

OECD Economic Surveys: Italy 2011



Executive Summary

Italy's economy has passed the deep recession triggered by the global crisis and seems set for a gradual recovery. The strength of this recovery is uncertain: it would be wise to plan for no more than the rather sluggish growth seen in the decade prior to the crisis. Hence, the priority remains structural reforms to increase growth potential, while maintaining a stable fiscal framework oriented towards consolidation, as appropriately pursued during the crisis. Such a policy can sustain confidence in Italian public finances in the face of the large stock of government debt, in turn helping to support the financial system whose health is crucial for the recovery.

Fiscal policy must achieve short-term consolidation and long-term sustainability. Italy now has a satisfactory framework for planning overall spending and revenues over three years; it will be subjected to practical testing over the years 2011-13. The government's objective is to reduce the overall deficit below 3% of GDP by 2012. Plans emphasise expenditure restraint, but the outcomes for some components – a public sector wage freeze, cuts in transfers to the regions and reduced tax evasion – are uncertain. If serious slippage occurs, further cuts in spending and possible action on taxation, starting with base-broadening measures, would need to be considered. Two decades of pension reforms have made a key contribution to long-term sustainability.

Structural policy should remain on the agenda. All the issues identified in the previous Survey remain important. Liberalisation that has begun in services should be completed and extended to other areas, for example transport and local services. Reform of the public administration has shown some initial success in improving transparency, but the deeper aspects of the plans to improve efficiency in public administration must be pursued too. The use of various audit mechanisms, such as regulatory impact analysis and public spending reviews, should become an integral part of public policy making.

University sector legislation has rightly concentrated on the governance of public universities. Universities, potential students and the government all suffer from a lack of clear information on university performance. Problems in individual institutions range from financial crisis to poor recruitment procedures, and overall links to the private sector in respect of both teaching and research are weak. With improved governance in place, tuition fees should be progressively increased to reflect a larger share of costs; this would increase university funding and provide better “price” signals to students and universities. A system of income-contingent-repayment loans would also be needed to support student access to university education. The new quality assurance agency will need to work to develop reliable indicators of performance to aid both students and universities in their planning. Further action to facilitate university-business research collaboration, especially through allowing contracts that permit an efficient share of costs and benefits between individual researchers, their institutions and the private sector, would help to improve university finances and would boost Italy's weak showing on many measures of R&D and innovation performance.

Environmental policies should be better focused on developing economically efficient ways to achieve environmental objectives. Much of this can be characterised as “getting the prices right”, whether through more and better use of taxes and charges or with more use of cost-benefit analysis

to select appropriate policies and assess existing ones. Economic incentives can be better used in water and waste management, but here reform of governance is also needed. Full privatisation of these local services together with the institution of strong national regulators would improve both outcomes and economic efficiency. Policies can be designed to encourage innovation in environmentally friendly technologies, increasing the economy's ability to deliver "green growth", though governments must encourage innovation focused on environmental outcomes, rather than specific technologies. The integration of environment and climate change concerns in other policies, like energy and transport, remains crucial.

Assessment and recommendations

Italy's economy has begun to recover from its worst post-war recession, following the global crisis, but the early signs are that growth may remain weak, as it has been for some years. This relatively poor past performance, with dismal productivity growth, underlines the importance of structural reforms that lead to more robust growth, as identified in past *Economic Surveys*. Another pressing challenge is to continue to improve fiscal sustainability. Although the budget deficit widened less than in many other countries, as a result of the government's responsible fiscal policies, due to the impact of the crisis the public debt-to-GDP ratio is nonetheless rising once again from one of the highest levels in the OECD, against a positive background of relatively low private debt. With bond markets having become more sensitive to sovereign risk, action to bring the budget toward balance remains crucial. Stronger growth would of course also help the debt-to-GDP ratio to decline and public finances to improve. Thus, policies to sustain economic growth and secure fiscal sustainability together would increase the chance of success.

Implementation of policy reforms is key to spurring economic growth

Although activity is recovering from the downturn of 2008-09, the negative effects of the recession on potential output may persist for some time. GDP will not return to its pre-crisis level before 2013-14, still well below the level that would have prevailed under the pre-crisis trend, even though this past trend was itself sluggish. A key priority is therefore to stimulate productivity growth and labour supply. The structural reform agenda should focus on measures to: reduce regulatory and administrative barriers to competition; improve the efficiency of secondary and tertiary education; increase the efficiency of the tax structure; lower public ownership; re-orient the economy towards environmentally sustainable growth and further improve the functioning of the labour market.

The government has already taken important actions in these directions. Recent reforms include, for example, changes to the bankruptcy law, continued implementation of European Union directives that liberalise the energy market and legislation that requires greater use of public tendering for local public-service contracts. In secondary education, changes include reforms of governance and incentives, which should be followed through. Meanwhile, promising reform of higher education is also underway, as discussed in this *Survey*. However, previous plans to liberalise professional services have been stalled for some time and should be speeded up. And high on the agenda should be: less rigid, more employment-oriented, labour market regulation; measures to encourage the return to work, steps to increase activity rates, including among women and youth; following up and completing reforms liberalising access to and competition in professional services; an improved framework for enterprise and innovation; and other competition-enhancing

measures. This Survey also discusses how policy can protect the environment as cost-efficiently as possible, improving the sustainability of growth.

Fiscal policy should put the debt to GDP ratio on a downward trend

Unlike most countries, Italy's response to the financial crisis and recession consisted of shifting expenditure towards social and some industrial support, rather than a deficit-increasing fiscal stimulus. The measures were designed to be budget-neutral, with some small stimulus from the redeployment of public spending towards categories considered to have higher multiplier effects. This stance was appropriate and was largely dictated by the high initial indebtedness and a history of high deficits. So far, this policy has bolstered Italy's position in the debt markets during an extended period of nervousness over bank and sovereign debt. To further bolster credibility, the government tightened policy in mid-2010, to keep the budget on track, in line with the requirements of the Excessive Deficit Procedure of the European Stability and Growth Pact. As a result, the 2010 general government deficit declined to 4.6% of GDP, 0.8 percentage point below the 2009 outcome.

Market nervousness about the global deterioration of public finances makes sustained reduction of public debt more than ever necessary. Fiscal policy in the Public Finance Decision for 2011-13 foresees further tightening to reduce the general government deficit to 2.2% of GDP by 2013. Under the authorities' scenario, public debt would peak in 2011 at just over 119% of GDP and then start to decline slowly to 115% in 2013. The necessity to pursue tightening, with most of the payoffs in terms of debt reduction yet to come, underlines the cost of past policies which had allowed debt to remain too high, though debt had been set to decline before the crisis hit. *Italy should continue to implement fiscal consolidation policies in the foreseeable future.* The government has taken an important step forward by laying out in some detail its spending plans for the period 2011-13 – *continued improvements in fiscal credibility depend on their implementation.* As from 2013, *further consolidation may be required*, as indeed presaged in the Stability Programme released in mid-April, subsequent to the finalisation of this Survey. Guidelines for debt reduction in the medium term are currently being discussed in the European Union.

Planned expenditure cuts may need to be supplemented by other measures

The government plans to achieve practically all of the 2011-13 consolidation by cutting spending as a share of GDP, as well as by reducing tax evasion. Important spending reductions are to come from a public sector pay freeze and reduced transfers to the regions. The pay freeze will expire in 2013, while the balance of regional spending and revenue may be difficult to fully control during the coming transition to extended fiscal federalism. If there is some slippage in these measures, *further spending cuts will be needed, if necessary supplemented by revenue-raising measures such as broadening tax bases by eliminating many tax breaks and reduced rates.* Taxes on a number of environmentally-related externalities could also be introduced or raised. Increasing real-estate taxation can raise revenue because it is difficult to avoid and the short-term distortions are small; there are limits, however, because high property taxation may reduce incentives to save and invest. *Plans to reduce tax evasion should be carried through. To maintain the credibility of these plans, tax amnesties, such as that in*

2009-10 on undeclared funds held overseas, should be avoided. The 2010 fiscal package indeed eschews recourse to such measures.

An enhanced fiscal framework

Since 2008, multi-year budgeting has wisely covered a three-year period. In 2009 the legal basis for the three-year plans was strengthened and budget documentation has become more transparent and provided better information about official projections. This includes analysis of deviations from previous plans and projections. Budget offices in the two chambers of parliament also publish analysis of the official projections. These changes represent a significant improvement in budgetary processes and monitoring. Some countries have also been experimenting by creating an independent fiscal council to monitor and assess official fiscal projections. The Italian authorities may like to consider further improving the system for monitoring fiscal policy by instituting such a council.

The pension reform has enhanced fiscal sustainability

Long-term sustainability requires dealing with future claims, notably pensions. Italy recognised relatively early the long-term fiscal implications of the pension system and took action to defuse it in reforms already in the 1990s. These earlier reforms were gradual, so that pension expenditure is still high but its path has been stabilised relative to GDP, apart from the increase in the ratio in 2008-09 which was entirely due to the fall in GDP. Average pensions relative to wages are higher than in most countries, and activity rates among the over-60s are low. Legislation in 2010 increased the retirement age for women in the public sector, raised the age of entitlement to pension payments beyond the retirement age (using the “exit window” mechanism) and linked changes in the retirement age to life expectancy. The 2010 changes, by raising the effective retirement age, have reduced the projected ratio of pension expenditure to GDP over the next 35 years significantly and, again because of the higher retirement age, raised average pension levels in the long run. Nevertheless, by 2060, the ratio of average pensions to average wages will fall by one quarter from its current level. This is substantial and may require further increases in private pension saving.

The pension reforms require higher activity rates among older age groups

Over the next 15 years the main impact of the pension reforms is projected to be through a steady increase in the effective retirement age, implying significantly higher employment rates among older workers. For workers in larger companies with secure jobs this is simply a question of staying on longer. But labour market turnover may be difficult for older people. Some wage flexibility will be required as productivity likely declines with age for at least some workers. The completion of the transition from a final salary pension scheme to a defined contribution scheme will remove one barrier to such flexibility near retirement age. There are other reasons for seeking greater flexibility in the labour market; youth unemployment is high and female participation still relatively low though increasing. The increased role for enterprise-level productivity in recent reforms to collective bargaining

arrangements should improve overall outcomes, but more progress on flexibility in other dimensions, including for older workers, is needed.

Social protection provision needs to be reviewed

The most significant expenditure items in the anti-crisis measures were *ad hoc* extensions to the employment-based income support schemes (*Cassa Integrazione*) combined with other targeted mechanisms to guarantee income support. The *Cassa Integrazione* (CIG) and its extensions can, like the short-time working subsidies in other countries, help to keep workers attached to the labour market. Following the extensions to the CIG, most firms and workers now have some access to a safety net, though its structure is rather fragmented. For those eligible for the CIG, nominal replacement rates are quite generous, especially for the low paid, though they are subject to quite low ceilings, and can be paid for up to three years. Despite the short-term benefits of keeping workers in firms to help maintain employability, in the longer term it gives insufficient incentive for workers to look for firms or sectors with better prospects. The extensions to the *Cassa Integrazione* were a sensible way to quickly expand social protection in the recession, but reforms – which must of course be within overall constraints on public finances – are needed: *shorter eligibility periods and lower replacement rates for the CIG should be gradually phased in and active labour market measures and job-search infrastructure developed. In the longer term, reforms should aim to develop a less fragmented “flex-security” safety net.*

Transparency can help improve public sector efficiency

Successive governments have recognised the need to increase public sector efficiency but change is slow. *Efforts in the “Brunetta” reform to make more use of output-based measures of performance must continue, choosing measures of performance with care to avoid distorting incentives.* This process can be supported by increased transparency, where some initial success in requiring ministries to publish information on rates of absenteeism and salaries at quite a detailed level has been achieved. However, it is too early to tell whether the programme as a whole will have significant effects on efficiency.

Another useful example of transparency was the publication in 2008 of *Public Expenditure Reviews*, by the Technical Committee on Public Finance. These covered four key spending departments and made specific recommendations for improving efficiency. In the case of compulsory education, for example, many of the recommendations parallel those made in the last *Economic Survey* and are also part of the government’s current programme. The Technical Committee has been disbanded, but legislation in 2009 provided for the State General Accounting department to prepare analysis and evaluation of spending efficiency in each ministry. Further sectoral studies along the lines of those produced by the Technical Committee on Public Finance, which would benefit from using the data on indicators of performance that this process will provide, should be undertaken. As recommended by previous *Economic Surveys* and the OECD’s *Review of Regulatory Reform* in 2009, *more systematic use should be made of Regulatory Impact Analysis, as well as of Cost Benefit Analysis and Strategic Environmental Assessment, when designing specific new policies.*

Tertiary education reform

Tertiary education is a specific case where public funding is already being cut and therefore ways will have to be found to increase efficiency to improve or even maintain performance. While there is currently a lack of internationally-comparable information on tertiary education learning outcomes and research outputs, it is recognised that Italian universities lag behind those in other countries, even though, measured by publications, Italian scientific production is quite substantial. The proportion of Italians with a tertiary degree is among the lowest in the OECD area – between Mexico and Portugal – although this reflects poor participation rates in the past rather than current trends. Indeed, current participation rates are among the highest in the OECD area. In addition, no Italian university is in the top 100 according to two world university ranking systems. The underperformance of tertiary education restricts the supply of skilled professionals.

Universities must satisfy some requirements for accreditation of degree courses, which have been gradually made more stringent. There is no compulsory outside auditing of examination results, nor is there a tradition of anonymous benchmarking through outside examiners. The new quality assurance agency, ANVUR, has, among its tasks, the definition of clear performance measures for universities and to design a matching assessment and reward system. The resulting information should focus on student outcomes and be suitable for benchmarking comparisons across universities. These assessments will be made publicly available, to enable universities to compare themselves with others and to enable students – and their potential employers – to make informed choices.

A controversial issue is the legal status of diplomas, the *valore legale del titolo di studio*. Until recently, in the public administration, simple possession of a tertiary diploma could largely determine promotion or salary decisions, irrespective of performance or responsibilities. While it makes sense to make recruitment conditional on the possession of an appropriate diploma, *reward systems that use the valore legale in place of performance assessment in the public sector should be completely abandoned.*

Giving universities effective autonomy and responsibility

Universities in Italy are already academically autonomous but their decision-making structure, dominated by departmental or faculty groups with insufficient incentive to coordinate a university-wide policy within a strategic framework, has not always led to efficient management in most universities. Greater efficiency should come from systems which decentralise decisions to universities, ensure appropriate autonomy and accountability in their management, and allocate resources according to the demand for their courses by well-informed students and allocate research funds on a competitive basis.

Legislation passed at the end of 2010 is designed to reform governance along the lines required. It would allow strategic and management decisions to be taken by a management board where incumbent academics are widely represented but not dominant; it would also be obligatory to have two or three outside members with relevant expertise. *University reform legislation should be implemented on these lines, providing clear responsibilities and transparency about decision-making. Rectors and management should be held to account for the*

results of their decisions, possibly with salaries or bonuses related to the institution's performance. This would need appropriately qualified rectors, as well as well-adapted funding arrangements.

Legislation in 2008 allowed public universities to convert to private foundations with more autonomy. No institutions have made the transformation, due to unclear financial consequences. Clarifying this, and setting clear accreditation conditions for setting up new private institutions, is necessary if private sector provision is to expand.

Boosting financing through raising tuition fees, implementing income-contingent loans

Currently, tuition fees are relatively low because a university's fee income is capped at 20% of its basic grant from central government, an arrangement which, paradoxically, implies that universities should lower their fees if their central grant is cut. While higher tuition fees would increase income in tight university budgets, benefit the better schools and thereby sharpen competition, and provide incentives for students to finish their courses on time, they can have some adverse effects. *Italy could consider gradually removing the cap on tuition fees, so that students would be responsible for a higher proportion of costs. Concerns about access should be addressed by a system of loans with income-contingent repayment, whereby students would be liable to repay the loans only once they start working and their income exceeds a certain threshold, supplemented if necessary by a system of grants or scholarships.* Evidence from other countries suggests that such a combination of fees and loans does not have the effect that might be feared of causing a significant drop in the number of students. A significant subsidy, whether through student grants or subsidies to universities, should be retained to reflect society's economic and other interests in educating students. The 2010 reform law creates a state-backed system of loans at competitive rates. However, it is not yet clear what level of funding will be made available for such a measure.

Strengthening links with the private sector

The private sector can help to provide both funds and direction to research efforts. The incentive system should allow universities and their researchers to benefit both financially and scientifically from research and innovation-led contracts with private sector companies. Some provisions of the 2010 University law go some way towards this. Increasing collaboration would both increase overall research output and improve its dissemination. Improving framework conditions for entrepreneurship and reducing barriers to entry for small innovative firms is a necessary condition to take full advantage of enhanced research capabilities.

Selection of students, vocational orientation

Lack of selection at entry and a lack of alternative types of tertiary education contribute to slow completion and high drop-out rates. With the exception of medical studies and a few others, universities are not generally allowed to select students at entry – possession of the high-school diploma (*maturità*) is sufficient. Increasingly, however, universities are taking advantage of loopholes that allow selection in other disciplines. *A selection process that*

weeds out weak students at entry (or very soon afterwards) should be generalised, alongside clear guidelines for access to degree courses matched with the type and structure of secondary education pursued. However, maturità results currently have a clear regional bias, so they could not easily be used on their own for selection. The 2010 University law introduces an incentive for students who complete their studies with top grades within the legal duration of the course by converting public loans into grants. It could also be useful to expand the small number of vocationally-oriented tertiary courses. The constitution of the first Istituti Tecnici Superiori in October 2010 represents a step in this direction if they can develop along the lines of the two-year courses, strongly integrated with commerce and industry, offered by the French Instituts Universitaires Technologiques.

Reforming staff recruitment and career structure

Until recently the recruitment procedures for academic personnel appeared to give a disproportionate advantage to local candidates and thus discourage applications from larger pools of qualified scholars from within Italy and abroad. The 2010 University Reform Act introduces a new two-step recruitment system which, if properly enacted, should guarantee substantial improvements; specific measures linking recruitment procedures and their outcome to levels of funding should also ensure that in the future universities will have strong incentives to recruit highly-qualified academics. It is crucially important, therefore, that the reform be implemented, both at the national and local levels, as rigorously as possible, and stringent merit-based evaluation criteria be applied. At the local level, reliance on outside assessors, including foreign ones, should be encouraged. The new recruitment system will only work effectively as part of the overall changes to governance and financing, geared towards increased autonomy and accountability, included in the 2010 legislation.

Until recently, salary progression for tenured university professors – as is traditionally the case in many European academic systems – has been largely independent of performance. Salary steps in Italy have now been made conditional on submitting reports of research and/or teaching activity. *Another aspect of university autonomy should be the ability to reward teachers and researchers based more closely on their performance.* The 2010 University reform makes this possible by instituting a Merit Fund (*Fondo per la premialità*) in each university.

Environmental policy should reduce pollution costs efficiently – notably by getting prices right

Italy's arsenal of tools used to mitigate the environmental impact of human activity incorporates the key principles – polluter pays, pricing of externalities, cost-benefit analysis and environment assessment studies. But in many of these areas Italy falls short of what is desirable. In the important area of greenhouse gas emissions, although emissions relative to GDP are relatively low, Italy is the third largest emitter in the European Union and emissions were rising steadily up to the crisis in 2008 but have fallen since then. While Italian passenger vehicles are relatively energy efficient, road freight vehicles are much less so and air pollution in several Italian cities remains critical, partly for local climatic reasons. The handling of waste disposal is a difficult problem, reflecting poor planning, as well as the presence of criminal activity in some cases.

Getting the “price” right is an essential element in a cost-efficient approach to reducing pollution because it provides the incentive to abate where costs are lowest. In the long run the right price on pollution stimulates innovation, because it raises the return from investment in environment-related research and development. The transport sector is a case in point. It is an important source of negative environmental externalities that can be priced. But with fuel taxation high by OECD standards, though only slightly above the EU average, and increasingly strict European emissions regulations, much has already been done to “get the price right” for pollution, while avoiding inappropriate penalties on a key sector. However, the real level of tax on fuel has been falling, reducing the incentive to economise, although tightening emission standards on new engines may have partly offset this. Tax rates set to deal with specific externalities – notably those related to CO₂ in sectors not covered by the EU trading scheme – should be set at the same level in all sectors. Furthermore, emissions performance in commercial transport has improved much less than that in private passenger transport; this seems to be linked with inconsistent or lax enforcement of standards rather than the relatively small rebate on commercial fuel taxation. Nevertheless, environmentally harmful rebates should be phased out, along with other rebates and exemptions such as for taxis, aviation, agriculture and shipping.

Pursuing environmental objectives: getting governance right

Responsibility for most aspects of environmental policy implementation and enforcement is decentralised to regional governments, which are, however, restricted in the extent to which they can pass independent legislation. The balance between central legislation and local implementation seems about right, although there have been occasional conflicts. There is some fragmentation of environmental reporting and environmental inspection agencies so that data may not be of uniform quality across the country, hindering improvement by benchmarking. Also, the analytical capacity of regional environmental agencies (ARPA) is variable, due to variation in size and wealth among the regions. Representatives of the ARPA meet several times a year under the aegis of the national agency ISPRA, but coordination does not extend to joint work at the technical level. Despite the logic of decentralisation, *there is a case for re-integrating the ARPA in a more formal national network if this would increase overall efficiency by reducing duplication of technical effort in some areas.*

An important aspect of environmental policy is to make systematic use of analytical tools to assess the environmental impact of policy. Procedures for Environmental Impact Assessment (EIA, used for specific projects, especially infrastructure) and Strategic Environmental Assessment (SEA, the term applied when looking at the consequences of plans and programmes, policies and strategies) exist and, on paper, seem adequate. Their influence is weak, however; assessments are often undertaken too late for alternative policies to be seriously considered. *These assessments should follow transparent, consistent and stable procedures and the role of these assessments in policy making should be reinforced.* One problem is that policy changes are frequently introduced by government decree, which do not require an SEA; once the decree is approved, the government usually has to produce parliamentary legislation within a relatively short period of time, which does not allow for meaningful discussion of alternatives. Unless the Environment Ministry or relevant parliamentary committees are powerful enough to challenge this approach, it will be difficult for EIA and SEA to do their job effectively.

Costs and benefits should be looked at more closely

The balance of costs and benefits in rail transport should be re-assessed. For example, there is some disagreement over the analysis of costs and benefits of Italy's high speed rail programme. Similar criticisms to those already mentioned for EIA and SEA apply to the use of Cost Benefit Analysis (CBA) in environmental and other areas. *CBA should be used more consistently, with common shadow prices applied to similar externalities across different projects. CBA reports, with their assumptions clearly stated, should be publicly available.* In the case of rail, the very high construction costs in Italy, along with the tendency for rail projects to have a considerable political content, adds weight to the need for another look at the rail programme. Cost-benefit evidence for road-charging in Milan is, on the other hand, encouraging, mainly due to reduced congestion. *The use of road charging elsewhere, at least experimentally and with provision for monitoring and assessing the results, should be encouraged.*

Green growth policies should be clear about ends and means, notably in energy policy

A key objective in energy policy is to reduce greenhouse gas emissions, for which a subsidiary objective, imposed at the European Union level, is to increase the share of renewables in gross final energy consumption. For this, Italy uses a system of "green certificates", in which electricity distributors have to acquire certificates to cover a certain share of their supply. They obtain them either when purchasing renewable electricity or by buying them from other distributors, so their price varies with supply and demand and falls as technology improves. Since, as with tradable emission rights, the same price applies to all kinds of renewable technology, this is a cost-minimising way of meeting the target.

However, Italy increases the short-term costs by differentiating between different kinds of wind power, and by using a feed-in tariff of guaranteed prices for solar power. A feed-in tariff reduces price uncertainty for investors and therefore may provide stronger incentives for innovation. Innovation in environmental technology and associated employment both benefit the environment directly and may have spin-offs in other areas. But care must be taken not to go too far. Innovation and skilled employment generated in pursuit of green policies may be thought of as benefits but this has to be weighed against the available supply of these factors, since they are also relevant as costs of green policies.

For example, feed-in tariffs, which provide a much higher level of subsidy for solar than for wind, may encourage R&D for solar power but, if set as fixed prices for too long, can generate very high rents for only small emission reductions. While partly a result of EU rather than national policies, some energy-related targets are being pursued at excessive cost. Even if the overall target for the share of renewables made sense for Italy, it is unlikely to be efficient to have different subsidy programmes for different sources. *Feed-in tariffs should be reduced. These and other tools intended to encourage particular technologies should be avoided. Measures such as undifferentiated green certificates, which take account of targets at less cost, should be used instead.* In view of the uncertainty and inefficiencies created by frequent changes in the framework, *the planned decree on replacing the green certificate system with a new mechanism for incentives to renewables should be tempered by allowing as much continuity*

with the existing system as possible. Transparency and consistency of rules on incentives should be ensured over time to improve their effectiveness.

Nuclear power may make an important long-term contribution to reducing carbon emissions and, through diversification, to energy security in Italy. The current approach, whereby not only decommissioning costs but all risks are to be taken on by operators may, without some guarantees from government, be unworkable given the long-term nature of the risks. On this sensitive topic, the necessary work on CBA, and that of the agency to be set up to plan the strategy, should be undertaken with the maximum degree of transparency to ensure that public discussion is based on the best available information.

Governance reform is needed in water supply

One basic governance issue in municipal waste and water supply is that many utilities are current or former publicly-owned companies or departments of municipal administrations. As emphasised in the previous *Economic Survey* and the *Regulatory Reform Review*, environmental and economic objectives will be difficult to achieve until conflicts of interest are dealt with. Hence, strict “arm’s length” rules are required, for which full privatisation of waste and water treatment entities may be necessary; even privatisation would be no guarantee on its own. In turn, private ownership of such local monopolies, which should be allocated by public tender for a fixed period, would require a strong, independent, national regulator acting in cooperation with the Competition Authority.

With improved governance, getting the price right becomes easier. In the case of water supply, price setting that fully implements the full-cost recovery principle and gives an incentive to reduce losses in distribution should be encouraged. Currently some of the highest losses occur in the driest regions. A “right” to drinking water can, if desired, be implemented through a pricing scheme with a small quantity supplied free to households.

Waste policy has suffered from poor planning, but has some successes too

Waste frequently makes the headlines in Italy: media attention on waste in Italy is largely focused on the situation in the South. In some areas there has been a striking inability of local government to achieve a consensus on where and how to dispose of waste. Most notoriously, these two problems overlap in Campania, the region whose capital is Naples. The problems here have resulted from mismanagement exacerbated by illegal activity. The imposition of outside waste “commissioners” has not provided a durable solution, and may have weakened the incentive of local officials to resolve the underlying problems, even if in other regions the special power of national commissioners seems to have been beneficial. It would be helpful to review local procedures (not just in Campania) for balancing conflicting interests in waste management and disposal to see if they need improving.

Some aspects of waste handling in Italy seem to work well, using economic incentives quite effectively – notably the consortia responsible for recycling commercial packaging waste. Upstream taxes on individual products themselves, identified in consumer pricing information and linked to likely costs of disposal, should play a greater supporting role, however. Use of landfill and incineration can also be discouraged through appropriate taxes.