

Catalonia's fiscal balance after the deployment of the 2006 Statute of Autonomy

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The object of this work is to do an approximate estimate of Catalonia's improved fiscal balance following the financial deployment of the Statute of Autonomy of Catalonia applied to 2007, defined as the base year of the new financing system under common regime.



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With the agreement of the **Council of Fiscal and Financial Policy of 15 July 2009**, laying the foundations of the 2009-2013 financing system under common regime, the deployment of the two main financial instruments provided for in the **2006 Statute of Autonomy of Catalonia (SAC)** was completed.¹ The third additional arrangement of the SAC had been already implemented since 2007, by which Catalonia would receive a portion of territorialised infrastructure investment from the Spanish government over the 2007-2013 period equivalent to at least its proportional contribution to national GDP. The specific contents of the «national infrastructure investment» concept was a matter of controversy between the Spanish and Catalan governments, based on which an agreement was reached that was implemented from 2008, with retroactive effects back to 2007.

Both the reform of the financing system and arrangements regarding investment by the Spanish government are to reduce Catalonia's negative fiscal balance in relation with overall Spain, according to all available estimates. Persistence in time and especially the size of the negative fiscal balance has raised

much concern among Catalan institutions and social and economic stakeholders. Several pieces of academic work point towards this imbalance as one of the main obstacles to the full use of Catalonia's own development potential and the creation of social welfare and cohesion instruments in line with the demands of a developed society in the medium and long term.

The reform of the financing system and the third additional arrangement regarding investment by the Spanish government are to reduce Catalonia's negative fiscal balance.

The object of this paper is to do a rough estimate of Catalonia's improved fiscal balance following the financial deployment of the SAC applied to 2007, which has been defined as the base year of the new financing system under common regime. However, it needs to be born in mind that setting this base year is a merely theoretical allocation as the first year in which new financing will be effectively implemented will be 2009, and 2007 was the first year in which the third additional arrangement was applied. This

means that the sum of funds with which this arrangement was enforced had a provisional character that has been later completed with an additional allocation by the Spanish government. Thus the appropriateness of using 2007 for theoretical purposes, yet without being able to ever compare it with the fiscal balance published for that year, is supported by two facts: first, it is a budgetary calculation for which there are ultimate – or practically ultimate – data on most variables, and secondly, the present paper intends to do an estimate of its results in terms of GDP rather than to establish an absolute figure.

As will be explained in each section, this paper is not making an own calculation of Catalonia's fiscal deficit or investment in Catalonia by the Spanish government, but it takes an approach to both figures for 2007 based on previous studies that are detailed for each case. It is neither intended to describe in detail the functioning and allocation of resources within the new financing system, although an own estimate of the return expected for the base year has been done, with the limitations mentioned in the respective section.

The paper does not intend to analyse the advantages

or shortcomings of the new financing model nor the forecast contained in the third additional arrangement and the agreement by which it is deployed, or the SAC as a whole or as to its financial arrangements. As has been said before, the aim of the paper is only to present estimate figures, pointing out specific limitations due to corrections based on the deployment of the financial block of the Statute of Autonomy regarding Catalonia's negative fiscal balance with Spain.

Catalonia's fiscal balance with Spain: estimation methodologies and results used

The concept of fiscal balance between the nation and a region (or any part of its territory) is misleadingly straightforward. It basically has to do with the difference between the revenue raised by the national government in one specific region and expenditure done there (either directly or through transfers to other authorities acting there). As the extension of the methodological document worked out by the **Comisión de Expertos sobre Metodología para la**

Elaboración de las Balanzas Fiscales de las Regiones Españolas (2006) on request of the Spanish government shows, the issue is not that easy and gives room for a wide range of approaches. The two basic alternatives used are known as «monetary

flow» and «benefit flow». Both involve different ways of territorial calculation of both the revenue and the expenditure of one specific administration. The criteria used are detailed in chart 1.

According to a schematic interpretation, the «monetary

Chart 1. Methodological description of alternative criteria to estimate the fiscal balance

«Monetary flow»	
REVENUE	Tax revenue is allocated to the territory where the economic capacity subject to taxation (taxable object) is located, which can be income, wealth or consumption, and non-tax revenue is allocated to the territory where payment for the units creating it is done.
EXPENDITURE	Expenditure is allocated to the territory where it is materialised, i.e. where personnel is located, current goods and services used, transfers collected and investment made. This means to confer a «real» sense to the «monetary flow» criterion as opposed to «cash flow» or «liquidity flow», which would lead to attribute public expenditure to the region where the public sector makes the payment. For instance, goods and services bought are allocated to the territory where they are used, not to the territory having acquired them, and investment is allocated to the territory where it is materialised.
«Benefit flow»	
REVENUE	Revenue is allocated to the territory where people reside who eventually bear the load (economic or effective incidence), no matter who the person legally required to pay is and where he or she resides (legal or formal incidence).
EXPENDITURE	Expenditure is allocated to the territory where the beneficiary lives, no matter where the public service is provided or the investment is made. In this case, it is necessary to establish hypotheses on the scope of beneficiaries and the amount of benefits provided by goods and services.

Source: Own, based on the Grup de Treball per a l'Actualització de la Balança Fiscal de Catalunya (2009).

flow» criterion uses the territory where both payment and expenditure take place as a basic allocation principle, while «benefit flow» emphasises that government expenditure in a given region can benefit the residents of the rest, and government revenue can be born by residents of regions different from the one actually receiving the funds. All in all, they are not two conflicting methods (both have been accepted as academically valid) but two different ways of measuring effects of one same phenomenon.

Fiscal balance between the nation and a region is the difference between the revenue raised by the national government in one specific region and expenditure done there.

What becomes relevant in this context is at what point the use of one or the other approach is appropriate. Guillem López Casasnovas (2006) provides a suggestive view of this issue in stating: «Beyond the academic controversy on the different approaches to fiscal deficit, it is convenient to remind that it is the reason that creates the interest, as the monetary approach is precisely what is underlying in claiming the regional policy originating it. [...] The alternative/complementary approach of the

load/benefit perspective has a wider academic tradition as it is related with looking into personal redistribution of government action, typical of centralised public tax revenue, and does not require any setting including multiple jurisdictions, rather typical of tax federalism. Extension of the load/benefit approach beyond the individual to the functional and especially the territorial level is definitely feasible but it starts from different assumptions: one single jurisdiction, one single tax relation between national government and its citizens. For this reason it is important to consider both approaches in the light of their acceptance and interpretation within the constitutional framework, by which proposals feature either federalist or centralist trends.»

The picture of the approaches described becomes definitely trickier if considering that in both cases some additional hypotheses are needed regarding both the revenue and the expenditure side, leading to final results that can be very differing. This phenomenon is found in the first official fiscal balance between every region and the national government elaborated by the Instituto de Estudios Fiscales (2008) on the 2005 fiscal year on request of the Spanish government, in which following the basic approach scheme described above,

the result are six different fiscal balances for each region.

The «monetary flow» criterion uses the territory where both payment and expenditure take place as a basic allocation principle, while «benefit flow» emphasises that government expenditure in a given region can benefit the residents of the rest, and government revenue can be born by residents of other regions.

As regards Catalonia, it seems that the «monetary flow» approach is the most appropriate as what we intend to measure is the effect on fiscal balance following the increase of resources for the territory (Catalonia) applying some specific allocation criteria in territorial expenditure by the Spanish government, no matter the benefits for residents of other territories with new allocations, or for residents in Catalonia with new allocations to other territories. The Government of Catalonia made an estimate of its fiscal balance with Spain on two occasions, one officially and the

other assisted by a group of experts. The latest review (Grup de Treball per a l'Actualització de la Balança Fiscal de Catalunya, 2009) nominally encompasses the 2002-2005 period, though there are also homogeneous series for 1986-2005 created in parallel following the two possible approaches, but without the diversity in intermediate hypotheses featured in the official assessment. From a methodological and data consistency point of view, the results of the document published by the Government of Catalonia regarding the «monetary flow» approach seem a good starting point for our purpose.

The «monetary flow» approach is the most appropriate as what we intend to measure is the effect on fiscal balance following the increase of resources for Catalonia applying some specific allocation criteria in territorial expenditure by the Spanish government.

Before giving the results, one last methodological consideration should be made. Calculating the fiscal balance between regions and the national government can be affected by

national revenue in relation with the non-corrected series, which reflects that its origin is not taxation but means higher expenditure capacity. In this respect, revenue from public deficit is especially relevant, as it can buffer or even drastically reduce the amount of the fiscal balance with the national government, for instance in times of recession. However, such situations are misleading

regarding the structural component of regional fiscal balances as deficit situations need to be followed by periods of contention in public expenditure while revenue is kept or increases.² For this reason, the document of the Working Group of the Government of Catalonia worked out a fiscal deficit series while neutralising the public deficit effect featuring the differing evolution shown in

Graph 1. Evolution of Catalonia's fiscal balance. «Monetary flow»

Percentage on regional GDP



Source: Own, with data from the Grup de Treball per a l'Actualització de la Balança Fiscal de Catalunya (2009).

▲ The differing evolution of fiscal deficit reflects the impact of public deficit in the 1986-2005 period.

graph 1 and showing the impact of deficit in the 1993-1996 period. Nevertheless, the very features of the estimate aimed at by the present paper makes it difficult to decide which of the two series (accounting or neutralised) is more appropriate, so we will show both results.

Our estimate of Catalonia's fiscal deficit with Spain in 2007 is based on applying the average deficit on GDP rate in the 2001-2005 period –the last five years

for which the government gave data– to GDP in Catalan 2007 market prices. The calculation of this estimate is shown on chart 2.

Calculating the fiscal balance can be affected by national revenue with non-taxation origin but higher expenditure capacity. Revenue from public deficit is especially relevant.

Estimate of revenue increase of Catalonia based on the 2009-2013 financing system

The financing system for the 2009-2013 period has its provisional setup according to the text of the bill by which the financing system of Spanish

Chart 2. Fiscal balance (FB) estimate for Catalonia in relation with Spain in 2007. «Monetary flow»

	2001	2002	2003	2004	2005	2001-2005 average
Original Catalan fiscal deficit/ GDP series (%)	8.8	10.2	9.3	9.1	10.3	9.5
Catalan fiscal deficit/GDP series with neutralised Public deficit (%)	7.2	8.5	7.4	7.4	7.7	7.6
						2007
Catalan market price GDP in current €m						196,536,9
FB of Catalonia in €m						18,749,6
FB of Catalonia with neutralised public deficit in €m						15,015,4

Source: Own, with data from the Grup de Treball per a l'Actualització de la Balança Fiscal de Catalunya (2009) i de la Comptabilitat Regional d'Espanya.

regions under common regime and cities with autonomy statute as approved by the Council of Ministers on 11 September 2009, by which the main points of the agreement by the Council of Fiscal and Financial Policy of 15 July 2009 are transposed coordinately. In essence, the basic mechanism is the one in place

for the different schemes under common regime since 1986: an estimate for each region of expenditure needs covered by means of a tax basket completed where applicable with government transfers. Expenditure needs are established based on some distribution variables considered relevant, applied to a set

of resources that are usually the result of accruing the funds added by the government to the existing amount of resources in each review of the system.

Despite this basic coincidence, the future system introduces quite significant changes as to the previous schemes (cf. chart 3 for resources allocated to each region):

Chart 3. Determination of different concepts provided by the 2009-2013 financing system

Amounts in the base year 2007. Million euros

Allocation of resources/needs						
	Financing needs 2007 (1)	Additional funds 2009 (2)	Additional funds 2010 (3)	Total overall financing needs (1+2+3)	Convergence fund participation (4)	Total system resources (1+2+3+4)
Catalonia	18,474.66	1,137.03	455.59	20,067.29	1,055	21,122
Galicia	7,919.76	223.57	178.35	8,321.68	305	8,627
Andalusia	21,376.98	935.21	625.30	22,937.49	399	23,336
Asturias (Principality of)	3,037.15	58.45	72.21	3,167.80	114	3,282
Cantabria	1,873.04	63.73	42.62	1,979.39	21	2,000
La Rioja	999.24	52.01	27.78	1,079.04	0	1,079
Murcia Region	3,402.84	261.81	94.80	3,759.45	65	3,824
Valencia Region	11,281.08	871.83	221.39	12,374.30	709	13,083
Aragon	3,763.06	167.56	98.26	4,028.87	42	4,071
Castile-La Mancha	5,500.47	304.00	149.43	5,953.91	98	6,052
Canary Islands	5,410.17	373.93	90.14	5,874.24	310	6,184
Extremadura	3,309.22	64.92	75.63	3,449.77	129	3,579
Balearic Islands	2,420.12	209.90	59.85	2,689.86	153	2,843
Madrid	14,936.85	1,053.67	256.94	16,247.46	846	17,093
Castile-Leon	7,442.73	197.03	160.07	7,799.83	261	8,061
Total RCR*	111,147.37	5,974.64	2,608.36	119,730.37	4,507	124,237
*RCR: Regions under common regime						

Source: Own, based on data of the Spanish Ministry of Economy and Finance.

► Overall financing needs (OFN) or expenditure needs of all regions are two-tiered: the first tier (75% of total resources) is allocated uniformly based on the adjusted population³ in each region, forming the so-called Basic Public Service Guarantee Fund, the purpose of which is to allocate a homogeneous coverage of a portion of public services throughout the territory under common regime.⁴ The goal of the second OFN tier (the remaining 25%) is to allow each region to develop the rest of its jurisdictional attributions under conditions more or less adjusted to their fiscal capacity. OFN (which include most of the resources accrued by the government to the system) are covered in each region by means of the taxation capacity of the new tax basket and positive or negative government transfers if applicable.

► The convergence fund (CF) comes in after allocating overall financing needs and takes into account the relative taxation capacity of each region with a double goal materialised in two different tiers: on the one hand, the cooperation fund intending to bring fiscal capacities of worse-off regions closer to the average; on the other, the competitiveness fund intending to approach the collection of resources per capita to fiscal capacity per

capita in those regions with a fiscal potential above average, as is the case of Catalonia. The resources of the convergence fund are provided by the Spanish government.

The mechanics of the new system establishes that some key distribution variables are to be applied based on 2009 values, which will not be available before 2011 and have in turn effects on the final distribution of resources from 2010.

A core element in the dynamics of the financing system, evolution of governmental taxation revenue (GTR), which determines the conversion of the value of resources added to the system by the government over 2009 and 2010 according to the base year, had to be estimated on a hypothetical basis. To make this conversion, we took the estimates by Ángel de la Fuente (2009), who uses the government revenue figures of the first five months in 2009 as compared to the same period in 2007 and the hypothesis for 2010 that the resulting loss in revenue will be half of that experienced in 2009, equivalent to 83.687% of 2007 revenue and 92.012% for

2010. The system sets 2007 as the base year, but it should be considered that as opposed to previous systems, the 2009-2013 scheme will not do a definite estimate of resource distribution according to the base year until 2012, in which the final settlement for 2010 is planned. The mechanics of the new system establishes that some key distribution variables (such as population or GTR evolution) are to be applied based on 2009 values, which will not be available before 2011 and have in turn effects on the final distribution of resources from 2010.

With all these limitations, chart 4 provides an approach to the benefits of full application of the system based on 2007 values, which mean a better financing for Catalonia of around 14.3%, that is, 2.648 €bn according to the base year. Still, this calculation does not include the part allocated for language normalisation that, despite being mentioned in legal reference texts and a part of general system resources, is not quantified nor its distribution criteria mentioned anywhere. It neither includes the additional sums for improving financing of Catalonia's own jurisdictional attributions (police and jails) that were part of the Catalan-Spanish financing agreement.

Chart 4. Variation of the whole of resources provided by the financing system for each region

Amounts in the base year 2007. Million euros

	2002-2008 system (homogenous terms)	2009-2013 scheme	Increase	Increase (%)	Allocation of new resources (%)
CCatalonia	18,475	21,122	2,648	14.33	20.23
Galicia	7,920	8,627	707	8.93	5.40
Andalusia	21,377	23,336	1,960	9.17	14.97
Asturias					
(Principality of)	3,037	3,282	245	8.06	1.87
Cantabria	1,873	2,000	127	6.80	0.97
La Rioja	999	1,079	80	7.99	0.61
Murcia Region	3,403	3,824	422	12.39	3.22
Valencia Region	11,281	13,083	1,802	15.98	13.77
Aragon	3,763	4,071	308	8.18	2.35
Castile-La Mancha	5,500	6,052	551	10.03	4.21
Canary Islands	5,410	6,184	774	14.31	5.91
Extremadura	3,309	3,579	270	8.15	2.06
Balearic Islands	2,420	2,843	423	17.47	3.23
Madrid	14,937	17,093	2,157	14.44	16.48
Castile-Leon	7,443	8,061	618	8.30	4.72
Total RCR*	111,147	124,237	13,090	11.78	100.00

*RCR: Regions under common regime

Source: Own, based on data of the Spanish Ministry of Economy and Finance.

Government investment in Catalonia: effects of applying the third additional arrangement of the SAC

The first section of the third additional arrangement of the SAC literally

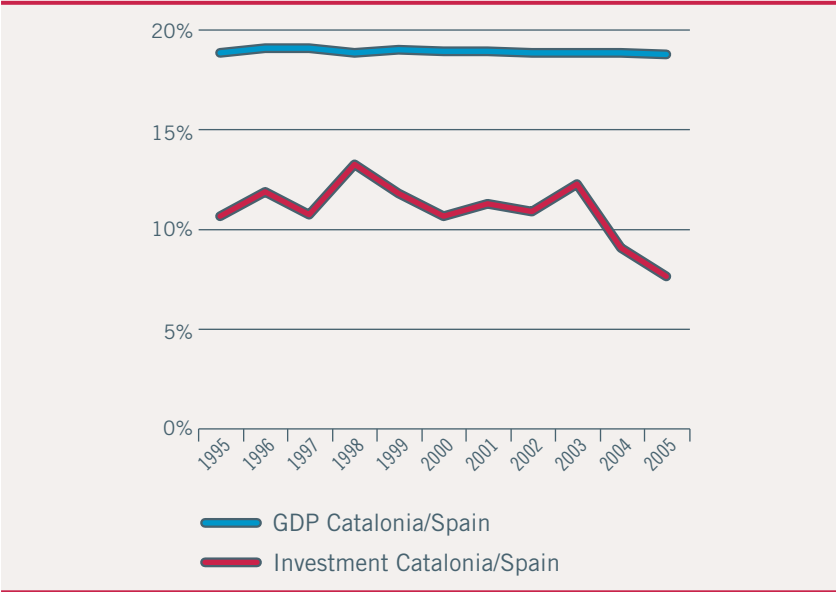
states that «investment of the Spanish government in Catalonia in infrastructure, excluding the Interterritorial Compensation Fund, has to be equivalent to the relative share of Catalonia's gross domestic product in Spain's gross domestic product over a seven-year period. This investment can also be used to eliminate motorway tolls or build alternative high-capacity roads». This has been a long-standing claim of different Catalan institutions

and stakeholders given the lack of government investment in Catalonia and continuous reduction of public allocations per capita.

Graph 2 shows the distance between the share of government investment in Catalonia and the goal set out in the Autonomy Statute applied to the 1995-2005 period. It also provides a quite significant picture of systematic discrimination of its citizens,



Graph 2. Comparative evolution of government investment in Catalonia and Catalan GDP related to Spanish GDP in percent



Source: Own, with data from Ramon Ramon Barberán Ortí and Ezequiel Uriel Jiménez (2008) and Spanish regional accounting.

▲ The graph shows the discrimination of Catalonia in government investment compared to the Catalan share in Spanish GDP.

considering that the line between 15% and 16.5% comes to define the degree of population-related investment.

Investment of the Spanish government in Catalonia in infrastructure, excluding the Interterritorial Compensation Fund, has to be equivalent to the relative share of Catalan GDP in Spanish GDP over a seven-year period.

In order to estimate quantitative improvement following the application of the third additional arrangement (cf. chart 5), we have

Chart 5. Territorialised government investment Catalonia/Spain. Fiscal balance result. «Monetary flow»

	2001	2002	2003	2004	2005	2001-2005 average
INV CAT/SPA (%)	112	10.8	12.2	9.0	7.6	10.2
2007						
GDP CAT/ESP (%)						18,7
3AA final application estimate in €m*					4.201,4	
Allocation trend of government investment in Catalonia in €m						2.289,6
Increase of government investment in Catalonia 2007 in €m						1.911,8

* 3AA: Third additional arrangement of the Statute of Autonomy of Catalonia

Source: Own, with data from Ramon Ramon Barberán Ortí and Ezequiel Uriel Jiménez (2008) and Spanish regional accounting.

made an estimate for 2007 of the difference between this result and that emerging from a hypothetical allocation trend of government investment in Catalonia – obtained from the national investment series territorialised by the fiscal balance following «monetary flow» as elaborated by Ramon Barberán Ortí and Ezequiel Uriel Jiménez (2008) – which is counted as the average proportion allocated to Catalonia in the 2001-2005 period, applied to 2007 government investment figures.

In 2007, the Spanish government allocated €bn 3.195 unilaterally to comply with the Statute, which was later increased to €bn 4.021.

It needs to be reminded that the territorialised government investment figure considered to comply with the third additional arrangement is not actual government investment strictly speaking but, as a result of the 'arrangement interpretation' agreement, it includes one part of this investment (the one corresponding to functional group 4 in the national budget) and territorial capital transfers of that functional group.

In 2007, the first year of application, the Spanish

government allocated €bn 3.195 unilaterally to comply with the Statute, which was later increased following the interpretation agreement to €bn 4.021, according to the latest official figures.

Aggregation of results

The aggregation of the preceding estimates in a final calculation of the effect full application of the financial arrangements of the SAC will have on Catalonia's fiscal balance with Spain in 2007 values is detailed in chart 6. The most significant result is the reduction of fiscal deficit by 24-30% according to the «monetary flow» criterion, €bn 4.56 in absolute figures, reducing it from 10% of GDP to a range between 5.3% and 7.2%.

However, this does not include some specific sums that are not included in the bills to apply the new financing system, as has already been mentioned.

Nevertheless, one last significant methodological precision has to be made related to the aggregate figures in table 6. The figures based on the fiscal balance – and thus the projections we made according to them – are those of settled government expenditure. However, both estimates for the new financing system and those

for government investment according to the third additional arrangement of the SAC are budgeted figures, that is, subject to variation as the year passes. As regards the financing system, realisation of budget forecasts are, as we have seen before, intricately related with governmental taxation revenue (GTR), but government investment is far more discretionary and the degree of actual performance of government investment in Catalonia is historically and consistently low in general terms. The interpretation agreement of the third additional arrangement provides for a correction mechanism in case of insufficient budget performance, but no definite data have been published so far.

The reduction of fiscal deficit is 24-30% according to the «monetary flow» criterion, €bn 4.56 in absolute figures, reducing it from 10% of GDP to a range between 5.3% and 7.2%.

Although this is not enough for the aspirations of a part of the Catalan society, the figures shown in chart 6 definitely represent a significant progress in reducing Catalonia's fiscal deficit, a goal explicitly set by the

Government of Catalonia, at least since the negotiation that originated the 2002-2008 financing system. The effects of the economic crisis on public revenue will probably reduce the potentialities

of the new financing system for generating resources during the first years of validity.

However, once this initial situation is overcome, it can be expected, according

to theoretical estimates made, that its application will represent clear and perceptible progress in rebalancing the financial relations between Catalonia and Spain.

Chart 6. Situation of Catalonia's fiscal balance with Spain, 2007

Effect of the implementation of the deployment of the 2006 SAC

Value	
Market price GDP of Catalonia, 2007. Current €m	196,536.9
Increase of resources provided by the Spanish government to Catalonia	€m
New resources provided by the reform of the financing system	2,647.6
Increase of government investment related to the 2001-2005 trend	1,911.8
Total resource increase	4,559.4
Estimate of Catalonia's fiscal balance with Spain in 2007 without the new SAC	€m
With neutralisation of the public deficit effect	-15,015.4
Without neutralisation	-18,749.6
Estimate of Catalonia's fiscal balance with Spain in 2007 with the new SAC	€m
With neutralisation of the public deficit effect	-10,456.0
Without neutralisation	-14,190.2
Reduction of Catalonia's fiscal balance with Spain in 2007 without the new SAC	%
With neutralisation of the public deficit effect	30.4
Without neutralisation	24.3
Fiscal deficit of Catalonia with Spain in 2007 as of GDP after the new SAC	%
With neutralisation of the public deficit effect	5.3
Without neutralisation	7.2

Source: own

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Notes

1. The legislative deployment of the agreement was pending, having now been completed in the bill to reform the Organic Law on Regional Financing and the project to regulate financing of regions under common regime, passed by the Council of Ministers on 11 September 2009, without changing the financial framework set out on 15 July 2009.
2. An example of this situation will occur soon with the announced increase of national taxes. Although it may increase Catalonia's fiscal deficit with Spain in the short term, additional resources arising from this increase will serve to finance more government expenditure in Catalonia for preceding years, which should have brought about a reduction of Catalan fiscal deficit in that period.
3. Population weighed according to allocation of expenditure needs to which we referred earlier.
4. In theory, these services are education, health and basic welfare. In this respect, as well as for the rest of thoughts regarding the model architecture, the comparison between real effects of applying the new financing system and its theoretical layout should be the object of deeper reflection that is beyond the scope of this paper.