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COMMISSION OPINION

of **XXX**

on the Draft Budgetary Plan of SPAIN

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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 2014 submitted on 15 October 2013 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 SGP. In addition to the Draft Budgetary Plan, Spain submitted a report on effective action and an Economic Partnership Programme as recommended by the Council in June 2013. The Council opened the Excessive Deficit Procedure for Spain on 27 April 2009 and recommended to correct the excessive deficit by 2012. On 21 June 2013, the Council concluded that Spain had taken effective action but adverse economic events with major implications on public finances had occurred. The Council therefore adopted a revised recommendation under Article 126(7) TFEU ("the revised EDP recommendation") and 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.
5. The Draft Budgetary Plan is based on a macroeconomic scenario, in which the Spanish economy is emerging from recession to achieve positive growth in 2014. Economic growth is expected to be still driven primarily by net exports, with domestic demand gradually exerting less of a drag on growth. The contraction in employment is expected to come to an end with the annual change dropping to -0.2% in 2014 and inflation to pick up slightly to 1.5% in 2014. The Draft Budgetary Plan scenario reflects recent significant revisions to national account data. The macroeconomic scenario in the Draft Budgetary Plan for 2014 appears slightly favourable compared with the Commission 2013 Autumn Forecast. Real GDP growth in 2014 is expected to be slightly stronger and the growth composition to be more growth-friendly, as the DBP foresees a stronger recovery in domestic demand

and especially in gross fixed capital formation. Moreover, the Draft Budgetary Plan assumes a higher GDP deflator and a stronger improvement in the labour market.

6. The macroeconomic forecast underpinning the Draft Budgetary Plan has been prepared by the Spanish Ministry of Economy and Competitiveness. Based on the information available to the Commission at this stage, a draft law on setting up an independent fiscal body in charge of producing or endorsing macroeconomic forecasts is in the national parliament for adoption by the end of 2013. Regulation 473/2013 requires that the draft budget be based on independently endorsed or produced macroeconomic forecasts.
7. The Draft Budgetary Plan expects the 2013 general government deficit to decrease to 6.8% of GDP from 10.6% of GDP in 2012. When excluding the impact of bank recapitalisations carried out in the framework of the financial sector programme, the deficit is expected to reach 6.5% of GDP. These figures are in line with the Commission 2013 Autumn Forecast. These forecasts are based on revised data for 2012, when the deficit (excluding bank recapitalisations) is now estimated to have reached 6.8%¹ of GDP and nominal GDP to be 2% lower. The Draft Budgetary Plan targets a general government deficit of 5.8% of GDP in 2014. This is in line with the revised target adopted by the Council in June 2013. The deficit reduction in 2014 is expected to be achieved by a combination of expenditure restraint and higher revenues.
8. There are significant risks to the 2013 budgetary target, should revenues not come in as strongly as currently expected in the last quarter of the year or should expenditure restraint, notably at regional level, not be as strict as planned. For 2014, the Commission 2013 Autumn Forecast foresees a general government deficit of 5.9% of GDP in 2014, thus slightly higher than the Draft Budgetary Plan. This essentially reflects slightly more cautious nominal growth and employment assumptions, implying weaker revenue growth. Moreover, there are some implementation risks, in particular regarding regional revenue measures and the effect of measures to fight tax and social security fraud.
9. After four years of steep increase in the government debt, the Draft Budgetary Plan foresees the upward trend in gross debt to continue in 2013 and 2014, with the debt ratio reaching 94.2% in 2013 and 98.9% in 2014. This is an upward revision of around 2¾ pps. in both years compared to the Stability Programme, driven mainly by an upward revision of stock-flow adjustment in 2013, but also to some extent by a lower GDP deflator and a higher primary deficit. In 2014, a somewhat more negative primary balance and slightly higher interest expenditure than was foreseen in the Stability Programme is offset by higher nominal GDP growth and lower stock-flow adjustment. The Draft Budgetary Plan does not contain a breakdown by component of the stock-flow adjustment. Compared to the Draft Budgetary Plan, the Commission 2013 Autumn Forecast has a slightly higher debt profile, which for both 2013 and 2014 mainly reflects a lower GDP deflator and, in the case of 2014, slightly lower GDP growth.

¹ The deficit of 6.8% of GDP in 2012, net of bank recapitalisation costs, is corrected for the one-off direct budgetary impact of capital injections to banks recorded as deficit-increasing (3.8% of GDP) in the context of the on-going financial sector programme for recapitalisation of financial institutions in Spain. When taking into account also the impact of financial sector support operations on the revenue side, the deficit excluding the support for financial institutions was 6.9% of GDP.

10. The Draft Budgetary Plan reports an incremental (from one year to the next) consolidation effect of discretionary measures of 3¾% and 1½% of GDP in 2013 and 2014, respectively. In 2013, the bulk of the effect stems from revenues measures (2¼% of GDP), whereas in 2014 the effect is evenly distributed on the revenue and expenditure side. Some of the measures, notably measures to fight fraud and measures at regional level, carry certain implementation risks, also in light of the track record in 2012. The fiscal consolidation in 2014 as envisaged in the Draft Budgetary Plan does not rely on one-off measures to any large extent, but it relies heavily on a one-year extension of the higher personal income tax rates introduced in 2012 and originally foreseen to expire by the end of 2013, and a one-year delay in reversing measures, foreseen to be temporary, in corporate taxation.
11. The Commission 2013 Autumn Forecast projects the headline deficit to decrease to 6.8% of GDP in 2013 (6.5% net of the costs of bank recapitalisation within the framework of the financial sector programme), above the target recommended by the Council on 21 June 2013, and to drop further to 5.9% of GDP in 2014, marginally higher than the target recommended by the Council. The respective improvement in the structural balance, corrected for revisions in potential output growth and for unexpected revenue windfalls/shortfalls, falls short of the efforts recommended by the Council, especially for 2014. Based on a bottom-up assessment, which estimates the size of the additional effort for 2013 on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the Council Recommendation and the Commission Autumn Forecast, no additional net consolidation measures were taken in 2013, in line with what was deemed necessary to reach the structural targets spelled out in the EDP recommendation. For 2014 the bottom-up estimate of the fiscal effort is around 1¾% of GDP, which would fall somewhat short of what was deemed necessary to reach the structural targets spelled out in the EDP recommendation. Accordingly, whereas in 2013 it appears that Spain will comply with the Council EDP recommendation, provided that risks to the budgetary target are dispelled, the assessment for 2014 points to risks of non-compliance.
12. For 2015 and 2016, Spain has not yet specified sufficient measures to bring the headline government deficit in line with the targets recommended by the Council. Moreover, in 2015, the potential expiry of temporary measures taken in previous years widens the gap relative to the EDP target. However, the budgetary adjustment in 2015 and 2016 falls far short of the revised EDP recommendation.
13. Spain also plans to implement the following fiscal structural measures: i) strict monitoring of budgetary developments at regional and local levels; ii) the creation of an independent fiscal institution; iii) the reduction in healthcare and public administration spending; iv) the elimination of commercial arrears in the public sector; v) the reduction of price inertia in public expenditures and revenues; vi) improving pension sustainability; vii) the simplification and strengthening of the efficiency of Spain's tax system; viii) the fight against the informal economy and ix) the increase in the efficiency of public administration. These measures, if effectively implemented, can be expected to contribute to the effective and lasting correction of Spain's excessive deficit situation.
14. In accordance with Council recommendation of 21 June, Spain has also submitted an Economic Partnership Programme. The Economic Partnership Programme confirms the reform agenda and timetable for fiscal and other structural reforms included in the 2013 National Reform Programme and the Stability Programme and it gives in

some cases more detail on the content of measures as well as on their expected timeline. These reforms, if effectively implemented, can be expected to contribute to a lasting correction of the excessive deficit. However, some recommendations by the Council addressed to Spain on 9 July 2013 in the context of the European Semester are so far only partly backed by concrete measures. This is the case, for example, of the systematic review of major spending items with a view to improving the efficiency of public expenditure (under CSR 1). Moreover, regarding the review of the tax system (CSR 2), the Economic Partnership Programme mainly refers to the conclusions of a group of tax experts scheduled for February 2014. In most cases, the reforms still remain to be adopted and / or fully implemented, swift and full implementation being key for the success of the Economic Partnership Programme. On this basis, the Commission has made a proposal for a Council Opinion.

15. Overall, the Commission, based on its forecast, concludes that the Draft Budgetary Plan for Spain is at risk of not complying with the rules of the SGP. In particular, in 2013 Spain appears to have taken effective action in line with the Council EDP recommendation but there is a risk that the Draft Budgetary Plan for 2014 sent on 15 October will not fulfil the requirements in the EDP recommendation. This risk arises from somewhat favourable assumptions for nominal GDP growth and growth composition in the Draft Budgetary Plan and from a lower structural effort than recommended by the Council. The Commission is also of the opinion that Spain has made some progress to address the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2014 budget will be fully compliant with the SGP and notably to address the risks identified by the Commission in its assessment of the Draft Budgetary Plan. Moreover, it invites the authorities to make further progress towards implementation of the fiscal recommendations under the European Semester.

Done at Brussels,

For the Commission
Member of the Commission