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COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in Spain following the adoption of the COUNCIL RECOMMENDATION to Spain of 21 June 2013 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a COUNCIL DECISION

establishing that no effective action has been taken by Spain in response to the Council Recommendation of 21 June 2013

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1. INTRODUCTION

On 27 April 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC) that an excessive deficit existed in Spain and in accordance with Article 104(7) TEC issued a recommendation to correct it by 2012. Since then the Council issued three new recommendations to Spain on the basis of Article 126(7) of the Treaty on the Functioning of the European Union (TFEU), on 2 December 2009, 10 July 2012 and 21 June 2013, extending the deadline for correcting the excessive deficit to 2013, 2014 and 2016 respectively, as the Council considered that Spain had taken effective action, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred.[1]

Specifically, on 21 June 2013, in order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, 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 was consistent with an improvement of the structural balance of 1.1%, 0.8%, 0.8%, and 1.2% of GDP in the years 2013-2016 respectively based on the Commission 2013 spring forecast extended to 2016. To achieve this improvement, additional fiscal policy measures of 2%, 1% and 1.5% of GDP in 2014, 2015 and 2016, respectively were deemed necessary.

Spain was also asked to implement the measures adopted in the 2013 budget plans at all levels of government and to stand ready to take corrective action in case of deviations from budgetary plans. Moreover, Spain was called on to reinforce its medium-term budgetary strategy with well-specified structural measures for the years 2014-2016.

Furthermore, Spain was requested to (i) strengthen the effectiveness of the institutional framework by raising further the transparency in implementation of its Stability Law as well as by establishing an independent fiscal institution to provide analysis, advice and monitor compliance of fiscal policy with national and Union fiscal rules, (ii) to undertake concrete steps to rein in the increasing structural deficit in the social security system, and (iii) to give a greater emphasis to the growth friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system. Finally, to ensure the success of the fiscal consolidation strategy, the recommendation also pointed out that it was important to back the fiscal consolidation with comprehensive structural reforms, in line with the Council Recommendations addressed to Spain in the context of the European Semester and the Macroeconomic Imbalances Procedure.

In its recommendation, the Council established a deadline of 1 October 2013 for effective action to be taken in line with the provisions of Article 3(4) of Regulation (EC) No 1467/97. On 15 November 2013, the Commission concluded that based on the Commission 2013 autumn forecast, Spain had taken effective action and considered that no additional steps in the excessive deficit procedure were necessary at that point in time. Since then the excessive deficit procedure has been kept in abeyance.

However, risks of non-compliance with the Council Recommendation of 21 June 2013 appeared as of 2014. Based on its assessment of the 2014 Stability Programme and the Commission spring forecast, in July 2014 the Council concluded that the measures

[1] All documents related to the excessive deficit procedure of Spain can be found at:http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/spain_en.htm .

underpinning the budgetary strategy needed to be specified further and that additional efforts were needed to fully comply with the Council Recommendation of 21 June 2013. Based on its assessment of the 2015 Stability Programme, the Council concluded in July 2015 that there was a risk that Spain would not comply with the provisions of the Stability and Growth Pact.

Similarly, the Commission's Opinions on Spain's Draft Budget Plans for 2014, 2015 and 2016, have all concluded that Spain was at risk of not complying with the rules of the Stability and Growth Pact. In particular, the Commission pointed out risks related to the structural effort in the plans being lower than those recommended by the Council. Moreover, the Commission flagged risks to the achievement of the headline deficit targets.

On 9 March 2016, based on the Commission 2016 winter forecast, the Commission also concluded that there was a risk of non-compliance with the deadline to correct the excessive deficit, given the still significant excess over the 4.2% of GDP intermediate headline balance target for 2015 and the 2.8% of GDP target for 2016 and the fact that the fiscal effort achieved until then fell short of the recommended one. On that basis, the Commission issued a recommendation to Spain to step up efforts to ensure compliance with the Council Recommendation of 21 June 2013. In particular, Spain was recommended (i) to take measures to ensure a timely and durable correction of the excessive deficit, including by making full use as appropriate of the preventive and corrective tools set out in Spain's Stability Law to control for slippages at the sub-central government level from the respective deficit, debt and expenditure rule targets; and (ii) to report to the Commission on measures in response to the Commission Recommendation in its updated 2016 draft budgetary plan or, at the latest, in a dedicated section of its forthcoming 2016 Stability Programme.

This document is structured as follows. Section 2 presents the recent macro-economic and budgetary developments and outlook for 2016-2017. The subsequent section reviews the budgetary implementation over the 2013-2016 period. It is followed by a section assessing effective action. Section 5 discusses developments in response to the Council Recommendation of 21 June 2013 regarding the fiscal framework. The last section concludes.

2. RECENT MACRO-ECONOMIC DEVELOPMENTS AND OUTLOOK FOR 2016-2017

In 2013, real GDP contracted by 1.7%, a slightly deeper decline than projected in the macroeconomic scenario underpinning the 2013 EDP recommendation. This difference was compounded by a much weaker GDP deflator, leading to a nominal GDP contraction of 1.1% vs. the projected growth of 0.1%.

After the Spanish economy came out of recession in the third quarter of 2013, it has experienced a strengthening recovery, also thanks to reforms undertaken in response to the crisis and the successful completion of the financial assistance programme. The recovery is accompanied by strong job creation, in a context of continued wage moderation and benefitting from the labour market reforms. Substantial external adjustment also took place, supported by cost-competitiveness gains. While in real terms, the recovery and the associated turnaround in the labour market are proving much stronger than projected at the time of the 2013 EDP recommendation, price developments over 2013-2015 were much slower than expected and were even negative in 2014. The assessment of budgetary developments since the 2013 EDP recommendation has to take account of these two factors, which affect the fiscal consolidation process in two opposite directions. It also has to take into account the low-interest rate environment, which has helped the fiscal consolidation by reducing interest expenditure.

In 2014, real GDP expanded by 1.4%, compared to an expected 0.9% expansion in the baseline scenario.

In 2015, Spain’s economy expanded by 3.2% in real terms, more than double the rate forecast in the baseline scenario underlying the EDP recommendation. Improved access to credit for both firms and households and enhanced confidence, together with declining oil prices, supported domestic demand. Specifically, strong private consumption was underpinned by solid job creation and subdued price developments, which sustained households' real disposable income in a context of continued wage moderation. Investment, especially in equipment but also non-residential construction, continued to grow strongly. By contrast, as strong domestic demand fuelled imports, net exports proved negative for growth. In nominal terms, GDP expanded by 3.6%, more than one percentage point stronger than expected. As a result, and despite three years of lower-than-expected inflation, the level of nominal GDP in 2015 was only marginally below the expectation in the baseline scenario underpinning the EDP recommendation, which by definition – in the absence of structural effort – was not expected to bring Spain's deficit back below 3% of GDP by 2016.

After the very strong first half of 2015, growth has decelerated somewhat and is likely to continue to moderate in 2016 and 2017 while remaining robust. Positive labour market developments, improved access to credit for firms and households, and low oil prices are expected to continue to support growth. The drag on domestic demand from private sector deleveraging is expected to fade out. Accordingly, Spain’s economy is forecast to grow by 2.6% and 2.5% in 2016 and 2017, respectively.

Table 1: Comparison of macroeconomic developments and forecasts

		2012	2013	2014	2015	2016	2017
Real GDP							
Baseline	g	-1.4%	-1.5%	0.9%	1.4%	1.9%	n.a.
EDP scenario	g	n.a.	-1.5%	-0.5%	0.7%	0.9%	n.a.
Current forecast	g	-2.6%	-1.7%	1.4%	3.2%	2.6%	2.5%
Nominal GDP							
Baseline	g	-1.3%	0.1%	2.0%	2.6%	3.2%	n.a.
EDP scenario	g	n.a.	0.2%	0.5%	1.9%	2.1%	n.a.
Current forecast	g	-2.6%	-1.1%	1.0%	3.8%	3.5%	3.9%
GDP deflator							
Baseline	g	0.1%	1.6%	1.0%	1.2%	1.2%	n.a.
EDP scenario	g	n.a.	1.7%	1.0%	1.2%	1.2%	n.a.
Current forecast	g	0.0%	0.6%	-0.4%	0.6%	0.9%	1.4%
Potential growth							
Baseline	g	-0.9%	-1.4%	-1.5%	-0.1%	0.6%	n.a.
EDP scenario	g	n.a.	-1.4%	-1.5%	-0.1%	0.6%	n.a.
Current forecast	g	-0.6%	-0.8%	-0.3%	0.0%	0.4%	0.7%
Output gap							
Baseline	% POT	-4.6%	-4.6%	-2.3%	-0.8%	0.6%	n.a.
EDP scenario	% POT	-4.6%	-4.6%	-3.7%	-2.9%	-2.6%	n.a.
Current forecast	% POT	-7.5%	-8.3%	-6.7%	-3.7%	-1.5%	0.3%
General government balance							
Baseline	% GDP	-10.7%	-6.8%	-7.5%	-6.5%	-6.1%	n.a.
EDP scenario	% GDP	n.a.	-6.5%	-5.8%	-4.2%	-2.8%	n.a.
Current forecast	% GDP	-10.4%	-6.9%	-5.9%	-5.1%	-3.9%	-3.1%
General government debt							
Baseline	% GDP	84.2%	91.3%	96.8%	100.6%	103.3%	n.a.
EDP scenario	% GDP	84.2%	91.3%	98.2%	102.8%	106.6%	n.a.
Current forecast	% GDP	85.4%	93.7%	99.3%	99.2%	100.3%	99.6%

3. BUDGETARY IMPLEMENTATION OVER 2013-2015 AND OUTLOOK FOR 2016

3.1. Budgetary implementation in 2013

Despite the worse-than-expected recession, the headline deficit contracted from 10.4% of GDP in 2012 to 6.9% of GDP in 2013, missing the EDP target by 0.4% of GDP. Net of financial sector assistance, which had a very large impact in 2012, the deficit narrowed from 6.7% of GDP in 2012 to 6.4% of GDP in 2013. The narrowing was due to the impact of discretionary measures more than offsetting the cyclical downturn and the increase in interest expenditure. Despite lower-than expected interest rates having a beneficial impact on interest expenditure, the fast increase in the debt ratio still resulted in higher interest expenditure. Among the measures with the largest deficit-reducing impact in 2013, there are the increases in VAT rates legislated in 2012 and in some excise duties. On the expenditure side, measures focused on the continuation of public sector wage and hiring freezes, structural reforms to improve the efficiency of spending in health and education, public administration reforms and reforms to early retirement and pension indexation. Although the headline target was missed, the Commission considered that there was effective action on account of the fiscal effort being met.

Table 2: Budget implementation 2013-2015 and prospects for 2016

(% of GDP)	2013	2014	2015	2016
	Outturn	**Outturn**	**Outturn**	**Forecast**
Revenue	**38.2**	**38.6**	**38.2**	**38.2**
of which:				
- Taxes on production and imports	11.2	11.5	11.7	11.9
- Current taxes on income, wealth, etc.	10.2	10.1	10.1	9.9
- Social contributions	12.4	12.5	12.2	12.2
- Other (residual)	4.5	4.5	4.2	4.1
Expenditure	**45.1**	**44.5**	**43.3**	**42.1**
of which:				
- Primary expenditure	41.8	41.1	40.3	39.2
of which:				
Compensation of employees	11.1	11.0	11.0	10.7
Intermediate consumption	5.3	5.3	5.2	4.9
Social payments	19.3	19.1	18.4	18.0
Subsidies	1.1	1.1	1.2	1.1
Gross fixed capital formation	2.2	2.1	2.5	2.3
Other (residual)	2.8	2.5	2.1	2.3
- Interest expenditure	3.4	3.4	3.1	2.9
General government balance (GGB)	**-6.9**	**-5.9**	**-5.1**	**-3.9**
Primary balance	**-3.5**	**-2.5**	**-2.0**	**-1.1**
One-off and other temporary measures	-0.4	-0.4	-0.2	0.0
GGB excl. one-offs	-6.5	-5.5	-4.9	-3.9
Output gap	-8.3	-6.7	-3.7	-1.5
Cyclically-adjusted balance	-2.4	-2.3	-3.1	-3.1
Structural balance (SB)	**-2.0**	**-1.9**	**-2.9**	**-3.1**

Source: Commission 2016 spring forecast

3.2 Budgetary implementation in 2014

Although nominal growth in 2014 was slower than originally foreseen, due to much lower-than-expected inflation, the government deficit only narrowly missed the EDP target for 2014, reaching 5.9% of GDP. Excluding financial sector assistance, the deficit was 5.8% of GDP. The narrowing of the deficit was facilitated by the favourable economic environment, in particular a pick-up in revenue growth and a stabilisation of interest expenditure and social transfers, where falling unemployment benefits more or less offset the increase in pension expenditure. Discretionary measures on the revenue side positively contributed to the bottom-up measure of the fiscal effort in the amount of 0.6% of GDP. The measures included some additional hikes in excise duties, a further reduction in tax exemptions for corporate income tax and some revenue-increasing measures by regional authorities. Similarly to 2013, some expenditure retrenchment was supported by the continuation of public sector wage and hiring freezes, structural reforms to improve the efficiency of spending in health and education, public administration reforms and reforms to early retirement and pension indexation. However, these measures simply offset the impact of rising expenditure, yielding a zero contribution to the bottom-up measure of fiscal effort. Moreover, there was a one-off deficit-increasing impact of about 0.2% of GDP from compensation claims related to the fuel tax judged illegal by the European Court of Justice (the so called "*céntimo sanitario*"). [2]

3.3 Budgetary implementation in 2015

Despite stronger-than expected economic growth in 2015, in both real and nominal terms, the EDP headline deficit target was missed by a wide margin, reaching 5.1% of GDP in 2015, versus a target of 4.2%.[3] The reason behind the slippage is twofold. On the one hand, the cuts

[2] See European Court of Justice Judgement in Case C-82/12

[3] Slippages in relation to domestic targets were concentrated at the regional level, where the deficit turned out 0.9 pp. higher than the targeted 0.7% of GDP, and the social security system with a deficit of 1.3% of GDP, 0.7 pp. above its target. The central and local governments over-performed their respective targets by a total of 0.6 pp. In parallel, the central, regional and local governments failed to comply with the Stability Law's expenditure rule, whereby the variation in the eligible expenditure of the central, regional and local governments should not exceed the reference rate of medium-term growth of Spain's GDP (1.3% in 2015)

to the personal income tax implied a revenue loss of almost 0.4 % of GDP, partly offsetting the impact of revenue-raising measures. On the other hand, expenditure slippages at both central and regional government level more than offset the impact of deficit-reducing expenditure trends, i.e. another year of virtually stable social transfers and a more than 0.3 pp fall in interest expenditure. The budgetary outcome was also adversely affected by a few one-off factors. They include a decision by Eurostat to reclassify some private-public partnership (PPP) projects as public investment with a negative impact on the deficit in 2015 of about 0.2% of GDP as well as support to the financial sector of 0.1% of GDP. They also include the part of the payback of the foregone 2012 Christmas bonus that followed from a Court ruling (0.1% of GDP). There was also a one-off affecting the budgetary outcome in a positive way, owing to the sale of UMTS licences having decreased capital expenditure by 0.2% of GDP in 2015.

In 2015, the debt ratio was more or less stable, thanks to a stock-flow adjustment in the form of net sales of financial assets compensating for the still negative deficit-growth dynamic.

Table 3: Main discretionary measures in 2013-2016 (% of GDP)

Revenues	Expenditure
2013	
• Hikes in personal income tax (including on non-residents) (0.2% of GDP) • Hikes in Value Added Tax (0.8% of GDP) • Hikes in excise duties and environmental taxes (0.3% of GDP) • Social security contributions (0.2% of GDP) • Regional government tax measures (0.2% of GDP) • Local government tax measures (0.1% of GDP)	• Cancellation of the 2012 Christmas bonus (0.5% of GDP) • Public employment restraint measures (−0.3% of GDP) • Employment policies (−0.3% of GDP) • Expenditure on long-term care (−0.1% of GDP) • Regional measures, excluding public employment restraint measures (−0.7% of GDP) • Local measures, excluding public employment restraint measures (−0.1% of GDP) • Other measures at central government level (−0.4% of GDP)
2014	
• Corporate income tax - Changes to deductibility of depreciation expense and asset revaluation levy (−0.1% of GDP) • Value Added Tax (−0.1% of GDP) • Social security contributions (0.1% of GDP) • Regional government tax measures (0.1% of GDP) • Local government tax measures (0.1% of GDP) • Fight against tax fraud (0.1% of GDP)	• Public employment restraint measures (−0.1% of GDP) • Employment policies (−0.1% of GDP) • Public administration reform (CORA) (−0.1% of GDP) • Regional measures (−0.2% of GDP) • Pension reform (−0.1% of GDP) • Compensation claims related to the fuel tax judged illegal by the ECJ ("*céntimo sanitario*") (0.2% of GDP)
2015	
• Reduction in personal income tax (including on non-residents) (−0.3% of GDP) • Reduction in corporate income tax (−0.3% of GDP) • Value Added Tax (0.1% of GDP) • Local government tax measures (0.1% of GDP) • Fight against tax fraud (0.1% of GDP)	• Partial repayment of 2012 Christmas bonus (0.1% of GDP) • Public employment restraint measures (−0.1% of GDP) • Other public employment measures at regional level (0.1% of GDP) • Public administration reform (CORA) (−0.1% of GDP) • Local public administration reform (−0.1% of GDP) • Pension reform (−0.1% of GDP) • Compensation claims related to the fuel tax judged illegal by the ECJ ("*céntimo sanitario*") (−0.2% of GDP)
2016	
• Reduction in corporate income tax (−0.1% of GDP) • Reduction in personal income tax (−0.3% of GDP) • Fight against tax fraud (0.1% of GDP)	• Public employment restraint measures (−0.1% of GDP) • Spending cuts (*acuerdos de no disponibilidad*) at central government level (−0.2% of GDP) • Spending cuts (*acuerdos de no disponibilidad*) and other saving measures at regional government level (−0.2% of GDP) • Public administration reform (CORA) (−0.1% of GDP)

Revenues	Expenditure
	• Local public administration reform (−0.1% of GDP) • Pension reform (−0.1% of GDP)
2017	
• Reduction in personal income tax (including on non-residents) (−0.1% of GDP) • Fight against tax fraud (0.1% of GDP)	• Partial repayment of 2012 Christmas bonus (−0.1% of GDP) • Pension reform (−0.1% of GDP)
Note: The budgetary impact in the table is the impact reported by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure. Source: 2016 Stability Programme, 2016 and 2015 Draft Budgetary Plans.	

3.4 Projected budget developments in 2016

The Commission 2016 spring forecast projects the general government deficit to continue narrowing to reach 3.9% of GDP in 2016. That improvement is again mainly due to the cyclical recovery, which is expected to continue supporting tax revenues and keeping social transfers in check. In particular, while pension expenditure is expected to continue rising, falling unemployment should reduce the growth of social transfers in the near future. Furthermore, previous improvements in financing conditions and the decelerating public debt ratio imply that interest expenditure is likely to continue to fall. The reduction in the general government deficit is also the result of new saving measures at central and regional government level decided by the caretaker government in response to the Commission Recommendation of March 2016. In particular, the government announced that it would implement provisions in domestic legislation to enforce fiscal discipline on regional governments. To that end, on 6 April, it called on 12 regional governments to approve cuts in budget appropriations to ensure compliance with their deficit targets. For 2016, the target for each region was set at -0.7% of GDP on 20 April, up from -0.3% originally. Furthermore, on 29 April 2016, the government adopted cuts to budgetary appropriations at central level by EUR 2 billion. According to the 2016 Stability Programme, total savings from the new measures at central and regional level are estimated at around 0.4% of GDP. The Commission 2016 spring forecast incorporates a deficit-reducing impact of about 0.3% of GDP from them −0.2 pp. at central government level and 0.1 pp at regional level.[4] Together with the continued rationalisation at central government level (CORA) and the 2013 local administration reform, they are expected to rein in the rising trend in expenditure. These saving measures are subject to implementation risks, as they require active involvement by different tiers of government and strict enforcement. Furthermore, the above savings only partly offset the impact of other pre-existing expansionary measures, including the cuts to the corporate and personal income tax enacted in November 2014, the second pay-back of the previously foregone Christmas bonus in 2012 as well as the upward trend in expenditure linked to population ageing.

The expected deviation from the 2016 deficit target recommended in June 2013 is forecast to reach around 1.1% of GDP at unchanged policies. It is mainly explained by the worse starting position (base effect ¾% of GDP), but also by an insufficient fiscal effort in 2016.

Finally, according to the Commission 2016 spring forecast, the debt ratio is expected to peak at slightly above 100% of GDP in 2016, thus exceeding the Treaty reference value in all years.

4. EFFECTIVE ACTION IN 2013-2015

4.1 Background information

The assessment of effective action is based on the data notified by the Spanish authorities in April 2016 and validated by Eurostat, and the Commission 2016 spring forecast. It takes into account the economic and budgetary developments since the Council Recommendation of 21 June 2013. The methodology for assessing effective action is the one endorsed by the Council in June 2014. The assessment starts by comparing the headline deficit target and the recommended improvement in the structural balance in the Council Recommendation with the headline deficit and the apparent fiscal effort, measured by the change in the structural budget balance. If the headline deficit and/or the required improvement in the structural balance are not achieved, a careful analysis is carried out. The careful analysis takes into account –via the adjusted change in the structural balance - (i) the impact of revisions in potential output growth and (ii) the impact of revenue windfalls or shortfalls compared to the EDP scenario underpinning the Council Recommendation. The above is complemented by a bottom-up assessment of consolidation measures undertaken by the Spanish government. Relevant information on baseline and EDP macroeconomic scenario has already be presented in Table 1.

4.2 Headline targets and adjustment in the structural balance

In 2013, Spain did not reach the recommended headline deficit target but the Commission concluded that the fiscal effort had been delivered.[5] For 2014, the general government deficit was notified in spring 2015 at 5.8% of GDP, just reaching the intermediate deficit target set by the Council for that year, but then in autumn 2015 it was revised up to 5.9% of GDP, marginally above the target, on account of a downward revision in the underlying GDP figure (i.e. resulting in a denominator effect). In 2015 Spain's general government deficit reached 5.1% of GDP, well above the intermediate target set by the Council of 4.2% of GDP.

Based on the Commission 2016 spring forecast, the structural balance in 2015 deteriorated by 1% of GDP, compared to a recommended structural improvement of 0.8% of GDP. In cumulative terms over 2013-2015, the unadjusted change in the structural balance stood at 0.6% of GDP, which is significantly below the cumulative recommended structural improvement of 2.7% of GDP. This warrants a careful analysis.

4.3. Careful analysis

The adjusted change in the structural balance amounts to -0.7% of GDP in 2015, leading to a gap of 1.5% of GDP vis-à-vis the recommended structural improvement of 0.8% of GDP. In cumulative terms over 2013-2015, the adjusted change in the structural balance equals -0.2% of GDP, which is again well below the recommended cumulative structural improvement of 2.7% of GDP.

The fiscal effort based on the bottom-up method yields -0.5% of GDP in 2015, well below what is deemed necessary to comply with the Council Recommendation of 21 June 2013 (1% of GDP), and to no effort over the 2013-2015 period, against the recommended cumulative structural effort of 3% of GDP).

For 2016 – i.e. the deadline for the correction of the excessive deficit set out in the June 2013 recommendation – the headline deficit is forecast to reach 3.9%, well above the deficit reference value of the Treaty and the recommended deficit target of 2.8% of GDP. The unadjusted and adjusted changes in the structural balance are both projected to be -0.2% of GDP, further widening the gap with the recommended effort. Also based on the bottom-up method, no fiscal effort is projected to be delivered by Spain in 2016, which implies falling significantly short of the 1.5% of GDP effort deemed necessary to achieve the target.

Table 4: Compliance with the requirements of the corrective arm

% of GDP	2013	2014	2015	2016
Headline balance				
Headline budget balance	-6.9	-5.9	-5.1	-3.9
EDP requirement on the budget balance	-6.5	-5.8	-4.2	-2.8
Fiscal effort - change in the structural balance				
Change in the structural balance	1.4	0.1	-1.0	-0.2
Required change from the EDP recommendation	1.1	0.8	0.8	1.2
Cumulative change in the structural balance		1.5	0.6	0.4
Cumulative required change from the EDP recommendation		1.9	2.7	3.9
Fiscal effort- adjusted change in the structural balance				
Adjusted change in the structural balance	0.9	-0.4	-0.7	-0.2
Required change from the EDP recommendation	1.1	0.8	0.8	1.2
Cumulative change in the structural balance		0.5	-0.2	-0.4
Cumulative required change from the EDP recommendation		1.9	2.7	3.9
Fiscal effort - calculated on the basis of measures (bottom up approach)				
Fiscal effort (bottom-up)	-0.3	0.9	-0.5	0.0
Requirement from the EDP recommendation	0.0	2.0	1.0	1.5
Cumulative fiscal effort (bottom-up)	-0.3	0.6	0.0	0.0
Cumulative requirement from the EDP recommendation		2.0	3.0	4.5

Source: Commission 2016 spring forecast

5. FISCAL FRAMEWORK

Since 2012, Spain's fiscal framework has been strengthened in order to, among other things, prevent deviations and ensure compliance by all government levels with their respective deficit, debt and expenditure rule targets. Since the Council Recommendation of 21 June 2013, Spain has strengthened its fiscal framework further, namely by creating an independent fiscal institution (AIReF) and amending its 2012 fiscal responsibility act (i.e., the Stability Law).

In particular, AIReF was created in law in November 2013 and became operational the following year. It is entitled to assess and deliver opinions on a large number of public finance developments. The amendments to the Stability Law aim to, among other things, give incentives to all public administrations to reduce public sector arrears to commercial suppliers. They also provide for a sharper definition of corrective measures – such as cuts in budgetary appropriations (*acuerdos de no disponibilidad*) [6] – to ensure their effectiveness in correcting deviations from fiscal targets. However, while the Stability Law includes meaningful tools to prevent and correct deviations from fiscal targets, the experience over 2014 and 2015 shows that these were not used to the needed extent on non-compliant public administrations. Following the March 2016 Commission Recommendation, the Spanish government has started to enforce corrective provisions in the Stability Law that had not previously been implemented.

The Council Recommendation of 21 June 2013 also called on Spain to take steps to rein in the increasing structural deficit in the social security system, and give greater emphasis to the growth friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system. To that end, in December 2013, Spain adopted a reform revising pension indexation and introducing as from 2019 an automatic adjustment of future retirees' new pensions to take account of changes in life expectancy. However, the social security administration kept recording deficits over 2013-15, against the backdrop of sluggish growth in social security contributions, which was partly due to various schemes offering reduced rates for new permanent contracts. Furthermore, since June 2013, Spain has been implementing a public administration reform, with a view to eliminating duplicated administrative structures, reducing administrative burdens, streamlining overheads and rationalising the size of the central government's public sector entities. Lastly, in 2014 Spain adopted a tax reform. It focused on corporate income taxation, where a broadening of the tax base was accompanied by a lowering of tax rates, and on personal income taxation, where rates were reduced across the board. Although some elements of the reform are steps in the right direction (such as the broadening of corporate income tax bases), the reform could have been funded by shifting revenues towards less distortive taxes, such as consumption, environmental and recurrent property taxes. Its negative budgetary impact explains much of the higher-than-planned deficit and the significant worsening of the structural balance in 2015; it also weighs on the expected fiscal developments in 2016.

Against the backdrop of a relatively high number of possible breaches of EU public procurement legislation brought to the Commission's attention in recent years, the 2016 Country Specific Recommendations call on Spain to enhance control mechanisms for public procurement and coordination of procurement policies across government levels. Evidence shows that there are disparities in the implementation of public procurement across contracting authorities and entities and that insufficient ex-ante and ex-post control mechanisms hinder the correct and uniform application of public procurement legislation. The limited use of centralised or joint procurement instruments prevents efficiency gains which would contribute to fiscal savings. The absence of an independent body in charge of ensuring efficiency and legal compliance in public procurement throughout the country hampers the proper implementation of procurement rules and may create opportunities for wrongdoings.

6. Conclusions

After Spain's EDP was put in abeyance in November 2013, Spain narrowly missed the 2014 headline deficit target (on account of a downward revision of GDP in autumn 2015, which resulted in a denominator effect). In 2015 Spain's general government deficit reached 5.1% of GDP, well above the intermediate target of 4.2% of GDP set by the Council. Since 2014, Spain delivered a much lower fiscal effort than recommended, measured both according to the unadjusted and adjusted change in the structural balance as well as to the bottom-up effort. In 2015, fiscal policy was relaxed with personal income tax cuts and expenditure slippages contributing to a worsening of the structural balance. A low interest rate environment and a stronger-than-expected economic recovery, also thanks to reforms undertaken in response to the crisis, the successful completion of the financial assistance programme and favourable labour market developments, have helped Spain to reduce its general government deficit. At the same time, the fiscal consolidation process was hampered by a negative inflation surprise relative to the macroeconomic scenario underpinning the EDP recommendation. However, in 2015 the better-than-expected economic developments, in both real and nominal terms, were not used to accelerate the deficit reduction, but to allow a loosening of fiscal policy.

Annex

Table A1: Adjustment of apparent structural effort for the revision in potential growth – details of calculation

	Pot. growth assumptions underlying the Council Recommendation (%)	Pot. growth (COM 2016 SF) (%)	Forecast error (%)	Structural expenditure (% of pot. GDP) (COM 2016 SF forecast)	Correction coefficient (% of nominal pot. GDP)
	(1)	(2)	(3)=(2)-(1)	(4)	(5)=[(3) x (4)]/100
2013	-1.4	-0.8	-0.6	40.6	-0.3
2014	-1.5	-0.3	-1.1	40.3	-0.5
2015	-0.1	0.0	-0.1	40.6	0.0
2016	0.6	0.4	0.2	41.2	0.1

Table A2: Adjustment of apparent structural effort for the revenue shortfalls/windfalls as compared to standard elasticities – details of calculation

CAB methodology revenue elasticity ε*=1.0	**Change in current revenues (yoy) (EUR bn)**		**Discretionary revenues measures (EUR bn)**		**Nominal growth assumptions (%)**		**Current revenues in t-1 (EUR bn)**		**Revenue gap (EUR bn)**	**Correction coefficient**
	June reco. (1)	*2016 SF (1')*	*June reco. (2)*	*2016 SF (2')*	*June reco. (3)*	*2016 SF (3')*	*June reco. (4)*	*2016 SF (4')*	*(5)=[(1')-(2')- ε*x (3') x (4')]- [(1)-(2)- ε*x (3) x (4)]*	*=(5) expressed in % of nominal pot. GDP*
2013	2.2	0.8	15.8	16.8	0.1	-1.1	383.4	389.6	2.91	0.3
2014	-4.1	5.4	-11.3	2.0	2.0	1.0	379.3	390.4	0.12	0.0
2015	12.6	11.3	2.1	-1.2	2.6	3.8	391.9	395.8	-3.54	-0.3
2016	11.6	13.5	0.0	-1.8	3.2	3.5	403.5	407.1	1.61	0.1

Table A3. Forecast of key variables for the computation of the fiscal effort under the baseline scenario

			2016
Enters top-down	α	*Structural expenditure (% of potential GDP)*	41.16
		Potential GDP growth (%)	0.35
	β	*Current revenue (EUR billion national currency)*	420.5
		Discretionary measures with impact on current revenue (EUR billion national currency)	-1.765
		Nominal GDP growth (%)	3.5
		p.m Elasticity on current revenue	1.04
		p.m Output gap (% of Pot. Output)	-1.5
Enters bottom-up		*Discretionary measures with impact on total revenue net of one-offs and other temporary measures (EUR billion national currency)*	-2.369
		Total expenditure net of one-offs and other temporary measures (EUR billion national currency)	470.183
		Interest expenditure (EUR billion national currency)	32.13
		Total unemployment (in thousands)	4567.3
		Unemployment benefits (EUR billion national currency, 2014)	25.813

Source: Commission calculations based on spring 2016 forecast