



Independent Authority
for Fiscal Responsibility

Report

25 July 2017

Report on the setting of individual budget stability and regional government debt targets for the Autonomous Regions 2018-2020

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 contact details:

C/José Abascal, 2, 2ª planta. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Web: www.airef.es

Executive Report

In this report, AIRcF analyses the proposals submitted by the Ministry of Finance and Civil Service (MINHAFFP) on the horizontal distribution of budgetary stability and public debt targets in the Autonomous Regions (ARs) for the period 2018-2020.

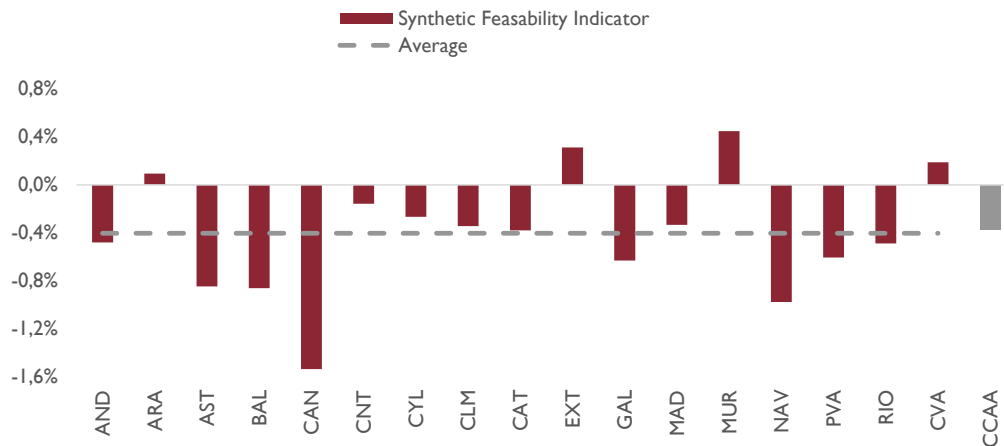
As in previous years, the AIRcF assessment focuses on the first year, 2018, taking 2016 as a starting point, being the last year with available end-of-period figures. The lack of information on the projected evolution of the revenue from the System of Regional Finance (SRF), which affects the whole period under analysis, creates a degree of uncertainty that increases as we move forward in time. Reviews of SRF and the expenditure rule are also expected to take place during the period covered by the proposal.

In terms of the stability target for 2018, set for the Regions as a whole at -0.4% of GDP, AIRcF considers the proposal presented by the MINHAFFP to be adequate. Under this proposal, the ARs would have individual targets equal to that established for the subsector. This assessment rests on the fact that this target is considered feasible for all Regions according to the analysed indicators.

The main criterion followed by the MINHAFFP for the homogeneous distribution of the stability target for the Regional subsector as a whole is that it is feasible. In order to verify the likelihood of each Region achieving their targets, the AIRcF has used the synthetic feasibility indicator¹, already applied in the previous report on setting targets for the ARs, which combines two indicators in line with the ECOFIN conclusions of 6 December of last year. The first of these measures, following European Commission methodology, is the required primary structural effort for 2018 for ARs to reach the proposed target of -1.4%. The second tracks evolution in non-financial expenditure (with some corrections) consistent with targets compliance, supposing that ARs assume same expenditure responsibilities.

According to this indicator, the achievement of a target of -0.4 would require a fiscal structural effort only in four Regions: Extremadura, Region of Murcia, Comunitat Valenciana and Aragón. Based on the effort made in previous years, the required correction for these four regions can be considered feasible, although demanding for the Region of Murcia. At the sector level though, there are signs of some spare fiscal capacity (see the following graph and graph from part 3).

¹ For more information, see the [description of the calculations made and the indicators used](#) in the Report on setting Regional targets of 22 December 2016.

GRAPH. SYNTHETIC FEASIBILITY INDICATOR (% GDP)


Despite agreeing on the feasibility of the Regional subsector achieving the stability target, in this report AIReF makes a series of considerations regarding the presented proposal.

On the one hand, it is contradictory to argue that the setting of equal stability targets for all regions contributes to transparency and monitoring of this target, while also making the assertion that the expenditure rule may be a greater restriction for some of them. If this is so, and it seems obvious that it is, the expenditure rule should be taken into account in setting the stability target, as stated in the Organic Law on Budget Stability and Financial Sustainability (LOEPSF). For the sake of transparency, it should be clear which is the stability target consistent with the expenditure rule. Moreover, according to AIReF forecasts, the implementation of the debt rule would restrict the deficit and could be achieved by almost all Regions but Extremadura and the Region of Murcia (see the following graph and graph 8 from part 4).

GRAPH. BUDGET BALANCE IN 2018 CONSISTENT WITH THE IMPLEMENTATION OF THE EXPENDITURE RULE WITH RESPECT TO THE STABILITY TARGET (% GDP)



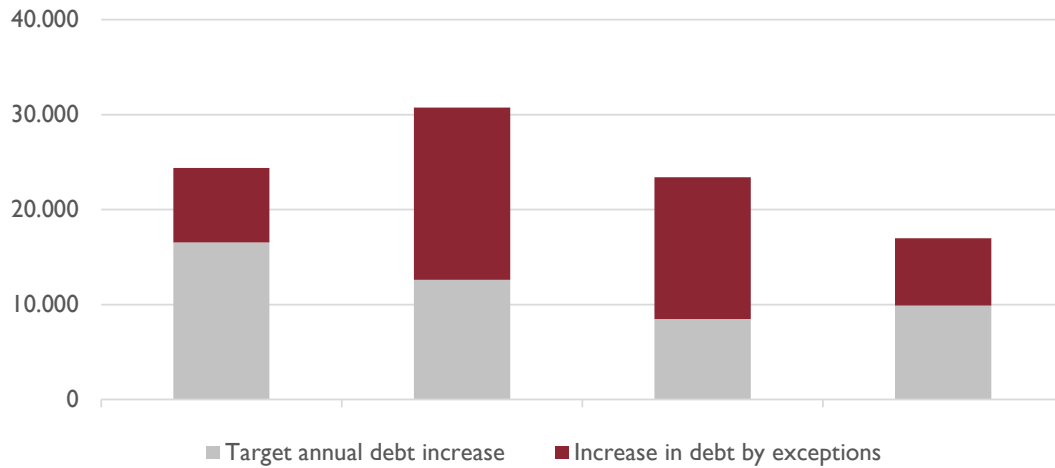
Accordingly, the contribution of the Regional subsector to the fulfilment of Spain's commitments in the 2017-2020 Stability Programme Update (SPU) would exceed the scope of this Report, to the extent that compliance with the expenditure rule, coupled with the announced revenue evolution from the SRF in 2018, could lead the subsector to a situation close to budgetary equilibrium.

On the other hand, the proposal also argues that a homogeneous target for all ARs avoids transferring the discussion on possible imbalances arising from the financing system to the sphere of budgetary targets. AIReF considers impossible to separate the two areas given the impact of the SRF on their deficits.

The stability in expense dynamics, limited by the expenditure rule and the variability of revenue determined by the SRF, greatly hinder the possibility of medium-term fiscal planning in accordance with the principle of financial stability. In this respect, and in this time-frame, an analysis of the debt stability should be included in the proposal, stating the required primary balance to reach the reference level established by the LOEPSF at 13% of regional GDP.

Finally, in relation to the debt targets, the lack of transparency and predictability noted in previous reports continues to be an issue. As the escape clause which allows for targets rectification at year-end is not limited and the amount of these exceptions can be significant (see the following graph, shown in graph 10.0 of part 5)

GRAPH. DEBT INCREASES DUE TO EXCEPTIONS IN RELATION TO TOTAL ANNUAL DEBT INCREASE. TOTAL REGIONAL SUBSECTOR (MILLIONS OF ₪)



In this context, AIReF recommends that the presented proposal should:

- Discuss the restrictions imposed by the implementation of the expenditure rule for many Regions.
- Publish the SRF revenue for the proposal horizon, as well as its distribution by region.
- Append forecasts for 2017 year-end figures.
- Include a methodological explanation and the criteria that supports the setting of a deficit target of 0.4% GDP for each and every one of the ARs, as well as the feasibility of this target.
- Specify the escape clauses of the debt targets, limiting the exceptions to rectify the initial targets at the end of the fiscal year.

Likewise, AIReF recommends that future proposals, in addition to the above, include a medium-term debt sustainability analysis.