

Fiscal Decentralization

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Types of Federalism

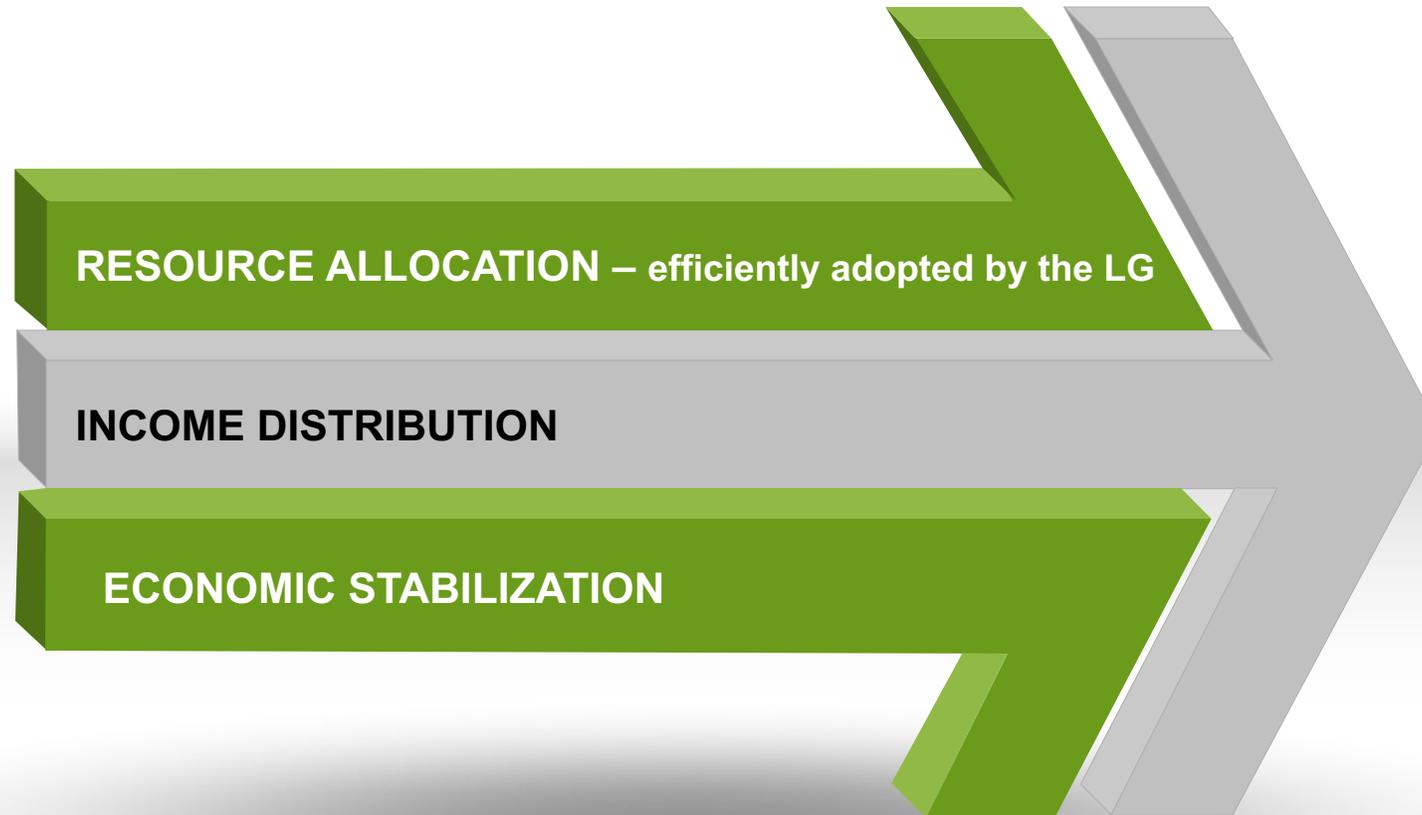
➤ Political Federalism

➤ Fiscal Federalism

There are 3 main principles related to these two groups:

- The principle of subsidiarity – The C.G will perform only those powers and functions that the sub-national government will not be able to carry-out efficiently
- The principle of diversity – considers citizen's needs. The more heterogeneous the population is the more the decentralization process would be convenient.
- Equivalence principle - differentiated services offered at different levels of local government. “Tailored” services based on local government needs.

Functions of Government Policies



Fiscal Decentralization

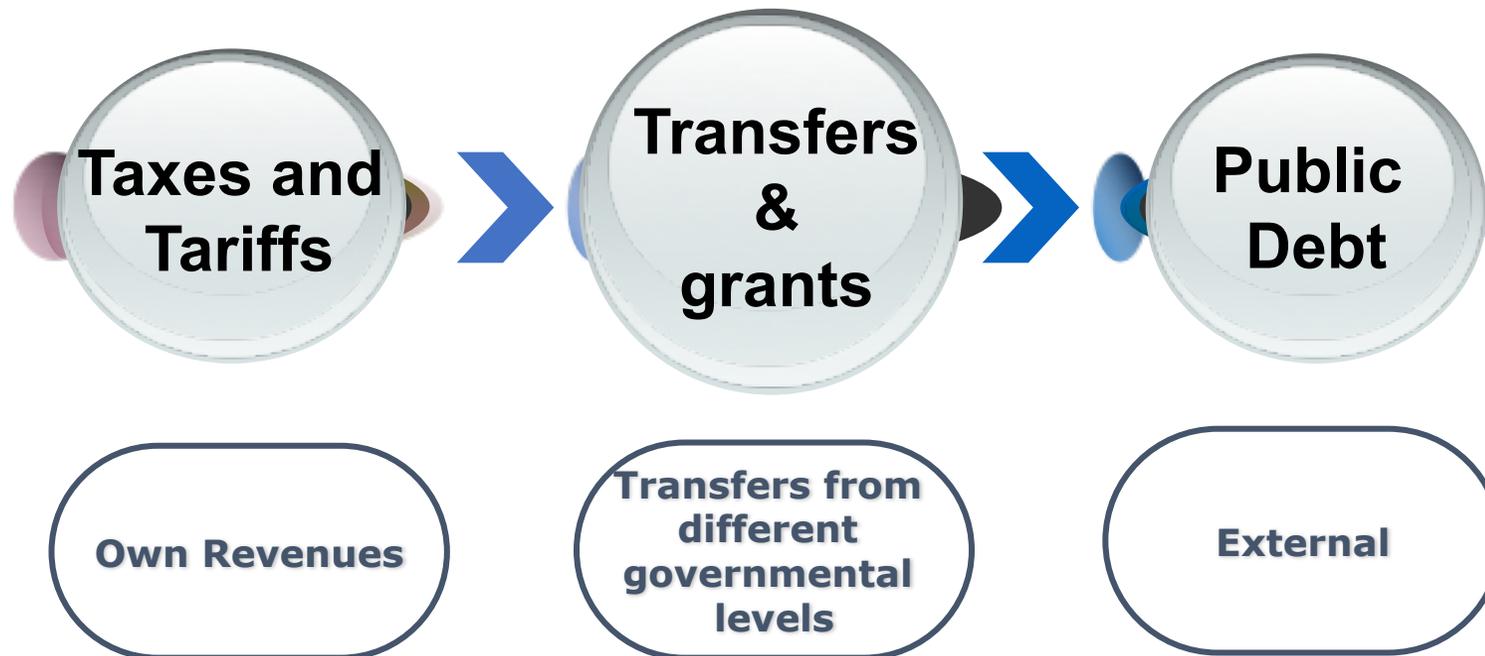
The process of devolution of authority over fiscal impacts

- The collection of revenues from local taxes and tariffs offers the highest level of autonomy whilst the discretionary transfers offer the lowest level of local autonomy.

- Three possible financing models:
 - ❑ L.G entirely design, manage and implement their tax system
 - ❑ L.G receive their financial resources entirely from the C.G
 - ❑ Mixed model (own resources + grants and transfers from the C.G)

Local expenditure is financed by

The degree of decentralization affects the composition of local government expenditure.



Type of Transfers

- **General:** transfers are not tied to a particular destination or scope. LG are free to choose the way on how to spend these resources
 - Fixes amount (lump-sum)
 - Conditional
- **Specific:** serve to fulfill a specific purpose.
 - Fixed amount (lump-sum)
 - Conditional
 - Closed
 - Opened
- **Vertical vs Horizontal Transfers**
- **Matching and Non-Matching Grants**
 - Selective (conditional)
 - General (unconditional)

Advantages of Fiscal Federalism

- Improve local efficiency
- Decrease corruption levels
- Responsible local entities
- Efficiency gains
- Economic growth and development (depends on institutional setting)
- High quality services
- Better outcomes
- Promotes innovation by using new technologies and procedures (*laboratory of federalism*)

Advantages of a Centralized State

- Generates more balanced spatial distribution
- Fiscal imbalances between richer and poorer areas are lower when the fiscal system is centralized
- Equalization role of the government
- Reduces the incentives for opportunistic behaviour

Fiscal decentralization could be successful if:

- Cross-country differences and path-dependency
- Efficient design of the relationship between different levels of government
- Clear attribution of functions
- Identification of several funding sources and equalization mechanisms
- Demographic developments
- Realistic fiscal rules on indebtedness
- Political and ideology-related variables
- Higher budget discipline

Impact of financial crisis on Fiscal Decentralization

- Financial cuts
- Political instability
- Weak managerial leadership
- Weak demand, insufficient investments and increased unemployment
- Incapability of adopting a strategic approach
- Decline of GDP and Economic development
- Lower local capacities and competences
- Higher controls (top-down approach)
- Stronger central control over financial and human resources
- National austerities

Fiscal crisis impact of Fiscal Decentralization

- Main reaction toward the crisis are:
 - reorientation
 - buffering the impact of the crisis
 - continuous adjustments
 - avoiding problems for catching opportunities

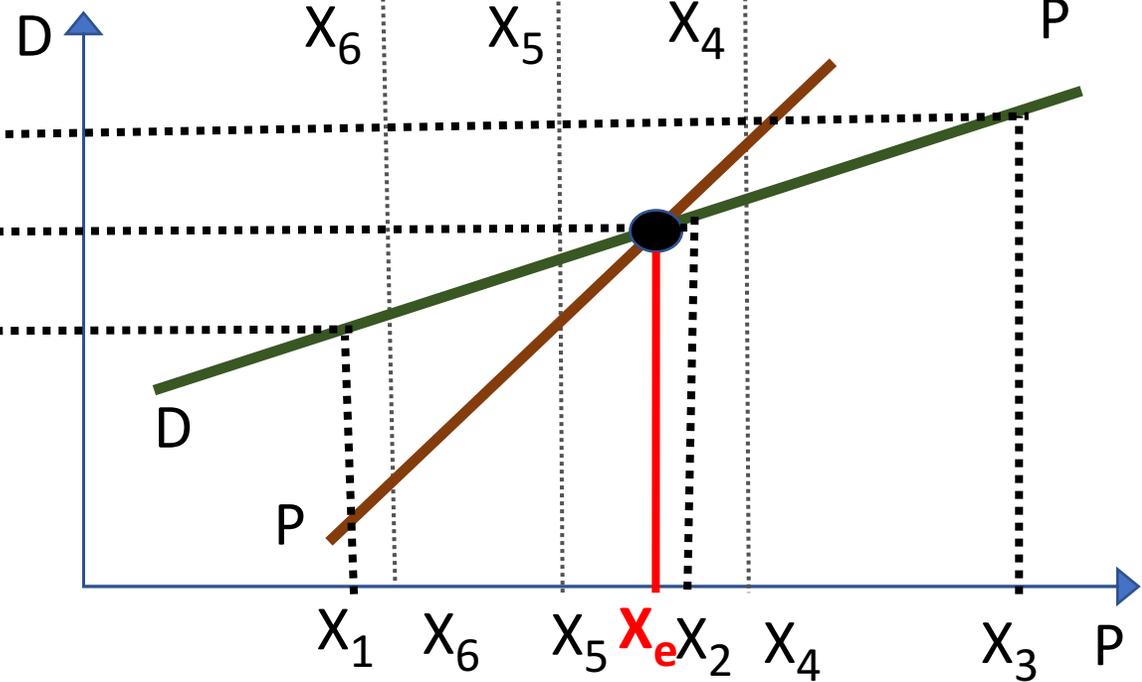
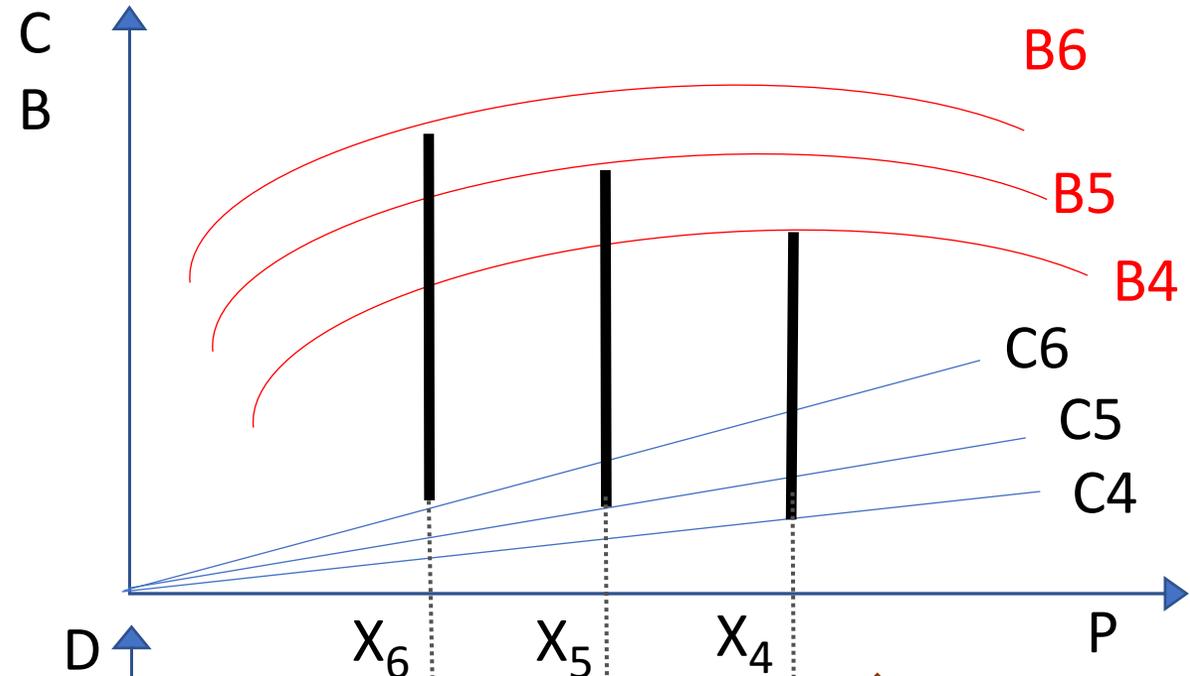
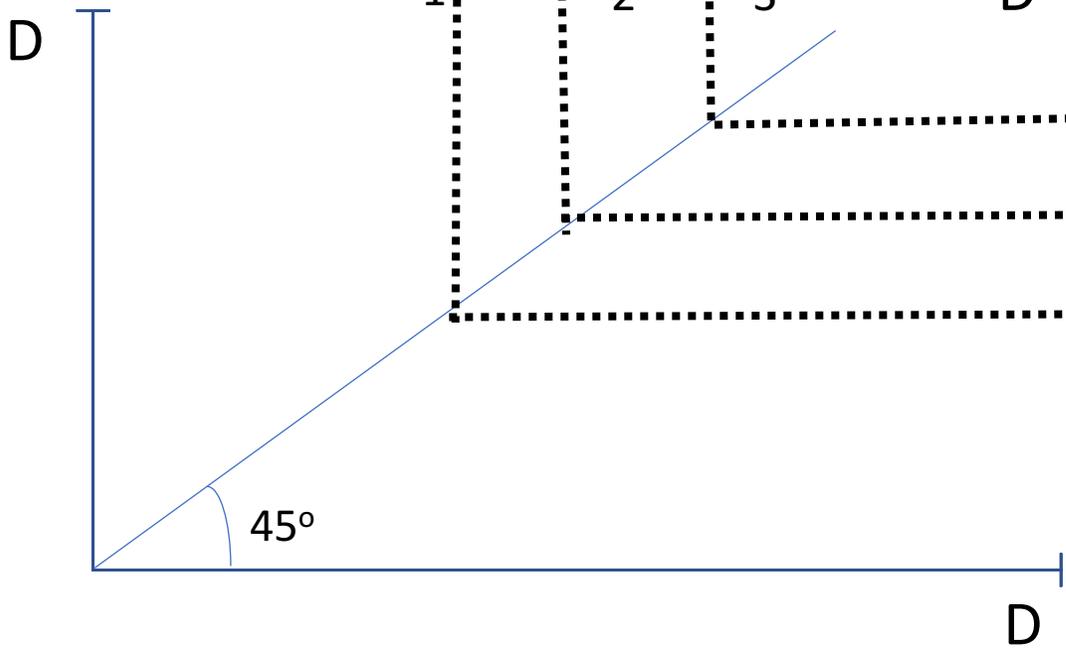
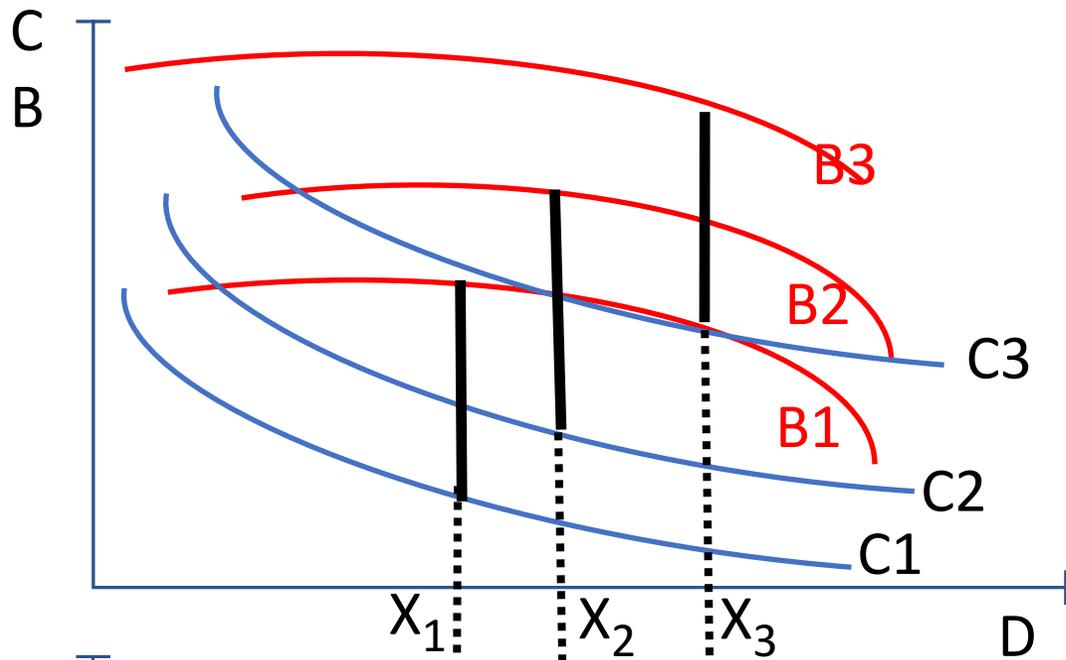
Fiscal Federalism Models

- **Tiebout**
- **Oates**
- **Leviathan and General equilibrium model**
- **II Generation Fiscal Federalism Theory and Political Economy**

The traditional theories of fiscal federalism are based on the idea that this system ensures a more efficient resource allocation in the public sector of supply of goods and services whose consumption is territorially limited to residents.

Tiebout Model

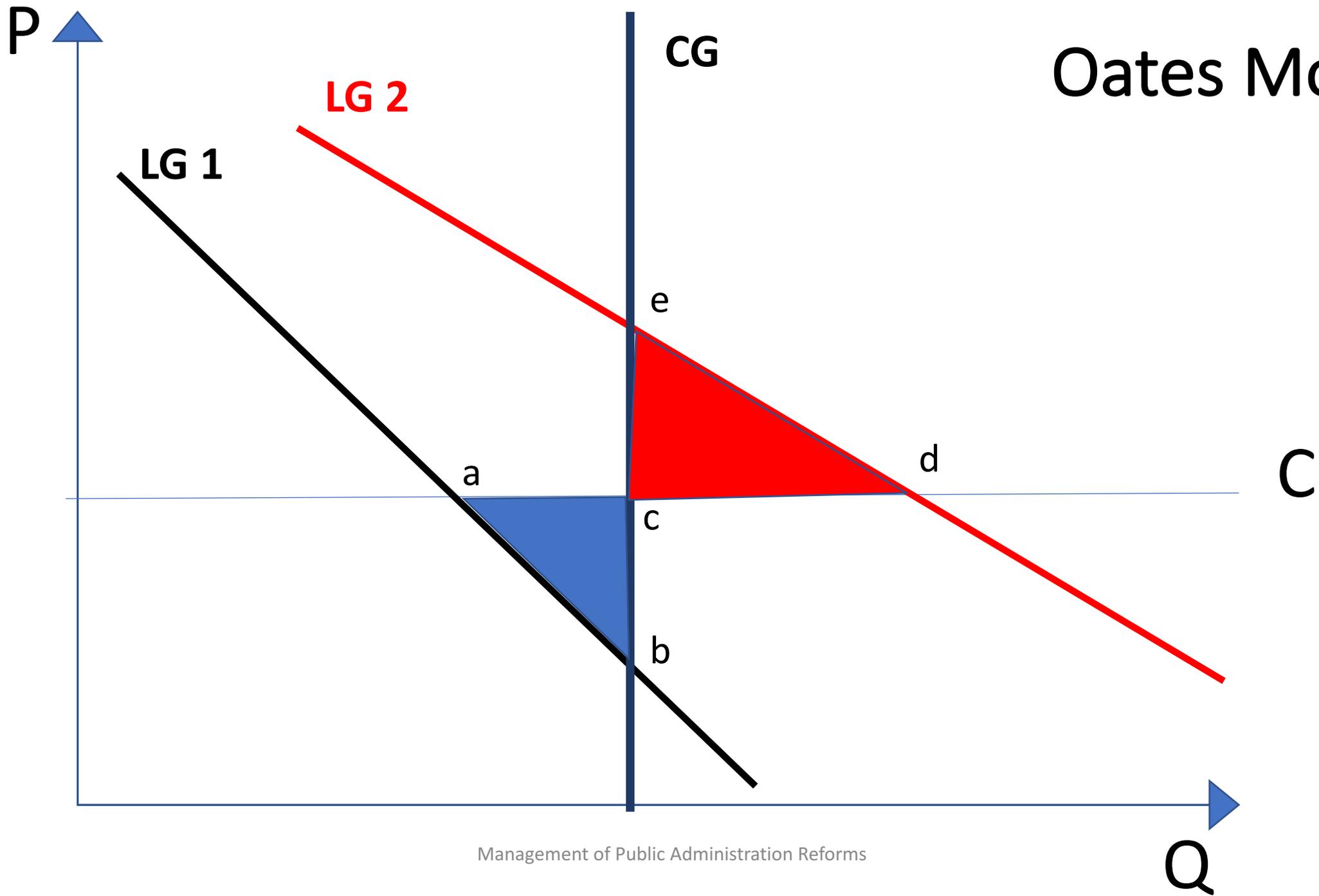
- Tiebout models, which view the state-local public sector in the context of a static long-run equilibrium model devoid of politics, but in which individuals are free to move among numerous jurisdictions;
- This model includes the competition among local authorities. Therefore, citizens and private entities will move in those local areas that are more efficient.
- Hypothesis:
 - free mobility of citizens
 - the citizens move toward those areas/municipalities that offer public services similar to their preferences
 - perfect information on the quality of public services and their tax base
 - no spillover effect
 - public production offers constant returns



Oates Model

- According to this model, a decentralized system is able to satisfy more the citizens needs compared to a centralized system.
- This model is based on the following hypothesis:
 - centralization is able to offer only unitary political forms in the country
 - local and regional areas are composed by homogenous needs
 - the production process is characterized by constant costs (there are no economic scale)
 - there are no spillover effects

Oates Model



Leviathan and General Equilibrium Models

- **Leviathan** public choice models, in which those making tax and budgetary choices (or setting agendas for voters) have substantial economic and political power over inputs, outputs, or agendas. The government is seen as a monopolist that maximizes tax revenues.
- **General equilibrium models** of taxation applied to local government to study the incidence of property taxes.

II Generation Fiscal Federalism Theory & Political Economy

➤ II G. Fiscal Federalism Theory

- ❑ Because of non-appropriate decision-making during fiscal distress
- ❑ It states that decentralization could be effective but it might also have disadvantages

➤ Political Economy

- ❑ Focus on legislation and electoral system. The aim is to understand different fiscal systems aiming to understand the advantages of trade-offs between the central and local level. It also aims to analyze the advantages of spillover effects and the relationship between the coordination and the local autonomy

Example: Italian Government Levels

- The State (central government)
- Regions
 - Regions with special status (Sicily, Sardegna, Valle d'Aosta, Friuli-Venezia Giulia e Trentino-Alto Adige – Art. 117 and art. 118 of the Constitution)
- Provinces (abolished)
- Metropolitan Cities
- Municipalities

- Starting from

The State

➤ The State is responsible for:

- State security
- Financial markets and currency systems
- State organs and related electoral laws
- Public order and security
- Legislation (especially: tax legislation) it imposes several fiscal rules on local governments
- Foreign policy and international relations
- State relations with the European Union
- State relations with religious institutions
- Immigration

Local Governments

- Local governments are responsible for:
 - ❑ To have their own status, powers and functions
 - ❑ They are autonomous in applying their own taxes and tariffs that should comply with the Constitution and the principles of the Coordination of Public Finances and Tax System.
 - ❑ Equalization fund – Transferring funds from State to L.E
 - ❑ Local Government could borrow money only for investments. However, they can borrow money only if their budget fulfills certain conditions

Regions and Provinces (abolished for a substantial change)

➤ **Regions** (20: 15 have Ordinary Status and 5 Special Status)

Their authorities are listed in art. 122 of the Italian Constitution

- Regional Council: Exercises legislative powers attributed to the region and other functions conferred by the Constitution
- The Municipal Council: has executive powers at the regional level
- The regional President

➤ **Provinces** (107). Law no. 56 of 7 April 2014 “*Legge Delrio*” “abolished” provinces for a new organization

- Mayors assemblies
- The Council of the province
- The President of the Province

Transfers to provinces are composed by ordinary contribution + additional registration tax.
Equalization and incentive fund = 16% of revenues

Communes and Metropolitan Cities

➤ **Communes**

- ❑ The Mayor who is elected by the citizens
- ❑ Councilors elected by the Mayor
- ❑ Communal council that has the power to approve the balance sheet and other laws and regulations.

➤ **Metropolitan Cities (14):** Law no. 54 of 7 April 2014 “*Legge Delrio*”

- ❑ Transfers are done based on their demographic characteristics, ordinary contributions and by 4% of ICI contribution.
- ❑ Standard need index (compare revenues of municipalities and determine, based on a standard-need index, the transfers for each)
- ❑ Equalization and incentive fund = 84%

Revenue sources of Communes

- Own taxes
- Regional and other taxes from partnerships
- Taxes and changers for public services
- Revenue transfers
- Regional transfers
- Sales and transfers of securities
- Resources from investments
- Other resources
- State transfers

Law (l.d)	Date
281	16 May 1970
142	08 June 1990
504	30 December 1992
77	25 February 1995
546	28 December 1995
549	28 December 1995
662	23 December 1996 (amended l.d 446 of 23 December 1997, amended l.d 137 of 10 April 1998)
59	15 March 1997
143	4 June 1997
244	30 June 1997
442	10 November 1997
469	23 December 1997
112	31 March 1998
360	28 September 1998
267	18 2000 August (amended law no.125 on 6 August 2015 and then l.d no. 78 of 19 June 2015)
42	5 May 2009
78	31 May 2010
216	26 November 2010
118	23 June 2011
147	27 December 2013
208	28 December 2015