



Report on the government sector initial budgets for 2015

Executive summary

1. This report appraises the measures adopted by the government sector in Spain since the preparation of their draft budgets¹ and analyses all the new information available to the Independent Authority for Fiscal Responsibility (AIReF) since it published its *Report on the government sector 2015 draft budgets and main budgetary lines* in October 2014.
2. AIReF restates in this new report its assessment that the 2015 budgetary stability target set at -4.2% of GDP for the government sector as a whole is very demanding. However, AIReF detects a recomposition by subsectors of the non-compliance risks. Now it sees greater difficulties for compliance with the 2015 target in the Social Security Funds and continues to believe there is a high risk of non-compliance by the autonomous regions (ARs). In the case of local corporations (LCs), however, it believes there is more leeway for them to deliver on the target. For central government, AIReF is still estimating it has a margin to be able to comply with its deficit target.
3. The prerequisites for compliance with the -4.2% of GDP target identified in the October report on draft budgets are now seen as follows. The macroeconomic situation and current fiscal position are a sound basis for the government sector to work towards the stability target for 2015. Although the public deficit recorded by the whole government sector for 2014 was 5.7% of GDP, two tenths of a percentage point above the deficit target of 5.5% of GDP, the deviation from target is justified by a one-off, non-recurring factor (refund of the "health cent" tax). Compliance with budgetary targets and the correction of macroeconomic imbalances of recent years lend credibility to the fiscal consolidation effort.

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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¹ The Independent Authority for Fiscal Responsibility thus complies with article 17.2 of the Organic Law on budgetary stability and financial sustainability (*Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera*, LOEPySF) establishing the obligation for AIReF to issue a report on the initial budgets of the government sector.

4. The macroeconomic scenario of cyclical recovery is developing significantly better than expected in October 2014. The downside risks identified in October have not materialised, whereas additional factors giving momentum to growth have appeared since then. There is greater confidence both in the domestic and international environment. All of these factors are making it possible for domestic demand, the external sector and the labour market to develop better than expected, thus facilitating compliance with the demanding revenue scenario envisaged in the budget.
5. The expectations of additional revenue for the Social Security system stemming from the new system of direct settlement and the inclusion of payments in kind in the contribution base have not materialised. As a result, it is very likely that Social Security revenue will be below the figure forecast in its budget. Nevertheless, this underperformance on the revenue side will be partially offset within the Social Security Funds by the continuation of the good pace of reduction of expenditure on unemployment benefits, which will end the year below budget. In any event, it is highly likely that the deficit in the Social Security Funds by the end of 2015 will be several tenths of a percentage point above the demanding target of 0.6% of GDP.
6. The autonomous regions are starting off the year after recording a deficit in 2014 amounting to 1.7% of GDP. That means they will need to take steps to bring down this figure by a full percentage point in order to achieve the deficit target for 2015. The analysis of the budgets for this subsector does not reveal any measures that will make a significant contribution to cutting the deficit, and the improved macroeconomic scenario will only be tangibly reflected in their revenues as of 2016. Therefore, it is very likely that the AR subsector will end 2015 with a similar deviation from the deficit target to the one recorded in 2014.
7. The declining trend in interest rates has intensified over the last six months bringing the financial expenses of central government in 2015 even further below the budgeted figure. Some of this margin —almost 0.3% — will be transferred to the ARs and LCs.
8. The local corporations ended 2014 with a surplus of 0.5% of GDP. It is estimated that they will record a similar balance in 2015. This view is based on an analysis of the 2015 budgets of this subsector and on the assessment that the expenditure rule will continue to work well this year.
9. The most recent information indicates that the leeway seen currently in the LCs, and any there might be in the central government subsector, will hardly offset the negative deviations from targets by the ARs and the Social Security Funds.

AIReF makes a number of recommendations in its report. The ones highlighted below are all recommendations aimed at improving the framework for implementation of the current budgetary stability regulations in force and guaranteeing the correct enforcement of the LOEPySF:

1. AIReF has not been able to appraise compliance with the expenditure rule by the budgets of central government and of the autonomous regions as required to do so under article 17.1 of the LOEPySF. Consequently, its analysis has been limited in scope to the State. The absence of the necessary information and the lack of experience seen in the calculation of the expenditure rule by the ARs are two of the factors that have prevented AIReF from taking a view.

Given the importance of the implementation of the expenditure rule in the process of fiscal consolidation AIReF makes the following recommendation:

- o *The economic and financial reports accompanying the budgets from the different public administrations in the government sector should include the figure for non-financial uses with the necessary breakdown for calculation of the expenditure rule as well as information on the methodology used.*
- o *The General State Comptroller (IGAE) should publish a manual on the calculation of the expenditure rule by the ARs, similar to the manual that already exists for local corporations. This would help to guarantee harmonisation of the methodologies used.*

2. Inconsistencies have been detected for the government sector as a whole between the budgetary stability target and the target for public debt. At the moment, therefore, as the forecast for real GDP growth for 2015 is above 2%, the first transitory provision of the LOEPySF stipulates the obligation for the debt ratio to be reduced by at least two percentage points of GDP. Even when taking into account the effect that nominal GDP might have on the debt ratio, this could be inconsistent with the budgetary stability target.

AIReF recommends a revision in 2015 of the debt reduction path and the use of the appropriate legal mechanisms to extend the transitory period for compliance with the limits set out in article 13. The requirements specified in the first transitory provision should be adapted and a credible, demanding reference path defined for the sustained reduction of the debt ratio that would allow the public administrations to guarantee financial sustainability.

3. The implementation of the expenditure rule puts the LCs subsector into a position of persistent surplus that is not sustainable and may generate an inadequate composition of public spending.

AIReF recommends an analysis of the financial capacity of each subsector, which should take into account the services they provide under the current distribution of competences in Spain.

4. One of the instruments with greatest potential in the LOEPySF are the automatic preventive measures based on the self-discipline of each public administration.

AIReF recommends early action be taken within the scope of the LOEPySF by implementing the automatic preventive measures provided for in article 18.1 so that each administration monitors the implementation of its budget and adjusts its spending to ensure compliance with the budget stability target.

5. For the administrations that have failed to comply with the 2014 stability target there must be more stringent monitoring of their budget implementation within the framework of an economic and financial plan (EFP) that guarantees the correction of imbalances. In this respect, early communication of any deviations observed in the non-compliant administrations becomes especially relevant. It would trigger the commencement of the period within which they have to prepare an EFP and would avoid any repetition of what happened last year when most of the EFPs prepared due to non-compliance with the 2013 targets were only approved in December 2014.

AIReF recommends that early action should be taken by the Ministry of Finance & Public Administration (MINHAP) within the framework of the LOEPySF to implement corrective measures, in particular submission of EFPs. For that to happen, it is essential for the MINHAP to publish before 15th April its report on the degree of compliance with the budgetary stability target, the public debt target and the expenditure rule for 2014 so that the procedure set out in the LOEPySF can be activated.

6. In the case of public administrations with a high level of debt that fail to comply on a recurring basis with the stability target and therefore with the EFP submitted as a consequence of that non-compliance, more progress must be made towards phasing in the measures provided for in the LOEPySF.

AIReF recommends due consideration be given to the implementation of the coercive measures laid down in article 25 of the LOEPySF, especially in the case of those regions whose budget for 2015 shows evidence of a clear risk of a new failure of compliance.

7. AIReF cannot assess compliance with the debt target by the autonomous regions because there is uncertainty about the operations that will eventually be included in its calculation, given the possibility that the MINHAP may determine that there are circumstances to be taken into account in the compliance with that target.

AIReF recommends limiting any room for discretionary action and avoiding the exclusion of operations for the purposes of verification of compliance with the public debt targets set.

Report on the initial budgets of the government sector in Spain for 2015

1. Purpose and scope

The purpose of this document is to report on the initial budgets of the government sector in Spain. The Organic Law on Budgetary Stability and Financial Sustainability (*Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera*, LOEPySF) states in article 17.2 that before 1st April each year the Independent Authority for budget Responsibility (AIReF) will produce a report on the degree of compliance with the budgetary stability and public debt targets of the initial budgets of the public administrations (PAs) in Spain. This report will also cover compliance with the expenditure rule for the budgets prepared by the central government and the autonomous regions (ARs).

Article 18 of Royal Decree 215/2014 approving AIReF's Organic Statute states that the Authority will prepare its report on the initial budgets of the public administrations for 2015 taking into account any variations detected in the documentation submitted to it previously. It will note in particular any differences compared with the information analysed for the publication on 15 October 2014 of its Report on the government sector 2015 draft budgets and main budgetary lines², which was completed with a report³ on the autonomous regions published on 16th December 2014.

The scope of the report is determined by the variations detected with regard to the information analysed for the publication of the reports on the drafts and main budgetary lines published on 15 October and 16th December last year.

The following information in particular has been examined:

- Supporting documentation for the State General Budget (SGB) and regional government budgets. Aggregate data on the budgets approved by local corporations (LCs) were also made available to AIReF.
- Updates on the information contained in the main budgetary lines of the budgets of the ARs and LCs and the supplementary data accompanying them.
- Aggregate information on the subsector in the case of the budgets approved by the LCs for 2015 with a breakdown by budgetary heading.
- Publication of the preview of year-end 2014.
- Monthly report on tax collection from the State Tax Authority corresponding to December 2014.
- The Economic & Financial Plans (EFPs) of the ARs approved on 26 December 2014 and 30th January 2015.

²<http://www.airef.es/es/contenidos/informes/66-informe-sobre-los-presupuestos-de-las-administraciones-publicas>

³<http://www.airef.es/es/contenidos/informes/79-el-objetivo-de-estabilidad-de-2015-para-las-ccaa-es-de-muy-dificil-consecucion>

- Regulatory measures adopted subsequent to the passage through parliament of the budgets that have a significant impact in 2015.
- Concrete information for the follow-up of certain revenue measures in the Social Security Funds.
- Analysis of the current macroeconomic scenario.

1.1. Limitations on the scope

The scope of this report has been limited by the following circumstances:

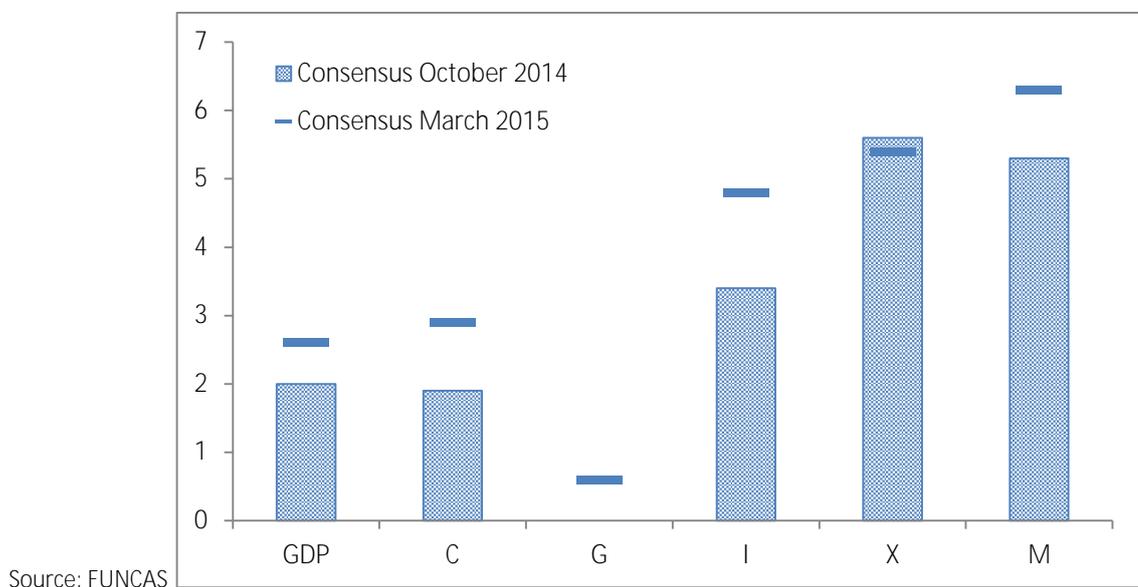
- a. The late date on which 2014 year-end figures were known and the non-availability of budget implementation data for the first months of 2015. Although 2014 year-end figures were published before this report was issued, the late availability of the data in advance of the report made it difficult to conduct an in-depth analysis of the information with a view to assessing its impact on compliance with the budgetary stability target for 2015. This difficulty was compounded by the fact that the publication of implementation data for January and February for the State, and for January for the ARs and the Social Security Funds, was on 31st March, the same date on which this report was published. It is worth remembering on this point that article 3.2 a) of the budget frameworks directive states that cash-based fiscal data for these subsectors should be published before the end of the following month.
- b. The poor level of detail of the information concerning the LCs. The information provided by the Ministry of Finance and Public Administration (MINHAP) on the budgets of the LCs is given down to the budgetary heading level, without any information on adjustments in national accounts terms. This information is aggregate data for the subsector as a whole, with the exception of the six largest city councils.
- c. Not enough information is available to analyse compliance with the expenditure rule for the autonomous regions or for the central government as a whole. The analysis made is limited to the State subsector as a result. The absence of the necessary information and the lack of experience seen in the calculation of the expenditure rule by the ARs are two of the factors that have prevented an assessment being made of the budgets of the central government overall and of the ARs, from the standpoint of their adequacy for the expenditure rule.
- d. There is still uncertainty about the operations to be included in the calculation of the debt target for the ARs. This uncertainty prevents a view being expressed on compliance with the debt target in this subsector.

2. Budgetary stability target.

2.1. Key changes in the macroeconomic environment

The data for the last quarter of 2014 and the first quarter of 2015 have confirmed the economic recovery. The improvement has impacted positively on growth expectations for 2015 overall. As shown in figure 1, the forecasts given in March 2015 by the FUNCAS expert panel for GDP growth in 2015 have improved significantly on the figures published in October 2014.

Figure 1. Macroeconomic scenario for 2015. FUNCAS panel consensus predictions.



A number of different factors, both external and domestic, have contributed to that improvement: (i) cheaper oil prices; (ii) better lending conditions driven by the repair of the financial sector and the European Central Bank's QE policy; (iii) depreciation of the euro; (iv) the progressive reduction in the level of debt in the private sector; and (v) the announcement of new, expansionary fiscal measures after the draft budgets had already been prepared.

The improvement in expectations is clearly reflected in more buoyant domestic demand, with private consumption and investment driven by higher disposable income for households and lower production and financial costs for businesses. The performance of the labour market also reinforces the recovery of domestic demand. In fact, job creation accelerated in the second half of 2014 and the positive trend is expected to continue in 2015 in a context of wage moderation and containment of unit labour costs increases.

The negative contribution of external demand has lessened. As is to be expected, part of the improvement in disposable income for households and businesses leaks out of the country through more dynamic imports. This negative contribution to growth should be offset at least partially by higher exports thanks to the depreciation of the euro and the progressive recovery of the Eurozone, mainly the external market.

The more benign financial environment is having a major effect on the interest burden of the public administrations. The declining trend in the key reference rates for long-term (10 years) debt and in the implicit average rates in the portfolio of debt issued by the Treasury intensified in the second half of 2014. All-time low public debt yields together with a declining sovereign risk premium should bring down **the State's financial expenses in 2015 below initial forecasts**.

The upside indicated in income levels and consumption should, in principle, funnel through into more growth in tax bases and, ultimately, into higher taxation revenues.

However, there are other factors that may work in the opposite direction for both indirect and direct taxes. Specifically, new information is available on taxation revenues for the months of October, November and December so the year-end figures for the main taxes are now known. When analysing those year-end figures, certain deviations can be detected as compared with the preview of 2014 settlement data included in the draft SGB. They mainly impact direct taxation, and under that heading the tax most affected would be corporation tax.

In the case of direct taxes, in addition to the uncertainty generated by deviations in year-end 2014 figures there is the uncertainty about the impact of the tax reform scheduled for 2015 and 2016, and mainly affecting personal income tax (*Impuesto sobre la Renta de las Personas Físicas*, IRPF) and corporation tax. Although the tax reform figures quantified in the economic report accompanying the laws that passed the reform could be achievable in line with the macroeconomic scenario, it should be highlighted that the measures making up that reform have not been quantified individually. Furthermore, there is no information available about tax revenue collection for the first months of 2015 in order for a more in-depth evaluation of the reform to be possible.

In particular, corporation tax has been highly impacted in recent years by the offsetting of tax loss carry-forwards from previous years, regulatory measures and the variability of tax rebates. As a consequence of that, in 2014 there was a big difference in the revenues collected from that tax compared to the initial budget, as well as to the preview of the year-end settlement in the draft 2015 SGB. As the starting point for 2015 is lower than the figure expected in 2014 corporation tax will have to grow in cash terms by 26% to reach the figure forecast in the 2015 budget

Likewise, the forecasts for revenues from social contributions in the budgets are not materialising despite the improved macroeconomic environment observed in recent quarters. One factor to be highlighted is the uncertainty associated with the tax revenue collection capacity of the structural measures announced (the new system of direct settlement and the inclusion of remuneration in kind in the contribution base). Moreover, the potential cost of collection of the tax revenue in the new measures approved since then would have to be assessed (extension of the flat rate and a new 500 euros exemption in the contribution base).

The variability of rebates for indirect taxes and the lack of dynamism in consumer prices also generate uncertainties with regard to the impact of revenue collection for value-added tax (VAT).

Lastly, on the expenditure side, the improvement observed in the cyclical labour market trend, together with the progressive exhaustion of unemployment benefits, will reduce their associated cost and partially offset the deviation expected in contributions.

2.2. Central government subsector

The *Report on the government sector 2015 draft budgets and main budgetary lines* signalled the existence of possible points of leeway in the expenditure budget, mainly in financial expenses. These margins for manoeuvre could produce effective savings in the budgeted expenditure and offset the upward deviations that other subsectors are likely to experience.

Since the publication of the report on 15th October last year, a series of measures have been passed with an economic impact for the central government that affect the deficit target set for this subsector and reduce the size of the margin for improvements to be made.

Key variations with regard to the documentation analysed in the reports on the main budgetary lines

The main variations in regulations adopted following publication of the report on 15th October that have affected the SGB and that were not taken into account in it are:

- Amendment of the financial terms of the lending operations undertaken and charged to the regional liquidity fund (*Fondo de Liquidez Autonómico*, FLA) and the supplier payments financing fund (*Fondo de Financiación de los pagos a Proveedores*, FFPP2), with a 0% interest rate now set until expiration of the first interest period of 2016. Royal Decree-law 17/2014 includes a series of measures that were not envisaged in the 2015 SGB. One of their aims is to share out the financial savings between the administrations. This amendment to the financial terms in 2015 entails a loss of revenue for central government totalling 2.2bn euros.
- Effects on the borrowing requirements of the central government due to its greater contribution to funding mechanisms and the granting of an interest-free year. The increased borrowing required to cover the financial contributions to the funding mechanisms for the ARs and the LCs and the granting of a new interest-free year to the territorial administrations under Royal Decree-law 17/2014 will give rise to a higher interest payment burden not envisaged in the SGB 2015. Nevertheless, because the central government is paying low interest rates for its debt, it is likely that this higher financing amount will have practically no economic impact.
- Approval of new tax-related measures in Royal Decree-law 1/2015, of 27th February, on a second opportunity mechanism, reduction in financial burden and other social measures. The measure with the greatest taxation impact contained in that Royal Decree-law affects personal income tax (IRPF) and involves an extension of the cases when deductions in IRPF can be made for large families or families with disabled dependents. According to the economic report accompanying the Royal Decree-law the tax revenue cost of this measure is estimated to be 410 million euros in annual terms and is calculated on an accrual basis. From the standpoint of their cash impact, these deductions are described as negative taxes. That means they can be applied for prior to the submission of a tax return, and so a major portion of this lower revenue collected would affect 2015.
- Approval of Royal Decree 198/2015, of 23rd March, developing the fee for use of inland waters for the production of electricity in interregional demarcations. This Royal Decree approves the regulatory **implementation of the "water fee", as it is known, created** under Act 15/2012, of 27th December on taxation measures for energy sustainability.

The legislation specifies in the text that its provisions will be applicable from 1st January 2013 onwards and so the amount corresponding to 2013 and 2014 will be collected in 2015. According to the economic report, that amount was around 305 million euros.

Conclusions

It can be concluded from the analysis of the new information that there is still sufficient room for this subsector to achieve compliance with its target. Nevertheless, the leeway seen in the draft State General budget —mainly in the chapter on financial expenditure— will be earmarked, at least partially, to offset the impact of the new measures approved. These new measures fundamentally entail lower revenues for the central government and therefore make it less possible for any offsetting of the deviations existing in other subsectors.

However, the foreseeable improvement in the macroeconomic scenario could have a favourable effect on tax bases, although uncertainty exists around the revenue refunds linked to the main taxes.

Recommendations

AI ReF makes the following recommendation with the aim of substantiating the implementation of the stability legislation and remedying the limitations on the scope:

- Publication of the information on non-financial uses in the initial budget of the central government, including the breakdowns required in order to calculate the expenditure rule. The Economic & Financial Report of the SGB should contain information on the methodology used for the calculation of the expenditure rule for central government as well as the details concerning its compliance with that rule.

Good practice guidelines

AI ReF proposes the following good practice guidelines:

- It would be advisable for the MINHAP to give itemised details of the economic impact of the individual measures stemming from the tax reform that affect personal income tax and corporation tax. The effects of the tax reform will be felt in 2015 and 2016. Given the economic impact of this reform, it would be advisable for itemised details to be provided on the economic impact of the individual measures affecting personal income tax and corporation tax.
- It would be desirable for the draft budget and the initial budget to include a presentation in national accounts terms. Details should be made available of the necessary adjustments to show the correspondence between revenues and expenditure in the budget and resources and uses in national accounts in order to facilitate monitoring of the stability target.
- It would be advisable for the reconciliation between the budget balance and the balance in national accounts terms included in the draft and the budget to give detailed information allowing for the deficit/surplus balance of the entities to be analysed, especially for those entities forming part of the central government but whose budgets are not included in the SGB. The inventory of entities belonging to the general government sector includes, *inter alia*, the Deposit Guarantee Fund (*Fondo de Garantía de Depósitos*), the Electricity System Deficit Securitisation Fund (*Fondo de Titulización del Déficit del Sistema Eléctrico*) and the National Distance Learning University (UNED). The 2015 SGB does not contain any economic information on these entities, nor on how they affect the stability target for 2015.

2.3. Social Security Funds subsector

The *Report on the government sector 2015 draft budgets and main budgetary lines* concluded that the 2015 budgetary stability target of the Social Security Funds was only narrowly achievable, thanks to the fact that the surplus in the State Public Employment Service (*Servicio Público de Empleo Estatal*, SEPE) and the deviation from target in the Social Security system offset each other. **The subsector's capacity to comply with the demanding revenue targets depended on the outcome of the new revenue management measures (CRETA) and the full inclusion of payments in kind into the contribution base, which required strict monitoring.** Significant risks were observed in non-financial expenditure.

Key variations with regard to the documentation analysed in the reports on the main budgetary lines

Additional information has become available since the publication of the report on 15th October that must be taken into account when assessing compliance with the 2015 target.

- Approval of the Activation for Employment Scheme. This scheme is regulated in Royal Decree-Law 16/2014 of 19th December and is targeted at the long-term unemployed with family dependents who have exhausted their entitlement to unemployment protection. It consists of active policies and a new financial subsidy that will entail additional expenditure on unemployment benefits quantified in the economic report as amounting to 850 million euros.
- Extension until March 2015 of the reduction in employer contributions for common contingencies to the Social Security system when hiring workers on indefinite employment contracts. The extension of the flat rate was approved by Royal Decree-law 17/2014, of 26th December, on financial sustainability measures in the autonomous regions and local entities and other measures of an economic nature. Although it does not appear to entail a substantial financial cost it is an additional risk for the demanding revenue path projection for 2015.
- Setting of a minimum exemption of 500 million euros in the employer base for contributions for common contingencies paid into the Social Security system for workers hired on indefinite term contracts in 2015. This measure (Royal Decree-law 1/2015, of 27th February, on a second opportunity mechanism, reduction of financial burden and other social measures) is a fixed exemption that has a lower cost than the flat rate but it entails an additional risk for the performance of revenue from social security contributions in 2015.

Conclusions

- With the information currently available, it seems unlikely that the margin generated in the SEPE thanks to the better performance of the labour market and from the exhaustion of unemployment benefits will be sufficient to offset the deficit in the Social Security system. As a result, it is highly likely that the 2015 year-end deficit will be several tenths of a percentage point above the stability target set.
- The performance of revenue is the main risk for compliance with the stability target of the Social Security Funds in 2015. In its budget for 2015, the Social Security system forecasts revenue from contributions

totalling 109,833 million euros. Achieving this figure would demand growth of more than 10% higher than the preview of 2014 year-end, without including the impact of the new measures adopted (extension of the flat rate and the new exemption of 500 million euros in the contribution base).

The analysis of the performance of the macroeconomic variables with an influence on revenue from social contributions —especially full-time equivalent (FTE) employment and compensation per employee— does not uphold this trend in revenue from social contributions.

- On the contrary, a surplus is observed in the SEPE that was not forecast in the initial budget. This surplus is essentially due to:
 - A margin in the forecast for expenditure on unemployment benefits. The budget of the SEPE for 2015 forecasts a similar amount for unemployment benefits as in the preview of 2014 year-end. The forecast made by AIReF shows a downward trend even when taking into account the new Employment Activation Scheme.
 - Moreover, in addition to this lower expenditure for SEPE, revenue from contributions is higher than expected in the initial budget.

Recommendations

AIReF makes the following recommendations concerning the object of the report:

- Early enforcement of article 18.1 of the LOEPySF. In view of the risks and uncertainties highlighted above regarding revenue estimates, monitoring of the data on revenue budget implementation is deemed necessary, as provided for in article 18.1 of the LOEPySF. The ultimate aim of this monitoring would be to adopt sufficiently in advance, as and when necessary, any measures that would allow compliance with the stability target for 2015.
- Submit with the budgets of the Social Security system all the supporting documentation required by budget legislation, especially, the following information not included in the budget for 2015:
 - Preview of the budget settlement for the current year as stated in the State General Budget law.
 - Information allowing the fiscal balance to be matched with the balance in national accounts terms.

2.4. Autonomous Region subsector

The key conclusions of the reports published by AIReF in 2014 on the main budgetary lines of the ARs for 2015 are upheld in this report. The conclusion reached in those earlier reports was that compliance with the budgetary stability target for 2015 was unlikely for the AR subsector because of:

- Risk of non-compliance with the 2014 stability target.
- Additional risks observed in the scenario forecast for 2015:
 - Overestimation of the revenues included in the budget for 2015 with regard to the Funding System resources, to the forecast revenues from the tax on asset transactions and documented legal acts (*Impuesto sobre transmisiones patrimoniales y actos jurídicos documentados*, ITPyAJD) and the tax on inheritance and donations (*Impuesto sobre sucesiones y donaciones*, ISD), and the uncertainty in the materialisation of revenue from real estate asset disposals.
 - Stagnation and lack of concrete development of the expenditure consolidation measures forecast for 2015. This stems from, on the one hand, the discontinuation of measures taken in previous years and, on the other hand, the lack of additional measures other than estimates for non-implementation or withholding of budget appropriations or decisions on their non-availability.

Without taking into account year-end 2014, compliance with the deficit target set for 2015 is deemed very likely in the case of the autonomous regions of Basque Country, Galicia and Navarra, and likely in Asturias, Canary Isles, Cantabria, Castilla-La Mancha and Castilla y León. However, risks of non-compliance are seen in the regions of Aragón, Balearic Isles, Madrid and La Rioja. The risks are considered very high in the following regions: Andalusia, Catalonia, Extremadura, Murcia and Valencia.

Key variations with regard to the documentation analysed in the reports on main budgetary lines

With regard to 2014, year-end data published recently confirm the estimate of non-compliance with the stability target set for the subsector in that financial year.

As far as 2015 is concerned, there are no substantial variations in the content of the budgets approved compared to the information that was analysed with their main lines. The only variations arise from the following circumstances:

- Passing of Royal Decree-law 17/2014, of 26th December, whose measures may lead to a saving in budgeted interest payment expense amounting to 2,337 million euros, according to the valuation reported by the ARs.
- Approval on 26th December 2014 of the EFPs of the autonomous regions of Cantabria, Castilla-La Mancha, Catalonia, Murcia and Valencia, and on 30th January the EFP of Navarra. In some cases those plans meant the presentation of a scenario for 2015 that differs from the one included in the budgets approved. In Catalonia and Valencia the main budgetary lines report underscored the existence of revenues from the State forecast in their draft budgets that did not appear in the 2015 State General Budget in the end. In the scenario for 2015 contained in their EFPs those revenues are replaced by other operations that likewise raise uncertainties about compliance with the stability target for this year.

Conclusions

- The conclusions reached in the main budgetary lines report for the subsector overall for 2015 are upheld in this report. The deviation in the year-end figures for the previous year and the overestimation of revenues observed in the forecast for 2015 together with the stagnation of expenditure containment measures point to a high risk of non-compliance with the budgetary stability target set at -0.7% for this subsector, despite the savings measures for interest payments in Royal Decree-law 17/2014. Despite the savings that might be made from the measures approved by Royal Decree-law 17/2014, there does not seem to be sufficient margin this year to allow for the fiscal retrenchment needed to reach the stability target set for this financial year at -0.7% of GDP.

When taking into account both year-end 2014 and the budget scenario for 2015, a high risk of non-compliance with the stability target for 2015 is observed for Andalusia, Aragón, Balearic Isles, Cantabria, Castilla-La Mancha, Catalonia, Extremadura, Murcia and Valencia.

- In the case of Aragón, Balearic Isles, Cantabria and Castilla-La Mancha, the risk stems essentially from 2014 year-end.
- As regards Catalonia and Valencia, in addition to the retrenchment required as a result of the 2014 year-end result, there is the fact that the uncertainties stated at the time about the revenues scenario in the draft budgets can still be seen in the scenario for 2015 contained in the EFP, although this time they concern different budget items.

- o In the case of Andalusia, the sale & leaseback operation that conditioned the risk viewed in the budget lines report for compliance with the 2014 target was finally classified as non-financial income in that year. The non-recurring nature of the operation, accounting for 0.2% of regional GDP, together with the overestimation of revenues in the 2015 budget, mean uncertainties remain about the likelihood of compliance with the 2015 stability target for the region.
- Some of the measures in Royal Decree-law 17/2014 and the delay in applying corrective measures reduce in practice the potential of the LOEPySF to keep the public deficit under control. On the one hand, the new Autonomous Region Financing Fund created under Royal Decree-law 17/2014 provides for the funding through either its Financial Facility option or the Autonomous Regional Liquidity Fund to cover any deficit deviations from previous years still outstanding. That means there is now a piece of legislation in force in the form of this Royal Decree-law with a provision for the State to finance on a permanent basis deficit deviations from past years at a low interest rate (the short-term lending interest rate is zero). On the other hand, as an additional factor, there is the delay in activating the corrective measures set out in the LOEPySF, both as regards the approval of EFPs as well as the non-activation of preventive mechanisms whenever risks of non-compliance with the stability target are detected.

Recommendations

AI ReF makes the following recommendations:

1. Aimed at substantiating the implementation of the stability legislation and remedying limitations on the scope:
 - Inclusion in the budgets of the ARs of sufficient and adequate information for verification of their financial sustainability targets (article 6 of the LOEPySF) and calculation of the expenditure to be included in it (in the terms set out in article 12 of the LOEPySF) with a sufficient level of detail to work out how that calculation has been made.
 - Establishing by the MINHAP of a transparent and verifiable system of debt targets that limits as far as possible the margin for discretion.
2. Relating to the purpose of the report:
 - AI ReF recommends the MINHAP takes early action within the scope of the LOEPySF with regard to the autonomous regions whenever a high risk of non-compliance with the fiscal stability

target for 2015 is seen, so that any deviations observed in the scenario for 2015 may be detected and corrected in time. To do that it is essential for MINHAP to publish without delay its *Report on the degree of compliance with the budgetary stability target, the public debt target and the expenditure rule for 2014*, in order to activate the procedure laid down in the LOEPySF for non-compliant ARs.

- AIReF recommends the MINHAP should continue to phase in the measures envisaged in the LOEPySF and give due consideration to the implementation of the coercive measures provided for in article 25 of the LOEPySF. In the case of highly indebted autonomous regions that fail to comply on a recurring basis with the stability target and so with the EFP submitted as a consequence of this non-compliance, the measures provided for in the LOEPySF should be phased in and due consideration given to the application of the coercive measures laid down in its article 25, especially in the case of those regions whose budget for 2015 provides evidence of a clear risk of a new failure of compliance.

2.5. Local Corporations (LCs) subsector

The information received to prepare the Report on the main budgetary lines of the 2015 budgets of the local corporations limited the scope of the analysis of the stability target to the subsector as a whole.

The report concluded that the forecast budget settlement reported for 2014 and underpinning the data on the main lines of the budgets for 2015 prepared by the LCs allowed for their compliance with the stability target in both years. Nevertheless, the margin for compliance could be affected by the existence of the following circumstances:

- The non-materialisation in full or in part of, and/or delay in, the economic impact expected from the local government reform. The positive economic impact expected from the reform —both the financial amount and in the calendar for its implementation— could be affected by the approval by some ARs of interpretative rules on the application of the law regulating the local reform as well as by the filing of the dispute to defend local government autonomy in relation to that law.
- The upward trend usually taken by investment expenditure in pre-election years, the exhaustion of fiscal pressure measures and the possibility of a more flexible expenditure ceiling as requested by the LCs.

Key variations as regards the documentation analysed in the reports on the main budgetary lines

Unlike all the other subsectors where approved budgets are available, in this subsector the only information available to AIReF is the information provided by the MINHAP. As a result, the variations analysed in this report mainly depends on the differences in the information sent by the MINHAP:

- Latest quarterly data published by the State General Comptroller (*Intervención General de la Administración del Estado, IGAE*) corresponding to the fourth quarter 2014, as well as the preview of budget implementation to date to the end of that year submitted by the MINHAP.
- Approval of Royal Decree-law 17/2014, of 26th December, on financial sustainability measures in the ARs and LCs and other measures of an economic nature, whose implementation may entail savings of 701 million euros in budgeted expenditure on interest payments according to the press release published on that Royal Decree-law by the MINHAP.
- Aggregate information for the subsector on the budgets approved by the LCs for 2015, with a breakdown by budgetary chapters.
- Individualised information with a budgetary chapter breakdown on the budgets approved by the six city councils with more than 500,000 inhabitants that are provincial capitals or capitals of an autonomous region (Barcelona, Madrid, Malaga, Seville, Valencia and Zaragoza).
- Provisional settlement corresponding to 2013 in the system for participation of the LCs in State taxes, which has been incorporated into the State General Budget for 2015.
- Updated economic report of Law 27/2013, on the rationalisation and sustainability of local government, giving explicit details of the methodology to calculate the economic impact expected from the local reform.
- Borrowing levels published by Banco de España.

There is no information available on:

- Litigation concerning the local reform in relation to the impact of the rules approved by the ARs and any appeals filed.
- Adjustments in national accounts allowing for the non-financial budget balance to be matched with the net lending (+)/net borrowing (-) of the subsector.

Conclusions

- Greater leeway for compliance can be seen in the local corporations subsector. It is highly likely that this subsector will comply with the target for 2015 with a comfortable surplus. The data received confirm the conclusion contained in the report published in October on comfortable compliance with the target in 2015. The margin of compliance will depend on the weight of the adjustments in national accounts terms given that their financial amount is not known.

According to the information sent by the MINHAP, the non-financial budget balance of the budgets approved for 2015 is still a very similar figure to the balance for budgets in 2014: approximately 4 billion euros. This supports the assessment that it is highly likely 2015 will end with a budget surplus at least similar to the one recorded in 2014 on the assumption that all the other factors will remain constant.

- It is important to verify compliance with the two fiscal rules — stability target and expenditure rule— both in the initial budget and in budget implementation, because depending on the individual situation of each local corporation, one or other of the rules is more restrictive and both of them guarantee the long-term stability of the subsector. The application of the expenditure rule implies the existence of greater leeway in budget implementation than the leeway resulting from the budgets approved for 2015. With the budget information published by the MINHAP the expenditure that would be included in the calculation for the purposes of the expenditure rule is estimated as usually being around 80% of the budget appropriations initially approved.

The 2015 budget approved for local entities contains a 6.5% increase in non-financial expenditure compared to the budgets implemented in 2014, whereas revenue remains practically constant. Nevertheless, the application of the expenditure rule to the subsector as a whole at year-end means it is impossible to spend the total amount budgeted once this has been adjusted to national accounting criteria. According to the provisions of the LOEPySF and under the agreement reached by the Council of Ministers on 27th June 2014, all the public administrations can increase by 1.3% at most compared to 2014 their expenditure in 2015 to be included in the calculation for the purposes of the expenditure rule.

The report published by the MINHAP on 24th October 2014 on the degree of compliance with the budgetary stability target, public debt and expenditure rule for 2013 determined that in the case of the local corporations subsector, the expenditure eligible for inclusion in the calculation for the purposes of the expenditure rule amounted to 47,121 million euros. When the medium-term GDP reference growth rates for the Spanish economy in 2014 and 2015 are applied to this figure, the maximum expenditure that could be included in the calculation in 2014 would be 48.45 billion euros, on the assumption

that all of the other components making up the calculation perform at the same rates. Given the level of expenditure budgeted for the LCs in 2015 (62.8 billion euros), because of the application of the expenditure rule full implementation of this amount does not seem likely unless the national accounts adjustments and the adjustments necessary to reach the computable expenditure for the purposes of that rule could offset the difference between the amount budgeted and the spending limit.

- The budgetary expenditure scenario for 2015 does not provide evidence at least in part of the forecast economic impact of the local reform given that budget chapters 1 and 2, on which it has the greatest impact, record increases between the 2014 preview and the budgets for 2015 of 6% and 12% respectively.
If the initial budget information were to incorporate the savings measures foreseen by the local government reform under Law 27/2013, on the rationalisation and sustainability of local government, quantified in the 2015 Budgetary Plan as being 3,524 million euros, the outcome would be a dilution of its effect as a consequence of the increase foreseen in other expenditure items.

Recommendations

AI ReF makes the following recommendation aiming at substantiating the implementation of the stability legislation and remedying the limitations on the scope:

- Add the information corresponding to the adjustments in national accounts to the budget information so that budget figures can be matched up with net lending (+)/borrowing (-).

Good practice guidelines

AI ReF proposes the following good practice guidelines:

- Publication of the individualised information on budget implementation and compliance with the three fiscal rules for the six largest municipalities, in line with the debt information according to the Excessive Deficit Procedure (EDP) published by Banco de España.

3. Debt target and expenditure rule

The conclusions stated in the Report on the draft budgets and main budgetary lines of the Autonomous Regions for compliance with the stability target and the expenditure rule are upheld in this report.

ANNEX:

Variation in the assessment made by AI ReF of 2015 compliance between the main budgetary lines report and the report on initial budgets

VARIATION IN THE ASSESSMENT MADE BY AIReF OF 2015 COMPLIANCE	
TOTAL GENERAL GOVERNMENT	
AIReF restates in its assessment that the public deficit target for 2015 is very demanding.	
AIReF ASSESSMENT OCTOBER 2014	AIReF ASSESSMENT MARCH 2015
Compliance with the deficit target of 5.5% of GDP in 2014 as the basis for budgetary compliance in 2015.	The public deficit for the government sector overall stands at 5.7%, although two tenths of a percentage point are due to an extraordinary, non-recurring factor during the year (refund of the "health cent"). This result can be considered a reasonable basis on which to work towards the 2015 stability target. Compliance with targets over the last few years affords credibility to the fiscal consolidation effort.
Confirmation of the macroeconomic scenario of cyclical recovery of the economy without any of its key downside risks materialising.	The macroeconomic scenario is developing significantly better than forecast. The downside risks have not materialised and, to the contrary, additional factors driving growth have appeared. There is greater confidence in the domestic and international environment. All of these factors are making it possible for domestic demand, the external sector and the labour market to develop better than expected and this should facilitate compliance with the demanding budget revenue scenario.
Compliance with the expectations of higher revenue for the Social Security stemming from the new direct settlement system and the full inclusion of remuneration in kind in the contribution base and the maintenance of the current declining trend in expenditure on unemployment benefits	These expectations have not materialised. It is very likely that Social Security revenues will remain much lower than forecast in its budget. This will be partially offset in the Social Security Funds by the continued good pace of reduction of expenditure on unemployment benefits, which will end the year below budget. In any event, it is highly likely that the deficit in the Social Security Funds by the end of the year 2015 will be several tenths of a percentage point above the demanding target of 0.6% of GDP and closer to the 2014 year-end result.
The leeway in the State's expenditure budget, essentially in financial expenses and in the LCs subsector, offsets the probable negative deviation in AR subsector with regard to the 2015 stability target.	The declining trend in interest rates has intensified over the last six months and so financial expenses in 2015 will be even lower than budgeted. Some of that leeway will be passed on to the ARs and the LCs. Nonetheless, this will only allow this subsector to take two tenths of a percentage point off its GDP deficit reduction for 2015 after having ended 2014 with a deficit of 1.7% of GDP. The analysis of the budgets for this subsector does not reveal any measures that will make a significant contribution to cutting the deficit and the improved macroeconomic scenario will only be tangibly reflected in their revenues as of 2016. Therefore, it is very likely that the AR subsector will end 2015 with a similar deviation from the deficit target to the one recorded in 2014. The surplus in the LCs will hardly offset this deviation. This is inferred from the content of their budgets and the implementation of the 2015 expenditure rule. Nor does the State have practically any margin left in its budgets as a consequent of the new economic measures approved subsequent to the approval of the budgets.

CENTRAL GOVERNMENT	
The leeway seen in the draft SGB under financial expenses will partially at least be earmarked to offset the impact of the new measures approved, lessening the possibilities of offsetting the deviations in other subsectors. Nevertheless, as far as revenue is concerned the foreseeable improvement in the macroeconomic scenario could have favourable effects on the tax bases although there is uncertainty surrounding the refunds of revenues from the main taxes.	
ASSESSMENT AIReF OCTOBER 2014	AIReF ASSESSMENT MARCH 2015
The central government target of 2.9% is deemed achievable with the leeway that exists in the expenditure budget, essentially in financial expenses.	The adoption subsequent to approval of the budgets of new regulatory measures with an economic impact means that the leeway seen in the draft SGB under financial expenditure will at least partially be earmarked to offset the impact of the new measures. These new measures essentially entail lower revenue for the central government and so make it less possible to offset existing deviations in other subsectors.
The taxation targets seem achievable provided the forecasts in the macroeconomic table supporting the 2015 draft SGB materialise. Nonetheless, there are uncertainties surrounding the refunds on the revenue from the main taxes.	The macroeconomic scenario is developing significantly better than forecast. The downside risks have not materialised and, to the contrary additional factors driving growth have appeared. There is greater confidence in the domestic and international environment. All of these factors are making it possible for domestic demand, the external sector and the labour market to develop better than expected and this should facilitate compliance with the demanding budget revenue scenario. Nevertheless, uncertainty remains about refunds of the main taxes (corporation tax and VAT),
SOCIAL SECURITY FUNDS	
It is highly likely the deficit in the Social Security Funds will end 2015 several tenths of a percentage point above the demanding target of 0.6% of GDP and closer to the 2014 deficit.	
AIReF ASSESSMENT OCTOBER 2014	AIReF ASSESSMENT MARCH 2015
The analysis of the macroeconomic variables with an influence on contribution revenues, especially FTE employment and compensation per employee does not sustain revenue performance as reflected in the SGB.	Despite the improvement in macroeconomic forecasts (compared to the forecasts published in October 2014 by the FUNCAS experts panel) the variables with an influence on revenue from contributions still do not back up revenue performance as contained in the SGB.
However, there are additional elements of a structural nature that may significantly impact revenue from contributions in 2015: 1) The start-up of the new direct settlement system (CRETA), currently being trialled but due to be fully operational in May according to sources in the Social Security system. 2) The full inclusion of remuneration in kind into the contribution base during 2015.	There is no certainty about the impact of the structural measures adopted and affecting contribution revenues: 1) The new direct settlement system still being developed and rolled out does not seem to be able to make a substantial contribution to revenue collection.. 2) The effect observed in 2014 of the inclusion of remuneration in kind in the contribution base does not allow for expectations of a strong impact on revenue collection for 2015.
No significant risks are observed in the forecast for non-financial expenditure.	Significant risks are still not seen in the forecast for non-financial expenditure
The 2015 budget provision for unemployment benefits seems excessively prudent under current legislation with the employment forecasts in the macroeconomic scenario and the possible exhaustion of contributory benefits, thus giving some leeway in the SEPE budget that will allow it to make a substantial surplus next year provided the initial transfer from the State is maintained.	The forecast for expenditure on unemployment benefits, even when taking into account the new employment activation scheme subsidy and its funding by the surplus funds in the SEPE, has a certain amount of leeway that together with slightly higher than budgeted collection of contributions will allow it to make a surplus. This surplus does not seem to be enough to offset the deviation in revenue in the Social Security System.

AUTONOMOUS REGIONS	
AIREF restates its assessment and deems that there is a high risk of non-compliance with the public deficit target for the ARs in 2015. Despite the savings that might come from the measures in RD-Ley 17/2014, it does not see sufficient margins to make the fiscal retrenchment necessary to achieve the target set.	
AIReF ASSESSMENT OCTOBER 2014	AIReF ASSESSMENT MARCH 2015
Risk of non-compliance with the stability target for 2014 that might stand at similar levels to 2013. There is a high risk of non-compliance in eight regions and a tight year-end in another six.	The non-compliance of the subsector is confirmed with the preview data showing a deficit of 1.66% of GDP. Only four ARs comply with the target: Basque Country, Canary Isles, Galicia and Navarra.
Unlikely compliance with the 2015 -0.7% of GDP stability target for the autonomous regions subsector because of: 2014 year-end forecast Overestimation of revenues in 2015 Stagnation and lack of concrete definition in 2015 of expenditure consolidation measures other than budgetary non-implementation, budget appropriation withholding and decisions on non-availability.	There is a high risk of non-compliance with the stability target of the subsector due to : 2014 year-end data The maintaining of the overestimation of revenue for 2015. In the ARs with an approved EFP the revenue where the over budgeting was detected has been replaced by revenue of another nature and higher Stagnation and lack of concrete definition of the expenditure measures in 2015 and an increase of non-implementation of expenditure with the EFP scenarios.
LOCAL CORPORATIONS	
It is highly likely the LC subsector will comply with the budgetary stability target for 2015 with a higher margin than can be deduced from the approved budgets.	
The likelihood of compliance with the revenue and expenditure forecasts included in the main lines of the budgets of the LCs for 2015 is conditioned by the materialisation, in part at least, of the expected savings from the local government reform (3,523.5 million euros).	In the budgets approved by the LCs for 2015 there is no evidence of the economic impact of the local government reform. Even though the information on the initial budgets includes savings measures forecast with the local reform their effect is diluted by the increase in other expenditure.
2015 may be settled complying with the target set but with a lower contribution to the overall target.	Given the year-end results obtained in previous years, it is highly likely that the subsector obtains in its implementation of the 2015 budget a higher surplus than can be inferred from the initial budgets approved. The application of the expenditure rule to the whole subsector means that the surplus achieved is higher than the surplus from the initial budgets, which are drawn up closer to the budget equilibrium set. The expenditure rule entails more restriction on spending than the limitation stemming from the application of the stability target, therefore, compliance with both fiscal rules is important, as is their verification, both in the initial budget and in the implementation given that depending on the individual situation of each local corporation, one or other rule is more restrictive and both guarantee the long-term stability of the subsector.