SHORT ARTICLES

THE GAMBLE OF FISCAL FEDERALISM IN ITALY

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Abstract.

Since the Italian Constitution has undergone a profound reform with regard to the relations between central and local government. Although a widespread opinion argues that, Italy has taken its first steps towards a federal system, in fact it has strengthened its regionalism. Only in 2009, in particular, has Parliament implemented the new Article 119 of the Constitution, which deals with fiscal federalism. This article argues that the Act does not aim at achieving a system of competitive fiscal federalism, but, rather, a financial system in which healthy competition among areas is combined with cooperation, in order to effective protection of the entirety of citizens' rights. However, new principles and standards are laid down, which seek to enhance autonomy, transparency, accountability. In particular, the incremental variations based on historical spending will be replaced with standard spending, which implies a strong cultural change.

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1. Introduction.

With the 2001 reform of the Italian Constitution and in particular Title V thereof dealing with relations between central and local government, Italy has taken its first steps towards a federal system. In fact, Italy has gone from a regional system in which central government enjoyed all the powers combined with a limited role for local government to a system that can best be defined as 'federalist like' because the federalisation process has not yet been completed, especially in terms of establishing a house of parliament representing the interests of the regions, provinces and municipalities as such.

A significant step towards the development and growth of the federal system in Italy will undoubtedly occur through implementation of fiscal federalism governed by article 119 of the Constitution. The fact is that up to now there has been a structural anomaly: the federal system has been achieved only in part relating to administrative functions (Bassanini Law) and legislative powers (reform of Title V of the Constitution) while the whole issue of funding has remained where it was before, based essentially on a model of grants made by central government. The effect of this asymmetry is that public spending (excluding pensions and interest) is at this point in time divided equally between central government on the one hand and the regions/local authorities on the other hand but the latter raise less than 18% of tax revenues. There is thus a weak link between taxation and spending. Centralised government may well have been checked but federalism has not been created.

From this perspective the Italian situation is similar to that which reigned in Spain in the 1980s when the new constitution granted greater legislative and administrative functions to the autonomous communities there but not the power to levy taxes. This lack of association between spending and taxation led to public spending spiralling out of control and the remedy was fiscal federalism, which was quickly and resolutely introduced shortly afterwards.

By contrast in Italy central government continues to be the paymaster of last resort. It is clear that a federal system which does not also incorporate fiscal federalism will not be very effective. Maintaining a model essentially based on grants from central government in a country that has witnessed a

decentralisation of significant legislative powers since 2001 creates serious confusion, disassociates spending from taxation, generates an institutional situation that makes it nigh impossible to keep public accounts under control and fosters duplication of facilities, inefficiencies and little accountability. This defect damages the system like a virus as the figures on public spending by central and local government over the past few years demonstrate.

2. The challenges of fiscal federalism.

Briefly, and before examining the issues associated with fiscal federalism and its implementation, it is worth explaining the 'federalist like' system that operates in Italy today. The constitutional reforms of 2001 significantly overhauled the relationship between the legislative powers of the State and those of the regions. Article 117 of the Constitution sets out the exclusive competencies of the State (for example, foreign policy, defence and armed forces, the administration of justice, immigration, etc.) and the concurrent competencies of the State and regions whereby the former lays down the basic principles in a national law and the latter specify the contents in more detail through regional laws (for example, foreign trade, health care, scientific research, etc.). All of the other matters not specified in the Constitution fall within the competence of the regions, which in effect amounts to a residual competence in their favour.

The 2001 constitutional changes did not just concern the distribution of legislative powers between the State and the regions. Other issues were addressed too, the most important of which and quite representative of the entire system is the principle enshrined in the first paragraph of article 114 of the Constitution: «The Republic is composed of Municipalities, the Provinces, the Metropolitan Cities, the Regions and the State». Whereby the State, regions, metropolitan cities, provinces and municipalities are all at the same level thereby overturning the previous approach that saw the State as being above everyone and everything.

The question is: is Italy a federal country? If one considers the classic federal countries perhaps Italy cannot be considered to be federal system. There are no elements of strong autonomy of constituent parts like, for example, in the United States and

Germany (e.g. relationship between constituent parts and local authorities, involvement of constituent parts in any constitutional revision process, role in the administration of justice). However, if we consider the constitutional reform of 2001, the regions and local authorities have become bodies that together with the State itself make up the Italian Republic and that enjoy legislative and administrative autonomy guaranteed directly by the Constitution. The central government cannot limit their autonomy if not within the boundaries permitted by the Constitution itself.

It is necessary to underline the difference existing between the typical model of federalism – which is a process concerning the aggregation of states/regions originally apart – and the Italian federalism like, where "federalism" take birth by the division of the State which was originally unitary.

Compared to the past, central government has more limited powers to intervene to safeguard the unity of the system and limit the authority of local government. What the 2001 constitutional reforms lack are transitional provisions which guarantee the change over to the new system. These are slow processes. For example, regional authorities where envisaged by the 1948 Constitution but they were actually created only in 1970.

Today the most important factors are three: a) the actual implementation of the reform; b) negotiation and sharing among central government, regions and local authorities; c) the interpretation of the Constitutional Court (which decides on the constitutionality of laws). Law No. 42 of May 2009 is key to promoting this implementation process and already contains in its title a reference to "fiscal federalism". Is this perhaps the Italian route to federalism?

3. Constitutional reform and the optimal dimension of local autonomy.

The implementation of fiscal federalism, the details of which are explained shortly, will witness an essential aspect of the functioning of the constitutional reforms of 2001 taking shape, i.e. the independent raising of financial resources by local government within the framework of coordinating principles laid down by national law as provided for in the first paragraph of article 119 of the Constitution: «Municipalities, Provinces, Metropolitan Cities

and Regions shall have financial autonomy with respect to revenues and expenditures».

The second, third and fourth paragraphs of article 119 of the Constitution then go on to provide as follows respectively: a) local authorities, from this standpoint equivalent to the regions, may set and levy their own taxes and revenues («Municipalities, Provinces, Metropolitan Cities and Regions shall have independent financial resources. They set and levy taxes and collect revenues of their own, in compliance with the Constitution and according to the principles of co-ordination of State finances and the tax system. They share in the tax revenues related to their respective territories»); b) national laws must establish equalisation funds without restrictions as to how they may be used («State legislation shall provide for an equalisation fund, with no allocation constraints, for the territories having lower per capita taxable capacity»); c) the overall resources raised from the foregoing sources must be such as to fully fund the functions of the regions and local authorities («Revenues raised from the above-mentioned sources shall enable Municipalities, Provinces, Metropolitan Cities and Regions to finance fully the public functions attributed to them»).

The principles that govern local taxation have thus been significantly modified in light not only of the wording of the new article 119 but also the indispensable link that Title V establishes between that same article 119 and article 117 of the Constitution granting the State exclusive legislative power over national taxes (paragraph 2, subparagraph e) and granting the State and the regions concurrent competency in relation to "coordination of the public finances and taxation system" (paragraph 3), evidently granting the regions residual exclusive competence over regional and local taxes.

It must be said that, from the standpoint of the method, implementing article 119 within the framework of the new Title V of the Constitution calls for a deep transformation of the State, perhaps the most radical one in decades. It means committing a vast number of regions and local authorities to be able to rigorously manage resources, increase the efficiency and productivity of their facilities for providing services, assess performance, and adopt 'carrot and stick' policies capable of fostering ability, merit, quality and productivity. It means in

substance putting in place an essential tool to attain the revolution of the institutional and administrative system which has often been announced in the past (and to some degree commenced) but which has never been fully achieved up to now.

Also because the question of fiscal federalism, i.e. the allocation of resources among different levels of government, raises a constitutional issue of paramount importance that goes to the very heart of the form of State because it concerns the relationship between central and local politics, the common need to have resources to fund public services and above all the guarantee that all citizens can enjoy their civil and social rights equally.

It has to be said that the essential levels of civil and political rights remain in the sphere of national legislative competence.

Since 2001 both the regions and local authorities (provinces, metropolitan cities and municipalities) have enjoyed autonomy directly guaranteed by the Constitution. As for legislative powers both the State and the regions can pass laws on the subjects that fall within their remit, allocating "administrative functions" to local authorities, according to the principles set by the Constitution (in summary: the subsidiarity principle). However, the State has exclusive legislative power in relation to a series of matters that touch upon regional competence, including the identification of the "fundamental functions" of local authorities. The distinction between "fundamental functions" and "administrative functions" of local authorities is not a simple one. Therefore, through the "fundamental functions" clause the State can significantly limit the legislative autonomy of regions in connection with the exercise of administrative functions.

For a series of historical and financial reasons, local authorities are not generally in favour of regional power. They prefer to engage in direct dialogue with central government. They prefer the far-reaching and thorough intervention of the State when it comes to fundamental functions. This also has an impact on financial relations. It is, therefore, not completely correct to state that the Italian system follows a hierarchical structure: central government - regions - local authorities. This naturally makes the financial system of the functions of the regional and local authorities more complicated.

4. The Act of Parliament on fiscal federalism.

Article 119 of the Constitution and hence Italian fiscal federalism is to be implemented through delegated legislation whereby parliament entrusts the national government - through Law No. 42 of 5 May 2009 – "Delegation to the government in the matter of fiscal federalism further to article 119 of the Constitution" – with the task of adopting legislation to establish and organise fiscal federalism. It should be said that the principle that informs the law is "institutional loyalty among all levels of government", which applies to the whole process of implementation of fiscal federalism, as well as the principle of "participation by all public administrations in attaining the objective of the national public finances consistent with the restrictions imposed by the European Union and international treaties".

The federalism in the Constitution is thus a 'joint' one, in which healthy competition among areas is not a *bellum omnium contra omnes* (war of everyone against everyone) but a system of cooperation-emulation-subsidiarity aimed at creating the best conditions for the effective protection of the entirety of citizens' rights, securing sustainable growth for the nation as a whole through harnessing the energy and resources of each regional and local community, adapting management choices and mechanisms to the peculiarities of each community, re-establishing political accountability for resources and spending, fostering the productivity and efficiency of public facilities and enhancing the synergy between private initiatives and public action, all within the logic of horizontal subsidiarity.

5. Legislative principles and guidelines.

Given the complexity of the law that has been passed, summarised in ten points hereunder are its main criteria and principles.

It is provided that the move to the new system must not lead to a greater fiscal burden for citizens. The greater taxation powers of the regions and local authorities will correspond to a reduction in the taxation imposed by central government

commensurate with local government's greater fiscal autonomy. The overall tax burden should not increase and every transfer of central government functions to local government should be accompanied by the transfer of human resources and facilities in order to avoid duplication of functions or additional costs.

Fiscal autonomy entails: the end of the grants system based on historical spending and the gradual move to a system based on standard needs; the introduction of effective taxation and spending powers for local government, meaning that there will be taxes that regional and local authorities may determine the content of within the limits and framework laid down by law, in essence: i) derived taxes, in the sense of taxes established by the State but whose revenues the regions and local authorities are entitled to; ii) regional and local surtaxes (a given proportion of the revenue remains with the geographic area that generated it; iii) own taxes properly speaking, in the sense of taxes established by the regions and local authorities themselves; a series of regional and local taxes that assure flexibility, room for manoeuvre and territoriality, with this latter criterion expressing more than any other the ethos of the system that it is sought to introduce since it assigns a central role to the concept of territory in its many meanings and ensures that there is a link in general between the place that tax revenues come from and the place that they are spent in; the possibility for more efficient administrations that manage to contain costs, services being equal, to fine tune their taxes (for example, reducing the rates or introducing deductions or exemptions). In particular, in order to finance essential levels of services (especially health, education and welfare) regions will have the following available to them: i) regional taxes to be determined on the basis of a link between the type of tax and the service provided; ii) a personal income tax (IRPEF) surtax; iii) regional share of VAT receipts; iv) specific shares of the equalisation fund. On a transitional basis expenditure will be financed by revenues from the existing regional production tax (IRAP) until such time as that is replaced by other taxes. The provinces and municipalities will have their own taxes, shares of revenue, surtaxes and dedicated taxes linked to matters such as tourism or urban mobility; a connection between the tax and the function performed by the authority (principle of correlation between taxation and benefits).

As regards standard needs and costs, the funding for the regions and local authorities must be based not on historical spending, which could also include waste and inefficiency, but on costs calibrated having regard to a public administration's average level of efficient management. Reference is to be made to the costs borne by an administration that provides services and performs functions respecting average efficiency parameters, in other words, the effective need in relation to each service rendered is to be taken into account. Therefore, the councilors will have to answer to the electorate for any costs over and above the level taken as the benchmark.

Equalisation is based on the following suppositions: overcoming of the criterion of historical spending; reference to standard needs and costs for expenditure in connection with essential levels of service that must be guaranteed throughout the country and for the fundamental functions of local authorities; full equalisation for authorities with lowest tax revenue generating capacity per capita as regards expenditure in connection with essential levels of service and the fundamental functions of local authorities, as always within the limits of standard needs and costs. Equalisation means bridging the gap between the different areas of the country, guaranteeing essential services to the citizens of each region in accordance with the principle of social solidarity thereby assuring that the least well off regions can provide services to their citizens with minimum uniform levels. For local public transportation, reference will be made to the national benchmark and the associated standard needs; equalisation of the differences in capacity to generate tax revenues must be done without changing the order and without impeding modification over time depending on how the economic picture develops. This is very important because it is a reasonable limit to equalisation. In short, the wealthiest region, province or municipality before equalisation must contribute to the equalisation fund but may not after equalisation end up being poorer than another area that previously had fewer resources. For example, if the revenues pro capita from taxation are 100 in a wealthy region and 70 in a poorer region, equalisation can take place in order to achieve some balance and guarantee essential services for everybody. However, equalisation cannot be so extensive as to produce an outcome whereby because of it the resources pro capita in the first region

end up being 80 and those in the second one 90, and perhaps only because the second region spends more and in a worse way; the regions may redefine equalisation for the local authorities in their territory subject to agreement with those authorities.

In order to afford guarantees for local authorities, Law No. 42 of 5 May 2009 provides for: taxes established by the State or region in their capacity as holders of legislative power, subject to a significant degree of flexibility and respect for the local authority's own autonomy; sharing of national and regional taxes, in order to assure the stability of the local authority; full equalisation based on standard needs for expenditure in connection with fundamental functions.

The system of rewards and sanctions envisages: rewarding virtuous conduct and behaviour that demonstrates efficiency in the exercise of fiscal powers and in financial/economic management; penalising the bodies that do not achieve an economic/financial balance or do not provide essential levels of service, including disqualification from office for the management in charge of local authorities suffering from a financial crisis and in the worst cases the option for the State to step in directly itself. Irregularities that cause serious financial difficulties amount to violations of law for the relevant regional managers.

The convergence pact is a mechanism through which the central government, subject to joint discussions and assessment at a so-called 'unified conference', sets out a path for dynamic coordination (which must be submitted to parliament with the national economic and financial planning document) to achieve the objective of a convergence between standard costs and needs as well as service targets, which the local authorities are obliged to adhere to. In the event of a failure to attain the objective, the central government establishes the reasons therefore and takes suitable corrective action through a special purpose "plan to attain convergence objectives".

Transitional provisions envisage the establishment of metropolitan areas whose autonomy in matters of revenue and expenditure should be commensurate with the complexity of the broader functions assigned to them. Moreover, other fundamental functions are identified in addition to those already exercised by the province concerned.

They are: general planning of the territory and infrastructure networks; structuring of coordinated systems for the management of public services; promotion and coordination of economic and social development.

The transitional provisions also set out the procedures governing the establishment of metropolitan cities through a referendum to be held in the provinces in which the cities of Turin, Milan, Venice, Genoa, Bologna, Florence, Bari, Naples and Reggio Calabria are located. It is further provided that a specific legislative decree will regulate the resources to be allocated to the city of Rome for its role as the national capital. Rome will also be given its own set of assets. Finally, municipalities will be granted a series of specified administrative functions in addition to those that they already exercise.

The following principles will govern coordination of the various levels of government: transparency in the different capacity per capita to generate tax revenue before and after equalisation so as to highlight financial flows between bodies; a role for each region and local authority in observing the stability pact; introduction of a series of rewards and sanctions for respectively the most and least virtuous bodies.

Law No. 42 of 5 May 2009 provides as follows in order to implement the fifth and sixth paragraphs of article 119 of the Constitution: specific rules for allocating *additional resources* and adopting *special measures* in favour of given regions and local authorities to remove particular forms of economic and social imbalance (the measures are financed by the State budget, EU grants and national co-funding); that the sixth paragraph of article 119 of the Constitution on the transfer of State assets to the regions and local authorities is to be implemented.

The following are envisaged for coordination purposes: a "parliamentary commission for the implementation of fiscal federalism", comprising 15 deputies and 15 senators appointed by the speakers of both houses of parliament, whose function is to give opinions on draft implementing legislation, check progress on implementing Law No. 42 of 5 May 2009 itself, submit observations and provide the government with whatever evaluation might be of use to it in drawing up implementing legislation. The commission is to be dissolved at the end of the transitional phase. The commission is to liase with the regions and

local authorities and to this end a committee of their representatives is set up. It is provided that should the government decide not to follow the opinion of the joint parliamentary commission or those of the other relevant parliamentary commissions, it must submit the text concerned to the houses of parliament and make a statement thereon before them: once 30 days have passed the government may adopt the legislation in final form; a "joint technical commission for the implementation of fiscal federalism", set up at the Ministry of Finance, an advisory body whose function is to provide advice to the government and local authorities as well as to obtain and analyse whatever information may be necessary for the drafting of the implementing legislation; a steering body in the shape of the "permanent conference for the coordination of the public finances", comprising all of the institutional players involved in the process of achieving fiscal federalism, whose function is to check the working of the new financial order of the regions and local authorities, the adequacy of resources and consistency of data. It performs an advisory role and is the forum for sharing information among all concerned.

The commitment of central and local government to combating tax evasion and avoidance is acknowledged, including rewards for the regions and local authorities that achieve positive results in this area in terms of increased tax revenues.

It is provided that the regions with special constitutional status and the autonomous provinces shall contribute to attaining the objectives of equalisation and solidarity, shall exercise the rights and duties associated therewith and shall adhere to the internal stability pact and EU obligations in the manner to be set forth in legislation implementing their respective regional and provincial constitutions. Any new functions allocated to them will be funded by sharing revenues from national taxes and excise duties. Within the framework of the State-Regions Conference a round table is established between the central government and each single region with special constitutional status and each autonomous province in order to assure their participation in achieving equalisation and solidarity and observing the internal stability pact. This forum also serves to assess the consistency of the financial resources allocated to the said regions and provinces

after the entry into force of their constitutions in order to check coherence with the new system of public finance.

The transitional phase for regions: in respect of the equalisation fund there will be a gradual move away from the grants given to the single regions in 2006-2008 to the principle of standard needs. The new equalisation will operate once the financial aspects of the essential levels of services and fundamental functions have been determined with the switching to the principle of standard needs within 5 years. For non-essential levels funding will have to progressively depart from historical spending within 5 years but in cases where regions cannot objectively bear the change the State may adopt corrective action in the form of compensation but only for a maximum of five years. On a transitional basis regions will not have to bear any shortfall between projected and effective revenues.

The transitional phase for local authorities: the State and the regions will fund the additional administrative functions transferred to the local authorities as well as those that the latter already perform. The system of historical spending is to give way to one based on financing standard needs within a period of 5 years for expenditure connected to fundamental functions and other spending. Until such time as the rules on fundamental functions take effect in full, the functions performed by provinces and municipalities are financed on the basis that 80% of expenditure is to be considered as fundamental and 20% as not fundamental.

Finally there are financial saving clauses providing that: the new system of public finance is to be compatible with the growth and stability pact; the reform and implementing legislation must not lead to any new or greater burden on the public finances; the transfer of functions must be accompanied by a transfer of personnel to avoid the duplication of functions.

Very briefly: financial independence and accountability for all levels of government; granting of independent resources to regions and local authorities in accordance with the principle of territoriality; regional law may, in relation to a taxable base not subject to taxation by the State: a) introduce regional and local taxes; b) decide the changes to tax rates or tax relief that municipalities, provinces and metropolitan cities may adopt in the exercise of their own autonomy; a region may share the revenue

from regional taxes and its part of national taxes with local authorities; prohibition against adopting measures in relation to the taxable base and rates for taxes that do not pertain to one's own level of government; guarantee of maintaining an adequate degree of fiscal flexibility through establishing a basket of taxes and shares of taxes payable to the regions and local authorities, the composition of which is made up to a significant extent by taxes that allow room for manoeuvre; fiscal flexibility spread over a number of taxes with a stable taxable base and distributed in a generally uniform manner throughout the country so as to enable all the regions and local authorities (including those with the lowest revenue generating capacity) to fund – through harnessing their own potential – spending levels beyond merely the essential services and functions associated with local authorities; reduction of national taxation commensurate with the greater taxation powers of the regions and local authorities allied to a corresponding reduction in the central government's human resources and facilities; regulation of local taxes in a way that allows horizontal subsidiarity to be exploited in full; territoriality of taxes, neutrality of taxation and ban on the exporting of taxes.

What will the main problems associated with the application of the law on fiscal federalism be? The end of the system whereby central government transferred funds to local government implies a massive undertaking: to eliminate all state funds aimed at financing regions and local authorities and to have them replaced by revenues raised on foot of the fiscal autonomy enjoyed by those same regions and local authorities with the only exceptions beings equalization funds and special measures.

The application of Law No. 42 of 5 May 2009 will be important in order to establish how federal Italy has really become. Consider the following examples.

If most of the funding for regions ends up being guaranteed by sharing the revenue from national taxes, the autonomy of regions will be limited. As a matter of fact, revenue sharing is not substantially that different from grants. On the contrary, the autonomy of the regions will be stronger if they mainly depend on their own taxes or surtaxes rather than revenue sharing. The same is true for local authorities which are further limited by the fact that they do not enjoy legislative power.

If the so-called 'special measures' provided for by the Constitution for specific local government bodies become a form of additional and permanent equalization there will be no drive towards efficiency for the public administration. If special measures are limited in scope and time, the less virtuous too will improve their efficiency. The main difficulties in enforcement will lie in the sharp differences between certain geographical areas of Italy. North and South exhibit strong economic and infrastructure differences. The unemployment rate in the South is much higher while per capita income is much lower. Tax evasion is higher there too. One figure: the net average household income in 2006 in the North was almost 31,000 euros but only 23,500 euros in the South. The phenomenon of the black economy is mostly concentrated in the South which accounts for 45% of the total (source INAIL-ISTAT-IRES). The transitional phase will last no less than seven years and will try to reduce the infrastructure deficit of the least wealthy areas as well as to increase the efficiency of public administration. Another example: costs for health care are generally higher in the South but many people living there move to the North to receive public medical care.

Fiscal federalism cannot bring about an increase in the tax burden. This is stated by the law but it is not enough. For this reason, forms of coordination and collaboration among state, regional and local authorities are envisaged, especially with the aim of avoiding overlapping in tax assessment and collection. As a matter of fact, it is necessary to avoid duplication of activities, and hence of spending. Those bodies which efficiently act to fight evasion will be assigned additional resources. Already today, municipalities can keep part of the higher receipts stemming from their efforts in tax collection. The enforcement of the law will be accompanied by the transfer of a meaningful set of assets from the State to regions and local authorities.

Lastly, the issue of special regions. For historical reasons, five of the twenty regions in Italy enjoy a special degree of autonomy guaranteed by five separate constitutional laws (Valle d'Aosta, Trentino Alto Adige, Friuli Venezia Giulia, Sicily and Sardinia). Each constitutional law also guarantees that the regions concerned have significant fiscal autonomy. The law on fiscal federalism requires the State to have "open negotiations" with special regions (especially the first two named above, which are

the richest) to involve them in the equalization process in favour of the less wealthy areas.

This is a crucial time for the Italian system, to implement federalism but above all to improve the overall performance of the public system for citizens, families and businesses. A lot will depend on how Law No. 42 of 5 May 2009 is applied and enforced.

6. The power to tax.

Alongside the rationalisation of expenditure through benchmarking, the second plank of the fiscal federalism reform is increasing the fiscal autonomy of local authorities through a series of provisions to be found here and there in Law No. 42 of 5 May 2009, ranging from principles and guidelines to be followed in the delegated legislation to the more detailed provisions specifically set forth in articles 12 and 21, the latter article concerning the transitional phase. The value of fiscal autonomy can be deduced for example from subparagraphs a and e of article 2.2 which place autonomy in generating tax revenues, accountability at all levels of government and the allocation of resources on the basis of territoriality at the top of the list of principles that the law itself seeks to achieve. But also the provisions in subparagraph u on tax assessment and collection that assure efficient methods for direct allocation and automatic payment seem to point in the direction of local taxation, especially if read in conjunction with the rewards on offer for virtuous behaviour and efficiency in the exercise of taxation powers as per subparagraph z.

Overall, therefore, local taxation should acquire more weight as compared to national taxation within a framework in which the total tax burden should fall thanks to the beneficial effects of cuts in spending or at the very least rationalisation. In any event the Constitutional Court has ruled out that any reform of the financial independence of local government and specifically the regions can operate to decrease their resources without affording them alternative means of raising revenue, having regard to the overall financial picture in light of the functions exercised rather than to just single taxes or items of income (judgments 29/2004, 241/2004, 381/2004, 431/2004 and 155/2006).

Tax revenues should also play a greater role in the context of local finance as a consequence of greater autonomy in levying taxes and as a result of the power that the regions enjoy to introduce local taxes in relation to a taxable base not already subject to regional or national taxation (articles 7.1.b.3 and 12.1.g). One can deduce as much also from the emphasis that the law places not only on the taxation powers of municipalities and provinces recognised by the State for the purposes of primarily financing fundamental functions (articles 12.1.a and 12.1.b) but also on the issue of dedicated taxes in connection with investments linked to managing the territory concerned (article 12.1.d).

Naturally these are just general principles destined to be incorporated into and elaborated on in detailed delegated legislation. That said, they can serve as interpretative tools in cases of judicial review in light of the provisions of article 119 of the Constitution and can be relied on by the Constitutional Court in this regard.

The entry into force of Law No. 42 of 5 May 2009 and associated delegated legislation should resolve the issue of the relationship between a region's legislative power and local authorities' regulatory autonomy in tax matters.

The Constitutional Court's view that legislation governing the basic framework for local taxes is a precondition for local authorities to exercise their own regulatory powers should open the way to rules on three levels operating on two planes, national and local or regional and local, as the Court itself has stated.

What remains to be seen is whether, in the wake of Law No. 42 of 5 May 2009 and the first pieces of delegated legislation, the issue of the types of sources of funding for local authorities has been addressed. Initially the Constitutional Court had ruled that for non-tax funding the State could act "in conformity with the new division of competencies and new rules" also without the need to first enact a coordinating national law (judgment 16/ 2004) only to then admit shortly afterwards that the maintenance of existing funds and their financing were lawful as was the making of changes to the legal framework that had established them (judgments 320/2004, 423/2004, 36/2005 and 225/2005).

In relation to the transfers specified in the current article 119 of the Constitution, i.e. the equalisation funds, special

measures and additional resources, the Court has already laid down some essential markers. The fund must be used solely for bodies that have a lower tax revenue generating capacity and the grants must not be subject to restrictions on their use (i.e. they must not be "grants with strings attached" as American writers would say). The special measures and additional resources are over and above that which is required to fully cover the functions assigned to local government, must fulfil the equalisation objective laid down in the Constitution and be addressed not to all bodies but merely single bodies or categories thereof.

The Court then held that regardless of the provisions of subparagraph e of the second paragraph of article 117 of the Constitution and the State's exclusive competence in the equalisation of financial resources, the regions could set up or replenish funds devoted to special measures and additional resources whenever they exercised planning powers for areas within their remit (judgments 16/2004 and 49/2004). The Court held that State funds divided among the regions (judgment 370/2003) or among regions and local authorities (judgment 49/2004) or among local authorities circumventing the regional level were unconstitutional and ruled out the transfer of resources conceived and given effect to by methods other than those envisaged by the fifth paragraph of article 119 of the Constitution, methods that owed much to past practice when national law and the way the Ministry of the Interior was run allowed virtually any form of transfer of resources to local authorities on the basis of distributions that were essentially discretionary.

It is not that clear if the Court considers that only national law impinging on the financial independence to raise revenue and spend funds infringes the fifth paragraph of article 119 of the Constitution or whether also provisions that are not binding as regards spending but nonetheless create a general dependence on State revenue fall foul of the Constitution. It appears that grants from central government that by their very nature or structure have nothing to do with the types covered by the fifth paragraph of article 119 of the Constitution are admissible even though they come with restrictions as to their use provided that they concern matters falling within the State's exclusive remit, especially if the principle of sincere cooperation has induced central government to involve the Conference owing to its heavy interference in the

exercise of administrative functions in spheres that pertain to the regions or local authorities.

The interpretation thus far given by the Constitutional Court regarding the limits to State grants that can be made consistent with article 119 of the Constitution would seem to bring to the fore the division of legislative power enshrined in article 117 of the Constitution, which might well do justice in the specific cases that the Court had to consider also in light of the principle of sincere cooperation but risks depriving the strictly financial and fiscal rules in article 119 of the Constitution of any binding force thereby opening up an avenue of parallel funding.

It remains to be seen if, following the entry into force of Law No. 42 of 5 May 2009 and associated delegated legislation, that approach can be maintained or whether a more rigid assessment will be employed warranted by the greater detail of the rules in both bilateral and trilateral situations. In other words, one must wait and see if the escape route offered by the principle of sincere cooperation that saved State intervention in the area of funding falling outside the scope of the fifth paragraph of article 119 of the Constitution can survive the new rules. And also if the progressively more precise fine tuning of the fiscal framework governing relations between the various levels of government will enable the Constitutional Court to continue to rely on factors of financial necessity or use principles that cut across al sectors such as antitrust rules to justify macroeconomic intervention likely to have significant repercussions on the funding and fiscal autonomy of local government.

The Constitutional Court pronounced on this topic decision n. 201/2010, such pronouncement has to be mentioned, even if it concerns the Sicily Region.

Put another way, one must await developments in caselaw to understand whether the Constitutional Court intends to treat Law No. 42 of 5 May 2009 or rather the associated delegated legislation as constituting a turning point in the financial and fiscal autonomy of local government or whether by contrast central government intervention will be assessed in much the same way that it has been since the reform of Title V of the Constitution. In particular, it is necessary to understand if, after article 119 of the Constitution has been implemented with a body of rules expressly designed to give full effect to the constitutional

provisions in question, the legal framework so formed will be considered as the sole source of law governing financial autonomy or whether by contrast there will still be room for a sort of parallel system whereby the type of funding one can deduce from article 119 of the Constitution will apply only to the spheres in which local government bodies pursue their own policies on foot of the legislative and administrative powers granted to them while outside that sphere central government – using agreement with all concerned as a shield or exercising broad powers whose boundaries are not well defined – can continue with a looser financial regime than the strict one founded on article 119 and subject only to general and fluctuating limits rooted in principles like proportionality and subsidiarity or on emergency type needs of a macroeconomic nature.

Any assessment of the degree of implementation of fiscal autonomy must start from what the actual situation is, which can be summarised as follows:

The municipalities can currently rely on the following taxes: municipal property tax (Legislative Decree No. 504/1992), electricity surtax (article 6 of Legislative Decree No. 511/1988), municipal advertising tax (Legislative Decree No. 507/1993 and article 63 of Legislative Decree No. 446/1997), waste disposal tax (Legislative Decree No. 507/1993 and article 49 of Legislative Decree No. 22/1997), dedicated taxes (article 1.145 of Law No. 296/2006) and a personal income tax surtax (Legislative Decree No. 360/1998).

The provinces likewise can rely on a personal income tax surtax and a share of the electricity surtax (same legal basis as above) as well as motor vehicle registration tax (article 56 of Legislative Decree No. 446/1997), motor vehicle insurance tax (article 60 of Legislative Decree No. 446/1997), a share of landfill taxes (article 3.27 of Law No. 549/1995), and a waste disposal tax surtax for environmental protection and health functions (article 19 of Legislative Decree No. 504/1992).

Among implementative legislation adopted to enforce federalism, it has to be mentioned at least the "state federalism" ("*federalismo demaniale*") d.lgs. 85/2010.

7. Concluding remarks.

In short, the new structure of economic-financial relations between central and local government seeks to overcome the grant system of funding and endow regions, provinces, municipalities and metropolitan cities with greater independence in levying taxes and spending resources subject to observing the principles of solidarity and social cohesion. Key principles of fiscal federalism are, firstly, coordination of taxation centres with spending centres thereby automatically ensuring that bodies will be more accountable for their spending and, secondly, replacement of historical spending based on continuity with spending levels reached the previous year with standard spending.

To become operative fiscal federalism requires a series of measures that will take seven years: two years for implementation and five years of transition. The law makes provision above all for an ad hoc commission to draft the contents of the implementing decrees, to be ready within two years after the entry into force of the law. Provision also exists for a permanent commission to be set up to coordinate public finances.

The funding of the functions transferred to the regions through the implementation of fiscal federalism will obviously lead to the cancellation of the relevant appropriations from the State's budget including personnel and operating costs.

An equalisation fund with no restrictions as to use will be set up in favour of regions with reduced revenue raising capacity as required by article 119 of the Constitution.

Fiscal federalism introduces a rewards type system for bodies that assure high quality services and impose a tax burden below the average for that of other bodies at its own level of government providing equal services. Vice versa for bodies whose performance is wanting, sanctions can be imposed in the form of a ban on hiring personnel and making discretionary spending. At the same time those bodies have to clean up their balance sheets through disposing of part of their real and personal property and resorting to their taxation powers to the maximum allowed.

Automatic sanctions are also imposed on executive and administrative organs should a region or local authority fail to achieve the economic-financial balance and objectives set for it. Specifically, management in charge of a local authority which is declared to be insolvent will be disqualified from office.

Turin, Milan, Venice, Genoa, Bologna, Florence, Bari, Naples and Reggio Calabria will become metropolitan cities. Rome, the capital of Italy, already enjoys special legislative, administrative and financial autonomy within the limits prescribed by the Constitution.

The implementation of fiscal federalism must be compatible with the financial commitments undertaken with the stability and growth pact. To conclude, the implementation of fiscal federalism is a gamble that needs to pay off for the sake of progress in the Italian economy and institutions.

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