REPORT ON THE MEDIUM-TERM FISCAL-STRUCTURAL PLAN 2025-2028

REPORT 51/24

November 5th, 2024

Independent Authority for Fiscal Responsibility

The mission of the Independent Authority for Fiscal Responsibility, AAI (AIReF) is to ensure strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

AIReF Contact:

C/José Abascal, 2, 2nd floor. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Website: www.airef.es

This document may be used and reproduced, in whole or in part, provided its source is acknowledged as AIReF

Publication date: November 5th, 2024

CONTENTS

EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) must report on the Medium-Term Fiscal-Structural Plan (MTP) that replaces the Stability Programme Update in the new European fiscal governance framework. However, the draft General State Budget for 2025, as well as the Budgetary Plan, have not yet been presented, exceeding the legally established dates. Accordingly, with the limited information available to date, AIReF reports on the MTP as a core element of the new European fiscal framework. Together with this report, AIReF publishes the Report on the Draft Budget and Main Budgetary Lines of the General Government (GG) for 2025, in which it updates its macroeconomic and fiscal forecasts at unchanged policies up to 2029, which serve as the basis for the analysis of the MTP.

While the MTP may be in line with the European Commission's June guidelines, it does not provide sufficient detail to be considered a useful medium-term budgetary planning tool. Firstly, it does not contain any information on the budgetary scenario beyond 2024, neither for the General Government sector as a whole nor by sub-sector. Nor does it include a detailed macroeconomic outlook beyond 2026. Secondly, although it contains a regulatory commitment to the evolution of primary expenditure net of revenue measures, the MTP does not explicitly state how this commitment is to be met, either in the form of specific measures or broad lines of action, or the degree of effort to be made by each sub-sector. In short, the content of the MTP is a clear step backwards with regard to the information in the Stability Programme Update - the document it replaces as the central element of the Member States' medium-term budgetary planning.

Consequently, AIReF's analysis of the MTP is based on stylised simulations of a scenario at unchanged policies and a second scenario in which it is assumed that the MTP commitment will be met, maintaining the rest of AIReF's forecasts on revenue growth, interest, etc. unchanged.

In addition to the lack of information, the plans have some methodological peculiarities. Specifically, the need for European fiscal policy to return to a framework of rules, after several years of suspension, has meant that, in this first round, the long-term macroeconomic scenarios that underpin the debt sustainability analyses and determine the required structural adjustment and the expenditure path are based on certain technical assumptions and methodologies that were not designed for this purpose and which, in practice, reveal some inconsistencies: e.g. the upward profiles of potential growth in the long term inconsistent with demographic ageing.

In terms of national ownership, one of the elements that conceptually underpins the new framework of rules is differentiation by country. AIReF has reiterated that this is reinforced not only by giving countries the initiative to shape their own fiscal strategy but also by encouraging their preparation to be transparent, consensual and through dialogue with the main national stakeholders. In this regard, the lack of involvement of the Autonomous Regions (ARs) and Local Governments (LGs), the absence of presentation or discussion of the Spanish plan in Parliament, and the lack of participation of AIReF in the preparation process - something that has happened in other countries - all stand out. The way in which the medium-term Fiscal-Structural Plans are prepared and drawn up, their content and ambition are decisive in terms of putting the final goals of the reform into practice.

Lastly, AIReF would like to point out that there is still a significant degree of institutional uncertainty that stems from both the implementation of the new European fiscal framework and the national fiscal framework. On the one hand, certain issues exist that are currently being negotiated and which will be turned into the code of conduct for implementing the European fiscal framework, referring to essential elements for the effectiveness of the new framework such as the definition and treatment of discretionary revenue measures or the functioning of the annual and cumulative control account.

As for the national framework, the uncertainty stems, firstly, from the need to apply the new European fiscal framework to the reality of the General Government in Spain. The European legislation explicitly states the need to transpose the new European fiscal framework, although it grants a deadline of December 2025. However, the different GG authorities are already drawing up their budgets, which must be compatible with the commitments of the MTP, although the plan itself does not contain any detail on the application of its commitments in each sub-sector. Moreover, no proposals have been made for the reform of the national fiscal framework to date, nor has there been any indication of how to guarantee compliance with the MTP's commitments through the current framework.

Secondly, the lack of approval of the stability targets applicable in the coming years according to the current regulations hampers the budgetary processes of all GG authorities. To date, only the reference rate of the expenditure rule is known: 2.6% for 2024, 3.2% for 2025, 3.3% for 2026 and 3.4% for 2027.

Given this lack of definition of the national fiscal framework, there is still a risk that governments will draw up budgets that do not comply with the European and national fiscal framework, as has also been pointed out in previous reports. In this regard, it should be recalled that AIReF has already warned of the risk of non-compliance with the expenditure rule in 2024 and 2025 for a large number of the GG authorities.

In view of the above, AIReF recommends that the Ministry of Finance should take advantage of the transposition of the Directive on national fiscal frameworks to design a credible and effective medium-term budgetary framework that ensures the coherence, consistency and effectiveness of the national fiscal framework. AIReF also makes recommendations to adapt the national expenditure rule to the European expenditure rule, both in its practical application and through the necessary regulatory changes.

Analysis of the Medium-Term Fiscal-Structural Plan

As already stated, AIReF's analysis of the MTP is based on stylised simulations of AIReF's scenario at unchanged policies, to which a second scenario is added in which it is assumed that the MTP commitment will be met in terms of net expenditure, maintaining the rest of AIReF's projections unchanged.

The MTP is based on a short-term macroeconomic scenario that the Government is drawing up for the period 2024-2026 and which was already endorsed by AIReF on September 28th, albeit with many caveats because the request for endorsement took place in the middle of the National Statistics Institute's (INE) statistical revision process and, above all, because of the total lack of information on the fiscal scenario of the MTP. The macroeconomic scenario underpinning the MTP is more favourable after 2025 than that estimated by AIReF in the short term. The most significant discrepancies can be seen in the forecast of the deflators. Specifically, the macroeconomic scenario of the MTP considers an increase in real economic activity of 2.7%, 2.4% and 2.2% in the period 2024-2026. AIReF forecasts higher growth in volume terms than the Government for 2024 (2.9%), but not so in 2025 and 2026, when AIReF, in its scenario at unchanged policies, projects growth of 2.3% and 2%

respectively, such that over the period as a whole the discrepancies are practically non-existent. Conversely, the GDP deflator forecasts, which in the new framework play a crucial role in the calculation of the fiscal adjustment, are more optimistic for 2025 and 2026, such that over the period as a whole, a cumulative discrepancy of almost 1 percentage point is generated. As a result, short-term nominal growth is more favourable than AIReF's forecast.

For its part, the long-term macroeconomic assumptions of the MTP are not very different on average from those projected by AIReF. However, there is higher growth in deflators and a lower cost of servicing debt. Furthermore, the upward profile of the potential GDP growth forecast by the Government is difficult to explain in the context of expected demographic ageing.

At a fiscal level, AIReF bases its analysis on a complete fiscal scenario drawn up for the years 2024-2029. On the basis of this scenario, AIReF considers that the withdrawal of the measures will enable the General Government deficit to be reduced to 2.7% in 2025, rising, as from 2028 to 2.9% of GDP in 2029 in the absence of additional measures. The sustainability analysis indicates that until 2029, debt maintains a downward path due to nominal growth, although its fall would slow to stand at 98% of GDP in 2029. These macroeconomic and fiscal forecasts have been prepared under the assumption of unchanged policies and thus do not incorporate the adjustment path commitment contained in the MTP due to a lack of detail on its implementation.

The MTP contains a GG growth commitment of primary expenditure net of revenue measures of an annual average of 3% between 2025 and 2031. This is equivalent to cumulative growth of 23.3% until 2031 and with a downward profile over time (net expenditure growth of 3.4% on average from 2025 to 2028. This commitment is on average 0.3 points higher than the reference trajectory presented by the European Commission in June and its time profile is also different.

The analysis of the path of growth in expenditure net of revenue measures shows that it is necessary to adopt additional measures to those contained in AIReF's scenario at unchanged policies to ensure its compliance. While the MTP forecasts average growth of 3% in the period 2025 to 2031, AIReF's scenario estimates an annual average of 3.6%. Furthermore, there are also differences in the time profile.

With the exception of 2025, AIReF's scenario at unchanged policies shows higher rates of growth in net expenditure than the MTP, with the difference being greater at the end of the period. This means no additional measures would be necessary in 2025 to comply with the MTP forecast. However, between 2026 and 2028 - the end of the plan period - additional measures, either on the expenditure or revenue side, would be needed of around 0.2 points of GDP per annum. Between 2029 and 2031, the additional measures needed to achieve the MTP forecast would be between 0.3 and 0.4 points of GDP.

Alternatively, AIReF considers a scenario in which the evolution of net expenditure follows the forecast set out in the MTP until 2031, starting from AIReF's year-end 2024 forecast. As from 2031, AIReF applies its long-term revenue and expenditure forecasts until the deficit and debt path is completed up to 2041. As a result of lower net expenditure than in the scenario at unchanged policies, the Government deficit would also be structurally reduced such that in 2031, the deficit would be 1.6% of GDP. This figure is higher than in the MTP, at 0.8% of GDP, due to differences in both revenue forecasts and discretionary revenue measures. The lack of detail on these variables in the MTP prevents the proper identification of the source of the discrepancies.

These differences widen to 2041, with a deficit in the MTP of 2% of GDP compared with 3.3% in AIReF's adjustment scenario. In this case, the differences are based on the methodologies used and on higher expenditure on interest associated with a higher level of debt. Whereas AIReF carries out a complete exercise of the revenue and expenditure forecasts, as contained in the Opinion on the Sustainability of the General Government, the MTP follows the methodology of the Commission's sustainability analysis, maintaining the structural primary balance constant and incorporating the cost of ageing calculated in the Commission's Ageing Report and the impact of the revenue measures on the pension system.

An alternative exercise is to estimate how much net expenditure could grow under AIReF's macroeconomic and fiscal scenario to reach the fiscal balance in 2031 contained in the MTP, at 0.8% of GDP. Respecting the time profile of the MTP and starting from AIReF's year-end forecast, if expenditure net of revenue measures were to grow by an annual average of 2.8% between 2025 and 2031 instead of the 3% commitment, the deficit would stand at the figure estimated by the MTP in 2031.

AIReF has also noted in successive reports the relevance of 2024 from the point of view of sustainability, as it is the starting point from which the new European framework is to be applied. In this regard, AIReF forecasts growth in net expenditure of 4.1% in 2024 compared with the 5.3% commitment contained in the MTP, which in turn is double the 2.6% growth recommended to Spain by the European Council. If the growth forecast in the MTP materialises, AIReF estimates that the deficit in 2024 will rise to 3.5% of GDP. In this case, the deficit that would be reached in 2031 with the MTP growth in expenditure forecast would stand at 2% of GDP and the level of public debt in 2041 would stand at 95.8% of GDP, showing an upward profile at the end of the period. If, Conversely, AIReF's forecast is finally met in 2024, depending on how the functioning of the control account in European legislation materialises, this would provide a margin against possible deviations in subsequent years. Accordingly, the result finally attained is crucial to guarantee the commitment to maintain a deficit below 3% and the debt reduction target until 2041.

Implications for the sustainability of public accounts

These differences in the forecast path of the fiscal balance are also reflected in the evolution of debt. The debt reduction estimates considered by the Government in the MTP are very favourable compared with those of AIReF. Specifically, the Government's forecast is reduced by more than 40 points of GDP in the adjustment scenario, to stand at 76.8% of GDP in 2041.

AIReF, for its part, in the scenario at unchanged policies, places debt at 108.9% in 2041. However, in the adjustment scenario, it would not be reduced as much as the Government envisages. The application of the rates of evolution of net expenditure of the fiscal commitment in the period 2025-2031, together with the rest of the macro-fiscal variables projected by AIReF (tax revenue, growth, interest rates), imply a reduction in the debt-to-GDP ratio of 21.4 points with respect to the scenario at unchanged policies at the end of the period, placing it at 87.5% of GDP in 2041.

Accordingly, under AIReF's revenue forecasts, compliance with the expenditure path commitment contained in the MTP, although it would represent progress in terms of sustainability, does not in itself guarantee the deficit and debt reduction contained in the MTP.

1. INTRODUCTION

On October 15th, 2024, the Government submitted the Medium-Term Fiscal-Structural Plan 2025-2028 (MTP) to the European Commission for the first time, in the context of the new framework of European fiscal rules. This plan, which replaces the previous Stability Programme Update, becomes the Government's main medium-term fiscal document, covering a four-year period up to 2028. The document will be issued every four years and, from now on, the usual publication date will be April 30th. However, due to the introduction of the new framework, the presentation of this first edition was exceptionally scheduled for September 20th, although the submission was made on October 15th, following an extension granted at the request of the Member States, including Spain.

AIReF has a legal mandate to evaluate the MTP. Articles 14 and 16 of Organic Law 6/2013 of 14 November on the Creation of AIReF establish the duty to evaluate the medium-term macroeconomic forecasts currently included in the MTP, and to evaluate, in particular, the commitments that guarantee compliance with the fiscal rules. This evaluation is being made exceptionally at this time due to the delay in the submission of the document as a result of the start of the new framework.

AIReF endorsed the figures of the macroeconomic scenario underpinning the MTP, but said it would update its evaluation when it had complete information

on the MTP and the Spanish national accounting data. On September 24th, 2024, AIReF issued its endorsement of the macroeconomic forecasts underpinning the MTP and the draft General State Budget (GSB) for 2025, although the latter has not yet been submitted. AIReF considered that the Government's GDP growth forecasts accompanying the budget and the MTP would fall in the central probability range in both nominal and real terms. However, AIReF's scenario does not incorporate the structural adjustment that the Government is certain to have to implement as from 2025. AIReF prepared a second scenario to determine whether the Government's path is feasible once a potential fiscal adjustment is incorporated. In this second scenario, the Government's forecasts, albeit at the upper limit, are still within AIReF's central probability range and AIReF therefore endorsed the Government's figures. However, it warned of the complexity of the context and said that it would update its estimates and its evaluation when it had complete information from the MTP and the national accounting data, which it has undertaken in this report.

At the time of issuing the endorsement, AIReF made two recommendations and a best practice guideline. It recommended that the Ministries of Economy, Trade and Enterprise and of Finance should provide more information on the budgetary and fiscal measures incorporated in the macroeconomic scenario as otherwise it might be advisable to carry out the endorsement process in two stages, as takes place in other countries: a first stage with the macroeconomic outlook at unchanged policies and another with the complete outlook after seeing the breakdown of the proposed measures. Furthermore, it recommended the INE to assess the compliance of the statistical revision schedules with the needs of the budgetary cycle. Finally, it issued a best practice guideline for the Government to prepare a complete economic scenario with a horizon of at least four years, including investment and expenditure needs and details of fiscal measures, coinciding with the duration of the MTP.

The MTP will be completed annually with the submission of the Budgetary Plan, which, in turn, must be aligned with the measures of the draft budget and main budgetary lines of the GG. The commitments of the MTP, which guide medium-term fiscal policy, must be specified annually through the Budgetary Plans, where the budgetary measures of all the GG authorities must be detailed. These plans must specify the budgetary measures for the General Government Sector, on both the revenue and expenditure sides, to ensure compliance with the multiannual expenditure forecast. At the date of issue of this report, the Government has not yet submitted the Budgetary Plan 2025, having passed the October 15th deadline. Spain has requested an extension to submit it together with the General State Budget (GSB) for 2025. For their part, the Autonomous Regions and Local Governments have already submitted their draft budgets or have drawn up the main lines of their budgets for 2025, which have been reported on by AIReF.

The purpose of this report is to evaluate the MTP, which is structured in six sections. Following this introduction, Section 2 provides a general evaluation of the content of the MTP in the context of the new European fiscal framework. Section 3 analyses the short- and medium-term macroeconomic scenario and discusses the quantification of the reforms and investments that allow for the extension of the adjustment period. Section 4 examines the fiscal scenario, evaluating the path of expenditure net of revenue measures up to 2031. Section 5 then contains the recommendations arising from the analysis. Finally, Section 6 includes a supplementary analysis on medium-term fiscal planning.

2. EUROPEAN FISCAL GOVERNANCE REFORM AND THE MTP

Medium-term Fiscal-Structural Plans are the main element for implementing the new European fiscal governance framework in force as of April 30th, 2024. The reformed framework maintains the ultimate goal of guaranteeing the sustainability of national public finances as a necessary condition for the stability of the euro. But it innovates to achieve this in a way that is feasible, manageable for countries, sustained over time and compatible with economic growth. To this end, the reform has several aims:

i. Strengthen national ownership of the sustainability of public finances.
ii. Reconcile budgetary stability with economic growth.
iii. Design a more transparent and simpler system of fiscal surveillance.

The aim is to strengthen national ownership by giving countries the initiative to shape their own fiscal strategy and also by encouraging their preparation to be transparent, consensual and through dialogue. While the reform of the Pact initiated in 2011 in the wake of the financial crisis encouraged the creation of national IFIs to promote national ownership, this reform goes a step further, relying on the initiative of countries to identify their medium-term commitments. Medium-term fiscal-structural plans are thus the ultimate expression of national ownership:

i. They must embody proposals for fiscal commitments, reforms and investments for a horizon of at least four years. In exchange for this capacity for initiative and for being able to consider differentiated strategies between countries, the commitments must fulfil a twofold condition. On the one hand, they must be stable over time, since they can only be modified for justified reasons. On the other hand, they must satisfy the *ex ante* sustainability requirements established by the European Commission on the basis of a common methodology. In other words, when considering commitments, the Commission's so-called reference trajectory must be taken into account.

ii. It is also hoped that, while respecting national legal frameworks, these commitments will be debated in Parliament before being submitted to European institutions and that there will be prior dialogue with the main stakeholders, such as regional authorities, civil society and social stakeholders. This is certainly not a requirement of this first round of plans, likely due to the very tight deadlines, but it is provided for in Article 11 of the Preventive Arm Regulation 1263/2024.

With the aim of making budgetary stability compatible with economic growth, the fiscal commitments in the national plans are established in terms of net primary expenditure and, in addition, an extension of the adjustment period may be requested to meet sustainability requirements. In fact, as from this reform, fiscal commitments are defined in terms of primary expenditure net of discretionary revenue measures. The setting of limits to the growth of this variable allows fiscal margins to be generated in expansionary phases or if extraordinary revenue is recorded. Furthermore, public expenditure on cyclical unemployment is excluded, allowing this item to act as an automatic stabiliser. Accordingly, the aim is to overcome the procyclicality that characterised fiscal policy prior to this reform. In addition, expenditure on EU programmes with full EU funding and national expenditure with EU co-financing are also deducted from primary expenditure. Moreover, to promote economic growth, plans may propose an adjustment period of up to seven years provided that reforms and investments to boost growth are undertaken.

Lastly, the reform sought to simplify fiscal supervision and make it more transparent by pivoting on a single variable - primary expenditure net of discretionary revenue measures. The existence of several indicators generated margins of discretion and arbitrariness in fiscal surveillance. Furthermore, unlike the structural balance, net primary expenditure is a directly observable variable. However, its *ex ante* determination is not straightforward since the reference trajectory provided by the Commission to countries with debt above 60% of GDP is based on a stochastic and deterministic debt sustainability analysis that requires economic and budgetary scenarios of up to 17 years for each country. In doing so, the Commission relies on a common methodology published in its 2023 Debt Sustainability Monitor. As this is a common methodology that applies to all countries, the Commission necessarily incorporates simplifying assumptions such as using constant primary balance assumptions instead of full projections of public accounts for the entire projection horizon needed.

The way in which medium-term fiscal-structural plans are prepared and drawn up, together with their content and ambition, are decisive for the implementation of the ultimate aims of the reform discussed above. Spain submitted its Fiscal-Structural Plan to the EU institutions on October 15th, the main features of which are as follows:

i. Although it is a four-year plan for 2025-2028, an extension of the adjustment period to seven years (until 2031) is requested in order to achieve the public debt sustainability requirements of the new Pact. This request is justified by the reforms and investments of the Recovery and Transformation Plan for the Spanish economy together with additional reforms and investments in the areas of migration, housing and improvement of the business climate. The plan quantifies the impact of these reforms and investments on GDP at 3.3 percentage points in 2031 over the baseline scenario.

ii. The proposed growth path for primary expenditure net of discretionary measures differs from the reference trajectory that the Commission transmitted to Spain in June and which should have been taken into account in its preparation. As shown in Table 1, there are differences in the average as well as in the time profile. Spain considers an average growth path for net primary expenditure in the period 2025-2031 of 3%, 0.2 points above the reference trajectory, justified by the use of more up-to-date population projections (Europop 23) and by the impact from 2031 of the revenue from the latest pension reform. These deviations are concentrated in the first three years where growth rates for expenditure are proposed to stand at 0.5 pp (including 0.7 points in 2026) higher than those of the reference trajectory.

TABLE 1. FISCAL COMMITMENT 2025-2031. PRIMARY EXPENDITURE NET OF DISCRETIONARY REVENUE MEASURES (ANNUAL RATES OF CHANGE).

Growth rate of eligible expenditure	2024	2025	2026	2027	2028	2029	2030	2031
MTP	5,3	3,7	3,5	3,2	3	3	2,5	2,4
Commission reference trajectory	3,8	3,2	2,8	2,7	2,7	2,7	2,6	2,5

Source: Medium-Term Fiscal-Structural Plan 2025-2028 and Commission reference trajectory

iii. The expenditure path commitment presents higher growth rates for expenditure in the initial years when the macroeconomic scenario of the plan also presents higher rates of economic growth. The greatest constraints to expenditure growth are postponed to the end of the period.

iv. A different year-end forecast for primary expenditure net of discretionary measures is provided for 2024 than the one used by the Commission in the determination of the reference trajectory (5.3% vs. 3.8%).

v. In terms of preparation and drafting:

- Its drafting has been preceded by numerous technical meetings with the Commission.
- It has been submitted to the EU institutions without prior debate in Parliament or consultation with civil society, social stakeholders and regional authorities.
- AIReF has been asked to endorse the macroeconomic scenario for the 2024-2026 scenario.
- The plan and the reference trajectory have been made public at the time of their referral to the EU institutions.

vi. And in terms of content, it is in line with what has been strictly established by the new EU rules. In terms of macroeconomic and budgetary information, this implies a very limited provision of information since a complete macroeconomic scenario is only provided for the two years 2025-2026; there is no budgetary information for the adjustment period (2025-2031) beyond the expenditure, deficit and public debt path and the structural balance. In other words, the budgetary projections are limited to 2024, for which a year-end forecast of public revenue and expenditure by economic classification is provided. The proposed multiannual expenditure forecast is provided for the GG Sector, but not by sub-sector to identify the adjustments of each tier of the GG, which should be taken as a reference when drawing up their annual budgets. Beyond the reforms and investments indicated in order to request the extension of the adjustment period and the inclusion of a set of additional budgetary measures, no details are provided on the measures or channels through which it is intended to achieve the expenditure path.

After its submission to the EU institutions, the Spanish Plan will be evaluated by the Commission in order to propose to ECOFIN the adoption of a recommendation establishing the net expenditure forecast and the reforms and investments to be met by the Spanish General Government during the adjustment period. To this end, the Commission will assess the content of the plan, whether the extension of the deadline is justified and whether the net primary expenditure path complies with sustainability requirements. If the assessment is not positive, the submission of a new plan will be requested, which, if it is again considered not to meet the requirements, could lead the Council to recommend that the Commission's reference trajectory be taken as the multiannual expenditure forecast.

3. MACROECONOMIC SCENARIO

This section evaluates the macroeconomic scenario of the Medium-Term Fiscal-Structural Plan (MTP). To evaluate this scenario, AIReF starts by drawing up its own macroeconomic forecasts, which comprise a complete and detailed macroeconomic outlook in terms of the main aggregates of demand, expenditure and inflation for the 2024-2029 horizon and a long-term macroeconomic scenario that is drawn up on the basis of a production function and which incorporates an update of AIReF's demographic forecasts. The MTP macroeconomic outlook for the years 2024-2026 was endorsed by AIReF on September 24th, albeit with caveats due to the complete lack of information on the fiscal scenario.

The lack of detail in the MTP on the fiscal consolidation measures underpinning the commitment to the expenditure path has led AIReF's scenario to be a scenario at unchanged policies. However, in order to evaluate the Government's scenario, AIReF carries out a highly stylised simulation exercise in which it tries to assess what the impact would be on growth of a possible fiscal adjustment of 0.4 percentage points, consistent with the Government's commitment in the MTP.

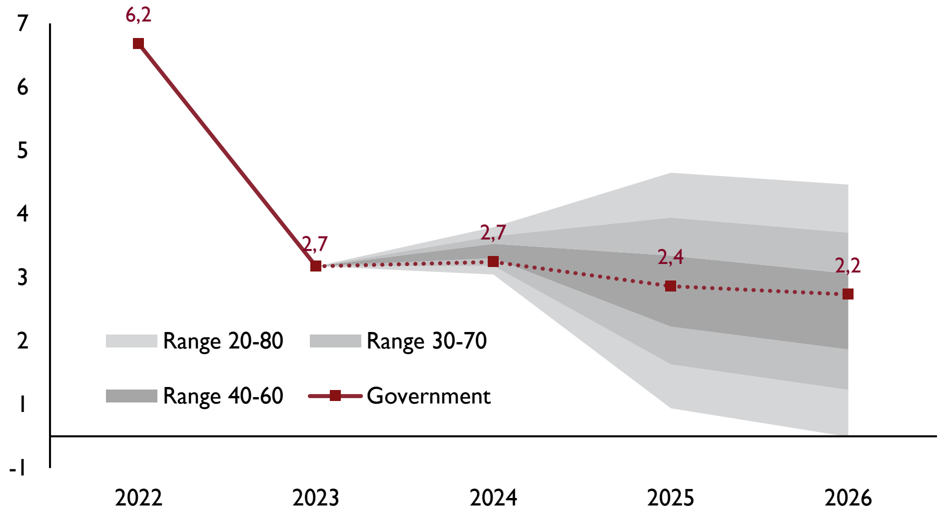
At the methodological level, the MTP scenarios present certain technical peculiarities. The new fiscal rules have come into force using methodologies from the previous framework, which placed greater emphasis on the cyclical position as a necessary variable for determining the structural balance and paid less attention to the nominal potential growth path. However, this variable now plays a central role in the calculation of the structural adjustment commitment and the expenditure path. For its estimation, the new fiscal rule framework requires macroeconomic projections to be performed on the basis of the estimates of potential GDP obtained with the common methodology, according to the European Commission's EUCAM model[2] up to t+10 and the *Ageing Report* methodology beyond that horizon. The combination of both methodologies leads to some inconsistencies that will be addressed in a future Potential Output Working Group.

Once the potential growth of the economy has been determined according to this common methodology, governments derive actual GDP by incorporating assumptions of a technical nature. In particular, the forecasts of actual GDP growth in the MTPs from T+2 onwards are determined by the estimates of potential growth obtained for each country from the EUCAM methodology and the incorporation of two assumptions of a technical nature, common to all countries: (1) the assumption of closure of the output gap and convergence to potential GDP over a period of three years; and (2) assumption of a feedback effect of fiscal policy on economic activity (with a multiplier of 0.75 percentage points common to all countries). Countries may depart from these technical assumptions provided they present justified arguments for doing so.

In this regard, AIReF considers that in order to foster greater national ownership and consistency, governments should present their own macroeconomic forecasts consistent with budgetary forecasts, at least over the MTP horizon and greater detail of the nature of the measures they intend to implement. This would achieve greater consistency and coherence between the macroeconomic and fiscal outlook over the projection horizon and increase the chances of meeting commitments. The impact of a given fiscal adjustment crucially depends on the composition and nature of the fiscal measures intended to achieve it.

As regards the evaluation of the figures, the macroeconomic scenario of the MTP considers an increase in economic activity of 2.7%, 2.4% and 2.2% in the period 2024-2026. AIReF forecasts higher growth in volume terms than the Government for 2024 (2.9%), but less growth in the years 2025 and 2026, when AIReF projects growth of 2.3% and 2%, respectively. In short, the Government's estimates stand in the central probability range of AIReF's own forecasts and over the period as a whole the discrepancies are marginal (see Figure 1).

FIGURE 1. RATE OF CHANGE OF GDP IN VOLUME TERMS (%)



Source: INE, Ministry of Economy, Trade and Enterprise and AIReF

The GDP deflator forecasts, which in the new framework play a crucial role in the calculation of the fiscal adjustment, are higher in the Government's scenario for 2025 and 2026. Specifically, AIReF places GDP deflator growth at 2.9% in 2024, 2.4% in 2025 and 2.1% in 2026, while the Government's deflator forecast is 3.1% in 2024, 2.7% in 2025 and 2.4% in 2026 (0.8 points higher for the three years as a whole).

Overall, the Government's nominal GDP growth forecast is identical to AIReF's in 2024, but it is higher in 2025 and 2026. The Government's nominal GDP forecast for 2024 is identical to AIReF's. However, as a result of the cumulative discrepancies in the expected evolution of real GDP and the implicit deflator, the Government's forecast for nominal GDP in 2025 and 2026 would be at the upper end of the central range of AIReF's forecasts.

FIGURE 2. RATE OF CHANGE OF THE GDP DEFLATOR (%)

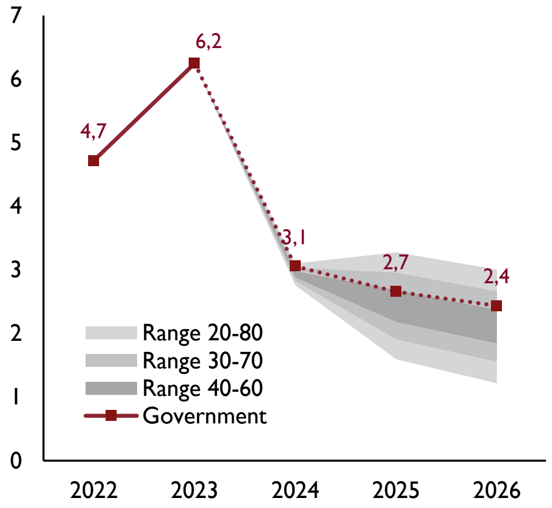
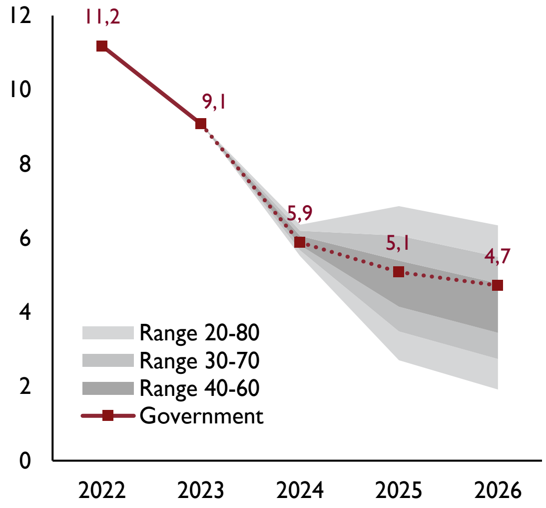


FIGURE 3. RATE OF CHANGE OF NOMINAL GDP (%)



Source: INE, Ministry of Economy, Trade and Enterprise and AIReF

The Government's growth scenario is more optimistic than AIReF's if we bear in mind that the latter is a scenario at unchanged policies that does not incorporate the impact of the fiscal adjustment commitment. Conversely, the Government's macroeconomic scenario incorporates the impact of the adjustment measures. As mentioned in the endorsement report, the implementation of a possible structural adjustment programme of 0.4 percentage points per year over a seven-year horizon in AIReF's forecasts would reduce GDP growth in volume terms in 2025 and 2026 to 2% and 1.8%, respectively. However, this exercise should be seen as an approximation, as it depends on the specific measures adopted. Under these assumptions, it can be seen that in the case of real GDP, the MTP scenario remains within AIREF's central probability range, while in the case of nominal GDP, the Government's forecast for 2025 would be above the 60th percentile and for 2026 would be slightly above that level.

FIGURE 4. FORECASTS OF CHANGE IN REAL GDP. SCENARIO WITH FISCAL ADJUSTMENT MEASURES OF 0.4 PP OF GDP IN 2025 AND 2026

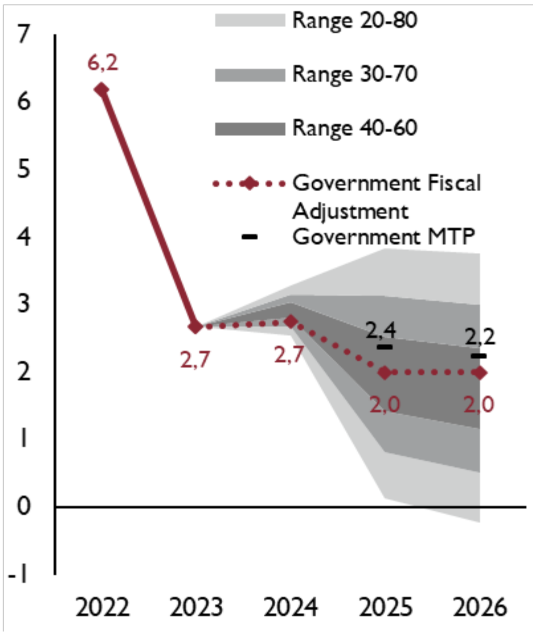
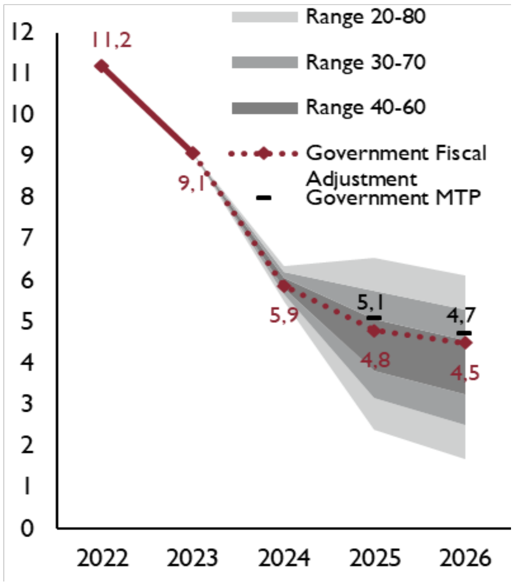


FIGURE 5. FORECASTS OF CHANGE IN NOMINAL GDP. SCENARIO WITH FISCAL ADJUSTMENT MEASURES OF 0.4 PP OF GDP IN 2025 AND 2026



Source: INE, Ministry of Economy, Trade and Enterprise and AIReF
Note: "Government MTP" is the macroeconomic scenario presented in Section 2.2 and Table 16 of the Government's document, while "Government Fiscal Adjustment" includes the paths of GDP in volume and current terms presented in Table 13 of that document.

In addition, an inconsistency is detected in the short-term macroeconomic outlook of the MTP. The MTP presents two different GDP forecasts for the years 2024-2026, for the same fiscal adjustment. Thus, Table 13 of the MTP mentions that "*for the sake of prudence, and to avoid deviations from the common methodology, for the debt sustainability exercise it has been decided to apply the impact of this fiscal multiplier on the real GDP path of the domestic macroeconomic scenario, which is already consistent with the fiscal path of the fiscal effort scenario*".

The main discrepancies between the Government and AIReF are concentrated in the outlook for investment, where the Government's estimates are much higher than those forecast by AIReF. In particular, AIReF estimates a certain degree of acceleration in investment thanks to the momentum in construction, but maintains a relatively moderate tone for investment in machinery and capital goods, in line with its recent evolution. Conversely, the Government considers that investment in construction will pick up "*contributing to close the existing gap in the housing stock*", on the basis of a number of additional measures included in the MTP focused on improving the alignment of the housing stock with demand. This means that, as a whole, the expansion in investment forecast by AIReF is a long way from that envisaged by the Government. The Government's forecast is also optimistic compared with the forecast range of other institutions and agencies included in the FUNCAS panel.

Finally, the Government's forecasts are more optimistic than AIReF's as regards the reduction in the unemployment rate, envisaging a fall to below 10% in 2026. However, within the framework of the MTP, this variable has no impact, despite its importance in determining public expenditure.

3.1. The long-term macroeconomic scenario of the Medium-Term Fiscal-Structural Plan

The long-term macroeconomic variables (2025-2041) are relevant for the design of the reference trajectory for net nominal expenditure. In the average for that period, the Government's and AIReF's long-term scenario are similar. The discrepancies of both with respect to the European Commission's long-term scenario that underpins the calculations of the reference trajectory that this institution sent to the Government on June 21st are also small, on average.

TABLE 2. COMPARISON OF LONG-TERM SCENARIOS

	Average 2025-2041			
	Government	EC	AIReF	Average 1998-2023
Change in real GDP (%)	1,4	1,3	1,4	1,8
Change in real potential GDP (%)	1,4	1,4	1,4	1,8
Change in GDP deflator (%)	2,3	2,4	2,1	2,3
Implicit nominal interest rate (%)	3,2	3,3	3,5	3,8

Source: Ministry of Economy, Trade and Enterprise, European Commission and AIReF

The main differences can be seen in the forecast of deflators and interest rates, which play an essential role in determining the adjustment and the net expenditure forecast. Specifically, in the case of actual GDP growth and potential GDP growth, both the Government and AIReF scenarios assume growth of 1.4% on average over the period 2025-2041. Both scenarios are in line with the European Commission's previous guidance of June 2024 and all of them assume a slowdown in economic activity in the long term as a result of demographic ageing. The main differences lie in the estimates of the GDP deflator, for which the Government estimates an increase of 2.3% (2.4% in the case of the EC) while AIReF forecasts an increase of 2.1% on average for the period. There are also discrepancies in the interest rates on long-term debt for which the Government estimates an average of 3.2% compared with AIReF's 3.5%. In other words, the Government assumes more favourable conditions for reducing the public debt ratio in the form of higher inflation and lower interest rates.

Despite the similarities of the two scenarios, the profiles of the variables differ due to the different methodologies incorporated in the Government scenario. This results in significant differences in the profiles of the evolution of the macroeconomic assumptions over time. The most significant difference is the improvement in activity in the Government scenario in the 2030s, which does not seem consistent with the consensus on demographic evolution and is not supported by economic but purely methodological arguments.

FIGURE 6. PANEL OF VARIABLES LONG-TERM SCENARIO

FIGURE 6.A CHANGE IN REAL GDP (%)

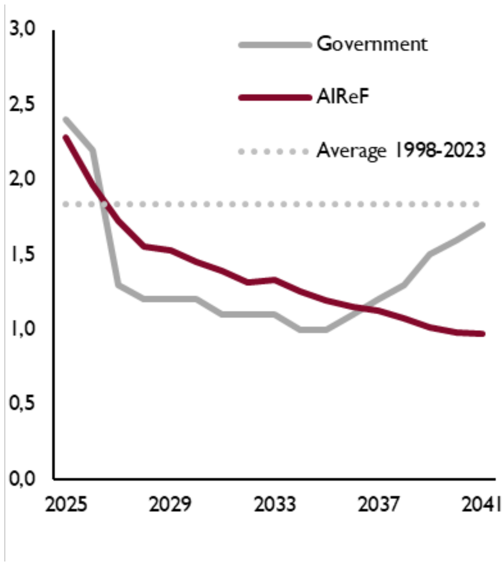


FIGURE 6.B CHANGE IN REAL POTENTIAL GDP (%)

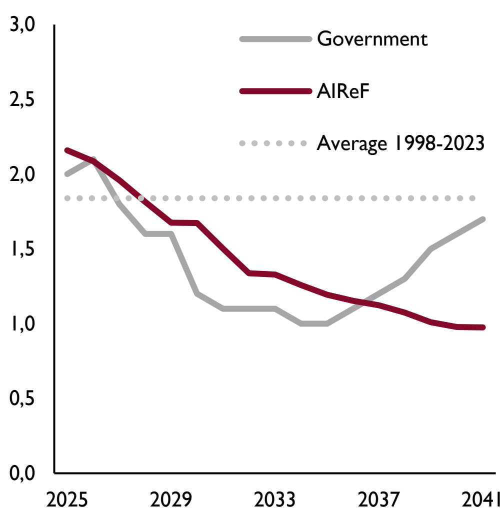


FIGURE 6.C CHANGE IN GDP DEFLATOR (%)

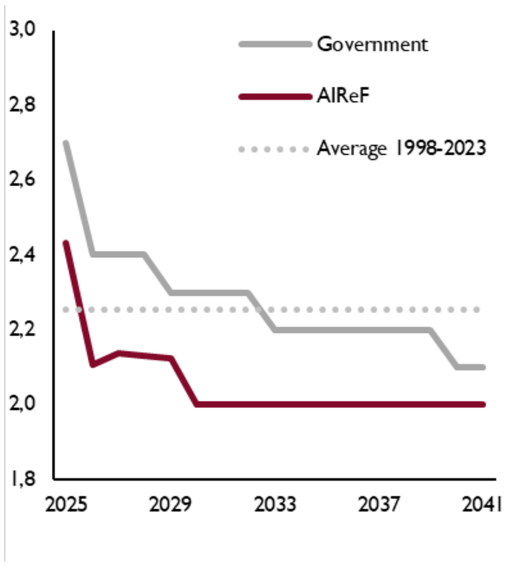
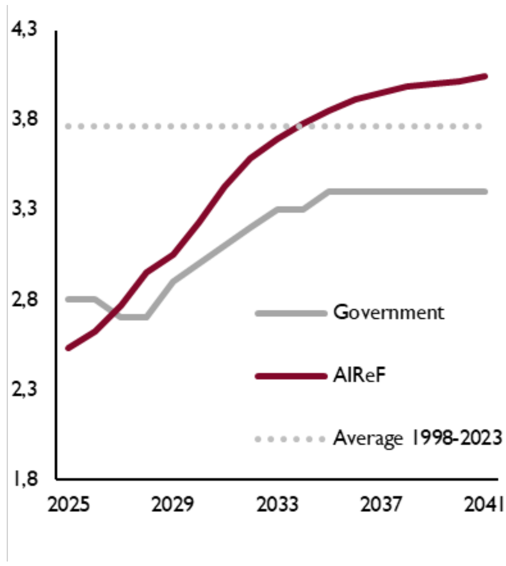


FIGURE 6.D IMPLICIT NOMINAL INTEREST RATE (%)



Source: AIReF, European Commission and Ministry of Economy, Trade and Enterprise

3.2. Reforms and investments in the extension of the adjustment period

MTPs replace the previous Stability Programmes and National Reform Plans in such a way that they not only contain medium-term fiscal commitments, but also the reform and investment commitments that governments plan to implement in the coming years. In this regard, Article 14 of Regulation 2024/1263 provides the possibility for countries to obtain an extension of the adjustment period by extending it by up to a maximum of three years, provided that they incorporate a set of reforms and investments that entail an improvement in potential growth, help fiscal sustainability and address the EU's common priorities, as well as the country-specific recommendations (CSRs). For the first time, the regulations allow the reform and investment commitments contained in the Recovery and Resilience Facility (RRF) to be taken into account when requesting an extension of the adjustment period. So far, only four countries, Italy, Spain, France and Finland, have requested such an extension.

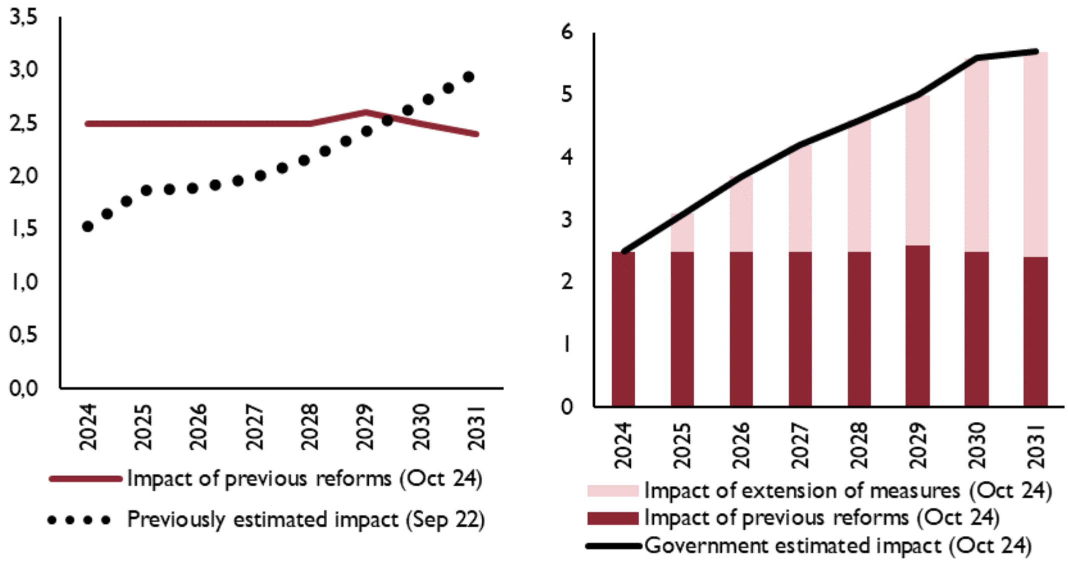
The macroeconomic outlook can only incorporate the impact of reforms already implemented. Given the complexity involved in quantifying the impact of reforms and investments, the European Commission's communication of June 21st does not allow the incorporation in the medium- and long-term scenario of reforms that have not been implemented or legislated, but it does require a quantification of their effects on potential growth and fiscal sustainability. In the case of Spain, *Table 14* of the MTP shows a calibrated estimate of the effect on potential GDP and the structural balance of the reforms implemented in recent years, as well as those that support the extension of the adjustment period and other reforms and additional investments that the Government is committed to introducing in the coming years, mainly in the areas of migration and housing, and the improvement of the business climate.

AIReF considers that, if implemented in line with the Government's commitments, the reforms as a whole could have a positive impact on the growth of the economy and contribute to fiscal sustainability. However, the ex *ante* quantification of the impact on GDP is complex. On the one hand, the impact of any economic policy depends to a large extent on the specific nature of the law and its practical implementation, which are unknown for the time being. On the other hand, the *ex ante* quantification of the macroeconomic impact of these measures is a complex process that depends to a large extent on the model or models used and the calibration applied. An example of this is the estimated impact of the reforms associated with the RTRP currently being implemented by the Government, which differs markedly in its time profile from what the Ministry of Economy, Trade and Enterprise itself projected only two years ago[1].

FIGURE 7. IMPACT OF REFORMS ON POTENTIAL GDP OF THE MTP (DEVIATIONS FROM BASELINE SCENARIO, PP)

FIGURE 7.A CALIBRATION OF THE IMPACT ON POTENTIAL GDP OF PREVIOUS GOVERNMENT REFORMS

FIGURE 7.B CALIBRATION OF THE IMPACT ON POTENTIAL GDP OF THE MTP



Source: Ministry of Economy, Trade and Enterprise

Another example is the uncertainty about the long-term impact that can be attributed to the RED mechanism. This mechanism, together with labour reform and active employment policies, is one of the central elements included in the "*human capital*" pillar which, according to Government estimates, will have an impact in 2031 of an additional 1 point of GDP to that estimated for 2024 (0.9 pp). The effects of the RED mechanism are calibrated by the Government "on the basis of the change in the elasticity between unemployment and GDP during the life of the COVID ERTEs [Job Retention Support Schemes]". In this regard, the recent evaluation conducted by the OECD on the role of the ERTEs during the COVID-19 period[2] suggests that, while ERTEs mitigated the impact of shocks on employment and workers' skills, their impact on productivity and in the longer term may be small, as they do not

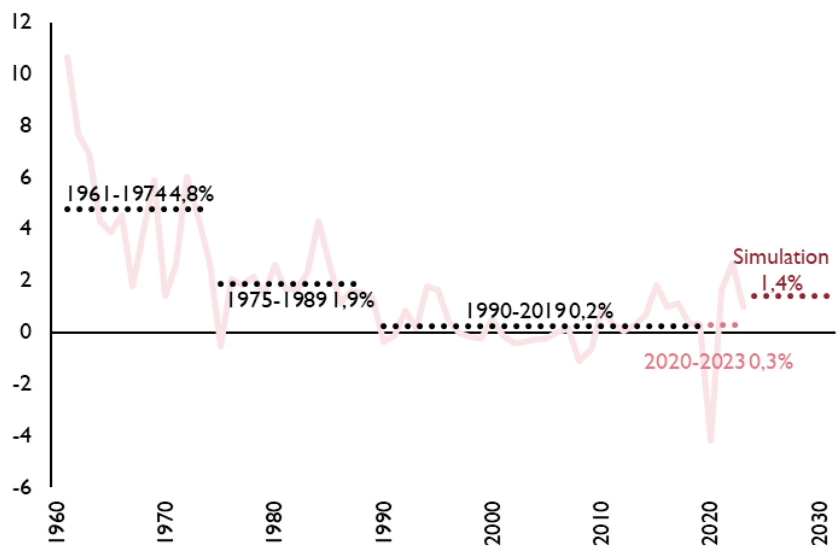
[1] See the RTRP 2022 Execution Balance Document.

[2] OECD (2024), Preparing ERTE for the Future: An Evaluation of Job Retention Support in Spain During the COVID-19 Pandemic, OECD Publishing, Paris, https://doi.org/10.1787/a70bf8ec-en.

improve efficiency in the allocation of the labour force towards more productive jobs.

In general, both the assumptions used to calibrate the impact of the reforms on potential GDP and the results provide information on the degree of ambition of the goals set. For example, for the calibration of the impact of the reform of the National Plan for Digital Skills and the AI Strategy, the assumption of convergence of the weight in employment of ICT workers to the EU average is used, which implies raising the weight of workers in these activities from the current 4.4% to the 4.9% that currently exists in the EU. The size of this change is similar to that observed between 2020 and 2023, suggesting that this result could be achievable. In the same vein, the simulations carried out with AIReF's General Equilibrium Model (MEGAIReF) suggest that, in order to achieve the macroeconomic impact of the human capital pillar, an increase in total factor productivity of between 1.2% and 1.6% each year, averaging 1.4%, would be necessary. In other words, average total factor productivity growth would have to reach levels similar to those recorded between 1975 and 1989, far from those of the last 30 years.

FIGURE 8. CHANGE IN TOTAL FACTOR PRODUCTIVITY (%)



Source: AMECO and AIReF

However, beyond the *ex ante* calibration of the impact of the measures, which is merely a theoretical exercise, an *ex-post* evaluation will be necessary to be able to measure their impact. AIReF considers that, irrespective of the degree of feasibility of each of the measures, any *ex ante* simulation needs to be considered with an *ex-post* evaluation using micro-data to analyse whether the goals are being achieved.

4. PATH OF GROWTH IN EXPENDITURE NET OF REVENUE MEASURES

The net expenditure path is the reference variable for monitoring compliance with the commitments acquired in the new European framework of rules. The net expenditure path establishes the maximum expenditure growth that can be recorded during the adjustment period, such that *ex ante*, this growth guarantees a reduction in the public debt ratio in the ten years following the adjustment period and compliance with the safeguards of the new framework of rules.

Analysis of the path for growth in expenditure net of revenue measures shows that it is necessary to adopt additional measures to those included in AIReF's scenario at unchanged policies to ensure compliance. The MTP contains a commitment to growth in primary expenditure net of GG revenue measures of an annual average of 3%. The MTP contains a commitment to growth in primary expenditure net of GG revenue measures of an average of 3% per annum between 2025 and 2031, equivalent to cumulative growth of 23.3% up to 2031. Although the structural adjustment is homogeneous over the time horizon, the path for net expenditure growth has a clearly downward profile, such that higher GDP growth is accompanied by higher expenditure growth, which makes the fiscal effort less countercyclical.

At unchanged policies AIReF estimates average annual growth in net expenditure of 3.6% between 2025 and 2031 compared with 3% in the MTP. In cumulative terms, AIReF forecasts growth between 2023 and 2031 of 28.5% in net expenditure compared with 23.3%. There are also differences in the time profile. At the starting point of the plan – 2025 – the MTP includes similar growth to that of AIReF's scenario at unchanged policies. In contrast, for the rest of the period, AIReF's scenario shows higher growth rates, with the difference being greater at the end of the period.

In 2025, no additional adjustment would be necessary to comply with the MTP reference rate, whereas an adjustment of around 0.2 points of GDP per annum would be needed until 2028. In 2025, the growth rates in AIReF's scenario at unchanged policies and that of the MTP are the same – 3.7% –, which means that, according to AIReF's estimates, no additional adjustment will be necessary. This is mainly because AIReF's scenario at unchanged policies already includes a structural reduction in the deficit sufficient to comply with the MTP due to the withdrawal of measures introduced to combat the energy and food price crisis. Between 2026 and 2028, the measures already incorporated in AIReF's scenario at unchanged policies are not sufficient to comply with the MTP. In the period after the plan, 2029-2031, the largest differences in annual rates between the MTP scenario and AIReF's scenario at unchanged policies are recorded, between 0.8 and 0.9 points of growth, which would translate into 0.3 and 0.4 points of GDP adjustment. Once again, it is important to stress that this adjustment can take place both on the expenditure side and in the form of measures to increase revenue.

TABLE 3. GROWTH IN PRIMARY EXPENDITURE NET OF REVENUE MEASURES BY 2024. MTP VS AIREF (% GDP)

Growth rate of eligible expenditure	2024	2025	2026	2027	2028	2029	2030	2031
Government MTP								
Annual	*5,3*	*3,7*	*3,5*	*3,2*	*3,0*	*3,0*	*2,5*	*2,4*
Cumulative		*3,7*	*7,3*	*10,8*	*14,1*	*17,5*	*20,4*	*23,3*
AIReF at unchanged policies								
Annual	*4,1*	*3,7*	*4,0*	*3,7*	*3,4*	*3,8*	*3,4*	*3,3*
Cumulative		*3,7*	*7,9*	*11,9*	*15,7*	*20,1*	*24,3*	*28,5*

Source: MTP and AIReF

Furthermore, discretionary revenue measures reduce the growth rate of net expenditure in all years, by between 0.3 and 1.1 points, except in 2026. The calculation of the growth in primary expenditure net of revenue measures in AIReF's scenario is based on the medium-term fiscal and macroeconomic forecasts set out in this report. For 2030 and 2031, they are supplemented with AIReF's long-term forecasts following the methodology of the Opinion on the Long-term Sustainability of the GG. In addition to the evolution of primary expenditure and discretionary revenue measures, it is important to know the expenditure forecasts that are excluded from their calculation. By component, the profile of EU-related expenditure, both in terms of EU and national co-financing, is conditioned by the execution of the RTRP and the growing execution of the 2021-2027 Operational Programmes of the Structural Funds. In addition, expenditure on cyclical unemployment after the reduction in 2024 and 2025, practically stabilises. Finally, one-offs and non-recurring expenditure peak in 2024 to stabilise in the medium term.

TABLE 4. ESTIMATED PRIMARY EXPENDITURE NET OF REVENUE MEASURES FOR 2024-2031 (€BN)

Growth rate of eligible expenditure	2023	2024	2025	2026	2027	2028	2029	2030	2031
GG expenditure	681,0	717,5	749,2	780,3	806,7	835,8	868,6	901,9	938,4
Interest	35,7	39,5	41,6	44,5	48,0	52,7	56,4	61,3	66,9
EU funds	24,2	23,5	22,9	25,8	20,4	17,3	15,1	13,6	14,0
Cyclical unemployment	1,1	0,6	0,2	0,0	0,0	-0,1	-0,2	-0,1	0,0
One-off expenditure	1,3	3,5	3,0	2,5	2,5	2,5	2,5	2,5	2,5
Net primary expenditure	**618,7**	**650,3**	**681,5**	**707,5**	**735,7**	**763,4**	**794,9**	**824,6**	**854,9**
Discretionary revenue measures		6,5	7,4	-1,6	2,3	2,8	2,8	2,8	2,8
Primary expenditure net of revenue measures		643,8	674,2	709,1	733,5	760,7	792,1	821,8	852,1
% change in primary expenditure net of revenue measures		**4,1**	**3,7**	**4,0**	**3,7**	**3,4**	**3,8**	**3,4**	**3,3**

Source: AIReF

Discretionary revenue measures are mainly implemented by the CG, especially in the first few years, although the annual contribution from the SSFs for the measures linked to the pension reform also stands out. In the years 2024 and 2025, the withdrawal of measures introduced to combat the energy and price crisis stands out, although there is also a contribution from the Autonomous Regions. The negative figure for 2026 corresponds to the end of the temporary taxes on the energy and financial sectors. Between 2027 and 2028, the contribution of the measures stabilises at around 0.2 points of GDP, explained by the fiscal drag of Personal Income Tax[3] and the SSF measures associated with the reforms of the pension system. In aggregate terms, the

[3] If, in the end, European regulations do not consider the fiscal drag of Personal Income Tax as a discretionary revenue measure for the purposes of calculating the European expenditure rule, the average annual growth rate of primary expenditure net of revenue measures would rise from 3.7% to 3.9%, with a particular impact in 2024, when it would increase from 4.1% to 4.6%.

most relevant measures in the period as a whole are the fiscal drag of Personal Income Tax and those associated with the pension reforms.

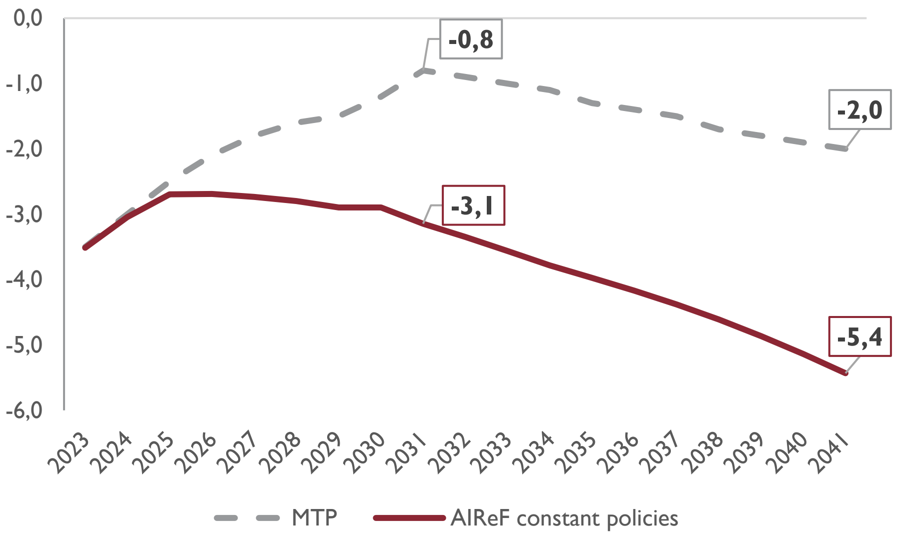
TABLE 5. BREAKDOWN OF REVENUE MEASURES FOR 2024-2029 (€BN)

Discretionary revenue measures	2024	2025	2026	2027	2028	2029	2030	2031
CG	2,4	4,3	-4,0	-0,4	0,0	0,0	0,0	0,0
SSFs	0,7	1,1	0,8	0,9	0,9	1,0	1,0	1,0
ARs	0,0	0,2	0,0	0,0	0,0	0,0	0,0	0,0
Non-indexing of PIT	3,4	1,8	1,7	1,8	1,8	1,8	1,8	1,8
Total	**6,5**	**7,4**	**-1,6**	**2,3**	**2,8**	**2,8**	**2,8**	**2,8**

Source: AIReF

AIReF estimates a deficit of 3.1% of GDP in 2031 compared with the 0.8% included in the MTP at the end of the adjustment period. Beyond the differences in the evolution of net expenditure already explained, it is not possible to analyse the reasons behind the discrepancies between the two scenarios due to the lack of detail in the MTP. Subsequently, using AIReF's long-term forecasts, the deficit, in the absence of additional measures, would continue on an upward path to reach 5.4% of GDP in 2041, compared with 2% in the MTP. In both cases, the main factor behind the increase in the deficit is the impact of ageing on public accounts.

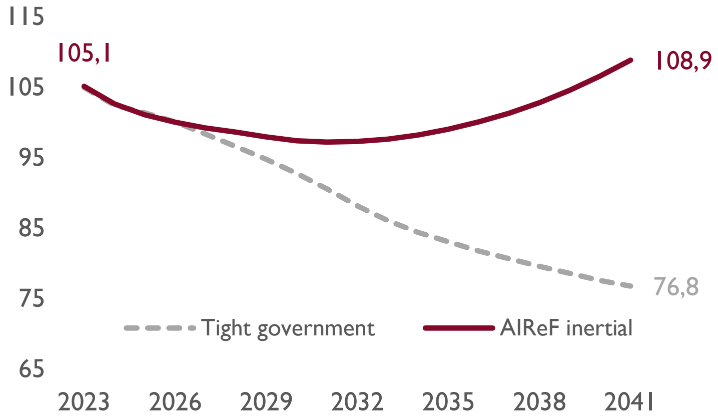
FIGURE 9. EVOLUTION OF THE PUBLIC BALANCE. AIREF VS MTP (% GDP)



Source: MTP and AIReF

In terms of debt sustainability, AIReF estimates in its projection at unchanged policies an upward trajectory after the initial stabilisation due to nominal growth, which would distance it from the MTP scenario. Specifically, AIReF estimates a reduction in the debt ratio of 6.5 points of GDP up to 2028 with respect to the 2023 level, bringing it down to 98.7% in 2028. Subsequently, AIReF's estimates at unchanged policies point to an increase in the debt ratio of 3.7 points of GDP by 2041 to 108.9%. The increase observed between 2024 and 2041 would be determined by the accumulation of deficits of 66 points (60 of which will be to service debt), which will not be sufficiently offset by the contribution of nominal GDP growth to reducing it (62.7 points).

FIGURE 10. EVOLUTION OF DEBT UNTIL 2041 (% GDP)



Source: Government and AIReF

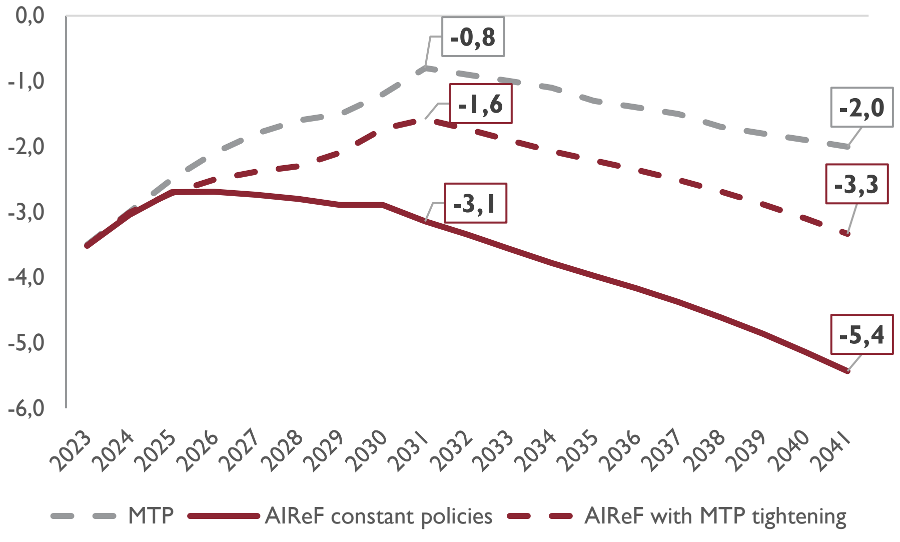
4.1. Scenario of compliance with the MTP path

Under AIReF's macroeconomic forecasts and public revenue forecasts, compliance with the MTP commitment to net expenditure growth would take the public deficit to 1.6% of GDP in 2031 compared with the 0.8% forecast in the MTP. AIReF's analysis of the MTP is based on a stylised simulation of AIReF's scenario at unchanged policies in which it assumes annual compliance with the growth rates of primary expenditure net of revenue measures in the MTP. This simulation takes as its starting point the level of revenue and expenditure forecast by AIReF in 2024. Accordingly, under AIReF's revenue forecasts, compliance with the expenditure path committed to in the MTP, although it would mean progress in terms of reducing the structural deficit, does not in itself guarantee the deficit and debt reduction included in the MTP.

With respect to AIReF's scenario at unchanged policies – a deficit of 3.1% of GDP in 2031 –, there would be a reduction in the deficit of 1.5 points of GDP corresponding to the cumulative reduction in expenditure in the consolidation period. The discrepancy between AIReF's adjustment scenario and that of the MTP – 0.8 points of GDP in 2031 – is due to differences in both revenue forecasts and discretionary revenue measures. Higher revenue forecasts imply a smaller deficit over the forecast horizon. Conversely, a higher forecast for discretionary revenue measures implies more room to increase expenditure without exceeding the limit established in the MTP, thus implying a higher deficit. Once again, the lack of detail of these variables in the MTP prevents the source of the discrepancies between AIReF's scenario and the MTP from being properly identified.

These differences widen until 2041, with an MTP deficit of 2% of GDP compared with 3.3% in AIReF's adjustment scenario. In this case, the differences are based on the methodologies used and the effect of expenditure on servicing debt associated with a higher level of debt. While AIReF carries out a complete exercise of the revenue and expenditure forecasts as included in the Opinion on the Sustainability of the GG, the MTP follows the methodology of the sustainability analysis, maintaining the structural primary balance constant and incorporating the cost of ageing calculated in the Commission's Ageing Report. In both AIReF scenarios, the evolution after 2031 is the same once the adjustments in net expenditure are finalised.

FIGURE 11. EVOLUTION OF THE PUBLIC BALANCE. AIREF VS ADJUSTED AIREF VS MTP (% GDP)

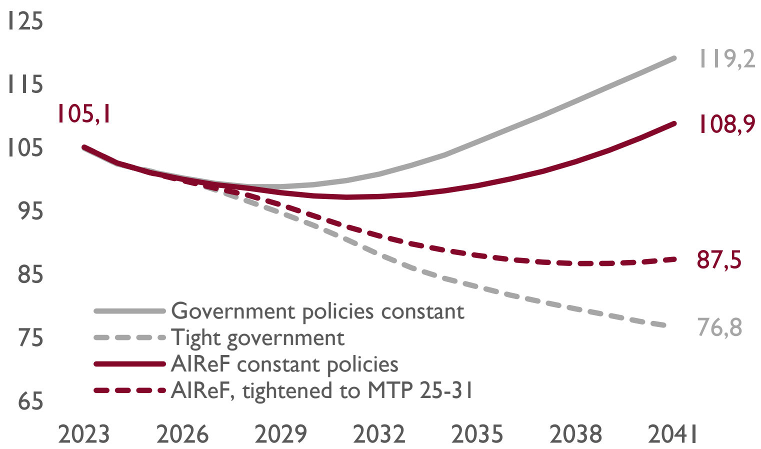


Source: MTP and AIReF

In terms of sustainability, the Government's adjustment scenario shows very favourable dynamics, bringing the debt ratio to 76.8% of GDP in 2041. The deficit and debt ratios are reduced by 4.6 and 42.4 percentage points respectively compared with the Government's no-policy-change scenario in 2041.

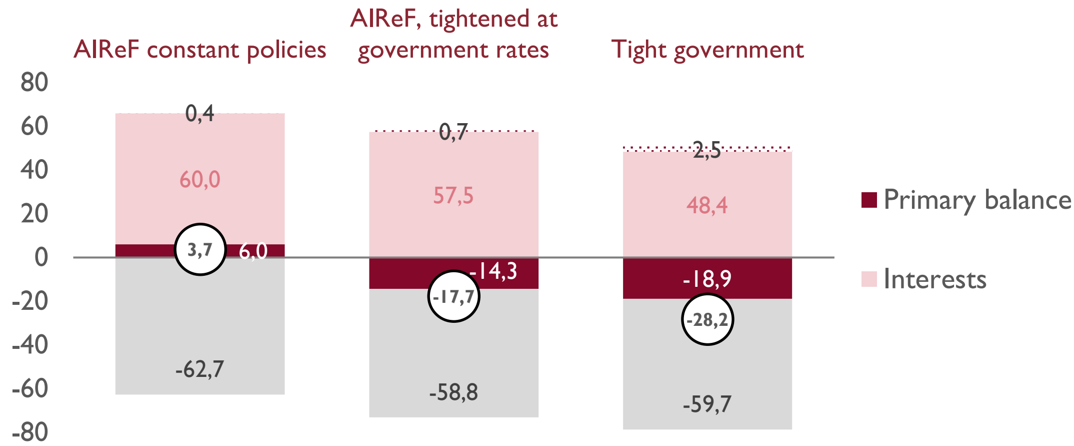
Conversely, AIReF's adjustment scenario projects a less demanding reduction in the debt ratio, reaching 87.5% of GDP in 2041. Applying the rates of evolution of net expenditure of the fiscal commitment in the period 2025-2028 together with the rest of the macro-fiscal variables projected by AIReF (tax revenue, growth, interest rates) means a reduction in the debt-to-GDP ratio of 21.4 points with respect to the scenario at unchanged policies at the end of the period, compared with 42.4 in the MTP scenario.

FIGURE 12. DEBT (% GDP)



Source: Government and AIReF

FIGURE 13. CUMULATIVE CONTRIBUTIONS OVER THE PERIOD 2024-2041 TO THE CHANGE IN THE DEBT-TO-GDP RATIO



Source: Government and AIReF

To reach the 0.8% of GDP balance of the MTP in 2031, the primary balance net of revenue measures would have to grow by an annual average of 2.8%. An alternative exercise is to estimate how much net expenditure could grow under AIReF's macroeconomic and fiscal scenario to reach the balance in 2031 included in the MTP, -0.8% of GDP. Respecting the time profile of the MTP and based on AIReF's 2024 year-end forecast, if expenditure net of revenue measures were to grow by an annual average of 2.8% between 2025 and 2031 instead of the 3% commitment, the deficit would stand in 2031 at the figure estimated by the MTP. This would also bring the debt trajectory closer to that projected in the MTP.

4.2. Alignment with the national fiscal framework

AIReF makes a preliminary estimate of the growth in primary expenditure net of revenue measures by sub-sector up to 2029. The CG has the lowest average increase in net expenditure between 2024 and 2029, at 3.1%, heavily influenced by the impact of revenue measures, which also explains the irregular profile. For their part, the SSFs, after the normalisation of inflation, show contained rates of growth in expenditure due to the effect of revenue measures, resulting in an annual average of 3.9%. The territorial administrations show average rates of 4% for the Autonomous Regions and 3.9% for the LGs. In both cases, the average is influenced by the high value in 2024.

TABLE 6. PRIMARY EXPENDITURE NET OF REVENUE MEASURES FOR 2024-2029. (% CHANGE)

	2024	2025	2026	2027	2028	2029
GG	**4,1**	**3,7**	**4,0**	**3,7**	**3,4**	**3,8**
CG	-2,8	2,9	6,2	4,4	3,6	4,2
SSFs	6,2	3,4	3,7	3,5	3,2	3,4
ARs	6,1	4,2	3,1	3,4	3,4	3,7
LGs	7,0	4,7	2,9	3,3	3,4	3,8

Source: AIReF

Compliance with the national expenditure rule between 2024 and 2027 would be sufficient to meet the path contained in the MTP. The national expenditure rule is applied individually to each GG sub-sector with the exception of the SSFs. It also has different reference rates from the MTP and a different methodology for calculating net expenditure. Currently, the reference rate of the national expenditure rule is below that of the MTP between 2024 and 2026 and above it in 2027, 3.4% for the national expenditure rule compared with 3.2% for the MTP. Under AIReF's revenue forecast, it is assumed that the CG, the ARs and the LGs comply with the national expenditure rule in each year of the period, while the rate of the SSFs is maintained at unchanged policies. This means that each year the GG Sector would comply with the annual growth rate of the MTP in 2024, 2025 and 2027. In 2026, the annual growth rate of net expenditure would not be complied with, but would still be lower in cumulative terms since 2023. In deficit terms, compliance with the national expenditure rule would imply reaching a deficit of 1.6% of GDP in 2029 compared with the 1.5% projected in the MTP.

TABLE 7. CALCULATION OF PRIMARY EXPENDITURE NET OF REVENUE MEASURES FOR 2024-2029 UNDER THE ASSUMPTION OF COMPLIANCE WITH THE NATIONAL EXPENDITURE RULE (% CHANGE)

	2024	2025	2026	2027	2028	2029
GG	**2,2**	**2,6**	**3,9**	**3,2**	**3,5**	**3,9**
CG	-2,6	0,4	5,6	3,1	3,8	4,4
SSFs	6,2	3,4	3,7	3,5	3,2	3,4
ARs	1,9	2,8	2,9	2,9	3,6	3,9
LGs	1,5	4,2	3,2	3,3	3,6	4,0

Source: AIReF

Compliance with the path of stability targets proposed by the Government would also be sufficient to meet the path set out in the MTP. This exercise would be similar to the one described in the previous section, given that the MTP deficit path is the same as that set out in the Government's proposal. Accordingly, in this scenario, expenditure would grow by an average of 3.4% per annum between 2024 and 2027, compared with the 3.9% in the MTP over the same period.

4.3. Starting point: 2024

The Medium-Term Fiscal-Structural Plan (MTP) considers a deficit in 2024 of 3%, in line with AIReF's estimates, although there are significant differences between the components of the two estimates. The MTP considers a level of both expenditure and revenue that is 0.4 points higher than AIReF's estimate. Consideration of the starting point is fundamental when it comes to evaluating the impact of the MTP. The MTP includes forecasts for net expenditure growth and deficits from 2024 to 2031, although the plan is in place from 2025 to 2028. AIReF has based its analysis on its own year-end forecast to the extent that it considers this to be the most realistic approximation bearing in mind that most of the year has already elapsed. However, as AIReF has pointed out in successive reports, 2024 is a crucial year for sustainability and the materialisation of different scenarios in this year will have medium- and long-term consequences, as shown below.

TABLE 8. REVENUE, EXPENDITURE AND BALANCE. MTP VS. AIREF (% GDP)

	2024		Difference AIReF-MTP
	MTP Government	AIReF Current	
REVENUE	41,8	41,4	-0,4
EXPENDITURE	44,8	44,4	-0,4
NET LENDING/BORROWING	**-3,0**	**-3,0**	**0,0**

Source: MTP and AIReF

The MTP considers revenue in 2024 to be 0.4 points higher than AIReF, estimating a higher weight of all the main components, with the exception of taxes on capital. The MTP estimates the weight of tax collection to be 0.2 points higher than AIReF, considering that both taxes on production and taxes on income will account for 0.1 points more than in AIReF's estimate, while the estimate for taxes on capital is somewhat lower. It also estimates an additional 0.1 points more weight for social contributions and almost 0.2 points for other revenue.

TABLE 9. MAIN REVENUE HEADINGS. MTP VS AIREF (% GDP)

	2024		Difference AIReF-MTP
	MTP Government	AIReF Current	
REVENUE	**41,8**	**41,4**	**-0,4**
TAXES	24,1	23,9	-0,2
On production	*11,2*	*11,1*	*-0,1*
On income	*12,5*	*12,4*	*-0,1*
Capital	*0,3*	*0,4*	*0,1*
CONTRIBUTIONS:	13,4	13,3	-0,1
Other revenue	4,3	4,1	-0,2

Source: MTP and AIReF

The MTP estimates expenditure in 2024 that is 0.4 points higher than AIReF's forecast, with the differences concentrated in compensation of employees, social benefits in cash and gross capital formation. When comparing the estimates of the main components of public consumption, the MTP estimates higher compensation of employees than AIReF by 0.1 points, while they are aligned for the rest of the components. The MTP also estimates a higher weight of social benefits in cash (0.2 points) and gross capital formation (0.1 points). Conversely, the MTP estimates a lower weight for subsidies and other expenditure by 0.1 points.

TABLE 10. MAIN EXPENDITURE HEADINGS. MTP VS AIREF (% GDP)

	2024		Difference AIReF-MTP
	MTP Government	AIReF Current	
EXPENDITURE	**44,8**	**44,4**	**-0,4**
Compensation of employees	10,9	10,8	-0,1
Intermediate consumption	5,6	5,6	0,0
Social transfers in kind via market	2,7	2,7	0,0
Social benefits in cash	17,0	16,8	-0,2
Interest	2,5	2,5	0,0
Gross capital formation	2,7	2,6	-0,1
Subsidies and other expenditure	3,4	3,5	0,1
NET LENDING/BORROWING	**-3,0**	**-3,0**	**-0,1**

Source: MTP and AIReF

AIReF forecasts growth in expenditure net of revenue measures of 4.1% in 2024 compared with the 5.3% commitment in the MTP. Should the growth forecast in the MTP materialise, AIReF estimates that the deficit in 2024 would rise to 3.5% of GDP. This would mean a higher net expenditure level of €7.7bn in the MTP.

The discrepancies between the expenditure growth of the two scenarios are concentrated in the total expenditure of the GG, which accounts for 0.9 points of the 1.2 percentage points of the difference. The remaining 0.3 points can be explained by a different estimate in terms of the quantitative importance of the revenue measures, one-off or non-recurring expenditure and the estimate of expenditure on cyclical unemployment. Although the revenue measures and the exceptions to eligible expenditure may be very significant, in this case the differences are concentrated in the forecasts of total expenditure. Specifically, 0.4 points of GDP are fully passed on to the deficit estimate.

TABLE 11. CALCULATION OF PRIMARY EXPENDITURE NET OF REVENUE MEASURES FOR 2024. MTP VS. AIREF (% GDP)

Growth rate of eligible expenditure	2023 AIReF	2023 Government	2024 AIReF	2024 MTP
GG expenditure*	45,4	45,4	45,2	45,6
Interest	2,4	2,4	2,5	2,5
EU funds*	1,6	1,6	1,5	1,5
Cyclical unemployment	0,1	0,2	0,0	0,1
One-off expenditure	0,1	0,1	0,2	0,2
Net primary expenditure	**41,3**	**41,3**	**41,0**	**41,3**
Discretionary revenue measures			0,4	0,3
Primary expenditure net of revenue measures	41,3	41,3	40,6	41,0
% change in primary expenditure net of revenue measures			**4,1**	**5,3**

* In GG Expenditure and EU Funds of the MTP for 2024 the amount estimated by AIReF for the RTRP has been included to standardise all the columns.

Source: MTP and AIReF

The treatment of year-end 2024 for the purposes of compliance with the MTP is crucial for its effectiveness in improving the sustainability of public finances. If 2024 is included to measure the cumulative growth in net expenditure, the forecast of 5.3% in 2024, in a scenario in which AIReF's forecast is met, would provide a margin against possible deviations in subsequent years. However, insofar as the implementing regulations are not yet known, there is uncertainty as to the extent to which the commitment is linked to the year that serves as the basis for the MTP, 2024 in this case, and how it affects the operation of the control account. In the event that it does consolidate the 2024 difference, the net expenditure in AIReF's scenario would not exceed that of the MTP until 2028. Even if the net expenditure growth rates from 2025 to 2027 were higher in AIReF's scenario, in cumulative terms they only reach the same level in 2027. Moreover, in those years the deviations are lower than the amount of the annual control account, 0.3% of GDP. As from 2028, both the annual and cumulative rates would be higher in AIReF’s scenario than in the MTP.

If the growth in net expenditure of the MTP in 2024 is consolidated, the deficit in 2031 under AIReF's revenue forecasts would be 2% of GDP compared with the 0.8% forecast in the MTP. In this case, in addition to the existing differences in the revenue forecasts and discretionary revenue measures, there are also differences in the level of expenditure due to the 2024 year-end figures, which means an additional worsening of 0.4 points of GDP in 2031.

The level of net primary expenditure finally recorded in 2024 will have a significant impact on the evolution of the fiscal path and the debt ratio in subsequent years. Given that the relevant variable in the new governance framework is established in terms of changes in expenditure, the initial level over which it will accumulate has a significant effect on the evolution of the balance and public debt. For 2024, the MTP submitted by the Government assumes growth in nationally-financed net primary expenditure of 5.3%, exceeding the estimate made by AIReF (4.1%) and by the EC in the calculation of the reference trajectory (3.8%), as well as that set in the CSR (2.6%) for 2024. Given AIReF's revenue forecast, the rate of 5.3% would likely raise the deficit above the target commitment of 3% in 2024.

TABLE 12. NATIONALLY-FINANCED NET PRIMARY EXPENDITURE. CUMULATIVE PERCENTAGES USING DIFFERENT STARTING POINTS IN 2024.

		2024	2025	2026	2027	2028	2029	2030	2031
Government fiscal commitment	*(growth rate)*	5,3	3,7	3,5	3,2	3,0	3,0	2,5	2,4
	(cumulative rate of change)	5,3	9,2	13,0	16,6	20,1	23,7	26,8	29,9
Rate estimated by AIReF for 2024	*(cumulative rate of change)*	4,1	4,1	4,1	4,1	4,1	4,1	4,1	4,1
Rate estimated by EC* for 2024	*(cumulative rate of change)*	3,8	3,8	3,8	3,8	3,8	3,8	3,8	3,8
Rate included in the CSR for 2024	*(cumulative rate of change)*	2,6	2,6	2,6	2,6	2,6	2,6	2,6	2,6

(*) Rate estimated by European Commission for 2024 in calculation of reference trajectory

Source: Government and AIReF

FIGURE 14. DEBT (% GDP)

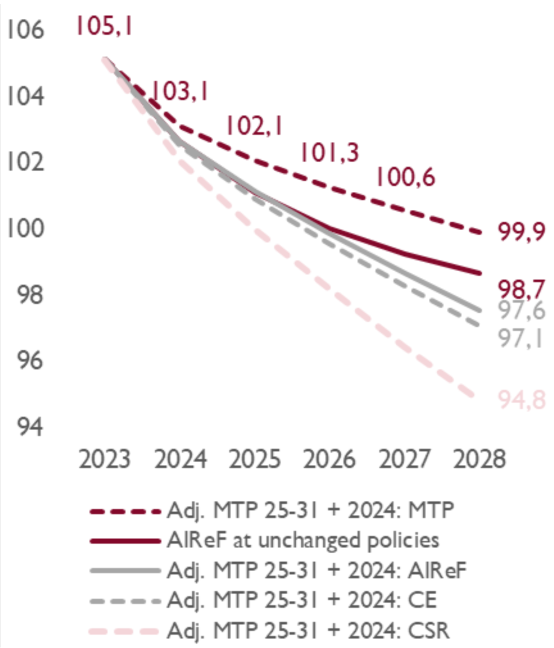
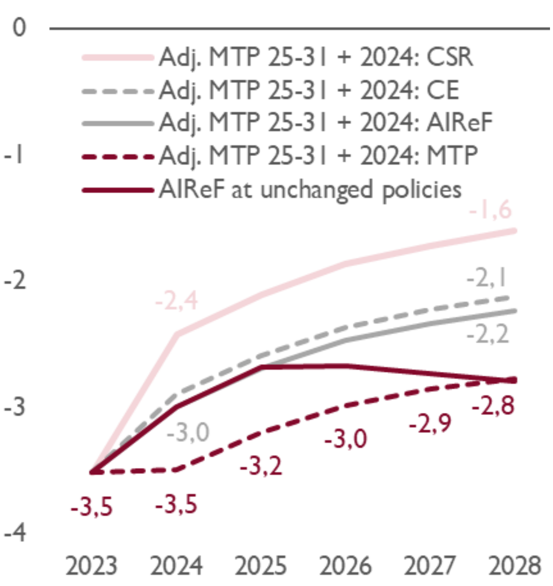


FIGURE 15. PUBLIC BALANCE (% GDP)



Source: Government and AIReF

Starting from a different level of expenditure in 2024 may lead to the deficit and public debt standing at different levels in 2028, considering the same rates of growth in MTP expenditure in subsequent years. Taking into account the evolution of revenue estimated by AIReF, the deficit compatible with the 5.3% change in expenditure in 2024 would stand at 2.8% in 2028, while with AIReF's forecast (change in expenditure of 4.1% in 2024), it would stand at 2.2%, 0.6 points higher than that projected by the Government in its adjustment scenario in 2028 (1.6%). As for the debt ratio, it is projected to be close to 100% in the first case and 97.6% in the second, with the Government's estimate in its adjustment scenario standing at 96.6%.

5. RECOMMENDATIONS

5.1. New recommendations

Adaptation of the national expenditure rule to the European expenditure rule.

With the entry into force of the reform of the European fiscal framework, the expenditure rule has become more relevant and has become the key indicator for fiscal surveillance at a European level. This rule is regulated in Regulation (EU) 2024/1263 of 29 April 2024, which specifies the elements involved in its calculation.

At a national level, the Organic Law on Financial Stability and Sustainability, approved on April 27th, 2012, includes an expenditure rule as one of the fiscal rules for internal application. Article 12 regulates the requirements for its calculation.

According to their respective regulations, the way the expenditure rule is calculated at a European level is different from the national one. Unlike the national rule, the European rule excludes the national expenditure of projects co-financed by European funds and one-off and other temporary measures from eligible expenditure. It also corrects the eligible expenditure for increases and decreases in revenue measures not only of a permanent, but also of a temporary nature.

Furthermore, the calculation of the reference rate that marks the permitted annual change in eligible expenditure is not based on nominal GDP in the medium term, as occurs in the national expenditure rule, but depends on the debt sustainability analysis of each country and is fixed in the Medium-term Fiscal-Structural Plan for a period of four years. Accordingly, the reference rates of the national and European expenditure rules do not necessarily have to coincide.

In addition, the subjective scope of application is also different, since it covers the GG Sector in the case of the European expenditure rule, while it excludes the Social Security Funds from its application in the case of the national rule. Consequently, compliance with the national expenditure rule does not automatically guarantee compliance with the European expenditure rule even if the reference rates coincide.

Lastly, the European expenditure rule has a multiannual approach insofar as annual deviations from the expenditure rule are recorded in a control account that must not exceed 0.3% of GDP per annum and 0.6% cumulatively. Conversely, compliance with the national expenditure rule is measured on an annual basis and any excess over the reference rate triggers corrective measures.

In this context, AIReF considers that there are no reasons to justify these differences and therefore the Ministry of Finance should bring the criteria for applying the two expenditure rules closer together until such time as it amends Article 12 Organic Law on Budgetary Stability and Financial Sustainability so that both rules are calculated in the same way.

Consequently, AIReF **makes the following recommendation to the Ministry of Finance:**

1. ***Promote the amendment of Article 12 of the Organic Law on Budgetary Stability and Financial Sustainability so that the definition of eligible expenditure of the national expenditure rule matches that of the European expenditure rule.***

Until the above amendment is implemented, AIReF **recommends** that the **IGAE (General State Comptroller)**:

2. ***Bring the criteria for the practical application of the national expenditure rule as close as possible to the criteria of the European expenditure rule, respecting the limits established by the Organic Law on Budgetary Stability and Financial Sustainability. To this end, the IGAE should draw up a new unified guide to the expenditure rule for all GG sub-sectors, which should contain the specificities of the different sub-***

sectors. This guide would replace the current calculation guides applicable to the ARs and LGs.

Ensure that the transposition of the National Fiscal Frameworks Directive allows for the development of a genuine national medium-term budgetary framework.

Recognising that sustainable public finances require suitable national institutions, in addition to the new Preventive Arm Regulation of the Stability and Growth Pact, the European fiscal governance framework adopted this year also amends the National Fiscal Frameworks Directive. In particular, the vision towards the medium and long term that embodies this European reform cannot be achieved exclusively through the medium-term fiscal-structural plans envisaged in the Regulation. These plans are the central element of European fiscal co-ordination by formalising multiannual commitments to the EU institutions, but there is no guarantee that they can replace the necessary national medium-term planning, whether in terms of their purpose, their content or the way they are prepared. The experience of this first round of fiscal-structural, including the Spanish plan, is evidence of this.

The National Fiscal Frameworks Directive adopted in 2011 already required countries to have a national medium-term budgetary framework with a broader scope than the fiscal-structural plans. The amendments introduced under the new reform establish, in addition: (i) that multiannual targets be consistent with the preventive arm of the Pact, (ii) that national fiscal rules promote the adoption of medium-term fiscal planning consistent with the preventive arm and (iii) that annual budgets be consistent with national medium-term targets.

Consequently, the European Directive, which must be transposed by December 2025, offers the opportunity to design a true medium-term budgetary framework adapted to the national reality in order to comply with European commitments. Transposition also offers the opportunity to help eliminate the discrepancies between the national and European frameworks in terms of the expenditure rule mentioned above.

Consequently, AIReF **makes the following recommendation to the Ministry of Finance:**

1. ***Harness the transposition of the National Fiscal Frameworks Directive to design a credible and effective medium-term budgetary framework by ensuring the coherence, consistency and effectiveness of the national fiscal framework.***

6. SUPPLEMENTARY ANALYSIS ON MEDIUM-TERM FISCAL PLANNING

6.1. Best practices in drawing up a medium-term fiscal plan

In this section, AIReF describes the elements that a medium-term fiscal plan should include in order to constitute a fiscal strategy, in accordance with international best practices and guidelines.

In principle, the preparation of medium-term fiscal plans enhances the credibility and consistency of public finances to the extent that they contain medium-term fiscal projections and targets consistent with macroeconomic projections and thus with short-term economic developments and medium-term trends. Moreover, medium-term planning enhances the consistency of fiscal policy by presenting government targets and commitments, together with the economic and fiscal policy measures needed to achieve them.

The ability of a medium-term fiscal plan to improve the sustainability of public finances depends, to a large extent, on the institutional framework in which it is prepared, its design and content, and the degree of effective implementation of the MTP.

The Fiscal Transparency Manual[4] of the International Monetary Fund (IMF) defines a set of best practices on the presentation of fiscal targets, policies and projections. In addition, the IMF has recently published a practical document[5] which defines some of the main elements in the design of a medium-term fiscal plan, based on international experiences. Based on these references, it is possible to identify the following elements that would be key to the preparation of a coherent and robust medium-term fiscal plan:

1. The medium-term fiscal plan should be embedded in the legal-institutional framework of budgetary programming. Thus, the medium-term fiscal plan should be an instrument to ensure compliance with fiscal rules by introducing a medium-term forecast consistent with the limits set by the fiscal rules. The fiscal plan should be the first milestone in the preparation of the Budget. In this way, the plan would define an aggregate, multiannual expenditure forecast by economic classification consistent with the fiscal rules, which, at least in the first year, would act as an expenditure ceiling for the Budget. In turn, the fiscal plan will be more effective if it is integrated with other multiannual planning instruments that specify the aggregate multiannual expenditure paths of the fiscal plan with a greater degree of detail (organic or policy).

   In addition, the preparation of a fiscal plan requires a sound legal framework that defines the institutions involved in the preparation and their jurisdiction, the information exchange processes, the basic content of the plan and the responsibility for approval. The responsibility for approval is particularly important because the plan, given its multiannual nature, must have a high degree of national ownership. In this regard, even if the plan is drafted by the Government, the presentation or approval by Parliament and the consultation of relevant stakeholders reinforce the ownership of the plan and thus its credibility.

   Lastly, the involvement of Independent Fiscal Institutions (IFIs) in the process of drawing up the fiscal plan is crucial, as they provide an independent analysis of its feasibility and potential degree of compliance. The *ex ante* evaluation of fiscal projections and targets by an IFI should help moderate the optimistic bias in the Government's fiscal policy. *Ex-post* evaluations of any deviations from projections make them more transparent, making it easier to see how important compliance is for the sustainability of public accounts.

[4] International Monetary Fund (2018). *Fiscal Transparency Handbook*

[5] Teresa R. Curristine, Isabell Adenauer, Virginia Alonso-Albarran, John Grinyer, Koon Hui Tee, Claude P. Wendling & Delphine Moretti (2024). *How to Develop and Implement a Medium-Term Fiscal Framework.* IMF How To Notes

2. The fiscal plan should define or refer to the Government's economic policy strategy, understood as the set of broad targets it intends to achieve in terms of the performance of the economy (such as growth, expenditure, etc.), and the instruments to achieve them. The fiscal strategy should be consistent with that strategy and contribute to the achievement of its goals.
3. A key element of the fiscal plan is the presentation of a comprehensive macroeconomic scenario underpinning the fiscal projections that form part of the fiscal strategy, analysing the determinants of the main aggregates and the key relationships between them, as well as an explanation of past deviations in the projections. It is also necessary to contextualise the economic situation in which the fiscal plan is drawn up, analysing recent economic developments, both domestically and internationally, and their influence on the medium-term outlook. These projections should be based on a set of external assumptions about exogenous variables (such as commodity prices and global interest rates), preferably made by external agencies, e.g. international organisations or independent fiscal institutions. Macroeconomic projections should have a horizon consistent with that of fiscal projections and include those variables relevant to the fiscal strategy. Thus, it is essential to project nominal GDP, distinguishing between the real component and the deflator. Similarly, it is advisable to include projections of other variables such as potential GDP, the demand-side components of GDP (which, in many cases, will constitute a proxy variable for the tax base of the various taxes), the relevant price indices and employment and wage indicators. The preparation of projections should use information that is as up-to-date as possible and be performed using projection models appropriate to the technical capabilities (financial programming, semi-structural models, etc.). Ideally, the fiscal plan itself would present a reference or summary of macroeconomic projection methodologies.

   Lastly, the projection of macroeconomic variables should be consistent with the fiscal scenario. This typically involves presenting a macroeconomic projection at unchanged policies (without fiscal policy measures) and a macroeconomic scenario with measures, which considers the macroeconomic impact of fiscal policy and the relationship between fiscal policy and the real sector.
4. The core of the fiscal plan is the medium-term fiscal scenario (3-5 years). The fiscal scenario usually constitutes the second section of a medium-term fiscal plan and comprises the presentation of the public finance position, the fiscal strategy, including fiscal policy targets and measures to achieve them, and details of fiscal projections:
   a. First, to contextualise the medium-term fiscal scenario, it is necessary to describe the starting point by analysing recent

fiscal policy developments, explaining at least the evolution of revenue, expenditure, public debt and recently adopted policy measures, with details of their impact where possible.

b. Fiscal policy guidelines and strategy should then be established, consistent with the fiscal rules. The fiscal strategy has to clearly define the Government's fiscal targets and measures, explaining their design, scope and how the implementation of these measures will achieve the targets.

   Fiscal policy targets should be presented clearly and precisely, establishing numerical targets for fiscal aggregates (e.g. expenditure growth, evolution of the primary balance or debt level) for specific time periods. These targets, together with fiscal policy measures, need to be consistent with existing fiscal rules, explaining how they contribute to their attainment.

c. The fiscal strategy is reflected in the projections of public revenue and expenditure, presenting a fiscal scenario at unchanged policies and one with policy measures, with details of their estimated impact. The projections should be broken down by sector (GG Sector and relevant sub-sectors) and by expenditure items (typically by economic and, where appropriate, functional classification) in line with the implementation of the fiscal strategy.

These fiscal projections also need to be consistent with macroeconomic projections. Thus, revenue will be projected on the basis of aggregate macroeconomic variables that can act as a proxy for tax bases, taking into account the value of tax elasticities. On the expenditure side, which usually has a larger discretionary component than revenue, projections will also take into account the effect of macroeconomic variables, as well as the effect of existing multiannual expenditure commitments, in particular for investment projects. At any event, it is necessary to quantify the impact of fiscal measures, distinguishing whether they are of a permanent or temporary nature. The plan itself should contain a reference to the methodology for projecting fiscal variables.

The presentation of the fiscal projections should be accompanied by an economic interpretation of the projections, identifying the main trends and drivers, as well as the relationship with the macroeconomic scenario.

Lastly, within the fiscal scenario chapter, a reconciliation of projections should be carried out, analysing the magnitude of the deviations between the actual values of fiscal variables with respect to the projected values. It is essential to specify the causes and explanatory factors of these deviations in the fiscal projections, breaking them down into policy effects, macroeconomic factors and other factors that may represent errors in the fiscal projection methodology used.

5. Given the importance of the evolution of public debt for the sustainability of public finances, a medium-term fiscal plan, the third section of a fiscal-structural plan, seeks to project and analyse debt dynamics:

   a. The projection of public debt, based on the debt dynamics equation, must be consistent with the macroeconomic projections and assumptions and with the fiscal scenario. Typically, the application of a Debt Sustainability Analysis (DSA) methodology makes it possible to analyse the determinants of debt evolution (real GDP, real interest rate and primary balance). This analysis, in turn, makes it possible to identify the extent to which debt evolution responds to the behaviour of the primary balance and, therefore, to the Government's fiscal strategy.

   b. The projection of the evolution of public debt should be complemented by a sensitivity and scenario analysis and the formulation of stochastic projections. The analysis of debt sensitivity and scenarios to changes in macroeconomic variables is a fundamental tool for studying the feasibility of the debt projection and the potential extent of deviations in more adverse situations than those of the central scenario. Similarly, the preparation of stochastic debt projections, using fan charts, facilitates the evaluation of projection uncertainty and potential biases.

   c. The debt projection should be complemented by a study of the effect on public finances of long-term factors such as demographics and pensions, long-term growth trends and productivity and the impact of climate change. Thus, the fiscal-structural plan could present an evaluation of the sensitivity of fiscal variables, and in particular debt, to changes in these long-term factors.

6. Lastly, a medium-term fiscal plan should include an analysis of fiscal risks. Fiscal risks are factors, such as the occurrence of macroeconomic shocks or the materialisation of contingent liabilities of various kinds, which cause fiscal variables to deviate from their projected values. Some fiscal risks may be large in magnitude and their materialisation may jeopardise the success of the fiscal strategy and the sustainability of public finances. Accordingly, the last section of a structural plan usually aims to evaluate the impact of fiscal risks on medium-term fiscal projections.

   The macroeconomic risk analysis should evaluate the effect of shocks relevant to the economy under analysis. On the one hand, the sensitivity of fiscal variables to changes in exogenous variables should be evaluated. Similarly, it would be necessary to prepare full macroeconomic scenarios under shocks such as commodity prices or interest rates, analysing changes in fiscal projections under these alternative scenarios. The preparation of stochastic projections for fiscal variables also helps in the evaluation of macroeconomic risks. In addition, it is advisable to include in the medium-term fiscal plan an analysis of the most relevant specific risks, such as the occurrence of implicit or explicit contingent liabilities for the public sector arising from public corporations, sub-national governments, public-private partnerships, public guarantees, the financial sector, court rulings against the State and natural disasters.

6.2. Fiscal-structural plans in the EU's new fiscal governance framework

The new EU fiscal governance framework introduces National Medium-Term Fiscal-Structural Plans (MTPs) as a central element of the preventive arm of the Stability and Growth Pact (SGP), as regulated in Regulation (EU) 2024/1263. Accordingly, EU Member States must submit an MTP, with a time horizon coinciding with the duration of national legislatures (4 or 5 years). This plan must establish a fiscal forecast that includes the stability commitments of the Member States, as well as the reforms and investments to be adopted. Overall, the fiscal commitments and the reforms and investments should aim to ensure a sustained and gradual reduction of public debt and sustainable and inclusive growth, avoiding a pro-cyclical fiscal policy.

The Commission will evaluate the MTPs, considering whether the fiscal commitments undertaken allow public debt to be brought on a downward path, or below the 60% of GDP threshold set in the SGP, and maintain a deficit below the 3% of GDP limit set in the SGP.

Article 13 of Regulation (EU) 2024/1263 establishes the requirements in terms of content to be met by Member States' MTPs. In turn, the Commission's Communication C/2024/3975 of June 2024 sets out guidance to Member States on the preparation and content of MTPs. Thus, the main elements of the MTPs are as follows:

1. The fiscal commitment undertaken by the Member State, which is established in terms of growth in nationally-financed net primary expenditure. This variable is defined as public expenditure net of spending on servicing debt, discretionary revenue measures, expenditure on EU programmes fully matched by revenue from EU funds, national expenditure on co-financing of EU-funded programmes, cyclical

elements of expenditure on unemployment benefits and one-off and other temporary measures.

The MTP should consider the economic and fiscal strategy (revenue or expenditure measures, investments, structural reforms, etc.) that is intended to be implemented to ensure compliance with the commitments of the net primary expenditure path. The fiscal adjustment implicit in the net primary expenditure path should be realised within the 4-5 year horizon of the MTP, but can be extended up to three years, if the extension is justified by the implementation of structural reforms and investments.

2. The macroeconomic assumptions, which should be prudent and include mandatory four- or five-year (T+4 or T+5) projections for: potential GDP growth, interest rate assumptions, real and nominal GDP growth and the GDP deflator. The central macroeconomic scenario should be plausible and consistent with the fiscal and economic strategy outlined in the plan and, in particular, with the fiscal adjustment associated with the net primary expenditure commitment. Optionally, it is possible to include projections up to T+4 for the composition of demand-side GDP growth, the composition of potential GDP, the labour market or deflators and prices in the macroeconomic scenario.

3. The budgetary forecasts, which should describe the fiscal and economic strategy, analysing the overall composition of the fiscal adjustment and the general revenue and expenditure policies that will be implemented to achieve the fiscal adjustment.

   These forecasts should focus on key budgetary parameters, such as the headline deficit, net primary deficit, and public debt, with projections up to T+4, ensuring that these are consistent with the macroeconomic assumptions presented. In addition, it should provide a breakdown of nationally-financed public investment and interest expenditure up to T+4.

   Budgetary forecasts by economic classification are only required for the year in which the plan is submitted (T). Similarly, the MTP is only required to present the budgetary impact of fiscal measures in T-1 and T, including revenue measures (one-off and other) and one-off expenditure measures. For other expenditure measures, the inclusion of the impact is optional. Similarly, it is optional to present the revenue and expenditure measures proposed to be implemented during the remainder of the duration of the MTP, in line with the economic and fiscal strategy.

4. Detailed projections of debt, the public deficit and underlying macroeconomic assumptions, with a time horizon extending up to ten years after the end of the adjustment period (e.g. up to T+14 for four-year plans and up to T+17 in case of an extension).

For Member States for which the Commission develops a reference trajectory for net primary expenditure (i.e. those that breach the SGP debt or public deficit limits), it is mandatory to include a sensitivity analysis in the MTP that demonstrates plausibly that debt will be maintained on a downward path or at a prudent level under various conditions. These debt projections should be performed taking into account the fiscal commitment path, but, if Member States present a more favourable reference trajectory or assumptions than those of the Commission, debt projections should also be drawn up considering a primary expenditure path at unchanged policies.

5. Information on reforms and investments. The MTPs should provide details of the reforms and investments to be implemented in response to the challenges identified in the European Semester, the country-specific recommendations (CSRs) and EU priorities (green and digital transitions, social and economic resilience, energy security and, potentially, defence capabilities).

   Furthermore, if an extension of the fiscal adjustment period by up to three years is requested, the reforms and investments to be implemented that justify such an extension must be explained. In this case, a series of data requirements are established that the MTPs must include: the evaluation of the impact of these measures on potential growth and fiscal sustainability; the relationship with EU priorities, the CSRs and the Recovery Plans; as well as information on the main target of each measure, the main steps to achieve that target, the associated deadlines and, where appropriate, indicators or other elements that can support an evaluation of the implementation.

   Lastly, in the case of reforms and investments already implemented, their effects, especially on future fiscal sustainability and potential growth, should be analysed on the basis of sound, data-driven economic evidence.

6. Implicit and contingent liabilities, which comprise items that could potentially have a significant impact on public finances. These could include public guarantees, non-performing loans and liabilities arising from the operation of public corporations. Contingent liabilities related to natural disasters or climate events should also be included to the extent possible.

7. National parliaments and Independent Fiscal Institutions are consulted in the preparation of the MTP.

6.3. Content of the EU's national Medium-term Fiscal-Structural Plans

Most EU Member States have already submitted their national medium-term fiscal-structural plans to the European Commission, which has published them on its website.

The central element of the MTPs is the fiscal commitment in terms of the nationally-financed net primary expenditure path, which reflects the fiscal adjustment that countries must make in order to meet the targets of the Stability Pact and ensure the sustainability of public finances. This adjustment is to be carried out over a period of four or five years (depending on the length of national legislatures) and can be extended by up to three years, if the extension is justified by the implementation of structural reforms and investments. Of the 19 national MTPs already submitted, only four countries have applied for an extension to the adjustment period: Spain, Italy, France and Finland.

A first comparative analysis of the information available in the MTPs submitted by some of the Member States (Spain, Italy, Portugal, Greece, the Netherlands and France) makes it possible to identify some common elements on the practical implementation of the new EU governance framework in relation to international best practices.

Firstly, in terms of national ownership, beyond the drawing up of the MTP by the government, national parliaments have also been involved in the process, either with a presentation or with a debate in the House before it is submitted to the Commission (Italy, Portugal, Greece and the Netherlands). The Independent Fiscal Institutions have also been involved to some extent, endorsing or reporting on the MTP or elements of it (such as macroeconomic or fiscal projections). This involvement, except in the case of Spain and the Netherlands, has been voluntary and, in most of these six countries, the information provided by the government to the IFIs referred to macroeconomic projections.

As regards the content of the MTP, all six documents make a general reference to the economic policy strategy that is defined, mainly with reference to the Recovery Plans. Only France gives over a full section to this issue.

As regards the macroeconomic scenario:

1. In all cases a table of exogenous assumptions (oil prices, interest rates, exchange rates and measures of economic activity of trading partners or

the rest of the world) is used as a starting point, although France and Spain do not go as far as T+4.

2. In general, the macroeconomic projections comprise a scenario at unchanged policies and a scenario with measures for real, nominal and potential GDP and the GDP deflator. These two scenarios are presented in the debt sustainability analysis tables, as established in the Commission Communication (MTP Tables 7a and 7c). Only Italy goes beyond the requirements of the Commission Communication and includes a full macroeconomic outlook at both unchanged policies and with measures up to 2029.
3. The main macroeconomic outlook of the document also projects the above-mentioned variables up to T+4, in line with the mandatory nature established in the Commission Communication. As for the optional projection variables (demand components, prices and deflators and labour market variables), Italy, Portugal and the Netherlands project them to the full MTP horizon (up to T+4 or T+5), although this is not required by the Communication.
4. The MTPs analysed do not contain an evaluation of deviations from previous macroeconomic projections. In this regard, it should be borne in mind that the MTPs are a new element for which there is no history of projections.

In terms of fiscal policy strategy:

1. All countries define general qualitative targets largely geared towards the sustainability of public finances.
2. The six countries set quantitative targets in terms of the nationally-financed net primary expenditure path, in line with the new European fiscal rules. In the case of Italy and Spain, which request an extension of the adjustment period, the forecast is presented until 2031. France, which also extends the adjustment period, does so until 2029 and the rest of the countries are limited to T+4 or T+5.
3. In terms of the fiscal policy measures to achieve this forecast, most countries adhere to the requirements of the Communication and the impact quantification horizon is limited, with only the Netherlands showing the impact up to T+4 while the rest of the countries limit themselves to T or T+1. The description of fiscal measures in relation to the fiscal targets is usually general, partly because they are not only included as content of the fiscal scenario, but also in the section on "Reforms and Investments", especially in the case of countries requesting an extension of the adjustment period. The breakdown of the fiscal impact of the measures is

heterogeneous. Most countries focus on discretionary revenue measures by tax category, although Portugal, Greece and the Netherlands offer a higher level of disaggregation by tax category and France by affected sector (households/businesses).

As regards fiscal projections:

1. The six countries analysed include a fiscal scenario at unchanged policies and with measures for fiscal variables such as the total public balance, the structural primary balance and spending on servicing debt. These scenarios are as required by the Commission Communication (MTP Tables 7a and 7c). However, Italy chooses to present a full fiscal scenario at unchanged policies by economic classification.
2. The horizon of the revenue and expenditure projections by economic classification does not always reach the MTP horizon. Thus, while Italy, the Netherlands and Portugal extend them to T+4 and France to T+1, Spain and Greece adhere to the requirements of the Commission's Communication and only project to T.
3. A reconciliation of past fiscal projections, analysing the magnitude and causes of deviations or projection errors, is not included by any of the countries.

In the area of public finance sustainability analysis:

1. The six countries analysed present debt projections, according to the Debt Sustainability Analysis (DSA) methodology, breaking down the projection into growth, interest, inflation (except the Netherlands), primary balance and stock-flow adjustment.
2. Uncertainty about debt projections is illustrated by all the countries studied, except the Netherlands, with the sensitivity analysis of the projections to changes in the growth-interest rate differential, in the primary balance and to financial stress, as established in the Communication. In some cases, such as Italy, Portugal and the Netherlands, the analysis is extended with stochastic projections using fan charts. Italy also presents debt scenarios based on macroeconomic scenarios prepared with the QUEST model.
3. Long-term trends, such as the cost associated with ageing, are not explicitly analysed. Only Spain includes the cost of ageing, in terms of impact on the public balance, while Italy analyses the effect of ageing on potential GDP, in line with the European methodology of the Ageing Group.

In the area of fiscal risks:

1. The MTPs of the countries analysed do not evaluate macroeconomic risks beyond a debt sensitivity analysis and, where appropriate, stochastic debt projections.
2. The analysis of specific fiscal risks is limited to presenting the quantification of contingent liabilities related to guarantees and public corporations, as required by the Communication. Some countries also provide information on public-private partnership risks and legal actions against the State.

Lastly, as regards the evaluation of the impact of structural reforms and investments, all the countries studied include a section on this issue, as established in the Communication. In the case of Spain, France and Italy, where reforms and investments are necessary to justify the extension of the adjustment period, the following is included:

1. France presents a brief description of the economic impact of each of the reforms on employment, growth and public expenditure. This evaluation is based on previous evaluations by the French Treasury, other institutions and academia.
2. Italy includes an appendix describing the evaluation of the impact of reforms and investments. As regards the impact on GDP of the expenditure linked to the Recovery Plan, the QUEST model is used for the evaluation of the macroeconomic effect and the MACGEM - ITA model for the sectoral impact. As regards structural reforms, their impact is evaluated through simulations with the QUEST model, which are calibrated on the basis of the Recovery Plan indicators and the empirical evidence available.
3. Spain includes a section and an appendix evaluating reforms and investments and quantifying their impact on GDP and the deficit (see Section 3.2).

The preliminary analysis of the MTPs of some EU countries leads to the conclusion that, in general, they comply with the requirements established by the Commission Communication. However, some countries go further and elaborate on the relevant information, e.g. by providing greater disaggregation of fiscal measures, or by extending the projection horizon for all macroeconomic and fiscal variables and for the impact of fiscal policy measures. Some Member States have also chosen to strengthen the DSA by including fan charts or full scenarios. In terms of international best practices (see Box 1), in general, aspects relevant for fiscal sustainability such as explicit consideration of the cost of ageing or other long-term factors, analysis of forecast errors or the evaluation of fiscal risks are not considered and discussed in detail. In addition, greater specificity between the fiscal targets in terms of the net primary expenditure forecast, the fiscal measures applied and the fiscal and policy strategy could be desirable.

The President of AIReF

Cristina Herrero Sánchez