**Tax Equalisation between Spanish Regions**

José M Durán-Cabré[[1]](#footnote-1)

1. Introduction

Spain had traditionally been a unitary country, with two tiers of government, the central government and the local one. The 1978 Constitution introduced a third level of government, the regional one, and Spain started a quite fast process of decentralisation. Nowadays, regional expenditure accounts for around 35% of all non-financial public expenditure, a greater percentage than that of many historically federal countries. Therefore, although Spain is not a federal country from a legal perspective, indeed from a fiscal federalism perspective and its experience in decentralisation, it may be a reference for unitary countries that have started or foresee to set out a political process of decentralisation, such as Morocco.

This paper is divided into three sections in addition to this brief introduction. Section Two aims to briefly explain the historical background. In section Three, the financing systems of the Spanish regions will be described while analysing their features, evolution and current situation. After analysing the Spanish experience, in the last section, the conclusions of this paper will be presented with an emphasis on what issues can be learned and what may be useful to take into account for an autonomous Sahara Region.

1. Background

The Spanish Constitution of 1978 marked the recognition of Spain as a democratic country and the creation of a new intermediate level of government, the Autonomous Communities (AC or ACs hereafter), covering autonomous regions. Although the claim for autonomy came in fact only from some regions (particularly, Catalonia, the Basque Country and to a lesser extent Galicia), finally the whole national territory was divided into autonomous regions, altogether 17 ACs, each one with its own autonomous institutions. This is the so-called “*café para todos*” (coffee for everyone) solution, the option adopted to solve this political problem of how to find a suitable fit for those regions claiming a system of self-government. Consequently, once the autonomic process began, territories that never before had claimed a regional government, also received recognition as ACs.

Nonetheless, the Constitution established two alternative systems of accession to autonomy: the high-speed way, whose pace for the recognition as an AC had to be faster and, in addition approved by referendum, or the slow way, whose pace was wider and for which an affirmative referendum was not required. This difference, although important at the beginning of the process because the level of responsibilities were not the same, became less important once all ACs became responsible for similar competences, mainly those related with the welfare state, such as education, health and social services.

Another difference introduced by the 1978 Spanish Constitution was the recognition of the “historical rights” of the so-called foral territories, which include two ACs, the Basque Country and Navarre. This has indeed been a very important difference, because, as I will later comment, these two regions have enjoyed a very different financing system, both from the point of view of tax power and from the one of the resources available for the responsibilities.

To sum it up, since the late seventies and early eighties, Spain has gone from being a unitary, centralised country to a highly decentralised one, where ACs play an essential role in the provision of public services and take up a significant share of public revenues. As a consequence, although Spain is not a federal country from a legal point of view, its current situation is nowadays much closer to one of federal country than to the one of unitary one, with three levels of government: central, regional and local. In this paper, I am going the concentrate on the regional one.

1. The Financing Systems of the Spanish Regions

The allocation of responsibilities among the different levels of government in Spain is set out in the Constitution, which establishes a general framework, and it is more precisely defined in the autonomy statutes of each AC. In general, there are three categories of power: exclusive powers of the State, shared powers and exclusive powers of the AC. The State is exclusively competent in certain matters, such as international relations, defence, and administration of justice, customs matters, currency, general finances and state debt. Exclusive powers of an AC may vary among regions, as it depends on their respective statute but, for instance, they are competences related with agriculture, rail and land transport transiting only through an AC or the organisation of the self-government institutions. Finally, the most important responsibilities are the ones shared between the State and the ACs, including education, commerce and consumer policy, banking and insurance, economy and finance or environmental protection, among many others.

In order to be able to exercise their responsibilities, ACs require revenues, which are foreseen in the same Constitution and are subsequently specified in the laws that regulate the financing system of the Spanish regions. There are two very different regional financing systems: the so-called common regime that covers fifteen ACs, and the special foral regime that includes only two ACs (the Basque Country and Navarre).

* 1. The Financing System of the Foral Territories

The foral system is based on “historical rights”, as specified in the First Additional Provision of the Constitution, and presents important peculiarities. Moreover, to my knowledge, currently there is no other developed country that employs a similar financing system. A short overview of the functioning of the foral systems reflects two key features: foral territories apply and collect all their taxes, with the exception of the custom and mandatory municipality taxes; the foral ACs transfer to the State an amount, which must reflect the cost of the public services offered by the State to the citizens of the foral territories.

As a consequence of this system, the tax autonomy of the foral territories is very large, especially in what regards the application of direct taxes; these territories establish their own legislation and are also in charge of administrating and controlling these taxes.[[2]](#footnote-2) For example, these territories apply their own personal income tax or corporate tax and, are also in charge of all the phases related with their application and control. The national income tax and corporation tax are usually not applied in these regions. In regards with indirect taxes, it is also worthy of mentioning the fact that these territories retain the part of taxes that corresponds to them, although, in this case their tax power is more limited as a result of the harmonised norms of the European Union (EU) regarding value-added tax (VAT) and excises duties. Therefore, they levy the national VAT or excise duties.

The revenues obtained from their taxes allow the foral communities to finance all their designated competences, and to contribute to the financing of all the other services provided by the State to their citizens.

The calculation system employed in determining this contribution, known as quota (*cupo*) in the Basque Country and payment (*aportación*) in Navarre, is therefore of crucial importance when determining the net results of the foral system, and even more important when comparing the foral system with the common regime applied to the rest of the ACs. This matter will be emphasised later in this paper, but I already highlight that the final result shows that the foral communities are greatly favoured by their financing system. If these communities were to apply the common regime, their results would be lower given that these territories have an average income higher than the Spanish average. The difference relies in the fact that the foral communities do not participate in the equalisation mechanism of the financing system of the common regime. This allows these communities to maintain their resources, which, without a doubt, is not equitable to the other communities. Indeed, when calculating the Basque quota or the Navarre payment, the equalisation is not taken into account, hence these communities do not participate in the financing of the equalisation grants.

* 1. The Spanish Financing System of the ACs of Common Regime

**Initial Phase**

Article 157.1 of the Spanish Constitution states that:

*“The resources of the Self-governing Communities shall consist of:*

*a) Taxes wholly or partially made over to them by the State; surcharges on State taxes and other shares in State revenue.*

*b) Their own taxes, rates and special levies.*

*c) Transfers from an inter-territorial compensation fund and other allocations to be charged to the State Budget.*

*d) Revenues accruing from their property and private law income.*

*e) Interest from loan operations”*.

The following article, no. 158, of the Spanish Constitution further details the concept of “inter-territorial” solidarity by noting that:

*“1. An allocation may be made in the State Budget to the Self-governing Communities in proportion to the amount of State services and activities for which they have assumed responsibility and to guarantee a minimum level of basic public services throughout Spanish territory.*

*2. With the aim of redressing inter-territorial economic imbalances and implementing the principle of solidarity, a compensation fund shall be set up for investment expenditure, the resources of which shall be distributed by the* Cortes Generales(Parliament) *among the Self-governing Communities and provinces, as the case may be”.*

In order to comply with the institutional mandate, the 8/1980 Law was adopted, regarding the financing of the ACs. The law regulates the fundamental frame of the autonomic financing. As expected, this system has suffered various reforms throughout the course of time to comply with the greater role of the ACs regarding their expense competences.

Indeed, there was a progressive transfer of competences from the State to the AC done at different paces depending on the AC. The State also estimates the amount of resources each community should receive according to the competences they manage and by using the effective cost of the services in the moment of the transfer as a basic element for the assessment of the amount. The financing of these services is initially done by ceding certain taxes and by transferring a general grant known as “participation in the general revenues of the State”. The ceded taxes in this first stage are mainly related to wealth (basically, Annual Net Wealth Tax, Inheritance and Gift Tax, and Capital Transfer Tax and Stamp Duty), which therefore are not very significant from a revenue perspective. ACs are responsible for their administration, but they cannot introduce legal changes to them.

ACs can also levy their own taxes and fees, although they cannot levy any taxable event already taxed by the State or municipalities, which in fact means they can only implement minor taxes as most important events are already taxed. Furthermore, ACs may under no circumstances introduce measures to raise taxes on property located outside their territory or likely to hinder the free movement of goods or services.

Consequently, the main revenue source of the ACs, in this first stage, will be the amount of grants received. The grants will be specific whenever they correspond to certain expenses or general whenever their scope is the financing of the totality of expenses of a community, and is calculate as a percentage of the total taxes of the State.

**Evolution**

The 8/1980 Law which regulated the financing system of the ACs under the common regime, established that a revision of the model shall take place every 5 years, with the objective of allowing it to adapt to a changing reality, especially in what regards the increasing role of the ACs in the expenses policies. This is why we can observe a new financing system for the years 1981-1986, 1987-1991, 1992-1996 and 1997-2001. In 2002, a definitive financing system was established in order to give the Spanish autonomic system a final form. Nonetheless, the always-changing Spanish reality of the following years, has forced the implementation of a new system in 2009 and the reintroduction of the five year revision clause.

The reforms are established in the frame of the Fiscal and Financial Policy Council, institution created by the 8/1980 Law in which both the State and all ACs under the common regime participate and whose main goal is to assure the coordination between the ACs and the State for public finance matters. Nonetheless, before reaching formal agreements within the council, in practice there may be bilateral meetings and pacts between the State and different ACs, agreements which looked for the best interest of each AC. Moreover, in fact, Catalonia has been the leader of the negotiation process and has had a great influence on the directives and main points of the financing systems that should be subject to change. For example, the percentages of ceded taxes to the ACs of the current system, which will be discussed in greater detail later, were initially established in the new Statute of Autonomy of Catalonia, and later generally applied in the agreement regarding the new financing system.

Two elements of the different reforms introduced are of crucial relevance and of practical use for the autonomy of the Sahara.

* In Spain, the development of the financing systems of the ACs has seen a rapid increase in regards to the expenses assumed by the ACs, while the revenues have been modified at a very different pace. This fact generates a high dependency of the ACs on the grants received by the State, as they represent the main financing sources of their expenses. Therefore, there is an absence of equilibrium in what concerns fiscal responsibility. The recurring reforms, especially those applied in 1997 and 2002, have tried to increase the percentage of ceded taxes and the tax power of the ACs, as well as reducing the relative importance of the grants. The partial cession of the personal income tax represents a very relevant change given the high importance of this tax.
* The final results of the financing system, that is, the amount of resources per capita that each AC receives in order to finance its competences, offer outcomes difficult to understand as a consequence of the lack of equity criteria. There is no explicit criterion or a concrete objective in regards with equity due to the fact that the equalisation grants are calculated bases on hypothetical expenditure needs that are highly depended on the starting point, the so called “status quo”. The recurring reforms have always respected the status quo and the fact that no community could lose as a consequence of the new financing system. This fact will be further explained, as I continue to analyse more deeply the current system.

**Current System: Features**

The current financing system established for the 5-year period of 2009-2013 contemplates the following characteristics regarding the tax power:

* The ACs receive revenues from a wide range of tax sources (tax basket), further explained in Table 1. This includes the main taxes of the Spanish taxation system, including the Personal Income Tax and the Value Added Tax, that are by far the two taxes that raise the higher amount of tax revenues. Even if the cession is not total, the transfer percentages are high and represent at least half of the raised revenues.
* The tax power, as explained in Table 1, varies highly. If the level is high this means that the AC can modify, without restrictions, the tax rates, deductions and tax credits. If the level is medium, as it is in the case of the income tax, this means that the AC has the right to modify the regional tax rates of the tax corresponding to the general tax base, as well as the thresholds and tax credits with certain restrictions. However, does not provide ACs with the authority to modify the tax rates applied on the savings tax base of the income tax. When the tax power is low, it is limited to the modification of the tax rate within certain range.
* As far as the administration of the tax is concerned (last column of Table 1), ACs are responsible for the management, auditing and collection of only minor taxes, which means that most revenues are collected by the State Tax Administration Agency.

**Table 1: Bundle of taxes for the common regime ACs**

|  |  |  |  |
| --- | --- | --- | --- |
| TAX | ACs’ share | AC legal power | Administration |
| Income Tax | 50% | Yes, medium | State |
| VAT | 50% | No | State |
| Excises (fuel, tobacco and alcohol) | 58% | No | State |
| Capital Transfers Tax | 100% | Yes, high | AC |
| Stamp Duty | 100% | Yes, high | AC |
| Inheritance and Gift Tax | 100% | Yes, high | AC |
| Annual Net Wealth Tax | 100% | Yes, high | State / AC |
| Car Registration Tax | 100% | Yes, low | State / AC |
| Gambling Tax | 100% | Yes, high | AC |
| Retail Fuel Sales Tax | 100% | Yes, low | State / AC |
| Electricity Tax | 100% | No | State |

Related to the equalisation mechanism, the current financing system sets out an important first grant called the *Guarantee Fund*:

* This is an explicit equalisation grant for essential services of the welfare state, with the aim of allowing all ACs to provide a similar level of essential welfare state services (education, health and social services) while making a similar fiscal effort. The so-called Guarantee Fund is composed by 75% of ceded taxes plus a contribution from the State. This 75% is intended to represent the weight of the welfare-state expenditure in relation to the total expenditure of the ACs. Furthermore, as ACs might have used their regulatory powers or are responsible for all collecting tasks regarding a few taxes, which in turn affect their final revenues, tax revenues considered for the grant are calculated from a normative point of view. This fund represents, therefore, the total ACs’ expenditure needs that are funded.
* The resources of the Guarantee Fund are distributed among the ACs according to different variables representing their expenditure needs. The variables and their weightings are shown in Table 2. The most important indicator of needs is related to the population, with a weight of 97%. For this reason this global indicator is known as the *adjusted population*.
* The corresponding amount from the Guarantee Fund to each AC is the difference between its respective expenditure needs and 75% of its ceded taxes (an indicator of its fiscal ability).

Therefore, the Guarantee Fund of an AC is positive when its fiscal ability is below its expenditure needs, but can also be negative if its fiscal ability is greater than its expenditure needs. It is both a vertical and a horizontal fund, and the equalisation of the fund is complete as all the ACs dispose of the same resources to provide essential welfare services.

**Table 2: Indicator of needs for the common regime ACs**

|  |  |
| --- | --- |
| Resident population | 30.0% |
| Protected population by age brackets | 38.0% |
| Population over 65 years | 8.5% |
| Population between 0 and 16 years | 20.5% |
| Total population variables | **97.0%** |
| Area | 1.8% |
| Geographic dispersion | 0.6% |
| Isolation (island) | 0.6% |
| Total non-population variables | **3.0%** |
| TOTAL | **100.0%** |

In addition to the Guarantee Fund, ACs also obtain 25% of ceded taxes, which depends on the fiscal ability of each region. These are, therefore, non-equalised resources, which imply that overall equalisation is partial, that is, only complete up to 75% of resources.

Nonetheless, the equalisation system also sets out three other funds, called adjustment funds:

* The *Global Sufficiency Fund* which guarantees the “status quo” and that all ACs obtain more revenues with the new financing system compared to their previous situation. The fund can be positive but also negative if the corresponding resources according to the “status quo” are smaller than ceded taxes plus the Guarantee Fund. Therefore this fund is an element of a complete equalisation mechanism, contrary to the partial equalisation of the previous guarantee fund.
* The *Competitiveness Fund* seeks to improve equity and efficiency by reducing the differences in financing per capita between the ACs. The beneficiaries are those ACs whose per inhabitant financing (tax revenues, Guarantee Fund and Sufficiency Fund) is below the average or that have a financing per inhabitant index that is lower than their fiscal ability index per inhabitant. The fund is distributed among ACs’ beneficiaries on the basis of the adjusted population.
* Finally, the *Cooperation Fund* seeks to achieve regional development and stimulate regional growth and convergence in terms of income. The fund is only for ACs with low regional GDP per capital, low density of population or low population growth. The fund is distributed according to relative population and GDP disparity.

**Current System: Assessment**

The current financing system must be evaluated according to the different elements that integrate it.

Firstly, from the *fiscal responsibility* perspective, it can be positively valued, as the tax basket is composed of a high number of taxes, including those that currently represent the pillars of the Spanish taxation system. The percentage of these taxes over the total resources of the ACs is of 83.9% in 2010 according to the calculations completed by De la Fuente (2012) and shown in Table 3. Nevertheless, it is important to highlight that the taxes over which the ACs hold legal power represents only 48.1% of their total resources. As expected, this value differs greatly from AC to AC according to the tax ability of each one; nonetheless, it reflects that, in average, less than half of the revenues depend on the decisions made by the ACs.

Nonetheless, as far as the fiscal responsibility is concerned, the result is even worse as official polls made about the role of the ACs (*Instituto de Estudios Fiscales, Área de Sociología Tributaria,* 2011), show that yet most Spanish citizens do not know that the most significant taxes fund both the State and the ACs. Indeed, in 2010, therefore after more than 15 years of sharing the tax, only 23% of Spaniards recognise that the personal income tax is also levied by ACs. The conclusion of all this would be that it is not sufficient to grant normative powers; the manner in which the whole process is developed is also really important. If the decentralisation is not visible to the public eye, the gain in terms of fiscal responsibility will be minimal.

Another matter to take into account refers to the equalisation mechanisms of the financing system. As one probably noticed in the previous part, the equalisation mechanism is rather complex, opaque and difficult to comprehend. The current financing system sets out for the first time in Spain an explicit criterion regarding equity which implies that 75% of all tax resources of the ACs will be subject to equalisation, in order to guarantee that all ACs can finance all expenses of the welfare system by making the same fiscal effort. The remaining 25% will not be equalised because, in theory, it will be distributed between communities according to their economic ability. Hence, until now, one can state that the system is designed by employing certain logic ground. Nonetheless, the introduction of the adjusted funds contradicts the previous argument. On one hand, the system continues to pursue the maintenance of the status quo, as all the previous system did, although this idea does not comply with the equity criterion that the own system explicitly establishes. On the other hand, given that the maintenance of the status quo would imply large disparities between the regional resources, another fund was implemented: the Competitivity Fund. This fund aims to reduce disparities by compensating the ACs that end up with worse financing. Furthermore, this system marks the introduction of a new fund for poorer and less developed regions, although already there is a specific fund for the economic development of less developed regions, which given this specific fund it is not contemplated in the autonomic financing system.

As it can be observed in Table 3, the final results of the financing system in 2010, its second year of application, present disparate results in regards with equity. Column 3 details the adjusted average financing per capita each AC received according to what the financing system establishes. In order to facilitate the comprehension of this value, it is presented as an index, where 100 represents the average value for all the ACs, while a value greater than 100 indicates that the community receives more resources per adjusted capita than the average and a value inferior than 100 indicates that the resources of the community are below the average. The final resources of each AC proceed from its own fiscal ability (column 1) and the different grants of the equalisation system (column 2). ACs are ranked from higher to smaller fiscal ability (column 1). If the equalisation system were partial, the situation would reflect that ACs whose fiscal capacity is higher than the average, in our table from Madrid to Asturias, would also benefit from higher resources per capita and that the ranking of the ACs would remain unchanged. Consequently, Madrid should be the AC with the highest resources per capita, followed by Baleares and the rest of the ACs. Nonetheless, this circumstance does not occur. If the equalisation system were to be total, all ACs would have the same resources and the value obtained in column 3 would be 100 for all ACs. However, this circumstance does not occur either. Hence, there is not clear logic that explains the result of the system.

Rich regions, such as Cantabria and La Rioja, whose fiscal ability is above average, are greatly benefited from the equalisation system. However, other rich regions such as Madrid, Baleares and Catalonia lose resources from the application of the equalisation system. On the other hand, poor regions, whose fiscal ability is below the average, such as Extremadura or Castille and León are greatly benefited by the equalisation system and, obtain final resources that are above the average. We can also encounter poor regions such as Valencia, Murcia or Andalusia, that although they benefit from the equalisation system, their final per capita resources are below the average. This result is a consequence of different factors, but the maintenance of the status quo is by far the most important and influent factor.

**Table 3. Average financing index per adjusted capita. 2010**

|  |  |  |  |
| --- | --- | --- | --- |
| ACs | Homogeneous fiscal ability  (1) | Funds  (2) | Total resources  (3) |
| Madrid | 120.3 | -19.6 | 100.7 |
| Balearic Islands | 104.5 | -2.1 | 102.4 |
| Catalonia | 99.5 | -0.2 | 99.3 |
| Cantabria | 91.1 | 26.8 | 117.9 |
| Aragón | 89.1 | 15.8 | 104.9 |
| La Rioja | 84.8 | 31.1 | 115.9 |
| Asturias | 84.0 | 23.4 | 107.4 |
| Average (all ACs) | **83.9** | **16.1** | **100.0** |
| Castille and León | 79.7 | 29.7 | 109.4 |
| Valencia | 77.4 | 15.5 | 92.9 |
| Murcia | 72.4 | 22.9 | 95.3 |
| Galicia | 70.9 | 34.6 | 105.5 |
| Andalucía | 69.0 | 26.9 | 95.9 |
| Castille-La Mancha | 68.7 | 30.0 | 98.7 |
| Extremadura | 60.4 | 52.6 | 113.0 |
| Canary Islands1 | 43.51 | 51.8 | 95.3 |

Source: De la Fuente (2012)

1 The financing of the Canary Islands has certain peculiarities that do not allow a comparison between its fiscal ability and the ones of the other ACs.

1. What Can Be Learned from the Spanish Experience in order to Regulate a Financing System for the Autonomous Sahara Region?

**The Coexistence of Two Systems with Disparate Results**

Two different systems of financing regions exist in Spain: the common one, applied in fifteen ACs, and the foral one, that affects only two regions. Each one, as explained in the previous section, has very different features, particularly the foral system, which marks an unprecedented system within the international framework. No federal country has a regional financing system similar to the foral one. On the other hand, a key difference between the two systems is precisely the equalisation mechanism between regions. The territorial equalisation aims to assure that those territories with lesser resources can provide, with equal fiscal effort, a similar level of public services to their citizens. I do not deal now with the extent to which this objective is achieved; I only want to point out that an equalisation mechanism exists and, in general, richer communities contribute and fund it, while poorer ones benefit from it. Nonetheless, this situation is not encountered in the foral system, because the payments made by these two communities do not contemplate the existence of the equalisation mechanism. These circumstances are not a result of norms dictated by the Spanish Constitution; they are the result of the laws that regulate the foral system, laws that, of course, can be modified. The consequence of this difference is that given that the foral communities are regions with higher income than the Spanish average, the current financing system allows them to obtain higher (around 50%-60%) per capita revenues than the rest of the ACs. Without a doubt, this difference represents a destabilising item of the autonomic financing and, if I may so, of the same state of the ACs themselves.

In practice, the difference between the results is generally seen in Catalonia, community where an important part of the population has a deep nationalistic sentiment, as an unfair disadvantage. Being one of the rich regions, the final resources that reach Catalonia after the financing systems is implemented have always been lower, and sometimes much lower, than the resources obtained by poorer communities. From the Catalan perspective, the question to raise is quite straightforward: why should one region finance equalisation grants if other ACs with similar income do not do it? Faced with this situation, the alternative chosen by many was requesting the same treatment received by the Basque Country and Navarre, without assessing whether there is any technical foundation in this request. We should not forget that the main goal is to obtain the same results or at least similar results. This is a matter which generates divided opinions, and each person has its own, but as an observer of the reality, I consider that the current discussion regarding Catalonia’s independence would be significantly different if the difference between the results of the foral system and the common one would be lower.

As a consequence, in Spain, and now in Morocco, the recognition of the autonomy of a region is proposed as the solution to an existing political problem. The financing of these autonomies is also due to a political agreement. Nonetheless, it is utterly important to assure that the economic results of the chosen system must not allow the existence of certain disparities which ultimately are nothing but a continuous source of conflict, and represent an obstacle in solving the tackled problem.

**The Territorial Equalisation**

In the common regime of autonomic financing system of Spain, the first step consists in calculating the expenditure needs of each AC, ceding certain taxes and determining certain equalisation grants in order to cover the expenses generated by the respective expenditure needs. Nonetheless, this calculation is not an easy one and was not done properly since its very beginning. This fact has generated a starting point, the previously mentioned *status quo*, which has subsequently conditioned all the recurring reforms. The current equalisation mechanism is immensely complex, not very transparent, its grounds are difficult to comprehend and it generates a final resources allocation that could easily be qualified as arbitrary. In the case of Catalonia, this situation has also been considered as a factor of discrimination which undoubtedly is behind the current independency controversy. Indeed, whenever a pronounced nationalist sentiment exists, there is added difficulty in understanding why after the implementation of the solidarity mechanism, a richer region receives fewer resources per capita than poorer regions. From this perspective, we could state that the financing system is inefficient because it penalises richer regions. Furthermore, the system is also regarded as unfair because it does not show a clear pattern in its results: some rich regions are benefited by the regime, while others are not; its effect on the poorer regions can also be disparate.

In conclusion, a recommendation would be the **implementation of an equalisation system with a clear and explicit equity criterion and, in which the calculation of the equalisation grant is coherent and according to the established equity criterion**.

**The Fiscal Responsibility**

The recognition of the autonomy of a community has already been categorized as a political issue. However, when determining its functioning economists can provide useful recommendations in order to improve it. In regards to the fiscal responsibility, it is important to highlight that governments must be, in the eyes of their citizens, the main responsible for the revenues and spending. While it is true that equalisation grants must have a role in the financing system, we must not disregard the fact that when grants are the main revenue source of a territory, and the autonomy of it only reflects in its ability to decide its own expenses, the government of said territory can easily claim that its actions are limited because the central government does not provide it with all the necessary resources. The autonomic government must be held responsible in front of its citizens both for the ways in which it uses and raises funds. It is always easier to increase the expenses of a certain competence when revenue comes from another government than to increase a tax that allocates more resources for specific purposes. If the government does not have enough tax autonomy, it has a higher incentive to spend the received funds in an irrational way.

The severe economic crisis suffered by Spain in recent years has clearly shown that the fiscal illusion produced in the years of rapid economic growth has led various governments to dedicate resources to superfluous objectives and to a wasteful pattern of spending. The Spanish real estate boom had led to increasing public revenues and had generated a clear sentiment of fiscal illusion. The taxation of certain taxable events related with the real estate market, taxes which were little perceived by the citizens, had generated high revenues during the growth phase. This is not a consequence of decentralisation, but it represents a clear example of what fiscal illusion can provoke.

Concluding, the recommendation is that **ACs must have sufficient tax power and this power must be perceived and understood by citizens. The Moroccan Initiative stipulates the correct principles, which subsequently will have to be developed**. Clearly, as with all the processes, its implementation must be gradual, matter which I following comment.

**Autonomic Financing: an Open Process**

The recognition of autonomy, and its consequent implementation, creates a decentralisation process with regards both to the expenditure and revenue sides, which must be done progressively. In any case, as demonstrated by countries with an extensive federal tradition, this is an open process that evolves in time and this evolution does not always go in the same direction. The Spanish experience in autonomous development is still young although the system has been developing during the last 35 years; however this experience is sufficient enough to say that, in what concerns financing, the process is an open one. The economic evolution is not lineal: some periods register growth and others recessions. Population also varies with the course of time. The role of governments in the functioning of the economy has also seen great variations. With all this taken into account, it is important for the financing system to consider all these changes periodically in order to better adjust to a changing reality. For example, when determining the equalisation grant, the system should establish how this amount should change each year and establish an almost automatic index of evolution. However, afterwards, from time to time, the model should be evaluated and revised, as well as reformed whenever it is considered appropriate. The experience derived from its application and the results obtained must be useful tools towards the improvement of the financing system.

Moreover, **discussion forums should be organized**. All ACs should participate in order to exchange ideas between themselves and also with the representatives of the State, and create a political and technical debate that would help the improvement of the autonomy. As previously stated, the recognition of the autonomy of one or more regions is a political decision. Nonetheless, how to assure that an autonomous region is properly functioning is not only a political matter but also a technical one. The experience of other countries can without doubt shed light on this matter. From the Spanish experience **a clear, transparent and coherent financing system is an essential recommendation**.

1. Conclusions for the Initiative

The Moroccan initiative for negotiating an autonomy status for the Sahara region foresees the distribution of powers between the Sahara autonomous region and the State, as well as the regional financial resources required for the development of these powers. Similar to the Spanish Constitution, article 13 of the Initiative states that the resources of the Sahara autonomous Region will come in particular from:

* Taxes, duties and levies enacted by the regional authorities;
* Proceeds from natural resources allocated to the Region or the share of proceeds collected by the State from natural resources locates in the Region;
* The necessary funds in order to keep with the principle of national solidarity;
* Proceeds from the Region’s assets.

Therefore, the Initiative stipulates a basic framework of a regional financing system with two key issues:

* Taxes, duties and levies enacted by the Region in order to guarantee the principle of fiscal responsibility to the autonomous region;
* The necessary funds in order to guarantee the principle of national solidarity.

Logically, these two issues will require a further development made by law, which will have to take into account other important questions. As far as tax responsibility is concerned, what taxes are suitable for decentralisation; what legal power is allocated to the region; and what government is responsible for collecting the taxes. Regarding the equalisation mechanism, what level of national solidarity is established; and what sort of equalisation mechanism, based on the assessment of expenditure needs (as the Spanish or the Australian ones) or based on the fiscal ability (as for the Germans or Canadians).

These are rather technical issues, but indeed important for the good functioning of the system. For instance, not all taxes can be easily decentralised. A value-added type tax and the corporation tax are two examples of taxes that, although possible, are quite difficult to decentralise. An income tax or a property tax, by contrast, would be easier to decentralise, although taking into account that the possible impact on redistributive or competitive issues. Likewise, before decentralising tax collection and tax auditing policies it is important to assess if the regional government can be ready to take this responsibility. Therefore, there are significant technical matters to be considered as they finally affect the smooth functioning of the financing system. On the other hand, the equalisation mechanism is a sensitive issue, where the widest possible consensus is always welcome. If there is a single autonomous region, the mechanism requires the agreement from both the regional and the central governments.

In conclusion, decentralisation is an open process that evolves in time. For that reason, it is important to introduce a clear and a coherent financing system, to establish mechanisms of collaboration between the different governments and to foresee periodically the assessment and revision of the financing system.

**References**

* Bosch, N. (2010), “The Reform of Regional Government Finances in Spain”, *IEB’s World Report on Fiscal Federalism 2009*, Instituto de Economía de Barcelona.
* Bosch, N.; Durán Cabré, J.M. (2005), “Evolución del sistema de financiación de las CCAA en los últimos 25 años y perspectivas de reforma”, in N. Bosch; J.M. Durán Cabré (eds.) *La financiación de las comunidades autónomas: Políticas tributarias y solidaridad interterritorial*, Publicacions i Edicions Universitat de Barcelona.
* Bosch, N.; Durán Cabré, J.M. (2008), “The financing system of Spanish regions: main features, weak points and possible reforms” in *Fiscal Federalism and Political Decentralization: Lessons from Spain, Germany and Canada*, N. Bosch and J.M. Durán Cabré (eds.), Edward Elgar Publishing Ltd.
* De la Fuente, A. (2012), “El sistema de financiación regional: la liquidación de 2010 y algunas relfexiones sobre la reciente reforma”, Hacienda Pública Española / *Review of Public Economics*, 203, 121-138.
* Instituto de Estudios Fiscales (2011). *Opiniones y actitudes fiscales de los españoles en 2010*. Documentos de Trabajo. Madrid.

1. Professor of Political Economics, Barcelona University. [↑](#footnote-ref-1)
2. In fact, taxes are regulated and collected by provincial counties, rather than by ACs, something relevant in the Basque Country, which consists of three different provinces, Álava, Guipúzcoa and Vizcaya. Consequently, Basque provincial counties must contribute with the financing of regional government’s expenditures according to a distribution formulae mainly based on the income of each province. This situation does not take place in Navarre because there is only one sole province and, therefore, provincial county and AC are the same. [↑](#footnote-ref-2)