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COMMISSION OPINION

of 21.11.2018

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. The Draft Budgetary Plan for 2019 was submitted to the Commission and the Euro group on 15 October, without a draft Budget Law being submitted in parallel to the Spanish parliament. On the basis of that Draft Budgetary Plan for 2019, 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. On 8 August 2016, the Council gave notice to Spain under Article 126(9) TFEU to correct its excessive deficit by 2018.[1] Assuming a timely and durable correction of the excessive deficit, Spain will be subject to the preventive arm in 2019. On 13 July 2018, the Council recommended Spain to ensure that the nominal growth rate of net primary government expenditure does not exceed 0.6% in 2019, corresponding to an annual structural adjustment of 0.65% of GDP towards a medium-term objective of a balanced budget in structural terms.[2] Spain should use windfall gains to accelerate the reduction of the general government debt ratio. As its public debt is expected to amount to 96.9% of GDP in 2018, the year in which the excessive deficit is expected to be corrected, Spain also needs to make sufficient progress towards compliance with the debt reduction benchmark.

   As the Draft Budgetary Plan did not contain all the information required according to the Code of Conduct of the Two Pack[3] and did not give a complete picture of the planned measures, on 19 October 2018 the Commission sent a letter to the Spanish

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[1] According to that notice, Spain shall 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. This improvement in the general government deficit is consistent with a deterioration of the structural balance by 0.4 % of GDP in 2016 and a 0.5 % of GDP improvement in both 2017 and 2018, based on the updated Commission 2016 spring forecast.

[2] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Spain and delivering a Council opinion on the 2018 Stability Programme of Spain, OJ C 320, 10.9.2018, p. 33–38

[3] In particular, the Draft Budgetary Plan does not contain a no-policy change scenario, data on investment expenditure fully financed by EU funds, a break-down of one-offs in revenue and expenditure items and data on employment (hours worked) and labour productivity (hours worked).

authorities inviting them to provide the missing data and additional information on the measures. A reply was received on the same day and, over the subsequent days, the Commission received additional information, which has been taken into account in the Commission's assessment of budgetary developments and risks.

5. The Draft Budgetary Plan forecasts real GDP growth to reach 2.6% in 2018, in line with the Commission 2018 autumn forecast. For 2019, the Draft Budgetary Plan forecasts real GDP growth to slow to 2.3%, 0.1 percentage point higher than the Commission 2018 autumn forecast, with small differences in the composition of growth. In the Commission 2018 autumn forecast, employment growth is expected to be lower and wages to increase faster than in the Draft Budgetary Plan. In addition, lower real GDP growth and a smaller GDP deflator result in lower nominal GDP growth. Overall, the macroeconomic projections underlying the Draft Budgetary Plan are plausible. They have been endorsed by Spain's independent fiscal authority (Airef). In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament should be based on an independently endorsed macroeconomic forecast.

6. The Draft Budgetary Plan projects a headline deficit of 2.7% of GDP in 2018, which is in line with the Commission 2018 autumn forecast. In 2019, the Draft Budgetary Plan aims at reducing the deficit by 0.9 percentage points, which translates into a deficit target of 1.8% of GDP and an improvement of the structural balance[4] of 0.4% of GDP. The Commission 2018 autumn forecast expects the headline government deficit to narrow only to 2.1% of GDP in 2019 and the structural balance to remain unchanged. The difference is mainly due to a slightly weaker underlying trend in the Commission 2018 autumn forecast for revenues (mainly related to less buoyant social security contributions) and a smaller net deficit-reducing impact of the planned measures. Moreover, the Draft Budgetary Plan includes one-off expenditure of about 0.1% of GDP in its deficit forecast for 2019, relating to court orders affecting regional governments (including the cancellation of an ATLL water concession). By contrast, the Commission forecast treats it as a contingent liability. If that expenditure were to materialise, it would add to the difference between both forecasts.

7. The Draft Budgetary Plan reports new revenue and expenditure measures, amounting to 0.6% and 0.2% of GDP respectively in 2019, with a net deficit-reducing impact of 0.4%. Revenue measures include increases in direct taxation, namely on corporate income, the introduction of new taxes on financial transactions and on revenues from digital activities and measures to fight tax fraud. The Draft Budgetary Plan also factors in increased social security contributions induced by the increase in the minimum wage. Spending measures include the indexation of pensions to the consumer price index in 2018 and 2019 and increases in minimum and non-contributory pensions, as well as additional spending on education, social and R&D polices. The Commission 2018 autumn forecast estimates the impact of the measures at 0.4% of GDP for revenues and 0.3% of GDP for expenditure, i.e. a lower net deficit-reducing impact of 0.1% of GDP. The main difference stems from the revenue side, where the Commission forecast expects a lower yield of the financial transactions tax and the tax on revenues from digital activities and makes a cautious ex-ante assessment of the measures to fight tax fraud. In addition, the Commission

[4] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

forecast only treats as a measure the additional social security contributions induced by the increase in the minimum wage through the automatic adjustment of the minimum contributory base, while the additional contributions paid by minimum wage earners are treated as a second-round effect.

8. Some of the planned revenue-increasing measures (and in particular, the increase of the minimum social contribution base) increase the tax burden on labour. Net of the impact of one-off transactions, the investment ratio is planned to remain unchanged in 2019 compared with 2018. In order to strengthen its fiscal framework, in the Council Decision of 8 August 2016[5], the Council also requested Spain to take measures by increasing the automaticity of mechanisms to prevent and correct deviations from the fiscal targets and strengthening the contribution to fiscal consolidation of the spending rule. The Draft Budgetary Plan does not report plans in those areas. The Council also requested Spain to take measures to improve its public procurement policy framework. Spain adopted a new law on public sector contracts in November 2017. A new governance structure has been created, but the adoption of the planned Procurement Strategy is delayed.

9. The plausibility tool developed by the Commission in consultation with Member States points to a high degree of uncertainty surrounding the output gap estimate provided by the commonly agreed methodology. That uncertainty has been reflected in the Council Recommendation of 13 July 2018, which includes an adjustment requirement of 0.65% of GDP for 2019 instead of the requirement of 1% of GDP.

10. Both the Draft Budgetary Plan and the Commission 2018 autumn forecast project that the headline deficit target of 2.2 % of GDP for 2018 required by the Council Decision of 8 August 2016 will not be achieved. In addition, the required fiscal effort is not expected to be met, according to all usual metrics. However, at 2.7 % of GDP, the headline deficit is forecast to be below the Treaty reference value of 3.0% in 2018, in line with the deadline set by the Council.

In 2019, for Spain to comply with the requirements of the preventive arm, the nominal growth rate of net primary government expenditure[6] should not exceed 0.6%, corresponding to an annual structural adjustment of 0.65% of GDP. The Draft Budgetary Plan targets a face-value growth rate of nominal expenditure of 1.7%, but that figure is not adjusted for the impact of one-off measures. The growth rate of net primary expenditure as recalculated by the Commission on the basis of the Draft Budgetary Plan is 2.2%, which corresponds to a gap to the required growth rate of ¬0.6% of GDP. The improvement in the recalculated structural balance in the Draft Budgetary Plan amounts to 0.4% of GDP, implying a gap with the required adjustment of -0.3% of GDP. According to the Commission 2018 autumn forecast, the gaps are even larger, at -1.1% of GDP for the expenditure benchmark and -0.6 % of GDP for the structural balance. It points to a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.

[5] Council Decision (EU) 2017/984 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, OJ L 148, 10.6.2017, p. 38.

[6] As part of the agreement on the EFC Opinion on "*Improving the predictability and transparency the SGP: a stronger focus on the expenditure benchmark in the preventive arm"*, which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

11. The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will decline from 97.0% in 2018 to 95.5% in 2019, below the Commission's projection of 96.2%. Both according to the Draft Budgetary Plan and the Commission 2018 autumn forecast, Spain is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019, which would require an improvement of the structural balance of 0.6% of GDP.

12. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Spain is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, the Commission projects a risk of significant deviation from the required adjustment path to the medium-term budgetary objective. Moreover, Spain is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019. Therefore, the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2019 budget will be compliant with the SGP and to use windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

13. The Commission is also of the opinion that Spain has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 13 July 2018 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of those recommendations will be made in the 2019 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in May 2019.

In light of the fact that the Draft Budgetary Plan was submitted without a draft Budget Law being submitted to the national parliament in parallel, the national authorities are invited to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan in the event that the draft Budget Law that eventually is submitted to the parliament differs significantly from the Draft Budgetary Plan submitted on 15 October 2018.

Done at Brussels, 21.11.2018

For the Commission
Pierre MOSCOVICI
Member of the Commission