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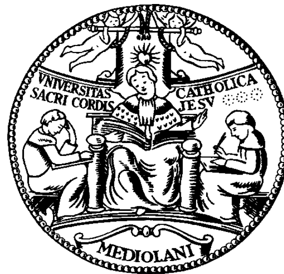

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Decentralization and intergovernmental fiscal relations in Italy: a review of past and recent trends

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Abstract

The system of intergovernmental fiscal relations in Italy has moved along cycles with varying degrees of decentralization. The traditional system based on three layers of governments (national, municipal and provincial) moved in 1972 to a four layer system with the addition of Regions, bodies endowed with legislative power. As measured by the own revenue to spending ratio, decentralization was at maximum in the years before world war two as all of spending by local governments was financed by local taxes. As measured by the local spending to total public spending ratio, the degree of decentralization has steadily increased starting from the coming to life of regional governments as the functions assigned to regional and local governments have progressively increased over time. Regional and local taxes have declined up to the beginning of the Nineties and moved upward in the last 12 years.

In 2001 a major Constitutional reform was approved that changed the distribution of powers between national and local governments assigning the latter more spending and taxing powers. The system of fiscal federalism designed by the new Constitution, however, is far from satisfactory. On the expenditure side, the sharing of responsibilities between national and regional government is marred by the overlap of legislative competence on a variety of crucial public activities. Inadequacy is even greater on the financing model, as the new Constitution does not state clearly the fundamental choices on the degree of interregional diversity that the new system is expected to generate in the provision of public goods. It decentralizes spending responsibilities but at the same time makes a strong requirement for uniformity, assigning the national government the power to determine the "essential levels of performance" that are to be provided in all regional territories. Great emphasis is laid on own taxes (which greatly differ in per capita terms in different Regions due to long standing differences in per capita incomes) but no indication is provided on the extent equalization (full or partial) of fiscal capacity.

The paper provides a description of long run changes in the system of intergovernmental fiscal relations in Italy, brings to the surface the contradictions of the new Constitution and provides some suggestions on how they can be corrected with the help of time honoured theorems of fiscal federalism.

JEL classification: H77, H11.

1. Introduction [*]

The Italian system of intergovernmental fiscal relations finds its definition in the Constitution of 1948 and in a long sequence of legislation that has spanned over the last 55 years culminating in the Constitutional reform of 2001. The 1948 Constitution, which defined Italy as a Republic, disposed the first move towards decentralization of a previously fully centralized country. It instituted Regions (originally 20 in number), it assigned them the power to legislate on certain competences and defined a system of financing based on tax autonomy and needs oriented equalization schemes. It made almost no reference to the competence and financing of local governments (municipal and provincial): the national legislation on local governments, enacted in the Thirties, was untouched by the 1948 Constitution. The 2001 Constitution defines new legislative competence and financing rules of all decentralized governments, Regions and local governments. Ordinary legislation has not yet been enacted to implement the new Constitutional rules, so that the whole system of regional and local governments is presently in a sort of apnea.

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 public spending and 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 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. The new Constitution is not written in a language that lends to clear cut answers. Its implementation has barely started and no decision has yet been taken on the precise configuration of the new Italian system of intergovernmental relations. Last but not least, the first rulings of the Constitutional Court on

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"what is really meant by the new Constitution" indicate that it will take some long testing period before the real strength of decentralization in the new Constitution can be measured.

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 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 university 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 to join 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.

The concluding paragraph summarizes 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. Though clearly oriented to an increase in decentralization of spending powers, the new Constitution is ambiguous on the proposed tax and financial arrangements. It does not design a fully defined system of fiscal federalism and leaves to future legislation the task to decide on those very fundamental questions, that Constitutions are normally expected to answer.

2. 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 followed periods of centralization; major reforms and minor adjustments overlapped over time. Public spending by decentralized governments was slowly increasing before world war two; it fell drastically as a share of GDP after 1950. It increased steadily after 1972. At the local governments level, tax revenues financed 100% of spending in 1935. The percentage progressively fell starting from 1950, was down almost to zero in 1973 and stayed there until 1980. Regional governments resources in 1972 were given, for about 90%, by grants from the national budget. The percentage rose to 95% in 1980. Small changes occurred for both level of governments in the Eighties. A brief description in qualitative and general terms of the evolution of the system of intergovernmental fiscal relations in Italy follows in the next pages.

2.1 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, taxes on consumption, 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 tax rate and maximum tax rates were defined. Standard minimum 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 public services or functions. It may come as a surprise that, in face of 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 service, was expected to balance.

Price increases during 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 it still conditions the way of thinking of Italian policy makers) was to give the national government the task to evaluate the appropriate matching of revenues and expenditures of individual local governments 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 the budget via tax increases and/or expenditure cuts. When the budget could not be made to balance at the local level (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 gap between expenses and revenues. 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 a so-called "budget clearing" grant.[1] Looking at their mapping on the national territory, Italian local governments could be grouped into three main areas: 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 central part of the

[1] The "budget clearing" grant was administered under the form of special loans mostly 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

country which took advantage of the yearly negotiations with the national government to share into the "budget clearing" grant program to finance higher than average per capita spending.[2]

2.2 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 set by national legislation made a mockery of the constitutional indication of tax autonomy as own tax sources assigned to regions were almost nil. Most of the financing came from a need based equalization scheme adjusted to provide full financing of the historical levels of expenditures prevailing under 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 of growth of GDP, a situation not dissimilar from what has been happening in the recent steps towards decentralization.[3]

2.3 The centralization of local government finances. At almost at the same time of the inception of regional governments, a major reform proposal of the tax system was underway that became legislation in 1973. The reform instituted a truly general personal progressive income tax, modified the corporation income tax, introduced the value added income tax,

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increases in the stock of local government debt, but it was everywhere considered as a current 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.

[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 0.8% per year.

reformed taxation of capital income, redefined procedures for tax payments and tax assessments. The whole Italian tax system was overhauled and modernized. As an important tenet from the present paper point of view, the reform cancelled local government taxes, all gone in a single stroke under the accusation that local taxes had very high collection costs and that diversity in tax rates violated the principles of horizontal equity. 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 would 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 with full centralization of financing at the local level.

2.4 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 were entitled, at the end of 1977, to determine anew and almost freely the whole of their 1977 expenditure lines under the guarantee that the "budget clearing" loans would 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

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[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" is perhaps too noble a term, given that "needs" were, in the early years of the working of this program, determined directly by the recipient government.

was set equal, for each local government, to the difference between the admissible level of spending and the yield of the remaining local 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.

2.5 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 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 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.

2.6 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

[6] Starting in 1984, the amount of the "equalizing grant" fund was set equal to the sum of all 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

Regions (OSR). They are in number of 15. The Constitution defines also five Special statute Regions (SSR), 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 regional revenue of national taxes. Percentage of tax sharing is about 100% in Sicily, 90% in Valle d'Aosta and in the two provinces of Trento and Bolzano, about 70% in Sardinia and 50% in Friuli Venezia Giulia. Specific grants are assigned to Sicily and Sardinia for the financing of health expenditures. Sicily receives also specific grants 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 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.

3. 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 more on own tax revenues 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, claimed for more autonomy requesting more transfers from the national budget, more own tax revenues with rates flexibility and

admissible expenditure levels, and of objective needs indicators, that began to be applied in 1984, moved in

substitution of unconditional for special purpose conditional grants. At the same time, applied economic studies in agriculture, health and mass transport (the three most important functions of regional governments) were criticising the system of special purpose conditional grants, with their 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 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. They would probably not have produced any impact on the evolution of intergovernmental fiscal relations if it were not for two external events. 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 to raise taxes to reduce the public sector borrowing requirement: it was considered appropriate that local governments should bear some of the political costs of the deficit adjustment process.

Some time honoured theorems on fiscal federalism, the challenge of the Lega Nord party to the interregional resource transfer and the response to the fiscal-financial crisis of the summer 1992, all together originated a variety of changes in intergovernmental fiscal relations along the entire decade of the Nineties that included:

- higher local and regional taxes;
- a revision of the financing rules for special statute regions;
- decentralization of administrative functions to local and regional governments;
- a new equalization plan based upon per capita fiscal capacity equalization;

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favor of the latter. In 2003 the two components had, approximately, the same weight.

- the extension of the European stability and growth pact to local and regional governments, and finally:
- a movement for Constitutional reforms designeds to increase decentralization of tax and expenditure powers.

The next paragraphs will briefly discuss these events.

4. 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 (a pay-roll tax 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] was transferred from the national insurance companies in charge of health 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 part 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.[7]

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 a standard minimum tax rate equivalent to the reduction of the national personal income tax rate. 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.[8]

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[7] The higher yield was compensated by a reduction of about 11 percentage points of the standard rate of the corporation income tax.

[8] 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. The complexity of the special exemptions and progressivity schemes adopted by some Regions made it impossible to compute the standardised tax yields that were needed for a correct determination of equalizing grants, resulting in a penalisation of regional fiscal efforts. This undesired result should be kept in mind of future fiscal federalism system: too much tax autonomy (the freedom to tamper with tax basis, exemptions and progressivity at the local level) may hinder the working of intergovernmental fiscal relations.

In 1998, the tax on premia paid by car owners for compulsory automobile accident insurance – up to then a national government tax – 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 year grant and the revenue from the new tax.

4.1 A detour on fiscal imbalance statistics. According to standard wisdom, substitution of local tax revenues to grants from national government produces a better system of fiscal federalism because of better matching of costs and benefits of public activity and because of greater accountability. An increasing ratio of own tax revenue to total spending (or, as it is called, a reduction in fiscal imbalance) is taken to indicate an adjustment towards a better system of intergovernmental fiscal relations. There is no more than partial truth in this proposition and the reduction of fiscal imbalance is not sufficient to justify the claim. In a fully decentralized setting, tax revenues would entirely cover expenditures. The budget would be balanced and, presumably, the marginal net benefit would be zero. It is the marginal balancing between costs and benefits that establishes accountability. In such case, the unbalance rate is nil and the ratio of tax 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 or it may generate higher spending. So the question has to do with properties and effects of different grant programs on the spending and taxing propensities of recipient governments.[9] In evaluating the merits of declining fiscal imbalance ratios in the Italian situation, two properties of the Italian grants programs are relevant. First, grants derived from the principle of need equalization are assigned to all local and regional governments and not only to the "deserving poor" and are much influenced by historical pattern of spending. Second, the national government has encountered difficulties in maintaining a firm commitment on the amount of the equalizing grants: in many cases the receiving regional governments have succeeded in forcing the national government to adjust

[9] 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. Conditional matching grants have been shown to produce diverted effects on spending in non financed sectors.

the initial amount of the grant to the level of expenditure outcomes. Tax revenues have increased but in no case a sub-set of local or regional governments was given enough tax revenues to dispose away with equalizing grants and entirely finance its expenditures with own revenues. Rich regions, municipalities and provinces still share into the equalization grant program: the grant dependence ratio varies among local governments but in no case is equal to zero.

Equalizing grants with universal coverage, strong emphasis on historical spending patterns and soft budget constraints prevent increasing values of the own tax revenues to spending ratio from generating better budget decisions and higher accountability. Local administrators still spend more time negotiating with the national government on the amount of grants than explaining budgetary constraints to resident taxpayers. Progress in the system of fiscal federalism cannot be measured solely by the changes in a statistical ratio.

5. Readjustment of finances of special statute regions

As mentioned in prg. 1, special statute regions (SSR) are financed by a share of the yield of national taxes generated in the regional jurisdiction. The percentage of tax sharing was negotiated taking into account the diverse competence assigned to each region by the Constitutional rulings that brought them into being. The choice of the percentage was made under the implicit assumption (not entirely realistic when the complex process of Constitutional amendments started in the Sixties) that both the national government budget and the social security institutions budget would be balanced. As national taxes would finance public consumption and investment, for a region receiving 90% of the regional yield of national taxes, this would correspond to the cost of all public expenditure programs with the exception of defence, international affairs, justice and police and general administration costs. A more correct percentage would have been lower, in the order of 75% but, as all the SSR had per capita incomes below the national average, the higher percentage served to generate an implicit equalizing grant.

Over time, the national government budget has come to pay for the annual deficit of the social security system (that absorbs now about 10% of total tax revenue) and for the connected mounting cost of debt service (another 10% of total tax revenue). The 90%

percentage now grossly outruns the cost of regional competence. The mismatch was further aggravated at the time of the transfer of spending responsibilities: under the excuse of superior national interest, national agencies and departments – with the tacit approval of national Parliament – resisted the transfer of expenditure controls to regional governments. As a result, SSR were assigned the resources but not all the corresponding expenditure programs and were let with financial resources to be freely spent on expenditure programs of heir choice. In some cases the resources were devoted to generate growth of local economic activity and local tax bases; in other cases to integrate personal income with no long term effects on local economic bases.

This situation was partially corrected in the Nineties, by a de-facto revisions of the tax sharing percentages and by progressive transfer of the spending responsibilities associated to the Constitutional competence of various SSR. On the average, the sharing percentages are still too high as they do not take into account the persistence of the high cost of public debt service and of the social security institutions deficit; the devolution of spending responsibilities is still incomplete, but the mismatch is now not as big as it used to be.

6. Transfer of administrative functions to regional governments

As the debate on Constitutional reform that had begun in 1990-91 was proceeding in the special Parliamentary Constitutional reform Commissions, with no apparent results, the national government decided to proceed and decentralize some expenditure programs by means of ordinary legislation. Programs of road construction, agriculture, environment protection, employment agencies, welfare and disability treatment, protection from natural disasters, and still others were progressively transferred from national agencies to regional governments. Regions have no legislative power on these programs but are entitled to define rules of execution within the boundaries defined by national legislation. More autonomy, though not full autonomy. The process came to be named as “administrative federalism”. While spending was devolved to regional or local governments, no solution was provided for financing thus anticipating the troubles that would arise in the finance provisions of incoming Constitutional reform.

(i) historical patterns vs. regional needs. National expenditures programs to be transferred to regional or local governments present a regional distribution resulting from administrative decisions on the organization of public production and on the selection of beneficiaries of public programs. In the short run, the transfer of functions to the periphery and the assignment of resources (be they human or financial) cannot but reproduce the regional patterns of the pre-existing national government decisions. In an ideal world, however, devolution of functions to decentralized governments requires a "model" that generates the resources assigned to each Region. The model may be based on needs evaluations or on tax resources together with an equalization plan.

As it happens, the pre-existing regional distribution patterns cannot always be reconciled with the results of some theoretical financing model and questions arise on how the two can brought into unity. This is a much complex question as the national government is squeezed between two conflicting forces: to defend what it had been doing before devolution took place and to respond to the critique of interested regional governments on the most evident irrationalities of the historical regional expenditure patterns. It is interesting to notice that an expenditure regional pattern would not be challenged by Regions when the function was national, but would be considered unacceptable when the function has become regional.

The national government has promised that gradually, in the future, history will be superimposed by need evaluation, but this has not happened and devolution of spending power is marred with protests on the lack an equitable pattern in the regional distribution of resources.

(*ii) increase in spending*. Unhappiness with historical patterns of regional resource distribution may generate strong pressure by unhappy Regions for additional compensating resources. 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 regional governments and national government bureaucrats, additional funds are provided by the national budget. This is what has happened in Italy with the transfer of functions via ordinary legislation. Decentralization has 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 in 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 as th problems are maintained in the long run. An excess of government to government negotiation substitutes for citizens to governments relations.

7. The internal stability pact and a new equalization plan

In search for more efficient control of local and regional spending and for more accountability in their budgetary decisions, in the second part of the Nineties the national government adopted two decisions that affected the system of intergovernmental fiscal relations: the "internal stability pact" in 1998 and a new fiscal capacity equalization plan in 1999, to complement the need oriented equalization plans of a long standing Italian tradition. A few comments follow on both themes.

7.1 The internal stability pact. At the time when the growth and stability pact was blossoming in Europe, 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 on budget deficit outcomes but local and regional governments would only be passive recipients of national policies direct to reduce grants, limit expenditure growth and increase local 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; instead a subsidy on interest rate on outstanding debt was promised if the system of local and regional governments met the over-all deficit target.

Local and regional governments could not but accept the principle that they had to contribute to the growth and stability pact targets and their ex-ante acceptance of this principle justified the denomination of "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 to have chased tax arrears to temporarily meet the targets. Some research show that in years 1999 and 2000 local governments as a whole met the targets, whereas regional governments overran the assigned targets on health expenditures. Similarly diverse results were obtained in following years.

7.2 Per capita fiscal capacity equalization plans. Concern over the systematic overruns in health spending (which represented the bulk - about 85% - of all regional spending) suggested to assign regional governments a portion of the yield of the national 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 Ordinary Statute Regions on the basis of a scheme of partial equalization of their per capita fiscal capacity. Thus, financing of health expenditures in any Region would result from the sum of two components: about 60% on the basis of "needs" (estimated according to demographic and health related indicators) and the remaining 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 historical levels of regional health expenditures of year 2001 to the expenditure levels implied by the new equalization grants would be very slow: it was planned on a time span of

13 years up to 2013. In addition to constrain health expenditures growth within the growth of tax revenues, the new plan was intended 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, discussed with varying sentiments in political and academic circles, was eventually approved and became D.Lgs. n.56/2000. It was then somewhat of a surprise that a centre-left majority would approve a bill that explicitly provided for incomplete fiscal capacity equalization. As we shall see in next paragraph 9, the reasons for the surprise are no longer there.

8. The 2001 Constitutional reform

At the closing of the decade when the sequence of innovations discussed in the previous paragraphs took place, the Italian Parliament approved a reform bill of the Constitution that passed the confirmation referendum in October 2001. The new 2001 Constitution rewrites the system of intergovernmental fiscal relations; changes touch a variety of points, but for our purposes is sufficient to consider four new articles. 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 for themselves special assignment of legislative competence.

8.1. Assignment of legislative power: what competence for what level of government. The new Constitution provides its own solution to the assignment problem. The new art. 117 assigns a first group of public matters to a regime of exclusive national government competence.[10] Then it assigns a long list of functions to the regime of “concurrent regional

[10] 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.

competence"[11]. In such a regime, regional governments have autonomy and competence to legislate, but their power is bound by limits that are defined, for each competence or matter, by "fundamental principles legislation" to be enacted by the national government. This "fundamental principles legislation" should guarantee the "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 latter 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"[12], 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 reform bill currently discussed in Parliament (see below prg. 10) has 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".

8*.2. Assignment of execution power: administration to local governments*. The new Constitution assigns local governments (municipalities in the first place) the power to execute

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[11] 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.

[12] 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.10) or in the list of the concurrent competence of regional and national governments (see footnote n.11). Squeezed between the two lists of national competence and concurrent (national and regional) competence, the quantitative relevance of exclusive regional competence cannot be easily predicted.

regional and national legislation. This change echoes Article 83 of the German Basic Law, which assigns the power of execution to the Lander[13]. 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.

8.3. 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 provisions on financing (as well as the entire 2001 Constitutional bill) were inspired by the German Basic Law. They do not provide, as the German Basic Law does, 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 reserves to the regime of concurrent

[13] Economists were first exposed to the option to separate legislative powers from execution powers by G. Stigler (1957).

competence. If there is, as indeed is the case, some sort of national interest (be it to guarantee individual rights or to account for 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.

8.4 Decentralization has increased. A preliminary synthetic evaluation 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 entitled 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 criteria. On the basis of this evidence, no judge could but sentence that decentralization in Italy has increased.

8.5 "Not all that shines is gold". However, further reading of the new Constitution shows some contradicting evidence. There are at least two provisions that challenge the case of an increase in decentralization.

A – The second period of art. 117, item m), assigns the *"determination of the essential levels of outputs*[14] *concerning the civil and social rights that must be guaranteed on all the national territory"* to the exclusive competence of the national government. Thus the national government has the constitutional 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 objectives: an indisputable quest for uniformity.

[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.

Art. 117.2/m raises a host of complicated problems. First, there is nowhere in the Constitution an explicit comprehensive list of “civil and social rights”. Of course, the Italian Constitution defines – in the opening section and in Part I – the right to health care, to education, to welfare assistance and to social security. 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 a “formal” Constitution and a “de facto” Constitution. Thus, the amplitude of the Constitutional provision (exactly which “rights” the uniformity requirement applies to) cannot be precisely read anywhere and it will be left for definition by future Constitutional Court decisions.

Second, there is problem of interpreting the meaning of the words “essential levels 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. A mixture of technical and ideological problems.[15] If the word “essential” is interpreted to require spending levels not dissimilar from present ones, then the Constitutional dictum can be read as a predicament for equal treatment (same output) of all citizens, irrespective of the region of residence where they vote and pay regional taxes.

The decentralization traits of the new Constitution are thus countered by a strong suggestion 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.

[15] Many economists would interpret the proposition “essential levels of outputs” as a predicament for a minimum standard level of output, corresponding to lower expenditures than present levels; they would accompany this interpretation with a requirement for lower tax rates and then let individual regional governments to adjust their tax rates to choose the desired level of output. Many constitutional law scholars think that this solution, however reasonable, is not compatible with the new Constitution.

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"*. This sentence can be read as a safeguard clause against the temptation for the national government to take advantage of devolution and reduce spending in the functions assigned to regional competence. Under this reading, the clause should apply in the transition process and be of temporary effect; it would apply to the over-all expenditure figures for each function or activity transferred from national to regional governments competence. Many commentators, however, take it to be a permanent feature of the financing model and to apply individually to each Region rather than to the regional system. Under this interpretation, 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.

These two elements – the affirmative power of the national government to set level of output at the regional level and the quest for preservation of the historical pattern of regional spending – would counter the view that the new Constitution has increased decentralization. As a matter of fact, some scholars are reading the new Constitution as entitling the national government to a more pervasive interference with regional activity and as providing a stronger quest for uniform treatment than was the case with the old Constitution.

9. Implementation of the new Constitution

Provisions in the new Constitution do not include norms directed to regulate the transition from the old to the new regime. Some of the Constitutional norms are immediately effective, but others are not and ordinary legislation is required to define the technicalities of transition. The legislative competence assigned to Regions, under the concurrent or residual regime, concerns a variety of public functions and include the whole array of budgetary items: provision of public services, transfer payments to individual or business, regulatory powers and, finally, institution of new regional taxes. 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. Up to the present, Regions have been very cautious in enacting new legislation in the sectors assigned to their competence. Decentralization has entered the Constitution but, as of now, is stalled. Implementation of the Constitutional changes loom complex and controversial due to the indeterminacy of the Constitutional language. Some of the complexities are presented here.

9.1 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 written anew and can be read in (or derived from) the 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" embodied in existing legislation which may or may not (Constitutional scholars are divided on the issue) require an approval vote by Parliament. Regional governments representatives are afraid that the word "fundamental" will be associated with detailed arrays of norms to pre-empty the future 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.

9.2 Allocation of execution power (or assignment of administrative functions). Regional governments are also prevented from legislating in the fields assigned to their competence by the lack of decisions on the assignment of administrative functions to a chosen level of government. The new Constitution makes the statement that administrative powers do not necessarily belong to the level of government that has legislative competence: a decision will have to be made on who will execute what. On the other side, there is no explicit indication in the Constitution on Who is expected to take the decision.

The situation is one of a deadlock that can be illustrated referring, as an example, to the field of education. Expenditures on education by the national government presently amount to about 5% of GDP, with labour costs covering about 90% of total spending. Will the 700.000 teachers and administrative staff of the national school system be transformed in regional governments employees (or possibly local governments employees, if the execution

power in education should be allocated to municipal governments)? No plan has been made 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 that school buildings remain in the property of local governments, with regional governments legislating on all matters of school organization. Lacking the design of the new administrative configuration of the school system, the legislative power of regional governments is *de facto* suspended and implementation of the new Constitution postponed to an undetermined date.

9.3 Equalization criteria. Equalization criteria are a crucial aspect of fiscal federalism in a country like Italy where interregional differences in per capita incomes are very large, ranging from –50% to +50% around the national average. On this issue the new Italian Constitution is far from clear. On the one hand, it calls for a per capita fiscal capacity equalization plan but does not put a quantitative target on the extent of equalization (whether it shall fully or partially eliminate the differences in per capita revenues resulting from interregional differences in the tax basis); it also indicates that equalizing grants should be of the unconditional, general purpose variety. On the other, art. 117.2/m states that the most relevant regional public functions be performed under the constraint of uniform treatment of all citizens. It is well known that fiscal capacity equalization plans are incompatible with uniform treatment unless the uniformity requirement is set sufficiently low. Even full equalization of fiscal capacity would not satisfy the uniformity requirement in fields such as education and health, as equal needs at the regional level do not necessarily produce equal per capita spending.

The contradiction between the two conflicting criteria has acted perhaps as the most powerful delay-factor in the implementation of the new Constitution. Nobody in the present government has yet started thinking on how to solve the dilemma: implementation of the new Constitution is thus suspended until politics will face the two hard questions of diversity and accountability on one side and equal treatment on the other.

9.4 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 governments have 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 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 help to define the uncertain boundaries between the power of the national government to interfere and the autonomy of the Regional governments. In one important decision, 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 a great number of cases, the Court motivates its decisions and in doing so 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 proposed by the national government. The decisions of the Constitutional Court are progressively cutting away corners in the set of solutions that could possibly be derived from the new Constitution. This is happening in many sectors, but is of major relevance in financing, the sector where the Constitutional provisions are most undetermined.

There is one line of political thinking arguing that the true meaning of a Constitutional provision is only defined by a Court ruling. But there are other lines of political thinking (see Finer S.E., V.Bogdanor and B.Rudden (1995)). 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 options will not have been pre-emptied by the, now in the hundreds, Constitutional Court rulings.

10. Developments of recent years: a slide backward

After the approval of the 2001 new Constitution, a few important changes have

occurred in the practice of intergovernmental fiscal relations in Italy; none of them relates to the possible effects of the new Constitution but they are possibly of long standing effect; not all of them carry a positive value. To be noted are: (a) an increasing tightening of control over local and regional finances by the national government; (b) the evolution of the new (year 2000) grant equalizing formula to finance regional governments.

With regard to the first event, the internal stability pact has been evolving from an ex-ante planning commitment on the dynamics of primary deficit of local and regional governments towards a system of cash limits on spending accompanied by penalties for not meeting the deficit targets. Specific growth limits on single expenditure categories are being imposed on regional and local government budgets (on new hiring and employment, on purchases of goods and services, and so on); in one year, tax increases have been forced on decentralized budgets; in next year, local tax increases have been prevented, as the national government is pursuing a policy of tax reduction. Furthermore, 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. Finally, the Treasury has started a strategy of monitoring cash outcomes in regional governments and local governments on a quasi continuous time basis. Taken all together, the new deficit control measures, based on direct control of budgetary items, are designing a strong drift away from decentralization.

With regard to the fate of the year 2000 new equalization plan in the financing of regional governments, recent events are showing that the per capita fiscal capacity partial equalization plan is running into deep trouble. The plan intended, among other things, to steer the regional pattern of health spending away from the historical patterns: it would provide more money to Regions (be they rich or poor) with per capita health spending lower than the national weighted average and it would give more money, for the same value of Health needs, to rich regions than to poor regions. Equalization of fiscal capacity (with own taxes accounting for about 60% of health spending) was intended to be partial or incomplete.[16]

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[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.

When the first computations of the grant allocations under the new formula were produced, the Regions losing resources with respect to the historical level of spending would not accept the results. The grant formula was rejected on the ground that they had not been explained exactly the content of the original bill presented in Parliament. Further, the point is repeatedly made that health care belongs to the list of "civil and social rights" that, according to the new Constitution require a strict adherence to the principle of equal treatment: no financial rule can 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 postponing the date of implementation of the new formula. The fate of the new equalization plan can now optimistically be defined as uncertain and the uncertainty spills over to the new Constitution, shadowing the provisions on the fiscal capacity equalization plans of art. 119.

11. Another Constitutional reform?

In November 2004 a new Constitutional reform bill has been voted in the lower Chamber (Camera dei Deputati). The text is a modified version of a bill voted in the spring of 2004 by the Senate[17]. 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.[18]

11.1 More exclusive competence for the Regions. The bill approved by the Chamber of Deputies disposes that *health assistance and organization, organization of education, local*

[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.

police be assigned to the newly regime of "exclusive legislative competence" of Regional governments, together will all the functions that in the present Constitution 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 included in the "residual list". Though the wording of the text is far from unequivocal, the new reform bill has been hailed as a further step towards decentralization and has brought the English word "devolution" into the Italian language as education and health – presently in the regime of "regional concurrent competence" – are assigned to the regime of regional exclusive competence. Health and education are the two most important public services: taken together they count for more than 10% of GDP and about 25% of total current spending net of interest payments. There are some caveats to note.

11.2 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 merit goods are maintained in the list of regional concurrent competence. The functions assigned to regional exclusive legislative competence are, respectively, "health assistance and organization" and "school organization .. and teaching programs on topics of the Region's specific interest". The new bill proposals design a complex interlock of legislative competence. With regard to education, the national Parliament would enact both "general norms" and "fundamental principles legislation". The regional governments, abiding to the nationally defined fundamental principles, would enact own legislation on the educational system; also they would enact, this time in full autonomy, legislation on school organization. With regard to health care, the national government would enact "fundamental principles legislation" 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 *health assistance and organization*, thus autonomously defining the actual supply of health services.

[18] See G. Pisauro e G. Salvemini (2004) for an account of the proposed changes.

11.3 Conflicting provisions. The reform proposal is being strongly opposed by the minority opposition in Parliament under the opinion that decentralization of the organization and daily working of the education system will break a very important channel of unity in the country. Similar arguments are given for health care. Fears for the breaking of national unity seem however somewhat misplaced as the national government maintains full power on the grand design (general norms and fundamental principles) of the educational system and of the health system (via fundamental principle legislation). Furthermore, the national government, maintains 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.

The solutions proposed by the new bill, however, can be criticized on the ground that it generates a very confused sharing of powers on two fundamental public services, health and education. The new bill uses a varied terminology when referring to health care and education. It implicitly defines a segmentation of activities of these two public services and assigns different segments to different level of governments and to different regimes of legislative competence. The emerging picture on the allocation of responsibilities between national and regional governments is one of unnecessary confusion, with the prospect of inefficiency and permanent conflicts among institutions, on Who is in charge of What.

12. Concluding comments: what decentralization ahead?

Intergovernmental fiscal relations in Italy have been an area of political debate and experimentation in fiscal principles and economic policy. They are again 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 or accept (some degree of) diversity?

In year 2000 a bill was introduced that provided, over a 13 years time horizon, a planned diversity in per capita spending of regional governments related to the differences in regional per capita tax basis and incomes, constrained within the interval of plus and minus 5% of national average per capita expenditures. Its efficacy has been suspended at its first 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.

If and when the new Constitution will be implemented, Italy will be more decentralized, but it is not possible to predict now what the pattern decentralization will be. Due to the indeterminacy of the new Constitution the properties of the future Italian system of intergovernmental relations will have to be defined by ordinary legislation. Politics and

economic policy will have to explicit those value judgements that we would expect to find in the Constitution and to solve the conflicting, contradictory and sometimes mistaken indications of the constitutional text. A lot of legalistic tinkering will emerge, on what is really meant in the financially relevant provisions of the new Constitution. Whatever solution will be found, it will not be protected by precise Constitutional statements, thus leaving the fiscal federalism system under the vagaries of changing political values and Parliamentary majorities. Elsewhere [Giarda (2003)] a solution has been proposed that relies on the theorems of fiscal federalism and fills the gaps in the uncertain value system of the new Constitution. The list of open issues includes choices on:

- the tax instruments to assign to regional and local governments;
- whether rich (high tax base) governments should continue to be recipients of equalizing grants;
- whether equalization of fiscal capacity will be full or partial;
- how to integrate the fiscal capacity equalization criterion with the uniformity requirement;
- how to match the provision that requires full financing of transferred functions with the outcomes of equalization plans;
- 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;
- whether national financing rules should preferably be oriented to financing of legislative competence (al the regional level) rather than execution costs (at the local governments level);

Behind this list, which could still be enlarged, the fundamental policy issue has to do – as it has been repeatedly stressed – with the question whether decentralization maintains any merit when it is forced to operate under the constraint of uniformity. Countries have lived and happily live in political systems with varying degrees of centralization as the efficiency advantages of a decentralized system of government in meeting individual preferences are countered by the distributional advantages of a centralized government in the search of equal treatment of citizens in different regions. So the degree of decentralization is a matter of social and political preference. Whatever the choice, there seems to be little scope for a

federal, multi level and decentralized, system of government bound by a tight constraint of uniformity.

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