INTERGOVERNMENTAL FISCAL RELATIONS IN ITALY

By

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The Italian system of Intergovernmental Fiscal Relations (IFR) finds its definition in the Constitution and in a long sequence of legislation that has spanned over the last 55 years. A minor part of the innovations has come about via constitutional changes; the substantive part of the new (post World War II) legislation has been adopted, within the boundaries defined by the 1948 Constitution, via ordinary legislation.

Four layers of government exist: state, regions, provinces, municipalities. Activity and fiscal power of regional governments as well as the system of their fiscal relations to the central government are framed by the Constitution and by ordinary legislation designed to implement constitutional principles. Activity and fiscal powers of local (provincial and municipal) governments are not treated in the constitution: they are defined by ordinary legislation. Regions (and regional governments) are endowed with legislative power; local governments take political decisions and operate via administrative action.

Policy analysis of issues of IFR in Italy and policy action on the reform of IFR must take into account the differences that the Italian Constitution attributes to different levels of government.

Historically, up to 1940, relations between central and decentralized (local) governments (Regional governments were activated in 1970) have always adopted the principle of "tax sources separation: one level of government one set of taxes." Every local government was supposed to adjust expenditures to tax yields produced by a standard tax rate on tax basis defined by national legislation and with limited flexibility in the setting of tax rates. Grant programs with equalizing properties in favor of poorer communities entered Italian legislation in the late Forties.

The decade of the Seventies has been one of decentralization of spending power: decisive in this respect were (a) the repeal of local revenue sources substituted by central government; (b) a general political penchant for systems of IFR characterized by a soft budget constraint environment for both local and regional governments; (c) the institution of Ordinary Statute Regions (in 1970-72) financed mainly by central government transfers. The decade of the Nineties has seen a decentralization of taxing power, as regional and local governments have been progressively assigned own taxes or shares of central government taxes collected in their political or administrative boundaries, with corresponding reduction

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in central government transfers. The pendulum seems thus to be swinging back towards stronger fiscal responsibility of spending units.

Recent years have seen a progressive increase in the role and power of Regions and local governments to influence the making of central government policies. This influence is higher – and sometimes with binding effects – when proposals for new legislation tackle matters that are in the statutory powers of the Regions or that relate to financing rules. A body has been put into effect (the State-Regions Conference) that has a say on all legislative projects that touch upon matters related to Regions and on the administrative decisions directed to implement national legislation that touches upon matters of regional interest. Members of the Conference are all the Regions Presidents and a selection of central government. Cabinet members. The Regions Presidents are themselves member of a Regions Presidents Committee that defines common positions on issues to be discussed in the State-Regions Conference. De facto, if not by statutes, all legislative projects bearing regional consequences have to go through the Conference, if only for purpose of information. In many cases an agreement has to be reached before Parliament begins examination of any bill proposed by the central government that touches upon regional interests. De facto balances of power can, of course, always be modified, but any reform of IFR in Italy is unlikely to be adopted before an agreement is reached within the State-Regions Conference. This is the case also for municipalities and provinces, that are set up in a similar Conference – where the local government seats are assigned to leaders of their three main associations. Formally, the state-local governments conference is not as relevant as the state-regions Conference but no decisions on local governments activity is likely to be taken without previous consultation or approval.

Be it by the force of law or because of sheer political power, regional and local governments exercise a strong influence on the shaping of policy actions that define the course of their activity.

In the last two-three years, two important developments have taken place. The first one follows from one of the international obligations the country has adhered to in the process of the European Monetary Union, the progressive reduction of the general government budget deficit. The strength of the international commitments have led the national legislator to design procedures by which local and regional governments are expected to abide to quantitative budget outcomes (the procedures have been named “internal stability pact”) set by the national legislator.

The second one is represented by a set of legislation (the so-called “federalismo amministrativo”) designed to transfer to local and regional governments: (a) the administrative functions related to the implementation of existing national legislation; (b) the full responsibility for the supply of a variety of public services (maintenance and construction of roads of regional interest, etc) and for the management of a variety of expenditure programs (employment agencies, mass urban transportation and railways, agricultural and environment programs, etc.)

The paper describes the Italian system of IFR as it is defined by the existing legislation; it refers to basic propositions of fiscal federalism and it discusses also some of the changes that are been proposed via both ordinary legislation and constitutional changes.

1. An overall view: institutions and data

1.1 *Institutions.* The set of decentralized governments in Italy comprises 15 regions with ordinary statute (OSR), 5 regions with special statute (SSR) one of which (Trentino-Alto Adige) divides into two Provinces, each with its own special statutes. Provinces with ordinary statute are in number of 102; municipal governments (Comuni) are in number of 8100, ranging from 70 to 3,300,000 inhabitants. Each of these governments is run by political bodies elected with a variety of electoral systems, ranging from “many-parties pure proportional” systems to “winner catches-it-all” systems. There exist also some 100 mountain communities (comunità montane) run by representative of the participating municipal governments (some 600 municipal governments are involved in the system).

One basic tenet of the system is the limited degree of hierarchical dependency of lower levels of governments from intermediate levels of government. Local governments do not fiscally depend upon regional governments in terms of financing as their tax and borrowing powers are set by national legislation and the bulk of programs of grants and subsidies that integrate own resources are decided upon and managed entirely through the central government budget. Local governments relate to regional governments in those matters where the latter have legislative power (as it is the case in the fields of land use and zoning regulation, of local public transportation and those areas of welfare for the elderly where assistance is intertwined closely with health care). Some relations between local and regional governments – relevant for financial affairs – arise in the financing of public works as Regions have administrative powers in the management of programs financed by the EU and co-financed by national (central government) resources.

Local government representatives have staunchly resisted in the past, and resist nowadays, the notion that equalizing schemes among municipalities and/or needs assessments at the local level could be better managed at the regional than at the national level. They prefer to deal with a distant master rather than relate to a more closely located political decision maker. This position gives the mayors’ union a strong national exposure as they deal directly with the national government. Be it wrong or right, this position is going to influence the process of constitutional reform that is presently under way that will be discussed below. There are a few exceptions (in some the SSR territories, where municipalities relate directly and are financed by Provincial or Regional governments) but the basic structure is one of no over-lapping of financing by higher institutions.

1.2 Some data. The simplest way to look at the present setting of the division of expenditure and taxing power among different layers of government is to consider the set of government accounts designed for the national accounting system. Table 1.1 shows absolute values and vertical balance ratios (total own revenues to total final expenditures) for general government, central government, local and regional government, social security system in 1980, 1985 and 1990 onwards. The v.b.r for social security has maintained stable over the last 20 years, the central government has shown a phase of steady decline from 1980 to 1992 and then a steep increase, whereas the local and regional government sector rose slowly from 1980 to the beginning of the Nineties, then bounced in 1993 and remained stable thereafter. Vertical balance ratios are affected in the Italian case by the way national accounts treat the shares of central government, taxes assigned to regional governments (mainly Special Statute Regions). Though receiving governments have no power on tax base or tax rates determination or on tax assessment, the money that flows into regional governments budgets is defined as regional own money rather than be treated, as it probably should, as central government transfers.

For an evaluation of the data of Table 1.1, one should consider that more than 130 trillions lire out of central government total final expenditures of 383 trillions is spent for interests on public debt.

In terms of ratios of GDP (see Table 1.2), the central government is running a surplus of 9.4 percent, where the regional and local system is running a deficit of 6.4 percent, and the social security system a deficit of 4.8 percent. The general government system shows a deficit of about 2.0 percent.

1.3 Recent evolution in the institutional framework. As it will be discussed in more detail in page 7 below, changes have occurred in recent years, widely talked about and discussed in Italy, but of no great financial importance (the novelties are known as “federalismo amministrativo”). Administrative functions and expenditure responsibilities have been transferred from the central government to regional and/or local governments; other public functions have transferred upward, from municipal to provincial and central governments. The overall figures described in paragraph 1.2 are not going to be changed significantly as the financial resources transferred to lower levels of government amount to less than 0.5 percent of Italian GDP.

Due to the emergence to relevant political size of a political party (the Lega Nord) with strong support in the higher income regions, issues of fiscal federalism were moved, starting 1990-1992, from public finance courses in Universities to political debate. Starting with 1990 in the work of a Parliamentary Commission charged with the task of proposing constitutional reforms, the country has been indulging in the design of proposals of constitutional reforms all including propositions descending from theories and practices of federalism tout court and of fiscal federalism, the latter been defined in a large and interesting variety of ways. Question that brought up for discussions vary from division of public functions between center and periphery, subsidiary principle, division of political power, structure of Chambers and Assemblies of political representatives, assignments of taxing powers, structure of Chambers and Assemblies of political representatives, assignments of taxing powers to regional and local governments, equalizations principles and criteria, constraints on spending and budget constraints in different levels of governments – in other words the whole barrage of questions and theorems raised and proposed in A. Smith or J.S. Mill chapters on the role of government in a society. Work on constitutional reform resumed in 1996, more or less on the same lines, but did not end up well. Presently, a proposal for reform of the “rules of government” is under examination in the Italian Senate, after being approved in the House of Representatives in late summer. Too much of the discussion has been devoted to the notion that fiscal federalism was to be considered equivalent to minimization of the tax burden. Overall, the debate has shown that the nice symmetries embedded in the theory of economic policy sometimes do not work: the reasons and the process by which political bodies unite into a federation (thus creating a country with a federal government) cannot easily be adapted to a country that decides to decentralize functions and powers previously held by a central government. I shall go back to some of the policy issues later on.

2. State-Regional relations

The Italian Constitution defines two different models of fiscal relations between regional and central governments. The first related to the Ordinary Statute Regions (OSR), the second to Special Statute Regions (SSR). OSR are 15 in number comprising about 85% of the Italian population. SSR are in number of 5. Regions differ in size (population varies from 400,000 in Molise to more than 9,000,000 in Lombardy), in wealth (per-capita income varies from 1 in Calabria to 3 in Lombardy). They come from different traditions: autonomy and self-government have been historically of higher value to the North than to the South.

2.1 Constitutional assignment of functions to OSR

The public functions attributed to regional governments by article 117 of the Constitution center around health, local transportation, agriculture, professional training, environment, etc. On these maters, Regional governments have legislative powers: they can legislate within the boundaries set by national legislation. The prevailing system is thus one of joint responsibility of central and regional governments: the central government is entitled by Constitution to define in the functions the Constitution assigns to Regions, areas of “national interest.” It does so by means of “frame legislation” which sets principles and general guidelines regional legislation has to abide to.

Taking a historical perspective, one observes that the national legislator has unfortunately kept a very acute interests in matters belonging to functions assigned to Regions: pieces of new legislation are enacted almost every year by the national Parliament in matters where Regions have legislative power. Conflicts arise both at political and judiciary level. The Constitutional Court keeps taking decisions on the proper boundaries between national interest or national legislation and regional autonomy -- an endless story. Regional autonomy is most frequently challenged in the field of health. Regions are endowed with spending and regulatory power in health but the system set up in 1978 (modified in 1992 and again in 1997) can still be defined as (and actually is) a National rather than a regional Health Service.

Regional autonomy is frequently challenged by the national legislator also in programs directed to private economic activity and regional development, as in agriculture, small business incentive programs, environment. The national Parliament interest arises because of the alleged failures of regional governments in the poorer areas of the country (the Mezzogiorno) to tackle efficiently the tasks attributed to them by national legislation directed to promote economic growth or development. Many authors have questioned the wisdom of Constitutional provisions that assign large scale development functions to decentralized governments: the local bureaucracy is seldom qualified to manage the sophisticated procedures that are required to make selective programs of economic incentives work. In many cases, national legislation that provides resources for functions to be performed by regional governments attaches strings to the transferred money: it defines complex procedures and maintains power of guidance and control in central government offices, hoping that this would improve the implementation of the laws. Sometimes the process works, in most cases it causes long delays in realizations.

The discussion about the real strength of regional autonomy has taken interesting turns at the beginning of 1999. The central government brought on the table of the State-Regions Conference plans for a joint management of expenditures on infrastructure programs. The central government would accept the long standing request of regional governments, to ex-ante "regionalize" the allocation of capital expenditures on a variety of centrally financed programs (from road construction to environment related expenditures, sewage and water systems, etc.). The Regions would set up a comprehensive plan of investment expenditures that would be financed by central government, regional and U.E. money, implemented by regional governments under the supervision of the Development Department of the Treasury. A lot of fun in making up plans – one for each region but also some headache for the Budget Department in the Treasury. The procedure is having some positive effect in Regions where plans are constructed in line with resource availability. In other Regions, the process finds a resting point on plans whose financial implications extend well beyond available resources: it creates a hang-over of political claims on future spending that provides occasional nightmares to people in the Budget Department.

2.2 Financing of O.S.R. pre year 2000 reform

The financing of Regions activity is framed by art. 119 of the Italian Constitution which talks of own taxes, tax sharing, special purpose grants, all to be oriented to satisfy "needs". In 1972 when Regional governments became operative, "needs" were defined equal to the historical values in the different regions for the programs in the fields that were being transferred from central to regional governments. Financing was determined on a pure transfer, unconditional grants basis. In later years, transfers were progressively substituted by sharing of central government taxes (such as the gasoline tax) and by devolution of tax basis (such as the tax on business value added -IRAP- a variation on the old times Michigan v.a.t., the tax on automobile licenses, the regional personal income tax surcharge and other minor revenues sources, etc.). Tax rates and rates of tax sharing have been set in such a way as to exactly substitute transfers in the region where per capita tax basis would be higher, with government transfers to make the difference with historically determined pattern of spending in regions where yields of own revenues and of tax sharing would not entirely cover expenditures.

2.3 Functions assigned to Special Statute Regions and financing

Regions with special statute are 5 in numbers, one of which is divided into 2 provinces each with its own special statute. They extend over about 15% of the Italian population. The 1948 Constitution and successive constitutional legislation have assigned to S.S.R. a wider and diversified spectrum of public function than to O.S.R. The spectrum is wider in Sicily than it is in Trentino-Alto Adige or Valle d'Aosta; it is even wider than in Sardinia or in Friuli Venezia Giulia. Financing is secured by own taxes (the tax on regional value added - IRAP) and by sharing of revenue from national taxes produced in the region. Percentage of sharing varies from about 100% in Sicily to about 90% in Valle d'Aosta e Trentino-Alto Adige to about 70% in Sardinia and 50% in Friuli Venezia Giulia. Specific grants are assigned to Sicily and Sardinia for the financing of health expenditures. Sicily receives also specific grants devoted to development purposes. Tax sharing per capita provide vastly different resources in different S.S. Regions. For each percentage point, yields are higher in Friuli, Trentino or Valle d'Aosta than in Sardinia or Sicily. Overall per capita revenues differ sharply among different S.S.Regions as there are no equalizing schemes among SSRegions or between SS and OS Regions. Consolidated accounts of regional spending show that Trentino and Valle d'Aosta experience by far the highest levels of per capita public expenditures: the combined effect of high tax sharing percentages and high regional per capita incomes.

2.4 Main differences between the two models

S.S.R have a wider spectrum of public functions to perform (not a uniform model) than O.S.R.: as a consequence they have higher spending per capita. Differences in per capita spending towards O.S.R. are not related only to higher decentralization of spending power. The sharing percentages attributed to some of the S.S.R. were decided upon political considerations rather than upon a close evaluation of the regional cost of the functions to be decentralized. S.S.R. spend more money on functions they share with ORS and on functions that in other regions are carried on by the central government. Some of the S.S.R. are located in rich areas of the country, others in less developed areas. No equalizing mechanisms exist among them.

2.5 Properties of the recent (March 2000) reform of O.S.R. financing

A main headache in regional financing has always been associated with health. Health expenditures absorb some 85% of the global regional budgets and have been traditionally financed entirely by specific and conditional central government grants. Starting in 1993 a fraction – about 50 percent – of total spending on health have been substituted by the devolution of the entire yield of the pay-roll tax levied on salaries and self-employed incomes. Regions had, however, no power upon either the tax base or the tax rates, or the collection procedures. So money for health would flow from central government Treasury accounts into regional governments budgets irrespective of its origin, be it the Treasury's money or the pay-roll tax revenue. Health was organized in the Regions' budget as a real sub-budget. As the central government would, sooner or later, pay for the entire health bill regional politics never considered health financing as a matter they should worry about.

Regional heads of the Health Departments would operate more as regional agents of the National Department of Health than as regional politicians. Regions have responsibility to organize supply of health services according to the law that sets and defines users' rights irrespective of the resources allocated to health in the national budget. The health sub-budget has been, since its inception in 1979, a Treasury nightmare as the legislation never defined rules by which demand (by patients, doctors and hospital administrators) would be matched by financial resources. A tradition developed over time by which (i) the Treasury would limit cash transfers to Regions, (ii) Regions would spend more than the money transferred, (iii) the central government would, later on, pay off the debts incurred by regions (towards the suppliers, if not explicitly covered by borrowing).

In 1999 a decision was taken, with some unhappiness in the Health Department: a) to remove the budget separation in Regional health expenditures financing; (b) to bypass the procedures defined by the Health National Plan to determine the rate of growth of health expenditures as a by-product of the desired growth of "health needs satisfaction". A classics in the Budget versus Spending Departments saga.

The reform defines a situation by which total resources assigned to Regions (for health and all other expenditures) are given by:

(a) own tax revenues flowing directly into Regions budgets and amounting to about 70 percent of total current (consumption) expenditures;

(b) a fraction of the yield of the national V.A.T. is set aside to provide a fund to be attributed to individual Regions according to a scheme that

(b1) equalizes up to 90 percent the differences in standardized per capita tax revenues in different Regions and,

(b2) assigns a fraction of total resources according to health related indicators (population weighted for health related risk factors, such as age structure and other demographic factors), in order to account for the Constitutional mandate that financing of Regions' activities has to be "need related".

There was strong political debate on the equalization issue. Sentiments in the Finance, Budget and Social Affairs Committees, where the proposal was discussed, were divided as to the proper equalization percentage. The government had originally proposed 80 percent. Southern Regions Presidents in the President Regions Committee and representatives of Southern Regions in the Parliamentary committees – both in the Chamber of Deputies and in the Senate – were in favor of 100 percent equalization schemes. A compromise was struck on the 90 percent percentage. It must be said that it is perhaps the first time that the national Parliament accepts the principle that in a basic public service such as health, equalization can be set at less than 100 percent. It is a fact that actual levels of output or expenditures tends to be lower in Southern regions than national averages. In principle, however, planned levels of outputs or expenditures are bound, by national legislation, to respect uniformity. The government argued that, in the long run, the rate of growth of resources flowing to regions' budgets would be higher than under previous legislation and that each region would gain with respect to existing legislation forecasts. The argument was accepted and the government proposal approved, but the break with tradition is bound to remain in Parliamentary memory for possible future action.

3. State-municipal government fiscal relations

Functions, activities and financing rules of municipalities, provinces and mountain communities set by ordinary legislation. The 1948 Constitution all but ignores local governments if it were not in that it states that regional governments are expected to delegate administrative activities to local governments. Local governments have no legislative power: they operate via political and administrative decisions in fields and with procedures that are defined by national or regional legislation. Local governments are general purpose public bodies. Their activity is regulated by “frame” or “principle” legislation by they can take budgetary decisions on almost any field of activity, provided it not being “against a law”. Local governments in the richer part of the country have been - in the past - very active in promoting actions complementary to programs financed by the central government, in fields such as schooling and education, welfare, public works, etc.

Taxing and borrowing powers are defined by national legislation. Autonomy is mainly defined in terms in tax rates on tax bases defined uniformly on a national basis. Recently, however, they have acquired the opportunity to redefine tax bases in property taxes, tax on refuse collection and disposal. They have wider autonomy in matters related to user charges. Their borrowing power is defined in terms of a maximum ratio of interest payments to total revenues.

Own revenue, including tax sharing, provides about 60 percent of total spending. Some 5 percent comes from Regions transfers; 30 percent from central government transfers and about 5 percent from net borrowing. The transfers system, as it exists in year 2000, is constructed upon programs of general purpose unconditional grants, serving different objectives.

(i) ad hoc financing of "essential services", i.e. the services that local governments provide in behalf of the central government; they count for about 10% of total transfers;

(ii) equalizing grants, to adjust for differences in the yield of the tax on building values (ICI), accounting for about 10% of the total;

(iii) historical expenditures related grants, accounting for about 60% of the total;

(iv) grants related to the cost of debt service for investment purposes, as measured at the end of 1992, accounting for about 20% of the total.

Programs (i) to (iii) show figures that are increasing over time at a rate that is set, on the average, 1 percentage point above the rate of planned inflation. Program (iv) is on a diminishing path, as the end of 1992 stock of debt is progressively refunded.

3.1 Historical trends in state grants to local governments

50 years ago municipal and provincial governments were operating entirely on own tax revenues. Strong differentials in fiscal capacity had produced strong differences in provision of public services in different municipalities. In the early 50's the central government introduced some programs of subsidies aimed to: (a) meet the low income elasticity of most local revenue sources; (b) equalize resources of poorer local governments. The latter part of the program was constructed as a procedure that would allow poorer communities to borrow to finance the gap between current (consumption) expenditures and tax revenues resulting from the maximum rate levels set by national legislation. As debt service (capital refunding and interest charges alike) was allowed to be counted as a component of consumption expenditures - thus, in the following year, financed by borrowing - an unholy pattern developed where authority to borrow was negotiated yearly by single municipal governments with central government officials. By the end of the Seventies' consumption expenditures by local governments - measured on regional averages - had moved towards uniform per-capita values. Comparisons of expenditure levels of single communities with equivalent demographic and social structures would, however, show dramatic differences in per-capita consumption expenditures. Differences were due to different abilities to negotiate with central government. officials and/or to different political relations.[1]

Present transfer programs (item (iii) of the previous paragraph) are still influenced by the pattern of historical expenditures determined at the end of the Seventies when all the debt accumulated by local governments for consumption purposes was taken up by the central government and loans were substituted by block grants paid by the central government budget.

In the last decade state grants have been progressively substituted by transfer of tax bases from central government to local governments. Surcharges on excises on electricity consumption, a new tax on buildings value (ICI), stiffer enforcement of the refuse disposal tax, environmental taxes, taxes on building permits, sharing of the tax on car accidents insurance premium, etc. have provided, since 1989, a strong increase in local governments own revenues. Correspondingly a reduction has occurred in level and dynamics of central government transfer. Beginning January 1, 2001 municipal governments will be assigned a

[1] It happened that local governments in regions of central Italy, run by then leftist governments, would gain access to the "borrow as you like program" described in the text and thus provide services that would be higher than national averages.

share of the personal income tax, set at 1 percentage point of the personal income tax base. Transfers for consumption purposes to individual municipalities will be reduced by the exact amount of the yield generated, in the same community, by the sharing of the personal income tax base.

3.3 Open questions

In the last decade, local governments have been assigned own tax bases and sharing in central government taxes, have also been assigned more functions previously supplied by central government agencies. Also public functions previously in the responsibility of municipal governments (such as auxiliary activities in the state schooling system) have been transferred to the central government budget. Some functions (of minor importance) have been transferred from municipalities to provinces. All these transfers of functions and of means of financing were inspired to the principle that no extra cost should arise for the public sector or for general governments accounts.

At the beginning of the Nineties an effort was made by the legislator to implement some leveling of per capita expenditures in relation to traditional determinants of local government expenditures (such as population, density, demographic structure, economies or diseconomies of scale, etc.). A model was adopted of a very complex structure. It was expected to apply to the whole ensemble of Italian municipalities, widely different in tradition, in per capita incomes, in size and economic and demographic structure. The standardized per capita expenditures was expected to substitute for the jungle in per capita transfers produced by the administrative process I have described in the previous pages. The model did not make it clear whether it wanted to standardize per capita expenditures or, more ambitiously, per capita local output. It was not well accepted by university professors and could not be explained to local administrators and politicians. By and large, it has been failure and its inception has been delayed, year after year. Presently, the overall pattern of central government transfers is still a jungle (though differences in the size of the trees are a bit lower than they used to be twenty years ago).

In 1999 the central government was again given the power to reform the system of grants to local governments. Action was not taken on the issue for a variety of political reasons; most important among them was the lack of any agreement among local governments mayors as to how needs or equalizing formulas should be defined. A remake of such legislation, with small variations, is treated in a new proposal submitted by the government to Parliamentary evaluation.

4. Administrative federalism: a mixed blessing

A major effort started in 1997 to decentralize functions to regional and local government previously performed by the central government. This effort has taken a variety of forms. The road national system (presently managed by the ENAS, a national agency), has been split into two segments: roads of national interest, and roads of regional interest, the former being maintained into the ENAS system, the later devolved to Regions. Financial and planning responsibilities for mass transport have been split on the principle of regional versus national interest. Financial provisions for environment and agriculture have been devolved to Regions. Supply of previously national services (employment agencies and others) has been put in the responsibility of regional governments, and so on. Overall, the effort works out to about 0.5% of GDP (12.000 billion lire).

The transfer of responsibilities implies transfer of employees and of structures; it involves a reduction in administrative costs in central government offices and a corresponding increase in expenditures at the regional level. Expenditures by central government agencies are thus being transformed into transfers to regional governments.

The implementation of the transfer of functions is presently under way but it is becoming a highly complex affair. A by-partisan committee has been given the task: (i) to define the extra costs imposed by the function transfer process upon single individual regional governments; (ii) to project into future years the financial consequences of programs that would expire in the near future or that have expired in the near past; (iii) to deal with the costs of central government employees refusing to become regional governments employees.

Regional governments look uneasy upon the prospect of receiving responsibility for functions transferred from the central government. they consider to be currently performed at an “inadequate” level of output. They fear the pressure that would be imposed upon their budget once the transfer has been completed with financial transfers that pay for actual rather than desired provision of public services.

In due time, starting from 2002, the financial transfers are expected to be transformed in an increase of the VAT assigned for the financing of regional governments.

5. Macro fiscal coordination: the “internal stability pact”

After Italy’s entry in the EMU was accomplished thanks also to the measures adopted for the 1997 budget, the question aroused as to how make regional and local governments share into the objective of respecting the budget projections the country had accepted to produce for its over all general government budget. The question has a variety of interesting corners, in Italy as well as in other countries, be they organized in a centralized unitary government or in a federal type setting. There are general questions on:

(a) how to make individual decisions on borrowing compatible with overall deficits objectives;

(b) how to treat central governments transfers: whether deficits should be defined using own tax revenues and final expenditures only or including also central government transfers;

(c) which financial statistics to use, those relevant for the local budgetary process as defined by existing legislation and procedures, or those relevant for the computation of Eurostat type deficits.

In the Italian Treasury a lot of talking occurred on this issue in the summer of 1998. Deficit credits were discussed as a means to make individual decisions compatible with national aggregates. How to assign them to individual governments? What percentage of what? Then, how to organize a market were credits could be traded. Then the question arose on the connection between expenditure appropriation and borrowing decisions that have to be taken together. But actual spending, the statistics that is relevant for the Eurostat general government statistics have nothing or little to do with the type of figures that are considered in budgetary decisions. Over the lunch table discussions went on for a couple of months among different generations of economists working for the Treasury. The conclusion was that investment expenditures and borrowing for capital spending by individual governments could not be managed within the boundary of global constraint on budgetary deficits.

With the financial law for 1999, a procedure (named “internal stability pact”) was set up by which the system of local and regional governments was expected to produce a reduction in its deficit with respect to the values resulting from no-policy projections. The global reduction was apportioned among the three layers of government (regions, provinces and municipalities); then single governments were assigned rules they were supposed to abide to, given the previous year deficit. The deficit figures are computed using cash data on payments and revenues and by excluding capital spending from the expenditure aggregate and central government transfers from revenues.

All regions and those local governments with population over a given size, were expected to regularly provide information on the evolution of their budget surplus or deficit. A lot of problems arose because Italian sub-national governments have not tradition in working with cash-based budget. What data are known from the 1999 experience show that the system of local governments succeeded in meeting the target of deficit reduction assigned to them, whereas the regional governments ensemble went overboard. The procedure of the “internal stability pact” was continued in 2000. The Quarterly data the Treasury is collecting show patterns similar to those of 1999.

Overall the experience with getting the sub-national governments to meet deficit reduction targets defined within the EMU procedure is having a mixed success. The talking the Treasury keeps delivering, via my words, to the Conference of the Regions Presidents and to the Mayor Conference has made some impression on local and regional politicians. The monthly and quarterly statistics that regional and local government officials have to send in to the Treasury, have put some pressure on local budgetary offices. For 2001, the financial law being presently discussed in Parliament imposes upon regional and local governments the obligation to show, ex-ante, that budgets submitted for approval to local and regional assemblies meet the targets assigned to them. Furthermore, a provision in the same bill would force regional governments to raise taxes if expenditure on health should be higher than targets assigned by national legislation, a provision which is – as anybody would expect – highly disputed and also suspected on Constitutional grounds.

6. Projects of constitutional reform: a step forward or what?

Italian Parliament has started analyzing a proposal for Constitutional reform that would enlarge.

7. Summary and conclusions (in progress)

Decentralization is political action directed to decentralize government activities previously performed by the central government, both on the expenditure and tax revenue sides. Italy was born and developed as a unitary state. Historically functions that were, in the early stage of its political life, performed at the local level, such as education and welfare, were in the middle of the Nineteenth Century brought up into the powers of the national government. Taxes had also a strong origin in local governments (provinces and municipalities). The country that emerged from unification, decided that – aside from the fundamentally national government functions such as defense, international relations and basic infrastructure – the citizens would better be served by nationally conducted education and welfare. The country, along with the French tradition, moved steadily towards centralization of services with strong national attributes.

Local governments maintained taxes on income from land and building property. In later decades municipalities and provinces were given consumption related taxes, taxes on personal income, shares of revenues from taxation of small business activities. The overall pattern that emerged from this system of taxation was such that per capita revenues would not show great differences in most of the municipalities in the country. There were exceptions, of course. Agriculture was richer in the North than in the South and so was private consumption and income, thus providing higher spending opportunities, both on current and capital expenditures. Differences were deemed to be acceptable, so that no general equalizing transfer program was put into being. In the richer parts of the country local governments developed into powerful agents of the expansion of public services in the fields of welfare, of professional education, of integrating national government provisions of many centrally managed public functions.

In the years after World War II, the collapse of the agricultural sector – Italy still had more than 40 percent of its labor force in agriculture in 1950, is now below 6 percent – made the tax structure incapable of keeping expenditure levels in different municipalities and provinces within acceptable differences. Vast programs of equalizing grants were put into effect to generate acceptable differences in current per capita expenditures, and transferring to the national government, the function to finance infrastructure, capital expenditures in the poorer regions of the country.

Meanwhile, in 1948 the new Republican Constitution provided for the birth of regional governments, which were assigned a variety of public functions, ranging from health to agricultural development, to local transportation, employment services, professional training, to be financed with own tax revenues, sharing of national taxes and special purpose grants. The reason for Regions to enter the Italian Constitution after World War II have probably to do with suggestions from the Allied forces (which operated on a similar basis in the shaping of the German Constitution); they were an echo of a minority position that was present in the middle of the Nineteenth century among political leaders mostly from the northern part of the country. Regions were put into a limbo for more than 20 years: the political system as a whole was very much uncertain as to what should be done about Regions; some section of the Italian politics feared that some of them would be run by the then alive Italian communist party. So political decision as to their inception kept being delayed year after year.

The local tax system entered progressive difficulties starting the mid-Fifties. New housing for post World War II reconstruction programs, were excluded from property taxation: tax revenues at the local level would not follow up to the outstanding growth of post war incomes. The collection of consumption taxes was being crumbled by the development of the internal market. The management of the local personal income tax was not relaying upon a properly defined tax base. A lot of ad hoc competition among local governments produced clamorous change of residence of well-known personage with wide public recognition. The Tiebout model of people getting together according to income levels to minimize the individual cost of income redistribution within the local community would not be accepted by the political system.

In 1970 two contradicting events occurred at the national government level. On one side, election for Regional Parliaments were indicated and the whole local government tax system was cancelled and substituted with a system of grants from the national government. Institutional decentralization was on its way accompanied with centralization of taxing power.

The years after 1970 have been in Italy years of movement towards decentralization. Not a continuous function of time, as the degree of decentralization remained relatively stable in the Seventies, moved slowly along during the Eighties, and accelerated in the Nineties. My paper deals mainly with the process of decentralization of spending and tax power in Italy. A few characteristics make it very specific and probably not easy to be generalized.

The first is that pressure for decentralization derives from the attempt to provide a response to the success of a political party (the Lega Nord) which has made a flag of issues such as “taxes back to the regions where they are paid” or of plain words such as “secession.” Back in the shadows of the sentiments that are pushing for decentralization are the old welfare economics people like myself who think that provision of public services should bear some relation to individual preferences; that political democratic processes are by far the best known tool to reveal preferences and that, under circumstances to be defined by economic analysis, a case can be made for decentralizing budgetary decisions on regional or local governments.

The second is that it is conducted under the rules of political consensus: gains and losses to the participants are a crucial issue in the decision process.

Decentralization implies a break with uniformity in the provision of services of public interest. Some inequality in the provision of services is a property of a decentralized form of government. It is true that different per capita levels of services in different areas could be provided also by a national government. It could do it by explicit choice or by letting the environment to lead the ride for diversification. In Italy, for example, national legislation on fundamental services such as education and health is based on a sacred "uniformity principle:" actual provision, however, show significant differences in different parts of the country. Differences show both in terms of per capita spending and in terms of actual supply levels. Differences are let to arise in force of different attitudes of the community where services are supplied, in view of the different interests that central government representative in different areas are forced to take into account. In poorer areas central government, representatives are faced with issues of unemployment and subsides to economic activities, in richer areas they face more concern on the size and quality of public services.

Be as it is, decentralization would not be justified if it were not met by some explicit reference to willingness to pay, thus some reference to per capita incomes.

In a mature country, with full-fledged political representation of the various territories and areas, extensive reforms that would move power (tax rates and tax bases, supply and provision of services and connected budgetary decisions) away from the national government into regional or local governments will face a hard time. The two classical corners of welfare economics – efficiency, if there is one, and redistribution – are stubbornly facing each other.

The third characteristics has to do with the existing regional distribution of expenses related to programs to be decentralized. Most frequently, when it comes to programs different from those widely spread on the national territory, receiving regions either jealously want to maintain the prevailing level of national government spending in their territory or complain that the cost share of the transferred functions they are receiving from the central government is inadequate with respect to the "regional or municipal needs." This phenomena, widely present in the decentralization process under way in Italy, belong the general category of distribution aspects, though of a less dignified variety.

The course of action that has been taken in Italy has had different properties, which I resume:

1. Decentralization of taxing power to both local and regional governments under the constraint that nobody should, in the short run, make extra money. Yields of new revenue from tax sources would be deducted, lira for lira, from national government transfers. The gain for local and regional governments would be only in terms of prospects of higher growth rate from tax revenue sources than from programs of central government transfers.

2. Assignment of some tax rate autonomy (and also some autonomy in determining tax basis) to receiving governments.

3. Decentralization of tax revenues via sharing of tax revenues produced in the regional or local territory by some national tax (such as the personal income tax), with corresponding reduction in central government transfer programs.

4. Transfer to regional governments of administrative power on national government, regulated public activity, with transfer of the corresponding cost and resources on a historically determined basis.

5. Transfer to regional governments of political and legislative power (Regions in the Italian constitution, operate by law) on services previously managed at the central level (example maintenance and construction of roads defined of regional interest).

6. Redefinition, in favor of regions, of the national versus regional interest in a variety of activities previously shared between the two layers of government.

7. Transformation of conditional and specific grant programs into addition to the general purpose, unconditional grants program.

8. Specifically for health, a major innovation.

9. Definition of a fund fed with 40 percent of the yield of the national VAT to be distributed among the 15 regions according to "need factors" and to be used as a buffer in the pseudo-horizontal scheme designed to equalize, as in below, the yield of regional own taxes.

10. Introduction of an "equalization formula" for the distribution of transfers that would be left after the assignment of new tax sources and of tax sharing. First step has been to introduce the notion of "equalization of standardized fiscal capacity" to stand along side with the criterion of "full financing of equalized needs" that could be derived from the Italian Constitution. Regions starting in 2001 will be financed according to a three-cornered hat:

- Historical (year 2000) expenditures with weights declining from 100% in 2001 to 0% in 2012.
- Need factors related to population weighted with age structure, etc., (estimate of health needs)
- An equalizing formula that reduced to 10 percent the maximum allowable difference in the per capita yield of regional taxes.

Taxes on income: Regional governments were established at the beginning of the 70's and fully financed via a program of transfers related to the regional weight of previously run state functions transferred to regions and to some notion of "needs." In later years state transfers were partly submitted – lira for lira – by the devolution of the yield of some state tax.

History shows a basic tenet of inter-governmental fiscal relations in Italy, that is: a long run process of decentralization of spending and tax power is underway. The process is managed under the rule of no extra costs for general government accounts.

Thus:

When more tax revenues are attributed to local governments they are accompanied by reduction in state transfers.

When functions are transferred to local or regional governments, the state increases the amount of its transfer to local governments.

Strengthening of non-central government powers arrives via a process of decentralization of public functions with transfer of resources on a region by region, municipality by municipality basis.

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Italy: General Government (Public Administration): Grants between level of Government

Billion of Lira

Year	Central Government Grants From other level of general gov.	Central Government Grants to Other level of general gov.	Local Government Grants from other Level of general gov	Local Government Grants to other Level of general gov	Social Security Grants from other Level of general gov	Social Security Grants to other Level of general gov
1980	5,636	48,659	37,922	5,855	16,105	5,149
1985	18,536	140,880	94,874	1,196	46,026	17,360
1990	15,892	202,369	136,007	628	66,366	15,268
1991	14,412	222,063	157,550	452	64,516	13,963
1992	13,154	235,053	160,532	500	74,524	12,657
1993	3,398	161,455	97,818	725	63,644	2,680
1994	3,718	172,341	97,785	813	74,625	2,974
1995	3,681	170,320	96,390	745	73,932	2,938
1996	3,464	179,820	99,565	417	80,268	3,060
1997	3,100	198,676	109,833	487	88,851	2,621
1998	8,349	201,773	117,815	1,896	83,968	6,463
1999	3,668	233,510	132,809	185	100,707	3,489

Percent of GDP

Year	Central Government Grants From other level of general gov.	Central Government Grants to Other level of general gov.	Local Government Grants from other Level of general gov	Local Government Grants to other Level of general gov	Social Security Grants from other Level of general gov	Social Security Grants to other Level of general gov
1980	1.45	12.55	9.78	1.51	4.15	1.33
1985	2.29	17.38	11.70	0.15	5.68	2.14
1990	1.21	15.42	10.37	0.05	5.06	1.16
1991	1.01	15.53	11.02	0.03	4.51	0.98
1992	0.87	15.63	10.67	0.03	4.96	0.84
1993	0.22	10.42	6.31	0.05	4.11	0.17
1994	0.22	10.42	5.91	0.05	4.51	0.18
1995	0.21	9.53	5.39	0.04	4.14	0.16
1996	0.18	9.48	5.25	0.02	4.23	0.16
1997	0.16	10.06	5.56	0.02	4.50	0.13
1998	0.41	9.81	5.73	0.09	4.08	0.31
1999	0.17	10.97	6.24	0.01	4.73	0.16

Italy: General Government (Public Administration): Consolidated Central and Local Government and Social Security

Billion of Lira

	Consolidated General Government			Consolidated General Government			Consolidated General Government			Consolidated General Government		
Year	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio
1980	130,288	163,555	0.80	85,948	70,621	1.22	7,265	43,666	0.17	37,075	49,268	0.75
1985	313,063	415,023	0.75	214,770	194,725	1.10	18,734	113,087	0.17	79,559	107,211	0.74
1990	559,451	705,253	0.79	387,183	337,270	1.15	43,562	190,428	0.23	128,706	177,555	0.72
1991	625,407	769,488	0.81	431,130	364,029	1.18	49,369	209,914	0.24	144,908	195,545	0.74
1992	698,902	842,545	0.83	480,779	408,308	1.18	59,027	214,609	0.28	159,096	219,628	0.72
1993	749,454	896,373	0.84	461,230	451,430	1.02	119,104	216,597	0.55	169,120	228,346	0.74
1994	751,333	898,914	0.84	453,617	434,104	1.04	128,074	226,053	0.57	169,642	238,757	0.71
1995	806,847	941,925	0.86	493,267	462,906	1.07	135,358	224,560	0.60	178,222	254,459	0.70
1996	866,896	989,116	0.88	490,801	434,616	1.13	148,004	245,319	0.60	228,091	309,181	0.74
1997	940,966	993,234	0.95	542,631	401,849	1.35	152,266	263,052	0.58	246,069	328,333	0.75
1998	951,827	1,006,204	0.95	529,545	395,355	1.34	161,753	271,932	0.59	260,529	338,917	0.77
1999	998,503	1,039,014	0.96	582,398	383,867	1.52	147,984	285,350	0.52	268,121	369,797	0.73

Percent of GDP

	Consolidated General Government			Consolidated General Government			Consolidated General Government			Consolidated General Government		
Year	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio	Revenue	Expenditure	Vertical Balance Ratio
1980	33.6	42.2	0.80	22.2	18.2	1.22	1.9	11.3	0.17	9.6	12.7	0.75
1985	38.6	51.2	0.75	26.5	24.0	1.00	2.3	14.0	0.17	9.8	13.2	0.74
1990	42.6	53.8	0.79	29.5	25.7	1.15	3.3	14.5	0.23	9.8	13.5	0.72
1991	43.8	53.8	0.81	30.2	25.5	1.18	3.5	14.7	0.24	10.1	13.7	0.74
1992	46.5	56.0	0.83	32.0	27.1	1.18	3.9	14.3	0.28	10.6	14.6	0.72
1993	48.3	57.8	0.84	29.8	29.1	1.02	7.7	14.0	9.55	10.9	14.7	0.74
1994	45.4	54.4	0.84	27.4	26.3	1.04	7.7	13.7	0.57	10.3	14.4	0.71
1995	45.1	52.7	0.86	27.6	25.9	1.07	7.6	12.6	0.60	10.0	14.2	0.70

1996	45.7	52.2	0.88	25.9	22.9	1.13	7.8	12.9	0.60	12.0	16.3	0.74
1997	47.7	50.3	0.95	27.5	20.4	1.35	7.7	13.3	0.58	12.5	16.6	0.75
1998	46.3	48.9	0.95	25.7	19.2	1.34	7.9	13.2	0.59	12.7	16.5	0.77
1999	46.9	48.8	0.96	27.4	18.0	1.52	7.0	13.4	0.52	12.6	17.4	0.73

Spending/GDP for level of government

Year	General	Central	Local	Social Security
1980	42.2	18.2	11.3	12.7
1985	51.2	24.0	14.0	13.2
1990	53.8	25.7	14.5	13.5
1991	53.8	25.5	14.7	13.7
1992	56.0	27.1	14.3	14.6
1993	57.8	29.1	14.0	14.7
1994	54.4	26.3	13.7	14.4
1995	52.7	25.9	12.6	14.2
1996	52.2	22.9	12.9	16.3
1997	50.3	20.4	13.3	16.6
1998	48.9	19.2	13.2	16.4
1999	48.8	18.0	13.4	17.4

Spending/Gen. Gov. spending for Level of Government

Year	Central	Local	Social Security
1980	43.2	26.7	30.1
1985	46.9	27.2	25.8
1990	47.8	27.0	25.1
1991	47.3	27.3	25.4
1992	48.5	25.5	26.0
1993	50.4	24.2	25.4
1994	48.3	25.1	26.5
1995	49.1	23.8	26.9
1996	43.9	24.8	31.2
1997	40.5	26.5	33.0
1998	39.3	27.0	33.6
1999	36.9	27.5	35.6

Own resources/total spending for each level of government

Year	General	Central	Local	Social Security
1980	79.7	121.7	16.6	75.3
1985	75.4	110.3	16.6	74.2
1990	79.3	114.8	22.9	72.6
1991	81.3	118.4	23.5	74.2
1992	83.0	117.7	27.5	72.5
1993	83.6	102.2	55.0	74.2
1994	83.6	104.5	56.7	71.2
1995	85.7	106.6	60.3	70.9
1996	87.6	112.9	60.3	73.9
1997	94.7	135.0	57.9	75.1
1998	94.6	133.9	59.5	77.0
1999	96.1	151.7	51.9	72.5

Note:
Le risorse affluite ai bilanci regionali negli ultimi quattro anni, inclusivi del gettito dell'IRAP e dell'addizionale IRPEF, sono ammontate rispettivamente:
1996 mld. 122.000
1997 mld. 128.800
1998 mld. 138.100
1999 mld. 141.100
nei dodici mesi terminanti ad aprile 2000 il finanziamento complessivo alle Regioni è ammontato a 146.200 mld.

Limitando l'esame ai soli trasferimenti di parte corrente (inclusa la sanità) i dati diventano:
1996: 116.200
1997: 121.700
1998: 127.500
1999: 128.200
i dodici mesi terminanti ad aprile 2000: 131.100

Negli anni 1998 e 1999 il gettito IRAP e addizionale IRPEF affluito ai bilanci regionali è ammontato a 45.800 e 45.200 mld.