level of e-procurement use is negligible. As with centralised purchasing, e-procurement can save resources. It can also increase transparency and create incentives to streamline procedures. Coordination with regional and local government in gradually increasing the use of e-procurement is needed, including ensuring that appropriate links are created between current electronic platforms.

**Judicial reform is at varying stages of completion and/or implementation.** The February 2013 reform of court fees and legal aid reduced the fees that had been introduced in November 2012 and broadened the eligibility criteria for legal aid.<sup>66</sup> In December 2013, Spain also completed the transposition of the Mediation Directive<sup>67</sup> by adopting the remaining implementing provisions on training and registers of mediators and on electronic mediation. The June 2013 reform on the Council for the Judiciary brought about some changes in the way members of the Council are appointed. The latest policy developments consist of the approval by the Council of Ministers of an ambitious draft reform (*anteproyecto de ley*) of the judiciary.<sup>68</sup> The implementation of previous reforms — some of them dating back to 2003 —

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<sup>66</sup> A legislative proposal to further reform the legal aid system is currently before parliament.

<sup>67</sup> Directive 2008/52/EC of 21 May 2008 on certain aspects of mediation in civil and commercial matters.

<sup>68</sup> The draft proposal aims to modify the structure of the judiciary to ensure a more efficient division of workload, in particular through the creation of the "*tribunales provinciales de instancia*". It also fosters the specialisation of judges, it reinforces the legal safeguards that guarantee the independence of judges and it

continues. However, it is important that the momentum is maintained. Examples include developing the *Oficina Judicial*, a common pool of resources to assist judges, and developing better links between regions' electronic case management systems. Overall, the amount of legislative reforms to come is considerable, but so, too, is the need for implementation of reforms that have been already passed. Data available for 2010-12 show that length of proceedings and rate of resolving cases have improved for litigious civil, commercial and administrative cases in the court of first instance.<sup>69</sup> Empirical literature available show that reducing the backlog ratio and disposition time has had significant positive effects on companies birth rates and attraction of foreign direct investment.<sup>70</sup>

**The authorities are strengthening anti-corruption policies but more remains to be done.** The most recent measures were adopted in December 2013. They include a law on transparency, public access to information and good governance, two bills (*anteproyecto de ley*) on monitoring party funding and improving the accountability of central government senior public officials and announced plans to reform criminal law and criminal procedure law to fight against corruption. These measures are being introduced against the backdrop of a difficult economic situation, several high-profile cases investigated in the past few years, an increased number of lawsuits started and of judgements delivered on corruption-related crimes.<sup>71</sup> The perceived level corruption by Spanish citizens relatively high,<sup>72</sup> bringing the risk of eroding trust in public institutions. The 2014 EU Anti-Corruption Report<sup>73</sup> acknowledged the comprehensive programme of legislative reform launched by the Spanish government to strengthen anti-corruption and integrity-related policies. At the same time, it noted that Spain does not have dedicated legislation protecting whistleblowers and regulating lobbying activities and indicated that there is scope to bolster the Court of Auditor's capacity and powers to supervise political party funding and to increase the independence of the office monitoring asset disclosure of central government's senior officials. It also reported weaknesses with regard to public spending, decision-making and control mechanisms in regions and local entities, thus calling for enhancing audit mechanisms and transparency in public procurement and urban development processes. Equally important is the availability of judicial procedures ensuring a prompt response to corruption cases, including a rapid execution of judgments.

#### 4. CONCLUSIONS

**Spain came out of its double-dip recession in the third quarter of 2013 amidst continued economic adjustment, improved market confidence and a gradual relaxation of financial conditions.** GDP growth is forecast to accelerate and the labour market is showing signs of

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extends the months of judicial activity to the whole year. Finally, it entrusts the management of the Civil Registry to the "judges of peace". Actual changes to court locations (i.e., the amendment of the so-called judicial map will be carried out in separate legislation.

<sup>69</sup> Source: 2014 EU Justice Scoreboard.

<sup>70</sup> See European Economy – Economic Papers: The economic impact of civil justice reforms, European Commission, May 2014.

<sup>71</sup> According to Spain's General Public Prosecutor Office's 2013 Annual Report, the number of number of lawsuits started for corruption related offences increased by 17% over 2010 and 2012. The number of corruption related judgements delivered increased by 151% over the same period of time, with 44% of the judgements related to abuse of powers (*prevaricación administrativa*) and 39% to embezzlement (*malversación*).

<sup>72</sup> See the 2013 Special Eurobarometer report. Specifically, 63 % of respondents (highest percentage in the EU) feel personally affected by corruption in their daily lives (EU average: 26 %), while 95 % say that corruption is a widespread problem in the country (EU average: 76 %) and 91 % state that corruption exists in local and regional institutions (EU average: 77 %). [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_397\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_397_en.pdf)

<sup>73</sup> <http://ec.europa.eu/anti-corruption-report/>

stabilisation, but unemployment remains very high and private- and public-sector deleveraging needs constrain economic growth prospects. The nine country-specific recommendations addressed to Spain in 2013 highlighted these and other challenges, and included deficit correction through continued fiscal consolidation, tax reform, implementing the financial sector programme, completing the 2012 labour market reform, addressing social problems, reforming product and service markets, network industries and public administration.

**The analysis in this SWD leads to the conclusion that Spain has made some progress in addressing the country-specific recommendations issued in 2013.** Spain has advanced decisively with the comprehensive policy agenda in the 2013 national reform and stability programmes and in the CSRs. A number of important reforms have been passed into law broadly in accordance with the planned timetables. Notably, Spain has adopted reforms on pensions, healthcare, independent fiscal institution, public administration, financial sector, non-bank financial intermediation, labour market, corporate insolvency, internal market, liberalisation of the housing rental market, and to tackle the electricity tariff deficit. Full implementation of the reforms is essential to reap their expected benefits. In this respect, the situation is diverse. While some reforms are already into force, a majority of them required follow-up actions and, therefore, implementation is ongoing and sometimes still at an early stage. Moreover, the implementation process is not devoid of risks, including those deriving by the need of joint delivery efforts by various tiers of government in several cases (e.g. active labour market policies, market unity, public administration reform). In addition, some key items, such as the reform of professional services and associations, have been delayed. The 2014 national reform and stability programmes and the Commission's analysis in this SWD confirm the overall robustness of last year's reform agenda and are largely set in a line of continuity. The focus is on completing outstanding items, complementing them with new measures where necessary and proceeding swiftly with implementation.

**Spain's 2014 national reform programme and stability programme include an agenda of structural reforms to enhance competitiveness, support employment creation and boost GDP growth.** Maintaining the reform momentum, while promptly introducing further reforms where necessary, is essential for consolidating and accelerating the incipient economic recovery and enhancing growth and job creation. The government's economic agenda for the next twelve months focuses on two mutually reinforcing pillars: deepening the reforms, and favouring economic recovery and job creation. However, most measures and reforms listed in the NRP will only be deployed in full gradually and over the medium-run. A comprehensive and swift implementation of the many measures announced or already adopted is paramount.

## OVERVIEW TABLE

2013 commitments	Summary assessment <sup>74</sup>
<b>Country-specific recommendations (CSRs)</b>	
<p><b>CSR 1:</b> Deliver the structural fiscal effort as required by the Council recommendation under the EDP to ensure correction of the excessive deficit by 2016. To this end, implement the measures adopted in the 2013 budget plans at all levels of government, reinforce the medium-term budgetary strategy with sufficiently specified structural measures for the years 2014-16. A durable correction of the fiscal imbalances is predicated upon the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth and employment. After achieving the correction of the excessive deficit, pursue the structural adjustment at an appropriate pace so as to reach the medium term objective by 2018.</p> <p>Ensure a strict and transparent enforcement of the preventive and corrective measures provided for in the Budgetary Stability Organic Law.</p> <p>Establish an independent fiscal authority before the end of 2013 to provide analysis, advice and monitor compliance of fiscal policy with national and EU fiscal rules.</p> <p>Improve the efficiency and quality of public expenditure at all levels of government, and conduct a systematic review of major spending items by March 2014.</p>	<p><b>Spain has made some progress on addressing CSR 1 of the Council Recommendation:</b></p> <p><b>Some progress</b> — The headline target is likely to be slightly overachieved in 2014. However, although Spain plans to meet the headline EDP targets recommended in June 2013, budgetary targets are subject to downside risks (in particular for 2015 and after) and the planned fiscal efforts fall short of the Council's recommendations throughout the programme.</p> <p><b>Substantial progress</b> — Compared to 2012, there has been progress on implementing the Budgetary Stability Organic Law, in particular, as regards the availability of detailed and comprehensive evaluation reports of regions' economic and financial plans..</p> <p><b>Some progress</b> — Spain's independent fiscal institution was created by law in November 2013, The creation of Spain's independent fiscal institution did not, however, meet the deadline provided for in EU law, and the delay in setting it up has resulted in the AIREF not being able to assess the 2014 stability programme. At the time of writing (i.e., 23 May 2014) the authority had not started operations.</p> <p><b>Some progress</b> — Spain did not conduct a specific comprehensive and systematic review of major spending items by March 2014, as recommended in the CSR. However, measures to rationalise spending on health, employment, and public administration provide information on some key expenditure items.</p>

<sup>74</sup> The following categories are used to assess progress in implementing the 2013 CSRs of the Council Recommendation: **No progress:** The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. **Limited progress:** The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. **Some progress:** The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. **Substantial progress:** The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. **Fully addressed:** The Member State has adopted and implemented measures that address the CSR appropriately.

<p>Increase the cost-effectiveness of the health-care sector, while maintaining accessibility for vulnerable groups, for example by reducing hospital pharmaceutical spending, strengthening coordination across types of care and improving incentives for an efficient use of resources.</p> <p>Take measures to reduce the outstanding amount of government arrears, avoid their further accumulation and regularly publish data on outstanding amounts.</p> <p>Adopt the disindexation law to reduce the degree of price inertia in public expenditures and revenues, in time to have it in force by the beginning of 2014 and consider additional steps to limit the application of indexation clauses.</p> <p>Finalise by end-2013 the regulation of the sustainability factor so as to ensure the long-term financial stability of the pension system, including by increasing the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy.</p>	<p><b>Some progress</b> — Measures to contain expenditure in the healthcare sector have been gradually implemented. Measures to guarantee access to healthcare for vulnerable groups have been taken, but the number of complaints regarding restrictions on access has grown.</p> <p><b>Substantial progress</b> — Measures to prevent late payments by the public sector and to establish permanent tools to monitor and control commercial debt in the public sector were adopted in December 2013. This follows measures to pay down commercial arrears through the three waves of the Supplier's Payment Scheme (throughout 2012 and the first quarter of 2014). However, at the time of writing, implementing legislation needed to be adopted, so that the enforcement mechanisms set out in the law could be applied.</p> <p><b>Some progress</b> — The dis-indexation draft law was sent to parliament in December 2013 and its parliamentary adoption is expected throughout 2014. The law needs to be accompanied by secondary legislation to set out the details of periodic and non-periodic indexation, although its principles have already come into effect on public sector contracts, with the 2014 budget law</p> <p><b>Fully addressed</b> — The sustainability factor for the pension system was regulated in 2013 and indexation of pensions was reviewed.</p>
<p><b>CSR 2:</b> Conduct a systematic review of the tax system by March 2014. Consider further limiting tax expenditure in direct taxation, explore the scope to further limit the application of the reduced VAT rates and take additional steps in environmental taxation, notably as regards excise duties and fuel taxes. Take further measures to address the debt bias in corporate taxation.</p> <p>Intensify the fight against the shadow economy and undeclared work.</p>	<p><b>Spain has made some progress on addressing CSR 2 of the Council Recommendation:</b></p> <p><b>Some progress</b> — The government appointed an expert committee in July 2013. On 13 March 2014, it delivered its report, which focuses on simplifying the tax system and increasing its efficiency. The reform proposal has not yet been adopted by the government.</p> <p><b>Some progress</b> — The plan to combat fraud and undeclared work is being implemented, but this work will end in 2014.</p>
<p><b>CSR 3:</b> Implement the financial sector programme for the recapitalisation of the financial institutions, including the measures promoting non-bank intermediation adopted in November 2012.</p>	<p><b>Spain has fully addressed CSR 3 of the Council Recommendation</b></p>
<p><b>CSR 4:</b> Finalise the evaluation of the 2012 labour market reform covering the full range of its objectives and measures by July 2013, and present amendments, if necessary, by September 2013.</p>	<p><b>Spain has made some progress on addressing CSR 4 of the Council Recommendation:</b></p> <p><b>Some progress</b> — The government published its</p>

<p>Adopt the 2013 national Employment Plan by July 2013 and enact swiftly a result-oriented reform of active labour market policies, including by strengthening the targeting and efficiency of guidance.</p> <p>Reinforce and modernise public employment services to ensure effective individualised assistance to the unemployed according to their profiles and training needs.</p> <p>Reinforce the effectiveness of re-skilling training programmes for older and low-skilled workers.</p> <p>Fully operationalize the Single Job Portal and speed up the implementation of public-private cooperation in placement services to ensure its effective application already in 2013.</p>	<p>evaluation of the labour reform in August 2013, and a separate assessment from the OECD, commissioned by the government to complement its own evaluation, was published in December 2013. These evaluations have so far not been followed by announcements of significant amendments to labour market legislation.</p> <p><b>Some progress</b> — As part of the reform of active labour market policies, the annual employment plan was published in August 2013. Evaluation of this plan, the 2014-16 activation strategy and a new 2014 annual employment plan are being prepared.</p> <p><b>Limited progress</b> — Work is underway to improve the cooperation between public and private employment agencies. Apart from the mutual learning programme among regional PES, recently put in place, no further measures were adopted to strengthen public employment services.</p> <p><b>Limited progress</b> — Limited progress, despite updating the catalogue of professional certificates.</p> <p><b>Limited progress</b> — Work on the single job portal is ongoing, but it has not been completed. Work on improving the cooperation between public and private employment agencies is also ongoing, but it needs to be fully and effectively implemented.</p>
<p><b>CSR 5:</b> Implement and monitor closely the effectiveness of the measures to fight youth unemployment set out in the Youth Entrepreneurship and Employment Strategy 2013-2016, for example through a Youth Guarantee.</p> <p>Continue with efforts to increase the labour market relevance of education and training, to reduce early school leaving and to enhance life-long learning, namely by expanding the application of dual vocational training beyond the current pilot phase and by introducing a comprehensive monitoring system of pupils' performance by the end of 2013.</p>	<p><b>Spain has made some progress on addressing CSR 5 of the Council Recommendation:</b></p> <p><b>Some progress</b> — There has been progress implementing the 2013-16 youth employment and entrepreneurship strategy. The first evaluation is expected in summer 2014. The draft national Youth Guarantee implementation plan was submitted to the Commission in December 2013.</p> <p><b>Some progress</b> — Spain has begun a reform of its vocational education and training system, to better adapt young people's skills to labour market needs and to make vocational education and training more attractive. National authorities are planning to complete the legislative framework after evaluating the first pilot cycle at the end of 2014/15.</p> <p>The organic draft law on the quality of education, which is expected to have a significant impact on reducing early school leaving and improving the quality of education, was adopted in November 2013. It will come into force in stages, over the 2014/15 and 2016/17 academic years. It is therefore too early to assess its effectiveness. Spain is also working on designing its lifelong learning plan.</p>
<p><b>CSR 6:</b> Adopt and implement the necessary measures to reduce the number of people at risk of poverty and/or</p>	<p><b>Spain has made some progress on addressing CSR 6 of the Council Recommendation:</b></p>

<p>social exclusion by reinforcing active labour market policies to improve employability of people further away from the labour market</p> <p>and by improving the targeting and increasing efficiency and effectiveness of support measures including quality family support services.</p>	<p><b>Some progress</b> — The 2013-16 national action plan on social inclusion was adopted in December 2013; its implementation will need to be closely monitored. The 2013 annual employment plan also contains some measures to improve the employability of the most disadvantaged. Other relevant measures include the continuation of the PREPARA programme, a programme for professional requalification.</p> <p><b>Limited progress</b> — Limited progress has been made on measures to tackle child poverty and improve the efficiency of family support services. The approval of the second strategic plan for childhood and adolescence (PENIA II) in April 2013 and of the 2013-16 national action plan on social inclusion in December 2013 send a positive signal, although these have yet to be implemented. They will need to be complemented by other plans, such as the comprehensive family support strategy (PIAF) which should provide a framework for social, legal and economic support and protection for large families, single parents and families with special needs.</p>
<p><b>CSR 7:</b> Urgently adopt and implement the draft Law on Market Unity and speed up all complementary actions needed for its swift implementation.</p> <p>Ensure the effectiveness, autonomy and independence of the newly created regulatory authority.</p> <p>By the end of 2013, adopt and implement the Law on professional associations and services, so as to remove any unjustified restriction to the access and exercise of professional activities,</p> <p>(By the end of 2013, adopt) the Law on Entrepreneurship. Regroup and concentrate support schemes for the internationalisation of firms.</p>	<p><b>Spain has made some progress on addressing CSR 7 of the Council Recommendation:</b></p> <p><b>Substantial progress</b> — The law on the guarantee of market unity was adopted in December 2013. Its implementation (including changes to sector specific legislation) is underway, and will continue throughout 2014. Swift and full implementation remains key.</p> <p><b>Substantial progress</b> — Law 3/2013 of 4 June creates Spain's Commission for Markets and Competition, by merging Spain's Competition Commission with the supervisory and regulatory authorities for energy, telecommunications, postal services, audio-visual industries, railway and air transport. The statutes of the new Commission for Markets and Competition were adopted on 30 August 2013, while its internal operating regulations were adopted on 4 October 2013.</p> <p><b>Limited progress</b> — The adoption of the reform of professional services continues to be delayed.</p> <p><b>Substantial progress</b> — Law 14/2013 to support entrepreneurs and their internationalisation received parliamentary approval on 27 September 2013.</p>

Reduce the number and shorten licensing procedures, including for industrial activities, and spread the use of the "express licence" approach to activities other than retail.

Review insolvency frameworks for companies and individuals, including through limiting personal liability of entrepreneurs and easing second chances for failed businesses.

Remove unjustifiable restrictions to the establishment of large-scale retail premises.

By March 2014, review the effectiveness of the regulatory framework to support the development of the housing rental market.

**CSR 8:** Tackle the electricity tariff deficit by adopting and implementing a structural reform of the electricity sector by the end of 2013. Intensify efforts to complete the electricity and gas interconnections with neighbouring countries.

Reduce the contingent liability for public finances stemming from unprofitable transport infrastructure. Set up an independent observatory to inform the assessment of future major infrastructure projects. Take measures to ensure effective competition in freight and passenger rail services.

**CSR 9:** Adopt in line with the presented timetable the reform of the local administration and define by October 2013 a plan to enhance the efficiency of the overall public administration.

**Substantial progress** — Law 21/2013 of 9 December on environmental evaluation is expected to ease the licensing of industrial activities by speeding up environmental licensing procedures.

The express licensing process was extended, by Law 20/2013 on market unity, to cover selected economic activities (including some manufacturing activities) which are carried out in permanent establishments that have a functional display and public sale area which does not exceed 750 m<sup>2</sup>.

**Some progress** — The law on entrepreneurship was adopted in autumn 2013 and brought improvements to the framework for corporate insolvency. The Royal Decree Law 4/2014 of 7 March facilitates refinancing agreements to accelerate the deleveraging process.

**Limited progress** — No regulatory measures have been taken to remove restrictions on setting up large-scale retail premises. The government plans to discuss regulatory barriers to this at the sectoral conferences.

**Substantial progress** — In June 2013 the Spanish Parliament adopted the law on promoting the rental housing market.

**Spain has made some progress on addressing CSR 8 of the Council Recommendation:**

**Some progress** — Despite the Royal Decree-Law 9/2013 on urgent measures to guarantee the financial stability of the electricity system, adopted in July 2013, and the Law 24/2013 on the electricity sector, adopted in December, a significant electricity tariff deficit was registered in 2013. Gas and electricity interconnections with France and Portugal have been expanded, but still fall short of the target.

**Some progress** — The government is studying ways to minimise negative spillovers from insolvent toll motorways on public finances. There was no progress on an independent transport monitoring body. Some measures to promote competition in railway freight have been adopted or are in the pipeline, and preparations have been made to liberalise passenger railway services.

**Spain has made some progress on addressing CSR 9 of the Council Recommendation:**

<p>Adopt and implement the on-going reforms to enhance the efficiency of the judicial system.</p>	<p><b>Substantial progress</b> — The reform of local public administration has been passed. Implementation of the experts committee’s recommendations on public administration reform is on-going and will continue throughout 2014/15.</p> <p><b>Some progress</b> — Spain is carrying out legislative reforms relating to different aspects of the functioning of the judicial system. These reforms are at different stages of completion. The most recent indicators on the efficiency of the justice systems show that length of proceedings and the rate of resolving cases have improved for first<sup>t</sup> instance civil, commercial and administrative cases. Progress is still much needed in implementing measures aiming to improve the use of ICT tools.</p>
<p><b>Europe 2020 (national targets and progress)</b></p>	
<p><b>Policy field target</b></p>	<p><b>Progress achieved</b></p>
<p>R&amp;D target: 2 % by 2020</p>	<p>Spain is not on track in reaching its national R&amp;D target, in spite of having lowered it in 2013 from 3.0 % to 2.0 % of GDP. In 2012, Spain’s R&amp;D intensity was 1.3 %. Private R&amp;D intensity fell by 1.8 % over the 2007-2012 period despite a shrinking GDP.</p> <p>Total expenditure in R&amp;D amounted to 13,392 million in 2012, down by 5.6 % compared to 2011. The decrease over the last year was higher in the public sector (-7.4 %) than in the private sector (-4.1 %). At the same time, expenditure in higher education fell by 7.2 % in 2012.</p>
<p>Employment rate target by 2020: 74%</p>	<p>The employment rate (20-64) went from 61.6 % in 2011 and 59.3 % in 2012 to 58.2% in 2013 (53.1 % for women).</p>
<p>Greenhouse gas emissions, base year 1990: National Target: -10% (compared to 2005 emissions, ETS emissions not covered by this national target)</p>	<p>The change in non-ETS greenhouse gas emissions between 2005 and 2012 was -15 %.</p> <p>According to the most recent national projections submitted to the Commission, and taking into account existing measures, it is expected that the target of 10 % will be missed: A reduction of 2.5 % in 2020 as compared with 2005 is expected (i.e. a projected shortfall of 7,5 percentage points).</p>
<p>Renewable energy target: 20 % Share of renewable energy in all modes of the transport sector: 10 %</p>	<p>Spain is currently on track to achieve its 20% renewable energy target: The proportion of renewables in final energy consumption reached 14.26 % in 2012.</p>
<p>Indicative national energy efficiency target for 2020:</p>	<p>Spain announced the policy measures it plans to adopt to implement Article 7 of the Energy</p>

<p>Spain has set an indicative national energy efficiency target of 20%, which implies reaching a 2020 level of 121.6 Mtoe primary consumption and 82.9 Mtoe final energy consumption.</p>	<p>Efficiency Directive.</p>
<p>Early school leaving rate target by 2020: 15%</p>	<p>The early school leaving rate was 26.5 % in 2011, 24.9 % in 2012 and 23.5 % in 2013 (provisional figures), far from the national target of 15 %.</p> <p>Some progress has been achieved towards meeting the target. The effectiveness of policies and measures to combat early leaving from education and training is difficult to assess in the light of the evident effect of the prolonged economic crisis on the permanence of young people in the education system.</p>
<p>Tertiary education rate target by 2020: 44 %</p>	<p>The tertiary educational attainment rate was 40.6 % in 2011, 40.1 % in 2012 and 40.7 % in 2013 (provisional figures), close to the national target of 44 %.</p>
<p>Reduction of population at risk of poverty or social exclusion target by 2020 (in number of persons): - 1.4 / 1.5 million people at risk</p>	<p>The number of people at-risk-of-poverty or social exclusion increased by almost 300 000 between 2011 and 2012, reaching 13 090 000.</p>

**ANNEX**  
**Standard Tables**

**Table I. Macro- economic indicators**

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
<b>Core indicators</b>								
GDP growth rate	4.1	3.3	0.9	0.1	-1.6	-1.2	1.1	2.1
Output gap <sup>1</sup>	-0.2	2.1	-0.5	-5.9	-7.3	-8.1	-6.7	-4.7
HICP (annual % change)	2.6	3.2	2.5	3.1	2.4	1.5	0.1	0.8
Domestic demand (annual % change) <sup>2</sup>	4.7	4.1	0.4	-2.0	-4.1	-2.7	0.4	1.6
Unemployment rate (% of labour force) <sup>3</sup>	15.5	10.7	13.2	21.7	25.0	26.4	25.5	24.0
Gross fixed capital formation (% of GDP)	23.3	27.4	27.2	20.7	19.2	17.7	17.1	17.5
Gross national saving (% of GDP)	22.2	22.6	20.0	17.3	18.5	19.0	19.0	19.5
<b>General Government (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-3.0</b>	<b>0.0</b>	<b>-4.2</b>	<b>-9.6</b>	<b>-10.6</b>	<b>-7.1</b>	<b>-5.6</b>	<b>-6.1</b>
<b>Gross debt</b>	<b>63.9</b>	<b>49.3</b>	<b>46.4</b>	<b>70.5</b>	<b>86.0</b>	<b>93.9</b>	<b>100.2</b>	<b>103.8</b>
<b>Net financial assets</b>	<b>-51.3</b>	<b>-36.4</b>	<b>-27.4</b>	<b>-48.2</b>	<b>-59.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	38.1	38.7	38.1	36.2	37.2	37.8	38.1	36.9
Total expenditure	41.0	38.6	42.3	45.7	47.8	44.9	43.8	43.0
<i>of which: Interest</i>	4.2	2.4	1.7	2.5	3.1	3.4	3.5	3.6
<b>Corporations (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-1.0</b>	<b>-3.7</b>	<b>-4.2</b>	<b>2.3</b>	<b>7.5</b>	<b>6.1</b>	<b>4.9</b>	<b>5.3</b>
<b>Net financial assets; non-financial corporations</b>	<b>-94.9</b>	<b>-109.5</b>	<b>-144.2</b>	<b>-133.1</b>	<b>-132.5</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>0.8</b>	<b>3.1</b>	<b>7.3</b>	<b>14.5</b>	<b>15.2</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	14.2	15.6	15.4	13.3	13.3	12.3	12.0	12.5
Gross operating surplus	20.2	19.4	19.6	20.7	21.6	21.9	21.7	22.0
<b>Households and NPISH (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>3.2</b>	<b>-0.4</b>	<b>1.3</b>	<b>3.7</b>	<b>2.4</b>	<b>2.5</b>	<b>2.7</b>	<b>2.9</b>
<b>Net financial assets</b>	<b>116.5</b>	<b>98.1</b>	<b>83.7</b>	<b>79.1</b>	<b>86.8</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	38.7	37.7	38.0	38.1	36.3	35.2	34.9	34.5
Net property income	3.9	3.8	3.4	3.0	2.7	2.9	3.1	3.3
Current transfers received	20.6	19.5	20.5	23.1	23.9	24.4	24.4	24.2
Gross saving	8.4	7.3	8.8	8.5	6.9	6.9	6.9	7.0
<b>Rest of the world (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-0.6</b>	<b>-4.1</b>	<b>-7.1</b>	<b>-3.5</b>	<b>-0.6</b>	<b>1.5</b>	<b>2.0</b>	<b>2.1</b>
<b>Net financial assets</b>	<b>29.7</b>	<b>45.4</b>	<b>81.4</b>	<b>89.1</b>	<b>91.5</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-0.8	-3.3	-4.6	-1.1	0.7	2.4	3.3	3.7
Net primary income from the rest of the world	-0.9	-1.4	-2.0	-2.0	-1.2	-0.8	-1.0	-1.3
Net capital transactions	1.0	1.0	0.5	0.4	0.6	0.7	0.6	0.6
Tradable sector	49.3	45.9	42.7	44.4	45.2	45.6	n.a	n.a
Non tradable sector	41.7	44.3	48.2	47.3	46.5	45.6	n.a	n.a
<i>of which: Building and construction sector</i>	8.7	11.0	11.9	8.7	7.9	7.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	91.3	95.0	106.5	103.3	96.5	95.5	95.4	93.7
Terms of trade goods and services (index, 2000=100)	95.9	98.8	100.7	97.6	95.4	96.0	96.5	96.4
Market performance of exports (index, 2000=100)	102.0	103.7	99.2	104.5	107.8	112.3	114.5	116.2
<b>Notes:</b>								
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
<sup>2</sup> The indicator on domestic demand includes stocks.								
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
<b>Source:</b>								
Commission 2014 spring forecast (COM); Stability programme (SP).								

**Table II. Comparison of macroeconomic developments and forecasts**

	2013		2014		2015		2016	2017
	COM <sup>1</sup>	SP	COM <sup>1</sup>	SP	COM <sup>1</sup>	SP	SP	SP
Real GDP (% change)	-1.2	-1.2	1.1	1.2	2.1	1.8	2.3	3.0
Private consumption (% change)	-2.1	-2.1	1.3	1.4	1.6	1.8	2.3	2.8
Gross fixed capital formation (% change)	-5.1	-5.1	-1.4	0.5	4.2	3.0	4.6	6.7
Exports of goods and services (% change)	4.9	4.9	5.5	5.0	6.7	6.1	6.3	6.5
Imports of goods and services (% change)	0.4	0.4	3.4	3.6	5.8	5.0	5.8	6.3
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	-2.6	-2.6	0.4	0.7	1.5	1.2	1.9	2.6
- Change in inventories	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.5	1.5	0.8	0.6	0.5	0.5	0.4	0.3
Output gap <sup>1</sup>	-8.1	-7.8	-6.7	-6.6	-4.7	-4.8	-2.9	-0.7
Employment (% change)	-3.0	-3.0	0.6	0.9	1.4	1.5	1.7	2.4
Unemployment rate (%)	26.4	26.1	25.5	24.9	24.0	23.3	21.7	19.8
Labour productivity (% change)	2.3	1.8	0.7	0.3	0.8	0.2	0.5	0.5
HICP inflation (%)	1.5	n.a.	0.1	n.a.	0.8	n.a.	n.a.	n.a.
GDP deflator (% change)	0.6	0.6	0.3	0.5	0.7	0.8	1.2	1.5
Comp. of employees (per head, % change)	0.7	0.7	0.2	0.2	0.3	0.6	1.1	1.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.5	1.5	2.0	2.0	2.1	2.4	2.5	2.5
<u>Note:</u>								
<sup>1</sup> In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<u>Source :</u>								
Commission 2014 spring forecast (COM); Stability programme (SP).								

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2013	2014		2015		2016	2017	Change: 2013-2017
	COM	COM	SP	COM <sup>1</sup>	SP	SP	SP	SP
<b>Revenue</b>	<b>37.8</b>	<b>38.1</b>	<b>38.5</b>	<b>36.9</b>	<b>38.8</b>	<b>38.9</b>	<b>39.0</b>	<b>1.3</b>
<i>of which:</i>								
- Taxes on production and imports	11.0	11.1	11.4	11.1	11.8	12.0	12.1	1.0
- Current taxes on income, wealth, etc.	10.3	10.8	10.8	9.7	10.8	10.9	11.0	0.8
- Social contributions	12.8	12.8	12.6	12.7	12.5	12.3	12.3	-0.5
- Other (residual)	3.7	3.5	3.7	3.4	3.7	3.7	3.7	0.0
<b>Expenditure</b>	<b>44.9</b>	<b>43.8</b>	<b>44.0</b>	<b>43.0</b>	<b>43.0</b>	<b>41.7</b>	<b>40.1</b>	<b>-4.7</b>
<i>of which:</i>								
- Primary expenditure	41.4	40.3	40.5	39.4	39.4	38.0	36.4	-5.0
<i>of which:</i>								
Compensation of employees	11.3	11.1	11.0	10.5	10.6	10.1	9.5	-1.8
Intermediate consumption	5.5	5.3	5.4	5.3	5.1	4.9	4.6	-0.9
Social payments	19.3	19.3	19.2	19.1	18.8	18.4	17.8	-1.6
Subsidies	1.0	1.1	1.2	1.0	1.1	1.1	1.0	0.0
Gross fixed capital formation	1.5	1.3	1.6	1.3	1.6	1.6	1.5	0.1
Other (residual)	2.7	2.2	2.2	2.2	2.1	2.0	1.9	-0.8
- Interest expenditure	3.4	3.5	3.5	3.6	3.6	3.7	3.8	0.3
<b>General government balance (GGB)</b>	<b>-7.1</b>	<b>-5.6</b>	<b>-5.5</b>	<b>-6.1</b>	<b>-4.2</b>	<b>-2.8</b>	<b>-1.1</b>	<b>6.0</b>
<b>Primary balance</b>	<b>-3.7</b>	<b>-2.1</b>	<b>-2.0</b>	<b>-2.6</b>	<b>-0.6</b>	<b>0.9</b>	<b>2.7</b>	<b>6.3</b>
One-off and other temporary measures	-0.4	0.0	-0.2	-0.5	0.0	0.0	0.0	0.4
<b>GGB excl. one-offs</b>	<b>-6.7</b>	<b>-5.6</b>	<b>-5.3</b>	<b>-5.7</b>	<b>-4.2</b>	<b>-2.8</b>	<b>-1.1</b>	<b>5.6</b>
Output gap <sup>2</sup>	-8.1	-6.7	-6.6	-4.7	-4.8	-2.9	-0.7	7.3
Cyclically-adjusted balance <sup>2</sup>	-3.3	-2.4	-2.3	-3.9	-1.9	-1.4	-0.7	2.5
<b>Structural balance (SB)<sup>3</sup></b>	<b>-2.8</b>	<b>-2.4</b>	<b>-2.2</b>	<b>-3.4</b>	<b>-1.9</b>	<b>-1.4</b>	<b>-0.7</b>	<b>2.1</b>
<i>Change in SB</i>	<i>1.3</i>	<i>0.4</i>	<i>0.7</i>	<i>-1.1</i>	<i>0.2</i>	<i>0.5</i>	<i>0.7</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>1.8</i>	<i>0.9</i>	<i>1.0</i>	<i>-0.3</i>	<i>0.5</i>	<i>0.4</i>	<i>0.6</i>	<i>-</i>
Structural primary balance <sup>3</sup>	0.6	1.1	1.3	0.1	1.7	2.3	3.0	2.5
<i>Change in structural primary balance</i>		<i>0.5</i>	<i>0.8</i>	<i>-1.0</i>	<i>0.3</i>	<i>0.6</i>	<i>0.7</i>	<i>-</i>
<b>Expenditure benchmark</b>								
Applicable reference rate <sup>4</sup>	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Deviation <sup>5</sup> (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
<b>Notes:</b>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<sup>4</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.								
<sup>5</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.								
<b>Source:</b>								
Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.								

**Table IV. Debt dynamics**

(% of GDP)	Average 2008-2012	2013	2014		2015		2016	2017
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>62.4</b>	<b>93.9</b>	<b>100.2</b>	<b>99.5</b>	<b>103.8</b>	<b>101.7</b>	<b>101.5</b>	<b>98.5</b>
Change in the ratio	9.9	8.0	6.3	5.6	3.6	2.2	-0.2	-2.9
<i>Contributions<sup>2</sup> :</i>								
<b>1. Primary balance</b>	<b>6.9</b>	<b>3.7</b>	<b>2.1</b>	<b>2.0</b>	<b>2.6</b>	<b>0.6</b>	<b>-0.9</b>	<b>-2.7</b>
<b>2. “Snow-ball” effect</b>	<b>2.5</b>	<b>4.0</b>	<b>2.2</b>	<b>1.9</b>	<b>0.8</b>	<b>1.1</b>	<b>0.4</b>	<b>-0.6</b>
<i>Of which:</i>								
Interest expenditure	2.2	3.4	3.5	3.5	3.6	3.6	3.7	3.8
Growth effect	0.5	1.1	-1.1	-1.1	-2.0	-1.7	-2.2	-2.9
Inflation effect	-0.2	-0.5	-0.3	-0.4	-0.7	-0.8	-1.1	-1.5
<b>3. Stock-flow</b>	<b>0.5</b>	<b>0.3</b>	<b>2.0</b>	<b>1.7</b>	<b>0.2</b>	<b>0.6</b>	<b>0.3</b>	<b>0.4</b>
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								
		<b>2013</b>	<b>2014</b>		<b>2015</b>		<b>2016</b>	<b>2017</b>
			<b>COM</b>	<b>SP</b>	<b>COM</b>	<b>SP</b>	<b>SP</b>	<b>SP</b>
<b>Gap to the debt benchmark<sup>3,4</sup></b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Structural adjustment<sup>5</sup></b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>To be compared to:</i>								
Required adjustment <sup>6</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Notes:</b>								
<sup>1</sup> End of period.								
<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.								
<sup>3</sup> Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.								
<sup>4</sup> Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.								
<sup>5</sup> Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.								
<sup>6</sup> Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP/CP) budgetary projections for the previous years are achieved.								
<i>Source :</i>								
<i>Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.</i>								



**Table V. Sustainability indicators**

	Spain			European Union		
	2013 scenario	No-policy-change scenario	Stability programme scenario	2013 scenario	No-policy-change scenario	Stability programme scenario
S2*	-0.3	0.3	-2.8	2.4	2.4	0.7
<i>of which:</i>						
Initial budgetary position (IBP)	0.7	1.3	-1.9	0.5	0.4	-1.3
Long-term cost of ageing (CoA)	-0.9	-1.0	-0.9	1.9	2.0	2.0
<i>of which:</i>						
pensions	-0.7	-0.4	-0.4	0.7	0.8	0.9
healthcare	1.2	1.2	1.2	0.9	0.9	0.8
long-term care	0.4	0.4	0.4	0.6	0.6	0.6
others	-1.9	-2.1	-2.1	-0.4	-0.4	-0.3
S1**	1.9	2.6	-0.9	1.5	1.7	-0.2
<i>of which:</i>						
Initial budgetary position (IBP)	0.4	0.3	-3.2	-0.2	-0.4	-2.0
Debt requirement (DR)	2.0	3.0	3.0	1.5	1.8	1.5
Long-term cost of ageing (CoA)	-0.6	-0.7	-0.7	0.2	0.3	0.3
S0 (risk for fiscal stress)***	0.42	:		:		
Debt as % of GDP (2013)	93.9			88.9		
Age-related expenditure as % of GDP (2013)	24.4			25.8		

Source : Commission; 2014 stability programme.

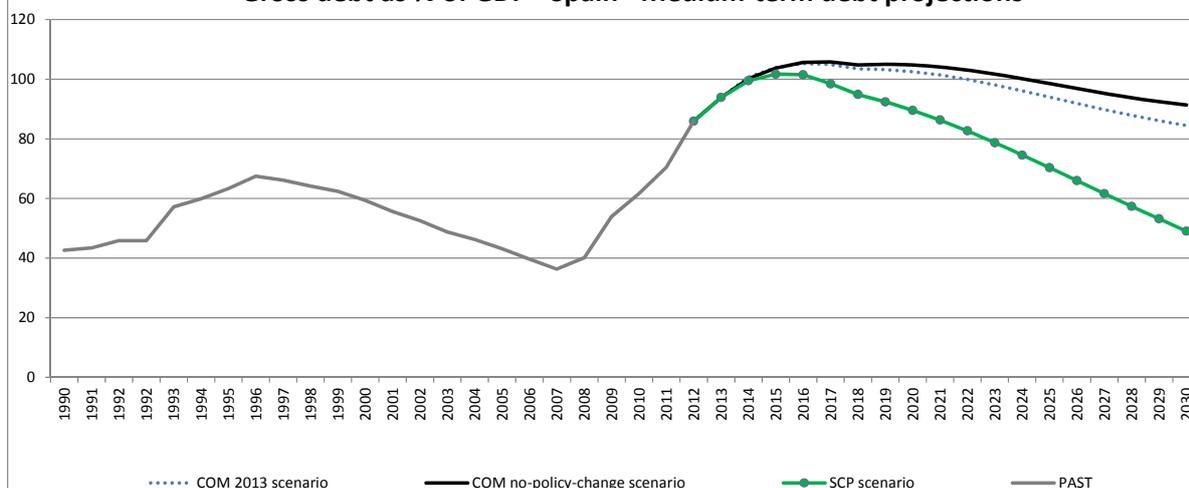
Note : The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.

\* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60 % debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.

\*\* The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.

\*\*\* The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.

**Gross debt as % of GDP - Spain - Medium-term debt projections**



**Table VI. Taxation indicators**

	2002	2006	2008	2010	2011	2012
<b>Total tax revenues</b> (incl. actual compulsory social contributions, % of GDP)	34.1	36.8	32.9	32.2	31.8	32.5
<b>Breakdown by economic function</b> (% of GDP) <sup>1</sup>						
Consumption	9.5	9.9	8.2	8.8	8.5	8.6
of which:						
- VAT	5.8	6.5	5.1	5.6	5.4	5.5
- excise duties on tobacco and alcohol	0.9	0.8	0.8	0.9	0.9	0.9
- energy	1.7	1.4	1.3	1.4	1.3	1.3
- other (residual)	1.1	1.1	1.0	1.0	0.9	0.9
Labour employed	15.7	15.6	16.0	16.0	16.0	15.7
Labour non-employed	0.8	0.8	1.0	1.4	1.5	1.5
Capital and business income	5.9	7.1	5.5	4.3	4.2	4.6
Stocks of capital/wealth	2.9	3.8	2.8	2.6	2.4	2.8
<i>p.m.</i> Environmental taxes <sup>2</sup>	2.1	1.9	1.7	1.7	1.6	1.6
<b>VAT efficiency</b> <sup>3</sup>						
Actual VAT revenues as % of theoretical revenues at standard rate	52.4	59.2	44.5	42.1	40.6	41.6
<b>Note:</b>						
1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.						
2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.						
3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.						
<i>Source: Commission</i>						

**Table VII. Financial market indicators**

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	329.2	332.0	346.1	347.9	308.0
Share of assets of the five largest banks (% of total assets)	43.3	44.3	48.1	51.4	-
Foreign ownership of banking system (% of total assets)	10.1	9.6	9.5	9.1	-
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1),2)</sup>	4.1	4.7	6.0	7.5	8.2
- capital adequacy ratio (%) <sup>1)</sup>	12.2	11.9	12.1	11.6	12.0
- return on equity (%) <sup>1),3)</sup>	9.2	8.0	1.5	-21.0	8.2
Bank loans to the private sector (year-on-year % change)	-1.0	1.3	-1.9	-7.4	-8.6
Lending for house purchase (year-on-year % change)	0.1	0.9	-1.2	-3.3	-4.1
Loan to deposit ratio	110.8	108.8	108.7	108.1	98.7
CB liquidity as % of liabilities	3.1	2.1	5.8	12.8	8.0
Banks' exposure to countries receiving official financial assistance (% of GDP) <sup>4)</sup>	6.8	6.9	6.4	5.9	5.6
Private debt (% of GDP)	213.2	213.9	206.5	195.3	-
Gross external debt (% of GDP)					
- Public	28.8	27.5	26.2	32.1	40.8
- Private	60.7	58.6	55.7	54.3	53.5
Long term interest rates spread versus Bund (basis points)*	75.7	150.8	283.3	435.1	299.2
Credit default swap spreads for sovereign securities (5-year)*	87.2	168.9	250.0	325.7	185.5
<b>Notes:</b>					
<sup>1)</sup> Latest data June 2013Q2.					
<sup>2)</sup> Includes loans to private sector, public administration, other credit institutions, and nonresidents.					
<sup>3)</sup> After extraordinary items and taxes. Includes only the net income attributable to the group.					
<sup>4)</sup> Covered countries are CY, EL, LV, HU, IE, PT and RO.					
* Measured in basis points.					
<i>Source:</i>					
Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).					



**Table VIII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Employment rate (% of population aged 20-64)	68.3	63.7	62.5	61.6	59.3	58.2
Employment growth (% change from previous year)	-0.1	-6.5	-2.2	-1.9	-4.2	-3.0
Employment rate of women (% of female population aged 20-64)	58.3	56.3	55.8	55.5	54.0	53.1
Employment rate of men (% of male population aged 20-64)	78.1	71.0	69.1	67.6	64.5	63.3
Employment rate of older workers (% of population aged 55-64)	45.6	44.1	43.6	44.5	43.9	43.4
Part-time employment (% of total employment, 15 years and more)	12.0	12.8	13.3	13.8	14.7	16.0
Part-time employment of women (% of women employment, 15 years and more)	22.7	23.0	23.2	23.5	24.5	25.8
Part-time employment of men (% of men employment, 15 years and more)	4.2	4.9	5.4	6.0	6.6	7.9
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	29.3	25.4	24.9	25.3	23.6	23.4
Transitions from temporary to permanent employment	20.1	17.8	15.9	10.8	14.4	:
Unemployment rate <sup>1</sup> (% of labour force, age group 15-74)	11.3	17.9	19.9	21.4	24.8	26.1
Long-term unemployment rate <sup>2</sup> (% of labour force)	2.0	4.3	7.3	9.0	11.1	13.1
Youth unemployment rate (% of youth labour force aged 15-24)	24.5	37.7	41.5	46.2	52.9	55.5
Youth NEET rate (% of population aged 15-24)	14.4	18.3	18.0	18.5	18.8	18.6
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	31.9	31.2	28.4	26.5	24.9	23.5
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	39.8	39.4	40.6	40.6	40.1	40.7
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	22.0	18.0	20.0	20.0	21.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	16.0	18.0	18.0	19.0	15.0	:
Labour productivity per person employed (annual % change)	1.1	2.5	2.2	2.3	3.3	2.3
Hours worked per person employed (annual % change)	0.3	0.5	0.2	0.3	-0.7	-0.1
Labour productivity per hour worked (annual % change; constant prices)	0.7	2.4	1.9	1.6	3.5	1.9
Compensation per employee (annual % change; constant prices)	4.4	4.1	0.3	1.3	0.2	0.0
Nominal unit labour cost growth (annual % change)	5.6	1.4	-1.8	-1.0	-3.0	-1.7
Real unit labour cost growth (annual % change)	3.2	1.3	-1.8	-1.0	-3.0	-2.3
Notes:						
<sup>1</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.						
<sup>2</sup> Long-term unemployed are unemployed persons for at least 12 months.						
Sources:						
Commission (EU Labour Force Survey and European National Accounts)						

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Sickness/Health care	6.4	6.8	7.3	7.2	7.0
Invalidity	1.5	1.6	1.7	1.8	1.8
Old age and survivors	8.7	9.1	10.2	10.8	11.2
Family/Children	1.3	1.4	1.5	1.5	1.4
Unemployment	2.1	2.5	3.7	3.6	3.7
Housing and Social exclusion n.e.c.	0.2	0.2	0.2	0.2	0.2
<b>Total</b>	<b>20.3</b>	<b>21.7</b>	<b>24.9</b>	<b>25.3</b>	<b>25.6</b>
of which: means tested benefits	2.7	2.9	3.6	4.0	4.2
<b>Social inclusion indicators</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
At-risk-of-poverty or social exclusion <sup>1</sup> (% of total population)	24.5	24.5	26.7	27.7	28.2
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	30.6	30.0	33.1	33.2	33.8
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	27.7	24.3	21.4	20.9	16.6
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	20.8	20.1	21.4	22.2	22.2
Severe Material Deprivation <sup>3</sup> (% of total population)	3.6	4.5	4.9	4.5	5.8
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59)	6.6	7.6	10.8	13.4	14.3
In-work at-risk-of poverty rate (% of persons employed)	11.2	11.7	12.8	12.2	12.3
Impact of social transfers (excluding pensions) on reducing poverty	17.5	20.2	25.7	26.0	25.0
Poverty thresholds, expressed in national currency at constant prices <sup>5</sup>	7 367	7 203	7 114	6 670	6 393
Gross disposable income (households)	717 149	720 999	702 619	702 336	682 498
Relative median poverty risk gap (60% of median equivalised income, age: total)	24.4	28.9	32.3	30.9	31.4
<b>Notes:</b>					
<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
<sup>2</sup> At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.					
<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.					
<sup>4</sup> People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.					
<sup>5</sup> For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)					
<b>Sources:</b>					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					

**Table IX. Product market performance and policy indicators**

Performance indicators	2004-2008	2009	2010	2011	2012	2013
Labour productivity <sup>1</sup> total economy (annual growth in %)	0.3	3.0	2.1	2.6	3.0	1.8
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	1.4	1.2	9.7	3.3	4.7	4.6
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	0.1	-10.5	19.7	10.6	n.a.	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	1.1	18.4	-4.5	7.8	12.2	4.4
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	62.4	65.7	67.9	70.6	n.a.	n.a.
Policy indicators	2004-2008	2009	2010	2011	2012	2013
Enforcing contracts <sup>3</sup> (days)	515.0	515	515	515	510	510
Time to start a business <sup>3</sup> (days)	60.4	47	47	28	28	23
R&D expenditure (% of GDP)	1.2	1.4	1.4	1.4	1.3	n.a.
Tertiary educational attainment (% of 30-34 years old population)	38.4	39.4	40.6	40.6	40.1	40.7
Total public expenditure on education (% of GDP)	4.3	5.0	5.0	4.8	n.a.	n.a.
	2008	2009	2010	2011	2012	2013
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	1.6	n.a.	n.a.	n.a.	n.a.	1.5
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	2.9
Product market regulation <sup>4</sup> , Network Industries <sup>5</sup> (Index; 0=not regulated; 6=most regulated)	1.8	n.a.	n.a.	n.a.	n.a.	1.6
Notes:						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, for this indicator are presented in detail on the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the product market regulation indicators are presented in detail on the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1.00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1.00.html</a> .						
<sup>5</sup> Aggregate ETCR.						
<i>Source :</i> Commission, World Bank - <i>Doing Business</i> (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						

**Table X. Green growth**

		2003-2007	2008	2009	2010	2011	2012
<b>Green Growth performance</b>							
<i>Macroeconomic</i>							
Energy intensity	kgoe / €	0.19	0.18	0.17	0.17	0.17	0.17
Carbon intensity	kg / €	0.57	0.50	0.47	0.45	0.45	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	1.18	1.01	0.86	0.76	0.68	n.a.
Waste intensity	kg / €	n.a.	0.19	n.a.	0.18	n.a.	n.a.
Energy balance of trade	% GDP	-2.6%	-3.7%	-2.4%	-3.0%	-3.8%	-4%
Energy weight in HICP	%	9	10	10	10	11	12
Difference between change energy price and inflation	%	1.0400001	6.2999997	-1.6	4.3000002	12.6	7.4000001
Environmental taxes over labour taxes	ratio	11.9%	9.8%	9.7%	9.6%	9.1%	n.a.
Environmental taxes over total taxes	ratio	5.4%	5.1%	5.4%	5.2%	5.0%	n.a.
<i>Sectoral</i>							
Industry energy intensity	kgoe / €	0.19	0.17	0.16	0.16	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	9.5	9.1	8.5	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.10	0.11	0.11	0.11	0.11
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.03	0.03	0.03	0.04
Public R&D for energy	% GDP	n.a.	0.03%	0.03%	0.03%	0.03%	0.01%
Public R&D for the environment	% GDP	n.a.	0.04%	0.05%	0.03%	0.03%	0.02%
Recycling rate of municipal waste	ratio	37.6%	48.3%	42.1%	37.8%	37.0%	36.7%
Share of GHG emissions covered by ETS*	%	n.a.	41.0%	38.1%	35.0%	38.3%	39.7%
Transport energy intensity	kgoe / €	0.70	0.65	0.63	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	1.76	1.64	1.58	n.a.	n.a.	n.a.
<b>Security of energy supply</b>							
Energy import dependency	%	79.3%	81.3%	79.1%	76.8%	76.4%	73.3%
Diversification of oil import sources	HHI	n.a.	0.06	0.06	0.06	0.07	n.a.
Diversification of energy mix	HHI	0.32	0.32	0.32	0.31	0.29	0.27
Share renewable energy in energy mix	%	6.4%	7.4%	9.5%	11.5%	11.5%	12.6%

Country-specific notes:

The year 2012 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)

Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

\* Commission and EEA.

\*\* For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.

\*\*\* For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.

## **List of indicators used in Box 4 on the potential impact on growth of structural reforms.**

**Final goods sector mark-ups:** Price-cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities<sup>75</sup>).

Source: Commission services estimation using the methodology of Roeger, W. (1995). "Can imperfect Competition explain the Difference between primal and dual Productivity?" *Journal of Political Economy* Vol. 103(2) pp. 316-30, based on EUKLEMS 1996-2007 data.

**Entry costs:** Cost of starting a business in the intermediate sector as a share of income per capita. The intermediate sector is proxied by the manufacturing sector in the model.

Source: World Bank, Doing Business Database. [www.doingbusiness.org](http://www.doingbusiness.org). 2012 data.

**Implicit consumption tax rate:** Defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes. The implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced so that the combined impact is ex-ante budgetary neutral.

Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013. 2011 data.

**Shares of high-skilled and low-skilled:** The share of high skilled workers is increased, the share of low-skilled workers is reduced (halving the gap vis-à-vis the best performers). Low-skilled correspond to ISCED 0-2 categories; high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.

Source: EUROSTAT. 2012 data or latest available.

**Female non-participation rate:** Share of women of working age not in paid work and not looking for paid work in total female working-age population

Source: EUROSTAT. 2012 data or latest available.

**Low-skilled male non-participation rates:** Share of low-skilled men of working age not in paid work and not looking for paid work in total male working-age population

Source: EUROSTAT. 2012 data or latest available.

**Elderly non-participation rates (55-64 years):** Share of the population aged 55-64 years not in paid work and not looking for paid work in total population aged 55-64 years.

Source: EUROSTAT. 2012 data or latest available.

**ALMP:** Active Labour Market Policy expenditures as a share of GDP over the share of unemployed in the population.

Source: EUROSTAT. 2011 data or latest available.

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<sup>75</sup> The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.

**Benefit replacement rate:** Share of a worker's pre-unemployment income that is paid out by the unemployment insurance scheme. Average of net replacement rates over 60 months of unemployment.

Source: OECD, Benefits and Wages Statistics.

[www.oecd.org/els/benefitsandwagesstatistics.htm](http://www.oecd.org/els/benefitsandwagesstatistics.htm). 2012 data.