

## Fiscal Decentralization in Spain: An Asymmetric Transition to Democracy

Teresa Garcia-Milà, Universitat Pompeu Fabra, Barcelona, Spain  
Therese J. McGuire, University of Illinois, Chicago, Illinois, USA

Revised March 22, 2002

### I. Introduction—a theoretical approach to asymmetric devolution

Asymmetric fiscal decentralization, by which we mean different fiscal arrangements between the central government and different groups of, or individual, lower-level governments, may be justified from an economic efficiency perspective. As argued by Tiebout (1956), Oates (1972) and others, a decentralized system of regional and local governments is better able to accommodate differences in tastes for public goods and services. This efficiency argument calls for decentralization of fiscal authority to regional and local governments, but not necessarily asymmetric decentralization. However, when the differences in tastes for public goods and services arise out of differences in history, culture and language across regions of a country, asymmetric treatment may be justified. History, culture and language may influence how a group of people (a region) views autonomy, independence and fiscal authority. Some regions may have had experience with autonomous government in the past, they may have a culture that is strongly reliant upon (or leery of) the central government, or they may be fearful of losing their separate languages if they do not have special arrangements. To accommodate differences in taste for independence, autonomy, and fiscal authority, it may be necessary to have different fiscal arrangements between the central government and the different regions comprising the country.<sup>1</sup>

Another efficiency argument for asymmetric decentralization centers on differences among regions in their capacities for public administration. Efficient provision of public goods and services as well as efficient decision making are reliant upon a well-functioning bureaucracy and supportive political institutions. If some regions have greater capacities for running governments and public agencies than other regions, perhaps because these regions have historical experience with autonomy, it may be more efficient to devolve fiscal authority to these regions alone, or at least more quickly to these regions than to regions without sufficient administrative capability.

Neither of these efficiency arguments for asymmetric devolution may hold in perpetuity. If fiscal authority is devolved in stages more or less quickly to different regions because of their different capacities, even the regions with less authority will, over time, develop administrative capabilities. In the limit, administrative know-how should be similar across the regions and an asymmetric system may not be needed to achieve efficiency. Similarly, as regional governments gain experience and as mutual trust between the central government and its regions develops, in other words, as a

---

<sup>1</sup> See Petchey, Shapiro and Walsh (1997) for a discussion of differences across sub-national governments in values and in preferences for political structures.

formerly centralized system matures into a decentralized one, differences in taste for independence and fiscal authority may dissipate, and the rationale for asymmetric treatment, embedded in historical and cultural differences, may no longer be compelling.

We explore the implications of these theoretical arguments for the case of Spain. The remainder of this chapter is divided into five additional sections. In section II we argue the relevance of these theories to the Spanish case. In section III we present information on economic, historical, and cultural diversity in Spain. Sections IV and V are devoted to a description and evaluation of the system of fiscal decentralization in Spain. We conclude in section VI with a discussion of the relevance of the Spanish experience for emerging democracies.

## II. Relevance of theory to Spanish case

In many respects the two economic efficiency reasons for an asymmetric decentralization system that we have identified were present in Spain at the time the decentralization process began in the late 1970s. On one hand there were and continue to be regions with a strong sense of nationality, of identity differences in questions of language, culture, laws and even economic relationships. The majority of individuals in these regions have clear preferences for deciding and administering many aspects of public intervention, without having to follow centrally decided policies. The Basque Country, Galicia and Catalonia, the so-called historic nationalities in Spain, are clearly identified in this group.

Differences in public administration know-how were also present in Spain at the time the current decentralized system was discussed and established. For centuries Navarra and the Basque Country had a particular political and fiscal arrangement (“fueros”) that survived centralizing attempts of different Kingdoms. In fact, Navarra and one province in the Basque Country (Álava) kept part of this special arrangement even during Franco’s dictatorship, while the other two Basque provinces (Vizcaya and Guipuzcoa) that had not supported Franco’s movement had their special regime abolished during that period. Catalonia established an autonomous regional government in 1932 that endured through the short-lived Second Republic and the three-year Civil War that started in 1936. Galicia adopted an autonomous system in 1936 that was never implemented because of the eruption of the Civil War.

These three regions, the Basque Country, Galicia and Catalonia, with different degrees of intensity, have both preferences and experience to favor decentralization from an economic efficiency perspective. Navarra also had the experience, related to a long history of self-government and the existence of specific laws developed by them, and the preference to be autonomous, although possibly to a lesser extent given the lack of a strong national identity.

At first glance, then, it seems that it was appropriate to design a decentralization process that would be asymmetric for the different regions, taking into account their preferences and their experience. We analyze whether the design and degree of asymmetry were appropriate and to what extent asymmetry eased or fueled the tensions that were present

when Spain was designing not only a decentralized system, but also a democratic system that would enable the country to move away from a dictatorship that had endured for almost 40 years. When analyzing these issues we cannot forget that in addition to the cultural and historical differences across regions, there were, and still are, economic differences. Because of these differences, some regions were concerned about what fiscal decentralization would do to the regional solidarity built into the centralized system.

### III. Regional diversity in Spain

Today Spain is divided into seventeen regions, called Autonomous Communities (see Figure 1), with regional governments that were created following the guidelines established in the democratic Constitution ratified in 1978.<sup>2</sup> These regions are diverse from many perspectives including history, culture, language and economic conditions. Understanding these differences may help understand the asymmetric fiscal decentralization model that was established in the late 1970s.

The existence of Spain as a country dates back several centuries, and is the result of a long process that combined several kingdoms and other forms of political organization. One important step towards the creation of Spain was the unification by marriage of the Kingdom of Castilla with the Kingdom of Aragón (which includes Aragón, Catalonia, Balearic Islands and Valencia) in the late 15th century. The Spanish kingdom expanded and grew strong in Europe and America, though many local laws and autonomous forms of government prevailed for at least two centuries. In the early 1700s, Felipe V, with the so-called “Decretos de Nueva Planta,” abolished the political and administrative autonomy of Aragón, Catalonia, Mallorca and Valencia, with the purpose of centralizing and unifying political power. This was especially painful for Catalonia, which had a long history of community and self-government, had been an important political and economic power in the Mediterranean, and had conquered the Balearic Islands and País Valenciano in the early 1200s. Although Catalonia unified with the Aragón Kingdom by marriage in the early 1100s, the organization was a confederation rather than a centralized kingdom, and therefore the autonomy and identity of Catalonia had remained.

It is interesting to note that the very special political and economic organization of the three provinces of the Basque Country and of Navarra, the “fueros,” survived this centralizing attempt by the Spanish kingdom. The reasons seem quite clear, and are linked to the support that these provinces provided to the King in his political conflicts. The special arrangement for these provinces allowed them to keep a wide range of autonomy, with an independent fiscal authority and even a free trade area that prevailed until the mid-1800s. Although they lost some of their political autonomy in the late 1800s, they kept a special fiscal arrangement that prevailed until Franco's dictatorship, and that for Navarra and Álava even remained during that very centralized period.

---

<sup>2</sup> The complexity of the fiscal decentralization model is explained in detail below.

The historical and cultural diversity is in some regions enhanced by the fact that they have their own languages. There are four languages spoken: Castilian, Catalan, Galician and Basque, plus several dialects. In the late 19th and early 20th century the nationalistic sentiment of Galicia, the Basque Country and especially Catalonia became quite strong. These movements cannot be considered in isolation from the fact that these three regions each have their own language, a major identifying characteristic. It is also interesting to note that these three regions either established an autonomous government during the Second Republic or had approved an autonomous status and were in the process of establishing an autonomous government when the Civil War broke out in 1936.<sup>3</sup>

Spain is also a diverse country economically. Per capita income and GDP differ across regions, although differences are not as big as in other European countries such as France, Italy or Germany.<sup>4</sup> As can be seen from Table 1, the richest region, Madrid, has a GDP per capita more than twice that of the poorest region, Extremadura. Differences in the 1950s were even larger, with the richest regions having an income per capita three times that of the poorest, but by the mid-1970s the differences had fallen to a factor of a little over two, and have remained essentially unchanged ever since.

The industrial mix of the country was quite diverse years ago, with the north (mainly the Basque Country) and northeast having most of the manufacturing, while the center (with the exception of Madrid), the south and the northwest were mainly agricultural. The manufacturing and agricultural sectors have decreased in favor of the services sector, as has happened in most industrialized countries, but the strength of the regional economies is in most cases still related to the initial industrial mix. Some regions, like the Balearic Islands, have strongly benefited from the tourism boom that Spain experienced in the last third of the century. Madrid has taken advantage of being the political capital, building a strong economy and becoming the main financial center, the center for telecommunications, and the Spanish headquarters for many large international firms.

Through public investment, and in some cases detailed development plans, the central government has attempted to help poor regions grow faster and catch up. The effectiveness of these public actions on long run growth has not been proven, although short run effects were noticeable. It is probably fair to say that some regional solidarity was built into the public investment policy of the central government before the decentralization process took place, which could explain why some regions feared that regional redistribution might vanish with the advent of decentralization. On the other hand, once the decentralization process started, fears based on opposite grounds arose as regions did not want to be left out of any advantages associated with the decentralized system.

Economic, cultural and historical diversity influences and constrains the type of decentralization model that may be designed. In the following section we analyze how the diversity of the Spanish regions influenced the decentralization system adopted in Spain in the late 1970s.

---

<sup>3</sup> A comprehensive historical analysis of Spain and its regions can be found in Fusi (1989).

<sup>4</sup> Hall (1999) and Esteban (1999) illustrate this fact.

#### IV. Fiscal decentralization in Spain

Democratization and decentralization processes cannot really be separated in Spain. In fact, the basic structure of the state of the autonomies is contained in the Constitution, which was ratified by referendum in December 1978 and defines the start of democracy in Spain. While the concept of asymmetry is established in the Constitution, its details are developed in a high level law, “Ley Orgánica de Financiación de las Comunidades Autónomas,” (LOFCA) passed in 1980. The third set of relevant laws is the “Statutes of Autonomy,” developed and approved by each region in accordance with the general principles of the Constitution.

The Constitution establishes two possible layers of asymmetry. The first and most important enacts two completely different systems of decentralization, the Foral and the Common regimes. The Foral regime is instituted for only the Basque Country and Navarra, the Common regime for the other fifteen regions (see Table 1). The primary difference between the two regimes is that regions in the Foral regime have authority to raise taxes locally, whereas regions in the Common regime have limited local taxing authority<sup>5</sup>. In terms of spending responsibilities, the regions of the Foral regime have similar responsibilities to five regions under the Common regime.

Under the Foral regime the majority of the taxes are ceded (*impuestos concertados*) to the autonomous government, giving responsibility for tax administration and, subject to constraints, autonomy to set rates and bases to the regions. The major taxes—income, corporate, wealth, inheritance and wealth transfers—are fully administered by the regional governments. Thus, in the Foral regime citizens do not pay any part of these taxes to the central government. In 1997 a reform was passed that extended the taxing authority of the regions, easing many of the constraints. The value added tax (IVA) is collected and administered by the regional government, but without any authority to set rates or define the base.

To compensate for the services that the central government provides to the region, the regional government pays an amount to the central government (“*cupo*” for the Basque Country and “*aportación*” for Navarra). The “*cupo*” and “*aportación*” are essentially grants or transfers from the regional government to the central government. The central government directly raises some minor taxes and these revenues are taken into account when the “*cupo*” and “*aportación*” are calculated.

Contrary to a cost-accounting basis, the “*cupo*” and “*aportación*” have not been calculated according to the effective cost of the services that the central government provides to, and the effective revenue that the central government raises in, the two regions under the Foral regime. Instead, they have been calculated as a percentage of the difference between the national cost of those services not devolved and the national

---

<sup>5</sup> Taxes are partially ceded over the years as is explained later in the text. During the first several years regions in the Common regime had no autonomous taxing authority to speak of.

revenue of the taxes not devolved.<sup>6</sup> In effect, this formula allocates to the regions in the Foral regime some percentage of an artificially and narrowly defined national deficit. The percentage is a function of the region's income share. Although the percentage was to have been updated as those shares changed overtime, it has not been changed since it was first established in 1981.

The Foral regime regions also contribute to the central government's solidarity fund. The "Fondo de Compensacion Interterritorial" (FCI), a conditional grant that supports investment spending and is designed to help the growth of poor regions, is considered a national service, and therefore the Foral regime regions, through the "cupo" or "aportación", contribute to the solidarity fund.

The Common regime underwent a substantial change, agreed upon in July 2001 and effective as of January 2002, that cedes substantial taxing authority to the regional governments. It is important though to describe the initial set up, as it has been the basis of the system for over twenty years, and it has conditioned the reforms undertaken. Initially the Common regime was characterized by having a fair amount of expenditure responsibility, but very little revenue autonomy. The regions in this regime were mainly financed by central government transfers, which accounted for more than 75 percent of the revenues of these regions. The regions of the Common regime also had ceded taxes, although this was largely an administrative role since, unlike with the regions of the Foral regime, they had no authority to set tax rates and bases for these taxes.<sup>7</sup> These ceded taxes included the wealth tax, the inheritance tax, a tax on wealth transfers, and taxes on gambling, and accounted for approximately ten percent of the revenues of the regions. Finally regions in the Common regime could initially, and still are able to, impose some taxes and fees, for which they have complete authority to set rates and bases, although these revenue sources represent a small percentage of regional revenues (around four percent).

The second layer of asymmetry established by the Constitution concerns the fifteen regions of the Common regime. The Constitution defines two alternative paths for devolution of spending responsibilities, one slow and one fast. This is set out in Articles 143 and 151, which is how the two sets of regions are sometimes referred. In effect the two groups were given different amounts of spending authority. The high-responsibility regions were responsible for health and education, in addition to all of the common responsibilities held by the ten low responsibility regions.<sup>8</sup> The Constitution specifies that eventually the two paths could meet, whereupon all of the regions in the Common regime would have identical spending responsibilities. That eventually occurred in January 2002

---

<sup>6</sup> National deficit is also subtracted.

<sup>7</sup> In the 1997 reform, some limited authority to set parameters of the ceded taxes was devolved.

<sup>8</sup> Common responsibilities are: 1. Forestry, agriculture, livestock and fisheries in internal waters; 2. Urbanism and housing; 3. Roads; 4. Ports and airports without commercial activity; 5. Hydraulic exploitations, channels and irrigation; 6. Environmental protection; 7. Monumental patrimony of the Autonomous Community, cultural promotion and of the regional languages, libraries, museums and conservatories; 8. Self-government institutions; 9. Internal commercial fairs, sports promotion and tourism.

when the final transfer of health responsibilities was agreed upon. Health and education account for the largest part of the budget, representing more than 80 percent of the total spent by the high-responsibility regions (for more details see Monasterio and Suarez (1998)).

As mentioned, the largest revenue source for regions in the Common regime has been transfers from the central government. The unconditional grant was distributed according to formulas that differed for the high- and low-responsibility regions, but the most important factor for both was population. Those regions responsible for health expenditures received a conditional health grant as well<sup>9</sup>. The regions with lower income per capita also receive a solidarity grant (FCI) and funds, mainly FEDER development funds, from the European Union.

The way the transfers are determined has changed over time. The initial method was based on cost, that is, the central government would transfer an amount equal to the historical cost (before decentralization) of the services that were devolved to each region. This method assumed that the regional allocation of spending made by the central government before the decentralization process had started was adequate. This criterion was meant to be temporary, for the transition period, and in 1986 was changed to a distribution formula. The idea was to have an allocation mechanism that would be a function of some indicators of need. A weighted formula based on several variables was applied: population, insularity or not, area, separate provincial government or not, relative wealth and fiscal effort<sup>10</sup>. The weights were set not according to general economic principles, but rather to reproduce as close as possible the distribution that existed previously under the “effective cost” allocation, making sure that all regions received at least as much as under the previous allocation.

Starting in 1986 financing agreements lasting for five-year periods were established. Every five years a revision would take place and a new agreement would be established for the following period. Very few changes were introduced at the end of the first period (1987-1991), with only a small revision of the weights in the distribution formula incorporated into the agreement for the second period (1992-1996). The negotiations in 1996 for the 1997-2001 period agreement led to fairly significant changes with respect to local revenue-raising authority. Regions were granted some authority over rates for all previously ceded taxes as well as an additionally ceded 15 percent of the income tax. For fear that the new changes would diminish the total funds available, Andalucia, Castilla-La Mancha and Extremadura opted out of this reform, introducing additional complexity to an already cumbersome set up. The latest reform, effective January 2002, has established a financing system applicable to all fifteen regions under the Common Regime. As the differences between high and low responsibility regions have vanished, and health is no longer financed by a specific grant, the financing model has become more uniform and transparent.

---

<sup>9</sup> In the 2002 system, health financing is integrated in the general financing and does not have a specific conditional grant anymore.

<sup>10</sup> Fiscal effort is calculated as the distance between the region’s share of revenues from personal income tax and the region’s share of GDP.

In 1993, two years into the second five-year period, a substantial revision of the system, at least in spirit, was implemented. The revision established a new approach that would be continued with the changes introduced in 1997 and in 2002. The reform of 1993 ceded to the autonomous communities an initial 15 percent of the income tax (IRPF), but with no authority to set tax rates. The idea behind the reform was to involve the regional governments more deeply in the revenue process. There was an incentive to be more efficient in the collection of the tax, as the region would keep 15 percent of the fiscal effort above a reference value. But there were final changes to the reform that introduced limits to the possible gains and guarantees for minimum revenues, as some regions were worried about the outcome.

The latest reform, effective January 2002, is not restricted to a five-year period as were the previous reforms. This reform unified the financing scheme for all the fifteen regions in the Common Regime, a task that was eased by the fact that responsibilities finally converged for the high- and the low-responsibility regions. It has further simplified and clarified the model by eliminating the conditional grant for health, which is now financed within the general system. Finally it has increased by a significant amount the revenue responsibility of the regions. The central government has ceded approximately one third of the personal income tax and the value added tax, as well as special taxes on gas, alcohol or tobacco. It has also eased many of the restrictions on establishing rates and exemptions for the ceded taxes (except for the value added tax and the special taxes that are regulated by the European Union).

These changes in the system have tried to accommodate complaints about the lack of autonomy in revenue within the Common regime. The term used in Spain has been co-responsibility, meaning a sharing of responsibility for revenues between central and regional governments. As we have seen, the process towards higher regional responsibility in revenues has been slow, limited, and very complicated, as not all regions had initially participated, but the latest reform seems to go in the right direction in that regions are gaining revenue raising authority responsibility leading to possible gains in efficiency.<sup>11</sup> However, an important motivation behind the changes has been to try to keep more tax revenues in the regions where those taxes are paid. Rich regions aimed to redefine the system in a way that reduces their contribution to solidarity, while poor regions tried to avoid that larger revenue autonomy would decrease the total amount of funds that they receive.

While the two groups of regions under the Common regime—the high- and low-spending responsibility regions—started quite apart but eventually converged to identical circumstances, the Foral and Common regimes are intended to remain under different financial arrangements with the central government. We explore the basis for such differential treatment in the next section.

---

<sup>11</sup> The lack of local revenue authority together with the continuous renegotiation of the system over the past twenty years created a situation whereby regions may have had incentives to borrow in excess since they did not bear all the costs of such decisions (see Garcia-Milà, Goodspeed and McGuire (2001) for an elaboration of this argument).



## V. Evaluation of the decentralization process in Spain

Given the revealed differences in preferences and in administrative know-how, asymmetric decentralization was probably a good economic decision for Spain in the late 1970s to early 1980s. It probably also helped to ease some of the political tensions expressed by nationalists, mainly of the Basque Country, Catalonia and to a lesser extent Galicia. Establishing a flexible system that could be revised was also important given the lack of experience in these matters for many regions and for the country as a whole.

After twenty years, regions have caught up in knowledge, and probably also in preferences towards autonomy, although the latter is more questionable.<sup>12</sup> Under the new circumstances whereby regional governments have matured and citizens have gained experience with decentralized government, it is probably more efficient to move towards a system that gives up asymmetry for gains in simplicity, clarity, revenue autonomy, certainty, and transparency in solidarity.

Spain has partly moved in this direction. Within the Common regime, convergence in spending responsibility has occurred: responsibilities in education were devolved to all regions in 2000, and devolution of responsibility for health was agreed upon in January 2002.<sup>13</sup> Spain has also introduced some changes to the financing scheme, slowly moving towards a per capita distribution of grants and higher revenue responsibility for the regions. The recent changes towards higher revenue autonomy have been applied to all fifteen autonomous communities under the Common regime, a step toward simplicity and clarity.

In one respect the complexity and transparency of the system have not improved much. Little has been done to discuss openly the degree of solidarity that regions can agree upon, or to establish clear and transparent equity criteria. The need for an open discussion about solidarity is revealed by the fact that rich regions sense that they are contributing too much, while poor regions believe that they receive too little. Not surprisingly, perhaps, given the lack of open discussion concerning solidarity, regions have tried to push each new revision of the system towards the direction that will likely give them more funds.

The most important asymmetry built into the system—the large difference between the Foral and the Common regimes—has remained unchanged, and appears not to be subject to change for the foreseeable future.

---

<sup>12</sup> A sense of regional identity has developed in many autonomous communities. This sense of identity is linked to the existence of and experience with autonomous government rather than strong cultural or language differences.

<sup>13</sup> The 2002 reform has responded to some of the demands of health economics experts (López Casanovas 1999) that have been calling for incorporating the health transfer in the general system (was previously financed by a conditional grant) and to include additional parameters, besides population, that take into account some characteristics of the population and the services provided.

As several authors have pointed out, generalizing the Foral regime to other regions in the exact terms as currently applied to the Basque Country and Navarra would not be sustainable. If all regions were under the Foral regime, and the payments to the central government (cupo or aportación) were similar to the ones set for Navarra and the Basque Country, all regions except Extremadura and Andalucía would keep more money than what they have right now (see Zubiri (2000) and Zubiri y Vallejo (1995)). Castells (2000) has estimated that the ratio of per capita funds for the regions under the Foral regime is 1.8 times that of the five regions in the Common regime that have high spending responsibilities, these being the regions with expenditure responsibilities comparable to those of the Foral regions.

The asymmetry is not only in terms of the degree of revenue autonomy but also in the details of implementation as a distinct revenue advantage has been given to the regions under the Foral regime. While one can argue that the Foral regime had strong historical, political, and cultural reasons to prevail in the past, it is hard to argue from an economic efficiency perspective that such a disparate treatment is justified in the future.

If asymmetric treatment is no longer justified, how should Spain move toward a more symmetric system? The most crucial asymmetry in the system--the different systems applied to the Basque Country and Navarra on the one hand and to the other fifteen regions on the other--will be difficult to remove. Applying a reformed Common regime to the two regions of the Foral regime would likely improve efficiency and transparency, and possibly political acceptability, at least among the fifteen regions of the Common regime. As this change may be difficult to implement for historical reasons, if the Foral regime prevails, it is essential that the revenue advantages given to this group disappear.

Within the Common regime, the fifteen regions should be given greater revenue-raising authority, especially for revenues at the margin. Any justification for current restrictions on regional taxing authority, such as lack of administrative know-how at the regional level or lack of trust by the central government, is no longer relevant given twenty years of experience with a decentralized system.

While the Spanish system of decentralization needs flexibility and the possibility of revision, as do all political systems, it also needs a more solid foundation in basic principles so that there is less uncertainty about the future. When regions are uncertain about the amount and source of funds and about the future rules of the game, they may engage in strategic behavior, face perverse incentives, and make inefficient decisions. Certainty, but not lack of flexibility, is needed to achieve efficiency.

A move towards symmetry does not necessarily mean that all regions end up with identical revenue and expenditure responsibilities. Because of historical, cultural and language differences, some regions may choose to go further down the path of autonomous government than others. If the choice of degree of autonomy is available to all, and if greater expenditure responsibilities are linked to greater revenue-raising

authority, then different choices over the degree of autonomy should not lead to economic inefficiencies.

## VI. Relevance of the Spanish case for emerging democracies

The Spanish decentralization system is often presented as an example for emerging democracies to follow. The fact that Spain has been looked upon as a model to follow is probably not unrelated to the fact that, as mentioned above, the democratization and decentralization processes in Spain were tightly linked.

There is no question that the peaceful and fast transition from a dictatorship to a democracy in Spain is a model to be followed by emerging democracies. There are few examples of comparably peaceful and successful transitions. It is also true that the establishment of a decentralized state by the Constitution eased some nationalistic tensions and helped to accomplish the transition to a democratic system. So, in a broad sense, Spain is clearly a model to follow. But, not all of the details of the decentralization process and system are worthy of imitation.

Initial asymmetry may be justified if the emerging democracy has regions with cultural, ethnic or historical differences that are related to differences in taste for autonomy, or if there is some experience of decentralization for some regions but not for others. Under these circumstances, it may be economically efficient to start with asymmetric decentralization.

But asymmetry builds in complexity, sometimes linked to lack of transparency, and may hide perverse economic incentives resulting in inefficient regional decision making. Asymmetry also may build up regional tensions as over time regions become more alike in their preferences for autonomy and in their knowledge of autonomous administration, thus weakening the rationale for an asymmetric system. What may be right at the start, may not be desirable in the long run. And once asymmetry is established, it may be difficult to move to a symmetric system.

We have identified a few problematic features of the Spanish system that may not be worthy of imitation.

- a. Persistent asymmetric treatment over time, both in the financing regime but also in the details of the implementation, with differences in revenues per capita that are not justified by economic or solidarity arguments. It is important that these differences in treatment vanish over time so that the regions come to trust the system and do not engage in perverse behavior in order to obtain more from the central government. This desire to work for a better deal with the central government arises not only because the regions need more funds (more money is always welcome), but also because they want to achieve equal treatment.

- b. The limited taxing authority of the fifteen regions in the Common regime breaks the link between the cost and the benefit of a public decision, and likely induces inefficient local public spending and excessive borrowing. It also limits the choices of the regions and creates unsatisfied needs that could be avoided if the regions' residents are willing to finance local spending with regional taxes.
- c. The continuous evolution of the system, without clear rules. Constant re-negotiation of the system adds complexity and introduces uncertainty about the future. It may trigger perverse strategic behavior on the part of the regions and result in political dissatisfaction.
- d. The absence of an explicit discussion about regional solidarity. Lack of agreement among regions on the proper level or range of redistribution creates numerous problems, adds instability and a lack of transparency, and creates incentives for inefficient economic behavior.

Asymmetric fiscal decentralization has satisfied some nationalistic claims and eased tensions among regions in Spain, and it has provided an important foundation for a stable transition to democracy. However, if certain aspects of the system had been designed differently, the economic outcome would be more efficient and Spain would have a system today that the regions would find more satisfactory. Emerging democracies can learn from the Spanish experience and design a decentralized system that achieves autonomy and solidarity at a smaller cost.




## References

- Castells, A. 2000. "Autonomía y solidaridad en el sistema de financiación autonómica," *Papeles de Economía*, no. 83, 37-59.
- Esteban, J.M. 1999. "Un análisis de las desigualdades interregionales en Europa: la década de los ochenta," in *Desequilibrios territoriales en España y Europa*, edited by Antoni Castells and Nuria Bosch, Ariel.
- Fusi, Juan Pablo (coordinator), 1989, "España Autonomías," Espasa-Calpe 1989.
- Garcia-Milà, T., T. Goodspeed and T. McGuire. 2000. "Fiscal Decentralization Policies and Sub-national Government Debt in Evolving Federations," mimeo.
- Hall, R. 1999. "Disparidades regionales en Europa durante los años noventa. Una referencia a España y sus regiones," in *Desequilibrios territoriales en España y Europa*, edited by Antoni Castells and Nuria Bosch, Ariel.
- López Casanovas, G. 1999. "Los problemas de la financiación sanitaria en España. Especial referencia a su descentralización autonómica," in *Financiación Autonómica. Aspectos Económicos y Debate Político*. FEDEA.
- Monasterio C. and J. Suarez, *Manual de hacienda autonómica y local*, Ariel 1998.
- Oates, Wallace E., *Fiscal Federalism*, New York: Harcourt Brace Jovanovich, Inc., 1972.
- Petchey, Jeffrey, Perry Shapiro and Cliff Walsh, "Transfers in Federal Systems: A Critical Survey," in *Intergovernmental Fiscal Relations*, Ronald C. Fisher, ed., Boston: Kluwer Academic Publishers, 1997.
- Tiebout, Charles M., "A Pure Theory of Local Expenditure," *Journal of Political Economy*, October 1956.
- Zubiri, I. 2000 . La capacidad normativa de las comunidades forales. Su extensión al esto de Comunidades Autónomas. *Papeles de Economía*, no. 83, 127-146
- Zubiri, I. And M. Vallejo. 1995. 'Un análisis metodológico y empírico del sistema de cupo.' Fundación BBV.

**Figure 1: Asymmetric Fiscal Decentralization in Spain**



**Legend**

-  Common Regime – High Responsibility
-  Common Regime – Low Responsibility
-  Foral Regime

**Table 1: 1999 GDP per Capita of Regions in Spain  
Grouped by Fiscal Responsibility**

	1999 GDP per Capita (euros)	(Relative to Average for Spain = 100)
<b>Foral Regime</b>		
Navarra	18,492	(130)
País Vasco	17,379	(122)
<b>Common Regime</b>		
<b><i>High Responsibility</i></b>		
Andalucía	10,067	(71)
Canarias	13,496	(95)
Cataluña	17,570	(124)
Galicia	11,266	(79)
Valenciana	13,510	(95)
<b><i>Low Responsibility</i></b>		
Aragón	15,464	(109)
Asturias	12,739	(90)
Baleares	17,514	(123)
Cantabria	13,410	(95)
Castilla-León	12,990	(92)
Castilla-La Mancha	11,617	(82)
Extremadura	8,774	(62)
Madrid	19,254	(136)
Murcia	11,692	(82)
La Rioja	16,313	(115)

GDP data are from Contabilidad Regional de España, Instituto Nacional de Estadística (INE).  
Population data are from Proyecciones y Estimaciones Intercensales de Población, INE.