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Regional Decentralization in Spain: a Way to Increase Dynamics of Economic Growth

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Paper will present the impact of Spanish devolution process on the regional economic situation. Decentralization of power from central to regional and local government since the ratification of the Constitution in 1978, is one of the most important factors of Spanish success. The shape of Spain is determined by actions heading towards prevention of the country's disintegration into different political structures. This course of action was successful and it allowed Spain to connect democratic developments with devolution of responsibilities and fiscal measures. Because of historical factors, an asymmetry in power decentralization can be observed. Some regions, specifically those with more practice in self-governing, obtained immediately a high level of responsibilities, while others, gradually increased them for the last twenty years. However all Autonomous Communities have nowadays much the same competencies. Another situation can be observed in fiscal autonomy field. The Basque Country and Navarre function under special agreements with the central government, which grants them a nearly exclusive fiscal autonomy. The remaining fifteen regions have been dependent on central government grants and ceded taxes for years, with a low level of fiscal autonomy. As a result, economic indicators in the Basque Country and Navarre reached much higher levels than in other parts of Spain. Also the situation in the labor market is much better in the two regions. Anyway the decentralization process speeded up the acquisition of governing skills and helped to improve methods of spending European structural funds. This is so important because European means obtained by Spain within the framework of structural funds and Cohesion Fund have played the role of the most significant instrument to determine economic development of Spain and particular regions. The European aid resulted in raised economic development rate, increased investment in infrastructure and caused considerable unemployment reduction.

Keywords: regions, decentralization process, fiscal autonomy, devolution of responsibilities, growth.

Introduction

Devolution of power from central to regional and local government since the restoration of democracy and ratification of the Constitution in 1978 is one of most important factors of Spanish economic and social evolution. In Spain, two systems of financing regional expenditures were established. There is an ordinary system (*Regimen Comun*) which is applied in a majority of Spanish regions, and a charter system (*Regimen Foral*) which is based on historical rights of the Basque Country and Navarre. The charter system allows the aforementioned regions to set the tax system and financing expenditures scheme to optimize their growth rate. Moreover, decentralization process speeded up the acquisition of governing skills

and helped to improve methods of spending European structural funds. This is so important because European means obtained by Spain within the framework of structural funds and Cohesion Fund have played the role of the most significant instrument to determine economic development of Spain and its particular regions.

1. Historical background of decentralization process

At present Spain is divided into seventeen regions, called Autonomous Communities (*Comunidades Autonomas*), which were established after the death of Francisco Franco and the restoration of democracy. This administrative system was created on the strength of democratic Constitution in 1978, as a result of general public

demand. After four decades of dictatorship, the process of democratization had to be combined with the process of central government power devolution, as Spanish regions and their communities are varied in many aspects including history, culture and language. Comprehending how different Autonomous Communities are is crucial to understanding the process of decentralization.

Spain as one political organism is several centuries old and was established during a long- lasting process of unifying different kingdoms and various territorial organizations. However, present-day Autonomous Communities are still based on their predecessors, the medieval kingdoms. The first important step towards unity was made when the Kingdom of Aragon and the Kingdom of Castilla were joined by a royal marriage at the end of the 15th century and yet both Kingdoms kept their autonomy. The new organism expanded in the decades to follow and became one of the most powerful states throughout Europe.

Many regional and autonomous governments survived until as late as 18th century. At the beginning of the 18th century, Philippe V issued an edict called *Nueva Planta*, which abolished the autonomy of Aragon, Catalonia and Valencia, and centralized the country [6]. Only three provinces of the Basque Country and Navarre retained autonomy, owing to their support for Philippe V in his political actions. The aforementioned provinces, as loyal territories, also kept self-regulating fiscal authority and free trade area. This autonomy called *fueros* lasted for more than a hundred years, until mid-19th century, despite centralizing aspirations of the Spanish kingdom. Even then this area held a special fiscal entitlement, which did not change until General Franco's dictatorship [3],

The aforementioned historical differences are strengthened by cultural integrity and own language. In present-day Spain, four languages have an official status - Spanish, Catalan, Galician and Basque. Since the end of the 19th century, feeling of regional identity increased in Catalonia, the Basque Country and Galicia. Nationalist sentiments grew during the Second Republic. Legal validation of the 1931 Constitution allowed historical regions to establish their own governments. Only Catalonia had enough time to fully carry through its autonomous status and to establish a government. The Basque Country received an autonomous status for two provinces only, and

that no earlier than the Civil War. In Galicia only autonomous status was created and approved by a plebiscite, but the Civil War prevented the region from carrying its autonomy through [10].

Historical conditions, centuries of autonomy, regional identity, and own languages - among other factors - prompted the Spanish society to fight for regional autonomy after Franco's death and determined the present shape of the country.

2. Regional decentralization in Spain

Process of public devolution in Spain started with the creation of a democratic Constitution, ratified in 1978, which predicted Autonomous Communities' rights to self government. In accordance with the Constitution, State of Autonomies (*Estado de Autonomías*) was founded. Seventeen ACs make up the State of Autonomies. Despite many features typical for a federal state, the Spanish Constitution excluded in Article 145 any possibility of self- governing communities' federation.

During the last three decades, Spanish regions have taken over responsibilities for providing local communities with public goods and services within their respective territories. Depending on the way a given region became an Autonomous Community, we can point out two different groups of regions. The first are the regions with a *low level of responsibilities*, which assumed competencies according to article 148

- not immediately, but after five years. All those regions are listed in table 1. The most important responsibilities included organization of their institutions of self-government, town and country planning and housing, public works, regional transportation and infrastructure, agriculture, management of environmental protection, culture, tourism and sport promotion, etc [1],

For historical reasons, only a small group of regions immediately received the full range of competencies mentioned above. Those regions, with a *high level of responsibilities* according to article 151, were also granted powers in education, health area, justice and public order. After a quarter of century some differences exist, but all ACs have much the same competencies

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Central government, according to article 149 of Spanish Constitution, has the exclusive competence over such areas as economic stability, international relations, regulation of basic

Table 1. Key administrative data for Autonomous Communities

Autonomous Communities	Provinces	Municipalities	Year of statute approval	Initial level of competencies	Financing System
Andalusia	8	769	1981	HIGH	LOFCA
Aragon	3	730	1982	LOW	LOFCA
Asturias	1	78	1981	LOW	LOFCA
Balearic Islands	1	67	1983	LOW	LOFCA
Canary Islands	2	87	1982	HIGH	LOFCA
Cantabria	1	102	1981	LOW	LOFCA
Castile-La Mancha	5	916	1982	LOW	LOFCA
Castile and Leon	9	2247	1983	LOW	LOFCA
Catalonia	4	945	1979	HIGH	LOFCA
Valencia	3	541	1982	HIGH	LOFCA
Extremadura	2	382	1983	LOW	LOFCA
Galicia	4	315	1981	HIGH	LOFCA
La Rioja	1	174	1982	LOW	LOFCA
Madrid	1	179	1983	LOW	LOFCA
Murcia	1	45	1982	LOW	LOFCA
Navarre	1	272	1982	HIGH	CHARTER
Basque Country	3	250	1979	HIGH	CHARTER
Ceuta/Melilla	0	1 + 1	1995	-	-
SPAIN	50	8101	-	-	-

Source: Laborda J. L., Escudero C. M. (2006) Regional Decentralization in Spain: Vertical Imbalances and Revenue Assignments, Georgia state University, WP 06-10, pp. 5.

conditions guaranteeing equality of all Spaniards, defense and the Armed Forces, foreign trade, currency system, public finances and debt, basic Social Security legislation and funding, etc. At present, central government is responsible for approximately 50% of all public expenditures, Autonomous Communities for 35%, and local authorities for around 15% [7].

Transfer of responsibilities was only the first step in the process of power decentralization. Along with the competencies, Autonomous Communities had to receive also the resources to finance all expenditures. Spanish Constitution laid out two systems for financing regional expenditures. There is an ordinary or common system (*Regimen Comuni*) which is applied in the majority of Spanish regions, and a special or charter system (*Regimen Foral*), which is based on historical rights of the Basque Country and Navarre.

The concept of asymmetry in financing regional expenditures is written down in the Constitution, but its details are developed in the Autonomous Communities Financing Act of 1980 (*Ley Organica de Financiacion de las Comunidades Autonomas - LOFCA*). LOFCA established the main rules of the ordinary system,

while detailed applications are completed by the Autonomous Communities' Fiscal and Financial Policy Council (*Consejo de Politica Fiscal y Financiera de las Comunidades Autonomas*), an institution responsible for coordination of financing at the central and regional levels of administration. The Council debates needs for adjustments in regional finances and makes necessary changes. Important reforms used to be made every five years: in 1986, 1992, 1996, 2001, and this five-yearly assessment system was changed in 2002, when all common-system Autonomous Communities reached the upper limit in terms of the decentralization of responsibilities. For years, in Autonomous Communities under ordinary system, one could observe considerable expenditure responsibilities, but with very restricted revenue autonomy. Their role in setting tax rates or bases was very limited. The financial system was based exclusively on ceded taxes and the Sufficiency Fund - resource treated as a participation in state revenues. Until 1997, the central government established and controlled ceded taxes, while the regional authorities were only responsible for their collection and administration. Negotiations within the Autonomous Communities Fiscal and

Financial Policy Council in 1996 led to an increase of regional fiscal autonomy. Regions received some authority over the rates for all ceded taxes [7].

It should also be noted that even under the common system, transfers to high- and low-level responsibility ACs differed, because there were different financial needs. Regions with high level responsibilities received more grants for financing education and health services. Finally, with the reform of 2002, existing disparities in responsibilities and expenditures between fifteen regions under a common system have been removed. Since 2002, reform has also increased revenue autonomy of the aforementioned regions. Autonomous Communities assumed direct control over nearly one third of personal income tax, value added tax and special taxes on gas, alcohol and tobacco. The central government also eased many previous limitations on setting up rates and exemptions from ceded taxes [3].

Ceded taxes and Sufficiency Fund are not the only resources for financing regional expenditures. Autonomous Communities have other possibilities. ACs have some scope to introduce, collect and regulate some minor taxes and surcharges including wealth tax and death duties, property transfer or gambling taxes [2].

Autonomous Communities may run up a debt, but only to finance investment purposes, and annual repayments can not exceed 25% of the region's current revenues. Moreover, regional borrowings are coordinated by the central government, in line with its macroeconomic policy [9].

Finally ACs can receive conditional grants as Interterritorial Compensation Fund (*Fondos de Compensation Interterritorial*) or European

Community structural funds. The aim of these funds is to give equal opportunities to all Autonomous Communities and to correct regional disparities between them.

The second system of fiscal decentralization - the charter system - covers the Basque Country and Navarre, and is characterized by the complete decentralization of revenues' responsibilities, or in other words, extensive fiscal autonomy. The most important taxes, including income, wealth, corporation or inheritance tax, are administrated in full by regional governments. Indirect taxes, such as value added tax or excise duties are administered on the regional level, but regional authorities have no rights to define bases or to change tax rates. It should also be noted that the power over autonomously regulated taxes is limited by the rules of tax harmonization on state level, which means that the effective overall tax burden must not be lower than the burden existing in the rest of the State. Furthermore, international tax treaties must be kept, and free movement of capital and persons within the Spanish territory must be respected and guaranteed.

At the end of each fiscal year, regional governments of the Basque country and Navarre transfer the previously agreed quota (called *Cupo*) to compensate central government's nationwide expenditures of general nature, such as armed forces or diplomatic representation [4].

3. Social and economic evolution of Spanish regions in the light of devolution process

Two diagrams below show GDP per capita and unemployment rate changes in Spanish Autonomous Communities. All regions have

been divided into three groups, depending on the level of their responsibilities. Available data illustrated how well developed the charter system regions are - namely the Basque Country and Navarre. Recently both regions achieved high levels of economic development in terms of GDP per capita, and they have no problems with unemployment.

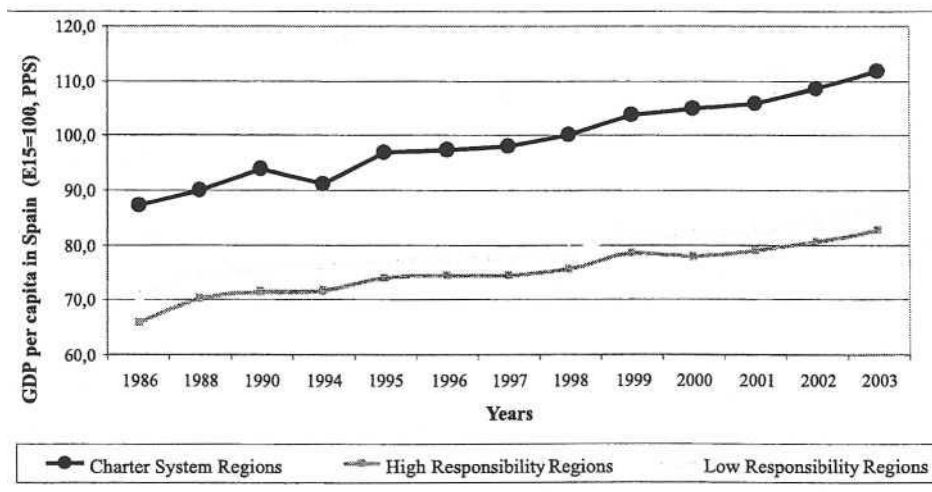
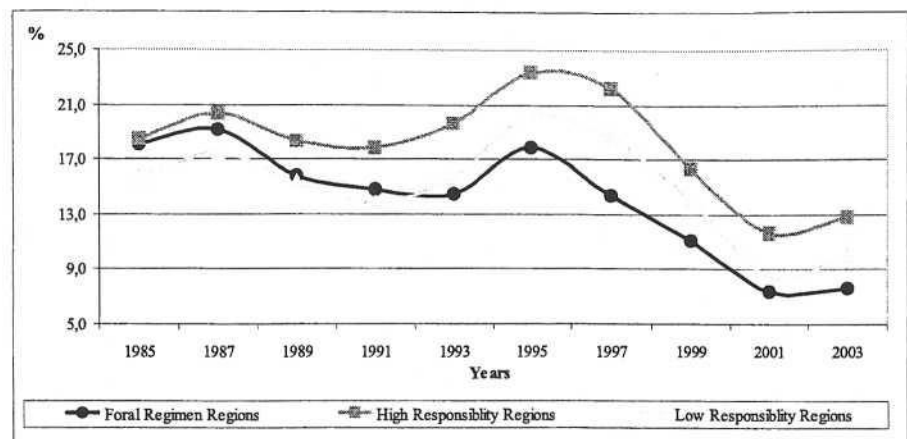


Diagram 1. Evolution of GDP per capita rate in Spanish regions (1986-2003)

The level of economic growth ' is strongly connected with the situation on the labor market, which leads to large disparities in unemployment rate between the analyzed groups of Spanish regions. With the economic expansion in the Basque Country and Navarre, the number of jobs is on the increase. Since the integration with the EC, unemployment rates decreased more than twice: from 19% workforce in 1987, to less than 7% in 2004. Other fifteen regions experienced a decrease in unemployment rates, but their present situation is less favorable. Furthermore, in 1985 unemployment indicators in the charter regions were running at a higher level than in the low responsibility regions and almost at the same level as in high responsibility regions (Diagram 2).



Source: Eurostat

Diagram 2. Unemployment rate in Spanish regions (1985-2003)

Conclusions

The shape of present-day Spain is determined by actions heading towards prevention of the country's disintegration into a large number of small political formations. In accordance with the Constitution, State of Autonomies was designed to consolidate the country, with a simultaneous decision to gradually decentralize and delegate power among newly created Autonomous Communities. In many aspects, this course of action was successful and it allowed Spain to connect democratic developments with devolution of responsibilities and fiscal measures. Historical and cultural factors, however, made Spanish decentralization a very complex process. As a result, the so-called "asymmetry" may be observed in the process of transferring responsibilities and fiscal entitlements to regional governments. Some regions, namely those with more experience in self-governing, obtained immediately a high level of responsibilities, while others gradually increased them for years. Today, all Autonomous Communities have much the same competencies.

Another situation can be observed in fiscal autonomy. Two regions - the Basque Country and Navarre - function under special agreements with the central government, which grants them

a nearly complete fiscal autonomy. The remaining fifteen regions have been dependent on central government grants and ceded taxes for years, with a low level of fiscal autonomy. It seems that the charter system favors the two aforementioned regions. As a result, economic indicators in the Basque Country and Navarre reached much higher levels than in other two groups of regions. Also the situation in the labor market is much better in the charter regions. The gap has broadened despite European and central government funds granted to the less developed regions. Furthermore, the process of European Integration and accession of less developed countries of Central Europe causes outflow of huge amounts of funds from many Spanish regions. Investment in public capital stock will decrease, and along with the autonomy of taxation system, which is insufficient to achieve high level of economic development, it can effectively lead to a further increase of regional inequity in Spain. Nevertheless, the process of public power devolution between regions in Spain provides an excellent example for the new member states, in which this course of action has already been undertaken or will be undertaken in the near future.

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