

Budgetary Framework in Spain: Efficiency, accountability and transparency in the reform of the Spanish budget institution

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1. Introduction

The process of reform in which the Spanish budget institution is engaged has as its principal points of reference, budgetary discipline and budgetary balance. Both these attributes have been deemed by the Spanish government to be indispensable prerequisites for the development of fiscal policy conducive to stable economic growth and consistent with our objectives of real convergence within the European Union. In this respect, it can be said that Spain's fiscal policy successes of recent years must be largely attributed to the institutional budgetary measures adopted since 1996.

The objective of this paper is to present an economic/institutional analysis of the new framework in which Spanish budgetary policy is currently formulated, with special attention paid to the legal rules recently approved, in December 2001, on budgetary stability. In our opinion, both the General Law on Budgetary Stability (LGEP) and the Organic Law Supplemental to the LGEP (LOC) imply an in-depth reform of the Spanish budget institution, in line with the institutional transformation initiated in 1996. These changes are supported by the drafting in 2005 of a new General Budget Law, in accordance with the current government's electoral commitment and as formally adopted in the LGEP. From the

standpoint of the implementation of fiscal policy reorganized and geared toward observance of the principle of macroeconomic stability, this paper seeks to present an appreciation of the instruments and mechanisms of coordination and incentives incorporated to the accountability and transparency in the budget cycle.

2. The reform of the Spanish budget institution: the General Law on Budgetary Stability and the Supplementary Organic Law of December 2001

A preliminary question is that of the very relevance of the legal and rules-based treatment of issues related to budgetary discipline and balance. As argued in the previous sections, I feel that the content of a set of rules in these areas should serve a purpose of institutional design, apart from the requirements for legal formalization inherent in any state of law. I would recall that the design of budget institutions should follow the creation of any contractual frameworks for coordination and incentives that make budgetary agents behave in accordance with the overall objectives that a higher-level institution may set as regards budgetary policy.

From the standpoint of institutional economy, it cannot be ignored that if fiscal rules are accompanied by adequate tools for coordination and incentives, they are an indispensable factor for creating budget institutions that are able to ensure allocative performances consistent with sound fiscal policy and with levels of public action applicable to economically developed countries.

On studying the contents of the General Law on Budgetary Stability (LGEP) and its Supplementary Organic Law, it seems reasonable to believe that their nature as basic codes in the framework of which budgetary policy must be conducted requires, first of all, the enunciation of the pertinent governing principles, which must always serve the stated objective of making effective and efficient management of public policies consistent with the requirements for budgetary stringency, as necessary for achieving stable, sustained economic growth. In the LGEP, the first of these recognized principles is that of “budgetary stability,” which must govern, as seems reasonable, all aspects of the budgetary process—the

preparation, approval, and execution phases. The notion of inherent budgetary stability is identified with a budget in balance or, where applicable, in surplus, computed in terms of the national accounts. A second principle is that of a multiyear scenario in which public sector budgets must be prepared, even though such preparation must remain consistent with the traditional annual budget principle as regards approval and execution. A third principle, which is very important for the effectiveness of the disciplinary mechanisms contained in the LGEP, is that of transparency, which makes it mandatory for important information for verifying compliance with the principle of budgetary stability to be sufficient and adequate at the same time that it is accessible and public. The last of the principles included in the draft LGEP is that of efficiency in the allocation and use of public resources. This principle recognizes the importance of making the macroeconomic aspects of budgetary stability consistent with the microeconomic aspects of public management, which make it necessary, in a context of scarce resources, to operate in accordance with the criteria of efficiency, quality, and effectiveness. I feel that this recognition gives full meaning to the notion of budgetary stability, sometimes intentionally condemned for its simple form as a numerical expression.

The construction of such an institutional framework as required in both Stability Laws involves recognizing, as stated above, the multijurisdictional reality of our public sector. Specifically, our structure of political decentralization, with an intermediate level of government as represented by the autonomous regional governments in addition to the central government and the local corporations, together with their financial interrelations, makes compliance with the stability principle even more difficult. As a result, the disciplinary design of the rules should concern all the budget officials involved, without going against the principle of financial autonomy for the autonomous regional governments, recognized in Article 156 of the Spanish Constitution. I feel that this broad-based formulation of budgetary discipline is the only valid one for circumstances such as these, given that the formation of the consolidated balance that is a part of budgetary policy involves all those officials, with their behaviors, on strategic occasions, depending on how they are influenced by the incentive schemes contained in the models applicable to the decentralization of revenue and expenditure. However, the impetus of an institutional reform such as this can only be attributed to the central government, inasmuch as the Spanish Constitution in its Article 149.1.13 and 18,

in conformity with the postulates of fiscal federalism theory, assigns to the central government the role of adopting basic measures of this type, so as to achieve, through the government's economic policy, the indispensable domestic and external economic stability. Although it is true that in the period 1997–2001 performance in terms of aggregate deficit for all of our public sector operators was successful, it is no less true that the model of bilateral negotiation between each autonomous regional government and the central government lacks the institutional attributes necessary for ensuring its effective conduct over time, especially in economic circumstances marked by reduced growth. Hence, the need to address the creation of a duly institutionalized multilateral coordination mechanism based on values such as transparency and incentives to meet the commitments adopted. Given the organic nature given to the Supplementary Law for the case of the autonomous regional governments, it can be declared, as recommended by the Council of State in its decision prior to the submission of the rules to the Parliament, consistent with the Constitution, in accordance with the principle of autonomy recognized therein and to which I refer.

Having established the subjective context in which the main budgetary decision makers, necessarily affected by the LGEP in its design of coordination and incentive mechanisms, must operate, I will now briefly describe the design in question. First, the rules require that budget officials operating at the level of the central government, autonomous regional governments, and local corporations to establish in their budgetary and public spending rules, any tools and procedures that may prove necessary to observe the principle of budgetary stability. The LGEP requires that the national government ensure observance of this principle by all budget officials. Its nonobservance seems to be considered through the recognition of exceptional deficit positions that will in any case require an explanation and the formulation of corrective plans. Here, I am in the presence of one of the incentive mechanisms included in the Law, based on the principle of transparency: the cost of giving public notice of deficit recognition.

As regards coordination of the budgetary actions of all levels of government, the responsibility lies, as stated above, with the national government. The latter, by March 31 of each year, will be required to set the budgetary stability objective in a multiyear scenario, and this will cover

the next three fiscal years, on an annual basis. This objective setting exercise will have to include the assigning of specific objectives for all the government sub sectors involved: the general administration of the central government, its autonomous agencies, and other subordinate bodies not primarily financed with commercial revenue, entities making up the social security system, the general administration of the autonomous regional governments and its subordinate public bodies and organisms not primarily financed with commercial revenue, and the administration of the local corporations and their subordinate public bodies and institutions with the same financing circumstances. For the purposes of the budgetary stability objectives, public enterprises and other bodies primarily financed with commercial revenue from any level of government are treated in terms of “financial balance,” with implications for consolidation strategies to prevent or reduce possible losses. In accordance with the European System of National and Regional Accounts of the Community (SECNRC), their financial link with subordinate administrations ensures their control for the purposes of the budgetary stability objectives.

The multiyear budgetary objectives referred to above will be set at the time the macroeconomic framework is being established for the same period, as set forth in the Stability and Growth Program required by the European Commission. They are to be approved by the Council of Ministers and then placed before the Parliament for debate and approval. Once again, this is in keeping with the push for the national government to announce its budgetary policy objectives. These objectives will be assessed annually, at the end of each fiscal year, in a report that the General Intervention Office of the central government administration will forward to the government by September 1 every year. The implications of this control for the government will be clarified in the annual review of stability objectives, given the yearly nature of the estimates.

As regards the budget preparation process, the LGEP and the LOC provide for a series of reform measures of various depths, depending on the area of competences established for each administration. For the central administration, they establish:

- (a) the obligation to draw up a number of multiyear scenarios of public revenue and expenditure estimates, before preparation of the central government general budgets (PGE), with details of the annual expenditure commitments for implementing the budget policies. They will be required to note any budgetary contingency generated by the legal rules or administrative instruments, the approval of which will be dependent on their compliance with the financial restriction set in the budgetary scenarios in question.

- (b) the setting of the ceiling on nonfinancial expenditure for the central government budget (PE), to which annual PGE appropriations must be subject. This expenditure ceiling commitment explicitly and formally adopted by the government at the beginning of the budgetary process in the agreement on the Parliament's approval of the annual budgetary stability objective, must be applied as a disciplinary mechanism to prevent undesirable incrementalist practices.

- (c) the establishment of a "budget execution contingency fund" that will be included in calculation of the ceiling on PE expenditure and can facilitate the streamlining of budgetary changes consistent with the financial restriction established for compliance with the budgetary stability principle. For the effective operations of this flexibility mechanism, it is essential for its management to be returned to the Ministry of Finance, which will propose to the Council of Ministers how the credits are to be used, always for meeting the needs of the fiscal year, in a nondiscretionary way and with no initial contribution. Another efficiency requirement should be the mandatory financing of any change in appropriation (extraordinary, incremental, supplemental, or incorporating) from that fund or through reductions in other appropriations. In no case may the remainder of the budget execution contingency fund be incorporated into other fiscal years. To safeguard the jurisdiction of the Parliament, the approved rules establish that the government must report to the Parliament each quarter on use of the fund. The quantity initially considered for this budgetary section is 2 percent of the approved expenditure ceiling.

- (d) for the bodies of the state's general government sector incorporated under public law and not included because of their nonbudgetary financing, and whose activity is making them incur losses, the LGEP provides for the obligation to prepare a management report on the causes of the financial imbalance. They will also be required to submit a medium-term reorganization plan with corrective measures.

As regards the autonomous regional governments, the measures included in the LOC for the purpose of ensuring compliance with the budgetary stability principle are as follows:

- (a) The task of the central government, in exercise of its constitutional jurisdiction, will be to ensure that the autonomous regional governments adopt, within their recognized autonomy, any legislative and administrative measures that may be pertinent for making their budgetary actions consistent with the budgetary stability objective approved by the Parliament.
- (b) In observance of the principle of transparency, the requirement is established for the autonomous regional governments to provide the Ministry of Finance with any information requested from them to enable the ministry to verify compliance with the budgetary stability principle.
- (c) Assigning to the Fiscal and Financial Policy Council (CPFF) the functions of coordinating and supervising the budgetary actions of the autonomous regional governments, as the body responsible for liaison between the latter and the central government. In particular: (1) the CPFF is considered the seat of the discussions at which the budgetary stability objective for all of the autonomous regional governments, and subsequently the individual details, will be established every year. The reports on these activities will be essential for the government in the preparation of its consolidated budgetary stability objective; and (2) the CPFF will be the body to which the autonomous regional governments that have not complied with the budgetary stability objective must submit an economic and financial plan for deficit

correction in the medium term. Once the CPFF has received a report, it will forward it to the Ministry of Finance, responsible for compliance monitoring.

- (d) As regards the borrowing capacity of the autonomous regional governments, the traditional source of budgetary instability, the draft LGEP acts on two fronts. On the one hand, it introduces compliance with the budgetary stability objectives as a decisive factor for authorization by the central government of the credit operations of the autonomous regional governments, pursuant to Article 14.3 of the Organic Law on Autonomous Financing, 8/1980 (LOFCA). On the other hand, it creates a public central information office concerning operations of any type carried out by the autonomous regional governments referred to as credit or debt and the assumption of risks and financial charges. This information and notification mechanism will be supplied with data on a mandatory basis by the entire financial sector.
- (e) As regards public bodies not included in the general administration of the autonomous regional governments because their financing is primarily nonbudgetary, the requirement is established for the autonomous regional governments to adopt measures to correct any imbalances that may finally affect budgetary stability.

As an assessment of the institutional design envisaged by the LGEP and the LOC for this territorial area, I think it appropriate to point out that the area is adequately covered by coordination and incentive mechanisms for promoting the achievement of budgetary stability, in an attempt to take account of the sharing of jurisdiction between the autonomous regional governments and the central government, established in the Spanish Constitution. The national government can thus exercise its competencies as the body in charge of economic policy, carrying out the primary supervision tasks as regards compliance with the stability objectives. In the model envisaged, this role is carried out using a coordination tool, voluntarily created by the government and all the autonomous regional governments jointly and establishing regulatory policies for ensuring commitments to fiscal discipline in the sphere of competence of the autonomous regional governments. The institutional design thus transforms the bilateral negotiation (central government-autonomous regional government) mechanism into one of

multilateral negotiation (central government-autonomous regional governments), with presumable gains in efficiency associated with the reduction in costs derived from strategic behavior.

As regards the incentive mechanisms, I can differentiate between two types: (i) the mechanisms based on the notification of budgetary behaviors and on the principle of transparency, such as the creation of the Credit Report Office and the obligation to report on positions of imbalance; and (ii) those restrictive measures, such as the tightening of debt approval conditions. Compliance with the constitutional principle of the financial autonomy of the autonomous regional governments seems to have guided this institutional design, discarding in advance the punitive incentive mechanisms, as well as consideration of its complex enforcement in this domestic environment. The only exception noted, as already done at the local level, was the requirement for the sharing of responsibilities for those cases where noncompliance with the stability principle by the autonomous regional governments can lead to noncompliance at the national level, with the requirement for sanctions as envisaged in the Stability and Growth Pact.

In addition, I feel that the expected strengthening of the sharing of fiscal responsibility arising from the new model of autonomous financing approved by the Council on Fiscal and Financial Policy on July 27, 2001 and applicable continuously as of January 1, 2002, can foster budgetary behaviors that are more consistent with the need for matching the principles of financial autonomy and of budgetary stability. I also think that this greater durability of the autonomous financing system needs to be supported, so as to reduce the strategic behaviors generated by expectations of extraordinary changes in the resources to be received. I also think that the complexity of the institutional design in this area of vertical relations will require a prudent exercise of regulatory development of rules for both the central and autonomous levels.

The last area of institutional reform addressed by the rules on budgetary stability is that of the local corporations. State legislative powers over local finances—Law Governing Local Finances—facilitate this design, insofar as their financial autonomy is constitutionally limited to matters of adequacy and management. The measures envisaged in the LGEP are:

- (a) Establishment by the government, on the proposal of the Ministry of Finance, of the global budgetary stability objective for all the local corporations together. The difficulty of assessing such a heterogeneous reality as that generated by more than 8,000 corporations of very different sizes existing in Spain means that conditions must be established through regulations to be met individually by these entities. Similarly, state regulations could be used to ensure compliance with the stability principle. The LGEP, following a certain parallelism with the design presented for the autonomous regional governments, assigns to the National Commission on Local Administration a role as coordinating body that should be kept informed of those actions related to the budgetary stability objectives. These budgetary actions must be supervised and monitored by the Ministry of Finance, which can require any necessary information for this purpose.
- (b) As in the case of the autonomous regional governments, those local corporations that do not comply with the budgetary stability objective established will be required to draw up a medium-term economic/financial plan to correct the imbalance. This plan must be submitted for approval to a plenary meeting of the corporation and then forwarded to the Ministry of Finance as supervisory body.
- (c) For bodies incorporated under public law and not included in the general administration of local corporations because their financing is primarily nonbudgetary, and which incur losses that affect their compliance with the stability principle requirements are established for reporting on the corrective management measures to be adopted, similar to those envisaged in equivalent cases for the central government and the autonomous regional governments.

Last, I must point out that the LGEP addresses the matter of the use of possible public surpluses within the scope of the General State Budgets (PGE). Establishing a difference between the central government's general administration sector and the social security system, in the first case it is envisaged that any positive balance upon budget closure will be

earmarked for reducing the central government's net indebtedness, while in the second case, it opts for a priority application to the Social Security Reserve Fund, in line with the social agreements on the maintenance of the derived pensions scheme from the so-called Toledo Pact.

It should be borne in mind that the LGEP provides for the budgetary stability objective (budgetary balance) to be temporarily computed jointly for the central government and the social security system, until completion of the process of separating the social security sources of financing (those related to contributory pensions compared with the noncontributory ones and with the rest of expenditure appropriations not linked to the contributory pension scheme). Notwithstanding the concern shown by the LGEP with respect to the existence of positive budgetary balances, I believe it is not essential for the design of the budget institution, if clear guidelines are shown for maintenance of the reorganization and consolidation measures undertaken since 1996, which contributes to building a reputation and adding to it in terms of fiscal policy credibility.