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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of SPAIN

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of SPAIN

{C(2015) 6892 final}

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of SPAIN

1. INTRODUCTION

In view of the forthcoming general elections, Spain submitted its Draft Budgetary Plan (DBP) for 2016 on 11 September 2015, ahead of the deadline of 15 October set in Article 6 of Regulation (EU) No 473/2013. Spain is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure for Spain on 27 April 2009. The country is recommended to correct the excessive deficit by 2016.

The Draft Budgetary Plan incorporates the central government budget that was adopted by the government on 31 July 2015; for the sub-central government level, the Plan includes the latest publicly available information on budgetary execution – i.e., up until May 2015 (for regional governments) and Q1 2015 (for local entities) – while assuming compliance with the targets set for the regions and local governments for both 2015 and 2016.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on an (ad-hoc) Commission forecast. The subsequent section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses these fiscal developments (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal structural reforms in response to the latest country-specific recommendations adopted by the Council on 14 July 2015. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP projects growth to peak at 3.3% in 2015 (up from 1.4% in 2014) and then to moderate in 2016 to 3.0%. As in 2014, the growth projections for 2015 and 2016 continue to be driven by internal demand, whereas net external demand is envisaged to turn broadly neutral. The DBP foresees that private consumption and investment in equipment will keep recording sound growth rates, although moderating somewhat in 2016. The resilience of private consumption and equipment investment is set to be driven by strong employment growth (at 3.0% in both 2015 and 2016), further improvements in confidence and financial conditions and the effects of the reduction in personal income tax. Moreover, investment in construction is forecast to register positive growth rates both in residential and non-residential construction. With respect to the Stability Programme, real GDP growth in 2015 has been revised upwards significantly (from 2.9% to 3.3%), through higher contributions from both domestic and net external demand. For 2016, the macroeconomic scenario remains broadly unchanged.

To underpin its assessment of the 2016 DBP ahead of the autumn forecast, the Commission has carried out an ad-hoc update of the 2015 spring forecast (ad-hoc Commission forecast hereafter). This forecast incorporates the latest available information until the cut-off date of

29 September 2015. Based on it, the projection for real GDP growth for 2015 in the DBP appears broadly plausible, although slightly above the Commission's central scenario. For 2016, the macroeconomic scenario of the DBP appears somewhat optimistic, especially in view of the DBP's assumptions of higher oil prices in 2015 and especially 2016. Real GDP growth is expected to grow by 0.3 pp. faster in the plan compared to the ad-hoc Commission forecast, while the GDP deflator is forecast to increase by 0.2 pp. more. Higher real growth is mainly due to stronger private consumption, while the higher increase of the GDP deflator is explained by the impact of the higher increase in oil prices assumed in the DBP on the private consumption deflator. Similarly, employment is projected to grow 0.5 pp. faster in the DBP. Risks to the Commission's growth forecast for 2015 appear skewed to the upside, whereas for 2016, downside risks are related to the external sector and in particular the intensity of the deceleration of emerging economies.

Box 1: The macro economic forecast underpinning Spain's Draft Budgetary Plan

The macroeconomic forecasts underpinning the 2016 DBP have been endorsed by Spain's independent fiscal institution –*Autoridad Independiente de Responsabilidad Fiscal*, *AIReF*–in a report published on AIReF's website on 31 July 2015[1]. While deeming the forecast macroeconomic scenario as "probable", AIReF flagged that the composition of growth could differ from the government's forecast (with more consumption and less investment relative to the latter) and employment growth could be weaker.

AIReF's mandate is broad, thus allowing it to play a relevant role in Spain's budgetary processes. It is mandated, among others, to issue reports assessing the Stability Programme, the DBP, compliance of general government budget performance with numerical fiscal rules, the regions' economic and financial plans and to give advice on the activation of the correction mechanisms set out in Spain's Organic Law on Budgetary Stability and Financial Sustainability.

[1] http://www.airef.es/es/contenidos/informes/291-la-airef-avala-como-probables-las-previsiones-del-escenario-macroeconomico-del-gobierno

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.4	2.9	3.3	3.1	2.9	3.0	2.7
Private consumption (% change)	2.4	3.3	3.4	3.4	2.9	3.0	2.7
Gross fixed capital formation (% change)	3.4	6.3	6.4	6.3	5.8	5.6	5.4
Exports of goods and services (% change)	4.2	5.4	5.5	4.9	6.0	6.0	5.5
Imports of goods and services (% change)	7.6	6.7	6.0	6.1	6.4	6.4	6.0
Contributions to real GDP growth:							
- Final domestic demand	2.1	3.2	3.3	3.4	2.9	2.9	2.7
- Change in inventories	0.2	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.8	-0.2	0.0	-0.2	0.1	0.1	0.0
Output gap[1]	-6.7	-4.0	-3.9	-3.8	-2.0	-1.5	-1.8
Employment (% change)	1.3	3.1	3.0	2.9	3.0	3.0	2.6
Unemployment rate (%)	24.5	22.1	22.0	22.4	19.8	19.7	20.6
Labour productivity (% change)	0.2	-0.2	0.2	0.3	-0.1	0.0	0.1
HICP inflation (%)	-0.2	-0.4	-0.1	-0.4	0.9	1.1	0.8
GDP deflator (% change)	-0.5	0.6	0.5	0.5	0.9	1.1	0.9
Comp. of employees (per head, % change)	-0.2	0.2	0.5	0.6	1.0	1.4	0.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.0	1.7	1.5	1.7	1.8	1.6	1.5

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

N.B. The ad-hoc Commission forecast does not incorporate revised GDP data reported in the September 2015 EDP notification.

Source :
Stability Programme 2015 (SP); Draft Budgetary Plan 2016 (DBP); Ad-hoc Commission forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP expects the general government deficit to shrink from 5.8% of GDP in 2014 (including bank support of 0.1% of GDP) to 4.2% of GDP in 2015, in line with the recommended EDP targets; the deficit projection is unchanged compared to the Stability Programme, despite the upward revision in underlying real GDP growth in the Plan, indicating a relaxation of the fiscal stance. The ad-hoc Commission forecast projects a higher deficit in 2015, of 4.5% of GDP. The difference stems from the expenditure side: beside the impact of slightly lower nominal GDP than in the Plan's macroeconomic scenario, which contributes to a smaller drop in the expenditure ratio, the Commission also foresees compensation of employees to grow somewhat faster than the Draft Budgetary Plan. Regarding revenues, both the DBP and the ad-hoc Commission forecast expect tax revenues to accelerate from 2014, in particular taxes on production and imports.

For 2016, the DBP targets a general government deficit of 2.8% of GDP. The deficit reduction in 2016 is planned to be achieved by a combination of expenditure restraint and higher revenues. The expenditure ratio is projected to fall by 1.4 pps., reflecting mainly the effect of nominal GDP growth, lower interest expenditure and limited growth in social transfers and compensation of employees and intermediate consumption. In spite of the planned cuts in corporate income tax rates and the full effect of previous cuts in personal income tax rates, the revenue ratio is forecast to increase by 0.2 pp., reflecting an improved macroeconomic outlook.

The ad-hoc Commission forecast foresees a general government deficit of 3.5% of GDP in 2016, 0.7 pp. higher than the DBP. 0.3 pp. of it reflects a worse starting position. The remaining 0.4 pp. difference in 2016 is due to lower underlying GDP growth and a more prudent view on current expenditure restraint, in particular at the regional and local level, as well as a different assessment of the impact of some tax and non-tax revenue measures, some of which have not been sufficiently specified to be included in the ad hoc Commission forecast.

In addition, data recently published by the General State Comptroller (IGAE) and notified by the Spanish statistical office to Eurostat on 29 September 2015, i.e. after the submission of the Draft Budgetary Plan, show a lower nominal GDP in 2014 and, in turn, a slightly higher general government deficit to GDP ratio, at 5.9% of GDP[2]. Given the worse starting position, notified data also point to a slightly higher planned deficit for 2015, at 4.3% of GDP. The new data for the outcome of 2014 have not been included in the ad-hoc Commission forecast, as they have not yet been validated by Eurostat, but will be included in the Commission 2015 autumn forecast. On the other hand, if the rapid growth in tax revenues observed until August keeps momentum, this would lead to a better-than-expected deficit outcome

On the basis of the DBP, in 2015 the structural deficit[3] is expected to decrease by ¼ pp. and reach 1.6% of GDP in 2015, which is 0.1 pp. lower than in the Stability Programme. In 2016, the DBP forecasts the structural deficit in Spain to remain virtually unchanged at 1.6% of GDP, the same level as in the Stability Programme. The ad hoc Commission forecast estimates the structural deficit to widen by about ½ pp. to reach 2.3% of GDP in 2015, and then to widen slightly further to 2.5% of GDP in 2016.

Very notable differences in the appraisal of one-offs, in particular in 2015, contribute to the different estimates of the *change* of the structural balance. In particular, several temporary

[2] The authorities reported a deficit for 2014 of EUR 61.3 bn (marginally smaller than the figure validated by Eurostat in spring 2015), which based on updated lower GDP figures translates into a deficit of 5.9% of GDP (against 5.8% in spring). Excluding bank recapitalisations, the 2014 deficit is reported as 5.8% of GDP.

[3] As recalculated by the Commission services on the basis of the information provided in the DBP, using the commonly agreed methodology. Note that this recalculation results in values for the structural balance that differ significantly from those reported in the DBP, which amount to -0.7% and -0.5% of GDP for 2015 and 2016, respectively.

deficit-increasing measures classified as one-off in the DBP do not qualify as one-off according to the Commission classification[4].

[4] Several deficit increasing measures classified as one-off in the DBP, such as the return over 2015-2016 of the unpaid 2012 Christmas bonus (0.2% of 2015 GDP), the advancement of the second leg of the personal income tax reform initially foreseen for 2016 to July 2015 (0.1% of 2015 GDP) and measures to reduce social security contributions for new open-ended contracts (0.1% of GDP in 2015) do not qualify as one-off according to the Commission classification, as they are deficit-increasing and fully under the control of the government.

Table 2. Composition of the budgetary adjustment[5]

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**37.8**	**37.8**	***37.8***	**37.9**	**37.8**	***38.0***	**38.0**	**0.2**
of which:								
- Taxes on production and imports	11.2	11.3	*11.5*	11.5	11.4	*11.6*	11.6	0.4
- Current taxes on income, wealth, etc.	10.0	9.9	*9.9*	10.0	9.7	*10.0*	9.9	0.0
- Capital taxes	0.5	0.5	*0.5*	0.5	0.5	*0.6*	0.5	0.0
- Social contributions	12.3	12.3	*12.0*	12.0	12.3	*12.0*	12.0	-0.2
- Other (residual)	3.8	3.8	*3.9*	3.9	3.9	*3.8*	3.9	0.0
Expenditure	**43.6**	**42.0**	**42.1**	**42.4**	**40.6**	**40.7**	**41.4**	**-2.8**
of which:								
- Primary expenditure	40.3	38.9	39.0	39.4	37.7	37.9	38.6	-2.4
of which:								
Compensation of employees	10.8	10.5	10.7	10.8	10.1	10.4	10.6	-0.4
Intermediate consumption	5.2	5.0	5.1	5.1	4.8	4.9	5.0	-0.3
Social payments	18.8	18.1	18.0	18.1	17.7	17.5	17.7	-1.2
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	-0.1
Gross fixed capital formation	2.0	1.9	1.9	2.0	1.9	1.9	1.9	-0.1
Other (residual)	2.5	2.4	2.3	2.4	2.2	2.2	2.4	-0.3
- Interest expenditure	3.3	3.1	3.1	3.1	2.8	2.8	2.9	-0.4
General government balance (GGB)[1]	**-5.8**	**-4.2**	**-4.2**	**-4.5**	**-2.8**	**-2.8**	**-3.5**	**3.0**
Primary balance	**-2.5**	**-1.1**	**-1.2**	**-1.5**	**0.1**	**0.1**	**-0.6**	**2.6**
One-off and other temporary	-0.4	-0.3	-0.5	-0.1	-0.1	-0.3	0.0	0.0
GGB excl. one-offs	**-5.4**	**-3.9**	**-3.7**	**-4.4**	**-2.7**	**-2.4**	**-3.5**	**3.0**
Output gap[2]	-6.7	-4.0	-3.9	-3.8	-2.0	-1.5	-1.8	6.8
Cyclically-adjusted balance[2]	-2.2	-2.0	-2.1	-2.5	-1.7	-2.0	-2.5	0.4
Structural balance (SB)[3]	**-1.8**	**-1.7**	**-1.6**	**-2.3**	**-1.6**	**-1.6**	**-2.5**	**0.3**
Structural primary balance[3]	1.4	1.3	1.4	0.7	1.2	1.2	0.4	-0.1

Notes:

[1]For 2014, the general government deficit includes bank recapitalisations amounting to 0.1% of GDP.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

N.B. The ad-hoc Commission forecast does not incorporate revised GDP data reported in the September 2015 EDP notification

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan 2016 (DBP); Ad-hoc Commission forecast (COM); Commission calculations

3.2. Debt developments

[5] The ad-hoc Commission forecast does not factor in the revised deficit data for 2014 notified by the Spanish statistical office to Eurostat on 29 September 2015, as it is currently under validation by the latter.

The DBP foresees the debt-to-GDP ratio to peak at 98.7% of GDP in 2015, before declining to 98.2% of GDP in 2016. This is only slightly lower than the ratios presented in the Stability Programme. The decline in the debt ratio in 2016 is mainly driven by strong nominal GDP growth, which more than offset the effect of interest expenditure and a positive stock-flow adjustment. The DBP does not provide a breakdown of the various components of the stock-flow adjustment.

Compared with the DBP, the ad-hoc Commission forecast projects slightly higher debt ratios, mainly reflecting a lower primary balance in both 2015 and 2016 and lower nominal GDP growth. The ad-hoc Commission forecast foresees the debt-to-GDP ratio to reach 99.0% in 2015 and 99.5% in 2016.

Debt projections in the DBP as well as in the ad-hoc Commission forecast do not yet reflect the data recently published by the General State Comptroller (IGAE) and notified by Spain's statistical office to Eurostat on 29 September 2015, which report a debt-to-GDP ratio of 99.4% of GDP in 2014 and which would also point to a higher planned debt ratio for 2015, at 99.7% of GDP.

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**97.7**	**98.9**	**98.7**	**99.0**	**98.5**	**98.2**	**99.5**
Change in the ratio	5.6	1.2	1.0	1.3	-0.4	-0.6	0.5
Contributions[2]:							
1. Primary balance	**2.5**	**1.1**	**1.2**	**1.5**	**-0.1**	**-0.1**	**0.6**
2. "Snow-ball" effect	**2.4**	**-0.3**	**-0.5**	**-0.4**	**-0.8**	**-1.0**	**-0.6**
Of which:							
Interest expenditure	3.3	3.1	3.1	3.1	2.8	2.8	2.9
Growth effect	-1.3	-2.8	-3.1	-3.0	-2.8	-2.8	-2.6
Inflation effect	0.5	-0.6	-0.5	-0.5	-0.8	-1.0	-0.9
3. Stock-flow adjustment	**0.6**	**0.4**	**0.3**	**0.3**	**0.5**	**0.5**	**0.5**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

N.B. The ad-hoc Commission forecast does not incorporate revised GDP data reported in the September 2015 EDP notification.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan 2016 (DBP); Ad-hoc Commission forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The DBP reports an incremental consolidation effect resulting from discretionary measures of 0.6% and 0.3% of GDP in 2015 and 2016, respectively (see Table 4). In both years, this net effect stems solely from expenditure-based measures, as revenue-raising measures mostly at regional and local level are outweighed by the effects of the tax reform, which lowered personal and corporate income taxes. On the expenditure side, savings stem from efficiency-enhancing policies (as per the public administration reform), the continued implementation of the 2013 pension reform and various measures at the regional and local level.

Table 4. Main discretionary measures reported in the DBP[6]

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (%	
	2015	**2016**
Total taxes	-0.2	-0.2
Personal income taxes	-0.3	-0.1
Corporate taxes	0.0	-0.2
Fight against fraud	0.1	0.1
Others	0.0	0.1
Regional government	0.1	0.0
Local government	0.1	0.0
Social Security	0.0	0.1
Total	0.0	0.0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan 2016

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (%	
	2015	**2016**
Repayment of Christmas bonus and 1% pay hike	0.3	0.1
Public employment	-0.1	-0.1
Labour market measures	-0.1	0.0
CORA (public admin. reform)	-0.1	-0.1
Regional government (excl. public employment)	-0.3	0.0
Local government (excl. public employment)	-0.1	-0.1
Social security	-0.1	-0.1
Total	-0.6	-0.3

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan 2016

6 The table reports the incremental annual budgetary impact of main discretionary measures. The DBP reports also the incremental annual impact, however, not according to ESA2010 breakdown.

The ad-hoc Commission forecast takes into account incremental consolidation measures with a net-effect of about 0.3% of GDP in 2015 and below 0.1% of GDP in 2016. In particular, compared with the DBP, the forecast does not incorporate the still-to-be-adopted financial transactions tax and has a more conservative estimate of the budgetary impact of measures against tax fraud and on rebates regarding employers social security contributions for new open-ended hirings (for 2016 only). There are also notable differences in the assessment of reported non-tax measures at regional level (around 0.1% of GDP), which consist of the sale of administrative concessions and various real estate assets, for which the forecast sees the materialisation of implementation risks. Neither does the forecast include savings at regional level from the application of the new pharmaceutical and healthcare spending rule (see Section 5 for further details on the new spending rule). There is no evidence of any region having agreed to apply the new rule at the cut-off date of the forecast (the incentives for doing that have not yet been defined), nor has the Government's Delegated Committee for Economic Affairs decided to extend its implementation to 2016. The Commission services also consider that the reported measures for 2016 to restrain regions' intermediate consumption – other than the above-mentioned pharmaceutical spending rule – and current and capital transfers (totalling around 0.1% of GDP) have virtually no backing in the existing regions' economic and financial plans and have therefore not been taken on board in the ad-hoc Commission forecast. Moreover, the forecast only incorporates part of the reported savings from the implementation of the envisaged limitations to the new hirings civil service non-replacement rule, in light of latest developments in public sector employment. Lastly, on the 2013 local administration reform, the forecast does not incorporate savings originating from the transfer of health, education and social services from local entities to regional governments (around 0.05% of GDP), as these are not likely to have a net effect at general government level (i.e. the higher savings of local governments transferring those services to regions would correspond to higher expenditure by the regions).

4. Compliance with the provisions of the Stability and Growth Pact

For 2015, the DBP plans the headline deficit to decrease to 4.2% of GDP, in line with the EDP headline target. The Stability Programme already targeted a deficit of 4.2% of GDP, with lower underlying GDP growth. In fact, despite steadily improving GDP growth forecasts, the target has been unchanged since the 2014 DBP issued in October 2013. With the deficit forecast to reach 4.5% of GDP in 2015 according to the ad-hoc Commission forecast, and also taking into account the information received from the 29 September EDP notification, Spain is not expected to reach the headline target for 2015 recommended under the EDP. Furthermore, while the latest recommendation issued on 21 June 2013 under Article 126(7) of TFEU ('the 2013 EDP recommendation') requires Spain to achieve an improvement in the structural balance of 0.8% of GDP in 2015, the DBP foresees an improvement limited to 0.2% of GDP (based on the structural balance as recalculated on the basis of the information in the DBP, using the commonly agreed methodology). The ad-hoc Commission forecast points to an expected deterioration in the structural balance by 0.5 pp., more than 1¼ pps. below what was recommended.

Accounting for revisions in the potential output growth estimate and unexpected revenue windfalls/shortfalls since the time of the 2013 EDP recommendation, the estimated corrected change in the structural balance amounts to -0.6% of GDP in 2015, i.e. 1½ pps. below the effort required in the 2013 EDP recommendation[7]. In cumulative terms over 2013-2015, Spain is expected to achieve an (uncorrected) improvement in the structural balance of 1.0% of GDP, which is below the cumulative target of 2.7% of GDP. In the same period, the cumulated corrected improvement in the structural balance is estimated at 0.0% of GDP, 2.7 pps. below the recommended effort[8].

The 2013 EDP recommendation requires Spain to adopt additional measures in 2015 of around 1% of GDP. However, according to a bottom-up assessment (which estimates the size of the fiscal effort for 2015 on the basis of the additional revenue measures taken and the expenditure developments under the control of the government between the EDP scenario and the ad-hoc Commission forecast), Spain is expected to record an effort of -0.4% of GDP in 2015, which is 1.4 pps. lower than what was required[9]. In cumulative terms over 2013-2015, the fiscal effort based on this method amounts to 0.8% of GDP, against a required effort of 3% of GDP.

For 2016, the headline balance forecast in the DBP is in line with the EDP target of 2.8% of GDP. However, the achievement of the planned headline deficit target may be subject to risks. In particular, according to the ad-hoc Commission forecast, the general government deficit is forecast to stand at 3.5% of GDP in 2016, about ¾ pp. higher than the EDP target.

The 2013 EDP recommendation requires Spain to achieve an improvement of the structural balance of 1.2% of GDP in 2016. However, the DBP foresees no change in the structural balance as recalculated using the commonly agreed methodology. In turn, the ad-hoc Commission forecast projects the structural deficit to deteriorate by 0.2 pp. in 2016. Correcting for the change in the estimated potential growth between the projections underlying the 2013 EDP recommendation and the ad-hoc Commission forecast, as well as revenue windfalls/shortfalls, the estimated change in the structural balance would be -0.4 pps. This is about 1½ pps. below the recommended structural effort.

On a cumulative basis over 2013-2016, the estimated shortfall amounts to 3.1 pps. when measured against the uncorrected change in the structural balance, and to 4.4 pps. when corrected.

Finally, the bottom-up estimate of the fiscal effort in 2016 is -0.2% of GDP. This falls short of the target of about 1¾% of GDP of measures deemed necessary in 2016 to reach the structural targets spelled out in the 2013 EDP recommendation, leading to an underperformance of 3.8 pps. of GDP in cumulative terms over 2013-2016.

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7 Most of the difference between the uncorrected and corrected structural balance is due to the impact of revisions in potential output growth compared to that underlying the growth scenario in the recommendation.

8 However, specifically at the turning point of the cycle, developments in the structural balance may tend to somewhat underestimate the true fiscal effort. In particular, estimates of the potential growth seem to bottom-out at still negative values, while real GDP growth returns firmly into positive territory, thus possibly leading to some overestimation of the cyclical component of fiscal consolidation.

9 However, the exclusion of unemployment benefit payments related to the evolution of the number of unemployed from the usual metric for the bottom-up effort may in the case of Spain lead to some underestimation of the fiscal effort. In particular, measures taken specifically to target (unwarranted) access to the unemployment benefit system may have contributed to fiscal consolidation, although not showing in this particular metric for fiscal effort. Also, long-term unemployed leaving the unemployment benefit system and turning to social assistance schemes may further reduce the effort as measured by this metric.

Box 2. Council recommendations addressed to Spain

On 21 June 2013, the Council recommended Spain under Art 126(7) of the Treaty to correct its excessive deficit by 2016. To this end:

- Spain should put an end to the present excessive deficit situation by 2016.

- Spain should 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 services' 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 the years 2013-2016 respectively.

- Spain should implement the measures adopted in the 2013 budget plans at all levels of government and stand ready to take corrective action in case of deviations from budgetary plans. The authorities should reinforce the medium-term budgetary strategy with well-specified structural measures for the years 2014-16 that are necessary to achieve the correction of the excessive deficit by 2016.

- The Council establishes the deadline of 1 October 2013 for the Spanish government to take effective action and, in accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

Furthermore, the Spanish authorities should (i) strengthen the effectiveness of the institutional framework by raising further the transparency in implementation of the Budgetary Stability Law as well as by establishing an independent fiscal council to provide analysis, advice and monitor compliance of fiscal policy with national and EU fiscal rules, (ii) undertake concrete steps to rein in the increasing structural deficit in the social security system, and (iii) give a greater emphasis to the growth friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system.

On 14 July 2015, the Council also addressed recommendations to Spain in the context of the European Semester. In particular, in the area of public finances the Council recommended to Spain to:

- Ensure a durable correction of the excessive deficit by 2016 by taking the necessary structural measures in 2015 and 2016 and using windfall gains to accelerate the deficit and debt reduction.

- Strengthen transparency and accountability of regional public finances.

- Improve the cost-effectiveness of the healthcare sector, and rationalise hospital pharmaceutical spending.

Table 5. Compliance with the 2013 EDP recommendation[10]

(% of GDP)	2014	2015		2016	
	COM	DBP	COM	DBP	COM
Headline balance					
Headline budget balance	-5.8	-4.2	-4.5	-2.8	-3.5
EDP requirement on the budget balance	-5.8	-4.2		-2.8	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	0.3	0.2	-0.5	0.0	-0.2
Cumulative change[2]	1.5	1.7	1.0	1.7	0.8
Required change from the EDP recommendation	0.8	0.8		1.2	
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[3]	-0.2	-	-0.6	-	-0.4
of which: *correction due to change in potential GDP estimation (α)*	-0.5	-	-0.1	-	0.0
correction due to revenue windfalls/shortfalls (β)	0.0	-	-0.1	-	0.3
Cumulative adjusted change [2]	0.5	-	0.0	-	-0.5
Required change from the EDP recommendation	0.8	0.8		1.2	
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)[4]	1.3	-	-0.4	-	-0.2
Cumulative fiscal effort (bottom-up)[2]	1.2	-	0.8	-	0.7
Requirement from the EDP recommendation	2.0	1.0		1.5	
Cumulative requirement from the EDP recommendation	2.0	3.0		4.5	

Notes

[1]Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on DBP are recalculated by Commission on the basis of the Draft Budgetary Plan scenario using the commonly agreed methodology. Change compared to t-1.

[2] Cumulated since the latest EDP recommendation.

3 Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.

[4]The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

Source :

Draft Budgetary Plan 2016 (DBP); Ad-hoc Commission forecast (COM); Commission calculations.

[10] The ad-hoc Commission forecast does not factor in the revised deficit data for 2014 notified by the Spanish statistical office to Eurostat on 29 September 2015, as it is currently being validated by the latter.

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

The Draft Budgetary Plan reports on progress towards compliance with the country specific recommendations issued by the Council in the context of the 2015 European Semester, particularly those relating to fiscal governance. Spain has made some progress to comply with these recommendations. Specifically:

- The latest policy developments in response to the 2015 country specific recommendations for Spain consist of the approval in mid-June 2015 of a new fiscal rule on healthcare spending for application at regional level. Regional governments adhere on a voluntary basis to the new rule set out in Spain's healthcare law (i.e., law 14/1986, as amended). They then commit to limiting growth on healthcare and pharmaceutical spending to the last published reference rate of medium-term growth of the Spanish economy's gross domestic product. In exchange, participating regional governments would become eligible for financial incentives (still to be) agreed by the ministry of finance with the health industry. Should eligible spending exceed the abovementioned reference rate, then the region concerned would be prevented from offering healthcare services other than those included in the common basket of health services and would be asked to apply efficiency-enhancing measures adopted by the Government's Delegated Committee for Economic Affairs. The new rule is intended to be in force in 2015 only although it can be extended to 2016 following an agreement of the above mentioned government committee. At the cut-off date of this report, there was no evidence of regions having subscribed to the new mechanism (as the set of incentives for those had not been completed), neither had the Government's Delegated Committee for Economic Affairs decided on any extension of the mechanism beyond 2015.

- The Council also recommended the Kingdom of Spain to increase transparency and accountability in region's public finances. Linked to the above, the ministry of finance is expected to start publishing detailed data on regional government's spending on health and pharmaceutical products in October 2015 –with data referred to June this year. Notwithstanding progress made, there remains room for achieving greater convergence of budgetary codes, budgetary documents, accompanying tables and public accounting rules for regional governments in the interest of transparency and to improve budget procedures.

- Last, the DBP makes explicit reference to other non-fiscal recommendations. The Commission will assess the progress made in implementing the country specific recommendations in February 2016.

6. OVERALL CONCLUSION

Based on the ad-hoc Commission forecast, the headline budgetary deficit is expected to decrease from 5.8% of GDP in 2014[11] (including bank support of 0.1% of GDP) to 4.5% in 2015 and to decline further to 3.5% of GDP in 2016. The improvement in the headline budgetary deficit planned in the Draft Budgetary Plan towards correction of the excessive deficit in 2016, the deadline set in the EDP recommendation, relies mainly on revived nominal GDP growth, with somewhat optimistic underlying growth assumptions in 2016; expenditure restraint also plays a role but some of the planned savings are not yet underpinned by specified measures. Accordingly, based on the ad-hoc Commission forecast, Spain is not expected to achieve the budgetary headline targets set in the EDP recommendation, as the Commission foresees a deficit of 4.5% and 3.5% of GDP in 2015 and 2016, respectively. There are both positive and negative risks to the deficit projections in the ad-hoc Commission forecast. On the one hand, the deficit-to-GDP ratio outcome of 2014, published by the General State Comptroller (IGAE) and notified by Spain's statistical office to Eurostat after submission of the Draft Budgetary Plan, implies a slightly worse starting position for 2015. On the other hand, if the rapid growth in tax revenues observed until August keeps its momentum, this would lead to a better-than-expected deficit outcome. As regards the structural effort, the expected improvement in the structural balance falls considerably short of the fiscal effort required under the EDP in both 2015 and 2016, regarding both the uncorrected and the corrected change in the structural balance. Compared to the baseline scenario in the 2013 EDP recommendation, based on bottom-up calculations, the planned reduction of the deficit is not based on any additional consolidation effort, as the bottom-up method indicates an annual effort of around -0.4% of GDP in 2015 and -0.2% in 2016. Therefore, for both 2015 and 2016, the amount of additional measures specified in the Draft Budgetary Plan is clearly below what was deemed necessary to reach the structural targets spelled out in the EDP recommendation.

Spain has made some progress to comply with the country specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance. While since June 2015 there is a new voluntary mechanism in law to encourage regional governments to limit spending on healthcare, so far there is no evidence of any regional government having subscribing to it, as the set of incentives for those has not been completed as of yet. Moreover, there remains room to achieve greater convergence of budgetary codes and public accounting rules practises at regional level in the interest of transparency and to improve budget procedures.

[11] The ad-hoc Commission forecast does not factor in the revised deficit data for 2014 notified by the Spanish statistical office to Eurostat on 29 September 2015, as it is currently under validation by the latter.

Annex. EDP related tables

Table A1. Baseline scenario underlying the EDP recommendation

% of GDP	2013	2014	2015	2016
Revenues	36.8	35.9	36.1	36.1
Current revenues	36.6	35.4	35.6	35.5
Discretionary measures with impact on current revenue (EUR bn)	15.8	-11.3	2.1	0.0
Expenditure	43.3	42.9	42.2	41.6
Real GDP growth (%)	-1.5	0.9	1.4	1.9
Nominal GDP growth (%)	0.1	2.0	2.6	3.2
Potential GDP growth (%)	-1.4	-1.5	-0.1	0.6
Structural balance	-4.4	-5.5	-5.7	-5.9
General government balance	-6.5	-7.0	-6.0	-5.6
p.m CAB methodology revenue elasticity	1.0	1.0	1.0	1.0
p.m Apparent revenue elasticity	-24.4	1.0	1.1	0.9
p.m Output gap (% of pot. Output)	-4.6	-2.3	-0.8	0.6

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in Spain {COM(2013) 383 final}

Table A2. EDP scenario underlying the EDP recommendation

% of GDP	2013	2014	2015	2016
Real GDP growth (%)	-1.5	-0.5	0.7	0.9
Potential GDP growth (%)	-1.4	-1.5	-0.1	0.6
Structural balance	-4.4	-3.6	-2.8	-1.6
General government balance	-6.5	-5.8	-4.2	-2.8
p.m Output gap (% of pot. output)	-4.6	-3.8	-2.9	-2.6

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in Spain {COM(2013) 383 final}

Table A3. Current estimates of the macroeconomic and fiscal developments

% of GDP	2014	2015	2016
Revenues	37.8	37.9	38.0
Current revenues	37.2	37.3	37.4
Discretionary measures with impact on current revenue (EUR bn)	2.0	-1.1	-1.8
Expenditure	43.6	42.4	41.4
Real GDP growth (%)	1.5	3.1	2.7
Nominal GDP growth (%)	0.9	3.7	3.6
Potential GDP growth (%)	-0.2	0.1	0.5
Structural balance	-1.8	-2.3	-2.5
General government balance	-5.8	-4.5	-3.5
p.m CAB methodology revenue elasticity	1.0	1.0	1.0
p.m Apparent revenue elasticity	1.8	1.1	1.0
p.m Output gap (% of pot. Output)	-6.7	-3.8	-1.8

Source: Ad-hoc Commission forecast

Table A4. Changes in structural balance corrected for revisions in potential output gap and revenue windfalls/shortfalls

Uncorrected fiscal effort (ΔS)				Corrected fiscal effort (ΔS^*)				*Required fiscal effort in the latest Council recommendation (**R**)*				Deadline for correction
2013	**2014**	**2015**	**2016**	**2013**	**2014**	**2015**	**2016**	**2013**	**2014**	**2015**	**2016**	
1.4	0.3	-0.5	-0.2	0.9	-0.2	-0.6	-0.4	1.1	0.8	0.8	1.2	2016

Table A5. Adjustment of apparent structural effort for the revision in potential growth – details of calculation

	Pot. growth assumptions underlying the June 2013 recommendation (%) (1)	**Pot. growth (COM 2015 ad hoc forecast) (%) (2)**	**Forecast error (%) (3)=(2)-(1)**	**Structural expenditure (% of pot. GDP) (COM 2015 ad hoc forecast) (4)**	**Correction coefficient α (% of nominal pot. GDP) (5)=[(3) x (4)]/100**
2013	-1.4	-0.6	-0.9	40.1	-0.4
2014	-1.5	-0.2	-1.3	39.7	-0.5
2015	-0.1	0.1	-0.2	39.8	-0.1
2016	0.6	0.5	0.0	40.3	0.0

Table A6. Adjustment of the apparent structural effort for revenue shortfalls/windfalls as compared to standard elasticities – details of calculation

CAB methodology revenue elasticity ε*=1	**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 β**
	June 2013 reco. (1)	*2015 ad-hoc f'cast (1')*	*June 2013 reco. (2)*	*2015 ad-hoc f'cast (2')*	*June 2013 reco. (3)*	*2015 ad-hoc f'cast (3')*	*June 2013 reco. (4)*	*2015 ad-hoc f'cast (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	-0.6	383.4	390.4	0.8	0.1
2014	-4.1	4.5	-11.3	2.1	2.0	0.9	379.3	395.81	0.4	0.0
2015	12.6	15.5	2.1	-1.0	2.6	3.7	391.9	409.6	-0.6	-0.1
2016	11.6	15.5	0.0	-1.8	3.2	3.6	403.5	425.1	3.3	0.3