

# 1. Executive Summary

In Spain, the presentation of the **General State Budgets** represents one of the most important annual events for our economy. These budgets are the **primary economic policy document**, among other reasons because they define fiscal policy in a context in which there is no autonomy in the monetary and exchange areas.

The Draft General State Budgets for fiscal year 2007 (PGE-2007) form part of an **international framework of great economic dynamism**, with very significant increases in the volume of world trade and production. Nevertheless, this positive international outlook is shadowed by the **increased risk of a significant economic deceleration** during the next year, a possibility heightened by a variety of phenomena: a growth slowdown in the United States, persistent macrofinancial imbalances, a rise in inflation rates and the failure of the Doha Round negotiations. The **Spanish economy could maintain a growth level of close to 3%**, somewhat more moderate than in previous years.

In this climate of opportunities (strong worldwide growth) and risks, the Draft PGE-2007 seem to correspond to an approach that is too closely linked to the political dimension and less to the adoption of measures to meet the challenges our economy is facing. It is true that the transfer of competences to regional governments and prior budgetary commitments restrict the State's scope of action. However, it is equally true that **preference has been given to making even more limited use of this capacity to influence the development of the Spanish economy through the budget balance, the volume of expenditure and the composition of the budget**. As a result, we find that the **economic policy line that the PGE-2007 follow is not, in our opinion, the one needed by the Spanish economy**, whose main problem lies in a structural loss of competitiveness that can only be resolved through far-reaching reforms. Several **reasons** back up this statement:

- **The situation in Spain is good, but the model is reaching its limits**, and this is also taking place in an international scenario in which risks are increasing. Spain's real annual growth rate is maintained at over 3%, but this has been achieved unevenly: a strong boost from domestic demand, a worsening of the external deficit, inflation far above a rate that is compatible with price stability, high levels of household debt and extremely slow progress in productivity.

- As a result, **the economic policy should aim at achieving macroeconomic stability in the short term** (expenditure restraint) **and establishing the bases for a change in model in the medium and long term** (structural reforms). Both objectives require immediate measures. However, these objectives do not appear to guide the fiscal policy that is taking shape in the PGE-2007, because:
  - It does not have the stabilizing nature that it could and should demonstrate. **The budgetary surplus goal (0.2% of the GDP for the State and 0.7% for the Governments) is not ambitious enough**, so in the short term, it does not represent a true restraint of aggregate expenditure, and in the long term, it compromises the stability of the public accounts.
  - **The budgets provide for a significant increase in non-financial expenditure, equivalent to the economy's nominal growth rate (6.7%)**. They also entail a **higher non-productive structural expenditure**, i.e., they include an increase in current expenditure items that generate permanent commitments, conditioning future fiscal stability without contributing to improving competitiveness. **Thus, the problems caused by the lack of structural reforms are aggravated**. And even though **the allocation of more funds to items relating to boosting productivity—education, R&D+i, infrastructures, etc.—is a step in the right direction**, greater progress would necessarily require such structural reforms.
  - These budgets largely demonstrate a **short-term approach**, evident, for example, in the Labour Reform to convert fixed-term contracts into open-ended ones. There are political determinants (Autonomous Community and municipal elections in 2007 and General Elections in 2008) that take precedence over the economic factors, thus imposing a shorter horizon on the economic policy than is advisable to achieve the necessary change in model, with the resulting opportunity cost. In short, **necessary reforms are delayed, and therefore their potential cost increases in the future, when the situation may not be as favourable as it is today**.
  - **Furthermore, necessary changes are not being undertaken in the area of Social Security Administrations**, more specifically in the pension system, **changes essential to ensuring its sustainability** in the increasingly near future, when demographic variables will exert greater pressure. **The surplus in these Administrations for 2007 and the resulting growth of the Social Security Reserve Fund are good news**, but unfortunately, they are **temporary and insufficient** in the face of the

magnitude of an implicit debt that could land the system in dire financial straits within 15-20 years.

In conclusion, and elaborating on our commentary of last year regarding the budgets then under discussion, with the Draft Budgets presented by the Government, the opportunity to take advantage of the upswing of the cycle to adopt the adjustment measures that the Spanish economy needs to establish a more competitive growth model has once again been wasted. Electoral calculations and the short horizon of the political cycle have prevailed over arguments of economic soundness and efficiency. The price to be paid in a short time frame may be a worsening of the imbalances in the economy's current climate of dynamism, and/or a sharp adjustment with significant decreases in growth rates.