Eurogroup

Brussels, 18 November 2016
(OR. en)

EG 32/16

EUROGROUP 34
ECOFIN 1075
UEM 382

COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	16 November 2016
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2016) 8005 final
Subject:	COMMISSION OPINION of 16.11.2016 on the Draft Budgetary Plan of Spain
Enclosed:	C(2016) 8005 final

Delegations will find attached document C(2016) 8005 final.

EUROPEAN
COMMISSION

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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SPAIN

3. On the basis of the Draft Budgetary Plan for 2017 submitted on 15 October 2016, along with the report on action taken by Spain in response to the Council Decision of 8 August 2016 giving notice to Spain to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit (the report on effective action), the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Draft Budgetary Plan was submitted by the caretaker government on the basis of unchanged policies. Following the general elections on 26 June 2016, the new government took office on 4 November.

5. Spain is currently subject to the corrective arm of the SGP. The Council opened the Excessive Deficit Procedure for Spain on 27 April 2009. On 8 August 2016, the Council gave notice to Spain under Article 126(9) of the Treaty to correct its excessive deficit by 2018. To that end, Spain is required to reduce the general government deficit to 4.6 % of GDP in 2016, to 3.1 % of GDP in 2017 and to 2.2 % of GDP in 2018. That improvement in the general government deficit is consistent with a deterioration of the structural balance by 0.4 % of GDP in 2016 and improvements by 0.5% of GDP in both 2017 and 2018, based on the updated Commission 2016 spring forecast.

6. Overall, the macroeconomic projections underlying the Draft Budgetary Plan are cautious in 2016 and plausible in 2017. The macroeconomic forecast underpinning the Draft Budgetary Plan assumes annual real GDP growth to reach 2.9% in 2016 and 2.3% in 2017. This is slightly different from the forecast underpinning the 2016 Stability Programme, with real GDP growth of 2.7% in 2016 and 2.4% in 2017. Growth is expected to be driven by domestic demand in both years, while net trade would detract from GDP growth, as imports are forecast to grow faster than exports. In contrast, the Commission 2016 autumn forecast assumes net external trade growth

to give a small positive contribution to growth. The Commission forecasts growth to reach 3.2% in 2016 and 2.3% in 2017.

7. Spain complies with the requirement of Regulation (EU) No 473/2013 that the Draft Budgetary Plan has to be based either on independently endorsed or independently produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan for 2017 have been endorsed by AIReF, Spain's independent fiscal institution. In its endorsement, AIReF nevertheless flagged both upside and downside risks, including lower interest rates and oil prices on the one hand and lower global growth on the other.

8. The Draft Budgetary Plan expects the general government deficit to decline from 5.1% of GDP in 2015 to 4.6% of GDP in 2016 and to decrease further to 3.6% of GDP in 2017. Based on the projections in the Draft Budgetary Plan, the recalculated structural balance is expected to deteriorate by 1% of GDP in 2016 and by a further 0.1% of GDP in 2017. The gross debt-to-GDP ratio is expected to remain stable at slightly below 100% in both 2016 and 2017. The current low interest rate environment, coupled with the stabilising debt ratio, is expected to result in further reductions of interest expenditure as a share of GDP in both 2016 and 2017. Euro area sovereign bond yields remain at historically low levels. Based on the information included in the Draft Budgetary Plan, interest expenditure in Spain is expected to fall from 3.1% of GDP in 2015 to 2.8% in 2016 and is projected to decrease further in 2017, to 2.7% of GDP. This compares to the 3.5% of GDP recorded in 2014, when interest expenditure peaked. The interest expenditure forecast in the Draft Budgetary Plan is broadly in line with the Commission 2016 autumn forecast.

9. The Draft Budgetary Plan reports a net overall deficit-reducing impact from fiscal policy measures amounting to 0.7% and 0.2% of GDP in 2016 and 2017, respectively. In both years, that net overall impact stems largely from current expenditure, as revenue-raising measures are largely outweighed by the effects of the 2014 Personal and Corporate Income Tax reform, even after factoring in the recently adopted increase in Corporate Income Tax instalment payments. On the expenditure side, the Draft Budgetary Plan projects savings from the public administration reform, the continued implementation of the 2013 pension reform, various measures at regional and local levels and, in 2016, from spending cuts at central government level. Based on the Commission assessment of those measures, the Commission 2016 autumn forecast includes a net overall deficit-reducing impact amounting to 0.2% of GDP in 2016 and slightly below 0.2% of GDP in 2017. Differences compared to the government estimates mostly come from the expenditure side. Overall, while the measures taken by the caretaker government in 2016 have significantly increased the probability of meeting the 2016 deficit target, further measures will be needed to fulfil the 2017 headline deficit and structural effort targets.

10. According to the Commission 2016 autumn forecast, the headline deficit is expected to decrease to 4.6% of GDP in 2016, in line with the headline deficit target established by the Council. While the Council decision to give notice adopted on 8

August 2016 under Article 126(9) of the TFEU[1] requires Spain to limit the deterioration of the structural balance to at most 0.4% of GDP in 2016, the Commission 2016 autumn forecast points to an expected deterioration in the structural balance of 1.0% of GDP, 0.6 percentage point above what was requested. This warrants a careful analysis. While the larger-than-expected worsening of the structural balance appears to be driven mostly by revenue shortfalls, the analysis of the fiscal effort based on the adjusted improvement in the structural balance ('top-down' method) and on the amount of measures taken ('bottom-up' method) still shows that there is a risk of underperforming the required fiscal effort. Under the former, the estimated corrected change in the structural balance is projected to be at -0.5% of GDP in 2016, thereby marginally missing the -0.4% of GDP target. The latter leads to a similar conclusion, as it projects the net impact of structural revenue measures and expenditure developments under the control of the government to have a net-expansionary impact of 0.1% of GDP, compared to the zero impact required by the Council. Nonetheless, based on the fulfilment of the intermediate headline deficit target for 2016, the excessive deficit procedure should be kept in abeyance at this stage. On a no-policy-change basis, the expected headline deficit of 3.8% of GDP in 2017 is 0.7 percentage point above the headline deficit target required by the Council, whereas for 2018, it is 1 percentage point above. While acknowledging the no-policy-change nature of those projections, the Commission 2016 autumn forecast projects that in the absence of further measures the fiscal effort would fall short of the level required by the Council in both years based on any of the metrics.

11. On 8 August 2016, the Council also called on Spain to strengthen its fiscal framework and its public procurement policy framework. The Spanish government has put forward some measures in response to the Council decision, which however fall short of its requirements. While the Draft Budgetary Plan provides detailed information on the implementation of the preventive and corrective mechanisms in the Stability Law throughout 2016, it does not report on plans to amend that law to make the implementation of those mechanisms more automatic. Furthermore, in the absence of appropriate implementing legislation, the application of the Stability Law's spending rule remains unclear and can be subject to interpretations that undermine its contribution to fiscal discipline. Regarding public procurement, the measures presented in the Draft Budgetary Plan can go some way towards improving some public procurement practices in Spain, but overall they do not address the need for a consistent framework that ensures sufficient transparency and coordination of public procurement across all contracting authorities and entities. Furthermore, the report does not spell out clear objectives for public procurement, instruments for action or a timeline for their adoption and implementation.

12. Spain, which is currently under the corrective arm of the SGP, submitted a Draft Budgetary Plan on the basis of unchanged policies. Overall, the Commission is of the opinion that the Draft Budgetary Plan is at risk of non-compliance with the provisions of the SGP. While acknowledging the no-policy-change nature of those projections, the Commission's forecast for 2017 projects that neither the intermediate headline deficit target, nor the recommended fiscal effort will be achieved. Therefore, in line with the Commission Communication 'Towards a positive fiscal

[1] See Council decision giving notice to Spain to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit at http://data.consilium.europa.eu/doc/document/ST-11552-2016-INIT/en/pdf

stance for the euro area', further measures will be needed to meet the headline deficit and structural effort targets going forward. Until such measures are taken, risks to the timely and durable correction of the excessive deficit by 2018 remain[2].

The Commission is also of the opinion that Spain has made limited progress in responding to the specific Council requirements to strengthen its fiscal framework and its public procurement policy framework. The Commission therefore invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of these requirements will be made in the 2017 Country Report and in the context of the country-specific recommendations to be adopted by the Council in 2017.

The Commission invites Spain to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan for 2017, showing compliance with the requirements set out in the Council decision of 8 August 2016, in principle at least one month before the draft budget law is planned to be adopted by the national parliament. The updated Draft Budgetary Plan will also have to include information on the actions being taken in response to the Council requirements to strengthen Spain's fiscal and public procurement policy frameworks, in accordance with Article 1(5) and (6) of the Council decision to give notice of 8 August 2016. The Commission will re-examine compliance with the requirements set out in the above-mentioned Council decision on the basis of the information in the updated Draft Budgetary Plan.

Done at Brussels, 16.11.2016

For the Commission
Pierre MOSCOVICI
Member of the Commission

[2] In a letter of 8 November 2016 addressed to Vice President Dombrovskis and Commissioner Moscovici, the Spanish Minister of Economy, Industry and Competitiveness, announced that the Spanish government would submit an updated Draft Budgetary Plan within the next coming weeks. According to the letter, that updated budget would ensure compliance with the 2017 headline deficit target of 3.1% of GDP in 2017 and the structural effort requirement of 0.5% of GDP.