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Comments and enquiries should be addressed to:

European Commission
Directorate-General for Economic and Financial Affairs
Unit Communication
B-1049 Brussels
Belgium
E-mail: ecfin-info@ec.europa.eu

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European Commission
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Contributors:

Gerrit Bethuyne, Francisco de Castro, Luis Garcia Lombardero, Lucas Gonzalez Ojeda, Peter Grasmann, Oskar Grevesmuhl, Magda Lewandowska, Mihai-Gheorghe Macovei, Maria-Cruz Manzano, Ismael Valdes Fernandez, Sonia Vila Nuñez, Corina Weidinger Sosdean, Jakub Wtorek, and the financial crisis task force of the Directorate General for Competition. Co-ordination and editing were ensured by Jakub Wtorek and technical assistance was provided by Michel Gerday.

The report was prepared in liaison with the ECB.

Comments on the occasional paper would be gratefully received and should be sent, by mail or e-mail to:

Gerrit BETHUYNE
European Commission
Unit ECFIN.DDG1.F.4
B-1049 Brussels

Gerrit.Bethuyne@ec.europa.eu

or

Peter GRASMANN
European Commission
Unit FISMA.E.1
B-1049 Brussels

Peter.Grasmann@ec.europa.eu

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ABBREVIATIONS

AENA	Aeropuertos y Navegación Aérea, Airports and Air Navigation
ALMPs	Active Labour Market Policies
BdE	Banco de España
bps	basis points
BRRD	Bank Recovery and Resolution Directive
BSOL	Budgetary Stability Organic Law
CDS	Credit Default Swaps
CEPYME	Confederación Española de la Pequeña y Mediana Empresa
CIT	Corporate Income Tax
CNMV	Comisión Nacional del Mercado de Valores, National Securities Market Commission
CoCos	Contingent Convertible securities
CRR	Capital Requirements Regulation
CSR	Country Specific Recommendation
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
EC	European Commission
ECB	European Central Bank
EMU	Economic and Monetary Union
ESM	European Stability Mechanism
FROB	Fondo de Reestructuración Ordenada Bancaria, Fund for Orderly Bank Restructuring
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices
ICO	Instituto de Crédito Oficial
IDR	In-Depth Review
LFS	Labour Force Survey
LOMCE	Ley Orgánica para la Mejora de la Calidad Educativa, Law on Quality of Education
LTD	Loans-to-Deposits
MARF	Mercado Alternativo de Renta Fija, Alternative Fixed-Income Market
MIP	Macroeconomic Imbalance Procedure
MW	MegaWatt
NFC	Non-Financial Corporation
NIIP	Net International Investment Position
NPL	Non-Performing Loan
NRP	National Reform Programme
PES	Public Employment Service
PIT	Personal Income Tax
PPS	Post Programme Surveillance
q-o-q	quarter on quarter
RDL	Real Decreto-ley, Royal Decree-Law
SAFE	ECB Survey on the Access to Finance of small and medium-sized Enterprises
SAREB	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.
SME	Small and Medium-sized Enterprise
SSM	Single Supervisory Mechanism
y-o-y	year on year

EXECUTIVE SUMMARY

This third post-programme surveillance report provides an assessment of Spain's economic, fiscal and financial situation following its exit from the financial assistance programme in January 2014. A staff team from the European Commission (EC), in liaison with staff from the European Central Bank (ECB), carried out the third post-programme surveillance visit to Spain on 12-18 March and 14 April. The European Stability Mechanism (ESM) participated in the meetings on aspects related to its own Early Warning System. The report covers also the specific monitoring of policy progress by the Commission in the context of the Macroeconomic Imbalances Procedure (MIP).

The economic recovery strengthened further towards the end of 2014. Reforms introduced since 2012 have contributed to the improved prospects in the labour market, further easing of financial conditions and enhanced confidence. The expansion of economic activity is underpinned also by lower oil prices, a favourable exchange rate and a less restrictive fiscal stance.

Following a significant improvement in recent years, the current account balance deteriorated in 2014 but remained positive. This was related to the slowdown in external markets, but also to high import growth linked to the pick-up in final demand. The current account balance is expected to further strengthen in 2015. A more pronounced current account adjustment is still needed to further reduce the large stock of net external liabilities.

The labour market is recovering, but it still faces structural problems. Job creation has accelerated with employment increasing by 2.5% year-on-year in Q4 2014. Nevertheless, at 23.7% in Q4 2014 unemployment remains very high, and is even higher for the youth, while long-term unemployment risks becoming structural. Labour market segmentation remains a challenge, with the rate of temporary employment close to 25%.

The private sector has reduced further its debt overhang. The orderly deleveraging of the private sector has further advanced, but deleveraging needs remain high. Access to credit, in particular for households and healthier companies (including SMEs) with positive growth prospects, has improved significantly. Government debt is still increasing and bringing it back to the 60% reference value will require a continued fiscal effort in the long run.

The stabilisation in the banking sector continues, marked by the improvement of banks´ asset quality, strengthened solvency and liquidity and a return of the sector to profitability. However, these signs of stabilisation are not uniform across financial institutions. Overall stabilisation and in particular profitability have been driven by a decline in banks' funding costs in a low-interest rate environment and a fall in provisioning, as non-performing loans are being reduced. Lending volumes across the main areas of business are still contracting, but at a slower pace, as demand for new loans recovers from low levels. The process unfolds within a context of necessary deleveraging and increasing availability of non-bank financing.

The restructuring of the Spanish banking sector, and in particular of banks that have received state aid, is progressing well. Most banks under restructuring plans are well advanced in achieving the targets under these plans. The sale of public stakes in banks to private investors has made good progress, in particular by the complete sale of two banks. Completing the restructuring and privatisation of the two remaining state-owned banks is necessary to put the banking sector on a sound long-term footing. The adoption and implementation of the necessary secondary legislation on the savings bank law of 2013, which includes the requirement that banking foundations with controlling stakes in banks set up a reserve fund, is proceeding. FROB, the Fund for Orderly Bank Restructuring, will shortly take up the new role of national executive resolution authority, leaving the national supervisors (Bank of Spain, CNMV) with the preventive role.

A key milestone for improving the management of SAREB's financial assets has been completed. SAREB's challenge of divesting its significant asset portfolio while maximising value remains significant.

SAREB is undergoing a change in servicers' contract, with the introduction of incentives that link the remuneration of servicers with their performance. The new servicers are already operative and the migration of assets has started. Close monitoring of future SAREB's profitability is warranted, given that additional provisioning requirements can still be imposed on SAREB by the Bank of Spain.

However, challenges for the Spanish financial sector remain. In particular, despite the improved economic outlook, a still declining stock of credit and the current low interest-rate environment pose risks to the long-term sustainability in banks' profitability. Moreover, savings banks secondary legislation is still awaiting its approval and full and effective implementation. Also, the privatization of the banks still under the control of the FROB, and particularly of Bankia, remains to be completed.

Some additional progress has been observed in recent months on structural reforms:

- **There has been further progress in improving the quality of taxation and the efficiency of public administration.** Implementation of the public administration reform continues, but reducing average payment periods for commercial transactions remains a challenge, especially at regional and local levels. The reform of personal and corporate income taxation has been in force since January 2015. While reducing the tax wedge on labour and broadening the corporate tax base, the reform is a partially missed opportunity to simplify the system significantly.

- **Recently, new initiatives have been adopted to combat labour market duality, to improve the effectiveness of active labour market policies, and to support labour market integration.** Spain has put in place a new measure to support indefinite employment, targeted at low wages, which can have a positive effect on employment, especially for vulnerable groups (low skilled workers and long-term unemployed) although more measures would be needed to significantly reduce duality. The implementation of measures to make active labour market policies more effective is moving ahead, although gradually. Measures to modernise the public employment service are going in the right direction, although slowly, also due to complexity derived by implementation at different government levels. The reform of professional education and training, which opens to competition the provision of training for workers, has been recently adopted.

- **The insolvency framework has been further reinforced, and reforms of the business environment gradually implemented.** Spain has advanced further with the reform of the insolvency framework, including the development of a framework for personal insolvency, which sets provisions for a fresh start (full debt relief) for individuals. The implementation of the law on market unity progressed further, although full implementation at regional level remains a source of concern. A new electricity interconnection has been opened between France and Spain, although further progress is needed in this area to achieve a more efficient internal energy market. Additionally, a 49% stake in the operator of the airport network (AENA) has been sold to private investors.

The reform momentum needs to be maintained, also ensuring full and effective implementation. Unfinished reforms need to be brought to completion (e.g. the market unity law), or should be complemented with additional measures (e.g. tackling segmentation in the labour market). There are notably implementation risks stemming from the need for joint delivery by various tiers of government. In addition, there are some pending key reforms, such as the reform of professional services and professional associations, which, if adopted, would benefit the whole economy.

On the basis of the analysis in this report, repayment risks for the ESM loan are very low at present. Overall, Spain is benefiting from structural reforms, fiscal consolidation and bank recapitalisation, which are increasingly reflected in financial sector stabilisation, a strong economic recovery and low sovereign risk premia. Nonetheless, significant imbalances remain. Full and effective implementation of the reform agenda and its further strengthening are paramount to sustain the recovery, further rebalance the economy and maintain low risk premia going forward.

1. INTRODUCTION

1. Spain exited successfully the financial assistance programme for the recapitalisation of financial institutions in January 2014. The Programme had been agreed by the Eurogroup on 9 July 2012 for a period of 18 months([1]) and provided an external financing by the euro area Member States of up to EUR 100 billion. Eventually, Spain used EUR 38.8 billion for bank recapitalisation, under restructuring and resolution plans approved by the EC under State-aid rules, and around EUR 2.5 billion for capitalising SAREB. Both the bank-specific conditionality and the horizontal conditionality included in the Memorandum of Understanding were fulfilled as scheduled.([2]) In July 2014, Spain made a voluntary early repayment of EUR 1.3 billion and a scheduled repayment of EUR 0.3 billion that was not used for the subscription of capital instruments of SAREB. In March 2015 Spain made a second voluntary early repayment of EUR 1.5 billion. As of end-March 2015, the outstanding amount of the European Stability Mechanism (ESM) loan is EUR 38.2 billion.

2. Staff from the European Commission, in liaison with the European Central Bank, undertook the third post-programme review for Spain from 12 to 18 March, and on 14 April 2015. The ESM participated in the meetings on aspects related to its own Early Warning System. Post-programme surveillance (PPS) aims at a broad monitoring of the repayment capacity of a country having received financial assistance.([3]) There is no policy conditionality under PPS, although the Council can issue recommendations for corrective actions if necessary and where appropriate. PPS is biannual in terms of reporting and missions. The previous PPS mission took place in October 2014.([4])

([1]) However, the restructuring of the banks receiving public support under the State aid rules is expected to take up to five years.

([2]) For more details see the fifth review report: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/op170_en.htm

([3]) PPS is foreseen by Art. 14 of the two-pack Regulation (EU) N°472/2013. It starts automatically after the expiry of the programme and lasts at least until 75% of the financial assistance has been repaid.

([4]) For more details see the second PPS report: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/op206_en.htm

3. Spain is also subject to monitoring under the Macroeconomic Imbalances Procedure (MIP), which in the case of Spain takes place in the context of post-programme surveillance (PPS). In March 2014, under the MIP, the Commission concluded that Spain is experiencing macroeconomic imbalances which require decisive policy action, with specific monitoring. In February 2015, the Commission issued a Country Report([5]), in which it presented the in-depth review (IDR) on the prevention and correction of macroeconomic imbalances, as well as an assessment of progress towards implementing the 2014 country specific recommendations (CSRs), and concluded that Spain continues experiencing macroeconomic imbalances which require decisive policy action with specific monitoring.([6]) The Commission suggested that the monitoring will rely on PPS reports. Unlike the Country Report, this PPS does not constitute the basis for new CSRs, but it covers the specific monitoring of the policies recommended to Spain by the Council in July 2014([7]) in relation to the adjustment of the imbalances. An overview of the progress with the recommendations related to the MIP since the second PPS mission is provided in the Annex B. This report does not provide an assessment of fiscal policy, in order to avoid an overlap of surveillance processes.

([5]) For more details see the 2015 Country Reports (staff working documents): http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

([6]) See Communication from the Commission to the European Parliament, the Council, the European Central Bank and the Eurogroup: "2015 European Semester: Assessment of growth challenges, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011" COM/2015/0085 final

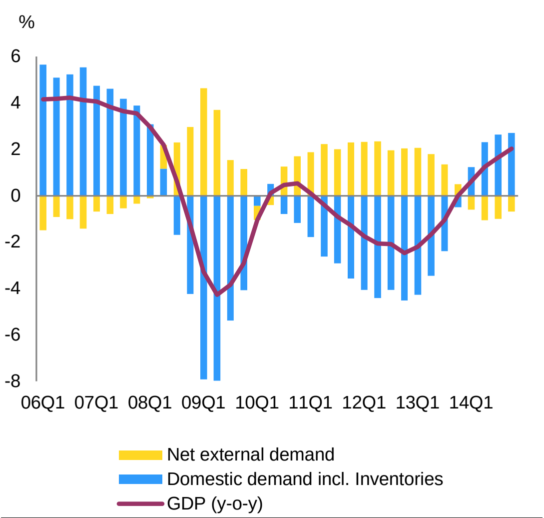
([7]) On a proposal from the Commission, the Council adopted country-specific recommendations to Spain in July 2014: http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/2014/index_en.htm

2. RECENT MACROECONOMIC AND FINANCIAL SECTOR DEVELOPMENTS

2.1. RECENT MACROECONOMIC DEVELOPMENTS

4. Since the end of the long double-dip recession in the second half of 2013, the economic recovery has progressively firmed up. Real GDP surprised on the positive side in the fourth quarter of 2014 when it grew by 0.7% quarter on quarter (q-o-q), after 0.5% q-o-q in Q3 2014. In year on year (y-o-y) terms, GDP grew by 2.0% in Q4 2014 compared to 1.6% in Q3 2014. The overall improvement in the macroeconomic outlook during 2014 was explained by better labour market prospects, loosening financial conditions, rising confidence, a less restrictive fiscal stance, a favourable exchange rate and the fall in energy prices. Growth continued to be driven by a robust contribution from domestic demand while the negative contribution from net external demand narrowed slightly (see Graph 2.1).

Graph 2.1: **GDP growth and components**



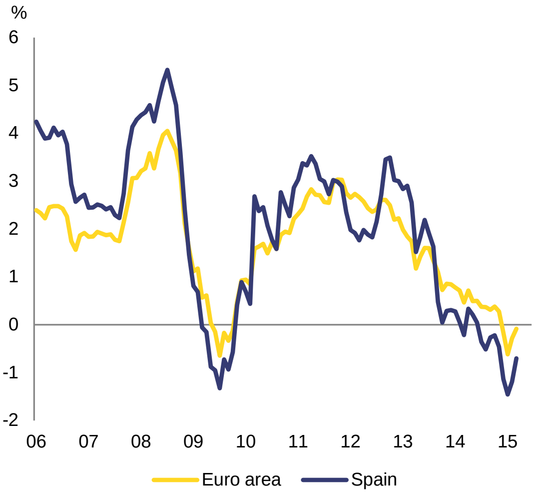
Source: INE

5. In particular, private consumption remained resilient and displayed an accelerating path during the year, due to a pick-up in employment growth. Gross fixed capital formation accelerated further in Q4, owing to higher growth in its two main components, namely equipment investment and, especially, construction. Specifically, equipment investment gathered some steam and grew by 10.4% on the year, while construction picked up strongly in the fourth quarter, thereby rising by 2.4% y-o-y compared with a meagre 0.1% in Q3 2014. Such an increase was due to the acceleration in both residential and non-residential construction components. In turn, the less negative contribution from the external sector (-0.7 percentage points y–o–y) stemmed from the slight acceleration of exports during the year, also helped by the euro depreciation, coupled with a deceleration of imports.

6. Factors supporting growth in 2014 are set to keep fuelling activity over the forecast horizon, despite the continued drag from high levels of private and public indebtedness and deleveraging. Economic activity is expected to remain resilient over 2015 and 2016, mainly driven by domestic demand. The drag from the external sector observed in 2014 should narrow, and net exports are expected to prove slightly negative for growth in 2015 and turn broadly neutral in 2016.The external adjustment is also envisaged to accelerate with respect to 2014.

7. Inflation is expected to remain negative. HICP inflation has been negative since July 2014 (see Graph 2.2) and is expected to remain so until almost the end of 2015. Negative headline and core inflation are explained, at least in part, by the still large slack in spite of the recent pick-up in domestic demand. Moreover, the fall in oil prices has accentuated downward price pressures. Negative inflation and relatively robust job creation should underpin the growth in real households' disposable income in the prevailing context of wage moderation.

Graph 2.2: **Inflation developments**



Source: Eurostat

8. The labour market keeps gaining momentum, but unemployment remains very high. According to the Labour Force Survey (LFS), employment increased by 1.6% y-o-y in Q3 2014 and by 2.5% y-o-y in Q4 2014, while the labour force rose in the last quarter of 2014. In February 2015, the not seasonally adjusted unemployment rate stood at 23.9%, 2.1 percentage points lower than year before. The situation remains particularly difficult as regards youth and long-term unemployment. The positive trends are confirmed by the data from the social security records. The number of workers affiliated to social security rose by 3.3% on the year in March, with registered unemployment falling by 7.2% y-o-y. While new indefinite contracts increased by 27% on the year in March, the labour market segmentation remains very high, with the rate of temporary employment at 24.2% in Q4 2014.

9. With the 2014 deficit coming in at 5.8% of GDP, i.e. at the EDP target, fiscal consolidation appears on track so far. The deficit was, however, slightly above what was expected by both the authorities, which targeted a deficit of 5.5% of GDP, and the Commission, which had 5.6% of GDP in its 2015 winter forecast. Excluding the effect of bank support, the deficit was 5.7% of GDP. Regarding compliance with the 2015 deficit target of 4.2% of GDP, the winter forecast still sees risks, forecasting a deficit of 4.5% of GDP. The 2014 outturn data confirms this assessment of risk. More generally, improving macroeconomic conditions alone are not likely to be sufficient for a timely and durable correction of the excessive deficit by 2016, and additional consolidation measures are needed. Government debt in 2014 was reported at 97.7% of GDP and was expected to increase to 99.7% of GDP by the end of 2015 according to the March 2014 EDP notification. On the basis of the Commission 2015 winter forecast, the debt ratio was expected to increase to 101.4% of GDP in 2015.

10. The household and corporate sectors are reducing their debt overhang. The total stock of private-sector debt amounted to 182% of GDP in non-consolidated terms in Q3 2014 (72.4% of GDP household debt and 109.6% of GDP NFC debt), some 36.8% of GDP lower than the peak in Q2 2010.([8]) Most of the reduction is due to the 24.5% of GDP fall in debt of non-financial corporations since the peak. The progressive amortisation of the credit stock has been the main channel of private sector deleveraging (and debt write-offs have also played a role), with aggregate bank lending on a systematically declining path since 2011. Recent data show some deceleration in this contraction and confirm previous evidence that aggregate deleveraging is at least to an extent taking place selectively, with the financial sector ready to fund healthier corporations with positive growth prospects.

11. The external balance deteriorated in 2014, but remained positive. The current account balance recorded a surplus of 0.8% of GDP in 2014, compared to the 1.4% of GDP recorded in 2013.([9]) The growth slowdown in emerging economies in the second half of 2013 added to the deceleration in the EU in the first half of 2014, thereby dragging down exports. By contrast, rising domestic demand fuelled imports, also pushed by some transitory factors such as car-scrapping schemes and retained consumption and investment in previous years. Altogether, this led to a deterioration in the trade balance, partly offset by a rising surplus in the balance for services. Spain keeps making progress in restoring price and cost

([8]) In consolidated terms, the NFC debt decreased from 119% in Q2 2010 to 95.1% in Q3 2014. Financial derivatives are excluded from debt calculations.

([9]) The Bank of Spain estimated in its forecast published in March 2015 that the current account balance recorded a surplus of 0.8% of GDP in 2014.

competitiveness, along with widening its export base and deepening geographical diversification of exports. However, the import propensity remains high. The net international investment position (NIIP) has been decreasing since Q3 2014 and reached 93.5% of GDP in Q4 2014. A more pronounced current account adjustment is still needed to reduce considerably the large stock of net external liabilities.

12. The housing market shows signs of stabilisation. For the first time since Q1 2008 unsubsidised housing prices rose for three quarters in a row, by 0.8% y-o-y, 0.3% and 1.8% in the second, third and fourth quarter of 2014, respectively.([10]) Prices of new dwellings went up by 1.9% y-o-y and those of used dwellings by 1.7% in Q4 2014. In January 2015, the number of transactions on dwellings in land registries increased by 9.6% y-o-y. Despite these incipient signs of some modest recovery, there is still a large stock of unsold houses. The evolution of the housing market remains important for banks' future profitability and the success of SAREB.

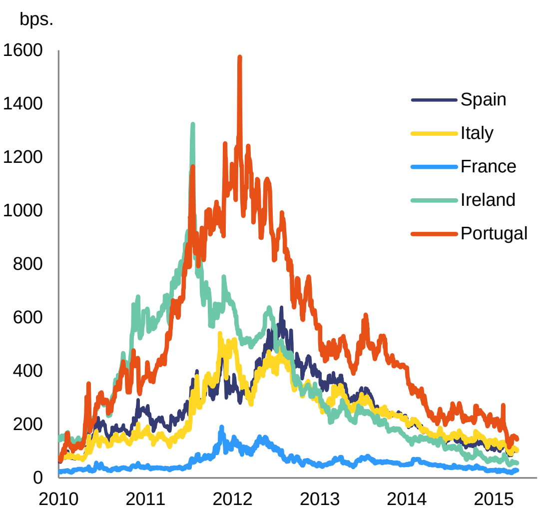
13. Overall, progressing in the correction of imbalances while maintaining healthy GDP and employment growth remains a considerable policy challenge. The adjustment process is advancing but vulnerability to shocks remains large as stock variables (such as the accumulated debt, the negative net international investment position, and very high unemployment), respond only slowly to a turnaround in the underlying flows (such as net credit flows).

2.2. FINANCIAL SECTOR DEVELOPMENTS

14. The stabilisation of financial markets and the financial sector progressed further. At the beginning of April 2015, the 10-year government bond yield fell to a record low of around 1.2%, compared to 6.4% at the beginning of July 2012. The 10-year spread over the German bund also fell, to less than 100 basis points (see Graph 2.3). 5yr CDS spreads went down to about 80 basis points in April 2015. Share prices recovered significantly after the sell-off in October 2014 and grew by about 15% until end February. Recent monetary policy decisions and implementation by the ECB further fostered liquidity and resulted in further rise in prices of financial assets across the board.

15. The Spanish financial sector continues to enjoy ample liquidity. As regards the funding structure of banks, deposits are almost flat while wholesale funding reliance continues to decrease. The slight decline in deposits, driven by a decline in time-deposits, reflects a growing preference for alternative investment vehicles, such as mutual and pension funds, in a context of low bank deposit interest rates and an increase in domestic consumption. This also leads to increased fees and commissions for banks. Total deposits of households and non-financial companies (NFCs) declined marginally by -0.8% y-o-y in February 2015 (see Graph 2.4), with NFCs deposits decreasing by around 0.5% y-o-y and household deposits by about 0.9%. The market-based funding opportunities were restored. Bank debt issuance on wholesale markets has been consolidating its upward trend since 2013 but at lower volumes, while the cost of funding has improved. The three-month repo rates decreased to close to 0% and are entering negative territory, comparable to rates in other euro area countries. Repo volumes through central counterparties are also stabilising and bilateral repos have increased.

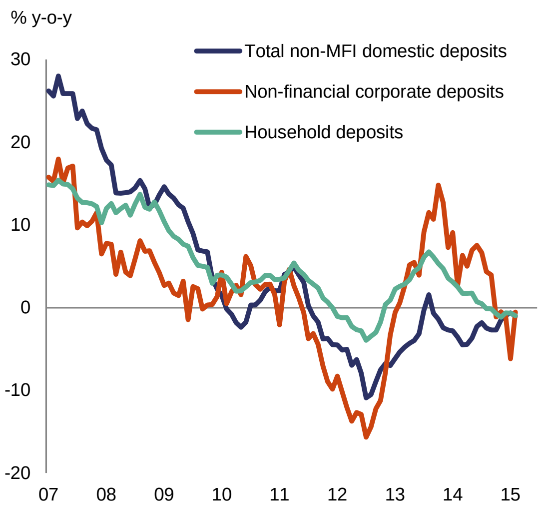
Graph 2.3: Euro area sovereign spreads to the 10-year German bund



Source: IHS Global Insight and own calculations

([10]) Source: INE. Other data sources present different results, but also signal stabilisation of prices.

Graph 2.4: **Bank deposits**

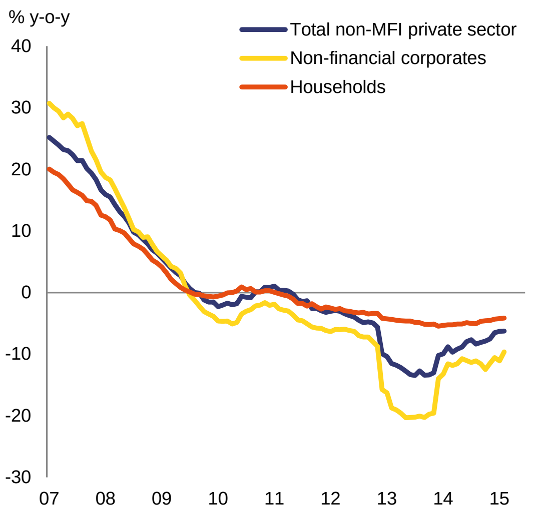


Source: BDE

16. Spanish banks' reliance on Eurosystem funding fell again. Banks' total net debt with the Eurosystem amounted to EUR 124 billion in March 2015, down by about EUR 280 billion from its peak of more than EUR 400 billion in mid-August 2012. Spanish banks have reduced their share in total Eurosystem borrowing from around 44% in August 2012 to around 28% in March 2015.

17. The contraction of private credit decelerated, while new credit is growing, notably to SMEs and for consumer financing. The decline in lending activity has continued to decelerate in line with the economic recovery. However, the main credit indicators are still in negative territory, while economic growth reached 1.4% in 2014. This indicates an emerging shift, and reduction, in the contribution of bank lending to economic activity, partly explained by the country's cyclical position, other sources of finance, and the ongoing structural change in the Spanish economy. The decline in the stock of private domestic credit continued but decelerated to around 6.2% y-o-y as of February 2015. Credit to households was declining by around 4.1% y-o-y while credit to non-financial corporates (NFCs) was shrinking by about 9.7% (see Graph 2.5). If external borrowing and issuance of bonds are also taken into account, the rate of contraction in the total stock of financing to NFCs decelerated further to 5.2% y-o-y as of February 2015. New domestic lending to NFCs remains volatile, but advanced into positive territory. It increased by 2.5% y-o-y in February 2015, driven by continued expansion of the granting of new loans below EUR 1 million (a proxy for loans to SMEs), which increased by about 7.1% y-o-y. The decline in loans above EUR 1 million decelerated significantly to -0.7% y-o-y. In the last quarter of 2014, credit to government started to increase again at an accelerated pace reaching an annual growth rate of about 16% as of December 2014 and 5.5% in February 2015. This is also due to a base effect linked to the pre-amortisation of loans from the suppliers' payment scheme in November 2013.

Graph 2.5: **Bank loans to the private sector**



Source: BDE and own calculations

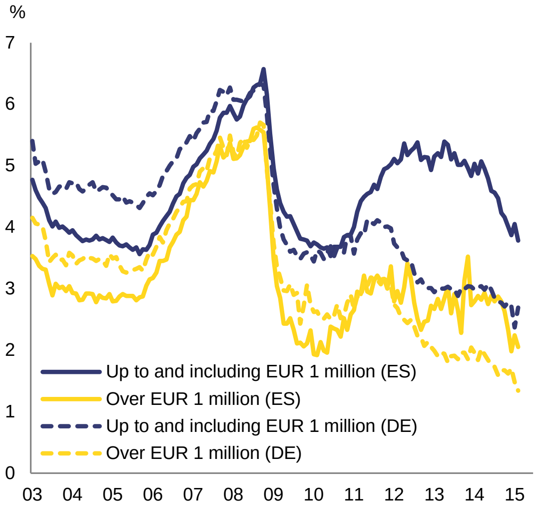
18. Access to finance for companies and households further improved. According to the Banco de España's latest Bank Lending Survey([11]), during the last quarter of 2014, credit standards for approving loans to NFCs remained flat, but margins on loans for both SMEs and large companies went down further, together with the relaxation of collateral requirements. This was supplemented by improvements as regards the non-interest rate charges and the size of the loan, which were particularly noticeable for SMEs. The increase in the demand for loans, both from SMEs and larger companies – but with greater intensity

([11]) See the report at: http://www.bde.es/webbde/en/estadis/infoest/epb.html in the case of SMEs – continued to rise in the fourth quarter of 2014 and the demand outlook remains positive. Similarly to the rest of the euro area, the loan demand by NFCs continues to be driven by financing needs for short-term investment in inventories and working capital rather than by fixed investment. The survey also indicates a reduction in the cost of credit for households as banks are reducing their lending margins and reports a significant increase in the demand for consumer credit. The prospects for the first quarter of 2015 are positive, with an expected continued increase in the demand for new loans and further easing in the supply standards for consumer financing.

19. In line with developments elsewhere in the euro area, access to finance has become less of a concern for Spanish companies, including SMEs. The percentage of respondents considering it the most pressing problem remained flat at about 17% in the latest round of the SAFE survey([12]) (April-September 2014), after having declined significantly from a maximum of 30% in 2012 to close to the EMU average at present. Nonetheless, access to finance remains the second most pressing problem after market competition. For the second consecutive semester, the number of domestic SMEs reporting an improvement in the availability of bank loans exceeded those noting otherwise. Moreover, Spanish SMEs expect this favourable trend to strengthen over the next six months following the period covered by the survey. Another sign of the improved access to finance is the significant decline in the cost of new credit since the beginning of 2014. The average interest rate for loans to NFCs above EUR 1 million dropped by about 85 bps to 2% as from February 2014 to February 2015, whereas the one for loans below EUR 1 million recorded a bigger decline of around 110 bps to 3.8% over the same period. Moreover, the spread with interest rates for loans to German NFCs decreased by around 38 bps for loans above EUR 1 million and around 88 bps for loans below EUR 1 million over the same period (see Graph 2.6). The cost of financing by issuance of debt and commercial paper also dropped.

([12]) Survey on the access to finance of small and medium-sized enterprise in the Euro Area at: https://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html

Graph 2.6: **Bank interest rates for loans to NFCs**

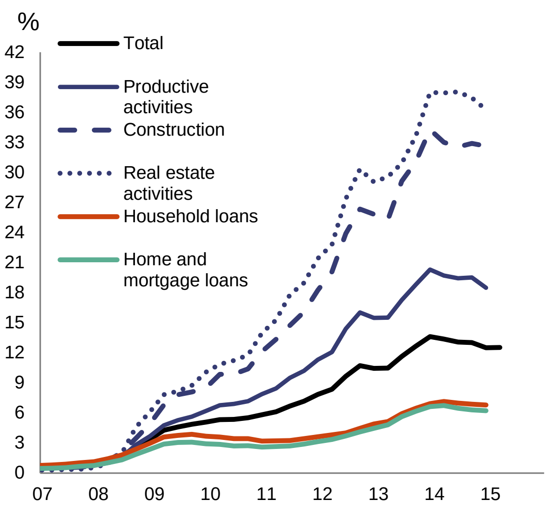


Source: ECB

20. Non-performing loans in Spanish banks' balance sheets peaked in the first half of 2014 and declined continuously afterwards. The non-performing loans ratio (NPLs) for NFCs and households at system level decreased by 1 pp from 13.5% at the end of January 2014 to 12.5% at the end of January 2015 (see Graph 2.7). The stock of impaired assets went down by over EUR 25 billion over the same period, as banks continued to dispose of impaired assets, whereas the total loan portfolio to NFCs and households contracted by EUR 89 billion during the same period. Non-performing loans for construction activities, which account for the highest share in the total non-performing loans, have been on a declining trend since Q2 2014.

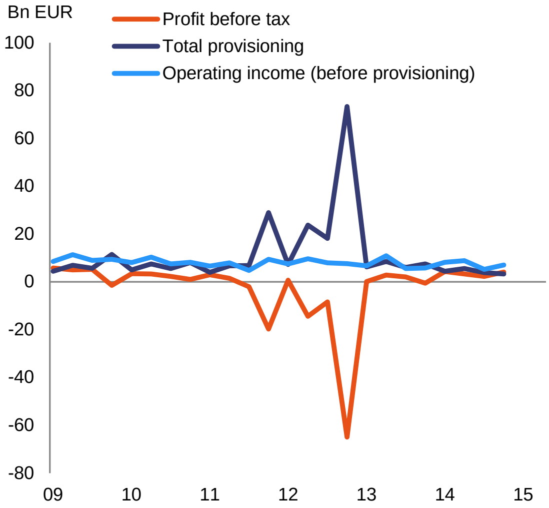
21. Restructured/refinanced loans declined in the second half of 2014. They accounted for 13.7% of the total loans to the private sector at the end of December 2014, down from 14.2% in June 2014. Based on the classification criteria of Banco de España (BdE), 51.2% of restructured/refinanced loans were classified as non-performing, 18.1% as substandard and 30.8% as performing loans. Similar to the case of non-performing loans, refinanced and restructured loans show a high degree of concentration in real estate (22.6% in construction and 25.9% in mortgages).

Graph 2.7: **Non-performing loans**



Source: BDE and own calculations

Graph 2.8: **Bank profits**



Source: BDE

22. Banks' profitability rose in the first nine months of 2014 relative to the similar period of 2013, despite a challenging operating environment. Spanish banks' profits increased in the first three quarters of 2014 (see Graph 2.8) despite shrinking credit volumes. Net interest income was only slightly higher than in 2013, but due to some higher interest margins, and reductions in operating expenditures, impairment losses and provisioning, the profit before tax doubled to about EUR 9.7 bn in the first nine months of 2014.

23. Spanish banks' capital levels continued to increase further during 2014 due both to the generation of internal resources and some regulatory capital issuances. The Capital Requirements Regulation common equity tier 1 ratio stood at 11.8% in December 2014. Total regulatory own funds ratio was 13.8% and increased by 60 bps over 2014. Apart from market forces, the ECB's comprehensive assessment was an important driver for the banks to further increase their capital levels before the results were published in October 2014. None of the Spanish banks had to raise additional capital to meet the minimum threshold set up by the ECB. Only Liberbank failed to pass the exercise as of 31 December 2013 by EUR 32 million but increased its capital by EUR 575 million in June 2014, still before publication of the results. In addition, some banks have managed to raise equity during the second half of 2014. Other issuances of non-core capital instruments such as contingent capital instruments that qualify as own funds have also reinforced Tier 1 ratios.

3. FINANCIAL SECTOR RESTRUCTURING AND REFORM

3.1. PROGRESS WITH BANK RESTRUCTURING

24. The effective implementation of the restructuring plans of state-aided banks is well underway. The burden-sharing exercises have been completed. In terms of capacity, some entities have already reached their operational targets, while others continue reducing the number of branches and cutting their work force. They are also reducing their lending volumes in line with their restructuring objectives. As regards the required divestments of subsidiaries, banks are mostly on track although some specific sales are facing difficulties due to the complexities when selling real estate companies or to sell/liquidate not fully-owned subsidiaries. The monitoring of restructuring plans will continue in the coming years, including possible adaptations to significant market changes in duly justified situations. The main challenges relate to the disposal of the two remaining FROB([13])-owned banks.

25. Banks are adjusting their balance sheets and credit portfolios at a good pace in order to reach a balanced and sustainable business structure. Liquidity and funding positions continue the positive trend observed in previous months, with lower loans-to-deposits (LTD) ratios and a decreasing recourse to ECB funding for most of the entities. In terms of solvency, the capital injected in the banks, the loan-loss provisions set aside in 2012 and 2013 and other balance sheet adjustments provided a comfortable buffer for Spanish banks to pass the comprehensive assessment exercise performed by the ECB.

26. On 20 June 2014 the Commission approved the revised restructuring plan for NCG Banco following its sale to Banesco Group. In December 2013 Banesco, a banking group based in Venezuela with presence in Latin and North America, won a tender for the sale of NCG Banco. The European Commission concluded that the sale process and the proposed amendments to the restructuring plan were in line with EU state aid rules. The revised restructuring plan is, overall, consistent with the principles of the original restructuring plan. It will allow NCG Banco to return to long-term viability through its integration into a sound credit institution. NCG Banco will also continue to fundamentally change its business profile, winding down non-core and riskier activities and becoming a regional bank in the North of Spain, trading as Abanca, and focusing on traditional banking activities. In October 2014 the shareholder's meetings approved the merger between NCG and Banco Etcheverria (also owned by Banesco, a Spanish holding company).

27. On 21 July 2014 the FROB entered into a sale and purchase agreement with BBVA for its stake in Catalunya Banc. BBVA, one of the main Spanish banks and an international banking group, emerged as winner of the auction for an amount of EUR 1.16 billion. In parallel, and in order to support that auction process, Catalunya Banc sold a portfolio of loans, mainly mortgages (of a nominal value of EUR 6.4 billion and book value of EUR 4.2 billion) to Blackstone, a large investment firm, for a value of EUR 3.6 billion. The European Commission, in a decision adopted on 17 December 2014, concluded that the transaction does not constitute new aid and that the new set of commitments preserves the original balance in terms of return to viability, burden sharing and mitigation of competition distortions, whilst properly taking into account the sale of the entity to a non-aided bank in a competitive process.

28. The FROB started the re-privatisation of Bankia in 2014. On 28 February 2014, 7.5% of the shares held in Bankia by BFA were sold on the market through an accelerated book building exercise. Since then, and despite the further rise in stock market valuations of Spanish banks, no further privatisation of parts of Bankia has been carried out or announced.

29. The other FROB-owned bank, BMN, is planning to tap capital markets in the future. BMN plans to access the capital markets as a way to either repay the financial assistance provided by the FROB and/or allow the FROB to sell its equity stake in the bank along with other existing investors. Depending on market conditions, FROB's divestment of its stake in BMN could take place through a listing of the bank in the stock exchange together with a sell-down of FROB, and other existing shareholders', participation in the

([13]) ***F****ondo de* ***R****eestructuración* ***O****rdenada* ***B****ancaria* (Fund for orderly bank restructuring) http://www.frob.es bank. Moreover, at the end of 2014, Liberbank repaid the EUR 124 million of contingent convertibles (CoCos) injected by the FROB.

3.2. SAREB – RECENT DEVELOPMENTS AND OUTLOOK

30. The main source of revenue continued to be financial assets. These account for over 80% of total turnover and have an even bigger share in net margin. Compared to 2013 there has been an increase of turnover in the retail channel for financial assets, individual recovery and sales of loans to third parties.

31. According to definitive figures,([14]) the turnover in 2014 was EUR 5 billion, i.e. 23% higher than in 2013. The earnings before interest, taxes, depreciation and amortisation (EBITDA) decreased to EUR 1 billion, which is nearly 18% lower than in 2013. The decrease of EBITDA has been more than offset by lower financial expenses. As a result the pre-tax loss amounted to EUR 783 million compared to a loss of EUR 402 million a year before. Lower interest rates, as well as the repayment of EUR 3.4 billion of senior debt in 2014 contributed to a decline of financial expenses. Overall, SAREB has already repaid about 10% of its initial stock of senior debt. After the prescribed consultation to the Bank of Spain, a new subcategory of financial assets had to be provisioned, leaving the impairment provision at EUR 719 million, compared to EUR 259 million a year before, and resulting in net losses at EUR 585 million.

32. SAREB has finalised the process of choosing new servicers for its loan portfolio. As the previous servicing contracts were about to expire, SAREB decided to change the servicing model in order to improve its activity. Four servicers have been selected, and the process of migration has started. A main challenge is now to ensure a timely and smooth migration of the loan portfolios to new servicers that will not impact negatively on SAREB's business performance. The migration is expected to be finalised by the end of the year.

33. The main source of uncertainty for SAREB continues to be the development of the real estate market. As mentioned in the previous chapter, the real estate market in Spain shows recent signs of stabilisation or turnaround. Sales in the housing market are on an upward trend, while prices have stabilised. As regards plots of land, sales are stable while prices continue to decline, albeit at a slower pace. Additionally, possible revision of the accounting rules for asset valuation, which may result in new impairments, is also a source of uncertainty for SAREB in the nearest future. The Bank of Spain should quickly complete the formal consultation process required to issue the Circular with the new accounting framework for SAREB.

3.3. PROGRESS WITH FINANCIAL SECTOR REFORMS

34. Despite several recent reforms of the insolvency framework, the number of insolvency procedures declined in 2014 in the improving economic environment. Due to the severe crisis and the fact that Spanish firms were usually delaying the opening of insolvency procedures for too long, the firms that were ultimately initiating the proceedings faced a much more difficult financial situation in general than their European peers. In the last few years Spain made progress in removing bottlenecks in the corporate insolvency framework (see Box 3.1). Nonetheless, in 2014 only around 7,000 insolvency cases have been started, 30% less than in 2013. The economic recovery and the improved liquidity and solvency situation of firms are probably the main reasons for the decline. Banking sector data indicate that until mid-March 2015, refinancing agreements (introduced under RDL 4/2014) corresponding to the restructuring of about EUR 6.4 bn of debt have been carried out (EUR 50 million on average per restructuring).

([14]) As the Circular outlining the accounting rules for Sareb has not been published yet, the company consulted the supervisor on the accounting rules to be applied for 2014. As a result, SAREB reported the write-off of EUR 719 million against 2014 results, mainly due to the impairment of the insolvent companies' loans portfolio, loans which were initially granted without an actual guarantee, as well as equity loans. Therefore, the preliminary data do not reflect any impairment provision.

35. The Government approved the Royal-Decree Law 1/2015 (RDL) on a new personal insolvency regime at end-February 2015 (see Box 3.1)**.** Amongst other measures, the RDL prolongs the existing two-year suspension of evictions for vulnerable families by two further years, and extends the scope of the code of good practice to protect some additional vulnerable mortgagors. This is meant to address acute social problems caused by the crisis. In addition, for the first time in Spain, households are allowed to be declared bankrupt in a simple and effective way. This means that a 100% debt relief could be granted by a judge under a bankruptcy process after all the debtor's assets are sold. Some debts would be excluded, such as taxes. Basically all individuals([15]) can benefit from this new regime. This benefit can be revoked if the five-year payment plan envisaged is not respected or conditions of life of the debtor change considerably within this period. This new regime means *de facto* that the *datio in solutum* for many mortgage creditors is introduced in Spain: debtors could potentially choose to liquidate their assets (in the vast majority of cases normally almost only a first dwelling) and all remaining debts would be legally forgiven upon the fulfilment of certain conditions. Although in many cases the remaining debt was already very difficult to recover for banks, this new provision could potentially incentivise "strategic defaults" for some vulnerable households that were still able to service their mortgages, but whose value of their property pledged as collateral had significantly decreased. While the new personal insolvency regime is open for microenterprises and should help reduce the debt overhang of many heavily indebted households, its scope of application is limited by

Box 3.1: Royal Decree-Law 1/2015 on second chance provisions

Several corporate insolvency reforms have recently been adopted because small firms rarely file for bankruptcy and an excessive proportion of firms entering insolvency end up being liquidated. In 2012, the Royal Decree-Law (RDL) 6/2012 introduced a category of distressed mortgage debtors entitled to debt restructuring or partial debt discharges (a so-called code of good practice confirmed and extended by the Law 1/2013). In September 2013, the Entrepreneurship Law (Law 14/2013) established a new type of out-of-court procedure suitable primarily for SME debtors. In March 2014, refinancing agreements, a pre-insolvency procedure suitable for bigger debtors, were also considerably reformed (RDL 4/2014, approved by the Spanish Parliament as Law 17/2014). Finally, in September 2014, the government made the proper insolvency procedures more flexible (RDL 11/2014).

In February 2015, the government adopted a RDL 1/2015, reforming further the corporate insolvency, and introducing a framework for personal insolvency. In particular, the RDL:

- **made the out-of-court procedures more flexible,** by extending their scope of application (from now on they can be applied not only to business owners or companies, but also to individuals with liabilities under EUR 5 million) and lifting some limitations on their content (the voting majorities and opportunities given to the negotiating parties have been aligned with those of the refinancing agreements, e.g. debt write-offs, payment extensions, extending the effects of agreements to dissenting creditors).

- **set provisions for a fresh start (full debt relief) for individuals.** Insolvent debtors who have acted in good faith, and whose assets have been liquidated, or are insufficient to cover liabilities, could be granted a debt relief (the so-called second chance) by a judge under an insolvency procedure (excluding public debts, taxes etc.). The benefit of debt relief can be revoked if the five year payment plan is not respected or conditions of life of the debtor change considerably within this period.

- **extended the number of beneficiaries entitled to mortgage debt restructuring.** The code of good practice introduced by the RDL 6/2012 has been revised by including debtors over 60 years old in the category of distressed mortgage debtors eligible for debt restructuring (e.g. giving up property in full or applying a partial debt write-off).

- **applied some measures of social character.** The moratorium on evictions of vulnerable debtors from primary residences has been extended by two years.

exclusion of public and secured creditors, and also by some necessary filters included in the system. The implementation of the RDL should be carefully followed to assess whether or not it could undermine the full recourse recovery framework for Spain's mortgage market (i.e. covered bonds).

36. The participation to the Single Supervisory Mechanism (SSM) has entailed significant changes for the supervisory procedures of the BdE. The BdE adopted in September 2014 a new organisation chart of its Directorate General Banking Supervision with the aim to mirror the organisation of the SSM. Since a significant number of supervisors joined the SSM, the BdE will step up the recruitment of temporary and permanent staff to ensure the appropriate supervision of credit institutions in the context of the new European supervision framework. Going forward, the General-Directorate Banking Supervision will have to address *inter alia* the following challenges: (i) the separation of on-going supervision teams from on-site inspections teams for the significant banking groups; (ii) the co-existence of the SSM supervisory processes for banks supervised by the SSM with the BdE supervisory processes for less significant institutions; (iii) the additional information to be provided to the SSM through the local members of the JSTs.

37. Spain adopted a Law on Savings Banks in December 2013 (Law 26/2013). The Law set a complete new legal framework for the savings banks sector in Spain and imposed the conversion of almost all savings banks into "banking foundations". These are new legal entities without a bank licence,([16]) whose financial activity has to be completely transferred to a credit institution in exchange for shares. The main goal of the Law was to make the governing bodies of savings banks and banking foundations more professional and independent in order to avoid interference of banking foundations in the proper management of bank activities. The Law further sets incentives to reduce controlling stakes of banking foundations in banks.([17]) These incentives have been designed to impose additional costs on banking foundations that have significant controlling stakes in banks.

38. Regulatory implementation of the Law 26/2013 is currently in process. The Ministry of Economy and Competitiveness has elaborated a draft Ministerial Order developing some corporate governance aspects and the accounting obligations of the banking foundations. In April 2015, the draft was put to public consultation.([18]) It determines the content and structure of the annual corporate governance reports of banking foundations' and establishes standard models on which the saving foundations shall publicly release such reports. In addition, the draft empowers Bank of Spain to clarify and develop financial reporting rules, for both public and confidential reporting, that would apply to banking foundations.

39. In order to fully implement the Law, the BdE should quickly complete the formal consultation process required to issue secondary legislation, *Circular del Banco de España.* The secondary legislation should develop crucial aspects regarding incentives to reduce controlling stakes held by banking foundations in banks.

40. The process of adopting this Circular has started. The BdE submitted a draft Circular to public consultation ending last November. Banking foundations and banks under control made various comments on this draft. Thereafter, the Circular was sent by the BdE to the Spanish State Council for its, mandatory, opinion. It is currently uncertain when the Circular will be finally approved. It is likely that the Circular will be finally approved with quite some delay after the entry into force of the Law on savings banks, adopted in December 2013.

41. The latest draft provides some additional elements on the co-operation with the SSM and on jointly managed credit institutions. A new chapter in the draft regulates the cooperation between the BdE and the SSM in relation to the activity of banking foundations when the participating bank is under SSM supervision. The

([16]) Only two of the former savings banks could continue to operate as credit institutions after then entry into force of the Law.

([17]) More intrusive measures, such as outright bans, were not pursued, due to concerns of compatibility with the Spanish constitution.

([18]) The draft Ministerial Order can be found at http://www.tesoro.es/legislacion-y-politica-financiera/normativa-nacional/audiencia-publica.

Circular also stipulates that when several banking foundations maintain a participation in a credit institution that is jointly managed, it will be considered as a single participation. In cases of non-concerted action, the management protocol should explicitly mention that fact. Particularly, in the cases of banking foundations which formed part of Institutional Protection Schemes (IPS), the fact that such IPS is not in place should be stated in the protocol. The BdE is entrusted with the capacity to check if concerted action exists or not.

42. Measures to promote bank financing brought tangible results. The Instituto de Crédito Oficial (ICO)'s on-lending activity to SMEs via commercial banks accelerated further. In 2014, ICO provided SMEs with EUR 21.4 bn of new credit with banks' intermediation, an all-time record. At the end of 2014, this gave ICO a 14% market share in the lending market under EUR 1 million. In addition, in 2014 ICO mobilised EUR 32.4 bn of funds financed by third parties, out of which EUR 19.9 bn went to SMEs. It has helped reduce the average interest rate on new loans under EUR 1 million to NFCs to 4% as of January 2015.

43. Measures to strengthen non-bank financial intermediation were further implemented. Until mid-March 2015, the alternative fixed-income securities market (MARF) saw 12 debt issuances of about EUR 510 million in total, an increase in volume of around one third compared to October 2014. In November 2014, the law 22/2014 regulating venture capital companies and closed-end collective investment schemes was adopted by the Parliament. The law aims at fostering the venture capital sector, especially for SMEs at early stages of development, at reducing administrative procedures for venture capital companies and at transposing the EU Directive on alternative investment fund managers. The venture capital market has also recovered from the crisis, supported by actions of the Fond-ICO Global. Venture capital associations estimate that after the crisis years of 2011-2012 with around EUR 240-250 million annual commitments, an annual fundraising of EUR 2-3 bn is possible for the Spanish venture capital market. While a considerable progress, this would be less than in 2007, the peak year, and in per capita terms a still lower level than in peer countries. It is also expected that the Law on corporate financing, which includes measures to promote access of firms to bank and non-bank financing, will be adopted by the Parliament in the coming weeks.

3.4. CHALLENGES AHEAD

44. Although the economic outlook has improved over the last months, low lending volumes and the current low interest-rate environment pose challenges to the recovery in banks' profitability. Funding costs have decreased during 2014 due to improved market sentiment and cheaper deposits. However, a prolonged low interest rate environment could damage banks' net interest margins and therefore the core business of Spanish banks that are particularly exposed to floating rate mortgage loans. The positive trend as regards lower provisioning requirements and lower structural costs should alleviate the pressure on interest margins. Despite the relative better outlook for Spain, in the case of the biggest banks, the weak economic outlook for the euro area and some emerging countries could endanger more long-term sustainable profitability.

45. The completion of the privatization of the banks still under the control of the FROB, and in particular of Bankia, remains a challenge. This is especially the case if the state aims to maximize the recovery of the value of its investment in these entities.

46. The approval and implementation of savings banks secondary legislation remains a challenge given the delays accumulated. In addition, some allegations and challenges by former savings banks are expected which may further complicate the smooth transition to the new legal framework.

47. Spain is in the process of the legal implementation of the Bank Recovery and Resolution Directive (BRRD).([19]) The Law implementing the BRRD is currently in the Spanish Parliament and is expected to be approved before the Summer. In order to finalize the

([19]) Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

implementation process a Royal Decree including some additional measures will tentatively be adopted in September. In the meantime, the FROB is taking the necessary actions to be fully prepared to adapt its structure and operations to the new regulatory environment as a National Resolution Authority. In this regard, the adequate exchange of information with Banco de España and the Single Resolution Board is seen as a priority. The completion of the privatisation of the banks still under the control of the FROB, and particularly of Bankia, also remains a challenge.

4. PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

This chapter gives an update of measures taken in response to the 2014 country specific recommendations (CSRs), which are relevant for the macroeconomic imbalances procedure (MIP). More details by single reform item can be found in the table annexed to this report.

4.1. MEASURES TO IMPROVE THE QUALITY OF PUBLIC EXPENDITURE AND TAXATION AND THE EFFICIENCY OF PUBLIC ADMINISTRATION

48. Despite some progress in reducing average payment periods for commercial transactions, additional efforts are needed, especially at regional and local levels. Late payments have detrimental effects on the business environment, by exacerbating the burden of already financially-constrained firms which can ultimately push them out of business.([20]) Policies to reduce public sector commercial arrears have been at the top of the agenda in Spain. To that end, throughout 2012-14 the central government implemented a scheme to repay regions and local entities' commercial arrears (i.e., the suppliers' payment scheme). An additional scheme (the regional liquidity fund), still in place, was set up to help regions meet their public deficit financing needs. Spain's stability law was also amended in December 2013 so that all general government subsectors comply with the 30-day average payment rule for commercial transactions set out by Directive 2011/7/EU, in force since March 2013.([21]) The amendments mandate all administrative bodies to publish regularly on their website their average payment period and set out a procedure to monitor compliance by the Ministry of Finance. The first data for average payment periods calculated according to a standard methodology and covering all general government sub-sectors was published in October 2014. This publication triggered the launch of the procedure to ensure compliance with the above-mentioned legal obligation. According to the latest published data referred to January 2015, Spain's social security administration boasts the lowest average payment period of all general government subsectors, followed by the central government. Local entities have on average shorter payment periods than regions, although both of them are well above the 30 day limit, with considerable variations across regional and local entities. High payment delays prompted the Ministry of Finance to send in March 2015 warning letters to Valencia, Aragon and Extremadura, the three worst performing regions in this field. Other private sector institutions publish data measuring the length of public sector payments.([22]) Discrepancies with official data are due to methodological issues.

49. In November 2014, the parliament adopted the tax reform. The reform focuses on cuts in personal income taxes (PIT) and corporate income taxes (CIT) and is not as comprehensive or ambitious as it could have been. It is a partially missed opportunity to simplify the system significantly, to fix its shortcomings, and to sustainably lower labour taxation by shifting the tax burden further to indirect taxes (consumption or environmental) or recurrent property taxes. Positive elements of the reform are (i) some reduction of the labour tax wedge, however with a short-run impact mainly on disposable income (and hence consumption and imports) rather than on labour costs (and thus employment), (ii) measures to broaden the corporate tax base and reduce the debt bias, and (iii) measures to reduce tax fraud. Not being revenue neutral (the cumulated ex-ante cost over 2015-16 is estimated by the government at 0.9% of GDP, while the ex-post cost at 0.6% of GDP), the reform makes fiscal consolidation more difficult.([23])

([20]) European Economy, *The economic impact of late payments*. Economic papers 531. September 2014.

([21]) Directive 2011/7/EU of 16 February 2011 on combating late payment in commercial transactions.

([22]) These include (i) CEPYME (Spanish SMEs business organisation) via a late payment report carried out with the collaboration of the Spanish Ministry of Industry; (ii) ATA (self-employed association); (iii) *Plataforma multi sectorial contra la morosidad* (confederation of business associations); and (iv) *Intrum Justitia* (credit management company).

([23]) For more details on the tax reform see the 2015 country report (staff working document): http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

4.2. MEASURES TO IMPROVE THE FUNCTIONING OF THE LABOUR MARKET AND ENHANCE HUMAN CAPITAL

50. Additional measures have been recently put in place to strengthen the strategic orientation of activation policies and their link with income support. The new programme for the support and activation of long-term unemployed, adopted in December 2014 and in place since 15 January, has started its implementation, and registers some 35 000 beneficiaries (another 15 000 requests are currently being examined). The programme targets the long-term unemployed who have exhausted unemployment benefits and subsidies, and combines income support (EUR 426 per month, during 6 months) with personalised activation and support to employability measures. It incorporates the "active job-search" requirement (monitored by the regional public employment services). In line with the new active labour market policies framework, the allocation of funds to the regions for the development of the programme is based on the number of potential beneficiaries and the results achieved. Approximately EUR 130 million from State funding have been allocated to this end, of which 40% are being distributed amongst the regions on the basis of potential beneficiaries and 60% will be distributed depending on successful roll-out. The government foresees indeed that the programme will provide support to approximately 400 000 beneficiaries, but the effectiveness of the activation measures will very much depend on the capacity of national and regional employment services to design and implement individualised labour market integration programmes to the beneficiaries.

51. Spain has put in place a new measure to support indefinite employment, targeted to low-wages. The Social Security contributions' *flat rate* has benefited approximately 20% of new indefinite contracts, possibly partly due to the lack of information among employers. Of these, most were full time contracts (77.4%), 45.3% of the contracts were signed by young workers (under 35 years), while very few (4.5%) were signed by workers over 55 years (showing a potential link with low skills). As regards the sectoral analysis of the use of the flat rate: 23.8% of the contracts were signed in retail, 14.7% in tourism-related activities, 13.6% in industry and 7.2% in construction. An assessment by wage distribution shows that the flat rate has predominantly benefited lower wages, which has been a decisive factor in designing the new scheme of reduced employers' contributions to the social security, adopted on 27 February by the Royal Decree-Law 1/2015. The new measure features a temporary reduction in the employers' contribution to social security to promote indefinite employment. The first EUR 500 of the salary of a new indefinite job will be exempt from contribution to social security during two years.([24]) The reduction has no impact on the generation of benefits and rights for the worker, and may benefit all firms and self-employed who increase net indefinite employment between 1 March 2015 and 1 September 2016, and maintain this new employment level for at least 36 months. Indeed, the new measure is progressive: concentrating in the first EUR 500 of wages, it benefits to a greater degree low-wage jobs, in which low-skilled workers, those without work experience and/ or those affected by long-term unemployment and temporality are more represented. Importantly, the measure is compatible with recent efforts to promote hiring of young and long-term unemployed, including the hiring incentive of EUR 300 (during 6 months) for workers registered in the national youth guarantee system, and the financial incentives foreseen in the new activation programme for the long-term unemployed. According to the first estimates, the new scheme of reduced contributions to the social security will be 45% cheaper for the state than the flat rate. Although the new measure can have a positive effect on employment, more measures would be needed to significantly reduce duality.

52. The current system of hiring incentives presents some efficiency barriers. Despite the streamlining of the hiring incentives system in 2012 and the simplification of contract templates in 2014, the structure of incentives applying to different contractual forms remains complex; moreover, doubts persist on their actual effectiveness. In this regard, Spain has a legally binding commitment to develop in 2016 a comprehensive evaluation, at all levels, of the effectiveness of hiring incentives, including both subsidies and reductions in social security contributions. This is a step in the right direction,

([24]) Firms with less than 10 workers can benefit from an additional exemption of contributions to social security for the first EUR 250 of wages in the third year.

which could help redesign or further rationalise the current hiring incentives system.

53. New measures to reinforce and modernise the public employment service (PES) are going in the right direction, although progress is slow, also due to the complexity derived by implementation at different government levels. Relevant measures have been put in place, namely the establishment of a common catalogue of services for all PES (national and regional), still to be effectively implemented, and a best-practices exchange programme among PES, to promote mutual learning and guarantee minimum service standards across the country to all unemployed. The single job portal is now functioning and the framework for public-private cooperation in recruitment services is in place, although the latter is still subject to some procedural barriers. The 2015 budget has increased the investment on the modernisation of the PES by EUR 85 million compared to 2014, and, in consonance with the new framework of active labour market policies, the funds allocated to the regional PES are also now partly based on performance. However, the unemployment challenge and the implementation of new measures such as the programme for the long-term unemployed and the youth guarantee may put a heavy strain on the PES, and additional measures to improve its capacity and effectiveness may be needed.

54. The youth guarantee is still facing some implementation challenges. While the legal framework and the registration tool are in place, the implementation of the system depends now on a close cooperation between all the involved authorities. Reaching potential beneficiaries of the system remains the main challenge. Data on registration published monthly are not encouraging. First results of the numerous pilot projects on outreach are to be known soon, and will feed into a national outreach comprehensive strategy.

55. Wage moderation continues. While the social partners are still negotiating a new multiannual agreement on wages and employment, the last available data show that in Q1 2015 labour cost has decreased by -0.5%, while wage cost decreased by -0.2%.

56. The reform of professional training for employment was adopted on 20 March and opens to competition the provision of training for workers. The new system foresees the possibility for private training agencies, duly accredited and / or registered, to participate directly in the system as training providers. In a context of economic recovery, the overall objective of the new system is to contribute to business competitiveness, and to improve employability and prospects for career development of workers. It is supposed to be achieved by diversifying, decentralizing and increasing the efficiency of the training supply, as well as increasing the efficiency of public financial resources. The social partners will still have a role in multiannual planning and programming. The new system allows implementation of the "individual training account" (accompanying the worker throughout his/her career in order to prove the training history) foreseen already by the 2012 labour market reform.([25]) Moreover, the new system features an increased flexibility for firms, which can now choose between a possibility of providing training within the firm (owned or contracted), or entrusting the delivery of training to an external accredited body. There will be also more flexibility for the unemployed, since a "training-check" will be established, so that the job-seeker will be able to choose an entity which will train him/her (subject to the advice and monitoring by the Public Employment Service). As it is the case with other recent measures adopted, the new training system also foresees the allocation of funds based on results: in this case, there is a maximum advance payment of 25% of the total training activity cost. In the future, the government also plans to monitor results of the new training system, in terms of improved performance in the workplace, insertion of workers, stability of employment, and improving the competitiveness of enterprises.

([25]) The 2012 labour market reform introduced an individual "training account": employees with a minimum seniority of one year are entitled to a paid training leave of maximum of 20 hours a year. Cumulative leave is allowed up to a maximum of three years.

4.3. STRUCTURAL MEASURES TO PROMOTE GROWTH AND COMPETITIVENESS

57. Regional governments need to bolster the implementation of the law on market unity. The law addresses regulatory fragmentation in Spain's internal market, originating from disparities in central and sub-central government legislation governing access to and exercise of economic activities.([26]) It also puts in place better regulation tools such as legislative simplification and administrative burden minimisation to eliminate or prevent barriers to market unity. The time-consuming implementation of the law is ongoing. It is relatively more advanced at central than at regional level. To illustrate, the central government has completed to date around 50% of the planned amendments to sector specific legislation to remove inconsistencies with the law on market unity, while the rate of completed amendments at regional level is much lower, at around 17%, with pending changes affecting legislation on tourism, agriculture, manufacturing, health and social services.([27]) In parallel, 20 sectoral conferences – i.e., bodies with central and regional government representatives working to adapt regulatory frameworks to principles of the law – have been convened since the beginning of 2013. 34 technical groups on specific policy areas reporting to them have been tasked with the simplification of requirements for access to and exercise of economic activities set out in regions' legislation. At the time of writing one agreement had been reached at sectoral conference level on gambling. Technical groups have been more successful in making agreements, but these will have to be validated by the respective sectoral conference and then, implemented by the relevant government. Prompt completion of the legislative adaptation processes and visible progress in the area of sectoral conferences are critical for the law to bear its expected economic impact.

58. The law on market unity also sets out two potentially useful procedures to underpin its implementation. Firstly, companies and individuals can report barriers to market unity to designated one stop shops and seek redress from the competent authorities within shorter deadlines than ordinary administrative appeals. Secondly, the law entitles Spain's Competition Commission to file *ex officio* or at the petition of economic operators contentious-administrative appeals with regard to general provisions or measures it deems contrary to the law. To date, 88 complaints have been submitted under the first procedure and more than 50% of the complaints accepted by the competent administration have been ruled in favour of the complainant. Both procedures can therefore become a useful tool for administrations to simplify requirements and eliminate hurdles to market unity.

59. In spite of recent progress, it is still relatively cumbersome to start up a business in Spain. Several measures have been adopted in recent years to simplify business start-ups. These have helped to improve Spain's position in international rankings on company creation. The 2015 edition of the World Bank's *Doing Business* report ranks Spain at 74th position for the ease of starting up a company (it was 115th in the 2014 edition). Despite considerable progress, it is still more cumbersome to start a business in Spain than in other European countries sharing similar legal systems, a fact that could translate into lower firm dynamics.([28]) The latest legislative developments include: (i) the approval in February 2015 of secondary legislation enabling CIRCE (an information system to set up various company forms online) to host additional company forms and (ii) to merge the existing two networks of one stop shops for company creation. Combined, they

([26]) See *Market reforms at work.* European Economy 5/2014, September 2014. This report estimates the potential impact of selected reforms in Spain Italy, Portugal and Greece. It shows that reforms implemented by mid-2013 are estimated to boost labour productivity in the sectors affected by the Services Directive by around 5.7 % in Spain. Given that the directive covers an average of 40 % of GDP in the four countries, the full economy-wide effects should be considerable. Similarly, an ambitious implementation of the law on market unity, which is broader in scope than the Services Directive and on which it is modelled, could have a positive effect on productivity growth.

([27]) To note: data on progress made by Melilla, Canarias, País Vasco and Catalonia in adapting their own legislation to the law on market unity is not available.

([28]) *Business dynamics and red tape barriers*, European Economy Economic Papers 532, September 2014. The study aims at estimating the impact of changes in the administrative cost of starting a business and/or exporting on entry dynamics in 17 European countries over 2004-2011. It shows that the higher the level of red tape barriers, the lower entry dynamics. In the case of Spain, the decrease in the cost to start a new firm over the period 2010-14 is predicted to increase start-up rates from 7.9 % to 9.2 %.

could further reduce the time needed to create a company. A forthcoming study measuring the ease of getting licences shows that time needed, costs incurred and number of permits required to carry out selected economic activities is relatively high in Spain, thus underpinning the case for sustained simplification efforts.([29]) The publication later this year of World Bank indicators measuring the ease of doing business at regional level could also shed further light on the time, cost and number of procedures needed to carry out pre-specified business transactions across selected Spanish cities, and therefore be the basis for further simplifying licensing procedures.

60. The government is running out of time to reform professional services in the current legislature. A first draft law to reform professional services and professional associations was published on 2 August 2013. The draft law aimed to: (i) limit the number of professions with mandatory membership to cases where this is justified and proportionate; (ii) ensure that registration and membership fees to those professional associations do not create barriers to competition; (iii) increase the transparency and accountability of professional associations *vis-à-vis* consumers of professional services and its own members; and (iv) ensure market unity in the access to and exercise of professional services in Spain. However, submission to parliament of the reform has not taken place to date. Admittedly, the implementation of the Services Directive in Spain reduced barriers to the access and exercise of regulated professions. However, this does not weaken the case for reforming professional services still further. To begin with, a reform is overdue from a legal perspective. Law 25/2009, applicable since end-December 2009, calls on the Spanish government to submit to Parliament – within the twelve months following its entry into force – a draft law spelling out which professions require membership in the relevant professional bodies. The government has not yet submitted such a draft. Moreover, professional services are inputs for business, with their quality and competitiveness having considerable spill over effects across the whole economy. Given relatively high forward linkage effects, the price moderating effect through profit margin compression([30]) of a competition-enhancing reform in professional services is likely to benefit the rest of the economy. Failure to adopt the draft law on professional services and associations in the current legislature would be a missed opportunity to tackle remaining obstacles to the access to and exercise of regulated professions in Spain.([31])

61. A new electricity interconnector between France and Spain (Baixas – Santa Llogaia) has doubled the existing connection capacity from 1 400 to 2 800 MW. The new interconnector was officially inaugurated in February 2015. Despite a significant improvement, the achieved capacity is still far away from the minimum threshold necessary for integration of the Spanish, Portuguese and French electricity markets. Higher interconnecting capacity would improve the security of electricity supply, enhance competition and thereby exert downward pressure on electricity prices, and enable a better integration of renewable energy sources into the European network.

62. The 2014 electricity tariff deficit should be smaller than the deficits in previous years. Energy policy strategies in Spain over the last decade have resulted in an increase in regulated costs of the electricity system and have been, to a large extent, passed on to electricity consumers in the form of higher charges. The electricity tariff deficit (i.e. the gap between the charges paid by consumers and various regulated costs — including distribution costs and subsidies for renewable energy production) reached

([29]) European Commission (forthcoming), Study on the compliance by Member States on the time needed to get licences and permits to take up and perform the specific activity of an enterprise as from beginning of 2014.

([30]) *The Economic Impact of Professional Services Liberalisation,* European Economy Economic Papers 533, September 2014. The study evaluates the effects of regulatory barriers in four professions – legal, accounting, architectural and engineering – in the EU over 2008-11. It concludes that regulation that is less strict improves their allocative efficiency in the professional services sector and reduces its larger-than-average profitability through intensified business dynamics. In the case of Spain, the decrease of OECD Product Market Reform indicator from 2011 to 2013 increases the degree to which resources are efficiently allocated (allocative efficiency index) by 1.89 percentage points and decreases profit rates by 1.78 percentage points in legal services and by 0.99 in architectural services.

([31]) For more analysis of the potential effects of the reform of professional services see the 2015 country report (staff working document): http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

EUR 3.54 bn in 2013. The 2013 reform of the electricity system helped to reduce costs of the system and to increase its revenues. Provisional assessment suggests that until November 2014, still a significant deficit was recorded, but it does not include all the revenues of the system. The November deficit was EUR 370 m higher than initially foreseen. The gap is mainly due to lower demand for electricity and the fact that consumers were contracting less power to reduce their costs. The final deficit outcomes in 2014 are still to be seen.

63. The gas tariff deficit accumulated until end-2014 was higher than initially expected. The accumulated gas tariff deficit of EUR 1.12 bn will be paid by gas consumers over the next 15 years, and it includes: EUR 725 m accumulated deficit of 2012-14 (out of which EUR 400 m correspond to 2014), EUR 338 m of additional underground storage costs, and EUR 60 m due to demand lower than expected. Corrective measures already implemented in mid-2014 (RDL 8/2014) should deliver annual savings in the system's costs of around EUR 240 million. If the savings are not sufficient to close the deficit in future, automatic increases in gas tariffs shall be triggered, in line with the principle of system's financial sufficiency.

64. It is still uncertain whether the insolvent toll motorways will be taken over by a public company. Operators of toll motorways with low traffic flows and which have been declared insolvent represent a non-negligible contingent liability for the state. The authorities intend to create a public company which would take over management of the motorways and refinance the debt of operators with a substantial haircut. On the basis of the reformed insolvency law, the authorities have already proposed agreements to the creditors of four out of eight concessions in difficulty, and proposed that only one court takes care of the eight insolvency procedures. The negotiating parties have not yet reached any agreement on the basis of the government's proposal, and delays in negotiations may be expected. In case the agreements are not accepted by creditors, the court will start liquidation procedures.

65. A Ministerial Order, which will be the basis for opening the corridor *Levante* for competition in passenger rail services, is under preparation. In 2014, the authorities announced that corridor *Levante* (network between Madrid, Valencia and Alicante) will be opened to competition. In December 2014, a draft Ministerial Order was submitted for public consultation. The revised version of the Order is being prepared so that licences in the corridor *Levante* can be put into tender still in 2015. In March 2015, a preliminary draft law on railway sector was adopted by the Council of Ministers. The law intends to revise the system of charges to access railway infrastructure, to set legal provisions for creation of the Railway Safety Agency, or to increase competences of seaports in management of their railway infrastructure.

66. A 49% stake in AENA has been sold to private investors. In July 2014 the government announced that a 21 % stake in AENA, the operator of the network of 46 airports and two heliports, would be offered to strategic investors and at least 28 % would be placed on the stock exchange. The initial public offering was launched in February 2015. Despite a strong demand in the retail tranche, small investors have been awarded a 6-7% stake in the company, TCI fund a 7.5% stake, and institutional investors the rest of 49%. The privatisation of AENA could bring around EUR 4.3 bn of financial revenues for the state.

ANNEX A

Main macroeconomic and financial indicators

Table A.1: **Main economic and financial indicators**

	1995 -1999	2000 -2004	2005 -2008	2009	2010	2011	2012	2013	2014 (e)	2015 (f)	2016 (f)
Core indicators											
GDP growth rate	3.6	3.7	3.2	- 3.6	0.0	- 0.6	- 2.1	- 1.2	1.4	2.3	2.5
of which domestic demand incl. stocks	4.1	4.3	3.7	- 6.4	- 0.5	- 2.7	- 4.3	- 2.7	2.2	2.6	2.6
Private consumption (annual % change)	3.3	3.5	2.6	- 3.6	0.3	- 2.0	- 2.9	- 2.3	2.4	2.7	2.6
Public consumption (annual % change)	2.7	4.7	5.7	4.1	1.5	- 0.3	- 3.7	- 2.9	0.1	0.3	0.1
HICP (annual % change)	2.8	3.2	3.5	- 0.2	2.0	3.1	2.4	1.5	- 0.2	- 1.0	1.1
Unemployment rate (% of labour force)	17.8	11.3	9.3	17.9	19.9	21.4	24.8	26.1	24.5	22.7	20.9
Gross fixed capital formation (% of GDP)	22.9	27.0	30.3	24.3	23.0	21.4	19.7	18.5	18.9	19.4	20.0
Gross national saving (% of GDP)	21.9	23.0	21.7	20.3	19.7	18.7	19.8	20.4	20.1	20.5	20.8
General Government (% of GDP)											
Balance (g)	- 4.1	- 0.5	0.2	- 11.0	- 9.4	- 9.4	- 10.3	- 6.8	- 5.8	- 4.5	- 3.7
Gross debt	63.0	51.3	39.0	52.7	60.1	69.2	84.4	92.1	97.7	101.4	102.4
Interest expenditure	4.4	2.6	1.6	1.7	1.9	2.4	2.9	3.3	3.3	3.2	3.2
Households											
Households saving rate	12.9	11.4	8.6	15.3	10.9	11.9	9.5	10.4	9.8	9.3	9.4
Rest of the world (% of GDP)											
Trade balance	- 0.7	- 2.7	- 5.5	- 1.2	- 1.3	- 0.2	1.6	3.4	2.4	2.6	2.4
Trade balance, goods	- 3.6	- 5.8	- 8.2	- 3.8	- 4.4	- 4.1	- 2.7	- 1.2	- 2.0	- 1.7	- 1.9
Trade balance, services	2.9	3.1	2.7	2.7	3.1	3.9	4.2	4.6	4.4	4.3	4.3
Current account balance	- 1.4	- 4.3	- 8.9	- 4.3	- 3.9	- 3.3	- 0.4	1.5	0.6	0.6	0.5
Net financial assets	- 26.2	- 38.7	- 68.4	- 89.1	- 84.2	- 85.4	- 87.9	- 95.2	- 95.2	n.a.	n.a.
Net international investment position (i)	- 26.9	- 41.3	- 69.7	- 93.8	- 89.1	- 91.4	- 92.8	- 98.2	- 96.5	n.a.	n.a.
Net international investment position (j)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	- 90.0	- 92.6	- 95.1	n.a.	n.a.
Competitiveness (index, 2005=100)											
Real effective exchange rate relative to the rest of the euro area	87.4	91.7	100.3	101.1	100.0	98.3	93.4	91.6	90.2	90.1	89.9
Real effective exchange rate relative to the rest of the European Union	88.6	90.0	98.4	102.3	100.0	98.4	93.0	91.7	90.0	88.8	88.5
Real effective exchange rate relative to the rest of 37 industrialised countries	87.2	87.7	99.5	104.0	100.0	98.7	92.1	92.5	91.5	87.9	87.3
Banking sector											
Assets (% of GDP)	170.8	189.9	267.9	319.4	321.1	336.8	339.4	300.4	280.8	271.6	n.a.
Private domestic credit (y-o-y %)	11.8	14.7	18.9	- 1.6	0.8	- 3.2	- 9.9	- 10.2	- 6.5	- 6.3	n.a.
Non-performing loans (NPLs), total	3.3	1.1	1.5	5.1	5.8	7.8	10.4	13.6	12.5	n.a.	n.a.
NPLs, productive activities	n.a.	1.2	1.5	6.2	7.9	11.3	15.5	20.3	18.5	n.a.	n.a.
" of which, construction, and	n.a.	1.0	1.7	8.5	12.1	18.2	25.8	34.3	32.6	n.a.	n.a.
" real estate activities	n.a.	0.6	1.8	10.1	14.0	21.4	29.1	38.0	36.2	n.a.	n.a.
NPLs, residential mortgages	n.a.	0.4	1.0	2.9	2.6	3.1	4.4	6.6	6.2	n.a.	n.a.
Tier 1 ratio (%)	n.a.	n.a.	n.a.	9.3	9.6	10.2	9.7	11.7	11.6	n.a.	n.a.
Interest rates											
10 year spread vis-à-vis the Bund	1.6	0.2	0.1	0.8	1.5	2.8	4.3	3.0	1.5	1.1	n.a.
CDS 5 year	n.a.	n.a.	14.6	92.0	204.0	319.6	431.9	235.4	90.5	81.7	n.a.

(e) 2014: estimates or latest available data
(f) 2015: forecast
(g) General government balances include capital transfers related to support of banks
(i) ESA95 and BPM5
(j) ESA2010 and BPM6
Source: Ameco, BdE, Eurostat, IHS Global Insight, own calculations

ANNEX B

State of play with MIP relevant recommendations

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
1. Measures to improve the quality of public expenditure and taxation and the efficiency of public administration			
[CSR 1] Ensure that the new independent fiscal authority becomes fully operational as soon as possible.		The NRP announces that the independent fiscal authority will be operational in 2014.	On 14/11/2013 the independent fiscal authority (AIReF) was created by Organic Law 6/2014. Its legal framework is virtually complete. AIReF's recruitment of staff, other than its managing board – i.e., president and three directors – took place during the summer of 2014. As of end-March 2015, AIReF has issued nine reports, three opinions and two technical documents.
[CSR 1] Ensure a full implementation of the preventive, corrective and enforcement measures in the Budgetary Stability Organic Law at all levels of government, including on the elimination of public sector commercial arrears.	The NRP informs on the application of provisions of the Budgetary Stability Organic Law (BSOL) to date.		The majority of economic and financial plans for regions having not complied with the 2013 deficit target were adopted late in 2014: in July 2014, the Fiscal and Financial Policy Council (FFPC) approved the Economic and Financial Plan of Aragón only. On 23/12/2014, it approved those of Catalonia, Valencia, Murcia, Cantabria and Castilla-La Mancha. In January 2015, the Coordination Committee between the Spanish General Administration and the Region of Navarra approved the Economic and Financial Plan of Navarra. The measures contained within these plans aim at fulfilling objectives throughout the period 2014-2015. Moreover, no preventive measures were taken last year on regions at risk of non-compliance with the 2014 deficit target, despite visible deterioration in regions' budget execution. On 25/11/2014, the Ministry of Finance published for the first time data on average payment periods covering all general government levels referred to the month of October. The latest published data refer to January 2015. Spain's social security administration records the lowest average payment period of all general government subsectors, followed by the central government. Local entities have on average shorter payment periods than

			regions, although both of them are well above the 30 day limit.
[CSR 1] Carry out by February 2015 a systematic review of expenditure at all levels of government to underpin the efficiency and quality of public spending going forward.			The Ministry of Finance set up in June 2014 a taskforce looking into expenditure reduction in Spain's regions. The working group has looked into ways to further rationalise spending in areas such as healthcare, education, social spending and public administration. At the time of writing, measures had been identified but they had not been published and no agreement had been reached at the Financial and Fiscal Policy Council (a forum gathering representatives from the regions and central government's finance departments) on their adoption.
[CSR 1] Continue to increase the cost-effectiveness of the healthcare sector, in particular by further rationalising pharmaceutical spending, including in hospitals and strengthening coordination across types of care, while maintaining accessibility for vulnerable groups.	The NRP lists measures which have been adopted to increase the cost-effectiveness of the healthcare sector.		On 24/10/2014, the Council of Ministers gave an authorisation to adopt a framework agreement for centralised purchasing of pharmaceutical products.
[CSR 1] Adopt by the end of 2014 a comprehensive tax reform to make the tax system simpler and more conducive to growth and job creation, preservation of the environment and stability of revenues.	The NRP announced that the tax reform is supposed to: (i) modernise the tax system in accordance with international best practices; (ii) ensure sufficient tax income and increasing revenue collection by paying special attention to thin fiscal bases and to tax fraud, but without discouraging job creation; (iii) contribute to fiscal consolidation and job creation, and (iv) favour economic development, ensure market unity and fiscal neutrality and enhance the competitiveness of the Spanish economy.	The reform is to be adopted in the second half of 2014.	The tax reform was adopted on 20/11/2014, covering personal income taxation and corporate income taxation, to be implemented from January 2015 onwards.
[CSR 8] Implement at all government levels the recommendations of the	The NRP announced three flagship initiatives for 2014: (i) the new law on		As at end-December 2014, 129 of 222 public administration reform measures had already been

committee for the reform of the public administration.	the common administrative procedure, (ii) the reform of the law of public grants and (iii) amendments to the law on Spain's civil service, to cater for proper human resource planning, training and evaluation of performance. These initiatives come on top of other planned measures to remove duplicated administrative structures, reduce overheads and simplify administrative burdens. Last, the NRP refers to the entry into operations of the Ministry of Finance's economic and financial database, which will gather all economic and fiscal data from the three levels of general government.		implemented (58.1% of the total number of measures) while 61 others were at an advanced stage of implementation. Measures to remove duplicated administrative structures have presented greater implementation difficulties.
[CSR 8] Strengthen control mechanisms and increase the transparency of administrative decisions, in particular at regional and local levels.			Spain has done some progress in strengthening transparency of administrative decisions. The provisions on transparency and public access to information became effective in December 2014 at central government level; they will enter into force in December 2015 at sub-central government level. However, no progress has been made in strengthening control mechanisms in particular at regional and local levels. There have been no initiatives to enhance these powers in the public procurement and urban planning areas.
[CSR 8] Complete and monitor closely the ongoing measures to fight against the shadow economy and undeclared work.	The NRP lists measures adopted in 2012 and 2013 to reduce undeclared work and tax avoidance.		On 13/03/2015 the government adopted a new draft law reorganising labour inspectorate and submitted it to the Parliament. The government foresees that a reform of measures against tax fraud will be in place in the first half of 2015, and they will follow international guidelines and OECD recommendations.
[CSR 8] Adopt pending reforms on the structure of the judiciary and on the judicial map and ensure implementation of adopted reforms.	The NRP announces that first instance courts will be replaced by provincial courts (*Ley Orgánica del Poder Judicial* and *Ley de Demarcación y*		On 27/02/2015 the government agreed to submit to parliament a draft law reforming the code of civil procedure and a draft organic law reforming Spain's organic law on the judiciary. Some progress was achieved

	Planta Judicial). Moreover, to reduce burden on judges, in cases where there is no controversy, clerks could assume responsibilities originally borne by judges (*Ley de Jurisdicción Voluntaria*). Finally, the reform intends to improve efficiency of the system by (i) proposing that a panel of three judges, instead of a single judge, oversees major cases, (ii) quarterly publication of binding jurisprudence by the Supreme Court, and (iii) changes in the judicial career.		since the last PPS report in implementing adopted reforms – i.e., the so-called *Oficina Judicial* – and improving interoperability between regions' electronic case management systems.
2. Measures to make the financial sector stable and make sure that deleveraging of the private sector goes smoothly			
[CSR 2] Complete the reform of the saving banks sector, as regards the adoption of secondary legislation and complete the restructuring of state-owned savings banks in order to accelerate their full recovery and facilitate their return to private ownership.			Discussion on the first draft of the act implementing the savings banks law started in October 2014. Regulatory implementation of the law 26/2013, of 27 December, on savings banks and banking foundations is currently in process. The Ministry of Economy and Competitiveness has elaborated a draft of the Ministerial Order developing some corporate governance aspects and the accounting obligations of the banking foundations established in the Law. In April 2015, the Order has been put to public consultation.
[CSR 2] Promote banks' efforts to sustain strong capital ratios.			Solvency of banks has been further strengthened.
[CSR 2] Monitor the asset management company SAREB's activity in order to ensure timely asset disposal while minimising the cost to the taxpayer.			A key milestone for improving the management of SAREB financial assets, i.e. the introduction of incentives in the servicers' contracts that link the remuneration with the performance of the loan portfolio, is completed. The new servicers are already operative and the migration of assets has started.
[CSR 2] Complete the ongoing measures to widen SMEs access to finance, in particular by finalising the ongoing measures to improve non-bank	To foster new bank lending, the NRP announced that ICO (state-owned bank and finance agency) should expand further its lending facilities to Spanish		On 03/10/2014, the Council of Ministers adopted a draft law on promoting corporate financing. The law has a double objective of improving access to bank credit (e.g. requiring credit institutions to notify a SME in advance if

financial intermediation.	banks, including financing of export activities. The NRP also announced a draft law on promoting corporate financing which has a double objective of improving access to bank credit and developing non-bank financial intermediation.		its credit line is to be reduced and improving the regime on mutual guarantee funds) and developing non-bank financial intermediation (e.g., simplifying the regime on bond issuances, rationalising the rules on securitisation and enhancing their transparency, and establishing a framework for crowd-funding). The law should be adopted by the Parliament in the coming weeks. In November, the law 22/2014 regulating venture capital companies and closed-end collective investment schemes was adopted by the Parliament. The Royal Decree 83/2015 implements the law. The law intends to promote direct financing for young, growing, or emerging firms. In particular, it has created a framework to set up debt funds aimed at financing of SMEs ("SME-venture capital company").
[CSR 2] Remove remaining bottlenecks in the corporate insolvency framework, in particular by enhancing the expertise of insolvency administrators and the capacity of the judicial system to handle insolvency cases, and develop a permanent framework for personal insolvency, paying due attention to balanced creditor/borrower rights and financial stability considerations.			On 27/02/2015 the government adopted the Royal Decree Law 1/2015 reforming further the insolvency framework. The RDL (i) makes the out-of-court procedures for SMEs more flexible, (ii) sets provisions for a fresh start (a second chance) for individuals and entrepreneurs, (iii) extends the number of beneficiaries entitled to mortgage debt restructurings (within the framework of the code of good practices developed for banks), and (iv) extends the moratorium on evictions of vulnerable debtors from primary residencies.
3. Measures to improve the functioning of the labour market and enhance human capital			
[CSR 3] Pursue new measures to reduce labour market segmentation to favour sustainable, quality jobs, for instance through reducing the number of contract types and ensuring a balanced access to severance rights.			In February 2015, the Government adopted a new temporary scheme form of reduced employers' contributions to social security for net indefinite employment (first EUR 500 are exempted of contribution). The scheme will expire in August 2016. For certain time the new scheme co-existed with the temporary "flat rate" for net indefinite employment introduced in February 2014, which expired at the end of March 2015.

[CSR 3] Continue regular monitoring of the labour market reforms.	The NRP focuses on the description of the already adopted measures (i.e. part-time strategy, new flat rate social security contribution to create net indefinite employment), and in the description of the comprehensive reform of active labour market policies.		The Government regularly publishes data on employment, unemployment and activity, evolution of contracts and hiring trends (including on the use of hiring subsidies), dismissal procedures and collective bargaining.
[CSR 3] Promote real wage developments consistent with the objective of creating jobs.			The social partners' *Interconfederal Agreement for Employment and Collective Negotiation 2012-14* linked wages to productivity growth, and included guidelines for wage bargaining in 2012, 2013, and 2014. The social partners are currently discussing a new multiannual agreement.
[CSR 3] Strengthen the job-search requirement in unemployment benefits.			On 5/09/2014, the Council of Ministers adopted the 2014-2016 Activation Strategy, which establishes the new multiannual tool to frame the work of the different public employment services (national and regional), with common objectives and actions. The strategy intends, among other objectives, to reinforce the links between active and passive labour market policies, by enhancing activation of unemployed perceiving an unemployment benefits. The activation programme for the long-term unemployed has introduced strict benefit conditionality: rejection of any employment offer disentitles beneficiaries from the right to remain in the programme (and receive the income support); active job search is an entry requirement which is also regularly monitored in order to maintain the right to participate.
[CSR 3] Enhance the effectiveness and targeting of active labour market policies, including hiring subsidies, particularly for those facing more difficulties in accessing employment.			On 4/07/2014, the Council of Ministers adopted a RDL 8/2014 on urgent measures to reinforce growth, competitiveness and efficiency (validated by the Parliament on 10/07/2014), which, among others, modifies the Law 53/2006 of 16 December, on Employment, to adapt it to the new active labour market policies (ALMPs) model, set out in the 2014-2016 Spanish Activation

			Strategy. On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy intends to improve targeting of ALMPs and in consequence the employability of groups particularly affected by unemployment: workers over 55, long-term unemployed and beneficiaries of the PREPARA programme. The Strategy is accompanied by a regulation on employment programmes and should lead to a results-based reallocation of funds. A new temporary programme of activation and support for the long-term unemployed was adopted on 19/12/2014 (Royal Decree-Law 16/2014).
[CSR 3] Reinforce the coordination between labour market and education and training policies.			On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy intends to improve the employability of young people and promoting entrepreneurship, to improve the quality of vocational training for employment. The Strategy is accompanied by a regulation on vocational training for workers. Regarding the education and training system the implementation of the new basic vocational education and training, together with the broadening of dual vocational training is expected to contribute to improve employability and strengthen the links with the labour market. The reform of the training system for the employed was adopted on 20/03/2015. The reform, guided by the principles of transparency and competition in the provision of training, foresees the possibility for duly accredited private training agencies to participate directly in the system as training providers.
[CSR 3] Accelerate the modernisation of public employment services to	The NRP refers to the new occupational training system and the	Reform of the occupational training	On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy is complemented by a

ensure effective personalised counselling, adequate training and job-matching, with special focus on the long-term unemployed.	establishment of a new, common catalogue of employment services (applicable to all, national and regional, employment services).	system to be finalised in 2014.	mutual learning and best practices exchange programme among Public Employment Services, and the regulation of a common catalogue of employment services, as the minimum to be provided by all employment services in Spain, which was set by Royal Decree adopted on 16 January.
[CSR 3] Ensure the effective application of public-private cooperation in placement services before the end of 2014, and monitor the quality of services provided.			The framework agreement on public-private cooperation in recruitment services was set in June 2014. Bilateral agreements are now being signed by regional and national public employment services (PES) with employment agencies. The agreement between the national PES and private agencies related to the beneficiaries of the PREPARA programme was signed at the end of 2014.
[CSR 3] Ensure the effective functioning of the Single Job Portal and combine it with further measures to support labour mobility.			On 17/07/2014, the Minister of Labour presented the new *Portal de Empleo y Autoempleo*, called Empléate (www.empleate.gob.es)
[CSR 4] Implement the 2013-2016 Youth Entrepreneurship and Employment Strategy and evaluate its effectiveness.			The 2013-16 Youth Entrepreneurship and Employment Strategy continues to be implemented. Most of strategy's short-term measures are already implemented; however many of the medium and long-term measures – and the first evaluation – are still pending.
[CSR 4] Provide good quality offers of employment, apprenticeships and traineeships for young people and improve the outreach to non-registered unemployed young people, in line with the objectives of a youth guarantee.			On 4/07/2014, the Council of Ministers adopted a series of legislative measures (via RDL 8/2014) covering the implementation of the national youth guarantee plan (validated by the Parliament on 10/07/2014). Until mid-March there was only around 33 000 subscriptions and the provided offers were not yet reported.
[CSR 4] Effectively implement the new educational schemes to increase the quality of primary and secondary education.	The NRP describes the progress on implementation of the dual vocational training, but there are no announcements of further measures to promote vocational education and		The Law on Quality of Education (LOMCE) is being implemented gradually, starting from the school year 2014/2015. The complex implementation process requires dialogue with regions.

	training.		
[CSR 4] Enhance guidance and support for groups at risk of early school leaving.	The NRP draws on the implementation of the Law on Quality of Education (LOMCE) to improve education performance and combat early leaving from school and training. The law was adopted in November 2013.		The Law on Quality of Education (LOMCE) is being implemented gradually, starting from the school year 2014/2015. The complex implementation process requires dialogue with regions.
[CSR 4] Increase the labour-market relevance of vocational education and training and of higher education, in particular by enhancing the cooperation with employers and supporting the training of trainers and tutors.	The NRP describes the progress on implementation of the dual vocational training, but there are no announcements of further measures to promote vocational education and training.		The Law on Quality of Education (LOMCE) is being implemented as foreseen, gradually, starting from the school year 2014/2015. Linked to the youth guarantee system, in place since July 2014, a specific committee has been set up in the labour market sectorial conference, which will examine, among others, the relevance of education and training curricula to the labour market needs. The implementation of the pilot projects on dual vocational training continues, and its extension to other sectors and companies is already foreseen (including also by amending the 2012 RDL establishing the bases for dual vocational training in Spain).
4. Structural measures promoting growth and competitiveness			
[CSR 6] Ensure an ambitious and swift implementation of Law 20/2013 on Market Unity at all levels of administration.	The NRP gives more detail on secondary legislation needed to implement the Law on Market Unity. It describes the planned changes 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.		As of end-March 2015, the implementation of the law was more advanced at central than at regional level judging from progress made in removing inconsistencies between sector specific legislation and the law on market unity. 20 sectoral conferences – i.e., bodies with central and regional government representatives working to adapt regulatory frameworks to principles of the law – have been convened since the beginning of 2013 and 34 technical groups on specific policy areas reporting to them have been tasked with the simplification of requirements for access to and exercise of economic activities set out in regions' legislation. At the time of writing one agreement had been reached at sectoral conference level on gambling. To date, 88 complaints had been submitted before the Council of market unity reporting barriers to market unity

			and more than 50% of the complaints accepted by the competent administration have been ruled in favour of the complainant.
[CSR 6] Adopt an ambitious reform of professional services and of professional associations by the end of 2014, defining the professions requiring registration in a professional organisation, and the transparency and accountability of professional bodies, opening up unjustifiably reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain.		End-2014	No progress.
[CSR 6] Further reduce the time, cost and number of procedures required for setting up an operating business.	As far as the Law on Entrepreneurship adopted in 2013 is concerned, the NRP announced the issuance of company model statutes (to speed up the creation of private limited companies) and the publication of regulatory indicators at regional level (Doing Business project at regional level in cooperation with the World Bank), to help assess business climate in Spain's regions. The NRP refers to the regional transposition of the law on environmental assessment, adopted in December 2013, which is expected to speed up licensing for environmental programmes, plans and projects. Moreover, the NRP announced the plan to enforce the observance of administrative deadlines across all government levels, which is supposed to benefit firms.		Some progress has been made in further reducing the time, cost and number of procedures required for setting up and operating business. Despite progress, the most recent indicators measuring ease to start-up a business show that it is more cumbersome to start-up a business in Spain than in other European countries sharing similar legal systems.
[CSR 6] Address unjustified restrictions to the establishment of	The NRP announces that cooperation on retail reform between central and		Royal Decree-Law 8/2014, adopted on 4/07/2014 facilitates licensing procedures for the establishment, sale

large-scale retail premises, in particular through a revision of existing regional planning regulations.	regional authorities is conducted in the framework of the Law on Market Unity.		and expansion of retail outlets. Smooth implementation at sub-central government level of this reform is however needed for the amendments to deliver the expected results.
[CSR 6] Identify sources of financing for the new national strategy for science, technology and innovation and make operational the new State Research Agency.			Limited progress has been made in identifying sources of financing for the new national strategy for science, technology and innovation. While the 2015 national budget increases public spending on research and innovation by 4.8 %, a substantial part of the increase is earmarked to reimburse multiannual research and innovation project grants committed in previous exercises, thus leaving only a small portion of the public research and innovation budget increase to support the national strategy for science, technology and innovation. No progress has been done in setting up a new State Research Agency.
[CSR 7] Following the reform of 2013, ensure the effective elimination of deficit in the electricity system as of 2014, including by taking further structural measures if needed.	The NRP announced that the regulatory framework of the 2013 reform tackling the electricity tariff deficit will be further developed.		On 12/12/2014, the government approved Royal Decree 1054/2014, to finance the 2013 tariff deficit by the five major electric utilities, estimated at EUR 3 540 million, and to address the 'cyclical imbalances' for future years.
[CSR 7] Address the problem of insolvent toll motorways so as to minimise costs for the State.			Until mid-March, the authorities have proposed agreements to the creditors of four out of eight concessions in difficulty. The agreements imply substantial haircuts. Four other agreements are still pending. The proposed agreements are interlinked, meaning that all the eight have to be validated so that a public company, which would take over the motorways, can be set up. To facilitate the process, the authorities proposed that only one court takes care of the eight insolvency procedures.
[CSR 7] Set up an independent body to contribute to the assessment of future major infrastructure projects by the end of 2014.	The NRP informs that an advisory council on infrastructure projects will be set up.		No progress
[CSR 7] Take measures to ensure effective competition in freight and passenger rail services.	The NRP announced a gradual liberalisation of passenger rail services.	Liberalisation of passenger rail services to be gradually deployed over 2014.	On 13/03/2015, the Council of Ministers adopted a preliminary draft law on railway sector. The law intends to revise the system of access charges to railway infrastructure, to set legal provisions for creation of the Railway Safety Agency, or to increase competences of

			seaports in management of their railway infrastructure. After the public consultation, the Council of Ministers will adopt the final draft. A Ministerial Order, which will be the basis for opening the corridor *Levante* for competition in passenger rail services, is under preparation.

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