
BALANCE OF FUNDING REVIEW: PAPERS FOR MEETING 6

PAPER 22: SUBNATIONAL FINANCES IN SPAIN: LESSONS FOR THE UK? (PAPER BY PROFESSOR JOHN LOUGHLIN AND SUZANNAH LUX, CARDIFF UNIVERSITY)

1. Introduction: why Spain as a comparator?

This report will examine subnational funding arrangements in Spain with a view to drawing lessons for the UK. There are good prima facie reasons why Spain makes a good comparator for the UK, although there are also important differences between the two countries which means that care must be taken in lesson-drawing from one country to the other.

1.1 *Similarities*

First, both countries have passed from being high levels of political centralisation to forms of decentralisation or devolution which, in Spain's case, has been very radical and, in the case of the UK, quite significant.

Second, the ethnic and/or linguistic profiles of the two countries have some similarities. The Spanish Constitution defines Spain as a "one and indivisible nation" but also refers to "nationalities and regions". Although it is not specified in the Constitution, the "nationalities" are taken to refer to Catalonia, the Basque Country and Galicia all of which have distinct languages and cultures and, in the case of the first two, had autonomous political systems before the Franco dictatorship. Although the UK does not have a written constitution, its informal constitution recognises that it is composed of distinct nations (England, Scotland and Wales as well as Northern Ireland), while England is further composed of planning regions. The English planning regions are similar to most of the Spanish "ordinary" regions in that they have little historical, cultural, linguistic or other basis.

A third type of similarity is in the process of decentralisation that each country has adopted. This is both asymmetrical and incrementalist: there were asymmetries in the kinds of regional and the pace of decentralisation with fast and slow tracks (see below, Section 2.1). It is not certain whether the Spanish model of asymmetry and incrementalism influenced the UK devolution process but there are certainly similarities: the Scottish Parliament with powers of primary legislation and some tax-raising powers; the Northern Ireland Assembly with primary legislative powers but no tax-raising powers; the National Assembly for Wales with powers over secondary legislation and no tax-raising powers; the proposed English regional government with powers similar to those of the Welsh Assembly. UK devolution has also been incrementalist with Scotland, Wales and Northern Ireland on the "fast track" and with the English regions on the "slow track".

Finally, the decentralisation reforms in both Spain and the UK have been strongly influenced by membership of the European Union directly, in the sense that EU regional funding has been an important rationale and motivation for regionalisation and regional mobilisation as well as indirectly, in the sense that the principles of subsidiarity and partnership are essential elements of European “good governance”. These similarities are outlined in Table 1.

1.2 Differences

There are, on the other hand, a number of important differences between the two countries, which caution against a direct application of lessons from one to the other. The most obvious difference is that Spain was an authoritarian dictatorship under General Franco before launching its decentralisation process in 1978. Decentralisation was an essential element of democratisation. Similarly, both were linked to the prospect of entry into the European Community (as it then was), which occurred in 1982.

The UK, on the other hand, while it has experienced a strong tendency towards centralisation over the past fifty years, is an old-established political democracy, the basis of which was laid in the 19th century. Second, the “autonomic state”, with a strong role for the autonomous communities, was an essential feature of the constitutional design of the new Spanish state from the very start of democratisation. In the UK, devolution is still becoming an essential element of UK constitutional structures, which are still largely dominated by the doctrine of parliamentary sovereignty. Third, although there are similarities between the Scottish Parliament and the Spanish ACs, the Welsh Assembly is, and the proposed English regions will be, relatively weak bodies in comparison. Finally, the Spanish provinces and municipalities are much weaker than their English (or more generally UK) counterparts, given the powerful position of the Autonomous Communities.

Table 1: Decentralisation in Spain and the UK: Similarities and Differences

Similarities		Differences	
Spain	UK	Spain	UK
Regionalised Unitary State	Regionalised Union State	From Dictatorship to Democracy	Old Established Democracy
Nationalities and Regions	Nations and Regions	The Autonomic State – Strong role for the Regions	English Regions will not have the same status and role
Asymmetrical Decentralisation	Asymmetrical Devolution	Weak position of Provincial and Local Governments	Councils have few revenue sources and must meet national standards but still stronger local tradition than Spain
Incrementalist Decentralisation Process	Incrementalist Devolutionary Process		
European Dimension	European Dimension		

2. Overview of the Spanish Territorial System

Spain is a unitary state with a highly decentralised territorial system, which has to allow for the cultural, linguistic and historical diversity of its territories.

Decentralisation in Spain has been largely motivated by political and historical rather than economic factors. The 1978 Constitution tries to balance a concern with what it defines as the “unity and indivisibility of the Spanish nation” (which is found in the whole territory of Spain while recognising the existence and rights of its “nationalities and regions”). The Constitution also guarantees the rights of the municipal and provincial levels of government. It is this duality of centralising vs. decentralising forces that has dominated the Spanish transition to democracy as well as the institutional design of the “autonomic state”. Today, the autonomic state is accepted by the vast majority of the Spanish people as well as almost all of the political parties.

2.1 The Processes of Decentralisation

There are a number of distinctive features of Spanish decentralisation. First, we need to distinguish between two different political decentralisations: (i) the transfer of political and policy responsibilities and functions from the central state to the Autonomous Communities, sometimes known as “the first decentralisation”; (ii) the transfer of political and policy responsibilities from both the central state and the ACs to the provinces and municipalities, sometimes known as “the second decentralisation”. It is the first decentralisation, which has thus far been the more important of the two. Basically, the ACs have been the primary beneficiaries of the reforms while there has been what might be termed a “regional centralisation”, that is an accumulation of functions, resources and powers at the AC level.

There are, however, a number of important differences with regard to both the nature and the pace of decentralisation to the ACs, in that it has been both asymmetric and incrementalist (Garcia-Milà, T. and McGuire, T. (2002); Vinuela, 2000). There have been at least two forms of asymmetry present in Spanish decentralisation. First, there are two distinct regional finance systems: the Foral Regime, which is found in the Basque Country and Navarre and the Common Regime, which is found in the other 15. The Foral Regime is based on ancient “foral” privileges possessed by the Basque Country and Navarre, which gave them a certain degree of autonomy over tax collection and use and which they retained, at least to some extent, under Franco.

Another asymmetry lies in a division made in the Constitution between regions that were placed on a “fast broad track” (FBT) to devolution and those that were on a “slow narrow track” (SNT). The FBT regions included the three historic nationalities, Catalonia, the Basque Country and Navarre, Galicia as well as Andalusia, Valencia and the Balearic Isles (Vinuela, 2000). Thus, the fast track regions include both the Foral Regime and some Common Regime regions. The FBT regions were given a broad range of devolved responsibilities immediately, while the SNT regions would have to wait five years and had to hold referendums to have popular approval of AC status. In common with the English planning regions, many of the SNT regions, such as Extramadura, were created simply for administrative or statistical purposes and had

no historical, linguistic or cultural basis for their existence. It was thought at the time that some of these regions may not opt for AC status but, in the end, all did.

The second important feature of Spanish decentralisation was its incrementalist nature. First, there is the difference between the FBT and SNT regions, with the latter having to wait to accede to the top group. Second, the FBT regions themselves only achieve full autonomous powers, particularly financial powers, over a very long period, 25 years in all (between 1978 and 2003). Competencies would be transferred at 5-yearly periods and the transfer was not always accompanied by the necessary financial resources, leading at times to an explosion of debt on the part of the ACs that had to borrow to meet their commitments. The 5-yearly negotiations came to an end in 2003. All of this introduced a dynamic into central-regional and inter-regional relations in Spain that, while justified politically as a way of dealing with diversity, may have been detrimental from the economic, fiscal and inter-regional perspectives (Garcia-Milà, T. (2003); Garcia-Milà, T. and McGuire, T. (2002)). The first decentralisation came to an end in 2003, with the completion of the transfer of responsibilities to the ACs and the harmonisation of the competences and fiscal arrangements for all the Common Regime ACs. Thus, the Common Regime passed from asymmetry to symmetry. There is still asymmetry in that the Foral Regime remains untouched despite criticisms of its harmful effect on the principles of inter-regional solidarity (the Basque Country and Navarre, while among the richest regions pay less into the Inter-territorial Compensation Fund (García-Mila (2003))).

Table 2: Spanish Subnational Government Structure

Autonomous Communities (17)	
<ul style="list-style-type: none"> • Foral Regime (Basque C. & Navarre) • Common Regime (the rest) 	<ul style="list-style-type: none"> • Fast Track (7) • Slow Track (10)
Provinces (50)	
Municipalities (8,106)	
<ul style="list-style-type: none"> • 100,000+ inhabitants (55) • 50 – 100,000 inh (61) • 10 -50,000 inh. (515) • 5 – 10,000 inh. (514) • fewer than 5,000 inh. (6,961) 	

2.2 Provinces and Municipalities

Provinces and municipalities have not benefited in the same way as the autonomous communities from the process of decentralisation and the transfer of powers. However talks began in January 2002 to examine ways of consolidating and increasing taxation and political powers of the municipalities and provinces. The new financing system which was introduced in 2003, sets the framework for a new sharing of responsibilities and resources between the municipalities, provinces and autonomous communities.

3.0 Scope of Responsibilities – ACs, Provinces and Municipalities

3.1 Autonomous Communities

The transfer of responsibilities to the autonomous communities is based on the principle that all responsibilities not expressly allocated to the state by the Constitution are delegated to the autonomous communities.

The main responsibilities of the autonomous communities are as follows:

- internal organisation of community bodies;
- country planning;
- town planning and housing;
- civil engineering (railways and roads)
- management and construction of hydraulic dams
- agriculture, lakes and forest protection;
- fishing and craft industries;
- economic development;
- culture;
- research;
- promotion of tourism, sport and leisure activities;
- social welfare.

In addition, the fast track ACs have, since 1978, been responsible for education, health and, in the case of the Basque Country and Navarre, the police force. All the slow track autonomous communities have been responsible for education since 2000, for health since 2002. Since the end of 2003 the slow track communities have had all the same responsibilities as the fast track autonomous communities.

Autonomous communities have powers to legislate in relation to the responsibilities they exercise.

3.2 Provinces

With the exception of the provinces in the Basque country, the process of regionalisation has meant that the role and responsibilities of the provinces has been significantly reduced. Their main responsibility is now to provide technical and financial assistance to municipalities with fewer than 5,000 inhabitants and to invest in certain services which fall outside the municipal territorial remit, such as secondary road networks, certain hospitals). They can also take on responsibilities which are delegated by the autonomous community or the state.

3.3 Municipalities

Municipalities have different levels of responsibility for service provision, depending on their size.

All municipalities are responsible for the following services (regardless of their size):

- law and order;
- road network maintenance;
- water supply and street lighting;
- waste disposal;
- cemeteries upkeep;
- slaughterhouses;
- heritage assets conservation.

Municipalities with more than 5,000 inhabitants are in addition responsible for:

- markets and public parks;
- libraries;
- sewerage and waste treatment.

Municipalities with more than 20,000 inhabitants are in addition responsible for:

- emergency and fire-fighting services;
- social reinsertion;
- sports facilities.

Municipalities with more than 50,000 inhabitants are also responsible for:

- protection of the environment;
- urban public transport.

4.0 AC Finance System

4.1 Background and Reforms

The ACs finance system was set out in pluri-annual agreements established in the Tax and Financial Policy Council between the central state and the ACs which have been re-negotiated every five years until 2002, when this requirement ceased. The most recent agreement covers the period from 2002-2006 and applies to all ACs with the exception of Navarre and the Basque Country.

After the 2002 reforms of regional government financing, this now operates according to the following principles (Gomez-Pomar Rodriguez, 2002):

- Stability over time: no more 5-yearly negotiations.
- Universality: the financial regime applies to all the ACs in the Common Regime.
- Sufficiency, Autonomy and Solidarity: ACs are guaranteed sufficient resources to carry out their responsibilities in an autonomous way and there is continuing solidarity through the Inter-regional Solidarity Fund (Fondo de Compensación Interterritorial).
- A widening of fiscal co-responsibility and a reduction of state transfers.

- Co-ordination: there will be new mechanisms of financial co-ordination between the state administration and the regional administrations and new financial instruments between the different levels of government.
- Integration of all public services: this follows the integration of health into the functions now exercised by all the ACs.

These reforms were the culmination of a long-drawn out process whereby the ACs' financing system has been moving towards greater autonomy. Although decentralisation of functions occurred during this period, many ACs argued that fiscal autonomy did not keep pace with their spending responsibilities (Garcia-Milà 2002). There was, nevertheless, a decrease in state transfers, balanced by an increase in tax receipts. Initially several taxes were transferred from the state to the autonomous communities, followed by the transfer of a share of the income tax receipts from state to autonomous community level. However at first the autonomous communities had no leeway to adjust the rate of the tax.

Reforms 1997-2002

The 1997 reforms were introduced partly as a result of political negotiations between minority Madrid governments (PSOE and PP) and nationalist governments in Catalonia and the Basque Country (in particular Pujol's nationalist Catalan government).

These reforms meant that the system changed considerably with the introduction of the 'tax co-responsibility principle' which allowed autonomous communities to benefit from 30 per cent of national income tax receipts. Most importantly from the point of view of their financial autonomy, the autonomous communities were given the power to adjust the rates of tax and the tax base, within certain defined limits.

2002 Reforms

There were further changes introduced in 2002, again partly a result of negotiations between the nationalists and the Madrid government, designed to further increase the tax autonomy of the autonomous communities.

4.2 Taxes raised by the autonomous communities after 2002

The autonomous communities in the Common Regime have the power to raise the following taxes:

4.2.1 Personal Income Tax

The personal income tax (*impuesto sobre la renta de las personas físicas* - IRPF) represented over 36 per cent of regional tax revenue in 1997. The ACs' power to set the tax base and rates increased over the last seven years. In 1997 they benefited from 30 per cent of the income tax revenue raised in their area. They had the power to set the tax base and could determine levels of rebates (within certain limits) on half of this sum and received the other half in the form of a 'territorial share'. In 2001 their power to set tax rates was extended to cover the full 30 per cent of income tax

receipts. Since the new finance system was introduced in 2002 (to cover the period 2002-6) the autonomous communities received both a greater share of income tax receipts (33 per cent) and were given the power to adjust the tax rates on this share within a margin of plus or minus 20 per cent of the state tax rate. They are also able to modify the tax base with tax deductions or rebates.

4.2.2 Complementary taxes on games [i.e. gaming/betting tax?] and on sewerage

Since January 2002, ACs have a greater power to set the rates of these taxes within certain limits.

4.2.3 Wealth tax, transfer tax, tax on donations and inheritance

Autonomous communities have been able to levy a wealth tax, a transfer tax on real estate and a tax on donations and inheritance since 1997. Since January 2002 they have also had the power to set the rates of these taxes within certain limits.

4.2.4 Vehicle tax receipts

Autonomous communities have received vehicle tax receipts since January 2002

4.2.5 Tax on fuels

In 2002 a local tax on fuels to finance the health sector was also introduced.

4.2.6 Discretionary Taxes

Autonomous communities may also (at their own discretion) create certain taxes, for example games taxes (e.g. betting) and taxes on vacant property. To take a specific example, the AC of Extremadura took the decision in 2001 to introduce a tax on banks and savings banks. Receipts from the tax, which was levied at a rate of between 0.3 per cent and 6 per cent of deposits, were intended to finance investment in regional development.

Table 3: Main regional own tax revenue

	Tax Base	Leeway over Rate	Weight in regional revenue excluding borrowing
Personal income tax	33 % of personal income revenue	Yes, (within a range of more or less 20 % of the tax rate set by the central government)	8%
Inheritance and donations tax	Inheritance and donation	Yes	2%
Wealth tax	Assets	Yes	1%
Transfer Tax	Real estate transactions	Yes	5%

Source: Dexia Crédit Local 2002, *Finance in the fifteen countries of the European Union, second edition* (Paris: Dexia 2002)

4.3 *Foral System*

As noted above, Navarre and the Basque Country have their own specific tax raising system. They levy all national taxes but in return pay a subsidy for the public services provided by the state which is set by an agreement with the state (*concierto* for the Basque country and *convenio* for Navarre). While the Navarre AC resources are mainly raised by taxation, the Basque Country revenue is derived mainly from transfers from its three provinces.

5.0 Provinces

Provinces have relatively limited tax raising powers. They have the power to levy a surtax on the business tax (*recargo sobre actividades económicas*) in the form of a single rate which cannot exceed 40 per cent. The collection level, however, is the municipalities.

6.0 Municipalities: limited but growing fiscal autonomy

6.1 Negotiation of Local Pacts

Municipalities have benefited less from the decentralisation process than have the ACs. Negotiations between the central government, ACs and municipalities began in 2002 to improve the situation. The outcome of these negotiations were the drawing up of local pacts (*pactos locales*) between the three levels. Because of the structure and the inter-dependent nature of the decentralised system of government in Spain, any move towards increasing the power for the municipalities needs to involve both the central government and the ACs, largely because this involves shifting certain functions from the AC level. The local pacts are designed to redistribute functions between the three levels of government with the aim of redefining and broadening the authority of the municipalities. Although the pacts are not legally binding on any of the levels of government, they have played an important role in preparing the way for legislative changes resulting in more power for the municipalities (Ruiz Almendral, V. (2002)).

The first local pact was negotiated in the mid-1990s between central government and the municipalities and resulted in legislative changes in 1998 and 1999 which increased municipal authority. Amongst other changes this pact dealt with matters such as security in public places, transport and parking and environmental protection. However, because the first local pact did not involve the ACs, it was limited in scope because it could not address matters which were under the jurisdiction of the latter.

Negotiations on a second set of local pacts began in 2002. These pacts [were/are being] separately negotiated between the ACs and their municipalities. The central government also plays an important role as its remit is to define the general principles governing the shift in responsibilities and authority from the AC level to the municipal level. It is significant that negotiation of the second series of pacts began after January 2002, i.e. after the reforms increasing the fiscal autonomy of the ACs had come into force. This meant that the ACs were no longer as preoccupied with obtaining further authority for themselves and could therefore give more attention to

the needs of the municipalities (Ruiz Almendral 2002). The municipalities have, nevertheless, encountered problems in their negotiations with the ACs, particularly with regard to the issue of increasing municipal fiscal autonomy.

An important principle of the local pacts was that the funding for the new municipal responsibilities should be by way of financial transfers from ACs to their municipalities. However it has proved extremely difficult for the ACs and municipalities to reach an agreement in this regard.

6.2 Municipal taxation

In 1998, municipal tax receipts represented 35 per cent of all municipal revenue excluding borrowing. Municipalities are able to take advantage of three mandatory and two optional taxes.

6.2.1 Mandatory taxes

Tax on property (Impuesto sobre bienes inmuebles)

This tax is levied on either buildings or land and represents approximately 47 per cent of municipal tax revenue. Municipalities have discretion over the tax rate, which is set annually within limits defined by the state. The rates vary depending on whether the property is in a rural or urban area.

The tax base is the registered value of the land and buildings. This is determined by the state and is updated by about three to four per cent on an annual basis. There is also an individual update for each municipality, with the aim of bringing the registered value of land in line with market prices.

Business Tax (Impuesto sobre actividades económicas)

This is the second largest source of tax revenue for municipalities. It is levied on the profits generated by industrial, commercial or artistic activities. The tax base is made up of a fixed share which depends on the type of activity and a variable share which is determined by various factors such as the floor space used, number of employees and electricity consumption. Municipalities can set their own rates within limits defined by the state and based on their population figures.

This tax was under threat of abolition by the PP government of Aznar, which was sympathetic to business and anti-tax. It is still unclear what the position of the current PSOE government of Zapatero will be, although they will undoubtedly be less sympathetic to business.

Tax on motor vehicles (Impuesto sobre vehículos de tracción mecánica)

This is the third largest source of tax revenue for municipalities. They have limited discretion with regard to setting tax rates or base which are both determined by the state based on the type of vehicle and its engine power although municipalities can vary the rate based on the size of their population.

6.2.2 Optional taxes

Tax on construction, installations and works (Impuesto sobre construcciones, instalaciones y obras)

This represented 11 per cent of municipal receipts in 1998. It is levied on the real cost of the construction, installation or works carried out. The minimum reference rate is set by law and municipalities have a limited power to increase it in proportion to the size of their population.

Tax on capital gains in urban areas (Impuesto sobre incremento de valor de los terrenos de naturaleza urbana)

This represents 8 per cent of municipal tax revenue. It is payable on any real estate transaction and is based on the value of the property in the land register with an adjustment for the number of elapsed years since the last sale. Municipalities have a degree of discretion to set rates within state-imposed limits.

Table 4: Main municipal own tax revenue

	Tax base	Leeway over rate	Collection level	Weight in local revenue (excluding borrowing)
Property tax	Land and buildings registered value	Yes, within a range	Municipalities	16%
Business tax	Profits from industrial, commercial or artistic activities	Yes, within a range	Municipalities	7%
Vehicle tax	Vehicles	Yes, within a range	Municipalities	5%
Tax on construction, installation and works	Real cost of the construction, installations or works	Yes, within a range	Municipalities	4%
Tax on capital gains in urban areas	Real estate transactions	Yes within a range	Municipalities	3%
Total own resources (excl. borrowing)				35%

Source: Dexia Crédit Local 2002, *Finance in the fifteen countries of the European Union, second edition* (Paris: Dexia 2002)

7.0 Discretion over local taxes – municipalities and autonomous communities

The proportion of tax revenue over which autonomous communities and municipalities have some discretion (i.e. have the power to set the tax rate and/or base) is:

- 35 per cent for municipalities (as a percentage of total revenue excluding borrowing);
- 16 per cent for autonomous communities (as a percentage of total revenue excluding borrowing).

8.0 State transfers – ACs, Provinces and Municipalities

State transfers include transferred tax revenue, a general grant and an earmarked grant.

8.1 Transferred tax revenue

With the introduction of the new financing system applicable to ACs from 1st January 2002, these receive 35 per cent of VAT receipts and 40 per cent of taxes on petrol, tobacco and alcohol. They have no discretion over the applicable tax rates.

8.2 The general grant

All three levels of local government receive a share of state general receipts in the form of a general grant (*participación en los ingresos generales del Estado*). This corresponds to a percentage of state tax receipts, indexed to the trend in GDP.

The sanitary and social services grant, which was an earmarked grant up until 2002, has now been incorporated into the general grant.

In terms of the allocation criteria, in the case of ACs, the population counts for 94 per cent, the area for 4.2 per cent, scattered housing for 1.2 per cent and insularity for 0.6 per cent. In the case of provinces and municipalities the criteria used are mainly the number of inhabitants and schools and the tax contribution.

8.3 Earmarked grants

8.3.1 Autonomous communities

Autonomous communities receive operating and investment earmarked grants. Since 2002, the operating earmarked grants are the grants allocated within the framework of contract-programmes, i.e. programmes designed to stimulate the priority economic development sectors.

The investment earmarked grants include the following grants.

Inter-territorial compensation fund (Fondo de Compensación Interterritorial – FCI)

This is designed to compensate for inter-regional differences and is intended to fund local capital expenditure. The allocation criteria include population, net migration and unemployment. In addition regions must have an average per capita revenue of less than 75 per cent of the national average per capita revenue level to qualify for this grant.

Grants allocated within investment agreements

These agreements are established between the state and the autonomous communities and fund joint specific investment projects.

8.3.2 Municipalities

Municipalities receive assigned grants for specific investment projects.

8.4 European Union Grants

Spanish local governments continue to receive grants from the European Union as part of its regional development policy. Spain is still classified as an Objective 1 area, which means that the grants involved are considerable. This funding will continue until 2007.

9.0 Control of Debt

As noted above the level of AC debt has increased dramatically since the decentralisation process began, largely because fiscal decentralisation did not keep pace with political decentralisation.

The central state has set controls on levels of debt and deficit for the autonomous communities to ensure that national aims of achieving a balanced budget are met, as well as ensuring Spain's obligations under the European Union Stability and Growth Pact are adhered to. The control measures are set out in the 1980 Regional Finance Act, as well as in the pluri-annual financial agreements negotiated between the state and the individual autonomous communities. Aznar's neo-liberal government introduced further controls on the budget and debt levels of the autonomous communities by means of the Budget Stability Act, in force since January 2002, which applies to ACs, provinces and municipalities. This act provides that the granting of authorisations to borrow by the state, depends on the AC, province or municipality in question having a balanced budget. In addition, it provides that ACs, which do not maintain a balanced budget can be fined.

Table 5: Overview of local revenue by type (as a percentage) 1998

	Total Subnational Sector	Municipalities	Provinces	Autonomous Communities
Own tax revenue	27	32	58	20
Financial transfers	55	36	28	67
Other own revenue	10	23	7	6
Borrowing	8	9	7	7
Total	100	100	100	100

Source: Dexia Crédit Local 2002, *Finance in the fifteen countries of the European Union, second edition* (Paris: Dexia 2002)

The table above sets out the data for the year 1998.

10. Conclusions: Lessons for the UK?

We believe that it is the Review Group, which should finally decide what lessons might be drawn from the Spanish case study for reforming the UK system of local finance and we would recall the important differences between the two countries outlined at the beginning of this paper. It is useful, nevertheless, to suggest the five Stoker and Meehan (2003) ‘design principles for a system of local government finance’ are a good framework within which to assess the Spanish system and to see what lessons might be derived from it for the UK. These principles are: accountability, equity, fairness, buoyancy and a ‘holistic approach’ that encourages ‘joined-up’ working between agencies. To these might be added in year predictability (how far each option would yield a predictable revenue stream in a particular financial year) and collectability/administrative ease/cost are also important considerations.

Keeping this in mind, we would like to highlight the following features of the Spanish system, drawn from the literature, which might be of assistance to the Group in drawing their conclusions. These concern first the process of decentralisation and secondly the substantive features of the taxation systems.

10.1 Process of Fiscal Decentralisation

Asymmetry: Political vs. Economic considerations

The asymmetrical process of decentralisation in Spain has solved certain political problems but has created economic and fiscal problems. For instance the fact that fiscal decentralisation has not always kept pace with political decentralisation has meant that the autonomous communities have not always had the resources to meet their increased responsibilities for service provision. This encouraged a certain

amount of fiscal irresponsibility on the part of the ACs, who had to borrow in order to meet their responsibilities.

Although spending responsibilities and responsibilities for service provision are now similar for the different autonomous communities, the existence of the two different financial systems has led to an asymmetry between the Basque Country Navarre, on the one hand, and the other fifteen autonomous communities, on the other. It has been argued that the foral regime gives a distinct revenue advantage to these two regions (Garcia-Milà 2002) and it has been estimated that regions under the foral regime enjoy 1.8 times the per capita funds of the five regions in the Common Regime that have comparable spending responsibilities (Garcia-Milà 2002, quoting Castells, A. 2000). Furthermore, they contribute less to the Inter-regional Solidarity Fund. Whilst the foral regime has strong historical, political and cultural roots, it is questionable from an economic efficiency perspective whether such disparate treatment is justifiable. The differences have also led to tensions and challenges in the Spanish and European courts (Darby et al. 2003).

It has been argued that even taking account of the 2002 reforms, the fifteen autonomous communities in the common regime still have relatively limited tax raising powers, particularly when compared to the Basque Country and Navarre (Garcia-Milà 2003). This has led to inefficient local public spending and excessive borrowing and limits the choices the regions can make with regard to spending.

Solidarity and equalisation between autonomous communities

The 2002 reforms were an important step towards greater fiscal autonomy for all the autonomous communities and resulted in a system of greater simplicity and clarity. However, the 2002 reforms did not improve the complexity and lack of transparency with regard to the question of equalisation and solidarity between the different regions. There is still a lack of open discussion on this issue and, in particular, little has been done to establish clear and transparent equity criteria between regions. This means that the richer regions tend to feel that they are contributing too much whilst poor regions feel they are receiving too little (Garcia-Milà (2003)).

This lack of transparency has resulted in regions attempting to steer reforms and revisions to the taxation system in a direction that will give them greater funds.

Buoyancy/Holism

There are a great variety of taxes in the Spanish system at both regional and local levels. In some respects, this variety is a positive feature and meets the recommendation along these lines made by the European Charter of Local Self-government of the Council of Europe. Some local taxes, in particular, such as the business tax are recognised as among the most buoyant. The Spanish case illustrates that it is possible for a decentralised political system to operate with such a wide variety of taxes and that this is a strength.

There is, on the other hand, a disadvantage in that the great number and complexity of the taxes militate against transparency and accountability, particularly as the principle of joint responsibility is now central to the system. This means that there is no clear

line for the citizen between taxation on the one hand and political decision-making on the other as each level of government can pass responsibility for difficulties to the other. Furthermore, the complexity of the system gives greater opportunities for both tax avoidance and tax evasion.

10.2 Regional and Local Taxation

Focus on decentralisation to ACs

As noted above, the municipalities have not benefited to the same extent from the fiscal decentralisation process as have the ACs. Although negotiations are **taking place** with the aim of increasing the fiscal autonomy of the municipalities in line with their increase in responsibilities, problems have been encountered by the municipalities in reaching an agreement with the ACs on this issue. The ACs have been reluctant to allow a share of their own funds and financial authority to be transferred to the municipal level. The local pacts which set the framework for this proposed transfer of authority have both advantages and disadvantages. On the one hand they are an important means of defining the role of the different levels of government. However, because they are not legally binding, they are dependent on the voluntary cooperation of the different levels of government including the ACs. Cooperation from the autonomous communities on the issue of increased fiscal authority for the municipalities has been hard to achieve (Ruiz Almendral 2002).

Collectibility/Administrative Ease

It has been argued that Spain has a ‘semi-decentralised tax administration system’ defined as an economic federation within which there are two institutions at different levels of government with tax administration responsibilities (Esteller-Moré 1999). The central tax authority in Spain administers the income tax (with regional authorities having rate setting powers), whilst the regional tax authorities have administrative responsibility for the wealth tax, amongst other taxes. This semi-decentralised system reduces the effectiveness of tax policy for two main reasons. Firstly, there are variations in the tax parameters across the regions which means that certain regions have less ability to counter tax evasion by means of an increase in audits or the imposition of fines. Secondly, there is a lack of integration between the different taxation responsibilities of the different levels of government which also leads to a reduction in effectiveness of tax administration. This, reduction, however, in effectiveness has to be balanced against the advantages of greater regional and municipal fiscal responsibility (Esteller-Moré 1999).

10.3 Municipalities

Disparities in tax capacity and fiscal equalisation

It has been argued that the equalisation grant system in Spain does not succeed in equalising the differences in tax capacity between the different municipalities in Spain, partly because the grant system does not only reward those municipalities which are prepared to exert a greater tax effort (i.e. set a higher tax rate) but also

(surprisingly) rewards, to some extent, those municipalities which have a higher tax capacity in the first place (Castells 2000). This means that those municipalities which have a lower tax capacity either have to exert an above-average tax effort (i.e. set a higher tax rate) and/or provide a below average level of public services and/or incur higher levels of public debt. It also means that decreases in levels of tax capacity have to be compensated for by the municipalities using one or more of these methods. The process of fiscal adjustment used by different municipalities in the face of a decrease in tax capacity is greatly influenced by the political situation of the municipality in question. For example, it has been found that minority governments or those which govern in coalition tend to delay the adjustment process and are also less willing to raise tax rates to compensate, choosing to increase their debt levels instead. In addition left-wing and right-wing governments tend to react differently to variations in tax capacity, with left-wing governments more inclined to raise taxes to compensate for a decrease in tax capacity and right-wing governments more willing to reduce public spending and level of service provision. (Castells 2000).

The fact that the equalisation grant system in Spain does not succeed in equalising differences in tax capacity and the fact that municipalities vary in how they tackle both the differences in tax capacity across municipalities and decreases in their own tax capacity leads to variations in levels of service provision and debt across municipalities.

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