Freeing up Spain's Autonomous Communities

Miguel Cardoso

The Autonomous Community Liquidity Fund succeeded in reducing the cost of regional financing and avoiding the need for more procyclical fiscal policies. Nevertheless, having achieved that goal, there is now a need to implement a plan that allows regional governments to return to market-based financing. Prolonging regional dependence on central government leads to perverse incentives which may slow down the necessary public sector debt reduction process.

In 2012, various factors coincided which increased the cost of Autonomous Community financing. We can see a structural fall in revenue as a result of the impact of the recession being felt. There are also demographic factors that keep some costs permanently high. Similarly it is felt that a certain standardisation should be introduced to the regional financing system, which makes some Autonomous Communities especially vulnerable. Finally, the financing of the Spanish state now finds itself subject to an environment of distrust. The setting up of the Autonomous Community Liquidity Fund meant that when this situation righted itself, regional financing costs would fall. Without this mechanism, some regional governments would have had to implement policies that were much more restrictive than those which were eventually seen, while the risk of spillover to other parts of the public administration or the financial sector would have increased.

Almost five years after implementation and having achieved its goals, it is now the time to ensure there is an exit plan for Spain's Autonomous Communities. Conditions could not be better: the expansion of the economy means a less traumatic fiscal adjustment is needed, while the European Central Bank's intervention is keeping financing costs at relatively low levels. Here we can add a new regional financing system, with improvements made to existing institutionality, resulting in greater credibility, independence and implementation capacity and a better perception of medium-term solvency for regional governments, allowing them a smoother return to markets.

Why should all this be a good thing? Firstly, because in the current context there are perverse incentives - given the impossibility of discriminating, the cost of the heterodox policies implemented by some regional governments can be distributed across all Spanish tax payers. Secondly, although it is imperfect, the market offers a further control mechanism, with the advantage that its judgements are transparent and plainly visible to voters. Finally, it should not be forgotten that current conditions are transitory: neither growth will stay as rapid nor will the ECB continue its quantitative easing indefinitely. Designing the road map to take Spain's regions out of the Autonomous Community Liquidity Fund should be one of the Government's priorities for 2017.