

PRESS RELEASE
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APIE Summer Course at Menéndez Pelayo University

"THE REFORM OF THE FISCAL FRAMEWORK AND THE MEDIUM-TERM STRATEGY REQUIRE A COMPREHENSIVE APPROACH", STATED CRISTINA HERRERO

- The new European fiscal framework poses a major economic and institutional challenge for the Spanish economy and will require a sustained reduction in debt in a highly decentralised context with high investment needs
- The focus of supervision shifts to the spending variable managed almost equally by the Autonomous Regions and the Central Government. There is little time left to define a strategy that involves all General Government sub-sectors
- According to AIReF's estimates, net spending will have to grow by a maximum of 2.7% on average to meet the requirements of the new framework in the event of an adjustment over seven years
- The figure of 2.7% is demanding compared with the historical average for this variable, which has stood above 4.5% since 2018, with the exception of 2021
- The reform also requires adapting the national fiscal framework, which has become outdated, and exploring different ways to do so. The decentralised nature of the Spanish system means it is necessary to address the distribution of the national commitment between different General Government sub-sectors
- Cristina Herrero calls for a comprehensive approach to address the implementation of the new fiscal governance at a national level, the reform of the regional financing system and a solution to the extraordinary financing mechanisms

The President of the Independent Authority for Fiscal Responsibility (AIReF), Cristina Herrero, took part today in the 41st Summer Seminar of the Association of Economic Information Journalists (APIE) at the Menéndez Pelayo International University in Santander and gave a lecture on the control of public accounts in which she reviewed the implications of the new European fiscal framework, finally approved on April 30th. As the President stated, the reform of the framework and the necessary medium-term strategy to contain debt require a comprehensive vision.

Cristina Herrero began her speech by reviewing the changes associated with what is referred to as the new economy that affect public finances and their control, among which

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she highlighted technological developments and the availability of large volumes of data, which affect the operations of the General Government (GG), and the investment needs associated with these changes, which must be compatible with the sustainability of public finances. The President also referred to the start of the use of Artificial Intelligence by the GG as an attractive and useful tool for improving effectiveness and efficiency. However, it also poses major challenges in terms of training, planning, development of human capital and access to sources of information. Its use is still limited in the specific case of AIReF, but possible new application areas have already been identified.

In this regard, she quoted, by way of example, the identification of risks and improvements that the institution is going to implement in the Local Government (LG) Monitor, a dynamic and interactive tool that makes it possible to visualise the evolution of the main variables that define the economic situation of a local government and compare it with others. During the month of July, the Monitor will incorporate a module on the sustainability risk situations of Local Governments and the classification of the different risk situations of Local Governments with more than 20,000 inhabitants. Later on, this will be expanded with economic-financial indicators that will allow an overall evaluation of the net sustainability position of all Local Governments.

The reform of the fiscal rules

The President of AIReF referred to the reform of the European fiscal framework, which was finally approved on April 30th, which represents a major challenge for the Spanish economy. Spain will have to ensure a reduction in public debt, which remains at very high levels in a highly decentralised context, with growing investment needs related to climate, security, and digitalisation. Moreover, time is short to propose a fiscal strategy that cannot ignore the territorial dimension because the Autonomous Regions (ARs) and Local Governments control almost half of the spending.

Cristina Herrero noted that Local Governments control 12% of spending on water, waste, urban transport and social care for the elderly, among other items. And the ARs control 32% of spending, with jurisdiction over health, education and long-term care. These figures are significant because, as the President pointed out, control of the spending variable will be the only control variable in applying the new European fiscal framework. Countries will have to present their own multi-year strategies and commit to a path of spending net of revenue measures that will ensure a sustained reduction in debt and reduce the public deficit to below 3% of GDP. This path, which must be agreed with the EU authorities, will only be revised in exceptional cases.

As Cristina Herrero pointed out, determining this spending path will not be simple. AIReF's calibration exercises show the major challenge this entails at an aggregate and sectoral level, with an annual adjustment of 0.43% of GDP over seven years or 0.63% over four years. If the adjustment is implemented over seven years, net spending will have to grow on average by a maximum of 2.7% to meet the requirements of the new framework, according to AIReF's estimates. According to the President, this limit is "demanding" in relation to the historical behaviour of this variable, which has stood above 4.5% since 2018, except for 2021. The years of consolidation between 2014 and 2017 saw lower rates. On average, net spending grew by 5.9% between 2019 and 2023 compared with 3.2% in the previous four-year period.

According to AIReF, a smaller adjustment will be needed in the medium term than in the previous crisis, but one that will be sustained over time and which will require a contribution from all the General Government sub-sectors, as future spending pressures, especially those related to the ageing population, will affect all the sub-sectors. Furthermore, there are other reasons why it is advisable for all General Government sub-sectors to contribute to the adjustment, such as the fact that the Central Government has assumed part of the deficit of the Social Security Funds and the increase in debt caused by the pandemic, or that a large part of the ARs' debt is in the hands of the Central Government via the extraordinary financing mechanisms.

Adapting the national framework

Cristina Herrero also remarked that the reform of the European framework will require a reform of the national framework, which has become outdated. In her opinion, the Organic Law on Budgetary Stability and Financial Sustainability must be adapted to the new Stability and Growth Pact regulations and the reformed fiscal framework directive will need to be transposed.

Until such time, it will be necessary to address the challenge of implementing the new European fiscal framework in a decentralised reality such as Spain's, which requires addressing the distribution of the national commitment among all the General Government sub-sectors. This can be achieved in different ways. Specifically, the President of AIReF referred to two possible examples: a response similar to the current regulations and practice in Spain, which would result from applying the same net spending rate to all General Government sub-sectors, including the Social Security Funds, and a similar approach to the new European governance, by incorporating the specific features of each GG sub-sector, with differentiated spending rates for each sub-sector. These are just two examples of the multiple existing approaches, with their advantages and disadvantages. However, neither case solves the problems of sustainability.

In this regard, Cristina Herrero called for a comprehensive approach to fiscal reform, its national implementation, and the medium-term strategy required to reduce debt. This implies tackling three interrelated aspects with a comprehensive approach: new fiscal governance, reform of the regional financing system and extraordinary financing mechanisms.