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Devolution-Max á la Basque: A Model for a Scotland within the UK?

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Foreword

Along with Professor Charlie Jeffery of Edinburgh University (who is also one of our Trustees) we at the David Hume Institute were delighted to be awarded funding from the Economic and Social Research Council for a series of four ‘conversations’ on issues related to constitutional change in Scotland. We are most grateful to the ESRC for this support. This paper, and its four companion pieces, is a product of our first conversation, on macro-economic policy issues and related institutional and regulatory matters.

We appreciated that we were covering a very broad spectrum in this ‘conversation’, hence the need for a diverse but exceptionally well informed set of contributions. Professor Jeffery and I, with advice from other DHI Trustees and other supporters of the Institute, agreed the areas to be covered and selected those who we hoped would provide suitable high quality inputs. It was most pleasing that all agreed to contribute. We also agreed that Hamish McRae (principle economics correspondent of the Independent) could play a valuable role in bringing together material from the papers and assisting with communications and dissemination.

The process agreed was to first seek papers, then to organise a round table debate (held at the RSE on 9th October) including inter alia all of our authors and Hamish McRae and then to hold a full DHI seminar (again at the RSE, on 19th November). The roundtable discussion was extremely valuable and we thank all of those who took part. Some of the papers were revised to take account of that debate. The seminar was also a great success, with an audience strong in terms of quality and quantity and excellent contributions from Hamish – who with immense clarity set out the key findings at the outset – and all our authors, and then an extended, vibrant and constructive question and answer session. We squeezed an enormous amount into less than two hours.

In my view all of the papers are first rate. My sincere thanks go to Cesar Colino, Paul Johnson, Owen Kelly, Gavin McCrone and Brian Quinn; and also of course to Hamish McRae. The papers were released in unedited form on our website on the 19th November and were widely discussed in the media at the time of our seminar. We have also distributed them widely to key interested parties and intend to continue to make use of them going forward – as we make progress with the next three ‘conversations’.

As is traditional I have to note that the views expressed in all these papers are those of the authors rather than of the David Hume Institute. However, I am able to stress that we believe that each of these papers is a very effective, informed and important contribution to the policy debate on one of the most important policy topics to be addressed in Scotland for many a decade. We commend each paper to you as worthy of your close attention.

Jeremy A Peat
Director, The David Hume Institute
November 2012

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Introduction: some background on the “economic-financial agreement” of the Basque Country

As is well-known, regional funding arrangements in Spain consist mainly of two different regional finance regimes, one so-called common-system regime, for 15 autonomous communities (hereafter ACs), which could be said to correspond roughly to what in Scotland is discussed under the label “Devolution plus”; and one special regime, so-called charter regime, for the Basque Country and Navarra, which pretty much resembles what in the Scottish discussion is dubbed “Devolution Max”. In the context of the current public discussion in Scotland about possible alternatives to the independence scenario, the Basque Country has been often presented as an illustration of the Devolution Max option. It may then seem worthwhile for Scottish readers to be given a description of the real contours, advantages, effects and limitations of this model as a viable reform option.

In this brief paper, after looking at its history, main features and consequences, I will argue, in short, that the Financial-Economic Agreement with the Basque Country (*Concierto Económico* in Spanish), a system of full fiscal autonomy or virtual “fiscal sovereignty”, has been particularly profitable for the Basque Country and provided it with more resources and more per capita funding than all the other Spanish regions. At the same time, however, it has proved ineffective at preventing secessionist demands, has been conflict-ridden within the Spanish and European constitutional settings, and has created inequitable and detrimental effects to other regions.

Before reaching any conclusion about the exportability of the Basque finance system, some caveats should be made with respect to certain basic differences between the Basque Country and Scotland, about the real extent of fiscal and spending autonomy of the Basque government and about the effects of this Agreement. These may qualify or even question the desirability or applicability of the model to other countries. At present, this discussion is also highly relevant not just for the Scottish case, but also for the Spanish one, since some in Catalonia are advocating for themselves a similar asymmetric system of devolution max as a possible alternative to secession.

The first thing that should be pointed out is that the Basque funding arrangements are an anomaly in comparative terms. Apart from certain similarities with the fiscal arrangements in the Italian regions of Val d’Aosta or Trentino-Alto Adige, no other devolution finance model exists where the federal government cannot raise taxes in part of its territory (Claeys and Martire 2011). Given its known consequences in terms of autonomy and per capita funding, this extremely asymmetric model appears as a very attractive model for rich units in decentralized or federal countries, but may be viewed as an unjust system in the rest of the units.

Furthermore, apart from its history, the Basque Country differs from Scotland in its size, since its current population is only of about 2 million, a 5% of the Spanish population and 6% of its GDP and a regional government budget of 10,500 million euro in 2012.

It has no extra revenues from natural resources, but enjoys a healthy export oriented and innovation oriented economy. Other relevant difference with Scotland is that the Basque Country is internally organized in a sort of federative structure among three historical provinces, which are the ones traditionally levying the taxes from the Basque citizens. Finally, the Basque Financial-Economic Agreement counts historically on a cross-party consensus within the Basque Country, and is also supported by the main Spanish state-wide parties, having been upheld now by the Spanish Constitutional Court case-law and, with some limitations, by the European Court of Justice. Only academics and increasingly politicians in other regions have raised criticisms of the privileged nature and the inequitable effects of this Agreement for the central government and the rest of the regions, proposing its abolition or approximation to the common-regime (see Castells et al 2005; Corcuera 2008; Martínez Churiaque 2008; Monasterio 2010; Claeys and Martire 2011). Understandably enough, other politicians in wealthy regions just want a similar deal.

As will be seen below, the Basque Financial-Economic Agreement is based on full fiscal autonomy in all taxes except VAT (subject to EU regulations), which maximises government spending discretion and makes the system more accountable to its citizens but also more risky for regional finance under economic downturn. At the same time, a quota is paid to the Spanish government to contribute to the maintenance of central state expenditure in powers not devolved to the Basque government, in areas such as defence and police (including regional police, entirely funded by the central government), foreign policy action, the state railways, ports and airports, the Royal House, Congress, Senate and other branches of government, an interregional cooperation fund, etc.

Regarding the division of powers in the Spanish system, and the powers devolved to the Basque government, it should be reminded that, firstly, the Spanish government has retained, also in the Basque Country, responsibilities for social security, justice, defence, foreign affairs, transfers to the UE, macroeconomic coordination, regulation and supervision of the financial sector and banking, citizenship, immigration, customs, etc. Welfare services have been devolved, but not welfare or social security benefits (mainly pensions and unemployment insurance or subsidies). That means that also in the framework of the Basque Financial-Economic Agreement still 50% of public expenditure in Basque Country rests with the central government, mainly corresponding to social security pensions and unemployment benefits. It also means that the central government still raises 40% of public revenues in the Basque Country. In fact, social security contributions raised in the Basque Country through payroll taxes have not been sufficient to cover the benefits for the last eight years. Given that the Basque Country has more numerous and higher pensions than the Spanish average, while the social insurance contributions of Basque employees were 6064.3 million euro, expenditure on contributory pensions in the Basque Country totalled 7001.1, that is, there is a 936.8 million euro gap, equivalent to 8.9% of the regional budget in 2012.

Furthermore, the Basque Country does not enjoy special borrowing powers vis-à-vis other Spanish regions, although it is true that given its healthy economy and per capita resources, it receives better ratings in the credit markets than other ACs.

In all these issues, the Basque Country is subject to decisions made by the central government, the Bank of Spain or within the multilateral intergovernmental bodies dealing with budget stability, consolidation plans and debt ceilings in Spain, such as the intergovernmental Council on Fiscal and Financial Policies. The Spanish government is also responsible for Basque EU obligations and has had to defend several times the special fiscal arrangements against appeals of the European Commission before the ECJ. In European affairs, a bilateral commission between the central and the Basque government exists that in practice has not met for many years. As a result of this fact, the Basque Country participates in multilateral intergovernmental bodies on EU issues with the other Spanish regions.

Due to this special system of taxation and the politically determined miscalculation of the quota remitted to the central government and other adjustments, the Basque government benefits from at least 60-80% more per capita funding than other Spanish ACs. This has allowed that this AC spends twice as much in health, education and social services than other ACs. For example, in the remit of social services, the Basque Country, with 773.21 euros per capita (alongside Navarre, with 488.10 euros), is the AC that spends more moneys, vis-à-vis the average social spending in Spain of 280 euros per capita (data from a report by the Association of Directors and Managers of Social Services in March 2012).

In the context of the discussion of the recent Catalan demands for a new fiscal pact similar to the Basque arrangement, some studies have shown the practical impossibility to extend this Financial Agreement model to other regions in Spain. It would become virtually unsustainable for the Spanish state (Zubiri 2007; De la Fuente 2012). In the next sections we briefly look at the history, the features and the problems of the system of the Financial-Economic Agreement with the Basque Country.

A bit of history

Pursuant to the Spanish Constitution of 1978 and the subsequent enactment of regional Statutes of Autonomy, two distinct groups of *Comunidades Autonomas* developed in terms of devolution finance. ACs under the common (or general) regime and ACs under the so-called charter regime (*régimen foral* in Spanish from *fuero*= medieval charter or right). The latter are the Basque Country and Navarra. Their finance is regulated under the so-called Financial-Economic agreement (*Concierto Económico*). Basque financial autonomy is thus interpreted by some as having its roots in the Middle Ages. Despite early annexation to the Kingdom of Castile the three historical territories or provinces today constituting the Basque Country — Alava, Guipúzcoa and Vizcaya—, maintained, as was the case in many other territories in Spain— their own legal system and immunities.

Their charter rights guaranteed, until well into the 19th century, administrative, military and fiscal autonomy. In the 19th century, the 1869 Constitution, supported by both Spanish and Basque liberals, sought to reduce these immunities and create a modern state administration. Due to several political and technical reasons, these medieval rights were largely abolished but some of the specific fiscal regime of the Basque provinces was kept in place.

These reasons had to do with the compromises reached to end the repeated civil wars fought between the liberal central state and anti-liberal traditionalists mostly located in the Basque provinces and the North-East of Spain, but also with the lack of administrative capacity of the Spanish State, by 1876, (Claeys and Martire 2011; Ruiz Soroa 2006). That meant that the Spanish constitutional monarchy failed in its attempts to establish the constitutional unity of the country also in taxation. The central government encountered special problems to accomplish this mostly due to technical issues, since it was almost impossible for the national treasury to levy taxes in the Basque territories because it did not have the technical means to do so, for example, there were no land registries, good census and statistics. So the central government decided to rely on the Basque provincial authorities, who knew well the terrain and were able to collect taxes there (López Basaguren 2005).

In this context, the central government accepted a financial agreement, which was supposed to be provisional and transitional, through the Royal Decree of 28 February 1878. It was a way to ensure the incorporation and the contribution of the formerly tax-exempted Basque provinces (Álava, Vizcaya and Guipúzcoa) to the state treasury. Under this agreement, the three provinces kept their right to collect their own taxes, but needed to contribute to the Spanish budget in equal form as other Spanish provinces for the costs the central government. This contribution was also called the quota (*cupo*).

This special fiscal regime was abolished during the Franco's dictatorship for the provinces of Vizcaya and Guipúzcoa, but was kept in place for Alava and Navarra, who had supported Franco in the Civil War in the 1930s. The return to democracy, following Franco's death and the period of transition re-established the old regime of fiscal and financial autonomy for all four provinces, through its incorporation in the 1978 Constitution. The latter, due to different historical and political circumstances, such as the attempt to appease Basque nationalism and prevent violence, included a first additional provision establishing that the Constitution "protects and safeguards the historical rights of the so-called charter regions", and that its "general revision" had to be carried out "in accordance with the Constitution and the Statutes of Autonomy".

The 1979 regional Statute of Autonomy of the Basque Country introduced in its Articles 40 and 41 the legal basis for the system of a financial-economic agreement. The statutory regulation of the Agreement was negotiated between the central government and the Basque Country in 1981, and followed in its main principles the agreements set up in 1876, but with the difference that the three territories or provinces composing the autonomous community of the Basque Country were no longer to be treated separately in the Agreement, but as a single political unit.

In terms of the ideas behind this Agreement, a kind of "compact theory" of the Financial Agreement had been developing among the Basque regionalists and then nationalist parties, which regarded the Agreement as something like a pact between equally sovereign entities. In practice, it had never been so originally, since it was always approved and amended by the Spanish parliament, the only sovereign.

For different reasons, however, this compact theory interpretation of the agreement became dominant among Basque parties during the transition and was gradually accepted by the central government, which had important implications for the functioning of the system, making it virtually unamendable, or amendable only to the advantage of the Basque Country.

This notion transpires especially in the configuration of the Agreement from the 1981 Act, but also after the 2002 reform, whereby the compact nature of the agreement is reflected in the way it is approved and protected against amendment by the Spanish parliament unilaterally. Since the approval of the Spanish Constitution in 1978, six Agreement regulations have been passed, in force during 1982–86, 1987–91, 1992–96, 1997–2001, 2002–06 and 2007–2010. The amendments in 1997 consisted in an increase of Basque taxation powers. Then, it was revised again in 2001 addressing some innovations to tackle problems arisen since 1981. In 2007 it was again revised to ensure the Basque Country full powers over personal and corporate taxes, as well as administrative control over VAT, alongside new indirect and excise taxes. This Act also renewed the five year quota and introduced some revisions to adapt itself to the budget stability rules set by the EU (see Claeys and Martire 2011 *Órgano de coordinación tributaria de Euskadi* 2010).

More recently, in 2010, the central government agreed to the so-called legal “shield’ of the Financial-Economic Agreement, which meant that provincial tax rules can now only be appealed to the Constitutional Court and not to ordinary courts, as had been the case until then, permitting neighbouring regions to file lawsuits against Basque provincial tax regulations in administrative courts. Similarly, the Court of Justice of the European Union recognized in 2008 the autonomy of provincial Basque to set a corporate tax different from the rest of Spain.

The Financial-Economic Agreement: main features

Constitutional and statutory basis

Pursuant to the constitutional additional provisions establishing the singularity of the Basque Country (and Navarre) and recognising its historical rights, the regional Statute of Autonomy of the Basque Country was able to regulate some issues which would otherwise have required the approval of an Organic Law in the Spanish parliament –e. g. the creation of a regional police, internal organization by provinces and, most importantly, the establishment of a special financial economic agreement— (see Corcuera 2008).

There are two main statutes governing this economic agreement: the Act approving the Economic Agreement with the Autonomous Community of the Basque Country (*Ley por la que se aprueba el concierto económico con la Comunidad Autónoma del País Vasco*), which establishes the basic rules of the system and the scope of autonomy of Basque institutions regarding tax regulations; and the Act approving the method for determining the tax contribution quota of the Basque Country for each five year period (*Ley por la que se aprueba la metodología de señalamiento del cupo del País Vasco para cada quinquenio*). These two pieces of regulation contain the substantive aspects of the Financial-Economic Agreement, which can be summarized in the following features:

8 Main institutional features of the Agreement¹

It is established as a fiscal compact or treaty between two governments: The statutory act that regulates the economic agreement builds on a political agreement or pact between the central and Basque governments, which is subsequently ratified by the two parliaments through a single article Act without possibility of amendment (legally it has the same procedure as international treaties). According to this procedure, the only role of the Parliament is to ratify an agreement previously reached between the Basque institutions and the Spanish State Government. The Spanish parliament is not entitled to modify such rules unilaterally. This ensures an advantageous bilateralism between the region and the State and strengthens the position of the region, since the approval of measures is dependent upon the existence of special agreements.

Indefinite validity and duration: Since 2002 the agreement has permanent validity, which combined with the amendment procedure established means that in practice the Basque government enjoys a veto power over any reform initiative not suiting its interests.

Gives the Basque Country its own tax regulatory powers and autonomy in tax management: Basque provincial institutions (*Diputaciones forales* or provincial councils) have the power to establish the tax regulations applicable to the Basque Country and to set, collect, manage, and inspect all taxes levied (which, in practice, means all taxes except custom duties levied on goods imported from outside the EU). The Basque government and the provinces have their own tax agencies or revenue services. The result is a complex system where four tiers of government (five with the EU) spend, but essentially only one of them (the provincial one) raises taxes. The procedure for levying and manage tax yields, at all stages corresponds to the provincial authorities and is a power exerted, when appropriate in collaboration with other government tax authorities.

Internal decentralization in taxation: The authority on taxation is exercised not by the AC itself, but by the elected bodies of the three provinces: Álava, Vizcaya and Guipúzcoa. Their treasuries regulate, levy and administer all the Basque Country taxes. The Basque Parliament is then in charge of enacting the provisions to ensure a certain level of harmonization among the three bodies.

Establishes the obligation to pay a certain amount, fee or quota to the central Treasury, which is referred to as the Basque contribution quota (or cupo). Basque authorities collect taxes and pay the central government a fixed share corresponding to the expenses by the central government in non-devolved powers, keeping the remainder to finance its spending. That means that funds transferred by the Basque Country to the central government are not calculated depending on the amount of taxes collected, but rather on an assessment of exogenous variables such as the expenditure in the powers not devolved by the central state Budget.

¹ For the following I draw on, and summarise, Ruiz-Almendral 2004; Monasterio 2010; Órgano de coordinación tributaria de Euskadi 2010; Zubiri 2003, 2007, 2011.

Unilateral risk: The results deriving from the management of the Agreement correspond only to Basque Country. Just as the central government does not participate in the raising of the revenues made by the provincial councils, neither does it provide a minimum revenue guarantee for regional public expenditure as in other regions. The charter ACs run all the risk themselves. This makes this system attractive for more wealthy ACs, but not for less wealthy ones.

Double decision capacity (the Spanish “West Lothian question”): the Basque government, besides negotiating bilaterally its own financial agreement, also sits in the multilateral Council of Fiscal and Finance Ministers with voting rights, which means it can also decide on the funding arrangements of the other regions. The latter, however, may not have a say in the negotiations regarding the Basque financial agreement. Also MPs in the Spanish parliament elected in Basque constituencies may vote on the common-regime funding arrangements. MPs elected in other constituencies may not amend the regulations on the Basque Agreement. This Spanish West Lothian question has so far not been problematized in the public discussion, but represents by all means a clear democratic anomaly.

Financial supervision of local government: unlike other Spanish ACs, the Basque government has legislative authority over municipalities and may establish and regulate local taxes and transfers to local governments in its territory, within a very flexible framework established by the central government. In other regions this is regulated by the central government.

Taxes and Coordination of taxing powers

The Economic Agreement grants the Basque authorities broad authority regarding the regulation of direct taxes (Income Tax and Corporate Tax) but little regulatory power in practice regarding indirect taxes. Basque institutions have tried to pursue a distinctive tax policy to enjoy a competitive advantage over other regions.

Given the internal tax decentralization within the Basque Country, to coordinate the tax policy there exists the Basque Tax Coordination Agency (*Órgano de Coordinación Tributaria de Euskadi – OCTE*), created in 1989. This agency is composed by representatives of the three provincial councils and of the Basque government. Regarding coordination with the central government, the Basque government must reach an agreement with the central government in case new taxes are created. This happened in 1986, when Spain joined the European Union and the VAT was introduced (Ruiz Almendral 2004).

The limits of the Basque regulatory powers are not clearly defined. The Agreement establishes that Basque tax authorities have the obligation to respect the system, terminology and definitions set forth in the Spanish General Tax Law. They are not allowed to establish tax privileges, nor to impede Spain’s single market or hinder free competition and the free movement of persons and capital. Finally, “global effective tax burden” shall be at least equal to that of the rest of Spain (Ruiz Almendral 2012; Zubiri 2007).

The following table shows the difference in tax powers of charter ACs and common regime ACs in Spain

Main Taxes in Spain	Legislative Powers of charter ACs (The Basque Country and Navarra)	Legislative Powers of common-system ACs
Personal income tax	Total regulation of the tax	Tax rates (must have same number of tax brackets as the State tax) Tax credits, under certain conditions
Corporation income tax	Total regulation of the tax	None
Tax on income of non-residents	Regulation of the tax only in the case of permanent establishment in the charter territory	None
Wealth tax	Total regulation of the tax	Tax rates Minimum threshold Tax credits
Death and gift taxes	Total regulation of the tax	Deductions (mainly, for family circumstances) Tax rates Deductions and tax credits Tax administration
Taxes on transfers and official documents	Total regulation of the tax	Tax rates Tax credits Tax administration
Gambling taxes	Total regulation of these taxes	Exemptions Taxable base Tax rates Tax credits Tax administration
Value added tax	None	None
Excise duties	None	None

Source: Zubiri 2007, Ruiz-Almendral 2012.

As seen in the Table, the taxes under the financial Agreement include all the main taxes of the Spanish tax system, such as personal and corporation income taxes, the wealth tax, the death and gift taxes, the capital transfer tax and stamp duty. Also those taxes harmonized under EU regulations (such as with VAT, excise duties, and the tax on the income of non-residents) rest with the Basque provincial authorities, but in that case they may just collect them and have to be regulated by the central parliament.

In general, taxes in the Basque Country do not differ greatly from the rest of Spain. In personal income tax, for example, there are slightly higher rates and a larger progressivity, alongside more tax credits for family circumstances. In corporate tax, the rate in the Basque Country is slightly lower (Ruiz-Almendral 2004, 2012).

General limitations of Basque financial autonomy

The taxation system of Basque authorities must respect some general principles listed in the Agreement (Article 2): the constitutional principle of solidarity, correspondence with the overall structure of State taxation (which shall not be distorted by the exercise of taxation powers by the AC), coordination, tax harmonization, mutual collaboration and compliance with the Treaties or International Agreements signed by the Spanish State or to which it adheres. Similarly, the rules of the agreement will have to be legally interpreted in accordance with the regulations in the Spanish Tax Code.

General principles limiting Basque Fiscal autonomy

- Respect for the principle of solidarity in the terms laid down in the Constitution and in the Statute of Autonomy.
- Regard for the general taxation structure of the State.
- Coordination, fiscal harmonisation and cooperation with the State, in accordance with the rules laid down in the present Economic Agreement.
- Coordination, fiscal harmonisation and mutual cooperation between the Institutions of the Historical Territories pursuant to the regulations enacted by the Basque Parliament for these purposes.
- Compliance with the International Agreements or Treaties signed and ratified or adhered to by the Spanish State. In particular, it shall comply with the provisions laid down in the International Agreements signed by Spain to avoid double taxation, as well as fiscal harmonisation measures of the European Union, and shall be responsible for making the refunds called for, pursuant to application of said Agreements and rules.

The tax systems in the provincial territories have to take into account the rules for tax harmonization in the Financial-Economic Agreement and the principle of collaboration. The agreement rules include a set of provisions that aim to guarantee an adequate level of harmonization – not homogeneity – between these systems and the Spanish one. Basque authorities must maintain a general tax burden ‘equivalent’ to that of the rest of Spain. This last provision is certainly ambiguous: there is no official interpretation of what exactly can be considered to be a non-equivalent level of tax burden (Ruiz Almendral 2004).

Principles of Harmonization

In drafting their tax legislation, the Historical Territories shall:

- Respect the General Tax Law in matters of terminology and concepts, without prejudice to the peculiarities established in the present Economic Agreement.
- Maintain an overall effective fiscal pressure equivalent to that in force in the rest of the State.
- Respect and guarantee freedom of movement and establishment of persons and the free movement of goods, capital and services throughout the territory of Spain, without giving rise to discrimination or a lessening of the possibilities of commercial competition or to distortion in the allocation of resources.
- Use the same system for classifying livestock, mining, industrial, commercial, service, professional and artistic activities as is used in the so-called common territory, without prejudice

Institutions of intergovernmental relations

In terms of the institutions established for the coordination of the Financial-Economic Agreement, the rules provide for a closer collaboration procedure with the central government on questions of taxing and budget stability. The third chapter of Act 12/2002 established a so-called Joint Commission of the Financial-Economic Agreement, with equal representation of the Basque Country (one delegate for each of the three provincial councils, and three for the regional government) and the central government, which is meant to decide on the modifications to the agreement and the methodology of the quota. This Commission must take decisions by unanimity. The functions of the Joint Economic Agreement Commission are:

- Agree on modifications to the Financial-Economic Agreement.
- Agree on coordination and cooperation commitments in matters of budgetary stability.
- Agree on the methodology to be used in setting the quota for each five-year period.
- Agree on the system and appointment of the Members of the Board of Arbitration, and on operations, summons to and details of meetings, and the system for adopting agreements.
- Any and all agreements involving matters of tax and finance deemed necessary at any given time for the correct application and development of the provisions contained in the present Economic Agreement.

The Act also establishes two further institutions: the Coordination and Evaluation Commission, responsible for adjusting the tax regulations prior to their publication and an Arbitration Board – consisting of experts with recognised prestige in tax matters, and appointed for six years by the Spanish Treasury and the Basque Treasury, responsible for resolving any conflicts between the State and the Basque administration. The functions of the Coordination and Evaluation Committee are:

- Evaluate the adaptation of the tax legislation to the Economic Agreement prior to the publication thereof.
- Resolve any concerns put forward on the application of points of connection laid down in the present Economic Agreement.
- Make whatever studies they deem necessary for the adequate structural and functional organisation of the autonomous regime within the fiscal framework of the State.
- Provide the competent Administrations with uniform action criteria, computer plans and programmes, and to organise the instruments, resources, procedures or methods for the effective materialisation of cooperation principles and information exchange.
- Analyse the cases and questions that have arisen over inspection matters between the Administration of the State and the respective Territorial Governments, and to examine valuation problems for tax purposes.
- Issue reports requested by the Spanish Ministry of Finance, the different Finance Departments of the Basque Government and the Territorial Governments, and the Board of Arbitration.
- Any other functions related, in particular, to the application and execution of the present Economic Agreement.

*The calculation of the Basque contribution quota:
political determinants and economic effects*

As was mentioned above, the quota (*cupo*) serves to pay the Spanish State's expenditures on certain areas not devolved. The method for calculating the *Cupo* is regulated by the Economic Agreement Act and the Five-year Quota Agreement Act. It is calculated by multiplying the cost of the expenses incurred by the State in connection with non-devolved powers by a coefficient which tries to represent the relative proportion of income of the Basque Country within Spain (currently it is fixed at 6.24%). Then, taxes collected by the State within the Basque country, or from persons resident in the region, and the amount of State deficit attributable to the region are deducted from the amount of expenses assumed by the State (Corcuera 2008, Martínez Churriaque 2008)

The quota to be remitted is determined by establishing a fiscal capacity ratio or 'attribution rate', calculated as the percentage which the Basque Country revenue represents within those of the State. The resulting quantity (gross quota) must also undergo certain adjustments, in order to take into account other variables (e. g. taxes not included in the Agreement such as VAT). After these adjustments and compensations, the net quota is obtained.

Since 1987, when health services were devolved to the Basque Country, the net result of financial flows between the central government and the Basque government has benefited the Basque Country. This has raised criticisms, since the politically determined miscalculation of Basque fiscal capacity and of real central expenditure in non-devolved matters may in practice amount to the subsidising of the Basque Country, one of the wealthiest regions in Spain, by the central government and the rest of the regions. This means just a fiscal privilege and goes clearly against the principle of equality established in the Spanish Constitution (Corcuera 2008, Martínez Churriaque 2008)

According to many recent studies available, this undervaluation amounts to an estimated 2,500 million euros for the period 2002-2006 and 4,500 since 2007 (Monasterio 2010, De la Fuente 2011). According to De la Fuente's study, for example, the calculation procedure of the cost of the exercise of central powers contained in the Agreement is extremely generous for the Basque Country. According to his estimates, the Agreement offers the Basque Country an extra annual funding of € 4,500 million compared to what would correspond in case the quota was calculated with reasonable criteria.

In concrete terms, the fact that the Basque Country (like Navarra) is exempt from contributing to the financial equalization scheme represents for this AC, for example, an extra income of 1,790 million euros. Similarly, according to this study, the assessment of the cost of non-devolved powers for the central government is greatly undervalued, implying another savings of 1,740 million to the region. Other extra 950 come from the calculations made when assessing the adjustments for the VAT, which according to De la Fuente, use outdated criteria about the weight of the Basque Country in the share of domestic consumption and the tax base (De la Fuente 2011).

Matilla (2012), for example, concludes, in a recent report, that the common system ACs are virtually 'subsidising' each year the Basque Country with 1,820 million euro, due to the calculation made by the central government of VAT revenue collection. Catalonia, Madrid and Andalusia are by far the regions most affected by this Agreement. More than 300 million euros a year are unduly transferred by this regions compared with the amount that would be transferred should the appropriate rules and calculations on VAT collection be applied. Other regions such as Castile and León, Galicia and Valencia transfer between 100 and 200 million euro (see Matilla 2012).

Although these figures are unknown to most of the Spanish population, there is increasingly a growing demand among experts outside the Basque Country that the method of calculation of the Basque contribution quota should be revised. All politicians and public opinion in the Basque Country, aware of its advantages, fully support the financial Agreement system and associate it with the essence of its particular history, identity and self-government.

Outside the Basque Country, however, the very constitutional asymmetry establishing the protection of charter rights previous to the Constitution and allowing for different funding rules and inequality of results has been questioned many times, although not publicly. Also some of its effects have been criticised, such as increasing divergence in tax systems, inefficiency and instability of the general funding system, since many ACs demand to reach the same per capita resources and spending levels. It has also been argued that maintaining such asymmetry is the price to pay to keep the Basque Country integrated in Spain. But, as argued above, it is not necessarily the legal asymmetry or institutional design, but the way it has been implemented –e. g. how the quota is calculated and adjusted— due to political reasons, what has made this AC privileged and in practice subsidised by the rest of the regions.

Especially controversial, for its consequences on the Spanish state, is the effects for Catalonia and its demands of an improved fiscal treatment. The fact that the Basque Country and Navarra do not contribute to the vertical equalization scheme to guarantee equal public services all over Spain, implies that other rich regions have to contribute a larger share of their revenues to poor regions, which is obviously unfair. This unjust economic imbalance is only sustainable, it has been argued, because the Basque Country and Navarra only represent together 8 per cent of the national GDP.

Propensity for domestic conflicts and compatibility issues with the EU

The consequences of the Agreement in its normal operation have also brought about some administrative and political conflict and controversy. The Financial Agreement system and particularly Basque tax policies have created conflicts with the neighbouring Spanish regions, and with the central Government. Many of them have initiated judicial actions against certain tax regulations arguing that those regulations favoured relocation of companies from other regions, provided for disguised subsidies and state aids contravening the single market and hindering competition (see Ruiz Almendral 2004, Claeys and Martire 2011).

The Agreement regime has also created certain tensions with European Union Law, since the miscalculation of the quota, together with occasional lower rates for corporate income taxes in the Basque Country has been deemed by some to be to the benefit of Spain vis-à-vis other EU countries. Also the very existence of such different tax regimes within the same country has been questioned. A decision of the European Commission in 1993 stated that some of the tax measures in the Basque corporation income tax may be inconsistent with the right of establishment (Section 43, EC Treaty) and may also fall under the category of 'state aids' (Section 87, EC Treaty) (Ruiz-Almendral 2004, 2008; Martín and Urrea 2009). A 2008 ruling of the ECJ has accepted the agreement under several conditions.

Regarding the future prospects of the Financial-Economic Agreement within the European context, it could be altered if a European fiscal union is finally implemented in the next three or four years. Some experts believe that a modification of the Basque Financial Agreement and even of the regional Statute of Autonomy would be required to implement measures to establish a European 'finance ministry'. One of the main reasons for these potential amendments will be the requirement to create a single rate in corporation tax for the whole EU, which would end with the Basque exceptionalism. Just last March, the European Commission approved the creation of a harmonized corporate tax, which would mean that companies would pay their taxes to a single authority. The regional Statute of Autonomy specifies that this is a Basque provincial jurisdiction, so it is questionable that the Basque Financial Agreement could adapt to new rules adopted from Brussels on limiting the public deficit or the tax powers of the Basque provinces.

Conclusions

This contribution has sought to present the history and the main features of the unique and complex Basque finance Agreement. We have seen how its distinct features originate in a long history and how its current operation has been determined by political and institutional factors that make many of its rules invulnerable to change as long as proposed reforms go against Basque interests. We have also described its advantages and profitable results for the Basque Country, and the high coordination requirements it demands from intergovernmental bodies, but can also doubt of its accommodating effects on the secessionist demands within the Basque Country. We have demonstrated certain unfair and inefficient effects of the system that are mainly suffered by the Central government and the rest of Spanish regions. Finally, we have shown its proclivity to conflict with other regions, with the centre, and especially with the EU legal framework.

From all this, Scottish readers seeking for a third ways between the status quo and independence may conclude that some version of the Basque variant of devolution may well have obvious advantages for Scotland and for Scottish nationalists, but it is not at all evident that such an asymmetric and unfavourable deal will ever be accepted by the UK government, the other nations in the UK or even count on the support of all Scottish unionists, due to the problems of equity and efficiency it generates and to its propensity for future conflict and incompatibility with the EU.

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