

CATALONIA BACKGROUND INFORMATION
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**FISCAL DEFICIT AND CURRENT FINANCE SYSTEM OF
THE SPANISH AUTONOMOUS COMMUNITIES**

This document aims to explain the origin of the fiscal deficit between Catalonia and Spain, as well as the unequal distribution between the Spanish Autonomous Communities, due to the current financing system.

The fiscal deficit between Catalonia and Spain

This study presents the results of the fiscal balances of Catalonia for the period 2006-2010, the settlement of the financing model of the Spanish Autonomous Communities in the common tax system ending two years after the natural year.

Here it should be indicated that two of the autonomous communities, the Basque Country and Navarre, are omitted from the study because they benefit from a special fiscal regime due to their historic ('foral') tradition.

To calculate 2009 and 2010, a small adjustment must be made that permits all elements of the new model of financing of the Spanish Autonomous Communities in the common tax system to be included. Although not approved until the end of the year, this new model was in force throughout 2012. The current financing model was approved on 18 December 2009 (Law 22/2009, of 18 December, regulating the financing system of the Spanish Autonomous Communities in the common regime, and of cities with a statute of autonomy, and modifying certain fiscal regulations) and accepted by the Joint Committee on Economic and Fiscal Affairs of the Spanish and Catalan governments on 22 December 2009).

The calculation of the 2009 and 2010 balances therefore includes the advance of extra-budgetary funds by the Spanish Administration to the Autonomous Communities, as additional resources paid into the autonomous financing system (obviously, this advance must not be charged to the fiscal balance of the year in which the amount is entered, to avoid duplication in the calculation).

Table 1
Fiscal balance of Catalonia in relation to the Spanish public sector 2006-2010
Neutralised for the economic cycle. Money flow

Million euros	2006	2007	2008	2009	2010
Taxes paid by Catalonia:	47,786	51,823	57,403	61,812	61,872
Expenses received in Catalonia:	33,293	35,910	40,203	45,403	45,329
Balance	-14,493	-15,913	-17,200	-16,409	-16,543
% / GDP	-7.9 %	-8.1%	-8.5 %	-8.4%	-8.5%

In times of economic crisis and high unemployment rates, the money flow method is even more significant, since the Government's spending policies have a great impact in stimulating receptor economies. It can therefore be concluded that Catalonia is suffering a continuous shock of contraction as a result of the fiscal deficit of the Autonomous Communities.

The benefit flow method also shows a slight worsening of the Catalan fiscal deficit during the years analysed.

Table 2
Fiscal balance of Catalonia compared with the Spanish public sector 2006-2009
Neutralised for the economic cycle. Benefit flow

Million euros	2006	2007	2008	2009	2010
Taxes paid by Catalonia:	47,025	50,907	56,300	60,460	60,577
Expenses received in Catalonia:	36,705	39,771	44,440	49,199	49,319
Balance	-10,320	-11,136	-11,860	-11,261	-11,258
% / GDP	-5.6 %	-5.6%	-5.9 %	-5.8%	-5.8%

The benefit flow method is perfectly reasonable, but its empirical use is often complicated by a multiplicity of approaches and accounting elements that, although valid, make the final result much more sensitive to small changes in these elements.

Contributions made by Catalonia and expenditure in its favour 1986-2010, money flow

Origin of the fiscal deficit of Catalonia:

- Catalonia contributes, on average, 19.2% of the revenue of the Spanish Administration, including the Social Security Administration

- Catalonia receives, on average, 17.1% of the expenditure of the Spanish Administration, including the Social Security Administration

Contributions of Catalonia and expenditure in its favour 1986-2010, money flow and Social Security excluded

If we exclude inter-personal redistribution by means of rights acquired on an individual basis (Social Security plus unemployment benefit):

- Catalonia contributed 19.7% of the revenue of the Spanish Administration
- Catalonia received 11.2% of the expenditure of the Spanish Administration

The imbalance between the contribution made by Catalonia and the expenditure made by the Spanish government in its favour (8.5 pp) is increasing.

This difference is equivalent to over 40% of the tax levied:

For every euro contributed by Catalonia, 43 cents did not return in the form of expenditure in its favour.

During the period 1986-2009, Catalonia suffered, on average, an annual fiscal deficit of 8% of the Catalan GNP (money flow, neutralised).

Specifically, in 2010, the fiscal deficit for Catalonia (according to the money flow method) was equivalent to 16,543 million euros, 8.5% of the Catalan GNP.

On 29 March 2011, the Spanish Congress approved a motion urging the Spanish government to update the fiscal balances of the 17 Autonomous Communities and to publish them in November 2011. Up to now, they have still not been published.

The Parliament of Catalonia is preparing a bill that will make it compulsory to update the fiscal balances every year.

Current financing system of autonomous communities of ordinary regime. Initial situation

The current financing system starts determining the tax capacity of each territory. It is determined by the collection of taxes assigned to the Autonomous Communities (AC). All calculations are done in homogenous terms regarding the normative capacity in order to be able to compare across AC.

Tax capacity, 2010

AC	EUR million	EUR per capita	index	ranking
Madrid	17.057	2.641	133,3	1
Balearic Islands	2.692	2.434	122,9	2
Catalonia	17.629	2.347	118,5	3
Aragon	3.062	2.273	114,8	4
Cantabria	1.337	2.258	114,0	5
Asturias	2.259	2.083	105,2	6
La Rioja	653	2.026	102,3	7
Castile and León	5.133	2.006	101,2	8
Valencia	9.511	1.861	93,9	9
Galicia	5.015	1.793	90,5	10
Castile-La Mancha	3.599	1.715	86,6	11
Murcia	2.433	1.664	84,0	12
Andalusia	13.428	1.604	81,0	13
Extremadura	1.675	1.513	76,4	14
Canary Islands	1.767	834	42,1	15
TOTAL	87.250	1.981	100	

Catalonia is 18.5% above the Spanish average. It is the 3rd AC in tax generation per capita after Madrid and the Balearic Islands.

STEP 1: GUARANTEE FUND FOR ESSENTIAL PUBLIC SERVICES (GF)

This fund aims to ensure uniform access to the basic services -namely health care, education and social services- to all citizens regardless of their place of residence. Each AC must have the same amount of resources making a similar fiscal effort.

The different sub-funds enclosed in GF are distributed based on the so-called “*adjusted population*” indicator¹, which accounts for the expenditure needs from each AC.

Resources for this fund:

- Horizontal fund: 75% of tax revenues assigned to the AC
- Vertical fund: additional transfer from the central government that is set to evolve in line with the observed growth rate the Central Government's tax revenues².

¹ This indicator is gauged as a weighted average of seven variables: population (30%), area (1.8%), dispersion (0.6%), insularity (0.6%), equivalent protected population (38%), population aged 65 years or above (8.5%) and population up to 16 years of age (20.5%).

Resources for each AC after the Guarantee Fund

AC	GF allocation EUR million	Resources after GF EUR million	EUR per capita	index	ranking
Aragon	49	3.112	2.310	107,4	1
Castile and León	694	5.827	2.277	105,8	2
Balearic Islands	-190	2.502	2.262	105,1	3
Asturias	168	2.426	2.238	104,0	4
Catalonia	-911	16.717	2.225	103,5	5
Madrid	-2.700	14.358	2.223	103,3	6
Cantabria	-24	1.313	2.217	103,1	7
Galicia	1.153	6.168	2.205	102,5	8
La Rioja	52	705	2.187	101,7	9
Castile-La Mancha	958	4.557	2.172	101,0	10
Extremadura	680	2.354	2.126	98,9	11
Valencia	1.179	10.691	2.091	97,2	12
Murcia	543	2.976	2.036	94,6	13
Andalusia	3.541	16.969	2.027	94,2	14
Canary Islands	2.306	4.073	1.922	89,4	15
TOTAL	7.498	94.748	2.151	100	

This partial levelling grant does not modify the AC order set according to its initial tax capacity (fulfilling the ordinality principle) but causes an intense cut in AC's tax capacity differences. At this point, Catalonia is only 3.5% above the Spanish average in per capita terms.

STEP 2: GLOBAL SUFFICIENCY FUND (SF)

The main goal of this fund is to guarantee the revised *status quo*, which are the resources from the previous system plus additional means that include compensations for population growth and other adjustments.

It increases the overall resources to the system and avoids that any AC loses resources as regards the application of the previous system in effect until 2008.

Resources: additional transfer from the Central that is set to evolve in line with the observed growth rate the Central Government's tax revenues

Allocation: Each AC obtains additional resources up to its revised *status quo*. The allocation is gauged as the difference between the base year financing

² This growth rate only considers the evolution of the Central Government's tax revenue from the total revenue raised by the taxes shared with AC.

needs –previous system resources plus new system additional contributions– and the revenue arising from its tax capacity plus transfers from GF.

Resources for each AC after the Sufficiency Fund

AC	SF allocation EUR million	Resources after SF EUR million	EUR per capita	index	ranking
Cantabria	393	1.705	2.880	129,0	1
La Rioja	171	876	2.719	121,8	2
Extremadura	580	2.934	2.650	118,7	3
Aragon	418	3.530	2.620	117,4	4
Castile and León	863	6.691	2.614	117,1	5
Asturias	299	2.726	2.514	112,6	6
Galicia	770	6.938	2.480	111,1	7
Castile-La Mancha	459	5.016	2.390	107,1	8
Catalonia	-152	16.565	2.205	98,8	9
Andalusia	1.081	18.049	2.156	96,6	10
Madrid	-436	13.922	2.156	96,6	11
Murcia	75	3.051	2.087	93,5	12
Canary Islands	140	4.213	1.989	89,1	13
Valencia	-597	10.094	1.975	88,5	14
Balearic Islands	-472	2.030	1.835	82,2	15
TOTAL	3.593	98.341	2.233	100	

Note: To be able to compare across AC, SF resources are adjusted according to specific powers assumed by certain ACs.

This grant significantly alters the ranking of the AC in relation to their initial position in tax capacity terms.

Catalonia moves from the 3rd to the 9th position in the ranking and falls to 1.2% below the Spanish average.

Unlike the GF grant, SF is not set to evolve in line with adjusted population's growth, reversing the previous levelling mechanism over time and triggering a significant loss of relative positions.

STEP 3: CONVERGENCE FUNDS

It contains 2 funds, the Competitiveness Fund and the Cooperation Fund.

- Competitiveness Fund: partially compensates those AC with per capita funding (tax revenue + GF + SF) below the average or below their fiscal capacity³.
The resources are distributed among beneficiary AC according to their adjusted population. However, the total amount of allocated resources to each AC is capped.
- Cooperation Fund: resources are devoted to those AC with a per capita GDP below 90% of the Spanish average or a population density below 50% of the Spanish average or with low density's population keeping a population growth below 90% of the Spanish average.

The resources are allocated among beneficiary AC distributing the total endowment on 2/3 according to their per capita GDP and on 1/3 according to their population (regarding the one third sub-fund, no AC may receive more than 40% of this sub-fund).

Autonomous Community	Cooperation Fund M€	Competitiveness Fund M€	Convergence Fund M€
Andalusia	500	0	500
Aragon	51	0	51
Asturias	145	0	145
Balearic Islands	0	559	559
Canary Islands	115	73	188
Cantabria	0	0	0
Castile and León	338	0	338
Castile-La Mancha	119	0	119
Catalonia	0	863	863
Extremadura	164	0	164
Galicia	380	0	380
La Rioja	12	0	12
Madrid	0	367	367
Murcia	80	62	142
Valencia	0	1.115	1.115
TOTAL	1.905	3.038	4.943

³ This differs from tax capacity index. It is gauged as follows:

$$ICFi = 0,75 + 0,25 \frac{CFi/Pai}{CFt/Pat} \quad \text{where}$$

CFi: AC's tax resources in normative terms

Pai: AC's adjusted population

CFt: total tax resources in normative terms

Pat: total adjusted population

AC FINAL RESOURCES

These final resources compound the main available funds to Autonomous governments in order to finance the responsibilities devolved to the AC. These resources are shown according to specific powers assumed by certain ACs to be able to compare across AC.

Autonomous Community	M€	€/person	index	ranking
Cantabria	1.705	2.880	122,8	1
Extremadura	3.099	2.799	119,4	2
La Rioja	889	2.757	117,6	3
Castile and León	7.028	2.746	117,1	4
Aragon	3.581	2.658	113,4	5
Asturias	2.870	2.647	112,9	6
Galicia	7.318	2.616	111,6	7
Castile-La Mancha	5.135	2.447	104,4	8
Balearic Islands	2.589	2.341	99,8	9
Catalonia	17.428	2.320	98,9	10
Andalusia	18.549	2.216	94,5	11
Madrid	14.289	2.212	94,4	12
Valencia	11.209	2.193	93,5	13
Murcia	3.193	2.184	93,1	14
Canary Islands	4.401	2.077	88,6	15
TOTAL	103.284	2.345	100	

Finally, the Convergence funds alter the final relative position placing Catalonia far below from its initial position: Catalonia obtains resources 1.1% below the Spanish average and ranks in the 10th position.

FINAL RESOURCES, REAL TERMS (PPP-ADJUSTED) INDEX

Resources are adjusted to reflect regional prices' differences.

Autonomous Community	index	ranking
Extremadura	137.5	1
Cantabria	127.2	2
Castile and León	125.0	3
Aragon	118.3	4
Castile-La Mancha	117.1	5
Galicia	115.1	6
Asturias	113.5	7
La Rioja	108.4	8
Canary Islands	104.0	9
Andalusia	97.9	10
Balearic Islands	95.3	11
Murcia	94.3	12
Valencia	93.4	13
Catalonia	91.2	14
Madrid	90.7	15

Note: These are computed using an index of relative consumer prices reported by FUNCAS (Spanish savings Banks Foundation)

Catalonia had the highest prices in 2010; 8.5% above the Spanish average. In real terms, Catalonia obtains resources 8.8% below the Spanish average and ranks in the 14th position.

EVALUATION OF THE FINANCING SYSTEM

Catalonia is ranked 3rd in tax capacity; 18.5% above the Spanish average. After the application of the whole financing system funds, Catalonia obtains resources 1.1% below Spanish average and moves to the 10th position. In real terms, these resources fall up to stand 8.8% below the Spanish average and rank in the 14th position.

In nominal terms, Catalonia loses 7 positions and almost 20 percentage points. In real terms, Catalonia loses 11 positions and 27 percentage points.

The financing system does not accomplish with the ordinality principle and it is highly arbitrary. Here are a few examples:

- There are 8 AC that receive more resources than Catalonia despite having a lower tax capacity (generating lower revenue in taxes).

- There are 3 AC that have a tax capacity below the average that end up with resources above the Spanish average.
- There are 3 AC that gain resources from the system in the end despite being relatively rich (above average).
- There are AC with similar initial tax capacity and significant different final resources.

DISTRIBUTION OF TAXES

100% TRANSFERRED TAXES TO THE AC

- Inheritance and gift tax
- Wealth tax
- Property transfer and stamp duty
- Gambling taxes
- Tax on electricity
- Special tax on certain means of transport
- Tax on hydrocarbon-oil retail sales

They represent the 11.2% of non-financial revenues of Catalan government (2012 Budget).

PARTIALLY TRANSFERRED TAXES TO THE AC

- 50% of personal income tax
- 50% of VAT
- 58% of excise duties on hydrocarbons
- 58% excise duty on manufactured production of alcohol
- 58% excise duty on manufactured production of tobacco

They represent the 63.1% of non-financial revenues of Catalan government (2012 Budget).

**Government of Catalonia
Ministry of Economy and Knowledge**