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Manuel Giménez Abad
de Estudios Parlamentarios y del Estado Autonómico

CASE STUDY ITALY: THE INTRODUCTION OF FISCAL FEDERALISM

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First of all, I wish to thank the Gimenez Abad Foundation and the Forum of Federations for inviting me to take part in this Conference. I would like to start from the important elements stressed in the presentation by professor Frosini to tackle some of the issues relating to the Italian system and in particular the developments in the field of fiscal federalism.
I will try and provide some short answers to the following questions, in order to give you some elements regarding the "Italian way to federalism":

1) Is Italy a federal country?
2) Which are the relations among the Central Government, Regional and local Authorities?
3) What type of financial autonomy do Regional and local Authorities enjoy under the Constitution?
4) Which is the financial autonomy of Regional and local Authorities today?
5) What is going to change once the law on fiscal federalism is enforced?
6) Which will the main problems be in the enforcement of the law on fiscal federalism?
7) Which are the main tools for the enforcement of the law?

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1) IS ITALY A FEDERAL COUNTRY?

If one considers the classic federal countries maybe Italy cannot be considered a federal system. There are no elements of strong autonomy of member states (in Italy: regions) which are, for instance, present in the United States and Germany (e.g.: relationship between member states and local authorities; involvement of member states in the constitutional revision process; organization of the judiciary power).

However, if we consider the constitutional reform of 2001, Regional and local Authorities have become bodies which make up the Italian Republic, together with the central Government and which enjoy legislative and administrative autonomy guaranteed directly by the Constitution. The Central State cannot limit their autonomy if not within the boundaries allowed by the Constitution itself.

Compared to the past, the Central State has more limited powers to intervene in the protection of the unity of the system and limit the authority of the territorial bodies. In the 2001 constitutional reform, however, what is missing are transitional provisions which guarantee the change over to the new autonomy system.

These are slow processes: for example, regional authorities where envisaged by the 1948 Constitution but they were actually created only in 1970.

Today the most important factors are three:

- The actual implementation of the reform,
- Negotiation and sharing among Central Government, Regional and local Authorities,
- The construction by the Constitutional Court (which decides over the constitutionality of laws).

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Law 42 of 2009 is fundamental to promote this implementation process and contains already in its title the reference to “fiscal federalism” (even if, as you know, changing names is not enough in order to change things).

Is this maybe the Italian way to federalism?

2) WHICH ARE THE RELATIONS AMONG CENTRAL GOVERNMENT, REGIONAL AND LOCAL AUTHORITIES?

After 2001, both Regional and local bodies (provinces, metropolitan cities and municipalities) have enjoyed autonomy directly guaranteed by the Constitution.

As to the legislative power, both the Central State and the Regional Authorities can pass laws in the subject matters they are charged with, assigning administrative functions to local bodies, according to the principles set by the Constitution (in summary: the subsidiarity principle).

The Central State, however, has the exclusive legislative competence on a series of subject-matters which involve regional competence, among which the identification of the “fundamental functions” of local bodies.

The distinction between “fundamental functions” and “administrative functions” of local bodies is not a simple one. With “fundamental functions” the State can, therefore, strongly limit the legislative autonomy of Regional Authorities as to the exercise of administrative functions.

Because of a series of historical and financial reasons, local bodies are not generally in favor of regional power. They rather prefer to have a direct dialogue with the State. They rather have a far-reaching and thorough intervention of the State when it comes to fundamental functions.

This has also an impact on the financial relations.

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It is, therefore, not completely correct to state that the Italian system follows a hierarchical structure: State-Regional Authorities-local bodies. This makes also the financial system of the functions of the regional and local authorities more complicated.

3) WHAT TYPE OF FINANCIAL AUTONOMY DO REGIONAL AND LOCAL AUTHORITIES ENJOY UNDER THE CONSTITUTION?

Both Regional Authorities and local bodies enjoy autonomy in terms of revenues and spending (Art. 119, paragraph. 1, Cost.: Municipalities, provinces, metropolitan cities and regions shall have revenue and expenditure autonomy).

However, the Constitution simply sets the principles of fiscal federalism:

- financial autonomy;

- types of revenues of Regions and local bodies (own taxes, sharing of State revenues equalization fund for the areas with lower tax capacity per inhabitant);

- special State interventions for specific local bodies or Regions for the protection of cohesion and solidarity;

- assets of Regions and local bodies.

For more detailed provisions, the Constitution makes reference to the state law on the coordination of public finance and of the tax system (law 42/2009).

The Italian Constitution, anyway, does not indicate the individual taxes which can be collected by the autonomous bodies, as is detailed in the German constitution, which therefore offers them a higher level of guarantee of resource autonomy and stability.

In this respect, the Italian and the Spanish Constitutions are much more similar. They require a broad intervention by law to establish the real autonomy in terms of revenue and spending by Regions and local bodies. This is maybe the way in which a higher flexibility of the system can be achieved.

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Tax issues are anyway to be regulated by a law (art. 23 Cost.). Therefore, this separates the role of the State and Regions (which have legislative power) from that of local bodies (whose power is only to pass regulations).

4) WHICH IS THE FINANCIAL AUTONOMY OF REGIONAL AND LOCAL AUTHORITIES TODAY?

The Constitutional Court has stressed many times that the constitutional reform of 2001 risks to be deprived of its meaning if fiscal federalism is not implemented.

Waiting for the implementation law, the Court has stated that some state laws are unconstitutional, namely those which provided for the transfer of resources with an allocation constraint in relation to matters for which Regions have legislative power.

The Court has thereby guaranteed, at least partially, the autonomy of spending by Regions.

For the Constitutional Court, instead, the autonomy of revenues requires for the implementation law to be passed.

Until today, the autonomy of revenues has been strongly limited and affected by the decisions of the legislator at central level. In some cases and for some taxes the possibility has been recognized for Regions and local bodies to change the surtaxes on state taxes or to intervene on the rates or on concessions relating to their taxes, with a very limited possibility of change.

For a number of years, the national finance act has banned the possibility for autonomous bodies to apply or change the surtaxes.

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The only attempt made in 2000 to introduce a higher degree of revenue autonomy for Regions and to progressively reduce the equalization for less rich Regions was stuck because of implementation difficulties which emerged already in the first year of the thirteen envisaged for the transitional stage.

Until today, the regional and local finance is mainly based on transfers (derivative finance).

As known, this is a hindrance both for the local managers to take on their responsibilities and for the democratic control by citizens.

Some summary data.

If we consider the average 2001-2003 public spending, the central administration has spent 23% of the total, regional and local administrations approximately 34%.

From 1990 through 2007, the total transfers from the State to Regions and local bodies have been reduced from 73.1% to 44.5% of the overall revenues of the Regions and local bodies. On the contrary, tax revenues of Regions and local bodies went from 14.8% to 43.9%.

However, also for the latter it is always the State which, through a state law, has issued decisions on almost all decision-making powers as to the revenues of territorial bodies and their pre-requisites.

Some critics have talked about the “fairy tale of fiscal federalism”.

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5) WHAT IS GOING TO CHANGE ONCE THE LAW ON FISCAL FEDERALISM IS ENFORCED?

Law 42 is a delegation act, that the national government has to enforce by the end of May 2011.

It introduces some very important principles which guarantee a higher level of revenue autonomy for Regions and local authorities.

First of all, it provides for the assignment of autonomous resources to municipalities, provinces, metropolitan cities and regions, in relation to their respective competence, according to the principle of territoriality. The resources, therefore, stem from pre-requisites connected to the territory.

Secondly, the law guarantees that Regions and local authorities can “shift” the taxes within the boundaries set by the state law.

Regions (and partially local authorities) will be entitled to change the rates of their taxes and decide about deductions and allowances. Moreover, they will be entitled to change the rates of the surtaxes on the taxable bases of the state taxes. Moreover, they will be entitled to set taxes on the basis of pre-requisites (objectives) which are not yet subject to state taxation (very few indeed).

Thirdly, different forms of financing are envisaged.

For regions, the spending for the so called LEP (ELSs - essential levels of service which shall be guaranteed all over the country; in particular: health care, education, welfare) shall be fully financed through equalization. The rules regulating ELSs are to be issued under the exclusive legislative competence of the State. It therefore stresses that the system is unified.

For local bodies, spending for “fundamental functions” (the main administrative functions) shall be fully financed through equalization. The regulation of the fundamental functions, too, is left to the exclusive legislative competence of the State.

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However, the full financing shall not be related to the costs really incurred into (historical expenditure), but to the “standard needs”, which is the expenditure corresponding to an average good management. Regional and local administrations are thereby forced to be efficient, otherwise they must resort again to fiscal leverage to get the financing.

Citizens will judge them on the basis of this.

For all of the other expenditures of Regions and local authorities (which are estimated to be equal to 15-20% of the overall amount of their spending) the equalization shall reduce the differences between the tax capacity per inhabitant but shall not guarantee the full financing.

The part which is not financed through equalization shall be financed through the higher level of tax maneuverability guaranteed by the autonomous bodies.

6) WHICH WILL THE MAIN PROBLEMS BE IN THE ENFORCEMENT OF THE LAW ON FISCAL FEDERALISM?

The end of the transfer finance from the central to the local levels implies a massive work: to eliminate all state funds aimed at financing Regions and local bodies and to transform them in tax autonomy of Regions and local authorities. Only exceptions being: equalization funds and special interventions.

The enforcement of law 42 will be important in order to establish how much federal has Italy really become.

I will give you a couple of examples.

1) If most of the financing of Regions will be guaranteed by state revenue sharing, the autonomy of Regions will be limited. As a matter of fact, the revenue sharing is substantially not very different from transfers.

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On the contrary, the autonomy of the Regions shall be stronger if they mainly have own taxes or maneuverable surtaxes rather than revenue sharing.

The same is true for local authorities which are further limited by the fact that they do not enjoy legislative power.

2) If the so called special interventions provided for by the Constitution for specific territorial bodies become a form of additional and permanent equalization there will be no drive to efficiency for the public administration. Shall special interventions be limited in scope and time, the less virtuous bodies, too, will improve their efficiency.

The main difficulties in the enforcement will rest in the strong differences characterizing the geographical areas of our country.

North and South show strong economic and infrastructural differences. The unemployment rate in the South is much higher, the *per capita* income much lower. Tax evasion is higher.

One figure: the net average household income in 2006 in the North was almost 31,000 euro, 23,500 in the South.

The phenomenon of off-the-books economy is mostly concentrated in the South which accounts for 45% of the total (source INAIL-ISTAT-IRES).

The transition stage will last no less than seven years and shall try and reduce the infrastructural deficit of the least rich areas as well as increase the efficiency of public administration. Another example: costs for health care are generally higher in the South but many people living in Southern regions move to the North to receive public medical treatments.

Fiscal federalism cannot bring about an increase in tax burden. This is stated by the law but it is not enough.

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For this reason, forms of coordination and collaboration among state, regional and local administrations are envisaged, especially with the purpose of avoiding overlapping in tax assessment and collection. As a matter of fact, it is necessary to avoid duplications of activities, hence of spending.

Those bodies which will efficiently act to fight evasion shall be assigned additional resources. Today already, municipalities can keep part of the higher receipts stemming from their activity aimed at tax recovery.

The enforcement of the law will be accompanied by the transfer of a meaningful set of assets from the State to Regions and local Authorities.

Lastly, the issue of special Regions.

Because of historical reasons, five of the twenty Regions in Italy enjoy special conditions of autonomy guaranteed by five separate constitutional laws (Valle d'Aosta, Trentino-Alto Adige, Friuli Venezia Giulia, Sicily and Sardinia). Each constitutional law guarantees also that they enjoy a strong revenue autonomy.

The law on fiscal federalism require the State to have "open negotiations" with special regions (especially the first two, which are the richest) to involve them in the equalization process in favor of the less rich areas.

This is a crucial time for the Italian system, to implement federalism but above all to improve the overall performance of the public system for citizens, families and businesses.

A lot will depend on the enforcement of law 42.

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7) HOW TO ENFORCE THE LAW?

The passing of the law was characterized by a constant dialogue between Government and local bodies, between the majority and the opposition in Parliament. We can talk of a bipartisan law.

The enforcement shall go on along the same path. It is difficult, if not impossible, to think of a quasi-federal reform against the will of autonomous bodies which make up the Republic.

The law provides for tools of dialogue and exchange of views to reach shared solutions in terms of the implementation decrees of the reform, first in the Government-Regions-local bodies joint commission and later in the Control Parliamentary Committee.

Until today Italy has remained half way between federalism and centralized system, with the risk of summing up the flaws, rather than the virtues, of each system: duplication of administrative facilities, non-taking on of responsibilities by the administrators.

Law 42 is a chance to make a choice. Spring 2011 will tell us whether this chance has been fully tapped on.

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