Independent Authority for Fiscal Responsibility

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AIReF MAKES PROPOSALS TO ENSURE COMPLIANCE WITH NEW FISCAL RULES

- **The Independent Authority for Fiscal Responsibility (AIReF) publishes its Opinion on the new European fiscal governance, in which it proposes to make the process of setting targets as transparent as possible and to start the dialogue with the General Government now**

- **The new framework incorporates a medium-term vision and differentiated treatment by country, makes expenditure net of revenue measures the only operational variable, introduces incentives for investment and reforms and strengthens the national commitment to improve compliance**

- **AIReF considers that it improves on the previous framework by making sustainability the key issue, seeking a better balance between sustainability and growth, streamlining supervision and shifting the complexity from supervision to diagnosis**

- **It points out that its implementation in Spain will entail major challenges, such as fostering consensus to give stability to the plans and strengthen national ownership, adapting the national framework to the European framework, distributing the targets and adjustments among all General Government sub-sectors and making debt reduction compatible with spending and investment needs**

- **AIReF makes various proposals to address these challenges, such as publishing the Commission's reference trajectory as other countries have done, making the whole process transparent and starting immediate dialogue with the General Government**

- **It considers that the reform of the national fiscal framework should be addressed together with the reform of the financing system and the extraordinary financing mechanisms, given the interconnections, and that spending and investment needs should be made explicit**

- **AIReF notes that it has already proposed recommendations in its reports along the same lines**

The Independent Authority for Fiscal Responsibility (AIReF) published its Opinion on the reform of fiscal governance in the European Union (EU) on its website today, in which it analyses the main new features, the improvements the change entails and the challenges it poses for an economy such as Spain's. It also

considers a series of proposals to ensure that the fiscal-structural plan actually strengthens national ownership, to adapt the fiscal framework to the European fiscal framework, including the distribution of rules among the General Governments sub-sectors, and to encourage the practical implementation of the reform. Specifically, AIReF proposes making the process of setting targets as transparent as possible and to start immediate dialogue with all the General Government sub-sectors.

In the Opinion, AIReF explains that the economic governance of the European Union (EU) is made up of a set of rules and institutions that have been created since 1992 with the aim of preventing and correcting fiscal and macroeconomic imbalances, which is structured around the Stability and Growth Pact. In February 2024, the EU institutions and Member States agreed on a far-reaching reform of the fiscal governance framework. The reform, resulting from in-depth reflection and negotiation, came into force on 30th April 2024; accordingly, Member States will have to submit the first round of national medium-term fiscal-structural plans in September.

As AIReF points out, the reform has been affected by the fact that the macroeconomic environment is very different from the environment when the original Pact was designed, both in terms of lower growth, a greater presence of shocks and major spending and investment needs to tackle a complex geopolitical environment and other trends, such as climate change and an ageing population.

New features

AIReF points out that one of the main features of the new framework is that it is anchored in the analysis of the risks to the sustainability of each country's debt. This entails a medium and long-term perspective on the public finances whereby adjustment commitments are differentiated by country and are not only determined by the starting position but also by associated future pressures, such as ageing.

Secondly, AIReF explains that these adjustment commitments will be established through a single operational variable, primary expenditure net of discretionary revenue measures, cyclical unemployment and spending entirely financed with EU funds, as well as national co-financing spending. According to AIReF, this variable is more predictable and controllable by the fiscal authorities than the concept of the structural balance on which the previous framework was based.

Thirdly, AIReF points out that the new system contains incentives for investment and reforms that seek to enhance growth in the form of a longer adjustment period. Moreover, two escape clauses are incorporated, both at a European and a country level, to allow fiscal policy to play a stabilising role in exceptional circumstances. Finally, the reform seeks to improve compliance with the fiscal framework by strengthening each country's commitment to its adjustment forecast (national ownership) and to develop credible enforcement mechanisms.

In addition to amending the Stability and Growth Pact Regulations, AIReF explains that the governance reform also entails changes to Directive 2011/85 on national fiscal frameworks, which was introduced to improve national budgetary processes and was, among other elements, the first impetus for the creation of Independent Fiscal Institutions

(IFIs), such as AIReF. The modifications focus on three aspects: improving budgetary statistics, adapting national budgetary frameworks to the reform of the Pact and preserving the role of IFIs by setting minimum standards in terms of independence, funding, the allocation of resources and access to information. In terms of the tasks assigned, the legislation leaves it to each country to define in detail the mandates of their respective institutions. However, in addition to the task of analysing, endorsing and producing the annual and multi-year macroeconomic forecasts and checking compliance with national rules, a new task of analysing the consistency, coherence and effectiveness of the national fiscal framework is explicitly introduced. The deadline for transposing this Directive is December 2025.

According to AIReF's current estimates, the application of the fiscal rules in Spain will require a fiscal adjustment of 0.63 points of GDP per year over the period 2025-2028 or 0.43 points per year over the period 2025-2031, in the event that the adjustment period is extended to seven years, linked to the materialisation of reforms and investments. This adjustment will be set out in a path of primary expenditure net of revenue measures committed to for the next four years. Adherence to this fiscal path will ensure, with a high probability, that the debt ratio falls in the medium to long term, even in more unfavourable scenarios than the central scenario. However, certain methodological aspects of the new framework have yet to be made public, which could cause these calculations to change. AIReF also warns that changes in the forecasts that affect the starting position could also cause these estimates to vary.

Improvements and challenges

In AIReF's opinion, the reform of EU economic governance entails four fundamental improvements that can enhance the rationality and effectiveness of the way fiscal policy is planned and supervised. Firstly, the reform explicitly places sustainability at the heart of the new fiscal rules, which makes sense given the current high levels of debt, with a differentiated country-by-country approach and a strengthening of medium-term planning. It also strives for a better balance between fiscal consolidation and economic growth by seeking to preserve investment. It also streamlines the operational indicators used for fiscal policy surveillance and shifts the complexity from the implementation to the diagnostic phase.

According to AIReF, the implementation of the new framework at a national level entails four significant challenges. The first is associated with the aim of strengthening national ownership of the adjustment path, which will require the political commitment of the government presenting the medium-term plan and that of all the institutions and stakeholders with responsibilities for fiscal policy, especially in a country with a high degree of spending decentralisation such as Spain. AIReF explains that the fact that the plans must be established for a minimum period of four years, with no possibility of revision except in exceptional circumstances – including a possible change of government – makes it advisable to seek consensus on the measures underlying these plans.

The second challenge is to adapt the national fiscal framework to bring it up-to-date and make it consistent with the European reform. According to AIReF, the transposition of the reform of the Directive on National Fiscal Frameworks that will have to be completed before 31st December 2025 provides an opportunity to update Spanish legislation on

financial sustainability. In this regard, AIReF notes that the empirical evidence suggests that IFIs are well placed to contribute to the diagnosis of national budgetary frameworks.

The third challenge, according to AIReF, is to distribute the targets and their implementation among the different tiers of government. This process of distributing fiscal policy targets entails greater complexity in Spain due to the high degree of decentralisation and makes it necessary to address this while also considering the possible reform of the regional and local financing system and the extraordinary financing mechanisms, which could have significant effects on that distribution. The final challenge is to make debt reduction compatible with the growing needs for spending (defence, industrial policy, climate change, digital transition and ageing) and investment.

Proposals

To tackle these challenges AIReF makes various proposals, such as publishing the Commission's reference trajectory so that the different territorial tiers of government and other institutions can be aware of it. Furthermore, the subsequent negotiation process with the European Commission, prior to the presentation of the medium-term fiscal-structural plans, should be transparent and consensual. It also proposes that the specific technical analyses for Spain should be disseminated before each round of approval of the fiscal plans so that a robust and transparent diagnosis can be made of the adjustment needs of our economy.

AIReF also proposes initiating immediate dialogue with all the General Government sub-sectors to reach a consensus on a distribution of targets that will ensure compliance with the commitments made at a European level and to tackle the process of reforming the national fiscal framework, and particularly the distribution of targets between General Government sub-sectors together with the reform of the regional and local financing system and the extraordinary financing mechanisms as the only way to achieve a comprehensive solution to these three closely interrelated pillars. Finally, AIReF proposes tackling medium-term fiscal planning in a comprehensive manner, making the estimated investment needs for the Spanish economy and the measures envisaged to address them explicit.

AIReF also notes that it has already proposed several recommendations in this regard, such as the one included in the Report on the 2023 Rebalancing Plan on the need to involve all the institutions, relevant national stakeholders and representatives of the different regional and local authorities in the design of the new fiscal-structural plans. AIReF also recommended in the Report on the Initial Budgets to start work on reforming the national framework to ensure consistency and coherence with European rules.