

# Regional government access to market funding

Mar Delgado and Javier J. Pérez



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## REGIONAL GOVERNMENT ACCESS TO MARKET FUNDING

The authors of this note are Mar Delgado and Javier J. Pérez of the Directorate General Economics, Statistics and Research

### Introduction

Spain's regional governments (or "autonomous communities") have regularly resorted to debt to fund themselves in recent decades. This has come about in parallel with the progress seen in the transfer of budgetary powers since the current constitutional regime was set in place.<sup>1</sup> In turn, access to debt by regional and local authorities is part of a global trend, associated with the across-the-board increase in budgetary decentralisation in many advanced and emerging economies over this period, along with increased investor demand for sub-national public debt on international capital markets [see Canuto y Liu (2013)].

In Spain's case, overall regional government debt<sup>2</sup> averaged close to 12% of GDP in the 2000-2017 period, with a level, nonetheless, significantly higher than this in recent years (24.7% in 2017 Q3), with around 40% of this amount relating to debt securities and the remaining 60% to loans granted by resident and non-residents entities alike, belonging both to the private sector (financial institutions in the main) and to the public sector (mainly central government). In terms of maturity, 93% of the debt related, taking the reference period on average, to long-term instruments (see Table 1).<sup>3</sup> The breakdown of these figures by region reveals a high degree of heterogeneity, both regarding the level of debt (in 2017 Q3 there was a difference of around 25 pp of GDP between the most and least indebted region) and in the weight of securities relative to total debt (in Q3 last year some regions posted a weight of over 50%, while others resided chiefly on loans, with a value of less than 5% of this ratio).

For the regions as a whole, the greater weight of loans as opposed to securities is determined by recent developments since 2012, given that until that year the percentage of each type of regional debt generally stood at around 50% (see Chart 1). This change has mainly been due to the operation of the successive extraordinary measures and additional liquidity support mechanisms for the regions launched by the State since that year<sup>4</sup> [see Delgado, Pérez and González (2016) and Delgado et al. (2015)], which took the form of bilateral loans from central government to the regional governments. Behind the intervention by the State were the regional governments' difficulties in gaining access to financial markets, stemming from the financial tensions generated by the euro area sovereign debt crisis, and in reducing the significant delays in supplier payment periods which came about during the crisis and which have continued to date. Hence, the regional government debt in the hands of central government has climbed from zero prior to 2012

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1 Article 157 of the Spanish Constitution establishes that the regional governments may finance themselves with debt. The Organic Law on the Financing of the Autonomous Regions (LOFCA) implements this mandate, imposing certain limitations on the autonomous regions' long-term debt and, in particular, requiring prior authorisation from central government.

2 Debt measured according to the Excessive Deficit Protocol (EDP), the relevant concept for the purposes of the ceilings set in the European Stability Pact and the Spanish Stability Law, and defined in Community Regulations. It comprises regional government bonds, chiefly in the form of securities that are not shares and loans (from private and public institutions alike). Regarding the definition of public debt in the EDP, see [https://www.bde.es/webbde/en/estadis/infoest/htmls/notamet\\_pde\\_en.pdf](https://www.bde.es/webbde/en/estadis/infoest/htmls/notamet_pde_en.pdf).

3 Considering as long-term issues those with a repayment term of over 12 months.

4 Currently, the mechanisms operate through the so-called "Regional Government Financing Fund" in force since 1 January 2015.

## THE COMPOSITION OF REGIONAL GOVERNMENTS' EDP DEBT (a)

TABLE 1

As % of GDP

	Average 2000-2007 (b)	2012	2015	2016	2017 Q3
1 Regional government debt (1 = 2.1 + 2.2 = 3.1 + 3.2 = 4.1 + 4.2)	6.0	18.2	24.4	24.8	24.7
2 By type					
2.1 Securities	3.1	6.1	4.6	4.2	4.2
2.1.1 Short-term	0.2	0.4	0.0	0.0	0.0
2.1.1 Long-term	2.9	5.8	4.5	4.1	4.1
2.2 Loans	3.0	12.1	19.8	20.6	20.6
2.2.1 Short-term	0.4	1.1	0.9	0.8	0.6
2.2.1 Long-term	2.5	11.0	18.9	19.8	19.9
3 By term					
3.1 Short-term (3.1 = 2.1.1 + 2.2.1)	0.6	1.4	0.9	0.8	0.7
3.2 Long-term (3.2 = 2.1.2 + 2.2.2)	5.4	16.8	23.5	24.0	24.1
4 By holder					
4.1 Residents	—	—	—	—	—
4.1.1 Loans	1.8	9.3	17.3	18.3	18.4
4.1.1.1 Financial institutions	1.8	5.4	4.9	4.2	3.8
4.1.1.2 From central government	0.0	3.3	11.6	13.3	13.9
4.1.1.3 Other	0.0	0.5	0.8	0.8	0.7
4.1.2 Securities	—	—	—	—	—
4.2 Non-residents	—	—	—	—	—
4.2.1 Loans	1.2	2.8	2.5	2.3	2.1
4.2.2 Securities	—	—	—	—	—

SOURCE: Banco de España.

a Chapter 13 of the Banco de España Statistical Bulletin publishes detailed quarterly information.  
<http://www.bde.es/webbde/es/estadis/infoest/a1307e.pdf>.

b Average of the quarterly debt series as a % of GDP.

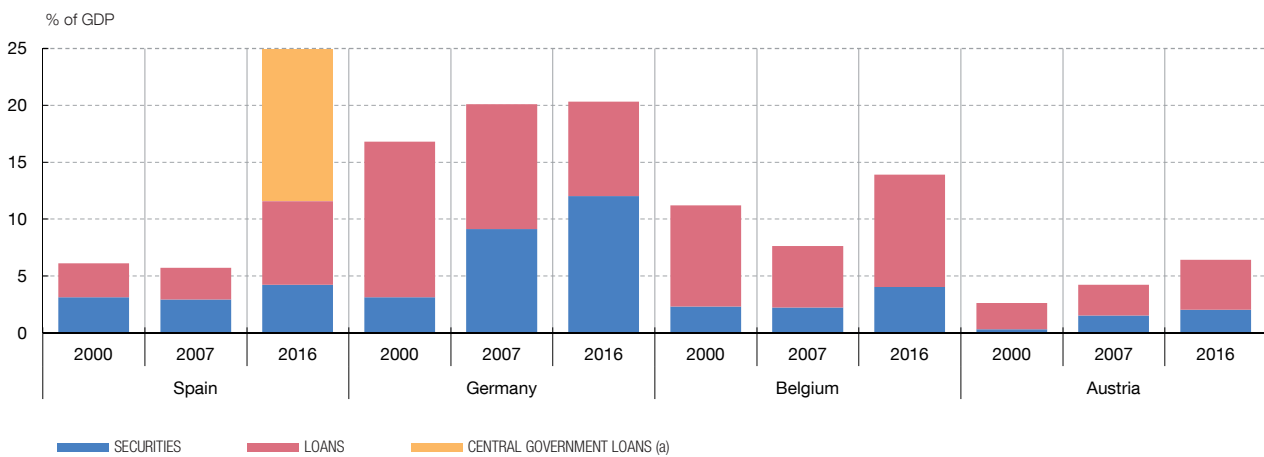
to 56.1% of the total in 2017 Q3, becoming the main source of coverage of the financing needs of the regional governments as a whole (see Chart 2). The current situation marked by majority recourse to central government loans is very different from that in place before 2012. In the previous period, the regional governments would cover their financing needs independently, resorting both to international capital markets and to the credit markets.

However, against the background of the firming economic recovery and the favourable financial conditions of recent years, there appears to be something of a turnaround. There has been a slight increase in the annual volume of regional governments' securities issues, which rose to account in 2016-2017 for around 40% of the annual change in regional debt, compared with the low of 16% in 2015. Also, the number of issues made has stabilised,

## STRUCTURE OF REGIONAL DEBT IN SELECTED EU COUNTRIES

CHART 1

### 1 WEIGHT OF TERRITORIAL DEBT IN TOTAL GENERAL GOVERNMENT DEBT



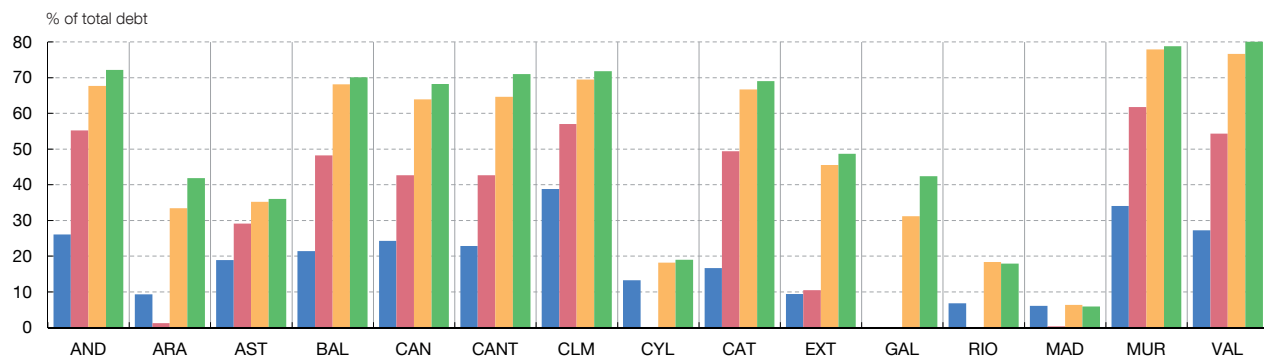
SOURCES: Banco de España and Eurostat.

a Only applicable for Spain. No specific information is available for the other countries.

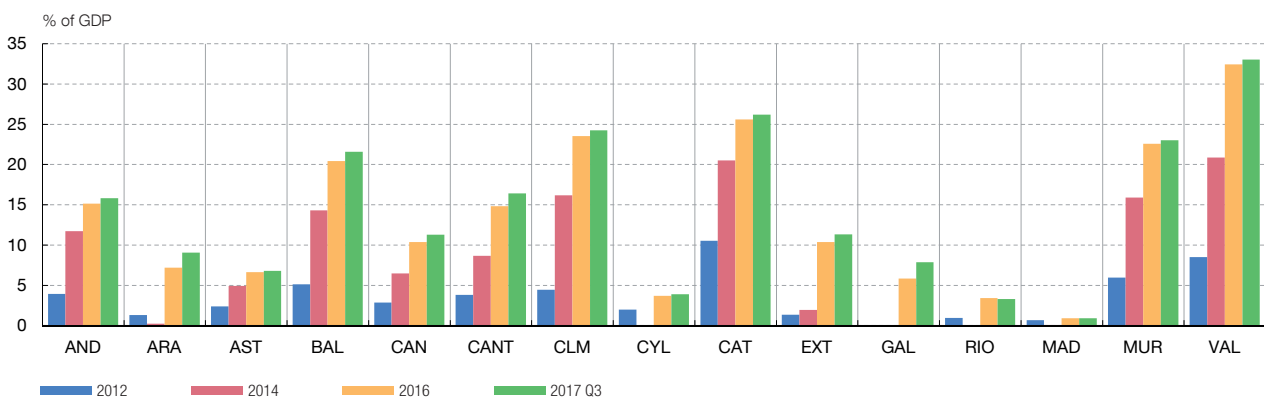
## REGIONAL GOVERNMENT DEBT TO CENTRAL GOVERNMENT ARISING FROM ADDITIONAL LIQUIDITY SUPPORT MECHANISMS

CHART 2

### 1 WEIGHT OF CENTRAL GOVERNMENT LOANS IN TOTAL REGIONAL GOVERNMENT DEBT

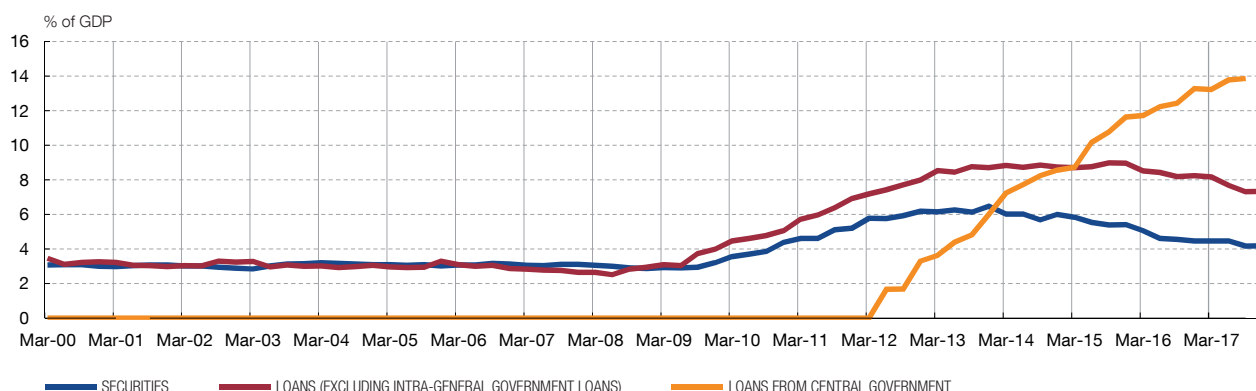


### 2 WEIGHT OF CENTRAL GOVERNMENT LOANS IN REGIONS' GDP



SOURCE: Banco de España.

TOTAL REGIONAL GOVERNMENT SECURITIES AND LOANS AS A PERCENTAGE OF GDP



SOURCE: Banco de España.

a More detailed information is available in Chapter 13 of the *Statistical Bulletin*: <http://www.bde.es/webbde/es/estadis/infoest/bolest13e.html>.

albeit at low annual levels in historical terms. In 2016 and 2017 seven regions tapped the capital markets, compared with the four that did so in 2015. The cost of financing held at levels that were low and similar to those of the Treasury<sup>5</sup>, with the rates of issue on 12-month bills or notes standing on average in 2016-2017 at 0.0% (-0.2% in the case of the Treasury) and at 1.8% on 10-year bonds (1.5% for the Treasury)<sup>6</sup>, compared with the respective rates of 0.3% and 1.8% for these two instruments in 2015.

The rest of this note will address in greater detail the composition of regional government debt, and the relevance of the financial markets in the different periods following Spanish membership of the Economic and Monetary Union (EMU).

### The composition of regional debt

From the onset of EMU, the weight of securities and of loans in overall regional debt held stable – at around 3% of GDP in both cases – until late 2008 (see Chart 3). Thereafter, both the volume of securities and that of loans (excluding loans to other general government sectors) increased significantly, stabilising as from 2012 and falling in the subsequent years, at which time central government loans began to play a predominant role. Thus, in 2017 Q3 regional government debt in the form of securities amounted to 4.2% of GDP, compared with 20.6% in the case of loans, 13.9 pp of which took the form of bilateral loans vis-à-vis central government.

In terms of composition by maturity, in 2017 Q3 99.3% of regional government securities were long-term, a figure higher than that of 94.4%, on average, for the pre-crisis period (2000-2007). In the case of loans, long-term instruments are also predominant, albeit with somewhat lower percentages: 97% in 2017 Q3 and close to 85% on average for the 2000-2007 period (see Table 1 once more). With regard to the holders of loans, excluding central government, in 2017 Q3 somewhat more than 68% were in the hands of residents and the rest with non-residents, a percentage slightly up on the figure of 60% for 2000-2007, and on the figure for the State.<sup>7</sup>

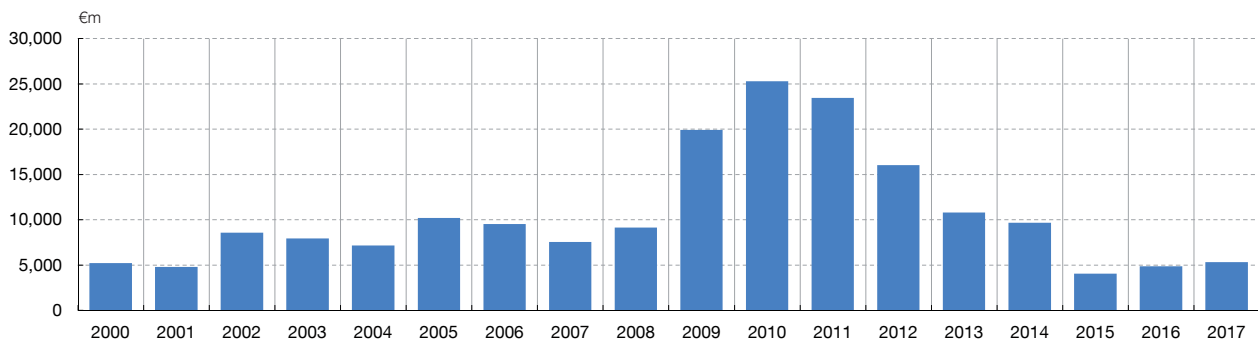
<sup>5</sup> For a discussion of the beneficial effects of the Eurosystem's monetary policy on public debt issuance costs, and public finances in general, see Burriel, Martí and Pérez (2017).

<sup>6</sup> Weighted average of yields on regional government issues in each class of instrument. In the case of the Treasury, the marginal rates on new issues are taken.

<sup>7</sup> For overall general government, around 55% of loans are vis-à-vis residents [Delgado, García and Zubimendi (2017)]. The breakdown by holder and by government tier is not available for debt securities.



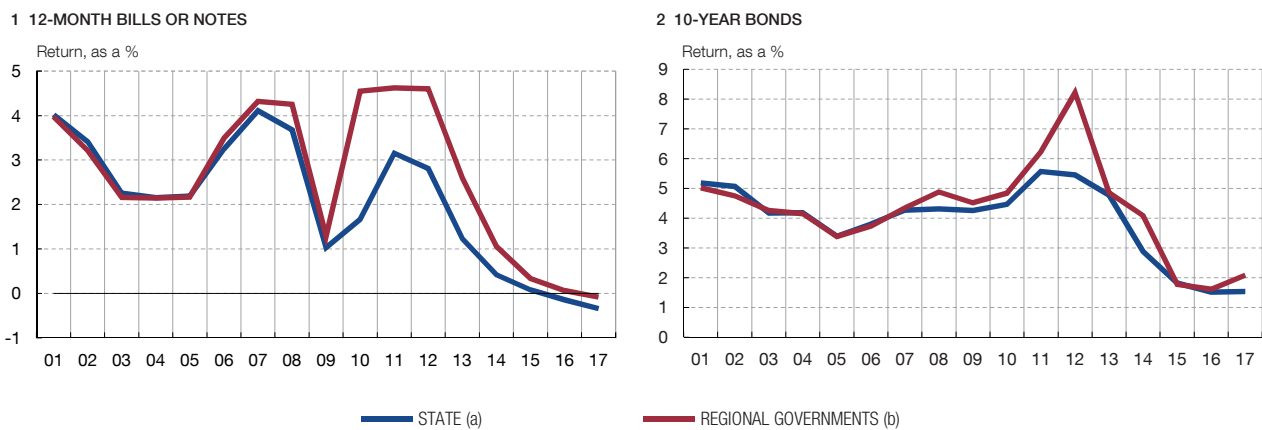
ANNUAL VOLUME OF REGIONAL GOVERNMENT ISSUES



SOURCE: Banco de España.

a Total securities issued in a year, without considering term structure of redemptions of securities issued.

ANNUAL AVERAGE RETURN ON STATE AND REGIONAL GOVERNMENT DEBT ISSUES



SOURCES: Secretaría General del Tesoro y Política Financiera, banco de España, CNMV, Bolsas y Mercados Españoles, official Regional Government gazettes and Instituto Valenciano de Finanzas.

a Effective marginal rates on new issues.

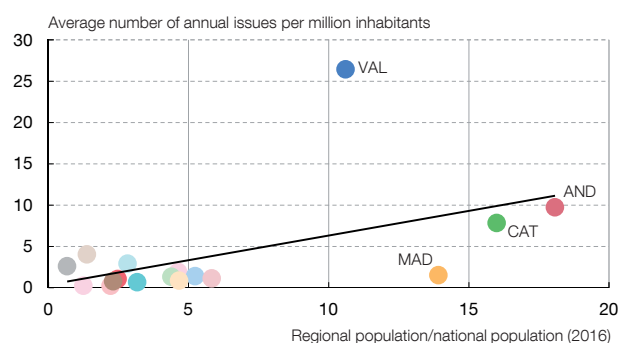
b Weighted average of yields on regional government issues (own data). More information in the monthly debt statistics on the website of the Secretaría General del Tesoro: <http://www.tesoro.es>.

### Regional government access to debt securities markets

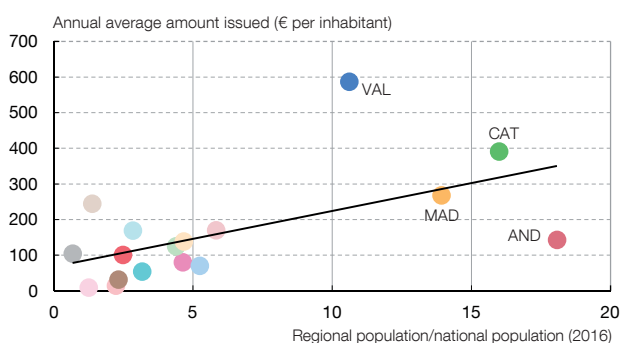
Chart 4 shows the annual volume of debt issues by regional governments as a whole in the period 2000-2017. The increase in the volumes issued in the economic crisis period can be seen in the chart, as can the subsequent reduction as from 2012, a tendency which came to a halt in 2015, when the low for the last two decades was recorded. The volume issued increased slightly in 2016 and 2017, standing at around €5.3 billion in this latter year, up 25% on 2015. Nonetheless, this figure is still low in historical terms, given that from 2000 to 2017 somewhat more than €10.5 billion per annum was issued on average, peaking at €25.25 billion in 2010.

Chart 5 shows the annual average yield on regional government and Treasury debt issues for two representative instruments: 12-month notes or bills (left-hand panel) and 10-year bonds (right-hand panel). During the pre-crisis period, the issuance costs of regional government debt securities, taken as a whole, were practically identical to those of the State, a situation likewise attained in 2013 for 10-year debt, and somewhat later, around 2015, for 12-month securities. The interim period largely matches the euro area sovereign

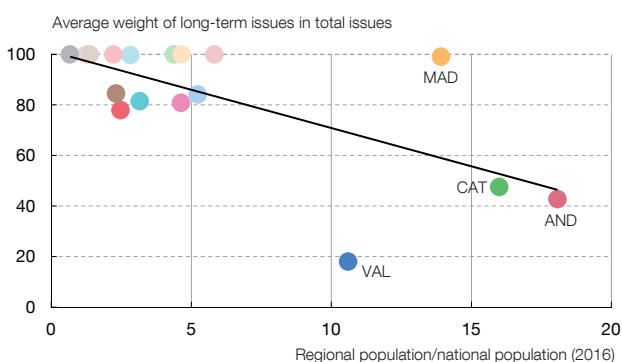
1 NUMBER OF ISSUES IN TERMS OF SIZE OF REGION



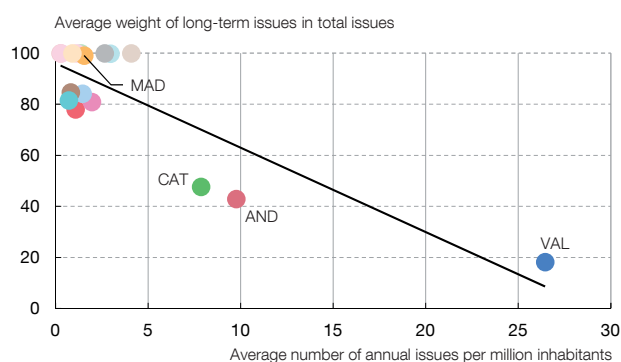
2 AMOUNT ISSUED IN TERMS OF SIZE OF REGION



3 TERM STRUCTURE OF ISSUES IN TERMS OF SIZE OF REGION



4 RELATIONSHIP BETWEEN TERM STRUCTURE AND NUMBER OF ISSUES



SOURCES: INE and Banco de España.

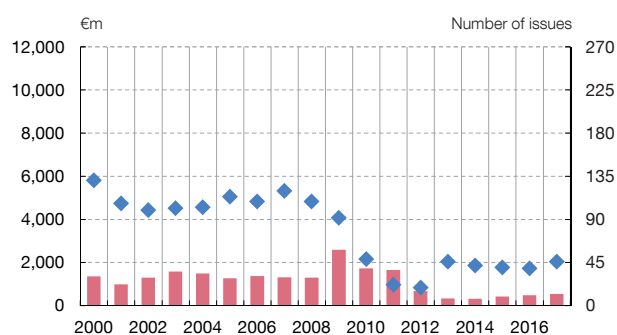
a The averages refer to the annual indicators in the 2000-2017 period.

debt crisis, which affected the regional governments to a greater extent. Thus, the year 2012 saw the biggest spread between 10-year bonds issued by regional governments, taken as a whole, and 10-year Treasury bonds, standing at 280 bp, compared with approximately 15 pp and 40 bp for the averages for 2000-2011 and 2013-2017, respectively. In the case of 12-month bills or notes, the maximum spread between the regional government and Treasury instruments in the period was in 2010, when it stood at 290 bp, compared with the average of 10 bp for the 2000-2009 period, and it held at over 100 bp between 2011 and 2013, on a declining path, narrowing to 26 bp in 2017.<sup>8</sup>

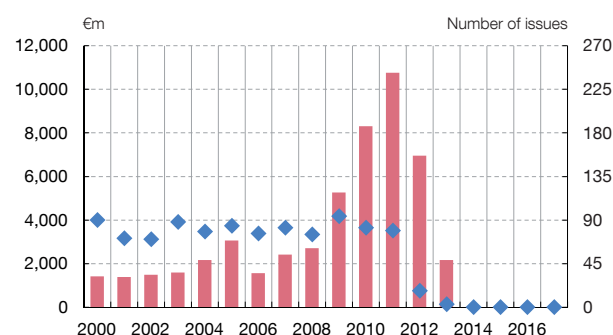
The breakdown of the foregoing figures at the regional level reveals a high degree of heterogeneity, although there are some common patterns. Specifically, there appears to be a positive association between the size of the region and the number of issues, as well as between size and annual amount issued, in euro per inhabitant (see Chart 6). Likewise, within the group of the biggest regions, Andalusia, Catalonia and the Valencia region tended to record, on average, from 2000 to 2017, a higher percentage of short-term issues than the rest, in relative terms. From a historical standpoint, these three regions have been very active in raising resources on international markets, if the recent years are excepted

<sup>8</sup> The comparison using the two measures of yield should be taken by way of illustration, given that they are not entirely comparable. The measure of State return is the average of the effective rates of issue, while the yield shown for the aggregate of the regions is the amount-weighted average of the rates of return on the securities issued.

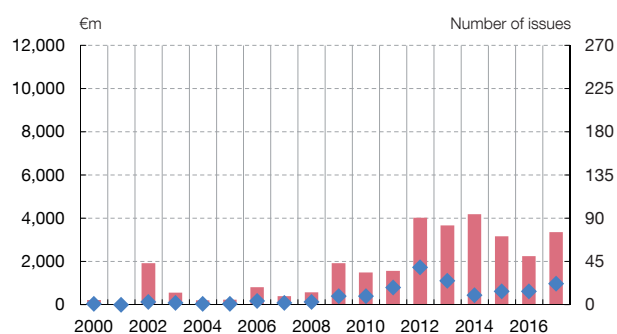
## 1 ANDALUSIA



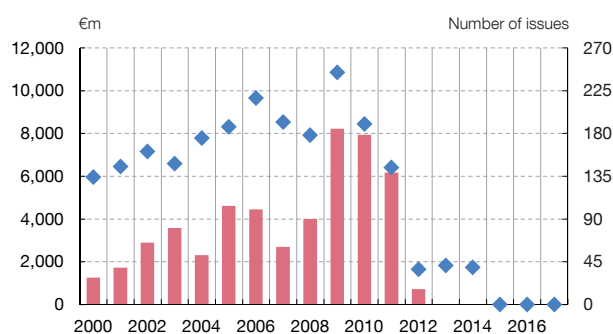
## 2 CATALONIA



## 3 MADRID REGION



## 4 VALENCIA REGION



■ VOLUME OF ISSUES (€m)

◆ NUMBER OF ISSUES (right-hand scale)

SOURCE: Banco de España.

a The amount of the issues is the sum of the total amount not weighted by the redemption period of the debt security.

(see Chart 7). Indeed, from 2012 to 2017 the Catalan regional government made no long-term issues, or short-term issues from 2013, while the annual average for total issues from 2000 to 2011 was somewhat over 80 per annum. A similar case is the Valencia region, which has not made long-term issues since 2012, or short-term issues since 2014, compared with an annual average of over 175 from 2000 to 2011. In the biggest regions, both Andalusia and the Madrid regional government maintained a continuous presence on markets throughout the 2000-2017 period, although with an issuance volume in the case of Andalusia that has fallen most significantly since 2012.

Generally, the differing degree of regional government participation in the State's extraordinary financing mechanisms, between 2012 and 2017, has brought about differentiated capital market access dynamics. It should be recalled that, since 2015, the extraordinary funds are structured in the so-called "Regional Government Financing Fund" (RGFF).<sup>9</sup> This fund is divided essentially into two vehicles. The first is the so-called "Regional Government Liquidity Fund" (RGLF), which regional governments not fulfilling budgetary stability, public debt or average supplier payment period objectives must obligatorily join, and which provides continuity to a similar, previous fund of the same name created in 2012. The

<sup>9</sup> Royal Decree-Law 17/2014 of 26 December 2014, on financial sustainability measures for regional and local governments and other economic measures. The fund "launches new mechanisms enabling financial savings to be shared among all tiers of government, to prioritise social spending, to continue helping the regional and local governments with greater funding difficulties and to boost those that have managed to overcome such difficulties".



regional governments included in this fund are subjected by the State to accepting budgetary conditions, with reinforced budgetary control measures, in keeping with the demands of the Law on Budgetary Stability and Financial Sustainability [see Hernández de Cos and Pérez (2013) for a description of these measures]. The second fund is the “Financial Facility” (FF), intended for those regional governments meeting stability objectives.<sup>10</sup>

Compliance with the membership conditions for the various funds (the original RGLF, the new RGLF and the FF) have varied over time, as has the willingness of individual regional governments to belong to them, in cases in which they had decision-making power, meaning that regional government membership of the funds has differed in different years. In December 2017 nine regions (Andalusia, Aragon, the Balearic Islands, Cantabria, Castile-La Mancha, Catalonia, Extremadura, the Murcia region and the Valencia region)<sup>11</sup> had acceded to the RGLF, and four to the FF (Asturias, the Canary Islands, Castile-León and Galicia)<sup>12</sup>. The remaining ordinary-regime regions (the Madrid region and La Rioja) did not receive any funding either from the RGLF or the FF in 2017, as did neither the specific-status regions (Navarre and the Basque country).

As can be seen in Chart 8, from 2015 to 2017 those regions not availing themselves of the above funds (Navarre and the Basque country) or which availed themselves only occasionally of them (the Madrid region and La Rioja in 2015, in the case of the FF; Castile-León and Asturias in 2015 and 2017, also the FF) resorted to the markets for funding. The exception was Andalusia, which mainly made short-term issues in these years. The remaining regions did not issue securities from 2015 to 2017, and received funding either from the RGLF or from the FF. Of note has been the behaviour of some regions which have decided to resort to issuing again following years of inactivity, as is the case of Asturias (which had not issued since the 1980s) and the Basque country (since the 1990s). Castile-León, for its part, has significantly increased its issuance volumes, far exceeding past dynamics. All these developments appear to reflect the sound current conditions of financial markets.

Given the exceptional nature of the State funds and the favourable macroeconomic and financial conditions in place, the muted progress observed in the more active role being played by regional governments in tapping the capital markets for funds will foreseeably strengthen in the medium term, in a context marked by the fulfilment of the budgetary stability objectives. In any event, while these mechanisms are operational, the explicit factors of conditionality governing the budgetary conduct of the governments concerned must be strictly applied so as to avoid incentives to pursue inappropriate budgetary policies [see Hernández de Cos and Pérez (2015) and Delgado, Pérez and González (2016)].

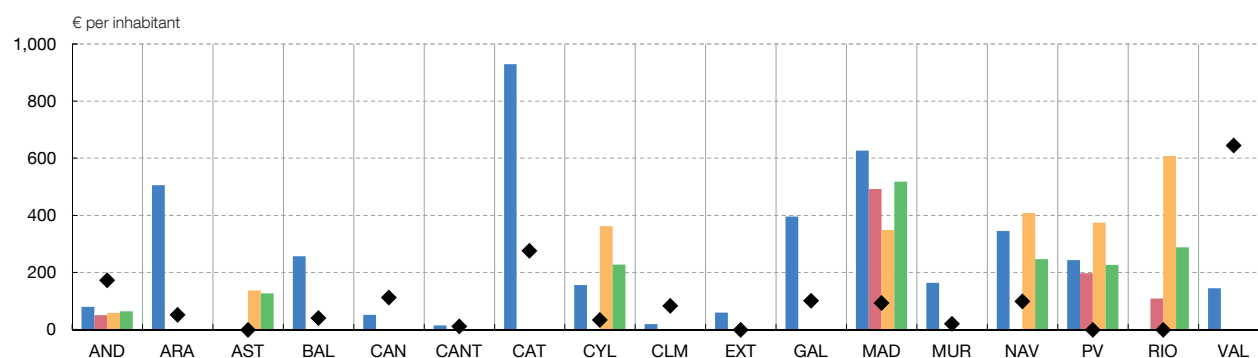
15.2.2018.

<sup>10</sup> There is also a third, less quantitatively significant fund, the “Social Fund”, intended to pay regional government obligations to local governments that have arisen owing to social spending agreements.

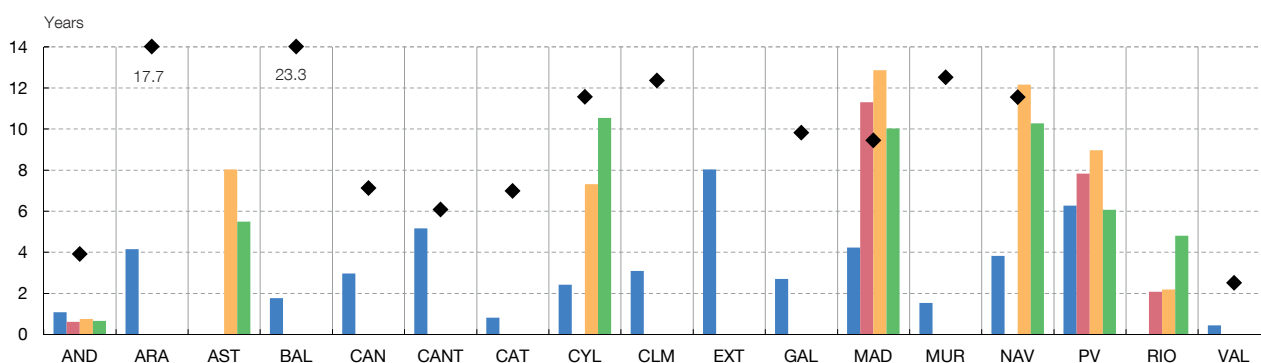
<sup>11</sup> The following regions availed themselves of the RGLF in 2012: Andalusia, Castile-La Mancha, Catalonia, the Valencia region, Asturias, the Balearic Islands, Cantabria and the Murcia region. In 2013: Andalusia, Castile-La Mancha, Catalonia, the Canary Islands, the Valencia region, Asturias, the Balearic Islands, Cantabria and the Murcia region. In 2014: Andalusia, Castile-La Mancha, Catalonia, the Canary Islands, the Valencia region, Asturias, the Balearic Islands, Cantabria, the Murcia region and Extremadura. In 2015: Castile-La Mancha, Catalonia, the Valencia region, Cantabria and the Murcia region. In 2016: Andalusia, Castile-La Mancha, Catalonia, Aragon, the Valencia region, the Balearic Islands, Cantabria, the Murcia region and Extremadura.

<sup>12</sup> The following regions availed themselves of the FF in 2015: Andalusia, Aragon, Asturias, the Balearic Islands, the Canary Islands, Castile-León, Extremadura, Galicia, the Madrid region and La Rioja. In 2016: the Canary Islands and Galicia

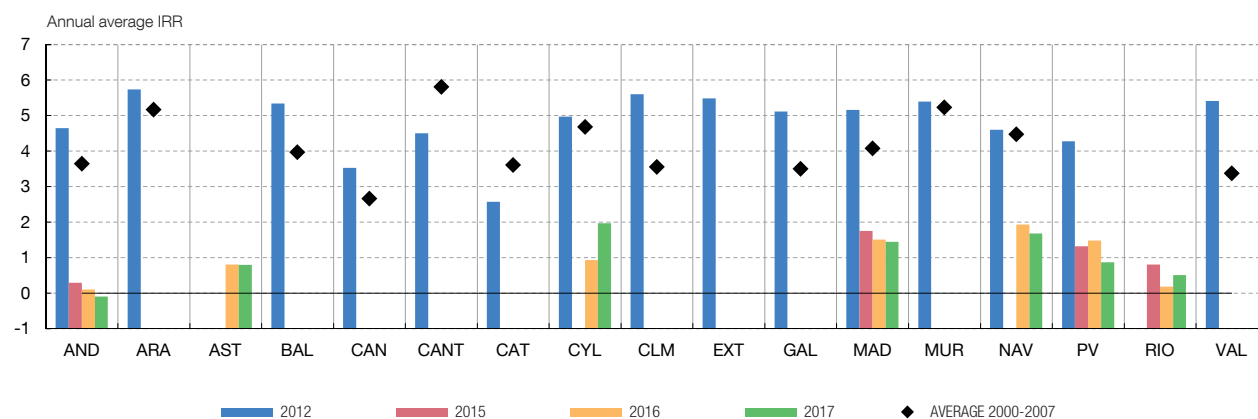
1 AMOUNT ISSUED PER CAPITA (a)



2 AVERAGE REDEMPTION TERM OF THE ISSUES (b)



3 AVERAGE RATE OF RETURN (c)



SOURCES: Banco de España, CNMV, INE, Bolsas y Mercados Españoles and own data.

- a The amount of the issues is the sum of the total amount not weighted by the redemption period of the debt security.
- b Average weighted by the amounts issued of the average redemption term of the regional government issues.
- c Average weighted by the amounts issued of the rate of return on regional government issues.

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