# Where Does Financial Responsibility Lie? Emerging Paradigms From A Comparison Between Germany And Spain

## Abstract

Financial responsibility traces the academic and political debate of any decentralising process. This is even more so in the European context, in which taxes – exclusively set and regulated by the subnational legislator – play a marginal role in subnational financing, though in theory they are the most genuine instrument for making SNGs pay for their decisions. Against this framework, this contribution delves into a selection of case studies (i.e., Germany and Spain) testing the principle of financial responsibility from a comparative and legal perspective. The basic assumption is that the way in which the vertical fiscal gap is addressed influences the degree of financial autonomy (and hence responsibility) of subnational entities. As such, the major issue at stake is the revenue structure of the subnational level of government, with regard to the legal tools and procedures devoted to revenue-sharing, as these elements play a key-role in defining the extent to which SNGs are made financially and politically responsible for their financing.

# Introduction and Background Theories

Financial responsibility is at the heart of any decentralising process. This is even more so in the European context, where it is frequently at the center of the debate in the reforming processes under discussion or implementation. Making subnational governments (SNGs) responsible for the decisions they take in financial-related matters is a precondition for efficiency (Boadway and Shah, 2009, pp. 29-60) and activating democratic control. At the same time, taxes – exclusively set and regulated by the subnational legislator – tend to play a marginal role in subnational financing, though in theory they are the most genuine instrument for making SNGs pay for their decisions.

This trend is theorised in the second-generation studies on fiscal federalism, which develop a flexible approach to fiscal equivalence, i.e., '*fiscal responsibility at the margin*'. The concept advocates for at least a partial responsibility of subnational entities on the revenue side (Bird 2009: 453), built on the the idea that entities entrusted with powers for their financing tend to be politically more responsible to their citizens.

# Embedding Financial Responsibility in the Constitutional Dimension

This framework discloses in the legal discourse the importance to investigate financial constitutions under the lens of these revised theories and compare the legal tools and the decision-making procedures of revenue distribution across and within the different levels of government.[1] While ensuring the coverage of spending needs, they circumscribe the extent to which SNGs have been made responsible for their financing.

The basic assumption is that SNGs should be vested with powers not only on the spending, but also on the revenue side, at least at the margin. This is essential to political autonomy, which cannot be conceived without an appropriate balance between the two dimensions. Financial autonomy is both an instrumental and essential component of political autonomy (Korioth, 1997; Ruiz Almendral, 2004, pp. 99-101): activating democratic control serves as a tool to strengthen political autonomy itself. The significance of linking the two sides of autonomy comes to the fore if one considers the essential role played by the democratic principle in financial matters.

In this respect the assignment to SNGs of a margin of discretion to affect their financial endowment is crucial. Having this in mind, the legislative competence to tax is the typical vehicle for making subnational entities bear the economic and political costs of the decisions they adopt. The legislative power is the most accurate indicator of political autonomy and as financial autonomy is a major component of the latter, law-making becomes a critical factor also in terms of financial responsibility (Vandelli, 2011, p. 25). Otherwise, the existence and the sufficiency of resources would depend on the discretion of another authority: the central one.

Furthermore, this kind of power is of relevance only if associated with taxes whose revenue flows wholly or partially to the SNGs themselves. This strengthens the connection between decision-making and resources and contributes to making a leap forward in terms of financial and political responsibility.

At the same time, if it were for the exclusive power of SNGs to impose and regulate their own taxes (i.e, with full authority), financial responsibility would hardly be found in practice. However, this is a too minimalistic approach and appears inappropriate for addressing the phenomenon. Although a few recurrent patterns do emerge, federal systems adopt in this respect differentiated solutions to foster responsibility whose impact on the system change dramatically from one case to the next. Germany and Spain are interesting cases in this respect. While in both systems the center holds a predominant role in the tax field, financial responsibility is eventually ensured through two legal solutions with highly differentiated characteristics.

# Subnational Responsibilities in Tax Law-making: The Cases of Germany and Spain

In Germany, the legal solution consists in assigning a co-legislative role in tax matters to the *Länder*, via the *Bundesrat* (Kloepfer, 2011, par. 13). Even though the latter is a federal organ, its composition and functioning guarantee the representation of the *Länder* executives. The decision-making power lies at the center, but the legal act is the outcome of a legislative process that calls for the double approval of the same text. Federal laws relating to taxes – i.e., all material tax laws, including acts which amend or repeal a previous law – require the consent of the *Bundesrat*, if the revenue thereof accrues wholly or partially to the *Länder* (art. 105.3 BL). The scope of the provision is broad: most taxes fall under this rule, as there are few exclusive federal taxes. Therefore, any alteration of the *Länder* financial endowment cannot be decided solely by the federal level via the *Bundestag* but needs an express vote of (the community of) the *Länder* via the *Bundesrat*.
In contrast, the Spanish Autonomous Communities (ACs) have been assigned significant legislative competences on well-determined elements of the so-called 'ceded taxes'. Important tax-sources are included, though differences are likely to be found in the scope of the transferred powers. In some cases (e.g., taxes on gambling, on inheritance and gifts) the transfer of authority concerns the design of essential elements (e.g., tax base) and the power is somehow comparable to an exclusive competence (except from the power to impose the tax that belongs to the center). Competences are restricted (limited tax-rate varying power) in other cases (e.g, tax on means of transport and hydrocarbons). Even the mere transfer of the tax-rate varying power is important. Not only is the latter one of the most visible tax elements, but the assignment of legislative competences always goes along with the entitlement to a quota of the related revenue. As such, through law-making ACs co-determine their resources. To understand the impact on responsibility, the role of the single tax (and the receipts thereof) on the entire tax-system is also of relevance. Emblematic is the individual income tax: it is one of the pillars of the system, ACs have extensive legislative powers on it and 50% of its revenue accrues to them.
Responsibility in the Spanish case rests on a complex legal framework that is the result of a 'concurrent' power, which combines legal acts of the central and the subnational government (Ramos Prieto, 2012, p. 305). This occurs based on the allocation of competences set forth in the national law[2].The decision to levy a tax remains at the center and it is always a national act that provides for the transfer of revenue and eventually of certain legislative powers. ACs have – if any – a merely consultative role via the Fiscal and Financial Policy Council.

# What Does this Entail for Financial Responsibility?

The two solutions have little in common, only two elements co-exist. First, the decision to levy a tax happens through a legal act of the center. If SNGs had the full authority over the tax, the latter should be classified as 'own tax'. Second, the legal framework thereof is the outcome of a meeting of wills, as it is the combination of decisions involving the national and subnational level.
Besides these common traits, the comparison reveals wide discrepancies that impact on the extent SNGs are made responsible 'in action'. For a better understanding, a distinction between the substantial and the procedural dimension is needed.
The first approach considers the object of the law-making process, i.e., 'what is decided', and examines the kind of powers assigned to SNGs. The aim is to discern who decides whether to impose a tax, how to structure it and, finally, who quantifies the tax burden. The powers transferred to the Spanish ACs comprise mostly the determination of the tax burden and, partially, the tax structure. However, the decision to levy the tax remains exclusively at the center. In contrast, the German *Länder* through the *Bundesrat* approve almost every tax law. Although the act is federal in nature, SNGs have the competence to co-design all tax elements, including the power to levy it. Therefore, the *Länder* influence the entire tax

regime and, in so doing, co-determine *ab origine* their financial endowment. Conversely, the ACs only have a say *ex post,* i.e., after the center makes use of its exclusive power to levy a tax and only if it opts to activate the transfer of legislative powers over the potentially transferable taxes[3].
Even greater discrepancies appear when the legal tools are scrutinised observing the procedural dimension, namely 'how decisions are made'. Only the Spanish option guarantees effective autonomy to the SNGs. Solely the ACs are autonomous in determining their resources through laws enacted by their legislatures, valid and enforceable exclusively within their territory. Conversely, the consent of the *Bundesrat* does not uphold the autonomy of the single *Land*, but it provides for a form of representation of territorial interests on a collective dimension. The *Länder* participate as a whole and single units are integrated in the federal legal order (Palermo and Woelk, 1999, p. 1103). Although in tax matters the *Bundesrat* has a power equal to the *Bundestag*, the autonomy of each entity is limited. First, the working rule is the majority principle and the votes of the single entity are based on a weighted formula of territorial representation. Second, the body does not exclusively channel territorial interests, but integrates multi-faceted interests also of a political nature, combining federal with regional claims. This is enhanced by the way the *Bundesrat* functions and the role of political opposition to the *Bundestag* it has taken up in practice (Anderheiden, 2008, parr. 56–60).
Furthermore, this kind of divergent law-making solutions – individual *vs* collegial – impact the degree of differentiation each system allows for. While the decentralisation of substantial tax-powers implicitly permits variable tax-pressure on a territorial basis, the functioning of the *Bundesrat* integrates territorial interests in the federal decision-making process, while preserving the uniformity of the tax pressure in the entire federation.

## Contemporary Relevance for the Topic and the Challenges Ahead

The constitutional reality shows a great variety of instruments and procedures that prompt financial responsibility. Such a multifaceted nature finds evidence in the selected case-studies, where the legislative competence of certain taxes is the result of either a joint or a concurrent decision-making process.
Scrutinising existing experiences and ongoing reforms in order to appraise the extent to which financial – and as such political – responsibility of SNGs is infused into the system, is central in federal systems, as a way to ensure that rules are observed and objectives are reached. The basic assumption is that these are crucial factors for benefiting from decentralisation and this is even more the case due to the repeated revising processes of financial constitutions and the never-ending and ever-changing nature of the decentralising processes. Moreover, federal systems could take advantage of this approach, with a view to fostering changes and offering operative solutions beyond the shortsighted glimpse of political and electoral dynamics (Bird, 2010).
Developing countries could benefit the most from this since fiscal decentralisation is included in the policy agenda of numerous countries. Simultaneously, effective fiscal decentralisation is rather weak, though in certain cases formally foreseen. The reluctancy of the center to decentralise the power to tax is further exacerbated by the distortive or lacking use of the related powers from SNGs. These cases would require additional investigation and would gain from comparative observations of existing legal solutions to the extent that all are observed in-context.

[1] The term financial constitution is the literal translation of *Finanzverfassung*, used by Austrian and German scholars to refer to constitutional provisions governing public finance. In particular, it entails the determination, distribution and use of financial resources by different levels of government (Hellermann, 2010, 1099ff; Pernthaler, 1984, 21ff; BVerfGE 55, 274, 300).
[2] The scope of the legislative competences is defined in general terms through *Ley Organica de Financiacion Autonomica* –

LOFCA (art. 19.2), while the details of the single ceded tax are in Law 22/2009 (arts. 46-52).
[3] Art. 11 LOFCA lists the taxes that can be ceded to ACs, but these require an ordinary law of the central authority to turn into effectively transferred.
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# Further Reading

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