Ministero dell'Economia e delle Finanze

Dipartimento del Tesoro

What governance arrangements to deal with the trade-off between investment needs and cuts in public spending?

OECD

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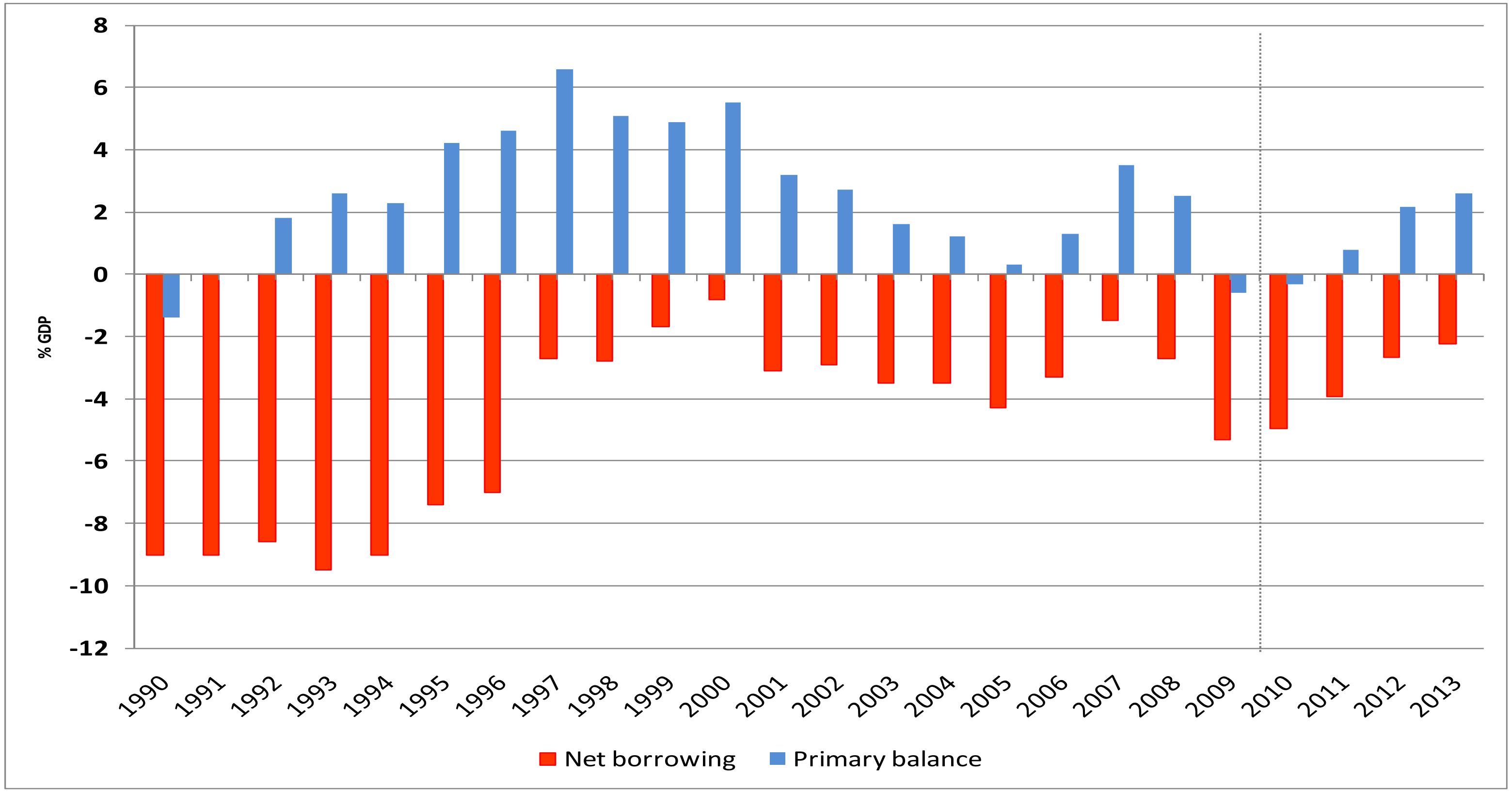
Effective action already undertaken before the summer

- Consolidation measures were presented at the end of May and converted into law in July, in line with EDP commitments which called for effective action by 2 June.
- The size of the fiscal adjustment amounted to a cumulative €12 billion in 2011 and €25 billion in 2012 and in 2013.
- The Government confirmed Italy's commitment to reduce net borrowing below 3.0% of GDP by 2012.
- The primary balance is expected to improve from -0.4% of GDP in 2010 to 1.0% in 2011 and 2.5% in 2012, with a cumulative adjustment of about 2.9pp over 2010-2012.

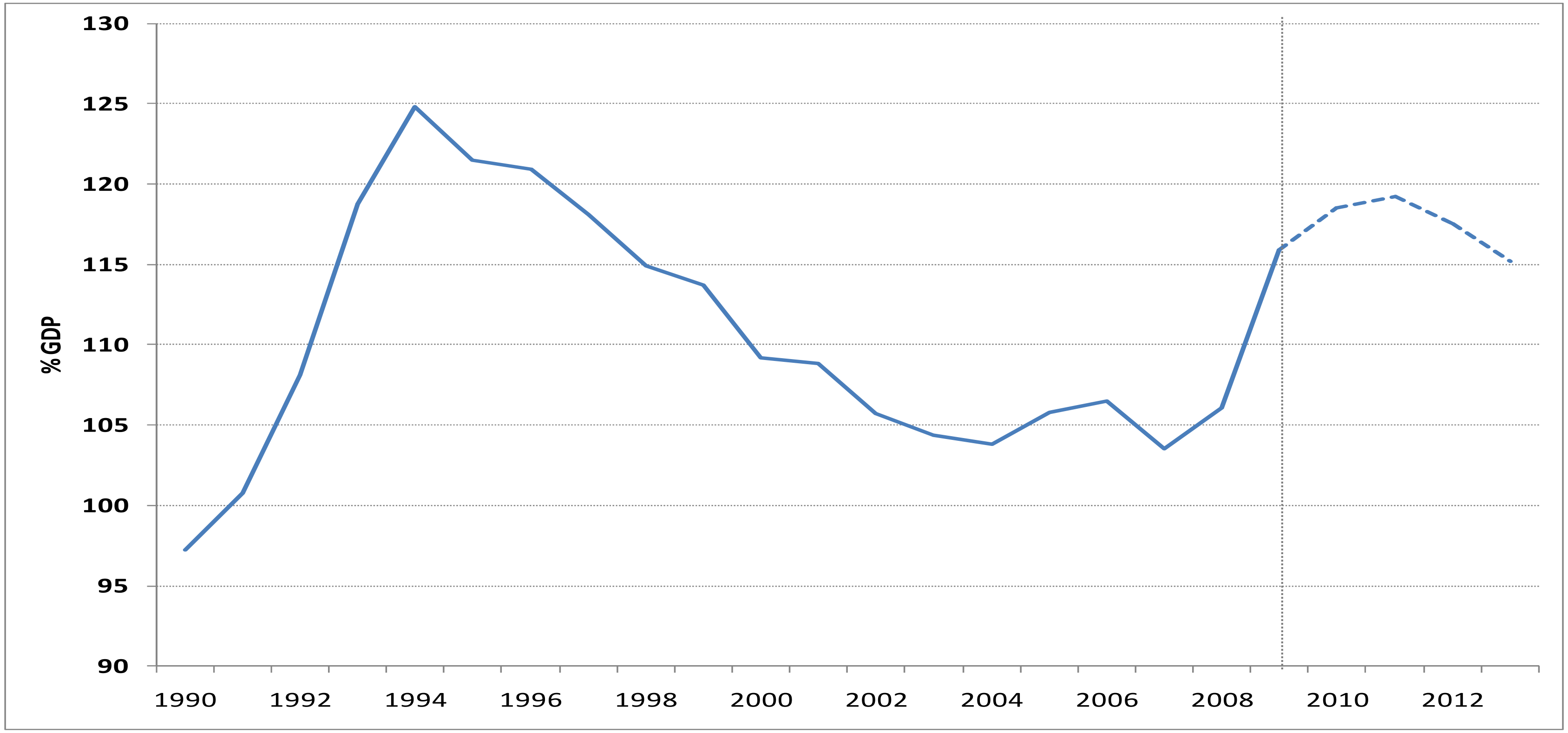
Gradual but significant tightening in 2010 already



Source: ISTAT (up to 2009), Public Finance Decision for 2011-2013 afterwards

In 2012, general government net borrowing is expected to drop below the 3.0% threshold, to 2.7% and further decrease to 2.2% in 2013. The primary balance is expected to go back into positive territory as of 2011 and to progressively increase thereafter (to 2.6% of GDP in 2013)

Debt/GDP: heading downwards again



In 2010, the government estimates the debt/GDP ratio to rise to 118.5%, and then level off in 2011 in the policy scenario, with a reduction to 117.5% in 2012 and 115.2 in 2013.

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Local governments: sizeable spending cuts

- Burden sharing of local governments in achieving national public finance targets over 2011-2013.
- Gross contribution from local government to budget consolidation of about €8.5bn (5.5 from regions, 2.5 municipalities, 0.5 provinces). Net contribution of €7.95bn.
- Sub-national governments are required to improve efficiency of public spending, with particular reference to personnel costs to compensate for the reduction in central government transfers.

Fiscal consolidation and structural reforms

- Reform of the public sector (completed)
- Reform of the budgetary framework (completed)
- Pension reform (completed)
- Reform of the education system (ongoing)
- Tax system reform (ongoing + forthcoming)
- Fiscal federalism (ongoing)

Fiscal federalism: tackling Italy's long-standing problems

FISCAL FEDERALISM

- Financial autonomy at local level
- Gradual shift from historical costs to the provision of essential levels of services and transfer mechanisms
- Clearer responsibilities and duties between the State and the Regions
- Accountability

Shifting from centre to periphery would enforce the benefit principle, i.e. paying taxes for public services whose efficiency can be controlled by citizens.

Fiscal federalism: a long and winding road

- In 2009, the Parliament approved the law on fiscal federalism.
- Some Legislative Decrees have already been implemented over the past few months, while others are expected in the coming months.
- In May 2010 the Government set the rules for transferring part of State-owned assets to regions and local governments, with the view of increasing local governments' financial autonomy and encouraging more efficient management of public goods.

Fiscal federalism: property management

- Local governments are allowed to assign transferred properties to real estate funds or sell them (with the exception of specific assets with high institutional relevance).
- Local governments should prepare a property management and divestment plan: identifying a list of properties to be assigned to existing real estate funds set by the Ministry of Economy and Finance or new funds established by local governments.
- In case of divestment, proceeds have to be used to reduce public debt.

Fiscal federalism: strengthening fiscal autonomy

- As a result, central transfers to local governments and tax revenue sharing are reduced accordingly.
- The July 2010 budget provides further tools for the strengthening of local governments' financial autonomy.
- In particular, it enhances the role of local governments in fighting tax evasion by introducing the participation of municipalities in tax auditing activities.
- One third of the amount of taxes and penalties levied in detected cases of tax evasion is attributed to municipalities.

Fiscal federalism: increasing quality of public spending

- The budget also included the 2010 update of the Domestic Stability Pact which sets the burden sharing of regions and local governments in achieving national public finance targets.
- In order to offset the reduction in central government transfers, sub-national governments were required to improve efficiency of public spending, with particular reference to personnel costs.

Fiscal federalism: ongoing work

- Harmonisation of accounting practices among central and local governments, which is key to enhance transparency of public accounts and accountability of sub-central governments.
- Definition of standard requirements of local governments and standard costs of public services to provide correct incentives.

Fiscal federalism: ongoing work

- Simplification of local taxation to cut the number of municipal taxes from 18 to 2.
- Shift in local taxation from labour income to real estate revenues (stable taxation base).
- Possible introduction of certification regarding the state of a region's public finances to be prepared by the President of the region at the end of her/his mandate in order to reduce the risk of any unexpected budget shortfall.

The new public finance and accounting framework

- Better coordination across level of governments in defining targets and setting budget polices.
- Better control of expenditure and its quality.
- Better transparency and informative content of central government's financial statements.

The new public finance and accounting framework

- New financial planning cycle and new planning documents for the central government.
- Classification of spending by missions and programmes for the central government budget.
- Harmonisation of accounting practices among central and local governments.
- Strengthening of the mechanisms for qualitative and quantitative control of expenditure.

The Domestic Stability Pact and the rules on investment

- The Domestic Stability Pact, introduced in 1999, is the pillar of Italy's fiscal framework. In addition, there are other fiscal rules regarding Regions' health expenditure (Health Pact).

- It consists of specific constraints for local authorities, along with information, communication and certification requirements, and sanctions in case of non-compliance.

- It includes a balanced budget rule for municipalities and provinces with at least 5,000 residents, and a constraint on the nominal growth of expenditure for Regions.

The Domestic Stability Pact and the rules on investment

- The Pact covers both current and capital expenditure of local governments. It excludes lending and healthcare expenditure.
- It is supplemented by Art. 119 of the Constitution, as modified in 2001, which allows local authorities to overshoot their budget only if resources are allocated to finance investment.
- It has evolved over time.

The Domestic Stability Pact and the rules on investment

- At the onset and up to 2002, there was a ‘golden rule’ whereas a broadly-defined capital expenditure of local governments was excluded from the computation of financial targets. In 2003, the golden rule was suspended for non-compliant local entities.

- In 2005, financial targets were replaced by a thresholds on both current and capital expenditure. In particular, capital expenditure could not exceed its 2001-2003 average, plus a small margin.

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The Domestic Stability Pact and the rules on investment

- However, in order to preserve growth in capital expenditure, exceptions were introduced, allowing investment above the threshold if financed through divestment of other assets.
- In 2006, while keeping the threshold system, local governments were allowed to finance additional investment by reducing current expenditure. Moreover, municipalities were allowed to exceed the threshold on capital expenditure by using revenues stemming from their anti-tax evasion actions.

The Domestic Stability Pact and the rules on investment

- Since 2007 the golden rule is no longer part of the Pact. Both capital and current expenditure are limited by financial targets.
- However, since then the Government has put in place some exceptions, trying to preserve the level of capital expenditure at local level.
- In 2008 the Government introduced the cash basis principle for the accounting of capital expenditure, which made easier for local entities to run a budget surplus and spend it for new investment.

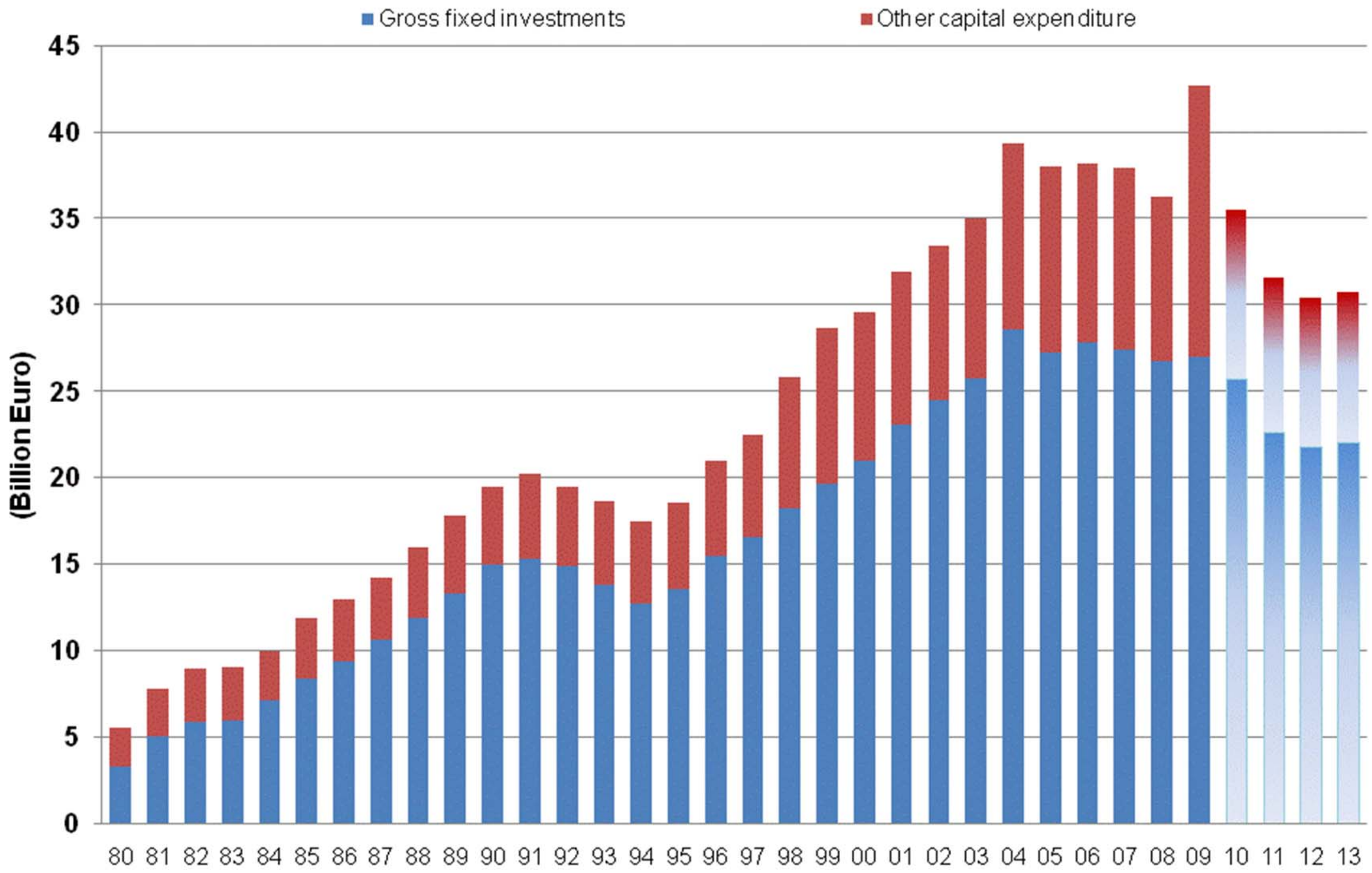
The Domestic Stability Pact and the rules on investment

- In 2009, in order to counterbalance the effects of the crisis, new temporary exceptions were introduced to boost public investment made by municipalities and provinces.
- Temporary and extraordinary interventions in favour of workers and firms, implying capital expenditure, were allowed.
- Moreover, a rewarding mechanism was introduced for local authorities which fulfilled the 2008 Domestic Stability Pact. In fact, against a background of tight fiscal consolidation, virtuous local entities were allowed to exclude part of capital spending from the computation of financial targets.

The Domestic Stability Pact and the rules on investment

- In 2010 exceptions to the enforcement of sanctions were introduced in case of failure to comply with the Pact, when failure was due to capital account programmes co-financed by the EU.
- In line with the principles set by the Law on federalism, the July 2010 fiscal package reinforced the reward mechanisms for virtuous provinces and municipalities introduced in 2009.
- Moreover, they will benefit from additional central resources to be assigned according to a forthcoming Decree.

Capital expenditure of sub-national governments



Source: ISTAT (up to 2009) , and Public Finance Decision 2011-2013, afterwards