

Fiscal federalism and regional integration: lessons from Spain

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1. Introduction

After a long dictatorship, which ended with the death of Franco in 1975, Spain started a transition period that involved important changes in its political, social and economic structure. The fiscal decentralization process, and the integration of Spain in the European Community (presently European Union) are part of the changes linked to the democratization process. Although both processes share the timing, they moved along different and independent paths. Neither of them limited or enhanced the progress of the other.

The design and evolution of the fiscal decentralization model for Spain, with the creation of seventeen Autonomous Communities (ACs), is mainly the result of a complex political negotiation, rather than a search for economic efficiency in the application of the principle of subsidiarity. It also reflects the fear of the central government to loose control, political but also economic control. The outcome is that the Autonomous Communities end up having important expenditure responsibilities, but the central government keeps under its control almost all revenue authority. This separation of expenditure responsibilities from revenue raising authority builds in the model important incentives for economic inefficiency.

Although the economic links to Europe had been important for many years, accession to the European Community was not possible without democracy. In July of 1977, immediately after the first democratic government was elected, Spain submitted its application to become member of the European Communities (EC). Membership into the EC became a reality in January of 1986, after a long and laborious negotiation. By this time the State of the Autonomies was a reality, and although devolution from the central to the regional governments was going at its own pace, with some regions having more responsibilities than others, decentralization was in a path that had no return.

It is not until integration is already a reality and decentralization is well established that the two processes start having some interaction. There are several dimensions where one can identify the influence of the integration process in the evolution of the decentralization model. One clear influence is the European regional development policy, which, as we will see in detail, becomes an important source of financing for the poorest regions of Spain. The Spanish regional solidarity fund, established within the fiscal decentralization model, was in 1990 redesigned and closely linked to the European structural funds.

The Maastricht Treaty, and the convergence conditions that all member states had to meet to access the Monetary Union, also had some impact on the financing conditions of the Spanish regional governments. Regional debt had increase fast in the years 1989-1992, and although it did not translate into large amounts of accumulated debt because the starting point was low, the central government, in its 1992 Convergence Program included some limits to the debt of the Autonomous Communities. It is not clear how binding these limits were, as the regions that had larger debts and were not meeting the requirements established in the plan (*Escenarios de Consolidación Presupuestaria*) got extensions to their limits, which therefore lost their effectiveness. More recently, the central government, through the *Ley General de Estabilidad Presupuestaria* approved in December of 2001, imposed a balanced budget on all layers of the public administration, including the ACs. The requirements of this Spanish law are more restrictive than the Growth and Stability Pact established in 1997 for the EMU countries, and therefore its implications for the financing of the regional governments cannot be considered a consequence of the integration of Spain in Europe.

The harmonization on indirect taxation at the EU level has recently conditioned the jurisdictional powers over some indirect taxes (such as VAT) that were partially ceded to the Autonomous Governments as of January 2002. It is under question, thought, if the central government would have given more legislative freedom to the Autonomous governments had the EU restrictions not been in place.

Subtler, but probably more important, impacts of the accession of Spain to Europe are the incentives to become a more competitive and efficient economy, and to require more policy and budgetary discipline. The spillover effects of this process on the organization and behavior of the fiscal decentralized model has, to my knowledge, not been studied and goes beyond the goal of this paper.

In what follows we describe the fiscal decentralization model of Spain, pointing out those characteristics that make it quite unique. We also present a brief description of the Spanish economy viewed from the regional perspective. Along the chapter we try to point out the interconnections, if they exist, between the fiscal decentralization process and the integration to Europe.

2. Fiscal decentralization: an asymmetric model¹

2.1 Basic framework

Spain is presently divided in seventeen regions², called Autonomous Communities, with regional governments that were created following the guidelines established in the democratic Constitution ratified in 1978. The details of the decentralization process were developed in a high level law, “Ley Orgánica de Financiación de las Comunidades Autónomas” (LOFCA) passed in 1980. During the early 1980s, each Autonomous Community developed and approved its own Statute of Autonomy, in accordance with the general principles of the Constitution and the LOFCA.

The fiscal decentralization model in Spain presents some asymmetries that respond to the historical regional differences and the complex political process in which the model was negotiated and approved. Regional diversity in Spain is large in many dimensions,

¹ Parts of this section are extracted from “Fiscal Decentralization in Spain: An Asymmetric Transition to Democracy”, by Teresa Garcia -Milà and Therese McGuire, forthcoming in a volume edited by Richard Bird that will be published by the World Bank.

² See the map in Figure 1 for location and names of the seventeen Autonomous Communities.

including history, culture, language and economic conditions. Some regions have a national identity enhanced by the existence of their own language. Such is the case of the Basque Country, Catalonia and Galicia. Also some had in the past their own forms of government. For centuries Navarra and the Basque Country had a particular political and fiscal arrangement (“fueros”), that survived centralizing attempts of different Kingdoms. Catalonia, that had lost its political and administrative autonomy in 1714, established an autonomous regional government in 1932 that endured through the short-lived Second Republic and the three-year Civil War that started in 1936. Galicia adopted an autonomous system in 1936 that was never implemented because of the eruption of the Civil War.

It is not therefore surprising that the decentralization process was designed with some asymmetries that are well established in the Constitution. The most important asymmetry enacts two completely different systems of decentralization, the Foral and the Common regimes. The Foral regime is instituted for only the Basque Country and Navarra, while the Common regime is applied to the other fifteen regions³. The primary difference between the two regimes is that regions in the Foral regime have authority to raise taxes locally, whereas regions in the Common regime have limited local taxing authority, although it has increased over the years. In terms of spending responsibilities, the regions of the Foral regime have had similar responsibilities to the five regions under the Common regime with high responsibility level.

The **Foral** regime is characterized by an almost complete decentralization of the revenue responsibilities, and quite important devolution on expenditure responsibilities, including health and education. The majority of the taxes are ceded (impuestos concertados) to the autonomous government, that is responsible for tax administration and has autonomy (with some constraints that were eased in 1997) to set rates and bases. The major taxes – income, corporate, wealth, inheritance and wealth transfers – are fully administered by

³ We leave aside the African cities of Ceuta and Melilla that have presently a similar status than the autonomous communities of the common regime.

the regional government⁴. The value added tax (IVA) is collected and administered by the regional government, but without any authority to set rates or define the base.

To compensate for the services that the central government provides to the region, the regional government pays an amount to the central government (“cupo” for the Basque Country and “aportación” for Navarra). These transfers from the regional to the central government are calculated as a percentage of the difference between the *national* cost of those services not devolved and the *national* revenue of the taxes not devolved. The percentage is a function of the region’s income share. The Foral regime regions also contribute to the central government’s solidarity fund, which will be discussed in more detail in the next section.

The **Common** regime was set up under almost opposite grounds to the Foral regime. The main source of revenues were transfers from the central government, complemented with the revenues of some ceded taxes, although this was largely an administrative role since, unlike the regions of the Foral regime, they had no authority to set tax rates and bases for these taxes. Initially the ceded taxes were: wealth, inheritance, wealth transfers and taxes on gambling. Excise taxes and fees on services provided by the regional governments were under the responsibility of the Autonomous Communities. The Common regime has undergone many revisions, and most recently a substantial change, effective as of January 2002, that cedes some taxing authority to the regional governments⁵.

There is a second layer of asymmetry established by the Constitution that affects the regions under the Common regime. Two alternative paths for devolution of spending responsibilities are defined, one slow and one fast, established in Articles 143 and 151, which is how the two sets of regions are sometimes referred. The two groups were given different amounts of spending authority. All regions were responsible for what has been called common responsibilities: 1. Forestry, agriculture, livestock and fisheries in internal

⁴ The provincial governments (Diputaciones) are the ones that effectively collect taxes and then transfer the revenues to the regional government. The main issue here is that taxes are paid and stay in the region and it is the region that transfers resources to the central government and not the other way around.

⁵ Details of those changes will be discussed later on.

waters; 2. Urbanism and housing; 3. Roads; 4. Ports and airports without commercial activity; 5. Hydraulic exploitations, channels and irrigation; 6. Environmental protection; 7. Monumental patrimony of the Autonomous Community, cultural promotion and of the regional languages, libraries, museums and conservatories; 8. Self-government institutions; 9. Internal commercial fairs, sports promotion and tourism. In addition, the five high-responsibility regions were responsible for health and education, attaining the same level of expenditure devolution as the regions under the foral regime. In Table 1 we summarize this information⁶.

The Constitution specifies that eventually the two paths could meet, whereupon all of the regions in the Common regime would have identical spending responsibilities. That occurred in January 2002 when the final transfer of health responsibilities was agreed upon.

2.2 Evolution over time

To the complexity of the model, with the Foral and the Common regimes, and the coexistence of high and low responsibility regions within the latter one, we find yet another complexity, its revision every five years, many times with additional adjustments, bilateral negotiations and other agreements in between formal revisions. In some occasions not all regional governments have accepted the revised model (that was the case for Extremadura, Andalucia and Castilla la Mancha in 1996), coexisting the two regimes, the two layers of responsibility within the common regime, and two financing schemes for the common regime, the revised for the majority of regions, and the old one for the three that had opted out. Fortunately the latest revision, agreed upon in July 2001 and effective as in January 2002, has brought back all the Common regime regions to a unique system that does not require anymore a revision every five years as it was mandated before. It has also unified the responsibility level of all regions, with education and health now under the responsibility of regional governments all over the Spanish territory.

⁶ Police and prisons have been partially devolved to Basque Country and Catalonia.

Although the latest revision of the model cedes substantial taxing authority to the regional governments, it is important to describe the original set up, as it has been the basis of the system for over twenty years.

Focusing on the regions that are regulated by the Common regime, up to very recently a good way to describe the model would be its fiscal asymmetry, that is the unbalance between substantial expenditure responsibilities (especially for the high responsibility regions) and a high dependence on central government transfers to finance them. Central government transfers have been historically the largest source of regional revenues, accounting for almost 90% of regional revenues for some regions in the initial years, and somewhat decreasing over time, but still covering above 60% of revenues for the high responsibility regions in 1999. It is therefore important to understand what is behind the criteria that establish those transfers.

The way the transfers are determined has changed over time. The initial method was based on cost, that is, the central government would transfer an amount equal to the historical cost (before decentralization) of the services that were devolved to each region (previously subtracting revenues from ceded taxes). This method assumed that the regional allocation of spending made by the central government before the decentralization process had started was adequate. This criterion was meant to be temporary, for the transition period, and in 1986 was changed to a distribution formula. The idea was to have an allocation mechanism that would be a function of some indicators of need. A weighted formula based on several variables was applied: population, insularity or not, area, administrative units, relative wealth and fiscal effort⁷. The weights were set not according to general economic principles, but rather to reproduce as close as possible the distribution that existed previously under the “effective cost” allocation, making sure that all regions received at least as much as under the

⁷ The administrative units criteria assigns half a percentage point for each provincial government within the region and half a percentage point for the regional government. This criterion has been questioned as provincial governments receive their own resources. Fiscal effort is calculated as the distance between the region’s share of revenues from personal income tax and the region’s share of GDP.

previous allocation. Also some restrictions on the growth rate of revenues respect to the initial effective cost allocation were established, perpetuating therefore the initial misallocation⁸

Within the common regime, transfers to high and low responsibility regions differ according to the different financing needs that those regions have. High responsibility regions, in charge of education and health, received two separate grants, a conditional grant for health, and a general unconditional grant for all the other expenditures. The health grant is distributed according to population, and has functioned completely separate from the general system. The variables that influence the distribution for the unconditional grant are the same for high and low responsibility regions, but the weights differ. For high responsibility regions, population has a higher weight, in accordance with the fact that education expenditures have a high component of variable cost. Table 1b shows the initial and revised weights for distributing the general grant for the two types of regions within the Common regime. The general grant is equalizing in two ways. It is paid out of revenues from taxes that are overall progressive, and then distributed according to population, building in the system an important equity scheme given the large differences in income per capita across regions that we have documented⁹. There is an additional redistributive component, although disappearing over time, as the distribution formula gives some weight to counteract income inequality. This second component has become less important in the revision of the formula, and even more so as education and health expenditures have been devolved to all Autonomous Communities in recent years.

After the transition period that ended in 1986, financing agreements lasting for five-year periods were established. Every five years a revision would take place and a new agreement would be established for the following period. Very few changes were introduced at the end of the first period (1987-1991), with only a small revision of the

⁸ Comunidad Valenciana is one of the communities that has been negatively affected by these restrictions, a fact that shows in its low revenues per capita.

⁹ The foral regime regions, Basque Country and Navarra, are not part of this equity scheme, obtaining therefore a better financing per capita given that both regions are above the Spanish mean in per capita GDP.

weights in the distribution formula incorporated into the agreement for the second period (1992-1996). The negotiations in 1996 for the 1997-2001 period agreement led to fairly significant changes with respect to local revenue-raising authority. Regions were granted some authority over rates for all previously ceded taxes as well as an additionally ceded 15 percent of the income tax. For fear that the new changes would diminish the total funds available, Andalucia, Castilla-La Mancha and Extremadura opted out of this reform, introducing additional complexity to an already cumbersome set up.

The latest reform, effective January 2002 and not restricted to a five-year period, has established a financing system applicable to all fifteen regions under the Common Regime, incorporating health financing in the general-purpose grant. As the differences between high and low responsibility regions have vanished, and health is no longer financed by a specific grant, the financing model has become more uniform and transparent. It has also increased by a significant amount the revenue responsibility of the regions. The central government has ceded approximately one third of the personal income tax and the value added tax, as well as special taxes on gas, alcohol or tobacco. It has also eased many of the restrictions on establishing rates and exemptions for the ceded taxes (except for the value added tax and the special taxes that are regulated by the European Union).

As we have seen, the process towards higher regional responsibility in revenues has been slow, limited, and very complicated, as not all regions had initially participated, but the latest reform seems to go in the right direction in that regions are gaining revenue raising authority responsibility leading to possible gains in efficiency.¹⁰

¹⁰ The lack of local revenue authority together with the continuous renegotiation of the system over the past twenty years created a situation whereby regions may have had incentives to borrow in excess since they did not bear all the costs of such decisions (see Garcia-Milà, Goodspeed and McGuire (2001) for an elaboration of this argument).

3. Regional Economic Disparities

3.1 Economic facts

Before we discuss the outcome of the decentralizing model on revenue capacity and expenditure decisions, it is useful to know the economic diversity of the Spanish regions. Spain, with near 40 million inhabitants represents around 10% of the population of the European Union, 15% of its area, and a little over 8% of its GDP. Spanish average income per capita is 80 % of the European Union's mean, with a few regions around the European mean, but the majority far below it. These differences in per capita GDP, quite large across regions, are illustrated in Table 2. The richest region, Madrid, has a per capita GDP twice as large as the one of Extremadura, the poorest region. These differences were larger in the 1950s, when the per capita GDP of the richest region was three times that of the poorest. By the mid 1970s the differences had decreased to a factor a little over two, and with small variations it has remained that way to the present. The regional ranking has had little variations, with Extremadura always at the bottom, followed by Andalucia, while the top place in the ranking has been shared by regions such as Madrid, Baleares, Cataluña, Navarra and Pais Vasco. Although regional differences are important in Spain, in fact other European countries, such as France, Italy or Germany show larger regional disparities¹¹.

As can be seen from Table 2, population is quite unevenly distributed across regions, with some regions such as Andalucia or Catalonia representing each more than 15% of the population, while others like Cantabria, Navarra or La Rioja with populations around 1% of the total. Although only five regions within the Common Regime have had high responsibilities in regional expenditures, they represent almost 55% of the population, that together with the two foral regime regions account for more than 60% of the Spanish population. When taking the size of the regions into account, one can conclude that the process towards expenditure devolution in Spain was quite advanced even before the latest reform was implemented.

¹¹ This fact is illustrated, among others, in Hall (1999) and Esteban (1999)

Table 2 also shows that regional differences are unrelated to the decentralized financing schemes, with rich and poor regions in both the high and low responsibility regions in the Common regime. It can be observed though, that both regions under the foral regime are relatively rich, a fact more related to their history and economic development than to the circumstances related to the present financing scheme. It is true, though, that the foral regime has turned out to favor these two regions, given that their tax revenues do not pool with the revenues of all the other regions to be then distributed mainly according to population. The foral regions contribute to the solidarity fund (FCI), but that is a small part of the equalization process that is behind the decentralizing financing scheme.

The differences in income per capita are strongly related to unemployment and participation rates, which, as can be seen in Table 3, vary largely across regions. Behind those differences one can find some common patterns across regions, such as high unemployment among youngsters and women, and a lower participation rate of women. On average women's unemployment rate doubles that of men, and their participation rate is around 60% of the one for men.

Differences in industrial mix, especially in the second half of the twenty-century, could well explain the present income disparities. The relatively poor regions have traditionally had large shares of agriculture activity, while it is in the richest regions, with the exception of Madrid, where most of the industrial activity was located. For example in 1980 the share of employment in agriculture was 41% in Galicia, 36% in Extremadura and around 25% in Andalucia, Castilla la Mancha, Castilla y Leon, Asturias, Cantabria and Murcia. Those numbers had dropped to half their value by the late 1990s. The manufacturing and agricultural industries have decreased in favor of the service sector, a trend observed in most industrialized countries, but the relative strength of the regional economies is still quite related to its original industrial mix. For some regions this change towards predominance of the service sector, and in particular activities related to tourism, has been especially beneficial. Such is the case of the Balearic Islands, and to a lesser extent the Mediterranean coast in general and the Canary Islands, that have benefited

from the tourism boom that Spain experienced in the last third of the 20th century. Madrid has taken good advantage of being the political capital, building a strong economy and becoming the financial and telecommunications center of Spain, as well as the Spanish headquarters for many firms.

3.2 Regional development policies and their European link.

Regional development policies have been part of the Spanish central government policy for a long time. The large sustained growth that Spain experienced during the 1960s was not equally distributed across regions. Large migration movements occurred at the time, being the reduction in the agriculture sector, predominant in the south, center (with the exception of Madrid) and northwest, what nurtured labor force for the expanding industry of the north and north east of Spain. There were also important migration flows to other European countries such as Germany, Switzerland or France. Several development plans were designed to foster industrial activity on those areas that had little manufacturing tradition, although its effectiveness has always been questioned.

With the creation of the State of the Autonomies a regional solidarity fund was established in the 1978 Constitution, and was effectively set up in 1984 under the denomination of *Fondo de Compensación Interterritorial* (FCI). In its origins the fund was not purely redistributive, given that it had two roles: i) provide resources to all regions to finance investment related to the activities that had been devolved from the central government to the regions; ii) provide resources to relatively poor regions for investment in infrastructures that would improve economic growth and would help reduce economic differences across regions¹². The second goal is the one that prevailed when the FCI was revised in 1990, becoming a pure solidarity fund that would provide resources to the less developed regions. Only regions that meet the Objective 1 criteria

¹² Nevertheless, the funds were distributed according to a distributional formula where the relative income had the highest weight: 70% of the fund was distributed according to the inverse of income per capita; 20% in proportion to the emigration flows; 5% proportional to unemployment; 5% as a function of regional area. The lower bound of the total amount distributed was established as a percentage of the new civil investment carried on by the central government.

for European Development Funds would qualify for FCI¹³. The first original role of the FCI - provide funds for general investment - was then incorporated in the general financing model.

The change in policy established in 1990 can be clearly seen by comparing Figure 2 and Figure 3 that represent, for the two periods respectively, average annual FCI per capita in relation with the average annual regional income per capita. For the initial period all regions received resources through the FCI transfer, and although the relation between the amount received and the income per capita is negative, it is not highly redistributive except for the lowest segment of the income distribution. Starting in 1990, only the ten poorest regions qualify for FCI, and by then the amounts received are clearly inversely related with regional income, while the total over all the regions decreases.

The revision of the FCI was strongly influenced by the regional development programs of the European Union, adopting the EU criteria for selecting recipient regions, and establishing coordination criteria for providing and spending the FCI according to the EU funds received. Since the accession of Spain to the European Union in 1986, many regions in Spain qualify for several European Union structural funds such as the Development Fund, the Social Fund, the Structural agriculture fund and later on the Cohesion Fund. Figure 4 shows the relationship between average annual income per capita, and the per capita annual average of European funds received, adding all types of European structural funds for each region over the 1986-1999 period. It is quite clear that there is an inverse relation between the funds receive and the regional income per capita, bringing evidence that overall the structural European program favors relatively poor regions in its distribution of funds.

It is worth noting that the development funds represent for some regions an important inflow of resources, as it is documented in Table 4. For example Extremadura, the region with the lowest income per capita, has received in recent years total development funds that account for more than 4% of its GDP, being the annual average over the 1986-99

¹³ Regions with per capita GDP below 75% of the European average.

period above 3%. Other regions, such as Andalucia, Galicia and Castilla La Mancha have also benefited largely from the regional Spanish and European policies.

The Spanish government has also used direct public investment as a way to reduce regional disparities and enhance growth in the less developed regions. The outcome of this policy is reflected in the public capital that regions have accumulated over the years. Angel de la Fuente (2003a) evaluates to what extent public investment decisions have given priority to redistributive criteria as opposed to efficiency criteria. His conclusion is that the public investment policy in Spain has been clearly redistributive, especially during the 1980s and 1990s.

The effectiveness of the regional policy has been highly questioned, although recent studies (de La Fuente 2003b) show that European regional development funds in the period 1994-99 have contributed significantly to the growth of the less developed regions of Spain. Nevertheless there is no concluding evidence that regional convergence is occurring in Spain, or elsewhere in Europe. Even though countries have been somewhat converging in the second third of the twentieth century, regional differences have at the best remained unchanged, as has been shown by Boldrin and Canova (2001).

4. The outcome of fiscal decentralization in Spain

4.1 Revenues

The complexity of the system makes it difficult to present numbers that can be compared across regions and over time. For a given year, regions have different levels of responsibilities, even within the three groups that we have identified: foral, common high- and common low-responsibilities. These differences are not referred to the main expenditures, education and health, but also to other minor expenditures that have been devolved to regions at different moments of time. Given that changes in the financing system have occurred almost continuously, it becomes difficult to look for over time

patters across regions. An additional difficulty is that transfers are not a clean measure of the across regions equalizing policy, given that they are a residual once ceded taxes are discounted. Given the dependence of the ceded taxes from central government rules, one interesting variable to analyze is the sum of transfers and ceded taxes.

Table 5 displays per capita euros in 1999 constant values, of the sum of transfers and ceded taxes. This amount is a proxy of the regional financing that is more directly determined by the central government. This is especially true for the early years, and a good approximation at least up to 1996. If the latest reform, effective in 2002, is well implemented, the regions will have more corresponsibility in their revenues, and ceded taxes will reflect better the regional decisions. Regions are grouped according to their level of responsibility, and only regions in the common regime are represented in the table. Numbers in bold correspond to regions and years with non-university education and health responsibilities; in italic non-university education responsibilities only; a shaded cell identifies the year when university education is devolved to a region. Except for Comunidad Valenciana and Murcia, table 5 shows certain redistribution pattern¹⁴.

It is interesting to look at total revenues per capita by region, which incorporates other sources of revenues, own taxes but mainly borrowing, a source of financing that has been fairly important for some regions. In Table 6 we present total revenues for all regions in per capita euros (constant values of 1999). As we can observe comparing Tables 5 and 6, differences in the two values are quite large for some regions, while both tables show quite similar numbers for other regions. The most interesting fact to point out in Table 6 is that the two regions under the foral regime have the largest revenues per capita, confirming that their especial financing arrangement is beneficial, especially so for Navarra.

¹⁴ Madrid is hardly comparable with the other regions of its group as over the period analyzed it had less responsibilities devolved than the other regional governments.

4.2 Borrowing

Given that revenues from own taxes have been small, comparison of Tables 5 and 6 allow us to infer that borrowing has been quite important for some regions at certain times. As can be seen in Table 7, regional debt as a percentage of regional GDP is low at the beginning, but shows a growing pattern over time. Debt increased fast during the period 1989-1992, and although absolute numbers were never very high due to the very low starting point, the growing pattern was a concern for the Spanish government when conditions on deficit and debt were set up for the countries in order to enter the European Monetary Union. The Spanish 1992 Convergence Program, revised in July 1994, specified limits to the debt path of the ACs. The effectiveness of those limits is under question, as the regions that were not fulfilling the requirements, usually the regions with larger accumulated debts, got extensions and renegotiations of the conditions. Nevertheless, one can see in this convergence program a clear influence of the European integration process on the financing conditions of the regional governments.¹⁵

At the end of 2001 the Spanish central government approved a law that imposes a zero deficit for all levels of government (there are exceptions to this very strict condition, but roughly one can talk about a zero deficit rule). This restriction on the public budgets goes far beyond the requirements of the European Stability and Growth Pact, and therefore it cannot be said that the implications for the Autonomous Communities are due to the European integration process, even though the Spanish central government has attempted to link the new law to the Spanish integration process in Europe.

¹⁵ The decentralization model imposes some conditions on the borrowing of the regions completely unrelated to the European integration process. Long run borrowing can be used only to finance investment. Principle and interest payments cannot be larger than 25% of the regional government revenues. Regional governments need the approval of the Central Government to issue public debt and to borrow in the international markets. They also need to commit and follow the agreements stated in the *Consejo de Política Fiscal y Financiera*, the reference body for financing agreements where all Autonomous Governments are represented.

4.3 Some facts on health and education

Table 8 displays average annual education and health expenditures per capita for the seven communities that have been responsible for those very important public services for many years. With the exception of the Canary Islands, it can be concluded that the two regions under the foral regime can spend larger amounts per capita on those two basic services than the other regions, a fact related to their larger budget possibilities.

In Figure 5 we can see the evolution over time of the per capita expenditures on education (thousands of constant 1999 euros). For the low responsibility regions the figure represents the average spent by the central government in education in those regions. For the high responsibility regions in the common regime and for the regions under the foral regime the values correspond to the amount spent on education by the regional governments, calculated as an average over the regions. It is interesting to note that within the common regime regions, expenditure per capita has been higher in those regions where education was still in hands of the central government. The foral regime regions have had even higher expenditures on education over the period. It will be interesting to analyze the corresponding numbers in a few years, after education has been in the hands of all regional government for some time.

5. Concluding remarks

Fiscal decentralization in Spain emerged quite independently from its integration to Europe, even though both processes developed and consolidated in Spain about the same time period. The common ground for these two important events was the democratic Constitution, which established the basis for the decentralization process, and later on made possible that Spain finally joined the European Community.

After some time, and once the two processes had been well established, it is possible to identify some interactions. It is the case, for example, of the regional solidarity fund, with

an important revision in 1990 that was clearly influenced by the European development policy. The convergence programs designed to meet the Maastricht criteria so that Spain could be part of the EMU, also influenced conditions on regional governments' debt in the early 1990s. Even more strict conditions, requiring a balanced budget for all levels of the administration in Spain, have recently been imposed by the Spanish government, inspired on a less restrictive European Stability Pact. The most recent reform of the financing model for the Autonomous Communities, that has ceded important taxing authority to the regional governments, has been conditioned by the harmonization on indirect taxation at the European level.

It is interesting to note that the Spanish decentralization system has often been presented as an example for emerging democracies to follow. In many respects it has been very successful, combining a solid democratization process with a high fiscal decentralized model. There are problems though, like its complexity, linked with lack of transparency, and the asymmetries built into the system that could probably be justified initially but that are difficult to defend in the present.

The successive revisions of the system have been in essence moving towards the right direction, and especially the last one, effective in 2002, seems to be getting at some crucial dysfunctions of the model. Within the common regime the fifteen regions are finally converging towards identical expenditure responsibilities and a common financing scheme that is simplifying the model and should be clarifying and providing transparency to the financing scheme. The new model is also reducing the gap between expenditure and revenues responsibilities, ceding new taxes and extending the authority of regions to set rates and bases for those taxes ceded.

Nevertheless there are still some issues that remain to be addresses seriously. Little has been done to discuss openly the degree of solidarity that regions can agree upon, or to establish clean and transparent equity criteria. The need for an open discussion about solidarity is revealed by the fact that rich regions sense that they are contributing too much, while poor regions believe that they receive too little.

As we have noted, the European patterns have clearly influenced the Spanish regional development policy, and fiscal discipline has become a central issue at all layers of the public administration, including the Autonomous Communities. If we open our analysis to other aspects of the Spanish economy, the accession of Spain to the European Community, and later to the European Monetary Union, has also been important in terms of establishing incentives for the Spanish economy to go through structural changes that would make it more competitive and more efficient. It is not at all clear that the improvement in efficiency has arrived to the public administration, but definitely the budget restrictions, and tax competition, probably had their effects.

Overall the European integration has not been central to the designed of the fiscal decentralization process in Spain, although it had some side influence. But as Europe deepens and expands its integration process, while at the same time the regional governments assume more responsibilities, there is an open question about what will be the role of central governments in this new political and economic environment, and how the process will condition the fiscal decentralization model that prevails in the different countries that form the European Union.

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Figure 1: Asymmetric Fiscal Decentralization in Spain



Legend




-  Common Regime – High Responsibility
-  Common Regime – Low Responsibility
-  Foral Regime

Table 1 – Common regime

Level of Responsibilities		Responsibilities
HIGH (art. 151)	LOW (art. 143)	<ul style="list-style-type: none"> * Forestry, agriculture, livestock and fisheries in internal water * Urbanism and housing * Roads * Ports and airports without commercial activity * Hydraulic exploitations, channels and irrigation * Environmental protection * Monumental patrimony of the Autonomous Community, cultural promotion and of the regional languages, libraries, museums and conservatories. * Self-government institutions * Internal commercial fairs, sports promotion and tourism
		* Education (management of the educational system at all levels)
		* Health (medical assistance at all levels)

Source: Castells (2001)

Table 1b Weights to determine central government transfers

	1987-1991	revised 1992	revised 2002
Low responsibility regions			
Population	59.00	64.00	
Insularity	0.70	0.40	
Area	16.00	16.60	
Administrative units	24.30	17.00	
Relative income	4.20	2.70	
Fiscal effort	5.00	1.82	
Dispersion		2.00	
High responsibility regions			
Population	84.40	94.00	94.00
Insularity	3.10	1.50	0.60
Area	15.00	3.50	4.20
Administrative units		0.40	
Relative income	0.40	2.70	
Fiscal effort	1.70	1.82	
Constant	-2.50		
Dispersion		0.60	1.20

**Table 2: 1999 Population and GDP per Capita of Regions in Spain
Grouped by Fiscal Responsibility**

	1999 GDP per Capita (euros)	(Relative to Average for Spain = 100)	Population as percentage of Spanish total
Foral Regime			
Navarra	18,492	(130)	1.35
País Vasco	17,379	(122)	5.22
Common Regime High Responsibility			
Andalucía	10,067	(71)	18.21
Canarias	13,496	(95)	4.17
Cataluña	17,570	(124)	15.52
Galicia	11,266	(79)	6.85
Valenciana	13,510	(95)	10.10
Low Responsibility			
Aragón	15,464	(109)	2.97
Asturias	12,739	(90)	2.67
Baleares	17,514	(123)	1.95
Cantabria	13,410	(95)	1.33
Castilla-León	12,990	(92)	6.27
Castilla-La Mancha	11,617	(82)	4.32
Extremadura	8,774	(62)	2.71
Madrid	19,254	(136)	12.89
Murcia	11,692	(82)	2.81
La Rioja	16,313	(115)	0.66

GDP data are from Contabilidad Regional de España, Instituto Nacional de Estadística (INE).
Population data are from Proyecciones y Estimaciones Intercensales de Población, INE.

**Table 3: 2002 Unemployment and participation rates
Grouped by Fiscal Responsibility**

	Unemployment rate	Participation rate
Foral Regime		
Navarra	5.06	54.59
País Vasco	9.25	54.34
Common Regime		
<i>High Responsibility</i>		
Andalucía	18.95	52.44
Canarias	11.14	56.76
Cataluña	9.22	57.71
Galicia	11.87	50.98
Valenciana	10.46	56.00
<i>Low Responsibility</i>		
Aragón	5.57	50.11
Asturias	10.38	44.51
Baleares	6.65	60.21
Cantabria	9.74	50.67
Castilla-León	10.68	49.21
Castilla-La Mancha	9.19	49.82
Extremadura	18.55	50.04
Madrid	6.72	56.20
Murcia	11.25	54.36
La Rioja	7.30	52.76

Source: Encuesta de Población Activa, Instituto Nacional de Estadística

Figure 2

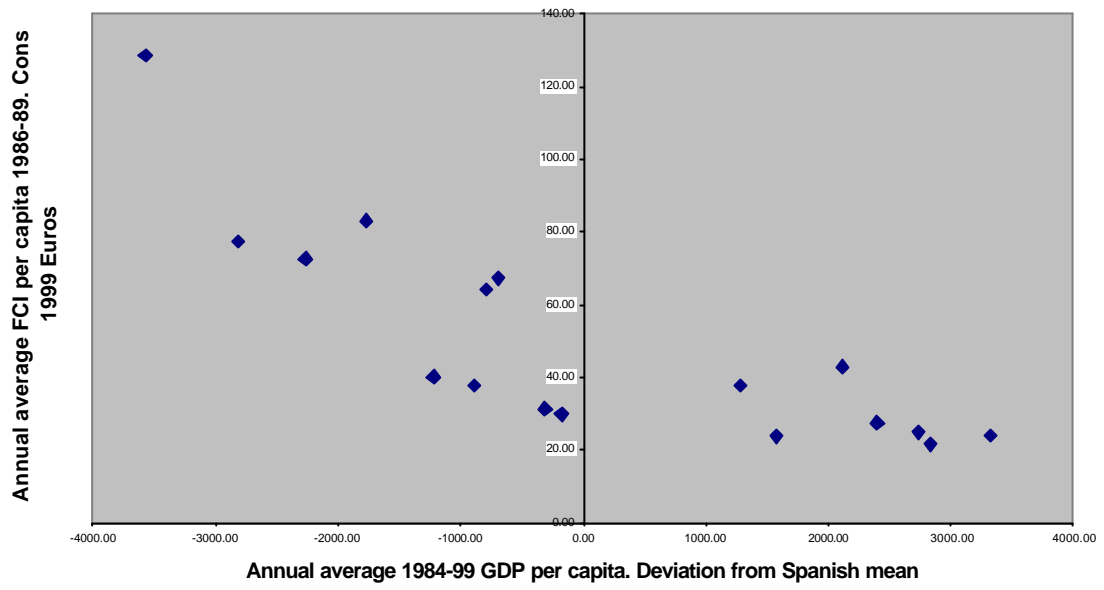


Figure 3

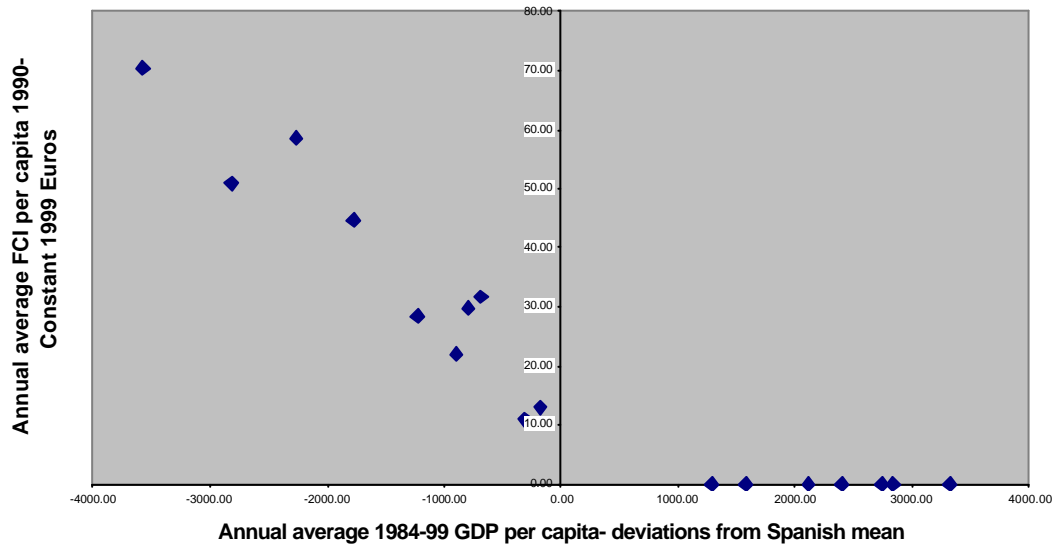


Figure 4

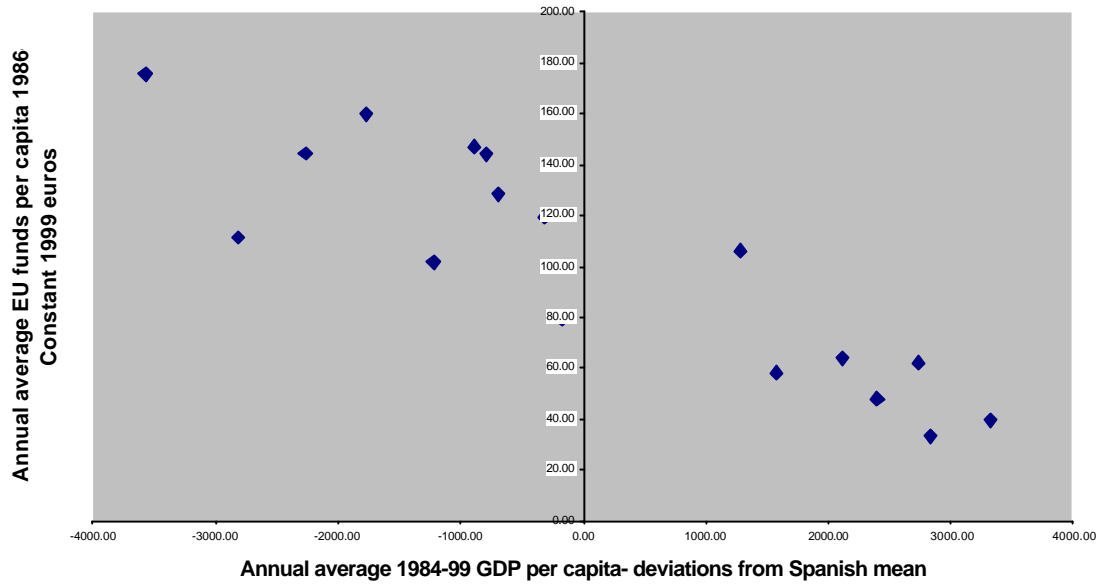


Table 4 - Regional development funds as a percentage of regional GDP

	FCI annual average 1984-89	FCI annual average 1990-1999	European Structural funds annual average 1986-99
Andalucía	1.12	0.57	1.92
Aragón	0.37	0.00	0.86
Asturias	0.46	0.20	1.60
Baleares	0.21	0.00	0.30
Canarias	0.81	0.29	1.54
Cantabria	0.36	0.09	1.17
Castilla-león	0.79	0.27	1.66
Castilla-Mancha	1.14	0.44	2.18
Cataluña	0.27	0.00	0.38
Extremadura	2.19	0.87	3.32
Galicia	1.03	0.62	2.19
Madrid	0.20	0.00	0.26
Murcia	0.50	0.27	1.27
Navarra	0.23	0.00	0.47
País Vasco	0.39	0.00	0.57
Rioja	0.23	0.00	0.47
C.Valenciana	0.34	0.11	0.84

Table 5 - Transfers plus ceded taxes - Per capita euros, constant values 1999

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
High responsibility														
Andalucía	852.03	1022.09	1168.26	1276.72	1374.03	1384.90	1566.09	1548.21	1541.18	1583.42	1707.32	1829.88	1948.89	2093.16
Cataluña	815.83	999.90	1055.12	1138.09	1326.06	1354.98	1513.92	1516.21	1644.09	1587.36	1702.13	1773.78	1670.01	1780.10
C.Valenciana	505.70	<i>574.67</i>	1000.88	1140.26	1205.61	1284.50	1462.77	1424.25	1338.85	1244.26	1259.98	1326.79	1302.78	1399.29
Galicia	<i>590.70</i>	<i>641.72</i>	739.08	<i>821.42</i>	<i>888.25</i>	1368.88	1544.87	1623.00	1614.48	1679.06	1737.98	1827.46	1842.67	1996.23
Canarias	<i>501.73</i>	635.01	<i>734.00</i>	<i>800.63</i>	<i>825.53</i>	<i>840.56</i>	<i>1003.13</i>	<i>871.14</i>	1344.18	1454.78	1445.10	1519.09	1507.81	1581.56
Low responsibility														
Aragón	252.84	279.67	294.62	309.29	334.14	348.41	382.85	364.58	565.74	677.64	765.94	857.09	803.29	<i>1222.70</i>
Asturias	250.34	303.16	306.07	304.63	347.53	396.29	405.47	424.97	522.89	486.61	596.62	658.82	533.09	606.56
Baleares	173.08	211.87	204.78	201.99	285.00	274.19	280.59	308.38	344.42	377.67	438.75	515.78	793.82	<i>822.82</i>
Cantabria	358.09	410.98	461.37	440.45	480.00	484.70	473.73	534.72	572.16	406.75	479.98	690.07	654.98	<i>1034.74</i>
Castilla-León	252.48	259.49	298.73	318.00	384.83	396.58	460.25	483.53	749.87	811.88	922.40	971.91	886.40	963.76
Castilla-Mancha	366.59	569.63	477.68	538.20	589.22	623.31	653.48	859.59	1055.78	1122.69	1096.61	1161.33	1252.82	1235.89
Extremadura	318.73	381.38	354.44	470.63	601.84	526.90	517.77	552.90	562.69	704.01	1058.19	1143.08	1290.23	1280.89
Madrid	145.50	206.20	222.76	229.92	432.88	333.08	349.24	330.99	325.10	346.84	417.97	489.30	307.41	<i>490.01</i>
Murcia	138.71	197.80	294.49	324.92	331.59	359.82	358.47	357.21	350.64	385.39	490.68	535.92	513.44	<i>791.88</i>
Rioja	300.53	342.76	371.54	388.00	455.26	468.31	549.89	529.20	572.54	635.19	694.43	772.01	750.38	<i>1189.65</i>

Sources: Liquidación de los Presupuestos de las Comunidades Autónomas, Ministerio de Economía y Hacienda;
 Instituto de Estudios Fiscales; Instituto Nacional de Estadística

Numbers in bold face correspond to regions and years with non-university education responsibilities, in italic for non-university education.

Shaded cells identify when devolution of university education happens.

Table 6 - Total revenues - Per capita euros, constant values 1999

High responsibility

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Andalucía	754.95	822.25	898.42	1081.48	1240.07	1402.78	1522.32	1575.95	1822.02	1773.60	1750.97	1748.36	1870.04	1965.84	2108.19	2242.34
Cataluña	882.83	907.55	1008.97	1238.73	1271.53	1437.31	1652.47	1793.11	2237.76	1842.46	2047.13	2099.68	2088.35	2246.48	2251.84	2256.44
C.Valenciana	<i>370.56</i>	<i>440.33</i>	<i>568.67</i>	<i>655.19</i>	1067.93	1239.65	1335.81	1462.45	1636.38	1538.37	1518.91	1413.22	1436.96	1502.15	1717.22	1724.93
Galicia	<i>491.25</i>	<i>523.91</i>	<i>615.00</i>	<i>663.30</i>	763.69	<i>871.84</i>	<i>1056.53</i>	1659.30	1864.09	1911.11	1851.95	1886.43	1929.90	2007.81	2099.97	2276.27
Canarias	<i>615.27</i>	<i>790.34</i>	<i>848.08</i>	1032.89	<i>1101.86</i>	<i>1202.03</i>	<i>1251.63</i>	<i>1260.62</i>	<i>1431.73</i>	<i>1335.50</i>	1807.26	1882.19	1825.12	1933.51	2149.83	2268.16

Low responsibility

Aragón	163.35	197.62	298.67	355.27	351.58	453.54	571.60	592.36	525.97	561.94	833.97	714.15	983.30	1050.29	1141.06	1539.64
Asturias	236.85	284.84	340.09	385.07	427.84	469.24	550.64	626.20	702.37	687.61	751.53	745.05	796.47	850.41	907.73	965.82
Baleares	152.78	214.93	210.13	264.05	260.07	383.05	390.43	372.15	429.29	452.54	507.84	519.11	545.03	651.44	<i>1154.85</i>	<i>1169.73</i>
Cantabria	265.40	347.59	482.76	550.32	849.33	690.42	812.40	712.51	549.76	652.00	669.74	465.60	559.28	789.42	892.87	1297.83
Castilla-león	153.81	254.67	303.63	314.80	439.20	550.23	706.20	759.52	759.83	776.44	858.30	914.30	1013.49	1040.77	1093.06	1177.77
Castilla-Mancha	209.45	246.30	396.90	601.36	530.19	636.30	638.38	713.76	787.55	985.55	1200.64	1220.79	1203.03	1264.91	1420.80	1366.77
Extremadura	242.12	387.95	405.90	476.25	386.43	507.42	664.41	607.12	780.42	780.96	719.56	819.53	1187.40	1264.56	1429.90	1421.13
Madrid	154.50	223.17	274.62	313.90	379.20	398.64	485.21	546.55	512.64	537.61	451.52	478.82	607.19	679.31	731.11	<i>945.21</i>
Murcia	166.68	255.17	353.14	304.28	396.61	618.06	521.97	518.54	465.80	497.65	466.37	479.42	581.27	645.01	729.80	<i>1024.27</i>
Rioja	251.10	334.62	405.31	445.33	512.79	612.92	731.98	557.91	704.96	624.77	729.78	770.37	840.05	905.80	1047.69	<i>1475.45</i>

Foral

Navarra	1242.26	1377.30	1540.79	1486.17	1638.26	1781.45	3089.33	3117.12	3154.95	3245.61	3061.73	3258.90	3107.12	3281.87	4040.39	3953.25
País Vasco	<i>679.08</i>	767.44	<i>834.81</i>	<i>906.67</i>	1492.99	1593.40	1742.04	1859.65	2133.13	2129.42	2214.46	2189.57	2277.26	2224.14	2361.51	2473.76

Sources: Liquidación de los Presupuestos de las Comunidades Autónomas, Ministerio de Economía y Hacienda; Instituto de Estudios Fiscales; Instituto Nacional de Estadística

Numbers in bold face correspond to regions and years with responsibility in health and non-university education, in italic for responsibility in non-university education. Shaded cells identify when devolution of university education happens

Table 7 – Debt as a percentage of GDP

Comunidades Autónomas	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Andalucía	0.8	0.7	0.8	1.5	3.0	4.0	5.7	6.9	7.6	7.8	8.8	9.5	9.3	8.7
Aragón	0.4	0.5	0.7	0.6	0.5	1.3	2.4	3.8	4.7	4.6	4.8	5.3	5.2	5
Asturias (Principado de)	0.9	0.9	0.7	1.2	1.4	2.5	3.3	3.2	3.8	3.8	3.8	3.9	4.2	4.1
Balears (Illes)	0.3	0.3	0.2	0.4	0.6	1.9	2.5	3.0	3.1	2.8	2.6	2.8	2.8	2.6
Canarias	2.0	1.6	1.7	1.7	1.7	2.5	2.9	4.2	4.9	4.6	5.8	4.7	4.6	3.8
Cantabria	1.5	2.5	2.6	4.7	6.6	7.2	6.2	6.0	5.2	4.1	2.7	2.9	2.6	3.1
Castilla y León	0.4	0.3	0.3	0.3	0.6	1.2	1.8	2.4	3.4	3	3.2	3.5	3.5	3.3
Castilla-La Mancha	0.3	0.2	0.3	0.7	0.7	0.8	1.8	2.2	2.9	2.7	2.8	2.9	3.1	2.8
Cataluña	2.5	2.6	2.4	2.6	2.6	3.2	4.2	5.3	6.7	7.9	8.6	9.3	9	8.8
Comunidad Valenciana	0.9	0.8	0.8	1.2	2.1	3.2	4.4	5.5	6.4	6.4	7.2	7.8	8.3	9.1
Extremadura	0.4	0.3	0.3	0.3	0.5	0.7	3.8	5.2	6.2	6.1	6.4	6.2	6.4	6.5
Galicia	0.6	0.5	0.4	0.6	1.8	4.4	5.9	7.7	9.0	8.5	9	9.2	9	8.8
Madrid (Comunidad de)	0.2	0.4	0.6	1.2	1.6	2.5	2.8	3.6	4.1	3.8	4.2	4.5	4.6	4.6
Murcia (Región de)	1.2	1.8	2.1	3.2	3.6	4.6	5.3	5.7	5.8	5.4	5.2	5	4.7	4.6
Navarra (Comunidad Foral)	1.6	1.4	1.0	1.0	0.8	0.6	4.6	8.5	11.4	10.3	9.5	8.7	7.5	6.8
País Vasco	1.9	1.9	2.2	2.4	2.9	3.4	4.1	5.3	6.3	6.4	6.8	7.1	6.2	5.4
Rioja (La)	0.4	0.3	0.3	1.1	2.2	3.7	3.5	3.8	3.4	4.1	3.5	3.1	3.1	3.2

**Table 8 - Education and health. Annual average 1984-99.
Per capita euros, constant values 1999**

	Education	Health
Common -high responsibility		
Andalucia	415.80	502.92
Canarias	555.08	631.00
Cataluña	385.22	534.45
Galicia	410.34	577.97
C.Valenciana	396.36	550.08
Foral		
Navarra	458.21	751.54
País Vasco	458.21	663.64

Sources: Liquidación de los Presupuestos de las Comunidades Autónomas, Ministerio de Economía y Hacienda; Instituto de Estudios Fiscales; Instituto Nacional de Estadística; Ezequiel Uriel, IVIE.

Figure 5 - Per capita education expenditures

