COUNCIL OF THE EUROPEAN UNION

Brussels, 9 July 2012
(OR. en)

12171/12

LIMITE

ECOFIN 669
UEM 252

LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Spain

COUNCIL RECOMMENDATION

of

with a view to bringing an end to the situation
of an excessive government deficit in Spain

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission, Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU), Member States are to avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 27 April 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit existed in Spain and issued a recommendation to correct the excessive deficit by 2012 at the latest, in accordance with Article 104(7) TEC 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[1].

---

[1] OJ L

(4) On 2 December 2009, the Council decided, in accordance with Article 3(5) of Regulation (EC) No 1467/97, that effective action had been taken and that unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of that recommendation. As a result, the Council decided to adopt a revised recommendation under the excessive deficit procedure (EDP) to correct the excessive deficit by 2013 at the latest. In order to bring the headline government deficit below the 3 % of GDP reference value by 2013 an average annual fiscal effort of 'above 1,5 % of GDP' over the period 2010-2013 was recommended. In calculating the average annual fiscal effort, the 2011 deficit in the Commission services 2009 autumn forecast was taken as the starting point. The total fiscal effort needed to reach the nominal deficit target of 3 % by the deadline was then calculated by assuming a gradual closure of the output gap by 2015.

(5) On 15 June 2010, the Commission concluded that Spain had taken effective action in compliance with the Council recommendation of 2 December 2009 to bring its government deficit below the 3 % of GDP reference value and considered that no additional step in the EDP was therefore necessary.

(6) According to Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under the EDP, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation. The occurrence of unexpected adverse economic events with major unfavourable budgetary effects needs to be assessed against the economic forecast underlying the Council recommendation.

(7) In accordance with Article 126(7) of the TFEU and Article 3 of Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit, the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0,5 % of GDP as a benchmark.

(8) After recording a significant contraction in 2009, when real GDP fell by 3,7 %, the economy continued to contract in 2010, albeit by a mere -0,1 %. The economy returned to positive economic growth in 2011 (0,7 %), supported by the dynamism of Spanish exports, which were helped by the improving competitiveness of the Spanish economy, and the contraction of imports, in line with the weakness of domestic demand. However, according to the most recent update by the Commission services of the economic outlook in Spain for 2012-2013, which is an update of the 2012 Spring Forecast incorporating the fiscal measures taken in late May 2012 at regional level and latest economic and budgetary developments, Spain is likely to fall back into recession, and record negative annual economic growth in both 2012 and 2013. Both private and public sector deleveraging and the sizeable unemployment level are a heavy drag on domestic demand. In addition, the weakening of the international environment is preventing external demand from offsetting the weakness of domestic demand, resulting in the contraction of the Spanish economy.

(9) The general government deficit reached 9,3 % of GDP in 2010, down from 11,2 % in 2009. The improvement in the budget balance was driven by both cuts in total expenditure and an increase in total revenues, mainly as a result of discretionary measures. In 2011, the deficit outturn was significantly worse than expected, 8,5 % of GDP compared with a target of 6 % of GDP. Spain informed Eurostat on 17 May 2012 that the 2011 general government deficit could be revised up by around 0,4 % of GDP due to new information on some expenditure items of the autonomous regions which had not been included in the March 2012 EDP notification. Around two thirds of the 2011 budget deviation occurred at the regional level, while central government and social security recorded much smaller slippages. The budget deviation was mainly explained by weaker-than-expected revenues due to the materialisation of a less favourable economic environment than foreseen in the 2011 Stability Programme and a less tax-rich growth composition, while expenditure overruns were limited.

(10) According to a Commission services update of the 2012 spring forecast, the general government deficit is projected at 6,3 % of GDP in 2012, which compares to an expected deficit of 5,3 % of GDP in the 2012 Stability Programme and the draft 2012 budget law. The latter is based on revenue-raising measures which include mainly increases in direct taxation, such as changes to income and corporate taxation, and a fiscal amnesty. Some of these measures have been announced as being temporary, such as the increase in income tax (limited to 2012 and 2013), or will have a one-off impact, such as the change in the tax instalment system for corporate taxes in 2012 and the fiscal amnesty. The draft budget law and the Stability Programme foresee that total expenditure declines as a result of deep cuts in both capital and current spending, including from savings in the areas of health care and education at regional level. The projected deviation from the target in 2012 is mainly linked to expected revenue shortfalls, especially in social security, and higher social expenditure, due to a worse macroeconomic outlook, a less tax-rich growth composition, and a stronger deterioration in the labour market. This budget forecast is still subject to major risks. A further deepening of the economic crisis and implementation risks at regional level due to the fact that many budgetary measures will only apply to part of the year, could imply an even larger deviation. The necessary ongoing rebalancing of the Spanish economy from non-tradables to tradables also implies a risk of economic growth becoming less tax-rich. Very recent budgetary outcome figures for the first months of 2012 point to continued downward pressure on revenues and indicate a need to implement further structural measures without delay.

(11) According to the Commission services update of the 2012 spring forecast, on the basis of unchanged policies, and with real GDP expected to shrink by 0,3 % on the previous year, the government deficit is projected at 6,1 % of GDP in 2013 compared to the original target of 3 % of GDP. The 2012 Stability Programme projects a sizeable increase in revenues from taxes on production and imports, not yet underpinned by concrete measures, which is also expected to be partially compensated by lower taxes on labour. The Stability Programme also includes – so far not fully specified – cuts on the expenditure side, pertaining in particular to the area of education and health care at regional level. For 2014 and 2015, the envisaged further consolidation is not yet sufficiently supported by measures to underpin the proposed deficit target and few concrete measures are included in the Stability Programme.

(12) The Commission services update of the 2012 spring forecast shows that the structural deficit was 8,7 %, 7,3 % and 7,0 % of GDP in 2009, 2010 and 2011 respectively. It is expected to reach 4,3 % of GDP in 2012. This implies an average fiscal effort of 1,5 % of GDP between 2010 and 2012, which is in line with the minimum required average annual fiscal effort of 'above 1,5 %' of GDP specified by the Council in 2010-2013. Correcting for the change in the macroeconomic scenario between the projections underlying the Council recommendations of 2 December 2009 and the current forecast, the estimated average annual fiscal effort between 2010 and 2012 would be 0,5 percentage points of GDP higher. Spain has so far thus taken effective action as regards the path for the structural deficit up to 2012.

(13) According to the Commission services 2009 autumn forecast, which was underlying the Council recommendation under the EDP of 2 December 2009, the Spanish economy was expected to contract by 0,8 % in 2010 and to grow by 1 % in 2011. The years 2012 and 2013 were beyond that forecast's horizon period, but under the hypothesis of a gradual closure of the large negative output gap by 2015, higher growth than in 2011 was expected for 2012 and 2013. The outcome of real GDP for 2010 and 2011 was slightly more positive than expected in the 2009 Autumn Forecast. Nevertheless, the composition of economic growth was less tax-rich than expected, as the accumulated contribution of domestic demand for 2010 and 2011 was -2,7 percentage points of GDP, compared to a forecast of -1,1 percentage points, due to the faster than expected downsizing of the non-tradable sector. The results from the Commission services update of the 2012 spring forecast for 2012 and 2013 show that the Spanish economy is likely to face significant headwinds, which were not expected in the 2009 autumn forecast. While the 2009 autumn forecast assumed growth rates of well over 1 % per year in 2012 and 2013, the latest forecasts point to growth rates of -1,9 % and -0,3 %, respectively, on a no-policy change basis. Furthermore, the growth composition is likely to continue to be biased towards net external demand, with continued negative effects on tax revenues.

(14) Gross public debt rose to 68,5 % of GDP in 2011, and according to the Commission services update of the 2012 spring forecast it is expected to surge to 80,9 % of GDP in 2012 and to 86,8 % in 2013, based on a no-policy-change scenario, thus exceeding the Treaty reference value in all years. This increase in the debt ratio is mainly driven by higher interest payments and to a lesser extent by the dynamics of the primary deficit. The stock-flow adjustment is sizeable in 2012, contributing 5,4 percentage points of GDP to the increase, and is linked to the plan to settle invoices of providers of public bodies and other outstanding operations. Risks related to the macroeconomic scenario and the budgetary targets, as well as to additional financial restructuring and recapitalisation operations in the framework of the financial assistance requested, could contribute to a further increase in public debt.

(15) The budgetary position has deteriorated substantially compared to when the earlier Council recommendation was framed, due to a worse-than-expected economic outlook, which is also less tax-rich. Moreover, the sizeable contraction of the economy is affecting employment and unemployment in a very negative way. This is having negative effects on both the revenue and expenditure side, with a shortfall of social contributions and higher social transfers. Considering all these factors, and given in particular the marked deterioration in the fiscal outlook since the original Council recommendation under the excessive deficit procedure, an additional year for the correction of the excessive deficit would therefore be warranted.

(16) Granting an additional year for the correction of the excessive deficit requires the attainment of intermediate headline deficit targets of 6,3 % of GDP for 2012, 4,5 % of GDP for 2013, and 2,8 % of GDP for 2014. On the basis of the Commission services update of the 2012 spring forecast, the underlying required improvement in the structural fiscal balance resulting from these headline targets is 2,7 % of GDP in 2012, 2,5 % of GDP in 2013 and 1,9 % of GDP in 2014. Given very recent fiscal outturn data for the first months of 2012, additional measures will be needed to achieve the deficit target in 2012. The situation will have to be monitored closely and further corrective action would have to be taken early on if further slippages were to materialise.

(17) Given the severe market pressure on Spanish sovereign debt, the Government needs to underpin the credibility of the consolidation effort by adopting the announced multi-annual budget plan for 2013-14 by the end of July 2012. This would require specifying in detail all the structural measures that are necessary to achieve the budgetary targets in 2013 and 2014, and accelerating the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. The importance of taking timely action on this point to avoid the risk of future slippages warrants the shorter deadline of three months for taking effective action.

(18) On 10 July 2012, the Council adopted country-specific recommendations for Spain, the first of which was based, inter alia, on the assessment of Spain's National Reform Programme and its Stability Programme for 2012-15. That first recommendation calls for strict enforcement of the Budget Stability Law and the adoption of strong fiscal measures at regional level. This would mitigate the risks of a slippage at regional level. Given the decentralised nature of Spain's public finances, a strong fiscal and institutional framework is essential. This framework could be reinforced also by establishing an independent fiscal institution to provide analysis, advice and monitor fiscal policy. Given their recent poor track record, budgetary compliance by regional governments, together with a greater sensitivity of revenues to the ongoing structural adjustment, the uncertain revenue impact of the fiscal amnesty and potential further restructuring and recapitalisation operations in the framework of the financial assistance requested, pose risks to the budgetary strategy.

(19) In parallel to the regular reviews of the financial assistance for the recapitalisation of financial institutions for Spain referred to in the Statement by the Eurogroup of 27 June 2012, monitoring of progress on implementation of its EDP commitments will be carried out at an interval of three months.

(20) Spain fulfils the conditions for the extension of the deadline for correcting the excessive general government deficit as laid out in Article 3(5) of Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the EDP,

HAS ADOPTED THIS RECOMMENDATION:

1. The Spanish authorities should put an end to the present excessive deficit situation by 2014.

2. The Spanish authorities should deliver an improvement of the structural balance of 2,7 % of GDP in 2012, 2,5 % of GDP in 2013, and 1,9 % of GDP in 2014, in order to bring the headline government deficit below the 3 % of GDP reference value by 2014, based on the Commission services update of the 2012 spring forecast. The headline deficit targets should be 6,3 % of GDP for 2012, 4,5 % of GDP for 2013, and 2,8 % of GDP in 2014.

3. The Spanish authorities should implement the measures adopted in the 2012 budget and in the Autonomous Communities' rebalancing plans and the Government should adopt the announced multi-annual budget plan for 2013-14 by end of July 2012, including a medium-term budgetary strategy, which fully specifies the structural measures that are necessary to achieve the correction of the excessive deficit by 2014. In view of recent fiscal outturn data for the first months of 2012, the Spanish authorities should adopt without delay additional measures in 2012 to ensure the fulfilment of the budgetary plans for 2012. They should also stand ready to adopt further measures should risks to the budgetary plans materialise and accelerate the reduction of the deficit in 2013 and 2014 if economic or budgetary conditions turn out better than currently expected.

4. The Council establishes the deadline of three months for the Government to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

In addition to the report foreseen in recommendation (4) and in parallel to the financial assistance for the recapitalisation of financial institutions referred to in the Eurogroup statement of 27 June 2012, the Spanish authorities should report on progress made in the implementation of these recommendations every three months as well as in a separate chapter in the Stability Programmes which will be prepared until 2015.

Furthermore, the Spanish authorities should strictly apply the new provisions of the Budgetary Stability Law regarding transparency and control of budget execution. In line with the country-specific recommendations under the European Semester, the Council also requests Spain to establish an independent fiscal institution to provide analysis, advice and monitor fiscal policy, stick to the enforceable nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets throughout the year for all the levels of the general government sector.

This Recommendation is addressed to the Kingdom of Spain.

Done at Brussels,

For the Council
The President