Market Monitoring

An application to Italy of the EU methodology

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Overview

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1. Why is Italy interested in this project?

➢Market monitoring consists of a horizontal screening aimed at identifying a relatively limited number of sectors offering the greatest potential for growth and adjustment and which present signs of poor market performance in terms of integration, competition and innovation.

➢In a time of crisis the **greatest challenge for Italy** as well as for other countries is to come up with **immediate policy responses**, however, **without placing the priority on short-term needs** that could dampen the momentum of the reform processes.

➢A long-term perspective requires the **identification of sectors experiencing structural problems** also prior to the crisis. Pre-existing long run weaknesses may hamper the exit form the current recession if they are not dealt with.

➢We are interested in market monitoring as an evidence –based tool allowing for the better **identification and prioritasion of inefficient markets** where adjustments can deliver gains in terms of growth and jobs.

Reference scenario in terms of INTEGRATION

Balance of payments (billions of euros)	2004	2005	2006	2007	2008
Current account	**-13.1**	**-23.6**	**-38.3**	**-37.7**	**-53.6**
Goods	8.9	0.5	-10.2	3.2	-0.7
Non-energy products (1)	36.9	37.5	37.5	47.9	56.6
Energy products (1)	-28.0	-37.0	-47.7	-44.7	-57.3
Services	1.2	-0.5	-1.3	-7.1	-7.4
Income	-14.8	-13.6	-13.6	-19.6	-29.5
Transfers	-8.3	-10.0	-13.3	-14.2	-16.0
of which: EU institutions	-6.5	-8.2	-8.1	-8.4	-10.3
Capital account	**1.7**	**1.3**	**1.8**	**2.3**	**0.8**
Intangible assets	..	0.1	-0.1	-0.1	..
Transfers	1.7	1.3	1.9	2.3	0.8
of which: EU institutions	2.8	3.7	3.8	3.3	2.2
Financial account	**9.0**	**20.9**	**25.4**	**26.2**	**49.6**
Direct investment	-2.0	-17.6	-2.3	-37.0	-18.3
Outward	-15.5	-33.6	-33.5	-66.3	-29.9
Inward	13.5	16.1	31.3	29.4	11.6
Portfolio investment	26.4	43.4	44.3	18.1	118.5
Equities	0.5	-16.0	-8.8	-0.3	70.4
Debt securities	25.9	59.3	53.1	18.4	48.1
Financial derivatives	1.8	2.3	-0.4	0.4	6.8
Other investment	-19.6	-8.1	-16.7	46.2	-51.8
of which: MFIs (2)	-10.0	27.0	44.0	83.0	-18.5
Change in official reserves (3)	2.3	0.8	0.4	-1.5	-5.6
Errors and omissions	**2.4**	**1.4**	**11.1**	**9.2**	**3.2**

(1) Based on Istat foreign trade data. – (2) Excluding the Bank of Italy. – (3) A minus sign indicates an increase in the reserves.

➤ International trade and foreign investments flows have worsened in the past few years.

➤In 2008 the inflow of direct investment into Italy fell by 60.4 per cent, from €29.4 billion to €11.6 billion (equal to 0.7 per cent of GDP). **Source: Bank of Italy**

Reference scenario in terms of COMPETITION

➢ *Italian practices still have significant scope for improvement in a number of policy areas. A coherent and well implemented programme of reform could help Italy better overcome the crisis, improving its relative performance compared with other Eurozone economies, attracting investors and empowering its entrepreneurs to compete and create better-paying, more productive jobs. The policy areas highlighted for attention include, among others, improving the performance of key service sectors such as retailing, transport and professional services."* Source: **OECD**, **Regulatory Reform in Italy: Better Regulation to Strengthen Market Dynamics, 2009**

➢ *"In some public services having greater relevance for the national economy and citizens wellbeing there is evidence of poor qualitative levels, unsatisfying economic conditions, competition distortions and entry barriers for new competitors. These sectors can be identified in: post and telecommunication; transports; electricity and gas; oil distribution; bank and insurance." Source:* **Italian Competition Authority**, **Reforms proposals for the annual law for market and competition, February 2010.**

Reference scenario in terms of INNOVATION

Figure 2: Innovation performance (2008 Summary Innovation Index)
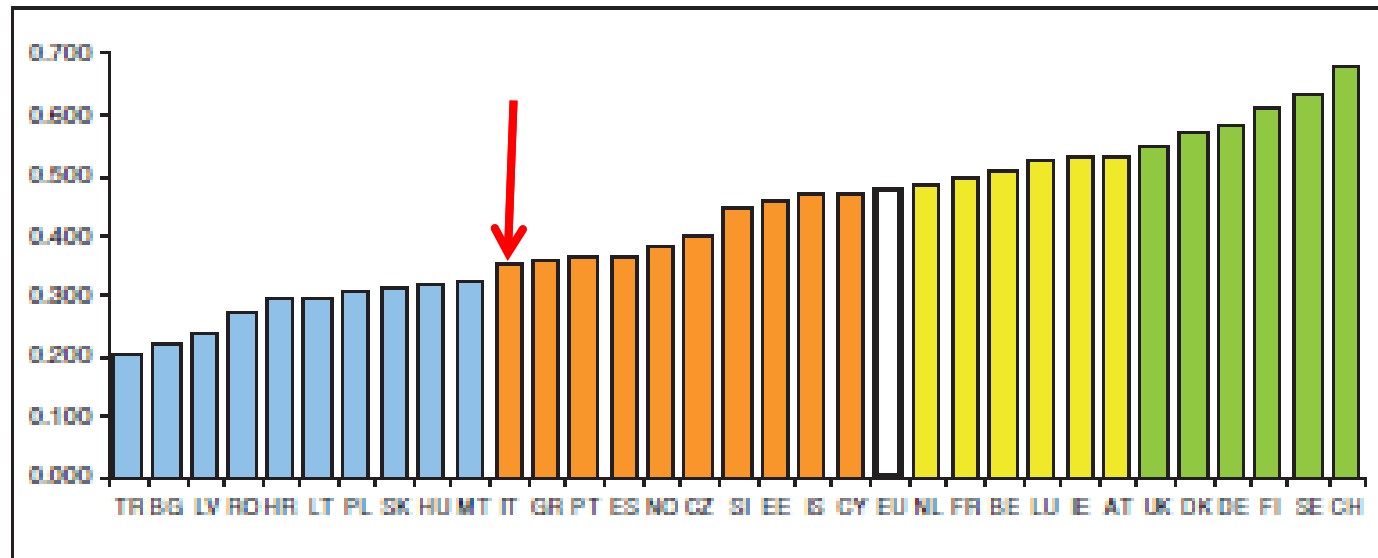
Reference data for most of the underlying indicators are for 2006 and 2007.

For Italy, innovation performance is below the EU27 average and the rate of improvement is also below that of the EU27. Relative strengths, compared to the country's average performance, are in Finance and support and Economic effects and relative weaknesses are in Human resources, Firm investments and Linkages & entrepreneurship. **Source: European Innovation Scoreboard 2008**

2. Methodology

In this first phase Italy replicated the exercise made by the Commission at EU level using the revised methodology and the short list of indicators. The selection process has followed the core selection diagram suggested by the Commission.
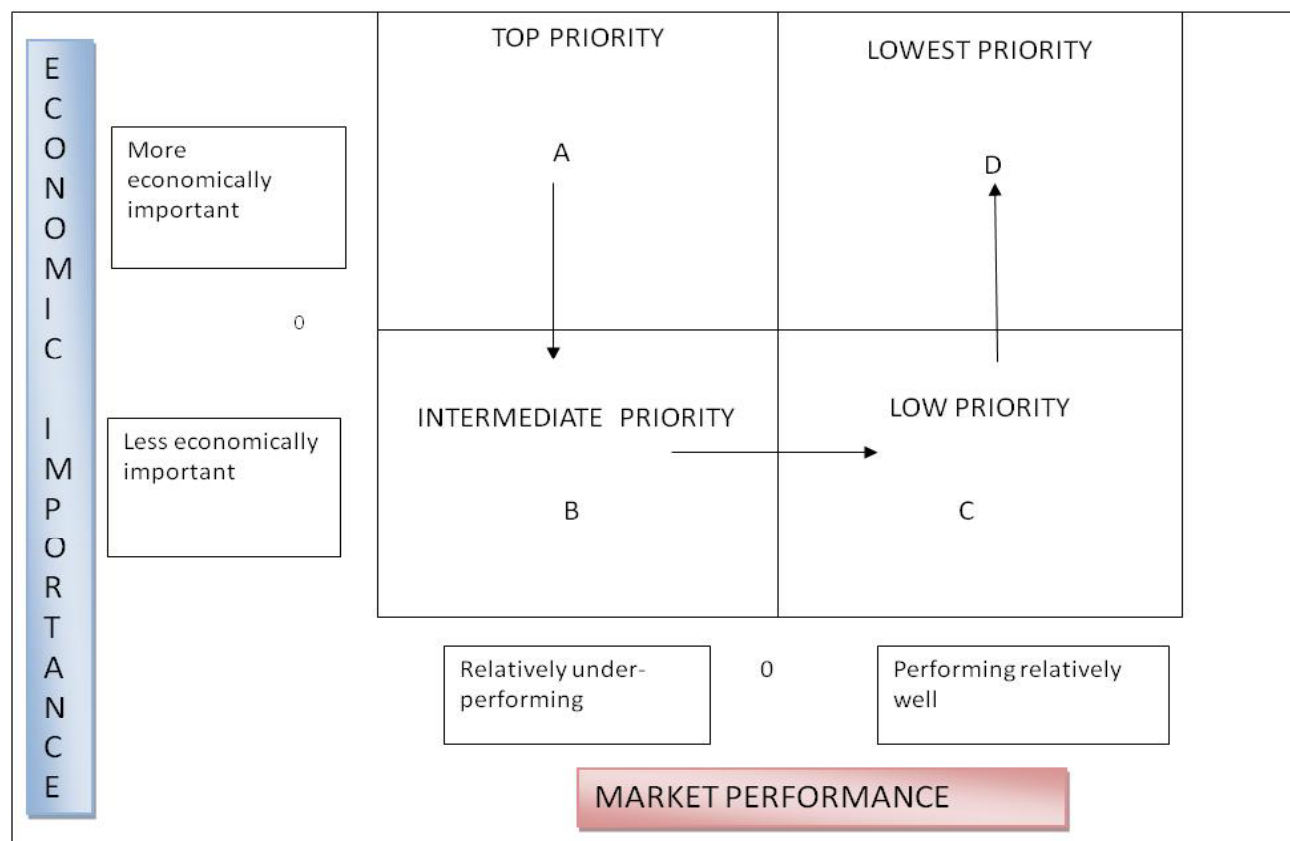
Methodology - Market performance indicators

1. Competition   Mark-ups (Christopoulou and Vermeulen, 2007)

                      C4 (Orbis database, 2008)

                      TNF (Orbis database, 2004-2008)

2. Integration   *Openness (Eurostat, 2005)*

                      Foreing Control of Enterprises (Eurostat, 2003-2005)

                      Price dispersion (ISTAT and Eurostat, 2005)

3. Innovation   ICT (EUKLEMS database, avg 2001-2005)

                      Quality of Labour Index (EUKLEMS database, avg 01-05)

                      Labour Productivity Growth (EUKLEMS database, 95-05)

Methodology - Economic Performance Indicators

1. *Value added share*

    (EUKLEMS, March 2008, 2005 reference year)

2. *Consumption share*

    (ISTAT, 2005)

3. *Investment share*
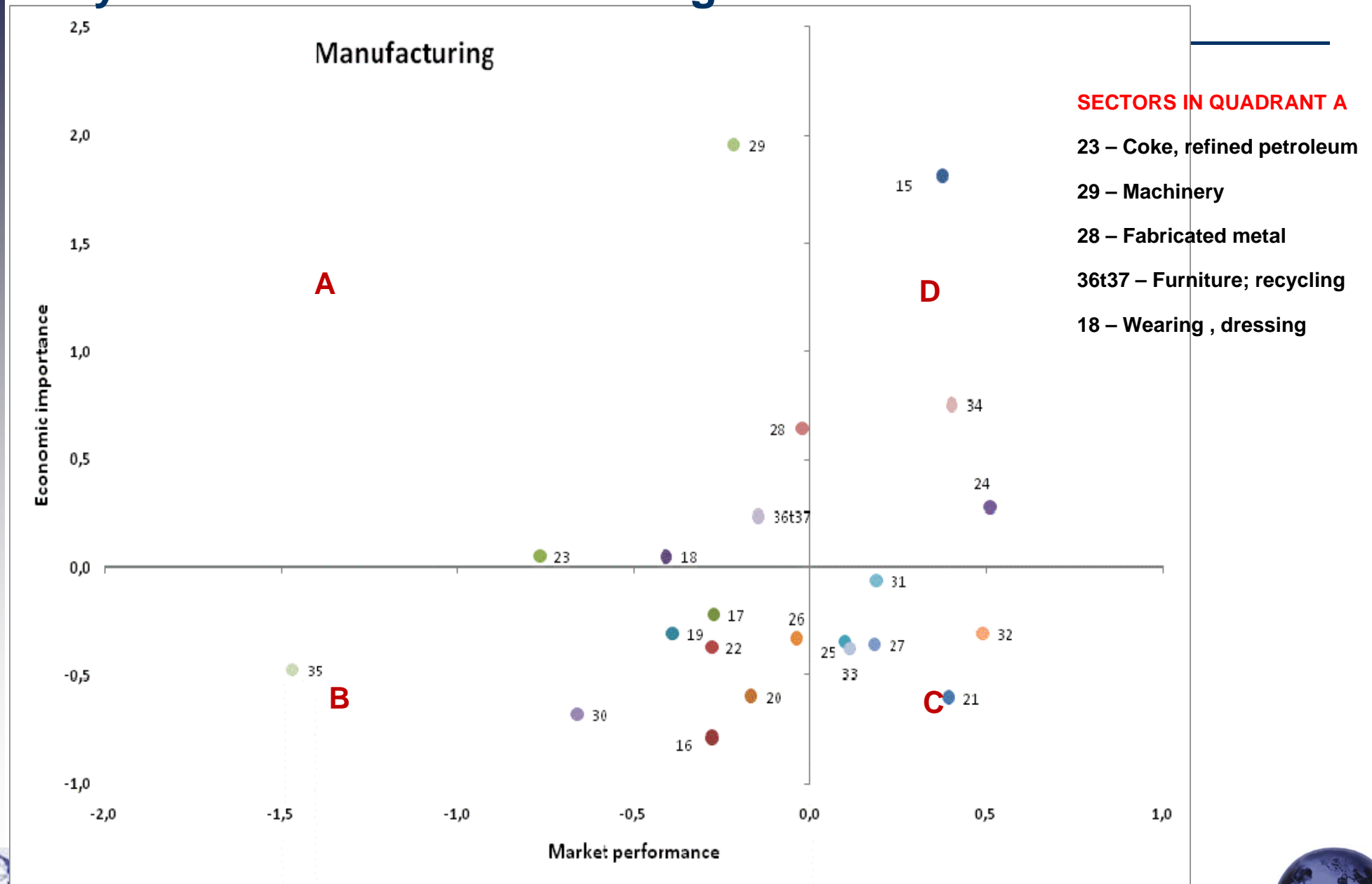
    (ISTAT, 2005)

Notes on the adopted methodology

➢ Each indicator is normalized and then an average is taken for each category

➢ No access to the Thompson Financial Services database on mergers and acquisitions for Italy
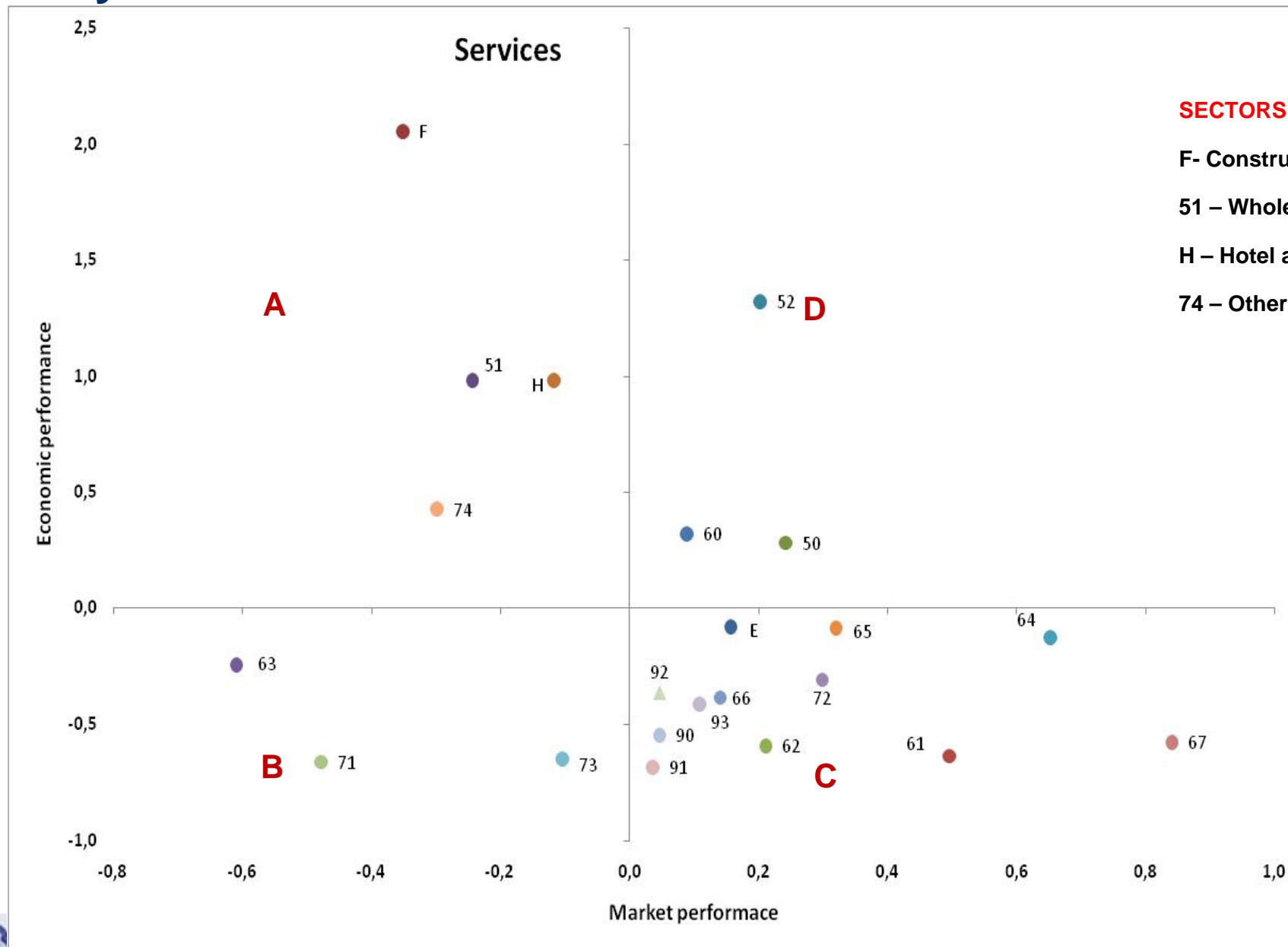
Foreign Control of enterprises: the ratio of Italian enterprises controlled by a EU25 institutional unit over the total number of Italian enterprises by NACE sector (Eurostat 2003-2005)

➢ **Price dispersion:** coefficient of variation of prices (i.e. standard deviation over average) calculated as the ratio of Italian over EU25 average of monthly price indexes for the year 2005 (ISTAT and Eurostat, 2005)

Italy - Results for manufacturing sector

SECTORS IN QUADRANT A

23 – Coke, refined petroleum

29 – Machinery

28 – Fabricated metal

36t37 – Furniture; recycling

18 – Wearing , dressing

Italy – Results for services sector

Is the methodology developed at EU level applicable and meaningful at country level?

To answer this question we evaluated:

A. The convergence of signals of market malfunctioning between Italy and EU

   – A high number of matching sectors allows for a prioritisation of interventions at EU level and facilitate the phase of in-depth analysis of causes of market malfunctioning.

B. Implications for Single Market

   – The correct evaluation of market malfunctioning at national level through meaningful and available indicators can provide sound-evidence grounds for the development of policy options aimed at a fully integrated internal market.

A- Convergence of signals: comparison of results for most problematic sectors

➢ In Italy 11 sectors (6 from manufacturing and 5 from services) resulted economically important and poorly performing. At the EU level the sectors found in the same quadrant are 9.

➢ 7 sectors out of 11 found for Italy in the quadrant A match with the top priority sectors found at EU level.

➢ Sectors resulting as intermediate priority (quadrant B) in Italy are 12 (14 in EU). 5 of these are the same at national and EU level. Of particular relevance is "Research and development", resulting as relatively underperforming both at italian and EU level.

There are convergent signals of market malfunctioning at national and EU level

B – Implications for the Internal Market

➤ To translate the methodology at national level with the aim of contributing to a better understand of market malfunctioning it is necessary to **work extensively on the proposed indicators**. Some of them are best suited to monitor sector performance from a EU wide perspective rather than from a national perspective (e.g. Integration indicators).

➤ Market monitoring is a strategic tool to ensure that priorities are grounded in sound economics but it is important that it is tested at national level

Need of further involvement of Member states to apply the methodology internally to strengthen the results at EU level and translate them into policy actions.

Comments and remarks on Commission methodology after implemementation

➢ The application at national level need to be tailored to the Member State dimension: the <u>integration</u> domain should be reviewed to be significant at national level

➢ In the case of <u>competition</u> it is of great relevance to capture the different dimensions as effective competition is a multidimensional concept reflecting elements of market structure, performance and conduct.

➢ As general issues the indicators selected by the Commission are theoretically ambiguous and may sometimes contradict each other (see for example mark ups and concentration ratios).

➢ The competition indicators are not exhaustive in catching these aspects as they do not take into consideration the role of entry by foreign firms and the market contestability.

➢ In general there is too much attention to market shares: all measures based on market shares or number of firms in the market, such as C4 and TNF, may fail to pick up the selection effect.