Public Investment across Levels of Government: The Case of Galicia, Spain

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Key messages

- Facing both a deteriorating financial situation and upward pressure on expenditures, Galicia had little choice but to use public investment as an adjustment variable in a tight fiscal context.

- Galicia has focused on improving the efficiency of public investment by introducing several new measures, such as the promotion of inter-municipal investments and the creation of an online platform for public procurement. The region’s response to the crisis demonstrates its willingness to innovate to alleviate its impact on public investment. However, time is needed in order to assess the impact these new measures have had on investments.

- The recent budget crisis and the need for new approaches on the budget side have created the best political environment for introducing new reforms to enhance the efficiency and transparency of investments.
1. Regional overview

1.1. Political context

Galicia is Spain’s most western autonomous community (AC), and is bordered by Portugal to the south. With only 2.8 million inhabitants, the region is sparsely populated; it accounted for 6% of Spain’s population and 5.2% of national GDP in 2010. It is characterised by a very long coastline (more than 1 700 kilometres) as well as rugged terrain.

Galicia has always preserved a strong sense of regional identity, based on its unique culture and language. After the transition to democracy, it was the third region (following Catalonia and the Basque Country) to be given the special statute of Nacionalidad Historica, in recognition of its cultural specificities. The region was granted the status of autonomous community in 1981.

Galicia has strong trade and cultural relationships with Portugal, especially with its Northern region. In recognition of the strong existing links between these two regions, Galicia-Northern Portugal was the third European European Grouping for Territorial Co-operation (EGCT, which aims at improving international territorial co-operation) and the first in Spain. Galicia also has strong relationships with Latin America, linked to the important historical diaspora that emerged from substantial Galician emigration to America.

1.2. Institutional background

All ACs have their own legislatures and executives. Galicia has an unicameral elected assembly (Parliament) formed of 75 deputies elected for a 4-year term. Besides its legislative functions, the Parliament is responsible for appointing the president of the regional executive and for monitoring policies. It is also in charge of approving the AC’s annual budget. Executive power is in the hands of the regional government (Xunta de Galicia), which is responsible for elaborating and implementing the budget, administering own taxes, etc. Municipalities, although key players in the decentralisation process, are unable to pass laws for self-government, in contrast to regional governments.

Spain’s institutional framework has been shaped by decades of regionalisation reforms. The 17 regions or AC have relatively large executive, legislative and regulatory powers. However, the decentralisation process in Spain has been asymmetric across regions. ACs with a history of self-governance, Galicia in particular, received their responsibilities in the 1980s. The other regions received additional responsibilities at the end of the 1990s, mostly in the education and health sectors. Today, the competencies of all ACs are very similar.

For instance, competencies relative to universities were initially only devolved to the Nacionalidades Historicas. Facing an asymmetrical distribution of powers, other ACs started to bargain with the central government (CG) for greater responsibilities. The CG finally signed the Agreements of Autonomy in 1992, devolving to all ACs competencies similar to that of the Nacionalidades Historicas – in all sectors except health and education. The CG decentralised these latter competencies in the late 1990s and early 2000s; universities became the responsibility of ACs between 1995 and 1997, primary/secondary education between 1997 and 2000, and health between 2001 and 2003 (Alonso Sanz, 2009). Large reallocations of funds and human resources between the CG and ACs accompanied the decentralisation of these essential competences.

Further pressure for decentralisation started to rise in the 2000s, linked to the desire of a few ACs (the Basque Country and Catalonia) for greater independence. Both of these regional Parliaments approved (in 2004 and 2005 respectively) new statutes of autonomy, devolving further competencies to the AC level. In both cases, the texts were submitted to the national Parliament and bilateral negotiations were conducted.
with the CG. After extensive negotiations, the new Catalan statute of autonomy was approved by both the national Parliament and regional referendum. In contrast, the Basque plan was considered unconstitutional by the national Parliament and rejected, as many people feared it could lead to regional secession.

Due to the bilateral and asymmetric nature of this decentralisation process, the extent to which responsibilities and resources were transferred differs across ACs, which has often created competition among them for additional responsibilities and resources (OECD, 2007). For instance, while decentralising the health sector in the early 2000s, more than 140,000 public servants under the responsibility of the CG were “transferred” to the ACs (Alonso Sanz, 2009). Since the decentralisation phenomenon has been accompanied by extensive transfers of money and human resources to regional governments, it is not surprising that ACs have been determined to get the most of limited resources during the process.

Under the Spanish Constitution, neither the CG nor the ACs can unilaterally backtrack on the autonomy statutes. Functions and competencies can be exclusively assumed by the regions or by the CG, or be shared (Table 1), as stipulated in Section 149.1 of the Constitution. For instance, immigration and defence are exclusive competencies of the CG, whereas environmental policy and the general organisation of self-government (such as the aforementioned possibility of amending the statute of autonomy) are exclusive competencies of Galicia.

Table 1. Distribution of competencies between autonomous communities and the central government

<table>
<thead>
<tr>
<th>Central government</th>
<th>Autonomous regions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exclusive legislative and executive competence</td>
<td>Exclusive legislative and executive competence</td>
</tr>
<tr>
<td>• Immigration and emigration</td>
<td>• General organisation of self-government</td>
</tr>
<tr>
<td>• International affairs</td>
<td>• Changes in municipal boundaries and creation of supra-municipal bodies</td>
</tr>
<tr>
<td>• Defence</td>
<td>• Land-use planning and housing</td>
</tr>
<tr>
<td>• Justice</td>
<td>• Infrastructures of regional scope</td>
</tr>
<tr>
<td>• Commercial, penal, labour, industrial and intellectual property and civil law</td>
<td>• Agriculture, forests, and river fishing</td>
</tr>
<tr>
<td>• Foreign trade</td>
<td>• Domestic trade and fairs</td>
</tr>
<tr>
<td>• Monetary system, exchange regime, state treasury and debt</td>
<td>• Tourism</td>
</tr>
<tr>
<td>• Infrastructures of national scope</td>
<td>• Culture</td>
</tr>
<tr>
<td>• Sea fishing</td>
<td>• Social services</td>
</tr>
<tr>
<td>Power to set basic legislation</td>
<td>Competence subject to basic state legislation</td>
</tr>
<tr>
<td>• Banking and insurance activities</td>
<td>• Economic development</td>
</tr>
<tr>
<td>• Health care</td>
<td></td>
</tr>
<tr>
<td>• Social security</td>
<td></td>
</tr>
<tr>
<td>• Education</td>
<td></td>
</tr>
<tr>
<td>• Local self-government</td>
<td></td>
</tr>
</tbody>
</table>


Galicia is divided into 315 municipalities and 4 provinces. Until recently, provinces had few political or budgetary powers, but they are gaining more and more importance within the regional framework. As far as local authorities are concerned, competences depend on the size of a municipality’s population (Table 2). Costly services are provided by the AC for small municipalities.
Table 2. Main municipal competencies in Galicia

<table>
<thead>
<tr>
<th>All municipalities</th>
<th>Municipalities over 5,000 inhabitants</th>
<th>Municipalities over 20,000 inhabitants</th>
<th>Municipalities over 50,000 inhabitants</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Waste collection</td>
<td>• Treatment of collective waste</td>
<td>• Civil protection</td>
<td>• Urban passenger transport services</td>
</tr>
<tr>
<td>• Supply of drinking water to households</td>
<td>• Provision of social services</td>
<td>• Fire prevention and extinction</td>
<td>• Protection of the environment</td>
</tr>
<tr>
<td>• Surfacing of public local roads</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


1.3 Socio-economic background

Galicia was the Spanish region with the highest average per capita GDP growth between 1995 and 2009. Its GDP has doubled since Spain’s integration into the European Union (EU) 25 years ago, reaching roughly EUR 60 billion in 2011 (Figure 1). This represents EUR 21,000 per capita, which places Galicia among Europe’s “transition regions” (between 75% and 90% of the EU average level of per capita GDP). Since the region has only passed the 75% threshold in recent years, Galicia will, for the purposes of EU Cohesion Policy, pass from a “convergence region” (below 75% of the EU average) to a transition region in the new programming period, which begins in 2014. This will have significant repercussions for future European funding.

Figure 1. Evolution of GDP per capita in Spanish autonomous communities

Source: OECD regional accounts.

In terms of unemployment, Galicia also fares better than most other Spanish ACs. Its 15.4% unemployment rate in 2010 was well below the national average of 20.1%. As in the rest of Spain, youth unemployment is high, reaching 35.4% in 2010.

The most important sectors for Galicia’s economy are services (45.8% of regional GDP), industry (12.7%) and construction (10.1%). A large part of employment is concentrated in commercial activities, most of all in family businesses. Although companies in Galicia are mostly SMEs, a few multinational
firms such as Inditex (Zara), PSA (Peugeot) and Pescanova, account for a large share of the region’s economic activity and exports.

1.4. Main strengths and challenges for Galicia

A number of geographical and socio-economic challenges could obstruct economic performance in the future. First, Galicia is relatively inaccessible, which has been, and still is, a major obstacle to its development. Its location at the western end of Spain (and Europe), together with its rugged topography, explain why most transport infrastructure is relatively recent. Highways were only built 20 years ago and there are only a small number of railway lines, most of which are of poor quality. This situation is partly compensated by the existence of four relatively important ports, whose related activities are mainly fishing, maritime tourism and ocean freight (the port of Vigo in particular is one of Europe’s most important fishing ports).

Second, there are major and growing disparities in demographic and economic development between the coast and the inland territories. The population is concentrated in a few towns, mostly located on the coast, and in the municipalities surrounding them. Vigo and A Coruña are the largest cities, with respectively 300 000 and 250 000 inhabitants. The urban areas are economically well developed and benefit from good-quality infrastructure. In contrast, inland territories are sparsely populated and predominantly rural. They are characterised by a very large network of small cities that account for the largest share of the Galician population. In consequence, inland territories are often relatively poorly served by public infrastructure.

Third, the region is facing serious demographic issues. The birth rate in Galicia is lower than in the rest of Spain, despite the implementation of pro-natal policies. Galicia has the lowest immigration level (the region hosted only 2% of all foreign migrants in Spain between 1996 and 2005). The consequence of these two developments is a rapidly aging population. Since 1990, the share of population aged 0-14 dropped by 40%, whereas the share over 65 increased by 50%.

As a consequence of these socio-economic trends, Galicia is facing three serious challenges with respect to public service provision and investment.

First, its aging population implies that the share of inactive people will increase while fewer people will participate in the labour market, which will add to the demand for certain public services while reducing the tax base. This will make it more and more difficult to achieve good public service provision.

Second, the region’s sparse population is a challenge for developing infrastructure networks, be it for transport, water or other services. Investments are often not profitable because they do not benefit a sufficient number of people. This makes it very difficult to provide good quality public services throughout the territory and discourages private companies from investing.

A more short-term challenge is the difficulty of securing investment financing. Because Galicia will no longer be a convergence region, funding from the EU will decline from 2014 onwards. Furthermore, the regional match funding of European funds will likely increase, so co-funding requirements could become more difficult to meet. Since the EU funds represent a large share of the region’s revenues, this could have a very negative impact on the room for manoeuvre left for regional investment. These difficulties are magnified by deficit targets set by the central authorities. Financial challenges faced by Galicia will be considered more in depth in Section 2. To compensate for its degraded financial capacity, the region must enhance the efficiency of its investments, in particular by improving its technical and administrative capacities and enhancing co-ordination. Although there is room for improvement concerning inter-sectoral co-operation, Galicia has developed co-ordination at the municipal level with very encouraging results.
The region has also focused on improving technical and administrative capacities through the creation of sectoral agencies for public investment and the introduction of an online platform for public procurement.

2. Public investment in the region

2.1. Key priorities for public investment in the region

Public investment was more affected by the crisis in Galicia than in most other ACs: it was cut by 30% over 2007-2010 and by 54% over 2008-2011 (Figure 2). Cutting public investment allowed Galicia to keep other expenditures relatively stable. As a result, public investment as a share of total public expenses has fallen sharply since the beginning of the crisis (Figure 3).

As far as the composition of public investment is concerned, a major share (almost 50% in 2011) of investment in Galicia is directed towards the infrastructure sector, i.e. high capacity roads, schools, hospitals, etc. (Figures 4 and 5); investments in water (infrastructure and maintenance) account for another 30% and innovation for almost 20%. Renewable energies account for only 2% of total public investment, although Galicia is a leading region in Europe in this sector. Most investments in renewable energies are made by private companies, albeit most often under the influence of government policies that incentivise such investments. Major investments in Galicia include, for example, investments in the framework of the Regional Operation Program or a high-speed train linking the region to Madrid (Boxes 1 and 2).
Box 1. The Regional Operational Programme

The Regional Operational Programme (ROP) for Galicia is a large-scale EUR 2.7 billion programme, EUR 2.2 billion of which are financed through the ERDF. The programme corresponds to approximately 6.2% of total EU funding to be spent in Spain under Cohesion Policy in 2007-2013. Galicia has chosen to put the knowledge-driven economy, transport and energy at the core of its development strategy as well as environment and water management. Along with the EUR 2.2 billion of European funds, national contributions account for EUR 548 million.

Box 2. AVE Madrid-Galicia

The construction of a high-speed railway (AVE: Alta Velocidad Española) between Madrid and Galicia is under way. This project regroups investments of over EUR 2.2 billion; approximately half of the financing is made up of EU funds.

Although this rail line could help to alleviate the relative inaccessibility of Galicia, it has generated an intense public debate. While proponents of the construction insist on its economic coherence and strategic importance for the region (linking Galicia to the rest of Spain), opponents argue that the line will not be profitable.

This investment was scheduled and prioritised by the central government, and almost all of the funds engaged come from either the CG or the EU. The AVE line remains a top priority for regional authorities, part of their strategic objective to improve Galicia’s connection to the rest of Spain.

2.2. Financing public investment

Overall, the current budget of Galicia’s regional government (current revenue minus current spending) decreased significantly between 2007 and 2010. The total budget evolved in a similar way, passing from a positive to a negative balance in 2010 (Figure 6). In contrast, the capital balance, or the difference between regional or local capital funds and capital transfers received (from supra-national, national or sub-national authorities) on one side, and capital funds spent (either by the AC itself or transferred to municipalities or companies) on the other, has been negative but improving. It will be shown that this better performance is mostly the result of cuts in capital transfers to local governments and reflects
the fall of public investment, which has been used by regional authorities as an adjustment variable to meet deficit targets.

**Figure 4. Development of the budget balance, current balance and capital balance of Galicia**

![Graph showing the budget balance, current balance, and capital balance of Galicia from 2007 to 2012.]

*Note:* Planned value for 2011 and 2012.

*Source:* Galician Institute of Statistics.

**Revenues**

Recent trends in revenues (whether from tax revenues or transfers from the CG) point to a deterioration in the financial capacity of Galicia’s regional government, as do borrowing conditions.

The region has been facing a significant fall in tax revenues. As Spanish ACs are relatively autonomous, they are granted a number of own taxes, with the CG. Regional governments in Spain receive a significant share of the CG’s tax revenue; in particular, they used to receive 33% of personal income tax and 35% of VAT. A reform of the funding of the Spanish ACs was passed in 2009, increasing the amounts received by ACs in shared taxes: ACs now receive 50% of both VAT and personal income tax. An equalisation grant that accounts for the difference between revenues and expenditure needs is redistributed among all ACs, except for the Basque Country and Navarra, which have distinct financing arrangements.

Indirect taxes (VAT, taxes on insurance premiums, etc.) have been the most affected by the crisis (Figure 7), decreasing by more than 30% between 2007 and 2010, including a fall in VAT by more than 40%. In comparison, revenues from direct taxes only started to decline in 2010. As a result, the share of tax revenues in total budget financing (tax revenues, transfers from the CG and debt) dropped from 40% in 2007 to 31% in 2010.

The expected increase in tax revenues for 2011 and 2012 probably reflects the changes introduced by the 2009 reform of sub-national governments’ finances. Moreover, the Galician government is planning a series of tax increases and to fight tax evasion between 2012 and 2014 in order to restore public finances.
Transfers from the CG account for almost half of total revenues in Galicia. They rose over the 2007-2009 period (due in particular to the Spanish stimulus package), but have declined since 2010, reaching a level below their pre-crisis value (Figure 8). This evolution is not surprising, as general transfers from the CG to ACs are calculated based on CG revenues. Hence, the recent trends in central tax revenues have automatically affected transfers to Galicia.

Planned budgets for 2011 and 2012 show a sharp anticipated decline in CG transfers: more than 50% between 2010 and 2012. Although this decrease can be partially explained by the economic turmoil, it also reflects the impact of the aforementioned 2009 reform. Indeed, the reform reduced the amount of equalisation grants, as the new system provides only partial equalisation (80% of needs instead of 100%). Hence, there is increased reliance on own/shared taxes and a reduced share of transfers in the revenue mix of sub-national governments in Spain. According to Galicia’s forecasts, the rise in tax revenues will not compensate for the decline in central transfers. This could have major impacts on expenditures, in particular on investments.
Galicia’s debt has risen sharply since the beginning of the crisis (Figure 9). Previously, the region had relatively small levels of debt, but debt has almost doubled since 2007 reaching 12.8% of regional GDP in January 2012 – ranking 6th out of the 17 ACs in terms of debt. The government has used debt to compensate for the decline in taxes and central grants mentioned above. Interest charges have grown as a result of both a larger volume of debt and high interest rates. However, the introduction of deficits targets by the central authorities is likely to interrupt this trend, at the expense of expenditures. In order to reach the CG’s ambitious deficit targets, Galicia has already planned a series of expenditure cuts.

Part of the increased interest charges (Figure 10) can also be explained by the successive downgrading of Galicia – albeit linked to the CG’s grading – by rating agencies, and by increasing difficulties with access to financial intermediation. To help the regions get through their financial difficulties, the CG recently established a EUR 18 billion liquidity fund. Galicia has not had to tap this fund yet, since it still fares better than most other ACs in terms of fiscal performance. The region’s 2011 deficit amounted to 1.6% of GDP; among the Spanish autonomous communities, Galicia was the closest to meeting the CG-imposed deficit objective of 1.3% of GDP.

**Figure 6. Debt**

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt (EUR millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>4,000</td>
</tr>
<tr>
<td>2008</td>
<td>5,000</td>
</tr>
<tr>
<td>2009</td>
<td>6,000</td>
</tr>
<tr>
<td>2010</td>
<td>7,000</td>
</tr>
<tr>
<td>2011</td>
<td>8,000</td>
</tr>
</tbody>
</table>

**Figure 7. Repayment of debt**

<table>
<thead>
<tr>
<th>Year</th>
<th>Repayment (EUR millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>400</td>
</tr>
<tr>
<td>2008</td>
<td>300</td>
</tr>
<tr>
<td>2009</td>
<td>200</td>
</tr>
<tr>
<td>2010</td>
<td>600</td>
</tr>
</tbody>
</table>

*Source: Bank of Spain.*

*Source: Galician Institute of Statistics.*

**Expenditures**

The crisis had a major impact on expenditures. At the central level, the CG has approved a rule linking public spending to GDP (Royal Decree Law 8/2011), by which expenditure growth will not exceed average GDP growth, in nominal terms, considering a nine-year period. This rule is directly applicable to the CG itself and to some local governments (provinces, ACs or province capital cities and municipalities over 75,000 inhabitants).

At the regional level, the Economic and Financial Rebalancing Plan of Galicia for 2012-2014 aims at decreasing expenditures by almost EUR 200 million over a three-year period. Expenditure cuts in 2011 have already led to estimated savings of EUR 40.3 million, but this is well below the planned value of EUR 75.5 million. Most of the planned cuts in current expenditures concern public employment.
The main components of Galicia’s expenditure structure include social protection and health care, education and public administration (Figure 12). For 2010-2011, the regional government tried to preserve budgets for education and health, which were considered to be priorities. However, even those sectors are currently affected by austerity measures. In addition to the general cut in public wages carried on by the central government, the Galician regional authorities have implemented measures in order to extend teachers’ working hours instead of hiring new teachers, and reduced the funding of sick leave benefits for public workers.

The main adjustment variables used by the regional government in its cuts so far are investment (30% decrease between 2007 and 2010, while on average Spanish regions decreased their public investment by 43.5%), current transfers and capital transfers to local governments and companies (both public and private). In particular, current transfers to local authorities were anticipated to decline sharply in 2011 and 2012.

**Evolution of capital transfers**

Capital transfers received by the region have declined since the beginning of the crisis. External funds – and European funds in particular – have remained relatively stable, which explains why they account for such a large share of public investment funding in 2011. EU funds were associated with high
levels of absorption (around 99%) until 2006. This has changed a little with the growing economic difficulties since, but absorption in Galicia remains above 90%. However, the decline in capital transfers from the CG and the future the decline in EU funds (as a result of Galicia’s exit from the EU’s convergence regions in 2014) will reduce the regional government’s room for manoeuvre in terms of investment.

In order to face the future decline in EU funds in 2014, in 2009 the Fundación Galicia Europa launched the Convergence Regions on the Way to Cohesion (CROWC) initiative. Uniting with other regions that are leaving the convergence category, they asked for the creation of a “safety net” consisting of an endowment up to two-thirds of the EU support they received over the 2007-2013 period for 2014-2020. Whether or not they will receive such funding is currently under discussion at the European level.

Galicia cut capital transfers to local authorities and companies by 61% between 2007 and 2010. As a result, the capital balance has improved since 2008, but this was not enough to compensate for the decline in the current balance. Moreover, such a sharp cut in capital transfers to local authorities could automatically reduce investment at the municipal level. This impact is essential to consider since municipal investment accounted for more than twice the investment by the region (EUR 2 500 million in 2009). Cuts in capital transfers to private and public companies could further affect both private and public investment.

3. C-o-ordination for public investment across levels of government

3.1. Vertical co-ordination between the region and the CG or other supranational authorities

Using agreements and co-financing to co-ordinate with the central government

The asymmetric nature of Spanish decentralisation complicates the management of relations between the CG and the ACs. This bilateral, asymmetric and competitive interaction is reflected in the management of sub-national public investments. The ACs’ current expenditure is financed by a mixture of taxes, tax-sharing arrangements and unconditional transfers negotiated in a multilateral forum (Council of Fiscal and Financial Policy, composed of officials from the CG’s Ministry of Finance and ACs). In particular, equalisation grants (between all ACs except the Basque Country and Navarra) result from negotiations in the council over formulae. These general transfers finance current expenditures and are based upon an equalisation formula. A second main category of transfers from the CG concerns capital expenditures. These funds are managed through bilateral co-operative agreements, so-called convenios de colaboración, between the CG and the various ACs. A convenio is an agreement specifying the obligations of both signatories, i.e. the CG and an AC, for developing a concrete project. Both parties are free to decide whether they want to sign such an agreement. This form of bilateral funding is not exclusively limited to the funding of investments and can be applied to any project that is not recurrent in nature. Similar bilateral agreements are also signed with the CG for attributing EU funds to regions (for example in the case of the Technological Fund mentioned in Box 3).

Through those bilateral agreements, which determine the objectives of each investment, the CG has an important role in regional development and in influencing the long-term strategic planning of ACs, as convenios de colaboración are earmarked, and regions must sign those agreements in order to benefit from central funds. In parallel, the CG directly funds any investment of general interest, like for example airports, roads and waterways crossing more than one AC. Such projects are often under the responsibility of the CG only – although in many cases ACs and municipalities also engage own resources (for instance in the case of water investments). Thus, the sub-national authorities sometimes contribute to make general interest investments possible in their own territories.
Very little legislation exists regulating the allocation of funds within the framework of *convenios de colaboración* (OECD, 2007). Indeed, the legislation is limited to a set of general rules of procedures, which is a source of great flexibility. Although they are not permanent in nature, *convenios de colaboración* can be extended over time (either by automatically extending the agreement period or signing another one). Terms of the agreements can be re-negotiated between the parties without having to start the process over. Besides their flexibility, *convenios* are also very transparent, as they are published in the *Official Bulletin* of the CG. According to law, each *convenio* must have a monitoring commission responsible for solving problems of interpretation and compliance with the terms of the deal. When these arbitration mechanisms fail, the administrative courts are responsible for solving conflicts between levels of government. Ultimately, the Constitutional Court can intervene, when disagreements are linked to the distribution of competencies between the CG and ACs.

The use of these bilateral agreements between the CG and ACs has been a way to preserve a degree of earmarked funding in a context of strong regionalisation, where more and more powers were devolved to ACs. With the exception of Navarra and the Basque Country (which have a different budgetary framework), the ACs sign a large number of *convenios* with the CG every year (an average of 59 each in 2010). Galicia signed 65 *convenios de colaboración* in 2010, which accounted for 2% (EUR 63 million) of the CG’s total bilateral *convenios* funds. However, Galicia is relatively well positioned today in terms of economic performance and fiscal consolidation compared to other Spanish ACs, which tends to improve its bargaining stance *vis-a-vis* the CG when negotiating future investment agreements. From 2011 onwards, signature of *convenios de colaboración* between the CG and ACs that breach the objective of budget stability will be subject to the drafting of a binding report issued by the Spanish Ministry of Economics and Finance.

The allocation of CG funds via *convenios de colaboración* has evolved in the same way as the CG’s current transfers, increasing after 2007 and with a sharp decline in 2010, which further reduces the region’s financial capacity for investments (Figure 13). In the face of the CG’s financial difficulties, co-financing of bilateral agreements by ACs has recently escalated: the share of regional funding reached 47% in 2010, where it was only 24% in 2007.

Figure 10. **Funding from the Spanish state to Galicia through bilateral agreements**

![Funding from the Spanish state to Galicia through bilateral agreements](image)

*Source: Informes sobre los convenios de colaboración Estado-Comunidades Autónomas suscritos durante 2010.*

*Convenios de colaboración* are negotiated on a sectoral basis, distributed between the different Spanish ministries. This framework is representative of the sectoral vertical approach of multi-level co-ordination. Indeed, very little inter-sectoral co-ordination exists in Spain, be it at the national or regional levels (see Section 3.3). In 2010, most agreements signed between Galicia and the CG concerned the environment, rural and marine affairs, education and health sectors (Figure 14).
Regional public investments in Spain also receive important financial support from the European Union. In the case of Galicia, EU structural funds represent the most important financial source for public investment, accounting for 32% of overall funding in 2011. This share has risen sharply over the last few years because of the decline in other revenues. Yet, the allocation and management of EU funds is, to a large extent, determined by the central government as it often manages the distribution of EU funds across ACs taking EU criteria into consideration.

**Box 3. The Technological Fund**

The allocation and management of EU funds is often determined, to a large extent, by the central government. A good example of the CG’s influence over the distribution of EU funds is the allocation process of the Technological Fund (Fondo Tecnológico) framework. Financed by the European Regional Development Fund (ERDF), it is intended to promote regional R&D in Spain and is directed in priority to companies located within convergence regions (70% of the funds must be allocated to companies in the four Spanish convergence regions: Andalucia, Castilla la Mancha, Extremadura and Galicia).

Companies apply directly for funds to an organisation under the direction of the Spanish Ministry of Economy. Projects are selected based upon a series of criteria: companies’ revenues dedicated to R&D, strategic interest of developed technologies for the Spanish economy, etc. The allocation of these funds is thus decided by the CG since a national body is responsible for selecting projects. Galicia does have influence over the distribution of funds, however: the region is responsible for producing a preliminary evaluation of each project, assessing whether it is compatible with regional needs. A project cannot be selected if this report is not favourable.

Galicia’s share of the Technological Fund has increased significantly over the last few years thanks to the region’s relatively good (compared to other ACs) fiscal performance and to modifications in funding requirements. Until 2010, only 5% of the Technological Fund was granted to Galicia, mostly because the minimum investment required used to be EUR 5 million, which made it very difficult for small Galician firms to apply.

In 2011, the regional government of Galicia and the CG’s Ministry of Science and Technology signed an agreement with the aim of making specific calls for proposals (financed through the ERDF Technological Fund) adapted to Galicia. The call had two specific objectives: increasing the share of the Technological Fund allocated to Galicia and fostering high-impact R&D projects in the region.

In order to promote the participation of Galician SMEs, the Galician government negotiated a decrease in the minimum

**Figure 11. Breakdown of Galicia’s agreements with the CG by ministry (2010)**

Source: Informe sobre los convenios de colaboración Estado-Comunidades Autónomas suscritos durante 2010.
required budget for projects, from the usual EUR 5 million to EUR 1.5 million. The aim of this decrease was to engender projects more suited to the Galician business tissue. Additionally, financial incentives were used to promote project applications – as funding in the form of a fully covered grant and not through the usual combination with stretches of reimbursable loans. The first call for proposals was launched in Galicia in 2011 with a budget of EUR 30 million. A total of 26 R&D projects were selected and funded, involving 106 companies, 65 of which were SMEs (61%).

3.2. Co-ordination between the region and lower levels of government

Moving from earmarked grants to non-earmarked transfers

Vertical transfers between the regional government and municipalities have been conducted for a long time, mainly through earmarked grants. The costs for municipalities associated with application processes have led the regional authorities to rethink this institutional arrangement. Indeed, application costs were sometimes disproportionate in comparison to the amounts received from the regional government. As a result, most regional government grants for municipal investment currently take the form of general purpose mechanisms (non-earmarked grants), instead of grants that specify concrete outcomes (earmarked grants) (as in the case of the Local Co-operation Fund described in Box 4).

Box 4. The Local Co-operation Fund

A good example of the shift from earmarked to non-earmarked grants can be found in the evolution of the Local Co-operation Fund (Fondo de Co-operación Local).¹ The fund was created in 1990 with the aim of reducing inter-municipal disequilibrium in terms of service provision and infrastructures, and has become more and more important over time. This fund is redistributed among all municipalities. Since 2000, the Local Co-operation Fund is granted a share of the regional budget (around 2.8% in 2010). In 2002, grants distributed by the fund passed from earmarked to non-earmarked, with a new system of “automatic” distribution based on specific and explicit criteria such as the number of inhabitants or the surface area of a municipality.

Note: 1. See Ramos Prieto (2011) for more details.

Simplifying horizontal co-ordination across sub-national governments

Initially, municipal co-operation was only possible through the creation of an inter-municipal body, which was a very long and bureaucratic procedure, under the condition that the financial risk had to be assumed by one municipality only. As a result, co-operation at the local level was not much developed.

Co-operation procedures have been simplified through the introduction of “hard” and “soft” inter-municipal agreements. As far as “soft” agreements (i.e. voluntary) are concerned, a new type of contracting between municipalities has been developed (inter-municipal convenios de colaboración), which are more flexible than the previous system and allow financial risks to be distributed among municipalities. The regional government is trying to promote this kind of “soft co-operation” among municipalities as a step towards a more advanced system of strong municipal associations. Central and regional governments are exploring reforms to promote greater inter-municipal co-operation, with a view to promoting eventual mergers of municipalities on a voluntary basis. Incentives are used to promote inter-municipal co-operation. In particular, “soft” agreements are promoted through financial incentives, as funding from the region is given in priority to projects involving several municipalities. This has greatly increased the number of inter-municipal investment projects. However, as this initiative is recent, it is too early to assess whether it has had an impact on regional investment. Co-operation can vary across sectors (Box 6).
“Hard” (i.e. imposed) inter-municipal co-operation has only been used in one urban zone (Vigo), through the imposition of inter-municipal service provision by law. The creation in recent months of the Metropolitan Area of Vigo, a municipal association of 14 municipalities defined by the regional government, was based upon previous history of “light co-operation” among 12 of the 14. This imposed inter-municipal co-operation aimed to recognise the de facto reality of the urban area formed by these municipalities, improve service provision (for transport, water, social services) within the area and increase efficiency through the introduction of common expenditures.

Box 5. Sectoral inter-municipal co-operation in Galicia

The question of the optimal scale for investment seems particularly relevant in the water sector. Municipalities must provide their inhabitants with drinking water, and municipalities over 5,000 inhabitants must also manage the treatment of collective waste. This devolution of competences implies very large costs for small municipalities. This can explain why “soft” inter-municipal agreements tend to be very popular in this sector.

Two pilot projects have been introduced for evaluating the economies of scale achieved by managing the integrated water cycle (water provision, sanitation, treatment of collective waste, etc.) at the inter-municipal level. The Consorcio del Louro will come into force in mid-2013 and will regroup four municipalities around the Louro River, while the Consorcio de Aguas de Valdeorras (launched in October 2012) regroups nine municipalities in a very rural, sparsely populated area.

Local co-operation is also developed in other sectors by involving municipalities in the urban mobility plan (plan for public transport) developed by the regional government. This plan concerns the seven biggest cities in Galicia, regrouping around 50% of the population. It aims to introduce a common pricing policy for the whole area, to integrate inter-urban transport lines (regional competency) with intra-urban lines (municipal competency), to enlarge the supply of public transport and to improve information about transport. Other areas of increased co-operation include preventing and managing risks (mainly with respect to fires), culture and sports, and infrastructure.

3.3 Cross-sectoral co-ordination

From Galicia’s perspective, cross-sectoral co-ordination is a major challenge in Spain, especially as far as vertical co-ordination is concerned. Line ministries at the CG level often seem to take purely sectoral approaches to investment financing. Galicia reported to the OECD Regional Questionnaire that no multi-sectoral co-ordination exists between the CG and regional authorities as far as convenios de colaboración are concerned.

Galicia has developed a multi-annual strategic plan (Plan Galicia) that attempts to integrate policies across different sectors and that could help alleviate this problem at the regional level. This master plan regroups several regional-level sectoral plans for road infrastructure, transport, water, innovation, etc. Structuring these sectoral plans within the same document is intended to avoid conflicting objectives and improve policy outcomes. Although Plan Galicia allows for greater sectoral co-ordination, there is still room for improvement. In particular, the alignment of sectoral objectives and implementation could be addressed as a future step in the regional harmonisation of sectors.

4. Building sub-national capacities for effective public investment

4.1. Strategic planning and horizontal co-ordination mechanisms

Engaged citizens and firms

The regional government has been willing to engage citizens – and, to a lesser extent, firms – in the development of the numerous sectoral plans. Galicia responded to the OECD Regional Questionnaire that citizens were involved in the elaboration of the regional strategy.
Citizens were consulted in particular in the water and infrastructure sectors. A new sectoral body (the Council for Sustainable Use of Water) is being created with the participation of civil society (citizens, academics, etc.). The council will be a tool for dialogue with the civil society for making public information public on changes in the water provision framework and water regulation. The council will also be involved in all future regulation regarding water.

Citizens were also consulted on the elaboration of a major plan for road infrastructure. The Plan MOVE 2009-2025 is a multi-billion euro plan subdivided into eight different programmes, including plans at the municipal level for the seven biggest cities in the region. Funding involves resources from the EDRF, the CG and own funding. Actions to improve alternative modes of transport (such as the creation of parking lots within cities, pedestrian or bicycle lanes) were developed in co-ordination with the regional transport authorities.

Galicia’s response to the OECD Regional Questionnaire indicated that private actors are not involved in planning public investment. However, one example of consultation with the private sector was during the development of an electronic public procurement platform; associations of Galician companies were engaged in the establishment of this new tool.

4.2. Financing public investment and involving private actors

Private actors have not been very involved in the implementation of projects as PPPs have not been used much in Galicia. The regional government has so far only relied on PPPs for a few large-scale projects (for instance, in the construction of highways – autoestradas de Galicia). Currently, two PPP projects are being implemented and three are operational. However, the crisis has also had a negative impact on the use of this type of contract, as access to funding by private companies has become more difficult and more expensive. This explains why no other PPPs are currently planned. Galicia recently made two calls for tender for PPPs but was not able to find companies which to contract.

4.3. Organisational and management capacities

Structure: Departments/agencies involved in designing and financing public investment in the region

In 2011-2012, several public agencies were created at the regional level with a special institutional framework (the agencies for infrastructure, innovation or public modernisation are a few examples). These agencies co-ordinate their activities with the CG through a council that brings together both the CG and AC representatives. The creation of these public bodies aims to increase flexibility and to introduce a system of management based on contracts and performance indicators. Moreover, some of these agencies may be funded by own taxes and fees, which is seen as an incentive for better management.

The Galician Infrastructure Agency was created in 2011. One of its objectives was to develop management by objectives and monitoring of results. The rationale for its creation was based upon the flexibility of this new structure: less bureaucratic than previously used alternatives with the right to generate own revenues, in particular via the creation of new user fees.

In parallel to the development of the agencies, the regional government should focus on enhancing their accountability and oversight mechanisms. Indeed, although agencies can bring many advantages in terms of managing public investment, they can potentially have a negative impact on transparency. In particular, it could be more difficult for citizens or external observers to assess an agency’s contribution to regional development, as statistics for agencies are often distinct from those of the regional authorities.

As they were only created recently, it is difficult to assess whether these agencies have had a positive impact on investment effectiveness so far.
Staffing capacity (HR capacities)

Capacity challenges for public investment can arise from a lack of human capital at the regional level. There are concerns about the scarcity of know-how among public administration employees and about the long-term consequences of severe constraints in human resources management in the regional administration. Galicia reports having difficulty attracting skilled staff and that salaries in the public administration cannot compete with those of the private sector. Moreover, the regional government cannot compete with the CG or the private sector in terms of long-term employment and career evolution. The lack of human resources is also identified by the region as a key challenge for managing public procurement.

The creation of the public agencies mentioned above could be a way of improving the human capacity problem. For now, employees of these agencies are exclusively regional public servants, but it is planned that the agencies will be able to have their own staff and to hire professionals from private companies and experts. This could alleviate this problem.

4.4. Efficiency, integrity and transparency

Reaching an efficient scale for public investment

As mentioned in the previous section, the Galician authorities have focused on two tools in order to improve the efficiency of public investment through economies of scale. First, they have imposed mergers between the municipalities of the Vigo metropolitan area. Second, they introduced regional financial incentives for horizontal co-operation between municipalities, aiming to achieve an effective scale for public investment.

The regional government of Galicia is also trying to achieve a scale for investments through the re-centralisation of some services. When municipalities are not large enough or do not have the resources necessary to implement certain services, the regional government can offer to provide them instead. These services include tax collection and investment-intensive services like water provision and waste management (which are competences of all municipalities regardless of their size). For example, it is planned that municipalities will soon be able to delegate the management of sanitation to the regional government on a voluntary basis if they do not feel they have sufficient technical or financial resources to provide good-quality services (sanitation usually represents 30-40% of total water cycle costs). Such services represent very high costs for small municipalities. Hence, delegating them to higher levels of government allows them to realise economies of scale and improve the efficiency of public investment.

Enhanced public efficiency and transparency in public procurement through a new online platform

Galicia recently launched a new online platform (www.conselleriadefacenda.es/sicon) in order to develop online procurement, which could have a positive impact on the efficiency and transparency of public investment in the region. The main goal of the platform is to integrate all public entities and private companies in a one-stop-shop for public procurement. The procurement platform is divided into four distinct sections.

The first section aims to share public procurement offers, outcomes and public management procedures with all public entities, including municipalities. This component regroups all calls for tenders linked to AC-related public bodies. Around half of municipalities have already registered.

The second section regroups information relative to companies. As public tenders must be registered on this platform, the regional government has been able to centralise information on about 3 500 companies so far. This system will allow the length of future public procurement procedures to be reduced.
by aggregating information (for example relative to firm solvency) that will not have to be provided for each application in the future.

Third, an electronic payment system was introduced in parallel to the online procurement platform in order to improve the efficiency of fund collection, and is currently being used in a pilot area. A reduced payment period has been used with success as an incentive for firms to use the electronic payment system: those who do are paid in 25 days instead of 40. The electronic payment system should be generalised across the whole AC in 2013.

The creation of this platform should enhance procurement efficiency. First, it centralises information about companies. Second, it improves access to information, which positively affects the number of applications. Third, it reduces contracting costs for municipalities, especially small ones. The preliminary feedback on this new platform in terms of transparency and competition is encouraging. Criteria for defining and publishing offers have been harmonised (each public entity used to have its own procedures). The platform was also fundamental in allowing firms to identify effective criteria in the contract award process, as all companies can access the winning bidders’ dossier.

The number of firms competing in public tenders has risen since the platform was launched. However, it is difficult to assess whether or not this larger number is linked to the establishment of the platform, because applications to public contract offers tend to increase during economic turmoil, when private sector demand is weak.

In addition to improving the efficiency and transparency in public management, this online platform also created important indirect outcomes, such as promoting benchmarking and knowledge transfer among different regional institutions, and allowing small entities (either regional services or small municipalities) to be involved without being overloaded with administrative work related to formal procedures.

Galicia benefitted from informal exchanges with other ACs while establishing the online platform. In particular, exchanges with the Basque Country (widely considered the leading region in Spain for this kind of contracting) were useful.

Performance monitoring and learning

Use of performance evaluation and monitoring for CG funds and municipalities

What is surprising about the vertical co-ordination of public investment in Spain is the limited use of ex ante conditionalities attached to CG funds for regional investment and the near-absence of any performance evaluation to assess the success of the bilateral investment agreements. While there are some requirements attached to central government funding, especially with regard to timing, co-financing and the prioritisation of certain areas, the overall use of conditionalities does not seem to be very common, especially when compared to EU structural funds for regional development. The same can be said of conditionality, monitoring and performance assessment at the municipal level. Although conditionalities are sometimes used (for some contracts, a share of regional earmarked grants is withheld or reduced if municipalities do not meet the objective), there is no systematic evaluation of investments’ outcomes nor ex post control.

The fact that performance evaluation of investment projects funded by central government grants is often seen in Spain as an infringement of regional autonomy has added to the reluctance of employing stricter performance indicators (OECD, 2007). Nevertheless, Galicia is actually one of the first regions to establish performance budgeting indicators (see below).

Use of performance evaluation and monitoring for EU funds
Compared to national or local funds for public investment, the use of EU funds involves extensive conditionality and monitoring, as well as performance assessment. Requirements attached to EU funds include reporting requirements, requirements related to the spending timeframe, the prioritisation of policy areas, co-financing requirements, additionality requirements, the use of *ex ante* economic evaluation tools as well as the use of environmental impact analysis. As indicated in the OECD National Questionnaire, this focus on conditionalities and the related monitoring procedures have been perceived as excessive by Spanish authorities. They nevertheless pointed out that EU conditionality, monitoring and performance evaluation have contributed to a stronger focus on results. The introduction of performance budgeting indicators in Galicia, for example, is interpreted by many as a pre-emptive policy from the regional government that anticipates further EU requirements. Indeed, Galicia is one of the EU pilot regions within the European Commission (DG REGIO) project of using outputs and outcomes indicators as a central mechanism for managing public investment funded by EU funds.

Recent trends in Galicia

The regional government aims to shift the management of public investment from a mere expenditure control to actual output and outcome achievements. The regional government introduced some principles of performance budgeting in the 2011 budget process (without any demand or guidance from the central government). The main purpose of this initiative was to use the outputs and outcomes achieved by the government sectors as input for the negotiation process of the 2013 budget. Indicators are being developed for all investment policies, aiming to improve budgetary management and efficiency, and identify inefficient expenditures in a context of crisis and fiscal austerity. The recent budget crisis and the need for new approaches for the management of public finances have created a favourable political environment for introducing this kind of system. The regional government used the experience and know-how from the management of EU funds to develop it.

5. Lessons learnt and good practices

Facing both a difficult revenue situation and upward pressure on current expenditures, Galicia had little choice but to use public investment as an adjustment variable in a tight fiscal context. In an effort to mitigate the effects of this squeeze on resources, Galicia has focused on improving the efficiency of public investment through the introduction of several new measures. In particular, two measures are very encouraging:

- Galicia has been very active in trying to reach a more effective scale for public investment. Besides imposing the provision of inter-municipal services by law in the Vigo area, the region has developed a new inter-municipal type of contracting allowing municipalities to achieve economies of scale. Incentives have been used in order to promote such an agreement, through the allocation of lines of funding reserved for inter-municipal projects. As a consequence, the number of inter-municipal contracts is rising. The region has also promoted the re-regionalisation of some municipal public services on a voluntary basis.

- Second, Galicia has introduced an online platform for public procurement. The platform centralises information about companies and improves access to information. The introduction of this new tool has also reduced contracting costs for municipalities, especially small ones. Criteria for defining and publishing offers have been harmonised.

Although there is room for improvement in terms of inter-sectoral co-operation and planning in Galicia, the region has engaged in large initiatives in order to limit the impact of the crisis on public investment. The first results are encouraging. However, since these measures were only taken recently, it is still too early to estimate their full benefits.
NOTES

1. For example, taxes on gambling and lotteries, a tax on atmospheric pollution or revenues generated by the rate of water treatment levy.

2. Such as the personal income tax or the VAT.

3. See Blöchliger and Vammalle (2012) for more details about the reform.

4. Exempt from these multilateral financing arrangements are the Basque Country and Navarra, which collect their own taxes and then pay a quota to the central government.

REFERENCES


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