



EUROPEAN
COMMISSION

Brussels, 12.10.2015
C(2015) 6892 final

COMMISSION OPINION

of 12.10.2015

on the Draft Budgetary Plan of SPAIN

COMMISSION OPINION

of 12.10.2015

on the Draft Budgetary Plan of SPAIN

GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SPAIN

3. In view of the forthcoming general elections, Spain submitted its Draft Budgetary Plan for 2016 on 11 September 2015, ahead of the deadline of 15 October set in Article 6 of Regulation (EU) No 473/2013. The Draft Budgetary Plan incorporates the central government budget that was adopted by the government on 31 July 2015 and which is scheduled to be approved by Parliament by end-October 2015. However, it does not include up-to-date and fully specified measures for regional governments. It factors in the latest publicly available information on budgetary execution. – i.e., up until May 2015 (for regional governments) and Q1 2015 (for local entities) – while assuming compliance with the targets set in July 2014 and 2015 for all general government sub-sectors for both 2015 and 2016, respectively.
4. On the basis of this Draft Budgetary Plan, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. To underpin its assessment, the Commission has prepared an ad-hoc forecast (hereafter: ad-hoc Commission forecast), with a cut-off date of 29 September 2015.
5. Spain is currently subject to the corrective arm of the SGP. The Council opened the Excessive Deficit Procedure (EDP) for Spain on 27 April 2009. In its latest recommendation issued on 21 June 2013 under Article 126(7) of TFEU ('the 2013 EDP recommendation'), the Council recommended Spain to correct the excessive deficit by 2016 at the latest. In order to bring the headline government deficit below the 3% of GDP reference value by 2016, Spain was recommended to reach a headline deficit target of 6.5% of GDP in 2013, 5.8% of GDP in 2014, 4.2% of GDP in 2015, and 2.8% of GDP in 2016, which based on the Commission 2013 spring forecast extended to 2016, is consistent with an improvement of the structural balance of 1.1%, 0.8%, 0.8%, and 1.2% of GDP in years 2013-2016 respectively.
6. The Draft Budgetary Plan is based on a macroeconomic scenario of continued strong economic growth in Spain, driven by domestic demand, in particular private consumption and investment in equipment. Employment is also expected to continue expanding at a rapid pace. When compared to the ad-hoc Commission forecast, real GDP growth of 3.3% in the Draft Budgetary Plan for 2015 appears broadly plausible, although slightly above the Commission's projection of 3.1%. However, the

macroeconomic scenario in the Draft Budgetary Plan for 2016 appears somewhat optimistic. According to the ad-hoc Commission forecast, risks to growth projections appear skewed to the downside and are mainly related to the external sector, should the deceleration in emerging markets intensify.

7. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by Spain's Independent Fiscal Institution – *Autoridad Independiente de Responsabilidad Fiscal, AIREF* – on 31 July 2015. However, AIREF flagged that the composition of growth could differ from the government's forecast (with more consumption and less investment relative to the latter) and that employment growth could turn out weaker than expected.
8. The Draft Budgetary Plan expects the 2015 general government deficit to decline from 5.8% of GDP in 2014 (including bank support of 0.1% of GDP) to 4.2% of GDP in 2015 in line with the recommended EDP targets. For 2016, the Draft Budgetary Plan targets a general government deficit of 2.8% of GDP, also in line with the recommended EDP target. The headline deficit targets have remained unchanged compared to those in the stability programme of April 2015, while the macroeconomic outlook has improved since then. The Commission takes note of data published by the General State Comptroller (IGAE) and notified to Eurostat by the Spanish statistical office on 29 September 2015, i.e. after the date of submission of the Draft Budgetary Plan. These data, which still need to be validated by Eurostat before the Commission 2015 Autumn Economic Forecast, show a lower nominal GDP in 2014 and, in turn, a slightly higher general government deficit to GDP ratio, at 5.9% of GDP. Given the worse starting position, notified data also point to a slightly higher planned deficit for 2015, at 4.3% of GDP. The deficit reduction in both 2015 and 2016 is expected to be achieved by a combination of expenditure restraint and higher revenues, against the backdrop of high nominal GDP growth. The Draft Budgetary Plan foresees the structural balance to improve by 0.2% of GDP in 2015 and to remain unchanged in 2016¹, well below the improvement recommended by the Council.
9. The ad-hoc Commission forecast foresees a deficit of 4.5% of GDP in 2015, 0.3 pp. higher than in the Draft Budgetary Plan. The difference stems from the expenditure side. Besides the impact of a slightly lower nominal GDP than in the Plan's macroeconomic scenario, which contributes to a smaller drop in the expenditure ratio, the Commission also foresees compensation of employees to grow somewhat faster than the Draft Budgetary Plan. Regarding revenues, the Draft Budgetary Plan, as the ad-hoc Commission forecast, is based on tax revenues accelerating from 2014, in particular taxes on production and imports. Regarding 2016, the ad-hoc Commission forecasts a deficit of 3.5% of GDP, 0.7 pp. higher than the target in the Draft Budgetary Plan, and 0.5% of GDP above the 3% of GDP reference value. This difference reflects a worse starting position, lower underlying nominal GDP growth and a more prudent view on current expenditure restraint, in particular at the regional and local level, as well as a different assessment of the impact of some tax and non-tax revenue measures, some of which have not been sufficiently specified to be

¹ I.e., as recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology. Note that this recalculation results in values for the structural balance that differ significantly from those reported in the Draft Budgetary Plan, which amount to -0.7% and -0.5% of GDP for 2015 and 2016, respectively.

included in the ad-hoc Commission forecast. It is noted that the ad-hoc Commission forecast does not include the new data for the outcome of 2014, as they have not yet been validated by Eurostat.

10. The Draft Budgetary Plan foresees the debt-to-GDP ratio to peak at 98.7% of GDP in 2015, before declining to 98.2% of GDP in 2016. This is only slightly lower than the ratios presented in the Stability Programme. These projections do not yet reflect the data recently published by the General State Comptroller (IGAE) and notified by Spain's statistical office to Eurostat on 29 September 2015, which report a debt-to-GDP ratio of 99.4% of GDP in 2014 and which would also point to a higher planned debt ratio for 2015, at 99.7% of GDP. The decline in the debt ratio in 2016 is essentially driven by strong nominal GDP growth offsetting the effect of interest expenditure and positive stock flow adjustments. Compared with the Draft Budgetary Plan, the ad-hoc Commission forecast projects slightly higher debt ratios, at 99% and 99.5% of GDP in 2015 and 2016, respectively, mainly reflecting a somewhat lower primary balance in both 2015 and 2016 and lower nominal GDP growth.
11. The Draft Budgetary Plan reports an incremental net deficit-reducing impact from discretionary measures of slightly above $\frac{1}{2}\%$ and $\frac{1}{4}\%$ of GDP in 2015 and 2016, respectively. In both years, this net effect stems solely from expenditure-based measures, as the reported revenue-raising measures mostly at regional and local level are outweighed by the effects of the tax reform, which lowered personal and corporate income taxes as from January 2015. On the expenditure side, savings stem from efficiency-enhancing policies (through the public administration reform), the continued implementation of the 2013 pension reform and various other measures affecting current spending at the regional and local level. The ad-hoc Commission forecast takes into account incremental discretionary measures with a net consolidation effect of about $\frac{1}{4}\%$ of GDP in 2015 and only a very marginal one in 2016, as implementation risks for some of the measures, notably those at regional and local government level, are expected to materialise. In particular, this holds for the sale of administrative concessions and various real estate assets and the expected savings at regional level from the new pharmaceutical and healthcare spending rule, the rules governing limitations to new public sector hirings and savings from the transfer of health, education and social services from local entities to regional governments.
12. The 2013 EDP recommendation requires Spain to achieve an improvement in the structural balance of 0.8 pp. of GDP in 2015. However, the Draft Budgetary Plan foresees an improvement of 0.2 pp. of the (recalculated) structural balance, whereas the ad-hoc Commission forecast points to a deterioration by 0.5 pp., notably due to the significant different appraisal of one-off operations in line with the Commission classification. When correcting the change in the structural balance for revisions in potential output growth and unexpected revenue windfalls/shortfalls, the gap widens further to $1\frac{1}{2}$ pps. compared to the recommended effort. Furthermore, when measured as the adjusted cumulative effort in 2013-2015, there is a gap of $2\frac{3}{4}$ pps. compared to the recommended effort. Based on a bottom-up assessment, the additional net consolidation measures fall short by 1.4 pps. of what was deemed necessary to reach the structural targets spelled out in the 2013 EDP recommendation for 2015. On a cumulative basis, the short-fall amounts to 2.2 pps. over the 2013-15 period.
13. Regarding 2016, the (recalculated) change in the structural balance for 2016 (0% of GDP) in the Draft Budgetary Plan is significantly below the 1.2% of GDP effort

recommended by the Council. In turn, the ad-hoc Commission forecast projects the structural deficit to deteriorate by 0.2% of GDP. The projected structural balance corrected for the change in the estimated potential growth and for revenue windfalls/shortfalls unexpected at the time of the 2013 EDP recommendation points in the same direction. On a cumulative basis over 2013-2016, the shortfall with respect to the effort that was recommended by the Council amounts to 3.1 pps. when measured against the uncorrected change in the structural balance, and to 4.4 pps. when referring to the corrected indicator. Finally, the bottom-up estimate of the fiscal effort in 2016 is negative (-0.2% of GDP), thus below the 1.5% of GDP of additional measures deemed necessary in 2016 in the 2013 EDP recommendation to reach the recommended structural target, leading to a shortfall of 3.8 pps. in cumulative terms over 2013-2016. Based on an overall assessment of the Draft Budgetary Plan, compliance with the 2013 EDP recommendation is at risk.

14. The Draft Budgetary Plan reports on progress towards compliance with the country specific recommendations issued by the Council in the context of the 2015 European Semester, particularly those relating to fiscal governance. Spain has so far made some progress to comply with the 2015 fiscal structural country specific recommendations. The latest action in response to those recommendations consists of the adoption in mid-June 2015 of a new voluntary fiscal mechanism to encourage regional governments to limit healthcare spending. However, the design of the incentives has not yet been completed and regional governments have so far not subscribed to it. Moreover, the Ministry of Finance is due to start publishing detailed data on regional governments' spending on health and pharmaceutical products in October 2015. Notwithstanding progress made, there remains room for achieving greater convergence of budgetary codes, budgetary documents, accompanying tables and public accounting rules for regional governments in the interest of transparency and to improve budget procedures.
15. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Spain, which is currently under the corrective arm, is at risk of non-compliance with the provisions of the Stability and Growth Pact. The improvement in the headline budgetary deficit planned in the Draft Budgetary Plan towards correction of the excessive deficit in 2016, the deadline set in the 2013 EDP recommendation, mainly relies on revived nominal GDP growth, with somewhat optimistic underlying growth assumptions in 2016; expenditure restraint also plays a role but some of the planned savings are not yet underpinned by specified measures. Based on the ad-hoc Commission forecast, Spain is not expected to ensure compliance with the budgetary headline targets set in the 2013 EDP recommendation, as the Commission foresees a deficit of 4.5% and 3.5% of GDP in 2015 and 2016, respectively. There are both positive and negative risks to the deficit projections in the ad-hoc Commission forecast. On the one hand, the deficit-to-GDP ratio outcome of 2014, published by the General State Comptroller (IGAE) and notified by Spain's statistical office to Eurostat after submission of the Draft Budgetary Plan, implies a slightly worse starting position for 2015. On the other hand, if the rapid growth in tax revenues observed until August keeps momentum, this would lead to a better-than-expected deficit outcome. Furthermore, the forecast change in the structural balance falls clearly short of the fiscal effort recommended by the Council. The Commission therefore invites the authorities to strictly execute the 2015 budget and take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the Stability and Growth Pact. The Commission is also of the opinion that Spain has made some progress towards compliance with regard to

the country-specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance and invites the authorities to make further progress.

16. In light of the compliance risks highlighted above and the fact that the Draft Budgetary Plan does not include up-to-date and fully specified measures for regional governments, the national authorities are invited to submit an updated Draft Budgetary Plan including fully specified regional measures, as soon as possible. The new plan should take into account the present Opinion in order to fully comply with the Stability and Growth Pact.

Done at Brussels, 12.10.2015

*For the Commission
Pierre MOSCOVICI
Member of the Commission*