

Mario Rey¹

PROBLEMS AND PROSPECTS OF LOCAL FINANCE IN ITALY

I. Organization and financial sources
of local government in Italy1. The sub-national levels of government in Italy

The first part of this report deals with the present organization and finance of local government in Italy. Particular attention is given to local government in the strict sense of the term, i.e. the Province and the Commune. Some reference will also be made to the Region to give as complete a picture as possible of present Italian sub-national levels of government among which there is a high degree of integration. The second part of the report deals with the revenues and outlays of local government.

The Italian Constitution establishes three levels of sub-national government: the Region, the Province, and the Commune. The regional, the provincial and the communal councils are all elected directly by the citizens. Apart from the Regions, which are based on a dual organizational system, local government bodies are characterized by a high degree of structural and financial homogeneity, independently of their demographic and physical dimensions and independently of the economic and social environment in which they operate. These three types of body may be considered as levels of general, multifunctional government, distinguished by their different territorial jurisdiction.

A) THE REGION. The Regions as a form of government were created by the Constitution of 1948. However their names and jurisdictions stem from the political divisions existing before the unification of Italy (1870 and 1918). In other words, the Regions have an historical nature and boundaries with, in some

¹ Professor at the University of Turin.

cases, their own ethnic and linguistic characteristics. Five Regions with a special Statute were created to take account of these differences (Aosta Valley, Trentino - Sud Tyrol, Friuli-Venezia Giulia, Sardinia and Sicily). Their functions, responsibilities and financial resources are much wider than those of the other fifteen Regions with Ordinary Statutes. Furthermore, while the Regions with Special Statutes became operative immediately after the second world war, the fifteen Regions with Ordinary Statutes began operating in 1970.

Under the Italian Constitution, the Regions have a particular importance due to their power to issue laws in the areas established by the Constitution. Because of legislative responsibility of the Regions, together with their administrative role, Italy has often been likened to a federal rather than unitary State. In certain activities, such as regional planning, public health, welfare, tourism, commerce, public works, public transport, the Region has a deep impact on the activities and lives of the Province and the Commune through legislation, expenditure programmes and controls.

B) LOCAL GOVERNMENT: THE PROVINCE AND THE COMMUNE

a) The Province. There are at present 95 Provinces. The Province constitutes an areawide level of government. Its territory covers several communes and is centred around a large/medium-size town. According to the 1981 Census, the demographic dimensions range from Rome with 2.830.570 inhabitants to Isernia with 18.794 inhabitants. The three main sectors of activity of the Province were traditionally: 1) psychiatric health; 2) provincial roads; 3) secondary education (from 14 years to pre-university diplomas) excluding teaching staff, who come under the central government.

Until 1970, the Provinces played two major roles, as bodies concerned with the social and economic development of their area, and therefore involved with growth promotion projects; and as bodies providing help and support for minor communities.

In the last few years, the importance of the Province has notably diminished for various reasons:

- 1) The Regions have become the centre of development planning and promotion. In certain cases they have formed their own territorial entities operating over a wide area, such as the inter-communal "Comprensori" created by the Region Piedmont.
- 2) The difficulties and inefficiencies caused by the small operating scale of the Communes have been tentatively dealt with through associative agreements among the Communes (as an alternative to strengthening of the role of the Province).
- 3) The creation of the National Health Service in particular has removed all responsibilities for the health and welfare sector, especially the psychiatric field, from the Province.

However, associative agreements among Communes as a solution to area-wide problems have been criticized in various quarters recently. Several research projects and parliamentary bills propose to re-establish the Province as a territorial government body on an intermediate level between the Region and the Commune, with responsibility for planning in the provincial area and for setting up and running real areawide services (large public works, public transport, etc.).

b) The Communes. The Commune is the core of local government in Italy, by merit of political tradition, financial relevance and the increasing variety and complexity of its functions. At present there are 8086 Communes in Italy. Their demographic size and consequently the dimensions of their budget, personnel, and property, plant and equipment vary greatly. According to the 1981 Census, six Communes (Rome, Milan, Naples, Turin, Genoa and Palermo) exceeded 500.000 inhabitants; 43 numbered between 50.000 and 100.000 inhabitants; 215 between 30.000 and 100.000; 719 between 10.000 and 30.000; 519 between 1.000 and 10.000; and 1904 numbered less than 1.000 inhabitants (of which 1.398 were situated in North - West Italy, in particular in the Regions of Lombardy and Piedmont).

The structure and range of the functions and responsibilities of each Commune are legally the same, although obviously the differences in size and assets greatly affect their ability to carry out their activities. The Commune's fields of action are very numerous and continuously expanding, due to both the devolution of powers decreed by State and Regional laws, and the autonomy enjoyed by the Communes in selecting local public interests.

The Commune's principal fields of regulation and direct intervention are: town planning and zoning; planning of commercial activities; local police; urban traffic; local public works and their administration; aqueducts; sewage; rubbish disposal; roads and street lighting; cemeteries; pre-school and compulsory education buildings; public nurseries; sports facilities; local museums; theatres; parks and gardens etc.); education, cultural and welfare services.

Furthermore the Commune has ample freedom in selecting either private bodies or public production for implementing a project or running a service. In the case of public production, there is a further choice between direct management by the Commune and creation of a special municipal body. The latter solution is adopted by medium-large Communes in the sectors of public transport, rubbish disposal, aqueducts, municipal chemists, the production of milk and in some cases the production and supply of gas, electricity.

Moreover, in recent years, forms of joint shareholding have developed between public and private bodies in sectors such as airports, motorways, industrial areas, exhibition halls, through the creation of companies subject to private law.

2. Institutional Aspects

Since 1945, Italy has experienced substantial economic development which has had profound economic and social repercussions: rapid growth in incomes and consumption; a decrease in the agricultural working population and a marked shift towards industry and the tertiary sector; at first these phenomena were particularly evident in North-West Italy (the so-called industrial triangle of Milan - Turin - Genoa), with the growth of large industrial and urban agglomerations. Later these developments extended to North-East (Veneto) and Central Italy (Emilia-Romagna, Tuscany, Umbria, Marche), where however there was greater distribution spacial diffusion of population and growth of smaller-scale industrial centres; considerable migration flows from mountain and country areas towards urban areas, and from the south to the North, with a consequent decline of some regions and congestion of others.

As in other European countries, the Italian local government structures set up to handle the tasks typical of a mainly agricultural society became increasingly inadequate. For this reason, extensive reforms have been introduced which, over the last fifteen years, have concerned both institutional and financial aspects. This influx of reforms cannot be regarded as complete and requires further adjustments. A common characteristic of these local institutional and financial reforms is the more direct assumption of responsibility at the higher government levels, the State and the Regions, in areas which concern or affect economic development, equalization of regional and local imbalances, and income distribution.

Consequently, the activities of the higher levels of government are characterized, for the State, by greater involvement and for the new Regions, by intensive involvement in the life of the provincial and communal communities. Local government bodies are the terminals for state and regional decisions and financing, with a marked degree for overlapping, interdependent roles and responsibilities. Before proceeding to an analysis of financial aspects, we should briefly examine the repercussions of these tendencies on institutional aspects. However, we should not overlook the close connections between the two areas. Three stages of legislative innovation must be pointed out from the institutional point of view:

- a) the Regions with ordinary Statutes were created in 1970;
- b) the laws for the devolution of a wide range of functions from the State to the Regions and to local government bodies became operative in 1975 and 1977;
- c) the National Health Service was created in 1978, when the respective roles of the State, the Regions and the Communal Associations (the so-called Local Health Units) were defined as regards the planning, financing and management of the health sector. While financing remained highly centralized at State level, wide management autonomy was accorded to the (compulsory) Communal Associations.

Furthermore these institutional adjustments were effected in a context of increasingly overlapping and integrated responsibilities among the various government levels. This enables us to identify two important trends which have prevailed in the last ten years.

a) The trend towards stronger horizontal administrative integration among bodies operating at the same level, particularly among the Communes. This is the result of several convergent forces, namely:

- the abolition of various mono-functional bodies in a number of sectors, in particular health and welfare, and the transfer of functions (and related personnel and assets) to the local bodies, particularly to the Communes, regarded as general government authorities;
- the attempt to overcome the problems of small-scale Communal dimensions, which, as we saw earlier, are considerable;
- the attempt to eliminate or reduce the complex spillover effect, which, in urban and metropolitan areas particular, is brought about by the high degree of interdependence and mobility between Communes.

Other countries, such as Great Britain and West Germany, have chosen the solution of institutional adjustments with the abolition and merger of minor local bodies and the creation of larger new entities. Italy, as we have seen, has chosen to maintain the old entities and to create authorities based on agreements between Communes. Apart from the particular case of the mountain Communities, these authorities are normally responsible for a particular area of local activity: urban planning, public transport, health etc. The most notable example is that of the 671 Local Health Units: formally created as Communal Associations, in practice, in non-urban areas, they are increasingly assuming the role of a new level of government, although this is limited to the health and welfare sectors; in urban areas, the Commune and the Local Health Unit are more closely linked.

b) The trend towards stronger vertical administrative integration. As we saw earlier, in recent years relations between government levels have increasingly shifted from a model of relatively separate responsibilities (where each type of body played a precise role) to one of mixed integrated responsibilities. It is important to note that this trend towards administrative integration mainly takes place within each sector.

We shall see later that the growing importance of conditional State and Regional grants has been a significant factor in determining this administrative integration sector by sector.

It is not possible at the moment to say whether these trends will continue in the future. There are many who wish to reverse them, through a revision of the old local bodies, the Provinces and the Communes.

3. Financial Aspects

We now turn to an analysis of local government financial sources. As in other countries, there are generally four basic channels of finance: taxes or surtaxes referred to a local taxable basis; various types grants from higher government levels; fees and charges; public debt.

In the last fifteen years, the importance of these sources of regional and local finance has varied greatly: therefore we should distinguish between Regions and local governments:

A) Regions. We shall deal here with the model of the Regions with Ordinary Statutes. According to the Constitutions, the Regions should have both their own taxes and state grants. In practice, the Regions rely on state grants for about 96 per cent of their finance, while their own taxes constitute only about 1 per cent of current revenues. In 1983, current revenues of the Regions as a whole were Lire 45,491 billion (1 US \$ = 1700 lire), of which Lire 43,832 were state grants. 1983 capital revenues amounted to Lire 9,624 billion of which Lire 9,217 billion were state grants. It is worth noting that unconditional grants represent only a limited part of these grants (the Common fund and the Development fund). The majority of State grants is earmarked for particular sectors: the most important is the allocation of the National Health Fund. Other important items are the public transport fund, the pre-school fund, the agricultural fund, the school building fund, the public housing fund, etc.

This situation is in turn reflected in the Regions expenditure structure: 1983 current outlay by the Regions totalled Lire 42,576 billion, of which Lire 38,737 billion or 91% were transfers in kind. Capital outlay amounted to Lire 14,661 billion, of which Lire 11,158 billion, or 76% were transfers in kind.

This characterizes the role of the Regions in the Italian public financial system:

- a) the Regions do not create real flows of goods and services. They are bodies which allocate financial flows. This is in line with their strategic planning role;
- b) the Regions are a junction of considerable incoming and outgoing public financial flows: they perform an important allocative function as regards State funds;
- c) these funds are mainly granted for broad functional purposes.

B) Provinces and Communes.

In the last fifteen years, local government finance - Provinces and Communes - has been subject to various adjustments, particularly as regards current financing:

- a) financing of current outlay. We must distinguish three different periods: up to the tax reform (1973), 1973-1977; 1978 to today:

I) Up to 1972. In this period, local government, and in particular the Communes, had considerable taxing autonomy. The Communes had a family income tax and a range of excise and surtaxes: in 1972 these taxes accounted for 55% of current revenues and approximately 36.5% of current outlay. These taxes and surtaxes were abolished by the general reform of the Italian tax system, which did not provide for a stable system of local finance. In fact the tax reform has more or less totally centralized tax revenues. The problem of defining local taxing responsibility has been postponed for examination at a later date.

Furthermore, until 1977 the Communes and Provinces were allowed to have a current deficit; these deficits were subject to the approval of central government and, under certain conditions, covered by the public debt.

II) From 1973 to 1977. The tax reform provided that for a temporary four-year period local government bodies be financed by grants substituting the abolished local taxes; these grants were allocated on the basis of the revenues collected the year before the abolition of these taxes. This was the most difficult period for Italian local finance, as it was no longer possible for local government to raise its own taxes, the practice of current deficit budgeting became much more widespread, though varying from one Commune to another.

The financing of sub-national bodies through the State budget reached its high point in this period, as a result of the applica-

tion of the regional finance law and of the tax reform, both based on maximum centralization of tax responsibility. Under this concept, the financial autonomy of the Regions, the Provinces and the Communes consisted above all of autonomy in deciding how and in which areas to spend. Finance was provided for the most part by the State budget. This concept was based on three main considerations:

- the state budget was able to resolve the financial crisis of local government bodies, which had been heavily penalized by economic growth, better than autonomous forms of taxation;
- when local government raised its own taxes strong horizontal imbalances were created to the detriment of the less developed areas;
- the development of modern tax systems made it difficult to create sub-state levels of tax responsibility.

III) From 1978 to today. In 1978, law no.43 radically reorganized State grant financing. First of all, local government's current deficit is charged to the State, ratifying wide differences in levels of per capita spending by the various local bodies. It has also become compulsory to draw up balanced budget estimates. As we shall see later, local government may have recourse to the public debt to finance capital outlay. The State also imposed numerous conditions on spending (eg on the employment of new personnel) and on revenues (compulsory increases in certain fees; the management of certain sales services must reach breakeven point). Finally, the State to a certain extent equalizes the distribution of its grants, in order to reduce the differences in levels of per capita spending down to the average demographic level of the area.

b) Financing of local government capital outlay. Here there are two main channels of finance: State and regional grants, and the public debt. State and regional grants for capital outlay, and for public works in particular, are provided for a specified project. They may take the form of both a matching grant with partial coverage by the beneficiary, and a lump sum. When finance is provided through the public debt, local government must respect two basic conditions: a qualitative condition where by financing is provided for a specific purpose, that is for capital spending, and a quantitative condition whereby interest may not exceed 25% of the body's current revenues.

Local government may contract public debt with both the Cassa Depositi e Prestiti, which is the bank of local government bodies, and with the lending banks. Furthermore, since the interest rates of the Cassa Depositi e Prestiti are about half those of the banks, the latest state legislation only allows loans to be arranged with the banks when the Cassa will not concede them.

In 1983, the capital revenues of the Communes amounted to Lire 19,947 billion, of which Lire 15,432 billion were provided by the public debt and Lire 4,164 by grants. The capital revenues of the Provinces were Lire 2,469 billion of which Lire 2,462 billion were provided by the public debt.

To summarize, the general characteristics of financial relations among Italian government bodies are as follows:

- a) the main form of financing, provided for general purposes, is State grants, part of which pass through the "filter" of the Regions;
- b) the State transfers provided for the ordinary operations of the Provinces and the Communes are generally non-conditional;
- c) regional finance, on the other hand, is usually provided for broad areas and purposes;
- d) State funds are often divided according to a multi-level mechanism: this particularly applies in the case of sectorial funds, which are divided first among the Regions and then within the Regions;
- e) because of changes in the economic situation, the amounts granted are often determined annually, although there is ample room for negotiation between central government and the Regional, Provincial and Communal Associations;
- f) in the last few years, State grants have tried to get away from criteria of allocation based on historical spending, that is the sum actually spent in the particular year chosen, and to adopt objective parameters based on requirements, equalization or incentives.

It is worth making a few observations about this general picture of intergovernment financial relations, since it could be considered an extreme case of so-called "cooperative federalism". In the last few years, a number of risk factors have come to light, so much so that many qualified observers have asked for a certain degree of revision. The most notable is the Governor of

the Bank of Italy, who recently criticized the high degree of separation among the centres responsible for raising taxes (in practice there is a single centre, that is the State), and the profusion of centres responsible for spending decisions which exert all kinds of pressure on the State. These risk factors are as follows:

- a) the uncontrollability of the State budget. The faulty construction of the financial grant mechanisms, in the first place the extreme centralization of financial resources, means that the State budget has gradually found itself having to sustain the spending of various kinds of body on the basis not of predetermined sums but of a system, which in practice petrifies almost entirely the historical sums spent by these autonomous decision-making centres. This problem has come to the fore in the last few years. It is becoming less and less feasible to expect that the grants which finance the most diverse public sectors continue to be determined according to the forecast or actual spending of the sectors themselves.
- b) A further serious outcome of this mainly, if not exclusively, grant financing structure is the decrease in accountability. With the historical spending coverage system, the decision-making bodies give little consideration to the relationship between the expenses arising and the financial resources available. The public bodies are therefore extremely unfamiliar with national financial constraints that is with the ability-possibility of obtaining greater finance from sources other than external grants. The decision-making bodies are consequently led to consider the real or estimated need of public goods and services as their principal if not only point of reference. This is not to say that the problem of resources does not arise, but it is presented and seen as an external factor concerning relations between the authority which needs funds and the State or and the Regions which do not provide sufficient funds. This situation provides even less room for the relations-hip between the authority and the citizens, who are not required to sustain the cost of the local authority's spending decisions. This is a serious deviation from the principle of the democracy of public finance.

- c) A third disadvantage of the totally or mainly centralized financing system for the public sector is the conflict existing between the objective of decentralized decision making and the objective of control of public spending. In a situation where the central State is the only or principal financier of the public sector these two objectives necessarily conflict; the need to control public spending risks becoming incompatible with decentralized decisional autonomy. If the State rigorously controls public spending it cannot not impose strict limits on the decentralized bodies decisional autonomy.
- d) A further serious consequence emerges if we follow this line of reasoning. Should the State be unable to ensure grants based on historical spending, the various bodies budgets will sooner or later become tight.
- e) The equalizing role of State finance as regards the poorer areas is severely weakened in this situation. Under the current system the State becomes a general financier. This undermines its ability to simultaneously pursue objectives such as stabilization, income distribution and equalization in the provision of public local services.
- f) Another problem is the conditional nature (for broad purposes or for specific projects) of most of the grant programmes especially of those where Regions have an allocative role.
- g) A last problem arises from uncertainties over the sum to be granted: the central government's main concern at present is to stabilize the economy in the short term and to reduce the deficit of the public sector. For this reason the sums granted under the various programmes are decided on an annual basis.

Mario Rey

Organization and financial sources of local government in Italy

Summary

There are three sub-national levels of government in Italy: the Region, the Province and the Commune. Five Regions have a Special Statute with greater responsibilities and powers. The other fifteen Regions which began operating in 1970, have an Ordinary Statute.

All have the power to issue laws in various fields established by the Constitution. Some of these fields, such as regional planning, public health, welfare, tourism, commerce, public works, public transports have a great impact on activities of local governments. The Region acts through legislation, expenditure programmes and controls.

There are at present 95 Provinces. The Province is an areawide level of government. In recent years the role of the Province has notably diminished due to the increasing importance of the Region, to the growing relevance of associative agreements among the Communes, to the creation of the National Health Service which removed the Province responsibility for the psychiatric health.

The Commune is the core of local government. At present there are 8086 Communes. Their demographic size varies greatly. Six Communes exceeded half a million inhabitants and 1904 numbered less than 1,00 inhabitants. The Communes fields of action are very numerous and continuously expanding.

As in other European countries the Italian local government structures, set up to handle the tasks typical of a mainly agricultural society, became increasingly inadequate due to the repercussions of sharp economic growth experienced after the war. There has been a more direct assumption of responsibility at the higher government levels, the State and the Regions, in areas which concern or affect economic development, equalization of regional and local imbalances, and income distribution.

Various institutional adjustments and reforms have been introduced in the last 14 years. Two main tendencies can be noticed:

- a) a greater horizontal integration especially among the Communes. This integration has been based on associations and agreements among the local governments, and not, as it has been in other countries, on mergers of old bodies.
- b) A greater vertical integration, through a closer links, sector by sector, between State, Regions and local governments.

As far as the financing aspects are concerned, the system of State grants is at present prevailing. This is particularly true for the Regions which receive most of their financial resources from State grants. Most of these are available to Regional governments for broad functional purposes. On the other hand, the

Region's outlays are mostly transfers in character. The regional role in the Italian system of public finances might be seen as a "junction" of flows of public funds.

As to the local government financing, after the tax reform at the beginning of the 70 most of the old local taxes has been abolished. Local governments are financed for about 2/3 of their current budget by State block grants. This system is now under review. A new system of local taxing powers might be introduced in a near future. Capital expenditures are financed by public debt or by specific conditional transfers granted by the State or by the Region.