



Independent Authority
for Fiscal Responsibility

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General Report on the 2018-2019 Economic-Financial Plans of the Autonomous Regions

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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1. Purpose and scope

1.1. Purpose of the report

AIReF must issue a report on the Economic-Financial Plans (EFPs) of the Autonomous Regions that did not comply with the budgetary stability target, government debt target or the expenditure rule in 2017¹. According to the *Report of the Ministry of Finance (MINHAC), of 13 April 2018, on the degree of compliance with the budgetary stability target, government debt target and expenditure rule for 2017*², 12 Regions failed to comply with one or more of the fiscal rules (see Table 1). According to article 21 of the Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF in the Spanish acronym), the non-compliant Regions are obliged to draw up a EFPs to ensure compliance with the rules in 2018 and 2019.

TABLE 1: REASONS FOR SUBMISSION OF THE 2018-2019 EFPs

REGIONS	REASONS FOR SUBMISSION OF THE EFPs		
	Non-compliance with budgetary stability target	Non-compliance with expenditure rule	Non-compliance with public debt target
Aragon	X	X	
Asturias		X	
Castile and Leon	X	X	
Castile La Mancha	X	X	
Catalonia		X	
Extremadura	X		X
Madrid		X	
Murcia	X	X	
Navarre		X	
Rioja		X	
Basque Country		X	
Valencia	X		

¹ AIReF must issue a report on the EFPs prepared prior to their submission to the competent bodies, in application of article 23 of the LOEPySF and article 19 of the Organic Law 6/2013 establishing AIReF.

² [Report on the degree of compliance with the budgetary stability target, government debt target and expenditure rule for \(April 2018\)](#)

AIRcF is responsible for evaluating the EFPs, prior to their submission to the Fiscal and Financial Policy Council (CPFF) or competent body for approval. According to the LOEPySF, AIRcF is responsible for evaluating the EFPs to assess the suitability of their measures and the alignment of their forecasts to the fiscal rules. In the event that AIRcF formulates any recommendations, the Region must reflect it in the EFP by modifying its content or, in the case of not following said recommendation, explaining the reasons for the departure therefrom. Subsequently, once AIRcF has issued the reports, the EFPs shall be forwarded to the CPFF and, in the case of Provincial Communities, to the Joint Commission and the Coordinating Commission of the Basque Country and Navarre, respectively.

Within this evaluation reports are issued on the 2018-2019 EFPs submitted by 11 of the 12 Regions obliged to submit them. At the date of publication of this report EFPs have been received from all of the Regions required to prepare them, except that of Navarre which has informed AIRcF that it has differences with the MINHAC in relation to the 2017 computable expenditure and that, according the resolution of these discrepancies the appropriateness of submitting an EFP will be considered. In this regard, it should be noted that article 17.3 of the LOEPySF provides that, given that the first report (in April) is based on advance data, when assessing compliance with the targets and the expenditure rule a reasonable margin to cover the variations with respect to the second report (in October), where provisional data is used, should be taken into account. However, once the first report (13 April 2018) has already determined the Region's non-compliance without considering these margins of variation with respect to the second report, the LOEPySF does not provide for exceptions or postponements in the submission of the EFPs.

1.2. Scope limitations

There are a number of circumstances that have limited the analysis of the 2018-2019 EFPs:

- **Limitations relating to the analysis of the expenditure rule:** as noted in previous reports, the analysis of the expenditure rule is conditioned by the lack of information on the items that make up the computable expenditure included in the MINHAC reports on the degree of compliance with the deficit and debt targets and the expenditure rule. Despite the fact that the detailed information provided by the Regions has generally improved, the shortcomings that still exist in the information published by the MINHAC in this area (lack of individualised information and changes in annual criteria that prevent having a homogeneous series of computable expenditure) make it difficult to analyse compliance with the expenditure rule.
- **Limitations to the analysis of the debt target:** the limitation originates from the system for setting these targets, according to which there are different clauses, one of which is generic, covering the debt transactions exempted from the targets set for 2018 and 2019. For this reason, the targets initially set are not the ones that will eventually be used to measure compliance, without the possibility of knowing, at the date of

preparation of this EFP or issue of this report, the limit that will actually be in place a year-end. However, the breadth and flexibility of the system for setting these targets has allowed us to make a forecast that is favourable towards compliance.

– **In addition, for 2019 there are other circumstances that affect the analysis of the fiscal rules in this year:**

- **To date, the individual targets and the expenditure rule have not been set for 2019-2021:** The budgetary stability target, debt target and the expenditure rule for 2019 used to prepare the EFP are those initially set for the 2018-2020 period and can be revised at a later date with Government approval of the individual targets for each of the Regions for 2019-2021 and with the setting of the reference rate of the expenditure rule for this same period.

On the other hand, it should be recalled that it is expected that Spain will leave the Excessive Debt Procedure (EDP) in 2018, which means that, from 2019, the rules envisaged in the European regulations for when Member States are in the preventive part of the Stability and Growth Pact will be applied to our country. Among other requirements, from then onwards compliance with the European expenditure rule for the General Government (GG) sub-sector will be required, with a reference rate that the Commission has calculated at a growth in computable expenditure of 0.6% in 2019 compared to 2018³. This reference rate takes the position of the GG with respect to the MTO (medium-term objective) into account, as well as its fiscal position and level of indebtedness. Depending on these variables, the expenditure growth rate is determined in order to converge towards this MTO. Therefore, insofar as Spain has not yet achieved its MTO, which is structural balance, the reference rate is reduced by a margin of convergence, which makes the limit imposed by the European regulation more demanding than that derived from the LOEPySF.

- **The Regional Financing System's (RFS) resources for 2019 have yet to be communicated:** as of the date of preparation of the EFPs and AIRcF's corresponding reports, MINHAC has not reported a forecast of the RFS resources that the Regions under the general tax regime will receive in 2019. This fact, recurring at this time of year, is compounded by the uncertainty arising from the resources that the Regions could receive linked to the reform of the current RFS. Despite this, the estimates contained in the draft EFPs sent, which describe the assumptions on which they are based, were compared with AIRcF's forecasts, made according to its own models on the evolution of State income and the latest information available on the rest of the variables that affect the current RFS.

³ [Proposal for a specific recommendation to Spain from the Commission \(May 2018\)](#)

2. Main conclusions

2.1. Relative to 2018

The EFPs of 8 Regions (Aragon, Asturias, Castile and Leon, Castile La Mancha, Catalonia, Rioja, the Basque Country and Valencia) would allow compliance with the targets and the expenditure rule. In the case of the deficit target, compliance is considered to be very likely for the Basque Country, likely for Asturias and Rioja and for the feasible rest, although difficult to achieve in the case of Castile and Leon and Aragon, although the latter has relaxed the tension a little by adopting an credit non-availability agreement in its EFP. In the case of Valencia the feasibility is conditional upon the justification of the extraordinary revenues expected to be received in the year from settlements of healthcare concessions of previous years. Given the relevance of such income, which have meant that the likelihood of compliance has gone from unlikely to feasible, it is recommended that Valencia includes the detail of this information into its EFP in order to assess the possibility of effective realization of the income indicated.

In relation to the expenditure rule, there is no risk of non-compliance for Aragon, Castile and Leon and Rioja and it is considered that there is a moderate risk of non-compliance for the other Regions.

Finally, compliance with the debt target is considered possible for all of them.

However, the EFPs of 3 Regions (Madrid, Murcia and Extremadura) would not allow compliance with the targets and/or the expenditure rule. It is considered unlikely that the Regions of Murcia and Extremadura will comply with their deficit targets and for Madrid there is a high risk of non-compliance with the expenditure rule. In the last report on the initial budgets dated 3 May all these Regions had already been warned of these possible non-compliances, recommending the first two to use fiscal levers in order to continue to progress in the deficit reduction process and, in particular, the monitoring of expenditure execution. In the case of Madrid, it was recommended to design immediate correction mechanisms against possible deviations in the expenditure rule that would complete the Region's current monitoring systems and to incorporate them into the EFP. However, the actions envisaged by these Regions in their EFPs are not considered sufficient to allow compliance:

- Murcia included credit withholdings. This measure, although it would not enable compliance with the deficit target, slightly contributes to reducing the distance towards compliance.
- In Extremadura, the net impact of its measures has little effect on its fiscal situation.
- On the other hand, Madrid has included information on the current expenditure control mechanisms into its EFP, which comply with the recommendation made in previous reports.

Finally, compliance with the debt target is expected for all of these Regions, including for Extremadura which failed to comply with the target for 2017. In this case, correcting the deviation does not require any additional adjustment as it was due to a temporary mismatch in the debt increases which can be exempted for the purposes of compliance, which does not affect 2018.

AIRcF has made recommendations to these three Regions in their individual reports on the basis of the fiscal situation of each. The different fiscal situation of these Regions would make it possible to differentiate between two groups: on the one hand, there would be the Regions of Extremadura and Madrid for which it is considered possible to implement actions that would allow compliance with the deficit target or the expenditure rule and, on the other hand, there would be Murcia for which the distance to compliance with the stability target makes it unfeasible to achieve such compliance in the horizon of the EFPs and even in the medium term. With regard to the first group, the recommendations are directed towards compliance with current targets, either through the implementation of corrective actions envisaged in the expenditure monitoring system provided for by the Regions (Madrid and Extremadura) or by including adequate and sufficient information to support the operations of higher income reflected in its scenarios (Extremadura) in the EFP. With regard to Murcia, it is considered that the current EFP does not allow compliance with the fiscal rules in the Region and it is understood that the correction of the situation requires joint and complementary actions of the MINHAC and the Region. For this reason, it is recommended that Murcia avoid fiscal policy actions that might hinder compliance with the fiscal rules, without prejudice to the fact that, at the same time, it is recommended that the MINHAC set a path of realistic targets for this Region.

In general, the evaluation of the EFPs has not led to substantial changes in the assessment of the level of compliance with the fiscal rules with respect to that indicated in the last report on the initial budgets. With the exception of Valencia, as indicated above, the inclusion of measures and greater information in the EFPs of the Regions that have implemented additional actions to those envisaged in the budget has only meant that the risk of non-compliance with the deficit target (Aragon) has been lessened or the distance towards compliance (Murcia) has been reduced slightly. In all cases, except in Valencia, there is no substantial change in the assessment of compliance with the targets or the expenditure rule, keeping the same rating of probability of compliance as that assigned by AIRcF in the last report on the initial budgets for 2018⁴ issued on 3 May⁵.

⁴ [Report on the initial 2018 budgets of the Autonomous Regions](#)

⁵ Of the Regions with EFPs, Madrid is the only one whose rating of probability of compliance with the deficit target has changed in relation to the above-mentioned report on the initial budgets. However, this change did not arise from the information in the EFP, but rather the execution data analysed until March, as highlighted in AIRcF's latest publication on the monthly monitoring of execution data (March data).

2.2. Relative to 2019

The existence of uncertainties in the information relating to 2019 prevents AIRcF issuing an opinion on compliance with the fiscal rules in this year, except for the Basque Country. According to the limits noted above, there are significant uncertainties in the information available for the second year of the time horizon of the EFPs for the Regions under the general tax regime, which prevents AIRcF issuing a conclusive opinion on compliance with the deficit target and the expenditure rule and, in the event of observing deviations, on the actions to be taken in 2019. Only in the case of Valencia, whose 2019 forecasts record a growth in expenditure that entails a rate of change of computable expenditure well above the reference rate of the expenditure rule set to date, is it recommended to revise the scenario and the measures envisaged for 2019 in order to include forecasts that fall within the limits arising from compliance with the fiscal rules. In the case of the Basque Country, given that the limitations are not as significant, AIRcF issues an opinion on 2019, whose rating is similar to that of 2018, considering compliance with the stability target to be likely, and simultaneous compliance with the expenditure rule to be feasible, for which moderate risks of non-compliance are observed. On the other hand, compliance with the debt target is expected for 2019 for all of the Regions, meanwhile the flexibility of the current target setting system is maintained.

Without prejudice to the foregoing, AIRcF has analysed the forecasts of the Regions under general tax regions for that year and, in general, has observed discrepancies in the income and/or expenditure trends. The differences between the estimates made by the Regions in the EFPs and those estimated by AIRcF can be observed in both income and expenditure:

- **In income, the are mainly centred around the RFS resources that the Regions will receive.** AIRcF's estimates reflected the effect that the VAT Immediate Information System (IIS) will have on the 2017 settlement of the RFS resources to be used in 2019. The impact arising from the implementation of the new VAT management system amounts to approximately 2 billion less income to be received by the Regions in 2019 compared to what they would have received had this new system not been implemented (see Box 1). With the exception of Catalonia, which does take into account this effect in its EFP, the regional forecasts analysed are higher than AIRcF's forecasts.
- **In expenditure, the differences are mainly due to the expected evolution of current expenditure.** AIRcF generally forecasts higher expenditure growth than that forecasted by the Regions in the EFPs, mainly due to a greater effect of the Agreement with the Trade Unions from March than the Regions and due to the estimates for healthcare and education expenditure consistent with AIRcF's model.

From a time perspective, it can be seen that the Regions' behaviour relating to compliance with the stability target is strongly conditioned by the RFS resources and the rigidity of regional expenditure. The individual reports on the EFPs included an

estimate of the evolution of the Regions in deficit terms in a medium-term horizon. It is noted that compliance is closely related to the evolution of the RFS resources and for this reason, it is estimated that in 2019, which is when the RFS resources are affected by the VAT IIS, the Regions would not comply with the deficit target, but they could rectify the situation in the following years⁶. As noted by AIRcF in previous reports⁷, in the case of the Regions, the lack of flexibility of regional expenditure against annual variations in financing means that the assessment of the fiscal situation can change from year to year without a change in behaviour in the Region that would make it deserving or undeserving of fiscal discipline measures.

⁶ All the Regions with the exception of Murcia

⁷ [Report on expected compliance of the GG of July 2017](#).

VAT IMMEDIATE INFORMATION SYSTEM

What is it?

It is a new VAT management system which was approved by Royal Decree 596/2016, of 2 December, with effect from 1 July 2017, by which mainly large companies must provide all their billing records to the Spanish Tax Agency (AEAT) almost immediately (within four days) through Electronic Headquarters. On the other hand, it allows collaborating entities to present and enter their self-settlements 10 days later than other entities, i.e. the deadline changed from the 20th to the 30th of each month.

What effect has it had on collection?

VAT revenues realised from the 21st of each month are not accounted for this month, but rather for the next month. This means that, for any given year VAT revenues for that year are those entered from the 21st December of year n-1 until the 20th December of year n.

With the introduction of the VAT IIS, the deadline for entry is extended from the 20th to 30th of each month, which meant a shift effect for declarations relating to the November VAT. With the previous system these declarations would have been entered in 2017 but with the IIS they were entered in January 2018 (approximately 4 billion). This shift has meant that in 2017 only 11 months' VAT were entered instead of 12 (VAT declarations from December 2016 to October 2017).

What is the impact on the deficit and the treasure of the Public Administrations?

The establishment of the VAT IIS affects the resources in cash and accrual terms (national accounts) of the State and of the Regions:

- **In 2017** The State and provincial councils^[1] had 11 months of collection available in cash terms (due to the effect of shift noted above). However, in accrual terms, they were not affected by the VAT IIS because the income corresponding to the year's accrual is recorded in the national accounts (declarations from January to December of the year regardless of income) and, therefore, a national accounting adjustment was made for the monthly amount entered for 2018 as the accrual corresponded to 2017.

On the other hand, the Regions under the general tax regime received 12 months worth of collection as the instalment payments of the RFS are calculated based on the initial budget forecast for cash and this is carried out without taking the effect of the IIS into account, given that the reform was approved after its calculation.

- **In 2019:** when the final settlement of the 2017 RFS is made, as the VAT transfer is calculated on the real cash collection, this monthly amount would be adjusted by a greater amount, which means that the Regions will receive 2 billion less revenue from the State, which will result in a greater deficit and less cash for the Regions and, conversely, the State would record a lower deficit and greater cash in this same amount.

[1] The provincial councils are in the same case as the State as they are not part of the RFS.

3. Recommendations to the MINHAC

3.1. Budgetary stability and expenditure rule

In the report published on 3 May on the initial budgets of the Regions, it became apparent that the mismatch of the targets between sub-sectors is reproduced at the individual level by Regions, where it is observed that in 2018 the expenditure rule is more restrictive than the stability target set for many Regions while there are still Regions experiencing difficulties in closing the gap to the target. This situation in 2018 seems to be replicated in the medium-term perspective. In this way, ignoring the forecasts for 2019, affected by the impact of the VAT IIS on system resources, it is noted that for many Regions compliance with the expenditure rule would lead to more stringent balances than the targets set to date. In light of this situation, it is noted that for some Regions compliance with the targets seems difficult given their fiscal situation. In this sense, consideration of expenditure rule in setting the targets could facilitate the establishment of achievable paths that encourage efforts in this direction.

Non-compliances with the expenditure rule in 2017 accompanied by comfortable compliance with the stability target means that the rule did not act as a de facto effective limit.

In response to these considerations, it was recommended that the MINHAC, in line with what was stated in AIReF's previous reports on setting individual targets, should take into account the expenditure rule when setting said targets. This recommendation is not reiterated as it is awaiting a response from the MINHAC.

In this line, given the fiscal situation of Murcia, AIReF made a specific recommendation in this regard. The distance observed in AIReF's forecasts for the Region in relation to the current targets set, both in 2018 and in the medium-term prospects, makes it necessary to implement joint and complementary actions between the MINHAC and the Region, to progress with the necessary fiscal consolidation process. In the current circumstances, AIReF believes that the development of an effective EFP for Murcia would necessarily entail setting a realistic target path, without prejudice to the requirement held by the region to make a clear commitment that would lead to the implementation effective actions aimed at compliance with the fiscal rules.

As a result, AIReF **recommends that MINHAC should:**

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1. ***Take into account the situation of Murcia in order to set a realistic target path so that an economic plan - financial with a feasible scenario can be developed.***
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3.2. Transparency

Background

For the planning of appropriate measures and paths adjusted to the fiscal rules, the biannual framework implemented by the EFPs requires realistic scenarios for the two years that they cover. The development of these scenarios requires complete, up-to-date information on the targets and the main revenue and expenditure headings. In this sense, the absence of a homogeneous and transparent forecast for the system resources to be received in the second year of the plan or the definitive targets that will be in place that year reduces the ability to forecast and analyse the data relating to this year, as already noted in previous reports on the EFPs. This is in addition to another set of circumstances highlighted in the first section of the report, which limit AIRcF's analysis of the forecasts of the plans, some of which, referring to the expenditure rule and transparency, have been included in recent reports as recommendations to the MINHAC, and that are not reiterated as such as they are pending response, although this necessity is still noted: the publication of both the individual detail of the elements taken into consideration for the calculation of the computable expenditure and the homogeneous series of computable expenditure; and updating the guide for calculation of the expenditure rule and making the methodology to be followed in the measurement of the rule transparent in advance.

Reason for reiteration: not following the recommendation

In the report on the 2017-2018 EFPs it was recommended that MINHAC should bring forward certain processes and information to facilitate the preparation of the plans. In this sense, the publication of the report on compliance with the fiscal rules for 2017 has been brought forward with respect to other years, which has allowed the preparation of the EFPs. However, it was also recommended that the MINHAC provide an updated forecast for system resources for the years included within the scope of the EFPs and to bring forward the approval of the targets and the reference rates for the expenditure rule that will be in place in the years of the plan. The MINHAC responded, with regard to the first matter, that they provided the only forecasts possible with the information available at that time and, with regard to the second, that bringing forward the target approval process would mean having a forecast with less information which could break the coordination between domestic deadlines and those of the European semester. However, AIRcF understands that the preparation and analysis of the plans would be facilitated by a homogeneous forecast for all Regions, even with provisional information, of the financing system resources and the targets toward which the EFPs should be directed.

Therefore, AIReF *reiterates the following recommendations to the MINHAC:*

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1. *To bring forward the notification of essential information that would help the Region prepare the plan within the deadline set, reducing the current uncertainties, which would entail among other actions, the following:*
 - a. *Communication to the Regions, at the time of preparation of the EFPs, the forecast for system resources for the years included within the scope of the EFPs.*
 - b. *Bring forward, coinciding with the preparation of the EFPs, the process of approval and distribution of the definitive budgetary stability and government debt targets and the definitive reference rate for the expenditure rule for the years included within the scope of the EFPs.*
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The President of AIReF



José Luis Escrivá