

Supplementary report on the main budgetary lines for 2015 of the Autonomous Regions

Executive summary

AIReF has analysed the Autonomous Regions' main budgetary lines from the standpoint of their adequacy for the stability and debt targets and expenditure rule set for 2015.

The main conclusions drawn from the analysis are:

- 1. At this moment in time, the view is that the 2015 stability target for all the Autonomous Regions —set at -0.7% of GDP— will be very difficult to achieve.** For the Autonomous Region subsector as a whole, the scenario of the draft 2015 budgets, including the expected revenues and the maximum expenditure that can be made during the year, presents a high risk of deviation from the target set.
- 2. In general, the likelihood of deviation from the 2014 deficit target, together with the additional risks identified in the 2015 scenario, require early application of the automatic preventive measures envisaged in the Organic Law on Budgetary Stability & Financial Sustainability (LOEPySF, *Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera*).**

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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Article 18.1 of the LOEPySF provides for the adjustment of public expenditure as an automatic preventive measure, tied to the monitoring of budget implementation data. In this regard, the Autonomous Regions that present a deviation risk must adjust their expenditure in line with a realistic revenue forecast that they will have to update over time in the event that the risks identified in the draft 2015 budget materialise.

3. AIReF has assessed the 2015 budget scenario of each Autonomous Region from the standpoint of its adequacy for the stability target (without taking into account year-end 2014).

It is deemed highly likely that the Autonomous Regions of Basque Country, Galicia, and Navarra will comply with the deficit target and likely that the Autonomous Regions of Asturias, the Canary Islands, Cantabria, Castilla-La Mancha and Castilla y León will also do so. However, risks of non-compliance can be observed in the Regions of Aragón, Balearic Islands, Madrid and La Rioja. The risk of non-compliance is deemed very high in the Regions of Andalusia, Catalonia, Extremadura, Murcia and Valencia.

4. **The final assessment concerning the adequacy of the Autonomous Regions' draft 2015 budgets for the stability target must take into account year-end 2014 as the starting point for the 2015 assessment and in general this is very tight.** Year-end 2014 is very tight and needs the controls to have been intensified and stringent application of the closure of accounts orders approved in the last quarter of the year. Moreover, a fairly high risk of deviation from the 2014 deficit target has been identified in some Autonomous Regions that will mean that additional retrenchment not initially envisaged in the draft budgets presented would be required in 2015.
5. **AIReF cannot issue an opinion on the adequacy of the Autonomous Regions' main budgetary lines for 2015 and the debt target and expenditure rule.** Lack of the necessary information, uncertainty with respect to the transactions eligible for inclusion in the debt target and lack of experience in

calculating the expenditure rule, are just some of the factors that prevent AIReF from assessing the Autonomous Regions' draft budgets with respect to their adequacy for the debt target and the expenditure rule.

6. AIReF makes the following general recommendations:

- **Enhance transparency**, with respect to both setting the targets and the information necessary to verify the adequacy of the budgets to meet the targets.
- **Improve and expand the content of the information accompanying the draft budgets** to allow verification of their adequacy for the targets set (deficit and debt) and compliance with the expenditure rule.
- **Coordinate the calendars for budget preparation and approval procedures** thus guaranteeing that the information required for drawing them up is available.
- **Put the budget in a multiyear framework**
- **Apply the mechanisms established in the LOEPySF** for preventing and detecting possible deviations, hence avoiding any delays that could impede their correction.

Introduction

On the 15th October 2014, the Independent Authority for Fiscal Responsibility (AIReF) issued the *Report on the Public Administrations' main guidelines and draft budgets for 2015* pursuant to Organic Law 2/2012, of 27th April, on Budgetary Stability and Financial Sustainability (LOEPySF) and the Organic Statute of the AIReF. This report pointed out that the information facilitated by the Ministry of Finance & Public Administration (MINHAP) limited the scope of the report with respect to the part dealing with the Autonomous Regions and Local Corporations to an aggregated analysis of each of these subsectors. It was for this reason that it announced a subsequent report: an individualised report on each Autonomous Region.

The aim of this report is to analyse the main guidelines of the 2015 budget of each Region. This report has taken into account the information submitted to the Ministry of Finance & Public Administration by the Autonomous Regions in application of article 13 of Order HAP/2105/2012 amended by Order HAP/20182/2014, together with the draft 2015 budgets presented, the information contained in the Economic & Financial Plans (EFPs) submitted to AIReF by the Regions and the supplementary information that they submitted in response to the request for clarification made by this authority.

AIReF, in turn, has made a series of its own calculations in order to analyse the information, including the following:

- The rates of change of the different budget items have been calculated on the basis of the data from the questionnaire on the main lines of the 2015 budget submitted by each Region, containing information on:
 - On the one hand, the forecasts for year-end 2014, which, where necessary, have been updated based on the supplementary information facilitated by the Regions.

- On the other hand, the 2015 forecasts. The latter have been updated using the data from the draft budgets adopted by the Autonomous Regions.
- The GDP figures at regional market prices from the INE's Spanish Regional Accounting (CRE, *Contabilidad Regional de España*) have been used as the GDP of each Region for the years in which this information is available. The starting point for the other years is the national GDP figure used in the macroeconomic scenario accompanying the draft 2015 General State Budget. The regional structure of the latest regional GDP at market prices published by the INE is then applied to the national GDP figure. AIReF, for its part will shortly publish its own *Report on the macroeconomic forecasts in the Autonomous Regions' Budgets for 2015*, which presents its own estimates of real GDP based on explicit econometric forecasting and reconciliation models.
- Revenues from the funding system payable in interim instalments and final settlement each year have been considered as the amount of the interim instalments, plus/minus the settlement made two years previously, minus the instalments paid to the State by the Autonomous Regions for the settlements payable to the State for 2008 and 2009, offset by the advance payments made by the State each year for deferring such settlements for a period of over 5 years.

AIReF must analyse the main budgetary lines of the Autonomous Regions from the standpoint of their adequacy to meet the stability and debt targets and the expenditure rule set for 2015. Pursuant to the Organic Law adopting the AIReF and its Organic Statute, the main budgetary lines of the Autonomous Regions must be analysed from the standpoint of their adequacy to meet stability and debt targets and the expenditure rule. However, the individual budgets can only be analysed with respect to their adequacy for the stability target. Two general sections are included on the debt target and the expenditure rule that explain the factors that prevent their assessment and recommendations have been formulated with a view to correcting them.

The following general recommendations are made in line with AIReF's report issued on 15th October:

- ✓ Put the budget process on a mid-term timeline.
- ✓ Enhance transparency with a view to expanding the scope of the analysis and examine the annual budget as part of the Stability Programme and the Budget Plan.
- ✓ Coordinate the calendars for presenting the draft budgets of the different Public Administrations.
- ✓ Make public the list of entities included in the Autonomous Region subsector and pursuant to the System of National and Regional Accounts currently in effect (SEC 2010).

Budget stability target

AIReF must issue its opinion on the adequacy of the main lines of each Autonomous Region's budget for 2015 and with respect to its stability target. In the course of the analysis that has been conducted to draft this report, it has been observed that the year-end 2014 —the starting point for the 2015 assessment— is very tight in almost all the Autonomous Regions. Additional risks can also be seen, mainly in the 2015 revenue scenario. Both these aspects are dealt with in detail in each Region's individual report.

Revenues have been over-estimated in the 2015 scenario. As highlighted in the report of 15th October, a possible overestimation of budget revenues is observed in the 2015 scenario envisaged by the Regions as a whole. This is most evident in the following lines:

- State transfers, both those concerning the funding system and other items of different kinds. The regional draft budgets include revenue forecasts that are not contemplated in the draft General State Budget at this time.

- Forecasted revenues from Tax on Asset Transactions and Documented Legal Acts. The performance envisaged for these revenues in the two years 2014-2015 does not appear to be endorsed by their performance to date or by the measures envisaged for the period, despite the improvement in the expected revenues from this tax in 2015 according to the study conducted by the AIReF into projected tax revenues based on house prices and second-hand housing transactions.
- Disposals of assets. There is uncertainty about their materialisation due to both the nature of these revenues and implementation in previous years. However, this risk could be mitigated insofar as some of the transactions planned for 2014 that have not materialised in that year could be carried over to 2015.

Stagnation and lack of details concerning cost curtailment measures. As far as expenditure is concerned, a general stagnation is observed in the cost-curtailment measures, driven on the one hand by the discontinuation of measures applied in previous years and, on the other, by a lack of additional high impact measures, other than non-implementation estimates, withholding budget appropriations or decisions on non-availability of funding for appropriations that have not been specified at the time of drawing up the budget. As highlighted by the report of 15th October on the Autonomous Regions subsector, regional expenditure consists to a large extent of items of a highly rigid nature, such as health, education and social expenditure, which account for almost 70% of the total expenditure of the Autonomous Regions. This means that they are hardly affected at all by changes in the economic cycle.

Year-end 2014, which is the starting point for the 2015 assessment, is very tight in almost all the Autonomous Regions. In the course of the analysis that has been

conducted to draft this report, year-end 2014, which is the starting point for the 2015 assessment, is seen to be very tight in almost all the Autonomous Regions, taking into account the year-end forecasts and the latest budget implementation data to 30th September published, in national accounts terms. This situation requires the controls to have been intensified and the stringent application of the closure of accounts orders approved in the last quarter of the year. Their effectiveness can then be checked as the implementation data for the last quarter of the year becomes available.

- 7. In application of the legislation in effect (article 21 of the Organic Law establishing the Independent Authority for Fiscal Authority (AIReF) and article 20 of its Organic Statute), AIReF must warn of any deviation risk regarding compliance with the stability targets set.** In the course of the work carried out for the drafting this report, circumstances have been identified in several Regions that make deviation from the targets set for 2014 likely to a greater or lesser extent. In the cases in which this deviation is more evident or significant, and therefore difficult to correct within this year, these circumstances have been highlighted, in an independent section, pursuant to article 21 of the Organic Law establishing AIReF and article 20.1, section b) of its Statute, for the purpose of activating the preventive measures in chapter IV of the Organic Law on Budgetary Stability & Financial Sustainability (LOEPySF, *Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera*).
- ✓ **This report includes the individual reports on the seven Autonomous Regions whose publication was brought forward to 5th December calling for the activation of the preventive measures set forth in the Organic Law on Budgetary Stability & Financial Sustainability.** In order to bring forward the application of the preventive measures in that Organic Law as much as possible, a preview of the report on the main budgetary lines of the 2015 budgets for Extremadura, Valencia, Murcia, Catalonia, Andalusia, Castilla-La Mancha and the Balearic Islands was published

on 5th December. Risks were identified in these Regions of more evident and/or significant deviation than those driven by the tensions observed in a year-end that is very tight for the Autonomous Regions as a whole. The aforesaid reports are included in this document along with those on the rest of the Regions. Some aspects have been updated in line with the information contained in the updated Economic & Financial Plans (EFPs) received after the 5th October.

- ✓ **A high risk of non-compliance with the 2014 deficit target is seen in the Autonomous Region of Aragón, which has an Economic & Financial Plan in effect.** A high risk of non-compliance is seen in the Autonomous Region of Aragón, although this region has an Economic & Financial Plan that was approved by the Fiscal & Financial Policy Council on 31st July and, therefore, this Plan is subject to quarterly monitoring by the Ministry of Finance & Public Administration (MINHAP). For this reason, despite a risk of non-compliance with the stability target being seen, the gradual application of the preventive measures set forth in the Organic Law on Budgetary Stability & Financial Sustainability has to occur in the context of this monitoring process. The Ministry of Finance & Public Administration cannot be called upon to apply the preventive measures of article 19 of said law.

AIR^eF makes the following recommendations in the scope of the analysis conducted:

- ✓ Activate the preventive measures set forth in the Organic Law on Budgetary Stability & Financial Sustainability for the Autonomous Regions of Extremadura, Valencia, Murcia, Catalonia, Andalusia, Castilla-La Mancha and the Balearic Islands.
- ✓ Publish as soon as possible the Aragón EFP quarterly monitoring report, in compliance with article 24 of the Organic Law on Budgetary Stability & Financial Sustainability.

- ✓ Set the budget stability targets for all the Autonomous Regions far enough in advance for them to draw up their draft budgets. In particular, the Government should approve the 2015 budget stability targets for the Autonomous Region of the Basque Country and the Autonomous Region of Navarra before the beginning of that year. The resolutions agreed between the State and each of these two Autonomous Regions by the joint committee that are of any financial significance should also be published.
- ✓ Each Autonomous Region should set in motion the process for monitoring budget implementation data established in article 8.1 of the Organic Law on Budgetary Stability & Financial Sustainability once 2015 has started, in order to make the necessary adjustments to expenditure if revenues do not perform in line with forecasts.

Debt target

AIReF must issue an opinion on the adequacy of the main lines of each Autonomous Region's 2015 budget with respect to their debt targets. To make this assessment, it would be necessary to check that the volume of debt of each region at year-end 2015, divided by expected regional GDP, does not exceed the debt target set. This verification would first require an estimate to be made of the level of debt of each Autonomous Region at the beginning of 2015, and secondly, to aggregate the net increase that is expected during the year.

However in the course of the preparatory work for drafting this report, the following **constraints** have come to light:

- 1. Uncertainty about the 2014 debt target compliance forecast insofar as the eligible operations are not known.** The volume of 2014 year-end debt is the starting point for calculating the debt at year-end 2015. So first of

all, the 2014 debt target compliance forecast would have to be assessed.

However, this assessment cannot be made due to the uncertainty surrounding the transactions that will finally be eligible for verifying compliance with the public debt target by each Autonomous Region, as the Council of Ministers' Resolution of 27th June recognises the possibility that the Ministry of Finance & Public Administration may determine that there are circumstances that have to be taken into account in debt target compliance.

On the basis of the data provided by the Ministry of Finance & Public Administration in its report of 24th October on *the degree of compliance with the 2013 budget stability and public debt targets and the expenditure rule*, the Autonomous Regions' debt transactions that were not deemed eligible at year-end for the purposes of debt target compliance, amounted to €7,835m, which accounts for 32% of the net increase in the debt for the year. Apart from their significant amount, these transactions are not given sufficient publicity to allow them to be monitored.

2. Insufficient information on the net increases in debt envisaged by the Autonomous Regions in 2015. The Autonomous Regions' draft 2015 budgets do not, in general, provide information on the amount they expect to increase their debt during the year in terms in which this information is necessary for assessing debt target compliance. In other words, they do not quantify it as a net increase referring to the territorial scope of the Autonomous Region in SEC 2010 terms.

Nonetheless, according to the latest data published by *Banco de España* concerning the debt situation at 30th September, the volume of the debt at 30th September 2014 already exceeds the debt target for 2015 in five Autonomous Regions (Balearic Islands, Castilla-La Mancha, Catalonia, Murcia and Valencia).

3. In the case of the Autonomous Regions of Navarra and the Basque Country, the debt targets have not been set.

No Council of Ministers' Resolution has been adopted to set the deficit and debt targets for the Autonomous Regions of Navarra and the Basque Country pursuant to the procedure set forth in article 16 of the Organic Law on Budgetary Stability & Financial Sustainability. Although this affects both the deficit and the debt target, the repercussion is greater in the case of debt, where the targets are different for each region. It is not therefore possible to assess whether the draft budgets of these two Autonomous Regions are in line with their respective debt targets.

All these circumstances prevent an assessment of the adequacy of the Autonomous Regions' draft budgets for compliance with their debt targets.

The AIReF makes the following recommendations in the scope of the analysis conducted:

- ✓ Establish a transparent and verifiable debt target system, limiting any possible margin for discretion as much as possible.
- ✓ Publish in full the Council of Ministers' Resolutions that set the individual debt targets of the Autonomous Regions, given that the reference of these agreements published does not include the clauses, where they exist, which exempt an Autonomous Region from compliance or any other developments that could affect the assessment of their compliance.
- ✓ Set the debt targets for all the Autonomous Regions far enough in advance to allow them time to draw up their draft budgets. In particular, the government should approve the 2015 budget stability targets for the Autonomous Regions of the Basque Country and Navarra before the beginning of that year.
- ✓ Include sufficient and adequate information in the Autonomous Regions' budgets to allow financial

- sustainability targets to be verified (article 6 of the Organic Law on Budgetary Stability & Financial Sustainability).
- ✓ The Ministry of Finance & Public Administration should expand the questionnaires on the main lines of the draft budgets to include information that makes it possible to assess their adequacy with the debt targets.

Expenditure rule

AIReF must issue an opinion on the adequacy of the main budgetary lines of each of the Autonomous Regions' 2015 budgets with regard to the expenditure rule. Compliance with this rule is a very recent requirement, as it only appeared when the Organic Law on Budgetary Stability & Financial Sustainability came into effect and it was set for the first time for 2013. According to the Ministry of Finance & Public Administration's reports of 11th April and 24th October, all the Autonomous Regions complied with the expenditure rule in the settlement of their 2013 budget.

As for the main lines of the Autonomous Regions' draft budgets for 2015, they are deemed to have been drawn up in accordance with the expenditure rule if the change in expenditure calculated for the purposes of the rule does not exceed the reference mid-term GDP growth rate of the Spanish economy. For 2015, this was set at 1.3% by Council of Ministers' Resolution of 27th June 2014.

Hence, in order to assess this rule, it would be necessary to check that the eligible expenditure budgeted by each Autonomous Region in its draft 2015 budget does not grow by more than 1.3% against the previous year. To make this check, in turn, the eligible expenditure would first have to be calculated both for 2014 and for the draft 2015 budget, in order for it to then compare these and verify that they have not changed by more than 1.3%.

Pursuant to the Organic Law on Budgetary Stability & Financial Sustainability, the Autonomous Regions' eligible expenditure consists of their non-financial uses in SEC 2010 terms. They then subtract from this figure the debt interest payments, the part of the expenditure funded by the European Union or other Public Administrations and any transfers that the Autonomous Regions may make to the Local Corporations under the funding system.

Furthermore, once the eligible level of expenditure for 2015 is calculated this way, this figure should be reduced by an amount equivalent to any reduction in receipts envisaged for this year against 2014 driven by regulatory change or, on the contrary, which could increase if permanent increases in receipts are envisaged.

However, the following **constraints** have come to light in the course of the preparatory work for drafting this report:

1. Lack of information on non-financial uses in SEC 2010 terms. Pursuant to the Organic Law on Budgetary Stability & Financial Sustainability, eligible expenditure is calculated with data expressed in national accounts terms, given that the uses excluded from the expenditure rule are subtracted from the Autonomous Regions' non-financial uses in SEC 2010 terms.

However, the Autonomous Regions' draft budgets do not include this information as they do not generally compile information in national accounts terms, except for information concerning the budget balance.

2. Not all the Autonomous Regions provide information on the change in revenues envisaged for 2015 driven by regulatory changes. This information is necessary for correcting eligible expenditure and, therefore, for assessing the suitability of the expenditure rule, as has already been pointed out.

Faced with the lack of data for calculating eligible expenditure, the Autonomous Regions have been asked to provide this

information. However, the information submitted does not generally allow an assessment of the expenditure rule to be made for a variety of reasons. The main causes are the fact that non-financial uses are not submitted (the expenditure reported is presented in public-sector accounting terms) and the fact that the change in revenues driven by regulatory changes is not quantified.

On the other hand, on the basis of the information submitted by the Autonomous Regions, it is apparent that they are not sure how the expenditure rule works and, in particular, about how to calculate eligible expenditure. Consequently, some Autonomous Regions have not submitted certain essential data for calculating eligible expenditure as they have understood that these were not necessary.

In general, all these developments make it impossible to calculate eligible expenditure and, consequently, to assess the adequacy of the Autonomous Regions' draft budgets with regard to the expenditure rule.

The AIReF makes the following recommendations in the scope of the analysis conducted:

- ✓ Include the information necessary in the Autonomous Regions' budgets to calculate eligible expenditure in the terms set forth in article 12 of the Organic Law on Budgetary Stability & Financial Sustainability, in a sufficient degree of detail to be able to verify how this calculation has been made.
- ✓ That the Ministry of Finance & Public Administration expands the questionnaires on the main guidelines of the draft budgets to include information that will enable an assessment to be made of their fit with the expenditure rule.
- ✓ That the Ministry of Finance & Public Administration publishes the methodology that the Autonomous Regions must use to calculate their expenditure rule. Just as there is a calculation methodology published for the Local Corporations, it would be advisable to publish a guide for

the Autonomous Regions, given, as has already been stated, that there appears to be uncertainty about how the expenditure rule works generally, and in particular, about how eligible expenditure is calculated.