Decentralization and intergovernmental fiscal relations in Italy: a review of past and recent trends

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Paper presented at the Special Session on "Reforming the Italian public sector: Outcomes, lessons, perspectives" of the 60th Congress of the International Institute of Public finance – Milano, Università Bocconi, August 23-26, 2004

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The Italian system of intergovernmental fiscal relations finds its definition in the Constitution of 1948, in a long sequence of legislation that has spanned over the last 55 years and in the Constitutional reform of 2001. The 1948 Constitution, which defined Italy as a Republic, disposed the first move towards decentralization of a fully centralized country. It instituted Regions (originally 20 in number) assigning them the power to legislate on certain competences and defined a system of financing based on tax autonomy and needs oriented equalization schemes. The 1948 Constitution did not touch upon the competence and financing of local governments (municipal and provincial); the national legislation, enacted in the Thirties, regulating their governance, the assignment of functions and the financing rules, was untouched by the Constitution. The 2001 Constitution defines new legislative competence and financing rules of Regions; it also redefines functions and financing of local governments. Ordinary legislation has not yet been enacted to implement the new Constitutional rules, so that the whole system of regional and local is presently in a sort of apnea. Trial legislation is currently being adopted both at national and regional level, as if to challenge the Constitutional Court to define, by negative action, the exact boundaries of the Constitution and the acceptable operational meanings of the new constitutional principles.

The problem addressed in this paper is whether the country has moved or is bound to move towards a more decentralized distribution of powers in regulatory activity, in public spending and in taxation. All recent legislative novelties, by both ordinary legislation and Constitutional reforms, together with the additional Constitutional changes presently being discussed in Parliament would call for a positive

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(*) The author is professor of Public Finance in the Università Cattolica of Milano. Thanks are due to a long list of old time colleagues and friends, professors of economics and professors of constitutional law with whom I have discussed topics related to the content of this paper. Among the many, I should mention Massimo Bordignon, Franco Bassanini and Enrico De Mita. Some of them have suggested that economists should not tamper with Constitutions, but I have found counter encouragement in S.E.Finer, V.Bogdanor and B.Rudden, *Comparing Constitutions*, Clarendon Press Oxford 1995, a book which has enlivened the preparation of this and two previous companion papers on the intergovernmental fiscal relations aspects of the new Italian Constitution. Two of my former professors, Giancarlo Mazzocchi and Richard Musgrave still bear some responsibility for some of the opinions expressed in this paper.

answer. Ordinary statistical indicators utilized as measures of decentralization would also lead to a positive answer.

Closer inspection of both new Constitutional provision and recent trends in ordinary legislation show that the case is not as clear as it appears at first sight. The paper provides elements that may help to clarify the issues that are relevant for an appropriate answer, but it does not intend to provide a definite answer. The new Constitution is not written in a language that lends to clear cut answers. Furthermore, the government actions on implementation of the new Constitution are slow and timid in taking or prosing the decisions that would direct the Italian system of intergovernmental relations on a precisely defined course. Last but not least, the first rulings of the Constitutional Court on the litigations between national and regional governments on the relative legislative powers on a variety of issues, indicate that it will take some long testing period before the real strength of the decentralization drive in the new Constitution is cleared.

Paragraph 1 is constructed on a quasi-historical approach. It provides a narration of events beginning in 1934 when a new finance bill for local (municipal and provincial) governments was enacted. It runs to the beginning of the Seventies when Regional governments came to life and describes events up to the beginning of the Nineties when "decentralization" and "fiscal federalism" left the public finance courses to enter the Italian political debate. Paragraph 2 presents the pros and cons of decentralization as they were commonly discussed in the Nineties. Paragraphs 3, 4 and 5 discuss the transfer of tax and public expenditure power to local and regional governments in the decade from 1992, including a detour on special statute Regions which have been often in the background of recent political debates. Paragraph 6 describes the implications of the European stability and growth pact on intergovernmental fiscal relations; also, it presents the entrance in the Italian scenery of fiscal capacity equalization plans aside to the more traditional need related equalization plans. Paragraph 7 presents the major changes on intergovernmental relations incorporated in the new Constitution enacted in 2001 compared with the provisions of the old 1948 Constitution. Paragraph 8 discusses the slow and timid implementation process of the new Constitution and some of its open problems that are waiting for a political solution. Paragraph 9 reviews briefly actions taken by the national government to control spending at the regional and local government in face of re-emerging budgetary deficit control problems. Paragraph 10 presents brief comments on the proposals, currently discussed in Parliament, to further increase decentralization of spending powers.

A paragraph of summary and conclusions follows, to state the main propositions of this paper. First, that the Italian-style decentralization process seems to be targeted on

the objective to increase autonomy of lower layers of governments (regional and local) in regulatory activities, in public spending and in taxation, under the avowed constraint of nationally uniform level of outputs of public goods assigned to the competence of regional governments and of equal treatment of the citizens in all parts of the country. An ambiguous maximization problem, that would possibly never find a satisfactory solution in a decentralized setting. Second, that the new Constitution does not adequately define the properties of the new system of intergovernmental fiscal relations. It is clearly oriented to an increase in decentralization of spending, but it is ambiguous in the tax and financial arrangements that would be necessary to construct a properly working system of fiscal federalism. The issues that need to be solved by future political decisions are briefly summarized.

1. A synthetic story from 1934 to 1992.

Competence and financing of local and regional governments in the period from 1934 to 1992 went through a cyclical sequence of changes and reforms. Increases in the degree of decentralization were followed by declines; major reforms over-lapping to minor, ordinary life, adjustments.

Public spending by decentralized governments was slowly increasing before WW2; it fell drastically as a share of GDP after 1950. It increased steadily after 1972. Tax revenues financed 100% of spending of local governments in 1935. The percentage progressively fell in years from 1950 to 1972, when it practically fell to zero and stayed there until 1980. Regional governments resources in 1972 were, for about 90%, in the form of grants from the national budget. The percentage rose to 95% in 1980. Small changes occurred for both level of governments in the Eighties.

What follows, presents first local government finances up to 1972, then Regions and local government financing up to the beginning of the Eighties. It closes with the decade ending in 1992.

1.1 Early financing of local governments. In the mid-thirties the financing structure of local governments was given its first comprehensive definition. It was based, in large part, on the principle of separation of tax bases and consisted of a local progressive income tax, a set of consumption taxes, taxes on business income, proportional taxes on the imputed (cadastral) rent of housing and agricultural land (shared with the national government). This diversified package of taxes was intended to provide "adequate revenue" for a system of municipalities or provinces of vastly different population sizes and economic structures. A standard minimum rate was defined; in some cases maximum rates were also defined. Standard rates were planned to cover "compulsory" expenses in all local governments, but a proviso was set to

entitle (and force) local governments to adjust tax rates in order to pay for the execution of compulsory spending. No explicit proviso was made for performances to be attained for the different services. Surprisingly enough, given the deep differences in local per capita incomes in different areas of the country, no equalization scheme was set up. Current budget, inclusive of debt repayment, was expected to balance.

Price increases at the end and after the end of the second world war and the national government decision not to increase the cadastral tax bases of housing and farm income made the financing system of local governments to collapse. The stress was higher in southern areas, where municipalities and provinces were more dependent on these sources of revenues. Two decisions were taken in the early Fifties. The first was to assign municipalities a per capita general purpose unconditional grant and a specific unconditional grant for the financing of school expenditures. The second decision (of long standing effects as occasionally it still conditions the way of thinking of policy makers) was to give the national government the task to evaluate the appropriate matching of revenues and expenditures on a case by case basis. National government functionaries were given the power to condition the efficacy of the budget approved by local governments councils on measures to be taken to balance it via rate increases and/or expenditure cuts. In case the budget could not be made to balance (because rates had reached the maximum and/or spending could not be further reduced), a procedure was set for the national government to cover the fiscal gap. This procedure applied originally to a limited number of governments, but progressively extended to larger and larger numbers. In the later part of the Seventies, almost half of all local governments in the country had access to the special "budget clearing" grant.[1] From a regional perspective, the Italian local governments could be classified into three main groups: the rich north where consumption, personal income and business income at the local level were capable to provide financing for current and capital spending, the poor south where spending was compressed and heavily financed by national government resources, the mid part of the country which took advantage of the yearly negotiations with the national government to share into the special "budget clearing" grant program.[2]

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[1] The "budget clearing" grant was administered under the form of special loans by the national Cassa Depositi e Prestiti, a lending institution born for the financing of public works by local governments. The debt service charges (interest and capital repayments under a French type amortization plan) accumulated from previous years budget clearing loans could be charged as "necessary expenditure" in next year budget and concur to the legitimate claims for the new "budget clearing" loan. So the loan was formally generating increases in the stock of local government debt, but it was everywhere considered as a currente expenditures related grant, never to be refunded.

[2] Local governments in the central part of the Italy, an area with average or above average per capita incomes, were traditionally run by "leftist" majorities. It is a common opinion that the national government (then strictly "center") consented them the access to the special "budget clearing" loans as a result of an *entente* negotiated in national political circles.

1.2 Italian Regions: competence and financing in 1972. At the beginning of the Seventies, after more than 20 years of legal pondering, Regions came to life, election held, functions assigned, financing defined. So the decentralization process in Italy started. Functions previously performed by the state (national government) were transferred to regional governments. The pattern of regional spending that followed from the transfer of power, was an echo of the spending of the state in the different regions. It reflected the uniformity pattern that was appropriate for the previous national responsibility. The financing rules that were established by the national Parliament made a mockery of the constitutional indication of tax autonomy: own tax sources were almost nil. Most of the financing came from a need based equalization scheme adjusted to provide full financing of the historical levels of spending prevailing under the previous national provision. The dynamics of the fund was determined on an annual basis in the national government budget process.

The institution of regional governments was hailed as a major breakthrough in the distribution of powers in the country. It is interesting that the first step to decentralization came into being while the country was experiencing a drastic reduction in the rate growth of GDP, a situation not dissimilar from what has been happening in the recent further steps towards decentralization.[3]

1.3 The centralization of local government finances. Almost at the same time of the inception of regional governments, a major reform proposal of the tax system was underway that became an enabling law in 1971 and actual legislation in 1972 and 1973. The reform instituted a truly general personal progressive income tax, modified the corporation income tax, introduced the value added income tax, reformed taxation of capital income, redefined procedures for tax payments and tax assessments. The whole Italian tax system was overhauled and modernized. The reform also cancelled local government taxes, all gone in a single stroke. A local tax on all non wage incomes was instituted but temporarily assigned to the national government with the promise that a new system of local government financing should be devised by 1978. The yield of the abolished local taxes was substituted, for all local governments, by transfers from the national government budget planned to grow at a pre-determined rate in the years from 1973 to 1977. The special "budget clearing" loans (or grants) also were set to grow at a predetermined rate of growth.

The Seventies thus began with decentralization of spending power at the regional level without tax autonomy and full centralization of financing at the local level.

[3] Italy had been growing at an average annual rate of about 6% from 1951 to 1972. It grew less than 3% from 1973 to 1981. Since 2001, the average growth rate of GDP has declined to less than 0.5% per year.

1.4 New financing rules: the renaissance after 1978. Year 1978 brought two important addition to the system of intergovernmental fiscal relations. First, health care responsibilities and spending were transferred from the national health insurance companies to the Regions; the transfer was accompanied by a soft worded financial provision that stressed uniformity, equal treatment[4] and historical levels of spending. Second, local governments budgets were freed from the constraints of the predetermined rate of growth on national government transfers. Local governments were entitled, at the end of 1977, to determine anew and almost freely their 1977 budget expenditure lines with the guarantee that the special "budget clearing" loans would be assigned to entirely cover the deficits resulting from the revised budgets. For 1978 and following years the various expenditure categories could increase according to some maximum admissible rate of growth over 1977 values. The "budget clearing" loan and all existing transfer programs from the national budget were repealed and substituted by a new all inclusive "equalizing grant"[5] the amount of which was set equal, for each local government, to the difference between the admissible level of spending and the yield of the remaining user fees and charges.

Years from 1978 to mid-eighties came to be named as the "renaissance years" of local and regional governments. Local governments systematically outsmarted the national government agencies in charge of control on the evaluation of spending needs; the total transfer of resources to local governments was determined by adding up the individual "equalizing grants" computed, in each local government budget, as a difference between the admissible level of spending and the yield of users' fees and charges. Regional governments obtained that the amount of the equalization fund be tied to total tax revenues, with tax burden on the rise due to the bracket creep associated with high rates of inflation. Health spending began to outstrip the annual allocations in the national budget and the national government systematically provided ex-post accommodation of the gap between spending and the special purpose health grants initial allocation.

1.5 The new squeeze: 1984-1992. In 1985 the size of the general government primary deficit (spending net of interest minus revenues) reached its all-times maximum. Starting from 1985 the growth of public spending in real terms was reduced to below 1% per year and taxes increased. Local and regional governments were made

[4] The law that assigned Regions the health care function represents a most interesting example of the autonomy cum uniformity paradox that mutters the Italian decentralization process. It also illustrates the cultural disregard for the role of fiscal and financial rules in the design of a decentralized supply structure of public goods that is common to most politicians, constitutional reformers, public administration scientists and constitutional law scholars.

[5] The term "equalizing grant" may seem somewhat preposterous to local finance scholars, as needs were, in the early years of the working of this program, determined directly by the recipient government, by all means a quite unconventional way to define needs indicators to be used in the formula of an equalizing plan.

to participate in the effort. Primary deficit began to fell at the rate of one percentage point of GDP per year. Cash limits were imposed on local and regional spending. The amount of equalization funds was strictly tied on to a planned rate of inflation.[6] The Treasury directly intervened on the level of regional spending on health in the attempt to make it compatible with the amount initially allocated with the budget. The primary deficit was brought down to zero by 1991, though the over-all deficit was being pull upward by the mounting cost of interests on public debt.

1.6 The case of the special statute Regional governments. Regional governments we have referred to in previous pages are defined, in constitutional terms, as Ordinary statute Regions (Regioni a statuto ordinario). They are in number of 15. The Constitution defines also five Special statute Regions (Regioni a statuto speciale), having a wider (and diversified) spectrum of competence than Ordinary statute Regions and also a different financing system. One of the five is divided, according to a constitutional amendment, in two special statute Provinces, thus generating six special autonomy sub-national governments which cover about 15% of the Italian population. Financing is secured mostly by sharing of the regionally produced revenue of national taxes. Percentage of tax sharing is about 100% in Sicily, 90% in Valle d'Aosta and in two provinces of Trento and Bolzano, about 70% in Sardinia and 50% in Friuli Venezia Giulia. Percentages of tax sharing are not, as it should be, exactly correlated with the extent of competence. Specific grants are assigned to Sicily and Sardinia for the financing of health expenditures. Sicily receives also specific grants for development purposes and the same was initially the case for the two provinces of Trento and Bolzano. Tax sharing and own taxes provide vastly different per capita revenues in different S.S. Regions due to differences in tax bases. Consolidated accounts of regional spending show that special statute Regions have much higher public spending than ordinary statute regions, with Trento, Bolzano and Valle d'Aosta experiencing the highest levels of regional per capita public expenditures as a result of the combined effect of high tax sharing percentages and high regional per capita incomes.

Special statute Regions financial arrangements (and particularly the sharing of national taxes) have come to be considered as an example to imitate by the many

[6] Starting in 1984, the amount of the "equalizing grant" fund directed to financing local governments was set equal to the total of 1983 individual equalizing grants increased by a given percentage each year. The amount assigned to any individual local government was determined equal to the individual equalizing grant of 1983 plus a share of the yearly increase of the fund. The formula to apportion the annual increase of the over-all fund among the individual governments has shown some changes over time but, fundamentally, it was, and still is, based on well known empirical relation that shows a U shaped curve of per capita spending as a function of population size. With the progressing of inflation the relative weights of history, as incorporated in the initial 1983 self determination of admissible expenditure levels, and of objective needs indicators, that began to be applied in 1984, moved in favor of the latter. In 2003 the two components had, approximately, the same weight.

advocates of decentralization. Some of the pathologies of special statute financing rules are discussed below.

2. The turnaround of the Nineties.

At the beginning of the Nineties the options for decentralization became more attractive to political opinions. National political leaders and public finance students were dissatisfied with the lack of a properly designed financing scheme of health expenditures at the regional level and with the permanent over spending above the initial budget allocation. The opinion developed that expenditure control at the regional and local level would better be served by a financing structure that relied on own tax revenues more than on transfers from the national government.

Regional and local political leaders were complaining for the excessive controls of national government agencies over their activities and claiming for more autonomy. In their language, autonomy had at least three separate implications: more transfers from the national budget, more own tax sources with rates and base flexibility, more unconditional grant programs and less special purpose conditional resources. Applied economic studies in agriculture, health and mass transport (the three most important functions of regional governments) were stressing the paradox of the system of special purpose conditional grants in these fields with the highly detailed procedures and objectives set by the national legislation, that prevented adaptation to the diversity of regional-local needs.

Finally, students of public administration, administrative and constitutional law were stressing that the existing Constitution had too narrowly defined the competence of regional and local government and that efficiency and accountability would better be served by a greater decentralization of legislative and administrative functions from national to regional and local governments.

Some of these sentiments were finding support in a variety of studies and researches being conducted in universities, research centres and in the public administration. Looking backward 14 years later, the most conspicuous aspect of the public debate was then the absence of economic analysis on the allocation of public functions on the different layers of government. Efficiency analysis, the backbone of economics, was left to administrative science studies. All of this would probably not had any impact on the system of intergovernmental fiscal relations had not two external events occurred.

The first was the rapid political rise of a new political party (the Lega Nord) which made a political issue of the interregional resource transfer (and of the connected redistributive issue) implicit in the uniform pattern of per capita public spending across

the country and in the high differentials in per capita incomes and tax bases existing between the northern and southern regions.

The second was the financial crisis the country was experiencing in 1992 when dramatic decisions were to be taken in terms of raising taxes to reduce the over all budget deficit: it was considered appropriate that local governments should bear some of the political costs of the deficit adjustment process.

The challenge posed by the Lega Nord party to the interregional resource transfer and the rising strength of regional and local governments leaders in national politics gave birth to a movement for (a) transfer of administrative functions to regional and local governments and, (b) Constitutional reforms based on the increase of spending and taxing powers of regional and local governments.

Increase in local and regional accountability and removal of the soft budget constraint prevailing in intergovernmental fiscal relations were the leading arguments behind the tendency towards decentralization of taxing powers. Higher own tax revenues were expected to provide for stronger incentives in the control (reduction of the growth rate) of local and regional spending, a much sought-after budgetary policy objective.

Before entering a discussion of the new Constitutional provisions on the division of powers between the national and the regional and local governments it is useful to review the decentralization of tax revenues and the transfer of administrative functions and spending powers that have occurred in the Nineties via ordinary legislation. It is useful also to discuss the introduction, in the same period, of the equalization criteria that would be more suitable for a strongly decentralized country and of the rules directed to implement the European stability and growth pact at the local and regional level. All these changes have been taken to imply the inception of a decentralization process that found, later in 2001, its full Constitutional support and that promises (or threatens, according to different points of view) to be further accelerated by the proposals of further Constitutional reforms presently discussed in Parliament.

3. More tax revenues to local and regional governments.

In 1992 a tax on the value of housing and residential areas was instituted and assigned to municipal governments. The estimated yield of the tax at the standard minimum rate of 0.4% was subtracted from the general purpose unconditional grants assigned to municipal governments. Local governments were authorized to increase the rate up to 0.7% and were also authorized to differentiate rates (including the exemptions regimes) between owners-occupied houses and houses to let or houses used as vacation residence. The per capita yield of the tax varied greatly among municipalities; only in a

very limited number of them the yield would be equal or greater than the general purpose "equalizing grant". The tax reduced the degree of vertical unbalance but had no effect on marginal spending decisions. The system of municipal governments did not reduce its vociferous claims that national budget resources were insufficient to finance the appropriate level of performances in the functions attributed to them.

In the same year the compulsory social contributions (on wage income and income of self-employed) finalized to the financing of health expenditure [at a rate of 8% for wage income and of circa 5% on self-employed incomes] and collected by the national insurance companies in charge in health care, was transferred to regional governments. Its yield would then cover about 40% of global health expenditures, with widely different coverage rate in different regions. The Regions had no power to change the rates or interfere with the determination of the tax base. This assignment had no effect on regional budget decisions as the national government would define the level of acceptable spending on health in every region and would pay for the difference between spending and the yield of the health social contributions.

In 1997, as a piece of an extensive reform of the corporate income tax and of the taxes on capital income, the health social contributions were abolished and substituted with a new tax (IRAP: regional tax on productive activities) to be paid by employers and self-employed on the value added generated in the firm; the rate was set at 4,25%; the tax was not deductible from the tax bases of either the corporation income tax or the personal income tax. A special rate applied for wages in public sector. The yield of the tax was about 70% bigger than the revenue of the abolished social contribution for health.

Next year, the rates of the progressive personal income tax were reduced across the board by half percentage point and a regional personal income tax was instituted with the standard minimum tax rate equal that absorbed the reduction of the national personal income tax. Regions could increase the tax rates and could also introduce progressive elements in the tax but could not interfere with the determination of the tax base, a task that was maintained entirely in the power of the national government. Furthermore the regional tax on car ownership was reformed to produce an increase in revenues.

As it has been the case with local governments, the tax revenues of regional governments increased substantially, but the yield of all taxes computed at the standard – nationally uniform tax rate – could not match spending on health care and other functions in any region. Furthermore, as most of the equalization plans relating to health and transportation were defined in expenditure terms (the level of admissible spending on health in each region being determined by a national government procedure), the

yield of the new taxes at the regional level would simply be deducted from the planned level of spending to generate the value of the equalizing grant.[7]

In 1998, the tax on premium paid by car owners for compulsory automobile accident insurance – up to then a property of the national government – was transferred almost entirely to provincial governments. As it was the case for municipal and regional governments, the yield of this new provincial tax showed insufficient to finance historical levels of spending by individual Provinces. The new equalizing grant was defined as the difference between the previous value of the grant and the revenue from the new tax.

This brief description of policies that in Italy have generated an increase of the tax revenues of decentralized governments and a corresponding reduction of the amount of transfers from the national government, raises at least one questions: whether the partial substitution of own tax revenue to grants revenue produces a better system of fiscal federalism.

The standard wisdom, as enunciated in some IMF and OECD papers, is that if the ratio of tax revenues to total spending is too small, problems in the budgeting of decentralized governments arise because of inadequate accountability and inadequate joint evaluation of costs and benefit in budgetary decisions. An increasing ratio is to be considered an indicator of an adjustment towards a better system of intergovernmental fiscal relations. Sometimes this ratio, or some parental statistics, is considered a measure of fiscal unbalance (a negative tenet of a system of fiscal federalism).

There is no more than some truth in this proposition. The increase in the own revenue to spending ratio is not sufficient to justify the claim that it will produce better budgetary decisions at the local-regional level. In a fully decentralized setting own revenues would entirely cover for spending. The two sides of the budget would be balanced and, presumably, the marginal net benefit would be equal to zero. It is the marginal balancing between costs and benefits that establishes full accountability. In such case the unbalance rate is nil and the ratio of own revenues to spending is 100%. In theory, any ratio lower than 100% does not produce marginal balancing of costs and benefits. Grant money comes free, it may be a substitute for higher taxes, it may generate higher spending or lower taxes. So the question has to turn to the properties and to the objectives of the grant program and also to the frequently investigated effects

[7] In 1999 and following years some Regions raised the rates of the regional personal income tax, or introduced progressive elements, or defined exemptions or special treatments of some taxpayers' category. It became difficult, if not impossible, not to penalize decentralized fiscal effort, as it turned out to be very difficult to compute what the regional tax yield would have been if the changes had not taken place. The Regions tax activism, when applied to tax parameters different from the pure tax rates, made it difficult to compute the standardized tax revenue that was necessary to compute the equalizing grant without penalizing individual "fiscal effort". Complicated solutions had to be found to nobody satisfaction. This element should be kept in mind when a system of fiscal federalism has to define the extents and limits of tax autonomy of decentralized governments.

of different grant programs on the spending and taxing propensities of recipient governments. Specific conditional matching grants have been shown to produce diverted effects on spending in non financed sectors. General purpose unconditional grants assigned on the basis of equalization formulas have been shown to spread on both expenditure increases and tax reduction for less than their nominal value; they constitute the grant programs more. Equalizing grants present the higher risk of a dissociation between expenditure and tax decisions. Two points can be made. The first has to do with the commitment of the national government on the amount of the equalizing grants. In the Italian experience, the actual amount of grants has resulted higher than the initial intended assignment, as the receiving governments have been able to force the national government to adjust the initial budget allocations to the level of their spending. The second has to do with the fact that in no cases, equalization grants are reserved only to the "deserving poor". All local and regional governments have been in the past and still are receiving "equalizing grants" from the national budget. Tax revenues have increased but in no case a single, high tax base, local or regional government, has become self-sufficient, i.e. is capable of financing its expenditures entirely with own revenue. Rich regions, rich municipalities, rich provinces all share into the equalization grant program. The decentralized system, and each of its component, is entirely dependent on the national budget allocations to finance spending, in different ratio, but none equal to zero.

The ratio of own resources to spending has increased but all local and regional governments depend upon the national budget for financing. When they start the budget session, they spend more time talking to the national government than to resident taxpayers. A change will occur only when a sufficiently large segment of regional and local governments will be left with adequate tax instruments to finance their affairs.

In conclusion, the improvement of a fiscal federalism system should not be measured by the increase in a statistical ratio.

4. Partial house-cleaning in the special statute regions mess.

Each special statute region had negotiated, in the years from 1948 to 1985, its own financial setting, essentially based on sharing of national taxes yield generated in the regional jurisdiction. The setting up of special statute Regions provides an example of the unsatisfactory results that decentralization in a unitary country is capable of generating.

The percentage of tax sharing was negotiated taking into account the diverse competence assigned to each region. When the 90% percentage was assigned to Special statute Region A, it was intended to pay for all expenditures with the exclusion of

defence, international affairs, justice administration, police, i.e. the national public goods that were absorbing circa 10% of total national tax revenue. However the percentage was determined on the basis of two propositions that were (or proved to be) untrue: that the general government budget was (or would permanently be) balanced (thus no public debt and no interest charges) and that the social insurance national companies would balance expenditures with the yield of pay-roll taxes. Presently interest charges and social security system deficit amount to more than 25% of total tax revenues. All the special statute regions being recognized - at the moment the decision on financing – as below the average national per capita income, some special additional financing was assigned to them for development purposes. As a result, for all special statute regions, the financial settlement – which has now the value of a constitutional norm – resulted in revenues well exceeding the required expenditures.

The second event was that national agencies and departments in charge of functions such as education, health, police, local finance, welfare assistance and so on, de facto refused – under the excuse of a superior national interest and with the tacit approval of the national Parliament – to transfer the administrative functions and the connected expenditure obligations to the six regional and provincial governments. In a few years the fiscal regulations of the special statute Regions entered the limbo of political oblivion. Lot of public money flowed into their budgets.

In the Nineties, the fiscal stress the country was suffering, induced some changes and gradually some of the functions in the competence of the six jurisdictions were transferred and began to be paid with the money that had been assigned starting many years before. The transfer has never been completed, but the situation is now not as bad as it used to be.

5. Transfer of administrative functions to regional governments

As the discussions on Constitutional reform that had begun in 1990-91 were proceeding in long discussions in the special Constitution reform Commissions set up at different dates in different legislatures with no apparent results, the national government decided to try to extend decentralization of expenditure programs by ordinary legislation. Functions previously assigned to national government agencies were transferred to regional governments by means of ordinary legislation. Programs in road construction, agriculture, environment protection, employment agencies, welfare and disability treatment, protection from natural disasters, and still others were progressively transferred to regional governments. Regions had no legislative power on this programs but they were entitled to define rules of execution within the boundaries of a loosely defined set of national legislation. More autonomy, though not full

autonomy. The process, for reasons that remain obscure, came to be named as "administrative federalism" (federalismo amministrativo). Financing took a contorted turn which deserves some comments, as it provides some caveats for the future procedures to decentralization. Three possible negative outcomes have come to light in the Italian experience.

(i) historical patterns vs. regional needs. Functions to be transferred to regional governments consist of either provision of public services (public consumption or transfers to individuals) or programs directed to finance private activities (transfers to business) or public investment projects. Public consumption may include public production. Execution of these functions by the national government has required, in the past, administrative decisions as to the distribution on the national territory of both public output and selection of beneficiaries of public programs. Transfer of functions to the periphery and assignment of resources (be they human or financial) cannot ignore what the national government has been doing before the transfer occurs. In an ideal world, transfer of function should go together with some decision on how the resources should be distributed on the territory. The national government should provide some rationality for the pattern of regional distribution of resources. Alternatively it could simply reproduce the pattern of regional distribution that prevailed before the transfer of function occurred. But it happens that historical regional distribution patterns cannot always explained rationally. Simple rationality can be used by the recipient Regions to maintain that the existing pattern of regional resource distribution are highly irrational. Also, a pattern that would not be challenged by Regions when the function was national, can be unacceptable when the function has become regional.

So, how to match needs evaluation with history ? The national government can suggest that gradually, in the future, history will be superimposed by rationality, but this promise may not be, and it has not been, sufficient.

(*ii) increase in spending*. Unhappiness with historical patterns of regional resource distribution may generate strong pressure, before the transfer of functions is executed, to placate requests by unhappy Regions with additional resources provided by the national budget. But, helas!, also national government agencies may become unhappy when they observe that some of their functions and of their budget are taken away to be transferred to regional governments. To placate Regions' Governors and central government bureaucrats, additional funds are provided by the national budget. This is exactly what has happened in Italy with the transfer of functions via ordinary legislation. Decentralization meant higher public expenditures.

(iii) shared responsibility and red tape. When a multiplicity of functions is transferred from national to regional governments, it is inevitable that financing be structured along a number of special purpose grants. Special purpose financing has a

tendency to degenerate in a regime of shared responsibility in execution and administration. Shared responsibility when responsibilities are not exactly defined by legislation implies long working of cooperative bodies where representatives of the national and local and regional governments search for solutions to the always conflicting objectives of the two different layers of government. It is not only a matter of finding a solution in the transition phase when transfer of functions is negotiated. The problems are maintained in the long run as an excess of government to government relations over citizen to governments relations is generated.

This unsatisfactory situation is bound to prevail all the times that, by choice or by necessity, the transfer of functions and activities assumes a too prominent role with respect to the selection of an appropriate transfer of financing instruments.

6. The internal stability pact and a new equalization plan.

In addition to the transfer of functions to regional governments discussed in the previous paragraph, two other events occurred in the second part of the Nineties that are relevant for the progress of the decentralization process. In 1998 the "internal stability pact" appeared on the scene of Italian intergovernmental fiscal relations; in 1999 and 2000 a fiscal capacity equalization plan was added to the traditional needs oriented equalization plans. A few comments follow on both themes.

6.1 The internal stability pact. At the time when the growth and stability pact was blossoming at the European level, questions arose on how it strictures could be transferred on local and regional governments. The growth and stability pact referred to general government, i.e. to the consolidated accounts of all levels of governments. The national government would take responsibility in Europe but local and regional governments would only be passive recipients of reductions in transfers, cash limits on expenditure increases and forced increases of their own taxes. In 1998 a decision was taken to assign deficits targets to the systems of local and regional governments, the deficit being defined as the difference between final expenditures and own revenues (revenue excluding transfers from the national budget). Also, incentives were provided for regional and local governments to reduce the stock of their outstanding debt. No penalties would be charged on governments that missed the deficit targets. A subsidy on interest rate on outstanding debt was promised if the system of local and regional governments met the over-all deficit target. A separate target was defined for health expenditures by regional governments.

Local and regional governments could not but accept the principle that they had to contribute to the growth and stability pact targets (their ex-ante acceptance of this proposition justified the denomination o "pact" for something that would carry, after

approval by Parliament, the strength of law. The government proposals were adjusted in Parliament to exclude capital spending from expenditure, so that the deficit target was defined in terms of current expenditures only. As individual governments could not master the mysteries of accrual accounting (as requested by Eurostat rules), the deficit targets were computed on cash outcomes.

The internal stability pact had mixed results. Many local and regional governments did not even try to enter the computations and comparisons of budget outcomes over the years. Others are known tohave chased tax arrears to meet the targets. Analysis shows that for 1999 and 2000 the targets were globally met, truly not both years for all levels of governments, while the target was missed for health expenditures which systematically overran the assigned targets in most regions. No information is available for the following years.

The internal stability pact was constructed as an implementation of a nearly forgotten Constitutional norm that requires "coordination" of national and regional governments finances. Interesting discussions in the government, in local government circles, in academia and research units, but the results – due perhaps to the lack of an adequate system of rewards and punishments – have not been enthusiastic.

6.2 Per capita fiscal capacity equalization plans. In 1999, unhappiness in the government over the systematic overruns in health spending (which represented the bulk - about 85% - of all regional spending) suggested that Regions ought be assigned a portion of the yield of the value added tax, of such an amount that – added to the yields of the regional tax on productive activities and of the regional personal income tax – it would provide full financing of health spending in the base year of 2001. From then on, health expenditure growth would hopefully be tapped by the growth of the sources of revenue devoted to health care financing. At the same time it was decided that the yield of the VAT assigned to the regional governments system should be divided among the 15 Regions on the basis of a scheme of partial equalization of their per capita fiscal capacity. Thus, financing of health expenditures would result as the sum of two major components: about 60% on the basis of "needs" (estimated according to demographic and health related indicators) and about 40% on the basis of an equalization plan directed to reduce differences in per capita revenues from own taxes to no more than 10% of the national per capita average. The transition from the equalization grants needed to finance historical levels of regional health expenditures of year 2000 to the equalization grants constructed with the criteria described above would be very slow: it was planned on a time span of 13 years from 2001 to 2013. The new plan was intended, (a) to constrain health expenditures growth within the growth of tax revenues and, (b) to modify the interregional distribution of resources for health care financing. Health

care was no longer entirely financed according to needs evaluations. Some of he richer regions would gain; some of the poorer regions would lose.

The new bill (D.Lgs. 56/2000) was discussed, with varying sentiments, in political, cultural and academic circles. It came somewhat as a surprise that a centre-left majority would sponsor and approve a bill that explicitly introduced in the Italian legislation the notion that richer regions could, with a given tax rate, finance (moderately) higher level of per capita spending. As we shall see in one of the next paragraphs, the surprise is no longer there.

7. The 2001 Constitutional reform

The new 2001 Constitution has rewritten the system of intergovernmental fiscal relations that had been either inherited from the past or defined by the 1948 Constitution. Changes have touched a variety of points, but four articles are relevant for our purposes. Art. 117 deals with the traditional assignment question (the distribution of legislative powers between national and regional governments). Art. 118 relates to the assignment of the administrative functions (the power of execution) between local, regional and national governments. Art. 119 deals with financial questions such as the assignment of revenue sources, tax autonomy, equalization grants and formulas; it also presents propositions on the complex issue of fiscal coordination among different levels of government. Art. 116 entitles individual Regions to propose bills directed to define special assignment of legislative competence to individual Regions.

7.1. Assignment of legislative power: what competence for what level of government. The new Constitution provides an ambitious solution to the assignment problem. The new art. 117 assigns a first group of public matters to a regime of exclusive national government competence[8]. It then defines a regime of shared political responsibility, based on the ethical foundations of "national interest" or "fundamental individual rights" or "citizenship rights". Following the Basic Law of the Federal Republic of Germany, it assigns a long list of functions to the regime of "concurrent regional competence"[9]. In such a regime, regional governments have autonomy and competence to legislate, but their power is bound by limits that are to be defined, for each competence or matter, by "fundamental principles legislation" to be enacted by the national government. This "fundamental principles legislation" should guarantee the

[8] The list includes, among other functions, foreign policy, defence, law and order, currency and financial markets, environmental protection, equalizations plans and the determination of the essential levels of outputs concerning civil and social rights to be guaranteed on the entire national territory.

[9] The list includes, among other functions, foreign trade, work conditions, education organization, scientific research, health care, land use, ports and airports, energy production and distribution, transportation, co-ordination of public finances and tax system.

"national interest", the individual rights written in the Constitution, and the proper coordination of interregional cost or benefit spillovers of the Tiebout-Oates variety.

The same art. 117 states that Regions have legislative competence on all matters not assigned to either of the two previously defined regimes. In defining this competence no qualifying adjective is utilized. In early reading of the new Constitution, constitutional law scholars ventured to add the adjective "exclusive" to the words "regional competence" and this looked natural enough, as it would be difficult to think of a different solution for something that did not belong to the regimes of either "exclusive national" or "regional concurrent competence". More recently, the Constitutional Court has come to name the public functions assigned to the unqualified competence of Regions as "residual competence"[10], being carefully to avoid assigning them to a regime of "exclusive regional legislative competence". The practice has been followed by constitutional law scholars thus sending their economist friends in an interpretation marsh. The confusion is further aggravated as the new constitutional proposals currently discussed in Parliament (see below prg. 9) have introduced the explicit qualification of "exclusive regional competence", thus making laymen to wonder what might be the legislative regime for the present "residual" list. Despite the marshes and unless differently stated, in this paper, the "residual list" of regional competence will continue to be qualified as "exclusive regional legislative competence".

7.2 Differentiated autonomy. Art. 116 of the new Constitutions entitles any individual Region to introduce bills in the national Parliament to obtain for itself a transfer of functions from the concurrent to the exclusive competence regime; also to obtain the transfer of certain functions assigned to the exclusive competence of the national government to the regime of concurrent competence. This article, much discussed and much criticized has two different ancestors. The first is the existence in Italy of the 5 Special statute Regions, with their special and very generous financial treatment; their specialty and the related financial privileges have often been looked after by the most outspoken advocates of Constitutional reforms. The second is the Spanish regime of Catalonia, very frequently discussed and presented in Italy as a good example of an appropriate move towards decentralization.

7.3. Assignment of execution power: administration to local governments. The new Constitution assigns local governments (municipalities in the first place) the power to execute regional and national legislation. This change echoes Article 83 of the

[10] Matters assigned to the regime of exclusive regional competence are defined as all matters not included in the list of the national government competence (see footnote n.3) or in the list of the concurrent competence of regional and national governments (see footnote n.4). Squeezed between the two lists of national competence and concurrent (national and regional) competence, the future quantitative relevance of exclusive regional competence cannot be easily predicted.

German Basic Law, which assigns the power of execution to the Lander[11]. A decisions as to what level of government will be assigned the task to execute what legislation, will be taken by future national and regional legislation. Execution by municipal governments of national and regional legislation is going to change radically the way of life of Italian municipalities, as they might be charged with responsibility in fields such as education, now entirely in the hands of central government agencies. Assignment of administrative powers to local governments is subject to the condition that municipal government can perform properly ad efficiently the administrative duties. Should this turn out to be impossible due to too small dimensions, future regional or national legislation can assign the performance of administrative functions to levels of government higher than municipal governments under the J. Stuart Mill-Leone XIII-European Constitution subsidiarity criterion.

7.4. Financing: the system of fiscal federalism. According to the new art. 119, each regional and local government will be financed by: (a) own taxes, with autonomy in the determination of both tax rates and tax bases; (b) revenue from sharing of national government taxes; (c) unconditional general purpose grants derived from a per capita fiscal capacity equalization formula. With respect to the old Constitution, two changes are particularly relevant: (i) the introduction of sharing of national taxes as an ordinary means of financing and, (ii) the shift from a pure needs equalization plan to a fiscal capacity equalization plan.

The new Constitutional provision, however are very general and uncommitted. They do not provide, contrary to the German Basic Law, the list of taxes to be assigned to regional governments; nor they indicate the extent of equalization (whether it be full or incomplete). Also, in search of more regional autonomy, they explicitly exclude special purpose and conditional grants from the list of instruments that can be used in equalization plans. This is a most surprising provision in face of the very large role that the new Constitution reserve to the regime of concurrent competence. If there is, as indeed is the case, some sort of national interest (be it guarantee of individual rights or accounting of spillover effects) in the public functions assigned to the regime of concurrent competence, then special purpose and conditional grants are essential to match regional autonomy with supra-regional objectives).[12]

Art. 119 states also that the transfer of functions is to be fully paid by additional resources coming from list of instruments described above under (a) to (c). This can be seen as a safeguard clause against the temptation for the national government to take advantage of the transition process to reduce spending in the functions assigned to

[11] Economists can find echoes of the option to separate legislative powers from execution powers in G. Stigler "The tenable range etc.

[12] The more so when account is taken of the uniform levels of outputs requirement that are discussed below in prg. 7.6.

regional competence. However, the wording of this provision, as it will be discussed below, is equivocal and threatens the road to decentralization.

7.5 Decentralization has increased. A preliminary synthesis of changes introduced by the new Constitution would assert that decentralization has increased. The legislative powers of Regional governments have increased: the spectrum of functions assigned to the regime of concurrent competence is greater than before and the regime of exclusive regional competence is created that applies to a variety of functions. Regions are entitle to propose bills to the national Parliament to shift functions from concurrent competence to exclusive competence and from national competence to concurrent competence. The power of execution is preferably assigned to local governments. Stronger wordings is used to define tax autonomy; sharing of national taxes has been introduced; a fiscal capacity equalization criterion has substituted needs equalization.

On the basis of this evidence, no judge could but sentence that decentralization in Italy has increased. Further evidence is incorporated in the reforms enacted via ordinary legislation in the Nineties discussed in paragraphs 3 to 6. Taken together, the case for an increase in decentralization is strengthened.[13]

7.6 However, "not all that shines is gold". However, further reading of the new Constitution adds new and contradicting evidence. There are provisions the weight of which is such that some scholars are reading the new Constitution as a straight continuum of the old one or even as a text entitling the national government to a more pervasive interference with regional affairs. At least two provisions challenge the case of decentralization increase.

A - Among the functions assigned to the exclusive competence of the national government (second period of art. 117, item m)), there is the *"determination of the essential levels of outputs[14] concerning the civil and social rights that must be guaranteed on all the national territory"*. This is a strong wording for a Constitutional text. The national government has the duty to define the level of output of public services and the level of benefits that citizens have the right to expect from regional government activities on the entire national territory. Regional governments have to abide to this determinations. The provision is strong and unequivocal in its final objective: an indisputable quest for uniformity.

Art. 117.2/m raises a host of complicated problems. First is that there is nowhere a comprehensive list of "civil and social rights" anywhere; of course the Constitution, in

[13] Some figures with comments could be added at this point.

[14] The Italian text uses the word "prestazioni", a term which refers to the physical outputs in public services or the real benefits in transfer based programs such as welfare assistance, but which can indicate also the activities (in the terminology of production theory) utilized to produce physical outputs. In health care a "prestazione" is an x-ray test, an emergency treatment, a specialist's visit; in other terms the word defines an elementary or basic component of public goods output.

its various articles, defines – in the opening section and in Part I – individual and social (the right to health care, to education, to welfare assistance, to social security and so on). It also defines (or suggests) the ways these rights ought to be guaranteed. It is well known that, in many cases, actual ordinary legislation in Italy has given solution to the problem of rights protection in ways that differ from Constitutional suggestions (education and health are two cases in point), to the point that political scientists have come to distinguish between "formal" Constitution and "de facto" Constitution. Thus, the amplitude of the Constitutional provision (exactly which "rights" it applies to) cannot be read anywhere and it will be left to the Constitutional Court to settle the question in future years.

A second set of problems is to interpret the sequence "essential levels of outputs" or "of performances". How are outputs going to be defined in public services and in welfare programs. What criterion for choosing the level of output. What is really meant by "essentiality" and how the concept is matched with fiscal budgetary conditions. As said above, a host of very difficult problems. If the difficulties are solved, the Constitutional dictum can be read as a predicament for equal treatment of (same output for) all citizens irrespective of their region of residence (where they vote and pay taxes).

The decentralization traits of the new Constitution are thus countered by a strong suggestion or a predicament (or an imposition?) of uniform treatment. The penchant for uniformity in the new Constitution seems even stronger that in the old one. Depending on the national government future political choices and on the Constitutional Court future rulings, the new Constitution – hailed as a move towards a "federal system" – may turn out to be no more than a repeat of the old unitary country.

B - The second provision of the new Constitution that bears on its decentralizing properties can be read in art. 119 (the financial provisions) where it is stated that *"the total of resources derived by the various sources of revenue must be such to wholly finance the public functions assigned to Regions"*. If it is read to imply, as many commentators are doing, that the provision applies to each single Regions and it is taken as a provision of permanent value, than the pattern of regional spending (and of existing interregional differences) will be permanently frozen on the levels prevailing in the last year before decentralization is implemented. A situation that would present the paradox of a "quasi federal system" crystallized on the spending pattern existing under the pre-reform, unitary, Constitution.

The two elements we have discussed, the affirmative power of the national government to set level of output at the regional level, and the possible preservation of the historical pattern of regional spending, would certainly not be qualified as properties of a system of intergovernmental relations that moves towards decentralization.

8. Implementation of the new Constitution

The reform plan presented in the new Constitution is not accompanied by the norms that have, in similar cases, regulated the transition from the old to the new regime. Some of the Constitutional norms are immediately effective, others are not as they require ordinary legislation to define the operational criteria and the technicalities of transition. The legislative competences assigned to Regions, under the concurrent or residual regime concern a variety of public functions that can be grouped under the different headings of (a) provision of public services, (b) transfer payments to individual or business, (c) regulatory powers and, finally, (d) the power to institute new regional taxes. Over all, Regions have been very cautious in exercising the new powers. Most if not all the activities included in the transferred competence are presently regulated by national legislation that defines performances, organization and administration, as well as benefits and beneficiaries.[15] Up to the present, Regions have been very careful in enacting new legislation in the sectors assigned to their competence. Decentralization is in the Constitution, but decentralization is, at the moment, stalled.

The indeterminacy of the Constitutional language is making implementation of the Constitutional changes difficult and controversial. Some of the reason are presented here, with no claim to completeness or legal accuracy.

8.1 Fundamental principles legislation. The national government has not yet defined the fundamental principles that are to constraint the autonomy of the Regions in legislating on matters belonging to the regime of concurrent competence. The Constitutional Court has sentenced that fundamental principles need not be rewritten anew as they can be read and derived from existing national legislation. Three years have elapsed after the coming to life of the new Constitution and the regional affair agency of the national government is on the verge of producing a blueprint of the "fundamental principles" that can be read in the set of existing legislation relative to any specific public function. Constitutional law scholars debate whether the big book of fundamental principles derived from existing legislation will have to be ratified by Parliament or whether it can be constructed directly by the executive power. Regions are afraid that the word "fundamental" will be associated with detailed arrays of norms taken from existing legislation, in order to (or so that) pre-empty the actual regional legislative power. In any case, at the moment an accepted and recognized set of "fundamental principles" does not exist, thus de facto preventing regional legislation to be adopted.

[15] Possibly in no other country, public spending is so heavily dependent on legislation as it is in Italy. The legality principle is a fundamental principle of Italian public life. Italy has special courts (tribunali amministrativi regionali) to assess the legitimacy of execution (of administrative decisions).

8.2 Transition procedures. In regulatory legislation, Regions could start any moment provided they are cautious enough, to operate, but they have not done so. In legislation concerning programs of transfer payments to individual or business, Regional action preliminarily requires the availability of financial resources: it is, in other words, dependent upon material transfer of financial resources from the national to the regional budgets. And this has not been done yet. In legislation concerning public services, the Regions' power to legislate is de facto suspended until a decision will be taken on the level of government that will be in charge of execution, be it the local, regional or national agencies and burocracies. As an example, consider the case of education. This is a costly public service (about 5% of GDP) where labour costs cover about 90% of total spending. Are the 700.000 teachers and administrative staff of the national school system to become regional governments employees (or possibly local governments employees, if the execution power in education should be allocated to municipal governments)? Nobody yet has started thinking on how to organize the possible transfer of factors of production (workers mobility, school buildings ownership, and so on) from the national to the regional governments. It is also possible that all teachers and administrative staff remain employed by the national government and school buildings in the property of local governments, with regional governments legislating on all matters of school organization.

8.3 Equalization criteria. The indeterminacy of the new Constitution from a system governed by national legislation to one governed by a mix of national and regional legislation raises some intriguing questions on financing.

Health and education belong to the regime of concurrent competence, thus Regions' autonomy can be exercised only within the constraints of "fundamental principles national legislation". Furthermore, they will be managed and organized under the, presumably strict, system of national regulations that will be enacted to define the "essential levels of performances". The setting of such indicators is tantamount of a definition of the need requirements to be financed: the equalizing grant has solely to provide the difference between the cost of the "essential levels of outputs" determined for each expenditure sector where it is required and the regional standardized tax revenues. This is a somewhat different outcome from the one generated by a per capita fiscal capacity equalization plan. With full equalization, the plan would generate equal per capita spending in all regions, something that differs and possibly conflicts with the financing of uniform level of outputs. One of the two criteria must be made to prevail. In other countries it is common practice that the two criteria be jointly utilized in equalization formulas. This has been done also in Italy and we have presented the case of D.Lgs.56/2000. Given the strong Constitutional dictum, in Italy this may turn out to be no longer possible: financing according to cost coverage of essential levels of outputs

is somewhat of an "absolute" criterion that allows no compromise or middle of the road solutions.

Future policies, thus, will be charged with very complicated ideological problem. Whether the equalization plans should aim for partial or full equalization of fiscal capacity and whether fiscal capacity equalization plans can be integrated with needs or performance financing. Two critical questions for any system of fiscal federalism. Deciding on them will not be easy for any government or any majority. Some study and research is being done outside of government circles, but it is a real mystery why political debate has not started yet to pose the ground rules for constructing the procedures for a decision.

8.4 Whither financing: with legislation or execution? The new Constitution provisions on financing apply to all levels of government (regions, provinces and municipalities): the same open list of financing instruments, the same plea for autonomy, the same criteria for equalizing grants. There is a lively debate on what powers exactly the Constitution assigns to Regions on matters of municipal and provincial finances. The Constitutional wording on matters such as coordination of tax system and of public finances is undetermined, if not obscure. The question is not without implications for the design of equalization plans of local finances. The alternative is whether they will be managed by the regional governments or directly by the national government, thus bypassing Regions. Debates are under way also on what Regions activities can be considered included in the concurrent competence of Regions on the matter of coordination of public finances; the question is whether Regions will be entitled to absorb some of the powers of the national government on budgets of local governments. Not surprisingly, local governments associations are very much against any hypothesis that the new Constitution has introduced in the public sector a decision tree that places them on a subordinated level to Regions.

A related issue concerns the financing rules of activities belonging to the legislative competence of Regions that will assigned, for execution, to local governments. The question here is whether financing should be assigned to the regional governments and then resources transferred from regional to municipal budgets. The alternative would be direct financing of execution by the national government. A set of thorny issues that divides regional from local governments.

8.5 The Constitutional Court activism. The national Parliament has enacted, after the coming to life of the new Constitution, a lot of legislation dealing with matters belonging to the new regional competence. Some Regional Council has enacted legislation dealing with matters belonging to the traditional fields of competence of the national government but now under presumptive regional competence.

The Constitutional Court is being repeatedly and continuously called upon to disentangle the competence conflicts between national and regional governments. It has to do so in the absence of the "fundamental principles legislation" that should supposedly define the complex boundaries between the power of the national government to interfere and the autonomy of the Regional governments. In one important decision, the Court has stated that the fundamental principles can, until legislation is passed that defines them, be derived from the general propositions of existing national legislation. The Court has also argued that, while waiting for the fundamental principles and also waiting for the transfer of financial resources, somebody (some legislative body) has to take care of new needs and new circumstances and that nobody is better equipped, transitorily at least, than the agent (the national government) who brought the existing legislation into being.

The activism of the Constitutional Court is of course a consequence of the activism of the interested agents entitled to question the legitimacy of the newly enacted legislation. By settling, with ordinary operational diligence, a great number of cases, even on many minor problems, the Court motivates its decisions and in doing so it sets an interpretative agenda of the new Constitution. Nothing to complain, if it were not for the fact that no concrete system of intergovernmental relations (and of fiscal intergovernmental relations) compatible with new Constitution has yet been established by the ordinary legislator. The motivations of the Constitutional Court are progressively cutting away corners in the feasible set of solution that could possibly be derived from the new Constitution. This is happening in many sectors, but is of major relevance in the one sector, that of financing, where the Constitutional provision are the least defined of all the reformed provisions.

It is true that one line of political thinking takes it for granted that the true meaning of a Constitutional provision is only that one defined by a Court ruling. But there are other lines of political thinking. It is to be hoped that, when the time will come for the national government to provide its own political view of the new system of intergovernmental relations in Italy, the set of option will not have been pre-emptied by the, now in the hundreds, Constitutional Court rulings and decisions.

9. Developments of most recent years: a slide backward.

In the last three years some changes have occurred in the practice of intergovernmental fiscal relations in Italy. A variety of factors are behind such choices, such as the automatic increase in over-all budget deficit due to the slowdown of the economy since 2001, the cost of the participation to Iraq's missions, the loss of attention to expenditure control, the increase in public sector wages, and, more fundamental, an

orientation of economic policy favourable to tax reduction with the expectation of strong output incentive effects, have all concurred to the re-emersion of budgetary problems. A factor may also be that the new Constitution was approved by the old Parliament with a partisan (strict majority) vote; the new text touches upon issues the Lega Nord components of the majority consider as their banner and belonging to their raison d'etre. Also, an increasing number of regional and local governments are turning to centre-left majorities, thus generating a political contraposition between decentralized and central governments. A few propositions can be presented on this subject.

(i) the internal stability pact has been evolving towards a system of cash limits on spending and penalties for not meeting the deficit targets; furthermore, specific limits on single expenditure categories are being imposed on regional and local governments (on new hiring and employment, on purchases of goods and services, and so on); in some cases tax increased have been forced on decentralized budgets; in another year they have been prevented from adjusting taxes, as the national government is pursuing a policy of tax burden reduction. In the last months, the national government has determined cuts in the volume of equalizing grants to local governments.

(ii) strict regulations have been imposed on the level of borrowing by local and regional governments; incentives have been provided for the selling of their building properties; restrictions have been imposed on debt liabilities management at the local and regional level.

(iii) finally, it is useful to recover events concerning the application of the new grant formula to finance regional health expenditures. When the first computations of the allocations under the new formulas were produced, the Regions losing resources with respect to the historical level of spending would not accept the outcomes. The grant formula was rejected on the ground that they had not been explained exactly the content of the year 2000 proposals. Further, the point was made that health care was included in the "social rights" that, according to the new Constitution required a strict adherence to the principle of equal treatment and that no financial rule could be played against the implied uniformity requirement. At the end of year 2003 an agreement was not yet reached on the grant distribution formula for 2002. So the government went for a compromise solution. The fate of the new equalization plan can now optimistically defined as uncertain.[16]

10. Another Constitutional reform?

[16] The fiscal capacity grant formula was intended to stimulate growth of tax bases in below average income regions and also to consent, in 13 years, a differentiation of health spending of no more than 3 to 5 per cent around national averages, in favor of richer regions.

New Constitutional reforms are presently discussed in the lower Chamber (Camera dei Deputati). The main proposed changes relate to the functions of the two houses (Chamber of Deputies and Senate), the power of the head of government, the relative powers of government and Parliament, the notion of an Upper House (the Senate) specializing in intergovernmental relations on the lines of the German Bundesrat. Though this latter development may result of the greatest importance for the future of intergovernmental relations (fiscal and otherwise), we shall not consider these propositions but concentrate on some changes that are proposed to the new (not yet implemented) art. 117 where it defines the legislative competence of regional governments.

10.1 More exclusive competence for the Regions. At the present stage of discussion (an approval vote was taken few months ago by the Senate)[17] the bill disposes that *health care and organization, organization of education, local police* be assigned to the newly regime of "exclusive legislative competence" of Regional governments, together will all the functions that in present text are included in the "residual" list. The proposed text thus makes it clear that the "residual" list, integrated by the three new functions, defines a regime of regional exclusive competence, removing the uncertainties on what were the exact regional powers on the functions that could be included it. Though the wording of the text is far from unequivocal, the new reform proposal would provide a strong ideological turn in the distribution of powers between centre and periphery as education and health (istruzione e tutela della salute) – presently defined by the Constitution as "regional concurrent competence" – are instead explicitly assigned to the regime of regional exclusive competence. Health and education are the two most fundamental public services: taken together they count for more than 10% of GDP and about 25% of total current spending net of interest payments. The move to the exclusive legislative competence of the Regions represents a radical change with respect to the present situation, a swing backward to something that prevailed in the early years of united Italy, the 1860's.

10.2 Words weighting. The new assignments to the regime of exclusive competence do not concern the final social objectives of " "health (tutela della salute)" and "education (istruzione)"; these social or public or merit goods are maintained in the list of regional concurrent competence. The functions assigned to regional exclusive

[17] Constitutional reforms require two consecutive approval votes on the same, identical, text in each of the two Houses. Then if approval has obtained more than 2/3 of the eligible votes in each call, the change becomes definitive. Otherwise, the bill is submitted to a popular referendum, which is decided on simple majority. A 50% participation quorum is required.

legislative competence are, respectively, "health assistance and organization" and "school organization .. and teaching programs on topics of the Region's specific interest". When these proposals will become Constitutional provisions, the country will be faced with a nice interlock of legislative competence. On education, the national Parliament would enact general norms on education plus fundamental principles legislation on the same objective. The regional governments, abiding to the nationally defined fundamental principles, would enact legislation on education. They would also enact, in full autonomy, legislation on school organization. On health care, the national government would enact fundamental principles on the "tutela della salute". Regional governments would legislate, abiding to the nationally defined fundamental principles, on the same "tutela della salute". They would also legislate, in full autonomy, on organization of health services supply.

10.3 Conflicting provisions. The reform proposal is being strongly opposed by the minority opposition in Parliament because of fear that decentralizing the working and organization of the education system could break a very important channel of unity in the country. Fears seem somewhat misplaced because the grand design (general norms and fundamental principles) of the educational system is in the sole hands of the national government that has also the right to set the fundamental principles for health care. Furthermore, the national government, maintains, in the reform proposal, the right to define the essential levels of outputs concerning civil and social rights that must be guaranteed on all the national territory. The ideological war on whether school organization and health care and organization should be assigned to the regime of exclusive regional competence or maintained within the regime of concurrent competence seems therefore misplaced. The proposed reform does not attack uniformity and equal treatment more than the present Constitutional text does. It seems rather to generate a very confused sharing of powers on two fundamental public services, health and education. The segmentation of activities in health care and in education, with the consequent assignment of the segments to different levels of governments and to different regimes of legislative competence will be likely to produce inefficiency in decision making and unnecessary conflicts between public institutions.

11. Concluding comments: what decentralization ahead?

Intergovernmental fiscal relations in Italy have been an area of political debate and experimenting in fiscal principles and economic policy. They are still on the agenda of Constitutional reform bills, while the implementation of the new Constitution is stalled. Local and regional governments are presently under the squeeze of expenditure control related to the European stability and growth pact requirements.

Conventional statistical ratios show that decentralization of public spending in Italy has been on the rise, at least in the last 15 years. The increase has been accompanied by a decrease of the fiscal unbalance ratios (an increase of the own tax revenue to expenditures ratio), an event that is commonly defined as a "good property" of the decentralization process. This event, however, hides the fact that marginal budgetary decisions have not been affected at all by the increase of tax revenues: all regional and local governments, irrespective of their tax bases, are still recipients of equalizing grants.

In some cases decentralization has taken place under the strict constraint of uniformity, thus raising the question: what is decentralization that does not plan (some degree of) diversity?

In year 2000 a bill was introduced that provided, along a time horizon of 13 years, a planned diversity in per capita spending of regional governments of up to plus or minus 5% of national averages. Its efficacy has been suspended at its firs application, when the grant allocation formula generated differences in the growth rates of per capita admissible regional spending of no more than 0.1% plus or minus around the national average of about 5.0%. In other cases decentralization has taken place under the constraint of not generating changes in relative positions of historical patterns of spending, as it has been the case with local government finances.

The peculiar decentralization process Italian-style has taken a sudden move in 2001 when a Constitutional reform was enacted that increased the legislative powers of regional governments and the execution power of local governments. The reform was hailed as a "federalist reform" or as a move towards a new system of "fiscal federalism". The pace of the decentralization process is bound to further increase if and when the new Constitutional reform bill presently discussed in Parliament will be approved.

The Constitutional reform, while transferring spending and regulatory power to regional and local governments, has been taxonomic in the definition of financing instruments, over-determined and contradictory in the definition of equalization criteria.

When the new Constitution will be implemented, Italy will be more decentralized. However, the new Constitution does not contain the necessary provisions to insure that the decentralization process will be correctly defined, nor to insure that the new system of intergovernmental relations or the system of fiscal federalism will respect the properties that are suggested by economic theory.

The properties of the future Italian system of intergovernmental relations will have to be defined via ordinary legislation. Politics and economic policy will have to explicit the value judgements that the Constitution omits. They will also have to solve the conflicting, contradictory and sometimes mistaken indications that are contained in

the text. A lot of legalistic tinkering will emerge, on what is really meant in the financially relevant provisions of the new Constitution.

Here is a short list of the open issues:

- choose the tax instruments to assign to regional and local governments;
- decide whether rich (high tax base) governments should continue to be recipients of equalizing grants;
- decide whether equalization of fiscal capacity will be full or partial;
- integrate the fiscal capacity equalization criterion with the full need financing associated to the uniformity requirement;
- decide how to match the provision that requires full financing of transferred functions with the outcomes of equalization plans;
- decide whether equalizing grant programs should be the same or differ for functions belonging to different regimes of competence;
- what to make of the financial and tax relations between regional and local governments;
- decide whether national financing rules should preferably be oriented to financing of legislative competence (Regions) rather than execution costs (local governments);

Behind this list, which could still be enlarged, the fundamental policy issue has to do – as it has been already stressed – with the question whether decentralization has any merit if it operates under the constraint of uniformity. On this, I have some prejudice that may have emerged in the paper, but I prefer to leave it open to the discussion.

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Milano, august 13th, 2004.