Chapter 9
Characterizing the Risk Factors for Financial Sustainability in Spanish Local Governments

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ABSTRACT

This chapter aims to analyze the characteristics of Spanish governments that fail to achieve budgetary stability, as well as propose a model for the analysis of financial sustainability of governments that can help in predicting risk for financial sustainability. The analysis is focused on Spanish local governments with more than 5,000 inhabitants that have elaborated the annual plan because they did not achieve budgetary stability (79 local governments). Using the principal components analysis, the authors developed a model for the analysis of the characteristics of these governments. The model is made up of three components created from six indicators usually considered in the literature as relevant. The results evidence the indicators useful to measure the three dimensions identified by the IPSASB as relevant: revenue dimension, debt dimension, and public services dimension.

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INTRODUCTION

The control of the deficit and debt of public administrations is one of the main objectives of the European Union. With the crisis, public administrations have seen the need to increase the public services provided at the same time as they have faced revenue reductions and pressures resulting in financial difficulties. The financial sustainability of governments is considered an essential part of the economic recovering from the crisis. Its measurement, management and control is a challenge to public administrations around the world. It can be highlighted for example the Recommended Practice Guideline (RPG) of the International Public Sector Accounting Standards Board IPSASB (2013), which point out the need to monitor the ability of public entities to sustain their projects in the long term.

The literature contains several definitions of financial sustainability and different proposals about how to measure and analyse financial condition in local governments (Groves et al., 2003, Carmeli, 2007, Jones and Walkers, 2007; Rodríguez-Bolívar et al., 2014, 2016). There are also some contributions proposing models to identify entities with financial distress (Zafra-Gómez et al., 2009a, 2009b; Manes Rossi, 2011; Cohen et al., 2012; García-Sánchez et al., 2012). This chapter aims to contribute to this research stream with a proposal of the main indicators that characterize governments with financial stress.

In Spain, the Law of Budgetary Stability and Financial Sustainability prohibits public entities from obtaining deficit and from increasing expenditure over the increase in the Gross Domestic Product (GDP), and limits public sector administration debt to 60% of the GDP (44% for Central Government, 13% Autonomous Communities or States and 3% for local government). The entities that do not fulfil the objectives of Law of Budgetary Stability and Financial Sustainability must prepare a Financial-Economic Plan that within a year will allow the entity to fulfil these objectives.

In 2014, 888 local governments (out of 8,125) have had to elaborate the Financial-Economic Plan because they did not fulfill their objectives. These governments can be considered as having problems of financial sustainability. Our research analyzes the characteristics of the Spanish governments that fail to achieve budgetary stability and proposes a model for the analysis of the financial sustainability of governments that can help predict risks for financial sustainability.

Our analysis is focused on Spanish local governments with more than 5,000 inhabitants that have elaborated the annual plan because they did not achieve budgetary stability (79 local governments). We aim to characterize the financial situation of these governments using traditional financial and budgetary indicators to show the factors that can lead to this situation and the most relevant indicators. The variables included in the analysis are based on the level of debt of the government, along with variables representing the economic capacity of the entity.