



Subnational Tax Competition to Fight High Taxation

Juan Pina's speech at the Europe Liberty Forum,
Athens, May 9th, 2019

Good morning, kaliméra everyone.

I'm going to talk about the largest project conducted by the Foundation for the Advancement of Liberty, or Fundalib in Spain. It is not just a project that we are proud of, but more importantly, we believe it is really necessary in any large country, and especially in a country with the territorial tensions that you all know Spain has.

We could say that the mission or the final goal of the project is to defend, preserve and enhance domestic tax competition among the country's regions. By doing so, we obviously push for more devolution to the subnational governments, a more federal and less centralized Spain.

The magic tool for this is our annual Regional Tax Competitiveness Index, which is inspired in the U.S. Tax Foundation's equivalent work. It was thanks to an Atlas Network grant that we could accomplish the first edition, and thanks to the Tax Foundation we completed our resources for the second one and we are working on the third edition. We are grateful to these two great institutions which are engines for economic freedom. At the same time, by publishing the Index we also provide visibility for the Taxpayers Union, which is one of the grassroots associations that we foster and support.

Those of you who know more than one or two places in Spain will probably single out one specific feature: diversity. Diversity of languages, cultures, mentalities, levels of development and, yes, diversity in the feelings of national attachment or detachment.

As many scholars have pointed out, Spain needs to be federal in order to even be. Even if we don't call the system "federal", even if we invented another name for it back in the seventies, the name "autonomic", what we have is a sort of federalism.

But, because we didn't dare to implement a real, full-fledged federal system back then (during those difficult years just after the dictatorship was over) what we built was something in the middle: rather centralized in some matters, quite decentralized for some others, and often duplicating services and expenditure through parallel levels of government acting at the same time on the same citizens.

While the official name of our system is "autonomic", we informally call it "coffee for all". Let me tell you why. Back in the seventies, when the democratic constitution was being drafted, it was crystal clear that a strongly devolved government was to be given to at least two regions, Catalonia and the Basque Country, and possibly to Galicia. It was a time of creative pragmatism, so, in order to ease tensions with

the military and the far right, a minister came with the idea to mask that devolution by giving “autonomy” to all other regions as well. And he said about the devolution claims by some regions, “OK, do they want coffee? Then coffee for all”.

But of course, the amount of coffee was a bit larger for the said regions than for all of the others. In any case, most of this federalism was curtailed through an organic law a few years later. So “coffee for all” soon became “chicory for all”, not real coffee but a rather limited amount of autonomy. And furthermore, over the next forty years until now, each of our seventeen “autonomous” regions has evolved towards less or more autonomy for some matters or for some others, so all in all, what we have now is seventeen different situations.

Well, at the beginning of our democracy that system was OK. It helped us navigate through our transition. It bought everyone time. But forty years later, and with mounting tensions as you have seen in the recent years, the system is rather exhausted.

Now, some classic liberals will tell you that the solution is to dismantle devolution and recentralize everything under Madrid’s command and control. I am from Madrid, but I beg to disagree. I think the classic liberal and certainly the libertarian solution is to finally go for the real federalism which is still pending. Deeper devolution may prove more efficient to keep Spain together in the long run, while attempting to recentralize the country will certainly increase tensions and eventually fracture the country.

The fiscal consequence of this “autonomic” system has been a high amount of complexity. Our coffee for all has become rather personalized in several matters, including taxation.

There are only two out of the seventeen regions which have a tax agreement with the central government. They can collect their own taxes and then pay Madrid a certain amount which is negotiated every year. Anyway, their autonomy to increase or decrease most of the main taxes is still very limited. These two regions are the Basque Country and Navarre. Catalonia, where the autonomy and even independence sentiment is quite strong as you know, has never been granted a similar agreement and this is probably one of the reasons for the recent surge of the independence movement.

All regions have the responsibility to spend most of the money, because they are in charge of expensive services like health care and education, but they are not responsible for deciding how much to charge, or through which taxes, or how to divide the burden among types of taxpayers. This creates a lot of tensions, especially when a region is governed by one party but a different one is in office at the national level, and then the latter has the power to open more or less the tap of taxpayer money, giving more money or less money to that particular region.

This whole system has led to fiscal irresponsibility and to many regions feeling wronged. While most of the main taxes are the same everywhere, the regional tax authorities do have some limited autonomy to increase or decrease parts of some of the main taxes, as well as some secondary taxes in full. And this is an embryo for the truly federal taxation system that we should have.

How limited was the inter-regional tax competition, which was the gap between the best and worst performing regions, where was it best or worst to pay taxes? Nobody knew until we came in in 2017 and we published the first edition of this “Autonomic” Tax Competitiveness Index, under the able leadership of our colleague and head of research Cristina Berechet. It was very needed. It showed a few things. First of all, it showed that a rather hidden but real tax competition did exist in Spain. It showed that the

difference between the best and the worst tax jurisdictions amounted for around 24%. But 24% on the regionally levied taxes only, so all in all the difference is still not so large.

Even so, the media were frantic about this index, so we achieved a second goal: making people discuss taxation in a country that doesn't. And making them do the math and realize that the less taxed regions happen to be more developed and better off. What a coincidence. That first edition was one of the finalists to the Liberty Award Europe granted by the Atlas Network. It also motivated the U.S. Tax Foundation to join forces with us, and we are very grateful to Scott Hodge and Daniel Bunn here for their continued support. And the biggest achievement, especially for a first edition, was that we induced two immediate policy changes and we paved the way for a third one later in the year.

The second edition was presented last December and it sky-rocketed in terms of media attention. Just as an example of this, the value of the media coverage obtained had been 45,000 euros in 2017 and it quadrupled to 179,000 in 2018. Three regional presidents reacted to the index. One regional tax minister called for a specific press conference to evaluate their performance in our index, etcetera.

In these first four months after the launching of the second edition of our index, we have already recorded ten policy changes in line with our index conclusions, compared to three reforms after the previous edition. Now, there are impending elections to most regional parliaments and the electoral campaign starts tonight at midnight. It will be interesting to see how the various candidates discuss regional taxation, and it will be important to follow developments along the rest of the year.

All in all, I think we are making progress:

- First, because we effectively point out the most damaging regional taxes and we succeed to induce tax reform.
- Second, because we prove that internal tax competition is beneficial, because it creates a strong incentive for politicians to redress their high-taxation dreams and to compete instead by raising less taxes than their neighbours. All in all, the average tax is kept lower than it would be in a centralized system.
- And finally, by showing the inefficiencies in the "autonomic" system we push for a truly federal one where the more developed regions will stop being deprived of a lot of resources every year, and the poorer ones will stop wanting to receive and will start wanting to compete. We show that forty years of state-planned territorial redistribution of wealth has not worked, and what the poorer regions need is to have the power to choose better fiscal policies and increase their tax competitiveness.

I hope that for once in our history we can lead the way in Europe, we can show other countries that federalism, and especially economic federalism, is positive. As Hayek explained, government does not have all the information to take the right decisions. So let's not fall for the "fatal conceit" that a centralized government far away is better than many smaller ones taking different decisions. Some will fail and some will succeed, but the average will be better, and the ones failing will certainly emulate their neighbours and follow the best policies. We classic liberals and libertarians believe that competition brings about excellence, and territorial competition through devolution certainly does.

Thank-you very much.