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Working Papers

11

Unioncamere Veneto

CONSIGLIO REGIONALE DEL VENETO

REGIONE DEL VENETO

Responsibility and Federalism

Figures, ideas and remarks to speed up the realization of fiscal federalism in Italy

September 2009

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September 2009

Presentation

"Responsibility and Federalism" is the new contribution of ideas and proposals that Unioncamere del Veneto, together with the Regional Council and Regional Committee of Veneto, want to offer in the debate about Federalism.

Just a couple of months ago the law to implement the art.119 of the Constitution was approved. As a matter of fact this represents a turning point in the realization of Federalism in our Country.

Actually this work represents the fourth leg of an in-depth investigation about fiscal federalism which started more than 2 years ago with a first Survey Paper about the "The Cost of Non-Federalism", a second one concerning "Public Spending and Federalism" and the third on "Federalism and Competitiveness".

Unioncamere del Veneto draws attention to the effects that the Federal Reform could bring into the economic system which is more and more involved in global competition. The experience in Europe shows us that the federal model represents the most modern and effective form of government, the one that can best contribute to Italy's civic and economic growth while improving its standing within the European Union.

To achieve this objective the productive system is required to improve its economic performance, but as citizens we must also require the utmost efficiency from our Public Administration, above all from those working at a central level.

In Italy the Public Administration accounts for 50 percent of the country's total expenditure and represents the biggest enterprise of the Country. Veneto Region has 48 civil servants in every 1000 inhabitants compared to the national average of 57.

So, the costs of the Public Administration are lower than the rest of the Country and it is time to implement different politics on a regional basis, which should not be penalizing as the Stability Pact or the Sector Studies.

Unioncamere del Veneto hopes that the data and analysis contained in "Responsibility and Federalism" will be a useful suggestion for the debate that is developing and for those whose duty it is to put into effect – upon the new decrees – the new Federalism Law.

Venice, September 2009

Federico Tessari
President, Veneto Unioncamere

Foreword

The work of our Observatory on Federalism and public finance, initiated on cooperation with Unioncamere del Veneto, continues with this publication.

The website www.osservatoriofederalismo.eu was created in order to disseminate information about the activities of the working group, as well as to keep abreast of any events concerning the topics of federalism and fiscal matters in which the working group is involved at regional, national and European level.

As in the other previous works, this Survey Paper wants to offer figures and proposals to speed up the implementation of fiscal federalism, with the only difference being that now we can discuss starting from the Law 42/2009, which represents a fundamental step in the Federalism reform for our Country.

The approved Law is actually a great "revolution" as it introduces in our public finance system some of the fundamental principles such as; the need to coordinate entities having authority to spend and entities having authority to levy taxies, financing of essential services (healthcare, social assistance and education) based upon standard costs rather than on past spending levels, rewarding schemes for virtuous institutions, fiscal subsidiarity and hence the possibility for regional governments to levy local taxes that can best reflect territorial peculiarities.

Even if we can state that the Federalism reform is officially started, the way to the complete fulfilment seems still far away.

Now it is time of decrees and this is the hardest step.

This is the reason why we want to continue, through this survey, with our study and proposals activity, so that this reform can succeed in achieving what 60 years of charitable welfare in favour of the South has failed to do: reduce the number of civil servants (and related expenses) and effectively increase resources for investments in order to reduce the gap in wealth between the Northern and Southern regions of Italy.

We still have to understand if and how the reform will succeed in achieving the other important objectives. For example we hope that taxes in the future will be collected locally, placing the Inland Revenue Service (Agenzia delle Entrate) under the control of the regional authorities. We also hope that central state government spending will be reduced in favour of the local and regional Administration with the transfer of government staff from the center to the periphery. Moreover, the possibility for the virtuous regional governments, rather than the inefficient ones, to collect taxes on their territory thus eliminating any sort of privilege and giving responsibility to the local administrators.

Such proposals should help reduce tax evasion and increase a better savings in public expenditure at central level thus leaving more resources to lower the tax burden on enterprises, to financially support the poorest families and last but not least, to grant health care and social assistance.

Venice, September 2009

Marino Finozzi
President, Veneto Regional Legislative Assembly

Foreword

We are particularly pleased to see the new results of the research and analysis we have been developing for several years in cooperation with Unioncamere del Veneto in the framework of public financing and in particular, on federalism.

As regional Councillor for economic policies, I feel it is essential for the competitive performance of our region to remain high; unfortunately, however, there are indicators that give us cause for concern and tell us that it is time to change.

The financial crisis which is affecting the regional productive system as well as the national and international one, shows characteristics which seem to be mainly based on structural problems rather than cyclical ones.

The real challenge is that of grasping the new productive factors for each economic sector which is able to lead out of the crisis.

It is necessary therefore to create all the conditions to allow the richest regions like Veneto, Lombardia and Emilia Romagna to produce and to export at competitive prices and quality, to create employment and invest in infrastructures.

Without these conditions these Regions will no longer be able to make as significant a contribution to the country's balance of payments. At that point the entire Italian system might be at risk of crumbling.

It is therefore extremely urgent to proceed toward the complete implementation of the fiscal and institutional Federalism.

The study we are presenting today focuses on a Region which is crushed by extremely high fiscal pressure - even superior to the national average - and whose benefits are not invested in efficient infrastructures and services, but in charitable welfare payments in favour of other regions. Furthermore, Veneto region is also pressed by unfair competition from the bordering regions, which instead, benefit from special statutes.

We believe that interventions must be differentiated taking account of the level of efficiency demonstrated by every Region in the management of the financial resources.

Of course, we don't mean to put everyone into the same category; today we need to do a careful analysis making a distinction between the efficient and inefficient Public Administrations and plan the possibility of a bonus for virtuous behaviour and sanctions for dissolute management.

The Law 42/2009 (approved last April) definitely is a step in the right direction, but the timing is crucial. This is the reason why we need to keep an eye on the decrees; they must be put into effect for the fiscal federalism implementation.

These are reforms for which both the business community and citizens can no longer wait and, at this point, egotism of individual regions or state burocracy will be unable to oppose.

Venice, September 2009

Vendemiano Sartor
Regional Councillor
for Economic and Institutional Policies

The research was promoted and carried out in the framework of the *Regional Observatory on Federalism and Public Finances*, instituted by the Veneto Legislative Assembly and Unioncamere del Veneto, with the contribution of the Department for Economica and Institutional Policies of Veneto's regional Government.

The planning of the survey, in addition to the collection, processing and assessment of the data is the result of the work performed by a team co-ordinated by Gian Angelo Bellati, Director of Unioncamere del Veneto and Roberto Crosta, CCIAA of Venice Secretary-General; team members are Serafino Pitingaro, Renato Chahinian, Giovanna Guzzo and Marco Mazzoni of Centro Studi Unioncamere del Veneto, Alberto Cestari, Catia Ventura and Andrea Favaretto of Centro Studi Sintesi.

The report was drawn up by Centro Studi Unioncamere del Veneto with the contribution of all the members of the working group.

Our special thanks go to the members of the Regional Conference on Economic and Labour Trends (CREL) of Veneto's Legislative Assembly, to the Municipality of Venice working group coordinated by the Councillor Maurizio Baratello and all the politicians and specialists, who participated in the meetings of the working platform dedicated to the issue of federalism with all their useful ideas, remarks and suggestions.

Summary

Introduction*

Centro Studi of Unioncamere del Veneto, with the cooperation of the Veneto Legislative Assembly, the Council of the Veneto Region and other public and private Bodies, Centro Studi Sintesi included, have been working for years on the federalism issue and its possible involvement at economic level. Works and research can be consulted on the website www.osservatoriofederalismo.it.

Thanks to the recent approval of the Law 42/2009 on fiscal federalism, today we have entered a new phase. The news and the ambitions of the Reform, if implemented on time, could deeply change the structure of public Italian finance and of the entire public and private system; but they have to be worked on as they do not have to remain incomplete for a long time, as has happened before in Italy with other Laws, or implemented just in a partial or unsatisfactory way.

This work wants to give some thoughts for reflections and a contribution to monitor the application of the Law 42/2009 offering the knowledge and expertise of some local public and private bodies, being aware that such a law on the federalism issue needs to be shared with all local government's levels.

For that reason Unioncamere del Veneto and its Centro Studi will be always open towards comparisons and communication with all the national and local parties interested in important Reforms such as Federalism, and those ones willing to evaluate and work on it together with citizens and enterprises.

The **first chapter** focuses on the so called "own tribute", a theme on which we are working and collaborating with a new working group launched from the Venice Municipality. In particular we have studied a concrete case to be imitated, the one of Friuli Venezia Giulia. It represents for some aspects, expecially for the **collection of taxation at regional level**, a unique model in our Country and is an example which could be followed also by the other Italian regions.

The **second chapter** deals with **advantageous taxation** and delves deeper into the matter of the accomplished autonomy of the **Italian Chamber of Commerce** in order to demonstrate the opportunity that **can be a real possibility for the federalism system.**

The **third chapter** updates the data on **fiscal residue**; more specifically it deals with the quota of financial resources that the richest regions send to the poorest ones. It has been proved that, the more the fiscal residue increases, the greater is the Poverty in Southern Regions and the higher the risk for the Northern Regions not to be competitive with the most economically advanced European Regions.

The **fourth chapter** studies the efficiency and inefficiency of part of the Italian public expenditure with a **comparison among Italian regions**. With this chapter we want to warn the legislator about a common error in our Country, that is to put everyone into the same category by adopting the same disciplinary measures against all the Bodies without distinguishing the virtuous from the non virtuous.

These measures go in the opposite direction of a **"responsibility principle"** that a federalist system should encourage. The reference in the title "Responsibility and Federalism" is anything but random. The approval of the Law on fiscal federalism is a real turning point for the political party who has won the recent election. They have to demonstrate now a better management of public affairs by striking out the inefficiency that still persists in some areas of the

* Gian Angelo Bellati, Director of Unioncamere del Veneto and Eurosportello Veneto.

Country. The Legislator is also called to issue different directives – as per the Law 42/2009 – in order to get major public expenditure savings and therefore better efficiency in the P.A.

The **fifth and last chapter** proposes a European benchmarking analysis on the allocation of the human and financial resources in the public sector, which aim to evaluate the level of efficiency of the P.A. in Italy, Germany and Spain, but above all in the Italian Regions.

Being difficult to define and quantify, the standard costs, which could postpone the issue of the decrees, we have tried to **determine an "optimal level of expenditure" leaving out the definition of the cost of single services**. The results we reached are definitely remarkable; **in some Italian Regions the public expenditure is managed in a very efficient way even compared with P.A. of other European Countries**. In some other regions however the expenditure parameters are 2 or 3 times greater than the national average. If these latter adopted the same parameters of the most virtuous region, **considering the "optimal level of expenditure", we could obtain both a public expenditure savings up to 28 billion euro per year** as well as an increase in the investment for families and enterprises services.

Our analysis shows how **using the parameter of public expenditure per capita in an absolute way deprives Regions of their responsibilities**.

In some cases it would be more correct, both technically and ethically, to **compare such parameters to the real life cost**, which are so different from one region to another and to the **earned income.** Otherwise we will continue to increase waste of money, inefficiency and demotivation.

For this reason we call for the proposal to improve the **horizontal solidarity** and not only the vertical one as we are doing today. With the horizontal solidarity we will have a transparent and verifiable system regarding the "solidarity flows" between the regions that give and the ones that receive. Meanwhile, in order to reduce costs for the management of the huge sums of money given as contributions, through the so called "advantageous taxation" we should aim at **exemptions** and **fiscal authomatic incentives**, which would reward the productive regions to the detriment of those enjoying the charitable welfare.

We do believe that in this way the **investments spending** can be increased with greater benefit of the infrastructure which still have to be realized, expecially in the South. This will bring a disadvantage to the **public staff spending** which is still used, expecially in the less economically efficient regions, **like a "social security cushion" and definitely represents a financial burden for the national public expenditure, therefore acting as a brake to our economic competitiveness**.

1. Fiscal federalism and regional taxes*

1.1 Act No. 42/ 2009 - fundamental principles and essential elements

Italian Act No. 42 of 5 May 2009 confers implementing powers in the field of fiscal federalism on the Government, which is called upon to apply the provisions of article 119 of the Italian Constitution. Such enabling act defines the guidelines for the reform of the financing mechanisms of local authorities, thus giving effect to article 119 of Title V of the Italian Constitution as modified by the constitutional reform of 2001. **Rather than implementing article 119 alone, Act No. 42/2009 seems to be giving effect to the entire Title V of the Constitution**, which due to the long delay in the recognition of financial autonomy for Regions and Local Authorities has so far lacked effectiveness from many perspectives.

Indeed some fundamental themes contained in Title V have been implemented only in a partial, temporary and - in many respects - inadequate way. Let us consider, for instance, the requirement to coordinate public finances – an issue addressed by the enabling act, which lays down, among other things, the need to harmonise public budgets; or again the requirement to define essential performance levels (so called 'l.e.p.' - *livelli essenziali delle prestazioni*) in the matter of social rights and fundamental functions to be delivered by local authorities pursuant to article 117, paragraph 2, letter m) and p) respectively of the Constitution, while taking into account the need to fully finance such levels and functions.

On the other hand, the implementation of the Act will require focused actions to **coordinate and innovate the entire tax system**, as well as to design a mechanism for equalising regional resources that is far more sophisticated than the ones experimented so far.

The law provisions under examination contain some underlying fundamental principles, such as for instance, **the need to coordinate entities having authority to spend and entities having authority to levy taxes**, (which will automatically increase accountability within local authorities when it comes to managing resources); or else **the need to substitute the "historical spending principle", whereby the previous year's spending levels serve as a reference, with the "standard cost principle"**.

Moreover Act No. 42/2009 emphasises the principle of **horizontal subsidiarity**. Among other general coordination principles, art. 2 calls for the definition of regional and local taxation rules able to enhance horizontal subsidiarity.

Also families are considered by the Act, which has a **strong "favor familiae"**. Indeed, art. 2 calls also for the identification of suitable instruments to give full effect to articles 29, 30 and 31 of the Constitution with respect to family

* This Chapter was prepared by Centro Studi Unioncamere del Veneto (paragraphs 1.1, 1.2, 1.3) and by Centro Studi Sintesi (paragraph 1.4).

rights, the establishment of a family and the carrying out of family-related duties. This provision is a major quality leap for our system. Financing based upon historical spending has always been the fundamental flaw in the mechanism that governs regional and local finances. From the decrees authored by the Treasury Minister Stammati in the 1970s onward, regional and local authorities have been receiving financing proportioned to the money they had spent in the past. As a result, inefficient management has been systematically rewarded, while virtuous practices have been punished (on account of an equation whereby historical spending figures result from the sum of costs of services and squandered resources). Many of Italy's current problems, including its remarkable public debt, stem from the perverse principle of historical spending. It follows, that this practice should be abandoned in favour of a radically new concept, since any alternative solution would be tantamount to putting a new patch on an old dress.

Bearing that in mind, the reform under examination has introduced a new criterion, namely that of the **"standard cost" (intended to finance services instead of inefficiencies)**. From now on, a standard cost will be established for each service provided by local authorities and all entities will have 5 years to comply with it (transition period). All services provided across the country shall meet specific efficiency and suitability requirements.

By replacing the historical spending principle with the standard cost concept a virtuous mechanism will be set off, putting an end to the financing of inefficiencies and squandering. Should it happen, for instance, that some regions keep exceeding the standard cost approved at national level – so that, like what happened in the past, **a box of plasters in some local health corporations is one hundred times more expensive than in others**[1] –, those regions will be called to order: their regional administrators will no longer be allowed to submit a receipt to the central government to be reimbursed for extravagant expenses - as they used to do in the past-, instead they will have to levy higher taxes on their citizens. If that doesn't add up, citizens will hold administrators accountable and punish them through their vote.

The implementation of fiscal federalism will entail the need to finance those functions that will be transferred to the regions and the cancellation of the connected state payments to regional and local authorities, including those to cover staff and operating costs. **This is the end of both the so called "derived finance" and the practice of recovering losses or refunding expenses against receipts**, which led the latest Prodi Government to allocate 12 billion euros to 5 regions with extra deficit in the health care sector (Budget Law 2007), or else which caused the government currently in office to allot 140 million euros to the unstable Municipality of Catania and 500 million euros to the Municipality of Rome to rescue them from major financial disruption - both measures being of a one-off nature.

Current ordinary transfer payments made by the central government to local entities, which amount to over 20 billion euros a year (of which 12 billion euros assigned to municipalities and 8 billion assigned to regions, provinces and other local authorities) will be replaced by autonomous tax resources. However, the fact that transfer payments will be replaced by taxes, is only one of the changes that will be made to the fiscal framework of regions and local authorities. So, for instance, the implementation of the standard cost principle will affect the territorial distribution of approximately 50 billion euros allocated to ordinary statute regions according to cost-sharing schemes (to be used primarily for the

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[1] Evidence of this is contained in the interview with the President of Regione Calabria published in *IlSole24Ore* of 14 April 2009.

healthcare sector). In the field of education then, the handover of authority over schools from the central to the regional government will be accompanied by a decentralization of taxes in the amount of approximately 40 billion euros. **In sum, the entry into force of fiscal federalism will marshal resources in the estimated amount of 100-110 billion euros, at least.**

As a result, regional and local taxes will increase, while state taxes will decrease correspondingly. Part of the taxes that citizens used to pay to the State will now be paid to the regions and local authorities, thus paving the way for the so-called "tax traceability". This means that taxpayers will be aware of the services for which taxes are levied and will be able **to use their vote to judge their administrators' management conduct**. Through this process the overall tax burden is expected to decrease.

The Reform, on the other hand, foresees an equalisation fund with no specific allocation – as laid down by art. 119 of the Constitution – for the benefit of regions with limited fiscal capacity.

Autonomy and accountability will be therefore virtuously paired and will offer the chance to rationalise spending and exert democratic control over regional and local administrations. **On the other hand, regional and local administrators will at last be able to use the tax handle** to implement policies that fully support the subsidiarity principle.

Moreover through deductions, allowances and tax relief schemes local administrations will be able to design targeted policies to boost site-specific production and social facilities, an option which is hardly feasible today. The federalist reform will therefore greatly increase the regional and local autonomy.

To become operative fiscal federalism will require a number of steps to be taken over 7 years, during a 2-year implementation phase and a 5-year transitional period. Pursuant to Act No. 42 of 2009 a preparatory joint committee shall be set up to define the contents of the implementing regulations that will have to be drawn up within 2 years of the entry into force of the Act.

Turin, Milan, Venice, Genoa, Bologna, Florence, Bari, Naples and Reggio Calabria will become metropolitan cities and simultaneously the corresponding provincial bodies will cease to exist: the provincial authorities will be abolished as soon as the metropolitan authorities are ready to take office.

1.2 Initial implementation of the Act on fiscal federalism

Enabling Act No. 42 of 2009 lays down that within 24 months of the entry into force of the decree, delegated legislation will have to be made concerning the different aspects of the subject, such as for instance the autonomy of all government levels in terms of revenue and spending mechanisms, the simplification of the tax system, the allocation of resources to municipalities, provinces, regions and metropolitan cities - so that these entities can manage such funds autonomously, the definition of "standard costs and needs", the establishment of an equalisation fund, the reduction of the state tax burden and the integration of databases run by local authorities and the central government for the purpose of fighting tax evasion, and so on.

It is worth noting that according to the provisions of the Enabling Act, before starting work on the legislative decrees, a wealth of financial, economic and tax information will have to be collected and processed to support the decision of the delegated lawmaker.

To that end, a specific provision (art. 2, paragraph 6) of the Enabling Act states that **at least one of the required decrees shall be passed within twelve months of the entry into force of the Act and shall contain the fundamental principles pertaining to the harmonisation of public budgets;** it also states that when adopting the draft decree the Government shall have to submit to the Parliament, as an annex to the decree, a report on the entire financing scheme for the local bodies and a proposal – based on quantitative figures – concerning the basic financial flows between the State, the ordinary and special statute regions, autonomous provinces and local authorities, suggesting possible mechanisms for the distribution of resources. These are in fact the "facts and figures of fiscal federalism", that is to say, the data base which is needed to give concrete form to the reform under way and put it into perspective. The reform has triggered intense discussion in political circles as well as in Parliament during the work of committees.

Harmonising accounting systems across the different government levels is in fact a prerequisite to ensure the transparency of decision-making processes, the efficiency of control systems and the coordination of public finances, not to mention a systematic analysis and assessment of revenue and spending.

The critical aspects of the Italian accounting system were addressed also by Italy's Statistical Institute (Istat), the Court of Auditors (*Corte dei Conti*) and the State General Accounting Department (*Ragioneria Generale dello Stato*) during the parliamentary hearings which led to the adoption of the enabling act on federalism. Indeed, one must be aware of the real financial quantities of individual territories to be able to make a reliable estimate of the "costs", or rather of the resources, that must be shifted.

This is also the reasoning behind the draft framework law on accounting and public finances, which confers legislative powers on the Government in the fields of adjustment of accounting systems, equalisation of resources, spending efficiency and enhanced controls. Such framework law was approved on 24 June 2009 by the Senate (S.1397) and is now being assessed by the Lower House (C.2555).

The draft revolves around four main topics: coordination of public finances, harmonisation of accounting systems, reform of the instruments that govern public finances and revision of the control systems.

The distinctive features of Act No. 42/2009 were clearly illustrated by Italy's Minister of Economy and Finance Giulio Tremonti when presenting the Unified Report on the Economy and Public Finances ("*Relazione unificata sull'economia e la finanza pubblica*" - RUEF). Such Report reveals that the crucial issues of Act no. 42/2009 have to do with the financial quantification of the processes involved in the implementation of fiscal federalism. The financial quantification is precisely the topic of the first legislative decree to be passed. The Minister argued that information gathered from the financial statements of the different institutional bodies is key to calculate the consolidated historical spending for each function first, and define standard costs then. However, **while regional financial statements are not homogeneous and are hardly comparable with one another, the financial statements of local authorities are classified according to a homogenous scheme and are assessed by the**

Interior Ministry. Nevertheless, also the latter differ in terms of accounting principles, especially as regards the use of the functional classification and the diverse practices of outsourcing services. With reference to the financial statements of regional and local authorities, one must define the type of data to be used in the quantification. Financial data subdivided by function (commitment of expenditure and ascertained expenditure) seem to be the most appropriate information one can deliver, although they are difficult to gather. General data could be gathered through SIOPE[2], although this system provides only cash flow information according to the economic classification /SEC[3].

1.3 Regional taxes as key to foster growth

After mentioning the next steps that will lead up to the implementation of the Act on fiscal federalism, it is worth considering **which taxes could be best decentralized**.

First of all, let us clarify the difference between a region's own taxes (regional taxes) and state taxes. According to the constitutional jurisprudence, state taxes are established by a state law, regardless of whether the revenue is transferred - wholly or partly - to the regions and local authorities. Regional taxes instead are those established by the regions under their own laws, in compliance with the legal obligations laid down by article 119, paragraph 2 of the Constitution.

One of the basic principles contained in Enabling Act No. 42/2009 with which future implementation decrees will have to comply is to be found in art. 2, paragraph 1, letter a) and refers to "autonomy in the field of revenues and expenditures" and to the "greater accountability for administrative, financial and accounting polices at all levels of government".

Regions, therefore, **must become fully accountable not solely for expenditures, but also - and most importantly - for revenues. Only tax autonomy will allow regional governments to enjoy management autonomy. On the other hand, citizens, that is voters, will be able to judge the services they receive and whether those services are worth the taxes paid to receive them. Hence, voting citizens will use their vote to judge the performance of regional administrators.**

For that to happen however, local administrators must not have the option of putting the blame on the State for their poor operation, claiming that they were not given adequate resources. To avoid such situations, regions and local authorities must be granted maximum taxation autonomy.

However, to make sure that the local taxation autonomy does not result in a heavier tax burden for the taxpayer, national taxation should be

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2 SIOPE (*Sistema informativo sulle operazioni degli enti pubblici* – Information system on the operations of government bodies) is a system for the online collection of information on the cash transactions, payments and collections, made by the treasurers and cashiers of the Public Administration. It has been developed in implementation of Article 28 of Law No. 289/2002 as a joint effort of the State General Accounting Department (*Ragioneria Generale dello Stato*), the Bank of Italy and Italy's Statistical Iinstitute ISTAT.

3 To learn more about this, please refer to the *Relazione unificata sull'economia e sulla finanza pubblica*, issued by Italy's Finance Minister in April 2009, *www.tesoro.it*.

lowered and regional taxation should be introduced to offset such reduction.

Following the example of other European countries, a way to implement such taxation scheme is levying taxes on real estate that citizens and companies are free to use. Over the years **federal countries and countries with a decentralised multi-tier government structure** have been able to select a number of criteria to finance local bodies, and **real estate taxation has been their preferred choice**. It is noteworthy that Ireland and Great Britain, which have limited fiscal decentralisation, get the entire local revenue from the property tax they levy on real estate.

The most sensible principle on which to base local taxation is a person's freedom to use a building. In addition to being easy to ascertain and not overlapping with other bases for assessment of taxes, the freedom to use a building allows local authorities to fine-tune local taxation according to multiple parameters (income, location, title, family size, intended use etcetera), thereby pursuing specific economic and social objectives[4].

That would not be an additional tax, as it would replace other national taxes, nor would it be a new version of ICI, Italy's municipal tax on real estate, or a form of property tax, since the basis of assessment would be the freedom to use a building, rather than ownership of it. This tax could be the starting point of a fiscal federalism which, in the absence of taxation autonomy, would be incomplete and prone to let public spending soar.

Although 7 years will be required for federalism to be fully operative in Italy, the approval of the enabling act on federalism has made it possible to adopt straight away a number of measures to tackle some of the economic issues that trouble the country.

One of these is the possibility for regions to establish their own taxes: this is key to reorganise growth policies in Italy.

The enabling act on fiscal federalism emphasises regional taxation autonomy and allows regions and local authorities to use mechanisms of tax exemption, concession and reduction to develop policies which fit the specific production and social characteristics of the territory concerned.

At last, the regional fiscal policy[5] will be capable of providing tax incentives or tax relief schemes to support certain business categories, to encourage compliance with higher environmental standards or again to foster non profit organisations which play a social role. If used for incentive purposes, the regional tax autonomy can mean a reduction in the tax burden. Conversely, the burden could increase in case of inefficient management, for instance if the expenditure on a given service fails to be based on standard costs or if no effort is put into removing inefficiencies that cause the cost of one and the same type of service to vary remarkably across regions, even though its quality is the same.

That would be a virtuous combination of autonomy and accountability: expenditures could be rationalised, while local voters could exert democratic control on the government.

Fiscal federalism can help rationalise public spending and any money so saved ("dividend") can be used to promote growth.

Art. 7 of the enabling act on fiscal federalism provides remarkable autonomy to the regional and local authorities in the field of their own taxes, allowing them to introduce innovative fiscal policies at regional level based upon

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[4] Cipolletta I., "La regione è mobile…qual piuma", published in *Il Sole 24 Ore*, 18 June 2009.

[5] See. Baratello M., *Federalismo Fiscale – Da Venezia una prospettiva per l'Italia*, Centro Produzione Multimediale, April 2009.

tax relief and incentive schemes. The dividend resulting from the rationalisation of expenditure coupled with a wiser distribution of resources could enable the tax handle to be used locally to reduce the tax burden and foster economic and social growth, thus bearing the virtuous fruits of fiscal federalism.

In Italy the so-called "own taxes" mentioned in article 119 of the Constitution are in fact an unknown subject: currently in ordinary statute regions there is only one tax falling within such category, namely the regional tax on truffle gathering. That is the outcome of a Constitutional Court ruling of 2003 stating that "own taxes" must be established by a regional law: paradoxically that decision put a freeze on the regional taxation authority, pending state legislation for the coordination of public finances, which finally has been approved.

Own taxes (both autonomous taxes, i.e. established by the regions and not related to the state level, and derived taxes – i.e. governed by a state law but whose revenue is allocated to the regions) are an ideal ground for the application of the subsidiarity principle and enable the regional and local authorities to develop an autonomous fiscal policy through tax deduction and allowance schemes, as well as modulation of the tax base.

Finally, thanks to the Enabling Act No. 42/2009, own taxes represent a genuine opportunity for regional and local authorities to reduce the tax burden and implement subsidiarity in a fully structured way.

Moreover, **own taxes are the prerequisite for the true autonomy of any institution, the instrument that allows local fiscal policy measures to be adopted without risking sanctions by the European Court of Justice,** as evidenced by the famous rulings concerning the cases of Azores and Spain.

The Act paves the way for **tax relief mechanisms (so called "privileged taxation - *fiscalità di vantaggio*") that do not represent state aid** according to the definition of art. 87 of the EU Treaty and follow the guidelines of the well known European Court of Justice's judgements on the tax systems of the Azores and the Basque Country.

Article 2, paragraph 2 letter mm) of the Act explicitly mentions such mechanisms; it states that the guiding principles and criteria of the implementing decrees shall include the identification of tax mechanisms able to foster growth, particularly through the creation of new enterprises in less developed areas. Said mechanisms shall comply with Community law.

Privileged taxation is mentioned also in art. 16 letter d) with reference to ordinary statute regions, which are free to set up actions to promote economic growth, and again in art. 27 paragraph 3 letter c) with reference to special statute regions and autonomous provinces which, through their own law, can create tax mechanisms to encourage growth.

Regional tax relief mechanisms (or tax regimes fostering growth) could incorporate and fully legitimate innovative fiscal policy measures intended for the regional level, such as for instance the possibility of **introducing regional laws to grant tax abatements to those who invest in production facilities**, reducing the red tape required for granting traditional incentives to entrepreneurs. Further examples could include regional tax policies to encourage a **higher presence of non-profit organisations** in the field of public utilities or social policies, so as to remedy the shortcomings of both private and state actors. Such practice has been successfully experimented by other countries, to the advantage of users. So, it would be possible to avoid the irrational mechanisms of levying and redistributing the same resources. These ways of implementing fiscal federalism do not increase the overall tax burden, instead they reduce bureaucracy and promote economic and social development.

1.4 Taxes to be decentralised: the case of Friuli-Venezia Giulia

When analysing and assessing any local public administration, in addition to the public functions performed by such administration and its level of taxation autonomy, one should always consider the **form in which tax revenue is collected and the efficiency of the collection mechanism**. In other words, determining which taxes falls within the competence of a given unit of public administration is not enough, one should also consider how (and most importantly when) such revenue actually flows into that unit's coffers. This is no marginal issue: in the recent past, because of the well know problems with the apportionment of the VAT share among ordinary statute regions, **financial flows between the central government and the regions were disrupted** and the regions were forced to resort to the financial market to cover the costs of the provision of some public services[6] (with the ensuing inconvenience and costs).

Regional administrations commonly collect the revenue from "own taxes" on the basis of an agreement with Italy's Revenue Agency. As for derived taxes (revenue-sharing arrangements) a distinction must be drawn between ordinary and special statute regions. Ordinary statute regions can receive their share of VAT revenue, which represents the largest part of revenue from devolved taxes, only after such share has been determined by a specific Prime Minister Decree (DPCM). This means that the national VAT revenue, or rather part of it, is allocated to each region according to parameters laid down by legislative decree Dlgs. No. 56/2000. Such parameters should gradually lead to calculate resource requirements on the basis of objective local spending needs, rather than according to past spending levels. By contrast, **special statute regions (so-called autonomous regions) benefit from large shares of tax revenue collected locally according to the rules laid down by their regional statute.** It is worth noting that autonomous regional statutes must be approved by a constitutional law.

Autonomous Region Friuli-Venezia Giulia has recently made a step forward towards the direct collection of tax revenue to which the region is entitled. Friuli-Venezia Giulia has been allocated, among other things, **60% of IRPEF (personal income tax), 45% of IRPEG (corporate income tax), 80% of VAT and 90% of other state taxes**. The Memorandum of Understanding between the Central Government and the Region signed on **6th October 2006** marked the beginning of a path that will lead the regional government to enjoy increasing autonomy in the collection of said state taxes. The Memorandum includes the following main provisions:

1. the Central Government will modify the criteria and mechanisms for **transferring the share of state tax revenues to which the Region is entitled by opting for the direct transfer of such revenues to the Region's coffers**;
2. the Central Government will pay to the Region Friuli-Venezia Giulia **the money (credit) that the Region is owed by the State** for shares of state tax revenue accrued and only partly paid;
3. the revenue-sharing arrangement (for state tax revenue) can be adjusted **to accommodate any major change in the health care system**;

[6] Pending the entry into force of Dlgs. 56/2000, the state contribution to the equalisation mechanism to cover healthcare spending in the years 2002 -2005 has been temporarily assigned to the regions in the form of cash advances, while approximately 11 billion euros were "set aside" for the 2002-2004 period (Corte dei Conti, "Relazione sulla gestione finanziaria delle Regioni. Esercizi 2004-2005", decision n. 14/2006, p. 85).

4. solely for **IRPEF taxes withheld from pension payments**, the place of collection shall be the place of residence of the pension drawer, regardless of the physical place of collection.

The provisions of the Memorandum of Understanding acquired legal value by means of legislative decree **Dlgs. No. 137 of 31 July 2007** enacted by ministerial decree **DM of 17 October 2008**. Pursuant to article 1 of Dlgs. No. 137, the state tax revenue is handled differently according to the form of payment. If taxes are paid through the "F24 payment form" the revenue flows into the relevant central government's account and after accomplishing specific procedures the central government pays those sums back into the regional treasury's account. Instead, revenue collected through other mechanisms – other that the F24 payment form – is paid directly into the regional accounts, thereby skipping the handling by the central offices altogether[7]. In addition, the decision was made to collect regional taxes locally and firm Equitalia Friuli-Venezia Giulia Spa was established for such purpose.

The benefits for the Region are remarkable and stem from the immediate availability of a large share of the state tax revenues to which the regional government is entitled. It is worth noting that in autonomous regions, derived taxes (that is taxes to which the new legislation passed for Friuli-Venezia Giulia applies) account for 70-80 percent of total tax revenue, and are therefore a "cornerstone" of the regional budget. **Under the current circumstances, the "Friulian system" is not applicable to ordinary statute regions,** since in the latter the amount of shared revenue is not determined permanently in advance; instead it is negotiated from time to time between the state and the regions in compliance with the equalisation objectives of legislative decree Dlgs. No. 56/2000 and with the need to cover the costs of the regional health service.

One should note, however, that the special statute regions already benefit from a tax system that allows them to collect tax revenue in a better way and in a larger proportion than ordinary regions, with advantages for the management of their entire budget. Let us compare, in this connection, two special statute regions (Friuli-Venezia Giulia and the Province of Trento) and two ordinary statute regions (the Veneto and Emilia Romagna). As stated earlier, special statute regions have much more tax revenue available than ordinary statute regions (by reason of their larger spending competencies); in addition they benefit from a tax system that enables them to withhold a large amount of state tax revenue. As a result (Table 1.1 and Graph 1.1), the **tax revenue of special statute regions is predominantly fed by revenue-sharing arrangements, that is by taxes devolved by a different government level (the State).** In specific, devolved taxes account for 74% of Friuli's total tax revenue (the remaining 26% is represented by the region's own taxes). In Trento instead 84.5% of total tax revenue originates from revenue – sharing arrangements and shares of state taxes (the province's own taxes account only for 15.5% of the total). In ordinary statute regions the baseline is totally different: in the Veneto and in Emilia Romagna devolved taxes account for 43.9 and 43.7 percent respectively of the Title I taxes, while the regions' own taxes exceed 50 percent.

This situation has repercussion also on the management of regional taxes: Friuli Venezia Giulia is able to collect 63 percent of tax revenue within the financial year according to the accrual principle and Trentino performs even better in that respect, collecting 82.1 percent of taxes within said period. By contrast, the long time required for allocating the share of VAT revenue to which

[7] See *Il Sole-24 ore* of 30 August 2007.

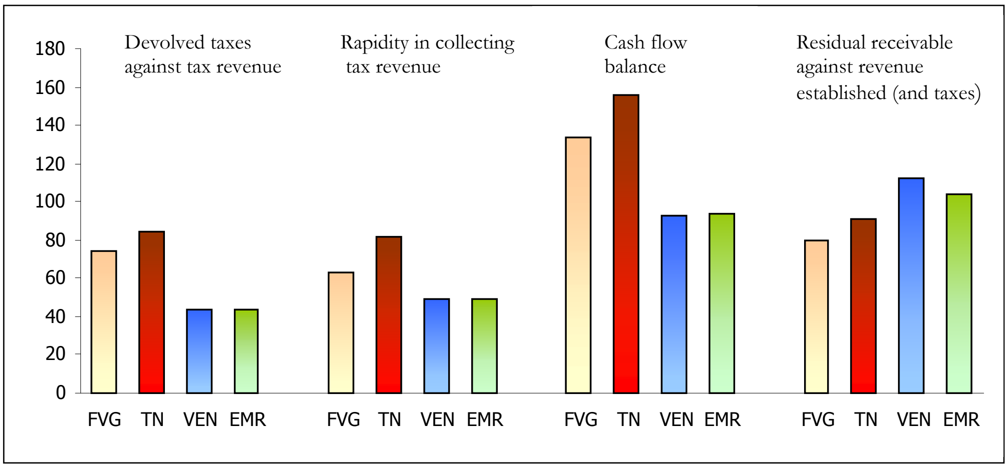
regions are entitled prevents ordinary statute regions from having a considerable amount of tax revenue available quickly: the Veneto is able to collect only 48.8 of the tax revenue to which it is entitled (i.e. established for the current financial year) and Emilia Romagna performs similarly (49.1%).

The outcome of these two diverse systems is a **larger amount of cash for special statute regions**. Looking at the cash flows, one sees that the amounts collected by Friuli-Venezia Giulia exceed expenditures by 33.4 percent, while Trento has a 56.3 percent surplus. In the Veneto instead current revenue collected covers only 92.8 percent of current expenditures paid, and Emilia Romagna follows suit (93.9%).

Table 1.1 – *Management of resources in some regions. Percentage values (average 2005-2007)*

Devolved taxes against tax revenue	
Friuli-Venezia Giulia	74.0
Aut. Prov. Trento	84.5
Veneto	43.9
Emilia Romagna	43.7
Rapidity in collecting tax revenue	
Friuli-Venezia Giulia	63.0
Aut. Prov. Trento	82.1
Veneto	48.8
Emilia Romagna	49.1
Cash flow balance	
Friuli-Venezia Giulia	133.4
Aut. Prov. Trento	156.3
Veneto	92.8
Emilia Romagna	93.9
Final residual tax receivable against amounts established (and taxes)	
Friuli-Venezia Giulia	80.2
Aut. Prov. Trento	91.1
Veneto	112.1
Emilia Romagna	103.9

Source: Processed by Centro Studi Sintesi on data provided by the Italian Court of Auditors and regional financial statements



Graph 1.1 – *Management of resources in some regions. Percentage values (average 2005-2007)*

Source: Processed by Centro Studi Sintesi on data provided by the Italian Court of Auditors and regional financial statements

All revenue established which fails to be collected transforms into residual tax receivables, which accrue over the years if the administration is incapable of collecting such taxes. **Residual tax receivables are higher in ordinary statute regions**. In the Veneto uncollected taxes amount to 112.1 percent of taxes determined, whereas the figure is close to 104 percent in Emilia Romagna. Instead the average amount of residual tax receivables against tax revenue is only 91.1 percent in Trentino and 80.2 percent in Friuli-Venezia Giulia.

To address this, **the law implementing fiscal federalism contains provisions concerning instruments and mechanisms for tax assessment and collection that ensure efficient forms of direct crediting or else automatic transfer of the collected revenue to the bodies who are entitled to that tax** (articles. 2, letter u). **It is to be hoped that the implementing decrees will be able to quickly grant collection autonomy to local government bodies, in addition to revenue autonomy.**

1.5 Some considerations

The approval of the act on fiscal federalism marks the beginning of a new age when more appropriate and effective solutions will be found to solve Italy's chronic economic and social problems. Representatives elected during the recent administrative elections will have to face up to the new situation and help manage public accounts more proficiently, so as to eliminate pockets of inefficiencies that are particularly evident in some areas of the country.

Fiscal federalism means accountability. The reform foresees mechanisms to reward those public bodies that deliver high quality services while having a tax burden lower than the average when compared with other similar bodies of the same level of government, all other delivered services being equal. By contrast, sanction mechanisms are foreseen for less virtuous government bodies, which will not be allowed to hire new employees and spend money for discretionary activities. At the same time, the latter bodies will have to balance their budget, resorting also to the alienation of property and real estate and the use of their tax autonomy to impose higher tax rates, if need be.

Moreover, **automatic sanction mechanisms are foreseen for government and administrative bodies which fail to keep their balance sheets healthy and do not respect the economic-financial objectives** assigned to the region and local authorities; administrators who caused local bodies to be in financial difficulties will not be eligible for election again. It is to be hoped that such rewarding and sanction mechanisms, coupled with tighter controls and other measures contained in the recently approved law, will be sufficient to bring about a more balanced and efficient public structure and will be successful in eliminating extravagant expenditure and squandering, which in the past decades have been the canker in regional and local accounts.

Moreover, in the light of the above, comparing special and ordinary statute regions is all the more interesting in the context of fiscal federalism.

Fiscal federalism means autonomy. Ordinary and special statute regions differ remarkably in terms of tax systems and ways of collecting resources, with ensuing gross imbalances. According to the provisions contained in their statute, special statute regions can withhold as much as 90 percent of a variety of state taxes, whereas ordinary statute regions are entitled solely to a share of the value added tax and some other minor taxes; such VAT share was 46.1 percent in 2007. In fact, every year the Veneto and the other ordinary statute regions "negotiate" the share of state taxes they are owed; every year the decision is made by the State and the Conference of the Regions on the basis of parameters contained in legislative decree Dlgs. No. 56/2000. Special statute regions, instead, can count – with adequate certainty – on a set amount of resources, since their special statutes, which are adopted by means of a constitutional act (Constitutional Act No. 5 of 28 February 1948 for Friuli Venezia Giulia), rank higher than ordinary law and, as a result, can be modified only through the procedure of art. 138 of the Constitution.

In addition to being entitled to withheld more state taxes, special statute regions can collect a large part of such taxes directly, without any mediation by the State. **This is the case of Friuli-Venezia Giulia which, thanks to a recent agreement with the central government, will be able to have a large part of state taxes owed to it readily available** (namely 74% of tax revenue). Needless to say that such option is not viable for the Veneto or the other ordinary statute regions. Following Friuli's example, to give the Veneto more autonomy and cash resources, **one could set up "Equitalia Veneto"**, whose tasks would include the collection of the region's own taxes and – at least – an advance on the state taxes (VAT first and foremost) that will be later transferred to the region in the framework of the revenue-sharing arrangement. The same model could be applied to the other ordinary statute regions.

Fiscal federalism means solidarity. The new law calls on special statute regions to actively pursue equalisation and solidarity objectives and carry out the rights and duties that stem from such objectives, while respecting the provisions of their special statutes. The implementing regulations will have to take into account the functions actually performed by the regions, the burdens they have to carry, the permanent structural disadvantages, if any, and the per capita income. This means that, to comply with the equalisation and solidarity requirement, part of the tax revenue coming from the "rich" regions will have to be transferred to "poor" regions and the latter might include special statute regions. To see how that will translate into practice, we will have to wait for the delegated decrees, which within two years of the approval of the enabling act – presumably in the autumn of 2011 – will have to specify the actual operation criteria and the facts and figures at stake. They will also have to define the standard costs of regional services, so that equalisation flows can finance efficient expenditure rather than squandering – the latter being a common aspect in the practice of establishing a budget according to past spending levels.

For the "rich" special statute regions in Northern Italy the Act provides for an alternative: rather than transferring resources out of the regional borders, they can take part in interregional solidarity and contribute to the state budget by performing new functions that had been previously carried out by the State. Again in this case one will have to wait until the entry into force of the delegated decrees. Assuming that more functions are devolved to a given region, the latter will have to transfer part of its revenue in the name of equalisation, but there will a cap on such transfer and once that threshold has been exceeded, the region will be entitled to additional funding, through forms of revenue-sharing applied to state taxes and excise duties, without prejudice for constitutional laws in force. Of course it not yet possible to identify which the new functions could be, nor to determine what a region should give and what it should receive or the mechanisms for giving and receiving resources.

Moreover, as stated earlier, another fundamental objective of fiscal federalism is the gradual alleviation of the fiscal burden. That will be one of the main tasks of implementing decrees, which will have to design mechanisms to revise the maximum fiscal burden at regular intervals and determine how it should be shared among government levels. The fiercer the fight against squandering and tax evasion, the easier it will be to reach the objective of fiscal federalism.

2. Fiscal Federalism and advantageous taxation*

2.1 Federalism and advantageous taxation in Europe

Fiscal Federalism, advantageous taxation and State aids are elements strictly connected one to each other. This connection is the result of the decision handed down in case No. C-88/03 - **Portugal versus the European Commission - where the European Court of Justice explicitly acknowledges the compatibility of the fiscal concession measures adopted by internal regional institutions with EU law.**

In Europe, so far, the need to establish regional form of tax concessions has been sacrificed to an excessively rigid interpretation of the EU's prohibition of state assistance, particularly as regards the methods for establishing "territorial selectivity". This circumstance, with a few specific exceptions, up to now, has essentially deprived European States of any possibilities of adequately addressing the issue of fiscal competition. This is true not only if we consider competitors outside the EU, but also regarding the New Member State (as we know, many of these, mostly in Eastern Europe, are characterized by low level of fiscal capacity).

More specifically, the Commission's highly restrictive approach to this issue has complicated the attempts of larger states to defend themselves from fiscal competition coming from smaller States. In few years, just to give an example, Ireland managed to halve its overall fiscal pressure by lowering its tax rates on companies. The result has been a significant increase of competitiveness of the Irish system and a better ability to stimulate investment, above all from abroad. Up to a few years ago a similar fiscal policy in one of the Italian Region would not have been possible because of the restrictive approach of the Commission. And yet Lombardy's GDP is four times greater than Ireland's (over 250 billion Euro compared to 60 billion). However, just because Lombardy happens to be a Region within a State, in the eyes of Commission such attempt would have raised the issue of "selectivity". The tax regime of Lombardy would have been interpreted as an exemption from the generally applicable national taxation system.

This was clearly **an anachronistic approach**, **hardly in line with both the principle of subsidiarity and the emerging trend towards federalism that has characterized many European States in recent years**.

In more recent times, however, the possibility of a totally new direction has emerged: in fact the Commission and the European Parliament have recently approved a draft reform of the current Community Regulations regarding State assistance. This draft figures the introduction of some form of tax concessions for the most backward Regions.

More specifically , **the so-called "Hokmark Report" states that there is a need for a "more effective approach to the regional aid's granting, which should concentrate on investments in infrastructure and on horizontal assistance to the disadvantaged or less developed Regions of the European**

* This Chapter was drawn up by the Centro Studi of Unioncamere del Veneto.

Union, including the introduction of tax concessions" albeit only "for a transitional period not exceeding 5 years".

This is undoubtedly a significant opening to a more balanced vision of the problem.

This opening should be considered in conjunction with the recent decision handed down in case No. C-88/03 (Portugal versus the European Commission).

In this decision, the European Court of Justice explicitly acknowledged the compatibility of the fiscal concession measures adopted by internal regional institutions with EU law.

This decision is very important as emends the excessively restrictive approach adopted by the Commission so far. Up to now the "asymmetrical" measures, in other words those measures targeted only to certain regions, were tolerated as exceptions from the general prohibition against State Assistance (art. 87 ECT) and to be approved by the Commission itself (and within very restrictive time and "quantitative" limitations).

Therefore it is necessary to proceed to close examination of the Court of Justice's statement on the célèbre cause C-88/03, Portugal versus Commission.

2.2 The ECJ Azores sentence

With the 6th September 2006 sentence[8], the EU Court of Justice rejected the appeal proposed by Portugal Republic against a Commission's[9] decision regarding the normative rules containing the fiscal concession measures adopted by the autonomous region of Azores. In particular the Commission objected to the tax concessions in the decree num. 2/99/A in favour of the legal person resident in the Azores[10] saying that those grants should be qualified as State aid considering the exiting 3 requirements; public resources, incidence of commerce among the Member States and above all the territorial selectivity.

Thereby the Commission states that the acceptance of those measures should have been classified as exceptions from the general prohibition against State Assistance (art. 87 ECT).

On the contrary the Portugal authority claimed that the fiscal system adopted by the Azores aimed to "allow the companies of that Region to ride over the disadvantages of being in an insular region"[11].

In spite of the Portugal claim rejection, the European court of justice explicitly acknowledged the compatibility of the fiscal concession measures adopted by internal territorial authorities other than the State are fully in line with EU law.

As already mentioned, it is an important decision as **it adjusts the excessively restrictive stance taken until now by the Commission,** whereby the so-called "asymmetrical" measures, i.e. those applicable only in the territory of some regions, were tolerated just as an exception from the general prohibition of

[8] 6th September 2006 Sentence (C-88/03) available on the website www.eur-lex.europa.eu.

[9] 11th December 2002 Decision 2003/442/CE, available on the website www.eur-lex.europa.eu.

[10] 30th December 1999 Regional Decree num. 33/99/A.

[11] Paragraph 14 of the 6th September 2006 Sentence C-88/03.

State aid (laid down in art. 87 of TCE) and granted from time to time by the Commission itself within very restrictive limits of time and "quantity".

In other words **the interpretation of the territorial selectivity requirement related to the State aid discipline prevented from any other transitory differentiation of the fiscal matter.**

Therefore the Court of Justice did not follow the Commission's traditional interpretation and embraced the new innovative position put forward by the Advocate general Geelhoed whereby the fiscal measures adopted by Regional Bodies, providing a fiscal advantage, are "non selective" as long as they are endorsed "within the scope of powers that are sufficiently autonomous vis-à-vis the central state"[12].

In particular, when "a regional or territorial institution, in its autonomous power, settles a fiscal concession lower than the national one (..) within the territory of its competence (..) the relevant legal context regarding the selectivity evaluation might be only based on the geographical area interested to the fiscal measure whereby the territorial body, as per its Statute and power, plays the decisive rule in the definition of the politic and economic context as far as companies are concerned"[13].

In details, "in order to make effective a decision in the exercise of autonomous power, it is necessary (…) **that such decision was taken by a regional or territorial authority with a valid politic and administrative statute, different from the Central Government's one.**

Besides, **the below mentioned decision must have been taken excluding any direct intervention by the Central Government regarding its content.**

At the end, **the economic consequences of a tax reduction to the regional entrepreneurs had not to be compensated by funding of contribution from other regions or Central Government[14].**

In other words, the meaning of "political and fiscal autonomy (..) assumes (…) that the infra-state body not only is capable of taking decision concerning the reduction of tax measures in its territory regardless the central State policy, but it is also capable of taking charge of the political and economical consequences of such measure[15].

According to the Court of Justice, if all these conditions exist, the criteria of territorial selectivity is to be ruled out and consequently the discipline of the State aid too.

And hence, the freedom of introducing a sub-state level of fiscal advantages (in case also with different asymmetrical ad territorial conditions).

In the reasons of this sentence, it is the Court itself to offer the instruments to evaluate the requirement of "sufficient autonomy"[16].

More specifically the measures must be decided by bodies that have a three-fold autonomy:

a) **institutional autonomy**: i.e. the measures are adopted by a "regional or territorial authority, the political and administrative regulations of which are constitutionally granted and independent from those of the Central Government";

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[12] Paragraph 62 of the above mentioned Sentence.
[13] Paragraph 66 of the above mentioned Sentence.
[14] Paragraph 67 of the above mentioned Sentence.
[15] Paragraph 68 of the above mentioned Sentence.
[16] Paragraph 67 of the above mentioned Sentence and also mentioned in the Newspaper of Financial Regulation and Public Finance (pg.123) of Antonini L. and Barbero M. (2006) "Dalla CGCE un'importante apertura verso la fiscalità di vantaggio a favore delle imprese".

b) **decisional autonomy**: the measures must be adopted excluding any direct intervention by the Central Government" as to its contents;

c) **financial autonomy**: the measures may not be compensated by subsidies or taxes raised in regions or by the Central Government".

Compliance with the above requirements, says the European Court of Justice, proves the absence of territorial selectivity requirement and consequently rules out the application of any regulations on State aid.

The basic principle is to prevent the bodies from adopting this advantageous measures under the politic preassure of the central government Authority.

In order to avoid the measure being considered as State aid, it is therefore reasonable to let the sub-Statal administrators adopting the above mentioned measures and to let the respective burden being compensated by a resource transfers from the central Government.

Under this point of view the taxation reduction would be not only a merely effort of the financial body, but a double exchange from a body to another.

In the Azores Islands' case, the third requirement is lacking, as per the constitution of the National principle of solidarity: "it follows that the 2 profiles of the regional government fiscal policy, i.e. on a hand the decision to decrease the regional fiscal pressure thanks to the power of reducing taxation… and on the other hand the mission of carrying out the problems arising from insularity, are strictly connected and depend, from a financial point of view, from the central government financial account transfers".

2.3 The ECJ Basque Country case sentence

The above mentioned tendency has been taken into a wide consideration in the recent causes C 428/06 a C 434/06.

The Court has been called to comment upon (preliminary ruling[17] proposed by the "Tribunal Superior de Justicia de la Comunidad Autónoma del País Vasco" - Spain) some issues about fiscal measures adopted by Historical Territories of Vizcaya, Forales Diputaciónes de Álava, of Vizcaya and Guipúzcoa, which are the appropriate Authorities of all Territories with special Statute named "Historical Territories of Vizcaya, Álava and Guipúzcoa ("foral authorities").

In this case the Bruxells Court examined some measures adopted by the 3 foral authorities of the Basque Country[18].

In the adopted measures it was expected a sort of taxation for the local companies (32.5%) lower than the one applied in Spain (35%) together with other special measures regarding the fiscal treatment of some investments which not comply with the general Spanish law.

The Spanish Judge, called to evaluate the legitimacy of these measures, asked for an indictment to the Court of Justice to clarify if those ones could have been classified as "selective measures" and therefore State aids needing a specific authorization to the Commission before their application. (art. 88, co. 3, CE).

There is in fact a connection between the 2 matters – advantageous taxation and State aids; whereby a tax burden for the public finances exists, the notion of State aid must be comprehensive of fiscal measures (several types; non repayable grant, reduction, to tax exemption…).

Under this point of view some fiscal[19] measures can be included in the State aid ban, in order to protect the free business competition (Art. 87 CE).

As per this disposition, in order to be included in the State aid, the measures need to have all the necessary requirements of "selectivity" and "incidence on the commerce among Member States". If this latter is clearly defined, the "selectivity" requirement can be instead difficult to be interpreted as it is in the middle of State aid and the so-called "general measures".

In the above mentioned sentence, on preliminary examination, the Court stated that: "it is both to the Historical Territories and to the Autonomous Community of the Basque Country that reference must be made in order to determine whether their infra-State body enjoy sufficient autonomy to constitute

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[17] Information note on references from national courts for a preliminary ruling, Ufficial Journal of the European Union, June 11th , 2005
1. "the preliminary ruling system is a fundamental mechanism of European Union law aimed at enabling national courts to ensure uniform interpretation and application of that law in all the Member States".
5. "under the preliminary ruling procedure, the Court's role is to give an interpretation of Community law or to rule on its validity, not only to apply that law to the factual situation underlying the main proceedings, which is the task of the national court. It is not for the Court to decide issues of fact raised in the main proceedings or to resolve differences of opinion on the interpretation or application of rules of national law".
11. "any court or tribunals may refer a question to the Court on the interpretation of a rule of Community law if it considers it necessary to do so in order to resolve a dispute brought before it".

[18] At the paragraph 66 of the 11th September 2008 Sentence, the Court states that "The Autonomous Community of the Basque Country is made up of the three provinces: Alava, Vizcaya and Guipùzcoa. The boundaries of those provinces coincide with those of the Historical Territories, bodies which enjoy rights of ancient origin called "fueros", entitling them to levy and collect tax. However, many other areas of competence, in particular those of an economic nature, are exercized by the Autonomous Community"

[19] It's not an absolute prohibition. The EC Treaty found that some measures can comply with the common market ((art. 87, co. 2, CE). and some others that need the Commission approval to be considered such measures (art. 87, co. 3). It falls into this latter category for example, the "aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest"(art. 87, co. 3, lett.c).

the reference framework regarding the "selectivity" criteria to evaluate a measure adopted by one of those Historical Territories".

In second instance, the Court stated that the Court's responsibility is that of the Referral Judge (rectius, Tribunal Superior de Justicia de la Comunidad Autónoma del País Vasco), the only one having jurisdiction to identify the National law applicable and to interpret it, as well as to apply Community Law to the cases before him, to determine whether the Historical Territories and the Autonomous Community of Basque Country have such autonomy. In this case the laws adopted within the limit of the areas of competence granted to those infra-State bodies would have no selective nature pursuant to and in accordance with the EC art. 81 which prohibit the State aid.

Moreover the Court declared that, for the purpose of assessing if the measures taken by an infra-State body are "selective" State aids, it is necessary to verify if this body has a sufficient "institutional, procedural and economic[20] autonomy", such of being considered of general application within the infra-state body and with no selective criteria[21].

The Court underlined that the verification may be carried out only after prior review in order to ensure that the Historical Territories and the Autonomous Community of the Basque Country respect the limits of their areas of competence since the rules on, in particolar financial transfer, have been drawn up on the basis of those areas of competence.

The examined sentence within the "spanish area" offers important clarification about procedural, economic and financial autonomy. From an examination of the ECJ, it is apparent that infra-State bodies such as Historical Territories and the Autonomous Community of the Basque Country satisfy the institutional autonomous criteria since they have a political and administrative status which is distinct from the central government's one[22].

As far as the autonomous procedure is concerned, the Court reminds that an infra-State authority decision must have been taken without the Central Government being able directly to intervene as regards its content[23].

The Court offers some clarifications about it. On a hand it declares that such procedural autonomy does not preclude a conciliation procedure in order to avoid conflicts, as in the Spanish law, as long as the final decision is adopted by the infra-State body and not by the central Government[24]. On the other hand, the central Spanish government seems not to be able to directly intervene in the process of adopting a foral laws in order to ensure compliance with principles such as the solidarity and fiscal harmonisation. These principles instead have to be taken into account by the infra-state bodies when they adopt a fiscal taxation measure.

In fact, the infra-State body's obligation to take into consideration the State interest in order to respect the limits of the competence areas does not generally constitute an element calling into question the procedural autonomy[25].

The necessary verifications nevertheless are matter of the National Judge.

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[20] Moreover this statement is a recent change of trending of the Court which has been revealed in the well known 6th September 2006 Sentence, in the controversial issue Portugal vs European Commission, above mentioned. Before this innovative judgement the Court has always considered the aids as matter of the State and qualified the "selective measures" – therefore subjected to the State aid regulations – as measures not applicable in the whole territory even if issued by the territorial bodies.

[21] Paragraph 76 of the above mentioned Sentence.

[22] Paragraph 87 of the above mentioned Sentence.

[23] Paragraph 95 of the above mentioned Sentence.

[24] Paragraph 96 of the above mentioned Sentence.

[25] Paragraph 108 of the above mentioned Sentence.

As far as the economic and financial autonomy criteria is concerned, it is assumed that the economic consequences of a national tax rate's reduction won't be compensated by aids from other regions or the central government[26].

So far, the Court realized that an "attribution rate" is fundamental in the calculation of the necessary quota to cover the amount of the burdens undertaken by the State concerning the areas of competence which are not undertaken by the Autonomous Community. Although this quota has to reflect the relative weight of the Basque economy within the whole Kingdom of Spain, it is however set during what are essentially political negotiations. Consequently, a decision to reduce the tax rate does not necessarily have an impact on the level of that rate. As observed by Bruxelles Judges, an undervaluation of the attribution rate could be a mere indicator that the Historical Territories lack economic autonomy. In fact, in order to certify this lack, there must be a compensation, namely a causal relationship between a tax measure adopted by the foral authorities and the amounts undertaken by the Spanish State.

In any case, it is for the National Court to determine whether that process of setting the rate has the aim of allowing the central government to compensate the cost of a subsidy in favour of the Historical Territories enterprises.

Likewise it is for that Court to examine the effects of that process and verify whether, because of the methodology adopted and the economic data taken into account, the setting of the attribution rate and, more generally the calculation of the quota may have the effect of causing the Spanish State to compensate the consequences of a tax measure adopted by the foral authorities.

However the Court has not ruled out that a tax reduction adopted by the infra-State body could lead to a favourable financial transfer.

It is for the National Judge to evaluate if these foral rules adopted by the Historical Territories may result as hidden compensation in sectors such as the security, or the guarantee of minimum public services by the Spanish State or in the functioning of the Inter-territorial Compensation Found.

In the light of all of the foregoing, the answer to the question referred must be that Art. 87 (1) EC is to be interpreted as; **to evaluate whether a measure is selective, account is to be taken of the institutional, procedural and economic autonomy enjoyed by the authority adopting that measure. It is for the national Court, which alone has the jurisdiction to identify the national law applicable and to interpret it, as well as to apply Community law to the case before it, to determine whether the Historical Territories and the Autonomous Community of the Basque Country have such autonomy.** If so, the final result is that the laws adopted within the limits of the areas of competence granted to those infra-State bodies by the Constitution and the other provisions of Spanish law, are not of a selective nature within the meaning of the concept of State aid as referred to in Art. 87 (1) EC.

[26] Paragraph 123 of the above mentioned Sentence.

2.4 An hypothesis of application: Chamber of Commerce case

The ECJ sentence of Baque Country, together with the well-known Azores case, offers interesting points for analysis, not only because it clarifies the essential requirements necessary to identify the so-called "regional selective measures" (that are subject to the regulation on State Aid), but also because it suggests useful solutions for Italy. These are points to be taken into account, as the advantageous taxation has recently became an emerging trend towards the recent bill of law on fiscal federalism (especially when applied to Southern regions) by the Italian Parliament.

As a matter of facts, a real regional/local financial autonomy is the essential condition set by the European Court of Justice for any regional/local advantageous taxation measures to be legitimated. And it is in fact regarding this main issue that the Portugal's Appeal has been rejected.

In particular, it is necessary to demonstrate there is no direct link between the tax revenue reduction policy adopted by the local/regional institution and the central Government budget. More specifically, the tax revenue reduction adopted by a sub-State body can not be compensated by any transfer of funds (or any other form of direct financial support) from the State.

In this case new fiscal policy measures can be introduced and legitimated within the advantageous taxation arrangements on regional level; just to give an example, the chance to introduce regional laws regarding the abolition of taxes on productive investments and reducing bureaucracy as far as incentives to the companies are concerned.

Or, as already happened in other counties, the regional fiscal taxation could encourage many non-profit organisations to take part into the public and social utility sectors and to possibly provide solutions both for market and government failures. In this way, we would avoid the illogical mechanism of "withdrawal and redistribution" of resources.

These are forms of fiscal federalism implementation which not increase the overall tax pressure and, at the same time, reduce the level of bureaucracy and encourage economic and social development.

Similarly, **another hypothesis of advantageous regional taxation could be related to the Italian Chambers of Commerce**. But beforehand it is necessary to verify if Chambers of Commerce are able to enjoy fiscal federalism example.

Such verification is important to understand whether Italian Chambers of Commerce can apply the so-called advantageous taxation. If so - within the limits provided by the amount of taxes paid by enterprises (*diritto camerale*) to the Chambers of Commerce - they could provide contributions, exemptions or (more generally) financial aid at provincial level, without being a State Aid (see. Art. 83 EU Treaty) on condition that there is no selectivity within the Chamber of Commerce province.

As regards, answers can be provided in relation to the three ECJ requirements:

1. institutional autonomy: **Italian Law defines the Chambers of Commerce as "functionally autonomous"**. Furthermore, they have their own statute that, as approved by the Ministry, provides a high level of autonomy;
2. procedural/decisional autonomy: **Chambers of Commerce collect tributes paid at provincial level by enterprises**;
3. economic/financial autonomy: except for the Chambers with low power which receive contributions from the Equalizing fund financed by the more

powerful Chamber of Commerce, **the financial autonomy is guaranteed as the Chambers of Commerce don't receive derivative finance or contributions or compensations by external entities**.

The tribute paid by enterprises to the Chambers of Commerce (i.e. *diritto camerale*) is however based on a National law that defines the range within each Chamber decides the amount to be paid. Such tribute is characterized by a high level of autonomy and within the framework of an own tax (self-instituted and self-managed tax – i.e. *tribute proprio*) but it is still to verify if the national taxation nullify these advantages.

In the light of autonomy the **Chambers of Commerce are anyway a complete and tangible example of Fiscal federalism** as:

- enterprises pay the so-called "Chamber of Commerce annual tax" (*diritto camerale*) at provincial level;
- there is no transfer of funds from the centre to the periphery (with the exception of those Chambers which are financed by the special fund provided by the most powerful Chambers);
- time and place of payments together with the expenses are managed by each Chamber of Commerce;
- the responsibility of the Chamber of Commerce administrators and officials is therefore to the highest degree as well as the transparency of the expenses.

In the light of autonomy as well, it is hard to imagine, within the same country, a myriad of very different tributes decided for each province by every Chamber of Commerce; it would even contravene the Italian Constitution. It is obvious and necessary that a sort of fiscal coordination has to be introduced by the national law but in our opinion, such coordination does not reduce the procedural autonomy and the own tax feature of the "*diritto camerale*".

Last but not least we have to add that the **European Commission has already recognized the local (and not national) type of aid provided by the Chambers of Commerce to the enterprises.** Some years ago, surely before the ECJ Basque Country sentence, **the DG Competition and DG Agriculture of the EU Commission approved a regime of financial aid for agricultural enterprises provided by the Chambers of Commerce of Veneto and Piedmont**. Such acknowledgment is very important and demonstrates that the Commission has already accepted that there is no selectivity in the aids provided by Provinces and Regions as coming from autonomous resources on provincial level.

We wish that the Chambers of Commerce example, as a perfect functioning and result of a tangible fiscal federalism model together with the benefits deriving from advantageous taxation, could encourage the process of regionalization and fiscal autonomy which is carrying out in our Country with great difficulty.

3. Fiscal residua and corporate taxes*

3.1 An update on fiscal residua in Italian regions

Application of the act on fiscal federalism will have positive effects on the country's economy and will allow "healthy" competition between Italian regions. The standardisation of requirements for regional and local institution expenditures, in fact, will serve the purpose of defining financial targets upon which to base new equalisation systems and may therefore level off disparities in contributions between different regions.

At present only some regions[27] can guarantee availability of funds to cover public spending for the provision of services that fall within their competence. These are the regions which, thanks to higher taxes levied and lower expenses, succeed in sustaining local spending and in feeding the equalisation mechanisms, limiting the size of deficits in other regions. It is therefore essential to rationalise spending and ensure better use of public resources.

Indeed, the current institutional framework and the drainage of resources by Italy's central government appear to be extremely penalising for some areas of the country, since they produce a general situation of uncertainty with respect to resources and missed opportunities for investment in the most virtuous regions. Additionally, the presence of a strongly disproportionate and vertical regional system of redistribution of resources does not help build accountability in local governments and does not encourage independence of local institutions.

The thin state transfers and considerable levying of state taxes force local administrations to increase the local **tax burden** in order to avoid curtailment of public services. In Italy, however, the enhanced local financial autonomy – which results from a greater number of competencies assigned to the regions - has not determined a corresponding decrease in the levying of taxes by the central state. Veneto's tax burden is among the highest in Italy, amounting to 32.9 percent of the regional GDP; the region therefore ranks third in the relevant listing headed up by Lombardy (35.7%) and Emilia Romagna (34.7%). Additionally, the greatest part of available resources on the territorial level are not invested in efficient infrastructures and services; instead they are redistributed to other regions, thereby generating unfair competition between ordinary and special statute regions. Not by chance, Lombardy, Emilia-Romagna and Veneto are the regions that contribute the highest amount of funds for territorial equalisation.

In order to analyse the financial flows between Italian regions and across the different levels of institutional *governance,* we have updated the data on **fiscal residua** of public administrations, which had already been illustrated in previous studies[28]. Fiscal residuum is defined as being equal to the revenue (taxes and other types of revenue) of public administrations in a given territory minus the

* This Chapter was drawn up by the Centro Studi of Unioncamere del Veneto.

27 According to data contained in the *Territorial Public Accounts* (CPT) of the Ministry of Economic Development, the ratio between regional expenditures and revenue is less than 1 only in eight Italian regions (see Table 3.1).

28 Compare Unioncamere del Veneto (2007), Unioncamere del Veneto (2008) work cited previously.

expenditure performed by said administrations in that territory. Using the fiscal residuum criterion one can identify the regions where the public administration (the central government and local institutions) has a financial surplus or deficit.

We have decided to update the data using some methodological expedients[29] in the attempt to improve the indicator's accuracy and overcome some shortcomings of the data bank on *Territorial Public Accounts* (CPT) developed by Italy's Department for Development Policies (Ministry of Economic Development), which is currently used for calculating fiscal residua.

According to the *Territorial Public Accounts,* the average **revenue of public administrations in the Veneto[30] reached almost 63 billion euros** between 2005 and 2007, of which almost 54 billion refer to central administrations and 9 billion refer to local administrations (Regions, Provinces and Municipalities). During the same period, **the expenditure of public administrations in the Veneto[31] grew to 45.5 billion euros,** net of expenditures for interest and financial items, of which 31.2 billion refer to the central level and 14.3 billion refer to local institutions. In terms of per capita revenue, the figure settled in at over 13 thousand euros per capita, while expenditures were 9,521 euros per capita.

On the average, in the Veneto the balance of revenue and expenditures of public administrations amounted to 17.3 billion euros in the three-year period between 2005 and 2007, therefore the region ranks second among Italian regions with a financial surplus, just behind Lombardy (59,532 million) and in front of Emilia Romagna (16,776 million). **In per capita terms, the Veneto recorded a fiscal residuum of 3,626 euros per inhabitant,** which amounts to about half the residuum of Lombardy (6,231 euros) and is slightly less than Emilia Romagna's (3,967 euros). The group of regions that can boast a fiscal surplus also includes Lazio, Piedmont, Tuscany and Marche.[32]. With the exception of Friuli-Venezia Giulia, Trentino Alto Adige and Liguria, which recorded a limited surplus, all of the other regions have a deficit. It is worth stressing that the sum of tax revenue levied in Lombardy, Veneto and Emilia Romagna serves to offset the deficits accumulated by all of the other regions in Southern Italy.

Even in the new version, the updated information confirms the trend already brought out in previous analyses: it is always **the same regions – and only those – which contribute resources to territorial equalisation[33].** Incidentally such mechanism does not seem to have had any positive effect on the economic growth of Southern Italian regions.

According to the 2009 Svimez Report[34], in fact, **since the beginning of the decade Italy's South has grown less than the Centre - North, which is something that had never occurred since the end of the Second World War.** The South has a **GDP per capita** which is 58.6 percent of that in Centre- North. Contrary to what one would logically expect from a system of income

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[29] See Staderini A., Vadalà E. (2009), "*Bilancio pubblico e flussi redistributivi interregionali: ricostruzione e analisi dei residui fiscali nelle regioni italiane*" (The Public Budget and Interregional Redistributive Flows: reconstruction and analysis of fiscal residua in Italian regions) in *Federalismo fiscale,* n. 1/2009.

[30] This item includes revenues net of transfers from the EU and other foreign institutions, alienation of assets and collection of receivables.

[31] Expenditures of public administrations net of interest due, of financial items and lending.

[32] These results are also confirmed by the data processed by Staderini and Vadalà (2009), (work cited previously): Lombardy, Veneto and Emilia Romagna rank first in the listing of regions with the greatest fiscal residuum.

[33] The only significant change is represented by Lazio, which in 2004 joined the group of regions with a financial surplus on the basis of the region's fiscal residuum.

[34] SVIMEZ (2009), *Rapporto 2009 sull'economia del Mezzogiorno (*Report on the Southern Economy*)*, Rome, www.svimez.it

redistribution from the richest areas to the less wealthy areas of the country, **the gap has remained roughly unchanged** instead of diminishing. Additionally, and again according to Svimez, the southern regions produced 23.9 percent of the national GDP in 1951 and that figure has remained almost the same today (23.8%). In short, in spite of growing nearly at the same rate as the Centre- North, in sixty years the South has not succeeded in closing the existing development gap.

Table 3.1 – *Italy. Fiscal residuum of public administrations. Revenue and consolidated expenditures by region. Average 2005-2007*

Region	Millions of euros			Euros per inhabitant***			Ratio Expenditures /Revenue
	Revenue*	Expenditures**	Balance	Revenue	Expenditures	Balance	
Piedmont	60,259	48,661	11,598	13,804	11,147	2,657	0.8
Valle d'Aosta	2,030	2,230	-201	16,248	17,854	-1,605	1.1
Lombardy	156,164	96,633	59,532	16,345	10,114	6,231	0.6
Trentino Alto Adige	14,463	14,055	408	14,526	14,115	410	1.0
Veneto	62,858	45,523	17,336	13,146	9,521	3,626	0.7
Friuli Venezia Giulia	16,896	15,717	1,179	13,914	12,943	971	0.9
Liguria	20,621	20,010	611	12,814	12,434	380	1.0
Emilia Romagna	63,449	46,674	16,776	15,004	11,037	3,967	0.7
Tuscany	48,951	40,308	8,643	13,429	11,058	2,371	0.8
Umbria	10,018	10,198	-179	11,448	11,653	-205	1.0
Marche	18,182	15,524	2,657	11,811	10,085	1,726	0.9
Lazio	82,773	66,349	16,425	15,179	12,167	3,012	0.8
Abruzzo	12,854	12,910	-56	9,790	9,832	-43	1.0
Molise	2,746	3,257	-510	8,565	10,157	-1,592	1.2
Campania	44,688	49,899	-5,211	7,708	8,607	-899	1.1
Apulia	30,405	35,735	-5,330	7,466	8,775	-1,309	1.2
Basilicata	4,563	5,857	-1,293	7,707	9,891	-2,184	1.3
Calabria	14,990	19,682	-4,692	7,482	9,824	-2,342	1.3
Sicily	38,080	49,186	-11,106	7,584	9,796	-2,212	1.3
Sardinia	15,252	18,454	-3,201	9,187	11,115	-1,928	1.2
Ordinary Statute Regions (OSR)	**633,523**	**517,219**	**116,304**	**12,632**	**10,313**	**2,319**	0.8
OSR Northern Italy	363,352	257,501	105,852	14,807	10,493	4,314	0.7
OSR Central Italy	159,924	132,379	27,546	13,891	11,499	2,393	0.8
OSR Southern Italy	110,247	127,340	-17,093	7,819	9,032	-1,212	1.0
Special Statute Regions (SSR)	**86,722**	**99,642**	**-12,920**	**9,618**	**11,051**	**-1,433**	1.1
SSR Northern Italy	33,389	32,002	1,387	14,300	13,706	594	1.0
SSR Southern Italy	53,332	67,640	-14,308	7,982	10,123	-2,141	1.3
Italy	**720,245**	**616,861**	**103,384**	**12,173**	**10,426**	**1,747**	0.9
Centre- North	556,666	421,881	134,785	14,502	10,990	3,511	0.8
South	163,579	194,980	-31,401	7,872	9,383	-1,511	1.2

* Revenues net of transfers from the EU and other foreign institutions, alienation of assets and collection of receivables.
** Expenditures net of interest payable, equity investments, contribution of capital and lending.
*** Reference population as at 31 December (average 2005-2007) (Istat)

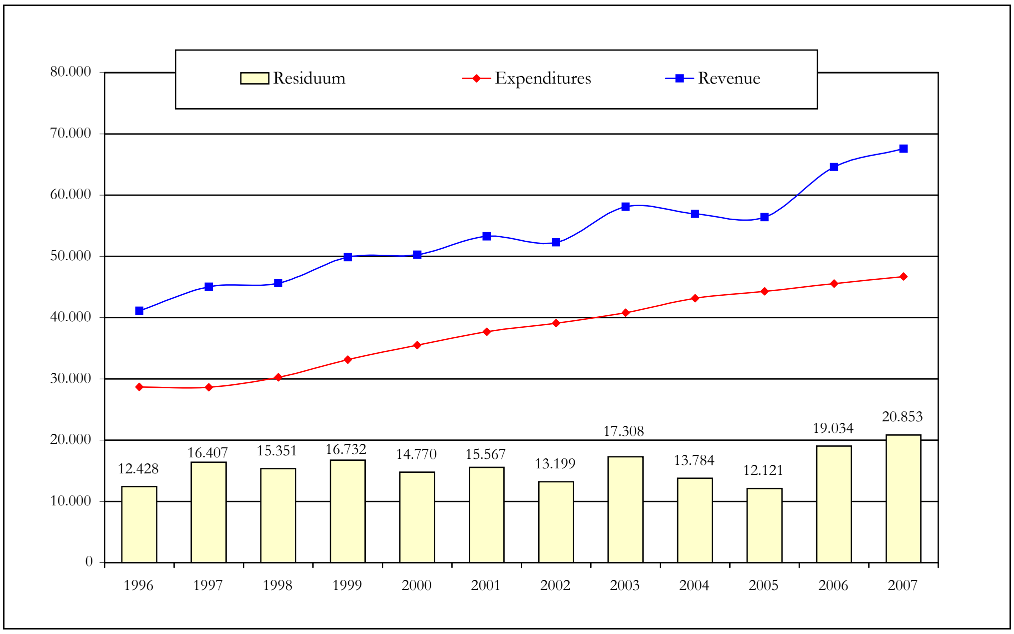
Source: Processed by Unioncamere del Veneto on data provided by the Department for Development Policies

The fiscal surplus recorded in the leading regions of Central Northern Italy is not a temporary or short-term fact: it has been confirmed over the long term as well. Between 2000 and 2007 the per capita fiscal residuum of these regions recorded surpluses that were not only higher than the national average, but also in constant growth. Just consider that at the beginning of the decade, **the Veneto alone contributed almost 127 billion euros to national solidarity, recording**

every year an average fiscal residuum of almost 3,400 euros per inhabitant (see Graph 3.1).

According to the most recent data available, in 2007 the Veneto recorded a fiscal residuum of 20.9 billion euros, or 4,315 euros per inhabitant, reaching the top positions in the list of regions with a financial surplus per capita, together with Lombardy (7,771 euros) and Emilia Romagna (4,478 euros).

Graph 3.1 – *Veneto. Fiscal residuum of public administrations. Distribution of revenue and consolidated spending. Millions of euros. Years 1996-2007*



Source: Processed by Unioncamere del Veneto on data provided by the Department for Development Policies

Obviously the persistence of these financial imbalances is bound to generate distortions in the local economies. For the more dynamic regions of Central-Northern Italy with greater fiscal capacity, like the Veneto, **the increase in fiscal residuum has** two main consequences: on one hand, it is causing a **progressive economic decline in the South,** on the other it is translating into a **progressive loss of competitiveness and consequent slowing of the economy,** both in the national context and on the European level.

A comparison between the 2000 - 2007 per capita GDP trends of Italy's two macro-areas and those of the weakest EU27 countries reveals a desolate picture. Since the beginning of the decade Central –Northern Italy has grown at an average annual rate of 1.6 percent, going from 2nd to 7th place in the relevant listing of European countries, led as always by Luxemburg. During the same period, Italy's southern regions, which are characterised by systematically negative fiscal balances, recorded no significant variations in the level of economic development: the GDP per capita of the area grew at an annual rate of 2.0 percent, less than half the growth of Spain (4.9%) and a little more than a third of the growth rate of Ireland (5.5%) and less than a third of the growth rate of Greece (6.2%)[35].

35 Please note that in terms of GDP per inhabitant, in the period taken into consideration Spain greatly surpassed the EU27 average (104.7%), especially thanks to the remarkable growth of its weakest areas. Greece is close to the average level (98.6%) and, among the new Member States, Slovakia has reached the level of development of Southern Italy (68.7%).

As pointed out by the Svimez Report, in parallel to the gap between Italy's North and South, also **the distance between Italy's South and Europe has grown, especially as a result of poor competitiveness.** If we consider the period between 2000 and 2005, which saw the progressive enlargement of the Union to lower income countries, the areas included in the "Convergence" objective grew at a rate of 4.8 percent per year on the average, thanks to the performance of the weaker regions of Germany (+3%), of Greece (+4.9%) and especially of Spain (+6.5%). In Italy, instead, the per capita GDP of the "convergence regions" grew by 1.5 percent, which was even less than the 1.7 percent recorded by the regions under the "Competitiveness and Occupation" objective[36].

These figures bring to light that in **Italy's low-growth economy, in spite of receiving considerable national financial resources (vertical equalisation) and EU funds (cohesion policies), the weaker areas have not been able to catch up growth and fill the gap**, unlike other less economically developed areas abroad.

In the Veneto, the social and economic system that enterprises and citizens work in is fraught with a greater number of risks because of the high level of fiscal residuum and fiscal pressure: the complex tax system, unclear laws, complex administrative procedures and lack of clarity on the amount of taxes that taxpayers have to pay to the State are just a few of the factors that hinder economic development in the regions.

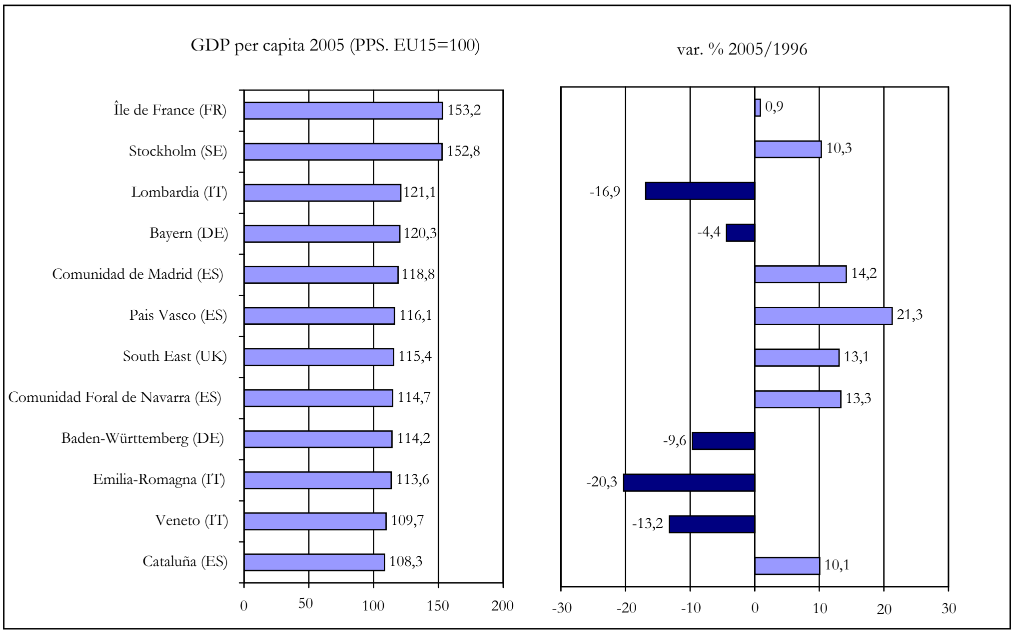
This situation makes life increasingly difficult for enterprises. The fiscal residuum grows, but it is used only to cover current expenditure and excess of welfarism, thus failing to foster the national economic growth or the development of the poorest regions.

From a national perspective, the greater fiscal residuum of the more virtuous regions (the Veneto, Lombardy and Emilia Romagna) does not help the most disadvantaged regions and seriously threatens their competitiveness at European level. Recent studies have shown that failure to reduce the fiscal residuum could have depressing effects on regional economies, especially in Italy, where the Veneto, for instance, could undergo a progressive economic decline. Data allow us to demonstrate that the Italian regions with the highest positive fiscal residuum (as a percentage of their regional GDP) have recorded the sharpest economic slowdown in Europe in the last decade.

Undoubtedly, if it were left in the region, this financial surplus would permit greater flexibility in expenditure and in the provision of essential services (such as health care), as well as greater investments, especially in strategic sectors for the competitiveness of the local economy, such as infrastructures, energy and R&D. **The data therefore corroborate the belief that, unlike the "horizontal" system of equalisation, the vertical system based on the "historical cost" principle is ineffective.** In fact, the German system of equalisation, based on a horizontal type of logic, facilitates verification of the financial flows between "donating" and "receiving" regions, inasmuch as it favours greater transparency and consistency in the utilisation of funds, while at the same time guaranteeing more accurate control.

[36] According to the new EU cohesion policy 2007-2013, the Italian regions eligible for the "Convergence" objective are Calabria, Campania, Apulia and Sicily. Basilicata was granted the transitory regime of the "Convergence" objective *(phasing out),* while Sardinia was admitted to the transitory support of the "Competitiveness and Occupation" objective *(phasing in).*

Graph 3.2 – *GDP per capita at purchasing power parity of several European regions. Year 2005 and % var. 2005/1996 (EU15=100)*



Source: Processed by Unioncamere del Veneto on Eurostat data

3.2 Company taxation

Taxation may be one of the elements that distort federalism, because if it fails to be applied in a uniform manner throughout the national territory, it can feed fiscal residua. Said **residua are generated by:**

a) at equal fiscal pressure, **a return on public spending lower than the amount levied;**
b) at equal public expenditure, **a greater fiscal pressure.**

Therefore, if we want to analyse the distortions in our system and look for possible remedies, it would behove us to consider these two aspects separately, to evaluate whether the occurrence of a certain fiscal residuum is due to taxes or public spending and can be best corrected acting on the one or the other lever.

In principle, we assume that taxes are the same for everyone and therefore there is no distortion in terms of tax rates between different territories and sectors. In practice, however, this not true. Distortions do occur, not only as a result of tax relief schemes granted to some territories or industries for social reasons or to relieve underdevelopment, but also because the effects of some tax rules vary according to the economic and financial situation of enterprises based in different areas.

This means that local production systems may be subject to different tax rates in real terms, notwithstanding equal nominal rates.

This fact actually produces greater fiscal pressure, which is added to other possible inequalities in expenditure. Since the most developed regions are generally subject to heavier fiscal pressure in real terms (even in proportion to the income produced) said "mismatch" contributes to increasing regional fiscal residua. Therefore, if this distortion could be eliminated or lessened, the degree of fiscal residuum would be reduced by the same amount.

3.3 The gap between the Veneto and Italy: the results of an experimental analysis

To go beyond official data and obtain more in-depth information on the economic and financial situation of the Veneto's production system, Unioncamere del Veneto has acquired the **data bank on the aggregate financial statements of companies based in the region.**

This useful instrument, which is still not widely used to understand macroeconomics, allows us to examine various aspects, there included the degree of fiscal pressure to which companies are exposed in relation to income stated on balance sheets and operations in general, with particular reference to the profitability of the company and its value added. This information cannot be found in other sources, since the many statistics produced by the financial administration on the subject of taxation focus on the correlation between amount of taxes and taxable income without considering the accounting income, which is instead the income that is effectively recognised by the civil code and on the basis of which the company distributes its dividends and makes new management decisions.

So, while tax rates are nominally the same throughout the national territory (except in special cases and areas foreseen by law, where tax concessions are granted), effective rates are not; the latter should be measured against the income earned and recognised in accordance with accounting standards. Although tax rules are slowly adjusting to this principle and begin to recognise (at least partially) the priority of international accounting standards, the application of the latter is still not widespread among SMEs. As a consequence, these companies end up struggling with an actual tax rate that is higher than the nominal rate due to total or partial non - deductibility of some costs sustained, not to mention the fact that this distortion can weigh differently from region to region, depending on the actual differences that arise between taxable and accounting income.

In general, it can be observed that an actual tax rate heavier than the nominal rate reduces a company's ability to make new investments, inasmuch as it cuts directly into the net yield, making the net return on investment lower and less profitable. Since the taxes stated in balance sheet (IRES + IRAP) are precisely the ones applied to the final income for the accounting period which remunerates the risk capital invested in the company (even if not totally for the IRAP), this penalising effect strikes the entrepreneurial investment, above all, limiting development and the financial solidity of our companies.

A comparison between the balance sheet data of Veneto companies and the corresponding data of all Italian companies for FY 2005 (last available data) and for some previous year reveals an extremely penalising situation for Veneto enterprises.

In fact, in FY 2005 taxes (IRES + IRAP) cut into the gross operating result of Veneto companies for a good 55.5 percent, against a national average of 45.3 percent; the total nominal tax rate on the taxable income in 2005 was 37.25

percent (33% of IRES and 4.25% of IRAP). Even applying the effects of IRAP, which has value added as its taxable base, into the more restricted base made up of gross income for the year, a **nominal tax rate of 47.45 percent is obtained, which is about two points above the actual national rate, but much lower (about 8 points) than the regional rate.**

As mentioned earlier, not only does this difference cause an **actual increase in fiscal pressure,** which is not supported by official rules and does not occur in the Italian average, it also generates **a distortion in the allocation of investments and in their yield, in relation to alternative investments made outside the Veneto.**

In fact, the analysis of the aggregate balance sheets reveals that Veneto companies had to earn a gross income of 13.5 percent to ensure investors a net yield of 6 percent on the capital they invested. Instead, companies on the national level earned a gross income of 11.7 percent (namely less than Veneto's average) in order to deliver investors a net yield of 6.4 percent (that is slightly greater than Veneto's).

Unioncamere del Veneto is conducting further research on the causes of these inconsistencies, but it is clear that the various rules on the fiscal non-deductibility of some costs cause the taxable income of Veneto companies to be higher than that of other regions.

This, of course, contributes to the growth of Veneto's fiscal residuum.

4. Public spending: efficiency and waste*

4.1 Trends in public spending in Italy

In a picture featuring scarcity of resources, European constraints and an international financial crisis it is important to analyse the dynamics of spending by the public administration and identify waste in order to optimize allocation of public revenue and improve administrative actions.

One of the most worrying aspects of public finance is the expansion of public spending, both in absolute terms and as a percentage of GDP. Unfortunately, the issue is strictly linked to a phenomenon (fairly widespread in Italy) of inefficiency and "waste" that afflicts public administrations. Indeed, implementation of the equation "increase in public spending = increase in services to citizens", is generally a Utopia.

Italy is marked by a high level of public spending: in 2008 public administration expenditure reached 49.3 percent of GDP, showing a rise of 3.6 percent against 2007 and confirming a continuing trend since the beginning of the decade. **The years 2000-2007 witnessed a rising trend in public expenditure against GDP, which went from 46.2 to 48.7 percent,** with an average over the period of 48.1 percent of GDP.

In 2008 **current expenditure, which represents almost total public spending (45.5% of GDP), recorded a growth rate of 4.5 percent against 2007,** with an increase in the incidence on GDP of 1.2 points compared to the previous year. Inertial dynamics of public spending depend on civil service payroll, which increased by 4.3 percent after a limited rise observed in 2007 (0.5%). Between 2007 and 2008 **capital spending (only 3.8% of GDP) fell by 6.1 percent, due to a considerable drop in gross fixed investments (-2.8%).**

Lastly, **a large part of current expenditure goes towards paying interest on debts, a liability that reached 5.1 percent of GDP in 2008,** surpassing the main European countries by 4-5 points. In effect public spending dynamics, driven by accumulating annual deficits, systematically generate new charges which eat up resources that could be used for the country's development.

However, this is not just a problem of "quantity", but also (and especially) of poor "quality" in Italian public spending. The main causes of the excessive rate of public spending come from a **"quality deficit", many times highlighted by the Court of Auditors** and more recently in a Green Paper on public spending.

It often happens that when public expenditure expands there is no parallel proportional expansion of the services that the state and the various territorial bodies should offer citizens. This is due to the fact that our country has diseconomies generated by public administration's inefficient operation practices, which means that **large quantities of public money are not managed, let's say "correctly",** i.e. in observance of the fundamental principles which should inspire public administrations' activities and which include "transparency".

* This Chapter was drawn up the Centro Studi of Unioncamere del Veneto.

Such inefficiencies, which take on gigantic proportions in Italy, affect many different sectors: the health service, the armed forces, water distribution, management of human resources in the civil service, public works, expenditure for drugs, delays in the judicial system and management of public works. Bureaucracy alone, which weighs heavily on businesses and citizens, represents waste that, according to an estimate by the Italian retailers' association Confesercenti, comes close to 3 percent of GDP, amounting to approximately 40 billion euros or 6.5 percent of total public expenditure[37].

The components of expenditure considered in the Green Paper on public spending give an idea of the dimensions of the phenomenon simply by looking at the aggregates with high incidence on the total, i.e. the judicial system, universities and health, which between them absorb approximately one fifth of primary public expenditure (that is to say, net of interest).

Regarding **the judicial system, which every year absorbs 6.5 billion euros,** Italy has more magistrates and uses more financial resources than other countries. Spending on justice is one of the fastest growing items in the Budget, but suitable improvements in results do not follow: the number of civil and criminal cases pending continues to rise, as does their average duration.

Also **universities, whose yearly allocation is around 7 billion euros**, have to struggle with the inefficient and discontinuous dynamics of public financing, mainly based on historical spending and an academic policy that does not take financial constraints into account.

In conclusion **the health service, which every year absorbs around 100 billion euros,** represents the main item in public expenditure and in terms of effectiveness is considered one of the best in the world. However, the growing dynamics seen over the last decade and the big regional differences in spending on health reveal a sector where inefficiency and waste seem to appear with greater frequency.

4.2 Health service expenditure: an overview

Population ageing and an increasingly greater demand for health services have led the health service turnover to grow over the years. According to the Cergas-Bocconi Observatory of Italian health corporations, **in 2007 expenditure on health in Italy was over 130 billion euros, excluding investments.** The sum is made up of 102 billion euros for public health expenditure and 28 billion for private health expenditure. The former is paid by the State to maintain public facilities and refund services provided by authorized private institutes; the latter is paid by citizens out of their own pockets when consulting a doctor or undergoing an operation in public and private structures, such as, for example, the nominal charge known in Italy as the "ticket".

[37] See Confesercenti (2005), *Dossier sugli sprechi della burocrazia 2005 (Dossier on waste caused by bureaucracy 2005)* www.confesercenti.it. According to a recent survey (June 2009) carried out by Centro Studi Unioncamere, in 2008 Italian businesses spent 16.6 billion euros on bureaucracy (1.1% of GDP), equal to an average 12,334 euros per business, that is to say 1,000 euros a month. Compared to 2006, firms spent about 1.7 billion euros more, with an average increase for each business of 4.4%.

The health sector represents the largest expenditure item in almost all European countries and, quite surprisingly, **Italy fares well in a comparison with these. Indeed Italy stands in the middle of the relevant EU ranking, with public health expenditure amounting to 6.7 percent of GDP in 2007, which is lower than the European average** (7.4% in 2006)**.** Public health spending was 8.7 percent of the GDP in France, 8.0 percent in Germany, 6.9 percent in the UK, and 6.1 percent in Spain. The figures therefore indicate that the health service expenditure in Italy is not excessive: even when public expenditure is combined with private spending, the Italian health service stands below the OECD average (8.7% compared to the EU average of 8.9%)[38].

The biggest headaches for the Italian health service do not so much come from the level of spending as from its recent dynamics, constantly above the GDP growth rate, and the great differences between regions. For a more detailed analysis in an attempt to identify a sector where inefficiencies and waste are concentrated, let us start with the simple observation that over 50 percent of regional resources are poured into the health service and analyse the figures contained in the regional financial statements and in the various regional reports by the Court of Auditors. The latter will reveal that **the biggest waste in Italy is concentrated in the health service. As the service is the most frequently used by citizens, this has significant social as well as politico-institutional repercussions.** However, on this question, it must be pointed out that the sources quoted show a lack of uniformity in the geographical distribution of waste.

An analysis of mortality and illness rates in Italy shows that in the regions where less money is spent and the public sector has an organised project, people live better and longer. This demonstrates that **an effective health service is best guaranteed in the regions where the health service is organised and appropriate services are provided according to scientific criteria.** This is the case of regions such as **Friuli-Venezia Giulia, Emilia, Tuscany, Marche and the Veneto. On the other hand, elsewhere and in Southern Italy in particular, things are worse: over 80 percent of the total Italian health service deficit is due to bad management in Liguria, Lazio, Campania, Abruzzo, Calabria and Sicily.**

4.3 A comparison of Italian Regions

In 2007 national health expenditure reached 102 billion euros[39], equal to 6.7 percent of GDP and 15.2 percent of primary expenditure. **Since the beginning of the decade health spending has grown by 46.7 percent**, with different growth trends in the regions: it goes from increases exceeding 50 percent for Molise (+63.7%) and Lazio (+54.4%) to smaller ones, like those, for example, for

[38] OECD *Health data 2009*, a Report that collects and compares economic data for 2007 relating to the major health services.
[39] In the State's General Annual Report for 2008 the Court of Auditors published the results for 2008 relating to the health service's consolidated financial statements, according to which health expenditure reached 108.7 billion euros, equal to 6.9% of GDP. However, as the figures have still to undergo further revision and adjustments, the analysis in this text examines the figures for 2007, which can be considered final.

Sardinia (+39.4%), Abruzzo (+40.3%) and Calabria (+40.9%). In 2007 the average cost per citizen was 1,743 euros, that is to say almost 530 euros more than in 2000, although there are important differences at regional level. The Province of Bolzano recorded the highest expenditure on health with 2,202 euros per capita, followed by the Valle d'Aosta Region with 1,989 euros, whereas Sardinia had the lowest expenditure with 1,616 euros. In 2007 public health facilities accounted for most of the expenditure on health care (61.9%), and authorized or accredited bodies guaranteed the remaining 38.1 percent. The incidence of the National Health Service's total expenditure on GDP has risen over time, to stand at 6.7 percent in 2007.

Of the 102 billion spent in 2007, over 20 went to private operators, specifically: 8.8 to accredited hospitals, 8.6 to authorized social-health care (e.g. rest homes) and 3.6 to specialist services. While hospital expenditure is stable, since 2000 the other two items have shown average annual increases of 6 percent, a rise determined above all by an increase in the needs of the elderly and disabled.

The 2008 CEIS[40] Health Report reveals that specialist services provided in clinics (specialty outpatient facilities) differ remarkably across regions, notwithstanding the fact that the nominal charges applied were substantially homogeneous. This is due to the adoption of different names for items on the general fee nomenclatures which leads to different incidence of costs on patients. In addition, when the different care systems are taken into account (hospital, territorial, pharmaceutical, specialist, etc.) it can be observed that although the overall number of facilities dropped by 7.9 percent in the period 2000-2006, there was no proportional drop in staff, which actually increased slightly. The number of doctors and administrative staff grew (1.8% and 2.0% respectively), while the number of nursing staff remained relatively unchanged (0.1%) and the number of technical staff dropped (-2.3%). In general the number of hospital beds was cut, but practices varied: while some regions reduced the number of hospital facilities, especially public ones, others opted for downsizing the average number of beds available in existing facilities.

4.4 Funding methods and regional deficits

One of the most interesting aspects to investigate is the overall funding method for Italy's National Health Service (NHS), which is established every year by the Finance Act that sets out the national budget. In the 2007 National Budget Law (Law no. 296/2006) ordinary health service funding was provided by the State for 96 billion, which was later further increased by 0.5 billion under law No. 64/2007, due to greater financial needs deriving from the abolition in 2007 of the standard prescription charge for specialist clinic services.

Considering revenues from extraordinary management and those from the *intramoenia* regime (whereby doctors employed in public hospitals - when not on duty - can provide their professional services for a fee using the hospital facilities),

[40] CEIS - Facoltà di Economia Università degli Studi di Roma "Tor Vergata" (2009), *Rapporto CEIS - Sanità 2008, La Sanità delle Regioni. Bilancio e prospettive a sette anni dalla riforma del Titolo V e alla vigilia del Federalismo fiscale* " (*CEIS Report – Health Service 2008, The Health Service in the Regions. Outcome and prospects seven years from the reform of Chapter V of the Italian Constitution and on the eve of fiscal federalism*), www.ceistorvergata.it.

the **total resources for funding** the National Health Service in 2007 amounted to 99.4 billion euros (a rise of 4.5 percent over 2006), 98.9 of which allocated to regions and autonomous provincial districts and 0.5 to other NHS bodies financed directly by the Central Government. Average national funding per capita is 1,687 euros, 1,678 euros of which for the regions and autonomous provincial districts. The per capita figures of the total NHS income differ widely across regions, going from a minimum of 1,598 euros in Campania to a maximum of 2,232 euros in the Autonomous Provincial District of Bolzano.

Health expenditure is constantly above the level of health service funding, which has brought about negative results since the birth of the National Health Service. However, over the years the increase in resources has been higher than expenditure, resulting in a drop in the deficit from 5.8 billion euros in 2004 to 3.3 in 2007, of which 0.180 billion euros profit (recorded in Lombardy, Autonomous Provincial District of Bolzano, Veneto, Friuli, Emilia Romagna, Tuscany, Umbria and Marche) and 3.466 billion euros losses (recorded by the remaining regions and autonomous provincial districts).

Inefficiency, waste and deficits advance together. From 1992 to 2007 the deficits accumulated by the NHS against the initial allocation of funding by the national health fund reached 57.3 billion, inclusive of regional budgets. A further 4.3 billion in the red is estimated for 2008 (losses relating to 2007 must be added to the 3.3 billion of the 2008 deficit). In the five-year period from 2003 to 2007 the deficit was 21.6 billion. **The regions in the South have recorded the worst results**: Lazio (-7.5 billion), Campania (5 billion) and Sicily (3 billion) alone have accumulated 70 percent of the total deficit. In the meantime the health service reimburses its suppliers with 288 days' delay. Yet again it is not by chance that the same regions always lead in denying reimbursements: Calabria pays after 634 days, Molise after 633, Campania after 615 and Lazio makes its creditors wait 451 days[41].

Under the terms of Law no. 405/2001, subject to new cover by the State, the deficit in health service accounts should be entirely charged to the Regional Governments. If the deficits for previous years are added to the current one, the debt accumulated by the Regions in the period 2001-2007, inclusive of the allocations already made, is around 24.7 billion euros. The actual quota charged to the regions, however, should be almost 29 billion euros, considering that the 2005 Budget Law (Law no. 311/2004) provided for an allocation of 2 billion euros to cover deficits (of which only 1,450 billion euros to share among the Regions); the 2006 Budget Law (Law no. 266/2005) provided a further 2 billion euros to cover the deficits of 2001-2003 (of which 50 million euros entirely appropriated to the Lazio Region, to make good the deficits for 2003 deriving from the funding for the Ospedale Bambin Gesù) and the 2007 Budget Law (Law No. 296/2006) provided 1 billion euros for the Regions benefiting from "flanking measures" (Liguria, Sicily, Abruzzo, Molise, Campania and Lazio).

In 2001 Lazio and Campania together presented a cumulative deficit amounting to 39.2 percent of the overall national deficit. The situation has worsened over time: the incidence of the two regions on the overall national deficit has increased almost constantly over the years and stood at 64.2 percent in 2007. **Lazio (42.8%), Campania (21.4%) and Sicily (16.9%) were the regions with the highest deficit in 2007**. The Lazio Region is the one that continues to record the highest cumulative deficit (2001-2007) per capita and that - despite the efforts made - features a heavy burden inherited from previous years. The regions

[41] See *Il Sole 24 Ore* "Hospitals, 27 thousand hospital beds cut" 14 April 2009 and "Sacconi: «We have made no cuts in resources for the health service»" 13 May 2009.

that achieved a situation of economic-financial equilibrium in 2007 are the Autonomous Provincial District of Bolzano, Autonomous Provincial District of Trento, Friuli Venezia Giulia and the Veneto, whereas Lombardy, Valle d'Aosta and Basilicata recorded low deficits.

Health service deficits are highly significant for the Regions, not just because they must be made good, but also because access to funds to integrate the amounts in the State-Regions Agreement (which gave rise to Law No. 405/2001) is subject to the adoption of initiatives to cover them (Law No. 112/2002). **Regional strategies to cover deficits have been very heterogeneous.**

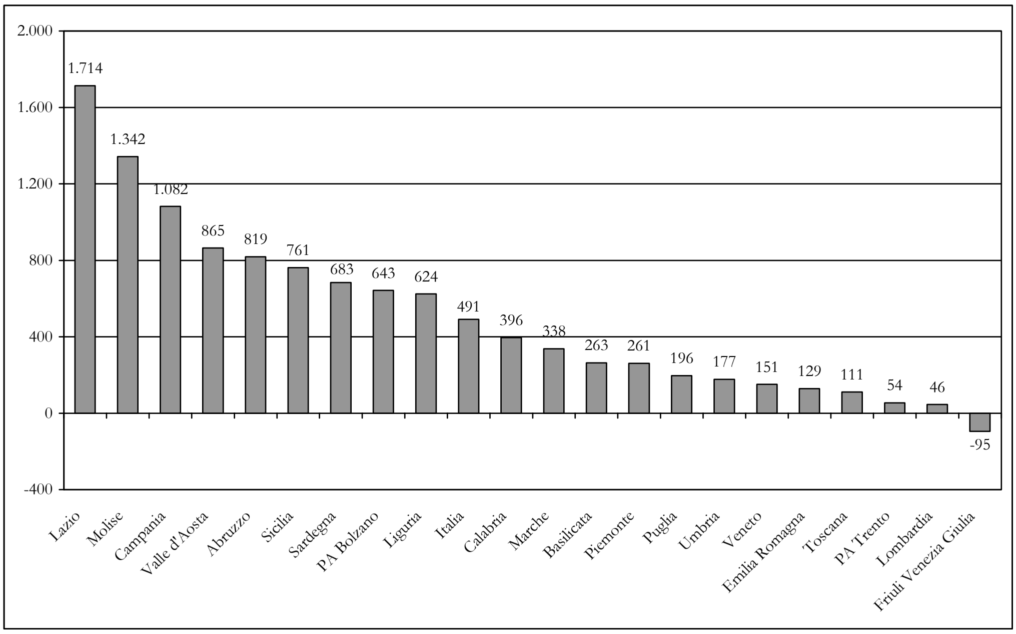
A first set of measures, relating to the regional additional payments (personal income tax - IRPEF - surcharge; regional business tax -IRAP - surcharge, quota of excise duty on petrol) was mainly introduced by the regions in the Centre-North (Piedmont, Lombardy, Veneto, Liguria, Emilia Romagna, Umbria and Marche), which then opted for a **progressive rate**, whereas those in the South (Molise, Campania, Abruzzo, Calabria and Sicily), together with Lazio, chose a **proportional rate**. Of all the Regions, only Apulia, which since 2002 had enjoyed the benefit of the proceeds from regional additional payments, decided to abolish it from 2006. Lombardy, Veneto, Liguria, Emilia Romagna, Tuscany, Umbria, Marche, Lazio, Abruzzo, Molise, Campania and Sicily have passed various resolutions over the years to increase the IRAP rate for certain legal entities (typically banks and financial and insurance bodies) even though at the same time they set up facilitation schemes for given categories of entities. The latter practice was common also in the other Italian regions.

Table 4.1 – *Italy. Financial deficits declared by Regions. Million euro. Years 2001-2007*

	2001	2002	2003	2004	2005	2006	2007	cumulative 2001-2007	Comp. % 2001	Comp. % 2007
Piedmont	-210	-40	-100	-671	1	-7	-91	-1,119	5.1	2.8
Valle d'Aosta	-33	-7	-10	-13	-14	-14	-14	-106	0.8	0.4
Lombardy	-281	-323	64	131	-14	-4	9	-417	6.8	-0.3
Bolzano	-297	-71	-25	25	28	25	17	-297	7.2	-0.5
Trento	4	1	-5	-9	-3	-14	-2	-27	-0.1	0.1
Veneto	-304	-204	-145	6	-114	71	2	-689	7.4	-0.1
Friuli VG	-18	34	19	9	27	18	24	114	0.4	-0.7
Liguria	-77	-44	-48	-329	-253	-100	-144	-996	1.9	4.4
Emilia R	-16	-50	-40	-380	-16	-38	13	-529	0.4	-0.4
Tuscany	-88	-44	20	-240	-15	-121	90	-397	2.1	-2.7
Umbria	-7	-10	-46	-52	-8	-41	13	-150	0.2	-0.4
Marche	-125	-98	-71	-163	-18	-39	11	-504	3.0	-0.3
Lazio	-987	-574	-711	-1,669	-1,733	-1,971	-1,407	-9,051	23.9	42.8
Abruzzo	-76	-136	-216	-104	-241	-140	-145	-1,058	1.8	4.4
Molise	-37	-19	-73	-44	-139	-59	-62	-432	0.9	1.9
Campania	-629	-638	-556	-1,182	-1,788	-756	-703	-6,251	15.3	21.4
Puglia	-166	-4	109	42	-412	-170	-200	-801	4.0	6.1
Basilicata	-28	-1	-19	-31	-43	-22	-13	-157	0.7	0.4
Calabria	-226	-148	-57	-128	-79	-35	-127	-800	5.5	3.9
Sicily	-415	-342	-267	-748	-563	-932	-555	-3,822	10.1	16.9
Sardinia	-106	-175	-143	-240	-327	-130	-5	-1,126	2.6	0.2
Total	**-4,122**	**-2,891**	**-2,323**	**-5,790**	**-5,725**	**-4,477**	**-3,286**	**-28,614**	**100.0**	**100.0**

Source: Processed by Unioncamere del Veneto on data supplied by the Ministry of Health

Graph 4.1 – *Italy. Cumulative health service deficit per capita, by Regions. Years 2001-2007*



Source: Processed by Unioncamere del Veneto on data supplied by the Ministry of Health

A second set of measures for covering deficits is represented by cost-sharing in health expenditure. Cost sharing policies have focused mainly on prescription drugs and on the nominal charge (known as the "ticket") on emergency services. The latter was established nationwide by Law No. 296/2006 for emergency cases that do not require hospitalization. More in general, authorized pharmaceutical care has been one of the preferential targets for covering deficits, both because two measures explicitly established in Law No. 405/2001 refer to it (cost-sharing scheme and control over drug distribution mechanisms), and because there is an explicit ceiling to spending on pharmaceutical care.

A third set of measures regards the transfer of hospital buildings and real estate transactions. The Lazio Region was the only one to opt for the transfer of hospital facilities: in 2000 it created an "ad hoc" business concern known as Gepra, which acquired all the health corporations' property (56 hospitals). Sicily, Sardinia and Abruzzo have also stated a wish to start sale and lease-back operations of their health corporations' real estate, including hospitals, by international tender.

4.5 Some considerations

For the three-year period 2009-2011 the recent Budget Law[42] estimates a cutback of around 3 billion euros in the national health service (one billion a year). In addition, within five years there will be a reduction of 27 thousand hospital beds, 13 thousand of which by 2011. Each Region shall present to the Central Government a plan to recover the losses and make good the deficit, but in some Regions it has not yet been possible to quantify the "hole"[43].

According to the Court of Auditors, the most difficult situations continue to be recorded in Central and Southern Italy: in 2008 just five Regions accounted for 87 percent of the total deficit. Under fire are Lazio, 1.7 billion in the red, Campania (627 million), Sicily (407 million), Calabria (358 million) and Puglia (253 million).

However, policies for reducing hospital beds often appear to be just a front, as there is a lack of real rationalization of costs in the sector. Cutting hospital beds while reducing and better allocating health expenditure will be just a first step in the government's anti-crisis plan (the so-called "2010-2012 Health Pact"), pending the implementation of fiscal federalism and a definition of "standard costs". The constraints and fines included in the plans for eliminating deficits should provide an incentive for heightened responsibility in managing health expenditure and an important premise for the implementation of responsible fiscal federalism.

The solution to the problem is therefore not to be sought in simplistic cuts in health spending, but in concrete policies that make the system not only financially sustainable, but also more equal, efficient and less "wasteful". This translates into reducing losses through recovered efficiency, increased citizen co-participation and cutting out services.

To achieve that, the mechanisms proposed by Law No. 42/2009 on the matter of fiscal federalism could prove useful, standard costs to start with. By defining standard costs for basic services and using them as a benchmark, it would be possible to calculate "unequivocally" the financial resources needed to guarantee – in conditions of efficiency – the quality and quantity standards of services (health, for example) throughout the country.

While this might not be enough to make equity a certainty, it will make it more likely than in the current situation, thanks to the mechanisms of responsibility triggered by creating equal opportunities, which should no longer require (hopefully) reimbursements to cover up managerial incompetence.

To do this it is necessary to act on the mechanisms that generate public expenditure, review priorities, eliminate superfluous activities, and redefine costs by exploiting the possibilities offered by new technologies and organizing the services offered more effectively.

[42] Law No. 203 of 22 December 2008.

[43] The Court of Auditors considers the situation in the Calabria Region critical, "with the emergence of deficits going back to the beginning of the decade and a debt of dimensions not yet clearly defined".

5. Regional differences in public spending and comparison with European federal models [*]

5.1 Introduction

Survey paper n. 9 of March 2008 ("Public Spending and Federalism") brought out the **possible savings in expenditures for the Italian Public Administration in the event several parameters of the public structure typical of two "federal" countries like Germany and Spain were adopted.** Slightly less than a year down the road, the scenario and prospects appear to have changed profoundly. Parliament passed a bill under delegated powers to implement the provisions of Title V of the Constitution, which envisions the autonomy in receipts and expenditures for all levels of government. In other words, Italy's institutional structure seems more oriented towards finally dropping anchor in the port of fiscal federalism.

One of the objectives of this reform is to hold public spending down: through greater autonomy and responsibility on the part of local institutions, public spending will be upgraded and total expenditures, currently among the highest in Europe, are likely to decrease. Additionally, **some civil service personnel should finally start to be transferred from the central administration to lower echelons,** to ensure that regional and local administrations have the instruments necessary to implement their respective spending policies.

But the need for federalism still remains a subject of topical interest. Taking the cue from the positive news of recent months, this paper will revise the contents of the publication issued in March 2008 and make an attempt at a more in-depth analysis, seeking to **estimate possible savings in expenditures at territorial level.** Additionally, **we shall analyse the placement of public servants at regional level** in several European systems, taking the specific economic situation of each territory into consideration.

5.2 Public sector and institutional models

Notwithstanding the efforts to improve civil service computerisation and accessibility undertaken in recent years, **employees (civil servants) continue to be the most important instrument through which the Public Administration pursues its institutional purposes. The distribution of personnel by governmental echelon is an indicator of the type of**

[*] This Chapter was drawn up by Centro Studi Sintesi.

institutional structure. Generally speaking, if most of the personnel are employed by State Administrations the structure is centralised; otherwise, there are favourable conditions for substantial decentralisation. Actually, **autonomy is measured not so much by the placement of public servants** (this may be a question of decentralisation), **but by the source of the financial resources used to pay employees' salaries:** if these expenditures are covered by the institution's own taxes, there will be a high level of administrative autonomy; if transfers are the prevalent source, on the other hand, the institution will have less autonomy in management.

Again on the theme of public salaries, Table 5.1 shows the dynamics of growth in the remuneration of public and private employees in several European countries. **Income per public employee (+33.8%) has grown at twice the rate of the private sector (+14.8%) and has remained well above the trend of inflation.**

Growth in Italian civil service salaries was the highest in Europe. In Germany, during the period between 1999 and 2006, the growth rate was only +8.3 percent, in line with growth in the remuneration of employees in the private sector, and was actually lower than inflation. In Spain the trend of growth in civil service salaries was greater than in the private sector, albeit with a much more modest margin than in Italy. In France, on the other hand, there was a higher variation in the private sector during the period considered (+23.0%), while growth amounted to +20.4 percent in the public sector.

Additionally, **withholdings from civil service salaries in Italy amounted to 26.8 percent of the total salary, as compared to 21.4 percent for the EU average and 14.9 percent in Germany**.

Table 5.1 – *Income for Civil Servants and private sector employees. Percentage growth in nominal terms for the period 1999-2006*

	Income per PA employee	Income per employee in the private sector	Inflation (IACP)	Share of PA salaries of total employee salaries (% - average'99-'06)
Italy	+33.8	+14.8	+18.3	26.8
Germany	+8.3	+7.5	+11.7	14.9
Spain	+22.1	+12.2	+25.4	20.8
France	+20.4	+23.0	+14.7	25.6
Euro area	+21.6	+14.7	+16.3	21.4

Source: ECB (Monthly Bulletin, June 2007)

The weight of the PA in a country inevitably depends on the number of civil servants employed. In this connection, the comparison with Spain and Germany brings out several of the most important peculiarities of Italy's public system. In 2008 the public administrations employed approximately 3.6 million individuals, an increase of 86,400 units over the figure of 2000. Such growth is diametrically opposed to what took place in Germany (over 400,000 workers less than in 2000), but is more modest compared to Spain (approximately 227,000 more employees between 2000 and 2008). Nevertheless, it must be borne in mind that despite this remarkable growth, Spanish public institutions employ fewer civil servants than the PA in Italy.

In this connection, Table 5.2 shows that in 2008 there were 60.6 public employees for every thousand inhabitants in Italy, 57.0 in Spain and only 54.8 in

Germany. During the period observed, the dynamics developed in different ways in the three countries: while in Germany there was a progressive reduction in the number of public employees per inhabitant, in Italy this indicator kept increasing until the two-year period between 2002 and 2003 (reaching 63.1) to then start decreasing in the following years. Although reductions were recorded in the number of civil servants in all of the countries analysed, the drop was less significant in Italy (from 61.9 in 2000 to 60.6 in 2008) than in Spain (from 58.8 to 57.0) and especially in Germany (from 59.7 to 54.8).

Table 5.2 – *Number of public employees (civil servants) in Italy, Germany and Spain*

	2000	2001	2002	2003	2004	2005	2006	2007	2008
In thousands of units									
Italy	3,525	3,569	3,595	3,619	3,615	3,631	3,636	3,618	3,611
Germany	4,909	4,821	4,809	4,779	4,670	4,600	4,551	4,541	4,505
Spain	2,356	2,314	2,303	2,330	2,353	2,387	2,436	2,512	2,583
Per 1,000 inhabitants									
Italy	61.9	62.7	63.1	63.1	62.4	62.1	61.9	61.2	60.6
Germany	59.7	58.6	58.3	57.9	56.6	55.8	55.2	55.2	54.8
Spain	58.8	57.2	56.2	55.9	55.6	55.5	55.7	56.5	57.0
Per 1,000 workers									
Italy	167.2	165.9	164.7	164.1	161.3	160.9	158.2	155.8	154.3
Germany	134.6	131.8	132.5	133.0	130.3	125.5	121.8	118.8	115.9
Spain	151.9	143.3	138.5	134.7	130.9	125.8	123.4	123.4	127.5

For Italy, number of employees (net of conscripts); for Germany, public employees as at 30th June; for Spain, personnel effective 1st January.
Source: Processed by Centro Studi Sintesi on data supplied by ISTAT and German and Spanish institutional sources

In addition to updating previous estimates, this chapter will analyse the manner in which civil servants are used and their placement in the territory. Italy's ratio of civil servants to population is significantly - although not excessively - higher than that of other countries. On the other hand, the gap is considerably larger if another indicator is taken into consideration, namely **the number of civil servants in relation to the overall number of employees**. The relative weight of civil servants is objectively high in Italy (154.3 per thousand employees), as compared to Spain's more limited value (127.5) and Germany's (115.9). Additionally, between 2000 and 2008 said ratio dropped more in Germany and Spain than in Italy, where the reduction was more limited (from 167.2 to 154.3 per thousand employed).

The dynamics by echelon of government take on different characteristics in the three countries considered (Table 5.3). **In Germany,** which has a mature and consolidated federal system, **the general reduction of** personnel (-8.2% between 2000 and 2008) concerned **all levels of government** without exception, from the Central Government (-11.6%) to the peripheral institutions (Länder -15.1%, Local Administrations -18.8%). **In Spain,** on the other hand, the important passage of competencies between the Central State and Local Autonomies generated an increase in civil servants of slightly less than 10 percent**;** yet**,** while **the Central Government was successful in reducing personnel by 32.2 percent,** the cut was almost perfectly compensated for by the personnel growth in the

Autonomous Communities and Local Institutions (34.0%); the general increase appears to be predominantly attributable to the sector of Universities.

In Italy, on the contrary, the country's peculiar nature is confirmed, which sometimes leads to paradoxical situations: despite the reform of Title V of the Constitution, the number of civil servants increased by 2.6 percent between 2000 and 2008, while regional, provincial and municipal administrations reduced personnel by 6.8 percent.

Table 5.3 – *Dynamics of civil servants by echelon of government. In thousands of units*

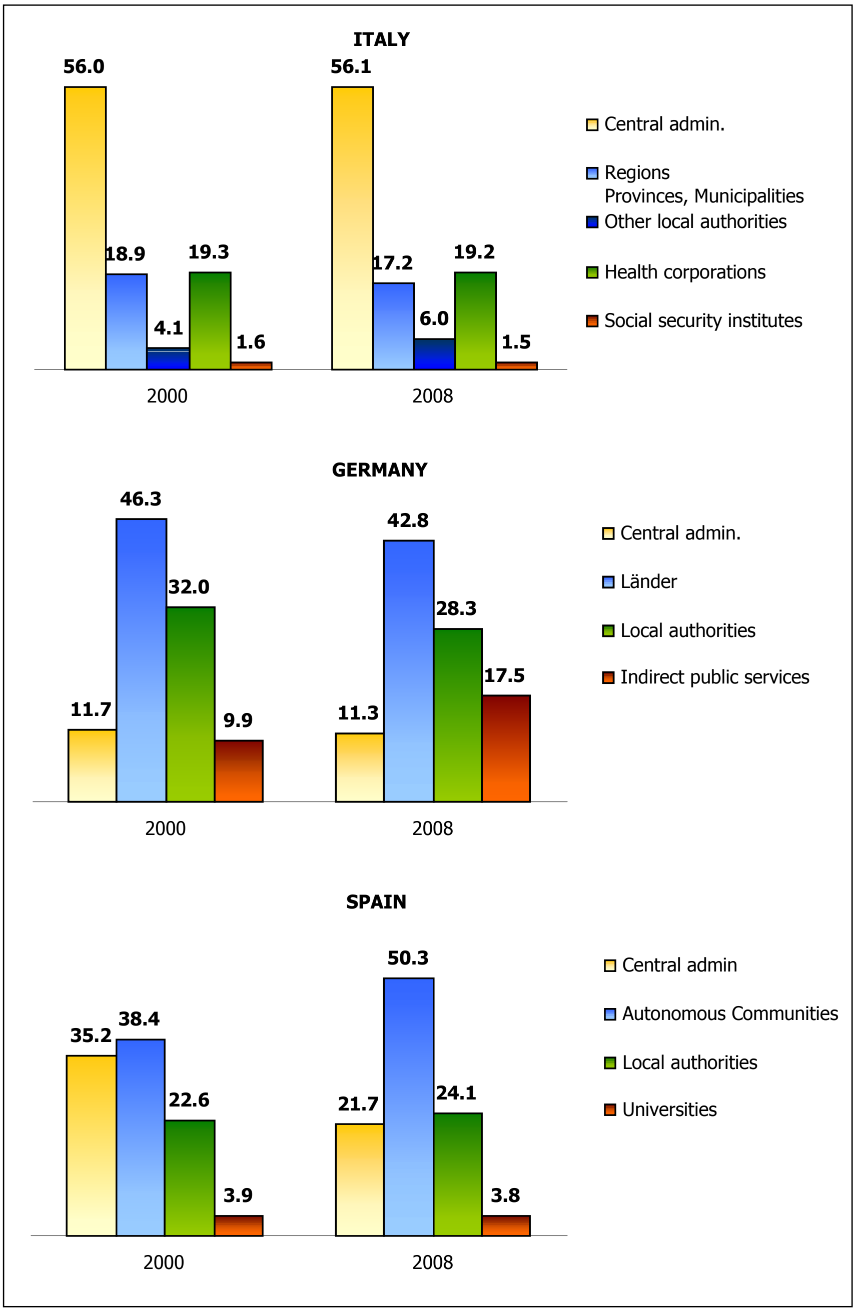
	2000	2008	Var.% 2000-08
ITALY*	**3,525**	**3,611**	**+2.5**
Central Government	1,975	2,027	+2.6
Regions, Provinces and Municipalities	665	620	-6.8
Health Institutions	682	694	+1.8
Social Security Institutions	57	55	-2.7
GERMANY	**4,909**	**4,505**	**-8.2**
Central Government	576	509	-11.6
Länder	2,273	1,929	-15.1
Local Authorities	1,572	1,277	-18.8
Indirect Public Services	488	790	+62.0
SPAIN	**2,356**	**2,583**	**+9.6**
Central Government	829	562	-32.2
Autonomous Communities	904	1,300	+43.8
Local Authorities	531	623	+17.3
Universities	92	98	+6.9

(*) The total includes smaller local institutions not specified in detail
Source: Processed by Centro Studi Sintesi on data supplied by ISTAT and German and Spanish institutional sources

The substantial "stability" of the national public system is also confirmed by Graph 5.1: for Spain, which has undergone a significant process of decentralisation over the last decade, the incidence of central personnel decreased from 35.2 percent in 2000 to 21.7 percent in 2008; in Italy, on the contrary, the reform of the second part of the Constitution seems never to have taken place.

Italy's finances inexorably feel the effects of the top-heavy public administration. In 2008 the cost of labour for public personnel in Italy, measured through the expenditures for salaries, amounted to 10.9 percent of the GDP, returning almost to the levels of the two-year period between 2005-2006, following a short-lived reduction. By contrast, in Germany this item of expenditure accounts for 6.9 percent of the GDP, continuing in a trend oriented towards a consistent reduction of costs (it was 7.8% in 2003). In Spain, on the other hand, the situation is similar to Italy's: with the international crisis - which produced heavier effects in Spain than in the other EU member states - as a likely accomplice, the Spanish Government spent 10.7 percent of the GDP on the remuneration of civil servants in 2008. It should be noted that with the exception of last year, this item of expenditure had remained almost constantly around 10 percent of the GDP, which was far from the levels of the Italian PA.

Graph 5.1 – *Civil servants by echelon of government: comparison 2000-2008. Percentage composition*



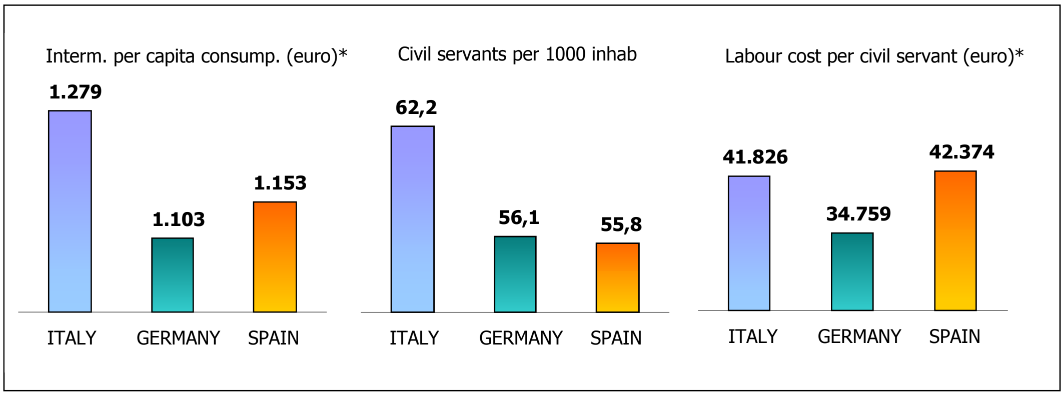
Source: Processed by Centro Studi Sintesi on data supplied by ISTAT and German and Spanish institutional sources

5.3 Other countries' federalism: effects on Italy's public spending

While awaiting the imminent implementation of fiscal federalism, it may be particularly interesting to provide an estimate of the **savings Italy could earn if it were to adopt some key parameters of the public systems of two federal countries** like Spain and Germany (which are in any case thoroughly decentralised from a taxation standpoint). In fact this paper is intended to estimate the savings that can be made at the territorial level, utilising known parameters, updated to 2007 and lengthen the time series to include 2003.

Graph 5.2 shows the three parameters under consideration, which are the basis for later estimates and projections. The expenditures per inhabitant for intermediate consumption[44], calculated under purchasing power parity in order to eliminate the distortions due to the different levels in the cost of living, is greater in Italy, where during the period from 2003 to 2007 this aggregate of expenditures amounted to 1,279 euros per capita, as compared to 1,153 euros in Spain and 1,103 euros in Germany.

Graph 5.2 – *Overview of parameters taken into account. Average 2003-2007*



(*) Expressed at purchasing power parity

Source: Processed by Centro Studi Sintesi on data supplied by Eurostat, ISTAT and German and Spanish institutional sources

As we have already observed, the number of public employees has decreased in recent years in both Italy and Germany, albeit in different proportions, while in Spain the headcount has increased slightly, especially since 2005. The simulation is based on the five-year average, which places Italy at higher levels than the other two countries: more precisely, Italy's PA employs 62.2 civil servants for every one thousand inhabitants, as compared to 56.1 in Germany and 55.8 in Spain.

The last parameter concerns personnel expenditure, namely the cost of labour to be shouldered by the Public Administration, consisting of the remunerations and social security contributions paid by the employer (i.e. the PA). In this respect; remarkable differences between the various countries show up when the expenditure for employees' income is divided by the number of personnel. In Germany, the cost of labour for each worker amounts to 34,759

[44] This expresses the sum of costs for goods and services utilised during the process of production, which may be transformed or may simply be consumed until exhausted. In short, they correspond to the expenditures necessary to operate the "machinery" of the public administration. In Italy, the expenditure for intermediate consumption amounts to 5.4% of the GDP (2008 data).

euros per year (average 2003-2007), while in Italy it goes up to 41,826 euros and 42,374 euros in Spain. It can be seen that there has been a significant increase in the average costs incurred for this expenditure item in Spain, to the point that it has surpassed the level of the Italian PA.

Suppose these key parameters were applied to the Italian case, the situation described in Table 5.4 would result. We chose to utilise two modular hypotheses: the first, defined as **hypothesis "A"** for convenience, is based on the first two indicators described above (intermediate consumption per inhabitant and the number of public employees per inhabitant) and is the basic proposal, capable, in any case, of bringing out the considerable savings that could be achieved for the Italian PA; **the second, defined as hypothesis "B",** adds the average cost of labour to the parameters already contained in "A". In this connection, there is another point worth making: this calculation is deeply affected by the social security laws and public employment laws of each country. For example, the different tax rates paid by the employer (and therefore the State) or the worker (the public employee) can generate considerable distortions with respect to the overall expenditure for personnel incurred by the Public Administrations. Therefore, hypothesis "B" is quite likely the least applicable one (at least over the short term) and is a purely theoretical and demonstrative exercise - even though interesting as it helps us compare the characteristics of each public system under examination.

Table 5.4 – *Possible savings for Italy if German and Spanish parameters were implemented (In % of GDP)*

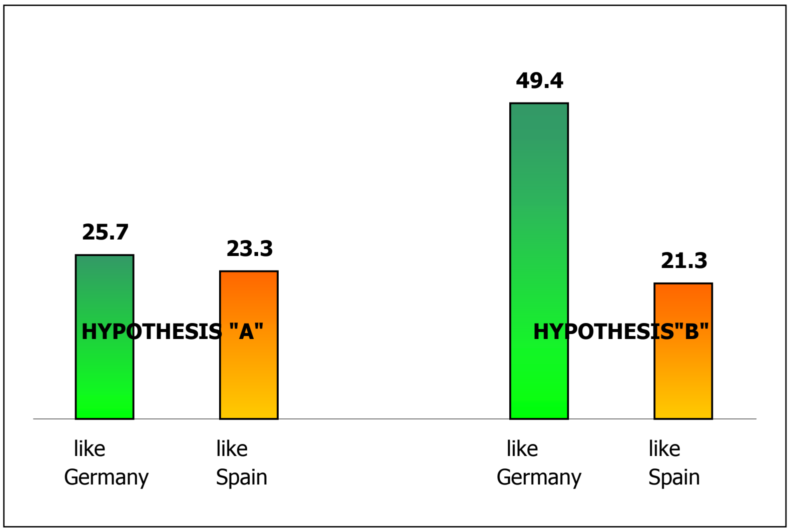
	2003	2004	2005	2006	2007	Average 2003-07
Like GERMANY						
Savings from intermediate consumption	0.9	0.9	0.8	0.5	0.5	0.7
Savings due to personnel reductions	0.9	1.0	1.1	1.2	1.1	1.1
Hypothesis "A"	***1.8***	***1.9***	***1.9***	***1.7***	***1.6***	***1.8***
Savings due to the lower cost of labour	1.8	1.4	1.5	1.8	1.8	1.6
Hypothesis "B"	**3.6**	**3.4**	**3.4**	**3.5**	**3.4**	**3.4**
Like SPAIN						
Savings from intermediate consumption	1.1	0.8	0.6	0.2	-0.1	0.5
Savings due to personnel reductions	1.2	1.2	1.2	1.1	0.9	1.1
Hypothesis "A"	**2.4**	**2.0**	**1.8**	**1.3**	**0.7**	**1.6**
Savings due to the lower cost of labour	0.4	0.0	0.0	-0.2	-0.8	-0.1
Hypothesis "B"	***2.8***	***2.0***	***1.8***	***1.1***	***-0.1***	***1.5***

Source: Processed by Centro Studi Sintesi on data supplied by Eurostat, ISTAT and German and Spanish institutional sources

After this due clarification, we can proceed with the analysis of the simulation results. Concerning hypothesis "A": **if Italy were to adopt the parameters of Germany, the savings would be on the order of 1.8 percent of the GDP per year,** 0.7 percent of which would be due to the decreased expenditures for intermediate consumption and 1.1 percent of which would be imputable to the lower number of civil servants. Similarly, adjustment to the parameters of the Spanish PA could guarantee average savings of 1.6 percent of the GDP per year, 0.5 percent of which would be due to decreased expenditures for intermediate consumption and 1.1 percent of which would be due to the lower number of civil servants. Nevertheless, while the estimate of possible savings in the case of Germany has no particular variations from one year to another, the simulation according to the "Spanish" model shows a rapid erosion of theoretical savings starting from 2003. To sum up, **through the application of hypothesis "A", Italy could benefit from savings in expenditures of 25.7 billion euros per year if it aligned itself with German standards, and of 23.3 billion if it adopted Spanish parameters** (Graph 5.3).

By integrating the indicator of the average cost of labour into this simulation, the hypothesis "B" results are obtained; in this case, by adopting the German laws, we could save up to 3.4 percent of the GDP every year, while the Spanish solution would guarantee lower savings than those calculated for hypotheses "A", inasmuch as the average cost of labour per employees is slightly higher than in Italy (see Graph 5.2). In this case, **the savings achieved by applying the German standard would go up to 49.4 billion euros,** while the savings guaranteed by the Spanish model would drop to 21.3 billion euros (Graph 5.3).

Graph 5.3 – *Possible savings for Italy if German and Spanish parameters were applied. Average 2003-2007 (in billion of euros)*



Source: Processed by Centro Studi Sintesi on data supplied by Eurostat, ISTAT and German and Spanish institutional sources

5.4 Territorial public spending: benchmarking savings

The quantity and quality of public spending is still the main critical issue in Italy, as evidenced by Table 5.5, which shows disaggregated data of public expenditures. Considering the expenditures actually managed by each echelon of government (that is net of transfers towards other public administrations and interest), it can be seen that the share attributable to the Central Government amounts to 11.6 percent of the GDP and is basically at the levels of the period prior to the reform of Title V of the Constitution. In the four-year period between 2005 and 2008, expenditures managed directly by Regional, Provincial and Municipal Administrations amounted to 8.4 percent of the GDP, in line with what had been recorded in the previous period; the effects of a certain devolution of competences can be better appreciated if the average expenditure between 1997-2000 is considered, which amounted to 7.7 percent of the GDP.

The expenditures of Health Institutions (Local Health and Hospital Corporations) have tended to increase, going from 5.5 percent of the GDP between 1997 and 2000 to the more recent figure of 6.8 percent. This phenomenon is mainly attributable to the progressive aging of the population and the effects of growing migration flows.

The public expenditure directly managed by the State, by Local Administrations and Health Institutions thus recorded an increase of 2.3 percent of the GDP over a period of approximately a decade; additionally, there are the growing expenditures of Social Security Institutions (17.2% of the GDP, including pensions) and a share of the interest on the public debt far above what other European countries are paying. The result is that **public expenditures between 2005 and 2008 reached 48.8 percent of the GDP** and are expected to exceed the threshold of 50 percent on a permanent basis, also as a result of the international economic crisis.

Table 5.5 – *Dynamics of public spending directly managed by each level of government. Average values (in % of GDP)*

	1997-2000	2001-2004	2005-2008
Central Administrations	11.4	11.6	11.6
Regions, Provinces, Municipalities and minor local institutions	7.7	8.3	8.4
Health Institutions	5.5	6.2	6.8
Direct public expenditure*	**24.5**	**26.1**	**26.8**
Social Security Institutions	16.4	16.5	17.2
Expenditures for interest	7.5	5.4	4.8
Total public expenditures	**48.4**	**48.0**	**48.8**

(*) Net of interest payable and transfers to public administrations
Source: Processed by Centro Studi Sintesi on ISTAT data

5.4.1 From the European models to the Italian case

The least common denominator of all hypotheses and simulations presented in this paper is the reduction of national public spending, which must be achieved through revised criteria for the allocation of public resources, more in line with real local needs.

In this connection, **adapting to the primary parameters of two "federal" public systems like Germany and, at least partially, Spain,** could be a road to travel. However, the attempt at transposing the German and Spanish models to Italy's territorial level is hampered by the lack of sufficiently detailed information, not entirely comparable data banks and by specific institutional and legislative systems, which make international comparisons[45] difficult. For these reasons,

[45] For example, it will be impossible to estimate the savings for each echelon of government, inasmuch as the legislative and administrative competencies of any public organisation vary across countries; therefore, it is almost impossible to determine the level of personnel, remuneration and expenditure for optimal intermediate consumption. Available instruments allow estimating how much and where the efforts must be concentrated to improve the quality of public spending; they cannot reveal precisely which level of government requires the greatest amount of intervention.

several adaptations were needed to apply the parameters of the two European countries to regional contexts.

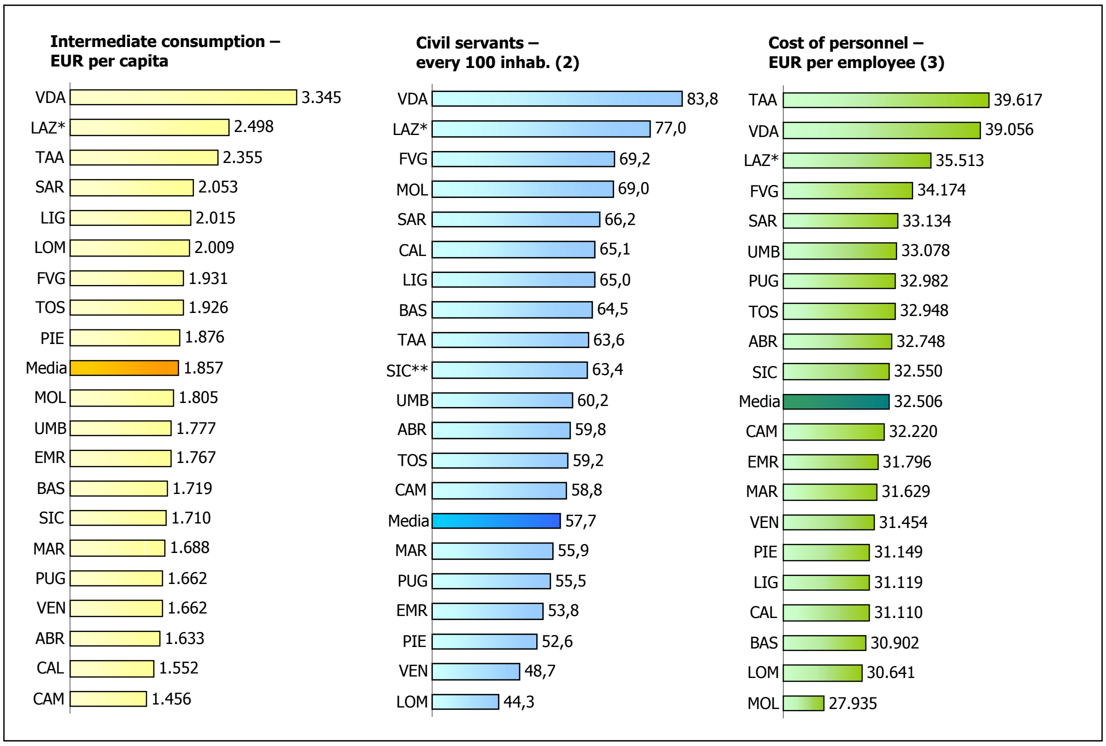
The baseline is provided by the data in Graph 5.4. The information refers to the three indicators already taken into consideration for comparison with Spain and Germany in the previous paragraph.

Between 2003 and 2007, the **per capita expenditure related to intermediate consumption** was particularly high in Valle d'Aosta (3,345 euros per capita), followed by Lazio (approximately 2,500 euros per inhabitant) and two special stature regions, namely Trentino-Alto Adige (2,355 euros) and Sardinia (2,053 euros). The smaller values are recorded, as a bit of a surprise, in several of Italy's central-southern regions; this result could be due to different ways of recording some balance sheet items and the practice of outsourcing some services, which could in fact have influenced the determination of expenditure figures.

The second indicator is the **number of civil servants per thousand inhabitants**[46]. Valle d'Aosta has recorded the highest ratio of civil servants to population (83.8 per thousand inhabitants): this figure can be explained by the negative effects of diseconomies of scale due to the region's scarce population and morphology. Also Lazio has a high number of civil servants (77.0 per thousand inhabitants) as a consequence of the "capital factor", namely, the presence of ministries, which considerably alter the actual number of employed civil servants. Friuli-Venezia Giulia is next, with 69.2 public employees per thousand inhabitants, followed by Molise (69.0). The regions with the smallest number of public employees are Lombardy (44.3 per thousand inhabitants) and the Veneto (48.7).

Finally, with reference to the **average cost of personnel per individual employee,** Trentino Alto Adige (South Tyrol) is at the top of the list, with 39,617 euros per employee. With the exception of Lazio, the top positions are all occupied by Regions with special statutes – although figures for Sicily are slightly lower. These results can be explained by the fact that in special statute regions regional administrations are granted greater independence in determining the remuneration of their employees, who account for a higher percentage of the civil servants in these areas. The lowest values were recorded in Molise (27,935 euros per employee) and Lombardy (30,641 euros).

[46] The data on civil servants disaggregated by region is available only for employees with an open-ended employment contract; therefore, workers on temporary contracts and with other forms of contracts are not included. In order to apply the parameter of Spain and Germany, inasmuch as it includes all public administration workers, it was decided to start from the overall national figure and estimate the disaggregated data by region on the basis of the territorial distribution of permanent employees. Thus, permanent employees are redistributed in an almost uniform manner.



Graph 5.4 – *Overview of parameters considered on the regional level. Media 2003-2007*

(*) This also includes personnel and resources employed in Lazio, but which indirectly benefit other territories.
(**) Includes employees with permanent contracts in the Region of Sicily (approximately 14,000 units).
(1) In the terminology of Territorial Public Accounting, this corresponds to the expenditure to purchase goods and services.
(2) Only permanent employees are counted (excluding foreign).
(3) In the terminology of Territorial Public Accounting, this corresponds to expenditures for personnel.
Source: Processed by Centro Studi Sintesi on data supplied by Territorial Public Accounting Office (Conti Pubblici Territoriali) and by the State General Accounting Department (Ragioneria Generale dello Stato)

5.4.2 Public expenditures according to European federal models: a regional estimate of savings

On the basis of the elements available, we proceeded to **estimate possible savings on the territorial level in the hypothesis that Italy adopts a public system with characteristics similar to those of two "federal" countries like Spain and, above all, Germany.** As stated earlier, this exercise - beyond the methodological limitations - is a mere projection and in-depth investigation of an estimate that has already been made on the national level; therefore, this simulation outlines the effort - which is theoretically necessary - to adapt the overall public system and the specific system of every part of the country to standards of expenditure oriented towards greater savings.

Again, concerning the regional estimate, it was decided to articulate the simulation in two parts: hypothesis "A" uses intermediate per capita consumption and the ratio of civil servants to the population as parameters, while hypothesis "B" adds the average cost of labour to the criteria already cited.

Let us start from hypothesis "A". By adopting the German system the overall savings would amount to 441 euros per inhabitant, approximately 41 euros more than the amount that could be saved with the Spanish model. **The territorial distribution shows the good performance of the Veneto and**

Lombardy, which are regions with lower margins of intervention: estimated savings in expenditures can still be obtained in these two regions, in the neighbourhood of 380 and 393 euros, respectively, if the German system is applied and 340 and 344 euros, respectively, if the Spanish system is used (Table 5.6). Surprisingly, Campania and Apulia follow: it is quite likely that these results are the fruit of a series of factors, including the large demographic size (which contributes to limiting the per capita impact), a probable inhomogeneous accounting of several expenditure items and the recourse to participated companies that are not accounted for in the data bank of the Territorial Public Accounting Office.

Nevertheless, **greater efforts should be addressed towards Special Statute Regions,** where savings could be remarkable**:** thanks to the German model, Valle d'Aosta could realise savings of over 700 euros per inhabitant (619 with the Spanish system), while in Trentino-Alto Adige (South Tyrol), Friuli-Venezia Giulia and Sardinia the savings would oscillate between 451 and 514 euros per capita. It is worth emphasising once again that the information currently available does not allow us to determine whether the savings should be imputed to one level of government in particular; therefore we cannot establish, within a specific territory, whether the central, regional or local administration is most inefficient.

Table 5.6 – *Possible savings for Italy if German and Spanish parameters are applied. Regional data (average 2003-2007). Savings in euro per inhabitant.*

Region	Hypothesis "A" (1)		Region	Hypothesis "B" (2)	
	Like Germany	Like Spain		Like Germany	Like Spain
Veneto	380	340	Lombardy	687	321
Lombardy	393	344	Veneto	712	314
Campania	407	375	Piedmont	776	351
Apulia	413	379	Emilia Romagna	785	345
Emilia Romagna	414	374	Marche	801	350
Marche	418	382	Apulia	810	347
Piedmont	421	381	Campania	818	342
Abruzzo	429	394	Abruzzo	853	360
Calabria	444	407	Tuscany	877	379
Umbria	446	408	Umbria	878	374
Sicily	452	413	Calabria	883	372
Tuscany	455	412	Basilicata	891	381
Basilicata	458	418	Molise	899	412
Molise	483	438	Sicily	900	375
Liguria	491	448	Liguria	929	414
Sardinia	498	451	Sardinia	973	414
Friuli-Venezia Giulia	500	459	Friuli-Venezia Giulia	1,012	416
South Tyrol	514	463	South Tyrol	1,050	419
Lazio*	597	553	Lazio*	1,188	514
Valle d'Aosta	700	619	Valle d'Aosta	1,402	569
TOTAL	**441**	**400**	**TOTAL**	**848**	**368**

(*) This also includes personnel and resources employed in Lazio, which indirectly benefit other territories. (1) parameters considered: intermediate consumption per capita and civil servants per 1,000 inhabitants; (2) parameters considered: intermediate consumption per capita, civil servants per 1,000 inhabitants and cost of labour per employee.

Source: Processed by Centro Studi Sintesi on data supplied by ISTAT, State General Accounting Department and Department for Development Policies

Hypothesis "B", which also includes the average cost for each employee, widens the gap that separates Italy from Germany (from 441 to 848 euros per inhabitant), while it reduces the difference from Spain (from 400 to 368 euros per capita). The reason for the considerable gap between Italy and Germany, as indicated, resides in the better standards of efficiency and, quite likely, in the different laws governing public employment.

5.4.3 Public spending according to current territorial standards: some estimates of possible savings

The above analysis creates a regional ranking of possible savings on the basis of the parameters used by the leading "federal" countries in Europe. The simulation can be "re-interpreted" starting from the current standards of public expenditure and taking into consideration the territory that presents the indicators. For that purpose, three theoretical scenarios were taken into account.

The **first scenario** (Table 5.7/a) calculates the hypothetical savings in expenditures for the Public Administration as a whole, if the parameters of those three territories are applied, which have the lowest values for each macro geographical area (North, Centre and South). The cue is taken from the first two columns of the ranking (hypothesis "A"): in the North the lowest savings would be obtained in the Veneto, in the Centre in the Marche and in the South in Campania. It is worth noting that the average values of the average indicators calculated for these three regions are lower than the figures relative to the total of the national public administration.

This solution, which – of course – is only theoretical, **would generate a reduction of 5.6 percent in public personnel** (187,500 units), **with overall savings of approximately 21 billion euros,** namely 1.5 points of the GDP (Table 5.7/b).

For each macro geographical area, the **second scenario** takes into account the Regions which have the lowest values in the three indicators under examination. So, Graph 5.4. illustrates the situation of the Veneto, Marche and Campania for intermediate consumption, that of Lombardy, Marche and Apulia in terms of number of public personnel, while for the cost of personnel, reference was made to Lombardy, Marche and Molise (Table 5.7/a).

The average values calculated in this manner show a larger gap between the national standards and those recorded by scenario 1. In fact, according to scenario 2, **the theoretical savings would be higher and achieve 25 billion euros, or 1.7 percent of the GDP,** while the number of employees would decrease by 10 percent (Table 5.7/b).

Finally, the **third scenario** takes into consideration the average values for the Veneto, namely the territory that is closest to the performance of the German and Spanish public systems (see Table 5.6) The indicators show considerable gaps with respect to the national average, especially where the expenditure for intermediate consumption and the rate of civil servants for every thousand inhabitants (Table 5.7/a) in taken into account.

When these indexes are translated into monetary magnitudes, it can be seen that **by extending the "Veneto model" to the entire national public administration, savings of over 27 billion euros would be generated, slightly less than 2 percent of the GDP** (Table 5.7/b). The greatest savings would be related to personnel management (about 17 billion euros less), with a **net**

reduction of over 500,000 units, thereby decreasing public employees to slightly over 3 million units (as opposed to the current 3.6 million).

These are purely hypothetical scenarios, which would be difficult to implement in actual life, but which confirm - to some extent - the need for better management of public spending, as well as for a more balanced distribution of resources in the territory.

Table 5.7/a – *Hypothetical savings in public expenditures on the basis of some structural parameters of the public administration.*
Outline of parameters used (Average 2003-2007)

Scenario 1	Veneto	Marche	Campania	**Average**	National Average
Intermediate consumption per capita (in euros)	1,662	1,688	1,456	**1,602**	1,857
Civil servants (per 1,000 inhabitants)	48.7	55.9	58.8	**54.5**	57.7
Expenditure for personnel per civil servant (in euros)	31,454	31,629	32,220	**31,767**	32,506

Scenario 2	North	Centre	South	**Average**	National Average
Intermediate consumption per capita (in euros)	VENETO (1,662)	MARCHE (1,688)	CAMPANIA (1,456)	**1,602**	1,857
Civil servants (per 1,000 inhabitants)	LOMBARDY (44.3)	MARCHE (55.9)	APULIA (55.5)	**51.9**	57.7
Expenditure for personnel per civil servant (in euros)	LOMBARDY (30,641)	MARCHE (31,629)	MOLISE (27,935)	**30,068**	32,506

Scenario 3	**Veneto**	National Average
Intermediate consumption per capita (in euros)	**1,662**	1,857
Civil Servants (per 1,000 inhabitants)	**48.7**	57.7
Expenditure for personnel per civil servant (in euros)	**31,454**	32,506

Source: Processed by the Centro Studi Sintesi on data supplied by Territorial Public Accounting Office and ISTAT

Table 5.7/b – *Hypothetical savings in public spending on the basis of some structural parameters of the public administration.*
Estimates on average data for the period 2003-2007

	Scenario "1"	Scenario "2"	Scenario "3"
	(Average for Veneto, Marche, Campania)	(Best average indicators for the geographical area)	(Veneto average)
Lower number of civil servants (in thousands of units)	187.5	340.0	523.3
Variation in the number of civil servants (%)	-5.6	-10.1	-15.6
Savings in expenditures for personnel (in millions of euros)	5,958	10,224	16,459
Savings in expenditures for intermediate consumption (in millions of euros)	14,894	14,894	11,385
Total savings in expenditures (in millions of euros)	**20,852**	**25,118**	**27,845**
In % of GDP	*1.5*	*1.7*	*1.9*
Per capita	*358*	*431*	*478*

Parameters utilised: expenditure for intermediate consumption per capita, civil servants per 1,000 inhabitants, expenditure for civil service employees.
Source: Processed by the Centro Studi Sintesi on data supplied by the Territorial Public Accounting Office and ISTAT

5.4.5 The cost of the central state: an investigation on the territorial level

To ensure data comparability**, all of the simulations proposed up to this point have considered the Public Administration as a whole, without making any distinction between echelons of government**. However, we have already seen that the Central State holds a large share of directly managed public spending[47] (11.6% of the GDP) and that such share is actually on the increase compared to levels recorded during the period prior to the reform of Title V of the Constitution (see Table 5.5). For this reason, we have chosen to further investigate the entity of public spending by the Central Administration and its distribution in the territory.

Again in this case, several methodological expedients became necessary. Firstly, the analysis was limited only to the fifteen Regions with ordinary statutes because in special statute Regions the Central Government has fewer competencies in public spending. Secondly, a corrective expedient was applied to the expenditures of the Central Administration in the Region of Lazio, which is inevitably affected by the "capital factor"; the presence of the most important national institutions in Rome translates into a surplus of expenditures for services and functions that benefit every area of Italy and not only the territory of Lazio.

The indicators considered were the expenditure for personnel and the intermediate consumption of the central administrations in relation to the population. Then, the possible savings and diseconomies in expenditures were calculated, in the hypothesis of extending the parameters of the regions with the lowest and highest expenditures to the entire national territory (excluding Special Statute Regions).

[47] Public spending net of interest and transfers of resources to other echelons of government.

The results of this simulation are summarised in Table 5.8. Concerning the **per capita expenditure on personnel,** the lowest values were recorded in Lombardy (792 euros), while the highest costs were seen in Calabria (1,330 euros), as compared to an average of 1,018 euros per capita. **Using Lombardy's parameters, the expenditure on personnel would decrease by over 11 billion euros** (-22.2%), going from 50.2 to 39.1 billion; by contrast the Calabrian system would determine additional expenditures of 15 billion euros (+30.6% compared to the current status).

The **expenditure on intermediate consumption of the Central Government** appears to be lowest in the Veneto (357 euros) and highest in Liguria (561 euros), for an average of 422 euros. If **Veneto's indicator was applied, the overall expenditure on intermediate consumption would decrease by 3 billion euros** (–15%), a drop from 20.8 to 17.6 billion euros; instead, Liguria's average value would increase state spending by 6.8 billion euros, or 33 percent more than the current expenditure.

Table 5.8 – *Expenditures of Central Administrations: a simulation on the territorial level. Average 2003-2007. Data in millions of euros*

	Expenditure on Personnel			Intermediate Consumption			Running Expenditures		
	Per capita expenditure (1)	Theoretical savings - like Lombardy	Theoretical higher spending - like Calabria	*Expenditure pro capita (euros pro capita) (2)*	Theoretical savings - like Veneto	Theoretical higher spending-s like Liguria	*Per capita expenditure (euros per capita)*	Total theoretic al savings	Total theoretical increase in expenditures
Piedmont	*888*	-412	+1,901	*441*	-362	+518	*1,329*	-773	+2,419
Lombardy	*792*	0	+5,025	*392*	-325	+1,587	*1,184*	-325	+6,612
Veneto	*919*	-595	+1,923	*357*	0	+958	*1,276*	-595	+2,880
Liguria	*1,190*	-634	+222	*561*	-325	0	*1,752*	-959	+222
Emilia Romagna	*868*	-310	+1,911	*373*	-67	+778	*1,241*	-377	+2,689
Tuscany	*1,047*	-914	+1,013	*444*	-310	+423	*1,491*	-1,225	+1,436
Umbria	*1,044*	-215	+245	*404*	-40	+135	*1,447*	-255	+380
MARCHE	*1,015*	-337	+477	*394*	-56	+254	*1,409*	-393	+730
Lazio	*1,030*	-1,257	+1,582	*435*	-412	+668	*1,465*	-1,669	+2,250
Abruzzo	*1,210*	-541	+155	*478*	-157	+108	*1,688*	-697	+263
Molise	*1,312*	-167	+6	*503*	-47	+19	*1,815*	-214	+24
Campania	*1,201*	-2,358	+742	*428*	-410	+769	*1,629*	-2,768	+1,511
Apulia	*1,293*	-2,029	+149	*469*	-455	+373	*1,762*	-2,484	+523
Basilicata	*1,271*	-285	+35	*424*	-40	+82	*1,694*	-324	+117
Calabria	*1,330*	-1,078	0	*461*	-209	+201	*1,791*	-1,286	+201
Media	***1,018***	**-11,130**	**+15,385**	***422***	**-3,214**	**+6,873**	***1,440***	**-14,344**	**+22,259**
Central gov't expenditures	**50,244**	**39,113**	**65,629**	**20,838**	**17,624**	**27,711**	**71,082**	**56,738**	**93,340**
% Variation		**-22.2**	**+30.6**		**-15.4**	**+33.0**		**-20.2**	**+31.3**

(1) Lazio's central government expenditure attributable to the entire country was divided into three weighted indicators (20% population, 30% primary central expenditures, 50% public spending net of the "capital" effect of Lazio).
(2) Lazio's central government expenditure attributable to the entire country was divided into three weighted indicators (20% population, 50% primary central expenditures, 30% public spending net of the "capital" effect of Lazio).
Source: Processed by the Centro Studi Sintesi on data supplied by the Territorial Public Accounting

Overall, the "running" expenditure, considered as the aggregate of spending for personnel and intermediate consumption, amounts to 71 billion euros: by **using Lombardy and Veneto's parameters, there would be savings of 20.2 percent, or 14.3 billion euros.** Otherwise, with the indicators of the other regions, the expenditure of Central Administrations would grow by 31.3 percent, reaching 93.3 billion euros.

In spite of being purely hypothetical, this exposition is useful in bringing out the need for change in the public system, not only at local level but also – and above all – at central government level. The new federal system should be accompanied by a new definition of the Central Government's functions and financial entities, especially in certain areas of the country. So, for instance, the passage of several subjects typically entrusted to the central government (such as education) to the Regions and local institutions could turn out to be a vehicle to make the entire public system more efficient.

5.5 Civil servants and territorial disparities: a European comparison

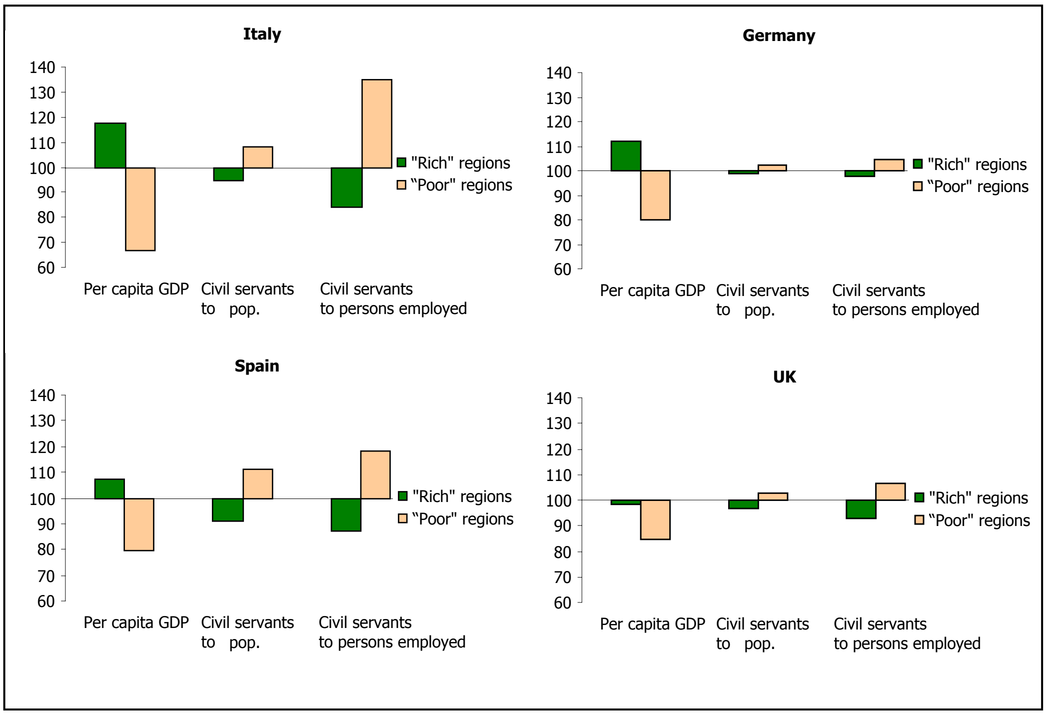
Setting aside the central theme for a moment, this paragraph goes into greater depth on possible savings in expenditures that could result from decentralised models. The previous reports brought out the high rate of civil servants in some areas of our country, with special reference to Special Statute Regions and areas in Southern Italy. **The public sector, therefore, seems to act as a "social safety valve" that helps cushion and** partially compensate for the lack of jobs: does this phenomenon take place in other countries as well? If so, to what extent?

The analysis concerned four EU member states which have undergone processes of administrative devolution over the last decade, namely Italy, Spain, Germany and the United Kingdom. The regions of each country were divided into two groups: **"rich"** regions, which have a per capita GDP higher than 90 percent of the national average (year 2006), and **"poor"** regions with a per capita GDP lower than this cut-off. Two indicators were considered: the civil servants to population ratio and the civil servants to persons employed ratio. It was decided to clear the national average values of the data relative to regions where the capital is located in each country (Lazio for Italy, the Comunidad de Madrid for Spain, Berlin for Germany and London for the United Kingdom), since the higher presence of civil servants in these areas due to the concentration of primary national institutions would artificially alter the reference parameters.

In this connection, a methodological aspect is worth clarifying: the aim of this paper is not make a direct comparison between Italian and German regions as to their number of civil servants or their civil servants to population ratio. **The aim of this paper, instead, is to measure the gap between "poor" and "rich" regions in each country by using the above-mentioned indicators.** For that reason, the following graphs and tables show only the indexes with a base of 100, equal to the national average. This approach also overcomes a certain lack of information and poor data comparability concerning, for example, the geographical distribution of civil servants: in Italy such information is available only for employees with permanent contracts, while in other countries both permanent and temporary employees are included. In any case, this problem is overcome by the fact that the subject of analysis, as mentioned earlier, is the difference between territories that belong to the same country and not between the regions of different countries.

Graph 5.5 summarises the information contained in greater detail in Tables 5.9/a, 5.9/b, 5.9/c and 5.9/d.

Graph 5.5 – *Correlation between economic wealth and the presence of civil servants on the territorial level: comparison between Italy, German, Spain and the United Kingdom. National average index = 100*



The "rich" regions have a per capita GDP that exceeds 90% of the national average; otherwise they were considered "poor" regions.
The indexes relative to the civil servants to population ratio and the civil servants to number of employed ratio were calculated considering the national average, net of the region where the capital city is located (Lazio, Berlin, Comunidad de Madrid, London).
Source: Processed by Centro Studi Sintesi on data supplied by Eurostat, Italy's General State Accounting Department and German, British and Spanish institutional sources

There are wide economic gaps between Italian regions (Table 5.9/a): Italy's "rich" regions have a per capita GDP amounting to 117.8 percent of the national average (index number on a basis of 100), while the most disadvantaged areas have a GDP that does not exceed 67% of the average. In the "poor" regions, there is a higher rate of civil servants, both with respect to the population and to the total number of employed persons. More precisely, assuming that the national average is equal to 100, in these territories the concentration of civil servants climbs to 108, while in the "rich" areas the rate is only 94.8. The territorial differences are even greater if one takes into consideration the presence of civil servants in relation to the labour force: again in this case, assuming that the national average is equal to 100, "poor" regions have a rate of over 135, about 50 points higher than the areas of Central-Northern Italy.

Table 5.9/a – *Economic wealth and incidence of civil servants in the territory: Italy. Average national index (excluding the capital) = 100 (net of employees working abroad)*

	GDP per capita(1)	Percent of Civil Servants in population (2)	Percent of Civil Servants in working labour force (2)
“Rich” Regions	**117.8**	**94.8**	**84.2**
Lombardy	130.7	79.7	69.2
South Tyrol	124.2	129.3	111.2
Emilia Romagna	122.3	97.3	82.4
Lazio	119.1	-	-
Valle d’Aosta	117.9	168.8	145.8
Veneto	117.5	87.8	77.5
Friuli-V.G.	112.4	127.1	115.6
Piedmont	110.0	94.9	86.9
Tuscany	109.2	105.7	97.2
Liguria	101.6	111.7	108.4
Marche	100.8	98.9	91.0
Umbria	93.2	106.0	98.7
“Poor” Regions	**67.0**	**108.3**	**135.1**
Abruzzo	82.1	105.0	107.3
Sardinia	76.9	117.6	124.7
Molise	74.9	122.8	137.0
Basilicata	71.7	115.4	137.0
Apulia	65.3	99.8	123.9
Calabria	64.9	115.4	150.0
Sicily	64.5	112.6	148.7
Campania	63.7	104.5	137.8
ITALY	**100.0**	**100.0**	**100.0**

(1) Including the region of the capital (Lazio)
(2) Excluding the region of the capital (Lazio)
Source: Processed by Centro Studi Sintesi on data supplied by Eurostat and Italy’s State General Accounting Department

Spain has a system similar to Italy’s (Table 5.9/b). The Spanish regional income varies remarkably across the country, although less than in Italy: Spain’s “rich” regions have a per capita GDP of 107.4 (national average = 100), while the average indicator for “poor” areas does not exceed 80. More specifically, in 2006 the Spanish regional income oscillated between an index of 130.5 in the Comunidad de Madrid to 67.7 in Extremadura.

The distribution of employees in the Spain follows a more diverging pattern than in Italy, albeit only by a little: “poor” regions have a civil servants to population rate of 111.3, as compared to 91 in the other areas (national average = 100, excluding the capital region of the Comunidad de Madrid). Roughly, the gap between “poor “ and “rich” regions is equal to 20.3 points, as compared to 13.5 points in Italy.

The situation changes considerably if the percentage of civil servants in the working population is taken into consideration. Spain’s territorial variability appears to be significantly less than Italy’s: the “poor” regions recorded an index of 118.2 (again national average = 100, net of the Comunidad de Madrid), while the more economically developed areas stood at 87. Stated more simply, the differential between the two groups of regions is 31.2 points in Spain, as compared to almost 50 points in Italy.

Table 5.9/b – *Economic wealth and incidence of civil servants in the territory: Spain. Average national index (excluding the capital) = 100 (net of employees working abroad)*

	GDP per capita (1)	Percent of Civil Servants in population (2)	Percent of Civil Servants in working labour force (2)
“Rich” Regions	**107.4**	**91.0**	**87.0**
C. Madrid	130.5	-	-
País Vasco	128.3	90.0	86.9
C. F. Navarra	125.6	95.0	88.1
Cataluña	117.9	72.7	66.1
I.Balears	109.4	91.7	82.4
Aragón	107.2	122.1	114.8
La Rioja	107.2	93.5	88.3
Cantabria	98.7	103.0	101.1
Castilla y León	95.1	121.4	126.6
C. Valenciana	91.5	85.4	82.5
Ceuta	91.0	248.9	347.2
P. Asturias	90.6	100.8	110.8
Melilla	90.1	243.8	325.4
“Poor” Regions	**79.7**	**111.3**	**118.2**
Canarias	88.8	107.8	105.9
R Murcia	83.4	105.7	103.1
Galicia	83.0	98.3	101.1
Castilla-La Mancha	78.0	122.8	126.6
Andalucía	77.6	109.5	121.3
Extremadura	67.7	151.0	177.1
SPAIN	**100.0**	**100.0**	**100.0**

(1) Including the region of the capital (C. Madrid)
(2) Excluding the region of the capital (C. Madrid)
Source: Processed by Centro Studi Sintesi on data supplied by Eurostat and the Spanish Government

To complete the analysis performed so far, it should be noted that Spain consists of 17 Autonomous Communities and two City-Regions, namely Ceuta and Melilla. These cities, situated in Northern Africa, have a high rate of civil servants in relation to the population and the work force; this is explained by their peculiar territorial location (there is a considerable military presence in these areas, for example) and by their small demographic and territorial size (Ceuta, 71,000 inhabitants in an area of 19 km2; Melilla, 67,000 inhabitants in an area of 13 km2).

Germany’s institutional and territorial entities have more even performances than their counterparts in Italy and Spain (Table 5.9/c). If Germany’s national average is set at 100, the seven “rich” federal regions (Länder) have an average per capita GDP of 112, while the remaining nine regions have an index of 80. The distribution of local income oscillates from 172.3 in Hamburg to 68.1 in Mecklenburg-Vorpommern.

Table 5.9/c – *Economic wealth and incidence of civil servants on the territorial level: Germany*
National average index (excluding capital) = 100
(Net of foreign employees)

	GDP per capita (1)	Percent of Civil Servants in population (2)	Percent of Civil Servants in working labour force (2)
"Rich" Regions	**112.0**	**98.7**	**97.6**
Hamburg	172.3	114.4	109.8
Bremen	135.5	108.0	117.2
Hessen	122.0	100.6	99.8
Bayern	117.7	101.8	95.6
Baden-Württemberg	111.3	100.5	94.5
Nordrhein-Westfalen	99.3	93.3	98.1
Saarland	96.8	96.0	104.9
"Poor" Regions	**80.0**	**102.3**	**104.4**
Niedersachsen	88.3	99.5	103.4
Schleswig-Holstein	87.6	106.5	107.1
Rheinland-Pfalz	87.2	104.7	103.0
Berlin	84.0	-	-
Sachsen	73.4	97.8	101.3
Sachsen-Anhalt	71.3	108.2	114.0
Thüringen	70.6	99.7	100.3
Brandenburg	69.9	98.0	96.9
Mecklenburg-Vorpommern	68.1	115.1	120.1
GERMANY	**100.0**	**100.0**	**100.0**

(1) Including the region of the capital (Berlin)
(2) Excluding the region of the capital (Berlin)
Source: Processed by Centro Studi Sintesi on data supplied by Eurostat and the German Statistical Institute

Public employment is quite balanced from the territorial standpoint: the "poor" regions have an incidence of civil servants in the population which, expressed as an index number, amounts to 102.3, while in the more developed areas this indicator is 98.7. There is a similar distribution when the number of civil servants in the work force is taken into consideration. The average index in the "poor" Länder (including those of Eastern Germany) amounts to 104.4, which is not far from the 97.6 recorded in the "rich" regions.

All things considered, there included the smaller disparities in the territorial income distribution compared to other countries, Germany not only has the lowest number of civil servants (55.2 employees per thousand inhabitants and only 118.8 per thousand employed) but is also showing a more homogeneous pattern across the regions. In short, Germany, which is undoubtedly the most "federal" of all big EU member states, is far from using its civil service as an instrument to absorb unemployment and support income. That holds true both for the "rich" Länder and in the areas that were once part of East Germany (DDR).

When looking at the facts and figures of Public Administration in the United Kingdom, one should be aware of the unique features of London's administrative territory: the British capital (7.5 million inhabitants) has a per capita GDP of 52,900 euros (2006), which is a good 65 percent above the national average. In addition to London, only one region (the South East) has a per capita income over the national average. Another distinctive feature of the UK political and institutional system is the devolution of administrative powers to Scotland, not to mention the open issues with Northern Ireland (Table 5.9/d).

Table 5.9/d — *Economic wealth and incidence of civil servants on the territorial level: United Kingdom*
National average index (excluding the capital) = 100

	GDP per capita (1)	Percent of Civil Servants in population (2)	Percent of Civil Servants in working labour force (2)
"Rich" Regions	**98.3**	**96.6**	**92.7**
London	165.3	-	-
South East	106.3	88.2	82.4
Scotland	96.3	119.5	116.3
Eastern	94.4	83.4	80.8
South West	91.9	101.9	99.6
"Poor" Regions	**84.5**	**102.8**	**106.5**
East Midlands	89.1	83.7	83.7
North West	86.9	104.1	108.2
West Midlands	85.9	100.0	103.0
Yorkshire and The Humber	85.0	101.3	105.7
Northern Ireland	81.3	133.3	140.8
North East	79.1	109.4	117.1
Wales	75.0	112.0	117.0
THE UNITED KINGDOM	**100.0**	**100.0**	**100.0**

(1) Including the region of the capital (London)
(2) Excluding the region of the capital (London)
Source: Processed by Centro Studi Sintesi on data supplied by Eurostat and the British Statistical Institute

Like Germany, the United Kingdom, with the exception of London and the South East, has a GDP per inhabitant that varies little across regions. Also the distribution of civil servants appears homogeneous, on the whole, with an average index of 102.8 in the "poor" regions and 96.6 in the "richer" areas. The only outliers are Northern Ireland (133.3) and Scotland (119.5). The regional differences are slightly wider if the civil servants to employed population ratio is considered: the range goes from the average of 106.5 in the territories with a low per capita GDP, to 92.7 in the wealthier regions. Again in this circumstance, Northern Ireland is completely outside the national average, with an index of 140.8.

5.6 Final Observations

This report has brought to light several aspects that may be worth considering in the delicate phase of implementing fiscal federalism. **Despite the reform of Title V of the Constitution** from 2001 until today **the Italian public system has remained prevalently centralised,** both from the point of view of public spending and in terms of personnel. Spain instead has gone through a wide-ranging decentralisation process, during which much of the public spending and personnel were transferred from central to local administrations.

In Italy the approval of the law on federalism is an important turning point. **A greater degree of autonomy and responsibility should,** in the mid to long term, **activate virtuous processes capable of generating significant savings in expenditures.** For example, between 25.7 and 49.4 billion euros of resources could be freed up (1.8-3.4% of the GDP) by adopting some key parameters of the public administration of a federal country like Germany.

On the territorial level, the smallest savings would be in Lombardy and the Veneto, indicating that these areas have reached satisfactory levels of efficiency and public performance; nevertheless, some areas could still be improved, transferring resources and personnel from central administrations to the local institutions. There seems to be more room for savings in Special Statute Regions; both physical (demographic dimensions, presence of mountains, insularity) and financial and institutional factors may have influenced this situation.

One of the key issues during the reform implementation process will be the transfer of civil servants from the central to the local administrative structures (first and foremost in the field of education). The empirical data confirms that, to some extent, public employment may have indirectly played a role as a "**social security cushion".** In fact, notwithstanding the large income variability across Italy, the presence of civil servants (especially in relation to the workforce) appears to be extremely unequal, to the advantage of "poor" regions. In the four countries taken into consideration (Italy, Spain, Germany and the United Kingdom) **public employment tends to take on greater importance in economically deprived areas– and this phenomenon seems to be magnified in Italy.**

This study has also detected some information gaps in the public accounting system which must necessarily be filled in the near future. In particular, the balance sheets produced by the state, regional and local institutions lack uniformity and consistency, especially when it comes to expenditure items and disaggregating data by territories. **The implementation of fiscal federalism is a unique opportunity to put some order into the national and local accounting systems and to harmonise them with Europe's.** This is not just a simple formality: the success of the federal reform implementation process will also depend on the quality and timeliness of the information supplied, so as to guarantee that the system is transparent and shared as much as possible. For these reasons, the first implementation decree will attempt to solve these problems.

Conclusions. Proposals to accelerate implementation of fiscal federalism

The heated debate over the failure to implement fiscal federalism has shed light on the crucial issues of a stalemate which, as we have seen, continues to damage the most dynamic Regions, which have the greatest fiscal capacity.

Approval of delegate law no. 42/2009, which was passed also thanks to the constructive abstention of almost the entire opposition in Parliament, is a great step forward towards implementation of the federal reform of the State.

This is an irreversible decision, and as such it must be promoted with determination and great collaboration between all of the institutional, national and regional subjects. It will not be simple, because the new Title V of the Constitution makes reference to a number of overlapping competencies. It has now therefore become urgent to start the Joint Technical Commission for the Implementation of Fiscal Federalism, where technical representatives of each echelon of government can share financial and tax information and express their informed opinion on how to restructure the financial framework of Municipalities, Provinces, Metropolitan Areas and Regions and intergovernmental financial relations.

Unfortunately we have seen that the current system of territorial solidarity fails to stimulate the efficiency of public administration and does not encourage the economic system and the economic convergence of Italy's Southern Regions. In particular, the current system of equalisation and the lack of local tax autonomy do not encourage the local governments to become accountable and fully independent in guaranteeing covering of expenditures on the provision of services in accordance with their competencies.

The Veneto plays an important role in national solidarity: its fiscal residuum has reached almost 21 billion euros, generating a wide gap between what the taxpayers pay to the various public administrations (central and periphery) and what they receive back in the form of services. The financial surpluses accrued by the Veneto, Lombardy and Emilia Romagna Regions and, in recent years by Lazio as well, go to pay the deficits of other Regions, especially of those in the South. There is a growing belief that the current system of equalisation has not benefited anyone.

Nevertheless, despite the limitations of equalisation and the current institutional system, the Veneto has succeeded in matching the economic performance of Regions belonging to federal countries. The implementation of fiscal federalism, therefore, would allow the Veneto to stimulate greater economic growth and a definitely higher quality of services with respect to European standards.

Federalism also generates better administrative efficiency: in federal countries, the rational allocation of public spending often produces a reduction in superfluous burdens and inefficiency. In fact, in countries where public spending is more decentralised, the expenditures for operation of the administrative apparatus are lower on the average.

For all of these reasons, the proposals to accelerate implementation of federalism in Italy contained in this paper do not differ from those stated in earlier studies[48], namely:

1. **Start mechanisms to cut expenditure in public administrations on the basis of their level of efficiency:** in regional and central organisations that employ a large number of civil servants and record a high level of intermediate consumption and high personnel costs, a system of turnover should be introduced that allows hiring 1 new employee for every 10 who retire. The savings so realised could be used for specific projects, such as for the construction of infrastructures and protection of the territory.

2. **Implement the transfer of civil servants from central administrations to local administrations,** in order to avoid recruiting new personnel, which would entail further costs that are transformed into additional taxes for citizens.

3. **Assign state-owned property to local administrations** for the purpose of enhancing the urban environment, cultural production and income generation. Redefine the roles and competencies of local bodies in running state- owned real estate currently managed by different parties.

4. **Assign the task of collecting tax revenues intended for the regions to the regional authorities themselves,** through the "regionalisation" of the Inland Revenue Department (*Agenzia delle Entrate*). For fiscal federalism to be truly implemented, the controlling authority over revenues should rest with the Regions rather than with the Central Government, so that each Region can become more accountable and fulfil fiscal obligations more efficiently, both through assistance to taxpayers and through direct controls to fight tax evasion. In this context, the Central Government should be in charge of monitoring and controlling the proper operation of all the local revenue offices to guarantee appropriate standards of efficiency and effectiveness.

5. **Reduce fiscal residua to the levels of other European regions:** Veneto's 20.9 billion euros of fiscal residua are untapped resources, which could help boost competitiveness, improve the quality of transportation, support enterprises, increase the available income of families to levels above European standards.

6. **Assert the principle of correlation between what is taxed and what is administered:** this principle reinforces the ties between administrators and citizens, inasmuch as the latter can more directly evaluate whether the amount of taxes paid is justified by the quality of services provided. This principle could be implemented through the introduction of a **real estate tax regime,** under which local administration could levy **local taxes** on real estate that citizens and enterprises are free to use.

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48 Compare Veneto Unioncamere (2007), Veneto Unioncamere (2008) work cited previously

7. **Adopt a "horizontal" subsidiarity model similar to Germany's,** namely, a form of equalisation through direct transfers from the Regions with lower needs and higher fiscal capacity to Regions with greater needs and lower fiscal capacity. That would enable the country to make the flows of interregional resources between regional institutions explicit, thereby guaranteeing greater transparency and therefore greater control of financial flows.

Some of these proposals have been taken up in the delegated law on fiscal federalism approved last spring, which contains innovative solutions and represents both an important synthesis of the legislative proposals that have come to the fore in recent years and a fundamental starting point.

The hope is that this work may be of use to Government representatives in Italy, who are now facing the great challenge of a difficult change, but also to our enterprises and trade unions, which - like the Chambers of Commerce - have the task of favouring the growth and competitiveness of the regional economic system.

Glossary

Central administrations: area of the Public Administration that includes the State, the Bank for Deposits and Loans, Social Security Bodies (Inail, Inps) and other Bodies associated to the central government. They are collectively referred to as the Central State.

Local administrations: area of the Public Administration that includes Provincial Districts, Municipalities, Mountain Communities, Chambers of Commerce, Universities, Bodies for the Right to Tertiary Education.

Local authorities: this definition includes both Local and Regional Administrations.

Public administrations: this area brings together the institutions whose main functions are the delivery of non-sellable services and the equalization of the Country's income and wealth. Their main resources include the mandatory payments made either directly or indirectly by units pertaining to other sectors (source: Istat). They include the Central, Regional and Local administrations.

Regional Administrations: area of the Public Administration that includes the Regions (Ordinary and Special Statute Regions), Local Health Boards, State Hospitals.

Overall surplus and deficit: the discrepancy between overall revenues and overall spending. This term is used in reference to the implementation or the management of the balance (assets and liabilities accrued and cash balance) and measures the excess (surplus) or shortage (deficit) of resources that can be acquired or were acquired compared to the actual or possible use (source: Istat).

Court of auditors: has contentious jurisdiction over the accounts of treasurers, receivers, cashiers and agents in charge of collecting, paying, conserving and handling public moneis or to hold in custody State valuables and assets, it also has auditing functions as envisaged by the general accounting regulations on state spending.

Derived finance model: Public Bodies work along the lines of a "derived finance" model that includes the following: a) centralisation, by the State, of the collection of financial revenues; b) distribution of the thus collected finances between the Public Bodies.
The collection is centralised through the following: centralisation of the taxation system; centralisation of indebtedness; centralisation of liquidity management.
In addition to these three types of centralisation (of taxation, indebtedness and liquidity management), the *«derived finance» model* is characterised by the subsequent *transfer* of the finances from the State to the all other local bodies:

these funds are the bulk of these bodies' revenues. The «transfer finance» model sees the «lower-ranking» public body (e.g.: a Municipality) almost completely dependent from the handouts it receives from a «higher-ranking» public body (e.g.: the State)

Länder: (or, unofficially, Bundesland) the Federal States of Germany. Each of the 16 Länder is represented at Federal level in the Bundesrat, the Federal Council.

Residuum: the difference between the Public Administrations' revenues and expenditure. It summarises the financial flows between different levels of government and the local territory.

Public spending: the public spending item includes public purchases and transfers to Local Administrations, businesses and individuals (in the form of pensions and other benefits, such as unemployment benefit). It includes current public spending, namely allocated to the production and redistribution of revenues for purposes not directly associated to direct production, the consequences of which become visible during the year, and capital account public spending that directly or indirectly affects public capital formation to be used for investments.

Running costs: these include the spending for staff in addition to the so-called "general services" function (that includes all costs associated to administrative management). These resources are necessary to keep the administrative machinery going.

Subsidiarity: the principle of subsidiarity (art. 118 of the Constitution) assigns administrative functions to Municipalities, allocating all other competencies bottom-up to the higher levels of government (Provincial Districts, Regions, State) for all the issues that the Municipalities would be unable to perform effectively and efficiently alone.

Title V: part of the Italian Constitution that governs the relationships and allocates competencies between State, Regions and Local Bodies. It was amended in 2001 through a dedicated Constitutional Law (no. 3/2001) following a referendum.

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