The Economic Crisis of 2008+: The impact on Spain's Public Finances and Federalism

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1. Background. Crisis, Spain

2. Spanish economic data: recent performance: From an intense expansion to economic recession since 2008.

3. Some explanations of the differential Impact of the crisis in Spain

4. Public Finance in Spain:
   1. The Expenditure side and decentralization.
   2. Revenue and fiscal Structure. AC Financing
   3. Deficit and Debt. Distribution among levels of Government

5. Territorial tensions: the case of Catalonia.

6. Final reflections and perspectives.
1. A note on the origin and causes of the crisis.

The origin of the last international financial crisis is a huge fraud linked to the issue of financial assets without proper guarantees by the United States Banks that were bought, rashly, by financial entities of most of the world’s developed countries, mainly Europeans, and shared among their customers.

Main factors:

- Easy credit conditions during the 2002–2008 period, that encouraged high-risk lending and borrowing practices.
- Real State bubbles. which subsequently burst.
- International trade imbalances and huge private indebtedness.
- Some fiscal policies choices that, in some cases, exaggerated the crisis.
- Policies applied by different Governments to bail out troubled banking sectors and private bondholders, assuming private debt burdens or socializing losses.
1. Seventeen Countries make up the Eurozone today
2. Expansion and crisis

% change in GDP, at market prices % change

(Eurostat, 2013)
2. Accumulated GDP growth ratio in Canada, Spain and US during the new century (FMI, 2013)
2. Unemployment rate, annual average (%)
(Eurostat 2013)
2. Current account balance of payments as percentage of GDP (Spain and Germany. Source: Eurostat)
(Source: Eurostat)
2. Consolidated gross Government debt (% of GDP)
(Source: Eurostat)
3. Reasons for the previous success and the fragility of the model

1. A growing part of the Spanish economy was dependent on the residential building sector. The increase of house prices, the subsequent “wealth effect” and the fiscal incentives applied to buy houses generated a “housing bubble” as in other countries.

1. The decreasing value of interest rates increased the overall debt of households (mortgages) and firms. Current account balances showed persistent deficits of about 10 percent of GDP as opposed to those of other European countries, which were a clear sign of the country’s continued loss of competitiveness. This involved a serious dependence on other countries through the financial system.

3. The general belief in the continuity and permanence of economic expansion made it difficult to introduce political changes. No anti-cyclical economic or structural policies were applied to cool down the overheating of the economy as a whole.
3. Some reasons for the differential crisis in Spain

• When the bubble burst, prices fell, assets were depreciated and this led to the crisis in the Financial System.

• The Government had to bail out the financial sector, thereby increasing the deficit. But the credit did not increase.

• The crisis in the real sector produced a slump in economic activity,

• The austerity policy defended by the European institutions has generated an intensification of the crisis in the southern European countries.

• The transfer of the monetary policy implied a limited margin of action for the governments integrated in the EZ to combat the crisis. EZ governments must issue their debt in a currency they cannot control.

• The sovereignty crisis was consequence of public accounts disequilibria and the speculative financial movements against the Southern countries.

• The Central European Bank could not play the role of a lender of last resort.
4.1 Public Finance in Spain: The expenditure side

Public expenditure /GDP in Spain and EU-15

(Source: OECD Economic Outlook)
4.1 Decentralization: Vertical Distribution of Expenditure
Source: IGAE (General Comptroller) (Several years)

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4.2 Public Finance in Spain: The evolution of revenues

Public revenue/GDP in Spain  EU-15
(Source: OECD Economic Outlook)
4.2 Spanish tax structure
EU-15 Direct taxes  Indirect taxes  Social contributions
(Source: European Commission: General Government Data)
4.2 Evolution of the main taxes
(PIT, VAT, Corporations, Excise Taxes)
(Source: AEAT, MHAP)
4.2 Fiscal system in Spain: Main topics

• Five main sources: Social Contributions, PIT, Corporate Tax, VAT and Excises Taxes.
• Similar Social Contributions than the EU average. Lower level in terms of traditional taxes.
• The crisis has affected seriously tax revenues, especially it has been the case of VAT and Corporation Tax.
• There are increasing difficulties of taxing capital and business revenues.
• The need to combat fiscal deficits following the sovereign debt crisis has obliged the Spanish Government (and ACs) to increase the fiscal burden and to cut some public services, and try to introduce flexibility in different markets.
• There are still high levels of fraud and corruption, especially in a context increasingly globalized.
• In the present situation it seems to be almost impossible to guarantee the maintenance of the welfare state in Spain (similar to the ones of the more developed European countries).
### 4.2 Vertical distribution of revenues

Source: IGAE (General Comptroller) (Several years)

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4.2 General (Common) Financing System in Spain

- EN
- TAX REVENUES
- TRANSFERS
- GENERAL ADMINISTRATION OF THE STATE (CG)
- AUTONOMOUS COMMUNITIES
4.2 The Common System

- 15 Regions. Vertical gap (top-down transfers); Horizontal gap (intensive redistribution).
- Devolved taxes: Property, Wealth Transfer and Gambling (all with strong regulatory powers).
- Shared taxes (managed by Central Government Tax Agency)
  - PIT (50%)
  - VAT (50%)
  - Excise taxes (58%)
  - Electricity and Automobile Licences (100%)
- Equalization transfers:
  - Essential Public Services Fund (Horizontal equalization)
  - Global Sufficiency Fund (Vertical: Adjustment clause)
  - Competitive Fund: (Re-ranking correction)
  - Cooperation Fund: (Compensation to low income regions)
4.2 Foral (Charter) Financing System

AUTONOMOUS COMMUNITIES

EN

TAX REVENUES

GENERAL STATE ADMINISTRATION

QUOTA/CUPO
4.2 Foral System (Basque Country and Navarre): Advantages and problems

- Advantages:
  Higher level of resources and expenditure.
  Total financial autonomy (with some harmonization rules).
  Incentives for sound fiscal management (independence).

- Problems:
  Bottom-up intergovernmental transfers
  Unequal fiscal competence.
  Frequent conflicts with the state.
  Lower fiscal pressure than that of standard Autonomous Communities.
  Low contribution to solidarity.
  Comparative grievances and demands for equalization.
4.3 Fiscal Balance and Public Debt
(Source: MEC: Stability Program, 2013)

**Fiscal Balance**

- Local Entities
- Autonomous Communities
- Social Security
- Central Administration

**Public Debt/GDP**

- 2007: 2.000
- 2008: 1.500
- 2009: 1.000
- 2010: 500
- 2011: 250
- 2012: 125

(Source: MEC: Stability Program, 2013)
4.3 ACs Public Deficit between 2011 and 2012.
(Source: MEC: Stability Program, 2013)
4.4 Pros and cons of the devolution process and the impact of the crisis

• Successful devolution of powers and positive citizens’ perceptions until the crisis.

• General Financing System: strong redistribution among Communities and Re-ranking, slow process of tax decentralization, poor level of accountability and problems of coordination.

• Privilege of the Charter System (against some constitutional principles) and comparative grievance (demand for Fiscal Pact in Catalonia).

• Process of and demands for “recentralization” in some regions as a consequence of the economic crisis and, in parallel, demands for independence in Catalonia.
5. Territorial tensions: The Catalanian case. Main facts

- More than 30 years of development of the SA.
- 2005 The process of reform of the Catalanian Statute begins.
- 2008: Severe economic crisis in Spain.
- 2010: Sentence of the Constitutional Court (31/2010). Huge demonstration against it in Barcelona: “We are a nation, we decide”.
- 2012, 11th September: About 1 million people in the streets, behind the slogan, “Catalonia, a new State in Europe”. President Mas decides to call for General Election, after trying to discuss the Fiscal Pact with Mr Rajoy.
- 2013, 23rd January: Statement of Sovereignty of Catalonia (85 votes) and proposal of referendum.
5. Some explanations: Catalonia singular characteristics

• One of the richest and industrial territories in Spain.

• Particular history, marked by the defeats of 1714, language and culture differentiate it from the rest of Spain.

• Strong Nationalist Parties (CiU, ERC) and other social institutions, that try to mark differences (ethnics, culture, language,..) with the rest of the state.

• Deficit of the Fiscal Balance (too large for the nationalist parties), serious incidence of the Crisis in the AC and Comparative grievance in respect to Foral Regions.

• Frustration with the new Statute of Autonomy and the CC Sentence, the spark which ignited the fire of demands for independence.
6. Last comments: Final reflections and perspectives

- 1. The crisis, as a great recession among the countries of the south of Europe.

- 2. Spanish Public sector and public finance show an intermediate level between the most consolidated WSs in Europe and the new EU members.

- 3. Collapse of revenue, growth of expenditure stabilizers, the financing of the financial sector debt and others, and the increase of debt risk premiums have made grow the fiscal deficit and debt.

- 4. The restricted policies applied to combat fiscal disequilibria have increased the recession and unemployment with no perspectives of change. The lack of a real Central Bank and more coordinate economic policy make more difficult the solution

- 5. The government has initiated some reform processes (labour market and others) without success. Inequality and poverty have increased and so social instability.

- 6. Process of decentralization of deficit and debt, and more predominance of the central Government economic policy. Demands for “recentralization” in some regions and for independence in Catalonia,