Reforming Fiscal Federalism and Local Government
Beyond the Zero-Sum Game
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Chapter 8

Italy: Law 42 on fiscal federalism

Summary

In 2009, the Italian parliament endorsed Law 42 on fiscal federalism, setting a milestone for Italy's gradual move towards decentralisation and federal institutions. The law, which is based on a constitutional amendment passed in 2001, increased tax and spending autonomy of the regions, provinces and municipalities and overhauled the equalisation system, tackling the wide fiscal interregional differences in a consistent and efficient fashion (Box 8.1). A set of legislative decrees, some of which have not yet been implemented, determines intergovernmental tax arrangements, equalisation, fiscal rules and accounting harmonisation. The cost of the reform to both the central and sub-central governments is not yet known, but there is strong pressure for the reform to remain "fiscally neutral".

The main factors driving the success of the reform were:

- *The electoral mandate and political pressure were strong*: Law 42 was adopted by a coalition composed of a centre-right party (*Popolo Della Libertà*) and a regionalist party (*Lega Nord*). The electoral campaign focused on federalism issues, with several regions pressing for more autonomy. The constitutional reform of 2001 had instead been adopted by a coalition government composed of a centre-left party.
- *The reform was ripe:* The period after 2001 saw a number of failed attempts to implement the constitutional amendment. Despite mounting pressure, particularly from the northern regions, various governments failed to push a reform agenda. In the meantime, fiscal relations had become ever more inefficient and prone to deficit bias. Experts had repeatedly criticised the shortcomings of the system. The economic crisis of 2008 exacerbated the risk that fiscal federalism will become unsustainable.
- *Reform steps were sequenced:* The reform was pursued in several stages. The constitutional reform of 2001 was followed by a framework law, which itself was followed by a set of legislative decrees. Sequencing could create a "veil of ignorance", forcing all the actors involved to agree on reform principles (lock-in) without knowing their individual and short-term consequences. Sequencing could also allow for agreement on the less problematic aspects of the reform before the more contentious ones were tackled.
- *Several reform elements were bundled:* The reform consisted of various elements that, once bundled, could satisfy a majority of actors and interests. The link between "taxing power" and "equalisation" held the reform together: an extension of taxing power appealed to the wealthier regions and the regions in the north, while equalisation was attractive to the poorer regions. In parallel and by amending the Internal Stability Pact, the central government succeeded in imposing stricter fiscal rules while allowing the regions more flexibility in implementing them.
- *Expert advice was consistent and unbiased:* The reform process was underpinned by extensive and consistent expert advice. The "High Commission for the study of the general principle of public finance and tax system", established in 2003, comprised

many external and independent experts. At the current stage, the public administration has been much more involved. The Bank of Italy, together with other institutions and research centres, prepared several reports pointing at the flaws of the old system.

Box 8.1. **The Italian Law 42 on fiscal federalism**

In 2009, the Italian parliament passed a framework law that thoroughly reshaped fiscal relations between central, regional, provincial and municipal governments. The law, based on a constitutional amendment dating back to 2001, aims at increasing both the efficiency and accountability of sub-central governments (SCGs) and at guaranteeing adequate levels of sub-central public services across the country. The reform replaces a sub-central funding system that had become opaque, inequitable with respect to public service levels and prone to spending excesses. The reform consisted of the following elements:

- *Spending responsibilities to be covered by own taxes:* In line with the constitutional principle of fiscal autonomy, SCGs will be entitled to a set of own taxes or shares in national taxes sufficient to cover their spending needs. Regions are entitled to the tax on productive activities (a regional business-*cum*-value-added tax) and the personal income tax; and they are entitled, within limits, to change the rates on these taxes. Regions are also entitled to a share in the national value-added tax. Municipalities will get a share of the value- added tax and the personal income tax and they will be allowed to levy a property tax on non-owner-occupied houses. The increase in taxing power will be fully offset by a reduction in intergovernmental grants. Only equalising grants and some special purpose grants will remain.
- *Clarification of spending obligations*: Responsibilities for public services at the SCG level will be divided into compulsory services (health care, education, social protection and local transport) and all other public services. While the central government will define minimum standards for compulsory services, SCGs are free to define standards and spending levels for the other services. All services not explicitly allocated to the central government level will be under the region's responsibility.
- *Equalisation of tax-raising capacity and standard cost:* Two different equalisation systems will be introduced, funded through a share of the national value-added tax: *i)* equalisation of the cost for essential and compulsory services, to be fully equalised and where equalisation should be based on standard cost instead of historical cost; *ii*) equalisation of tax-raising capacity, for which the equalisation rate would be less than 100%, leaving SCGs an incentive to develop their economic and fiscal base.
- *Harmonisation of accounting principles*: Accounting principles for regional and local levels of government (such as accounting and budget rules, the treatment of publicly-owned enterprises, depreciation rules etc), are being harmonised, so that regional and local accounts will be truly comparable and "creative accounting" avoided.

Law 42 is a framework law that sets down the principles for reform but leaves their implementation to a set of legislative decrees. These decrees also have to be passed by parliament, and only five of them are in force as of mid-2011. Pending issues include the functioning of the equalisation scheme and the tax shares allocated to each government level. There is some uncertainty whether the reform will be fiscally neutral for the central government. Parallel to adopting Law 42, the central government tightened fiscal rules in the Internal Stability Pact, and non-complying SCGs are sanctioned. To moderate the strictness of the rules, regions are given some flexibility in dividing up overall deficits and debt among their provinces and municipalities.

Context of the reform

Institutional framework

Italy is on a slow but steady path towards political and fiscal decentralisation. As a result of the fiscal federalism reforms during the 1990s, the spending share of the regions rose to around 30% and those of the provinces and municipalities to around 21% of total government spending, net of interest and social security payments (Buglione and Marè, 2007). All sub-central levels – regions, provinces and municipalities – have spending as well as taxing powers, making Italy unique among federal and quasi-federal countries. Health care makes up the bulk of regional expenditure, while education, transport and territorial development are main spending items of the provinces and municipalities. With SCG tax revenues hovering around 20% of total tax revenue, taxing power is low, resulting in a large vertical fiscal imbalance, with around 50% of total SCG revenue provided by transfers from the central government. The main autonomous taxes at the regional level are the regional tax on productive activities (a business-*cum*-value added tax) and a regional surcharge on the personal income tax, both introduced in 1997. Local governments rely essentially on the property tax. To contain overall tax pressure, regional and local power has often been curtailed by the central government. A number of special statute regions – *i.e.* islands and border regions – have wider spending prerogatives and benefit of special tax sharing programs, triggering a "multi-speed" federalism in the country.

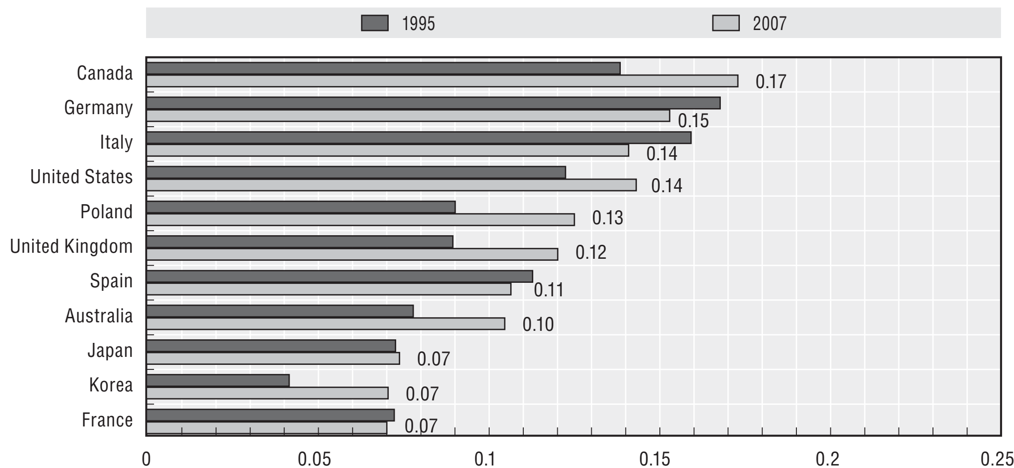
Economic and fiscal conditions

With average annual growth rates below 1.5% during much of the reform period, Italy's GDP growth was weak and clearly below the OECD average, except for a short period of stronger growth after 2006. Structural reforms, deemed necessary to boost productivity, were repeatedly postponed or watered down, contributing to low growth.[1] Structural government balances were negative throughout the entire reform period, although the internal stability pact, enacted in the wake of Italy's accession to the euro area, had reduced deficits from the high levels of the 1990s; and the primary balance was always positive between 2000 and 2007. Deficits as a percentage of total spending were higher at the regional and local than at the central level during much of the reform period. While the reform is seen by most interview partners as structural and driven by political demands, the crisis of 2008 and its aftermath and the resulting revenue shortfalls put new pressure on all government levels to curb spending.

Strong interregional disparities, especially between the north and the south, are an important issue in Italy. Among the high-income OECD countries, Italy has one of the largest regional GDP per capita disparities, except for Germany, which is adjusting to reunification, and Canada (Figure 8.1). In the southern part of the country, per capita GDP is around a third lower than in the north, reflecting a wide productivity gap; while unemployment is triple that of the northern regions. The southern regions have lagged behind the national average since the 1950s, despite a set of regional development policies.[2] Economic differences impinge on fiscal positions: tax-raising capacity is lower, and deficits and debt are higher in the south, despite a comprehensive transfer system. The unequal economic and fiscal situation was one of the main drivers in the debate on decentralisation, with the north asking for a "territorialised" fiscal system, *i.e.* one that left revenues where they were generated. The constitutional reform of 2001 that set the stage

Figure 8.1. **Italy suffers from significant interregional disparities**

Gini index of GDP inequality in selected high-income OECD countries



Note: Gini coefficients for GDP per capita are measured at the level of regions, *i.e.* territorial level TL2.
Source: *OECD Regional Statistics*.

for the fiscal federalism reform was meant to be a compromise between northern demands for more autonomy and southern demands for lower economic and fiscal disparities.

Issue history

The decentralisation process can be traced back to the constitution of 1948, which included several federalist elements, and to the creation in 1970 of a fully fledged regional level above the provinces and municipalities. In 1997, in the wake of an economic crisis and Italy's bid to join the euro area, the country passed the "Bassanini reforms", which devolved a set of spending and regulatory powers to sub-central governments. A system of "negotiated planning" was devised, with more involvement of SCGs in local and regional development. Although some taxing power was delegated to the regions, in line with new spending responsibilities, the revenue side remained much more centralised than the spending side. This institutional set-up required sizeable intergovernmental transfers, which were mainly determined by negotiations between the central government and individual regions, but was based on historical cost and lacked objective allocation criteria. In the second half of the 1990s, the northern regionalist movement started to claim that the generous transfer system was straining the resources of the economically rich north and discouraging economic development in the south, and it began to seek more autonomy. A reform of equalisation was passed in 2000 but was not implemented, because the poorer regions feared a reduction in transfers. In 2001, the constitutional reform was finally adopted, preparing a thorough revamp of fiscal relations. One of the main achievements of the constitutional amendment was that it clarified spending roles, the principle of fiscal autonomy and, in more general terms, how the transfer system and equalisation should work.

After the passage of the constitutional amendment, however, the path to reform was intricate. In 2003 the Berlusconi 2 government set up a High Commission on Fiscal Federalism to draft reform proposals, but when the commission presented its report, there was no legislative follow-up by the new Prodi government elected in 2006, and the commission was dissolved in 2007. Legislation passed in 2006, which aimed at clarifying

spending assignments, failed in a referendum, although the government had made implementing the constitutional amendment one of its priorities. Fiscal federalism became the "unfinished agenda". In view of the shortcomings of the legislation, the Constitutional Court had to step in frequently to rule on contentious cases, often in favor of the central rather than the regional level. In the meantime, the transfer system had become more and more opaque, cumbersome and prone to spending excesses. Problems were especially acute in health care, where costs rose by 10% or more annually, probably because regions could extract additional transfers if they ran deficits (soft budget constraint). When a new centre-right government (Berlusconi 3) was elected in September 2008, a thorough reform of fiscal federal institutions and a rapid implementation of the constitutional amendment were ripe.

Actors and interests

The main actors in the reform process were the three government levels, in particular central government and the regions. The core objective for the central government was to make sub-central governments accountable, *i.e.* to establish an intergovernmental fiscal framework that supported fiscal discipline. Central government wanted *i*) SCG spending to be largely covered by own tax revenue, as stipulated by the constitutional amendment, *ii*) a set of tighter fiscal rules within the internal stability pact including sanctions for non-compliance and *iii*) a transparent and formula-based equalisation system for SCGs whose tax-raising capacity or needs were below a fixed standard. Transfers were to be eliminated except for equalisation and for "special purposes". Given the dissatisfaction with the regional business-*cum*-value added tax, central government also wanted to broaden the regional tax base. The regions as a whole were basically happy with these demands. Most preferred the steadier stream of own tax revenues to the volatility of intergovernmental grants, whose opaque political determination was a permanent source of uncertainty as far as revenues were concerned. The regions also wanted a broader tax base and at least some rate-setting autonomy for the taxes assigned to them. Regions broadly agreed that the transfer system was highly ineffective; both in terms of efficiency and interregional equity, and that it should be overhauled. Regions and municipalities were hesitant to embrace tighter fiscal rules, fearing that they would have to shoulder the brunt of consolidation.[3] Municipalities, especially the cities, wanted to maintain their direct links with the central government and avoid too much dependence on the regions, a reflection of the historic importance of city-states.

The fault lines ran across the regions rather than between the regions and central government. The most contentious issues were tax autonomy and the extent of equalisation. While the wealthier regions favoured "territoriality", *i.e.* a system whereby taxes accrued to the region where they were collected, the poorer regions demanded strong equalisation that accounted for lower tax-raising capacity and a lower capacity to provide essential services. The wealthier regions also wanted more autonomy over the devolved taxes, while the poorer regions – especially those in the south – feared that tax competition and the ensuing mobility of households and firms would put them at a disadvantage. Some debates revolved around how the evidence should be interpreted: while some regions claimed that transfers should be reduced because they had failed to reduce the north-south gap, the poorer regions noted the ineffectiveness of the system and the need to strengthen it.[4] The municipalities disagreed on their capacity to shoulder the cost of additional services: while the large cities were ready to take over responsibility for a large

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array of services, the smaller ones feared being overwhelmed by spending obligations. In general, the demands from the northern regions were stronger and more consistent, and they were backed by the *Lega Nord* party, which had joined the coalition government. Several observers remarked that the south lacked the political equivalent of the *Lega* to bundle and streamline its demands. It was important that during the reform process a few regions – both in the north and the south – emerged as "bridge regions" able to mediate between opposing positions. The fact that these regions had no strong individual stakes in their reform proposals helped them to act as honest brokers and increased their trustworthiness.

Electoral mandate

The drive for reform of fiscal federalism in Italy comes from the entire political spectrum and is endorsed by a majority of the population. However, the wishes of the electorate are not always clear or consistent, and competing interpretations of how to approach reform may at times leave reforms unfinished. The interests of jurisdictions sometimes supersede party discipline, with members of parliament voting along regional rather than party lines. On the other hand, the potential threat of a no-confidence vote can undermine a federalist consensus across political parties, since it tends to enforce voting along party lines.

The 2001 constitutional reform was prepared by a centre-left government, and the reform was adopted just before regional elections that revealed strong demands for regional empowerment. The centre-right government elected in 2001 interpreted the constitutional reform as a mandate for strong reform but finally over-reached with its proposals. The centre-left that came back in 2006 made an attempt to link decentralisation to the liberalisation of local and regional public service markets, but the implementing law was not enacted. When the centre-right government again came to power in 2008, it had a clear mandate: the government was a coalition of a centre-right party (*Popolo della Libertà*) and a regionalist party (*Lega Nord*) that claimed more autonomy for the regional level. The government had focused its election campaign on the federalism issue, arguing that the constitutional reform of 2001 had still not been implemented and that it was time "to live up to fiscal federalism". Within a few months of the election, the government prepared the framework law.

The reform process

Policy formulation: sequencing

The Italian fiscal federalism reform extended over a long period and was sequenced into distinct steps. Each step made the reform more concrete and visible, while obscuring for as long as possible the more contentious elements. The constitutional reform of 2001 laid down the principle that sub-central spending responsibilities should be covered by own resources and that adequate equalisation should ensure a comparable level of public services across the country. Law 42 of 2009 took up these principles and cast them into operational policy objectives. The law stipulated that regions were entitled to the tax on productive activities, and to a share in both the value-added tax and the personal income tax. Tax revenues should suffice to cover spending levels for an average region. The local level was entitled to the property tax and some other minor taxes.[5] Equalisation was divided between an allocation for delegated services (health and education) with full equalisation based on standard cost, and an allocation for non-essential services with only

partial equalisation, based on tax-raising capacity. The legislative decrees – of which only five have been adopted so far – finally define the tax sharing system for the regional and local level, the allowed minimum and maximum tax rates, the degree of partial equalisation and the procedures for defining standard cost, especially in the health care sector.

Sequencing had the advantage of ensuring that governments acted under a veil of ignorance, which forced them to concentrate on long-term effects and to adopt a broader view. Specific numbers for revenue shares or equalisation formulas were not available, which made the assessment of short-term effects virtually impossible. The actors involved were obliged to consider the underlying principles rather than bargain for specific advantages, which in turn facilitated reaching a consensus. Some southern regions acknowledged the long-term advantages of stronger fiscal autonomy and of a more rational equalisation scheme, thereby mitigating the sometimes sterile north-south confrontation.[6] Several interview partners said they were convinced that sequencing produced a lock-in effect: once the different actors had agreed on the framework of Law 42, they could not retreat from the consensus once the numerical cornerstones of the legislative decrees became apparent. Others were more skeptical, pointing out that winners and losers of the more contentious consequences of reform are still widely unknown. They argued that once the additional calculations became available, distributional effects would become visible, and resistance to reform would increase, unless the central government put additional resources on the table. As a precautionary move, the central government agreed early on to a set of transitional arrangements in order to cushion negative short-term impacts of the reform.

Policy formulation: bundling

The reform consisted of several elements that could be bundled to satisfy the various interests. The principle of fiscal autonomy, *i.e.* that spending should be covered by own tax revenue, and the principle of "territoriality", *i.e.* that tax revenues should remain where they were generated, pleased the wealthier regions. Tax autonomy – the right to set and vary tax rates – pleased regions that boasted efficient public services and/or stood to benefit from inter-jurisdictional tax competition. Tighter fiscal rules were adopted mainly at the demand of the central government. However, the central government brought the regions on board by allowing them greater flexibility in dividing up the total sub-central deficit between the regional, provincial and municipal level, and a few regions made already use of this possibility.[7] The reform of the fiscal equalisation system satisfied two types of regions, those with low tax-raising capacity and those where the cost of providing services was above the national average. Although the correlation between low tax-raising capacity and high service costs is relatively high, the two equalisation systems do not always benefit the same regions.[8] The harmonisation of accounting rules was a strong priority of the central government, which was eager to compile comparable and reliable data on sub-central public finances, and was also intent on ensuring that SCGs did not circumvent tighter fiscal rules through creative accounting. The municipal level finally got more own revenues, less earmarked grants and a better functioning equalisation system.

The deal "more tax revenue "*versus*" better equalisation" was the lynchpin holding the reform together. The constitutional reform of 2001 explicitly called for an equalisation fund to balance the principle of sub-central self-funding. While early reform proposals focussed on decentralisation, autonomy and "territoriality", demands for equalisation

grew during the negotiations. The wealthier regions accepted the definition of "essential services" and minimum standards and accepted that their cost had to be fully equalised. Health care, now recognised as an essential service, became a central issue for the south. And, while the wealthier regions were inclined to a "horizontal" – *i.e.* between regions – equalisation model with limited equalisation, poorer regions preferred a vertical or gap-filling equalisation system, which puts the burden of equalisation on the central government rather than the wealthier regions. Finally, the regions accepted centrally determined minimum and maximum tax rates instead of full tax autonomy, as fully fledged tax competition was seen as benefitting the wealthier regions only.[9]

Experimentation

Several Italian regions – the islands and some border regions – have a special statute with extended spending and taxation powers. These regions have long acted as a laboratory for fiscal decentralisation experiments which, if successful, were transferred to or adopted by the other regions. For example, the value-added tax regime in force in some special statute regions inspired the tax-sharing system established by the reform. The experiments carried out in the special statute regions provided evidence that wide-ranging decentralisation of fiscal power could have beneficial effects at both the central and the sub-central level. While the demarcation of special and ordinary statute regions created an inherent "multi-speed federalism", the 2009 reforms were intended to reduce the institutional gap and to assign to the ordinary regions some prerogatives that special statue regions already enjoyed. The idea of experimentation was also carried forward once the framework law was adopted: in advance of the implementation of Law 42 for major metropolitan cities, a legislative decree from 2010 specifies a set of concrete rules and regulations for Rome.

Administrative setup

Once framework Law 42 had been elaborated, the subsequent implementation of the legislative decrees involved more actors and a heavier administrative structure. In 2010, an Intergovernmental Committee on Fiscal Federalism was created with equal representation for the central government, the regions, the provinces and the municipalities. The committee was divided into seven working groups, each treating one aspect of the reform, and steered by the Ministry of Economy and Finance. Each working group was composed of delegates of the Ministry of Economy and Finance, delegates from line ministries, each government level and external experts. The structure was chosen to concatenate leadership by the Ministry of Economy and Finance, with adequate representation of the relevant actors and interests. One of the main activities of the committee was to define the relevant information needed to establish the financing framework, as well as to collect data, to allow for informed decisions on reform needs and outcomes. The regional level co-ordinated its position through the Conference of the Regions, where all regional presidents meet and the reform was regularly on the agenda. Since the decisions of the Conference of the Regions have to be reached by consensus, this implied extensive interregional consultations but meant – although they are not legally binding – that the regions had a strong negotiation position.

The role of experts

Fiscal federalism is a widely discussed topic in Italian academic circles, so the government could rely on a large number of experts. While the elaboration of the framework law benefited from the input of *ad hoc* experts, the subsequent formulation of the legislative decrees was done by systematically involving experts as members of the working groups and for drafting reports. A major role of experts was to provide relevant information and data. Some interview partners argued that the lack of appropriate fiscal data could have resulted in misinterpretations of reform needs, slowing down the reform process.

The Bank of Italy, together with other prominent institutions and research centres, prepared several reports pointing out the flaws of the old system. Between 2004 and 2010 the Bank's study branch, in particular, prepared more than ten reports on topics such as economic and fiscal disparities, sub-central tax raising capacity, sub-central spending, and sub-central debt and debt management, pointing early to the need for reform and setting up a reform agenda.[10] The main conclusion of the reports was that there was ample room for more fiscal autonomy at the sub-central level and that the equalisation system had to be thoroughly overhauled.

Adoption, implementation and unfinished elements

Framework Law 42 was adopted by both parliamentary chambers in May 2009, with the abstention of the opposition parties. Several legislative decrees – each requiring an act of parliament – detailing the framework law were passed in 2010: the devolution of state-owned property to regional and local government; the new legislative framework for the capital city; the definition of expenditure needs for municipalities; municipal funding and the taxes allocated to the municipal level; the funding and tax system for ordinary regions; the definition of standard cost for the health care sector; and the harmonisation of sub-central accounting principles. In parallel, stricter fiscal rules were inserted into the Internal Stability Pact, though providing the regions also with some leeway in allocating debt between the municipal, provincial and regional level.

Several decrees that will spell out numerical cornerstones – such as the tax shares allocated to the sub-central level or the size of the equalisation fund – are still being drafted, although framework Law 42 was due to have been fully implemented by May 2011. Also, the calculation of standard cost across regions, which is essential for determining equalisation payments, has been delayed, due both to a debate on which indicators to take into account and to the lack of appropriate data. This is likely to give rise to potentially enduring conflicts between the central and sub-central government levels. Finally, although the central government aims at "fiscal neutrality" (meaning that the reform does not require additional central government resources), it is uncertain whether it can stick to this aim, especially if reform losers start to show signs of opposition.

Conclusions

The Law 42 of 2009 on fiscal federalism, based on the constitutional reform of 2001, was one of the farthest-reaching reforms of Italy's fiscal framework. Its success built on a set of abandoned or failed reform attempts. For years, experts had argued that a reform of fiscal relations was inevitable for reasons both of efficiency and of equity. The reform was pursued by a government that had a clear mandate for more regional autonomy and for an

overhaul of an excessive and inefficient transfer system. The sequencing of various reform steps – a constitutional reform followed by a framework law, followed by legislative decrees that set out numerical values for the various reform elements – made sure that actors had to agree on reform principles without knowing how they would be affected individually. Sequencing also made it possible to adopt the less contentious elements of the reform and to use the momentum generated to address the more difficult issues. The bundling of autonomy, efficiency and equity issues pleased both the wealthier and the poorer regions.

The reform also showed the formidable constraints for fiscal federalism reformers. Several key numerical cornerstones (such as the tax share allocated to the regions, tax autonomy, the size of the equalisation system and the way standard cost is calculated) are still lacking. While all actors agreed on the principles of the reform, it is not certain whether this consensus will persist once the outcomes for individual governments become available and distributional conflicts apparent. The public still has no clear appreciation of the nature and the consequences of the reform. Based on other countries' experience, specific equalisation formulae are often a particularly contentious issue, requiring a strong consensus on the underlying principles before the discussions on the numbers begin. Some parts of the reform have already been delayed, *e.g.* in the area of standard cost calculation. The coming phase, with more legislative decrees to be presented to parliament, will reveal whether the consensus can hold once concrete numbers are presented.

Notes

1. An overview of Italy's economic and fiscal development in the decade following the adoption of the reform can be found in OECD (2007).
2. OECD (2001) traces the various regional development approaches between 1950 and 2000.
3. To meet deficit objectives, the central government cut transfers to regions and municipalities, and regions are requested to cut their expenditure by a given percentage every year (5% in 2009 and 2010, 13% in 2011).
4. Spending data from the Ministry of Finance suggest that while transfers to and public spending in the south tended to increase until 1992, they subsequently tended to decline with respect to general government spending.
5. The 2009 property tax reform that abolished the tax on owner-occupied houses compromised the federalism reform, since municipal tax revenues declined considerably thereafter. After the reform, municipalities still rely strongly on transfers making up for the lost property tax revenues.
6. In recent years, the productivity gap between the south and the north had been closing, suggesting that the south is catching up (OECD, 2007). This can partly be ascribed to the economic slowdown in the centre-north regions.
7. Provinces and municipalities were not happy with this. They claimed that the new rules would have a cascading effect, and that regions would simply download deficits and debt to the lowest government level. A few regions have established an "intra-regional stability pact" with their provinces and municipalities.
8. In general, the north has a higher fiscal capacity and lower cost per capita to produce a given set of services than the south, but a few regions do not conform to this pattern (Matteis and Messina, 2010 and Bripi, Carmignani and Giordano, 2010).
9. However, tacitly and unofficially, some southern regions did not have such a negative view of tax autonomy, seeing it as a boon to attract new businesses and to compete with more industrialised and agglomerated regions.
10. As an example, see Franco, Massina and Zotteri (2004).

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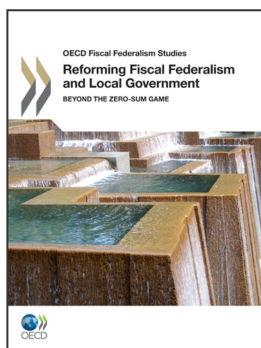

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