THE INCOMPLETE FEDERALISM, THE EXCESSIVE FISCAL PRESSURE, THE EFFECTS ON CONSUMPTION

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In Italy at the beginning of ‘70s there was an attempt to bring citizens closer to centralism, using a new model, based on derivative finance. This was a risky enterprise because of the distance, which had been evident until a few years before, coming from the absolute centralism.

The increasing imbalance, which became clear in the post-war period, took origin from the explosion of the gross national product, the increase in consumption and the big investments which made the macroeconomic system grow considerably. But at the same time, there was a structural rigidity of the local government bodies, unable to keep up pace with growing.

The derivative finance became a well-established model after the foundation of the National Health Service, the creation of the Ordinary Regions, the organization of the financial system of municipalities and the introduction of fiscal reform.

All these steps were not natural, on the contrary, in some periods of the Italian economic history, the devolution process was intentionally interrupted. This is the period of the forced fiscal centralization. After the petroleum shock of 1973, the inflation effects were very damaging to the national economic system. It was understood that, through the fiscal drag system, inflation would have decreased as a result of a lower pressure of the aggregate demand on the aggregate offer.

The fiscal drag was the most effective tool for the spread and balanced decreasing of inflation.

To go on more rapidly, a centralizing fiscal strategy was the next step.

The Seventies were characterized by failed attempts of devolution, by the instability of local finance and by the inflation effects worsening the macroeconomic weakness. There is no doubt that the macroeconomic choices must be decided by the central government.
The reference is to the vital and fundamental economic elements: employment, education, health care, the increasing process of the gross national product of the country, etc. It is also true that every central government tends to aim at centralization in situations connected with a negative economic trend. The State, in the years above mentioned, had a strong control on local authorities through an outstanding centralization system of fiscal revenue and decentralization of expenditure.

The transition from the derivative finance to a complete decentralized finance was difficult and, above all, long. This persistent period of transition can be explained by the government intention to maintain its “central” national sovereignty in order to respect the obligations imposed by the European Union to be an integral part of EMU (Monetary Unit).

The Nineties were characterized by a series of experiments which, at first, were expected to restore the derivative finance and, after, stimulate the process tending to an integrated decentralized finance.

Many economists laid stress on programmability of revenue; to understand how to gradually dissolve the transfer and, at the same time, make the local financial autonomy grow.

In 1990 the transformation was carried out through:

a) the general policy law about the local autonomies
b) introduction of ICI
c) direct election of mayor
d) Bassanini’s reform

In particular this reform, systematically decentralized many functions from the government to the local authorities. Moreover, it is also important to underline another point of the above mentioned reform concerning the introduction of fundamental principles: supplementary, efficiency, inexpensiveness, awareness of one’s responsibilities, adequacy, differentiation.

1 In 1980 almost 100% of regional expenditure was financed by State’s transfers.
The difficult process of preparation and transition finds a solution in a reform of Title V of the Constitution. The main points can be summarized as follows:

a) increase in legislative competences of Regions;
b) strengthening of administrative decentralization;
c) direct responsibility of the local government towards its electorate;
d) specific autonomy of revenue and expenditure.
THE EFFECTS OF THE REFORM

From articles 117 and 118 of the Reform it is possible to understand some important concepts formulated by the legislator. In particular, it is possible to distinguish among three main categories of functions: fundamental, assigned and peculiar.

The fundamental functions are exclusive competences of the State, the peculiar ones belong to Local Authorities, and as for the assigned ones it depends on authority assigning them, the State or Regions.

The debate on the interpretation of functions is still open. This is due to the confusion among the words and definitions and the correct understanding of them (e.g. assigned or shared?); only descriptive peculiar functions (Giardina); fundamental functions and peculiar ones which can be considered equivalent.

Therefore, it is important to take into consideration some concepts which can be helpful to better understand the referring topic.

- Regions are strongly linked to national laws limiting their field of action, even if they have a wide autonomy.
- Local government have no real sovereignty.
- The possibility to establish one’s peculiar taxes is to be considered rash.
- The amount of revenue and expenditure is quite vague.
- Title V is very close to unconstitutionality, when it underlines again the centralization of the national authority.
- It is possible to identify a reform of fiscal devolution instead of a real and authentic federalism.

The Italian federalism cannot be easily carried out. The increase in local taxes and, at the same time, the continuous imbalanced budgets of many municipalities is evidence of this.

To make a communitarian system more efficient is paradoxically heavier for the poorest municipalities.
This is due to the fact that they are obliged to spend more and weaken the per capita income of citizens. Without the contribution of transfer and the important support of the central government, every Local Autonomy has drastically changed its expenditure and revenue plans, sometimes doing painful choices in terms of management and efficiency of public services. Budgets have never been easily managed during the transition period, and today neither revenue coming from taxes nor additional taxes seem to be sufficient. Imposing taxes in a general way without distinction would mean to damage the weaker classes or small businesses which are not integrated in the economic fabric and cannot face an economic crisis and an extraordinary fiscal pressure (these two kinds of businesses are numerous in Southern regions).

One of the possible solutions to indirect and general imposition is offered by the innovative public finance allowing local authorities to have fewer limitations and not to influence their budgets, without damaging those who do not use services. This is an important and delicate step, considered by many experts as an epoch-making one, since it can guarantee a real autonomy and is a great target achieved to finally abandon the hierarchical connection to the state transfer.
THE INNOVATIVE PUBLIC FINANCE
There are many different tools of innovative public finance which can identify territorial, sectorial and structural deficiencies of a local system. The project financing has the prerogative to involve only those who can benefit and take advantage from the work carried out.
It is just like to hold a knife by the blade, since it is possible that some economic islands can form weakening the whole economic, cultural and social fabric. It is not a case that the High Commission has still some difficulties in defining the federalism process. Recently many interpretations have been introduced concerning the best way to carry out federalism, but many difficulties emerge when taking into consideration the cultural, environmental, geographical and economic differences of a system being on the point to become an (in)complete federal system. Assuming that “traditional” taxes, which are directly connected to the State or central government, are not eliminated or changed, or that also regional taxes or additional ones are not abolished, and at a local level direct or indirect taxes are substituted by the creative finance, in order to balance the local budget and respect the provisions of article 117 of the Reform: “Municipalities can . . . . their own taxes”.
Naturally, this kind of direct and excessive responsibility is assigned to the public manager, to the city manager, or to the mayor, who certainly know:
1) the territory
2) citizens’ income level
3) the general or particular dimensions of the work to carry out
4) the efficiency and efficacy
5) the elimination of distortions
Perhaps, it is difficult for a civil servant to have familiarity with the concepts above indicated, considering
the passed periods characterized by the carrying out of works of general interest. But time is showing that the excessive emphasis on financing is changing and transforming in maximization of profit, even if relating to public enterprises with a managerial administration, and making profit without damaging citizens. Works are increasingly free and varied. The only limits to a project of public interest are visible in the proportion between credits and debits (as regards a debit balance) and the limit of silent consent of the Bank of Italy when a certain margin of expenditure is exceeded. While microeconomic principles point out an objective deterioration in family’s income, from a macroeconomic point of view, on the contrary, the concepts before explained have ambiguous implications. Last debates try to show different hypotheses and among them two are particularly interesting. The first one aims at pointing out that fiscal contractions under particular conditions can be expansive (Giavazzi and Pagano, 1990). The second one is still connected to the traditional Keynesian theory underlining that, in any case and condition, a contraction of deficit cannot but weaken the aggregate demand. (Hogan, 2004). Therefore, if a Municipality freely start following this kind of policies, the effects on the product could even not be damaging. The following experiment wants to highlight a possible extreme situation deriving from what could happen if fiscal policies and public finance policies are freely adopted. The used data come from Prometeia data bank. Puglia Region is the object of the experiment, taking into consideration the projection period until 2015 analyzed by this research center. Using Bagnai Method, through a Winsolve simulator it is possible to note a variation from the projection caused by the free and creative finance which, as it was said before,
could transmit very surprising effects to the economic system considered.

The chart points out the effect of income and substitution caused by the increase in the rates of the necessary works (state roads which can be used paying a toll, after a BOR funding, sewers, parking places, tunnels funded by BOP or BOC). Even one only of these public works used systematically by a family could weaken the income.

As above explained, the decrease in pmc is not reached soon, but family saving decreases at first, leaving unchanged consumption expenditure (effect of income). Subsequently, the effect of substitution shows a trend changing the marginal inclination to consumption which never reaches the initial levels.
The simulation tries to point out some distortions that would arise in the following cases:
- there is no precise vertical strategy
- there is no integrated regional policy
- federalism, considered as a system, is not complete
Concerning this, it is important to underline that the first part of the simulation reaches year 2004 and was formulated by Prometeia; the endogenous and exogenous variables move according to variations which faithfully reflect the trends of the previous years.
On the contrary, this experiment aims at the stimulation of the model through the variation of the different kinds of taxation. In particular, avoiding the hypothesis of a strict central government policy and imposing a more aggressive local government, it will be possible to try to left unchanged taxation directly linked to the families' income. While, all conditions being equal, fixed taxation coming from local or regional works will be increased. One example is offered by the recovery of waterworks, or by parking spaces, etc. These must be considered as taxations which do not absolutely depend on income.
The simplified model is introduced by logarithmical formulas and follows the classical steps of first differences, the estimation of parameters, the use of a precise deflator. The first simulation on a very strong historical series tried a forecast until 2014. The first chart shows the analysis by Prometeia and our simulated and estimated trend. Since there are no divergences, both of them can be considered a good approximation.
Then, there was an attempt to simulate the variation of taxation which are not dependent on families’ income, without forcing on “what it could be”, and therefore without reducing the marginal inclination to consumption (so, the whole aggregate demand), the aim is to underline the effect of a similar manoeuvring on National Gross Product of the considered system. The reference points are Perotti (1999) and Giavazzi and Pagano (1990); the fundamental assumptions can be summarized in three points:

1) taxation has distorted effects
2) government enjoys privileges in terms of discount rate
3) public expenditure has always and in any case positive effects on national gross product.

The estimate of the empirical model is a simplification of the main econometric model. All private citizens are considered (as a whole) having a perfect access and the period of simulation 2005-2014 is considered as bad time (Perotti, 1999) during which a contraction of the fiscal
policy occurs and effects of "German view" type or the traditional Keynesian effect of aggregate demand weakening could emerge. As a consequence, the effects of the fiscal policy are estimated on the individual consumption (as a whole).

$$\Delta VCF = \alpha + \gamma_1 D_n FAMA_n + \gamma_2 D_n VIIN_n + \gamma_3 D_n VCC_n + \gamma_4 D_n VOP_n + \mu (VPIL_{n-1} - FAM4_n - VIIN_n) + \omega_n$$

VPIL = VCF + VIFL + VCC + VDS + VX - VM - VIIN - FAM4 + VOP + VCTOT + ERROR; \(^3\)

\((VPIL)_{t-1} = \text{(estimate of the variation of the available income using information at time (t-1))}\)

\(\omega_n = \text{error}\)

The elaborate studies examine with particular attention parameters \(\gamma_1\) and \(\gamma_2\), those related to the public expenditure and to variations in bad periods. This study, through the reaction curve of consumption is focused on fiscal charging, \(\gamma_1\) and \(\gamma_2\) and, in bad times, tries to point out what it could be.

If works of creative finance have a powerful influence from today until 2014, a remarkable increase in fiscal charging could occur. The equality of conditions imposes a justified strictness. The central government would act towards two directions:

1) reduction of public deficit and consequent reduction of public debt in the middle term

\(^2\) \(\ln(VCF) = -0.2812 + 0.991*\ln(VPIL)\);

\(^3\) VPIL= prodotto interno lordo (national gross product); VCF= spesa per consumi finali delle famiglie (expenditure for families' final consumption); VIFL= investimenti fissi lordi totali (fixed gross investments); VCC= spesa pubblica finale delle AAPP (final public expenditure of AAPP); VDS= variazione delle scorte (variable of stocks); VX= export; VM= import; VIIN= imposte indirette nette (indirect net taxes); FAM4= imposte correnti (current taxes); VOP= spesa pubblica work in progress (public expenditure work in progress); VCTOT= contributi finanziari alle imprese (financial contributions to businesses); Error = errore
2) obligation towards federalism

<table>
<thead>
<tr>
<th>Description</th>
<th>VIIN</th>
<th>FMA4</th>
<th>VCC</th>
<th>VOP</th>
<th>VIIN a</th>
</tr>
</thead>
<tbody>
<tr>
<td>R multiplo</td>
<td>0.98</td>
<td>0.993</td>
<td>0.998</td>
<td>0.93</td>
<td>0.785</td>
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<tr>
<td>$R^2$</td>
<td>0.974</td>
<td>0.987</td>
<td>0.997</td>
<td>0.88</td>
<td>0.617</td>
</tr>
<tr>
<td>$R^3$ corretto</td>
<td>0.9738</td>
<td>0.987</td>
<td>0.997</td>
<td>0.879</td>
<td>0.608</td>
</tr>
<tr>
<td>Observation</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>15</td>
</tr>
<tr>
<td>Variable</td>
<td>1.2945</td>
<td>1.2525</td>
<td>1.0254</td>
<td>0.620</td>
<td>-2.56</td>
</tr>
<tr>
<td>T</td>
<td>-16.78</td>
<td>-23.54</td>
<td>-22.32</td>
<td>-1.80</td>
<td>1.12</td>
</tr>
<tr>
<td>Ordinata all’origine</td>
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<td>-5.092</td>
<td>-1.612</td>
<td>-0.63</td>
<td>38.79</td>
</tr>
</tbody>
</table>

If the German view model fits, it would be possible to observe reactions of the consumption function when $\gamma_1$ and $\gamma_2 > 0$ and when $\gamma_3$ and $\gamma_4 < 0$ above all in bad times. The table shows a negative decrease for the simulation in bad times of the duration of fourteen years. While the analysis of the simulation decrease should confirm Giavazzi and Pagano’s forecasts, the econometric model of winsolve simulation, through Bagnai’s method, denies the existence of expansionistic effects in strict fiscal policies, on the contrary underlying an orthodox Keynesian effect of contraction of the consumption function.
Left chart: VIIN tax trend
Right chart: VIIN tax trend simulation 2001-2014

Simulation of University of Foggia.
Weakening of the consumption function with a shock, in bad times, of VIIN.
LIMITS AND CONCLUSIONS

Therefore, one may think that, carrying out political and economic strategies which are not coordinated and are imperfect, it is not possible to create a convergence able to let the system grow.

This is naturally an intentional simplification, a sort of extremization; the simulation is a vision, which is always and in any case, far from the real world. If the vertical transmission processes from the central government to the local or regional one do not interact in order to allow a satisfying running of the full or complete federalism, the effect produced will be an excess of fiscal charging which, weakening the whole structure, is not able to stimulate the economic circuit. As a result, the stronger is the fiscal pressure the weaker is the propulsive effect of expenditure for public works as a whole, not allowing the hoped multiplicative effect to occur.

The big limit of this kind of work is the estimation of measure. It is difficult to evaluate the usefulness of a healthy glass of water or of a smooth-flowing road as opposed to a higher family’s income.

That is to say, it is difficult to measure quality of life.


PEROTTI, R. (1999)


POTERBA, J. AND VON HAGEN, J. EDS. (1999)


VON HAGEN, J. AND HEPP, R. (2001)