

# REPORT ON THE INITIAL BUDGETS OF THE GENERAL GOVERNMENT FOR 2021

REPORT 01/21





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.

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## EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) has the legal mandate to assess the initial budgets of the General Government from the perspective of their compliance with fiscal targets, focusing its assessment, as laid down by law, on the main changes with respect to the previously reported draft budgets and main budgetary lines. As the fiscal rules for 2021 are suspended, AIReF's fiscal supervision takes on greater importance as a guarantor of the sustainability of the General Government.

AIReF gave its opinion on the draft budgets and main budgetary lines of the General Government for 2021 in its report of November 5<sup>th</sup>, supplemented in the case of the Autonomous Regions (ARs) and Local Governments (LGs) by the reports of December 3<sup>rd</sup>. At that time, AIReF estimated for its central scenario a reduction in the deficit to 8% of GDP for 2021, supported by GDP growth of 8.2%, although it continued to warn of the high level of uncertainty with regard to how the pandemic would develop and its effects on the economy, society and the public accounts.

More than one year after it began, the pandemic continues to shape the economic situation and the public accounts, and a high level of uncertainty remains as to how it will develop in the future. However, the progress made in the availability of vaccines means that the health crisis is expected to be resolved by 2021. Uncertainty also remains about the implementation of the Recovery, Transformation and Resilience Plan (RTRP), both in terms of the details of its implementation and the ability to deploy its effects in 2021.

In this report, AIReF updates its macroeconomic and fiscal forecasts in line with the latest available information, reducing the General Government deficit forecast to 7.6% of GDP in its central scenario. The main factors, with opposing effects, that explain the changes in the forecasts are the downward revision of the central macroeconomic scenario, with forecast

GDP growth at 6.6% for 2021; the new measures adopted by the Government, as well as the changes included in the budgets during their processing; and the incorporation of the new available information, mainly the closing of the General Government deficit at 11% of GDP in 2020.

### Revision of the macroeconomic scenario for 2021

The new macroeconomic scenario entails a downward revision of expected growth for 2021 to 6.6%, down from the 8.2% in the central scenario prepared in autumn 2020. This downward revision is mainly the result of the continued severity that the health crisis has shown in Europe and in the Spanish economy, with significant effects on growth. The latest information reveals that the recovery was cut short in the last quarter of 2020, when GDP stagnated, and GDP may have contracted over the first few months of the year. The successive waves of the pandemic are delaying expectations of a return to normal for the tourism sector, which is one of the key elements in determining the strength of growth in 2021. Another aspect that helps explain the downward revision in expected growth is the revision of the assumptions about the macroeconomic impact of the RTRP, which is now more spread over time. In particular, the impact of the RTRP in 2021 is reduced from 2.7 points of GDP to 1.6 points.

### Budgetary scenario of the General Government for 2021

AIReF estimates a General Government deficit of 7.6% of GDP in 2021 in its central scenario, thus lowering its forecast by just over 0.3 points compared with the November report. The revision of the macroeconomic scenario would mean a worsening of the deficit of one point, both as a result of its impact on revenue growth and through the denominator effect due to a lower level of nominal GDP. In addition, governments have adopted new measures to mitigate the effects of the pandemic, which, together with the changes that have taken place in the budgets during their processing, result in a higher deficit of one point of GDP. These factors are amply offset by the incorporation of the new information, mainly a more favourable than expected figure for year-end 2020, which reduces the deficit by 2.3 points compared with the previous report. Finally, AIReF continues to assume a neutral effect of implementation of the RTRP on the deficit in 2021.

After closing 2020 with a General Government deficit of 11% of GDP, the economic recovery, the gradual withdrawal of the measures implemented to mitigate the effects of the COVID-19 crisis, the absence of significant non-recurring elements such as the reclassification of the SAREB and the tax changes included in the Draft General State Budget lead to a reduction in the deficit of 3.3 points of GDP in 2021.

## EVOLUTION OF THE BALANCE OF THE GENERAL GOVERNMENT

	2020		2021	
	Lines 21	Year-end	Lines 21	Initial Budgets
<b>GG</b>	<b>-11.6</b>	<b>-11.0</b>	<b>-8.0</b>	<b>-7.6</b>
<b>CG</b>	-7.2	-8.4	-5.6	-6.0
<b>SSFs</b>	-3.8	-2.6	-1.5	-1.5
<b>ARs</b>	-0.6	-0.2	-0.8	-0.4
<b>LGs</b>	0.0	0.3	-0.1	0.3

AIReF forecasts that revenue will grow by 5.8% in 2021, to stand at 40.4% of GDP, 43.3% if RTRP revenue is included. This level would be 0.7 points higher than that forecast in the previous report. On the one hand, some of the tax measures included in the draft GSB were not approved, while some of the new tax categories (taxes on single-use plastic containers and on waste) have not progressed through the Parliamentary procedure, which leads to a lower impact expected in this year. On the other hand, although the downward revision of AIReF's central macroeconomic scenario means a reduction in the forecast for tax revenue growth, this effect is offset by the denominator effect as a result of the lower nominal GDP and the latest collection data, which are higher than AIReF's November forecast. In this regard, there is a noteworthy upward revision in corporate income tax and social contributions.

Expenditure, excluding the RTRP, will stand at 48% in 2021, according to AIReF's estimates, compared with 47.6% in the previous report. The approval of new measures to mitigate the effects of the pandemic on the economy involves an increase in expenditure of 0.9 points of GDP compared with the November forecast. Similarly, the downward revision of GDP growth affects the level of expenditure over GDP, which rises by 0.7 points as a result of the denominator effect. In contrast, expenditure closed 2020 at 52.3% of GDP, below the AIReF forecast, which implies a lower starting point for this year. Finally, AIReF continues to assume execution of RTRP-related expenditure as set out in the Draft General State Budget, which will drive the growth in expenditure to 5.3%, according to AIReF, to reach 50.9% of GDP.

By sub-sector, the deficit forecast of the Central Government (CG) rises mainly as a result of the new measures approved. In contrast, the forecast for the balance of the Autonomous Regions and Local Governments improves substantially, mainly as a result of the incorporation of the data for year-end 2020.

### Central Government

AIReF estimates a deficit of 6% of GDP for the CG in 2021, an increase of just over 0.4 points on the previous forecast. In this case, the most important

factor is the new measures adopted following the approval of the General State Budget, mainly direct support for companies affected by the health crisis. These measures, together with the changes incorporated during the parliamentary procedure for the GSB and the delay in the approval of the measures, lead to an increase in the deficit of 0.8 points. In contrast, the collection data since the previous report have been better than initially estimated by AIReF, offsetting in full the collection loss resulting from the downward revision of the macroeconomic scenario. Lastly, it should be noted that the evolution of the deficit in 2021 will also be marked by the impact of the reclassification of the SAREB within the public sector, which meant an increase in the deficit in 2020 that is not repeated in 2021.

### Social Security Funds

After reaching a peak of 2.6% of GDP in 2020, AIReF maintains the deficit estimate for the Social Security Funds at 1.5% of GDP. Although the extension of the job-retention schemes (ERTEs) and the extraordinary benefit for cessation of activity for self-employed workers has been approved, AIReF already incorporated the extension of the ERTEs in its previous estimate, which limits the increase in the expenditure forecast. This expenditure is offset by a higher forecast for social contributions in 2021.

### Autonomous Regions

The deficit of the regions will grow in 2021 to 0.4% from 0.2% at year-end 2020. For 2021, this represents a 0.4-point reduction on the previous forecast. This is the result of the new information available, mainly for year-end 2020, which included the containment of non-pandemic-related expenditure greater than previously estimated.

### Local Governments

The LGs would increase their surplus to 0.3% of GDP in 2021 in AIReF's central scenario, after closing 2020 with a similar surplus. Compared with the previous report, AIReF has improved the balance of the sub-sector by 0.4 points by incorporating the 2020 year-end data, which included a contraction in intermediate consumption and gross capital formation of the LGs that was not included in the previous forecast.

### Challenges that can be noted from the point of view of the sustainability of public finances

The halt in activity and the increase in borrowing needs resulting from the COVID-19 crisis have led to a sharp rise in the public deficit, which in turn has brought about a permanent increase in the ratio of public debt to GDP to 120% - its highest value of the last one hundred years. AIReF projects a reduction of up to 1.3 points in 2021, to 118.7% of GDP.

The risks and challenges for the medium- and long-term sustainability of the public accounts are high. In this regard, one of the main risks of the current situation is that the crisis will have permanent effects on the productive fabric. Another notable risk, in a context of high debt levels, is the greater reliance on the current favourable borrowing conditions, as a rise in interest rates might quickly generate an upward trend in the public debt ratio. The above is compounded by the well-known challenge of an ageing population and higher pension expenditure, which, if not financed with additional revenue, will lead to a very significant increase in debt from levels that are already historically very high.

### Recommendations

In this context, AIReF once again insists on the need for a credible and realistic medium-term fiscal strategy that guarantees the sustainability of public finances. Although it is essential in the short term to tackle the economic, health and social emergencies that this crisis generates, there are also strong arguments why it is important to provide the different authorities with a medium-term perspective: (1) to reflect the multi-year impact of projects financed with European recovery funds; (2) to provide certainty on the specific lines of action and to guide fiscal policy amid the uncertainty resulting from the pandemic; and (3) to comply with the Organic Law on Budgetary Stability and Financial Stability requirement to submit a medium-term plan (rebalancing plan) once the escape clause is triggered.

Furthermore, in the current extremely volatile and delicate context, AIReF, in line with other recommendations on high frequency data, also considers that a new recommendation should be made on the need to maintain or increase the reporting obligations of the General Government in a context of suspended fiscal rules.

It is precisely this same situation and the aim of ensuring the sustainability of local and regional governments that leads AIReF to make two new recommendations. Firstly, it considers that the debt of the Autonomous Regions should be adjusted to their real financing and liquidity needs, through debt authorisations and, where appropriate, extraordinary financing mechanisms, in order to avoid excessive use of debt. Secondly, it advocates the implementation of actions aimed at monitoring the main fiscal indicators of the Local Governments by the corresponding supervisory bodies.



# 1. INTRODUCTION

**AIReF has the legal mandate to report on the initial budgets of the General Government.** The Organic Law on Budgetary Stability and Financial Sustainability establishes the obligation for AIReF to prepare, by April 1<sup>st</sup>, a report on the initial budgets of the General Government from the perspective of their compliance with the expenditure rule and with the budgetary stability and public debt targets. The AIReF Regulation adds that when preparing this report, the changes that have taken place since the report on the main budgetary lines will be addressed. As the year-end 2020 public accounts, which contain essential information for the report, were not published until 29 March, AIReF has been forced to delay the issuance of the report by a few days.

**In the last quarter of 2020, AIReF issued its opinion on the main lines of the General Government budgets for 2021.** With the information available from the 2021 Budgetary Plan, presented on October 15<sup>th</sup> and the draft General State Budget for 2021, approved on October 27<sup>th</sup> by the Council of Ministers, AIReF issued, on November 5<sup>th</sup>, the report on the main lines of the 2021 budgets, which constitutes the first opinion on the forecasts for that year of the General Government and each of its sub-sectors<sup>1</sup>. Later, on December 3<sup>rd</sup>, this report was supplemented by issuance of the expanded report for the

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

Autonomous Region sub-sector<sup>2</sup> and individual reports for each region, in addition to the supplementary report providing individual evaluation of some Local Governments (LGs)<sup>3</sup>.

**Both the Central Government and most of the Territorial Administrations have approved their budgets for 2021.** The GSB for 2021 was approved by Parliament on December 20<sup>th</sup> and entered into force in January 1<sup>st</sup>. At a territorial level, 14 ARs currently have an approved budget for 2021, nine of which (Andalusia, Aragon, Asturias, Balearic Islands, Canary Islands, Cantabria, Castile-La Mancha, Navarre and Valencia) approved it in December 2020 and five (Galicia, Castile and Leon, Extremadura, Basque Country and Rioja) between January and February 2021. Therefore, there are only three regions (Catalonia, Madrid and Murcia) under a budgetary extension. For their part, most of the LGs have also approved their budgets for 2021.

**The health crisis continues to condition the economic situation and the prospects for growth, as well as the adoption of measures to mitigate the crisis.** The start of the vaccination process in Spain and in other economies is a huge step towards resolving the health crisis caused by the coronavirus. However, the successive waves of the pandemic and the maintenance of restrictive measures in many countries, together with the sluggishness of the vaccination process in Europe, continue to cast a high level of uncertainty over the economic recovery, delaying it over time with respect to the autumn forecast.

**This report presents an update of the forecasts for 2021, with the aim of assessing the initial budgets of the General Government from a macroeconomic and budgetary perspective.** Since AIReF issued its opinion at the end of 2020, there have been changes in both the macroeconomic and budgetary fields, which are analysed in this report. On the one hand, in line with other official institutions and private bodies, AIReF's growth estimates are revised downwards, to 6.6% in 2021. On the other hand, the deficit forecast for 2021 is also revised. These estimates incorporate the most recent figures from the quarterly accounts published on March 29<sup>th</sup>, the accounts of the institutional sectors published on March 31<sup>st</sup>, as well as the amendments approved in the parliamentary processing of the budgets and the economic policy measures implemented up to the time of publication of the report -

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<sup>2</sup> [Supplementary Report on the Main Lines of the 2021 Budgets of the Autonomous Regions.](#)

<sup>3</sup> [Supplementary Report on the Main Lines of the 2021 Budgets of the Local Governments](#)

including the new extension of the ERTes until May 31<sup>st</sup> and the fund for direct support for businesses and self-employed workers.

**Uncertainty about the development of the pandemic and about other essential determining factors of growth makes it necessary to establish certain assumptions.** Firstly, it is assumed that the vaccination process will speed up over 2021 so that herd immunity is gradually achieved, thus allowing a gradual transition towards the normalisation of economic activity in 2022. The slowdown in the infection process resulting from vaccinations in countries such as Israel or in certain population groups (healthcare workers and residents of old people's homes) and the announcement by the European authorities of a forthcoming acceleration in the vaccination process would support this assumption. This is an essential condition for an economy such as Spain's, which is so specialised in sectors that require social interaction. However, new waves of the pandemic requiring restrictions in the coming months cannot be ruled out. The recovery of tourist flows, a key element in determining macroeconomic scenarios, goes hand-in-hand with the assumptions about the pandemic. At the time of publication of this report, the specific projects that make up the Recovery, Transformation and Resilience Plan (RTRP) and the level of implementation that will be possible are not yet known in detail. This is compounded by the possible delay caused by the recent decision of the German Constitutional Court<sup>4</sup>. All this leads AIR<sup>e</sup>F to extend the macroeconomic impact of the RTRP over time, delaying it compared with the forecast made in autumn 2020. An impact of 1.6 pp of GDP in 2021 is now estimated, compared with 2.7 pp in the previous forecasts.

**It should be highlighted that these assumptions and, therefore, the macroeconomic scenario, will be revised with the Stability Programme Update (SPU 2021-2024).** It is important to highlight that these assumptions, and therefore the resulting macroeconomic scenario, will be revised when preparing the macroeconomic scenario for the 2021-2024 horizon, which is necessary for assessing the macroeconomic forecasts of the Stability Programme Update (SPU 2021-2024).

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<sup>4</sup> At a European level, the implementation of *Next Generation EU (NGEU)* requires that the EU's Own Resources Decision - approving the main sources of revenue of the European budget - has been approved by the national parliaments of the EU Member States. The German Constitutional Court blocked approval by the German Government until it decides whether NGEU is consistent with the EU Treaty and the German Constitution. In addition to ratification of the recovery fund in all Member States, EU approval of the national plans setting out the reforms and investments to be financed by these funds is still pending.

**The macroeconomic and budgetary assessment presented in this report is divided into six sections.** Following this introduction, Section 2 sets out the content and scope of the report. Section 3 analyses the evolution of the macroeconomic scenario, starting with recent economic developments and assumptions about tourism returning to normal and the impact of the RTRP in 2021 and other external assumptions. It then offers an in-depth analysis of the reasons for revising the scenario to end with an overview of the associated risks. Section 4 refers to the development of the budgetary scenario, indicating the impact of fiscal policy measures, and then analyses in detail the evolution of revenue and expenditure for the General Government as a whole and for each of the sub-sectors. It concludes with information on contingent liabilities and fiscal risks. Section 5 assesses the challenges to the sustainability of public finances resulting from the updated macroeconomic and budgetary scenarios. Finally, Section 6 presents the recommendations drawn from the analysis conducted.

## 2. PURPOSE AND SCOPE

The main purpose of this report is to assess the initial budgets in relation to the changes noted with regard to the previously reported main budgetary lines. AIReF prepares this report with the GSB for 2021, completed with the measures approved by the Government and the additional information received. With this data, it updates the forecast for 2021 for the Central Government (CG) and Social Security Funds (SSFs) sub-sectors. In the case of the ARs and LGs, the analysis has been carried out by comparing the information of the initial budgets for 2021 with the information analysed in the reports of the main budgetary lines, except in those ARs and LGs with budgets that have been carried over.

**As compliance with fiscal rules, which are suspended for 2021, is not to be assessed, AIReF's fiscal supervision takes on greater importance as a guarantor of the sustainability of the General Government.** The activation of this escape clause in October 2020, as a result of the extraordinary emergency situation resulting from the pandemic, rendered the fiscal rules for 2021 without effect. Instead, a General Government reference deficit was set for 2021. Against this backdrop of an absence of fiscal rules, the need for AIReF to monitor the fiscal situation of the different authorities in order to guarantee the sustainability of public finances is heightened.

**AIReF gives its opinion on the situation of the General Government as a whole and of each of the sub-sectors, which is supplemented in the area of**

**the territorial administrations with additional individual reports.** This report analyses the forecasts for 2021 for the General Government as a whole and broken down by sub-sector. In addition, the assessment included in this report for the AR and LG sub-sectors is supplemented, at a regional level, with the publication of the individual reports on initial budgets for 2021; and at a local level, with a more extensive report with the individualised analysis of the 21 large LGs and the three Provincial Councils in the Basque Country, in addition to the Local Governments with significant risks in terms of sustainability, according to AIReF's selection and rating methodology.

**The analysis has been constrained by the same limitations noted in the previous report on the main budgetary lines for 2021 of November 5<sup>th</sup> 2020:**

- 1. The lack of an initial budget in national accounting terms and national accounting adjustments.** The approved 2021 GSB, like the draft budget, does not include information on the reconciliation of the budgetary balance with the reference deficit, which is measured in national accounting terms. This information has been published since 2003 among the budgetary documentation, but stopped being published as from the 2017 GSB. Furthermore, the Economic and Financial Report of the Social Security system published information in national accounting headings until 2017. This lack of information, contrary to EU legislation and the principle of transparency provided for in the Organic Law on Budgetary Stability and Financial Sustainability (Articles 6 and 27) significantly conditions AIReF's analysis. In addition to failing to publish the adjustments, an initial budget expressed in national accounting terms is not published either, which makes it extremely difficult to reconcile the two methodologies.
- 2. The lack of greater transparency with regard to the obligations and potential risks of the CG.** Although it may not be classified as a limitation on the scope of the approved GSB, as was the case with the draft budget, the GSB does not include information on possible liabilities faced by the CG resulting from contingent liabilities. This lack of information takes on greater importance in the GSB for 2021 as AIReF considers there are greater fiscal risks than in other years as the ordinary risks are compounded by those generated as a consequence of the pandemic, as set out in Section 4.5 on contingent liabilities and fiscal risks.

**In addition, the initial 2021 GSB incorporates the amendments approved in the articles of the law, but not in the budget items.** The amendments that have been approved in the parliamentary procedure for approving the 2021 GSB and which have resulted in a quantified modification of the expenditure

statements have not been reflected in the initial appropriations of the affected budget items, although they have been set out in the articles of the approved budget law. In this regard, Article 2 of the Law on the General State Budget indicates, in a footnote, that these amendments have not been passed on to the initial appropriation figures “because they cannot be implemented in accounting terms”. This circumstance, without becoming a limitation on the scope, hinders the analysis and interpretation of the initial budgets and amounts to a lack of transparency with regard to implementation of the amendments which, despite being approved, have not been included in the budgetary appropriations. Neither is it known how or when they will be incorporated.

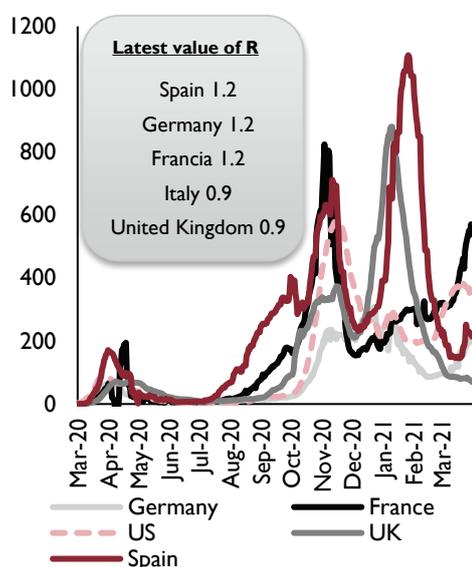


# 3. MACROECONOMIC SCENARIO

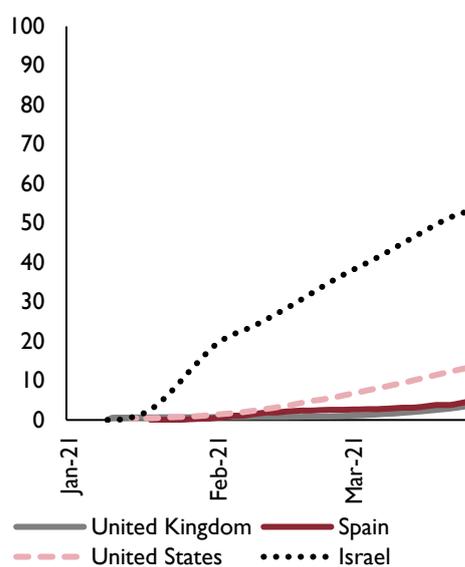
## 3.1. Recent evolution of the Spanish economy

**In addition to the new assumptions about the future development of the pandemic, the pace at which tourism will return to normal and the time distribution of the impact of the RTRP, the scenario for 2021 incorporates the most recent information on the position of the economy.** In this regard, the seriousness of the pandemic during the winter has cut short the economic recovery projected at the end of the previous year. The first quarter was marked by a high level of coronavirus infections in several European countries, in addition to the temporary disruption caused by the adverse weather phenomenon of Storm Filomena in Spain. As of the date of this report, France, Italy, Germany and also Spain are showing increasing rates of infection.

**FIGURE 1. NUMBER OF NEW COVID-19 CASES. (CASES PER MILLION INHABITANTS)**

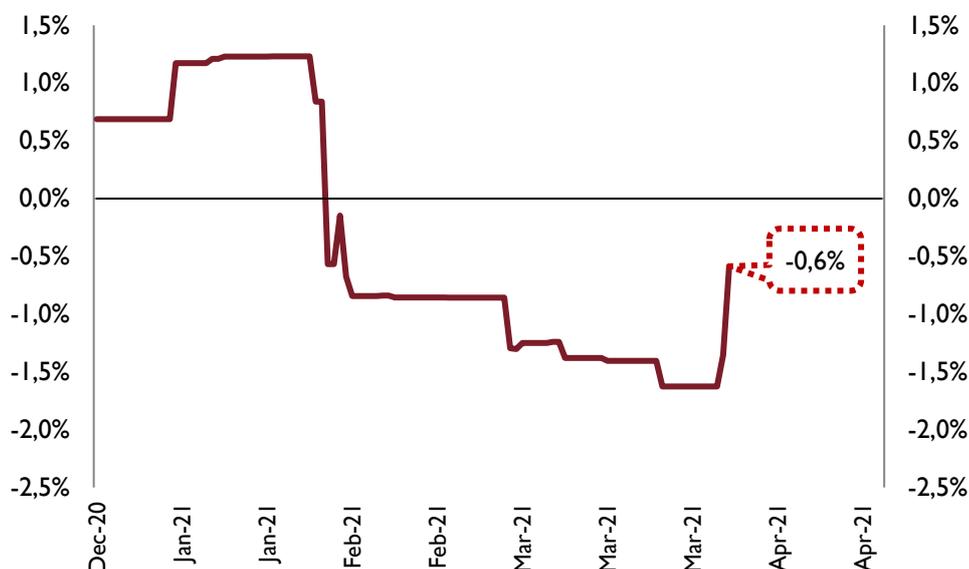


**FIGURE 2. VACCINATION RATE IN VARIOUS COUNTRIES. (PERCENTAGE OF PEOPLE WITH FULL CYCLE)**



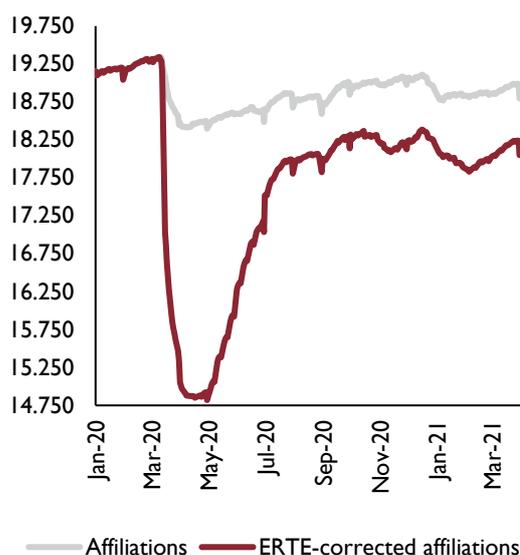
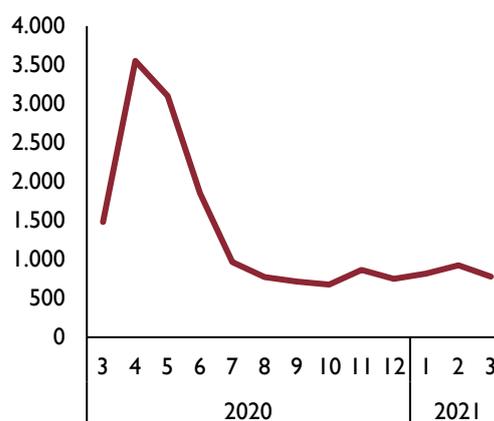
Source: Our World in Data. Data taken on 02/04/2021.

The available indicators suggest that, after stabilising towards the end of 2020, GDP may record a new contraction in the first quarter of 2021. In particular, the dynamic factor model calculated by AIReF (MIPred) - which synthesises the information on the most significant activity and employment indicators for the Spanish economy - currently offers an estimate of the quarter-on-quarter change in GDP for the first quarter of -0.6% (with information that is still very partial for 50% of the information on the quarter).

**FIGURE 3. ESTIMATE OF THE QUARTER-ON-QUARTER RATE OF CHANGE IN GDP**


Source: AIRcF (06/04/2021).

The recovery in employment was cut short at the start of the year, although there was an improvement in March. Although the unemployment rate remains at historically low levels in relation to the drop in activity recorded, the number of Social Security affiliations remains at levels lower than those seen before the crisis and the number of people under ERTes remains high.

**FIGURE 4. AVERAGE SOCIAL SECURITY AFFILIATIONS AND ERTE-CORRECTED AFFILIATIONS (THOUSANDS)**

**FIGURE 5. ERTE MONTHLY AVERAGES SINCE MARCH 2020 (THOUSANDS)**


Source: Ministry of Inclusion, Social Security and Migration.

**The persistence of the pandemic accentuates divergences between sectors, regions and individuals.** At a sectoral level, the manufacturing sector performed well, while the recovery in the activity of the services sector slowed down at the beginning of the year, although to a lesser extent than during the first wave of the pandemic in early 2020. These divergences can also be seen in the different Autonomous Regions, with a more marked deterioration in those with greater relative specialisation in service sectors or in those where the severity of the pandemic has required greater restrictions on mobility in the first few months of the year. In the same vein, at an individual level, the health crisis continues to have a greater impact on people with lower income levels and on certain groups such as young people, who have very high levels of unemployment.

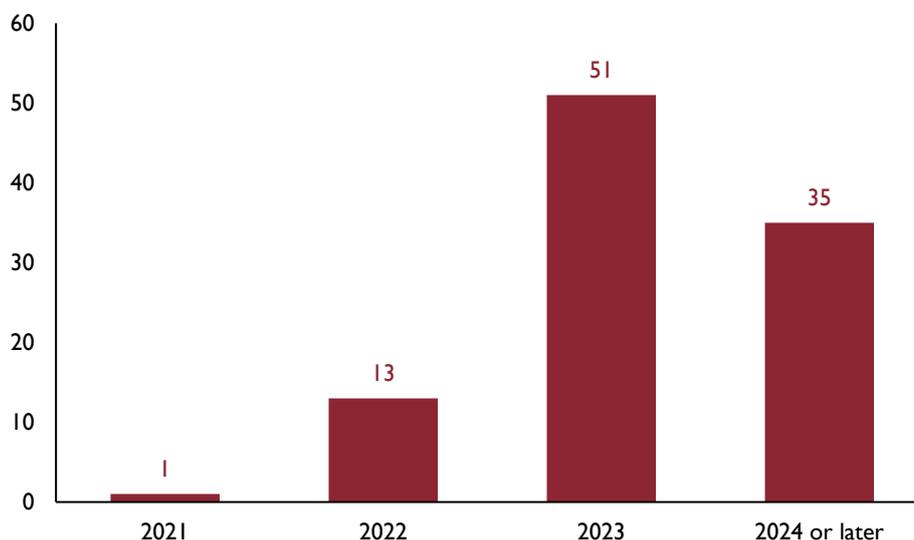
### 3.2. Assumption about the return of tourism to normal and about the impact of the RTRP in 2021 and other external assumptions

**Expectations for the recovery of international tourism are strongly dependent on deployment of an effective treatment to curb the health crisis.** The possible evolution of international tourism flows is closely interlinked with the evolution of the vaccination process and the pandemic. In Europe, it might be favoured if initiatives such as the Digital Green Certificate are implemented successfully. At present, the scenarios considered by the World Tourism Organization<sup>5</sup>, put full recovery of international tourist flows back to mid-2022 or even 2023. However, the assumption about the acceleration of the vaccination process in Europe, from which most foreign tourists visiting Spain come, leads us to expect an improvement in international tourism revenues over 2021.

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<sup>5</sup> See, "*Impact assessment of the covid-19 outbreak on international tourism*" <https://www.unwto.org/impact-assessment-of-the-covid-19-outbreak-on-international-tourism>.

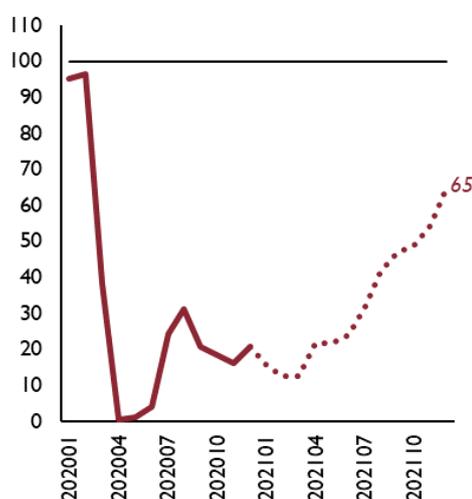
**FIGURE 6. UNWTO: YEAR OF RETURN OF INTERNATIONAL TOURISM IN EUROPE TO PRE-PANDEMIC LEVEL (% RESPONSES)**



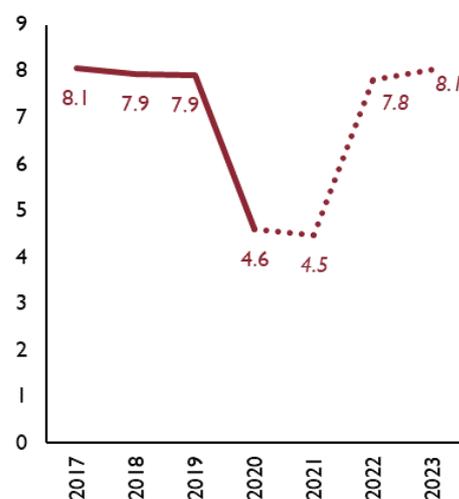
Source: UN World Tourism Organization.

Based on these premises, AIRcF's scenarios incorporate a recovery in revenue from international tourism over 2021, with full recovery delayed until 2022. This scenario of gradual recovery assumes that over the summer months foreign tourism would average a level close to 40% of that recorded before the crisis and would not recover pre-crisis levels until 2022.

**FIGURE 7. AIREF ASSUMPTIONS ON THE EVOLUTION OF AIR PASSENGER TRAFFIC (INDEX 2019=100)**



**FIGURE 8. ASSUMPTIONS ON THE EVOLUTION OF TOURISM. WEIGHT OF DIRECT BRANCHES OF TOURISM\*. (% TOTAL GVA)**



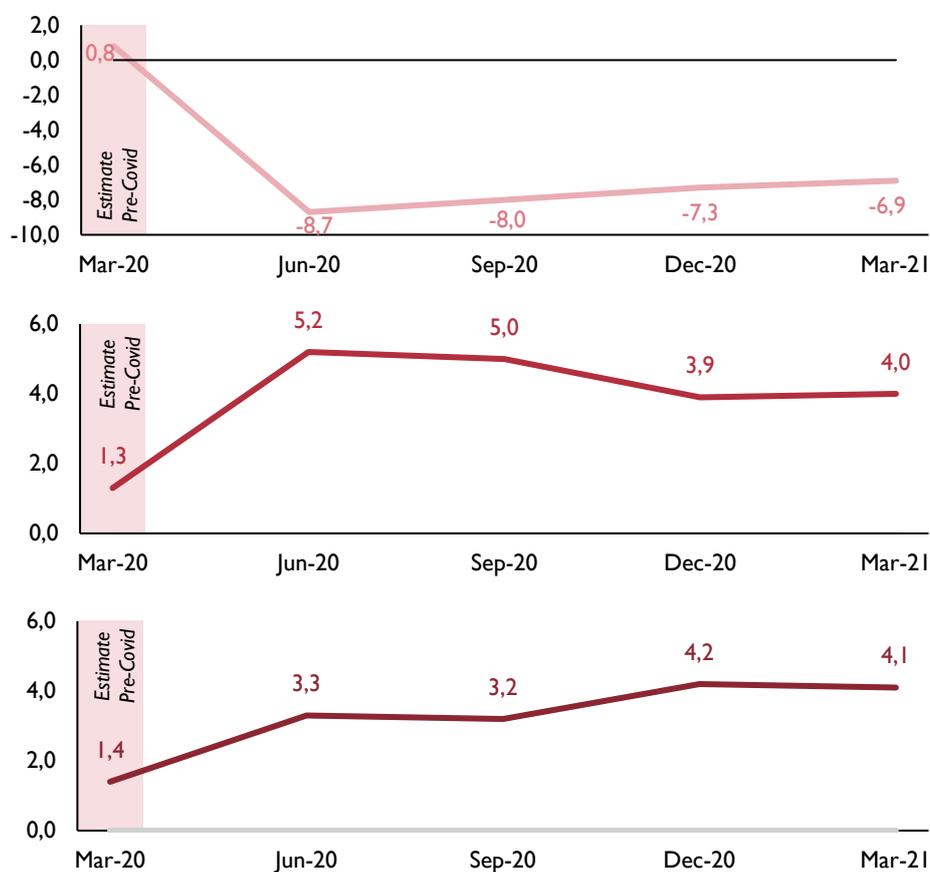
Source: INE and AIRcF.

\*Weight of branches 50-51-55-56-79-90-92 in GVA.

**Another essential determining factor for the intensity of the recovery in 2021 is the implementation and macroeconomic impact of the Recovery, Transformation and Resilience Plan.** AIReF has delayed the macroeconomic impact of the plan, which was previously assigned to 2021. This is due to the lack of detailed information on the projects contained in the plan that the Government must submit to the European Commission by April 30<sup>th</sup> and on the start of the implementation of these projects, together with the possible interference in the approval that, at a European level, might be caused, *inter alia*, by the decision of the German Constitutional Court to block the German Government's ratification of the NGEU. Accordingly, last October AIReF estimated that the RTRP would have an impact on GDP growth of 2.7 pp in 2021. When making this estimate, AIReF assumed full execution of the €27bn contained in the budgets for 2021, spread evenly over the year. With the information available, it is considered more plausible that execution of the funds will be delayed to the second half of 2021. Therefore, full deployment of the macroeconomic effects would be delayed over time. Specifically, the impact of the RTRP on GDP growth is estimated to reach a maximum level of 1.6 pp in 2021. This effect is conditional on the effective implementation of all budgeted resources in this year and on the detail of the projects undertaken being of sufficient quality to achieve the high multiplier effect that the economic literature associates with public investment performed in a coordinated manner by several countries in a context such as the current one (characterised by a high degree of slack in the economy and absence of expectations of interest rate hikes). As in the case of the scenarios of a return to normal tourism, the uncertainty around these estimates is high.

**Finally, this review of the scenarios takes into account the most recent forecasts on global growth and new technical assumptions about the financial, exchange and commodity markets.** In this regard, while the growth outlook for the US and China improves for 2021, driven by significant expansive fiscal policies, the growth estimates in the Euro area is revised downwards in the same year, compared with the expectations in autumn 2020.

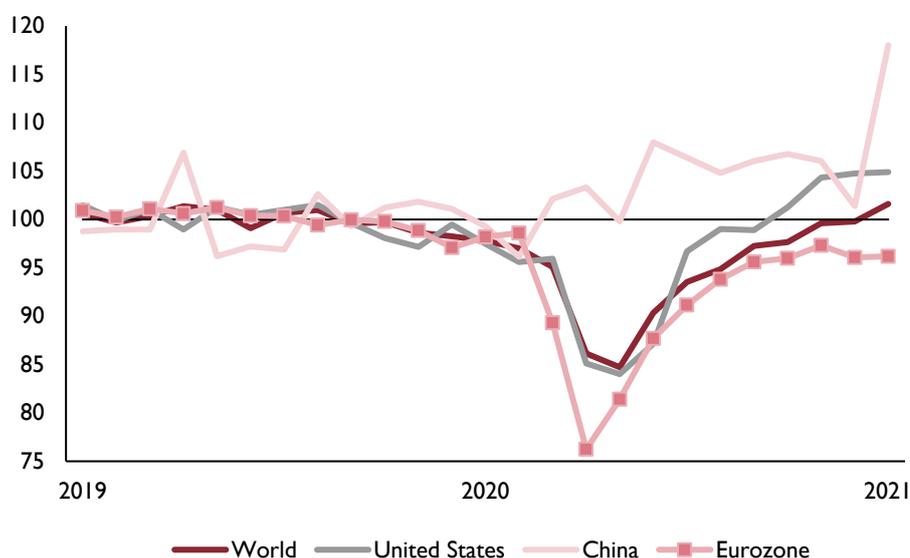
FIGURE 9. EVOLUTION OF GDP FORECASTS FOR THE EURO AREA (RATE OF CHANGE) IN 2020, 2021 AND 2022



Source: European Central Bank.

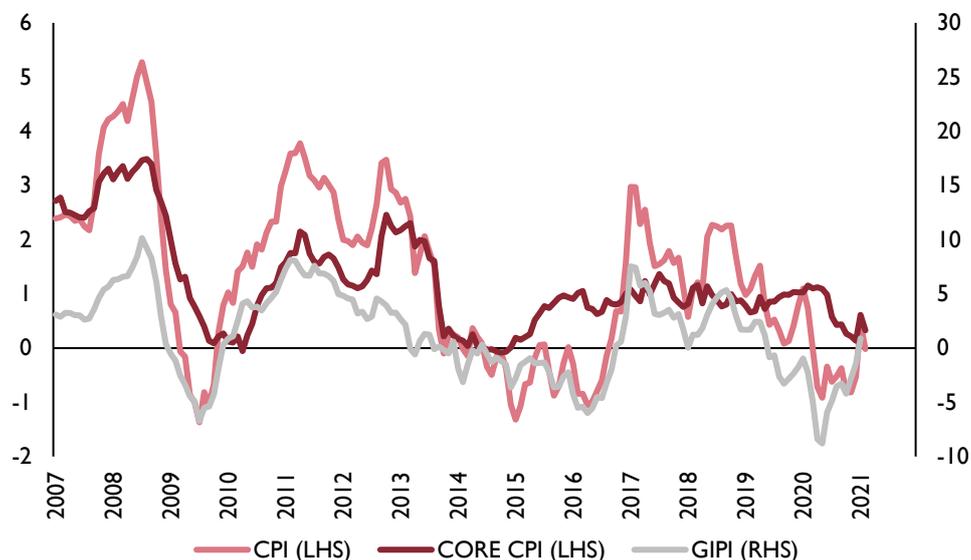
The better economic performance in geographical areas such as the US and China has also been reflected in the uneven recovery in foreign trade in goods by geographical area. While imports of goods, in terms of volume, in the US and China are even higher than before the pandemic, those destined for the Euro area are still below pre-pandemic levels.

FIGURE 10. WORLD TRADE IN GOODS. IMPORTS. INDEX 2019=100.

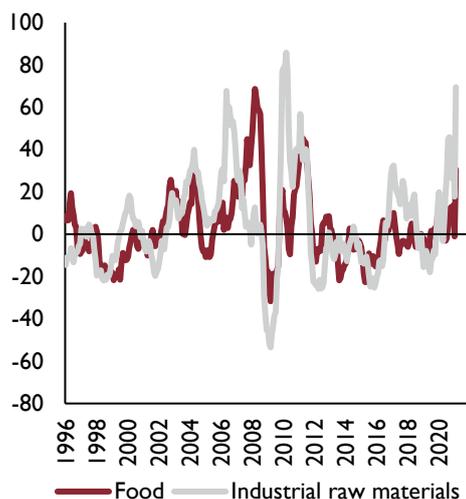
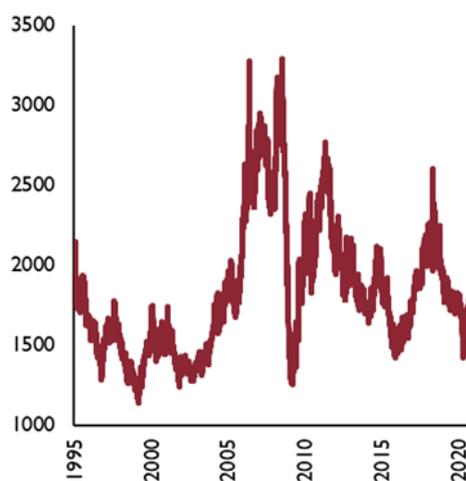


Source: CPB Netherlands.

**In commodity markets, prices have risen across the board, although global inflation remains contained.** Commodity and oil prices in international markets have turned upwards, encouraged by the improvement in the outlook for recovery in the United States and Asia. Inflation at the global level and in the case of the Spanish economy has also risen, although largely due to some base and composition effects associated with changes in the consumption basket during the coronavirus crisis. Core inflation indicators, which discount the most volatile components, maintain moderate increases at a global level in a context of weak demand and significant slack in job and product markets.

**FIGURE 11. CONSUMER AND INDUSTRIAL PRICE INDICES (YEAR-ON-YEAR RATE)**


Source: National Statistics Institute.

**FIGURE 12. THE ECONOMIST PRICE INDICES (YEAR-ON-YEAR RATE)**

**FIGURE 13. ALUMINIUM PRICE (USD/T)**


Source: Ministry of Economic Affairs and Digital Transformation.

### 3.3. Macroeconomic scenario for 2021

AIReF estimates growth of 6.6% in 2021, a downward revision of 1.6 pp compared with the central scenario presented in October 2020. This revision is partly the result of the more adverse evolution of the pandemic than expected in the central scenario of DBP 2021 for the first quarter of 2021 and,

to a greater extent, by the delay in the time distribution of RTRP projects, which, as indicated, does not decrease the estimated impact, but does shift part of it to 2022.

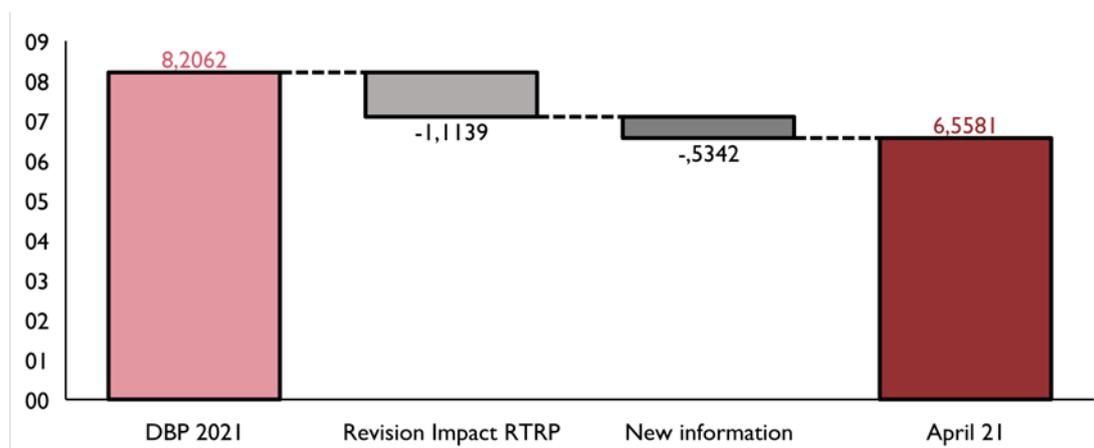
TABLE 1. FINAL MACROECONOMIC OUTLOOK. COMPARISON.

Year-on-Year Rates of Change	2020	2021			
		October scenarios			Current scenario
		Optimistic	Central	Pessimistic	
Domestic Demand*	-8.8	10.9	9.4	8.2	7.3
External balance*	-2.0	-0.9	-1.1	-1.7	-0.7
Gross Domestic Product	-10.8	10.0	8.2	6.5	6.6
Gross Domestic Product Deflator	1.1	1.5	1.3	1.1	1.5
Full-Time Equivalent Employment	-7.5	9.1	6.8	4.8	4.6

Sources: INE and AIReF estimates.

\* Contribution to growth

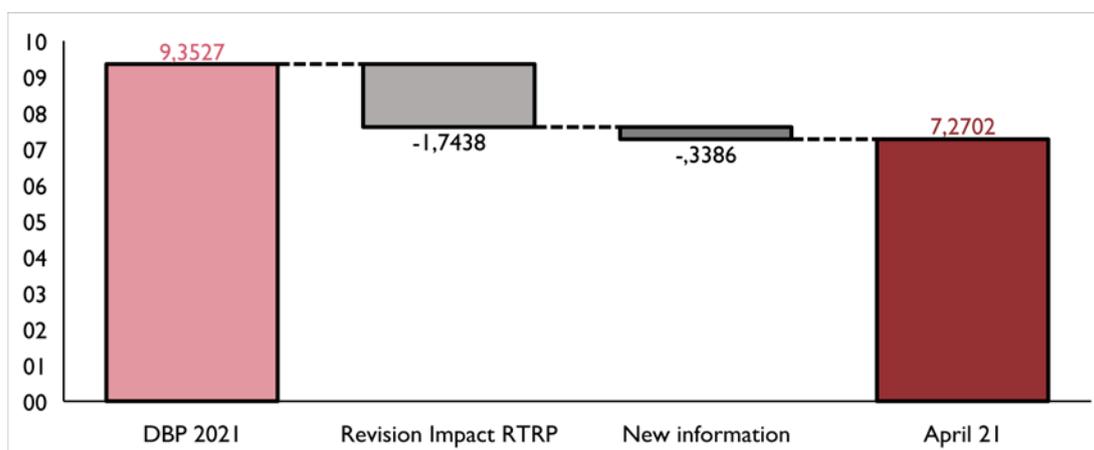
FIGURE 14. GROSS DOMESTIC PRODUCT IN 2021 IN TERMS OF VOLUME (RATE OF CHANGE)



Source: AIReF estimates.

Domestic demand and, in particular, investment growth is revised downwards due to the lower impact of the RTRP. The contribution of domestic demand to output growth is lower by over 2 pp compared with the estimates made in the autumn. This mainly reflects the lower expected growth in investment in equipment and construction in 2021 as a result of the delayed macroeconomic effects of the RTRP.

FIGURE 15. CONTRIBUTION OF DOMESTIC DEMAND (PERCENTAGE POINTS)



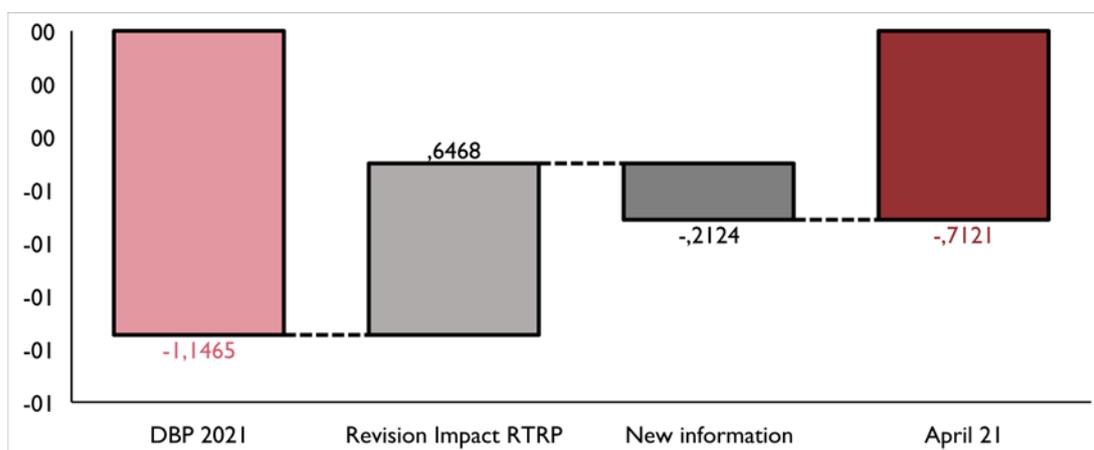
Source: AIReF estimates.

**Private consumption is also revised downwards, although it would remain the main driver of growth in 2021, with a contribution of 4.2 pp.** The current information on the evolution of private consumption available for the early months of the year points to negative performance as a result of the mobility restrictions implemented and, to a much lesser extent, adverse weather phenomena. Nevertheless, a significant recovery is expected over 2021 under the assumption that the pandemic will be contained, which would allow the deployment of the pent-up demand and the forced savings accumulated by households as a whole. Accordingly, the household savings rate would fall in 2021, although without returning to pre-pandemic levels as a result of the existing uncertainty.

**The only component to be revised upwards is General Government consumption.** Another component undergoing significant revisions is General Government consumption, mainly as a result of the incorporation of new information relating to the national accounts for 2020.

**For its part, the contribution of external demand would be negative, mainly due to the negative performance of tourism in the first half of the year and the partial improvement expected later.** However, compared with the estimates made in October 2020, the negative contribution of external demand is lowered by 0.5 points. This is due to the fact that a smaller recovery in imports is estimated, in line with the smaller recovery in domestic demand, while the forecast for exports is barely revised as the moderately negative effect of delayed implementation of the RTRP and the appreciation of the exchange rate would be more than offset by the relatively better performance of this aggregate towards the end of 2020.

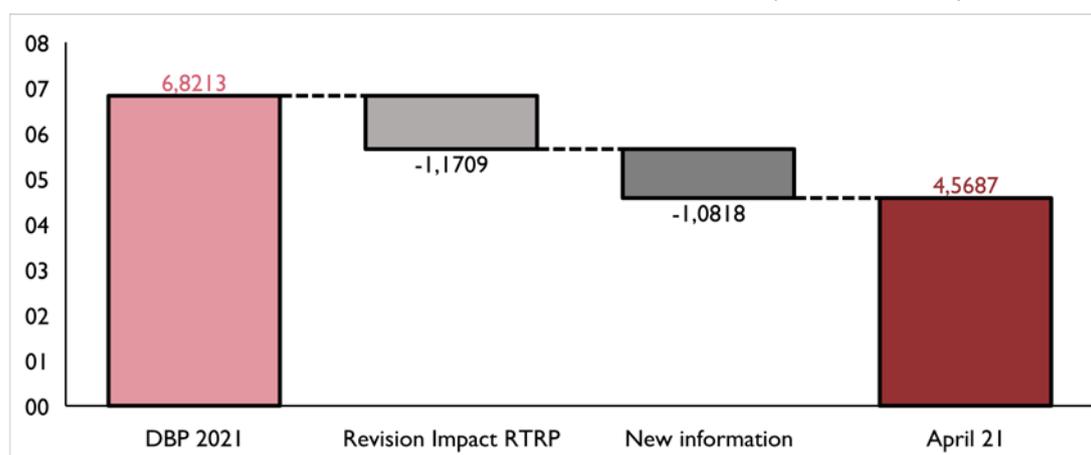
**FIGURE 16. CONTRIBUTION OF EXTERNAL DEMAND (PERCENTAGE POINTS)**



Source: AIReF estimates.

Full-time equivalent employment is expected to recover by less than the figure forecast in October, in line with the downward revision in GDP growth. Specifically, AIReF estimates full-time equivalent employment growth of 4.6%, 2.3 pp lower than expected in the October central scenario. This revision is the result of the downward revision in expected GDP growth in 2021. This evolution would lead to an increase in apparent labour productivity of 2%, 0.6 points higher than that forecast previously, thus starting to offset the large contraction (-3.5%) recorded in 2020.

**FIGURE 17. FULL-TIME EQUIVALENT EMPLOYMENT IN 2021 (RATE OF CHANGE)**



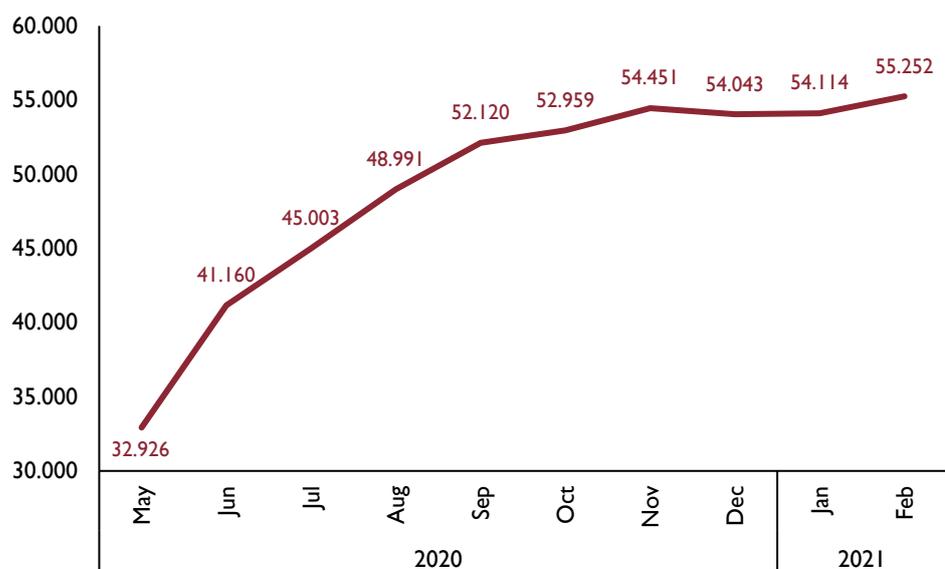
Source: AIReF estimates.

### 3.4. Risk overview

**Downside risks persist around this scenario.** As mentioned, the scenario presented in this report for 2021 constitutes an update made with the purpose of assessing the level of compliance of the initial budgets, by incorporating the most recent information on the pandemic and the economic situation worldwide. These estimates may be revised in relation to the assessment of the Stability Programme, when more complete information on the quarterly accounts or on the RTRP becomes available. However, at the time of presenting this report, uncertainty remains with regard to the severity of the successive waves of the pandemic until progress is made with the vaccination process.

**The deployment of an effective remedy to the pandemic is essential in order for activities involving greater social interaction to return to normal and the existing slack in the job market to be reabsorbed.** A slower deployment than that considered in the scenarios would delay the recovery of international tourism and hinder the upturn in consumption and investment expenditure, thus putting back the recovery in employment. The persistence of the pandemic also accentuates the possibility of permanent damage to the business fabric. However, the credit guarantee measures implemented have, for the time being, prevented the deterioration of business assets.

**FIGURE 18. OUTSTANDING BALANCE PENDING AMORTISATION OF LOANS UNDER MORATORIA (MILLION EUROS)**



Source: Bank of Spain.

**Uncertainty also exists about the macroeconomic impact associated with the Recovery, Transformation and Resilience Plan.** As of the date of this report, the national programme is still subject to negotiation with the European Commission and its final version has not yet been published or submitted for approval by the EU Council. The final impact that will be achieved in 2021 will depend on the level of execution of the expenditure already incorporated in the budgets for that year and the quality of the projects that are initiated.

# 4. ANALYSIS OF 2020-2021 BUDGETARY SCENARIO

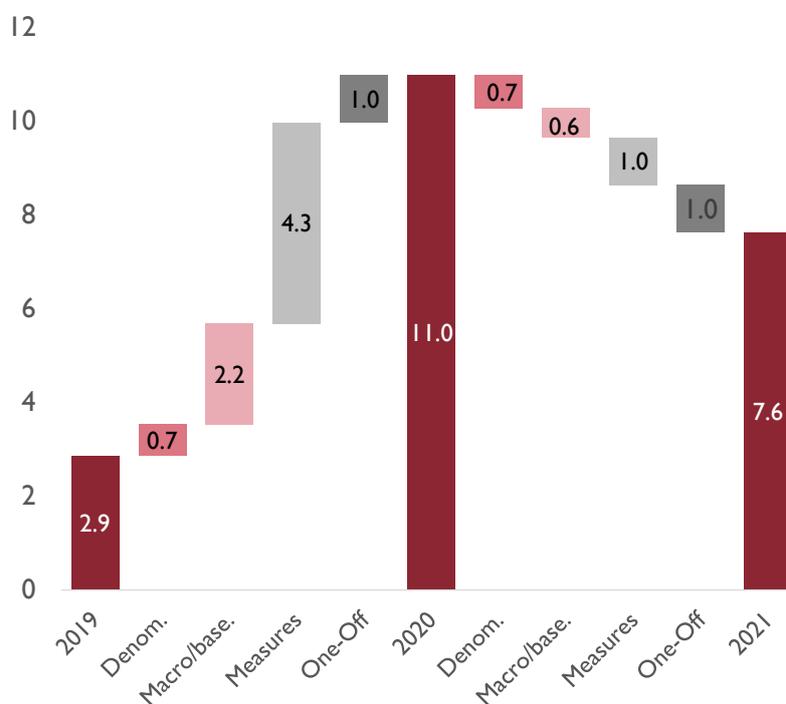
For its central scenario, AIReF estimates a deficit of 7.6% of GDP for the GG in 2021, a little over 0.3 points lower than that estimated in November in the previous report. Since AIReF's previous report, published on November 5<sup>th</sup>, several factors have led to a change in the budget forecast. On the one hand, the recent evolution of the pandemic and its consequences on the economy have led to the revision of the macroeconomic scenario, which in turn is passed on to the budgetary scenario. In addition, governments have also reacted by approving new measures to mitigate the effects of the crisis and changes have been introduced during the procedure for approving each public authority's budget. Furthermore, AIReF has incorporated the most recent information into its forecasts, particularly the figures for year-end 2020, which have placed the deficit at 11% of GDP. Finally, AIReF continues to assume that the Recovery, Transformation and Resilience Plan (RTRP) will have a neutral effect on the 2021 deficit. The update of the deficit forecasts would put AIReF's central scenario at 0.1 points below the reference rate set by the Government in the Budgetary Plan submitted to the European Commission in October.

**The new measures approved by governments raise the 2021 deficit by one point of GDP.** To mitigate the effects of the pandemic on the economy, Central Government approved, by Royal Decree-Law, the granting of direct aid in an amount of €11bn. In addition, some of the measures provided for in

the draft General State Budget to raise taxes were not approved in the end. Similarly, no significant progress has been made in processing the regulations for the creation of taxes on single-use plastic containers or waste, so their impact on revenue in 2021 is also reduced. Lastly, the Regional Governments have also continued to approve new measures to mitigate the health and economic crisis and estimates of healthcare and education expenditure associated with the pandemic have been updated according to the latest information available.

**The revision of the macroeconomic scenario results in an increase in the deficit of 1 point of GDP.** AIReF's central macroeconomic scenario means lower GDP growth in 2021, which would stand at 6.6% compared with the 8.2% forecast in the previous report. Lower economic growth, in turn, translates into lower growth in tax revenues. On the one hand, indirect taxes would mainly be affected by the lower forecast of domestic demand, while the forecast revenue from Personal Income Tax and social contributions would fall as a result of more limited growth in employee remuneration. The reduction in the GDP forecast in nominal terms for 2021 also raises the deficit-to-GDP ratio by 0.3 points.

**The new data incorporated in the deficit update, mainly the year-end 2020 figures, imply a deficit in 2021 that is 2.3 points of GDP lower.** The General Government deficit in 2020 was 0.6 points lower than that forecast by AIReF in its previous report, including some non-recurring, unforeseen elements. The lower expenditure in 2020 means a lower starting point for the current year. In addition, the tax collection figures published since the previous report have been above AIReF's expectations. Firstly, collection of the third instalment of Corporate Income Tax was higher than expected. Secondly, collection of VAT in January and February, which reflects the level of activity in the final months of 2020, was also higher than expected. Finally, the information provided by the various public authorities has been incorporated, as well as other data available to date.

**FIGURE 19. EVOLUTION OF DEFICIT BY COMPONENT, AIREF (% GDP)**


The economic recovery explains 1.3 points of GDP of the reduction in the deficit in 2021 compared with 2020, while the progressive withdrawal of measures will result in a reduction of 1 point. The weight of the deficit over GDP rises by 8.1 points in 2020 from 2.9% in 2019 to 11%. The fall in economic activity, which hampers the public accounts, explains 2.9 points of this change, and the measures implemented to mitigate the effects of the crisis on households explains 4.3 points, while 1 point is explained by non-recurring elements. A recovery in economic activity is expected in 2021 as the effects of the pandemic fade, leading to an improvement in the public accounts that will help reduce the deficit by 1.3 points. This includes the increase in revenue from economic recovery, the baseline evolution of expenditure and the denominator effect of nominal GDP growth. In addition to this, there is a further 1-point reduction due to the progressive withdrawal of the measures approved in 2020 to mitigate the effects of the pandemic.

The absence of non-recurring elements, such as the reclassification of the SAREB within the public sector, explains a further reduction in the deficit of 1 point in 2021. The reclassification of the SAREB as part of the General Government had an impact on the deficit in 2020 of €9.98bn as a result of the incorporation of the losses generated since its creation. This will not happen again in 2021 and the deficit will therefore automatically fall by that amount. In addition, €1.45bn was allocated to the deficit in 2020 as a result of the ruling on the Castor project, which will not be repeated in 2021.

**TABLE 2. REVENUE AND EXPENDITURE OF THE GENERAL GOVERNMENT WITHOUT RTRP (% GDP)**

% GDP	2019	2020		2021	
		Lines 21	Year-end	Lines 21	Current
REVENUE	39.2	41.0	41.3	39.7	40.4
EXPENDITURE	42.0	52.5	52.3	47.6	48.0
<b>NET LENDING/BORROWING</b>	<b>-2.9</b>	<b>-11.6</b>	<b>-11.0</b>	<b>-8.0</b>	<b>-7.6</b>

**TABLE 3. REVENUE AND EXPENDITURE OF THE GENERAL GOVERNMENT WITH RTRP (% GDP)**

% GDP		2020		2021	
		Lines 21	Year-end	Lines 21	Current
REVENUE	39.2	41.0	41.3	42.5	43.3
EXPENDITURE	42.0	52.5	52.3	50.5	50.9
<b>NET LENDING/BORROWING</b>	<b>-2.9</b>	<b>-11.6</b>	<b>-11.0</b>	<b>-8.0</b>	<b>-7.6</b>

AIReF forecasts that revenue, excluding the RTRP, will be 40.4% of GDP in 2021, above the forecast included in the previous report. On the one hand, the lower GDP forecast in AIReF's new central macroeconomic scenario means an increase in the weight of revenue compared with the November report. In addition, the revision of the macroeconomic scenario results in a reduction in the forecasts for the collection of taxes and social contributions compared with the previous report. These are offset by the incorporation of the most recent figures for collection and year-end 2020 figures. Including the RTRP, revenue would stand at 43.3% of GDP in 2021.

According to AIReF's estimates, expenditure in 2021, excluding the RTRP, will be 48%, compared with 47.6% in the previous report. In this case, the denominator effect of the lower GDP forecast also means an increase in the weight of expenditure. Furthermore, the new measures also imply a higher expenditure of about 1 point of GDP. Finally, excluding the effect of non-recurring elements, expenditure in 2020 was 1.2 points lower than estimated by AIReF in the November report. This is mainly due to lower than expected public consumption of the territorial administrations not linked to the pandemic. This implies a lower starting point, thus lowering the expenditure forecast for 2021.

**Fiscal projections remain subject to a high degree of uncertainty due to the development of the pandemic and implementation of the RTRP.** Although the health crisis is on the way to being resolved as a result of mass vaccination of the population, uncertainty remains about the pace of vaccination and the outbreak of new waves of the pandemic that might affect economic activity as at the start of the year. In addition, the RTRP is still in the design phase, and its detailed content is not yet known. Therefore, although its implementation is still within the timeframe set by legislation, early execution of the RTRP in the first half of the year can now be ruled out. However, AIReF

maintains execution of the RTRP in the terms set out in the GSB as part of its central scenario.

**AIR<sup>e</sup>F still deems it essential to design a credible and realistic medium-term fiscal strategy.** Although the budgetary stability and debt targets have been suspended, AIR<sup>e</sup>F continues to highlight the existence of high levels of debt that will become accentuated over the coming years. This increases the importance of fiscal oversight and the urgency of designing a consolidation path.

## 4.1. Impact of fiscal policy measures

**Fiscal policy measures are revised upwards, by 1 point of GDP compared with the report on the main budgetary lines.** The measures included in the public accounts for 2021 continue to be marked by the measures aimed at mitigating the negative effects that the pandemic has had on activity and income. Since the report on the main budgetary lines, these types of measures have taken on greater importance, contributing 0.9 points more to the expected deficit for 2021 together with, to a lesser extent, those measures integrated into the usual budget cycle.

### 4.1.1. Impact of measures against the COVID-19 crisis

**The measures against COVID-19 accounted for 4.3% of GDP in 2020 and might account for 2.7% of GDP in 2021.** Central Government and the Regional Governments took a wide variety of measures to mitigate the effects of the crisis in 2020. Although most of the measures adopted are temporary and will be automatically reversed, they will still have an impact on the deficit in 2021, albeit smaller than in 2020. In addition, new measures have been approved since the draft GSB for 2021 was approved on October 28<sup>th</sup>. Consequently, the total impact on GDP for 2021 will rise by one percentage point since AIR<sup>e</sup>F's last assessment.

**Particularly important among the new measures is the new package of extraordinary measures to support business solvency in response to the COVID-19 pandemic amounting to €11bn. These will have an impact on the deficit of 0.7% of GDP.** On March 12<sup>th</sup>, a package of extraordinary measures to support corporate solvency was approved for self-employed workers and companies. Part of this package of measures, amounting to a total of €7bn, will be implemented through direct support to companies and self-employed workers and will be aimed at settling debts and paying suppliers and other creditors, and will be managed by the ARs. Secondly, a COVID-19 line for restructuring financial debt with effects in 2021 and 2022 is created.

With an amount of €3bn, companies and self-employed workers who make use of it may reduce the outstanding principal in publicly-guaranteed transactions through debt renegotiation agreements. Finally, the package of measures includes the creation of a new recapitalisation fund for companies affected by COVID-19, under the Ministry of Industry, Trade and Tourism, with the aim of providing temporary public support to strengthen the solvency of Spanish companies through debt, capital and hybrid capital. This new fund will be endowed with €1bn, but will not, in theory, have a direct impact on the deficit as they will be financial transactions with viable companies.

**The estimated impact of the pandemic on healthcare expenditure in 2021 rises, although it maintains its weight as a proportion of GDP at 0.4%.** This increase in healthcare expenditure in 2020 has finally been valued at €1bn above the estimates of the previous report, amounting to 0.7 points of GDP. It has been recorded mainly by the ARs, although it has been financed by the CG through the COVID-19 Fund. The estimates for 2021 have been revised with the new information provided by the ARs, which raises the estimate of the previous report on healthcare spending in the year by close to €1bn, 65% of the expenditure incurred in 2020. It is still difficult to predict what proportion of this increase in spending will be structural to strengthen the healthcare system.

**At a regional level, measures for 2021 associated with the pandemic outside the area of healthcare have been reported for 0.3% of GDP.** With the new information provided, the estimates of the report on the budgetary lines in terms of weight are maintained, but with a different distribution. The expected impact of education measures is reduced by over €1bn. They would therefore only have an impact of 0.1 point of GDP, but the estimated cost of measures for boosting the economy and social services, which would amount to 0.2% of GDP, rises by €2bn.

**TABLE 4. IMPACT OF MEASURES**

Impact of the measures (sign + = greater deficit)	AIReF Report Main Lines				AIReF Report Initial Bud.				Differences	
	2020		2021		2020		2021		2020	2021
	€ million	% GDP	Millions	% GDP	€ million	% GDP	€ million	% GDP	€ million	
<b>Central Government</b>	<b>2,306</b>	<b>0.2</b>	<b>421</b>	<b>0.0</b>	<b>2,219</b>	<b>0.2</b>	<b>2,674</b>	<b>0.2</b>	<b>-87</b>	<b>2,253</b>
<b>Expenditure measures</b>	<b>2,083</b>	<b>0.2</b>	<b>437</b>	<b>0.0</b>	<b>1,504</b>	<b>0.1</b>	<b>2,143</b>	<b>0.2</b>	<b>-579</b>	<b>1,706</b>
Healthcare expenditure	1,317	0.1	77	0.0	1,030	0.1	76.5	0.0	-287	0
Social expenditure measures	147	0.0	0	0.0	147	0.0	0	0.0	0	0
COVID debt restructuring line		0.0		0.0		0.0	1500	0.1	0	1500
Other expenditure measures	619	0.1	360	0.0	327	0.0	566	0.0	-292	206
<b>Tax measures</b>	<b>224</b>	<b>0.0</b>	<b>-16</b>	<b>0.0</b>	<b>715</b>	<b>0.1</b>	<b>531</b>	<b>0.0</b>	<b>491</b>	<b>547</b>
VAT: Reduction in rates for COVID-19 medical supplies, e-books, disposable face masks, vaccines and in vitro diagnostics	72	0.0	52	0.0	301	0.0	538	0.0	229	486
Proportional reduction in Objective Estimation for the days in the state of alarm: instalment payments of the CIT for SMEs: Waiver of the Personal Income Tax Objective Estimation Regime and the Simplified and Special Agriculture VAT Regime.	152	0.0	-68	0.0	189	0.0	-78	0.0	37	-10
Support measures for companies and self-employed workers (RDL 35/2020)					0	0.0	71	0.0	0	71
COVID-19 deferrals and suspensions (RDL 7,8,11,15/2020)					225	0.0	0	0.0	225	0
<b>SSFs</b>	<b>30,536</b>	<b>2.7</b>	<b>10,881</b>	<b>0.9</b>	<b>29,869</b>	<b>2.7</b>	<b>12,646</b>	<b>1.0</b>	<b>-667</b>	<b>1,765</b>
Job-Retention Scheme	14,738	1.3	4,171	0.3	15,549	1.4	4,756	0.4	811	585
Self-employed workers	6,018	0.5	2,271	0.2	5,543	0.5	3,340	0.3	-475	1,069
Benefit for cessation of activity	4,726	0.4	157	0.0	3,859	0.3	1,322	0.1	-867	1,165
Exemption from contribution	2,388	0.2	63	0.0	2,248	0.2	509	0.0	-140	446
Temporary incapacity for work	2,108	0.2	1,263	0.1	2,112	0.2	1,263	0.1	4	0
Other measures	66	0.0	0	0.0	66	0.0	0	0.0	0	0
Minimum Living Income	492	0.0	2,956	0.2	492	0.0	1,456	0.1	0	-1,500
<b>Autonomous Regions</b>	<b>11,501</b>	<b>1.0</b>	<b>8,566</b>	<b>0.7</b>	<b>13,552</b>	<b>1.2</b>	<b>16,554</b>	<b>1.4</b>	<b>2,051</b>	<b>7,988</b>
Revenue measures AR	537	0.0	367	0.0	412	0.0	176	0.0	-125	-191
Non-healthcare expenditure measures	3,615	0.3	3,756	0.3	4,789	0.4	10,950	0.9	1,174	7,194
Of which: Support for companies and self-employed workers (RDL 5/2021)							7,000	0.6	0	7,000
Healthcare expenditure measures AR	7,349	0.7	4,443	0.4	8,352	0.7	5,428	0.4	1,003	985
<b>LG</b>	<b>2,960</b>	<b>0.3</b>	<b>1,326</b>	<b>0.1</b>	<b>2,268</b>	<b>0.2</b>	<b>729</b>	<b>0.1</b>	<b>-692</b>	<b>-597</b>
Revenue measures LG	1,255	0.1	474	0.0	1,018	0.1	78	0.0	-237	-396
Expenditure measures LG	1,705	0.2	852	0.1	1,250	0.1	651	0.1	-455	-201
<b>TOTAL MEASURES</b>	<b>47,303</b>	<b>4.2</b>	<b>21,194</b>	<b>1.7</b>	<b>47,909</b>	<b>4.3</b>	<b>32,602</b>	<b>2.7</b>	<b>605</b>	<b>11,408</b>

The impact of income replacement measures approved in 2020 is revised upwards by 0.1 points for 2021, amounting to 1% of GDP, due to the extension of the extraordinary benefits for self-employed workers. The extension of the job-retention schemes (ERTEs) was already provided for in the previous report. Both the ERTes and the extraordinary benefits and exemptions from social contributions for self-employed workers are extended until May 31<sup>st</sup> through RDL 2/2021 of January 26<sup>th</sup>, on strengthening and consolidating company measures to protect employment. However, the estimate of the additional impact that it will eventually have on the deficit is revised upwards by 0.1 point of GDP with regard to the previous report. However, this impact is still considerably lower than it had in 2020, at 2.7% of GDP.

AIReF updates the cost associated with ERTes for *force majeure* to €8.1bn in 2021, assuming that this measure remains in force until at least the end of June of this year. AIReF expects that the extension of the validity of the ERTes

approved on January 26<sup>th</sup> until May 31<sup>st</sup> will be maintained at least until June 30<sup>th</sup>. Part of the total amount - €4.76bn - is due to unemployment benefits corresponding to existing ERTes, the processing of which is simplified. The rest - €3.34bn - is the cost of the exemptions from social security contributions of the companies that benefit from these ERTes. These exemptions differ depending on the type of ERTE to which the companies are subject. These are different for the most protected sectors from those for companies that have been prevented from carrying on their activity as a result of administrative restrictions or decisions adopted by the authorities as a measure to contain the pandemic. The increase in the cost compared with the previous report is due to the increase in the number of ERTes in January and February resulting from the additional restrictions imposed due to the third wave. AIReF believes that the number of beneficiaries will fall as the months pass.

**The benefit for the cessation of activity of self-employed workers and the exemption from the payment of contributions, extended until May 31<sup>st</sup>, will have a total impact of €1.83bn for 2021.** AIReF's estimate of the impact of the support measures for self-employed workers has been revised upwards for 2021 by almost €1.5bn due to their extension until May 31<sup>st</sup> by RDL 2/2021 of January 26<sup>th</sup>. Specifically, the validity of all existing types is extended: the benefit for suspension of activity in view of the restrictive measures for containing the pandemic, the benefit compatible with the activity (with the invoicing requirement now made more flexible), the extraordinary low-income benefit for those who do not meet the requirements for other benefits and the benefit for seasonal self-employed workers. The number of self-employed workers receiving this benefit, about 350,000, has remained stable in recent months. The number of beneficiaries is expected to remain stable until the end of the period they are in force.

**AIReF reduces its estimate of the cost of the Minimum Living Income for 2021 by half, €1.5bn.** This change is justified by the data published, which show that the number of approved beneficiaries of the benefit is far lower than the number of potential beneficiaries that had been estimated.

**In fiscal matters, new measures have also been approved to mitigate the effects of the pandemic, although they would only have a small effect on the deficit.** Among the new measures approved are the changes to VAT on medical devices<sup>6</sup>, which increase the estimate compared with the previous

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<sup>6</sup> RDL 34/2020 of November 17<sup>th</sup>, 2020 extends until April 30<sup>th</sup>, 2021 application of zero-rate VAT on medical devices intended for public, non-profit and hospital entities and reduces the rate applicable to disposable surgical masks to 4%, valid until December 31<sup>st</sup>, 2021. RDL 35/2020 of 12 December 2020 establishes zero-rate VAT for vaccines and products for *in vitro* diagnosis of COVID-19 valid until December 31<sup>st</sup>, 2022.

report by €229m for 2020 and €486m for 2021. In addition to these changes in VAT, an additional €71m is estimated for 2021 for the measures taken to alleviate the economic situation of businesses and self-employed workers due to the restrictions under the new declaration of the State of Alarm, through RDL 35/2020 of December 22<sup>nd</sup>, 2020. This reinstates some tax measures that were previously in force and adopts new ones to help reduce the economic impact on particularly vulnerable sectors such as hospitality, retail and tourism. In addition, with the latest collection information available and the year-end data for 2020, it can be noted that from the deferrals and suspensions of tax debt deadlines in 2020, granted to facilitate compliance with tax obligations during the pandemic, that €225m of the €533m outstanding at the end of 2020 have been considered irrecoverable.

#### 4.1.2. New measures included in the Budgetary Plan and the General State Budget

**AIR<sup>e</sup>F incorporates in its estimates the amendments approved during the parliamentary processing of the GSB for 2021. Particularly noteworthy in the expenditure is the additional allocation of €283m to update the protection for dependent people.** The amounts of the minimum level of protection guaranteed by the General State Administration for each person benefiting from the System for the Autonomy and Care of Dependent People, for which €283m are transferred to the SSFs in addition to those initially planned, with the ARs in charge of the final processing. Consequently, this establishes the level of financing agreed between the GSA and the ARs for the System for the Autonomy and Care of Dependent People, which will have a final allocation of €566m.

**The valuation of the revenue measures for 2021 is reduced by €1.1bn compared with the previous report, mainly in environmental tax measures.** The changes stem from the rejection during the parliamentary procedure of the increase in diesel oil rates, the revision of the estimates of the tax on single-use plastic containers and the tax on waste, the pace of processing of the Anti-Fraud Act, and the exclusion of liquid yoghurts from the increase in VAT on sugary drinks.

TABLE 5. IMPACT OF REVENUE MEASURES: AIREF ESTIMATE

Impact of the REVENUE measures 2021	AIREF ESTIMATE Main lines		AIREF ESTIMATE Initial budgets		Differences Initial Bud. - Main Lines	
	€ million	% GDP	€ million	% GDP	€ million	% GDP
<b>Financial Transaction Tax (new tax)</b>	<b>593</b>	<b>0.0</b>	<b>593</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>
<b>Tax on Certain Digital Services (new tax)</b>	<b>542</b>	<b>0.0</b>	<b>542</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>
<b>Environmental taxation:</b>	<b>1,124</b>	<b>0.1</b>	<b>313</b>	<b>0.0</b>	<b>-811</b>	<b>-0.1</b>
Reduction of the diesel allowance	571	0.0	0	0.0	-571	0.0
Tax on Plastics (new tax)	123	0.0	98	0.0	-25	0.0
Tax on Waste (new tax)	431	0.0	215	0.0	-215	0.0
<b>Direct taxation measures</b>	<b>592</b>	<b>0.0</b>	<b>592</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>
Personal income tax: Increase in higher income bases	119	0.0	119	0.0	0	0.0
Corporate income tax: Limitation on exemption dividends and capital gains	473	0.0	473	0.0	0	0.0
<b>Indirect taxation measures</b>	<b>660</b>	<b>0.1</b>	<b>641</b>	<b>0.1</b>	<b>-19</b>	<b>0.0</b>
Change in VAT rate for sweetened and sugary beverages	208	0.0	189	0.0	-19	0.0
Insurance premium rate increase	452	0.0	452	0.0	0	0.0
<b>Fight against tax fraud</b>	<b>491</b>	<b>0.0</b>	<b>217</b>	<b>0.0</b>	<b>-273</b>	<b>0.0</b>
<b>Other measures</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>
<b>Total revenue measures</b>	<b>4,002</b>	<b>0.3</b>	<b>2,898</b>	<b>0.2</b>	<b>-1,104</b>	<b>-0.1</b>

The rejection of the increase in rates on diesel subtracts €571m from the increase in revenue estimated for the new revenue measures. The increase of rates on diesel A of €38 per 1,000 litres presented initially in the Draft was not accepted in the parliamentary processing of the budget.

**AIREF reduces the impact of the new taxes on single-use plastics and waste by €240m compared with the previous report.** The annual valuation of the tax on plastic has been revised using data from the production of plastic items for transport or packaging from the Industrial Product Survey of the National Statistics Institute (INE). On this production, less the recycling rate obtained from the data on Generation and Management of packaging waste of the Ministry for the Ecological Transition and Demographic Challenge, the established tax (0.45 euros/kg) is applied. This results in an estimate that is 20% lower than that presented in the draft GSB. It should be noted that the valuation of the Waste Tax<sup>7</sup> is also reviewed, resulting in an estimate similar to

<sup>7</sup> On the basis of the INE statistics on waste collection and processing, the preliminary estimate is drawn up considering municipal waste as the urban waste included in these statistics. A second estimate is made by replacing the urban waste data with the information on municipal waste contained in the Annual Report on Municipal Waste Generation and Management of the Ministry for Ecological Transition and Demographic Challenge. The final estimate is obtained as an average of both results.

that presented in the draft GSB. Lastly, the annual impact of both taxes is reduced to one single quarter of 2021 as the Draft Bill on Waste and Contaminated Soils was submitted to the Council of State on March 8<sup>th</sup> and must still be approved as a Bill and pass through the parliamentary processing procedure. This reduces the time it will be in force in 2021 and, therefore, the potential tax collection.

**The estimate of the increase in VAT on sugary and sweetened drinks is also reduced by €19m as liquid yoghurts have been excluded.** In the course of parliamentary scrutiny of the Budget, an amendment was adopted which excludes liquid yoghurts from the increase in VAT from 10% to 21%. Therefore, AIR<sup>e</sup>F has cut the regulatory impact of the initially proposed measure.

**The estimated impact of the measures to combat tax fraud is reduced by €273m due to the delay in their parliamentary processing.** The breakdown of these measures includes strengthening the list of defaulters, restricting the use of cash between employers and professionals, and adopting regulatory, organisational and operational measures in line with best international practices. The impact compared with the valuation in the previous report is reduced because the Law on Measures to Prevent and Combat Tax Fraud is still being processed through Parliament. The impact of the list of defaulters in 2021 is eliminated as it is not expected to be made effective until 2022 as the list refers to tax debts at December 31<sup>st</sup> of the previous year. The annual effect of the other anti-fraud measures is reduced as they will only affect half of 2021.

#### 4.1.3. Recovery, Transformation and Resilience Plan

**AIR<sup>e</sup>F maintains its fiscal estimate with respect to the figures included in the Report of the Main Budgetary Lines relating to the Recovery, Transformation and Resilience Plan.** The initial appropriations of service 50, corresponding to the Recovery and Resilience Facility, and those of service 51, corresponding to REACT EU, approved in the GSB correspond to the estimate included in the previous report. In the absence of new information, the annual forecasts are maintained, although a shift in project execution towards the second half of the year is assumed. This also means that part of the macroeconomic effects are shifted to 2022. At any event, the recent temporary suspension of the ratification of the Own Resources Decision by the German Constitutional Court might pose a risk of a delay to the full execution of these appropriations in 2020.

## 4.2. Evolution of General Government Revenue

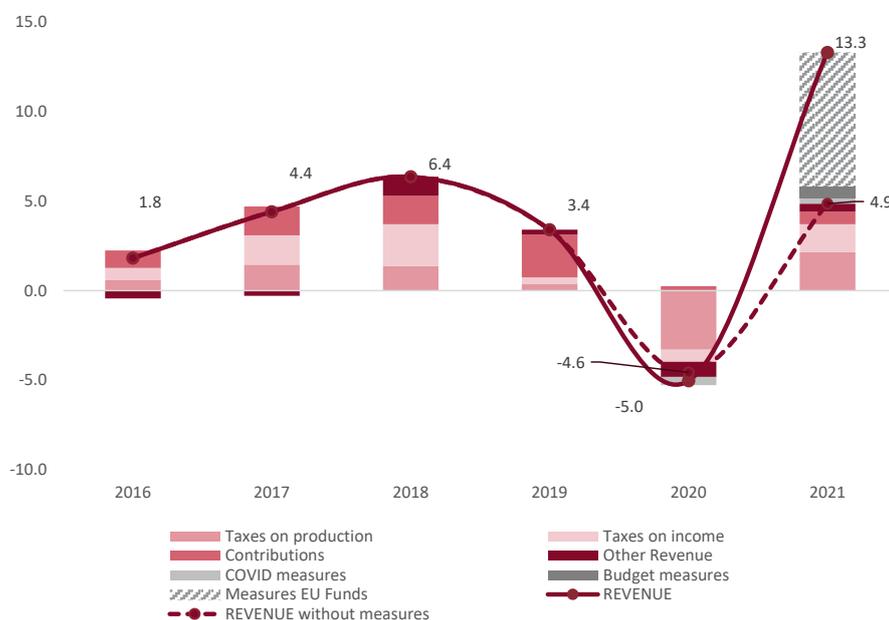
AIReF estimates that in 2021 revenue will stand at 43.3% of GDP, 0.7 points higher than that forecast in the previous report. The revised 0.7 points are the result of various opposing factors. On the one hand, in the downward direction, the updating of the macroeconomic scenario explains a reduction of 0.2 points as the denominator effect leading to an increase of 0.5 points does not offset the effect of a fall in the level of revenue amounting to 0.7 points. The change in the legislative measures results in the reduction of an additional 0.1 points. On the other hand, in an upward direction, the year-end figures for 2020 lead to a level of revenue that is 0.3 points higher, which will cause a carry-over effect in 2021. In addition to this, 0.7 points need to be added due to the incorporation of new information into AIReF's forecasts. This new estimate is 0.2 points higher than that forecast for 2021 in the Budgetary Plan, with differences in components.

**TABLE 6. BREAKDOWN OF THE CHANGE IN REVENUE BETWEEN AIREF'S ESTIMATES IN THE REPORT ON THE MAIN LINES OF THE 2021 BUDGET AND THE CURRENT FIGURE.**

	2021 Main Lines Report	Breakdown of change in % GDP				2021 Current	Current- Lines Difference
		Denominator effect	Effect of measures differential	Macro effect	Effect of year- end 2020/New information		
<b>REVENUE</b>	<b>42.5</b>	<b>0.5</b>	<b>0.0</b>	<b>-0.7</b>	<b>1.0</b>	<b>43.3</b>	<b>0.7</b>
<b>TAXES</b>	22.5	0.3	0.0	-0.4	0.5	22.9	0.4
<i>On production</i>	11.4	0.2	-0.1	-0.1	0.1	11.4	0.0
<i>On income</i>	10.7	0.1	0.0	-0.2	0.4	11.1	0.4
<i>Capital</i>	0.4	0.0	0.0	0.0	0.0	0.4	0.0
<b>CONTRIBUTIONS:</b>	13.4	0.2	0.0	-0.3	0.4	13.6	0.2
<i>Other Revenue</i>	6.6	0.0	0.0	0.0	0.1	6.8	0.2

By heading, income taxes, social contributions and other revenue are responsible for changing the 2021 forecast, with income taxes improving by 0.4 points and social contributions and other revenue each improving by 0.2 points. The year-end figures for 2020 have largely shaped the new forecast by raising the starting point by 0.1, 0.2 and 0.1 points of GDP, respectively. Taxes on production and capital maintain their weight in GDP.

AIReF's scenario estimates a recovery in revenue of 13.3% in 2021, 4.9% without taking into account the effect of the RTRP or the measures. The fall forecast by AIReF for 2020 was 6.4%, while the year-end figure shows a fall of 5%. This effect partly explains the revision of growth from 13.8% to 13.3% in the current forecast. With regard to the evolution of the measures, there is a fall compared with the previous report due to the decrease in some of the measures proposed in the draft GSB during its parliamentary procedure.

**FIGURE 20. CONTRIBUTIONS TO THE CHANGE IN REVENUE (%) AIREF**

**TABLE 7. RATE OF CHANGE (%) OF MAIN TAXES AND SOCIAL CONTRIBUTIONS IN NATIONAL ACCOUNTING TERMS**

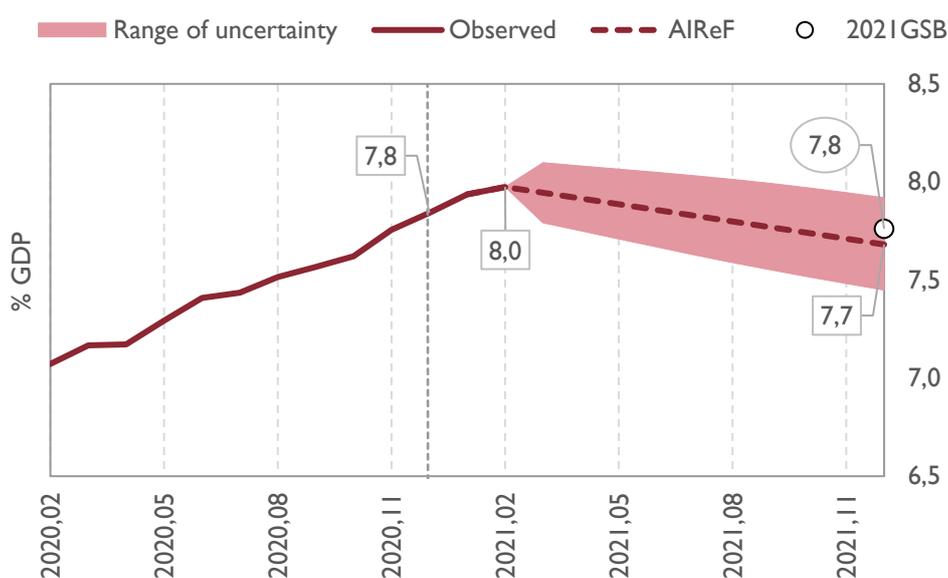
	2020 (Lines 21)	2020 (year-end)	Difference Current-Lines	2021 (Lines 21)	2021 (Current)	Difference Current-Lines
<i>Rate change %</i>						
<i>Taxes on prod. &amp; import.</i>	-12.2	-11.8	0.4	11.0	9.9	-1.1
<i>Household income tax</i>	0.1	-0.3	-0.4	5.1	6.3	1.2
<i>Corporate income tax</i>	-21.9	-13.8	8.1	10.7	14.3	3.6
<i>Social contributions</i>	-1.4	0.8	2.2	3.2	2.0	-1.2

**AIRcF estimates that tax revenue will stand at 22.9% of GDP, 0.4 points higher than in its previous forecast.** The denominator effect adds up to 0.3 points of this change due to the fall in the nominal GDP forecast. There are opposing effects between the changes arising from the revision of macroeconomic forecasts and the changes resulting from the updated information. The tax forecast updates subtract 0.4 points as they generally lead to downward revisions to the estimates as a result of the worsening macroeconomic outlook. In contrast, updating the data with the latest available information from 2021 generates a positive effect amounting to 0.5 points. This is essentially the result of a positive correction of the estimate of Corporate Income Tax in 2020, which consequently changes the estimate for 2021 in the same direction.

### 4.2.1. Personal Income Tax

AIReF revises the weight of collected PIT in 2021 by 0.1 points to stand at 7.7% of GDP, with expected growth of 6% on the figure for 2020. The components of PIT contribute 5.8 points towards its growth, while legislative measures contribute 0.2 points. These are, respectively, 0.6 and 1.1 points more than in the previous report. The changes in collection are the result of several opposing factors. Firstly, in terms of components, the downward revision of the macroeconomic estimates leads to lower revenue from withholdings, which are partially offset by the incorporation into tax payable of the income from ERTE benefits on which no withholdings were made in 2020. Secondly, the effect of the measures to combat tax fraud is reduced and some tax measures that were previously in force to mitigate the effects of the pandemic are reinstated.

FIGURE 21. EVOLUTION OF CASH REVENUE FROM PIT<sup>8</sup> (% GDP)

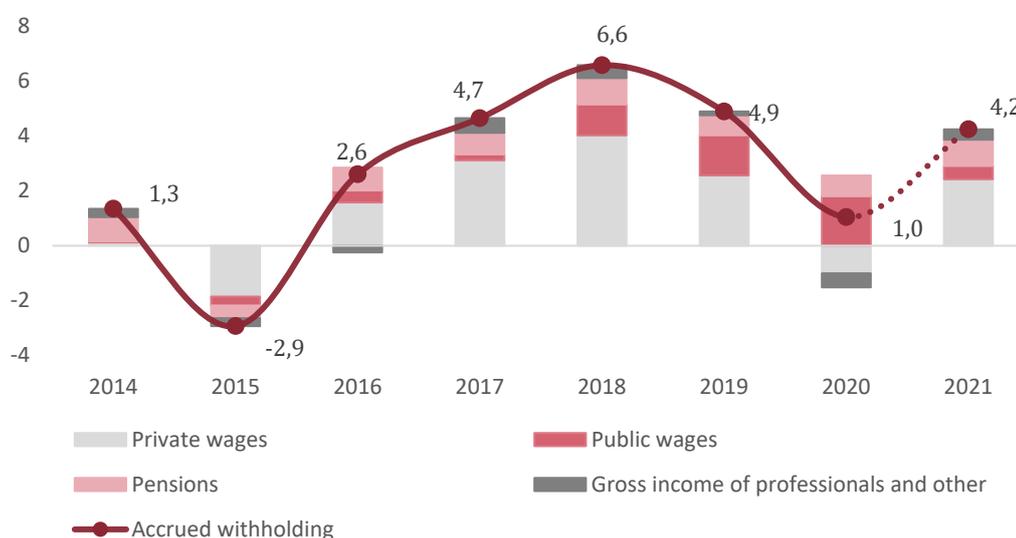


For 2021, accrued withholdings are expected to grow by 4.2% compared with 8.2% in the previous report. These results are essentially due to the macroeconomic evolution of employment and wages, which have softened the fall in employee remuneration in 2020 (leading to a fall that is 2.1 points lower than in the previous report) and have moderated their growth in 2021

<sup>8</sup> AIReF's range of uncertainty is estimated using a VAR model with two lags that includes the seasonally-adjusted series of revenue and expenditure of the sub-sector, nominal GDP, sub-sector debt over GDP and 10-year interest rates. Monte Carlo simulations are performed based on this model. The result of these simulations is sorted in percentiles, from which the range of uncertainty is obtained.

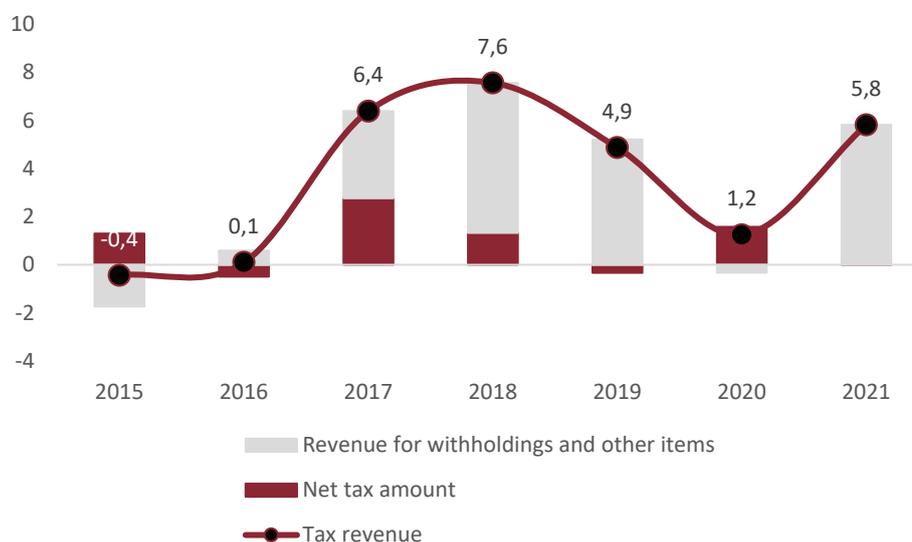
(leading to an increase that is 2.4 points lower). In the same direction, after the fall in withholdings to 1% recorded in 2020, growth of 4.2% is expected for 2021 with a positive contribution from both private wages and gross income of professionals and others. In contrast to what happened in 2020, the main driver of this growth will be the withholdings of private employees, which will rise by 4.4%, in line with the growth in employment. Withholdings for gross income of professionals and others will also record less growth as a consequence of the worsening of the macroeconomic outlook for 2021 compared with the outlook included in the previous report.

**FIGURE 22. CHANGE (%) IN ACCRUED PIT WITHHOLDINGS**



**AIReF estimates contribution to the growth in the net tax amount in 2021 that is 1.5 points lower than that of 2020.** The tax payable in 2021 reflects the fall in the previous year in income not subject to withholding linked to leased properties, capital gains and investment income that AIReF forecasts at 8.6%, 17.8% and 23.9%, respectively. This fall is partly offset by the revenue that is forecast to be collected due to recipients of the ERTE benefit to whom the SEPE did not apply withholding tax in 2020 as the amount did not exceed the minimum threshold.

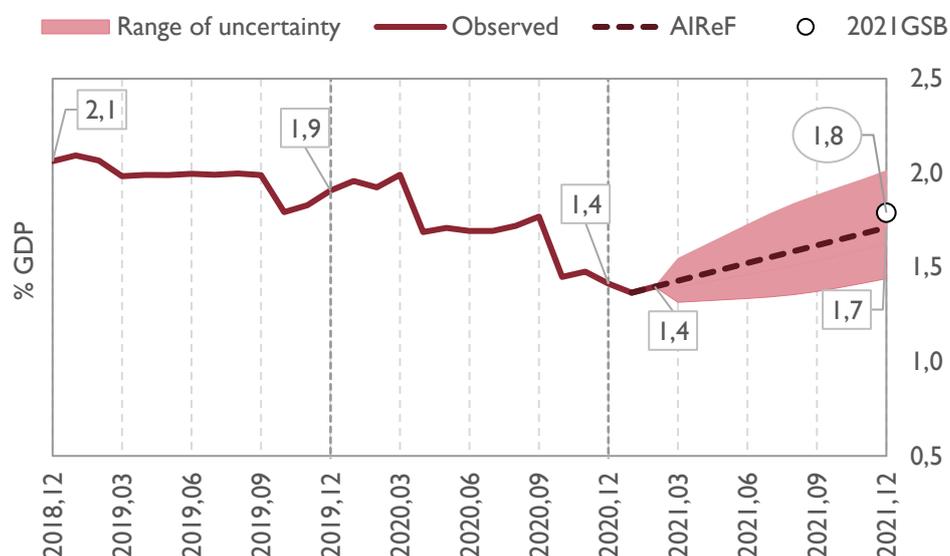
FIGURE 23. CONTRIBUTION TO GROWTH IN CASH BY COMPONENT IN PIT (% CHANGE)



**AIReF forecasts PIT growth in national accounting terms of 6.5%, in line with the growth in cash terms.** A lower adjustment of this cash figure to national accounts is expected compared with the previous report due to a smaller time lag between the cash and the accrual of the first few months and a larger lag, but with a negative sign, in the refunds due to the expected worsening of the macroeconomic situation and the effect of collection mechanics.

#### 4.2.2. Corporate Income Tax

**AIReF forecasts put the weight of Corporate Income Tax at 1.7% of GDP.** The new forecast incorporates the 2020 year-end figure, which was 0.1 points better than expected and updates the forecast for 2021 with the same effect. Collection of CIT in 2021 is expected to grow by 30.9%. The previous estimate had a high component of uncertainty as it was made without having information on the payment of the third instalment, which constitutes a significant part of the tax. The incorporation of year-end 2020 information has led to an increase of €1.6bn. After updating this information and the macroeconomic forecasts, the tax is expected to grow by 26.5%. This increase is reduced by 7.5 points compared with the previous report, in line with the revision of the gross operating surplus, a macroeconomic variable linked to the evolution of Corporate Income Tax. In addition to the growth in collection, there is an increase of 4.4% due to the effect of legislative measures, which are corrected in relation to the previous report due to the reduction of the effect of the anti-fraud law and the adoption of new COVID-19 measures to support vulnerable sectors.

**FIGURE 24. EVOLUTION OF CASH REVENUE FROM CORPORATE INCOME TAX (% OF GDP)**


The evolution of the tax is softened in national accounting terms by the effect of the settlement of the tax. The estimate published by the State Tax Administration Agency (AEAT) of the net tax amount accrued in 2020 and which will be made effective in 2021 is incorporated as new information. This update is expected to result in a drop in the number of requests for refunds, as a result of the lower amount that the minimum payment has meant in the instalments for 2020. This reduction in refunds affects 2021 in national accounting terms because it is the year in which the taxpayer requests the refund, placing their expected growth at 16.2%, 14.7 points below the increase in cash terms.

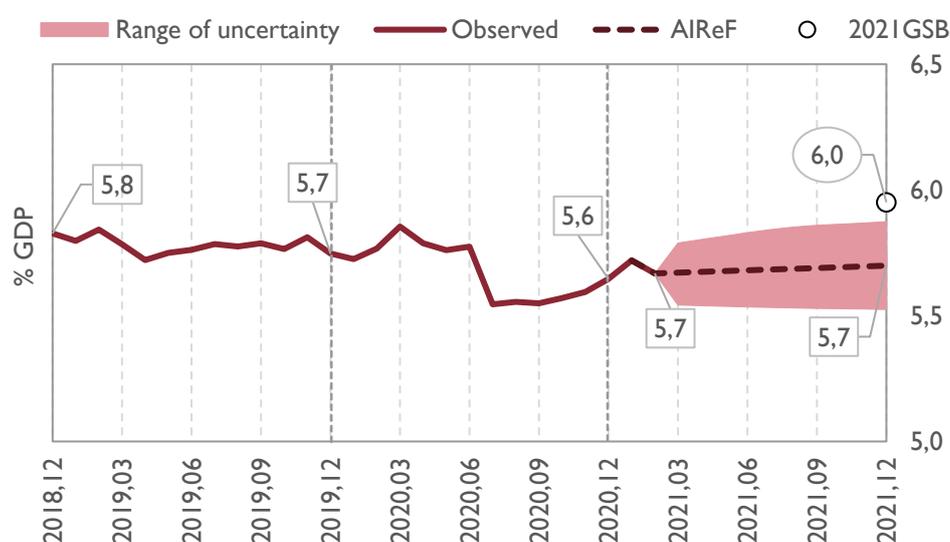
### 4.2.3. VAT

AIReF forecasts that the weight of VAT collection over GDP will be 5.7% in 2021, 0.1 points above the estimate in the previous report. The change is the result of the incorporation of the collection data for January and February, which is better than previously forecast by AIReF, and which reflects the increase in activity recorded over the final months of 2020. Collected taxes are expected to grow by 8.6%, of which gross revenue contributes 9.3 points, while refunds subtract 0.7 points. In addition, the policy measures incorporate 0.6 points of growth. As a consequence of the above, AIReF forecasts that VAT will grow by 9.2% in 2021.

VAT growth in 2021 is stronger in national accounting terms, resulting in expected growth of 10.8%. Shifting revenue to its accrual month moves more revenue affected by the pandemic to 2020 and revenue from months that

are no longer expected to be affected to 2021. This movement between cash and accruals entails an additional increase to that expected in cash terms. The rate of change for 2021 therefore stands at 10.8% in national accounting terms, in line with the forecast development of the macroeconomic variables, nominal private consumption and gross fixed capital formation in construction and intellectual property products.

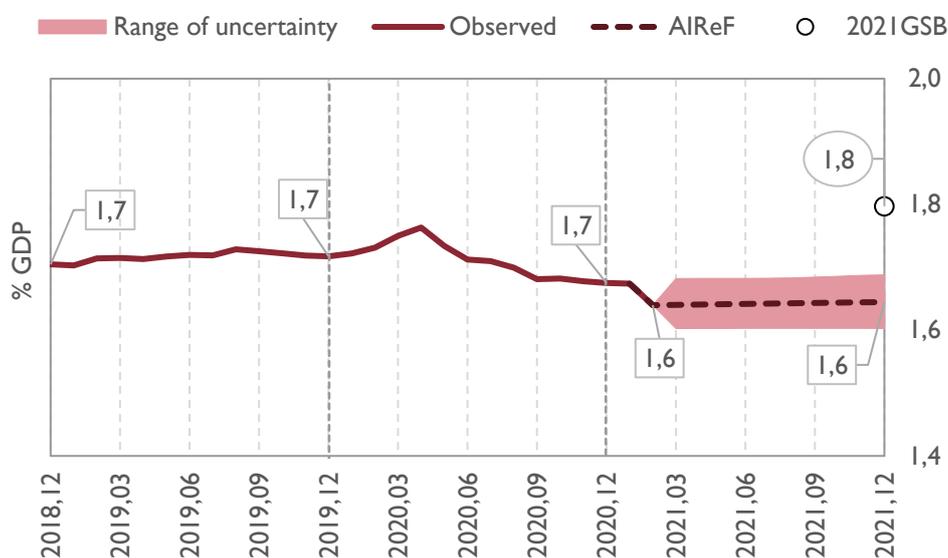
**FIGURE 25. EVOLUTION OF VAT REVENUE (%GDP)**



#### 4.2.4. Special Taxes

**Special taxes will account for 1.6% of GDP in 2021, in line with the estimate included in the previous report.** Following the update of the latest available information, growth in 2021 is expected to be 6.2%. As set out in the section on the impact of fiscal policy measures, the main new development is the rejection of the increase in diesel rates, which subtracts €571m from the previous estimate. However, the denominator effect, determined by a lower forecast of nominal GDP for 2021, means that the weight of special taxes remains the same. The Hydrocarbon Tax, which has been the most affected tax during the pandemic due to the lack of mobility, is expected, in turn, to be the main driver of growth in 2021, with a contribution of 5 points. The rest of the growth will come from 0.8 points due to the tax on alcohol and alcoholic beverages, 0.5 points from the tax on electricity, and it will be reduced by 0.1 points due to the fall in the tax on tobacco products. In national accounting terms, the same growth in special taxes is expected as in cash terms.

FIGURE 26. EVOLUTION OF REVENUE FROM SPECIAL TAXES (%GDP)



#### 4.2.5. Other tax revenue

According to AIReF's forecast, other tax revenue will be the equivalent of 0.8% of GDP, as in its previous forecast. Growth of 26.5% is expected in 2021. This has been revised with the update of the new information available and the correction of the impact of the new taxes on plastics and waste, limited in this report to a single quarter of 2021, as explained in the section on measures.

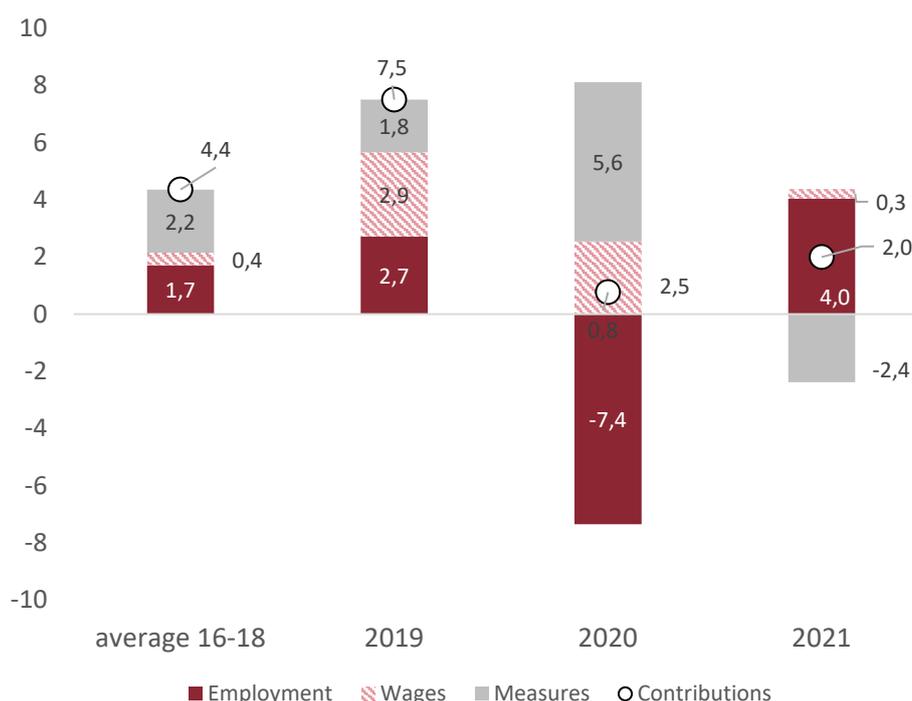
#### 4.2.6. Social contributions

AIReF estimates the weight of social contributions will fall in 2021 to 13.6%, 0.2 points more than in the previous report. Compared with the November estimate, AIReF increases the forecast by 0.2 points, due both to the final result for 2020 and the upward estimate of the contribution exemptions resulting from the extension of the time the measures for self-employed workers are in force. AIReF estimates growth of around 2% for 2021.

The positive trend in employment drives growth in contributions for 2021. In 2020, the exemption measures, together with the more positive than expected evolution of employee remuneration, led to a rise in the level compared with 2019. In 2021, even though there are still exemptions, they are smaller than in 2020, so their contribution to growth is negative. Compared with AIReF's previous forecast, the contribution of all the components is reduced due to an increase in the estimate of the cost of

exemptions for the year and, with regard to the components, to a more positive starting point. Both measures already adopted prior to the crisis and those focused on mitigating its effects, including the extension of the exemptions for self-employed workers from January to May, are included for both 2020 and 2021.

**FIGURE 27. BREAKDOWN OF GROWTH IN SOCIAL CONTRIBUTIONS**



#### 4.2.7. Other revenue

The weight of other revenue in relation to GDP rises by 0.2 points compared with AIReF’s previous estimate, to stand at 6.8% of GDP. The reason for the improvement in this type of revenue comes from the effect of year-end 2020, which contributes a further 0.1 points to the weight of this revenue category, which carries over to 2021.

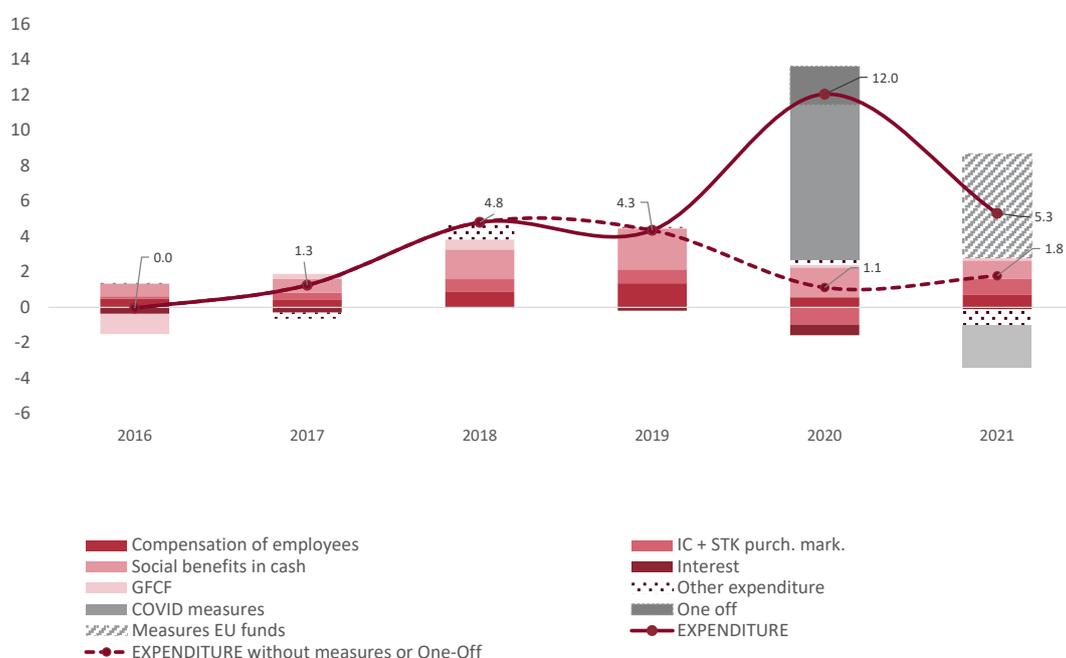
### 4.3. Evolution of General Government expenditure

AIReF’s expenditure estimates, without the RTRP, stand at 48% of GDP, compared with 47.6% forecast in the previous report. This increase is mainly due to the effect of the measures approved following AIReF’s report, which amount to 1% of GDP. Particularly important among these measures are those adopted by the Government to support the solvency of businesses and self-employed workers as a result of the pandemic, which amount to

0.7% of GDP. Another factor that has contributed to the increase in expenditure is the downward revision of the estimate of GDP for 2021, resulting in an increase in the expenditure to GDP ratio of 0.7%. In the opposite direction, the latest available execution data and, in particular, the better than expected figures for year-end 2020, especially as regards public consumption expenditure, have led to a decrease in starting expenditure for 2021 of 1.3% of GDP, which largely offsets the increase resulting from the above factors. This new estimate is 0.1 points higher than the expenditure forecast for 2021 by the Government in the Budgetary Plan. Including the RTRP, expenditure would stand at 50.9% of GDP.

**TABLE 8. FACTORS EXPLAINING THE DIFFERENCES BETWEEN THE ESTIMATE OF EXPENDITURE IN THE REPORT ON BUDGETARY LINES AND INITIAL BUDGETS (% GDP)**

	2021 Main Lines Report	Breakdown of change in % GDP				2021 Current	Current- Lines Difference
		Denominator effect	Effect of measures differential	Macro effect	Effect year-end 2020/New information		
<b>EXPENDITURE</b>	<b>50.5</b>	<b>0.7</b>	<b>1.0</b>	<b>0.0</b>	<b>-1.3</b>	<b>50.9</b>	<b>0.4</b>
Compensation of employees	12.0	0.2	0.1	0.0	-0.3	12.0	0.0
IC + STK purch. mark.	9.1	0.2	0.0	0.0	-0.5	8.7	-0.4
Social benefits in cash	18.2	0.3	0.1	0.0	-0.2	18.3	0.1
Interest	2.1	0.0	0.0	0.0	-0.1	2.0	-0.1
GFCF	3.8	0.0	-0.1	0.0	-0.1	3.7	-0.2
Other expenditure	5.3	0.1	1.0	0.0	-0.1	6.2	0.9

**FIGURE 28. CONTRIBUTIONS TO THE CHANGE IN EXPENDITURE (% ) AIReF.**


#### 4.3.1. Main components of public consumption expenditure

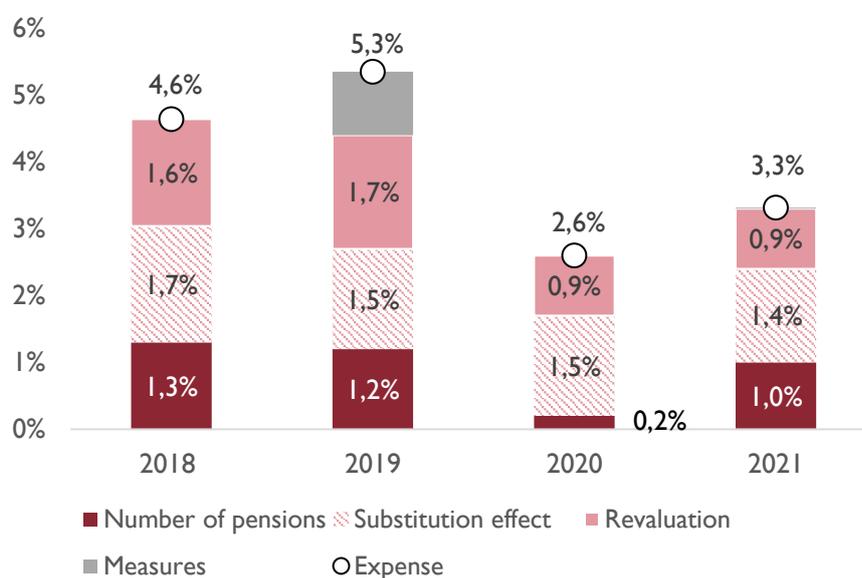
**AIReF maintains its forecast for compensation of employees at 12% of GDP for 2021.** In this case, the effect of the developments that have taken place since the previous report cancel each other out, making the impact on the forecast of this expenditure zero. Accordingly, the increases of 0.1 points due to the upward revision of the COVID measures reported by the Autonomous Regions and of 0.2 points due to the downward revision of the GDP estimate are fully offset by the reduction resulting from the lower initial expenditure for 2021, as the figure for year-end 2020 was considerably lower than expected in the area of the territorial administrations and, in particular, in the case of the Local Governments.

However, AIRcF reduces the combined estimate of intermediate consumption and social benefits in kind by 0.4 points of GDP to 8.7% of GDP. Unlike employee remuneration, AIRcF does reduce its estimate of the other two components of public consumption - intermediate consumption and social benefits in kind. It reduces its forecast for the two headings from 9.1% of GDP to 8.7%. The determining factor here was the lower expenditure recorded at year-end 2020 in both headings. In the specific case of intermediate consumption, the amount executed at the end of the year was lower than estimated in all sub-sectors. Particularly noteworthy was the reduction of almost 5% on 2019 in the Local Government sub-sector. In total, the reduction resulting from the year-end figures is 0.5 points, which is partially offset by the effect of the revision of GDP, which increases expenditure by just 0.2 points.

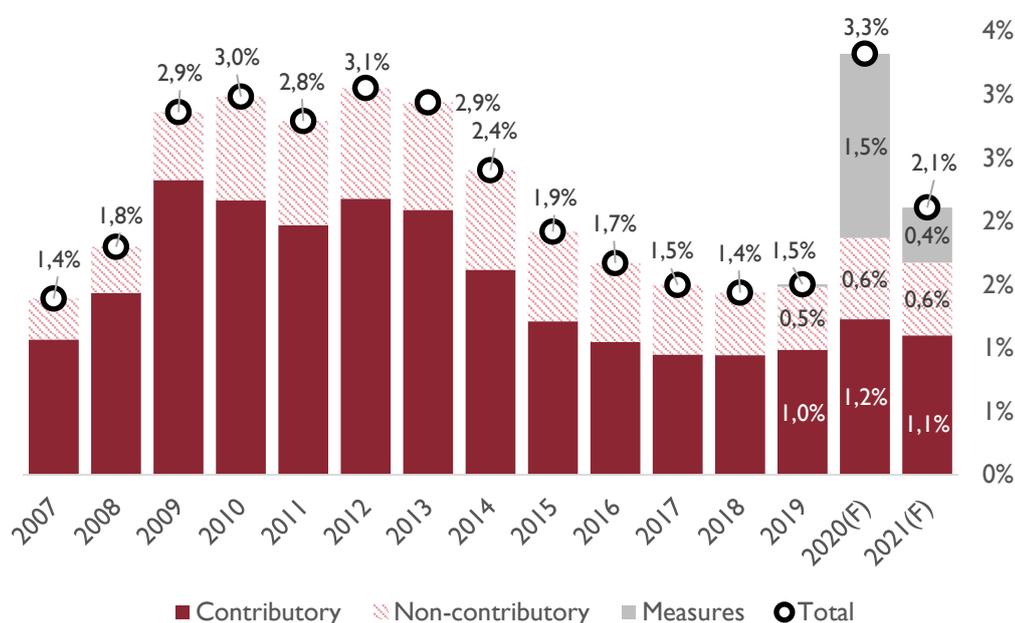
#### 4.3.2. Social Transfers in Cash

According to AIRcF's estimates, social transfers in cash will fall by 2 points of GDP in 2021 to 18.3% of GDP, 0.1 points more than in the previous report. The change in 2021 compared with the previous report is due to the starting point and an increase in the valuation of the COVID-19 measures, together with a somewhat more negative macroeconomic scenario. With regard to the measures, the estimate of the cost of ERTes rises as they have increased in the first two months of the year. The estimate of the cost of the benefit for self-employed workers also increases as it has been extended until June. The measures included in this heading have three effects: firstly, the impact of the measures taken in 2020 as a result of COVID-19 that will affect both 2020 and 2021, secondly, that of other expenditure measures approved in 2019 but which extend their effects to 2020 and even 2021, and finally, the measures included in the 2021 GSB. With regard to the macroeconomic effect, the estimate for the evolution of employment is somewhat more negative, pushing the cost of unemployment 0.1 points higher, increasing its weight over GDP from 2 to 2.1 points.

AIRcF maintains its estimate of a 3.3% increase in pension expenditure in 2021. It is expected that the growth in the number of pensions will once again be 1% in 2021. In addition, a revaluation of 0.9% is assumed. The cost of revaluing non-contributory pensions at 1.8% in 2021, as set out in the 2021 GSB, is included. With regard to the substitution effect, the data for 2020 indicate a reduction mainly due to the measures adopted in 2019. We therefore reduce the contribution to growth of the substitution effect to 1.4% for 2021.

**FIGURE 29. GROWTH IN PENSION EXPENDITURE. AIREF PROJECTIONS**


The weight of unemployment benefits as a proportion of GDP will fall to 2.1% in 2021, 0.1 points more than estimated in the last report. The increase in the estimate for 2021 is due both to the more adverse evolution of ERTes in the first two months of the year and to a macroeconomic scenario with a somewhat more pessimistic outlook for employment. This heading includes the cost of the ERTes, the payment of unemployment benefit to temporary workers who were not entitled to it and the cost of the benefits for domestic workers. In addition, it also includes non-extraordinary measures approved prior to the crisis, such as the subsidy for people aged over 52 and the increase in the national minimum wage. Finally, the cost of the measures included in the 2021 GSB has been included, specifically the impact of raising the IPREM (Public Multiple-Effect Income Indicator) by 5% on the cost of unemployment benefits.

**FIGURE 30. EVOLUTION OF UNEMPLOYMENT EXPENDITURE % OF GDP. AIREF'S FORECASTS**


The other items under the heading are also affected by the extraordinary measures, with their weight over GDP falling to 1.8% in 2021, the same as the estimate in the last report. Even though there is no difference in the aggregate weight, AIREF considers that the benefit for self-employed workers will rise by 0.1 points compared with the previous estimate due to its extension until June. This increase is offset by a 0.1-point lower estimate of the cost of the Minimum Living Income (MLI), due to the lower than estimated number of MLI beneficiaries. Expenditure for Temporary Incapacity for Work includes the cost of sick leave due to infection and quarantine resulting from the COVID-19 virus and is expected to be maintained until June 2021. Other benefits include the cost of the benefit for cessation of activity for self-employed workers, which is estimated to remain in force until June 2021. The MLI and its revaluation of 1.8% for 2021 set out in the 2021 GSB is also included.

### 4.3.3. Other expenditure

#### Subsidies

Subsidies will fall to 1.5% of GDP in 2021, the same level as estimated in the previous report. However, the estimate of the cost of exemptions rises by 0.1 points as a result of the extension of the benefit for self-employed workers. This increase is offset by the lower starting point due to the year-end 2020 figure. The reduction in weight in 2021 is due to the exemptions from contributions, which reduce their weight by 0.3 points of GDP, both as a

result of the more adverse evolution of ERTes and the extension of the exemptions for self-employed workers until June. In addition, the granting of support as a result of the measures taken due to COVID-19 has led to an increase in subsidies in the CG and AR sub-sectors.

### Interest

**AIReF revises interest expenditure downwards slightly for 2021, without prejudice to the increase in fiscal risk in relation to this expenditure item.**

According to AIReF's latest forecasts, interest expenditure has gone from the 2.1% of GDP estimated in the previous report to 2%. This 0.1-point reduction in expenditure is the result of the year-end 2020 figure, which was lower than expected. This reduction in the financial burden takes place in the current context of low interest rates. However, according to the latest data published by the Bank of Spain, public debt climbed to 120% of GDP at the end of 2020. The debt allocated to 2020 as a result of the reclassification of the SAREB contributed €35bn to this figure. This significant volume of debt amplifies the fiscal risk resulting from any increase in interest rates in the medium and long term.

### Gross capital formation

**The forecast for expenditure on gross capital formation is down by just under 0.2 points from the previous report, to 3.7% of GDP.** The downward revision of this heading results from the lower expenditure recorded at year-end 2020. In this regard, the investments estimated by AIReF, especially in the area of the Local Governments, have not been executed at the expected amount. This has led AIReF to consider a lower starting expenditure, with the consequent reduction in the estimate by 0.1 points of GDP. This does not affect expenditure on investments related to the RTRP as long as the assumption that the forecast contained in the 2021 GSB will be executed is maintained. Another factor that affects the lower estimate of expenditure is the downward valuation of COVID-19 measures in 2021. This is mainly the result of information received from the Autonomous Regions with regard to investment expenditure on education.

### Other expenditure

**It is other expenditure that records the largest increase in AIReF's estimates, by about 0.9 points of GDP, to 6.2% of GDP, due to the new measures.** The key factor explaining this change is the new expenditure measures adopted by the Government in relation to the pandemic. These entail higher spending of one point of GDP, of which 0.7 points are due to the extraordinary measures to support business solvency. The starting expenditure resulting from an improved year-end 2020 figure is 0.1 points

lower. Finally, this lower expenditure is largely offset by the GDP denominator effect.

FIGURE 31. GENERAL GOVERNMENT

FIGURE 38.A. NET LENDING/BORROWING (% GDP)

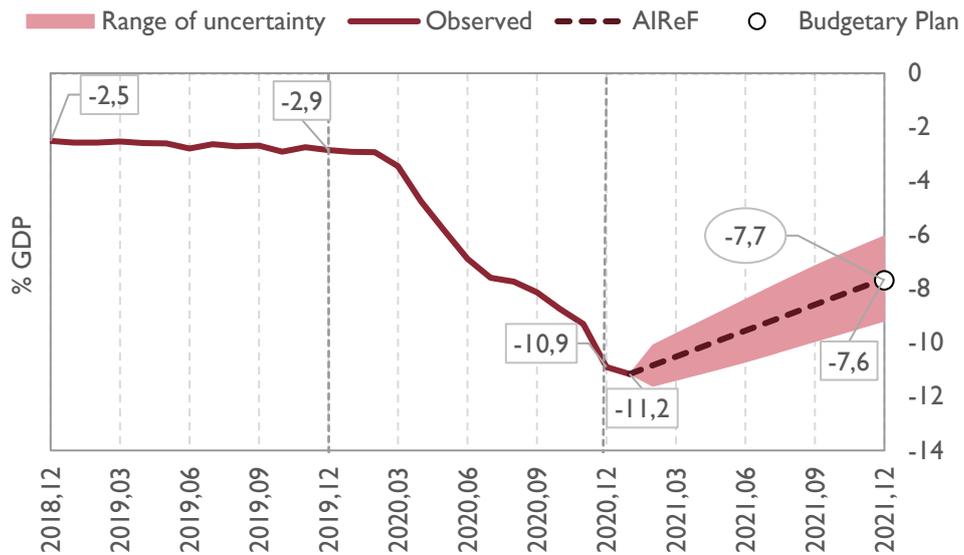


FIGURE 38.B. REVENUE (% GDP)

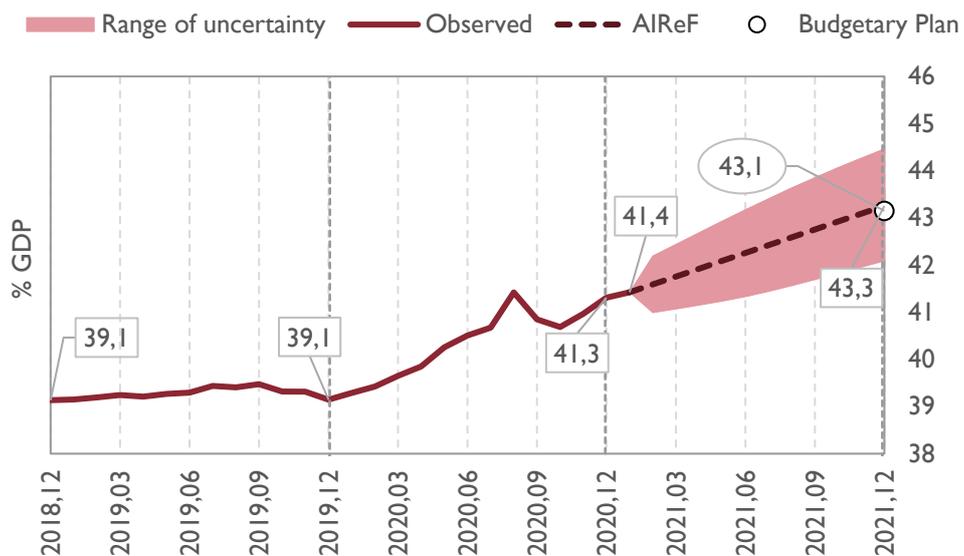
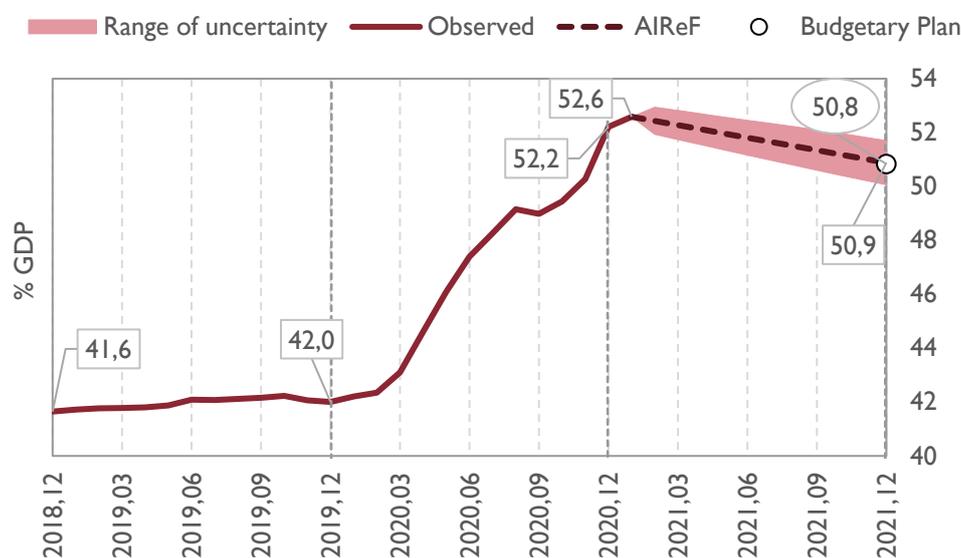


FIGURE 38.C. EXPENDITURE (% GDP)



## 4.4. Analysis by sub-sector

### 4.4.1. Central Government

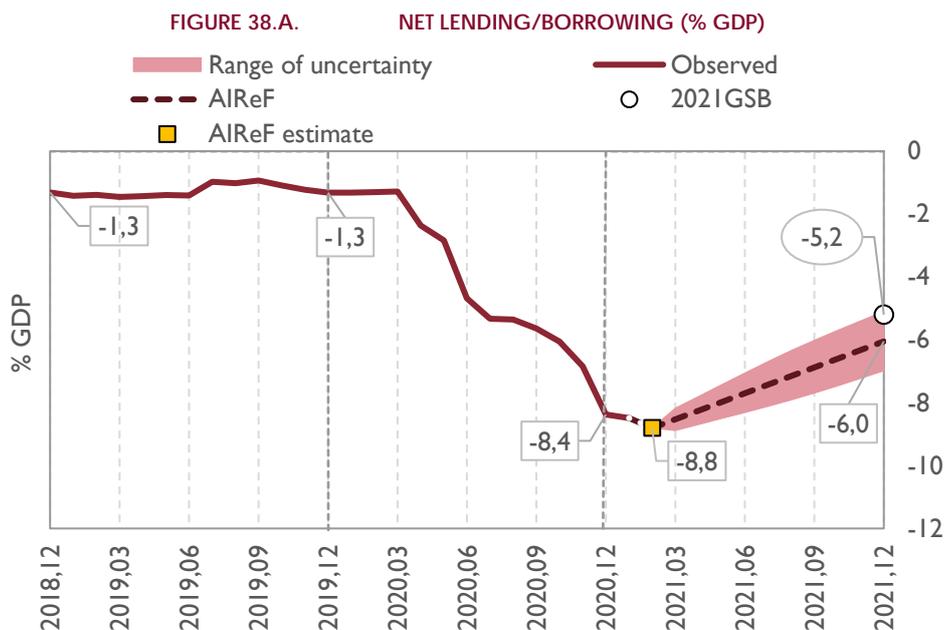
AIReF estimates a deficit of 6% of GDP for 2021, 0.4 points higher than that forecast in the previous report (5.6%). The main factors that have most influenced this increase in the deficit are the new extraordinary measures to support corporate solvency in response to the pandemic adopted by the Government following the approval of the GSB and, to a lesser extent, the approved amendments to the draft GSB and the delay in adoption of the revenue measures provided for therein. However, the higher tax collection since the previous report than initially expected by AIReF fully offsets the loss in collection resulting from the current downward revision of the macroeconomic scenario. The RTRP is still deemed to have a neutral effect on the deficit. This new deficit estimate is 0.8% of GDP above the 5.2% reference value forecast by the Government in October 2020.

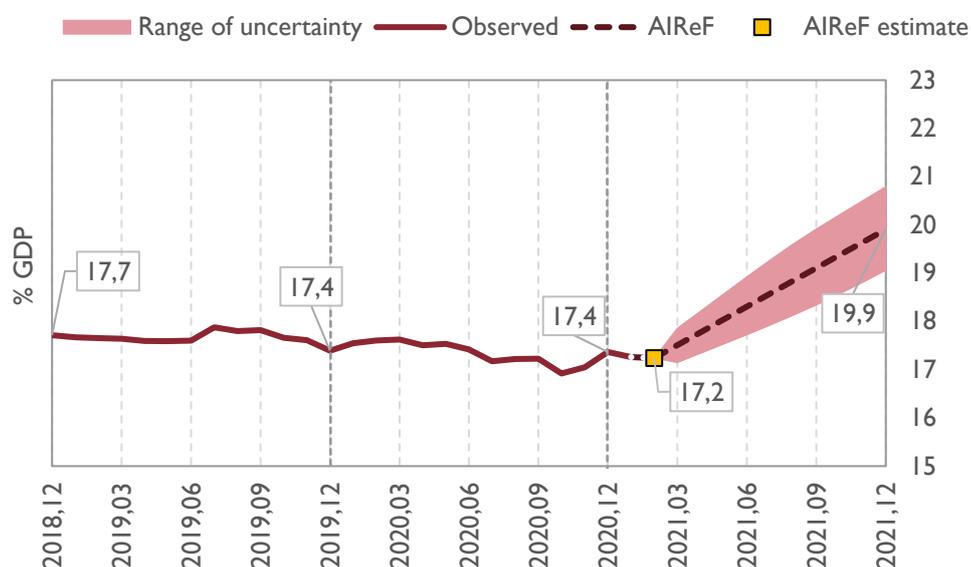
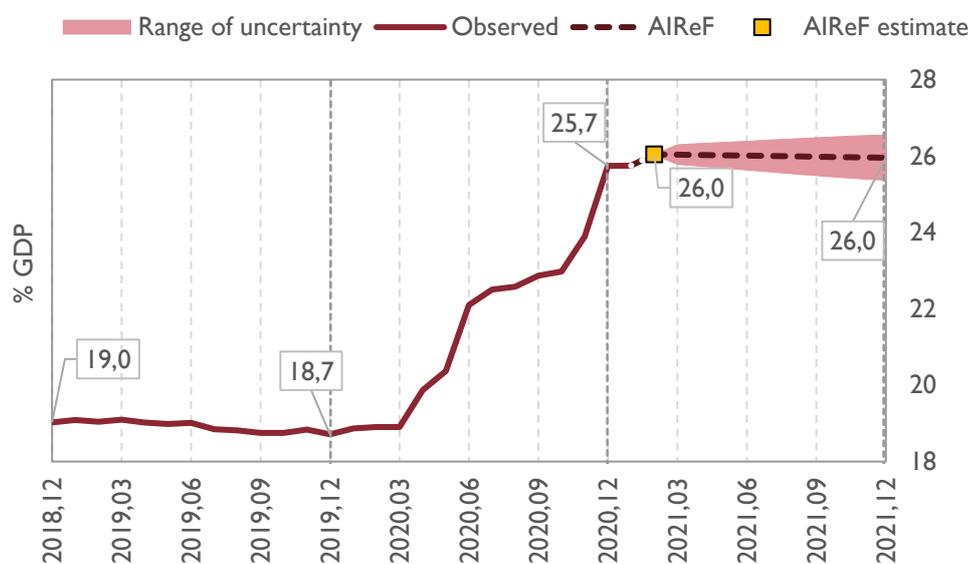
This deficit supposes a reduction of 2.4 points of GDP compared with year-end 2020, but the decrease would be 1.4 percentage points if non-recurring operations were deducted. This reduction is lower if the various non-recurring operations allocated at year-end 2020 are not considered. These non-recurring operations include the reclassification of the SAREB, the CASTOR gas storage facility ruling, the rulings on the nullity of RDL 2/2016 on the payment in instalments of Corporate Income Tax and on the right of third countries to accruals levied in Spain for non-resident income tax. All these

operations amount to a total of about €12bn. After deducting these operations, which will not be repeated in 2021, the expected reduction is 1.4% of GDP.

Within the CG, the estimate of the State deficit is raised to 6.1% of GDP, in contrast to the 5.6% estimated in the previous report, while the surplus of 0.1% forecast for the CG bodies is maintained. The main factors that have led to the revision of the CG deficit for 2021 falling on the State are the fact that it has borne the cost of the new measures to address the pandemic and the amendments to the revenue and expenditure in the parliamentary processing of the draft 2021 GSB. For this reason, the increase in the deficit mainly occurs in the State while for the CG bodies, the surplus forecast of 0.1% of GDP is maintained.

FIGURE 32. CENTRAL GOVERNMENT



**FIGURE 38.B. REVENUE (% GDP)**

**FIGURE 38.C. EXPENDITURE (% GDP)**


### Central Government Revenue

AIReF forecasts that CG revenue will increase its weight over GDP by 0.4 points in comparison with the last report, to stand at 19.9% in 2021. After ending 2020 with 0.2 points more than in AIReF's forecast, the CG's total revenue has been revised upwards. The update is focused on taxes on income, which are the only ones which record a change in their weight of GDP compared with the previous report.

**Taxes on income are now equivalent to 6% of GDP, up from 5.6% in the previous report, while other revenue does not change its weight over GDP.** In these taxes on income, the revision is due to a set of factors, particularly the upward revision of Corporate Income Tax, referred to in the previous section. Of the other sources of revenue, only taxes on production record changes in the forecast. However, they cancel each other out and so the effect is neutral in the change. This type of tax would add 0.1 points to the weight of revenue over GDP due to the year-end effect of 0.1 points. However, it is offset by the negative effect of 0.1 points as a result of the legislative measures that did not successfully pass through the parliamentary processing in the budget approval stage and the update of the COVID-19 measures approved since the last report, such as those affecting the VAT rate of certain COVID-related products. The update of the macroeconomic outlook does not entail any change with regard to the previous scenario as the 0.1 points that will be contributed by the denominator effect are offset by the effect of the lower level of this type of tax as its bases evolve in line with the evolution of nominal GDP.

### Central Government Expenditure

**AIR<sup>e</sup>F estimates expenditure of 26% of GDP for 2021, 0.9 points higher than the forecast in the previous report of 25.1% of GDP.** This upward revision of the estimate for expenditure in 2021 is the result of the updating of both the macroeconomic and the budgetary scenarios. On the macroeconomic side, the impact results from the update of the GDP estimate. As in the previous report, full implementation of the Recovery, Transformation and Resilience Plan (RTRP) in 2021 is assumed for an amount of €26.6bn. However, the risks resulting from implementation are maintained (see Section 4.5 on Fiscal Risks).

**Some amendments approved during the parliamentary procedure have led to an increase in expenditure compared with the forecast in the draft 2021 GSB.** In the approval process of the 2021 GSB, several amendments to expenditure have been passed. Implementation of these amendments may lead to greater expenditure, but their impact has not been included in the initial appropriations “because they cannot be implemented in accounting terms” (Article 2 of the Law on the 2021 GSB). These amendments include those relating to the agreed level of dependency care, which doubles from €283m in the draft to €566m, as well as the creation of a municipal transport fund to compensate for losses during the pandemic, for a minimum amount of €275m, through an extraordinary credit.

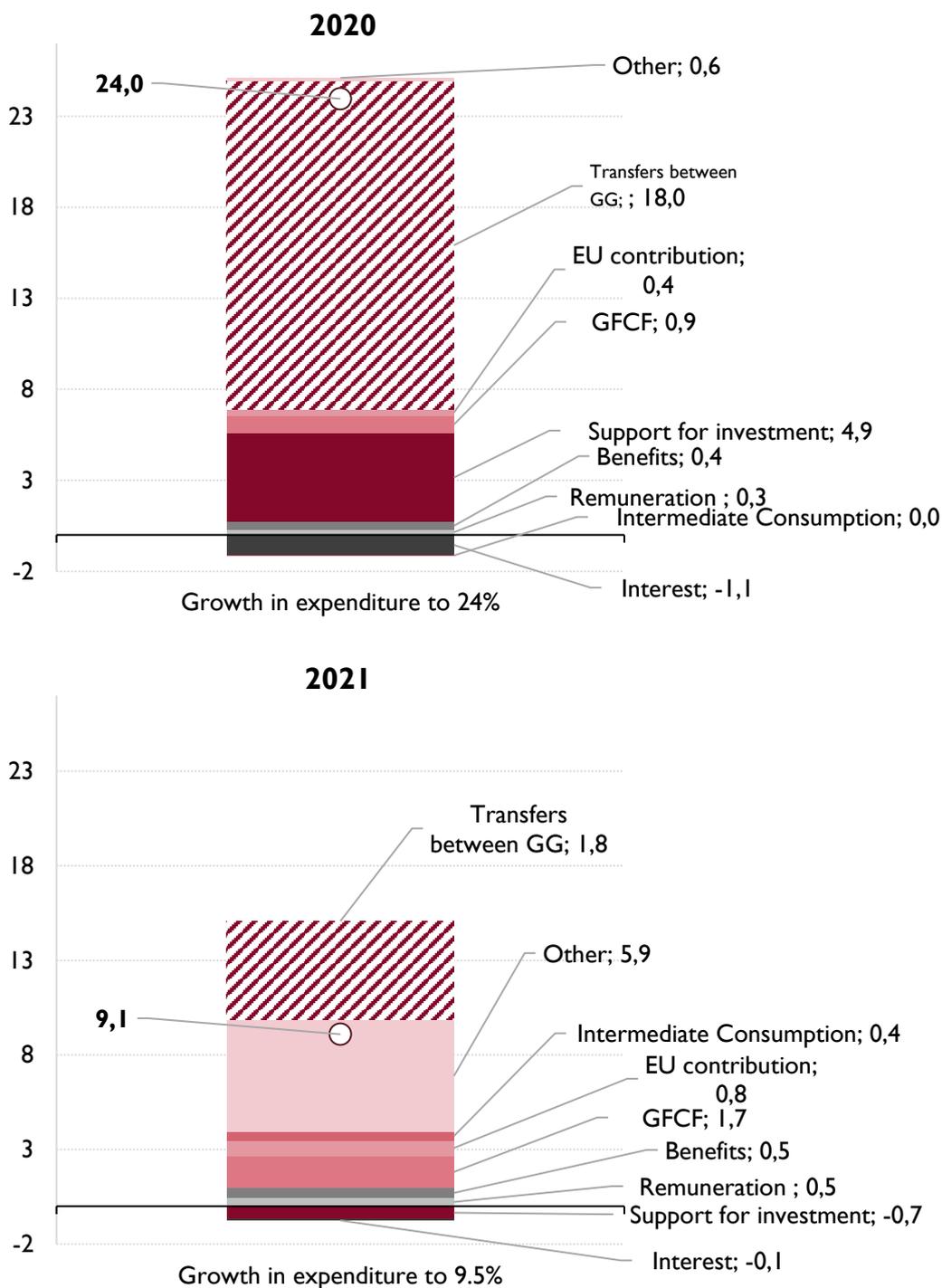
**Following the approval of the GSB for 2021, the Government has adopted new spending measures related to the pandemic.** The upward revision of CG

expenditure essentially stems from the new measures for supporting business solvency in response to the pandemic recently approved by the Government through Royal Decree-Law 5/2021. On the one hand, these lead to a further increase in expenditure on transfers between General Government sub-sectors of €7bn as management of the direct support to companies and self-employed workers is transferred to the Autonomous Regions. On the other hand, there is higher capital expenditure by the State of €1.5bn for the direct support to companies and self-employed workers that will be granted through the line created for the restructuring of COVID-19 financial debt. It is estimated that in 2022 a further €1.5bn will be spent to complete the approved €3bn. The increase in expenditure in 2021 due to the combined impact of these measures is 0.7% of GDP.

**Other factors that have influenced the revision of 2021 expenditure have been the update of the GDP estimate and the latest available budgetary information.** The effect of these factors moves in opposite directions. The update of the estimate of GDP leads to an increase in expenditure as a ratio to GDP, since, having been revised downwards, the denominator is lower with the consequent increase in the proportion of expenditure to GDP of 0.2 points. With regard to the budgetary information, after discounting non-recurring operations, the expenditure data recorded at year-end showed a more favourable final evolution than expected, particularly in terms of public consumption and interest, which leads to a lower starting expenditure for 2021. This has reduced spending by just under 0.1 points of GDP.

**According to the new estimate, expenditure is expected to grow by 9.1% in 2021 compared with that recorded in 2020.** This growth is less than the 13% expected in the previous report, largely due to the accumulation of non-recurring operations allocated to 2020, mostly at year-end. In January, the reclassification of the AP-4 and AP-7 motorways for €1.75bn was allocated as gross capital formation expenditure, without an impact on the deficit. In December, the operations associated with the SAREB and Castor and the rulings on CIT and the rights of third parties for Non-Resident Income Tax, referred to above, for a total amount of around €12bn, with an impact on the deficit, were allocated to 2020. Hence, if the expenditure allocated for these operations is deducted, growth in 2021 is 14.5%. In addition, expenditure grows mainly due to the expected boost resulting from implementation of the RTRP. Without this expenditure, growth would fall to 4.9% compared with last year. Another reason is the transfer to the SSFs of €8.3bn in 2020 that occurred after the report on the draft GSB, which reduces expenditure growth in 2021 compared with the previous year.

FIGURE 33. CONTRIBUTION TO THE GROWTH IN EXPENDITURE 2020-2021. CG IN % GDP.



#### 4.4.2. Social Security Funds

The Social Security Funds (SSFs) will reduce their deficit by up to 1.5% in 2021, with the estimate from the previous report maintained. Even though the level

of the balance is maintained with regard to the previous estimate, AIReF forecasts a higher level of both revenue and expenditure. This is due to an improvement in the starting point for contributions and an increase in the estimate of the cost of the benefit for self-employed workers due to its extension, which is partially mitigated by the reduction in the MLI.

**Revenue will reduce its weight over GDP to 15.8% in 2021, both due to the reduction in current transfers and the denominator effect.** In 2021, the weight of contributions fell by 0.8 points, mainly as a result of the recovery in GDP and the transfer of contributions for vocational training to the Central Government. This reduction in the weight of revenue is accentuated by the current transfers, which are expected to fall by 0.3 points. Compared with the previous report, the weight of contributions rises by 0.3 points both as a result of the increase in exemptions and the starting point. This impact is mitigated by the transfer of contributions for vocational training to the Central Government.

**The weight of expenditure will also fall in 2021, to 17.4% of GDP, 0.3 points more than in the last report.** This rise is due both to the increase in the estimate of the cost of measures for self-employed workers, which is somewhat mitigated by the lower estimate of the cost of the MLI, and to a macroeconomic scenario in which the recovery in employment is slower and, therefore, the cost of unemployment is higher.

FIGURE 34. SOCIAL SECURITY FUNDS

FIGURE 34. A. NET LENDING/BORROWING (% GDP)

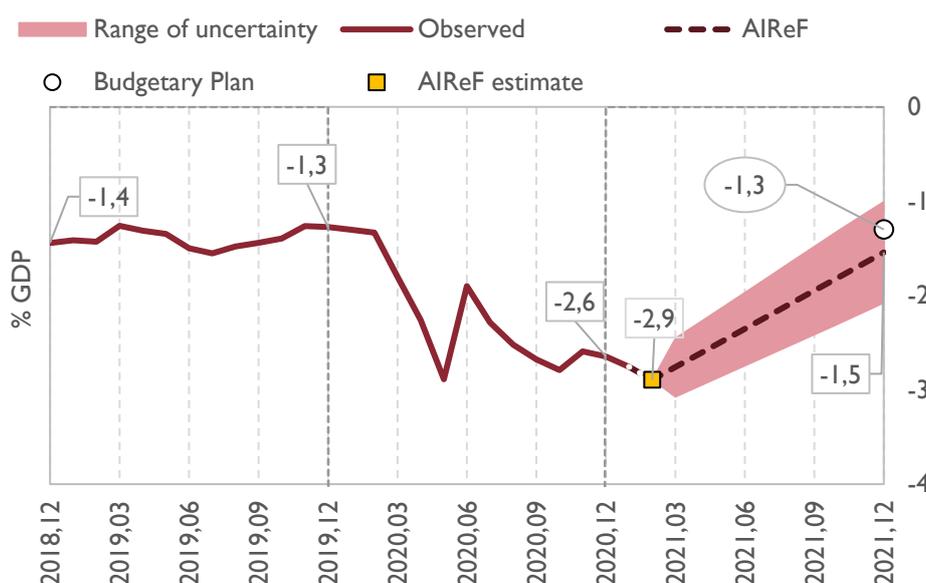


FIGURE 34. B. REVENUE

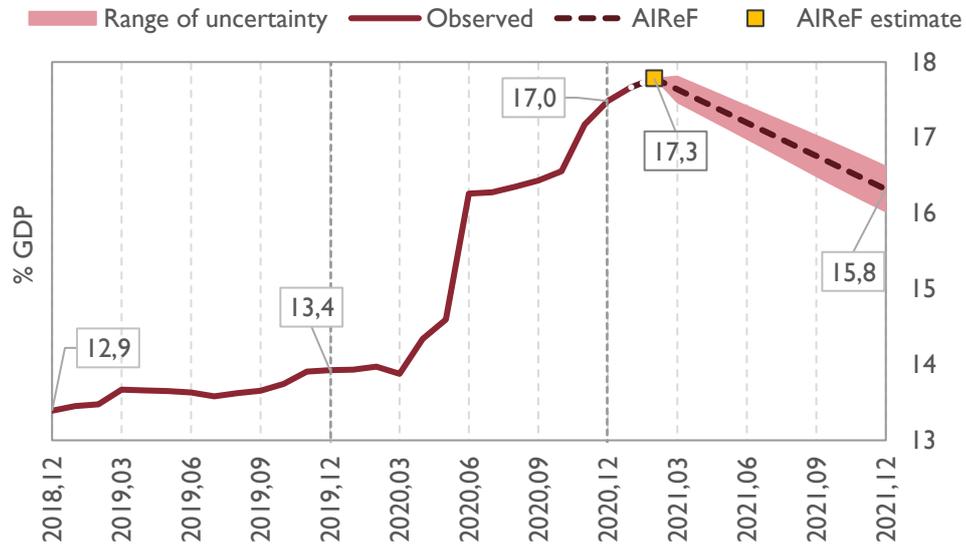
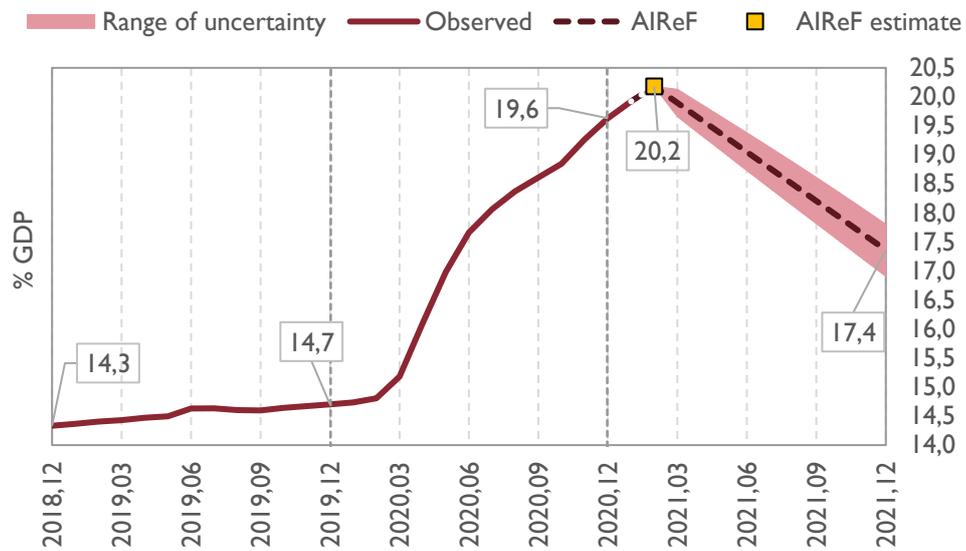
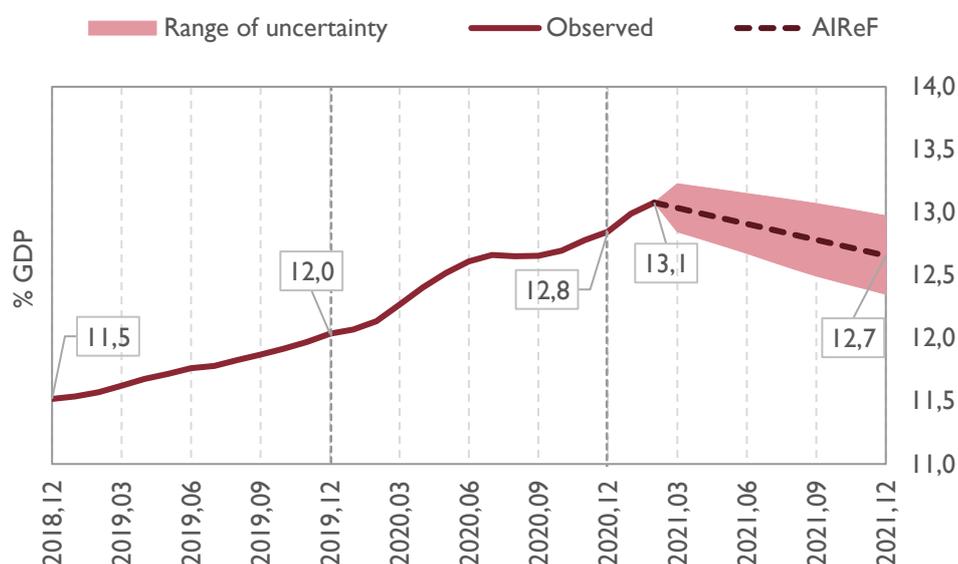


FIGURE 34. C. EXPENDITURE



**FIGURE 35. EVOLUTION OF THE CONTRIBUTIONS OF THE SOCIAL SECURITY FUNDS**


The evolution of the balance of the different agents of the Social Security Funds is not the same. By performing a simplified analysis, based on the estimate of the 2020 year-end position of each agent, the impacts are broken down into a denominator effect, an effect of the measures and a macro / baseline effect. In 2021, only this last item contributes towards increasing the deficit. This is due to the increase in pension expenditure. The SSS slightly increases its deficit for that reason, while the SEPE almost returns to a budgetary balance as a result of the reduction in the cost of ERTES.

**TABLE 9. BALANCE BY AGENT OF THE SOCIAL SECURITY FUNDS (%GDP)**

	2020	2021				Total impact (2)=(a)+(b)+(c)	Current forecast (3)=(1) - (2)
		Breakdown					
		Denominator effect (a)	Effect of measures differential (b)	Macro / Baseline New info. effect (c)			
SSFs	-2.6	0.2	1.2	-0.3	1.1	-1.5	
SSS	-1.3	0.2	0.0	-0.4	-0.3	-1.6	
SEPE	-1.3	0.1	1.2	0.2	1.4	0.1	

#### 4.4.3. Autonomous Regions

AIReF revises the forecast deficit of the Autonomous Region sub-sector for 2021 downwards to -0.4% of GDP, 0.4 points less than in the previous report. The deficit would therefore be below the reference rate of -1.1% set out in the Budgetary Plan. AIReF's forecasts in the Autonomous Region sub-sector update the data considered for the previous report on the basis of the information available on year-end 2020 and the information contained in the

regional budgets and forecasts of the medium-term plans and the GSB. They also take into account the new measures reported both at a regional and a State level and the revision of the macroeconomic scenario. Most of the change relating to the 2021 forecasts results from the year-end 2020 figures. In addition, other elements have been revised which, with different effects, generate a neutral impact on the balance for 2021. With a positive effect, the expenditure on employee remuneration not associated with the pandemic is revised downwards based on the information provided by the Autonomous Regions on workforce measures and growth, and the increased transfer of the GSB in the agreed level of dependency care is included. In the opposite direction, the growth forecasts for regional revenue outside the financing system of the Autonomous Regions under the ordinary regime are moderated slightly due to the worsening macroeconomic forecasts, and the expenditure from measures adopted or planned in relation to COVID-19 are revised upwards. With a neutral effect, direct support to companies from the GSA, which will be managed through the ARs, is incorporated.

**There are no significant changes at an overall level in the regional forecasts for 2021, so the gap with AIR<sup>e</sup>F's estimates with regard to the balance is widening.** As a general rule, the regional budgets maintain the forecasts of the draft budgets and budgetary lines reported in December. The Autonomous Regions of Catalonia, Madrid and Murcia still do not have a budget to date, although, with the exception of Murcia, they have sent an updated forecast for year-end 2021. Similarly, some ARs have updated their forecasts for 2021 in the medium-term budgetary plans sent to the Ministry of Finance, incorporating some changes in the budget figures and an improvement in their balance. However, this new information has a limited impact at the sub-sector level.

**The reduction in the forecast for the deficit in 2021 is mainly explained by the incorporation of the year-end 2020 figures.** The Autonomous Regions closed 2020 with a deficit of 0.2% of GDP, 0.4 points lower than expected in the report on the budgetary lines. This was the result, on the one hand, of a lower fall in revenue and, on the other hand, of a more limited execution of current expenditure than that provided for in the report. The improvement in the balance and changes in revenue and expenditure in 2020 are mostly translated into the current projections for 2021. From the information provided by the Autonomous Regions, it is clear that the pandemic in 2020 has had an impact similar to that foreseen in the previous report, although with a higher cost of spending measures adopted in areas other than education, and a lower fall in revenue. This implies that non-COVID-19 current expenditure as a whole has been implemented at below 2019 levels. These circumstances, together with the revenue received from the GSA,

have allowed the balance of the Autonomous Regions to improve by 0.4 points of GDP compared with 2019.

**The estimate of the cost associated with the pandemic in 2021 increases due to measures adopted by the Autonomous Regions. The impact will be around 0.05 points in the sub-sector's balance, to which the support for companies financed by the State is added.** Based mainly on the new information provided by the ARs, the forecasts of the expenditure associated with the pandemic in 2021 have been updated considering the following elements:

- Assessment of the impact in 2020: the estimated overall impact is maintained, with changes in its components. The valuation of healthcare and community healthcare expenditure resulting from COVID-19 increases by 16%, and the expenditure for measures adopted in areas other than education rises by 28%. In contrast, the fall in revenue was 26% lower than that foreseen in the previous report: particularly noteworthy was the performance of the Tax on Property Transfers and Stamp Duty, with collection 28% higher than estimated; revenue associated with the provision of services and production (sales) fell by 26% less; and, although with a smaller weight in the total, VAT collection in Navarre was more than 50% higher than estimated in November. In the opposite direction, other taxes on products have fallen by 56% more than expected.

**TABLE 10. CHANGES IN THE ESTIMATE OF THE COVID-19 IMPACT IN 2020. TOTAL AUTONOMOUS REGIONS (% GDP)**

<b>Total ARs</b>	<b>Current estimate</b>	<b>Report on lines</b>
<b>COVID measures</b>	<b>1.2%</b>	<b>1.1%</b>
Healthcare	0.7%	0.6%
Education	0.1%	0.1%
Other	0.4%	0.3%
<b>Macro impact</b>	<b>0.5%</b>	<b>0.7%</b>
<b>TOTAL</b>	<b>1.8%</b>	<b>1.8%</b>

- Incorporation of the information available in the first few months of the year on COVID-related healthcare and community healthcare expenditure executed to date: Expenditure has been projected taking into account the available year-end 2020 data (taken in relation to the relative infection rate, the protected population and other factors affecting expenditure), and execution in the early

months of 2021. It is still estimated that similar monthly staff expenditure will be generated until June with a gradual reduction thereof as from the second half of the year, and that part of the expenditure on intermediate consumption incurred in the previous year will be replicated in 2021. Regarding the other items of expenditure, the forecasts provided by the ARs have generally been used. Where there are no such forecasts, part of the expenditure of the previous year has been projected. Under these assumptions and data, the healthcare and community healthcare expenditure that Autonomous Regions might incur in 2021 as a result of the pandemic has been revised upwards by 22%.

- Update of non-health measures adopted or planned in relation to COVID-19 for 2021. With the new information provided, the expenditure on education estimated in the previous report is significantly moderated. In the opposite direction, there is a significant increase in the estimated cost in other areas as a result of measures implemented or planned to mitigate the effects caused by the pandemic. These measures mainly affect the area of economic promotion, with support and subsidies for households, self-employed workers and companies to address the economic effects of the pandemic, as well as social services, with improved support for the most disadvantaged sectors. Overall, the expected impact in 2021 rises by 16%, with a negative effect on the sub-sector balance of close to 0.5 points of GDP.
- Incorporation of support for companies financed by the GSA.

**TABLE 11. CHANGES IN THE ESTIMATE OF THE COVID-19 IMPACT IN 2021. TOTAL AUTONOMOUS REGIONS (% GDP)**

<b>Total ARs</b>	<b>Current estimate</b>	<b>Report on lines</b>
<b>COVID measures</b>	<b>0.8%</b>	<b>0.7%</b>
Healthcare	0.4%	0.4%
Education	0.1%	0.2%
Other	0.2%	0.1%
<b>Macro impact</b>	<b>0.6%</b>	
<b>TOTAL</b>	<b>1.4%</b>	<b>0.7%</b>

**AIReF has also updated the impact in 2021 of other adopted or planned regional measures according to the information provided by the Autonomous Regions. These improve the sub-sector's balance by under 0.5 points of GDP.** The impact of non-pandemic actions adopted with an impact in 2021 is revised based on data updated by the ARs, although their amount is not significant overall. Therefore, the new forecast includes the higher expected tax collection in Navarre in PIT as a result of the reversal of the measures adopted in 2019 and the impact of those set out in Provincial Law 21/2020; and in Valencia, in Inheritance and Gift Tax, due to inspection measures. In addition, the expenditure on employee remuneration not linked to the pandemic is revised downwards due to the update of the workforce forecasts and the measures adopted in this area.

**Approval of the GSB and the new measures announced by the Government with an impact on ARs also slightly improve their balance in 2021.** The main revenue of the ARs from the GSB, revenue from the regional financing system subject to instalment payments and the extraordinary transfer for the deficit, are maintained with regard to the reported draft budget, as well as other transfers in favour of the ARs, both direct and from the RTRP. It is also worth noting the increase in the transfer planned for the agreed level of dependency care, which rose from €283m to €566m, resulting in an improvement for the regional sub-sector. The new funds announced by the Central Government - €7bn (of which €26m are allocated to Ceuta and Melilla) - for direct support to companies, will be managed through the ARs, therefore resulting in an increase in revenue and expenditure for them.

**The revision of the macroeconomic scenario, albeit with a limited impact on the regional sub-sector, moderates the evolution of revenue at year-end.** Since the main regional revenue, from the financing system of Autonomous Regions under the ordinary regime, has already been set in the GSB, the worsening of the general macroeconomic forecasts has a limited effect on the outlook for the sub-sector in 2021. The expected growth in other regional revenue has been moderated. Therefore, although the positive results of year-end 2020 raise their level, the improvement is not fully carried over to year-end 2021: taxes levied by Navarre, contributions from the Provincial Councils of the Basque Country, revenue from the Special Tax Regime of the Canary Islands, as well as the Tax on Property Transfers and Stamp Duty, other tax revenue and revenue from services rendered and other market output.

**Finally, the assumptions of changes in other revenue and expenditure for which uncertainties persist or information on their implementation is not available are generally maintained. Thus:**

- a) It is still initially assumed that the new funds related to the RTRP expected for 2021 at a regional level will have a neutral effect on the deficit, although the individual distribution of the €10bn of the REACT EU has been updated in line with the communication issued by the Ministry of Finance on December 28<sup>th</sup>. The distribution assumed by AIR<sup>e</sup>F may therefore differ from that set out by the Autonomous Regions in their budgets or forecasts and, in either case, from the eventual distribution of all the funds. In this regard, it should be noted that the current forecasts in the Autonomous Regions might improve with the possible financing by these funds of part of the already planned expenditure not initially associated with this source of revenue.
- b) The Central Government has not yet approved the Royal Decree setting the final criteria for the distribution of the extraordinary transfer from the State to reduce the deficit of the Autonomous Regions. It is therefore still estimated that it will stand at 1.1% of regional GDP for each Autonomous Region. This is the criterion set out in most regional budgets and forecasts, although there are other possibilities, such as those included in the budgets of the Canary Islands and Extremadura. The budgets of Navarre and the Basque Country do not include any amount for this transfer, although the Basque Country has submitted a year-end forecast in which it includes the transfer calculated according to the criterion of AIR<sup>e</sup>F's scenario.
- c) It is still estimated that baseline growth will be higher than that of the previous year in expenditure not associated with COVID-19, except in relation to personnel expenses.

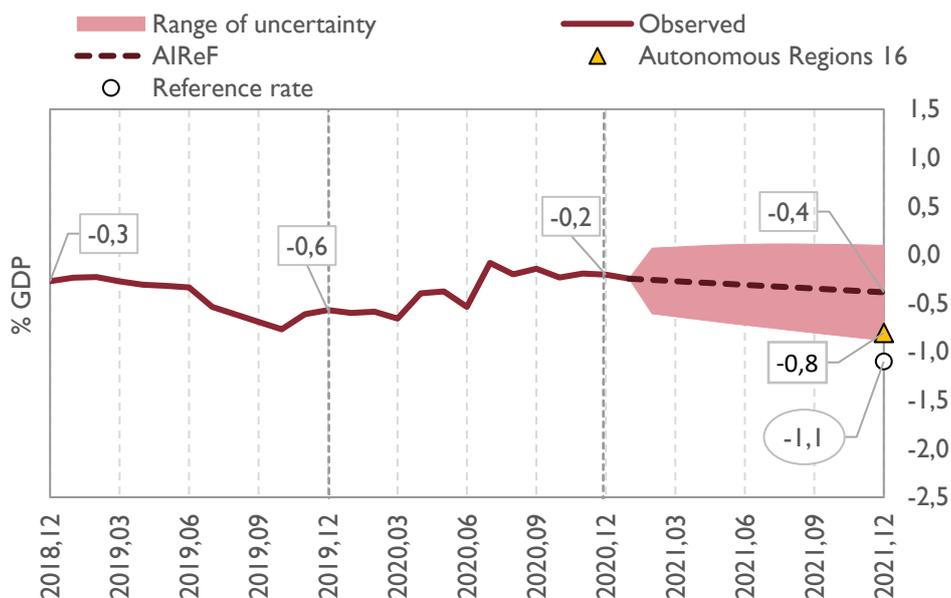
**With respect to the report on the budgetary lines, revenue raises its level and weight in 2021, mainly as a result of the year-end 2020 figures and the funds to be received from the GSA for direct support to companies.** Regional revenue increases its weight to 18% of GDP, which would be 16.5% without the RTRP funds and 15.9% without the transfers from the State for direct support to companies. Without these funds, valued at €18.7bn and €7bn, respectively, the revenue of the ARs would stand at a similar amount to that of 2020.

**The non-financial expenditure of the Autonomous Regions also increase its level and weight with the incorporation of the expenditure financed with the transfers from the State, moderated by the positive execution of 2020.** Expenditure would reach a weight of 18.4% of GDP after incorporating the expenditure linked to RTRP funds and support to companies financed by the State. Without these items, however, regional expenditure would be 16.3% of

GDP, a lower weight than forecast in the previous report despite the revision of GDP.

FIGURE 36. AUTONOMOUS REGIONS

FIGURE 36.A NET LENDING/BORROWING (% GDP)



(\*) Includes the forecasts of the ARs except Murcia, which has not submitted them.

FIGURE 36.B REVENUE (% PIB)

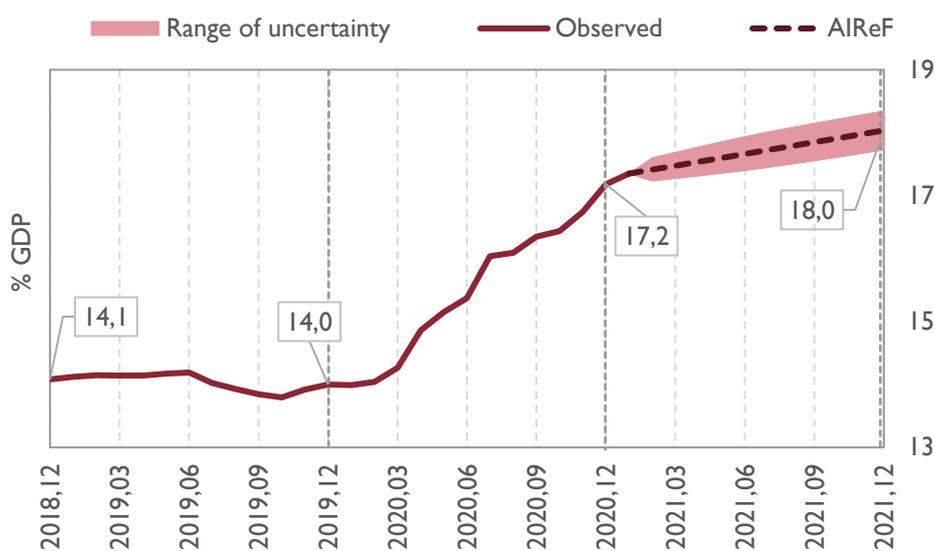
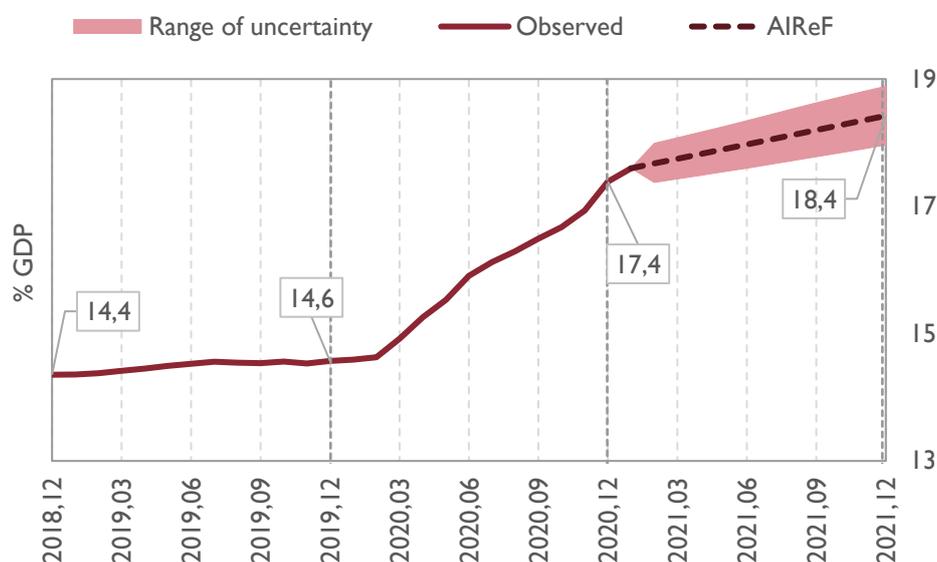


FIGURE 36.C EXPENDITURE (% PIB)



### Individual analysis

At an individual level, the outlook for almost all the ARs improves: the number of ARs that might end 2021 with a deficit lower than the set reference rate rises from nine to fifteen. Based on the current information available, AIReF estimates that all the Autonomous Regions except Murcia and Valencia could achieve a more favourable balance than the reference set for the sub-sector. The budgets of the Canary Islands, Galicia and Rioja already include deficit forecasts of less than 1.1%, and the current year-end forecasts of Castile-La Mancha, Extremadura and Madrid also include more favourable balances. This situation would remain even if the extraordinary transfers from the State were distributed under population criteria.

A detailed analysis of each Autonomous Region is included in the individual reports published with this report.

**FIGURE 37. MAP OF AUTONOMOUS REGIONS NET LENDING/BORROWING IN 2021 IN RELATION TO THE REFERENCE OF -1.1%. REGIONAL SUB-SECTOR.**

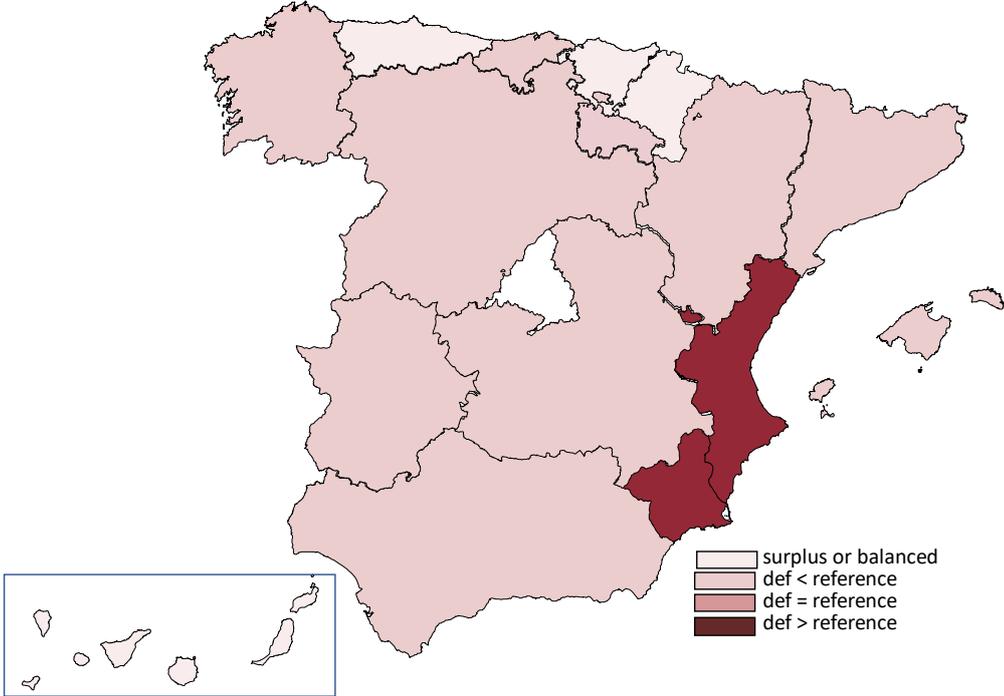


TABLE 12. CHANGES IN THE BALANCE FORECASTS FOR 2021 BY AR (% GDP)

Autonomous Regions	AIRcF Forecasts		AR forecasts	
	Current	Lines	Current	Lines
ANDALUSIA	-0.3%	-0.9%	-1.1%	-1.1%
ARAGON	-0.4%	-1.1%	-1.1%	-1.1%
ASTURIAS	0.1%	-0.7%	-1.1%	-0.8%
BALEARIC ISLANDS	-0.2%	-0.5%	-1.1%	-1.0%
CANARY ISLANDS	0.4%	0.4%	-0.2%	-0.2%
CANTABRIA	-0.1%	-1.1%	-1.1%	-1.1%
CASTILE AND LEON	-0.5%	-1.1%	-1.1%	-1.1%
CASTILE-LA MANCHA	-0.5%	-1.4%	-1.0%	-1.1%
CATALONIA	-0.4%	-0.5%	-1.1%	-1.1%
EXTREMADURA	-0.9%	-1.4%	-0.6%	-1.1%
GALICIA	-0.4%	-0.4%	-0.9%	-0.9%
MADRID	0.0%	-0.3%	0.0%	
MURCIA	-1.4%	-1.7%		
NAVARRRE	0.0%	-1.1%	-2.0%	-2.2%
BASQUE COUNTRY	0.2%	-0.9%	-1.1%	-2.2%
RIOJA	-0.1%	-0.6%	-0.5%	-1.1%
VALENCIA	-1.7%	-2.3%	-1.1%	-1.0%
<b>TOTAL AUTONOMOUS REGIONS</b>	<b>-0.4%</b>	<b>-0.8%</b>	<b>-0.8%</b>	<b>-0.9%</b>

### Medium-term outlook

AIRcF maintains its medium-term outlook, although the warning has been eased. As already pointed out in the previous report, in 2020 and 2021 much of the impact of the pandemic will be absorbed by the State. However, in 2022, the regional fiscal balance is expected to deteriorate with the recording of the settlement in favour of the State of instalment payments linked to 2020. This situation may be repeated in 2023. However, the positive revision of the macroeconomic scenario for 2022 improves the revenue expectations of the Autonomous Regions for this year compared with those set out in the December reports. This will mitigate to some extent the expected deterioration of the balance in 2020, which, however, may worsen by almost one point of GDP. In any case, the prospects of a deterioration and the warning that the situation might worsen with consolidation of a significant part of the expenditure incurred in 2020 and 2021 are maintained.

#### 4.4.4. Local Governments

**AIReF raises its forecasts for the Local Government sub-sector by 0.4 points for 2021, estimating that a surplus of around 0.3% of GDP might be achieved at year-end.** AIReF's forecasts for the Local Government sub-sector update the data considered for the Report on the 2021 budgetary lines on the basis of the latest information published on year-end 2020 and the update of the quarterly execution data of last year. They also incorporate the information contained in the GSB with an impact on the sub-sector, the financial data at the end of 2020 on local debt and deposits published by the Bank of Spain, as well as that provided by the Ministry of Finance Information Centre on the approved/carried over budgets of the Local Governments and that provided by the 24 large Local Government subject to individual evaluation by AIReF on approved budgets and forecasts for 2021. These entities account for 30% of the total result for the sub-sector. Based on all these data, AIReF improves its forecast of the local result for 2021, placing it in a surplus of around 0.3 points of GDP.

**The result published for year-end 2020 conditions most of the estimated improvement for 2021, of almost 0.3 points of GDP.** The year-end 2020 figures and the accompanying revision of the quarterly data of last year have led to a significant improvement in local results in 2020 from the second half of the year. This improvement was not included in the previous publications relating to accumulated execution at the end of September 2020. According to these new figures, at the end of the third quarter of 2020 the local sub-sector achieved a surplus of almost 0.2 points of GDP, more than 60% of that obtained at the end of the year. This corrected the previous publication which, although it did reflect a slight improvement in the second half of the year, only reported a positive result up to that date of less than 0.05 points of GDP. This improved result in 2020 seems to be mainly due to the lower negative impact of the context of the health, social and economic crisis. This was particularly the case in local expenditure, which, although it has increased by over 0.1 points of GDP as a consequence of the pandemic, has been offset with the non-execution of other spending, partly due to the "substitution effect".

**The lower expected increase in expenditure and the slight improvement in revenue determine the rest of the expected improvement in the local result in 2021.** The improvement in AIReF's estimates for the local result in 2021 is also affected by the revision of the forecasts made in the Report on the budgetary lines, both in relation to revenue and to expenditure. These changes were made as a result of the evolution in the second half of last year, the reduced expected impact of the measures planned for the local

sub-sector in 2021 to mitigate the effects of the pandemic, of around 0.5 points of GDP, as well as final approval of the GSB, which includes greater allocations for this sub-sector. In particular, the GSB incorporates revenue aimed at offsetting the lower income in 2020 from public transport as a consequence of the pandemic.

**AIReF raises the forecast for growth in local revenue to almost 7% as a result of the improvement in revenue more directly related to economic activity and the injection of new revenue from the State.** In the November 2020 Report, AIReF had put the estimated year-on-year increase in local revenue in 2021 at around 4%. With the current information on the positive evolution of the revenue of the Provincial Councils, the improved performance of other local revenue linked to economic activity, and the approval by the Law on the General State Budget of the financing to mitigate the fare deficit of the transport service for 2020, AIReF updates its forecasts of revenue to be obtained in the year, placing it at slightly under 7%.

**However, local expenditure would increase by 5%, reducing the November forecast, as a result of the lower estimated expansion of current expenditure directly related to COVID-19.** In November, AIReF estimated expenditure growth in 2021 could reach 6%, as a result of the increase in current spending, mainly social spending, given the extent of COVID-19 and the application of savings from previous years to this type of spending. With the current data for year-end 2020 and the new information sent by the large Local Governments on the impact of the pandemic last year, which shows the lower negative effect of the pandemic, AIReF updates its forecast of local expenditure for 2021, placing the estimated increase at around 5%.

**The analysis of the local budgets for 2021 corroborates the upward change in the results expected by AIReF for this year.** The Ministry of Finance Information Centre has sent AIReF the information requested on the budgets approved and/or carried over by the Local Governments for this year, which has a 76% degree of representativeness. According to these figures, raised to the national total, the results expected to be obtained this year by the local sub-sector might consolidate a surplus of around 0.3 points of GDP. This confirms the conclusions of AIReF's previous reports on the lower level of instability of local finances when faced with extraordinary situations than that suffered by other public authorities given the greater financial autonomy and stability of their revenue and their limited expenditure capacity.

**In addition, the information sent by the 24 large Local Governments on budgets to be executed in 2021 confirms the trend towards a slight improvement on the balance obtained in 2020.** As is customary in AIReF's reports, this report is completed with a supplementary report on the

individual assessment of the large Local Governments. The relative importance of these Local Governments in terms of population and budgets - over 25% - determines their influence on the sub-sector's result. According to the data provided, at a group level and despite the negative effect on their 2021 accounts of the fall in their revenue more directly linked to economic activity and the discretionary measures adopted in terms of expenditure and revenue to mitigate the negative effects of the pandemic, the expected results suggest that they will obtain a surplus of at least the same level as in the previous year. This information, which is prepared using criteria of prudence given the pandemic environment, improves on the result forecasts sent to AIReF in October by almost 3%, which extrapolated to the national total suggests a similar scenario with a slight trend towards improvement in 2021.

**In addition, the financial information on debt and deposits of the LGs confirms the trend towards consolidation of the local surplus at around 0.3% of GDP.** The latest data published by the Bank of Spain on local debt and deposits, corresponding to the end of 2020, corroborate the result achieved in the year, of a surplus of almost 0.3 points of GDP, given that the level of debt fell compared with the same period of the previous year by over 0.1 points (almost €1.3bn) and deposits rose by over 0.2 points (around €2.6bn). Should this trend continue in 2021, when the macroeconomic environment is expected to be more favourable, the results for 2021 would at least consolidate what was achieved in 2020.

**There are significant uncertainties with an impact in 2021 resulting from the expansive effect of the expenditure due to the suspension of fiscal rules, the extent and impact of the pandemic, and the application of the RTRP to spending.** As already highlighted in the November 2020 Report, the central scenario of AIReF's estimates for the local sub-sector in 2021 may be altered upwards or downwards by the limitations in scope resulting from the following elements: (i) the quantification of the expenditure to be incurred through application of the surpluses obtained in previous years as no infringement will be incurred in a context of suspended fiscal rules; (ii) the effect on revenue of the reduction in economic activity as a result of the pandemic; (iii) the measures taken or which may be taken to mitigate the effects of COVID-19; and (iv) the expenditure recorded resulting from the RTRP.

**AIReF has revised its estimate of the impact that application of local savings of previous years to expenditure might have in 2021 upwards by 0.05 points.** AIReF's current forecasts for 2021, which have been revised upwards given the positive results in 2020 and, therefore, the greater savings accumulated by the local sub-sector, raise the economic impact of applying these savings

to expenditure by over 0.05 points of GDP with regard to the November 2020 estimate. This affects the result for the year by almost 0.15 points. However, the total expenditure incurred at the end of the year, either with these surpluses from past years or with their own or external funds from the year in progress, will be mitigated by the limited expenditure capacity of these authorities given the necessary compliance with the legal guarantees required by procurement legislation. Therefore, it is expected that the higher volume of expenditure financed from these funds will be accompanied by a higher level of non-execution of the appropriations approved for the year.

**AIRcF revises downwards its estimate of the impact of the pandemic on local finances in 2021 following the downward revision of the negative effects in 2020.** The publication of the year-end data for 2020, which quantifies the effect of COVID-19 on local sub-sector expenditure at over 0.1 points of GDP (€1.25bnm), has led to AIRcF revising its estimates of the effect of the pandemic in 2021. In its November 2020 Report, AIRcF had quantified the estimated effect of the reduction in revenue and the increase in expenditure directly related to the economic and social crisis brought about by the health crisis at around €1bn in 2021. With the information on year-end 2020 and the impact of COVID-19, the improvement in the expected revenue of the Provincial Councils and other revenue linked to the evolution of the economic situation, the revenue for financing the 2020 deficit in urban collective transport, and the lower estimated effect on current spending that will be caused by the extraordinary situation, AIRcF has lowered the overall impact of the pandemic in 2021, placing it at less than 0.05 points of GDP.

FIGURE 38. LOCAL GOVERNMENTS

FIGURE 38.A. NET LENDING/BORROWING (% GDP)

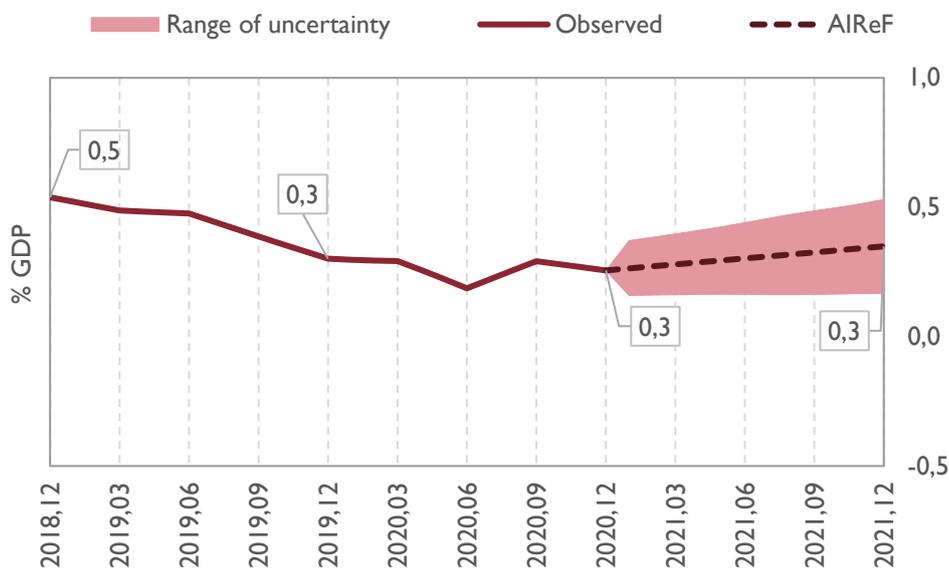


FIGURE 38.B. REVENUE (% PIB)

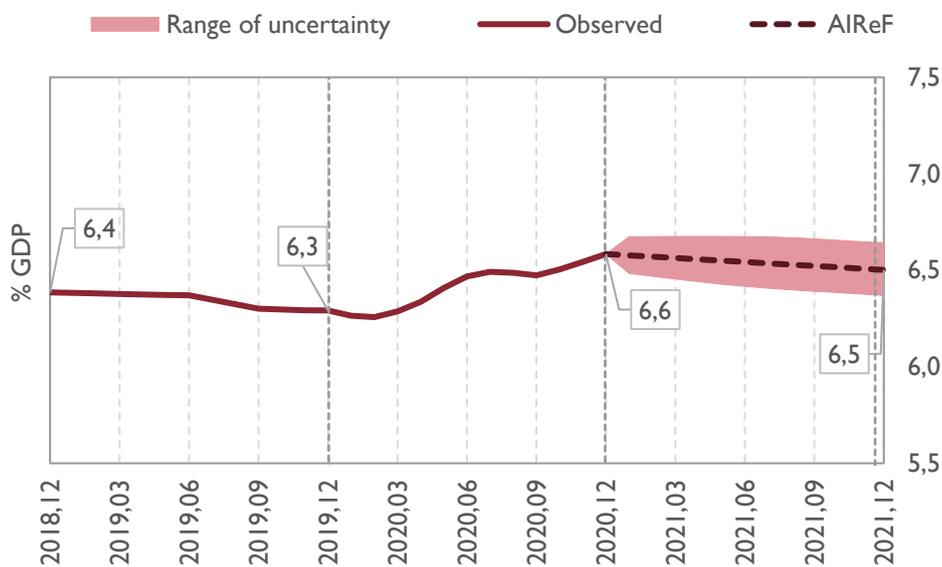
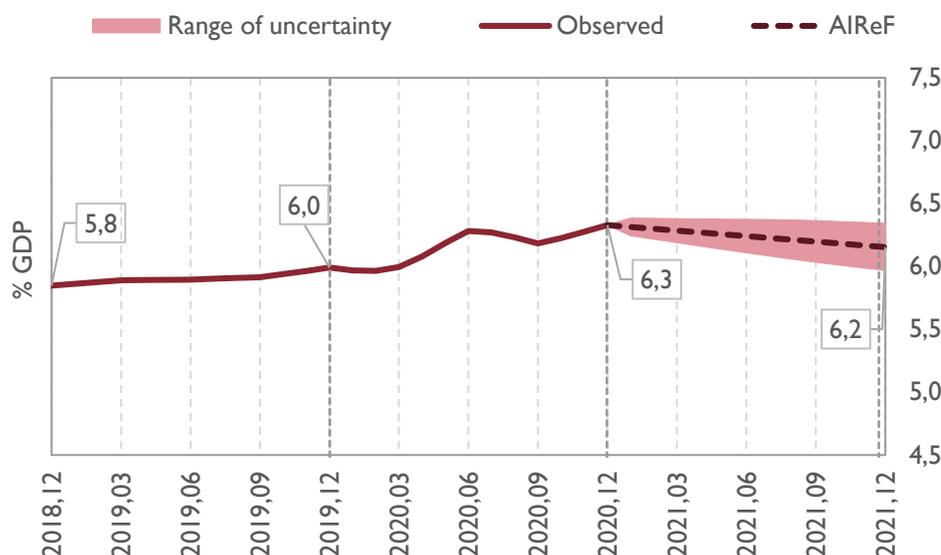


FIGURE 38.C. EXPENDITURE (% GDP)



#### Individual analysis. 24 large Local Governments

The data reported by the large LGs on the results to be achieved in 2021 are more prudent, but, in general, do not include significant changes with regard to those sent with the budgetary lines. In the supplementary Report on the individual evaluation of the LGs, AIReF analyses the 24 large Local Governments with the current estimated data for year-end 2021, according to the information of the budgets to be executed in the year. These balances expected by the Local Governments in 2021 do not include significant changes with regard to those set out in the December Report, except in the City Councils of Las Palmas de Gran Canaria and Valladolid and the Island Council of Tenerife, whose forecasts change from surplus to deficit.

**AIReF maintains its December 2021 deficit forecasts in the City Councils of Barcelona and Bilbao, and the three Provincial Councils and adds those of Palma and Valladolid to this situation.** AIReF has estimated the balance to be obtained at the end of 2021 for each of the 24 large LGs, basically according to the level of expected realisation of their forecast expenditure and the likelihood of realisation of the expected revenue. According to these forecasts, the City Councils of Barcelona, Palma, Bilbao, Valladolid, and the Provincial Councils of Araba/Álava, Bizkaia and Gipuzkoa will close 2021 with a deficit. However, in the case of the Provincial Councils, these results are highly dependent on the effect on the balance of the fall in revenue of transferred taxes resulting from the pandemic which are not passed on to other public authorities through contributions.

**The analysis of the evolution of computable expenditure in the large LGs in 2020 leads to the conclusion that its significant growth in 2019 was the determining factor, with the pandemic not having had a significant effect on the 2020 result.** The widespread increase in local spending in 2019 resulted in the sub-sector as a whole raising computable expenditure by 6% (above that allowed by the approved growth rate of 2.7%). As highlighted in AIReF's December Report, the City Councils of Bilbao, Madrid and Valencia and the Provincial Councils of Barcelona and Valencia expanded their computable expenditure in 2019 by around 10% (7% in the case of Valencia City Council). In 2020, the year in which compliance with fiscal rules does not apply, 11 of these large LGs have recorded increases in computable expenditure below the figures for 2019 despite the weight of the higher expenses for COVID-19, as they started off from very high baseline expenditure. However, after stripping out the effect of COVID-19, the City Councils of Cordoba, Las Palmas de Gran Canaria, Palma and Zaragoza, the Provincial Council of Valencia and the Provincial Council of Gipuzkoa show an increase in computable expenditure of over 6% in 2020 (double the reference rate that would operate in a context of economic stability).

**FIGURE 39. 24 LARGE LGS. COMPARATIVE OVERVIEW AIREF FISCAL INDICATORS IN 2020 AND 2021**

LOCAL GOVERNMENTS	EVOLUTION OF ECONOMIC AND FINANCIAL PLANS (EFP)	Stability		Computable expenditure	Debt ratio (DR)
		Year-End 2020	Forecast 2021	Year-End 2020	Forecast 2021
MADRID	Did not comply with ER15 and ER16. After 3 EFPs approved by Plenary Session but not by supervisory body, on Dec 17 EFP 17-18 is definitively approved. Did not comply with ER 19	+	+		44%
BARCELONA	EFP for non-compliance ER15 approved for 15-16. Revised due to fore. Non-compliance for 15 -16. New EFP 16-17. Did not comply with SR 18, new EFP 19-20	-	-		29%
VALENCIA	Did not comply with SR17, following the standardised criteria for calculating the SR of the IGAE guide. Should have submitted an EFP, which it has not done. Did not comply with ER 19	+	+	<2019	35%
SEVILLE	EFP for non-compliance ER18 approved for 19-20.	+	+	<2019	25%
ZARAGOZA	EFP for non-compliance ER15 approved for 16-17. Did not comply with ER 17 committed to in EFP due to time lag	-	+	>6%	90%
MÁLAGA	EFP for non-compliance ER15 approved for 16-17. Did not comply with ER 19	+	+	<2019	45%
MURCIA	EFP for non-compliance ST and ER18 approved for 17-18. Did not comply with ER 19	+	+	<2019	67%
PALMA	EFP for non-compliance ER15 approved for 16-17	+	-	>6%	44%
LAS PALMAS DE GRAN CANARIA	EFP for non-compliance ER178 approved for 18-19	+	+	>6%	0%
BILBAO	EFP 17-18 approved due to approving the 2017 budget with deficit, in breach of the provisions of the Law on Budgetary Stability and Financial Stability. In October 2019, faced with the forecast of non-compliance with SR 2019, they approved a new EFP 19-20.	-	-	<2019	0%
ALICANTE	EFP for non-compliance ER15 approved for 16-17	+	+		0%
CÓRDOBA	Did not comply with ER 19	+	+	>6%	55%
VALLADOLID		-	-	<2019	53%
VIGO	EFP for non-compliance ST and ER18 approved for 19-20.	+	+	<2019	0%
GUIJÓN	Did not comply with ER17. It did not approve the EFP in plenary session.	-	+	<2019	41%
L'HOSPITALET DE LLOBREGAT	EFP for non-compliance ER18 approved for 19-20.	-	+		6%
BARCELONA PROV. C.	EFP for non-compliance ER17 approved for 18-19. Did not comply with ER19.	+	+	<2019	0%
VALENCIA PROV. C.	EFP for non-compliance ER15 approved for 16-17. Did not comply with ER19.	+	+	>6%	10%
SEVILLE PROV. C.		+	+	<2019	2%
ISL. GOV. OF TENERIFE		+	+	<2019	12%
ISL. GOV. OF MALLORCA	EFP for non-compliance ST and ER17 approved for 18-19	+	+	<2019	26%
PROV. C. OF ARABA/ÁLAVA		-	-	<2019	55%
PROV. C. OF GIPUZKOA		-	-	>6%	44%
PROV. C. OF BIZKAIA		-	-		77%

<2019 2020 computable expenditure (estimated without the COVID effect) is lower than 2019. If it is an increase but this is less than 6%, blank box.

>6% 2020 computable expenditure growth (without COVID effect) of more than 6%

+ Forecast surplus

- Forecast Deficit

NB: The background colours in the debt column represent the tranche of DR: green if <75%, yellow if between 75% and 110% and red if >110%

**In a context of suspended fiscal rules, the functions of the supervisory bodies of the LGs are very limited.** AIReF requested the supervisory bodies of the LGs to conduct individual analyses of the information on their actions in relation to monitoring the components of the fiscal rules (net lending/borrowing, evolution of computable expenditure and debt). The information provided has revealed the problems in implementing these powers in the current context of suspended fiscal rules. However, fiscal oversight is more important than ever to ensure that the future sustainability of their finances is not compromised. AIReF therefore believes that coordination between the Ministry of Finance and the different supervisory bodies needs to be strengthened.

#### 4.5. Contingent liabilities and fiscal risks

**Contingent liabilities can have a significant negative impact on government accounts, as AIReF has pointed out in previous reports.** AIReF has been reporting on existing fiscal risks and contingent liabilities and noting that neither the Budgetary Plan nor the GSB include detailed and full information on contingent liabilities that may affect the year to which they relate. The failure to include fiscal risks and, consequently, their possible impact on the government accounts should they materialise makes it impossible to have a full overview of the actual fiscal situation of the General Government. For this reason, AIReF has been recommending full transparency and strict monitoring of these liabilities in its reports, as well as their inclusion in any fiscal planning performed in order to anticipate and minimise their impact.

**In this regard, in 2020, the materialisation of the fiscal risks resulting from the CASTOR gas storage facility and the SAREB, has led to a sharp increase in the deficit and debt of the CG.** In the report on the main budgetary lines of the General Government for 2021, and in previous reports, AIReF had already highlighted the possibility that the State would have to pay compensation of €1.45bn, with late payment interest included, for the closure of the Castor gas storage facility, which materialised in 2020 following the ruling issued by the Supreme Court. In addition, the reclassification of the SAREB as a public authority as a result of its negative equity has had an impact of €9.89bn on the deficit and €35bn on the debt of the CG. The materialisation of these two contingent liabilities entails a combined impact on the 2020 deficit of €11.35bn, which amounts to 1% of GDP in that year.

**For 2021, AIReF highlighted the existence of greater fiscal risks than in other years, mainly arising from the pandemic.** In the report on the main budgetary lines for 2021, AIReF already identified greater risks for 2021. These included risks arising from the implementation of the RTRP; risks relating to

guarantees granted to SMEs and self-employed workers to maintain the liquidity of the productive fabric; risks arising from the materialisation of another less favourable macroeconomic scenario; risks arising from an overly optimistic revenue forecast and the risk of turning expenditure associated with the pandemic into structural expenditure.

**In addition, as AIReF had noted in the previous report, some of the risks associated with the liquidity measures adopted by the State in 2020 to address the pandemic have already materialised in 2021.** The long duration of the pandemic and the consequent restrictions on mobility and venue capacity were already highlighted by AIReF as objective circumstances that raised the likelihood of enforcement of the public guarantees granted due to the pandemic. As expected, these circumstances have increased the risk of solvency problems for companies that had been granted loans and State guarantees. For this reason and to avoid the structural effects on the economy, the Government anticipates the foreseeable enforcement of public guarantees and, by means of Royal Decree-Law 5/2021, creates two COVID-19 Lines of direct support to self-employed workers and companies with the aim of reducing the debt entered into as from March 2020, giving priority to reducing the nominal value of the debt with public guarantees and allowing the conversion of part of the public guarantee into transfers to the companies and self-employed workers most affected by the crisis. The combined impact of these measures is an increase in the deficit of €8,5bn in 2021, amounting to 0.7% of GDP.

**In addition, the risks arising from the RTRP implementation process remain. This situation might affect the dynamism of the economy, with a negative impact on the deficit.** In order to make its estimates, AIReF has assumed implementation of the RTRP with a volume of expenditure of €26.6bn in 2021, as set out in the draft GSB for 2021, which is not changed in the approved GSB. Although its implementation is still within the time periods set by legislation, at the present date, the lack of specifics relating to the RTRP prevents it being executed until the second four-month period of the year. Early implementation of the projects in the first part of the year is therefore ruled out. Although AIReF maintains execution of the RTRP in the terms set out in the GSB as part of its central scenario, the macroeconomic effects would already be partially carried forward to 2022. This is one of the main reasons for the revision of the macroeconomic scenario, with the corresponding impact on fiscal forecasts. In addition, given that the details of the RTRP are not yet known, it is not possible to comment on the risks arising from an inappropriate selection of projects for achieving the desired effects on the recovery of the economy. The risk also remains that part of the expenditure of the RTRP will become structural with no permanent financing provided for.

Conversely, it is also feasible for the RTRP to finance expenditure already incurred or to be incurred in any event in the absence of the RTRP, which could support a reduction in the structural deficit.

**With regard to the other risks linked to the pandemic, uncertainty remains about the timescale for resolving the health crisis and the risk that expenditure linked to the pandemic will become structural.** The possibility of a fourth wave and the slower than expected vaccination rate, with the consequent delay in the immunisation of the population, shape the evolution and resolution of the health crisis, which remains the main risk faced by the Spanish and the global economy. In a different area, the risk remains that the temporary expenditure to address the crisis resulting from the pandemic, once the extraordinary needs that gave rise to it disappear, will remain and become structural.

**Lastly, in addition to known contingent liabilities at December 31<sup>st</sup>, 2019 of over €14bn, there are other transactions for which no information is provided and which may pose a risk to the deficit in the medium term.** The 2019 General Account of the GSA includes a list of contingent liabilities for an amount exceeding €14bn. The liabilities of a particularly significant amount include the SFL for companies awarded ACESA toll motorway concession contracts (€2.38bn), international energy arbitration for renewable energy support schemes (€9.63bn) and the appeals filed by the ARs and LGs in relation to the final settlement of 2017 VAT as a result of the new VAT management system (€2.02bn). In addition, there are other operations for which there is no information which might have a significant impact on the deficit over the coming years. This is the case of the investments in defence modernisation programmes which are currently underway, public-private partnership contracts and loans granted by public authorities that may turn out to be non-performing.

# 5. EVOLUTION AND SUSTAINABILITY OF THE PUBLIC DEBT

## 5.1. Recent evolution and short-term projections

The COVID-19 pandemic that broke out in the first quarter of 2020 has triggered an unprecedented economic crisis around the globe, with the consequent deterioration of public accounts and a significant increase in public debt ratios of economies around the world. Recent estimates suggest a global GDP contraction of over 3% in 2020 and public deficits of more than 10% of GDP in a large number of world economies.

FIGURE 40. DEFICIT OF THE MAIN ECONOMIES (% GDP)

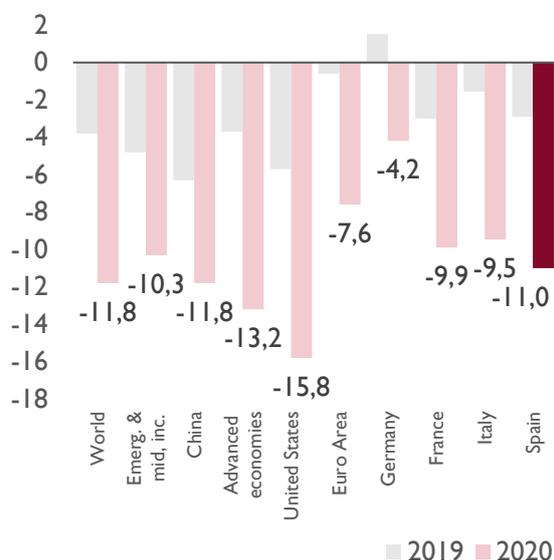


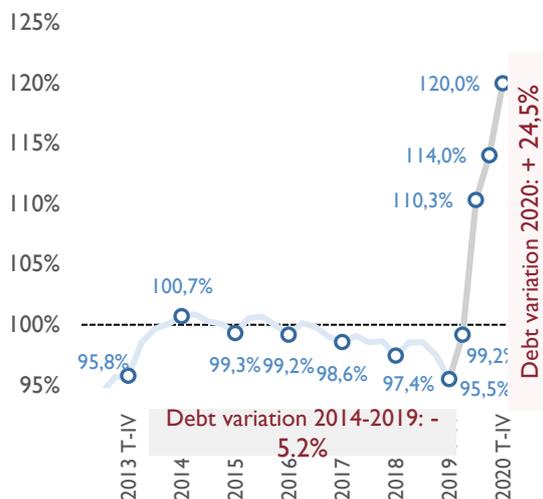
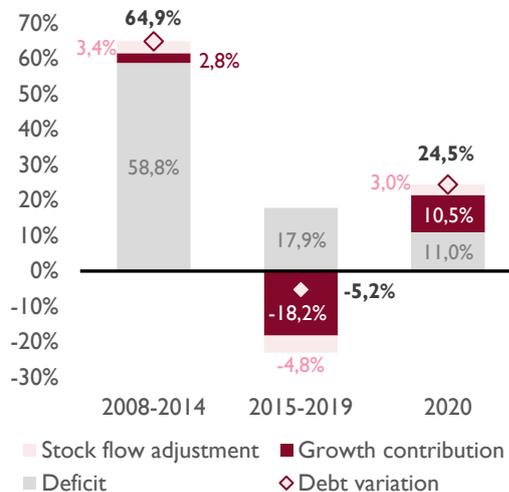
FIGURE 41. GROWTH IN DEBT IN 2020 OF THE MAIN ECONOMIES (%GDP)



Source: Bank of Spain, General Intervention Board of the State Administration (IGAE) and IMF (WEO April 2021)

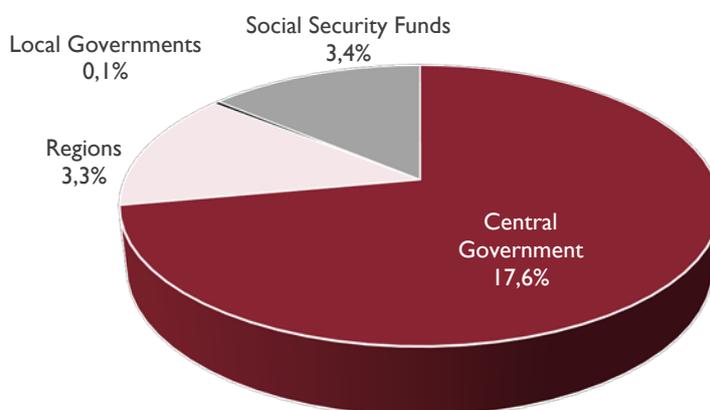
It is estimated that the global and the Eurozone debt ratios will increase by close to 15 points of GDP, which in both cases stand at around 100%. In order to address the health crisis, ensure liquidity support and assistance to companies and avoid mass redundancies, governments have taken unprecedented fiscal measures, which, together with the operation of automatic stabilisers, have resulted in a very significant worsening of public accounts. This has led to a significant increase in government debt. In particular, it is estimated that the global and the Eurozone debt ratios will increase by close to 15 points of GDP, which in both cases stand at around 100%. In 2021 and 2022, some stabilisation at these record high levels is projected.

The Spanish debt-to-GDP ratio stood at 120% in 2020, an increase of 24.5 points on the level of the previous year. A significant part of this increase (10.5 points) is due to the fall in GDP, the denominator of the ratio. The Spanish economy recorded a contraction in real terms of 10.8% in 2020 and is therefore among the economies most punished by the pandemic worldwide. For its part, the fiscal balance has contributed almost 11 points to the rise in the debt ratio, in line with the main comparable economies. In addition, the reclassification of the debt of Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Sareb) has added €35bn to government debt, which has accounted for most of the stock-flow adjustment (3 points).

**FIGURE 42. DEBT (% GDP)**

**FIGURE 43. CHANGE IN DEBT (% GDP) AND CONTRIBUTIONS**


Source: Bank of Spain, INE and compiled by author

The Central Government and the Social Security Funds have borne most of the increase in debt (21 points) by financing most of the expenses associated with the coronavirus pandemic. The extraordinary transfers and not passing on the fall in tax revenue to the instalment payments made to the Autonomous Regions under the ordinary regime have mitigated the increase in the debt ratio of the Autonomous Regions. This ratio has only grown by 3.4 points – to amount to 27.1% of GDP – of which 2.6 points are attributable to the denominator effect. For their part, Local Governments saw practically no increase in their debt.

**FIGURE 44. INCREASE IN DEBT BY SUB-SECTOR**


Source: Bank of Spain

**In 2020, despite higher borrowing needs, the cost of borrowing has continued to fall, recording a new all-time low.** Specifically, the average cost of outstanding State Debt stood at 1.86%, below the 2.19% at the end of 2019. The average cost of new issues fell to 0.18%, compared with 0.23% in 2019. This has been helped by the fact that just over 50% of the State debt issued during the year was allocated at negative rates, resulting in record low yields along practically the entire curve. It should be noted that at the end of the year, the Treasury managed to auction off a ten-year bond at a negative interest rate.

**The State's financial burden has been reduced for the sixth consecutive year, with interest expenditure at the end of 2020 standing at 2.2% of GDP.** Since mid-2012, the effective cost of financing General Government debt has been systematically reduced by a cumulative total of 210 basis points. This has made it possible to reduce interest expenditure both in absolute terms and as a percentage of GDP - one of the main indicators of a country's debt sustainability.

FIGURE 45. AVERAGE COST OF STATE DEBT (%)

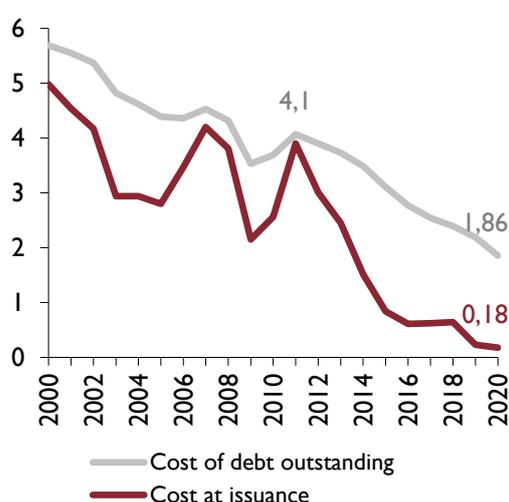
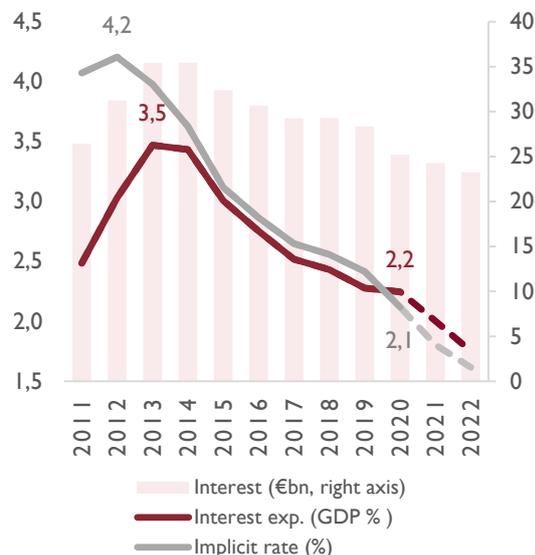


FIGURE 46. FINANCIAL BURDEN AND IMPLICIT RATE OF THE DEBT

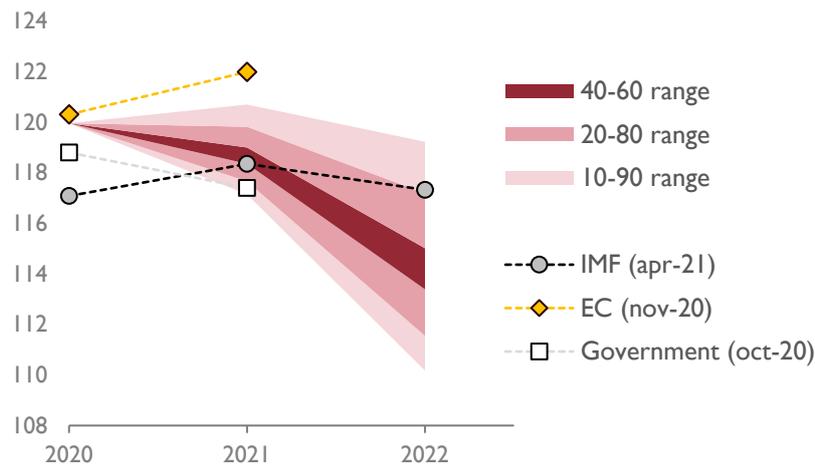


Source: Public Treasury, General Intervention Board of the State Administration (IGAE) and compiled by author

The rebound in economic activity that is expected in the coming quarters, together with the boost of the Recovery, Transformation and Resilience Plan and the improvement in the cyclical component of the public balance, project a reduction in the debt ratio of 1.3 points in 2021, to 118.7% of GDP. This reduction will speed up in 2022.

The gradual disappearance of the emergency measures related to the pandemic, as well as the expected rebound in economic activity, will result in a significant improvement in government balances in 2021 and 2022.

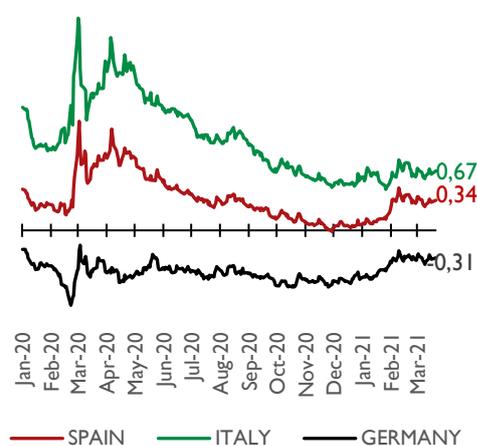
**FIGURE 47. STOCHASTIC DEBT PROJECTIONS (% GDP) AND FORECASTS BY THE GOVERNMENT AND OTHER INTERNATIONAL BODIES**



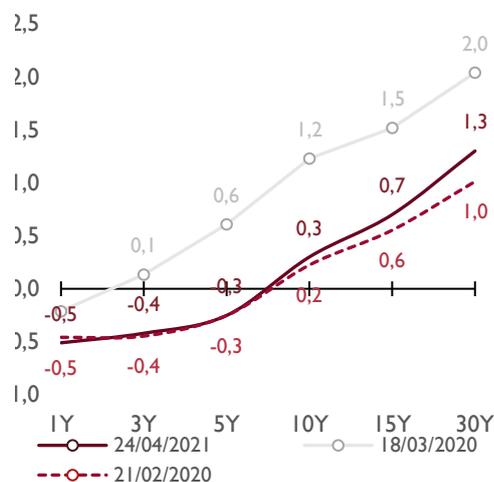
Source: IMF, EC, Government and compiled by author

## 5.2. Sustainability and risk analysis

**Despite the seriousness of the crisis, large-scale monetary policy support has helped stabilise debt financing conditions, both for sovereign and corporate debt, in a year when European governments have issued over €1 trillion of net debt.** Sovereign debt markets recorded a sharp rise in yields at the beginning of the crisis, mainly in the case of “peripheral” countries. In particular, the yield on the Spanish 10-year bond rose by over 100 basis points in just 15 days. The rapid and strong reaction of the ECB in March with the announcement of the Pandemic Emergency Purchase Programme (PEPP) and its subsequent extensions has prevented the fragmentation of European bond spreads. Sovereign debt spreads have recovered to pre-health crisis levels and the term yield curve has even fallen below the pre-pandemic level, standing firmly in negative territory for terms of less than five years.

**FIGURE 48. YIELD ON 10-YEAR SOVEREIGN BOND (%)**


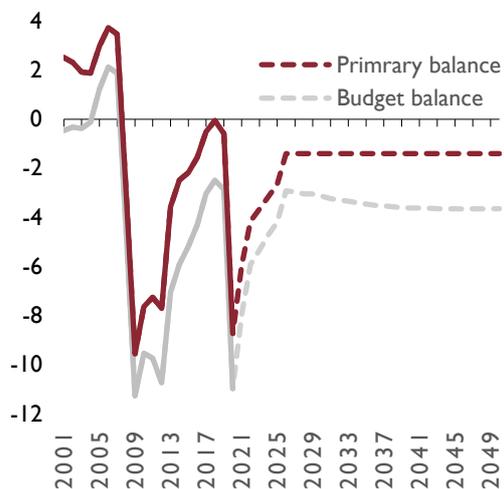
Source: Refinitiv

**FIGURE 49. SPANISH INTEREST RATE CURVE (%)**


The global fall in interest rates and the lengthening of debt maturities have mitigated in recent years some of the risks involved in maintaining high debt levels. The forecast that the current low interest rate environment will be maintained over a long period of time favours the dynamics of the debt ratio, helping to generate a positive “snowball” effect over the coming years. A negative interest rate differential over growth allows the debt ratio to remain stable even while maintaining a structural primary deficit in the medium term.

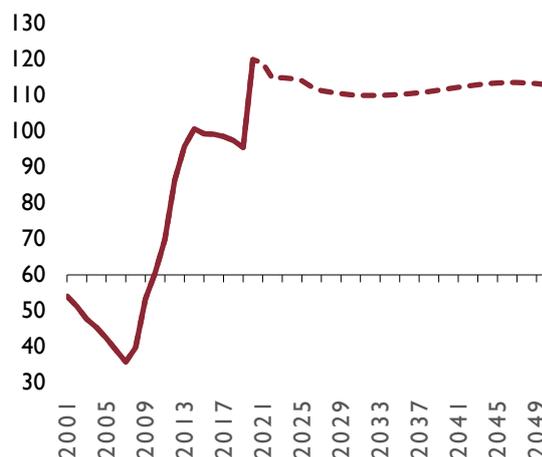
The current expectations of a lasting low interest rate environment offer greater room for manoeuvre when designing a medium-term consolidation strategy, and in theory make it possible to return to a balanced budget in a gradual manner that is not detrimental to growth. Achieving a balanced budget will be essential in order to cope with the debt pressure associated with the increase in pension expenditure resulting from the ageing population and to avoid maintaining the debt level above a threshold, which, according to economic literature, might be associated with a negative impact on growth.

**FIGURE 50. DEBT STABILISING PRIMARY DEFICIT (%GDP) UNDER CURRENT INTEREST RATE EXPECTATIONS**



Source: Compiled by author

**FIGURE 51. DEBT SIMULATION (%GDP) CONSISTENT WITH A PRIMARY DEFICIT OF 1.5%, IN THE CURRENT CONTEXT OF THE INTEREST-GROWTH DIFFERENTIAL**



The pandemic has heightened the challenges associated with high levels of public debt, the future sustainability of which is strongly linked to the policies of the European Central Bank. The emphatic and swift action by the monetary policy body has avoided the resurgence of any doubt about the sustainability of historically high debt levels. The purchase of public assets through the Pandemic Emergency Purchase Programme (PEPP) has covered most of the extraordinary borrowing needs of 2020, while managing to place the entire yield curve at historic lows, minimising spreads between Euro area countries.

Beyond the normality of the current functioning of sovereign debt markets, there are risks and challenges in the medium and long term. Once non-conventional instruments such as the PEPP have fulfilled their role (net purchases are expected to cease in 2022) and inflation forecasts converge to higher levels, interest rates might rise to levels more in line with their historical trend. The increase in the average maturity of the debt portfolio provides some protection against possible interest rate rises which, should they occur, would be transferred to the effective financial burden very gradually over several years. However, increases in interest rates would eventually have a major impact on the financial burden over the medium and long term, given the high accumulation of debt.

Although there is a significant risk that part of the COVID-19 Guarantee Lines will be enforced, the impact of the materialisation of these contingent

**liabilities on government debt is limited and does not, in itself, endanger its sustainability.** In 2020, the Government approved the implementation of two lines of guarantees for a joint amount of up to €140bn aimed at guaranteeing the financing granted to self-employed workers and Spanish companies affected by the economic effects of COVID-19. This has led to a significant increase in contingent liabilities. By the end of February 2021, the COVID-19 Guarantee Lines had deployed guarantees for an amount in excess of €90bn.

**In contrast, the increase in healthcare spending and expenditure on pensions as a result of the ageing of the population is one of the major risks to the sustainability of public finances in the medium term.** Higher structural expenditure that is not covered by additional revenue will lead to a very significant rise in debt from levels that are already historically very high.

**TABLE 13. RISK MATRIX**

	Short term		Medium/long term	
	Probability of occurrence	Impact in public debt	Probability of occurrence	Impact in public debt
Refinancing risk	Very low	Medium	Low	Medium
Interest rate risk	Medium low	Low	Medium high	Medium high
Contingent liabilities, public guarantees	Medium	Low	Medium high	Medium low
Contingent liabilities, population ageing	Medium low	Medium low	High	High

# 6. RECOMMENDATIONS

## 6.1. New Recommendations.

### **Reporting by the General Government in the context of the absence of fiscal rules.**

In order to deal with a situation as exceptional as that resulting from the pandemic, the escape clause provided for in the Organic Law on Budgetary Stability and Financial Stability for these circumstances was activated for the first time in 2020. This has led to the suspension of fiscal rules in 2021, as they were in 2020 and are expected to be in 2022.

The needs arising from the health, economic and social crisis triggered by the pandemic are pushing up public spending very significantly. This increase, together with the reduction in revenue, has caused the deficit figures and debt of the General Government to shoot up. This flexibility has been possible thanks to the suspension of fiscal rules, which allows governments to raise the level of expenditure, deficit and debt without limit.

Against this backdrop of an absence of fiscal rules, fiscal oversight of this entire increase in expenditure and of the new fiscal risks takes on greater importance. In this regard, having the provision of revenue for more adverse situations and in absence of fiscal risks, there is a risk that the General Government will maintain high growth in expenditure, no longer on a temporary basis and only to mitigate the effects of the crisis, but on a permanent basis, thus hindering the future reduction of the structural deficit.

It is therefore essential to maintain the reporting obligations contained in the Organic Law on Budgetary Stability and Financial Stability, which remains applicable except as regards the setting of fiscal rules and corrective measures. For this reason, in addition to the information that continues to be published, including the average payment period and monthly execution data, the reports provided for in Article 17(3) and (4) of the Organic Law on Budgetary Stability and Financial Stability on computable expenditure and the government deficit and debt calculated for the purposes of the fiscal rules, as well as data on computable expenditure in the monthly execution reports, must continue to be published. Although the expenditure, deficit and debt incurred do not entail any corrective action, these expenditure, deficit and debt indicators provide valuable information on the fiscal position and evolution of each public authority. It is important to bear in mind that, once the pandemic has ended, it will be necessary to return to a path of fiscal discipline. It is therefore essential to monitor these indicators on an ongoing basis.

Furthermore, information on those aspects that allows the monitoring of the effects of the pandemic (new measures adopted, contingent liabilities arising from the crisis or cash surpluses applied by the LGs) should be strengthened. In this regard, the Ministry of Finance has already strengthened the economic and financial reporting it requires from the territorial administrations. AIReF believes that the obligation of the territorial administrations to draw up new COVID-associated questionnaires should be maintained until fiscal rules are re-established. These questionnaires should incorporate information on the contingent liabilities that have arisen as a result of the pandemic and the cash surpluses applied by the LGs. In addition, in the interests of transparency, this information should be made public.

For all these reasons, AIReF makes the following recommendations to the Ministry of Finance:

1. ***Maintain or increase the publication of information on the activity of the General Government in a context of suspended fiscal rules and, in particular:***
  - ***Publication of the reports provided for in Article 17(3) and (4) of the Organic Law on Budgetary Stability and Financial Stability on computable expenditure and the government deficit and debt calculated for the purposes of the fiscal rules, as well as data on computable expenditure in the monthly execution reports.***

- *Publication of the additional information questionnaires requested from the territorial administrations as a result of the pandemic. Maintenance of the obligation to prepare them until fiscal rules are re-established and extension of their content in order to report on contingent liabilities and on cash surpluses applied by the LGs.*

### **Adjustment of the borrowing levels of Autonomous Regions to their real needs.**

The Ministry of Finance, in compliance with the recommendation made by AIR<sup>e</sup>F, established in the joint debt targets of the Autonomous Regions for 2020 and 2021-2023, as well as in its proposals for setting individual targets for those years, a new clause establishing that: "The public debt target of the Autonomous Region sub-sector may be adjusted by the effective amount of the execution of the additional financing mechanisms occurring during the year, providing it is not used to finance debt maturities or deficits in the respective year. It may also be adjusted for a reduction in the level of outstanding net debt both by the application of Article 32 of Organic Law 2/2012, of April 27<sup>th</sup>, on Budgetary Stability and Financial Sustainability and its special implementing rules in relation to the budget surplus, and for the financing of a deficit target higher than that actually incurred, in agreement with the Ministry of Finance."

At present, and although fiscal rules are suspended, the high levels of existing debt reinforces the need to establish mechanisms to avoid excessive use of borrowing.

For all these reasons, AIR<sup>e</sup>F makes the following recommendations to the Ministry of Finance:

2. *Adjust, through debt authorisations and, where appropriate, extraordinary financing mechanisms, the borrowing of the Autonomous Regions to the real financing and liquidity needs of each one of them.*

### **Coordination of supervisory bodies to monitor fiscal indicators**

Activation of the safeguard clause at a national level suspended compliance with all fiscal rules. This led, *inter alia*, to the suspension of the economic and financial plans in force and the procedures of those being processed. As regards Local Governments, which receive funds from the financing system through the assignment model, these plans must receive their final approval and be subsequently monitored by the financial supervisory bodies (the respective Autonomous Regions, if they have

assumed the corresponding powers in their statutes, or otherwise the Ministry of Finance).

This temporary suspension of fiscal rules is implemented at a European level as an extraordinary and short-term measure, with the aim of undertaking all the actions necessary to mitigate the current health crisis and the consequent economic and social crisis, without compromising the medium-term sustainability of public finances. This commitment to the medium-term sustainability of the General Government is what makes fiscal supervision even more necessary, with the financial supervisory bodies of the LGs being important bodies in fulfilling this mission.

For the issuance of this report, AIReF requested the supervisory bodies of the LGs to conduct individual analyses of the information on their actions in relation to monitoring the components of the fiscal rules and the medium-term sustainability of the analysed LGs. The information provided by the supervisory bodies highlights the difficulty in exercising their monitoring functions in the current situation as the economic and financial plans have been suspended. In addition, the analysis of budgetary stability linked to borrowing authorisations has been significantly limited due to the non-existence of infringements. Therefore, without specific powers to monitor fiscal rules in the current context, their actions are very limited. This runs counter to the spirit of the functions assigned to them and which are necessary to ensure medium- and long-term sustainability.

AIReF, in the exercise of its function of anticipating risks, believes that the coordination of the Ministry of Finance and the various regional supervisory bodies in defining common monitoring protocols, irrespective of whether or not corrective mechanisms are implemented in the current framework, is essential as a guarantee of future sustainability.

For all these reasons, AIReF makes the following recommendations to the Ministry of Finance:

- 3. Take the necessary steps, in the exercise of its functions of coordinating the supervisory bodies of the LGs, to promote actions to monitor the main fiscal indicators in order to ensure that the LGs' management of public funds in these years of suspended rules does not compromise the future sustainability of their finances.***

## 6.2. Live recommendations<sup>9</sup>

### Medium-term fiscal focus

In successive reports issued by AIR<sup>e</sup>F over 2020, it has recommended that the Government 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 revenue and powers, in order 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, Transformation and Resilience Plan.*

The Ministry of Finance considers that this recommendation has already been implemented with the presentation of the 2021 Budgetary Plan, with a reduction in the public deficit to 7.7%, and with the approval of the GSB for 2021. This entails returning to the path of consolidation that will be followed once the pandemic has been overcome. Preparation of this path will involve all territorial levels and will take into account the existing government debt and fiscal risks.

However, in AIR<sup>e</sup>F's opinion, the annual nature of both the budgetary plan and the GSB prevents these documents from satisfactorily complying with this recommendation. AIR<sup>e</sup>F also highlights a threefold reason why it is important to provide public authorities with a medium-term perspective: (1) to reflect the multi-year impact of projects financed with European recovery funds; (2) to provide certainty on the specific lines of action and to guide fiscal policy

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<sup>9</sup> This section sets out recommendations made in previous reports which, even though the Ministry of Finance has explained the reasons why it deviates from compliance with the recommendations, AIR<sup>e</sup>F considers them important for achieving the effectiveness and credibility of fiscal rules and a robust fiscal framework, which it believes is not guaranteed by the usual system and practices. It therefore considers that these recommendations should remain in force, they are “live recommendations” and it urges the Ministry of Finance to comply with them. Should this not be the case, it is not necessary to explain once again the reasons for deviating from them, unless they are no longer the same.

amid the uncertainty resulting from the pandemic; and (3) to comply with the Organic Law on Budgetary Stability and Financial Stability's requirement to submit a medium-term plan (rebalancing plan) once the escape clause is triggered.

Medium-term budgetary planning is particularly important in a complex context in which fiscal policy will be marked by the conflicting effect of different factors when the economy exits the crisis. The risk of the expenditure associated with the crisis becoming structural is combined with the provision of additional, but temporary, resources for the start-up of new projects, short-term or structural, initially charged to the RTRP. Therefore, in order to guarantee sustainability, it is necessary to ensure the structural financing of any expenditure that becomes permanent originating from both the pandemic and the RTRP.

In aggregate terms, it is necessary to lay down a fiscal policy that helps to recover pre-crisis activity levels and drive the future growth of the economy. At the same time, the sustainability of public finances requires reducing public debt to less vulnerable levels. This involves reducing the structural deficit that already existed before the crisis, and facing future challenges such as an ageing population. Although the implementation of the RTRP might help to reconcile both objectives, fitting all of these factors together requires a realistic and credible medium-term fiscal strategy that guarantees the sustainability of the General Government.

### **National accounting information in the GSB**

In the reports on the GSB of recent years, AIReF has been recommending to the Ministry of Finance: *that the following be included in the draft GSB:*

- *Information on national accounts adjustments to reconcile the budget balance with net borrowing or lending in terms of ESA 2010.*
- *Information on those entities which, although not of a public nature, are included for the purposes of ESA 2010 in the Central Government sub-sector and on the balance resulting from the net lending or borrowing of Central Government Bodies.*

It has also recommended: *that the draft GSB for next year should include an initial budget in national accounting terms for the Central Government and the Social Security Funds*

The Ministry of Finance has consistently deviated from these recommendations because it considers that the data already published in national accounting terms (monthly execution) are sufficient and because the adjustments are published in the six-monthly notifications made to the

EU. Furthermore, it argues that it is not necessary to provide further information on the entities since the information published complies with the current regulations.

AIReF does not share the Ministry of Finance's explanations. This institution considers that the national accounts adjustments published in the notifications to the EU refer to execution and not to the initial budget, which is when the GSB is drawn up and approved. Therefore, these adjustments do not allow the approved budgets to be reconciled with the stability target and they do not make it possible to know from the outset the forecast of the adjustments. This prevents adjustments from being properly monitored when they are a factor of possible deviation from the deficit target. AIReF also considers the information on the entities that form part of the ESA (European System of Accounts) to be essential because of their impact on compliance with the stability target. Finally, the existence of budgets expressed in national accounting terms would facilitate the monitoring of fiscal rules.

In conclusion, as the draft 2021 GSB once again fails to include national accounting adjustments, AIReF maintains the live recommendation that these adjustments be made transparent and included in the GSB. In addition to being a legal obligation (Articles 6 and 27 of the Organic Law on Budgetary Stability and Financial Sustainability), this is essential for determining whether the Budget is in line with the deficit target (or a reference as is the case of the 2020 GSB) and to prevent deviations from the target through the route of national accounts adjustments. In addition, and for the reasons indicated above, the recommendations on the national accounting information of the entities that fall within the ESA perimeter and that budgets should be prepared in national accounting are maintained as live recommendations.

The president of AIReF



Cristina Herrero Sánchez