

1 – Introduction and summary

In the last decade Italy has experienced a gradual process of fiscal decentralisation. The reforms implemented in past years changed the structure of the Italian system of public finance substantially.

Until the beginning of the '90s the local governments were responsible for important sectors of public expenditure (e.g. health) but they were financially dependent on grants from the central government.

The system suffered serious inefficiencies.

The reforms implemented in the '90s increase the autonomy of local governments on both the expenditure and the revenue side. The central government devolves to local governments a large share of its tax revenue and new local taxes are introduced. A new system of equalising grants is designed to support regions with small tax bases.

We provide an evaluation of the Italian experience by focusing on the following critical issues:

a) the consistency between the objective of enhancing efficiency through fiscal decentralisation and the objective of ensuring reasonable uniform standards for essential public services (e.g. health) in every local community;

b) the trade-off between interregional redistribution and the incentives of local governments to pursue active tax policies;

c) the effects of local governments fiscal autonomy on the North-South dualism.

In our paper we deal mainly with the regional level of government in relation to the central or national one. The case of municipal and provincial governments is touched on very quickly. The main reason is that presently in Italy fiscal federalism - a quite relevant and hotly debated issue – means mainly decentralisation at the regional level while solutions for the lower ones are supposed to be less relevant and certainly less debated.

2 – Central and Local Governments in Italy

The present situation is the outcome of a quite long process of both political and economic transformations that have marked Italy in the past 25 years or so. The roots of this process can be traced back to the pre-WWII regime.

It is therefore useful in order to understand why and how the different solutions and reforms have been adopted – in particular for an audience that has not lived the Italian events - to recall the main points of this rather bumpy process.

According to the Italian Basic Law or *Costituzione* – in force since January 1 1948 – Italy is a republic with strong elements of federalism. Five regions (out of 20) were given extensive powers from the very beginning by the way of special statutes (some of which were passed even before the *Costituzione*) and all the others had legislative powers over a number of problems – from local transports to urban planning, to agriculture, to health. The five regions account for just over 15 % of the total population.

This new level of government with rather large autonomy was a reaction to the previous quite rigid and centralist structure modelled on the French system.

The other, traditional levels are the Provinces (in number of 104: two of them – Trento and Bolzano/Bozen – with the powers given to the Special Statute Regions) and the Municipalities (about 8,100). More recently large towns have been divided into wards or boroughs with some responsibilities.

All these institutions are very different in size, population, income per person and even electoral systems.

While the Special Statute Regions were established immediately after the WWII (with one exception) only at the beginning of the seventies the ordinary regional governments came into existence and this part of the Italian Basic Law was at last implemented.

Almost at the same time – end of the '60s beginning of the '70s - economic policies changed deeply because of the labour and, more generally social, unrest that was typical of many European countries in those years and of the national and international macroeconomic scenario.

The Italian governments proposed and the Italian parliament passed many laws increasing social benefits to large sections of the population. According to the Italian Basic Law any additional public expenditure must be covered by some source of public revenue, in the annual budget. Very often the provisions in the first year of the reforms were rather limited, but the effects in the long run were much bigger.

This was one the reasons of public deficits during the '80s, which resulted in a rather large public debt: from about 60 % of GDP to over 100 %.

The first relevant fiscal reform in the first half of the '70s abolished almost all sources of local revenue and substituted a system of grants from the central government for them. This originated a sort of fiscal irresponsibility of all local governments: they could spend without taxing; bank credit and eventually special grants often covered deficits when they became too big.