

The Crisis in Public Finance in Italy

1. Introduction

At the beginning of the 'seventies, the state of public finance in Italy were already causing considerable concern. The two white papers presented by the Minister of the Treasury to Parliament in January 1971 and May 1973 showed that the size of public expenditure, its breakdown and the deficit were not consistent with the objectives of a non-inflationary growth of the economy.

The need to attenuate the effects of the crisis following the increase in oil prices made it vital to regulate public finance. However, the constraints imposed by the IMF — and later confirmed by the EEC — on the Treasury deficit revealed large gaps in information as well as a lack of effective powers of control by the financial authorities on the several agencies of the sector and the limited size of the aggregate under consideration.

Despite the increase in the ratio of tax revenue alone to GDP from 16.7 per cent in 1973 to 20.1 per cent in 1975 — partly made possible by the only partial correction in 1975 of fiscal drag due to inflation — tax receipts in recent years have covered only transfers by the state. The deficit has thus continued to rise, becoming even greater, to the extent that the "hidden deficits" are gradually being recognized and the need to regulate them realized.

The deterioration will be obvious looking at the evolution of the General Government's accounts, which however do not exhaust the public sector and exclude operations of a financial nature (see Table 1).

If we look at the enlarged public sector, as defined in section 2, which includes about a quarter of the whole of employed employees, the real extent of the crisis in public finance becomes even more clear. The ratio of the deficit to GDP thus rises to 13 per cent in 1976, to 12 per cent in 1977 and to 16 per cent in 1978.

TABLE 1

	1973	1974	1975	1976	1977
	(in thousand billions of lire) (a)				
Total expenditure	33.- (40.-)	40.6 (40.-)	56.6 (49.2)	67.- (46.6)	83.- (48.-)
Total receipts	27.7 (33.6)	34.6 (34.1)	39.9 (34.7)	52.8 (36.7)	65.9 (38.1)
Net indebtedness	5.2 (6.4)	6.- (5.9)	16.6 (14.5)	14.1 (9.9)	17.- (9.9)
Current receipts/current expenditures	0.92	0.94	0.82	0.88	0.89

(a) The ratio to GDP is shown in brackets.

In the following pages, we examine the situation of the main components of the public sector, with special reference to the causes which have determined it.

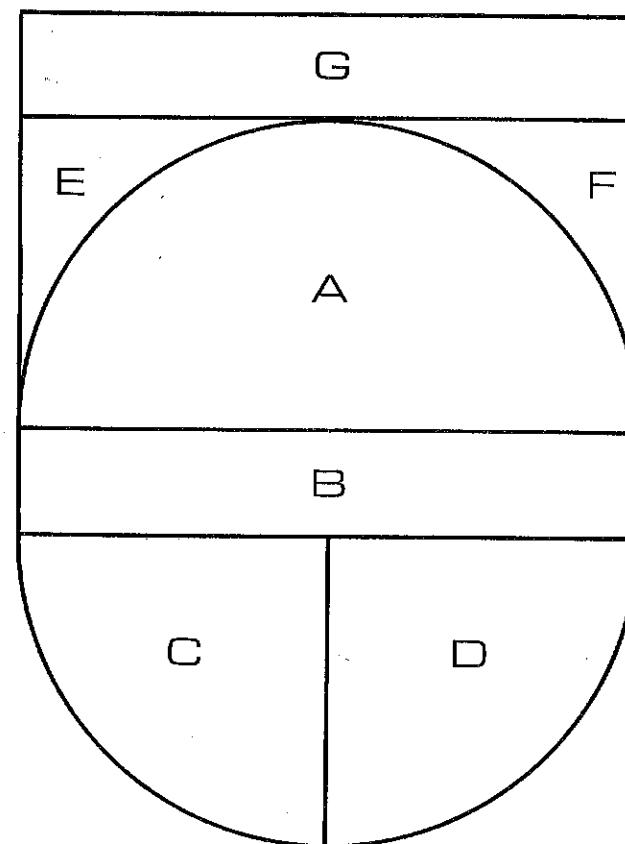
2. The Public Sector in Italy

In recent years, the state budget has absorbed a constantly declining proportion of total public expenditure. Direct activity, moreover, by now forms barely two fifths of total expenditure.

An aggregate to which particular importance has been attached is the "Treasury", the financial balance of which is reflected, through recourse to credit from the Central Bank, in the creation of the monetary base. In addition to the state budget, this aggregate comprises other operations which include the accounts kept with the Treasury by the Post Office Savings and Loan Fund (Cassa Depositi e Prestiti), the autonomous agencies, the Regions, the Fund for the South (Cassa per il Mezzogiorno) and the National Provident Fund (INPS).

If we add to the data of the state budget those of other bodies such as the Post Office Savings and Loan Fund, the Fund for the South, the Central Statistical Office (ISTAT), the National Research Council (CNR) and so on, we obtain the position of what is called the Central Government. If we add in the budgets of the local authorities (regions, provinces, town councils, chambers of commerce, universities, etc.) and social security and welfare agencies,

THE STRUCTURE OF THE PUBLIC SECTOR IN ITALY *



* The form of the scheme is taken from a report on Italy by the International Monetary Fund.

A = State Budget.

B = Budgets of the other Bodies of the Central Government (Postal Savings and Loan Fund, Fund for the South, National Statistical Office, National Research Committee, etc.).

C = Budgets of the Local Authorities.

D = Budgets of the Social Security System.

E = Budgets of the Autonomous Agencies.

F = Special Treasury Operations.

G = Budgets of other Public Enterprises (Hospitals, Municipal Enterprises, Harbour Authorities, ENEL).

We thus obtain the following aggregates:

A+B = Central Government.

A+B+E+F = Treasury.

A+B+C+D = General Government.

A+B+C+D+E+F = Public Sector.

A+B+C+D+E+F+G = Enlarged Public Sector.

we have the General Government account. The functions of this latter aggregate are essentially the production of non-tradable services and the redistribution of income and wealth.

Until a few years ago, the General Government constituted the widest term of reference for public finance in Italy. Considerable progress towards a more complete understanding of the financial phenomenon has been realized by moving on, to the traditional public sector, including the autonomous agencies and later by defining "the enlarged public sector" extended to the hospitals, the municipal enterprises, the harbour authorities and the electricity board (ENEL).

3. The Accounts of the State Budget

From 1965¹ to 1977, state expenditure in Italy increased from 7.8 to 56.3 billion lire, that is, from 21.3 to 32.5 per cent of GDP at market prices. The increase in expenditure was coupled with a substantial shift in its structure which has led to the state budget being defined as a "transfer budget". The state's direct activity, in the form of public consumption and investment, has fallen from 45 per cent of total expenditure to 28.3 per cent, while redistributive activities (such as interest and transfers) and financial operations have increased.

This transformation has made the budget figures less and less suited as a means of assessing the contribution of the state's activity to the formation of the domestic product. It has thus become necessary to supplement the data of the state budget with those of the beneficiaries of its fund transfers.

From the point of view of economic policy, this should have led to a closer coordination of the activities by the various agencies of expenditure in order to ensure that they were consistent with the macroeconomic objectives.

The changes in the breakdown of expenditure (see Table 2) show that its rapid increase was determined by the enormous expansion in indirect activity. Between 1965 and 1971, expenditure had grown by barely 3.6 percentage points in terms of GDP; in the six subsequent years, the increase was more than double (7.6 points).

¹ This year is significant for Italy, both statistically and economically. It marks the return of the state budget to the calendar year and the end of the longest postwar economic cycle during which the "economic miracle" took place.

TABLE 2
BREAKDOWN OF STATE EXPENDITURE
(as per cent)

	1965	1968	1971	1974	1977
Public consumption	42.7	38.1	35.9	34.6	27.1
Investments	2.3	2.6	2.2	2.0	1.3
Transfers	46.8	45.7	48.7	55.5	62.1
Financial Operations	4.6	8.7	8.7	5.7	6.9
Other	3.6	4.9	4.5	2.2	2.6
Total	100.0	100.0	100.0	100.0	100.0
Expenditure/GDP	21.3	22.8	24.9	25.4	32.5

Over 7 points in this increase were in the years from 1975 to 1977. In the previous triennium, however, there had already been signs of tension in the composition of the expenditure, with a sharp rise in the extent of the transfers. The already considerable burden, due to the financial mechanisms introduced by several important measures, was emphasized by the limited real increase in income (less than 4 per cent in three years).²

The most important measures from the financial point of view include the regional and income tax reforms, the new system of financing the deficit of the autonomous agencies, the burden to the state resulting from some security charges and from the funding of the debts of the health insurance institutions, of the hospital and of local entities.

The regional reform in 1972 (by which regions were given political status) meant that the state, in addition to transferring certain taxes, allocated the regions a "common fund" corresponding to the yield from various taxes and a fund for development programmes (see Table 3). From 1977 on, the extent of the latter fund was also linked to prices, i.e., it was partially indexed on the basis of variations of the GDP deflator.

² The difference in the ratio of expenditure over GDP do not, it should be added, represent real variations, since it does also incorporate real variations in GDP. If account is taken of the different rate of growth in the two periods 1965-1971 and 1971-1977 (35.6 per cent in the former and 19.4 per cent in the latter), the "real" increase in state expenditure was respectively 17.3 per cent and 15.5 per cent.

TABLE 3

	Common fund	Fund for regional development programmes
	(in billions of lire)	
1972	365	20
1973	565	—
1974	556	329
1975	487	383
1976	915	857
1977	1,132	737

The income tax reform in 1973-74 almost completely eliminated the local authorities' powers to impose taxes and concentrated them in the hands of the state. To replace the taxes suppressed, the state had to allocate to local authorities other resources (see Table 4).³ A "derivative" system of finance was thus created in substitution of a self-contained one.

TABLE 4

	Substitute amounts (a)		Total
	Direct taxes	Indirect taxes	
	(in billions of lire)		
1973	—	1,035	1,035
1974	627	1,456	2,083
1975	802	1,703	2,505
1976	890	2,030	2,920
1977	1,010	2,187	3,197

(a) In addition to the percentage increases, the annual variations also reflect the time lags in the payments.

The items representing financial intermediation by the state include — from 1973 — the advances to cover the deficits of the autonomous agencies — such as the Railways and the General Post

³ The transfers have been adjusted to taxes collected from municipalities and provinces in 1972 (for indirect taxation) and 1973 (for direct taxation) with a yearly percentage increase.

Office — which had previously been effected by the agencies themselves through recourse to the market.⁴ These advances have risen from 1,062 billions of lire in 1973 to 1,542 billions in 1977.

The state has also intervened in the financing of the "social fund" of the National Provident Fund — INPS — (which is responsible for a very modest part of each pension and of the "social — i.e. non-contributory — pensions" paid from 1969 to those over 65 who have no other income) and of the pension systems of self-employed workers. From 1975, too, it has borne the burden of funding the debts of the health insurance institutions towards hospitals. During the period 1975-77, these interventions amounted to just under 10 thousand billion lire, or 2.3 per cent of the GDP at the time.

From 1975, too, the budget has taken over the appropriation needed for the National Hospital Fund, which was supposed to be basically financed from an increase in the social charges paid into the budget.

In 1977, the approval of the first stage of the programme for putting the finances of the local authorities on a sounder basis led to the funding of the short term debts to the banks. The needs for 1977 (about 2,800 billion lire) were covered by the Postal Savings and Loan Fund. From 1978, the needs (about 6,800 billion lire for the year) were included in the state budget.

One item of the budget which has undergone an exceptional increase is that of interest payments. Between 1974 and 1977, this expenditure almost tripled, rising to about 6,000 billion lire.⁵ This increase was due to the sharp expansion in the annual deficits which in barely four years led to the doubling of the indebtedness (almost 80,000 billion lire) and to the rise in interest rates, sustained by the high rate of inflation. The cost of financing has also been affected by the change in the composition of the forms of cover, with a clear switch towards short-term financing, especially Treasury bonds. In particular, the average rate for total indebtedness rose from 5 per cent to 8 per cent between 1975 and 1977, with a cost for the new debt which was over 16 per cent in 1976.

⁴ Even before this, the cover was ensured by the state subsidies in the form of outright grants.

⁵ Taking account of interest on Treasury bonds advanced by the Treasury operations outside the budget and of the repayment by the Bank of Italy on securities subscribed.

If we now turn to the functional composition of expenditure, it should be noted that education, which is almost completely state-run in Italy, has absorbed a steadily increasing amount of resources. The causes of this phenomenon include the small average size of the schools (which do not allow of economies of scale in administration or the use of more adequate teaching equipment) and the excessive fragmentation of the disciplines. The pupil/teacher ratio, moreover, has dropped continuously, and is now substantially lower than for other countries (about one to six for the elementary school and two to five for secondary education). Even if, as a proportion of state expenditure, education fell by 5 percentage points in the period 1965-77 (from 19.1 to 14 per cent), its share of GDP has remained constant at 3.7 per cent.

At this point, it is superfluous to continue the functional analysis of state expenditure. If we exclude the functions which were influenced by the mechanisms already discussed, the other part of institutional expenditure by the state in 1977 formed barely a sixth of the whole budget and was mainly made up of public consumption and by investments.

4. The Social Security Sector

From the 'sixties, insurance expenditure has increased markedly to the point at which it has become one of the major components of public expenditure in Italy. Between 1965 and 1977, the sums paid as pensions by the many social security institutes shot up much more rapidly than GDP. They now form almost twice as high a proportion of that aggregate, having risen from 6.3 per cent to 11.9, with an elasticity of 1.64 to GDP.⁶

This rapid increase was caused by the considerable changes in the pension system⁷ such as the switch from the contributory basis to one based on earnings in determining the pension, the recognition of the right to a pension of self-employed workers, the introduction of the "social pension",⁸ and the linking of pensions to price and

⁶ The data do not apply to the supplementary payments by the many special agencies.

⁷ It has been calculated that, in recent years, an average of one measure affecting pensions has been passed every month.

⁸ Initially estimated at 350,000 units, the number of beneficiaries has turned out to be much higher (in 1977 the figure was over 850,000). Between 1969, when it was introduced, and 1977, the cost was 2,400 billion lire.

wage movements. A more remote cause of this explosion — which has probably still not exhausted its effects — goes back to a quarter of a century ago when the National Provident Fund's coverage was extended to all employed workers. The social security charges have thus increased both because of the large number of those drawing pensions and of the higher average amount received in wages. In 1976, the number of beneficiaries was just under 15.5 million, more than six million more than in 1965. In the same period, the average annual amount received in pensions was more than tripled, rising to 1.1 million lire, especially because of the switch from the contributory basis to that based on earnings (1968),⁹ and of the indexing of pensions to prices (1969) and wages (1975). With the earnings basis in particular, the pension was calculated as a percentage — which from 1976 is 2 points for every year of seniority — of the average earnings at their highest three years rate in the last ten years. This new formula, which has operated in favour of those who in their last working years have had sharp rises in wages, has replaced the previous basis of the whole of the working life as reflected in the amounts of the contributions paid.

Two distorting factors which have had an impact on social security expenditure are the anomalous numbers of invalidity pensions and the spread of the practice of drawing several pensions. The former phenomenon will be seen from the breakdown of pensions. At the beginning of 1977, disability pensions formed the main component (42.5 per cent) of pensions paid by category of pension, followed by old age pensions (40.5 per cent) and by reversible pensions (17 per cent).¹⁰

For lack of a general pension registry, the phenomenon of adding various pensions has been brought out by the marked excess in the number of pensions granted both over the number of actual pensioners and of the potential number of pensioners as calculated

⁹ At present, there are three different relationships between pension contributions and the amounts drawn. There is first the "capitalization system" then that of "distribution" and lastly that based on "performance". Under the first system, which up to 1963 was the main one and is now confined to local authorities, contributions are invested to finance future payments to beneficiaries. With the second system, which is now the most common one, the contributions received are used immediately to meet demands. With the third system, which is applied to civil servants, the Treasury, instead of putting aside the proportion of the contributions chargeable to it pays the pensions directly.

¹⁰ However it should be remembered that those pensions too, which, when the old age limits are reached, really become "age pensions", continue to be classed as disability pensions.

on a demographic basis. This practice has been estimated to cover about 2 million people. Taking account of the average amount of pensions, the cost can be put at about 2,000 billion lire — over 10 per cent of the total pension expenditure.

The social security charges as a proportion of GDP in Italy (19.4 per cent in 1976) are among the highest in industrialized countries. In the EEC, only Luxembourg (21 per cent) and the Netherlands (25 per cent) have higher figures than Italy. In addition to the different age structure of the population (a sixth of the people are over 60), it should be remembered that in Italy the pensionable age (60 for men and 55 for women) is one of the lowest in the absolute sense. And the indexing measures applied have subsequently raised the price elasticity of the expenditure above unity. In a period of high rates of inflation, this has contributed to the rapid increase in pension costs.

The rise in social charges has been much more modest, the figure having gone from 12 per cent of GDP in 1965 to 15 per cent in 1975. Even if the rate of contribution is still one of the highest in industrialized countries, coming second only to the Netherlands in the EEC, the welfare system has in recent years shown marked deficits.

Expenditure on pensions appears to be bound to grow with the passage of time, both because of the high price elasticity and of the full impact of certain of the latest measures such as those for self-employed workers. Failing an increase in the rates of contribution — an increase which, however, clashes with the policy of keeping down labour costs¹¹ — the share of the expenditure covered by contributions is destined to fall below the figure of 79 per cent in 1976, thus extending the financial needs of the sector.

5. Health Expenditure

Together with the pension costs borne by the welfare institutions, health expenditure is the most rapidly expanding component in the bill for social expenditure which now, in total, accounts for two fifths of overall public expenditure. Between 1965 and 1976, the proportion of health expenditure to GDP rose from 3.5 to 5.5

¹¹ In Italy, more than 80 per cent of social contributions are borne by employers.

per cent, with an elasticity of 1.57. The number of beneficiaries in this sector — which constitutes a veritable transfer in kind to families, that is, a type of collective consumption in the terminology of national accountants — has constantly increased, and now affects nearly 99 per cent of the population, as compared with barely 50 per cent twenty five years ago.

A structural cause of the growth of health costs relative to other forms of expenditure and to GDP is the low increase in productivity in the sector which is characterized by high labour intensity. From the institutional point of view, the line of division between centres which provide the services and those which finance them deserves to be stressed.

Under the heading of health expenditure, one of the items which has shown the sharpest increase is that of hospital costs which have been influenced in the main by the frequency and average duration of hospitalization and the average remuneration of the personnel. In 1977, expenditure on hospitals rose to the point at which they represented about half of the total expenditure on health as compared with 30 per cent in 1952.

The root cause of this marked expansion may be found in the "hospital reform" of 1968. By allowing the hospital boards to fix the amount of the daily hospitalization charges in terms of the costs borne, the reform practically abolished any constraint on expenditure, and deprived the national health institutions of any possibility of controlling the expenditure by influencing its formation. In addition, the introduction of a minimum ratio of the number of staff to the beds available had the effect of expanding the administrative personnel, thus leading to an increase in the staff costs per day of hospitalization.

In 1974 a new measure was adopted which was intended to improve the hospitals' financial situation by the wiping out (referred to above) of the debts of the national health institutions. In addition, a National Hospital Fund was set up, to be shared among the Regions for the financing of hospital expenditure.¹² From 1975 to 1977, the Fund received 8,500 billion lire, which, however, was not

¹² The arrangements for its distribution among the Regions do not appear to have taken account of the real needs of each of these, and this led to an aggravation of the total costs borne by the state. According to an analysis carried out for 1975, half of the Regions received resources in excess of their needs to the extent of over 200 billion lire. To the extent that the sums obtained from this amount were deposited with the banks, the financial requirements of the state were increased.

enough to cover the real needs and led to a "hidden debt" of over 3,000 billion lire.

Along with the expenditure on hospitals, there was an increase in expenditure on medicines, partly as a result of the rise in the average number of per capita prescriptions which has become one of the highest in Europe.

The proportion of GDP absorbed by public expenditure on health services is more than one point higher than the average of industrialized countries. To ascertain the reasons at the root of the differences between the various countries, OECD has isolated the main explicative variables¹³ for the three major areas of expenditure — hospital care, medical services and medical supplies.¹⁴ In 1974 — the last year covered by the survey — these three areas of expenditure accounted for 93.8 of health costs in Italy, compared with an average of 83.3 per cent for OECD.¹⁵

The finding was that:

$$\frac{\text{PHE}}{\text{GDP}} = \frac{\text{THE}}{\text{U}} \cdot \frac{\text{PHE}}{\text{THE}} \cdot \frac{\text{U}}{\text{C}} \cdot \frac{\text{C}}{\text{N}} \cdot \frac{\text{N}}{\text{GDP}}$$

that is, the public expenditure on health as a proportion of GDP is determined by the product of the cost of any service (THE/U) for the public share of total health expenditure (PHE/THE), for the number of per capita services (U/C) for the share of insurance cover of the population (C/N) and for the reciprocal of per capita income (N/GDP).

From a comparison (see Table 5) of the values of the explicative variables reconstructed for Italy and the average ones for the OECD countries — shown in brackets — certain general considerations emerge. In Italy, insurance cover is wider; therapeutic services per capita are double the OECD average; the public share of health expenditure is much higher, especially as regards non-hospital expenditure, and the cost of any service in relation to per capita income is much higher. The breakdown of the expenditure, moreover, gives

¹³ The age distribution of the population which undoubtedly influences the total expenditure is not explicitly considered, but is reflected in the value of the variables specified.

¹⁴ O.E.C.D., *Public Expenditure on Health*, 1977.

¹⁵ The balance is mainly formed of expenditure on research and on administrative costs.

TABLE 5

	Hospital care	Medical services (a)	Medical supplies (b)
Cost ratio (c)	1.21 (0.94)	0.29 (0.27)	0.61 (0.09)
Transfer ratio	0.95 (0.88)	0.90 (0.73)	0.90 (0.67)
Use ratio	2.3 (3.07)	4.9 (5.1)	17.15 (8.59)
Eligibility ratio	0.986 (0.921)	0.986 (0.91)	0.986 (0.98)
Percentage of total	50.8 (54.4)	24.8 (22.9)	18.2 (11.-)
Share on GDP	2.62 (2.33)	1.28 (0.92)	0.93 (0.54)

(a) Ambulatory services.

(b) Pharmaceutical products and therapeutic appliances.

(c) Ratio of cost of any service to per capita income.

an abnormally high ratio for the therapeutic costs, while the proportion of hospital costs is relatively low.

6. The Public Enterprises

The system of public enterprises (autonomous agencies, municipal concerns, the Electricity Board) has in recent years undergone a gradual financial deterioration, running up a deficit which constitutes roughly a fifth of the total deficit of the enlarged public sector. In general, it can be affirmed that this situation has been caused by an asymmetry in the relation of charges policy costs. While there has been a continuous rise in administrative costs, the proportion of receipts from the sale of goods and services produced has fallen in relation to that part stemming from transfers of resources by the state and by the local authorities.

Of the autonomous agencies, the one in the most difficult position is the Railways.¹⁶ Without going into the question of the redistributive objectives which it planned to achieve, the freezing of

¹⁶ Of the other autonomous agencies only the General Post Office has shown a structural deficit because of the services provided and the policy followed as regards rates.

the charges for over ten years (from 1963 to 1974) — while the level of prices had almost doubled — formed one of the reasons which led to the worsening of the Railways' financial position. This factor has thus been added to marked productive inefficiencies,¹⁷ although due to factors of a social nature — and to the keen competition from the growth of traffic on the motorways.¹⁸

Between 1965 and 1974, the railway deficit rose from 150 billion lire to 750 billion despite the reimbursement by the state of the sums foregone by losses in receipts due to the application of reduced rates to certain categories of users and the "normalization" of the accounts determined by EEC which landed the Treasury with the costs normally borne by the other transport firms (for example, the expenditure for pensions in excess of funds put aside). The increases in rates in 1976 and 1977 did not keep down the deficit which had gone up to 1,200 billion lire, with an increase of 150 billion over the previous year.

Similar considerations might provide an explanation of the causes of the deficits of the General Post Office, which were about 400 to 500 billion lire in the period from 1974 to 1977, and of the numerous municipalized enterprises. Separate treatment is called for in the case of ENEL, the Electricity Board (which deals with energy as a whole). This was set up in 1962, and forms the first example of nationalization in Italy.

When it was established, ENEL did not receive an endowment fund from the state, as it was felt that it was possible to compensate the nationalized enterprises (over 1,500 billion lire) from receipts, partly in view of the fact that the rates were at that time among the highest in Europe.

Up till 1974, despite increases in the cost of production, rates were kept unchanged and even actually reduced. In 1973, ENEL's budget got into the red, even if the insufficient budget amortizations had also had some influence on the positive results of the previous years.

The revision of rates in 1974, with an average increase of 65 per cent, was caused by the quadrupling of oil prices (oil and coal generated energy accounted for about 60 per cent of total produc-

¹⁷ Just under a third of the whole railway network carries a bare 3 per cent of the total goods and passenger traffic, with a cost ten times higher than the receipts.

¹⁸ Between 1950 and 1976, the share of total transport carried by the railways in Italy fell from 46.2 per cent to 9.7 per cent for passengers, and from 41.6 per cent to 19.5 per cent for goods.

tion). Income, however, did not even cover the variable running costs, and the result was increasing indebtedness. While the average cost per Kwh rose between 1964 and 1975 from 14.4 to 30.5 lire, average rates went up only from 14.4 to 25 lire.

In addition to the expenditure of personnel, financial costs showed the most rapid rise. The labour cost per person employed went up between 1963 and 1976 by 260 per cent. In the same period, the impact of financial costs almost tripled, partly because of the huge indebtedness, which stemmed from the need to compensate the nationalized firms.

Since the gross outcome (net of financial charges, amortization and taxes) has always been positive, ENEL's losses have really been due to financial charges. To obviate this basic flaw, as well as to finance a substantial investment programme, it was decided to allocate to ENEL over 5,000 billion lire as an endowment fund of which 3,000 billion were provided at the end of 1977 as part of the national energy plan. A fundamental principle introduced into the plan was the annual revision of the rates to bring ENEL's budget into balance by 1981.

7. Local Authorities Finance

In Italy the local authorities sector is one of the most delicate in the whole of public finance. The extremely high number of decision-making centres for expenditure in this sector has constituted a formidable obstacle to the control of its activity. The bodies in deficit have gradually increased over time, rising from less than 800 (around 10 per cent) in 1951 to over 2,000 in 1961, 3,700 in 1970 and almost 5,000 in 1976.

From 1974 to 1977, the net indebtedness of local authorities (including hospitals) rose from 1,100 to 6,200 billion lire, and total indebtedness from 16,100 billion to about 30,000 billion.

There are various reasons for this deterioration, ranging from the size, functions, and type of financing to inflation. Over three quarters of the roughly 8,100 town and village councils have a population of less than 5,000. This wide dispersion is reflected in the impact of running costs. This undereconomic scale of the unit has been rendered even more serious by the costs stemming from a hazy division of spheres of responsibility between the various govern-

ment levels (state, regions, provinces and municipalities) which has led to costly duplications of activities without any compensating increase in efficiency.

The introduction of the system of mortgages to balance the deficits by the Postal Savings and Loan Fund and the substantial suppression (by the tax reform) of the authority of the local authorities to levy taxes have destroyed the natural incentive to control expenditure which flows from the difficulties (including the political ones) of making the administered population pay higher taxes. There has thus been installed a system of full price reimbursements, which in the end has acted as a sort of "Please effect" and has encouraged the expansion of expenditure.

In more general terms, we may recognize that even the gradual switch — connected with a greater formal recognition of local autonomy — from specific and conditioned state contributions to generic and non-conditioned contributions has constituted a reason for the structural weakening of the financial equilibrium of the local authorities. The unconditioned contributions have proved a powerful disincentive, even before the tax reform, to the raising of taxes, reducing, in almost equal measure, the fiscal effort.

The intense inflation in recent years has helped to bring about a further deterioration in the accounts of the local authorities. The fixed percentages in the increase in state transfers to replace the taxes suppressed have not been sufficient to meet the rate of increase in prices. In addition, the high rates of interest have made recourse to bank credit particularly onerous. This recourse to borrowing has been greater than was needed because the failure to approve the local budgets within the prescribed times delayed the grant of the less onerous mortgages by the Postal Savings and Loan Fund. The substantial absence of control over local finances has also had the effect of accelerating the deterioration.

Another cause of the expansion of the local authorities' deficits, even if it is only partially reflected in them,¹⁹ was their part in covering the deficits of the municipalized enterprises. In 1977, these deficits rose to 1,100 billion lire, of which 95 per cent was imputable to urban transport bodies owing to the failure to raise fares in order to meet current costs.

¹⁹ Half of the additional amounts granted does not appear in the net indebtedness of the local authorities since it is accounted for as loans.

8. Conclusions

Among the causes of the crisis in the Italian economy in recent years, the structural imbalance of public finance bears a heavy responsibility. Despite the fact that the deficit has been the most carefully watched factor in the situation and that the combined ratio of taxation and social welfare contributions to GDP has increased — owing to automatic factors or to discretionary measures — by several points (between 1975 and 1977, it rose from 31.4 per cent to 35.7 per cent of GDP) more or less in line with the other industrial countries, the share of the public deficit in GDP in 1977 (12.2 per cent) was far above the figure for other countries. For 1978, this grew by over 4 percentage points, reaching an exceptionally high level for a developed country.

The year 1978 should mark a turning point for Italy's public finance. The field has been cleared of ambiguities — and most of the hidden deficits recognized — and fiscal policy should thus become more transparent.

As will be clear from the preceding pages, there are still numerous factors which indicate that expenditure is continuing to increase. The system is not yet running smoothly. Local finance is still subject to pressures making for higher expenditure as in the previous years and is suffering from the effects of a more intense activity on the part of the Regions; public enterprises are obliged to carry out substantial investment programmes. The initiation of the reform of the health services is clearly such as to prove expensive. The gradual adjustment of the value of the point on the sliding scale for civil servants and the private sector is tending to make state expenditure more price elastic.

In the light of these considerations, the three-year Plan submitted by the Minister of the Treasury last September shows that the inertia of the situation would call for funds for the expanded public sector which would amount to 18 per cent of GDP in 1981.²⁰

²⁰ On the basis of an econometric analysis of the period 1965 to 1975, state expenditure in 1980 would alone represent over 41 per cent of GDP. The most marked increases between 1976 and 1980 would flow from the interventions in the economic field (from 8.4 per cent to 10.5 per cent of GDP). They would be basically formed of items of a financial nature, administrative activity in the broad sense (from 5.7 per cent to 7.8 per cent of GDP) — which would be strongly influenced by the growth of interest charges — and the functions typical of income distribution such as interventions in the social field (from 7.2 per cent to 8.8 per cent of GDP) and

Taking account of the increase in fiscal burden in recent years, it is fairly unlikely that such a performance can still be repeated. Even if we consider the effect of measures already approved, such as the obligation to pay part of the cost of medicines (ticket), and of others, such as the unified collection of social contributions, linked to an increase in contributions for certain categories of persons insured (such as self-employed workers), as well as the increases in public fares, the share of the public deficit would still be too high.

The reform of the law governing state accounting approved last August and the three-year Plan were two important preconditions for a "new deal" in the public finance in Italy. The recognition of the interdependence of financial phenomena, with the resulting need to present the whole of the relevant proposals to parliamentary scrutiny is the most significant point in the reform of the accounting system. The extension of the frame of reference on a multiannual basis (3 to 5 years) represents an indispensable condition for conferring on parliamentary decisions regarding public finance a more precise awareness of the effects (and not only the immediate ones) of the measures passed. The decision to add a cash budget as well as an appropriation one and the finance law become the instruments for formulating an effective short term policy and for carrying out the necessary adjustments within an overall vision of the role of finance in the economy.

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for local finance (from 4.1 per cent to 5.6 per cent). As against this, the increases of an institutional nature would be kept down (rising only from 7.7 per cent to 8.6 per cent). See S. GAMBALE - G. P. SCOTTO DI CARLO, "Spesa statale: previsioni per il 1980", in *Moneta e Credito*, December 1977.