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AUTONOMY AND RESPONSIBILITY IN THE ITALIAN FEDERALISING PROCESS

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Autonomy and Responsibility in the Italian Federalising Process[1]

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Some questions

In any country fiscal federalism is a compromise between efficiency and distributive targets. Both federal countries and decentralized unitary States have to cope with this problem. Old federals States founded in the 19th Century or before, by merging a number of independent units, stressed the efficiency target of moving the supply of universal public goods to the federal level, but interstate solidarity was not disregarded at all – Canada, for instance, has an effective fiscal equalization scheme. Federal States born in the 20th Century from unitary States pursue the efficiency target by shifting some functions and related revenues from the central level to the regional level of government and stress more heavily than the oldest federal States the equity target. This is probably due to the guaranties that must be offered to the weakest regions in order to get to an agreement on the federal reform of the State.

Federal States show a very different degree of fiscal autonomy of the federated States (or Regions) and of fiscal equalization. Moreover equalization schemes rely both to fiscal capacity and needs, with different mixes in different countries. Often, national standards must be guaranteed all over the Country with regard to services which are of paramount importance to the well-being of population and have a relevant role in the process of growth both of territories and individuals (e.g. education and health).

The Italian Parliament is now discussing Bill S. 1117-B[2] which is intended to introduce a rational frame for fiscal federalism as required by art. 119 of the Constitution. The questions I would like to put are:

- Does Bill 1117-B design intergovernmental fiscal relations which are really fit to a federal Country?
- Does it guarantee a firm control on public expenditure development?
- Does it imply effective incentives to efficiency?
- What sort of equalization is planned?
- Is it too cumbersome or, in other words, can it really be implemented?

[1] This paper was delivered to the Workshop on Fiscal federalism held in Rome, Università Roma Tre, Faculty of Law on 20th April 2009. It deals with Bill S. 1117-B on Fiscal Federalism, then under final examination by the Senate. However arguments and judgements in the paper also apply to law n. 42/2009 since Bill 1117-B was not further modified by the Parliament.

[2] The Bill was submitted to the Senate as S. 1117, passed to the Camera as C. 2105 and returned to S enate as Bill S. 1117-B.

It is useful to begin with the purposes of the Bill as stated by the Government and frequently remarked by both politicians and technicians. Fiscal federalism is deemed to be necessary in order to assure accountability at all levels of government, improve efficiency and quality of public expenditures, defeat tax evasion and reduce pressure to budget's growth. Furthermore, it is suggested that fiscal federalism will unchain latent skills, boosting growth especially of Regions with per capita incomes well below national average.

There is no doubt that a genuine federal asset of the State would increase accountability and efficiency of public administration at any level of government. A genuine federal reform requires:

- local expenditure be covered mainly by taxes and other charges levied on local citizens;
- taxes and charges which are clearly visible to the citizen;
- taxes and charges which may be fixed to some non negligible extent by regional and local Authorities;
- tough fiscal rules (rules must be clear and bail out should be excluded);
- equalization rules which do not obliterate incentives to efficiency;
- coordination of fiscal policies between federal and local governments.

The international literature clearly shows that fiscal federalism by itself is not a sufficient condition to cap public expenditures and improve efficiency. What is really relevant is the *design* of fiscal federalism, which is obviously different between countries (Balassone, Franco, Zotteri, 2003; ISAE 2007). The conditions listed above have a role which cannot be disregarded.

Fiscal autonomy

Bill 1117-B will leaves Regions' fiscal autonomy substantially unchanged with respect to the present situation. Expenditures for supplying minimum standards of main public services (LEP- livelli essenziali delle prestazioni) will be covered by a share of VAT (with no real fiscal autonomy for Regions), a flat rate additional tax on the same base of the progressive income tax, Irap as long as it in not suppressed, and other regional taxes introduced and regulated by State legislation (on which Regions have a limited degree of autonomy with respect to rates, deduction, etc.). These sources of financing will cover broadly 90% of regional budgets. The remaining part of expenditures will be covered by regional taxes. In both cases a quote of expenditures will be covered by the equalization fund (see below).

Municipalities will meet expenditure needs for "fundamental services" (80% of the budget) with shares of VAT, shares of the (State) progressive income tax, and with their own taxes on real estates (not necessarily a property tax; a tax on rental values is not excluded – rather it is likely on houses occupied by owners). Some other sources of finance are not excluded but priority is given to the above mentioned taxes.

Provinces' taxes will bear mainly on motoring .[3]

[3] Provinces get most of their incomes from the tax on car insurance (wholly devolved to Provinces) and from the provincial tax on registration of motor-vehicles.

Both Municipalities and Provinces will have the faculty of applying new earmarked taxes to finance public projects or to meet special needs due to a relevant share of non resident people on present population.

Provinces' fiscal autonomy will not increase unless State legislation allows Provinces to change the level of taxation on car insurance, which is their main revenue (till now Provinces do not have such a power). Fiscal autonomy of Municipalities is substantially *reduced*, since the bill expresses a preference for fixed shares of VAT and of the Personal Income Tax (Irpef).[4] Municipalities' fiscal autonomy was already reduced by deleting the property tax (ICI) on houses used by the owners themselves.

It is rather odd that a reform which is claimed to introduce fiscal federalism reduces fiscal autonomy of local government. Effects on the control of public expenditure dynamics might be negative, since the fixed-rates devolved taxes ("compartecipazioni" to VAT and Personal Income Tax) are not transparent, i.e. they are not visible to the citizen-taxpayer – therefore they make accountability somewhat looser.

Resource equalization

Also the equalization schemes sketched in Bill 1117-B, both for Regions and local authorities, are not functional to accountability. Indeed the financial arrangements designed by the Bill are very peculiar and far away from the examples of other federal countries.

The Bill stresses the minimum level of services (LEP) and gives to need equalization a much greater role than to equalization of fiscal capacity. *Indeed, fiscal equalization is an instrument to get to equalization of needs.* Genuine fiscal equalization has a minimum role, since it is used only to reduce gaps in per capita resources used to finance non-LEP expenditures, i.e. at most 20% of the budget.[5]

No other country has a similar approach to fiscal federalism. Equalization schemes usually present different steps, performing first the equalization of revenues, then the equalization of needs or a mix of both criteria by comparing standard revenues to standard expenditures. Additional funds to guarantee minimum standards, or national standards, are sometimes present, but they have a subsidiary role. That is, supplementary funds are granted when the amount of resources assigned to a Region by general equalization schemes are insufficient to meet the financial requirements of national standards. For instance, in Spain[6] "Fondo di sufficienza" is addressed to reduce gaps between needs and revenues. A further fund (complementary grants) is apportioned among Regions which are unable to provide minimum levels (centrally

[4] The Bill lists among preferential sources of revenue also taxes on real estates with a compulsory exemption from any property tax of houses used by the owner itself. Thus new municipal taxation might bear on incomes from rented houses and perhaps also on properties used directly by the owner. The second option is however politically unappealing and has very little chance of being introduced.
[5] A different approach, more aligned with international experience was used by Osservatorio per la finanza e la contabilità degli enti locali within the Italian Ministry of Home Affairs (Ministero dell'interno) which approved a document in September 7, 2006 (Ministero dell'interno 2006). The document had no effective impact due to a redistribution of functions between Ministries and Departments.
[6] See, for instance, Martini 2007.

decided) of education and health services with their own resources and their shares of "Fondo di sufficienza". The additional funds are granted for at most 5 years. Should they not be sufficient to drive the Region to "normality", the equalization scheme will be changed in order to enable all Regions to provide the standard levels of services.

In some Countries, additional funds are granted if regional governments accept central policy guidelines, for instance for health services in Canada (France 2001). The approach is typical of old federal Countries, borne by aggregation of pre-existent States.

The Italian approach to fiscal federalism is completely different. It starts from the integral financing of Regions for standard levels of needs (LEP) and of local authorities for all their "fundamental functions" (i.e. fundamental services).[7] In both cases, the need criterion guarantees at least 80% of the budget.

This approach poses several problems, especially with regard to Regions.[8] First of all, if a large part of the budget is financed on a need criterion, there is a strong interest of all regional and local administrations to press the Government for more resources any time there is an increase in the production costs of LEP or of fundamental functions; and, obviously, there is a vested interest to get from the Government high standard levels of services (LEP).[9] Preference for a vertical equalization scheme (partially corrected by the VAT horizontal redistribution)[10] does not help capping the rate of expenditure growth nor increasing efficiency. Both results will depend heavily on the tightness of State control on regional and local authorities' budgets. It is supposed that the State will be continuously monitoring revenues, expenditures, levels of efficiency and quality of output of regional and local authorities; and that incentives and penalties will be timely applied to efficient and, respectively, inefficient authorities.

Indeed, DDL 1117-B contains several provisions to favour efficiency and penalize inefficient governments. Penalties are partially automatic (e.g. for Governments which do not meet the targets of the Internal Stabilization Pact) and may be very tough, including substitution of the Mayor with a Government Commissioner and the ban of being elected to political bodies, which is a very severe sanction for full time professional politicians. One can however question whether the central government will be really able to apply severe sanctions in pre-electoral periods against politicians of the same political wing. Recent experiences suggest they are not willing to do so.

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[7] All of Italian academicians who tried to implement art. 119 of the Constitution have followed this approach. So did the bill approved by the previous Government and a proposal of bill prepared by the Regions, which is very similar to Bill 1117.

[8] For Local Governments Bill 1117-B sets a simpler procedure bypassing the extreme difficulties of setting standard levels of service and estimating standard costs for a wide and heterogeneous bundle of services. Standard expenditure for "fundamental functions" is estimated by familiar statistical techniques on historical data. Then the equalization fund is distributed according to the gap between standard expenditure and standard revenues devolved to "fundamental functions". With regard to non-fundamental functions equalization is only on fiscal capacity. Therefore for municipalities and provinces the equalization scheme is more aligned with national and international experiences on the topic. See for instance Buratti (2001), Galmarini-Rizzo (2006, 2008).

[9] Experience with the National Health Service decentralized to Regions has not been satisfactory, since Regions have cumulated large deficits. Ex post State interventions (and sanctions) have been only partially effective. Some Regions still have large deficits.

[10] Equalization of regional resources financing standard levels of service (LEPs) is formally vertical, but the equalization fund is financed by a fixed share of VAT attributed to each Region. The whole mechanism is administered by the central Government, but it will not be difficult unveiling contributes of each "rich" Region to the fund and the distribution of benefits to "poor Regions.

Control on the dynamics of decentralized public expenditures and on the efficiency of local bodies might therefore be looser than desired despite the Government strongly claims the contrary.

Standard levels of service (LEP)[11] and standard costs

The Government's faith on efficiency gains strongly relies upon standard levels of services (LEP) and standard costs. But to fix meaningful LEP and standard costs will require a very cumbersome and time consuming procedure which will be carried on under continuous pressing by Regions, Provinces and Municipalities, not to say of southern regions paladins! The procedure set by DDL 1117-B to fix values of LEP and standard costs allows for larger scope to lobbying and political bargaining. In fact, both variables will be set by a legislative decree issued by the Government[12] with the support of a Committee (Commissione tecnica paritetica)[13] whose members belong in equal part to the central government and regional and local authorities and subject to control by a parliamentary committee[14].

But what is a standard level of service (LEP) for health, education and social services? It should be a level somewhat higher than the minimum level supplied by Regions, otherwise the constitutional legislator would have probably named them as *minimum* levels of service. And it should be a *sustainable* level of service, i.e. a level of supply which is compatible with the financial targets of public administration.

If there is agreement on this approach, most of the problems are still to be solved. Setting a minimum or desired level of service requires that all services are measurable and that measuring them does not have an "excessive" cost. Neither conditions are met. Some services in health and social services are not suitable to quantitative measurement and, for other services, measurement may be costly since it may require heavy statistical work.

Experience with standard levels of supply for health services (LEA, livelli essenziali di assistenza) is largely negative. LEAs set by a Prime minister's decree (DPCM) are simply a list of services that any Region must supply to citizens. LEAs do not imply any quantitative target. Standard expenditure for health services is then fixed on a per capita basis, taking account of the structure of population by age and adjusting the results for patient mobility (Arcangeli - De Vincenti, 2008).

We need a different, more analytical, approach to get reliable data. Different approaches have been suggested to get standard expenditures for health services. Most of them estimate standard expenditure without passing through standard levels of service and standard costs.

As far as I know, only Vittorio Mapelli (Mapelli 2007) developed an approach based on standard levels of service and standard costs. The model was tested on 13 Local

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[11] LEP stays for "Livelli essenziali delle prestazioni".
[12] DDL 1117-B, art. 2, comma 6.
[13] Commissione tecnica paritetica per l'attuazione del federalismo fiscale (DDL 1117-B, art. 4).
[14] Commissione parlamentare per l'attuazione del federalismo fiscale (DDL 1117-B, art. 3) made of 15 "deputati" and 15 "senatori".

Health Agencies (ASL) of region Lombardia. Mapelli considers needs for chronically ill people, who are 30% of total population but are responsible for 80-85% of demand-driven health expenditure (which is in turn 85% of total expenditure). Chronically ill patients can be detected by the NHS statistical system: data are get from health cards, prescriptions and hospital files. Statistical data are gathered for 15 epidemiological groups. For each group is set the necessary amount of resources on the base of health care protocols (which set the proper medical treatment for any disease) and standard costs for hospital treatment, drugs, etc. Standard costs for hospital treatments are assumed equal to DRG[15] tariffs,[16] those for consultation of specialist doctors equal to the respective tariffs, etc. The assignment to a specific Region is the sum of standard expenditures for chronic diseases computed as above, and of the standard cost of collective services (mainly for prevention) and of emergencies, both estimated on a per capita base.

For educational and social services we have to start from scratch.[17]

Standard levels of service (LEP) for education can probably be set fairly easily for *compulsory* education. We can estimate the number of students for each type of school by using demographic data. Standards as the ratios "students/teachers" and "students per class" are set by legislation. The number of hours of teaching and subjects to be taught are set by the Ministry of education, though schools are to some extent autonomous.[18] Standard levels of service for higher education are much more difficult to define. There is a clear social and political component in any choice. Furthermore, the matter is complicated by the choice among several education curricula.

Presently Regions have very little influence on the achievement of standard levels of education, since they are responsible only for planning the school network and for supporting families in coping with the costs of education (i.e. for the so called "diritto allo studio"); they do not have to finance and manage the school personnel (teachers and administrative personnel) who is employed by the State.

Standard regional expenditure on education could be probably set by reference to the number of students, the number of classes and few more parameters. Things will change substantially when the school personnel is passed to Regions according to art. 117 of the Constitution. Estimating the standard cost of LEPs will be extremely important, but very difficult. Indeed if the Ministry of Education would have till now accurately estimated the need for teachers of each region, the problem would not exist. But the Ministerial estimates are far from perfect. So one has to re-invent the procedure to estimate the standard need of teaching and non-teaching personnel in each region on the base of demographic data and of the estimated choices of the type of education by families. The Technical Commission on Public Finance appointed by the past Minister of Economy Padoa Schioppa started to investigate the problem which is anyway far from being solved (CTFP 2008, section E)[19].

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[15] Diagnosis Related Groups.

[16] DRG tariffs are used to compensate for patients mobility. They should also be used to reward general hospital activity, but the rule is not yet applied.

[17] There is a short bibliography on the topic of standard level of service (LEP) and standard expenditure of Regions, but most of the papers are preliminary discussions of the problem. A lot of work is still to be done.

[18] Indeed problems may arise from the different demand of full time classes.

[19] See also MEF-MPI (2007).

For social services the concepts of standard level of service and of standard costs are even more indefinite. Social services include a wide range of services to meet very different needs: needs of disabled, elders with no relatives, chronically ill patients, children aged under five, etc. Furthermore each of the above listed needs can be met by different types of services or by subsidies. For example, needs of old people with health problem and/or impairments may be met by recovering them in a residence or by paying a nurse or a personal assistant for some hours a day. Standard costs may be quite different according to he choice made by the local government.

Next, needs are not evenly felt in all the regions and in different towns/cities within a region. An interesting research by IFEL (IFEL 2008), made through thousands of interviews, shows that need for pre-school education is quite different in different regions. This result is perhaps not surprising, since in some places where large families are still prevalent and the share of employed women on total is low, they prefer keeping little boys with the family. The upshot is that lower demand may be the result of less intensive needs rather than of inadequate supply. The same presumably holds for services to the elderly.

Finally, different levels of government (State, Regions and local authorities) are involved in supplying social services, so that the allocation of resources to Regions should take account of services and grants provided by other authorities,[20] unless Regions become the only bodies responsible for social services (save the option of transferring the administrative functions to local authorities, as art. 118 of the Constitution allows).

Standard levels of service and standard costs are therefore a puzzle which will require time to be solved. There are both conceptual problems and practical problems concerning the availability of suitable data, that must be overcome. The probability that one year after the definitive approval of Bill 1117-B the financial consequences of the reform will be available is very low. Consider that the accounts of Regions and local authorities must be made homogeneous, a lot of reliable data and information must be gathered, conceptual problems must be solved and the solutions must have general approval by all levels of government.

A cooperative federalism

Most of these complication are due to the overwhelming weight given to equalization. 90% of total expenditures of Regions and 80% of expenditures of local authorities are fully equalized with respect to needs. The remaining 10-20% of expenditures will be covered with resources equalized with respect to fiscal capacity with a degree of equalization that will probably be around 90%.

Authorities with lower taxable basis are therefore strongly guaranteed. Some authors (CER 2008) argue that the North-South distribution of resources will not change substantially after the implementation of fiscal federalism, since southern regions have

[20] Renato Cogno suggests that standard levels (LEPs) for social services should be set including State grants (e.g. for paying the personal assistant to disabled persons). He shows that following this approach, overall public expenditure (by all levels of government) is less unevenly distributed by region (Cogno 2009).

costs higher than standard ones but levels of service below the average. The present per capita distribution of NHS resources does not take account of inefficiency, so that those Regions which have higher costs are forced by the budget constraint to reduce the level of services. In the next future, if federalism works well, they will have lower costs and higher levels of service producing only minor effects on interregional distribution.

Apparently there is no warrant on extra costs due to inefficiency or supply of services above standard levels (LEP). For some Authorities this may be a serious problem, since there is evidence of wide inefficiencies in several regional and local authorities, mainly located in the South and the Islands. But art. 20-1-C of Bill 1117-B introduces a loophole with regard to the financing of regional expenditure in sectors which are not subject to the provision of standard levels of service (LEP). Extraordinary financial support may be granted for five years to those Regions which, for some "acceptable reason", have expenditure above the attributed amount of resources after equalization of fiscal capacity.

Bill 1117 designs a strongly cooperative federalism in which full equalization of resources with respect to need is only the starting point.

Art. 16 sets rules to define the destination of special funds mentioned in art. 119-5 of the Constitution reflecting a clear favour for interventions intended to promote development and cohesion of underdeveloped areas of the Country. Art 22 introduces the equalization of infrastructures which should cope with inadequacy of infrastructures with respect to a set of parameters which include the gap of development, insularity and other references to Mezzogiorno. Last but not least, art. 2-mm introduces tax reductions, namely for new enterprises, as an incentive to the development of the Southern regions. On the other hand, the target of the development of underdeveloped areas of the Country is clearly set in art. 1-1.

A very cumbersome reform

I stressed above the heavy information requirements of LEP and standard costs. I argued that some theoretical and technical problems are to be solved and that the procedure set by DDL 1117-B is not in favour of a quick and good implementation of the Bill. Indeed, these are only a part of the obstacles the Government will have to overcome to implement fiscal federalism.

The Bill has been largely modified while under examination by the two legislative chambers. Some additions and changes to the Bill originally submitted by the Government to the Senate have highly complicated it. The costs of implementing the Bill will be high. Furthermore some articles are so cumbersome and confused that their implementation is very problematic.

As regard to the last point, consider art. 17-1-e which introduces "*an incentive scheme in favour of the Authorities which assure high quality of services and a degree of fiscal pressure below the average of the same type of authorities supplying the same services*…". The prescription clearly does not fit to Local governments and Regions, which supply a very wide number of heterogeneous services, so that it is virtually impossible compute a meaningful quality index for all services and even establish the level of supply. Furthermore, fiscal pressure in different local authorities is hardly comparable, since the local administrations may substitute taxes with quasi-prices.[21]

The lower Chamber added a new task for the Government: setting besides standard levels of service, standard costs and standard expenditure, the “service targets” (art. 2-2-f) for each Region and each local government, i.e. 20 Regions, 8.100 Municipalities, 107 Provinces. According to art. 18, the annual financial law (legge finanziaria) will set rules to ensure the convergence of actual costs to standard costs and of service targets to standard levels of service (LEP) and to fundamental functions (for Regions and Local government respectively). An inter-institutional committee (art. 5-1-h) will periodically check the convergence of costs and expenditures to the respective standards and of levels of services to the service targets.

These rules and other ones which I cannot quote for the sake of brevity are written in the (perhaps unconscious) belief that the central Government is omniscient. But it is not. Thus one can easily foresee a lot of work which will be delayed by frequent sharp contrasts with Regions and Local Authorities.

The bargaining process occurred during scrutiny of Bill 1117 by the Parliament was useful to get a quasi-unanimity on the reform, but seems to have produced poisonous fruits which might delay fiscal federalism for some years.

[21] The tax for refuse collection and disposal may be substituted by a tariff which has the nature of a price for the service supplied. The same holds for the tax levied against the private use of public ground and the tax on advertising.

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