

EXECUTIVE SUMMARY ON THE  
REPORT ON BUDGETARY  
EXECUTION, PUBLIC DEBT AND  
THE EXPENDITURE RULE





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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## EXECUTIVE SUMMARY

The purpose of this report is to analyse the budgetary execution, public debt and expenditure rule of the different Public Administrations (PAs) in 2020. AIReF had previously analysed the situation of the PAs in the context of the current COVID-19 crisis in the Report on the Stability Programme Update (SPU) 2020, published in May. However, this is the first time since the beginning of the crisis that this institution has given its opinion on the situation of each of the Regions and Local Governments (LGs) subject to individual monitoring.

On this occasion, AIReF is updating its macroeconomic and fiscal forecasts in a context that is still highly uncertain, both in the healthcare field and in the economic and fiscal spheres. Although the hardest part of the health crisis has been overcome and the de-escalation of the lockdown has been completed with the end of the state of alarm, the health crisis still persists with strong uncertainty about its future development and its repercussions on economic activity and the activity of the PAs. For this reason, it is not possible to resume AIReF's traditional approach of assessing the probability of compliance with the targets, therefore the analysis framework initiated in the previous report with two alternative scenarios is maintained. These scenarios offer an overview of the main variables which, in the current context, are still difficult to quantify, but help to identify the channels of transmission of the crisis, which is essential for designing measures and strategies.

For this report, AIReF has considered the data published on the economic situation, the budgetary execution of almost the entire first half of the year, the new measures approved by the governments, the information provided by each of the administrations and the data sent by the Ministry of Finance with a bearing not only on the result of the Central Government (CG), but also on that of the rest of the sub-sectors.

### **How has the macroeconomic scenario evolved?**

AIReF has updated the macroeconomic scenario for the period 2020-2021 published in May. In line with many other national and international

institutions and organisations, AIReF has lowered its estimates for the contraction of economic activity in 2020 to a fall in GDP of between -10.1% and -12.4%, depending on the duration of the pandemic, compared to the previously estimated -8.9 and -11.7%. This revision is mainly due to the greater contraction of GDP estimated for the second quarter of 2020, due to the adverse evolution of some activities of high importance in Spain's productive structure, which continue to be very negatively affected by social distancing measures and the decline in international tourism flows.

An incomplete and moderate recovery is expected in 2021. The need for social distancing measures to remain in place until an effective drug or vaccine is available, together with other factors such as the predominance in the productive structure of activities with greater social interaction, the seasonality of employment and a business demography with a greater number of small and medium-sized enterprises that are more vulnerable to financing difficulties, mean that a moderate recovery can be expected. And all this in a context where the pandemic is still spreading globally, which will undoubtedly affect the speed of global recovery. At the national level, the scenario of continuous outbreaks may end up affecting the confidence of families and companies, hindering the reactivation of consumption and employment.

### **How has AIReF changed its budgetary scenarios?**

AIReF estimates a PA deficit of 11.9% for 2020, which could reach 14.4% if the most adverse scenario materialises. With respect to the previous report, AIReF has increased its deficit estimate by 1% in scenario 1, mainly due to new measures approved by governments, and, to a lesser extent, to the revision of macroeconomic forecasts. The revision is smaller in the more adverse scenario, 0.6% of GDP, and is essentially due to the new measures.

Since the publication of the previous report, governments have continued to approve new measures or extend existing ones to mitigate the effects of the COVID-19 crisis, resulting in a deficit increase of 0.8% or 0.6% of GDP depending on the scenario. These measures include the Central Government's approval of the Minimum Living Income, the extension of the validity of ERTes (*Expediente de Regulación Temporal de Empleo* - Temporary Redundancy Plans) and the extension and reformulation of benefits for the self-employed. Likewise, the territorial administrations have also adopted new measures and the estimate of the impact of the crisis on health expenditure has been updated.

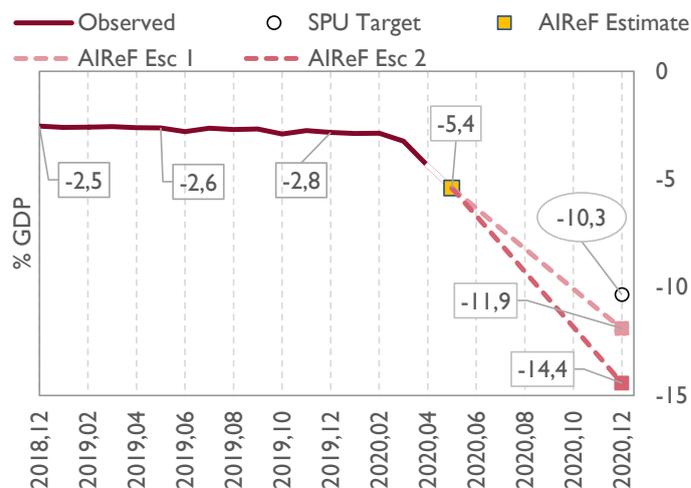
The revised macroeconomic scenario entails a further deterioration of the deficit by 0.2% of GDP in scenario 1. On the one hand, the lower projected GDP implies an increase of the deficit's weight over GDP by 0.1 % due to the reduction of the denominator. On the other hand, revenue projections have

been revised downwards in line with the new scenario and with the collection data known to date, while the forecast of a further fall in employment has meant that unemployment expenditure has been revised upwards. In scenario 2, the downward revision of GDP has a composition with varying effects on fiscal variables, so there is no increase in the deficit despite lower projected growth.

PA revenue will be 40.3% of GDP in 2020 if either scenario materialises. This is an upward revision compared to the previous report because, according to the information published by the General Intervention Board of the State Administration (*Intervención General de la Administración del Estado - IGAE*), the exemption from social contributions granted by ERTes and for the self-employed are not considered to be lower revenue in the national accounts, but rather higher expenditure on subsidies. Excluding this accounting effect, revenue has been revised downwards by 0.2% of GDP in scenario 1 since the last report, while it remains unchanged in scenario 2. Personal Income Tax (PIT) collection is performing better than expected, but it does not offset the downward revision in Value Added Tax (VAT), Corporate Income Tax (CIT) and Special Taxes resulting from the published performance data and the incorporation of the review of the macroeconomic scenario.

Meanwhile, PA expenditure will reach 52.2% of GDP in scenario 1, rising to 54.8% in scenario 2. In addition to the aforementioned effect of accounting for exemptions from social security contributions as expenditure on subsidies, the new measures approved and the increase in the estimate of the impact of COVID-19 on health expenditure in the Regions have also raised the expenditure forecast.

#### GENERAL GOVERNMENT NET LENDING/BORROWING (% GDP)



### What changes have occurred at the sub-sector level?

The distribution of the impact of the COVID-19 crisis by sub-sectors has changed substantially since the publication of the previous report, with the CG assuming part of the deterioration suffered by other sub-sectors by means of transfers. On the one hand, the Government has approved additional transfers to the Social Security Funds (SSF) in the amount of €15.7 billion. On the other hand, it has also approved the COVID-19 Fund for Regions in the amount of € 16 billion.

Thus, AIRcF estimates an increase in the CG deficit of between 3.2% and 2.7% to reach 7.7% in scenario 1 and 8.3% in scenario 2, mainly as a result of transfers and, to a lesser extent, the downward revision of tax revenue. For its part, the deficit of the SSF, despite the transfers already approved, will be between -3.9% and -5.1% of GDP, also reflecting the impact of the new measures approved. The Regions' deficit estimate has also been reduced, although to a lesser extent than the new transfers due to the higher estimated health expenditure and the new measures approved.

**NET LENDING/BORROWING BY SUB-SECTORS (%GDP)**

	2019	Scenario 1		Scenario 2	
		SPU report	Current	SPU report	Current
<b>PAs</b>	<b>-2.8</b>	<b>-10.9</b>	<b>-11.9</b>	<b>-13.8</b>	<b>-14.4</b>
<b>CG</b>	-1.3	-4.5	-7.7	-5.6	-8.3
<b>SSF</b>	-1.3	-5.0	-3.9	-6.1	-5.1
<b>Regions</b>	-0.5	-1.5	-0.4	-2.0	-0.9
<b>LGs</b>	0.3	0.0	0.0	-0.1	-0.2

### What are the implications from the point of view of sustainability?

The update of the macroeconomic and fiscal forecasts does not substantially change the conclusions of the previous report on the sustainability of public finances. AIRcF predicts a 22.1-27.7% increase in the debt-to-GDP ratio in 2020. This means the debt-to-GDP ratio will be between 117.6 and 123.2% GDP in 2020. The primary deficit will be the factor that contributes most to this increase. Although current economic prospects are surrounded by an unprecedented uncertainty, its high impact on debt levels is certain. The COVID-19 crisis will cause a sharp and, in principle, temporary, increase in the public deficit, which in turn will lead to a permanent increase in the debt-to-GDP ratio. The starting fiscal position represents an added difficulty in facing the challenges posed by the crisis. AIRcF simulations indicate that even assuming an annual reduction in the public deficit of 0.5% of GDP from the projected level in 2021, it will take at least two decades to return to the debt level of 95.5% recorded at the end of 2019, and that, in contrast to AIRcF's pre-crisis scenarios where the 60% level was reached

around 2035, this will no longer be achieved before 2050.

### **What does AIReF recommend in this context?**

At present, the fiscal framework applicable to the Public Administrations is not clear. The targets approved prior to the COVID-19 crisis have been far exceeded by the current situation. Furthermore, the PAs do not have realistic targets consistent with the new situation in order to be able to draw up their budgets for 2021 and their multi-year scenarios. There is also uncertainty about the consequences of non-compliance with the fiscal rules both in 2019 and in the current year.

Although the escape clause has been activated at European level, the government has not declared the exceptional situation provided for in our budgetary stability regulation, which would also entail the obligation to draw up a rebalancing plan to ensure the sustainability of public finances.

To address the current lack of definition of the fiscal framework, AIReF recommends the Government to:

- Clarify the fiscal framework applicable to each of the PAs as soon as possible, in particular with a view to drawing up the Budgetary Plan and the budgets of each administration, which means activating the exceptionality clause, clarifying the consequences of non-compliance with the fiscal rules and establishing a new stability and debt path.
- Establish a medium-term national fiscal strategy that provides fiscal guidance and realistically and credibly ensures the financial sustainability of the PAs.

Furthermore, AIReF also recommends:

- To explore, within the framework of the medium-term fiscal strategy, the implementation of the proposals made by AIReF in the Spending Review studies, in those already carried out and in those to be presented.