Hearing on the standard funding requirements and fiscal capacities of local governments and criteria for allocating resources

Summary

Alberto Zanardi, a member of the Board of the Parliamentary Budget Office (PBO), testified today before the Parliamentary Committee for the Implementation of Fiscal Federalism at a hearing on “Standard funding requirements and fiscal capacities: distribution of resources in local taxation, impact on the equalisation mechanism and the outlook for changes”.

In his remarks, Zanardi analysed the operation, in its second year of existence, of the equalisation mechanism of the Municipal Solidarity Fund (MSF). More specifically, the analysis conducted by the PBO focused on the redistributive effects generated in 2016, the changes in the calculation of standard requirements introduced for 2017 and the consequent impact on municipalities, and the consistency of the MSF with the design that inspired the Fiscal Federalism Implementation Act (Law 42 of 2009).

The equalisation component of the MSF gives rise to the transfer of resources in order to bridge the gap for each municipality between the estimated standard funding requirement and its fiscal capacity. The PBO’s analysis broke down that gap into a correction with respect to fiscal capacities and one with respect to standard requirements. The former states the fiscal resources of each municipality in terms of an equal per capita value for everyone, while the latter takes account of the various standard expenditure needs of each territory. The results for various aggregates of municipalities show that in 2016 the correction of fiscal capacities offset that of standard requirements: for example, in the case of a large municipality like Milan (Figure 2), the reduction in resources due to greater fiscal capacity (about €400 per capita) is nearly entirely offset by the determination of high funding requirements (about €350 per capital). This correlation is probably attributable to the fact that the determination of standard funding requirements, which is based on part on services actually delivered, reflects the fiscal capacities of each municipality.

This equalisation component is an innovative feature of the MSF, even if its relative weight in determining actual transfers to each municipality is still small (about 14 per cent in 2016 and 18 per cent in 2017), with the main factor still being the amount of funds allocated in the past.

For 2017, the relative weight of the equalisation component increases slightly. In addition, the method for computing standard requirements has been partially modified, with a view to increasing the attention focused on services actually delivered and to reflecting the specific features of uniform groups of municipalities. The result of these changes should be an increase in resources transferred to certain categories of municipalities or individual municipalities at the expense of others.

Examples? The changes benefit towns with 5,000-50,000 inhabitants but penalise smaller and larger municipalities. Among large municipalities, the penalisation is relatively larger in the South compared with the North and, above all, the Centre (Figure 14). Moreover, cities like Rome, Milan or Turin, which had benefitted significantly from the introduction of the MSF in 2016 with positive balances of about €16.5, €11.9 and €6.3 per capita respectively (Figure 9), will lose out in 2017 compared with the previous year, with reductions of €1.8 per capita for Rome, €10.4 for Milan and €6.7 for Turin (Figure 15). By contrast, cities like Ancona and Como show the reverse: in 2016 they lost €7.1 and €8.9 per capita, while in 2017 they will post gains of €6.4 and €4.1 per capita respectively.

Finally, Zanardi discussed a simulation exercise in which redistributive effects were measured in the case in which the equalisation of standard requirements and fiscal capacities were applied fully in the MSF mechanism. It found that the redistributive impact in terms of the size of the gains and losses would be amplified enormously. For example, Rome would increase its resources by 23 per cent compared with past levels, while Naples would experience a reduction of 24.3 per cent (Figure 22). These figures underscore the threat to the sustainability of the finances of the most penalised municipalities and the excess of resources compared with the effective expenditure capacity of the most advantaged towns.