

# **Regional tax autonomy in Spain: ‘words’ or ‘deeds’?**

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## **ABSTRACT:**

During the last three decades, the funding system of Spanish regional governments has evolved from one based on intergovernmental transfers to one based on shared taxes, with an increasing degree of tax autonomy. However, till very recently –and despite it was legally possible– regional governments made a low use of tax freedom. This situation has changed as a result of the current budgetary crisis, with an explosion of tax changes enacted since 2010. In this paper we describe the evolution of regional tax powers in Spain during the last three decades and the effective use of tax autonomy made by regional governments. We discuss why regions governments were so passive in tax matters during most of the period and so active in recent years.

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## 1. Introduction

During the last three decades many countries have pursued decentralization reforms, assigning responsibilities over the provision of important public services to regional and local governments (Brosio and Shah, 2009). A common argument used to justify these reforms is that decentralization brings government closer to citizens, increasing knowledge about demands and needs and improving policy responsiveness and accountability (Oates, 1972, Seabright, 1996). Yet, after many failed experiences with decentralization some authors have started to question the general validity of this statement. Many content now that failures are in general due to the ‘partial’ nature of these decentralization reforms (Devarajan *et al.*, 2009), ‘partial’ usually meaning that the decentralization of spending responsibilities is not followed by a decentralization of revenue responsibilities of a similar magnitude (see OECD, 2010), decentralized services being funded mostly through transfers.

Many authors have already warned about the perils of transfer-financing. First, transfers might soften the local budget constraint, creating incentives to run up excessive local deficits expected to be covered by future transfers (Rodden, 2000; Rodden *et al.*, 2003; Inman, 2001). Second, transfer financing may diffuse accountability (Rodden, 2002) and foster rent-seeking and clientelism (Weingast, 2009; Weingast *et al.*, 2006), thus eroding the very benefits gained from spending decentralization. Funding with transfers reduces the price of sub-national services and so the efforts of citizens in controlling sub-national incumbents. At the same time, sub-national politicians argue that bad quality of services is the fault of upper layers not providing an adequate amount of funds, avoiding being held accountable.

Given these considerations, it is generally accepted that the superiority of the decentralized provision of public services can be more clearly established if some basic premises are satisfied, namely: (i) A substantial share of public spending is funded through taxes, (ii) Citizens are aware of the level of government to which they are paying taxes, and (iii) Sub-national government have real tax autonomy, i.e. they are able to take decisions that affect the level and composition of taxes. These assumptions are paramount to ensure that sub-national politicians are able to engage into a ‘fiscal exchange’ with their fellow citizen-taxpayers (Bird and Slack, 2013) and that taxpayers have the right incentives to monitor the compliance with such a fiscal contract (Peralta, 2011). It would be difficult to fool citizens that are aware of paying taxes (condition ii) and of the governments’ capacity to modify them (condition iii) and to have a meaningful impact on the amount of revenues available (difficult without condition i).

However, the recommendation that revenue decentralization should parallel spending decentralization is easy to make but difficult to implement. The proof of this is the high degree of vertical imbalance existing in many decentralized countries, and the low degree of sub-national tax autonomy (see OECD, 2010, and Stegarescu, 2005). And even in countries that have formally pursued these steps, the formal degree of tax decentralization –what we call the ‘words’– is often much lower than the effective use of tax powers assigned to sub-national governments –what we call the ‘deeds’–. Why sub-national governments are sometimes reluctant to use its tax powers is an intriguing question. There are many possible explanations to this phenomenon, ranging from an inadequate tax mix, incomplete reforms and/or ex-post central government acts that make difficult the use of the formal sub-national tax powers, persistence of a soft-budget constraint syndrome, or much more simple, just revenue buoyancy, either at the sub-national or at the central level.

In this paper, we illustrate the difficulties in increasing the effective degree of sub-national tax autonomy by focusing on the case of Spanish regional governments. During the last decades, Spain undertook one of the deepest and more successful decentralization reforms. In the period that goes from the beginning of the 1980’s to the first years of the present century some of the most relevant public services (e.g., education, health, social services, etc.) were transferred to the newly created seventeen regional governments (the so-called Autonomous Communities, ACs from now on). Nowadays, this intermediate level of government represents nearly 35% of public spending<sup>1</sup>. The mere fact that this process was conducted orderly during a period of expansion of the Spanish welfare state should be considered a success. Moreover, there is some evidence that the assignment of responsibilities to the ACs improved policy responsiveness and outcomes in some services (albeit modestly, see Solé-Ollé, 2009).

However, there is also growing concern in Spain about the difficulty of containing sub-national spending and debt. During the first stages of the expenditure decentralization process, funding was mostly through intergovernmental transfers. The overall amount of these transfers and its allocation was discussed every five years. This had sense, given the permanent changes in the range of services provided by the ACs (the spending decentralization process was not completed till the beginning of this century, see Table 1) but did not provide the best incentives to the ACs to manage their budgets. This situation subsisted till nowadays and it is especially worrisome in the midst of the worst fiscal crisis

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<sup>1</sup> Spanish local governments have not experienced substantial changes during the same period and represent just a 15% of spending, more or less the same that at the beginning of the period.

most Spaniards have ever seen (see IEB, 2012)<sup>2</sup>. That the Spanish decentralization reform was too skewed towards transfer finance was something already discussed by Spanish academics and policy-makers at the beginning of the 1990s and it was during these years that the first steps were made to increase the level of ‘fiscal co-responsibility’, the term used in Spain during those years (see Castells, 1993). Several reforms have followed since then that increased both the reliance on taxes as a source of finance and the tax power of regions over them. In the following sections of the paper we describe the reforms in detail (section 2), and discuss its effects on effective tax autonomy (section 3). After revising the evidence, we content that despite the high degree of formal tax autonomy, the real degree of tax differentiation has been quite low until very recently. This situation has changed with the crisis, with an explosion of tax changes enacted since 2010. We end the paper discussing several explanations of the initial passive fiscal behaviour and of the recent shift to tax activism.

## **2. Tax decentralization in Spain: the ‘words’**

The Constitution of 1978 reserves all taxation powers to the central government. But the Constitution also says that taxation power can be transferred to the ACs, so that regional laws can regulate their taxes within the conditions set by the central parliament. The 1978 Constitution does not put explicit restrictions on the taxes that can be decentralised, except for custom duties which are the exclusive preserve of central government. The only limits set on the tax system are the need to fulfil some fiscal principles, such as equality (but not necessarily uniformity), market unity and solidarity.

Following these principles, during the last three decades the system has evolved from one based on intergovernmental transfers to one based on shared taxes, also with an increasing level of regional tax autonomy. Table 1 identifies several stages in the evolution of tax decentralization (Herrero & Tranchez, 2011, and Martinez-Vázquez, 2012). During the first stage, in the early eighties, there was not much tax autonomy, as the system was mainly based on earmarked transfers<sup>3</sup>. At this stage, the ACs were allowed to establish their *own taxes* in fields not occupied by the central government. This change provided a very small

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<sup>2</sup> Also, the recent wave of corruption scandals affecting many regional politicians is having an impact on citizen’s support of the decentralized state (see León, 2013). This might also be a reaction to the current momentum of Catalan secessionism. Note that the main motivation for decentralization during the design of the Spanish Constitution of 1979 was the appeasement of Catalan and Basque nationalism.

<sup>3</sup> This was the most practical means of carrying out the assignment of spending powers from the central government to each of the AC’s, which happened at a different speed in each region.

fiscal room for maneuver for ACs to set their taxes (more on this below). The ACs also administered and collected the so-called ‘traditional’ *ceded* taxes (i.e., *Wealth tax*, *Death and gift tax*, *Property transmission tax* and *Stamp duties*, see Table 2). The term *ceded* refers to the fact that it is the central government that has the responsibility of regulating and collecting the tax unless it decides to assign it (to *cede* it) to the ACs. The term ‘traditional’ is used because the list of *ceded* taxes has been enlarged in more recent periods. During this first period, regulation powers with respect to these taxes remained in the central government. The second stage ended in 1996 and was mainly characterized by a movement towards greater spending autonomy, thanks to the consolidation of the previous earmarked transfers into just one general formula grant. During this period the ACs were assigned for the first time a share of the *Personal income tax* (a 15%, in 1994), although with no regulatory power.

[Insert Table 1]

[Insert Table 2]

The third stage starts in 1997. In this period, the ACs were given the possibility of modifying the tax rates and some other provisions of the above-mentioned ‘traditional’ *ceded* taxes (see Table 3), with some limits. Also, after 1997, the ACs were allowed the possibility to decide over *Personal income tax* rates on a centrally-defined tax base. Since 1997 the regional personal income tax has consisted of a progressive rate schedule applied on the tax base defined by central government for its personal income tax. In order to make “fiscal room” for the regional income tax, the old progressive rate scale of the central tax was divided into two parts: 15% of each of the ten *original* rates of the schedule of the 1997 income tax became the regional rate schedule, and the remaining 85% of each *original* rate was made the new central rate schedule<sup>4</sup>. As seen in Table 4, in 1997 the old top rate of 56% was split into the 8,4% regional top rate and the 47,6% central top rate, and the *original* bottom rate of 20% was divided into the 3% regional bottom rate and the 17% central bottom rate. The tax credits of the *original* income tax were also split into two: 15% of each tax credit becomes a “regional” tax credit, 85% a “central” tax credit. In addition, regional parliaments can establish tax credits of a different kind: personal and family, non-entrepreneurial investments, uses of income (private health spending, charity donations, etc.). The main limitations on tax credits were that effective discrimination among income categories was not allowed, and that

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<sup>4</sup> The ACs shared an additional 15% of income tax revenues since 1994. With the new *Regional personal income tax*, the effective ACs share on the revenues coming from this tax was raised to a 30%.

regional governments were not allowed to modify their "share" (i.e., the established 15%) of the centrally-decided tax credits.

[Insert Table 3]

[Insert Table 4]

The fourth stage started in 2002. During this period the ACs sharing of income tax revenues was increased from the 30% to a 33%, and they were also assigned a share of VAT and *Excise tax* revenues (35% and 40%, respectively)<sup>5</sup>. Additionally, three small taxes were completely assigned to the ACs: *Transportation tax*, *Retail Gas tax* and *Electricity tax*. In the first two of them the ACs were also given some power to set the tax rates within some limits (see Table 3). Their power to modify tax rates, tax credits and other provisions in the income tax was also extended. Nevertheless, some limits remained (see Table 5). Firstly, the rate schedule had to remain progressive and have the same number of brackets than the central one. Secondly, the effective variation of the tax (before tax credits), resulting from a change in the tax rates, was not allowed to be higher than 20% in absolute value. Finally, the regions were not allowed to regulate the tax rates applied to capital gains and other irregular income. In the case of the traditionally *ceded* taxes, the few remaining limitations to the use of regional tax power were abolished, granting ACs a quasi-absolute power to set all the relevant tax parameters. In the last stage, after 2009, the ACs were granted an ever higher share of revenues in the income tax, the VAT, and excise taxes (50%, 50% and 58%, respectively). In the income tax, they were granted the possibility of modifying the basic personal and family relief and certain deductions, increasing also the freedom in designing the regional tax schedule. Notably, the requisite that the regional income tax should have the same number of brackets than the central one was abolished.

[Insert Table 5]

[Insert Table 6]

After all these changes, the formal degree of tax autonomy of Spanish ACs is quite substantial. Table 6 provides information of the share of the different sources of revenue after the last two reforms (2002 and 2009). In the last two columns one can see that non-earmarked

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<sup>5</sup>In the case of the VAT and Excise taxes ACs obtain a share of national revenues in each of the taxes equivalent to the regional share of a consumption indicator (either total consumption, for the VAT, of gas, tobacco or alcohol consumption, for excises).

revenues provide around 86% of total revenues after 2002 and around 83% after 2009<sup>6</sup>. This ensures a high degree of spending autonomy, although mandates and central government regulations also have an impact in Spain over the capacity of ACs to implement differentiated policies. Besides of that, note from the first two columns in Table 6, that tax revenues represented around a 69% and an 80% of non-earmarked revenues after the two aforementioned reforms. This increase is due to the increase in the shares of the *Personal income tax*, VAT and *Excise taxes* introduced by the 2009 reform. It is true, however, that ACs don't have tax autonomy over all these taxes. ACs have some autonomy over 64% and 56% of tax revenues (after 2002 and 2009, respectively), over around 45% of non-earmarked revenues (i.e., *Tax revenues + Equalization transfer*), or over around 38% of total revenues. Certainly, these numbers are less impressive, but still high on international standards.

### **3. The use of tax autonomy: the 'deeds'**

The description provided above suggests that Spanish regional governments do have plenty of possibilities of modifying the level and composition of the revenue budget, and of affecting the taxes borne by different economic sectors and income classes. Yet the general impression is that the ACs have been quite passive in this respect, at least until very recently. Here there is a summary description of the main tax decisions regional governments have taken during these last three decades.

*Own taxes.* Starting in the second half of the eighties, the ACs have created some new taxes. As discussed above overall these taxes represent a low share of either tax revenues (around 1.5% in 2010) or total revenues (around 0.85%), although in some cases one might argue that the main objective of these taxes is not to collect revenue. Another reason of this small weight is the legal condition required to introduce such taxes: new taxes can only be created in fields of taxation not previously occupied by the central government. The task of inventing a new tax is thus a difficult one, especially given the hostility of the central government to any new regional tax. Many of AC's new taxes have been denounced by the central government in front of the Constitutional court. In other cases, the threat of denouncing the measure or the use of legal tricks<sup>7</sup> has discouraged the introduction of such taxes.

Some ACs have been more active than others in this field (e.g., Catalunya, Galicia). Most of the new taxes created are either environmental taxes or taxes of different types of

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<sup>6</sup> The slight reduction in this number reflects the impact of the crisis, since Spanish sources (either taxes or transfers) have decreased to a greater extent than European funds.

<sup>7</sup> For example, the central government has reacted in some cases quickly introducing the same tax at the national level but then setting the tax rate to zero or granting a universal 100% tax credit.

gambling activities. On the environmental side, nine out of fifteen ACs have introduced a water tax earmarked to the funding of water cleaning facilities and (in the case of industrial uses) computed using information on pollutant concentration. Water taxes collected in 2010 777 million euro, a 62% of all revenues coming from own taxes. Also, six ACs have taxes on the disposal, treatment and incineration of garbage, on disposal of special residues, and on the emissions of pollutants to the atmosphere or to the sea. These taxes represent around the 8% of all own taxes. Eight ACs have taxes on the activities of casinos, bingos and jackpot machines, three have taxes on the activity of large commercial centers (Catalunya, Aragón and Asturias), two have some type of energy taxes (Galicia and Canarias), and one has a tax on bank deposits (Extremadura).

More recently, the budgetary crisis have fuelled the imagination of some ACs (the ones facing more budgetary difficulties), that have introduced (or tried to introduce) several new taxes. The most active AC has been Catalunya, with proposals in 2012 and 2013 of new taxes on banking deposits and medicine purchases (both actually blocked by the central government) and a tourist tax and a new lottery. Also, some of the above-mentioned environmental taxes have been adopted during this more recent period by ACs that did not have them previously.

*Traditional ceded taxes.* As explained above, these taxes were the first ones over which the ACs had a substantial degree of tax autonomy. For instance, already in the eighties these taxes were administered regionally (with the exception of the *Wealth tax*). Some authors argue (Esteller and Durán, 2006) that collection and inspection policies differed between regions with a clear impact on the effective tax burden. Moreover, since 1997 the ACs have enjoyed considerable autonomy in the setting of the main parameters of these taxes.

The first changes did occur following the 2002 assignment of new tax powers in the *Death and gift tax* and, to a lesser extent, also in the *Wealth tax* (see Solé-Ollé, 2012). More recently, there have also been changes in the *Property transmission tax*. In the *Death and gift tax*, the ACs undertook the following changes (Esteller and Durán, 2006): (i) increase of tax base reductions in the case of inheritances; (ii) reduction of nearly a 100% of the tax burden on inheritances to all direct family members (Cantabria and La Rioja) or to some of them (Asturias, Baleares, Castilla-León, Galicia, Madrid, Murcia y Valencia); this was done either through tax credits (in most cases) or changing the coefficients applied to pre-existing wealth (Asturias, Cantabria y Galicia); (iii) fiscal benefits for gifts of the main residence to direct family members. The reform undertaken by Madrid in 2005 was especially aggressive, since



donations to direct family members become fully exempt from the tax. In 2007, the above-mentioned ACs (the ones that did not do it before) extended the reduction to all direct family members. Also this same year, Aragón reduced the burden of this tax, although more slightly, and in 2008 Catalunya also changed this tax in the same direction, reducing the tax burden on both inheritance and donations between direct family members. Other ACs (Galicia, Andalucía, Asturias) that were initially reluctant ended up reforming the tax in order to attenuate the taxation of inheritances and donations between close family members, although in this case the tax burden is still notable.

The fiscal disparities provoked by these reforms have been substantial. One study commissioned in 2007 by the Spanish association of tax assessors (REAF, *Registro de Economistas Asesores Fiscales*) showed that the tax due in the case of inheritance between direct family members was virtually zero in Castilla-León (9 euro), Murcia (10 euro), Cantabria (16 euros), Comunidad Valenciana (27 euro), Madrid (101 euro) and La Rioja (101 euro), and was quite high in Extremadura (8.280 euro), Andalucía (8.509 euros), Galicia (6.515 euro), Asturias (6.133 euro), Catalunya (6.255 euro) and Canarias (5.583 euro)<sup>8</sup>. The tax was in between these extremes value in Aragón (932 euro) and Baleares (1.371 euro)<sup>9</sup>. The pattern of these decisions was clearly partisan: the ACs with a more aggressive policy of tax reductions were the ones controlled by the PP (e.g., Madrid) and the ones more reluctant to this policy were the stronghold of the PSOE (e.g., Andalucía)<sup>10</sup>. There is also the perception that tax competition might also have played some role in the generalized reduction of this tax, although it is not clear how empirically relevant this phenomenon is. On the one hand, the fact that, in the case of real estate donations, the *Gift tax* is collected in the region where the house is located (instead than in the region of the donor) might have stimulated some tax elusion<sup>11</sup>. There is however no evidence of real mobility of tax bases (i.e., of changes in residence by

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<sup>8</sup> This example uses the following assumptions: death of a father whose heirs are his widow and three children, one of them less than 21 years old and the other one handicapped; the inherited goods are the main residence (400.000 euro), a second-home condo (300.000 euro), a savings account (60.000 euro), and quoted shares (100.000 euro); the pre-existing wealth of the heirs are: 17 years-old daughter (5.000 euro), 24 years-old handicapped son (125.000 euro) and 26 years-old daughter (6.000 euro); see REAF (2007).

<sup>9</sup> The ACs belonging to the so-called 'foral' regime (País Vasco and Navarra) did not appear in that report, but it is already known that the tax burden in these taxes is very low in these regions since many years before. These ACs have always enjoyed a high degree of tax autonomy over traditional ceded taxes.

<sup>10</sup> Recall also that after 2004 the PSOE got the control of the central government –while most ACs were still controlled by the PP–; the PP used the tax powers at his disposal (occasionally in the hands of the ACs) to compete with the PSOE on the taxation issue.

<sup>11</sup> During the boom years a common tax strategy was to buy a condo in Madrid and then donate it to a child whose residence was registered in that place.

rich people). It seems, however, that the mere information that most ACs (lead by the ones ruled by the PP) was reducing the tax might have generated fears that that mobility would hurt revenues and force other governments to reduce taxes also (Solé-Ollé, 2012). In the case of the *Death and Gift tax* the decentralization of tax powers triggered a process of competition (real or perceived) to reduce and even abolish the tax. The outcome can be hardly considered an expression of the exercise of fiscal responsibility by the ACs. Moreover, we already know that this has happened before in other countries (Brülhart and Parchet, 2010). The conclusion is that this tax should not have been decentralized, at least without a proper central regulation.

In the case of the *Wealth tax* the ACs tax powers have been also substantial and after 2002 they were also able to administer and collect that tax. Despite these possibilities, the ACs have been less prone to modify this tax. Only one AC (Cantabria) did reduce substantially the tax schedule and the basic relief; other ACs have increased the basic relief for some groups. The above-commented study by the REAF also identified some inter-regional differences in the burden of this tax: for a given type of taxpayer (e.g., handicapped), while in Cantabria the tax due was just of 121 euro, and in Madrid, Cataluña, Canarias, Valencia, Galicia, and Andalucía it was around 200 euro, in the remaining ACs it was nearly 400 euro<sup>12</sup>. Note that the pattern of reductions in this tax also followed a clear partisan rule, right-wing controlled regions being more prone to reduce the tax. The activity on this tax stopped after its abolition by the central government (which is the layer retaining the original taxing powers) in 2008 as a part of the ‘stimulus package’ enacted by the PSOE government. Later on, in 2010, the tax was re-established by the PP government and assigned again to the ACs. Some of the ACs have decided to establish a 100% tax credit for all taxpayers, which means that the tax will not be reintroduced in these regions (i.e., Madrid, Baleares and Valencia, controlled by the right). Of the remaining regions, only Andalucía (a PSOE stronghold) has a tax rate larger than the basic one (2.75% vs. 2.5%). The rest of the parameters of the tax are very similar in all the regions.

Since 2010, and as a result of the fiscal crisis, all communities have increased the tax rate of the *Property transmission tax* from a 6% to a 7% (the only exception being Canarias, with a tax rate equal to 6.5%) and the tax rate of *Stamp duties* from 0.5 to 1. The purpose of this increase was to raise revenue. These are taxes whose tax burden is camouflaged into the price of a real estate transaction or any other irregular event (as the constitution of a society),

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<sup>12</sup> In this case the example is based on the following assumptions: a married couple owning its main residence (400.000 euro), a second-home condo (210.000 euro), two cars (15.500 and 24.000 euro), a savings account (72.000 euro), and the wife is handicapped of degree 66%.

so the marginal political costs of a tax increase are really low. These were also taxes whose revenues grew a lot during the last housing boom but plummeted with the housing bust in 2007 and 2008.

*Personal income tax.* The most frequent changes in this tax have involved the introduction of tax credit on the regional income tax quota, especially after 2002. The most widely-used tax credits have been the child tax credit and the housing tax credit (acquisition of main residence). The cost of these tax credits in terms of revenue foregone has been in general quite low, as it is also low the impact on the majority of taxpayers. However, the amount of these reductions might be substantial for specific types of taxpayers. Durán and Esteller (2006) show that this was the case in 2004 for a married couple with a single income earner, with two children less than two-year old, owners of the main residence bought two years ago with a mortgage. In this case, and for a family income equal to the median, the effect of regional tax credits is a reduction in the tax due of nearly a 35% in Castilla-León, Madrid and Galicia, of around the 20% in Catalunya and Murcia, in the range of 7-10% in La Rioja, Valencia and Castilla-La Mancha, and zero in the remaining ACs. For income levels below the median these differences do not arise, while they are much lower for incomes above the median. Madrid and other right-wing regions appear again as especially active here. The use of very specific tax deductions (instead than a reduction of the tax rate) allowed them to maximize the effects of the reform over government popularity at a low cost in terms of revenue. However, this explanation obscures the fact that during these years there were some practical difficulties in performing a full scale reform of the tax (see section 4).

It has not been until recently that some ACs have modified the tax schedule. Madrid was also a pioneer in this respect, reducing tax rates in 2007. The lowest tax rate in that AC was of 7.94% after that reform (it was 8.34% in the rest of ACs), representing a reduction of the tax due of a 4.46%. Reductions in the remaining tax brackets are much lower: from 9.73% to 9.43% in the second one (savings of 4% of the tax due), from 12.86% to 12.66% in the third one (savings of 3%), and from 15.87 to 15.77% in the fourth one (savings of 1.3%). The abolition after 2009 of the requirement that the regional tax schedule should have the same number of brackets than the central one also facilitated further changes in other ACs. Some ACs followed the path opened by Madrid and decided to keep marginal tax rates (especially at the top) lower than the basic ones. This is the case of La Rioja, whose tax mimics the one in Madrid. In these two regions, the 2012 combined central+regional top marginal tax rate was 50.9%. Other five ACs had a top marginal tax rate of 52% (Canarias, Castilla-La Mancha,

Aragón, Baleares and Cantabria), two have a 54% (Murcia and Valencia), one has a 55% (Extremadura), and two a 55.5% (Asturias and Galicia); Andalucía and Catalunya have a top marginal tax rate equal to 56%. There is a 5% difference between the AC with a lower and the AC with a higher tax rate. Differences in other high-income brackets are of a similar size. The bottom tax rate is more or less the same everywhere. Most ACs use a six-bracket schedule as the central government, but some of them have a seven or eight-bracket one (they have created new brackets at the top of the distribution to be able to apply higher marginal tax rates to the more affluent taxpayers). As before, right-wing controlled ACs tend to have lower marginal tax rates (especially at the top bracket). Left-wing controlled communities tend to have higher marginal tax rates and more tax brackets. The need to consolidate the budget probably also had some impact on the decision to raise taxes.

We can extract the following conclusions from this analysis: (i) Before 2010, the ACs were quite passive in term of tax policy decisions; the exceptions to this rule were the introduction of own taxes and of many deductions in the *Personal income tax* (both measures with a very low revenue impact), and the practical abolition of the *Death and gift tax* in some ACs (at least for some taxpayer types) and the reform of the same tax and reduction of its burden in the remaining ones; (ii) After 2009, all the ACs increased the tax rates of the *Transmission tax* and of *Stamp Duties*, and some of them increased the *Personal income tax* rates (especially the top ones) while others reduced them, and tried to create new taxes. The effective level of tax autonomy must be qualified as low, especially before 2010 but also in recent years, given the limited effect of the measures enacted on revenues. However, the trend in recent years suggests that something has changed in this respect.

#### **4. Discussion**

Several authors have expressed disappointment regarding the low use of tax autonomy made by Spanish regional governments during the years following the reforms (Lago *et al.* 2007, Martínez-Vázquez, 2013). Several possible explanations to the phenomenon have been proposed.

*Inadequate tax mix.* Although tax powers regarding some taxes increased a lot, tax autonomy regarding other important figures remained inexistent. For instance, the ACs have no powers over (relevant) indirect taxes, as the VAT and (most) *Excise taxes*<sup>13</sup>. This means

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<sup>13</sup> Of course there are efficiency and tax administration reasons that go against decentralization of these taxes. For example, in the case of the VAT a new kind of tax should be adopted to facilitate decentralization (see Bird and Gendron, 1998, and McLure, 2000, for a discussion of some

that, in practice, revenue diversification was low, and that the ACs faced a high marginal economic (and political) cost of raising public revenues. Note that during this period reducing personal income taxes was popular and there was room for increasing the VAT and *Excises* (tax rates were much lower than in the rest of the EU). Given this situation, sub-national politicians and taxpayers claimed that the situation was unfair, argued that a ‘vertical fiscal gap’ still existed and asked for compensation through the grant system, being thus reluctant to use the tax powers to cover that gap.

This situation might be much worse in regions which are net contributors to the equalization system (e.g., Catalunya, Madrid, Baleares). In Spain, there is full equalization of (standardized) tax revenues and during some periods one can argue that the grant has over-equalized, since thanks to the effects of needs assessments and special funds of dubious justification, rich ACs (those with per capita revenues above the average) ended up with a total level of revenues below average (see Figure 1). This situation has reverted a little bit after 2009, but the equalization power is still very high. In some of these rich regions (and especially in Catalunya), there is a lot of dissatisfaction with the actual degree of redistribution. Without popular acceptance of the current equalization arrangements it is difficult for politicians of the regions to convince citizens to further raise taxes.

*Central government obstructionism.* Although the stated motivation of the central government for the reforms was to increase the degree of tax autonomy, it might be that there was no real interest in achieving such a goal. So, ex-post the central government may have tried to impede the effective use of tax autonomy. The many difficulties in the creation of regional own taxes are a proof of this. Some central tax decisions, encroaching over in practice over regional tax powers are another one. One example of this is the way the reform of the *Personal Income tax* was carried out in 2002. The central government (controlled by the right at that time) decided to reduce the marginal tax rates of both the central and the regional schedules. The reason the central government decided to do this was to capitalize on the popularity of the reform; the ACs accepted the deal for several reasons: (i) the right-wing ACs followed the instructions of the party, (ii) the left-wing ACs did not want to be associated with such a reform and preferred to accept a generous financial compensation, and (iii)

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possibilities). Aside from the difficulties involved in these changes, the main impediment is EU regulations. After the 2009 reform the Spanish central government agreed to start conversations with the EU in order to allow the creation of a regional tax over the retail phase of the VAT, but there seems not to be a lot of real interest in dealing with this problem. In the case of Excise taxes, the main impediment is that these are taxes levied at producer’s place in Spain; the central government fears that fraud would increase with tax collection and the seller’s place.

resting the original tax powers on the central government, they could not effectively oppose the reform. In 2007, marginal tax rates were reduced again, this time by a left-wing central government, and again the reform reduced both parts of the schedule. Finally, in 2008, the left-wing central government decided to abolish the *Wealth tax* (also to capitalize on the unpopularity of this tax), compensating all the ACs for the loss of revenues<sup>14</sup>. The effect of assigning a tax to a sub-national government but then abolishing the tax opportunistically might have undermined the incentives to use the tax autonomy.

*Soft-budget constraint.* Second, even if the stated motivation for the reforms was to increase the level of tax autonomy, it might be that in practice neither central politicians nor the sub-national ones really want more tax autonomy. Life is easy for sub-national politicians without having to ask citizens the money they need to improve public services (or, the current situation, to avoid its deterioration), and the funding of sub-national services through centrally-determined transfers increase the political influence of central politicians (O'Neil, 2003). There is empirical evidence showing that during the nineties the ACs faced a soft-budget constraint. Although there were no episodes of formal bail-outs, the central government always added extra revenues to the transfer pool in each of the renegotiations of the system that took place every fifth year. These extra funds ensured that no AC loses in absolute terms as a result of the reform. The result of this was a high grow rate of regional spending (exceeding the growth of transfers received during the period and without any increase in tax effort) and debt, covered ex-post by an increase in the overall amount of funds transferred (Lago, 2007). Also, there is some evidence that the ACs with higher debt increases were the ones that saw their transfers (both equalization transfers and earmarked transfers) to growth in the future (Sorribas-Navarro, 2010). The process of fiscal consolidation that preceded the accession to the euro in the 1990's was also possible because the central government helped the ACs to reduce its deficit with higher transfers (Esteller-Moré and Solé-Ollé, 2006).

*Revenue largesse.* Perhaps the explanation to the low use of tax autonomy is simply the economic and budgetary situation. In a period of largesse of resources there is no need to raise tax rates to get more revenues. Spanish ACs saw how revenues related to the construction sector grew a lot during the boom years. Moreover, the central government revenues were also growing a lot (for the same reason) and that layer of government was even having a budget surplus; this generated the impression (see Lago, 2007) that the central government

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<sup>14</sup> These two decisions have to be understood as a strategy to capture a central position in the taxation issue. The ACs controlled by the right were precisely those that have begun to erode the Wealth tax and, especially, the Death and Gift tax during the previous years.

sooner or later would reform the system again and share these extra revenues with the ACs. Of course, one could argue that regional governments could still reduce taxes (this is, after all, also a sign of tax autonomy). But, even in good times, politicians might not be interested in reducing all kinds of taxes; they might want to reduce (or even abolish) the most unpopular ones. This is precisely what they did: they reduced and/or abolished the *Death and Gift tax* and tried to reduce also the Personal income tax, but were not able to do it because of the impediments created by the central government, which wanted to get full credit for the reform.

The explosion of tax increases after 2009 reform also points in the direction of this last story. Certainly, all these tax changes will probably not have a huge impact on revenues, but they suggest a change in the kind of story we were telling about the lack of use of regional tax powers in Spain. At the end, it seems that regional governments are using its tax powers when the incentives are correct and the situation requires it.

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## Tables

Table 1. *Evolution of revenue & spending decentralization in Spain*

	Before 1986	1987-1996	1997-2001	2002-2008	After 2009
<i>Revenue decentralization</i>	Earmarked transfers Administration & collection of 'traditional' ceded taxes Own taxes and fees	Consolidation of earmarked transfers into a general formula transfer Personal income tax sharing (15% in 1994)	Regional personal income tax (extra 15%) Tax autonomy (with limits) in the 'traditional' ceded taxes	Personal income tax share up to 33% New tax sharing in VAT & Excises (35% & 40%), and in other minor taxes (100% Transportation, Electricity & Retail gas taxes) More tax autonomy in the Personal income tax Tax autonomy in other minor taxes (Transp. & Retail gas) Nearly complete tax autonomy in the 'traditional' ceded taxes	Personal income tax share up to 50% VAT & Excises tax sharing up to 50% & 58% More tax autonomy in the Personal income tax
<i>Spending decentralization</i>	Service by service and AC by AC Low vs. High responsibilities (+ education & health)	Decentralization continues Decision to extend Education & Health to all AC's	Decentralization continues Education & Health extended to all AC's	Decentralization completed	--,--

Source:

Own

elaboratio

Table 2.  
*Taxes assigned to central and regional governments in Spain, after 2009*

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a) *Taxes fully assigned to regional governments*

a.1) *Traditionally ceded taxes* (since 1980's)

Wealth tax  
Death and gift tax  
Property transactions tax  
Stamp duties  
Gambling fees

a.2) *Newly ceded taxes* (since 2002)

Retail gas tax  
Transportation tax  
Electricity tax

a.3) *Own taxes* (since 1980's)

Gambling taxes (e.g., casinos, lotteries)  
Environmental taxes (e.g., water, emissions)

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b) *Taxes shared between regional and central governments*

Personal Income Tax: 50% (15%+15% in 1997-2001, 33% in 2002-08)  
VAT: 50% (35% in 2002-09)  
Excise taxes on alcohol, tobacco and gas: 58% (40% in 2002-08)

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c) *Taxes fully assigned to the central government*

Social security contributions  
Corporation tax  
Insurance tax  
Customs duties

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Source: Own elaboration from Duran and Esteller (2005) and Law 22/2009.

Table 3.  
*Regional powers over fully assigned taxes, after 2002*

<i>Tax</i>	<i>Power</i>
Wealth tax	Basic personal and family relief Tax rate schedule Tax credits Tax collection and inspection
Death and gift tax	Tax base reductions Tax rate schedule Amounts and coefficients of pre-existing wealth Tax credits Tax collection and inspection (since early 1980's)
Property transmission tax	Tax rates (over most bases) Tax credits (same bases than tax rates) Tax collection and inspection (since early 1980's)
Stamp duties	Tax rates (notary documents) Tax credits (notary documents) Tax collection and inspection (since early 1980's)
Gambling fees	Exemptions Tax base Tax rates and lump-sum quotas Tax credits Accrual Tax collection and inspection (since early 1980's)
Retail gas tax	Tax rates within bands (e.g., 0 to 48€/ 1000 litres for gas)
Transportation tax	Tax rate increase with a 15% ceiling

Source: Own elaboration from Duran and Esteller (2005).

Table 4.  
*Personal income tax rates in Spain, 1997*

<i>Taxable income</i> (pta)	<i>Marginal Tax Rates</i>		
	(a) <i>Central</i> %	(b) <i>Regional</i> %	(c=a+b) <i>Total</i> %
442.000	17,00	3,00	20,00
1.136.000	19,55	3,45	23,00
2.305.000	23,80	4,20	28,00
3.474.000	27,20	4,80	32,00
4.643.000	30,60	5,40	36,00
5.812.000	34,00	6,00	40,00
6.981.000	38,25	6,75	45,00
8.150.000	41,65	7,35	49,00
9.319.000	45,05	7,95	53,00
10.488.000	47,60	8,40	56,00

Source: Ministerio de Hacienda y Administraciones Públicas.

Table 5.  
*Regional powers over the personal income tax, after 2002 and 2009*

<i>After 2002</i>	<i>After 2009</i>
Tax rates, with limits:	Tax rates, with limits:
Progressive rate schedule	Same, but no need to keep same
Same number of brackets	number of brackets
Increase within $\pm 20\%$ band	
No powers with respect irregular income base	
Tax credits:	Tax credits:
Housing deductions within $\pm 50\%$ band	Housing deductions
Personal and family deductions, holding constant effective tax rate by bracket	Personal and family deductions
	Non-business investments
	Non-exempt subsidies received from the AC
	Basic personal and family relief, within $\pm 10\%$ band

Source: Own elaboration from Duran and Esteller (2005) and Law 22/2009.

Table 6.  
*Regional revenue sources in Spain, before and after 2009*

	% of <i>Free revenues</i>		% of <i>Total revenues</i>	
	2007	2010	2007	2010
Wealth tax	1.55	0.00	1.34	0.00
Death and gift tax	2.38	2.07	2.05	1.71
Property transmission tax	7.42	4.18	6.40	3.46
Stamp duties	6.83	2.60	5.90	2.15
Gambling fees	1.62	1.41	1.40	1.16
Retail gas tax	1.11	1.09	0.96	0.90
Transportation tax	1.72	0.63	1.48	0.52
Personal income tax	20.99	32.53	18.12	26.90
VAT	16.93	22.98	14.62	19.01
Excise taxes	7.41	11.29	6.39	9.34
Own taxes	1.01	1.17	0.87	0.96
<b>Tax revenues</b>	<b>68.96</b>	<b>79.94</b>	<b>59.54</b>	<b>66.12</b>
Equalization transfer	31.04	20.06	26.80	16.59
Non-earmarked revenues	100.00	100.00	86.33	82.71
Specific transfers			5.70	7.99
Capital transfers			7.10	8.34
<b>Total revenues</b>			<b>100</b>	<b>100</b>

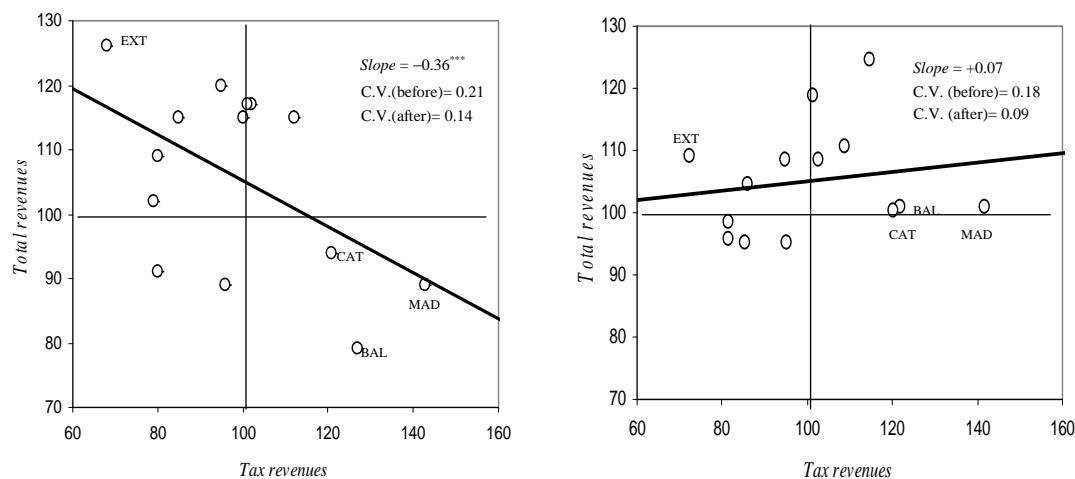
Notes: (1) Outlays; (2) *Basic revenues* = revenues taken into the account for equalization purposes; Total revenues = basic revenues + Own taxes + Earmarked transfers (Transfers of specific responsibilities to some AC's + mandates) + Capital transfers (Spanish regional policy + European Funds).  
Source: Ministerio de Hacienda y Administraciones Públicas.

Figure 1:  
Regional equalization in Spain before and after 2009

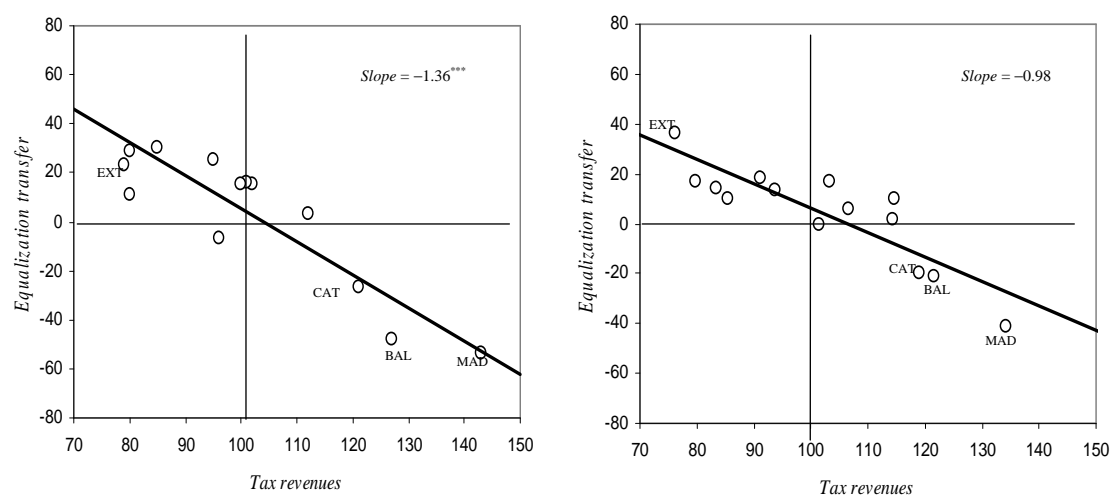
Before 2009

After 2009

a) Regional revenues before-after equalization



b) Equalization transfer vs. tax revenues



Notes: (1) Tax revenues = standard tax revenues as used for equalization purposes, expressed in per capita terms and relative to the Spanish average; Total revenues = standard tax revenues + equalization transfer, expressed in per capita terms and relative to the Spanish average; Equalization transfer = Total revenues (in per capita & relative to the average) – Tax revenues (in per capita, and relative to the average); (2) Revenues items considered = only those included in the financing system; does not include earmarked transfers (i.e., for investment purposes, to fund non-homogeneous responsibilities or central government responsibilities); (3) Before 2009: data for the 2009 fiscal year; After 2009 : data for the 2010 fiscal year; (3) Only common system AC's included in the graph (i.e., Basque Country and Navarra not considered); (4) Slope = slope of the linear regression line, \*\*\*=statistically different from zero (Panel a) or from one (Panel b); C.V. (before)= coefficient of variation of Tax revenues, C.V. (after) = coefficient of variation of Total revenues.

Source: Own elaboration with data from Ministerio de Hacienda y Administraciones Públicas.