ANCHORING FISCAL POLICIES AND MANAGING FISCAL RISKS AT NATIONAL AND SUBNATIONAL GOVERNMENT LEVELS

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Fiscal local government overview

- Three highly decentralized countries with high level of local government debt

Sources: IGAE, Japan and China Ministries of Finance and OECD Fiscal Decentralization Database.

Notes: Spain gross non-consolidated debt; China: includes some contingent liabilities. OECD average for 2008 and 2012.

Sources: Banco de España, China National Audit Office, Japan Ministry of Finance and OECD Fiscal Decentralization Database.
A severe fiscal crisis of Spanish regions

- Half way of consolidation strategy: *towards budgetary balance in 2018.*

Note: adjusted by the regularizations of commercial debt operations in 2009 and 2011 and excluding in 2010 and 2011 the final settlement of the regional financing system.

Source: IGAE and AIReF’s calculations.
How have these fiscal imbalances been addressed?
A comprehensive strategy based on 4 pillars ...

1. Stronger Fiscal Disciplinary Framework

- Budgetary Stability Principle at the **highest normative level**: Constitution + Organic Act.
- **ALL levels of public administrations** (regions and municipalities included) **subject to same rules**: budget balance (no deficits allowed - in structural terms for regions); debt rule; and expenditure rule. **Commercial debt and late payments included under the fiscal sustainability principle.**

  **Subnational enforcement mechanisms strongly reinforced**:
  - **Preventive**: risk of non-compliance → early warning by central government.
  - **Corrective**: non-compliance → automatic measures (ie, debt authorizations) + Rebalancing plans
  - **Penalties**: Gradually applied: expenditure freezing; interest bearing deposit; formal auditors missions or even regional administrations are put in receivership.

2. Improving Transparency

- **Information requirements become mandatory** (previously not biding): Oct 2012 Ministerial Order.
- **Extremely detailed regulation on**:
  - who provides what and how (electronic means).
  - Information becomes public and available in a single database: **The General Government Financial Information Center: Ministerio de Hacienda y Administraciones Públicas**
  - Non-compliance is made public and could trigger automatic corrective measures.

- **Some examples of informational gains**:
  - **Ex-ante control**: annual draft budgets; medium-term budgetary frameworks.
  - **Budgetary execution**: monthly (cash and national accounts) for regions and quarterly for municipalities.
  - **EFP and its follow up reports**:
    - Human resources (expenditure, structure, staff size)
  - **Since May 2015**: monthly information on the subnational financing system in national accounts terms.
How have these fiscal imbalances been addressed? A comprehensive strategy based on 4 pillars ... (cont’)

3. Central Government Financial Support to Face Liquidity Constraints

- Subnational governments suffer severe financing problems:
  - Loss of access to financial markets
  - Arrears to suppliers
  - Requiring central government financing
  - Strict financial and fiscal conditionality in exchange for this extraordinary financing.
  - Average period of payment starts to be closely monitored.

4. Voluntary Agreements between Central and Subnational Governments

- To rationalize the regional public sector:
  - 2010 and 2012 agreements adopted within the Fiscal Council (25% reduction in the units of the regional public sector since 2010)
- Looking for efficiency gains in the regional administration:
  - Measures to remove duplicities (Commission for the Reform of the Public Administrations).
- On relevant sectoral policies such as health-care:
  - Working group on efficiency and rationalization of health-care expenditure (in progress)

...and a key role to be played by AIReF
## AIReF contributes to 3 of the pillars

<table>
<thead>
<tr>
<th>Pillars</th>
<th>AIReF’s contribution</th>
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<tbody>
<tr>
<td><strong>1. Stronger Fiscal Disciplinary Framework</strong></td>
<td>Monitoring the whole budgetary cycle:</td>
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<td>Fiscal Policy Planning</td>
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<td>Regional Budgetary Targets</td>
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<td>Regional Macroeconomic Forecasts</td>
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<td>Budgetary Monitoring</td>
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<td>Ex ante Draft budgets Approved Budgets</td>
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<td>In year Identification of risks</td>
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<td>Enforcement</td>
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<td>Asking central gov to activate all the preventive, corrective and enforcement mechanisms (7 regions in 2014)</td>
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<td><strong>2. Improving Transparency</strong></td>
<td>• Reports are public. <a href="#">AIReF - Autoridad Independiente de Responsabilidad Fiscal</a></td>
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<td>• Recommendations directly aimed at reinforcing transparency. (ie regions must make explicit their assumptions and methodologies to estimate the economic impact of their measures).</td>
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<td>• Comply or Explain principle.</td>
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<td><strong>3. Central Government Financial Support to Face Liquidity Constraints</strong></td>
<td>• Attending meetings of the two coordinating bodies between the central government and subnational governments</td>
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<td>• Studies requested by:</td>
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<td>o the coordinating bodies.</td>
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<td>o individual regions and municipalities provided their scope does not go beyond their powers. In such a case, the request must be made by the coordinating bodies.</td>
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<td>• Close dialogue with regions and municipalities.</td>
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Augmented Bohn’s rule for Spain

What role for economic recovery and fiscal sustainability in determining the primary balance?

Time varying coefficients: Augmented Bohn’s rule

\[ pb_t - pb_{t-1} = \theta_1 \cdot (bt - bt-1) + \theta_2 \cdot (bt - 60\%) + \theta_3 \cdot Y_{gap} \]

Sources: INE, IGAE, AIReF

Quarterly data, 1986q1-2014q4
Augmented Bohn’s rule for Spain

What role for economic recovery and fiscal sustainability in determining the primary balance?

\[ pb_t - pb_{t-1} = \theta_1 \times [(b_t - b_{t-1})] + \theta_2 \times (b_t - b_*) + \theta_3 \times Y_{gap} \]

✓ Are the resulting signs in line with theoretical priors?
\[ \theta_1: + \text{ vs. } - \quad \theta_2: + \text{ vs. } + \quad \theta_3: + \text{ vs. -/+} \]

✓ Are the coefficients stable throughout the sample no

✓ What was the status quo before the crisis? Countercyclical FP

✓ How did FP respond to the negative shock? Continuation of countercyclical FP (exacerbation), eating up the previous buffer and leading to a procyclical FP, later on dominated by sustainability concerns

✓ How to spot institutional changes? 2012 onwards, recovery of sustainability as a primary goal, reaching a somewhat neutral tone