Fiscal federalism in Italy

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History of fiscal federalism in Italy

A – Pre-unitary phase (1820-1860)

In the so-called Resurgence period, one line of political thought considered that federalism was the only way to realize individual freedoms under a republican form of government.

Carlo Cattaneo in 1852 believed that the federal model represented the ideal form of State to realise individual freedoms: a unitary State will necessarily become authoritative and despotic since unity always implies a centralization of powers and the suppression of autonomy (and also of liberty); therefore, the only solution to this problem is ***pluralistic unity*** in the form of republican federalism.

History of fiscal federalism in Italy

B – Italian unification (1861)

The process that led the unification of Italy did not follow a federalist pattern, but it was rather the outcome of a "fusion" process led by the region of Piedmont. Nevertheless, the federalist idea remain very important since the creation of a nation necessarily involves that local autonomies are enhanced in a balanced manner.

History of fiscal federalism in Italy

C – Minghetti reform (1865)

Italy after unification developed a parallel system of taxation. The new framework introduced a separation between local and central finance. Nevertheless, in practice this principle of separation was been deeply redimensioned, since:

- Central State → established and managed all taxes
- Local autonomies → entitled to levy:

a) custom duties on internal consumption;

b) a surtax (*sovraimposta*) on national taxes.

Critical point: the taxing power of local autonomies did not express a full autonomy, since it was highly dependent on central finance.

The choice made by the Italian Constitution (1948)

After the end of the Second World War, the Constitutional Assembly had to decide on the form of the new Italian state. Choice between:

a) maintaining the substantially centralized State in the same form that was adopted in the post-unitary period following 1861; or

b) adopting a federal model.

Solution → *Regionalist* federalism

Arguments justifying the constitutional choice of 1948

a) the unitary State based on a "flexible" constitution (the *Statuto Albertino* of March 4, 1848) was so centralized that it permitted the Fascist regime to take power over all of Italy through a single coup d'État;

b) excessive fragmentation of sovereignty among local entities would have put national unity at risk;

c) Italians rejected monarchy in a referendum and the Constitutional Assembly drew up the Republican Constitution of 1948, which, being a regional model of fiscal federalism, formally represented a ***compromise*** between these two alternatives.

Characteristic of the Italian choice

Regionalism → compromise between a full federalism and a centralised State

Art. 5 IC represents the key principle of the Italian constitutional framework, which aims at finding the **delicate balance** between national unity and local autonomy.

Characteristic of the Italian choice (2)

The rationale behind the choice made by the Constitutional Assembly was aimed at forming an indivisible Republic composed by local autonomies capable of exercising their decentralized powers **in line** with national interests.

Decentralisation is structured between:

- Regions (ordinary and special);
- Provinces; and
- Municipalities.

Further developments

- The general tax reform of the Seventies reduced the taxing power of local entities and preferred to introduce a system of periodical transfers from national revenue (*i.e.* revenue apportioned out of national taxes). The only autonomy of sub-governmental bodies consisted in the possibility to decide the tax rate within a predetermined range.
- In the Nineties the centralised character of the Italian tax system increased (*e.g.* Law No. 142/1990; Legislative Decree No. 446/1997)

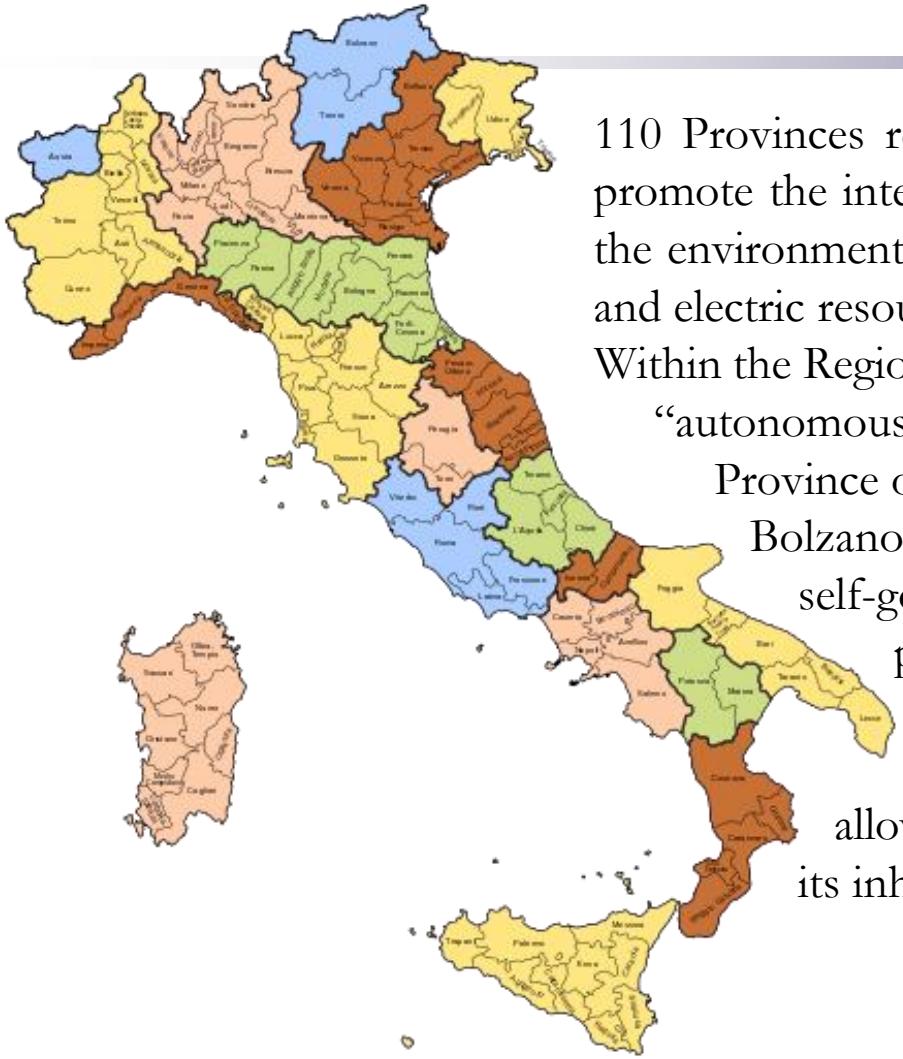
Decentralisation in Italy: a) Regions

Regions are the first level of administrative autonomy and, although they have been in existence since 1948, their local governments were elected for the first time in 1970:

a) Fifteen Regions have an "ordinary" statute

b) Five Regions have a "special" statute established under *ad hoc* constitutional laws. Such special statutes are reserved for Regions that have a particular geographic position (for example, the "insular status" of Sardinia and Sicily) or are constituted in order to protect linguistic minorities (*e.g.* the Slovenians and Germans in Friuli-Venezia Giulia, the Germans and Ladins in Trentino-Alto Adige, and the French in Valle d'Aosta). Special regions are, therefore, each "special" in their own way and cannot be considered homogeneously.

Decentralisation in Italy: b) Provinces



110 Provinces represent the intermediate local autonomy. They promote the interests of provincial communities in fields such as the environment (for example, parks and natural reserves), hydro and electric resources, public transport, etc.

Within the Region of Trentino-Alto Adige there are two "autonomous" Provinces (for example, the autonomous Province of Trento and the autonomous Province of Bolzano-Südtirol) that have such a significant level of self-governance that the Region itself is almost powerless against them. In particular, the Province of Bolzano has a wide range of exclusive legislative powers and its tax system allows it to retain almost 90% of the taxes levied on its inhabitants and local economic activities.

Decentralisation in Italy: c) Municipalities

The third level of decentralization is represented by Municipalities (*Comuni*), which are the primary political institutions for citizens and reflect a democratic tradition common to many EU Member States.

Actually there are **8.094 Municipalities**.

Legal sources of the Italian "regionalist" model

- Art. 5 IC → «*the Republic is one and indivisible. It recognizes and promotes local autonomies, and implements the fullest measure of administrative decentralization in those services which depend on the State. The Republic adapts the principles and methods of its legislation to the requirements of autonomy and decentralization*»
- Title V of the IC (*i.e.* Articles 114-133 of the IC)
- Constitutional Law No. 3 of 18 October 2001
- Law No. 42/2009 (Delegation Law, DL)

Implementation – work in progress:

- Legislative Decree No. 85 of 28 May 2010 implementing the "public property federalism" provided by article 19 of the DL
- Legislative Decree No. 156 of 17 September 2010, providing for a transitional regime for the capital city of Rome
- Legislative Decree No. 216 of 26 November 2010 on the determination of standard requirements in regard to municipalities, metropolitan cities and provinces; and
- Legislative Decree No. 23 of 14 March 2011, implementing municipal fiscal federalism.

Definitions of fiscal federalism in Italy

Three different approaches:

- Central State taxes collected by local autonomies aimed at financing public services in the territory of collection → this "commutative" approach does not give sub-national entities a proper tax autonomy;
- Sub-national entities receive a percentage of State's revenue and they avoid to incur in a direct accountability on how the financial resources are effectively used → this interpretation is preferred by local autonomies;
- Sub-national entities have autonomous taxing and spending power → this interpretation is the only that fulfils with the principle *no taxation without representation*

Until 2001, a proper form of fiscal federalism was not in force in Italy since, in practice, there was a system of "derivative" taxation of local entities, based on periodical transfers to local entities of portions of the revenue of national taxes → CENTRALISED, BUREAUCRATIC AND DERESPONSIBILISED SYSTEM.

The 2001 Constitutional reform

The cornerstone for the Italian federalist pattern is Constitutional Law No. 3/2001, which amended the IC and attributes relevant taxing powers to the Regions and introduced the principle of subsidiarity in relation to certain administrative functions.

The new scenario involves a distribution of competence between different levels of government, abandoning the former hierarchical principle.

The 2001 Constitutional reform (2)

Broadly speaking, new Art. 117 IC establishes:

- the areas of **regional *residual* competence** → the general rule is that Regions have legislative power over any subjects not expressly reserved to the State;
- the areas of ***exclusive* State competence**;
- the areas of ***concurrent* competence** of Regions and the State → legislative power is attributed to the Regions, who must exercise it in compliance with the fundamental principles laid down under national legislation.

The 2001 Constitutional reform (3)

TAXATION:

- State → "exclusive" competence over «*State tax and accounting systems*» (Art. 117, para. 2, lett. e), IC)
- State and Regions → "concurrent" competence in the field of «*harmonisation of tax accounts and coordination of public finance and tax system*»

As a general principle, in the subjects of concurrent competence the legislative competence belongs to Regions, with the exception of the fundamental principles whose legislative competence belongs to the State.

"Ordinary" Regions

Different % of co-participation to national revenue

North "ordinary" Regions:

- Own taxes → 40%
- Co-participation to State taxes → 35%

South "ordinary" Regions:

- Co-participation to State taxes → 52%
- Own taxes → 22%

Source: Italian Court of Auditors, Deliberazione No.14/SEZAUT/2012/FRG of July 25, 2012

"Special" Regions

Different % of co-participation to national revenue

"Special" Regions:

- Own taxes → 11%
- Devolved taxes → 56%
- Other entries → 13%

80%

- Transfer payments → 20%

Source: Italian Court of Auditors, Deliberazione No.14/SEZAUT/2012/FRG of July 25, 2012

Tax autonomy of "special" Regions

Tax autonomy of "special" Regions continues to be broader than that of the other 15 "ordinary" Regions, since it embraces:

- taxes and burdens on tourism or other "proper" taxes that "special" Regions can institute according to their Statute and in compliance with the principles of the national tax system
- national revenue co-participation;

Article 119 of the Constitution

Text before 2001:

Regions have financial autonomy in the forms and within the limits established by the laws of the Republic, which coordinate them with the finance of State, Provinces and Municipalities.

Regions have competence over *proper* taxes and portions of national taxes, in proportion to the necessities of the Regions for the expenses necessary to fulfill their normal functions.

New text:

Municipalities, Provinces, Metropolitan Cities and Regions have financial autonomy of entry and of expense.

Municipalities, Provinces, Metropolitan Cities and Regions have autonomous financial resources.

They establish and enforce *proper* taxes harmoniously with the Constitution and according to the principle of coordination of public finance and of the tax system. They participate to the revenue of national taxes levied in their territory.

After the 2001 reform: fiscal federalism *quo vadis*?

After the Constitutional reform of 2001, in the Italian Parliament there have been many debates on the method of enforcing fiscal federalism, but they did not find a quick outcome.

Although the Constitution formally attributes a taxing power to decentralised entities, fiscal federalism has not been properly enforced.

Therefore, the revenue of Regions, Provinces and Municipalities continued to be based on a "derivative" mechanism linked to national revenue.

Italian constitutional Court, Decision No. 37/2004

«*[…] the enforcement of this constitutional framework requires the necessary intervention of State law, which, with the aim of coordinating all public finance, shall not only address the principles that regional laws must comply with, but also determine the guidelines applicable to the whole tax system and define areas and limits where the taxing power of the State, Regions and local entities shall apply. […]*

[T]his will also require the definition of a transitional regime allowing for a smooth transition from the actual system – characterized by "derivative" regional and local financing (i.e. that is dependent on the State's budget) to unitary State legislation regarding all taxes, with limited possibilities for Regions and local entities to make autonomous choices – to a new system. Therefore, ***currently, […] there are no taxes that can correctly be defined as "proper" taxes of Regions or local entities […], in the sense that they are the result of their autonomous taxing power****, and thus regulated by regional laws or local regulations in compliance only with the principles of coordination:* ***"proper" taxes are absent because they are 'incorporated' […] into a system of taxes substantially governed by the State***».

Regional map of tax evasion

- Less than 20%
- Between 20% and 30%
- Between 30% and 40%
- Between 40% and 50%
- Between 50% and 60%
- More than 60%

Source: RICOLFI, L., *Contabilità nazionale liberale*, 2006

Delegation Law No. 42 of May 5, 2009

In 2009 the Parliament issued Delegation Law No. 42/2009 (DL), which opens the path to a concrete introduction of fiscal federalism in Italy.

Being a delegation law, it requires the issuance of more Legislative Decrees aimed at enforcing it.

DL defined:

- the enforcing principles of constitutional rules governing the Italian tax system (*i.e.* legality, ability to pay, fairness of administrative action);
- The general principles of coordination of the tax system (*i.e.* separation of legal sources, territoriality, etc.)
- The principles and criteria for taxes of Regions, Provinces, Municipalities and Metropolitan Cities.

Goals of Delegation Law No. 42/2009

DL No. 42/2009 aims at implementing Art. 119 IC in order to:

- guarantee the autonomy of accounting entries and expenses in compliance with the principles of solidarity and social cohesion (Art. 1, para. 1, DL); and
- grant autonomous financial resources to sub-national entities according to the principles of territoriality, solidarity, subsidiarity, differentiation and adequacy (Art. 2, para. 2, letter e), DL)

Rationale

Italian fiscal federalism as depicts by DL No. 42/2009 is the consequence of the dialectics between *autonomy* and *equality*, the delicate equilibrium of which requires a detailed legislative framework in order to **avoid excessive sub-national tax competition** leading to fragmentation of the tax system with negative consequences to:

- taxpayers (*e.g.* higher compliance costs); and
- tax authorities (*e.g.* practical difficulties in assessing and collecting taxes).

Distinction of taxes

The DL "codifies" the types of regional and local taxes. In this respect, regional taxes include:

- **derived "proper" local taxes**, established and regulated by State laws, the revenue of which is attributed to the Regions;
- **additional taxes**, which apply to national tax bases; and
- **autonomous "proper" local taxes**, established by Regions under their own laws in relation to areas not already subject to State taxation. This provision substantially acknowledges the restrictive position taken by the Italian Constitutional Court in its case law.

Remarkable aspects

- Art. 2, para. 2, letter l) → safeguard of the progressivity of tax system and compliance with the ability to pay principle;
- Art. 2, para. 2, lett. m) → gradual overcoming, for all sub-governmental entities, of the real cost criterion and adoption of: 1) standard level criterion for financing the essential public services; 2) equalisation mechanism of the fiscal capacity (*i.e.* intervention of the central State in case certain sub-governmental entities go below the minimum standard);
- Art. 2, para. 2, lett. n) → compliance with the principle of distribution of legislative competences between State and Regions in the coordination of public finance and of the tax system;
- Art. 2, para. 2, lett. o) → exclusion of double taxation on the same economic facts, with the exception of additional taxes provided by State or Regional laws;
- Art. 2, para. 2, lett. p) → principle of correspondence between responsibility for expenses and accounting entries

A concrete example: municipal tourism taxes

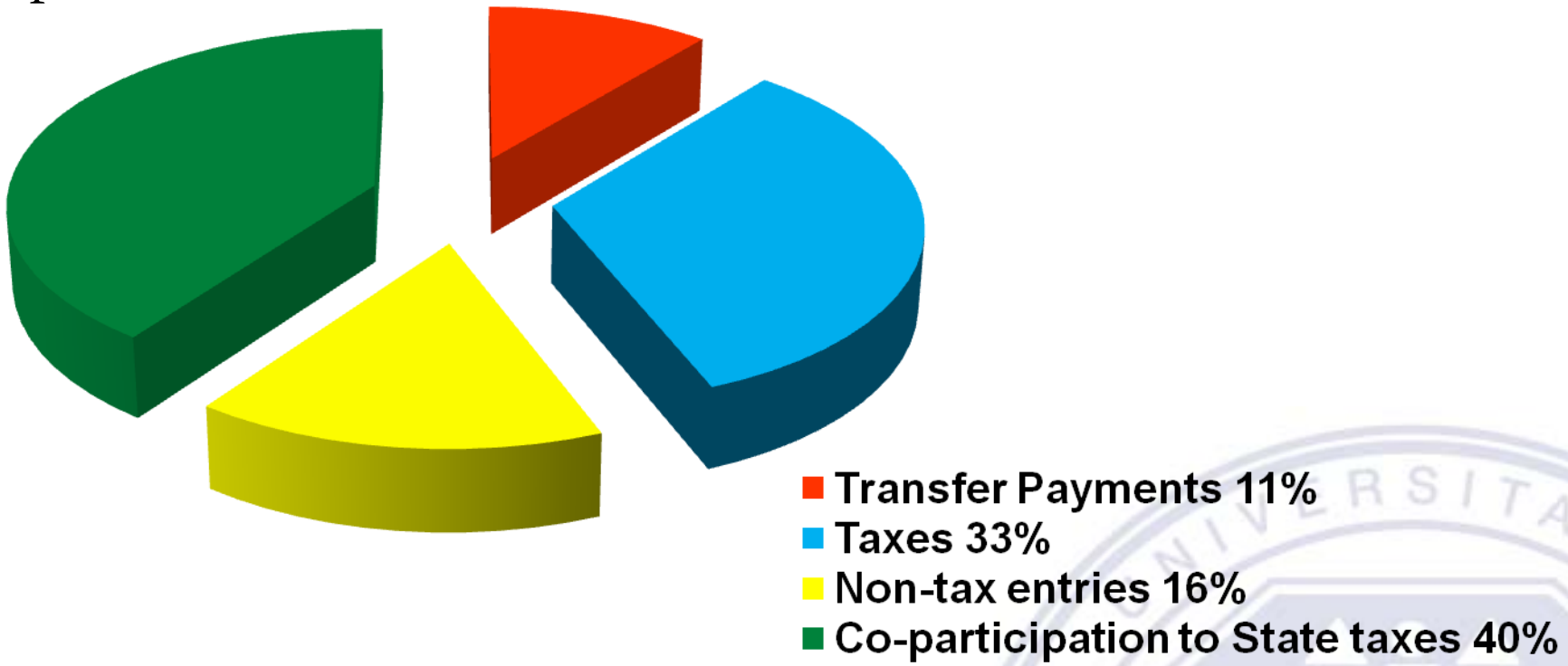
DL No. 49/2009 provided, in compliance with Art. 119 IC, the adoption of Legislative Decrees containing the discipline of one or more "proper" municipal taxes that «*attributes to the body the possibility to establish and enforce them in order to achieve particular goals, e.g. relisation of public works and long-term investments in social services or financing of costs connected to particular events such as tourism or urban mobility*» .

This provision was enforced by Art. 4, Legislative Decree of May 14, 2011, No. 23, which introduced the possibility for Municipalities to introduce daily tourism taxes of maximum € 5.

Certain Italian "art cities" introduced such municipal tourism tax (*e.g.* Rome, Florence and Venice).

Regional resources

In 2009 the financial resources of "ordinary" Regions were composed as follows:



Source: Italian Court of Auditors, Deliberazione No.14/SEZAUT/2012/FRG of July 25, 2012

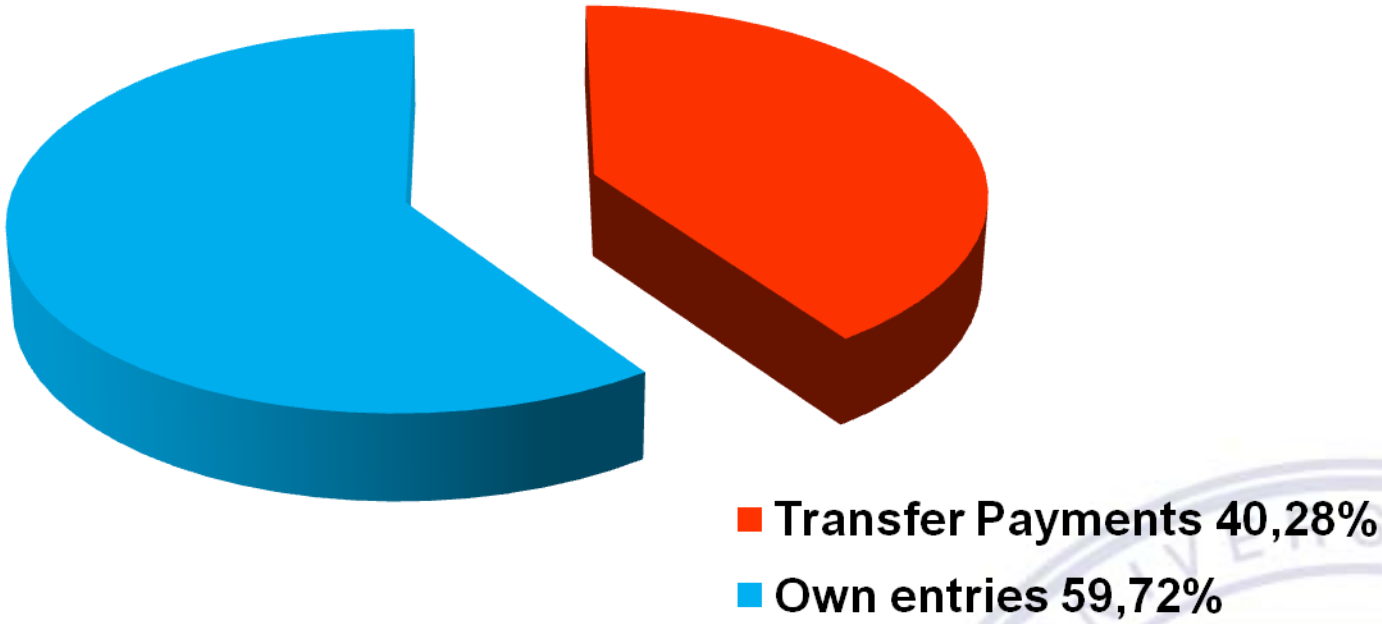
Provincial resources

(Million of Euro)

	2009	2010	2011	Change % 2009-2010	Change % 2010-2011
Taxes	4.652	4.694	5.196	0,90	10,69
Transfer payments	4.390	4.123	3.938	-6,08	-4,49
Non-tax resources	702	675	642	-3,85	-4,89
TOTAL RESOURCES	**9.744**	**9.492**	**9.776**	**-2,59**	**2,99**

Source: Italian Court of Auditors, Deliberazione No.13/SEZAUT/2012/FRG of July 25, 2012

Provinces:
Transfer payments *vs* own entries in 2011



Source: Italian Court of Auditors, Deliberazione No.13/SEZAUT/2012/FRG of July 25, 2012

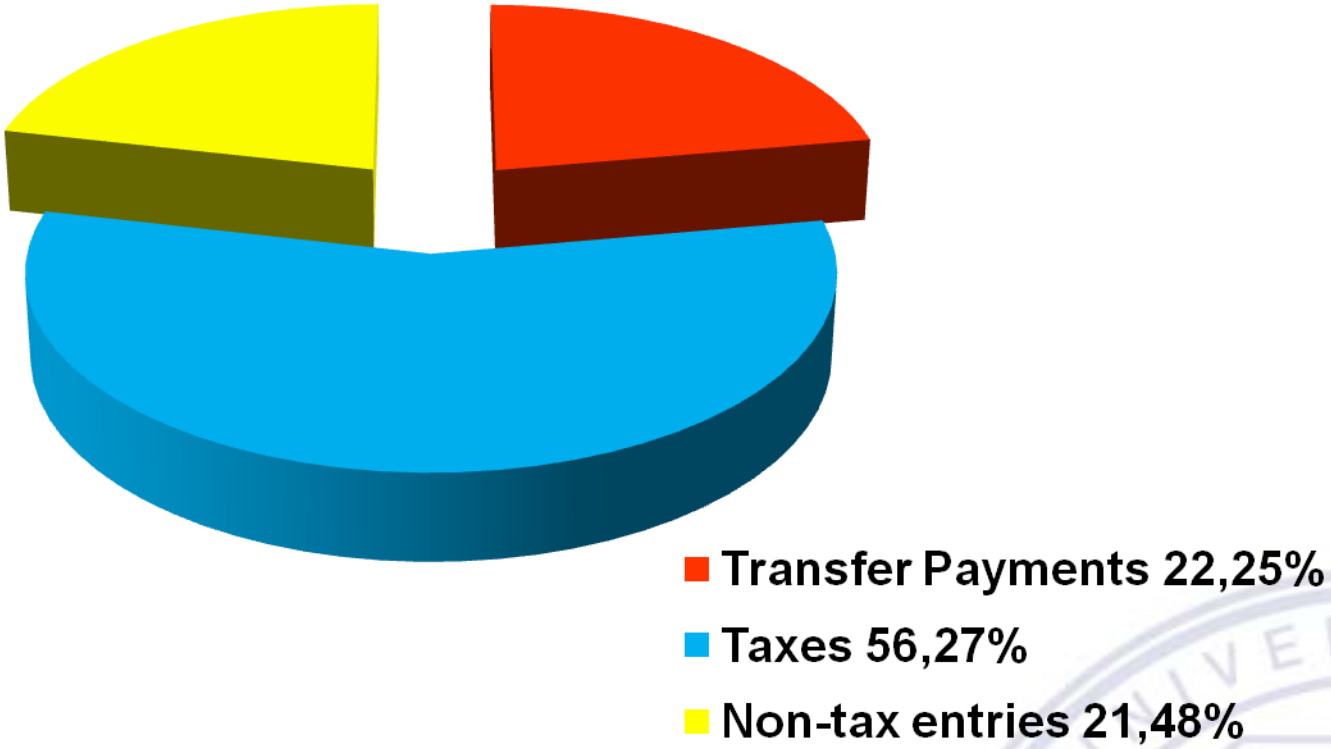
Municipal resources

(Million of Euro)

	2009	2010	2011	Change % 2009-2010	Change % 2010-2011
Taxes	19.621	20.671	30.020	5,35	45,23
Transfer payments	23.387	23.679	11.872	1,25	-49,86
Non-tax resources	10.621	10.775	11.461	1,45	6,37
TOTAL RESOURCES	**53.629**	**55.125**	**53.354**	**2,79**	**-3,21**

Source: Italian Court of Auditors, Deliberazione No.13/SEZAUT/2012/FRG of July 25, 2012

Municipalities:
Transfer payments *vs* own entries in 2011



Source: Italian Court of Auditors, Deliberazione No.13/SEZAUT/2012/FRG of July 25, 2012

Some comparative perspectives

Various analogies between the Italian and the German federal system, since they are both based on the principle of cooperation. According to the German type, also known as ***cooperative federalism***, the central legislative power prevails over local governments in order to guarantee a homogeneous application of tax rules within the national territory.

In this manner, the various Länder can participate in the legislative process by sitting in the Federal Council (*Bundesrat*) and the federation applies a mechanism of horizontal balancing of financial resources when necessary to re-establish equality among the Länder.

Critical remarks

- Long transitional period for the complete enforcement
- *Carte blanche* to the Government: according to the principle of legality of tax law (Art. 23 IC): it was preferable that the Parliament directly managed this delicate issue
- Concrete risk that fiscal federalism may become a factor of further economic differentiation between rich and poor areas of the country
- Necessity of more relevance of regional and local realities in the Parliament and in the Government
- A "fair" fiscal federalism would have to abolish the difference between "special" and "ordinary" Regions
- Actually regional fiscal federalism is **not** enforced

Thank you for your attention!