



2013 Spain Budgetary Targets

Distribution between government levels

January 2013

1. General government target and distribution between government levels

Spain's *Stability Programme 2011-2014* originally set the headline deficit target at 3% of the GDP for 2013. The target was determined following the official recommendations of the Council of the European Union. Afterwards the Spanish Central government distributed the headline deficit target among the different government layers.

In April 2011 the Central government announced that the deficit targets for the Central, Regional and Local governments would be 1.7%, 1.1% and 0.2% respectively. This allocation of targets implied that the Central government had 56.7% of the headline deficit target, the Regional governments had 36.7%, and the Local governments the remaining 6.7%.

However, in the light of the progressive deterioration of the fiscal outlook, in July 2012 the Ecofin Council unanimously approved a one-year extension of the deadline to correct Spain's excessive deficit, from 2013 to 2014. As a result, the revision of the *Stability Programme 2012-2015* relaxed the 2013 deficit ceiling for the Spanish General government from 3% of GDP up to 4.5%.

Accordingly, the Central government established a new distribution among the different government levels. The new targets were communicated to the Regional governments at the *Fiscal and Financial Policy Council* that took place in Madrid on 12th July 2012. But instead of extending this additional fiscal space to Regional and Local governments, the Spanish Central government imposed new targets that were tighter, thus biasing in an extreme form the consolidation efforts against the Regions (see table 1).

Table 1. 2012 and 2013 budgetary targets by government layer (% of GDP)

	2012 Target		2013 Target	
	<i>Stability Programme 2012-2015 (July 2012)</i>	<i>Stability Programme 2011-2014 (April 2011)</i>	<i>Stability Programme 2012-2015 (April 2012)</i>	<i>Stability Programme 2012-2015 (July 2012)</i>
Government Level				
General	6.3	3.0	3.0	4.5
Central	4.5	1.7	2.5	3.8
Regional	1.5	1.1	0.5	0.7
Local	0.3	0.2	0.0	0.0

The new intermediary deficit targets for 2013 were set at 3.8%, 0.7% and 0.0% for the Central, Regional and Local government respectively; implying that the Central government would keep 84.4% of the headline deficit target and the Regional governments the remaining 15.6%. No deficit is allowed for the Local governments.

As a result of this decision, the 2013 deficit target for the Central government more than *doubled* between the *Stability Programme for 2011-2014* and the July 2012 update for *2012-2015*, while for the Regions it *shrunk* by 36%.

Note also that the different government levels are required uneven efforts to achieve their deficit targets. The difference between the 2012 and 2013 deficit targets implies a reduction of 15.6% for the Central government but a 53.3% reduction for the Regions.

All this constitutes an unfair burden sharing among the different layers of government in the State. Moreover, it goes against the spirit and the basic principles of the revised Stability and Growth Pact and the July's Council's Recommendation. This is based on a more consistent, smart and growth-friendly fiscal consolidation that puts the focus on the structural fiscal adjustment over the medium term.

2. Deficit targets according to expenditure responsibilities

As a result of a long-standing decentralization process, Regional governments are in charge of significant and critical chapters of public expenditure, including Healthcare and Education. On



average¹, Regions are responsible for 36% of total public expenditures, Central government for 51%, and local governments for the remaining 14%.

A rational criterion would be to distribute budgetary targets between government layers according to their expenditure responsibilities. Following this principle, the 2013 deficit target for the Regional governments should be 1.6% of GDP, 0.9 percentage points *higher* than the current target. On the other hand, the deficit target for the Central government should be 2.3% of GDP, 1.5 percentage points *lower* than the current one (see table 2).

Table 2. 2013 Deficit target allocation according to expenditure responsibilities

Government Level	Expenditure (% total)	Current deficit target		Alternative deficit target	
		(% GDP)	(% total)	(% GDP)	(% total)
Central	50.7	3.8	84.4	2.3	51.1
Regional	35.7	0.7	15.6	1.6	35.6
Local	13.6	0	0	0.6	13.3
General	100	4.5	100	4.5	100

The deficit targets set by the Central government for the different government layers appear to be totally disconnected from the expenditure criterion. They are biased in favour of the Central government that captures 84.4% of the headline deficit target; 33 percentage points *higher* than it corresponds to its expenditure level. The deficit target for the Regional governments represents only 15.6% of the headline target; 20 percentage points *lower* that it should be. As a result, a disproportionate adjustment effort is required to the Regions, which carries serious economic and social consequences in a country that is going through a severe recession and through an important rebalancing of its economy, and that registers the highest unemployment levels in the Eurozone.

3. Deficit Targets according to the Spanish Organic Law on Budgetary Stability

The Organic Budget Stability and Financial Sustainability Act (2/2012) establishes the principle of budgetary stability and applies it to all public administrations and companies.

¹ Average expenditure distribution by government layer for the period 2005-2010. The devolution process is concluded by 2005. Most recent available data is for 2010. Source: Ministry of Finance and Public Administrations.



In its first transitional provision, it stipulates two conditions to be met by the deficit targets of the different government levels. First, it sets the year 2020 as the limit for the achievement of no structural deficit.

Second, during the transition period (2012-2020), the deficit targets for the Central government and the Regions must be distributed according to the percentage of headline *structural* deficit that each administration had in January 1st, 2012.

The Ministerial Order ECC/2741/2012 of December 2012 determines how to calculate the output gap and the cyclical component of the budget². According to this methodology, the Ministry of Economy and Competitiveness estimates that the budget sensitivity for Spain General government is 0.43 and for the Regional budget is 0.15.

Applying these figures to the estimated output gap, we obtain the budget cyclical component and, by difference with the observed (or target) deficits, its structural component.

Table 3. Cyclical and Structural components of the budget balance

	2011	2012	2013	2014	2015
Output gap	-4.6	-4.7	-3.8	-2.7	-1.4
General government balance	-8.9	-6.3	-4.5	-2.8	-1.9
Cyclical component	-1.978	-2.021	-1.634	-1.161	-0.602
Structural component	-6.922	-4.279	-2.866	-1.639	-1.298
Regional governments balance	-3.3	-1.5	-0.7	-0.1	0.2
Cyclical component	-0.690	-0.705	-0.570	-0.405	-0.210
Structural component	-2.610	-0.795	-0.130	0.305	0.410

Note: The output gap is published by the Ministry of Economy and Competitiveness, estimated using following the methodology described in the Ministerial Order ECC/2741/2012.

The 2011 Regional and General government balance correspond to the actual budget balance.

The 2012-2015 General and Regional government balance are the imposed targets for each year.

According to the current deficit target distribution, the Regional governments are supposed to achieve *structural surplus* by 2014. This is in contrast with the Spanish Organic Law, which, in the

² It establishes that the output gap is estimated using the Kalman filter to approximate the total factor productivity and that budgetary sensitivity is estimated following the same methodology that the European Commission, based on Girouard and André (2005).

first requirement reported above, gives a transitional period to achieve *structural* budget stability until 2020.

The General government will register a *structural* deficit until 2015, at least. That is, the Central government is forcing on the Regions a faster convergence towards budget stability than upon itself.

Table 4 summarizes the data. It shows that the Regional governments are assigned a decreasing fraction of the headline structural deficit target, in contrast, this time, with the second requirement of the Organic Law.

Table 4. Structural balance required for General and Regional governments, according to their current deficit targets

	2011	2012	2013	2014	2015
General government	-6.922	-4.279	-2.866	-1.639	-1.298
Regional government	-2.610	-0.795	-0.130	0.305	0.410
Regional / General	37.7%	18.6%	4.5%	-18.6%	-31.6%

Table 5 shows the deficit targets for the Regional governments that would best comply with the requirements of the Spanish Organic Law.

Table 5. Alternative deficit targets for the Regional governments in fulfillment of the Spanish Organic Law

	2011	2012	2013	2014	2015
Structural deficit					
General	-6.922	-4.279	-2.866	-1.639	-1.298
Alternative Regional	-2.610	-1.613	-1.081	-0.618	-0.489
Regional / General	37.7%	37.7%	37.7%	-37.7%	-37.7%
Cyclical Regional deficit	-0.690	-0.705	-0.570	-0.405	-0.210
Alternative Regional deficit	-3.3	-2.3	-1.7	-1.0	-0.7

In conclusion: In order to meet the terms of the Spanish Organic Law, the deficit target for the Regional government should be 1.7% of the GDP in 2013, 1% in 2014 and 0.7% in 2015.

4. Possible further steps in Spain's Excessive Deficit Procedure and their impact on regional public finances

On 14th November 2012, in the light of its Autumn Forecast, the European Commission adopted a Communication setting out its assessment of Spain's compliance with the Council Recommendation of 10th July 2012 for the correction of its excessive deficit. Vice President Olli Rehn acknowledged in a public statement the progress made in fiscal consolidation in a very difficult environment, and concluded that the estimated annual improvement in the structural balance in 2012 and 2013 was in line with the effort required by the Council Recommendation, so that no further steps were needed in the Excessive Deficit Procedure of Spain. He also stressed that it is vital to implement effectively the provisions of the Organic Budget Stability and Financial Sustainability Act (2/2012). Unfortunately, as section 3 of this document shows, this is not being done in what concerns the distribution of targets between government layers, thus eroding the internal credibility of the Stability Act.

We welcome more recent comments by Vice President Rehn indicating that the Commission could envisage a proposal to further extend the deadline for the correction of the excessive deficit, after its upcoming Winter forecast exercise on 22nd February, based on the deterioration of the economic outlook and the "effective action" undertaken by Spain. Such comments confirm the Commission's attachment to smart and growth-friendly fiscal consolidation as a key element of EU's crisis response.

Considering this, and bearing in mind the unfair decisions taken by Spain's Central government last July, after the latest extension, we call upon the Commission to fully exercise its prerogatives in terms of fiscal surveillance and to urge the Spanish authorities to reflect on all government layers, in a fairer, more proportionate and legally sounder manner, any possible future decision to grant another extension of the Excessive Deficit Procedure. The allocation of deficit targets to Regional and Local governments by the Central government cannot, and should not, go against the underlying principles of the Council's recommendations and the revised Stability and Growth Pact. The contrary puts at risk the stability objectives by pushing the country as a whole towards a self-defeating policy stance.