

Assessment of the Kingdom of Spain's Draft Stability Programme Update 2016-2019

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:

José Abascal, 2, 2nd floor. 28003 Madrid. Tel. +34 910 100 599

E-mail: Info@airef.es

Website: www.airef.es

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AIReF must issue a report on the content of the Draft Stability Programme Update (SPU) and decide whether or not it endorses the macroeconomic forecasts in it. The legislation currently in force in Spain stipulates that any macroeconomic forecasts included in the SPU must have a report on them issued by AIReF. That report will state whether or not the forecasts have been endorsed by the independent fiscal institution (article 14, Organic Law 6/2013). Likewise, AIReF must also issue a report on the content of the draft SPU in which it should especially assess the commitments guaranteeing compliance with the budget stability target, the government debt limit and the expenditure rule (article 16, Organic Law 6/2013).

AIReF has now received new documentation allowing it to make an assessment of the SPU 2016-2019, after not having been able to issue the report earlier within the statutory deadline. As explained in the information note it published (available in Spanish only) on 18th April,¹ AIReF was not able to issue and publish these two reports within the deadline set by legislation because of the absence of the content required for the appraisal to be made. The full SPU document is still not available today. On 21st April AIReF received additional relevant documentation on the 2016-2019 SPU that included the associated fiscal projections as well as its macroeconomic scenario. AIReF considers the documentation it has received to be sufficient for it to be able to fulfil the reporting obligation as mandated in Organic Law 6/2013 cited above. This document sets out the key conclusions of both reports under the commitment to confidentiality as regards the forecasts received. The report is accompanied by the mandatory recommendations made by AIReF for inclusion in the final SPU on the basis of the “comply or explain” principle. Once the SPU has been approved by the Council of Ministers for submission to the European institutions, AIReF will publish its full report with specific reference to the figures in it.

AIReF endorses the macroeconomic forecasts in the draft SPU 2016-2019 based on the exogenous assumptions underpinning them and the associated fiscal paths. Specifically, the macroeconomic scenario and growth forecasts for 2016 are deemed likely and seem compatible with the deficit forecast envisaged in the fiscal projections the Ministry of Finance and Public Administrations (MINHAP) has sent to AIReF. The deficit reduction path takes into account the proposal announced by the Government whereby the government deficit would be cut from 5% of GDP as recorded in 2015 to 3.6% of GDP in 2016. That deficit figure would mean a deviation of 8 tenths of a percentage point of GDP from the stability target agreed by Spain in 2013 with the European authorities. Spain's budget stability target for 2016 is 2.8% of GDP. AIReF already published its assessment of that target as extraordinarily demanding because it requires a deficit correction amounting to 2.2% of GDP. Such a reduction is not backed either by the approved budgets or by any information on available measures.

¹[Nota Informativa NO Informe sobre el Programa de Estabilidad 2016-2019.](#)

From 2017 onwards as we move towards the SPU horizon, the fiscal revenue projections contained in it can be deemed conservative, whereas the expenditure path in a scenario with no additional measures seems too restrictive. Although the macroeconomic and fiscal scenario contained in the SPU is likely overall, as we move towards the 2019 horizon projection an increasing number of risks are identified linked to inconsistencies AIReF has detected between the macroeconomic context and the fiscal projections. Firstly, there is an upside risk in the development of the expenditure lines. With the absence of restrictive measures going forward after 2017 and given their historical development and the hysteresis present in the key expenditure lines, AIReF views the government expenditure dynamic put forward in the SPU for the 2017-2019 timeframe as too restrictive and arbitrary. In addition, the materialisation of that restrictive expenditure trend entails, *ceteris paribus*, a short-term cost in terms of lower growth in productive activity, and so generates a downside risk for GDP growth. Secondly, there is an upside risk in the forecast of government revenues. Given the intense cyclical recovery of productive activity and the labour market, the effect on tax revenue as envisaged in the SPU can be viewed as conservative.

To achieve the 3.6% of GDP government deficit target forecast in the SPU in 2016 AIReF estimates that a budget consolidation effort amounting to some €4 billion would be required. AIReF's own estimates put the deficit in 2016 at around 4% of GDP if no other measures are implemented in addition to the ones already included in the initial budgets of the different General Government subsectors. Given that the fiscal revenue projection contained in the SPU for 2016 is viewed as realistic, and taking into account the uncertainty associated with the estimated impact of the cycle on government accounts, what is needed therefore is a supplementary effort to consolidate expenditure amounting to around 0.4% of GDP this year—some €4 billion—in order to attain the 3.6% of GDP deficit forecast in the SPU.

The credibility of the Government's announcement of an agreement on the non-availability of budget appropriations would be reinforced if concrete details of this agreement were given and made public. For 2016 the great majority of the measures announced by the Government are so-called non-availability agreements (AND, *Acuerdos de No Disponibilidad*) that prevent disbursements of approved budget appropriations. For the impact of this measure to be effective, approval is now required for the ANDs that have already been announced for a total amount of around €4 billion. The Government has announced one of these AND measures on the non-availability of approved budget appropriations totalling €2 billion for the Central Government. AIReF has requested—but still not received on the date of publication of this document—the report on the Council of Ministers' agreement underpinning this decision. It needs the report to be able to assess the budget lines the announced measure will apply to and the guarantees established in order to make it effective. AIReF recommends that the agreement should be approved and implemented as soon as possible and that concrete details on it should be given and made public.

The remaining consolidation effort for 2016 could come from the measures announced for the Autonomous Regions. In addition to the effort to be made by the Central Government, an additional consolidation effort of some €2 billion would still be left to be made. No measures have been announced for the Social Security system or the Local Corporations so it would seem this consolidation will come from the Autonomous Regions because measures have been scheduled for them. Within the aggregate estimate made by AIReF of a deficit of around 4% of GDP for the General Government sector as a whole, the deficit corresponding to the regional government subsector might be 0.8% of GDP in 2016. Consequently, if the new reference deficit figure of 3.6% for 2016 is to be lent credibility, in addition to the Central Government AND already announced, other measures are needed for the Autonomous Regions that will bring their deficit down to 0.6% of GDP at least. Thus, the Government's announcement of 0.7% as the reference deficit figure for this subsector does not seem ambitious enough given the forecast development of its revenue and the dynamic of its expenditure.

It would be advisable to set clearly differentiated net lending or borrowing paths for each Autonomous Region. In any event, the size of the consolidation to be made by the Autonomous Regions must take into account aspects such as the development of the regional financing system resources, the impact of the non-recurring operations recorded in 2015 and the implicit government expenditure restraint in order to achieve the forecast reduction. In this regard, the setting of exactly the same deficit reduction path for all the Autonomous Regions represents a risk for achievement of the overall budget stability target and an even clearer risk when it comes to compliance with the expenditure rule. The consequence of establishing the same target for all the regions is that it allows some of them to ease off as regards previously approved budget commitments and forecasts. .

In eight Autonomous Regions strict implementation of their budgets might be sufficient to bring their government accounts balance down below -0.7% of their regional GDP. From AIReF's analysis of the budgets prepared by the Autonomous Regions for 2016 it can be inferred that there are eight Autonomous Regions (see column 6 in the attached table) whose revenue and expenditure budgetary scenario for 2016 and the measures already scheduled or adopted by the autonomous regional governments should generate a deficit that will not surpass the 0.7% of GDP target announced by the Government for the subsector as a whole.

In the case of Andalusia, Asturias, Balearic Isles, Basque Country, Canary Isles, Galicia, Navarra, and La Rioja, if these regions achieve their budgets and the economic impact of the measures already envisaged in some of them is confirmed, an aggregate deficit of around 0.4% of their regional GDP could be achieved. For these eight autonomous regions, therefore, there would be no need to adopt at the current time any non-availability of appropriations measures on their initial budgets.

The budgets currently in force in the other nine Autonomous Regions might generate deficits higher than 0.7% of their GDP, making it necessary to adopt the ANDs announced by MINHAP in order to bring the deficit down to this level. There are nine Autonomous Regions (Aragón, Cantabria, Castilla y León, Castilla-La Mancha, Catalonia, Extremadura, Madrid, Murcia and Valencia) that would have to make an additional adjustment over and above the adjustment already incorporated in their

budgets. According to AIReF's estimates, implementation of their budgets would generate an aggregate deficit of around 0.9% of their regional GDP. To bring down the 0.8% of GDP deficit forecast in AIReF's central scenario by one tenth of a percentage point and so attain the 0.7% of GDP target announced by the Government, the AND required by the Ministry of Finance and Public Administrations (MINHAP) would have to amount to two tenths of a percentage point of GDP (see column 7 in the attached table). These ANDs have to identify the budget lines they will apply to and establish the necessary guarantees to make the measure effective. In addition, they should be incorporated into the corresponding Economic-Financial Plans (EFPs) to be submitted in May. The adoption of these ANDs does not mean in principle for any autonomous region a decrease in the primary non-financial uses compared to the previous year (see column 10 in the attached table). That is in contrast to the large dispersion of variation rates of these uses between the Autonomous Regions if they were all required to achieve a 0.7% of regional GDP deficit with expenditure reductions that might be as much as 2.5% year-on-year and growth rates higher than 7% (see column 11 in the attached table).

A sustained reduction of the government deficit over the next two years requires measures to be taken that are permanent in nature and this cannot be guaranteed by approving ANDs that only have an annual term. This fiscal consolidation must necessarily be sustained if the forecasts in the SPU are to be met. According to those forecasts this deficit in 2017 will fall to below 3% of GDP, which is the threshold set by EU legislation to exit the Excessive Deficit Procedure (EDP). Notwithstanding the need for all the subsectors in the General Government sector to make budget planning a multiyear exercise, those subsectors that have failed to comply with the deficit, debt or expenditure rule targets in 2015 will be submitting an Economic-Financial Plan (EFP) next month in May advancing concrete details on the budget management measures and decisions to be taken in 2016-2017. In any event, once there is a new Government —not an interim government any more— it will need to prepare a new SPU with a medium-term horizon in which a credible commitment to a balanced budget and the sustainability of government accounts can be seen.

A consolidation effort that is sustained over time requires the correct application of the expenditure rule and the consequent revision of MINHAP's interpretation of this fiscal rule. For subsequent years —2018 and 2019— and looking ahead in the medium and long-term, correct implementation of the expenditure rule is crucial. For that to happen, more concrete details and clarification of how it is applied are needed. Recently, MINHAP has made a number of interpretations of the expenditure rule that have contributed to making its application more flexible and in a way have distorted the ultimate purpose of this fiscal rule. These interpretations need to be reviewed and the methodological elements that are necessary for planning, monitoring and assessment of non-compliance with the expenditure rule should be clearly defined. A correct application of the expenditure rule in future years would allow for a fiscal consolidation effort that would be sustained over time and compatible with the moderate growth rates in government consumption that would nevertheless be entailed by weaker economic expansion.

Recommendations:

In line with the explanation given above in this assessment, AIReF recommends:

- Revising slightly downwards GDP growth in 2018 and 2019 if the decision is to maintain the government consumption reduction path included in the draft SPU for those years, which seems too restrictive for a scenario with no normative changes compared to the policies in force in 2016.
- Implementing with sufficient guarantees and publicity the announced €2 billion Central Government non-availability agreement.
- Approving differentiated net lending or borrowing paths for the Autonomous Regions. A single identical target for all the Autonomous Regions would mean a relaxation of the approved budget commitments and forecasts for eight regions (Andalusia, Asturias, Balearic Isles, Basque Country, Canary Isles, Galicia, Navarra, and La Rioja). However, for the nine other regions this common target would require an effort that poses risks for its materialisation, exactly as seen in previous years.
- Taking the necessary steps to guarantee the consolidation of that adjustment in subsequent years and to ensure that the deficit as included in the SPU forecasts will be brought down to below the 3% GDP threshold in 2017.
- MINHAP should review its recent interpretation of the calculation of the expenditure rule in which any expenditure deviations generated each year are deferred for consolidation in the future. Likewise, the methodological elements that are necessary to plan and monitor the expenditure rule and to appraise compliance with it must be clearly defined.



Attached table

Autonomous Regions	As a % of GDP							As a year-on-year % variation			In millions of euros	
	2015 year-end (1)	2015 expenditure not repeated in 2016 (2)	Variation system resources 16/15 * (3)	Measures adopted 2016 (4)	AIReF appraisal rest of budget development ARs (5)	AIReF 2016 central forecast (6) = (1)-(2)-(3)-(4)-(5)	Deficit correction (7)	Forecast with correction (8)=(6)+(7)	Variation primary uses without system payments or 2015 expenditure not repeated in 2016 in line with AIReF central forecast (9)	Variation primary uses without payment systems or 2015 expenditure not repeated in 2016 incorporating deficit correction (10)	Variation primary uses without system payments or 2015 expenditure not repeated in 2016 under a forecast of -0.7% for all the ARs (11)	Estimate (7) of the amount represented by the non-availability agreements (12)
Andalusia	-1,1%	0,0%	1,1%	-0,2%	-0,3%	-0,4%		-0,4%	5,7%	5,7%	7,4%	
Aragón	-2,1%	0,1%	0,5%	0,4%	0,0%	-1,1%	0,2%	-0,9%	1,9%	0,4%	-1,2%	70
Asturias	-1,5%	0,7%	0,5%	0,1%	-0,2%	-0,4%		-0,4%	5,6%	5,6%	7,2%	
Balearic Isles	-1,5%	0,6%	0,4%	0,2%	-0,3%	-0,6%		-0,6%	5,2%	5,2%	6,2%	
Canary Isles	-0,5%	0,0%	0,4%	0,0%	0,1%	0,0%		0,0%	1,8%	1,8%	6,3%	
Cantabria	-1,4%	0,5%	0,4%	-0,5%	0,1%	-0,8%	0,2%	-0,6%	3,1%	2,0%	2,6%	25
Castilla y León	-1,3%	0,2%	0,6%	0,2%	-0,4%	-0,8%	0,2%	-0,6%	2,1%	0,7%	1,6%	112
Castilla-La Mancha	-1,7%	0,1%	0,5%	0,0%	0,1%	-0,9%	0,2%	-0,7%	1,9%	0,6%	0,7%	79
Catalonia	-2,7%	0,6%	0,9%	0,0%	0,0%	-1,2%	0,2%	-1,0%	2,9%	1,3%	-1,0%	426
Extremadura	-2,7%	0,5%	1,1%	0,0%	-0,3%	-1,4%	0,2%	-1,2%	5,1%	4,3%	2,2%	36
Galicia	-0,6%	0,1%	0,7%	-0,3%	-0,2%	-0,3%		-0,3%	3,7%	3,7%	6,0%	
Madrid	-1,4%	0,1%	0,4%	0,0%	0,0%	-0,8%	0,2%	-0,6%	3,1%	0,7%	1,9%	425
Murcia	-2,5%	0,1%	0,9%	-0,3%	0,6%	-1,3%	0,2%	-1,1%	1,4%	0,1%	-2,5%	58
Navarra	-1,3%	0,5%	0,7%	-0,1%	-0,4%	-0,6%		-0,6%	3,3%	3,3%	3,7%	
Basque Country	-0,7%	0,0%	0,5%	0,0%	-0,2%	-0,4%		-0,4%	1,9%	1,9%	4,3%	
La Rioja	-1,1%	0,0%	0,8%	-0,1%	-0,1%	-0,5%		-0,5%	1,7%	1,7%	3,0%	
Valencia	-2,5%	0,3%	0,9%	-0,2%	0,0%	-1,5%	0,2%	-1,3%	4,9%	3,5%	-1,1%	212
TOTAL	-1,7%	0,2%	0,7%	0,0%	-0,1%	-0,8%	0,1%	-0,7%	3,5%	2,6%	2,6%	1.443

* In the case of Navarra, system resources means resources from the estimated agreed taxation revenues from IRPF personal income tax, corporation tax, VAT and IIEE special taxes. In the case of the Basque Country they are the resources from the financing of the Diputaciones Forales.