STABILITY PROGRAMME UPDATE

KINGDOM OF SPAIN

2014 - 2017

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1. EXECUTIVE SUMMARY

The Stability Programme is a key document for the design of the fiscal policy in the short, medium and long term, and for the coordination of economic policies in the European Union. At the same time, this document is considered a medium-term national fiscal plan referred to in Article 4 of Regulation (EU) No. 473/2013.

This Stability Programme Update responds in content and form to the provisions in the Stability and Growth Pact Code of Conduct.

Its structure has eight sections. After this summary, and an introductory section, we will describe the 2014-2017 macroeconomic scenario for the Spanish economy, which is the basis for the development of medium-term budget projections.

The paths of the public deficit and public debt, as well as the measures necessary to achieve the levels of public deficit at all levels in Public Administrations are described in section four.

Section five includes a comparison with the previous Stability Programme Update, explaining the reasons for the differences. In this section we analyse the variation of the deficit path against changes in interest rates and in the assumptions for growth in the Eurozone.

Sections six and seven study the sustainability of public finances in the long term and includes a quality analysis of public finances, respectively. It concludes with a section on the institutional framework of fiscal policy.

The 2014-2017 macroeconomic scenario maintains the conservative nature of the previous Stability Programme. The assumptions used are conservative and foresees a moderate economic growth, in line with that estimated by national and international public organisations and private analysts.

It is estimated that for this year, and the following three, a balanced economic growth, sustained over time and conducive to employment creation will be reached. The sustainability of growth is achieved by the significant progresses made in correcting the major imbalances in the Spanish economy. The competitiveness lost since the euro came into force has been recovered, prices have moderated significantly, private debt has decreased considerably, public deficit has shrunk during the past two years, despite the recession experienced, a surplus in the current account and a foreign net lending to the Rest of the World has been reached, allowing to initiate the process of reducing the external debt.

A remarkable aspect of the macroeconomic picture is that throughout the projection period, both domestic and external demand will contribute positively to growth. Domestic demand will do this for the first time in 2014, after six years negatively contributing to growth. The improvement in consumer confidence, the better employment prospects and price moderation, will encourage private consumption, which will gain momentum throughout the entire period. At the same time, the gross capital formation will also grow in 2014 for the first time in seven years, due to strong investment in equipment goods. Positive growth rate in construction investment is estimated as of 2015. External demand will continue to contribute positively to GDP variation, in a context of imports growth. This is explained by the maintenance of exports dynamism associated to the continuity of gains in competitiveness, and by the better growth prospects of the main destination markets for exports.

At the same time, the lending capacity of the Spanish economy will continue to increase, to levels standing at approximately 2.5% of GDP, which will allow a reduction of external debt, a decrease that by the biennium 2014/2015 could be close to € 47bn, thanks to the foreign net lending to the Rest of the World forecasted for those years.

In addition to a sustained recovery in time, it is a job-creating recovery. The structural improvements achieved with the Labour Reform of 2012 will enable job creation with growth rates below the ones achieved in the last year. As early as 2014 net employment will be created, for the first time since the beginning of the crisis. For the biennium 2014/2015 a significant reduction of the activity growth threshold is estimated and this will result in job creation, as well as a net creation of approximately 600,000 jobs between late 2013 and late 2015. Similarly, significant progresses will be achieved in reducing unemployment. For the first time since the beginning of the crisis, unemployment according to the Labour Force Survey will decrease in annual average terms in 2014. At the end of 2015 unemployment will be lower than that recorded at the end of 2011, both with regards to the number of unemployed and to the rate, decreasing the number of unemployed by nearly 800,000 people from late 2013 to late 2015.

For this and the following years, the commitment to fiscal consolidation is maintained, decreasing the level of public deficit. The public deficit targets set are based on conservative growth forecasts, which give greater credibility to fiscal policy. The targets for each year of the Programme are fully in line with the Recommendations of the European Council addressed to Spain in June 2013.

For the purpose of further balancing the fiscal effort necessary to achieve the medium-term deficit target, the deficit goal is reduced in 2014 down to 5.5% of GDP, compared to the 5.8% required. The conservative nature of the economic forecasts and the firm commitment of the Government to allocate the effects of the stronger growth to deficit reduction, make compliance feasible. The targets of 4.2% and 2.8% of GDP are maintained for 2015 and 2016. The path of deficit reduction continues in the additional year of projection, to set it at 1.1% of GDP.

The progress in fiscal consolidation achieved in the last two years, as well as those forecasted for the following ones, will allow reaching a primary surplus of 0.9% of GDP in 2016, which will increase to 2.7% of GDP in 2017. At the same time, progresses in deficit moderation will allow to slow the growth of public debt and reverse the trend as of 2016, having peaked in 2015.

Achieving these deficit targets requires following the structural efforts; back in 2013 a primary structural surplus was achieved (1.4% of GDP) for the first time since 2007. Further progress in fiscal consolidation initiatives is needed. Specifically, during the four years analysed, a decrease in the primary structural deficit of approximately 2.4 points is estimated.

As a result of these progresses, in 2017 the structural target for the medium-term of structural balance established in the Organic Law on Financial Stability will be reached, even before the deadline given for the year 2020.

Regarding the sustainability of public finances in the long run, the improvements achieved with the reforms of 2012 and 2013 stand out, allowing a reduction in pension expenditure for the end of the forecast period, in 2060, of approximately four tenths of GDP, despite the estimated population ageing.

2. INTRODUCTION

In the third quarter of 2013, the Spanish economy began a path of economic recovery, ending a deep and prolonged recession. To the extent that over the past two years important structural reforms have been carried out and the major macroeconomic imbalances have been improved, this nascent economic recovery rests on a solid foundation, therefore it is considered to be a sustainable and lasting recovery in time.

The external imbalance, which synthesised all the domestic imbalances, clearly improved in 2013, registering lending capacity to for the first time since 1997, standing specifically at 1.5% of GDP. With this result, the financing need of the Spanish economy has improved by approximately 11 percentage points of GDP since 2007. This is a key element to reduce the borrowing position compared to the Rest of the World, as measured by the net international investment position. At the same time, the positive nominal growth will also favour the progressive reduction of external debt. These changes significantly reduce external vulnerabilities, while the accrued external liabilities stock continues to be excessive and the change will require more time.

This new lender status compared to the Rest of the World that the Spanish economy has acquired would not have been possible without substantial changes in private sector balances. On the one hand, -households and non-profit institutions, non-financial corporations and financial institutions-, have now moved from showing a joint financing need of 11.6% of GDP in 2007 to a lending capacity of 8.6% in 2013, enabling at the same time a remarkable cut in their borrowing positions. On the other hand, the financing needs of the public sector had also reached excessive levels after the beginning of the crisis, exceeding the 11% of GDP recorded in 2009. Nevertheless, with the fiscal consolidation efforts started two years ago and the forecasted correction path of this imbalance, the public sector is also helping to improve the financial situation of the economy. In 2013 the public sector already showed primary structural surplus of 1.4% of GDP for the first time since 2007, summarising the consolidation effort carried out. This surplus will continue to grow up to 3.8% of GDP at the end of the Programme period.

The continuity of this process will allow that the greatest private investment, which accompanies the improved economic outlook and the rising consumption and the resulting lending capacity decrease of the private sector, will be offset by lower financing needs of the public sector, maintaining lending capacity for the whole economy. According to recent empirical works of the EC, a permanent improvement of the cyclically adjusted fiscal balance of the policy referred to in this Stability Programme, could generate a lasting increase in the current account surplus balance of approximately 0.7 percentage points.

With regards to the consolidating path of public administrations, in July 2013 the ECOFIN Council adopted a new Excessive Deficit Recommendation for Spain, which prescribed a deficit of 6.5% of GDP by 2013, with the gradual correction in subsequent years until achieving a public deficit below the 3% of GDP limit (2.8%) in 2016. In the Spanish National Budget for 2014 and in the Budget Plan sent to Brussels in October 2013 pursuant to the Two-Pack Regulations, the fiscal path committed to by the Spanish Government in this profile was adopted, assuming intermediate deficit commitments standing at 5.8% of GDP in 2014 and at 4.2% in 2015.

Taking into account the significant deficit reduction forecast for 2015 (1.6 percentage points of GDP in nominal terms) and to strengthen the credibility of the process, the Spanish Government has decided to enter in this 2014-2017 Stability Programme Update a more ambitious fiscal target for 2014, of 5.5% of GDP. Thus, the structural fiscal effort to be developed between 2014 and 2015 is more balanced and highlights the willingness of the Spanish authorities to allocate the growth dividends to the reduction of the public deficit, in accordance with the commitment announced in the previous 2013 - 2016 Stability Programme Update.

Taking into account the still significant effort to be carried out in the public accounts, the Government designed a multiannual strategy to frame the various measures to be adopted and to provide them with greater consistency. The primary target of the strategy is to increase efficiency in the revenues and expenses of the public administrations, in order to convert the public budget into a tool for economic growth, generating more favourable conditions for the private sector, production and employment. From the revenues point of view, the recent report from the Expert Committee on the Reform of the Tax System puts forward many recommendations in this regard, from which the Government presents a set of measures in this Programme, aimed at rebalancing the direct and indirect fiscal pressure. We must highlight that the rebalancing process started in 2012, with an increase of Value Added Tax (VAT) rates and a gradual increase in environmental taxation and excise taxes. Additionally, a reduction in contributions for new permanent contracts (100-euro flat fee) was approved in February 2014, representing significant savings for businesses and a boost to their labour demand.

Thus, distortions are eliminated in the basic decision making by economic agents, such as supply and demand for labour, savings or risk taking, while the weight of essentially neutral tools is reinforced from the point of view of resource allocation. Therefore the highest growth induced by this efficiency gain will be the one leading to revenue collections increases in the medium term, thus ruling out tax burden increases that oppose economic growth and job creation.

From the expenditure point of view, a thorough reform of the public administrations affecting all levels and subsectors has been carried out and continues in progress. The reform began in 2012 for personnel matters, trying to affect structural aspects such as replacement or temporary disability, and has continued expanding to include aspects of modernisation of the public administrations that affect efficiency improvements, such as the implementation of new technologies to reduce administrative burdens. In addition, and based on the conclusions of the report from the Commission for the Reform of Public Administrations (known in Spanish as CORA), presented in 2013, the goal is to promote the rationalisation of the public administrations structure, maintaining the flow of services and basic benefits to the private sector, but reducing unnecessary operating costs. This reform gradually extends to the territory as a dynamic process. It is complemented by the Local Reform adopted in December 2013 and by the reforms carried out in the Regional Governments affecting expenditure on health, pharmacy, education, personnel and reorganisation of public enterprises. In 2014, it is expected that the Council for Fiscal and Financial Policy agrees structural spending reform measures for the Regional Governments, continuing the process begun in 2012.

Therefore, it is a reform on the supply point of view, impinging on the private sector, increasing efficiency and reducing costs for the development of the economic activity, acting on direct benefits of the public sector and financing costs of the private sector. Ultimately, the impact of this strategy of fiscal consolidation keeps the limiting effects on short-term growth very small and makes those in the medium-term expansive.

Besides these changes in the balance between national and sectorial savings and investments, the macroeconomic and fiscal framework of this Programme shows other relevant structural changes. On one hand, it reflects the continuity of the adjustment process for the Spanish economy relative prices. Specifically, prices of non-tradable goods and services vs. tradable ones are adjusted, and this adjustment is achieved thanks to the different measures to make domestic competition more dynamic, such as the launch of the Market Unity process, the Law of Deindexation, the CNMC (Markets and Competition National Commission) constitution or the reform of Colleges and Professional Services, among others. In addition, the expected continuity in wage moderation also contributes, and will facilitate the growth moderation of prices for non-tradable services during the recovery phase of growth, also facilitating the reallocation of productive factors towards tradable sectors.

Equally, the moderation in prices of domestic production versus that of imports stands out, making the former more attractive than the latter. Both movements are fundamental, since the current account balance continues to further improve in a context in which the negative cyclical contraction gap will begin to move in the opposite direction. But in addition, the expected decline in real interest rates, linked to the contraction of the risk premium, also implies a change in the relative prices of present and future assets; therefore becoming a stimulus to consumption and investment which will be much more noticeable as the economy financing conditions normalise.

Finally, the undertaken dynamics of structural reforms itself is having some positive impacts on the Spanish economy on the supply side, which constitute a counterweight to various constraints from the demand side, such as the necessary deleveraging of the private sector and the necessary fiscal consolidation. Most of these changes will affect the allocation efficiency in production processes and growth of total factor productivity, estimated solid throughout the forecasting horizon.

A growth pattern with such profile has several advantages. The first one is that it allows real wages deflated with production prices to increase without damaging company profitability. The second one is that it increases the incentives to invest in productive capital. The third one, which is a summary of the previous two, is that it stimulates the growth of the various components of domestic demand based on an improvement of revenue flows, therefore promoting greater contribution to GDP growth without incurring financial imbalances. The fourth one is that it reconstructs the growth structure by increasing the weight of some of its most intensive collection elements, improving the elasticity of public revenues to GDP without any need to increase the tax burden.

Finally, it should be noted that this year, as a novelty, the Stability Programme presented by the Kingdom of Spain includes additional information responding to the information requirements established for the Member States under the excessive deficit procedure, as regulated by Regulation No 473/2013 of 21st May on common provisions for monitoring and assessing draft budget plans and for the correction of excessive deficit of the Eurozone Member States. In this context, additional detailed information on budget implementation of all the Spanish public administrations and each of the subsectors and the budget impact of discretionary measures taken in income and expenditure is provided.

3. MACROECONOMIC PROSPECTS

3.1. Recent evolution of the Spanish economy

3.1.1. International environment

The global economy has strengthened in the final months of 2013, driven by the consolidation of the positive trend of the activity in advanced economies, especially in the United States and, to a lesser extent, in the European economies. This increased momentum of developed economies has been partly offset by some slowdown in the growth of the emerging economies. Furthermore, the context of less uncertainty, favourable financial conditions and low inflation, has enabled some central banks to carry on expansionary monetary policies. This is without prejudice from the latest geopolitical risks.

In the United States, GDP grew by 4.1% in the third quarter of 2013 (annualised q-o-q rate), slowing down to 2.64% in the fourth quarter, largely due to a lower stock accumulation and to the reduction of investment in construction. On the positive side, private consumption, equipment investment and exports accelerated. The adverse weather conditions have distorted recent indicators but, in general terms, expansion has continued. It is expected that, after the 1.9% GDP growth in 2013, the pace is going to strengthen to 2.9% in 2014 and 3.2% in 2015.

In the second quarter of 2013, the Eurozone's GDP grew by 0.3% (non-annualised q-o-q rate), leaving behind one and a half year of declines. In the third quarter, progress lessens to 0.1% and in the fourth quarter it recovered 0.3%. In the latter period, private consumption remained almost stagnant but gross fixed capital formation grew and the external sector contributed four tenths to growth, due to the recovery in exports and the slowdown of imports. The main obstacles to growth inherent to the crisis, such as the high debt level, financial fragmentation, uncertainty and the need for fiscal adjustment have been damped.

In recent months, opinion indicators have shown a favourable evolution, according to the PMI manufacturing and services index, which in March pointed out to an increase of the total activity in the Eurozone for the ninth consecutive month, driven by an improvement in market conditions and by the increased level of new orders. After ending 2013 with a 0.4% decline, the European Commission forecasts a GDP growth in the Eurozone of 1.2% in 2014 and of 1.8% in 2015. A gradual strengthening of domestic demand and less dependence on the external sector growth, as well as a reduction in activity differentials between the Eurozone countries is expected.

In the fourth quarter of last year, GDP grew by 0.4% q-o-q in Germany, reporting a recovery in machinery investment and in exports, ending 2013 with a 0.4% growth (0.5% with calendar adjusted data). In recent months, opinion indicators have shown a very positive performance, and the European Commission forecasts an acceleration of the German growth in 2014 and 2015, up to 1.8% and 2%, respectively.

In France, the economic outlook is somewhat less favourable. In the third quarter of last year, GDP stagnated and in the fourth quarter it increased by 0.3% compared to the figure of the previous quarter, leading to a global increase, in

2013, also standing at 0.3%. In March, the composite PMI index went into expansion, recording its highest level in the last two and half years. A moderate recovery is expected, with a rise of the French GDP of 1% in 2014 and of 1.7% in 2015.

In Italy, the economy stabilised in the third quarter of 2013 and grew by 0.1% in the fourth quarter in q-o-q terms, the first increase since mid-2011. In March, the PMI manufacturing index went into expansion while the services PMI index come back to the contraction path after reaching in February the highest level since March 2011. After a 1.8% fall in the Italian GDP in 2013, a modest recovery is expected with a growth of 0, 6% in 2014 and of 1.2% in 2015.

Outside the Eurozone, the UK economy has gained momentum, boosted by improved confidence and monetary stimulus. The GDP grew by 0.7% in the fourth quarter of last year, a similar rate to the one recorded in the previous two quarters, ending the year with a 1.8% increase. The evolution of the labour market remains positive, inflation has moderated and PMI indices reached high levels in March. UK growth is expected to accelerate to 2.5% in 2014 and to stabilize at that rate in 2015, especially driven by domestic demand.

Adopting an overall perspective, the European Commission estimates that in 2013, growth in advanced economies stood at 1.2% and will strengthen in 2014 and 2015, recording growth rates of 2.2% and 2.5%, respectively.

In emerging economies, the estimated growth for 2013 is 4.6%, three tenths less than in 2012, lasting the slowdown path from the 8% of 2010. For this group of countries, a boost of the activity is expected, reaching 5% this year and 5.3% the coming one. China's growth is expected to reach 7.4% in these two years, three tenths less compared to the figure recorded in 2013. Conversely, an acceleration of seven tenths is expected in India, reaching 4.7% in 2014 and 5.4% in 2015. In Brazil, GDP grew by 2.2% in 2013, after the 0.9% recorded in the previous year, and increases of 2.3% in 2014 and of 2.9% in 2015 are expected.

Thus, according to the European Commission, the world’s GDP growth, excluding the EU, will accelerate in 2014 by seven tenths to 3.6% and by three tenths in 2015 to 3.9%. In parallel, the increase in volume of world imports of goods is expected to reach 4.9% this year and 6% next year, following the modest performance recorded in the previous two years.

On the other hand, the moderate pace of activity in advanced economies has helped to keep inflation very restrained, which in underlying terms, stood at 1.6% in January. In addition, oil prices fell by 2.7% in 2013, and the European Commission predicts further declines of 4.3% in 2014 and 2015. Regarding emerging economies, the evolution of inflationary pressures has been mixed. In China inflation remained at 2.6% in 2013, as a whole, while in India it still remains high, at 8.8% in January 2014, although it dropped by two percentage points compared to a year earlier. In the middle ground, Brazil's inflation reached 5.6% in January 2014, six tenths lower compared to a year earlier.

3.1.2. The adjustment of macroeconomic imbalances in Spain in 2013

In 2013 the Spanish economy showed a pattern of gradual recovery, especially during the second half of the year, in an environment of lower tensions in financial markets, progressive normalisation of external financing flows and improvement of the confidence and of the labour market behaviour. In this context, the GDP volume recorded negative q-o-q rates in the first two quarters (-0.3% and -0.1%, respectively) leading to positive growths in the last two quarters (0.1% in the third quarter and 0.2% in the fourth one). The year as a whole ended with an average annual decline in GDP of 1.2%, four tenths lower compared to the figured recorded in 2012 and one tenth lower than the forecast of the Spanish National Budget for 2014. Contraction of activity last year was the result of a still relatively weak domestic demand, which lowered 2.7 percentage points the GDP growth, after a negative contribution of more than four points the year before.

Its main components contributed to the less contraction trend in domestic demand compared the previous year. Spending on private consumption showed a gradual improvement throughout 2013, registering positive q-o-q rates as of the second quarter. Thus, the decline in private consumption for the year as a whole was 2.1%, seven tenths lower compared to 2012. Consumer demand improvement by households was largely determined by the lower weakening of the labour market and the more contained decline of the real gross disposable income as well as the increased of the wealth of the households. On the other hand, the savings rate remained at the same level of 2012 (10.4% of gross disposable income of households), in contrast to the sharply downward trend followed by this variable after the peak recorded in 2009 (17.8%). The household savings, together with the positive balance of net capital transfers received was large enough to finance its investment, recording a lending capacity of 2.5% of the GDP in 2013, one tenth above to that of 2012.

The final consumption expenditure of Public Administrations followed a contraction trend, in line with the fiscal consolidation process applied to the Spanish economy, although more moderate than in 2012, scoring an annual average drop, in volume, of 2 3%, two and a half points lower to that of the previous year.

The positive investment behaviour also contributed to the recovery of domestic demand. Gross fixed capital formation progressively reduced its rate of decline in the first half of 2013 and went into positive in the second half (0.7% q-o-q in the third and fourth quarters), showing a clearly different behaviour between its two main groups. Investment in equipment goods grew by 2.2%, following the 3.9% decline recorded in 2012, while construction investment slightly diminished its rate of decline, to 9.6%. Amongst the factors that drove the recovery of investment in equipment, the main ones were: the boost of the confidence, the improvement of the companies' financial position, the need to replenish productive capital and the dynamism of the export orders portfolio.

The external sector of the Spanish economy partially offset the contraction momentum of the domestic demand, contributing by 1.5 percentage points to the aggregate growth in 2013, one point less than the previous year. This contribution resulted from a strong growth in exports, which increased by 4.9% in real terms, more than double when compared to 2012, together with a modest growth in imports (0.4%), in contrast to the steep decrease witnessed in the previous year (-5.7%).

After a weak beginning of the year, exports rebounded to record a q-o-q rate of 7% in the second quarter of 2013, an expansive trend that continued in the second half of the year but at a more moderate pace. The year as a whole ended with a rise in exports almost three percentage points higher than the figure of the previous year and above the IMF forecast for world trade in goods and services in 2013 (2.7%), which points out to a global market share gain of Spanish exports. By destination, exports to the Eurozone and the European Union gained momentum, driven by the gradual recovery of the European economy and by the competitiveness improvements, while exports to emerging economies lost momentum.

In short, the behaviour of exports of goods and services last year as a whole was highly positive, with a strong y-o-y volume growth of 4.9% compared to those of our major trading partners: Germany and the UK (0.8%), France (0.6%) and Italy (0.1%). Broken down by components, exports of goods grew by 7.2% y-o-y, 4.5 percentage points higher than the world trade of goods, meanwhile the world trade of services dropped by one tenth. Within services, tourism exports increased by 2.6%, following a decline of half a percentage point recorded in 2012, while exports of other services fell by 1.9%, after the increases of the previous three years.

Imports of goods and services rose by four tenths in 2013, following a quarterly trend parallel to that of final demand, with drops in the first and last quarter of the year. All its components edged upwards, except non-tourism services, which fell by 4.5%. Imports of goods and tourism grew at a similar rate close to 1.5%, which favourably compares to the sharp declines of last year.

The terms of trade improved by 0.7% last year, following the deterioration observed in the previous three years, ending 2013 with a surplus of exchanges in goods and services of € 24.7 billion, the second consecutive surplus since 1997 (7.7 billion in 2012). The remaining items of the current balance also showed improvements. The balance of income and transfers reduced its deficit by almost € 3.6 billion, down to € 16.5 billion. As a result, the current balance recorded a surplus of € 8.2 billion, equal to 0.8% of GDP, the first positive surplus since 1987, following a deficit of € 12.5 billion in 2012. Finally, the position of the capital balance stood at € 7.5 billion, almost 30% higher compared to that recorded in the previous year, ending 2013 with a lending capacity of € 15.7 billion (1.5% of GDP) for the first time since 1997, compared to the 0.6% of GDP need recorded in 2012. These results show that the external imbalance, one of the most important of the Spanish economy, that reached 9.6% of GDP in 2007, was fully corrected in 2013 to achieve surpluses, which is the first step to redirect external borrowing.

Another significant feature of the Spanish economy in the last year is the continuity of the deleveraging process of private agents. The debt of non-financial corporations and households, embodied in securities other than shares, and in loans (including financial derivatives) continued to decline, reaching 129.7% of GDP at the end of the fourth quarter of 2013 for companies and 77.1% of GDP for households. Both together add up to a decline of 11 percentage points, thereby returning the leverage level of the private sector to pre-crisis values.

The smaller contraction of the Spanish economy was reflected in the labour market. According to the Labour Force Survey (LFS), employment declines, in an average annual rate, by 2.8%, in 2013, compared to the 4.3% fall of the previous year. However, that average annual rate conceals an improvement over the year, as the year ended with a y-o-y fall of 1.2%. In addition, with seasonally adjusted data, employment grew in the fourth quarter, 0.1% q-o-q compared to the 0.2% shrinkage registered in the previous quarter. The favourable employment evolution has continued in the first three months of 2014, according to the Social Security covered workers results.

After these results, it appears that the stage of job losses would have been left behind and we would be facing the beginning of a new phase of net job creation. In this new phase, the minimum employment creation threshold has been lowered, when compared to previous phases, and now stands below the 2% estimated some years ago. This change is partly due to the Labour Reform that came into force at the end of February 2012 by means of the Royal Decree-Law 3/2012, on urgent measures for the labour market. In this respect, it is important to highlight some aspects of the Reform that came clearly into force from the moment they were established, such as those related to a higher internal flexibility for companies, a higher use of the part-time option, an increase of salary moderation and an increase of opting outs to the general framework of the collective agreements, amongst others.

The employment adjustment in 2013, as a whole, continued to be more intense than the GDP drop (-1.2%), with the result of an increase in the apparent productivity per worker of 2.3%, one percentage point lower than in 2012. This productivity behaviour enabled the unit labour cost (ULC) to continue declining (-1.6%), although at a significantly slower pace than that of the previous year (-3%).

Waged employment losses for the overall last year affected both, permanent and temporary workers; but as the first group shrunk by 3.1% and the second by 4.6%, the temporary employment rate decreased by three tenths, to 23.1%. As for working hours, the employment adjustment focused on full-time workers, which fell by 4.3%, whilst part-time employment increased by 6.0%, this raised the part-time employment rate, which reached a historical peak of 15.8%. Regarding the distinction between public and private employment, waged employment loss continued affecting public employment with greater intensity, with an average annual decline rate of 5.6%, whilst private employment practically stabilised in late 2013.

Labour force continued its downward trend, falling by 1.1% for last year as a whole, so unemployment growth eased with intensity, ending the year with an unemployment rate of 25.7% of the employable population, the same figure as the one recorded a year earlier.

Inflation showed a sharp slowdown in the second half of the year, as base effects derived from the upswing of certain administered prices and of the VAT increase carried out in September 2012 were phased out. Besides these effects, other factors, such as moderation in labour costs per product unit, the weak behaviour of consumer demand and the slowdown of some import prices other than oil and other raw materials, especially food commodities, would have favoured the moderation of the prices. Thus, the Harmonised Index of Consumer Prices (HICP) recorded a y-o-y rate of 0.3% in December 2013, standing its annual average variation at 1.5%, 0.9 points below that recorded in 2012 and one tenth higher than that registered by the Eurozone. Core inflation also scored an average annual growth of 1.5%, one tenth lower than the previous year and two tenths above that recorded by the Eurozone. The downward path of prices continued in the first quarter of 2014, registering a y-o-y rate of -0.1% of the CPI in March.

3.2. Assumptions

Table 3.2.1 summarizes the main assumptions on which the macroeconomic scenario that includes this Stability Programme Update is based. These have been developed mainly using common assumptions considered by the European Commission (EC) in their winter forecasts, as well as the latest projections published by the IMF and own estimates.

Table 3.2.1. Basic assumptions of the Macroeconomic Scenario

	2013	2014 (F)	2015 (F)	2016 (F)	2017 (F)
Short-term interest rates (3-month Euribor)	0.2	0.4	0.6	0.8	0.9
Long-term interest rates (10-year debt, Spain)	4.6	3.7	3.8	3.9	4.0
Exchange rate (USD/euro)	1.33	1.37	1.37	1.37	1.37
Nominal effective exchange rate of the Eurozone (% change)	3.8	1.7	0.0	0.0	0.0
World GDP growth, excluding EU	2.9	3.6	3.9	4.1	4.3
EU GDP growth	-0.4	1.2	1.8	2.0	2.2
EU export markets growth (volume)	1.7	4.4	5.7		
World import volume, excluding EU	3.5	5.4	6.1		
Spanish markets of export	1.5	4.0	5.3	5.5	5.7
Oil price (Brent, Dollars/barrels)	108.7	107.3	103.7	103.5	103.5

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

First of all, with regards to financial variables, the slow recovery of the Eurozone suggests that monetary policy will continue a more expansive trend than that forecasted in the previous Programme. The path foreseen for interest rates in the long term follows a slight upward trend between 2014 and 2017, pursuing the reduction of the differential between the Spanish and the German bond, in line with what happened in 2013.

GDP growth in the European Union and the subsequent import forecasts, are taken from the assumptions used by the European Commission in its winter forecasts, with own estimates for 2016 and 2017. The dollar / euro exchange rate is also based on common assumptions by the European Commission and involves a closer alignment between both currencies, as the U.S. monetary policy becomes less expansive.

Forecasts on the price of the Brent oil barrel, in euros and dollars, reflect a gradual alignment in the evolution of the exchange rates for both currencies, while, predictably, the recovery in global demand over the forecast period will make its rate of decline to decrease between 2014 and 2017.

Finally, the growth of Spanish export markets corresponds to our own estimate based on the growth forecasts in world trade developed by the IMF and the European Commission. It is assumed that the expansion of Spanish markets will be in line with the expansion of world trade, with a growth rate of exports slightly higher, as Spain continues to derive gains in terms of cost competitiveness when the structural reforms that were launched gain momentum.

3.3. 2014-2017 macroeconomic prospects

The scenario on which this Stability Programme Update is based reflects, in the medium term, the consolidation of the nascent recovery of the Spanish economy, driven by job creation, the improvement of both consumers and businesses expectations, price and wage moderation, the gradual improvement in financial conditions for households and firms, following the financial restructuring process, and the maintenance of a strong dynamism of the export sector. Still, extensive capabilities of external funding that will enable a marked correction of external borrowing will be recorded in the future.

It is important to highlight that in the context of the Spanish economy, the progressive normalisation of financial conditions not only refers to the credit volume, but to its cost, which is very likely underestimated by the decline projected of long term interest rates. Similarly, the greatest opportunities for smoothing the profiles of the expenditure variables over time in view of the availability of a wide lending capacity of households and non-financial corporations and the use of new sources of financing alternative to bank credit stand out.

The still high level of indebtedness of households and non-financial companies will however imply a certain constraint to growth. Another constraint will be given by the fiscal consolidation process, although there are important nuances in this regard. As the empirical literature demonstrates[1], in circumstances where the need for correction of the deficit is important and financial stress disappears, the size of the multipliers decreases markedly, until becoming very low or even negative in a timeframe of 4-8 quarters. In this context, the multipliers would be significantly lower than those considered during the recession period.

On the other hand, the consolidation measures taken in the past will produce positive net results on growth through improvements in interest rates. Such consolidation is allowing a gradual reduction in the risk premium, which will be moving with some delay to the interest rates applicable to domestic credit. Similarly, progresses in fiscal consolidation positively affect the confidence of investors and consumers. Finally, as explained in more detail in the section on tax strategy, the design of fiscal measures was performed to have a positive impact on growth and employment.

From a medium-term perspective, the scenario is highly conditioned by the effects of structural reforms, which are a key aspect of economic policy of the Government within this legislature and that are explained in detail in the 2014 National Reform Programme. Indeed, reforms such as that of the recent

[1] Corsetti, G.; Meier, A.; Müller, G. (2012): What Determines Government Spending Multipliers? Economic Policy nº 27, pp 521-565; Hernández de Cos, P.; Moral-Benito, E. (2013): Fiscal Multipliers in Turbulent Times: The Case of Spain. Documentos de Trabajo nº 1309, Banco de España y BCE (2014): Fiscal Multipliers and the Timing of Consolidation. Economic Bulletin, abril 2014.

Bankruptcy Act, the Market Unity, the restructuring and recapitalisation of the financial system, that of Entrepreneurs, and so on., aimed at reducing the economic and financial costs in the development of economic activity, increase production, employment, generation of innovations and competitiveness in the medium term. Without this set of structural reforms, which are equivalent to a positive shock on the supply side, the recovery of the Spanish economy would not have succeeded.

Table 3.3.1. Macroeconomic prospects

Chain-linked volume indexes

2008=100, except as indicated

	ESA Code	2013 (A)	2013 (A)	2014 (F)	2015 (F)	2016 (F)	2017(F)
		Level	Annual variation as %				
1. Real GDP	B1*g	93.3	-1.2	1.2	1.8	2.3	3.0
2. Nominal GDP. Thousands of millions of Euros	B1*g	1023.0	-0.6	1.7	2.6	3.4	4.5
Components of real GDP							
3. Private consumption expenditure (*)	P.3	90.7	-2.1	1.4	1.8	2.3	2.8
4. Government consumption expenditure	P.3	97.5	-2.3	-1.3	-1.9	-1.8	-1.5
5. Gross fixed capital formation	P.51	64.7	-5.1	0.5	3.0	4.6	6.7
6. Change in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	102.5	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	115.9	4.9	5.0	6.1	6.3	6.5
8. Imports of goods and Services	P.7	85.6	0.4	3.6	5.0	5.8	6.3
Contributions to real GDP growth							
9. Domestic final demand		-	-2.6	0.7	1.2	1.9	2.6
10. Change in inventories and net acquisition of valuables	P.52 + P.53	-	0.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	1.5	0.6	0.5	0.4	0.3

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

Analysing the scenario in more detail, the creation of employment (about 900,000 full-time jobs in NC between 2014 and 2017) stands out. Indeed, structural improvements achieved with the Labour Reform of 2012 will enable the creation of employment with activity growth rates significantly lower than that of the past. In this respect, the Reform has already begun to bear fruit, judging by the moderation in job losses during the last months of last year. As a result, in 2014 net jobs will be created in all its indicators, a recovery that will be eased by a higher than initially expected domestic demand, triggered by the strongly expansive trend of investment in fixed capital and, to a lesser extent, of private consumption.

As a result of the recovery in employment, which will grow more strongly as of 2015, the unemployment rate will decrease gradually, being its effect enhanced in the first years of the forecast period by the decrease in the number of workers, due to the reverse migration flows. However, during the second half of the period increases of the activity rate due to a stronger momentum in the pace of economic activity are expected, placing the unemployment rate below 20% in 2017.

The high rate of job creation will cause the apparent productivity growth to decrease to a minimum of 0.6% in 2014 and 2015, although it will later recover gradually. This rate of productivity growth is positively valued, to the extent that it takes place in a context of job creation and balanced growth of the activity. In turn, this productivity evolution, together with wage restraint driven by moderate inflation, will continue to encourage a controlled behaviour in unit labour costs and competitiveness gains.

Table 3.3.2. Labour Market developments (*)

	ESA Code	2013 (A)	2013 (A)	2014 (F)	2015 (F)	2016 (F)	2017(F)
		Level	Annual variation as %				
1. Total employment (Thousands of persons)		17,252.0	-3.0	0.9	1.5	1.7	2.4
2. Full-time equivalent employment (Thousands of persons)		15,854.8	-3.4	0.6	1.2	1.5	2.3
3. Employed (Thousands of hours worked)		28,723.6	-3.0	0.7	1.6	1.8	2.2
4. Labour productivity per employee (Thousands of Euros)		58.8	1.8	0.3	0.2	0.5	0.5
5. Labour productivity, full-time equivalent (Thousands of Euros)		64.0	2.3	0.6	0.6	0.7	0.7
6. Productivity for hour worked (Euros)		35.3	1.9	0.5	0.2	0.5	0.8
7. Compensation per employee (**) (Thousands of Euros)	D.1	34.5	0.7	0.2	0.6	1.1	1.7
8. Labor unitary cost		-	-1.6	-0.4	0.0	0.4	1.0
9. Compensation of employee (Million Euros)		465,778.0	-3.5	0.7	1.8	2.6	4.0
10. Unemployment rate (% of labour force)		-	26.1	24.9	23.3	21.7	19.8

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

Regarding the composition of GDP, a correction of the growth pattern is expected in the period 2014-2017, with a more balanced contribution of external and domestic demand. In this respect it is a basic feature of the estimates that in all the coming years, from 2014 to 2017, both the contributions of domestic and external demand are positive, in contrast to what happened during almost all the years of the last expansion phase of the cycle, in which positive contributions of domestic demand went together with large external imbalances. Thus, a pattern of healthier and sustainable growth, not seen since 1997, is summarized.

The downward trend of the contribution of net external demand occurs despite the strong lasting dynamism in exports, based on competitiveness improvements and on the recovery of the world growth. However, the initial apathy of imports dilutes, in line with the dynamism of the domestic demand. Consequently the contribution of external demand in net terms decreases. Notwithstanding that, a slight reduction is expected in the elasticity of imports versus final domestic demand over the forecasting horizon, due to factors such as the recovery of significant flows of foreign direct investment or incentives for product innovation. Despite this minor contribution of the external balance to growth, a lending capacity will be recorded throughout the projection period, reaching approximately 2.5% of GDP towards the end of such period

The growing contribution of domestic demand to GDP growth will be largely determined by the strong momentum of investment in equipment goods, especially of the most competitive and export industries, accompanied by the recovery of private consumption. The latter will be supported by growth in disposable income, a progressive decrease in the number of households affected by severe liquidity constraints[2], the reduced growth of private consumption deflator, the improved economic expectations and some wealth effect. On the other hand, investment in construction will recover positive rates in 2015. Growth in all private components of domestic demand will also be essential to improve the financial conditions, both in terms of reducing the rates applicable to loans and in terms of demand induced by a more favourable economic environment.

[2] For households not subject to credit constraints and with formation of dynamic expectations (forward-looking), fiscal multipliers of public spending are negative, i.e., spending contraction expands spending in view of an expected reduction in the flow of taxes to be met.

Among the components of domestic demand, investment in equipment and other products will precede private consumption recovery, as already happened in the second half of last year. Equipment investment will be favoured, among other factors, by enhanced expectations for domestic consumption and exports, and by progress in the deleveraging process undertaken by companies. The deleveraging process will imply a lower pressure of debt service on investment spending and an improvement in its collateral net assets while the expected recovery will boost the lending activities, mainly for the most profitable units. The measures undertaken by the Government to rise lending to companies and promote other sources of financing other than banks will contribute to this recovery.

Private consumption, which will gradually settle until it reaches a growth rate of 2.8% in 2017, will support a stabilisation of the saving rate on household disposable income, in line with the long-term fundamentals. This stabilisation of the savings will be possible thanks to the growth of gross disposable income of households, though these will be somewhat tempered by the improvement of expectations on future income, higher public savings and the reduction of real interest rates in the long term.

Finally, the final consumption of public administrations will remain at negative rates until 2017, in line with the essential correction of the excessive deficit procedure.

With regards to cost-competitiveness, a conservative assumption is made, estimating that the appreciation of the euro against the dollar will be maintained in 2014, albeit with a slightly lower level. Maintaining the euro/dollar parity of macroeconomic prospects hypothesis (common static assumption for the forecasts of more than one year horizon, although predictably conservative), together with the expected evolution of the unit labour costs and the recovery of emerging economies are consistent with a certain boost of Spanish exports.

Imports of goods and services will progressively accelerate throughout the forecast period, reaching slightly lower rates compared to exports in 2017. The dynamism of exports and the gradual recovery of domestic demand, mainly of gross fixed capital formation, explain the upward trend projected for imports.

Table 3.3.3. Price developments

	ESA Code	2013 (A)	2013 (A)	2014 (F)	2015 (F)	2016 (F)	2017(F)
		Level	Annual variation as %				
1. GDP deflator		100.8	0.6	0.5	0.8	1.2	1.5
2. Private consumption deflator (*)		107.4	1.3	0.3	0.9	1.3	1.6
3. Public consumption deflator		99.4	1.3	0.3	0.4	0.5	0.8
4. Gross fixed capital formation deflator		89.8	-3.3	0.0	0.5	1.4	2.1
5. Exports price deflator (goods and services)		104.6	-0.9	-0.2	1.4	1.7	2.1
6. Imports price deflator (goods and services)		107.8	-1.6	-0.9	1.2	1.9	2.3

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

In the process of correcting the imbalances of the Spanish economy, inflation control will continue to play an important role. Despite the momentum of domestic demand, the growth rate of private consumption deflator will be clearly maintained below 2% during the period 2014-2017.

The absence of inflationary pressures will favour the continuity of wage moderation, positively affecting the competitiveness of domestic production and exports. At the same time, it will have a positive impact on the purchasing power of incomes, pensions and wages, boosting private consumption. This moderation in consumer prices will be largely transferred to the GDP deflator.

Controlled inflation will also result in a downward trend in the price of exports relative to imports, recording the terms of trade slightly negative variations as of 2016.

Significant progresses are estimated in the correction of the pending external imbalance, accumulated during the pre-economic crisis period and hence, in the foreign borrowing. Indeed, an extension of the path of gradual improvement in foreign net lending to the Rest of the World is expected in the coming years, moving forward in the process of lowering the external debt. The lending capacity of the Spanish economy will rise from 1.5% of GDP in 2013 to 2.5% of GDP in 2017. This improvement of the surplus face to the Rest of the World will be mainly driven by the increase in the current account balance, while the surplus in the capital balance (projected at around 0.7% of GDP) will also help to raise the lending capacity. In turn, the largest current account surplus is due to a gradual correction of the trade deficit, together with an increased surplus of the services balance, which more than offsets the slight increase in the deficit of primary incomes and current transfers.

Table 3.3.4. Sectorial balances

% of GDP	ESA Code	2013 (A)	2014 (F)	2015 (F)	2016 (F)	2017(F)
1. Net lending (+) / Net borrowing (-) vis-à-vis the rest of the world	B.9	1.5	2.0	2.4	2.5	2.5
- Balance on goods and services		2.4	3.2	3.7	4.0	4.2
- Balance of primary incomes and transfers		-1.6	-1.8	-2.0	-2.2	-2.4
- Capital account		0.7	0.7	0.7	0.7	0.7
2. Net lending (+) / Net borrowing (-) of the private sector	B.9	8.6	7.5	6.6	5.3	3.6
3. Net lending (+) / Net borrowing (-) of General Government	EDP B.9	-7.1	-5.5	-4.2	-2.8	-1.1
4. Statistical discrepancy		-	-	-	-	-

(*) 2013 figure includes financial assistance.
(A) Advance; (F) Forecast.
Sources: National Institute of Statistics and Ministry of Economy and Competitiveness.

From a sectorial point of view, the expanding lending capacity of the Spanish economy is largely explained by the decreasing deficit of Public Administrations, which fell from 7.1% of GDP in 2013, including aids to the financial sector, to 1.1% in 2017, while the private sector will gradually moderate its lending capacity throughout the forecast period, although it will remain at high levels. With regards to households, an improvement of two tenths of its lending capacity is projected by 2014, to 2.7%, two tenths more in 2015, to 2.9% of GDP, entering a gentle downward path thereafter. The expanding lending capacity of households projected to households for this year rests on a more moderate savings decline compared to investment; whilst as of 2015 savings increase and the sector’s investment initiates a smooth recovery. In the case of non-financial corporations, their lending capacity will remain high, which will boost business investment, although this will gradually moderate.

4. PUBLIC DEFICIT AND PUBLIC DEBT

4.1. The Public Administrations in 2013

In 2013, the General Government recorded a deficit of 6.62% of GDP in the National Accounts, excluding public financial assistance for the recapitalisation of the financial system, a figure very close to the committed target (6.5% of GDP) and 0.22 percentage points lower than the 6.84% deficit recorded in 2012. Once the revision of ESA 2010 is carried out, 2013 deficit is expected to meet the nominal target.

The intensity of the fiscal adjustment was lower than in 2012 as it was necessary to prevent the major structural transformation that the Spanish economy is implementing from being limited by the short-term negative effects of an overly intense fiscal consolidation, this more gradual adjustment process being mainly due to the structural effort.

Regional Governments (whose deficit decreased by 0.3 percentage points) and Local Entities (whose surplus increased by 0.2 percentage points), contributed to the public deficit decrease of 0.22 percentage points in 2013, while the Central Government and Social Security Administrations increased their financing needs by one and two percentage decimals, respectively, due to the greater impact of cyclical factors in these subsectors (Table 4.1.1).

Table 4.1.1. Balance of the General Government in 2013

% of GDP

	2012	2013	2013 Target
Central Government[1]	-4.21	-4.33	-3.80
Regional Governments	-1.86	-1.54	-1.30
Local Governments	0.22	0.41	0.00
Social Security	-0.99	-1.16	-1.40
Total General Government (1)	**-6.84**	**-6.62**	**-6.50**
Measures linked to the restructuring of the banking sector	*3.80*	*0.47*	
Total General Government	**-10.63**	**-7.09**	

(1) Does not include measures related to the restructuring of the banking sector.

Sources: Ministry of Finance and Public Administrations and National Institute of Statistics.

Although the fiscal adjustment in 2013 was less intense than in 2012, this does not imply a relaxation of the consolidation efforts, as shown by the variation in the primary structural balance, which stood at two percentage points, above the 0.22 percentage points in which the observed deficit was reduced.

If public financial assistance to financial institutions is included, for an amount equal to 0.47% of GDP, the deficit stands at 7.09% in 2013, after the 10.63% recorded in 2012, when the effect of bank restructuring on public deficit was 3.80% of GDP (Table 4.1.1).

Financial assistance to Spanish banks are considered temporary measures ("one-off") in public accounts that do not count as public deficit in order to assess the achievement of the target. The impact on public deficit of transactions carried out in 2013 amounted to € 4.8 billion (0.47% of GDP).

Table 4.1.2. The General Government in 2013

	Million euros			Percentage of GDP		
	2012	2013	% Var	2012	2013	Diff.
Revenues	**382,586**	**386,250**	**1.0**	**37.17**	**37.76**	**0.6**
Tax revenues	217,340	223,057	2.6	21.12	21.80	0.7
Direct taxes	109,342	110,143	0.7	10.62	10.77	0.1
Indirect taxes	107,998	112,914	4.6	10.49	11.04	0.5
Social security contributions	133,845	130,438	-2.5	13.00	12.75	-0.3
Other revenues	31,401	32,755	4.3	3.05	3.20	0.2
Expenditures	**492,046**	**458,827**	**-6.8**	**47.80**	**44.85**	**-3.0**
Expenditures (1)	**452,978**	**454,005**	**0.2**	**44.01**	**44.38**	**0.4**
Compensation of employees	115,213	116,090	0.8	11.19	11.35	0.2
Intermediate consumption	58,727	56,489	-3.8	5.71	5.52	-0.2
Social benefits	167,676	169,961	1.4	16.29	16.61	0.3
Interests (EDP)	31,513	35,096	11.4	3.06	3.43	0.4
Subsidies	10,439	10,447	0.1	1.01	1.02	0.0
Social transfers in kind (market production)	28,311	27,940	-1.3	2.75	2.73	0.0
Other current transfers	15,327	16,676	8.8	1.49	1.63	0.1
Gross capital formation	17,742	15,167	-14.5	1.72	1.48	-0.2
Capital transfers	45,871	10,158	-77.9	4.46	0.99	-3.5
Other expenditures	1,227	803	-34.6	0.12	0.08	0.0
Net lending (+) / Net borrowing (-) (EDP)	**-109,460**	**-72,577**	**-33.7**	**-10.63**	**-7.09**	**3.5**
Expenditures linked to the restructuring of the banking sector	*39,068*	*4,822*	*-87.7*	*3.80*	*0.47*	*-3.3*
Net lending (+) / Net borrowing (-) (EDP) (1)	**-70,392**	**-67,755**	**-3.7**	**-6.84**	**-6.62**	**0.2**
Memo items:						
Public debt	**884,731**	**960,676**	**8.6**	**85.96**	**93.91**	**8.0**
Implicit interest rate (%)	4.27	3.97				

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

Despite the decline in tax bases for the sixth consecutive year, the tax revenues of the General Government increased by 2.6% in 2013 compared to the previous year, driven by policy measures[3], while revenues from Social Security contributions, in a context of job losses, fell by 2.5%, which to a large extent explains the moderate increase in total non-financial resources (1%).

Within the tax revenues, direct taxes increased by 0.7% and indirect ones, despite the fall of aggregate nominal spending, rebounded by 4.6%, driven by higher value added tax rates as of September 2012, as well as by policy and management changes in the tax on hydrocarbons and by the creation of three new environmental taxes.

As for the expenses of the General Government, if resources transferred to the financial system in the process of bank restructuring are excluded, they rose by 0.2% last year, whereas if interest expenditure is also excluded, expenses fell by 0.6%. Among primary expenditures, the sharp falls of capital transfers (-21.6%, excluding bank restructuring costs) and of gross capital formation (-14.5%) stand out, together with more moderate declines in intermediate consumption (-3.8%) and of social transfers in kind provided via market producers (-1.3%). On the other hand, compensation of employees increased by 0.8% due to the knock-on effect

[3]The main rules with effects on tax revenues of 2013 were: Royal Decree-Law 20/2011 of 30th December on urgent measures on budget, tax and financial matters for the correction of the public deficit, with special emphasis on the personal income tax; Royal Decree-Law 20/2012 of 13th July on measures to ensure budget stability and promoting competitiveness, affecting mainly VAT; and Law 15/2012 of 27th December, on tax measures for energy sustainability, which created three new taxes and modified the tax on hydrocarbons.

resulting from the recovery of the extra December payment, and social benefits other than social transfers in kind increased by 1.4%. Among the other groups, other current transfers increased by 8.8%, and subsidies recorded a slight increase of 0.1%.

At the end of 2013, public debt, according to the methodology of the Excessive Deficit Protocol (EDP), amounted to € 960.7 billion (93.9% of GDP), compared to € 884.7 billion (86% of GDP) recorded at the end of the previous year, representing an increase of 8 percentage points of GDP, compared to the increase of 15.5 percentage points in 2012.

It should be noted in this regard that the State reduced its borrowing requirements in the previous year by 23.8%, despite the higher cash deficit (€ 39.7 billion, 36.8% higher than in 2012). This behaviour stems from the decrease in the net change of financial assets (€ 34.3 billion compared to € 68.1 billion registered in 2012), which in turn is explained by the decrease in loans to other Public Administrations. On the other hand, capital contributions increased by 18.9% in 2013 compared to the previous year, highlighting those granted to the Regional Liquidity Fund (RLF) and the European Stability Mechanism (ESM), amounting to € 23 billion and € 3.8 billion, respectively. It should be noted that the State contributed to provide liquidity to suppliers via the Suppliers Fund and with a proportion of the Regional Liquidity Fund.

As for the different subsectors that integrate the Spanish General Government, the Central Government deficit in 2013 (Table 4.1.3) according to the National Accounts and excluding public financial assistance the restructuring of the financial system, stood at 4.33% of GDP (€ 44.3 billion), compared with a deficit of 4.21% recorded in 2012, representing a deviation of half a point versus the committed target.

Table 4.1.3. The Central Government in 2013

	Million euros			Percentage of GDP		
	2012	2013	% Var	2012	2013	Diff.
Revenues	**132,124**	**138,021**	**4.5**	**12.84**	**13.49**	**0.7**
Tax revenues	75,268	102,137	35.7	7.31	9.98	2.7
Direct taxes	50,855	62,239	22.4	4.94	6.08	1.1
Indirect taxes	24,413	39,898	63.4	2.37	3.90	1.5
Social security contributions	13,024	12,649	-2.9	1.27	1.24	0.0
Other current transfers	35,644	12,184	-65.8	3.46	1.19	-2.3
Of which: within General Government	32,885	9,342	-71.6	3.19	0.91	-2.3
Other revenues	8,188	11,051	35.0	0.80	1.08	0.3
Expenditures	**214,540**	**187,169**	**-12.8**	**20.84**	**18.30**	**-2.5**
Compensation of employees	23,234	24,198	4.1	2.26	2.37	0.1
Intermediate consumption	9,438	9,211	-2.4	0.92	0.90	0.0
Social benefits	14,089	14,474	2.7	1.37	1.41	0.0
Interest (EDP)	27,211	31,379	15.3	2.64	3.07	0.4
Other current transfers	86,054	89,096	3.5	8.36	8.71	0.3
Of which: within General Government	74,295	75,950	2.2	7.22	7.42	0.2
Gross capital formation	6,250	5,247	-16.0	0.61	0.51	-0.1
Capital transfers	43,812	8,100	-81.5	4.26	0.79	-3.5
Other expenditures	4,452	5,464	22.7	0.43	0.53	0.1
Net lending (+) / Net borrowing (-) (EDP)	**-82,416**	**-49,148**	**-40.4**	**-8.01**	**-4.80**	**3.2**
Expenditures linked to the restructuring of the banking sector	39,068	4,822	-87.7	3.80	0.47	-3.3
Net lending (+) / Net borrowing (-) (EDP) (1)	**-43,348**	**-44,326**	**2.3**	**-4.21**	**-4.33**	**-0.1**
Memo items:						
Public debt	760,195	836,192	**10.0**	**73.86**	**81.74**	**7.9**
Implicit interest rate (%)	4.37	4.13				

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

Tax revenues of the Central Administration increased by 35.7% in 2013 compared to the previous year, against a fall of 24.6% recorded in 2012. This strong increase is mainly due to the final settlement of the regional financing system in 2010 being in favour of the Regional Governments, leading to a lower revenue for the State amounting to € 25.1 billion in 2012, while the settlement of 2011, carried out in 2013, has been in favour of the State. Indeed, payments on account to the Regional Governments in 2010 were calculated according to the previous regional financing system, which means lower participation in the State taxes than with the new funding system. On the other hand, current transfers received by the Central Administration from other government decreased by 71.6% in 2013, mainly due to the fact that the final settlement of 2010 in 2012 gave rise to a revenue in favour of the State coming from the Sufficiency Fund, that serves as a closing resource of the regional financing system.

The expenditure of the Central Administration decreased by 12.8% in 2013 due to a sharp decline in capital transfers for the recapitalisation of financial institutions (€ 4.8 billion compared to € 39.1 billion registered in 2012). Excluding public financial assistance to the financial system and interests, which increased by 15.3%, the expenditure rise stood at 1.8%, with increases in compensation of employees (4.1%) standing out, due to the effect of the extra December payment recovery, without which it would have been reduced, as well as other current transfers (3.5%) and the recovery of subsidies (66.6%). Among the groups that fell, declines of intermediate consumption (-2.4%), social transfers in kind of market producers (-22.2%) and gross capital formation (-16%) stand out reflecting the measures carried out.

Table 4.1.4. The Regional Governments in 2013

	Million euros			Percentage of GDP		
	2012	2013	% Var	2012	2013	Diff.
Revenues	**167,272**	**142,676**	**-14.7**	**16.25**	**13.95**	**-2.3**
Tax revenues	109,081	86,876	-20.4	10.60	8.49	-2.1
Direct taxes	48,080	36,646	-23.8	4.67	3.58	-1.1
Indirect taxes	61,001	50,230	-17.7	5.93	4.91	-1.0
Other current transfers	46,145	44,342	-3.9	4.48	4.33	-0.1
Of which: within General Government	44,093	42,217	-4.3	4.28	4.13	-0.2
Other revenues	12,046	11,458	-4.9	1.17	1.12	-0.1
Expenditures	**186,442**	**158,457**	**-15.0**	**18.11**	**15.49**	**-2.6**
Compensation of employees	69,165	68,985	-0.3	6.72	6.74	0.0
Intermediate consumption	28,484	26,243	-7.9	2.77	2.57	-0.2
Interests (EDP)	6,460	7,744	19.9	0.63	0.76	0.1
Social transfers in kind (market production)	25,745	25,662	-0.3	2.50	2.51	0.0
Other current transfers	37,836	14,288	-62.2	3.68	1.40	-2.3
Of which: within General Government	35,749	12,003	-66.4	3.47	1.17	-2.3
Gross capital formation	5,747	4,963	-13.6	0.56	0.49	-0.1
Capital transfers	5,115	4,394	-14.1	0.50	0.43	-0.1
Other expenditures	7,890	6,178	-21.7	0.77	0.60	-0.2
Net lending (+) / Net borrowing (-) (EDP)	**-19,170**	**-15,781**	**-17.7**	**-1.86**	**-1.54**	**0.3**
Memo items:						
Public debt	**185,456**	**206,773**	**11.5**	**18.02**	**20.21**	**2.2**
Implicit interest rate (%)	4.54	4.18				
Sources: Ministry of Finance and Public Administrations, Bank of Spain and National Institute of Statistics.						

On the other hand, in 2013, Regional Governments´ deficit, in National Accounts terms, stood at 1.54% of GDP (€ 15.8 billion), a figure that, although it is 0.2 percentage points above the target (1.3%), represents a reduction of 0.3 percentage points compared to 2012 deficit (1.86%), therefore showing the continued fiscal consolidation efforts undertaken by these governments (Table 4.1.4).

Regional Governments non-financial resources fell by 14.7% and, specially, the tax resources fell by 20.4% as a result of the liquidation of the regional financing system in 2010, which resulted in a sharp increase of tax revenues of Regional Governments in 2012, for the reasons outlined above, thus affecting last years' annual variation. On the other hand, expenses fell by 15% due to a decline in all groups except interests, which increased by 19.9%.

Regarding Local Entities (Local Governments, Council Offices, Town Councils and Island Councils), they increased the surplus by 0.2 percentage points in 2013 compared to the previous year, reaching 0.41% of GDP (€ 4.2 billion), so they amply fulfilled the balanced budget target committed to for the whole year.

The surplus increase of Local Entities was caused by an increase of non-financial resources (1.9%) and a decrease in non-financial expenses (-1.2%). Tax revenues and current transfers within the General Government, which together account for approximately 80% of total revenues, increased by 3.2% and 4.1%, respectively. On the expenditure side, main groups decreased, except compensation of employees and intermediate consumption, which were up by 0.4% and 1.4%, respectively; however, the compensation of employees is reduced when discounting the extra December payment.

Table 4.1.5. The Local Entities in 2013

	Million euros			Percentage of GDP		
	2012	2013	% Var	2012	2013	Diff.
Revenues	**63,849**	**65,059**	**1.9**	**6.20**	**6.36**	**0.2**
Tax revenues	32,991	34,044	3.2	3.21	3.33	0.1
Direct taxes	10,407	11,258	8.2	1.01	1.10	0.1
Indirect taxes	22,584	22,786	0.9	2.19	2.23	0.0
Other current transfers	21,011	21,792	3.7	2.04	2.13	0.1
Of which: within General Government	18,997	19,776	4.1	1.85	1.93	0.1
Other revenues	9,847	9,223	-6.3	0.96	0.90	-0.1
Expenditures	**61,562**	**60,846**	**-1.2**	**5.98**	**5.95**	**0.0**
Compensation of employees	20,286	20,369	0.4	1.97	1.99	0.0
Intermediate consumption	19,557	19,829	1.4	1.90	1.94	0.0
Other current transfers	11,215	11,078	-1.2	1.09	1.08	0.0
Of which: within General Government	9,746	9,846	1.0	0.95	0.96	0.0
Gross capital formation	5,418	4,853	-10.4	0.53	0.47	-0.1
Other expenditures	5,086	4,717	-7.3	0.49	0.46	0.0
Net lending (+) / Net borrowing (-) (EDP)	**2,287**	**4,213**	**84.2**	**0.22**	**0.41**	**0.2**
Memo items:						
Public debt	41,939	41,485	**-1.1**	**4.07**	**4.06**	**0.0**
Implicit interest rate (%)	4.05	3.01				
Sources: Ministry of Finance and Public Administrations, Bank of Spain and National Institute of Statistics.						

Finally, in a context of gradual recovery in economic activity, Social Security Administrations recorded a deficit of 1.16% of GDP (€ 11.9 billion) in 2013, 0.2 percentage points, higher than in 2012, but lower by the same amount than the committed target.

Revenues from Social Security Administrations fell by 0.3%, while expenses increased by 0.8%. In particular, social contributions, which account for approximately 80% of revenues, decreased by 2.4%, while social benefits, the main expense concept of these governments, as it exceeded 90% of their non-financial expenses, increased by 1.8%. Current transfers within the General Government, subsidies and intermediate consumption contributed to the moderation of the expenses of these governments, with reductions of 8.7%, 28.9% and 3.4%, respectively (Table 4.1.6).

Table 4.1.6. The Social Security Administrations in 2013

	Million euros			Percentage of GDP		
	2012	2013	% Var	2012	2013	Diff.
Revenues	**150,244**	**149,817**	**-0.3**	**14.60**	**14.65**	**0.0**
Social security contributions	120,057	117,121	-2.4	11.66	11.45	-0.2
Other current transfers	28,728	30,944	7.7	2.79	3.02	0.2
Of which: within General Government	27,467	29,799	8.5	2.67	2.91	0.2
Other revenues	1,459	1,752	20.1	0.14	0.17	0.0
Expenditures	**160,405**	**161,678**	**0.8**	**15.58**	**15.80**	**0.2**
Compensation of employees	2,528	2,538	0.4	0.25	0.25	0.0
Intermediate consumption	1,248	1,206	-3.4	0.12	0.12	0.0
Social benefits	149,279	151,957	1.8	14.50	14.85	0.4
Subsidies	2,836	2,017	-28.9	0.28	0.20	-0.1
Other current transfers	3,664	3,348	-8.6	0.36	0.33	0.0
Of which: within General Government	3,652	3,335	-8.7	0.35	0.33	0.0
Other expenditures	850	612	-28.0	0.08	0.06	0.0
Net lending (+) / Net borrowing (-) (EDP)	**-10,161**	**-11,861**	**16.7**	**-0.99**	**-1.16**	**-0.2**
Memo items:						
Public debt	**17,188**	**17,187**	**0.0**	**1.67**	**1.68**	**0.0**
Sources: Ministry of Finance and Public Administrations, Bank of Spain and National Institute of Statistics.						

4.2. The State Budget for 2014

The State Budget for 2014 falls within the new path of fiscal consolidation that extends the deadline for correcting the excessive deficit in two years, until 2016, which implies a more gradual adjustment process. This process, takes into account, on the one hand the current economic environment and, on the other, the important structural reforms that are taking place in the Spanish economy and whose effects could be slowed down by a too strong fiscal adjustment.

However, this Budget does not in any case imply a relaxation of the commitment on public deficit reduction and it is fully consistent with the fulfilment of the public deficit targets of 2014-2016 approved for the State by the Spanish Parliament in July 2013.

The Central Government Budget for 2014 was prepared under a less favourable macroeconomic scenario than the one included in this Stability Programme Update. Both contemplate a recovery in economic activity and in employment that will result, in turn, in a slightly recovery of the tax bases of the main taxes. In this context of consolidation of the recovery, the contribution to revenues derived from policy measures will be more moderate than in previous years. Thus, revenues in the State Budget for 2014 show an increase of 5.8% compared to the 2013 settlement, due to the progress foreseen in tax revenues (8.7%). In particular, the direct tax revenues will grow by 10% and the indirect ones by 6.5%. As for expenses, driven by interests and capital transfers, they rose by 2.5%.

Table 4.2.1. The State Budget for 2014

	2013	2014	% variation
	Settlement	Initial budget	
	Million Euros		
	1	2	3=2/1
Total revenues	**121,118**	**128,159**	**5.8**
Tax revenues	97,796	106,295	8.7
Direct taxes	62,019	68,208	10.0
Personal Income Tax	37,924	41,276	8.8
Corporate tax	19,964	22,327	11.8
Others	4,130	4,605	11.5
Indirect taxes	35,777	38,088	6.5
VAT	25,502	27,122	6.4
Excise duties	7,554	7,763	2.8
Others	2,721	3,202	17.7
Other revenues	23,322	21,864	-6.3
Total expenditures	**160,796**	**164,849**	**2.5**
Staff (a)	15,639	15,796	1.0
Goods and services	3,200	2,968	-7.2
Interests	28,407	36,616	28.9
Current transfers (a)	101,155	94,614	-6.5
Contingency Fund	-	2,666	-
Real investment	5,930	3,254	-45.1
Capital transfers	6,464	8,935	38.2
Budgetary balance	**-39,678**	**-36,689**	**-7.5**

(a) 2013 data homogenized in relation with the change of the treatment of the pensions paid by the State.

Source: Ministry of Finance and Public Administrations.

In 2014, it is expected that total State taxes (including the participation of Regional Governments and Local Entities in Personal Income Tax, VAT and Excise Taxes) will grow by 6.5% compared to the 2013 settlement, driven by expected increases in some direct and indirect taxes of 6.5%, both (Table 4.2.2).

Estimated resources from personal income tax amounted to € 73.2 billion, 4.6% more than at the end of 2013. Tax measures in this tax will have a reduced net revenue impact of € 83 billion. The main thrust comes from new measures affecting 2013 tax and that will have their collection impact in 2014, through the raising of the differential tax bill, such as the removal of the deduction for home purchase and the new tax regime for asset gains of less than one year. Measures to encourage entrepreneurs that include an effective tax reduction and that are intended to restore economic growth and to foster job creation are also included. Such measures include the new deduction for reinvestment of profits or incentive to taxpayers who provide financial capital and knowledge for the development of the society in which they invest. In addition, measures taken before 2014 such as, the increase in the withholdings rate of economic activities (which will have a negative impact on the differential tax bill payable in 2014) and the abolition of the public employees´ 2012 extra December payment, which raises withholdings of the first months of 2014 compared to the previous year, will have effects on the collection in 2014.

With regard to Corporate Income Tax, revenue expected for 2014 in the Budget amounts to € 22.3 billion, 11.8% more than in the settlement for 2013. This increase comes from the revenue impact of the above mentioned measures, which will allow expanding the tax base. The set of recent regulatory changes will mean an increase of € 2.9 billion in the collection of this tax. The most important measure here is the non-deductibility of share impairment in capital or equity participation as well as the negative incomes generated during the maintenance period of permanent establishments located abroad, estimated to raise revenue by € 3.7 billion.

Regarding the tax base, it is expected to grow as a result of fiscal measures and by the improvement of the gross operating profit of companies under gradual activity recovery, described in the macroeconomic scenario.

Table 4.2.2. The State Tax Revenue budget in 2014
(Including the participation of the Territorial Entities)

	2013	2014	% variation
	Settlement	Initial budget	
	Million Euros		
	1	2	3=2/1
Direct taxes	**94,040**	**100,128**	**6.5**
Personal Income Tax	69,946	73,196	4.6
Corporate tax	19,964	22,327	11.8
Non-Resident Income Tax	1,416	1,690	19.3
Others	2,713	2,915	7.4
Indirect taxes	**73,733**	**78,505**	**6.5**
VAT	51,939	54,849	5.6
Excise duties	19,073	20,453	7.2
Others	2,721	3,202	17.7
Total taxes	**167,773**	**178,632**	**6.5**

Source: Ministry of Finance and Public Administrations.

With regard to indirect taxes, revenues from Value Added Tax of € 54.8 billion are expected in 2014, representing an increase of € 2.9 billion compared to the settlement of 2013 (5.6% higher). Despite the negative impact on 2014 collection from the delay in the collection that will be introduced by the new special scheme of the cash basis, policy measures will have a positive net impact of € 117 million. A spending recovery in household consumption is expected, while the remaining components of final expenditure subject to VAT, the current and capital expenditure of the General Government and spending on house purchase will continue to decline but at slower rates than in 2013. Overall, a modest growth of total expenditure, which will boost revenue, is projected.

In 2014, revenues from Excise Duties will increase by 7.2% compared to 2013 settlement, reaching € 20.5 billion. No new measures with a significant impact on collections have been adopted. However, a positive impact is expected on collections of 2014 from actions taken previously, mainly increases in tax rates on alcohol and tobacco that were approved in July 2013. Thus, in the absence of these measures, the revenues would decline as a result of modest decreases included in the forecast for fuel and tobacco consumption.

On the other hand, the State's budget expenditure for 2014 accounted for € 164.8 billion, 2.5% higher than the settlement of 2013 (Table 4.2.1). The increase comes from three concepts: interest payments (€ 36.6 billion, 28.9% more than in 2013), capital transfers (provided with € 8.9 billion, representing an increase of 38.2%) and staff expenses (€ 15.8 billion, 1% higher than the amount paid last year, once data from 2013 are homogenised in relation to the change introduced in the economic classification of civil or military pensions to public employees or their relatives), while the remaining groups fall by 6.2% overall.

The increase in the above mentioned capital transfers is basically due to the funding increase from the Central Government Budget for certain costs of the electricity system. The financing of such a provision, which in 2014 stands at € 4.2 billion, will partly take place with the collection of new taxes and by modifying the existing ones, as included in Law 15/2012 of 27th December on fiscal measures for energy sustainability. As for interests, even though the cost of refinancing declined last year, the Central Government Budget for 2014 includes an increase due to the higher outstanding debt. However, a substantial reduction in these is expected compared to the budgeted amount due to the sharp decrease in rates being recorded this year.

As for the other groups, current transfers, which fell by 6.5% in 2014 to € 94.6 billion, stand out. Of this amount, approximately € 36 billion go to the funding systems of Territorial Administrations and, among the remaining allocations of these transfers, the following stand out: those allocated to the Social Security, whose total amounts is € 13 billion, the contribution to the Public State Employment Service, with € 14.6 billion, the contribution to the European Union, with a loan of € 12.8 billion, and the expenditure for retired civil servants´ pensions, a group to which approximately € 12 billion are allocated. The Central Government Budget for 2014 introduces, as a novelty, the allocation as current transfers of credits addressed to pensions for retired civil servants, while in previous years these were considered staff expenses. Most of these current transfers do not imply final expenditure of the State, since they are addressed to finance spending of other Public Administrations, such as Territorial Administrations, Social Security or the Public State Employment Service.

Finally, the allocations for current expenditure on goods and services and real investments, with an overall weight of approximately 4%, recorded declines of 7.2% and 45.1% compared to the settlement of 2013, respectively. However, it should be noted that State investments in infrastructure are not only included in the chapter of real investments, but is also in investments that Ministries (primarily of Public Works) carried out through capital transfers and financial assets.

The Social Security System Budget for 2014 responds to the fulfilment of the 2014-2016 budget stability targets, adopted on 28th June 2013 by the Council of Ministers, for the entire public sector and each agent in it. The 2014 Budget for the Social Security forecasts a net borrowing of 0.9% of GDP in budget terms (Table 4.2.3).

The consolidated Budget of non-financial revenues of the Social Security System for 2014 amounts to € 119.7 billion, which represents a decrease of 4.8% compared to 2013. The main source of funding are social contributions, with an amount budgeted of € 102.8 billion for this year and a decrease of 2.9%, which allows financing almost 80% of non-financial spending. Under this group contributions from companies and employed people, as well as unemployed contributions are included.

Table 4.2.3. The Social Security budget for 2014

	2013	2014	% variation
	Settlement	Initial budget	
	Million Euros		
	1	2	3=2/1
Total revenues	**125,677**	**119,691**	**-4.8**
Social Security contributions	105,863	102,840	**-2.9**
Current transfers	15,598	13,041	**-16.4**
of which: from the State	15,537	12,982	**-16.4**
Other revenues (a)	4,216	3,811	**-9.6**
Total expenditures	**125,795**	**129,436**	**2.9**
Current transfers	121,697	125,319	**3.0**
Contributory pensions	106,350	112,103	**5.4**
Non-contributory pensions	2,476	2,166	**-12.5**
Temporary disability	5,831	4,878	**-16.3**
Maternity	2,310	2,178	**-5.7**
Other current transfers	4,731	3,994	**-15.6**
Other expenditures (b)	4,098	4,117	**0.5**
Budgetary balance	**-117**	**-9,745**	-
% of GDP	-0.01	-0.93	-

(a) Property income, fees and other revenues and capital transfers.
(b) Staff, goods and services, financial expenses, real investment and capital transfers.
Source: Ministry of Labour and Social Security.

After these contributions, State transfers are the concept with a higher share in the revenue side of the Social Security Budget. It is expected that the Social Security will receive current transfers from the State of a total amount of € 13 billion in 2014, a figure 16.4% lower compared to that recorded in 2013, highlighting the contribution to finance minimum pension supplements, with a y-o-y fall of 3.3%. This decrease is due to obligations from previous years that had to be faced in 2013 (PNC, PF, Crib Plan and social contributions from non-professional caregivers).

The Budget for Social Security non-financial expenditure for 2014 totals € 129.4 billion, which represents a growth of 2.9% compared to the 2013 budget. Within total expenditure, current transfers stand out due to their importance and include contributory and non-contributory pensions, benefits for temporary disability and maternity benefits and other various benefits, such as family allowances and those linked to dependence.

Regarding the latter, it should be noted that Law 39/2006 of 14th December, launched the Long-Term Care System in order to promote personal autonomy and ensure the care and protection for dependent persons throughout the national territory, with the cooperation and participation of all Public Administrations, guaranteeing equal treatment to all dependent citizens, irrespective of their place of residence. However, the current scenario of public spending reduction required the Government to approve the Royal Decree-Law 20/2012 of 13th July on measures to ensure budget stability and the promote competitiveness, which led, among others, to a reduction in the maximum amounts of economic benefits going to care in the family, while reducing at the same time the amount of the Minimum Level of guaranteed protection and the postponing until July 2015 the incorporation of new moderate dependents into the Care System.

As a result of these measures, the Budget of the IMSERSO includes € 1.1 billion allocated in credits for current transfers, which represents a decrease in spending compared to 2013 of 48.6%. This deduction is mainly due to this year's reduction of the item aimed to finance obligations from previous years arising from the financing of contributions for non-professional caregivers, which in 2013 amounted to € 1.0 billion.

Contributory pensions were assigned a credit for 2014 of € 112.1 billion, 5.4% higher than last year, estimated in accordance with the increase of the group of pensioners, the variation of the average pension and a revaluation of 0.25%. Benefits for maternity, paternity and risks during pregnancy and during breastfeeding, whose endowment amounts to € 2.2 billion, falls by 5.7% compared to 2013, due to the evolution of total beneficiaries. Credit assigned to the payment of temporary disability benefits decreases by 16.3% down to € 4.9 billion, as a result of cost containment measures in the benefits and of reducing the number of affiliates.

Non-contributory pensions of the Social Security, which fall by 12.5%, appear in the Budget of the IMSERSO with a credit of € 2.2 billion (excluding the Basque Country and Navarre). This credit covers the higher cost due to the variation in this group and the 0.25% revaluation.

4.3. 2014-2017 Fiscal strategy. Analysis of measures and budget impact

4.3.1. 2014-2017 Fiscal strategy

Table 4.3.1.1 represents the basic variables of the 2014-17 fiscal strategy, whose backbone is the path of Public Administrations net borrowing, in Excessive Deficit Procedure (EDP) terms and with one-off contributions to the restructuring of the financial system. The main change with respect to the fiscal strategy outlined in September 2013 is the change in the budget target of 2014 from 5.8% to 5.5% of GDP; otherwise, and in line with the EDP Recommendation received by Spain in 2013, the budget targets of 2015 and 2016 remain at 4.2% and 2.8% respectively. Finally, the balance of 2017, 1.1%, represents the achievement of a structural effort above 0.5 percentage points (0.6), meeting the existing obligations in the Stability and Growth Pact for the countries that are outside the corrective arm but whose debt stock on GDP exceeds 60%.

The budget objective change in 2014 has been possible mainly due to lower expenses associated with the payment of public debt interests. On the other hand, however, temporary measures that would increase the deficit by slightly less than 0.2 percentage points of GDP are forecast, as detailed below. Still, the goal of 5.5% must be considered cautious.

The starting point of the fiscal strategy is the important budget consolidation effort carried out in 2012 and 2013, which amounts to a total of 4.2 and 3.2 points of GDP of impact of measures, respectively, and has made it possible to achieve a primary structural surplus (1.4%) in 2013 for the first time since 2007.

Analysing the main trends of the Public Administrations account budgets between 2013 and 2017 shows that the deficit reduction will be possible thanks to a contribution from both the income/GDP ratio, which rises 1.2 percentage points to 39,0%, and the expenditure/GDP ratio, which falls 4.8 percentage points to 40.1%.

A rebalancing between direct tax burden on labour an indirect taxes took place, increasing excise and environmental taxes, VAT rates and shifting products to different tax brackets. In addition, gradual steps have been adopted in the field of what is known as fiscal devaluation, following the VAT and other indirect taxes increase, and the reduction of social contributions involving the flat rate measure as of February 2014.

Table 4.3.1.1. Budgetary prospects

Excessive Deficit Procedure

	ESA Code	2013 (A) Level (mill. €)	2013 (A)	2014 (F)	2015 (F)	2016 (F)	2017(F)
			Percentage of GDP				
Net lending (+) / Net Borrowing (-) of financing by sub-sector (EDP. B9)							
1. Total Public Government (*)	**S. 13**	**-72,577**	**-7.1**	**-5.5**	**-4.2**	**-2.8**	**-1.1**
1a. Linked to the restructuring of the banking sector		**-67,755**	**-6.6**	**-5.5**	**-4.2**	**-2.8**	**-1.1**
2. Central Government (*)	S. 1311	-49,148	-4.8	-3.5	-2.9	-2.2	-1.1
3. Regional Governments	S. 1312	-15,781	-1.5	-1.0	-0.7	-0.3	0.0
4. Local Government	S. 1313	4,213	0.4	0.0	0.0	0.0	0.0
5. Social Security funds	S. 1314	-11,861	-1.2	-1.0	-0.6	-0.3	0.0
General governments (S. 13)							
6. Total revenue	TR	386,250	37.8	38.5	38.8	38.9	39.0
7. Total expenditure	TE	458,827	44.9	44.0	43.0	41.7	40.1
7a. Expenditures linked to banking restructuring		4,822	0.5	0.0	0.0	0.0	0.0
8. Net lending / Net borrowing	EDP. B9	-72,577	-7.1	-5.5	-4.2	-2.8	-1.1
8a. Net lending / Net borrowing without banking restructuring expenditures		-67,755	-6.6	-5.5	-4.2	-2.8	-1.1
9. Interest expenditure	EDP. D41	35,096	3.4	3.5	3.6	3.7	3.8
10. Primary balance		-37,481	-3.7	-2.0	-0.6	0.9	2.7
11. Temporary measures		5,208	0.5	0.2	0.0	0.0	0.0
Components of revenue							
12. Total Taxes		223,057	21.8	22.6	23.1	23.3	23.6
12a. Indirect taxes	D.2	112,914	11.0	11.4	11.8	12.0	12.1
12b. Direct taxes	D.5	105,107	10.3	10.8	10.8	10.9	11.0
12c. Taxes on capital	D.91	5,036	0.5	0.5	0.5	0.5	0.5
13. Social contributions	D.61	130,438	12.8	12.6	12.5	12.3	12.3
14. Investment income	D.4	10,808	1.1	1.1	1.0	1.0	1.0
15. Other		21,947	2.1	2.2	2.2	2.2	2.2
16. Total revenue	**TR**	**386,250**	**37.8**	**38.5**	**38.8**	**38.9**	**39.0**
p.m.: Tax burden		339,071	33.1	33.9	34.2	34.5	34.7
Components of expenditure							
17. Compensation of employees and intermediate consumption (17a+17b)	D.1+P.2	172,579	16.9	16.4	15.7	15.0	14.2
17a. Compensation of employees	D.1	116,090	11.3	11.0	10.6	10.1	9.5
17b. Intermediate consumption	P.2	56,489	5.5	5.4	5.1	4.9	4.6
18. Social payments (18= 18a+18b)		197,901	19.3	19.2	18.8	18.4	17.8
18a. Social transfers in kind supplied via market producers	D.63 (1)	27,940	2.7	2.7	2.6	2.5	2.3
18b. Social transfers other than in kind	D.62	169,961	16.6	16.5	16.3	15.9	15.4
19. Interest expenditure	EDP D.41	35,096	3.4	3.5	3.6	3.7	3.8
20. Subsidies	D.3	10,447	1.0	1.2	1.1	1.1	1.0
21. Gross fixed capital formation	P.5	15,167	1.5	1.6	1.6	1.6	1.5
22. Capital transfers		10,158	1.0	0.5	0.5	0.5	0.4
23. Other		17,479	1.7	1.7	1.6	1.5	1.5
24. Total expenditure	**TE**	**458,827**	**44.9**	**44.0**	**43.0**	**41.7**	**40.1**
p.m.: Government consumption (nominal)	P.3	205,515	20.1	19.5	18.8	17.9	17.0

(1) D.63 = D.6311+D.63121+D.63131.

(*) 2013 financial assistance included.

(A) Advance; (F) Forecast.

Sources: Ministry of Economy and Competitiveness and Ministry of Finance and Public Administrations.

Beginning on the revenue side, there are several factors contributing to the increase in its share of GDP. Cumulatively between 2014 and 2017, discretionary measures addressed to increase revenues will focus environmental taxation; most of the increase would be essentially due to the positive composition effects caused by the recovery favouring the most important components in the structure of the collection, such as private consumption, labour income and imports. About half of the increase in this ratio will occur in 2014, while the other half is split between 2015 and 2017, years covered by the tax reform planned by the Government. This is consistent with the fact that the reform was not primarily designed for collection purposes but serves other key targets such as promoting growth. Thus, as it will be later explained in greater detail, the sum of the effects of the tax reform implies a net revenue loss; and yet, the composition effect manages to stabilize the revenues to GDP ratio by stimulating growth, both by injecting income and eliminating distortions in relative prices.

By revenue components, the greater weight gain over GDP corresponds to indirect tax revenues (1 point, up to 12% of GDP in 2017) benefited from the increase in collection from environmental taxation, Tax on Financial Transactions and the shifting to the standard rate of VAT for certain product categories by Community legislation. These are followed by direct taxes, whose weight rises 0.8 percentage points up to 2017, reaching 11% of GDP that year, especially driven by the beneficial effects of the fiscal and structural measures on activity and job creation. At the end of the forecast period, the difference of revenue from direct taxes with that of indirect taxes is 0.4 percentage points of GDP higher than in 2013, as a result of the change to a more efficient tax system composition through the reform, which will be launched in 2015. Finally, the overview is completed with the slight loss of social contributions share, of approximately 0.5 percentage points up to 2017, a year in which they will amount 12.3% of GDP, reflecting the wage restraint that characterizes the multiannual scenario and that is essential to further economic recovery.

From the expenditure point of view, the set of measures adopted over the four years covered by this Update (amounting to nearly € 40 billion) account for a substantial part of the ratio decline, with cyclical factors also being relevant, since they affect certain items, especially unemployment benefits, and the denominator effect of a nominal GDP in acceleration. Within expenses, the only component whose weight increases over the years are interest expenses, from 3.4 to 3.8% of GDP between 2013 and 2017, solely due to the volume expansion of public debt as the implicit interest rate remains almost stable over the medium term. This means that primary spending would have declined even more, down by 5 percentage points from 2013 until 2017.

Due to the magnitude of the decrease in its weight on GDP, 3 percentage points to 17.1% in 2017, public consumption should be noted. Within it, its main items take part in this downward trend: compensation to public employees would lose 1.7 percentage points, reaching 9.6% of GDP in 2017; intermediate consumption, 0.8 percentage points to 4.7% at the end of the projection period and in-kind transfers 0.4 percentage points, dropping to 2.3% of GDP in 2017. This result is essential to ensuring the sustainability of fiscal consolidation, because it reveals a greater efficiency in the internal running of the Public Administrations, which without leaving the provision of services or basic social benefits aside carries out its functions at a lower cost. This is possible thanks to a set of measures related to downsizing and lightening administrative structures, such as those arising from the implementation of the recommendations of the CORA report for efficiency and modernisation of Public Administrations, the reform of the Local Administration that has created a system of cost transparency and control and the elimination of duplications, the maintenance of austerity in personnel management policies (e.g. the rules on limitation of staff replacement or freezing salaries of civil servants) or containment of pharmaceutical expenditure by Regional Governments and improving efficiency in the delivery of public services at all levels of Public Administrations. Regarding Regional Governments, it is expected that within the Council of Fiscal and Financial Policy agreements on structural expenditure reduction through improved efficiency measures will be reached.

Another fundamental aspect due to its importance within the total expenditure is not in-kind social benefits, which will reduce their share of GDP from 16.6% to 15.5% mainly due to two reasons. The first one, cyclical in nature, is the decline in spending on unemployment benefits, estimated to stand at approximately € 6 billion between 2013 and 2017. The second one is related to the introduction since 2014 of the revaluation factor in the pension system (see chapter 6), which will lead to increasing each pension by 0.25% yearly during this period.

Finally, among the expenditure categories that would further explain the rest of its decrease, capital transfers are included, with 0.5 percentage points drop (down to 0.5% in 2017), mainly due to the differential impact of the expenditures related to recapitalisation of financial institutions up to 2013. In addition other current expenditure should also be considered (with a weight decrease of 0.2 percentage points, down to 1.5%), including current transfers whose containment is the aim of an important number of measures planned by the Public Administrations. The remaining components of expenditure would remain essentially stable over the projection period, with small oscillations that tend to cancel themselves. The effort to stabilize the ratio on GDP of public gross fixed capital formation deserves special mention, as it had already experienced a significant setback in recent years and it is an important source of economies of scale and efficiencies in the private sector.

The expenditure structure reconstruction towards reducing overall operating costs of the Administration can also be seen in Table 4.3.1.2 regarding expenditure by function, in which the role of social protection (-7.5%, to a large extent due to the unemployment decrease) is the one showing a smaller fall among all those taken into account while general public services (+4.8%) show an increase due to higher interest payments. Regarding the health section, with a fall of its weight in GDP of 13.2%, it is influenced by measures to improve the ability to purchase inputs at lower prices by the Administration or the rationalisation in financing of drugs, rather than any lower level of service rendering.

Table 4.3.1.2. Change in the expenditure structure by function

	Weight of 2012 GDP expenditure (*)	Weight of 2017 GDP expenditure	Variation % Weight in the GDP
Public Administrations (S.13)			
01 General public services	6.1	6.4	4.8
02 Defense	1.0	0.8	-15.6
03 Public order and security	2.1	1.8	-15.1
04 Economic affairs	7.7	3.5	-54.4
05 Protection of the environment	0.8	0.7	-17.7
06 Housing and community services	0.4	0.3	-27.8
07 Healthcare	6.2	5.3	-13.3
08 Leisure activities, culture and religion	1.3	1.1	-16.8
09 Education	4.5	3.9	-13.6
10 Social protection	17.7	16.4	-7.5
Total expenditure	**47.8**	**40.1**	**-15.9**

(*) Financial assistance included.
Sources: National Institute of Statistics, Ministry of Economy and Competitiveness and Ministry of Finance and Public Administrations.

The following table summarizes the main policy changes and their differential impacts on income and expenditure compared to the previous year in the period 2012-2016.

Table 4.3.1.3. Impact of the main regulatory changes
Measured by their differential effect with respect to the previous year
% of GDP

	2012	2013	2014	2015	2016
Expenditures	**2.54**	**1.44**	**0.71**	**0.82**	**0.69**
Public employees extra payment 2012	0.49	-0.49	0.00	0.00	0.00
Public employment (personnel measures)	0.02	0.34	0.16	0.10	0.09
Labour market policies	0.10	0.27	0.13	0.00	0.00
Long-term care policies	0.02	0.14	0.00	0.00	0.00
Other General State Budget expenditure (including CORA)	0.85	0.42	0.13	0.11	0.11
Autonomous Community measures	0.93	0.69	0.14	0.16	0.13
Local Corporations measures	0.15	0.07	0.10	0.35	0.25
Social security expenditure	0.00	0.00	0.06	0.09	0.10
Revenues	**1.75**	**1.74**	**0.93**	**0.15**	**-0.08**
Total tax	**1.09**	**1.27**	**0.40**	**-0.19**	**-0.30**
Personal Income Tax and Non-resident income taxes	0.35	0.22	0.02	-0.23	-0.21
Corporate income Tax	0.45	-0.04	0.21	-0.06	-0.18
Special Tax Regularization (DTE) and combating fraud	0.12	-0.01	0.10	0.00	0.00
Excise duties and environmental taxes	0.03	0.30	0.06	0.00	0.09
VAT	0.15	0.79	0.01	0.04	0.00
Others (taxes & FTT)	0.00	0.01	0.00	0.06	0.00
Autonomous region measures	**0.37**	**0.22**	**0.33**	**0.12**	**0.16**
Local government measures	**0.09**	**0.10**	**0.09**	**0.12**	**0.06**
Social Security contribution	0.00	0.16	0.11	0.10	0.00
Combating Social Security fraud	0.19	0.00	0.00	0.00	0.00
Total	**4.29**	**3.18**	**1.65**	**0.97**	**0.61**

Source: Ministry of Finance and Public Administrations.

The main categories of measures are reviewed in detail below.

4.3.2. Tax Policy

MEASURES ADOPTED SINCE THE 2012 AND 2013 PROGRAMMES

Since 2012, Spain has adopted fiscal measures intended to meet deficit targets and the Recommendations made by the ECOFIN Council on the Stability Programme for 2012. Specifically, there has been a rebalancing of direct and indirect tax burden on labour and what is known as a fiscal devaluation. Elements of this process have been the VAT, excise and environmental taxes progressive increase in 2012 and the reduction of social security contributions for new permanent contracts in 2014 (100-euros flat fee).

In order to shift taxation from labour to consumption and environmental taxation, and to tackle the low level of VAT revenues, VAT rates were modified in 2012. Specifically, by Royal Decree-Law 20/2012 of 13th July on measures to ensure budget stability and to promote competitiveness, the tax base was extended by reclassifying goods and services subject to the reduced or super-reduced rates. In addition, the standard VAT rate was increased from 18% to 21% and the reduced rate from 8% to 10%.

In relation to environmental taxation, Law 15/2012 of 27th December on tax measures for energy sustainability, created three new taxes: on the value of electric energy production and on production and storage of used nuclear fuel, and increased taxation of excise taxes, such as hydrocarbons[4].

On the other hand, in order to ensure a taxation which incentives less indebtedness and home ownership, Personal Income Tax was modified. Specifically, by the above mentioned Royal Decree-Law 20/2012 the tax deduction for first home acquisition bought before January 20, 2006 is eliminated. Moreover, this measure was supplemented by Law 16/2012 of 27th December, under which several tax measures are adopted to consolidate public finances and boost economic activity. With regards to personal income tax, this law includes the elimination of the deduction for first home investment for new purchasers as of the first of January 2013.

In connection with the debt, and the need to discourage it, Royal Decree-Law 12/2012 of 30th March, under which several tax and administrative measures aimed at reducing the public deficit were introduced, limited the deductibility of companies' financial expenses. The aim of this measure was to broaden the tax bases and to reduce the high leverage. The measure establishes the non-deductible nature of those financial expenses generated within the commercial group, intended to carry out certain intragroup transactions unless it can be proven that the transaction responds to a valid economic reason. Additionally, a limit to the amount of deductible financial expenses in the year is established. This limit is a maximum of 30% of the operating profit for the year or a million euros, whoever is lower. Those expenses that were not deductible in the year will be in future periods, up to a maximum of 18 years.

[4] Additionally, Law 2/2012 of 29th June on the Spanish National Budget for the year 2012, and in line with the EU Directive applicable to energy products, rate 0 on biofuels is revised upwards as of the 1st of January, 2013, since they will be taxed at the same rate as the products into which they are incorporated

In addition, Royal Decree-Law 20/2012, of 13th July, amended the limitation on the deductibility of financial expenses, extending it to all companies in general, not limited to their membership to a trade group.

Additionally, in order to contribute to the recovery of public finances, since 2012, the tax rates for Personal Income Tax and deductions for economic activities were temporarily increased to 21%. Moreover, numerous measures related to Corporate Income Tax have been approved, many of them of a structural nature and others with a temporary nature through various Royal Decree-Law. Specifically, in the Corporate Income Tax, by Royal Decree-Law 12/2012 and 20/2012, measures such as limiting the deductibility of goodwill; the minimum instalment payment on income (by 12%); increasing the tax base for instalments with 25% of the amount of dividends and incomes to which the exemption for international double taxation is applicable; increasing the rates of partial payments for entities with a business turnover index exceeding net amount € 10, 20 and 60 billion (increasing from 21, 24 and 27%, to 23, 26 and 29% respectively); limiting the deductibility of financial expenses or limiting the compensation of negative tax rates in entities with a net turnover index exceeding € 20 billion (moving from 75 to 50% or from 50 to 25%, depending on whether the turnover index is less or greater than € 60 million) were approved. On the other hand, Law 16/2012 partially restricted tax deductible depreciation to 70% of the planned amount for large companies.

In addition, in the Property Tax, the tax rate for urban property was increased for the years 2012 and 2013, and this rise has been extended.

With regards to personal income tax, a special tax for prizes of lotteries (20% for prizes above € 2,500) was also introduced by the aforementioned Law 16/2012.

Additionally, the term of the Wealth Tax has been extended.

MEASURES ADOPTED FROM THE STABILITY PROGRAMME 2013 UNTIL THE PRESENT UNDER THE IMPLEMENTATION OF THE COUNCIL RECOMMENDATIONS

The ECOFIN Council recognised in July 2013 the efforts made by Spain and following the Stability Programme of Spain, it approved specific recommendations and specifically stated that the following aspects should be further deepened:

a) To consider a bigger limitation of the tax benefits in direct taxation

By Law 16/2013, of 29th October, the Consolidated Text of the Corporate Income Tax Act was modified for the purpose of ending the deductibility of the impairment of shares in the capital of companies and of negative income obtained abroad by permanent establishments. This measure seeks to avoid double deductibility of losses, in the first place, in the head office of the entity or permanent establishment that produces them, and, in the second place, in the investor's head office or headquarter. With these measures, the tax legislation of Corporate Income Tax approaches that of the surrounding countries.

In this Act 16/2013 the temporary measures established in the regulations of the aforementioned Corporate Income Tax have also been extended, contributing to limit tax benefits in direct taxation. Specifically, the limitation of 50% or 25% has been extended in offsetting negative tax bases for entities with turnover indexes above certain thresholds, the limitation of the deductibility of goodwill and intangible assets with indefinite service life by 1% and 2% respectively, the minimum instalment payment of 12% for entities with turnover indexes above € 20 million, increased rates for partial payments for entities with turnover indexes above certain thresholds, the inclusion in the basis of dividend instalment payments and income from transfer of shares entitled to exemption rights until 2015 and, finally, the limit of 25% or 50% in deductions for the promotion of certain activities.

These measures allow maintaining the positive trend in tax collection and contribute to the widening of the tax bases to continue recovering the effective taxation by the tax.

In addition, the aforementioned Law 16/2013 also gives continuity to the rise in the tax rate of Property Tax, established in December 2011 to increase the resources of Local Entities.

b) To explore the existing margin for further limiting the application of reduced VAT rates and to adopt additional measures with regards to environmental taxes

Also by Law 16/2013 of 29th of October, the new tax on fluorinated gases is set as of January 1, 2014, which will contribute to achieving the environment targets, in line with the basic principles governing the fiscal, energy and environmental policy of the European Union.

It is an indirect tax applied on the consumption of fluorinated greenhouse gases[5] and levies, in a single stage, the offer of these products in response to the global warming potential (GWP). The introduction of this tax continues the reform of environmental taxation carried out by means of Law 15/2012.

Moreover, by Decree-Law 7/2013 on urgent tax, budget and research, development and innovation promoting measures, of 28th June, the taxation of consumption with negative externalities, such as tobacco and spirits of medium and high alcohol content, rose. Regarding alcoholic drinks, taxation on intermediate products, as well as on alcohol and alcoholic beverages rose by 10%, without affecting beer or wine. As for tobacco, the tax structure is rebalanced so that the specific rate has more weight compared to the "ad valorem", approaching the current structure in most countries of the European Union. These developments also involve the introduction of instruments for achieving savings in health policy.

c) To adopt additional measures to reduce the bias in favour of indebtedness in corporate tax

The debt/equity ratio of firms, according to the latest estimates from the Bank of Spain based on the Central Balance Sheet data, fell in December 2013 to 109.3 per cent, its lowest level since June 1998.

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[5] Gases that are routinely used in many sectors, such as refrigerants, solvents, foaming agents and fire extinguishing agents

Although the maximum of the time series was reached in 2002 (123.7 per cent), in 2006 a new peak in the series was reached, which remained at approximately 122 per cent in 2007. Over a period of more than four years up to December 2011, the ratio dropped by 3 percentage points (with slight rises in 2010 and 2011).

In the two years from December 2011 to December 2013, it fell by almost 10 percentage points, especially in 2013 when the reduction accelerated with a decline that, according to estimates from the Bank of Spain, could reach more than 7 percentage points in one year and that was the maximum annual decline since 1995. Consequently, a more than three times higher adjustment took place in less than half the time.

These facts are a reflection of the effectiveness of policy measures adopted since 2012 to fiscally discourage companies' indebtedness. Among these measures, the already mentioned limitation of the deductibility of financial expenses, and two new measures adopted in September 2013 on the establishment of incentives for business capitalisation, stand out. This is a new deduction for reinvestment of corporate profits and the investment in new companies and so-called "business angels", both approved by Law 14/2013 of 27th September, to Support Entrepreneurs and their Internationalisation.

Deduction for ordinary profits reinvested in small companies

The measure seeks to encourage capitalisation as an alternative to indebtedness and therefore improving the financial position of small companies by increasing equity.

Small companies (net amount of turnover index below € 10 million) may apply a general deduction of 10% to the whole amount of the Corporate Income Tax derived from the benefits in the tax period that are effectively taxed and that are invested in new tangible or intangible fixed assets linked to the economic activity.

Business Angels: Law 14/2013

It aims to promote the attraction of equity by new or recently created companies. The individual investor (legal person) in such companies enjoys a double tax benefit:

a) At the time of the investment: a deduction of 20% of the state share of his / her personal income tax, on a maximum amount of € 50,000.

b) At the time of the subsequent divestment (i.e., when he / she sells the temporary stake in the business): enjoys full exemption from the capital gains that may be generated, provided they are reinvested in a new or recently created company.
In addition, it should be noted that Royal Decree-Law 4/2014, of 7th March, that implements urgent measures on refinancing and restructuring of corporate debt, has been recently approved with the aim to facilitate the survival of operationally viable businesses, but whose funding generates burdens that can cause their liquidation.

In this Royal Decree-Law, several tax measures are applied to the Corporate Income Tax and the Tax on Document Duties, pursuing to promote debt restructuring agreements for companies. Specifically, the following measures can be highlighted:

- Capitalisation of debts (capital increase as a result of compensation credits): in debt capitalisations for the debtor, a taxable capital gain will stop taking place when such debts have lost value compared to their nominal value. The tax treatment is therefore differentiated from the accounting treatment, by the introduction of the corresponding non-accounting adjustment in the Corporate Income Tax return.

- Incomes from acquittals and moratoria: the rule for assignment of income from refinancing agreements by the difference between the previous financial liability (debt) and the new financial liability agreed is amended, to regulate its fiscal taxation, while generated additional financial costs take place. If these are not enough to absorb the deferred income, a proportional rule will be used. Since it avoids a tax burden in the refinancing agreement year, these negotiations are facilitated.

- Exemptions in capital transfers and documented legal acts: the existing exemption in capital transfers and documented legal acts in all refinancing agreements and out-of-court payment agreements regulated by the Bankruptcy Act is extended.

All these measures will help reduce the debt bias.

d) To strengthen the fight against the informal economy and undeclared work

The measures included in the Law 7/2012, of 29th October, amending tax and budget legislation and adapting financial legislation to step up proceedings to prevent and fight fraud were fully implemented in 2013.

The purpose of the Law is to strengthen domestic legislation so as to highly restrict opportunities to defraud. It includes the following measures:

a. *Limiting the use of cash in business/professional transactions*

Scope: Transactions in which one of the parties acts as employer / professional. Not applied to transactions exclusively between individuals, or transactions in credit entities. In general, the limit is € 2,500. However, the limit is € 15,000 when the payer is a non-resident.

Failure to fulfil the measure results in a fine of 25% on the payment value settled in cash, both to the payer and the recipient of the payment (jointly and severally liable). However, the fine is waived to the party that voluntarily communicates the cash payment to the Administration within three months from the payment date.

b. *Measures associated with the asset regularisation programme*

A new obligation to report on accounts, securities and real estate located abroad is created, using the model 720, and, in case of non-compliance, a specific penalty is applied (€ 5,000 for each data or data set missing, with a minimum of € 10,000).

The non-applicability of the undeclared income is established. Exposed income which has not been declared shall be charged in the last fiscal year from those not prescribed.

c. *Exclusion from the modules system*

Exclusion of the objective assessment scheme for employers who invoice less than 50% of their transactions to individuals is set. This exclusion will only be applicable to employers whose total gross salary income of the previous year exceeds € 50,000.

d. *New measures to ensure the collection of tax debts:*

- Referrals of responsibility.
    - Extended liability of successors of companies which are to be liquidated for capital payments received prior to the formal liquidation.
    - Creation of a new case of vicariously liable for withholdings or implications: to managers of companies repeatedly presenting withholding or charged tax returns without proceeding to the tax debt settlement.

- Precautionary measures.
    - Possibility to adopt precautionary measures at any time during the tax audit and inspection procedure, including criminal tax offense processes.
    - Prohibition to take the property of those companies whose stakes or shares have been largely seized due to their belonging to a defaulter.

e. *Other measures included in Law 7/2012*

Sanctions in cases of taxpayer resistance during inspections get tighter.

The investment mechanism of the taxable person in cases of waiver of VAT exemption linked to the transfer of rural land, and to the second and subsequent sales of buildings, as well as the delivery of property in execution of the security right in the same, is established in the Value Added Tax in order to avoid the double injury that the lack of output VAT income and deduction of input VAT implies for the Administration. This investment rule of the taxable person will also be applied to subcontractors.

Standards leading to reconcile the legislation regulating the VAT with the insolvency legislation, in order to ensure tax neutrality and prevent abuse of the bankruptcy law, were introduced.

Article 108 of the Securities Market Act is amended to become a real anti fiscal fraud rule, intended to tax possible transfers of securities carried out in secondary markets, with the tax that would have corresponded to the onerous transfer of property belonging to companies represented by these securities.
Furthermore, by Organic Law 7/2012 of 27th December, amending Organic Law 10/1995 on the Criminal Code in terms of transparency and the fight against tax fraud and social security, the non-cessation of the settlement management or the debt payment due to the fact of remission of the Public Prosecutor is expected and an aggravated rate is created for defrauded amounts exceeding € 600,000, whose punishment is up to 6 years imprisonment with the consequent prescription after 10 years (art.135 bis).

Results

It should be noted that the Tax Agency received € 11 billion in 2013 as a result of its work in preventing and fighting fraud (€ 10.5 billion for homogeneous y-o-y comparisons)

These results consolidate 2012 and 2013 as the best of the Tax Agency time series, results which are also achieved in a context of deep decline in the tax bases subject to verification. Thus, the weight of revenues from the fight against fraud in relation to GDP consolidates the increase in recent years, from 0.6% in 2005 and 0.8% in 2009 to more than 1% of GDP in 2012 and 2013.

Furthermore, in order to increase tax revenues and strengthen the fight against tax fraud, the Tax Agency approved in 2014, extraordinarily, to draft a Special Plan to Intensify Actions which aims at increasing the contribution of tax revenues to finance various public services and to reduce public deficit. The Special Plan implies increasing officials' workload, with the possibility of receiving an additional variable remuneration only if the additional collection goals set are achieved, namely € 1.6 billion plus income from fraud control on the target initially planned.

The Tax Control Plan of the Tax Agency for 2014 will maintain as a priority objective the strategy to combat black economy, seeking the early detection of hidden activities and enhancing in-person interventions. The main innovation in this area will be the starring role that will be played by staff specialised in computer audit techniques, whose control unit is in the National Fraud Investigation Office, in order to detect tampering of ledgers and record books, keeping double accounting or partial concealment of the activity. In-person interventions aimed at analysing billing and payment methods will also be a priority. This milestone is considered particularly relevant because the use of computer auditing techniques, and generally, the computerisation of the mechanisms to combat fraud, highlight the trend of tax control towards integrated computer systems (electronic invoices, audits...) that anticipate the control moment.

e) To conduct a systematic review of the tax system by March 2014

By Agreement of the Council of Ministers of the 5th of July, 2013 a Committee of experts was created to reform the Spanish tax system and it produced a report with recommendations for a simpler, more neutral and efficient tax system, to ensure the adequacy of incomes with respect to the constitutional principles of economic capacity, generality, equality and progressiveness and to the fiscal consolidation commitment entered. The committee submitted its report on Thursday, the 13th of March, 2014, as scheduled.

From the report, the Government will carry out an analysis and assessment of the proposals contained in it in order to include those deemed appropriate in the regulatory reform bill that will be proposed to the Legislative Power.

The Report proposes a comprehensive reform of the tax system that will help to modernise the Spanish economy. 270 amendments to the tax and social contributions, grouped in 125 proposals, are suggested. The report is structured around two large reform blocks:

First block: An offset reduction of direct taxes and a boost to environmental taxes and to the fight against fraud.

Regarding direct taxes, experts propose a reduction of personal income tax to boost the economy and savings, and a Corporate Income Tax to help recapitalise companies, combining the reduction of tax rates with the elimination of some tax benefits that cause distortions in these taxes. Thus, it helps to encourage savings and growth and reduce debt.

Additionally it aims to intensify the fight against fraud by, for example, reducing the so-called estimate "objective systems" (modules). In addition, they propose a reform of environmental enforcement to meet the target related to the reduction of negative externalities arising from certain activities.

The Report also includes an analysis of the effects of regional financing on market unity and tax neutrality, with proposals for its reform, so that the tax system is harmonised in the common territory.

Second block, in the longer term: a fiscal devaluation.

In the longer term, they propose a reduction in social contributions for the lowest incomes to increase employment and a VAT reform that hardly affected consumption (driven by the reduction of personal income tax). This second block is postponed until a time of increased strength of domestic demand and lower public deficit.

In addition, a proposal to replace the housing tax being charged on personal income tax is included when land register authorities update property valuations.

Selective tax measures addressed to boost growth.

Apart from measures addressed to improve the structure of the tax system, a series of measures have been adopted aimed at supporting business structure and encourage job creation.

Among the already approved measures, those contained in Royal Decree-Law 4/2013 of 22nd February, on measures to support entrepreneurs, stimulate growth and create employment, must be highlighted. On one hand, a more favourable tax regime is set for self-employed persons initiating an entrepreneurial activity with the aim of encouraging business start-up operations and reducing the tax burden during the first years of exercising a professional activity. Thus, in the field of Corporate Income Tax, a tax rate of 15% for the first € 300,000 of taxable income, and of 20% for the excess on this amount is set. In line with this, a further reduction of 20% on net income of the economic activity received from taxpayers who have begun the exercise of an economic activity is established in the Personal Income Tax, applicable in the first tax period in which net return is positive and in the following tax period. The currently applicable limit to exemption from unemployment benefits is also removed in the single-payment option.

In September 2013, under Law 14/2013 of 27th September, to support entrepreneurs and their internationalisation, several measures aimed at reviving the activity and employment with little budget cost were approved:

Cash VAT: the cash basis special regime on a voluntary basis for taxpayers whose turnover during the preceding calendar year did not exceed € 2 million is created, effective from the 1st of January, 2014. This regime will allow paying the VAT when an invoice is paid or collected. Customers of suppliers applying the cash regime may not deduct VAT incurred until the payment is completed. When the period for availing the cash VAT ended last year, the small number of applications submitted, partly reflects the positive results of the measures aimed at reducing arrears in the public sector. The State Administration’s latest default figures, showing an average payment period reduction from 41.72 days in the fourth quarter of 2012 to 24.68 days in the same period of 2013 decreased the incentive for agents to request the application of cash VAT, benefit investment deduction, already mentioned.

Tax incentives for R&D: deductions for expenses and investments in R&D may be applicable as an option, without being subject to any limit on the quota and they will be paid, with a combined discount of 20% on its amount, provided they cannot be applied due to insufficient quota.

Extension of the "patent box" (reduction of income from certain intangible assets): the integration percentage of the income from asset usage transfer or exploitation in the tax base will stand at 40% (60% reduction).

In the second half of the year, the processing of the tax reform, that aims to be comprehensive, will be carried out. The aim of the reform is to suggest an improvement of the system efficiency, to rebalance the amounts of direct and indirect taxes in total collection. When a level of collection that allows to sustain revenue to GDP at approximately 38%-39% with stability is reached, as was proposed in the mid-nineties, the Government will take this opportunity to restore the tax structure, returning collection to the society.

On these principles, a gradual tax reform to simplify the tax system and encourage growth and employment will be approved. The gradualness of the reform will give a signal of fiscal policy in the medium and long term that sustains the confidence of agents in the continuous improvement of system efficiency, as well as in the compatibility of the reform with the sustainability of public finances. The impact of the reform, through efficiency gains and boosting domestic demand, will contribute to GDP growth resulting in increases in collection at a level that will ensure the sustainability of the tax revenue ratio on GDP in the medium and long term.

In the field of personal income tax rate, a total impact of approximately € 5,000 million is calculated in 2015 and 2016. This is a substantial impact on the liquidity of agents, compatible with the maintenance of the collection ratio on GDP. In order to calculate its amount, the positive impact of the new macroeconomic picture on tax bases and collection has been taken into account.

In turn and as of 2016, the Corporate Income Tax reform is intended to have effect on the collection. Stimuli for the progressive deleveraging of companies will be maintained, while reforms to approximate nominal to effective rates will be introduced.

In the field of estate taxation, an exercise to review the different taxes will take place, in order to progressively bring together the tax bases and goods ownership, thereby decreasing the emphasis on the transmission. It is a reform line that respects the recommendations of the Committee of experts and international organisations, which will help to stabilise collection and to improve efficiency of the tax system.

As regards indirect taxation, the review of the tax reform will focus on boosting environmental taxation at all levels of the Public Administrations, aimed at correcting externalities. In excise taxes, any reform is subject to the new European Directives. As of 2015, the projections also include the potential impact of a future tax on financial transactions, which will respect schedules and guidelines agreed within the European Union.

The right time to tackle the tax reform is now. In early 2014 a remarkable recovery in tax revenues was observed. Tax revenues accrued up to March amounted to € 38.9 billion, representing an increase of 7% compared to the same month of 2013. In homogeneous terms, calendar adjusted, growth stood at 4.7%, consistent with the tax revenue of the Spanish National Budget forecast for 2014.

This recovery of income at the beginning of 2014 is due to an improvement of tax bases since the third quarter of 2013, a period in which tax bases aggregated from incomes and spending rose by 4.4%, the first positive figure since mid-2010. In 2013 as a whole, the aggregated tax base declined for the sixth consecutive year (-1.9%), although it is the lowest rate of decline since 2007 and it is almost one point lower than that recorded in 2012 (-2,8%). The best performance during the second half of the year is observed in all components: gross household income is stabilised by the lower loss of employment; reported profits of corporations have positive rates since mid-year; and spending subject to VAT, which began the year with a strong contraction, has recovered in recent months thanks to the favourable evolution of household consumption.

Table 4.3.2.1. Tax bases of the main taxes in accrual terms

year-on-year % change

	2011	2012	2013	III.12	IV.12	I.13	II.13	III.13	IV.13
Tax bases	**-2.7**	**-2.8**	**-1.9**	**-0.5**	**-4.2**	**-5.0**	**-4.9**	**-2.4**	**4.4**
On income	**-1.5**	**-2.3**	**0.5**	**0.1**	**-4.1**	**-0.7**	**-3.2**	**-0.1**	**5.5**
On expenditures	**-4.3**	**-3.4**	**-5.1**	**-1.4**	**-4.5**	**-10.2**	**-6.9**	**-5.7**	**2.8**
· Gross household income	0.4	-4.2	-1.7	-3.8	-7.5	-3.7	-3.2	-2.1	2.2
· Corporate income Tax base	-15.0	14.2	15.9	15.1	32.3	22.1	-	6.3	30.1
· Final expenditure subject to VAT	-5.8	-4.5	-5.0	-2.3	-5.8	-10.8	-7.6	-5.5	4.4
· Consumption subject to excise duties	4.0	1.6	-5.3	2.3	2.1	-7.3	-3.3	-6.5	-4.2

Source: Tax revenue monthly report. February 2014. Tax Agency.

Revenue growth of SMEs and self-employed persons in the first quarter of 2014 is particularly remarkable. Excluding the periods affected by regulatory impulses (withdrawal of the 400 euros deduction or the VAT rate increase in July 2010), in comparison to the same period last year, up to March 2014, growth rates of revenues from SMEs / self-employed persons for working retentions (4.6%), gross VAT (6.1%) and partial payments (6.3%) are the highest ones since 2007 (mid-2008 in the case of employment retentions).

4.3.3. Labour Market and Social Security Measures

As of December 2013, a series of measures in the Social Security field addressed to increase revenues and to reduce costs were announced. Among the revenue growth measures, the bases changes and the move from a self-assessment system to one of open settlement of Social Security contributions can be highlighted. With regards to the measures aimed at reducing spending, those affecting Mutual Insurance Companies for Occupational Accidents and the Wage Guarantee Fund (known in Spanish as FOGASA) can be highlighted.

Royal Decree-Law 16/2013 introduced some measures addressed to increase revenues. Specifically, the calculation of the bases that now include certain payments in kind, such as luncheon vouchers, aids to transport or company cars that previously were not subject was amended. In addition, the Royal Decree-Law revised upward the contribution bases of self-employed persons.

On the other hand, the General Treasury of the Social Security is preparing the move from a self-assessment system of contributions to one of open settlement, in which the Treasury would calculate the quotas. In this system, the Social Security would directly invoice contributions to companies, indicating how much they must pay for each worker. This change will be processed as a Bill and in January 2015 it will be mandatory for all companies. Since November 2013 this system is being tested on some large companies to remove errors and this phase is expected to be completed in June 2014. The new system will be used from September by entities collaborating with the Social Security and as of January 2015 it will be mandatory for all companies.

In the case of expenditure, the fifth Final Provision of the Spanish National Budget Law withdrew the FOGASA coverage for eight days in the event of termination of permanent contracts for economic, technical, organisational or production or competition causes in companies with less than 25 workers. On the other hand, in April the Government submitted a Bill to the Congress amending the Social

Security Law including, amongst other measures, the allocation to Mutual managing benefits for incapacity for work.

The expected effect of these measures is estimated to be approximately three billion euros per year when they have all come into force, with a minimum of two billion in 2014 and one billion in 2015. Of these taxes, on the expenditure side, one billion euros are expected in 2014 and this adds to the impact of measures already planned and launched since the previous programme in Labour Market policy of € 327 million and one billion in 2014 of increased income from Social Security in addition to what was provided in the measures already in force in 2013 for Social Security, after discounting the negative budget effect of the flat rate in the first year. However, the flat rate of Social Security is expected to have a return on economic activity and increased revenues by collecting other taxes from employment and consumption. In 2015 it is still expected that the measures have an impact, especially the liquidation system change that needs implementation time.

As for the pension reform measures, the expected impact on the above programme was slightly reduced by some changes in the final approval, affecting the revaluation index upward, and that only have effects in the short term. The impact of all the Social Security reforms in pensions in 2013 implies an upward savings path from € 574 million in 2014 to over € 1 billion in 2017.

4.3.4. Public Administration Reform

With the establishment of the Commission for the Public Administrations' reform in 2012, a reforms process began that seeks to make a relevant qualitative change to the operation of Public Administrations and their relationship with citizens, addressing four key challenges for this purpose: the organisational challenge, which requires reviewing the organisation of the General State Administration, the regional challenge that requires a coordinated action by all public administrations, the technological challenge, that demands the full adaptation of the public administrations to changes of this nature and all of this in a budget rigor scenario, which brings us to the fourth challenge, the economic and budget challenge.

The CORA final report, presented by the Prime Minister on the 19th of June, 2013, seeks to address a comprehensive reform, affecting all Administrations (central, local, and regional), and a transversal reform, since it affects multiple functions performed by public institutions. This is a set of reforms that tackle from the institutionalisation of budget stability, to the distribution of powers amongst the Administrations, the market unity, efficiency gains through the centralisation of decisions, organisational changes to adapt to management improvements in the Administration (boost of the electronic Administration by means of the *Emprende* project on 3) or liquidity measures (Supplier Payment Fund and Regional Liquidity Fund) and regulations on electronic invoicing and commercial debt limit to solve the default problem of late payment in Public Administrations.

Even though in many cases the measures introduced in the CORA report provide new approaches, they fit within and give continuity to the targets set out regarding both fiscal consolidation and structural reforms. It is a reform process that, according to the latest monitoring report, presents a good implementation pace, since at the end of the first quarter of 2014, it has reached the 29.41% of the total compliance of the measures, with a total of 221 measures implemented or completed.

In any case, and as reflected in the reports, CORA was set up from the beginning as a live action constantly updated, so it is always open to incorporate new measures to rationalise and reform the Administrations in order to serve citizens and businesses more efficiently.

The public administration reform designed by CORA, has an additional total impact estimated in € 2 billion up to 2016. This net impact includes only the CORA measures not already established in other policies discussed in this report, and therefore excludes the local reform and staff policy, that are nevertheless part of the reform in CORA's broad scope.

The comprehensiveness, relevance and leadership of the exercise carried out by CORA were recently recognised by the OECD ("Spain: From administrative reform to continuous reform." OECD studies on public governance. April 2014), which concludes with the formulation of recommendation for its better execution and an overall positive evaluation.

Thus, at this level the impact of measures already foreseen in the budget plan for 2014 and in the effective action report, is maintained, which mainly stems out from the CORA report and from the actions of non-replacement of public employees, of temporary disability, wages containment, etc. The public employee decrease in all Public Administrations of approximately 300,000 public employees in the past two years, according to the Labour Force Survey, stands out. The impact of each measure on an annual average is of approximately € 1 billion per year for the staff policy and jointly of € 1.2 billion for the CORA scope and the State Budgets. Ultimately, on the effects of staff policy in the field of Public Administrations, the Stability Programme includes measures to maintain the containment effort in wage bill costs at the current level, always keeping in mind that the reorganisation of staff in the public sector is considered to have reached the bottom.

The approval of the Government reform agenda in this area emphasises measures for staff mobility, which enables to efficiently dimension management centres, and to enhance the professional career prospects for the officers themselves, through a firm commitment to the internal promotion policy. These reforms are part of the Public Administrations reform (CORA), which has been endorsed internationally.

4.4. The role of Regional Governments and Local Entities in the fiscal strategy

4.4.1. Regional Governments

I. Budget for 2014

With regards to the fiscal consolidation effort of the different regions in 2014, non-financial expenditure considered in the initial budgets of the Regional Governments decreased by 1.8% compared to the initial budgets for 2013. If financial costs in Chapter III are not taken into account, the decline is higher, reaching 2.4%.

The non-financial revenues are reduced by 1% compared to the initial budget for 2013. In the analysis of income and expenses variations it should be taken into account that, in the initial budgets for 2013, the Regions considered a deficit target in national accounting terms of 0.7% of GDP, although this target was loosened later, settling at 1.3% for all the Regions as a whole.

The comparison of the budget for 2014 with the implementation of the budget for 2013, recognised rights or obligations, shows an increase in both non-financial revenues, standing at 3.4%, and in non-financial expenses, standing at 0.4%. However, if the evolution of non-financial expenditure is compared without considering Chapter III, which mainly includes the debt interests, non-financial expenses fall by 0.8%. If by 2013 the effect of the application to the budget of generated obligations and registered in non-budget accounts of previous years is not taken into account, the non-financial expense increases by 0.8%; however, if Chapter III is excluded, a decrease of 0.4% takes place.

Table 4.4.1.1. 2014 Budget of the Regional Governments

year-on-year % change

Total Regional Governments	Budget 2014 / 2013	Budget 2014 / Recognized Rights or Obligations 2013	Budget 2014 / Recognized Rights or Obligations 2013 Adjusted Account 413
Chap. 1,2,4. Taxes & Current Transfers	-1.4	0.4	0.4
System resources subject to payment and settlement	-2.8	-2.5	-2.5
Inheritance and Gift Tax	14.1	-5.8	-5.8
Property transfer & Stamp Duty Tax	-2.4	18.4	18.4
Other tax	2.6	11.9	11.9
Other current transfers	3.0	6.7	6.7
3. Fees, public prices and other Revenues	-9.0	-3.2	-3.2
5. Property income	264.6	186.7	186.7
6. Real investment sales	-4.4	328.7	328.7
7. Capital Transfers	-10.7	14.0	14.0
Non-Financial Revenues	**-1.0**	**3.4**	**3.4**
1. Personnel Spending	-0.6	1.8	1.8
2. Current spending in goods and services	-0.8	-4.2	-5.3
3. Financial Spending	7.8	22.0	21.9
4. Current Transfers	-2.7	-6.4	-4.8
5. Contingency fund	-2.2		
6. Real Investments	-10.6	6.1	7.7
7. Capital Transfers	-11.6	13.0	16.0
Non-Financial Expenditure	**-1.8**	**0.4**	**0.8**
Non-Financial Expenditure (Without chapter III)	**-2.4**	**-0.8**	**-0.4**
Source: Ministry of Finance and Public Administrations.			

From the functional point of view and considering the purpose of the budget, the health, education and social services items account for 59.7% of the total budget for 2014, compared to the 62.8% of the initial budget for 2013. The three items decrease: health by 0.4%, education by 1.4% and social services by 0.9%, even though general budgets in 2013 already underwent a major consolidation effort compared to 2012, as health fell by 6.5%, education by 8.4% and social services by 14.4%.

On the other hand, expenditure allocated to "Public debt" increased in 2014 by 43.4%, so it reached 18.9% of the budget for 2014.

II. 2013: First year with public debt targets

Organic Law 2/2012 on Budget Stability and Financial Sustainability brought in 2013, the first year of full applicability of the Law, significant and important progresses in relation to the control and monitoring of the public debt of the Regional Governments.

For the first time, as it happened with stability targets, annual debt targets were set, being maximum indebtedness limits, computed according to the Excessive Deficit Protocol methodology, and they were expressed in relation to regional GDP. The debt targets are set during the first half of each year for the following three years, both for all Regional Governments as a whole and separately for each one of them, and must be consistent with the corresponding stability targets and with the planned reduction debt path.

On the other hand, the Law provides a range of preventive, corrective and coercive measures related to the breach or risk of breaching the debt target.

As for the first ones and for the warning referred to in Article 19 of Organic Law 2/2012, in 2013 it was not issued to any Regional Government since the required conditions to establish, with a minimum degree of certainty, non-compliance with public debt target at the end of the year by any region were not met.

Regarding corrective measures, they shall be applied for the first time during 2014 in the event of failure to comply with the debt target; therefore, once verified, by April 15, the compliance or non-compliance of the public debt targets for 2013 of different regions, all those showing upward deviations from the target must submit an Economic-Financial Plan (known in Spanish as PEF) that will allow them to return to the compliance path during the current year (2014) and the following one. As it happens in cases of breaching the stability target, the PEF submitted by the Regional Governments will be monitored by the Ministry of Finance and Public Administrations, and in case of deviation of the Plan implementation, new measures to ensure compliance will be applied.

In turn, all debt transactions of the defaulting Regional Government will require approval of the State, as long as the above mentioned breach persists, except for credit operations in the short term that are not considered external financing, which will not require authorisation when the Council for Financial and Fiscal Policy deems the economic-financial plan submitted by the Regional government suitable.

Finally, the award of grants or the signing of agreements by the Central Administration with defaulting Regional Governments will need, prior to the granting or the signing, approval by the Ministry of Finance and Public Administrations (MINHAP).

With regard to coercive measures, the PEF presented by the Regions due to the failure to fulfil debt targets will be monitored by the MINHAP and in case of deviation in the Plan execution, Regional Governments will be required to adopt the measures included in it or new ones to ensure compliance.

The compliance report of 15th April has identified three Regional Governments that fail to meet the debt limit (Aragon, Castilla-La Mancha and Navarra) and the deficit target for 2013, like Catalonia, Murcia and Valencia. Therefore, these six regions will need to submit a PEF.

III. Measures decided by the Central Government and the Council for Financial and Fiscal Policy affecting Regional Governments

Health and education measures of Royal Decree-Laws 14 and16/2012 implied a major improvement in rationalising these costs in Regional Governments. The overall impact of the measures amounted to more than € 10 billion between 2012 and 2013, taking into account the annual impact on incremental terms; and it was very close to the forecast target of € 11 billion, which was considered particularly ambitious.

Table 4.4.1.2. Health and education spending. ESA 95

Million Euros

EXPENDITURES (EDP)	2012	2013	TOTAL
Health spending of the Autonomous Regions	**-2,830**	**-2,597**	**-5,427**
Compensation of employees(*)	-1,084	-1,236	
Intermediate consumption	216	-812	
Social transfers in kind	-1,293	-485	
Other expenditure	-669	-64	
Education spending of the Autonomous Regions	**-2,871**	**-1,759**	**-4,630**
Compensation of employees(*)	-1,413	-950	
Intermediate consumption	-503	-175	
Social transfers in kind	-357	-192	
Other expenditure	-598	-442	
Total	**-5,701**	**-4,356**	**-10,057**

(*) Extra payment (December 2012) effect not taken into account.
Source: Ministry of Finance and Public Administrations.

On the other hand, the measure of public spending contention through compensation to employees due to the abolition of a bonus in 2012 had a delayed effect on some Regional Governments that continued to reduce this type of compensation along 2013. The bonus effect implied a saving of almost € 3 billion in 2012.

Regarding Property Tax, the Royal Decree-Law 4/2014, of 7th March, modified the first transitional provision of Law 22/2009, of 18th December, that regulates the funding system of the common regime Regional Governments and Cities with a Statute of Autonomy and changes certain tax rules.

This amendment means that the payments made by the AEAT for the collections of revenues from Wealth Tax to the common regime Regional Governments for the liquidation of the resources of the Financing System in 2012 and subsequent years, will not be deducted.

Therefore, this decision contributes to fiscal consolidation efforts being made by the set of Regional Governments, providing them with additional resources (of approximately € 600 million in 2014 and € 1 billion in subsequent years) by the State, creating an incentive for tax (revenue not reflected in Table A.2 as it is in net terms for Public Administrations).

Within the Council for Financial and Fiscal Policy, the creation of a working group to review Regional Governments' public spending has been planned, since they are responsible for most of the structural expenses and also, once the other major structural components of expenditure have been reviewed such as expenditure on pensions and personnel policies and of administrations reform under the CORA's umbrella.

The Regional Governments under PEF due to failure to comply with the adjustment targets or plan by liquidity adjustment mechanisms will have to adopt the conclusions of this working group to improve the spending efficiency. The fields covered will be health, pharmacy, education, social services, privatisations and public-private partnerships, among others. This review will guide the reforms on the expenditure side, under fiscal projections with effect on public consumption.

MEASURES FOR 2012

Considered globally, Regional Governments that submitted a PEF have executed € 3.9 billion in revenues measures and € 12.5 billion in spending measures, considering the withdrawal of the bonus in 2012. So, from an aggregate point of view, the Regional Governments presented in 2012 an implementation rate of 80% of all the measures, according to the monitoring reports of the fourth quarter of 2012.

MEASURES FOR 2013

According to the information supplied on December 31, under the new procedures for data provision by the Regional Governments, all Regions have adopted expenditure measures in 2013 amounting to € 7.0 billion, of which € 2.5 billion relate to staff costs. On the revenues side, measures amounted to € 2.2 billion.

Actions aimed at reducing the overall remuneration, mainly through the suppression of supplements and bonus reductions, have particular relevance within the measures affecting personnel costs. Regions that have adopted these measures were Andalusia (€ 298.5 million), Catalonia (runs in 2013 and 2014, amounting to € 502.1 million) and Murcia (€ 43.3 million in 2013, and extends to 2014). All together these measures represent a total amount of € 843.9 million, of which € 298 million reverse in 2014.

Regions that in 2012 recorded a financing need above the budget stability target set for that year, had to draft an economic-financial plan in accordance with Article 21.1 of the Organic Law 2/2012 on Budget Stability and Financial Sustainability, of 27th April, which states that in case of failure to comply with the budget stability target, the public debt target or spending rule target, the defaulting administration will draft a PEF that will help to achieve compliance. Thus, during the Council for Financial and Fiscal Policy the PEF of the Regional Governments of Andalusia, the Balearic Islands, Catalonia, Murcia and Valencia were approved in July 2013. At the end of the year, Castilla-La Mancha and the Community of Navarra joined based on October data.

The amount of expense saving measures (excluding the effect of the withdrawal in 2013 of the 2012 bonus) and of increased revenue expected from these PEF for 2013, adapted to the new stability target, amounts to € 7.2 billion for this set of Regional Governments.

The remaining Regions, except for Galicia and the Basque Country, presented similar information to the Ministry of Finance and Public Administrations in the field of the adjustment plan, as a result of being attached to a special funding mechanism (mainly Supplier Payment Plan and Regional Liquidity Fund). This information is updated and sent to the Ministry every month for tracking purposes. So, among other information, the adjustment plan should include the assessment of expenditure and income measures planned, adopted and implemented. In addition to this information, there is a new requirement to present multiannual budget frameworks in March and October.

MEASURES FOR 2014

For 2014, the Regions maintain their tax efforts, since on the revenue side, they continue the current trend of regulatory capacity increase in assigned taxes and the existing margin on own taxes, and disposal of real investments and on the expenditure side, cost containment policies based on reducing operating expenses, subsidies lines, investments and optimisation of the Reorganisation Plan of the Public Sector.

During 2014, the Regional Governments are planning to adopt income and expenditure measures amounting to € 4.9 billion.

- **Expenditure Measures for 2014**

The forecast of the expenditure measures effect for 2014 amounts to € 1.4 billion.

Regarding the measures derived from staff costs, no significant savings are expected in 2014, as the savings achieved in 2013 consolidates. However, the greatest impact measures are actions aimed at management measures and / or staff planning, reduction or withdrawal of bonuses or productivity and reduction of overall compensations.

The measures derived from the current expenditure on goods and services are mainly directed towards the rationalisation of expenditure related to rendering of services and supplies. These measures include actions such as renegotiating rents, centralisation of purchases and cleaning services, insurances, etc.; reduction of mobile phone terminals, among others.

Regarding grants and aids, Regions continue to reduce subsidies and aid lines, with certain exceptions (scholarships, school diners, to Local Governments for social policies and social economy, etc.), mainly keeping those with external funding.

Measures affecting current transfers are largely due to the public sector reorganisation. It is possible to notice the incidence of the Public Sector Reduction Plan in the spending cuts forecasted for 2014. The Report on the Reorganisation of the Regional Public Sector dated July 1, 2013 estimates that the adoption in 2012 and 2013, of additional measures by the Regional Governments increased the entities reduction from 508, initially committed, to a total of 751 entities.

Measures affecting Chapter VI and VII mainly stem out from reducing investments. Investment policies that are still in force aim at maintaining almost exclusively those investments financed with EU funds and the EIB, or those aiming to repair or maintain existing ones.

In the health care and education fields, even though additional savings are still expected for 2014, they decrease once the effect of the measures adopted in previous years settles. However, measures related to pharmaceutical costs derived from the centralised purchase of drugs and other pharmacy measures implemented in previous years, continue having effect in 2014.

- **Revenue Measures for 2014**

The forecast of the revenue measures effect for 2014 amounts to € 3.5 billion.

The tax measures represent 33% of total revenue measures, highlighting the change in tax rates, bonus and reductions of Capital Transfers and Documented Legal Acts Tax, Inheritance and Donations Tax, Hydrocarbons Tax and Wealth Tax, as well as the creation of new taxes and other actions arising from the fight against tax fraud.

Revenue measures other than taxes correspond to outsourcing transactions, alienation of concessions and of real investments, concentrated in the Regional Governments of Catalonia and Valencia, and included in the revenue estimates of their initial respective budgets. The forecast of this programme has been reduced by 30% to be cautious regarding the plans of the Regional Governments.

MEASURES FOR 2015-2016

The expenditure and revenue measures tend to even out these years, with a total of € 1.7 billion on the expenditure side in 2015 and of € 1.4 billion in 2016. Measures in the field of pharmaceutical expenditure are particularly relevant because their savings potential is still high, as well as that of savings related to the rendering of services and supplies in concerts, subsidies and transfers. The Working group is expected to focus its analysis on the most important expenses affecting the rationalisation of these items in the medium term.

On the revenue side, approximately € 1.3 billion and € 1.7 billion extra are expected to be collected these years. This is slightly less than the previous ones due to the depletion of non-tax measures. The system planned reform is also expected to affect certain indirect and environmental taxation at Regional Governments level, where these Regional Governments find higher capacity, with a major impact in 2015 and 2016. Various Regional Governments have introduced own taxes during the period 2012-2014, many of them environmental. For example, a generalisation of taxes on large commercial areas, electrical installations, waste, etc. is seen. Further rationalisation of this type of taxes is desirable according to the report of tax experts

4.4.2. Local Entities

Public finances of Local Entities will be affected by the Law on Rationalisation and Sustainability of the Local Administration (known in Spanish as LRSAL) (Law 27/2013 of December 27), approved in December 2013 and already in force. Its effects will be evident one year later than expected due to delays in the approval. The implementation of the publication of the actual cost of services before November 2014 stands out. A Ministerial Order already in the pipeline will regulate its calculation and centralised publication, in order to facilitate comparisons and transparency in public service activities.

Table 4.4.2.1. Saving differences between the draft law and the Law on Rationalization and Sustainability of Local Governments

Years	Differences in savings draft-law	Explanation of the differences draft law vs final Law
2014	-285	· Undue expenditure impact is reduced because the implementation of the measure requires reporting of the administrations with the competencies · Resizing of local government sector impact is reduced as the measures will not have impact till mid year (second level entities dissolution, and limited effect in first level) · Minor local entities no impact of dissolution this year as the impact comes in 2015 for non reporting accounts. · Exclusive staff, a higher number of local entities will be able to apply the exception of the tenth transitory provision for not having fiscal imbalance.
2015	-1605	· Undue expenditure impact is reduced as the number of local entities with fiscal non compliance was reduced. · No savings expected in health, education and social services as they will not be effective till the financing systems reforms . · Integrated management and mergers impact is reduced as they may suffer a temporary delay due to local elections in 2015. · Saving increase in local entities due to 2014 computed delay as dissolutions may come in 2015 after accounts report. · Resizing of local sector impact is reduced as there is one additional year for dissolutions of first and second level subsidiaries that provide basic services of water, supply, waste management and public transport. Savings in these areas are expected in 2016 and 2017. · Exclusive staff impact is reduced till 30 June 2015 as the period of the exception, half year saving applies.

Table 4.4.2.1. Saving differences between the draft law and the Law on Rationalization and Sustainability of Local Governments (Continuation)

2016	1494	· Slightly saving increase in undue expenditure because it is expected that Local governments cease to provide that kind of services in its first year of mandate. · Savings increase in health, education and social services are expected since they begin to be fully effective on January 1st, 2016. · Savings increase in Local government mergers and integrated management services because it is expected Local governments to foster these kind of measures in its first year of mandate and also it is expected that the effective cost system be fully effective. · Savings increase thanks to the resizing of the Local public sector since the extra year provided to eliminate first level subsidiaries and second level subsidiaries that provide services such as water supply, waste management and public transport runs out. · Savings increase in temporary staff, full time positions and similar; it takes into account the full financial year i.e. six months more than the previous year.
2017	305	· Savings increase thanks to the resizing of the Local public sector since this year ends the effects of the extra year provided to eliminate first-level subsidiaries and second-level subsidiaries that provide services such as water supply, waste management and public transport.

The compared impact currently provided in the LRSAL with the memory of the bill is presented in Table 4.4.2.1.

Recalculated annual savings are showed in the following table.

Table 4.4.2.2. Recalculated savings from the Law on Local Government Rationalization and Sustainability according to the law finally approved

	2014	2015	2016	2017	2018	2019	2020	TOTAL PERIOD 2013-2020	Percentage over total
Undue expenditure	659,192,548	2,463,788,148	612,182,898					**3,735,163,594**	46.5%
Transfer of competencies in health, education and social services			473,000,000	91,000,000	91,000,000	91,000,000	91,000,000	**837,000,000**	10.4%
Mergers and integrated management of basic services		622,080,000	981,520,000	302,900,000	64,000,000			**1,970,500,000**	24.6%
Minor Local entities		13,905,951						**13,905,951**	0.2%
Local public sector resizing	190,511,807	393,832,401	508,301,486	304,980,891				**1,397,626,585**	17.4%
Temporary and exclusive staff	10,560,000	29,920,000	29,920,000					**70,400,000**	0.9%
Total savings	**860,264,355**	**3,523,526,500**	**2,604,924,384**	**698,880,891**	**155,000,000**	**91,000,000**	**91,000,000**	**8,024,596,130**	100.0%
Percentage over total	10.7%	43.9%	32.5%	8.7%	1.9%	1.1%	1.1%	100.00%	
Source: Ministry of Finance and Public Administrations.									

4.5. Public debt forecasts

In 2013 the public debt/GDP ratio in Spain increased 8 percentage points to 93.9% (Table 4.5.2), compared with an increase of 15.5 points registered in 2012. This lower increase is due to the fact that financial transactions carried out by the State, primarily with regards to the banking restructuring and recapitalisation and the provision of liquidity to Territorial Administrations for them to finance their payments to suppliers, turned out to be much lower compared to the preceding year. Indeed, in 2013, public financial assistance to the financial institutions with impact on the public deficit was 3.3 points of GDP lower than that recorded in 2012 and, in addition, there was a net repayment of liabilities materialised in other accounts payable by the General Government equal to 0.9% of GDP, thus exerting an upward effect on the borrowing needs 1.8 points lower than that 2012.

These financial transactions are reflected in a primary deficit of 3.7% of GDP (since 0.5 points of financial assistance to banks, computed as capital transfers are included) and in a deficit-debt adjustment of 0.3%, both much lower, compared to the levels recorded in 2012 (7.6% and 3.7% of GDP, respectively). The decrease in net acquisitions of financial assets in 2013 helped to reduce the deficit-debt adjustment compared to the one recorded in the previous year, but it was largely offset, by the fall in financial transactions within the General Government as the debt (EDP) is accounted for on a consolidated basis. Additionally, the other adjustments component, which reflects the effect of various factors, such as differences between the interests paid and accrued, or between the nominal issued and currency captured in the discounts issuances, etc., also contributed to reduce, although slightly, the need for debt in 2013, compared with 2012 (Table 4.5.1). Finally, the slight decrease in the nominal GDP increased the debt/GDP ratio by 0.5 percentage points.

At the end of 2014, public debt will represent 99.5% of GDP, 5.6 points higher than in late 2013. This increase is mainly explained by a foreseen deficit for 2014 of 5.5% of GDP, to which a deficit-debt adjustment of 1.7% will be added, substantially offset by the increase in nominal GDP and with an effect on the debt / GDP ratio of -1.6 points. The 2014 debt level will benefit from the reduced requirements of net issuance by the Treasury of approximately € 6 billion (from € 65 to € 59 billion) that has been possible mainly due to the decline in bond yields.

Table 4.5.1. Debt stock-flow adjustment in 2013

% of GDP

	2013
Stock-flow adjustment	0.3
Financial assets	5.8
Accounts payable	0.9
Operations within General Government	-6.0
Others adjustments	-0.4
Source: Bank of Spain.	

The deficit-debt adjustment forecast for 2014 includes the financial transactions undertaken by the Supplier Payment Fund, the Electricity Deficit Amortization Fund and the parts of the loans to Greece, Portugal and Ireland assigned to Spain, among others.

As seen in Table 4.5.2, the debt/GDP ratio will peak in 2015, starting its reduction as of 2016 and standing below 100% in 2017. An improvement in the primary balance that will record surplus in 2016, as well as the narrowing of the difference between the implicit debt interest rate and the nominal GDP growth will contribute to this decline.

Table 4.5.2. Public debt dynamics

% of GDP

	2013	2014	2015	2016	2017	Variation 2013-2017
1. Gross debt level	93.9	99.5	101.7	101.5	98.5	4.6
2. Variation in the debt level	8.0	5.6	2.2	-0.2	-2.9	4.6
Contributions to the variation in the debt level						
3. Primary budget balance	-3.7	-2.0	-0.6	0.9	2.7	1.1
4. Interests paid	3.4	3.5	3.6	3.7	3.8	14.6
5. Effect of nominal GDP growth	0.5	-1.6	-2.5	-3.4	-4.4	-11.9
6. Other factors (debt-deficit adjustment)	0.3	1.7	0.6	0.4	0.4	3.0
p.m.: Implicit interest rate:	3.97	3.80	3.73	3.77	3.87	
Source: Ministry of Economy and Competitiveness.						

4.6. Cyclical orientation of the fiscal policy

To analyse the focus of the fiscal policy, this Stability Programme Update provides estimates of potential GDP of the Spanish economy following the production function methodology used by the European Commission and agreed within the Output Gap Working Group (OGWG). These estimates include the latest changes in methodology regarding the NAWRU's calculation, proposed by the European Commission and approved by the Economic Policy Committee (EPC) in March 2014.

More specifically, these changes focus on the NAWRU's calculation and replace the previous model on static expectations (backward-looking), providing highly pro-cyclical estimates, by means of a forward-looking specification not focused on the Phillips curve. Pro-cyclicality derived from the old methodology and Phillips' curve endpoint problems contributed to overestimate the NAWRU, with the corresponding effects on potential GDP, the output gap and the cyclical and structural components of the budget balance, key variables to design the economic policy.

As in the previous Stability Programme Update, some statistical changes have been incorporated in order to obtain estimates that are more accurate and consistent with the cyclical situation of the Spanish economy. In particular, short-term population projections published by the INE (National Institute for Statistics) in November 2013 have been used, as they are more recent than those published by Eurostat.

Table 4.6.1 shows the projected growth rates for the real GDP in the period 2014-2017, as well as the estimated potential GDP and the contributions to growth from its main components.

Table 4.6.1. Cyclical performance (1)
% of GDP, unless otherwise specified

	2013	2014	2015	2016	2017
1. Real GDP growth (% variation)	-1.2	1.2	1.8	2.3	3.0
2. Net lending (+) / Net borrowing (-)(*)	-7.1	-5.5	-4.2	-2.8	-1.1
3. Interests	3.4	3.5	3.6	3.7	3.8
4. Temporary measures	-0.5	-0.2	0.0	0.0	0.0
5. Potential GDP growth (% variation)	-0.1	-0.1	0.0	0.2	0.5
Contributions:					
- *total factor productivity*	0.5	0.4	0.4	0.4	0.5
- *labour*	-0.8	-0.7	-0.6	-0.5	-0.4
- *capital*	0.2	0.2	0.2	0.3	0.4
6. Output gap	-9.5	-8.3	-6.7	-4.8	-2.4
7. Cyclical balance	-4.6	-4.0	-3.2	-2.3	-1.2
8. Cyclically adjusted balance (2-7)	-2.5	-1.5	-1.0	-0.5	0.1
9. Cyclically adjusted primary balance (8+3)	0.9	2.0	2.6	3.2	3.8
10. Structural balance (8-4)	-2.0	-1.3	-1.0	-0.5	0.1
11. Primary structural balance (10+3)	1.4	2.2	2.6	3.2	3.8

(1) Using Potential GDP (production function). NAWRU calculated with a forward-looking Phillips Curve.
(*) 2013 financial assistance included.
Source: Ministry of Economy and Competitiveness.

The potential GDP will decrease slightly in 2014 by 0.1%, as in the previous year, levelling off in 2015 and starting a slightly expansionary path as of 2016, with growth rates of 0.2% in 2016 and of 0.5% in 2017. This upward potential growth path is due to the gradual recovery of the labour factor, derived, in turn, from a potential participation rate increase, which more than offsets the reduction in the working age population -due to the balance of net-migration flows- and other factors.

On the other hand, capital follows a very stable profile, due to its own accumulation dynamics, with growing contributions, between 0.2 and 0.4 percentage points, derived from a more favourable evolution of gross fixed capital formation, especially as of 2016. Finally, the contribution of Total Factor Productivity (TFP) to potential growth remains stable yet robust in the forecast period, within a range of 0.4 to 0.5 percentage points.

As a result of real and potential GDP evolution, the output gap reaches the maximum difference between potential and effective in 2013, gradually decreasing as of 2014 to reach -2.4% at the end of the forecast horizon. The NAWRU's new calculating method, since it is characterised by a softer potential growth path, implies more negative output gap estimates than those obtained with the backward- looking specification of the Phillips Curve.

From the output gap, the projected path of public deficit has been broken down into its cyclical and structural components. In order to properly understand the evolution of the structural balance, one must primarily refer to the temporary measures considered in the table. Thus, 2013 measures include two types of actions. On one hand, € 4.8 billion in aids to financial institutions affecting public deficit are included, as well as € 386 million from lower taxes due to asset revaluation resulting from the balance sheets update, made possible by the Law 16/2012. In 2014, temporary measures are considered to increase to approximately € 1.8 billion. Among these, it is worth to highlight the budget impact of the bonus from contributions related to the creation of permanent jobs, whose impact, even considered in the overall economy, is positive in terms of activity increase and employment growth; it is also relevant the estimated amount to be refunded during the collection year from the Tax on Retail Sale of Certain Hydrocarbons, following the recent ruling of the Court of Justices of the European Union.

As seen in Table 4.6.1, the structural balance reduction between 2014 and 2017 is estimated at 1.4 points, recording a structural surplus in the last year of the forecast period (0.1%) and therefore converging to the medium-term budget objective (MTO).

Focusing on the evaluation of the resulting structural efforts, in 2014 it can be seen that they would amount to 0.7 percentage points, a marginally lower figure than that estimated by the European Commission in its Recommendation of July 2013, although the net nominal deficit reduction in financial aids -first criterion to be considered in the Excessive Deficit Procedure- is four tenths higher (1.1 percentage points vs. 0.7 in the Recommendation). In 2015 the structural effort would be reduced to 0.3 percentage points, as a result of rebalancing efforts between 2014 and 2015, this figure being consistent with the substantial upward revision of GDP growth that has taken place in that year. In 2016 and 2017 the effort would stand at 5 and 6 tenths of GDP, respectively, in line with the specific obligations of the preventive arm of the Stability and Growth Pact, which requires a minimal structural effort of 0.5 percentage points, since public debt stock stands above 60% of GDP.

Thus, the structural deficit would be reduced by 1.6 percentage points from late 2013 to 2016, while according to the European Commission estimates, a decrease of 2.8 percentage points was projected in the context of a much more modest growth path in May 2013. However, in light of this new path, the fastest growing dividends are applied to a further reduction of the budget deficit in 2014. This restructuring of the fiscal path is consistent with the measures taken so far; it does not worsen growth prospects for the year and facilitates achieving the 2015 target, while improving growth prospects for next year.

In any case, based on complementary metrics, the effort Spain must carry out during the coming years is very substantial. Indeed, changes in the cyclically adjusted primary balance, as a rough indicator of the fiscal policy focus, stands between 2014 and 2017 at 1.1, 0.6, 0.6 and 0.6 percentage points of GDP, respectively.

4.7. Adjustment path to the Medium-Term Objective (MTO)

The current Code of Conduct of the Stability and Growth Pact adopted by the ECOFIN Council in January 2012 establishes the obligation to extend the macroeconomic forecasts until the maximum medium-term objective, a structural deficit, of 0.5% of GDP, is achieved, as well as detailing the main variables of the path to be followed in order to achieve this goal. In the case of Spain, the medium-term objective established by the Organic Law on Budget Stability is more ambitious, reaching structural balance.

As specified in section 4.6, the medium-term objective will be reached in 2017, as was the case in the previous Stability Programme Update under the NAWRU's estimate assumption using the Phillips curve with dynamic expectations, while convergence was reached in 2019 with the old methodology (NAWRU backward- looking). In the last year a structural surplus would be achieved, meeting the objective three years before the rule contained in the Organic Law on Budget Stability.

Table 4.7.1 Medium Term Objective (MTO) Convergence: Budgetary Plan

GDP %, unless otherwise specified

	2013	2014	2015	2016	2017
1. Regional Governments borrowing requirements (Net lending (+) / borrowing (-)) (2+3+4) (*)	-7.1	-5.5	-4.2	-2.8	-1.1
2. Structural balance	-2.0	-1.3	-1.0	-0.5	0.1
3. Cyclical balance	-4.6	-4.0	-3.2	-2.3	-1.2
4. One-offs and other temporary measures	-0.5	-0.2	0.0	0.0	0.0
5. Regional Governments borrowing requirements (Net lending (+) / borrowing (-)) (6-7)	-7.1	-5.5	-4.2	-2.8	-1.1
6. Revenues	37.8	38.5	38.8	38.9	39.0
7. Expenditures	44.9	44.0	43.0	41.7	40.1
Amounts to be excluded from the expenditure benchmark	6.5	5.7	4.9	4.6	4.6
7.a Interest expenditure	3.4	3.5	3.6	3.7	3.8
7.b Expenditure on EU programmes fully matched by EU	0.7	0.7	0.7	0.7	0.7
7.c Cyclical expenditure in unemployment benefits	0.6	0.6	0.4	0.3	0.2
7.d Effects of discretionary revenue measures	1.7	0.9	0.2	-0.1	0.0
8. Tax burden	33.1	33.9	34.2	34.5	34.7
9. Gross debt	93.9	99.5	101.7	101.5	98.5

NAWRU calculated using a forward-looking Phillips Curve.
(*) 2013 financial assistance included.
Source: Ministry of Economy and Competitiveness.

5. COMPARISON WITH THE PREVIOUS STABILITY PROGRAMME. SENSITIVITY ANALYSIS

5.1. Comparison with the previous Stability Programme

The following table shows a comparison of estimates of the previous Stability Programme with the current one.

Table 5.1.1. Differences with the previous Stability Programme update

	2013	2014	2015	2016	2017
GDP (% volume growth)					
Previous update	-1.3	0.5	0.9	1.3	
Current update	-1.2	1.2	1.8	2.3	3.0
Difference	-0.1	-0.7	-0.9	-1.0	
Budget Balance (% GDP)					
Previous update	-6.3	-5.5	-4.1	-2.7	
Current update (*)	-7.1	-5.5	-4.2	-2.8	-1.1
Difference	0.8	0.0	0.1	0.1	
Gross Debt (% GDP)					
Previous update	91.4	96.2	99.1	99.8	
Current update	93.9	99.5	101.7	101.5	98.5
Difference	-2.5	-3.3	-2.6	-1.7	

(*) 2013 financial aid included.
Source: Ministry of Economy and Competitiveness.

For the year 2013, the real growth forecast made in April 2013 was adequate and even one tenth of a percentage point lower than the growth experienced, confirming the conservative nature that characterised the above mentioned Programme. The Stability Programme for the period 2014 - 2017 revised upwards the estimates of real GDP growth formulated in April 2013 for 2014 and subsequent years, in line with the most recent economic trends, the forecasts of the leading research services and international organisations. However, the conservative nature of the estimates is maintained in the current forecasts. The main factors behind this revision are a higher dynamism than initially expected in the Labour Market, largely transmitted to private consumption, as well as an expansive process of investment in equipment provided, where positive surprises occurred and largely related to employment growth, the best prospects on corporate profitability and the maintenance of a positive export trend.

Regarding the budget balance, the projected deficit is slightly revised. The public deficit in the base year, 2013, is 0.8 percentage points of GDP higher than that proposed in the previous update of the Stability Programme, largely as a result of the support provided to the financial system (0.5 percentage points), but also as a result of both the downward revision of nominal GDP of 2012 and of the lower than expected deflators growth. In any case it is important to remember that in the Spanish National Budget for 2014 the public balance for 2013 was corrected by five tenths compared to the previous Stability Programme, so the difference compared to this latter figure would actually be three tenths, 2 of which would be due to budget transactions linked to the financial system.

The slight deviation of the public balance for 2013, as discussed in the previous chapter, was due to lower than initially expected revenues as a result of the less expansive nominal GDP growth, which grew by eight tenths less than projected in the moment of conception of the previous update of the Stability Programme. However, the total expenditure figure in 2013 was quite close to that originally forecast, after adjusting for financial aids, and the main differences affected the level of income.

As of 2014, a positive growth is expected and Spain will be closing its output gap, i.e. the GDP will get closer to its potential level. In this context, the fiscal policy multiplier will be lower and the consolidation will not have such a strong impact on growth. Besides, the role of automatic stabilisers will also facilitate compliance with the budget targets, increasing collection and decreasing social spending in an environment of GDP and employment growth.

Although at the starting point (2013), the forecast deficit was eight tenths of a percentage point of GDP above the one foreseen in the previous update, in 2016 the deficit will be only one tenth above the forecast of the previous update and, in any case, it will be in line with the Recommendation for 2013. Moving from a deficit of 2.7% to 2.8% was already present in September's multiannual projections.

As for the intermediate balances for 2014 and 2015, as discussed in paragraph 4, they have been revised to increase the structural effort in 2014, considering the major upward revision of GDP growth this year. Thus, the budget target for 2014, 5.5% of GDP in the last Update, underwent two changes: the Spanish National Budget became aligned with the Excessive Deficit Recommendation of July 2013 and therefore was raised to 5.8% of GDP, whereas now it goes back down to 5.5%. In the meanwhile, the goal for 2015, 4.1% of GDP in the last Update, became 4.2% in the Two-Pack forecasts and this is the value held in this Update.

The similarity between the deficit paths of the current Programme and its predecessor largely reflects positive nominal GDP growth paths in 2014, 2015 and 2016 similar in both programmes, so it is also reasonable to expect that the fiscal balances evolution will be very similar. The fact that the level of nominal GDP in 2016 is apparently 2.3% lower than the last update, may be possibly offset by the next GDP revision, which was discussed above.

In 2017 the expected deficit is 1.1% of GDP, i.e. the commitment with the fiscal consolidation remains on the whole horizon of the Programme and beyond.

Finally, the public debt path is also slightly higher than that projected in the previous update of the Stability Programme, especially as a result of the deviation of nominal GDP levels. The maximum debt as a percentage of GDP will be reached in 2015 and from 2016 a downward trend will start, standing below 100% at the end of the forecast period.

5.2. Risk scenarios and sensitivity analysis

In the macroeconomic and fiscal projection years, it is important to perform a sensitivity analysis with respect to the assumptions made in the baseline scenario. The Code of Conduct of the European Commission on the format and content of the Stability Programmes urges Member States to consider the sensitivity of macroeconomic and fiscal projections to different shocks. In particular, the Code of Conduct emphasises the interest rate and exchange rate variables.
The interest rate is key to the macroeconomic and fiscal scenario. On one hand, it has a direct effect on public finances, since it alters the financial burden of the

debt. On the other, it has an indirect impact since it is a key determinant of GDP growth due to its influence on consumption and investment decisions. For these reasons the first sensitivity analysis considered is a possible rise in interest rates, although this is not at all a likely scenario, given the normalisation of market conditions, progress in correcting macroeconomic imbalances and the strengthening of the euro institutions.

The exchange rate influences fiscal variables in countries that issue a lot of public debt in foreign currency. This is not the case of Spain, where the exchange rate would affect public finances due to its impact on GDP growth through net exports. This has led to simulate exactly a negative demand shock through lower demand from trading partners. This is, again, a highly unlikely scenario, given the improved growth outlook in the EU, which is the main destination of Spanish exports.

Simulations were carried out using the REMS model[6], a dynamic general balance model with a rigorous microeconomic basis applied to the Spanish economy.

5.2.1. Sensitivity to interest rates

The effect on the main macroeconomic aggregates of increasing the interest rate by 100 basis points (b.p.) in four quarters (25 b.p. each quarter) and keep it at that level for the four years of the forecast period, to gradually return to its initial value, beyond the forecast horizon was analysed

According to the results detailed in Table 5.2.1.1, GDP could fall by approximately 0.8% compared to its level in the baseline scenario at the end of the projection period, dragged down by the lower trend of domestic demand.

With regard to fiscal variables, they would be impaired by such a situation. First, the public balance is affected by lower tax collection and higher spending on social benefits, in an environment where domestic demand and job creation are lower. Besides, the increase in rates means higher interest payments, although it must be stated that the REMS model may overestimate this effect since all the debt is short-term debt, which forces to refinance it in each period. In practice, an increase of 100 b.p. in interest rates, besides being highly unlikely in the current context, would have a lower impact on interest payments since a large percentage of the debt is medium or long term debt. At the end of the forecast period deficit and public debt are higher than in the baseline scenario by 0.6 and 2.5 percentage points of GDP, respectively.

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

Table 5.2.1.1. Impact of a 100 b.p. increase of the interest rate

	2014	2015	2016	2017
Real GDP	-0.6	-0.4	-0.6	-0.8
Private consumption	-0.7	-0.5	-0.6	-0.6
Public balance (% of GDP)	-0.3	-0.4	-0.6	-0.6
Public debt (% of GDP)	0.9	1.3	1.8	2.5
Employment (employed)	-0.2	-0.2	-0.4	-0.5
Source: Ministry of Economy and Competitiveness.				

5.2.2. Sensitivity to economic growth of the trade partners

The effect on the main macroeconomic aggregates of an export market growth 4% lower than assumed in the baseline scenario was analysed. This shock kicks in gradually over the first four quarters and is maintained at that level for the four years of the forecast period, to gradually return to its initial value beyond the forecast horizon.

According to the results detailed in Table 5.2.2.1, GDP could fall by approximately 0.4% compared to its baseline scenario level at the end of the projection period, external demand being in this case the root cause.

The fiscal variables are also affected by this adverse scenario, although less than in the previous shock scenario. At the end of the forecast period, public deficit and public debt are higher than in the baseline scenarios by 0.1 and 0.8 percentage points of GDP, respectively.

Table 5.2.2.1. Impact of a 4% fall in the export demand

	2014	2015	2016	2017
Real GDP	-0.4	-0.3	-0.4	-0.4
Private consumption	-0.3	0.0	-0.2	-0.2
Public balance (% of GDP)	-0.1	-0.1	-0.1	-0.1
Public debt (% of GDP)	0.5	0.6	0.7	0.8
Employment (employed)	-0.2	-0.2	-0.3	-0.3
Source: Ministry of Economy and Competitiveness.				

6. THE SUSTAINABILITY OF PUBLIC FINANCES

6.1. Long-term budget projections

Projections regarding public expenditure associated with ageing population, by the Ageing Working Group (AWG) of the Economic Policy Committee (EPC) and the European Commission, are generally made every three years by mandate of the ECOFIN Council. The updated EUROSTAT demographic projections serve as the starting point for these exercises, together with a macroeconomic scenario created following a common methodology. The last exercise takes as input data EUROPOP 2010 and Spring Forecasts for 2011. An essential feature of this methodology is the hypothesis that there will be no changes in the economic policy other than those already legally substantiated at the close of the projection year. Five public expenditure categories are analysed in this exercise: pensions, healthcare, long-term care, education and unemployment. The latest projections were published in May 2012 in the Ageing Report, thus updating those made in 2009.

The EPC of April 9, 2014 endorsed the new projections made by the Ministry of Economy and Competitiveness and peer reviewed by the AWG on the 1st April. In this update of the projections, the impact of pension reforms adopted in 2013, both on sustainability of public finances in the long-term and on macroeconomic prospects is quantified. It is noteworthy that, to ensure equal treatment of this extraordinary assessment, the demographic and macroeconomic assumptions used in the 2012 revision were maintained. Therefore it should be expected that, since there are significant changes in these assumptions in the review scheduled for the Ageing Report for 2015, some results will differ from projections adopted recently.

Table 6.1.1 shows national projections approved by the EPC in April 2014, in extraordinary review, as well as their comparison with the previous year.

These estimates correspond to a projection exercise carried out between 2011 and 2012 and for a very long period, they differ from the estimates set out in this Stability Programme. The reason for this divergence is that the hypotheses for the long-term scenario used to support the pension expenditure evolution exercises contemplate a different evolution of the economy for the period 2014-2017 from the one projected when developing this Programme.

Table 6.1.1. 2010-60 Projections of ageing-related expenditure

% of GDP

	Increase 2010-2060	2010	2020	2030	2040	2050	2060
TOTAL EXPENDITURE (1+2+3+4+5)	**0.0**	**23.5**	**24.1**	**23.0**	**23.2**	**24.1**	**23.5**
1. Pension Expenditure	-0.4	10.0	10.2	10.0	10.2	10.5	9.6
Old age and early retirement Pensions [(a)]	0.5	6.7	7.3	7.3	7.6	8.1	7.2
Disability Pensions	-0.2	1.2	1.1	1.1	1.1	1.0	1.0
Survivor Pensions	-0.7	2.1	1.8	1.6	1.5	1.5	1.4
2. Healthcare Expenditure	1.3	6.5	6.5	7.0	7.4	7.7	7.8
3. Long-Term Care Expenditure	0.6	0.8	0.9	0.9	1.0	1.3	1.4
4. Education Expenditure	-0.5	4.2	4.0	3.4	3.4	3.6	3.7
5. Unemployment Expenditure	-1.1	2.0	2.5	1.7	1.2	1.0	0.9
Pro-memoria: Impact of Pension Reform							
Pension Expenditure Pre-Reform	3.6	10.1	10.6	10.6	12.3	14.0	13.7
Savings		0.1	0.4	0.6	2.1	3.4	4.1
Pro-memoria: Main Assumptions							
Potential GDP growth	1.7*	-0.1	2.5	2.3	1.2	1.2	1.6
Growth of Labour Productivity	1.4*	1.6	0.7	1.6	1.6	1.6	1.5
Male Participation Rate (15-64)	-1.0	80.8	80.7	80.3	80.4	80.3	79.8
Female Participation Rate (15-64)	10.6	65.9	71.8	75.7	77.2	76.8	76.5
Total Participation Rate (15-64)	4.7	73.4	76.3	78.1	78.9	78.6	78.2
Unemployment Rate (15-64)	-12.9	20.2	18.7	8.9	7.7	7.4	7.3
Population over 64/Population 15 to 64	31.3	24.9	28.4	36.0	47.4	57.0	56.2

(*) 2010-2060 Average.

(a) Includes minimum and non-contributory pensions

Sources: Ministry of Economy and Competitiveness, OECD, UOE, ESSPROSS.

As it can be seen in Table 6.1.1, the total expenditure on all five items of expenditure is maintained throughout the period at similar levels to those registered in 2010, even recording a fall of four decimal points at the end of the projection horizon. Regarding the projection of 2012, this change represents a savings in 2060 of more than 4 percentage points of GDP. This saving is exclusively due to the pension reforms of 2013.

As a result of the population ageing, health expenditure, for which no provision has been revised, becomes the fastest growing item, with a projected growth of 1.3 percentage points of GDP, substantially higher than that projected in the year 2009. With regards to long-term care, the projected increase stands at 0.7 points. On the other hand, due to both an ageing population and the falling unemployment rate, spending on education and unemployment will decrease over the period, 0.5 and 1.1 points of GDP respectively.

6.2. Strategy

The deepening on the reform of the pension system

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

In 2013 two important reforms have been adopted: first, the Royal Decree-Law 5/2013, of 15th March, on measures to encourage the continuity of the working life for older workers and to promote active ageing; and secondly, the Law 23/2013, of 23 December, regulating the sustainability factor and the index for revaluation of the pension system, which reflects the recommendations made by the Committee of Experts on the sustainability factor in its report dated 7th June, 2013.

The Royal Decree-Law 5/2013, among other measures, delays the age for early retirement. For involuntary retirement (derived from termination of employment due to reasons beyond the worker's free will), between 2013 and 2027 the age increases from 61 to 63 years and 33 years of contributions are required (as before the reform). For voluntary retirement, a gradual age increase is expected between 2013 and 2027, from 63 to 65, and a contributory period of 35 years (previously it was 33 years) is required. Partial early retirement access is also restricted by raising the minimum age from 61 to 63 for long work histories (36.5 years or more) and from 61 to 65 for medium ones (between 33 and 36.5 years).

The sustainability factor in Law 5/2013 ensures intergenerational equity, i.e., that the generosity of the pension system is the same for all retirees, regardless of life expectancy of the cohort to which they belong to.

Its application will begin annually as of 2019 and it will be automatically reviewed every five years. It will exclusively lie on new pensions, affecting only the income calculated for new pensioners, not retirement age. The factor will be linked to the changes observed in life expectancy at 67 years of age, taking 2012 as the base year.

Using mortality tables from Eurostat, the sustainability factor goes from 100% of the pension value for registrations in 2018 to 82% in 2060, in line with an increase in life expectancy at 67 from 18.8 years in 2012 to 22.8 years by 2060.

Law 23/2013 also replaces updating pensions according to the CPI for a new index for pension revaluation (IPR), which is a far-reaching structural reform through which the future sustainability of the pension system i.e. its ability to self-fund, is guaranteed. This index not only neutralises sustainability risks that any demographic or macroeconomic shock could cause, but it highlights the necessary correspondence between income and expenditure in the system.

All Social Security pensions, including non-contributory and pensions of retired civil servants shall be increased annually by the percentage increase in the IPR to be set annually by the Budget Law, which entered into force in January 2014.

To avoid major fluctuations in the IPR growth rate, all the components that go into its formula (incomes, expenditures and budget balance, expressed as a percentage of expenditure) are computed as 11-year averages centered on the year for which the IPR is calculated.

Overall, and according to the Cohorts Simulation Model of the Commission, all measures taken in 2013 have a significant macroeconomic impact. In particular, the effective retirement age increases almost by one year between 2014 and 2060. Until 2027, the effective retirement age increases by almost nine months, as a result of the establishment, in the Royal Decree-Law 5/2013, of more stringent conditions to access early retirement. This increase is in addition to the impact of two years estimated by the reform of 2011. Between 2027 and 2060 the sustainability factor generates an additional increase of 2 months.

Consequently, the reforms of 2013 have a significant impact on the participation rate and on the real GDP. Specifically, the participation rate for ages 15 to 74 increases by 1.3 points in 2060 (from 67.4 to 68.6%) and by 2023, the estimated increase already stands at 0.5 points (from 68.0 to 68.5%). On the other hand, this increased participation has a positive impact on employment and therefore, on GDP. So the impact of the reform in 2060 is an increase in real GDP of 1.8%, compared to the GDP without reform in 2060, and in 2023 this increase already amounts to 0.7%.

On the other hand, as of January 2011, all newly hired staff of public administrations will be integrated into the General Social Security Plan, so the current pension system for civil servants will gradually disappear.

Consolidation of public finance and Social Security Reserve Fund

Long-term sustainability of public finances is mainly strengthened by the adjustment of the expenditure associated with ageing. The most relevant indicator to assess the long-term sustainability of public finances, the so-called S2, stood in the monitoring report on debt sustainability (Debt Sustainability Monitor or DSM) of Autumn 2013 at 5.6% of GDP, explained in two-thirds by the deterioration in the primary structural balance and, in the remaining part, by the increase in ageing-related costs. This result implied that, for accrued income of public administrations to equal their accrued expenses in the long-term, an increase of the tax burden should be undertaken, a reduction of other public spending or a permanent combination of both of that magnitude on a permanent basis.

As a result of the pension reforms undertaken by Spain in 2013, the S2 sustainability indicator improved significantly. Using the Commission's Winter Forecast for 2014, an exercise has been carried out to estimate the S2 for the case in which the structural primary balance is maintained in the medium and long term, at the level estimated by the Commission for 2015 (no policy change scenario), that is, at -2.2% of GDP. As a result of the pension reforms of 2013, the Long Term Change component has contracted sharply, negatively contributing to the S2, both because of the employment and GDP increases , and particularly because the cost containment effort. Thus, the S2 went from requiring a fiscal adjustment of the primary structural balance to meet the intertemporal budget constraint over an infinite horizon of 5.6 percentage points, to 2.7 percentage points of GDP. Also, if a lower primary structural deficit for the medium and long term was used, as provided for in this Stability Programme, the initial Budget Position component would also experience a decrease, further moderating the indicator S2 level.

Table 6.2.1. Summary of S2 indicator

% of GDP

	Winter 2014 Post-reform	Autumn 2013*
S2	**2.7**	**5.6**
Initial Budgetary Position	3.8	3.8
Long Term Change	-1.1	1.9

(*) European Commission No Policy Change scenario.
Sources: Ministry of Economy and Competitiveness and Debt Sustainability Monitor, Autumn 2013.

On the other hand, it should be noted that due to the surpluses accumulated by the Social Security in the past, the pension system has reserve assets available to meet future needs for contributory benefits. Thus, from its inception in 2000, subsequent allocations to the Social Security Reserve Fund allowed it to accumulate € 53.7 billion (5.25% of GDP) in December 2013, after the amounts the Social Security used in 2012 and 2013 to meet the payment of pensions (€ 18.7 billion) were deducted. The average annual return of the fund stands at 4.56%. The management policy of reserve assets of the pension system, held in 2013, is based on principles of security, profitability, risk diversification and adaptation to the time horizon of fund inflows and arrangement thereof for coverage of contributory pensions.

Healthcare and pharmaceutical expenditure control

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

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

The containment measures above mentioned implied a drop in the number of public employees throughout the first three quarters of 2013 of 7.2%, 5% and 4.4% respectively. This containment was interrupted in the fourth quarter due to an increase of 2.3%. According to the Quarterly Labour Cost Survey (known in Spanish as ETCL) -labour cost per worker fall, in health and social services activities, was of 2% y-o-y up to the third quarter of 2013 and the fourth quarter experienced an increase due to the recovery in 2013 of the bonus, which was withdrawn in 2012.

With regards to pharmaceutical expenditure, spending by means of official National Healthcare System prescriptions experienced a remarkable deceleration in recent years, moving from a 6.9% growth in 2008 to an 8.8% reduction in 2011 and a 12.26% reduction in 2012 down to 6.01% in 2013. Annual savings in 2013, with respect to 2012, amounted to € 586.7 million.

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

As for the demand side, public spending on drugs has been limited since 2012 by means of new contributions from the user side. These contributions are more equitable and fair, arranged in such a way that users with more means contribute more, while protecting users with lesser means. This measure also has a discouraging effect on the unnecessary accumulation of drugs at home. In 2013, the Resolution of the 10th of September contributed to this approach because it changed the conditions for public funding of drugs dispensed to outpatients in hospitals pharmacy services, through the introduction of user contributions.

The result has been a reduction of 54 million in prescriptions issued in 2013, in other words, 5.93% less. Before the reform came into effect in July, when the new user contributions came into force, the number of prescriptions was growing at a rate of 2.23% (cumulative from January to June 2012 compared to the cumulative from January to June 2011). Concurrently, the average prescription price has remained at € 10.7 in 2012 and 2013.

From the 1st of July, 2012 until the end of January 2014, the National Healthcare System recorded a savings in drug costs alone of € 2.9 billion. Public spending on drugs is kept at 15% of health spending, which aligns Spain to the EU. Consumption of generic drugs continues to increase, and in January 2014 it represented a 47% of invoiced packaging drugs, compared to the 34.1% registered in 2011.

In addition, the fact that almost 1,000 marketed drugs have decreased their prices and the encouragement to prescribe generic drugs above mentioned also contributed to pharmaceutical savings.

Thus, current pharmaceutical bill in January 2014 stood below the one registered a decade ago, in January 2004.

The total economic impact in 2012, adding up all the measures mentioned so far, as well as other measures implemented as a result of the adaptation of Spanish regulations to European rules on assistance to citizens of Member States and the European Economic Area, the savings obtained in 2012 and 2013 from the creation of a centralised purchase platform, and other minor measures, result in a total budget implementation savings of National Accounts of € 5.4 billion.

Streamlining of the long-term care system

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

The measures included in this Royal Decree-Law express the need to achieve improvements in order to guarantee sustainability, which started to have an economic impact in 2012. Nonetheless, savings are expected to amount to € 1.4 and € 1.5 billion in 2013 and 2014 respectively.

6.3. Contingent liabilities

The latest available information on the guarantees granted by the Central Government, referred to the 31st of March, 2014 is itemised in this section.

i) **Guarantees from Royal Decree-Law 7/2008 on Urgent Economic-Financial Measures of the Concerted Action Plan in Eurozone Countries**. In Article 1, this regulation authorised the granting of State guarantees to any issues made from credit institutions after its coming into force. The outstanding balance of this concept is € 32.9 billion.

ii) **Guarantees for issues of the Electricity System Deficit Securitisation Fund**, whose most recent regulation is in Royal Decree-Law 6/2010 of 9April. The outstanding balance at the end of the first quarter of 2014 stood at € 22.5 billion

iii) **Guarantees for issues of the European Financial Stability Facility**, by virtue of Royal Decree-Law 9/2010, of 28 May, for an amount of € 34.7 billion.

iv) **Guarantees for issues of Securitisation Funds for SME Financing**, regulated in Article 55 of Law 17/2012, of 27 December, on the 2013 Spanish National Budget for 2013: its outstanding balance is € 1.7 billion.

v) **Guarantees for issues of the Fund for Orderly Bank Restructuring (FROB),** created by virtue of Royal Decree-Law 9/2009, on bank restructuring and strengthening of credit institution equity, which shows an outstanding balance of € 5.8 billion.

vi) **Guarantees for issues of the Company for Management of Assets from the Bank Restructuring Sector (Sareb),** created by virtue of Law 9/2012, of 14 November, on the restructuring and shutdown of credit institutions, whose outstanding balance is € 48.4 billion.

vii) Guarantees to non-classified institutions, with an outstanding amount of € 584 million.

Summarising, the total risk assumed by the State for guarantees amounted to € 146.5 billion on the 31st of March 2014.

7. THE QUALITY OF PUBLIC FINANCES

7.1. Introduction

Under the European Semester framework, the Commission published its Annual Growth Survey for 2014, which identifies the EU priorities for 2014 in order to boost growth and job creation, which were endorsed by the ECOFIN Council. In this context, and considering the current economic and financial situation, what is being advocated is to continue the consolidation of public accounts through a combination of expenditure and revenue measures that are efficient and conducive to growth, complemented with additional measures to strengthen growth potential.

On the expenditure side, it is recommended to focus on the quality of public spending and on the modernisation of the administration at all levels. In addition, to maintain investments in education, research, energy and action for climate is considered necessary, as it is to enhance the efficiency and sustainability of social protection systems, in particular pension systems.

On the revenue side, shifting the tax burden from labour to tax rates related to consumption and property is defended, and more attention is paid to environmental taxation and strengthening the fight against fraud.

7.2. Composition of expenditure

The fiscal consolidation process developed in Spain includes many of the elements recommended by the Commission.

Thus the Programme to reform Public Administrations has been launched. The CORA posted on 21 June 2013, a comprehensive report with numerous proposals addressing the restructuring and rationalisation of the Spanish Public Administrations. It is a spending review process because:

- A thorough analysis of the expenditure bases was conducted in order to identify potential savings and to make adjustments. So, CORA did the most thorough and detailed assessment of the Spanish public sector that has been carried out in recent times, in order to identify efficiency improvement niches, such as the existence of duplications and overlaps amongst administrations or the existence of room to simplify procedures and reduce administrative burdens.

- No immediate cuts are sought, but sustainability in the medium and long term, so it is a process that required and requires time.

- It focuses on structural spending, identifying numerous measures aimed at streamlining the public sector. Indeed, it is leading to a structural change based on efficiency criteria.

- An evaluation phase of the results of the measures taken has been included.

The CORA report identifies several areas of action, based on which the proposed measures and those being promoted can be classified into:

- General measures, among which the following must be highlighted: the Organic Law on control of commercial debt in the public sector, the Law on development of the electronic invoice and on the creation of an accounting register for invoices, the Law on Streamlining and Sustainability of the Local Administration: all approved in December 2013 and currently in force; restructuring of the public sector enterprise and foundation sectors in continuous process, and the reform of the Law on Subsidies.

- Measures aimed at eliminating administrative duplications, so that the cost of administrative activity is reduced. The analysis focused on the duplications of the Central Government Administration and the Regional Governments, as duplications with Local Entities were addressed in the Law on Streamlining and Sustainability of the Local Administration.

- Administrative simplification measures to reduce bureaucratic obstacles that hinder administrative procedures. In this area, the centralisation of service and supply contracts and the centralised management of recruitment services stand out.

- Measures related to the management of public services and resources, with the aim of centralising management activities that can be performed in a unified or coordinated manner.

- Measures related the institutional Administration, which implied a complete overhaul of the regulatory framework and the beginning of a process of reorganisation and restructuring of the administrative public sector.

The Organic Law 9/2013 of 20th December, on the control of commercial debt in the public sector seeks to eradicate public administrations' arrears and its damaging effects on the financial sustainability and budget stability. This Law amends the Organic Law 2/2012, of 27th April, on Budget Stability and Financial Sustainability and expands the concept financial sustainability, which now also includes the control of commercial debt. Public Administrations are now forced to publish their average payment period to suppliers and if the maximum 30 day deadline is exceeded by more than 30 days, the implementation of a progressive system of measures is triggered, which could even lead to the retention of resources to pay suppliers.

Law 25/2013 of 27 December, on the development of the electronic invoice and on creation of an accounting register for invoices in the Public Sector has the following implications for suppliers and administrations:

- Reduction of administrative burden and efficiency gains for businesses arising from the use of electronic invoicing.

- Suppliers who provide services to the public administrations will be better protected by providing them with greater legal security of the registration and control of their invoices.

- Public Administrations will have a greater accounting control of bills, enabling a better compliance of invoice payment times, a better control of public spending and of the deficit, and further the fight against fraud.

• Along with the law to control commercial debt, a complete system for the effective eradication of arrears by Public Administrations is created.

The reform of the Subsidies Law derives from the need to advance in the principles of rigor and austerity in public spending in the subsidies field, moreover seeking greater effectiveness in the fight against fraud in subsidies. In this respect, a text to enhance transparency is being prepared (for example, the National Subsidies Database will be enhanced); the simplification and inter-administrative coordination; the effectiveness and efficiency in the use of public funds (seeking greater joint responsibility of contributors and beneficiaries); and the fight against practices that harm the public finances (especially with the integration of control procedures requiring reimbursement).

Law 27/2013, of 27th December, on rationalisation and sustainability of the Local Administration, on the other hand, was necessary to ensure the proper functioning of Local Administrations. Its objectives are to clarify municipal competencies to avoid duplications with those of other administrations, so that the principle "one administrations one competency" becomes effective, rationalise the organisational structure of the Local Administration in accordance with the principles of financial efficiency, stability and sustainability and ensure a more rigorous financial and budget control. Furthermore, a model of management by results and management evaluation is implemented and the publication of the actual cost of the services is established, facilitating citizens with the necessary information to evaluate and compare the services they receive.

Apart from the Programme for the reform of the Public Administrations and complementary to it, the approval of Law 19/2013 of 9th December, on transparency, access to public information and good governance must be highlighted. This Law will also contribute to improving the control of public administrations management through the active advertising requirement for all administrations and public bodies, the recognition and guarantee of access to information and the establishment of good governance obligations to be met by public officials, as well as the legal consequences derived from non-compliance.

The reform of the pension system achieved through Law 23/2013, of 23 December, regulating the Sustainability Factor and the Index for Revaluation of the Pension System of Social Security should also be emphasized. This law complements the various reforms undertaken since 2011. The aim is to ensure medium and long term financial balance of the Social Security, and its impact is discussed in Chapter 6 of this Programme. Thus, this new law:

• Sets a minimum and maximum limit of annual revaluation, 0.25% and CPI plus 0.5% respectively.

• Introduces a sustainability factor, defined as a ratio that will link the evolution of pensions to life expectancy, which it will be reviewed every five years and it will be applied as of 2019.

Finally, a brief summary of the main figures of the Central Government Budget for 2014 is carried out. This is set in a context of moderate economic growth, which allows with a -4.7% reduction of expenditure available for ministries, to begin increasing certain items such as those destined to scholarships and research, not to mention the commitment to social spending.

It should be highlighted that more than half, 51.8%, of consolidated resources (State, Social Security, Autonomous Bodies and other bodies of the state administrative public sector) finance social spending, maintaining the austerity in public finances through greater efficiency in the use of resources.

It should be noted that, in line with the recommendations of the Commission and the ECOFIN Council, the allocation of items destined to scholarships and grants to students, increases by 21.5%, and the allocations for civil research in 2014, both with regards to non-financial and financial expenditure, are increased by 1.3%.

7.3. Composition of revenue

The achievement of tax objectives considers guidelines on tax matters prepared for the 27 Member States overall and most particularly those formulated specifically for Spain in June 2013. Important measures have therefore been taken complement those adopted in previous years in order to reduce distortions in the tax system and help to promote growth and employment

The main measures approved are:

• The reduction of tax benefits in direct tax has been continued since through Law 16/2013 of 29 October, the consolidated text of corporate income tax Law was modified in order to suppress losses from impairments of securities representing the capital share or equity of the entities and the negative income earned abroad by permanent establishments. In addition, the temporary measures established in the corporate income tax regulations have been extended, which help to limit tax benefits in direct taxation.

• Additionally, the trend started last year with regards to give more relevance to environmental taxation has been continued, by creating, by means of Law 16/2013, of 29 October, the new fluorinated gas tax as of 1 January, 2014.

New measures have been adopted to reduce the indebtedness of companies. These measures complement others adopted in previous years limiting the deductibility of financial expenses. Specifically, by Law 14/2013, of the 27 September, on support to entrepreneurs and their internationalisation, two measures have been adopted that contribute to this purpose: the deduction for ordinary profits reinvested in small companies and the deduction to the so-called business angels.

• Also in that Law, other measures were approved to promote economic growth and corporate finance, such as the new regime of cash VAT for SMEs, new fiscal incentives for R&D or the expansion of the "patent box".

In addition to these measures, following the recommendations made to our country in June 2013, a Committee of tax experts was created that prepared a report proposing a comprehensive reform of the fiscal system. This report seeks, among other objectives, achieving a tax system oriented to economic growth (improving savings and the system efficiency) and to reduce negative effects on market unity, focusing on key issues such as tax neutrality.

In order to achieve this goal, experts recommend a rate cut in direct taxation, both in personal and corporate income taxes, combined with a withdrawal of tax benefits that produce distortions in these taxes. Thus, deleveraging of businesses and households is incentivised and economic growth and job creation is encouraged.

Also, in order to reduce the negative externalities of certain activities, a substantial reform in regional environmental taxation is suggested.
Additionally, with the aim of ensuring the sustainability of the system, the possibility of undertaking a fiscal devaluation is raised in the long run, through a reduction of contributions for lower incomes and an increase of indirect taxation that would be carried out when the economy returned to the path of economic growth.

Following publication of the report, the Government is considering the proposals included in it and is working on a comprehensive fiscal reform that contributes to achieving the objectives of economic growth and job creation. This fiscal reform proposal will be presented in the second half of 2014.

The reform aims at:

• Modernising the tax system.

• Solve existing problems in the tax system such as the employment discouraging bias and low collection. This way it will be able to guarantee sufficient tax revenues and increase collection, paying particular attention to the narrowness of tax bases and the fight against fraud without discouraging employment.

• Contribute to fiscal consolidation.

• Encourage economic development, ensure market unity and fiscal neutrality and improve the competitiveness of the Spanish economy.

At the time of sending this Stability Programme, the reform is still in the design stage. However, some of the lines in which the Government is working in can be defined:

• The starting point of the reform, as the expert committee did, is the "status quo" of the tax system in 2014, That is, the analysis that is being carried out by the Government is based on the current situation, including all steps taken so far.

• The tax cuts planned by the Government will aim at reducing the tax wedge, i.e. reduce the gap between what a worker receives and what the employer pays. This reduction maximises the possible effect of a tax cut on economic recovery and job creation.

• A reduction of direct taxation will occur. Specifically, in the field of personal income tax, workers earning less than € 12,000 a year will be excluded from taxation to alleviate the tax burden on lower incomes. In addition, the low and middle incomes will see their applicable tax rate reduced. Also, tax deductions for families will increase, which may improve birth rates.

• The collection capacity will be assured by broadening tax bases. Additionally, the Government will consider various alternatives, including property taxation, environmental taxation with the least possible impact on competitiveness, payment mechanisms for service use, increase of use tax against those levied on the transfer of ownership or taxation on the financial sector in the harmonised EU framework. It should also be noted that by lowering the personal income tax, growth of domestic demand will be enhanced, and thus the increase in consumption will generate an increase in revenue from indirect taxes.

• The tax reform will also take into account considerations of equity and sustain efforts to reduce tax evasion and fraud.

• It should be noted that some of the specific measures proposed in the report, such as fiscal depreciation, are already being implemented in Spain as, in 2012, an increase in VAT rates and a reclassification of products of discounted rates to the general one took place and has been followed by reductions in social contributions. Recently, a new reduction of social contributions has just been introduced by a flat fee of 100 euros for hiring occurring from February 25th to December 31th, 2014, provided it ensures a net increase in permanent employment. This measure helps to improve competitiveness, to promote employment (especially permanent contracts) and to reduce the anti-labour bias of our tax system. In addition, it must be borne in mind that such devaluation is also underpinned by with the reduction of taxation for the lowest income brackets, which will also have a positive effect on the fiscal wedge.

Finally, this tax reform is a very ambitious work programme and, necessarily, it must be addressed within a sufficient timeframe. Therefore, measures should be taken in more than one budget year.

8. INSTITUTIONAL SCOPE OF THE FISCAL POLICY

8.1. The New Independent Fiscal Authority

On the 14th of November, 2013 the Organic Law 6/2013 on the creation of the new independent fiscal authority was adopted, as a result of two closely related reform processes.

The first one, the reform of Spanish budget framework undertaken by the Government, grounded on the need to ensure budget stability and seen as the essential base to achieve a sustained and sustainable growth and promote job creation.

The definition of this new framework began with the reform of article 135 of the Spanish Constitution in September 2011, which establishes the structural balance as a guiding principle of the budget policy and sets as limit to public administrations debt, the reference value established by the Treaty on the Functioning of the European Union. To make effective this new Constitution article, the Organic Law 2/2012 of 27th April on Budget Stability and Financial Sustainability was issued, in order to comply with these two key objectives.

After the breakthroughs that this Organic Law introduced in the Spanish budgetary framework, the Government considered necessary to continue the reform process, to further the achievement of the fiscal consolidation objectives and to strengthen the confidence in the stability of the Spanish economy, by creating a new independent institution to analyse budget policy.

The second process, concurrent with the adoption of the Organic Law on Budget Stability and Financial Sustainability, was being carried out at European level and involved the reform of the economic and fiscal governance system in the European Union by strengthening coordination, monitoring and surveillance mechanisms of budget and macroeconomic policies of the Member States. So, many rules have been approved requiring, among other measures, Member States to create independent fiscal authorities. This is the case of the Treaty on Stability, Coordination and Governance in Economic and Monetary Union, of the Regulation on common requirements for monitoring and assessing draft budget plans and for ensuring the correction of excessive deficit of the Member States in the Eurozone, and of Directive 2011/85/EU on requirements for budget frameworks of the Member States.

In this context, the recommendations to Spain under the European Semester framework; as part of the assessment of the excessive deficit procedure; and in the Memorandum of Understanding signed for the implementation of the financial aid destined to the restructuring of the Spanish banking system, included the creation of an independent fiscal authority to provide advice and assessment, and to supervise the conformity of budget policy with national and EU budget rules.

Thus, all these factors led to the approval of the Organic Law 6/2013, of 14th November, on creating the new Independent Fiscal Authority, which sets this Authority as an entity with autonomy and functional independence, whose ultimate goal is to contribute to the effective fulfilment by public administrations of the budget stability principle under Article 135 of the Spanish Constitution, through the continuous assessment of the budget cycle, the public borrowing and the analysis of economic forecasts.

The next step was the appointment of the President of this new Authority, following the procedure established in the Organic Law 6/2013 of 14th November. Thus, the Council of Ministers proposed on 24th January, Mr. José Luis Escrivá to occupy that position, having been ratified by the majority of the Finance Committee of the Spanish Parliament on 20th February.

Then, and with the report of the AIREF President and consulting Regional Governments, Local Entities and other agencies, such as the Bank of Spain, the IMF and the European Commission, the Council of Ministers adopted on 28th March the Royal Decree through which the Organic Statute of the new independent fiscal authority is approved, as required by the Organic Law 6/2013, of 14th November, with the aim of developing its organisation and internal functioning.

The independence of the AIREF is fully guaranteed by numerous provisions of the creating Organic Law, among which the following stand out:

• The AIREF is set up as an entity with its own legal personality and full public and private capacity within the Ministry of Finance and Public Administrations through the Minister but with full functional autonomy.

• Neither the President nor the AIREF staff may seek or take instructions from Public Administrations or any public or private entity.

• The President of the AIREF will be appointed from among persons of recognised prestige and broad experience in matters of budget, economic and financial analysis of the public sector, especially valuing their independence and objectivity. Moreover, their appointment must be approved by the appropriate Committee of Congress and the Senate. The mandate is for 6 years, non-renewable, in order to guarantee the independence of the President's decisions.

• The AIREF will have the necessary resources for the proper performance of its functions. Therefore a fee for the monitoring, advising and monitoring rate of fiscal policy has been created, which must be paid by all public administrations under the AIREF surveillance. In addition, it will also enjoy the revenues from public prices received by studies and assignments carried out, as specified annually in the Central Government Budget, and the products and income derived from the property and rights that constitute their assets.

To fulfil the purposes they have been entrusted with, the AIREF will be the only body to develop the following duties throughout the Spanish territory and with respect to all members of the public sector:

• Reporting. If the administration or entity to which the report relates to digress from the recommendations contained therein, it shall motivate it. Its creation Organic Law mandates reports on the following issues:

- Macroeconomic forecasts to be incorporated in the draft budgets of the Public Administrations or the Stability Programme.

- The changes that occur in the methodology used to calculate the trend estimates of revenue and expenditure and the growth reference rate referred to by the Organic Law on Budget Stability and Financial Sustainability.

- The Stability Programme draft, with special assessment of the commitments that ensure the compliance of the budget stability objective, the limit of public debt and the spending rule.

- The fulfilment of the objectives of budget and public debt stability and of the spending rule of all Public Administrations, considering the budget implementation and the measures provided in the current year and the immediately preceding one.

- The establishment of individual targets for Regional Governments on budget stability and public debt.

- The economic-financial and rebalancing plans of the Central Administration and the Regional Governments, prior to their approval.

- The projects and fundamental lines of the budgets of Public Administrations.

- The application of the correction mechanisms provided in the Organic Law on Budget Stability and Financial Sustainability.

- The occurrence of the exceptional circumstances under Article 11.3 of the Organic Law on Budget Stability and Financial Sustainability allowing diversion of the stability goal.

• Issuance of opinions on its own initiative on matters specified, such as the sustainability of public finances in the long term.

• Development of studies on behalf of the Government, the Council on Financial and Fiscal Policy, the National Commission for Local Administration, the Financial Committee of the Social Security, the Regional Governments and Local Entities.

Finally, it should be noted that for the proper performance of their functions, the AIREF will have access to the economic-financial information of any member of the public sector subject over which it exercises its functions. To this end, the Central Economic-Financial Reporting by Public Administrations will provide access to all the information available. In addition, if it requires additional information, it may send a request to the appropriate Administration. It is important to note that failure to provide the required documentation may be regarded as a breach of the duty to cooperate and may trigger the application of the corrective mechanisms provided for in the Organic Law 2/2012, of 27th April on Fiscal Stability and Financial Sustainability.

In conclusion, Spain has an independent institution to ensure compliance with tax rules and the definition of tight fiscal policies, thus reinforcing the credibility of the policies adopted and ensuring the sustainability of public finances.

APPENDIX. INTRODUCTION OF THE NEW NATIONAL AND REGIONAL ACCOUNTS SYSTEM ESA-2010

The methodological framework currently used for the development of the National Accounts of Spain (known in Spanish as NAS) is the European System of National and Regional Accounts (ESA-95), established by Council Regulation (EC) No. 2223/96 and binding in all countries of the European Union. This Regulation establishes a system of national accounts that meets the needs of comparability and accuracy of the necessary information to serve as a basis for economic, social and regional policy of the European Union and its Member States. The methodological framework of ESA-95, is broadly aligned with the System of National Accounts adopted by the Statistical Commission of the United Nations in 1993 (NAS-1993).

The NAS-1993 was updated in the form of a new System of National Accounts, NAS-2008, adopted by the United Nations Statistical Commission in February 2009, thus resulting in the need to revise the European System of Accounts (ESA-95) and create a version of the MAS-2008 adapted to the structures of the economies of the Member States.

In September 2014 the Regulation of the European Parliament and of the Council[7] will come into force, establishing the new System of National and Regional Accounts (ESA-2010) with the aim of adapting the national accounts to the new economic environment, to the advances in methodological research and to the users' needs. Thus, when the above mentioned Regulation comes into force, the current ESA-95[8] will be replaced by the ESA-2010 in all countries of the European Union.

The European System of Accounts established by this Regulation (ESA-2010) includes a methodological part (Annex A) and a data transfer programme (Annex B) defining the accounts and tables that all Member States must provide to the Commission on specified deadlines. Thus, the European Union will introduce the ESA-2010 in September 2014, when the data transfer programme included in the aforementioned Regulation comes into force, incorporating this new methodology in the national accounts of all Member States.

In the case of Spain, the National Institute of Statistics (known in Spanish as INE) is planning to incorporate as of October 2014 the new methodology of the ESA-2010 in the operations of the System of National and Regional Accounts by an operation of change in accounting basis. Thus, the new base 2010 of the National and Regional Accounts of Spain will include methodological and statistical changes regarding the current accounting base 2008. The first ones will mainly relate to the integration in this system of the principles contained in the ESA-2010 while statistical changes, as is common in the base exchange transactions in the field of national accounts, will have their origin in the use and adaptation of new statistics sources and in the application of new methods and procedures for estimating accounting aggregates.

[7]The Regulation (EU) No 549/2013 of the European Parliament and of the Council of the 21st of May, 2013 on the European system of national and regional accounts in the European Union must be first applied to the data to be transmitted to the European Commission (Eurostat) as of the 1st of September, 2014.
[8]Regulation (EU) No 549/2013 of the European Parliament and of the Council of the 21st of May, 2013 on the European system of national and regional accounts in the European Union.

These changes will have an impact on key macroeconomic aggregates and in particular, on GDP, with most of the impact stemming out from two methodological changes: the capitalisation of research and development costs and the capitalisation of military spending.

In the current ESA-95 system, expenditure on research and development (R&D) are considered intermediate consumption while in the new ESA-2010 the result of R&D activity is "capitalised", i.e., the results of this activity are recognised as fixed assets.

Similarly, in ESA-95 military procurement of weapons systems, military aircraft or vessels are considered intermediate consumption, regardless of their useful life, treatment that does not correspond to economic reality as military weapons systems (ships, submarines, military aircraft, tanks,...) are fixed assets used continuously for more than a year in the production of defence services. For this reason, in the ESA-2010 this type of expenditure will be treated as investment in fixed capital.

As a result of these two changes, GDP is expected to be revised upwards, and will affect other important macroeconomic aggregates, such as the budget deficit or public debt.

ANNEX: TABLES OF THE EFFECTIVE ACTION PROGRAM

Table A.1.1. Quarterly budgetary execution on cash basis for the General Government and its sub-sectors

EUR millions	2013				2014
	Q1	Q2	Q3	Q4	Up to February
Overall balance by sub-sector					
1. General Government	13,902	18,454	6,736	4,373	32,830
2. Central Government	-33	-2,629	-9,157	-7,303	15,670
3. Regional Governments	5,338	3,444	6,668	6,028	13,390
4. Local Governments	2,273	6,355	8,541	5,666	ND
5. Social security	6,324	11,284	684	-18	3,770
For each sub-sector	**General Government**				
6. Total revenue	**185,641**	**354,847**	**541,459**	**824,074**	**139,876**
7. Total expenditure	**171,739**	**340,475**	**534,723**	**819,701**	**107,046**

Table A.1.2. Quarterly budgetary execution on cash basis for the General Government and its sub-sectors (continued)

EUR millions	2013				2014
	Q1	Q2	Q3	Q4	Up to February
Overall balance by sub-sector					
1. General Government					
2. Central Government	-33	-2,629	-9,157	-7,303	15,670
3. Regional Governments					
4. Local Governments					
5. Social security					
For each sub-sector	**Central Government**				
6. Total revenue	**69,781**	**132,471**	**189,319**	**307,536**	**63,019**
7. Total expenditure	**69,814**	**135,100**	**198,476**	**314,839**	**47,349**

Table A.1.3. Quarterly budgetary execution on cash basis for the General Government and its sub-sectors (continued)

EUR millions	2013				2014
	Q1	Q2	Q3	Q4	Up to February
Overall balance by sub-sector					
1. General Government					
2. Central Government					
3. Regional Governments	5,338	3,444	6,668	6,028	13,390
4. Local Governments					
5. Social security					
For each sub-sector	**Regional Governments**				
6. Total revenue	**57,487**	**121,842**	**179,850**	**271,192**	**49,345**
7. Total expenditure	**52,149**	**118,398**	**173,182**	**265,164**	**35,955**

Table A.1.4. Quarterly budgetary execution on cash basis for the General Government and its sub-sectors (continued)

EUR millions	2013			
	Q1	Q2	Q3	Q4
Overall balance by sub-sector				
1. General Government				
2. Central Government				
3. Regional Governments				
4. Local Governments	2,273	6,355	8,541	5,666
5. Social security				
For each sub-sector	**Local Governments**			
6. Total revenue	**16,458**	**33,685**	**52,542**	**78,309**
7. Total expenditure	**14,185**	**27,330**	**44,001**	**72,643**

Table A.1.5. Quarterly budgetary execution on cash basis for the General Government and its sub-sectors (continued)

EUR millions	2013				2014
	Q1	**Q2**	**Q3**	**Q4**	**Up to February**
Overall balance by sub-sector					
1. General Government					
2. Central Government					
3. Regional Governments					
4. Local Governments					
5. Social security	6,324	11,284	684	-18	3,770
For each sub-sector	**Social Security**				
6. Total revenue	**41,915**	**84,076**	**119,748**	**167,037**	**27,512**
7. Total expenditure	**35,591**	**72,792**	**119,064**	**167,055**	**23,742**

Table B.1.1. Quarterly budgetary execution in accordance with ESA standards for the General Government and its sub-sectors

ESA 95		*Accumulated data*				*Non accumulated data*				
EUR millions	ESA Code	2013				2013				2014
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Up to February***
B.9 EDP Net lending (+) / net borrowing (-)										
1. General Government	S.13	**-6,186**	**-31,016**	**-46,982**	**-72,577**	**-6,186**	**-24,830**	**-15,966**	**-25,595**	**-9,856**
2. Central Government	S.1311	-9,533	-33,776	-39,619	-49,148	-9,533	-24,243	-5,843	-9,529	-10,516
3. Regional Governments	S.1312	-1,304	-8,020	-9,218	-15,781	-1,304	-6,716	-1,198	-6,563	-1,805
4. Local Governments	S.1313	**2,111**	**2,481**	**5,013**	**4,213**	**2,111**	**370**	**2,532**	**-800**	
5. Social Security	S.1314	**2,540**	**8,299**	**-3,158**	**-11,861**	**2,540**	**5,759**	**-11,457**	**-8,703**	**2,465**
General Government										
6. Total revenue	TR	**94,245**	**182,234**	**278,854**	**386,250**	**94,245**	**87,989**	**96,620**	**107,396**	**52,644**
Of which										
Taxes on production and imports	D.2	32,395	59,442	86,886	112,914	32,395	27,047	27,444	26,028	17,689
Current taxes on income, wealth, etc.	D.5	22,429	43,479	72,224	105,107	22,429	21,050	28,745	32,883	10,928
Capital taxes	D.91	1,163	2,262	3,678	5,036	1,163	1,099	1,416	1,358	497
Social contributions	D.61	32,583	65,216	97,483	130,438	32,583	32,633	32,267	32,955	21,662
Property income	D.4	2,824	4,355	5,937	10,808	2,824	1,531	1,582	4,871	747
Other[a]		2,851	7,480	12,646	21,947	2,851	4,629	5,166	9,301	1,121
7. Total expenditure	TE (EDP)	**100,431**	**213,250**	**325,836**	**458,827**	**100,431**	**112,819**	**112,586**	**132,991**	**62,500**
Of which										
Compensation of employees	D.1	26,058	57,306	83,771	116,090	26,058	31,248	26,465	32,319	14,271
Intermediate consumption	P.2	10,788	24,599	37,614	56,489	10,788	13,811	13,015	18,875	4,537
Social transfers	D.62, D.632[b]	44,286	90,744	142,807	197,901	44,286	46,458	52,063	55,094	29,042
Interests	D.41	8,245	16,894	25,520	35,096	8,245	8,649	8,626	9,576	5,516
Subsidies	D.3	1,370	3,038	5,126	10,447	1,370	1,668	2,088	5,321	521
Gross fixed capital formation	D.51	3,997	7,789	11,645	15,167	3,997	3,792	3,856	3,522	1,885
Capital transfers (includes financial assistance)	D.9	561	4,246	7,200	10,158	561	3,685	2,954	2,958	366
Other[c]		5,126	8,634	12,153	17,479	5,126	3,508	3,519	5,326	6,362

(*) Consolidated data of the Central Government, Regional Governments and Social Security until February.
(a) P.11+P.12+P.131+D.39rec +D.7rec +D.9rec (other than D.91rec) .
(b) Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.
(c) D.29pay+D.4pay (other than D.41pay) +D.5pay+D.7pay+P.52+P.53+K.2+D.8.

Table B.1.1. Quarterly budgetary execution and prospects in accordance with ESA standards for the General Government and its sub-sectors (continued)

ESA 95		*Accumulated data*				*Non accumulated data*				
EUR millions	ESA Code	**2013**				**2013**				**2014**
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Up to February**
B.9 EDP Net lending (+) / net borrowing (-)										
1. General Government	S.13									
2. Central Government	S.1311	-9,533	-33,776	-39,619	-49,148	-9,533	-24,243	-5,843	-9,529	-10,516
3. Regional Governments	S.1312									
4. Local Governments	S.1313									
5. Social Security	S.1314									
Central Government										
6. Total revenue	TR	**33,288**	**60,996**	**96,665**	**138,021**	**33,288**	**27,708**	**35,669**	**41,356**	**18,656**
Of which										
Taxes on production and imports	D.2	14,218	23,061	32,692	39,898	14,218	8,843	9,631	7,206	9,398
Current taxes on income, wealth, etc.	D.5	11,553	22,804	40,286	61,453	11,553	11,251	17,482	21,167	5,291
Capital taxes	D.91	262	308	726	786	262	46	418	60	259
Social contributions	D.61	2,597	5,903	8,690	12,649	2,597	3,306	2,787	3,959	1,900
Property income	D.4	3,060	4,949	6,922	11,941	3,060	1,889	1,973	5,019	1,089
Other[a]		1,598	3,971	7,349	11,294	1,598	2,373	3,378	3,945	719
7. Total expenditure	TE (EDP)	**42,821**	**94,772**	**136,284**	**187,169**	**42,821**	**51,951**	**41,512**	**50,885**	**29,172**
Of which										
Compensation of employees	D.1	5,319	11,924	17,237	24,198	5,319	6,605	5,313	6,961	3,540
Intermediate consumption	P.2	1,619	3,799	5,579	9,211	1,619	2,180	1,780	3,632	836
Social transfers	D.62, D.632 [b]	3,288	7,636	11,025	15,576	3,288	4,348	3,389	4,551	2,289
Interests	D.41	7,362	15,125	22,998	31,379	7,362	7,763	7,873	8,381	5,039
Subsidies	D.3	112	338	961	4,029	112	226	623	3,068	27
Gross fixed capital formation	D.51	1,342	2,662	3,965	5,247	1,342	1,320	1,303	1,282	889
Capital transfers (includes financial assistance)	D.9	235	3,343	5,923	8,100	235	3,108	2,580	2,177	141
Other[c]		23,544	49,945	68,596	89,429	23,544	26,401	18,651	20,833	16,411

(a) P.11+P.12+P.131+D.39rec +D.7rec +D.9rec (other than D.91rec).
(b) Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.
(c) D.29pay+D.4pay (other than D.41pay) +D.5pay+D.7pay+P.52+P.53+K.2+D.8.

Table B.1.1. Quarterly budgetary execution and prospects in accordance with ESA standards for the General Government and its sub-sectors (continued)

ESA 95		*Accumulated data*				*Non accumulated data*				
EUR millions	ESA Code	**2013**				**2013**				**2014**
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Up to February**
B.9 EDP Net lending (+) / net borrowing (-)										
1. General Government	S.13									
2. Central Government	S.1311									
3. Regional Governments	S.1312	-1,304	-8,020	-9,218	-15,781	-1,304	-6,716	-1,198	-6,563	-1,805
4. Local Governments	S.1313									
5. Social Security	S.1314									
Regional Governments										
6. Total revenue	TR	**32,948**	**66,890**	**103,356**	**142,676**	**32,948**	**33,942**	**36,466**	**39,320**	**20,855**
Of which										
Taxes on production and imports	D.2	12,514	25,010	37,326	50,230	12,514	12,496	12,316	12,904	8,291
Current taxes on income, wealth, etc.	D.5	8,793	17,321	25,662	34,397	8,793	8,528	8,341	8,735	5,637
Capital taxes	D.91	451	1,049	1,571	2,249	451	598	522	678	238
Social contributions	D.61	99	207	309	436	99	108	102	127	58
Property income	D.4	105	238	373	769	105	133	135	396	85
Other[a]		10,986	23,065	38,115	54,595	10,986	12,079	15,050	16,480	6,546
7. Total expenditure	TE (EDP)	**34,252**	**74,910**	**112,574**	**158,457**	**34,252**	**40,658**	**37,664**	**45,883**	**22,660**
Of which										
Compensation of employees	D.1	15,517	34,174	49,987	68,985	15,517	18,657	15,813	18,998	10,388
Intermediate consumption	P.2	5,280	12,169	18,809	26,243	5,280	6,889	6,640	7,434	3,571
Social transfers	D.62, D.632 [b]	6,364	13,545	20,122	28,761	6,364	7,181	6,577	8,639	4,219
Interests	D.41	1,791	3,707	5,620	7,744	1,791	1,916	1,913	2,124	1,348
Subsidies	D.3	518	1,185	1,767	2,812	518	667	582	1,045	280
Gross fixed capital formation	D.51	1,409	2,632	3,912	4,963	1,409	1,223	1,280	1,051	961
Capital transfers (includes financial assistance)	D.9	457	1,384	2,130	4,394	457	927	746	2,264	287
Other[c]		2,916	6,114	10,227	14,555	2,916	3,198	4,113	4,328	1,606

(a) P.11+P.12+P.131+D.39rec +D.7rec +D.9rec (other than D.91rec).
(b) Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.
(c) D.29pay+D.4pay (other than D.41pay) +D.5pay+D.7pay+P.52+P.53+K.2+D.8.

Table B.1.1. Quarterly budgetary execution and prospects in accordance with ESA standards for the General Government and its sub-sectors (continued)

ESA 95		Accumulated data				Non accumulated data			
EUR millions	ESA Code	2013				2013			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
B.9 EDP Net lending (+) net borrowing (-)									
1. General Government	S.13								
2. Central Government	S.1311								
3. Regional Governments	S.1312								
4. Local Governments	S.1313	**2,111**	**2,481**	**5,013**	**4,213**	**2,111**	**370**	**2,532**	**-800**
5. Social Security	S.1314								
Local Government									
6. Total revenue	TR	**15,141**	**30,073**	**46,641**	**65,059**	**15,141**	**14,932**	**16,568**	**18,418**
Of which									
Taxes on production and imports	D.2	5,663	11,371	16,868	22,786	5,663	5,708	5,497	5,918
Current taxes on income, wealth, etc.	D.5	2,083	3,354	6,276	9,257	2,083	1,271	2,922	2,981
Capital taxes	D.91	450	905	1,381	2,001	450	455	476	620
Social contributions	D.61	48	103	158	232	48	55	55	74
Property income	D.4	124	244	407	592	124	120	163	185
Other[a]		6,773	14,096	21,551	30,191	6,773	7,323	7,455	8,640
7. Total expenditure	TE (EDP)	**13,030**	**27,592**	**41,628**	**60,846**	**13,030**	**14,562**	**14,036**	**19,218**
Of which									
Compensation of employees	D.1	4,665	9,955	14,722	20,369	4,665	5,290	4,767	5,647
Intermediate consumption	P.2	3,663	8,084	12,419	19,829	3,663	4,421	4,335	7,410
Social transfers	D.62, D.632 [b]	283	567	854	1,120	283	284	287	266
Interests	D.41	296	566	765	1,261	296	270	199	496
Subsidies	D.3	364	765	1,193	1,589	364	401	428	396
Gross fixed capital formation	D.51	1,212	2,433	3,683	4,853	1,212	1,221	1,250	1,170
Capital transfers (includes financial assistance)	D.9	120	238	393	565	120	118	155	172
Other[c]		2,427	4,984	7,599	11,260	2,427	2,557	2,615	3,661

(a) P.11+P.12+P.131+D.39rec +D.7rec +D.9rec (other than D.91rec).
(b) Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.
(c) D.29pay+D.4pay (other than D.41pay) +D.5pay+D.7pay+P.52+P.53+K.2+D.8.

Table B.1.1. Quarterly budgetary execution and prospects in accordance with ESA standards for the General Government and its sub-sectors (continued)

ESA 95		Accumulated data				Non accumulated data				
EUR millions	ESA Code	2013				2013				2014
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Up to February
B.9 EDP Net lending (+) net borrowing (-)										
1. General Government	S.13									
2. Central Government	S.1311									
3. Regional Governments	S.1312									
4. Local Governments	S.1313									
5. Social Security	S.1314	**2,540**	**8,299**	**-3,158**	**-11,861**	**2,540**	**5,759**	**-11,457**	**-8,703**	**2,465**
Social Security										
6. Total revenue	TR	**38,310**	**80,730**	**112,987**	**149,817**	**38,310**	**42,420**	**32,257**	**36,830**	**25,864**
Of which										
Taxes on production and imports	D.2	0	0	0	0	0	0	0	0	
Current taxes on income, wealth, etc.	D.5	0	0	0	0	0	0	0	0	
Capital taxes	D.91	0	0	0	0	0	0	0	0	
Social contributions	D.61	29,839	59,003	88,326	117,121	29,839	29,164	29,323	28,795	19,704
Property income	D.4	739	1,428	2,098	2,794	739	689	670	696	444
Other[a]		7,732	20,299	22,563	29,902	7,732	12,567	2,264	7,339	5,716
7. Total expenditure	TE (EDP)	**35,770**	**72,431**	**116,145**	**161,678**	**35,770**	**36,661**	**43,714**	**45,533**	**23,399**
Of which										
Compensation of employees	D.1	557	1,253	1,825	2,538	557	696	572	713	343
Intermediate consumption	P.2	226	547	807	1,206	226	321	260	399	130
Social transfers	D.62, D.632 [b]	34,351	68,996	110,806	152,444	34,351	34,645	41,810	41,638	22,534
Interests	D.41	0	0	0	0	0	0	0	0	0
Subsidies	D.3	376	750	1,205	2,017	376	374	455	812	214
Gross fixed capital formation	D.51	34	62	85	104	34	28	23	19	35
Capital transfers (includes financial assistance)	D.9	0	0	0	0	0	0	0	0	0
Other[c]		226	823	1,417	3,369	226	597	594	1,952	143

(a) P.11+P.12+P.131+D.39rec +D.7rec +D.9rec (other than D.91rec).
(b) Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.
(c) D.29pay+D.4pay (other than D.41pay) +D.5pay+D.7pay+P.52+P.53+K.2+D.8.

Table A.2.1. Expenditure and revenue targets for the General Government in accordance with ESA standards

% GDP	ESA Code	2012(P)	2013(A)	2014.0	2015.0	2016.0	2017.0
1. Total revenue target (=table 1c. 6)	TR	**37.2**	**37.8**	**38.5**	**38.8**	**38.9**	**39.0**
Of which							
1.1. Taxes on production and imports	D.2	10.5	11.0	11.4	11.8	12.0	12.1
1.2. Current taxes on income, wealth, etc.	D.5	10.3	10.3	10.8	10.8	10.9	11.0
1.3. Capital taxes	D.91	0.4	0.5	0.5	0.5	0.5	0.5
1.4. Social contributions	D.61	13.0	12.8	12.6	12.5	12.3	12.3
1.5. Property income	D.4	1.0	1.1	1.0	1.0	1.0	1.0
1.6. Other		2.0	2.1	2.3	2.3	2.2	2.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		32.6	33.1	33.9	34.2	34.5	34.7
2. Total expenditure target (=table 1c. 7)	TE	**47.8**	**44.9**	**44.0**	**43.0**	**41.7**	**40.1**
Of which							
2.1. Compensation of employees	D.1	11.2	11.3	11.0	10.6	10.1	9.5
2.2. Intermediate consumption	P.2	5.7	5.5	5.4	5.1	4.9	4.6
2.3. Social transfers	D.62, D.6311, D.63121, D.63131	19.0	19.3	19.2	18.8	18.4	17.8
Of which Unemployment benefits		**3.1**	**2.9**	**2.6**	**2.4**	**2.2**	**1.9**
2.4. Interests	D.41	3.1	3.4	3.5	3.6	3.7	3.8
2.5. Subsidies	D.3	1.0	1.0	1.2	1.1	1.1	1.0
2.6. Gross fixed capital formation	D.51	1.7	1.5	1.6	1.6	1.6	1.5
2.7. Capital transfers *(2012 and 2013 financial assistance included)*	D.9	4.5	1.0	0.5	0.5	0.4	0.4
2.8. Other		1.6	1.7	1.7	1.6	1.6	1.5

Table A.3.1. Expected budgetary impact of the measures adopted and planned (differential terms)

Measures	Description	Target (cost/revenue)	Accounting principle	Level of implementation	Million euros			
		ESA Code			2013	2014	2015	2016
PERSONAL INCOME TAX PIT		D5			**2209**	**223**	**-2485**	**-2291**
Complementary charge	Involving application of a temporary, progressive levy on personal income tax, at a percentage rate ranging 0.75% for very low income to 7% for income over 300,000 during the years 2012, 2013 y 2014.	Revenues	Homogeneous Cash	RDL 20/2011, 30th of December. Law 22/2013, of 23d December (PGE 2014)	1,381	0		
PIT Reforme			Homogeneous Cash				-2,566	-2,381
Withholdings	Increase in the withholding rate for economic activities from 15% to 21%	Revenues	Homogeneous Cash	RDL 20/2012, 13th July. Law 22/2013, 23d of December (PGE2014)	400	-609		
Compensation for housing	Permanently ending of tax deductions for housing	Revenues	Homogeneous Cash	RDL 20/2012, 13th of July	430			
Lottery	20% tax rate on lottery winnings over 2,500 €.	Revenues	Homogeneous Cash	Law 16/2012, 27th of December	267	118		
Extra pay public employees 2012	Elimination of extra pay for public employees in 2012	Revenues	Homogeneous Cash	RDL 20/2012, 13th of July	-269	676		
Compensation for purchasing primary home	Permanently ending of tax deductions on investment in the main residence for any purchase made after 1st January 2013.	Revenues	Homogeneous Cash	Law 16/2012, 27th of December		90	90	90
capital gains < 1 year change to general rate	Only capital gains and losses from the sale of assets held by a taxpayer for more than one year will be included in the tax base.	Revenues	Homogeneous Cash	Law 16/2012, 27th of December		40		
20% reduction on net profits in first 2 years (flat rate regime)	20% reduction on net profits from economic activity by taxpayers who launch an economic activity, applicable in the first tax year in which a profit is made and the following year.	Revenues	Homogeneous Cash	Royal Decree-law 4/2013		-9	-9	
10% deduction on reinvested ordinary profits.	This incentive consist of a 10% deduction in the tax payable on profits in the tax year invested in new tangible fixed assets and real-estate assets for economic activity.	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs		-77		
"Business angels": 20% deduction and exemption from capital gains.	The investors enjoys two tax benefits: a) When the investment is made: A 20% deduction in state personal income tax payable, subject to a maximum of 20,000; b) on exiting the investment, full exemption for any capital gains, provided these are invested in another new or recently-founded entity.	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs		-6		

Table A.3.1. Expected budgetary impact of the measures adopted and planned (differential terms) (Continued)

Measures	Description	Target (cost/revenue)	Accounting principle	Level of implementation	Million euros			
		ESA Code			2013	2014	2015	2016
Corporate Income tax		D5			**-434**	**2,169**	**-607**	**-2,000**
Increase of withholding rate on capital gains		Revenues	Homogeneous Cash	Royal Decree-law 20/2011, 30th of December	-356			
Measures relating to instalment payments and other measures	Minimum instalment payment on accounting profits. Payment in instalments. Limits on deductions of financial cost. Ending of freedom on depreciation. Limits on deduction of goodwill. Limits on application of negative tax bases.	Revenues	Homogeneous Cash	Royal Decree-law 12/2012, 30th of March and Royal Decree-law 20/2012, 13th of July.	-2,786			
Corporate Income Tax reform			Homogeneous Cash					-2,000
Special tax on dividends originating abroad	Creation of a special tax on dividends and returns from abroad from the transmission of equity instruments of entities not resident in Spain.	Revenues	Homogeneous Cash	Royal Decree-law 12/2012, 30th of March and Royal Decree-law 20/2012, 13th of July.	-80	-9		
Limits on deduction of depreciation expenses.	Limits on tax deduction of fixed asset depreciation by large companies. It will be a maximum of 70% of the amount provided in tables. The measure will take effect in 2013 through installment payments. This excludes SMEs and micro-SMEs.	In 2013: 1900 D5; In 2014: +300 D5	Homogeneous Cash	Law 16/2012, 27th of December	1,900	300		
Asset revaluation levy	This levy allows the updating of balance sheets by taxpayers of corporation tax, tax payers of personal income tax involved in economic activities and taxpayers of non-resident income tax operating in Spain through a permanent establishment. This updating is voluntary, and is subject to a tax charge of 5% of the amount of the revaluation.	386 D91; -381 In D91	Homogeneous Cash	Law 16/2012, 27th of December	388	-381	-5	
Reduced rates of 15% / 20% for new companies during first two years.	A tax rate of 15% has been established for the first 300,000 € of the taxable base and 20% for the remaining amounts, in the first year of positive base and following year.	Revenues	Homogeneous Cash	Royal Decree-law 4/2013, 22d of February		-176	-175	
10% deduction for ordinary profits reinvested in fixed assets in small sized companies.	A 10% reduction in the Corporate Tax payable on profits in a tax year reinvested in new tangible fixed assets or real estateinvestments linked to its activity for companies with turnover of less than 10€ million.	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs		-547		
Return of 80% of balance pending deduction of RD&I	Deductions for R&D investment and spending may also optionally be applied, not subject to any limit on the tax payable, and be credited, with a joint discount of 20% of their value, when it is not possible to apply these due to the tax payable being too low	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs			-427	
Changes to tax regime for intangible assets	A reduction in the tax base of 40% or 60% depending on the case, of the net income from the intangible asset.	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs		-168		
Cancelation of deduction of losses in participated companies.	Change to the tax treatment of investment in resident and non-resident entities with a holding of at least 5% for over 1 year, and for permanent establishments abroad.	Revenues	Homogeneous Cash	Law 16/2013, 29th of October	500	3,150		
Other direc taxes	Special tax regularisation. Non-resident income tax and others.	IRNR D5; D21 or D29;	Homogeneous Cash		**-1,169**			

Table A.3.1. Expected budgetary impact of the measures adopted and planned (differential terms) (Continued)

Measures	Description	Target (cost/revenue)	Accounting principle	Level of implementation	Million euros			
		ESA Code			2013	2014	2015	2016
VAT		D21			**8,050**	**117**	**476**	
Reduction of VAT from 8% to 4% on housing purchases and increase in Excise	The reduction of the VAT rate on housing from the reduced rate to 4% was a temporary measure introduced in 2011 and extended unitil 31st of December 2012.	Revenues	Homogeneous Cash	Royal Decree-law 9/2011, 19th of August	612	288		
Rate increase from September 2012.	Increase of VAT rates, with the general rate up from 18 to 21%, and the reduced rate from 8 to 10%, with reclassification of some goods and services from the reduced rate to the general rate as from September 2012.	Revenues	Homogeneous Cash	Royal Decree Law 20/2012 13th of July	7,438			
Creation of cash-basis VAT system	From 1 January 2014, creation of a special, voluntary system for VAT payments on a cash basis for taxpayers with turnover of less than 2 million € during the previous year.	Revenues	Homogeneous Cash	Law 14/2013, 27th of September, Entrepreneurs		-171	171	
Health and Notaries tax at the general rate.	Adaptation of the VAT Law to the Community legislation	Revenues	Homogeneous Cash				305	
Excise duties and enviromental taxation	Tax on the value of electricity prodction. Tax on production of spent nuclear fuel. New tax on fluorinated greenhouse gases. A tax on emissions of halogeneated hydrocarbons. Tobacco products; a number of changes including an increase in duty rates and rebalancing the fiscal structure, increasing the proportional component and reducing the specific component. Increase in the rate on professional diesel, biofuels, natural gas (consumption and use in electricity generation). Diesel and fuel-oil used in electricity generation liquefied petroleum gas. Refunds under the tax on hydrocarbons judgement. Reform of the Energy Services Directive 2016. Alcohol and derivative beverages (a 10% increase in taxation on intermediate products and derivative drinks. Electricity (partial tax exemption for large consumers). Carbon (rate increase to 0.65 euro/gigajulio)	D21 and D29	Homogeneous Cash	Law 15/2012, 27th of December, fiscal measures for energy sustainability Law 16/2013, 29th of October. Royal Decree-law 7/2013, 28th of June. Law 16/2013, 29th of October.	**3,092**	**647**	**0**	**1,000**
Fees and other taxes on production (FTT)		D29	Homogeneous Cash		**149**		**600**	
Total		Revenues			**11,897**	**3,156**	**-2,016**	**-3,291**
Plan to combat tax fraud		D5 and D21	Homogeneous Cash		**1,050**	**1,000**		
Total					**12,947**	**4,156**	**-2,016**	**-3,291**

Source: Ministry of Finance and Public Administration.

Table A.4.1. Regional Governments. Expected budgetary impact of the expenditure and revenue measures adopted and planned

Measures	Description	Target (expenditure/revenue)	Additional annual budgetary impact (€ million)				
		ESA Code	2012	2013	2014	2015	2016
Staff spending	General remuneration measures	D1		859.4	33.4		
	Proportional decrease in hours and remuneration	D1		135.3	-5.9	4.0	
	Reduction/ending of bonuses and productivity benefits	D1		20.8	52.2		
	Management measures/Staff planning	D1		1,334.1	54.9	180.0	200.0
	Other Staff measures	D1	1,504.7	120.4	-84.3		
Pharmaceutical spending	Pharmaceutical spending resulting from centralised purchasing of medicines	D63	91.2	89.2	15.2	100.0	100.0
	Other pharmacy measures	D63	644.3	612.0	119.1	150.0	150.0
Current spending	Savings measures related to the provisions of services and supplies	P2		278.4	286.0	500.0	370.0
	Remuneration measures (agreements/contracts)	D63		136.9	-26.1		
	Other chapter II measures	P2	560.5	564.1	50.9	150.0	
Subsidies	Current and capital	D92, D99		1,127.5	214.6	300.0	200.0
Current transfers	Other chapter IV measures	Other current expenditure	3,133.8	783.2	227.8	145.0	145.0
Capital transfers	Other chapter VII measures	D92,D99	1,715.1	296.5	249.2	92.0	150.0
Other measures	Other measures (investment)	P51	1,971.5	687.9	254.7	100.0	100.0
Total expenditure measures			**9,621.0**	**7,045.8**	**1,441.7**	**1,721.0**	**1,415.0**
Personal Income Tax		D51		52.1	7.2	50.0	
Inheritance and Gift Tax		D91		175.4	163.1	86.0	86.0
Wealth Tax		D5		319.9	53.5		
Corporate Income Tax		D5					
Enviromental taxes		D29	50.3	67.1	109.3	500.0	500.0
Transfer and Stamp Tax		D21	76.5	323.9	357.6	150.0	200.0
Special Tax on certain means of transport.		D21	162.0	-1.7	0.0		
Tax on hydrocarbons		D21		369.4	144.2	100.0	100.0
Canary Islands General Indirect Tax (IGIC) and Import Tax (AIEM)		D21		245.5	0.0		
Fees		D29	188.4	53.5	23.3	80.0	80.0
Other tax revenue		D29	2,152.1	416.4	282.0	250.0	300.0
Non tax revenue		P51	1,225.8	213.5	2,318.8	100.0	500.0
Total revenue measures			**3,855.0**	**2,234.9**	**3,459.0**	**1,316.0**	**1,766.0**
Total Regional Governments` measures			**13,476.0**	**9,280.7**	**4,900.7**	**3,037.0**	**3,181.0**

Source: Ministry of Finance and Public Administrations.

Table A.5.1. Local Governments. Expected budgetary impact of the expenditure and revenue measures adopted and planned

Measures	Description	Target (cost/revenue)	Additional annual budgetary impact (€ million)			
		ESA Code	2013.0	2014.0	2015.0	2016.0
Staff spending	Reduction in staff spending	D1	210.2	206.4	228.7	226.7
Current spending	Reduction in expenditure of goods and services	P2	9.8	12.0	12.9	12.1
Public company sector	Dissolution of companies	P2		190.5	393.8	508.3
Investments and capital transfers	Reduction of investments and capital transfers.	P51, D9	124.7			
Supression of services	Other spending measures. Disappearance of smaller local authorities and ending of services not falling under local competences	D1, P2, other current expenditure	349.5	659.2	2,463.8	612.2
Health, education and social services	Transfer of competences in health, education and social services.	D1, P2.				473.0
Integrated management and mergers	Integrated management of public services and merger of municipalities.	D1, P2.			622.1	981.5
Total expenditure			**694.2**	**1,068.1**	**3,721.3**	**2,813.8**
Taxes	Tax increases, ending of exemptions and voluntary allowances	D29	652.6	558.1	926.5	327.9
Taxes	Reinforced effectiveness of enforced and voluntary collection	D29	18.0	32.9	25.0	21.7
Taxes	Fees and public prices	D29 Y P11	34.2	51.5	54.2	56.5
Other revenue	Other revenue measures	D7 Y P11 Y D4	293.6	284.7	236.8	240.5
Total revenues			**998.5**	**927.2**	**1,242.5**	**646.7**
Total Local Governments			**1,692.7**	**1,995.3**	**4,963.8**	**3,460.4**

LRSAL: Law on the Rationalisation and Sustainability of the Local Government (Law 27/2013, 27th of December).

Source: Ministry of Finance and Public Administration.