

The unsustainable dependence of Spanish Local Treasuries on taxes and charges related to construction activities

Dr. I. Puig-Ventosa¹

1 Introduction

During recent decades, urban areas in Spain have experienced an unprecedented level of growth which has been exacerbated in the recent years. Between 1987 and 2000 developed land increased by 29.5%, with estimated projections for 2005 and 2010 being 41% and 52% higher than in 1987.² The transformation from high to low density developments, and the frantic construction of new residences and industrial areas account for most of this transformation.

Although the process has affected almost the whole country, it has not been homogeneous, with hot spots around the coast (79% of all residences built in Spain between 1990 and 2000),³ mainly in the Mediterranean (see, for example, the occupation of the coastline, in Table 1), and in the metropolitan area of Madrid.

Table 1. Urban occupation of the 0-5km coastline in 1987 and 2000, in hectares

| Province | 1987 | 2000 | % 87-00 |
|------------------------------|--------|---------|---------|
| Girona | 9,990 | 10,344 | 3.5% |
| Barcelona | 20,393 | 22,984 | 12.7% |
| Tarragona | 13,154 | 14,834 | 12.8% |
| Castelló | 4,174 | 5,905 | 41.5% |
| València | 7,662 | 9,750 | 27.3% |
| Alacant | 13,156 | 20,676 | 57.2% |
| Murcia | 7,637 | 9,557 | 25.1% |
| Almería | 5,016 | 5,966 | 18.9% |
| Granada | 1,301 | 1,552 | 19.3% |
| Málaga | 16,461 | 19,825 | 20.4% |
| Total Mediterranean Coast | 98,945 | 121,393 | 22.7% |
| Cádiz | 12,414 | 14,539 | 17.1% |
| Huelva | 2,340 | 3,219 | 37.6% |
| Total Atlantic Coast (South) | 14,754 | 17,758 | 20.4% |
| Pontevedra | 11,723 | 12,171 | 3.8% |
| A Coruña | 14,600 | 15,731 | 7.7% |
| Lugo | 996 | 1,096 | 10.0% |
| Asturias | 6,591 | 7,719 | 17.1% |
| Cantabria | 6,792 | 8,583 | 26.4% |
| Bizkaia | 3,911 | 4,294 | 9.8% |

1. ENT Environment and Management

ipuig@ent.cat

² OSE, Observatorio de la Sostenibilidad en España (2006) Cambios de ocupación del suelo en España. Implicaciones para la sostenibilidad. Madrid.

³ Prats Palazuelo, F. (2006) "S.O.S. en el litoral". *Ambienta*. La revista del Ministerio de Medio Ambiente, 56 (12-16).

| Province | 1987 | 2000 | % 87-00 |
|--------------------------------|-------------|-------------|----------------|
| Gipuzkoa | 3,977 | 4,305 | 8.3% |
| Total Atlantic-Cantabric Coast | 48,590 | 53,899 | 10.9% |
| Illes Balears | 17,828 | 22,702 | 27.3% |
| Las Palmas | 16,145 | 17,207 | 6.6% |
| Santa Cruz de Tenerife | 10,902 | 12,241 | 12.3% |
| Total Islands | 44,876 | 52,150 | 16.2% |

Source: Adapted from OSE, Observatorio de la Sostenibilidad en España (2006) Cambios de ocupación del suelo en España. Implicaciones para la sostenibilidad. Madrid.

In 2005 alone, more than 800,000 new homes were approved,⁴ more than those built in France, Germany and the United Kingdom put together,⁵ despite those countries having almost 5 times the Spanish population. Consequently according to Eurostat, Spain has exceeded all these countries and others like Sweden in terms of number of homes per 1,000 inhabitants.

A number of factors explain such a high growth rate in the number of new homes, such as:

- (i) economic growth,
- (ii) increased population, mainly due to the baby-boom experienced in Spain in the 70s and immigration,
- (iii) increased number of tourists,
- (iv) increased number of second homes (3,360,631 in 2001)⁶
- (v) low interest rates,
- (vi) new buyers from other countries (mainly EU),
- (vii) reduction of the average number of members per household,
- (viii) property speculation. There was a stock of 3,106,422 empty homes in 2001.⁷

However, municipalities play a central role in urban planning, and their contribution is crucial in explaining these trends, as discussed in the following sections. In Section 2, the main sources of revenue related to urbanisation are presented, whilst section 3 quantifies to what extent municipalities depend on extraordinary sources of revenue derived from new construction activities. Section 4 suggests that stress over Local Treasuries is exacerbated when new urban developments tend to have low-density, because they imply higher costs for the municipal services to provide, which at the same time foster excessive construction as a means to obtain short-term revenue. Section 5 proposes a range of adjustments to the financial and taxation structure of Local Treasuries to overcome the environmental and economic impacts caused by the present situation. Section 6 presents some conclusions.

⁴ OSE, Observatorio de la Sostenibilidad en España (2006) Cambios de ocupación del suelo en España. Implicaciones para la sostenibilidad. Madrid.

⁵ Ministerio de Medio Ambiente (2006) Libro Verde de Medio Ambiente Urbano. Tomo I. Madrid.

⁶ INE, Instituto Nacional de Estadística (2004) Censos de Población y Viviendas 2001.

⁷ INE, Instituto Nacional de Estadística (2004) Censos de Población y Viviendas 2001.

2 Main taxes, charges and other sources of revenue related to construction activities in Spain

All sources of income for Local Administrations are principally regulated by the Spanish Act on Local Treasuries (Real Decreto Legislativo 2/2004, de 5 de marzo, por el que se aprueba el texto refundido de la Ley Reguladora de las Haciendas Locales). Among these sources, there are several taxes and charges related to urbanisation, which are described in the following sections.

For the purpose of this paper these resources have been classified between those that are levied only once, obtained in the short-term and able to finance other municipal policies (a), and all the others (b).

(a) One-off income sources related to new construction activities and capable of financing other policies

The budget of Spanish municipalities includes several sources of income related to new constructions. These are one-off revenue sources that can potentially be used to finance policies that would otherwise not be possible to implement. This causes the potential risk that some municipalities foster new construction activities with the aim of capturing this short-term income, at the expense of any mid or long term economic or environmental consequences.

Apart from the resources analysed in the following sections, a municipal Council can also increase its physical assets as a consequence of new urban developments (e.g. new municipality-owned land or new public equipments). This is not reflected in the municipal budget and therefore it is not included in the quantitative analyses performed in section 3; however, it may also be a reason to explain excessive construction prompted by municipalities.

(i) *Tax on constructions, installations and works (Impuesto sobre construcciones, instalaciones y obras, ICIO)*

ICIO (code 282 in Spanish income budgets) is a tax on any construction work for which a municipal license is required. The taxpayer is the owner of the work and the tax base is its cost. The tax payable is obtained by applying a tax rate to the tax base, which is determined by the local Council and cannot exceed 4%.

Levying this tax is not compulsory for municipalities; however, the majority do, with the percentage of municipalities having increased in recent years, along with the tax rate (see Table 2):

Table 2. Percentage of Spanish municipalities levying the Tax on constructions, installations and works average tax rate (ICIO), 2000-2006

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Percentage of municipalities | 77.37 | 79.05 | 80.27 | 81.28 | 82.59 | 83.63 | 84.39 |

| | | | | | | | |
|----------------------|------|------|------|------|------|------|------|
| charging ICIO | | | | | | | |
| Average tax rate (%) | 3.04 | 3.09 | 3.10 | 3.14 | 3.28 | 3.34 | 3.37 |

Source: Spanish Ministry of Finance

In general, ICIO is the highest source of revenue for local Councils when a new urban development occurs, and therefore is the most relevant tax from the viewpoint of this paper.⁸

Revenue generated by this tax is not earmarked or restricted at all; consequently it can be addressed to support any municipal policy.

(ii) Charges on construction licenses (Tasas urbanísticas)

Municipalities usually have in place charges on construction licenses. Some of these licenses are compulsory according to legislation on urban planning. Usually there is a list of tariffs for the different types of municipal licenses. In general, the amount collected with these charges exceeds the actual cost of the administrative services provided by the Council, therefore becoming a revenue stream and hence a means to finance local policies, although to a lesser extent.

These charges, as well as ICIO (see section 2.(a).(i)), affect both greenfield and brownfield construction. In the first case, they can be considered a one-off source of income, whereas in the second case they could be deemed to be a sustainable source of income since no development of (finite) land takes place (e.g. rehabilitation processes or new improvements in already existing buildings). In the analysis of Spanish municipal budgets it is impossible to separate both types of sources of revenue,⁹ although they are of a completely different nature. We will assume that most of the revenue from ICIO and construction charges comes from levying construction activities in new urban areas, which is probably very accurate in Spain at the present time, due to the amount of new housing being developed (see section 1) and the fact that in new developments ICIO and construction charges tend to have much higher values.

In both cases, ICIO and construction charges are levied by local Councils prior to the commencement of construction, regardless of the potential cost that these urban areas may have for the municipality in the medium or long term, in terms of public service provision. This time lag is fundamental to explain a potential imbalance in municipal budgets.

(iii) Revenue obtained by selling municipality-owned land

8. Initially, ICIO taxpayers have to make an initial payment, which has to be verified by the Council when the construction, installation or works gets to an end. Quite often, this verification process does not take place, which in general means less revenue for municipal Councils, and probably less revenue to be obtained from the Property tax (section 2.(a).(i)) in the years to come.

9. Only some municipal Councils have this information, but they do not provide it separately to the Ministry of Finance.

Finally, there is another very significant revenue stream, which is not of a fiscal nature. That is the sale of municipality-owned land (code 60 in Spanish income budgets) to property developers.

Although final approval from the regional government is required; in Spain municipalities can change the classification of land, typically from ‘not for building’ to ‘building’ land, thus increasing the value of the land by up to ten fold, if not more. Here there is another option for municipalities to obtain revenue: changing the qualification of municipality-owned land and selling it.

Despite some legal restrictions on the use of this revenue (although they vary a lot among regions), this has been profusely used as a source of financing. According to Campos (2006: 18): “The financial crisis of local administration [in Spain] has found a regular source of income in the change of qualification from not for building to building-industrial land”.¹⁰ Needless to say, this is also a one-off source of income.

(b) Other revenue sources related to urbanism

There are other sources of income for municipalities that are also related to urbanisation but unlike the ones discussed in the previous section these cannot create perverse incentives to municipalities to overdevelop new urban areas.

(i) Property tax (Impuesto sobre bienes inmuebles, IBI)

In general, the property tax (IBI) is the most important municipal tax in terms of revenue (code 112 in Spanish income budgets). It affects the property right (and other less common rights) of real estates and is linked to its assessed value (*valor catastral*) on a tax rate defined by the municipality, within the limits defined in the Spanish Act on Local Treasuries. It applies to both non-urban and urban real estates, being much higher in the latter.

After VAT on construction, IBI is the second biggest source of revenue for the Spanish public sector deriving from the construction sector.¹¹ However, this is not a one-off tax (it is levied annually by the municipality), and therefore cannot be deemed to create perverse incentives.

(ii) Municipal tax on the increase in the value of urban land (Impuesto sobre el incremento de valor de los terrenos de naturaleza urbana)

The Municipal tax on the increase in the value of urban land (code 114 in Spanish income budgets) is paid when a property is sold. The tax base is the increase in the value of the urban land since the last recorded sale, with a maximum period of 20 years. The Council can define the tax rate, which has to be within the range defined in the

¹⁰ Campos Palacín, P. (2006) “La construcción y la pérdida de valores naturales y culturales en el litoral mediterráneo español”. *Ambienta. La revista del Ministerio de Medio Ambiente*, 56 (18-23).

¹¹ San Martín, I., Cubero, J., Nieto, E., Riestra, T. (2007) *Real Estate Watch Spain*. Economic Research Department BBVA. January 2007.

Spanish Act on Local Treasuries. The Council has almost no means to influence the number of transactions and timing of when they take place, therefore this cannot be considered a perverse incentive either.

(iii) Special contributions (Contribuciones especiales)

Special contributions (code 36 in Spanish income budgets) are voluntarily levied by local Councils in the case of the execution of public works or the setting up or extension of municipal services, if the beneficiaries are only a part of the population. In this case, taxpayers are the owners of the properties that benefit from the municipal work/service. The base of the special contribution is the real cost of the works, with a maximum limit of 90% of this cost. This base is distributed among taxpayers according to several criteria defined in the Spanish Act on Local Treasuries.

Special contributions can only finance the works or services that originated them. Therefore, despite being a one-off source of income, they cannot be deemed to create perverse incentives.

3 The dependence of Spanish Local Treasuries on revenue sources related to new urban development

This section analyses the relative importance to Local Treasuries of taxes, charges and other sources of revenue that can create incentives amongst local Councils to overdevelop new urban areas.

Table 3 shows the revenue raised by each of the sources defined in the previous sections. Unfortunately, the Spanish Ministry of Finance provides no information on the revenue generated by charges separately, therefore it was not possible to include the charge on construction licenses in the following quantitative analysis.

Table 3. Revenue raised by different income sources related to urbanisation, and total income budget, in Spanish Local Treasuries, 2001-2004 (thousands of euros).

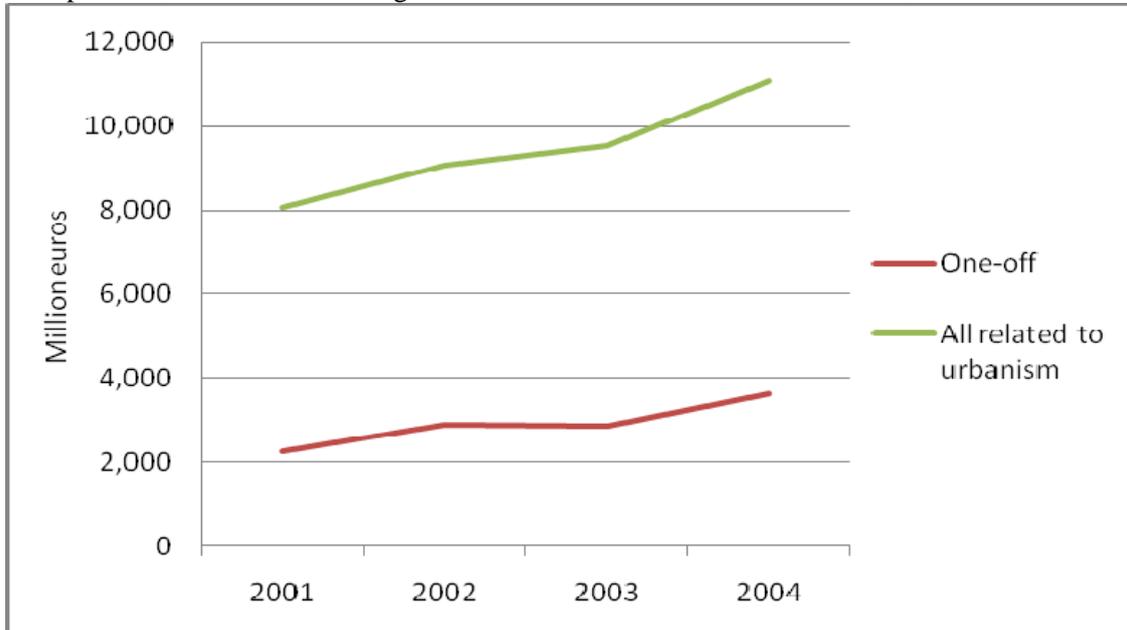
| Income source | 2001 | 2002 | 2003 | 2004 |
|--|------------|------------|------------|------------|
| Property tax (112) | 4,724,641 | 5,043,438 | 5,398,916 | 6,029,061 |
| Municipal tax on the increase in the value of urban land (114) | 796,108 | 914,867 | 1,054,348 | 1,176,377 |
| Tax on constructions, installations and works (282) | 1,233,666 | 1,341,010 | 1,555,279 | 1,872,734 |
| Special contributions (36) | 276,004 | 212,807 | 189,841 | 235,318 |
| Revenue obtained by selling municipality-owned land (60) | 1,023,768 | 1,552,659 | 1,318,755 | 1,766,390 |
| Total revenue related to urbanism | 8,054,187 | 9,064,782 | 9,517,139 | 11,079,881 |
| Total income budget | 31,546,599 | 35,492,446 | 36,314,970 | 40,373,668 |

Source: Spanish Ministry of Finance

Revenue raised by sources of income related to urbanism has notably increased in the period of analysis, by 37.57% between 2001 and 2004. Among these sources, those

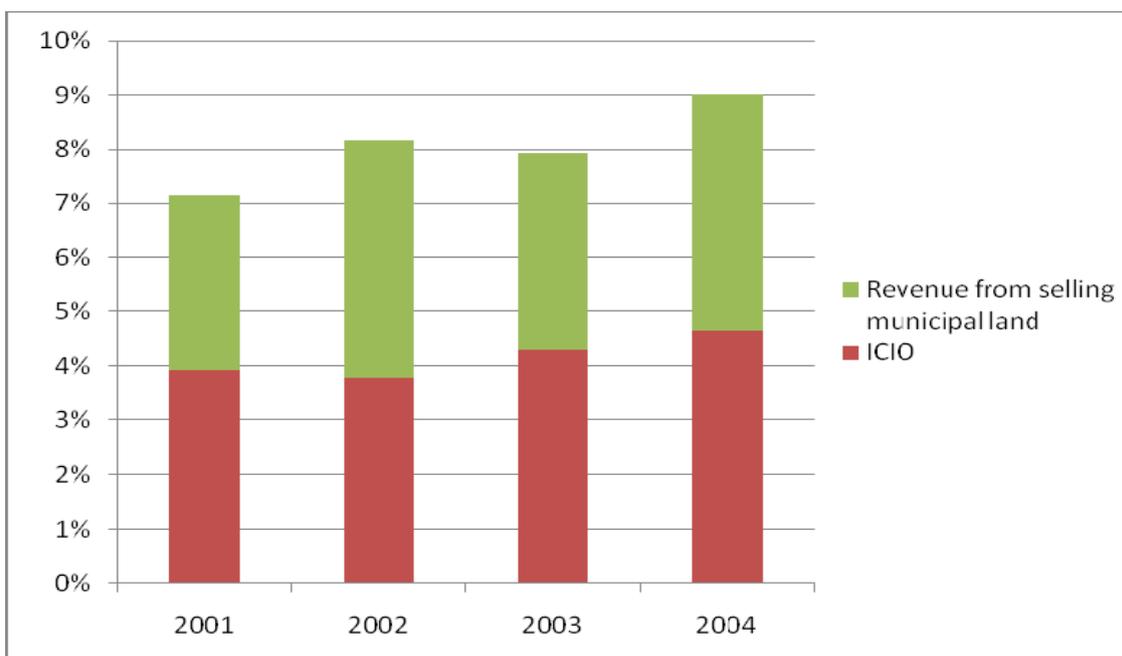
described in section 2.(a) (i.e. those that are one-off income sources and that are capable of financing other policies, (282) + (60)), have experienced a higher growth; by 61.21% between 2004 and 2001 (see Figure 1).

Figure 1. One-off income sources related to new construction activities and capable of financing other policies, versus all revenue generated from sources related to urbanism, 2001 - 2004.



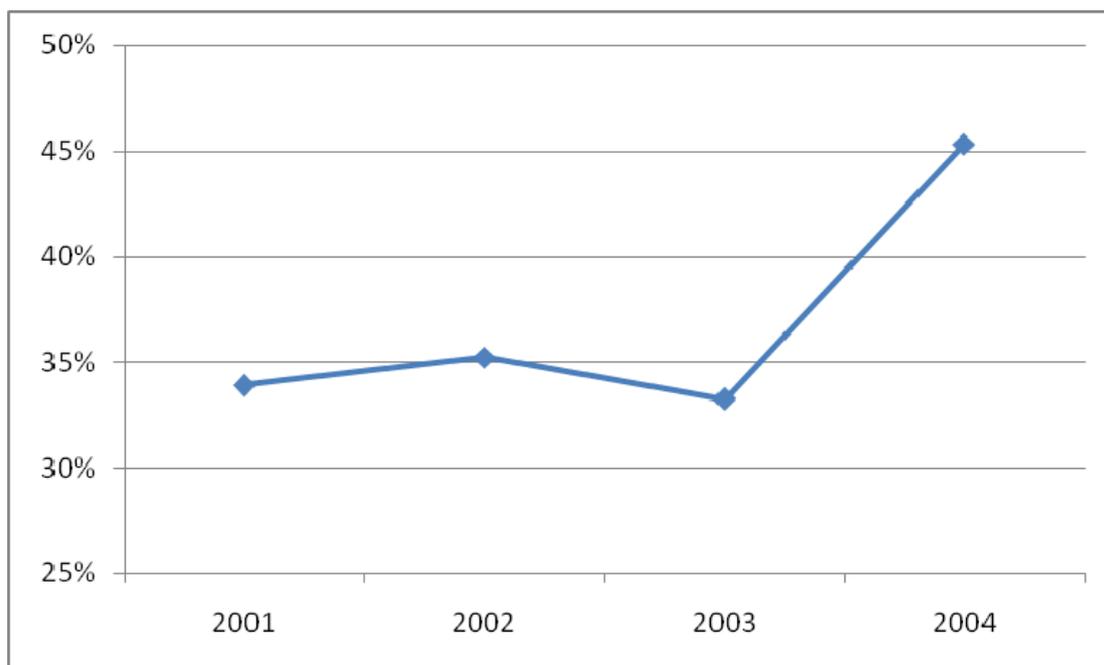
It is clear to see from Table 3 that both ICIO and revenue raised from selling municipality-owned land have increased more rapidly than the overall income budget, which means that their relative weight in the budget has risen (almost two points from 2001 to 2004, see Figure 2). The evolution in the revenue raised by ICIO is coherent with trends observed in Table 2, i.e. a growing number of municipalities levying this tax combined with a rise in the average tax rate.

Figure 2. Relative importance of one-off income sources related to new construction activities in the income budget of the Spanish Local Treasuries, 2001 - 2004.



In 2004, one-off income sources related to new construction activities accounted for 9.01% of the total income budget of Spanish municipal Councils. At first sight, this percentage may not seem excessive, but this changes if we do not consider operational expenses such as personnel, supplies, financial expenses or others, and compare it only to the concept of “real investments” (code 6 in Spanish expense budgets). Among other minor aspects, this concept includes any expense related to infrastructures (new or replacements) or new investments associated to public services. Most of the more visible actions in local policy are included in this chapter of the expense budget. As can be observed in Figure 3, the relative importance of one-off income sources related to new construction activities is not at all negligible, being as high as 45.33% in 2004.

Figure 3. Relative importance of one-off income sources related to new construction activities in relation to investments by Spanish local Councils, 2001 - 2004.



In consequence, it can be stated that the budget of Spanish municipalities has a significant dependence on income generated by selling their own land and on income raised by taxing new urban developments. As explained in the previous analysis it was not possible to include charges on construction licenses. Since they are also an important source of income (typically around 20-40% of the revenue raised by ICIO), this reinforces the conclusions achieved in the previous discussion.

The picture is strengthened if we consider that sources of income related to urbanisation can be characterised as pro-cyclic. Since they are intimately related to the evolution of construction activities, they are very dependent on a sector that shows pronounced cycles, which may generate financial instability for Local Treasuries¹².

When Spanish provinces are analysed individually, quite diverse trends can be observed (Table 4):

¹² Círculo de Empresarios. (2007) Un nuevo modelo para los Ayuntamientos españoles. Madrid.

Table 4. Revenue from different income sources related to urbanism, total income budget and total investment, in Spanish Local Treasuries, 2004 (thousands of euros).

| Province | (112) | (114) | (282) | (36) | (60) | Total income | Total investment (6) | [(282)+(60)] /Total income | [(282)+(60)] /Total investment |
|-------------|-----------|-----------|-----------|---------|-----------|-----------------|----------------------------|----------------------------------|--------------------------------------|
| A Coruña | 114,025 | 9,955 | 37,225 | 1,090 | 10,740 | 740,211 | 128,809 | 6.48% | 37.24% |
| Alacant | 298,346 | 47,257 | 98,799 | 5,332 | 53,805 | 1,425,707 | 245,790 | 10.70% | 62.09% |
| Albacete | 37,989 | 7,406 | 14,033 | 4,928 | 6,154 | 330,563 | 55,321 | 6.11% | 36.49% |
| Almería | 76,289 | 15,604 | 43,651 | 270 | 86,955 | 603,424 | 211,416 | 21.64% | 61.78% |
| Araba | 37,856 | 6,580 | 16,790 | 672 | 17,960 | 359,198 | 70,261 | 9.67% | 49.46% |
| Asturias | 115,096 | 22,664 | 39,476 | 1,073 | 20,302 | 818,059 | 151,660 | 7.31% | 39.42% |
| Ávila | 17,461 | 4,139 | 8,266 | 177 | 9,193 | 139,613 | 35,437 | 12.51% | 49.27% |
| Badajoz | 67,573 | 7,638 | 15,585 | 124 | 17,517 | 465,773 | 96,177 | 7.11% | 34.42% |
| Balears | 189,709 | 26,135 | 48,237 | 1,884 | 4,549 | 966,633 | 160,470 | 5.46% | 32.89% |
| Barcelona | 947,219 | 218,543 | 178,831 | 59,576 | 105,648 | 5,333,850 | 652,532 | 5.33% | 43.60% |
| Bizkaia | 104,880 | 15,324 | 51,899 | 4,292 | 32,530 | 1,273,275 | 315,196 | 6.63% | 26.79% |
| Burgos | 50,942 | 12,754 | 15,184 | 1,381 | 14,689 | 329,693 | 73,341 | 9.06% | 40.73% |
| Cáceres | 37,928 | 2,302 | 7,835 | 341 | 7,754 | 313,048 | 57,822 | 4.98% | 26.96% |
| Cádiz | 181,818 | 26,960 | 46,230 | 283 | 31,302 | 1,073,242 | 139,155 | 7.22% | 55.72% |
| Cantabria | 80,504 | 14,388 | 28,488 | 265 | 34,401 | 515,522 | 89,268 | 12.20% | 70.45% |
| Castelló | 105,688 | 14,386 | 29,993 | 2,284 | 18,684 | 487,139 | 98,574 | 9.99% | 49.38% |
| Ciudad | 62,411 | 5,696 | 17,768 | 716 | 12,015 | 411,046 | 88,804 | 7.25% | 33.54% |
| Córdoba | 89,452 | 12,628 | 20,892 | 674 | 15,829 | 597,460 | 119,879 | 6.15% | 30.63% |
| Cuenca | 15,752 | 3,787 | 5,449 | 386 | 3,252 | 165,733 | 37,346 | 5.25% | 23.30% |
| Gipuzkoa | 85,478 | 10,639 | 26,198 | 634 | 27,142 | 870,572 | 169,112 | 6.13% | 31.54% |
| Girona | 151,814 | 26,469 | 39,217 | 22,460 | 15,743 | 773,639 | 178,516 | 7.10% | 30.79% |
| Granada | 82,166 | 21,213 | 29,141 | 532 | 23,863 | 642,905 | 142,860 | 8.24% | 37.10% |
| Guadalajara | 30,807 | 5,092 | 15,441 | 98 | 5,723 | 199,767 | 48,384 | 10.59% | 43.74% |
| Huelva | 62,232 | 7,722 | 20,261 | 204 | 44,535 | 467,527 | 129,854 | 13.86% | 49.90% |
| Huesca | 35,660 | 2,667 | 11,571 | 556 | 7,915 | 228,685 | 82,415 | 8.52% | 23.64% |
| Jaén | 62,185 | 10,097 | 16,799 | 2,186 | 12,078 | 478,630 | 119,719 | 6.03% | 24.12% |
| La Rioja | 36,736 | 7,637 | 14,984 | 13,823 | 25,464 | 293,878 | 78,250 | 13.76% | 51.69% |
| Las Palmas | 136,715 | 24,680 | 32,682 | 1,045 | 21,451 | 917,449 | 158,049 | 5.90% | 34.25% |
| León | 60,246 | 9,095 | 14,893 | 3,432 | 32,771 | 365,729 | 75,483 | 13.03% | 63.15% |
| Lleida | 64,380 | 5,679 | 19,007 | 7,650 | 10,141 | 363,782 | 83,691 | 8.01% | 34.83% |
| Lugo | 31,145 | 2,498 | 8,919 | 112 | 623 | 229,820 | 44,009 | 4.15% | 21.68% |
| Madrid | 776,330 | 263,650 | 284,272 | 11,665 | 471,313 | 6,314,038 | 1,426,052 | 11.97% | 52.98% |
| Málaga | 283,248 | 54,135 | 98,870 | 1,728 | 69,413 | 1,539,793 | 267,059 | 10.93% | 63.01% |
| Murcia | 139,153 | 32,889 | 80,377 | 1,476 | 90,911 | 1,199,357 | 257,172 | 14.28% | 66.60% |
| Navarra | 65,736 | 11,641 | 46,125 | 38,437 | 31,456 | 629,277 | 195,292 | 12.33% | 39.73% |
| Ourense | 31,900 | 2,214 | 6,795 | 137 | 3,028 | 214,641 | 42,741 | 4.58% | 22.98% |
| Palencia | 19,839 | 3,368 | 4,197 | 190 | 8,488 | 125,534 | 22,383 | 10.10% | 56.67% |
| Pontevedra | 84,383 | 9,445 | 25,561 | 276 | 14,989 | 582,976 | 99,108 | 6.96% | 40.92% |
| Salamanca | 43,616 | 9,032 | 13,682 | 933 | 6,023 | 292,738 | 72,114 | 6.73% | 27.33% |
| Segovia | 17,097 | 3,117 | 9,832 | 483 | 15,727 | 140,320 | 37,332 | 18.21% | 68.46% |
| Sevilla | 198,269 | 32,600 | 54,593 | 2,392 | 38,163 | 1,403,508 | 259,096 | 6.61% | 35.80% |
| Soria | 10,563 | 1,347 | 3,267 | 251 | 4,762 | 87,373 | 28,768 | 9.19% | 27.91% |
| Tarragona | 154,496 | 19,385 | 41,487 | 16,339 | 68,800 | 773,294 | 146,812 | 14.26% | 75.12% |
| Tenerife | 101,691 | 18,799 | 32,170 | 1,097 | 36,116 | 886,572 | 158,252 | 7.70% | 43.15% |
| Teruel | 12,815 | 1,011 | 3,404 | 310 | 4,273 | 174,031 | 81,791 | 4.41% | 9.39% |
| Toledo | 58,656 | 10,427 | 38,923 | 4,350 | 28,073 | 467,012 | 93,042 | 14.35% | 72.01% |
| València | 377,259 | 55,183 | 93,992 | 13,248 | 58,330 | 1,940,796 | 380,116 | 7.85% | 40.07% |
| Valladolid | 63,110 | 8,594 | 27,494 | 952 | 11,126 | 391,333 | 92,370 | 9.87% | 41.81% |
| Zamora | 19,007 | 3,686 | 7,668 | 75 | 5,074 | 130,284 | 31,987 | 9.78% | 39.83% |
| Zaragoza | 101,389 | 28,220 | 26,283 | 2,498 | 69,594 | 899,221 | 198,304 | 10.66% | 48.35% |
| Total Spain | 6,029,061 | 1,176,377 | 1,872,734 | 235,318 | 1,766,390 | 40,373,668 | 8,027,391 | 9.01% | 45.33% |

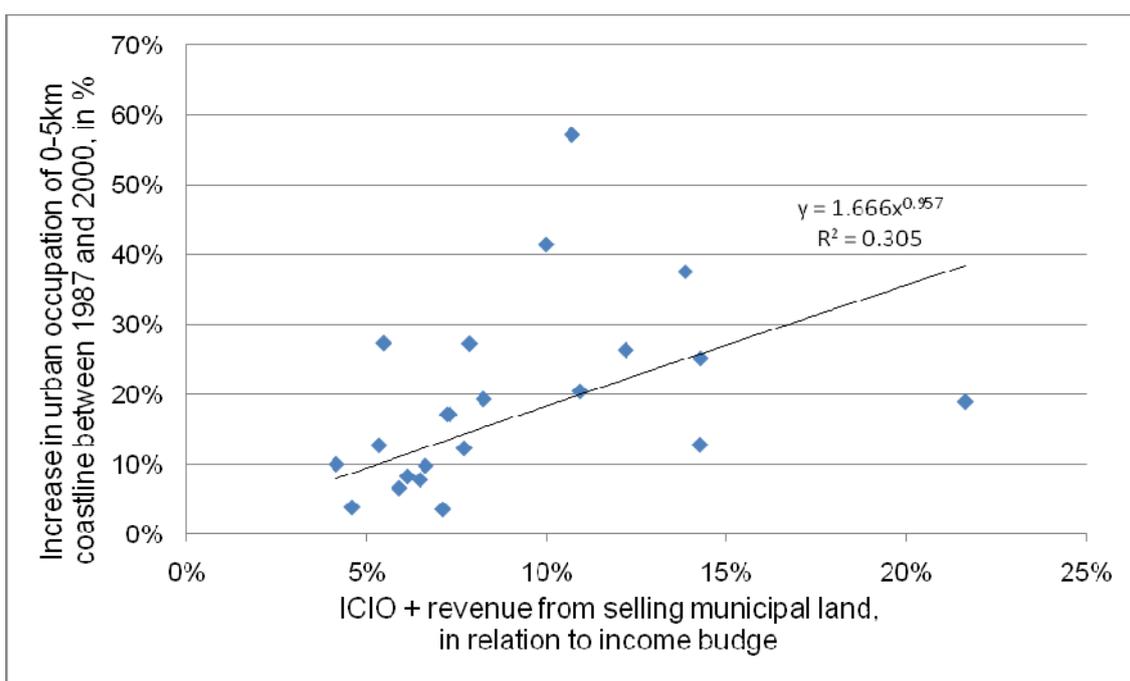
Source: Spanish Ministry of Finance

Table 4 shows that municipal dependence from one-off income sources related to urbanism varies significantly among the Spanish provinces. In general, a higher degree

of dependence is observed in provinces along the southern coastline,¹³ and in the Madrid region. In these areas, ICIO plus revenue obtained from selling municipal land account for 9.67% of total income budget and 51.33% of all municipal investment (as compared to the Spanish average of 9.01% and 45.33%, respectively).

Not surprisingly, we can also find a significant correlation between the urban pressure¹⁴ in provinces along the coast and the dependence of their Local Treasuries on one-off revenue sources related to urbanism (Figure 4):

Figure 4. Relation between urban pressure in Spanish provinces along the coast and their Local Treasuries' dependence on one-off revenue sources related to urbanism



One has to bear in mind that, since municipalities have a limited area suitable for urbanisation, sources of revenue obtained from new urban developments are, by definition, unsustainable, and will diminish in time. Several Spanish municipalities are already reaching this point.

As discussed, most of the revenue generated by sources analysed in section 2.(a) can be characterised as extraordinary, in the sense that they are one-off financial sources dependent on the use of a finite resource, such as land. However, this revenue is often used by municipalities to address expenses that can be characterised as ordinary, such as personnel, regular municipal services, etc. Therefore there is a risk that the municipality is reliant on extraordinary (and finite!) resources to sustain ordinary expenses.

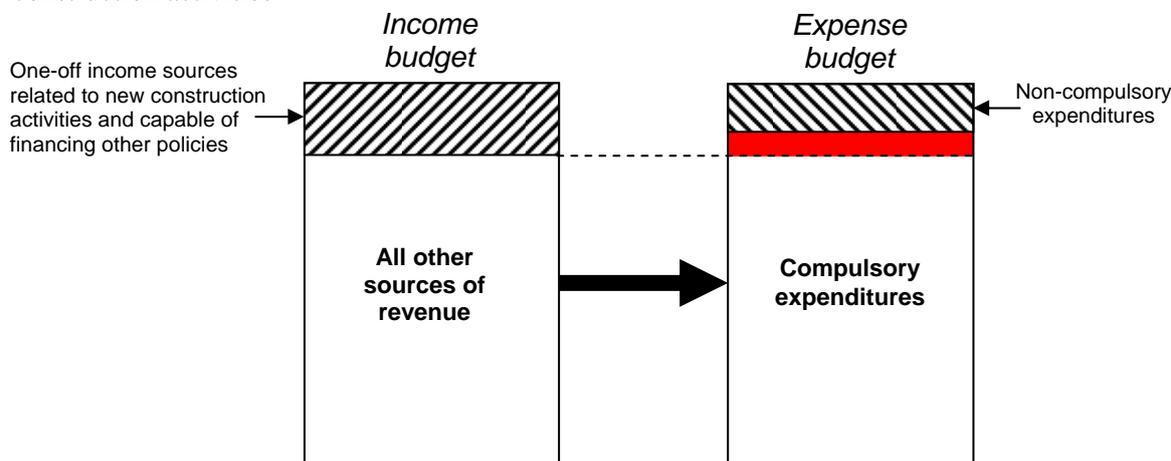
The situation is alarming for those municipalities in which the level of one-off income sources described in section 2.(a) is higher than the level of non-compulsory

13. Girona, Barcelona, Tarragona, Castelló, València, Alacant, Murcia, Almería, Granada, Málaga, Cádiz, and Huelva.

14. As a proxy of urban pressure in coastal provinces we use the percentage growth in urban occupation in the 0-5km coastline area, between 1987 and 2000 (Table 1).

expenditure. A drastic reduction in this revenue would imply municipalities not being able to finance compulsory expenditures (i.e. those services that they have the legal obligation to provide) (See Figure 5).

Figure 5. The risk of financing compulsory expenditures with one-off income sources related to construction activities



Fortunately the number of municipalities in this situation is limited, since the level of non-compulsory expenditures assumed by Spanish municipalities is high (for example, around 30% of total expenses in 2000-2003, in the region of Catalonia).¹⁵

4 The incidence of low-density urbanism

As described in Section 1, urban areas have expanded enormously in Spain during recent decades. This urban sprawl is the consequence of the property market, a preference for low-density urban areas expressed by customers facilitated by developers. In spite of the much higher environmental impacts derived from low-density developments (in terms of sealed soil, energy and water consumption, transport infrastructures and mobility requirements, etc.),¹⁶ Public Administrations in Spain have done nothing to redirect demand towards more sustainable housing.

More relevant for this paper (apart from the environmental costs), is that low-density urban areas also result in higher annual operational costs for the municipal services provided (e.g. waste collection, public transportation, street sweeping, water supply and sewage, public security, public lighting, pavement maintenance, etc.).¹⁷

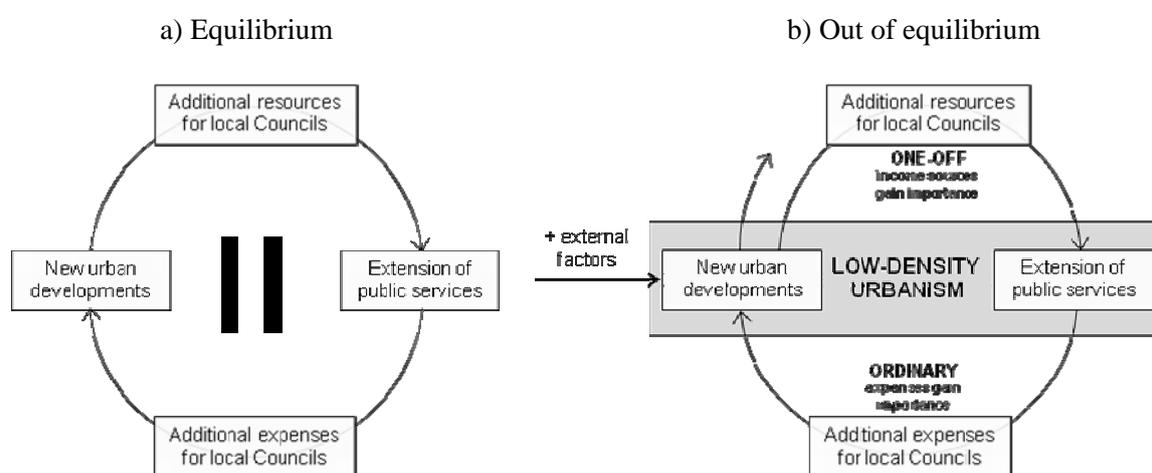
¹⁵ Vilalta, M. (Coord.), Mas, D. (2006) La despesa de caràcter discrecional dels ajuntaments i el seu finançament. Exercicis 2002 i 2003. Elements de debat territorial, 23. Diputació de Barcelona. Barcelona.

¹⁶ As for the environmental impact of urban sprawl, see Rueda, S. (2001) Los costes ambientales de los modelos urbanos dispersos. Agència Local d'Ecologia Urbana. Barcelona or Snyder, K., Bird, L. (1998) Paying the Costs of Sprawl: Using Fair-Share Costing to Control Sprawl. Smart Communities Network. <http://www.smartcommunities.ncat.org/articles/sprawl.pdf> [20 June 2008].

¹⁷ Puig Ventosa, I. (Coord.), Almazor Escartín, L., Freire González, J., Iraegui Navarro, J., Ortega Cerdà, M., Rodrigo Aribau, J. (2006) Costos i ingressos de l'urbanisme per als municipis: metodologia, cas d'estudi i propostes. Institut d'Urbanisme, Habitatge i Activitats Locals (IUHAL). Diputació de Barcelona; McGuire, T.J., Sjoquist, D.L. (2003) "Urban Sprawl and the Finances of State and Local Governments", in Sjoquist, D.L. (Ed.) State and Local Finances under Pressure. Edward Elgar.

This creates more pressure on local finances and leads to Local Councils trying to obtain extra resources. Revenue sources described in section 2.(a) are an easy way to partially obtain those resources, at the cost of developing new urban areas (those facing a higher demand, no matter their density or the mid and long-term costs they imply). This creates a negative feedback whereby municipalities stimulate urbanisation as a means to obtain further revenue required to sustain their budget, which suffers from the excessive costs of services provided to low-density areas (see Figure 6.b). This –along with several other factors such as strong demand for new homes, insufficient resources delivered by the State to Local Treasuries, corruption and others– explains the excessive urbanisation occurred in Spain.

Figure 6. Negative feedback created from excessive dependence on revenue from construction activities and excessive cost of public services derived from low-density urbanism.



5 Proposals

This section aims to suggest a range of adjustments to the financial and taxation structure of Spanish Local Treasuries that could help to address the problem of their excessive dependence from income sources related to new construction activities.

The underlying problem is that construction activities have been (and to a lesser extent still are) economically very attractive, particularly for developers, but also for most Public Administrations, through taxation. This paper has focused on local taxes and charges, but regional and national administrations also have important taxes in place (in particular, VAT, the Net Wealth Tax –impuesto sobre el patrimonio–, the Inheritance and Gift Tax –impuesto sobre sucesiones y donaciones–, etc.).

This paper does not advocate reducing these taxes, since taxing construction has the positive effect of redirecting to the Public Treasuries part of the added value generated by these activities, which also makes them a bit less economically attractive. The problem appears when the Administration that decides when and where to develop new urban areas is also the beneficiary of the taxes and charges derived. This is basically the present situation with Local Authorities, and it creates an incentive to excessively urbanise. Correcting this situation would involve greater empowerment to regional

Administrations to conduct urban planning and its development at the expense of Local Authorities. Needless to say, this would create great reluctance in Local Authorities, as their jurisdiction in this important field would be reduced.

Not surprisingly, considering the importance gained by the construction sector, in Spain construction activities have been repeatedly associated with corruption, particularly at the local level¹⁸. Of course, this is another factor to be addressed if the importance of revenue obtained from these activities is to be reduced in the municipal income budgets.

These proposals would require fundamental changes in Spanish legislation. There are several other proposals that could also be adopted. They require less structural adjustment but their impact would also be significant:

- From ordinary to extraordinary revenues. ICIO and charges on construction licenses levied to new urban developments are extraordinary sources of revenue in nature, and should be considered as such. Therefore, these resources should only be spent on extraordinary expenses.
- Brownfield *versus* Greenfield developments. The environmental impact of new occupation urbanism is higher than that of rehabilitation. This should be related to taxes and charges levied on construction. ICIO tax rate and construction charges on developments in new urban areas should be higher.
- Low-density *versus* high-density urbanism. In similar terms, IBI could be higher in low-density areas and for empty homes.

These three proposals require changes to the Spanish Act on Local Treasuries. The following two do not:

- Increase the contribution of other sources of revenue. In order to make Local Treasuries less dependent on sources of revenue related to urbanism, alternative sources of revenue could be created (e.g. new charges, such as waste taxes if still not in place) or increased (such as the Circulation Tax –Impuesto sobre Vehículos de Tracción Mecánica–, the Tax on Economic Activities –Impuesto sobre Actividades Económicas–, the Charge on garage entrances or the parking charges).
- Increase revenue obtained from services provided to low-density urban areas. Providing public services to low-density areas in general has a higher cost for Local Authorities. Therefore, it is fair to charge them accordingly. This is particularly possible in the case of some charges, and would alleviate the pressure on Local Treasuries (or –if overall revenue is not raised– at least it would eliminate cross-subsidies between high and low-density areas). If it is not possible to charge households according to the cost of the services provided, it may be worth considering provision of cheaper services to low-density areas. Although this might have some political cost.

¹⁸ Transparency International (2006). Global Corruption Report 2006. Chapter devoted to Spain, by Villoria, M. http://www.transparency.org/publications/gcr/download_gcr/download_gcr_2006 [20 June 2008]

6 Conclusions

During recent decades, Spain has experienced a dramatic development of new urban areas. Public Administrations have levied a number of charges and taxes on construction activities, which have become an important source of revenue.

Authority on urban planning and its development primarily falls within the remit of Local Authorities, and at the same time they benefit from the revenue of important taxes, such as ICIO, or taxes on construction licences. Another significant source of revenue has been generated from selling municipality-owned land for new urban developments. These are short-term one-off sources of revenue and, by definition, unsustainable, since they are based on the exploitation of a finite resource: land.

The present structure and responsibilities of Local Treasuries explains partially why Local Authorities have prompted construction activities in excess.

Ideally, both ordinary and extraordinary sources of revenue derived from new urban areas should more or less match ordinary and extraordinary expenses for the municipality derived from such areas. This is clearly not the case now in Spain; particularly if we consider that a significant percentage of urban areas developed in recent years are of low density, which entails high operational expenditure that exacerbates pressures on Local Treasuries, creating a negative feedback mechanism whereby urbanisation is encouraged.

These factors, among many others, explain the boom in construction activities experienced in Spain. The financial problem appears with the lack of new land to develop, and a recent down-turn in the construction industry. The environment will definitely benefit from this, but probably municipal income budgets –or at least some of its present flows– will experience some constriction. Adopting a pro-active role in reducing the dependence of Local Treasuries on one-off sources of revenue from construction activities will benefit the environment in the long term and also guarantee the financial sustainability of Local Authorities.

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