The fiscal and budgetary impact of COVID-19 pandemic on the public finances of the Basque Country: the Basque system of fiscal federalism put to the test

This article analyzes the fiscal and budgetary impact of the COVID-19 pandemic on the public finances of the Basque Country during 2020 and evaluates the performance and sufficiency of the system of fiscal federalism regulated by the Basque Economic Agreement. The research, which has a quantitative and qualitative character, employs the tools of fiscal and budgetary analysis – focusing on deficit and public debt management. The article concludes that the system of the Economic Agreement has withstood the demanding stress test provoked by the pandemic, maintaining unaltered the core principles that govern the Basque model of fiscal federalism: bilateralness in tax and financial relations between the Basque Country and the Spanish state, regulatory power and autonomy of tax management, and the principles of fiscal responsibility and unilateral risk.

El artículo analiza el impacto fiscal y presupuestario de la pandemia de la COVID-19 en las finanzas públicas del País Vasco durante el 2020 y evalúa el comportamiento y solvencia del sistema de financiación foral que regula el Concierto Económico. La investigación, de carácter cuantitativo y cualitativo, emplea las herramientas del análisis fiscal y presupuestario –prestando especial atención a la gestión del déficit y la deuda pública–. El artículo concluye que el sistema de Concierto Económico ha resistido la exigente prueba de estrés provocada por la pandemia, manteniendo inalterables los principios fundamentales que rigen el modelo de federalismo fiscal vasco: la bilateralidad en las relaciones tributarias y financieras entre el País Vasco y el Estado, la potestad normativa y la autonomía de gestión tributaria, y los principios de responsabilidad fiscal y de riesgo unilateral.

Artikuluak, COVID-19aren pandemiak 2020an Euskadiko finantza publikoetan izan duen eragina aztertu, eta Ekonomia Itunak arautzen duen foru-finantzaketa sistemaren portaera eta kaudimena ebaluatzen ditu. Izaera kuantitatiboko zein kualitatiboko ikerketa, aurrekontu analisi eta analisi fiskalaren tresnez baliatu da –defizitaren eta zor publikoaren kudeaketari arreta berezia eskainiz–. Artikuluak ondorioztatzen duenez, Ekonomia Itunaren sistemak, pandemiak eragindako estres-froga zorrotzari eutsi dio, euskal federalismo fiskal eredua egituratzen duten funtsezko printzipioak bere horretan mantenduz: Euskadiren eta Estatuaren arteko zerga- eta finantza-harremanen aldebikotasuna, araugintza-ahalmena eta zergak kudeatzeko autonomia, eta zerga-erantzukizunaren eta aldebakarreko arriskuaren printzipioak.

* Spanish versión available at https://euskadi.eus/ekonomiaz

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Table of contents

Keywords: COVID-19, Basque Country, Basque Economic Agreement, fiscal federalism, public debt.

Palabras clave: COVID-19, País Vasco, Concierto Económico, federalismo fiscal, deuda pública.

JEL codes: E62, H63, H77

Entry data: 2021/02/23 Acceptance data: 2021/07/08

1. INTRODUCTION

The COVID-19 pandemic has provided an ultimate testing ground for evaluating the resistance of the systems of governance and models of institutional organization in the majority of countries in the world.

The speed of contagion of the virus and its high degree of unpredictability obliged the public institutions to articulate an early, swift and coordinated response to be able to control the incidence of the pandemic, especially during the first wave. This emergency situation put to the test the capacity of response and the effectiveness of the federal or decentralized systems, fomenting an interesting debate over the comparative efficacy of the centralized and decentralized models of organization when confronting a crisis of these characteristics (Cameron, 2021; Steytler, 2021).

[1] This research is part of the research activity of the «Biography&Parliament» research group (ref. IT 1263-19) and the research project *Biografía colectiva y análisis prosopográfico más allá del Parlamento* (ref. PGC2018-095712-B-100), funded by the Ministry of Science and Innovation of the Government of Spain.

Logically, not all the federal or decentralized systems have responded to the crisis in the same way. The behavior of the governance framework and the performances obtained have differed notably amongst the different federations and decentralized countries (De Biase and Dougherty, 2021).[2] Currently, with the pandemic still latent, a framework of empirical and comparative analysis is being constructed and updated at the international level to study the impact of COVID-19 on the functioning of the federal or decentralized systems and compare this with the efficacy of the response achieved in centralized systems (Hegele and Schnabel, 2021; Béland *et al.*, 2021; Béland *et al.*, 2020; OECD, 2020b; Aubrecht *et al.*, 2020).

Within this line of research, the article aims to contribute to the formation of this empirical and comparative framework through an analysis of the case study of the Basque Country, focusing on the fields of taxation and financing. The urgent needs of financing provoked by the pandemic in a context of a decrease in tax revenues, constitute an opportune field of analysis for evaluating and comparing the sufficiency and solidity of the systems of fiscal federalism (OECD, 2020a). This has been a particularly sensitive issue in those systems where the sub-central governments have assumed a leading role in the organization and financing of the management of the pandemic, as in the case of the Basque Country. The aim of the article is to analyze the fiscal and budgetary impact of the pandemic on the public finances of the Basque Country and evaluate the behavior and sufficiency of the asymmetrical system of fiscal federalism regulated by the Economic Agreement.

The initial hypothesis of the article is that the system of the Economic Agreement has withstood the impact of the pandemic, maintaining unaltered the core principles and characteristics that govern the Basque model of fiscal federalism, of which the following stand out: bilateralness in the relations between the Basque Country and the state, regulatory power and autonomy in the tax management of the Basque institutions, and the principles of fiscal responsibility and unilateral risk.

The article pays special attention to the development of the last two principles, posing two key initial questions: Who has assumed the repercussions of the lower tax collection and the deficit provoked by the pandemic in the public finances of the Basque Country? Has the pandemic structurally altered the regular or normal governance framework and fiscal and financial relations that are articulated in the Economic Agreement?

These questions go beyond the theoretical-academic field of the framework of fiscal federalism, directly affecting the political level and inter-governmental relations at the level of the Spanish state and, to a lesser degree, that of the European Union. The continuity of an exclusive regime of financing, with the high levels of

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[2] Also see the collection of articles on the response to the first wave of the pandemic in 18 federal or decentralized countries published in Number 19 (2020) of the journal *Cuadernos Manuel Giménez Abad.*

self-government conferred by the Economic Agreement, has not sustained itself for over 140 years based solely on historical and juridical reasons. If the economic and financial aspect of the system breaks down, the historical and juridical narrative comes to nothing. For that reason, each crisis constitutes a test for the continuity of the system and an ideal opportunity for evaluating its condition, strength and capacity of resilience.

The research employs the tools of fiscal and budgetary analysis to develop a study with a quantitative and qualitative character, and is mainly based on budgetary statistics and official publications with a fiscal and financial character. The statistics on budgetary implementation elaborated by the Basque Government and the statistical series on the public debt published by the Bank of Spain are the main primary sources used. Due to the current nature of the issue, the press and other complementary secondary sources are also employed.

On the basis of the available sources, the analysis is centered on the 2020 fiscal year and covers the management of the first two waves of the pandemic in the Basque Country. In relation to the most recent budgetary statistics – especially those for 2020 – provisional data are employed in most cases. Therefore, the data might undergo certain alterations following their definitive settlement. Where statistical sources have permitted this, statistical series have been elaborated from the year 2002, with the aim of analyzing the 2020 health crisis in perspective with the 2008 financial crisis.

The article is structured in four sections in addition to this introduction. The first section contextualizes the historical scope of the pandemic and its repercussion on the political and institutional framework of the system of decentralization in Spain and the Autonomous Community of the Basque Country (henceforth, ACBC), focusing on the field of the fiscal governance of the Basque Country. The second section analyzes the fiscal and budgetary impact of the pandemic on the accounts of the Basque Country during the 2020 fiscal year, covering both the aspect of revenues and that of public expenditure. The third section examines budgetary stability and financial sustainability in the system of the Economic Agreement. The final section of conclusions presents the main results of the research and, in addition, answers the initial hypothesis and questions posed in this introduction.

2. THE SYSTEM OF THE ECONOMIC AGREEMENT FACING AN UNPRECEDENTED CHALLENGE

The system of regional financing in Spain has an asymmetrical character. Decentralization in the facet of expenditure is broadly similar for all the Autonomous Communities (henceforth, ACs). Conversely, in matters of financing and tax and financial autonomy there is a differentiation between two regimes of financing: the common regime and the *foral* regime.

The common regime is applied uniformly in all the ACs on the peninsula,[3] except for the ACBC – made up of the *foral* territories of Álava, Bizkaia and Gipuzkoa – and the *Foral* Community of Navarre.[4] Based on historical and political circumstances, these two ACs have preserved a singular and exclusive regime of financing of a federal type, which is rooted in the pre-constitutional «historical rights» of the *foral* territories.

The system of financing of the common regime has not resulted in the ACs developing a solid and decisive tax capacity. The ACs continue to be notably dependent with respect to instalment payments and transfers by the central administration when drawing up their budgetary policies. In addition to undermining the financial autonomy and restricting the margin of budgetary maneuver of the ACs of the common regime, this system also complicates accountability and blurs the fiscal responsibility of the governments of the ACs (Lago and Martínez-Vázquez, 2010).

Within the system of *foral* financing, the ACBC and Navarre function under a regime that is completely different from, and independent of the common regime of financing that governs the rest of the ACs. In contrast to the ACs of the common regime, the *foral* institutions of the Basque Country and Navarre exercise a broad fiscal, financial and budgetary autonomy (Zubiri, 2010). Within their respective territories, the *foral* treasuries manage and collect practically all taxes, both direct and indirect – including personal income tax (PIT), corporate income tax (CIT), taxes on inheritances and donations, and Value Added Tax (VAT) – and are amongst the sub-state entities with the greatest tax and financial power in Europe (Erkoreka, 2019). As a counterpoint, the Basque and Navarrese institutions pay an annual quota to the state in order to finance competencies and services that have not been transferred or decentralized and are developed by the central administration to the benefit of the Basque Country and Navarre. Consequently, it is the sub-central entities that transfer funds to the central treasury and not vice versa. The system of *foral* financing assumes a high degree of fiscal responsibility and is governed by the principle of unilateral risk (Rubí, 2009). Under this principle, the *foral* institutions assume the risk of eventual lower tax revenues, whether as a result of the economic conjuncture, their fiscal and budgetary policies, or for any other exogenous or endogenous reason. Although part of the analysis and results obtained in this article are also applicable to Navarre, for technical reasons and limitation of space, we focus on studying the case of the Basque Country.

The system of the Basque Economic Agreement, which has regulated the fiscal and financial relations between the Basque Country and Spanish state since 1878, has faced all kinds of contingency and adversity, surviving four constitutionally di-

[3] The Canary Islands and the Autonomous Cities of Ceuta and Melilla have a special tax regime.

[4] The two Autonomous Communities together have an approximate population of 2,800,000 inhabitants. With a per capita income of over 30,000 euros/inhabitant, and a solid industrial economy; they stand out as one of the regions with the highest levels of economic and social welfare in Spain.

verse political regimes, a Civil War, structural transformations in the institutional and governance framework of the Basque Country (assimilating the creation of new institutions such as the Basque Government or the European Union) and a host of economic crises of different types and degrees of gravity. In 2020, it had to confront the COVID-19 pandemic, whose peculiar cause in the form of a virus has resulted in a health, economic, social and fiscal crisis without precedent since the birth of the Economic Agreement. The system of the Economic Agreement had never faced a crisis that, in peacetime, entailed the literal paralyzation of a large part of the economic and entrepreneurial fabric and activity for such a protracted time.

The nearest precedent of a great pandemic was the so-called «Spanish flu» of 1918-1920. In spite of its high mortality rates – far higher in comparison with the COVID-19 pandemic – the Spanish and Basque institutions of that time did not apply restrictive measures that would have paralyzed economic and entrepreneurial activity (Erkoreka *et al.*, 2021b). Nor did that pandemic provoke a fiscal or budgetary crisis in the Basque treasuries, whose debt did not grow in the second half of the 1910s. Together with many other factors, the deep transformations in the political and institutional framework are a key factor when comparing the differences in terms of impact and institutional response between the «Spanish flu» and the COVID-19 pandemics. In the century separating the two pandemics, the consolidation of the welfare state has completely transformed the direction and system of priorities of the public administrations, in contrast to the economic and budgetary priorities that guided the activities of the liberal state at the start of the XX century (Erkoreka, 2021). In contrast to the weak intervention of the administration of that time facing the «Spanish flu», today's institutions have provided a response with a collective and integral character facing the health, economic and social crisis resulting from COVID-19, making use of the deficit and public debt for that purpose.

That is the reason why, with respect to its fiscal and budgetary impact, we find ourselves facing a crisis with unique characteristics in comparison to other previous crises. This exceptional character can also be transposed to the political and insitutional framework of the Spanish system of decentralizaiton, which has been deeply affected and altered by the pandemic crisis.

When analyzing the evolution of the system of decentralization and the framework of activities of the public administrations in relation to decision-making and management of the pandemic, four different stages can be distinguished (Erkoreka *et al.*, 2021a):

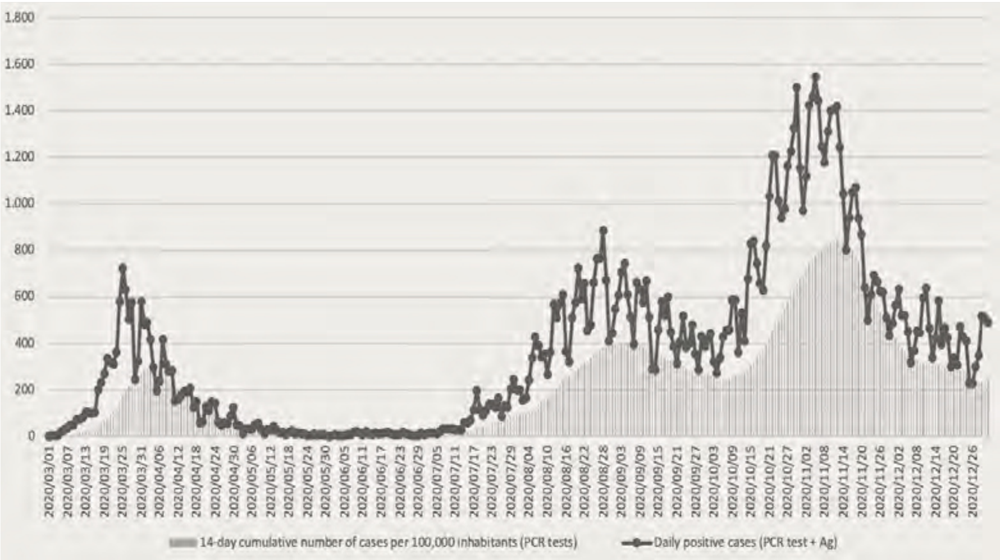
Outbreak and initial, uncontrolled spread of the virus prior to the state of alarm (late-January – 13 March). The first confirmed case of coronavirus in Spain was recorded on January 31, 2020. From mid-February onwards, the virus spread without control throughout the state. By early March cases had been confirmed in all the ACs. Facing the worsening of the health situation, the lack of epidemiological control and problems of coordination, the central government decided to decree the state of alarm, which came into effect on 14 March (Royo, 2020).

Declaration of the first state of alarm and centralization of powers under the single command of the central government (14 March – 21 June). Under the state of alarm, the central government assumed the single command of decision-making and managing measures facing the pandemic, suspending the effective exercise of self-government of the ACs and temporarily centralizing power in all the areas of competency needed to control the pandemic. The ACs continued to exercise their usual competencies of management and direction, but under the guidelines set out by the single command. Amongst other measures, a nationwide lockdown was imposed and non-essential activities were suspended between 30 March and 13 April (Kölling, 2020). With the state of alarm still in effect, the central government presented the «Plan for the transition towards a new normality» on 28 April. The plan, structured in four phases, laid the foundations for gradually reducing the lockdown measures and channeling the transition towards the «new normality» following the end of the state of alarm.

New normality and establishment of the framework of co-governance, in which the state and the ACs share responsibilities in the decision-making and management of the pandemic (22 June – 24 October). In the period of transition towards the new normality, the ACs gradually recovered the competencies and functions that had been centralized under the single command. At the same time, a model of co-governance was established, articulating a framework of cooperation and shared responsibility between the central government and the regional executives in the decision-making and management of the pandemic. From June onwards, in the new scenario of co-governance, the regional executives played a leading role in the decision-making and management of their health systems, in the organization of the systems for testing and tracking the virus, in the design and application of measures of containment and restriction, as well as in the implantation of policies of social protection and economic reactivation (Erkoreka *et al.*, 2021a).

Declaration of the second state of alarm, maintaining a model of decentralized management in the framework of co-governance (25 October – 9 May, 2021). In mid-October the situation worsened, marking the start of the second wave of the pandemic. Facing this situation, 11 ACs – including the ACBC – called on the central government to declare a second state of alarm that would provide greater juridical cover to the administrations when adopting more severe restrictive measures. On 25 October the central government declared a second state of alarm, subsequently extended until 9 May, 2021. The state of alarm imposed a curfew on the entire state from 23:00 until 6:00, restricted mobility between the ACs, and included other compulsory measures at the national level. In any case, the measures adopted were less severe than in March, when a total lockdown had been imposed. Similarly, in contrast to the first state of alarm, the second state of alarm respected the authority of the ACs, maintaining the framework of decentralized co-governance (Tudela, 2021).

Figure 1. **DAILY CASES OF CORONAVIRUS (PCR + ANTIGEN TESTS) AND THE 14-DAY CUMULATIVE NUMBER OF CASES PER 100,000 INHABITANTS (PCR TESTS) IN THE BASQUE COUNTRY (2020)**



Source: OpenData Euskadi, *Evolución del coronavirus en Euskadi*. Elaborated by the author.

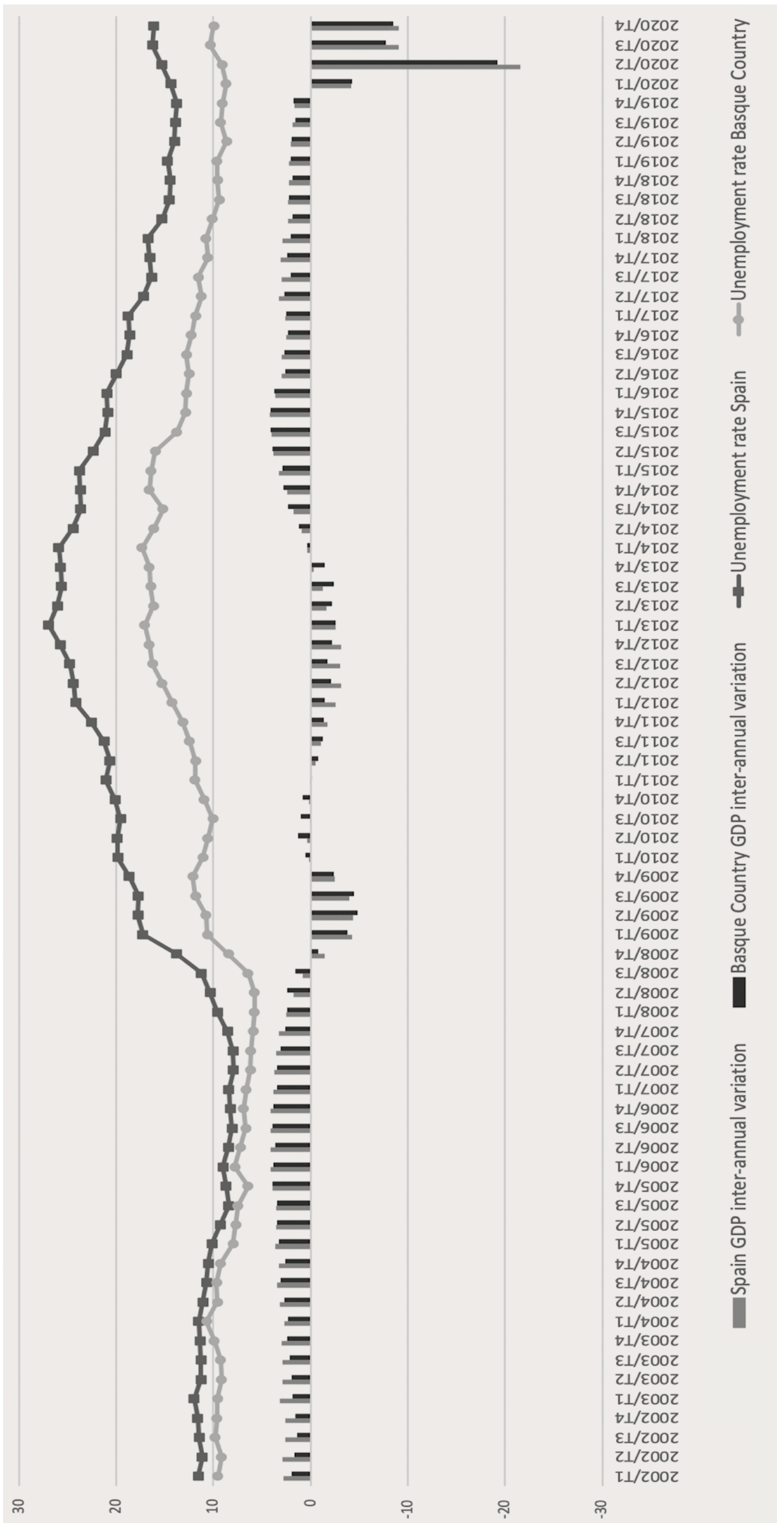
In spite of the deep disruptions caused by the pandemic in the framework of the general governance of the state, the power of the *foral* institutions to regulate taxes and autonomy in tax management was not affected by any of the states of alarm. Furthermore, the *foral* tax administrations carried out a frenetic activity in 2020 to adapt their management procedures and provide a swift response to the serious difficulties and challenges caused by the pandemic. The list of tax regulations elaborated and approved by the *foral* institutions over the course of 2020 is a tangible example of the intense activity they developed.[5]

3. THE FISCAL AND BUDGETARY IMPACT OF THE PANDEMIC ON THE PUBLIC ACCOUNTS OF THE BASQUE COUNTRY

Prior to the pandemic, the Basque economy managed to add a sixth consecutive years of growth to the GDP (2014-2019), drawing away from the long shadow cast by the economic crisis of 2008 (Alberdi and Olalde, 2020). Although the evolution of the GDP showed a slight deceleration in 2020, the forecasts of the Basque institutions for the evolution of the economy and the labor market were optimistic prior to the pandemic.

[5] To consult the production of regulations in tax matters by the *foral* institutions during 2020, see the *Boletín de Normativa Tributaria* (DAT) published monthly by the Basque Government, https://www.euskadi.eus/informacion/boletin-de-normativa-tributaria-dat/web01-a2ogazer/es/

Figure 2. **INTER-ANNUAL VARIATION OF GDP AND EVOLUTION OF THE RATE OF UNEMPLOYMENT IN SPAIN AND THE BASQUE COUNTRY (2002-2020)**

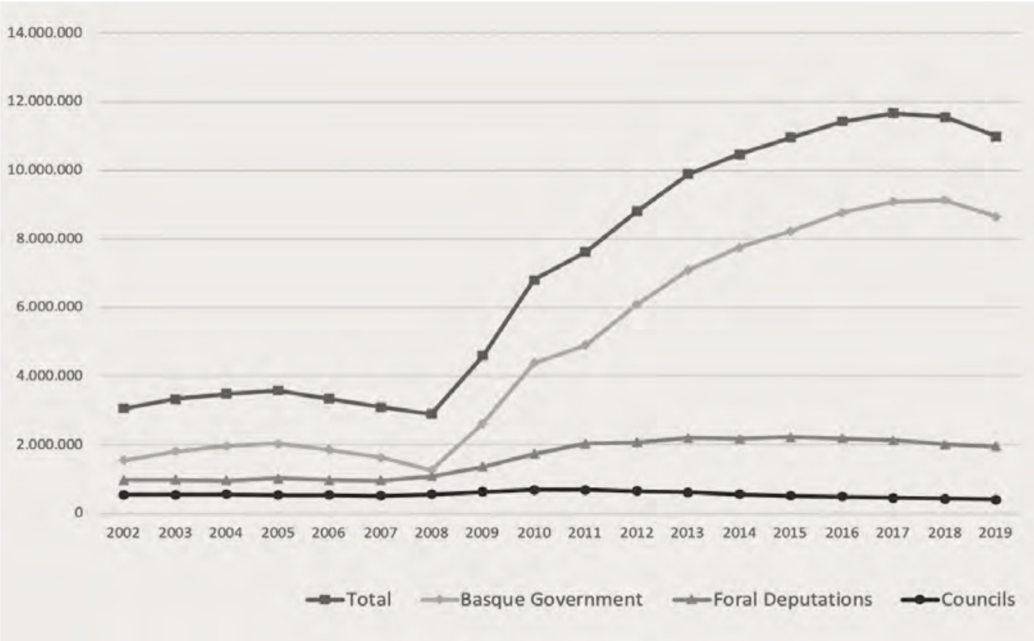


Source: Spanish Statistical Office (INE) and Independent Authority for Fiscal Responsibility (AIReF). Elaborated by the author.

In light of the favorable economic evolution and the increase in tax collection, the Basque institutions adopted a policy of reducing the debt incurred from 2017 onwards. The aim of this policy was to gradually put the public accounts in order following the accumulation of debt due to the crisis of 2008.

Figure 3. **EVOLUTION OF THE DEBT OF THE PUBLIC ADMINISTRATIONS OF THE BASQUE COUNTRY (2002-2019)**

(in thousands of euros)



Source: Basque Statistics Institute (Eustat). Elaborated by the author.

However, the unforeseen arrival of a «black swan» in the form of a global pandemic upset the forecasts and economic policies designed prior to the coming of the virus. The Basque economy, like other economies around the world, suffered a sharp fall in its GDP in 2020 (-9.5%). The injection of public funds into the Basque and Spanish economy cushioned the initial blow to the labor market.

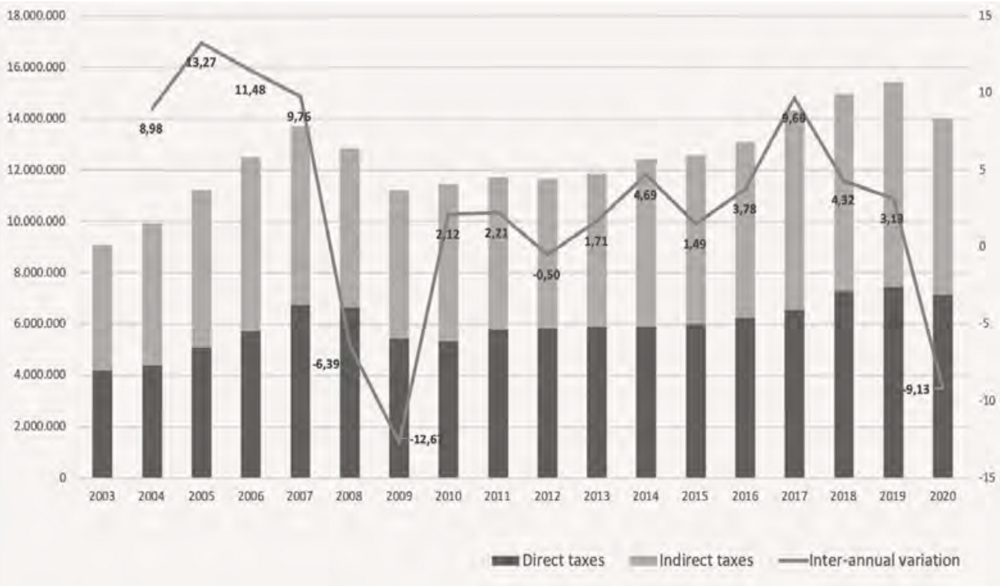
The intense pressure exercised by the pandemic on public accounts in the form of the fall of tax collection and the increase in social-health costs associated with the pandemic, has left a deep fiscal and budgetary footprint on Basque public finances in the 2020 fiscal year.

3.1. The consequences of the pandemic for the fiscal revenues of the Basque treasuries

The tax revenues of the *foral* treasuries of Álava, Bizkaia and Gipuzkoa, fell by more than 9% compared to the 2019 fiscal year.[6] It is worth mentioning that the Basque treasuries faced this fiscal crisis following a sexennium of notable growth in tax revenues. As can be seen below, while the fall in tax revenues of 2020 was very pronounced, the blow received was not as great as that of the year 2009, when tax revenues fell by over 12%.

Figure 4. **EVOLUTION AND INTER-ANNUAL VARIATION OF THE AGGREGATED FISCAL REVENUES OF THE FORAL DEPUTATIONS OF THE BASQUE COUNTRY (2003-2020)**

(in thousands of euros and %)



Source: Basque Government, *Estadística de ejecución presupuestaria*. Elaborated by the author.

[6] The Basque system of fiscal federalism structures a model with confederal features at the level of the ACBC's *ad intra* relations. The fiscal power emanating from the Basque Economic Agreement lies with the *foral* institutions (Representative Assemblies and *foral* Deputations) of the three *foral* territories that make up the ACBC: Álava, Bizkaia and Gipuzkoa. Each territory has its own tax administration that is in charge of regulating, maintaining and managing its own tax system. The *foral* Deputations transfer most of the tax collected to the regional government of the ACBC, the Basque Government, which is responsible for the greater part of public expenditure in the ACBC. Around 90% of the non-financial incomes of the Basque Government proceed from transfers from the *foral* Deputations (MORGAN *et al.*, 2020). The proportion of transfers from the central administration in the budgets of the Basque institutions is residual. The system of *foral* financing is an example of the strict application of the principle of fiscal co-responsibility.

The restrictive measures that the public powers applied from March onwards, the interruption of the administrative deadlines during the first state of alarm, the slowing down of the Basque and world economy, as well as the raft of tax reforms implanted by the *foral* tax administrations, altered and deeply distorted the development of the 2020 fiscal year.

The fall in the section of indirect taxes (-14%) was clearly higher than that of direct taxes (-4%). The lockdown and the measures of social restriction favored a pronounced decrease in consumption and private investment, as well as in economic activity and imports. In this context, the revenues from VAT and Special Taxes fell by 13.4% and 16.8% respectively, in comparison with 2019, vastly exceeding the level of the falls in 2008 and 2009. The clear differences in terms of the nature and the economic and social effects derived from the 2020 health crisis in comparison with the 2008 financial crisis are reflected in the uneven behavior of the principal taxes.

Figure 5. **INTER-ANNUAL VARIATION OF THE PRINCIPAL TAXES COLLECTED BY THE FORAL DEPUTATIONS (2004-2020)**

(in %)

Source: Basque Government, *Estadística de ejecución presupuestaria*. Elaborated by the author.

In the section of direct taxes, the behavior of the PIT cushioned and prevented a greater fall in the accounts of the *foral* treasuries. The positive evolution of public salaries and the pensions compensated for the contraction of revenues derived from the destruction of employment and the proliferation of ERTEs (Exceptional Temporary Employment Regulation), resulting in a moderate fall of 0.9% in revenues from the PIT with respect to 2019 (Guinea, 2020). This figure is far removed from the collapse suffered by the PIT in 2009, when it fell below 12%.

With respect to CIT, the provisional data produced an interannual fall of 19.3%, mainly due to the fall registered in business profits. However, the extension of the deadlines for presentation, postponements and other palliative measures applied to CIT by the tax administrations, might cause certain distortions in the comparison with other fiscal years.

3.2. **The fiscal policy of the Basque tax administrations facing the pandemic**

The exceptional emergency situation produced by the pandemic forced the Basque tax administrations to apply extraordinary fiscal measures, with the aim of providing an early response to the needs of taxpayers, avoiding the paralyzation of tax management, and attempting to mitigate the economic and social impact caused by the pandemic as far as possible.

At the start of the pandemic, the OECD published a report differentiating between four phases in the development of the pandemic and proposing a fiscal response plan adapted and linked to the needs identified for each phase (OCDE, 2020b: 10). By way of a summary, we will now briefly describe the priorities and instruments of the fiscal policy recommended by the OECD in each of the four phases identified:

- In phase 1 (urgent response), fiscal policies must prioritize the rapid provision of financial support to companies and households.
- In phase 2 (cushioning impacts and protection of capacity), the measures adopted in the previous phase must be maintained, complementing these in areas that are considered necessary.
- In phase 3 (recovery), fiscal incentives must be adopted with the aim of boosting investment, consumption and economic recovery.
- In phase 4 (resilience and debt sustainability), fiscal policy must be orientated to putting public finances in order and guaranteeing their sustainability.

The Basque tax administrations employed the OCDE's roadmap and recommendations when designing their fiscal policies to confront COVID-19, including measures with both a normative and management character (Martínez-Bárbara, 2020b: 2-3). Although the design and articulation of some of the measures adopted differed between the tax administrations of Álava, Bizkaia and Gipuzkoa, in general, they followed the same roadmap and calendar, adopting arrangements that coincided or were similar in many cases. Following the model of phases proposed by the OCDE, we will now summarize the main measures adopted by the three administrations during 2020:

- *Phase 1.* In immediate response to the state of alarm, the lockdown and the paralyzation of a large part of economic activity, urgent measures with a transitory character were approved during the months of March and April with the basic aim of protecting and strengthening the juridical security of taxpayers. The three tax administrations approved a raft of tax measures aimed at mitigating the economic impact and favoring the liquidity of taxpayers and the more vulnerable economic sectors, and guaranteeing and protecting the rights of taxpayers (Alonso, 2020b). To that end, transitory flexibilization measures were established and certain tax deadlines suspended, thus responding to the difficulties in, or impossibility of meeting tax obligations due to the health emergency and the state of lockdown (Mata and Carbajo, 2020).

- *Phase 2.* Having overcome the initial phase of urgency, but still immersed in a state of great uncertainty, the aim of the tax administrations was focused on trying to palliate difficulties and maintain the capacity of recovery of taxpayers and the more vulnerable economic sectors. On the one hand, some of the measures postponing and suspending deadlines approved in the first phase were extended. On the other hand, complementary measures of transitory flexibilization were approved for certain tax treatments in direct taxation, especially in the PIT and CIT (Martínez-Bárbara, 2020a: 143-145).

- *Phase 3.* The de-escalation and gradual lifting of restrictions from early May onwards marked a turning point in the economic evolution and in the orientation of fiscal policies. In this phase of economic recovery, in addition to managing the transition from phase 2 to phase 3 in an orderly and sustained manner – revising the measures of containment and mitigation, and adopting the necessary measures of support – the *foral* Deputations chose to implement economic recovery plans: «PlanÁ» in Álava, the «Bizkaia Aurrera!» plan in Bizkaia and the «COVID-19 Plan» in Gipuzkoa. These plans combined measures with a fiscal and budgetary character. In the framework of these recovery plans, the Deputations approved tax incentives and exemptions in direct taxation (mainly in the PIT and CIT), made use of fiscal expenditure, and included other fiscal incentives measures to encourage the economy and consumption (Calvo, 2020). Amongst the measures adopted in Phase 3, it is worth underscoring the novel and transitory introduction of the carry back mechanism for the first time in the Spanish state by the Deputation of Gipuzkoa for both legal and natural persons – Bizkaia also approved a similar mechanism, but exclusively for legal persons. This mechanism makes it possible to compensate for tax losses generated in the 2020 fiscal year with earlier positive taxable income (Martínez-Bárbara, 2020a: 148-151).

The progression to Phase 4, involving the restructuring and ordering of public accounts, will be conditioned by the evolution of the pandemic and the economy during 2021 and subsequent fiscal years.

3.3. The public expenditure policy and economic recovery plans in the Basque Country

In contrast to the lack of consensus and the discoordination shown by the different levels of government that form the framework of the Basque Country's multilevel governance in their hesitant initial response to the crisis of 2008, on this occasion it was possible to put together an early common response in the form of a huge mobilization of public funds at all levels of government: the European Union, the Spanish government, the Basque Government, *foral* Deputations and local governments.

In July 2020, the European Union approved the Next Generation EU European recovery fund, provided with 750,000 million euros, to fight against the pandemic and help the most affected member states (Macho, 2020). Spain chose to apply for up to 140,000 million euros of this recovery fund. On 7 October, the Spanish government presented the «Recovery, Transformation and Resilience Plan of the Spanish Economy» to orientate the execution of the first 72,000 million euros between the years 2021 and 2023. However, the plan did not define the regional division of the funds, which led to a series of bilateral and multilateral negotiations amongst the ACs and the central government. At the end of 2020, the quantity of the division of funds corresponding to the Basque Country and the amount the Basque institutions would be managing were still unknown.

Following the declaration of the state of alarm, the central government assumed the leading role in setting in motion the measures of social protection, economic reactivation and employment protection. Amongst the measures adopted it is worth underscoring the establishment of the Exceptional Temporary Employment Regulation (ERTE) mechanisms, the creation of the Minimum Living Wage, the mobilization of over 150,000 million euros in public guarantees to ensure the liquidity and solvency of the business fabric, as well as diverse plans to reactivate consumption and the labor market (Felgueroso *et al.*, 2021). The central government also created the COVID-19 Fund, provided with 16,000 million euros, as an extraordinary financing mechanism for the ACs.

In the sphere of the ACBC, the Basque Government assumed the leading role in the management and implementation of the expenditure policies facing the pandemic. Although tax power corresponds to the *foral* territories of Álava, Bizkaia and Gipuzkoa, after consolidating the transfers between administrations, the Basque Government emerges as the administration with the greatest expenditure functions in the ACBC. The Basque Government develops an extensive list of competencies, amongst which health, education, security and the regional police, employment and social policies, economic development and competitiveness, and the environment stand out due to their volume of expenditure. On March 24, the Basque Government approved a first emergency plan, provided with 841 million euros, for developing three priority lines of action:

- Guarantee the capacity of the health system to meet the health crisis and the rest of the services needed to meet the emergency situation.[7]
- Help the collectives most in need and guarantee social coverage.
- Support the economic and productive fabric whose activity had been paralyzed or affected by the health crisis. Among other measures, a line of financing for companies with a guarantee from the ACBC to the value of 500 million euros was created.

The initial emergency plan was subsequently supplemented with other economic measures and programs in order to reactivate the economy, the labor market and consumption. Amongst other measures, the Basque Government increased the program of financial support to companies to 1,000 million euros, approved a «Renewal Plan» and other analogous programs to encourage consumption, and assigned significant aid to companies and families.

In November, the Basque Government approved the «Berpiztu program for economic reactivation and employment in Euskadi (2020-2024)». The program is not an extraordinary, extra-budgetary fund, but a roadmap proposed by the Basque Government to reactivate the economy and the labor market over the next four years, with the specific aim of bringing down the unemployment rate in Euskadi to below 10%. The plan envisages mobilizing 13,250 million euros, between budgetary resources and public guarantees.

Although their main tool for influencing the economy is tax policy, the Deputations of Álava, Bizkaia and Gipuzkoa also employed budgetary policy to fight against the economic and social effects of the pandemic within their field of competencies. The recovery plans mentioned in the previous section also included allocations for expenditure of 29, 95.5 and 28 million euros by the Deputations of Álava, Bizkaia and Gipuzkoa, respectively. The main aim of these plans, which were supplemented with other measures and programs, was to reactivate the provincial economy and protect employment. Similarly, the three Deputations elaborated expansionary budgets for the year 2021.

Finally, the local governments also played an important role in the fight against the pandemic within their field of competencies. Given that the local councils do not have relevant competencies in health matters, their role in containing the pandemic was mainly centered on implanting and ensuring the fulfilment of restrictive and preventive measures – the local police forces played an important role in this respect – and regulating economic activity within the limits of their competencies. Similarly, depending on the needs and characteristics of each municipality, the local councils adopted measures of a social nature to help the more vulnerable groups

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[7] The socio-health expenditure associated with the pandemic reached 404 million euros in the ACBC during 2020 (Ministerio de Hacienda, 2021b). This extraordinary increase was equivalent to 2.9% of the tax revenues of the *foral* Deputations during 2020.

and guarantee social cohesion. They also approved and energized economic reactivation plans and policies at the local level – for example, through reductions in local taxes or subsidizing bonds to stimulate local trade or the cultural sector.

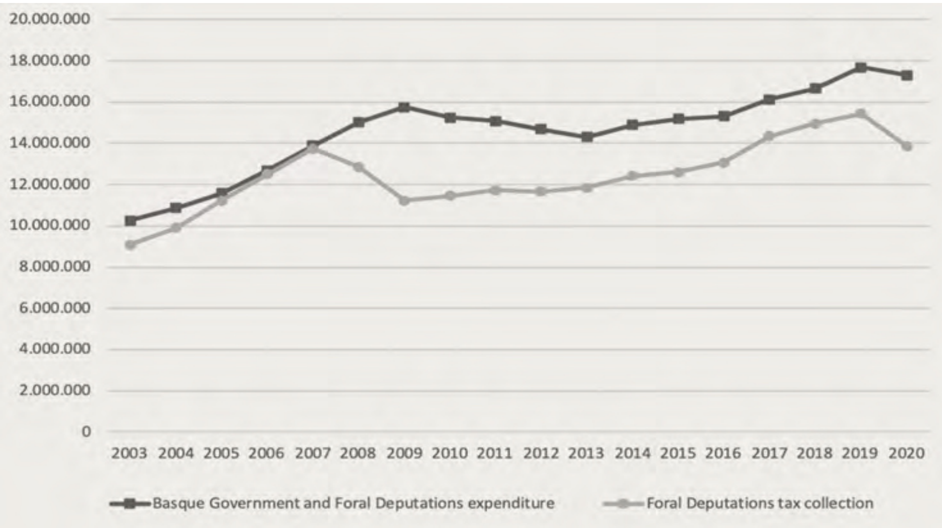
By way of a conclusion to this section, and in answer to one of the initial questions raised in the introduction, it can be noted that the pandemic did not structurally alter the framework of fiscal governance of the Basque Country. Just as in previous crises, the Basque institutions have employed their tools and exercised their power of tax and financial self-government to articulate their own response facing the pandemic. However, this does not mean that the system of the Economic Agreement has not been readjusted and adapted to face the challenges and needs provoked by the pandemic.

4. READJUSTMENT OF THE FRAMEWORK OF BUDGETARY STABILITY AND FINANCIAL SUSTAINABILITY IN THE SYSTEM OF THE ECONOMIC AGREEMENT

The fiscal and budgetary impact of the pandemic upset the balance of the Basque institutions' accounts for 2020, opening up a gap between fiscal revenues and public expenditure. The evolution of fiscal revenues of the three Deputations fell much more sharply than the consolidated expenditure of the Basque Government and the Deputations, which remained at levels similar to the pre-crisis fiscal year of 2019.

Figure 6. **EVOLUTION OF THE CONSOLIDATED EXPENDITURE OF THE BASQUE GOVERNMENT AND THE FORAL DEPUTATIONS AND TAX COLLECTION OF THE FORAL DEPUTATIONS**

(in thousands of euros)



Source: Basque Government, *Estadística de ejecución presupuestaria*. Elaborated by the author.

The imbalance between the public accounts and financing needs provoked by the pandemic made it necessary to revise and readjust the framework of the budgetary stability agreements at the European, Spanish and also the Basque regional levels. This has been a question of great political and economic importance at the European level. Analyzing the behavior of the deficit and the debt in the Basque Country is essential to answering the second initial question posed in the research: Who has assumed the repercussions of the fall in revenues and the deficit provoked by the pandemic in the public finances of the Basque Country? To this end it will be necessary to approach this question in the light of the system of multilevel governance within which the Basque treasuries work.

Starting with the European Union, the fiscal and budgetary policies of the public administrations of the whole European Union are conditioned by the Stability and Growth Pact agreed in 1997. This established certain common regulations of fiscal and budgetary discipline for all member states.

In the context of the European bailout of the Spanish banking system and the reform of Article 135 of the Spanish Constitution, the Spanish parliament approved a new Law on Budgetary Stability and Financial Sustainability (henceforth, LBSFS) in 2012. The aim of the LBSFS is to guarantee the budgetary stability and financial sustainability of all of the Spanish public administrations. By virtue of the LBSFS, the central government sets triannual objectives of budgetary stability and public debt, distributed across the different levels of the administration: the central administration, ACs, local entities (including provincial Deputations and local councils) and administrations of the Social Security.

The LBSFS contains a Third Final Provision which states that «by virtue of its *foral* regime, the application of the provisions of this law to the Autonomous Community of the Basque Country shall be understood without prejudice to the provisions of the Law of the Economic Agreement». In practice, up until 2020 this clause had only been used to negotiate the commitments in matters of budgetary stability of the common institutions of the ACBC – mainly, the Basque Government – relegating the fulfillment of the general regime of local entities to the *foral* Deputations (Hernando-Arranz, 2019). Thus, the *foral* Deputations, in spite of their broad fiscal power, were equated with the Deputations of the common regime, which are secondary institutions with scant tax and budgetary capacity within the general institutional framework of Spain (Alonso, 2020a).

Prior to the pandemic, the Basque and Navarrese institutions had repeatedly demanded recognition of a framework of budgetary stability of their own, which would be adapted to the singularities of the *foral* regime. The Deputations from the Basque Country argued that in the first instance, at the *ad extra* level, a single target of stability should be negotiated for the set of administrations of the Basque public sector within the Joint Committee on the Economic Agreement[8] (henceforth, the Joint Committee). And that subsequently, in the Basque Council of Public Finances, it should be decided *ad intra*, how the agreed targets and rules would be distributed amongst the different levels of government of the Basque Country[9] (Alonso, 2020a). This issue had not yet been resolved when the issue became urgent due to the pandemic.

The Spanish parliament approved the deficit and public debt targets on 27 February, shortly before the declaration of the first state of alarm. A pre-pandemic deficit target of 1.8% of GDP was set for the public administrations as a whole: 0.5%, the central administration; 0.2%, the ACs; 0%, local entities; and 1.1%, the institutions of the Social Security. Subsequently, at the meeting of the Joint Committee on 11 March, 3 days before the state of alarm came into force, the Spanish and Basque governments bilaterally agreed on an ambitious zero deficit target for the ACBC. Taking into account the health situation at that time, the agreement included a safeguard clause which stipulated that, «in case of a significant or substantial change occurring in the macroeconomic forecasts that are not attributable to discretional decisions of the Autonomous Community of the Basque Country, new budgetary stability targets can be set in the Joint Committee on the Economic Agreement».[10]

The arrival of COVID-19 made it necessary to readjust these targets, with the explicit consensus of the European institutions. For the first time in its history, in March 2020, the European Union activated the «general escape clause» of the Stability and Growth Pact, envisaged for exceptional situations of severe crisis. In this way, the regulations ensuring budgetary and financial discipline were temporarily suspended for the public administrations of the member states (Macho, 2020).

This measure afforded the Spanish government considerable flexibility when designing its fiscal and budgetary policies facing the pandemic. The central government did not automatically extend the suspension of the budgetary stability and public debt targets to the ACs or the local entities, and initially kept in place the targets approved at the end of February. In this way, as can be seen in the graph below, the central administration and the Social Security (which has a centralized character) assumed the greater part of the deficit and public debt during 2020 (AIReF, 2021).

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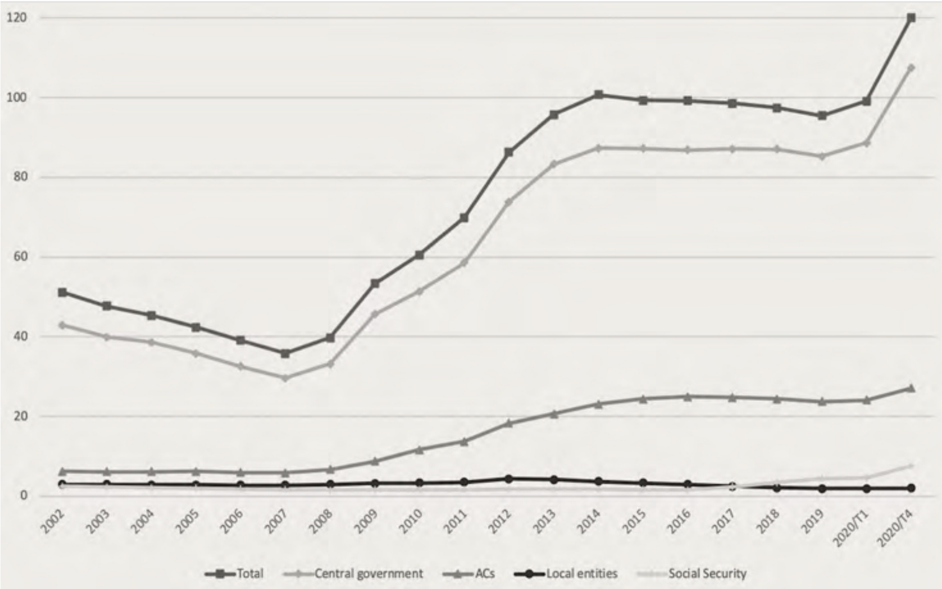
[8] The Joint Committee on the Economic Agreement is the highest committee for relations between the central and Basque administrations concerning matters of the Economic Agreement. To guarantee respect for the principle of bilateralness, the adoption of agreements within the Joint Committee requires unanimity (Martínez-Bárbara, 2019: 99).

[9] The Basque Council of Public Finances is an interinstitutional body on which the Basque Government, the *foral* Deputations and the local councils are represented. Its main function is to determine how the tax revenues raised by the *foral* Deputation should be distributed between the regional government and the provinces in order to finance their respective competences (Martínez-Bárbara, 2019: 25-26).

[10] Act 1/2020 of the Joint Committee on the Economic Agreement held on 11 March 2020,https://www.euskadi.eus/informacion/comision-mixta-del-concierto-economico/web01-a2conci/es/

Figure 7. **EVOLUTION OF THE DEBT ACCORDING TO THE EXCESSIVE DEFICIT PROTOCOL OF THE PUBLIC ADMINISTRATIONS OF SPAIN (2002-2020)**

(% of GDP)



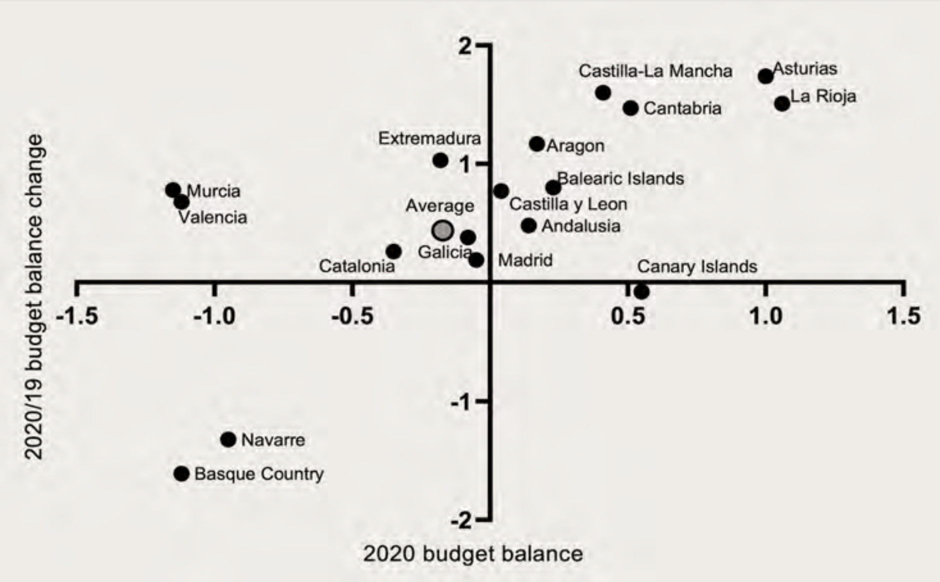
Source: Bank of Spain, *General Government Statistics*. Elaborated by the author.

In the first place, both administrations took responsibility for setting in motion and financing the main measures of social protection and for maintaining employment (ERTEs, Minimum Living Wage, etc.). In the second place, the central administration provided support to the ACs of the common regime against the budgetary effects of the pandemic, providing them with compensation for the fiscal gap in their accounts provoked by the pandemic. During the 2020 fiscal year, the government brought forward payment of the settlement of the regional financing system for the 2018 fiscal year, established instalment payments with respect to 2020 on the basis of the pre-pandemic growth forecast of 1.6% of the GDP[11] (when the GDP fell by more than 10%), and granted extraordinary resources to the ACs to finance the increase in socio-health expenditure and the fall in regional tax collection resulting from the pandemic (Conde-Ruiz et al., 2020).

[11] The ACs of the common regime receive in advance the funds from the regional financing system in application of the forecast existing at the time the draft bill for the general state budget is drawn up. These instalment payments are settled two years later on the basis of the definitive budgetary settlement.

Figure 8. **ACS 2020 BUDGET BALANCE AND CHANGE IN THE BUDGET BALANCE IN RELATION TO 2019**

(% of GDP)



Source: (Ministerio de Hacienda, 2021a). Elaborated by the author.

The accounts of the ACs of the common regime thus received a strong boost in 2020 with the injection of liquidity by the central administration. The ACs have not only had available a record level of resources to confront the pandemic, but, in addition, they closed 2020 with the best budgetary balance since 2006 (De la Fuente, 2021a). Thanks to the financial safety net provided by the central administration, the ACs as a whole showed a budgetary deficit of 0.21% of the GDP in 2020 – nine ACs obtained a surplus – considerably improving on the result of 2019, which closed with a deficit of 0.57% of the GDP. This extraordinary injection of liquidity provided a short-term solution to the financing problems of the ACs of the common regime, postponing them to 2022, when the regional system of financing for 2020 will be settled. When the budgetary year is settled negatively in 2 years' time, the formation of a large negative balance in the form of repayment to the central administration by the ACs of the common regime is foreseen (De la Fuente, 2021b). Under this system of financing, the ACs of the common regime suffer from a huge dependency with respect to the decisions of the central government – above all in circumstances of budgetary urgency that require a swift response – to the evident detriment of their financial autonomy. Similarly, the evaluation of the exercise of fiscal responsibility and accountability by the different administrations is also diluted and made more difficult (Lago and Martínez-Vázquez, 2010).

The finances of the ACs of the *foral* regime evolved in a completely different way. The Basque institutions, like those of the state, mainly depend on the management of their own fiscal revenues to finance themselves. The *foral* regime does not participate in the schema of flows and transferences employed in the system of financing of the common regime. Therefore, the Basque Country has only participated in some of the extraordinary funds and transfers created by the central government outside the system of financing the common regime – and it also participates in the European funds. In any case, its participation in those funds has been adapted to the framework of *foral* financing.

Apart from the system of financing the common regime, the central government approved the COVID-19 Fund in June, which was neither repayable nor conditioned. This was the principal fund created by the central government in 2020 with the aim of financially supporting the ACs. The fund, provided with 16,000 million euros, was shared amongst the ACs, principally taking account of the pandemic's impact on the areas of heath (9,000 million euros), education (2,000 million euros) and the fall in incomes (5,000 million euros).

Table 1. **DISTRIBUTION OF THE COVID-19 FUND AMONGST THE ACS**

(in million euros)

ACs	Health		Education	Fall in incomes	TOTAL	COVID-19 Fund (% GDP)
	Section 1	Section 2	Section 3	Section 4		
Andalusia	597,61	391,73	383,86	825,60	2.198,79	1,5
Aragon	146,58	109,77	53,45	120,67	430,47	1,2
Asturias	106,10	63,84	32,53	96,26	298,73	1,4
Balearic Islands	104,54	64,80	50,28	218,78	438,40	1,6
Canary Islands	158,98	98,85	87,37	205,97	551,16	1,4
Cantabria	64,71	29,52	22,14	60,42	176,80	1,3
Castilla-La Mancha	319,26	150,65	89,19	184,35	743,44	1,9
Castilla y Leon	349,16	195,66	84,04	214,57	843,44	1,5
Catalonia	1.246,53	474,50	337,44	1.107,09	3.165,55	1,5
Extremadura	96,00	58,14	43,30	79,99	277,42	1,4
Galicia	268,11	149,65	92,99	224,11	734,86	1,2
La Rioja	57,52	28,81	13,20	27,52	127,06	1,6
Madrid	1.495,75	613,87	291,70	945,05	3.346,37	1,0
Murcia	98,16	86,05	73,82	130,85	388,88	1,3
Valencia	449,63	263,04	214,19	558,77	1.485,63	1,4
Total common regime ACs	**5.558,64**	**2.778,88**	**1.869,48**	**5.000,00**	**15.207,01**	-
Navarre	88,73	56,80	29,29	0,00	174,82	0,9
Basque Country	328,63	152,32	87,23	0,00	568,18	0,8
Total foral regime ACs	**417,36**	**209,12**	**116,52**	**0,00**	**742,99**	-
Ceuta and Melilla	24,00	12,00	14,00	0,00	50,00	-
TOTAL	**6.000,00**	**3.000,00**	**2.000,00**	**5.000,00**	**16.000,00**	-

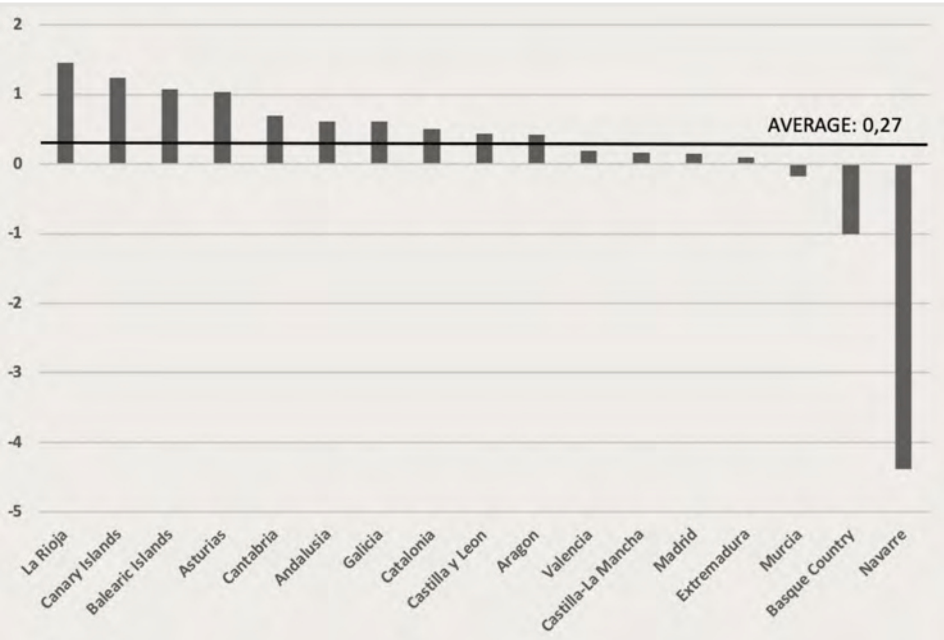
Source: Spanish Treasury Ministry and (AIReF, 2021).

Due to their singular tax regime, the central government excluded the Basque Country and Navarre from the fourth section, aimed at compensating for the lower tax revenues of the ACs. The First Final Provision of the Royal Decree-Law, regulating the creation of the COVID-19 Fund, states that the section of compensation for the fall in revenues «will be determined in terms of deficit and public debt» in the case of the Basque Country and Navarre:

The coverage for the fall in revenues due to the decrease in economic activity of the Autonomous Community of the Basque Country and the Foral Community of Navarre will be determined in terms of deficit and public debt in the Joint Committee on the Economic Agreement and the Coordinating Commission of the Economic Agreement.

Figure 9. **CAPACITY (+) OR NEED (-) OF FINANCING OF THE ACS (JULY 2020)**

(% of GDP)



Source: (Ministerio de Hacienda, 2020). Elaborated by the author.

In light of this Provision, the Basque Government urged the central government to convene the Joint Committee on the Economic Agreement as soon as possible and negotiate a new target for the deficit and public debt that would enable it to go to the debt market to cover the imbalance in its accounts. The delay in convening the Joint Committee led to an increase in political tension between the Basque and central governments. In mid-July, the deficit and public debt targets had still not been updated, with the strict targets established prior to the state of alarm remaining in place for the ACs of both the common regime and the *foral* regime. The difference resided in the fact that, while the former found themselves in a state of surplus at the end of July thanks to the injection of liquidity received from the central administration (registering a budgetary balance that was even better than in 2019), Navarre and the Basque Country required an urgent response to solve their financial needs.

Finally, the Spanish and Basque governments reached an agreement to update the deficit and debt targets for the ACBC on 31 July, outside the framework of the Joint Committee.[12] The zero-deficit target agreed in March was increased to 2.6% of GDP and the indebtedness target to 15.9% of GDP.[13] The President of the Basque Government, Iñigo Urkullu, signed an article in the newspaper *El País* in which he defended the importance of the agreement and underscored the differential fact of the regime of *foral* financing. In the article, he argued that «in the Basque Country, the same as in the state, but unlike the ACs of the common regime, the decrease in revenues can only be covered through public indebtedness», stressing that «with the agreement that has been reached, the Basque institutions will be the ones in charge of financing that deficit» (Urkullu, 2020).

Nonetheless, this agreement only affected the common institutions of the ACBC. For the *foral* Deputations and Basque local councils the goals of stability and sustainability continued to be governed by the strict regulations established for local bodies.

This issue was negotiated and reformed at the meeting of the Joint Committee held on 30 September 2020. That same day, the Spanish government announced the suspension of the fiscal rules for 2020 and 2021, annulling the deficit and public debt targets for all of the public administrations. Beyond establishing certain referential rates (whose fulfilment was not compulsory) for 2020 and 2021, it recognized that the *foral* Deputations had a differentiated status with respect to the local entities «for the purposes of the possibility of incurring deficit and debt», derived from the unilateral risk that they assumed in the exercise of their tax and financial power:[14]

The foral Deputations have a broad tax power in the Historical Territories, such that, facing a situation of economic crisis, they immediately assume the falls in revenues that cannot be compensated through ordinary transfers from other administrations and, therefore, they might need to have recourse to indebtedness, and are thus not considered local entities for the purposes of the possibility of incurring deficit and debt.

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[12] The agreement was subsequently ratified by the Joint Committee on the Economic Agreement held on 30 September, 2020.

[13] Two days before, on 29 July, the Spanish and Navarrese governments reached an agreement to increase the deficit of Navarre to 2.3% of GDP, a figure that was subsequently increased to 2.6%. Finally, the ACBC and Navarre closed the 2020 fiscal year with a deficit of 1.12% and 0.95% of GDP, respectively.

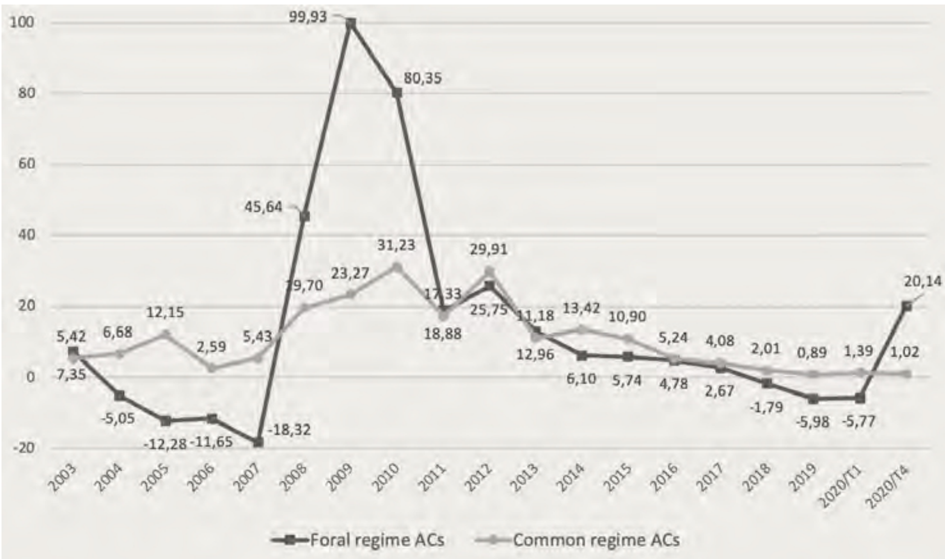
[14] Act 2/2020 of the Joint Committee on the Economic Agreement held on 30 September, 2020, https://www.euskadi.eus/informacion/comision-mixta-del-concierto-economico/web01-a2conci/es/

At the meeting, agreement was reached on a referential deficit rate of 3.5% of GDP for all the Basque administrations for 2020 (to the 2.6% agreed in June for the ACBC, a specific 0.9% was added for the *foral* Deputations), and of 3% for 2021 (2.2% for the common institutions of the ACBC and 0.8% for the *foral* Deputations). Subsequently, at the meeting of the Basque Council of Public Finances on 15 October, agreement was reached on the territorial share-out of the deficit targets amongst the three *foral* Deputations. In turn, each Deputation agreed with its respective local councils on the way the deficit would be shared and their budgetary targets adjusted to the new framework of general suspension of fiscal rules.[15]

Although the suspension of fiscal rules during 2020 and 2021 eclipsed this agreement in the short term, the Basque Government described it as a «landmark» and an endorsement of the regime of the Economic Agreement (Ferreras, 2020). The Basque Government interpreted this agreement as a lasting recognition that the *foral* Deputations had their «own identity» in matters of deficit and public debt.

Figure 10. **INTER-ANNUAL VARIATION OF THE DEBT OF THE ACS OF THE COMMON REGIME AND THE FORAL REGIME (2003-2020)**

(in %)



Source: Bank of Spain, *General Government Statistics*. Elaborated by the author.

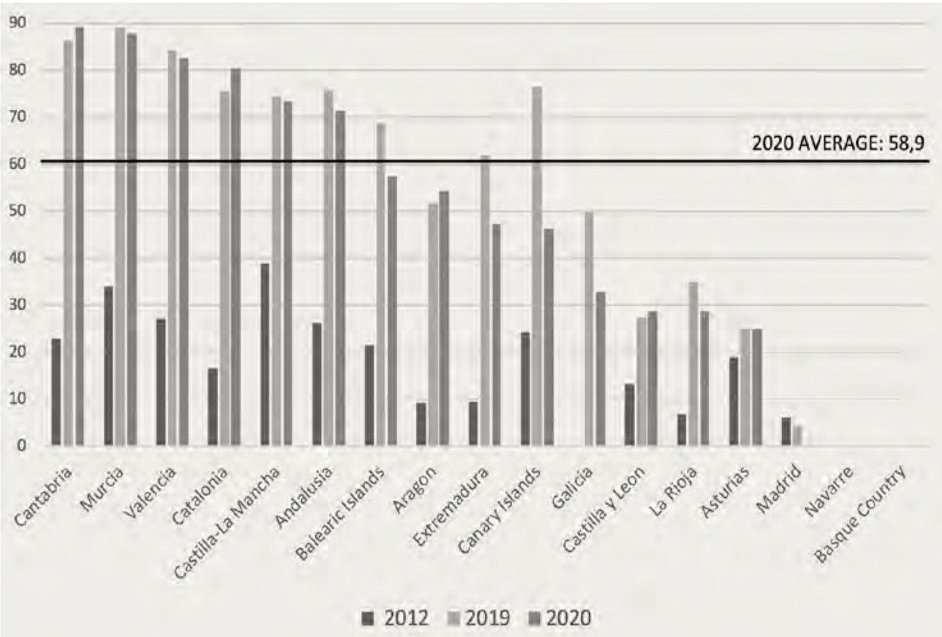
[15] Under the Economic Agreement, the framework of local financing is regulated at the provincial level in the Basque Country. Financial tutelage of the local treasuries corresponds to the *foral* Deputations of Álava, Bizkaia and Gipuzkoa. In this way, the share-out of the levels of deficit between Deputations and local councils, as well as the possibilities of using the budgetary excess and debt, were negotiated and agreed in the Territorial Finances Committee of each of the provinces, in which representatives of both levels of the administration took part on an equal footing.

The comparative behavior of public debt evinces a clear disparity between the ACs of the common and *foral* regimes. In contrast to the ACs of the common regime, the Basque institutions were able to immediately assume the repercussions on the Basque treasuries of lower revenues and deficit provoked by the pandemic, and had to take recourse to indebtedness for this purpose.

Management of the public debt in circumstances of emergency and fiscal crisis is a key indicator when evaluating the principle of fiscal responsibility in the response of the systems of federalism and/or fiscal decentralization (Herold, 2018). While the Basque institutions have applied a counter-cyclical policy – reducing their debt in cycles of expansion to strengthen their solvency and margin for action in times of crisis – the margin for action of the ACs of the common regime has been much more limited. The debt has in part been employed to compensate for, or cover the structural shortcomings of the common regime's system of financing. The differences in the exercise of fiscal responsibility do not only respond to the greater tax and financial autonomy exercised by the Basque institutions, but also to the greater risk that the latter assume due to the consequences of their fiscal and budgetary policies.

Figure 11. **INDEBTEDNESS OF THE ACS WITH RESPECT TO THE CENTRAL ADMINISTRATION ARISING FROM ADDITIONAL LIQUIDITY SUPPORT FACILITIES (2012-2020)**

(% of total debt of each AC)



Source: Bank of Spain, *La evolución de la deuda pública en España en 2020.* Elaborated by the author.

Similarly, it is worth underscoring that a large part of the debt accumulated by the ACs of the common regime since 2012 has been covered through additional liquidity support mechanisms on favourable financing terms, provided by the central administration (AIReF, 2020: 29-31). At the close of 2020, around 60% of the debt of all the ACs was in the hands of the central administration. As an exception to this, the Basque Country and Navarre are the only ACs that have chosen not to indebt themselves to the state and have turned to the debt market to finance themselves – albeit in less favorable conditions. Behind this decision, in addition to exteriorizing their financial power and autonomy with respect to the central government, the Basque institutions seek to preserve political and economic coherence in the application of the principles of bilateralness, fiscal responsibility and unilateral risk that govern the system of the Economic Agreement.

5. **CONCLUSIONS**

The system of the Basque Economic Agreement has demonstrated a capacity for adaptation and immediate response in the management of the COVID-19 crisis, withstanding the demanding stress test that the pandemic inflicted on its public finances, and maintaining unaltered the core principles of the Basque system of fiscal federalism.

In spite of the deep disturbances provoked by the pandemic in the framework of decentralized governance of the ACs in Spain, the tax regulatory power and autonomy of tax management of the *foral* institutions were not affected during either of the states of alarm. The Basque tax administrations continued to regulate and manage their respective tax systems, responding to the needs of tax taxpayers and financing by means of fiscal revenues the payment of the quota to the central administration, as well as the funding needs of the Basque public sector. The Basque tax administrations based themselves on the guidelines of the OCDE to adapt their management procedures, adopt extraordinary normative tax measures, and provide a swift response to the serious fiscal, economic and social consequences provoked by the crisis. At the same time, the Basque public sector as a whole made an important investment effort, articulating an immediate response to the health, economic and social crisis.

The fact that the pandemic has not structurally altered the framework of fiscal governance of the Basque Country or the schema of fiscal and financial relations regulated by the Economic Agreement, does not mean that the system has not been readjusted and adapted according to the circumstances. The financing needs provoked by the pandemic resulting from the fall in revenues and the increase of sociosanitary expenditure, made it necessary to readjust the framework of the agreements on budgetary stability and financial sustainability in the system of the Economic Agreement.

Within the channels of bilateral relations established by the Economic Agreement, the Spanish and Basque governments agreed to update and increase the deficit and public debt targets of the Basque Country – for both the common institutions of the ACBC and the *foral* Deputations. In these agreements it was recognized that the *foral* Deputations have a status of their own for the purpose of the possibility of incurring deficit and debt, which is derived from the unilateral risk that they assume in the exercise of their tax and financial power.

The updating of the stability targets guaranteed the liquidity of the system of *foral* financing and the fulfilment of the principles of fiscal responsibility and unilateral risk. In this way, the Basque institutions assumed, with immediate effect, the repercussions on the public treasuries of the Basque Country of the lower tax revenues and the deficit provoked by the COVID-19 crisis, taking recourse to the debt market to cover their needs of financing.

The pandemic, like other earlier crises such as that of 2008, has emphasized the deep structural differences that exist between the systems of financing of the common and *foral* regimes in terms of the exercise of fiscal autonomy and the principles of fiscal responsibility and unilateral risk. The confluence of these two highly disparate regimes of financing within the frontiers of the same state, make Spain into an interesting laboratory for tests that analyze the sustainability and contrast the behavior of the sub-central public debt between systems with high and low fiscal responsibility.

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