2013 Budget: Impact on fiscal consolidation

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The 2013 Draft Budget forecasts an overall deficit of 4.5%, in line with the agreed upon targets at the EU level. Meeting this target depends crucially on how the economy will perform.

The Draft Budget for 2013, to be approved before year-end, contains ambitious deficit targets, as agreed with EU authorities. Next year's revenue forecasts have been calculated on the basis of economic performance and the anticipated impact of the tax changes implemented since December 2011. Most budgetary items show a reduction in spending levels. It is worth noting the evolution of financial charges on debt and the overall sharp cutback in total resources available to the ministries. Underperformance relative to the government's optimistic GDP forecast, liquidity injections for nationalized financial institutions, and a larger than anticipated social security deficit could have negative implications on the final deficit figures and financing costs.

Initial situation

On Thursday, September 27th, the Council of Ministers approved the Draft General State Budget for 2013. This legal text defines the upper limit on spending and its distribution across the various policy areas: health, education, justice, etc., together with the government's revenue forecasts. Reflecting Spain's organisational structure, the State Budget also includes the figures for the various ministerial departments, the social security system, autonomous agencies, and state-owned public sector businesses[3]. The details contained in the draft budget are being debated by the political parties in the two legislative chambers –Congress of Deputies and Senate– in the final quarter of 2012. The final text, with the amendments included, must be approved before December 31st, 2012. This legal text will then become the State General Budget for 2013. There is no doubt as to its being approved, given that the Partido Popular (PP)[4] has an absolute majority.

The 2013 budget will be the second to be drafted by the Partido Popular (PP) since the elections on November 20th, 2011[5]. Once again, the priority objective will be to correct the imbalances in the

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[3] The budgets of the Autonomous Regions, Autonomous Cities, and local authorities are not included in the State Budget.

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[5] Exceptionally, the 2012 budget was approved in June 2012. The People's Party drew up the budget after the elections in November 2011.

public accounts. To better understand the context in which they were prepared, it should be recalled that in 2011, the preceding Socialist Party (PSOE) government agreed upon an overall government deficit of 6% with the European Union authorities. However, the final figure was much higher, 9.44%, which was a long way from the 8.9% the PP had considered feasible after adjusting the imprecise figures it inherited from the previous government when it came to office. This 0.54 point difference between the PP government's forecast and Eurostat's final revised figure is due to two factors. First, the downward revision of the Spanish economy's growth in 2011, from 0.7% to 0.4%, raising the deficit by 0.06 points. Second, as a result of the public aid to the banking sector, which added 0.48 points to the deficit.

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Table 1 lists the deficit targets for the general government as a whole agreed with the EU authorities. On this point it should be noted that on July 10th, 2012 the EU's Council of Economics and Finance Ministers (ECOFIN) gave Spain an additional year to bring the deficit to below 3%. This target is now due to be met in 2014. This decision was taken in response to the economy's worse-than-expected performance. The condition for ECOFIN's granting Spain an extra year for fiscal consolidation was its preparation of a biannual 2013-2014 budget. The budgetary plan that was approved in August 2012 envisaged a cumulative adjustment for the general government as a whole of 13,118 million euros in 2012, 38,956 million euros in 2013, and 50,075 million euros in 2014. As Table 1 shows, the biggest adjustment falls in 2013, with a figure of 25,838 million euros, of which 15,069 million (58.3%) is expected to be obtained through tax measures.

Following ECOFIN's revision in July 2012, the new deficit limits for total general government were set at 6.3% in 2012, 4.5% in 2013, and 2.8% in 2014. If these forecasts are met, the general government deficit will drop to below 3% in 2014, thus culminating the consolidation process. Moreover, on these forecasts, local authorities will reach budgetary equilibrium in 2013, and the Autonomous Regions will run a budget surplus in 2015.

Focusing on 2013, the 4.5% general government deficit forecast is distributed as follows: 3.8 points correspond to the central government, 0.7 to the Autonomous Regions, with local authorities expected to achieve budgetary equilibrium. Meeting these targets depends crucially on how the economy performs in 2013 –and therefore on the performance of revenues and some of the expenditure items, such as unemployment benefits.

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On this point, the government's forecasts are for a 0.5% contraction of GDP in 2013. By contrast, the panel forecast compiled by *Fundación de las Cajas de Ahorros* (Funcas) suggests a drop of 1.5%. This matches the European Commission's forecast. The International Monetary Fund (IMF) predicts a drop of 1.3% in its latest revision (October 2012), and BBVA's Research Department has just published its estimate for 2013 GDP, which predicts it will drop by 1.4%. If the government's optimistic forecast is not met, the revenue figure will be overestimated and expenditure underestimated,

Table 1

Summary of tax measures adopted by general government (millions of euros, in cumulative terms)

Measures	2012	2013	2014
Tax measures	4,975	15,069	15,425
Public administration	5,425	3,723	5,372
Employment	1,888	5,746	5,989
Social Security	70	-1,040	-2,551
Aid for disabled persons	160	1,391	1,473
Specific measures – national level	600	3,700	6,000
Specific adjustment measures – Autonomous Communities		6,867	12,867
Local government reform		3,500	5,500
Cumulative total	13,118	38,956	50,075
Annual change	13,118	25,838	11,119

Table 2

Government deficit targets for the public administration as a whole

Institution	2012	2013	2014	2015
State	-4.5	-3.8	-2.7	-2.1
Autonomous Regions	-1.5	-0.7	-0.1	0.2
Local Authorities	-0.3	0.0	0.0	0.0
Total	-6.3	-4.5	-2.8	-1.9

which will have a strong negative impact on the deficit and the Spanish government's financing capacity.

Meeting the deficit targets in 2013 will depend on the legacy from the previous year. Two factors are crucial to achieving the 2012 target. First, the liquidity injection due to be given to nationalised financial institutions –the impairment suffered by banking sector loans and equity has been estimated at 11,556 million euros. And second, the slippage in the social security deficit, which has been estimated by the government at 10.5 billion euros, due to the deterioration in revenues from social security contributions, the rising number of pensioners, and the sums allocated to pay for unemployment benefits. For this reason, it is highly likely that the general government deficit will overshoot the 6.3% target in 2012. In fact, the Bank of Spain's estimates put the 2012 deficit at

7.4%, the International Monetary Fund and BBVA at 7.0%, and the Funcas expert panel at 6.9%. Even so, cutting the public deficit by around 2.5 points –from 9.44% in 2011 to a figure close to 7%– would be a significant achievement given that the Spanish economy is in a deep recession.

The 2013 income budget: Objectives and constraints

The revenue forecasts in the draft 2013 General State Budget have been calculated taking into account the (i) downturn in the economy, and (ii) the impact of the tax reforms implemented since 2011.

In the case of the first of these factors, the impact of the economic cycle on tax revenues is well known. When quantifying this relationship, the key variable is domestic demand. This is the closest variable to the concept of the tax base, on both the income and expenditure sides. Official estimates of the drop in domestic demand in 2012 put it at 3.1%. This value is slightly higher than the -4.0% put forward by the Funcas expert panel and the International Monetary Fund in its October 2012 update. For 2013, the figures given in the draft budget estimate a drop of 1.1% in domestic demand, whereas Funcas puts it at -3.8%, and the IMF at -3.3%. As regards tax reforms, since December 2011 the government has been implementing a series of changes affecting the

Table 3

Central government non-financial income in 2013 (millions of euros)

Chapters	State	Total	Share of tax revenue	Share of total non-financial income
Personal income tax	42,251	74,215	42.6	38.3
Corporate income tax	19,012	19,012	10.9	0.1
Non-resident income tax	2,248	2,248	1.3	1.2
Pension fund contribution	995	995	0.6	0.5
Miscellaneous	133	133	0.1	0.1
I. Direct taxes	64,639	96,603	55.5	49.8
Value added tax	28,272	54,657	31.4	28.2
Excise duties and special taxes	8,438	19,956	11.5	10.3
Alcoholic beverages	331	717	0.4	0.4
Beer	121	277	0.2	0.1
Intermediate products	8	16	0.0	0.0
Hydrocarbons	4,405	10,362	6.0	5.3
Tobacco products	3,508	7,099	4.1	3.7
Electricity	65	1,485	0.9	0.8
Miscellaneous	2,884	2,884	1.7	1.5
II. Indirect taxes	39,594	77,407	44.5	39.9
I to II TAX REVENUES	104,234	174,099		89.8
III Fees and other income	4,324	4,324		2.2
IV Current transfers	9,211	9,211		4.8
V Property income	5,614	5,614		2.9
VI Sale of real estate	135	135		0.1
VII Capital transfers	527	527		0.3
III to VII OTHER REVENUES	19,811	19,811		10.2
TOTAL NON-FINANCIAL INCOME	**124,044**	**193,910**		

main taxes –personal income tax (IRPF), corporate income tax (IS), value added tax (VAT), and excise duties and special taxes– with the aim of slowing the drop in revenues. These tax changes, as we shall see, will have effects in 2012 and subsequent years.

As our starting point, Table 3 shows the government's non-financial income for 2013 broken down by tax type. The table shows the budgeted non-financial income in 2013 coming to 193,910 million euros –of which 89.8% are tax revenues (174,099 million euros). These figures are net of the fiscal benefits existing in all the taxes, such as deductions for dependent children in the case of personal income tax, or for investments in R&D in the case of corporate income tax. The loss of revenues caused by these fiscal benefits has been estimated at 38,986 million euros in 2013, or 20.1% of estimated revenues. The government's estimates show an increase in total non-financial income between 2012 and 2013 of 3.74%. The difference between the *Total* and *State* columns is due to the taxes transferred to the Autonomous Regions under Spain's system of fiscal decentralisation. Specifically, it is forecast that 40.12% of the total tax income obtained in 2013 will be transferred from the central government to the Autonomous Regions (69,865 million euros). Consequently, the State will have 104,234 million euros from tax revenues and 19,811 million euros from other income (fees, transfers, sale of assets, etc.). As Table 3 shows, the two pillars of the Spanish tax system are personal income tax (IRPF), which provides 42.6% of revenues, and value added tax (31.4%). The forecasts suggest that 74% of revenue will be obtained from these two taxes. Next in importance are the excise duties and special taxes (11.5%) and corporate income tax (10.9%), which together provide 22.4% of revenues.

Main legislative changes effective in 2013

The revenue forecasts for 2013 set out in Table 2 factor in the impact of the tax measures implemented since December 2011. Since that date, four pieces of legislation have been passed that include tax changes that will have an impact on revenues in 2013. The first package of measures was enacted by the PP government immediately after coming to power in the elections on November 20th, 2011 (Royal Decree/Law, December 30th, 2011). These changes to the tax system were passed as urgent measures to narrow the discrepancy existing between the deficit forecast by the outgoing government (6%) and the new government's initial estimates, which placed it at 8.5%. The second package was included in the 2012 State Budget. However, given that the 2012 budget was finally passed in June this year, the tax changes were introduced urgently via Royal Decree/Law 12/2012, March 30th, 2012. The changes incorporated in this second legislative instrument basically affected corporation tax. The third package of tax measures was enacted by Royal Decree/Law 20-2012 on July 13th, 2012. Among other measures, this raised the VAT rates and eliminated the tax deduction for investments in the primary residence. This tax reform took place after the ECOFIN Council meeting on July 10th, which recommended various measures to deepen the process of fiscal consolidation. The last set of tax changes was included in the draft 2013 State Budget. The following sections describe the main changes included in these four packages of tax measures.

(i) First package of tax reforms

The most important tax changes included in Royal Decree/Law 20/2011, December 30th, 2011, effective in 2013 are:

A sharp increase in the State tranche of the marginal rates of personal income tax in the "common regime" Autonomous Regions –i.e. all of Spain except the Basque Country and Navarre, which have fiscal autonomy regarding income tax. This complementary tax will be in force in 2012 and 2013. As Table 3 shows, the increase in the tax rate affects both income from savings and all other taxable income. The increase in the marginal rates varies

from 0.75 points, applicable to incomes of less than 17,702.2 euros, to 7 points for incomes over 300,000.2 euros. However, it should be borne in mind that the tax rates paid by residents of the Autonomous Regions in the "common regime" are made up of the state tax rates listed in Table 4 plus the regional tax rate set in each region[6]. The estimates in the draft State Budget indicate that this extra tax will raise an additional 1,772 million euros in 2013. The impact of this complementary tax on revenues in 2012 makes it reasonable to doubt the government's revenue forecasts for 2013. Initially, the government estimated that the reform would produce an additional 5,400 million euros in revenues. This was reduced to 4,100 million euros and then 3,702 million euros (this last estimate being given in the draft 2013 State Budget).

Delivering on its electoral promise, the government restored the tax deduction on mortgage (interest plus + capital), applying it retroactively from January 2011. The 2011 State Budget had eliminated this deduction for home purchases since January 1st, 2011 in the case of taxpayers whose taxable income was over 24,107.20 euros –for all other taxpayers the value of the deduction dropped with income, such that the maximum amount was the 15% of 9,040 euros for a taxable income of 17,707.20 euros or less. Following the recommendations of the EU authorities, the draft 2013 State Budget has included the elimination of this mortgage tax relief on homes purchased on or after January 1st, 2013. The government calculates that eliminating this incentive will bring in extra tax income of 430 million euros.

Property tax (IBI) has been temporarily increased in 2012 and 2013. IBI is a direct tax on properties such as homes, garages and commercial premises. Revenues from this tax are one of the pillars of local authority financing in Spain. To shore up its finances, the government raised the rates of this tax, which range between 4% and 10%. However, the increase is limited to properties whose cadastral value is higher than the median cadastral value in the municipality concerned.

The application of the super-reduced rate of VAT on home purchases has been extended until December 2012. This reduces the VAT paid on home purchases from 8% (reduced rate previously in force) to 4% (super-reduced rate). This change, originally approved in July 2011 by the previous socialist government, was intended

Table 4

Increase in marginal income tax rates in force in 2012 and 2013 (state tranche of tax)

General tax basis			Savings tax basis		
Threshold (euros)	Applicable marginal rate	Increment in marginal rate (points)	Threshold (euros)	Applicable marginal rate	Increment in marginal rate (points)
0.00	12.75	0.75	0.00	10.50	1.0
17,707.20	16.00	2.00	6,000.00	12.50	2.0
33,007.20	21.50	3.00	24,000.00	13.50	3.0
53,407.20	25.50	4.00			
120,000.20	27.50	5.00			
175,000.20	29.50	6.00			
300,000.20	30.50	7.00			

[6] A detailed description of the state and regional income tax rates in force in 2013 in the common regime Autonomous Regions is given in Sanz-Sanz and Romero-Jordán (2012).

to help reduce Spain's stock of unsold properties left over from the housing boom. In January 2013, homes will again be taxed at the reduced rate (currently 10%). Official estimates indicate that this tax change will boost VAT revenues by 750 million euros in 2013.

(ii)Second package of tax reforms

This package of measures was approved urgently by means of a Royal Decree. The reason being that the 2012 Budget was not submitted to debate on October 1st, as was required, so could not be approved before the end of the year. Under Spanish law this anomalous situation obliged the new government to extend the 2011 budget. Consequently, the People's Party government had to prepare a budget proposal for 2012, which was discussed in both houses of the Spanish parliament, and finally passed in June 2012. The government opted to approve a package of tax measures by Royal Decree/Law 12-2002, March 30th, 2012, which were incorporated in the 2012 State Budget. As will be discussed below, the measures include a series of changes to corporate income tax, most of which will be in force in 2012 and 2013. There was also a slight restructuring of the excise duty on tobacco products, increasing the specific component and reducing the *ad valorem* part. Additionally, for 2012 a tax of 8% on foreign dividends was passed, and a tax regularisation plan applying a tax of 10% to previously undeclared income (the proceeds of tax evasion) before November 30th, 2012.

The most significant changes made to the structure of corporate income tax (IS) are as follows. Firstly, the annual ceiling on deductions for amortisation of goodwill has been reduced from 5% to 1%. This measure will only apply in 2012 and 2013. The cost of this measure in 2013 is estimated at 20 million euros. Secondly, large companies no longer have freedom of amortisation. It has been kept in the case of small and medium-sized businesses, provided it is associated with job creation. This measure is expected to raise estimated revenues of 145 million euros. Thirdly, the deductibility of financial charges has been limited. Specifically, financial charges exceeding 30 percent of the profits for the financial year cannot be deducted –the first million euros of financing costs will not be affected by this new limit. With some exceptions, financial costs deriving from shareholdings in the same business group are not deductible. The impact of these measures is an estimated 286 million euros. Lastly, a minimum IS instalment payment has been set for companies with profits of over twenty million euros a year.

(iii) Third package of tax reforms

After the ECOFIN summit on July 10th, the government passed Royal Decree/Law, July 13th, 2012, which contained a series of measures to ensure budgetary stability and stimulate competitiveness. The measures in the budgetary area have affected VAT, excise duties, personal income tax (IRPF), and corporate income tax (IS).

In the case of VAT, the normal and reduce rates have been increased, but the super-reduced rate has been left unchanged at 4%. Specifically, the reduced rate was raised by 2 points from 8% to 10%, and the standard rate by 3 points, from 18% to 21%. The Royal Decree/Law also made a number of changes to the VAT tax base. For example, the normal rate of VAT is now applicable to cinemas, theatres and shows (they were previously subject to the reduced rate). Also, school stationery has been moved from the super-reduced to the normal rate (books are still taxed at 4%). Although this legislative instrument was passed in July, it came into force on September 1st, 2012. Table 5 illustrates the VAT rates in Spain in force as of January 1st, 2013. The government estimates given in the "Budget Plan 2013-2014" published in early August 2012 quantified the net impact of the tax reform on revenues at 9,774 million euros in 2013 –excluding the change in the tax treatment of home purchases. Using micro-simulation techniques, Sanz-Sanz and Romero-Jordán (2012) estimated that, on current levels of consumption, the impact of the reform on annual revenues would be 6,680 million euros –a figure approximately a third lower than the

official estimate. It should come as no surprise then, that the draft 2013 State Budget has cut its initial estimate by 1,940 million euros, to leave it at 7,834 million euros. The reform also increased the compensating percentages in the farming and fishing regimes, and the general and reduced rates in the special equalization surcharge regime. Along with the changes to VAT there was a restructuring of the taxes on tobacco products, with an increase in the minimum tax on cigars, cigarettes, and rolling tobacco, and a reduction in the minimum applicable to cigarettes. These changes will have a negative impact on revenues of 138 million euros.

Table 5

VAT rates in Spain following the 2012 reform

Super-reduced rate 4%	Reduced rate 10%	Standard rate 21%
Bread, milk, eggs, fresh fruit and vegetables, books, newspapers, medicines for human use, cars for the disabled, prostheses for the disabled.	Meat, fish, processed foods, water, medicines for animal use, public transport, hospitality (bars, restaurants, hotels), glasses and contact lenses. New housing.	Other goods: for example, alcoholic beverages, tobacco products, clothing and footwear, private transport (cars, motorcycles, etc.), fuel, electricity, etc. Refurbishment of housing. Tickets for the theatre, circus, cinema and other shows, digital television services, hairdressers, funeral services, flowers and plants, works of art.

In the case of personal income tax, tax relief on the purchase of a primary residence has been eliminated. The deduction applicable to homes bought before January 20th, 2006 was 25% in the first two years, and 20% in the third and subsequent years. After this time, the percentages dropped to 15% on a maximum amount of 9,015 euros. To offset the impact on homebuyers who purchased before January 20th, 2006, the legislation included an additional deduction of 5% on a limit of 4,507 euros (225 euros per income tax return). This complement has been repealed, with the general application of a 15% deduction for homebuyers who purchased their home before December 31st, 2012. The estimates in the draft General State Budget indicate that this measure will increase revenues by 430 million euros in 2013. The new legislation has also raised the withholding rate applicable to courses, lectures and seminars, and writing literary, artistic and scientific works from 15% to 19%. This change, applicable on a transitional basis in 2012 and 2013, will have an impact of 340 million euros in 2013.

The changes made to corporate income tax expand and deepen the changes introduced in the second package of reforms discussed above. On a transitional basis, limits have been set on the offsetting of losses against taxable income in 2012 and 2013. For companies with a turnover in excess of 20 million euros, the limit has been reduced from 75% to 50%. These limits drop from 50% to 25% if turnover is in excess of 60 million euros. The tax rate also rises as a function of turnover. For companies with a turnover in excess of 10 million euros, the rate has risen from 21% to 23%. The rate has gone from 24% to 26% for companies with a turnover exceeding 20 million euros. And the rate has risen from 27% to 29% if turnover is more than 60 million euros a year. The rate for instalment payments has risen from 8% to 12%.

A number of changes have been made to the structure of the tax that will be applicable permanently as of 2012. First, the limit on the deductibility of financial costs is now applicable to

all companies (it was previously only applicable to financial groups). And second, the tax rate on foreign dividends and earnings has been raised to 10%.

(iv) Fourth package of tax reforms

The changes included in the Presentation of the draft State Budget comprise the fourth and final

Table 6

Expected impact of the tax reforms in millions of euros
Measured as the difference with respect to the previous year

Taxes	2012	2013	Δ	Δ (%)
Personal income tax (IRPF)	**3,990**	**2,751**	**-1,239**	**-31.1**
Elimination of the allowance of 2,500 euros for the birth of a child	116			
Increase in the tax rate on incomes over 120 thousand euros	27			
Complementary levy	3,702	1,772		
Increase in the withholding rate for professional activities	330	340		
Elimination of bonus for public employees	-185	-615		
Elimination of tax deduction for home purchase		430		
Tax on lottery prizes over 2,500 euros		824		
Corporate income tax	**6,470**	**-2,757**	**-3,713**	**-57.4**
Increase in the limits for small businesses	-223			
Increase in the withholding rate for capital income	294	-294		
Measures affecting payments and compensation in large companies	2,999	-4,535		
Limitation on the deductibility of financial charges	1,300	286		
Elimination of freedom of amortisation	840	145		
Limits on deductibility of goodwill	210	20		
Special tax on foreign dividends	1,050	-1,050		
Limits on deductibility of amortization expenses		2,371		
Asset revaluation tax		300		
Non-residents income tax	**104**	**26**	**-78**	**-75.0**
Special tax return	**2,500**	**-2,500**	**0**	**0.0**
VAT	**1,372**	**8,584**	**7,212**	**525.7**
Rate increase in July 2010	-178			
Reduction in the VAT rate on home purchases from 8% to 4%	-750	**750**		
Rate increase in September 2012	2,300	**7,834**		
Excise duties and special taxes	**187**	**1,025**	**838**	**448.1**
Tobacco products	95	**-138**		
Hydrocarbons	92	**1,163**		
Fees and other income	**214**	**92**	**-122**	**-57.0**
TOTAL	**14,837**	**7,221**	**-7,616**	**-51.3**

package of tax reforms implemented to date. The modifications mainly affect IRPF and IS, and are as follows. As mentioned, the deduction for investments in the primary residence has been eliminated, and the treatment of capital gains on short-term investments and the treatment of lottery prizes have been changed. After January 1st, 2013, capital gains generated on investments held for less than a year –considered speculative– will be taxed at the standard rate for IRPF. At present, these capital gains are taxed at the much lower rate applicable to savings (see Table 3). Also, any prizes worth more than 2,500 euros awarded by lotteries organised by the *Sociedad Estatal de Loterías* (the national lottery company), the Autonomous Regions, the Red Cross or the *Organización Nacional de Ciegos Españoles* (Spanish National Organisation for the Blind), will be taxed at 20%. Prizes of this kind were traditionally exempt from personal income tax.

The draft also introduces some significant changes to the structure of corporate income tax. Firstly, a limit has been placed on tax deductibility of tangible fixed asset depreciation charges. Specifically, in 2013 and 2014, companies will only be able to apply 70% of the maximum coefficient envisaged in the amortisation tables. The impact of this measure has been estimated at 2,371 million euros. Secondly, companies can revalue tangible fixed assets voluntarily at low tax cost. As a particular case, real-estate assets have to be updated individually. The revaluation will be registered in a reserve account to which a tax rate of 5% will apply. It is estimated that this measure will raise an extra 300 million euros of corporate income tax revenues.

Table 6 summarises the expected effect of the tax changes mentioned in this section on the 2013 budget. The following points need to be borne in mind when interpreting this information. Firstly, as mentioned above, tax revenues in 2013 will be influenced by the tax reforms implemented in 2012 and in 2013. Secondly, the figures show the differential impact of 2012 revenues compared to the previous year. The increment in revenues is estimated at 7,221 million euros. However, if we discount the effect of these measures that will only apply in 2013, the impact on revenue will be 10,094 million euros. Thirdly, the government's estimates show that the biggest contribution to this figure will come from VAT (8,584 million euros) and IRPF reform (2,751 million euros). Corporate income tax, however, will have a negative effect (-2,757 million euros) on revenues in 2013, as a result of the changes made in 2012 to bring forward payments to this year and to limit large company's offsetting of losses. For this reason the measures the government has adopted include a restriction on large company's freedom of amortisation in 2013. Finally, as discussed above, there are reasons to think that the figures for the impact on revenues in 2013 might be overestimated by around 3 billion euros.

Cutbacks in public spending

The consolidated spending by the State, the social security administration, and autonomous agencies (under Chapters I to VIII) will increase by 2.5% in 2013, from 311,776 to 319,460 million euros. For the purposes of illustration, Table 7 summarises the consolidated State budget broken down by functional classification. Most items show a reduction in spending levels. As will be discussed below, one of the few exceptions is pension spending, which will increase by 4.9%. The behaviour of this item, which accounts for 43% of consolidated spending, is the main factor behind the 2.5% increase in total spending. 56% of total expenditure will be social spending, which basically consists of pensions and other benefits, which are managed by the social security administration (121,556 million euros), and unemployment benefits, which are managed by the state employment service (*Servicio Estatal de Empleo Público*, SEPE)(26,993 million euros). This section gives an overview of the spending items that have had the biggest impact on the preparation of the budget. It also shows the government's main adjustments to meet the deficit target.

State Budget

The State's spending will grow by 5.42% in 2013 –from 164,650 to 173,583 million euros. In other

Table 7

Consolidated State Expenditure Budget (Chapters I to VIII)
Summary of breakdown by spending policy (millions of euros)

Chapters	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	Δ (%) (2) /(1)
1. Basic public services					
Total (Justice, defence, citizen security, and foreign policy)	17,917.4	6.3	16,724.6	6.0	-6.7
2. Social spending					
Total	175,393.0	62.0	178,771.3	63.6	1.9
Pensions	115,825.9	40.9	121,556.5	43.3	4.9
Unemployment benefits	28,805.0	10.2	26,993.7	9.6	-6.3
Other current transfers	12,043.2	4.2	11,880.2	4.2	-1.1
Health	3,975.6	1.4	3,852.2	1.4	-3.1
Education	2,270.9	0.8	1,944.7	0.7	-14.4
Other social spending	12,472.4	4.0	12,544.0	3.9	0.5
3. Economic measures					
Total	26,995.3	9.5	24,177.3	8.6	-10.4
Farming, fishing and food	8,454.6	3.0	7,661.8	2.7	-9.4
Energy and industry	1,897.0	0.7	1,653.5	0.6	-12.8
Tourism, trade and SMEs	1,095.9	0.4	889.5	0.3	-18.8
Transport subsidies	1,616.8	0.6	1,178.2	0.4	-27.1
Infrastructure	6,900.8	2.4	5,966.6	2.1	-13.5
Civil R&D	5,562.7	2.0	5,562.8	2.0	0.0
Military R&D	757.6	0.3	363.3	0.1	-52.0
Other	709.5	0.3	901.3	0.3	27.0
4. General measures					
Total	62,622.7	22.1	61,197.7	21.8	-2.3
Transfers to other public administrations	49,686.0	17.6	48,285.8	17.2	-2.8
Finance and tax administration	5,757.2	2.0	5,501.5	2.0	-4.4
Other	7,179.5	2.5	7,410.4	2.6	3.2
TOTAL CHAPTERS I to VIII	311,776.4		319,460.6		2.5

words, the State's spending will increase by 8,933 million euros. Nevertheless, as Tables 8 and 9 show, this figure is –3,883 million euros after discounting social security payments, interest on the debt, and transfers to the Autonomous Regions. Two aspects of the central government budget are worth emphasising: (i) how financial charges on the debt have evolved, and (ii) the sharp cutback in the total resources available to the ministerial departments.

Two aspects of the central government budget are worth emphasising: (i) how financial charges on the debt have evolved, and (ii) the sharp cutback in the total resources available to the ministerial departments.

Interest charges on the debt will increase by 9,741 million euros in 2013 (33.8%), the ratio of debt to

Table 8

State Expenditure Budget (Chapters I to VIII)
Breakdown by Sections (millions of euros)

Chapters	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	∆ (%) (2) /(1)
1. Constitutional bodies					
Royal household, Parliament, National audit office, Constitutional court, etc.	383.96	0.1	367.61	0.1	-4.2
2. General Government Debt					
Debt interest	28,848.00	17.9	38,589.55	22.7	33.8
3. Civil Service Pensions					
Civil service pensions	11,280.00	7.0	12,150.00	7.2	7.7
4. Ministries					
Foreign Affairs	1,493.20	0.9	1,343.22	0.8	-10.0
Justice	1,574.00	1.0	1,507.78	0.9	-4.2
Defence	6,316.44	3.9	5,937.00	3.5	-6.0
Treasury and Public Administration	2,679.96	1.7	2,424.60	1.4	-9.5
Interior	7,701.78	4.8	7,214.19	4.2	-6.3
Public Works	7,291.08	4.5	6,488.70	3.8	-11.0
Education, Culture and Sport	3,093.31	1.9	2,561.16	1.5	-17.2
Employment and Social Security	20,924.40	13.0	23,798.39	14.0	13.7
Employment and Social Security, excluding transfers to the state employment service and the social security administration	500.36	0.3	458.9	0.3	-8.3
Industry, Energy and Tourism	3,752.93	2.3	2,952.57	1.7	-21.3
Agriculture, Food and Environment	2,252.69	1.4	1,680.15	1.0	-25.4
Prime minister's office	432.00	0.3	434.47	0.3	0.6
Health, Social Services and Equality	2,310.24	1.4	2,970.21	1.7	28.6
Economy and Competitiveness	6,061.21	3.8	6,301.11	3.7	4.0
Spending by various ministries	2,189.65	1.4	1,976.02	1.2	-9.8
Total for all Ministries	68,072.90	42.3	67,589.59	39.8	-0.7
Total for all ministries excluding transfers to the state employment service and the social security administration	43,604.51	27,1	39,721.20	23.4	-8.9
5. Transfers to the Autonomous Communities and the European Union					
32. Other financial relationships with territorial bodies	1,002.87	0.6	656.01	0.4	-34.6
33. Inter-territorial compensation fund	671.58	0.4	671.58	0.4	0.0
34. Financial relationships with the EU	11,770.72	7.3	11,900.60	7.0	1.1
35. Contingency fund	2,322.81	1.4	2,535.84	1.5	9.2
36. System of financing for rail authorities	36,489.31	22.7	35,314.23	20.8	-3.2
Total for Chapters I to VIII	164,650.00	100.0	173,583.02	100.0	5.6

Table 9

State Expenditure Budget (millions of euros), (Excluding contributions to the state employment service, the social security administration, and obligations from previous years)

Chapters	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	Δ (%) (2) /(1)
I. Personnel expenses	16,244.04	37.3	15,615.12	39.3	-3.9
II. Current expenditure on goods and services	2,922.97	6.7	2,749.3	6.9	-5.9
III. Financial expenses	27.42	0.1	24.94	0.1	-9.0
IV. Current transfers	7,554.24	17.3	6,909.07	17.4	-8.5
Current operations	26,748.68	61.3	25,298.43	63.7	-5.4
V. Contingency fund	44.46	0.1	30	0.1	-32.5
VI. Real investments	3,930.86	9.0	3,240.35	8.2	-17.6
VII. Capital transfers	4,668.49	10.7	3,484.59	8.8	-25.4
Capital operations	8,599.35	19.7	6,724.95	16.9	-21.8
Total non-financial transactions	3,5392.49	81.2	32,053.38	80.7	-9.4
VIII. Financial assets	8,212.03	18.8	7,668.48	19.3	-6.6
IX. Financial liabilities	0.37	0.0	0.37	0.0	0.0
Total financial transactions	8,212.4	18.8	7,668.85	19.3	-6.6
TOTAL BUDGET	4,3604.89	100.0	39,722.23	100.0	-8.9

GDP will reach a level close to 90% in 2013. In fact, debt interest in 2013 will be approximately equal to the spending by all the ministries, which is 39,721 million euros, after excluding transfers to the state employment service and the social security administration. As Table 7 shows, ministerial departments will suffer an average cut of 8.9% –which is in addition to the 16.9% initially envisaged for 2012. However, the cutback will be higher than this figure in certain departments, such as the ministries of Foreign Affairs (-10%), Finance (-9.5%), Agriculture (-25.4%), or Public Works (-11.0%).

In absolute terms, the ministries will see their overall budget reduced by 3,883 million euros. 46% of this figure will come from cuts in staff (628.9) and investment costs (1,874.4). Staff costs, which account for 39.7% of state expenditure, will be cut by 3.9%, representing a saving of 629 million euros. This reduction is partly explained by the freeze on new public sector recruitment passed in 2012 (see Sanz and Romero, 2012). The non-replacement of staff is having a direct effect on the total number of public employees working for the central government, which will drop from 561.8 thousand to 547.1 thousand (-2.6%). Also, the freezing of public employees' salaries for the third consecutive year will have a direct effect on staff costs. Nevertheless, the draft budget anticipates that the Christmas bonus, which was eliminated in 2012, will be reinstated in 2013. The State's investments, mainly in infrastructure, will be cut by 17.6% (690.5 million) while capital transfers will drop by 25.4% (1,183.9 million).

Social security budget

Social security spending is set to rise by 6.2% in 2013, to reach 7,537 million euros. 58% of this figure (4,396 million) is explained by the increase in contributory pension expenditure. These figures, which do not include pensions received by public employees, have been calculated assuming that the number of pensioners will increase and pensions will be revalued by 1%. However, the draft budget does not give any details of the change in the number of pensioners.

Table 10

Breakdown of the main social security expenditure items

Items	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	Δ (%) (2) /(1)
Sum total of expenses under Chapters I to VIII	120,698.27	100.0	128,236.23	100.0	6.2
Current transfers	115,634.3	95.8	121,697.2	94.9	5.2
Contributory pensions	101,953.8	84.4	106,350.1	82.9	4.3
Non-contributory pensions	1,995.01	1.6	2,475.5	1.9	24.1
Temporary Incapacity	5,799.2	4.8	5,830.6	4.5	0.5
Maternity, pregnancy and breastfeeding	2,369.8	1.9	2,309.8	1.8	-2.5
Care for dependent adults	1,326.0	1.0	2,126.5	2.6	60.4
Other transfers	2,190.4	1.8	2,604.7	2.0	18.9

Table 11

Breakdown of the main social security revenue items

Items	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	Δ (%) (2) /(1)
Sum total of revenues under Chapters I to VIII	120,698.30	100.0	128,236.26	100.0	6.2
Social security contributions	106,322.9	88.0	105,863.2	82.5	-0.4
From employers and employees	96,048.3	79.5	97,605.0	76.1	1.6
From the unemployed	10,153.7	8.4	8,137.2	6.3	-19.8
For termination of activity (self-employed)	120.8	0.1	120.5	0.0	-0.2
Current transfers received	8,929.8	7.3	15,549.0	12.1	74.1

Also, spending on non-contributory and welfare pensions will increase by 480 million euros. Recipients of these benefits are workers who did not pay contributions over the statutory minimum number of years for entitlement to a retirement pension who do not have a minimum subsistence income (5,007.8 euros in 2012). 82% of the social security system's revenues come from social security contributions paid by employers and employees. It is estimated that this income will increase by 1.6% in 2013. 7.7% of contributions are from the unemployed. As of 2013 these contributions will be paid entirely by the worker – up until 2012, 35% of the amount was met by the State employment service. In short, the Social Security administration's budget foresees a drop in contribution income in 2013, which will oblige the State to increase its transfers to the system from 8,929 million to 15,549 million euros.

Budget for autonomous and state agencies

Along with the central government and the social security system, the draft General State Budget includes the expenditure forecasts of the 73 Autonomous Agencies and the eight State Agencies. These agencies provide a wide variety of different services, and include bodies such as the State Employment Service, the National Library, the National Statistics Institute, the Tax Administration, and the National Research Council. The aggregate spending by these 81 agencies will be cut by 10.5% in 2013 (5,671 million euros). Thus, total spending will go from 53,723 million euros in 2012 to 48,052 million euros in 2013. The State Employment Service will manage 64.3% of this spending in 2013 (or

67.5% of the Autonomous Agencies' expenditure). This agency manages active policies to combat unemployment and pays unemployment benefits. Its figures are shown in Table 11.

Spending on unemployment benefits is projected to fall by 6.3% in 2013, to 26,696 million euros (a drop of 1,811 million euros). This figure includes both contributory unemployment benefits and non-contributory benefits (for unemployed people with dependants whose contributory benefits have been exhausted). The spending on contributory unemployment benefits has been estimated at 13,968 million euros. The government is confident that the legislative changes will reduce spending on unemployment even though the unemployment rate is set to remain close to 25% (24.35%). As regards unemployment benefits, Royal Decree/Law 20/2012, July 13th, 2012, reduces the amount of benefit paid from the seventh month onwards. The amount of benefit has been cut from 60% to 50% of the reference value. In the case of non-contributory unemployment benefit, the legislation has eliminated the special benefit for people over 45, and the age at which unemployed people can claim this benefit when their contributory unemployment benefit has run out has been raised from 52 to 55 years. Finally, the eligibility requirements for the basic guaranteed income received by long-term unemployed and disabled persons have been made stricter. In parallel, active policies to tackle unemployment have been cut back by 1,994 million euros (34.6%).

Table 12

Budget for State Employment Service programmes (millions of euros)

Items	Initial budget 2012 (1)	(%)	Initial budget 2013 (2)	(%)	Δ (%) (2) /(1)
Benefits for termination of activity (self-employed persons)	14.83	0.0	25.48	0.1	71.9
Promoting labour market access and job stability	5,759.56	16.6	3,765.34	12.2	-34.6
Unemployment benefits	28,805.05	83.0	26,993.70	87.3	-6.3
Internal transfers	139.51	0.4	132.03	0.4	-5.4
TOTAL	34,718.95	100.0	30,916.55	100.0	-11.0