

# EXECUTIVE SUMMARY

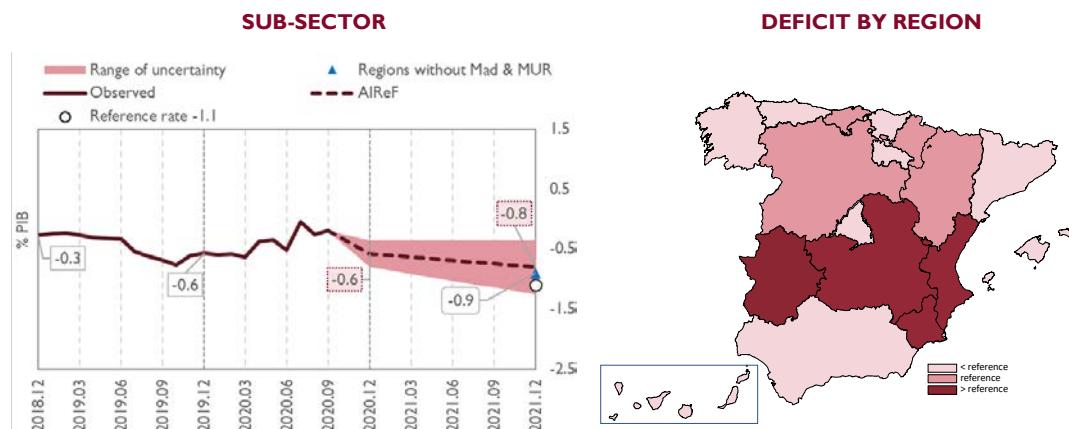
The Independent Authority for Fiscal Responsibility (AIReF) has to issue a report on the draft budgets and main budgetary lines of the Autonomous Regions for 2021. On 5 November, AIReF issued the report on the main budgetary lines of the General Government for 2021 with a preliminary assessment of the sub-sectors, which is now completed and updated at a regional level with the individual reports for each region.

As a result of the COVID-19 crisis, the budgetary stability targets are on hold following activation of the escape clause provided for in Article 11.3 of Organic Law 2/2012 on Budgetary Stability and Financial Sustainability and approval by the Lower House of the Parliament, following the report by AIReF dated 13 October. However, AIReF's fiscal oversight remains fully in force, becoming even more important as a guarantor of the sustainability of the public finances.

The Regions' deficit will grow in 2021 to 0.8%, from the 0.6% that is likely to be recorded in 2020 according to AIReF's estimates. This evolution is more positive than the one forecast in the Budgetary Plan, which places the 2021 reference rate of the regional deficit at 1.1%. The difference in the estimates mainly results from the assumptions on the level of consolidation of the expenditure associated with the health crisis as AIReF considers that, given its temporary nature and the evolution of the pandemic forecast by the government, part of this expenditure would not be repeated in 2021.

For the individual analysis, AIReF has assumed that the extraordinary transfer from the State to reduce the Regions' deficit would account for 1.1% of regional GDP for each Region, as it is the criterion considered in most of the draft budgets and budgetary lines. Under this criterion, nine Regions could close 2021 with a deficit below the reference value, four with a deficit similar to the -1.1% and another four would record a higher deficit. Considering other distribution criteria, as reflected in some draft regional budgets, the conclusions could change by region.

## EVOLUTION OF REGIONAL DEFICIT



AIReF estimates that the revenue of the Regions in 2021 will remain stable compared with 2020 without including the additional revenue linked to the Recovery, Transformation and Resilience Plan (RTRP). On the one hand, the net revenue linked to the Regional Financing System of regions under the ordinary regime will fall by around 2%, mainly as a result of the 2019 settlement. In addition, the extraordinary transfer from the State to cover part of the deficit is lower than the Covid-19 Fund they have received in 2020. The reduction under these headings would be offset by the recovery in the collection of regional taxes and other revenue.

On the expenditure side, AIReF forecasts that spending as a whole will grow by 2%, without including the impact of the RTRP. On the basis of the assumptions about the evolution of the pandemic in its central scenario, AIReF has estimated that the healthcare expenses associated with Covid-19 would be approximately 60% of those incurred in 2020 as the pandemic subsides in mid-2021. However, it is estimated that expenditure on education associated with the pandemic will approximately double in 2021, as the measures would continue throughout the academic year. Finally, AIReF incorporates the growth of personnel costs in accordance with the specifications of basic legislation included in the draft GSB, among other items, and assumes baseline growth of other expenditure not associated with the pandemic greater than that estimated for 2020.

However, some of the regional draft budgets and main budgetary lines forecast growth in expenditure not related to the RTRP higher than that estimated by AIReF, without specific information on the impact and nature of the measures underpinning this increase. This would raise the deficit if the budgetary appropriations were fully implemented. In the event that this increase eventually materialises, it might be structural and would not, in

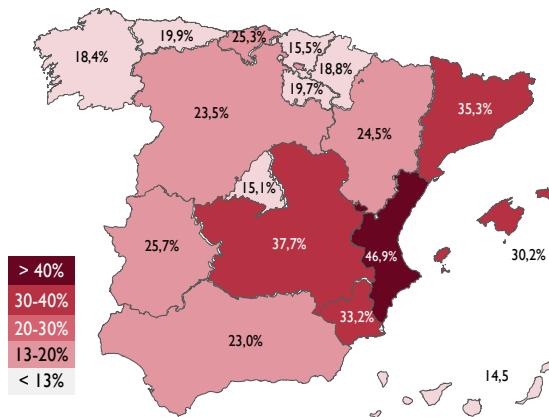
theory, be permanently financed, thus increasing the structural deficit that existed prior to the crisis.

The funds linked to the RTRP will raise the growth in expenditure to 11% and in revenue to 10%, according to AIReF's estimates, increasing their weight in GDP to 18% and 17.2%, respectively. However, the effect in terms of the deficit would be neutral.

AIReF warns of the risk of lower availability of revenue for the Regions in 2022 and 2023 as a result of the impact of the negative settlements of the Regional Financing System (RFS), the lower amount of funds linked to the RTRP and the absence of extraordinary transfers from the State. In 2022, a significant deterioration in the fiscal balance is expected with the recording of the settlement in favour of the State of the instalment payments associated with 2020. This situation will be repeated in 2023 if AIReF's revenue forecasts included in its 5 November report materialise. Finally, the funds linked to the RTRP will also follow a downward path in 2022 and 2023. This situation might be compounded by the consolidation of a significant part of the expenditure incurred in 2020 and 2021.

AIReF forecasts that debt will stand at around 26% of GDP in 2021, 1.4 percentage points of GDP lower than the ratio expected in 2020 as a result of the contribution of GDP (denominator effect). This expected debt level in 2021 would still be 1.6 points higher than that recorded in 2019.

REGIONAL DEBT-TO-GDP RATIO, 2021 (% GDP)



The increase in the debt ratio would be uneven across the different Regions. Valencia, the Balearic Islands and Murcia would be the territories that would record the largest increases in their debt in 2021 compared with 2020, from previous levels that were already high. In 2021, no Region will meet the 13% reference limit, although the Canary Islands, Madrid and the Basque Country would be the regions closest to the legal reference rate.

The forecast excess deficit in 2021 in some Regions over the reference set by the State and the settlement of instalment payments associated with 2020 will mean greater borrowing needs in 2022. As indicated in previous paragraphs, this might worsen in 2023 if AIReF's revenue forecast for 2021 set out in the 5 November report materialises.

Under a scenario of annual correction of the deficit by 0.25 points of GDP from 2023 for each region until budgetary balance is achieved, it is estimated that returning to the debt level of 23.7% of GDP recorded at the end of 2019 will require at least a decade. In contrast with the scenarios projected by AIReF prior to the crisis, where the level of 13% of GDP would be reached in around 2035, this limit is not forecast to be reached prior to 2049, even if the budgetary balance of the sub-sector as a whole is maintained.

In view of the above, AIReF makes the following recommendations to all the Regions:

1. To incorporate information on the specific measures underpinning the expenditure forecast, identifying the possible sources of financing and their nature (temporary or permanent) and assessing their additional economic impact, both in 2021 on the level forecast at year-end 2020 and, where appropriate, in the following years.
2. To adapt their actions in 2021 according to how the pandemic evolves and the scenario that eventually materialises, aiming to avoid structural increases in expenditure that are not accompanied by the corresponding structural financing.
3. To begin work on drawing up the Rebalancing Plan provided for in the Organic Law on Budgetary Stability and Financial Stability, which should be taken into account in the medium-term strategy of the General Government that will be designed to set out the path to fiscal recovery.

In turn, AIReF reiterates the outstanding recommendation to the Ministry of Finance that it repeated on 5 November:

4. That it should establish a national medium-term fiscal strategy that will act as fiscal guidance and will realistically and credibly ensure the financial sustainability of the General Government.