



Independent Authority
for Fiscal Responsibility

Report

14 February 2017

Report on the main lines of Public Administrations' budgets and initial budgets for 2017: Autonomous Regions (Articles 17.1 and 17.2 of the LOEPSF)

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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Executive Summary

The schedule of reports issued by AIReF on the evaluation of the main budgetary lines and approved budgets for the Autonomous Regions (AR) has been altered and fragmented by the presence of a caretaker Government for a large part of 2016, which has affected Autonomous Regions' budget preparation process for 2017. This exceptional situation has caused a delay in the publication of the report of the main budgetary lines, and its replacement with the budgets report in the case of those ARs whose budgets, to date, have been approved.

Therefore, the aim of this report is an assessment of the extent to which the budgetary information available for each region complies with fiscal regulations. This includes: main lines (article 17.1 of the LOEPSF) in 6 ARs (Aragón, Cantabria, Castilla-La Mancha, Catalonia, Madrid and La Rioja) and approved budgets (article 17.2 of the LOEPSF) in 9 ARs (Andalusia, Asturias, Balearic Islands, Canary Islands, Extremadura, Galicia, Murcia, Navarra and Valencia¹).

Individual assessment is still pending for two ARs (Castilla y León and Basque Country), from which no information has been forthcoming. However, an estimate has been drawn up of their fiscal situation in order to conduct a preliminary assessment of the subsector.

AIReF has assessed the implementation of the budgetary documents drafted by the 15 ARs studied, from a double viewpoint including the consideration of their feasibility and their equity, and that will add context to the assessment of budgetary actions from the time of setting the targets and throughout the budgetary cycle. With this analysis, AIReF grades the likelihood of reaching the stability target for 2017 (-0.6% of GDP):

- ✓ Very likely: Canary Islands.
- ✓ Likely: Andalusia, Balearic Islands and Galicia.
- ✓ Feasible: Asturias, Madrid and La Rioja.
- ✓ Unlikely: Catalonia, Castilla-La Mancha, Navarra and Valencia.
- ✓ Very unlikely: Aragón, Cantabria, Extremadura and Murcia.

¹ In the case of Valencia, this pronouncement is provisional and incomplete, pending clarification of the substantial differences observed in the levels of income and expenditure in the budget documents currently available.

For the four ARs deemed very unlikely to reach the target, AIReF understands that in compliance with article 19 of the LOEPSF the Ministry of Finance and Civil Service (MINHAFP) is obliged to take action. AIReF, therefore, once more implements the procedure foreseen both in the Act creating this authority and in its internal rules and regulations, and requests MINHAFP to activate the non-automatic preventive measures set forth in the above mentioned article.

Despite the fact that in eight of the ARs compliance with the stability target is deemed unlikely or very unlikely, AIReF considers it feasible that the AR subsector as a whole will comply. The central scenario forecast by AIReF situates the deficit one tenth of a percentage point above the set target, resting on the financing system resources update notified in October in the context of an extension to the General State Budget. In the event that this update did not materialise and the financing system resources were to remain as notified in October, AIReF's forecast for the subsector would worsen, dropping from feasible to unlikely.

In this respect, AIReF continues to draw attention to the fact that MINHAFP is refraining from using its leverage within the scope of the framework of fiscal discipline and the design of fiscal rules. Setting differentiated stability targets; rigorous implementation of the expenditure rule, without consolidating for the future past noncompliance; and the design of a multiyear framework of action in which the Economic and Financial Plans (EFP) play a substantive role, rather than merely formal as heretofore, would raise the likelihood of compliance with the set target.

With regard to the stability target, the recommendations concur on the need to bring into play the preventive mechanisms foreseen in the LOEPSF, encouraging the acting AR's deeper involvement in monitoring budget implementation and expediting action taken by MINHAFP in the event of clear signs of deviation becoming apparent. Similarly, for ARs whose budgets include financing system resources that exceed the figures notified by MINHAFP in October, in the context of a budgetary extension, AIReF recommends prudence in their implementation until it is known whether such amounts are due to be updated, withholding credit for the difference between budget forecasts and the resources quantified for a budgetary extension.

As for the expenditure rule, AIReF continues to observe problems relating to its interpretation and calculation on the part of ARs. AIReF, therefore, and without prejudice to the conduct of an in-depth review of the rule, insists in its recommendation that MINHAFP should undertake to develop the regulation as necessary to solve specific problems in its implementation.

Lastly, it is still not possible to assess compliance with the debt target, for which reason the analysis for each region is completed with a study of the sustainability of its debt path. Very high risks are appreciated for Catalonia, Castilla-La Mancha, Murcia and Valencia, and high risk in Extremadura and Balearic Islands. In this context, AIReF recommends setting multiyear debt targets, integration with the principle of budget stability and the expenditure rule, and comprehensive and differentiated assessment of the baseline situation for the various ARs, paying special attention to the impact on the system of financing and the dependence on the financing mechanisms of the State.

1. Introduction

AIReF is under the mandate to report on the Autonomous Regions' budgets in the initial stages of their preparation and approval, to enable early detection of any potential risk of non-compliance with fiscal rules. AIReF plays a prominent role in early detection of the risk of non-compliance with the fiscal rules, in order to adopt measures that will assure compliance by the end of the financial year. Hence, AIReF reports on the ARs' budgets from the outset, beginning with the main lines underpinning their preparation, aiming, throughout the parliamentary procedure, to incorporate any recommendations that may arise into the draft budgets. Subsequently, AIReF checks whether the approved budget will comply, or fail to comply, with the fiscal rules.

The mandate to report on the main lines of the budgets and initial budgets is set forth in the Organic Law on Budget Stability and Financial Sustainability (LOEPSF) and in the Act creating AIReF and its internal rules and regulations. As provided for in the LOEPSF and in the internal rules and regulations of AIReF, this institution is obliged to make public, before 15 October, a report on the draft General State Budget and the main budgetary lines of the Autonomous Regions (AR) and the Local Corporations (LC) from the viewpoint of their compliance with the expenditure rule and the budget stability and Government debt targets. Likewise, by 1 April, AIReF is obliged to report on the approved budgets taking into account the variations materialising since the last report.

The schedule for publishing these reports has been altered and fragmented owing to exceptional circumstances in 2016. The presence of a caretaker central government until late October 2016 and, additionally, in the case of Galicia and Basque Country, regional elections, has affected the process of drafting the AR budgets for 2017. As a result, the schedule for the publication of these reports

has also been altered and fragmented². In the regional context, the report on the main budgetary lines has been delayed or, as in the case of certain ARs, replaced with the budget report, the information on main lines having been superseded by that of the approved budgets.

This document provides an assessment of the main budgetary lines for 2017 in the six ARs whose budgets have not been approved yet. At the time of writing this report, the ARs of Aragón, Cantabria, Castilla-La Mancha, Catalonia, Madrid and La Rioja have submitted their main budgetary lines for 2017 and all ARs except Aragón and Madrid have approved their draft budgets. Subsequently, as soon as the budgets have been approved, AIReF will proceed to analyse any variations stemming from the parliamentary process, within the framework of the report envisaged in article 17.2 of the LOEPSF, whose content is defined in article 18 of AIReF's internal rules and regulations.

For the nine ARs whose 2017 budgets have been approved, assessment will be conducted of the budgets than their main lines. At the time of writing this report, the ARs of Andalusia, Asturias, Balearic Islands, Canary Islands, Extremadura, Galicia, Murcia, Navarra and Valencia have approved their budgets for 2017. For these ARs, the report can only cover their budgets given that, once these are approved, the information on budget items has been superseded and recommendations can no longer be incorporated in the parliamentary process. In these regions, this being AIReF's first opinion on the budgetary cycle for 2017, the budget assessment is comprehensive and not constrained to an analysis of variations with respect to the main lines and draft budgets, as stated in AIReF's internal rules and regulations. In the case of Valencia, nevertheless, this pronouncement is provisional and incomplete, pending clarification of the substantial differences observed in the levels of income and expenditure in the budget documents currently available.

Finally, the lack of information prevents AIReF from making individual pronouncements for Castilla y León and Basque Country. The ARs of Castilla y León and Basque Country have not submitted, at the date of issuing this report, information on the main lines of their 2017 budgets. Furthermore, these ARs have not approved their draft budgets. Therefore, AIReF is keeping individual assessments for these ARs pending, issuing only an estimate based on the latest information available of their fiscal situation in order to evaluate the subsector as a whole.

² On 7 December 2016 the Report [on the Public Administrations' Projects and Main Budgetary Lines: Local Corporations 2017](#)

2. Object of the report and limitations to its scope

The aim of this report is to assess the information on the 2017 budgets available at present, with a focus on the likelihood of compliance with the three fiscal rules defined in the LOEPSF. AIReF has prepared this report with the projects and main lines or, as applicable, approved regional budgets, as well as any additional information received. The adequacy of the budget documents to comply with the budget stability and Government debt targets and the expenditure rule in 2017 is evaluated with these data. With this aim in mind, AIReF has made an analysis for each region (with the exception of Castilla y León and Basque Country) of its revenue³ and expenditure⁴ estimates, the measures and national accounting adjustments planned, and the available information on debt and the expenditure rule for 2017.

As in previous years, the scope of this report in the assessment of the debt target and the expenditure rule is limited by:

- ✓ Public debt target: AIReF has still not been able to evaluate compliance with the debt target because of the lack of information on the forecasts for certain elements that form part of the calculation of this target.
- ✓ Expenditure rule: the information submitted or given in the budgets still presents inconsistencies, loopholes and interpretation differences in the calculation or appraisal of the eligible expenditure items. The consequence of these limitations is that, as in earlier reports, AIReF's analysis has been based on a series of assumptions and estimates⁵ to determine the possible effect that compliance with the expenditure rule may have on the Autonomous Regions' accounts and its relationship with the stability target.

³ In the case of revenue from the tax on asset transfers and documented legal acts (*Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados*, ITPAJD) AIReF has evaluated the Autonomous Regions' data by checking them against its own forecasting model, whose methodology is given in [Annex I in the Report on the main budgetary lines for the Autonomous Regions in 2016](#)

⁴ Regarding expenditure, an analysis is made of the main headings for current expenses in the regional forecasts, taking into account AIReF's estimates for trends in healthcare and education, using the model described in the [May Report on macroeconomic forecasts and draft Stability Programme Update for the Kingdom of Spain 2016-2019](#)

⁵ The methodology underpinning AIReF's calculations and estimates was published in [Annex III to the Report on the main budgetary lines in the Autonomous Regions for 2016](#)

The assessment includes a study of debt sustainability. As in earlier reports, the analysis is complemented in each region with a study of the medium- and long-term sustainability of its debt path. This assessment is made individually for each region by calculating different indicators of fiscal and macroeconomic stress, both in the short and medium term, for the different ARs.

3. Budget stability target and expenditure rule

A. Main features in the 2017 budgets

The exceptional circumstance of a caretaker Government in place for practically the whole of 2016 has impacted not only the publication date but also the content of the ARs' budgets for 2017. The presence of a caretaker Government has caused a delay both in setting the targets of the fiscal rules, and in drafting the General State Budget for 2017, heavily affecting Autonomous Regions' budgets.

- **On the one hand, most of the documents on main lines, projects and budgets have been drawn up envisaging stricter targets of the fiscal rules than those finally set for 2017.** The debt and stability targets, and the reference rate for the expenditure rule for 2017, were approved in parliament on 20 December 2016 (stability target of -0.6% of GDP and reference rate for the expenditure rule of 2.1%). As a consequence of the delay in setting the parameters for implementing the various fiscal rules, the budget information for the ARs analysed (with the exception of Murcia, Castilla-La Mancha and Cantabria) falls within the lower limits, which were the known limits at the time of preparing said information (stability target of -0.5% and reference rate for the expenditure rule of 1.8%)⁶. In the case of La Rioja, Canary Islands and Navarra, the forecast deficit in each region for 2017 is 0.1%, 0.2% and 0.4% of GDP, respectively, which is well below the limit demanded by the stability target. On the other hand, the debt target is only provisional until year-end, and therefore the target set for 2017 cannot be taken as a reference for measuring compliance.

⁶ Stability Programme Update (2016-2019) approved on 29 April 2016 and the April 2016 draft Report on the Spanish economy notified in the CPFF (Council for Fiscal and Financial Policy) of 28 April 2016.

- **Furthermore, the budgetary information contains different estimates for financing system resources.** The delay in drawing up the 2017 General State Budget has caused the financing system resources payable by the State, according to the ARs, to be either those communicated by MINHAFP in the scenario of a budgetary extension (Canary Islands and Balearic Islands), or those estimated by the ARs themselves (the remainder of ARs analysed). In like manner, this circumstance has conditioned the assessment conducted by AIReF, underpinned by estimates of financing system resources whose amounts are not limited by the extension to the General State Budget.

A growing trend is observed among the ARs analysed to incorporate specific information on the expenditure rule both in the project and in the budget. The projects for Cantabria and Catalonia, and the budgets for Andalusia, Canary Islands, Balearic Islands, Galicia, Murcia and Navarra include a specific section providing information on the calculation of the expenditure rule. Nevertheless, this information is insufficient for evaluating compliance with this rule, chiefly due to errors in the calculation of expenditure and to ARs' lack of knowledge of the measures of revenue taken into account by MINHAFP. Moreover, it is observed that some items not contemplated by article 12 of the LOEPSF (such as certain non-recurrent expenditures) are omitted from eligible expenditure.

By and large, the documents do not include appropriate and sufficient information to allow the verification of compliance with the debt target, as required in article 6 of the LOEPSF. As pointed out in earlier reports⁷, the system used for setting the debt targets hinders compliance with this legal obligation. Nevertheless, the ARs of Canary Islands and Galicia and, to a lesser degree, Murcia and Navarra (the latter with information for 2016 only) have incorporated to their budgets some information on compliance with their debt targets. The budgets for the ARs of Andalusia and Extremadura, however, forecast compliance with the 2017 debt target but fail to submit information regarding how they will accomplish it.

B. Results of the assessment

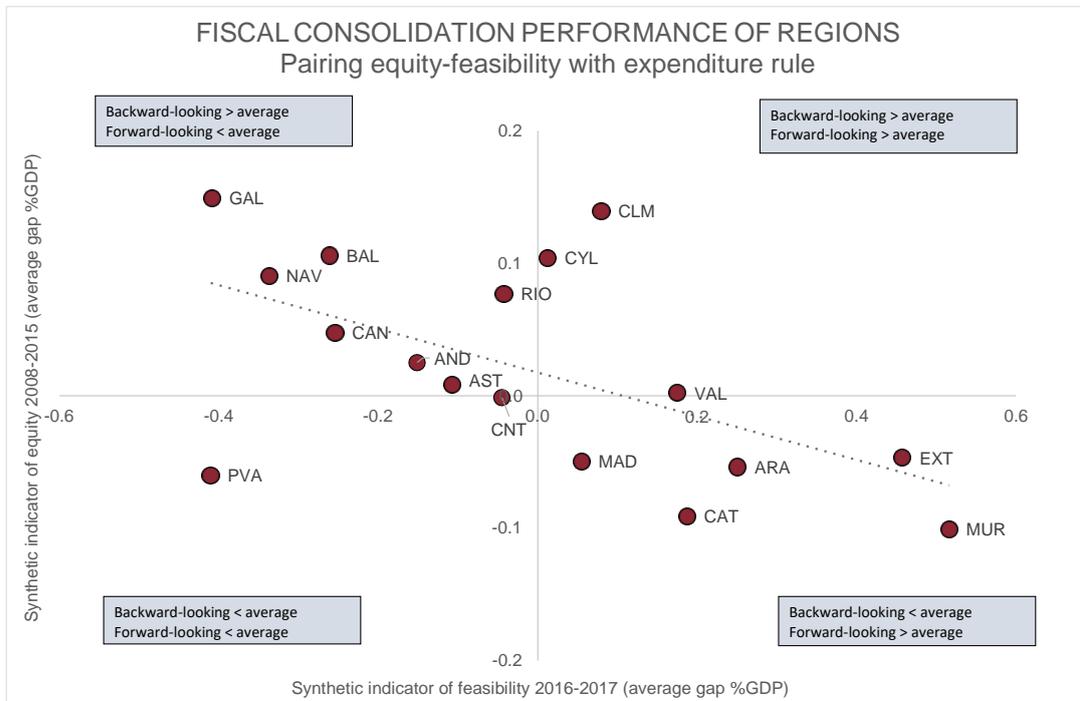
The point of departure for the individual assessment of the likelihood of compliance with the budget stability target is the evaluation of the feasibility of reaching them in the light of each AR's initial position, which AIReF made during the process of setting the targets for 2017. The effort required to reach in 2017 the target of -0.6%, measured in primary structural terms, in combination with the trend in non-financial uses and assuming that the ARs exercise homogeneous competences, has allowed to single out five ARs (Aragón, Catalonia, Valencia and, especially, Extremadura and Murcia) facing clear

⁷ [Report on setting individual targets for the ARs](#)

problems of feasibility to comply with the target. For these regions, meeting the set target would require on their part a fiscal consolidation effort in the period 2016-2017 significantly greater than the AR average (see chart 1).

The feasibility perspective, which is the main aspect to take into account, needs to be complemented with equity aspects. In the report on setting individual targets, equity aspects were added by means of an inter-temporal substitution relation of past and future efforts. Thus, of the five ARs identified as experiencing clear difficulties regarding the feasibility of reaching the target, only Valencia had made, in the period 2008-2015, an effort similar to the average for the subsector while the remainder has performed below average. Two other ARs performing below the subsector average, in the same period, were Madrid and Basque Country, with the difference that the latter also needs to make a smaller effort than the subsector average to meet the target in 2017. On the other hand, two ARs, having made greater-than-average efforts in the past, need to continue to strive harder than the average in 2017 (Castilla-La Mancha and, to a lesser degree, Castilla y León). In addition, other equity factors need to be taken into account such as the relative position of the regions in terms of resources received from the financing system or the use of their normative competences in taxation.

Chart 1. Fiscal consolidation efforts made by Autonomous Regions (% GDP)



From this feasibility-equity perspective, giving context to budgetary actions from the moment of setting the targets, and after analysing the information received, AIReF has differentiated the following two groups of ARs (see Table 1 and Chart 2):

- It is deemed unlikely or very unlikely that budget implementation will allow the target to be reached in the case of the five ARs in which feasibility problems were detected on setting the 2017 stability targets. The effort demanded of these ARs is not supported in the budgetary documents prepared by these regions for 2017, and therefore it is deemed that, if measures are not taken, reaching the targets set is unlikely for the ARs of Catalonia and Valencia and very unlikely for Aragón, Extremadura and Murcia.
- Similarly, compliance with the stability target is deemed unlikely or very unlikely in the ARs of Cantabria, Castilla-La Mancha and Navarra. In these ARs, AIReF finds that in the budgetary documents submitted, no appraisal of the effort required to comply with the stability target is made, even despite the fact that for Cantabria, and particularly Navarra, this effort is smaller than the average for all regions.

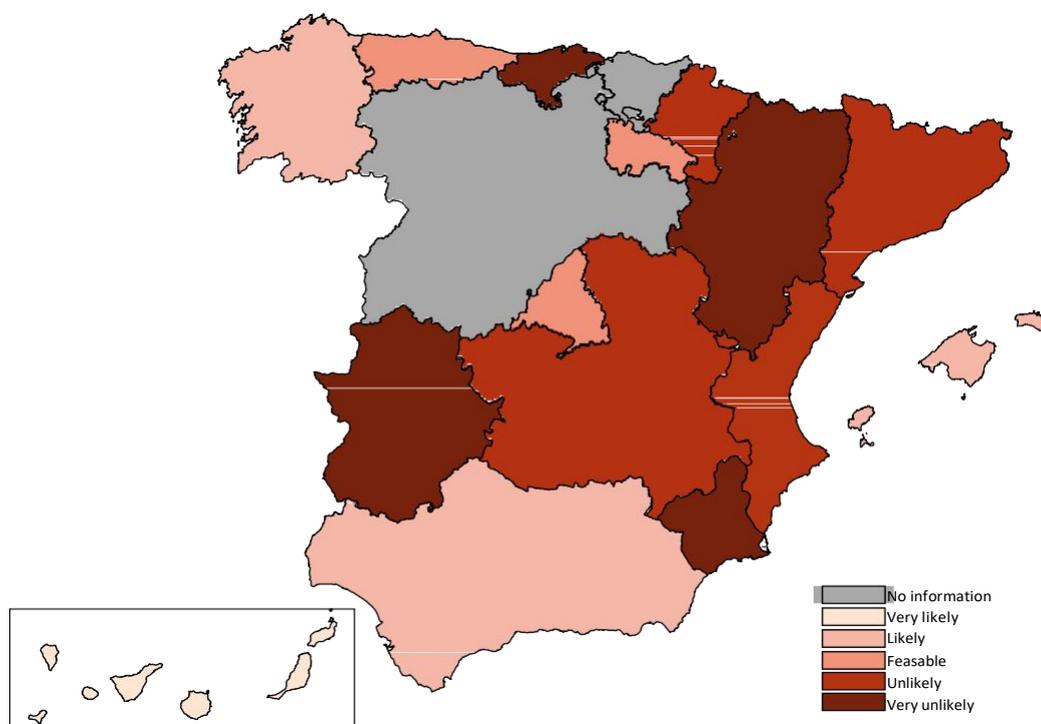
- **With regard to the rest of regions, their budget implementation ought to allow compliance with the target, with varying degrees of likelihood.** This group comprises Madrid, which needs to make a slightly greater effort than the average, and other ARs in which, with an effort below the average, their budget implementation will allow them to reach the target with varying degrees of likelihood (Andalusia, Asturias, Balearic Islands, Galicia and La Rioja).

Table 1. Likelihood of reaching the stability target from a feasibility-equity perspective

AUTONOMOUS REGIONS	Effort made in 2016-2017 with respect to the mean, as per synthetic feasibility indicator	Effort made in 2008-2015 with respect to the mean, as per synthetic equity indicator	Likelihood of complying with the target of -0.6% of GDP (*)
Andalusia	Slightly smaller	Similar	Likely
Aragón	Greater	Smaller	Very unlikely
Asturias	Slightly smaller	Similar	Feasible
Balearic Islands	Smaller	Greater	Likely
Canary Islands	Smaller	Greater	Very likely
Cantabria	Similar	Similar	Very unlikely
Castilla y León			
Castilla-La Mancha	Slightly greater	Greater	Unlikely
Catalonia	Greater	Smaller	Unlikely
Extremadura	Much greater	Smaller	Very unlikely
Galicia	Much smaller	Greater	Likely
Madrid	Slightly greater	Smaller	Feasible
Murcia	Much greater	Smaller	Very unlikely
Navarra	Much smaller	Greater	Unlikely
Basque Country			
La Rioja	Similar	Greater	Feasible
Valencia	Greater	Similar	Unlikely

Note: (*) The assessment of likelihood comprises an analysis of the budgetary documentation.

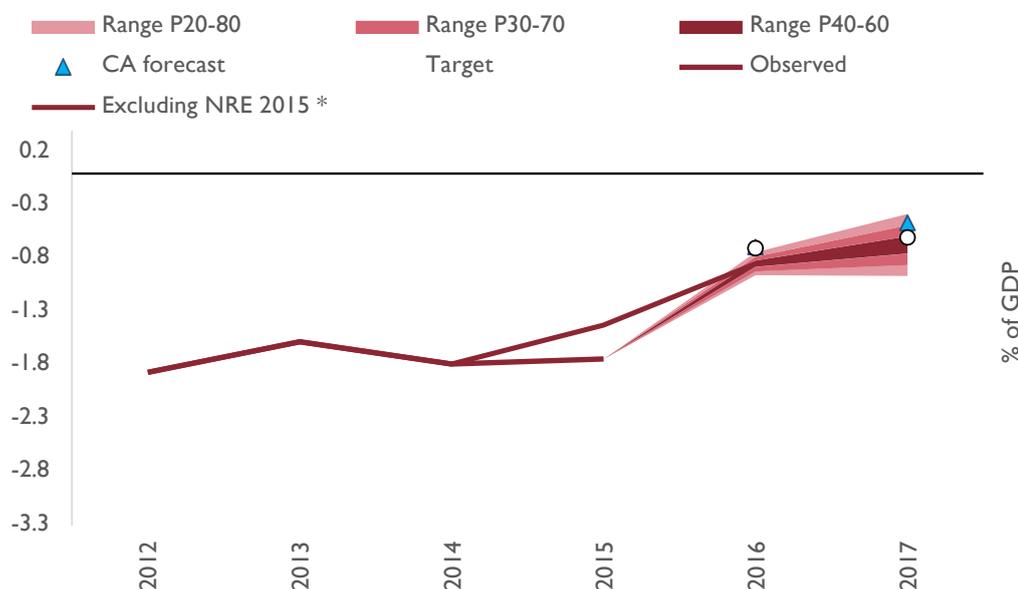
Chart 2. Grading scale for the likelihood of compliance with the stability target in 2017



The regions of Canary Islands, La Rioja and Navarra forecast reaching a deficit well below the stability target in 2017. The regions of Canary Islands, La Rioja and Navarra forecast reaching in 2017 a deficit of 0.2%, 0.1% and 0.4% of GDP, respectively. AIReF deems likely that Canary Islands will reach this figure, but finds it very unlikely that La Rioja or Navarra will meet their forecasts.

Despite AIReF finding it unlikely or very unlikely that the targets will be met in eight Autonomous Regions, it does however deem compliance with the stability target to be feasible, at -0.6% of GDP in 2017, for the subsector. The budget information prepared by the ARs highlights that the stability target of -0.6% of GDP may be feasible for the Autonomous Regions as a whole, AIReF's central estimate falling slightly above the target (see chart 3). This evaluation has been made on the basis of financing system resources not limited in their amount by the General State Budget extension. Should the final amount of the financing system resources be as notified to the ARs in October last year, AIReF's assessment would worsen from feasible to unlikely.

Graph 3. Forecast for ARs' borrowing requirements (% of GDP)



Note: (*) Balance after deducting non-recurrent operations from 2015

As for the trend in revenue, AIReF forecasts growth above 4% with respect to the estimated level for 2016, maintaining its weight in GDP. It is envisaged that, in the event of an update in the forecasts for revenue from State taxes for 2017, and likewise in the estimates for interim payments of the regional financing system resources pending settlement, growth in these revenues for the ARs overall would exceed 3%. Similarly, AIReF is of the opinion that all other incomes may register an increase of close to 6%, originating largely from the favourable expectations for growth in other tax revenue as well as expectations for greater EU funding.

In the event that the financing system resources are not updated, and the announced level is maintained, the resources forecast for the subsector overall would drop two tenths of a percentage point in weight over GDP, with respect to the weight maintained in 2016, with growth just under 3% with respect to 2016.

Expenditure in the subsector is expected to grow around 3% with respect to 2016, reducing by one tenth of a percentage point its weight over GDP. AIReF's estimate for growth in expenditure is guided by the forecast increase in current expenses of around 3% above the estimate for 2016, due mainly to the trend in healthcare and education expenditure estimated by means of the model developed by AIReF for expenses of this type. Capital expenditure is deemed likely

to grow approximately 6%, partly owing to the greater-than-expected implementation in some regions, of expenditure co-financed by EU funds in 2017.

Setting differentiated stability targets; rigorous implementation of the expenditure rule without consolidating past noncompliance for the future; and the design of a multiyear framework of action in which the Economic and Financial Plans (EFP) play a substantive role, rather than merely a formal one as hitherto, would raise the likelihood of compliance with the set target. On the one hand, last year's experience shows that setting differentiated targets for each Autonomous Region contributes positively to the likelihood of compliance with the target for the subsector, inasmuch as the ARs in a better fiscal position are able to achieve a lower target, in many cases already foreseen in their budgets, rather than exhaust the deficit margin permitted by the target⁸. In particular, it is likely that in 2017 several regions will adopt budget modifications, necessary for adjusting the 0.5% of GDP deficit forecast in their budget to a target of 0.6%.

For the ARs in which the expenditure rule is more demanding than the stability target, strict implementation of the former could help them reach the deficit target set for the subsector, and would serve as a de facto differentiating element. However, the accumulation of cases of non-compliance in previous years, owing to MINHAFP's interpretation of the implementation of this rule, has caused its differentiating potential to practically disappear, in turn greatly diminishing its possible contribution to compliance with the stability target.

Lastly, medium term planning with a realistic path in view, whose lines of action should be embodied in the EFP and given definition in the annual budgets, is essential for the Autonomous Regions furthest from the target to commit to its compliance and for MINHAFP to apply the preventive and corrective mechanisms foreseen in the LOEPSF with due rigour.

With regard to the expenditure rule, it can be seen that, generally speaking, the expected trend in expenditure may hinder compliance with the rule. According to estimates by AIReF, current expenditure developments point to an upward trend that may hinder compliance with the expenditure rule.

⁸ [Report on setting individual targets for the ARs](#)

In addition to this, special circumstances are observed in 2017 that may affect compliance with the expenditure rule. On the one hand, the adoption of measures to reduce revenue (Andalusia, Asturias and Galicia) makes compliance with the rule harder to reach, as it requires the variation in eligible expenditure to offset this loss of income. On the other hand, however, other ARs have adopted measures to increase their revenue (Aragón, Balearic Islands, Castilla-La Mancha, Catalonia and Navarra), which favours compliance by allowing greater variation in eligible expenditure. Finally, the ARs that receive most EU funds (Andalusia, Castilla-La Mancha, Galicia, Extremadura and Murcia), insofar as certification of their expenditure was delayed in 2016 owing to monitoring of the new operational plan, may benefit in 2017 from the transfer of certification to this year, assuming that MINHAFP takes this spill-over into account for calculating the eligible expenditure for this year, a circumstance that the breakdown given in the Report by MINHAFP on compliance with fiscal rules does not disclose.

4. Debt sustainability

Risks to financial sustainability and debt target compliance in the medium and long term vary sharply among the Autonomous Regions analysed in this report, with Catalonia, Castilla-la Mancha, Murcia and Valencia standing out for their very high level of risk, with Extremadura and Balearic Islands just one step behind. Risks to sustainability in the medium-long term are assessed according to the forecast evolution of debt in a baseline or central scenario⁹. The main features in this analysis are autonomous regions' heterogeneity and the general worsening with regard to the previous report¹⁰. In the case of Canary Islands, Castilla y León, Galicia, Madrid and Basque Country (moderately low risk) and Andalusia, La Rioja and Navarra (medium risk) the main long-term challenge consists in staying on track with the fiscal consolidation process. However, in the case of Aragón and Cantabria (moderately high risk), Balearic Islands (high risk) and, especially, Catalonia, Castilla-La Mancha, Murcia and Valencia (very high risk) to the risk of fiscal fatigue we must add the dangers associated with higher levels of debt and relative dependence on State financing mechanisms, which considerably heighten sensitivity to downturns in the macroeconomic and economic environment. Furthermore, in the case of ARs in which very high risks have been identified, the reference level of 13% of GDP established in the LOEPSF is not expected to be reached before 2040 (Extremadura, Balearic Islands) or 2045

⁹ [Report on setting individual targets for the ARs](#)

¹⁰ The above does not include Andalusia, Catalonia and Valencia, where some improvement has been observed, and Galicia and Madrid where no substantial change has occurred regarding last year's report.

(Catalonia, Castilla-La Mancha, Murcia and Valencia), always under the assumption of a central scenario. The above diagnosis is endorsed by the creditworthiness rating, which for the ARs of Catalonia, Castilla-La Mancha, Murcia and Valencia is non-speculative investment grade¹¹.

Regarding the identification of short-term risks, the situations of Cantabria, Catalonia, Extremadura, Murcia and Valencia stand out for their high indicators of fiscal stress, which are in turn compounded by high macroeconomic risks in the case of Cantabria and Valencia. Short-term risks are assessed on both the macroeconomic and fiscal dimensions, in the light of a range of especially relevant indicators. On the fiscal plane, an analysis is conducted of the impact of the cycle and discretionary measures, and the trend in expenditure, among other factors. On the economic side, aspects such as trends in the labour and housing markets are focused on, owing to their important role in regional revenue. Once more, and as in the long-term analysis, a wide diversity of situations is found among the Autonomous Regions. On the one hand, Cantabria, Catalonia, Extremadura, Murcia and Valencia present considerable fiscal risks, which in Extremadura and Cantabria would be smaller if the homogeneous primary expenditure adjusted per inhabitant were similar to the mean. On the other hand, short-term macroeconomic risks have also been identified with a potential fiscal impact in Aragón, Cantabria, Balearic Islands, Canary Islands, Galicia and Valencia.

5. Recommendations

In this report, providing an assessment of ARs' budgetary information for 2017, AIReF puts forward a number of recommendations with a twofold aim: on the one hand, to activate the preventive arm of the LOEPSF, boosting an early response both in each AR and in MINHAFP, and on the other hand, to improve the institutional framework for the establishment and instrumentation of the fiscal rules.

This general section includes the recommendations made to MINHAFP, as these affect all the ARs analysed in this report, and this Ministry carries the responsibility for their implementation. Likewise, this report voices recommendations that are applicable to all the ARs analysed, although any recommendations that involve a specific action to be taken by a given region will be included in that region's individual report.

¹¹ Likewise, it is exclusive of the rating given by agencies assigning a floor to ARs depending on the debt classification issued by the Spanish Treasury, on the understanding that a bail-out is implicit in regional debt.

Recommendations focusing on preventive action under the LOEPSF

AIReF believes that early action must involve a commitment by all the Autonomous Regions, whether or not they present any risk of deviation, to the exhaustive monitoring of the implementation of their budgets. In this sense, and in line with earlier recommendations by AIReF¹², it is deemed convenient that the ARs' general comptroller services should keep up their involvement in early detection of the risk of non-compliance with the fiscal rules. In this manner, AIReF finds that the reports issued by ARs' comptrollers, as required by the temporary measure arising from the stronger conditionality of the FLA 2016, would be insufficient. AIReF's opinion is that in these reports (i) greater stress should be placed on the risk of non-compliance at year-end than on monthly implementation, (ii) this should be made extensive to all the Autonomous Regions, regardless of whether or not they adhere to the regional liquidity fund (FLA), and (iii) ARs comptrollers should alert the regional Government if any risk of non-compliance is detected. Therefore, with regard to the ARs that, following the recommendation put forward in the 2016 budget report, have not informed AIReF that the above mentioned regional monitoring procedure has been implemented (Asturias, Balearic Islands, Canary Islands, Cantabria, Castilla-La Mancha, Catalonia, Extremadura, La Rioja, Murcia), ***AIReF recommends the following:***

The ARs of Asturias, Balearic Islands, Canary Islands, Cantabria, Castilla-La Mancha, Catalonia, Extremadura, La Rioja and Murcia should implement, as soon as possible, the necessary procedure for their general comptrollers services to issue monthly reports on the risk of non-compliance with the fiscal rules at year-end and, should the risk be detected, comptrollers should alert the regional Government to the need to adopt decisions for early correction of any deviations that may arise.

Additionally, for the ARs at high risk of deviation, AIReF believes that MINHAFP should take action, and consequently once again makes use of the procedure provided for in the Act creating this institution and its internal rules and regulations, and requests, as it did on previous occasions¹³, that MINHAFP activate the preventive non-automatic measures in article 19 of the LOEPSF. This is the case of Aragón, Cantabria, Extremadura and Murcia,¹⁴ ARs in which AIReF appreciates a clear risk of non-compliance with the stability target for 2017, as the possibility of compliance is rated as very unlikely. In view of the warning of the risk of non-

¹² Reports on Autonomous Regions' 2016 budget lines

¹³ Report on main lines for 2015 (December 2014) and for 2016 (December 2015)

¹⁴ All these ARs were pending submission and approval of an EFP 2016-2017 due to non-compliance with the stability target and the expenditure rule in 2015. Given that 2016 is finished, these documents are no longer of relevance for correcting the deviation in 2016, and the scenario and measures for 2016 are superseded by the approved budgets for 2017.

compliance and within the term of one month as foreseen in article 19 of the LOEPSF for the adoption of measures, **AIReF recommends that:**

MINHAFP should ask Aragón, Cantabria, Extremadura and Murcia for a multiyear planning document whose level of detail, binding nature and duration should take into account, with due consideration for the specificities of each autonomous region, the following aspects:

- ***the particular situation of each one of these regions as regards their relative position compared to the subsector for revenue, expenditure and normative capacity on taxation;***
- ***the size of the adjustment to be made;***
- ***the relation between the average effort required and the effort actually made in previous years, as shown in chart 1.A "Assessment of effort"; the equity-feasibility trade-off included in the individual report on each Autonomous Region;***
- ***and the sustainability of their debt path and the region's contribution to making it sustainable from the standpoint of the two factors that are most directly dependent on their own actions: their commitment to the consolidation of public accounts and the maintenance of a stable institutional framework.***

This medium-term planning exercise, agreed between the Region and MINHAFP, must be defined in the EFPs submitted to the Fiscal and Financial Policy Council, linked to 2016 year-end, and in the budget implementation for this year.

All analysed ARs except Balearic Islands and Canary Islands have included in their budgetary documentation a forecast for revenue in 2017 from the financing system resources. The forecast figures are greater than the amounts calculated and communicated by MINHAFP last October in the context of a budget extension. AIReF believes that an update may be notified on these amounts and, in fact, has made its assessment on the grounds of this hypothesis. Nevertheless, until it is revealed whether the financing system resources are greater or not than the notified amounts, AIReF believes that budget implementation should be prudent and according to the revenue that is actually being collected. ***To achieve this, AIReF recommends the following:***

While the financing system resources subject to interim payments are not updated with respect to the figures notified by MINHAFP in October, the necessary credit withholdings should be adopted, on the principle of prudence, to match expenditure to the resources actually received.

Recommendations with a view to instrumenting the principle of Financial Sustainability

With regard to setting the debt targets, the current design suffers from several shortcomings. Firstly, it does not guarantee medium- or long-term sustainability of the debt because AIReF observes that compliance with the debt targets that have been set since 2013 has no connection with either the increase in the region's debt or the gap to the long-term reference value of 13% of regional GDP. Secondly, the debt target is not coherent with the budget stability target, nor is there a medium-long term approach guaranteeing a debt reduction path in the event of exceeding the 13% limit, as per article 14 of the LOEPSF. Lastly, the setting of the debt target has not taken into account, explicitly and individually, the impact of the system of financing and the risks deriving from a relative dependence on the financing mechanisms of the State.

To achieve this, **AIReF recommends the following:**

That MINHAFP should design a system for setting the debt targets that fulfils a controlling function over EDP debt, incorporating the following features:

- *setting multiyear targets, proposing credible and demanding paths, compatible with guaranteeing financial sustainability.*
 - *integrating the principle of budget stability and the expenditure rule to guarantee coherence within the preventive framework in the medium-long term.*
 - *comprehensive and differentiated assessment of the point of departure for each AR, paying special attention to the impact of the system of financing and the dependence on the financing mechanisms of the State.*
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Recommendations focusing on improving the institutional framework

AIReF continues to appreciate several aspects with room for improvement that affect the framework for establishing, implementing and evaluating the fiscal rules, that have been highlighted in previous reports.

In particular, regarding the expenditure rule, it is deemed necessary to insist on the need to launch a debate and reflect on certain aspects of this rule. Until such a major debate is launched, regulations should be developed to solve this fiscal rule's specific implementation problems. ***To achieve this, AIReF recommends the following:***

That MINHAFP should set in motion the establishment of working groups within the Fiscal and Financial Policy Council and the Comisión Nacional de la Administración Local (National Local Administration Commission), to reflect and debate on possible modifications to the expenditure rule. Notwithstanding the foregoing, AIReF recommends that MINHAFP should undertake, at the earliest possible opportunity, the necessary development of regulations to solve this fiscal rule's specific implementation problems.
