

## LOCAL FINANCE IN CATALONIA: RECENT EVOLUTION, CURRENT SITUATION AND MAIN CHALLENGES\*

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### Abstract

This paper describes and analyses the current situation surrounding local finances in Catalonia, placing special emphasis on municipalities, in order to identify the main challenges in need of a solution today. The realities currently faced by city councils are, in many respects, quite different from when the main laws determining both their jurisdictional framework and their financing model were approved. This paper provides reflections on the role local government should play within the entirety of the Catalan public sector, as well as on the type of competences municipalities could assume, their degree of financial autonomy and the need to adhere to a certain principle of inter-municipal equality, while taking into account aspects such as municipalities' jurisdictional framework and their size, and the existence of a large number of supra-municipal entities.

Key words: Municipal financing; fiscal decentralisation; local finance.

## LA HISENDA LOCAL A CATALUNYA: EVOLUCIÓ RECENT, SITUACIÓ ACTUAL I PRINCIPALS REPTES

### Resum

*En aquest treball es descriu i s'analitza la situació actual de la hisenda local a Catalunya, especialment la dels municipis, per tal d'identificar quins són, a dia d'avui, els principals reptes que caldria afrontar. La realitat a la qual han de fer front actualment els ajuntaments és ben diferent, en molts aspectes, de la que hi havia quan es van aprovar les principals lleis que determinen tant el seu marc competencial com el seu model de finançament. L'escrit aporta reflexions sobre el paper que hauria de tenir el nivell de govern local dins del conjunt del sector públic català, sobre el tipus de competències que podrien assumir els municipis, sobre el seu grau d'autonomia financera i sobre la necessitat de donar compliment a un cert principi d'equitat intermunicipal. Tot això, tenint en compte aspectes com el marc competencial dels municipis, la seva mida i l'existència d'un elevat nombre d'entitats supramunicipals.*

*Paraules clau: Finançament municipal; descentralització fiscal; hisenda local.*

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\* This article is a translation of an original version in Catalan.

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## Summary

### Introduction

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## Introduction

Spain's process of fiscal decentralisation, which commenced with the country's 1978 constitution, has basically focused on the creation of the so-called "State of the Autonomies". The transfer of powers has taken place almost exclusively in one direction: from the central government to those of Spain's autonomous communities. And the efforts aimed at designing a financing model for said autonomous communities contrast with those focused on designing one for local governments and, more specifically, for municipal councils.

The revenue currently made available to Catalonia's municipal councils arises from a financing model established by a Spain-wide law from 1988 that was amended, in part only, in 2002.<sup>1</sup> There is, therefore, a certain degree of stagnation with regard to taxation at local government level. The everyday realities currently faced by municipalities are very different to those of thirty years ago. Today, their councils must provide a response to new public needs stemming from both recent social and technological changes and from the challenges caused by our increasingly globalised world. The issues faced by Catalonia's towns and cities are difficult to tackle with tools designed at the end of the twentieth century.

So, the purpose of this paper is to describe the main features shaping the current status of Catalonia's municipal finances to ascertain the main challenges faced, and hence the principal changes that need to be made.

It is divided into seven sections. Section One describes the weight of local governments within the Catalan local public sector as a whole. Section Two provides a brief description of the jurisdictional framework for municipalities, whilst Section Three describes their expenditure behaviour. The fourth and fifth sections are aimed at analysing two key aspects of the municipal financing model: their fiscal autonomy and the degree of compliance with the principle of inter-municipal equality. The sixth section covers the types of fiscal relations between the Government of Catalonia and local governments. Lastly, the final section provides some thoughts by way of conclusion.

## 1 The weight of the local public sector in Catalonia

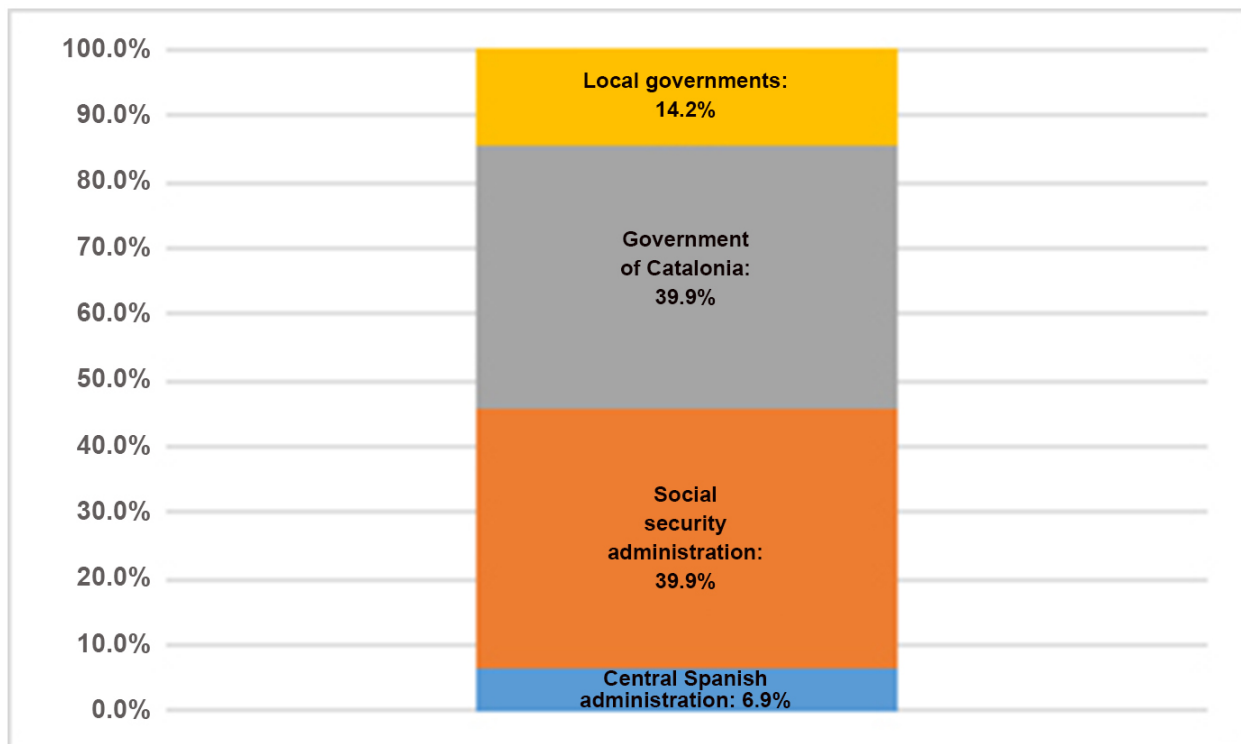
One of the indicators used to measure the different levels of government making up a country is the weight of the public expenditure carried out by each of them. In 2014, public expenditure in Catalonia totalled 75,740,880,000 euros, of which 14.2 % related to local governments, as shown in Graph 1.

The expenditure of the Government of Catalonia represented 39.9 % of the total. So, together, local government and the Government of Catalonia carry out more than half of Catalonia's public expenditure (54.1 %). The remainder comes from the central Spanish administration (6.9 %) and the social security administration (38.9 %).

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<sup>1</sup> Law 51/2002, of 27 December, amending Law 39/1988, of 28 December, governing local finances, Royal Legislative Decree 2/2004, of 5 March, approving the recast text of the Law governing local finances.

Graph 1. Public expenditure in Catalonia by level of government ( % of total). Actual figures for 2014



Own work based on Government of Catalonia (2017), *Els resultats de la balança fiscal de Catalunya amb el sector públic central els anys 2013 i 2014*; and Ministry of the Treasury, <http://serviciostelematicosex.minhap.gob.es/SGCAL/entidadeslocales>.

In the 1980s, the weight of local government in Spain as a whole hovered around the 12 % mark, and so the presence of local government has not changed much over the years. What's more, the situation in Catalonia is no so different from Spain as a whole. There has been a significant process of decentralising public expenditure, but this has gone in only one direction: from the central Spanish government to the Government of Catalonia, which has taken over the provision of the core services of the welfare state (health, education and social services).

The weight of the expenditure carried out by the central Spanish administration in Catalonia is 6.9 %, whilst that of the social security administration reaches 38.9 %. It can therefore be said that there is a 46 %-40 %-14 % split of public expenditure by administration level there (relating to the central Spanish government, the Government of Catalonia and local government, respectively).

In federal countries, this split of expenditure by levels of government is different, particularly with regard to the weight of local governments. Taking the average for Germany, Austria, Canada, the United States and Switzerland as our benchmark, these percentages stand at 51 %-30 %-19 % (León [coord.] *et al.*, 2015).<sup>2</sup> So, the weight of local governments is five points above that for those of Catalonia. On the other hand, that of the central government (30 %) is below that which, here, would fall to the Government of Catalonia (40 %).

## 2 The jurisdictional framework for municipalities

The jurisdictional framework for Spain's municipalities is defined in Law 7/1985, of 2 April, governing the bases for local government: more specifically, in Articles 25, 26, 27 and 28 thereto. The content of these four articles can be summarised as follows:

- i) Article 25 refers to the matters over which powers are exercised by municipalities under the terms established by central Spanish and autonomous community legislation. Point 1 states that municipalities

<sup>2</sup> The expenditure split by level of government for each of these individual countries, based on 2011 figures, is as follows: Germany: 61 %-23 %-16 %; Austria: 69 %-17 %-14 %; Canada: 34 %-47 %-19 %; the USA: 48 %-25 %-27 %; Switzerland: 43 %-37 %-20 %.

may promote all manner of activities and provide all those public services that help meet the needs and aspirations of their citizens. Point 2 establishes that municipalities shall exercise, in all cases, powers over a range of matters that it explicitly lists. Subsequently, Law 27/2013, of 27 December, on the rationalisation and sustainability of local administrations, established that municipalities shall exercise in all cases as their inherent powers, under the terms of central Spanish and autonomous community legislation, a series of matters. The most significant differences with those municipal powers established in Law 7/1985 are, firstly, the disappearance of some of these powers (for example, over abattoirs), participation in the administration of primary health care and social promotion and reintegration; secondly, a limitation on municipal social services-related powers, to assessing and informing on existing needs, and care in the case of emergency; and, thirdly, specification of the powers over upkeep, maintenance and monitoring of infant, primary and special education centres, thus excluding obligatory secondary education centres.

- ii) Article 26 defines the compulsory nature of the services that municipalities must provide depending upon population levels. It establishes that municipalities must, either alone or in association, provide a series of services that varies according to their size. Taking into account the changes made by Law 27/2013 to Law 7/1985, Table 1 provides a schematic outline of this Article's content.

Table 1. Services that must be provided by municipalities, depending upon their size

Services that all municipalities must provide	Street lighting Cemetery Waste collection Street cleaning Domestic supply of drinking water Sewers Access to population centres Paving of public thoroughfares Control of food and drink <sup>1</sup>
Services that must be provided by municipalities of more than 5,000 inhabitants	In addition to the above: Public parks Public library Markets <sup>1</sup> Waste treatment
Services that must be provided by municipalities of more than 20,000 inhabitants	In addition to the above: Civil protection Assessment and notification of situations of social need and immediate assistance for those in a situation or at risk of social exclusion <sup>2</sup> Fire prevention and extinction Public sports facilities
Services that must be provided by municipalities of more than 50,000 inhabitants	In addition to the above: Urban passenger transport Environmental protection

Own work, based on Article 26 of Law 7/1985 and Law 27/2013.

(1) Services no longer obligatory after Law 27/2013.

(2) Social services-related powers are limited in comparison with the previous Law.

So, whether the services to be provided by municipalities are obligatory or not depends upon whether they have fewer than 5,000, from 5,000 to 20,000, from 20,000 to 50,000 or more than 50,000 inhabitants. The most significant changes introduced by Law 27/2013 with regard to this Article are those covering the following points: Law 7/1985 stated that municipalities could request from their autonomous community dispensation from the obligation to provide the minimum services applicable to them when compliance therewith was impossible or very difficult. It also stipulated that autonomous communities could cooperate with provincial councils to guarantee provision of the services assigned to municipalities. Additionally, provincial councils could cooperate with district councils within the framework established by autonomous community legislation. However, with Law 27/2013, these points were eliminated and it was established that, in the case of municipalities of fewer than 20,000 inhabitants, the provincial council or equivalent undertaking coordinates, either via direct provision or through consortia, associations or other shared management formulas, the following services: waste collection and treatment, drinking water supply, and removal and treatment of wastewater, street cleaning, access to population centres, urban street paving and street lighting. Nevertheless, the provincial council or equivalent undertaking must charge the municipalities the effective cost of the service in accordance with its usage. Additionally, if these services are funded by local taxation, it shall be the provincial council or equivalent undertaking that shall be the recipient of the tax.

- iii) Article 27 refers to the possibility of the central Spanish administration and autonomous communities delegating powers to municipalities.
- iv) Article 28 contemplates the possibilities of municipalities carrying out complementary activities the purview of other public administrations, more particularly those associated with education, culture, the advancement of women, housing, health and environmental protection. This Article was abolished by Law 27/2013.

Article 84 of Catalonia's 2006 Statute of Autonomy also introduces changes into the framework of municipal powers. More specifically, its content can be summarised as follows:

- It guarantees core competences specific to local governments and lists them.
- It establishes that the distribution of administrative responsibilities between different local administrations takes into account their management capacity and is governed by the laws approved by the Catalan Parliament, by the principle of subsidiarity, pursuant to the provisions of the European Charter of Local Self-Government, by the principle of differentiation, according to the characteristics of municipal realities, and by the principle of financial sufficiency.
- It provides that it is the Government of Catalonia that decides upon and establishes mechanisms for the funding of new services arising from any possible broadening of the scope of the powers of local governments.

Even this brief and schematic description of the jurisdictional framework allows us to appreciate that it is a complex, changing one. Firstly, it establishes differences depending upon the size of the municipality, with four tranches whose limits are not justified. Also, municipal services can be either obligatory ("of obligatory provision", per the Law) or non-obligatory. In many cases, municipalities have ended up providing the same services, whether or not it is obligatory to do so (Vilalta, 2008).

### **3 A description of the behaviour of municipal expenditure**

The local government level in Catalonia is made up of a large number of undertakings: 947 municipalities (78 % of which have fewer than 5,000 inhabitants), 4 provinces, 41 districts, 60 associations of municipalities, 1 metropolitan area and 65 decentralised municipal undertakings, making a total of 1,118 local bodies. As can be seen from Table 2, in 2016, taken as a whole, they incurred a total expenditure of 11,212,270,000 euros, of which almost 81 % belonged to municipal councils. These municipal councils are, then, in quantitative terms, the leading bodies within Catalonia's local public sector as a whole. This is why the analysis performed in Sections 3, 4 and 5 of this paper focuses on describing the behaviour of municipal expenditure rather than that of all the bodies comprising the local government level.

Table 2. Expenditure of Catalonia's local bodies. Actual figures for 2016

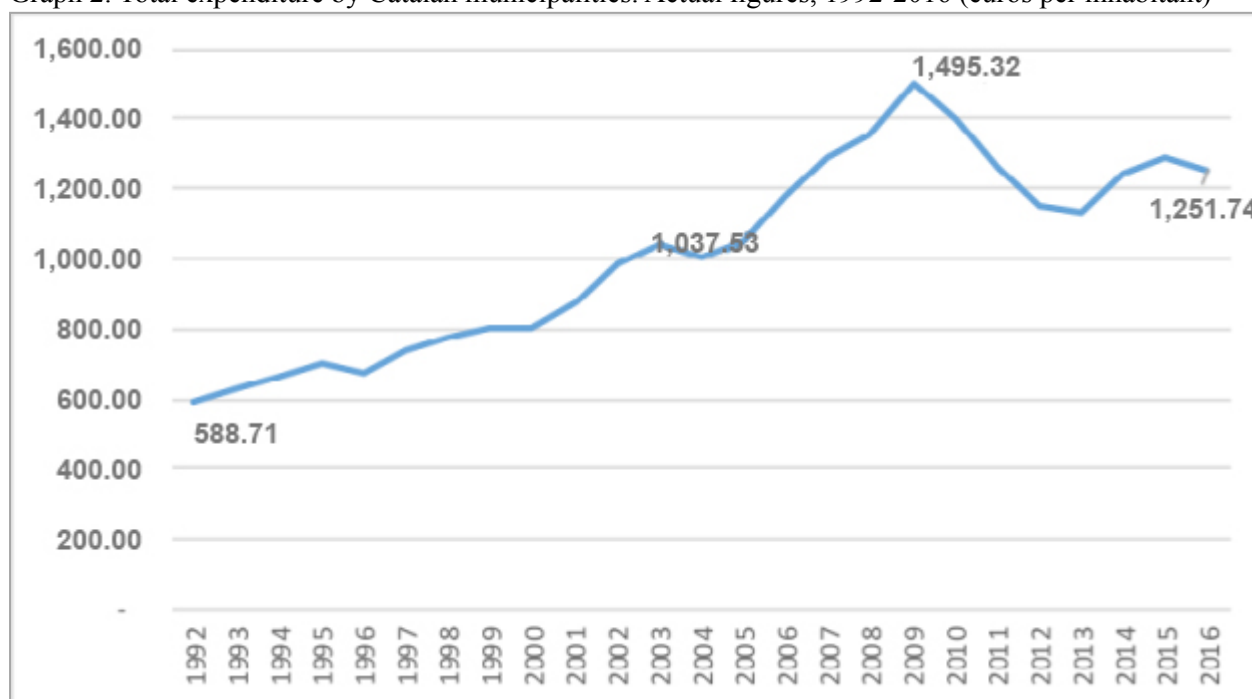
	€	€ per inhabitant	%
Municipal councils	9,042,290,000	1,202.02	80.6 %
Provincial councils	1,141,920,000	151.80	10.2 %
Metropolitan area	580,760,000	77.20	5.2 %
Districts	394,770,000	52.48	3.5 %
Associations	34,110,000	4.53	0.3 %
Undertakings of less than municipal scope	18,410,000	2.45	0.2 %
<b>Total</b>	<b>11,212,270,000</b>	<b>1,490.48</b>	<b>100.0 %</b>

Own work based on data from Spanish Ministry of the Treasury.

### 3.1 The functional allocation of the expenditure Catalan municipal councils

Graph 2 shows the trends in municipal expenditure from the beginning of the 1990s to date. In 1992, Catalonia's municipalities as a whole spent an average of 588.71 euros per inhabitant, whilst ten years later the figure had reached 1,037.53 euros, a sum that continued to increase until 2009. From this latter year on, one can appreciate a drop-off in municipal expenditure as a result of the measures that began to be adopted to tackle the economic crisis that had commenced two years earlier. Although 2005 and 2006 municipalities' *per capita* expenditure increased by 12.0 %, 2010 and 2011 saw a fall of 9.5 %. From 2014 on, a small recovery can be seen.

Graph 2. Total expenditure by Catalan municipalities. Actual figures, 1992-2016 (euros per inhabitant)



Own work based on Spanish Ministry of the Treasury data, INE [Spain's National Statistics Institute] (<http://www.estadief.meh.es/publica/Indice0021.html>).

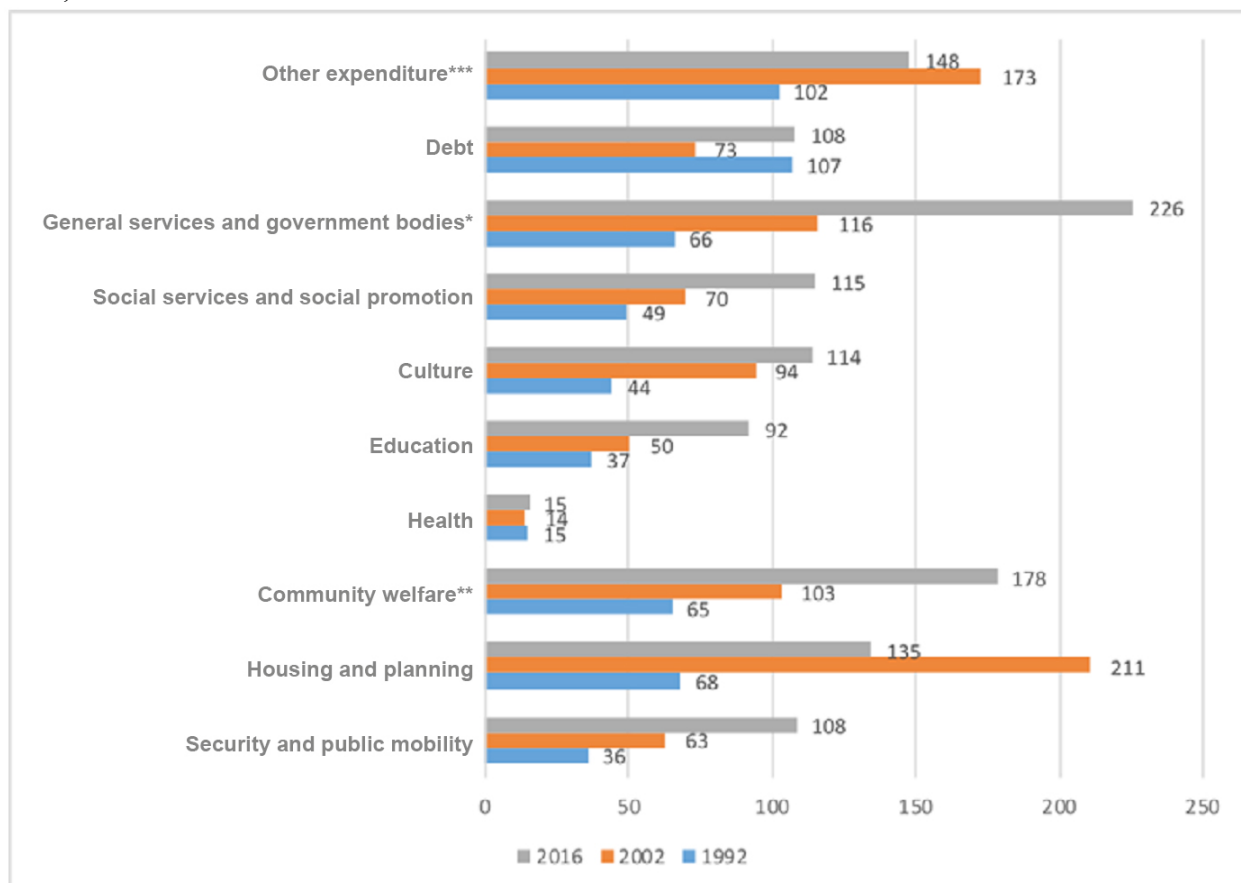
Graph 3 shows the volume of expenditure per inhabitant by Catalan municipalities as a whole according to its allocation for three different years: 1992, 2002 and 2016. As can be seen, municipal expenditure is fundamentally allocated to providing the services encompassed within "community welfare" (sanitation, water supply and distribution, waste collection, disposal and treatment, street cleaning, cemeteries and funeral services, street lighting, etc.) and housing and town planning. Also noteworthy is the expenditure earmarked for "general services and government bodies".

Health, education and social services have relatively little weight within the municipal expenditure budget, as they do not form a core part of town halls' activities. What's more, in many cases, they are non-obligatory services: in other words, municipal councils are under no legal obligation to provide them (Vilalta, 2008).

The way in which Catalonia's municipalities allocate their expenditure is one of the more important differences with the financing of those of federal countries. In those such as Germany, Austria, Belgium, Canada, the USA or Switzerland, education is one of the main sources of public expenditure. In Canada, for example, it represents 40 % of total expenditure by local bodies and, in the US, 38 %. In Germany and Switzerland, the figure stands at 27 %, and in Belgium and Austria, 19 % and 17 %, respectively. Such numbers stand in clear contrast to those of Catalonia's municipalities, where education represents around 6 or 7 % of the expenditure budget. On the other hand, health has a relatively important weight only in Austria's local bodies (at 23.5 %). In the other aforementioned countries, health, as in Spain, falls within the powers of regional (state) governments. For Catalan towns and cities, health services represent between 1 and 2.5 % of their budget. For their part, social services represent a significant part of local expenditure in countries such as Austria, Belgium and Switzerland. In Catalonia, municipalities dedicate to them between 7.5 % and 9 % of their budget.

So, although the essential services of the welfare state (education, health and social services) represent around 50 % of local expenditure in the aforementioned federal countries, the figure for Catalonia stands at some 18 %. The greater part of the latter's expenditure budget is allocated to "typically local" services (planning, waste collection, street lighting, etc.).

Graph 3. Expenditure allocation of Catalan municipalities a whole (euros per inhabitant). Actual figures for 2016, 2002 and 1992



Own work based on data from Badespe database, Spanish Ministry of the Treasury and INE.

(\*) Includes government bodies, general services, financial and tax administration and other administrations transfers.

(\*\*) Includes sanitation, water supply and distribution, waste collection, disposal and treatment, street cleaning, cemeteries and funeral services and street lighting.

(\*\*\*) Includes pensions; economic benefits for employees; industry and energy; agriculture, livestock and fishing; research, development and innovation.

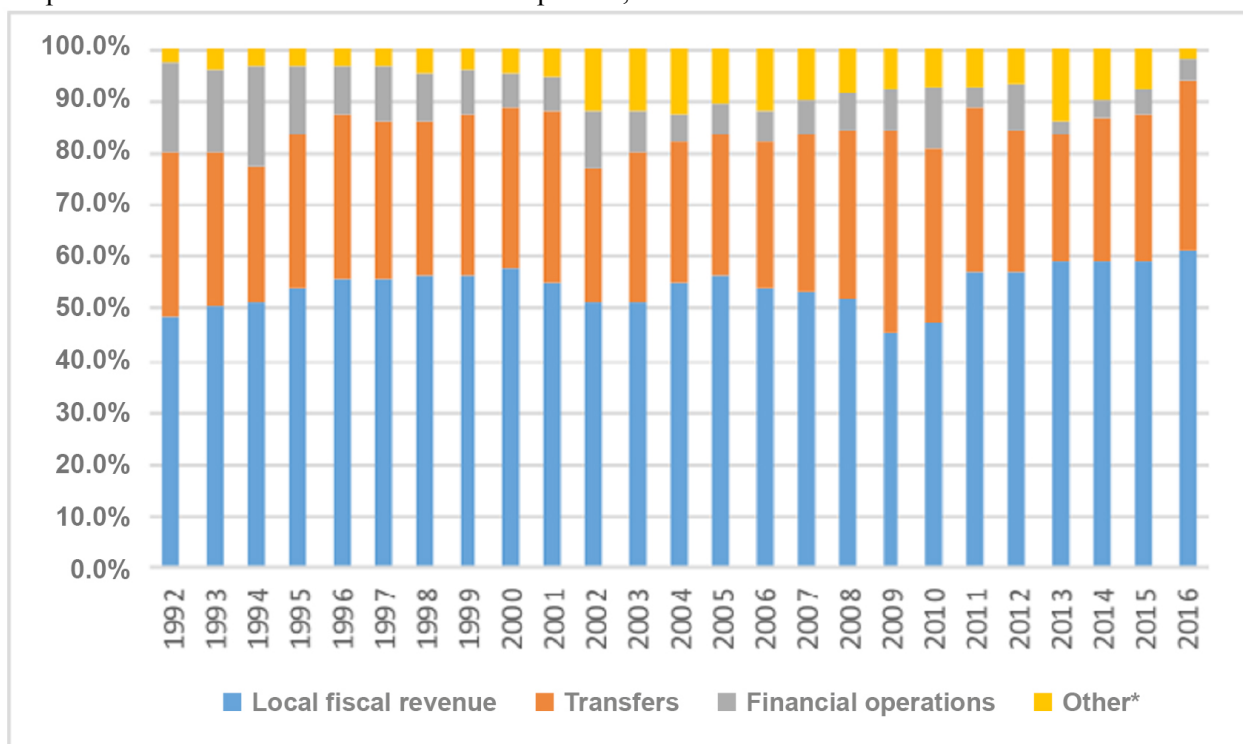


Whilst Graph 3 provides an image of expenditure allocation that is representative of the “average” municipality, it should be noted that there are significant differences in certain functions, depending upon municipality size. There is a degree of diversity in the expenditure behaviour of Catalonia’s municipalities depending upon their size (Vilalta, 2018). Not taking into account population numbers when establishing the jurisdictional framework and municipalities’ expenditure requirements has an impact upon efficiency in the provision of municipal services.

#### 4 The financial autonomy of Catalonia’s municipalities: the importance of municipal taxes

The financial autonomy of governments depends on their capacity to decide how much to spend, what to spend it on, and the sources of the revenue to fund this expenditure. Governments are fiscally autonomous if a significant part of their revenue comes from sources of taxation over which they can take decisions, both normative and with regard to management and administration. On the other hand, the higher the percentage of revenue sourced from transfers from other levels of government, the more dependent they are.

Graph 4. Revenue sources for Catalan municipalities, % of total



Own work based on data from Badespe database and Spanish Ministry of the Treasury.

(\*) Includes property income and disposals of *in rem* investments.

Graph 4 shows how Catalan municipalities have four main sources of revenue, as follows:

- i. *Local fiscal revenue*, including taxes, charges, public rates and special contributions. This is their main source of revenue. For the period analysed (1992-2016) this represented, on average, 55 % of total municipal revenue. In 2016, for example, 61 % of such revenue came from local taxes and rates paid directly by the public.
- ii. *Transfers* have contributed, over the period analysed, an average of 30 % of total municipal coffers. More specifically, in 2016, they represented 32.7 % of total revenue (3,230,590,000 euros).
- iii. *Financial operations*, which include financial assets (loan repayments, disposals of shares, bonds and other stakeholdings) and financial liabilities (chiefly debt in the form of loans). This source of revenue has contributed around 9 % of resources over the 1992-2016 period. In 2016, Catalonia’s municipalities obtained from such operations 415,850,000 euros.

- iv. And, finally, municipal councils obtain revenue from *other sources*, such as property income and the disposal of *in rem* investments (principally the sale of land). Such sources have contributed around 6 % of total municipal revenues over the 1992-2016 period.

These figures show how the sources permitting municipal councils a certain degree of financial autonomy represent around 54 % of their revenue budget. This percentage is not so different from the average for the federal countries mentioned above. However, what *is* different is the makeup of the contents of the tax “basket”. Catalan municipalities have five taxes over which they may establish elements such as the tax rate (within a certain range) or certain allowances. Specifically, the taxes comprising this “basket” are the tax on property assets (IBI), the tax on motor vehicles (IVTM), the tax on economic activities (IAE) and two discretionary taxes: the tax on constructions, installations and works (ICIO) and the tax on the increase in the value of land of an urban nature (IIVTNU). Following the 2002 reform of local finances, municipalities of more than 75,000 inhabitant and district and autonomous community capitals receive a “territorialised share” of personal income tax, VAT and special duties (tobacco, alcohol and fossil fuels).<sup>3</sup>

Table 3 shows, by way of example, the revenue contributed by each of these different types of taxations to Catalonia’s municipalities as a whole in 2016. IBI is, by far, the most important municipal tax, as it contributes 63.4 % of all tax revenue. In quantitative terms, it is followed by the IIVTNU, which represents 12.7 % of all tax revenue. The weight of the other taxes collected is, in all cases, less than 10 %.

This has not always been the case over the period analysed. Prior to the 2002 reforms, IAE constituted the second-most important tax, behind IBI, in quantitative terms. And, during the economic boom, headed by that in the construction sector, ICIO had a more important place within Catalan municipalities’ tax basket: for example, 2006 saw it making up 13 % of tax revenue: However, three years later, in 2009, this figure fell ten percentage points (De Gispert and Vilalta, 2013).

Table 3. Catalan municipalities’ revenue from taxes and tax participations. Actual figures for 2016

	€M	%
<i>Own taxes</i>		
Property tax (IBI)	2,769.94	63.4
Tax on economic activities (IAE)	352.27	8.1
Tax on mechanically powered vehicles (IVTM)	397.84	9.1
Tax on construction, installations and works (ICIO)	119.88	2.7
Capital gains tax on property transfer (IIVTNU)	554.10	12.7
<i>Total, own taxes</i>	<i>4,194.04</i>	<i>96.0</i>
<i>Tax participations</i>		
Personal income tax (IRPF)	94.22	2.2
Value-added tax (IVA)	62.21	1.4
Special duties	18.69	0.4
<i>Total, tax participations</i>	<i>175.12</i>	<i>4.0</i>
<b>TOTAL</b>	<b>4,369.16</b>	<b>100.0</b>

Own work, based on Spanish Ministry of the Treasury data.

<sup>3</sup> These percentages are as follows: IRPF, 1.6875 % of the tax payable in the territory; IVA, 1.7897 % of the net amount collected in the municipality and, in the case of special duties, 2.0454 % of the net amount collected and attributable to the municipalities for those on beer, wine and fermented drinks, on intermediary products, on alcohol and distilled beverages, on fossil fuels and on tobacco products. In the case of tourist municipalities 2.0454 % of the net amount collected and attributable to the municipality for the duty on fossil fuels and 2.0454 % of that on tobacco products.

As far as local taxes, charges, public rates and special contributions are concerned, municipal councils have a certain margin for deciding what terms are applicable (taxable base, tax rate, tax scales, tax benefits, etc.), making this another way in which they can exercise their financial autonomy. These taxes are, fundamentally, rates such as those on sewers, street lighting and waste collection. In 2016, they contributed 1,679,150,000 euros to Catalonia's municipalities as a whole; public rates, 193,170,000 and special contributions, 3,780,000 euros.

This tax "basket" is significantly different from those of the local governments of federal countries (Germany, Austria, Belgium, Canada, the US and Switzerland). The "representative basket" of their local governments comprises, in addition to taxes leviable on property, those on income and consumption. For example, for the local governments of these countries, taxes on personal income represented, on average, 45 % of total tax revenue (in 2015),<sup>4</sup> and consumption taxes contributed an average of 11 % (these are local government taxes in the USA, and are on retail sales). So, taxes on income and consumption represent more than half (56 %) of the tax revenue of these countries' local governments. This is a basket of tax types characterised by flexible bases and wide collection powers. In Switzerland, for example, 82 % of local governments' tax revenue comes from those on income, whilst in Germany this figure stands at 80 % (Vilalta, 2017). In Catalonia, on the other hand, municipalities' tax revenue come mainly from that on property assets (IBI provides 63 %), whilst taxes on income and consumption represent only 4 %, and are only in the hands of municipalities of more than 75,000 inhabitants, and only then in the form of territorialised participation.

## **5 Equality between municipal governments: the role of transfers within the financing model for municipalities**

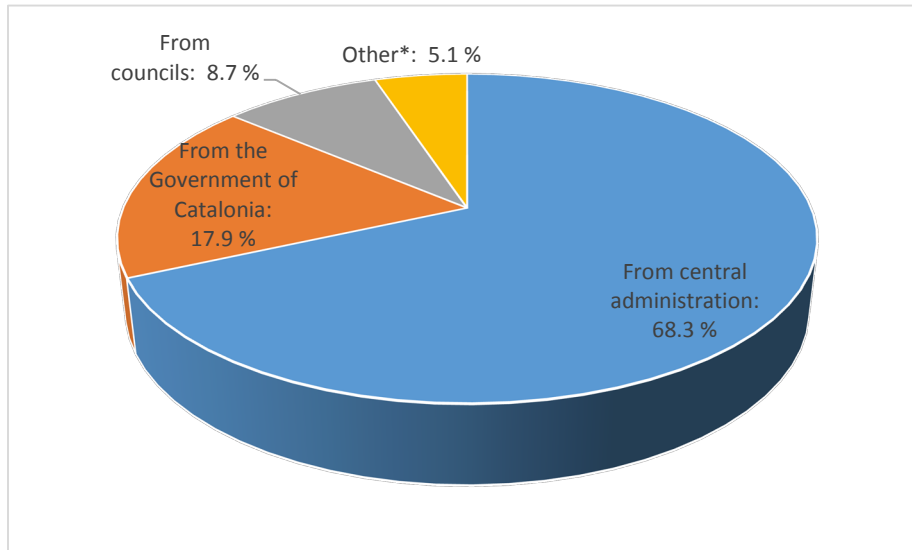
As noted above, around 30 % of the revenue for Catalonia's municipalities is obtained from transfers from other administrations or undertakings. Graph 5 shows that it is the central Spanish administration that makes the majority of this kind of transfers. In 2016, 68.3 % of the total of the transfers they received came from this administration. Fundamentally, this is an unconditional subsidy they receive in the form of the municipal share of Spanish state taxes (known as the "PMTE"), for municipalities of less than 75,000 inhabitants, and in the form of a supplementary fund for municipalities for municipalities of more than 75,000 inhabitants and provincial and autonomous community capitals. The PMTE is allocated using a formula based on three variables: population, with a 75 % weighting corrected by coefficients increasing as it grows, and fiscal effort and fiscal capacity, with a 12.5 % weighting each. Calculation of the amount of the supplementary fund is based on application of an evolution index referring to a fixed sum associated with a base year (2003).<sup>5</sup>

Transfers from the Government of Catalonia represent 17.9 % of the total and are channelled, principally, through an unconditional subsidy called the Catalonia Local Cooperation Fund (*Fons de Cooperació Local de Catalunya*), and through a large number of specific grants whose allocation is predetermined by the Government of Catalonia itself.

4 These figures have been drawn from the following sources: Government Finance Statistics Yearbook (GFSY), International Monetary Fund (IMF) for Canada: Statistics Canada, CANSI, and, for the USA <https://www.usgovernmentspending.com>. It should be noted that, in these sources, income tax falls within the item covering "taxes on personal income, business profits and capital gains". Also noteworthy is the fact that, on a local scale, this item basically comprises taxes leviable on personal income and, often, only those leviable on employment income.

5 For a detailed description of the workings of this subsidy, see Vilalta (2015).

Graph 5. Sources of transfers received by Catalonia’s municipalities, % of total (2016)

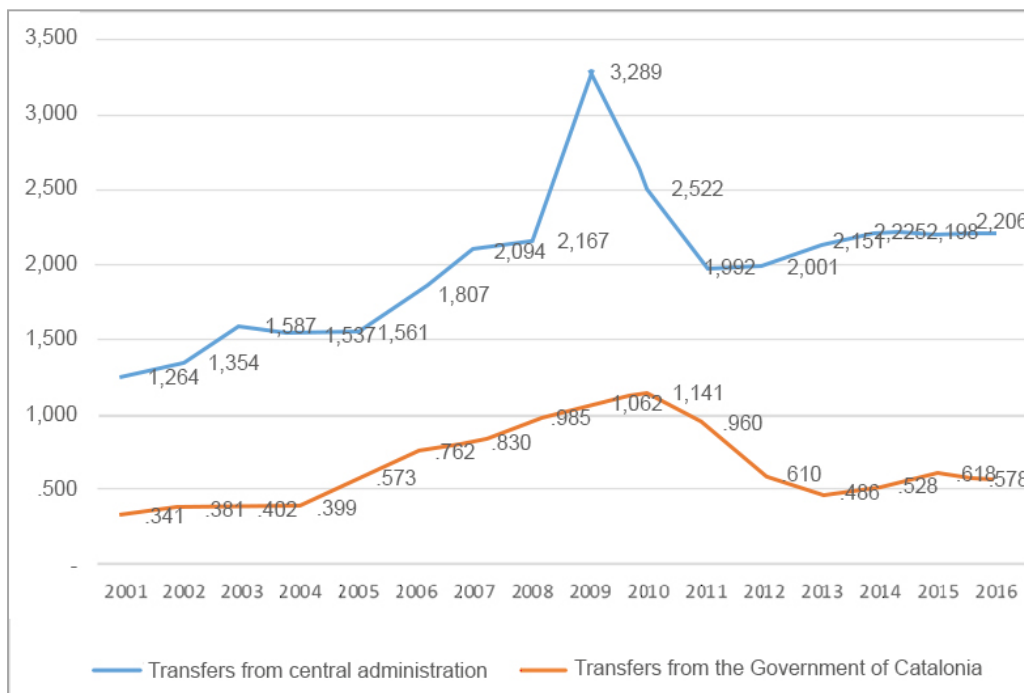


\* Includes: associations of municipalities, metropolitan area, districts, groupings of municipalities and smaller local undertakings, consortia, families and non-profit undertakings.

Own work based on Spanish Ministry of the Treasury data.

Graph 6 shows the trends in transfers received by Catalonia’s municipalities in the 2001-2016 period from the central Spanish administration and the Government of Catalonia, from which two important things can be observed: a) the increase in transfers from the former in 2009 and 2010, stemming from the implementation of a fund designed to offset the downturn caused by the economic crisis (the State Local Investment Fund); and b) the sharp drop-off in transfers from the Government of Catalonia from 2010 on.

Graph 6. Transfers received by Catalonia’s municipalities from the central Spanish administration and the Government of Catalonia. Actual figures, 2001-2016 (in billions of euros)



Own work based on Spanish Ministry of the Treasury data.

Both the compared system and economics literature give a significant role to inter-governmental transfers within the financing model for sub-central governments. Amongst other objectives, they are designed to enable vertical balance and horizontal equality. In a situation of vertical balance, the spread of powers (expenditure requirements) and revenue is designed in such a way that every level of government has enough resources to be able to provide the services with which they have been charged. If, for example the local government level is unable to cover its expenditure requirements with its potential tax revenue, whilst exactly the opposite happens to a different level of government, it is advisable to enable an unconditional subsidy to correct this imbalance. Given the design of the financing model for municipal governments in Spain, the total revenue obtained via the tax basket and that sourced from the unconditional subsidy from the central Spanish administration should permit the covering of municipal expenditure requirements. The instrument that should have contributed to ensuring vertical balance is the unconditional subsidy from the central Spanish administration. However, the amount of this subsidy has never been calculated with this goal in mind.

For its part, there would be horizontal equality if municipal governments were able to achieve an equal or similar degree of provision of the services assigned to them applying the same tax burden to their citizens. Given that the fiscal capacity of municipalities is different (taxable bases are not spread uniformly over a territory), we are faced with a situation of inequality. Inter-governmental subsidies appear to be a highly suitable mechanism for correcting this and become a tool to achieve a very clear objective: to enforce the principle of inter-municipal equality. Within the current municipal financing model, the instrument that should enforce this principle is again the unconditional subsidy from the central Spanish administration, but this has not been the case (Castells *et al.*, 2003; Vilalta, 2015). Municipalities with a greater fiscal capacity end up with more resources than those with a lower one. The way in which the unconditional subsidy from the central Spanish administration is distributed between municipalities does not help offset these differences.

## 6 Relations between the Government of Catalonia's finances and those of the municipalities

In Spain, the laws governing the jurisdictional framework and finances of local governments are approved by the central Spanish parliament. Powers over local matters belong to the central Spanish government. This is a significant difference between Spain's decentralisation model and those of federal countries. One of the main defining characteristics of a federal model for fiscal relations is the recognition of the local regime as a state power (of the *Länder*, state provinces, cantons, etc.), and not a federal government one (Argullol and Velasco, 2011). This is an institutional difference, of the concept of the organisational structure of state finances, and one that ends up affecting the distribution of powers and revenues between central and state governments, and between the latter and local governments.

Whilst the Government of Catalonia may decide upon its territorial organisation, it has no power to decide upon the funding of the different undertakings that may comprise the local government level. This therefore represents a dysfunction in our fiscal decentralisation model.

Under a federal system of financing, the subsidies provided by the central Spanish government to Catalonia's municipalities would make no sense. Under such a system, the municipalities would have barely any relationship with the central government. The main subsidies they would receive would come from the Government of Catalonia and, what's more, as happens in the aforementioned federal countries, these subsidies would have a "levelling" function: in other words, they should enforce the principle of inter-municipal equality (except in the United States, where this is not the case).

Catalonia's 2006 Statute of Autonomy was designed to make progress on this point. Article 219 provides that local government revenue from shares in central Spanish taxes and unconditional subsidies be received via the Government of Catalonia and distributed in accordance with the provisions of the Law on the Local Finances of Catalonia, approved by the Catalan Parliament. It establishes that, when the Government of Catalonia decides upon the distribution of this revenue, it respects the criteria stipulated by central Spanish legislation on the matter and, at the same time, said criteria must allow the Catalan Parliament to influence the distribution of these resources to take into account the singularity of Catalonia's institutional system and bearing in mind the fiscal capacity and expenditure requirements of local governments. This gives these grants a "levelling out" function over local government resources and bolsters relations between the finances

of the Government of Catalonia and those of its local authorities. Also, this represents progress towards a federalisation of fiscal structures, in that it opens up the door to financing relationships that are slightly closer to those between state and local governments in federal countries. Nevertheless, this Article was declared unconstitutional by Spain's Constitutional Court Judgement 31/2010, of 28 June, which provided an interpretation that made it clear that the distribution criteria set by the central Spanish government must be respected and thus uniform across the territory. This interpretation therefore reduces the possibility of progressing towards a more federal conception of relations between the finances of the Government of Catalonia and those of local governments.

## 7 Some final thoughts by way of conclusion

The above description and analysis of both the expenditure behaviour of Catalonia's municipal governments and the sources of their revenue make it clear how the Catalan local public sector level is made up of a great many undertakings, meaning it is not easy for local citizens to identify who they are receiving their public services from, who ends up responsible for what they are receiving and who ends up receiving the revenue from the taxes they pay. This may hinder accountability and may therefore have a negative impact upon efficiency in the provision of local public services. Given the very small size of Catalonia's municipalities, the supra-municipal level must obviously play a highly important role. When governments are small in size, economies of scale are lost and, what's more, it is difficult to ensure that they are in a position to provide the services with which they are charged efficiently and equitably (Vilalta, 2018). Some empirical works (Bosch and Solé, 2005; Balaguer *et al.*, 2007; Bel, 2012; Hortas and Salinas, 2014) have made this clear. These papers show that efficiency in the provision of certain municipal services improves after passing the threshold of a certain number of inhabitants and that efficiency in the provision of municipal services could be enhanced if the municipalities in question were larger. This could be achieved by either merging municipalities or leveraging the supra-municipal level. Catalonia already has many supra-municipal bodies (provincial councils, district councils, associations of municipalities, etc.), so all that needs to be done is to check whether they have the right size, if they all need to exist or if, on the other hand, some need to be abolished. At the same time, there is also a need to explore the implementation of inter-municipal cooperation and assistance models that would permit a reduction in municipalities' expenditure and the more efficient provision of services, as is already the case, for example, with Barcelona Provincial Council's Network of Local Governments (*Xarxa de Govern Local*).

It would be advisable to specify the jurisdictional framework of local governments and hence their role within the Catalan public sector as a whole. Of the Catalonia's total public expenditure by all levels of government, the local government level represents 14 %. This figure is lower than the average for local governments of federal countries, so what needs to be decided is whether there is a wish to approach this figure or not. If the answer is yes, it needs to be established which powers must be transferred from the Government of Catalonia to local governments. Catalan municipalities concentrate their activities in the provision of "typically local" services and, unlike in federal countries, they have little presence in the provision of the key services of the welfare state. Increasing the weight of local expenditure could be achieved, for example, by transferring powers over education and some local services. However, we need to take into account the aforementioned small size of Catalonia's municipalities. This is why it is only after tackling the issue of territorial organisation and, therefore, after establishing the role of the supra-municipal level of government in Catalonia, that we can talk of the possible transfer of powers from the Government of Catalonia to its local governments, to make the latter's role in the Catalan public sector as a whole similar to that of those of countries we might look to as a point of reference.

There is a need to review the municipal financing model. Figures show that Catalan municipalities have a certain decision-making ability over a raft of different taxes, in which the Property Asset Tax, IBI, plays the leading role. It is very common for property taxes to be in the hands of local governments and, in fact, this is the case particularly in places such as the United Kingdom and Latin countries. However, if we look at what happens in federal countries, it would be advisable to add to Catalan municipalities' tax basket taxes on income and on consumption. In the short term, in addition to thinking of how to broaden the tax basket, we need to study how to improve the current one. We need, for example, to: i) bear in mind the importance of

the land registry (*catastro/cadastr*) for IBI's proper functioning; ii) consider the role of the tax on economic activities, IAE, within the municipal tax basket, and, iii) take into account environmental factors in the configuration of the tax on motor vehicles, amongst other things.

The data indicates that municipalities are relatively dependent upon transfers from other administrations, especially the central Spanish government. The way of calculating the main subsidy they receive does not ensure compliance with any principle of equality. In other words, it does not act as a mechanism for levelling out revenue, meaning that, even though there is the same fiscal effort, some municipal councils (those with a greater fiscal capacity) end up enjoying greater revenues than others (those with scant fiscal capacity). This is not the case in federal countries, where transfers are allocated taking into account some form of levelling criteria (except in the USA). We therefore need to take a look at how we can enforce some principle of equality between Catalonia's municipalities. The compared system offers many good examples of how to do so (Vilalta, 2015).

In short, it can be concluded that, as far as the municipal financing model is concerned, there is a need to take a more in-depth look at municipalities' fiscal autonomy (broadening and revising the current tax basket) and to make it compatible with the principle of inter-municipal equality (implementing a "levelling out" subsidy).<sup>6</sup>

Lastly, it would be advisable to bolster the relations between the finances of the Government of Catalonia and that of local governments. In federal countries, the latter have barely any fiscal relationship with the central federal government. This is not the case in Spain, where the laws establishing the jurisdictional framework and financing of local bodies are approved by the central Spanish parliament, rather than those of the country's autonomous communities. This dysfunction needs to be resolved: one cannot have powers over territorial organisation without the ability to make decisions on the allocation of competences and on the financing model for local bodies. Articles 217 to 221 of Catalonia's 2006 Statute of Autonomy represent a step forward in this regard. Their application would probably have bolstered fiscal relations between the Government of Catalonia and its local governments, if the judgement of Spain's Constitutional Court of 27 June 2010 had not significantly watered down their content.

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<sup>6</sup> The Resolution of the Cabinet of Ministers of 10 February 2017 constitutes the Expert Committee for reviewing the model for the local financing model. This Committee issued a report containing a proposal for reforming the system along the lines of increasing municipalities' fiscal autonomy and redefining the current workings of the subsidies received by local governments.

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