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COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Spain

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(Only the Spanish text is authentic)

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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, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact 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 by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission[3]. As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the European Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU[6], alongside the proposal for the reinforced long-term budget of the EU for 2021-2027[7]. This proposal includes the

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1 Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

2 The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

3 https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

4 Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

5 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

6 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

7 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

establishment of a Recovery and Resilience Facility offering large-scale financial support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING SPAIN

5. On 15 October 2020, Spain submitted its Draft Budgetary Plan for 2021. On the basis of that document, the Commission has adopted an opinion in accordance with Article 7 of Regulation (EU) No 473/2013. The Draft Budgetary Plan was submitted without a draft budget bill being sent in parallel to the parliament. The latter was submitted only two weeks later after a period of continued budget negotiations.

6. On 20 July 2020, the Council recommended Spain[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Spain to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Spain's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value and Spain did not make sufficient progress towards compliance with the debt reduction benchmark in 2019. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled and that the debt criterion was not complied with. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the Spanish economy is expected to contract by 12.4% in 2020 and to grow by 5.4% in 2021. According to the Draft Budgetary Plan, the Spanish economy is expected to contract by 11.2% in 2020 before rebounding by 9.8% in 2021, driven by the fall and subsequent recovery of domestic demand, in particular private consumption. Unlike the forecast underpinning the Draft Budgetary Plan, the Commission forecast does not incorporate the potentially significant positive impact on economic growth of a policy package for 2021 to be funded by the Recovery and Resilience Facility. According to government estimates, assuming a full and swift absorption and high multipliers, it would increase real GDP growth by about 2.5 percentage points in 2021. The government also expects employment to contract in 2020 and to rebound thereafter, reflected in the unemployment rate reaching 17.1% in 2020, before falling back to 16.3% in 2021. The recovery is expected to be uneven across sectors. The manufacturing sector is set to resume activity more quickly than the services sector, where restrictions are expected to remain in place for longer, impacting in particular tourism-related activities such as transport and food and accommodation services.

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8 Council Recommendation of 20 July 2020 on the national Reform Programme of Spain and delivering a Council opinion on the 2020 Stability Programme of Spain, OJ C 282, 26.8.2020, p 54.

Overall, the macroeconomic projections underpinning the 2021 Draft Budgetary Plan imply considerably stronger economic growth than those of the Commission 2020 autumn forecast, in particular in 2021, primarily on account of the inclusion of the possible impact of a package of expenditure to be funded through the Recovery and Resilience Facility. Moreover, the projections in the Draft Budgetary Plan predate the introduction of stricter measures to contain the second wave of the COVID-19 pandemic, and do not assume a change in the trade relationship with the UK as of January 2021, both of which feature in the later Commission forecast.

Spain complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently-endorsed macroeconomic forecasts. In its endorsement of the forecasts, the National Fiscal Council (AIReF) nevertheless flagged the risk of less benign scenarios with lower growth, depending on the evolution of the COVID-19 pandemic and the implementation and impact of the Recovery and Resilience Facility and the other Next Generation EU funds.

8. For 2020, the Draft Budgetary Plan projects the general government deficit to rise to 11.3% of GDP. This increase in the government deficit by around 8½ percentage points compared to the preceding year results from both the normal working of automatic stabilisers, which is expected to lead to a contraction in revenue and an increase of cyclical expenditure, and from discretionary COVID-19-related measures. According to the 2021 Draft Budgetary Plan, the deficit ratio is expected to narrow to 7.7% of GDP in 2021, based on a macroeconomic scenario including the impact of a 2.2% of GDP policy package expected to be funded by the Recovery and Resilience Facility. However, the revenue/expenditure projections include only the fiscal impact on revenues of the assumed stronger economic growth resulting from expenditure under that Facility, not the aforementioned grants and expenditure themselves. For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place only in 2021, the Commission assumes in its budgetary projections for 2021 a 10% pre-financing of Recovery and Resilience Facility grants and treats it as a financial transaction with no impact on the budget balance, but with a government debt-reducing impact. In the case of Spain, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 6.4 billion in 2021.[9] On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast.[10] The evolution of the deficit in 2021 could turn out more favourable than the Commission forecast as a result of higher growth from the implementation of measures financed by the Recovery and Resilience Facility. In particular, the Commission 2020 autumn forecast projects the

[9] Indicative number based on the Council Presidency compromise proposal for the RRF regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[10] The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

general government deficit at 12.2% of GDP in 2020 and at 9.6% of GDP in 2021. The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will decline from 118.8% at the end of 2020 to 117.4% in 2021, while the Commission's projection points to an increase from 120.3% to 122.0% in those years, mainly due to the lower real GDP growth forecast.

As in other countries, the government has provided public guarantees to sustain economic activity and sectors particularly hit by the pandemic. Should these guarantees be called, this will be reflected in public debt and deficits in the future.

9. The Draft Budgetary Plan reports discretionary fiscal measures with a direct budgetary impact in 2020 of 5.5% of GDP, most of which were taken in response to the COVID-19 outbreak and its related economic effects of around EUR 60 billion. These consist of expenditure measures totalling EUR 59 billion (5.4% of GDP) and revenue measures equivalent to EUR 1 billion (0.1% of GDP). Expenditure measures in 2020 include additional spending on healthcare to cope with the medical emergency, support to workers and firms to safeguard employment, as well as income support to vulnerable groups. On the revenue side, measures in 2020 include some minor VAT reductions.

The Commission 2020 autumn forecast has taken on board the measures reported in the Draft Budgetary Plan, but with a lower estimate of their budgetary impact (1.3% of GDP). The Commission forecast considers a large share of the expenditure on short-time work schemes as part of the operation of the automatic stabilisers, whereas the budget appears to report the gross impact of these schemes. Similarly, some measures reported in the Draft Budgetary Plan such as the COVID-19 fund for regions, the salary increase in the public sector, and the pension indexation to consumer prices are incorporated implicitly in the baseline projections of the Commission forecast. About 0.3% of GDP worth of total measures are estimated to be not temporary.

Beyond the expenditure and revenue measures that have a direct impact on the deficit, the Draft Budgetary Plan also indicates liquidity support measures in 2020 of EUR 159 billion (14.4% of GDP), in the form of public loan guarantees, and tax deferrals within 2020 (EUR 18 billion or 1.6% of GDP). The take-up of the guarantees as of mid-October 2020 is estimated at 7.2% of GDP. Overall, the measures taken by Spain in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

10. For 2021, the Draft Budgetary Plan presents the phasing out of most of the 2020 measures and the implementation of a new tax package of about 0.6% of GDP. It also presents a set of recovery plans targeted at the sectors most affected by the COVID-19 crisis and additional transfers to sub-national levels of government to cope with the impact of the crisis. Most of the sectoral plans had not yet been specified in sufficient detail for them to be included in the Commission forecast.

The Commission 2020 autumn forecast includes about 0.1% of GDP of the new revenue measures as well as some new permanent expenditure measures of about 0.2% of GDP, including an ad-hoc revaluation of pensions by expected inflation (for the fourth consecutive year, overruling the revaluation mechanism still in force) and the full-year impact of the nationwide minimum income scheme, with an estimated impact 0.1% of GDP each in 2021. On the revenue side, the difference to the Draft Budgetary Plan is due to uncertainties surrounding the yield of some of the measures and the fact that some changes in taxation were not specified in sufficient details in the Draft Budgetary Plan. The 2021 draft budget law, which provided some more details, was submitted to the Parliament on 28 October, after the cut-off date of the Commission's forecast. Some forms of liquidity support are also expected to continue in 2021.

11. The Commission is of the opinion that the Draft Budgetary Plan of Spain is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Spain are supporting economic activity against the background of considerable uncertainty. Given the level of Spain's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, it is important for Spain to ensure that, when taking supportive budgetary measures, fiscal sustainability in the medium term is preserved. Spain is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

It is anticipated that Spain will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament

Done at Brussels, 18.11.2020

For the Commission
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