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COMMISSION OPINION

of 22.11.2017

on the Draft Budgetary Plan of Spain

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SPAIN

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 16 October 2017 by Spain, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. In the absence of a 2018 budget law, which is delayed compared to its legal schedule, the budgetary projections for 2018 in the Draft Budgetary Plan are made on the basis of unchanged policies. This includes the policy measures that the government has adopted to date, but no new planned measures for 2018. As emphasised in the Commission's letter to the Spanish authorities on 27 October 2017, it is important to ensure a timely submission of a complete Draft Budgetary Plan. In its reply on 30 October 2017, Spain has committed to submit an updated Draft Budgetary Plan as soon as the budget law has been presented to parliament.
5. Spain is currently subject to the corrective arm of the SGP. The Council opened the Excessive Deficit Procedure (EDP) 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 2018.¹ According to that Council Decision, Spain has 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. 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.
6. Overall, the macroeconomic projections underlying the Draft Budgetary Plan are plausible with regard to real GDP growth in 2017 and 2018, although subject to notable uncertainty in 2018. In 2017, the Draft Budgetary Plan forecasts that real GDP growth will reach 3.1%, 0.4 percentage point higher than in the Stability Programme, but in line with the Commission 2017 autumn forecast. The Draft Budgetary Plan projects somewhat more dynamic growth in employment and wages

¹ 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 148/38).

than the Commission forecast, as well as a slightly higher GDP deflator, resulting in higher nominal GDP growth. For 2018, the Draft Budgetary Plan forecasts that real GDP growth will slow to 2.3 %, 0.2 percentage point lower than the Stability Programme. The Draft Budgetary Plan attributes the now stronger deceleration of growth to, among others, increased uncertainty arising from the recent events in Catalonia. The Commission 2017 autumn forecast also projects that real GDP growth will slow down in 2018, but to 2.5 %. This slightly higher growth rate reflects the fact that the Commission forecast does not incorporate the impact of the uncertainty related to the recent events in Catalonia, while acknowledging the risk that future developments could have an impact on growth, the size of which cannot be anticipated at this stage. Despite lower growth of real GDP and private consumption, the Draft Budgetary Plan expects employment growth to be higher than in the Commission forecast.

7. Spain complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the *Autoridad Independiente de Responsabilidad Fiscal* (AIReF). AIReF also flagged downward risks linked to future developments in Catalonia.
8. The Draft Budgetary Plan deficit forecast for 2017 is unchanged compared with the Stability Programme, at 3.1 % of GDP. This is also the deficit projected in the Commission 2017 autumn forecast, although the Commission forecast projects that revenues from income taxes and social contributions will be slightly lower, which is offset by lower interest expenditure. In 2018, the Draft Budgetary Plan forecasts a deficit of 2.3 % of GDP, 0.1 percentage point higher than in the Stability Programme, driven by the downward revision to projected GDP growth and in the absence of new measures. The Commission 2017 autumn forecast projects a deficit of 2.4 % of GDP. The Draft Budgetary Plan forecast includes 0.2 % of GDP of investment linked to the expected settlement regarding distressed toll motorways, which it treats as one-off expenditure. The Commission 2017 autumn forecast treats this as a contingent liability, rather than including it in the deficit forecast. Excluding this element reveals a larger underlying difference (0.3 % of GDP) between the Draft Budgetary Plan and the Commission forecast regarding the 2018 deficit. Despite lower real GDP growth than in the Commission forecast, the Draft Budgetary Plan assumes stronger growth of income tax revenues and social contributions, based on stronger employment growth projections. While the Draft Budgetary Plan projects the recalculated structural deficit² to narrow from 3.3 % in 2016 to 2.8 % in 2017 and 2.5 % of GDP in 2018, the Commission forecast projects a smaller reduction, to 3.1 % of GDP in both 2017 and 2018, due to both lower structural revenues and higher structural primary spending, partly offset by lower interest expenditure. The Draft Budgetary Plan in fact projects that interest expenditure will stabilise at 2.6 % of GDP in 2017 and 2018 (down from 2.8 % in 2016), whereas the Commission forecasts a steeper decline to 2.5 % of GDP in 2017 and 2.3 % in 2018. This implies that the Draft Budgetary Plan forecasts an improvement in the structural primary balance of 0.5 percentage point over the 2016-18 period, compared with a 0.3 percentage point worsening in the Commission forecast. The projection for the gross debt ratio has been revised down by 0.7 % of GDP in both 2017 and 2018 in the

² Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

Draft Budgetary Plan compared with the Stability Programme, mostly reflecting a downward revision in the expected debt-increasing stock-flow adjustment. The ratio is projected to reach 98.1 % and 96.8 % of GDP in 2017 and 2018, respectively, only marginally lower than in the Commission 2017 autumn forecast. The main risks to budgetary targets and debt projections in the Draft Budgetary Plan stem from uncertainties regarding macroeconomic developments, in particular employment growth, and the absence of a 2018 budget. Although the Draft Budgetary Plan incorporates a budgetary impact of the possible settlement regarding distressed toll motorways of 0.2% of GDP in 2018, the final impact is difficult to assess and it cannot be excluded that the impact may be larger.

9. For 2017, according to the Commission 2017 autumn forecast, the headline deficit target of 3.1 % of GDP is expected to be achieved. The fiscal effort would fall 0.3 % of GDP short of the change in the structural balance required by the Council Decision of 8 August 2016. Adjusted for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendation, the shortfall would be 0.2% of GDP. On a cumulative basis over 2016-2017, the estimated shortfall amounts to 0.7% of GDP in unadjusted terms, and to 0.3% of GDP when adjusted. The bottom-up estimate of the fiscal effort in 2017 is 0.3 % of GDP, 0.2% of GDP below the requirement. However, given the 0.2% of GDP effort in 2016, when no extra effort was required, the bottom-up requirement is met on a cumulative basis over 2016-2017. For 2018, the Commission 2017 autumn forecast points to a headline deficit of 2.4 % of GDP, 0.2% of GDP above the requirement. It also forecasts no change in the structural balance, measured both on an unadjusted and an adjusted basis, which implies a shortfall of about 0.5% of GDP compared to the required structural effort. On a cumulative basis over 2016-2018, the estimated shortfall amounts to 1.3 % of GDP when measured against the unadjusted change in the structural balance, and to 0.8 % of GDP when adjusted. The bottom-up estimate of the fiscal effort in 2018 is -0.1 % of GDP, 0.6% of GDP below the target for both that year and the cumulative target for 2016-2018.
10. The Council Decision of 8 August 2016 also called on Spain to strengthen its fiscal and public procurement policy frameworks. As the 2017 Stability Programme, the 2018 Draft Budgetary Plan does not report on plans to review the Stability Law's spending rule or to make more automatic the implementation of the mechanisms to prevent and correct deviations from the fiscal targets. Regarding public procurement, on 19 October 2017, the Spanish parliament adopted a new law on public sector contracts, intended to address the need for a consistent framework ensuring transparency, effective control mechanisms and coordination across government levels in the field of public procurement. The measures in the law can improve public procurement practices in Spain. Much of their success will, however, depend on the way the new governance structure provided for in the law operates, the degree of ownership of the new public procurement framework by all government levels and the ambition of decisions taken at the time of implementation, such as on the content of the national procurement strategy. On 2 June 2017, Spain's Council of Ministers commissioned AIREF to carry out by the end of 2018 a spending review, focusing on public subsidies. Finally, the fiscal adjustment between 2011 and 2017 appears to have been driven by broadly similar contributions from the revenue and primary expenditure sides. Based on the information provided in the Draft Budgetary Plan, fiscal consolidation in 2018 is likely to come mainly from the expenditure side, with expenditure growing at a slower pace than nominal GDP. The public-spending-to-GDP ratio stood at 45.8% of GDP in 2011 and, after peaking at 48.1 % in 2012, it is

projected to have fallen to 41.1% in 2017 as a result of expenditure restraint and a recovery in nominal GDP. This fall appears to have been mostly driven by a drop in gross fixed capital formation, continuing a trend that started in 2009 under the pressure of the emerging social spending demands and, more broadly, fiscal consolidation needs following the crisis.

11. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Spain, which is currently under the corrective arm of the SGP, is broadly compliant with the provisions of the SGP as the Commission 2017 autumn forecast projects that the excessive deficit will be corrected in a timely manner. However, – while acknowledging the no-policy-change nature of the Draft Budgetary Plan projections – neither the Commission forecast nor the Draft Budgetary Plan project the headline deficit target set by the Council Decision to be met in 2018. Also the required fiscal effort in 2018 is not projected to be met by a wide margin.

The Commission is also of the opinion that Spain has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Decision of 8 August 2016 and in the Council Recommendation³ of 11 July 2017 in the context of the 2017 European Semester, calling for a strengthening of Spain's fiscal and public procurement policy frameworks. It thus invites the authorities to make further progress. A comprehensive assessment will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

The authorities are invited to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan, as soon as the government is able to present a draft budget law, and as a rule at least one month before the draft budget law is planned to be adopted by the national parliament, to allow an assessment of compliance with the SGP and in particular the provisions of the Council Decision of 8 August 2016.

Done at Brussels, 22.11.2017

For the Commission
Pierre MOSCOVICI
Member of the Commission

³ OJ C 261, 9.8.2017.