

## CATALONIA BACKGROUND INFORMATION [SERIES E / 2015 / 1.1 / EN]

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### FISCAL DECENTRALIZATION IN SPAIN

Fiscal decentralization is strongly endorsed by economic theory and international experience. The main argument justifying decentralization is that it increases citizens' welfare, as sub-central (regional and local) governments, being closer to citizens, have more information on their preferences and needs. Therefore they can better adapt public policies to these preferences taking this information into account. On the contrary, centralized systems, if they are uniform and homogeneous throughout the state despite locally different preferences, offer reduced levels of welfare (Oates, 1972). Another argument in favour of decentralization is the increased democratic control that citizens have over sub-central governments (Lockwood, 2006), which leads to higher levels of efficiency in the supply of public goods and services. Decentralization also offers higher incentives for innovation as there are many more governments offering the same services and the possibilities for innovation are multiplied. On the other hand, when there are no locally different preferences and the supply of a particular service presents high economies of scale (high fixed costs), then a centralized system will be more efficient.

This is seen quite clearly on an international level. In general, public services with a high fixed cost such as national defence are centralized whereas those services with a more personal character such as education, health, social services, cultural, leisure and even economic services are usually run in most countries at a sub-central government level.

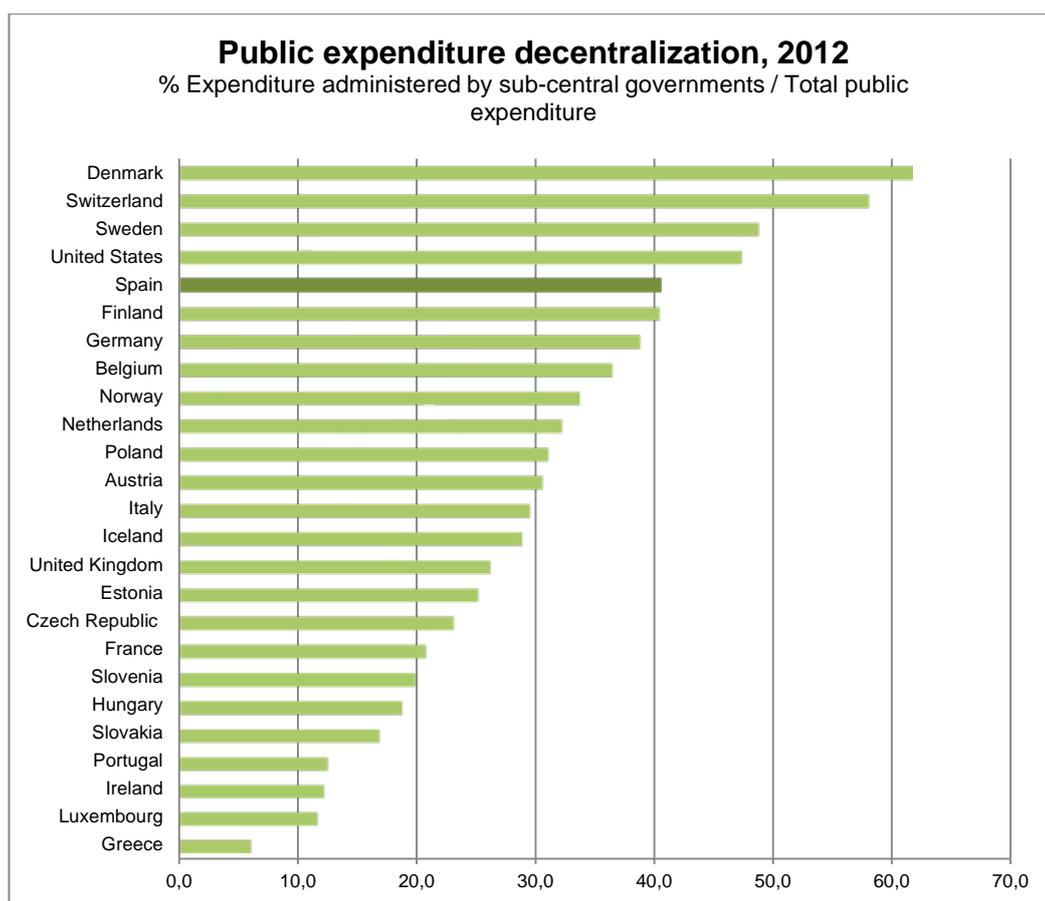
In this sense, it should be pointed out that decentralization is in place in both unitary countries – that is, those with two levels of government (local and central) – and federal countries – those with three levels (local, regional and central). In fact the most decentralized countries in the world are unitary countries (Denmark, Finland and Sweden).

Another issue to bear in mind is that decentralization means that the central government transfers to those levels of administration closer to citizens not just the capacity to decide and manage certain public policies but also the capacity to decide and administer the resources necessary to finance these transferred powers. For the decentralization of expenditure to be efficient and be economically guaranteed, this must also include a real decentralization of revenue. If, on the contrary, sub-central governments do not have control over revenues, their autonomy will be severely reduced.

Furthermore, it must also be mentioned that the most important aspect to decentralization is not so much the amount of expenditure or revenue managed

by the sub-central governments, but the capacity of decision they have regarding transferred expenditure and revenue powers. This is the key issue to decentralization. If this capacity for decision-making is low, we are faced with an administrative decentralization but not a real political decentralization. Thus, in essence, decentralization means diversity in policy design, management and also in results achieved. This is the true value of decentralization.

The most commonly used indicator to measure and compare internationally the degree of fiscal decentralization of a country is the expenditure administered by sub-central governments as a percentage of the total public expenditure of the country. The latest OECD figures show that in 2012 Denmark was the most decentralized country, where local spending made up 62% of total public expenditure, while the central government's expenditure made up the remaining 38%. Denmark is followed by Switzerland (local spending was 58% of total public spending), Sweden (49%), the USA (47%) and Spain (40%).



Source: OECD

However, as mentioned above, the amount of expenditure administered by a sub-central government and the capacity to decide on expenditure policies are two completely different matters. Although this is a difficult matter to quantify, it is highly significant qualitatively. For example, the Catalan government (the

Generalitat de Catalunya) has drawn up a report<sup>1</sup> listing the recentralizing measures taken by the current Spanish government in recent legislation. These measures have led to a significant drop in the Generalitat's capacity of decision, thus causing a serious conflict regarding policy and expenditure responsibilities. On the other hand, in other decentralized countries (particular in federal ones) the powers assigned to lower levels of government are full powers, thus making it harder for the central government to intervene.

Regarding revenue, in Spain we can see a lack of fiscal responsibility and financial autonomy of the autonomous communities which causes significant problems in managing the transferred public services and thus reduces the quality of fiscal decentralization. This is caused by the financing system by which these communities raise or receive revenues. The current model is based on two aspects: taxes and transferences. The autonomous community's own taxes make up an extremely small part of the former as they can only be applied in those areas where the central state has no legislation. The rest consists of the tax powers the State has passed on to the autonomous communities over time. These concessions include tax collection (the total or partial amount depending on each tax), capacity to legislate (basically regarding taxes on wealth and income tax), and revenue management (restricted to wealth and gambling taxes).

This lack of fiscal autonomy is worsened by the fact that, of all the transferred taxes collected by each autonomous community; only 25% reach the community directly. The other 75% is re-distributed among all the autonomous communities through four specific state funds (a fund to guarantee basic public services; a sufficiency fund; a cooperation fund; a competitiveness fund) dependent on certain parameters (population, status quo guarantee, etc.).

Hence, this model generates a lack of fiscal co-responsibility as the present system only allows autonomous communities to collect directly 25% of their taxation revenues. The 2012 income distribution figures for different governmental levels show Spain to be one of the most decentralized countries, with 57% of its non-financed income administered by central government, 31% by autonomous community governments and 11% by local bodies. However, in fact a significant part of the income assigned to autonomous communities, despite being transferred taxes, ends up being merely transferences, thus generating a lack of financial autonomy, significant risks of financial insufficiency, a very low level of fiscal responsibility and in compliance with the ordinality principle. The latter is seen in the fact that communities with a higher level of fiscal revenue raising, after the four re-distribution funds have been applied, end up in the lower positions on the list of resources per inhabitant, while those communities with less fiscal capacity have more resources per inhabitant to be able to fund the same services<sup>2</sup>. At the same time, the current model suffers from a lack of transparency and an excess of complexity which leads to a low level of citizen control, thus weakening one of the advantages of decentralization.

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<sup>1</sup> Generalitat de Catalunya (2014a)

<sup>2</sup> For a deeper analysis, see the information published by the Generalitat de Catalunya (2014b).

The Spanish constitution recognizes the fiscal sovereignty of the Basque country (Euskadi) and Navarre over all the taxation revenue raised in their area. In this way they enjoy a maximum level of fiscal autonomy and responsibility as they have complete legislating capacity regarding these taxes with no other limitations than those laid down by the European Union as well as the full capacity to collect and administer all the taxes via their own taxation agency.

In conclusion, it is clear that Spain still has a long way to go in the field of fiscal decentralization, both regarding expenditure and, above all, revenue.

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