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2003 UPDATE OF THE STABILITY PROGRAMME OF SPAIN (2003-2007)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS[1]

Spain submitted its fifth updated stability programme, covering the period 2003-2007, on 12 January 2004. The information provided in the updated programme largely complies with the data requirements of the revised code of conduct on the content and format of stability and convergence programmes[2]. However, the updated programme was presented six weeks beyond the 1 December deadline set in the revised code of conduct without any apparent justification.

The update confirms the budgetary strategy aiming at maintaining sound public finances defined by a budgetary position of close to balance or in surplus. Apart from incorporating the results of 2003, it does not present significant changes compared to the previous programme concerning both macroeconomic projections and fiscal targets.

Growth in 2003 is now estimated to have been lower than projected in the last year's programme (2.3% against 3%) mainly reflecting a more negative contribution of the external sector. For 2004 onwards, the programme envisages a return to sustained economic growth at around its trend rate (3%), which can be considered realistic and is broadly consistent with the Commission's autumn 2003 forecast. In line with the growth projections, employment creation is expected to strengthen from 1.8% in 2003 to slightly above 2% on average over the programme period. Inflation eased significantly throughout 2003, although by less than projected in the previous year's programme. Taking also into account the closing of the output gap over the programme period, the new inflation projections of 2.9% in 2004, down from an estimated 4% in 2003, and 2.6% in 2005-2007 for the GDP deflator appear on the low side.

Despite slower than expected growth and the effects of the reform of the personal income tax, the budgetary targets of the previous update were overachieved. The initial balanced budget target for 2003 now turns out to be an estimated surplus of 0.5%. This surplus is, however, based on the assumption of a balanced budget for territorial governments, for which very little information is currently available. The better than foreseen result can be explained by several factors, including the support of domestic demand to growth and the resilience of job creation, which helped sustain the GDP share of indirect taxes and social security contributions, respectively. In particular, the social security sub-sector is estimated to record a surplus of 0.9% of GDP compared to a projection of 0.5% in last year's programme. Lower than projected interest payments helped contain overall expenditure as a share of GDP.

The update retains a prudent balanced budget target for 2004 and small, though increasing, surpluses for the rest of the years in line with previous projections (0.1%, 0.2% and 0.3% of GDP for 2005, 2006 and 2007, respectively). By general government sub-sectors, central government excluding social security (i.e. the State and agencies such as the National Institute of Employment) is expected progressively to narrow its

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1 This assessment has been carried out on the basis of information available as of 13.2.2004.

2 *Revised Opinion of the Economic and Financial Committee on the content and format of the stability and convergence programmes*, document EFC/ECFIN/404/01-Rev 1 of 27.6.2001 endorsed by the Ecofin Council on 10.7.2001.

deficit from an estimated 0.4% of GDP in 2004 to 0.1% in 2007. The surplus in the social security accounts is projected to halve in 2004 to 0.4% of GDP, remaining unchanged thereafter. Territorial governments, within the framework of the General Law of Budgetary Stability, are expected to record balanced budgets throughout the programme period.

The programme envisages keeping the ratio of revenues and non-interest expenditure-to-GDP constant throughout the programme period at 40% and 37.4% respectively, while allowing for an increase in the capital expenditure share and a corresponding decrease in the share of primary current expenditure. The resulting primary surpluses, virtually unchanged at 2.6% of GDP during the programme period, are consistent with a steady decline in the debt-to-GDP ratio, from 51.8% in 2003 to slightly less than 44% in 2007. Given the rather conservative balanced budget objective for 2004, the targets for the subsequent years appear cautious, providing margin against less positive developments in the economy. Since budget targets have been set prudently and the path for the GDP deflator can be considered optimistic, a faster debt reduction cannot be excluded.

Based on trend GDP calculated by the Commission services[3] from the programme's projected actual growth, the cyclically-adjusted budget balance deteriorates by a half-percentage point to 0.1% of GDP in 2004. This reflects the better than expected result estimated for 2003 and the maintenance of the previous year's balanced-budget target for 2004. For the remaining programme period, the cyclically-adjusted budget balance improves by 0.2 percentage points to a surplus of 0.3% of GDP in 2007. The Commission's autumn forecast yields slightly more favourable estimates for 2004 and 2005. In the light of the result for 2003, an overachievement of the budgetary target for 2004 seems likely. Accordingly, the budgetary stance, including its evaluation in underlying terms, appears sufficient to ensure the maintenance of the "close-to-balance" objective of the Stability and Growth Pact throughout the period with a comfortable safety margin.

The programme highlights measures recently adopted to increase the quality of public finances, in particular on the expenditure side. The General Budgetary Law, approved in November 2003, reforms the budgetary procedure with the aim of enhancing the transparency and efficiency of public expenditure including the introduction of a system of budgeting by objectives and monitoring of the results. The General Subsidies Law seeks to improve the use of subsidies by providing for systematic cost/benefit reviews. Finally, the General Taxation Law simplifies and reforms the legal framework of tax management including the relationship between taxpayers and tax administration.

On the basis of current policies, as reflected in the situation of public finances and its medium-term evolution showed in the programme as well as the long-term projections for age-related expenditure provided in the programme, Spain seems relatively well placed to cope with the budgetary costs of ageing populations. However, such long-term projections of expenditure are very sensitive to the underlying assumptions, in particular on demography, where the impact of immigration is especially difficult to assess, and on the link between the average pension benefit and average productivity per worker, where a steady reduction of the former relative to the latter may be difficult to achieve.

[3] The commonly agreed methodology based on the production function approach is not yet applied to Spain, pending the resolution of estimation problems. Therefore, cyclically adjusted balances are calculated based on the Hodrick-Prescott filter methodology.

Moreover, even under relatively favourable assumptions on these two critical issues, the increase of pension expenditure in the long-term remains very large. Therefore, current policies need to be supplemented by measures to prevent the emergence of unsustainable trends, in particular a comprehensive reform of the pension system.

While a number of positive measures were recently adopted, including incentives for continued employment of female and older workers, the creation of a supplementary pension fund for civil servants and tax incentives for private pension provision, the economic policies as reflected in the updated programme are partly consistent with the recommendations of the Broad Economic Policy Guidelines, in that steps to implement a major pension reform are not taken. Notwithstanding these measures and the renewal of the multi-partisan agreement "Pacto de Toledo", aiming at ensuring the future financial viability of the public pension system, the calendar for the reform, specifically by aligning more closely contributions and benefits, is not yet defined.

1. INTRODUCTION

The fifth update of the Spanish stability programme[4], covering the period 2003-2007, was submitted to the European Commission on 12 January 2004, six weeks beyond the 1 December deadline set in the revised Code of conduct. The previous update examined by the Economic and Financial Committee on 10 February 2003 and by the Ecofin Council in its opinion of 18 February 2003[5], covered the years 2002-2006.

The overall budgetary strategy remains unchanged from the previous programmes. While the revenues-to-GDP ratio is expected to remain at a constant 40%, the expenditure ratio is planned to increase in 2004 and decline thereafter, mainly due to falling primary current expenditure and interest payments. As a result, the general government surplus in 2003 is expected to turn into a balanced budget in 2004 and to record small surpluses throughout the rest of the projection period. Finally, the debt-to-GDP ratio is envisaged to keep falling below 44% in 2007.

2. MACROECONOMIC ASSESSMENT

2.1. Macroeconomic developments in 2003

Contrary to previously expected, the economic slowdown persisted through the first half of 2003. As a result, GDP growth is likely to be less than 2.5%, up from 2.0% in 2002, but down from 3.0% projected in the December 2002 update

Despite the downward revision of growth, employment creation was remarkably resilient, helping sustain private consumption at around 3%. This strong job creation underpinned fiscal revenues, mainly through social security contributions, which in turn partially explains the overachievement of last year's fiscal objectives.

Headline and core inflation eased significantly throughout the year. Thus, HICP grew by 3.1% on average in 2003 down from 3.6% in 2002. Measured by the GDP deflator inflation is also expected to decline to nearly 4% from 4.4% in 2002. In last year's update, the corresponding projection for the GDP deflator was 2.8% in 2003, down from 3.5% in 2002.

2.2. External economic assumptions

The programme's central scenario is based on the external assumptions provided by the Commission earlier this autumn[6]. These assume a gradual recovery of the world economy which is expected to consolidate in the next two years. Specifically, world imports excluding EU15 are expected to grow by 8.3% and 8.6% in 2004 and 2005, respectively. Assumptions on the $/€ exchange rate, interest rates and oil and commodity

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4 *The updated programme is available on the website of the Ministry of Economy: http://www.mineco.es/sgpc/405SGPCM.htm.*

5 OJ C 51/4, 5.3.2003.

6 According to the Code of Conduct, Member States should endeavour to use common basic assumptions on the main extra-EU variables provided by the Commission.

prices are those considered in the Autumn Commission forecast for the period 2003-2005, hence not including the recent strengthening of the euro exchange rate.

2.3. Macroeconomic scenario

In the central macroeconomic scenario GDP growth, after recovering slightly to 2.3% in 2003, resumes at a rate close to trend output growth (3.0%) from 2004 to the end of the projection period. Apart from the downward revision in 2003, growth projections have not changed from the previous update.

This macroeconomic scenario is broadly in line with the Commission forecasts of GDP growth of 2.9% and 3.3% in 2004 and 2005, respectively (see Table 1). The main differences stem from a weaker contribution of domestic demand coupled with a less negative contribution of the external sector than envisaged by the Commission. Overall, the outlook for growth is plausible, subject to the improvement in the international economic setting and given the ongoing catching-up process of the Spanish economy.

Applying the production function method to the data in the programme, the implicit rate of potential growth turns out to be at around 3.1% between 2003-2005, only slightly below the corresponding estimates based on the Commission Autumn Forecasts. There is a rather sharp decline, however, in the last two years of the programme. The decline results from an estimated decrease in the contribution of labour, while the capital accumulation contribution is projected to be constant through the programme period. Nevertheless, these figures have to be interpreted cautiously given the technical problems involved by the application of this methodology to economic data[7].

Inflation in the programme appears somewhat optimistic specially as measured by the GDP deflator. The sharp fall projected in 2004 looks implausible in the light of available data. Conversely, employment forecasts in the programme look attainable in the light of recent experience, given the expected GDP growth around its potential. The combination of declining inflation and sustained employment growth in the medium-term appears conditional on the maintenance of wage moderation.

[7] The decomposition of potential GDP growth based on the production function (PF) approach highlights poor labour productivity performance coupled with strong employment content of growth. Total factor productivity (TFP) shows a zero contribution (resulting from the restriction imposed on the estimated PF for Spain that TFP growth should be non-negative). Therefore the application of PF approach raises concerns, including its use in assessing the fiscal stance. Accordingly, when the PF methodology was officially adopted for the assessment of the stability and convergence programmes, it was agreed to continue to use temporarily the HP filter approach in the case of Spain. In this respect, the sharp fall in potential GDP growth estimated for 2006 and 2007 applying the PF method contrasts noticeably with the more stable estimates of trend GDP growth provided by the HP filter. Similar results were obtained for the last year's programme.

TABLE 1. Main macroeconomic scenario: Commission forecasts - Updated Programme 2003-2007

		2003	2004	2005	2006	2007
GDP AND MAIN AGGREGATES (Annual average growth rate at constant prices, in %)						
Private consumption	**C.f.**	**3.1**	**3.2**	**3.4**		
	USP-03	**3.0**	**3.1**	**3.0**	**3.0**	**3.0**
Government consumption expenditure	**C.f.**	**4.0**	**4.3**	**4.0**		
	USP-03	**3.6**	**2.9**	**2.8**	**2.8**	**2.8**
Gross Fixed Capital Formation	**C.f.**	**2.8**	**3.9**	**4.5**		
	USP-03	**3.1**	**3.8**	**4.0**	**4.0**	**4.0**
Change in inventories [1]	**C.f.**	**-0.1**	**0.0**	**0.0**		
	USP-03	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Domestic Demand	**C.f.**	**3.1**	**3.5**	**3.8**		
	USP-03	**3.1**	**3.3**	**3.2**	**3.2**	**3.2**
Exports of Goods and Services	**C.f.**	**4.1**	**5.5**	**7.4**		
	USP-03	**4.4**	**6.3**	**7.0**	**7.0**	**7.0**
Imports of Goods and Services	**C.f.**	**6.4**	**7.2**	**8.5**		
	USP-03	**6.6**	**7.0**	**7.2**	**7.2**	**7.2**
External sector [1]	**C.f.**	**-0.9**	**-0.8**	**-0.7**		
	USP-03	**-0.9**	**-0.4**	**-0.3**	**-0.3**	**-0.3**
Gross Domestic Product	**C.f.**	**2.3**	**2.9**	**3.3**		
	USP-03	**2.3**	**3.0**	**3.0**	**3.0**	**3.0**
PRICES (Annual change, in %)						
GDP deflator	**C.f.**	**4.1**	**3.6**	**3.1**		
	USP-03	**4.0**	**2.9**	**2.6**	**2.6**	**2.6**
Private consumption deflator	**C.f.**	**3.2**	**2.9**	**2.6**		
	USP-03	**3.2**	**2.7**	**2.4**	**2.4**	**2.4**
LABOUR MARKET						
Employment [2]:						
Annual change, %	**C.f.**	**1.7**	**2.0**	**2.1**		
	USP-03	**1.8**	**1.9**	**2.1**	**2.1**	**2.1**
Unemployment rate	**C.f.**	**11.4**	**11.0**	**10.5**		
	USP-03	**11.3**	**11.0**	**10.0**	**8.9**	**7.9**
OTHER VARIABLES						
Net lending (+) or net borrowing (-) vis-à-vis ROW [3]	**C.f.**	**-2.1**	**-2.3**	**-2.5**		
	USP-03	**-2.6**	**-2.6**	**-2.6**	**-2.6**	**-2.7**
Trend GDP growth [4]	**C.f.**	**3.1**	**3.1**	**3.1**		
	USP-03	**3.0**	**3.0**	**3.0**	**2.9**	**2.9**
Output gap [4]	**C.f.**	**-0.2**	**-0.4**	**-0.2**		
	USP-03	**-0.2**	**-0.1**	**-0.1**	**-0.0**	**0.1**
Potential GDP growth [5]	**C.f.**	**3.3**	**3.3**	**3.2**		
	USP-03	**3.2**	**3.1**	**3.2**	**2.8**	**2.8**
of which: Labour contribution	**C.f.**	**2.0**	**1.9**	**1.9**		
	USP-03	**1.9**	**1.8**	**1.8**	**1.5**	**1.4**
Capital accumulation contribution	**C.f.**	**1.3**	**1.3**	**1.3**		
	USP-03	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**
TFP contribution	**C.f.**	**0.0**	**0.0**	**0.0**		
	USP-03	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Output gap [5]	**C.f.**	**-1.3**	**-1.7**	**-1.7**		
	USP-03	**-0.9**	**-1.0**	**-1.2**	**-1.0**	**-0.8**

1) Contribution to GDP growth
2) Full-time equivalent jobs
3) % of GDP
4) Hodrick-Prescott filter
5) Production function method

SOURCE: European Commission and Ministerio de Economía, Updated Stability Programme 2003-2007

2.4. Sectoral balances

The programme provides net borrowing figures vis à vis the rest of the world which, jointly with net lending for the general government sector, allow a calculation of the net borrowing requirements for the private sector. For 2004 and 2005 these are broadly in line with the Autumn Commission forecast. The gradual slight increase of general government net lending over the programme period is absorbed by a marginal increase in private borrowing. This would be consistent with the broadly flat profile of the private sector's consumption and investment shares.

3. FISCAL TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES

3.1. Programme overview

The new update revises only the budgetary objective for 2003, now expected to be a surplus of 0.5% of GDP instead of the balanced budget projected in the previous programme. For the period 2004-2006 budget targets remain unchanged: 0.0%, 0.1% and 0.2%, respectively. Finally, in 2007 a small surplus of 0.3% is envisaged (see Table 2). Although starting from a somewhat lower base, the debt-to-GDP ratio is set to decline broadly in line with the previous programme, falling below 44 % of GDP at the end of the forecasting period.

Table 2. Composition of the adjustment in public finances in 2003 USP

In % of GDP	2002	2003	2004	2005	2006	2007	2007-2003
Total revenues	**39.8**	**40.0**	**40.0**	**40.0**	**40.0**	**40.0**	**0.0**
tax receipts	36.1	36.5	36.6	36.7	36.7	36.8	0.3
Direct	10.9	10.8	10.9	11.0	11.0	11.1	0.3
Households	7.4	7.3	7.3	7.3	7.3	7.3	0.0
Coorporations	3.5	3.5	3.6	3.6	3.7	3.8	0.3
Indirect	11.6	11.8	12.0	12.0	12.0	12.0	0.2
Social contributions	13.6	13.8	13.7	13.7	13.7	13.7	-0.1
Total expenditure	**39.7**	**39.6**	**40.0**	**39.9**	**39.8**	**39.7**	**0.1**
Primary expenditure	36.9	37.0	37.4	37.4	37.4	37.4	0.4
Primary current expenditure	*32.0*	*32.0*	*32.1*	*32.1*	*32.0*	*31.9*	*-0.1*
Capital expenditure	*4.9*	*5.0*	*5.2*	*5.3*	*5.4*	*5.4*	*0.4*
Gross fixed capital formation	*3.4*	*3.5*	*3.6*	*3.7*	*3.8*	*3.8*	*0.3*
Interest payments	2.8	2.6	2.6	2.5	2.4	2.3	-0.3
Primary balance	2.8	3.0	2.6	2.5	2.6	2.6	-0.4
General government budget balance	**0.1**	**0.5**	**0.0**	**0.1**	**0.2**	**0.3**	**-0.2**
of which							
Central government	**-0.4**	**-0.4**	**-0.4**	**-0.3**	**-0.2**	**-0.1**	**0.3**
Territorial governments	**-0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
of which							
Regional governments	-0.2	0.0	0.0	0.0	0.0	0.0	**0.0**
Local governments	-0.1	0.0	0.0	0.0	0.0	0.0	**0.0**
Social security	**0.8**	**0.9**	**0.4**	**0.4**	**0.4**	**0.4**	**-0.5**
Memorandum items:							
Gross saving	*4.3*	*4.6*	*4.4*	*4.6*	*4.8*	*5.0*	*0.4*
Government budget balance in 2002 USP	*-0.2*	*0.0*	*0.0*	*0.1*	*0.2*	*-*	*-*
Government budget balance Commission forecast	**0.1**	**0.0**	**0.1**	**0.2**	**-**	**-**	**-**
Source: Update Stability Programme 2003-2007 and Commission Autumn Forecasts							

The surplus achieved in 2003 in spite of lower than expected growth suggests that the original target of a balanced budget had been set cautiously. Taking into account the plausible growth outlook during the programme period, the balanced budget in 2004 and the small surpluses thereafter constitute cautious targets, giving margin against less positive developments in the economy. This is consistent with the traditionally prudent fiscal-target setting by the Spanish authorities. Finally, the primary balance is foreseen to stabilise at around 2.6%.

On the revenue side, the update projects a steady share of total revenues at 40% of GDP. Tax revenues are projected to rise by 0.3 p.p. of GDP over the programme horizon (from 36.5% in 2003 to 36.8% in 2007)[8], reflecting an increase in the GDP share of corporate and indirect taxes. Overall, the revenue projections seem plausible as total revenues are set to grow in line with nominal GDP in a context of sustained economic growth around potential.

On the expenditure side, the primary expenditure ratio is projected to increase by about 0.4 p.p. of GDP in 2004, half of which accounted by capital expenditure, and to stay unchanged for the rest of the programme period. A slight reduction in current expenditure broadly offsets a further increase in capital expenditure after 2004.

By general government sub-sectors, the State deficit is expected to fall gradually to 0.1% of GDP in 2007 from an estimate of 0.4% for 2003. The social security sub-sector is projected to register a surplus of 0.9% in 2003 and 0.4% for the rest of the period, fully in line with the targets set one year ago[9]. Finally, territorial governments are expected to comply with the provisions of the General Law of Budgetary Stability, showing balanced budgets between 2003 and 2007.

Table 3 presents the cyclically-adjusted budget balances[10] and compares them based on the data in the programme with those in the Commission Autumn forecast. While output gaps and hence the cyclical components of data do not differ dramatically between the two projections, the more favourable outcome in the programme for 2003 yields a 0.5 percentage point difference in the cyclically adjusted balance (CAB) for that year. In turn, this results in an apparent expansionary fiscal stance in the following year, when the CAB is projected to fall back to balance. By contrast, the Commission forecast points to a slightly restrictive stance. The difference becomes marginal in 2005. Finally, the budgetary projections in the programme comply with the provisions set out in the Stability and Growth Pact, clearly respecting the close-to-balance or in surplus position.

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8 The comparison between the current and last year’s highlights a slight increase in total revenues as percentage of GDP (0.2 p.p.). However, tax receipts in the current programme are projected to be about one percentage point of GDP higher than in last year’s. Therefore, the current programme implies a sharp downward revision of other current revenues as a percentage of GDP. The update does not provide any information in this respect.

9 Central government and social security accounts will continue to be consolidated until the separation of their sources of financing is completed, which is envisaged to occur in 2012.

10 As indicated above, Spain continues to use a Hodrick-Prescott GDP filter, as agreed in the Ecofin Council on 12 July 2002.

Table 3.Output gaps and cyclically adjusted budget balances

	Spain's Updated Stability Programme					Commission's Autumn 2003 Forecasts				
	GDP trend growth	Output gap	Budget balance	CAB	CAPB	GDP trend growth	Output gap	Budget balance	CAB	CAPB
2003	3.0	-0.2	0.5	0.6	3.2	3.1	-0.2	0.0	0.1	2.6
2004	3.0	-0.1	0.0	0.1	2.7	3.1	-0.4	0.1	0.3	2.7
2005	3.0	-0.1	0.1	0.1	2.6	3.1	-0.2	0.2	0.3	2.6
2006	2.9	0.0	0.2	0.2	2.6					
2007	2.9	0.1	0.3	0.3	2.6					

CAB:Cyclically adjusted balance; CAPB: Cyclically adjusted primary balance. Calculated with the HP filter method.

Source: Commission's Autumn 2003 Forecasts and ECFIN calculations on Spain's updated Stability Programme 2003-2007

3.2. Developments in 2003

The achievement of a better than expected budgetary result in 2003[11], despite the lower than expected real GDP growth and the implementation of the personal income tax reform, was helped by several factors. The contribution of domestic demand to GDP growth projected in the 2002-2006 programme was broadly in line with the current estimates, whereas the external sector contribution turned out to be more negative than envisaged. This factor helps explain the healthy growth rates of indirect tax collections in 2003. Likewise, continuing dynamic job creation[12] involved a weaker than expected impact of the personal income tax reform on direct-tax collections while boosting social security contributions. In particular, the social security sub-sector is estimated to record a surplus of 0.9% of GDP compared with a projection of 0.5% in last year's programme. Consequently, total revenues are estimated to have risen as a share of GDP to 40%, 0.2 p.p. above last year's target, also helped by higher than planned inflation[13]. Moreover, higher than expected inflation presumably helped to maintain the GDP share of primary expenditure in line with the target by eroding the real value of expenditure items set in absolute amounts.

In addition to the restraining impact of higher than projected nominal GDP growth, the achievement of the target for overall expenditure was helped by lower than planned interest payments.

[11] This surplus, however, is based on the assumption of a balanced budget for the territorial governments, for which no information is currently available.

[12] Despite lower real GDP growth, last year's estimate for employment creation of 1.8% in 2003 has not been revised compared to the previous programme.

[13] While real GDP growth is now estimated to be 0.7 p.p. lower than projected in last year's update, nominal GDP is estimated to be 0.6 p.p. higher. In this respect, higher than foreseen inflation can help sustain tax revenues, in that tax-brackets are set on nominal incomes. A similar effect was observed in last year's programme for 2002.

Table 4. Implementation of the previous update in 2003: USP 2002 plans and estimated outcomes

In % of GDP	**2003**
Government plans (USP 2002)	
Government budget balance	0.0
Total revenue	39.8
Total expenditure	39.8
of which: Primary expenditure	37.0
Debt ratio*	53.1
CAB (Hodrick -Prescott filter figures)	-0.1
p.m. real GDP growth	3.0
p.m. inflation of GDP deflator	2.8
*p.m. effect of cyclical position**	0.1
Estimated outcomes (USP 2003)	
Government budget balance	0.5
Total revenue	40.0
Total expenditure	39.6
of which: Primary expenditure	37.0
Debt ratio	51.8
CAB (Hodrick -Prescott filter figures)	0.6
p.m. real GDP growth	2.3
p.m. inflation of GDP deflator	4.0
*p.m. effect of cyclical position**	-0.1
Difference: estimated outcomes (USP 2003) - Government plans (USP 2002)	
Government budget balance	0.5
Total revenue	0.2
Total expenditure	-0.2
of which: Primary expenditure	0.0
Debt ratio	-1.3
p.m. real GDP growth	-0.7
p.m. inflation of GDP deflator	1.2

Source: USP 2002, USP 2003 and Commission Services calculations

* Effects of cyclical position CPE=e_e (*ygap*), where e_e is the sensitivity of the budget to the output gap (*ygap*).

3.3. Public finances in 2004

The 2004 Budget Law, the second to be compiled with the Budgetary Stability Law, targeted balanced budgets in 2003 and 2004. However, the 2003 USP has revised the objective for 2003 to an estimated surplus of 0.5% of GDP while keeping the plans for 2004 unchanged. For the third year in a row, the budget is affected by the movement toward greater administrative decentralisation. In line with the new financial system of Autonomous Communities, more extensive powers and a higher degree of co-responsibility[14] on spending and revenues have been transferred to the local governments.

[14] Between 1996 and 2003 the share of territorial governments on total consolidated expenditure has increased by 14.6 percentage points. As a result, during the same period central government consolidated expenditure has fallen from 68.1% to an estimated share of 53.5%.

As already noted, the macroeconomic scenario is broadly in line with the Autumn Commission forecast and the only significant divergence arises in connection with the forecast of the GDP deflator and thus nominal GDP growth.

Based on a moderate nominal GDP growth, of 5.9%, than in the Commission forecast (6.6%), total revenues as a share of GDP are expected to remain constant at 40%. Indirect taxes are envisaged to increase from 11.8% to 12.0% due both to the domestic demand and a lower contribution to the EU Budget through the VAT resource[15]. Direct taxes are set to gain some strength due to buoyant corporate-tax collections and the fading-out of the effects of the 2003 personal income tax reform. Finally, social security contributions are set to remain unchanged as a percentage of GDP. Overall, the revenue projections seem prudent, in particular, the decline in the surplus projected for the social security sub-sector seems overestimated.

Total expenditure is set to increase by 0.4 p.p. of GDP on account of higher primary current and capital expenditure. Although the spending priorities identified in the Budget, including active labour market policies, the justice system and civilian security, and research and investment projects, can help explain the planned increase in the expenditure, the programme does not provide detailed information on these readings[16] (recall Table 2). The projection of interest payments stabilising at 2.6% appears cautious.

Overall, the objective of a balanced budget is well within reach and may well be overachieved taking into account the surplus in 2003 and the improvement of the economic environment.

3.4. Targets and adjustment in 2005-2007

The programme confirms the previous targets for 2005 and 2006 of general government surpluses of 0.1% and 0.2% of GDP[17], respectively, while aiming for a surplus of 0.3% in 2007. The primary surplus is set to remain broadly unchanged at around 2.6% of GDP through the programme period.

Total expenditure is envisaged to decrease as a percentage of GDP by 0.2 p.p. to 39.7% in 2007. This strategy mirrors that in previous updates and relies on primary current expenditure restraint, which is set to decline slightly from 32.1% of GDP in 2005 to 31.9% in 2007. This, coupled with a declining share of interest payments, allows for an increase in capital expenditure between 2005 and 2007.

Total revenues are set to grow broadly in line with nominal GDP projections. Only corporate taxes are set to gain some weight in GDP due to higher expected profits, while the GDP share of other tax receipts would remain unchanged.

Given the rather conservative balanced budget objective for 2004, the targets for the subsequent years appear cautious giving margin against less positive developments in the

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[15] This is to be compensated by a higher GNP-resource contribution, as agreed in the Berlin European Council in March 1999.

[16] The high degree of decentralisation of public expenditure and the lack of information concerning Territorial Governments constitute an additional source of uncertainty.

[17] For 2005, the Commission envisaged a surplus of 0.2% of GDP.

economy. In this respect, under the assumption of no policy change, the Commission forecasts a surplus of 0.2% of GDP in 2005.

3.5. Sensitivity analysis

3.5.1. Sensitivity to economic growth

The programme provides sensitivity analysis in the form of an alternative "moderate-growth" scenario. This assumes that annual GDP growth is lower than in the baseline by 0.5 percentage points from 2004 onwards (see Table 5). In such scenario, the general government balance is projected to register a small deficit of 0.1% of GDP in 2004, balanced budgets in 2005 and 2006 and a surplus of 0.1% of GDP at the end of the forecasting period. The CAB, although weaker than in the baseline, maintains the close-to-balance position. Additionally, the debt-to-GDP ratio remains on a downward trend falling below 46% at the end of the period.

Table 5. Sensitivity to GDP growth (as % of GDP)

	2003	2004	2005	2006	2007
BASELINE SCENARIO					
Real GDP growth	2.3	3.0	3.0	3.0	3.0
General government balance	0.5	0.0	0.1	0.2	0.3
Public debt	51.8	49.6	47.7	45.7	43.8
Trend GDP growth	**3.0**	**3.0**	**3.0**	**2.9**	**2.9**
Output gap	**-0.2**	**-0.1**	**-0.1**	**-0.0**	**0.1**
CAB (1)	**0.6**	**0.1**	**0.1**	**0.2**	**0.3**
MODERATE GROWTH SCENARIO					
Real GDP growth	2.3	2.5	2.5	2.5	2.5
General government balance	0.5	-0.1	0.0	0.0	0.1
Public debt	51.8	50.0	48.4	46.9	45.4
Trend GDP growth	**2.8**	**2.7**	**2.6**	**2.6**	**2.5**
Output gap	**0.4**	**0.2**	**0.1**	**-0.0**	**-0.0**
CAB (2)	**0.3**	**-0.2**	**-0.0**	**0.0**	**0.1**
Hypothetical CAB (HCAB)*	**0.2**	**-0.3**	**-0.3**	**-0.4**	**-0.5**
Fiscal effort indicator 1: CAB(1) - HCAB**	**0.3**	**0.3**	**0.5**	**0.6**	**0.8**
Fiscal effort indicator 2*: CAB(2) - HCAB**	**0.1**	**0.1**	**0.3**	**0.4**	**0.6**

Source: Commission services calculations based on figures provided in the Spain's updated stability programme. Trend GDP is calculated with the HP filter.
* See footnote 17.
** Fiscal effort to be made to meet budget balances in the baseline scenario with the moderate growth.
*** Implicit fiscal effort to meet budget balances in the moderate growth scenario

A useful exercise to assess the fiscal effort needed to meet the targets in the baseline scenario in case of lower growth is the calculation of a hypothetical CAB (HCAB). This adjusts the revenue and expenditure to GDP ratios in the baseline scenario for the effect of lower potential output in the "moderate-growth" scenario (see Table 5)[18]. The difference between such hypothetical CAB and the CAB (1) of the baseline scenario (fiscal effort indicator 1) gives a measure of the discretionary fiscal adjustment needed to meet the targets of the baseline subject to the lower GDP growth. It suggests that the CAB may deteriorate significantly in the absence of policy measures if the moderate scenario materialises, failing to keep the close-to-balance position in cyclically adjusted terms.

However, as indicated, the programme sets fiscal targets for the "moderate-growth" scenario, which imply that an effort would be made to stem the underlying deterioration of the CAB resulting form lower potential growth. Specifically, the targets show that the CAB (2) of the moderate growth scenario would not depart from the close-to-balance position. The fiscal effort indicator (2) shows that the adjustment implicit in the targets of the moderate growth scenario is considerable, reaching 0.6 p.p. of GDP at the end of the programme period. This entails a strong commitment of the Spanish authorities to the maintenance of the close-to-balance objective of the SGP, also in line with provisions of the General Law of Budgetary Stability[19].

3.5.2. Sensitivity to interest rates

The update also provides an interest rate sensitivity analysis. This simulates the effect on the baseline scenario of an upward/downward shift in the entire yield curve by one percentage point from 2004 onwards. As the average maturity of government debt is estimated at around six years, the impact of the interest rate shifts should mainly take place by debt substitution or new issuance.

Table 6. Sensitivity to interest rates (as % of GDP)

	2002	2003	2004	2005	2006	2007
HIGH RATES						
General goverment balance	0.1	0.5	0.0	-0.1	0.0	0.1
Public debt	54.5	51.8	49.7	47.8	46.0	44.3
BASELINE RATES						
General goverment balance	0.1	0.5	0.0	0.1	0.2	0.3
Public debt	54.5	51.8	49.6	47.7	45.7	43.8
LOW RATES						
General goverment balance	0.1	0.5	0.1	0.2	0.3	0.5
Public debt	54.5	51.8	49.6	47.5	45.4	43.3
Source: Updated Stability Programme 2003-2007						

18 This hypothetical CAB is computed under the assumption of unchanged policies from the baseline expenditure and revenue figures as follows: baseline revenues at potential are adjusted for the estimated difference in potential output by applying the standard semi-elasticity; baseline (primary) expenditure at potential is the same in nominal terms (thereby increasing as a share of GDP for a lower GDP level).

19 Provided a deficit is registered, a balanced budget situation must be restored within a three-year period.

Accordingly, the effect on the budget balance and debt ratio is increasing as with time (see Table 6) in both alternative interest rate scenarios. The relatively long maturity delays the impact of shifts in the yield curve. The close-to-balance and debt reduction objectives are not threatened.

3.6. Debt ratio

The programme envisages a steady reduction in the government debt to GDP ratio: from 51.8% of GDP in 2003 to 43.8% in 2007 (see table 7).

The decomposition of contributions to debt reduction shows that primary surpluses and nominal GDP growth are the driving forces behind this downward trend. Given that budget targets have been set prudently and the path for the GDP deflator has been regarded as optimistic, a faster debt reduction cannot be excluded.

In contrast, the stock-flow adjustment, calculated as a residual, remains positive and significant throughout the forecasting period, at around 0.9 p.p. of GDP. As in the previous update, the lack of information on below-the-line operations does not allow for further analysis. However, the sizeable stock flow adjustment may relate to acquisitions of financial assets by the general government sector from public-owned entities responsible for specific investment projects (mainly infrastructure)[20].

Table 7. Decomposition of changes in the government debt ratio (as % of GDP)

		2002	2003	2004	2005	2006	2007
Level of government debt	**USP-03**	**54.5**	**51.8**	**49.6**	**47.7**	**45.7**	**43.8**
	C.f.	**54.5**	**51.3**	**48.8**	**46.3**		
Change in government debt ratio:	**USP-03**	-3.0	-2.8	-2.1	-1.9	-1.9	-1.9
	C.f.	-3.0	-3.2	-2.5	-2.5		
• Contribution of primary balance	**USP-03**	-2.8	-3.0	-2.6	-2.5	-2.6	-2.6
	C.f.	-2.8	-2.6	-2.5	-2.5		
• GDP growth contribution	**USP-03**	-3.5	-3.3	-2.9	-2.7	-2.6	-2.5
	C.f.	-3.5	-3.3	-3.2	-2.9		
• Contribution of interest payments	**USP-03**	2.8	2.6	2.6	2.5	2.4	2.3
	C.f.	2.8	2.6	2.4	2.3		
• Stock-flow adjustment (residual)	**USP-03**	0.6	0.9	0.8	0.8	0.9	0.9
	C.f.	0.6	0.1	0.8	0.6		

Source: Commission estimates based on nominal GDP growth rate and budgetary balance projections given in the updated Stability Programme.

Note:The decomposition of changes in the gross debt ratio is based on the following equation for the budget constraint:

$$\frac{Dt}{Yt} \Xi \frac{Dt \Xi 1}{Yt \Xi 1} \Xi \frac{PDt}{Yt} \Xi \frac{Dt \Xi 1}{Yt \Xi 1} \bullet \frac{i \Xi yt}{1 \Xi yt} \Xi \frac{SFt}{Yt}$$

with: D_t = government debt; PD_t = primary deficit; Y_t = GDP at current prices; y_t = nominal GDP growth rate; i = implicit interest rate; SF_t = "stock-flow adjustment".

Source: Commission estimates based on nominal GDP growth rate and budgetary balance projections given in the updated Stability Programme.

[20] These general public-owned entities do not belong to the general government sector according to ESA-95 definitions. For instance, according to the 2004 Budget Law consolidated capital expenditure grows by 5.1%. Taking into account the investment effort from the State-owned entities brings this figure to 10.5%.

Finally, the programme does not provide information on the portfolio allocation of the social security reserve fund: accumulation of non-general government assets would, ceteris paribus, tend to slow the reduction in gross debt.

4. THE QUALITY OF PUBLIC FINANCES

As previously said, the programme confirms the strategy of control of public expenditure while allowing for the use of the margin of manoeuvre offered by the reduction in the debt burden. At the same time, the planned changes in the composition of public expenditure appear in line with the overall objective of improving the quality of public finances.

In this respect, investment on infrastructures, education and promotion of human capital and R&D+i have received special attention in the budget for 2004.

The programme highlights measures adopted in 2003 aiming at reinforcing the commitment to budgetary stability.

The General Budgetary Law, approved in November 2003, develops the guiding principles of the General Law of Budgetary Stability by pursuing a higher rationalisation of the budgetary process while enhancing transparency and efficiency on the expenditure side. The Law introduces a system of budgeting by objectives, complemented with an evaluation of expenditure policies and their degree of compliance with the fiscal targets.

The General Subsidies Law, approved also in November, seeks to enhance transparency and control of administrative procedures related to the subsidies by providing for systematic cost/benefit reviews. Finally, the General Taxation Law, approved in December, aims at simplifying and improving the framework of tax administration and includes taxpayers' rights. In addition, it contains an array of new provisions aiming at combating tax fraud and tax avoidance.

5. THE SUSTAINABILITY OF PUBLIC FINANCES

5.1. Quantitative indicators

The assessment of the sustainability of Spanish public finances is based on both quantitative and qualitative indicators. The quantitative indicators are run on the basis of a commonly agreed methodology by the Economic Policy Committee[21]. The purpose of the indicators is to signal possible unbalances on the basis of current policies and projected age-related expenditure trends. However, the limitations of this exercise are clear and results of these quantitative indicators need to be interpreted with caution. Being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of possible or even likely outcomes and should not be taken at face value. Instead, the indicators are a tool to facilitate policy debate and at best provide

[21] See the Report "The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme" (October 2003), available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

an indication of the timing and scale of emerging budgetary challenges that could occur on the basis of "no policy change". The quantitative indicators project debt and budget balance development according to two different scenarios, to take into account uncertainties over the medium term. The "programme" scenario is calculated on the following basis:

- Macroeconomic assumptions on GDP growth from 2008 onwards, interest rates and inflation are based on the agreed assumptions used in the EPC;
- The projections for age-related expenditures come from the stability programme complemented with the harmonised Economic Policy Committee projections. The former cover pension expenditure and are the same as in the previous update. The latter cover expenditure on health care, education and unemployment benefits. The two set of projections are not fully comparable: while the EPC projections rely on Eurostat demographic projections, the national estimates of pension expenditures rely on demographic projections run by the National Institute of Statistics[22]. The national projections show a lower increase in pension expenditure compared with EPC projections. As already stressed in the assessment of the previous update, it is unclear whether the more favourable demographic scenario used in the national pension projections would result in a permanently more "favourable" demographic profile for Spain or whether it would simply delay the full demographic impact of ageing population. Moreover, differences are also due to different evolution of average pension benefits: in the EPC projections they evolve in line with productivity whereas in the national projections average pension benefits capture only around 50% of productivity growth. Long-term pension expenditure projections are very sensitive to different assumptions on the evolution of the average pension benefit. Therefore, the link between the average pension and productivity growth should be further clarified.
- The projections for government revenues come from the programme. They are kept constant at the (cyclically adjusted) level in 2007.
- The starting point for gross debt and the primary balance is the 2007 levels reported in the programme.

A "2003 position" scenario is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2008 to 2050 assuming that no budgetary consolidation is achieved, i.e. the cyclically adjusted primary balance in 2008 remains the same as the 2003 level and no stock-flows operations take place.

Table below presents the debt and the budget balance development according to the two different scenarios. Overall, age-related expenditure is foreseen to increase by 5.9% of GDP between 2008 and 2050. Increases in pension and health care expenditures are only partially offset by a slight decrease in education and unemployment benefit expenditures.

It is possible to verify whether the projected level of debt respects the requirement to stay below 60% of GDP reference value for public debt at all times. Failure to do so would *a priori* indicate that there may be a risk of budgetary imbalances emerging in light of ageing population and that measures may be required to place public finances on a more sustainable footing.

[22] National demographic projections include the latest census data and have different assumptions on migration that lead to a higher number of immigrants.

According to the quantitative indicators, Spain appears to be relatively well placed to meet the budgetary costs of ageing population. The budgetary strategy based on a balanced budget over the programme period would allow the debt to GDP ratio to decrease substantially before the full impact of ageing takes place. Even if an upward trend of the debt to GDP ratio appears at the end of the projection period, the debt to GDP ratio will remain well below the reference value.

According to the figures reported in the programme, the cyclically adjusted primary balance should reduce somehow during the programme period. If instead it is maintained constant, the debt to GDP ratio will decrease even faster, reaching negative values within 20 years.

However, a sustainability gap arises when the financing needs are measured in net present value (see S2 indicator). This is due to the fact that in 2050 the debt to GDP ratio will be again on an increasing trend and not on a steady state position, as a result of a steep increase of pension expenditure during the last 20 years of projections.

Main assumptions - baseline scenario (as % GDP)	**2008**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Total age-related spending	18,3	18,2	18,7	20,2	22,9	24,3	5,9
Pensions	8,0	8,0	8,5	9,9	12,0	13,0	5,0
Health care	5,7	5,8	6,1	6,5	7,0	7,2	1,5
Education'	4,0	3,8	3,6	3,4	3,6	3,7	-0,3
Unemployment benefits'	0,6	0,6	0,5	0,4	0,4	0,4	-0,2
*Total primary non age-related spending**	19,0						
Total revenues	40,0	40,0	40,0	40,0	40,0	40,0	0,0

' based on the EPC projections

* constant

Results (as % GDP)	**2008**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Programme scenario							
Debt	41,4	36,3	12,8	-1,6	5,1	36,6	-4,8
Net borrowing	0,4	0,7	1,6	0,8	-2,1	-5,0	-5,4
2003 scenario							
Debt	37,9	31,6	1,3	-21,4	-26,8	-12,4	-50,3
Net borrowing	1,1	1,6	2,7	2,5	0,2	-1,9	-3,0

Sustainability gap	**S1***	**S2****
Programme scenario	0,4	1,3
2003 situation scenario	-0,3	0,6

* S1 measures the difference between the current tax ratio and the tax ratio that would ensure a debt level in 2050 as resulting from a balance budget position over the projection period. A positive sustainability gap indicates that there is a financing gap to reach this debt level in 2050. P.m. debt to GDP ratio at the end of the period: 9.0%

** S2 indicates the change needed in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

5.2. Additional qualitative features

As underlined in the EPC report on "The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme"[23] (October 2003), several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, Spain has a comprehensive strategy to meet the budgetary costs of ageing population. This strategy is based on several building blocks: first, the Permanent Commission of the Toledo Pact regularly reviews progress in the pension system towards financial sustainability, i.e. equilibrium between contributions and payments. Second, Spain is

[23] Available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

accumulating reserve funds for future pension payments: they should account by 2.6% of GDP in 2007. Third, structural reforms are underway in labour markets to increase participation rates. Fourth, the development of a multi-pillar pension system will also contribute to long term sustainability. Fifth, the new system for setting medicine prices should improve health care expenditure controls and contributes to contain expenditures.

However, the projected increase of pension expenditure (one of the highest among EU countries) raises concern. In addition, there are large differences between the EPC and the Spanish projections on future pension expenditures. As already indicated, these differences stem from both different demographic scenarios and different assumptions on the link between the average pension benefit and productivity growth. Given the uncertainty over future demographic trends and the effects of productivity growth on the average pension benefit, the possibility of an even larger increase in pension expenditure over the projection period cannot be ruled out. The fiscal measures to encourage voluntary pension schemes introduced in 2002 and the recent decision to constitute a pension fund for civil servants employed in the general administration are both measures that go in the direction of increasing the sustainability of the system, but are unlikely to be sufficient in order to cope with the budgetary implications of ageing.

5.3. Overall assessment

On the basis of current policies, as reflected in the situation of public finances and its medium-term evolution showed in the programme as well as the long-term projections for age-related expenditure provided in the programme, Spain seems relatively well placed to cope with the budgetary costs of ageing populations. The current strategy is based on the respect of the “close to balance” requirement over the medium term and the decreasing debt-to-GDP ratio. In addition, several measures have been implemented to ensure future sustainability as the development of reserve funds and the implementation of a multi-pillar system. However, such long-term projections of expenditure are very sensitive to the underlying assumptions, in particular on demography, where the impact of immigration is especially difficult to assess, and on the link between the average pension benefit and average productivity per worker, where a steady reduction of the former relative to the latter may be difficult to achieve. Moreover, even under relatively favourable assumptions on these two critical issues, the increase of pension expenditure in the long-term remains very large. Therefore, current policies need to be supplemented by measures to prevent the emergence of unsustainable trends, in particular a comprehensive reform of the pension system.

ANNEX 1. SUMMARY TABLES FROM THE 2003 UPDATED STABILITY PROGRAMME

Table A 0: Basic assumptions

	2003	2004	2005	2006	2007
Euro area short-term interest rate (annual average)	**2.3**	**2.3**	**3.2**	**-**	**-**
Euro area long-term interest rate (annual average)	**4.1**	**4.4**	**4.8**	**-**	**-**
USA: short-term (3-month money market)	-	-	-	-	-
USA: long term (10-year government bonds)	-	-	-	-	-
US$/€ exchange rate (annual average)	**1.13**	**1.16**	**1.15**	**-**	**-**
World GDP growth rate	-	-	-	-	-
World excluding EU, GDP growth	**4.0**	**4.6**	**4.6**	**-**	**-**
USA GDP growth	2.8	3.8	3.3	-	-
Japan GDP growth	2.6	1.7	1.5	-	-
EU-15 GDP growth	**0.8**	**2.0**	**2.4**	**-**	**-**
Growth relevant foreign markets	**-**	**-**	**-**	**-**	**-**
World import volumes, excluding EU	**6.3**	**8.3**	**8.6**	**-**	**-**
World import prices (manufactured goods in USD)	-	-	-	-	-
Oil prices (Brent USD/barrel)	**28.3**	**25.6**	**24.1**	**-**	**-**
Non-oil commodities prices (in USD)	7.3	1.9	0.7	-	-

Table A 1. Growth and associated factors

	2002	2003	2004	2005	2006	2007
GDP growth at constant market prices (7+8+9)	**2.0**	**2.3**	**3.0**	**3.0**	**3.0**	**3.0**
GDP *level* at current market prices (€ bn.)	**696.2**	**740.6**	**784.6**	**829.5**	**876.9**	**927.0**
GDP deflator	**4.4**	**4.0**	**2.9**	**2.6**	**2.6**	**2.6**
HICP change	-	-	-	-	-	-
Employment growth [24]	**1.5**	**1.8**	**1.9**	**2.1**	**2.1**	**2.1**
Unemployment rate	11.4	11.3	11	10	8.9	7.9
Labour productivity growth						
Sources of growth: percentage changes at constant prices						
1. Household and NPISHs consumption expenditure	**2.6**	**3.0**	**3.1**	**3.0**	**3.0**	**3.0**
2. Government consumption expenditure	**4.4**	**3.6**	**2.9**	**2.8**	**2.8**	**2.8**
3. Gross fixed capital formation	**1.0**	**3.1**	**3.8**	**4.0**	**4.0**	**4.0**
4. Changes in inventories and net acquisition of valuables [25]	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
5. Exports of goods and services	**0.0**	**4.4**	**6.3**	**7.0**	**7.0**	**7.0**
6. Imports of goods and services	**1.8**	**6.6**	**7.0**	**7.2**	**7.2**	**7.2**
Contribution to GDP growth						
7. Final domestic demand	**2.6**	**3.2**	**3.4**	**3.3**	**3.3**	**3.3**
8. Change in inventories and net acquisition of valuables	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
9. External balance of G&S	**-0.6**	**-0.9**	**-0.4**	**-0.3**	**-0.3**	**-0.3**

[24] Full-time equivalent, national accounts

[25] Contribution to GDP growth

Table A 2. General government budgetary developments

In % of GDP	2002	2003	2004	2005	2006	2007
Net lending by sub-sectors						
General government	**0.1**	**0.5**	**0**	**0.1**	**0.2**	**0.3**
Central government	**-0.4**	**-0.4**	**-0.4**	**-0.3**	**-0.2**	**-0.1**
State government	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Local government	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Social security funds	**0.8**	**0.9**	**0.4**	**0.4**	**0.4**	**0.4**
General government						
Total receipts	**39.8**	**40.0**	**40.0**	**40.0**	**40.0**	**40.0**
Total expenditures	**39.7**	**39.6**	**40.0**	**39.9**	**39.8**	**39.7**
Budget balance [4]	**0.1**	**0.5**	**0.0**	**0.1**	**0.2**	**0.3**
Net interest payments	**2.8**	**2.6**	**2.6**	**2.5**	**2.4**	**2.3**
Primary balance [26]	**2.8**	**3.0**	**2.6**	**2.5**	**2.6**	**2.6**
Components of revenues						
Taxes	36.1	36.5	36.6	36.7	36.7	36.8
Social contributions	13.6	13.8	13.7	13.7	13.7	13.7
Interest income	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total receipts	39.8	40.0	40.0	40.0	40.0	40.0
Components of expenditures						
Collective consumption	-	-	-	-	-	-
Social transfers in kind	-	-	-	-	-	-
Social transfers other than in kind	-	-	-	-	-	-
Interest payments	2.8	2.6	2.6	2.5	2.4	2.3
Subsidies	-	-	-	-	-	-
Gross fixed capital formation	3.4	3.5	3.6	3.7	3.8	3.8
Other	-	-	-	-	-	-
Total expenditures	39.7	39.6	40.0	39.9	39.8	39.7

Table A 3. General government debt developments

In % of GDP	2002	2003	2004	2005	2006	2007
Gross debt level	**54.5**	**51.8**	**49.6**	**47.7**	**45.7**	**43.8**
Change in gross debt	**-3.0**	**-2.8**	**-2.1**	**-1.9**	**-1.9**	**-1.9**
Contributions to change in gross debt						
Primary balance	**-2.8**	**-3.0**	**-2.6**	**-2.5**	**-2.6**	**-2.6**
Interest payments	**2.8**	**2.6**	**2.6**	**2.5**	**2.4**	**2.3**
Nominal GDP growth	**-3.5**	**-3.3**	**-2.9**	**-2.7**	**-2.6**	**-2.5**
Other factors influencing the debt ratio	0.6	0.9	0.8	0.8	0.9	0.9
Of which: Privatisation receipts	-	-	-	-	-	-
p.m. implicit interest rate on debt	-	-	-	-	-	-

[26] Actual balance less net interest payments.

Table A 4. Cyclical developments

In % of GDP	2002	2003	2004	2005	2006	2007
GDP growth at constant prices	**2.0**	**2.3**	**3.0**	**3.0**	**3.0**	**3.0**
Actual balance	**0.1**	**0.5**	**0.0**	**0.1**	**0.2**	**0.3**
Interest payments	**2.8**	**2.6**	**2.6**	**2.5**	**2.4**	**2.3**
Potential GDP growth	-	-	-	-	-	-
Output gap	-	-	-	-	-	-
Cyclical budgetary component	-	-	-	-	-	-
Cyclically-adjusted balance	-	-	-	-	-	-
Cyclically-adjusted primary balance	-	-	-	-	-	-

Table A 5. Divergence from previous update

In % of GDP	2002	2003	2004	2005	2006
GDP growth					
Previous update	2.2	3.0	3.0	3.0	3.0
Latest update	2.0	2.3	3.0	3.0	3.0
Difference	-0.2	-0.7	0.0	0.0	0.0
Actual budget balance	-	-	-	-	-
Previous update	-0.2	0.0	0.0	0.1	0.2
Latest update	0.1	0.5	0	0.1	0.2
Difference	0.3	0.5	0.0	0.0	0.0
Gross debt levels	-	-	-	-	-
Previous update	55.2	53.1	51.0	49.0	46.9
Latest update	54.5	51.8	49.6	47.7	45.7
Difference	-0.7	-1.3	-1.4	-1.3	-1.2

Table A 6. Long-term sustainability of public finances [27]

In % of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure	-	-	-	-	-	-	-
Old age pensions	8.4	7.9	8.0	8.5	9.9	12.0	13.0
Health care (including care for elderly)	-	-	-	-	-	-	-
Interest payments	-	-	-	-	-	-	-
Assumptions							
Labour productivity growth	-	-	-	-	-	-	-
Real GDP growth	-	-	-	-	-	-	-
Participation rates males (aged 20-64)	-	-	-	-	-	-	-
Participation rates females (aged 20-64)	-	-	-	-	-	-	-
Total participation rates (aged 20-64)	-	-	-	-	-	-	-
Unemployment rate	-	-	-	-	-	-	-

[27] Projections carried out by the Spanish authorities and different from those released by the EPC working group on ageing population.