

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



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THE GROWTH OF URBAN AREAS IN SPAIN

- Between 1987 and 2000 sealed soil in Spain increased by 29.5%, with estimate projections for 2005 and 2010 being 41% and 52%.
- This growth has been more intense in the coast (79% of all residences built in Spain between 1990 and 2000, mainly in the Mediterranean), and in the metropolitan area of Madrid.
- Only in 2005, more than 800,000 new homes were approved, more than those built in France, Germany and the United Kingdom, together.

¿WHY?

- economic growth
- increased population, mainly due to the baby-boom experienced in Spain in the 70s, and due to immigration
- increased number of tourists
- increased number of seconds homes (3,360,631 in 2001)
- low interest rates
- new buyers from other countries (mainly EU)
- reduction of the average number of members per household
- property speculation (3,106,422 empty homes in 2001)
- Preeminence of low-density developments

THE ROLE OF LOCAL COUNCILS

Taxes, charges and other revenue sources related to construction activities in Spain

For the purpose of this presentation these resources have been classified between:

- those that are levied only once (**one-off** sources of revenue), are obtained in the short-term and can potentially be used to finance other municipal policies
- **others**

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

These sources can 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.

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

Tax on any construction work by which a municipal license is required. The taxpayer is the owner of the work and the tax base is its cost. The tax rate is determined by the local Council, and cannot exceed 4%.

In general, ICIO is the **highest source of revenue** for local Councils when a new urban development occurs.

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 are compulsory, some are not. In general, their revenue exceeds the cost of the administrative services provided by the Council, thus they also become a way to finance local policies.

Both ICIO and construction charges are levied prior to the execution of the construction activities, and regardless of the costs that these urban areas may imply for the municipality in the mid or long term.

(iii) Revenue obtained by selling municipality-owned land

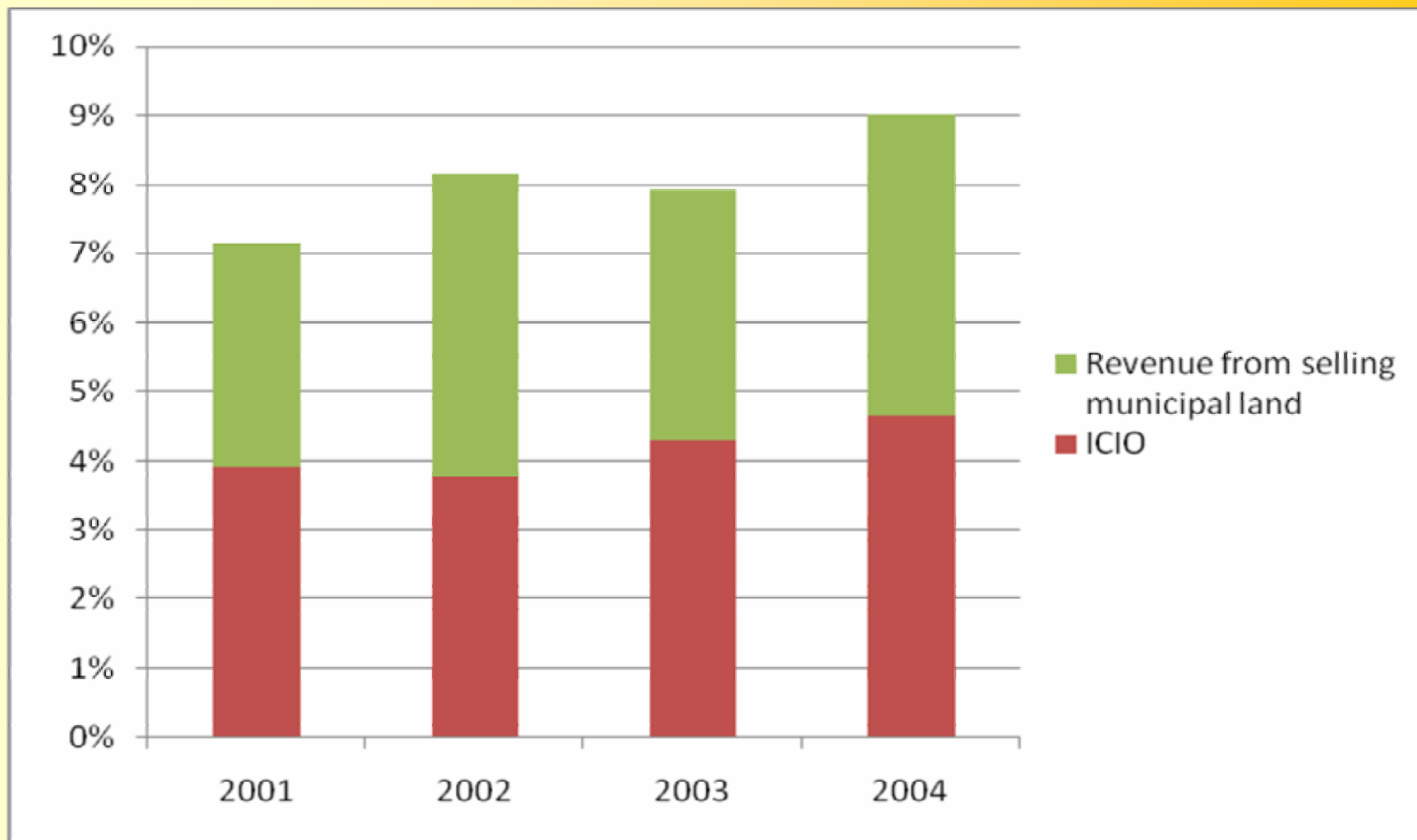
In Spain municipalities can change the qualification of the land, typically from not for building to building land. By means of this process, the price of the land boosts. Despite there are some legal restrictions, another source of revenue has been to change the qualification of municipality-owned land and then sell it.

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

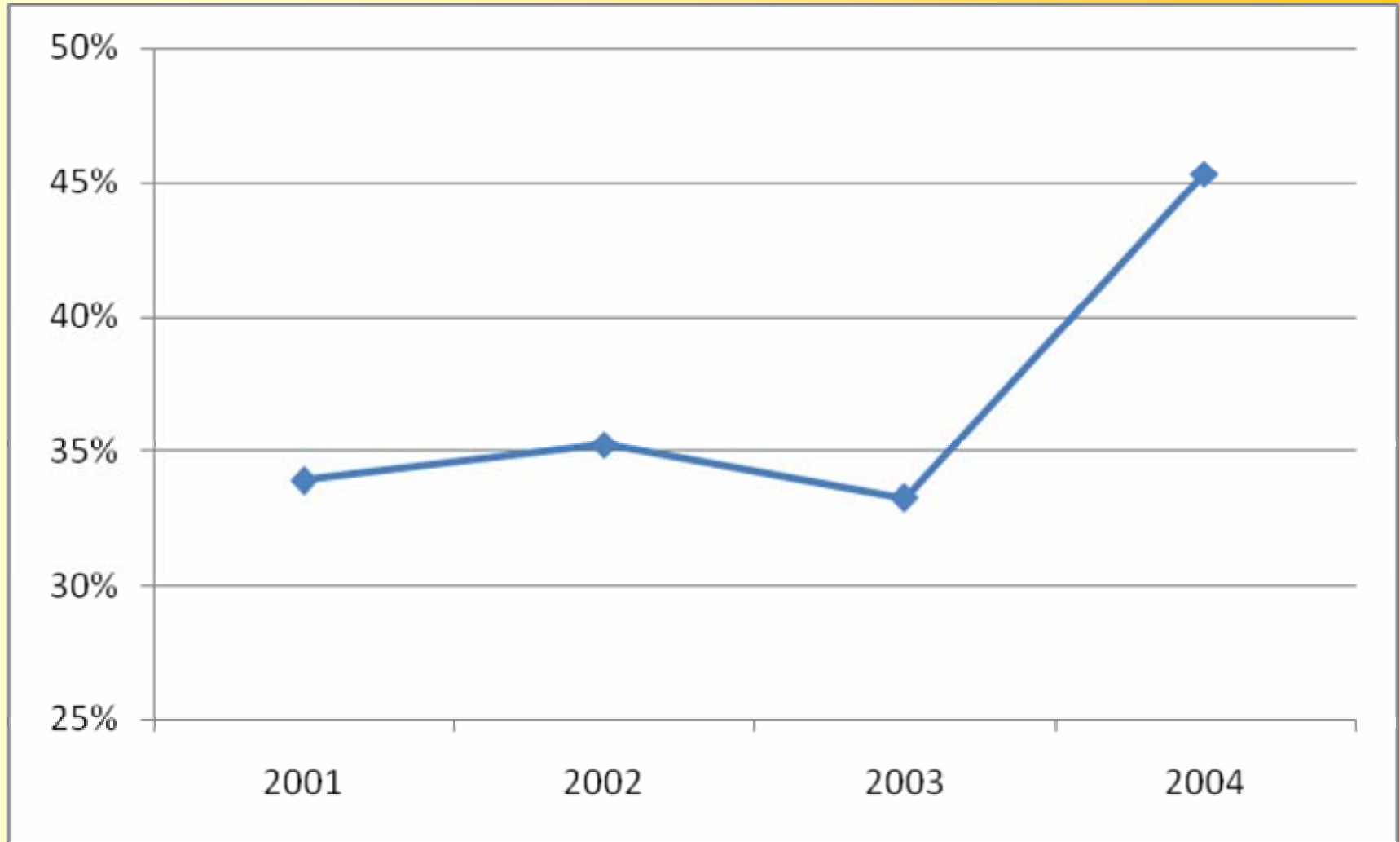
Revenue raised by the different income sources related to urbanism, and total income budget, in Spanish Local Treasuries, 2001-2004 (thousands of euros)

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

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

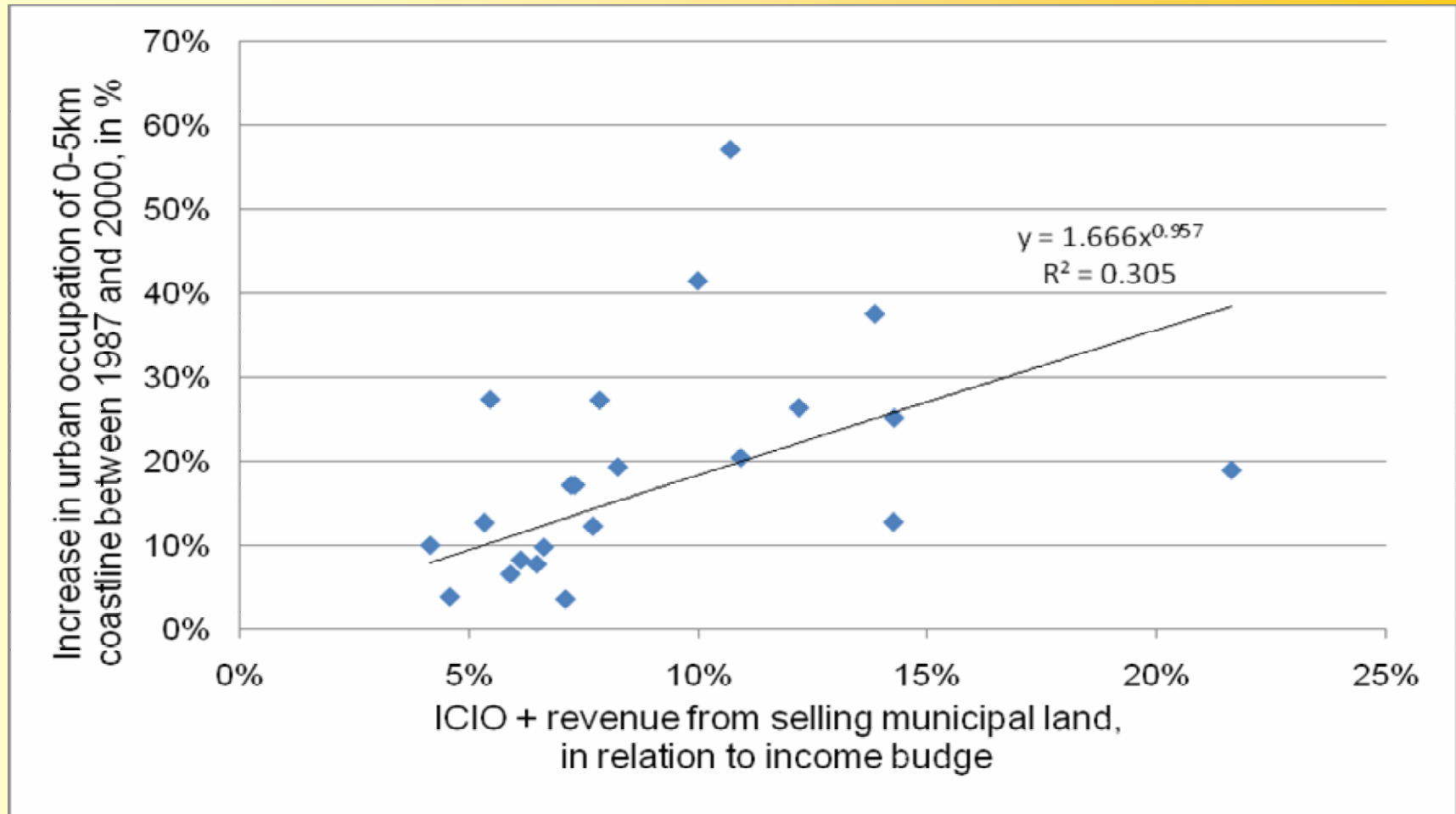


Relative importance of one-off income sources related to new construction activities in relation to investments by Spanish local Councils, 2001 - 2004.

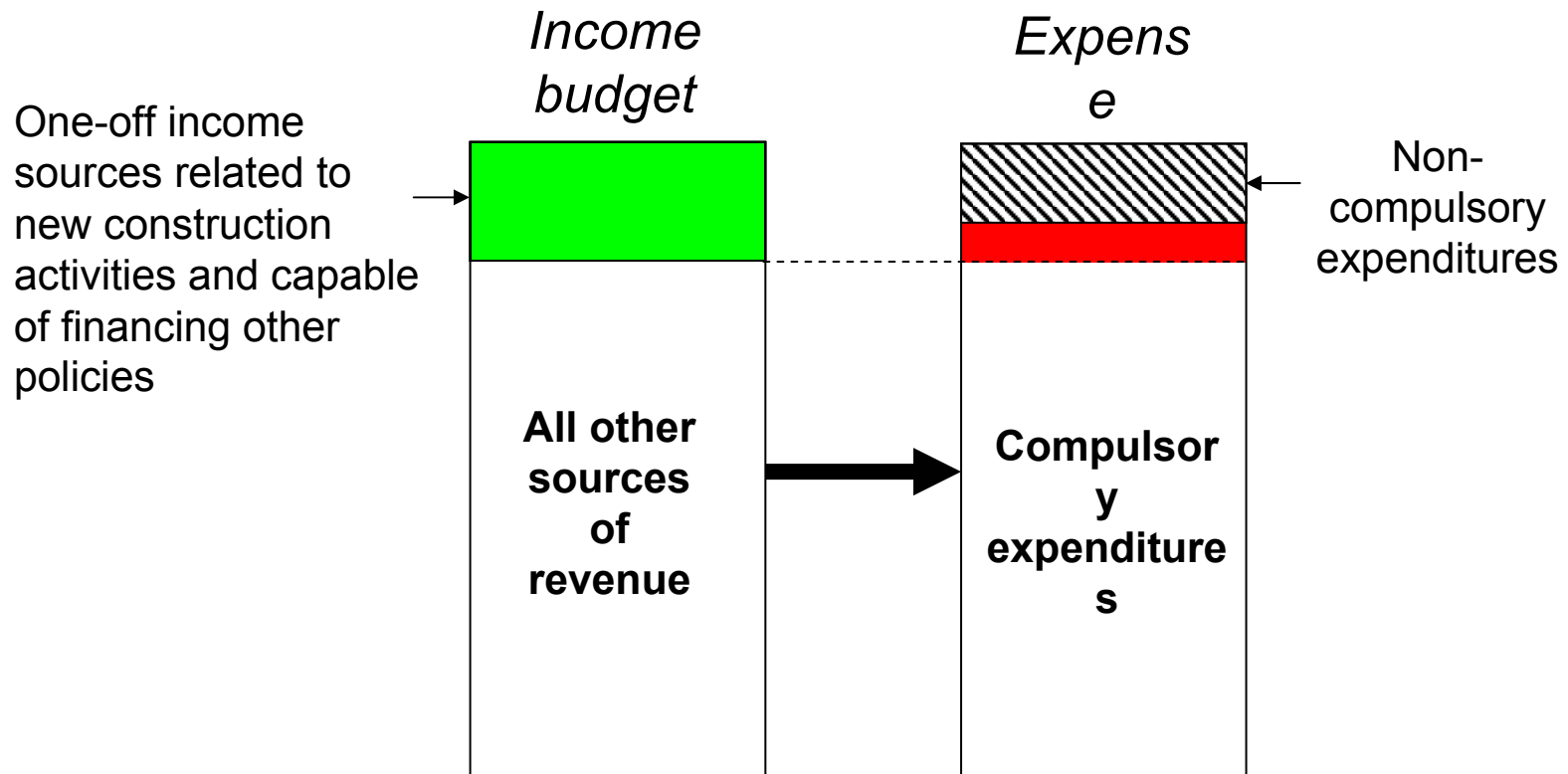


Dependence from one-off income sources related to urbanism varies significantly among Spanish provinces

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



The risk of financing compulsory expenses with one-off income sources related to construction activities



The costs of low-density urbanism

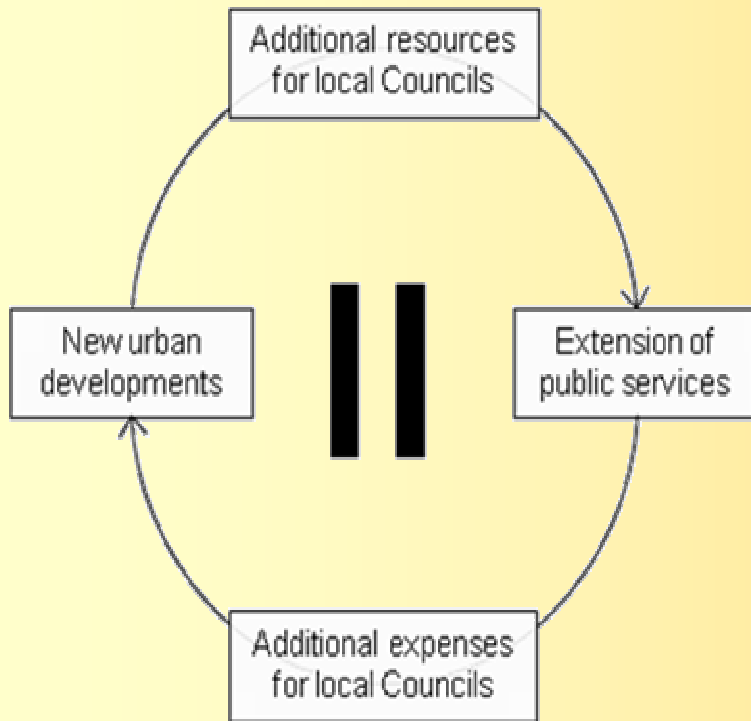
Low-density developments imply higher environmental impacts: sealed soil, energy and water consumed, transport infrastructures and mobility requirements, etc.

Apart from that, low-density urban areas also entail higher periodic 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.).

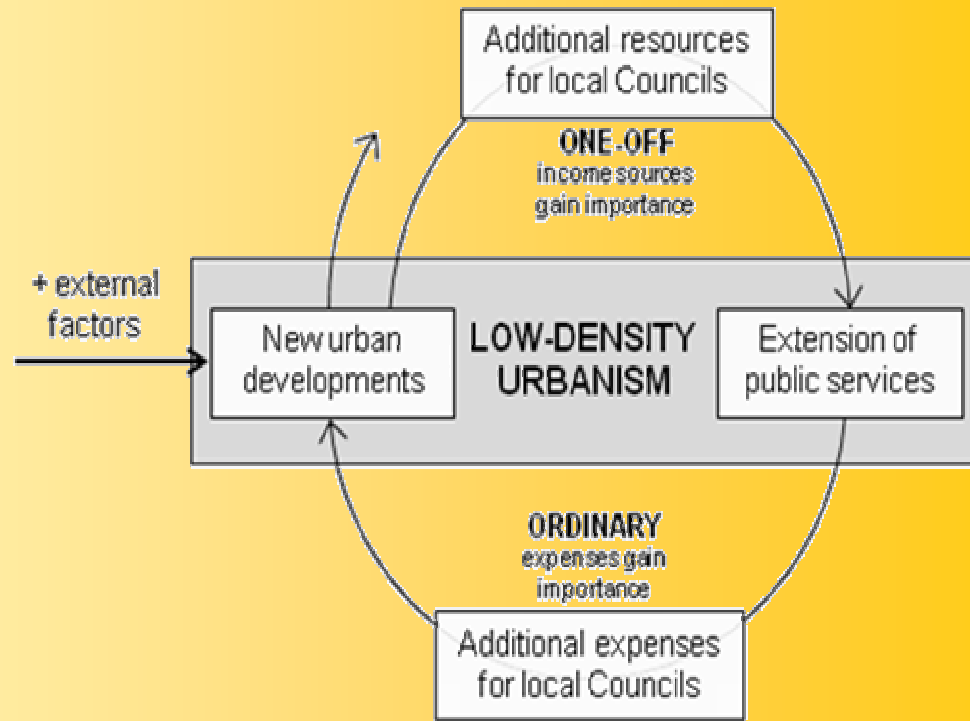
The incidence of the costs of low-density urbanism on Local Treasuries

Catch-22 situation created from excessive dependence on revenue from construction activities and excessive cost of public services derived from low-density urbanism.

a) Equilibrium



b) Out of equilibrium



Proposals (i)

~ **The Administration that decides when and where to develop new urban areas cannot be at the same time the beneficiary of the taxes and charges derived.** Correcting this situation would imply reinforcing the power of regional Administrations to conduct urban planning and its development at the expense of Local Authorities.

~ **From ordinary to extraordinary revenues.** ICIO and charges on construction licenses levied to new urban developments are extraordinary sources of revenue in nature. Therefore, they should only be spent on extraordinary expenses.

~ **Corruption.** In Spain construction activities have been repeatedly associated with corruption, particularly at the local level.

Proposals (ii)

~ **Rehabilitation versus new occupation.** The environmental impact of new occupation urbanism is higher than that of rehabilitation. These should be translated to taxes and charges levied on construction.

~ **Increase the contribution from other sources of revenue.** Alternative sources of revenue could be created (e.g. new charges) or increased (such as the Circulation Tax, the Tax on Economic Activities, 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 has, in general, a higher cost for Local Authorities. Therefore, it is fair to charge them accordingly. If not possible, it may be worth to consider providing cheaper services to low-density areas.

CONCLUSIONS:

- Dependence of Local Treasuries from one-off sources of revenue related to construction activities explains partially why Local Authorities have prompted construction activities in excess.
- This, among many other factors, explains the boom in construction activities experienced in Spain. The financial problem will appear with the lack of new land to develop, and with the slow-down of the construction sector that is now starting. The environment will 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 from one-off sources of revenue related to construction activities will benefit the environment and will also guarantee their financial sustainability.

THANKS FOR YOUR ATTENTION!

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