

## Local government finance

The time series on local authority public finance presented in this chapter are drawn from Istat surveys on the final accounts of local authorities.

The financial flows covered in this chapter originate from the final accounts approved by ordinary or special statute regional governments, ordinary or autonomous provinces and municipalities at the end of each fiscal year.

As to ordinary statute regional governments data refer to the years between 1973 to 2014; however, although these regions were established by Law no. 281 passed on 16<sup>th</sup> May 1970, the subsequent implementation decrees ratified the transfer of administrative functions to local authorities only in 1972.

As to special statute regional governments, established between 1946 to 1948, revenue and expenditure time series refer to the period comprised between 1966 to 2014, while data on expenditures on current and capital revenue relate to the period between 1954-2014.

Moving on to provincial and municipal authorities, time series on revenue and expenditures in the final balance sheet refer to the fiscal years running from 1967 to 2014, while the same information for the period between 1946-1966 are available online, although with different detail level in the entries in question, meaning that the results will be not comparable to those from more recent years.

Data on current and capital expenditures run from 1952 to 2014. Tributary revenues recorded by provincial and municipal authorities refer to the periods from 1998-2014 and 1993-2014 respectively (also at regional level).

Financial flows relating to revenue and expenditures are analysed on an accrual basis (assessment and commitment) and aggregated according to their economic classification.

Revenue and expenditures are divided by management type (current or capital accounts), by budget item and bracket<sup>1</sup>.

For all time series data of years 2013 and 2014 are provisional 2014.

### The survey on revenue and expenditures of autonomous regions and provinces

Istat conducts a survey on final accounts of special statute regional governments (*Rilevazione dei conti consuntivi delle Regioni a Statuto speciale*) and a survey on final accounts of autonomous regions and provinces (*Rilevazione dei conti consuntivi dei Comuni e delle Province*), collecting information directly from the authorities in question.

For the survey, since a single format valid for all regions has not yet been developed, Istat uses the official accounting records submitted directly by the authorities themselves.

Since fiscal year 1986, also to allow for national information on balance flows to be processed, autonomous regions and provinces have accepted a request formulated in a memorandum by the Ministry of Economy – Treasury Department (no. 18 dated March 1986, file no. 32337) to revise the classification system for their balance sheets, introducing a format (Regional information system – *Sir*) previously developed by an Expert Committee composed of members from the Ministry, the regional authorities and Istat and approved by the Inter-Regional Commission (now known as the Conference of State and Regions) in a meeting on 19<sup>th</sup> October 1983.

The codes used in the system have been applied by the authorities themselves to the individual balance entries which make up the primary unit of financial analysis, using a priority method to attribute entries containing a range of different types of expenditures.

However, amendments of the law and changes in the functions of authorities over time, up until the most recent constitutional innovations, have led to the old *Sir* classification losing its capacity to provide a reliable representation of financial activities of these institutions. The institutions have therefore gradually

<sup>1</sup> The total amount of revenue and expenditures is recorded net of special accounts, because clearing entries, which account for nearly all entries, would have artificially increased the totals, thus modifying the actual weight of the economic entries examined.

introduced more suitable classification systems for their balance requirements. The *Sir* classification has only remained in use for statistical purposes and has in most cases resulted in a gradual loss in data accuracy.

In more recent fiscal years some regions have completely abandoned the *Sir* classification or have used it exclusively for the strictly economic part of accounting.

This involved codifying and reclassifying the accounts by Istat in order to make the information coherent and comparable across the various regions.

The time series presented here are therefore the result of data recalculation after being taken directly from the accounting documents (final balance sheets) certifying the financial record of the results during the fiscal year by indicating ascertained and collected revenue, planned and paid expenditures divided by budget item, bracket and entry, in addition to the management of arrears, applying a specific code to each budget item (primary unit) allowing for financial flows to be highlighted using different methods.

The field of observation for the two surveys includes all ordinary and special statute regional governments and the Provinces of Trento and Bolzano/*Bozen*, which were granted independence by article 1 of Law no.142 dated 8<sup>th</sup> June 1990 and which are now considered on the same level as Italian regions.

The financial and fiscal autonomy of ordinary statute regional governments is linked to the legislative process which reformed their funding system.

Among other things, Law no. 281 dated 16<sup>th</sup> May 1970 assigned ordinary statute regional governments the revenue from certain types of taxes , mainly composed of transfers from the State and therefore accounting for only a small part of their overall revenue until the first half of the 1990s.

Tangible reforms to reinforce regional tax imposition autonomy have been only introduced since the second half of the 1990s, with the creation of genuine regional taxation together with a stake in the national fiscal revenue. From that moment on, the regional funding system has been profoundly transformed by the legislative system, passing from a system entirely dependent on the State to one in which the regions have acquired considerable financial independence.

Moreover, Law no. 662 dated 23<sup>rd</sup> December 1996 and the subsequent Legislative Decree no. 446 dated 15<sup>th</sup> December 1997 introduced two important sources of tax revenue for local authorities: the *Imposta regionale sulle attività produttive – Irap* (regional tax on productive activities) and the *Addizionale regionale all'imposta sul reddito delle persone fisiche – Irpef* (personal income tax regional supplement).

If, on the one hand, these reforms only partially changed the composition of regional revenue in terms of own revenue and transfers, on the other hand the attribution of these two taxes provided greater certainty and the possibility of planning regional tax revenue.

Legislative Decree no. 56 dated 18<sup>th</sup> February 2000 implemented fiscal federalism provisions for the regions, including both the suppression of fiscal transfers in favour of a share in national revenue and a rise in the Irap regional supplement.

Fiscal federalism regulations also established a “Equalisation fund”, the participation of regions in assessing taxation and, lastly, the abolition of local authorities’ entitlement to shares of Irap revenue.

The main sources of fiscal revenue for ordinary statute regional governments are therefore both supplements to state taxation and shares in state revenue, which may also be entirely assigned to regions; furthermore, tax rates may also be set, within pre-established limits, by the regions themselves.

The main source of funding for special statute regional governments, however, which have held greater legislative and administrative duties ever since their foundation, is formed by shares in fiscal revenue. The independence and the financial system of both special statute regional governments and the autonomous provinces of Trento and Bolzano/*Bozen* have very similar features to those of ordinary statute regional governments: they can in fact establish their own taxes within the limits of tax imposition autonomy clearly set out in the relevant legislation.

In the accepted meaning of the term, local authorities’ entitlement to shares in national fiscal revenue established in special statute regional government statutes are included along with taxes imposed and governed by the regions themselves.

With reference to the main taxes attributed to ordinary statute regional governments, autonomous provinces and special statute regional governments are also entitled to revenue from Irap and to the Irpef regional supplement.

Constitutional Law no. 3 dated 18<sup>th</sup> October 2001 completely reformed Item V, part 2 of the Italian Constitution, regarding the financial autonomy of regions, provinces and municipalities.

This recent institutional text applies a new and different division of regulative duties between State, regions and local authorities, in response to the principles of subsidiarity, federalism and partnership, modifying - among other things - Article 119 regarding the financial autonomy of regions and local authorities.

The new text of Article 119 of the Italian Constitution grants the same status to municipalities, provinces, metropolitan areas and regions in relation to financial autonomy of revenue and expenditures, defining the funding sources for territorial institutions, i.e. taxes and own revenue, shares in national fiscal revenue and the institution of the equalisation fund.

#### *Warnings for time series comparisons*

- The trend of data and indicators analysed in the tables is affected by changes in the accounting law over the years.
- Data for fiscal years 2013 and 2014 are provisional.

### **The survey on revenue and expenditures of provinces and municipalities**

Until 2004, the reference source for the data presented was the Survey on final accounts of municipalities and provinces (*Rilevazione dei conti consuntivi dei Comuni e delle Province*) conducted by Istat on the basis of the classification criteria used for provincial and municipal authorities in compliance with Presidential Decree no. 421 dated 9<sup>th</sup> July 1979.

Regarding provinces, data were collected on an annual basis, using a model jointly drawn up between Istat, the Ministry of the Interior and the Court of Auditors.

For municipalities, until 1982 Istat used *ad hoc* forms to collect data; in the following years the directly acquired information was integrated processing data from external sources.

In particular, in the period between 1999 and 2004, Istat conducted a rapid annual survey on the certificates for the balance sheet account over a representative sample of 860 Italian municipalities, completing these data with others taken from a survey performed by the Ministry of the Interior. The results were also used to draw up estimates for National Accounts data.

Since fiscal year 2005, Istat has decided to abandon these procedures and to process the data contained in balance sheet account certificates submitted every year to Prefectures by provinces and municipalities, to be entered into the Ministry of the Interior database.

The certificate template used by provinces and municipalities to submit their data changes every year, according to the provisions of a specific decree issued by the Ministry of the Interior.

Nonetheless, the information collected is based on that contained in the original Istat forms and covers all financial data and the most important information on individual services provided by the authorities themselves, thus substituting the final account certificate required in the past by the abovementioned Presidential Decree no.421/1979.

In this case the field of observation includes all provinces and municipalities, with the exception of Trento and Bolzano/*Bozen* which, given their specific autonomy are considered on the same level of regions and are dealt with in the survey on revenue and expenditures of regions and autonomous provinces (*La rilevazione delle entrate e delle spese delle Regioni e delle Province autonome*) and Valle d'Aosta/*Vallée d'Aoste*, where there is no provincial authority and the related functions are performed directly by the special statute regional government.

The tables presented in this chapter illustrate the financial data recorded over the years by local authorities by a range of different methods, stages and periods<sup>2</sup>. More specifically, data cover revenue and expenditures analysed by performance, item, bracket and economic entry, in compliance with Presidential Decree no. 194 dated 31<sup>st</sup> January 1996.

Initially the reform implemented by enabling act no. 825 dated 9<sup>th</sup> October 1971 reduced the application area of local taxation, replacing the abolished municipal taxes with revenue from the State. Local authority revenue was thereby obtained through transfers from national tax revenue and the fiscal powers of provinces and municipalities were completely abolished, with a resulting heavy centralisation of the tax burden by the State.

Since the mid-1990s, important changes have been brought about following the reform of independent local authorities (Law no. 142 dated 8<sup>th</sup> June 1990) and the numerous subsequent provisions, such as the Consolidated local authority law (Legislative Decree no. 267 dated 18<sup>th</sup> August 2000). The Consolidated

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<sup>2</sup> Exclusively regarding municipal authorities, data that have not been submitted on time are grossed up to the universe using specific techniques that take account of the population and the values relating to previous fiscal years.

Law formed an intermediate stage of a long process that was concluded with the reform of Item V, part 2 of the Italian Constitution, through Constitutional Law no. 3 dated 18<sup>th</sup> October 2001.

Within this framework, provinces and municipalities received ever wider independence, the duties between local offices were redistributed and central controls were reduced. Currently, the resources used by local authorities to fund expenditures are mainly sourced from local taxation, especially following the introduction in 1993 of the municipal property tax (substituted by the Residential Property Tax – Imu in fiscal year 2012) and, in 1999, the provincial and municipal Irpef supplement (in force until 2011 for provincial governments), two elements which represent increasing tax imposition granted over the years.

The budget reform, introduced by Legislative Decree no. 77 dated 25<sup>th</sup> February 1995, established stricter criteria for attributing tax resources, streamlining accounting procedures.

Lastly, the tax system review brought in with Legislative Decree no. 446 dated 15<sup>th</sup> December 1997 (as illustrated in the survey on revenue and expenditures of regions and autonomous provinces - *La rilevazione delle entrate e delle spese delle Regioni e delle Province autonome*) introduced the principle of derivative financing as a general rule also applying to the local taxation system. This last reform had a profound effect on the structure of local taxation, leading to the acceptance of a mixed financial system within which, alongside shares of national tax revenue, provinces and municipalities can also rely on a certain number of their own taxes.

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