

Italian Institutional Reforms: A Public Choice Perspective

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Introduction

IT'S STILL A LONG WAY TO GO TOWARDS STABILITY AND ACCOUNTABILITY

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Abstract: In this paper we give the details on the reforms undertaken in Italy in the last twenty years, pointing out that they have been aimed at increasing both stability and accountability on the institutional system. However, this process is far from complete, and based on the analyses of the following chapters, we highlight some possible directions.

Key words: Accountability; Italy; reforms; stability.

1. REFORMS AS A PROCESS

In Italy, the debate about constitutional changes and the first actual reforms date back to the early 1980s. The year 1982 saw both the establishment of the first Parliamentary commission on Constitutional reform (known as “the Bozzi Commission”, by the name of its chairman) and the first institutional reform, the “divorce” of the Bank of Italy from the Treasury¹, which greatly increased the independence of the Italian Central Bank (Tabellini, 1987). In the following years the process gained momentum and scope, embracing the electoral laws (twice), the procedures to approve the budget (several times), the relations between the central and the local governments, the judiciary, the role of the state in the economy, the governance of the

¹ The establishment of the 15 ordinary Regions in 1970 is generally considered as a late implementation of a principle of the 1948 Constitution.

economy, the institutions governing the fiscal and the monetary policy. The form and the internal organization of government, object of a constitutional reform law rejected by popular referendum in June 2006, are still unchanged, but the debate on the topic is still lively. Undoubtedly, the institutional, political and economic panorama of today's Italy is very different from that of the 1980s. No other Western democracy has undergone such sweeping changes like Italy in recent years.

Italian institutional reforms are scattered in time; they are a process, and there has never been a single act of constitutional modification to bind and to organize them into a coherent design. This makes it more difficult to characterize the direction and the motivations of the process. The analyses collected in this book, however, suggest that two main goals are common to all reforms. The first objective, predominant in the domain of politics, is making the Italian political system more competitive and accountable to voters. Reforms in this vein are, for example, the switch from proportional representation to majority voting after the referendum of 1993 and the decentralization of government functions to regions and municipalities. The second goal, prevalent in the domain of the economy, is to make the Italian economic system less exposed to uncertainties coming from the vagaries of party politics and to the disequilibria of public finances. The divorce of the Bank of Italy from the Treasury, the adhesion to the Maastricht Treaty, the reform of the budget laws are all meant to increase the stability of the Italian economy and public finances. Of course, the concern for competitiveness is not limited to politics, just as stability is a political concern too. Some reforms, like the privatization of state owned enterprises, have been justified as a means to improve the efficiency and competitiveness of these large firms and of the Italian productive sector as a whole (Bortolotti and Siniscalco, 2004). Likewise, the provision of majority top-ups in the electoral laws of regional and local governments is devised to increase the durability of these governments (Baldini and Legnante, 2000).

As for the forces that set this process in motion, the analyses presented in this book show that most of the reforms are demand-led. Demanders are, in turn, Italian voters, economic constituencies or other member countries of the European Union. To make an example, the electoral referendum of June 1993 received an overwhelming popular support, while the political establishment was inviting the Italian voters to "...enjoy the sun and the seaside, and stay away from the polls", as the then leader of the Socialist Party, Mr. Craxi, stated in several interviews. Moreover, between 1995 and 1997, the huge economic sacrifices needed to make the deficit-ridden Italy comply with the Maastricht numbers produced only a minimal social unrest.

The supply side of the process, chiefly the political parties, has by and large resisted the process of reform, especially at the beginning. The party

system perceived their political rents at risk. It took the crisis of the political parties in the early 1990s, when a wave of scandals loosened the parties' grip on Italian politics, to open the way for two of the main institutional innovations: the change of the electoral law in 1993 and the change of the structure of local governments, with the direct election of the mayors. Yet, as the party system reorganized around two broad alternative coalitions, Italian parties opposed two further obstacles to the process of institutional reform. First, time and again they failed to agree on a constitutional procedure that could make the institutional changes a bipartisan issue. The reforms eventually implemented were never designed behind a veil of uncertainty, nor enacted through a "massive act of political coordination" – the two hypotheses that constitutional political economy posits as preconditions for successful constitutional reform (Mueller, 1997). The process has therefore been slowed down, though not halted, and deprived of a coherent constitutional framework. Second, electoral politics has sometimes made the process move backwards, as in the case of the 2005 electoral reform, which reintroduced the PR system that the Italian voters had rejected by referendum in 1993.

Another general conclusion of the analyses of this book is that promoters and, in some way, the public opinion regard the process of Italian institutional reforms as the solution to economic problems. This may sound obvious, but it does mark a significant difference from the thinking behind the 1948 Constitution. Back then, the main problems that the new constitution was to solve were political ones, like the risk that a dictatorship emerged from democratic institutions as in 1922, and social ones, such as the coexistence of the Communist and the Catholic ideologies and values. The idea that institutional changes are needed to solve economic problems makes Italy a natural experiment in public choice and constitutional economics. The Italian process of institutional reforms is not only interesting *per se*, but also because it offers a unique test ground of scientific theories. Hence this book.

All the chapters of this book examine the process of Italian institutional reforms using the methodologies of public choice and political economics. A significant uniformity of approach thus binds these chapters together; furthermore, to make the analysis as complete as possible, the chapters analyze most of the main features of the process of institutional reform. This introductory chapter provides a brief historical description of the process of institutional reforms in Italy, presents the chapters and concludes by evaluating the process of reforms: how far it has gone, how far it has still to go.

2. A BRIEF HISTORY

To understand the need for institutional reforms in Italy one has first to analyze the political situation. Four stylized facts shaped the political history of the country after World War II. First, in 1948 Italy became a democratic republic, but a blocked one. The presence of the largest Communist Party in Western Europe (roughly one third of the electorate), which rejected the system of international alliances and the principles of market economy, made alternation in government impossible. The Christian Democrats and its allies of the so-called “constitutional bend” (*arco costituzionale*) had to stay in government and the Communist Party in opposition. Political competition was thus effectively jammed; voters could not put a badly performing government out of office. Second, the PR system adopted for the parliamentary elections increased the number of political forces that held seats in the Parliament. Up to twenty parties, and never less than a dozen, held seats in the eleven legislatures that span the life of the Italian parliament from 1948 to 1993. From the early 1960s onwards, Italian governments were supported by highly fractionalized coalitions, where small parties had a disproportionate power to blackmail the largest one (Padovano and Venturi, 2002). Third, the ideology of these coalitions was highly polarized, as they encompassed the Socialist Party on side and the libertarian parties such as the PLI on the other. Finally, the 1948 Constitution, influenced by the Fascist experience, organized the structure of government chiefly to prevent the insurgence of a strong, dictatorial leadership. Hence, the choice of weakening the executive *vis-à-vis* the legislative. This banned Italian voters from choosing their government and political leaders. The 50-some governments of the 1948-1993 period were engaged in continuing wars of attrition and had to redistribute political rents to remain in power. As the most seasoned Italian politician, Mr. Andreotti, candidly and disheartingly remarked about his 6th government in the late 1980s, “what my government does is trying to survive (*“tirare a campare”*), which is far better than governing to die (*“tirare le cuoia”*)”. Italian citizens were supposed to laugh.

In the 1970s-1980s the crisis of the political system reached its peak. First, the Christian Democrats were steadily losing votes for a variety of causes, such as the general leftward drift of the median voter in the 1960s-1970s, the economic crisis, the internal squabbles of the party, the secularization of the Italian society. From the 48% of votes in 1948, they ended with 33% in 1983. But the Communist Party was in no better shape. The “historical compromise” (*compromesso storico*), the grand coalition between the Christian Democrats, the Communist Party, the Socialists and other centrist parties that supported the governments of the second half of the

1970s, came to an end in 1979, after the PCI suffered a significant drop in suffrages. This marked the return to the blocked democracy. In 1985 the Communist Party endured another serious defeat in a referendum promoted to reintroduce the perfect indexation between wages and prices, which has been one of the causes of high inflation in Italy. The defeat in what was believed to be a highly popular issue gave the impression that the Communist Party was increasingly isolated from the true demands of the society. But all political parties were. The deep social unrest that spread in the Northern regions more or less at those times confirmed it. The *Lega Nord* (“Northern League”), a political movement that was external to the party system, rose to political prominence by calling for self-government of the Northern Regions. The Lega claimed that government policies aimed at developing the *Mezzogiorno*, mainly large public investments in basic industries and government programs to support consumption, failed to promote growth in that area. The Northern League was campaigning for a “fiscal revolt” of the North to keep tax revenues on its territory without transferring them to the corrupt central government (*Roma ladrona*, “Rome bandit”).

Already weakened, at the turn of the 1990s the Italian political system received two major external shocks. First, in 1989 the fall of the Berlin Wall and the demise of the former Soviet Union reduced the relevance of the ideological divide in Italian politics. The former Communist Party managed this historical transformation, converting into a social-democratic party, the PDS (Democratic Party of the Left) in 1991. The combined effect of these transformations made the PDS suitable to form the government. Second, in 1992 a wave of corruption scandals, known as *Mani Pulite* (“clean hands”) involved virtually all the *nomenklatura* of the parties members of government coalitions of the 1980s, as well as many owners of large private firms and managers of state owned enterprises. Between the elections of 1992 and 1994, all the parties that had governed Italy in the previous thirty years disappeared. Mr. Berlusconi, owner of the Italian largest media group *Mediaset* and wealthiest man of Italy, stepped into politics with the newly founded party *Forza Italia* (“Go ahead, Italy”) and won the 1994 elections over the left wing coalition led by the PDS.

In the midst of this political crisis, the country was facing a dramatic economic situation as well. In 1992 Italy signed the Maastricht Treaty that paved the way towards the Monetary Union. The Treaty imposed strict economic conditions to join the European Monetary Union: a deficit-to-GDP ratio smaller than 3%, a debt-to-GDP ratio below 60%, exchange rate stability and low inflation. In 1992 deficit stood at 10.3% of GDP, the public debt was around 108% and rising, only inflation was on the decline, but still above the European average. On top of that, in 1992 the high interest rate

imposed by Germany to fund reunification with the East caused the breakdown of the European Monetary System. Under increasing speculative pressure Italy was forced to leave the EMS agreement and devaluated the lira by 20%. Italy was clearly unsuitable to join the single currency.

The governments of those years were hardly an expression of the party system. In 1993 the President of the Republic called the Governor of the Bank of Italy, Mr. Carlo Azeglio Ciampi, to form the government. Mr. Ciampi managed the public finances and introduced major economic reforms, such as the demise of wage indexation, through an actual corporatist method of governance, the *concertazione* (Ciampi, 1996). This method foresees a negotiation process between the government, the confederation of industries and the trade unions; the Parliament basically has to transform the agreement into law.

In this situation, pressures to introduce institutional reforms met a softened resistance by the political establishment. In 1992 the Italian Constitutional Court allowed a popular referendum proposed by a middle-ranking MP of the Christian Democracy, Mr. Mario Segni, and supported by a group of MPs of the PDS. This referendum was aimed to introduce a plurality system in Italian parliamentary elections instead of the PR system, held responsible for the high fractionalization and low accountability of Italian parties. As already said, the proposal met the overwhelming support of the electorate. This result strengthened the idea that the initiative of citizens could reform the state.

In 1993 the Constitutional Court licensed other referendums initiatives on the direct election of the mayor, but this time the Parliament legislated to avoid another delegitimising defeat. Hence the direct election of the executive where introduced first at the local (1993) and then at the regional (1995) level of government. These reforms made local governments more stable and accountable. However, the overall picture is a patchwork of different voting systems. At the city and provincial level there is a run-off system, and the winning candidate has a 60% majority of seats in the council. At the regional level, the President is elected in a first-past-the-post system, and there is a top-up mechanism aimed at giving the President a 55% majority in the council. Finally, at the national level (and until the 2006 elections), the Lower Chamber is elected with the first-past-the-post system for 75% of the seats, while the remaining 25% are elected on the basis of proportional representation with a 4% threshold between competing party lists. For the Upper House there are no competing lists, but still there is a mechanism aimed at reducing the effects of plurality.

From the supply side, the political system made a few attempts to reform the institutions. As we have seen, this behavior can be explained as a corporatist defense of the political rents associated with the *status quo*. But it

is also true that article 138 of the Italian Constitution requires a very restrictive procedure for constitutional changes. These must be approved in two identical readings by both Chambers, and become immediately effective if neither 500,000 citizens, nor 20% of the members of Parliament, nor 5 Regional Councils ask for a referendum. This requirement is in fact equivalent to a supermajority. An agreement between the majority coalition and the opposition was the only way to reform the Constitution. The instrument for these changes was found in an *ad hoc* bicameral committee, called *Bicamerale*. In 1982 the first bicameral committee chaired by Senator Aldo Bozzi provided a comprehensive proposal for reforms, but they were never approved by the Parliament. In 1993 another bicameral committee was established, firstly chaired by Mr. Ciriaco De Mita and subsequently by Mrs. Nilde Iotti, but failed to come out even with a proposal, because of the dissolution of the party system.

In 1997 there was a serious attempt of a comprehensive constitutional reform, made with another bicameral committee chaired by Massimo D'Alema, one of the leaders of the PDS. This effort brought Italy as close as it has ever been to a systematic constitutional reform. The main political parties reached an agreement on the decentralization of government functions, on the direct election of the President of the Republic, on the electoral law, on the reduction of the members of parliament. Yet, the two coalitions dissented on the procedures to dissolve the chambers and on the powers of the judicial branch. As the constitutional reform project constituted a "package", the whole effort broke down. After the failure of the *Bicamerale*, constitutional reforms ceased to be a bipartisan issue. In 2001 the centre-left coalition amended the Constitution, giving more power to the regional authorities. These changes were approved in a referendum held in October 2002. In 2005 the Berlusconi government, supported a strong majority in both Houses, approved a comprehensive reform of the Constitution. This modification gave more power to the Prime Minister, changed the balance of power between the two Houses in favor of the Lower Chamber, devolved further powers to the regional and local governments ("devolution") and changed the structure of the Constitutional Court. The opposition called for a referendum, held in June 2006; 61% of the electorate voted no and the constitutional changes were rejected. Moreover, in 2005 the Berlusconi government changed the voting rules, getting rid of the plurality system emerged from the 1993 referendum in a last ditch effort to win the 2006 elections. The new electoral law is based on a PR system that gives 55% of the seats to the winning coalition at the national level in the Lower House, while for constitutional reasons in the Upper House this top-up system must work at the regional level and is therefore ineffective. Berlusconi lost the elections by a narrow margin but the new government is already working at a new electoral law, and the President

of the Republic has recently advocated a continuation of the process of reforms on a more consensual basis.

3. THE ANALYSES OF THE BOOK

The historical reconstruction carried out in the previous section provides just a brief description of the most important institutional changes carried out in Italy in the last 25 years. It also leaves out many reforms that, though not properly constitutional, are nevertheless quite relevant for the political and economic institutions of the country. They are the subject matter of the chapters of this book that are heretofore presented. The sequence of the chapters follows, as much as possible, the chronological order of the reforms.

Chapters 1 of the book, by Chiara Dalle Nogare and Matilde Vassalli, deals with the independence of the Bank of Italy after the “divorce” from the Treasury in 1981, generally regarded as the first main institutional reform. This reform freed the Bank from the obligation to purchase government bonds that were not subscribed by other financial intermediaries. As Tabellini (1987) points out, this “divorce”, coupled with the provision that the Bank chooses its own Governor with little formal interference from the political system, established the Bank as a highly independent institution. As Dalle Nogare and Vassalli point out, however, “...Central Banks do not live in a social and political vacuum. Their conduct is possibly affected by various actors living next to them and exerting pressure on them. Even if a Central Bank’s institutional status is one of perfect independence, the isolation of their moves from external pressure should at least be verified empirically, not given for granted”. This is what the authors set out to do, using data about the Bank’s behavior between 1984 and 1999, when the EMU effectively deprived the Bank of Italy of the control of the money supply. This period is certainly one of the most interesting of the Italian monetary history (Fратиanni and Spinelli, 2004), as it includes the establishment of the independence of the Bank from the Treasury, the working of the European Monetary System, with the recurring demands for competitive devaluation of the Lira, the signing of the Maastricht Treaty, the devaluation of 1992, the joining of EMU in 1997. Dalle Nogare and Vassalli base their examination of the Bank’s actual independence on indexes of external pressure specific to different types of interest groups. These indexes count the number of financial newspapers articles in which the government and different interest groups demand for easier or tighter monetary policy. The final result of their econometric analysis is that the Bank has been sometimes sensitive to pressure coming from the economic and the financial sector; the

responsiveness of the Bank to requests coming from the political sector and from the unions is less clear cut.

The electoral reform is seen as the “mother of all reforms”, both because it is with the 1993 electoral referendum that the process of institutional change gained momentum in Italy and because it regulates the principal-agent relationship between voters and their political representatives. Yet is also one of the most delicate issues. The veil of ignorance hypothesis does not hold in the case of electoral reforms, since parties can easily foresee whether they stand to gain or lose from any particular proposal. Moreover, the menu of electoral systems to choose from is quite variegated. It is therefore important to verify how much this difference in electoral systems maps into a difference in political outcomes. Guido Ortona, Stefania Ottone and Ferruccio Ponzano try to sort out this maze by examining how the different electoral systems adopted in Italy did in terms of the two main tasks that an electoral system performs: representing the political preferences of the electorate (representativeness) and ensuring stability to the political systems, chiefly the executive (governability). Furthermore, the authors try to see what would have been the composition of the Italian parliaments from 1992 to 2001 had either a pure PR or a pure plurality system been in place. The analysis takes advantage of the fact that the Italian electoral system between 1993 and 2005 was a mix of PR and plurality. This allows the authors to use the real votes obtained by the parties in the proportional ballot to simulate the composition of the Parliament under a pure PR, and the votes obtained in the plurality ballot to simulate the Parliament under a pure plurality system. The simulations seem to point out that things would not have been much different in terms of governability and representativeness had any of the two pure systems been in place instead of the mixed one. Much ado about nothing? The authors suggest that maybe 8 years and 3 elections are not enough for voters to adjust their voting strategies to the new rules. Alternatively, the Italian political equilibria are fairly robust and changes in the voting rules hardly upset them. In any event, this chapter does leave the reader with the (disheartening) impression that in Italy (and probably elsewhere as well) the expectations placed on electoral reforms are too high. More analysis is needed to verify how electoral rules interact with other institutional features, such as the form of government, to generate certain levels of representativeness and governability.

Chapter 3 and 4 lead us into the domain of economic reforms. In Chapter 3 Emma Galli and Nadia Fiorino examine the effects of the Maastricht Treaty on the evolution of the Italian public finances. By means of a time series model, they verify to what extent it has been the Maastricht provisions or other financial and institutional changes, identified in the literature, that made the Italian deficit to GDP ratio converge to the levels of the other two large

economies of the euro-zone, Germany and France. They conclude that the external constraint on the Italian fiscal policy choices increased dramatically after Maastricht, and its strengthening, more than anything else, is responsible for the convergence of the Italian deficit towards French and German levels. Even after the adoption of the Euro the coefficients measuring the sensitiveness of Italian public finances to the degree of stringency of the Stability and Growth Pact remain quite high. The dynamics of the Italian public finances is therefore still exceedingly dependent on the external constraint; the “culture of stability”, so often advocated by President Ciampi, seem not firmly rooted in the Italian political system yet.

In Chapter 4 Lilia Cavallari provides a model of the corporatist governance that matches quite closely the institutional features of the 1993 agreement on wage indexation mechanism. Two are the main contributions of her analysis. First, the model shows why that governance system worked in 1993 and before the adoption of the single currency. Second, it explains why it has not worked afterwards. The model predicts which economic outcomes can be expected by such a social pact, especially in terms of the relation between the programmed and the realized rate of inflation. The key point is that these results derive from a strategic interplay between unions, a national government and an independent central bank. The economic outcome of the pact is therefore sensitive to the nature of the central bank, national or supranational. Under a monetary union, a social pact and possibly a governance system like the one that produced the income agreements of 1993 in Italy may not work properly in a monetary union; it may even turn counter-productive. This happens when the inflation target is set according to nation wide, as opposed to union wide, criteria. Trade unions then cooperate with the national government but not with the central bank; this results in excessive wage restraints in the country and in the persistence of output gaps with respect to other member countries. The analysis suggests that, for corporatist governance system to produce desired results in a monetary union, the inflation target must be set at the union level. In the first half of the 2000s this has not been the case in Italy, and that may explain the failure of the *concertazione* to replicate the positive results of the early 1990s. The gist of Cavallari’s argument is that the problem of *concertazione* as governance method is not related to its institutional features but in the way it has been used by its actors in recent years.

Chapters 5 to 7 deal with the part of the Italian political institutions (and Constitution) that has been more extensively reformed; the territorial organization of the state and the structure of sub national levels of government.

Nadia Fiorino and Roberto Ricciuti consider whether the size of the legislature, measured by the number of legislators sitting in the legislative

branches, affects the production of laws and public spending. This is an important topic, both because many projects of constitutional reforms in Italy included a reduction of the number of the seats of the national Parliament (the Bicamerale D'Alema intended to almost halve them) and because theory does not provide an *a priori* on the effects of such a measure. To the extent that larger legislatures are associated with fewer voters per legislator, voters should be better able to monitor their representatives and thus demand more legislation – a substitution effect. On the other hand, as long as the number of legislators increases, the transaction costs needed to find a viable majority rise, making legislative output fall – an income effect. The determination of the actual effect of changes in legislature size on enacted laws is therefore left to empirical analysis. In 1995 Regions have been invested with the power to write their own constitutions (Statutes). Regional policy makers have generally used this opportunity to increase the number of seats in Regional councils with respect to the pre-reform *status quo*. At the same time Regions have been endowed with more power to tax and spend – a process still unfurling. The analysis, based on data about regional legislative output between 1980 and 2002, finds a significantly negative effect of the number of legislators on laws as well as a strong political-cycle effect, which increases legislation in voting years. Also legislative cohesion holds a similar effect, in line with the war of attrition literature. As the number of laws is correlated with public spending, Fiorino and Ricciuti argue that larger and more fragmented legislatures should spend less, *ceteris paribus*.

In Chapter 6 Fabio Padovano shifts the attention to the taxing behavior of local governments after the 1993 reform. Holding constant the level of local public spending (as well as many other social, political and economic indicators) the model verifies whether Italian municipalities are engaged in a “yardstick competition” *à la* Besley and Case (1995). Models of yardstick competition involve information spillovers across jurisdictions; voters look at public services and taxes in other jurisdictions to evaluate whether their government is wasting resources (through inefficiency or rent-seeking) and deserves to be voted out of office. Knowing that voters make such comparisons, government officials take the choices of other jurisdictions into account in making their own decisions, leading to strategic interaction between jurisdictions. Italian local governments provide a good sample to test for the implications of these models. They receive more than 50% of their revenues from a tax on house property, the ICI (*Imposta Comunale sugli Immobili*). While the tax base of ICI is determined by national procedures, mayors are free to decide the tax rate within the 4‰ to 7‰ range. This places the fiscal choices of mayors on a single dimension, making it easier for voters to include this information in their electoral choices. Previous studies

of yardstick competition in Italian local governments, such as Bordignon et al. (2002), find little support for the implication of the theory, possibly because of a limited sample size. In this chapter Padovano exploits a database of all the 8100-some Italian municipalities for the 1993-2001 period. He finds that mayors who run for re-election appear to be significantly affected by neighbors' tax rates, while mayors who are term limited do not. This is indeed evidence of yardstick competition, though not of a very fierce one, as the differences in the tax rates of the two samples are not huge. In line with the findings of Chapter 2 this may depend on a time-to-learn factor; Italian voters at the municipal elections need more electoral rounds to fully exploit the mechanism of yardstick competition (the analysis covers only 3 rounds on average). A longer time series and a more detailed exploitation of the large database might reveal more information. More generally, the chapter does say that decentralization improves voters' control on the government and on the representation of their preferences. Furthermore, a term limit of only two elections seems inefficient; an extension to three terms should increase the mayors' accountability.

In Chapter 7 Barbara Veronese exploits the fact that Italian reforms are a natural experiment in public choice to study the effects of a transition from a parliamentary to a presidential system on electoral and fiscal policy outcomes. The 1993 reform of the local governments is in fact a case in point. Before 1993 voters elected the local council through a PR system, and the council then elected the mayor, thus replicating the parliamentary system of the central government. The reform put in place an effective presidential system: voters directly elect the mayor as well as the council through a plurality system. To ensure government stability, the list associated with the mayor receives a majority premium, and motions of no confidence produce new elections². Specifically, this chapter tests the hypothesis that this institutional change "unbundles" the executive and the legislative powers, because the direct election of the mayor makes her more responsive to voters' preferences, even when these differ from the preferences of her party – an effective measure of electoral accountability. Such differentiation should have an impact on policy choices, especially on the composition of local public spending. The analysis does find significant evidence that the 1993 reform fosters political differentiation. Furthermore, political transformations drive also changes in the composition of the largest fields of local public finance too, increasing spending in social intervention and general administration, and reducing outlays for education and culture. The

² Quite flatteringly, in 2002 England introduced a reform of local governments (the "executive councils") along the lines of the Italian system. It is probably the first time that Britain took an Italian political institution as a model since the times of the Roman Empire.

empirical model developed by Veronese can be used to test the impact of similar reforms on different samples, not necessarily Italian or related to local governments.

The rules that define the structure of the public budget and the procedures for its approbation play a very important role in the determination of the level of public spending and deficit. Previous empirical literature (Alesina and Perotti, 1994; Lagona and Padovano, 2006) demonstrates that the cross-country variation in budget rules explains a considerable portion of the different financial performance of countries characterized by highly interrelated economies and similar levels of development. Institutional analyses of the Italian budgetary history (da Empoli, De Ioanna and Vegas, 2004) maintain that the slackening of the procedures in 1978 coincided with the introduction of the *Legge Finanziaria* (“Financial Bill”). Since then Italy changed the budget rules several times in the last 30 years. Chapter 8 by Padovano examines the evolution of the rules to approve the central government budget between 1980 and 2000. The methodology used – a nonlinear variation of the standard principal component analysis – allows to provide a methodologically sound numerical evaluation of the change of the stringency of the budgetary process that each reform and the Maastricht Treaty itself produced. This evaluation then enables to assess the impact of these reforms on the country’s fiscal performance. The analysis indicates that, while the years immediately before Maastricht are characterized by a broad increase of the binding force of the budget process, such evolution was in fact reversed from the mid 1995 onwards. This was due to the loss of power of the central government *vis-à-vis* lower and upper government levels, and to the increasing confusion in the division of labor within the various government levels and branches that the proliferation of shared responsibilities generates. Both these processes reduce the usefulness of the budget as a means to reveal the responsibilities of the fiscal and spending decisions to the citizen-taxpayer. Furthermore, the analysis confirms what already pointed out by Galli and Fiorino in Chapter 3, namely, that institutional variables are a quite important determinant of the Italian financial performance.

The administration of justice is generally considered one of the most backward and controversial aspects of the Italian political system. Recent data show that 800 days are on average needed to reach a first judgment in civil right suits, against the 130 of Germany, 153 of France and 275 of Spain. Moreover, the *Mani Pulite* scandals produced a very high tension between certain sections of the executive and legislative branches of government, on the one side, and the judicial branch, on the other. Judges and magistrates (and part of the public opinion) view, rightly or wrongly, any reform aimed at making the judicial system more efficient as an attempt to reduce the

independence of the judicial branch. Politicians (especially of the center-right) retort that these are corporatist defenses of a highly politicized magistracy. The result is a stalemate and a progressive erosion of the perception of the rule of law in the Italian society. In Chapter 9, Felli, Londono-Bedoya, Solferino and Tria provide an empirical investigation of the *malaise* affecting the Italian civil judicial system. They develop a model of the “demand for justice”, measured as the volume of civil litigation in Italy, of its determinants and of the strategic choices of litigants. On the supply side of justice, the analysis examines the effects of the only relevant institutional innovation introduced in the Italian judicial branch in the last 10 years, the so-called the *Giudice di Pace* (Honorary Judge). This new type of magistracy was aimed to provide an easier access to the citizen and a simplified procedure and hearing and contributed to the resolution of little less than 49% of first-degree proceedings. Notwithstanding the importance of this innovation, the analysis of the demand for justice in Italy confirms that the Justice of Peace did not contribute to improve the situation, as the lengthy time-spans and raised costs of associated processes and high market rates have a disincentive effect on recourse to justice, which seem to prevail over that connected to opportunistic behavior of the plaintiff. This could also partly explain the decreasing trend of the number of cases arising in recent years. The analysis confirms the need for a thorough reformation of the Italian judicial branch.

The financial crisis of the early 1990s forced the Italian government to sell many of its assets. The Italian “privatization campaign” represents one of the largest sales of state-owned enterprises among Western countries (Bortolotti and Siniscalco, 2004). This in turn generated one of the major institutional changes taken place in Italy in the 1990s, the creation of Independent Authorities. Their role is to regulate several key industrial sectors, such as energy, telecommunications, public works and so on, where the state had acted as a producer. Several issues are connected with this institutional evolution: why elected politicians choose to delegate function to these bodies; whether the delegation implies a real redistribution of power; and finally how these independent authorities fit in a system of checks and balances. In Chapter 10 Ilde Rizzo reflects on her experience as a member of the Public Works Authority (PWA) to provide an insider’s answer to these questions. The creation of the PWA is depicted as a political response to a demand for regulation expressed by the public opinion. The subsequent evolution of PWA, however, demonstrates how difficult it is to implement a real redistribution of powers from the government to the independent authorities. Delegation generates a set of complex interactions with many actors, like the judiciary and the bureaucracy. The formal delegation, through the establishment of an independent authority, is in itself insufficient to

guarantee its *de facto* independence and to foresee what type of decisions it will take. Furthermore, the benefits and costs of delegation might change through time, as it is the case when the independent authorities try to expand their scope and powers. It may then become convenient for an opportunistic politician to change, in practice, the scope of the delegation, without bearing the political costs of a clear change of the legislation. The morale of this insider's look is that more can be learned from the strategic interactions of these bodies than from the formal statutes under which they operate. Hence, every authority tells a partially different story.

Chapter 11 by Rosella Levaggi examines an important reform implemented in 1992 in the health care sector. In Italy a substantial portion of health care is financed through the public sector. The financial disequilibria and the need to meet the Maastricht criteria forced the governments of the early 1990s to rationalize public spending in this sector, the second largest item of public outlays (social security being the first). The 1992 health care reform introduced a separation between purchasing and delivering the health services, so to mimic the structure of a competitive market. Health care, however, is largely a regional responsibility; the organization of reformed internal market can thus vary considerably between regions. The analysis shows that these regional differences generate a trade-off between national goals (like the satisfaction of minimum standards) and the incentives to minimize costs; the more the control is stringent, the lower the incentive to an efficient use of resources. Furthermore, in presence of local monopoly and information asymmetries between the provider of the service (e.g. hospitals) and the receiver (patients), competition hardly reduces the costs. Benefits from competition might be obtained in the long run, in particular in a structure where the private and the public compete.

The final chapter, by Valentino Larcinese, provides empirical evidence on a vexed question of Italian politics: how much do the media, especially televisions, influence the voters? The question is crucial for the evolution of the Italian democracy, as Mr. Berlusconi, certainly one of the key (if not the key) figures of Italian politics after 1994, is *de facto* the owner of the 3 largest private TV channels, through his *Mediaset* group. Several opinion makers, the prestigious Italian journalist Indro Montanelli being the first in 1994, *The Economist* being another, and a great many Italians as well, believe that Mr. Berlusconi is "unfit" to govern Italy. His supposed power to influence the Italian voters through his TVs creates a conflict of interests incompatible with a proper functioning of a democracy. In other words, having Mr. Berlusconi as Prime Minister is equivalent to being ruled by an Orwellian Big Brother. Put it otherwise, the Italian democracy cannot really function until it gets rid of the Berlusconi "anomaly". Whatever he does in politics, constitutional reforms in particular, because of their fundamental

character and long lasting effects, must be rejected by this point of principle. In Chapter 12 Larcinese verifies whether Italian voters are in fact masterminded by the televisions. He examines the 2001 ITANES survey data and documents a number of empirical regularities in the media usage of the Italian electorate during the 2001 electoral campaign. Voters that expose themselves predominantly to Mediaset news programs appear much more prone to vote for the centre-right coalition and voters that are exposed to RAI news (the Italian public broadcasting company) are substantially more likely to vote for the centre-left coalition. Multiple regression analysis shows that this polarization can only partially be explained by voters' ideological leaning and opinions on policy issues and has instead much to do with evaluation of the political leaders and trust in the television channels. Even when these variables are considered, an unexplained higher propensity of Mediaset viewers to vote for *Forza Italia* persists. Larcinese uses these results to reflect on the quality of public deliberation in the Italian democracy. Some readers may dislike his results, but certainly the analysis has moved the argument from the domain of opinions to that of the facts.

4. WHAT'S NEXT?

Aristotle used to say that where "opinion is expressed, there the analysis stops". In this book the analysis is developed in the ensuing chapters; we think therefore appropriate using this paragraph to express our opinion, i.e., to put forward our ideas on what type of constitutional reforms should be introduced in the future in Italy, although in very general terms. We emphasize that these are the ideas of the editors of this book, and do not involve the contributors. Yet, they are not totally free from responsibility, because our suggestions are based on the analyses proposed by the contributors.

The first conclusion of the analyses on which we ground our proposal is that institutional reforms should improve the accountability and competitiveness of the political system and to increase the stability, especially of the executive branch. Among these two goals, we attribute greater importance to the first. It is true that Italian governments must become even more stable, in the sense that they should be supported by less fragmented coalitions, to reduce the risk of war of attritions. But the reforms and the political changes of the 1990s have already increased the durability of the Italian governments. Between 1948 and 1994 Italy had 47 governments, each surviving less than 12 months on average. Between 1994 and 2006 there have been only 8 governments, each lasting more than 18 months on average, an increase in durability of more than 50%.

The second conclusion of the analysis that we exploit is that political equilibria are very resilient to changes in any of their determinants. Electoral laws have been shown to be insufficient to generate a strong political competition, if they are not accompanied by measures that, for instance, stimulate the competition among government branches. Hence, for institutional reforms to produce noticeable effects each institution must have a single goal. Compromises among different goals should not cripple the potential effectiveness of a reform. Using electoral laws again as an example, they may serve two purposes, representing voters' preferences – in which case a PR system is to be chosen – or maximizing voters' control on their representatives, for which a pure plurality system seems better suited. There is a trade off between the two goals. Implementing an electoral law that tries to strike a balance among the two produces an hybrid that performs badly both in terms of representation of preferences and in terms of electoral control. In a word, we base our proposal on the old Keynesian *nostrum* that each instrument should have one target.

The analyses have shown that decentralization of government functions does serve the purpose of representing voters' preferences. The Oates theorem shows that decentralization allows supplying policies more adherent to heterogeneous voters' demands. Furthermore, mechanisms of horizontal competition, like exit options and yardstick competition, increase politicians' incentives to behave efficiently and to experiment new policies. In this respect, the analyses may suggest an extension of the term limits in the elections of mayors from 2 to 3 mandates. Moreover, the move towards greater fiscal autonomy and political responsibility of sub-central government levels should be pursued, to avoid common pool type of situations. As for the issue of which tasks to assign to each government level, the variety of solutions experienced in different countries suggest not only that there is not an optimal solution, but that the relevance attributed to the problem is likely to be exaggerated. The key point is rather avoiding shared responsibilities that make it more difficult for taxpayers-voters to identify who to praise or blame for a given policy choice. In Italy the argument generally leveled against this type of devolution is that it would increase the gap between the rich North and the poor South. Padovano (2007), as well as many decades of government intervention, show that this argument is probably flawed. Most transfers and revenue sharing schemes tend to widen this gap by impeding the market forces that drive regional income convergence.

Using decentralization for the task of representing voters' preferences, the electoral system is free to pursue the goal of maximizing voters' control on their representatives. We advocate the abandonment of PR in favor of first-past-the-post electoral systems. The French run-off system receives also

great appeal in Italy, for its alleged incentives for parties to aggregate in larger coalitions. The analysis of Chapter 2 suggests that the effects of the two systems may not be all that different. Electoral reform alone is insufficient to ensure political competition and electoral accountability. The direct election of the executive, i.e., the switch from a parliamentary to a presidential system of government appears thus necessary. But to make a presidential system work, an appropriate separation of powers between the legislative and the executive must be ensured, to make the system of checks and balances work. To this end, according to Persson, Roland and Tabellini (1997) the two branches must have conflicting interests and their agreement must be necessary for a decision to be taken. This setting puts the two branches in competition and creates the incentives for them to control each other, preventing abuses of power. The domain of budgetary laws is where this system of checks and balances works more effectively. This implies a reform of the budget rules that brings the current system closer to the “closed rules” model (Baron, 1991), whereby the power of the executive to propose the budget is strengthened, and the power of the legislative to amend it is reduced. Moreover, the chapter on budget rules underlines the importance of greatly simplifying the document. The optimum would a budget document divided in chapters specific to (a reduced number of) the spending ministries. This would allow transforming the budget and the tax system from a common pool to a document where voters can assign to each type of expenditure a corresponding tax price, substituting the general taxation with something closer to a generalized earmarked taxation. This may seem going very far, but it is probably the only way to connect projects of expenditure reform with the natural fiscal restraint that voters generally show in referenda – in other words, to make the reform of expenditure programs more popular.

The switch from a parliamentary to a presidential system, both elected through majoritarian systems, poses the issue of the number of legislators in a new light. The President is in fact elected in a nation wide district, which makes him/her more sensitive to the interests of the country as a whole. Legislators are elected in smaller district that lead them to cater more local interests. From a checks and balances point of view, a tension between these two objective functions is desirable. This in turn makes the reduction of the number of legislators a less sensitive issue.

The devolution of government functions to lower levels of government requires a check at the national level. The standard method is to make the Upper Chamber a Senate of the Regions, where representatives of the sub central government levels are elected (and have the right to vote, contrary to the constitutional law rejected in the 2006 referendum!). This implies also a separation of the competencies between the two chambers. A certain degree

of bicameralism might be however salvaged, to ensure the respect of legislative contracts and allow a certain amount of welfare enhancing logrolling. This may be obtained by assigning to one chamber the principal responsibility for given areas of legislation, and by granting the other the power to veto it. Again to respect the principle of separation of powers, the division of labor (*viz.* the principal responsibilities) among the two chambers should be clear cut.

As for the judicial branch, the independence of the Constitutional Court must be further increased, reducing the number of justices nominated by the political branches, or granting them a lifelong mandate. Padovano, Sgarra and Fiorino (2007) have shown that the Italian Constitutional Court acts more independently when the share of justices coming from the magistracy is higher. This increase in independence can be bargained with an increase in the efficiency of the lower level courts.

Finally, in this era of widespread government intervention in the economy, political democracy is not enough. Economic democracy must be enhanced, in the form of legislations that favors a large diffusion of property, encourage public companies, reduce the power of special interest groups and the scope of corporatist forms of governance, whose rules of the game are certainly less clear than those of electoral democracy. Of course this is another story, which deserves the analysis of another book. But we want to flag the issue, which is largely missing in the Italian discourse on constitutional reform.

These proposals are limited to general principles, and we are fully aware that in constitutional matters the devil lies in the details. Yet, these proposals have the advantage to be based on a clear set of priorities: improve accountability first, then government stability. Another fundamental criterion is assigning each institution to a specific goal. And finally, we take the fruits of these 20 years of demand-led institutional reforms and place them in a coherent constitutional basket.

More of course is to be said in this matter, but it goes beyond the scope of this introductory chapter. We leave this task to other public choice and political economics analyses, beginning with those of the chapters of this book. With respect to other disciplines that deal with constitutional matters, these analyses have the clear heuristic advantage of being able to theorize about the incentives of the actors in political games, their strategic interactions, the binding forces of institutions and rules and to verify these theories empirically. To the extent that these contributions will penetrate the constitutional culture of our times, as it happened in the XVIII century, we expect great progresses in constitutional knowledge and, possibly, a few wise reforms.

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