

## **NEED EQUALIZATION TRANSFERS AND PRODUCTIVE EFFICIENCY OF LOCAL GOVERNMENTS**

Alessandro Petretto

The paper deals with Need equalization formula for intergovernmental grants, and analyses, by a simple model, the impact of parameters changes on productive efficiency of a local government. By this kind of efficiency we mean producing and providing, at minimum cost and at high quality, a output level of a public service at least equal to a standard, fixed by the central government for pursuing horizontal equity among jurisdictions. In some German Landers the municipal transfers system is broadly inspired by such a criterion, and the recent reform of Italian equalization grants system moves in this direction. The main results of the paper are the following ones. An increase of the revenue sharing rate tends to reduce the quality of the public service, while it tends to induce the politicians and the public officials to contain production costs. Opposite effects are given by an increase of the rate of the equalization and of the standard tax rate. An increase of the minimum standard of the public service provision has a beneficial effect on cost-efficiency, while the impact on quality is not determined, depending on the structure of technology and costs. However, we find that, if quality and quantity are substitute both in preference and costs, then the local government reduces the quality. Finally, also in this setting, it is confirmed, that organising the equalization system with adequate transparency and simplicity can improve, through a higher accountability, cost-efficiency. We have also shown that without such remedies, the inefficiencies, in terms of low quality and high costs, can be, in some cases, paid by the grant and the revenue sharing. This creates perverse and contradictory effects on regional financial responsibility.