EUROPEAN
COMMISSION

Brussels, 28.11.2014
C(2014) 8804 final

COMMISSION OPINION

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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. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October 2014 by Spain, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Spain is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for Spain on 27 April 2009 and later in that year, recommended Spain to correct the excessive deficit by 2013, a deadline that was extended to 2016 on 21 June 2013 as the Council concluded that Spain had taken effective action but adverse economic events with major implications on public finances had occurred. 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 deemed consistent with an improvement in the structural balance of 1.1%, 0.8%, 0.8%, and 1.2% of GDP in years 2013-2016 respectively.

5. The Draft Budgetary Plan is based on a macroeconomic scenario of accelerating economic activity in Spain. In contrast to the preceding six years, internal demand is expected to contribute positively to growth as from 2014 and to become the driving force behind the recovery, based on a strengthening of private consumption and investment in equipment. Employment is expected to continue expanding, but at a slightly slower pace than expected in the Stability Programme. The macroeconomic scenario in the Draft Budgetary Plan for 2015 appears somewhat more benign compared with the Commission 2014 autumn forecast.

6. 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 Authority for Fiscal Responsibility – *Autoridad Independiente de Responsabilidad Fiscal - AIReF*. In its endorsement of the forecasts AIReF pointed out to downward risks to the official macroeconomic forecasts, in particular the impact of lower euro area growth on the Spanish economy. AIReF has been established as a body administratively attached to the Ministry of Finance, with a broad mandate to

monitor public finances and with its functional autonomy being formally guaranteed by law.

7. The Draft Budgetary Plan expects the 2014 general government deficit to decline from 6.8% of GDP in 2013 to 5.5% of GDP in 2014. For 2015, the Draft Budgetary Plan targets a general government deficit of 4.2% of GDP. The deficit reduction in both 2014 and 2015 is expected to be achieved by a combination of expenditure restraint and higher revenues. The Draft Budgetary Plan foresees the (recalculated) structural balance to improve by ¼ percentage point in 2014 and to remain unchanged in 2015.

8. The Commission 2014 autumn forecast foresees a deficit of 5.6% of GDP in 2014, 0.1% of GDP higher than in the Draft Budgetary Plan, but still below the EDP headline target of 5.8% of GDP. There are limited risks underlying both the Commission and the Draft Budgetary Plan's deficit forecasts for 2014, in particular if the planned expenditure restraint at various levels of government does not materialise as expected. Regarding 2015, the Commission forecasts a deficit of 4.6% of GDP, 0.4% of GDP higher than the target in the Draft Budgetary Plan. This difference essentially reflects a slightly worse starting position and a more prudent view on expenditure restraint, in particular at the regional and local level, as well as a different assessment of the impact of some revenue measures. Risks to the budgetary targets are related to contingent liabilities in the energy sector and implementation risks.

9. The Draft Budgetary Plan foresees the upward trend in gross debt to continue in 2014 and 2015, with the debt-to-GDP ratio rising from 92.1% in 2013 to 97.6% in 2014 and 100.3% in 2015. Although the stock-flow adjustment has been revised downward by more than 2% of GDP in 2014, the Draft Budgetary Plan does not provide a breakdown of the various components of the stock-flow adjustment and the revisions. Compared to the Draft Budgetary Plan, the Commission 2014 autumn forecast projects higher debt levels, which mainly reflect differences in inflation in 2014 and a somewhat higher primary deficit in 2015.

10. The Draft Budgetary Plan reports a consolidation effect resulting from discretionary measures of 1½% and 1% of GDP in 2014 and 2015, respectively. In both years, measures are predominantly on the expenditure side, with measures at regional and, above all, local level figuring prominently in 2015. On the revenue side, higher environmental taxes and further tax measures at regional and local level are expected to more than outweigh the impact of the tax reform, including the lowering of personal and corporate income tax rates. In turn, the Commission 2014 autumn forecast takes into account consolidation measures of about 1¼% of GDP in 2014 and about ½% of GDP in 2015, as some of the measures, notably those at regional and local government level, carry implementation risks. Moreover, the net cost of the tax reform could also be somewhat higher than planned. The focus on efficiency gains in public spending at various levels of governmnet makes the overall consolidation strategy more growth-friendly.

11. For 2014, the Draft Budgetary Plan projects the headline deficit to decrease to 5.5% of GDP, below the EDP deficit target of 5.8% of GDP. With the deficit forecast by the Commission reaching 5.6% of GDP in 2014, Spain is expected to comply with the headline target recommended under the EDP. The same EDP recommendation requires Spain to achieve an improvement in the structural balance of 0.8% of GDP in 2014. However, the Draft Budgetary Plan foresees an improvement of 0.3% of

GDP in the (recalculated) structural balance, whereas the Commission 2014 autumn forecast points to 0.2% of GDP. The improvement in the structural balance therefore falls short of the fiscal effort recommended by the Council, although specifically at the turning point of the cycle, developments in the structural balance for Spain may tend to underestimate the true fiscal effort. The same also holds when correcting the structural balance for revisions in potential output growth and unexpected revenue windfalls/shortfalls, and when measured as the cumulative effort in 2013-2014 (1.3 and 0.4% of GDP below the recommended fiscal effort, respectively). Based on a bottom-up assessment, additional net consolidation measures fall short by 0.9% of GDP of what was deemed necessary to reach the structural targets spelled out in the EDP recommendation for 2014. Regarding 2015, the headline balance forecast in the Draft Budgetary Plan is in line with the EDP target of 4.2% of GDP. However, according to the Commission 2014 autumn forecast, the general government deficit is forecast at 4.6% of GDP in 2015. The reported change in the structural balance for 2015 (0% of GDP) is below the 0.8% of GDP effort recommended by the Council. In turn, the Commission 2014 autumn forecast projects the structural deficit to deteriorate by 0.2% of GDP. The projected corrected change in the structural balance points in the same direction. On a cumulative basis over 2013-2015, the shortfall amounts to 1.4% of GDP when measured against the uncorrected change in the structural balance, and to 2.4% of GDP when corrected. Last, the bottom-up estimate of the fiscal effort in 2015 is close to 0% of GDP. This falls short of the target of about 1% of GDP of additional measures deemed necessary in 2015 to reach the structural targets spelled out in the EDP recommendation, leading to a shortfall of 1.6% of GDP in cumulative terms over 2013-2015. Therefore, based on an overall assessment of the Draft Budgetary Plan, compliance with the EDP recommendation is at risk.

12. The Draft Budgetary Plan contains measures to reduce the tax wedge. These consist of a permanent reduction of personal income tax rates (spread over 2015 and 2016). In addition a temporary reduction in social contributions on new contracts was available between February and December 2014. The measures could have a positive effect on employment, but their impact could have been larger had they focused more on cutting labour costs by lowering social contributions. The Draft Budgetary Plan makes explicit reference to the fiscal structural Country Specific Recommendations. Spain has made some progress towards compliance with the 2014 fiscal structural Country-Specific Recommendations. The independent fiscal institution issued its first reports in July 2014, including on the 2015 macroeconomic and budgetary forecasts. As from October 2014, the Spanish law mandates the various general government sub-entities to publish their average payment periods according to a common methodology. However, despite a visible deterioration in regional public finances throughout 2014, no preventive measures foreseen in Spain's Stability Law had been applied up until end-October on regions at risk of non-compliance. Moreover, the application of corrective measures on regions having not complied with fiscal targets has gone at a much slower pace than in 2013, with only one of six regional Economic and Financial Plans having been approved. Furthermore, the planned tax reform, while providing some simplification to the tax system, it is not revenue neutral and may render fiscal consolidation more difficult. In addition, an expert group had submitted review proposals on main spending items, including on healthcare, but no agreement had been reached on their implementation at central and regional government levels at the time of writing. Last, the draft budgetary plan reports progress on the implementation of Spain's public

administration reform. The reform was also recommended to Spain by the Council in June 2014, as it can help Spain consolidate its public finances and achieve efficiency gains.

13. 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. In particular, the Draft Budgetary Plan is not expected to ensure compliance with the budgetary targets set in the EDP recommendation. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2015 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 structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and invites the authorities to make further progress.

Done at Brussels, 28.11.2014

For the Commission
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Member of the Commission