

Non-Institutional Federalism in Spain

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Abstract

Spain has advanced significantly regarding the assignment of responsibilities on public expenditure and tax powers across regional governments. However, regions do not participate significantly in the decentralization process. The lack of federal institutions in which regions are represented motivates non-cooperative behaviours and fosters competition between all levels of government. The consequence is that the provision of public goods and services is rather inefficient.

We illustrate our argument using a very simple model with externalities in which the normative recommendation of decentralization does not guarantee the efficient provision of public goods. The adequate design of federal institutions would allow reducing such inefficiencies.

Finally we try to identify the political characteristics of the Spanish regime that may explain the lack of institutional mechanisms of cooperation-coordination between governments.

This type of analysis could be easily extended to the present situation in Italy.

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1 INTRODUCTION

In this pages we want to shed some light on the current process of political decentralization in Spain. The Central Government in this country had begun transferring responsibilities on public expenditure to Regional Governments at the beginning of the 80's. These developments ran parallel to a process of political and economic integration in Europe and a tendency towards the privatization of some of the public sector activities.

From an economic point of view, the Spanish regime of decentralization presents the following characteristics: i) A significant degree of decentralization of public expenditure, though still under strict surveillance by the Central Government, ii) A high degree of regional heterogeneity regarding the responsibilities received from the Central Government, iii) A Central Government that still controls most tax revenue sources, iv) Transfers from the Central Government are the main source of revenues for Regional Governments and the mechanism to assign them is subject to discretionary political bargaining², v) The coexistence of several -local, provincial, regional and central- tiers of government and the absence of adequate institutional mechanisms to assure their effective participation in the decentralization process, vi) The Central Government is still the unique agenda setter.

We believe that this regime of "partial" decentralization has different negative consequences: 1) Inefficient provision of public goods, at all levels of government, and disproportionate increases of public expenditure³, 2) Systematic confrontation between the Central and Regional Governments, which blocks any further reform of the present model and fosters the persistence of inefficiencies, 3) Regional Governments compete so as to maximize their share of total transfers, which leads to individualistic and noncooperative behaviors, 4) Limited democratic control over the activities of the different governments that has derived in a significant lack of accountability, 5) Regional Governments issue large amounts of debt, as opposed to the limits fixed by the European Commission, 6) Uniformity in the provision of public services and transfers that limits the mobility of factors of production and reduces the positive effects of fiscal competition between Regional Governments.

Although many of the normative recommendation regarding decentralization of public expenditure and tax revenue capacity have been implemented, we argue that such inefficiencies might be due to the lack of federal institutions. Spain, from a Constitutional point of view, cannot be classified as a federal structure. There are Regional Governments and Regional Parliaments, but still the Central Government keeps a tight control on their activities as well as on their sources of revenues. Although there is a Senate, in which regions are formally represented, regions do not play a decisive role in the decision-making process due to the limited role of this chamber in the Central Parliament. Therefore, the process of decentralization is directed according to a basis of a national majority and is decided in the Lower Chamber. Our goal is to analyze those political characteristics of the Spanish model, regarding decentralization, that may have an impact on the efficient allocation of public resources and on the overall economy.

The absence of institutional representation of Regional Parliaments (or Governments) in the Central Legislative might explain the delay in achieving more decentralization (regarding redistributive policies and tax powers) and in designing the instruments needed to avoid inefficiency and inequity problems that may arise from the further development of the process. Institutional reforms of federal institutions regarding majority rules, distribution of voting powers, controls between different levels of governments, the design of institutional mechanisms of cooperation-coordination between different levels of government, etc. have not been addressed in Spain yet.

The main conclusion of this paper is that economic efficiency suggests that, in Spain, a significant reform in its chamber of territorial representation should be implemented. This reform would force the policy-makers to

² Some mechanisms have been implemented in order to assign transfers automatically, but still they imply partial reforms to an initial estimation based on the cost of provision by the Central Government.

³ The provision of public goods/services by different levels of government overlaps very often.

face the issue of which territorial model they want for the country. At present, as we believe, the model is ambiguously defined in the Spanish Constitution.

Although we analyze the Spanish process of decentralization, the analysis could be easily extended to the case in Italy. Both processes present many similarities. In fact, the Spanish model is based on the model that was developed in Italy during the 70's. However, while the process in Spain has advanced significantly, in Italy it did not. There are significant differences with regards to the political framework in both countries, especially what concerns to the electoral regime, the regulation and the role of political parties and the role of the Senate. Nevertheless, the aggregate outcome of the model (the Italian model presents many inefficiencies similar to those in Spain) brings us to think that our conclusions still apply and we think that if the process in Italy is to advance, the participation of regions in the Central Legislative will become a crucial issue in the process. Italy in fact is another example of Non-Institutional Federalism.

The paper is organized in two different parts. On the one hand, after a brief revision of the literature related to the topic, in section 2 we introduce a very simple static model that illustrates, considering externalities in the provision of public goods, the necessity of having adequate Constitutional Agreements in order to guarantee the coexistence of different levels of government and the efficient provision of public services. On the other hand, in section 3, we mention what kind of agreements can be implemented. In section 4 we analyze the political structure in Spain and we study which are the elements that limit a further development of the current regime and that can explain the present inefficiency in the provision of public goods. Finally, we submit our conclusions.

1.1 Related literature

The analysis of political decentralization-integration in economies with a territorial structure has received significant attention from many different approaches in the economy. The literature related to the topic develops the seminal work of Tiebout (1956), Musgrave (1959), Buchanan (1950; 1960; 1965), Oates (1972; 1977), which are the basis of the so called normative theory of Fiscal Federalism. Contributions from Public and Urban Economics, Game Theory, Economic Growth and Political Science have enriched this line of research. The vast literature and the variety of results are so large that no attempt will be made to review all the literature thus we will just try to summarize the main contributions related to the topic.

The normative theory of Fiscal Federalism contends that the Central Government should keep the jurisdiction on income distribution, stabilization of the economy and the promotion of economic growth. Nevertheless, it has been widely accepted that, from a theoretical point of view, the assignment of responsibilities -and the creation of new levels of government- should take into account the following factors: i) Interjurisdictional externalities, ii) Economies of scale, iii) Heterogeneous regional preferences on public goods, iv) Asymmetries of information regarding the necessities of the different regions, and vi) The mobility of economic units. However, the prescription is rather general because the authors do not offer a precise delineation of the specific goods and services to be provided at each level of government.

The normative consensus extended also to the identification of the most relevant aspects to be considered when decentralizing taxes, which are related to: i) Interregional fiscal competition due to the mobility of tax bases, ii) Tax externalities and exports of tax burdens, iii) Distribution of the tax burden among individuals, etc. The normative recommendation was that Regional Governments could raise revenue but only in a manner which was non-distortionary or did not leak to other regions. Unfortunately for the new governments, this meant that those taxes on income, capital or labor -i.e. those with the highest tax revenue capacity- remained in hands of the Central Government. The outcome being an imbalance between public expenditure and tax revenue capacity, which derived in the development of complex and varied grant systems.

Criticisms to this literature, based on the Political Science approach⁴, are concerned about the applicability of the normative recommendations. This is based on the fact that the normative approach assumes that efficiency

⁴ We cannot avoid mentioning those criticisms related to the new evidence on economies of scale, on externalities and on the effects of fiscal competition and fiscal exports. Altogether, they raise some doubts on the effects of centralizing some expenditure as well as some instruments to correct economic inefficiencies

can be measured in terms of economies and diseconomies of scale, or in terms of access to public goods, which clearly ignores the role of bureaucracy and the political framework in which decisions are taken. There could be thus important political constraints that may prevent the central programs from generating an optimal pattern of local outputs.

These contributions, nevertheless, do not invalidate the theoretical results derived from the normative approach. They add a new dimension to the traditional analysis by considering the political framework in which decisions on decentralization are taken. Differences in political regimes and electoral systems introduce different controls on politicians and bureaucrats and regulate the relations between different tiers of government. Two main conclusions must be stressed to this respect. On the one hand, they show that one of the most relevant obstacles to efficiently achieve decentralization is the appropriate definition of the political institutions that "legitimate" the assignment of responsibilities. That is, to define correctly the constitutional relationship between the Central and Regional Parliament (and Executives). Different regimes will have significant effects on the performance of the Central Executive and Legislative as well as on the whole economy. On the other hand, the authors suggest that there should be a strong Central Executive to protect nation's interest in economic efficiency and to control for excessive local expenditure.

One may think that the model of partial decentralization in Spain can be explained according to the recommendations of the normative theory, which were based on economic arguments. However, the extraordinarily large literature that we find in Spain⁵ that deals with the issue of decentralization, contradicts that argument. These authors analyze, from a descriptive (and institutional) approach, to what extent the Spanish model adapts to the principles of Fiscal Federalism (accountability, fiscal responsibility, transparency, vertical and horizontal equity, etc.). Their main theoretical contributions and political recommendations have to do with the characteristics of the financial system: the mechanism to assign public resources across different levels of government, the assignment of tax powers across regions, the design of the instruments to correct for equity and inefficiency problems, etc. They show the inefficiency and contradictions, with respect to the normative prescriptions, of the present model. Nevertheless, they do not deepen on the arguments to explain such contradictions. Their contributions rarely include political-economy considerations. In this paper we try to fill this gap.

2 Efficiency and Political Institutions

In this section we present a very simple static model that illustrates the necessity to implement adequate Constitutional Agreements that guarantee the coexistence of different levels of government and the efficient provision of public goods.

We assume that public services generate externalities across regions⁶. The normative recommendation suggests that public services should be provided by different levels of government according to the scope of the externalities⁷. In this paper we show that even with total decentralization, inadequate institutional agreements introduce inefficiencies in the provision of public services. Inefficiencies occur because the lack of those agreements fosters competition among all levels of Government.

We consider an economy with N regions, distributed across P countries with A regions of equal size. We assume three different levels of government and three different public services, depending on the externalities

⁵ See Aja (1995-1998), Calsamiglia et al. (1991), Castells (1988), Castells and Bosch (1997), Fernández (1993), Monasterio and Zubiri (1996), Monasterio and Suárez Pandiello (1993), Monasterio et al. (1995), Pérez (1995), Ruiz-Huerta and Laborda (1994), Suárez-Pandiello (1997), Utrilla (1992), Zabalza (1994), among others.

⁶ Alternatively, we could also consider the role of economies of scale, differences in tastes for public goods across regions, fiscal competition within the same tier of government, mobility of factors of production, etc. However, all these complementary frameworks would reinforce our argument.

⁷ It is not very likely that one could assign all kinds of public goods across three levels of government only. There may exist some goods which benefit several regions in different countries or in the same one. We do this simplification to allow for the tractability of the model.

that they generate across the territory: federal, national and regional. We take regions as our unit of analysis and we assume that Federal and Central Governments provide their services, in different amounts may be, to the regions⁸.

Governments cannot issue debt; therefore, the usual balanced budget constraint applies. Governments fix a tax rate that is proportional to regional income. There is a unique federal tax rate for all regions and there is a single national tax for all regions in the country.

Finally, we assume that regions are endowed with an amount of productive capital, which might be different between regions. We assume that this capital is not mobile across regions. No assumption is made on a specific distribution of this capital across regions.

Governments maximize a social welfare function in which all regions are given the same weight. This does not mean that there will be a uniform provision of services, but that they do not consider equity arguments when maximizing. Implicitly, there is redistribution. However, it is not our goal to focus our analysis on redistributive issues or on the effects caused by distortionary taxation.

Regional welfare is measured according to income net of taxes

$$Y_{ik} - T_{ik}$$

where T_{ik} represents all taxes collected in region i in country k (for $k = 1 \dots P$)

The production function considered is similar to that in Alesina and Wacziarg (1998), but increasing the number of public services. The level of output in region i follows

$$Y_{ik} = A (K_{ik})^\alpha (F_i + \sum_{j=1}^{N-1} \beta_j F_j)^\gamma (G_{ik} + \sum_{j=1}^{A-1} \delta_j G_{jk})^\phi (S_{ik})^\mu$$

where A is technological progress, which is non region-specific; K_{ik} is the regional amount of private capital and it is exogenously given; F_i is the federal public service provided in region i , and F_j is the amount provided to the other regions which has an impact of β_j on region i ; G_{ik} is the national public service provided in region i , while G_{jk} is the quantity provided in the other regions in the country that generates an externality δ_j on region i ; finally, S_{ik} is the regional public service and it does not have any impact on the other regions.

We assume constant returns to scale, such that $\alpha + \gamma + \phi + \mu = 1$.

2.1 Decentralized provision

In this framework the National level provides the public service that generates externalities only across the regions within the same country. The Federal Government provides those public services with federation-wide externalities. Finally, Regional Governments provide services with no externalities. Any level of government takes the provision of the other governments as given.

In case of externalities the normative literature, from a theoretical point of view, suggests the distribution of responsibilities across levels of governments. However, we will show that even under total decentralization some inefficiencies in the provision of public services may arise, once regional heterogeneity in the externalities (regional differences in β and δ) are considered.

Initially, we take $\delta_j = \delta$ and $\beta_j = \beta$, for simplicity.

a) Any **Regional Government** in region i in country k solves

⁸ This is called deconcentrate provision or administrative decentralization in the literature. Central and Federal Governments provide their goods through their peripheral administration.

$$Max_{S_{ik}} Y_{ik} - T_{Rik}$$

$$s.t. T_{Rik} = S_{ik} \text{ with } T_{Rik} = \tau_{Rik} Y_{ik}$$

where τ_{Rik} is the regional income tax rate to finance the regional public service S_{ik} and T_{Rik} is the Regional Government tax revenue collection.

The solution to this problem provides the following F.O.C for each of the N regions

$$S_{ik} = (A \mu)^{1/(1-\mu)} (K_{ik})^{\alpha/(1-\mu)} (F_i + \sum_{j=1}^{N-1} \beta F_j)^{\gamma/(1-\mu)} (G_{ik} + \sum_{j=1}^{A-1} \delta G_{jk})^{\phi/(1-\mu)} \quad i=1, \dots, N. \quad (1)$$

The optimal quantity of public services provided and the optimal regional tax to be fixed in any of the N regions must satisfy

$$\tau_{Rik} = \mu = S_{ik}/Y_{ik} \quad \forall i = 1, \dots, N.$$

b) National Government

Each of the P National Governments (for $k = 1 \dots P$) maximize a social welfare function that takes into account all regions (A) in the country. All regions are given the same weight. However, governments do not provide the same amount of national public services to all regions in the country, which depends on the regional endowment of productive capital

$$Max_{G_{ik}} \sum_{i=1}^A (Y_{ik} - T_{Nik})$$

$$s.t \sum_{i=1}^A G_{ik} = \tau_{Nk} \sum_{i=1}^A Y_{ik} \text{ with } T_{Nik} = \tau_{Nk} Y_{ik}$$

T_{Nik} is the national income tax revenue collection in country k in region i and τ_{Nk} is the national income tax rate in that country.

F.O.C for each one of the P ($k=1 \dots P$) countries

$$G_{ik} = (A \phi)^{1/(1-\phi)} (K_{ik})^{\alpha/(1-\phi)} (F_i + \sum_{j=1}^{N-1} \beta F_j)^{\gamma/(1-\phi)} (S_{ik})^{\mu/(1-\phi)} - \sum_{j=1}^{A-1} \delta G_{jk} \quad i = 1, \dots, A. \quad (2)$$

The aggregate amount of national public services and the optimal national income tax rate satisfy

$$\tau_{Nk} = \phi / (1 + \delta (A-1)) = \sum_{i=1}^A G_{ik} / \sum_{i=1}^A Y_{ik}$$

c) Federal Government

Similarly to the National Government, the Federal Government maximizes the social welfare function that considers all N regions⁹.

$$Max_{F_i} \sum_{i=1}^N (Y_i - T_{Fi})$$

$$s.t \sum_{i=1}^N F_i = \tau_F \sum_{i=1}^N Y_i \text{ with } T_{Fi} = \tau_F Y_i$$

where T_{Fi} is the federal tax revenue collection in region i by fixing the tax rate τ_F .

⁹ We delete the sub-index k because the Federal Government takes all regions into account, independent of the country.

F.O.C are

$$F_i = (A \gamma)^{1/(1-\gamma)} (K_i)^{\alpha/(1-\gamma)} (G_i + \sum_{j=1}^{A-1} \delta G_j)^{\phi/(1-\gamma)} (S_i)^{\mu/(1-\gamma)} - \sum_{j=1}^{N-1} \beta F_j \quad i=1, \dots, N, \quad (3)$$

and the conditions for the aggregate provision and uniform tax rate

$$\tau_F = \gamma(1 + \beta(N-1)) = \sum_{j=1}^N F_j / \sum_{j=1}^N Y_j$$

As one can observe from F.O.C (2) and (3), Federal and National Governments take the effects of externalities into account. Therefore, an increase in the amount of federal (national) public services in the other N-1 regions of the federation (or A-1 in the country) will reduce the amount of the federal (national) public service provided in region i . The fact that governments take externalities into account allows avoiding the over-provision of those public services.

In case of pure federal and national public services (that is, considering $\delta = 1$ for all regions in the country and $\beta = 1$ for all regions in the federation), the results are very intuitive because what matters to regions is the aggregate provision of services, independent of where they are located. Therefore, under this specific assumption, individualistic and non-cooperative attitudes are avoided. At first sight, and from a theoretical point of view, total decentralization would be the first-best option because regions -and countries- do not have incentives to compete. It seems that institutions are not crucial to the model.

Nevertheless, the initial assumption that $\delta_j = \delta$ and $\beta_j = \beta$ does not prevent interregional competition to arise. Although the Federal Government, and the National Government as well, can compute the optimal aggregate and regional amounts of public services to be provided, the final allocation of resources matters to regions. The impact of one unit of public good (federal or national) provided in a region is larger than the impact of one unit provided in the other regions. Therefore, regions do have incentives to maximize the amount of public services received and this will motivate competition between regional governments.

If $\delta_j \neq \delta$ and $\beta_j \neq \beta$, the situation is even worse. Federal and National public services generate different externalities across regions in the federation as well as within the country. Again, the regional allocation of federal and national public services is more important for the regions than the aggregate provision. If there is a common tax -national or federal- some regions may receive larger net transfers (expenditure received minus taxes) than the others. Under this assumption, fixing common federal and national tax rates is rather complex. Regions have strong incentives to compete between them to receive the largest possible amount of national public services¹⁰ and they will play a non-cooperative game. The same happens at the federal level when regions compete to obtain the largest share of federal expenditure. The literature of Game Theory provides enough theoretical foundations regarding the suboptimality of the outcome that is obtained in this type of games.

Therefore, by relaxing a simple hypothesis in our model we provide a new framework in which having appropriate institutions becomes extremely important. In these institutions, regions (countries) should be able to deal with the conflicts that may arise between them when total decentralization occurs. If decisions on the regional distribution of national-federal public services, the taxes to be fixed and the design of the instruments to correct the externalities are not to be taken with the participation of all regions and all levels of governments, total decentralization will provide an inefficient outcome.¹¹

¹⁰ Regions do not compete in taxes and expenditure, which has some negative effects that are quite well known in the literature, but to maximize the resources that they receive from the National Government.

¹¹ One could argue that competition between regions would not arise if we assumed that the decision on the level of provision is not subject to political bargaining and that politicians in the federation, and the country, can implement their decisions with no difficulties. This is equivalent to assuming that Federal and National Governments act as social planners. However, we think that this is not realistic because this implies avoiding the role of politicians.

The type of mechanisms that will better guarantee the cooperation-coordination between governments is a totally different matter.

2.2 Total centralization and Partial decentralization

In this section we want to illustrate two alternative frameworks to that of total decentralization. In these frameworks political institutions become even more important. We just provide the main results that can be derived from this analysis.¹²

Total Centralization

The National Government provides all three different types of public services. Federal and regional public services are provided to the regions through a territorial administration. Let us assume also that regions have some bargaining power in the National Government.

Total Centralization introduces two different problems. First, the National Government does not take into account that federal-type services provided in the other countries generate an externality in the country.¹³ The result is that the federal public service is over-provided. The inefficient provision implies a higher income tax rate because of the extra resources needed to finance the over-provision. Dealing with this over-provision would require the implementation of some international agreements that guarantee the cooperation-coordination between National Governments. However, if these agreements are not properly designed (specifying the amount of services to be provided as well as fixing the contribution of each country), free-riding and non-cooperative behaviors may arise.

Second, the National Government finances the provision of all three public services fixing a unique national income tax. Therefore, regions only perceive the benefits of public expenditure in regional services, but not its costs. It is optimal for them to demand the largest possible amount of those services because the cost is shared between the other regions. If there are no pure national public services (e.g. if $\delta \neq 1$) the same result applies to national services.

Free riding and competition between different regions require the correct definition of institutional arrangements between them as well as the adequate representation of regions (now reduced to territorial administrative units) in the National Government/Parliament.

Partial Decentralization

This framework is the one that better adapts to Spain. Each level of government provides a different public service, but the National Government still accumulates the power to tax¹⁴. In this set up National Governments transfer resources to the Federal and Regional Governments, therefore intergovernmental transfers play a crucial role.¹⁵

¹² Analytical results are available upon request.

¹³ It does not take regions in the other countries into consideration.

¹⁴ In Spain some taxes have been ceded, but they represent a small share of total revenues. Sometimes, only the tax revenue collection is ceded, but not the legislative power on taxation.

¹⁵ Even that national Constitution in Spain introduces the possibility to establish some interregional transfers to correct for regional inequalities and inefficiencies derived from the process of decentralization, they have not been entirely developed yet. In fact, it seems that transfers from the center just try to provide enough resources for Regional Governments to finance the level of public expenditure that was previously provided by the Central Government. They do not accomplish much in the way of fiscal decentralization.

Most of the transfers have nothing to do with the internalization of spillovers benefits to other jurisdictions, the fiscal equalization across jurisdictions or the compensation for differences in costs regarding the provision of public goods, or to equalize fiscal capacities, etc.

We mention two main results only. On the one hand, if we assume that Regional Governments provide one single good only, the decision on the amount of regional expenditure depends on the amount of transfers that it receives from the National Government that is exogenous to the Regional Government.

On the other hand the Federal Government provides a federal public service, taking the transfers from National Governments and the taxes on national incomes as given. Although the amount of federal expenditure is exogenous to the Federal Government, when externalities are negligible, the regional allocation of public services matters to regions and they will compete to receive more resources. In this case, the Federal Government faces the problem of how to distribute public expenditure across regions.

Finally, the role of National Governments is much more complex. First, they have to decide the amount of national public services to be provided. Second, they have to fix the amount of transfers to the Regional Governments as well as their contribution to the Federal Government. Finally, they must choose the income tax rate.

It seems obvious that National Governments will have to fix some criteria on how to assign resources to the other levels of government: will they satisfy their demands? Will they estimate their necessities? Will some equity criteria be applied? Will it be the outcome of a process of political bargaining? Some criteria will have to be fixed in order to finance the provision of the federal public service also.

Within this framework, Federal and Regional Governments do not perceive the costs of their policies but their benefits. Therefore, their optimal policy is to maximize the transfers that they obtain from the National Government. Regional Governments (and National) have heterogeneous preferences on the amount of public services to be provided, while the cost of financing them is shared between all regions (countries). Beneficiaries push to overspend on their preferred services, while they wish to reduce spending on those services from which they do not internalize any benefit. Competition between all levels of governments, free-riding and individualistic behaviors arises.

Free-riding and competition affect all three levels of governments. Contrary to the situation of total centralization, in which there is a single unit of decision (National Governments), we now have three different units, which interact between themselves. This introduces considerable difficulties in the decision-making process. The size of such difficulties does depend on the specific design of the political institutions involved.

3 Cooperation-coordination Agreements

In the previous sections we tried to illustrate that when there are public services with different degrees of externalities, it might be more efficient to have different levels of government providing them, just like what the normative theory of Fiscal Federalism recommends. Nevertheless, we have seen also that this is not a sufficient condition, once political arguments are considered.

We tried to show the need, in a decentralized economy, to implement some kind of cooperation-coordination mechanisms between different levels of government. If such mechanisms do not exist, regardless of the level of decentralization, it is not very likely that there will be an efficient provision of public services due to free-riding, opportunistic behaviors and individualistic attitudes of the governments. However, the type of mechanisms that will better guarantee the coexistence of different levels of government and the efficient provision of public services is a totally different matter.

The literature of Fiscal Federalism distinguishes several patterns of institutional agreements of cooperation-coordination between different levels of government. On the one hand, they can be achieved and legitimated in a Chamber of Territorial Representation with the participation of all regions. This regime corresponds to a federal structure, in which this Chamber has some control also on those decisions taken in the House of Deputies that might have an impact on the regions. This pattern would reduce discretionality from the Central Government and also the individualistic attitudes of some Regional Governments. Besides, the agreements would not be subject to the representation of regional parties in the House of Deputies exclusively. Therefore, this model seems to provide more political stability.

It is not our goal going deep in the analysis of the mechanisms that best guarantee the participation of regions in the federal institutions. There are as many possibilities as federal countries although we can gather them in two groups mainly depending on whether regional governments or regionally elected members are those who participate in the central legislative.

On the other hand, the agreements could be achieved on a basis of bilateral or multilateral contacts among Regional and Central Executives. Any bilateral agreement may or may not be then implemented simultaneously in the other regions. However, under this mechanism the agreements are subject to bilateral political bargaining and thus depend on the political cycle. Regional differences in political bargaining powers, basically related to the representation of region-wide parties in the Central Parliament, introduce a significant level of discretionality between regions. These discretionalitys can be quite important and can originate conflicts between regions as well as a certain number of inefficiencies we already mentioned in the introduction. This situation clearly favors the Central Government and those Regional Governments that have a significant bargaining power. Powerful regions will behave opportunistically and will play a non-cooperative game due to the benefits of free-riding.

In Spain, it seems as though that the second model has been preferred. The outcome has been that the agreements are subject to bilateral political bargaining. Formally, there is a Chamber of Territorial Representation, although the effective participation of regions in the legislative is very negligible. This regime might explain the delay in transferring tax powers and in implementing adequate instruments to correct for the inefficiencies or/and inequities of the current model.

Another relevant point is which are the elements that explain why regions and central authorities in Spain have not committed to the reform of this inefficient system of partial decentralization yet. In the next section we will try to provide an answer to this question. We suggest that a reform of the institutions that guarantee the participation of regions should be achieved. We do not mean that by increasing the participation of regional governments all non-cooperative and individualistic behaviors would be eliminate, but it would help reducing many inefficiencies of the current regimes.

4 Political Framework in Spain.

Given the distortions that we described in a model of partial decentralization, we ask ourselves which are the factors, in Spain, that explain the delay in transferring tax powers, in implementing adequate instruments¹⁶ to correct for inefficiencies or/and inequities and in committing to the reform of the institutions of territorial representation. One could argue that this delay is due to the technical difficulties to design an adequate regime that can avoid fiscal exports, fiscal competition between regions and that satisfies the principle of horizontal equity simultaneously. However, these arguments are unsatisfactory to us because they neglect the political-economy analysis.

The Political Economy approach suggests that the design of appropriate mechanisms of coordination-cooperation between governments and the implementation of institutional agreements that guarantee the effective representation of regions in the Central Legislative would allow to reduce the negative effects of partial decentralization. Although in Spain there exist institutional agreements between Regional and Central Executives, the attempts made to reform the role of the Senate have not succeeded yet.

In this section we rise the question which elements have determined the design of the current political institutions in Spain. It is obvious that decentralization is the outcome of a bargaining process between politicians and bureaucrats at different levels of government. Observing the characteristics of the political framework before decentralization might be crucial to understand the development of the process.

¹⁶ A wide array of instruments have been analyzed in the literature, but Governments in Spain have been reluctant to develop them, although they are mentioned in the Constitution.

In the following pages we present the essential political elements that may provide a better explanation to the particular model in Spain. Most of them have to do with constitutional arrangements regarding the political representation of Regional Governments in the Central Legislative, the territorial organization in both countries, the regulation concerning the political parties and the role of policy-makers and bureaucrats. Our goal is to analyze the political characteristics of the Spanish model that have determined the present regime. We must stress that we will focus our analysis on those elements that may have an impact on economics decisions. We do not intend to make an analysis from a Political Science approach, this is beyond the scope of this paper.

4.1 Constitutional Arrangements of Territorial Representation.

Spain has a bicameral structure. The Parliament has a Lower Chamber (House of Deputies) and a Senate, which is the Chamber of Territorial Representation. From a formal point of view, regions do have a representation in the Senate and they participate in the decision-making process because the Senate is assumed to have some control on the legislative process. However, there are several factors that allow us to provide a more accurate vision of the effective role of the Senate.

First, the Senate has a very limited power to control the Executive and the Lower Chamber. The legal procedure for passing any act or law establishes that, in case of disagreement between the two chambers, the final decision of the Lower Chamber always prevails.

Second, the constituency is not the region itself but the province, which is the administrative division in which Spain was organized before the new constitution was established. Seats in the Senate are distributed across regions based on provinces, based on a number of seats for each province and a variable number, which depends on their population size. The result of this distribution is that regions with low population and many provinces are over-represented while those with few provinces and high populations are under-represented. Seats in the Lower Chamber are distributed based on the number of provinces and the population as well. This structure produces a similar party composition in both Chambers. Another aspect of the organization of electoral districts in provinces is that it strengthens the position of those parties with nation-wide representation, which tend to be more pro-centralist.

Third, the Spanish Constitution confers the initiative in the process of decentralization to the Central Legislative and Executive. This implies that Central Authorities control the timing of the process. Regions participate and motivate the regional debate in the Legislative depending on the bargaining power of their regional political parties in the House of Deputies.¹⁷ The current regime is based on bilateral agreements between central and regional executives. It is not likely that they are to be implemented in the other regions.¹⁸

4.2 Territorial Organization.

We should underline several aspects of the territorial organization in Spain that have clearly determined the current regime.

Complexity. There are four different tiers of government (central, regional, provincial and municipal). All of them hold some responsibilities on public expenditure. These responsibilities are not exclusive to a single level of government and they overlap very often. Given the lack of cooperation-coordination agreements the main consequence is the inefficient provision of public goods and services.

Heterogeneity and Fragmentation. There are significant differences between regions.

¹⁷ This debate occurs also when regional leaders have bargaining power within the structure of the ruling party, which has not occurred very often.

¹⁸ Although the system of intergovernmental transfers is now basically related to some regional macroeconomic variables, the total amount of transfers that regions will receive is still subject to political bargaining between the Central and the Regional Governments.

We must distinguish two main groups of regions. In the first group there are two regions that hold a special status that allows them a faster access to higher levels of powers and attributes them fiscal autonomy.

In the second group we find the regions that hold a regular status. All of them, in the long run, will receive the same responsibilities and will have the same sources of revenues. However, up to date, there are significant differences among them. This motivates regions be treated individually, emphasizing their differences and fostering individualistic attitudes. In this framework, achieving a consensus on decisions that might have asymmetric regional effects is quite difficult.

From an economic point of view it is hard to explain why there are so many regions (17 and two Autonomous Cities) and why there are so many discretionarities. It seems that the level of population, the size of the territory or even historical arguments, cannot explain how regions were created. Although most of the theories related to the creation of new jurisdictional units assume that regions are created on an economic basis, the present territorial division in Spain is largely culturally and politically determined.

Inequalities. Another characteristic of this fragmentation is that regional disparities in income levels are very high. Equity considerations have clearly prevailed in the process of decentralization. However, even that the principle of regional solidarity is so relevant, the present mechanism that determines the financial resources to the regions is not based on any equity criteria that are explicitly developed in the Constitution. In Spain social welfare is guaranteed on a individual basis, rather than regional. Intergovernmental Transfers are not recognized explicitly in the Constitution.

In this framework, it is very difficult to propose any reform that might introduce more efficiency in the model, especially if this may reduce resources available or may diminish the previous levels of expenditure in the poorer regions.

Political Competition. Given the protagonism of bilateral agreements between Regional and Central Governments, many regions have benefited from bilateral agreements reached by the most demanding regions. This has motivated that regions compete to maximize the amount of responsibilities and transfers that they receive from the Central Government. They have received many responsibilities regardless of their capability to manage them and the availability of resources. In some regions, the absence of previous Central Government activity, through the peripheral administration, has made difficult for them to have an efficient bureaucratic organization. Regional Governments argue that their inefficiency is due to the lack of resources and they demand more transfers.

4.3 Political parties.

The third element of this particular political framework in Spain is related to the role of political parties.

Central Majoritarianism. Although the system is formally proportional, we have argued that the electoral system yields a structure that is majoritarian because the electoral regime favors large nation-wide parties due to the fact that constituencies are based on provinces. There are a few regional parties with representation in the Central Legislative and their bargaining power changes over time depending on the number of representatives.

Partisan Hierarchy. Parties in Spain are characterized by the fact that electoral lists are closed and fixed. This gives excessive power to incumbent politicians and to party leaders. Nation-wide parties distribute their candidates across provinces strategically, in order to maximize the number of votes in the provinces.

Moreover, elected party members are usually subject to party discipline. In these parties a centralized conception of the country dominates and regional interests are subject to general interest. Regional party leaders are subject to party discipline also.

Last, but not least, we must stress that decentralization is a relevant topic during elections. Nation-wide parties give more or less relevance to the issue of decentralization depending on the regions and on whether the elections are general or regional. The outcome of the different electoral processes is quite interesting

because it is not rare to observe that voters reveal different party preferences in national and regional elections.

In Spain regional and central elections do not occur simultaneously. This has two effects. First, rivalry between regions increases, even if members of the same party govern them. Second, confrontation between the central and regional governments also increases if different parties lead them.

4.4 Bureaucrats and policy-makers.

The New Political Economy approach has retrieved the role of bureaucrats and policy-makers in economic models, originally introduced by the school of Public Choice during the 70's. Their argument is that policy-makers and bureaucrats are not considered as agents who act to maximize social welfare. Their decisions might be taken according to particular interests instead: maximizing the budget, reelection, social power, etc.

However, this argument somehow assumes that public officials and politicians are not accountable for their decisions. The assumption that voters cannot strictly control politicians may sound confusing in democratic regimes, but as Persson and Tabellini (1999) point out: "Politicians cannot commit to verifiable state contingent electoral promises (...) the reason why different constitutions produce systematically different policy choices is that they imply different allocations of control rights to politicians and voters".

We introduce this section because the Spanish regime favors the bilateral negotiation between Regional and Central Governments, which emphasizes the role of politicians and bureaucrats in the process.

At the Central level, we distinguish two types of agents. On the one hand, we must consider policy-makers. The simultaneous process of Europeanization-Decentralization-Privatization reduces the amount of public resources under their control and this diminishes their social power. Although public expenditure has been widely decentralized, central policy-makers still control one of the most powerful instruments to influence society: taxes. If tax decentralization occurred and if there were a Senate with legislative power to effectively participate in the legislative process and to control the Central Executive, the influence of central policy-makers on society would be significantly reduced. Moreover, by emphasizing the role of the Senate the Central Executive may have to face two types of political opposition: that of the other parties and that of the regions.

On the other hand, we mention the role of bureaucrats. Again, this simultaneous process affects significantly the size of the budgets under their control that may limit their expectations of promotion in the Administration. Besides, the fragmentation of a Central Government in regional units may provoke that some public employees might have to move to other regions; they could be forced to learn another language if they want to remain in the current region; they might have to change their current positions in the Administration and some might lose their jobs. If decentralization implied transfers of public employees to regional governments, it is not clear that Regional Governments would be willing to employ them without changes in their current status. In fact, in Spain Regional Governments have used public employment as a instrument of redistribution.

These arguments are extendable also to politicians and bureaucrats in the Regional Governments-Parliaments. They may also be willing to maximize their social status by increasing the budgets under their control. This has motivated an increase in the demands of new responsibilities, regardless of their capability to manage them, and has caused the expansion of public expenditure consequently.

Another consequence of this situation is that responsibilities on public expenditure between different levels of governments overlap very often. This allows us to introduce the lack of accountability that characterizes the current regime. The fact that the trade-off taxes-expenditures does not exist and that voters are confused regarding over which level of government is in charge of providing which resources, motivates the absence of political control to the governments. Politicians at all levels of governments can take advantage of this lack of accountability.

5 Conclusions

The normative theory of Fiscal Federalism provides many prescriptions that should be considered in order to achieve the efficient provision of public goods and services in any federal economy. This literature also provides many insights regarding all types of instruments that could be implemented in order to correct those equity problems that may arise in those regimes.

It seems reasonable that most of the normative prescriptions should be taken into consideration in any process of decentralization in which a central authority transfers some powers to the lower levels of government. However, using a simple static model, in which we assume that there are three types of public goods with different degrees of externalities, we show that the normative recommendation of total decentralization (each level of government is providing a unique public good) is not a sufficient condition to guarantee the efficient provision of public goods. We argue that the implementation of mechanisms of cooperation-coordination between regional governments and the central government and the design of political institutions that guarantee that regions participate in the process of decentralization play a crucial role in reducing such distortions. Inefficiencies are due to the non-cooperative behaviors of regional governments and to the competition that arises between all levels of government. The role of these institutions is especially relevant in a regime of partial decentralization because distortions are larger than in a totally decentralized regime.

We then analyze the process of decentralization in Spain. Although many of the normative propositions have been implemented in Spain already, we argue that the process of decentralization in Spain presents several characteristics that introduce many distortions in the economy. First, the provision of public goods, at all levels of government, is very inefficient and it has been increasing disproportionately. Second, there is a systematic confrontation between the Central and Regional Governments, which blocks any further reform of the present model and fosters the persistence of inefficiencies. Third, Regional Governments compete to maximize their share of total transfers, which leads to individualistic and noncooperative behaviors. Fourth, there is a significant lack of accountability. Finally, the uniformity in the provision of public services and personal transfers that guarantee the principle of horizontal equity, limits the mobility of factors of production and reduces the positive effects of fiscal competition between Regional Governments.

We provide two arguments to justify such inefficiencies of the Spanish regime. First, the lack of automatic mechanisms to assign financial public resources across regions, which are still subject to bilateral political bargaining. That is, the non specification of the principle of regional solidarity. Second, the absence of constitutional arrangements that allow regions to be represented in the national Legislative, as well as to have some kind of control on the Central Executive.

Finally we tried to identify the characteristics of the political regime in Spain that could explain the delay in introducing those institutions that guarantee the participation of regional governments in the decentralization process. In short, we could say that the main obstacle to introducing those institutions is that all the process has been designed from the central authorities and that regional authorities have had a negligible participation. More specifically, they have to do with the political representation of Regional Governments, the territorial organization of the country, the regulation concerning the political parties and the role of policy-makers and bureaucrats. We argue that the political framework before decentralization clearly determines the final development of the process.

Federal economies are facing the discussion on how to improve the regional representation in the central institutions as well as how to improve the control of those institutions on the Regional Governments. However, in economies such as Spain, this debate is still at a very early stage of development. We do not mean that introducing the institutions in which regions were represented would solve all of those problems, but it would reduce many of the inefficiencies. More important, it would establish a new political framework in which further reforms could be achieved at lower social and economic costs.

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