

Report on Autonomous Region Initial Budgets for 2017 (Article 17.2 of the Organic Law on Budget Stability and Financial Sustainability)

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

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Executive Summary

The scheduled publication of reports by the Independent Authority for Fiscal Responsibility (AIReF) that assesses Autonomous Region (MBL) and approved budgets was shifted due to the presence of a central caretaker Government for the bulk of 2016, affecting the drafting of Autonomous Region budgets for 2017. Due to this, the Report on Autonomous Regions MBL was delayed to February 14th. Therefore, in certain Autonomous Regions, approved Initial Budgets were directly assessed, since the information on which the MBL were drafted was outdated.

The aim of this report is to comply with the government mandate to assess the compliance of fiscal rules through an assessment of available budget information on each Autonomous Region. This information includes the MBL (Article 17.1 of the Organic Law on Budget Stability and Financial Sustainability) of Castile and Leon and the approved budgets (Article 17.2 of the Organic Law on Budget Stability and Financial Sustainability) of Cantabria, Catalonia, La Rioja and the Basque Country. Also, picking up from the February report, this report completes the partial assessment of Valencia's Initial Budget.¹

In addition, due to the recent publication of data that significantly alters budget information of the Autonomous Regions assessed in the previous Report, the AIReF has included updated projections for the 2017 year-end data of 11 previously-assessed Autonomous Regions now not subjects in a new report. These 11 Autonomous Regions are Andalusia, Aragon, Asturias, the Balearic Islands, the Canary Islands, Castile-La Mancha, Extremadura, Galicia, Madrid, Murcia and Navarre.

Using the feasibility-equity framework which assesses budget performance in the moment in which targets are stipulated, the AIReF's assessment of new available information has revised the likelihood of target compliance upward for all Autonomous Regions, and improved the rating in 7 cases. Currently, there are two sets of Autonomous Regions identified:

- 11 Autonomous Regions where budgetary execution would comply with targets, with varying degrees of likelihood:

¹ For Valencia, a preliminary and partial view is expressed once the significant discrepancies observed between revenue and covered expenditure levels are clarified in the numerous budget documents available.



- ✓ Very likely: The Balearic Islands, the Canary Islands and La Rioja
 - ✓ Likely: Andalusia, Asturias, Galicia and Madrid
 - ✓ Feasible: Castile and Leon, Castile-La Mancha, Catalonia and the Basque Country
- 6 Autonomous Regions where budgetary execution would not comply with targets, with varying degrees of likelihood:
- ✓ Unlikely: Aragon, Navarre and Valencia
 - ✓ Very unlikely: Cantabria, Extremadura and Murcia

In the 6 Autonomous Regions where budgetary execution would not comply with targets, the AIReF considers, without prejudice to the financial-economic plans for non-compliance in 2016², that these Autonomous Regions should perform a comprehensive monitoring of budgetary execution in order to address detected risks in their budget scenarios. For Aragon, which still has no approved budget, the inclusion of necessary information into its Initial Budget is recommended to sustain the revenue and expenses trend reflected in its budget scenario.

At the Autonomous Region sub-sector level, the AIReF still deems the stability target of -0.6% of GDP as feasible, since the resources from Autonomous Regions' financing system will increase in 2017 as compared to 2016. In addition, there is a GDP adjustment of two tenths required for 2017 target compliance, once the 2016 year-end data are confirmed at 0.08% GDP. These reasons back the AIReF's feasibility assessment, hovering around its central projection and in line with the stability target.

The 2017 stability target achievement requires a one-point difference of additional fiscal effort for each Autonomous Region. Therefore, the AIReF insists that uniform targets for separate regions do not reflect specific realities for each Autonomous Region. Moreover, for about half of the Autonomous Regions, the 2017 target increases deficit compared to 2016 levels. However, this can be rectified, to a greater or lesser extent, through compliance with the expenditure rule, as it is more restrictive than the stability target for Autonomous Regions, thus requiring them to exert additional effort.

² In line with 2016-year-end accounting closure data, Aragon, Cantabria, Catalonia, Extremadura, Murcia and Valencia have not complied with the 2016 budget stability target.



There remain constraints in assessing compliance to the expenditure rule due to the problems arising from the analysis and calculation methods used in each Autonomous Region. Despite these constraints, the AIReF deems that sub-sector use trends in Autonomous Region could contribute to expenditure rule compliance.

On the other hand, the flexible analysis by the Ministry of Finance and Public Functions (MINHAFP) in applying the expenditure rule has indeed reduced the effectiveness of this fiscal rule, which is why it is no more restrictive than stability targets in 2017 for Autonomous Regions overall.

Lastly, it is still not possible to assess debt target compliance. Therefore, this report only includes a debt sustainability analysis. Risks posed to financial sustainability are still very high for Autonomous Region sub-sectors, which pushes back debt limit compliance, set at 13% of GDP, about 5 years (i.e. not before 2045), when compared to the outlined timeline in the February Report. On a case by case regional level, there are still very high risks for Catalonia, Castile-La Mancha, Murcia, Valencia, and now Extremadura.

1. Introduction

On February 14th, the AIReF published a Report on Autonomous Region MBL and Initial Budgets for 2017 (Articles 17.1 and 17.2 of the Organic Law on Budget Stability and Financial Sustainability). Due to the 2016 political constraints, there was a shift in the normal scheduled publication of reports. The government mandate sets that previous year MBL information is to be submitted before October 15th and that Initial Budgets on April 1st. This was not the case and thus, the scheduled publication of the AIReF reports was shifted due to the presence of a central caretaker Government until the end of October 2016, in addition to regional elections that took place in both Galicia and the Basque Country. Because of these political constraints, regional MBL submissions were delayed to February 14th which led some Autonomous Regions to directly publish Initial Budgets, since MBL information was outdated.

Therein, the February Report based assessments for 2017 on information waiting on regional budgets to be submitted. The AIReF reported the 2017 MBL of six Autonomous Regions with non-approved budgets: Aragon, Cantabria, Castile-La Mancha, Catalonia, Madrid and la Rioja. Of these six, all but Aragon and Madrid had only Draft Budgets. It also published a report on nine Autonomous



Regions with approved budgets: Andalusia, Asturias, the Balearic Islands, the Canary Islands, Extremadura, Galicia, Murcia, Navarre and Valencia. However, it could only express a preliminary and partial view on Valencia's approved budget due to significant discrepancies observed between revenue and covered expenditure levels in its budgetary documents. Lastly, the AIReF could not express a view on Castile and Leon and the Basque Country, which, on the date of the publication of the February Report, had still not submitted information in regards to the MBL of 2017.

In this Report, the AIReF continues to comply with the government mandate to inform on Autonomous Region MBL and Initial Budgets for 2017. In this Report, it expresses a view on approved budgets for 4 Autonomous Regions and Castile and Leon's MBL. Picking up from the February Report, this Report assess the now approved Initial Budgets of Cantabria, Catalonia, La Rioja and the Basque Country. The MBL and Draft Budgets of these regions were assessed in the February Report, except for, as previously mentioned, those of the Basque Country. Also, Castile and Leon submitted MBL for 2017, which allows the AIReF to express a view on this Autonomous Region.

In addition, the AIReF rounds off the Valencia's Initial Budget assessment, as it was left pending in the February Report. Therefore, the AIReF will express a preliminary and partial view on Valencia's Initial Budget, once the significant discrepancies observed between revenue and covered expenditure levels are clarified.

Lastly, due to the recent publication of data that significantly affects budgetary information Autonomous Regions assessed the February Report, the AIReF includes an update on the 2017 year-end projections for 11 Autonomous Regions that had previously been assessed. These 11 regions' projections are simply updates and not subjects of this current report. The publishing of 2016 year-end data, new data resources in the lending system for Autonomous Regions in 2017 along with additional information submitted by regions themselves, calls for the AIReF to update the 2017 year-end projections for Autonomous Regions assessed in the February Report. This is necessary because no new report has been published for these previously-assessed regions as they remain in the same phase of their budgetary cycles.



Table 1. Autonomous Regions Budget Information for 2017 assessed by the AIReF

AUTONOMOUS REGIONS	Individual Reports Published for Regions by the AIReF	
	Published in February 2017	Published in April 2017
Andalusia	Initial Budget	Updated
Aragon	MBL	Updated
Asturias	Initial Budget	Updated
The Balearic Islands	Initial Budget	Updated
The Canary Islands	Initial Budget	Updated
Cantabria	MBL	Initial Budget
Castile and Leon		MBL
Castile-La Mancha	MBL	Updated
Catalonia	MBL	Initial Budget
Extremadura	Initial Budget	Updated
Galicia	Initial Budget	Updated
Madrid	MBL	Updated
Murcia	Initial Budget	Updated
Navarre	Initial Budget	Updated
The Basque Country		Initial Budget
La Rioja	MBL	Initial Budget
Valencia (*)	Initial Budget	Initial Budget

(*) In the February 14th Report, the AIReF expressed a preliminary and partial view on Valencia's Initial Budget. In this Report, the assessment is completed.

Significant differences have arisen in the in creation of regional budgets due to the presence of a central caretaker Government for the bulk of 2016. This political constraint meant a delay in setting targets and creating the 2017 State General Budget. This has meant that Autonomous Regions used fiscal rules which were overall stricter than those eventually set for 2017, also meaning discrepancies between previous estimates of available resource in lending system and those recently reported. Notably, most Autonomous Regions adjusted to the -



0.5% of GDP target³ known at that time⁴ instead of the -0.6% of GDP target eventually set. Also, they considered their own estimates of resources in the lending system⁵ instead of the resources they now know they will be afforded.

2. Report Aims and Constraints

This Reports aims to assess Autonomous Regions budget documents for 2017, released after the publication of the February Report, to examine compliance with the three fiscal rules defined in the Organic Law on Budget Stability and Financial Sustainability. This Report uses the regional MBL or approved regional budgets, released after the February Report. The information is also supplemented additional information received by regions. Budget document suitability as connected to compliance with budget stability, government debt and the expenditure rule of 2017 are also assessed. With this aim in mind, the budgets of Cantabria, Catalonia, La Rioja and the Basque Country are assessed in addition to the MBL of Castile and Leon.

Moreover, this Report includes a full assessment of Valencia's Initial Budget and an update of the 2017 year-end data projections of previously-assessed Autonomous Regions. This update is included, as mentioned previously, due to the recent publication of data that significantly affect the Autonomous Region budget information assessed in the February Report. The exception to the latter is Valencia, where a preliminary view on the Initial Budget was included in the February Report and will now be completed in this Report once the aforementioned discrepancies are clarified.

For the Autonomous Regions that the AIReF had expressed a view in regards to 2017 the February Report, it is noted that these assessments were based only on information available at that time. All the reports for 2017 are based on

³ There are a few exceptions: Murcia, Castile-La Mancha, Castile and Leon, the Basque Country, and Cantabria, which adjusted to -0.6% of GDP. On the other hand, the 2017 projected deficit in La Rioja is 0.1% of GDP and 0.2% of GDP in the Canary Islands, well below the limits required for stability target compliance.

⁴ Stability Programme Update (2016-2019) approved on April 29, 2016 and the April 2016 Report Draft on the Economy of Spain reported in the Political and Fiscal Policy Committee on April 28, 2016.

⁵ Except the Canary Islands and the Balearic Islands, that took into account resources reported by the Ministry of Finance and Public Administration in a budget extension scenario.



a previously expressed view by AIReF for 2017, except for Castile and Leon and the Basque Country, where no report was previously issued and Valencia, where only a preliminary and partial view was expressed and provided. Therefore, except for Castile and Leon, the Basque Country and Valencia, the AIReF's assessment has been achieved based on the assessed information in accordance to the terms outlined in Article 18.2 of the corresponding organic article.

As in previous years, the Report's assessment is constrained regarding debt and expenditure rule targets:

- ✓ Government debt target: it is still not possible to assess debt target compliance due to lacking information on certain projections required for assessment.
- ✓ Expenditure rule target: Expenditure information reported in budgets still show inconsistencies, gaps and discrepancies both in its analysis and its calculations determining the items that make up eligible expenditure. At the time this report was drafted, the Report on likelihood of budget stability, Government debt and the expenditure rule compliance for 2016 was not published yet. Moreover, the separate data requests sent to the MINHAFP were not responded. Therefore, the amounts used to meter the expenditure rule in each region are unknown. In addition, the criteria used for determining revenue of permanent nature and metering of expenditures co-financed by the European Union are also unknown. This means, similar to previous reports, that the AIReF's assessment is based on a series of estimates and assumptions⁶ with which it has attempted to determine the possible effect expenditure rule compliance could have over regional government accounts, and thus its connection to the stability target.

A debt sustainability assessment is provided based on the information considered in the February Report for Autonomous Regions, except for Castile and Leon and the Basque Country in which the information has been updated. As in previous reports, a separate assessment of medium and long-term debt path sustainability is provided. This is assessed using the information from the February Report, except for Castile and Leon and the Basque Country. No previous 2017 view was expressed for these regions; therefore, a new assessment

⁶ Method that supports AIReF estimated and calculation published in [Annex III of Autonomous Regions MBL for 2016](#)



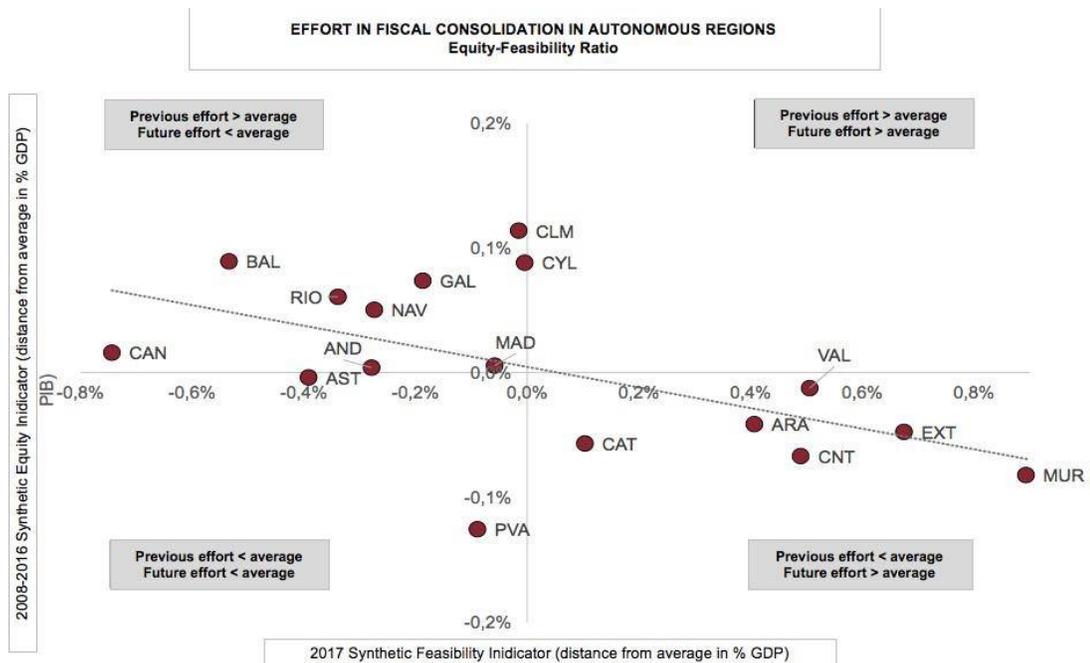
is provided based on of short and medium-term fiscal stress and macroeconomic indicators.

3. Budget Stability and Rule of Expenditure Targets

The assessment of the fiscal consolidation effort achieved by each Autonomous Region from a feasibility and equity stand-point is updated to include 2016 year-end data year data and the new resources in the lending system that the Autonomous Regions will have access to in 2017. This data has caused ranking changes for some Autonomous Regions. As indicated in the February Report, the starting point for assessing likelihood of stability target compliance for each region was achieved from feasibility-equity standpoint, while targets for 2017 were being set⁷. The feasibility-equity indicator was set using 2015 year-end data. This was the most recent data available needed for the construction of this indicator at the moment this report was drafted. Therein, equity considers the achieved effort by each region from 2008 to 2015, and feasibility by the effort to be achieved during the 2016-2017 period. However, since the publication of the 2016 year-end data, 2016 has been included too and consequently feasibility calculations have been limited to 2017. The latter includes the new data on resources of the lending Autonomous Regions will receive in 2017. With this new information, this report pinpoints the relative position of each Autonomous Region regarding fiscal consolidation effort (see Chart 1).

⁷ [February 14 2017 Report on Autonomous Regions MBL and Initial Budgets for 2017](#)

Chart 1. Effort in Fiscal Consolidation in Autonomous Regions (% GDP)



Using the feasibility-equity framework which assesses budget performance at the moment targets were set, the AIReF points out two sets of Autonomous Regions (see Table and Chart 2):

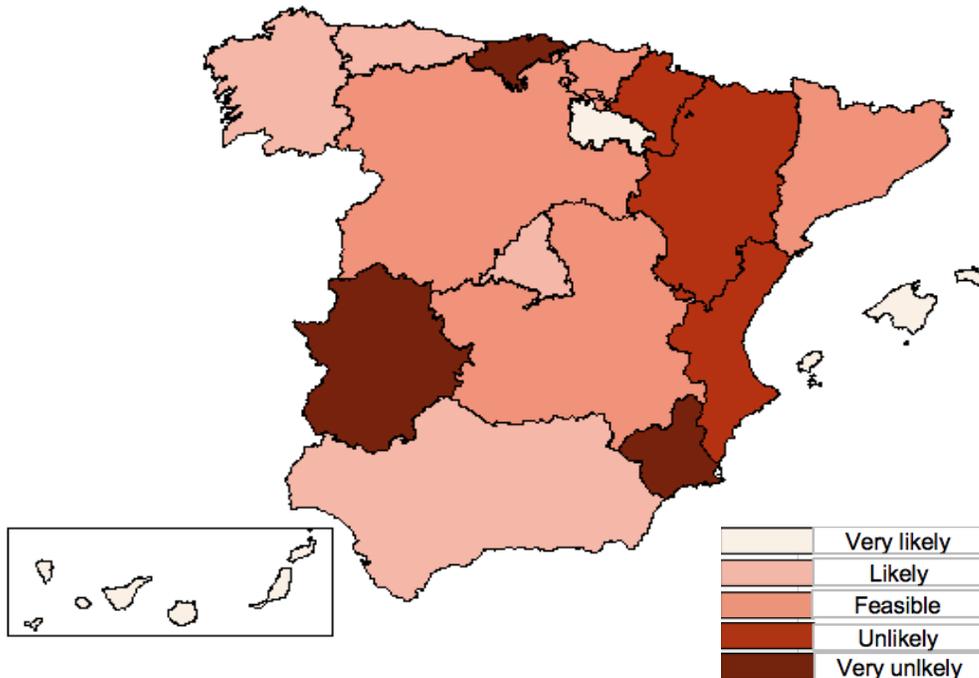
- **11 Autonomous Regions where budgetary execution would comply with targets, with varying degrees of likelihood.** The Autonomous Regions with target compliance deemed feasible are Castile and Leon, Castile-La Mancha, Catalonia and the Basque Country. The Autonomous Regions deemed likely to comply are Andalusia, Asturias, Galicia and Madrid and those very likely are the Balearic Islands, the Canary Islands, and La Rioja.
- **6 Autonomous Regions where the budgetary execution documents would not comply to the target.** These regions are Aragon, Navarre and Valencia whose target compliance has been deemed unlikely and Cantabria, Extremadura and Murcia deemed very unlikely.



Table 2. Changes with respect to February Report´s in the likelihood of compliance with the 2017 Stability Target

AUTONOMOUS REGIONS	Likelihood of complying to -0.6% GDP Target	
	Published in February 2017	Published in April 2017
Andalusia	Likely	Likely
Aragon	Very unlikely	Unlikely
Asturias	Feasible	Likely
The Balearic Islands	Likely	Very likely
The Canary Islands	Very likely	Very likely
Cantabria	Very unlikely	Very unlikely
Castile and Leon		Feasible
Castile-La Mancha	Unlikely	Feasible
Catalonia	Unlikely	Feasible
Extremadura	Very unlikely	Very unlikely
Galicia	Likely	Likely
Madrid	Feasible	Likely
Murcia	Very unlikely	Very unlikely
Navarre	Unlikely	Unlikely
The Basque Country		Feasible
La Rioja	Feasible	Very likely
Valencia	Unlikely	Unlikely

Chart 2. Likelihood of compliance with the 2017 Stability Target



The AIReF has revised upward the likelihood of compliance with targets set in all the Autonomous Regions, improving the rating among seven Autonomous Regions, mainly due to:

- **New data on resources in the lending system that Autonomous Regions will receive in 2017.** In the previous report, assessment was made considering interim payment estimates calculated by the AIReF and in accordance with tax revenue projections derived from the Authority's formulas using macroeconomic data available at the time. This estimate, coupled with the 2015 budget outturn projection published by the MINHAFP, indicated an increase of resources in the lending system in 2017 compared with 2016 levels, yet lower than eventually assessed in the 2017 State General Budget project. Accordingly, resource amounts reach to more than 5 billion, an increase of 5.7% from 2016 levels. This improvement affects Autonomous Regions overall that, to a greater or lesser extent, will receive more resources from the regional system of finance than those estimated in the February Report for most them.



- **Publication of 2016 year-end data.** The IGAE data published at the end March confirmed the AIReF 2016 year-end data projections for Autonomous Regions overall, at -0.8% of GDP during the fiscal year. However, on a case by case regional level, there have been slight differences affecting individual target compliance likelihood.

At the sub-sector level, the AIReF still deems compliance with -0.6% of GDP as feasible for 2017. The increased resources in the lending system that Autonomous Regions will receive in 2017 compared to 2016, coupled with the two tenths of a point adjustment to GDP required to comply with targets set 2017 once the 2016 year-end data is confirmed at -0.8% of GDP, supports feasibility of Autonomous Region sub-sectors in complying with this year's target, which hovers around the AIReF's main projection aligned with this target (see Chart 3).

Resources from the regional financing system are expected to growth above 6% in comparison with 2016 for the subsector as a whole. There is a 5.7% increase in available resources for Autonomous Regions overall, compared to 2016 levels and will be apparent when new data on resources in regional lending system included in the State General Budget for 2017 is published. In addition, from the 2016 year-end data, the AIReF deems remaining revenue could register an increase of more than 6%. This increase is expected due to the European Union (EU) revenue trend, expected to cover non-received 2016 revenue caused by a delay in implementing a certification procedure for co-financed expenditures in the current Operational Programme. The regional projections for Autonomous Regions overall are slightly above the estimates set by the AIReF (see Chart 4).

Regarding expenditure, new information points to a growth of around 4% compared to 2016 levels, keeping their weight over the GDP. Running expenditures growth projections hover around 3% above the 2016 level, while capital expenditure is expected to grow more than 15%, the latter linked to a higher level of achievement than expected in certain Autonomous Regions because of EU expenditures co-financed in 2017, tied to the registered slump in 2016. Regional projections of the regional sub-sectors overall are aligned with AIReF estimates, yet with some difference regarding the composition of expenditures (see Chart 5).



Chart 3. Autonomous Region Sub-Sector Net Lending in % of GDP

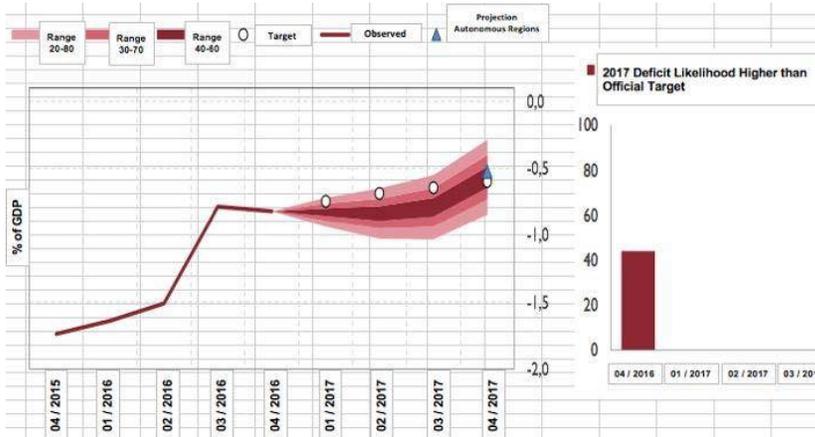


Chart 4. Autonomous Regions Sub-Sector Non-Financial Resources in % of GDP

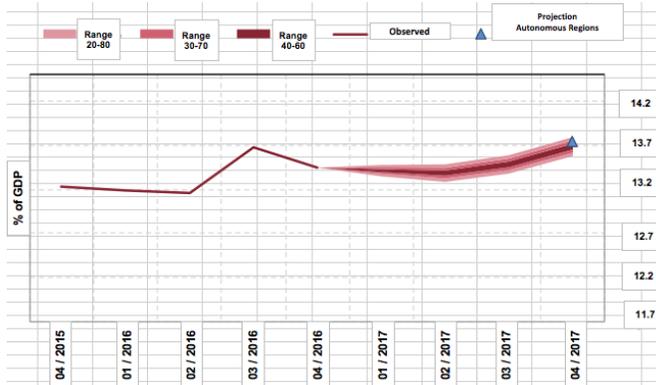
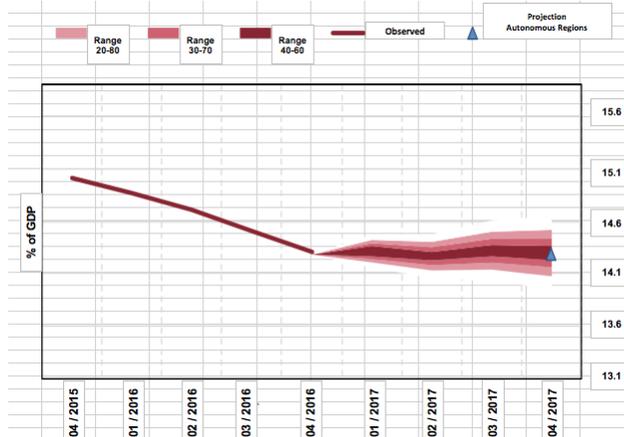


Chart 5. Autonomous Region Sub-Sector Non-Financial Uses in % of GDP





For the expenditure rule, the AIReF deems that Autonomous Regions sub-sector use trends could be compatible with this rule's compliance. In line with AIReF estimates, the 4% increase in non-lending expenditure could allow for the 2017 sub-sector compliance to this rule.

The flexible analysis of the MINHAFP in applying the expenditure rule has indeed reduced the effectiveness of this fiscal rule, which is why it is no more restrictive than stability targets for Autonomous Regions overall in 2017. As pointed out by the AIReF in previous reports, the flexible analysis of the MINHAFP in the expenditure rule application, allowing eligible expenditure consolidation that exceed the reference rate, reduced the implementation effectiveness of the fiscal rule. Although this could imply a deficit below the stability target in certain Autonomous Regions, it does not imply an additional restriction for the sub-sector overall with regards to the stability target.

On a case by case regional level, taking the 2016 year-end data into account, and data cleared from 2016 non-recurring operations, there is a one-point difference observed in required effort between the first and last Autonomous Regions on the list. As stated by the AIReF in previous reports, uniform targets for separate regions do not reflect current differences in each Autonomous Region. For practically all Autonomous Regions, the stability target for 2017 increases deficit compared to 2016 levels, while for others it requires a one-point adjustment in their regional GDP (see Table 3).

Expenditure rule compliance could rectify a part of this difference. The expenditure rule is more restrictive for Autonomous Regions where the stability objective does not require an additional effort. Therefore, this situation could rectify itself, to a greater or lesser extent, through expenditure rule compliance.



Table 3. Effort to Achieve the 2017 Stability Target

AUTONOMOUS REGIONS	2016 year-end	2016 year-end Cleared of Non-Recurring Operations	2017 Target	Difference	Expenditure Rule more Restrictive than Stability Target
Andalusia	-0.6%	-0.5%	-0.6%	0.1%	
Aragon	-1.1%	-1.1%	-0.6%	-0.5%	
Asturias	-0.5%	-0.3%	-0.6%	0.3%	
The Balearic Islands	-0.4%	-0.3%	-0.6%	0.3%	✓
The Canary Islands	-0.3%	-0.2%	-0.6%	0.4%	✓
Cantabria	-1.5%	-1.4%	-0.6%	-0.8%	
Castile and Leon	-0.6%	-0.5%	-0.6%	0.1%	✓
Castile-La Mancha	-0.7%	-0.7%	-0.6%	-0.1%	
Catalonia	-0.9%	-0.9%	-0.6%	-0.3%	
Extremadura	-1.6%	-1.3%	-0.6%	-0.7%	
Galicia	-0.5%	-0.4%	-0.6%	0.2%	✓
Madrid	-0.6%	-0.7%	-0.6%	-0.1%	✓
Murcia	-1.7%	-1.7%	-0.6%	-1.1%	
Navarre	-0.7%	-0.6%	-0.6%	0.0%	✓
The Basque Country	-0.7%	-0.7%	-0.6%	-0.1%	
La Rioja	-0.5%	-0.4%	-0.6%	0.2%	✓
Valencia	-1.5%	-1.4%	-0.6%	-0.8%	
Sub-sector	-0.8%	-0.8%	-0.6%	-0.2%	

4. Debt Sustainability

Risks to financial sustainability and compliance to the medium-term debt limit of 13% of GDP are still very high for Autonomous Region sub-sectors.

In the February Report, the AIReF assessed debt sustainability; new data on lending system resources; the 2016-year end accounting closure; the breakdown on Autonomous Region debts up to December 2016, and the expected mid-term changes in the macro-financial sphere. This new information implies debt target



limit compliance will have a 5-year delay compared to the timeline set in the previous report. Also, it will not occur before 2045. On the other hand, 2016 year-end data debt data confirms the high dependence on resources from additional lending facilities, creating a weight that reached 54% for regional sub-sectors overall (in Murcia, it reached 77.8%). Lastly, regarding the February Report, no significant change has occurred to Autonomous Region credit rating standards.

However, sustainability risks are very uneven among Autonomous Regions. High risks continue to be identified in Catalonia, Castile-La Mancha, Murcia, Valencia and now in Extremadura. In the baseline scenario, a slight improvement has been registered in assessments for Asturias, Madrid, and Navarre where identified risks are still slightly low. On the other hand, a slight deterioration is detected for Andalusia, Aragon, the Balearic Islands, the Canary Islands, Cantabria and La Rioja, where there is an increased risk of non-compliance with the debt limit. This is slightly high for Andalusia, and high for Aragon and at the same levels as stated in the previous report for the rest of regions. Lastly, in Castile-La Mancha, Valencia, Catalonia and Murcia there has also been debt deterioration and estimates continue to signal non-compliance with the reference limit of 13% debt-to-GDP ratio, before the year 2045. On a case by case regional level, in Extremadura, updated projections signal a delay in target compliance, which shifts risk assessment to very high. Debt sustainability in Castile and Leon presents mild risks. The latter region is in a slightly favourable situation, with low borrowing requirements and a very low dependence on lending facilities. In the Basque Country, risk are slightly low given the low base levels and lending needs that are entirely covered by the market.

Regarding the last Report, no substantial changes have been observed in short-term macro-fiscal risks and the situation is still quite varied. In the previous report, there were significant fiscal risks in Cantabria, Catalonia, Extremadura, Murcia and Valencia. These risks remain in the updated projections. However, if adjusted primary uniform expenditure per capita would equal the subsector average, short-term fiscal risks would reduce significantly in Extremadura and Cantabria. On the contrary, short-term fiscal risk would significantly increase in Castile-La Mancha, given its relatively low per capita primary expenditure. Short-term macro-economic risks have not changed significantly for Autonomous Regions overall with the inclusion of the new data. However, regional differences can be pointed-out, such as, improvement in the Balearic Islands and deterioration in La Rioja, the latter along with Asturias, Cantabria and Extremadura exposed to very high risks. If these high risks appeared in the medium term, they could have a fiscal impact in these regions.



5. Recommendations

As per previous published reports calling for early action to prevent fiscal rule non-compliance, the February 14th Report, laid out a series of **preventive action recommendations from the Organic Law on Budget Stability and Financial Sustainability**:

- It was deemed appropriate that Autonomous Regions General Comptrollers continue to include early risk detection of non-compliance risk within the framework of Article 18 of the Organic Law on Budget Stability and Financial Sustainability. The former is based on the understanding that published reports by regional comptrollers, in compliance with the temporary measure set forth by the enhanced regional liquidity fund conditions for 2016, would be insufficient since they do not include all Autonomous Regions nor a warning to regional governments. In this respect, it was recommended that Asturias, the Balearic Islands, the Canary Islands, Cantabria, Castile-La Mancha, Catalonia, Extremadura, La Rioja and Murcia, implemented the necessary protocols so that their regional comptrollers publish monthly reports addressing the risks of fiscal rule non-compliance at the year-end. If risk was detected, they were recommended to issue a warning to the regional government for the latter to take all the necessary actions and to rectify early-on potential fiscal slippages. Therefore, several Autonomous Regions indicated that they stipulated a protocol for monitoring and detecting these risks in addition to putting a warning system in place to alert regional government when necessary.
- In addition, for Aragon, Cantabria, Extremadura and Murcia, all Autonomous Regions with an elevated risk of fiscal slippage, the AIReF called on these regions to make use of the protocol of the Law and Regulation that created it, and asked the MINHAFP, as done in previous occasions⁸, to activate the non-regional preventive measures of Article 19 of the Organic Law on Budget Stability and Financial Sustainability. The MINHAFP considered that Article 19 was not deemed applicable. Such response was based on the fact that regions were subject to the coercive measures of Article 25 of the Organic Law on Budget Stability and Financial Sustainability. With the 2016 year-

⁸ Report on MBL for 2015 (December 2014) and for 2016 (December 2015).



end data, it would be required to consider also the adjustment foreseen in regional adjustment and/or economic-financial plans. And finally, the MINHAFP also argued that the updated projection in resources from the regional system of finance could substantially alter Autonomous Region fiscal position.

- Lastly, considering that only the Canary Islands and the Balearic Islands included figures on resources derived from the extension of the State General Budget reported by the MINHAFP in its revenue scenarios, it was recommended that all Autonomous Regions would adopt the necessary credit withholding measures until these figures were updated in order to comply with the principle of fiscal prudence, and to adjust expenditure to the resources level they currently receive. Various Autonomous Regions responded that they deemed their regional budget estimates more suitable than those given by the MINHAFP, but that they would adopt the necessary credit withholding measures as soon as a risk of fiscal slippage would be detected.

Based on the aforementioned recommendations, the need for early action is reiterated to assure target compliance, putting all Autonomous Regions, both those with or without identified fiscal slippages, on the line for budgetary execution monitoring. There should be comprehensive monitoring in Autonomous Regions with approved budgets and also for those where target compliance for 2017 is assessed as unlikely (Navarre and Valencia) and very unlikely (Cantabria, Extremadura, and Murcia). For Aragon, its compliance with targets has been assessed as unlikely, as its budget is still not approved. Hence, in this case it is recommended the inclusion of necessary data in the Initial Budget, to support a budget scenario with target compliance.

Therefore, the AIReF recommends:

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- ***Navarre and Valencia should adjust their budget scenarios to compensate for detected risks, under the terms specified in their regional report.***
 - ***Cantabria, Extremadura, and Murcia, all three assessed as very unlikely for target compliance, should adjust their budget forecasts, taking all required actions within a medium-term plan in agreement with the MINHAFP and formalized in an Economic-Financial Plan based on 2016 target compliance, for all the foreseen years.***
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- ***The MINHAFP to agree with Cantabria, Extremadura and Murcia on a medium-term plan to adjust budgetary execution so as to warrant individual targets compliance, and formalized such agreements, for all the foreseen years, in Economic-Financial Plans presented to the Fiscal and Financial Policy Committee due to non-compliance in 2016.***
 - ***Aragon to include necessary information in its Initial Budget to support the expenditure trend reflected in the current draft budget, where significant fiscal slippage risks are detected, to propose either measures for an improved projection in revenue or reduction in expenditure that would allow to compensate detected risks.***
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The February report also laid out recommendations related to **the expenditure rule**, insisting on the need to open a debate to reflect on certain aspects related to the regulation required to solve concrete problems tied to application of this fiscal rule. Therefore, the AIReF calls for the creation of working groups within the Fiscal and Financial Policy Committee to debate and reflect on possible modifications to the expenditure rule, as well as the timely achievement of a regulation to solve concrete problems associated with the implementation of the fiscal rule. Although the MINHAFP announced the creation of working groups at the December 1, 2016 Fiscal and Financial Policy Committee meeting, in its response to the February report calling for the creation of these groups, the MINHAFP deemed necessary to wait for results from regional changes to fiscal regulations, understanding that the publication of *the Guide for setting the expenditure rule for Autonomous Regions* would address doubts with regards to the analysis and calculation of the expenditure rule, and also, that regulation to be created and put in place once information from the working groups was available.

Up until now, there have been no changes to regional fiscal regulations nor does it seem that these will appear in the short-term. Also, following the announcement in the Fiscal and Financial Policy Committee, no working groups have been created. Given that the publication of the aforementioned Guide has not solved significant problems in analyzing and calculating the expenditure rule and that immediate solutions to effectuate proper monitoring are needed, the AIReF reiterates its recommendation from the February 14th Report below.

The AIReF recommends:



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- ***The MINHAFP to launch the creation of working groups in the Fiscal and Financial Policy Committee to debate and reflect on the possible changes required for the expenditure rule. Notwithstanding the foregoing, it also calls for the timely achievement of necessary regulatory developments to solve concrete implementation and reporting problems associated the fiscal rule, both general and on a case by case regional level, of the terms and criteria used for the expenditure rule calculation.***
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