# Smoke and Mirrors:
# How Regional Finances Complicate Spanish-Catalan Relations

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Abstract

This article examines the relationship between the form of fiscal decentralization in Spain and the rise in tensions between the Spanish and Catalan governments during the financial crisis, in particular from mid 2010 to mid 2013. As a profound budgetary crisis unfolded at regional government level in Spain, longstanding disputes over the regional financing system and its methods of redistribution among the seventeen autonomous communities escalated. Most notably, Catalonia, one of the most indebted regions, attributed its financial woes in part to over-redistribution. This is not a straightforward connection, but the lack of clarity regarding both the workings of the regional financing system and the causes of the regions' varying levels of fiscal (in)compliance reduced accountability and fuelled disputes among central and regional governments, giving both sides scope to offer different interpretations. The smoke and mirrors regarding regional finances combined with the nature of intergovernmental dynamics in Spain contribute to explaining the persistent inability to resolve regional fiscal problems and agree a long-lasting reform of the regional financing system.

Keywords

Spain, Catalonia, autonomous communities, fiscal decentralization, financial crisis, political economy

Author's Details

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**NOTE: Tables of figures are provided at the end of the article text, on pp. 16-17.**

## Introduction

Since the approval of the Constitution of 1978, Spain has transferred extensive policy competences to its seventeen autonomous communities (hereafter regions) and become one of the most decentralized countries in Europe. While the transfer of spending competences has been accompanied to some degree by a transfer of revenue-raising powers, the former outweighs the latter in all but the two regions with near fiscal autonomy (the Basque Country and Navarre), hence most also depend on revenue transfers from the central government to carry out the policy competences assigned to them. Moreover, the existence of two different regional financing models (the charter regime for the two afore-mentioned regions versus the common regime for the remaining fifteen) has frequently caused division.

The aim here is to analyse how longstanding controversies over the regional financing system have been exacerbated during the economic crisis and how this has interacted with the clash between the pro-sovereignty drive in Catalonia and a centralising Spanish government. As the crisis took hold in 2008, Spain's regional governments were endowed with the potentially dangerous mix of relatively limited tax autonomy but significant expenditure and borrowing autonomy – a form of fiscal decentralization which generates an accountability gap, risks fiscal indiscipline among subnational governments and creates expectations that the central government will bail them out if necessary (Rodden 2006). As their debt levels rapidly grew, the central government attributed part of the responsibility for Spain's budgetary crisis to the country's regional governments. This caused endless controversy, which was intensified by the longstanding debate over the flaws of the redistribution system. The fifteen regions under the common financing regime participate in an equalization mechanism, but it proves overly redistributive in some cases, while the two regions under the charter regime – which are among the richest in Spain in GDP per capita terms – are exempt from contributing to it. Dissatisfaction with this situation grew amid the increased fight for resources. Most notably, the nationalist government of Catalonia, one of the most indebted regions, repeatedly attributed its financial woes in part to over-redistribution.

Economists have analyzed at length both the nature of regional fiscal indiscipline in Spain and the flaws of the equalization mechanism (e.g. De la Fuente 2013a and 2012a, respectively). Yet there has been relatively little analysis of the politics of the perceived interrelationship between these two dimensions throughout the crisis beyond basic acknowledgement of Catalonia's dissatisfaction. This paper seeks to investigate the political uses and abuses of this alleged interrelationship focusing on the period from mid 2010 to mid 2013. Particular attention will be paid to Catalonia as the protagonist in the regional financing disputes and the main antagonist of central government in this regard, though due consideration will also be given to the broader inter-regional dynamics of the debate, which impact Spanish-Catalan bilateral relations.

I do not intend to suggest a straightforward connection between the level of fiscal (in)discipline of the regions and their respective treatment by the regional financing system, or to investigate the exact degree to which such a connection exists. This is inherently ambiguous, and other factors which have contributed to explaining differences in the regions' fiscal performance have been studied elsewhere, such as variations in the behaviour of regional revenues and expenditure throughout the crisis (see Leal Marcos and López Laborda 2013). My purpose is, rather, to address the following questions: How did politicians make use of such smoke and mirrors surrounding regional finances for partisan and instrumental motives during the period concerned? What political, economic and market conditions shaped their arguments? What were the consequences of this for Spanish-Catalan government relations, within the context of broader intergovernmental relations in Spain? And how does this relate to the continued inability to reach a satisfactory solution to the problems with the regional financing system?

This article maintains that the complexity of the regional financing system has provided a cover for sustaining different political viewpoints on regional fiscal and financial behaviour. This has exacerbated intergovernmental tensions and threatens to problematize the next reform of the common financing regime, a process which the Spanish government is due to undertake in the near future, starting in the second half of 2014 at the earliest.[1] In this sense, the paper aims to build on previous studies of the role of political factors in the persistent instability of the regional financing system in Spain (e.g. León 2009). It also hopes to contribute to the wider political economy literature (e.g. Rodden 2006) on the risks and pitfalls that politics poses to the expected improvements in efficiency, accountability and fiscal discipline often predicted by theorists of federal and decentralized fiscal models.

The article will begin with an overview first of the regional financing system and then of the regional debt crisis, considering the relationship between the two dimensions maintained by Catalonia. It will follow with an analysis of the political, economic and market conditions that shaped the evolution of the regions' fiscal performance and financing debates and impacted Spanish-Catalan relations from mid 2010 to mid 2013. The period of socialist (*Partido Socialista Obrero Español*, PSOE) central government until November 2011 will be contrasted here with the period of conservative (*Partido Popular*, PP) central government thereafter. A final section contemplates future prospects.

## The regional financing system

Articles 156 to 158 of the Spanish Constitution outline the basic principles of the regional financing system, which in the strictest sense is designed to ensure the regions have sufficient revenues to provide a minimum level of public services. Separately from the regional financing system per se, an Inter-territorial Compensation Fund implements the principle of territorial solidarity by promoting development in less prosperous regions in order ultimately to achieve income redistribution – a purpose also served by European structural and cohesion funds to Spain particularly in the 1990s and early 2000s (see, for example, Álvarez et al. 2004). A degree of overlap and indeed confusion between these two elements (service provision and solidarity) nevertheless results since the present regional financing system for services incorporates an equalisation mechanism to redistribute tax revenues among the regions, as well as a Cooperation Fund (see below) which fulfils a similar purpose to the Inter-territorial Compensation Fund (on this, see Fernández Llera and Delgado Rivero 2010). Controversy arises in particular over the nature of the equalisation mechanism due to the different ways in which the regional financing models treat the regions, as follows:

### *Charter regime*

Two of Spain's seventeen regions, the Basque Country and Navarre, have a specific financing system (*régimen foral*, from *fuero* or medieval charter) which grants them fiscal autonomy. This arrangement was either retained by or restored to them during the Transition in recognition of the long tradition in this regard in their provinces (see Colino 2012: 3-5). Under the agreement known as the *concierto* in the Basque Country and the *convenio* in Navarre, the provincial authorities legislate and levy almost all their own taxes and then pay an annual quota (*cupo* or *aportación*, respectively) to the central government towards those competences that remain exclusively the responsibility of the Spanish state (e.g. foreign and defence policy). In the Basque case, the *cupo* covers 6.24% of these general expenses, broadly in line with the region's share of Spain's GDP.

The Basque and Navarrese economic agreements enjoy cross-party support within their regions and are upheld by the main Spanish statewide parties, but a number of economists and political scientists (e.g. De la Fuente 2012b, Colino 2012) have criticised the system while Catalan nationalist politicians have often requested a similar model in recent times. Academic criticism is not so much of the concept of fiscal autonomy per se, which is acknowledged to bring some benefits such as increased accountability (compared to revenue-sharing arrangements), but rather of how it is applied in the Basque Country and Navarre since it exempts the two regions from contributing to the equalization mechanism in the common financing regime. They only make a much smaller contribution to inter-regional wealth redistribution via the Inter-territorial Compensation Fund. Estimates based on 2007 data suggest that this exemption reduces the Basque Country's contribution to the state coffers by around EUR 1.79bn per year. Other anomalies in the model lead to further savings for the region, thus bringing average per capita financing in the region overall to at least 60% higher than the average of the 15 regions under the common regime (De la Fuente 2012b: 4-5). This situation is generally only considered sustainable for Spain since it applies to two relatively small regions which together account for around 8% of the country's GDP, while it would not be exportable to a region the size of Catalonia, which contributes approximately 18%.

### *Common regime*

The remaining fifteen of Spain's regions conform to the common financing regime (*régimen común*) whereby they obtain resources from two main revenue sources: (1) specific taxes which are fully or partially ceded to the regions and (2) a central government contribution derived from non-ceded tax revenues. The model was first regulated by the 1980 regional financing law (*Ley Orgánica de Financiación de las Comunidades Autónomas*, LOFCA) and was subject to five-yearly revisions from 1986 until 2001, before the latest reform took place in 2009 (Bosch and Durán 2008, Borraz and Cantalapiedra 2010, Blöchlinger and Vammalle 2012). Over time the share of taxes ceded to the regions has gradually increased (along with their legislative and administrative powers over these taxes), leading to a proportional reduction in the central government contribution.[2]

A key feature of the model is an equalization mechanism to redistribute wealth. Since 2009, the majority of the resources within the system have been pooled into what is known as the Guarantee Fund for Fundamental Public Services (*Fondo de Garantía de Servicios Públicos Fundamentales*). This money has been distributed among the regions to ensure that they each have the same proportional level of resources to provide education, health and social services to their citizens. These needs are determined according to each region's 'adjusted population', calculated via a formula to take into account various demographic and geographic weightings. In addition, a much smaller Global Sufficiency Fund (*Fondo de Suficiencia Global*) is designed to ensure the regions have sufficient resources for the remainder of their devolved competences (i.e. beyond the essential services) and are net winners with the change of model in 2009. Finally, less than 5% of resources in the system are designated as two regional convergence funds. These are the Competitiveness and Cooperation Funds. The first (*Fondo de Competitividad*) compensates the usually richer regions with typically higher population growth (e.g. Catalonia and Madrid) if the outturn figures go against them, in an attempt to reduce the anomaly whereby their financing had often ended up below average under the previous model. The second (*Fondo de*

*Cooperación*) is aimed at increasing resources in the poorer regions with lower per capita incomes and/or negative population dynamics (ageing or declining populations).

The common financing model was given a very complex design under the 2009 reform in order to straddle the demands of different regions, and the central government promised an increase in its own contribution to help achieve consensus (Blöchlinger and Vammalle 2012). Nevertheless, progress towards solving the longstanding problem of the arbitrary effects of the equalization mechanism has proved limited (De la Fuente 2012a, 2012c and 2013c). This should ideally bring each region as close as possible to the mean in terms of level of financing per adjusted capita but it still proves either overly or insufficiently redistributive in some cases. This flaw has persisted over the years largely because all the regions have always fought to ensure their respective status quo would be maintained or improve with each reform, and the central government has repeatedly obliged since it would be politically costly for it to do otherwise (León 2009, De La Fuente 2012a).

The new system was implemented in 2009 with some one-off effects specific to that year only which gave the impression of a significantly improved equalization mechanism, but much of that apparent progress was reversed from the first year of full implementation in 2010 onwards (see De la Fuente 2012a, chapter 4). Central government transfers of the funds due to the regions (known as *entregas a cuenta*) are made throughout the relevant year based on initial revenue estimates, before being revised when the outturn revenue figures are confirmed and the regional financing system is liquidated 18 months after year-end. Thus it was not until mid 2012 that the full impact of the new model applied in 2010 came to light.[3] The results show that the regions of Madrid and Catalonia, for example, remained among the top three contributors to the common financing model in terms of per capita tax revenues, with their respective contributions reaching 48% and 23% above the mean in 2010 (see Table 1). Yet they both ended up ranked below average for the 15 regions in 2010 in terms of total financing per adjusted capita post-equalization. This is broadly similar to their position in 2007 (and beforehand), the final year under the 2001 model for which official figures were available when the 2009 model was devised (see De La Fuente 2012a).

In contrast, some of the regions that benefitted disproportionately from the 2001 model continued to do so. Extremadura, for example, one of the lowest tax revenue contributors per capita, maintained its third position out of the 15 regions post-equalization in 2010. Meanwhile, since the system is inconsistent and not overly redistributive in all cases, some of the relatively richer regions in per capita tax revenues remained relatively richer post-equalization (e.g. Cantabria and La Rioja) and some of the relatively poorer ones ended up equally poor or poorer still (e.g. Valencia, Murcia, Andalusia and Castilla-La Mancha). Similarly disparate outcomes emerged again in the liquidation statement of the 2011 regional financing system more recently published in July 2013 (Pellicer 2013). These longstanding flaws in the equalization mechanism, and the exemption of the Basque Country and Navarre from contributing to it, have created ample fuel for political divisions between the regional and central governments over the years, with Catalonia voicing the most grievances.

Beyond the debates over redistribution, the fight for resources during the crisis also unleashed tensions regarding the payment schedule for the Competitiveness Fund. Unlike the *entregas a cuenta* which are provisionally paid during the relevant year and later revised when the regional financing system is liquidated, the Competitiveness Fund was set up in 2009 such that payments from it were not due to be made until the liquidation date. This became subject to dispute in 2011 when the regions expecting to benefit from the Fund – Catalonia, the Balearics and Madrid, among others – argued that approximate payments should be made in that same year and they should not be forced to make additional cuts to compensate for this. At that time Catalonia estimated its share of the Fund for 2011 at EUR

1.45bn, which the central government disputed. Ultimately the region received EUR 835m in July 2013 once the outturn revenue figures had been confirmed.

Such discrepancies between initial estimates and final outturn figures were characteristic of the common financing model in general in the depths of the financial crisis. Although several regions asked for payments from the Competitiveness Fund for 2011 to be made that same year, most were still indebted to the central government at the time to varying degrees for windfall gains received in 2008 and especially 2009. In those years, the initial revenue projections on which the central government transfers to the regions were based were much greater than the final outturn revenue figures, since the government had not anticipated the extent of the effect of the crisis. Overall the regional governments were due to repay the central government in 2010 and 2011 for total windfall gains of EUR 5.514bn received in 2008 and a particularly substantial EUR 18.736bn in 2009 (in contrast, the liquidations of the 2010 and 2011 financing systems went in the regions' favour, showing the central government owed them EUR 5.102bn and EUR 4.358bn, respectively). Ultimately, due to the regions' inability to repay these windfall gains in full in 2010 and 2011, a repayment schedule was set up over a ten-year period. Such complexities over who is owed what and when gave politicians ample room to mention or omit particular versions of figures for reasons of political opportunism.

**Regional indebtedness (and its relationship to the regional financing models)**

Concerns over the fiscal indiscipline of many of Spain's regions throughout the crisis amplified tensions over the regional financing system. At the start of the crisis, Spain's total public sector debt as a percentage of GDP was among the lowest levels in Europe but it rapidly grew: total government debt (which comprises that of the central government, the regional governments, the local authorities and the social security system) rose from 36.3% of GDP at the end of 2007 to 93.4% in the third quarter of 2013,[4] when the Spanish government acknowledged the figure was set to reach 100% of GDP by the end of 2014. Borrowing by the regional governments in particular ballooned at an unsustainable rate. Prior to the crisis, the total debt held by the 17 regions as a percentage of GDP had hovered consistently just above 6% (varying between 6.0% and 6.4%) between 2000 and 2006 before declining to 5.8% in 2007. These figures were not surprisingly very low, given that Spain's regional governments had only been in existence since the early 1980s. Low interest rates following Spain's entry to the euro, combined with the availability of European structural funding and the cyclically elastic nature of regional tax revenues (Von Hagen and Foremny 2013: 24), had encouraged a rapid growth in real expenditure during the years of the construction boom, for which windfall revenues compensated. When the crisis hit, however, regional debt doubled both as a percentage of GDP and in absolute terms in only three years, increasing from 5.8% (EUR 61.0bn) at the end of 2007 to 11.6% (EUR 120.8bn) at the end of 2010. By the end of the third quarter of 2013 it had reached 19.3% of GDP (EUR 197.0bn). Valencia and Catalonia stood out as the first and third most indebted regions in terms of debt as a percentage of GDP at 29.8% and 27.2% respectively (and also the second and first in absolute terms with EUR 29.6bn and EUR 53.7bn). At the opposite end of the spectrum, Madrid had the lowest level of debt as a percentage of GDP at 12.0%. These debt figures were exclusive of billions of euros accumulated throughout the crisis in unpaid bills to suppliers and service providers, particularly in the most indebted regions. By the end of 2011, before the central government intervened to provide loans for repayment, these were estimated to have reached as much as EUR 30bn.

Concerns grew over regional finances in particular since the spirit of austerity was late in filtering through to the regions. Although the regions had started to suffer the fall in tax revenues in 2008, the reaction to adjust expenditure accordingly did not begin until 2010 (Leal Marcos and López Laborda 2013: 34). The regions faced a tougher task than the central government to trim their budgets: they manage around one third of state expenditure but around two thirds of this amount goes towards the fundamental policy areas of health, education and social services. These were far harder to control demand for and cut than areas being slashed by the central government, such as public investment in infrastructure, civil servants' salaries and the foreign office budget. Moreover, regional tax revenues from the ceded taxes, which had been increased under the 2009 financing system, suffered a greater fall as a result of the crisis than the transfers derived from non-ceded taxes, which had decreased (Leal Marcos and López Laborda: 30). Still, several regional governments also showed reluctance to cut back on expenditure in more feasible areas, and in 2010 there were concerns this would persist in the months leading up to regional elections scheduled to be held in many of the regions in May 2011.

In broad terms, a number of the regions which struggled particularly with fiscal discipline (and therefore also tended to lose their appeal to lenders and investors) coincided with those penalised by the equalization mechanism in the common financing regime. This was especially true of Catalonia, Valencia, Andalusia, the Balearics, Murcia and Castilla-La Mancha. These six regions all either experience a significant drop in their level of resources per capita between pre- and post-equalization and/or end up in the bottom half of the ranking of regions in terms of resources per capita post-equalization (see Table 1). This has been exacerbated by the fact that the first three are also among the four largest regions in Spain in terms of population size (the other being the Madrid region). This gives them particularly high spending needs to cover following the decentralisation of fundamental policy areas, for which it became difficult to obtain sufficient financing during the crisis, especially given the regions' relatively limited experience and investor base in this regard. This situation fuelled the long-standing controversy over the alleged injustices of the regional financing models, with Catalonia heading the debate.

Nevertheless, as mentioned in the introduction, the link between financing regimes and regional indebtedness has not been so straightforward. Many other factors – including regional variations in revenue and expenditure behaviour, (mis)management of finances and corruption, and levels of infrastructure investment from the central government – are deemed to have played a significant role in determining the indebtedness of each region. The comparison between Catalonia and Madrid is eloquent in this regard. Both are among the largest regions in Spain in terms of population size and the richest regions in terms of GDP and fiscal capacity per capita, and both suffer from the overly redistributive nature of the common regime financing system – indeed, the Madrid region is more penalised than Catalonia. Yet Catalonia has ended up far more in debt than Madrid and they became poles apart in terms of fiscal discipline and their appeal to investors during the crisis. Catalan politicians have often argued that as the capital Madrid has benefitted from factors such as increased infrastructure spending and other investments, while Catalonia itself has been accused of poorer financial management, but the complexity of the situation has created confusion as to what factors exactly have caused the discrepancy in fiscal discipline between the two regions. The convoluted nature of the regional financing system in itself creates an accountability gap, in particular in terms of its complicated division of revenue and expenditure responsibilities which is little understood by the general public (Bosch and Durán 2008: 15). Yet this was exacerbated further during the crisis by the opaqueness of the causes of the regions' varying levels of budgetary compliance and the degree to which these relate or not to the financing models – all of which served as fuel for disputes between the central and Catalan governments in particular, giving them scope to offer different figures and interpretations to pass the buck. The following sections consider the evolution of this situation over the period mid 2010 to mid 2013 under first the PSOE and subsequently the PP central governments.

**Regional finances under the PSOE minority central government**[5]

By mid 2010 concerns from Europe were growing about the threat that regional finances in Spain posed to the country's overall financial health and debt sustainability.[6] In this context, the central government first began to attempt a crackdown on regional government spending and borrowing in the second half of 2010 as the rapid growth in regional debt made it the main obstacle to Spain's deficit-reduction targets. The then PSOE government had set a year-end deficit target of 2.4% for the seventeen regional governments as part of an overall deficit target of 9.3% for general government. Nevertheless, attempts to instil fiscal discipline in the regions from 2010 until the end of the Socialist government's time in power in late 2011 were seriously hindered by political considerations in particular, especially since the minority central government relied on the support of regionally-based parties in parliament and sought to avoid imposing measures on the regions without achieving a consensual agreement.

The first step the central government took in 2010 was to begin to exercise its right to ban fiscally non-compliant regions from issuing new debt. Since Article 156 of the Constitution gave the regions the authority to design their own budgetary policies, the central government was not authorized to impose a budgetary ceiling on them and the stamp of approval for debt issuances was therefore the only significant lever it had on the finances of the fifteen regions under the common regime at the time. At a meeting of the Fiscal and Financial Policy Council (*Consejo de Política Fiscal y Financiera* or CPFF, the intergovernmental body that brings together the regional and central finance ministers) in November 2010, Economy Minister Elena Salgado announced that Castilla-La Mancha and Murcia were the only regions not on track to meet the year-end target deficit target of 2.4% of GDP and the government had already exercised its right to ban the two regions from issuing debt until they could present a credible plan for financial readjustment. Moreover, all of the regions' ability to issue debt was to become conditional on their meeting of deficit reduction targets on a half-yearly basis and plans (originally due to start in 2011) were brought forward for the regions to unveil their budgetary positions on a quarterly basis as part of a 'transparency exercise' designed to restore investors' confidence in Spain. In accordance with the new rules, the regions' deficits for the third quarter of 2010 were publically released for the first time in December 2010. These seemed to confirm that only Castilla-La Mancha and Murcia were not on track and their fiscal indiscipline would be compensated for by the stronger performance of the remaining regions, with a combined regional deficit for the 17 regions of 1.24% of GDP as of the third quarter of 2012.

The ability to limit regional debt issuances is a powerful tool, but political considerations would deter Prime Minister José Luis Rodríguez Zapatero from using it. This became apparent after significant revisions to several of the regions' deficit figures revealed the majority had failed to meet the 2010 target, bringing their combined deficit at year-end to 2.83% of GDP.[7] The new Catalan government in power since November 2010 was the first to reveal a substantially higher 2010 year-end regional deficit estimate in January 2011 than for the third quarter (1.71% of GDP), with the final figure presented in March that year coming in at 3.86%. In this context, Prime Minister Zapatero tried to allay international concerns about Spain's regional finances and reiterated in an interview with *The Financial Times* that the central government would use its power to prevent any region that was not complying with Spain's deficit-reduction targets from issuing debt (Mallet and Ford 2011). Before long, however, a bilateral bargaining arrangement with Catalan president Artur Mas led Zapatero to backtrack. After a one-on-one meeting with Mas in February, Zapatero promised to give the Catalan government authorization to start issuing debt to cover its 2011 financing needs, despite the fact that it had exceeded the 2010 deficit target and its 2011 financial readjustment plan (required to demonstrate compliance with the year-end regional deficit target of 1.3% of GDP) was yet to be approved by the central government. Mas also secured a pledge from Zapatero that the central government would pay around EUR 760 million euros it owed Catalonia for investments in infrastructure pending since 2008, following an agreement Catalonia had previously struck with the central government to receive a share of the latter's investment in infrastructure proportional to the region's weight in the Spanish economy (c.18%). Mas promised in return that Convergència i Unió (CiU) would support the minority PSOE central government on key pending economic reforms such as initiatives to support SMEs and boost the creation of jobs, and potentially the proposed new law on solvency requirements for the Spanish savings banks or *cajas de ahorros* subject to further negotiation.

The meeting showed the leverage the Catalan government had over the minority central government at the time, following the pattern since the 1990s whereby minority central governments in Spain have looked to peripheral nationalist parties for support in parliament (see Field 2010, Muro 2010). Nevertheless, the debate would continue throughout 2011 not least because the nearly EUR 1.9bn of debt which Catalonia was given permission to issue later in February was only the first tranche of at least EUR 11bn which the region had calculated it needed to cover its commitments in 2011, even assuming a proposed 10% slash in spending and the fulfilment of commitments which Catalonia expected from the central government. The central government repeatedly tried to hold back from giving the region permission to issue more debt until it could provide an adequate financial plan to meet the 2011 regional deficit target of 1.3% of GDP, while the Catalan government conspicuously continued to refuse to commit to the target and predicted a year-end regional deficit of 2.66% (i.e. still higher than the 2010 target) when it approved its 2011 budget in June that year. CiU continued to attribute the state of Catalan finances to (a) the previous Socialist-led tripartite coalition in the region (CiU had only returned to office in November 2010 after seven years in opposition); (b) the Socialist central government for allegedly failing to meet some of its financial commitments to the region (e.g. infrastructure spending, payment from the Competitiveness Fund); and (c) the overly redistributive nature of the common financing model.

Such tensions over regional finances between the central and regional governments in their bilateral relations were exacerbated by the traditionally competitive dynamics among the regions (on these dynamics, see Keating and Wilson 2009, Muro 2010). For example, the heads of over half of Spain's regions immediately condemned the prime minister's decision in January 2011 to let the Catalan government issue debt despite the fact it had exceeded the 2010 deficit target and its 2011 financial readjustment plan had not yet been approved. Moreover, Castilla-La Mancha and Murcia both remained banned at the time from issuing debt due to their fiscal incompliance. All fifteen regions of the common financing regime require central government permission to issue debt in the form of bonds or notes. Long-term bank loans can be secured without permission but only if a region shows previous and continued compliance with budgetary targets, and in 2011 this applied to only three regions (Madrid, Galicia, La Rioja) which had fulfilled the budgetary stability target in 2009 (the last year for which official figures were available at the time) by recording a deficit of less than 0.75% of GDP (Goikoetxea and Cantalapiedra 2011: 74). Zapatero tried to reduce tensions by insisting that Catalonia was only being given permission to issue debt for refinancing purposes rather than new financing needs, but he soon had to concede defeat again and promise to extend this concession to other regions in a similar position too.

Subsequent pledges to crack down on regional spending were similarly watered down due to political conditionality. At the European Council in March 2011, under pressure from the EU to ensure the sustainability of Spain's public finances, Zapatero promised to come up with Spain's own equivalent of a German debt brake. He committed to introducing a budgetary ceiling limiting spending by the central government to nominal GDP growth to avoid a growing structural deficit. Yet he shied away from pressures from both European officials and the opposition PP to make this rule binding for the regional governments too, preferring instead to seek a consensus within the intergovernmental CPFF on the matter in order to respect the regions' competences in the budgetary sphere. In the end, each region was left to decide whether to abide by the rule. It was not until August 2011, once Spanish bond yields were reaching unsustainable highs due to investors' distrust of the country's finances, that Zapatero reluctantly agreed to a pact with the PP to reform Article 135 of the Spanish Constitution to oblige all tiers of government in Spain (autonomous communities included) to adhere to the budgetary stability principle. Henceforth (with effect from 27 September 2011) neither the central nor the regional governments would be allowed to incur a structural deficit exceeding the margins set by the EU without incurring a penalty (see Hernández de Cos 2011).

In addition to these bilateral and inter-regional dynamics between the central and regional governments, debates over regional finances were complicated further by the appropriation of the issue by both the ruling party and opposition in the central government in Madrid for partisan motives. The contest between the PP and the PSOE often plays out across both central and regional levels, for example when either minority central governments or the opposition use the regions where they are in power as a tool to help their agenda at central level (see Field 2010, Muro 2010). This was exemplified in the debate over payments from the Competitiveness Fund corresponding to 2011 mentioned earlier, among other instances. When the PSOE central government refused to pay the Competitiveness Fund payments ahead of schedule in the first half of 2011 (rather than upon liquidation of the regional financing system in mid 2013), some of the PP-led regional governments (e.g. Valencia) were supported by the PP headquarters in Madrid when they threatened to take the matter to court. Moreover, the PP voted in favour of a CiU motion in the Spanish parliament in May 2011 requesting payment of the funds for 2011 in the same year, which was defeated. Yet when the PP central government came into power later in the year, the new prime minister Mariano Rajoy followed Zapatero in refusing to make the relevant payments in 2011.

## Regional financing sources

The fact that most of the regions – including Catalonia – could still access some forms of financing for much of the period of Socialist central government gave them a crucial degree of autonomy, even if they needed the central government's permission to issue debt. Nevertheless, securing financing rapidly became harder from the second half of 2010 onwards, especially for the largest and most indebted regions with the greatest financing needs. Indeed, when the central government gave Catalonia permission to issue nearly EUR 1.9bn of debt in February 2011, the new CiU government struggled at first to find a means to do so, experiencing the same difficulties as the previous Socialist-led tripartite coalition in Catalonia the year before.

Prior to the crisis, Spain's regional governments had met their financing needs primarily via bank loans (most often extended by the *cajas de ahorros*) and, in the case of the largest regions with the greatest needs (e.g. Andalusia, Valencia, Catalonia, Madrid), bonds issued on the public debt markets. These were subscribed by both Spanish and international institutional investors such as pension and insurance funds, as well as banks for their own portfolios. That was when regional bonds were considered solid investment grade by ratings agencies, in line with the rating of Spanish government debt at the time. However, the situation rapidly changed over 2010 and 2011 as investors became increasingly aware of the perilous state of Spain's regional finances and ratings agencies drastically downgraded many of the regions from strong investment grade to junk or near junk status. Only the relatively healthier regions like Madrid and the Basque Country managed to cling onto the lower rungs of investment grade status, broadly in line with Spanish government debt. Short-term retail bonds at expensive rates, credit lines from domestic banks and private placement notes tailored to specific investors became the new norm for many of the regions when the majority were almost completely shut out of the wholesale public debt markets from mid 2010. For many of these instruments the regions ended up paying at least double (often triple) the rates the Spanish Treasury was paying for central government debt of the same duration, even as Spanish bond yields rose dramatically too.

The difference between the first half of 2010 and the following eighteen months clearly reveals the change in funding opportunities. In the first half of 2010, fourteen new public bonds had been issued to institutional investors by various Spanish regions (Catalonia, the Balearics, the Canaries, Madrid, Andalusia, Valencia, Castilla-La Mancha, Galicia, Murcia) to raise a total of almost EUR 7.4bn of new financing. Yet the markets then closed to the regions and they did not issue any more new such bonds in the second half of 2010, followed by only three new issues (at very high rates) in 2011 in a brief window of opportunity in April and May to raise a total of EUR 1.3bn (see Table 2). More than 75% of the roughly EUR 30bn financing secured by Spain's 17 regions throughout 2011 would mature in under three years as they struggled to access longer-term financing. Moreover, approximately 37% of the financing secured that year was in the form of retail bonds (dubbed 'patriotic bonds') issued to largely unsuspecting individual investors, with the remainder split between short-term loans (c.36%), private placement notes (c.17%), new public bond issues for institutional investors (c.5%) and taps on existing bonds (c.5%).[8]

Struggling to issue debt to institutional investors, Catalonia was the first region to launch retail bonds to individual domestic investors – usually Catalan citizens, thus the name 'patriotic bonds' – in October/November 2010. Its first sale proved a success in the sense that demand was high, enabling the Catalan authorities to sell EUR 3bn of one-year paper. Yet the rate the Catalan government had to pay was very high – a return of 4.75% plus bank commission of 3%, amounting to 7.75% (around triple the rate paid by the Spanish government for Treasury bills of the same duration at the time). In the absence of sufficient alternative funding sources, the Valencian government decided to jump on the bandwagon, following Catalonia by offering EUR 1bn of Valencian 'patriotic bonds' at the same rate in December. Other struggling regions – the Balearics, Valencia, Andalusia and Murcia – would follow suit the following year. These regional governments had little other option, but selling these retail bonds to the unsuspecting general public unaware of the full extent of the regions' debt problems was akin to the scandal of the regional *cajas de ahorros* selling preference shares to customers as though they were as safe as deposits (on this, see for example Domínguez Martínez 2012). Overall, the regions with the greatest financial difficulties raised a total of EUR 15bn via one- and two-year retail bonds from the first issue by Catalonia in November 2010 through to the end of 2011 (see Table 3), and several of these subsequently had to be refinanced. Tables 2 and 3 show the contrast between 2010 and 2011 as short-term retail bonds became far more dominant in the latter year than the usually long-term traditional bonds issued to institutional investors, a situation which continued into 2012. The relatively healthier Madrid region never had to resort to 'patriotic bonds', despite also having large financing needs as one of the larger regions, since it continued to manage to secure sufficient financing from institutional investors (primarily via private placement notes) as well as loans.

## Regional finances under the PP majority central government

By the time the PP government came into power following the general elections held on 20 November 2011, the financial predicament of Spain's most cash-strapped regions had deteriorated further. At the end of 2011, the regions significantly over-shot the combined regional deficit target of 1.3% of GDP, coming in at 3.31%. This largely contributed to Spain overshooting its overall 6% target to reach 8.96%. Yet many of the regions' access to funding had by then almost completely dried up as they were struggling to continue to find demand for 'patriotic bonds'. In any case, they could not afford to keep issuing such expensive instruments (the final such issuance would take place in May 2012 – see Table 3). In this context, the situation changed substantially throughout 2012 as the new PP central government became the holder of the purse strings for several regional governments that became reliant upon loans from it. Moreover, it had an absolute majority and could therefore toughen its stance towards the regions. Concessions from Zapatero to Mas were now firmly in the past. In early 2012 the PP government presented a new Budgetary Stability and Financial Sustainability Law (approved on 27 April 2012) to implement the constitutional reform of Article 135 pacted with the PSOE in September 2011, but with significantly tougher regulations than those the PSOE had conceded to then. For example, the new Law established a stricter deficit ceiling than had been envisaged (no structural deficit would be allowed after a transition period) and set out the Spanish government's right to intervene any region that failed to comply with the fiscal targets it set, among other measures (see Hernández de Cos and Pérez 2013). Since the PP is a more centralist party than the PSOE, its critics have argued that the party's attempts to recentralize powers over regional finances (and indeed over local authority finances) have not only corresponded to the economic purpose of improving Spain's budgetary position, but have also been politically motivated.

The 17 regions' total gross financing needs in 2012 totalled around EUR 40bn, with Catalonia accounting for over a quarter of this amount. Many could no longer feasibly raise funds to meet these needs. Moreover, they had by now also accumulated billions of euros in unpaid bills to suppliers, to the extent that the National Association of the Pharmaceutical Industry in Spain (*Farmaindustria*) warned some pharmaceutical companies were starting to shy away from supplying medicines in certain Spanish regions. Faced with this situation, Spain's new central government thus took immediate action from January 2012 to avoid the immensely damaging repercussions for Spain of a potential regional government default. Since it had relatively greater access to financing than the regions (and at lower rates), it secured funds to make loans guaranteed by the Spanish Treasury to the regions as follows:

1) In January 2012 the government set up a EUR 10bn credit line (extendible to EUR 15bn) from the Official Credit Institute (ICO) split into two tranches. Proceeds from the first EUR 5bn tranche were to cover regional debt maturity needs in the first half of 2012. Six struggling regions tapped this tranche: Valencia (EUR 2.781bn), Catalonia (EUR 1.304bn), Andalusia (597m), Castilla-La Mancha (469m), Murcia (175m) and the Balearics (71m) (De la Fuente 2013a: 18). The second EUR 5bn tranche was designed to help repay the regions' outstanding bills to service providers, though ultimately this went unused since the government created a more comprehensive fund for this purpose – see (2).
2) In March 2012 the government set up a EUR 30bn (extendible to EUR 35bn) Fund for Financing Payments to Service Providers (*Fondo para la Financiación de los Pagos a Proveedores*, FFPP) to lend money to the regions in need to pay outstanding invoices to service providers and suppliers. In return, the regions would have to adhere to a strict adjustment programme to meet the regional deficit target set by the central

government, among other conditions. All fifteen regions of the common financing system except for Galicia used the Fund in 2012 to a total of EUR 17.104bn (with further funds going to the local authorities), with by far the largest amounts going to Valencia, Castilla-La Mancha, Andalusia and Catalonia. In 2013 the regions subsequently tapped the FFPP for a further EUR 4.565bn.[9]

3) In July 2012 the government set up an EUR 18bn Regional Liquidity Fund (*Fondo de Liquidez Autonómica*, FLA) to lend money to the regions primarily to cover debt maturities, with some limited funds to cover new financing needs and payments to suppliers too. Nine regions officially requested EUR 12.695bn from the FLA in the second half of 2012 according to the Spanish government at year-end (a figure it later updated to EUR 16.638bn in the 2014 budget presentation). Catalonia, Valencia and Andalusia borrowed by far the largest amounts, with smaller sums going to the Canaries, Castilla-La Mancha, Murcia, the Balearics, Asturias and Cantabria. In January 2013 the Fund was extended to help the regions into 2013 with the central government earmarking a further EUR 23bn to top it up, EUR 19.695bn of which was used.[10] As with the FFPP, the regions borrowing from the Fund had to comply with a strict adjustment programme.

These measures were essential to enable the regions lacking alternative financing sources to meet their needs. Six of the regions tapped all three of the financing measures in 2012 (the ICO line, the FFPP and the FLA), with Catalonia borrowing the second largest combined total (following Valencia) of nearly EUR 9bn out of over EUR 35bn across the fifteen regions of the common financing regime. In contrast, Extremadura, one of the poorest regions in terms of GDP and fiscal capacity per capita and yet one of the main beneficiaries of the common financing system, only required EUR 288m from the FFPP and did not tap the ICO line or the Regional Liquidity Fund (De la Fuente 2013a: 18). The contrast with the relatively healthier region of Madrid – which is more comparable to Catalonia in terms of its size and weight in the Spanish economy – was more striking still. Both regions started 2013 in a very different position. Catalonia was forced to make a new plea in January for EUR 9.073bn from the government's Regional Liquidity Fund for the year ahead (later increased to EUR 9.398bn). Yet the very same month, the region of Madrid managed to issue EUR 1bn of 5-year bonds on the public debt markets in the largest ever single auction by a Spanish region to start to meet its financing needs for the year. It also managed to place a further EUR 1bn of private placement notes with international institutional investors, among other smaller operations, in a sign of its continued ability to appeal to investors without needing to borrow from the various funds and credit lines set up by the central government.[11]

As many of the regions became reliant upon the funds set up by the central government and were subject to strict budgetary conditionality in return, significant progress in the fiscal discipline of the regions was made in 2012. The combined regional deficit at year-end came in at 1.76%, only 0.26% above the 1.5% target, a marked improvement on 2011. Murcia, Valencia, the Balearics, Catalonia and Andalusia missed the target again, though their performance showed signs of improvement. Nevertheless, the leverage these measures gave the central government to exercise greater control over regional finances caused endless friction. The creation of the much needed Regional Liquidity Fund in mid July 2012 via Royal Decree Law 21/2012 of 13 July was in fact repeatedly delayed throughout the first half of 2012 primarily due to stalemates between the central government and Catalonia over the fiscal discipline the regions using the Fund would be subject to, and the disputes continued thereafter. At the CPFF meeting on 12 July 2012, for example, Spanish budget minister Cristóbal Montoro angered Catalonia and several other regions by announcing that they would all still be obliged to meet the 2012 regional deficit target of

1.5%, despite the EU's decision to give Spain an extra year to 2014 instead of the original 2013 target to meet the 3% target for the general government (extended in 2013 to 2016). Montoro warned that various regions at risk of failing to comply would be called to bilateral meetings with the central government to agree additional budgetary measures. This was the first warning contemplated under the new Budgetary Stability Law. Any region which failed to implement sufficient measures to ensure compliance beyond the first warning would risk central government intervention.

Power was not entirely one-sided since pressure from the regions still exercised some constraints on the central government's actions. For example, it would have been politically very difficult for it to officially intervene in a non-compliant region that had used up all its warnings, as the Budgetary Stability Law foresees. Nevertheless, the Catalan government argued that the strict conditionality tied to the central government loans constituted a de facto intervention since the regions using these were only lent sufficient funds to remain compliant with the deficit targets and were banned from incurring additional debt from other sources. It maintained the Spanish government was expecting the regions to shoulder the brunt of the fiscal adjustment in Spain so that the central government had more room for manoeuvre. Other criticisms also grew from the Madrid regional government which, despite managing to continue to meet its financing needs of its own accord, often struggled to do so and blamed tough central government controls over regional debt issuances for reducing its ability to seize opportunities when markets conditions were propitious.

**Fuel for Catalan nationalist mobilization**

Under these circumstances, in the first half of 2012 Artur Mas started to shift away from CiU's traditional pro-autonomy stance to seek self-determination or even independence for Catalonia as he sought to combat the PP central government's attempts to exercise control over Catalan finances and its repeated refusal to grant a fiscal pact for Catalonia. At the very least, the Catalan government had long wanted a revision of the equalization mechanism in the common financing regime to ensure that it would cease to fall in the ranking of regions in terms of resources per capita. To support its case, it has frequently cited the negative balance between what the region contributes to Spain and what it receives from the central government. This deficit reached EUR 16.543bn in 2010 (around 8.5% of the region's GDP) according to the figures presented by the Catalan government in mid 2013, though depending on the method of calculation used other estimates of the Catalan deficit come closer to 5% of GDP (*El País* 2013) and none of these assume any redistribution in Spain (De la Fuente 2013b).

Governing as a minority in Catalonia since its return to office in 2010, CiU hitherto had been dependent on alliances with the Catalan branch of the PP to approve fundamental economic policies, but by mid 2012 this situation had become untenable for CiU amid growing discontent in Catalonia towards the centralising Spanish government and its austerity drive. Thus when Rajoy said no again to a fiscal pact, Mas called early elections in November 2012 in the hope of securing a sufficient majority to avoid having to rely on PP support to pass the 2013 regional budget. CiU had been caught unawares by the extent of the independence march in Catalonia in September 2012, but Mas chose to ride the wave. The fight for Catalonia's 'right to decide' – in other words, political sovereignty – became the key element of CiU's manifesto, but CiU lost ground in the elections to the pro-independence party Esquerra Republicana de Catalunya (ERC) and thereafter allied with the latter to secure its support in parliament. Rajoy agreed to consider revising the regional financing system again starting in 2014, but the separatist wave in Catalonia was by then continuing to grow regardless. The Rajoy-Mas disagreements had fed into the momentum building since 2010 in particular, when the Spanish Constitutional Court had annulled enhancements to the new 2006 Catalan statute of autonomy (see Keating and Wilson 2009, Muro 2010) previously approved by both the Catalan and Spanish parliaments and in a referendum in Catalonia.

Meanwhile, Spanish-Catalan bilateral relations were complicated further by the rise in inter-regional government tensions. For example, sparks flew in the first half of 2013 between the regions which had met the 2012 deficit target and those which had not, as the latter – led by Catalonia – argued they ought to be given a more generous deficit allowance in 2013 rather than all being subject to the same target. While Extremadura argued the Catalans should not be given a higher deficit allowance than other more fiscally compliant regions, Catalonia alleged it would not be in this position if it did not have to subsidize poorer regions like Extremadura itself via the equalization mechanism. At the same time, the Madrid regional government in particular made it very clear to the central government that a bilateral deal with Catalonia only to improve its financing position would not be acceptable.

## Future prospects

The flaws of the regional financing system combined with a chronic lack of transparency in regional finances have created a situation characterized by disparities in the treatment of different regions and smoke and mirrors, which has given politicians scope to propound different interpretations. Throughout the crisis, this situation often contributed to eroding European and international confidence in Spain and its finances. While the debate over the regional financing system in Catalonia has been symptom of and indeed overtaken by a broader clash between the Spanish and Catalan governments that is not purely economic in nature, the issue remains paramount and pressure for a revised system has grown from other parts of Spain too – especially the Madrid region, whose government made approaches to the Catalan government from early in 2013 to suggest they should join forces to petition the Spanish government for change. Yet agreeing a new reform looks set to prove more difficult than ever since the fight for resources has exacerbated the traditionally competitive dynamic among the regions. Such cross-regional competition compounds bilateral tensions, and political debates between the central government and opposition play out across both the national and regional arenas. Moreover, the anomaly whereby the Basque Country and Navarre do not contribute to the equalization mechanism looks likely to remain for the foreseeable future, not least since the PP is not in a position to further antagonise the Basque Nationalist Party (PNV) given that it might need its support in parliament were it to win the next general elections but not retain its absolute majority. Thus without a change in political dynamics it is hard to see how the next revision of the common financing model will be anything but another temporary sticking plaster that will come undone again in the near future.

Table 1: Resources per region for homogenous competences under the common regime in 2010

| | | | PRE-EQUALISATION | | | POST EQUALISATION | | |
|---|---|---|---|---|---|---|---|---|
| | Normative regional tax revenues* (EUR millions) | Adjusted population** | Fiscal capacity per capita (adj.) (EUR) | Fiscal capacity per capita (adj.) (as % of mean [100]) | Rank / 15 regions | Final resources per capita (adj.) (EUR)*** | Final resources per capita (adj.) (as % of mean [100]) | Rank / 15 regions |
| Madrid | 17,001 | 6,095,755 | 2,789 | 148 | 1 | 2,335 | 97 | 8 |
| Balearics | 2,677 | 1,104,358 | 2,424 | 129 | 2 | 2,331 | 97 | 9 |
| Catalonia | 17,163 | 7,434,588 | 2,309 | 123 | 3 | 2,281 | 95 | 11 |
| Cantabria | 1,248 | 590,968 | 2,112 | 112 | 4 | 2,734 | 114 | 1 |
| Aragón | 2,927 | 1,417,006 | 2,066 | 110 | 5 | 2,432 | 102 | 6 |
| La Rioja | 643 | 327,221 | 1,965 | 105 | 6 | 2,686 | 112 | 2 |
| Asturias | 2,190 | 1,124,410 | 1,948 | 104 | 7 | 2,492 | 104 | 5 |
| Castilla y León | 5,071 | 2,744,412 | 1,848 | 98 | 8 | 2,538 | 106 | 4 |
| Valencia | 9,016 | 5,020,576 | 1,796 | 96 | 9 | 2,134 | 89 | 15 |
| Murcia | 2,400 | 1,430,126 | 1,678 | 89 | 10 | 2,210 | 92 | 13 |
| Galicia | 4,884 | 2,968,169 | 1,645 | 88 | 11 | 2,421 | 101 | 7 |
| Andalusia | 13,161 | 8,220,687 | 1,601 | 85 | 12 | 2,224 | 93 | 12 |
| Castilla-La Mancha | 3,520 | 2,208,917 | 1,594 | 85 | 13 | 2,289 | 96 | 10 |
| Extremadura | 1,639 | 1,169,068 | 1,402 | 75 | 14 | 2,619 | 109 | 3 |
| Canaries | 2,211 | 2,192,893 | 1,008 | 54 | 15 | 2,209 | 92 | 14 |
| *Mean* | *5,717* | *2,936,610* | *1,879* | | | *2,396* | | |

*The tax revenue figures given here incorporate two of the adjustments to the official government figures recommended by De la Fuente (2012a and 2013c), namely to improve estimates of normative revenues across the fifteen regions (i.e. to remove the effect of different rates being charged in different regions) and to account for the special tax regime (REF) in the Canaries region, in order to facilitate inter-regional comparison.
** Adjusted for unit of need (based on demographic and geographic weightings)
*** After application of the Guarantee Fund, Global Sufficiency Fund, Cooperation Fund and Competitiveness Fund

*Source:* Based on Ministerio de Hacienda y Administraciones Públicas (2010 regional financing system liquidation statement) and De La Fuente (2012a and 2013c)

Table 2: Public bond issuances to institutional investors by region, 2010-2012

| Date of issue | Region | | Coupon | Term (in yrs) | Maturity date |
|---|---|---|---|---|---|
| 11-Feb-10 | Catalonia | 800 | 4.95% | 10 | 11-Feb-20 |
| 11-Feb-10 | Catalonia | 500 | E3M* + 0.95% | 3 | 11-Feb-13 |
| 04-Mar-10 | Balearics | 200 | 3.61% | 5 | 04-Mar-15 |
| 04-Mar-10 | Balearics | 300 | 4.80% | 10 | 04-Mar-20 |
| 09-Mar-10 | Canaries | 620 | 4.93% | 10 | 09-Mar-20 |
| 12-Mar-10 | Madrid | 500 | 4.69% | 10 | 12-Mar-20 |
| 17-Mar-10 | Andalusia | 900 | 4.85% | 10 | 17-Mar-20 |
| 17-Mar-10 | Valencia | 400 | 4.90% | 10 | 17-Mar-20 |
| 18-Mar-10 | Castilla-La Mancha | 400 | 4.88% | 10 | 18-Mar-10 |
| 26-Mar-10 | Galicia | 500 | 4.81% | 10 | 26-Mar-20 |
| 29-Mar-10 | Murcia | 150 | E3M + 0.88% | 3 | 29-Mar-13 |
| 30-Mar-10 | Murcia | 252 | 4.70% | 10 | 30-Mar-20 |
| 07-Apr-10 | Catalonia | 850 | 3.88% | 5 | 07-Apr-15 |
| 25-Jun-10 | Catalonia | 1,000 | 5.75% | 5 | 25-Jun-15 |
| 04-Apr-11 | Catalonia | 400 | 5.38% | 2 | 04-Apr-13 |
| 26-Apr-11 | Valencia | 400 | 5.50% | 2 | 26-Apr-13 |
| 13-May-11 | Andalusia | 500 | 5.37% | 2 | 13-May-13 |
| 26-Mar-12 | Madrid | 665 | 4.75% | 3 | 26-Mar-15 |
| 26-Mar-12 | Aragón | 150 | 4.88% | 3 | 26-Mar-15 |
| 30-Mar-12 | Castilla y León | 53 | 4.50% | 2 | 31-Oct-14 |

*E3M = Three-month Euribor interest rate

Source: Based on information provided to the author by Analistas Financieros Internacionales (AFI)

Table 3: Retail bond issuances to individual investors by region, 2010-2012

| Date of issue | Region | | Coupon* | Term (in yrs) | Maturity date |
|---|---|---|---|---|---|
| 19-Nov-10 | Catalonia | 3,000 | 4.75% | 1 | 21-Nov-11 |
| 17-Dec-10 | Valencia | 1,500 | 4.75% | 1 | 22-Dec-11 |
| 14-Feb-11 | Balearics | 300 | 4.76% | 1 | 15-Feb-12 |
| 27-Apr-11 | Catalonia | 960 | 4.75% | 2 | 27-Apr-13 |
| 02-May-11 | Catalonia | 2,234 | 4.25% | 1 | 02-May-12 |
| 27-May-11 | Valencia | 250 | 4.75% | 2 | 27-May-13 |
| 27-May-11 | Valencia | 473 | 4.25% | 1 | 27-May-12 |
| 05-Oct-11 | Andalusia | 600 | 4.25% | 1 | 05-Oct-12 |
| 21-Nov-11 | Catalonia | 2,639 | 4.75% | 1 | 21-Nov-12 |
| 21-Nov-11 | Catalonia | 1,581 | 5.25% | 2 | 21-Nov-13 |
| 21-Dec-11 | Murcia | 150 | 4.75% | 1 | 21-Dec-12 |
| 21-Dec-11 | Murcia | 67 | 5.50% | 2 | 21-Dec-13 |
| 22-Dec-11 | Valencia | 895 | 5.00% | 1 | 21-Dec-12 |
| 22-Dec-11 | Valencia | 163 | 5.50% | 2 | 20-Dec-13 |
| 15-Feb-12 | Balearics | 75 | 5.00% | 1 | 18-Jan-13 |
| 15-Feb-12 | Balearics | 200 | 5.50% | 2 | 14-Feb-14 |
| 21-Mar-12 | Andalusia | 369 | 5.00% | 1 | 21-Mar-13 |
| 21-Mar-12 | Andalusia | 145 | 5.50% | 2 | 21-Mar-14 |
| 29-Apr-12 | Catalonia | 1,531 | 4.50% | 1 | 29-Apr-13 |
| 29-Apr-12 | Catalonia | 782 | 5.00% | 2 | 29-Apr-14 |
| 09-May-12 | Murcia | 117 | 5.00% | 1 | 09-May-13 |
| 09-May-12 | Murcia | 53 | 5.50% | 2 | 09-May-14 |

*Note that the regions had to pay expensive bank fees of around 3% on top of the coupon rates for these retail bonds

Source: Based on information provided to the author by Analistas Financieros Internacionales (AFI)

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**Notes**

[1] At the time of writing, Prime Minister Rajoy has indicated that the revision of the common financing regime will start after attention has been focused in 2014 on the reform of Spain's tax system.

[2] Further complexity results from the fact that within the common regime the Canary Islands have a specific economic and tax system.

[3] The annual liquidation statements for the common financing regime are published by the *Ministerio de Hacienda y Administraciones Públicas*. Available here: http://www.minhap.gob.es/es-ES/Estadistica%20e%20Informes/Estadisticas%20territoriales/Paginas/Informes%20financiacion%20comunidades%20autonomas2.aspx

[4] Spain's public sector debt figures measured according to the Excessive Deficit Principle are published by the Bank of Spain. Available here: http://www.bde.es/webbde/es/estadis/infoest/htmls/cdp.html (figures cited as accessed on 8 February 2014)

[5] The following sections are informed by numerous articles in the Spanish press (especially *El País* and *Expansión*) and official government releases, as well as the many conversations and interviews on the subject of regional finances the author held with relevant experts in both government and the private sector over the period 2010 to 2013.

[6] Note that although the debt issued by Spain's regional governments had not been explicitly guaranteed by the Spanish government, the widespread view was the central government could not let a region default. Concerns about regional finances therefore negatively impacted Spanish bond yields throughout the crisis. In this regard, Spain fits the model propounded by Rodden (2006) whereby expectations that central governments will assume responsibility for bailing out their subnational governments are strongest in the countries where the latter rely on revenue sharing and transfers rather than just independent local taxation.

[7] Spain still just managed to meet its overall 9.3% deficit target for general government in 2010 due to strong fiscal readjustment by the central government. Here and elsewhere in the article, I give the official deficit figures announced by the Spanish government in March following the year in question (which exclude repayments owed following the liquidation of the regional financing system for prior years). Note, however, that these have often been subject to further modification at later dates, for example following revisions to GDP figures.

[8] My thanks to Madrid-based consulting firm Analistas Financieros Internacionales (AFI) for providing these figures on the financing secured by the regions in 2010 and 2011. For more information on the evolution of regional debt and financing options during the crisis, see Goikoetxea and Cantalapiedra 2011.

[9] According to provisional figures provided by the Spanish government in its 2014 budget presentation on 3 October 2013.

[10] As per note 9.

[11] Madrid did choose to tap the FFPP for EUR 1.257bn in 2012 (De la Fuente 2013a: 18) but this Fund was not viewed as an embarrassing central government 'bailout' in the same way as the Regional Liquidity Fund.