

AIR^eF CONSIDERS THAT EXPENDITURE COMMITMENTS IN THE FISCAL PLAN DO NOT GUARANTEE REACHING GOVERNMENT'S DEFICIT AND DEBT TARGETS

- The Independent Authority for Fiscal Responsibility publishes two reports in a budgetary context determined by the particularities of the European and national institutional framework
- In the Report on the Fiscal and Structural Plan, AIR^eF points out that the reform of the framework sought to overcome the limitations of the previous model, but the start-up has revealed weaknesses in design and implementation at a European and national level
- It states that the Spanish plan complies with the Commission's guidelines, but it is more a political commitment to aggregate fiscal targets than a real medium-term fiscal strategy
- Due to the lack of information available, AIR^eF presents a scenario at constant policies that shows that measures will be necessary from 2026 onwards to meet the deficit and debt targets set out in the Fiscal Plan
- In its scenario, AIR^eF estimates an average growth in net expenditure between 2025 and 2031 of 3.6% compared with the Government's 3%, with differences in the time profile
- AIR^eF performs two exercises to evaluate the plan and estimates that meeting the net expenditure growth rate commitments would take the public deficit to 1.6% of GDP in 2031, compared with the 0.8% forecast
- In the second exercise, AIR^eF calculates that, in order to achieve the deficit forecast of 0.8%, primary deficit expenditure net of measures would need to grow at 2.8%, compared with the 3% estimated
- Under AIR^eF's revenue forecasts, compliance with the expenditure path commitment would represent progress in terms of sustainability, but it does not in itself guarantee a reduction in the deficit and debt
- AIR^eF highlights the importance of taking into account the application of the national fiscal framework and the starting point that 2024 will represent, which will have a significant impact on the evolution of the fiscal path and on the debt ratio in the coming years
- AIR^eF issues recommendations to bring the national expenditure rule closer to the European rule and to take advantage of the transposition of the Directive on national fiscal frameworks to design a credible and effective medium-term budgetary framework by guaranteeing the coherence, consistency and effectiveness of the national fiscal framework.
- In the Report on the Main Lines, AIR^eF updates its medium-term macroeconomic and fiscal scenario up to 2029 for the General Government (GG) sector and for each of the sub-sectors and each Autonomous Region (AR) at constant policies, reports on the main lines of the draft budgets of the ARs and LGs and assesses the national expenditure rule for 2025.

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The Independent Authority for Fiscal Responsibility (AIReF) published the Report on the Main Lines of the Draft Budget of the General Government (GG) for 2025 and the Report on the Medium-Term Fiscal and Structural Plan (PFEMP) 2025-2028 on its website today, the first to be published following the entry into force of the new fiscal rules on April 30th. AIReF is under a legal mandate to report on this plan, which replaces the Stability Programme Update in the new governance framework and becomes the Government's main medium-term fiscal document. In its analysis, AIReF concludes that the PFEMP does not offer sufficient detail to be considered a useful medium-term budgetary planning tool and will not be sufficient to meet the European requirements of the new fiscal rules to reduce public debt on a sustained basis.

With the publication of these two reports, AIReF is adapting to the particularities of the current budgetary context marked by the entry into force of the new fiscal rules in Europe and a heterogeneous situation at a national level, with the publication of the first Medium-Term Fiscal and Structural Plan 2025-2028 and the approval of the budgets of the Autonomous Regions (ARs) and Local Governments (LGs), but without budgetary stability targets, the General State Budget for 2025 and the Budgetary Plan. In fact, AIReF will issue a new report when the draft budget for 2025 is presented and will update the evaluation of the main lines of the GG sector.

In the Report on the Fiscal and Structural Plan, AIReF explains that the reform of the European fiscal governance framework sought to overcome the limitations of the previous model in terms of the lack of national ownership, and the complexity and procyclical nature of fiscal policy. The new rules give countries the initiative to shape their own fiscal policy strategy, promoting debate in Parliament and dialogue with the main stakeholders, simplifying and making supervision more transparent by pivoting the framework on a single observable variable (expenditure net of revenue measures), and aiming to reconcile sustainability and growth.

Against this backdrop, the Fiscal and Structural Plans were shaped as the central element for achieving these goals, such that their preparation, content and ambition were key to the success of the reform. However, the start-up of this new framework has revealed weaknesses in its design and implementation at both a European and national level.

Specifically, AIReF points out that the Spanish plan, although it may be in line with the European Commission's June guidelines, does not provide sufficient detail to be considered a useful medium-term budgetary planning tool. As the report notes, it does not contain any information on the budgetary scenario beyond 2024 either for the GG sector or by sub-sector. Nor does it include a detailed macroeconomic outlook beyond 2026. Although it contains a regulatory commitment on the evolution of primary expenditure net of revenue measures, it does not explicitly state the way in which that commitment is expected 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. Accordingly, AIReF considers this to be a clear step backwards compared with the information in the Stability Programme Update - the document it replaces.

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Due to the lack of information, AIReF's analysis is based on stylised simulations of a scenario at constant policies and scenarios in which it is assumed that the PFEMP commitment will be met, while maintaining the rest of AIReF's forecasts unchanged. In addition to the lack of information, the plans have some methodological peculiarities. For example, the long-term macroeconomic scenarios are based on certain technical assumptions and methodologies that were not designed for this purpose and reveal some inconsistencies, such as the upward profiles of potential growth in the long term that are inconsistent with demographic ageing.

Lack of debate and consensus

Furthermore, AIReF highlights the lack of involvement of the ARs and LGs in the preparation of the plan, the absence of the presentation or discussion of the Spanish plan in Parliament and the lack of AIReF's involvement in the preparation process, something that has happened in other countries. According to AIReF, these elements were key to promoting genuine national ownership, one of the elements that conceptually underpins the new framework of rules.

In addition, AIReF states that a significant degree of institutional uncertainty regarding implementation remains at both the European and national levels. For example, certain issues exist that are currently being negotiated and which will be turned into the code of conduct for the development of 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 control account.

At a national level, the uncertainty stems from the need to apply the new European fiscal framework to the reality of the GG in Spain. European legislation explicitly states the need to transpose the EU directive, 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 PFEMP, although the plan itself does not contain any details on the application of its commitments in each sub-sector. Moreover, no proposals for the reform of the national fiscal framework have been made public yet, and the lack of approval of the stability targets is hampering 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, AIReF stresses that, as has also been pointed out in previous reports, there is still a risk that GG authorities will draw up budgets that do not comply with the European and national fiscal framework. 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 in a large number of the GG authorities.

In this context, 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 guarantees 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.

The Medium-Term Fiscal and Structural Plan

The PFEMP is based on a short-term macroeconomic scenario that the Government is drawing up for the period 2024-2026, which was endorsed by AIReF on September 28th and which is more favourable from 2025 onwards than AIReF's estimate for the short term. The biggest discrepancies can be seen in the forecast of the deflators. Specifically, the macroeconomic scenario of the PFEMP 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 it projects growth of 2.3% and 2% respectively, such that over the period as a whole, the discrepancies are practically non-existent. In contrast, 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 whole period a cumulative discrepancy of almost 1 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 PFEMP are not very different on average from those projected by AIReF, although there is higher growth in deflators and a lower cost of servicing debt. Furthermore, the upward profile of 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 GG deficit to be reduced to 2.7% in 2025 and then increase in the absence of additional measures as from 2028 to, reach 2.9% of GDP in 2029. The sustainability analysis indicates that up to 2029 debt maintains a downward path due to nominal growth, although its fall would slow to 98% of GDP in 2029. These macroeconomic and fiscal forecasts have been prepared under the assumption of constant policies. Thus, they do not incorporate the adjustment path commitment contained in the PFEMP due to a lack of detail on its implementation.

The PFEMP is committed to growth in primary expenditure net of revenue measures of an annual average of 3% between 2025 and 2031 and 0.3 points higher on average than the reference trajectory presented by the European Commission in June. The time profile decreases over time and is also different to that of the Commission. AIReF estimates that it will be necessary to adopt additional measures to those contained in its scenario at constant policies to ensure compliance, as it forecasts an average annual net expenditure of 3.6%, also with differences in the time profile.

With the exception of 2025, AIReF's scenario at constant policies shows higher rates of growth in net expenditure than the PFEMP, 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 PFEMP forecast. However, between 2026 and 2028 - the end of the period of the plan - additional measures would be needed, either on the expenditure or revenue side, by around 0.2 points of GDP per annum. Between 2029 and 2031, the additional measures needed to achieve the PFEMP forecast would be between 0.3 and 0.4 points of GDP.

AIReF exercises

Alternatively, AIReF considers a scenario in which the evolution of net expenditure follows the forecast set out in the PFEMP until 2031, starting from the closure forecast by AIReF in 2024. As from 2031, AIReF applies its long-term revenue and expenditure forecasts until the deficit and debt path is completed up to 2041. AIReF estimates that the public deficit would be 1.6% of GDP in 2031, a higher figure than that contained in the PFEMP (0.8% of GDP), due to the differences in both revenue forecasts and discretionary revenue measures. The lack of detail on these variables in the PFEMP prevents the proper identification of the source of the discrepancies.

The differences widen to 2041, with a deficit in the PFEMP 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 General Government, the PFEMP follows the methodology of the Commission's sustainability analysis.

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 PFEMP, at 0.8% of GDP. Respecting the time profile of the PFEMP and starting from the closure forecast by AIReF, 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 estimated figure 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 PFEMP, which in turn is double the 2.6% growth recommended to Spain by the European Council. If the growth forecast in the PFEMP materialises, AIReF estimates that the deficit in 2024 would rise to 3.5% of GDP. In this case, the deficit that would be reached in 2031 with the PFEMP 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, in contrast, 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. The result finally attained is thus 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 fiscal balance forecast are also reflected in the evolution of debt. The debt reduction estimates considered by the Government in the PFEMP 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.

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AIReF, for its part, in the scenario at constant policies, places debt at 108.9% in 2041. However, in the adjustment scenario, it would not be reduced as much as the Government envisages, but would fall by 21.4 points with respect to the scenario at constant 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 PFEMP, although it would represent progress in terms of sustainability, does not in itself guarantee the deficit and debt reduction contained in the PFEMP.

Report on the Main Lines of the GG for 2025

In the Report on the Main Lines, AIReF updates the medium-term macroeconomic and fiscal scenario up to 2029 for the GG sector and the ARs at constant policies in view of the lack of information, provides information on the main lines and draft budgets of the ARs and LGs and evaluates the national expenditure rule (3.2% by 2025).

In its macroeconomic scenario, AIReF revises expected growth for 2024 upwards to 2.9%. At constant policies and as seen in the Report on the Fiscal and Structural Plan, AIReF expects growth to slow to 2.3% in 2025 and 2% in 2026. It would then gradually fall to 1.5% in 2029. Regarding prices, AIReF projects the GDP deflator to slow faster than the Government, which is in line with the evolution of recent inflation. Thus, after rising by 2.9% in 2024 and 2.3% in 2025, its rate of increase stabilises at an annual rate of 2.1%, slightly above that of the CPI.

At a budgetary level, AIReF estimates that the deficit of the GG sector will stabilise at 2.7% of GDP between 2025 and 2027, after closing 2024 with a deficit of around 3%. Thereafter, the deficit will start an upward path to end at 2.9% in 2029. After the withdrawal of the measures to alleviate the price and energy crisis in 2025, the margin for deficit reduction without additional measures is exhausted.

By sub-sector, the Central Government will reduce its deficit in 2025 to 2% after the increase in 2024 due to the settlement of the territorial financing systems and will start an upward path to 2.5% of GDP in 2029, weighed down by the increase in the interest burden and the rise in military investment. The deficit of the Social Security funds will stabilise at 0.2% of GDP over the entire projection horizon, the deficit of the ARs will rise again in 2025 to -0.5% due to the normalisation of the flows of the financing system and then improve slightly to stabilise in 2028 and 2029 at -0.3% of GDP, and the deficit of the LGs will stabilise in the medium term with an estimated surplus of 0.1%, after reaching zero in 2025 and 2026.

Fiscal policy stance and debt sustainability

As contained in the Report on the Fiscal Plan, current estimates suggest that primary expenditure net of revenue measures would grow by 4.1% in 2024, 1.5 percentage points above the rate allowed by the Country Specific Recommendation (CSR) made by the European Council for Spain in July 2023. The PFEMP forecasts higher growth of 5.3%, which, if confirmed, would not allow the commitment to the deficit target of 3% of GDP to be reached in 2024, which could result in the European Commission initiating an excessive deficit procedure.

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In its medium-term inertial projection, AIReF estimates a reduction in the debt ratio of 7.2 points of GDP with respect to the 2023 level, falling to 98% in 2029. The reduction in the ratio will be underpinned by nominal GDP growth (25.4 points), with the deflator making a very significant contribution (13.6 points). The public deficit contributes to the increase in debt by 16.8 points, of which 15.9 points are interest. These projections imply a slowdown in the pace of reduction of the debt ratio, which is expected to be exhausted by the end of the decade. The moderation in the contribution of nominal growth, which will gradually fall over the period 2024-2029 (from 5.9% to 3.5%), with interest rates evolving upwards (from 2.4% to 2.9%) and the primary balance stabilising at around 0%, will result in a slowdown in the pace of reduction of the debt ratio, which is expected to be exhausted by the end of the decade.