

Report on expected compliance with the 2015 budget stability, government debt and expenditure rule targets by the public administrations in Spain

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 AIReF:

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Executive Summary

This report assesses expected compliance with the targets for budget stability, government debt and the expenditure rule by the different public administrations in Spain. In order to detect any risks of non-compliance AIReF has analysed mainly year-to-date budget implementation, the measures envisaged for this year and the measures adopted in previous years. It has also made its own estimates on the future development of revenues and expenditure and the impact of those measures.

The assessment has been made at subsector level and includes an individualised analysis of the 17 autonomous regions and of the six local governments in capital cities of provinces with a population of over 500,000.

Budget stability

As far as the **Central Government** is concerned, budget implementation to May and its expected trajectory for the rest of the year seem compatible with achievement of a public deficit of 2.9% of GDP for 2015. Therefore, AIReF is of the view that there is no risk for the Central Government of failure to comply with its budget stability target. The buoyancy observed in the key macroeconomic variables is driving revenue recovery. Nevertheless, the measures entailing lower revenue collection that have been adopted since the budget was approved mean revenue forecasts in the budget will barely be met. Expenditure, on the other hand, is being strictly implemented and the expectation is for this trend to be maintained, thus facilitating achievement of budget stability.

For the **Social Security Funds**, however, there is already practical certainty this early in the year of non-compliance with the 0.6% of GDP deficit target in 2015. On the revenue side the Social Security budget contains a very ambitious revenue collection forecast driven by the efficiency measures put in place. In practice, however, these measures are having a very limited effect on collection figures. Social contributions are growing at a rate slightly below nominal GDP growth. Although the improvement in employment is injecting buoyancy into contributions paid into the system there are factors, mostly associated with employment incentive policies, which are limiting this upward trend. Expenditure on pensions is in line with the forecast growth rate and even though there is an early indication now that expenditure on unemployment benefits will perform significantly better than the budget forecast, at best the Social Security Funds deficit in 2015 will record a similar figure to last year and so will not meet the ambitious target set for this year.

There is also a risk of deviation from the -0.7% of GDP target for the **Autonomous Regions** subsector. Meeting the target would require a

reduction of one percentage point of GDP. This does not seem to be an achievable goal in a year in which the funds from the regional financing system are barely growing by two tenths of a percentage point of GDP. According to the analysis made of budget implementation data, the measures adopted to date and the additional information furnished by the autonomous regions (ARs), the reduction in the deficit compared to 2014 would be around half a percentage point of GDP. Although the situation varies from one region to another, the risk of non-compliance is essentially due to deviations observed in revenues from their own regional taxes, expected financial transfers from the State that are not included in the State General Budget (SGB) and the non-materialisation of a large part of the sales and administrative concessions forecast in the budgets. On the expenditure side, the interest rate saving stemming from new financing measures has not been reflected as yet in an equivalent reduction in the deficit.

In the individualised analysis, a risk of non-compliance is identified in eleven of the seventeen regions. However, the possible failure to comply in 2015 by Andalusia, Aragón, Cantabria, Castilla-La Mancha, Madrid and Navarra might be corrected in 2016 by the forecast trend in the funds from the autonomous regional financing system, making it unnecessary a priori for any additional measures to be adopted.

Balearic Isles, Catalonia, Extremadura, Murcia and Valencia Region to a greater or lesser extent have a track record of significant and recurrent deviations from the annual targets set. That makes the preparation of an Economic-Financial Plan (EFP) for these regions especially important. Each EFP should be analysed in depth and contain a credible path for correction of the imbalance within a reasonable timeframe.

In the **Local Corporations** subsector the budget equilibrium target set is comfortably achieved. The surplus at year-end is estimated to be above 0.5% of GDP as a result of maintaining the levels of revenues forecast with no significant increases in expenditure. The individualised analysis of the six local governments in provincial capital cities with a population of over 500,000 seems to point to the consolidation of the surplus recorded in previous years.

This analysis by subsector reflects a likely reduction in the deficit of the **General Government sector overall** of at least 1% of GDP in 2015. The achievement of the target of 4.2% of GDP set for 2015 would require budget implementation of the different subsectors throughout the second half of 2015 to fall within the most favourable part of the range forecast by AIReF. In its October 2014 report on budget drafts and the March 2015 report on the initial budgets AIReF already described this target as “very demanding”. Since then, despite higher than forecast economic activity, the known data for budget implementation and AIReF’s estimate for the remainder of the year confirm the difficulty for the sector of compliance with the stability target set for 2015.

Government debt

Government debt has been analysed from the standpoint of financial sustainability given that the way government debt targets are set mean that in general terms they are met by all the public administrations in Spain. From this perspective the AIReF scenario reflects the difficulties that exist for the debt/GDP ratio to be brought down to 60% before 2030.

For the six local governments in provincial capital cities with a population of more than 500,000, and in line with the specific legislation applicable to Local Entities, AIReF analysed debt developments compared to ordinary revenues and observed the continuation of the downward path of this ratio that started in 2012.

Expenditure rule

AIReF has not been able to obtain the necessary information to be able to take an adequate view on the expenditure rule in the different administrations. Nevertheless, the estimates made with regard to the key expenditure items indicate that growth in the expenditure eligible to be included in the calculation for the Central Government and the Autonomous Regions may outstrip the reference rate set for 2015 (1.3%).

Recommendations

AIReF includes in its report a series of recommendations primarily addressed to the public administrations for which the assessment is that there is a risk of non-compliance with the budget stability target.

For the Social Security system:

- An evaluation should be made of measures that could be adopted to ensure on a permanent basis the financing of Social Security deficits through the State General Budget or for other decisions to be taken to balance the Social Security system.

For the Autonomous Regions:

- The EFPs should be adapted to the actual circumstances of each region in a way that guarantees the substantive aspects of the LOEPySF. The procedure for approval of the EFPs as well as their content should be made more flexible as and where required. In particular, it would be advisable for the strategic lines underpinning the EFPs that have to be prepared because of non-compliance with the 2014 targets to be presented at the meeting of the Fiscal and Financial Policy Council (CPFF) likely to be held at the end of July. The actual submission and approval of the detailed document could then be deferred until a new Council meeting that could be held in September or October.
- The ARs should adapt the content of the EFPs in line with aspects such as the size and recurrent nature of the deviation and the possibility of automatic correction without the need for any additional measures on top of the ones already adopted. AIReF will appraise all of these questions as part of the report it is mandated to issue prior to the submission of the EFPs to the CPFF.
- The ARs that record deviations in compliance with targets on a recurrent basis should prepare the EFPs within a multi-year framework coinciding with the timeframe set in the Stability Programme Update (SPU).

Other recommendations of a general nature:

- The financing system for the different subsectors should be analysed as a whole so that it can be brought into line with the level of expenditure (assessed on the basis of efficiency parameters) associated with the competences exercised by each of them and with compliance with the expenditure rule regulated by the LOEPySF.
- MINHAP should approve through a ministerial order a methodology to calculate the expenditure rule and develop the content and procedure for the information required to be sent so that each administration can make its own a priori calculation and monitor the expenditure rule it must keep its spending in line with.