



ECONOMY

The Budget for 2008 (I)

**AN INSOLIDARY
'SUDOKU'**

**The discord sowed by Zapatero
in the State Accounts**

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José Luis Rodríguez Zapatero has irresponsibly created an insolidary 'sudoku' among the Autonomous Communities. He has sowed discord in the State Accounts by disrupting the consensus arrived at in 2002 between Aznar's Government and all of the Autonomous Communities. The budgetary 'sudoku' is meant to be resolved without heeding the criterion of equity, ignoring the constitutional principle of national cohesion. On top of this, resorting to "budgetary engineering" to conceal an increase in structural spending (which jeopardises State Accounts in the medium term) undermines confidence in the future of the Spanish economy. This is particularly serious in a context of uncertainty where maximum transparency is essential. Also, the last Budget of Zapatero's Government is founded on assumptions of economic growth which are not believable.

An insolidary distribution of investments which disrupts national cohesion

The National Budget for 2008 dangerously consolidates a manifestly insolidary allocation of State investments. By virtue of the entry into force of the new Self-government Statutes, two Autonomous Communities, Catalonia and Andalusia, have taken up 37% of the investments in infrastructures that are to be divided among the different Autonomous Communities. This entails a rupture of the vertebrating role of the State. This distribution formula, which seems to respond to purely partisan interests, aside from nurturing an unhealthy and dangerous political struggle between Autonomous Communities and jeopardising cohesion among Spaniards, thwarts one of the basic functions of any modern state, namely the redistribution of income and wealth among the citizens living in territories with marked differences in their level of prosperity.

TABLE 1
Territorial distribution of real investment in 2008
State Sector (administrative, entrepreneurial and functional)
(Million euros)

AUTONOMOUS COMMUNITIES	MINISTRY OF PUBLIC WORKS AND MINISTRY OF THE ENVIRONMENT	REST OF MINISTRIES	TOTAL	PCT. OF REGIONAL TOTAL
Basque Country	414.82	82.13	496.95	2.0
Catalonia	3,469.25	156.36	3,625.61	14.9
Galicia	1,726.42	215.88	1,942.31	8.0
Andalusia	3,854.32	491.09	4,345.41	17.8
Principedom of Asturias	915.62	102.62	1,018.25	4.2
Cantabria	406.20	28.99	435.19	1.8
La Rioja	170.82	17.12	187.94	0.8
Region of Murcia	690.54	130.26	820.80	3.4
Community of Valencia	1,807.28	539.02	2,346.30	9.6
Aragon	799.05	401.54	1,200.60	4.9
Castile-La Mancha	1,130.42	145.40	1,275.81	5.2
Canary Islands	564.30	97.37	661.67	2.7
Foral Community of Navarre	127.29	24.13	151.42	0.6
Extremadura	601.05	78.27	679.32	2.8
Balearic Islands	226.76	43.97	270.73	1.1
Community of Madrid	1,425.88	1,189.81	2,615.69	10.7
Castile-Leon	1,829.16	360.03	2,189.19	9.0
Ceuta	31.90	49.95	81.84	0.3
Melilla	43.83	15.79	59.62	0.2
REGIONAL TOTAL	20.234,92	4.169,73	24.404,65	100,0
Non-regional and several regions	3,005.35	3,841.54	6,846.89	
Abroad	0.00	515.75	515.75	
TOTAL	23.240,27	8.527,01	31.767,28	

Source: National Budget Project for 2008. Economic and Financial Report. Ministry of the Treasury

One should not be deluded by the ‘official’ tables. According to the appendixes to the Budget, the application of the Autonomous Statute of Catalonia means that infrastructures in Catalonia are allocated 4,365 million euros (18.72%). For this purpose, endowments totalling 3,643 million euros are considered, to which “projects yet to be determined and initially not included in the regional total,” and motorway tolls totalling 723 million euros must be added. There is nothing to be criticised in the State substantially investing in Catalonia. What can be criticised is that it does so to the detriment of other regions which objectively need the investments just as much or even more than that Spanish region does.

Investments by the State General Administration must respond to the principle of national cohesion and territorial vertebration in order to develop the regions with lower income levels and, consequently, to support regional

convergence, thereby contributing to the maximum economic and social profitability of investments throughout all of Spain.

The problem caused by Zapatero through the rupture of the Autonomous Community financing model that was jointly adopted in 2002 is that now there could be a widespread attitude of negotiation of Public investments in different territories according to the indices that are most beneficial for each Autonomous Community.

“The Budget for 2008 consolidates a manifestly insolidary allocation of state investments. Catalonia and Andalusia take up 37% of the investments in infrastructures that are to be divided among the different territories. This entails a rupture of the vertebrating role of the State.”

Catalonia demands, pursuant to its Statute, investments according to its GDP. Andalusia, in turn, investments according to its population. This automatically turns the financing of an Autonomous Community into an unsolvable ‘sudoku’, with investments adding up to more than 100%, something which can only be squared away with a hammer, punishing the Autonomous Communities which have not reformed their Statutes with less investment than what justly corresponds to them. This insolidary ‘sudoku’ goes against the constitutional principle of national cohesion and it ignores the principle of equity.

We must add to this the effect arising from the massive loss of EU funds in the 2007-2013 period as a result of the deficient European negotiation carried out by Zapatero. Spain lost 90% of its funds, a net balance of 40,000 million euros, and that loss of EU funds is already posing additional difficulties for financing investments in many Spanish regions.

“To presume that the economy will grow by 3.3% in 2008 in the current economic situation is very brash to say the least. The recent financial crisis has opened up a period of uncertainty in the world economy.”

At a regional level and for a certain type of policymaker it may be comfortable to offer an ‘aggressive’ social policy, promoting populist decisions before the citizens, even if it means that other areas will be neglected, for instance transport and roads, and then pinning the responsibility for their malfunction to other areas of the State. It should not be forgotten that the responsibility for public investments is, first of all, of the policymaker closest to citizens. There are al-

ways means of offsetting possible deficits if there is the will to do so and if spending priorities are arranged according to the actual interests of citizens rather than according to electoral interests at any given moment.

It is also expressly acknowledged that there is an absence of investment projects to meet the volume of investments allocated to some Autonomous Communities, specifically Catalonia. This is the shortest road to wasting those resources because, in order not to lose that financing, investment projects with dubious economic or social benefits will be implemented. Public investments by the State must be directed by the State with a redistributive purpose and with an element of economic and social profitability for the State as a whole, rather than serving as a currency for transactions in an out-of-focus framework of discussions hinging on identity and 'historical deficits'. And speaking of historical deficits, there is nothing like the deficit of equity and cohesion contained in the latest budget submitted by Zapatero's Government.

“By making the negotiation of Public investments that are to be divided across the different Autonomous Communities conditional upon the most beneficial indices for each Autonomous Community (Catalonia according to its GDP and Andalusia according to its population), Zapatero has disrupted the territorial financing model agreed to by consensus in 2002”

Lack of credibility of macroeconomic scenarios

The macroeconomic table presented as the basis of the Budget for 2008 (see table 2) merits very little credit. To presume that the economy will grow by 3.3% in 2008 in the current economic situation is very brash to say the least. The recent financial crisis has opened up a period of uncertainty in the world economy. The chain effects of this financial crisis have only just begun and it is foreseeable that in forthcoming months they will continue to have a greater or lesser repercussion on the Spanish financial sector and also, consequently, on the real economy. Likewise, the price of Brent crude oil reached a historical high of 80.20 dollars per barrel at the end of September, in sharp contrast with the forecasts of the Government, which in its Budget sets the average price per barrel at 71.90 dollars in 2008.

Internally, the engine powering growth in the last few years has been domestic demand, and within domestic demand, the performance of household consumption. The latest macroeconomic figures betray an accelerating trend in the reduction of consumer spending as a consequence of growing debt levels in household economies, the increasing difficulty in accessing credit, and the consistent rise of interest rates over the last year. In 2008, the growth of household consumption will be at least three decimal points lower, which will make domestic demand drop around six decimal points, to 3.7%. These are the offi-

cial figures, although the forecasts given by respected economic outlook institutes point to a greater decline in the global growth of the Spanish economy, which would not reach 2.8% in 2008. To the strong reduction in the construction sector we must add the lower growth of investment in capital goods. All of this is an unequivocal symptom of a change in the economic cycle that is not taken into consideration in the main figures of the Budget.

TABLE 2
Macroeconomic scenario (Change in pct. over the same period of the year before, unless indicated otherwise)

ITEMS	2006	2007	2008
Domestic spending on final consumption	4.0	3.9	3.4
Domestic private spending on final consumption (a)	3.8	3.4	3.1
Spending on final consumption by Public Administrations	4.8	4.8	4.4
Gross capital formation	7.0	5.8	4.6
Gross fixed capital formation	6.8	5.8	4.6
Capital goods	10.4	9.9	7.9
Other products	4.6	2.7	2.6
Construction	6.0	5.1	3.8
Change in stock (contribution to GDP growth)	0.1	0.0	0.0
Domestic demand	4.8	4.3	3.7
Exports of goods and services	5.1	5.3	5.0
Imports of goods and services	8.3	6.8	6.0
Foreign balance (contribution to GDP growth)	-1.2	-0.8	-0.6
GDP	3,9	3,8	3,3
GDP at current prices: thousand million euros	981	1.051,1	1.121,5
Pct. change	8.0	7,1	6,7
PRICES (pct. change)			
GDP deflator	4.0	3.2	3.3
Labour costs, employment, unemployment benefits (pct. change)			
Remuneration (wage cost) per wage earner	3.0	3.1	3.1
Total employment (b)	3.2	2.8	2.2
wage-earner employment (b)	3.6	3.1	2.8
Employment: change in thousands (b)	571.8	509.9	419.1
Productivity per occupied worker (b)	0.7	1.0	1.1
Unit labour cost	2.3	2.0	1.9
Promemoria (Labour Force Survey – EPA)			
Unemployment rate (pct. of labour force) (c)	8.5	8.1	7.9
Unemployed (thousands)	1,837.1	1,802.8	1,809.5
Foreign balance (pct. of GDP)			
Trade balance (fob-fob)	-8.1	-8.4	-8.7
Financing capacity (+) financing needs (-) vs. rest of world	-8.1	-8.0	-8.3

(a) Includes households and non-profit institutions serving households. (b) Equivalent to full-time employment, according to the National Accounts. (c) Data corresponding to the new method used in the EPA.
Source: INE and Ministry of the Treasury

The performance of the foreign sector continues to be worrying, because exports to the euro zone have again declined after a short period with a slight recovery. Germany and France are not managing to finally take off after important macroeconomic adjustment processes. In Germany, which is Spain's largest ex-

port market and a key source of finance for Spanish capital markets, the business confidence index has fallen in the last few months.

Risks for the future while the real problems are not tackled

The forecast budget surplus of 0.3% of GDP will, by no means, be reached by controlling public expenditure — which will grow by 6.7% compared to 2007, thereby most likely increasing the relative weight of the public sector in the economy — but by increasing the tax burden borne by all of the citizens. Furthermore, this surplus will be insufficient in light of the cloudy economic future in sight.

The economic growth experienced this far should have prompted a more vigorous effort towards generating surpluses. Current surpluses represent the financing of future deficits in which Administrations will incur when the economic situation is depressed. The Bank of Spain has already warned about the destabilising effect of the Government spending before time the savings accumulated in times of prosperity.

“The Budget for 2008 incorporates a substantial increase of future spending commitments that will jeopardise budgetary stability as soon as there is a change of trend in the economic cycle.”

The bragged-about social policies effort just adds a mere two percentage points to the Budget compared to the last two Budgets of the Partido Popular's (PP) Governments. The National Budget for 2008, on the other hand, incorporates a substantial increase of future spending commitments that will jeopardise budgetary stability as soon as there is a change of trend in the economic cycle.

The electioneering announcement recently made by the Government of gift cheques, together with the raising of minimum pensions, expenditure on dependent individuals, personnel costs, tax benefits, etc. should make any responsible citizen feel concerned. Altogether, the medium-term commitments taken on by the Government represent between 22% and 25% of the Gross Domestic Product.

The Budget for 2008 does not consider a proactive management of the economic growth model. No structural reform measures are taken that would enable an increase of the productivity and competitive levels of our economy or to foster a greater attraction of investments. No measures are taken to make Spanish industries more competitive against delocalisation. Industrial policy has not been a priority in this office and it will not be a priority either in 2008, election year. Likewise, in spite of the weakness of the foreign sector and the importance of small and medium-sized enterprises (SMEs), the sum allocated to commerce, tourism and SMEs has fallen by 4.4% due to the decline in aids to smaller businesses.

In 2008, the policy aimed at closing the technology gap with respect to industrialised economies will be allocated 9,339 million euros. What is worrying about this financial effort is the small result in terms of the cost-efficiency of investments throughout this term of office. The issue with this policy is not really how much is spent, but what the goals are when spending and what results are obtained. Development and innovation should be especially stressed in order to make our industry more competitive.

The Government's decision to raise the rates applied to the personal income tax brackets by 2% once again falls short with respect to real inflation, especially when the inflation in Spain is among the highest in the euro zone and there is a serious lag carried over from previous years that has not been corrected in spite of the recent micro tax reform carried out by Zapatero's Government. It should not be forgotten that inflation, because of its very nature, is the most unfair form of taxation and it especially affects taxpayers from the lower income brackets.

“Obscurantism in Public Accounts does not seem to be the most adequate means of improving confidence in the future of the Spanish economy. A responsible Government should be the first one with nothing to hide and should give an example of transparency in its accounts.”

To speak of a reduction of the tax burden in this office when there has actually been an unprecedented increase of tax pressure in recent years, both for individuals and for companies, is quite sarcastic.

To set the budgetary debate in its context, it should first of all be noted that the Budget is not very flexible in terms of modifying its expenditure structure, because personnel charges, interest on debt, transfers to the Autonomous Communities and Local Governments, pensions or contributions to the EU, are all figures that are predetermined on the National Budget. Any electoral measures in the form of 'gift cheques' for certain groups, especially if those measures become consolidated in the future, will dangerously weigh down upon Public Accounts in a less optimistic future.

Secondly, the weight of the State in relation to all of the Public Administration bodies in Spain has declined in recent years and now represents a mere 22% of total expenditure. However, its capacity to guide the Spanish economy remains very high via the supplementary composition of Public expenditure, the arrangement and regulation of tax revenues, the financing of the rest of the Public Administration bodies, the generation of economic expectations, and the strategic guidance it exercises in respect of the rest of the Public Administration bodies.

Thirdly, we must underscore the lack of transparency in the presentation of the items making up the accounts of the successive socialist Governments. Three years after the change of Government, the accounts have become increasingly cryptic, making it difficult to make both international and inter-temporal comparisons because the data are not homogeneous.

“It is quite sarcastic to speak of a reduction of the tax burden in this office when there has actually been an unprecedented increase of tax pressure in recent years for both individuals and companies”

‘Budgetary engineering’ has become a habit aimed at touching up accounts which conceal a substantial structural expenditure in the medium term. The non-financial expenditure ceiling approved in Parliament is exceeded by resorting to financial operations which conceal real expenditure, the widespread use of extra-budgetary operations, the creation of freely disposable budgetary sums, etc., which prevent a proper scrutiny of budgetary operations, both by the Parliament and by scholars in the field or the European institutions that see to the fulfilment of the budgetary stability objectives.

“This insolidary ‘sudoku’ budget goes against the constitutional principle of national cohesion and it ignores the principle of equity.”

Obscurantism in Public Accounts does not seem to be the most adequate means of improving confidence in the future of the Spanish economy in a context in which all of the players in international markets stress one thing above all others: transparency. A responsible Government should be the first one with nothing to hide and should give an example of transparency in its accounts.