Chapter 2

Maintaining fiscal sustainability: Structural fiscal issues

Major progress has been made in moving towards fiscal sustainability, thanks to substantial consolidation on both spending and revenue sides. Further structural improvements can build on these gains and, more fundamentally, support the government's reform programme aimed at improving productivity and growth. Tax compliance is more expensive for companies in Italy than in most OECD countries, while tax expenditures are very numerous. Simplifying the tax system can raise investment and growth, as well reducing costs in the tax agency and improving compliance. Value for money in public spending is always important but particularly so in a situation of tight budgets. Ad hoc spending reviews have been undertaken, but a systematic approach is needed. Some existing tools to promote value for money can be improved, while reform of public administration, including better use of transparency and anti-corruption measures, can support their effective use. The Internal Stability Pact (ISP) has been a necessary domestic counterpart of European fiscal rules, but has imposed a number of constraints on sub-national administration that go beyond what is needed for EU purposes. Constitutional reforms, balanced budget rules for sub-national administrations and final implementation of long-awaited rules on fiscal federalism provide an opportunity to considerably simplify or eliminate the ISP.

Italy has made much progress in strengthening its fiscal policy, reducing the structural budget deficit by around four percentage points between 2009 and 2012, with some further tightening since. The headline deficit is now below 3% of GDP. However, the debt-to-GDP ratio is still rising as the economy has contracted and inflation fallen. The manner in which the necessarily tight budget targets are achieved can be as important as the level of the targets themselves.

The effort to contain the deficit and to undertake significant fiscal consolidation in difficult circumstances has led to tensions: in relations between central and sub-national government; in public spending control; and in taxation. For example, central government transfers to regions, provinces and municipalities have fallen substantially with little reduction in their statutory obligations; civil servant salaries and recruitment have been largely frozen for four years; and already high levels of taxation have been increased.

Successive governments have aimed to deal with these problems. A 2009 framework law set out the basic lines for fiscal federalism, but the working of the Internal Stability Pact, designed to make local government finances compatible with the European Union standards and constraints, has not always worked smoothly. Two successive governments have started Spending Reviews aimed at finding cost-efficient ways to cut spending. The government is implementing changes to the tax system changes under a framework law passed in the spring of 2014.

This chapter explores tax policy and spending control to suggest ways in which improvements in these areas can help to meet the macro constraints on overall fiscal policy more efficiently. The next section looks at how changes to some aspects of the taxation system could meet policy objectives at less cost and be made more growth-friendly. The subsequent section discusses how government have met spending targets, notably through the Spending Review, and what is needed to ensure effective spending control in the future. The final section looks at the Internal Stability Pact and evolving fiscal federalism, in the context of a continuing, perhaps growing, regional divide.

Taxation

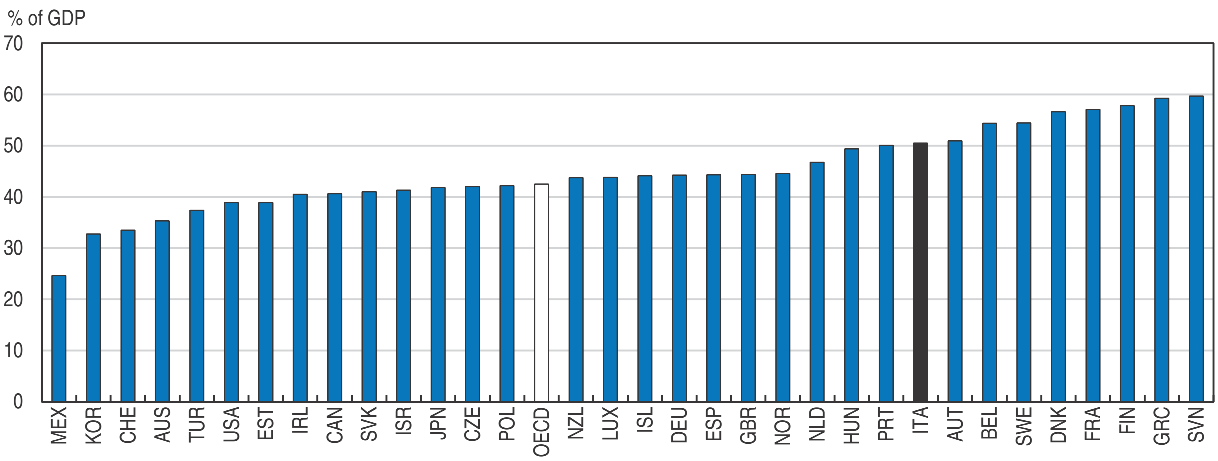
Total public spending is relatively high in Italy (Figure 2.1). High taxation is needed to finance it. The distortionary effect of taxation is amplified by a number of factors. Two of the most important are tax evasion and complexity. Other problems are often related to these two – frequently changing tax rules, difficulty in understanding what the rules are, and an invasive tax administration, for example.

Tax compliance

Tax evasion is a major problem in Italy and, although its full extent is not known accurately, it is considered to be higher than in most OECD countries. Tax evasion is likely one of the main reasons that the underground economy is relatively large in Italy. Prior the latest revision of national accounts methodology, the national statistics institute, Istat,

Figure 2.1. **Public spending is relatively high in Italy**

Total public expenditure, 2013 or latest data available



Source: *OECD Economic Outlook 96* (database).

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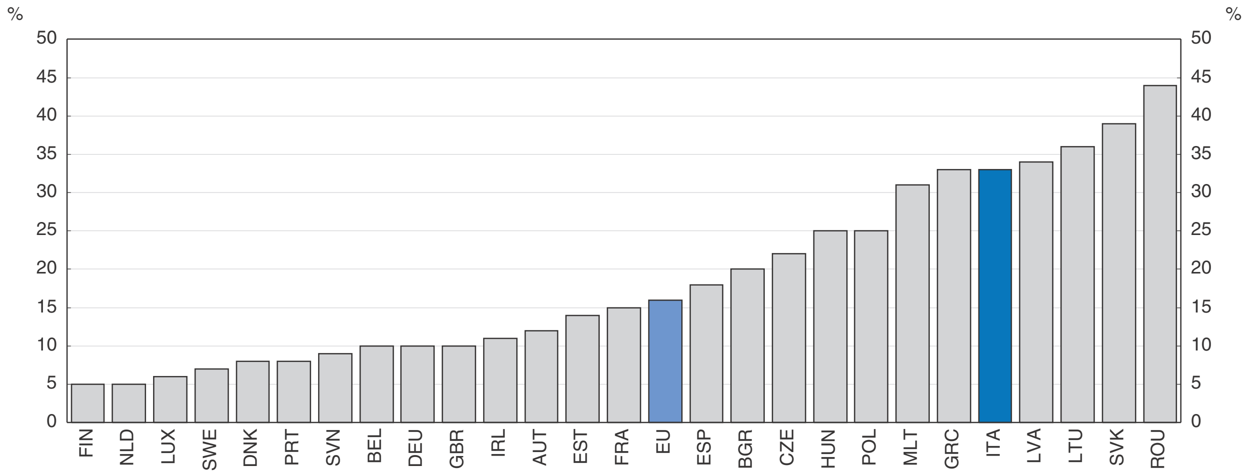
estimated that economic activity that would in itself be legal if declared accounted for some 17% of GDP in 2008, having fallen by around two percentage points of GDP since 2000 (Istat, 2010). A Bank of Italy estimate also put the figure, calculated on a different basis, at just under 17% for the period 2005-08 (Ardizzi et al., 2012). With the recent switch to the new national accounts methodology, Istat now includes estimates of specific illegal activities (related to prostitution, illegal drugs and contraband cigarettes) in the national accounts, along with all other European statistics institutes. Istat estimates that the underground economy now accounts for 12.4% of recorded GDP, of which 0.9% is due to those specific illegal activities (Istat, 2014). OECD (2012) discusses the links between different concepts of the underground economy and measuring tax revenue lost to evasion.

Although now thought to be smaller than previously estimated, the existence of the underground, untaxed, economy increases the effective tax burden on the rest of the economy, undermines fair competition and is a source of social inequity. Attempts to deal with it often lead to second-best (or worse) taxation methods, for example where taxes are used that are economically inefficient but hard to evade, such as stamp duties. Even taxes which are normally thought of as hard to evade, such as the value added tax, lose considerable revenue to evasion in Italy. Tyson (2014) reports estimates suggesting that non-compliance in VAT is equivalent to over 40% of actual revenue of just over 6% of GDP. Reduced rates and exemptions account for revenue losses – compared with full compliance at the standard rate applied to all transactions – of about twice this (Tyson, 2014, Box 1). European commission calculations of the impact of non-compliance show a "VAT gap" for Italy of about 33%, significantly higher than in most other countries and about twice the EU average (Figure 2.2). Responding to this high rate of non-compliance for VAT, the 2015 budget extended the "reverse charge" mechanism, which switches the obligation to pay VAT from the seller to the buyer in certain circumstances, notably when the buyer is large relative to the seller (e.g. supermarkets buying from small suppliers, or purchases by the public administration). This is estimated to raise revenue by about EUR 1.6 billion, about 2% of total VAT revenue.

Figure 2.2. **VAT Gap estimates in the EU26 countries, 2012**



Note: The VAT Gap can be defined as the difference between the amount of VAT actually collected and the VAT Total Tax Liability (VTTL), in absolute or percentage terms. The VTTL is an estimated amount of VAT that is theoretically collectable based on the VAT legislation.
Source: European Commission, 2012.

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In order to reduce evasion, many individuals' income tax declarations are checked against the *redditometro* ("income-meter") where statistical methods are used to judge whether a person's declared income is compatible with the person's ownership of various goods (houses, cars, yachts, etc.) or other known activities. This is a cost-effective way of "profiling" taxpayers to detect those more likely to be evading tax and who therefore justify deeper investigation. Some diversion of expenditure to items known not to enter the calculation is one likely result, and this could be an indirect contribution of tax evasion to the regulatory burden. The *redditometro* is more effective the more information is available about individual transactions. This may reduce the degree of administrative simplification that is advisable, if it would lead to data needed for tax purposes no longer being collected.

Necessary measures against evasion are likely to increase the administrative costs of tax collection in Italy. Unfortunately available data does not allow a reliable comparison. The administrative costs of the tax agency alone are not particularly high compared with other countries (OECD, 2013b, Table 5.4). But that data is particularly unrepresentative for Italy: it does not include social security contributions, and is thought to significantly understate the true cost-to-revenue ratio as it does not take account of expenditure incurred on tax related work carried out by other agencies (e.g. the tax fraud work of the Guardia di Finanza and debt collection activities performed by Equitalia spa). The same report notes that a number of countries (including Estonia, Hungary, the Netherlands and the United Kingdom) have made significant savings by bringing collection of social security contributions into the same agency or ministry responsible for tax collection. Nevertheless there are important challenges associated with these mergers, which need to be considered. These include (non-)comparability of data systems, the different ethos of staff (collecting revenue versus helping people, for example), and different legal frameworks for difference revenue types (OECD, 2013b, Table 1.4).

Tax amnesties and incentives to disclosure

A Ministry of Finance study into evasion makes two important points, first that there is a cultural element in tax evasion; and second that tax amnesties have played an important part in maintaining this culture (MEF, 2014b). MEF (2014b) states quite clearly that the government has no intention of renewing the tradition of tax amnesties.

Amnesties, in which the punishment provided by law is reduced or removed for all (or some categories of) outstanding offences, in order either to clear a judicial backlog, to start a new policy with a clean slate, or in some cases to support other policies, have been prevalent in Italy.* According to MEF (2014b) there have been 80 tax amnesties (*condoni tributari*) in the 150 years of the Italian state. Amnesties are not restricted to taxes, but have also been used frequently in immigration policy where they could be thought of as establishing a *de facto* path to immigration through an employability test (OECD, 2005). Amnesties used also to be *de facto* quite frequent in urban planning for individual violations of construction permit requirements, but are much less frequent now as the rule of law has become better established. Nevertheless in recent years the central government has on occasion suspended or altered planning restrictions (which are in principle reserved to sub-national government) in order to boost the construction industry.

The line between an amnesty and measures to encourage voluntary declaration can be thin. Most countries reduce the penalty on unpaid taxation on assets held abroad when there is voluntary disclosure and the standard Italian provisions for this are similar to many countries (OECD, 2010a). However an additional "one-off" measure was taken in 2008, reducing the penalties to a very low level (50% tax rate on imputed returns of 2% per annum); this was not referred to as an amnesty (it was called a tax "shield"), but, since the penalties were very low, in practice it was very similar. This measure raised a significant amount of revenue in 2009 but likely at the cost of encouraging further evasion.

The March 2014 tax reform enabling law provides for measures to improve relations between taxpayers and the authorities, including simplification measures such as pre-filled tax forms for individuals (Box 2.1). These are good steps. The law also provides for measures such as reduced penalties to encourage voluntary disclosure. An OECD report in 2013 suggested that in some countries incentives for voluntary disclosure are underused, though Italy was at that time one of a minority of countries reporting that it already had such provision (OECD, 2013b). Incentives for voluntary disclosure can be a useful way to improve compliance but they have to strike a difficult balance between generosity that can be exploited by deliberate evaders and too-strong penalties in other cases. In December 2014 the government proposed new rules for dealing with voluntary disclosure, both of capital held abroad and of domestic undeclared activities. Penalties for evasion are reduced in the case of voluntary disclosure, but not eliminated, and full payment of outstanding taxes and interest is required. Criminal sanctions will be retained only for the most serious offences, essentially when evasion is part of an operation to recycle gains from illicit activities. The government subsequently announced it would publish revised proposals in February 2015.

* MEF (2014b) reports that the largest recorded tax amnesty was implemented in the year A.D. 118, when tax arrears of about 900 million sesterces, equivalent to almost one year's imperial revenue, were cancelled by the emperor Hadrian. See MEF (2014b) Footnote 91.

Box 2.1. **The enabling law for tax reform**

In March 2014 Parliament passed the "Delega Fiscale" an enabling law allowing the government to introduce tax reforms in subsequent decrees. The aim of the reform is to achieve a simpler, more equitable and efficient tax system as well as economic growth and higher employment. The main measures planned are in the following areas:

- Reform of the land register and cadastral property values.
- Monitoring and reduction of tax evasion.
- Monitoring and rationalisation of tax expenditures.
- A redefinition of abuse of law and tax avoidance combined with simpler tax rules.
- Revision of tax litigation procedures and electronic services within tax trials procedures.
- Enforcement of audits – electronic invoicing.
- Taxation of small business and entrepreneurial income.
- Indirect taxes and VAT.

Tax compliance costs

The Italian tax system appears complex, at least judging by the number of tax expenditures (discussed below). This may not necessarily imply inefficiency since what matters to taxpayers in practice, apart from the total amount of tax they have to pay, is the administrative cost (which might be a direct financial cost, or the time taken) of dealing with the tax system. It is difficult to measure overall complexity directly, but some indicators of the cost of dealing with the tax system are available from the World Bank. These show that two relevant indicators – the number of separate taxes that businesses are required to pay, and the length of time it takes them to pay the major taxes – are both significantly higher in Italy than in other countries (Table 2.1). It should be noted that the World Bank indicators are quite narrowly defined, for a specific type and size of company, so their international comparability is uncertain.

Table 2.1. **Cost to companies of dealing with the tax system**

World Bank World Development Indicators, 2013

	Italy	Germany	France	Spain	United Kingdom	United States
Number of business taxes to pay	**15**	9	8	8	8	11
Time to prepare and pay taxes[1] (days)	**269**	218	137	167	110	175

1. Corporate income tax, value added or sales tax, and taxes on labour including payroll taxes and social security contributions.

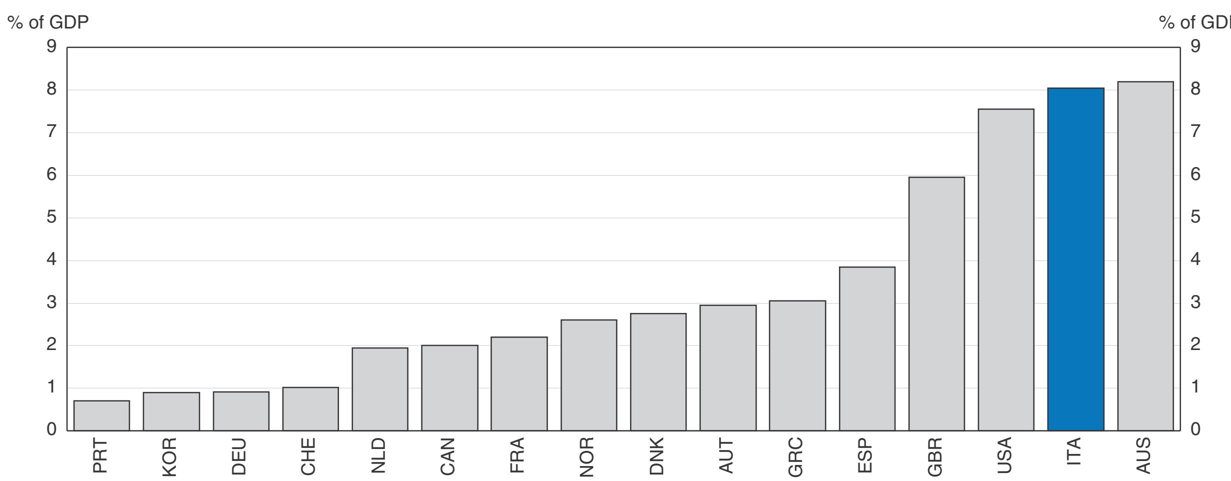
Source: *World Development Indicators*, *http://wdi.worldbank.org/table/5.6*.

The Italian government's policy programme has simplified dealing with the tax authorities. Measures taken in 2014 concern mainly personal taxation, but also reduced paperwork for some company taxation. The scope for simplification is sometimes revealed by an example: prior to the recent simplification, the definition of "first house" for VAT purposes was not the same as that for stamp duty. The ongoing process of simplification to improve efficiency in the public administration needs to continue to identify and eliminate this kind of incoherence.

Tax expenditures

Tax expenditures are an essential part of all tax systems, to adjust them to policy objectives such as progressivity, constitutional constraints, social or industrial objectives. They are not easy to define, since they rely on the interpretation of what the benchmark tax structure is, for which a number of definitions compete (OECD, 2010b); there is no cross-country survey of their use on standardised definitions. It is therefore hazardous to assert that the Italian tax system has too many of them, but this does seem to be the case. Given the difficulty of standardising definitions, cross-country comnparisons cannot be conclusive. Nevertheless, out of ten OECD countries surveyed – but not including Italy – OECD (2010b) reports that none had more than 486 (France, in 2008) tax expenditures, whereas Italy's own report shows 720 (MEF, 2011). Another way of looking at the importance of tax expenditures is in terms of revenue lost, although difficulties defining the counterfactual against which to measure revenue losses, combined with non-standardised definitions of tax expenditures themselves, mean that international comparisons are difficult. An IMF study reports that out of 14 countries Italy loses more revenue than any except Australia (Figure 2.3) Tyson (2014).

Figure 2.3. **Tax expenditures are expensive**



Source: Tyson (2014).

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In some cases, there may be little gain from tax simplification in overall administrative costs for the public administration, so a case by case approach is needed. If there is a switch from reducing poverty through low VAT rates to using means-tested benefits, for example, administrative savings in the VAT system could be more than offset by the costs of effective means-testing. In this example, since the government is aiming to expand means-tested benefits as one part its strategy for labour market reform, it will be incurring these costs in any case. A phase-out of redistribution-motivated exemptions and reduced rates in the VAT system could be planned as part of the expansion of the benefit system. The revenue gains from removing VAT-related tax expenditures could finance both higher social benefits spending and probably a lower standard VAT rate, since currently all consumers benefit – to different degrees – from the tax expenditures but only low-income people would be entitled to the higher benefits.

A small number of tax expenditures were eliminated in 2014. Of the seven items eliminated, 5 were tax credits to encourage specific activities by specific types of firms or in specific areas. Two concerned specific fuel tax reductions: these were very minor compared with the major tax expenditure in this area, such as on road-transport fuel, which, apart from any administrative costs, are environmentally counter-productive.

Transactions taxes – stamp duties

Transactions taxes, especially those associated with change of ownership of land or buildings attract a significant number of tax expenditures. These reveal problems with the taxes themselves, as the tax expenditures attempt to attenuate the worst of the distortions that they create. Most of these taxes come under the heading of stamp duty (*imposta di registro*). The related transactions (including those where no payment is made) are subject to a variety of taxes, some are fixed charges, while others are related to the value of the property transferred. In the latter case, the *imposta di registro*, there are two basic rates (9% and 12%) applied in different cases, but in addition a number of exemptions or reductions are applied. For example, on the purchase of a first house the *imposta di registro* is reduced from 9% to 2% and two other taxes are applied as a fixed charge instead of a proportionate charge. The loss of revenue was estimated at around EUR 1 billion in 2011 (MEF, 2011, p. 365). Another example is a reduction of a similar nature applied to transfers of small tracts of agricultural land. In this case the reduction is much greater (from taxes totalling 12% to a rate of 1%) but the revenue loss is much smaller (EUR 44 million) because there are far fewer transactions, and the total tax paid is limited to EUR 1 000. Other cases concern different rates according to the land's designation for planning purposes. Other minor exemptions and reduced rates exist. In the past there were very many more; most of them were abolished in 2011.

A different kind of transaction, but facing similar taxation, concerns contracts. Rental contracts are also subject to the *imposta di registro*. Where these apply to rental accommodation contracts, a reduced rate is applied. Mortgage contracts are also subject to this tax, except for residential loans whose exemption counts as a tax expenditure. The exemption of insurance policies also counts as a tax expenditure.

In general, taxes on transactions are easy to collect but it is hard to make them proportionate to standard criteria of ability to pay or some negative externality. For instance, a residential property that generates income (either actual or imputed) can be taxed on that income. A wealth tax might also fit some social objectives (though likely to distort savings-investment decisions). But there is no obvious reason in either case why the tax should be a function of how often ownership changes. While charges related to the actual administrative costs for the registry are appropriate, transactions taxes tend to reduce economic efficiency, by making it more expensive to shift resources from one use, or user, to another. In the case of taxes on house purchase, for example, they can inhibit geographical mobility in the labour market.

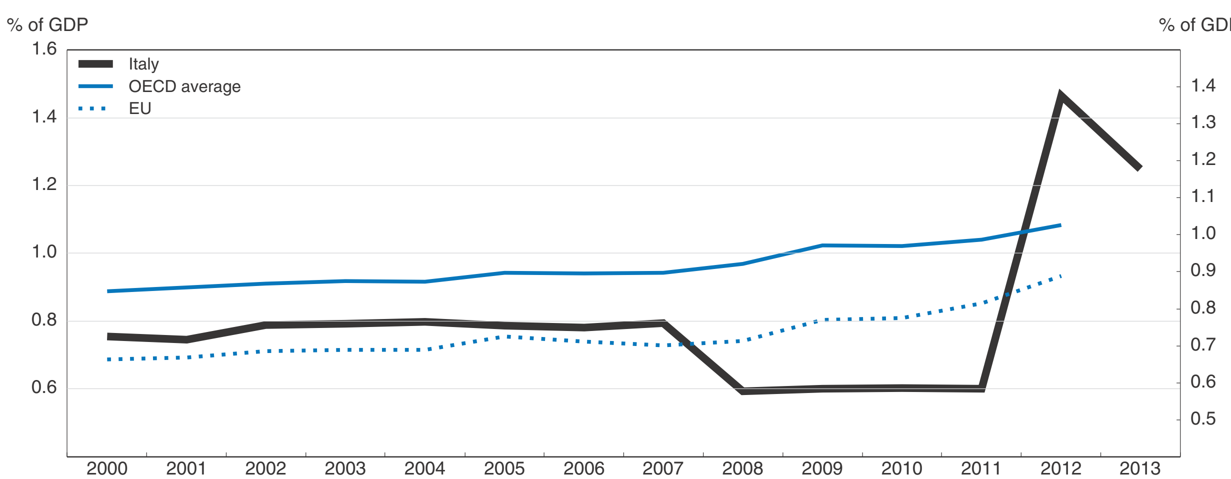
In the case of the *imposte di registro*, therefore, many of the related tax expenditures are needed to avoid their worst distortionary effects. The policy aim should be to remove these taxes altogether (except those directly covering administrative costs) rather than to reduce the tax expenditures. In the short run, this would be difficult because of revenue losses. In fact their high levels in the first place are partly due to tax evasion elsewhere: taxes on transfers of property are very difficult to evade if legal title to a property is to be claimed. A hidden benefit of reduced evasion on "better" taxes on incomes or current expenditure is thus that such inefficient taxation, and the complicated apparatus that avoids some but not all of its effects, could be radically simplified.

Property taxation

Property taxation, at moderate levels, avoids many of the distortions to labour supply from income taxes and even expenditure taxes (Johannsson et al., 2008). Adequate property taxation, including on owner-occupied housing, should therefore be part of a cost-efficient taxation strategy. In Italy there have been sharp swings in revenue from such taxation over the past few years (Figure 2.4). Taxation on owner-occupied houses was abolished in 2008. This tended to disrupt local government finances, since the lost revenue needed to be made up by increased transfers from the centre. Potentially losing revenue, this also reduced the freedom of manoeuvre and accountability of local government since municipalities were no longer free to set that part of taxation as a function of their perceived needs. The lost revenue implicitly means higher taxes elsewhere, and this will have increased distortions in the tax system. Revenue from property taxation revenue fell from 0.8% to 0.6% of GDP, compared with an OECD average of almost 1%, before rising sharply with the reintroduction of the tax (Figure 2.4).

Figure 2.4. **Unpredictable property taxation**

Recurrent taxes on immovable property



Note: The EU area refers to OECD country members. The aggregates are calculated as a simple average.
Source: OECD (2014), *Revenue Statistics* (database).

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A revised property tax (IMU) was re-introduced in 2012, which applied to all homes including owner-occupied houses. In 2013 the government announced that it might abolish IMU on owner-occupied housing and in the meantime its payment would be suspended. Disagreement within the governing coalition left everyone uncertain as to what the legal situation was. In the end the government abolished the IMU on owner-occupied housing and at the same time announced that a new tax would be introduced in 2014. The new tax, "IUC", incorporates the former property tax (IMU) with a new services tax (TASI) and a charge dedicated to financing waste disposal (replacing an existing charge). For owner-occupied homes, IMU applies only to those in a "luxury" category. Some uncertainty continued, as by mid-2014 only about one quarter of municipalities had met the deadline for setting the TASI rate, for example. The government has announced that there will be further modifications to the tax in 2015, probably including all first homes in the tax again, but a final decision has not yet been made.

One of the political difficulties in reintroducing housing tax has been the lack of updated data on housing values. "Cadastral" values are used for evaluating the implied rents that are used to assess tax, but these are based on property valuations that are many years out of date. The government has announced that cadastral values will be re-assessed to take into account market values; a government decree to launch this process is expected in the spring of 2015, with the process expected to take up to 5 years. Such a revaluation is essential. The more difficult cases concern relative cadastral values that differ substantially from relative market values within the same geographical area. This is an obvious source of unfairness, but may also be a source of resistance to reforming cadastral values, from those owning undervalued properties.

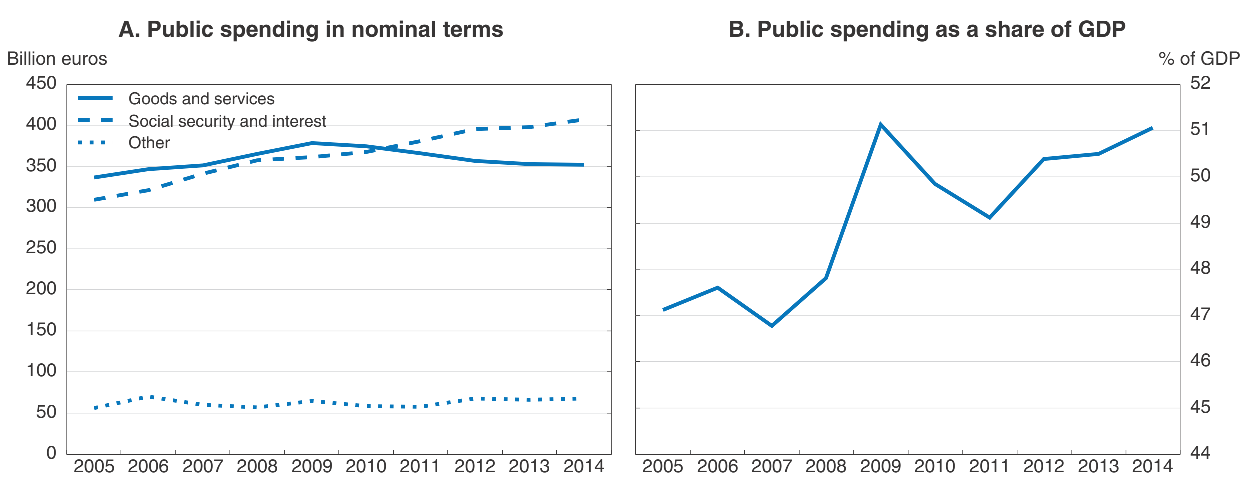
Spending control

Spending on goods and services has declined in recent years

In 2014 public spending on goods and services and public sector wages in nominal terms was below the level of 2008 and has been falling continuously since 2011. Nevertheless, total spending has risen as a share of GDP, despite the intention to concentrate most of the fiscal consolidation on the spending side. The effect on the ratio of total spending to GDP of successful reductions in goods and services spending was offset partly by renewed weakness in GDP after 2011 and partly by continuing increasers in entitlement spending on social security – especially but not only on pensions (Figure 2.5). To cut the budget deficit, taxation has had to be increased as the weak economy cut into revenues.

The impressive results in overall spending control have not always been growth friendly. For example, public investment, including infrastructure, has fallen substantially. The share of investment in public spending is one of the lowest in the OECD (Figure 2.6). Spending on education, vital for the development of human capital, has also been reduced

Figure 2.5. **Cuts in total discretionary spending, while other spending rises**



Source: *OECD Economic Outlook 96* (database). Data for 2014 are estimates.

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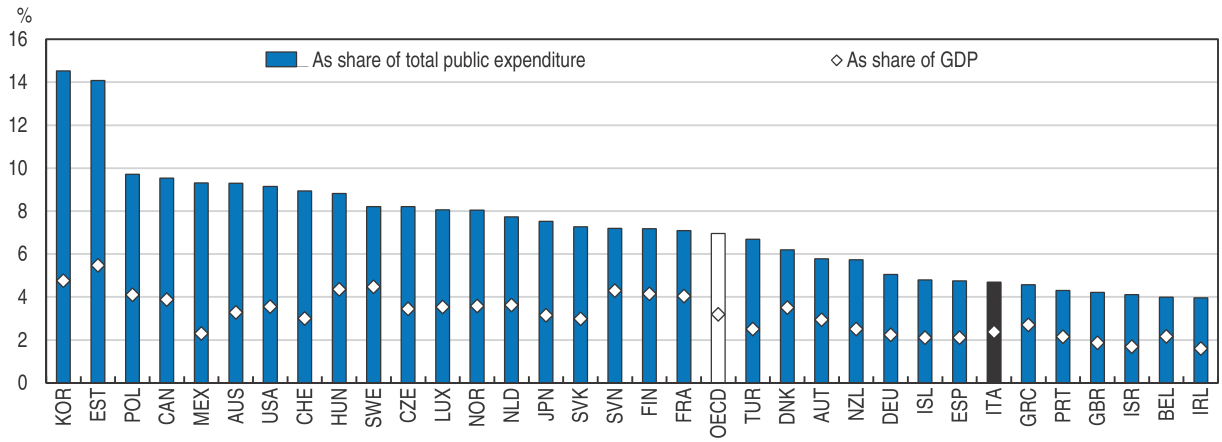
Figure 2.6. **Low public investment**

Public investment, 2013 or latest data available



Source: *OECD Economic Outlook 96* (database).

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since 2009. In that period, average performance of school students measured by OECD PISA data has in fact improved slightly, nevertheless. Although this corroborates analysis that showed that there was previously room for more efficient education spending in Italy (see below), further reductions need to be avoided as the share of spending in GDP is now far below the OECD average.

About one tenth of public spending is on debt interest payments (Table 2.2). The cost of high debt can be seen in the fact that debt interest absorbs more resources than current expenditure on education, or more than three times as much as on defence. Interest spending was the equivalent of about 5% of GDP in 2013, higher than all but two OECD countries, and about twice the median. Along with high pension spending, the result is that actual current primary spending, excluding pensions, is already lower in Italy than in many countries, meaning that the search for economies is particularly difficult.

One advantage that Italy has relative to many other countries is that a series of pension reforms have stabilised the projected future level of pension expenditure as a share of GDP. Indeed, over the next ten years it is projected to fall by around 1% of GDP to around 15%. In many other countries the share is still set to rise, although few have yet reached 15% of GDP. This fall is the result of an acceleration of the phase-in of pension reforms made in the mid-1990s. Owing to the difficulty of reaching political agreement on the reforms in the 1990s, those changes were phased in over a very long period. Though putting a cap on overall costs, this allowed them to remain high in the meantime, contributing to the build-up of public debt.

Spending control has improved

In the years prior to the financial crisis, spending control was not always very effective, both at sub-national level and in central government. One reason for this was that laws were often amended by parliament to add new spending measures or tax deductions in a way that was difficult for the government to control. An important series of budgetary reforms changed this. The government now issues a budgetary plan, in the economic and financial document (DEF), setting overall spending and deficit limits, in the

Table 2.2. **Components of public spending**

General government, per cent of GDP, 2011

	Italy	OECD average
Total spending	**49.1**	44.0
Current goods and services	**19.6**	20.0
Transfers		
Pensions	**14.9**	8.7 (2009)
Companies	**1.4**	
Investment	**2.8**	3.4
Other	**5.9**	
Debt interest	**4.7**	2.6
By programme[1]		
Education	**3.6**	5.1
Health	**6.8**	5.8 (2012)
Defence	**1.3**	1.3
Environment protection	**0.9**	0.7

1. Expenditure by programme is final consumption expenditure only; it excludes transfers and investment.

Source: Istat, *General Government Account*, October 2014; SEC2010; *OECD Economic Outlook 96* (database); *COFOG Database*.

spring of each year, and the actual budget law (currently called the Stability Law) passed in the autumn has to keep within these limits. A constitutional modification, in Article 81, now also requires that any legislative measure that has fiscal implications has to include provision for providing the resources, limiting the possibility of issuing new debt. This now prevents spending (or tax reducing) measures being included in non-budgetary legislation.

The new budgetary process implied a move towards planning spending over a three-year horizon rather than one year at a time, but this was not fully followed through. Since 2009, budgetary documentation has presented projections of programmed spending for three years ahead, but only the first year has legislative force. A pre-commitment to spending control is implicit in the projected spending programme. The latest budgetary projections for 2016, for example, show a continuing fall in public expenditure as a share of GDP in order to meet the structural budget balance targeted for 2017.

Budget projections of spending on unchanged policies, however, show that expenditure will exceed the programme targets without further legislation. To ensure that the targeted budget balance is met, the government has legislated an increase in VAT that will occur automatically in 2016 unless other measures are taken. In the future, an alternative approach could be to legislate spending targets, by main programme or by ministry, for more than one year.

Spending control has begun to focus on efficiency

Gains in efficiency could offset at least some of the impact of cuts in public spending. The 2009 *OECD Economic Survey* of Italy highlighted evidence of spending inefficiency in education, suggesting that "accountability" measures, such as better collection and use of performance information for schools and teachers, and more emphasis on teacher training and less on absolute numbers of teachers, were among the measures that could lead to improvements (Boarini, 2009). Governments have moved somewhat in this direction although resistance to use of improved student performance information has been strong. Some spending cuts in education had indeed been planned before the impact of the financial crisis became clear, as part of a policy to improve efficiency.

Despite the cuts in nominal expenditure on education, and limited progress on improving accountability, average student performance at age 15 as measured by PISA data has been improving. Between 2003 and 2011 average performance in mathematics increased in Italy by more than in most OECD countries, though it is still below average. Student performance would not be affected very quickly by policy changes, so these improvements may be related to trends apparent before the spending reduction; for example there was a substantial increase in teacher's salaries between 2000 and 2010. Nevertheless, the improvement in PISA results at a time of spending cuts at least suggests that efficiency improvements were indeed possible.

Few other spending programmes were subjected to such significant cuts as education. Cuts in expenditure on buildings and equipment could have an impact over a long period, so the government has rightly decided to try to protect education spending from any further budgetary consolidation measures. It should push forward with the programme to develop accountability, however, especially with strenuous efforts to develop systematic information on student performance that can be of practical help to teachers in improving results, to demonstrate that accountability measures are ways to improve overall performance, not to penalise individual teachers or schools.

Spending reviews

Previous *OECD Economic Surveys* have drawn attention to the need to develop spending review processes within the public administration and pointed out that a good start had already been made in 2007-8 with the work of the Technical Committee for Public Finance which was part of a spending review process launched in 2007, but not fully followed through (OECD, 2009, 2011, 2013c). Many of the accountability measures mentioned for education, and the identification of areas where education spending could be reduced with least damage, were suggested in the work of that Technical Committee. Its suggestions in other areas have been taken up much more slowly or not at all. Its preliminary report in 2008 suggested a number of reforms in the judicial sector, for example (MEF, 2008). These began to be taken up in 2012, and are now being further developed under the current government.

In 2012 and again in 2013-14, successive governments called in outside experts to conduct ad hoc spending reviews to identify where spending cuts could be achieved with least impact. The 2012 spending review looked at public investment in general. Between 2008 and 2014 general government capital spending has fallen by about 20% in nominal terms, similar to the fall in private investment, and more than current spending. One of the government's priorities is to boost capital spending especially on important infrastructure projects such as broadband network access and key transport links. But public investment spending appears to be relatively inefficient in Italy. Studies highlight higher unit costs and slower delivery on road and rail projects, adjusting for objective differences, than in other European countries (Bank of Italy, 2012). This report locates the problem in certain key areas: overlapping responsibilities between levels of government, insufficient attention to cost-effectiveness both in selection of projects and in implementation, and lack of technical capacity in evaluation and implementation. A boost to investment is one of the means planned to strengthen Europe's economy, but unless cost-effectiveness is improved in Italy, at best it will be less useful than in other countries and at worst it could waste large amounts of resources.

The spending review launched in 2013 took a further step forward, directing its efforts towards identifying specific candidates for spending reductions. A summary presentation of the review's preliminary results was leaked and is widely available on the web (Commissario Straordinario, 2014), but no full report has been published so it is difficult to know whether it has useful lessons beyond some of the practical examples it highlighted. A key approach was to use whatever data was available to benchmark types of spending either within the country or comparing Italy with other countries. For example, there is an allowance payable to disabled people for them to get help in the home. The number of such allowances paid per head of population is nearly twice as high in some regions as in others. The review concludes that part of this difference is due to over-generous allocations in some regions, so that savings can be achieved through reinforced controls. Another example is that transfers to support rail transport are 30% higher per kilometre of network in Italy than in Germany, France or the UK (though much lower than in Belgium and the Netherlands). The spending review recommends reducing transfers towards to the European average, on the grounds that the excess represents potential efficiency savings.

Identifying likely efficiency savings in this way is one thing, and studies like those carried out in the spending reviews are valuable and should be continued and refined. But obtaining value for money needs to be an integrated part of policymaking and administration, not something that requires recourse to ad hoc commissions.

Obtaining value for money

While strategic policy choices can have important budgetary implications, so can less high profile matters such as public procurement. The 2013 spending review attributed cost inflation in the provision of public services to a number of problems, particularly pervasive gaps in management capacity, wages policy and public procurement systems (Council of Ministers, 2013, p. 14). There are many signs of inadequacies in cost control at this level and it has proven difficult for previous governments to deal with them. As long ago as 1993, budget legislation included provisions intended to reduce variation in public procurement costs across the country and Consip (originally "*Concessionaria Servizi Informativi Pubblici*", established to manage IT development in the then Treasury Ministry) was eventually given a role in providing procurement services for central government ministries so as to ensure all ministries get the best value for money.

Consip reports that in areas where it has taken over responsibility for procurement, ministries can make savings of 22% on average. Despite these apparent benefits, Consip is still used directly for only 3% of total public administration expenditure. Consip estimates that its reference prices or framework contracts are used for something like 5% of total expenditure. This seems a small proportion, partly because most of government spending is either transfers or wages and salaries. When these are excluded, Consip covers something like 20% of relevant expenditure. It is not clear, however, that effective follow-up procedures exist to ensure that actual contracts or purchases make the implied savings.

Much public procurement occurs at sub-national level, for which Consip is not currently responsible. The 2013-14 spending review proposed that the number of purchasing centres nationwide be reduced from an estimated 32 000 to less than 40 – as far as expenditure above a certain threshold would be concerned. These would cover the regions and major cities as well as Consip for the central administration. In April 2014, several provisions were introduced to increase the role of purchasing centres for new procurement, to aggregate demand and obtain better prices and increased control over the public procurement system.

In parallel with Consip, which provides procurement services, ANAC, the national anti-corruption agency, has a section responsible for monitoring value for money in public procurement. Prior to a re-organisation in mid-2014 this was a separate agency, AVCP. Not all major public investment projects were automatically subject to monitoring by AVCP. The emergence of major cost over-runs and suspected corruption at a high level in two key construction projects, the 2015 International Exhibition in Milan, and the construction of the “Mose” the anti-flood gates to protect the Venice lagoon, prompted the government to incorporate it into the anti-corruption agency.

ANAC itself was previously part of the agency responsible for measuring and evaluating performance in the public administration, CiVIT, but was separated from it in 2014. This separation was recommended in the 2013 *OECD Economic Surveys* on the grounds that anti-corruption and performance management were very different things, so that combining them could potentially lead to conflicts of interest without any potential gains in efficiency or economies of scope. From that point of view, incorporating the former AVCP into the anti-corruption agency might not have the anticipated results. On the other hand, since it is fairly clear that the construction industry in general, especially public works, is one of the major activities penetrated by organised crime as well as being vulnerable to “normal” corruption, it could be a rational step. The anti-corruption agency’s mandate was initially mainly concerned with developing and promoting procedures in the public administration to avoid and detect corruption, rather than taking legal or other action against actual cases of corruption. It has now been given somewhat stronger powers; these include the power to recommend that prefects force the replacement of executive officers involved in corruption practices in companies, as well as special investigating powers over the biggest public contracts, such as the Milan Expo 2015. It might nevertheless have made more sense to look further into why those particular contracts had escaped AVCP monitoring, and into what other measures that should normally avoid cost-overruns or prevent corruption did not work, before modifying ANAC’s mandate yet again.

Improved public administration is essential

As mentioned, measures to improve cost-efficiency in public spending have been sought for at least 20 years. Plans to improve efficiency in the public administration also date back at least to the late 1990s. In two key areas – performance management and transparency – there has been progress but also evidence that the process is slow.

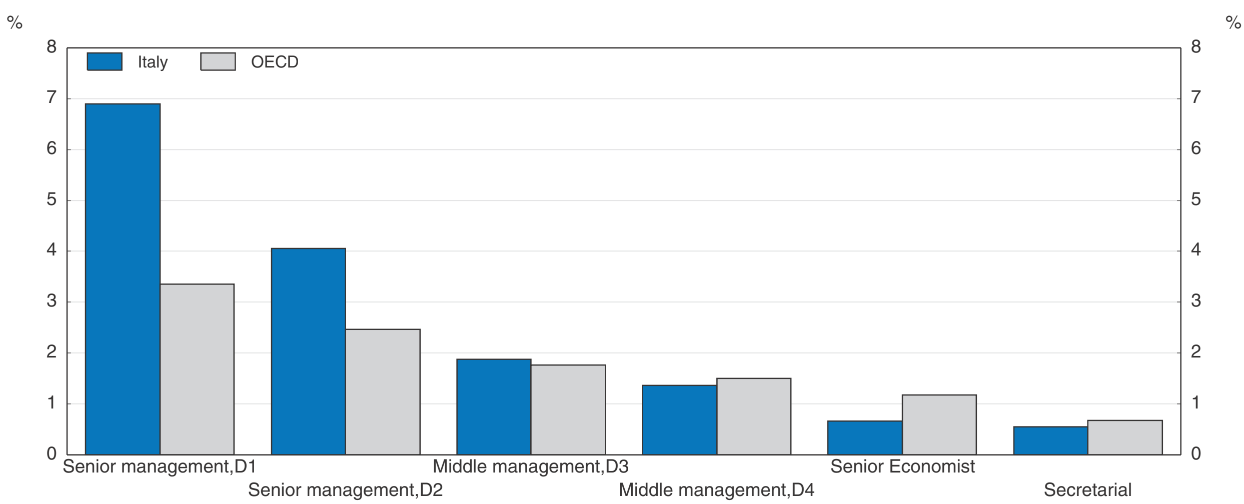
Performance management

The development of performance management techniques has been one constant objective of reforms, especially since the “Brunetta reform” of 2008. But for the moment performance evaluations are applied essentially only for managerial staff, while almost all managers are evaluated as meeting at least 90% of the maximum scores (ANAC, 2014). Earlier reforms changed the employment status of public servants, removing the theoretical right to a job for life, but in practice barriers to mobility within the public administration have remained an obstacle, whether for providing incentives or for managing reorganisations. For example, only in 2014, as part of an emergency decree on simplification and improving public administration, was it made easier for public administrations to re-assign civil servants to jobs different from that for which they were recruited and to move them (within a limit of 50 kilometres from their existing post).

However, other measures in the same decree included imposing immediate cuts on consultancy expenditure by a number of public agencies, including independent regulators. Such expenditure may represent wasted resources, in which case the governance of those agencies needs to be improved; indeed the simultaneous requirement for cuts in salaries in these agencies suggests that they may be overspending. The salary structure across public administration is not standardised. International comparisons show that senior civil servants have much higher relative pay in Italy than elsewhere, whereas at least some types of employee appear much less well paid (Figure 2.7). The government has recently been imposing salary caps on many public appointments to reduce this disparity. Further provisions for eliminating unjustified salary differentiations as part of a new human resources management policy are being planned.

Figure 2.7. **High pay for some civil servants**

Salaries relative to the average for employees with tertiary education, 2012



Source: OECD (2013), *Government at a Glance 2013*, OECD Publishing, Paris.

How to read this figure: In Italy, managers at the most senior civil service level were paid, on average, seven times the average national earnings for tertiary graduates, compared with an average across the OECD of a little over three times. For senior economists, while in the average OECD country they are paid more than a typical tertiary graduate, in Italy they were paid less.

StatLink http://dx.doi.org/10.1787/888933185007

One difficulty in introducing performance management has been the budget constraints of recent years, which have prevented reforms being eased through monetary incentives. Both recruitment and salaries have been largely frozen for several years. The overall number of civil servants, which is not particularly large by international standards, declined by about 6% between 2007 and 2012 – more than half of this reduction coming from a cut of one-third of those on temporary contracts. Over the same period average earnings initially rose quite substantially, but have been largely unchanged since 2009. But there are other signs of change such as the steady rise in the number of women in senior managerial positions: the share of female managers rose from 35% to 43% between 2007 and 2012, while for more senior management it rose from 25% to 35%.

In the future, the increasing numbers of staff retiring and the impact of the last few years of frozen recruitment, will allow recruitment to accelerate somewhat. The government have spoken of the opportunity for generational change that this represents. Generational change does not guarantee behavioural change if incentives are not improved, although it is important to allow the recruitment of employees with the skills required for modernising and digitalising public administration. An important focus, also common to most of the programmes to improve public administration over the years is transparency.

Transparency

According to Allio and Rangone (2015), the tradition of public administration in Italy was more oriented towards secrecy than transparency until the late twentieth century; secrecy was the norm and access to information the exception (De Pretis, 2010, cited in Allio and Rangone, 2015). Factors such as complex procedures and requirements for repeated presentation of documents both create and encourage lack of transparency. This results not only in slow administrative processes but also in fertile ground for corruption. Measures to improve transparency began in the 1990s and have continued to be developed. Often they have been working in parallel with measures to simplify all aspects of public administration.

The 2013 *OECD Economic Surveys* suggested that transparency could be promoted by a general freedom of information act, which a number of other countries, starting with the United States, have already implemented. Italy is moving in this direction in intent, as its transparency provisions have moved in the direction of a total disclosure principle (see Allio and Rangone, 2015, for a detailed discussion of the evolution of transparency provisions, and the link with improving public administration and reducing corruption). Although there is a commitment to total disclosure it is often taken to mean full disclosure of information that is specified in explicit instructions, with no implication for information that is not covered. A freedom of information approach would require that all information should in principle be publicly available, with nevertheless provision for withholding information on grounds such as national security or privacy considerations, as well as on grounds of disproportionate cost.

A significant example of transparency is provided in the case of environmental information. Transposing EU Directive EC/90/313 introduced the obligation to provide environmental information to anyone submitting a request, regardless of their legitimate interest (Allio and Rangone, 2015). That this is possible in the environmental domain should show that such freedom of information provision is compatible with the Italian legal tradition.

Allio and Rangone (2015) also provide evidence that the development of anti-corruption and transparency measures is subject to problems of poor planning and implementation. In particular, transparency measures that are designed in part to improve public administration's compliance with policy intentions can themselves lead to automatic non-compliance. Examples are the introduction of requirements for publication of salary and curriculum vitae information for senior management (part of the Brunetta reforms) and the requirement of the 2013 anti-corruption law that all public administrations publish their plans for preventing and dealing with corruption. In both cases, the law laid down that administration should publish the information much more quickly than was possible. As a result, by early 2014 only a minority of public administrations had published an anti-corruption plan, much less had it approved by ANAC. Such delays are probably unavoidable, in which case they should be taken into account in the originating legislation. If compliance is objectively difficult even when administrations are well-intentioned, non-compliance risks seeming "normal" and becoming a cover for deliberate non-compliance.

Allio and Rangone (2015) suggest a parallel between examples like those – of quasi-automatic non-compliance – and the tendency for Italian legislation to assume that regulation in itself solves problems. Despite significant efforts to simplify regulation, and the creation some years ago of a "simplification unit" within the prime minister's office, it seems that there is still a tendency to introduce regulations without regard for their full impact. For each rule abrogated, 1.2 new rules are drafted (Parliamentary Commission, 2014).

Nevertheless, transparency has improved. For example, information on earnings and the curriculum vitae of public officials is now published online, helping to check whether the right people are in the right jobs and whether they might have conflicts of interest. Another example is the enabling law on tax reform, which provides for the tax collection agency to change its approach towards actively helping taxpayers to comply rather than concentrating on penalising evasion. A first step will be the that the tax administration will issue taxpayers with income tax declarations already filled with information already known to the authorities, leaving the taxpayer with a much simplified task. Developing this kind of public-service approach in the public administration generally should help to improve efficiency, whether it concerns improving tax compliance at least cost or improving value for money in expenditure.

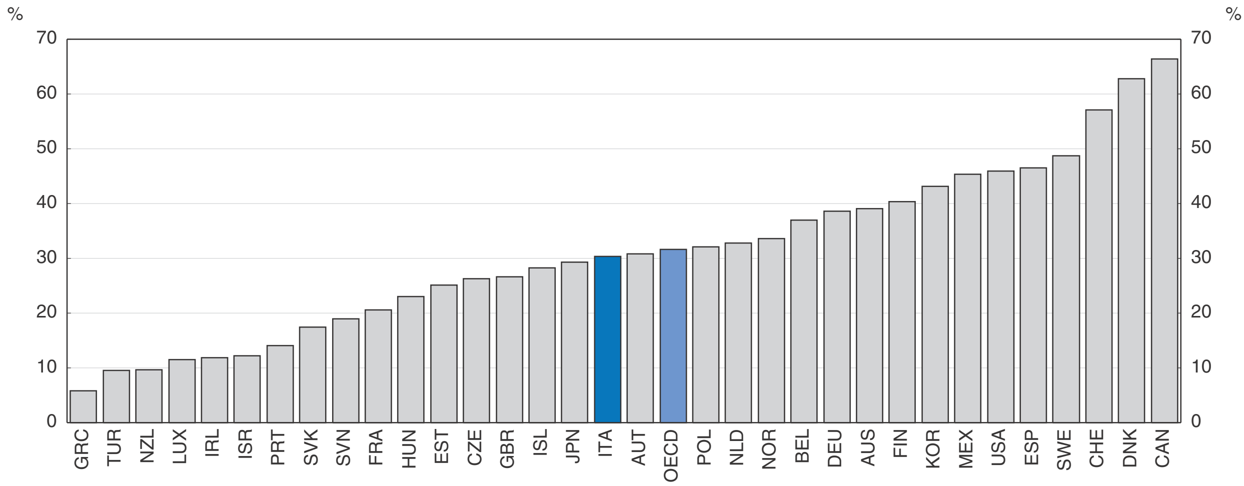
Simplification can improve transparency as well as reducing costs. Progress in simplification has proceeded well in many areas; some are invisible to objective indicators but some are reflected in OECD indicators of product market regulation. Just one example is where reductions in the number of steps required to set up new firms has contributed to improvement in Italy's score on barriers to entry since 1998. Past complexity and the continuing need for administrative reform is nevertheless revealed in recent measures: the 2015-17 Agenda for Simplification included a specific measure to prevent the public administration from requiring individuals to provide information that is already present in the national population register. Yet the Brunetta reforms (from 2009) already included a provision that offices of the public administration could no longer require a citizen to provide a document which itself is produced by the public administration (whether the same or another office). As the 2013 *OECD Economic Survey of Italy* noted, there were many delays in this provision becoming effective (O'Brien, 2013). The need for the additional measure in the 2015-17 Agenda shows that even if the letter of the 2009 reform may by now fully operational, its principle – that the public administration should not require duplication of information provision from citizens – had not been absorbed.

The Internal Stability Pact

Italy has a considerable high degree of decentralisation of government and public spending responsibility for a non-federal state, though somewhat below the OECD average in 2011 (Figure 2.8). This average would be somewhat lower if restricted to non-federal countries. By 2013 the share had fallen to about one quarter of total public spending, as some public spending restrictions have fallen particularly on sub-national spending (Table 2.3). The sub-national share of spending excluding pensions and debt interest is about 50%.

Figure 2.8. **The share of sub-national spending is below the overall OECD average**

Sub-national spending as a share of total government spending, 2012



Source: OECD (2013), *Government at a Glance 2013*, OECD Publishing, Paris.

StatLink http://dx.doi.org/10.1787/888933185018

Table 2.3. **Sub-national government spending, 2013**

Billion EUR

	Current	Capital	Total
Total sub-national	**171.5**	**26.4**	**198.0**
of which:			
Regions	115.2	13.5	128.7
of which:			
North	*56.7*	*5.3*	*62.0*
Centre	*27.6*	*2.6*	*30.1*
South	*31.0*	*5.6*	*36.5*
Provinces	7.2	2.6	9.8
Municipalities	49.1	10.3	59.4
Memorandum item:			
Health spending	93.7	4.5	98.2
Total public spending	767.7	42.5	792.

Note: current spending is recorded on accruals basis, investment on a payments basis. Data may not be fully comparable with Figure 2.8, as some social security spending may be included in sub-national expenditure in this table.
Source: Corte dei ContI (2014), Ministry of the Economy and Finance, OECD calculations.

The Internal Stability Pact, introduced in 1999, is intended to ensure that the financial situation of local, provincial and regional administrations (collectively, "sub-national government") is consistent with Italy's obligations under the European Union fiscal rules for euro area countries. The European Union fiscal rules concern the levels of the deficit and gross debt. The Internal Stability Pact (ISP) could in principle set objectives only for deficits, since the debt of sub-national government in Italy has always been relatively small. However, the ISP has been used to pursue other objectives than simply those deriving from the EU rules, namely: eliminating deficits in sub-national entities; ensuring sub-national participation in specific priorities for public spending; and limiting the tax burden (Corte dei Conti, 2014).

In 2001, the Italian government made significant changes to the constitution, increasing the policy prerogatives of sub-national government and providing for a system of fiscal federalism under which the tax and spending powers of sub-national governments would be reinforced, and the rules determining fiscal transfers from the central state to sub-national government revised to ensure more financial autonomy. An outline for the rules of fiscal federalism was approved by parliament in 2009, but much of the detail related to standard costs has yet to be agreed and the only part operating in practice is the system for calculating central finance for health expenditure. Health expenditure indeed accounts for around half of sub-national government spending. For regional administrations it accounts for about 85% of spending.

The Internal Stability Pact, non-health spending

For provinces and municipalities with over one thousand inhabitants the ISP sets target budget surpluses, as a certain percentage of expenditure. For regions, however, in addition to restrictions on borrowing (sub-national governments must run balanced budgets, excluding capital expenditure), the ISP imposed limits on total non-health spending. The national government rightly prefers to pursue fiscal consolidation through controlling spending rather than increasing tax, since overall taxation is already high. A significant part of central government spending is accounted for by transfers to the regions, corresponding to about half of total regional expenditure including health. Central government therefore includes cuts in these transfers as part of budget consolidation measures and imposes spending limits on regions in order to prevent them from responding by raising taxation.

The logic for imposing spending restrictions on the regions is therefore clear. But it reveals a weakness in the current arrangements, which clearer definitions of national-sub-national responsibilities and consistent rules for fiscal federalism should be able to deal with. The planned constitutional reform will allow regions which run balanced budgets to obtain further autonomy from central government.

The spending limits are negotiated annually between the central government and the regions, and have been complicated by accounting definitions, and ad hoc exceptions. They have continued to be largely based on historical patterns of expenditure, in the absence of standard cost pricing for transfers that is beginning to be used for health spending. Thus, regions that have traditionally spent more than others continue to do so, while regions wishing to spend more have been prevented from doing so even if they currently spend less than the average.

The Health Pact

The Internal Stability Pact strictly speaking covers only non-healthcare spending, while health spending, financed centrally but administered by the regions, is subject to a separate Healthcare Pact, introduced in 2006. The health pact, which was preceded by attempts to limit spending such as a ceiling on pharmaceutical spending, is based on controlling deficits. Some regions are operating under "re-entry plans" (*piani de rientro*) to correct previous excessive deficits. In some cases the health authorities are under compulsory administration (so-called "*Commissariamento*") where external commissioners are brought in, replacing the normal administration, to ensure compliance with national policy. Between 2008 and 2010 six regions (Abruzzo, Calabria, Campania, Lazio, Molise and Sicily) were brought under this process, as they had failed to comply with their "adjustment plan" targets to eliminate deficits, which were set in 2007. These problems have still not been resolved, as technical working groups seek to find a way for these regions to eliminate their deficits during 2014-16.

Health is also the one area where fairly straightforward fiscal federalism rules for expenditure are now in operation. This is the so-called "standard cost model", where central government transfers funds for health policy on the basis of a calculation of spending needs which assumes a uniform cost for specific kinds of spending. This covers mainly the health care interventions that are mandated by national laws. This results on central transfers being allocated essentially on the basis of demographic indicators. Per capita transfers (adjusted for demographic structure) are calculated on the basis of the previous period's expenditure in three of the five regions who perform best on costs. Implementing this approach in health is an important achievement. In the past, serious overspending on health, frequently accounted for by individual hospitals rather than being generalised in any particular regions was a recurrent problem, plagued by self-fulfilling expectations of central government bailouts.

The use of standard costs leaves regions free to spend more than standard costs, but also to retain the savings if they are able to do better. To be durable, the system for determining standard costs must encourage cost reduction without being too draconian.

While incentives to improve efficiency are present, it is clear that such corrections are not achieved without cost. According to a survey about half the population in the regions in "commissariamento" perceives the quality of the health service to be declining, compared with about 30% in other regions (RbmSalute-Censis, 2014). According to the same survey, health provision, such as measured by waiting times, varied widely across the country, although not according to a simple north-side divide.

Problems of accounting and spending definitions

Accounting differences have been mainly related to those between accruals-based and cash-based accounting and the fact that sub-national accounting conventions were incompatible with national and European standards until 2012. It is still the case that many sub-national governments have to calculate two different balances, one for ISP purposes and one normal one. It is intended to move to a cash-based approach as from 1 January 2015 but this target may be hard to meet. In any case there are good reasons why accruals-based accounts are needed, not least for predicting debt, so moving to cash balances may leave some problems unresolved.

More persistent problems arise from using historical spending as a starting point for deciding on the level of central transfers, rather than an assessment of need, and from the ad hoc changes that happen each year reflecting varying central government priorities.

Use of EU structural funds, which are spent mostly by the regions, has also caused some regions difficulties. EU finance is disbursed only once proof of the use of matching funds has been provided. This has often meant that regions are unable to use EU finance because the domestic share of expenditure required causes them to exceed the spending limits imposed under the ISP, even though the expenditure directly covered by EU funds does not count as net spending by the region itself for the purposes of the Pact. It is not clear whether this is an inherent problem or one that can be managed with good administration, since some regions, such as Puglia, managed to largely eliminate this as a constraint on its use of EU funds, through improvements in capacity. In any case, allowing regions to run up debt providing it was covered by existing agreements on structural funds would be an alternative solution providing somewhat more flexibility. The 2015 Stability Law envisages that co-funding of regions will not be considered by the ISP in 2015, thus providing some mitigation of the problem.

Constitutional changes and fiscal federalism: Inconsistencies and delays

Prior to 2001 problems of co-ordination of national and sub-national budgets were much less important. Constitutional changes in 2001 delegated much wider areas of budget and policy responsibility to the regions and provinces, but left two problems. One was that of legislative overlap where several levels of government could claim competence, such as tourism (where regions, provinces and municipalities have overlapping responsibilities, in addition to central government), or inappropriate delegation of some policies such as that which required every region to have its own energy plan rather than a coherent national approach.

Many of these problems should be resolved by constitutional changes now going through parliament. The government plans to put these changes to a referendum at the end of 2015. These changes will abolish the provinces. Their administrative functions will be absorbed into the regional or municipality levels. These changes are already under way as measures taken in 2014 removed finance for elected officials and initiated the process for transfer of functions. The constitutional changes will also recentralise some functions. Central government will be responsible only for a specific list of policy areas, planned to be wider than under current arrangements, leaving the regions as the default level for other matters. But the national government will have a reserve power to legislate on matters that may not be on that list, if it deems that important national interest are at stake.

The other problem generated by the 2001 constitutional changes was that fiscal arrangements were never aligned with the changed constitutional powers of sub-national government. The constitutional law of 2001 mandated the government to implement an appropriate system of fiscal federalism, which might logically have delegated wide taxation powers to sub-national government, given the range of their spending responsibilities, and could perhaps have avoided some of the problems with the Internal Stability Pact discussed earlier. But it was not until 2009 that a clear plan for a system of fiscal federalism was legislated.

The fiscal federalism legislation passed in 2009 was in the form of enabling legislation, requiring the government to develop rules to implement the guidelines in subsequent decrees. The 2009 legislation side-stepped many difficult issues of implementation, but did set out a rational structure for sub-national finances. On the revenue side, it specified that certain taxes would be for use only by sub-national government, the local property tax and a locally determined surcharge on personal income tax; there would be a system whereby poorer regions were partially compensated for their low revenue-generating capacity by a system of redistribution based on simple rules. The frequent changes in the structure of local property taxation described earlier would have made this system very vulnerable had it actually been in place. On the expenditure side, finance for expenditure that is mandated by national legislation would be provided by transfers from central government, with the level of such transfers set by reference to "standard costs" for meeting those expenditure commitments.

Little of this structure is yet in place, especially as concerns taxation and the equalisation system, so sub-national finances are still dominated by transfers from central government. This is partly because there have been several changes of government since 2009 and perhaps also because of the strong and persistent regional divide. This divide could make it difficult to agree on the details of revenue-sharing and items such as infrastructure spending, where southern regions are in need of investment but also suffer from high costs and risk of corruption.

Although little is in place there has nevertheless been progress. Allocation of central funds for health is now based on the standard cost approach: transfers are calculated on the basis of calculations of need taking into account demographic and other characteristics of the population, taking standard cost as the average of the three best-performing based regions. Some progress has also been made in calculating standard costs for other types of expenditure, but so far only for illustrative purposes.

Simplifying the Internal Stability Pact

The ISP has become more complex than is necessary to bring sub-national finances in line with EU fiscal constraints. This has partly seemed necessary because there has not been a good alignment between responsibility for tax and spending at different levels and the constitutional division of policy responsibilities. Once the new constitutional arrangements are in place and the balanced budget rule for sub-national government implemented (foreseen for 2016), it should be possible to rapidly implement fiscal federalism in accordance with the 2009 enabling law, adjusted to be in line with the new structure of sub-national government. Sub-national government's powers of taxation would be appropriately defined and in line with their autonomous spending responsibilities (i.e. excluding national policies which are delegated, for which central government finance is provided). This should allow the ISP to be considerably simplified, concerning itself only with setting deficits and not with the composition or level of spending. Appropriate accounting rules should be able to deal with the difficulties that have sometimes occurred fitting the expenditure of matching EU funds within the constraints. Once this is done, there should be no need for central government to interfere in any detail.

A further step could be to define the ISP in terms of strict limits on debt rather than the balance. This would provide some year-to-year flexibility (which could be withdrawn in the case of persistent violations).

Recommendations for structural fiscal policy

- Continue efforts to reduce tax evasion, through simplifying the tax code and collection procedures as well as through more effective enforcement.
- Simplify tax collection procedures so as to reduce the cost of compliance to companies.
- Avoid the use of tax amnesties.
- Broaden the tax base and simplify the tax system, in particular by cutting the number of tax expenditures.
- Eliminate *ad valorem* stamp duties in excess of the reasonable charges for administrative costs.
- Extend the use of multi-year budgeting to include legislating spending limits for ministries or major programmes over more than one year.
- Get better value for money in public spending through better use of centralised procurement, cost information systems and benchmarking, at all levels of government.
- Continue public administration reforms, including performance management, transparency and anti-corruption policy, to support moves to increase attention to cost-efficiency.
- Implement fiscal federalism arrangements in line with the 2009 enabling law. This implies clear allocation of spending and taxation responsibilities, in line with the new constitutional arrangements, a transparent revenue-compensation system, and central government transfers to sub-national government based fully on standard costs.
- With sub-national balanced budget rules and full fiscal federalism in place, replace the spending limits and ad hoc measures of the Internal Stability pact with simple rules based on keeping debt of sub-national administrations under control, as foreseen in the 2012 constitutional reform.

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