

# Italy's fiscal devolution moves it towards federalism

PM Berlusconi aims to give each region the funding of the most efficient region



Italy's Prime Minister Silvio Berlusconi holds a news conference during a summit of European Union leaders. Berlusconi has vowed to devolve an unprecedented amount of financial resources to the country's provinces and municipalities.

BY LUCIO LEVI

**A** LANDMARK BILL ON FISCAL FEDERALISM has been submitted to the Italian parliament, setting in motion Italy's move towards becoming a truly federal nation.

The bill fulfills Prime Minister Silvio Berlusconi's electoral promise to devolve an unprecedented amount of financial resources to the country's provinces and municipalities.

The bill has the backing of Italy's

regional, provincial and municipal authorities.

The parliament had been expected to approve the bill, submitted to it on Oct. 3, 2008, by the end of the calendar year.

There had been mounting pressure to devolve financial powers because Berlusconi's government, elected in April 2008, is a coalition with the decisive support of two territorial movements, the Northern League, rooted in Northern Italy, and the Sicilian League for Autonomy.

The main proponent of the bill is the Northern League, which at times took a decidedly secessionist stance. It won eight per cent of the vote in April's election.

Berlusconi is facing the challenge that he has to reconcile the differing views on the federal future of Italy of his coalition partners. They oscillate between a push for greatest autonomy possible for the North by the Northern League and the wish for a strong central government that safeguards the unity and solidarity of the country. The latter is expressed by the post-fascist Alleanza Nazionale, which has a strong backing in Italy's south and elsewhere as well.

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Under the bill, the three levels of sub-national government – regions, provinces and communes – will share a quota of income tax and of the value added tax (VAT) with the central government. In principle, the deal will not entail a tax increase, but simply a shift of the fiscal burden from the centre to the periphery. Taxes could potentially increase, but only if regional and local governments levy new taxes for specific initiatives.

In 2001, power was given to Italy's 20 regions to deliver services in health, education and welfare. But this bill goes further and changes the way Rome delivers funding to the regions to pay for the cost of social services. The principal mechanism of the reform is to calculate the "standard costs" of public services in areas such as health, education, welfare and public transit in every region.

This will mean that inefficient regions will be identified and assessed accordingly. Initially, every region will receive funding that matches the cost of program delivery in the country's most efficient region. That will be the baseline. However,

the regions which are unable to meet that standard will be assisted by an adjustment fund.

An important feature of the bill is that the current transfer of tax revenues from richer northern regions to poorer southern ones will be wound down gradually over a five-year period.

### Making regions accountable

The stated goal of introducing fiscal federalism in Italy was to enhance the accountability of local authorities and to reduce the income gap between North and South. The reason the politicians of the less efficient regions like the fiscal bill is that they believe the resources made available to them will increase.

The North is happy because equalization payments - transfer payments that go to the South - will be reduced over the long run. The South is happy because they can keep "their" taxes although they may not be looking too closely at the long-term effects of this change.

However, the government may be breaching its own commitment to heighten the accountability of local and

regional governments with a generous grant to two local governments ruled by centre-right majorities - Rome and Catania (in Sicily) - plus the region of Lazio to relieve their heavy financial deficits. To an outside observer, it has the markings of rewarding inefficiency.

The implementation time for the bill, if passed, is expected to be lengthy. The parliament is now expected to approve it by the end of the year. Then, the government will have two years to set the pieces in place before the bill comes into effect. The transitional period will last at least five years. In 2015 or even in 2020 the new fiscal arrangement is supposed to be up and running at full speed.

Now it is up to the Italian Parliament to assume a leading role in discussing, amending and passing the bill. A joint commission for the achievement of fiscal federalism, made up of representatives of the four levels of government (from municipalities to national government) has been entrusted with the task of calculating the cost of services, which is key for determining fiscal allocations.

The joint commission must create

## Italy's zigzag path to federalism

In 1861, immediately after the birth of the Italian state, Count Camillo Cavour, the architect of political unification, introduced a bill for the establishment of a regional order of government in Italy. It proved to be an impossible dream.

Inspired initially by the French unitary state model, Italy remained unchanged for a century. The roots of inward-looking centralization lay in the context of ever-present tensions between the states of the European continent, which shared long territorial borders. This inward trend was reinforced by the process of economic integration of the national space brought about by the industrial revolution.

It was only in 1970 that a regional order of government was established in Italy, even though the Constitution of the Republic of Italy, of 1948, contained a provision for it. Decentralization did not begin due to political concerns related to the Cold War and to the dom-

inant role of the Italian Communist Party in some regions.

But it was only over the last decade that Italy transformed its political system with the objective of "federalizing" the country. Various reasons led to an increased push for federalization. First, the general dissatisfaction with the central political institutions and the inability of the central government in Rome to fulfill its tasks. Second, there was a growing unwillingness in the northern part of Italy to endorse transfer payments to the poorer south. An important role was played by the popularity of the idea of subsidiarity, according to which powers and activities must be allocated as near as possible to the citizens.

The most vocal proponent of federalism was the sometimes secessionist Northern League. European integration and then globalization also progressively eroded Italian national sovereignty and paved the way for the current experiment with decentralization.

In 1999 and 2001 the Italian Constitution was amended in order to

expand the powers of the regions. Following the federal principle, the residual competencies – those not explicitly mentioned in the Constitution's list of national government's competencies or in the list of shared competencies – were assigned to the regions.

Presidents of the Regions began being directly elected in 1993. At the same time, Article 119 of the Constitution, which sets out the notion of financial autonomy for Italy's regions, had not yet been put into effect by any Italian government. This financial autonomy is an essential element of the devolution of power and one that is necessary for a federal Italy.

And yet, Italy has to contend with financial obligations flowing from its membership in the European Economic and Monetary Union, including a commitment to balance its budget and to reduce its colossal debt, which is more than 106 per cent of Italy's GNP. It is against this backdrop that the devolution of real fiscal resources to the regional and local authorities began in late 2008.

from scratch a common database of costs that could be shared among all the actors in the negotiations.

Before the introduction of its fiscal federalism bill, the first major initiative of the Berlusconi government was to abolish the municipal real estate tax, as promised during the electoral campaign. This was the only real local tax in Italy. The municipalities have been compensated for the loss of this income with a transfer of funds from the central government proportional to the income formerly received from the municipal tax. Owing to the difficulties deriving from the international financial crisis, for the time being, only half of the figure has been transferred.

Centralizing a tax levy – while decentralizing the spending of tax revenues – does not promote financial restraint, accountability and efficiency of regional governments.

### Regions collect taxes

Principled proponents of federalism in Italy have argued that this practice is very distant from federalist principles, which require that regions collect and spend their own tax revenue rather than centralize it in the hands of national government.

The fact is that, owing to the income gap between Italy's North and South, federalism is facing serious difficulties. The average income in Calabria, at the "toe" of Italy, is 40 per cent lower than in Lombardy, whose capital, Milan, is the centre of fashion and finance in Italy.

The Northern League party is opposed to the policy of monetary transfers from rich northern regions to poorer southern regions. According to the party's electoral program, 90 per cent of the tax yield should stay in the territories where it is generated.

On the other hand, the Autonomy Movement demands that income from gasoline taxes refined in Sicily should remain in Sicily. It is almost impossible to reconcile such contradictory demands. The bill contains a compromise between the two contradictory positions that is



Italy's populist Northern League Party, led by Umberto Rossi (right), staunchly supports devolving financial resources to the country's provinces and cities. Rossi is flanked by party colleague Roberto Calderoli at a party rally in June 2008.

meant to square the circle.

Only recently has the notion of federalism taken any traction in Italy. This is a consequence of transfer of powers to the European Union on the one hand and to the regions and local communities on the other.

Yet despite all the steps Italy has taken toward federalism so far, there are some important reasons that further steps in this direction may prove difficult.

### Power to the regions ... and to the Mafia?

In most cases, it can be argued that federalism improves the management of public service and public resources, since it enhances the responsibility of local and regional authorities. But this argument is not universally applicable.

In Italy, there are regions that escape the control of central government, which has thus far been unable to subdue the gangs of organized crime – not only the Mafia in Sicily but several other major crime organizations in the South, namely the Camorra in Campania and the 'Ndrangheta in Calabria. In these regions, a decentralization process could well mean strengthening the power of criminal gangs.

Also, an essential aspect of the Northern League's program is its micro-nationalism – based on its members' affection for "Padania," or the Po Valley,

in Northern Italy, a community with no particular historical roots.

The Northern League has been accused of xenophobia and even racism and the Berlusconi government itself was criticized for xenophobia by the Council of Europe in June 2008.

To press their demands for regional autonomy, the Northern League's leaders periodically threaten the secession of Padania. They have gone so far as to proclaim that their activists are ready to resort to armed conflict.

Around the same time, six black farm labourers were murdered by the Camorra in Castelvolturno, near Naples in September 2008, prompting the Northern League's Minister of the Interior, Roberto Maroni, to declare that "the government is facing a civil war."

Italy's recent history shows how fragile are the fundamental principles of the rule of law and democracy.

Major forces outside the government's control include not only multinational corporations, but also the Roman Catholic Church and organized crime.

The situation is so delicate that there are some political observers who warn that the establishment of federalism in Italy could jeopardize the unity of the state. 