



Independent Authority
for Fiscal Responsibility

Report on the General Government
sector draft budgets and main
budgetary lines in 2016:
Autonomous Regions subsector

Contents

1. Context and object of the report
2. Budget stability target and expenditure rule
3. Government debt target
4. Recommendations
5. ANNEX. Individual analysis by Autonomous Region

1. Context and object of the report

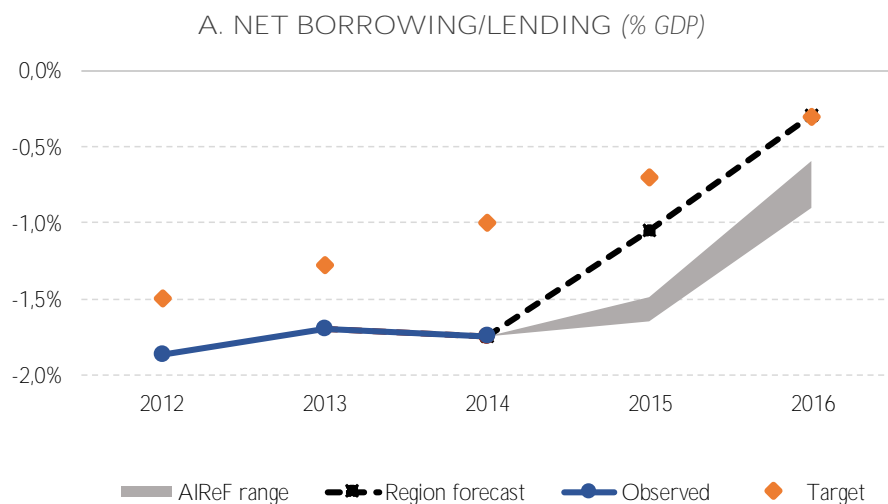
1. The object of this report is to make an assessment of the main lines of the budgets prepared by the Autonomous Regions from the standpoint of their adequacy for compliance with the budget stability target, the government debt target and the expenditure rule in 2016.
2. The evaluation of the 2016 budget drafts and lines incorporates a debt sustainability study.

1. Context and object of the report

- ✓ Considerable effort made by the Autonomous Regions to cut the deficit between 2010 and 2014, resulting in a reduction of more than 2 percentage points of GDP.
- ✓ Very heterogeneous situation in the Autonomous Regions.
- ✓ In 2014 AIReF recommended the adoption of preventive measures.
- ✓ The risks identified by AIReF in 2014 have materialised in 2015.
- ✓ Need for early identification of risks of non-compliance in 2016 in order to address the problems properly and improve the institutional framework.

2. Budget stability target and expenditure rule

AIReF believes that there is a **risk of non-compliance** by the Autonomous Regions subsector with the budget stability target set at -0.3% of GDP for 2016.



Source: INE, MINHAP and AIReF estimates

This risk stems from the likely deviation from the stability target in 2015 and the uncertainty about the development of certain revenue and expenditure items in 2016.

2. Budget stability target and expenditure rule

AIReF's updated estimates **confirm the risk of non-compliance for 2015** stated in the report it published on 15th July 2015 and a larger deviation:

- ✓ Revision of **2014 year-end**: 0.1% of GDP higher deficit compared to the initial figures for the AR subsector.
- ✓ Increase in the **year-on-year change in primary expenditure**: 5.8% in September compared to 3.5% in April.
- ✓ **Booking in 2015 accounts of the capital expenditure** made by Catalonia in previous years (0.1% of national GDP, 0.6% of the region's GDP).
- ✓ **Revision** by some Autonomous Regions of their year-end forecasts.

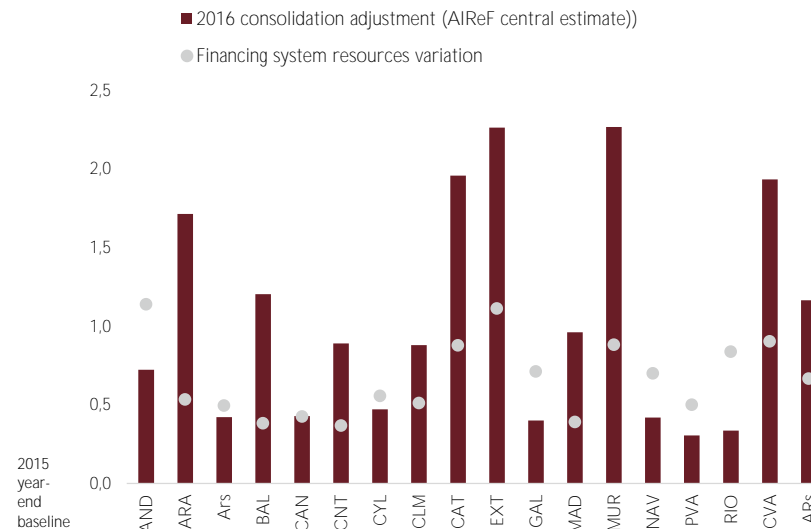
Autonomous Regions	AIReF forecasts for 2015 year-end (%GDP)	
	Lower	Higher
Andalusia	-1,1	-0,9
Aragón	-2,1	-1,9
Asturias	-0,8	-0,7
Balearic Isles	-1,6	-1,4
Canary Isles	-0,8	-0,7
Cantabria	-1,3	-1,1
Castilla y León	-0,8	-0,7
Castilla-La Mancha	-1,3	-1,1
Catalonia	-2,9	-2,8
Extremadura	-2,6	-2,5
Galicia	-0,8	-0,6
Madrid Region	-1,3	-1,2
Murcia Region	-2,7	-2,4
Navarra	-1,2	-1,0
Basque Country	-0,7	-0,5
La Rioja	-0,7	-0,6
Valencia Region	-2,3	-2,1
Total Autonomous Regions	-1,6	-1,5

2. Budget stability target and expenditure rule

The adjustment needed to comply with the target in 2016 –more than 1% of GDP– is not fully taken into account in the budget lines presented by the Autonomous Regions for next year:

- ✓ **The growth in the regional financing system resources** (0.7% of GDP) is not sufficient to achieve the stability target in 2016.
- ✓ **Expenditure rule:** Autonomous Regions with an adjustment that is less than the development in the resources of the financing system.

CONSOLIDATION ADJUSTMENT 2015/2016 AND COVERAGE THROUGH THE FINANCING SYSTEM RESOURCES (% GDP)

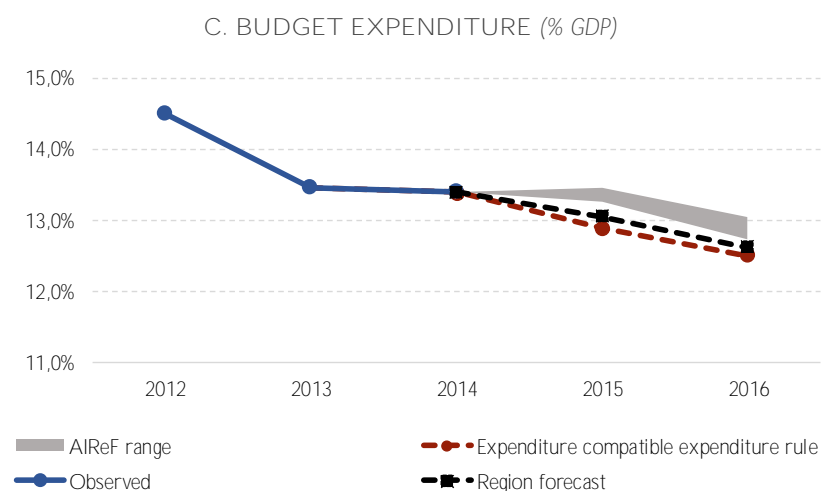
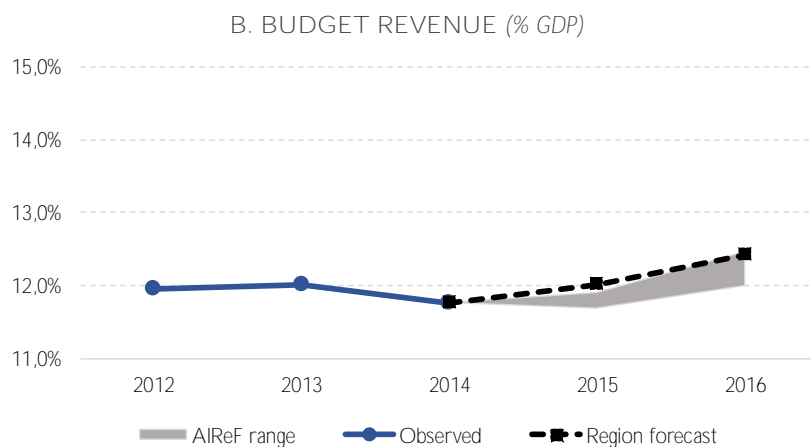


Source: AIReF estimates

2. Budget stability target and expenditure rule

Uncertainties surrounding the forecast development of some items:

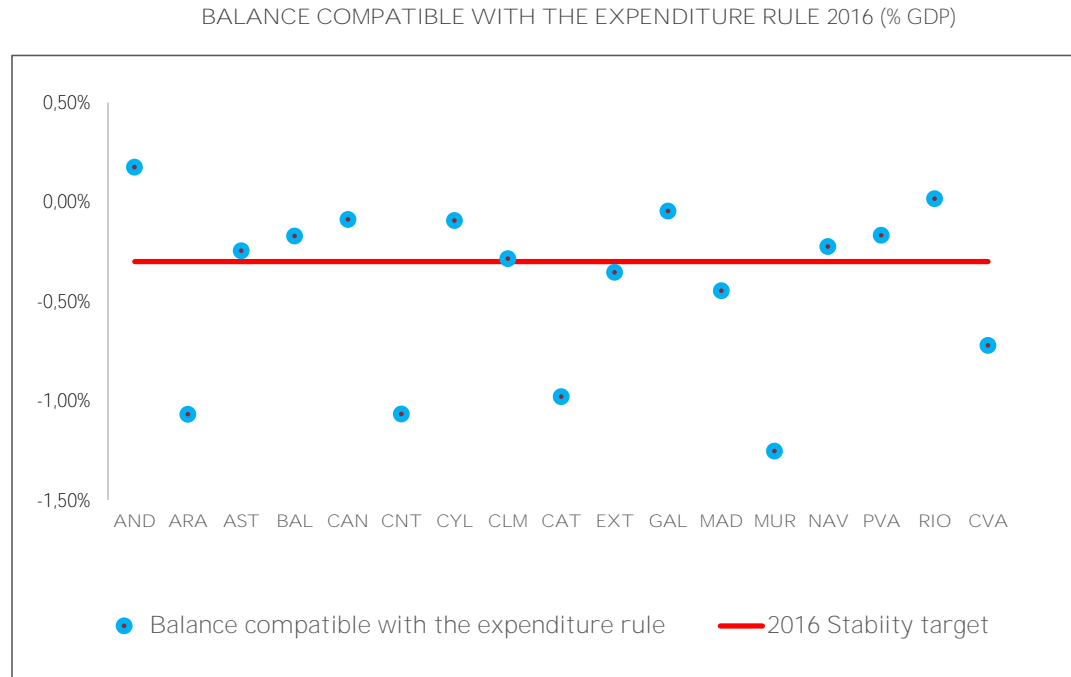
- ✓ **Revenue from the State** other than funding from the regional financing system not contained in the State General Budget (0.1% of GDP).
- ✓ **Interest expenses.** Valuation of this item not consistent in several Autonomous Regions with the conditions of the additional financing mechanisms and major differences with the AIReF estimates.
- ✓ **Current expenditure.** Forecast development in the lines or in the drafts not consistent with the measures adopted (0.1% of GDP).



Source: INE, MINHAP and AIReF estimates

2. Budget stability target and expenditure rule

In 2016 the expenditure rule becomes binding and compliance with it will mean a lower deficit than the 0.3% of GDP target.



Source: AIReF estimates

In 2016 AIReF sees a risk of non-compliance with the expenditure rule by several Autonomous Regions.

2. Budget stability target and expenditure rule

✓ **Likely compliance** with the stability target in **2016**:

- ❑ Andalusia, Asturias, Basque Country, Canary Isles, Castilla y León, Galicia, Navarra and La Rioja.

Expenditure rule. Compliance with the expenditure rule would require a stricter stability target in 2016:

- ❑ Castilla y León and Galicia. The forecast development of expenditure might compromise their compliance.
- ❑ Risk of non-compliance in Andalusia.

✓ **Moderate risk** of non-compliance in **2016**:

- ❑ Castilla-La Mancha, Madrid, Balearic Isles and Cantabria.
- ❑ Aragón. Uncertainty because of measures still in a very early phase of adoption.

✓ **Very high risk** of non-compliance in **2016**:

- ❑ Catalonia, Extremadura, Murcia and Valencia.

Expenditure rule:

- ❑ The development of expenditure does not seem compatible with compliance in Balearic Isles, Castilla-La Mancha, Catalonia, Extremadura, Madrid and Valencia.

2. Budget stability target and expenditure rule

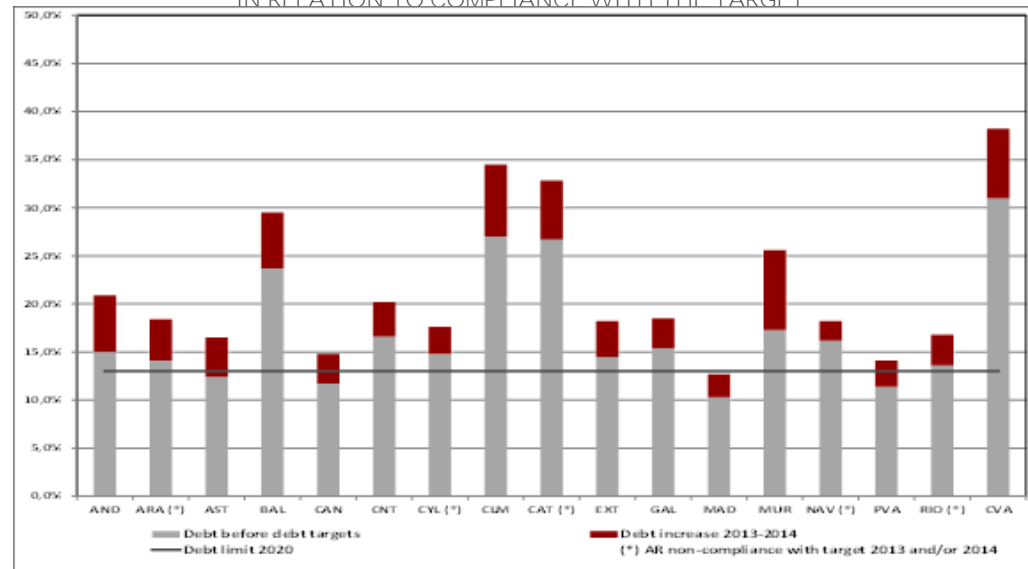
Autonomous Regions	2016				
	AIReF forecasts		Stability target	Deviations from stability target	
	lower	higher		Maximum	Minimum
Andalusia	-0,5	-0,3	-0,3	-0,2	0,0
Aragón	-1,1	-0,6	-0,3	-0,8	-0,3
Asturias	-0,4	-0,2	-0,3	-0,1	0,1
Baleares	-0,9	-0,5	-0,3	-0,6	-0,2
Canary Isles	-0,1	0,1	-0,3	0,2	0,4
Cantabria	-0,9	-0,5	-0,3	-0,6	-0,2
Castilla y León	-0,4	-0,2	-0,3	-0,1	0,1
Castilla-La Mancha	-0,7	-0,4	-0,3	-0,4	-0,1
Catalonia	-1,6	-1,2	-0,3	-1,3	-0,9
Extremadura	-1,5	-1,0	-0,3	-1,2	-0,7
Galicia	-0,4	-0,1	-0,3	-0,1	0,2
Madrid	-0,8	-0,5	-0,3	-0,5	-0,2
Murcia	-1,6	-1,2	-0,3	-1,3	-0,9
Navarra	-0,3	-0,1	-0,3	0,0	0,2
Basque Country	-0,3	-0,1	-0,3	0,0	0,2
La Rioja	-0,1	0,1	-0,3	0,2	0,4
Valencia	-1,5	-1,3	-0,3	-1,2	-1,0
Total Autonomous Regions	-0,9	-0,6	-0,3	-0,6	-0,3

3. Government debt target

The debt target does not contribute to the long-term sustainability of the EDP debt:

- ✓ This is a system of setting targets that makes exceptions to the initial target and so distorts the way debt targets are set and tracked.
- ✓ No information is available that allows compliance with the 2016 debt target to be determined.
- ✓ Compliance with debt targets has been not linked to the increase in debt in the region since the debt targets were established in 2013 nor is it linked to the current debt level and the gap between it and the reference value of 13% of regional GDP in 2020.

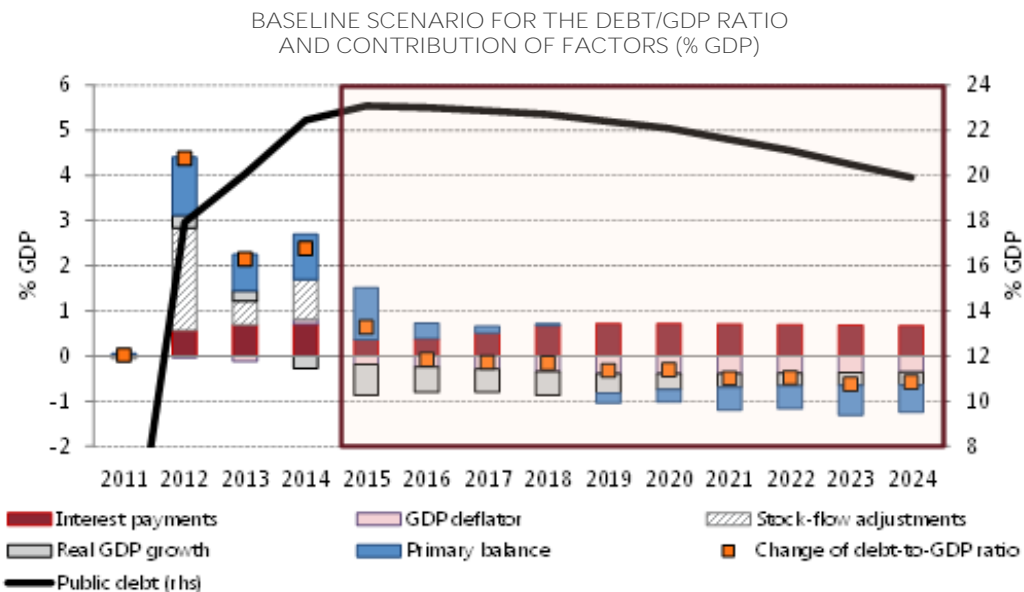
INCREASE IN DEBT IN THE AUTONOMOUS REGIONS SINCE 2013 (%GDP)
IN RELATION TO COMPLIANCE WITH THE TARGET



Source: INE, MINHAP and AIReF estimates

3. Government debt target

The Autonomous Region subsector debt follows a **declining trend as of 2016**, although not enough to reach the 13% debt-to-GDP ratio targeted in 2020.

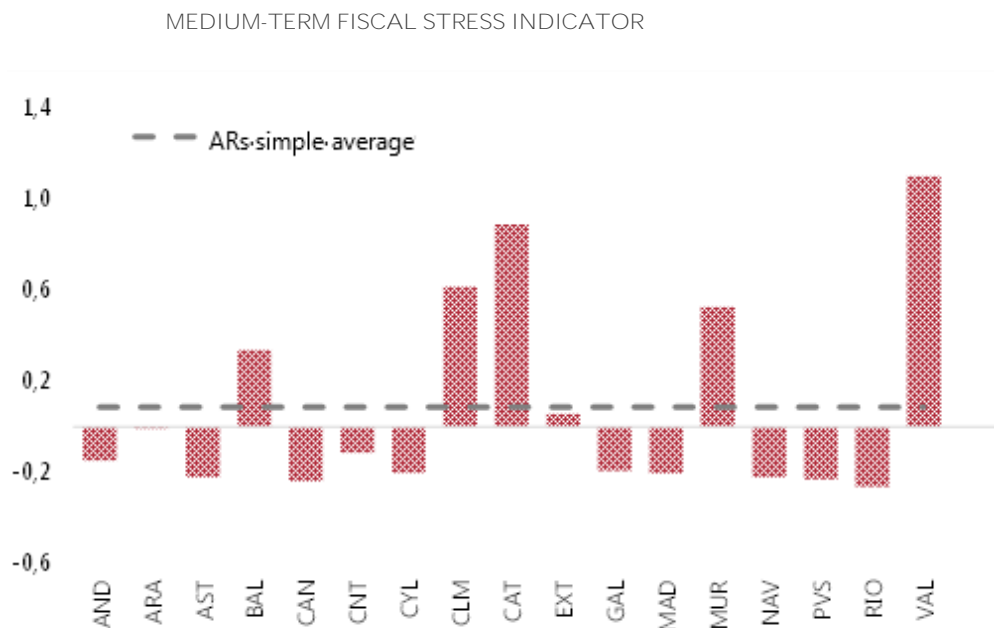


Source: AIREF estimates

Alternative scenarios of fiscal easing (historical and political with no changes) can give rise to unsustainable debt trajectories.

3. Government debt target

A very heterogeneous situation exists with regard to medium-term fiscal stress from debt sustainability.



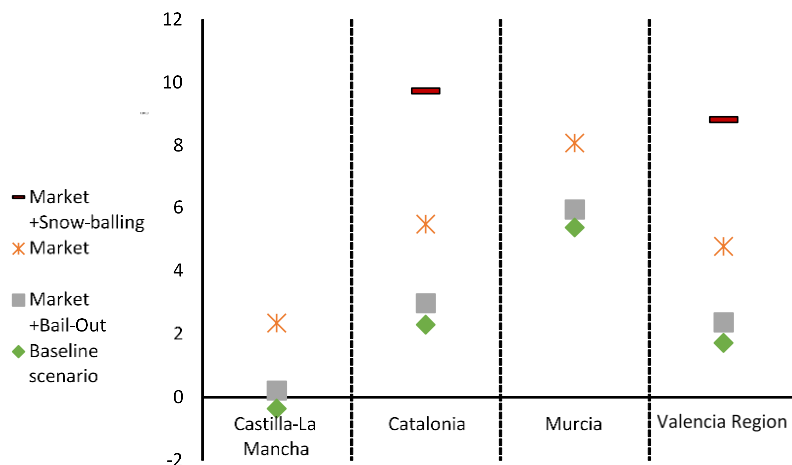
Note: The indicator quantifies the average adjustment in the accumulated primary structural balance between 2015 and 2030 compared to the baseline simulation (previous graph, that the Autonomous Regions have to make to reach the debt target in 2030 (13% of regional GDP). The fiscal effort included for 2016-2018 is consistent with the Stability Programme Update 2015-2018, which entails reaching the budget stability target in the long-term (i.e. a balanced total fiscal balance).

To successfully stabilise their debt in the long-term some regions must make a very ambitious fiscal effort whereas others seem to be in a relatively comfortable position.

3. Government debt target

Access to additional financing mechanisms is especially relevant for the autonomous regions with greater fiscal stress.

Gap between the debt/GDP figure in 2024 for the simulated scenarios and the baseline figure (2015), % GDP



Baseline scenario: Assuming the financing mechanisms are maintained
Market scenario + Bail out: Financing in the market, but with the existence of some kind of bail-out mechanisms.
Market scenario: Financing in the market and absence of bail-out mechanisms:
Market + Snow-balling: Similar to the above but adding liquidity problems

Source: AIReF estimates

Note: The graph shows the result in terms of debt accumulation between 2015 and 2024 for each one of the simulated scenarios

In certain conditions the Autonomous Regions with greatest debt levels might begin to have non-sustainable dynamics.

4. Recommendations made by AIReF

All Autonomous Regions:

- ✓ Automatic preventive measures under article 18 of the LOEPSF
- ✓ Special attention to the ARs with the highest debt levels



Audit services should report regularly to the regional governments on budget implementation and whether it is appropriate to take additional steps

Autonomous Regions with a high risk of non-compliance:

- ✓ Independent section in the report for the purposes envisaged in art. 21 of the Organic Law 6/2013
- ✓ Sending to MINHAP
- ✓ Non-automatic preventive measures in article 19 of the LOEPSF



MINHAP should request multiannual planning with a level of detail, binding nature and duration that takes into account the:

- ✓ Particular situation of each one of them
- ✓ Amount of the adjustment to be made
- ✓ Sustainability of their debt path
- ✓ Contribution of the region to this goal (consolidation commitment and stable institutional framework)

4. Recommendations made by AIReF

Extremadura shows a high risk of non-compliance in 2016:

- ✓ Deviation in the 2015 year-end forecast is 0.7% of GDP higher than the reported figure
- ✓ Uncertainties in the forecast revenue from EU funds
- ✓ Higher like-for-like per capita expenditure in the common regime Autonomous Regions
- ✓ High use of capacity to raise more taxation revenue although with a margin still available in some taxes

Catalonia shows a high risk of non-compliance in 2016:

- ✓ Absence of main budgetary lines and budget draft
- ✓ Very high risk for financial sustainability
- ✓ The uncertainty of its political context makes the materialisation of scenarios leading to non-sustainability of its debt more likely
- ✓ Potential liquidity tensions

4. Recommendations made by AIReF

Murcia shows a high risk of non-compliance in 2016:

- ✓ Deviation in the 2015 year-end forecast is 1.5% of GDP
- ✓ Per capita expenditure close to average, but the highest per capita expenditure on basic services
- ✓ High use of normative capacity to increase taxation revenue although with a margin still remaining in some taxes
- ✓ Risk for financial sustainability

Valencia shows a high risk of non-compliance in 2016:

- ✓ A transfer from the State amounting to 1.3% of GDP not included in the State General Budget
- ✓ Lower than average per capita like-for-like primary expenditure for basic public services overall
- ✓ High use of normative capacity to increase taxation revenue although with a margin still remaining in some taxes
- ✓ High risk for financial sustainability

4. Recommendations made by AIReF: Improve institutional framework

Government debt target (*MINHAP*)

- Design a system to set debt targets that complies with the function of oversight of the EDP debt and in which it should incorporate a credible, demanding revision of the debt reduction path endorsed by the maintaining of the necessary fiscal consolidation effort and a stable institutional framework

Expenditure rule (*MINHAP*)

- The normative development of article 12 of the LOEPSF so that the calculation criteria and its application are regulated and detailed as well as procedures and deadlines for exchange for the necessary information.
- It would also be advisable to set up working groups within the CPFF and CNAL on the expenditure rule

Multiyear framework (*ARs & MINHAP*)

- Consolidation of the budget as the document in which the multiyear planning of the region in the medium term is set out on paper.
- MINHAP must promote multiyear planning in the framework of LOEPSF measures.

Transparency (*National Accounts Technical Committee, CTCN*)

- Approval and publication of the internal rules of procedure of the CTCN
- CTCN should send its reports to AIReF



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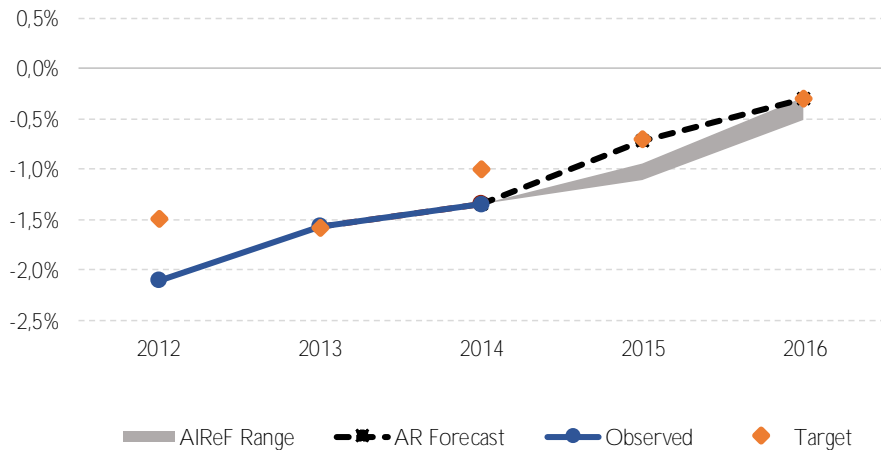


Andalusia

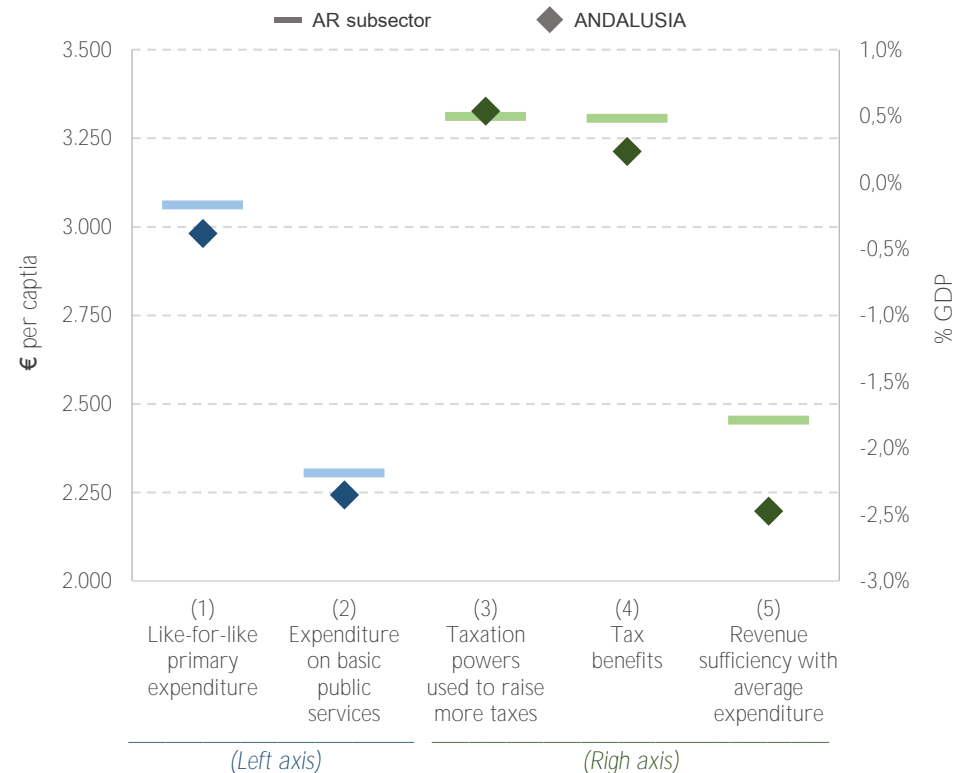
Moderate risk of non-compliance with the stability target:

- ✓ Need to curb expenditure more in order to achieve the target.
- ✓ Clear risk of non-compliance with the expenditure rule.
- ✓ No significant risks associated with financial sustainability are observed.

A. NET LENDING/BORROWING (% GDP)



Source INE, MINHAP, Autonomous Regions and AIReF estimates

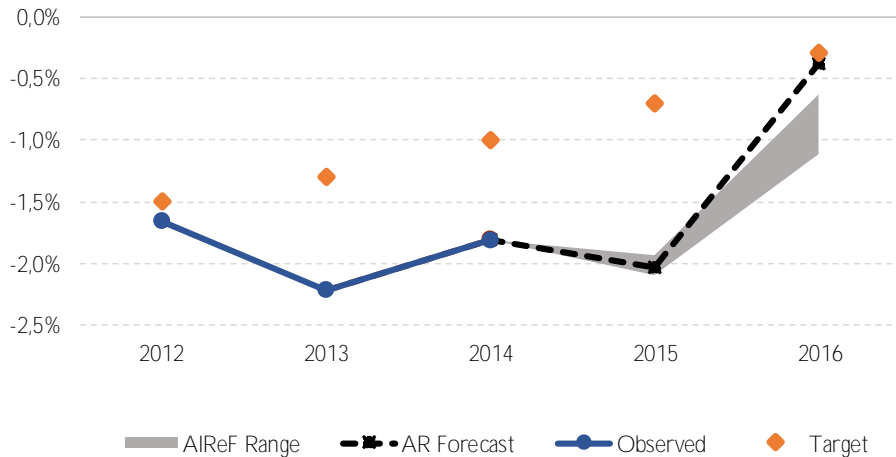


Aragón

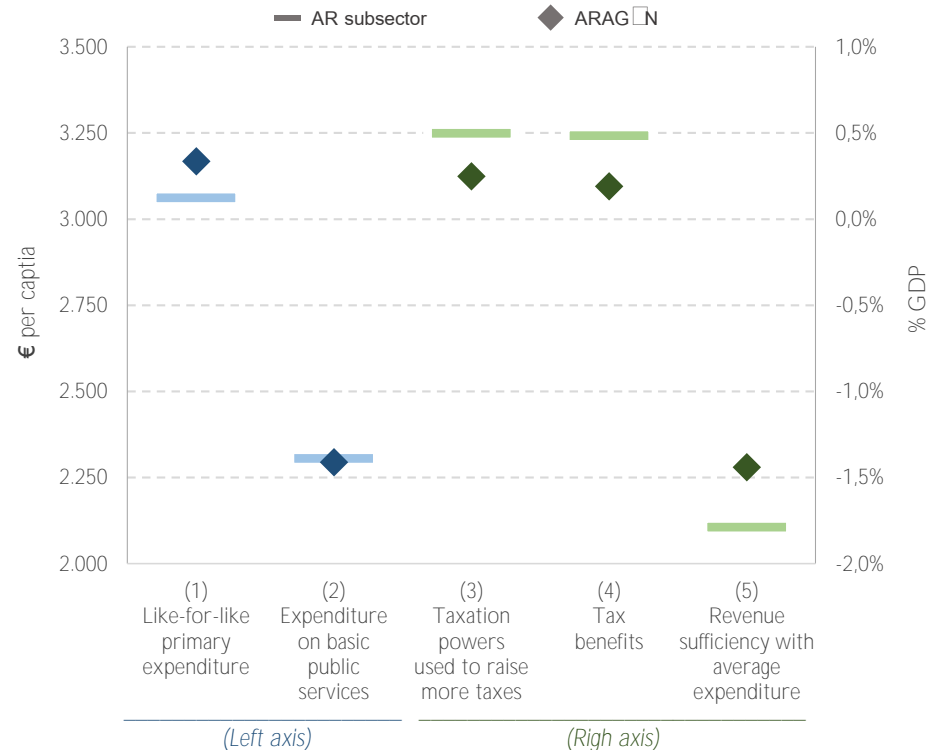
Risk of non-compliance with the stability target but not possible to judge its intensity:

- ✓ Deviation in the 2015 year-end figures covered in the main budgetary lines.
- ✓ Measures in a very preliminary phase of adoption.
- ✓ No significant risks associated with financial sustainability are observed.

A. NET LENDING/BORROWING (% GDP)



Source INE, MINHAP, Autonomous Regions & AIReF estimates

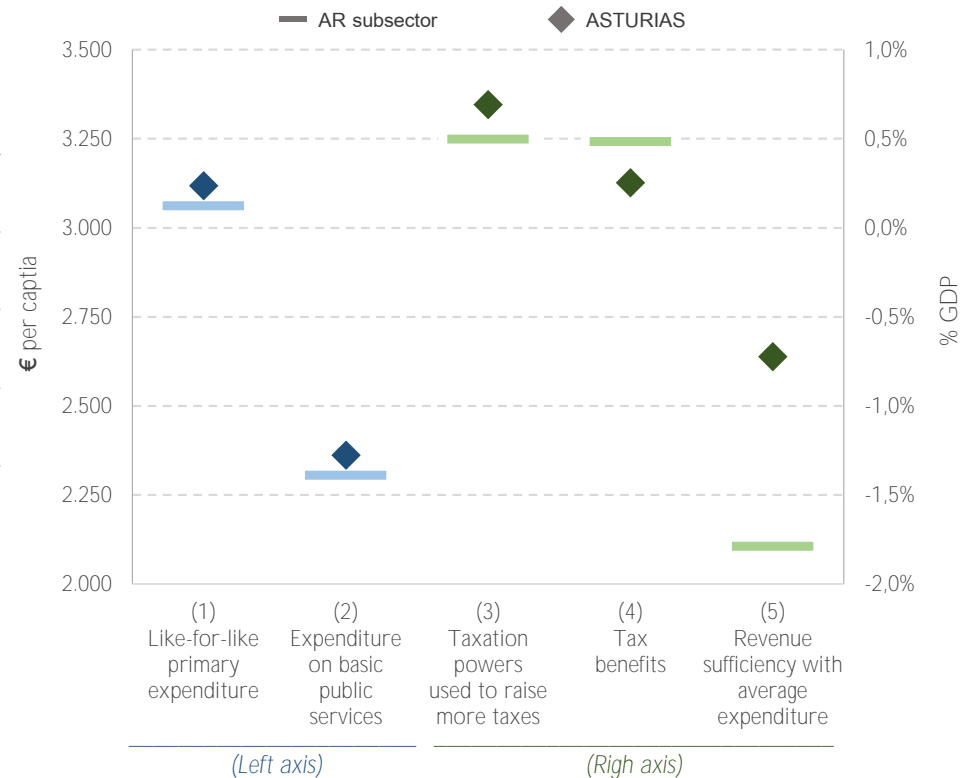
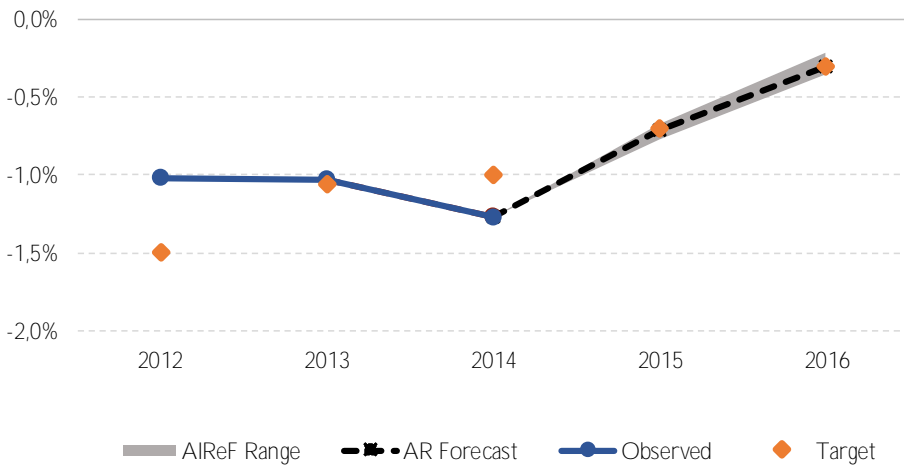


Asturias

Compliance with the stability target is likely:

- ✓ Need for contained implementation of expenditure to meet the expenditure rule.
- ✓ Very positive government debt dynamic.
- ✓ No significant risks associated with financial sustainability are observed.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIREF

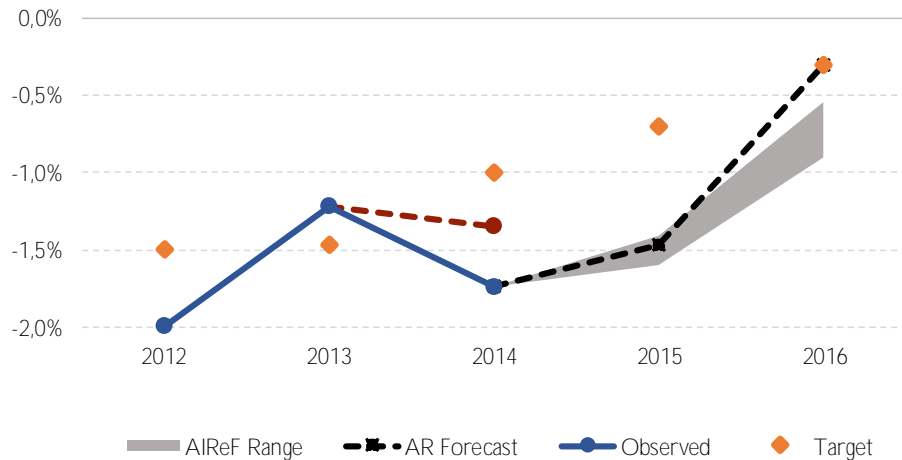


Balearic Isles

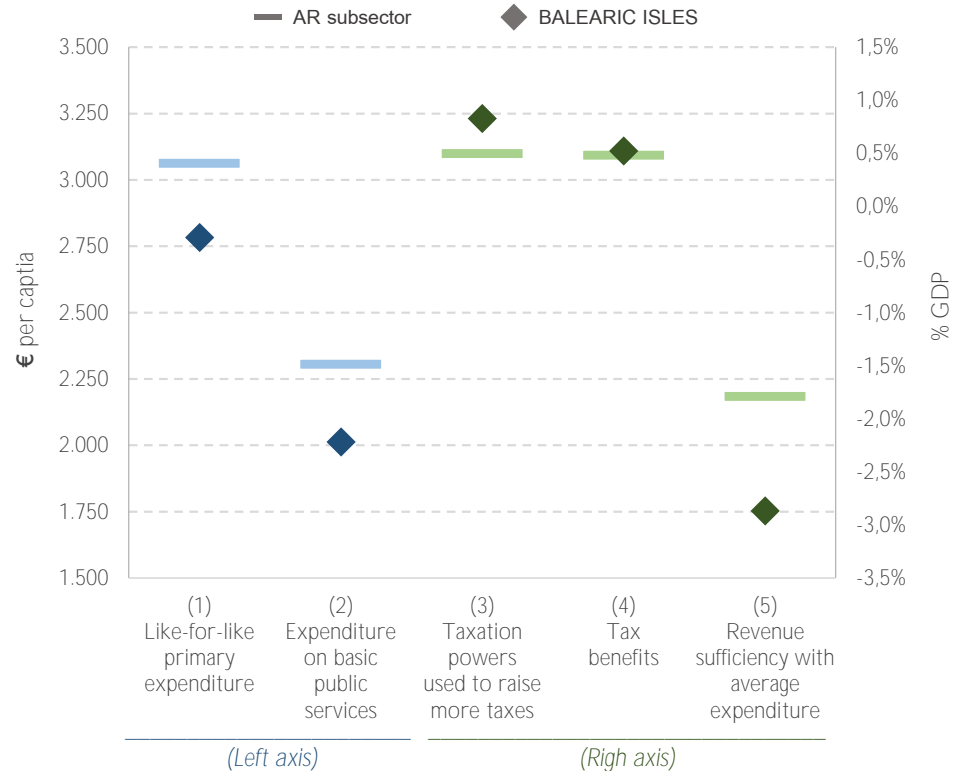
Moderate risk of non-compliance with the budget stability target:

- ✓ Large adjustment to be made in 2016 and uncertainty about the valuation and implementation capacity of implement the measures included in the budget.
- ✓ Not risk-free as regards financial sustainability.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

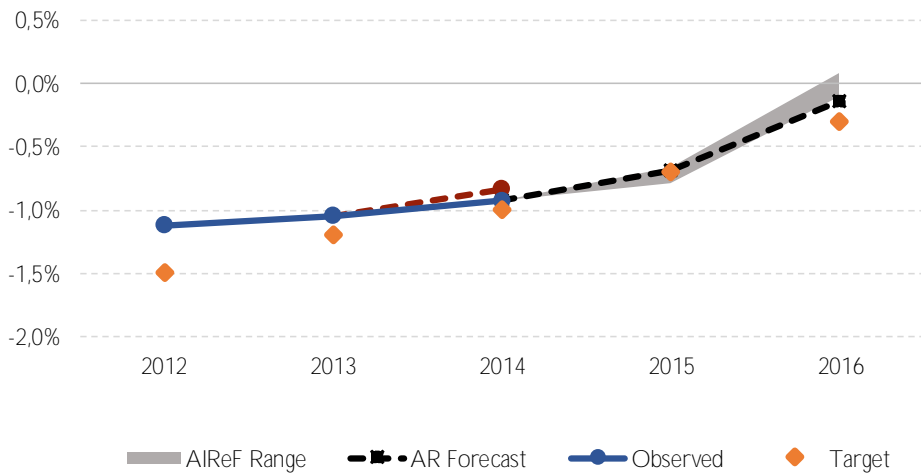


Canary Isles

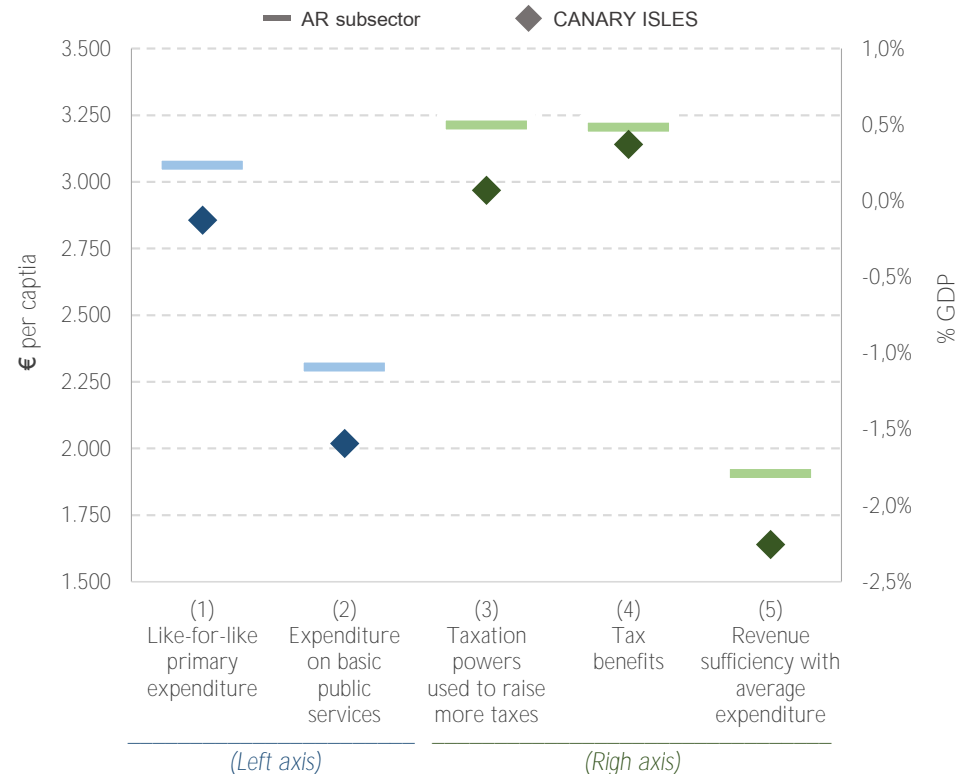
Likely compliance with the budgetary stability target:

- ✓ Might even achieve a lower balance, as indicated by the region, consistent with the application of the expenditure rule.
- ✓ No significant risks of financial sustainability are observed.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

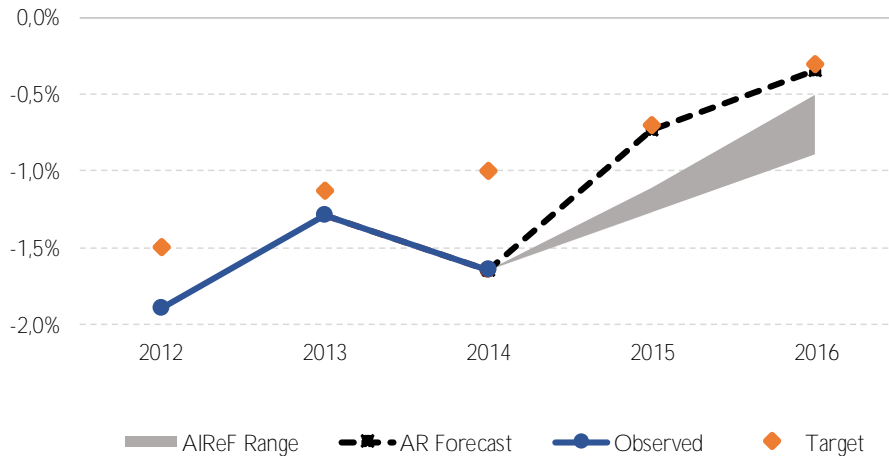


Cantabria

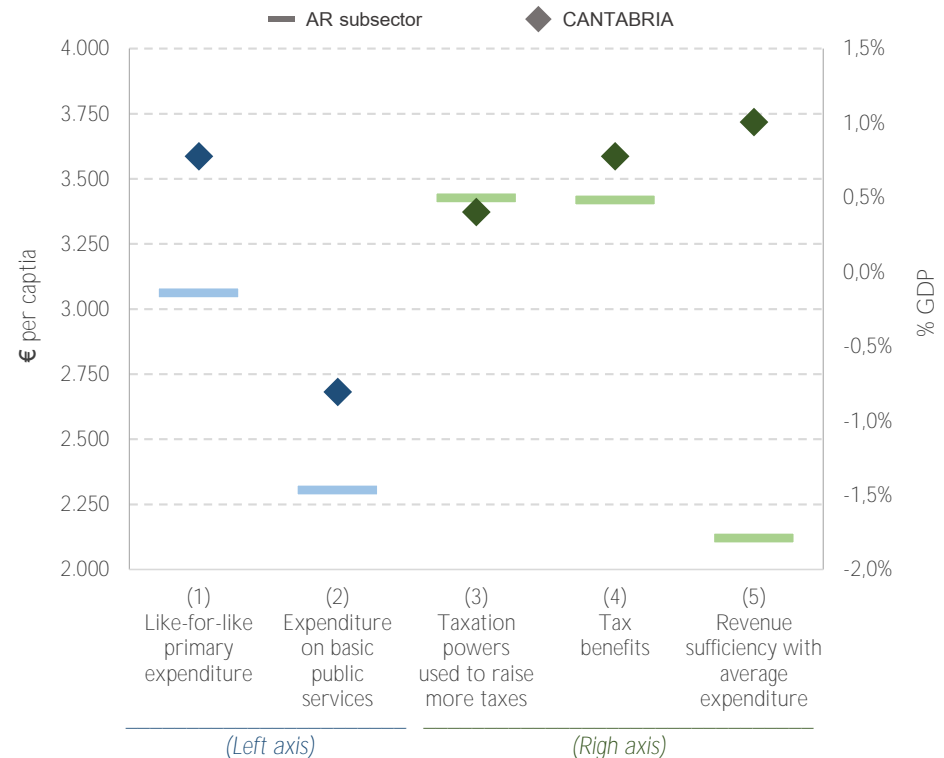
Moderate risk of non-compliance with the budget stability target:

- ✓ Essentially due to the expected 2015 year-end deviation, not taken into account by the region.
- ✓ It seems to have leeway in revenue and expenditure margins to achieve the target set.
- ✓ There are no significant debt financial sustainability risks.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

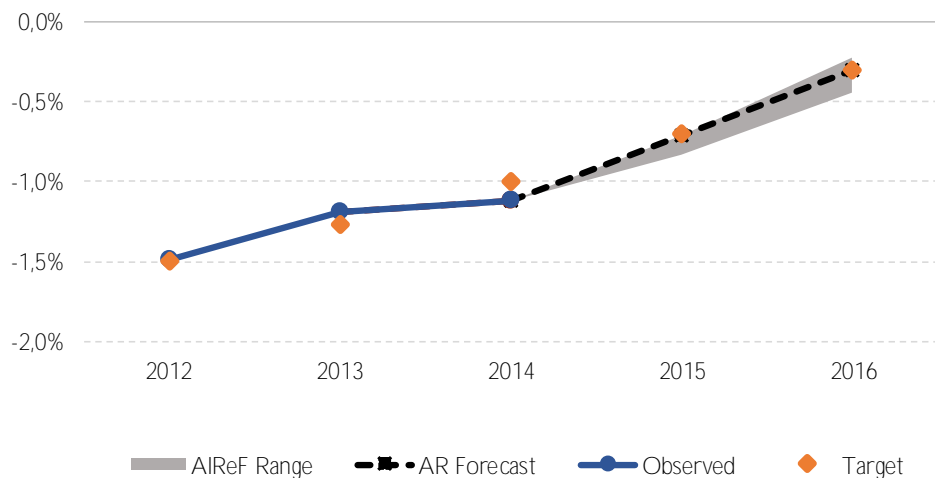


Castilla y León

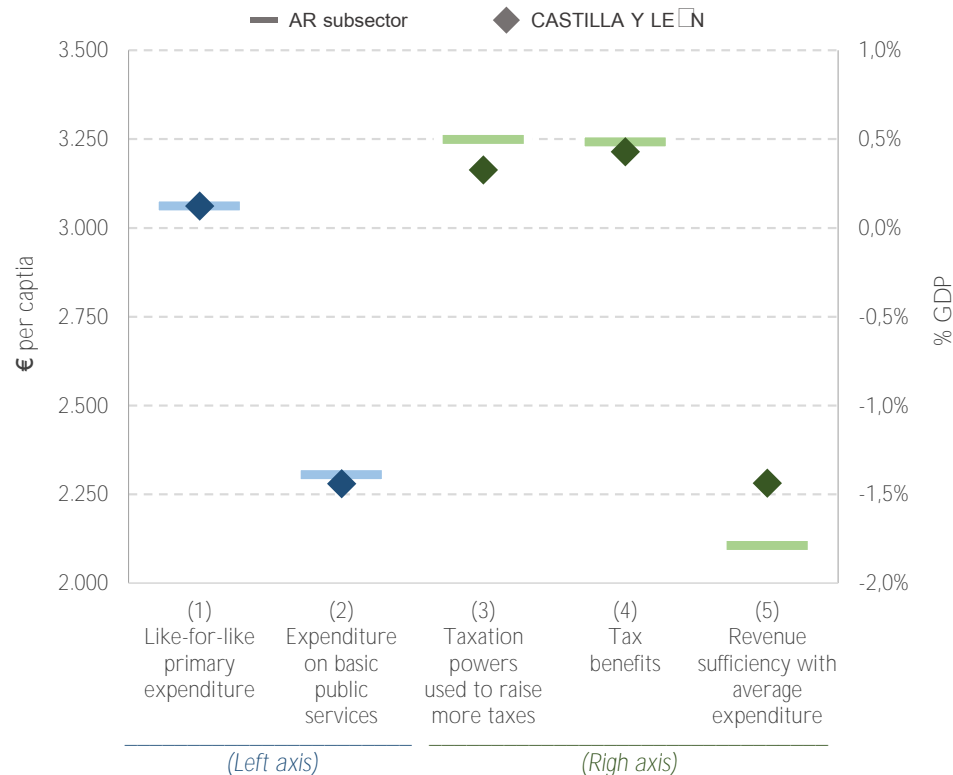
Likely compliance with the budget stability target:

- ✓ The forecast development of expenditure could compromise compliance with the expenditure rule.
- ✓ There are no significant debt financial sustainability risks.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIREF estimates

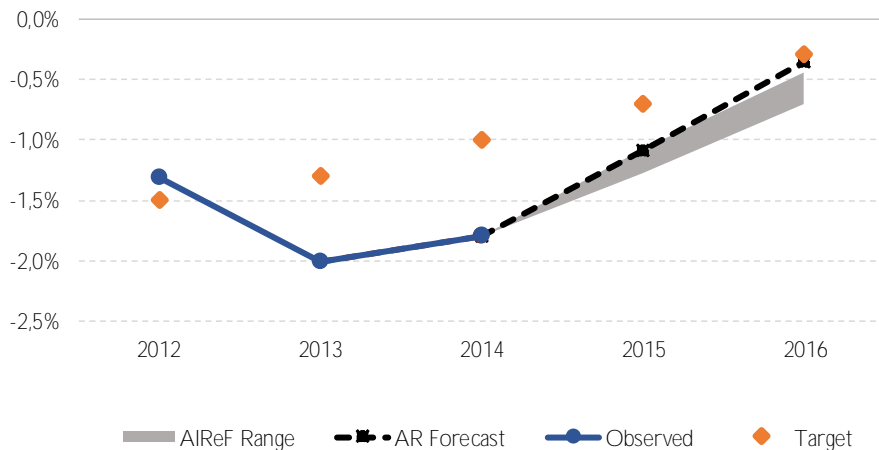


Castilla - La Mancha

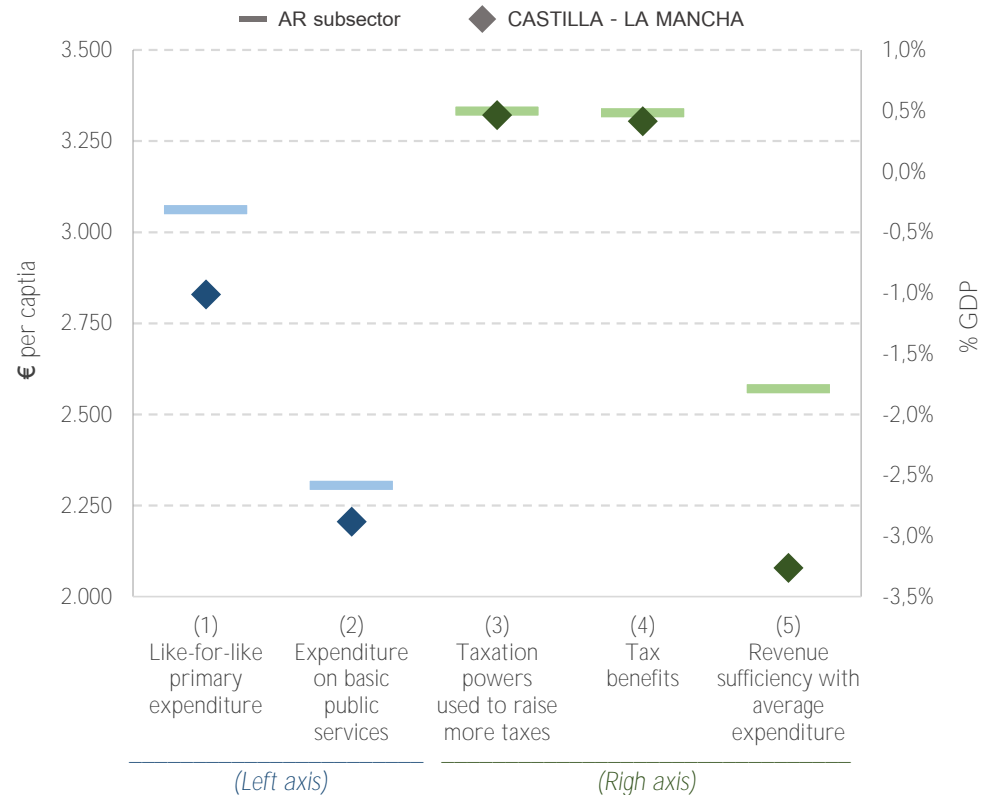
Moderate risk of non-compliance with the budget stability target:

- ✓ Due to uncertainty over the expenditure forecast by the Region which might also be incompatible with achievement of the expenditure rule.
- ✓ Debt sustainability shows risks.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

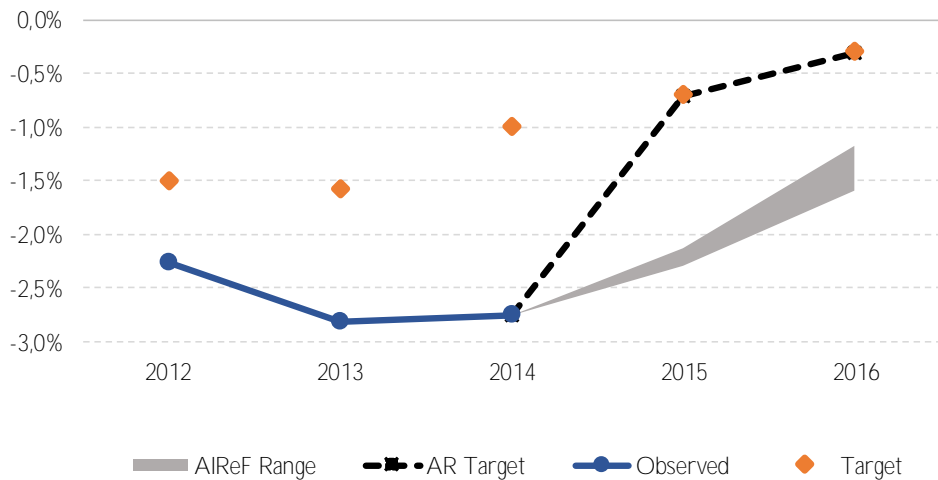


Catalonia

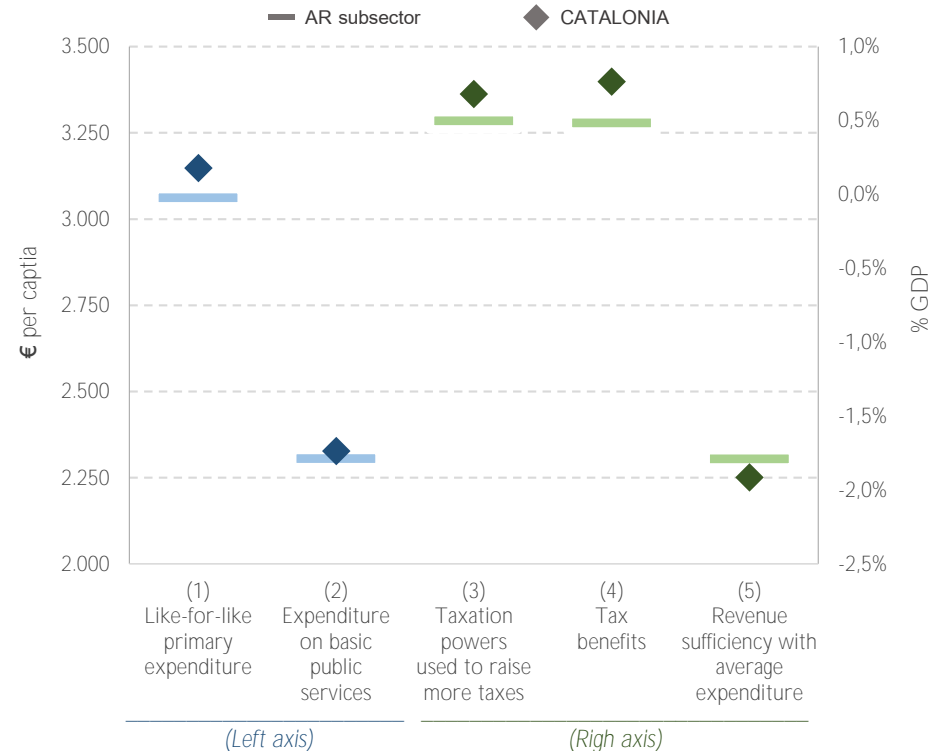
Very high risk of non-compliance with the budget stability target:

- ✓ Its budget scenario for 2016 does not include the large baseline deviation this year.
- ✓ The development of expenditure forecast by the Region also compromises the expenditure rule.
- ✓ Very high risks of debt sustainability.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

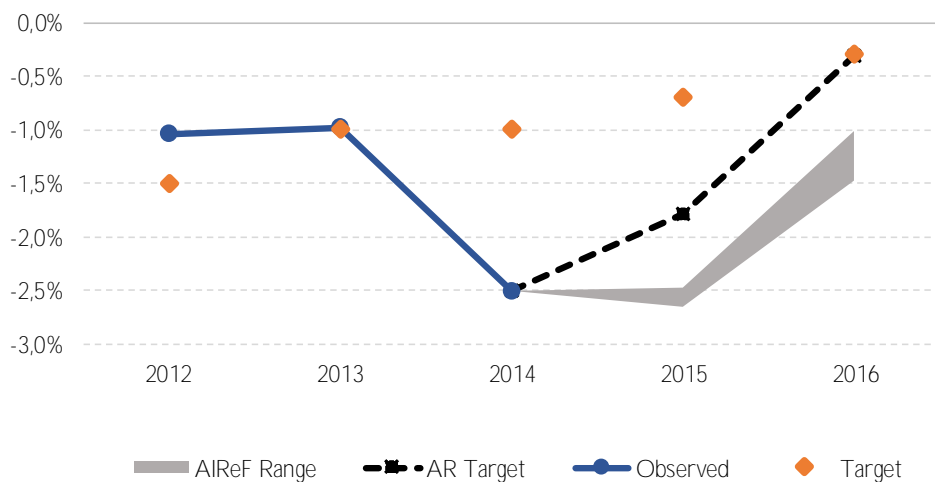


Extremadura

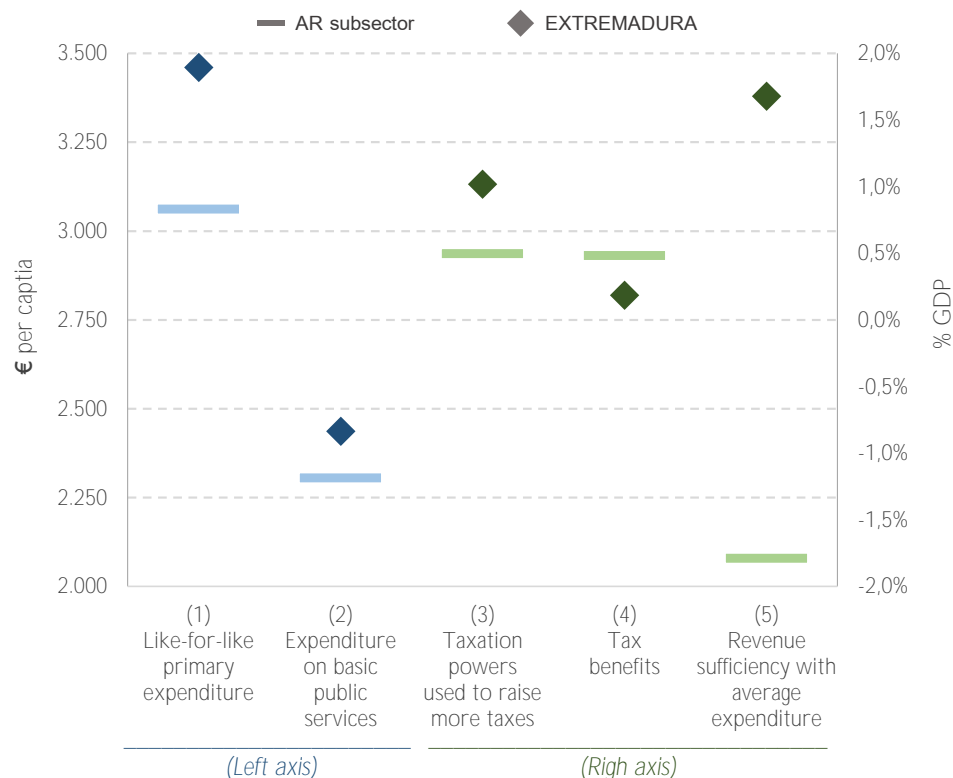
Very high risk of non-compliance with the budget stability target:

- ✓ Its 2016 budget scenario only includes a part of the large baseline deviation.
- ✓ The development of the expenditure forecast by the Region might compromise compliance with the expenditure rule.
- ✓ No significant debt sustainability risks are observed.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIReF estimates

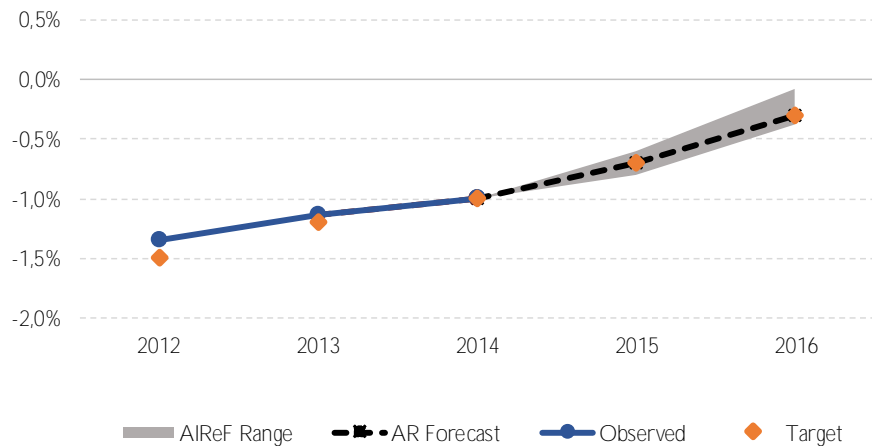


Galicia

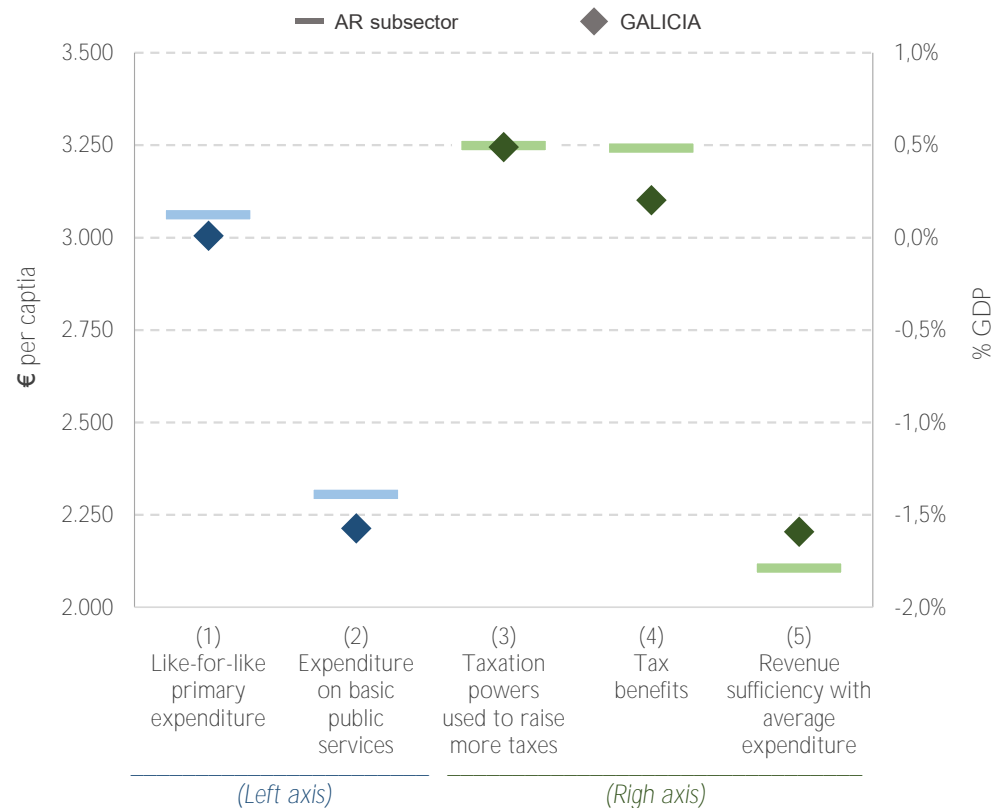
Likely compliance with the budget stability target:

- ✓ Greater spending restriction stemming from the application of the expenditure rule might lead to a stricter balance than the stability target.
- ✓ No significant debt sustainability risks are observed.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIREF estimates

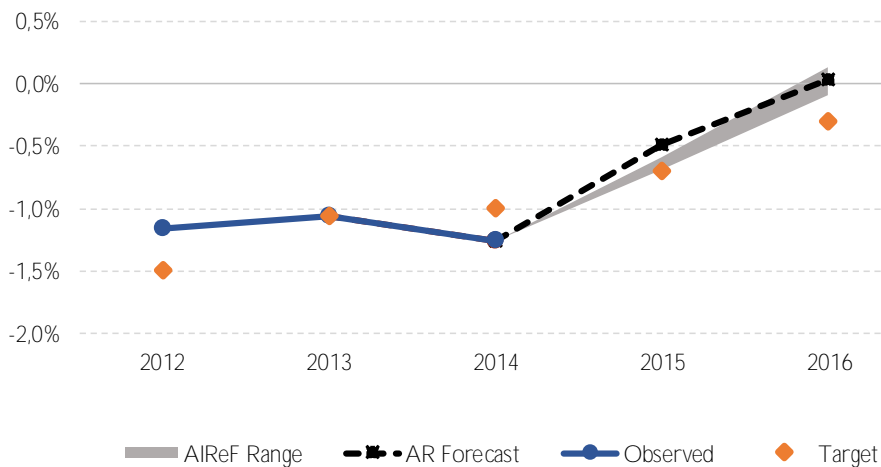


La Rioja

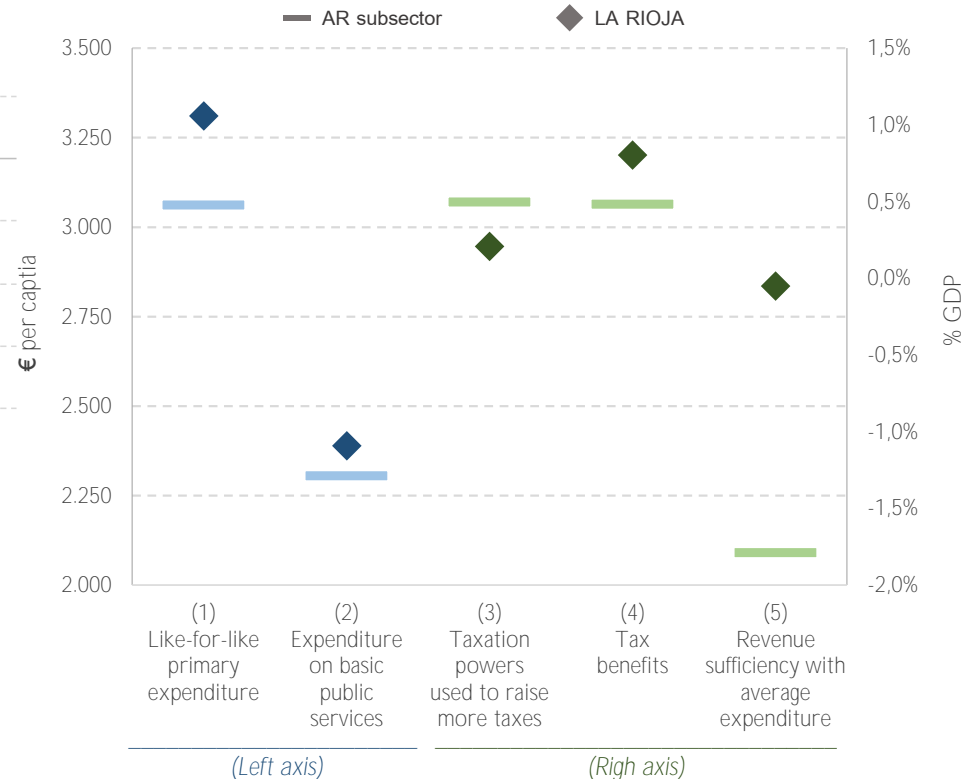
Likely compliance with the budget stability target:

- ✓ It might even achieve a lower balance consistent with the application of the expenditure rule.
- ✓ No significant risks of debt sustainability are observed in the medium and long term.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIREF estimates

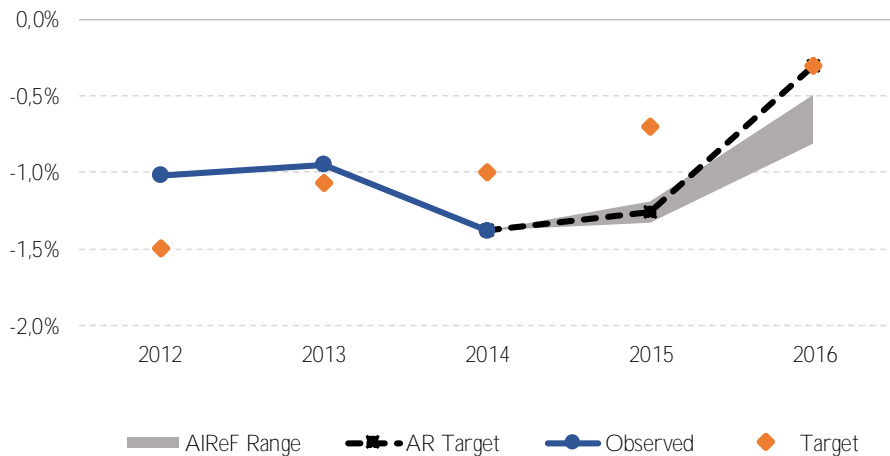


Madrid

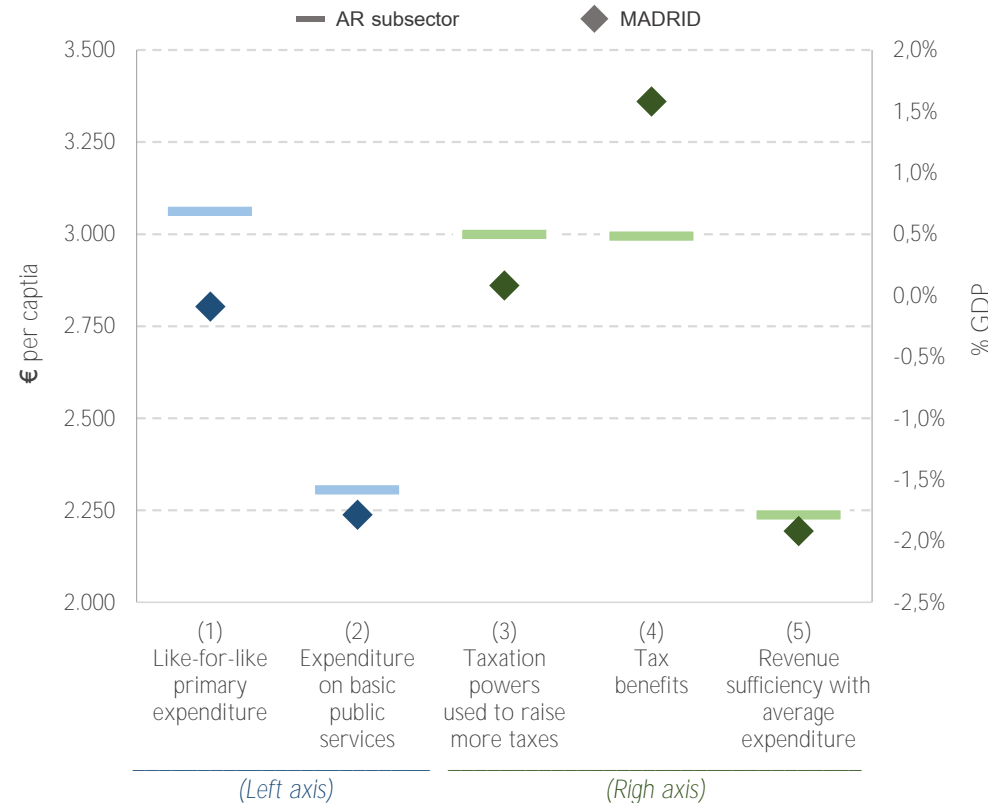
Moderate risk of non-compliance with the budget stability target:

- ✓ Due to the uncertainty associated with some revenue items included in the budget.
- ✓ No significant risks of debt sustainability are observed.

A. NET LENDING/BORROWING (% GDP)



Source: INE, MINHAP, Autonomous Regions & AIREF estimates

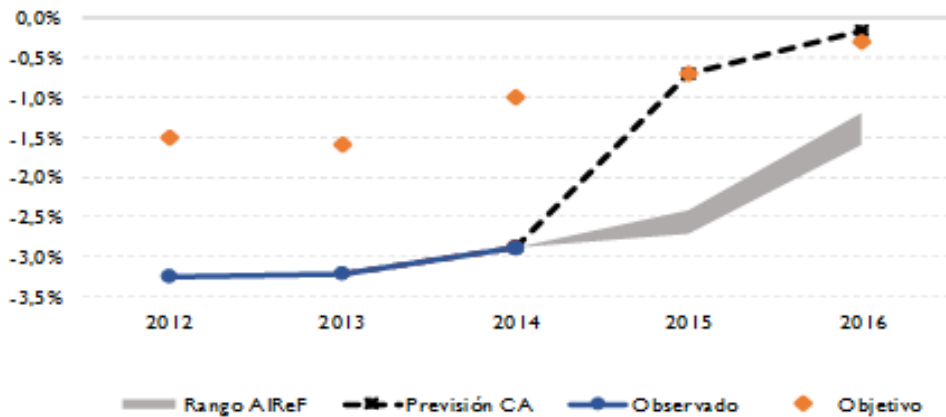


Murcia

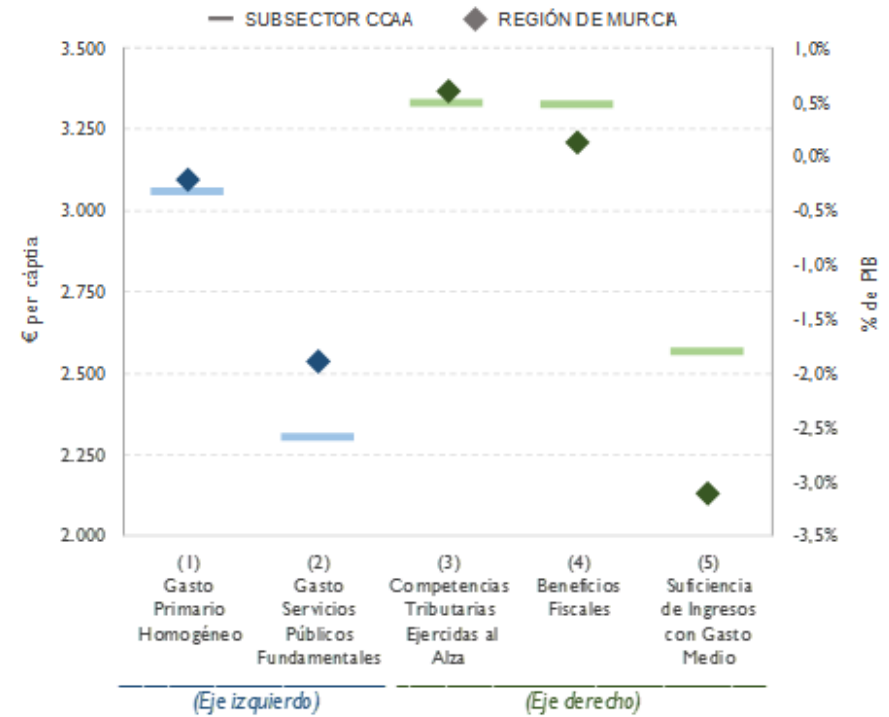
Very high risk of non-compliance with the budget stability target:

- ✓ Due to the expected deviation at 2015 year-end not taken into account by the Region.
- ✓ Shows debt sustainability risks.

A. CAPACIDAD/NECESIDAD DE FINANCIACIÓN (% PIB)



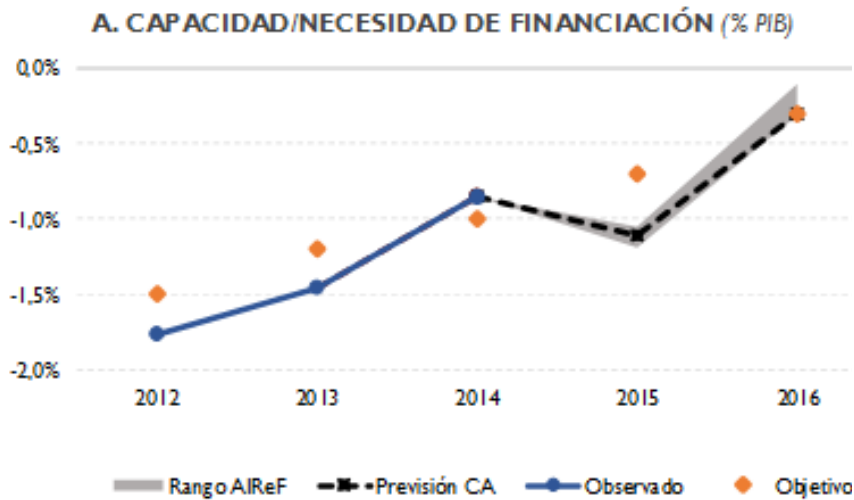
Source: INE, MINHAP, Autonomous Regions & AIReF estimates



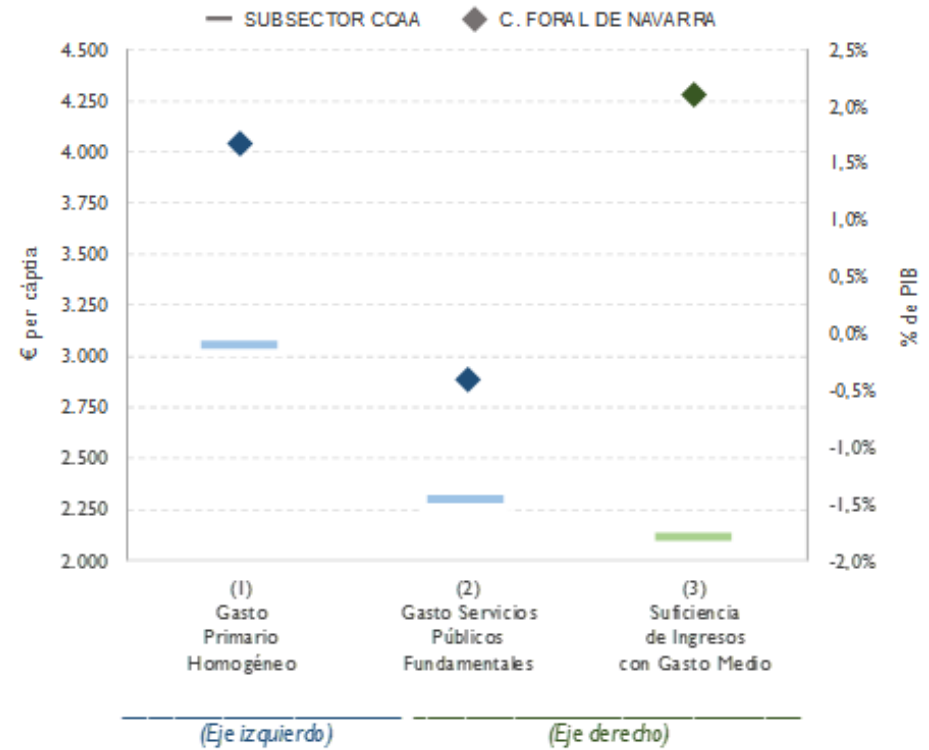
Navarra

Likely compliance with the budget stability target:

- ✓ The application of the expenditure rule would entail a more demanding balance that is not taken into account by the Region.
- ✓ No significant debt sustainability risks are observed.



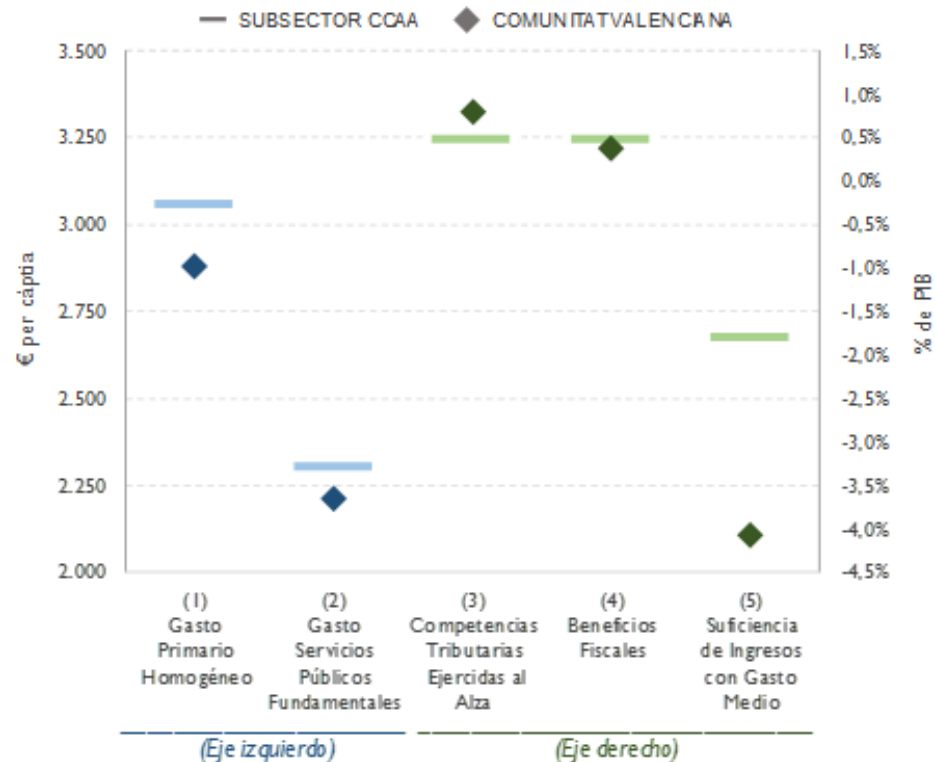
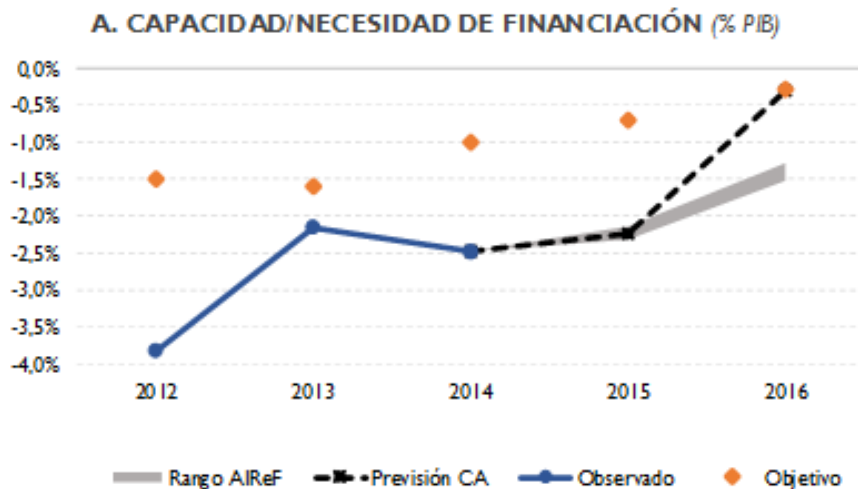
Source: INE, MINHAP, Autonomous Regions & AIREF estimates



Valencia

Very high risk of non-compliance with the budget stability target:

- ✓ Due essentially to the possible deviations seen in the revenue budgeted in 2016.
- ✓ The forecast development of expenditure might be higher than is compatible with the expenditure rule.
- ✓ There are high debt sustainability risks.



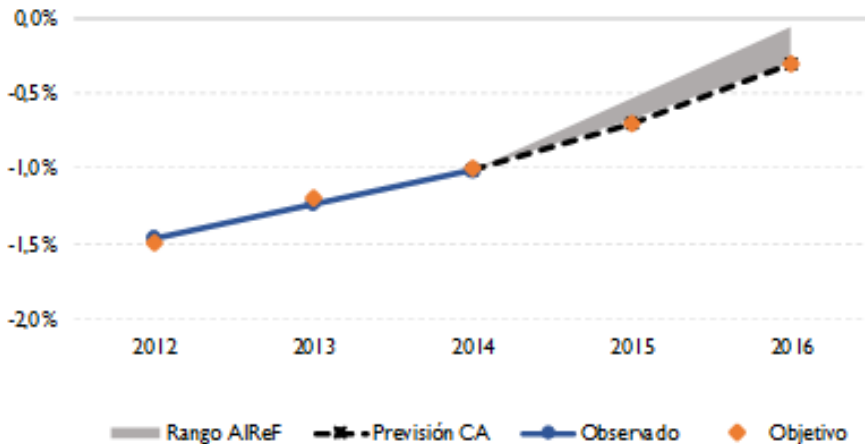
Source: INE, MINHAP, Autonomous Regions & AIReF estimates

Basque Country

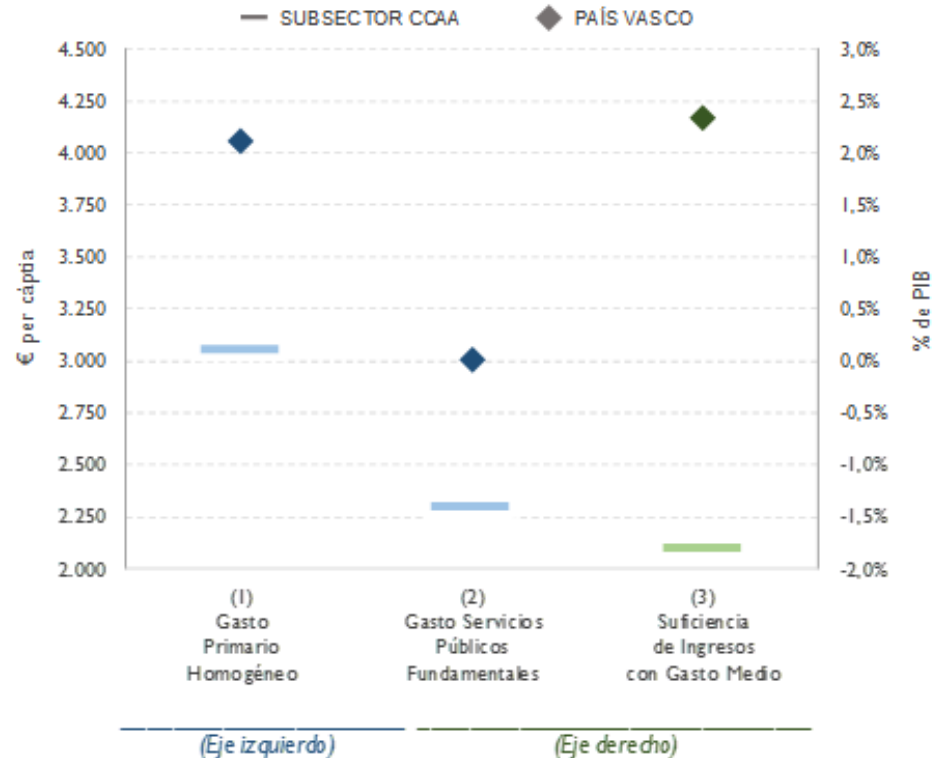
Likely compliance with the budget stability target:

- ✓ The balance stemming from the application of the expenditure rule, according to AIREF estimates, might be slightly stricter than the stability target set and this is not envisaged by the Region.
- ✓ The debt dynamic is very favourable, reinforced by a level that is very close to the target, so no significant risks associated with debt sustainability are observed as a result.

A. CAPACIDAD/NECESIDAD DE FINANCIACIÓN (% PIB)



Source: INE, MINHAP, Autonomous Regions & AIREF estimates



Notes on the graph showing the Indicators on relative position of revenue and expenditure

- (1) Like-for-like primary expenditure measures the non-financial primary expenditure, net of payments from financing system resources, per adjusted inhabitant in the period 2012-2013, in terms of like-for-like powers over expenditure.
- (2) The expenditure on basic public services measures the per adjusted inhabitant expenditure for the period 2012-2013 on the functions of health, education and social protection in the Functional Classification (COFOG).
- (3) The indicator of taxation powers used to raise more taxes measures the positive taxation impact in 2015, as a % of GDP, of the normative measures approved by each Region.
- (4) The tax benefits indicator measures the estimate in 2015, as a % of GDP, of the reduction in the revenue from ceded taxes stemming from the normative measures approved by each Region.
- (5) The revenue sufficiency Indicator with average expenditure measures the net borrowing or lending, as a % of GDP as an average in the years 2012-2014 on the assumption that the per adjusted inhabitant like-for-like primary expenditure was the same as the average in the subsector.



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