



Independent Authority
for Fiscal Responsibility

Report on the main lines of Public Administrations' budgets and initial budgets for 2017: Autonomous Regions

14 February 2017

Table of Contents

1. Context for the publication of this report
2. Aim of the report
3. Budget stability target and expenditure rule
4. Debt sustainability
5. Airef's recommendations

1. Context for the publication of this report

- **To report at the initial stages of budget drafting and approval** for early detection of the risk of non-compliance by:
 - ✓ Examining the main lines in order to incorporate any recommendations into the approved budget.
 - ✓ Checking changes incorporated to the approved budget.
- **Regulations and timeline:**
 - ✓ Main lines and draft budgets (article 17.1 LOEPSF): before 15 October
 - ✓ Initial budgets (article 17.2 LOEPSF): by 1 April

1. Context for the publication of this report (II)

Exceptional circumstances in 2016: The presence of a caretaker Government until the end of October and, in addition, regional elections in Galicia and Basque Country.



1) Disruption and fragmentation of the schedule for the publication of reports (in the Autonomous Regions):

- Delay in the report on main **budget lines**.
- Replacement of the report on main lines with the initial budget report (for Autonomous Regions with approved budgets).

2) Budgetary information content:

- The most stringent fiscal rules (-0.5% of GDP), are applied, except in Murcia, Cantabria and Castilla-La Mancha.
- Financing system resources limited by the General State Budget extension:
 - ✓ The budgetary information has not allowed the resources that the Autonomous Regions may eventually receive to be reflected.
 - ✓ AIReF's assessment is conditional on its estimates for financing system resources whose amounts are not limited by the General State Budget extension.

Table of Contents

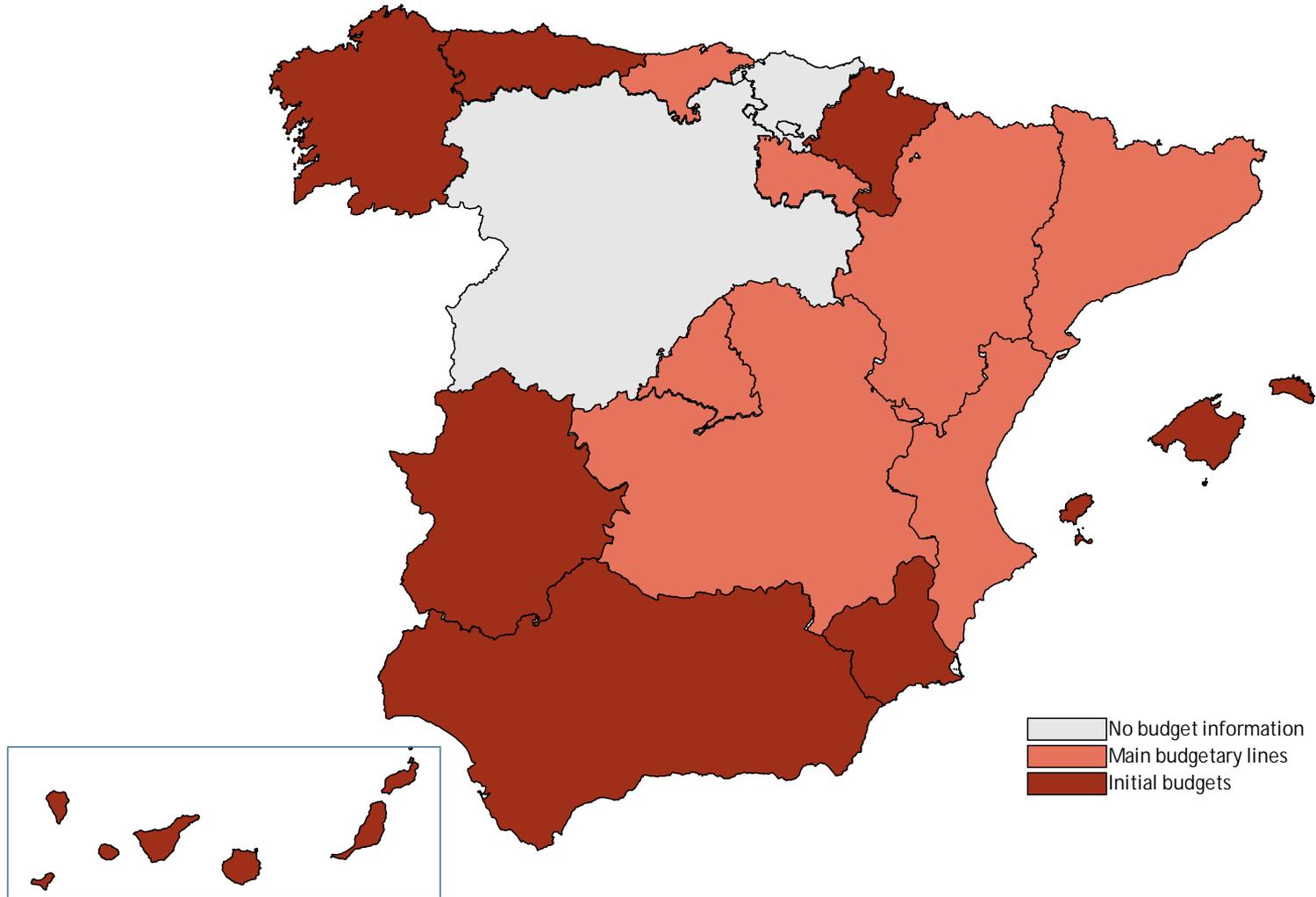
1. Context for the publication of this report
- 2. Aim of the report**
3. Budget stability target and expenditure rule
4. Debt sustainability
5. Airef's recommendations

2. Aim of the report

- **Assess the suitability of the ARs' budgets for compliance by year-end with the budget stability and Government debt targets, and the expenditure rule for 2017, on the basis of information available at the time of issuing this report, namely:**
 - ✓ **Main budgetary lines: 6 Autonomous Regions**
 - ✓ **Initial budgets: 9 Autonomous Regions** (provisional and incomplete submission by Valencia owing to substantial differences in the information submitted)
 - ✓ **No budget information: 2 Autonomous Regions** (pending individual evaluation, but estimated according to the assessment for the subsector)

2. Aim of the report (II)

Information available on AR's budgets



2. Aim of the report (III)

- The scope of the report is limited by available information for:
 - ✓ **Debt target:** no references for measuring compliance
 - ✓ **Expenditure rule:** inconsistencies, loopholes and interpretation discrepancies persist, causing the analysis to be based on estimates
- The assessment incorporates an individual sustainability study for medium- and long-term debt.

Table of Contents

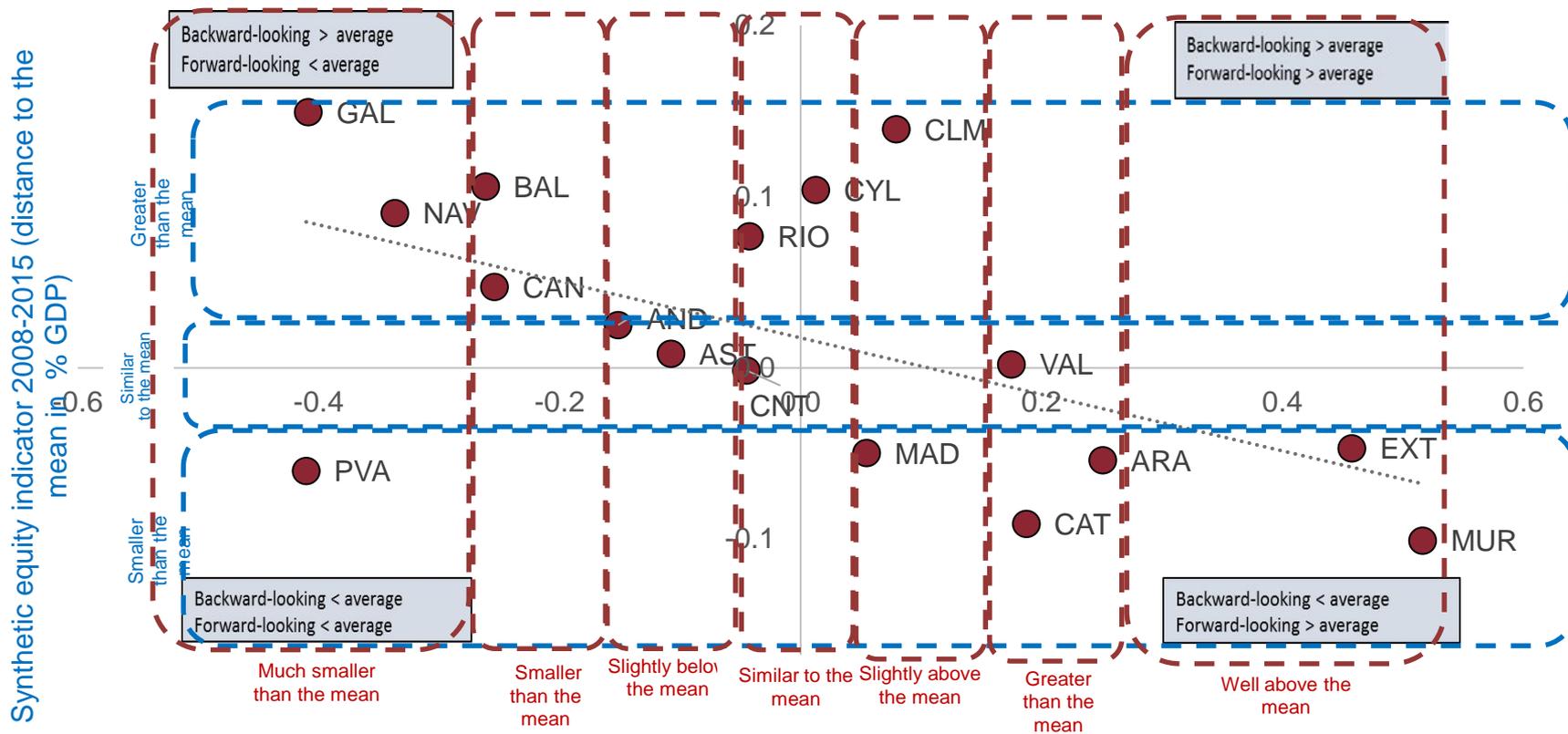
1. Context for the publication of this report
2. Aim of the report
3. **Budget stability target and expenditure rule**
4. Debt sustainability
5. Airef's recommendations

3. Budget stability target and expenditure rule

- Individual assessment of the likelihood of compliance with the target (-0.6% of GDP):
 - ✓ Starting with "feasibility" (effort required in 2016-2017, with regard to the mean, to reach the set target):
 - 5 Autonomous Regions face clear feasibility problems: Aragón, Catalonia, Valencia, Extremadura and Murcia (significantly greater-than-average effort required to comply in 2017) .
 - ✓ And complementing it with "equity" aspects (effort made in 2008-2015 with respect to the mean):
 - Of the 5 ARs mentioned above, only Valencia made an effort similar to the mean while the rest made smaller efforts.
 - The other 2 ARs making a smaller-than-average effort are Madrid and Basque Country (the latter differs in that a smaller-than-average effort is required to comply in 2017).
 - Another 2 ARs, having made greater-than-average efforts in the past, need to continue to strive harder in 2017 (Castilla-La Mancha and, to a lesser degree, Castilla y León).

FISCAL CONSOLIDATION EFFORT REQUIRED OF THE ARs

Equity-feasibility trade-off



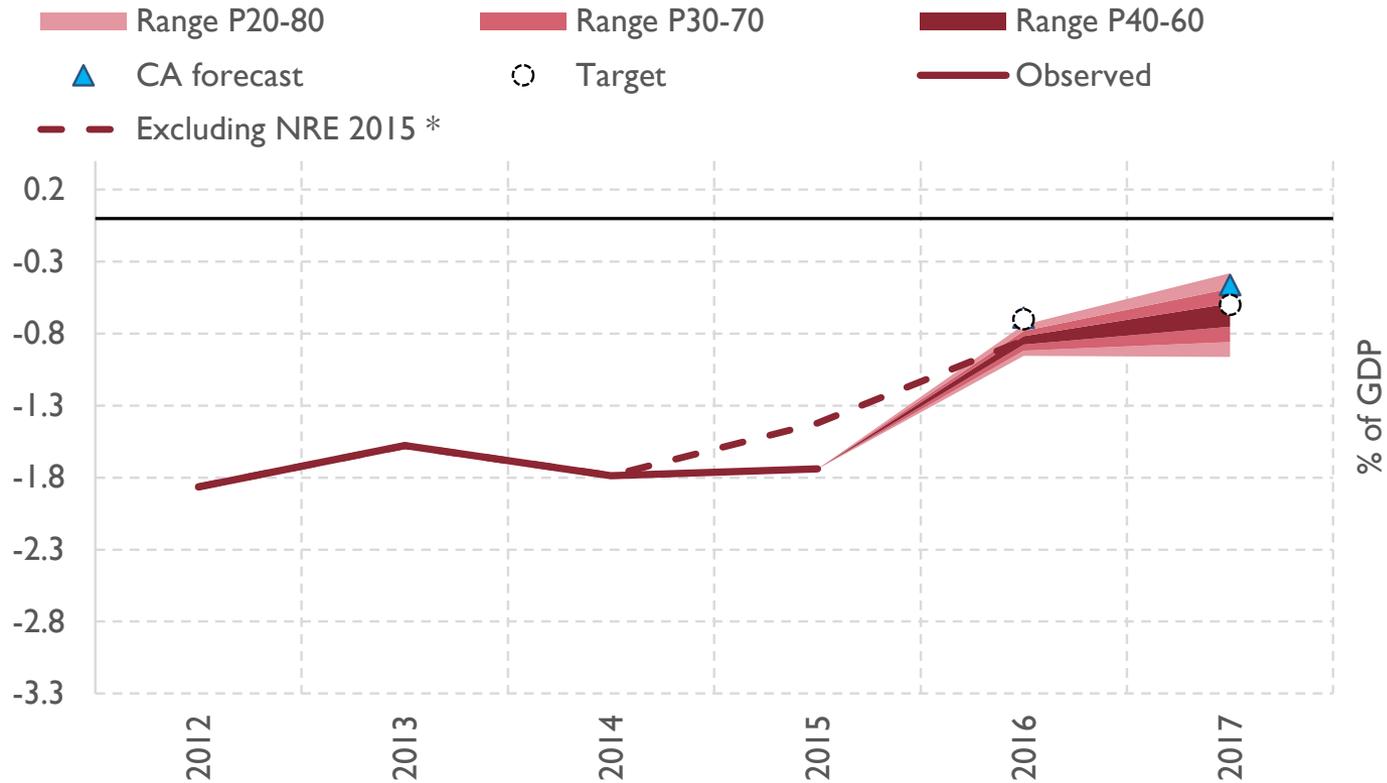
Synthetic feasibility indicator 2016-2017 (distance to the mean in % GDP)

3. Budget stability target and expenditure rule (IV)

- Three ARs forecast a considerably smaller deficit than the target of 0.6% of GDP.
 - ✓ Canary Islands: 0.2% of GDP
 - ✓ La Rioja: 0.1% of GDP
 - ✓ Navarra: 0.4% of GDP
- AIReF only deems it 'likely' that Canary Islands will reach this deficit and 'very unlikely' that La Rioja or Navarra will achieve this figure.

3. Budget stability target and expenditure rule (V)

AIReF deems it feasible that the AR subsector will comply with the stability target in 2017



Based on estimates for financing system resources whose amount is not limited by the General State Budget extension. In the absence of the above estimate for resources, the target is deemed unlikely.

3. Budget stability target and expenditure rule (VI)

MINHAFP's use of tax discipline and fiscal rule design levers would increase the likelihood of compliance with the target for the subsector:

- ✓ **Setting differentiated targets:** aiming for a more ambitious target rather than exhausting the deficit margin allowed by the homogeneous target
- ✓ **Stringent application of the expenditure rule** (without validating past slippages of non-compliance): this would contribute toward reaching the subsector deficit target and serve as differentiating factor
- ✓ **Multiyear validity for EFPs** (realistic path whose lines of action are presented in the EFP and further defined in the annual budgets): commitment to compliance by ARs most distant from targets and strict implementation of corrective measures

3. Budget stability target and expenditure rule (VI)

- Subsector resources: AIReF forecasts growth above 4% with respect to the forecast for 2016, maintaining its weight in GDP but, if the financing system resources are not updated, these would drop two tenths of a percentage point in weight over GDP with respect to 2016, with growth just under 3% with respect to 2016.
- Expenditure in the subsector: this could grow around 3% with respect to 2016, reducing by one tenth of a percentage point its weight in GDP, following a trend marked by an expected rise of approximately 3% in current expenses, compared to the estimate for 2016, based on the evolution in healthcare and education expenditure forecast by AIReF.

3. Budget stability target and expenditure rule (VII)

On the expenditure rule the envisaged expenditure increase (around 3%) appears to be compatible with growth in eligible expenditure of 2.1%, the reference rate set for 2017.

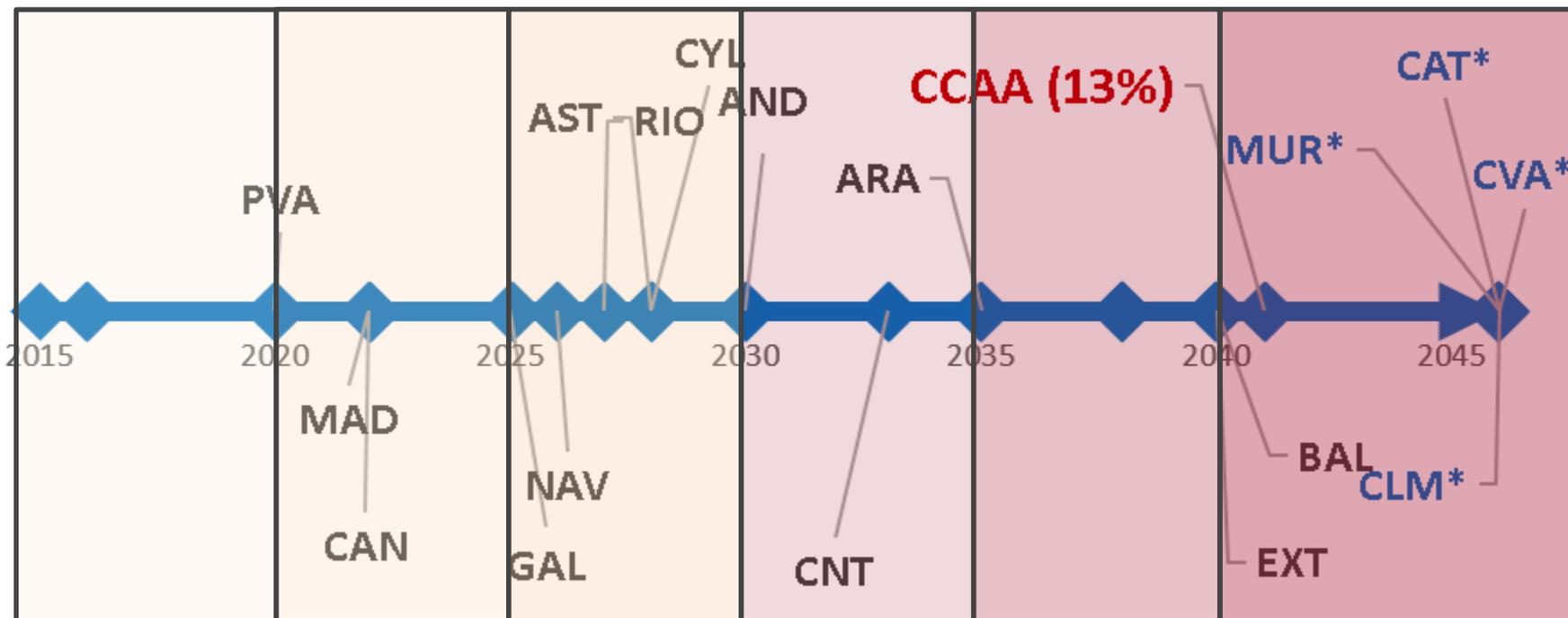
There is some uncertainty associated to:

- the quality of available information: methodology and assessment problems.
- evolution of current expenses that, according to AIReF estimates, are very tight.
- the treatment given by MINHAFP to:
 - ✓ assignment of EU funds that, in 2017, will show the consequences of the slowdown in certification of expenditure in 2016, owing to the implementation of monitoring procedures on the new operational system.
 - ✓ tax measures.

Table of Contents

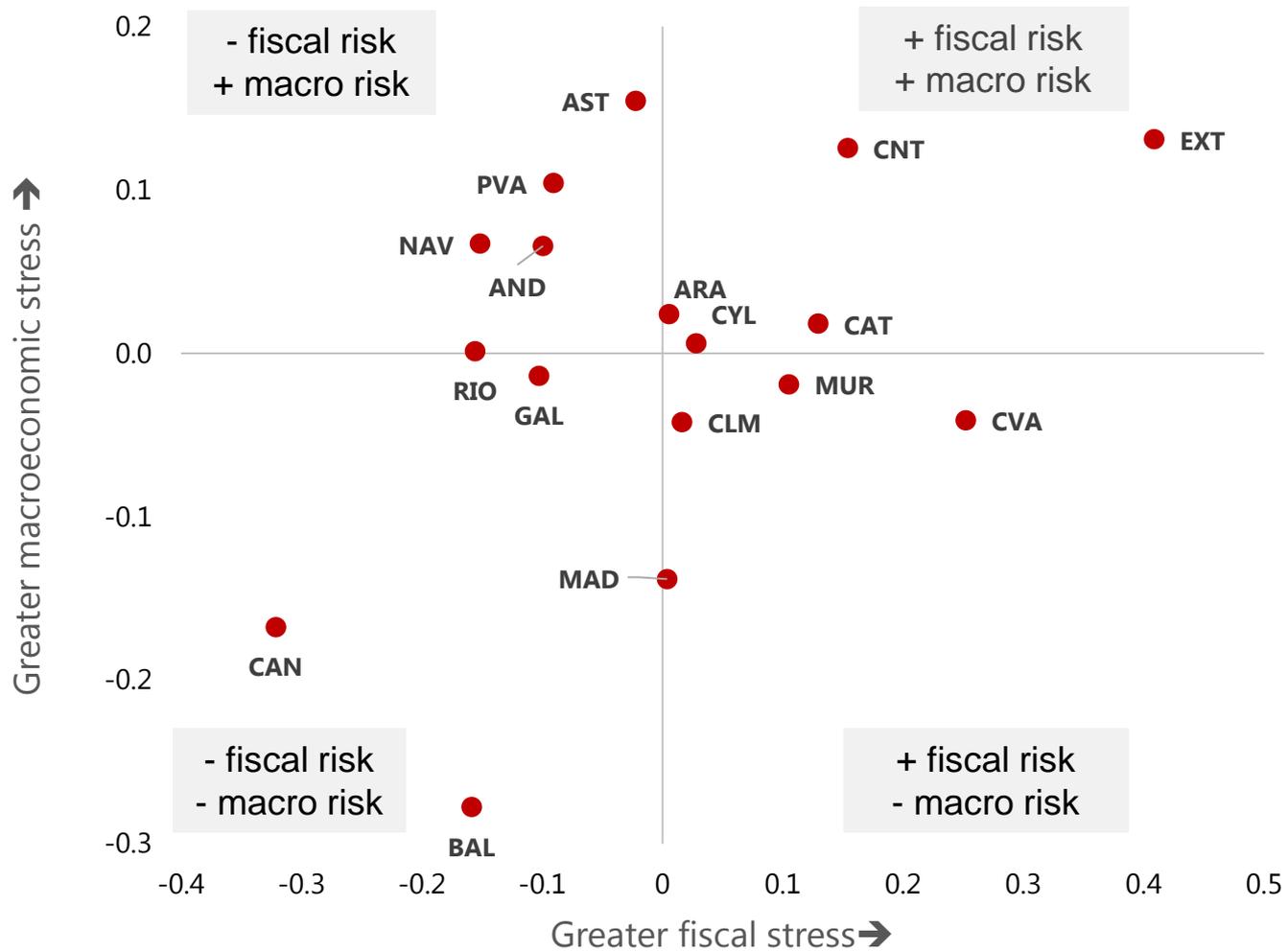
1. Context for the publication of this report
2. Aim of the report
3. Budget stability target and expenditure rule
- 4. Debt sustainability**
5. Airef's recommendations

4. Debt constraints



- **High risks** in BAL and EXT and **very high** in CLM, CVA, CAT and MUR.
- High **dependence** on government financing mechanisms and significant risks in covering their own needs without such mechanisms.
- The main **long-term challenge** consists in staying on track with the fiscal consolidation process. Risk of fiscal fatigue.

4. Short-term risks



HETEROGENEOUS SITUATION . Greater macro-fiscal vulnerability in CAT, CNT and EXT

Table of Contents

1. Context for the publication of this report
2. Aim of the report
3. Budget stability target and expenditure rule
4. Debt sustainability
5. **Airef's recommendations**

5. General recommendations

5.1. Focus on preventive actions

- ARs that have not done so already should implement, as soon as possible, the necessary procedure for their general comptroller services to issue monthly reports on the risk of non-compliance with the fiscal rules at year-end and, should the risk be detected, they should alert the regional Government to the need to adopt decisions for early correction of any deviations that may arise.
- The necessary credit withholdings should be applied so that, in accordance with the principle of prudence, expenditure is matched to the revenue actually received.
- MINHAFP should activate the warning procedure for risk of non-compliance (article 19 of the LOEPSF) in the case of Aragón, Cantabria, Extremadura and Murcia requesting the submission of a multiyear plan.

5. General recommendations (II)

5.2.

Recommendations for instrumenting the principle of Financial Sustainability

- That MINHAFP should design a system for setting 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.

5. General recommendations (III)

5.3. Recommendations focused on improving the institutional framework

- 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 a comprehensive review of the expenditure rule.
- That MINHAFP should undertake, at the earliest possible opportunity, the necessary development of regulations to solve this fiscal rule's specific implementation problems.



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