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# Informative note

The President of the Independent Authority for Fiscal Responsibility (AIReF), Cristina Herrero, took part yesterday in the meeting of the Fiscal and Financial Policy Council (CPFF), where she informed participants of the conditions that AIReF, as guarantor of the financial sustainability of public finances, considers should be included in the agreement to write off the debt of the Autonomous Regions (ARs).

The President outlined the following points:

## THE RETURN TO THE MARKETS OF THE ARs

The 2008 financial and sovereign debt crisis placed Spanish public finances in a difficult position. In just one year, tax collection fell by more than 4 GDP points, which forced increased indebtedness, affecting both the State and the Autonomous Regions, in a context in which the cost of financing was very high, making it difficult or impossible for some ARs to obtain financing in the financial markets.

This situation led to the creation of extraordinary financing mechanisms. At the same time, fiscal consolidation measures had to be adopted to send the markets an unequivocal signal of commitment to stability and due to the obligation to do so by the application of European and national fiscal frameworks which were not suspended, unlike what happened in the recent crisis. In some cases, the adjustment measures took the form of a reduction in expenditure and, on other occasions, a rise in taxes or a combination of both options, in a context in which the European response was also different.

As their name suggests, the extraordinary financing mechanisms were intended to be temporary, which also applied to suspending the no bailout clause necessary for their creation. However, almost 20 years later, these mechanisms, now called additional financing mechanisms, are still in place. In this regard, it may be advisable to address the return of the ARs to the markets, to the discipline that these impose, and to recover the no bailout clause.

## REFORM OF THE FINANCING SYSTEM AND GUARANTEE OF COMPLIANCE WITH FISCAL RULES

Without prejudice to the fact that other channels could have been used, such as debt restructuring, the proposed write-off is a step in that direction, but it is not enough to end the permanent interim nature of these mechanisms, which were designed as extraordinary measures yet became permanent.

The additional financing mechanisms and the regional financing system's permanent interim nature make it difficult to carry out the medium-term planning necessary for the sustainability of public finances. AIReF has always stated that tackling the extraordinary financing mechanisms had to go hand in hand with reforming the regional financing system and guaranteeing compliance with fiscal rules.

## WRITE-OFFS MUST BE CONDITIONAL

A debt write-off operation must be accompanied by fiscal conditionality for two reasons: the moral risk problems surrounding this type of operation and the need to reinforce the guarantees of compliance with fiscal rules.

We have seen that the obligation to comply with fiscal targets established in both national and European regulations is not a sufficient guarantee. In 2024, the national fiscal framework was fully in force, including a rule that does not require approval in the

National Parliament. This is the expenditure rule concerning which, the Organic Law on Budgetary Stability and Financial Sustainability unequivocally states that General Government expenditure may not grow above the economy's potential growth in the medium term, which, for 2024, was 2.6%. However, the Medium-term Structural-fiscal Plan (MTP), which was presented last October, already recognises that eligible expenditure growth for the purposes of this rule would have been 5.3%. However, if we look at growth at the regional level, AIReF's calculations indicate that growth could be around 7%, with ARs whose expenditure would have grown at double-digit levels.

Accordingly, it is worth reinforcing compliance with fiscal rules with fiscal conditionality associated with the debt write-off process, given that the regional liquidity fund will not disappear, such that both the headline deficits recorded in the fiscal year and the deficit surpluses generated in previous years will continue to be financed through it. It thus makes no sense to write off debt if there is no guarantee that debt will not continue to accumulate in the future above and beyond what is permitted under the fiscal rules.

## MONITORING THE IMPLICATIONS OF THE TREATMENT OF THE OPERATION IN SPANISH NATIONAL ACCOUNTING TERMS FOR PUBLIC ACCOUNTS

Another important aspect in this debt consolidation process is the treatment of this type of operation in Spanish national accounting terms. In these terms, the counterpart of a debt write-off is a capital transfer, in this case, from the State to the ARs. This means that, in the year of the write-off, there is an increase in the revenue of the ARs and an increase in State expenditure amounting to €83 bn.

The impact of this transfer on expenditure will depend on its nature and on whether, in practice, as in previous years, deficit targets take precedence over the expenditure rule.

The nature of the transfer would affect the calculation of the Central Government's expenditure rule, which could see its spending capacity restricted by €83 bn in the year of the debt write-off. At a regional level, it would be necessary to break with the traditional primacy that the deficit target has in practice, despite not enjoying regulatory support. 2024 is a good recent example, in which exceptionally high revenue, derived from the mechanics of the financing system, has led to a widespread breach of the expenditure rule, according to AIReF's estimates.

In this regard, it is necessary to limit the use of the increase in regional revenue in the year of the write-off, which could precisely be carried out through the fiscal conditionality that should accompany the write-off process. The enforceable fiscal conditionality should take into account each AR's starting position and relative position with respect to a financing system whose reform has not yet been resolved.

## ELIGIBLE EXPENDITURE, THE KEY VARIABLE

In addition, without going into the degree of connection between the distribution criteria and the causes that gave rise to the debt of items 1 and 2, in item 3 it seems a very partial approach to only take into account the upward exercise of the regulatory powers in matters of Personal Income Tax as an approximation of the effort made by the ARs. Accordingly, with all the limitations that this may present, the variable that best reflects this effort is eligible expenditure, since the effort may come from the expenditure side or the revenue side. The fact that eligible expenditure is defined as expenditure net of revenue measures would make it possible to consider both options.

## INTEREST SAVINGS IN FISCAL RULES

The write-off will mean a saving in interest that implies a reduction in the ARs' headline deficit and an increase in the deficit of Central Government. However, it should be considered that interest is not included in the calculation of eligible expenditure for the purposes of the expenditure rule. Consequently, this saving does not modify the calculation of the expenditure rule and, therefore, does not generate a greater margin of expenditure on other public policies.