

Fiscal federalism in the Italian Constitution:
the aftermath of the October 7th referendum

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The new Constitution, with the October 7th referendum confirming the Bill approved by the Italian Senate on March 8th 2001, provides important changes in the intergovernmental relations as they were set in the 1948 Constitution. The Constitutional reform is known under the heading of “a federalist reform”, with more powers transferred from the centre to the periphery and lesser interference of the national government on sub-national government activities. It would better be described as a reform that changes the structure of the Italian “fiscal federalism”, as it rewrites entirely Title V of the 1948 Constitution.

The paper reviews some of the basic propositions of fiscal federalism as they can be read in the Italian legislation. It considers the sharing of powers between national and sub-national governments, the sources of financing (with respect to both the power to legislate and the power to execute) and the equalisation rules. It compares the old, 1948 text and the new text resulting from the October 7th referendum. It presents briefly relevant topics of the new Constitution not treated in the old text.

1. Semantics of “fiscal federalism”.

In academic discussions and political debates in Italy, the expression “fiscal federalism” has been given a variety of meanings. It is used by professors of constitutional law or of public administration to identify a process of constitutional

^(*) Professor of Public finance in the Catholic University in Milano. The text differs from the one presented at the Conference as, two days after the closing of the Conference, a national referendum was voted that changed the entire Title V of the Italian Constitution. The wording of the paper has been accordingly adapted. As Italy’s traits of a unitary, non-federal country, are not changed by the new Constitution, the term “federalism” – contained in the initial suggestion of the Conference organizers – was changed in “fiscal federalism” and referred to the latter’s treatment in the now-old and in the new Constitution. This is a shortened version of a longer paper on the same topic, written in Italian (see Giarda (2001)).

reforms based on decentralization of political and administrative powers. It is used by debating politicians to favour or oppose the transformation of Italy from a unitary state into a federation of region-states. Public finance students consider it a textbook heading when searching for efficient structures of intergovernmental fiscal relations. Rich northerners like it better than poor southerners. Public economics and tax law professors have taken it as an easy-to-use set of propositions implying the assignment of taxing powers and sharing of national taxes to sub-national governments. A few years ago, it has been used as a metaphor to advocate outright reduction of the tax burden.

The expression “fiscal federalism” was born in the U.S., a federal country, at the end of the 50’s. Scholars were investigating the conditions under which the federal government would be entitled and justified to interfere with the activities of the states. From the very beginning, three main questions were treated under its heading: efficiency, equality and equity. Efficiency was related to the possible sub-optimality (in the way welfare economics defines optimality) of the outcomes of budget decisions at the state or local level and on the tools the federal government might use to promote efficiency in the over-all allocation of resources. Equality was related to the opportunities for the federal government to govern the process by which state and local budgets would, via their budget policies, effect the welfare or income position of individuals in different states and possibly violate the principle of equal treatment of equals. Equity was related to the possibility that state budget policies could nullify the progressive effects of the tax system produced by the federal personal income tax.

In later years, fiscal federalism was integrated in the economic theory of government laid out in Adam Smith’s Book V of *The Wealth of Nations* and in the development of the theory of public goods, as rediscovered by P. Samuelson and R. Musgrave. Following suggestions by G. Stigler and C. Tiebout, it became accepted that the allocation of resources to and within the public sector could be made more efficient by taking into account the different spreading of benefits of public goods provision over nation-wide or state and local territories and jurisdictions.

Following these developments in the U.S., the welfare economics theorems and propositions applied to a multi-levels system of governments – fiscal federalism in the public finance textbook sense – progressively spread over to Europe and were applied also to unitary, non-federal, countries.

Furthermore, “fiscal federalism” has come to be known as an agenda for reforms aimed to transferring legislative (regulatory, expenditure and tax) powers away from the central or national governments in favour of regional or local governments. The two words, originated forty years ago as a banner in support of federal government interference, have become a password for autonomy and decentralization.

This paper, following my profession's tradition, gives "fiscal federalism" the scope adopted in 1959 Musgrave's textbook *The theory of public finance*:

(i) which public goods and activities should be provided by which level of government;

(ii) how the activities of each level of government should be financed with own tax sources and/or national government transfers.

The word "fiscal" is then taken to apply to both sides of the budget, expenditures and revenues, following the tradition that "fiscal policy" is almost the same thing as "budgetary policy". The word "federalism" is meant to apply to a system of intergovernmental relations where fiscal autonomy and budgetary liberty of sub-national governments are exercised, for some of their activities, under the umbrella of central government guidelines budget. Or, looking at it from a different angle, "fiscal federalism" is a system where the central government has only limited powers (and its budget a limited scope), in terms of the functions it performs and of the interference it exercises on sub-national governments.

In most countries, fiscal federalism finds its source and regulation in the Constitution or in Statutes having constitutional strength. Constitutions have different structures in unitary states and in federal countries. They also have different long run evolutions. In unitary states, fiscal federalism has shown a tendency to evolve with progressive decentralization of legislative power (on both the tax and expenditure side of the budget). In federal countries, fiscal federalism is initially defined in the form of assignment of limited powers to the federal government and evolves by progressive interference of the central government in the previously independent business of the sub-national governments. Historical evolution in unitary states shows well defined trends towards decentralisation, whereas in federal countries swings in the relative weight of federal and state governments are not uncommon.

In both systems, historical evolution is led by the evolving values of society. Changes in the powers to legislate on the various fields of public activity are accompanied by changes in the power to execute own and other governments' legislation. Substantive changes are produced by Constitutional changes, often preceded by trend setting changes in ordinary legislation.

1. What competence for what level of government.

The theory of public goods and Constitutions in some country permit to draw some inference on what public functions should be allocated to what level of government. The optimal area is one that better internalises the benefits produced by government supply. Public goods and programs can be classified according to whether

benefits are better appropriated at local, state (or regional) or national level. A large fraction of government activities can thus be allocated to different layers of governments according to benefit rules. Powers to decide upon properties of these activities, upon levels of output to meet constituencies needs or taxpayers' preferences are thus assigned to the level of government that better meets the territorial distribution of benefits.

The old Italian Constitution did not provide a fully developed model of assignment of functions to different levels of governments¹. The new Constitution provides a more complete picture. It assigns a first group of public matters to a regime of exclusive national government competence². It assigns other matters to regional governments, under a so-called regime of **exclusive legislative competence**³: under this regime, Regions have full power to legislate, within the boundaries set in other section of the existing Constitution.

It is a tenet of public expenditures theory that a variety of public functions however cannot be neatly assigned to a layer of government, due to the presence of spillovers of benefits, of expenditures with distributive effects and merit goods characteristics. Constitutions in some countries and Constitutional courts in others have affirmed the power of the national government to interfere in the decisions of sub-national governments. They have done so by defining regimes of **shared political responsibility**, based on the ethical foundations of "national interest" or "fundamental individual rights" or "citizenship rights" that are variously defined in different Constitutions. The new Italian Constitution and in the Basic Law of the Federal Republic of Germany shared responsibility is named "concurrent competence".

The old Italian Constitution assigned (in article 117) a relatively short list of public functions to the regime of regional concurrent competence. The new Constitution substantially enlarges the list, correspondingly shortening the list of functions assigned

¹ The old Constitution assigned to a regime of concurrent legislative competence (though the words were not actually there) local police, health care, vocational training, land use, tourism, mass transport and road system of regional interest, agriculture, and few other minor functions. Actual transfer of legislative power, after Regions were instituted in 1970, has proceeded slowly: Regions have not been very popular with the national legislator.

² The new Constitution assigns to the exclusive competence of the State (the national government) a list of competence inclusive, among others, of foreign policy, defence, law and order, currency and financial markets, environmental protection, the determination of the essential levels of performances concerning civil and social rights to be warranted on the entire national territory.

³ 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.2) 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. Exclusive regional competence remains a banner of the recent Constitutional reform.

to the competence of the central government⁴. The resulting list is similar to the list of the Lander competence in the FRG.

In the regime of concurrent competence, sub-national governments have autonomy and competence to legislate, but their power is bound by limits defined by “frame legislation” or by “fundamental principles legislation” enacted by the national or federal government. This “fundamental principles” legislation should guarantee either the “national interest” or the “individual rights” written in the Constitution. In the FRG Basic Law the boundaries on federal government interference are narrower, and more accurately defined, than in the new Italian Constitution⁵.

1.1 Competence and sources of revenues.

It is not the task of this paper to discuss whether in Italy the allocation of public functions and legislative competence to different levels of government is appropriate. However, different powers to legislate, be it exclusive or shared power, imply different financing structures.

Local public activities associated to full legislative power (those functions assigned to sub-national governments with full autonomy), should be financed mainly with local or regional taxes. Interference, guidance and control from higher levels of governments should be minimised.

Local public activities associated to limited legislative power (those functions assigned to sub-national governments in a regime of shared responsibility), should be financed with a wider variety of instruments, spanning from own tax revenues to conditional grants aimed to realize the nationally set objectives. Some interference from higher levels of governments is expected to be present. FIN QUI ORE 13 DEL 23 OTTOBRE.

2. Financing of exclusive competence.

One axiom of fiscal federalism is that a sub-national governing body legitimated by democratic elections should have the power to raise money for the financing of the

⁴ The new Constitution assigns to the regime of concurrent competence, among others, matters such as foreign trade, work conditions, education, scientific research, health care, land use, ports and airports, energy production and distribution, transportation, co-ordination of public finances and tax system.

⁵ In the new Italian Constitution the national government has the right to set the “fundamental principles” that will define the boundaries for regional legislation. The discipline of concurrent legislation in FRG Basic Law, gives the Federation the right to legislate in the matters assigned to the regime of concurrent legislative power to the extent that:

(i) a matter cannot be effectively regulated by the legislation of individual Lander, or
(ii) the regulation of a matter by a Land statute might prejudice the interests of other Lander or of the whole body politic, or
(iii) the maintenance of legal or economic unity, especially the maintenance of uniformity of living conditions beyond the territory of any one Land, necessitates such regulation.

functions that are written in its Charter or that have been assigned to it by the Constitution. A second tenet is that expenditures on functions that belong to exclusive or primary competence of a level of government should be financed entirely by own tax revenue, possibly supplemented by the yield of sharing into the yield of a central government tax⁶.

By choosing tax rates, sub-national governments determine the level of spending on their statutory functions. Revenues, however, are much affected by inter-jurisdiction differences in the tax bases. Poor communities or regions will acquire smaller per capita resources, thus determining lower levels of expenditures and, presumably, lower provision of services. Inter-jurisdictional differences are a natural consequence of the choice to assign a competence to sub-national governments and of the unequal distribution of income on the national territory.

Are interregional differences in performances a sufficient reason for a national government to take action to correct them? In general terms, the answer is negative. Under the assumption that the functions assigned to a layer of government were correctly decided upon, inequalities in income distribution are a problem that should be dealt with by the central government. If it is successful in its efforts, the resulting personal disposable income, i.e. personal earned income adjusted by national government subsidies could be taxed at the local level. Allocation of resources would be taken care by sub-national governments, distribution of income by the national government.

The matching of local revenues (from local taxes and sharing of national taxes) with local expenditures would, (i) strengthen political responsibility in budget making at the local level and, (ii) adjust provision of services to citizens' preferences. As national policies are unlikely to eliminate income inequalities in different areas or regions, per capita output of public services is going to be higher in rich regions than in poor regions. Such interregional or interstate differences are the natural consequence of the regime of exclusive competence: any individual state or region can be thought of as a sovereign state. No need for any state or local government to share responsibilities with other states on purely local matters.

A problem, much discussed in the U.S., may however arise. Poor regions may not be able, with standard or average tax rates, to finance expenditure levels close to the levels prevailing in neighbour jurisdictions. They may thus be forced, by the pressure of needs at the local level or due to the imperfect working of federal redistribution policies, to raise taxes to finance the higher expenditures. In the financing of activities of purely regional or local interest, a case can be made for the national legislator to ignore such

⁶ Differences between own taxes and tax sharing need only to be reminded. Decentralised governments autonomously define own taxes legal structure inclusive of tax rates. Tax sharing produces revenue to local governments under rules that are set entirely by national legislation.

circumstance. However, higher tax rates in poor regions may have undesirable effects on the distribution of real personal income, a matter that is a legitimate concern for the central government. In conclusion, financing of the exclusive competence of regional government cannot rely exclusively on local taxes. Some equalisation plan is called for. Richer regions (or their inhabitants) are to put up the money required to finance such equalisation plans. Equalisation can take different routes. The selection of the grant program could be related to evaluation of needs or to reduce the effects of disparities in tax bases (actual or potential). For exclusive competence it is not appropriate for the national government to become involved in regional needs evaluation. A grant program directed to reduce the revenue consequences of the lower tax bases would be sufficient. A reduction of the differences, rather than a levelling off of per-capita resources, should be target of the equalization scheme.

In the old Italian Constitution, there were no activities assigned to the exclusive competence of regional governments but only activities assigned to a regime of concurrent competence.

The new Constitution changes the approach to equalisation, stating – in comma 2 of article 119 – that the yield of own taxes and shared national taxes is to be integrated with “equalization grants in favour of territories with lower per capita fiscal capacity”. It would thus seem that “needs” is not expected to enter the equalisation grant formula.

The new Constitution does not indicate the “extent” of equalisation, whether differences in per capita fiscal capacity are to be eliminated or only reduced. It would seem that in presence of matters of purely regional interest, one should opt for reduction rather than for elimination. After all, as Musgrave put it 40 years ago, “a high degree of absolute equalisation is not compatible with a workable system of fiscal federalism”.

3. Financing of concurrent competence

The *values* that, in Constitutions, provide the foundations for the regime of shared responsibility of national and regional governments find a correspondence in analytical categories of welfare economics, such as spillovers effects, merit wants or citizens’ rights. One matter, income distribution, is not treated explicitly by Constitutions, though fiscal theory considers it as belonging to the realm of national governments⁷. Because of these factors, sub-national units in modern societies cannot stand unrelated to each other. They have to join in a system of fiscal federalism. They

⁷ Income distribution objectives appear in Constitutions as norms of equality of treatment of all citizens on specific public functions, such as education, health, etc. Alternatively, they are treated under the headings of minimum provision in the field of social security, progressiveness in taxation, freedom of access to some public services, and so on. Reduction in income disparities is more of an economist’s child than a Constituent’s target.

can do so by way of ad-hoc contractual agreements. With many units involved, negotiations of ad-hoc contracts would be unproductive. This explains why many Constitutions provide general rules on how solidarity principles are to be translated into programs of financial redistribution from haves to have-nots.

Equalisation programs are, together with fiscal autonomy, at the hearth of fiscal federalism. In the discussion of financing of matters of pure regional interest, reference has been made to equalisation plans based upon reduction of fiscal disparities. Matters such as health care or education can hardly be treated under the same principles.

As already mentioned, the old Italian Constitution assigned functions to regional governments only in a regime of concurrent competence. Health was prominent among them⁸. In order to define the principles of equalisation, it quoted three concepts: “needs”, “necessary expenditures” and “normal functions”. The model implied in these words made no reference to regional taxes in the sense that expenditures were not expected to bear any relation to tax yield. It gave absolute priority to the evaluation of “needs” and it asked for the central government to provide whatever amount of resources was required to meet the cost of the assessed “needs”. As revenue of regional taxes was (and still is) more unevenly distributed than need related expenditures, central government transfers were required to match needs with resources in low-income regions. Shares of national taxes would finance an “equalisation fund” to be apportioned among regions to cover the difference between the monetary cost of “needs” and the revenue from regional taxes.

3.1 The new Constitution.

The new Constitution does not separately treat financing of exclusive and concurrent competence of regional governments. It emphasizes the role of own tax sources, sharing of national taxes and fiscal autonomy. In the description of central government’s powers, it employs words that seem to reduce its power to interfere with regional powers. It stresses co-ordination, but the power to co-ordinate tax and budgetary affairs of different layers of government is assigned to the regime of concurrent legislative competence.

It has already been noted that the new Constitution changes the approach to equalisation. The main criterion, indicated in paragraph 2 of article 119, is that of supplementing revenues of regional taxes in territories with lower per capita fiscal capacity. There is no indication as to the required extent of the reduction in fiscal capacity differentials⁹. In the previous paragraph it was argued that complete levelling

⁸ Other important regional competencies related to mass transport of local and regional interest, agriculture,

⁹ This is one main difference with the German Basic Law provisions that define the dimension of the maximum allowed differences.

off of differences, though not excluded by the actual wording, would be inappropriate for matters of purely regional interest.

The construction of a grant formulas for activities where a strong national interest prevails, as it is the case with education or health, cannot be done without making some judgement on the degree of interregional inequality that is deemed desired or acceptable. Full equalisation of potential fiscal capacity would produce, under a regime of uniformity in regional tax rates, a levelling off of per-capita revenues and expenditures. Instead, partial equalisation would maintain some interregional differences in per-capita resources and expenditure levels: low-income regions would have lower spending than with full equalisation and a positive correlation would be maintained between per capita spending on public services and per capita regional incomes. Public spending at the regional level would remain, as with full equalization, a declining fraction of income. The criterion is adopted in Germany, Canada, Australia and, recently, Italy¹⁰.

Equalization objectives would not be properly defined in terms of mere per capita regional expenditures. Ideally, reference should be made to performances and service provision, thus to individual welfare. In practice, to “needs” as they may be assessed at the regional level.

Paragraphs 4 and 5 of article 119 proposed for reform, introduce two concepts that can be used to supplement the fiscal capacity criterion. The first is “special grant programs” that could be used when “individual person rights” are at stake; the second is the statement according to which “activities transferred (from the central government) to regions must be fully financed”. Future Parliaments may thus interpret the new Constitution as indicating that grant equalisation programs related to activities to be provided in regime of concurrent competence should consider the two complementary criterions:

- reduction in fiscal capacity differentials and,
- safeguard of individuals rights.

Grant formulas should thus take into account – besides fiscal capacity – demographic and cost factors, charges paid for access to services provided and the whole barrage of “needs” estimates at the regional level.

3.2 On properties of equalizing grants.

An important policy question, on which debate has raged in the U.S. in earlier years as well as in Italy in more recent years, concerns the strings and conditions attached to equalising grants. A choice has to be made between “block, unconditional grants” or “conditional grants”, with the possible option for “matching grants”, requiring specific co-financing by the receiving governments.

¹⁰ The criterion was introduced with article 10 of Bill no. 133/1999 and Decree Law n.56/2000.

“Need” factors acquire a specific relevance when Constitutions define a national interest in regional programs and classify them in the regime of concurrent legislative competence, as it is done in the FRG Basic Law and in the new Italian Constitution. In such cases, national legislators have frequently made the financial transfers to sub-national governments conditional upon it being spent in the assisted program; in some cases the conditions give origin to administrative controls on the correspondence between actual spending and intended destination. Conditional grants are common practice in Italy in financing of a variety of programs; they are used in Australia in the financing of health expenditures; they belong to the very tradition of intergovernmental fiscal relations.

Receiving governments resist the notion of conditional grants, considering it a violation of the principle of fiscal autonomy that is granted to them by the Constitution. In some cases, in the U.S. as well in Italy, a class of specific or categorical grants has been adopted. They are based on need evaluations but are assigned without conditions: meeting the objective is left to the political responsibility of the receiving government.

In recent years, the financing of regional governments in Italy has moved away from programs of conditional grants in the two most important fields of their activity: local transportation and health. Previously based on needs assessment, over-all financing of regional governments is now based on a mixed formula which relies on needs assessment (population weighted for regional health risk)¹¹ for about 40% of total spending and on reduction of differences in per capita potential fiscal capacity for the remaining 60%.¹²

The new Italian Constitution provides a strong support for equalisation to be realized with block grants possibly supplemented by categorical (unconditional) grants in those cases where “individual’s rights” are touched upon by the regions’ activity.

5. Summary and concluding comments.

The new Italian Constitution changes the model of fiscal federalism in Italy in a variety of aspects. In addition to a massive transfer of legislative powers from the State to the Regions and to changes in the financing rules, the new Constitution touches the allocation of administrative functions (of the power of execution), the legal status of local governments, the financial relations between Regional and local governments, the

¹¹ As health related expenditures take up about 80% of total regional spending, when the grant formula was revised in year 2000, it was decided that the only adjustment on average per capita expenditure would be done in relation to health risk factors (demographic structure, specific regional risks, availability of hospitals, etc.).

¹² In the short and medium term, a strong weight is given to the historical levels of health related expenditures. The grant system brings the standardized tax base of each Region up to at least 90% of the standardized national average.

option for differentiated regional autonomy. A short review of the main changes follows.

A. The changing pattern of fiscal federalism: State-Regions relations

1. More legislative powers are assigned to regional governments. Legislative competence in many fields presently belonging to the national government is transferred to a regime of shared responsibility with the regional governments. Conspicuous in this respect is the transfer of education – primary schools to university – from national to concurrent (State and Regions) legislative competence. In other fields, regional powers presently belonging to the regime of concurrent competence, are transferred to the regime of exclusive regional competence.

2. In finance, more emphasis is given to regional taxes and to regional sharing of national taxes. The latter will be assigned to Regions according to the regional distribution of tax bases, thus providing an important change relative to the old Constitution, where shared national taxes accrued to a national fund to be divided among regions according to need evaluation.

3. The proposed equalisation criteria seem to take into account that regional expenditures belong now to the two regimes of exclusive and concurrent legislative power. Expenditures for exclusive competence will possibly be financed under an equalisation scheme that relies on partial equalisation of per capita potential fiscal capacity. Expenditures for concurrent competence will possibly be financed under a scheme that relies on both partial equalisation of per capita fiscal capacity and needs evaluation.

4. Regional fiscal autonomy is likely to increase, as the proposed text is heavily worded against conditional grants. “Needs” will continue to be important in the financing of concurrent competences, but they will probably be treated under a regime of categorical (or specific) grants without administrative control on the actual destination of resources.

All together, the new Constitution is apt to generate greater interregional differences in service levels than the old Constitution. It provides more opportunities for higher expenditure levels in richer regions. Future governments and Parliaments will determine the timing and the extent of the changes. Uniformity appears no longer to be an absolute Constitutional value.

B. Differentiated regional autonomy.

The new Constitution entitles single regional governments to submit Bills to Parliament directed to obtain (a) transfer of competence from the regime of exclusive central government power to the regime of concurrent legislation and, (b) transfers of competence from the regime of concurrent legislative power to the regime of exclusive legislation. The first possibility is limited to a few items, though one is very precious:

education. The second extends to the whole range of competence Regions share with the central government. Regions have the right to submit proposals, but the national Parliament is under no obligation to approve them.

The notion of differentiated competencies in favour of single Regions poses complex financial questions that are not properly treated in the reform proposal. If one looks at the experience of the 5 Italian Regions that presently hold Special Statutes¹³, the most likely possibility is that differentiated competence will be financed with higher rates of tax sharing.

C. Local (municipal and provincial) governments.

The new Constitution touches upon local governments (municipalities and provinces, integrated with the newly established Metropolitan Cities) in two respects, Constitutional recognition and power of execution.

Local governments finance receive full treatment in the new Constitution, deeply innovating with respect to the old Constitution. Equalisation principles for local governments were not treated in the old Constitution. The new one extends to local governments the criterion of “fiscal capacity equalisation” provided for regional governments.

The new Constitution assigns the power to execute the whole of legislation, be it enacted at the regional or central government level, to local governments (municipalities in the first place). This change provides somewhat of an institutional revolution. It echoes Article 83 of the German Basic Law, which assigns power of execution entirely to the Lander. A decision as to what level of government is going to be assigned the task to execute what legislation, will be made in future national and regional legislation. No suggestions are provided with respect to financing. 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. The financing of governments that provide services with no other power than to execute legislation of other levels of government is no simple matter. Situations may vastly differ. Aid to small business can be strictly regulated and also restricted by financial appropriations. In public services, execution is strictly determined by legal binds only in limited cases. Will local governments be given some discretion in the management of administrative functions assigned to them, or will they simply act under a rigid mandate? Efficient financing is going to be very different in the two alternatives. Rigid mandates remove performance incentives: they require categorical grants, possibly supported by full pass-through conditions. Autonomy not supported by tax effort is likely to produce fiscal irresponsibility. In all cases local governments will become readers and interpreters of

¹³ Valle d’Aosta, Trentino-Alto Adige, Friuli-Venezia Giulia, Sardegna e Sicilia.

their communities' needs versus the distant (regional or national) regulator. Not a nice situation for fiscal accountability.

D. Regional power to co-ordinate finances of local governments.

The new Constitution assigns Regions the power to co-ordinate public finances. It does not specify whom they are supposed to co-ordinate. The most likely candidate cannot be others than local governments' finances. This possible outcome of a rather obscure proposition in article 117 of the new Constitutional text, is likely to provide some interesting exchange of opinions between regional and local politicians (and also between supporters, in academia, of the two layers of government). Regional co-ordination of local governments activity cannot touch the equalisation criteria, as this very specific matter is reserved to the exclusive competence of the national government. If some power were assigned to regional governments by national legislation, it would provide some flexibility in the management of equalisation formulas for local governments with lower tax basis.

E. Fiscal partnership, budget constraints and reform implementation.

Recent years in Italy have seen a progressive reduction in the budget deficit of the public sector deficit. The stability pact requirements designed by the European Institutions have substantially been met. However, budget deficit targets have been attained by means of better than planned performances on the tax revenue side accompanied by higher than expected expenditures. Over spending has occurred mainly in health care (in the joint responsibility of central and regional governments) and in local public transportation (in the joint responsibility of central, regional and local governments). Processes were designed to establish a working partnership between sub-national and national governments towards meeting the objectives of deficit control. Ex-ante acceptance of spending control was easily attained, but expenditure outcomes have been systematically higher than initial estimates.

Over-spending seems to associate with shared political responsibility. In health care, it is partly due to input price policies (drug and labour prices) that belong to the national government competence. By and large, it is however a consequence of the poor working of the NHS at the regional and local level, a Regions' concurrent competence. Similar considerations apply to public financing of local mass transport.

The situation is one of soft budget constraint. Cost overruns invalidate initial estimates and the national government and Parliament are unwilling to make Regional governments to pay for them. Fiscal partnership between the centre and the periphery does not show a satisfactory record. The new Constitution does not sufficiently strengthen fiscal discipline. Truly, it excludes the possibility of deficit financing of current expenditures. This, however, is counteracted by the loss of fiscal accountability associated with, (a) the bigger share of public activities that will be managed in the

regime of concurrent legislative power and, (b) the assignment of the power to execute regional and national legislation to local governments.

Further worries arise if one looks at the possible course of implementation of the proposed reforms. Transfer of powers to the periphery has a tradition, in Italy, to be budget expensive, despite it being always dubbed as a zero cost process. Central government agencies are not apt to accept the budget cuts that should finance the increase in revenues of sub-national governments. This is a practical matter, not specific to the reform proposal we are discussing, that is relevant for macro-economic analysis.

F. Concluding comments.

Decentralization takes government closer to the people and could increase accountability, making for more efficient provision of services and, possibly, for reduction in tax rates. It produces baskets of public consumption closer to individual preferences.

The main novelties in the allocation of powers in the new Constitution occur in the regime of concurrent legislative competence. The actual shift of powers will be determined by the national legislation setting the “fundamental principles” for each competence assigned to regional governments. A lot of decisions of the Constitutional Court will be required on the dividing line between “fundamental” and “detailed” principles. Also, some shivering is provided by thoughts of future financing rules. They will have to thread between **diversity** (fiscal federalism requires wider differences than would be accepted in a truly unitary state) and **uniformity** of service delivery on the national territory (see the recent decision of the German Supreme Court on individual rights in the regime of concurrent competence). They are expected to adapt to the diversified territorial mapping of the **competence to legislate** and the **power to execute** and to reconcile the local aspiration for **fiscal autonomy** with the central government aspirations to **control the budget deficit** of the public sector.

Pros and cons, returns and risks, are all there, as it should be, in an ambitious proposal of Constitutional reform.

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