

Technical report on calculating the deficit targets of the autonomous communities in accordance with Organic Law 2/2012, dated 27 April, on Budget Stability and Financial Sustainability



Source ACN

The Organic Law on Budget Stability and Financial Sustainability requires from Central Administration and Autonomous Communities a similar effort in fiscal consolidation.

The objective of this report is to explain the reasons why the deficit target assigned to the Autonomous Communities (AC) for the period 2013-2016 by the Fiscal and Financial Policy Council is in breach of the criteria set forth in Organic Law 2/2012, the Spanish stability law. This law stipulates that until 2020 the deficit targets for the Central Administration and the Autonomous Communities must be determined in accordance with the weight of the structural deficit of these two administrations at 1 January 2012, that is, on the date the year 2011 is closed. This signifies an unbiased treatment between the two administrations, as it requires of them a similar effort in fiscal consolidation.

1. THE CONCEPT OF STRUCTURAL BALANCE

The structural balance is obtained by removing the effect of the economic cycle on the budget balance. In times of growth, the impact of the cycle on the budget balance is positive as revenue is higher than expected and cycle-related spending, such as unemployment benefits, are lower. On the other hand, in times of recession, the cycle adversely affects the budget balance, as revenue falls due to lower economic activity and

expenditure related to certain benefits increases significantly.

Thus, **the budget balance has a cyclic component and structural component** such that:

$$\text{BUDGET BALANCE} = \text{CYCLIC BALANCE} + \text{STRUCTURAL BALANCE} + \text{ONE-OFF MEASURES}^2$$

When the budget balance is positive we refer to surplus and when negative, to a deficit.

As the current budget balance is negative, we may re-word the expression above as follows:

$$\text{BUDGET DEFICIT} = \text{CYCLIC DEFICIT} + \text{STRUCTURAL DEFICIT} + \text{ONE-OFF MEASURES}$$

Where:

$$\text{STRUCTURAL DEFICIT} = \text{TOTAL DEFICIT} - \text{CYCLIC DEFICIT} - \text{ONE-OFF MEASURES}$$

The difficulty in determining the structural deficit lies in the fact it is not an observable statistic variable. It is for this reason that the European Commission has defined a calculation method to decompose the total deficit into cyclic and

1. Difference between non-financial revenue and expenditure.

2. One-off measures are those which are not of a permanent nature. These measures may be in effect during a given period of time – such as the elimination of the extra salary for public employees- or they may be ad-hoc (non-recurring) such as the disposal of buildings or the concession of real assets.

structural. This methodology is based on two variables:

1. The cyclic position of the economy, that is, the gap between effective and potential production (output gap), expressed as a percentage of GDP. If the output gap is positive, this signifies that production is greater than its potential level and if negative, that production is lower than potential. The potential production level will be determined by the quantity and quality of production factors.

2. The sensitivity of the budget balance to the cyclic position (semi-elasticity) shows the response of public accounts to the economic cycle. This response will vary in strength in accordance with how the tax system is configured; more or less provision of public services; the manner in which these public services are rendered, etc.

The formula for obtaining the cyclic deficit is as follows:

$$\text{CYCLIC DEFICIT} = \text{OUTPUT GAP (\% GDP)} * \text{SEMI-ELASTIC}$$

Once the cyclic deficit has been calculated, the structural deficit is obtained as the difference compared to the total deficit.

2. ORGANIC LAW 2/2012 ON BUDGET STABILITY AND FINANCIAL SUSTAINABILITY

a. Article 3 of Organic Law 2/2012 establishes the structural balance or surplus as the criterion of budget stability.

b. Transitory provision one of Organic Law 2/2012 stipulates in point 1b that, during the transitory period (2012-2020), the deficit must be reduced while main-

The deficit targets for the Autonomous Communities which meet the criteria set out in Organic Law 2/2012 are 2.5% of GDP (2013), 2.24% (2014), 1.62% (2015) and 1.09% (2016), values significantly higher than those set by the Spanish Central Government.

taining the distribution of the structural deficit between the Central Administration (CA) and the Autonomous Communities (AC) – as observed in 2011:

"The structural deficit of the Public Administrations as a whole must be reduced by at least 0.8 percent of national Gross Domestic Product as an annual average. This reduction would be distributed between the State and the Autonomous Communities in accordance with the structural deficit percentages recorded at 1 January 2012".

Therefore, throughout the transitory period the weight of the AC in the joint structural deficit of the CA and AC, must be the same as that recorded on 1 January 2012, that is, that relating to the end of 2011. In other words, the distribution of the reduction of the structural deficit must maintain the proportion at 1 January 2012 between the State and the AC. Both descriptions are the equivalent for calculation purposes.

Here should note that the transitory period runs from 2012 (first year the law is applied) to 2020. This is an important element as it determines the starting point for evaluating the structural effort required by the targets established -in accordance with transitory provision one of Organic law 2/2012- is the outturn for 2011.

3. CALCULATING THE STRUCTURAL DEFICIT OF THE AC IN ACCORDANCE WITH ORGANIC LAW 2/2012

The report on the Spanish economic situation, dated 25 June 2013 and prepared by the Ministry of Economy and Competitiveness, provides the value of the two benchmark variables for decomposing the deficit into cyclic and structural: the output gap and semi-elasticity. In 2011 the output gap was -5.1% of GDP. It is estimated that the sensitivity of the budget balance of the Spanish Public Administrations to the cyclic position (semi-elasticity) is 0.48 (0.30 for the General State Administration and Social Security and 0.18 for the Autonomous Communities³).

Thus, the following cyclic deficit is obtained by multiplying the output gap by the sensitivity cycle of the CA and AC:

$$\text{CA CYCLIC DEFICIT (AGE + SS)} = 5.1 * 0.3 = 1.53\% \text{ GDP}$$

$$\text{AC CYCLIC DEFICIT} = 5.1 * 0.18 = 0.92\% \text{ GDP}$$

Once the cyclic deficit has been calculated, by the difference between this and the total deficit the structural deficit is obtained. As the data on the total deficit for 2011 are 5.68% of GDP for the CA; 3.31% for the AC, and 0.45% for the Local Corporations (LC), we can obtain the structural deficit for the different administrations:

$$\text{CA STRUCTURAL DEFICIT} = 5.68 - 1.53 - 0.48 = 3.67\% \text{ GDP}$$

$$\text{AC}^6 \text{ STRUCTURAL DEFICIT} = 3.31 - 0.92 = 2.39\% \text{ GDP}$$

$$\text{LC}^6 \text{ STRUCTURAL DEFICIT} = 0.45 - 0^7 = 0.45\% \text{ GDP}$$

3. The sensitivity of the budget balance of Local Corporations to the cycle is deemed null.

4. Update of the Stability Programme of the Kingdom of Spain 2013-2016.

5. One-off measures linked to the banking restructuring.

6. In 2011 there were not one-off measures in the outturn of the Autonomous Communities and Local Corporations.

7. It is considered that the budgets of Local Corporations are not sensible to the stages of the economic cycle, since all its deficit is of structural nature.

TABLE 1

	Deficit targets of PA	Spanish economy output gap	Cycle-sensitivity		AC weight in structural deficit	Decomposition of PA Deficit (State+SS+AC)			Decomposition AC Deficit (as per OL 2/2012)		
			PA	AC		Cyclic	Structural	Total	Cyclic	Structural	Total
2011						-2.45	-6.06	-8.51	-0.92	-2.39	-3.31
2013	-6.5	-6.5	0.48	0.18	39.46	-3.12	-3.38	-6.50	-1.17	-1.33	-2.50
2014	-5.8	-5.2	0.48	0.18	39.46	-2.50	-3.30	-5.80	-0.94	-1.30	-2.24
2015	-4.2	-3.6	0.48	0.18	39.46	-1.73	-2.47	-4.20	-0.65	-0.98	-1.62
2016	-2.8	-1.7	0.48	0.18	39.46	-0.82	-1.98	-2.80	-0.31	-0.78	-1.09

PA: Public Administrations AC: Autonomous Communities

TABLE 2

	Deficit targets of PA	Spanish economy output gap	Cycle-sensitivity		AC weight in structural deficit	Reduction effort			Decomposition AC Deficit (as per OL 2/2012)		
			PA	AC		Structural deficit	Variation	AC effort	Cyclic	Structural	Total
2011						-6.06			-0.92	-2.39	-3.31
2013	-6.5	-6.5	0.48	0.18	39.46	-3.38	-2.68	-1.06	-1.17	-1.33	-2.50
2014	-5.8	-5.2	0.48	0.18	39.46	-3.30	-0.08	-0.03	-0.94	-1.30	-2.24
2015	-4.2	-3.6	0.48	0.18	39.46	-2.47	-0.83	-0.33	-0.65	-0.98	-1.62
2016	-2.8	-1.7	0.48	0.18	39.46	-1.98	-0.49	-0.19	-0.31	-0.78	-1.09

PA: Public Administrations AC: Autonomous Communities

The calculations above reach the conclusion that the weight of the structural deficit of the AC (2.39%) in the CA and AC as a whole (6.06%) in 2011 stood at 39.46%, as can be seen from the following calculation

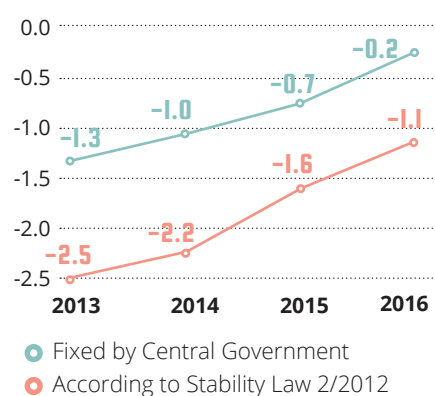
WEIGHT OF THE AC IN THE STRUCTURAL DEFICIT OF 2011 =
 $2.39 / 6.06 * 100 = 39.46\%$.

We may conclude, therefore, that **during the transitory period the structural deficit of the AC must account for 39.46% of the structural deficit of the CA and AC as a whole.**

4. DEFICIT TARGETS FOR 2013-2016 IN ACCORDANCE WITH ORGANIC LAW 2/2012

On 28 June and 12 July 2013 the Central Government adopted two resolutions that included the Ecofin Excessive Deficit Recommendation dated 21 June and set the deficit target for the public administrations as a whole (PA) at 6.5% of GDP

GRAPHIC1: DEFICIT TARGETS FOR AUTONOMOUS COMMUNITIES (*)



(*) Targets approved in 2013 for the period 2014-2016. These targets are shown because they are submitted in the appeal of the Generalitat to the Central Government. The revision of the targets approved later by the Central Government (-0.3 in 2016) would render similar values.

for 2013; 5.8% for 2014; 4.2% for 2015 and 2.8% for 2016.

Based on the targets established for the administrations as a whole, the output gap of the Spanish economy, the cycle-sensitivity and the weight of the

AC on the structural deficit of 2011, applying the previous calculations, we can obtain the deficit targets resulting from the application of Organic Law 2/2012.

As regards the calculation, it should be noted that the estimate of the structural deficit of the AC is based on two procedures that provide the same result, as can be seen in the two tables 1 and 2. In table 1, the calculation of the structural deficit of the AC is the result of applying to the total structural deficit objective the weight of the AC in the structural deficit of 2011 (39.46%). In table 2, the procedure derives from applying to the total structural effort the weight of the AC in the structural deficit of 2011 (39.46%).

Therefore, **the deficit targets for the AC which meet the criteria set out in Organic Law 2/2012 are 2.5% of GDP for 2013; 2.24% GDP for 2014; 1.62% GDP for 2015, and 1.09% GDP for 2016,** values significantly higher than those approved by the Fiscal and Financial Policy Council (CPFF), as shown in Graphic 1. ■