

Recommendations issued by AIReF in Q3 2017: Summary

The comply or explain principle is the key tool available to AIReF to fulfil its remit. Under this principle, public administrations must follow the recommendations made by AIReF or explain the reasons why they depart from them. Implementation of the recommendations made by AIReF should give rise to a constructive, transparent dialogue between the independent fiscal institution and the competent levels of government.

In the third quarter (Q3) of 2017, AIReF issued the Report on the expected compliance with the targets for budgetary stability, public debt and the expenditure rule of the General Government (GG) for 2017 and the Report on the establishment of individual 2018-2020 budget stability targets and public debt targets for the Autonomous Regions (ARs). The AIReF also reported on the Economic Financial Plans (EFP) for Andalusia, Aragon, the Canary Islands, Cantabria, Catalonia, Galicia, the Basque Country, Comunitat Valenciana and the Region of Murcia, and issued an updated report on the EFP for Extremadura. In addition, it reported on the initial budgets for Castilla y León and Castilla - La Mancha.

As a result of its assessment, the AIReF issued a total of 29 recommendations to the Ministry of Finance and Public Administrations (MINHAFP) (18), to the Ministry of Employment and Social Security (MEYSS) (1), to the particular Region (30) and to the individual Local Government (16) (as the competent bodies to develop said recommendations)¹.

The majority of the recommendations issued this quarter were aimed at increasing the effectiveness of the General Government fiscal discipline framework contained in the LOEPSF. With this purpose, on the one hand, the recommendations have been aimed at improving the setting and application of fiscal rules, and, on the other hand, there has been a renewed emphasis on the need to promote the effectiveness and gradual nature of the LOEPSF's corrective measures. Likewise, individual recommendations have been issued to the ARs and LGs aimed, basically, at adopting actions to allow compliance with the fiscal rules at the end of the year.

In accordance with the Resolution of the President of the AIReF on the Calendar for the request and receipt of information for the issuance of reports and the follow-up of the recommendations, a letter was sent to the competent entities requesting information on their intention to comply with the recommendations or explain their departure. The AIReF believes a positive dialogue has been established with these letters, since all Administrations have responded, except for the City Council of Palma de Mallorca.

¹ Each recommendation can be directed to more than one administration.

Application of the LOEPSF

The LOEPSF does not regulate a preventive procedure for the Central Administration (CA) similar to the procedure in place for the Regions in the event of appreciating deviation risks, which has been especially relevant in 2017 insofar as it is in that subsector in which the main deviation risks have been observed. For this reason, the AReF again recommended that transparent control of the Regional execution should be articulated through monthly monitoring by the MINHAFP. The Ministry replied that, at present, all available data is published monthly, which permits the Ministry to adequately ensure that it is aware of the risk of deviations at year-end. While the AReF is aware of these publications, it insists on the need for the MINHAFP's evaluations of the Regional execution to be transparent in order to show the effect of the adopted measures on compliance with the targets.

With respect to the Social Security Fund, the AReF again requested that the Toledo Pact Commission identify potential measures aimed at ensuring the financial balance and sustainability of the Social Security System. The MEYSS believed progress was being made both within the Toledo Pact Commission and in the social dialogue between the Government and the economic and social partners, both of which were essential steps to be able to propose and adopt concrete measures.

As for the ARs, the AReF made several recommendations regarding the EFPs, which constitute one of the main corrective measures foreseen in the LOEPSF. During this quarter, the reports on the EFPs were issued together with the individual report on the expected compliance with the 2017 targets of the ARs, as both assessments coincide, except for the Basque Country, whose report on the EFP was issued earlier.

At the Regional level, the recommendations made in relation to the EFPs were directed first to the MINHAFP to review the calendars and deadlines for their preparation, through three actions: (i) publish the report on compliance with the targets immediately after its issuance; (ii) communicate the system revenue forecast; and (iii) advance the approval of the final stability and public debt targets and the reference rate for the expenditure rule. The MINHAFP responded that the report was already being published as soon as possible, but that it would be expedited. Regarding the system revenue, the MINHAFP argued that the only possible forecasts are provided with the information available at that time. Finally, the MINHAFP argued that it was not justified to advance the approval of the targets, since this would mean having an economic and revenue forecast with less information, which could disrupt the necessary coordination between the internal and community regulations. In this regard, the AReF reminds the Ministry that the internal regulations (article 15 of the LOEPSF) establishes that the MINHAFP must submit the target proposals for the ARs prior to April 1 of each year, which would be in line with its recommendation. In any case, the AReF insists that the approval of the EFPs cannot become a mere formality.

On the other hand, the reports on the EFPs include individual recommendations to the ARs that were at risk of breaching the stability target or the expenditure rule in 2017. Regarding expenses, the AReF recommended that the Regions of Aragon, Valencia, Extremadura, the Region of Murcia and Cantabria apply credit withholdings to cover deviations appreciated in execution. Only Cantabria reported that it was applying the withholdings, while Aragon and Extremadura noted that they would assess the opportunity to apply such withholdings if needed. Finally, Valencia and the Region of Murcia did not consider complying with the recommendation, arguing, in the case of Comunitat Valenciana, that it would be difficult to apply this recommendation as it was underfunded, and, in the case of the Region of Murcia, that it was unnecessary due to the fact that the increased revenue from the June approval of the GSB would allow it to compensate for deviations. In addition, the AReF recommended that Andalusia adopt measures to ensure

compliance with the expenditure rule at year-end and review any discretionary spending increase, to which the region responded that it had adjusted the budget scenario included in the EFP, although it did not eliminate the larger expense measures.

On the revenue side, the AIREF recommended that Aragon, Cantabria and the Region of Murcia explore the existing margins in terms of regulatory tax competences. In all cases, the Autonomous Regions responded favourably to exploring or studying this possibility, although the Region of Murcia maintained negative revenue measures in the EFP.

Regarding the Local Governments (LG), in terms of the EFPs, the AIREF reiterated to the MINHAFP that it will arbitrate the necessary procedures to ensure coherence with the limits in the compliance with the fiscal rules between the Adjustment Plans and the EFPs for the same years. In this regard, the MINHAFP reported that these procedures existed for the ARs and reminded the LGs that the plans must be coherent and share the same projections, despite their different time horizons and targets, in line with the AIREF recommendations.

Likewise, it was recommended that all the guardianship bodies of the LGs apply the interpretation of article 25 of the LOEPSF homogeneously, to which the MINHAFP responded that it annually requested from the aforementioned bodies the statistics related to the responses to the requirements imposed on those LGs that, by omitting the approval or through breach of the EFPs, were in the subjective scope of article 25 LOEPSF, and that the data provided was published in the Information Centre.

With respect to the LGs, different recommendations were made individually: the application of article 25 of the LOEPSF for not having an EFP in force for 2017 (Madrid City Council), or for presenting risks of non-compliance with the EFP targets (City Councils of Barcelona and Palma de Mallorca and Diputaci3 de Valencia); the adoption of execution measures to guarantee fulfilment at year-end (City Councils of Valencia, Zaragoza, Bilbao and Gij3, Diputaci3 de Barcelona, Diputaci3 de Sevilla, Island Council of Tenerife and Consell de Mallorca); the streamlining of the 2017 EFP approval process (City Council of Murcia); the adoption of debt reduction measures to reduce the debt-to-income ratio to below 75% (City Council of Malaga) and the monitoring of the fiscal rules to guarantee compliance (City Councils of L'Hospitalet de Llobregat and Valladolid).

Of the responses received, the City Councils of Barcelona, Gij3n, Murcia, M3laga, L'Hospitalet de Llobregat and Valladolid; the Diputaci3 de Sevilla, the Diputaci3 de Barcelona and the Island Council of Tenerife reported compliance or their commitment to comply with the recommendations. The City Council of Madrid approved availability agreements to comply with the EFP forecasts while the contentious-administrative appeal is being resolved. However, both the Diputaci3 de Valencia and the City Council of Zaragoza departed from the recommendations, considering that they do not violate the fiscal rules by deviating from the EFP targets, provided that they are within the general targets set for the local subsector, as the AIREF notes that regarding fiscal rules, the limits to comply with are those set in the EFPs. Finally, the City Council of Valencia indicated that it had adjusted its execution to comply with the expenditure rule and, therefore, it expected to comply, lacking more up-to-date information; and the Consell de Mallorca stated that although it is monitoring the Expenditure rule, it will only be certain of its compliance upon settlement and that, in case of non-compliance, it would follow the legally established procedure.

Budget Stability Targets

In the report on the expected compliance with the 2017 General Government budget stability, public debt and expenditure rule targets, it was recognized that compliance with the stability target was considered feasible for the General Government as a whole, although the situation varied by subsector, as subsectors such as the LGs could end the year with a surplus while others, such as the CA (and to a lesser extent, the SSF) presented high risks of deviation. Consequently, it was recommended that a clear methodology for the vertical distribution of the deficit target be established and published, taking into consideration the financial situation of the various subsectors, providing rigour, realism and enforceability to the establishment and subsequent fulfilment of the stability targets. The MINHAFP response was that article 15.2 of the LOEPSF already indicated a clear methodology for the vertical distribution of the deficit target, and that, in any case, these targets should be consistent with the path set by the European Commission. In this regard, the AIREF notes that article 15 of the LOEPSF only considered formal but not substantive aspects of the distribution of the targets, insisting on the need to make the underlying calculations transparent.

In the report on the establishment of the individual 2018-2020 budget stability and public debt targets for the ARs, the AIREF recommended that the Ministry's proposal include an explanation of the methodology and criteria used to support the setting of homogeneous deficit targets as well as a consideration of their feasibility. The MINHAFP responded that the feasibility of the target was due to the fact that it was less demanding than the previous year while there was greater revenue available from the Autonomous Financing System (SFA). However, it indicated that it would seek to broaden the technical and methodological basis on successive occasions, which the AIREF views positively.

In relation to the above, it was also recommended that the MINHAFP proposal for the distribution of the individual AR targets include the following: (i) the projected SFA revenue for each Region for the target period; (ii) a year-end forecast for the year immediately preceding that period; and (iii) a medium-term debt sustainability analysis. The Ministry promised to take this last recommendation into consideration, noting that the revenue was already being published in the Stability Programme and the monthly 2017 year-end forecast was available on its website. The AIREF highlights the relevance of this information in order to report on the distribution of the targets and specifies that there is no breakdown by region in the Stability Programme and no monthly year-end forecast published by the MINHAFP.

Debt targets

Regarding the AR debt targets, the AIREF recommended to the MINHAFP that when the Autonomous Regions incurred a deficit lower than the fixed stability target, the debt target would be adjusted to the financing needs incurred at the end of the year. The MINHAFP did not consider it appropriate to follow this recommendation, alleging, among other reasons, that the debt target must be consistent with the stability target and that it is formulated in terms of maximums without incentives in the current context in the ARs to exhaust their margin of indebtedness. The AIREF, without questioning that the debt target should be consistent with the stability target, believes that when measuring compliance, debt margins should not be permitted to be higher than the actual financing needs, which would not help to control the debt and, therefore, the effectiveness of this fiscal rule.

On the other hand, the MINHAFP recommended to continue in the direction it began in 2016 and 2017, limiting the exceptions that permit the initial AR debt targets to be corrected. The Ministry responded that it will consider this recommendation, but that it expects that the exceptions will be reduced in the future due to the improvement of the fiscal balances.

Expenditure rule

Regarding the expenditure rule, the AIREF insisted on speeding up the actions necessary for the constitution of the work groups announced to analyse the expenditure rule, and that the specific problems in the application of the rule be immediately resolved. The MINHAFP, in addition to stating that the working groups are being constituted, it recognized that the specific problem of applying the rule to the smaller LGs has been identified and it is reinforcing the insistence and urgency expressed by the AIREF to resolve the practical application problems.

Moreover, MINHAFP was recommended to eliminate the new heading, “Transfers of expenditure capacity from other Public Administrations” included in the questionnaire for the drafting of the Canary Islands EFP, unless it was justified and compatible with the LOEPSF, in which case, it should be included in the “Guide for the determination of the expenditure rule of the Autonomous Regions”. The MINHAFP responded that the heading could not be eliminated, since it covered the transfer of expenditure capacity between Autonomous Regions. The AIREF understands that it is not possible to transfer expenditure capacity and, therefore, only in the event that this concept is compatible with the LOEPSF should it be included for general knowledge in the aforementioned guide for the ARs.

On the individual level, in addition to the above recommendations for the ARs that have an EFP, it is recommended that the Balearic Islands adopt the necessary measures to guarantee compliance with the expenditure rule at year-end and review any discretionary spending increase measures. The region reported that it was monitoring the budget, although it acknowledged that there were methodological issues with the expenditure rule that made it difficult to calculate.

Transparency

The AIREF made two recommendations related to publication in order to increase transparency. First, it recommended that all data necessary for the verification of compliance with the fiscal rules be published, both at the LG subsector level and at the individual level, publishing the main components involved in the calculations. The MINHAFP responded that all available information was published transparently and that this provided adequate control and monitoring of the compliance with the fiscal rules. While the AIREF views this positively, it still believes that the information is insufficient and insists on the need to increase transparency.

Second, MINHAFP was recommended to publish the signed commitments adopted in the meetings with the financial guardianship bodies of the LGs on common fiscal rule application criteria, as well as the actions that are separate from said criteria. The MINHAFP responded that the publication of the agreements would entail the consideration of their content by the political representatives, which could distort their content and purpose and, consequently, reiterated the invitation to the 2017 meeting sent to the representatives of the AIREF.

Spending Review

The Council of the European Union in 2017 urged our country to review spending in order to identify possible areas to improve efficiency in public spending. Therefore, in line with the efficiency principle which inspired the LOEPSF, the AIREF recommended that these review processes implemented by various Public Administrations, jointly or individually, lead to effective efficiency gains and be permanently incorporated in the budget practices. The MINHAFP stated that it shares this recommendation and noted that, at the regional level, the incorporation of the spending reviews into the budget practices would be carried out respecting the margin of autonomy of the ARs.

All ARs have shown interest in collaborating with the AIREF's spending review, being committed to provide the necessary data and participate in the working groups created for that purpose. In addition, the majority of the ARs have explained that measures have already been implemented to improve spending efficiency and, in some cases, to reduce costs. The case of Cantabria is noteworthy, in that it has commissioned the AIREF to complete a study on the viability of its companies and foundations. Also noteworthy is Catalonia, which includes in its budget law for 2017 a spending review process that involves all government departments for the 2017 and 2020 period.