

# Fiscal rights for Communities in the Spanish constitution

*Regional leaders add their demands to Socialist Party's plan for constitutional change.*

BY VIOLETA RUIZ ALMENDRAL

**Spain** is not formally a federal state but rather a country going through an impressively fast decentralization process, which started in 1978 and has led to a system that is very hard not to define as federal. The recent proposal put forward by the Socialist Party, to amend the Constitution to reflect the reality of Spain as a highly decentralized country, indirectly confirms its federal nature.

Spain is a country made up of 17 constituent units called Autonomous Communities, including the Basque Country in the north and Catalonia in the east. Spain resembles a federal country in some ways because these Communities have similarities to the provinces, states and *Länder* of Canada, the U.S. and Germany.

But Spain is not quite so federal when it comes to the distribution of revenues, which has always been the subject of considerable debate and, to a large extent, still remains an unsettled issue. After substantial reforms in 1997 and 2002, fiscal federalism is once again a work in progress as proposals to amend the system proliferate. While this is not unexpected, the outcome is still unclear and the present debate on revenues is part of a much larger reform process: that of the federal system itself.

In the last decade, there has been a growing need to reform the Statutes of Autonomy and the Constitution. The first were drawn up between 1979 and 1982, at a time when it was still uncertain what was to become of Spain's young democracy, as shown by the 1981 coup d'état. Back then, the special regions called Autonomous Communities represented a strange reality in a country with a strong centralist tradition. The situation has changed and experts argue the Constitution should reflect Spain's present reality as a quasi-federal state.

## Communities demand fiscal rights

It remains to be seen whether the discussions among the political parties on constitutional change, which started in January and will lead to formal negotiations in June, are going to tackle the rules governing the distribution of revenues between the central government and the Communities. There was really no way that Spain's fiscal federalism challenges could have been solved in 1978. At that point, the initial option to become an Autonomous



Photo: Al Teich

*In Catalonia, people have a different perspective: Visitors take coffee on the terrace of Barcelona's Parc Guell in front of Antonio Gaudí's surrealistic mosaics.*

Community soon gave way to a general enthusiasm for this new form of decentralization – dispassionately called State of Autonomies (*Estado de las Autonomías*) to avoid the controversial term “federation.” By 1982, all territories had become Communities; they had assumed authority and were political realities. Taxation powers lagged behind this decentralization frenzy. First, it was necessary to adequately transfer all powers, as well as the means to finance them. Then would come a greater autonomy in taxation.

In principle, a certain level of fiscal autonomy is a right granted to all the Autonomous Communities, which enjoy “financial autonomy for the development and execution of their authority,” according to the Constitution, which also includes a list of resources that will constitute the Communities' income. This list details almost all kinds of possible existing resources. However, the Constitution also allows the central state to approve a law regulating how these resources will be distributed among Communities and establishing the limits for the exercise of their financial powers on the resources.

Until January, there was a major unresolved question: was it really the role of the central government to decide the financial arrangements or must they be agreed upon by all the Communities and the central government? Or rather, should they be agreed upon on a bilateral basis, between every Community and the central government? A Constitutional Court decision in January put an end to the dispute: the court said the Communities should negotiate with the central government, but the final word and the deciding opinion final belong to the central government.

**Violeta Ruiz Almendral** is Associate Professor of Tax and Finance Law at the Universidad Carlos III de Madrid and a member of Board of Directors of the Forum of Federations.

## Catalonia usually comes first

In practice, though, financial arrangements have always been discussed first between the central government and one of the Communities, and then extended to the rest. Or rather, Catalonia has normally decided on a fiscal arrangement with the central government that was eventually extended to the rest of the Communities. It is important to take this trend into account because the recently approved Statute of Catalonia substantially increases its financial autonomy. An increase in the taxes shared by the central government and Catalonia is called for. On the other hand, a minimum investment in the Community is required to compensate for the existing fiscal imbalance in this otherwise rich region. For now, these are just proposals as there are at least two problems with this:

First, unless the Constitution is successfully reformed, the new financial arrangements can only be set by a law from the central government. But, because general elections will take place in 2008, a major change in fiscal federalism should not be expected before the elections. Already the Statute of Catalonia has generated great political stress – which was exacerbated by its challenge before the Constitutional Court, with the decision still pending.

Second, as other Communities including Andalusia and Valencia also are seeking their own greater autonomy, any major reform of the financial arrangements will probably not take place until all of the Statutes have been reformed. At this point, seven Communities have proposals to amend their Statutes, which include various versions of the Catalan claim for greater autonomy:

**Table 1:**  
**Statutes of Autonomous Communities in Spain**

| Autonomous Community | Date proposed* | Status                          |
|----------------------|----------------|---------------------------------|
| Basque Country       | Jan. 18, 2005  | Rejected                        |
| Valencia             | July 4, 2005   | In process                      |
| Catalonia            | Oct. 5, 2005   | Approved (referendum) June 2006 |
| Andalusia            | May 5, 2006    | In process                      |
| Balearic Islands     | June 19, 2006  | In process                      |
| Aragon               | June 26, 2006  | In process                      |
| Canary Islands       | Sept. 14, 2006 | In process                      |
| Castile and Leon     | Dec. 5, 2006   | In process                      |

\* Date proposal was introduced in Parliament



Photo: Wikipedia Commons

Spanish Prime Minister José Luis Rodríguez Zapatero was a key defender of the new Charter for Catalonia, adopted in 2006.

## The Catalan Statute and its financial “new deal”

Why are all Communities copying the Catalan model? The answer is simple: while Catalonia has virtually the same level of authority as the rest of the Autonomous Communities, it traditionally has shown a stronger interest in autonomy. It was Catalonia’s Statute in 1979 that set the agenda for a major reform in Spain, which was quickly transformed from a central-state model into a substantially decentralized country. It was also the need for the support of CiU – *Convergència I Unió*, the centre-right nationalist party – that made the different central governments (the Socialist Party in 1993 and the People’s Party in 1996 and 2001) agree on a change of the financial system largely based on a model proposed by Catalonia.

Something similar might happen this time around, but it will not be easy. Discussions on the Statute of Autonomy of Catalonia were bitter and not always productive. The initial use of the term *nation* by Catalonia created great concern and was the subject of passionate political discussions. According to some analysts, this represented the perfect smoke screen to avoid negotiating even touchier issues such as the distribution of revenues. If, however, other Communities keep increasing their demands for greater fiscal autonomy, this discussion will be unavoidable.

The changes introduced by the Statute of Autonomy of Catalonia will not be implemented until a decision is made by the central government, because most of them involve the central government giving away some of its taxation powers to Catalonia. Thus, the cornerstone of Catalonia’s new fiscal deal is an increase of so-called “ceded taxes,” which are taxes created by the central government, which then delegates some powers onto Communities (see Table 2). The Statute of Catalonia defines these taxes as its “own” resources, altering its definition as a tax returned by a voluntary action of the central government. It will be necessary to wait for the process of reform of the Statutes of Autonomy to be completed to see a real reform in fiscal federalism.

Continued on page 20

## Berlin's hangover: a € 61 billion city debt

about how to get Berlin's budget back in shape. The Green party, for example, argues that the trade tax could be raised to the level of neighbouring Potsdam without driving more businesses away. That would create additional revenues of 100 million euros per year. Also, the public service should be rolled back more, with a combination of layoffs and increased part-time work at lower salaries. The Greens also advocate that kindergartens should be privatized. Today, one-third of the kindergartens in Berlin are public. The Greens also flirt with the idea of levying a tax on tourists. The Christian democrats (CDU) urge the sale of apartments to some of the private equity firms that seem interested; they also favour the privatization of Tempelhof airport.

Some more radical ideas are also being tossed around. For example, academics urge that a system of public bankruptcy should be created, making a debt moratorium possible for Berlin. The advantage would not only be that the city of Berlin could get a fresh start, but the system would also be advantageous in terms of incentives, in the sense that creditors would be able to downgrade Berlin as a debtor and become more careful in extending it credit. On the other hand, Eric Schweitzer, president of the Berlin Chamber of

Commerce, pleads for Berlin to become a Special Economic Zone, with preferential tax rates and lighter bureaucracy to attract business. And Wolfgang Tiefensee of the SPD, the federal minister for transportation, would like to add a clause to the German Constitution giving Berlin more rights to federal subsidies, given its role as the nation's capital.

But, more generally, the Berlin case brings home that Germany urgently needs to provide itself with a financial system that gives *Länder* governments genuine fiscal autonomy, and thereby true responsibility. The good news is that talks are already under way within the reform commission which was created on Dec. 15, 2006, called "Federalism reform II". The aim of this commission is to disentangle the money flows and responsibilities between the federal and *Länder* governments, and to create powerful sanctions for unacceptable deficits. One of the more precise proposals in this regard, put forward by the prime minister of Saxony, Georg Milbradt (CDU), is to limit regional deficits to about 1.5 per cent of gross domestic product, beyond which *Länder* would be forced to raise taxes, to give up financial authority over their budgets or to limit the bailout obligation of the federal system, so that financial markets would eventually create their own sanctions for bad fiscal management. 6

## Fiscal rights for Communities in the Spanish constitution

**Table 2: Taxes shared or devolved by Madrid to the Communities**

| Tax                                       | Yield to Communities in per cent | Administration     | Maximum legislative power of Communities  |
|---|----------------------------------|--------------------|---|
| Personal income tax                       | 33                               | Central government | <ul style="list-style-type: none"> <li>• Tax rates (must have same number of tax brackets as the State tax)</li> <li>• Tax credits, under certain conditions</li> </ul>               |
| Tax on wealth                             | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Tax rates</li> <li>• Minimal deduction</li> <li>• Tax credits</li> </ul>   |
| Death and gift taxes                      | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Reductions in taxable income</li> <li>• Tax rates</li> <li>• Deductions and tax credits</li> <li>• Tax administration regulations</li> </ul> |
| Taxes on transfers and official documents | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Tax rates</li> <li>• Tax credits</li> <li>• Tax administration regulations</li> </ul>  |
| Gambling taxes                            | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Exemptions</li> <li>• Taxable base</li> <li>• Tax rates</li> <li>• Tax credits</li> <li>• Tax administration regulations</li> </ul>          |
| Value Added Tax                           | 35                               | Central government | None  |
| Excise                                    | 40                               | Central government | None  |
| Tax on wine                               | 40                               | Central government | None  |
| Tax on electricity                        | 100                              | Central government | None  |
| Tax on vehicles                           | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Tax rates (under certain conditions and limits)</li> </ul>   |
| Special tax on gasoline                   | 100                              | Communities        | <ul style="list-style-type: none"> <li>• Tax rates (under certain conditions and limits)</li> <li>• Tax administration regulations</li> </ul>   |

The table above shows the distribution of taxes as of January 1, 2002