

THE LOCAL PUBLIC SERVICES LIBERALIZATION AND THE FUNCTIONAL FEDERALISM: THE CASE OF ENERGY SERVICES IN ITALY

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Summary

The theory of FOCJ (Functional, Overlapping, Competing Jurisdictions) introduces a notion of <<functional federalism>> where each jurisdiction is responsible for the provision of a specific class of public goods. In other terms, the model contemplates that citizens can choose some local public goods without moving from one jurisdiction to another, as Buchanan's and Tiebout's theories would assert.

This theory appears especially suitable to explain and illustrate the evolution of Italian scenery, where the liberalisation of energy sectors has enabled the consumers to choose their own supplier of gas and electricity. This could be achieved detaching the production and sell of the service from the management of the related network. In this way, it is possible to introduce for the first time a real competition between the suppliers of local public goods and to break off the monopolies of the local incumbent: citizens addressing the same seller, belong to the same "functional jurisdictions", while citizens leaving in the same area can belong to different jurisdictions.

In the future, we can imagine two kinds of jurisdictions: the first one is a small jurisdiction, with high level of localness, where the supplied service is specialized and "customised"; the second one is a bigger jurisdiction, where, thanks to scale-economy, the supplied service is undifferentiated and cheaper.

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I. INTRODUCTION

In recent years Italy has been crossed by profound legislative and regulatory changes affecting the management and the provision of public services. Mainly after a push by the Community institutions, Italy as well has introduced regulations aimed at a cost-effective and competitive management of those services that were once exclusive prerogative of public authorities (central or local) and should be provided to as many citizens as possible.

At the end of the last century the State renounced as progressively as relentlessly to intervene in the country's economy in order to promote in various industrial sectors the research of an efficiency that only free market rules seem to guarantee¹, as indicated by an abundant economic literature².

As a matter of fact, over the past twenty-five years the law was mainly dominated by the presence of the State prevailing on the economy; today, however, the scenario has definitely changed and the roles seem reversed as the economy appears to clearly prevail on the State.

In Italy, the prodromes of these changes can already be seen from the mid 90's by Law n° 474 of July 30th 1994 "*Norme per l'accelerazione delle procedure di dismissione di partecipazioni dello Stato e degli enti pubblici in società per azioni*", ("Provisions for the acceleration of procedures for the disposal of the State and Public bodies shareholdings in joint stock companies") which, for large sections, still governs privatizations: it is during these years, in fact, that following the transformation of public enterprises into joint stock companies, from the point of view of the intervention of the State in the economy, there is the replacement of the State contractor with the State regulator.

Along with this new role of the public power, it becomes necessary to ensure that the disciplines to be observed are, as much as possible, expression of objective market rules. At the same time, the organization of public utilities, that was formerly based on the entrusting of the service to a public legal monopolist usually integrated both horizontally and vertically, and on a tariff structure set at the level of national or local economic policy, is focusing increasingly on a model

¹ For a brief overview of the main doctrines that in the last 30 years have privileged the public management of services and the free deployment of market forces, see Massarutto A. (2002) pp. 90-96.

² On the inefficiencies of public companies compared to private companies, see, among others, Le Grand J., 2003; Dixit A., 2002, pp. 696-727. On the experiences of public service companies' privatization, see Vuylsteke C., 1989; Roth G., 1987; Havrylyshyn O., McGettigan D., 1999.

that foresees the vertical disintegration of production chains in order to liberalize the entry of operators (public and private) in those stages that are not characterized by the presence of natural monopolies, and the replacement, where possible, of tariffs with market prices (as last result of the introduction of competition).

The underway paradigm shift, which for many aspects can be described as historic, has interesting elements of analysis from multiple points of view. This article aims to read the phenomenon in the perspective of the “theory of clubs”, which explores the geographical extent and density of population of the areas in which a single public body (central or local) is providing one or more public services to the resident community in order to identify their optimal allocation³.

In particular, we focus on energy services because they have been considered the best services to exemplify some considerations that will follow as they, perhaps more than others, are showing effectively the first hard changes through the application of the provisions introducing the sector liberalization and competition in the sale stage⁴.

First, gas and electricity, until a few years ago supplied in economics (i.e. directly by the municipalities), or from the so called ex-municipal firms, are two perfect examples of local public services, meaning with this concept services characterized by non-rivalry in consumption (and in this sense are public), but whose access is made easier only for the citizens of a certain local system (hence the character of place) (Bellandi, Petretto, 2002).

Secondly, being services provided through a network that directly connects final users to the service provider, they are also perfect examples of club goods⁵, because the supplier can exclude from its provision those who don't pay for the service.

³ “We will speak of an *optimal allocation* (...) when, in addition to the efficient supply of public goods and the efficient distribution of a certain number of individuals across jurisdictions, each jurisdiction has its optimal population size and thus there are an optimal number of jurisdictions in the federal state”. Wellisch D. (2000), p.88.

⁴ Here, we refer in particular to the two community directives, the 96/92CE on the electricity market, and the 98/30/CE on the gas market, and the relating Italian laws of transposition, the Legislative Decree n° 79 of the 16th march 1999, “Attuazione della direttiva 96/92/CE recante norme comuni per il mercato interno dell'energia elettrica” (the so called “Bersani Decree”), the legislative Decree n° 164 of the 23rd may 2000, “Attuazione della direttiva n. 98/30/CE recante norme comuni per il mercato interno del gas naturale, a norma dell'articolo 41 della legge 17 maggio 1999” (the so called Letta Decree).

⁵ For a definition of “club goods” see paragraph 3.

II. THE REGULATORY FRAMEWORK: A PARADIGM SHIFT

Before the introduction of the two Community directives, the supply of gas and electricity was considered an essential service whose management had necessarily to take place under monopoly conditions (or in special regime), since this procedure was considered the proper counterweight to public service obligations imposed to the sole operator and allowed, as it was the case for other public utilities, to subsidize the less profitable activities of the chain with the most profitable ones. Furthermore, also the economic theory “has legitimized the division between activities run in a competitive regime and protected sectors, stressing that in this second area there were market failures arising from the presence of natural monopolies, externalities and imperfect information due to the short-sightedness of individuals” (Solimene, 2002), suggesting that the recourse to public monopoly or regulated regimes for the management of public services was the best solution to avoid the dissipation of social welfare and to achieve an efficient allocation of resources.

Over time, however, this role of the State as the "guarantor of the general interest" has been questioned especially by the *public choice* theory, which has suggested that in reality there are possible distortions in the conduct of bureaucratic machineries with respect to the pursuit of citizens interest, which are reflected directly on the decision-making processes within the public undertaking; in other words, the State seeks to maximize a utility function that at times may not coincide with that of the community it represents and “the frequent failures, primarily blamed by theorists and politicians of errors of evaluation of managers, should be interpreted as deliberately pursued, resulted from the bargaining process between different interest groups” (Gobbo, 1997).

The awareness that market failures can be replaced by state failures has accelerated the process of redefinition of state/market boundaries that, in the late 90's, began to affect also the gas and electricity sector. The previous model of public management of services with administrative prices, largely widespread in Europe, laid in fact itself open to several criticisms including, in particular, the absence of the risk of losing control in favour of other entities (the so-called risk of take over, that characterizes especially the listed companies) and the minor power of control reserved to backers. The success of the public choice theory has helped to accelerate this process.

Another aspect that is not less important than the previous is the awareness that through the

energy sectors liberalization consumers would have the possibility of choosing from whom to buy the services, thus increasing their satisfaction and being able with their choices to boost operators to enhance the quality of the provided services⁶.

Not all stages of gas and electricity production chains can be opened to competition in the same way: some stages such as the management of transport and transmission networks are typical examples of natural monopoly and the only possible competition is that for the management of infrastructures through competitive bidding (competition for the market); in others, such as the sale, it is possible the coexistence of several entities offering the service and therefore they can be completely opened to competition (competition in the market).

To differently regulate these stages, firms had to be unbundled (the so-called unbundling): this choice was necessary to make easier and more transparent the access to essential facilities for all the undertakings concerned. For those firms operating the networks and at the same time directly involved in the upstream or downstream stages, it would have been in fact quite easy to overcome or eliminate competition in the liberalized stages (production and sale) by imposing excessively high access prices to distribution networks.

Only by maintaining differentiated the players operating at different stages of the chain, the access to essential facilities could be regulated to ensure that it will occur in a non-discriminatory way. At present, therefore, the final stages of energy chains have a local distribution network whose property is in most cases in the hands of local authorities (or to ENEL in the case of the electricity sector) and the management will entrusted in the future through competitive bidding, while the sale has been liberalized and can be operated by anyone (subject to obtaining a permit from the Ministry for the Economic Development under art. 17 of the “Letta Decree”). Therefore, citizens are no longer bound to buy gas and electricity from the local or national monopoly, but they can freely choose their supplier and organize themselves into buying groups even if they are hundreds of miles away: one of the most important novelties, then, is that the geographical location of the end user is no longer a constraint to the choice of the public services provider. This latter element is at the basis of the latest developments in the economic theory

⁶ “It’s a natural presumption that consumer choice is in general preferable to state planning. Only in special circumstances, where there are significant market failures, is this general presumption overruled. These special circumstances can arise on the demand side – people are all-informed or irrational, or their choices adversely affect others- or on the supply side – costs are such that monopoly supply is more efficient or the firm’s activities are damaging to others. And even in these cases, the costs of intervention may exceed those of the failures themselves, and, in any event, market-based instruments can help to alleviate problems such as pollution”. Helm D. (2004), p. 259.

that studies issues related to the provision of public services and, more generally, of club goods (we will define them in the next paragraph): we refer here to the studies focusing on the determination of the optimal geographic scope (region, state, states federation) to efficiently structure the public services provision and, more specifically, the theory of functional federalism.

The following paragraphs will focus especially on the gas sector: this choice is dictated by the fact that in this area, the liberalization process is at a more advanced stage and, therefore, is exemplary of the evolution for the future scenarios of the other energy services.

In fact, many of our considerations may be ascribed to the electricity sector and, more generally, to all the LPS where the services supply can be unbundled from the network management (for which it is no longer necessary to respect the geographical link between the company providing the service and the community benefiting from it). The liberalization process of the electricity sector has been delayed compared to that of gas and the existence of a wide range of consumers bounded until the first of July 2007 (the civil ones) would oblige to distinguish between qualified customers and those who will be qualified only after that date; in fact, the following considerations refer only to the former, while for the latter it is not possible to choose the supplier and therefore to speak of federalism, even if, in perspective, the two energy sectors are designated to become very similar.

III. A POSSIBLE UNDERSTANDING KEY. THE FUNCTIONAL FEDERALISM

The scenario that is shaping up as a result of the energy sectors liberalization can be interpreted through the theory of functional federalism formulated in the 90s by Casella, Frey (Casella, Frey, 1992) and Eichenberger (Frey, Eichenberger, 1996, and Frey, Eichenberger, 1999), which can be regarded as a development of the clubs theory formulated in the mid '60 by James Buchanan (Buchanan, 1965). A club is defined as “a volunteer group of individuals, in which individual members derive mutual benefits from sharing the same consumption and cost of production/supply of goods or services marked by the following characteristics: a) full or limited technical possibility of exclusion, b) partial rivalry due to phenomena of congestion in the

consumption and/or in the production of good, possibly mitigated by the existence of economies of scale or size” (Rebba, 1998).

If we assume that a state is divided into administrative areas (e.g. regions), which we call jurisdictions, and within each area there is only one supplier of a particular club good for the entire community that lives in this area, then you can make a comparison between the different supply systems of the various communities.

Economic theory identifies different ways of comparison (Kerber, 2003): the first is the so-called yardstick competition, which occurs when only information can cross the boundaries of a jurisdiction, while goods, services, companies and consumers are confined in the origin jurisdiction. In this case the systems are closed because the citizens of a certain area can only consume goods and services produced by firms of the same area and there is no factors mobility; the only possible comparison is between provision systems thanks to information exchange. In fact this is the previously mentioned “competition as learning process”.

We have a second more articulated level of comparison where businesses and households in a definite region can buy goods and services produced by firms of other regions. In this case the provision system characteristics can affect directly the goods production costs, making the undertakings of a certain jurisdiction more competitive than others. Therefore, the existence of a single market puts into competition firms from different jurisdictions and, indirectly, their systems for the provision of club goods.

A third level of comparison, more complex than the previous ones, is possible when citizens can move from one jurisdiction to another. In this case the size of a jurisdiction will depend on the attractiveness that it exerts on citizens, which in turn depends, among other things, on the provision system of the club goods and its features (price of provision, service quality, likelihood of congestion of the service, etc..).

Finally, we have the fourth and most comprehensive level of comparison when a firm can choose the supply system without having to change its location. In this case the competition between jurisdictions is the highest since the transition costs and costs of transferring from one jurisdiction to another, which often represent insurmountable exit barriers for those who would

like to switch provider, are cleared. This scenario, where economic actors (firms, households, etc..) can freely choose the jurisdiction to which they belong without having to physically move to another area, is described by the theory of functional federalism.

Many Federalist theories have suggested scenarios in which it is possible a third level comparison between jurisdictions: amongst the most important theories we mention the models developed by Buchanan and Tiebout, both of which represent an attempt to identify the jurisdiction optimal scope and the right size of the users community to obtain an efficient local public services provision, from both the allocative and productive point of view.

Buchanan's theory states that the LPS provided by local communities are treated as club goods (as you can exclude from their consumption who does not contribute economically to their production) and that the population can be divided into many clubs on the basis of the LPS enjoyed. To determine the optimal size of these communities , it is necessary to take into account, on one hand, the congestion costs and, on the other hand, the benefits resulting from the sharing of the provision costs of the LPS between those who benefit from the service itself. The curve of the average cost per capita characterizing the production of these services assume a U-shape and “the optimal number of service users and the efficient level of supply correspond therefore to the minimum point of this cost curve” (Rebba, 1998). The major criticisms raised against this theory refer mainly to the lack of attention to the <<spatial>> elements of LPS and other characteristics such as the limited (or absent) divisibility of the consumption and the production of goods, the existence of economies of scale and scope.

Tiebout's theory (C. M. Tiebout, 1956) is a model of *jurisdiction shopping* and foresees the creation of local communities of users who have similar preferences regarding the LPS provision: to create such a situation, which would allow to achieve in the same place both the productive and allocative efficiency, conditions that can be difficult to find in the real world are necessary. The theory, in fact, provides among other assumptions that the costs of moving from one jurisdiction to another are equal to zero, there is no externality between one jurisdiction and another, citizens have full information on LPS provided by different jurisdictions and the optimal number of residents in a certain jurisdiction can be determined, so as to minimize the cost per capita of the LPS production and provision.

The theory of functional federalism seeks to overcome the limits of this and other previous theories, making possible a comparison of fourth level between jurisdictions. The basic concept underlying the model is that of functional, overlapping, competing jurisdictions (FOCJ): “FOCJ arise on the basis of the services to which they are appointed (these are insurmountable limits to their competence: in this sense they are *functional*), they may overlap geographically and functionally (*overlapping*), they compete to attract new members (*competing*) and they have enforcement powers against their own members, they can also establish rates and charges for the use of the offered services (*jurisdictions*)” (Abrescia, 2003). We can use the original words of the authors, also: “<< functional federalism >>: a regime where individuals organize themselves in a pattern of overlapping jurisdictions without explicit ranking, with each jurisdiction responsible for the provision of a specific class of public goods” (Casella, Frey, 1992). The FOCJ appear immediately a concept far more flexible than clubs or jurisdictions developed by the previous theories and being not closely related to a defined administrative geographical area, overcome the problem of transfer costs from one jurisdiction to another; in fact, in FOCJ it is not the user who receives the services to seek and move to the jurisdiction that best meets its preferences, but it is the latter that is capable to make its offer of goods and services to the citizen without obliging him to change the place of residence.

This model, by clarifying some aspects of the concept of jurisdiction, is particularly useful to describe the current situation of companies that provide energy services at local level, and to interpret the dynamics of their development.

Functional federalism is based on a territory division into jurisdictions that are defined as “a democratic governmental unit with authority over its citizens, including the power to tax” (Frey, Eichenberger, 1996) In our view, in the light of the described liberalization process of public services, the concept of jurisdiction may be generalized. In fact, the federal system constituted by FOCJ, as pointed out, is not imposed from above but rises from the bottom in response to citizens' preferences and their formation can occur through either the citizens' initiative or existing territorial authorities.

The first case, namely the creation of a federal system where the LPS are provided by private citizens organized for this purpose, is usually regarded as the most unlikely because it would be a

radical development of the current territorial system structure and mean a sort of <<social privatization>> of local public services and other public functions of government moreover, this hypothesis would require “a constitutional decision, which ensures that the emergence of FOCJ is not blocked by existing jurisdictions such as direct competitors or higher level of governments” (Frey, Eichenberger, 1996). While the second case, which foresees the initiative of the existing local authorities, would be more viable and feasible in practice even according to the authors.

At this point, it is useful to make some clarifications regarding the Italian market. First, following the full liberalization of the gas and electricity sale, the provision of these services is no longer an exclusive responsibility of local authorities or public municipal companies, but it can also be operated by private or partly private companies. However, since energy services are still considered essential services for the community, the law foresees that the supply companies, together with the distribution ones, follow certain “public service obligations” that turn into minimum levels of safety, regularity and quality that the supply has to meet (Caiazza, 2004).

Secondly, the application of the horizontal subsidiarity principle, also recalled by the Italian Constitution⁷, provides the state intervention in all those cases where citizens are unable through their own initiative to satisfy certain community needs. As noted, this feature of the subsidiarity principle agrees with the theory that defines the concept of public service on the grounds of the assumption of market failure: the activity for which the market is unable to meet adequately the community needs becomes a public service and justifies the State complementary intervention to the citizens’ initiative (Dugato, 2002).

Thirdly, ever since the entry into force of the Constitution, at least with regards to services characterized by individual fruition⁸, the << subjective >> notion of public service, according to which the concept of "public" coincided with that of "State" or "state", has been gradually replaced by the << objective >> notion according to which a service is public when it is for the public and not necessarily run by the State. In fact, article 43 of the Constitution states that “for purposes of general utility the law may originally reserve or transfer, by means of expropriation and apart from compensation, to the State, to public bodies or communities of workers or users

⁷ Art. 118 of the Italian Constitution states: “States, regions, metropolitan cities, provinces and municipalities shall promote the autonomous initiatives of citizens to carry out activities of general interest, on the grounds of the subsidiarity principle”.

⁸ The services of *individual use* are those “designed to meet the specific interests of individual members of the community, who in fact use them individually” (eg. Transport services), while services of *collective use* are those “designed to meet the interests of the society as a whole”. See, among others, Sorace D., 2002, pp. 113.

certain undertakings or categories of businesses that are related to essential public services or energy sources or monopoly situations and have the nature of primary common interest”.

According to this article, the State *can* repeal the right to run the activities of general interest, but this is not an obligation and the public management of services is not the only solution envisaged by the Constitution. Moreover, from the transfer of certain activities workers or users, which are necessarily subjects of private law, may also benefit. Finally, nothing would prevent from transferring to workers or users business previously run by the State, thus implementing a reverse transfer, i.e. from private to public⁹.

It is important to highlight, among other things, that the clarification made by Frey and Eichenberger about the difference between the concept of FOCJ and privatisation¹⁰ seems to move from the need of internalising the spillovers typical of the collective fruition services. In the case of education and health, in fact, the benefits generated from the services provision also extend to those who do not make directly use of them (as, for example, families without children benefit from a society in which people are more educated). For this reason, there is the need to tax individuals regardless of their direct use of the services (of course, the direct beneficiaries will pay them as users): only a public entity, therefore, is capable to internalise the positive spillovers through taxation¹¹. However, in the case of energy services the presence of such spillovers is not obvious.

Finally, we note that since 1990 (especially with the Law n° 142/90) the LPS sector was hit by a process of profound transformation that has led municipal companies to pursue aims typical of for-profit companies and have a structure similar to the that of the private companies, so the differences between public and private-owned companies have become today very reduced.

All these considerations lead to believe that functional federalism could be made more flexible

⁹ The problem of the ownership of the firm providing public services was already discussed by Musgrave in his theory of the fiscal federalism (that has partly inspired that of the functional federalism) and came at the same conclusions: “provision, as I use the term, means the political process by which such goods are made available, and not their public production. The issue of public ownership of the means of production, the key feature of socialism, is only peripheral to my fiscal economics, the institution of the public sector is needed to complement, not replace, the private sector and has nothing to do with socialism as an alternative order”. Buchanan J. M., Musgrave R. A., 2000, p.37.

¹⁰ “The concept of FOCJ does not just amount to privatization”. Frey B., Eichenberger R., 2000.

¹¹ Also according to Vanberg: “To be sure, *functional* jurisdictions with individual membership may be said to differ from “privatization” if only communes were allowed to operate as service provider. But why should access to the market be restricted to communal suppliers where services are concerned that can be provided on the basis of individual membership? Why should not non-communal suppliers, such as private firms, be allowed to offer their services to citizens, and why should not citizens be allowed to decide for themselves whether they prefer communal or private suppliers? If responsiveness to citizens’ preferences is what we aim at, why should we want to exclude a priori potential private competition?”. Vanberg V. J., 2000, p. 378.

and closer to the current and more widespread interpretation of the concept of "public service", especially after the liberalization process repeatedly invoked, if we assume that the jurisdictions may arise from the initiative of both private citizens and existing territorial authorities (in accordance with the already mentioned horizontal subsidiarity principle).

This generalization allow to imagine a concept of "jurisdiction" more articulated and less bound than thought by Frey - Eichenberger since, in this case, it simply coincides with a supply (sale) centre of a definite LPS, or with a group of users who turn to the same seller. Furthermore, at least in the case of energy services, the specifications made by the two authors seem not to be important.

The main difference with the original model of functional federalism concerns the coercitive power the supplier may exercise towards the users belonging to each FOCJ, that in our case is limited to the possibility of demanding the payment of tariffs for the service. In other words, under this version of functional federalism, that we might call subsidiary functional federalism, those providing a LPS do not necessarily have the right to exercise other public functions of governance, in addition to the just described coercitive powers.

This generalization of the concept of jurisdiction, made more general by taking into account the tasks and tools of coercion entrusted to the service provider, and the possibility that the LPS is provided by both a public and private subject do not change, in our view, the distinctive features of the theory of functional federalism (in particular, the possibility to identify jurisdictions that do not coincide with a specific and determined territorial). While other aspects of FOCJ, namely the concepts of functional, overlapping, competing, well describe the competition between companies selling LPS.

As for the functional aspect of FOCJ, the functional federalism identifies some jurisdictions on the basis of the service (function) provided, and foresees that each user can participate simultaneously in several jurisdictions, one for each service from which he benefits. This aspect is particularly suitable, for example, to describe the situation of a citizen who buys gas and electricity from two different companies (each of which identifies a different jurisdiction); however the two jurisdictions can coincide when different services are bought from the same undertaking (as in the case of a multiservice company).

The concept of overlapping also allows to assume the existence of two or more companies (jurisdictions) performing the same function in the same geographical area: this is exactly what happens today in the Italian gas and electricity market following the sale liberalization¹².

As a result, we also have the concept of competing, because since the replacement of the local public monopolies by a competitive market, every citizen (and any eligible customer, in the case of electricity) is free to purchase gas from the firm it prefers, and this implies that every provider has to compete with the others not to lose customers. Companies providing LPS have found themselves suddenly in competition in the free market and have had necessarily to employ their internal resources in order to provide the services at a better quality/price ratio than competitors.

It is worth to note that, until now, competition in the energy sectors in general and in the gas sector, in particular, was very limited. This impasse is due to several reasons and we can highlight at least three of them.

First, the liberalization process, which, given the scope of the new introduced features, can not be assimilated rapidly, has still to be finished and, consequently, the emerging market is still suffering the inertial elements which limit *de facto* the meeting of supply and demand, especially with reference to the import of gas in Italy, the introduction of competition at this stage, which is still affected by the presence of a strong dominant position, is essential to obtain the positive effects on the downstream stages of the industry¹³.

Secondly, distribution tariffs make economically profitable to geographically concentrate the flow of sold gas, in order to cut the share of fixed costs (Mazzantini, 2006). Many small provisions scattered on the national territory are far less favourable than a few (or even one) suppliers geographically concentrated in one place only: this is a major obstacle to seek customers outside the area where firms, especially small-sized, have traditionally operated.

Thirdly, the possibility of the former municipal company (which is traditionally the one that sold gas in a certain area before the liberalization) to run the local distribution network (with a

¹² The concepts of *overlapping* and *functional* comes from the fact that the supply of each club good to be efficient requires an optimal size of the community of users that can be different from the one required from the other club goods: "but if the optimal club size depends on the specific public good, then all consumers in a theoretical model should be divided in a complex system of overlapping jurisdictions". Casella A., Frey B., 1992.

¹³ See Autorità Garante della Concorrenza e del Mercato, 2002, Case A329 "Blugas-Snam", in *Bollettino* n° 47/2002; Autorità Garante della Concorrenza e del Mercato, 2005, Indagine conoscitiva IC22 "Stato della liberalizzazione dei settori dell'energia elettrica e del gas naturale".

transitional period that ends 31/12/2011) makes difficult the entry into new markets for companies other than that of origin. The local incumbent controls in fact a variable more than rivals, namely the price and access terms to the distribution network. At present then, the Italian gas market is divided geographically in a way that recalls very closely the territorial division of the former municipal companies.

IV. IMPLICATIONS OF THE FUNCTIONAL FEDERALISM

1. Public and private

The LPS liberalization and the introduction of competition into their supply would allow to achieve, on the supply side, higher levels of efficiency and, on the demand side, higher rates of satisfaction. In fact, citizens maintain the possibility to express their preferences through both the *exit option* and the *voice option* to correct the guidance and the choices of the providers.

In general, the *voice option* can be exercised through complaints to the provider when the service does not meet consumers' expectations or what is foreseen by the General sales Terms (the so-called Carta dei Servizi) while the *exit option* is exercised by choosing a different service provider (which essentially means to change your belonging FOCJ, at least with respect to that service)¹⁴. Especially the second option represents the true revolutionary aspect of the liberalization process since, to date, in case of dissatisfaction, the citizen could exercise indirectly the *exit option* only by moving elsewhere. While the exercise of the option becomes now more realistic, because citizens, who are not satisfied with the service, can simply change provider.

More in details, if the service is provided by public companies, the *voice option* is exercised effectively also through the election of the political class that appoints the leaders of the FOCJ providing the service, thus the control exercised (indirectly) by voters is added to that exercised by the market. To note that in recent years local governments are increasingly creating proper holding at the head of more or less large groups of shared undertakings providing SPL, and if, on the one hand, this allows to appoint at the head of each company the most competent people

¹⁴ "Accordino to a "Tiebout" mechanism, individuals and communities are free to leave their current functional jurisdiction to join an other jurisdiction that best meets their preferences in toto (total exit) or just for some local public goods (partial exit). Thus, individuals who choose a particular FOCJ can be considered as consumers choosing their "favourite basket" of local public goods in order to maximize their utility given some spatial, temporal and informational constrains (which define the degree of accessibility to the service), but without (...) needing to change their residence". Rebba V., 1998, p. 378.

and technicians in that field¹⁵, on the other hand there is always the risk of attending a "political management" of the positions of prestige, which may become, as they are more than they were in the past, goods of exchange between parties. Therefore, a reasoned and consistent exercise of the *voice option* by the citizens becomes increasingly more important.

2. Local rootedness and great dimension

Since the system of the functional federalism is added and not substituted to the hierarchical organisation of the existing local authorities, trying to increase the flexibility level by taking as reference the lowest level of local government (that in Italy corresponds to the municipalities¹⁶), we can identify on the basis of their scope three different types of FOCJ:

- intra-community club (smaller than a single municipality)
- community club (its scope coincides with that of the municipality)
- inter-community club (that provides the service to two or more municipalities)

This classification is useful to try to identify some possible developments of the FOCJ. In the gas case, it seems impossible to create FOCJ that have a dimension smaller than the municipalities (intra-community), because this would mean to split up the former municipal firms into smaller entities contradicting both the logic of the reform introduced by Letta decree and the purely economic considerations (since to have more than one firm running and selling the service in a very restricted area would mean to multiply the operational and organizational costs and lose the advantages linked to scale economies).

Said that, also in the light of what occurred and is still occurring in Italy, it seems possible to identify two trends of development: the first is given by the widening of the territorial area where the firm providing the service operates, in order to exploit the scale economies and have, eventually, the possibility of being quoted in the exchange, the second refers to the formulation of a growing number of monofunctional governance units specialized in providing a single service of relatively small size, such as, according to Rebba, "the special districts (clusters), which provide community services characterized by a significant degree of localness" (Rebba, 1998).

¹⁵ "Quite another advantage of FOCJ is that they open up the politicians' cartel ("classe politique") to functionally competent outsiders. While all-purpose jurisdictions attract persons with broad and nonspecialized knowledge to become politicians, in FOCJ it is rather persons with a well-grounded knowledge in a particular functional area (...) who are successful". Frey B., Eichenberger R., 1996, p. 320.

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The two trends clearly respond to different necessities: in the first case, in fact, the agreements between local communities belonging to the same hierarchical level for the creation of more extended FOCJ are aimed in particular at implementing common policy of development that will increase the efficiency in the provision of the LPS thanks to the cost reduction and the exploitation of economies of scope and scale existing in the sale or distribution stage. This model, moreover, allows firms to achieve sufficient dimensions to be quoted in the Italian Exchange and find in this way new capitals for development and growth.

In the second case, the agreement between a certain number of citizens living within the same local community are aimed at make the supply of a certain LPS more adequate and in accordance with local populations' needs. This second solution can be particularly useful in those areas characterized by the presence of a productive fabric which is especially homogeneous and geographically concentrated, as for instance in the case of the industrial districts, or in all of those cases where we prefer to maintain the decision-making centres closely rooted in the territory because the LPS supply is considered, by the local authority, a mean of *local governance*.

V. CONCLUSION

The theory of functional federalism seems to be particularly useful to interpret the dynamics that characterize the Italian energy sectors in the last years.

These markets appear today to be the most advanced ones with respect to the possibility of introducing a true competition among providers and a real opportunity of choice for consumers: the possibility of unbundling the network management and the service supply has, in this perspective, a key role for the removal of the entry barriers in each single local market (being understood the necessity of regulating carefully the access to the distribution networks so that their management does not give privileges to local incumbents). In these sectors, therefore, the technology and the structure of the chain make possible to put in competition operators localized in different areas and geographically distant extending the market to the national level (at least).

The revolutionary aspect of the reform of certain local public services – such as the energy ones – caught by the functional federalism theory is the possibility of releasing the supply of these services from their “geographical dimension” interrupting the biunique relationship between the municipality (as LPS supplier) and the users that until some years ago seemed to be insurmountable.

To note as in the last years also the Constitutional Court has recognized the groundlessness of all the local and regional provisions tending to privilege local service supplier or contractor at the expenses of those coming from areas without stable relations with the territory where the service has to be supplied or the contract has to be realized¹⁷.

The energy market evolution seems to predict the development of two rather different types of FOCJ: on the one hand, there will be jurisdictions offering undifferentiated, standardized and low-quality services, but at low prices; on the other hand, there will be room for the diffusion of jurisdictions offering more specialized, high-quality services maybe with additional services and at higher prices, which are addressed mainly to a niche demand.

¹⁷ This discrimination is not "based on any technical reason, neither can be considered justifiable in the name of efficiency and good administration, as is "quite possible that even firms having headquarters and organization outside the region possess the necessary – and required by the regulation and the calls for bids – technical and organizational requirements to assure an efficient execution of contracts" Constitutional Court, "Sentence n° 440, 22th december 2006".

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