ITALIAN LOCAL GOVERNMENTS: THE GROWING SPACE FOR ECONOMIC-FINANCIAL STRATEGY

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From a centralised to a decentralised system of finance

The national context

Main observation can be made regarding the direct correlation between amount of available resources and functions assigned to the authority, which depend in turn on the notion of State that is adopted. It seems evident, in fact, that a notion of Public Authority (and thus also local authority) that is "neutral" in terms of the economy implies a limited financial need compared to a notion of authority that has the power to take an active role in economic and social affairs. Local authorities need resources to carry out the functions assigned to them. In the first case the revenue from management of assets can be high with a certain amount of revenue coming from taxes. In the second case, which is (generically) a model of the welfare-state, most of revenue comes from taxes.[1]

Within this second notion, which is that of modern socio-economic systems, the distribution of functions (and thus, the need to finance activities designed to carry them out) can be very different at different levels of the Public Authority. At one extreme all (or almost all) functions could be carried out centrally, at the other, they could be handed out to local bodies.

As far as our system is concerned, looking at the complex of functions assigned to local authorities[2], we can identify two distinct forms of financing, represented by the different roles played by transfer payments and direct income.

A first model of reference, defined as centralised (or derived financing), is characterised by the predominance of state contributions in local authority revenue. In this situation the state imposes considerable limits on the freedom of choice of the local authorities in terms of running costs and management of capital (borrowing and divestment). From a theoretical point of view, at least, this model is a function of a plurality of objectives.[3]

First of all a centralised system facilitates co-ordination of taxation, both within the system itself (via a limited number of taxes) and in the wider context of economic policy, at least within a context of defined and identified objectives, actions, instruments and powers.

Moreover, the application of principles of fiscal theory is easier and more possible in such a system, compared to a system of autonomous finance. In particular, objectives of vertical standardisation (balance between income and expenses at various levels of government) and horizontal standardisation (equilibrium between local authorities in terms of available income) can be achieved. Another advantage of centralised financing can be seen in the fact that economies can be made both in the management of taxes (thanks to the increased specialisation) and in evaluating the advantage of different forms of financing and in the management of assets. Finally, centralised financing, avoids the risk of policies regarding public funds being subject to individual interests where there is a strong contractual power[4], or conversely, it avoids a rigid opposition between individuals and local authority, with the adoption by the latter of penalising means towards private enterprises who are "forced" (where this is possible) to abandon certain projects that could generate wealth for the whole community a series of limitations. A centralised system of financing, on the other hand, has, in particular the effect of avoiding responsibility at the level of costing, leading to rising costs in the hope of a corresponding increase in the level of transfer payments.

At the other extreme we find the model that can be defined as decentralised (or autonomous) financing. According to this model most of the resources needed by the local authority for carrying out its objectives should be collected by the authority itself, thus leading to greater autonomy and responsibility.

The decentralised model provides for the greatest autonomy of institutions, together with responsibility for achieving economic advantage. Within a system of autonomous financing, in fact, income is "managed" to a greater degree in terms both of size and time. For example, the local authority would be able to activate a "safety valve" (increase of local taxes or prices, although within certain limits) in order to face unexpected or extraordinary needs, in this way avoiding going into the red.

As well as speed, the local authority is given more flexibility in dealing with its needs; it can, in fact, decide on different policies based on increasing revenue via taxes rather than tariffs or via the management of assets (planning divestment) rather than having recourse to debt. It is also clear that income can be managed over time to coincide with expenses, thus again avoiding recourse to different forms of indebtedness and returning income to the community (in general or to specific categories.)

A fundamental advantage of the system of financial autonomy lies in its greater transparency , in the sense that the links between levels of taxation and results in terms of activities of the administration are directly perceivable. Greater transparency leads to a strong sense of managerial responsibility (both administrative and political), which in turn provides the conditions for an economical management of assets, taxation and tariffs in order to cover financial needs. Moreover the local authority would be more motivated to take action on tax evasion (particularly if this were easily identifiable). The context for all this is, however, the search for greater efficiency, bearing in mind the fact that an increase in fiscal pressure determines an immediately perceptible political cost.

It has also been shown that an autonomous system of financing determines a kind of competition between local authorities due to the fact that their actions together with other factors provoke value judgements on the part of families and businesses[5]. This phenomenon may be interpreted in two ways. One view holds that competition between authorities could stimulate efficiency, with beneficial effects at the political level (with the growing importance of managerial capacity as a criterion of choice of administrators) as well as social and cultural level (via emphasis of the strong reciprocal influence between public and private sectors). A different approach takes as its starting point the existence of differences between players in the competitive game (for differing reasons: geographical, economic, social etc.) to draw a negative conclusion. According to this view, competition would emphasise the existing economic imbalance and reduce the time scale for producing results with the postponement of action at the level of infrastructure. There would also be undesirable effects at the political and social level because competition between authorities could lead to confrontation.

Not wanting to view the situation from an ideological perspective, as many tend to do, we can see that both models have strong points at a theoretical level. We can share the view, therefore, that the degree of decentralisation should be decided on the basis of, on the one hand, the recognition of the utility of a certain amount of competition (without allowing the negative effects

to take over) and, on the other, the existence of intervention to bring about structural equilibrium, (made necessary by the existence of considerable initial competitive difference).

The autonomy of local authorities can be directly linked to the prevalence of direct revenue as opposed to transferred revenue. Autonomy is reduced in more or less direct proportion to the growth of transfer payments. Greater analysis of the typology of transferred revenue is, however, called for. It should be remembered that some transfer payments are linked to the realisation of certain works (allowing for only a modest autonomy), while the financial object of others is indistinct, allowing for a (relatively) greater degree of discretion. On the other hand, local authority autonomy in terms of taxation must be considered to be relative, being limited (most of the time) to variations in the rate of taxation and not other elements of the tax itself. Thus, in reality the systems of financing adopted can be placed along a continuum running from strong centralisation at one end to strong decentralisation at the other. The extreme form of financial autonomy can be identified in fiscal federalism, which implies an extension of autonomy to the power to legislate in terms of taxation, giving confederates considerable liberty within the fiscal system as a whole. In practice, this form of autonomy allows for major intervention in tax on assets, while income tax adjustments are explained as "extras", compared to those imposed by other levels of government. In a such a system, there would be a strong correlation of price of services (in the widest sense including also the use of certain infrastructure) with their cost. Moreover, fiscal federalism advocates a conception of state intervention as a source of distortion (and as such to be reduced to the minimum and/or placed under the control of smaller units than the nation) and the strong conviction that the existence of competitiveness between authorities is a stimulus for them to reach conditions of business economic advantage.

Without entering into the merits of this argument, which is already causing some debate in our country, we can point out here how the move to fiscal federalism, if carried out too quickly within a nation state (such as ours) and not one that is already federal, could be "blocked" by contrasting economic interests (that have been consolidated over the years), or, on the other hand, could emphasise already existing imbalances, with inevitable repercussions at a social level.

Local authority revenue and financial autonomy

In order to have a clearer understanding of types of local authority revenue we will outline the structure of town council revenue.[6]

Revenues can be classified according to the nature of the source of income and can be divided into revenue from ordinary (taxation and asset management) and extraordinary (disinvestment and borrowing) administration . The new financial and accounting regulations set out six different classes of income (defined as Items/Entries-*Titoli*- which can be divided into Categories):

Item I: Income from taxation

- ✓ Category I: rates (municipal tax)
- ✓ Category II: taxes or duties
- ✓ Category III: special local taxes

Item II: Income deriving from contributions from the State, Region or other public bodies

- ✓ Category I: State contributions and transfer payments
- ✓ Category II: Regional contributions and transfer payments
- ✓ Category III: Regional contributions and transfer payments for delegated functions
- ✓ Category IV: contributions and transfer payments from ec and international organs
- ✓ Category V: contributions and transfer payments from other bodies in the public sector

Item III: Income not deriving from taxation

- ✓ Category I: income from public services
- ✓ Category II: income deriving from property
- ✓ Category II: interest on loans and debts
- ✓ Category IV: net profits of special corporations, dividends
- ✓ Category V: other income

Item IV: Income deriving from alienation, capital transfer and collection of credit

- ✓ Category I: alienation of assets
- ✓ Category II: capital transfer from the State
- ✓ Category III: capital transfer from the Region
- ✓ Category IV: capital transfer from other public sector authorities

- ✓ Category V: capital transfer from other sources
- ✓ Category VI: collection of credits

Item V: Income deriving from loan creation

- ✓ Category I: cash advances
- ✓ Category II: short-term financing
- ✓ Category III: acceptance of mortgages and loans
- ✓ Category IV: bond issue

More precisely, income from ordinary administration corresponds to the first three items, the so-called current income, whereas income from extraordinary administration corresponds to items IV and V, capital account income. Item VI refers to clearing entries.

Taxes

The levying of taxes is an essential element of a public body, being an expression of its sovereignty. If at a legal level this represents a compulsory deduction of wealth, within an economic perspective it can be seen as indirect compensation for the performing of functions and delivery of services to the community.[7]

Income from taxes can be divided into two distinct groups according to the existence (or not) of a link with a service offered by the authority. More precisely we can distinguish between municipal taxes (rates) when describing a compulsory contribution determined on the basis of taxable capacity and not corresponding to a specific service of the public body (in the case of town councils: e.g. ICI - property tax, ICIAP -tax on practice of arts and professions etc.) and taxes or duties, which are contributions paid by citizens for specific services received from the local council, even if not requested (e.g. TOSAP - tax on occupation of public areas and spaces, TSRU - rubbish collection tax etc.).

Transfer payments

Sums transferred from the State to local authorities constitute a typical source of finance and represent a way of distributing resources collected at higher levels of public sector government.

They can be classified in two different categories depending on the presence or not of a constraint in the destination. More precisely we can distinguish between indistinct transfer

payments representing a general financing of the authority and targeted transfer payments which are attributed to an authority for a specific purpose (function or realisation of a specific work).

The amount of transfer payments received by a local authority depends both on the size of funds of the transferring body and on the criteria for distribution. Regarding the size of funds transferable to local authorities, it can be said that political considerations generally prevail albeit backed up by technical evaluations. Generally speaking for the purposes of this research transfer payments can be said to be decided with criteria that consider first of all the needs of the transferring body and only secondly those of the authority receiving the financing.

In actual fact the criteria determining the amount of funds can be various. Over and above any "political" criteria, we can thus envisage a way of determining grants by applying a rate proportional to macroeconomic variables (GDP for example) or to tax revenue (or part of it). Research into a correlation between needs and requirements of the local authority could, moreover, lead to a grant based on an estimation of spending requirements (determined in various ways).

The analysis of criteria by means of which the funds, once decided, are distributed between the various authorities is particularly interesting for its reflection on the "responsibilisation" of the authorities themselves. One criterion, which we can define as "footlist", determines the size of transfer payment in relation to costs of a particular service, function, project, or, even its management in general. A second criterion, defined as "historical spending", determines the amount of resources in relation to past spending. In this way a totally deresponsibilising mechanism is created, since spending is encouraged without looking at quality, with the result that the authorities that have spent more during the year or years taken into consideration are rewarded. A third, somewhat more complex, criterion consists in determining standards for classes of local authority (according to certain variables) by means of algorithms (of output and efficiency). This criterion, defined as "expected spending", is however, difficult to apply, even for simple services, due to the numerous variables on which the calculation is based.[8]

A fourth criterion, defined as "parameters of requirements", determines the size of transfer payments according to certain parameters, such as population, geographical situation of the municipality, rate of unemployment, etc. In other words requirements are expressed in terms of certain variables.

The criterion linked to "autonomous income capacity", which measures transfer payments in inverse proportion to the autonomous income of local authorities, aims to guarantee the same amount of resources to similar authorities, effectively leading to a reduction in self-financing. In

fact, it is very likely in this case that the local authority will reduce fiscal pressure and rely more on transfer payments to meet its needs. This method however supposes the existence initially of a situation of equilibrium.

In the case of services or groups of services with divisible demand we can hypothesise a "transfer price" criterion, consisting in the transfer of resources commensurate with the amount of services provided (evaluated in terms of the price).

Finally, regarding project financing we can use a criterion which selects projects presented by local authorities on the basis of the wider objectives of political economy, at the same time bearing in mind the amount of investment needed.

Income not deriving from taxation

This category includes income from a wide variety of sources, including management of public services, property, interests on loans and debts and profits of specialised firms contracted to the authority.

The size of this type of income is obviously influenced by the type of management of public services chosen; direct management includes earnings and costs in its balance sheet, whereas contracted firms or public limited companies (S.p.A.), having legal and financial autonomy, will figure only as profit (or loss) on the balance sheet.

Income from equity

This is linked to the phenomenon of divestment of (available) assets by the local authority. Authorities with often considerable fixed assets can liquidate them, using the funds thus obtained in a more profitable way. From this point of view, and excepting what is said later in this chapter, divestment can be a valid source of alternative finance to indebtedness.

Borrowing

In typical local authority administration recourse to loans is generally linked to a process of investment, even though there have been cases of loans taken out to finance deficits in the running of the authority itself.

Public authority management, moreover, shows a strong correlation between decisions to invest and decisions to borrow. A global consideration of sources and use of financing is however essential for the overall running of the authority, particularly at a time such as this, typified by an

increase in demand for public goods and services and a process of reorganisation of the same leading to the setting up of new juridically autonomous bodies.

The indicators

Evaluation of the degree of financial autonomy of local authorities can be considered by means of a series of indicators.

At the level of system, an indicator determined by the relationship between local public spending and global public spending (or other macroeconomic scale) may be proposed. This can be, in particular, an index of the degree of centralisation/decentralisation of public spending, without being an evaluation of any single local authority.

In the analysis of local authority budget, the index of degree of financial autonomy defined by the ratio between total own income (Item I - tax revenue and Item III- non-tax revenue) and total current income (including also Item II - transfer revenue) takes on particular significance.

This indicator must be investigated in relation to two aspects. Firstly, we have already seen how the prevalence of transfer payments (or on the other hand own income) only *tends* to show a reduced (or increased) autonomy, due to the need to adjust our judgement according to the specific structure of the system of transfer payments and own income. In order to fully appreciate this aspect we must consider the constraints existing in the use of these resources. In fact, if the global income were tied to the carrying out of a particular activity decided by other levels of government, we could not, strictly speaking, talk of autonomy but rather of decentralisation of spending.

Secondly, it is clear that the indicator in question suffers from serious cognitive limitations. It is certainly true that observation of the universe of local authorities demands simple and uniform indicators, but it must be pointed out that the system of indicators to be drawn from local authority budgets regulated by the new financial and budgetary norms can lead to misleading judgements where the lack of homogeneity typical of local authorities is not taken into account. One aspect of this lack of homogeneity that could influence the indicator lies in the nature of the authority itself; it is difficult to pass a valid judgement without considering the size of the authority as well as its social, economic and geographic make-up. Moreover, the financial autonomy indicator leaves out considerations relating to different methods of running services. As we have already mentioned above, some services may not be directly managed but contracted to companies (special firms or S.p.A.). In the light of the new financial and budgetary regulations, while earnings from directly managed public services appear in the profit and loss account, earnings from services managed by

S.p.A. or special firms figure in the accounts of these companies, influencing the balance sheet of the local authority only in the case of profits to be distributed. Consequently, comparison between two or more authorities regarding their financial autonomy would show higher indicators for those that run their own services, even where there is a loss.[9] Generally, however, we are concerned with indicators that, even if "adjusted", do not do justice to the complexity of the situation. For example, in reality, even some own income is "tied" to some extent (think, for example, of maximum tariffs) or limited not so much by the conditions set by other levels of government but by decisions previously made by local authority government itself, for example to increase amount of debt or the size of staff.

The european perspective

This gradual transformation from a system of derived financing to one of autonomous financing must be looked at in the light of the wider transformations taking place in the countries of the European Union. This does not mean denying national political and legislative autonomy but rather underlines how, in terms of putting policy into practice at least, decisions made at the level of European government must be considered.

Reference to the Maastricht Treaty is obvious as far as devolution of functions from a national to European level is concerned, in line, moreover, with the Treaty of Rome and the Single European Act. The Maastricht Treaty further defines the most appropriate levels for realisation of community policies. The Treaty of Rome, as Leonardi (1995) observes, mainly considered government at the level of State and Community structures, on the basis that an agreement about subdivision of responsibilities was sufficient to regulate the productive process and manage the Common Market. The experience of twenty years has, however, shown that , although some functions carried out at national level could be managed successfully at Community level, the transfer of decision-making powers to European level caused a loss of State sovereignty, i.e. of control of social interests, leading to reticence in the transfer of the functions. With the Single Act of 1985, which decided the setting up of the Single Market by 1992 and the reduction of state interference, the Community became the point of reference for important policy decisions. To achieve this, however, close collaboration with institutions at the sub-state level (up to then absent from the process of European integration) was necessary. With the PIM (Mediterranean integration

plans) in 1985, followed by the Community Support Frameworks, collaboration was built up between European Community, nation states and local/regional authorities.

A European Charter of Local Autonomy setting out the minimum rights of local autonomy has been signed by member countries (including Italy, who ratified it in 1989). Without going into this convention in detail, we can point out some important elements regarding financial autonomy[10]. In particular is stipulates that duties formally recognised as belonging to local authorities must have sufficient means to be carried out (art.3 annex.2). It also states that there must be an adequate relationship between local authority functions and the financial resources available to carry them out (art.9 annex 2). Moreover, the Charter states that resources assigned to local authorities must not be limited in their use in any way by a superior authority (art.9 annex 7), in blatant contradiction to what happens at a national level. Local autonomy is further reinforced by a series of other measures, such as, for example, the possibility that part of the resources should come from rates or taxes to be decided by the local authority itself (art.9 annex 3) and the possibility of recourse to different sources of finance and access to money markets (art.9 annex 4 and 8).

The minimum rights set out by the Charter are not, however, always respected by member states. There is no statutory control system, similar to that developed by the European Convention on Human Rights. However, it should be underlined that before imposing observance by threat of sanctions, a wider understanding of the Charter itself and of the benefits implied by the spread of a culture that respects autonomy, would at least encourage actions that will eventually be imposed by statute.

The close collaboration between European Community, State and national authorities that began with PIMs and Community support frameworks, on the one hand, and the Charter for local autonomy, on the other, was given a political and institutional basis with the principle of subsidiarity introduced by the Maastricht Treaty. This principle holds that "decisions must be taken at the closest possible level to citizens." Although it refers to the relationship between Community and nation states in defining spheres of competence[11], the subsidiarity principle is also central to the concept of division of duties between State and local authorities in that it is taken as a basic principle for the European Charter for local autonomy[12]. The diminishing role of the State must be investigated not only in relation to European institutions but also to peripheral institutional levels. In fact, the terms of the Maastricht Treaty reinforced the European role of local institutions by means of setting up the Committee for the Regions (art.198 A), emphasising the need for a greater socio-economic cohesion (art.3. point J), refusing to generally favour public bodies in

access to financial markets (art. 104A) or to limit the sphere of organisations with whom local authorities could negotiate loans (art. 74B).

We would like to look beyond these, nevertheless important, measures to consider the importance of the phenomenon itself; in other words to investigate the changing idea of the relationship between local authority, nation state and European Community. In the light of the business economic perspective taken, Maastricht has important implications for local authority autonomy. The subsidiarity principle implies a bottom-up type of process, in the sense that local government departments take the decisions by means of which community policies are decided, thus determining a real change of perspective both regarding the widespread attitude towards European integration within local authorities and the "centralising" tendency often shown by Italian legislation.

The creation of the Committee for the Regions, representing a link between society, local and regional institutions and European institutions, is particularly significant here[13]. This agency plays an important role, in terms both of its influence on decisions taken at a European level and at the level of information about the tasks of sub-national local bodies in the process of integration.

Integration and evolution of local authority finance systems

The process of European integration has thus brought about and will continue to bring about substantial changes in the running of local authorities. In particular, the acquisition of financial autonomy by various levels of government in terms of decisions about spending and source of income (within the perspective of autonomy of taxation), determines a reduction in State influence over local authorities. The process of European economic and monetary union in the next decade will thus inevitably have strong repercussions on their methods of financing.

Models of financing local government spending vary greatly from one European country to the next. The process of European integration and the existence of a series of similar problems have pointed to common methods of search for financing.

In some countries there are institutions specialised in the provision of funds for local authorities. These financial institutions, which are to varying degrees directly controlled by the central authorities, have played a fundamental role in the supply of investment financing, as opposed to the modest role played (directly) by money markets.

Central authorities have considerable influence over the choice of channels for financing both by means of a series of limitations that precluded the study of alternative channels (as is the case in Italy) and by artificially "manipulating" a number of critical variables in the decision-making process of the authorities. In this case, although the local authorities had access to alternative instruments/channels, it was not economically viable to use them.[14]

More recently alternative models of financing to the traditional one have grown up. Firstly, as already mentioned, the financing of public infrastructure has been carried out by means of project financing, mostly via the setting up of a carrier company (which takes on the risk of the project with modest backing from the public sector).

A second model, not necessarily seen as an alternative to the first, consists in direct access to money markets via the issue of bonds.

The new models of financing, within a weakly connected system, will have particular repercussions on the cooperation/competition relationship between local authorities, between local authorities and other levels of government and between the public and private sectors. Regarding cooperation/competition between local authorities, the present situation and future forecast point to the creation of various aggregated forms of local authority.

Phenomena such as economies of scale (in the supply certain services, for example) and barriers to certain types of investment (that cannot be achieved alone) are factors that encourage the creation of various kinds of aggregates between authorities at different levels of government. As far as the public-private sector relationship is concerned, the practice of project-financing considerably increases the degree of possible collaboration between public and private sector (consider the involvement of private promoters in carrier companies).

Models of financing of local authorities following the process of European integration do not necessarily lead to improvement in the government of local authorities. They can be seen as alternatives to the routes used up to now, resulting from a combination of causes which reinforce the strategic management of the local authority, widening the range of choice in terms of economic management. This range is nevertheless subject to a series of factors; thus, in terms of access to markets we must consider limitations represented by national legislation, the existence of suitable intermediaries and the size of the local authority.

The role of infrastructure in economic development and the backwardness of Italy

Having analysed the juridical and political factors destined to have an impact on the economic-financial strategy of local authority finance, other equally important factors will now be considered.

We will look, in particular, at the function of infrastructure in a country's economic development and the inadequacy of the Italian situation compared to European standards.

An interesting theoretical discussion of the topic has been developed by M. E. Porter[15]. He identifies four factors determining national advantage, factors that promote or impede the creation of companies' competitive advantage.

First of all, *the condition of factors*, represented by factors of production, understood as human and physical resources, resources of knowledge, capital and infrastructure. It must be remembered that factors of production inherited by a nation are few, given that most are the result of investment over time. The availability of factors is not, however, sufficient to achieve competitive advantage. This, in fact, depends on the efficacy and efficiency of their use, which, in turn is influenced by other determinants.

The second condition necessary for competitive advantage is *the condition of domestic demand*. In particular we should look at its composition, size, model for growth and at the internationalisation of domestic demand (via, for example, the influence of foreign needs).

A third factor determining national competitive advantage is represented by the presence of competitive *industrial supply or related sectors*. The presence of competitive firms in certain industrial sectors contributes to the creation of competitive advantage in other firms who use their products. The benefits are not so much linked to the mere availability of machinery or other resources, which would otherwise be modest in global sectors, as to the possibility of creating coordination between chains of value of different firms.

A fourth determining factor is represented by the *strategy and structure of domestic firms and the rivalry model*. In relation to the first aspect, it is held that the management of firms is influenced by the national context. Thus, the difference between nations in terms of managerial direction and organisational skills can create advantages and disadvantages in the various industrial sectors. As far as domestic rivalry is concerned, Porter maintains that the existence of intense domestic rivalry is functional to the acquisition of world leadership also in global sectors.

This outline would not be complete without showing the importance of random events and the role of government. Within a limited perspective, the role of government is important for its influence on international competition. However, its contribution is vastly superior in the way it influences the four determining factors identified. Thus government can influence factor conditions by means of education policy, subsidies, policy regarding money markets, etc. Local demand can be influenced by the definition of standards and regulations, which influence the requirements of purchasers, in the same way as the government in its role as purchaser of goods and services can influence a nation's industry.

The government can also influence industrial supply and related sectors otherwise than as a customer by means of control of advertising media and regulation of support services; and strategies, structures and rivalry between companies can be influenced by fiscal policy and anti-trust norms.

If we view the situation from the other way round similar considerations can be made; the combination of factors can influence government decisions, thus setting up a dialectical relationship. Porter's model described here lends itself to being used in the perspective taken as a basis for this work. If we consider the distribution of functions between the various levels of government, we can see that local governments' range of action can be very different. If the influence on industrial supply and related sectors and on demand is limited, the perspective of competition inherent in a federalist structure widens the range of action of the authorities themselves with actions that can influence firms' structure and strategy (in particular via fiscal policy). The field of action that offers the greatest freedom of action, however, is that represented by the conditions of factors, in particular via the actions at the level of infrastructure.

Infrastructural resources[16] represent a fundamental condition for regional development. Comparative analysis of the Italian situation gives a worrying picture. Firstly, infrastructure is quantitatively and qualitatively inadequate compared to our European partners, as a result of physical deterioration together with changing consumer demands technological development, etc. This picture is also a result of the considerable variation in infrastructural resources throughout Italy with most of the deficit being due to the south, (where very few regions are in line with European standards and are anyway vastly inferior to major overseas competitors). Secondly, this difference in infrastructure continues to increase, given the reduction in public resources that can be destined for investment, as a result of the process of European integration, which continues to demand a reduction in national debt and which has grown more rapidly than the process of local

authority autonomy in taxation. As a consequence, local authorities have tended to increase their own debt, thanks also to the relaxing of some norms, with negative effects due to the extent of the debt itself.

The scarcity of resources, however, is not specific to Italian local authorities, but is a situation shared with other European bodies. Generally speaking and without considering individual sectors the European answer is oriented in two directions. One solution is the introduction of a form of "specific taxation", aimed to cover cost of specific works, and a form of pricing (or surtax) for services[17]. A second solution suggests alternative methods of financing for public works, by means of recourse to the private sector to (partially or totally) cover requirements. Different solutions have been used, varying from the issue of bonds or the setting up of a joint (public-private) company to oversee the construction and management of the work, to the contracting out to a private firm or, even, total privatisation (whereby the service is completely taken out of the public sphere).

In the last ten years some important reforms from this point of view have been introduced in Italy. Law no 142/90 enables town and provincial councils to run public services that have as object the production of goods and social services and activities for economic and civil development, both directly and by contract to third parties, via special firms, institutions or via limited companies with local authorities having the majority share. Another law (498/92, art.12) removed this obligation for majority shareholding on the part of the local authority.

The process undertaken, to varying degrees in different European countries, tends more and more to the extension of private shareholding and the introduction of the logic of private management. In this context, then local authorities need to develop certain elements.

First of all the ability to plan collective needs within a framework of greater autonomy and competition between different bodies. Evaluation of projects, particularly where they are complex, becomes essential when other public or private bodies may be involved in their realisation. The existence of substantial capital requirements or at any rate the consideration of the fact that others may be interested in sharing in the work should stimulate the local authority to look for partnerships. Finally, recourse to financial markets to cover needs implies a new attitude on the part of local authorities, at least in Italy.

Within the perspective under consideration, the crucial nature of economic and financial strategy is obvious in determining the compatibility of the initiative with the economic, financial

and patrimonial evolution of the authority. This is all the more evident in the case of initiatives involving third parties as in the case of project financing.

Phenomena of divestment and privatisation

In order to examine the factors determining an increase in the role of economic and financial strategy in the local authority, we must first look at two important process that have characterised local public economies over recent years: the divestment of property and the process of privatisation. Local authorities are generally owners of a substantial amount of real estate and other property. The establishment of the welfare state has meant that these assets has been managed with social aims in mind to the neglect of economic advantage[18]. Where not strictly linked to local authority objectives management of fixed assets has resulted in modest revenue only. This phenomenon has been accentuated both by the conception of the modern state as administrator of wealth from taxation rather than from property and by the increasingly modest contribution to economic advantage made by revenue deriving from property.

The reduction of available resources coming from transfer payments has brought about a reconsideration of the management of local authority property and real estate. This has led in some case to the decision to divest the property, often for different reasons but with the same final objective in mind. In periods of scarce resources, for example, it may be appropriate to divest property when this is not used for social goals. This solution becomes imperative in cases of balance deficit or high debt, when financial charges can have a negative effect on the management economy, or in cases where resources must be generated for priority projects. Moreover, proceeds from such divestment result in more limited "political costs" than an increase in fiscal pressure or local tax (even within the limits implied by financial autonomy).

Divestment is, however, hindered by a series of limitations (formal procedures for the sale of assets, change of purpose of buildings etc.) which combine with the reluctance to change on the part of the civil service and political classes to slow down the process. Bureaucratic obstacles, introduced originally to maintain the idea of a state that is "neutral" in economic terms (but which should have been able to meet much of its needs from management of assets) have not only prevented authorities from achieving their original objectives but have led to non-economic behaviour (consider, for example, local authority debt or the obstacles to the running of local authority concerns).

As far as privatisation of local authority businesses in concerned, we can say that in some cases the historical reasons for direct intervention of councils in sectors such as milk, dispensing of pharmaceuticals, gas and electricity, transport (including airports) are no longer valid[19]. If social objectives are no longer valid and at the same time the revenue obtained is small (or even in deficit), privatisation seems a viable alternative[20].

As well as being influenced by historical and political or economic factors, the privatisation process has been encouraged by financial considerations, in that municipal concerns have needed to recapitalise, to various degrees depending on the sector, in order to remain competitive.

The slow process of privatisation of some municipal businesses is due in part to the existence of juridical constraints that complicate the process and in part to the existence of vested interests which see privatisation as a threat to the existence of "guaranteed income" (e.g. producers and distributors of milk for the Dairy, private pharmacists working for municipal chemists etc.)[21]. Much of the privatisation process of municipal firms, however, comes under the heading of indirect privatisation and as such does not envisage the effective transfer of public activity to the private sector even though it involves modifications in the way of running the business. This also includes regulation, in other words, the liberalisation of conditions of entry and running of a particular sector/activity and the dependence of the sector on rules of the market. Formal privatisation where the juridical status of the ownership of a firm changes is also an indirect form of privatisation.

From the point of view of financial management of local authorities, while deregulation or contracting out can bring changes due to the introduction of pressure of competition, formal privatisation (e.g. the transformation in S.p.A.) has wider-ranging effects, starting from the recognition of the juridical status and the greater "freedom" exercised by administrators.

The form of privatisations that has the greatest impact on the financial running of the local authority is, however, fundamental privatisation which consists in the total or partial (majority or minority) transfer of equity from the public to the private sector. The experience of the last few years shows that, despite the declared intent to promote fundamental privatisation, most privatisations that have taken place have been formal, although this can be seen as a pre-requisite for achieving true privatisation.

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Notes

[1] Borgonovi E., *Principi e sistemi aziendali per le amministrazioni pubbliche,*EGEA, Milan, 1996,p.212.

[2] Rebora G., *Un decennio di riforme*, Guerini e Associati, Milan, 1999.

[3] Borgonovi E., op.cit.pag.218 and following; and PICA F., *Manuale di finanza locale,* Maggioli, Rimini, 1989.

[4]Take, for example, the hypothesis of a local authority with a large industry located in the area.

[5] Bozeman B, *Public Management: the State of the Art,* Jossey-Bass, San Francisco 1993

[6] Boccia F., Nigro M., La Finanza Innovativa, Il Sole 24 ore Libri, Milan 2000

[7] Borgonovi E., op.cit. p. 202-3

[8] Pola G., Introduction to *Perequazione e finanza locale*, Il Mulino, Bologna, 1992

[9] For discussion of methods to rectify these indicators, cf. Farneti G., Il sistema degli indicatori negli enti locali, Giappichelli, Turin, 1996.

[10] Leonardi R., Convergence, Cohesion and Integration in the European Union, Mc Millan, London 1995

[11] Communication of European Commission to Council and Parliament on the principle of oct 1992; conclusions of European Council, Edinburgh, 11-12 December 1992.

[12] Art. 4 European Charter for local autonomy, ratified by law no.439/89

[13] The criteria adopted in Italy allow for the nomination of eleven regional, seven municipal and six provincial representatives.

[14] The example of England is interesting here. Local authorities financed much of their requirements by the issue of long-term bonds, developing a secondary internal market; during the 80s, however, financing via long-term loans issued by specialised financial institutions and controlled by central authorities (Public Works Loans Board) forced this instrument and the "direct" channel out of the market.

[15] Porter M. E., On Competition, Harvard Business School Press, Boston 1998

[16] The concept of infrastructure is not always defined in the same way. Cf. Confindustria "Le infrastrutture a rete", SIPI, Roms, 1990

[17] OECD, Urban infrastructure: finance and management, Paris, 1991.

[18] Coda V. *L'orientamento strategico dell'impresa*, Utet, Turin 1988

[19] Typical cases are those of municipal dairies and chemists. The former previously carried out the function of guaranteeing hygiene and safety and collecting/distributing milk in certain areas ("white zones") as a monopoly. Now, however, the goal of guaranteeing a safe product is guaranteed by legislation and membership of the European Union itself implies respect of certain norms safeguarding health and hygiene. The adoption of the community regulation of 1973 effectively liberalised the market for fresh milk (following the introduction in 1963 of UHT milk with no limitations).Cf; Advisory Board of the Municipality of Milan, Aziende Farmacie Municipali, 1993

[20] Nigro M. Le fonti di finanziamento degli enti locali italiani, Liuc Paper n. 97 Serie Economia e Istituzioni 2001

[21] Vitale M., Liberare l'economia: le privatizzazioni come terapia alla crisi italiana, Marsilio, Venice, 1993