



Report on the main budgetary lines for 2015 of the Autonomous Region of Catalonia

In the two years 2014-2015, the Autonomous Region of Catalonia must make a fiscal effort equivalent to 1.2% of the expected regional GDP for 2015. At year-end 2013, the Region's net borrowing was €3,860m, which is 2.0% of its regional GDP. Using the year-end as a starting point, in order to meet its stability target in 2015 it has to reduce its deficit by €2,420m. This is 1.2% of the regional GDP forecast for 2015.

There are risks that in 2015 the Autonomous Region of Catalonia may not achieve its deficit target for the year, which has been set at 0.7% of its regional GDP. On the basis of the information available in the questionnaire on the main budgetary lines submitted by the Region, facilitated by the General Government Financial Information Centre (Ministry of Finance & Public Administration, MINHAP), there are implementation risks that may jeopardise compliance with the stability target for this year. The Region presented its draft budgetary plans for 2015 on 2nd December, so it has not been possible for AIReF to analyse the plans for the purposes of this report. Should subsequent analysis of the data alter the conclusions of this report, it will be updated when the Report on the main budgetary lines of all the Autonomous Regions is published. The risks indicated are based on:

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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- **Practical certainty of non-compliance with the target set for 2014.** In the fiscal scenario initially forecast by the Region for the year-end, a very high risk of non-compliance with some revenue items is observed. Should this risk materialise, the Region would be required to carry out additional fiscal retrenchment in 2015 over and above the effort already foreseen in the information presented.
- **Deviation risks observed in the 2015 fiscal scenario (main budgetary lines questionnaire for 2015).** The greatest deviation risks detected in the main budgetary lines questionnaire for 2015 relate to the expected revenues, affecting the revenues from the funding system paid out by the State payable with interim instalments and final settlement, the compensation of the IDEC (tax on deposits of financial institutions) and capital transfers from the State. The total sum of these items accounts for 1.1% of the regional GDP estimated for this year.

The Region's 2014 deficit could stand at over 2% of its regional GDP. Risks related to certain revenues in the 2014 year-end scenario expected by the Region are observed in the main budgetary guidelines questionnaire. From a quantitative standpoint the greatest uncertainty concerns income from property and disposal of property assets. These risks have been confirmed by the Region in the supplementary information submitted.

In application of article 20 of Royal Decree 215/2014, of 28th March, approving the Organic Statute of the Independent Authority for Fiscal Responsibility, an independent section is included in this report on the deviation risk detected in 2014.

Analysis of the possible deviation from the 2014 budgetary stability target

The **Autonomous Region of Catalonia expects to achieve its 2014 stability target with a 5.7% increase in revenues and a 0.9% reduction in expenditure in public-sector accounting terms.** On the basis of the information available in the main budgetary lines questionnaire submitted to the Ministry of Finance & Public Administration (MINHAP) for 2015, by year-end it expects to achieve the stability target fixed for the year at -1% of the regional GDP. This would be the outcome of non-financial revenues increasing 5.7%, which is largely dependent on receiving the proceeds of sales of property assets and concessions, and a 0.9% reduction in non-financial expenditure, above all in capital expenses. Adjustments are expected in the public accounts in order to present them in national accounts terms, which will increase the deficit by a further €87m.

The above notwithstanding, and if all the other initial estimates remain true, the deficit would be 2.2% of the regional GDP when taking into account the new year-end forecasts contained in the supplementary information the Region submitted for income from property, property asset divestments and adjustments for obligations pending application to the budget (account 409/413).

The primary deficit expected by the Region is 0.9% of the regional GDP in public-sector accounting terms. Expected non-financial interest expenditure (chapter 3 of the expenditure budget) for year-end 2014 accounts for 1.0% of the regional GDP.

Revenues from the funding system paid out by the State to the Region in 2014 went down 3.9% against 2013. The largest items recorded as non-financial revenues are the revenues from the funding system payable with interim instalments and final settlement. These were down 3.9% against what the Region received in 2013. The average reduction for all the Autonomous Communities under the common regime is 3.3%.

The measures foreseen by the Region for 2014 account for €1,954m. The Region reports revenue measures for this year with an impact valued at €1,954m. The largest ones are the allocation of concessions and disposal of property assets, followed by those related to the Tax on Asset Transactions & Documented Legal Acts. However, no additional expenditure measures have been adopted over and above those applied in 2013, although the elimination of the extraordinary pay supplements has been maintained, amongst other measures, in similar terms to the previous year.

The main risks of deviation from the 2014 stability target relate to the amount expected for certain revenues and national accounts adjustments to the public accounts.

1. A risk of non-compliance can be observed in the **revenue scenario** given by the Region for 2014 in its estimates of the following items:

- **Taxes:** It expects to collect €260m more than in 2013 from the Tax on Asset Transactions & Documented Legal Acts. In 2013 it raised the general rate of the tax with effect as of August. The Region has estimated that in the first half of 2014 the impact of this measure has been €108m. However, the materialisation of these revenues to September suggests some risk of deviation from the expected scenario. This conclusion is in line with the findings obtained in the study carried out by AIReF on the projected tax revenues for the whole Autonomous Regions sub-sector, stemming from the performance of free-market housing prices given by INE, the Spanish Statistical Institute, and the data from the Professional Association of Registrars on second-hand housing transactions.¹ The outcome of this analysis shows that the year-end 2014 forecasts presented produce an upward deviation against the average values in the model.

In other taxes apart from the Tax on Asset Transactions & Documented Legal Acts and the Tax on Inheritance & Donations, the Region estimates 124% growth in 2014

¹The model is estimated on a quarterly basis for the common sample (2004Q1-2014Q1), with the data in logarithms and corrected for seasonality. The series show a stable correlation in the long term (they are co-integrated). The model finally estimated is as follows: $\ln(ITPAJD) = c + 0,94 * \ln(Transactions)_t + 2,2 * \ln(HousingPrices)_t + \varepsilon_t$

against year-end 2013. This grouping includes taxes specific to the Region, such as environmental taxes and the IDEC (tax on deposits of financial institutions), which the Region values at the amount collected by the State that is generated in the Region.

- **Asset revenues:** The year-end 2014 scenario initially included revenues, valued at €1,100m, basically from allocating concessions. This estimate has been altered in the supplementary information submitted by the Region, which brings the initial estimate down by €1,045m. The new year-end figure seems to be in accordance with the developments observed to September.
 - **Disposal of property investments: The year-end 2014 scenario initially gave the figure of €864m.** This estimate has been updated in the supplementary information submitted by the Region, which brought it down €445m against the initial forecast. However, there is still some uncertainty about the complete delivery against these transactions in the year.
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2. In the **adjustments from public accounts to national accounts** estimated by the Region for 2014, there was no initial expectation of an adjustment stemming from the obligations pending application to the budget (account 409/413). The supplementary information submitted by the Region envisages a negative adjustment of €600m for this item.

Analysis of the possible deviation in the 2015 forecasts

The Autonomous Region of Catalonia expects to reach the 2015 stability target with a 2.2% increase in revenues and a 0.9% increase in expenditure. For 2015, the budgetary stability target is -0.7% of regional GDP. According to the available information, this outcome would be obtained with a 2.2% positive year-on-year change in non-financial revenues and a 0.9% year-on-year increase in non-financial expenditure. Additionally, in public-sector accounting terms this deficit would be reduced with the positive adjustments in national accounts terms, estimated at €244m. This would mean net borrowing would be in line with compliance of the stability target.

The above notwithstanding, with the new year-end forecasts for certain items mentioned in the 2014 analysis section, the increase in non-financial revenues indicated above would be 10.0%.

According to the Region's estimates, there is a primary balance in public-sector accounting terms. Expected non-financial interest expenditure for 2015 (chapter 3 of the expenditure budget) accounts for 0.8% of regional GDP.

Revenues from the funding system that the State expects to pay out to the Region increase 2.6% against 2014. The largest items recorded as non-financial revenues are from the funding system payable with interim instalments and final settlement. The 2015 General State Budget envisages a 2.6% increase in these revenues against 2014. The average increase for all the Autonomous Regions under the common regime is 2.8%.

The discontinuation for 2015 of measures adopted in earlier years means higher expenditure/lower revenues of approximately €1,467m. The Region estimates that the effect of the measures foreseen in 2015 will bring revenues down €933m against those expected for year-end 2014. This negative impact stems from non-repetition of transactions adopted for 2014 with respect to allocation of concessions and disposal of property assets. Factoring out these operations, the revenue measures

expected are valued at €760m. Of these, €635m are attributed to the expected pay-out from the State for IDEC (tax on deposits of financial institutions); €65m are attributed to the reform of Inheritance & Donations Tax, and €59m to the creation of new environmental taxes. The expenditure measures —above all in staffing levels—will mean €534m more expenditure. This is mainly due to the discontinuation of the measure to eliminate extraordinary pay supplements that had been in place until 2014.

The main risks of deviation from the 2015 stability target come from the expected amount of the revenues from the funding system, the compensation of the IDEC (tax on deposits of financial institutions), capital transfers received and the adjustments in national accounting.

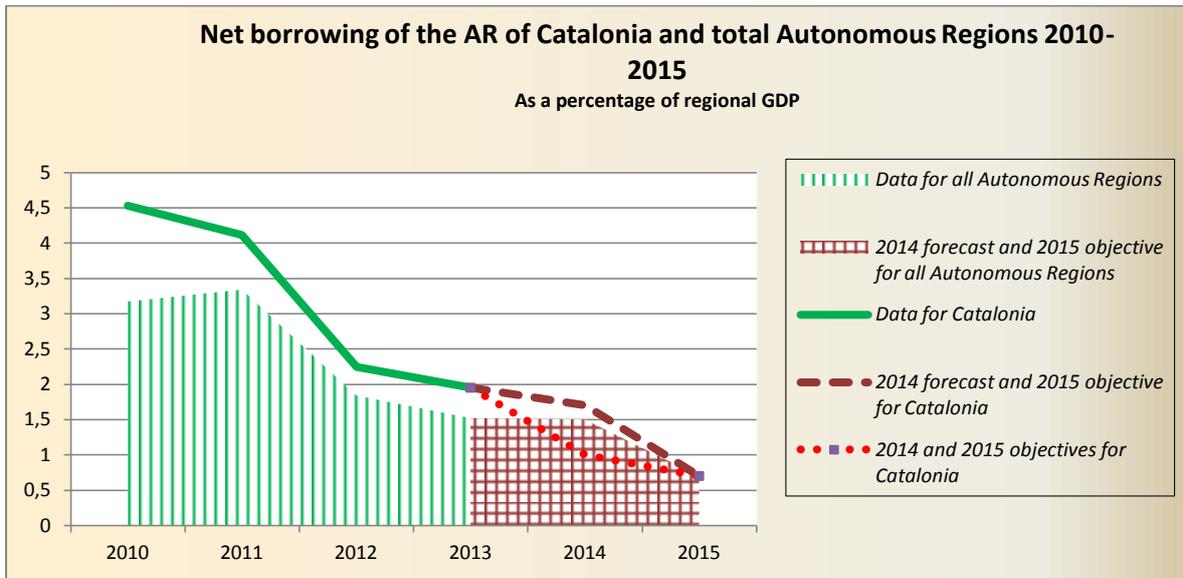
1. The **revenue** scenario foreseen by the Region for 2015 presents a risk of non-compliance with the stability target. This can be seen above all in the following items:
 - **Revenues from the funding system payable with interim instalments and final settlement:** The Region expects to receive an advance payment from the State Competitiveness Fund for €789m. However, this advance payment is not envisaged in the General State Budget.
 - **IDEC (tax on deposits of financial institutions):** The Region estimates the amount payable for compensation of the IDEC at €635m. However, given that in this Region's case the tax was approved subsequent to the provisions established in the State Law (1st December 2012), Catalonia is not among the regions entitled to receive the compensation envisaged in the Organic Law on the Financing of Autonomous Regions (LOFCA), which the State pays out to Andalusia, Extremadura and Canary Islands. Consequently, for the moment, the only amount that will certainly be received for IDEC would be from the collection of the State-wide tax that corresponds to the Region. This amount is significantly below the figure given.

- **Capital Transfers:** A €690m increase is expected against the year-end forecast due to the change in the funds that the Region expects to receive from the State for historical debt, stemming from the application of Additional Provision Three of the Catalan Autonomy Statute, for €759m. At present, there is no evidence of the existence of such a commitment in the General State Budget.
2. In the **national accounts adjustments** estimated by the Region for 2015, it does not foresee any adjustment from account 409/413. This represents a turn-around in the tendency of previous years, when the adjustments for this item have added an additional amount of around €500m to the deficit, 0.3% of regional GDP.

Report on the application of the corrective mechanisms established in Organic Law 2/20152, of 27th April, on Budgetary Stability & Financial Sustainability (article 21 of Organic Law 6/2013 on the establishment of an Independent Authority for Fiscal Responsibility and article 20 of the AIReF Statute).

The graph below shows that between 2010 and 2013 the Autonomous Region of Catalonia achieved a fiscal adjustment of €5,420m. This is more than 2.6% of regional GDP. This fiscal adjustment is significantly higher than that of the Autonomous Regions sector as a whole (vertical green bars), which was almost 1.8% of GDP.

The graph also shows the expected fiscal adjustment for 2014 and 2015 in line with the targets established (dotted red line) and the amount needed to reach the 2015 target if the risks of not meeting the target for 2014 materialise (dotted brown line).



The Autonomous Region of Catalonia presents practical certainty of non-compliance with the stability target established at -1% of regional GDP for 2014. According to the available information for the issuing of the individualised Report on the main budgetary lines of the Autonomous Regions' budgets for 2015 (information from the questionnaire submitted by the Ministry of Finance & Public Administration) and taking into account the data on the Region's execution of non-financial operations to 30th September², in national accounts terms there are certain circumstances in the Autonomous Region of Catalonia that could mean a deviation in its compliance with the targets established for 2014. In the supplementary information it submitted, the Region itself reduced the expected revenues from the administrative concessions and the disposals of property assets and calculated a negative adjustment for the account 409/413. This effectively confirms the risk observed, as stated explicitly in the section *Analysis of the possible deviation from the 2014 budgetary stability target*.

² According to the latest data published by the IGAE (Government Comptroller's Office), the **Region's net borrowing to September 2014 was €3,070m**. This is 1.5% of its GDP, 0.3% higher than the figure recorded on the same date of 2013.

<http://www.igae.pap.minhap.gob.es/sitios/igae/es-ES/ContabilidadNacional/infadmPublicas/infadmcomunidadesautonomas/Paginas/imnofinancierasCA.aspx>

In compliance with Article 20.1, section b) of the AIReF Organic Statute, this possible deviation is explicitly stated in this report, in an independent section, for the effects established in Organic Law 6/2013, of 14th November.

Consequently, this report is submitted to the Ministry of Finance & Public Administration given that it is deemed advisable to activate the measures established in article 19 of Organic Law 2/2012, of 27th April, on Budgetary Stability & Financial Sustainability.

Nonetheless, until an Economic & Financial Plan is approved on the grounds of non-compliance with the 2014 stability target, any measures adopted must be incorporated into the budgetary scenarios for 2014 and 2015 within the framework of the monitoring of the 2013 Economic & Financial Plan, which might be approved before the year-end.