

Assessing Degrees of Fiscal Discipline: An Application to Italian Municipalities

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Rules for coordination between different levels of government are often adopted in developed countries to regulate financial relationships in contexts of fiscal federalism. Their purpose is to guarantee both macroeconomic stability at national level and the efficiency advantages of decentralization. The utility of fiscal rules at sub-national level nonetheless varies with the country's decentralization structure and above all with the nature of the financial links between entities at different levels.

There are many fiscal rules applicable at sub-national level, although none is fully effective in controlling local public finances or exempt from the risk of being evaded (rules on budget balances; expenditure caps; ceilings on the own revenue; limits on the stock of debt or on the issuance of new debt; restrictions on the type of expenditure that can be financed with debt).

In Italy, the constraints imposed on the public finances by the Stability and Growth Pact force the country to control its budget balances and the stock of debt with reference to general government, i.e. to the consolidated accounts of central government, local government and social security institutions. Control of the public finances thus requires the cooperation of a wide range of entities and not just the commitment of the central government such as regions, provinces, and municipalities. From 1999 to the present the stringency of the domestic stability pact has been changing quite a lot on yearly base. In fact, we address the Pact stringency issue through a content analysis run on the texts of the national budget laws (from 1999 to 2007), in order to place the sub-national rules along a spectrum of hard budget constraints versus soft budget constraints. We then evaluate empirically the impact of the different type of fiscal discipline on the indicators of the economic and financial performance of Italian Municipalities tracing a distinction between municipalities belonging to ordinary statute regions and those belonging to special statute regions.

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