

REPORT ON THE PUBLIC ADMINISTRATIONS' INITIAL BUDGETS FOR 2019

REPORT 11/19





Independent Authority
for Fiscal Responsibility

The Independent Authority for Fiscal Responsibility (AIReF by its Spanish acronym) was created with the mission of ensuring strict compliance with the principles of budgetary stability and financial sustainability set out in article 135 of the Spanish Constitution.

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EXECUTIVE SUMMARY

Within 1 April, AIReF has the legal mandate of evaluating the initial budgets of the Public Administrations (PAs) from the perspective of their adaptation to the fiscal targets, focusing its assessment on the main budgetary lines and draft budgets previously reported on, in accordance with its organic law. In the case of the PAs that have not approved their budgets the assessment has been carried out with respect to the effects of the budgetary extensions.

On 28 January 2019, AIReF issued its report on the draft General State Budgets (GSB) and the main budgetary lines of the PAs for 2019, thereby completing the analysis of the Budgetary Plan carried out on 26 October. In said report AIReF noted the lack of realism of the target of -1.3% GDP, which required an adjustment of 1.4 points to be made from the end of 2018, which AIReF estimated at -2.7% GDP at the time.

Having analysed the new information, AIReF continues to consider the achievement of the target of -1.3% GDP to be unlikely for the General Government (GG), although it has revised the deficit estimated for 2019 slightly downwards, placing its baseline scenario at -2.1% GDP, 0.1% below its previous forecast.

The changes in AIReF's assessment with respect to the estimate made in the previous report are primarily due to the non-approval of the GSB for 2019, and the inclusion of the latest execution data published, including the end of 2018 that finally stood at -2.6%.

The non-approval of the GSB for 2019 has meant that a significant part of the measures contained in the Budgetary Plan and in the draft GSB have not been put in place, with a net positive effect on the deficit. However, the revenue measures of the Social Security Funds, the revaluation of pensions and the wage increase for public employees had already entered into force before the presentation of the draft GSB before Parliament.

TABLE OF REVENUE MEASURES: GOVERNMENT'S AND AIREF'S ESTIMATE

REVENUE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
Corporate Income Tax	1.516	1.516	1.516	1.516	0
PIT Increase of rates on higher income	328	250	328	250	0
New tax figures	2.050	1.397	2.050	349	0
Tax on Financial Transactions	850	640	850	160	0
Tax on certain Digital Services	1.200	757	1.200	189	0
Green taxation (Hydrocarbons Tax)	670	670	670	503	0
VAT	-53	-53	-77	-58	0
Heritage Tax	339	8	339	0	0
Fraud prevention	828	460	828	348	0
TOTAL CA IMPACT	5.678	4.248	5.654	2.908	0

Maximum contribution bases Increase of 7%		1.000	850	850	850
Minimum wage. Minimum bases General Regime		600	1.279	600	600
Special Self-employed Workers Regime Measures	1.500	1.000	6	6	6
Quota for professional contingencies			456	456	456
Additional contributions local police forces			254	254	254
Others			154	154	154
TOTAL SSF IMPACT	1.500	2.600	2.999	2.320	2.320

Note: CA (Central Administration) and SSF (Social Security Funds)

TABLE OF EXPENDITURE MEASURES: GOVERNMENT'S AND AIREF'S ESTIMATE

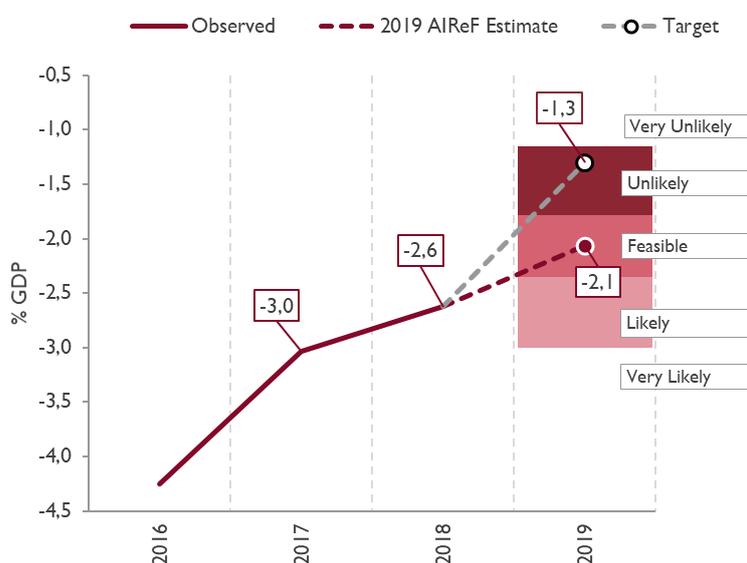
EXPENDITURE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%	736	843	588	588	588
Measures quantified jointly in the Budgetary Plan	1.318	1.318	1.633	1.435	920
Improve minimum and agreed level of dependency		515	515	515	0
SS caregiver contributions		0	315	315	315
Recover subsidy for those older than 52 years		323	323	242	242
Paternity leave of 5 to 8 weeks		300	300	225	225
Minimum income		180	180	138	138
Measures listed in the Budgetary Plan and quantified in the additional information	425	725	492	812	0
Increases in expenditure included in the GSB 2019 not expressly identified in the Budgetary Plan			2.415	2.415	0
TOTAL MEASURES	2.479	2.886	5.128	5.250	1.508

In addition, in the first few months of the year the Government approved, by Royal Decree-Law, part of the expenditure measures quantified in the Budgetary Plan and included in the draft GSB for a total amount of 1,633 million. AIReF had already reduced the impact of these measures by 200

million in 2019, since their entry into force had been delayed until the second quarter of the year according to the budget processing calendar. Following the approval of the Royal Decree-laws, the final amount is estimated at 920 million, due to not having developed the measure to improve dependency that was included in the draft GSB in the amount of 500 million euros.

Another factor that has contributed to reducing the deficit estimate for 2019 has been the incorporation of published closing data for 2018 that presented a GG deficit of around 0.1% less than AIReF's forecasts. In net terms, this difference was mainly caused by the better behaviour of social contributions and revenue from the European Structural Funds.

GENERAL GOVERNMENT NET LENDING/BORROWING (% GDP)



Analysis by sub-sectors

The analysis by sub-sectors shows a certain "stagnation" of the fiscal scenario, in which it is easy to anticipate the results that will be obtained in at least three of the sub-sectors. The Local Governments (LGs) will maintain their surplus at around 0.5% GDP; the Autonomous Regions, with some exceptions, will be situated close to budgetary balance, and Social Security will replicate the deficit of 1.4%/1.5% GDP of previous years. Only the Central Administration (CA) presents a greater uncertainty due to the link between tax revenue and the economic cycle. This situation is only altered by the effect of non-recurring operations, especially court ruling, and the higher or lower revenue from the European Union that, as long as it is not in line with expenditure execution, could have a very significant impact in some Regions.

In this sense, AIReF estimates that in 2019 only the CA will reduce its deficit with respect to the end of 2018, maintaining the level recorded last year in the

other sub-sectors. This adjustment, that could reach 0.5% GDP, is reduced to 0.3% if we exclude the non-recurring operations of both years.

ADJUSTMENT OF THE 2018-2019 DEFICIT (% GDP)

Lending (+) Borrowing (-) as % GDP	Year-end 2017	Year-end 2018	2019 Objective	2019 AIReF closing
Central Administration	-1,9	-1,5	-0,3	-1,0
<i>Non-recurrent operations</i>	<i>-0,2</i>	<i>-0,5</i>		<i>-0,3</i>
<i>Deficit without non-recurrent operations</i>	<i>-1,7</i>	<i>-1,0</i>		<i>-0,7</i>
Social Security	-1,5	-1,4	-0,9	-1,4
Autonomous Regions	-0,3	-0,2	-0,1	-0,2
<i>Local Corporations</i>	<i>0,6</i>	<i>0,5</i>	<i>0,0</i>	<i>0,5</i>
Regions and LGs	0,3	0,3	-0,1	0,3
General Government	-3,1	-2,6	-1,3	-2,1

On the other hand, the assessment made on 28 January is generally maintained, while the Social Security forecasts improve by 0.1%.

COMPARISON OF AIREF'S CLOSING FORECAST FOR 2019

Lending (+) Borrowing (-) as % GDP	January Report	Current Report
Central Administration	-1,0	-1,0
Social Security	-1,5	-1,4
Autonomous Regions	-0,2	-0,2
Local Corporations	0,5	0,5
Regions and LGs	0,3	0,3
General Government	-2,2	-2,1

AIReF carried out its assessment and analysis while considering a scenario of funding flows between administrations in line with that included in the budgets of the Territorial Administrations (TAs), which provide for similar financing system resources to those reported in July, complemented by those derived from the neutralisation of the effect that the Immediate Information System (IIS) for the VAT, adopted in 2017, has on the settlement of these resources¹.

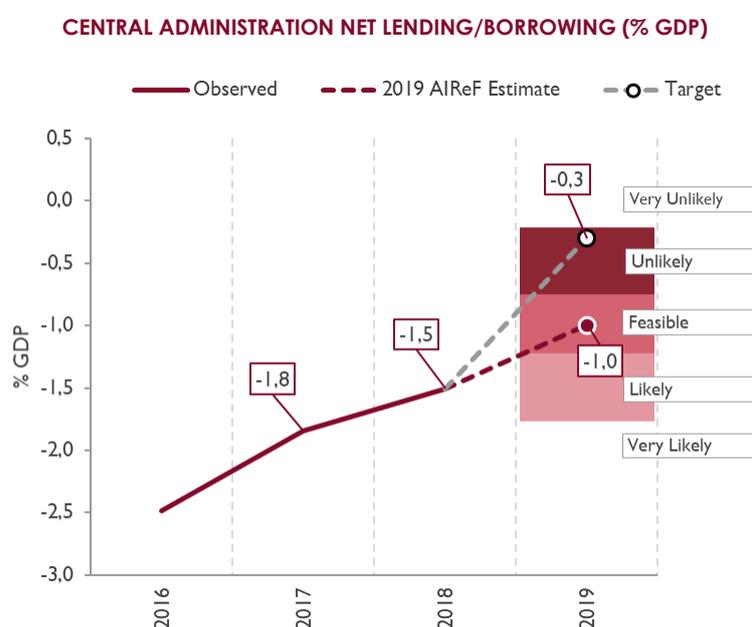
However, given the uncertainty about whether any measures aimed at offsetting the impact of the VAT-IIS rules will be implemented, the probability of compliance with the stability target in the event that this does not happen is assessed.

¹ See Box 1 of the [Report on the main budgetary lines and draft budgets of the PAs: draft GSB for 2019](#)

• Central Administration

A deficit of 1.0% GDP with a slight improvement of less than 0.1% GDP with respect to that envisaged in the January report is forecasted. Therefore, the achievement of the stability target of -0.3% GDP for 2019 remains unlikely.

Despite the fact that the end of 2018 was worse than expected at the time of preparing the previous report, mainly due to the imputation of non-recurring operations, the improvement of the balance occurs as it is precisely this sub-sector in which the effects of the non-approval of the GSB are concentrated, which has meant a substantial downward revision in their revenue estimates and, to a greater extent, of expenditure estimates.

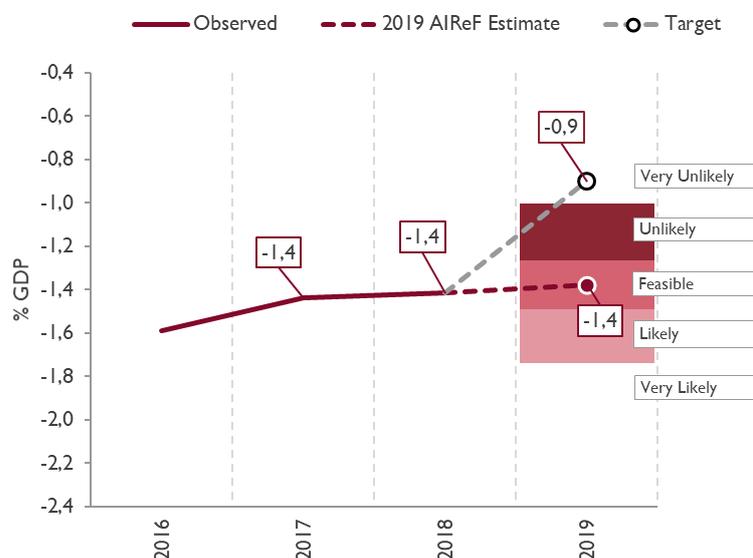


• Social Security Funds

A slight improvement in the closing forecasts of the SSF sub-sector with respect to the previous report is expected, going from -1.5% GDP to -1.4%, a similar deficit to that achieved in 2018. According to these forecasts, the target of -0.9% GDP for 2019 remains highly unlikely.

This positive variation derives from the published closing data for 2018 which were more favourable than expected, mainly due to the good evolution of contributions, which have led to a lower starting deficit level. In addition, in the context of the SSF, there have been no changes in the impact assessment of the measures in force despite the non-approval of the GSB.

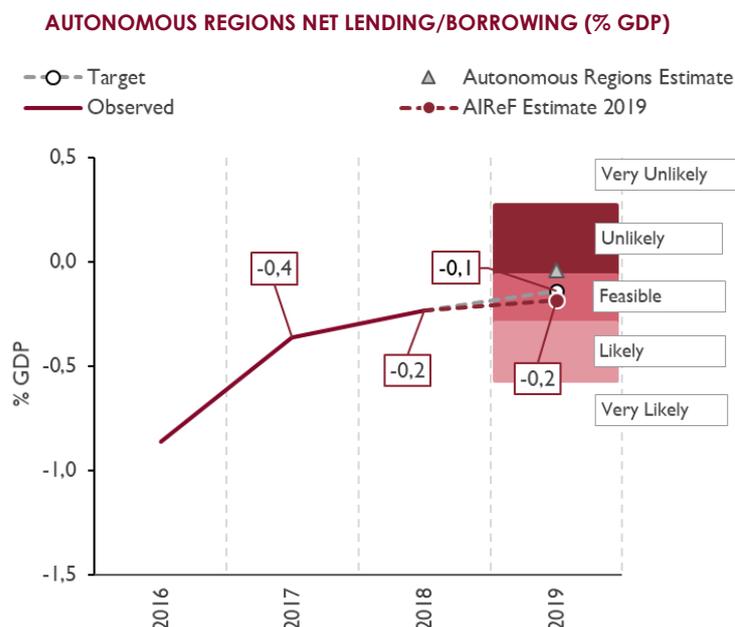
SOCIAL SECURITY FUNDS NET LENDING/BORROWING (% GDP)



- **Autonomous Regions**

With a slight improvement with respect to the January report, AIReF still considers compliance with the stability target of -0.1% GDP to be feasible, with a baseline scenario that is maintained at the -0.2% estimated in the previous report under the assumption of a funding scenario of in line with that envisaged in said report.

This invariance is due to the fact that the regional forecasts for 2019 do not feature substantial changes with respect to the main budgetary lines and draft budgets and that the improvement at the end of 2018 is only partially translated to 2019, also remaining offset by other factors in a significant portion.



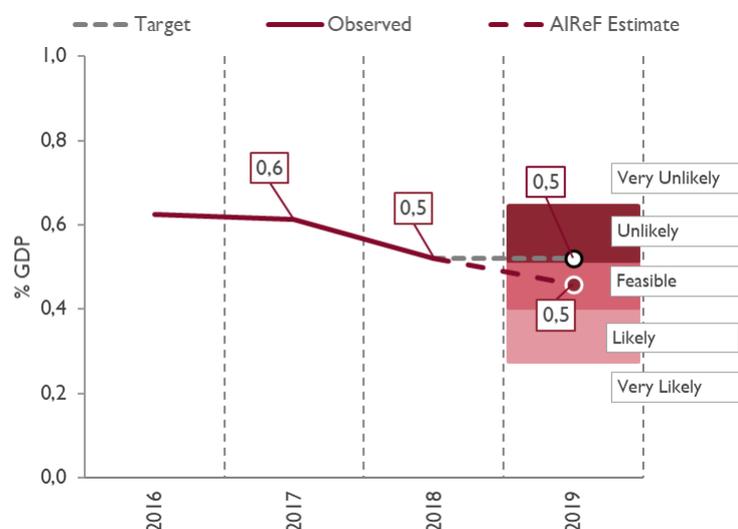
• **Local Governments**

AIReF believes that it is very likely that the local sub-sector will comply with the balance target in 2019, as it is feasible to achieve a surplus of around 0.5% GDP, slightly lower than in 2018. The assessment of the January report, under the assumption of a State funding scenario in line with that envisaged in the report, is therefore maintained.

There have been no significant changes in the budgets with respect to the main budgetary lines and draft budgets, nor in the 2018 closure published, although both the revenue forecasts of the financing system and the expected expenditure on investments have been revised downward, conditioned by the regulation of financially sustainable investments, whose extension to 2019 did not occur until March (Royal Decree-Law 10/2019, of 29 March).

Regarding the expenditure rule, the forecasts of the Report on the Main Budgetary Lines and Draft Budgets are maintained in all sub-sectors, except in the CA in which an improvement is observed due to the lesser expenditure derived from the budgetary extension.

LOCAL GOVERNMENTS NET LENDING/BORROWING (% GDP)



Recommendations

AIReF recommends:

1. That the setting of budgetary stability targets for the 2020-2022 period is underpinned by a government debt reduction pathway, which translates into a fiscal strategy that includes an analysis of the evolution of the structural balance in the medium term. At the same time this future planning must take into account the European framework and the margin available in 2019.
2. To publish the analysis and information that serves as a basis for determining the path of the stability targets and debt for the GG and for each of the sub-sectors.
3. That the MINHAC:
 - establishes a procedure for the application of article 32 of the Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF) to the TAs that includes a repayment schedule that takes into consideration the liquidities and financial costs associated with early repayment of the debt.
 - promotes the regulatory amendments that detail the competences of the LGs' financial guardianship bodies, and specify whether it is this body or another that should verify the calculations of compliance with the fiscal rules made by local intervention boards or equivalent bodies in the LGs of their territory.
 - specifies the consequences of the finding of errors in the calculation of the fiscal rules, as well as the consequences for the guardianship body

or responsible body, in the event of not properly exercising these functions.

In addition, two recommendations addressed to the MINHAC that have been reiterated in previous reports, and that AIReF considers relevant for the effectiveness of the fiscal rules, remain active.

Finally, in this report AIReF sets out the provisional main findings from the analysis of the Regions and the LGs, which will be included, along with the corresponding recommendations, in the individual reports to be published in the near future.