Financing Autonomous Governments in Spain: Two Alternative Visions

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1. The evolution of the Spanish "State of Autonomies" has been strongly marked from the outset by the problems posed by the financing of the Autonomous Communities (henceforth, ACs). To some extent, this is only to be expected. All political systems built around different levels of government, in which political power is shared between a central government and intermediate governments, inevitably generate two types of tension. On the one hand, there is the tension that exists between the central government and the whole ACs and which is generated by the distribution of this political power as it relates to all financial matters.

On the other hand, there is the tension that exists among the governments of the ACs themselves. First, because they are engaged in a constant struggle to obtain the largest possible share of the financial resources assigned to the regions, a struggle that is all the more direct and inevitable as the proportion of these resources derived from state subsidies increases and the tax revenue paid directly by citizens to their respective governments falls. But also, and more especially, because there is always a degree of conflict, a trade-off, between the two principles on which a political system of these characteristics is based: that is, between the union (and its consequences, namely territorial equality in the union in relation to all that falls under the jurisdiction of the central government) and the freedom of the intermediate-level governments to take decisions on matters related to their own specific responsibilities. This tension between 'shared-rule' and 'self-rule', between equality and freedom, is inherent to political systems of this kind (usually, federal systems), but the system will work, and be both stable and viable, if it is are able to strike the right balance between the two.

The tension between these two principles (freedom and equality) arises both in the relationship between the central government and the intermediate, as well as in the relationship between the intermediate governments themselves (that is, between the governments of Spain's ACs). The reason for this tension is that the lower a region's fiscal capacity, the greater is its need for equality, unlike regions that enjoy a high level of fiscal capacity. But the tension might also arise from the fact that the regions' preferences differ in terms of the degree of autonomy and self-government to which they aspire. This means that the greater the diversity between the regions (and, of course, the existence of different national realities can be a powerful influence here), the harder it is to strike a balance between freedom and equality that can satisfy all the regions and the harder it is, therefore, to find a formula that can endow the overall political edifice with stability.

2. Essentially, the tensions that characterise the regional financing system are a reflection of two fundamentally different conceptions of the state about key point as to just how much political power should be concentrated in the hands of central government or whether this power should be distributed evenly between the central government and the intermediate government. Depending on the stance adopted, two very different visions of the design of the financing system emerge.

The first leads directly to the conclusion that the power of taxation resides almost exclusively with the central government. According to this vision, there is no more than one fiscal relationship: that which the citizens in any of the regions have with the central power, which defines the essential elements of the taxes, and which applies those elements according to a principle of equality between all citizens. According to this particular conception, there are only two relevant issues regarding the financing of the ACs: first, determining what portion of the total resources (derived, in essence, of course, from state taxation) corresponds to the central government and what portion corresponds to the governments of the ACs; and, second, establishing criteria for the allocation among the ACs of the portion that corresponds to them.

So, the regional financing issue, and more generally that of regional autonomy, is limited to one part of the fiscal equation, that of spending, while it ignores the other part, that of revenue, which corresponds almost exclusively to the central government. This is far from being a trivial issue, because the lack of tax autonomy seriously limits the ability to determine the overall size of the budget and, hence, to exercise autonomy of spending.

This conception erodes the quality of political autonomy and self-government. First, because there can be no real political power without taxing power. Second, because the weakening of this fiscal relationship impedes that the citizens are able to compare what they pay in taxes with what they receive by way of public services. And, finally, this conception also affects the quality of autonomy, because it ends up becoming, like it or not, a form of central government dirigisme of regional spending, via the determination of their expenditure needs.

3. In opposition to this conception, there stands another that advocates a balanced distribution of political power between the central government and the intermediate government. In this second vision, as far as public finances are concerned, a democratic government is characterised by the fact that it provides services to the citizens that are under its jurisdiction, that are funded with taxes paid by these same citizens (who are, we might add, the ones that decide the nature and quantity of these services as well as which taxes and how much tax they will pay).

This vision can be applied to the different levels of government that make up the political system: to the country's central government; to each regional government in its territory; and, in a more limited framework, to the municipal governments, again each within its own municipal territory. The vision is opposed by two extreme standpoints. On the one hand, the one I outlined above, which concentrates all the power of taxation (and, in essence, all the political power full stop) in the hands of a single central government; that is, the unitary state model. And, at the other extreme, that which denies the central government the power to tax in one part of the territory; that is, the confederal state model. And, of course, that which results from a secessionist project, which quite simply seeks the disappearance of any sovereignty of the previous central government in that region which wants to break away.

However, when a territory forms part of a larger political community (and, by definition, all intermediate governments do), this basic rule cannot be applied absolutely – it has certain undeniable limits, the first derived from the application of an inter-territorial principle of equity and the second from the constraints that market integration imposes on fiscal autonomy.

The first limit leads us to reject the possibility that the citizens in some territories, simply owing to the fact that they have less fiscal capacity than those in other territories, have no option other than to receive a lower level of public services making the same fiscal effort, or to have to make a higher fiscal effort in order to receive the same level of services, which is what would happen if we were to apply this principle in its purest state. This is why it is generally accepted to introduce some kind of equalization mechanisms that attenuate the impact of this rule on the poorest territories. However, it should be quite clear that these mechanisms should be a corrective to the basic conceptual design of the regional financing system, not its starting point. And that, in order to implement them, there must be some degree of basic consensus regarding the content and the scope of this inter-territorial equity, questions that have a marked historical (i.e. that vary with time) and spatial component, as evidenced that in certain countries (such as the FRG and Australia) they are very powerful and in others, like the US, they are very weak.

The second limit derives from the fact that, in the context of integrated markets, tax autonomy (and tax competition) taken to its extreme would be harmful in terms of both efficiency and equity. This is why tax harmonization mechanisms are essential, and they become more necessary as more little is the territorial scope of the government (i.e. it has little ability to internalize the effects of taxing on markets), as more mobile are its tax bases and as more integrated are the corresponding markets.

In accordance with this second conception, the agenda of questions that has to be addressed when designing the regional financing system is very different from that when seen in the light of the first conception. First, the tax bases that the intermediate governments can access, and the scope of their normative and administrative responsibilities, need to be determined. Second, to the extent that the potential resources and expenditure needs of the different levels of government are likely to evolve asymmetrically over time; mechanisms need to be in place to periodically reset the relative sufficiency of these different levels of government (vertical equity). Third, suitable mechanisms need to be designed to meet the goal mentioned above of inter-territorial equity, in accordance with the degree of equalization considered desirable. Fourth, and finally, a well-designed financing system should include the rules of fiscal discipline to be applied to the intermediate level of government (especially as regards deficit and debt limits).

4. These two visions of the distribution of political power between central government and intermediate governments give rise, therefore, to two different and, as far as their essential elements are concerned, opposing models of public finance. Some countries (most operating a federal system) are inspired by the second conception; others (typically, unitary states) by the first.

Either of the two models can prove satisfactory if there is a broad political and territorial consensus as to which is preferred. However, it may occur that such a consensus is not forthcoming. When disagreement is more or less homogeneous across all the territories that make up the political community, there are only two possible ways out: the imposition of one model at the expense of the other, with the obvious tensions and instability to which this will give rise, or the adoption of a hybrid model resulting from a pact being struck between the proponents of both models. However, when the lack of consensus can be clearly delimited in geographical terms (i.e., in some regions there is a clear preference for one model and in other regions for the other), then the possibility of adopting specific solutions in certain regions should be considered. In short, this is what has happened in more than one country (Scotland in the UK; Quebec in Canada; Flanders in Belgium) when this problem has occurred, and it has served to maintain the stability of the union and to reduce calls for independence. And, above all, it has served to satisfy the aspirations of different regions that also have different preferences as to how political power should be shared between the common government and self-government. As such, it would appear to be a formula to take into consideration. Unless, of course, the preferences are expressed in terms of what a region does not want another region to have, rather than in terms of what the region wants for itself. In this case, the problem would appear to have a very difficult solution.