STABILITY PROGRAMME UPDATE

KINGDOM OF SPAIN

2013 - 2016

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1. INTRODUCTION

The Stability Programme and the Spanish National Reform Plan are two key documents for the design of economic policy, establishing objectives, measures and a specific timetable. They are two closely linked programmes from a functional standpoint, with a common macroeconomic scenario, a unified approach for the diagnosis of upcoming challenges and guidance with respect to the measures to be applied, and significant interrelations that reinforce the attainment of their respective objectives.

In this update, both documents are presented at the close of the 2012 reporting, a year which may be considered as a turning point for the Spanish economy since 2007, the year that marked the start of a deep and prolonged economic recession. This is because global and permanent solutions are being introduced in several areas essential to economic recovery, making progress in the correction of the existing significant imbalances. This occurred mainly in three areas: the financial system, the labour market and the public accounts.

With respect to public accounts, there have been two main novelties. From an institutional standpoint, the new Organic Law on Budgetary Stability and Financial Sustainability (LOEPSF) was approved. This law defines a framework for strict control over the budgets of all public sector agents and a strict fiscal rule of equilibrium throughout the cycle enabling the reconciliation of long-term sustainability with the short-term counter-cyclical role of fiscal policy. Secondly, for the first time since the beginning of the crisis, a systematic and coordinated effort within all the Public Administrations was undertaken to reduce the public deficit, which had remained at unsustainable levels since 2009.

The result is known. In a year in which activity contracted by 1.4%, making it the second year of greatest recessive intensity in the current crisis since 2009, the need for financing by the Public Administrations, net of one-offs related to the support of financial institutions, decreased by two percentage points of GDP, from 9% to 7%. This result was possible thanks to the application of discretionary measures of more than 4 percentage points of GDP and an effective structural effort, in accordance with the latest EC estimates in the order of 2.6% of GDP.

Last year, only financial and social expenditure increased. The former, mainly due to the size of the public deficit and the corresponding increase in debt. The latter, aside from expenses of a cyclical nature, because of pensions. Spain's fiscal history contains scarce precedents of consolidation of this magnitude carried out in such an adverse environment. Without the institutional framework provided by the Organic Law on Budgetary Stability and Financial Sustainability, most likely this task would have been impossible.

Attaining this objective has been essential. The credibility of public accounts has been substantially reinforced, with Spanish Public Administrations proving, even in the most adverse cyclical conditions, that they are capable of complying with the reduction of their excessive deficits, an obligation inherent to EU Member State status. Furthermore, it was revealed that the effective organisation of all levels of administration in order to reach a common goal is perfectly possible, even amidst widespread diversity in starting conditions and economic situations.

This progress in fiscal consolidation was expressed by a decrease in the interest rate differentials and an improved environment for the Treasury to cover its financing needs. Significant achievements have also taken place in the financing of the Regional Governments and Local Entities with initiatives such as the Regional Government ICO (Official Credit Institute) Maturity Facility, the Supplier Payment Fund and the Regional Liquidity Fund.

A debate is currently underway on the role of fiscal policy within academic circles and international organisations such as the EU and the IMF. This debate focuses on the intensity of the fiscal consolidation required, after verifying the determination of Eurozone countries to commit to correcting their levels of public deficit in a context of economic recession.

In the specific case of Spain, the significant fiscal effort made in 2012 could not be postponed, due to a situation that required decisive measures. The public accounts ended the fiscal year 2011 with a deficit of significant magnitude. Furthermore, highly notable deviation was recorded with respect to the objectives established, something that was unforeseen even as we approached the end of the fiscal year. Doubts over the capacity to control public accounts had a negative impact on the markets, reducing the credit rating of sovereign debt and making public and private financing difficult.

Therefore, in the case of Spain a dramatic consolidation effort was unavoidable in order to make it clear that a commitment to budgetary rigour had been assumed and to re-establish credibility in the control of public accounts. Thus, the medium-term strategy to remedy public accounts had to be based on firm action in which the effort to correct budgetary imbalances focused on the initial years, in order to recover the lost credibility and to maintain access to the capital markets.

Following completion of that phase, it is necessary to continue fiscal consolidation. The size of the current deficit levels and the evolution of long-term debt over the last five years make a clear adjustment strategy necessary.

However, this strategy must be consistent with the adverse economic environment. Accordingly, it is important to maintain the commitment with fiscal consolidation, complying with deficit reduction objectives, but in cyclically adjusted terms. In other words, instead of focusing the attention on the levels of nominal deficit, the objectives must be set in terms of a structural effort in line with the most recent positioning of the EU and the IMF.

The rationale that justifies this approach is related with the increased uncertainty of the recovery of the European economy, whose recession is deeper and longer than initially anticipated, with the subsequent direct and indirect repercussions on the growth of the Spanish economy. In this regard, in recent months both the IMF and other international organisations have lowered their projections for Spain as well as for the Eurozone and the world economy. While the projections in April 2013 of this organisation forecast a growth this year for the Eurozone and world economy of -0.3% and 3.3%, respectively, in July 2012 these figures were significantly higher (0.7% and 3.9%).

Significant progress was made in 2012 towards the adjustment of a good number of internal and external imbalances necessary to initiate the economic recovery. Competitiveness and private debt improved significantly, exports performed favourably in a context of recession in economies with a high degree of integration with the Spanish economy, and the external financing needs of the economy decreased.

For all these reasons, the medium-term macroeconomic scenario described in this Programme reflects a path for recovery of the activity that, on solid foundations, is characterised by positive growth rates starting in 2014, albeit somewhat lower than those provided in the previous official forecast. These prospects for medium-term growth are based on conservative assumptions, thus increasing the credibility of the medium-term fiscal policy.

The deficit path envisaged by this Programme should not be understood as a moderation of the commitment to fiscal consolidation. To the contrary, structural efforts not inferior to those of the previous Stability Programme Update are proposed, and are more significant in 2014 and 2015. Rather, the prolongation of this adjustment involves an adaptation to the new cyclical environment, endeavouring to preserve the rebound from recession by the end of 2013 or beginning of 2014 and, accordingly, start generating employment and continuing to improve public accounts. Otherwise, as explained in the Programme, approximately two thirds of the structural deficit as of year-end 2011 will have been corrected in 2013, attaining the Medium-Term Fiscal Objective in 2017, practically balancing the structural deficit of all Public Administrations, 3 years before required by the Organic Law on Budgetary Stability and Financial Sustainability. As a result of this adjustment, public debt will decrease, bringing it to around 85% of GDP in 2019. The measures for rebalancing the public accounts is also balanced, as outlined in this Programme, with approximately 55% consisting of public expenditure actions.

Because one of the underlying reasons for projecting another 2 years of elimination of excessive debt is the uncertainty regarding the pace of the rate of recovery of Western economies, a decision has been made to balance the impact of this risk on the deficit adjustment path by adding another commitment to this fiscal strategy. Specifically, if as a result of positive surprises in growth, tax collection increases and expenditure is less than envisaged, the difference will be mainly channelled towards a lower deficit. Therefore, the probabilities of a quicker deficit reduction than the one described increase.

Lastly, it is important to emphasise that the fiscal strategy described cannot be understood separately from the significant boost to the structural reforms which contribute to sustaining and improving the medium and long-term growth potential of the economy. In an exercise of transparency and in order to endow this strategy with greater predictability, a "road map" was provided in the 2013 National Reform Plan, which includes a strategy and specific measures with precise schedules for the implementation of pending actions in key sectors for the growth and sustainability of finances and in the labour, capital, and goods and services markets. On both pillars, a balanced budget and a flexible economic structure in which the greatest rigidities have been eliminated, the Spanish economy will be in a suitable position to fully benefit from the next expansionary phase of the cycle.

This new Stability Programme Update responds in content and form to the provisions of the Stability and Growth Pact Code of Conduct. Following the adoption of the six Regulations and Directives at the end of 2011, the code in force is the one adopted by ECOFIN in January 2012. Furthermore, following the entry into force in January 2013 of the Treaty on Stability, Coordination and Governance, the signatories (Spain among them) assumed new commitments in the area of fiscal policy to be implemented in this Stability Programme.

The most significant innovation is the definition of an adjustment path to attain the so-called MTO (medium term objective), which is the structural deficit that, under the aforementioned Treaty, may not exceed 0.5% of GDP. Consequently, this path is specified along with the information required for its evaluation. The attainment of this objective follows a prolongation of the analysis period through 2019, the year in which a significant improvement of the financial and real variables of the economy is described.

This Programme is comprised of seven sections. After an initial introductory section, the macroeconomic prospects are described, with special attention to the recent performance and prospects of the world and Spanish economy, specifying the main economic magnitudes that describe the macroeconomic picture for Spain in the medium term, and which provide the basis for the preparation of medium-term budgetary projections.

Section 3 describes the deficit and public debt path, as well as the measures required to attain public deficit targets at all Public Administration levels.

Section 4 provides a comparison with the previous Stability Programme Update, explaining the reasons for discrepancies. Among others, the more adverse economic performance and maintenance of the deficit containment effort in structural terms are worthy of note. In this section, a sensitivity exercise for the deficit path is undertaken; sensitivity to variations in interest rates and to changes in growth assumptions in the Eurozone.

Section 5 examines the sustainability of long-term public finances and analyses the effects of the ageing of the population on public accounts and the initiatives proposed to ensure the future of pensions.

Section 6 provides an analysis of the quality of public finances, paying special attention to the impact of public revenue and expenditure measures on growth, and the advances planned to achieve a more favourable growth structure.

The final section concerns the institutional framework of the fiscal policy. It describes the significant progress to improve discipline and control over public finances, with measures to strengthen the transparency of public accounts and the creation of the Independent Fiscal Authority.

2. MACROECONOMIC PROSPECTS

2.1. Recent evolution of the Spanish economy

2.1.1. International environment

In recent months, the global economy has shown some positive signs, although the rate of activity continues to be moderate and uneven, affected by high uncertainty and signs of fragility. This has led to a downward revision of economic prospects, particularly for Western economies. The situation of the financial markets has continued to improve, while opinion polls point to an improvement in confidence. This progress, in many cases, has yet to be reflected in the activity indicators of advanced economies, affected by restrictive credit conditions, the consolidation of balance sheets of economic agents and fiscal adjustments.

In 4Q2012, the GDP of the Eurozone fell by 0.6% (quarter-on-quarter rate), following decreases of 0.1%, 0.2% and 0.1%, reported in the first three quarters, in a macroeconomic environment characterised by the fragmentation of financial markets and fiscal consolidation in most of the Eurozone countries. The drop in GDP affected all countries in the zone except Estonia and Slovakia. The contraction of the GDP in the Eurozone was due to a fall in internal demand which, after expanding by 0.6% in 2011, contracted 2.2% in 2012. The main factors behind this contraction were household consumption which, after growing 0.1% in 2011 contracted 1.2% in 2012, and gross fixed-capital formation, which fell by 4% in 2012, after an increase of 1.6% in 2011. External demand increased its contribution by 0.6 points despite the slowdown in exports, due to the contraction of imports which mirrored internal demand.

By country, the German economy, which had enjoyed three quarterly increases in its GDP, albeit with a deceleration profile, contracted 0.6% in the fourth quarter, since its exports were impacted by the on-going recession of its main commercial partners in the Eurozone. France's GDP fell 0.3% in the fourth quarter, after having recorded an increase of 0.2% in Q3 and two decreases of 0.1% in Q1 and Q2. Accordingly, its GDP stagnated in 2012, after having risen by 1.7% in 2011. Lastly, Italy's GDP, which had been negative for a year and a half, fell 0.9% in the 4Q2012, 0.7% more than in the third quarter, and the greatest decrease among the main Eurozone economies. In summary, in the whole of 2012, the Eurozone GDP decreased by 0.5%, the first decrease since 2009 after growing 2% in 2010 and 1.5% in 2011.

Outside the Eurozone, the United Kingdom re-entered recession, after having grown slightly as a result of the Olympic Games, accumulating an increase of 0.3 pp. in 2012, 0.7% less than the preceding year.

In the United States, in Q4 GDP rose by 0.4% (annualised quarter-on-quarter rate), after +3.1% in Q3, and ended 2012 with an increase of 2.2% (1.8% in 2011), in an environment of high uncertainty due to the lack of a fiscal agreement. The moderation of activity in the fourth quarter is due to the strong decrease (-22.1%) of expenditure in national defence, following the increase of 12.9% in Q3, and a negative contribution of 1.5 points to the growth in inventory changes, after having contributed 0.7% in the third quarter. On the other hand, other internal demand items increased their growth with an acceleration of private consumption (1.8%) and residential investment (17.6%), and a shift to positive territory of the investment in equipment (11.8%). However, the foreign sector contributed 0.3% to GDP growth, 0.1% less than in the previous quarter, with a bigger reduction in imports (-4.2%) than exports (-2.8%). Consequently, 2012 ended with a growth in GDP of 2.2%, 0.4% above the rate recorded in 2011.

The GDP of the whole of the OECD, after growing 0.3% in the third quarter, contracted by 0.1% in the fourth quarter (quarter-on-quarter rate), the first contraction since the 1Q2009 when GDP fell by 2.3%. In year-on-year terms, growth moderated from +1.2% in Q3 to +0.8% in Q4. However, the evolution of the emerging economies was sounder, and Q4 performance showed a strengthening of the activity rate, as a consequence of the measures to boost internal demand adopted in several countries to compensate the weakness of external demand. Trade of goods underwent moderate growth in Q4 with respect to the previous quarter, since the value of G7 exports and imports, expressed in dollars, increased by 1.2% and that of the BRICS by 1%. The evolution by country showed broad differences, with progress in both flows in the United States, France, China, India, Russia and Brazil as opposed to decreases in Japan. In Germany and the United Kingdom, imports grew and exports contracted.

In March, the PMI purchasing managers index progressed 0.3 to 51.2. The production, employment and new order components improved, especially the latter, while input prices declined significantly. The PMI services index increased 0.2 to 53.4, with decreases in new businesses, employment and especially input prices. The composite index representing 85% of global GDP progressed 0.2 pp. to 53.1, placing the average of the first three months of the year at 53, a similar level to that of the fourth quarter. The global level of new businesses increased at a sound rate albeit more slowly than in the past, while employment progressed for the sixth consecutive month and cost inflation moderated. The advance composite index, prepared by the OECD, revealed an increase of 0.13 points in February in the overall area (100.5), the fifth monthly increase, which placed year-on-year growth at 0.36%, with disparate activity rates, among advanced as well as emerging economies.

The European Commission Winter Forecasts, published on 22 February, forecast global GDP growth of 3.2% in 2013, 0.1% less than the forecast of the previous autumn, maintain +3.9% for 2014. In advanced economies the increase will continue to be very moderate, with an increases of 1.1% in 2013 and 2.1% in 2014, inferior by 0.3% and 0.1%, respectively, to the forecasts supplied three months ago. The forecasts for the Eurozone have been revised downwards by 0.4% to -0.3%, and have been kept unchanged at 1.4% for 2014. The forecasts for Germany and France in 2013 were reduced by 0.3% to 0.5% and 0.1%, respectively, while in Italy the reduction is half a point, to -1%. Growth in 2013 for the United States is also revised downwards by 0.4% to 1.9%, remaining at 2.6% in 2014. On the other hand, the forecasts for the emerging and developing economies were revised upwards, with a growth of 5.4% in 2014, 0.1% above the autumn forecast, and which will increase slightly to 5.7% in 2014.

The moderate activity rate in 2012 has contributed to containing consumer prices in advanced economies, and it is expected that this trend will be maintained, whereas in some emerging economies inflation remains high. The price of Brent Crude registered a monthly decrease of 6.6% in March, after three consecutive increases, and compared to the previous year recorded a decline of -13.5%. The European Commission expects it to go from an average of 111.8 dollars/barrel in 2012 to 113.7 in 2013 and to 106.4 in 2014. For the prices in dollars of non-oil commodities and following the decline of almost 10% in 2012, they are expected to fall by -2% in 2013 and by -1% in 2014.

2.1.2. The correction of macroeconomic imbalances in Spain in 2012

2012 saw the continuation of the contraction phase of the Spanish economy, which commenced in the second half of the preceding year. In the first three quarters of the year, the contraction rate was moderated, intensifying in the last quarter of the year when GDP fell 0.8% quarter-on-quarter, after having fallen between 0.3% and 0.4% in the first three quarters. Year-on-year, GDP fell by 1.4%, 0.1% less than the growth projection envisaged in the Spanish National Budget.

The contraction of GDP in 2012 was driven by the evolution of internal demand. Over the whole year, internal demand contributed to a negative GDP growth of 3.9%, two points higher than the one reported in 2011. All its headings contributed to the decrease in internal demand. *Household spending and spending of non-profit organisations* serving households decreased as the year went by, with a brief interruption in Q3 which probably reflects the advance of certain purchasing decisions in July and August as a result of the increase in VAT rates which was effective on 1 September. In the year overall, this variable fell by 2.1% in real terms. However, in 2012 households reported a lower savings rate to moderate the effects on their consumption of lower levels of available income. Despite the lower level of savings reported in 2012, households maintained their financing capacity mainly reducing their level of investment.

Final consumer spending by Public Administrations contracted with the reduction concentrated in Q1 and Q3, with lower reductions in the other two quarters, although the lowest actual decrease in the last quarter of the year was offset by a greater reduction in current terms of the wages of civil servants during this period of the year. In the year overall, this variable registered a fall of 3.7% in real terms.

Similarly to household spending, gross fixed capital formation progressively contracted as the year went by, with the exception of Q3 when the rate of contraction notably moderated, and in which in fact investment both in capital goods and other intangible assets reported positive quarter-on-quarter rates. In the year overall, gross fixed capital formation contracted 9.1%, although with relatively differentiated behaviour with regard to its main components. Investment in both capital goods and other intangible assets fell by 4.9% after having progressed 2.5% during the previous year, while investment in construction contracted 11.5%, 2.5% more than the preceding year.

Contraction in internal demand was partially offset by the foreign sector which contributed 2.5 points to GDP growth, 0.2% more than in 2011. This contribution was the result of moderate growth in the exports of goods and services which rose by 3.1% over the year, and a contraction of 5% in the imports of goods and services in line with the evolution of domestic demand.

After a weak beginning to the year with a quarter-on-quarter reduction in exports of 2.6%, the following two quarters witnessed a clear recovery in which an increase of 5.1% was reported in the third quarter, ending the year with a another fall of 0.9%. The relative weakness of the Eurozone and of the European Union overall led both areas to lose influence in all export destinations. In 2012, the share of exports to the Eurozone fell by 3.2% to 49.5%. A similar decrease was witnessed in the share of exports to the European Union whose weight fell to 62.8%.

In short, despite the decrease in 4Q2012, the performance of exports of goods and services during the year 2012 was positive, with year-on-year growth of 3.1%. By components, the export of goods rose by 2.9% year-on-year, seven percentage points higher than that of the global goods market, and exports of services increased by 3.4%. Within services, tourism exports fell 1.1%, after having grown by 6.4% in 2011, while exports of other services rose 6.6%, 1.2 percentage points more than the previous year.

Imports of goods and services contracted 5% during the year following a quarterly profile parallel to that of end demand, with falls in all quarters of the year except in Q3 when a recovery parallel to that of exports occurred. All components fell in 2012: tourism to the greatest extent (-7.4%), followed by imports of goods (-5.5%) and, at some distance, by imports of non-tourist services (-2.3%).

Despite the decline in the terms of trade, which fell 2.3%, 2012 ended with a surplus in trade of goods and services, the first since 1997, amounting to €10,700 million following a deficit of €8,432 million in 2011. The remaining items of the current account balance also experienced improvements in 2012. The balance of income and transfers saw its deficit reduced by €11,300 million to €19,626 million. The current account balance closed with a deficit of €8,926 million, down €30,400 million from that of 2011. Lastly, the capital account reported a balance of €1,145 million higher than that of 2011, and 2012 ended with financing needs of €2,365 million, 0.2% of GDP and three points lower than the financing needs recorded in 2011.

The marked correction of the external imbalances of the Spanish economy was parallel to the progress in the deleveraging of private agents. In this regard, after increasing the volume of loans granted to non-financial companies by more than 49 points since the last quarter of 2003 through 2Q2010 to reach 141.8% of the GDP, a progressive reduction was reported since this spike, which placed the level of debt of non-financial companies at 131.9% of the GDP in 4Q2012, 10 percentage points below its peak, with significant adjustments attained throughout 2012; 7.9% of the GDP.

In the case of households, a high increase was also reported in their leverage level, which rose from 57.6% of GDP at the end of 2003 to 87.3% in the 2Q2010. From that moment, households also began to reduce their indebtedness, which fell by 7.6 points of GDP until the end of 2012. In both processes, the agents adjusted their behaviour so that the savings of families and non-financial companies now exceeds their investment and part of the borrowing capacity generated has been earmarked toward reducing debt.

The fall in GDP reported in 2012 also extended to employment which, according to the Labour Force Survey, fell by 4.5%. Seasonally adjusted series show there was a significant reduction in employment in the 1Q2012 when it fell by 1.6%, before moderating its reduction rate in the following two quarters to 1%, finally falling by 1.3% in the last quarter.

The loss of employment was felt by salaried employees whose number was reduced by 5.7%, while the number of self-employed workers rose by 1.4%. If the behaviour of employed workers is broken down between the public and private sectors, it is observed that while the loss of public employment rose in

2012 from 2.6% to 5.5% year-on-year, the reduction in salaried employment in the private sector stabilised in the year at approximately 5.8%. In parallel to the loss of salaried employment, the active population underwent a moderate reduction of 0.2% in the year, the first one since the beginning of the economic crisis. Consequently, the unemployment rate ended the year at 25%.

The EPA (Labour Force Survey) for 1Q2013, with a less dramatic year-to-year drop in employment than 4Q2012 (-4.6%), essentially reflects a prolongation of the trends described above, with a strong impact of public employment, whose annual drop rate accelerated by 1.3 pp. with respect to the first quarter, and a less significant drop in private employment (half a point in the annual rate). As for unemployment, its rise continued to slow down, as regards the annual as well as the quarterly rate, against the backdrop of a 1% annual decrease in the active population. The unemployment rate stood at 27.16%, and the seasonally adjusted rate at 26.6%.

The fall in employment was more intense than the contraction of the GDP, therefore the apparent productivity per full-time equivalent rose 3.2% in 2012 after having increased 2.2% in 2011. The greater wage moderation reported in 2012, and the productivity improvements, gave rise to a reduction of unit labour costs of 3.4%, two percentage points more than in 2011.

Inflation estimated by the year-on-year change in the Harmonised Consumer Price Index was 2.4%, 0.8% below 2011 and a 0.1% less than the Eurozone. The inflation profile was a progressive acceleration between July and October which remitted at the end of the year reflecting the effects of various measures aimed at limiting pharmaceutical expenditure, as well as the rise in VAT rates which entered into force on 1 September.

Underlying inflation was 1.6%, the same level as the previous year. Underlying inflation at constant taxes was far more subdued and presented an annual average of 0.9%, with a 0.2% annual rate in December. The influence of tax changes on inflation is revealed upon analysing the CPI at constant taxes, for which the year-on-year variation rate of the CPI is reduced to 1.8%, 0.6% below the general CPI with taxes, while the difference with the underlying one, which was 0.8%, was extended to 0.9%. This trend towards moderation was confirmed when the National Institute of Statistics published its April Consumer Price Index Flash of 1.4%.

2.2. Macroeconomic scenario assumptions

The table below describes the main underlying assumptions for the macroeconomic scenario of this Stability Programme Update.

Table 2.2.1 Basic assumptions of the macroeconomic table

	2012	2013	2014	2015	2016
Short-term interest rates (3-month Euribor)	0.57	0.37	0.67	0.81	1.05
Long-term interest rates (10-year debt, Spain)	5.87	4.84	4.51	4.15	3.80
Exchange rate (USD/euro)	1.28	1.35	1.35	1.35	1.35
Nominal effective exchange rate of the Eurozone (% change)	-5.3	2.6	0.0	0.0	0.0
World GDP growth, excluding EU	3.9	4.0	4.5	5.1	5.7
EU GDP growth	-0.3	0.1	1.6	2.1	2.5
EU export markets growth (volume)	4.9	4.6	5.8	6.7	7.4
World import volumes, excluding EU	4.0	4.2	6.0	6.8	7.5
Oil prices (Brent, USD/barrel)	111.8	113.7	106.4	108.0	110.0

(F) Forecast
Sources: European Commission and Ministry of Economy and Competitiveness.

Starting with the financial variables, a conservative approach is followed, forecasting a slight tightening of the monetary policy in 2014, parallel to the recovery in the Eurozone. However, since it is a gradual upturn in growth and in the absence of inflationary pressures on costs, it is expected that said increase in rates will be gradual and will not exceed 30 bp per annum between 2014 and 2016.

The tendency for long-term rates is also based on conservative assumptions, considering a moderate decrease in the risk premium of Spanish debt, together with an increase in the yield of German bonds. These trends imply a drop in the risk premium of 60 bp. between 2013 and 2014, compensated by an increase of the yield of the Bund of around 20 bp. This is also a conservative assumption. This path is maintained in similar terms in the following years. The main driver behind the reduction in the risk premium would be fiscal consolidation and its impact on the deficit (in the medium-term this will also affect the course of public debt itself) and the advances made in the restructuring and correction of the financial system. Considering the evolution of the yield of Spain's 10-year bond in recent days, this certainly seems to be a conservative assumption.

The growth figures for the GDP in the EU and the world, as well as the volume of imports, were taken from the common hypotheses used in the EU winter forecasts, with our own, subsequent estimates for 2015 and 2016. The USD/EUR exchange rate is also based on common assumptions, although it is necessary to point out that some uncertainty exists in relation to the final evolution of the euro in 2013. If, for example, the cut-off date for the calculation of the assumptions had been the first week of April 2013, the bilateral euro rate would have been 1.30, which would represent a slight increase to the average for 2012. Under such circumstances, the common assumption of the winter period seems to have overestimated the magnitude of said increase.

Something similar can be said regarding the nominal effective exchange rate for the Eurozone, which undergoes an increase in 2013 that may be lower, which may also occur with oil prices, the figures for which, in accordance with the Code of Conduct, are taken from the common assumptions but which could easily be lower (if we were to use data from the first week of April, the price would be approximately 2.3% less in 2013).

Finally, figures for the evolution of Spain's export markets come from our own estimates, which closely follow EC winter forecast estimates although a somewhat lower evolution is preferred, which fits in with the conservative nature of these estimates. In any case, the aforementioned recovery is noteworthy, particularly from 2014 onwards, which will be important for maintaining a positive and substantial contribution of foreign demand toward growth in the entire projected horizon.

2.3. 2013-2016 macroeconomic scenario

The underlying scenario to this Programme makes the road for correcting the main imbalances that exist in the Spanish economy stretch on into the medium term: foreign trade deficit, private and public indebtedness. Consequently, growth foundations are increasingly solid, with a continuous decrease of liabilities vis-à-vis the rest of the world which increases the possibilities for spending, something that is consistent with foreign solvency in the medium and long term. The variable that best summarises this evolution is the financing capacity of the Spanish economy vis-à-vis the rest of the world, which evolves from a need to finance 0.2% of GDP, to a financing capacity of 4% in 2016. A financing capacity of 1.9% of GDP will be recorded in 2013. Such circumstance will place the Spanish economy in a position to face the next stage of expansion on more solid macroeconomic grounds.

However, in the short term, the demand for extensive financing capacities to the private sector, ranging from 10.4% of GDP in 2012 to 7% in 2016, slows possible growth, by moderating consumption and private investment. Therefore it is expected that GDP will improve moderately over the entire projected horizon; moving into positive territory in 2014 (0.5%) and just above 1% in 2016 (1.3%)

Table 2.3.1 Macroeconomic prospects

	ESA CODE	2012 (A)	2012 (A)	2013(F)	2014(F)	2015(F)	2016(F)
		Level	Annual Variation as a %				
1. Real GDP	B1*g	95.0	-1.4	-1.3	0.5	0.9	1.3
2. Nominal GDP. Thousands of millions of Euros	B1*g	1,049.5	-1.3	0.2	1.9	2.4	3.1
Components of real GDP							
3. Private consumption expenditure (*)	P.3	93.8	-2.1	-2.5	0.0	0.4	0.8
4. Final consumption expend. of the p. administrations	P.3	100.9	-3.7	-4.4	-3.1	-3.8	-3.6
5. Gross fixed capital formation	P.51	66.2	-9.1	-7.1	-0.9	2.0	4.3
6. Change in stocks (% of GDP)	P.52 + P.53	113.8	0.1	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	111.0	3.1	4.1	5.9	6.9	7.1
8. Imports of goods and Services	P.7	85.2	-5.0	-3.7	2.6	4.7	6.2
Contributions to real GDP growth							
9. Domestic final demand		-	-3.9	-3.7	-0.8	-0.1	0.6
10 Change in stocks	P.52 + P.53	-	0.0	0.0	0.0	0.0	0.0
11 Foreign trade balance	B.11	-	2.5	2.4	1.3	1.0	0.7

(*) It also includes households and non-profit institutions serving households (ISFLSH)
(A) Advanced
(F) Forecast
Sources: National Institute of Statistics (INE) and the Ministry of Economy and Competitiveness

Under these circumstances, the greater flexibility introduced by the labour reform of 2012 is that it will make it possible to create employment with growth rates just slightly over 1%, which are perceptibly lower than those that were necessary in previous cycles, since it is estimated that the contribution to growth by aggregate demand will not be significant in practically the whole projection horizon.

Although in 2014, net employment may start to be created in certain quarters, it is expected that 2015 will be the first year with year-on-year growth in employment. Nevertheless, the unemployment rate will start to decrease from 2014 and with even greater intensity in 2015. This trend will be based on significant wage moderation, where wage increases per employee will not exceed half a percentage point throughout the entire projected horizon. To complement this, a similar approach will be needed in the Public Administrations.

Table 2.3.2 Labour Market (*)

	ESA Code	2012 (A)	2012 (A)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
		Level	Annual Variation as %				
1. Total employed people (millions)		17,777	-4.2	-3.5	-0.2	0.5	1.0
2. Full-time equivalent employment (millions)		16,518	-4.4	-3.4	-0.4	0.3	0.7
3. Labour productivity per employee (thousands of euro)		58.1	2.9	2.4	0.6	0.3	0.3
4. Labour productivity, full-time equivalent (thousands of euros)		62.6	3.2	2.2	0.9	0.6	0.7
5. Compensation per employee (**) (thousands of euros)	D.1	33.8	-0.3	11	0.4	0.5	0.5
6. Unit labour cost			-3.4	-1.1	-0.4	-0.1	-0.2
7. Employees Compensation (thousands of euros)		481,038	-5.4	-2.4	-0.1	0.7	1.1
8. Unemployment rate (% of active population)			25.0	27.1	26.7	25.8	24.8

(*) Data per National Accounting, except for unemployment rate
(**) Compensation per employee, full-time equivalent.
(A) Advance
(F) Forecast
Sources: National Statistics Institute and Ministry of Economy and Competitiveness.

This pattern of correction also stands out in the composition of the growth achieved. Domestic demand will contribute negatively to growth until 2015 inclusive, although with decreasing magnitude (from -3.7 in 2013 to -0.1 in 2015). On the other hand, foreign demand will be positive throughout the projected horizon, moving from 2.4 pp. in 2013 to 0.70 pp. by 2016. From a different angle, the trade balance of goods and services will go from a surplus of 1% of GDP in 2012 to a surplus of 6.4% of GDP in 2016. The degree of adjustment achieved, from a deficit of 6.7% of GDP in 2007, is unprecedented in Spain's economic history.

The investment in equipment and other products will precede private consumption during the recovery and will show positive growth rates from 2014 onwards. The consolidation of the growth in exports from mid-2013 onwards, as well as the financing capacity generated on a sustained basis by non-financial entities (benefiting, among other factors, by the restraint in wages, causing unit labour costs to decrease over the entire 4-year period projected) will be factors leading to an improvement that, in quarterly rates, could start to be noticeable by the end of 2013.

A more pronounced decrease in private consumption is forecast for 2013, with a quarterly increase that will be more solid as of 2014. This is explained by the decrease in the ability of this sector to generate savings and disposable income, which will not make a positive contribution to the reactivation of the economy until 2014. Nonetheless, from 2014 onwards there will be other aspects that will become more important, such as the stabilization of employment, which could reverse the fall in private consumption.

The figures for end consumption of the Public Administrations will continue to have intensely negative signs until 2016, which is in accordance with the extension of the period to correct the excessive deficit through said year.

Moving on to the items comprising external demand, exports of goods and services, after a number of quarters with figures that were lower than those obtained 3Q2012, will start to recover at the end of 2013, showing an average rate of 4.1% in this period, and as of that moment will benefit from a gradual pick-up in growth rates of our main export markets until 2016, when an average rate in excess of 7% is expected. Nevertheless, the behaviour of the destination markets in 2013 is expected to be better than in 2012.

As regards cost competitiveness, although the euro/dollar exchange rate could increase vs. its average value in 2012, which may partially offset the profits obtained through relative unit labour costs, it is expected that further gains will still be obtained this year, albeit lower than those of 2012. This is expected to continue over the entire projected horizon until 2016 and entails a neutral contribution to the exchange rate and an evolution of unit labour costs that is better than most of our trade partners. This aspect, without ignoring competition through channels other than price, is increasingly important when explaining the performance of our exports, given that the geographical markets they target are expanding and they increasingly include countries that are highly cost-competitive.

Imports of goods and services will maintain negative variation rates during 2013, explained by negative final demand, and the improved competitiveness of Spanish production. Imports will recover from 2014, driven by exports and, to a lesser degree, by the stabilisation of domestic demand. The depreciation of the effective exchange rate, whether it is deflated by labour costs or by deflators related to private consumption, will be, in any case, an element that curbs the progress of imports.

The restructuring and correction of the Spanish financial sector is another important factor behind the macroeconomic forecasts included in this Programme. Within the macroeconomic scenario, it is assumed that the aggregate financial conditions of the private sectors will experience a gradual quarterly easing over the first two years of the forecast, which could have an impact on private spending, particularly on consumption but also on investment.

Nevertheless, the financial situation of each sector is heterogeneous and the most solvent agents will probably enjoy easier access to new credit. On the other hand, the decrease in the need for financing of the Public Administrations will be another positive aspect that should facilitate improved credit flow towards the private sector.

Table 2.3.3 Price Evolution

	ESA CODE	Level	Annual Change in %				
1. GDP deflator		101.6	0.1	1.4	1.4	1.5	1.8
2. Private consumption deflator (*)		106.4	2.4	1.9	1.5	1.7	1.7
3. Harmonized index of consumer prices (HICP)		119.2	2.4	1.7	1.6	1.7	1.8
4. Public consumption deflator		98.8	-1.5	2.2	0.5	0.6	0.8
5. Gross fixed capital formation deflator		97.0	-1.5	0.3	1.2	2.3	3.1
6. Exports deflator (goods and services)		105.6	1.9	1.9	2.7	2.9	3.3
7. Imports deflator (goods and services)		109.3	4.3	2.6	2.7	2.9	3.3

(*) Includes households and non-profit institutions serving households
(A) Advance; (F) Forecast
Sources: National Institute of Statistics and the Ministry of Economy and Competitiveness.

This review of the main parameters of the macroeconomic forecast cannot be concluded without mentioning the positive role to be played by prices in the path for correcting the imbalances of the economy. In spite of the fact that the cyclical gap will start to close from 2014 onwards, the growth of the private consumption deflator will be kept below 2% from 2013; in this first year the rate will be even higher than in subsequent years due to the effect of the increase in prices caused by the rise of the VAT in September 2012.

Lower inflation is a reflection of not only a higher degree of competition in the markets of goods and services (associated with the Government's liberalisation reforms) but also the persistence of a negative cyclical gap that still exists at the end of the projected horizon, and the absence of inflationary pressures with regard to costs, most notably labour costs. Said restraint will be transferred, to a large degree, to the GDP deflator, which will also be affected by the downward correction in housing and construction prices throughout most of the years analysed.

Table 2.3.4. Balances by Sector

GDP %	ESA Code	2012 (A)	2013 (F)	2014 (F)	2015 (F)	2016(F)
1. Net lending (+) / borrowing (-)vis-à-vis the world	B.9	-0.2	1.9	2.9	3.6	3.9
- Balance of foreign goods and services traded		1.0	3.3	4.6	5.6	6.4
- Balance of primary incomes and current transfers		-1.9	-2.0	-2.3	-2.6	-3.1
- Net Capital transactions		0.6	0.6	0.6	0.6	0.6
2. Net lending (+) / borrowing (-)from the private sector	B.9	10.4	8.3	8.3	7.7	6.6
3. Net lending (+) / borrowing (-)from the public sector	EDP B.9	-10.6	-6.3	-5.5	-4.1	-2.7
4. Statistical discrepancy	-	-	-	-	-	-

(A) Advance
(F) Forecast
Source: National Institute of Statistics and Ministry of Economy and Competitiveness

3. PUBLIC DEFICIT AND PUBLIC DEBT

3.1. The Public Administrations in 2012

In 2012, the Public Administrations recorded a deficit of 7% of GDP in the National Accounts excluding the resources transferred to financial institutions within the framework of restructuring the banking sector, in comparison to a 9% deficit recorded in 2011. This is a very considerable correction against the backdrop of a dramatic fall in activity.

The drop of 2 percentage points (pp.) in the public deficit of 2012 breaks down as follows: Central Administration -1 pp., Regional Governments -1.6 pp., Local Entities -0.3 pp. while, within the context of a deteriorating labour market, the Social Security Administrations increased their deficit by 0.9 pp. (Table 3.1.1)[1]

Table 3.1.1 Deficit of the Public Administrations in 2012

% of GDP

	2011⁽¹⁾	2012	Target 2012
Central Administration⁽²⁾	-5.13	-4.11	-3.50
Regional Governments	-3.31	-1.76	-1.50
Local Entities	-0.45	-0.15	-0.30
Social Security	-0.07	-0.97	-1.00
TOTAL PUBLIC ADMINISTRATIONS⁽²⁾	**-8.96**	**-6.98**	**-6.30**
Measures linked to the restructuring of the banking sector	*0.48*	*3.65*	
TOTAL PUBLIC ADMINISTRATIONS	**-9.44**	**-10.64**	

1) Prior to the settlement of the 2009 Financing System.
2) Does not contain measures related to the restructuring of the banking sector.
Source: National Institute of Statistics and Ministry of Economy and Competitiveness.

Considering the recession experienced by the Spanish economy last year, the intensity of the fiscal consolidation, measured by the change in the primary structural balance was clearly greater than the decrease of 2 pp. in the deficit.

If the financial assistance provided to the credit entities is included, equivalent to 3.65% of the GDP, the deficit for 2012 reaches 10.6% following the 9.4%

[1] The breakdown of the 2011 deficit into subsectors was carried out prior to the settlement of the 2009 financing system. Said settlement was extraordinary and positive for the State in an amount of 23,000 million euros (2.17% of the GDP) and negative for the Autonomous Communities in an amount of 19,000 million (1.78%), and for the Local Entities in an amount of around 4,000 million (0.39%). Therefore, if said settlement is included, the deficits in 2011 would be 3.44%, 5.09% and 0.84% of the GDP for the Central Administration, the Autonomous Regions and the Local Entities, respectively. However, including said settlements in one sole year (as is done by the NC accrual calculations), while they are actually being settled in cash over a period of 10 years, would distort the comparison with 2012, which turned out to be a normal fiscal year with positive settlements for the territorial entities.

recorded for 2011, when the effect of bank restructuring on the public deficit was 0.48% of GDP (Table 3.1.1).

The financial assistance provided to the Spanish credit entities has a one-off impact on the public accounts. Only the following two items have an impact on deficit: 1) capital contributions made by the FROB to cover negative equity and 2) the conversion of FROB's preferred shares into ordinary shares (which takes place as a result of the non-compliance with Business Plans or because the entity concerned is in a situation of resolution in accordance with the provisions of Chapter IV of Law 9/2012. With these criteria, the impact on the public deficit of the transactions completed in 2012 amounted to €38,343 million (equivalent to 3.65% of GDP).

Table 3.1.2 Public Administrations in 2012

	Millions of euros			Percentage of GDP		
	2011	2012	% Var	2011	2012	Diff.
REVENUE	**379,671**	**382,044**	**0.6**	**35.71**	**36.40**	**0.7**
Tax revenues	206,582	213,589	3.4	19.43	20.35	0.9
Direct taxes	101,626	106,256	4.6	9.56	10.12	0.6
Indirect taxes	104,956	107,333	2.3	9.87	10.23	0.4
Social security payments	140,035	134,955	-3.6	13.17	12.86	-0.3
Other revenue	33,054	33,500	1.3	3.11	3.19	0.1
EXPENSES	**480,073**	**493,685**	**2.8**	**45.15**	**47.04**	**1.9**
EXPENSES (1)	**474,937**	**455,342**	**-4.1**	**44.66**	**43.39**	**-1.3**
Salaries and wages	123,550	116,087	-6.0	11.62	11.06	-0.6
Intermediate consumption	62,216	59,386	-4.5	5.85	5.66	-0.2
Social services and benefits	163,809	168,491	2.9	15.40	16.05	0.6
Interest (PDE)	26,082	31,322	20.1	2.45	2.98	0.5
Subsidies	11,820	10,060	-14.9	1.11	0.96	-0.2
Social in-kind transfers (via market)	29,952	28,720	-4.1	2.82	2.74	-0.1
Other current transfers	17,757	15,417	-13.2	1.67	1.47	-0.2
Gross capital production	30,696	18,151	-40.9	2.89	1.73	-1.2
Capital transfer	14,575	44,999	208.7	1.37	4.29	2.9
Other expenses	-384	1,052		- 0.04	0.10	0.1
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-100,402**	**-111,641**	**11.2**	**-9.44**	**-10.64**	**-1.2**
Expenses linked to the restructuring of the banking sector	5,136	38,343	646.6	0.48	3.65	3.2
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE) (1)	**-95,266**	**-73,298**	**-23.1**	**-8.96**	**-6.98**	**2.0**
Memo items:						
PUBLIC DEBT	**736,468**	**883,873**	**20.0**	**69.26**	**84.22**	**15.0**
Implicit interest rate (%)	4.05	4.25	5.1			

(1) Does not include expenses linked to the restructuring of the banking sector.
Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

Despite the decrease in the tax bases for the fifth consecutive year, tax revenue increased in 2012 by 3.4% (around €7,000 million) thanks to the stimulus of the regulatory measures[2].

[2] The main laws that affected the tax revenue in 2012 were Royal Decree-Law 20/2011, 30 December, on urgent measures for budgetary, tax and financial matters to correct the public deficit, with special impact on personal income tax ("IRPF"), and Royal Decree-Law 12/2012, of 30 March, whereby various tax and administrative measures were passed to reduce the public deficit, and Law 20/2012, of 13 July, on measures

With regards to tax revenues, direct taxes grew 4.6%, driven by the Corporate Tax (which triggered a cash increase of 29%), while the impact of the increase in indirect taxes, as a consequence of the drop in nominal aggregate spending, was limited to 2.3%. The absolute increase in collection of Corporate Tax surpasses the sum of the increase in collection of the Personal Income Tax and Value Added Tax. In turn, the effective tax rate for companies with a turnover of more than €60 million, when comparing fractioned payments of 2012 and 2011, increased by 3.6 percentage points in 2012. On the other hand, the decrease in employment caused the revenue for social security payments to drop by 3.6% in 2012.

As for expenses, these (with the exception of resources transferred to the financial system during the bank restructuring process) decreased by some €19,600 million (-4.1%) last year, a decrease that amounts to -5.5% (€24,899 million less) when considering primary expenditures or without interest. Within primary expenditures, worthy of note are the decreases of the most important public consumption headings, such as wages of employed workers (-6%), intermediate consumption (-4.5%) and social transfers in kind via market producers (-4.1%) and, on the other side, current transfers made to companies and households, which decreased by 13.2%, subsidies (15%) and capital transfers (excl. bank restructuring expenses) with a decrease of close to 30%. Lastly, gross capital formation registered a decrease of 40.9%. In short, fiscal consolidation has affected all public expenditure headings with the exception of interest (which constitutes a contractual expense and grew 20.1%) and social benefits which, driven by unemployment expenditures and pensions, increased by 2.9%. The remainder of the expenditure headings decreased last year around 10%.

As of year-end 2012, public debt, according to the PDE methodology, was €883,873 million (84.2% of GDP), versus a debt of €736,468 million (69.3% of GDP) at the end of 2011. Of the 15 percentage points in the Debt/GDP ratio (significantly higher than the deficit for the period), a significant part (about 6 pp.) corresponds to the financing transactions undertaken by the Government during the year.

In this regard, attention should be drawn to the fact that the Government appreciably increased its financing needs last year; mainly as a result of the loan granted to the Fund for Orderly Bank Restructuring (FROB) in the amount of €39,468 million, and of a part of the contributions to the Regional Liquidity

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to guarantee budget stability and to promote competitiveness, which particularly affected Corporate Tax and the VAT. The enactment of these last two laws meant that the State taxes (including the participation in territorial institutions), which recorded a drop of 4.6% (in terms of cash) over the first eight months of the year, ended the year with an increase of 4.3%.

Fund (Spanish initials, FLA); to the FROB (€6,000 million); to the European Stability Mechanism (ESM) (€3,809 million); and to the Fund for the Financing of Payments to Suppliers (€500 million). On the other hand, last year €6,000 million were returned from past contributions to the Financial Asset Acquisition Fund (FAAF).

As to the different subsectors that comprise the Spanish Public Administrations, the deficit of the Central Administration (Table 3.1.3) rose noticeably, as a consequence of the expenses linked to the restructuring of the banking sector (recorded, as appropriate, as capital transfers). If these expenses are ignored, considering them as a one-off item, as well as the final settlement made in 2011 of the 2009 financing system for the Territorial Administrations, whose inclusion would distort the results (as explained in Note 1 above), a comparison with 2012 would reveal that the Central Administration reduced its deficit by one percentage point (1 pp.), leaving it at 4.1% of the GDP.

Table 3.1.3 The Central Administration in 2012

	Millions of euros			Percentage of the GDP		
	2011	2012	% Var	2011	2012	Diff.
REVENUE	**144,800**	**132,411**	**-8.6**	**13.62**	**12.62**	**-1.0**
Tax revenue	100,389	75,836	-24.5	9.44	7.23	-2.2
Direct taxes	59,018	51,500	-12.7	5.55	4.91	-0.6
Indirect taxes	41,371	24,336	-41.2	3.89	2.32	-1,6
Social Security payments	13,390	13,832	3,.3	1.26	1.32	0.1
Other current transfers	24,806	35,293	42.3	2.33	3.36	1.0
Of which: goes to p. administrations	21,800	32,540	49.3	2.05	3.10	1.1
Other revenue	6,215	7,450	19.9	0.58	0.71	0.1
EXPENSES	**181,327**	**213,861**	**17.9**	**17.05**	**20.38**	**3.3**
Salaries and wages	24,484	23,064	-5.8	2.30	2.20	-0.1
Intermediate consumption	10,524	9,431	-10.4	0.99	0.90	-0.1
Social benefits and services	13,727	14,018	2.1	1.29	1.34	0.0
Interest (PDE)	22,752	27,155	19.4	2.14	2.59	0.4
Other current transfers	83,713	86,679	3.5	7.87	8.26	0.4
Of which: goes to p. administrations	70,826	75,151	6.1	6.66	7.16	0.5
Gross capital production	9,115	6,206	-31.9	0.86	0.59	-0.3
Capital transfers	14,009	43,100	207.7	1.32	4.11	2.8
Other expenses	3,003	4,208	40.1	0.28	0.40	0.1
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-36,527**	**-81,450**	**123.0**	**-3.44**	**-7.76**	**-4.3**
Expenses linked to the restructuring of the banking sec.	5,136	38,343	646.6	0.48	3.65	3.2
Settlement of the 2009 financing system	23,120			2.17		
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-54,511**	**-43,107**	**-20.9**	**-5.13**	**-4.11**	**1.0**
Memo items:						
PUBLIC DEBT	622,298	760,268	22.2	58.52	72.44	13.9
Implicit Interest Rate (%)	4.14	4.36	5.4			

(1) Does not include expenses linked to the restructuring of the banking sector. And prior to the settlement of the 2009 Financing System
Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

The significant fall in tax revenue (-24.5%) is mainly due to the fact that the settlement carried out of the 2010 territorial financing scheme was performed using the stake percentages of the new financing system in State revenue, while payments on account were carried out with the percentages that were in force under the previous financing system. Conversely, the transfer of cash received by the Central Administration from the other administrations increased appreciably (more than 49%), due to the fact that the Fiscal Equalisation Scheme, that acts as a clearing mechanism for the regional financing system, underwent a significant increase.

Expenses were driven upwards by the increase in interest (19.4%) and capital transfers, which tripled due to the resources used to finance restructuring of the banking system. Without these two items, expenses decrease by 0.7%, and the decreases in the two main components of public consumption stand out: wages of employed workers (-5.8%) and intermediate consumption (-10.4%), which last year contributed to a fall in public consumption of this subsector of 6.2%, as a result of fiscal consolidation measures.

Table 3.1.4 The Regional Governments in 2012

	Millions of euros			Percentage of the GDP		
	2011	**2012**	**% Var**	**2011**	**2012**	**Diff.**
REVENUE	**134,586**	**168,038**	**24.9**	**12.66**	**16.01**	**3.4**
Tax revenue	76,048	106,983	40.7	7.15	10.19	3.0
Direct taxes	34,023	46,008	35.2	3.20	4.38	1.2
Indirect taxes	42,025	60,975	45.1	3.95	5.81	1.9
Other current transfers	44,706	47,307	5.8	4.20	4.51	0.3
Of which: goes to public administrations	42,378	45,159	6.6	3.99	4.30	0.3
Other revenue	13,832	13,748	-0.6	1.30	1.31	0.0
EXPENSES	**188,734**	**186,474**	**-1.2**	**17.75**	**17.77**	**0.0**
Salaries and wages	74,907	69,928	-6.6	7.04	6.66	-0.4
Intermediate consumption	29,871	28,299	-5.3	2.81	2.70	-0.1
Interest (PDE)	5,119	6,375	24.5	0.48	0.61	0.1
Social transfers in kind (via market)	27,167	26,223	-3,.5	2.55	2.50	-0.1
Other current transfers	24,664	37,574	52.3	2.32	3.58	1.3
Of which: goes to p. administrations	21,645	35,480	63.9	2.04	3.38	1.3
Gross capital production	11,625	5,574	-52.1	1.09	0.53	-0.6
Capital transfers	6,564	4,988	-24.0	0.62	0.48	-0.1
Other expenses	8,817	7,513	-14.8	0.83	0.72	-0.1
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-54,148**	**-18,436**	**-66.0**	**-5.09**	**-1.76**	**3.3**
Settlement of the 2009 financing system	-18,951			-1.78		
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-35,197**	**-18,436**	**-47.6**	**-3.31**	**-1.76**	**1.6**
Memo items: PUBLIC DEBT	**141,363**	**184,500**	**30.5**	**13.29**	**17.58**	**4.3**
Implicit Interest Rate (%)	4.24	4.51	6.4			

(1) Does not include expenses linked to the settlement of the 2009 financing system
Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

The 2012 deficit of the Regional Governments, in turn amounted to 1.8% of GDP (according to the National Accounting), 0.3% above the target of 1.5%. An important effort was made in the area of fiscal consolidation last year to bring down the 2011 deficit of 3.3% of GDP (excluding the settlements made in relation to the 2009 regional financing scheme). (Table 3.1.4).

With regard to revenues, it is worth highlighting that there was a noticeable increase in taxes (40.7%), which was due to the settlement of the regional scheme for the year 2010 whose effects on tax revenues of the Regional

Governments was similar, although in the opposite direction of the effects recorded for the Central Administration and indicated above. The settlement was carried out with the stake percentages of the new regional financing scheme, whereas the amounts paid on account were made using the percentages in force for the previous financing scheme. As a consequence, the expenses reflecting the transferal of funds amongst the public administrations recorded a significant increase (63.9%) last year. This increase, together with interest (24.5%), caused a drop of just 1.2% in total uses. The rest of the expenses dropped 10.7%.

Worthy of note are the important advances in budgetary restraint made by the Regional Governments in such sensitive areas as education and healthcare. These efforts affect broad areas of public spending such as staff (which decreased 6.6%), intermediate consumption (-5.3%), and social benefits in kind (-3.5%), all of which is reflected in a 5.7% drop in the final consumption of these public administrations over the past year.[3]

As for the Local Entities (municipal, departmental and provincial governments and councils), reduced their deficit by 0.3% in 2012, leaving the final figure at 0.15% of GDP well below the 0.3% target. The correction of their deficit was possible thanks to the fall in spending (-12.1%), since revenue also dropped, but much more moderately (-2.4%). Tax revenue, which rose 2.1%, contributed decisively to moderating the decrease in revenues. The fiscal structure of the Local Entities makes them less dependent on economic cycles than the rest of Spain's public administrations.

[3] The most important legal provisions that affected the spending of the Autonomous Regions (in which healthcare and education played the most relevant roles) are Royal Decree-Law 14/2012, 20 April, on urgent measures for the streamlining of public spending in education, Law 16/2012, 20 April, on urgent measures to guarantee the maintenance of the National Healthcare System and improve the quality and the safety of its services, and Law 20/2012, 13 July, on the measures to guarantee budgetary stability and promote competitiveness.

Table 3.1.5 The Local Entities in 2012

	Millions of euros			Percentage of the GDP		
	2011	2012	% Var	2011	2012	Dif.
REVENUE	**63,880**	**62,377**	**-2.4**	**6.01**	**5.94**	**-0.1**
Tax revenue	30,145	30,770	2.1	2.83	2.93	0.1
Direct taxes	8,585	8,748	1.9	0.81	0.83	0.0
Indirect taxes	21,560	22,022	2.1	2.03	2.10	0.1
Other current transfers	20,492	20,510	0.1	1.93	1.95	0.0
Of which: goes to public administrations	18,547	18,701	0.8	1.74	1.78	0.0
Other revenue	13,243	11,097	-16.2	1.25	1.06	-0.2
EXPENSES	**72,834**	**64,001**	**-12.1**	**6.85**	**6.10**	**-0.8**
Salaries and wages	21,503	20,568	-4.3	2.02	1.96	-0.1
Intermediate consumption	20,589	20,417	-0.8	1.94	1.95	0.0
Other current transfers	15,556	11,371	-26.9	1.46	1.08	-0.4
Of which: goes to p. administrations	13,724	9,586	-30.2	1.29	0.91	-0.4
Gross capital production	9,674	6,128	-36.7	0.91	0.58	-0.3
Other expenses	5,512	5,517	0.1	0.52	0.53	0.0
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-8,954**	**-1,624**	**-81.9**	**-0.84**	**-0.15**	**0.7**
Settlement of the 2009 financing system	-4,16			-0.39		
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-4,785**	**-1,624**	**-66.1**	**-0.45**	**-0.15**	**0.3**
Memo items:						
PUBLIC DEBT	**35,420**	**41,964**	**18.5**	**3.33**	**4.00**	**0.7**
Implicit Interest Rate (%)	2.38	3.67	54.6			

(1) Does not include expenses linked to the settlement of the 2009 financing system
Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

Finally, in a context of deteriorating economic activity and employment that is even more intense than the initial forecast, the Social Security Administrations recorded a deficit in 2012 that amounted to 0.97% of GDP, which represents an increase of 0.9% with respect to the 0.07% deficit of 2011. The Social Security System (Managing Entities and Mutual Insurance Companies for Occupational Accidents) closed its accounts with a deficit of 0.85%, the Public State Employment Service (Spanish initials, SPEE) with 0.02% and the Wage Guarantee Fund (Spanish initials, FGS) with 0.09%.

The revenue of the Social Security Administrations fell 4.7% last year, while their expenses increased by 1.2%. Payments into the Social Security system, which constitute approximately 80% of the revenue, were 4.3% less than the prior year, while the cost of social services rendered (the main expense category for these administrations, considering that it represents 90% of their costs) increased by 3.5%. Using data taken from the budgetary executions of the Social Security System and the SPEE, the amounts recorded for contributory pension plans (4%) and the cost of unemployment (5.6%) were partially compensated by the decrease experienced in other services, the most important being temporary disability, with a decrease of 12.7% and maternity leave, which dropped 3.7%. Final consumption and subsidies (with respective decreases of 4.1% and 22.9%, respectively) also contributed to the restraint in expenses by these public administrations (Table 3.1.6).

Table 3.1.6 The Social Security Administrations in 2012

	Millions of euros			Percentage of GDP		
	2011	**2012**	**% Var**	**2011** 1	**2012**	**Diff.**
REVENUE	**157,860**	**150,445**	**-4.7**	**14.85**	**14.33**	**-0.51**
Social Security payments	125.770	120,325	-4.3	11.83	11.46	-0.36
Other current transfers	30,732	28,721	-6.5	2.89	2.74	-0,.15
Of which: amongst the public administrations	29,148	27.449	-5.8	2.74	2.62	-0.13
Other revenue	1,358	1,399	3.0	0.13	0.13	0.01
EXPENSES	**158,633**	**160,576**	**1.2**	**14.92**	**15.30**	**0.38**
Salaries and wages	2,656	2,527	-4.9	0.25	0.24	- 0.01
Intermediate consumption	1,232	1,239	0.6	0.12	0.12	0.00
Social benefits and services	144,477	149,577	3.5	13.59	14.25	0.66
Subsidies	3,667	2,826	-22.9	0.34	0.27	-0.08
Other current transfers	5,697	3,642	-36.1	0.54	0.35	-0.19
Of which: amongst the public administrations	5,678	3,632	-36.0	0.53	0.35	-0.19
Other expenses	904	765	-15.4	0.09	0.07	- 0.01
NET LENDING (+) / BORROWING (-) OF FINANCING (PDE)	**-773**	**-10,131**	**-**	**-0.07**	**-0.97**	**-0.89**
Memo items:						
PUBLIC DEBT	**17,169**	**17,188**	**0.1**	**1.61**	**1.64**	**0.02**

Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

3.2. The State Budget for 2013

The Central Government Budget for 2013 forms part of the 2013-2014 Budgetary Plan approved by the Government and sent to the European Commission on 3 August 2012. The 2013-2014 Budget sets forth the main lines of the Government tax policies aimed at complying with the path established for budgetary consolidation approved by the ECOFIN Council on 10 July 2012 in which, considering the complicated economic context and high public deficit in 2011, Spain was granted an additional year (until 2014) to get its deficit within 3%, modifying at the same time the deficit goals for the interim years. In no way did such grace period imply an alleviation but instead, much to the contrary, a tightening of the fiscal consolidation efforts made , as can be construed from the evolution of the structural deficit that was estimated for the forecast period.

A good number of the measures included in the 2013-2014 Budgetary Plan were already approved by the Government in Royal Decree-Law 20/2012, 13 July, on measures to guarantee budgetary stability and promote competitiveness, and others that would be implemented by means of, among others, the 2013-2014 Central Government Budgets and other specific laws at the level of Regional Governments and Local Entities.

The Central Government Budget for 2013 was prepared within a macroeconomic scenario that was somewhat more favourable than the one existing for this Stability Programme Update, albeit in both cases decreases in economic activity and employment were contemplated for 2013 GDP (mitigated somewhat more in the former than the latter case, with regard to those recorded for 2012). Despite this decrease, for the sixth consecutive year, of the taxable bases set forth in the projections, the State Budget foresees a 3% increase in revenue, thanks to the prolongation in 2013 of the effects of the measures adopted in December 2011 and throughout 2012, whereas expenses, driven by interest and capital transfers, will increase by 8.4%, thus resulting in a deficit, in terms of National Accounts, of €40,390 million (3.85% of the GDP), as opposed to the 43,733 million (4.17% of the GDP) in 2012 (Table 3.2.1)[4].

The 2013 State Budget shows a high increase in tax revenues (over 40%) due to the distortion produced by the agreement in 2010 with the Autonomous Communities on the distribution of 2012 State revenue: a unique fall in taxes, due to greater transfers to the Regional Governments, offset by an equally atypical rise in current transfers to the State, in order to offset excessive payments on account from the Fiscal Equalisation Scheme made in the past, in accordance with the rules of the previous financing system of the Regional Governments. The return in 2013 to normal levels of both headings (taxes and Fiscal Equalisation Scheme) caused the aforementioned extraordinary increase in taxes and a sharp fall in non-tax revenue (close to 60%), due mainly to current transfers.

Table 3.2.1 The State Budget for 2013

	2012			2013	% Variation	
	Initial budget	Recognised Rights/Obligations	Receivables/ Payables	Initial Budget		
	1	2	3	4	5/=4/1	6=4/3
TOTAL REVENUE	**119,233**	**131,767**	**123,344**	**127,026**	**6.4**	**3.0**
Tax revenue	75,941	82,030	75,644	106,917	40.8	41.3
Direct taxes	54,846	55,697	52,053	66,182	20.7	27.1
Personal Income Tax (IRPF)	29,232	28,557	26,532	42,251	44.5	59.2
Corporate tax	19,564	23,005	21,435	19,012	-2.8	-11.3
Others	6,050	4,135	4,086	4,919	-18.7	20.4
Indirect taxes	**21,095**	**26,333**	**23,591**	**40,735**	**93.1**	**72.7**
VAT	13,633	19,068	16,384	28,272	107.4	72.6
Special	4,502	4,326	4,285	9,578	112.7	123.5
Others	2,960	2,939	2,922	2,885	-2.5	-1.3
Other revenue	43,292	49,737	47,700	20,109	-53.7	-57.8
TOTAL EXPENSES	**152,630**	**153,589**	**152,357**	**165,087**	**8.2**	**8.4**
Personnel	27,338	26,743	26,851	27,672	1.2	3.1
Assets	16,480	15,477	15,555	15,847	-3.8	1.9
Liabilities	10,858	11,296	11,296	11,825	8.9	4.7
Goods and services	3,248	3,529	3,528	2,857	-12.0	-19.0
Interest	28,876	26,059	26,055	38,615	33.7	48.2
Current transfers	80,496	85,405	84,244	81,751	1.6	-3.0
Contingency Fund	2,367	-	-	2,595	9.6	-
Real investment	5,281	-7,195	6,762	3,902	-26.1	-42.3
Capital transfer	5,024	4,658	4,917	7,695	53.2	56.5
BUDGETARY BALANCE	-33,297	21,822	-29,013	-38,061	14.3	31.2
Adjustments	-3,679	21,911	-	-2,327		
BALANCE IN N.C.	-36,976	43,733	-	-40,390		

Source: Ministry of Finance and Public Administrations, Bank of Spain and the National Institute of Statistics

[4]The values for variation and percentages of the GDP that appear in this section may not match the Budgetary Plan because they are calculated (with the exception of the table regarding the Social Security) with the budgetary figures that were ultimately settled and paid in 2012 and approved in the Budgets for 2012 and 2013, as well with the updated GDP figures.

It is forecast that total State taxes will grow 4.8% in 2013 (this includes the participation of the Regional Governments and Local Entities in personal income taxes, VAT and special taxes, in order to avoid the distortions mentioned above) and that the taxes levied on spending will contribute the most to the aggregate, since they will grow 9.8%, while income taxes will increase at a slower pace (about 1%) (Table 3.2.2).

The forecast revenue from personal income tax amounts to €74,215 million, an increase of 5.1% vs. 2012. The main impetus to this tax comes from the supplementary levy whose effects will be felt in 2013 when the last accruals of 2012 are paid and, particularly, from the increase in the annual tax payments to be filed in June, when the increase in tax rates levied on the savings base will be reflected. The end to deductions for the purchase of homes and the new taxation on lottery prizes will also contribute to an increase in tax collection in 2013. Had these measures not been adopted, the IRPF tax would have decreased by 1.5%

It is forecast that the collection of Corporate Tax (€19,000 million) will drop 11% vs. 2012. In this case, the tax measures will have a lesser impact in 2013 than they did in 2012 due to the temporary nature of some of such measures (the tax on dividends and income from foreign sources) and to the fact that others only affected the way the tax was paid while not altering the tax burden itself (measures related to the base and the rates for instalment payments), so that the effect in one year is compensated when the taxes are paid the following year and the same effect is observed with regard to an increase in rate for taxes withheld for capital gains. The only additional driving forces found in 2013 in comparison to 2012 are the effects that are pending from prior measures (because they affect businesses that do not declare their payments made on account according to the tax base or because they are not totally included in the payments that they do make), and the new measures regarding the limitation of deductions for depreciation and the revaluation of assets.

With regard to the base for Corporate Income Tax, it is envisaged that corporate profits may grow in 2013 due to an improvement in added value, operating results and a lower growth rate of provisions.

Table 3.2.2 Budget for State Tax Revenue in 2013
(Including the participation of the Territorial Entities)

	(1) **2012** Initial budget	(2) **2012** Settlement	(3) **2013** Initial Budget	**(3)(1)**	**(3)(2)**
DIRECT TAXES	**98,720**	**96,152**	**97,151**	**-1.6**	**1.0**
Personal Income Tax	73,106	70,631	74,215	1.5	5.1
Corporate Tax	19,564	21,435	19,012	-2.8	-11.3
Non-Resident Income Tax	2,411	1,708	2,248	-6.8	31.6
Other	3,639	2,377	1,676	-54.0	-29.5
INDIRECT TAXES	**69,077**	**71,594**	**78,637**	**13.8**	**9.8**
VAT	47,691	50,463	54,657	14.6	8.3
Special	18,426	18,209	21,096	14.5	15.9
Other	2,960	2,921	2,884	-2.6	-1.2
TOTAL TAXES	**167,797**	**167,745**	**176,788**	**4.8**	**4.8**

Source: Ministry of Finance and Public Administrations

With regards to indirect taxes, the revenue obtained from Value Added Tax is expected to be €54,657 million in 2013, which corresponds to an increase of €4,194 million vs. 2012 (8.3%). The increased momentum in tax collection will come from the increase in the tax rates, which have been in force since September 2012 and, much less notably, from the fact that the super-reduced tax rate for purchasing new homes has ended (it was changed from 4% to 10%). The positive effects of the changes made to the laws will exceed the negative effects on spending subject to the tax, which is expected to drop again in 2013. Consumer spending in households, which is the part of the tax base with the greatest weight, will grow in nominal terms somewhat less than in 2012, due to weakened household incomes, restrictions on consumer credit and the increase in VAT itself. Cash and capital spending of the Public Administrations will continue to fall at rates close to 7%. Finally, spending on the purchase of residential property, despite its slow recovery, will record negative values for yet another year.

In 2013, the revenue from Special Taxes will grow to €21,096 million, which is €2,887 million more than in 2012 (15.9%). Part of this increase is due to the inclusion within this concept of the State portion of the Tax on the Retail Sale of Hydrocarbons which, as of 2013, will be included in the Special Tax on Hydrocarbons.

With regard to expenditures, these are expected to reach €165,000 million in 2013 (€12,700 million more than in 2012, 8.4% as stated above) (Table 3.2.1). The main driver behind this increase will come from interest (€38,615 million, 48% more than in 2012) and capital transfers (with allocations of €7,695 million and an increase of 56%), while the rest of the categories will fall overall by 2.1%. The notable increase in capital transfers is due to the endowment from transfers to the National Energy Commission to finance certain costs in the electricity network, while the increase in interest is principally derived from an increase in the debt generated by the transactions that the State has undertaken to correct the financing of the banking system and from the liquidity support provided to the Territorial Administrations.

The increased volume of expenditure is related to the current transfers that, with an endowment of €81,751 million (3% less than in 2012), represent approximately 50% of the total expense. The most important headings in this area are the mechanisms to finance the Territorial Administrations with some €35,300 million and a decrease of 3.2% (with respect to the 2012 budget); the allocation to the Public State Employment Service (Spanish initials, SPEE) of €10,300 million (-22%); an allocation of €11,600 million (a 1% increase) was made for the contribution by Spain to the European Union Budget; and, finally, the current transfers to Social Security amount to €15,500 million, a figure that represents an increase of 80% with respect to the settlement of 2012 due to the fact that in 2013 the State now finances the entirety of the non-contributory pensions and other non-contributory benefits, whereas contributory pensions are financed by social security contributions, thus ending the process of separation between the sources of financing for Social Security agreed upon in the Toledo Pact. The end of this process of separation between the sources of financing, whose application began in 2002, requires that the provision for the supplement to minimum pensions for 2013 be raised to the amount of €7,900 million (from the €3,800 million for this concept in the 2012 budget).

It can be seen that the majority of these current transfers do not imply a final expenditure for the State, since they are aimed at financing the expenditure of other public administrations, such as the Territorial Administrations, the Social Security and the SPEE.

After current transfers and interest, staff expenses are the third item of importance by volume. These are expected to increase by 3.1% (vs. 2012) up to €27,672 million. The staff expenditure heading includes the expense of active staff and pensions for retired civil servants. As regards the former, which will increase by 1.9% up to €15,847 million, worthy of note is the freeze on staff wages of those at the service of the Public Administration, as occurred in preceding years, together with the measures included in Royal Decree Law 20/2012, dated 13 July, on Measures to Guarantee Budgetary Stability and Promote Competitiveness, which introduces significant modifications to the Basic Statute of Public Employees in the area of civil servant leave and holidays. Containment of expenditure on active staff will be achieved, as in 2012, via the non-replacement of public employees with the exception of 10% replacement of staff in the State Security forces and agencies combating tax fraud. The pensions of retired civil servants total €11,825 million, an increase of 4.7% vs. 2012, due to the net increase in pensioners, the effect of replacing former pensions (lower) with new ones (higher) and to the 1% increase in pensions and 2% for those less than one thousand euros per month.

Lastly, funding for current spending on goods and services and real estate investment register drops in the current scenario of fiscal consolidation of 19% and 42% respectively, although their joint weight in total expenditure is in the order of 4%. However, it is worth noting that State investments in infrastructure go beyond real estate investments and are supplemented by the investments made by Ministries (mainly the Ministry of Public Works) via capital and financial asset transfers.

The Social Security Budget for 2013 complies with the 2013-2015 budget stability goals and restriction on non-financial spending by the State for 2013, approved by the Council of Ministers on 20 July 2012, for the entire public sector and each of its agents. The objective envisaged while preparing the Budget for Social Security was a situation of budgetary balance (Chart 3.2.3).

The consolidated Budget of non-financial revenue of the Social Security System for 2013 totals €125,685 million, and represents a 4.8% vs. 2012. The main sources of financing are labour contributions with a volume for 2013 of €105,863 million and a decrease of 0.4%, to finance a total budget of 82.6%. This heading covers the contributions of companies and employed workers and contributions from the unemployed.

After these contributions, State contributions are the most significant in relation to financing the Social Security budget. For 2013, the Social Security will receive current transfers from the State of €15,537 million, which represents an increase of €6,669 million, chief amongst which is the contribution for minimum pension supplements, with a year-on-year growth of 107% which represents, as mentioned in relation to the State budget, a volume of additional resources of some €4,100 million, making it possible to complete the state financing of these supplements a year in advance, pursuant to the terms of transitory provision fourteen of the General Social Security Law.

Chart 3.2.3 The Social Security budget for 2013

	2012 Initial Budget	2013 Initial Budget	% change
TOTAL INCOME	**119,884**	**125,685**	**4.8**
SS contributions	106,323	105,863	-0.4
Current transfers	8,930	15,598	74.7
of which: from the state	8,868	15,537	75.2
Other income (a)	4,631	4,224	-8.8
TOTAL EXPENSES	**119,864**	**125,803**	**5.0**
Current transfers	115,664	121,697	5.2
Occupational pensions	101,954	106,350	4.3
Non-occupational pensions	1,995	2,476	24.1
Temporary disability	5,799	5,831	0.5
Maternity	2,370	2,310	-2.5
Other current transfers	3,546	4,731	33.4
Other expenses (b)	4,200	4,106	-2.2
BUDGET BALANCE	**20**	**-118**	-
In % of GDP	0,00	-0,01	

(a) Asset income, taxes and other income and capital transfers.
(b) Personnel, goods and services, financial expenses, real estate investments and capital transfers
source: Ministry of Employment and Social Security.

The budget for Social Security expenditure for 2013 totals €125,803 million, which represents a growth of 5% vs. 2012. The most important expenditure items are the current transfers which group pensions, contributory (that increased by 4.3%) or otherwise (24.1%), temporary disability (0.5%) and maternity benefits (that declined by 2.5%) and other various benefits (that increased by 33.4%) in which family and dependency-related benefits have significantly increased their endowment in the 2013 budget (36% and 60% respectively).

With regard to the latter, worthy of note is that Law 39/2006, dated 14 December, saw the implementation of the Long-Term Care System so as to further personal autonomy and guarantee care and protection for dependent persons throughout national territory, with the cooperation and participation of all the public administrations, ensuring equal treatment to all dependent citizens irrespective of their place of residence. However, in the current scenario of reducing public spending, the government approval of Royal Decree Law 20/2012, 13 July, on Measures to Guarantee Budget Stability and Promote Competitiveness have led, amongst others, to a reduction in the maximum amounts of economic benefits for care in the family while at the same time reducing the amount of the Minimum Level of guaranteed protection, as well as the elimination of state financing of contributions to Social Security of non-professional caregivers and the postponement until July 2015 of the incorporation into the Care System of new moderate dependents.

As a result of these measures, the budget of the IMSERSO has been funded for current transfers in the amount of €2,126 million, which represents an increase in spending compared to 2012 of 60%, mainly owing to the funds allotted to paying obligations from previous years arising from the financing of contributions of non-professional caregivers, which total €1,034 million.

Contributory pensions are assigned a credit for 2013 of €106,350 million(4.3% increase), estimated in accordance with the increase in the number of pensions, the substitution effect and the 1% increase in pensions for 2013. Maternity benefits, with funds of €2,310 million, falls by 2.5% compared to 2012, in keeping with the evolution of the total beneficiaries. Credit assigned to the payment of temporary disability benefits increases to €5,831 million, with a 0.5% increase over 2012, a moderate growth which reveals the effectiveness of the measures to contain expenditure for these benefits.

Non-Contributory pensions of the Social Security which grow by 24% appear in the IMSERSO budget with a credit for €2,476 million (excluding the Basque Country and Navarre). This credit covers the cost arising from the variation of this group and the 1% increase of pensions for 2013 together with the payment obligations pending from previous years.

3.3. 2013-2016 Fiscal strategy

This Stability Programme Update is prepared in a context of uncertainty regarding the international economy which naturally includes Spain. The commitment of Spain to budgetary stability prevents the implementation of expansive fiscal policies. Therefore, favourable growth momentum must come largely from competitiveness gains stemming from the reforms occurring in different areas of the Spanish economy. In this sense, the progress made in the restructuring and capitalisation process of the banking system is relevant as it is making possible the recovery of the trust of international investors in the Spanish financial system, while enabling the flow of financing to companies and households to return to normal, essential in order for economic activity and employment to grow again.

Under these conditions, the projections of the reduction path of public deficit set out in this Stability Programme Update for 2013-2016 aims to consistently and realistically adapt to the current outlook for the Spanish economy for that period. These forecasts are formulated in a scenario of weak international macroeconomic environment and gradual dissipation of institutional doubts regarding the euro, thanks to the progress made in the banking union and the coordination of policies in the Eurozone.

Furthermore considering the most recent evolution of the figures for the Spanish economy, a 2-year extension has been given -until 2016- for situating public deficit below 3% of the GDP. This extension does not in any way entail an easing of the efforts in fiscal consolidation. As will be described elsewhere in this Update, and according to various versions of the estimated output gap, between 3 to 4 percentage points out of the 5.1 percentage reduction points of GDP, net of one-off and temporary measures, until reaching 2.7% in 2016, is attributable to the budgetary correction, and the rest, between 1 and 2 percentage points, to the action of automatic stabilisers in the scenario of improvement of the economic cycle which is expected to occur during the projection period.

As an additional component of the fiscal strategy, the Government is committed to invest the positive results of an effective growth above the projected growth rate in reducing public deficit. This means that any positive surprise with regard to growth caused by an increase in collection or a reduction in the cyclical expenditure will not be countered with any discretionary measures that prevent a reduction of the deficit beyond the targets for the GDP growth path. Section 4.2 offers a simulation of the impact on the deficit path of a positive shock on interest rates, placing them 1 point below the forecasts in macroeconomic assumptions, with an aggregate impact such that the deficit in 2015 would stand close to 3% of the GDP. An occurrence of this magnitude could naturally lead to an elimination of the excessive deficit one year before the maximum horizon considered by this Stability Programme Update.

Budgetary consolidation throughout the entire period projected will be based on a slight increase of the weight of revenue in the GDP and a significant drop of the expenditure weight, after discounting aid to the banking system in 2012. The increase in revenue will come mainly from the change in structure of GDP components during the period, as the GDP increase will be more relatively based on internal demand (chief component of tax bases) than external demand (which generates less tax collection) while, following the tax rates and bases in 2012 and 2013, no increases in fiscal pressure will occur.

A reduction in the weight of public spending in the GDP will occur chiefly in public consumption, which will fall throughout the entire period, while social benefits (driven by unemployment and pensions) will grow during the first years and then stabilise, and even fall slightly (as a percentage of the GDP), during the final years.

Chart 3.3.1. Budgetary projections
(Excessive Deficit Procedure)

	ESA Code	2012 (A) Level (mill. €)	2012 (A) % GDP	2013 (F)	2014 (F)	2015 (F)	2016(F)
Net lending (+)/borrowing (-) (EDP. B9)							
1. Total Public Administrations	**S. 13**	**-73,298**	**-7.0**	**-6.3**	**-5.5**	**-4.1**	**-2.7**
2. Central Administration	S.1311	-43,107	-4.1	-3.7	-3.5	-2.8	-2.0
3. Regional Governments	S.1312	-18,436	-1.8	-1.2	-1.0	-0.7	-0.2
4. Local Entities	S.1313	-1,624	-0.2	0.0	0.0	0.0	0.0
5. Social Security Administrations	S. 1314	-10,131	-1.0	-1.4	-1.0	-0.6	-0.5
Public Administrations (S. 13)							
6. Total income	TR	382,044	36.4	37.0	36.8	37.1	37.1
7. Total expenditure	TE	493,685	47.0	43.3	42.3	41.2	39.7
7a. Expenses linked to banking restructuring		38,343	3.7				
8. Capacity/Need of Financing	EDPB9	-111,641	-10.6	-6.3	-5.5	-4.1	-2.7
8a. Borrowing with no banking restructuring expenses		-73,298	7.0				
9. Interest paid	EDPD41	31,322	3.0	3.3	3.5	3.6	3.6
10. Primary balance		-80,319	-7.7	-3.0	-2.0	-0.5	0.9
11. Temporary measures							
Income breakdown							
12. Total Taxes		217,489	20.7	21.6	21.6	22.1	22.2
12a. Indirect taxes	D.2	107,333	10.2	10.8	10.8	10.9	10.9
12b. Direct taxes	D.5	106,256	10.1	10.4	10.5	10.8	11.0
12c. Taxes on capital	D.91	3,900	0.4	0.4	0.4	0.4	0.4
13. Social Security contributions	D.61	134,955	12.9	12.5	12.3	12.2	12.1
14. Investment income	D.4	10,228	1.0	1.0	1.0	1.0	1.0
15. Other income		19,372	1.8	1.9	1.9	1.8	1.8
16. Total income	**TR**	**382,044**	**36.4**	**37.0**	**36.80**	**37.1**	**37.1**
p.m.: Fiscal pressure		335,429	32.0	32.5	32.3	32.6	32.7
Expenditure breakdown							
17. Employee wages and intermediate consumption (17a+17b)	D.1+P.2	175,473	16.7	16.4	15.6	14.8	13.9
17a. Employee wages	D.1	116,087	11.1	10.9	10.4	9.8	9.3
17b. Intermediate consumption	P.2	59,386	5.7	5.4	5.2	4.9	4.6
18. Social transfers (18= 18a+18b)		197,211	18.8	18.9	18.9	18.6	18.3
of which, unemployment benefits							
18a. Social transfers in kind via market	D.63 (1)	28,720	2.7	2.6	2.5	2.3	2.1
18b. Social benefits (not in kind)	D.62	168,491	16.1	16.3	16.4	16.4	16.2
19. Interest	EDP D.41	31,322	3.0	3.3	3.5	3.6	3.6
20 Subsidies	D.3	10,060	1.0	1.1	1.0	0.9	0.9
21. Gross fixed capital formation	P.5	18,151	1.7	1.5	1.5	1.4	1.3
22. Capital transfers		44,999	4.3	0.7	0.6	0.6	0.5
23. Other expenditure		16,469	1.6	1.4	1.3	1.2	1.2
24. Total expenditure	**TE**	**493,685**	**47.0**	**43.3**	**42.3**	**41.2**	**39.7**
p.m.: Public consumption	P.3	211,446	20.1	19.7	18.9	17.7	16.5

(1) D.63 = D.6311+D.63121+D.63131
(A) On-going; (F) Forecast
Sources: Ministry of Economy & Competitiveness and Ministry of Finance & Public Administrations

As regards distribution of financing needs, the proposed scheme is based on the need to minimise deficit reductions for agents whose balance has greater cyclical sensitivity, mainly Social Security and the Central Administration, whose joint deficit is maintained (at the expense of increasing the former by 0.4 percentage points and decreasing the latter by the same amount). Meanwhile, the Regional Governments and Local Entities, with lower cyclical sensitivity, would jointly reduce their deficit by about 0.8 percentage points. In the following years, however, this pattern would be reversed. Indeed, as of 2014 and once the cyclical gap starts to close, the Central Administration and Social Security will jointly eliminate 2 deficit points, while the Regional

Governments will reduce deficit by approximately 1 point, mainly due to cyclical factors. In turn, Social Security reform measures will also facilitate this consolidation, as will later be described.

Tax policies. The recommendations of the European Commission on the Stability Programme and National Reform Plan of 2012, approved by the ECOFIN Council on 10th July 2012 included the need to adopt immediate fiscal measures to mitigate the structural problems and correct the deficit.

These recommendations included the proposal to introduce a tax system in keeping with the effort made in fiscal consolidation to support more growth, including a shift in tax treatment from work to consumption and environmental taxation. In particular, it recommended combating low Value Added Tax (VAT) revenue by broadening the tax base and ensuring a tax treatment less biased toward debt and home ownership.

In order to comply with the specific recommendations adopted on 10th July 2012 by the ECOFIN Council, Royal Decree Law 20/2012, 13th July, was approved on Measures to Guarantee Budgetary Stability and Promote Competitiveness. This law includes major modifications to VAT-such as the increase in tax rates as of 1st September 2012-, Personal Income Tax -eliminating the tax deduction for home acquisition- and Corporate Income Tax, by limiting the offsetting of negative tax bases and the deductibility of financial expenses or increasing instalments payment.

The measures contained in RDL 20/2012 were subsequently supplemented by Law 16/2012, 27th December, under which various tax measures are adopted aimed at consolidating public finances and boosting economic activity. With regard to personal income tax, this law includes the elimination of the deduction for house mortages for new purchasers as of 1st January 2013, and a special tax on lottery prizes of the State, Regional Governments, Spanish National Organisation for the Blind, the Spanish Red Cross and similar European entities which were exempt until 1st January 2013. As regards Corporate Tax, tax-deductible depreciation of large companies is partially restricted and in the three income taxes (Corporate Tax, Non-resident Income Tax and Personal Income Tax for economic activities) it is possible for taxpayers to update their balance sheets.

The reform of environmental tax treatment was articulated by Law 15/2012, 27th December, on tax measures for energy sustainability, which included the creation of three new taxes and increased rates of special taxes. With regard to the taxation of energy products, Law 2/2012, 29th July, on the Central Government Budget for the year 2012, increased the existing zero rate for biofuels.

In order to ensure compliance with the committed fiscal consolidation path, a number of measures are scheduled which should contribute to obtain additional resources from 2013 onwards:

In the area of Corporate Tax, continuity was given to the measures adopted on a temporary basis in 2012 and 2013, the minimum general split payment of 12% of the book profit for certain entities, the increased rates for split payment, the restriction of the deductibility of goodwill, and the restriction of the deductibility of intangible assets with an undefined useful life, the incorporation into the tax base of the split payment of 25% of dividends and revenue exempt by virtue of article 21 of the TRLIS[5], and the restriction to tax deductible depreciation. These measures avoid the negative impact initially forecast, making it possible to maintain the positive trend in tax collection through 2015 (Table 3.3.2). In addition, new adjustments will be made that contribute toward the broadening of the tax bases in order to continue to recover effective taxation for this tax.

Secondly, as regards Personal Income Tax, continuity is also given to the supplementary levy on the total state tax payable, which was initially established for the 2012 and 2013 tax periods by Royal Decree Law 20/2011, 30th December, on urgent measures in budgetary, tax and financial matters, in order to correct the public deficit. The differential impact of this measure prevents the negative impact initially forecast in 2014.

Thirdly, modifications are made to the VAT law applicable to certain healthcare products and services performed by notaries in relation to financial transactions to comply with the EU regulations and Rulings of the Court of Justice (case C-360/2011).

Lastly, and in accordance with European Union recommendations, emphasis is placed on the goal of displacing taxation from work to consumption with the greatest negative externalities, new direct environmental taxes are established, and special taxes are modified. At the same time, tax on motor vehicles (known as road tax) will be revised to introduce environmental criteria.

In order to increase the resources available to Local Entities, the increase of the property tax rate is likewise continued for those urban properties with the greatest value, also established in December 2011. This measure avoids the negative impact initially forecast for 2014.

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[5] Texto Refundido de la Ley del Impuesto sobre Sociedades: Consolidated Corporate Tax Law

In relation to the revenue of the Regional Governments, a positive, though very low tax rate is fixed (approximately two per ten thousand) on deposits of credit entities configured as taxpayers. The aim is to obtain resources to compensate the Regional Governments which already have similar regional taxes in place, and which must be compensated by Law.

Also, in accordance with the announcement during the State of the Nation debate, together with the fiscal consolidation measures, which have restored credibility in the Spanish public finances, five selective packages of measures will be approved to stimulate economic growth:

Firstly, effective as of 1st January 2014, a special optional VAT regime is created which will allow taxpayers to avoid depositing the VAT until invoices are paid (cash criterion). This measure will reduce cash flow difficulties for many companies associated with the current obligation to pay VAT to the Treasury before receiving payment from the customer.

The implementation of this measure represents no cost but rather a tax deferment so in 2014 less revenue will be collected than what will be recovered in 2015.

Secondly, in order to provide an incentive for business capitalisation and investment, to favour research and investigation activities and endow companies with greater legal certainty, some new tax incentives of the Corporate Tax will be promoted.

Lastly, a new tax incentive in personal income tax will also be established in order to boost the capture of equity by either new or recently created companies from individuals providing financial capital and, where appropriate, capture their business or professional know-how.

Overall, as reflected in Table 3.3.2, the tax measures, without any other Regional Government revenue or contributions, allow additional income of €17,005 million in 2013, €4,708 million in 2014 and €562 million in 2015, in which indirect and environmental taxation take part to a greater degree.

No later than 2015, a complete reversion will take place of the extraordinary supplement of the IRPF introduced in December 2011, without this hampering compliance with the fiscal objectives projected for such year and those that follow.

Expenditure policies. Together with the measures envisaged in the 2013-2014 plan presented in August 2012, others have been adopted, including the planning of additional measures with an impact as of 2013.

Worthy of emphasis is the reform of Public Administrations with impact on various Administration areas. Firstly, by establishing the Commission for Reform of Public Administrations, (Spanish initials, CORA). This Commission seeks to achieve an austere and efficient Public Administration of competitive value for Spain, streamlining structures, procedures, and resources. Work will be completed on 30th June.

Its results, as part of the consolidation of the Central Government Budget, will achieve substantial savings in State expenditure. The Commission work will be structured along the following action lines:

- **Administrative overlaps.** The goal is to identify and eliminate overlaps and strengthen cooperation mechanisms, so as to decrease the expense of administrative activity. Insofar as the competences attribute to the Local Administration are already under reform in a draft for the amendment of its Basic Precepts Law, the overlaps to be identified in this study are those between the General Public Administration and Regional Governments.

- **Administrative simplification.** It will review administrative hurdles that hinder administrative processes in order to achieve greater simplification to benefit citizens.

- **Management of common services and resources.** Its goal is to centralise management activities which may be conducted in a unified or coordinated manner, because they are similar or of the same type, thus making a greater use of public resources.

- **Institutional administration.** The different types of organisations that constitute it will be analysed and the regulatory framework and the models identified therein as optimal will be reviewed. Relevant changes will be made in the list of existing organisations.

In 2013, the adoption of expenditure measures in the State is also expected, in addition to revenue measures and those regarding employment policies, in order to achieve additional savings in the Central Government Budget for an amount of €1,000 million, irrespective of civil service measures. These measures affect Chapters II, IV, VI, and VII in all Ministry departments, and worthy of note is the fact that a part of the corrections will be carried out as concepts aimed at transferring finalist resources to Regional Governments, to be distributed by sectorial conferences, so that the Regional Governments must, in turn, decrease expenditure in these areas by the amount they will cease to receive from the State.

As regards 2014, the government will proceed to determine the limit of non-financial expenditure of the State, including expenditure control measures that will make it possible to achieve the budgetary stability goal on the basis of the forecast revenues that will include the effect of the tax measures adopted. In this sense, worthy of mention is the growing impact on the expenditure budget of measures taken in previous years, such as the virtual freezing of the public employment offer or the strict control of staff replacement rates, which both generate significant savings in staff expenditure, and the measures for administrative streamlining from CORA, which are expected to generate the first savings this year, deploying their full effects in 2014 onward.

As regards current transfers, they will continue to be reviewed and adapted, assessing the suitability of eliminating non-essential subsidy facilities. This streamlining of current expenditure will be accompanied by an investment optimisation policy, which will seek to ensure that available resources have the maximum impact on the economy, stimulating growth and employment, at the lowest possible cost, in line with the Europe 2020 Strategy and the priorities arising from the recently agreed financial prospects.

Secondly, as part of the reform of the Public Administrations, civil servant measures are emphasised. Their expected impact on all Public Administrations is €3,700 million in 2013 (negative impact of Table 3.3.2 is the differential effect respect to that of 2012) and an additional €1,650 million in 2014, by means of significant measures for Public Administration efficiency such as: minimum of 37.5 working hours, reduction of credits and trade union leaves, maximum of 3 personal days and for seniority; restriction of the public employment offer; control of temporary disability. Preparatory work for professional civil servant career.

Thirdly, the next reform of Local Administrations is worthy of note. The Council of Ministers has been informed about the Draft Bill on local reform to improve **efficiency in the provision of services** and their sustainability. The impact of the reform is crucial, with expected savings of €8,000 million in 2014-2015, where the greatest impact is concentrated. This reform entails significant effort in terms of the reorganisation of competences between Public Administration levels, as well as professional improvement of the civil servant function at the local level.

In 2013, before the implementation of the local reform, Local Entities envisage a significant effort with an impact of more than €2,000 million, half of which is in the form of decreased investment. For following years, the maintenance of the increased Property Tax is expected.

Moreover, Regional Governments expect to make a significant effort with regard to all areas of their own budgets in 2013 while, at the same time, healthcare and education reforms launched after RDL 14 and 16/2012 continue to have an impact in 2013 due to the fact that it only had an impact on education for 4 months in 2012 and for one semester in healthcare. Overall, an impact on healthcare expenditure of more than €6,000 million is expected, mainly in these sectors, where Regional Government expenditure is concentrated; effort that should continue in upcoming years in expenditures side in the form of an additional €2,000 million each year. Regarding Regional Governments revenue, there is still room to deplete the current regulatory capacity on taxes of its own. The estimate for the next few years is an additional €2,000 million per year, provided the current trend of increasing regulatory capacity in transferred taxes and the margin of its own taxes - particularly environmental taxes- continues. In the area of long-term care, greater savings of about €1,200 million in 2013 and €500 million in 2013 are expected due to the implementation of the reform initiated in 2012.

Employment policies: The measures adopted in 2012 have their greatest impact in 2013 (over €3 million) due to the time required for their implementation or the months required for the groups to be affected. These measures were already approved in 2012 and specified in the August 2012 biennial plan, for example regarding the elimination of signing bonuses, the elimination of the special subsidy for people over 45 who deplete the contributory benefits, streamlining of the subsidy for those over the age of 52, previous employment requirement for Active Insertion Income, unemployment benefits, elimination of coverage of part of Social Security contributions during the unemployment period, adjustment of unemployment benefits, modification of benefits and subsidies linked to part-time contracts.

In 2013, the efficiency of active employment policies will be promoted by means of greater collaboration between national and regional public employment services, as well as by promoting public-private collaboration. Progress will also be made towards stronger links between active and passive employment policies. These will enable better integration of unemployed people and progress in the fight against fraud.

The new reform of the active employment policy system lies in its orientation towards results: common goals are set forth to determine priorities for each year, toward which the Public Employment Services must work, sharing the data required for monitoring and evaluation. The new framework for active policies thus strengthens the effectiveness of active employment policies and promotes efficiency in expenditure decisions.

Measures to strengthen coordination among public employment services and public-private collaboration. The framework Agreement for public-private collaboration in labour intermediation entails the coordinated behaviour of Regional Government and State Employment Services. The Single Employment Portal will enable the dissemination of job offers and demands and training opportunities throughout all of Spain, as well as in other countries of the European Economic Area. To this end, the Public Employment Services will record all job offers and demands in the databases of the Information System of the Public Employment Services. The State Public Employment Service will ensure dissemination of this information to all citizens, companies, and public administrations, to ensure transparency and market unity.

Training measures for improvement of quality in vocational training, emphasising their adaptation to the real needs of the productive fabric, in particular regarding the updating and review of professional certificates.

Measures for groups specially impacted by unemployment, particularly young people. To this end, the 2013-2016 Entrepreneurship and Youth Employment Strategy has been presented.

The aforementioned measures will be complemented in 2015 by new actions on active and passive employment policies.

In the Social Security domain, the impact of RDL 5/2013 measures is estimated to have an impact of almost €1,000 million in annual savings as of 2014. These savings are regarded as established in the measures of the biennial plan for 2014, and would be additional for 2015. This would be added in the future to the application of the measures arising from the reform of the system which are currently being assessed for approval in coming months, mainly the sustainability factor, as well as the potential impact of the future Desindexation Law. With regard to the sustainability factor, an a priori calculation would indicate that its entry into force could moderate the evolution of expenditure around 2% of the GDP on average per annum, from its entry into force through 2016. As for the Desindexation Law, it would also have an impact on the evolution of public spending.

Table 3.3.2 below provides a summary of the impact of these measures, grouped into the main revenue and expenditure categories. The table includes the approximately €3,000 million in additional measures that will be taken in 2013 to reach the target financing need of 6.3% of the GDP for all Public Administrations which, as described in the previous paragraphs, would include €800 million in taxation measures on consumption displaying greater negative externalities, another €1,000 million to improve coordination of active and passive employment policies, and finally another €800 million from additional measures for savings in another series of State budgetary chapters.

As an additional guarantee, if in the month of September 2013 the Government identifies any deviation in budgetary execution, new budgetary non-disposability measures would be adopted to comply with the budgetary objectives.

Table 3.3.2. Impact of the main regulatory changes

Measured by their differential effect with respect to the previous year

	GDP Percentage			
	2012	**2013**	**2014**	**2015**
Total Expenditure	**2.5**	**1.5**	**0.9**	**1.0**
Public employment	0.5	-0.2	0.2	0.1
Employment policies	0.1	0.4	0.0	0.0
Social expenditure (dependency)	0.0	0.1	0.1	0.0
Other Central Government Budget expenditure (including CORA) General State Budget	0.8	0.4	0.1	0.1
Regional Government measures (not including public employment measures)	0.9	0.6	0.2	0.2
Local reform and adjustment plans	0.1	0.2	0.3	0.5
Social Security expenditure	0.0	0.0	0.1	0.1
Total Revenues	**1.7**	**2.1**	**0.7**	**0.3**
Total tax	1.2	1.6	0.4	0.1
Personal Income Tax and Non-Resident taxes	0.3	0.3	0.0	0.0
Corporate Tax	0.4	0.0	0.3	-0.1
Special Tax regularisation and fight against fraud	0.1	0.0	0.1	0.0
Environmental tax and water tax	0.0	0.2	0.0	0.0
VAT	0.1	0.8	0.0	0.1
Excise taxes	0.0	0.2	0.0	0.0
Other	0.0	0.0	0.0	0.0
Real Estate Tax	0.1	0.0	0.0	0.0
Regional Government revenue measures	0.4	0.3	0.2	0.2
Social Security contribution revenues	0.0	0.2	0.0	0.0
Social Security fight against fraud	0.2	0.0	0.0	0.0
Total	**4.2**	**3.6**	**1.6**	**1.3**

The above table does not include the impact of future measures to be approved in the Social Security domain, so the discretionary measure figures provided in the table are conservative assumptions. However, following the approval of these new measures, the total amount of the measures might be increased by 2-3 pp. between 2014 and 2015, thus standing at 1.7 in both years. Furthermore, in 2015 the impact of any additional measures on active policies should be added.

By comparing these results to the estimated need for discretionary measures provided in section 3.6, it can be seen that the efforts committed through 2015 always fall within the estimated range of said need. Should evidence be revealed in any of these years of the need to adopt more measures to attain the projected budget objectives, the Government will do so automatically.

The year 2016 is not included in this table of measures, as it is difficult to define them three years in advance with the same degree of precision as that applied in 2014 and 2015. Moreover, 2016 is a year that falls beyond the horizon of the current term of office, so it does not appear prudent to make final commitments at this time on the precise measures to be taken. Nonetheless, section 3.6 provides an assessment of the needs for discretionary measures that year, and a battery of viable proposals is already available.

From a macroeconomic point-of-view, the expenditure adjustments included in the Stability Programme reduce the weights of expenditure in the GDP, as shown in table 3.3.1, from 43.3% in 2013 to 39.7 in 2017. Furthermore, from a functional point-of-view, there is also a considerable variation in the weight of the various components of expenditure in the GDP as shown in table 3.3.3.

Table 3.3.3 Change in the expenditure structure by function

	Weight of 2011 GDP	Weight of 2016 GDP	Variation % Weight in the
PUBLIC ADMINISTRATIONS (S.13)			
1 General public services	5.7	6.1	7.2
2 Defence	1.1	0.8	-20.6
3 Public order and security	2.2	1.7	-22.4
4 Economic affairs	5.3	3.3	-38.0
5 Protection of the environment	0.9	0.6	-30.6
6 Housing and community services	0.6	0.4	-42.0
7 Healthcare	6.3	5.4	-15.6
8 Leisure activities, culture, and religion	1.5	1.0	-36.1
9 Education	4.7	4.0	-15.7
10 Social protection	16.9	16.6	-1.8
Total expenditure	**45.2**	**39.7**	**-12.0**
Sources: National Institute of Statistics and Ministries of Economy and Competitiveness and Public Finance and Public Administrations			

Between 2011, the last year when the National Institute of Statistics published data on expenditure by functions, and 2016 the weight on the GDP of all headings is reduced with the exception of general public services, which increase slightly. The reason for this increase is that this function includes interest payments, which goes from somewhat less than 2.5% of the GDP for 2011 to 3.6%, almost 1.2 percentage points more. Deducting the increase of interest payments from this heading, the remaining general public service expenditure reduces its weight in the GDP by 23.7%, clearly above the average reduction of -12%.

Further, the least reduction in the weight in the GDP corresponds to social protection expenditure (-1.8%) which, together with interest payments, is the only type of expenditure that experiences a nominal increase within the period. The Healthcare and Education functions are the next smallest reductions, while the correction has the greatest impact on the other functions, with the largest percentage reduction in housing and community services (42%).

3.4. Public debt estimates

In 2012, the public debt/GDP ratio in Spain increased by 15 percentage points, reaching 84.2% of GDP (Table 3.4.2). This considerable advance was mainly the result of the financial operations carried out by the State, among others, as part of the banking restructuring and recapitalisation, as well as to provide territorial administrations with liquidity to cover their financial needs and payments to their suppliers. These operations were reflected in primary deficit of 7.7% of GDP (including 3.6 points of financial aids to banks, computed as capital transfers) and in a deficit-debt adjustment of 3.4 points, much higher than the history of this component due, to a large extent, to the financial assets acquired by the State as a result of said operations. The strong rise of financial assets last year was partly countered by the likewise considerable increase in financial operations among public administrations, as the debt (EDB) is accounted for in net terms. By contrast, in 2012, for the first time in many years, the stock of pending payments by public administrations underwent a dramatic drop, and had an upward impact on the debt needs of these administrations. Additionally, other adjustments, which reflected the effect of several factors, such as differences between interest paid and accrued, or between the nominal value issued and the cash value captured in bonds issued at a discount, etc. contributed toward slightly reducing the adjustment between debt and deficit in 2012 (Table 3.4.1). Finally, the drop in the nominal GDP increased the debt/GDP ratio by 0.9 percentage points. Despite the increase recorded last year, Spanish public debt was still below the average in the Eurozone (90.6%).

At the close of 2013, public debt will account for 91.4% of the GDP, 7.2 points more than at the close of 2012. The main factor in the increase with respect to 2012 is the deficit forecast for 2013, 6.3% of the GDP, to which a deficit-debt adjustment of 1 percentage point of the GDP will be added, minimally offset by the slight advance in the nominal GDP, with an effect on the debt ratio of -0.1 points.

Table 3.4.1. Stock-debt flow adjustment in 2012

	2012
Stock-flow adjustment	3.4
Financial assets	10.9
Accounts payable	2.7
Operations between Public Administrations	-9.8
Other adjustments	-0.3
Source: Bank of Spain	

The debt-deficit adjustment forecast for 2013 includes the effects on public debt of instruments such as the Electricity Deficit Sinking Fund, the Supplier Payment Fund, and the parts assigned to Spain of the loans to Greece, Portugal, and Ireland, as well as the loan for the recapitalisation of the Spanish financial system made by the European Financial Stability Facility.

As observed in Table 3.4.2, the debt stock will continue to progress until 2016 at a relatively slower pace, as a result of the gradual reduction of the primary deficit, which after 2016 will become a primary surplus. This improvement of the primary balance over the period, arising from the fiscal consolidation efforts, is added to the decrease of the differential between the implicit debt rate and the increase in the nominal GDP, which contributes to situating the Spanish public debt on a sustainable path, with gradually smaller increases in the debt/GDP ratio, which will become reductions beyond the forecasting horizon.

Over the entire 2013-2016 period, the debt ratio will increase by 15.6 percentage points, up to 99.8% of GDP. The greater contribution to this increase will come from payments for debt interest, with 14 percentage points, primary deficit, with 4.6 percentage points, and the stock-flow adjustment, with 4 percentage points, whereas the growth of the nominal GDP over the projection period will subtract 7 percentage points from the debt ratio.

Table 3.4.2. Public debt dynamics

% of GDP

	2012	2013	2014	2015	2016	Variation 2012-2016
1. Gross debt level	84.2	91.4	96.2	99.1	99.8	15.6
2. Variation in the debt level	15.0	7.2	4.8	2.9	0.7	15.6
Contributions in the variation in the debt level						
3. Primary budget balance	-7.7	-3.0	-2.0	-0.5	0.9	-4.6
4. Interest paid	3.0	3.3	3.5	3.6	3.6	14.0
5. Effect of nominal GDP growth	0.9	-0.1	-1.6	-2.2	-3.0	-7.0
6. Other factors (debt-deficit adjustment)	3.4	1.0	1.0	1.0	1.0	4.0
p.m.: Implicit interest rate:	4.25	3.93	3.86	3.82	3.77	
Source: Ministry of Economy and Competitiveness						

3.5. Cyclical orientation of the fiscal policy

In order to analyse the orientation of the fiscal policy, the 2013-2016 Stability Programme Update provides estimates of the potential product of the Spanish economy following the methodology of the output function used by the European Commission (EC) and agreed within the *Output Gap Working Group* (OGWG). In addition, this time a statistical change has been introduced and the official method for the calculation of potential growth has been verified by means of a methodological variant. More specifically, the statistical change consists in using the short-term population projections published by the Spanish National Institute of Statistics in November 2012, as these are more recent than those used by EUROSTAT.

As regards methodological variants, it should firstly be pointed out that the range of possibilities to estimate the potential growth of an economy is very wide. To give an example: the methods used by the EC, the IMF, and OECD display significant discrepancies, with the consequent differences in results and the remarkable uncertainty to which their interpretation is subject. More specifically, the methodology used by the EC (which Member States must use in their Stability Programmes) generates considerably pro-cyclical potential growth profiles which tend to closely mimic the observed GDP rates. The equilibrium unemployment rate estimated by means of this method (NAWRU) also tends to replicate the variations in the observed unemployment rate, involving a hysteresis that is scarcely realistic. In this sense, other methods, such as that of the OECD, display less counter-intuitive results. Thus in its 2012 Economic Outlook, the OECD estimated an average potential growth of 1.5% for Spain in the 2012-2017 period, a figure considerably higher than the one obtained using the EC method, as will now be seen.

The main consequence of this pro-cyclicality of the EC potential is that, in recessive times, it tends to underestimate cyclic gap levels, and thus to overestimate structural public deficit. Variations in the cyclical gap (output gap) are also usually underestimated, so estimation of the structural effort made by a country during a fiscal consolidation process is biased downwards. This was the case of Spain in 2012.

In order to mitigate the problem of pro-cyclicality, an aspect which was often discussed in the OGWG, this time, together with the official EC method, an alternative *forward-looking* specification of the Phillips curve was used to calculate the NAWRU, as opposed to the current *static expectation model* of the European Commission. This variant was discussed within the OGWG in January 2013, although it has not been yet included in the official methodology. To summarise, this estimation generates more stable unemployment equilibrium rates that become more stable over time, and thus a lighter potential growth, closer to the intuitive idea of potential growth. The counterpart is that the cyclical gaps arising from these paths for potential growth are also larger and structural deficits are smaller. Application of this methodology, in any case, does not involve a total "debugging" of the calculation of the potential of pro-cyclical factors: for example, estimation of the NAWRU continues to be very sensitive to what is known as the "endpoint problem", or the last annual observation within the statistical process of extraction of said rate. From the point-of-view of evaluation of the impact of labour market reforms on potential growth, these limitations of methodology often mask its true impact on certain key variables, such as the equilibrium unemployment rate.

Tables 3.5.1 and 3.5.1 Bis illustrate the growth rates expected for the real GDP in the central scenario for the 2013-2016 period, as well as the potential GDP estimated for said period and the contributions to the growth of its main components. Table 3.5.1 is based on the alternative method for calculation of the NAWRU, whereas 3.5.1 Bis reflects the official method, based on static expectations in the wage-forming process.

Table 3.5.1. Cyclical performance (1)

% of GDP, unless otherwise specified

	2012	2013	2014	2015	2016
1. Real GDP growth (percentage %)	-1.4	-1.3	0.5	0.9	1.3
2. Borrowing requirements (Net lending (+) / borrowing (-))	-10.6	-6.3	-5.5	-4.1	-2.7
3. Interest	3.0	3.3	3.5	3.6	3.6
4. Temporary measures	-2.7	0.0	0.0	0.0	0.0
5. Potential GDP growth (variation %)	0.1	-0.3	-0.3	-0.3	-0.2
Contributions:					
- labour	-0.6	-0.7	-0.6	-0.5	-0.5
- capital	0.2	0.1	0.1	0.1	0.2
- total factor productivity	0.5	0.3	0.2	0.1	0.2
6. Output gap	-7.7	-8.5	-7.8	-6.7	-5.3
7. Cyclical balance	-3.7	-4.1	-3.7	-3.2	-2.5
8. Cyclically adjusted balance (2-7)	-7.0	-2.3	-1.7	-0.9	-0.2
9. Cyclically adjusted primary balance (8+3)	-4.0	1.0	1.8	2.7	3.5
10. Structural balance (8-4)	-4.3	-2.3	-1.7	-0.9	-0.2
11. Primary structural balance (10+3)	-1.3	1.0	1.8	2.7	3.5

(1) Using Potential GDP (output function) NAWRU calculated with a forward-looking Phillips Curve.
Source: Ministry of Economy and Competitiveness

In contrast, the following table reflecting the method considered by the European Commission can be examined.

Table 3.5.1. Bis Cyclical performance (1)

% GDP, unless otherwise specified

	2012	2013	2014	2015	2016
1. Real GDP growth (% change)	-0.4	-0.8	-0.8	-0.7	-0.6
Contributions:					
- labour	-1.1	-1.2	-1.0	-1.0	-0.9
- capital	0.2	0.1	0.1	0.1	0.2
- total factor productivity	0.5	0.3	0.2	0.1	0.2
6. Output gap	-6.0	-6.4	-5.2	-3.7	-1.8

(1) Using Potential GDP (output function) NAWRU calculated with a forward-looking Phillips Curve.
Source: Ministry of Economy and Competitiveness

Potential GDP decreases over the projection period, more intensely in the EC method in force, and in the result of the alternative method, a 0.3% annual average in the first three years and 0.2% in 2016, a contractive evolution which is accounted for by the detraction from growth of the work factor and the less positive contribution of Total Factor Productivity (TFP). In turn, the behaviour of the work factor reflects the increase in the structural unemployment rate and the reduction of the population of working age as a result of the drop in net migratory flows. Nonetheless, it should be pointed out that the effects of the crisis on structural unemployment are artificially prolonged for some years even after the end of the crisis, as a result of the mechanical extension of the NAWRU, which for some years has carried out the EC method.

Given the potential GDP estimates and the real GDP forecasts, the output gap will be more negative in 2013 than last year, although after 2014 it will be gradually reduced, reaching -1.8% with the first method and -5.3% with the alternative method at the end of the forecasting horizon; after 2017, it will continue to close at a more rapid pace.

In order to go from cyclically adjusted deficits to structural deficits, the measures that constitute one-offs each year are deducted. The measures considered in each year are included in the following table:

Table 3.5.2. One-off measures in 2012

	2012
Suppression of the Christmas extra pay	0.5
Extraordinary contribution to the Deposit Guarantee Fund	0.1
Tax regularisation	0.1
Change in the Property Tax payment schedule	0.2
Min. Instalments	0.1
Special levy on external currencies	0.0
Bank recapitalisation	-3.7
Temporary reduction of VAT for purchase of new homes	-0.1
TOTAL	-2.7
Source: Ministry of Finance and Public Administrations	

The method arising from the alternative calculation of the NAWRU, characterised by a smoother potential growth, involves a considerable difference with respect to the structural balances given by the EC in its winter forecasts. To illustrate this difference (and for a relatively similar GDP growth path) in 2013 the structural balance of the Public Administrations amounted to -2.3% of the GDP in accordance with this latter estimate, whereas in the EC winter forecasts, it was -4.7% of GDP. According to these data, two thirds of the 2011 structural deficit (-6.2% of GDP) would have been eliminated between 2012 and 2013, which gives an idea of the great tax effort made in both years.

We will now assess the structural efforts arising from each method. To begin with, it should be borne in mind that in its latest estimate of January 2013, the EC estimated the structural effort in 2012 at approx. 2.6 pp., arising from the reduction in the structural deficit proper as well as from the sum of extraordinary and unexpected revenue shortfalls[6] for the amount of 1.5 GDP pp., which involved the adoption of extraordinary consolidation measures. For 2013, the latest EC estimate, including revenue shortfalls, reflected a structural effort of 2.6 pp., even though this figure will be reassessed in the next report on Effective Compliance with the Recommendation for Excess Deficit Procedures for Spain, to be published in May 2013. In both years, the figures given in the table do not include the adjustment due to extraordinary revenue shortfall, the quantification of which ultimately depends on the new EC spring macroeconomic forecasts.

Structural efforts are higher (and most probably, more realistic) when the NAWRU is calculated using the procedure under study in the OGWG. The reason is that, in a recession, the reduction of the output gap is less concealed by the pro-cyclicality of the potential, whereas in expansion, the lower pro-cyclicality of the NAWRU involves a smaller contraction of the cyclical gap and requires a greater reduction of the structural to reach a given deficit target. To be more precise, the structural efforts in 2012 and 2013 would be, according to this calculation, 1.9 and 2 pp. respectively, as opposed to 1.4 and 1.2 pp. in the EC winter forecasts. The differences between both figures are mainly due to the following factors: i) some discrepancies as regards the valuation of one-off measures in 2012, for 0.2 pp.; ii) greater commitment to reduction of nominal deficit in 2013 than expected by the EC in its latest forecasts (6.7%); iii) the rest would be mainly due to partial elimination of pro-cyclicality in this Programme Update, which would generate greater cyclical deficit in both years (in 2012, 0.7 pp. as opposed to 0.3 pp. in the EC forecast, and 0.4 pp. in 2013 as opposed to 0 according to the EC) and a smaller improvement in the output gap as of 2014. There might also be a reduced residue due to the differences between the initial macroeconomic scenarios.

As of 2014, structural efforts according to the latter model in the next three years would amount to 0.7, 0.8, and 0.8 pp. of GDP. Even though they are lower than in the two previous years, this is consistent with the structural deficit level estimated in late 2013, in the sense that a substantial part of the structural deficit would have been already cumulatively eliminated between 2012 and 2013. This path, which would balance a necessarily pro-cyclical position of the fiscal policy and the existence of a yet negative cyclical gap until 2016 is in no way less demanding than that posited in the latest Stability Programme Update, whose structural efforts in 2014 and 2015 amounted to 0.2 pp. each year, which is also the case when the structural effort is evaluated following the official EC method. Thus, this is a path that takes as its starting point the verification of greater cyclical weakness in the years

[6] These revenue shortfalls are usually associated with what are known as "composition effects"; or the impact of changes in the composition of GDP on tax revenues. This issue will be discussed in section 3.6.

analysed and, as such, increases the structural effort required to reach a certain nominal deficit target.

Evaluation of structural effort by means of the primary structural effort is also interesting, as the increased load due to debt interest may lead to an undervaluation of the actual structural effort. From this point-of-view, primary structural efforts in 2012 and 2013 would amount, taking for example the NAWRU alternative estimation method, to 2.6 and 2.3 pp. respectively, whereas in 2014-16 they would amount to 0.8, 0.9, and 0.8 pp.

Inasmuch as the estimation of structural effort is directly affected by the uncertainty surrounding calculation of potential growth as well as the uncertainties surrounding the effect of consolidation policies regarding the components of demand, it has been deemed convenient to provide a range for prediction of structural efforts[7]. In any case, it should be borne in mind that structural effort is only an estimate of the value which the difference between structural balances in consecutive years will later have, and thus is one more variable in the set of estimates included in the Stability Programme.

Table 3.5.3. Structural effort intervals calculated using the NAWRU alternative estimation methods

	2013	2014	2015	2016
Structural effort (forecast interval)	(1.8,2.1)	(0.6,0.8)	(0.7,0.9)	(0.7,0.9)

However, structural effort is not the most faithful measure of the effort actually displayed by a country to reach a certain deficit target. Certain variables with autonomous evolution, such as debt interest expenditure or certain social provisions not linked to the cycle (mainly pensions) raise deficit per se when they are increased, thus concealing part of the actual effort carried out if it is measured by means of the concept of structural effort. Analogously, the aforementioned losses in tax revenues linked to changes in growth composition are not included in the variation in structural balances, thus underestimating real effort. This issue will be discussed in section 3.7 below.

[7] To calculate the ends of the forecasting intervals, the efforts obtained by means of both NAWRU extraction methodologies as top-down exercises, based on the estimation of a GDP path by means of the application of tax multipliers to a baseline scenario, from which the potential growth path is derived, have been considered. This "meshing" of results to build forecasting intervals for structural efforts is a frequent practice.

3.6 Medium-Term Objective Convergence (MTO)

The current Code of Conduct in the Stability and Growth Pact adopted by the Ecofin Council in its meeting of January 2012 establishes the obligation of extending the forecasts for the main macroeconomic variables until the time when the medium-term objective, a maximum structural deficit of -0.5% of the GDP, is reached. It also establishes the obligation of describing main variables in the path to be taken to attain this target. In the case of Spain, the medium-term objective established by the Organic Law on Budgetary Stability is even more ambitious, achieving structural balance. This section seeks to provide a timeline for the time when both targets might be reached.

In order to establish the structural balance and the time when the medium-term objective is reached, two variations of the European Commission methodology have been used to calculate the potential GDP. The difference between them, as indicated in section 3.5, lies in the specification used to estimate the NAWRU of the Spanish economy. In this first exercise, a forward-looking specification of the Phillips curve has been used, whereas static expectations are used in the second. Both specifications are applied to the growth path until 2016 shown in the tables below, as was done in the rest of the programme. In order to ensure the consistency of the potential GDP used in the rest of the Programme with that in this section, after 2017, the potential GDP is obtained by the procedure of extrapolating for a period of up to 10 years which the Commission submitted to the Economic Policy Committee in January/February 2013.

Tables 3.6.2 and 3.6.4 provide a synthesis of the macroeconomic projections beyond 2016. In both cases, the GDP growth will be the same, with an acceleration of up to 3.2% in 2019 and a reduction of the unemployment rate which would be below 15% in 2019. It is necessary to stress that these projections have been obtained by basically prolonging the tendency of the main variables through 2016, and therefore they are not economic projections in the strict sense.

Both specifications determine different times to reach the medium-term objective, as the structural deficit displayed for 2016 in each of them is somewhat different, although in both scenarios the same budgetary consolidation measures are applied. In the case of the Phillips curve with dynamic expectations, the target is reached by 2017. If static expectations are used, the target would be reached in 2019. In both the annual adjustment of structural deficit amounts to between 6 and 7 pp. The resultant structural balances may be observed in tables 3.6.1 and 3.6.3. By the year 2019 the cyclical gap will be practically closed with the potential GDP calculated with dynamic expectations, while in such year the cyclical gap would have already inverted its sign and would be positive with the NAWRU variant calculated with static expectations.

Even though a constant fiscal policy scenario has been envisaged, a rise in tax revenue/GDP ratio is observed as years go by. The reason for this trend is that the macroeconomic situation underlying these fiscal forecasts includes a greater increase in domestic demand in the last years which, by its very nature, yields higher collection levels. In other words, the negative composition effects that still have a certain impact at the beginning of the forecast horizon would partially reverse.

It is important to point out that, even with the specification that yields a later date, structural balance is reached in 2019, one year before the deadline established in the Organic Law on Budgetary Stability and Financial Sustainability.

Table 3.6.1 Medium Term Objective (MTO) Convergence: Budgetary Plan
GDP %, unless otherwise specified

	2012	2013	2014	2015	2016	2017
1. Regional Governments borrowing requirements (Net lending (+) / borrowing (-)) (2+3+4)	-10.6	-6.3	-5.5	-4.1	-2.7	-0.9
2. Structural balance	-4.3	-2.3	-1.7	-0.9	-0.2	0.5
3. Cyclical balance	-3.7	-4.1	-3.7	-3.2	-2.5	-1.5
4. One-offs and other temporary measures	-2.7	0.0	0.0	0.0	0.0	0.0
5. Regional Governments borrowing requirements (Net lending (+) / borrowing (-)) (6-7)	-10.6	-6.3	-5.5	-4.1	-2.7	-0.9
6. Revenues	36.4	37.0	36.8	37.1	37.1	37.9
6.a Total revenues in a scenario of no policy change from 2012	37.0	37.0	37.0	37.0	37.0	37.0
7. Expenditure	47.0	43.3	42.2	41.2	39.7	38.8
Amounts to be excluded from the expenditure benchmark	6.1	6.7	5.5	5.1	4.7	4.4
7.a Interest expenditure	3.0	3.3	3.5	3.6	3.6	3.5
7.b Expenditure on EU programmes fully matched by EU funds	0.7	0.7	0.7	0.7	0.7	0.7
7.c Cyclical expenditure in unemployment benefits	0.6	0.7	0.6	0.6	0.4	0.3
7.d Effects of discretionary revenue measures	1.7	2.1	0.7	0.3	0.0	0.0
8. Tax burden	32.0	32.5	32.3	32.6	32.7	32.8
9. Gross debt	84.2	91.4	96.2	99.1	99.8	96.9

NAWRU calculated using a forward-looking Phillips Curve

Source: Ministry of Economy and Competitiveness

Table 3.6.2 Adjustment path to the Medium Term Objective (MTO): Macroeconomic Premises
GDP %, unless otherwise specified

	2012	2013	2014	2015	2016	2017
1. Real GDP growth	-1.4	-1.3	0.5	0.9	1.3	2.5
2. Nominal GDP growth	-1.3	0.2	1.8	2.4	3.1	5.0
3. Deflator GDP growth	0.1	1.4	1.4	1.5	1.8	2.4
4. Potential GDP growth	0.1	-0.3	-0.3	-0.3	-0.2	0.2
5. Output gap (potential GDP %)	-7.7	-8.5	-7.8	-6.7	-5.3	-3.1
6. Employment, people	-4.2	-3.5	-0.2	0.6	1.0	2.2
7. Employment, hours worked	-4.2	-3.4	0.3	1.4	1.8	2.1
8. Unemployment rate (%)	25.0	27.1	26.7	25.8	24.8	22.0
9. Gross fixed capital formation	-9.1	-7.1	-0.9	2.0	4.3	4.8
10. Compensation per employee	-0.3	1.1	0.4	0.5	0.5	0.5

NAWRU calculated using a forward-looking Phillips
Source: Ministry of Economy and Competitiveness

Table 3.6.3 Adjustment path to the Medium Term Objective (MTO): Budgetary Plan
GDP %, unless otherwise specified

	2017	2018	2019
1. Regional Governments borrowing requirements (net lending (+) / borrowing (-)) (2+3+4)	-0.9	0.6	2.1
2. Structural balance	-1.2	-0.6	0.0
3. Cyclical balance	0.3	1.2	2.1
4. One-offs and other temporary measures	0.0	0.0	0.0
5. Regional Governments borrowing requirements (Net lending (+) / borrowing (-)) (6-7)	-0.9	0.6	2.1
6. Revenues	37.9	38.3	38.6
6.a Total revenues in a scenario of no policy change from 2012	37.0	37.0	37.0
7. Expenditure	38.8	37.7	36.5
Amounts to be excluded from the expenditure benchmark	4.1	3.8	3.5
7.a Interest expenditure	.5	3.4	3.2
7.b Expenditure in EU programmes fully matched by EU funds	0.7	0.6	0.6
7.c Cyclical expenditure in unemployment benefits	-0.1	-0.2	-0.4
7.d Effects of discretionary revenue measures	0.0	0.0	0.0
8. Tax burden	32.8	33.0	33.1
9. Gross debt	96.9	92.2	85.6

(2) NAWRU calculated using a backward-looking Phillips Curve
Source: Ministry of Economy and Competitiveness

Table 3.6.4 Adjustment path to the Medium Term Objective (MTO): Macroeconomic Premises variation %, unless otherwise specified

	2017	2018	2019
1. Real GDP growth	2.5	2.8	3.2
2. Nominal GDP growth	5.0	5.6	6.4
3. GDP Deflator growth	2.4	2.7	3.1
4. Potential GDP growth	0.0	0.9	1.4
5. Output gap (potential GDP %)	0.6	2.5	4.4
6. Employment, people	2.2	2.5	2.9
7. Employment, hours worked	2.1	2.4	2.8
8. Unemployment rate (%)	22.0	18.6	14.9
9. Gross fixed capital formation	4.8	5.5	6.4
10. Compensation per employee	0.5	0.5	0.5

(2) NAWRU calculated using a backward-looking Phillips Curve
Source: Ministry of Economy and Competitiveness

3.7. Budgetary effects of structural reforms

Measurement of discretionary fiscal effort makes it possible to quantify the volume of budget consolidation measures which are, a priori, required to reach a certain reduction of nominal deficit. From the point-of-view of fiscal policy, this is a highly relevant magnitude, as it identifies, for each structural effort to be achieved, the sum of budget resources to be mobilised.

The quantification of the discretionary effort is based on the following elements:

a) The amount of the deficit to be reduced.
b) The influence of the cycle on revenues and expenditure.
c) The influence of growth composition on revenue growth.
d) The effect of various autonomous factors, such as interest expenditure or social expenditure not linked to the cycle (mainly pension expenditure).

As for point c), it is clear that there are some tax richer compositions of growth than others. For example, the structure that determines the current cyclical status of the Spanish economy, characterised by strong expansion of exports, as well as by the considerable drop in private consumption and housing investment and by decline in employment, leads to a gradual loss of tax revenues over the GDP, both direct and indirect, which goes beyond the variation in the cyclical balance of Public Administrations. The change is greater when compared to the prevailing situation in the latest expansive cycle, with strong rises in revenues directly or indirectly linked to the expansion of the real estate sector (VAT, transfer tax, capital gains arising in the Personal Income Tax and the Property Tax), and the solid advance in private consumption (VAT), while, at the same time, the contribution of exports was clearly lower. Several authors have estimated that this type of "composition effects" on public revenues represented approximately 3% of the GDP in the latest expansive stage, particularly relevant in VAT and the Corporate Income Tax.

Taking all this into account, the following table summarises all the discretionary measures which were (and will be) necessary to reach the budgetary objectives in 2012 (2013-2016). Composition effects have also been internally estimated. Given that the cyclical factor involves an uncertainty margin, the amount of these measures is also given as a range.

Table 3.7.1 Discretionary measures

2012	2013	2014	2015	2016
(4.5;4.7)	(3.4;3.6,)	(1.6;1.8)	(1.5;1.7)	(1.4;1.6)

According to these results, the real discretionary efforts made in 2012 would be approximately 5 GDP points, much higher than the apparent structural effort of 1.9 pp. After 2012, discretionary efforts would follow a decreasing tendency for many reasons: mainly, lower nominal deficit reductions, more favourable cyclical contributions, and lower composition effects as the domestic demand components, “richer” in tax revenue gain weight. As previously seen, the reduction in discretionary measures is compatible with stability and even a slight increase in structural efforts towards the end of the horizon.

In any case, none of the years requires discretionary measures of less than 1.5 GDP pp., which involves a considerable continuous effort over the 4 remaining years to eliminate the excessive deficit. Comparing these figures to the structural efforts, the former are almost twice the latter in most years - another argument for describing structural effort as a measure that is only partially significant to calibrate the real fiscal effort made by a country.

3.8. The role of Regional Governments and local governments in fiscal strategy

3.8.1 Regional Governments

In 2011, Regional Governments did not achieve the stability target established for that year, reaching 3.31% of the national GDP compared to the 1.5% established.

In 2012, a significant fiscal consolidation effort was made by the Regional Governments, reducing their aggregate deficit almost by half, down to 1.76% of the national GDP. This represents a slight deviation of 0.26% over the budget stability target, fixed at a deficit of 1.5% of the national GDP.

This improvement in regional fiscal performance was mainly due to two factors. Firstly, the entry into force of Organic Law 2/2012 of 27 April on Budgetary Stability and Financial Sustainability, whose application has been accompanied by a number of additional regulatory initiatives and developments related to the budget and financial stability of the Regional Governments. Secondly, the commitment made by regions as regards consolidation of their public accounts, which has led to an unprecedented fiscal effort by Regional Governments in 2012, based on an ambitious programme of expenditure reduction and revenue increases.

This expenditure control effort by Regional Governments can be analysed in national accounting terms. The severe recession puts strong upward pressure on the expenditure of the Regional Governments, closely linked to the welfare state and thus difficult to reduce. Expenditure has decreased by more than €2.200 million. However, this figure is distorted by the effects of the extraordinary financing mechanisms, which imply an increase in other current expenses and conceals the effort in expenditure reduction which can be seen in net budget terms (-8.2% expenditure reduction, discounting the effect of the extraordinary financing mechanisms, which involve the accounting of a significant amount of payment obligations not previously recorded in the budget, which has mainly affected Chapters II and VI).

The reduction of non-financial uses, not taking into account the aforementioned effect, which distorts the variation in non-financial expenditure, and discounting the rise in interest, which is autonomous, reaches €16,400 million. Worthy of emphasis is the reduction by 6.6% (€5,000 million) of employee compensation, and 5.3% (-€1,600 million) in intermediate consumptions, as well as the reduction by €7,700 million in capital expenditure, with a 52% drop of investment by the Regional Governments. In parallel, total resources have increased, although they have been impacted by the change in the financing system. Non-financial revenues were slightly reduced, but revenues other than system revenues subject to interim payments and settlement were reduced by 4% in 2012. As a whole expenditure containment has led to practical fulfilment of the deficit target.

As regards the fiscal consolidation effort made by the regions in 2013, non-financial expenditure envisaged in the initial budgets of the Regional Governments has been reduced by 7.4% with respect to the 2012 initial budgets, without including the Regional Government of Catalonia, whose 2013 budget has not yet been approved. The non-financial revenues were reduced by 5.6% with respect to the initial budget for 2012. However, the comparison between the 2013 budget and the execution of the 2012 budget, recognised rights or obligations, yields a 3.7% increase in revenues and an 8.7% expenditure reduction. Nevertheless, if the effect of budgetary recording of obligations generated in previous financial years arising from the application of extraordinary financing mechanisms is discounted for 2012, non-financial expenditure drops by 4.7%.

Table 3.8.1.1 2013 budget for the Regional Governments

TOTAL REGIONAL GOVERNMENTS (not including Catalonia)	Budget 2013 / 2012	Budget 2013 / Rights or Obligations Recog. 2012	Budget 2013 / Rights or Obligations Recog. Adjusted for 2012	Budget 2013 / Collections or Total Payments 2012
	Variation as a %			
Chap. 1,2,4. Tax and Current Transf	-6.5	2.2	2.2	3.6
System resources subject to interim payments and settlement	-5.6	1.1	1.1	1.1
Tax w/o Inheritance and Donations	18.2	-1.5	-1.5	20.6
Capital transfers and documented legal acts	-10.8	21.0	21.0	31.1
Other tax	8.5	17.7	17.7	18.2
Other current transfers	-19.2	-5.2	-5.2	-1.7
3. Fees, public prices, and other Revenues	12.1	1.6	1.6	16.0
5. Equity Revenues	-35.0	-7.1	-7.1	-5.5
6. Disposal of real investments	196.2	565.4	565.4	702.5
7. Capital Transfers	-14.0	5.9	5.9	11.4
NON-FINANCIAL REVENUES	**-5.6**	**3.7**	**3.7**	**8.0**
1. Compensation of employees	-5.4	1.4	1.2	1.8
2. Current expenses in assets and services	-1.8	-29.4	-15.2	-17.7
3. Financial Expenditure	40.0	38.9	47.8	38.7
4. Current Transfers	-10.9	-9.4	-8.5	-1.5
5. Contingency Fund	224.1	-	-	-
6. Real Investments	-24.7	-4.6	-4.2	22.2
7. Capital Transfers	-25.1	-15.6	-15.8	5.7
NON-FINANCIAL EXPENDITURE	**-7.4**	**-8.7**	**-4.7**	**-0.8**

From the functional point-of-view, expenditure on healthcare, education, and social services account for 66.4% of the 2013 budget. In 2012, they amounted to 67.1% of the initial budget. A considerable consolidation effort in these expenditures is observed in the budgets presented: healthcare is reduced by 6.5%, education is reduced by 8.4%, and social services by 14.4% compared to the 2012 budget. As for "Public debt" expenditures, they continue to grow in 2013, by 34.2%, and their weight amounts to 12.2% of the 2013 budget.

Organic Law 2/2012 of 27 April on Budgetary Stability and Financial Sustainability has been a crucial step in the control and monitoring of the finances of regional governments by the central Administration, which was one of the main challenges to ensure budget stability and the medium- and long-term financial sustainability of all the Public Administrations.

The measures taken by the central Administration as part of the extraordinary funding mechanisms for the Regional Governments in 2012 led to the reduction of 21.13% of the outstanding non-financial debt a percentage which rises to 30.31% when only suppliers are considered.
In the financial mechanisms area, the effort to solve the Regional Governments' liquidity problems is maintained and even increased. Thus, Royal Decree-Law 21/2012, 13 July, on measures for the liquidity of the public Administrations and in the financial area, establishes the *Regional Liquidity Fund* (Spanish initials, FLA) with a total drawn of €16,640 million for 2012, so completing the work carried out by the *Fund for the Financing of Payments to Suppliers.* FLA resources have made it possible to perform credit operations in favour of the Regional Governments in order to cover their financial needs. This fund, managed by the Official Credit Institute, will be prolonged throughout 2013. This fund also enables better monitoring of the financial and fiscal status of the Regional Governments that are part of it and, since 2013, has strengthened control over Regional Governments that fail to achieve the deficit target or have a high late payment rate.

Execution of expenditure measures: Overall expenditure measures for the Regional Governments, both those included in the 2012-2014 economic-financial rebalancing plans and the additional measures communicated later, amount to €15,584 million, of which 80% has been executed.

Execution of revenue measures: Overall revenue measures for the Regional Governments, both those included in the 2012-2014 economic-financial rebalancing plans and the additional measures communicated later, amount to €5,076 million, of which 76% has been executed.

As can be seen in the attached table, the Regional Governments that have displayed the highest percentage of execution were Galicia, Catalonia, and Navarre. By contrast, the Regions with the lowest effect in application of their expenditure measures were Murcia, the Balearic Islands, Extremadura, and Aragón.

a) Measures established by the Central Government affecting Regional Governments:

In terms of national accounting, it is estimated that the impact of healthcare and education measures, approved by Royal Decree Law 14/2012 and 16/2012, together with the suppression of the December extra payment in these sectors in 2012 amounts to €6,000 million. Discounting the effect of the extra payment, the impact would amount to €4,200 million (0.4% of the GDP).

Table 3.8.1.2 Effect of healthcare and education measures

Sec 95. Base 2008 (million euros)

CURRENT USES (PDE)	2012
REGIONAL GOVERNMENTS HEALTHCARE	-3,053
Compensation of employees	-2,145
Intermediate consumption	212
Social transfers in kind supplied via market producers	-1,047
Other current uses	-73
REGIONAL GOVERNMENTS EDUCATION	-2,973
Salaried employees' wages	-2,023
Intermediate consumption	-384
Social transfers in kind by market producers	-263
Other current uses	-303

The economic impact of measures on education was originally estimated at €3,987.5 million within one year. Taking into account the fact that the measures started to be effectively applied in September, at the start of the school year, 8 months would be pending application in 2013, so the estimated savings may be attained or surpassed.

The originally estimated healthcare savings were €7,267 million per year.

Another one of the measures taken which has had a significant effect on fiscal consolidation of the Regional Governments was Royal Decree-law 20/2012,13 July on measures to guarantee budgetary stability and promote competitiveness, which includes various measures to reduce and streamline the expenditure of public Administrations and increase revenues: Measures for control of staff costs; elimination of the extraordinary payment; reduction of social expenditure, in particular dependency expenditure, and measures to increase VAT, Personal Income Tax, and Special Taxes collection.

As regards the resizing of the public sector, taking 1 July 2010 as the initial reference point for the re-organisation processes, and combining all the re-organisation processes in the strict sense and the other measures adopted since 1 July 2012, the Regional Governments have forecast a net reduction of 686 entities, 28.5% of those in existence as of 1 July 2010.

As of 1 October 2012, 291 of the scheduled closures had taken place and 62 new entities had been created, so that the net effect is a reduction of 229 entities, which amounts to 33.4% of the total reduction scheduled, 9.53% of the entities existing in the initial situation. However, according to the information available, 247 entities were being phased out as of 1 October 2012, which have later shutdown, are in the winding up process, or have ceased their activities.

b) Budgetary consolidation established by the Regional Governments:

The Regional Governments have also gradually taken their own medium-term fiscal consolidation measures in their 2013 Budgets. All the 2013 Regional Governments Budgets have been approved, except Catalonia and the Basque Country, although the Basque Country is currently processing the Draft Budget Law for 2013.

b1) Expenditure measures

On the expenditure side, staff costs actions stand out. Some of the measures for 2013 involve the consolidation of the measures implemented in 2012 concerning civil servants, employees, temporary workers, and senior officials. The most frequently envisaged measures are reduction of wage complements; suspension of employee benefits; the introduction of flexible working hour measures (together with a proportional wage reduction); reduction of staff by attrition; reduction of days off for personal matters and holidays; temporary suspension of the complement for temporary disability arising from common contingencies; forced retirement and the elimination of bodies and departments and integration of administrative structures.

Specific control measures for healthcare staff: these are mostly measures implemented in 2012, but they continue to have effects in 2013. The most common measures are: temporary reduction of professional career complements; suspension of variable productivity complements; elimination of free days after days on call; reduction of the service portfolio; reduction of replacements; increase of the temporary employee workday, among others.

Specific measures for education staff: as in healthcare, the measures for education staff were implemented in 2012. The most common measures are: increase in teaching hours, increase in student ratios, elimination of complements, reduction of replacements, suspension of complements, re-organisation of education inspection departments, forced retirement, and staff reduction through amortisation of temporary employee positions.

In the case of operational costs, they include savings arising from the launch of centralised purchase systems, energy savings plans, measures for greater efficiency and savings in management and purchase of supplies.

Increased reductions in investment costs are also included, as well as the decrease both of real investments and capital transfers, through reduction and prioritisation of investment in infrastructures and operation of eligible for subsidies services, and adjustments and reorientation of aid.

In the coming years, this programme forecasts expenditure reduction by €1,900 million in 2014 and €2,000 million in 2015. In order to comply with the corrections required in the following years, the Regional Governments must continue to take measures. There is margin for expenditure reduction in the Regional Governments both in basic services, which some Regional Governments provide under more efficient conditions, and in non-basic services. The measures envisaged concern additional staff costs measures to those included in the biennial plan, intermediate consumption, other current expenditure and investment, and sale of assets, whose process has already begun and has a two-year maturity period.

b2) Measures regarding revenues

On the revenue side, the following measures are particularly relevant: the raise of the Property Tax rates or reduction of the exempted minimum; the raise in the tax rate for the Capital transfers and documented legal acts; application of the regional tranche of the Tax on Retail Sales of Certain Hydrocarbons; the raise of the treatment fee; and the increase of the Inheritance and Donations Tax in certain cases.

In addition, making use of their tax-collection capacity, the Regional Governments have created new taxes and modified some of the taxes which they had established in the past: taxes on plastic bags, on environmental impact or activities with environmental impact, gaming tax, and tourist accommodations tax.

In addition, the Regional Governments have planned to dispose of both land as well as real assets.

Regulatory legislation on the financial system (for the Financing of Regional Governments [LOFCA] and Law 22/2009) assigns significant regulatory competences to the Regional Governments relative to the taxes transferred, competences of which the Regional Governments have made considerable use, particularly in the last two years.

These competences are very wide-ranging as regards both direct and indirect taxation, with the limit imposed by Community regulations on VAT harmonisation and Special Taxes. In some cases, such as hydrocarbons taxation and the Tax on Certain Means of Transport, Regional Governments can approve the levy within a maximum tax band, established in State regulations. However, as regards the remaining taxes, Regional Governments do not have a cap on raising the levy rate, which provides extensive potential for growth in their tax revenues.

In recent years, as part of fiscal consolidation plans, the exercise of regional regulatory competences has considerably increased by means of the increase in levy rates and reduction of tax benefits.

Thus, as regards the Personal Income Tax, after 2010 Regional Governments started raising tax rates and reducing the regional deductions which they had approved in previous years. More specifically, in 2013 all Regional Governments except two are applying a levy that is equal to or higher than the extra levy imposed by State legislation. In 2010 the subsidiary extra State levy disappeared; since then, Regional Governments must expressly approve a levy as a way to strengthen their tax co-responsibility.

As regards the Wealth Tax, all Regional Governments, except for one, are effectively applying the tax, and competences are being increasingly used by raising rates in several Regions and reducing the exempted minimum in others.

Also as part of direct taxation, there has been a suppression of the tax benefits approved in previous years in the Inheritance and Donations Tax, so that Regional Governments are in the process of increasing the revenue potential of this tax.

As regards indirect taxes, Regional Governments have basically modified the Transfer Tax and Stamp Duty and hydrocarbon taxation, without overlooking other taxes such as the Tax on Certain Means of Transport.

As regards the Transfer Tax and Stamp Duty, many Regional Governments have taken measures to increase levies both in the Property Transfer and Certified Legal Document modalities in 2012 and 2013, thanks to which a considerable increase in collection for this tax can be anticipated. A table describing these measures is provided.

As regards hydrocarbon taxation in 2012 and 2013, Regional Governments have expedited the implementation of regional rates of this tax, with the ex-novo introduction of the regional rate in some cases (three Regional Governments), increasing the rate which had already been established, in other cases (six Regional Governments), or enlarging the catalogue of products to which the tax can be applied (one Region). There is still a certain margin to increase collection for this tax, as not all Regions have made full use of their regulatory competences. As regards the Tax on Certain Means of Transport, five Regional Governments so far have introduced increased levy rates for certain vehicles, and there is considerable margin for growth for other Regions to do so in 2013.

Finally, several Regional Governments have introduced their own taxes in 2012 and 2013, many of them of an environmental nature. For example, levies on large commercial premises, electrical installations, waste, etc. have become generalised. This is the result of a flexibilisation of the limits established in the Organic Law for the Financing of the Regional Governments for the creation of these taxes, as well as several Constitutional Court rulings favouring the constitutional nature of them.

Two tables are included. The first one summarises the main taxation changes approved in 2012 and in the Budget and Tax Measures Laws for 2013. The second table shows the main measures taken by Regional Governments with regard to staff costs in addition to those established in the basic State regulations.

Table 3.8.1.3 Regulatory changes in 2012 and changes in projects/budgets/measures in 2013

REGIONAL GOVERNMENT	PERSONAL INCOME TAX	PROPERTY TRANSFER TAX AND CERTIFIED LEGAL DOCUMENTS TAX	INHERITANCE AND DONATIONS TAX	PROPERTY TAX	SPECIAL TAX ON RETAIL SALE OF CERTAIN HYDROCARBONS / TAX ON CERTAIN MEANS OF TRANSPORT	OTHER	NEW TAXES
Andalusia	With effect starting on 1 January top marginal rates higher than those established in the State scale for taxable incomes exceeding €.60,000	Increase in the general levy for notarial documents with effect from 22/6/2012: from 1.2% to 1.5%.		Regulates the tax scale with effect from 1/1/2012: increases tax rates by 10%.	In 2012, increase of the regional rate for the Special Tax on Retail Sale on Certain Hydrocarbons, doubling it to the maximum band allowed is exhausted, except for diesel for agricultural use.	Increase in tax rates on gambling	Tax on non-face-to-face gambling activities (11.9 million euros).
Aragon	The 2013 Budget law establishes various regional deductions in Personal Income Tax.	New deductions and reductions in 2012.	In 2012 new reductions and bonuses. In 2012: Reduction of tax liability in inheritances acquired by SP in kinship Groups I and II: the reduction is established at 33% (20% in 2012, and the percentage was expected to gradually increase, reaching 100% in 2015).				
Asturias	The Budget Law regulates the regional scale of the Personal Income Tax applicable after 2013: it is progressive and consists of 7 bands. The four first bands and their rates are the same as in the general State scale and the three last ones establish margin rates higher than those established by State regulations.			Gradual increase in the Inheritance Tax, mostly for higher taxable incomes, so that the increase in the first taxation band is 10%, and 20% in the highest income band.	Increase in regional Hydrocarbon Tax.	Gambling tax, the casino tax is increased in general, a new reduced rate is created for casinos that maintain jobs, and the taxable income and levies for electronic bingo are regulated.	Natural person property tax (23 million euros), Tax on deposits in credit institutions (30 million euros), Tax on electronic gambling (1.2 million euros).
Balearic Islands	Elimination of several deductions in Personal Income Tax (such as the Deduction for tax liabilities paid in Onerous Property Transfer Tax and Certified Legal Document Tax for the purchase of the first home by certain groups or purchase of a subsidised home, among others).	In 2012 Onerous Property Transfer Tax: rate regulation (transfer of certain cars) and increase in real estate rates. In 2013, increase in Onerous Property Transfer rates (real estate transfer) and in Certified Legal Document rates (notarial documents).		Starting on 31/12/2012, the 100% reduction of tax liability is eliminated, and the minimum exempted is fixed at 700,000 euros.	In 2012, rate regulation in both taxes.	Increase in water treatment rates.	Tax on environmental damage due to use of rental vehicles without a driver (15 million euros), Tax on environmental damage due to large commercial undertakings (8.5 million euros), Tax on beverage packaging (35 million euros).
Canary Islands	The regional scale, which is gradual and has only 4 bands, is modified, and the margin rate applicable to the tax base is 22.58%, higher than the 21.5% established in the previous scale.	In 2012 new rates are established for provision of guarantees, transfer of real estate assets. In 2013 administrative concession rates are raised and new rates are also created.	In 2012 the main inheritance and donations deductions were eliminated.		In 2012, regulation of regional rates in Special Tax on Retail Sale of Certain Hydrocarbons.	Increase in tax rates on tobacco and fuel. Increase in the General Indirect Tax for the Canary Islands. Fixed rates applicable to "B" and "C" type gamins machines are increased, and the taxable income and levy rates for bingo are regulated.	CAC tax customer deposits in CA Credit Institution (30.03 million euros), CAC tax on environmental impact of large commercial undertakings (8.13 million euros), CAC tax on environmental impact of certain activities (0.75million euros), CAC part. in tax w.o. gambling activities (TP 6 Law 13) (1.45 million euros)
Cantabria		Increase in real estate transfer rates, notarial document rates, etc. in 2013.	Increase of reductions and deductions in 2012.		In 2012, rate regulation in Special Tax on Retail Sale of Certain Hydrocarbons.	Increase in the water treatment rates.	
Castile and León		In 2013, general increase in Onerous Property Transfer rates and Certified Legal Document rates in 2013, as well as inclusion of income limits applicable to tax benefits.	Elimination of the main inheritance and donations reductions in 2013.		En 2012 increased rates in Special Tax on Retail Sale of Certain Hydrocarbons.	Increase in the general taxation rates for gambling, from 20% to 35%.	
Castile - La Mancha		In 2012, general rate increase (starting on 7/8/2012), transfer of real estate assets: from 7% to 8%, administrative concessions from 7% to 8%, etc.					Tax on various developments (16.55 million euros), Tax on gambling activities (4 million euros), Other indirect taxes (10.13 million euros), thermosolar tax (4 million euros).

Catalonia		Increase in Certified Legal Document Tax for notarial documents, from 1.2% to 1.5%. The applicable rate is also increased for cases in which VAT exemption has been waived, from 1.5% to 1.8%.		Starting on 31/12/2012, the minimum exempted is established at 500,000 euros, and the Tax scale is regulated, establishing margin rates higher than those established in the State additional scale.	The Special Tax on Retail Sale of Certain Hydrocarbons increased from 1 April 2012. The regional rate applicable to petrol and diesel for general use, bringing it to the highest band.	In gambling taxes, the taxable income and applicable levy rate applicable to internet or telematic games, as well as to certain special types of bingo are regulated, and the taxable base bands to gambling casinos are changed.	Creation of the Tax on stays in tourism establishments and of the Tax on deposits in credit institutions.
Extremadura	Several deductions are eliminated, such as deductions for rental of the first home for under 35s, large families, and people with disabilities, or for domestic aid, among others.	In 2012: increase in the real estate transfer rates, new administrative concession rate, transfer of movable asset rates… Also increase in notarial document rates.		The tax scale is regulated: gradual, with 8 bands, with applicable rates in each band being 50% higher than those in the scale additionally approved by the State.	In 2012, increase in the Special Tax on Retail Sale of Certain Hydrocarbons. New rates for Tax on Certain Means of Transport are created.	Tax rates for installations with an environmental impact and the Tax on deposits in Credit Institutions are raised.	Tax on gambling activities (1.7 million euros), tax on dumps (4.59 million euros), water treatment tax (34.44 million euros).
Galicia		General rate increase with some deductions for business promotion.	Deductions for business promotion.	The scale is regulated: gradual, with eight bands, and higher rates than those additionally established in the State-approved scale.			
Madrid	Elimination of the regional deduction for investment in a newly built first home, as well as the regional deduction complementary to the deduction for first-home investment.	95% deduction on tax liability in taxable operations, in both modalities, which are directly related to the launch of the Integrated Development Centres.				Gambling casino rates are reduced and reduction of taxable liabilities for creation and maintenance of employment are regulated.	Tax on gambling activities (40 million euros)
Murcia		In 2012 the general levy type for notarial documents was raised from 1% to 1.2% and in real estate transfer when VAT exemption is waived: from 1.5% to 2%.	In 2012 application of deductions in tax liability for mortis causa acquisitions was restricted, and in 2013 a new margin rate higher than the State-approved scale was additionally established for taxable incomes higher than 398,777.08 euros.		The regional Special Tax on Retail Sale of Certain Hydrocarbons is increased until the maximum band allowed by Law 22/2009 is reached (with effect starting on 1/11/2012).	The tax on installations with an environmental impact is eliminated.	Tax rates on gambling (55.8 million euros), tax rates on raffles, tombolas, bets, and others (0.003 million euros), tax on electronic gambling activities (1.75 million euros).
La Rioja		Eliminates 2% reduced levy rate on transfers where exemption is waived.				In gambling taxes, the taxable bases for technical, telematic, and interactive games and gambles are regulated.	Environmental (3.65 million euros).
Valencia	The regional deduction for purchase or outside financing is cancelled.	In 2012 the general Certificated Legal Document Tax is raised until 31/12/2013. In 2013, the Onerous Property Transfer Tax was temporarily raised (until 31/12/014). Real estate transfer tax was raised from 7% to 8%.		The 100% reduction is eliminated.	In 2012, the regional Special Tax on Retail Sale of Certain Hydrocarbons was eliminated.		Online gambling tax (13.93 million euros), tax on activities with an environmental impact (28.68 million euros), tax on waste disposal in dumps (1.57 euros).

Table 3.8.1.4 Significant changes in staff costs in addition to basic State regulations

REGIONAL GOVERNMENT	GENERAL RETRIBUTION MEASURES	SENIOR MANAGEMENT RETRIBUTION MEASURES	PROPORTIONAL REDUCTION OF WORKING HOURS AND RETRIBUTION	REDUCTION/ELIMINATION OF BONUSES AND PRODUCTIVITY INCENTIVES	STAFF MANAGEMENT / PLANNING MEASURES	OTHER
Andalusia	Elimination of the specific complement for extra pays for Andalucía Healthcare System public servants and temporary employees. 5% reduction of Justice staff and University teaching and research staff. 5% reduction in instrumental company and consortium salaries.	Senior Management reduction between 7.5% and 6%. Adaptation of the economic system for senior management in Andalucía public companies to that established for senior management and civil servants in the General Administration.	10% reduction in the working hours and fixed and periodic remuneration of temporary employees.	10% reduction of all variable remuneration. Suspension of accrual and payment of all bonuses.		Homogenisation of instrumental compa company collective agreements %
Aragon					Appointments of temporary teaching civil servants will be extended, at most, until 30 June of each year. No extensions of active employment will be granted as a general rule.	
Asturias		Suspension of the right to receive the increase in the destination complement until it is equal to the Managing Director complement from reintegration in active employment. In addition, bonuses for extraordinary services are banned from member of the Governing Board and other senior management.			Suspension, until 1 January 2015, of the extension of permanence in active employment.	
Balearic Islands	Suspension of remuneration for civil servant and employee careers as well as for homogenisation of the specific civil servant and employee complements. Suspension of certain remuneration for non-university teaching staff. 32% reduction of the "administrative career" remuneration for healthcare staff.					Suspension of social action benefits, except for aids for families with children under 18 and relatives of people with disabilities. Measures for rationalisation of remuneration and professional classification of instrumental public company staff.
Canary Islands			20% reduction in working hours (10% for staff working than 25 hours per week) as well as for remuneration of temporary civil servants and temporary employees, with exceptions.	Initial credits for staff overtime and civil servant bonuses are reduced to the limit of 0.10% of the total staff cost in article 13 in the former case and 0.10% to the total staff cost in articles 10, 11, 12, in the latter case, except in section 05.	Repeal of rulings authorising of recognising the extension of permanence in active employment, save exceptions.	Decrease of the Social Action Fund from 4 million euros to 3 million euros, maintaining the destination of the credits included therein
Cantabria			Voluntary reduction of the specific complement for temporary teaching staff providing part-time services is established.		In 2013, both the appointment and the extension of temporary civil servants for execution of temporary programmes are suspended.	Ordinary working hours for healthcare staff will increase by 21 hours in the annual computation, in no case entailing recognition of any economic complement.
Castile and León			Temporary civil servant teachers may be appointed with fewer working hours than those generally established, with basic and temporary remuneration proportional to working hours.			Elimination of compensation, including allowances and travel expenses to attend Economic and Social Council Meetings.
Castile - La Mancha	The specific complement or equivalent for non-statute civil servants will be reduced by 10% up to a maximum of 3% of the individual gross salary.3% reduction in staff salaries. Reduction in healthcare staff complements	3% reduction in senior management and assimilated staff remuneration	Reduced working hours for temporary workers, with proportional reduction in remuneration, up to a limit of 15%. For the rest of staff, the possibility of requesting a reduction in working hours and salary.	Elimination of incentives by goals and, generally speaking, extraordinary bonuses for non-statute civil servants.	Elimination of extensions and renewals of permanence in active employment for all staff.	Special voluntary leave for civil servants and permanent statute staff, with a minimum duration of six months and a maximum duration of three years. Regulation of personal leaves, granted with no remuneration, whose accumulated duration may not exceed six months in a one-year period.

Catalonia	Reduction in remuneration for the amount equal to an extraordinary pay and, when relevant, an additional specific complement pay or equivalent.					
Extremadura		5% reduction in remuneration. Elimination of the right to a special complement for the difference between the destination complement and the temporary position held before reintegration. Elimination, of the privilege obtaining a vacant position with a corresponding destination complement on return from a free appointment position.				Transfer of date of payment of extraordinary pays to public sector staff work scheduled to be accrued in June and December to January and July, respectively.
Galicia	For the annual specific complement, a reduction equivalent to the sum of the additional June and December pays. Reductions analogous to those in the specific healthcare and justice staff complements.5% reduction in University of Galicia salaries.	Remuneration of the President of the Regional Government and senior management will be reduced between7% and5.4% Remuneration of Boards of Directors of public trade companies and public businesses may not exceed 85% of the global amounts estimated for 2011.		Safeguards as regards bonuses for extraordinary services		Reduction equivalent to that of staff costs for agreements, contracts, and collaboration agreements, transfers to financial institutions financed for the most part by the Region, and the management rates of companies declared to be own means and technical service.
Madrid		Remuneration of certain senior management will be lower by 20% than that of the Managing Director.				Social benefits and social action expenditure are suspended, save for exceptions. Compensation clauses in staff employment agreements are banned both in the General Administration and in Foundations and Consortiums.
Murcia		Remuneration of members of the Governing Board and senior management are reduced by 3%. Remuneration cap for public company management, regional trade companies, and regional public foundations: remuneration corresponding to the position of Managing Director	Civil servants and permanent statutory staff may voluntary request the reduction of their working hours, with the corresponding reduction in remuneration, with a maximum limit of one third of working hours This reduction will be compulsory, with the same limit, for temporary staff.	Ban reduction on remuneration for overtime, which will be compulsorily compensated with additional free time. Elimination of payment of amounts as variable productivity bonuses, productivity incentives, or complements of identical or similar nature, except for research staff for execution of R&D+I programmes	No new extensions to permanence in active employment will be given to regional Administration civil servants and the statute staff in the Murcia Healthcare System. Extensions already authorised will end within a maximum of 9 months, save for exceptions.	Payment of compensation for attendance of certain collegiate bodies will be exceptional. Suspension of the announcement, granting, and payment of any social action aid or similar.
Navarra		Cancellation of life and accident insurance specifically purchased for senior management. "Special use" for Government members and other senior management and former senior management is excluded from the healthcare service		Elimination of allowances established as compensation for travel while on duty.	Elimination of the extension of permanence in active employment, save for exceptions.	Some provisions not given by the public healthcare service for public servants in the special use Healthcare Service, such as optician and dentist, are restricted.
Basque Country		The maximum annual amount paid to senior management in public companies governed by private law, public companies, foundations, and consortiums may not exceed the remuneration corresponding to a Government councillor.				Extraordinary pays are transferred to January and July. Contributions to any social insurance system including retirement coverage for Region staff will be reduced by 0% with respect to those applied until 1 June 2010.
La Rioja						The authorisation of the Regional Minister of Education, Culture and Tourism is required before the formalization of collective agreements affecting the personnel in the University of La Rioja. The authorisation requires a report of the Budget Office.
Valencia	Compensation of seven days per year worked, up to a maximum of six months in cases of termination or withdrawal of commercial or senior management contracts and for the dismissal of labour workforce of the Generalitat Public Sector			Productivity allowances accruals are prohibited for labour and non-official staff.		Suspension of the call and award of any social action benefit.

3.8.2. Local Entities

In 2013, according to the information available regarding Local Entities budgets, of all expenditure items, investment expenditure experienced the greatest decrease in 2013, €1,343 million. Together with current transfer expenditure, this amounts to a decrease of almost €2,000 million. Staff costs and purchase of goods and services were also decreased by €600 million, to which the slight impact in 2013 of the law for the reform of local regimes, currently a draft bill, should be added. Financial expenditure increased (due to a large extent to the interest of the loans formalised by the mechanism for supplier payment) as well as the Contingency Fund, which had not existed in the 2012 budget and which first appeared in 2013 as a result of the coming into force of the Organic Law for Budgetary Stability and Financial Sustainability.

On the non-financial revenue side, revenues from direct taxes (mainly the Property Tax) and from current transfers (mainly from Local Entities participation in State taxes) increased by €1,135 million. Capital transfers experienced the largest drop, not reaching €1,200 million.

Table 3.8.2.1 Local Entities' Expense Budget

Expenditure	2013	2012	Difference
Staff costs	16,175	16,596	-422
Purchase of goods and services	15,409	15,618	-209
Financial expenditure	1,680	1,512	168
Current transfers	16,115	16,732	-616
Contingency fund	126	0	126
Disposal of real investments	3,643	4,986	-1,343
Capital transfers	1,049	1,197	-148
TOTAL	**54,198**	**56,641**	**-2,443**

The launch of the local reform law in coming years is to be taken into account. The aim of the draft law on the rationalization and sustainability of the Local Administration is to apply the principles of budget stability, financial sustainability, and efficiency to Local Administrations, yielding savings amounting to €7,619 million in the period between late 2013 and 2019, plus a further €1,200 million in wage reduction. Its goals are:

- To clarify municipal competences, to prevent duplicities, under the principle of "One Administration, one competence". This prevents the re-assumption of competences not attributed by Law, with no adequate financing (what are known as "improper competences").

  The change in competences will take place with the entry into force of the Law, in such a way that Municipalities must start to adjust their structures to the new competences by means of the corresponding resizing plans, which must include, where appropriate, the elimination of services that fall outside their scope of competence. Within this framework, a transitional system is established for the assumption by the Regional Governments of the education, healthcare, and social services which were being exercised by Municipalities. A transitional five-year period is established for healthcare and education services. In the case of social services, the transitional period will be one year.

- To streamline the structure of Local Administration, in accordance with the principles of stability, sustainability, and efficiency, so that expenditure does not exceed revenue. Municipal services will be subject to an evaluation process by the Ministry of Finance and Public Administrations to find their real costs and compare these with the efficient ones. Municipality associations and lesser local entities will be subject to the same evaluation process, which they must pass in order to continue. In all cases, financial coverage of mandatory services at a standard cost is guaranteed, so that municipal services that are non-efficient according to the methodology approved by the State will become dependent on Provincial Councils, while minor local entities will become dependent on municipalities. The local economic public sector will also be subject to a rigorous streamlining process.

- To guarantee more rigorous financial and budgetary control. The controlling function in Local Entities is strengthened and the Government is given the power to establish regulations on control procedures. The new measures affect Local Administration civil servants entitled to give service throughout Spain, who will become functionally dependent on the Central Government. Within three months, entities with a territorial scope smaller than a municipality or associations must submit their accounts to the corresponding State and Regional Governments organisation so as not to be eliminated.

- To promote the private economic initiative, preventing disproportionate administrative intervention.

The expected impact of the local reform is summarised in the following table. Total savings of €7,619 million concentrated in 2014-2015 are expected, without including the savings from the restriction on salaries of employees throughout the entire Local Administration (€1,200 million), to be determined in the annual Central Government Budget law.

Table 3.8.2.2 Impact of the Draft Bill for Streamlining and Sustainability of the Local Administration (euros)

CASE: APPROVAL Oct-12	LAW FOR RATIONALISATION AND SUSTAINABILITY OF LOCAL ADMINISTRATION ARTICLES	2013	2014	2015	2016	2017	2018	2019	TOTAL PERIOD 2012-2019	Percentage over total
Compulsory Expenditure Envisages case of transitory nature of healthcare and education competences	25.2 AND 26.1		707,615,238	1,524,094,457	8,975,761	8,975,761	8,975,761	8,975,761	2,267,612,739	29.76%
Inappropriate expenditure	27 and pursuant to 57, 57 bis, and Final Provision 4		680,160,237	2,601,563,199	453,440,158				3,735,163,594	49.02%
Associations and minor Local Bodies	Additional Provision 6a, Additional Provision 12, and Transitional Provision 4a		73,152,462						73,152,462	0.96%
Resizing of the sector	86		381,023,614	1,016,602,971					1,397,626,585	18.34%
Temporary employees	Transitional Provision 10	61,530,000		17,640,000					79,170,000	1.04%
Exclusivity system	Transitional Provision 11	66,672,000							66,672,000	0.88%
Net total savings		128,202,000	1,841,951,552	5,159,900,627	462,415,919	8,975,761	8,975,761	8,975,761	7,619,397,381	100.00%
Percentage over total		1.68%	24.17%	67.72%	6.07%	0.12%	0.12%	0.12%	100.00%	

Note: the impact on local public servants' remuneration has not been quantified of the maximum and minimum limits established in the annual Central Government Budget Laws (an addition 1.2 billion dollars).
SOURCE: based on data taken from the IEF study of 12/12/2012 and calculations made in accordance with the regulation text.

4. COMPARISON WITH THE PREVIOUS STABILITY PROGRAMME. SENSITIVITY ANALYSIS

4.1. Comparison with the previous Stability Programme

The following table shows a comparison between the forecasts in the previous Stability Programme and the current one.

Table 4.1.1 Differences with the previous Stability Programme Update

	2012	2013	2014	2015	2016
GDP (volume growth %)					
Previous update	-1.7	0.2	1.4	1.8	
Current update	-1.4	-1.3	0.5	0.9	1.3
Difference	0.3	-1.5	-0.9	-0.9	
Budget balance (% of GDP)					
Previous update	-5.3	-3.0	-2.2	-1.1	
Current update	-10.6	-6.3	-5.5	-4.1	-2.7
Difference	-5.3	-3.3	-3.3	-3.0	
Gross debt (% GDP)					
Previous update	79.8	82.3	81.5	80.8	
Current update	84.2	91.4	96.2	99.1	99.8
Difference	4.4	9.2	14.7	18.3	
Source: Ministry of Economy and Competitiveness					

The Stability Programme for the 2013-2016 period substantially revises the GDP growth forecasts formulated in April 2012 downwards. This difference in forecasts mainly affects the period after 2013, as the forecast for 2012, which was revised upwards in the Central Government Budget 2013, turned out to be 0.3 pp. lower than the result finally recorded (-1.4%).

In 2012, the contributions of domestic and external demand, considered overall, were quite similar to those expected. In the case of external demand, the growth rates finally recorded were clearly lower than those forecast, as a result of a weaker external environment than expected, so that the contribution of the external sector was ultimately 2.5 GDP points, as opposed to the 2.7 GDP points expected. In the case of domestic demand, its contribution in 2012, -3.9 GDP points, was somewhat lower than expected. By components, while the gross formation of fixed capital contracted by one point more than the -8% expected, consumption variables differed from forecasts to a larger extent. Private consumption demand contracted in 2012 by 2.1% against the -1.4% forecast; on the contrary, the contraction in public consumption, which was 3.7%, also in real terms, was clearly lower than initially expected. Nonetheless, these comparisons were distorted by the retrospective revision of the Quarterly National Accounts carried out by the National Institute of Statistics in 2012 after the publication of the previous Stability Programme Update.

Even though the labour reform mitigated its elasticity with respect to the GDP, employment had a somewhat worse evolution than anticipated. In addition, since the active population was more resilient in number than expected, until the third quarter, in a labour market situation such as the current one, the average unemployment rate in 2012 was 25%, whereas the previous Update had forecast a 24.3% rate. By contrast, the contraction in the nominal GDP was -1.1%, 0.4 pp. lower than initially expected, so that the deficit/GDP and the debt/GDP ratios slightly increased.

In short, the drop in the savings rate down to 8.2%, which anticipates a certain future correction of private consumption and a worse external environment which is reflected in significant differences - particularly in 2013 and 2014 - of Spanish export market growth rates with respect to the latest Update, make it advisable to revise the growth profile after 2013 with lower rates than forecast. Other factors have also contributed to this downward revision, such as a greater need for discretionary fiscal measures to achieve a certain nominal public deficit objective, as a result of an increase in the cyclical sensitivity of public revenues (cf. section 3.5 on the cyclical orientation of the fiscal policy) or a greater contraction of domestic demand and a worse external environment which make it necessary to revise the growth profile downwards after 2013.

Thus, while the previous Programme forecast a clearer recovery during the first half of 2013, the current Program forecasts a trend towards stabilisation during the second half of this year and a slight recovery of activity in late 2013, with a more continuous and more significant recovery during 2014. Both the worse carry-over in 2013 and a more limited estimate of the growth recovery during 2014 for the previously indicated reasons, would contribute to the downward revision of 2014 growth. In the case of 2015 and 2016, the main reason for the downward revision is the extension of the elimination of the excessive deficit for two years (after the extension from July 2012 to 2014) until 2016, while the previous Update was based on the completion of the profile in 2013.

Referring now to the differences in the budget balance, the fiscal path forecast in the previous Programme concentrated the adjustment measures in the first two years, in such a way that a budget balance of -5.3% of GDP was reached in the first year, dropping to -3% in 2013, and moving on to values close to the balance which would be attained beyond the forecast horizon. The large difference between the deficit ultimately recorded and the forecast deficit may be attributed to a large extent to the cost of the reform of the financial sector, which has surpassed three percentage points. In fact, deviation with respect to the forecast capital transfers surpasses 4 GDP points, and accounts on its own for more than three quarters of the deficit deviation with respect to its target. To a lesser extent, the deviation can also be partially attributed to a smaller reduction of expenditure than initially anticipated, and which accounts for almost the entire remaining deviation.

However, in order to reach this result it was necessary to take additional measures by means of Royal Decree-Law 20/2012, 13 July, for an amount of more than €13,000 million in 2012, since both the greater impact of unemployment on the Social Security accounts and a particularly high cyclical sensitivity of revenues indicated the possibility of a significant budget deviation, given the execution figures in 2Q2012.

As of 2013, both the lower growth rates, underpinned by a larger cyclical gap than in the previous Update, and the factors related to growth composition which have an impact on tax collection, made it advisable to make the fiscal consolidation path less abrupt, so as not to incur in an overly pro-cyclical tax orientation (cf. section 3.5 again). For all these reasons, and having already introduced a significant front load in the fiscal path in 2012-13, the remaining consolidation will be somewhat slower if we consider the borrowing needs of Public Administrations, even though annual structural efforts increased as a result of the re-evaluation of the cyclical situation.

Finally, the evolution of public debt, whose trend is clearly increasing more than in the previous Stability Programme, is mainly due to two factors. Firstly, the higher deficits forecast throughout the period, which lead to higher public debt levels; secondly, the lower GDP growth rate in real terms, which also results in the raising of the debt/GDP ratio. Nonetheless, even though the levels are higher compared to those in the previous Update, stock dynamics are similar, with a maximum that would be only reached two years later (2016), and a downward trend after that point.

4.2. Risk scenarios and sensitivity analysis

A sensitivity analysis with respect to the assumptions adopted in the baseline scenario is important when making macroeconomic and fiscal projections. In the case of Spain, the level of interest rates is a variable with a strong influence on economic prospects. Given the recent decrease of the risk premium and the gradual decrease in the interest rate of debt issues, the exercise of simulating an interest rate reduction shock may be relevant.

In addition, given the uncertainty regarding the evolution of European economies, another variable whose evolution is hard to predict is external demand. Since Spain concentrates a large part of its external trade in European Union countries, simulating higher growth of these markets with respect to the baseline scenario has likewise been deemed relevant.

Simulations were carried out using the REMS model[8], a dynamic general equilibrium model with a rigorous microeconomic basis applied to the Spanish economy.

4.2.1. Sensitivity to interest rates

An analysis has been made of the effect on the main macroeconomic aggregates of reducing the interest rate by 100 basis points (bp.) over four quarters (25 bp. each quarter) and maintaining it at that level during the four years of the projection exercise, then gradually returning it to its initial value.

According to the results given in Table 4.2.1, the GDP might increase by around 0.7% with respect to its baseline scenario level at the end of the projection period, affected by the better evolution of private consumption and investment. By contrast, net exports would not have a positive contribution due, to a large extent, to the increase in imports, arising in turn from the greater dynamism of domestic demand.

Regarding fiscal variables, they would benefit from this situation. The boom in domestic demand and job creation would improve revenue collection and reduce certain expenditure categories, including unemployment benefits. In addition, the interest rate reduction entails a lower interests payment, which has a positive impact on public accounts. At the end of the projection period, public deficit and public debt would be lower than those in the baseline scenario, by 0.7 GDP pp. and 2.5 GDP pp., respectively.

Table 4.2.1 Impact of a 100 bp. reduction of the interest rate

	2013	2014	2015	2016
Real GDP	0.8	0.2	0.6	0.9
Private consumption	1.8	1.3	1.7	1.9
Gross capital formation	12.0	9.3	7.8	6.0
Public balance (% of GDP)	0.6	0.5	0.7	0.7
Public debt (% of GDP)	-0.6	-1.1	-1.8	-2.5
Net exports (% of GDP)	-2.2	-1.8	-1.6	-1.2
Employment (employed)	0.2	-0.1	0.2	0.5
Source: Ministry of Economy and Competitiveness				

It is important to highlight the consequences of a simulation exercise such as this one on public deficit. When the assumptions of the macroeconomic table were described, we already mentioned that those relative to long-term interest rates were relatively conservative. If at any given point downward risks

[8] Bosca, J. E., Diaz, A., Doménech, R., Ferri, J., Pérez, E. y Puch, L. (2011) "A rational expectations model for simulation and policy evaluation of the Spanish economy", en Bosca, J.E., Doménech, R., Ferri y Varela, J. (Eds.) The Spanish Economy: a General Equilibrium Perspective, Palgrave Macmillan.

concerning interest rates materialise to an extent such as the one envisaged for this year, its impact on the deficit path would be considerable, given the commitment to transfer any positive surprise in growth mainly toward deficit reduction. More specifically, supposing that the interest rate shock took place from the start of the projection period, the new levels reached by the deficit over the GDP are reflected in the following table.

Table 4.2.1Bis Deficit path for a reduction of 100 bp. of the interest rate

	2013	2014	2015	2016
New deficit over GDP	-5.7	-5.0	-3.4	-2.0

This table clearly shows that a relatively greater reduction of interest rates would make it possible to attain the 3% of GDP target in 2015.

4.2.2. Sensitivity to the economic growth of the commercial partners

The effect on the main macroeconomic aggregates of a growth of EU markets 2 pp. higher than in the baseline scenario has been analysed.

Should recovery in Europe be quicker and more intense than expected, it would have a positive impact on the main macroeconomic and fiscal variables in Spain. For this reason, a growth of European markets 2 pp. higher than that projected during the four years of the projection period, that then returns to the baseline scenario level, has been simulated.

According to the results given in Table 4.2.2, GDP might increase about 0.2% with respect to the baseline scenario level at the end of the projection period, affected both by the greater external demand and by its effect on national demand.

Fiscal variables also improve in this scenario, while less intensely, given that their impact on growth is also more modest than in the case of the interest rates. At the end of the projection period, public deficit and public debt are lower by 0.1 GDP pp. and 0.2 GDP pp., respectively, than those in the baseline scenario.

Table 4.2.2. Effect of a 2% increase in EU growth
Cumulative deviations from the baseline scenario

	2013	2014	2015	2016
Real GDP	0.3	0.1	0.2	0.2
Private consumption	0.2	0.1	0.1	0.1
Gross capital formation	0.8	0.5	0.4	0.1
Inflation	0.2	0.0	0.0	0.0
Public balance (% of GDP)	0.1	0.0	0.0	0.1
Public debt (% of GDP)	-0.1	-0.1	-0.1	-0.2
Net exports (% of GDP)	0.2	0.2	0.2	0.2
Employment (employed)	0.1	0.1	0.1	0.1
Source: Ministry of Economy and Competitiveness				

5. THE SUSTAINABILITY OF PUBLIC FINANCES

5.1. Long-term budget projections

Projections regarding public expenditure associated with ageing population by the Working Group on Ageing of the Economic Policy Committee and the European Commission are made every three years under mandate of the ECOFIN Council. The updated EUROSTAT demographic projections serve as the starting point for these exercises, together with a macroeconomic scenario created following common methodology. An essential feature of this methodology is the hypothesis that there are no changes in economic policy other than those with legal substantiation at the close of the projection year. Five public expenditure categories are analysed: pensions, healthcare, long-term care, education and unemployment. The latest projections were published in May 2012 in the Ageing Report, thus updating those made in 2009.

Table 5.1 shows national projections based on the European exercise of the Ageing Group. The European methodology takes as its reference the new EUROSTAT demographic projections published in May 2011. These projections do not include the impact of specific structural reforms in the Spanish case.

Table 5.1 2010-2060 projections of expenditure associated with ageing

	Incr. 2010-2060	2010	2020	2030	2040	2050	2060
TOTAL EXPENDITURE (1+2+3+4+5):	4.0	23.6	24.5	23.6	25.3	27.6	27.6
1. Pension expenditure	3.6	10.1	10.6	10.6	12.3	14.0	13.7
Retirement and early retirement pensions	4.0	6.8	7.5	7.8	9.5	11.1	10.9
Other pensions (disability, survival)	-0.5	3.3	3.1	2.8	2.8	2.9	2.8
2. Healthcare expenditure	1.3	6.5	6.5	7.0	7.4	7.7	7.8
3. Long-term care expenditure	0.7	0.8	0.9	0.9	1.0	1.3	1.5
4. Education expenditure	-0.5	4.2	4.0	3.4	3.4	3.6	3.7
5. Unemployment expenditure	-1.1	2.0	2.5	1.7	1.2	1.0	0.9
Memorandum: Impact of pension reform							
Pre-reform pension expenditure	6.6	10.1	10.9	11.8	14.5	16.8	16.7
Pension expenditure with sustainability factor	2.9	10.1	10.6	10.6	12.1	13.4	13.0
Memorandum: Hypothesis for the year							
Potential GDP real growth	1.6*	-0.1	2.4	2.2	1.1	1.2	1.6
Work productivity growth	1.4*	1.6	0.7	1.6	1.6	1.6	1.5
Men's participation rate (20-64)	-0.9	85.5	85.2	84.7	84.2	84.8	84.6
Women's participation rate (20-64)	11.8	69.7	77.4	80.3	81.2	81.5	81.5
Total participation rate (20-64)	5.3	77.7	81.4	82.6	82.7	83.2	83.0
Unemployment rate (15-64)	-12.9	20.2	17.2	8.9	7.7	7.4	7.3
Population over 65 / working age population	31	25	29	36	47	57	56

Source: Ministry of Economy and Competitiveness
(*) Average 2010-2060 period

As can be seen in Table 5.1, the total increase between 2010 and 2060 of the five expenditure categories is 4 GDP percentage points. By category, this increase is mainly due to pension expenditure dynamics, which increased by 3.6 GDP points during the period. The second expenditure category with the greatest increase is healthcare expenditure, whose projected rise is 1.3 GDP points, considerably lower than the 1.6 points projected in 2009, thanks to the expenditure control measures described in section 5.2. The advance is more moderate in long-term care, at 0.7 points. However, education and unemployment expenditure will be reduced over the period, by 0.5 and 1.1 GDP points, respectively. The reform of the pension system is a crucial factor in these projections, and in fact enables significant containment of this expenditure category compared to a non-reform scenario. As can be seen in Table 5.1, thanks to the reform, the expenditure increase between 2010 and 2060 is reduced by half with respect to the expenditure increase that would be obtained with the same demographic and macroeconomic scenario without a reform. Pension expenditure increased by 3.6 GDP points as opposed to the 6.6 points in a non-reform scenario so that the estimated savings for the reform, excluding the sustainability factor, amounts to 3 GDP points.

The relevance of the sustainability factor has been strengthened by Organic Law 2/2012, 27 April, on Budgetary Stability and Financial Sustainability, Article 18.3 of which establishes that, should a long-term deficit of the pension system be projected, the Government will revise the system, automatically applying the sustainability factor in the terms and conditions established in Law 27/2011, 1 August, on the updating, adaptation, and modernisation of the Social Security system.

5.2. Strategy

The reform of the pension system

The reform of the public pension system approved on 1 August 2011, after the adoption of the Report on the Evaluation and Reform of the Toledo Pact[9] includes as its main measures the increase of the statutory retirement age by two years, to 67, gradually between 2013 and 2027; recognition of long-term contribution histories, in such a way that retirement at 65 is possible with a 100% pension when a contribution period of 38 and a half years is certified; increase in incentives for voluntary extension of working life beyond the statutory retirement age; and use for calculation of the new pension of the contribution bases of the last 25 years prior to retirement, as opposed to the 15 years established before the reform.

This reform is complemented by a set of reforms which includes early and partial retirement measures and measures for the promotion of work and pension compatibility included in Royal Decree-Law 5/2013, 15 March, on measures to encourage the continuity of the working life of older workers and to promote active ageing. As regards early retirement, the minimum age for access is gradually increased, in line with the scheduled increase of the ordinary age, so that the voluntary early retirement age will be gradually increased from the current 63 to 65 years in 2027 and involuntary early retirement will increase from 61 to 63 in the same period, except for contributors with very long histories who will continue to be able to retire at 61. Greater gradualness is introduced in the application of reductive coefficients, depending on the contribution history, and a minimum contribution period of 35 years is established in the case of voluntary early retirement and 33 years in the case of involuntary early retirement. As regards partial retirement, this modality is re-channelled towards its original aim of facilitating inter-generation transfer of know-how and experience by means of the limitation to 50% of the maximum working day reduction on a general basis, and by means of the increase of the minimum worker contribution period to 33 years. As regards work and pension compatibility, the possibility of salaried and self-

9 Report on the Evaluation and Reform of the Toledo Pact, approved by the Spanish Parliament on 25 January 2011.

employment is opened, receiving 50% of the pension, with exemption from payment of most social contributions. This Royal Decree-Law strengthens the economic contributions to the State to be made by companies with profits that carry out collective lay-offs affecting people over the age of 50. The estimated impact of the measures included in the Royal Decree-Law are savings of €250 million in 2013 and €820 million in 2014.

Moreover, actions for regulation of the sustainability factor have already been taken in order to revise the basic system parameters depending on the evolution of life expectancy and other demographic and economic factors. An expert committee has been appointed to draft a report on the sustainability factor, which will be then sent to Parliament before 31 May, so that the Toledo Pact Commission may, between June and July, make the recommendations on the regulation of the sustainability factor to be approved in 2013.

Even though current regulations envisage that the sustainability factor will start to be applied in 2027, depending on the expert committee report results and the structural deficit, it may be applied in advance as established in the Organic Law on Budgetary Stability and Financial Sustainability, which envisages its application when a long-term deficit of the pension system is projected.

These measures are complemented by others aimed at preventing companies from making employment adjustments that have a massive impact on older workers and at promoting their permanence or reintegration under guarantees in the labour market:

- The labour market reform of February 2012 and subsequent implementation regulations have launched a system of contributions to the State by companies that include workers over the age of 50 in collective lay-offs.
- In July 2012 and March 2013, changes were made in the special unemployment subsidy for older workers. In addition, workers who are not entitled to or who have already depleted this subsidy constitute a priority group for active employment policies.
- After the coming into force of the labour market reform, forced retirement clauses in collective agreements have been banned. These clauses prevented workers who wished to remain employed from doing so after a certain age.

Finally, it should be borne in mind that, since January 2011, all new civil servants in Public Administrations are included in the General Social Security Plan, so that the pension system for civil servants will gradually disappear.

Consolidation of public finance and Social Security Reserve Fund

Long-term sustainability of public finances is strengthened both by adjustment of the expenditure associated with ageing and by the fiscal consolidation strategy. Consequently, the two basic elements in the sustainability indicator will be reduced, delimiting public finance risk.

The most relevant indicator for evaluating the long-term sustainability of public finances, known as S2, had a value of 12% of GDP in the 2009 sustainability report (SR2009), as a result of deterioration of the primary structural balance and the increased expenditure associated with ageing projected at that time. This result meant that, in order for accumulated Public Administration revenues to be equalled to their accumulated expenditure in the long term, tax pressure would have to be increased, other public expenditure would have to be reduced, or a combination of both measures of a similar magnitude would have to be implemented on a permanent basis.

In the 2012 Fiscal Sustainability Report (SR2012) of December 2012, however, the situation has considerably improved. S2 has gone from demanding a correction of the primary structural balance in order to comply with the inter-temporal budget restriction within an infinite horizon of 11.8 pp. to 4.8 pp. in only three years. This remarkable progress is accounted for by the advance made in the two S2 components. Firstly, the initial budgetary position contracted from 6.1 pp. in SR2009 to the current 2.9 pp. thanks to the ambitious strategy of public finance consolidation. Secondly, the long-term change, which measures the projected increase in the expenditure associated with ageing, has dropped from 5.7 pp. to 1.9 points thanks to the recent pension, healthcare expenditure, and long-term care expenditure reforms. It should also be noted that in this exercise the structural primary balance projected by the Commission in its autumn forecast for the initial year 2014 is decisive. For Spain this balance is -1.3% of GDP, which amounts to a 1.2 pp. deterioration with respect to the balance projected for 2013 of -0.2% of the GDP. A reasonable sensitivity scenario has been introduced, which assumed that the 2014 balance is the same as in 2013, as is the case of most Member States. This lower deficit scenario yields a considerable contraction of S2 of up to 3.8% of GDP, one point less than in SR2012.

Table 5.2.1 S2 Indicator Summary

	SR2012	Lower Deficit	SR2009
S2	**4.8**	**3.8**	**11.8**
Initial Budgetary Position	2.9	1.9	6.1
Long-Term Change	1.0	1.9	5.7

Source: Own source and European Commission: 2012 and 2009 Sustainability Reports (SR2012 and SR2009) and Stability Programme Evaluation Working Document

In addition to S2, SR2012 includes a new S1 indicator, which endeavours to evaluate sustainability within a considerably shorter period, and establishes a debt target of 60% of GDP. More specifically, this new S1 indicator measures the fiscal effort required until 2020 to return the debt ratio to the reference level of 60% of GDP by 2030, taking an additional element into account: the financial cost of delaying the adjustment until 2020. Until now, S1 measured the improvement in the structural primary balance that must take place until 2060 to stabilise debt at 60% of GDP. The shortening of the time period means that the value of S1 increases to 5.3 pp. However, two qualifications should be made. Firstly, it should be pointed out that Spain is one of the Member States where S1 has been most reduced since the prior publication of the sustainability report; secondly and more importantly, maintaining the traditional definition, the improvement is greater, reaching 3.2 pp. (former S1 scenario). Furthermore, the sensitivity scenario with a lower deficit also generates an S1 indicator that is considerably lower than that of SR2009.

Table 5.2.2 S1 Indicator Summary

	SR2012	Former S1	Lower Deficit	SR2009
S1	**5.3**	**3.2**	**4.0**	**9.5**
Initial Budgetary Position	2.5	2.8	1.4	5.9
Cost of Delay	0.9	-	0.7	-
Debt Requirement	2.2	0.6	2.2	-0.1
Long-Term Change	-0.3	-0.3	-0.3	3.6

Source: Prepared by the authors and European Commission: 2012 and 2009 Sustainability Reports (SR2012and SR2009) and Stability Programme Evaluation Working Document

It is also necessary to indicate the reserve assets that the pension system already has to cover future needs regarding contributory benefits, thanks to the cumulative Social Security surplus. Since its creation in 2000, the successive provisions to the Social Security Reserve Fund made it possible to have €63,009 million (5.99% of the GDP) as of December 2012, after discounting the amounts used by the Social Security in 2012 to pay pensions (€7,003 million), which released the system from occasional liquidity pressures. This figure was made possible thanks to the high yields on Reserve Fund investments. The investment policy, maintained in 2012, was based on the principles of security, profitability, risk diversification, and adaptation to the Fund's time horizon, yielding average annual returns of 4.2%.

Healthcare and pharmaceutical expenditure control

The urgent measures to guarantee the National Healthcare System and improve the quality and security of the benefits approved in Royal Decree-Law 16/2012 have and will continue to have a permanent effect on the reduction of public healthcare expenditure due to the decrease in staff costs and the reforms introduced, mainly in pharmaceutical expenditure. Both represented 63% of public healthcare expenditure in 2010.

As regards the decrease in staff costs, Royal Decree-Law 20/2011 establishes that in 2012 frozen wages for public employees would be maintained; replacement of healthcare staff was restricted to strictly necessary situations, and the working hours of civil servants were increased to 37.5 hours per week. In parallel, in 2012 several legislative measures concerning public employees affected healthcare staff and had significant impact on the healthcare expenditure reduction, i.e. the suppression of the Christmas extra payment, the modification of the wage system in cases of temporary disability, the reduction in the number of personal days, and the elimination of additional holidays.

The aforementioned austerity measures led to a 2.8% drop in occupancy of healthcare activities (public and private) in 2012 according to LFS data, as well as to a drop in healthcare staff costs by €1,850 million, likewise in 2012.

As regards pharmaceutical expenditure, expenditure by means of official National Healthcare System prescriptions has experienced a remarkable deceleration in recent years, moving from a 6.9% growth in 2008 to an 8.8% reduction in 2011 and a 12.26% reduction in 2012. Annual savings in 2012 with respect to 2011 amounted to €1,365 million.

The effort achieved in this area is the result of the measures taken in Royal Decree-Law 16/2012, involving pharmaceutical expenditure reduction from the supply side, through the decrease in prices, the promotion of use of generic drugs and the benchmark price system, and the elimination of financing of drugs for minor symptoms (Resolution of 2 August 2012, of the Directorate General of the Basic Portfolio of Services for the National Healthcare and Pharmaceutical System).

From the demand side, expenditure was restricted by means of new contributions on the part of users, more equitable and fair, in such a way that users with more means contribute more, while protecting users of lesser means, who will make lower or no contributions. This measure also has a discouraging effect on the unnecessary accumulation of drugs in the home, which contributes to reduced expenditure.

The result has been a reduction of the number of prescriptions written in 2012 amounting to €59.5 million, in other words, 6.12% with respect to the previous year. Up to July, the date when new user contributions came into force, the number of prescriptions was growing at a rate of 1.45%. In parallel, the average prescription price was reduced by 6.55% at the year-to-year rate.

In addition, the fact that almost 1,000 marketed drugs have decreased their prices and the prescription of generic drugs has reached 34.4% has also contributed to pharmaceutical savings.

The measures mentioned so far, as well as other measures launched as a result of the adaptation of Spanish regulations to European rules on assistance to citizens of Member States and the European Economic Area, the savings obtained in 2012 from the creation of a centralised purchase platform, and other minor measures, come to a total National Healthcare System savings of almost 59% of the €7,267 million forecast for the 2012-2014 period in the Autonomous Regions Economic-Financial Plans as regards Healthcare.

Streamlining of the long-term care system

Structural data and the most significant figures in long-term care expenditure revealed the need to correct a situation which endangered the viability of the Long-Term Aid System. To this end, Royal Decree-Law 20/2012, 13 August, on measures to guarantee budget stability and promote competitiveness, established, among others, a decrease in the amounts corresponding to the minimum guaranteed protection level; the reduction of the maximum amounts of economic benefits for family care; the elimination of state financing of Social Security contributions of non-professional caregivers; and the modification of the calendar of application of services and benefits for people in a situation of Moderate Dependency, postponed until July 2015.

The measures included in this RDL express the need to apply improvements to guarantee sustainability, which started to have an economic impact in 2012. Nonetheless, savings are expected to amount to €1,391 and €1,473 million in 2013 and 2014 respectively.

5.3. Contingent liabilities

This section itemises information on General State Administration guarantees. The latest information available on the following categories is dated 28 February 2013:

i) **Guarantees from Royal Decree-Law 7/2008 on Urgent Economic-Financial Measures of the Concerted Action Plan in Eurozone Countries.** In Article 1, this regulation authorised the granting of State guarantees to any issues made from credit institutions after its coming into force. The outstanding balance of this concept is €66,398.6 million.

ii) **Guarantees for issues of the Electricity System Deficit Securitisation Fund**, granted by virtue of the authorisation given in Additional Provision Twenty-One of Law 54/1997, 27 November, on the Electricity Sector, with an outstanding balance of €17,069.1 million.

iii) **Guarantees for issues of the European Financial Stability Facility**, by virtue of Royal Decree-Law 9/2010, 28 May, for an amount of €31,943.7 million.

iv) **Guarantees for issues of Securitisation Funds for SME Financing**, regulated in Article 55 of Law 17/2012, 27 December, on the 2013 Central Government Budget: its outstanding balance is €3,610.6 million.

v) **Guarantees for issues of the Fund for Orderly Bank Restructuring** (FROB), created by virtue of Royal Decree-Law 9/2009, on bank restructuring and strengthening of credit institution equity, which shows an outstanding balance of €10,945 million.

vi) **Guarantees for issues of the Company for Management of Assets from the Bank Restructuring Sector (Sareb),** created by virtue of Law 9/2012,14 November, on the restructuring and shutdown of credit institutions, whose outstanding balance is €50,780.8 million.

vii) **Guarantees to non-classified institutions,** with an outstanding amount of €670 million.

To summarise, the total risk assumed by the State for guarantees amounted at 28 February 2013 to €181,417.8 million.

6. THE QUALITY OF PUBLIC FINANCES

6.1. Introduction

Within a context of fiscal consolidation, the quality of public finances comes to the forefront. The Annual Growth Survey of the Commission and the guidelines of the ECOFIN Council in February explicitly indicate this issue and request Member States to pay particular attention to the structure of the budget, so that the inevitable correction of budgetary imbalances contributes to growth while maintaining social coverage and improving the efficiency and effectiveness of public finances.

On the expenditure side, European guidelines point to the need to prioritise expenditure in education, research and development and energy, as well as to improve the overall efficiency of the expense. On the revenue side, ECOFIN highlights the need to broaden tax bases, eliminate insufficiently justified tax benefits and improve tax compliance and the efficiency of the tax system. In terms of tax structure, a request is made to reduce the tax burden on labour wherever it is comparatively highest.

6.2. Composition of expenditure

In accordance with the 2013-2014 Biennial Plan approved on 3 August 2012, the overall correction of imbalances of public accounts is mostly being undertaken on the expenditure side, promoting measures that increase its efficiency.

With regard to the State, in 2013 the expense of ministerial departments will decrease by 9%. Within the general budgetary scope of adjustment, the priorities established in the Central Government Budget for 2013 are social expenditure, which includes an increase of almost 5% of the expense of pensions as a result, among other factors, of the 2% increase of the lowest pensions, and expenditure in research, development and innovation, with priority given to actions aimed at increasing the quality and relevance of research funded with public resources, maintaining the endowment for civil research at the levels of 2012 in order to do so.

Regarding staff expenditures, the measures adopted in Royal Decree-Law 20/2011, 30 December are added to those included in Royal Decree-Law 20/2012, 13 July, on the 2013 Central Government Budget. Among the measures of July 2012, worthy of mention are the suppression of the extra payment in December 2012, the reduction of personal days and the elimination of additional holidays and personal days for seniority; in addition to the unification of the leave system throughout all administrations and the adoption of measures to streamline Public Administration staff expenditures. In

2013 the same budgetary discipline continues, maintaining the freeze on wages and public job offers, except for sensitive sectors such as healthcare and education staff, State security forces and tax fraud corps, where 10% of retirees will be replaced.

In parallel, the activity of all Public Administration levels and their business sector is being streamlined. Following the approval of the Plan for the Reorganisation and Streamlining of the State's Public Business and Foundation Sector in January 2012, in February 2013 the Draft Bill for the Streamlining and Sustainability of the Local Administration was presented, which will implement a management by objectives model based on the utmost transparency in appraising the results.

As was described, the Commission for the Reform of Public Administrations, CORA, works to achieve a parsimonious, efficient Public Administration, acting at the level of individual expenses and services.

Measures have been taken to streamline two of the most relevant expenditure headings: healthcare and education expenditure. The measures adopted in April 2012 seek to ensure quality public services and security in their provision.

In February 2013 the Supplier Payment Plan was extended with over €2,600 million, giving a second chance to suppliers of Local Entities and Regional Governments already included in the Plan, and broadening the scope of application to new Administrations. Local Entities of the Basque Country and Navarre included in the State tax participation model are allowed to join, as well as Municipality Associations. The requirement for invoices to have been issued prior to 1 January 2012 is nevertheless maintained. However the type of invoices that may benefit from the Plan is broadened, even for Municipalities and Regional Governments included in the initial phase. Specifically, the new contracts included in this extension are those corresponding to administrative concessions, management packages, agreements, real estate lease agreements, contracts for water, energy, transportation and postal service sectors, public works concession contracts, public service management contracts and public-private collaboration contracts.

The transposition of the Directive on combating late payments in commercial transactions is completed. The modifications include a 30-day payment period for all private transactions extendable to 60 days, and a greater penalty for late payment is established, increasing interest and ordering the payment of a fixed quantity.

In order to limit late payments of the public sector, a plan is proposed with permanent tools for the monitoring and control of commercial debt in the public sector. This plan is comprised of three types of actions:

- **Amendment of the Organic Law on Budgetary Stability and Financial Sustainability** so that control of commercial debt is included in the principle of financial sustainability; the concept of average payment period to suppliers (APP) as an indicator of the volume of commercial debt; administrations are obliged to publish the APP and have a treasury or financial plan. The breach of the APP will trigger corrective and coercive preventive measures.
- **Establishment of an invoice control system** by means of a new law that makes it obligatory to enter all invoices issued by suppliers into an administrative registry; the use of electronic invoices in the public sector will be promoted – obligatory as of 2015 for given individuals-; all administrations will have a general point of entry of electronic invoices as well as an accounting registry integrated with it.

- **A third phase of the supplier payment plan.** Just as in the prior phases, the formalisation of long-term loans is facilitated for territorial administrations, albeit subject to fiscal and financial conditionality in the form of a plan to balance public accounts, among other elements.

6.3. Composition of revenue

The achievement of tax objectives considers guidelines on tax matters prepared for the 27 Member States overall and most particularly those formulated specifically for Spain in June 2012. Important measures have therefore been adopted which, on the one part, eliminate distortions from the tax system that incentivise family and corporate debt. Furthermore, tax structure is changed increasing the weight of indirect and environmental taxation, making it possible to decrease taxation on labour when public accounts' balance so allows. In fact, the increases in personal income tax introduced in 2012 are temporary in nature and the taxation on labour of those groups with greater difficulties in the labour market have been lightened with a selective tax decrease. The main measures approved are the following:

- Increase of VAT rates, in force since September 2012, by virtue of Royal Decree-Law 20/2012, 13 July, which increases the general rate from 18% to 21% and the reduced rate from 8% to 10%, phasing out exemptions and reclassifying certain goods and services in the highest rate categories. Its impact on the generation of tax revenue in 2012 is €2,441 million and the estimated figure for 2013 is €8,584 million.

- Environmental tax reform, Law 15/2012, 27 December, by means of the creation of three new taxes and a user fee as of January 2013. Its estimated impact is the generation of tax revenue in 2013 of €1,841 million.

- Decrease of incentives for households taking on debt eliminating the deduction for investment in the main dwelling (mortgage interest and principal) in personal income tax, as of January 2013.

- Reduction of the incentives for businesses taking on debt by limiting the deduction for interest to a maximum quantity per annum of €1 million or 30% of EBITDA in the corporate income tax, measure that is in force as of the approval of Royal Decree-Law 12/2012, 30 March. Furthermore, effective in the 2012 and 2013 financial years, the maximum annual deductible limit for intangible assets corresponding to goodwill obtained by the acquisition of business entities and restructuring is reduced and the freedom of amortisation is eliminated for large companies.

- Reduction of taxation on the labour factor in new contracts for entrepreneurs, introduced with the labour reform of February 2012. Social Security contributions are reduced for a maximum period of 3 years when hiring unemployed people either young (i.e. below 30 years of age) or over the age of 45. Furthermore, tax deductions in Corporate Tax of €3,000 apply if the former contract is signed with a person under the age of 30, or of 50% of pending unemployment benefits when hiring a recipient of unemployment benefits.

In 2013, Royal Decree-Law 4/2013, 22 February, includes the following new measures to encourage entrepreneurship and self-employment and the hiring of young people:

- Decreased taxation of business start-ups as of January 2013: in the first year in which they make a profit and the following year. Start-ups will be taxed at a reduced rate of 15%. Self-employed persons may apply a reduction of 20% to net earnings obtained during the first year with positive results and the following one.

- Promotion of self-employment: unemployed persons who establish themselves as self-employed may benefit from a complete exemption from the unemployment benefit in the Personal Income Tax when the benefit is received in the form of a lump payment.

- Flat rate of €50 in social security payments for new self-employed workers under the age of 30 for the first 6 months of the start of the self-employment activity. During the following 6 months, a 50% reduction will be applied to the contribution base, which will become 30% during the following 18 months.

- Incentives for hiring young people until the unemployment rate falls below 15%. The contribution of the company to Social Security will be reduced, for a maximum of 12 months, by 75% for companies with over 250 workers and 100% for the rest, when individuals under the age of 30 without prior labour experience or from sectors devoid of any demand for employment or those who have been unemployed for more than 12 months are hired part-time with a training affiliation. Self-employed workers and companies of up to 9 workers will benefit from a 100% reduction of the contribution of the company to Social Security for common contingencies during the first year for permanently hiring an unemployed person under the age of 30.

The "first young person employment" contract is introduced: this is an amendment of the current temporary contract for young people under the age of 30 who are unemployed and lacking prior professional experience, with incentives for the transformation into open-end contracts (bonus of €500 /year for 3 years or €700 if women are hired). Incentives are introduced to internship contracts so that young people up to the age of 30 who have completed their education have an initial labour experience associated with their degree; reducing the contribution of the company to Social Security for common contingencies up to 50%.

The section on tax measures as part of the medium-term fiscal strategy also describes other measures pertaining to Corporate Income Taxation that avoid introducing unnecessary distortion in the performance of productive activities, and promote the innovation and capitalisation of the business network. They include:

- Application of cash VAT schemes for small and medium-sized enterprises: creation of a special and voluntary scheme that makes it possible to defer the payment of VAT until invoices have been collected. This scheme will be applied as of January 2014 to small and medium-sized enterprises and self-employed individuals not subject to the quarterly estimated tax system and with a turnover of less than €2 million.

- Incentives to profit reinvestment: deduction of up to 10% of the Corporate Tax for any profits that are reinvested in productive capital for companies with a turnover of less than €10 million.

- Incentives for business innovation: possibility of recovering deductions for R&D that could not be applied within a year, 3 years after they have been generated.

7. INSTITUTIONAL SCOPE OF THE FISCAL POLICY

7.1. The new independent fiscal authority

The Spanish budgetary framework is the subject of an extensive reform that reflects the commitment of Spain with budgetary stability, as the basis for boosting growth and job creation and that incorporates European legislation on the subject of economic and tax governance into our legal system.

The reform commenced in September 2011, with the amendment of Article 135 of the Spanish Constitution that introduces a fiscal rule at the maximum legislative level of the legal system to limit structural public deficit and public debt, and continued with the approval of Organic Law 2/2012, 27 April, on Budgetary Stability and Financial Sustainability, thereby complying with the mandate contained in such Article 135 of the Spanish Constitution. Spain therefore became a pioneer in introducing European legislation on budgetary discipline into its Constitution.

The Organic Law on Budgetary Stability and Financial Sustainability has three fundamental objectives: to guarantee the budgetary sustainability of all Public Administrations; to increase trust in the stability of the Spanish economy; and to reinforce the commitments of Spain with the European Union, allowing a continuous and automatic adaptation to European legislation.

Budgetary sustainability becomes the guiding principle for the action of all public administrations that cannot incur structural deficit and should respect the debt ceiling and the expenditure rule. It furthermore ensures budget programming coherent with the objectives of stability and public debt by means of the preparation of medium-term budgetary frameworks for annual budgets.

The fulfilment of these provisions is guaranteed by means of the new preventive mechanisms, for early warning and automatic correction, as well as by means of the reinforcement of sanction mechanisms, corrective as well as coercive.

Along the line of the advances introduced by the Organic Law on Budgetary Stability and Financial Sustainability in our legislation, the Government has deemed it necessary to continue making progress in the process for reform and reinforcement of the Spanish budgetary framework, presenting the Draft Organic Law for the creation of the Independent Fiscal Authority (IFA). The creation of such Authority will likewise make it possible to comply with the specific recommendations of ECOFIN to Spain and with the provisions of the Treaty on Stability, Coordination and Governance of the Economic and Monetary Union, the Directive on the requirements applicable to the budgetary frameworks of Member States and the Regulation on common requirements for the monitoring and assessing of draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the Euro area.

The creation of the IFA means that Spain will have an independent institution with functional autonomy to ensure compliance by all public administrations with the principles of budgetary stability and financial sustainability, by means of the on-going assessment of the budgetary cycle and public debt and the analysis of macroeconomic projections.

In order to comply with these objectives the IFA will undertake the following tasks:

- Preparation of reports. If the administration or entity to which the report refers deviates from the recommendations contained therein, reasons should be provided. The reports envisaged in the Draft Bill cover the following areas:

    - The macroeconomic projections included in the budgetary projects of the public administrations or the Stability Program.
    - The changes in the methodology used to calculate trend projections for revenue and expenditure and the reference growth rate to which reference is made in the Organic Law on Budgetary Stability and Financial Sustainability.
    - The Stability Programme draft.
    - Compliance with objectives for budgetary stability and public debt and with the expenditure rule by all public administrations.
    - The advisability or otherwise of activating preventive, corrective and coercive measures envisaged in the Organic Law on Budgetary Stability and Financial Sustainability as well as the monitoring thereof.
    - The occurrence of the exceptional circumstances envisaged in Article 11.3 of the Organic Law on Budgetary Stability and Financial Sustainability that allow a deviation from the stability objective.
    - The establishment of individual stability objectives for the Regional Governments.
    - The economic-financial and rebalancing plans of the Central Administration and Regional Governments.
    - The draft budgets of the Public Administrations.

- Issue of opinions at its own initiative on matters to be determined, such as the long-term sustainability of public finances.

- Preparation of studies, commissioned by the Government, the Council on Financial and Fiscal Policy and the National Commission for Local Administration.

The reports and opinions of the IFA, for whose preparation it will have access to all economic-financial information relative to the various public administrations, will be public and reasoned.*

The independence of the IFA is fully ensured by means of several provisions of the Draft Bill:

- The IFA is configured as an entity endowed with a legal personality of its own and full public and private capacity, ascribed to the Ministry of Finance and Public Administrations by means of the Minister and with full functional autonomy.

- Neither the chairman nor its staff may request or accept instructions from any public or private entity.

- The Chairman of the IFA will be appointed from among persons of recognised prestige and broad experience on matters of budgetary, economic and financial analysis in the public sector, with special value given to his independence and objectivity of judgement. His appointment should furthermore be accepted by Congress and the Senate.

- The IFA will have the resources necessary to carry out its tasks.

In short, Spain will have an independent body that will reinforce the credibility of the budgetary policy and fiscal consolidation process, and comply with European demands.

7.2. Increased transparency

The application in 2012 of Organic Law 2/2012, 27 April, on Budgetary Stability and Financial Sustainability (OLBSFS) and the Order HAP/2105/2012, 1 October, have led to an improvement in budgetary information and increased monitoring of compliance with the objective of budgetary stability.

This Order complies with the OLBSFS' mandate of broadening the quantity and frequency of autonomous and local administrations economic and financial information, and introduces organisational novelties and procedures to assure the quality of these reports. Thus, several objectives established by the OLBSFS are attained: greater transparency, more continuous knowledge and control, and earlier release of information on the budgetary and financial results of the Public Administrations.

Specifically, among these novelties the following are notable:

- For the first time, there is information relative to treasury plans, number and costs associated with staff of these Administrations, budgetary information will be more complete and released early enough to make it possible to comply in turn with European information commitments. Specifically: budgetary frameworks, fundamental budget lines, draft budgets, budgets actually approved, possible modifications to these and their execution. In addition to information relative to financial plans, rebalancing plans, adjustment plans, non-availability agreements or the uses given to debt authorisations, for Regional Governments.

- The frequency of the supply of information is increased: for the first time there is monthly information relative to budgetary execution data of Regional Governments, and also on national accounts terms, treasury plans or staff data, among others. Likewise, for the first time there is quarterly information of local entities on these matters.

- The procedure to be followed and the consequences of possible breaches of the reporting obligations are specified, giving rise to a requirement that, if not addressed, will be made public, and to the application of the automatic corrective measures envisaged in OLBSFS Article 20.

- Organisation and flow of information management improvements are included, channelling such information by electronic means with standard models and via sole contacts, the auditors general.

The main milestone in the improvement of transparency was the publication of monthly data on national accounting terms as of 2013, for Social Security and Regional Government subsectors, as it was already being done for the Central Administration, and quarterly for local entities. Likewise monthly data are published in budgetary terms for all Regional Governments since July 2012.

The monthly data from the Regional Governments are published one and a half months after the end of the period of reference. This delay is considered a huge improvement in the transparency of reporting in a decentralised country. Furthermore, the Directive on National Budgetary Frameworks requires publication on a monthly basis of cash data, no later than the end of 2013. In the case of Spain it has been decided, firstly, to publish monthly data as of July 2012, in budgetary terms with a year-on-year comparison and in-depth analysis, and secondly, to broaden the information with the monthly publication of the national accounts as of January 2013. The purpose of this change is to improve comparability and facilitate the monitoring of fiscal policy.

On the other hand the information on the 2013 Regional Governments' budgets has improved, both for drafts as well as for approved budgets. The information has been processed in order to make it homogeneous, and its publication includes, for the first time, an executive summary that details the main questions relative to the economic and functional classification, and the procedure foreseen by the Regional Governments to present the budgetary balances in national accounts terms, for the purpose of measuring the objective.

The application of the OLBSFS, since its approval in April 2012, has resulted in an improved monitoring of the measures envisaged, essentially in the Regional Government subsector, and has had a positive effect on compliance with the stability objective in most Regional Governments.

In the first place, all Regional Governments submitted Economic Financial Plans (Spanish initials, PEF) for 2012-2014. Their monitoring was conducted in application of Article 24 OLBSFS and the Ministerial Order of October that regulates reporting. Therefore, the Ministry of Finance and Public Administrations published the first reports to monitor compliance with the measures contained in the PEF up to the third quarter of 2012 following the publication of the execution data in national accounts for that period. In light of the application of revenue and expenditure measures and of budgetary execution, requirements were sent to all Regional Governments.

In these plans for the correction of budgetary imbalances, in addition to evaluating the fiscal conditionality in accordance with the provisions of the PEF and various actions on matters of structural reforms, several types of commitments have been included, for which the corresponding monitoring is undertaken:

- Monitoring of the volume of debt, total and commercial, of the Autonomous Communities.
- Reduction of the average payment periods.
- Reorganisation of the public business sector: with public monitoring by means of quarterly reports on the size and effects of the Regional Governments reorganisation processes.

On the other hand, the OLBSFS establishes the grounds to create the additional financing mechanisms (First Additional Provision) linked to financial and fiscal conditionality, and based on the adjustment plans.

Some remarks on the three financing mechanisms follow:

- ICO facility for 2012 debt maturities: The Regional Governments of Andalusia, Balearic Islands, Castile-La Mancha, Catalonia, Murcia and Valencia have taken advantage of this facility.

- Fund for the Financing of Payments to Suppliers: created for the Regional Governments and local entities.

By means of Royal Decree-Law 7/2012, 9 March, a Fund is created to finance payments to suppliers in an unprecedented operation to address the serious problem of the Territorial Administrations overdue invoices, focusing on the ones prior to 2012.

The main results of the Supplier Mechanism in the Regional Governments are:

- The payment of almost 4 million invoices from 29,000 suppliers for a total amount of €17,705 million. (26.1% of the beneficiary suppliers were self-employed and 72% were small and medium-sized enterprises, which received €6,854.67 million overall).

- Over 50% of the invoices paid under such mechanism correspond to healthcare expenses, either by direct payment to the supplier or to financial entities that previously financed the Regional Governments for such invoices.

In the case of Local Entities, the main results of the Supplier Mechanisms were:

- Access by 3,777 local entities, paying 1,796,696 invoices and in an amount of €9,598 million, from 114,935 suppliers.

The amounts of this first phase of the mechanism must be added to almost 1,200 million more for the second phase currently underway, for the payment of invoices from 5,000 suppliers.

- Regional Liquidity Fund (Spanish initials, FLA) created by Royal Decree-Law 21/2012, which was joined in 2012 by the Regional Governments of Andalusia, the Principality of Asturias, Balearic Islands, Canary Islands, Cantabria, Castile-La Mancha, Catalonia, Murcia and Valencia.

This third mechanism has provided liquidity to the regions at a reasonable cost, contributing toward ensuring the rendering of their essential basic services, and has reinforced the control over the Regional Governments that have adhered to it, under additional fiscal conditionality.

In 2012, maturities of financial debt principal in an amount of €9,458 million, interest expenses in an amount of €883 million, and €6,300 million to 23,240 suppliers in 282,693 invoices were financed by means of FLA resources. The total amount drawn was €16,640 million. Approximately 63.3% of the invoices paid with FLA funding reflect expenditures in fundamental public services: 50% to healthcare, 6.6% to education and 6.7% to social services.

In 2012 this mechanism allowed those Regional Governments adhering to the FLA savings in financial expenses in an amount exceeding €366 million per year. This liquidity support mechanism has been maintained in 2013, although no additional Regional Governments have adhered. The initial quantity for the FLA in 2013 amounts to €23,000 million. Through the end of April invoices from 3,300 suppliers were paid, of which around 90% correspond to payments for the rendering of fundamental public services.

For 2013 the Government has reinforced the controls applied to the Regional Governments that have deviated from the 2012 deficit target, or that require a detailed monitoring of their cash position in accordance with data available on the evolution of their commercial debt and average payment period. In this manner the control has extended to the monthly monitoring of the allocation given by Regional Governments of the resources received from the clearance of the financing system, as well as of the amounts paid and pending payment, by items or programs of expenditure, corresponding to the management of fundamental public services either with their own or with external resources. Therefore, in connection with the application of Law 15/2010, 5 July, amending the Law 3/2004, 29 December, which establishes measures to combat late payments in commercial transactions, commercial debt is monitored monthly, itemised on the basis of the nature of the expenditure giving rise to it and the year of its generation, the evolution of legal payment periods to suppliers and the measures adopted and envisaged by the Autonomous Region, to ensure compliance with the aforementioned periods.

As a result of the financing mechanisms adopted in 2012, the amount pending payment by the Regional Governments was reduced by 21.13%.

7.3. Methodological Explanations in the implementation of the Organic Law on Budgetary Stability

Organic Law 2/2012 on Budgetary Stability and Financial Sustainability entrusted the Ministry of Economy and Competitiveness with implementing the application of the methodology envisaged for the calculation of trend projections for revenue and expenditures and the reference growth rate. In compliance with this mandate, on 20 December 2012 the Ministry of Economy and Competitiveness approved a Ministerial Order for the methodological implementation of Organic Law 2/2012, 27 April, on Budgetary Stability and

Financial Sustainability for the calculation of trend projections for revenue and expenditures and the reference growth rate of the Spanish economy.

In its first appendix, this Order describes the production function process currently applied by the European Commission to calculate the potential considering time series of variables such as the GDP; capital stock, the working-age population and the unemployment rate, as well as its medium-term projections, to estimate what the potential GDP of the Spanish economy was in the past and what it may be in the forecast period. The potential GDP that results from the estimation procedure described in the Ministerial Order takes part in two ways in the process for the stabilisation of public finances.

In the first place an average of the growth rates of the potential GDP of the economy combined with the growth of the GDP deflator entails a limit to the growth of Regional Government expenditures that may only be surpassed if additional revenue is raised. The objective of this rule is to avoid unsustainable expansions of public expenditure during times of economic expansion when its growth is cyclically above its potential and cannot be subsequently financed.

The second use is to be able to determine the output gap, which is the percentage of the GDP in which the observed GDP differs from the potential one. When the real observed GDP is greater than the potential one, tax revenue is higher than normal and unemployment expenditures are lower, the opposite of what happens when the potential GDP exceeds the one observed. The output gap indicates the effect of the economic cycle on the budgetary balance. This aspect for cleaning budgetary balances of the effect of economic cycles is developed in the second appendix to the aforementioned Order, where the method utilised to determine the effect of the cycle on the budgetary balance is described, which is basically obtained by multiplying the output gap by the sensitivity to the output gap of revenue and expenditure.

In February 2013 the Commission made a slight modification to the process for calculating the impact of the cycle by replacing sensitivity with semi-elasticity. As a result, the Ministry of Economy and Competitiveness is in the process of approving a new Ministerial Order that contains this new procedure.

The cyclical component figures of the budgetary balance that appear in this program have been calculated using this new method.