Finance Committee

28th Meeting, 2015 (Session 4), Wednesday 11 November 2015

Basque Country visit: 26-27 October 2015

1. This report summarises the key findings from a recent fact finding visit to the Basque Country. We express our sincere thanks to the people we met and in particular to Ainara Jauregi Rekondo for organising the visit.

Basque Country – Summary

2. The Spanish Basque Country[1] has a population of 2.2m and 3 territories or regions within it: Bizkaia, Gipuzkoa and Araba. It is a prosperous part of Spain, comprising 6.07% of Spanish GDP with only 4.66% of the Spanish population.

3. The Basque Country is unique in that it has a distinctive cultural and historical context which largely explains the strength of autonomy it currently holds within Spain.

4. Almost all taxes are collected at the local (or regional) level, with funding then sent from the regional government to the Basque and Spanish Government. In that sense it is the reverse of the traditional UK model, whereby taxes are largely administered at the UK level and then passed in grant to the Scottish Government, who then distribute grants to the local authority level[2].

5. The Basque Country operates with significant fiscal and economic autonomy, paying the Spanish state for "reserved" services like foreign affairs, defence and armed forces, the monarchy, customs and general transport and contributing to the Spain-wide social security "pot". Social Security is one area that the Basques do not control, with that area of policy largely controlled from Madrid.

6. The amount the Basque Country contributes to the Spanish state is known as the "Quota" or "Cupo." Since 1981 it has been set at 6.24% of Spanish State expenditure in areas not devolved to the Basque Country.

7. Of the Budget spent by different levels of Government in the Basque Country, 70% is spent by the Basque Government, 15% is spent by the 3 territories or regional provinces, with the remaining 15% spent by the Foral authorities (or Towns).

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[1] There are 7 parts of what historically constitutes the Basque country: 3 spanish territories; 3 French territories and Navarre which is an autonomous community in Spain.

[2] Interestingly, it is also opposite to the UK in terms of electoral turnouts, which tend to be higher at local elections than in national elections.

The Economic Agreement

8. The Economic Agreement regulates the financial and tax relations between the Spanish state and the Basque County. It derives from a historical power held in the Basque Territories to regulate, manage and collect taxes. As such the Basque Country has a history of a specific Basque tax system with its own Treasury and tax collection infrastructure.

9. Although taxes are collected at the regional level there are differences in administrative arrangements. For example, rules on co-ordination, harmonisation and collaboration for Basque taxes are decided in the Basque Parliament. Taxes administered within the Basque Country are as follows:

- Income tax
- Corporation tax
- Wealth tax
- Inheritance and Gift tax
- Capital Transfer tax and Stamp Duty
- Gaming fees
- Local Inland Revenue
- Property tax
- Business activity tax
- Motor Vehicle tax
- Other local taxes

10. Taxes which are administered by the Spanish state are as follows:

- Income tax for non-residents
- Tax on deposits in Credit Institutions
- Excise Duties
- Tax on Gaming Activities
- Tax on value of electricity generation
- Tax on production of nuclear fuel generation
- Tax on storing nuclear fuel and radioactive waste
- Value Added tax
- Tax on insurance premiums
- Special Manufacturing tax
- Coal tax
- Tax on Flourinated Greenhouse gases

11. Nearly all taxes, whether direct or indirect are collected by the provincial councils in their own territories.

12. The Basque Country does have borrowing powers but these are restricted largely by a requirement to comply with EU borrowing treaties and the Spanish macro-economic framework, which has quite severe borrowing restrictions since the financial crash. Prior to the crash the only borrowing limit was set by the Basque Parliament.

13. As mentioned in the summary above, the Basque Country pays the **Quota** (Cupo) to the Spanish central government. Since 1981 it has remain unchanged at 6.24% of Spanish State expenditure in areas not devolved to the Basque Country. As such, the Quota is related to Spanish state spending rather than Basque spending. The terms of the Quota can be renewed every 5 years, but the last updated Economic Agreement was signed in 2007. As the parties have not reached an agreement over a new five-year Economic Agreement law, the method to calculate the Quota will continue in place until a new agreement is reached.

14. There was a general feeling that the **arbitration processes** in place worked quite well. There are three institutions in place to settle any possible disputes around the terms of the Economic Agreement. Because the Economic Agreement is bilateral, the inter-governmental machinery provides equal weighting to the Basque and Spanish representatives. The bilateral relationship was considered a key element of the Economic Agreement.

a) **The Economic Agreement Joint Committee** is made up of 12 members: 6 from the Spanish state and 6 from the Basque Country (3 from Basque Government and 3 from the provincial territories). This is the most “political” of the 3 main inter-governmental bodies summarised here. Its most important functions are to agree any amendments to the Economic Agreement; co-ordination and co-operation commitments regarding budgetary stability; and the methodology to calculate the Quota.
Its resolutions must be adopted unanimously.

b) **The Legislative Assessment and Co-ordination Committee** is made up of 8 members (4 from Spanish Government; 4 from Basque Country (one from Basque Government and one from each of 3 territories) and has a key role in assessing the practical application of the Economic Agreement. For example, it is responsible for assessing tax legislation prior to enactment; resolving enquiries; issuing reports; analysing issues raised.

c) **The Arbitration Board** is made up of 3 members who are appointed jointly by Spanish and Basque Inland Revenue ministries (the appointment must be mutually agreed) and who must have over 15 years of professional tax experience. The function of the Arbitration board is to resolve any disputes over the interpretation and application of the Economic Agreement. Appointments are for a single 6-year term. Disputes presented to the Arbitration Board are usually technical in nature and relate to tax locations and domicile – for example, where should VAT, Corporate tax be paid and how should that be divided up?

15. When questioned on how these bodies operate in practise, people we met said they functioned well. Information sharing was deemed transparent, and relations between relevant officials were cordial.

Lessons for Scotland and UK in agreeing a Fiscal Framework

16. It is clear from the above summary, that there are quite major differences between the fiscal relationships of the Basque and Spanish governments when compared with the Scottish and UK governments. However, we feel there are lessons that can be drawn for the fiscal framework between Scotland and the UK.

17. Nearly all the politicians and officials we met were strongly supportive of the Economic Agreement. It was seen as an effective mechanism for governing, which has allowed the Basque Country to develop a successful and distinctive economic and industrial policy. There was agreement around the strong causal link between the Economic Agreement and the positive economic and social indicators evident in the Basque Country. For example, on GDP per capita, productivity, employment, Research and Development spend, inequality and Higher Education participation, the Basque Country significantly outperforms Spain as a whole. A key message was that Scotland's tax powers must be for a "purpose" and usable.

18. We met politicians from across the political spectrum. It was striking, that although they had disagreements around policy choices and the constitution, all agreed that the Economic Agreement was useful in allowing for a distinctive Basque approach to managing the economy for local needs. As such, it is possible for a common "team Basque" approach to be taken into the bilateral negotiations with the Spanish state. A key message was that a "team Scotland" approach to negotiations with the UK state is achievable.

19. As mentioned, the bilateral relationship based on a partnership of equals was seen as key as illustrated by the requirement for unanimity in agreeing any changes to the economic agreement. While Madrid in theory, like the UK Government, constitutionally holds the upper hand, the Basques have significant bargaining power in that they collect taxes and "have the money in their pocket". As such disagreements over the size of the Quota tend to end in stalemate because the Basques can simply refuse to hand over money. As such, even though the Quota can be changed every 5-years, changes to the level of the quota have not taken

place since 1981. A key message was that the bilateral relationship must be one of equals.

20. Given the Finance Committees interest in behavioural responses to variances in income tax, we asked whether there was much labour mobility between different parts of Spain. We were told that despite the Basque Country having higher personal income taxes than the rest of Spain, this wasn't really much of an issue. This is a practical case for Committee to draw on which suggests that differences in income tax rates do not lead, in and of itself, to any significant labour mobility. Other factors around quality of workforce, infrastructure and R&D investment were seen as far more critical.

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