

# REPORT ON THE MAIN LINES OF THE 2021 BUDGETS OF THE AUTONOMOUS REGIONS

REPORT 38/20





Autoridad Independiente  
de Responsabilidad Fiscal

The mission of the Independent Authority for Fiscal Responsibility (AIReF) is to ensure strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

AIReF Contact:

C/José Abascal, 2, 2º planta. 28003 Madrid, Tel. +34 910 100 599

Email: [Info@airef.es](mailto:Info@airef.es).

Website: [www.airef.es](http://www.airef.es)

This document may be used and reproduced, in whole or in part, provided its source is acknowledged as AIReF

## TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	5
INTRODUCTION, PURPOSE AND SCOPE .....	9
1. BUDGETARY SCENARIO .....	13
1.1. Funds from the Recovery, Transformation and Resilience Plan.....	22
1.2. Medium-term Outlook.....	24
2. PUBLIC DEBT .....	26
2.1.1. Debt level.....	26
2.1.2. Sustainability of the public debt.....	28
3. RECOMMENDATIONS .....	31
3.1. New recommendations in the individual reports.....	31
3.2. Live recommendations .....	33



## EXECUTIVE SUMMARY

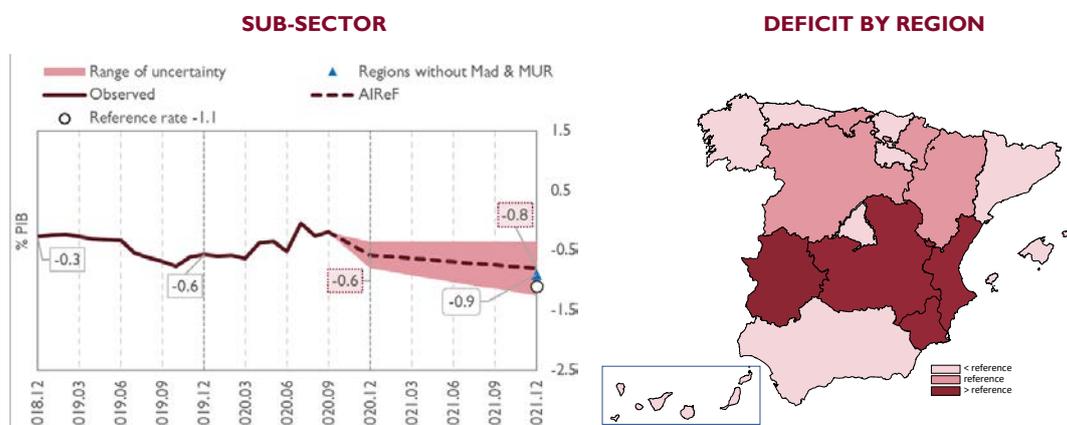
The Independent Authority for Fiscal Responsibility (AIReF) has to issue a report on the draft budgets and main budgetary lines of the Autonomous Regions for 2021. On 5 November, AIReF issued the report on the main budgetary lines of the General Government for 2021 with a preliminary assessment of the 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

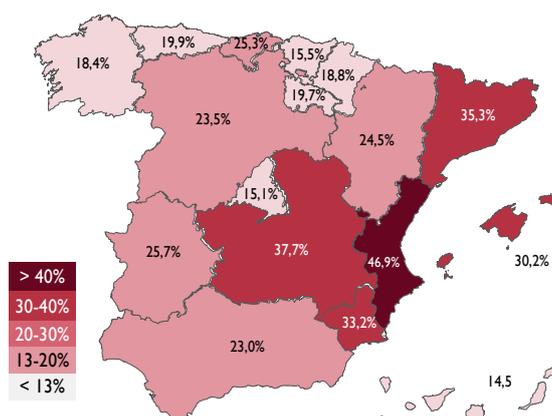
theory, be permanently financed, thus increasing the structural deficit that existed prior to the crisis.

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

AIRcF 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 AIRcF'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.

AIRcF 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.

## INTRODUCTION, PURPOSE AND SCOPE

**Before 15 October each year, the Independent Authority for Fiscal Responsibility (AIRcF) has to prepare a report on the main lines of the budgets of the regions for the following year.** Article 20 of Organic Law 6/2013 on the creation of AIRcF establishes that, before 15 October each year, AIRcF must prepare a report on the draft budgets and main budgetary lines of the General Government for the following year.

**The uncertainties arising from the current context have delayed the presentation of the regions' budgetary lines for 2021.** Preparation of the lines and draft budgets at a regional level has been delayed due to a lack of knowledge until recently about fundamental aspects for designing the regional budgets, such as the funding they will receive from the State, the situation relating to fiscal rules or targets and financing from European Union (EU) funds. Consequently, AIRcF has postponed the preparation of individual reports until the information becomes available

**Some uncertainties persist in the preparation of the regions' draft budgets.** The regions' draft budgets and budgetary lines have been prepared without knowing the distribution between the regions of the extraordinary transfer of €13.486bn included in the General State Budget (GSB), which will be determined through a Royal Decree of the Government. In addition, uncertainty remains about the total specific amounts that each region may receive from the European funds linked to the Recovery, Transformation and Resilience Plan (RTRP), as well as about their implementation, impact over time, nature of the projects to be funded and recording of the associated expenditure and revenue.

**The agreed suspension of fiscal rules in 2020 and 2021 conditions the subject matter of the report.** 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 AIRcF dated 13 October on the existence of the exceptional circumstances referred to in the aforementioned Organic Law. For 2021, only the 1.1% deficit for the regional sub-sector has been indicated as a reference rate. This conditions AIRcF's opinion, normally aimed at assessing, in terms of likelihood, compliance with the fiscal rules set for the corresponding year, which now focuses on analysing the outlook in 2021 expected by each region.

**This report updates the preliminary assessment of the regional sub-sector contained in AIReF's report of 5 November on the main budgetary lines of the General Government for 2021<sup>1</sup>.** On the basis of the preliminary information available in the Budgetary Plan and in the Draft GSB for 2021 presented in October, AIReF issued its first opinion on the General Government forecasts for 2021, with an overview of each sub-sector. This report updates and completes the previous one, after the individual information of most of the regions has become available. This information has been obtained from the draft budgets and/or main budgetary lines and other data submitted by the regions. As of the report date, 13 regions have published their draft budgets and information has been received on the budgetary lines for 2021 of the remaining regions, with the exception of the regions of Madrid and Murcia. In these cases, in which the budgetary estimates and the measures planned for 2021 are not available, AIReF takes its own forecasts under its central scenario and other information available to date.

---

<sup>1</sup> [Report on the Main Lines of the 2021 Budgets of the General Government](#)

TABLE 1. INFORMATION ANALYSED BY REGION

Regions	Information analysed
Andalusia	Published draft budget
Aragon	Published draft budget
Asturias	Budgetary lines*
Balearic Islands	Published draft budget
Canary Islands	Published draft budget
Cantabria	Published draft budget
Castile and Leon	Published draft budget
Castile-La Mancha	Published draft budget
Catalonia	Budgetary lines
Extremadura	Published draft budget
Galicia	Published draft budget
Madrid	<i>Partial information</i>
Murcia	<i>Partial information</i>
Navarre	Published draft budget
Basque Country	Budgetary lines
Rioja	Published draft budget
Valencia	Published draft budget

\* In Asturias, the budgetary lines have been analysed as the draft budget was presented on 2/12/2020, after the report had been drawn up. However, the changes in the draft budget figures compared with the analysed budgetary lines have been highlighted.

**In order to conduct the analysis, AIReF has defined its central scenario for 2021 under a series of assumptions that condition its assessment.** The assumptions underpinning AIReF's central macroeconomic scenario are set out in detail in the AIReF report of 5 November. In addition, given the existing uncertainties about fundamental elements that condition the situation of the regions, AIReF makes the 2021 assessment on the basis of the following assumptions:

- It is assumed that the health crisis will end in the middle of next year, with the recovery starting in the second half of the year. This assumption determines the estimates of the impact of the pandemic in 2021 and the evolution of other revenue and expenditure, in the absence of specific information on the nature and impact of the measures underpinning the regional scenarios.
- It is initially considered that the new funds linked to the RTRP expected for 2021 in the regional sub-sector will have a neutral effect on the deficit. This includes the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU funds) and the Recovery and Resilience

Facility (RRF). The regions will record these funds either as transfers from the Central Government (CG) or directly as EU funds. Although there is still a great deal of uncertainty about implementation of the RTRP, AIReF has made certain assumptions about its distribution among the regions to ensure the consistency of the individual reports as a whole based on the information contained in the GSB. In this regard, AIReF assumes the partial distribution of some funds included in the Economic and Financial Report of the Draft GSB and estimates a distribution of the rest of the funds assigned to the regions in proportion to their population. The resulting distribution may therefore differ from that set out by the regions in their draft budgets or budgetary lines and, in either case, from the eventual distribution of the funds, the criteria for which are not yet defined.

- The distribution of the extraordinary transfer from the State to reduce the regions' deficit has been estimated by considering that it will account for 1.1% of regional GDP for each region. While other possibilities are considered in some of the regions' forecasts, this criterion is the one considered by most of the draft budgets and budgetary lines. In accordance with Article 118 of the Draft Law on the GSB, Central Government will set the definitive distribution criteria by means of a Royal Decree.

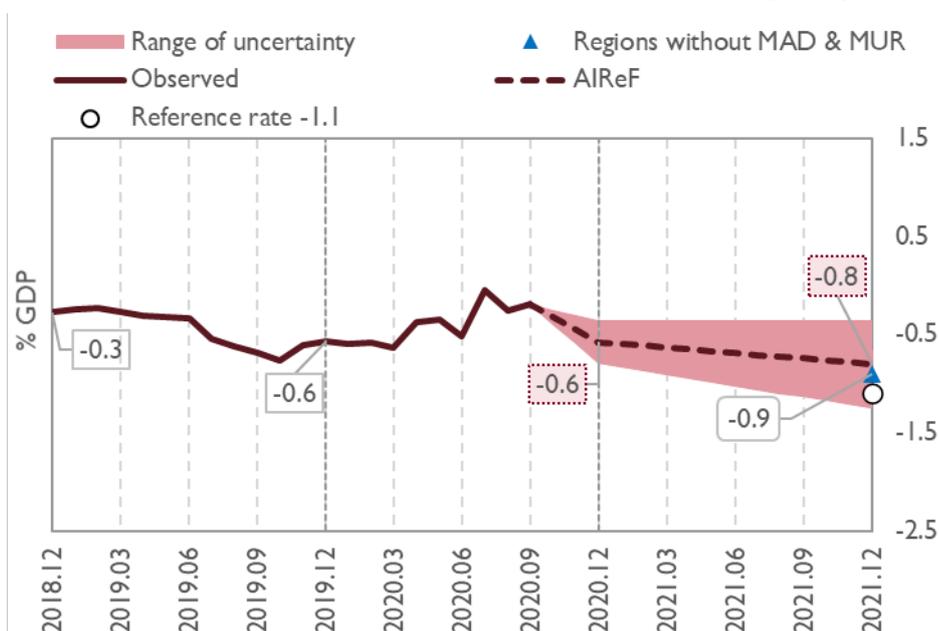
# 1 • BUDGETARY SCENARIO

**AIReF forecasts that the regions' deficit in 2021 will be 0.8% of GDP, below the reference rate of -1.1% of GDP and maintaining the estimate set out in the 5 November report.** In the last two weeks, most of the regional draft budgets have been presented, three of the regions that did not have the draft budgets as of the report date have been provided<sup>2</sup>, as has information on year-end 2020 and other partial data requested in relation to the regions of Madrid and Murcia. However, on many occasions the regional documents do not contain specific information on the measures and actions that underpin most of their forecasts, especially in relation to expenditure. At any event, the following elements have been incorporated to update AIReF's forecasts: update of year-end 2020 and the impact of the pandemic, with regard to which there have been no significant changes compared with the forecast in the November report; update of the revenue forecasts of Navarre and the Basque Country; revision of the impact in 2021 of measures adopted in previous years; and, as far as possible, information on new measures.

---

<sup>2</sup>The draft general budget of Asturias for 2021 was submitted on 2 December, after the report date. Therefore, the main analysis has been performed on the main budgetary lines submitted previously by the region, although the differences noted compared with the submitted draft budget have been highlighted.

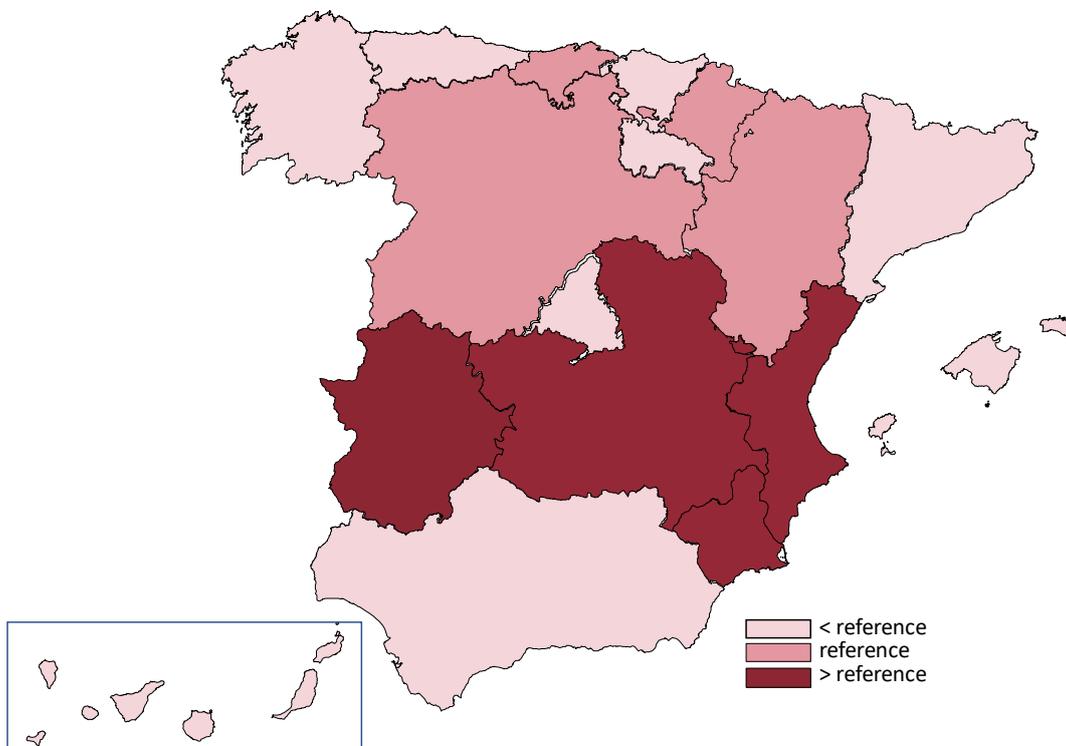
FIGURE 1. NET LENDING/BORROWING. REGIONAL SUB-SECTOR (% GDP)



At an individual level, nine regions could close 2021 with a deficit below the reference value, four with a deficit similar to -1.1% and another four would record a higher deficit. With the information available, under AIReF's assumptions of the evolution of expenditure and the distribution of the State transfers to cover the regional deficit in proportion to regional GDP, AIReF estimates that the regions of Andalusia, Asturias, Balearic Islands, Canary Islands, Catalonia, Galicia, Madrid, Basque Country and Rioja would reach a more favourable balance than the reference set for the sub-sector; of these, the forecasts for the deficits of Asturias<sup>3</sup>, Canary Islands and Galicia are also below 1.1%. In contrast, Aragon, Cantabria, Castile and Leon and Navarre would close with a similar balance, as reflected in their draft budgets; and Castile-La Mancha, Extremadura, Murcia, and Valencia would exceed said deficit.

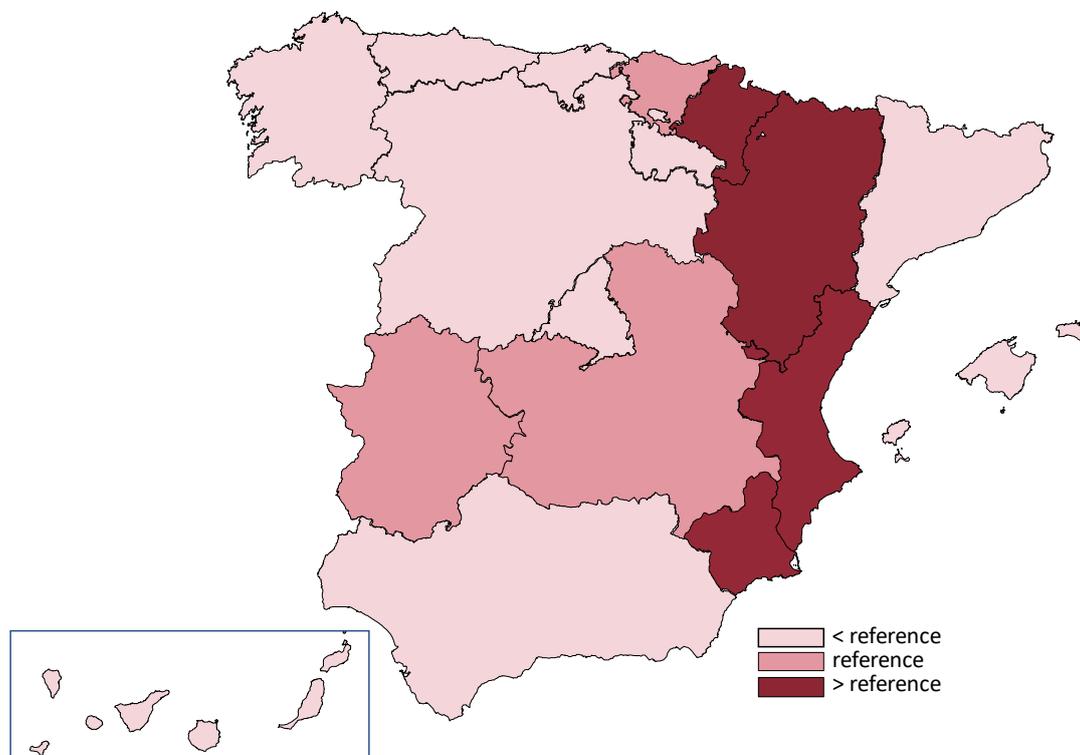
<sup>3</sup> The draft general budget of Asturias for 2021 assumes a deficit equal to the reference rate. However, as of the report date, only the main budgetary lines were available, in which the region estimated a lower balance (-0.8% of GDP).

FIGURE 2. MAP OF REGIONS. NET LENDING/BORROWING IN 2021 IN RELATION TO THE REFERENCE OF -1.1%. REGIONAL SUB-SECTOR.



The individual situation, however, might change under other criteria for distributing the extraordinary transfer from the State to cover the regions' deficit. Applying a transfer distribution criterion based on the adjusted population would change the situation for several regions: Extremadura and Castile-La Mancha would improve the year-end figure to a deficit similar to the reference rate; Cantabria and Castile and Leon might close the year at a lower figure; the Basque Country would worsen to said rate; and Aragon and Navarre would exceed this deficit.

**FIGURE 3. MAP OF REGIONS. NET LENDING/BORROWING IN 2021 IN RELATION TO THE REFERENCE RATE OF -1.1% WITH DISTRIBUTION OF THE TRANSFER FOR THE DEFICIT ACCORDING TO POPULATION CRITERIA. REGIONAL SUB-SECTOR.**



In general, the regions record the transfer as 1.1% of their GDP, with some significant exceptions. The regional draft budgets and budgetary lines record the extraordinary transfer at 1.1% of their estimated regional GDP, except in the case of Extremadura, Canary Islands, the Basque Country, and Navarre. While Extremadura includes a higher amount, in line with the application of population criterion, the situation is the opposite in the other three regions. The Basque Country and Navarre have not included any amount of this transfer in their forecasts and assume a balance of -2.2%, in line with the figure agreed in the Mixed Commission on the Economic Arrangement and the Coordinating Commission of the Economic Agreement. If the agreed particular reference is retained for them and no amount is received from the State, the situation could improve for the other regions or for the Central Government to the extent that the sum not allocated to the Basque Country and Navarre is distributed among them or not. In the same vein, the Canary Islands, which starts from a surplus situation in 2020, sets out a lower amount than that which would correspond under any of the two aforesaid criteria.

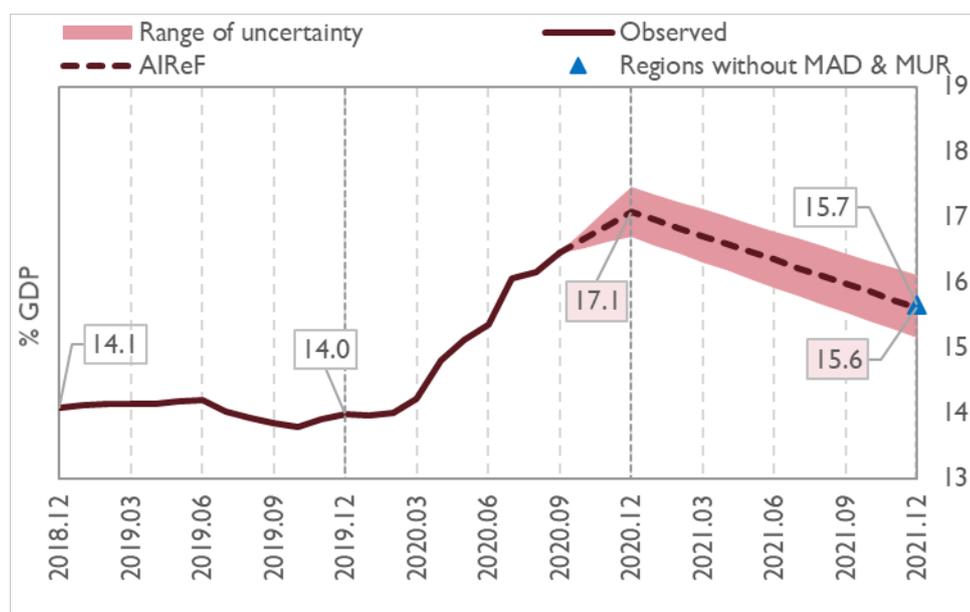
**TABLE 2. ESTIMATED DISTRIBUTION OF THE TRANSFER FOR THE DEFICIT IN 2021. COMPARISON WITH THE COVID-19 FUND**

Regions	COVID-19 fund received in 2020 (% GDP)	Extraordinary transfer from the State for deficit (% GDP)		
		Regional forecast	AIRcF estimated distribution under GDP criterion	Distribution under adjusted population criterion
Andalusia	1.5	1.1	1.1	1.4
Aragon	1.2	1.1	1.1	1.1
Asturias	1.4	1.1	1.1	1.3
Balearic Islands	1.6	1.1	1.1	1.1
Canary Islands	1.4	0.5	1.1	1.4
Cantabria	1.3	1.1	1.1	1.2
Castile and Leon	1.5	1.1	1.1	1.3
Castile-La Mancha	1.9	1.1	1.1	1.4
Catalonia	1.5	1.1	1.1	0.9
Extremadura	1.4	1.5	1.1	1.6
Galicia	1.2	1.1	1.1	1.3
Madrid	1.0		1.1	0.8
Murcia	1.3		1.1	1.3
Navarre	0.9	-	1.1	0.9
Basque Country	0.8	-	1.1	0.9
Rioja	1.6	1.1	1.1	1.1
Valencia	1.4	1.1	1.1	1.2

AIRcF estimates that the regions' revenue in 2021, without considering the funds of the RTRP, will remain at similar levels to that of 2020, slightly below the aggregate regional forecasts. The reduction in unconditional transfers from the State is forecast to be offset by the expected recovery in regional taxes and other revenue linked to production, the positive evolution of the traditional European Union structural funds of the 2014-2020 operational programme and, in the case of the Basque Country, the increase in contributions from the Provincial Councils. The revenue of the financing system of regions under the ordinary regime will fall by 2%. Moreover, the extraordinary transfer from the State intended to cover the regional deficit, of €13.486bn, is 16% lower than the COVID-19 fund distributed in 2020 to address the pandemic. Overall, this revenue, which accounts for about 70% of total revenue without the new RTRP funds, will fall by 3%. In contrast, AIRcF expects 5% growth in revenue from the Tax on Asset Transfers and Documented Legal Acts (AT&DLA), and an 11% rise in other tax revenue. Added to this growth is the 8% increase expected in other revenue of the regions, which includes, among other things, the revenue associated with production, revenue from

traditional EU structural funds and revenue received from the Basque Country Provincial Councils.

FIGURE 4. NET REVENUE WITHOUT RTRP. REGIONAL SUB- SECTOR. (% GDP)



Only three regions plan to adopt revenue measures in 2021, although the impact of measures taken in previous years is expected in the year. Only in the Balearic Islands, Galicia and Navarre are tax measures planned for 2021. For 2021, Navarre plans to adopt tax changes in the transferred “agreed taxes” because of the tax modifications expected at a State level in Inheritance and Gift Tax, VAT on Sugar-sweetened Drinks and the Tax on Insurance Premiums. These tax increase measures, valued at €15m, would offset part of the fall in revenue of €56m resulting from the tax reduction approved in 2019 in Personal Income Tax and Wealth Tax. The Balearic Islands is creating a Landfill and Waste Incineration tax to be applied as from 1 July with an effect estimated at €0.5m. In Galicia, the reduction planned for 2021 in taxes on gambling would be added to those adopted in 2019 in Personal Income Tax, Inheritance and Gift Tax and the Tax on Asset Transfers and Documented Legal Acts. Alongside this, the net positive effect expected in 2021 from other measures previously adopted by the regions is estimated at around €150m, a limited overall impact that takes on importance at an individual level. Thus, Andalusia estimates a fall in revenue of €150m due to the removal of the medicine auction system and the reduction in Personal Income Tax approved in 2019, partially offset by the higher revenue of €30m expected from asset disposals. The Canary Islands forecasts a net reduction of €30m as a result of the reduction in Personal Income tax in 2019 and the increase in the

Wealth Tax approved in 2020. In Catalonia, the tax changes approved in the first quarter of 2020 in Inheritance and Gift Tax, the Waste Charge, the Tax on Asset Transfers and Documented Legal Acts and other taxes, together with the creation of new environmental taxes might increase revenue by around €300m. In Murcia, the net loss of revenue is estimated at €15m due to the combined effect of the reduction in Personal Income Tax approved in 2018 and the increase in the same tax in 2016 and in taxes on gambling for 2020. Lastly, Rioja forecasts a rise in revenue of over €10m because of the combined effect of the tax changes approved in 2020 in Wealth Tax and Inheritance and Gift Tax and the 2018 reduction in Personal Income Tax.

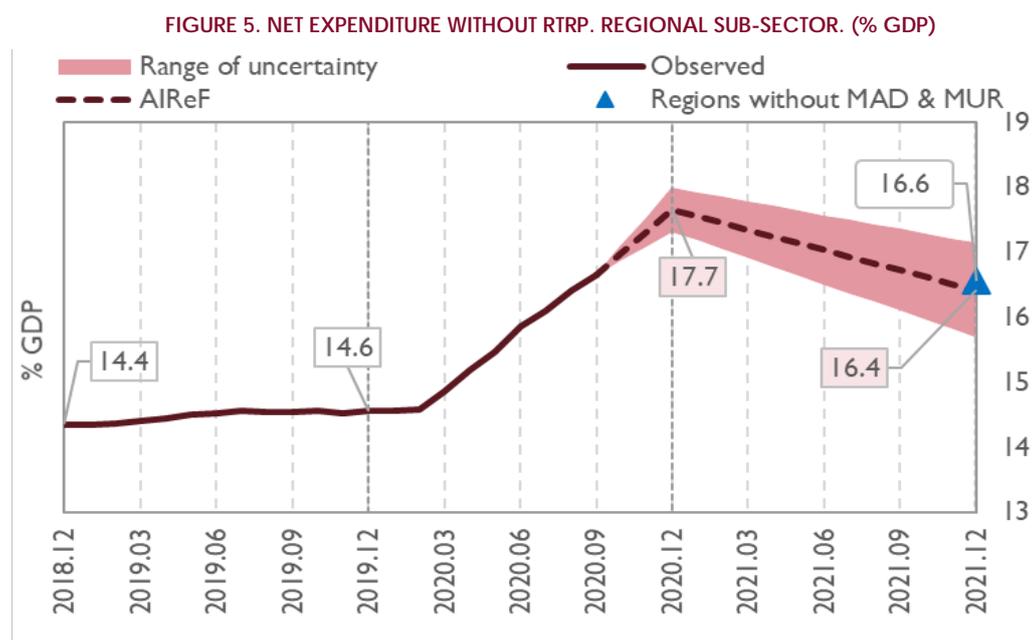
**TABLE 3. REGIONAL REVENUE MEASURES WITH IMPACT IN 2021 (€M)**

Regions	Tax reduction measures		Tax increase measures		Other	
	€m	Tax	€m	Tax	€m	Item
Andalusia	-22	PIT			-90	Removal of medicine auctions (-) and disposal of investments (+)
Balearic Islands			1	Environmental		
Canary Islands	-38	PIT				
Catalonia			145 9 152	I&GT Tax on AT&DLA Environmental		
Galicia	-6 -1 -4	I&GT Tax on AT&DLA Gambling				
Murcia	-15	PIT				
Navarre	-50 -6	PIT WT	2 13	I&GT VAT & Insurance Premiums		
Rioja	-4	PIT	3 12	I&GT WT		
<b>TOTAL</b>	<b>-146</b>		<b>337</b>		<b>-90</b>	

The regions present revenue forecasts, without RTRP funds, that are slightly higher than those estimated by AIReF, with more discrepancies in their composition. There are significant differences in the aggregate forecasts of some revenue headings with those estimated by AIReF. On the one hand, the extraordinary transfer from the State to cover the deficit is not incorporated in Navarre and the Basque Country and is recorded in the Canary Islands for an amount lower than that calculated by AIReF. Therefore, the aggregate data are lower in this regard than the figure provided for in the draft GSB. However, there is an opposite effect with a greater impact in other headings, which brings the forecasts of the regions closer to those of AIReF. Thus, the draft budget of Valencia records within the revenue from the financing system, as

usual in its budgets, an amount that is €1.3bn higher than that resulting from the draft GSB. On the other hand, in aggregate terms, the regional draft budgets and budgetary lines include very sharp increases in EU structural funds from the 2014-2020 operational programme and more optimistic estimates of the recovery in tax revenue, mainly from the Tax on Asset Transfers and Documented Legal Acts.

**AIReF forecasts that the expenditure of the sub-sector will grow, without application of RTRP funds, by 2% over the 2020 level, which is below the aggregate estimates of the regions.** Without detailed and specific information on the impact and nature of the measures that underpin most of the appropriations of the draft budgets and budgetary lines, AIReF's forecasts consider three fundamental elements: the estimated impact of the pandemic, the evolution of personnel costs not linked to the pandemic and a trend increase in other expenses, higher than that recorded in 2020 as it is understood that the execution of expenses not associated with the pandemic will normalise.



**AIReF estimates that the pandemic will have a more limited impact in 2021 than in 2020 in accordance with the assumptions of the central scenario.** AIReF forecasts that the impact of the crisis in 2020, in line with the regions' aggregate forecasts, will amount to 1.8% of GDP. Given that the duration of the pandemic in 2021 is forecast to be more limited, its impact on expenditure will fall by around 40%. This effect, together with the expected increase in revenue, leads to the expected effect of the crisis being lower by one point

of GDP. The calculation has considered that just over 60% of the estimated extraordinary healthcare expenditure for 2020 will pass on into 2021, while in the field of education, the effect of the measures adopted for the 2020/2021 academic year has been taken as double that recorded in 2020.

**TABLE 4. AIREF'S FORECAST OF THE COVID-19 IMPACT IN 2020 AND 2021. REGIONS (% GDP)**

	2020	2021
<b>COVID measures</b>	<b>1.1%</b>	<b>0.7%</b>
Healthcare	0.7%	0.4%
Education	0.1%	0.2%
Other	0.3%	0.1%
<b>Macro impact</b>	<b>0.7%</b>	
<b>TOTAL</b>	<b>1.8%</b>	<b>0.7%</b>

**AIReF estimates an increase in personnel costs of around 3%, lower than that included in the aggregate regional forecasts.** This estimate includes the maximum growth in the wage bill of 0.9% set by the draft GSB, the estimated needs because of the expected impact of the pandemic, mainly in the areas of healthcare and education, an average wage drift and the specific measures identified by the regions in this area. Although the draft budgets generally indicate the need to strengthen personnel, they do not identify all the assumptions and specific measures underpinning the appropriations and their impact on the expenditure of the previous year. For the regions of Asturias, Balearic Islands, Canary Islands, Catalonia, Castile-La Mancha, and Extremadura, it has been possible to identify and incorporate some specific measures in this area into AIReF's forecasts, and in others, such as Aragon and Navarre, it has been possible to determine the impact of specific actions carried out in 2020, but in most cases the elements incorporated do not explain all the changes forecast by the regions.

**Some of the draft budgets and budgetary lines forecast growth in expenditure greater than that estimated by AIReF. These increases might be structural in nature and should they materialise, they would raise the sub-sector's deficit by 0.2 points.** In most of the regions, the evolution of expenditure not financed by revenue is in line with AIReF's estimates. However, at an aggregate level there is a discrepancy because of the recording of higher expenditure than that calculated under AIReF's assumptions in the regions of Andalusia, Asturias, Castile-La Mancha, Catalonia, Galicia, Rioja, and Valencia. While this growth implies only 1% more growth and an additional 0.2 points of GDP over AIReF's forecast for the sub-sector, it involves much higher changes at an individual level. In addition, if this increase materialises, it might be structural

and would not, in theory, be permanently financed, thus building on the structural deficit that existed prior to the crisis.

### 1.1. Funds from the Recovery, Transformation and Resilience Plan.

Incorporating the new RTRP funds would raise revenue growth to 10% and expenditure growth to 11%, increasing their weight in GDP by one and a half points. AIReF assumes a neutral impact of these funds on the regional deficit and includes the amount of 1.5% of GDP, €18.793bn quantified for this year for the regional sub-sector. It is estimated that part of the REACT funds will be used to meet current healthcare, educational and other needs. However, it is expected that most of the REACT funds received directly from the EU, as well as half of the REACT funds and most of the RRF funds from transfers from the State, will finance investments and other capital expenditure.

FIGURE 6. TOTAL NET REVENUE. REGIONAL SUB-SECTOR. (% GDP)

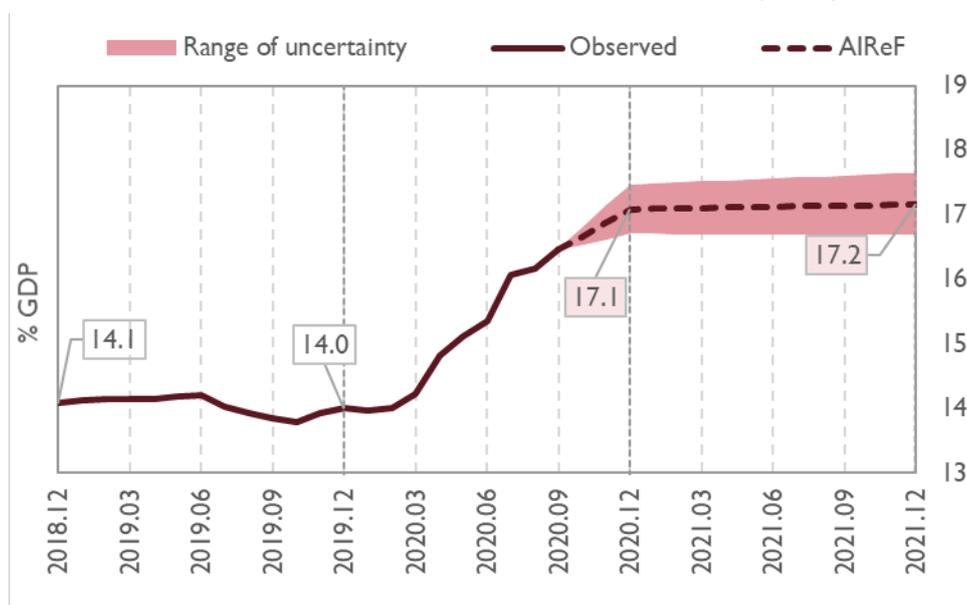
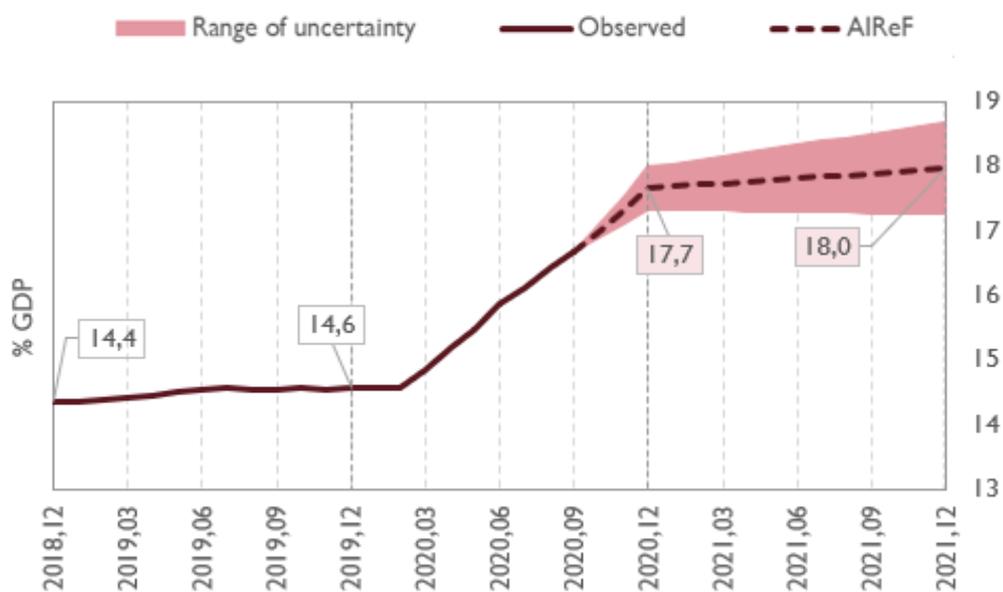


FIGURE 7. TOTAL NET REVENUE. REGIONAL SUB-SECTOR. (% GDP)



Seven of the draft budgets and budgetary lines analysed include an estimate of the new European funds, in general only associated with REACT-EU and below the distribution estimated by AIReF. In the regions of Aragon, Balearic Islands, Castile-La Mancha, Catalonia, Galicia, Rioja and Valencia, the budgetary scenarios incorporate revenue forecasts for the new European funds, although only for those associated with REACT-EU and below AIReF's estimates, except in the case of Castile-La Mancha. All of them assume the neutral impact of these funds on the deficit by including appropriations for expenditure for the same amount.

TABLE 5. ESTIMATED RTRP FUNDS IN THE INITIAL FORECASTS OF THE REGIONS FOR 2021

Regions	Estimated RTRP funds in the Regions' initial forecasts for 2021
Andalusia	no
Aragon	yes
Asturias	no
Balearic Islands	yes
Canary Islands	no
Cantabria	no
Castile and Leon	no
Castile-La Mancha	yes
Catalonia	yes
Extremadura	no
Galicia	yes
Madrid	
Murcia	
Navarre	no
Basque Country	no
Rioja	yes
Valencia	yes

## 1.2. Medium-term Outlook

AIReF warns of the lower availability of revenue in 2022 and 2023 because 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. While the natural subject of this report is the analysis of the budgetary forecast for 2021, AIReF believes it is essential to warn about the medium term, particularly in a context of suspended fiscal rules. In 2020 and 2021, a major part of the impact of the pandemic will be absorbed by the State thanks to the maintenance of instalment payments set for the financing system of regions under the ordinary regime above real revenue and, to the exceptional transfers agreed in their favour (COVID-19 Fund and transfer for deficit).

The settlements of the financing system for regions under the ordinary regime are estimated at 0.4% of GDP in 2022 and 0.3% of GDP in 2023. In 2022, a significant deterioration in the fiscal balance in regions under the ordinary

regime 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.

## 2. PUBLIC DEBT

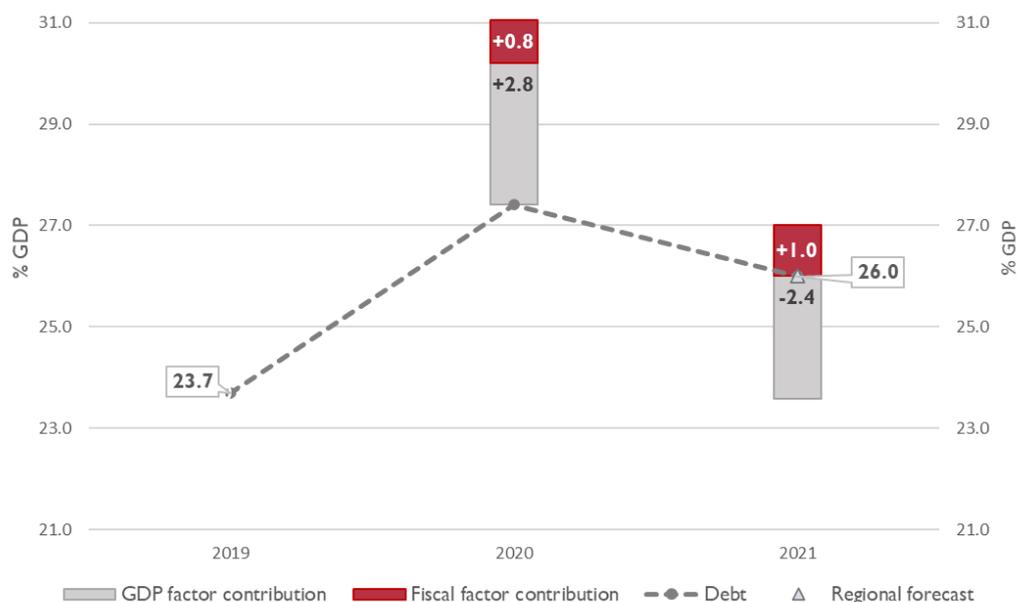
### 2.1.1. Debt level

AIReF forecasts that the regions will reduce their debt to around 26% of GDP in 2021, mainly because of the contribution of GDP growth. AIReF estimates that regional debt will fall by 1.4 percentage points of GDP from the 27.4% expected for 2020 to the 26% estimated for 2021. Estimates of GDP growth in 2021 would offset the forecast fiscal deterioration, allowing a fall in the debt-to-GDP ratio.

The debt level in 2021 would stand at 1.6 percentage points above the 2019 level, thus worsening the pre-crisis position. The debt level in 2021 would stand at 1.6 points above that recorded at year-end 2019, which is a worsening of the pre-crisis situation. This increase in the debt level compared with the 2019 level is the result of the general fiscal deterioration of the accounts in 2019, 2020 and 2021 and, to a lesser extent, the repayments of the negative settlements of 2008 and 2009.

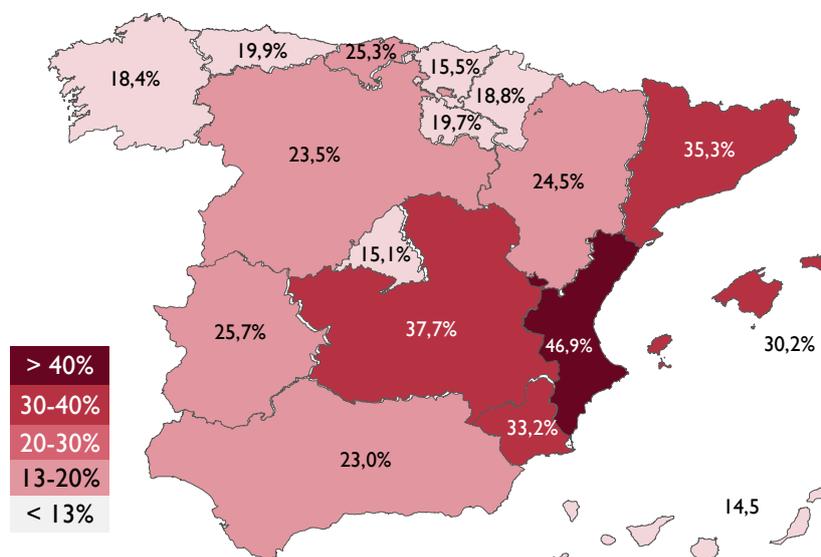
Debt levels will increase in the coming years, thus delaying the reduction of the debt ratio. The forecast excess deficit in 2021 in some regions over the reference set by the State and the settlement of the instalment payments associated with 2020 will lead to new borrowing needs in 2022. These additional future fiscal efforts will delay the adjustment to the established debt targets. This situation might worsen in 2023 if AIReF's revenue forecast for 2021 contained in the 5 November report materialises.

The already high levels of indebtedness and the increased availability of additional revenue, such as that associated with the RTRP, make it advisable to control debt growth. The existence of very high debt volumes together with the possibility of making use of additional resources, such as those associated with the RTRP, to finance historic expenditure volumes, imply the need to control debt growth by avoiding structural increases in the deficit.

**FIGURE 7. FORECAST EVOLUTION OF REGIONAL DEBT (% GDP)**


Based on the available information, AIReF estimates that there will be five regions in 2021 with a debt ratio higher than 30%. Based on the information available, under AIReF's assumptions for the evolution of expenditure and the distribution of the transfer from the State to cover the regional deficit in proportion to regional GDP, AIReF estimates that the Autonomous Regions of Valencia, Castile-La Mancha, Catalonia, Murcia, and Balearic Islands will have a debt ratio above 30%, when there were only three regions that exceeded this ratio at the end of 2019.

The increase in the debt ratio will be uneven across the different regions. Valencia, Balearic Islands and Murcia would be the territories that would record the largest increases in their debt in 2021 with regard to 2020, from prior 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.

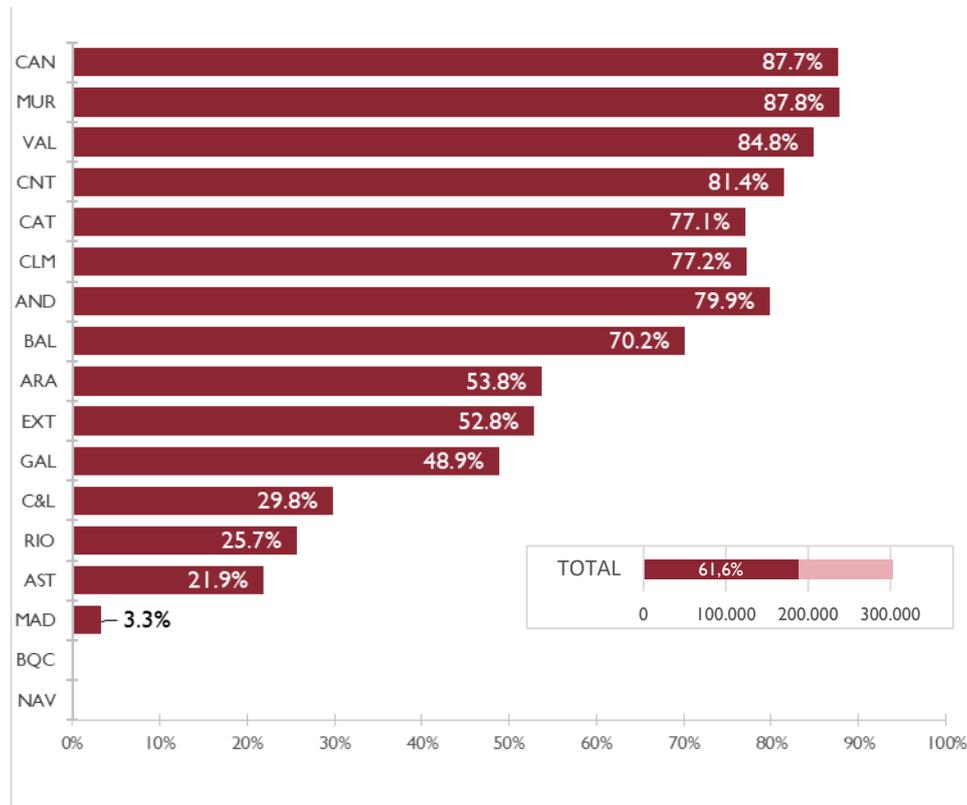
**FIGURE 8. REGIONAL DEBT-TO-GDP RATIO, 2021 (% GDP)**

### 2.1.2. Sustainability of the public debt

The sharp fall in economic growth, coupled with the deterioration of fiscal balances projected from 2022 onwards, will raise the level of financial sustainability risk for the entire regional sub-sector. Although in 2020 and 2021, the exceptional transfers agreed in favour of the regions (COVID-19 Fund and transfer for deficit) will pass on part of the increase in risk to Central Government, the worsening of fiscal balances forecast from 2022 onwards will lead to an increase in the volume of debt which, despite the expected recovery in GDP, will mean that the sub-sector's ratio will continue to rise. Despite worsening prospects for financial sustainability, the rating agencies have not downgraded the regions' ratings, except for Fitch, which has downgraded the regions of the Canary Islands, Cantabria, Rioja and Madrid from 'BBB' to 'BBB-', although it continues to place their long-term debt in the investment grade category.

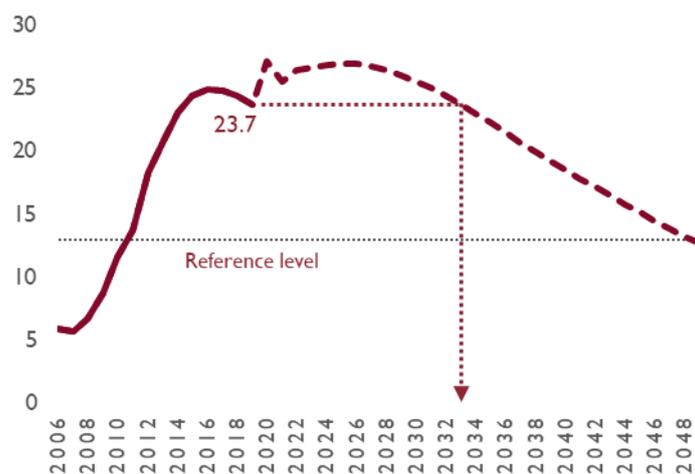
The extraordinary financing mechanisms will cover more than 90% of the 2020 borrowing needs, providing liquidity to the territories at a very low cost and avoiding the payment of higher spreads in the case of the most indebted regions. The dependence on financing through these mechanisms, which is already very high for certain regions (currently accounting for over 70% of the debt of eight regions, and over 80% for four of them), will continue to grow.

**FIGURE 9. WEIGHT OF EXTRAORDINARY FINANCING FUNDS OVER TOTAL REGIONAL DEBT, JUNE 2020**



Returning to the debt level of 23.7% recorded at the end of 2019 would require, under the assumption of a fixed annual correction of the deficit of 0.25 points of GDP, at least a decade. Under a scenario of annual correction of the deficit by 0.25 points of GDP projected for 2023 for each region until budgetary equilibrium 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 AIRcF prior to the crisis, where the level of 13% 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 is maintained.

**FIGURE 10. DEBT PROJECTIONS (%GDP) ASSOCIATED WITH THE PROJECTED DEFICIT REDUCTION SCENARIO FOR 2023**



The medium-term outlook underlines the urgency of designing a coordinated rebalancing plan. While the budgetary stability and debt targets are on hold, AIReF highlights the existence of high levels of indebtedness that will be accentuated in the coming years, which increases the importance of fiscal oversight and the urgency of designing a consolidation path.

# 3. RECOMMENDATIONS

## 3.1. New recommendations in the individual reports

In general, the nature and impact of the measures underpinning the regional budgetary scenarios are unknown. In some cases, the forecasts involve significant growth in expenditure over a level that is already exceptionally high in 2020. This may lead to regions having high deficit and public debt levels. These increases in expenditure may be due to several reasons, such as a higher forecast of the impact of the pandemic in 2021 compared with AIREF's central scenario, the forecast of appropriations for projects that would eventually be co-financed by European funds or other temporary or permanent measures. The implications from the point of view of sustainability are different in each case and pose an additional fiscal risk if they become structural increases in expenditure.

Therefore, AIREF ***recommends to all the regions in the individual reports that it issues with a view to approval of the 2021 draft budgets or budgetary lines, that they should include information on the specific measures underpinning their expenditure forecasts, identifying the possible source of financing and their nature (temporary or permanent) and assessing their additional economic impact, both in 2021 with regard to the forecast level at the end of 2020 and, as the case may be, in the following years.***

In addition, there is still a high level of uncertainty about the evolution of the COVID-19 health crisis. As AIREF has been pointing out in the reports issued since the start of the pandemic, short-term measures need to be taken to cushion the impact of the crisis, without losing sight of a more medium-term perspective.

This means implementing flexibility mechanisms such as those planned and already activated in national and regional legislation. However, emphasis

must be placed on the idea of maintaining fiscal responsibility, bearing in mind that fiscal oversight mechanisms remain in force.

This year there is a major provision of funds to address the current exceptional situation and in the absence of fiscal rules, there is a risk of maintaining high expenditure growth, not only temporarily and for a specific purpose, but permanently. It is therefore essential to insist on the need to use these funds flexibly and efficiently, adapting them to the actual needs of the pandemic and orientated towards actions that allow a better starting point to be reached for carrying out the future process of fiscal consolidation.

Consequently, AIReF particularly conveys to the regions the recommendation set out in its 5 November report, **recommending that they should all adapt their actions in 2021 to how the pandemic develops and the scenario that eventually materialises, aiming to avoid structural increases in expenditure that are not accompanied by the corresponding structural financing.**

Finally, the fiscal deterioration is expected to extend into the coming years because of the settlements of the instalment payments and the withdrawal of the extraordinary transfers from the State, leading to further increases in debt levels. This situation might be compounded if there is a consolidation of a significant part of the expenditure incurred in 2020 and 2021. In this context, the design of the annual budgetary framework cannot ignore a broader perspective. As already pointed out in the 5 November report, there are several factors that make medium-term planning necessary: the requirement of the Organic Law on Budgetary Stability and Financial Stability itself, the multi-year nature of the new RTRP funds, and the uncertainty resulting from the pandemic. This makes it particularly necessary for the budgets to be drawn up taking into account their impact in the medium term and the possible integration of their actions into the Rebalancing Plan required by Article 22 of the Organic Law on Budgetary Stability and Financial Stability, the preparation of which must be addressed as soon as possible by the regions, if possible, within the framework of a national medium-term fiscal strategy. In the same vein, AIReF **recommends that the regions should begin work on drawing up the Rebalancing Plan provided for in the Organic Law on Budgetary Stability and Financial Stability, in line with the medium-term fiscal strategy of the General Government that will be designed to set out the path to fiscal recovery.**

### 3.2. Live recommendations

The drafting of the regional rebalancing plans must be addressed from a coordinated and integrated perspective to ensure that all the efforts are channelled in a coherent line towards recovery for all tiers of government.

In this regard, it is essential, as recommended by AIReF in its successive reports issued over the year, to draw up a national medium-term fiscal plan. Specifically, on 5 November, this recommendation was reiterated to the Ministry of Finance insisting on the need for the Government to carry out said planning, which may form part of the National Recovery and Resilience Plan, meeting certain fundamental requirements.

Therefore, the following **recommendation made to the Ministry of Finance remains “live”**:

---

**1. *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. This requires:***

- *The support of all tiers of government, considering their fiscal realities in terms of revenues and powers, to ensure appropriate coordination and co-responsibility.*
  - *Considering the public debt levels and fiscal risks, particularly those assumed as a result of managing the COVID-19 crisis.*
  - *Establishing a tentative timetable for achieving milestones.*
  - *Acting as a framework for the rebalancing plans of the General Government and promoting coordination of the strategy with the recovery and resilience plan.*
- 

The president of AIReF



Cristina Herrero Sánchez