IV - STRATEGY 2007-2011:
GROWTH, RECOVERY, EQUITY

The programme, based on the Coalition's election manifesto, on which the government secured the parliamentary vote of confidence, forms the basis of the economic and financial policy set out in this Document. In Italy's budgetary procedure, the formal function of the Economic and Financial Planning Document is to establish the benchmark for the annual budget that is enacted subsequently in the Budget Law. The Document lays it down in the form of public finance balances which, after approval by Parliament, constitute the limits within which decisions must be taken at the subsequent "budget session" where overall government income and expenditure are set.

This Document sets out these constraints from two points of view: first, it establishes a multi-year timeframe, which, in the instant case, is the full Parliamentary term 2007-2011, and second, it indicates the government's actions and objectives, referring to the three underlying objectives of growth, recovery and equity.

The framework set out in the previous chapter shows that the Italian economy is suffering from a serious growth problem. After developing for several decades at far faster rates than the European area into which Italy has gradually integrated, from the mid-1990s onwards has fallen behind in terms of growth, which is heightening microeconomic instability and sense of social malaise. This has created a contradictory combination:

- The stagnant, and sometimes negative, performance of total factor productivity, inadequate mechanisms to reward quality, an overall rather business- and user/consumer-unfriendly environment, an outsized area of protected sectors shielded from competition, all of which have hampered economic development and reduced the economy's potential growth rate;
- the combination of a high deficit, a reduced primary balance, rising debt and low

growth are undermining the sustainability of public accounts, making them vulnerable to the likely rise in interest rates, pressure from the international financial market, and the judgment of the rating agencies;

- low growth, an inefficient and distorted tax system, ineffective budgetary policy for the purpose of redistribution, and widespread civil service backwardness are contributing to the unsatisfactory trends of the inequality and poverty indicators.

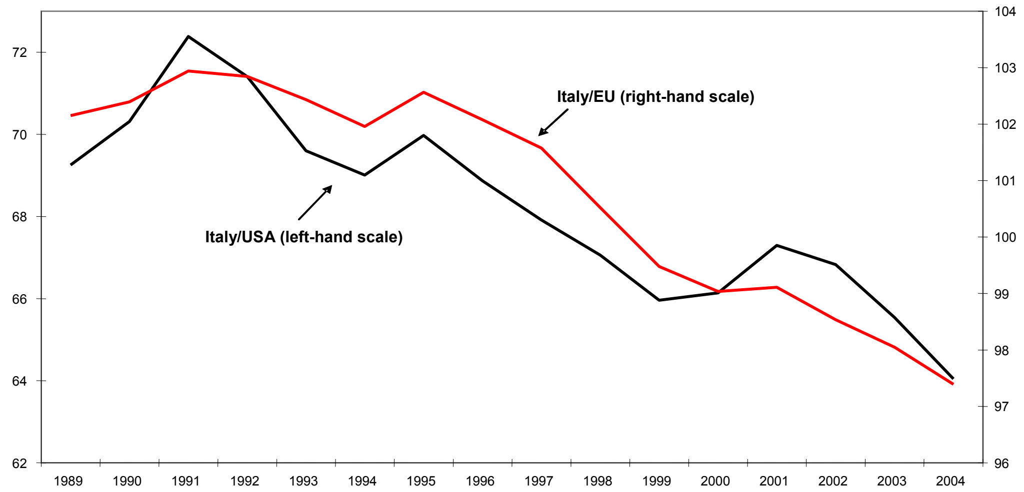
IV.1 Policies for growth

Consistently with the guidelines laid down in the Lisbon Strategy, economic policy must therefore act simultaneously on three fronts - recovery, heightened development, and equity - since they are mutually inseparable.

- More rapid growth is essential to generate the resources needed to reduce the public deficit and improve general well-being, for which effective action is also be taken to combat poverty and ease social tension, and reduce the public deficit.
- It is essential to reduce the budget deficit to free families and businesses from the paralysing fear of new measures and new sacrifices; this is the only way to make it possible to restore the confidence needed to invest in the future and open up prospects for the younger generation. Balanced public accounts are also an essential factor of equity: it is mainly the least protected and weakest sections of society that are the most seriously affected by financial difficulties, as well as the future generations with no voice or representation.
- Greater equity is indispensable for dealing with new forms of social marginalisation. Furthermore, in a democratic system it is essential to have political and social support for deficit reduction and reviving growth. The effort needed to reconvert the public and private economy must be equitably spread, and the weakest sections of society and future generations must be adequately safeguarded.

In the past 10 years, Italy has fallen significantly behind Europe and the other industrialised countries in terms of growth. The gap persists, even taking due account of the fact that the Italian population is growing less rapidly than the European average and above all the United States. Per capita income in Italy compared with the European average – both expressed in terms of purchasing power parity – reveals a constant decline since the mid-1990s. The differential between Italy and the United States shows a similar trend.

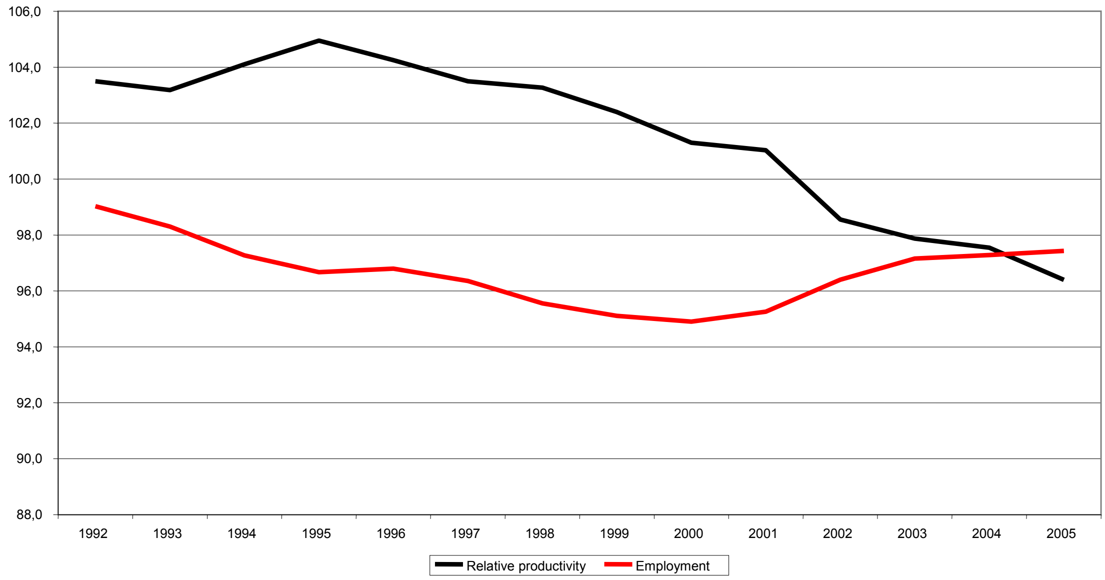
Figure IV.1 - Decline in Italian income



Source: Eurostat.

To a large extent Italy's backwardness in comparison with Europe must be put down to the productivity trend. In 1995, Italy’s hourly productivity was almost 4% higher than in the rest of the Euro area. In 2005, however, Italian productivity fell to three percentage points below the European average. Over that 10-year period, Italy's productivity growth was less than one-quarter of the Euro area's.

Figure IV.2 - Causes of the gap: hourly productivity and employment rate (Italy compared with the Euro area)



One of the contributory factors to Italy's low growth rate has also been the labour market trend. Employment levels are lower in Italy than in Europe, and despite the progress made since 1997, the gap still remains wider than it was in 1992.

Italian economic recovery therefore depends on an essential linkage between increased productivity and increased employment. In the past, Italy never managed to record a favourable trend for both these variables. The periods of strong productivity growth until the beginning of the 1990s, came along with lower employment rates. Conversely, since the late 1990s, virtually zero increase in productivity came along with high employment levels.

A combined and complete reform of both the goods market and the labour market can and must contribute to relaunching the dynamics of productivity and employment. This is the challenge facing economic policy over the next five years. Increased employment is essential to meet the demands of young people, women and older workers, whose employment levels are far lower than in the rest of Europe, which is unacceptable and must be corrected. The government is committed over the next five years to implementing a special plan on rights and employment for women, young people and the family in general (cf the Tables below) organically and consistently addressing the constraints which are preventing them from playing their full part in national economic and social life. But it is not enough merely to raise employment levels. Without an increase in productivity, real salaries were merely stagnate, depressing domestic demand, dampening growth prospects, and expanding the areas of social malaise and poverty. Sustained productivity will make it possible to substantially increase real incomes and at the same time reduce unit labour costs, with wholly positive effects on competitiveness, and the demand for investment and exports. Faster growth will also facilitate the work of reducing the public deficit and make it possible to deal more effectively with the problems of social and distributive equity.

EQUAL OPPORTUNITY PLAN OF ACTION

The government is committed to embarking on a special plan for equal opportunities and expanding citizenship rights, in order to guarantee its recovery policies while ensuring equity and growth, for it is convinced that it is only by taking wide-ranging action on economic, cultural, social and family factors that significant progress can be made towards that goal.

On the labour market, consistently with the "European Year of Equal Opportunities for All" designated by the European Union, the government intends to *encourage measures to foster women's employment as a means of raising women's employment levels (according to the Lisbon Council guidelines), improving their stability, safety and dignity in the workplace, and equal pay. This is the reason for the decision to use the reduction of the tax wedge for permanent employment, which will be benefit women's employment in particular. Similarly, the government intends to step up conciliatory public policies based on services for infants, particularly kindergartens, thereby addressing one of the major obstacles to enabling women to take paid employment.*

The government intends to extend maternity protection rights to women in casual employment, to take steps to regularise carers currently working illegally, and relaunch female entrepreneurship. It is therefore committed to supporting actions and rules which, consistently with the reform of article 51 of the Constitution and European directives, promote the recognition of talents, beginning with women and young people, by the Institutions, Public Agencies, professions and in career structures (up to the highest posts of responsibility) thereby investing in the value and the accountability of the individual.

The government is also committed to encouraging studies, research, gender statistics, and civic campaigns to promote a culture of equal opportunities, and respect for the rights and civil and social rights and duties of the individual. Against this background, the government will step up programmes to combat all forms of discrimination by focusing closer attention on protecting human rights through relaunching the role of the Inter-Departmental Committee on Human Rights, upgrading the Office for the Promotion of Equal Treatment and the Removal of Discrimination, adequately funding social protection programmes for the victims of people trafficking (also by enhancing the role of the existing Commission) and developing appropriate actions to support the victims of female genital mutilation.

YOUTH EMPLOYMENT PLAN OF ACTION

In order to make Italy competitive we must invest heavily in Italian youth, supporting and masking the most of the creative energies of our young people. Investing in youth means investing in the wealth of today's and tomorrow's Italian society.

Last year, the Council of Europe also adopted the European Youth Pact whose main purpose is to improve the education, training, mobility, vocational integration and social inclusion of young Europeans, while facilitating reconciliation between family and professional life.

The government is committed to embarking on a fully-fledged National Youth Plan aiming to enable young people to have a home and work, to set up in business, and to obtain credit and culture. Various measures have already been adopted by the government for this purpose, including its policy to use the reduced tax wedge for the benefit of permanent employment (which facilitates youth employment in particular), its commitment to relaunching a housing policy which will also support young couples and students away from home (as explained in the paragraph on its policies to ensure equity) the establishment of a fund (under Law 233/2006) to advance the right of young people to cultural education and vocational training, and their social integration, and facilitate their access to credit.

THE OBJECTIVES OF MEASURES FOR THE BENEFIT OF FAMILIES

In recent years Italy has lacked an economic and social policy which, taken as a whole, was appropriate for family responsibilities, or supplying families with social and housing services, and in general for supporting the family as a place in which to exercise intergenerational solidarity, and the care and protection of the children's welfare and affective relations. The government's aim is to restore a central role to the family, and in particular:

- *to guarantee two fundamental freedoms to young people: the freedom to be independent of their families of origin, and the freedom to create a family of their own;*
- *to combat poverty and social exclusion with particular reference to family issues;*
- *to broaden women's rights to join the labour market, without giving up the right to motherhood;*
- *to make it easier to reconcile professional, personal and family life;*
- *to combine recognition of the family as the expression of social life in respect of the rights of its members, including the children; to guarantee the rights of children of both sexes and create the conditions for a childhood be freed of the risk of poverty and given a wealth of opportunities for socialisation and growth, as a citizenship duty;*
- *to protect the well-being and health of children and young people, guaranteeing an organic and integrated system of mother-and-child protection, and for this purpose to network all the necessary social, health care and educational measures;*
- *to encourage an active old age, forming part of the network of affective, family and social relations, while simultaneously guaranteeing assistance for those in need of it.*

The pursuit of these objectives is an essential part of creating a system of welfare for human development in a freer and more solidarity-based society. And it is also essential for reopening the prospects for stable economic growth.

Development processes largely lie beyond the control of economic policy. But it can still facilitate or hamper growth depending upon how its essential tasks are performed. It can facilitate development if essential public goods and services are supplied effectively and cost-effectively, encouraging economic and financial stability, and promoting market competition and flexibility. It is the responsibility of the government to define a stable and effective set of ground rules for property rights, to improve the efficiency of the judicial and security system, to improve the quality of public services and in general to create the conditions that encourage investment in physical and human capital by businesses and families. The effects of these policies usually take time to be felt, but even in the short-term, significant results can be achieved. Hence the urgency of embarking upon the reform process.

Italy, in comparison with other industrialised countries, is penalised by the fact that it is tilted towards specialisation in low human capital-intensive sectors, with a dimensional structure that hamper the growth of small companies. These features not only reflect long-standing inefficiencies in Italy's capital market, but also an inadequate endowment in terms of knowledge and human capital; they depress the demand for skilled labour, render Italian businesses particularly vulnerable to competition from the developing countries, discourage investment in research and development, and make it more difficult to exploit the opportunities linked to the opening-up of the world markets and to technological innovation.

Businesses and employers play a decisive role in identifying the optimal positioning of the Italian economy in the international division of labour. Economic policy has the task of facilitating this positioning and the process of structural change that this implies, by offering business a benchmark framework, which will remain certain and stable across time.

Action by the government to support competitiveness and productivity will be organised along three main avenues - context, innovation and research, and taxation - strengthening the implementation of the Lisbon Strategy, and with the National Reform Plan that will be submitted to the European Commission this autumn.

The first avenue is intended to improve network and local environment actions in which businesses and citizens take their own investment decisions. The task of economic policy is to guarantee the efficient supply of public goods that the economy needs. Paramount among these are physical and immaterial infrastructure, and above all a regulatory framework that will bolster greater market competition, which is necessary to enhance the potential growth rate of the Italian economy. Our priority commitment, which has been set in motion by the decree approved by the government (see Table) is to reduce, and eventually eliminate the constraints that are hampering competition on the product market and unduly restrict the opportunities for development and employment in too many areas of the economy. With regard to intangible infrastructure, clarity and flexibility of company law and insolvency law are essential conditions to enable business to function fully and productively. With regard to physical infrastructure, the newly-initiated process of improving the quality of public capital expenditure must be boosted, laying down service objectives and selecting clear-cut priorities and implementation times. There will be a particularly powerful commitment to Southern Italy where it will come along with enhanced measures for social inclusion and security.

The second avenue of government actions will be designed to underpin the regeneration of the production system by introducing organisational improvements, disseminating new technologies and hastening internationalisation.

The new industrial policy model, which will involve both the central and the regional governments, will be designed by objectives and be implemented as a project. This framework will make it possible to achieve complementarity between the work of the different government departments and agencies, at both central and local levels, and like the more advanced experiences in other European countries, it will give an impetus to the Public-Private Partnership method.

Crucial to this will be the reform of the system of incentives for Higher Education and, consistently with the state of public finances, supporting research and development, fostering cooperation between business and universities and research establishments, and promoting innovation.

The third avenue comprises the automatic tax measures to benefit companies in general, designed to enable them to immediately recover margins of competitiveness by cutting production costs, particularly labour costs.

The government can and must create favourable conditions for growth. But the responsibility for seizing the opportunities emerging from more open and more competitive markets, from more effective regulation and a more appropriate tax system, and a more complete offering of public goods, lies with the social partners, businesses and families. If this is done, the Italian economy can move ahead towards substantially and permanently higher growth, narrowing the gap separating Italy from the rest of Europe. Hitherto, Italian businesses, families and workers have managed to overcome the sometime sudden changes in the domestic and international economic situation and promptly exploit the opportunities offered by these changes. Today, the world economy is going through a phase of strong growth, driven by the opening-up of markets and technological innovation. It is an opportunity that the Italian economy can and must exploit.

Why encourage competition? The consumers' interest

Competition policy measures hinge on the consumer, and by lowering the profits earned by monopolies and cartels it simultaneously drives the development and efficiency of the economy. This policy – agreed by the European Union – of increasing the level of competition in protected industries is based on the need for equity and efficiency. The opening up of new markets helps to keep prices down, with beneficial spin-offs on consumers by strengthening the purchasing power of their incomes and earnings. The reduction of the prices of protected services helps companies, too, because for the same real wages, companies' labour costs are reduced, as are the production costs of companies that purchase those services. In both cases Italian products become more competitive on the international markets. Lastly, the reduction of monopoly-holder profits is also a question of equitability. It holds out new opportunities to businesses that were previously excluded. It protects the weakest consumers.

These considerations led to the beginning, in the early 1990s, of a gradual opening up of Italy's markets in a number of industries. The effects are now beginning to be felt both by citizens and business. The market entry of new operators, privatisations, measures to unbundle network services and economic regulation backed up by sound technical guarantees have driven technological progress and have acted as a means of rebalancing prices and ensuring price transparency.

That path must be pursued, combining the measures already initiated to open up markets that are still closed to increased competition, with policies to increase competition that have not yet been fully carried through. As the Competition Authority has pointed out frequently in the past 10 years there are numerous statutory or administrative restrictions which still, wholly unjustifiably, restrict market access and conditions for running a business.

A comparison between what we have done and what our Community partners are doing to improve the conditions for consumers and business show that, in Italy, there is a far broader area of weak competition. It is therefore crucial for Italy to close that gap in order to seize the opportunities of the, albeit weak, recovery now taking place in Europe.

There are some areas that demand priority attention: electricity, gas, local public services, transport, telecommunications, distribution – particularly of certain types of commodities, such as drugs and medicines – banking and insurance services, and the liberal professions. The decree adopted by the government on 30 June 2006 and already in operations removes a series of obstacles to competition in relation to market access and business.

Table IV.1a Restrictions on competition eliminated by Decree Law to 23 of 30 June 2006 on market access

QUANTITY CIELINGS	BAKERIES
PROFESSIONAL QUALIFICATIONS	ELIGIBILITY TO TRADE (EXCEPT FOR FOOD)
MINIMUM DISTANCES	SHOPS
ANTITRUST CEILINGS	TRADE

Table IV.1 b Restrictions on competition eliminated by Legislative Decree 223 of 30 June 2006 on business

RESERVED OCCUPATIONS	PHARMACIES FOR OTC DRUGS NOTARIES FOR VEHICLE OWNERSHIP TRANSFER
SETTING MINIMUM TARIFFS	LIBERAL PROFESSIONS
BAN ON ADVERTISING	LIBERAL PROFESSIONS
RESTRICTIONS ON DISCOUNTED PRODUCTS	TRADE OTC DRUGS CAR INSURANCE
CONSTRAINTS ON PRODUCT RANGE	TRADE
RESTRICTIONS ON TYPE OF BUSINESS	PHARMACIES LIBERAL PROFESSIONS
BAN ON OWNERSHIP OF SEVERAL BUSINESSES	PHARMACIES TAXIS
EXCLUSIVE DISTRIBUTION CONSTRAINTS	CAR INSURANCE
CONSTRAINTS ON CUSTOMER MOBILITY	BANKING SERVICES

Why encourage competition? Less protected and more efficient services

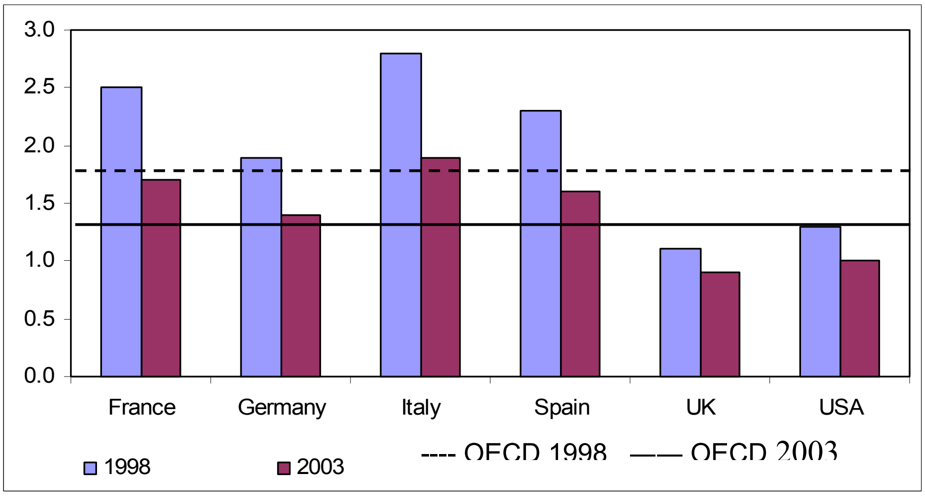
Services account for 71% of the GDP and 69% of employment in the Euro Area.[1] Enhanced competition in this sector is therefore essential; the European Union agenda has frequently advocated this, placing it at the heart of the debate on the structural reforms needed to underpin growth and employment.

The services industry also has major spin-offs in terms of the increased productivity of labour and on price levels. Low overall efficiency levels do much to explain the gap in productivity between the European Union and the United States.

Within the European Union the differences between individual countries and between the types of services are quite substantial. In Italy, prices in the services industry are rising more steeply both in comparison with the rest of the Euro area taken as a whole (+15.3% accumulated variation in the period 2001-2005, compared with +13.7% in the Euro Area) and the prices of goods (+2.5% 2005, compared with +1.9% of the general price index).

The rigidity of many markets in terms of prices and market access show that they are still shielded from competition, partly due to over-regulation. This prevents prices from being cut and quality from improving. The Italian situation can be clearly seen from the figures given in the following graph:

Figure IV.3 – Product market regulation indicators



Source: OECD. The scale is from zero (minimum) to six (maximum).

[1] Cf. "Competition, productivity and prices in the Euro Area services sector", BCE, occasional paper n. 44, April 2006.

Italy is the country with the most restrictive regulation of the goods and services markets. Progress since 1998 has done little to narrow the gap with the industrialised countries.

Why foster competition? The responsibility of economic policy

Removing regulatory and institutional barriers, however necessary, is not the be-all and end-all of competition-support measures. The measures must also form part of structural economic policy to give a fresh impetus to the investment needed for national development. And this action – to be implemented on the basis of public private partnership – must also include regulating and monitoring the markets newly opening up.

In order to have any significant effect on the level of competition, regulatory systems have to be enhanced, preserving the independence of the regulatory authority in a framework of general policy guidelines characterised by stability and designed to constantly improve the operation of the markets, also through dialogue between business and the economic policy authorities.

In the services sector, this will demand a variety of measures to promote the market entry of new businesses (energy), greater transparency in the services supplied (the financial sector and professional services), a clearer and more coherent regulatory framework, and superseding direct tendering (local public services).

Upstream of this process it will be equally essential to remove the distortions that are preventing competition from freely deploying its effects, involving the various institutional tiers: central government, with its powers and responsibilities spread across different departments, and the regional governments, which now perform regulatory functions in many areas of the economy.

In conclusion, competition policies should be designed to pursue three, interdependent, objectives:

- to open up all the markets on which competition is possible;
- to regulate sectors without an independent Authority;
- to strengthen the position of the end-consumer and protect customer relations.

In order to attain these objectives, the government intends to place competition and consumer protection policy at the top of its agenda.

For this purpose, following the example of the European Union, it will be necessary – in terms of the functions vested exclusively in central government in this field – to jointly define the structures, instruments and working methods on an interdisciplinary basis, that can fulfil the need to equip Italy with an organic and structural competition policy taking account, among other things, of its intersectoral features. The government therefore intends to set up a unit to assess the investigations and reports submitted by the Competition Authority, which will also be useful for any necessary investigations and the decisions to be taken as a result.

It will be necessary, first of all, to take action in areas offering the greatest net benefits of market-opening policies, where the Italian market is still out of step with European directives and which have been analysed and reported on – but so far ignored – by the Competition Authority. There are also areas of the economy in which the Competition Authority is currently conducting fact-finding investigations, beginning with the investigation of the mobility of the customers of financial intermediation services.

Particular and focused attention will be paid to professional services, also in relation to the consolidation of the EU approach in this field: the Strategic Plan adopted in Lisbon in 2000 considered the liberal professions to be important for the purposes of heightening competition, in consideration of their economic weight, and sets out the main thrusts of our philosophy for regulating them exclusively in terms of competition policy.

Investment in research, development and human capital

Any lasting recovery in growth and a gradual increase in the potential growth rate of the economy can only take place if total factor productivity pulls out of the long standstill of the past few years. This requires more investment, greater innovation, and increased research and development, as required by the Lisbon Strategy.

Research and development investment is significantly lower in Italy than in the rest of the industrial countries. This has largely been the result of private sector policies and decisions. Public sector research and development investment – whose quality, performance, usefulness and interaction with private research have to be very carefully assessed – does not significantly deviate from the average of the OECD countries. The private sector's low propensity to invest is partly a reflection of the poor supply of human capital and the structure of Italian businesses in terms of dimension and sector. But it also depends on the fact that for the same sectors and dimensions, the Italian enterprises invests comparatively less than our foreign competitors in research and development.

The shortage of human capital and the low propensity to invest in research and development have negative fallout on the dynamics of total factor productivity and the ability to fully exploit the opportunities offered by new technologies. Human capital, quite apart from its economic value, is a crucial element in the social and cultural fabric of Europe for creating a European social purpose.

It is not always or necessarily a matter of finding more central government resources to overcome these constraints, even though it is still to be hoped that they will be found. The Italian spend per full-time university student does not appear to be insufficient by international standards. But it could be made more productive with greater competition between different universities, and if the university system could begin to offer greater rewards to academic staff and for high quality research, judged on merit.

Simplifying and reorganising the incentives system could be one of the ways of encouraging private R&D investment without additional costs to the public purse, also by adopting a system of tax credits.

The development of human capital must be guaranteed from the lowest levels of the educational process. The government's work will therefore be designed to enhance the right to study by raising the school leaving age, improving the efficiency and the independence of individual schools, bringing school buildings up to statutory standards and encouraging the after-hours use of school buildings. It is in this connection that the problem of casually employed staff has to be addressed.

The framework of reference is that of the "Common European Area of Research and Higher Education". In Italy, where the cost per student is higher than the average of the leading European countries, the results of standardised tests at the international level has been disappointing. The reform of the education system must bridge this gap, and above all it must enable those who do not go into higher education to acquire a general education and vocational training that will enable them to adapt in the best possible way to the constant changes taking place in the economic and technological environment.

The mass dissemination of the new digital technologies is essential to the modernisation of the country, because it will help increase productivity. For this purpose measures will be adopted to promote the development of broadband connections, and to narrow the digital divide.

In southern Italy, where the skills gap between young students and their counterparts in other industrial countries is particularly serious, the huge supplemental resources available, also through Community channels, can be used to improve the quality of studies and teaching through projects involving all the parties concerned: students, teachers and the local production system.

Company dimensions and internationalisation

The structural shortcomings in Italy's industrial system have been amply documented and have certainly affected the growth dynamic of the Italian economy.

- In international terms, Italian companies are comparatively small, even within the same industries.
- Their comparative productivity falls far below that of companies of similar size in the other industrial countries. In Italy, micro-undertakings – that is to say, companies with fewer than 10 employees – account for almost 24 pr cent of the employed population but only 10% of output. Their productivity, in terms of the corporate system as a whole, is therefore just above 40%. The same figure for the European Union as a whole is 48%.
- Too few of Italy's small businesses eventually grow to achieve medium and large dimensions. Only 12% of the smallest firms, with fewer than six employees in 1987 had exceeded the 10 employee threshold in 2001. Just over 7% of Italian companies with between 6 and 9 employees had grown throughout that same period to reach the 20 employee threshold. The

situation is no better if one considers only new only recently incorporated businesses.

The small business model has been the strength of the Italian economy in the past, by contributing to the rapid growth of the Italian economy, at least until the end of the 1980s. The integration of the developing countries into the world economy and the technological revolution in information and communications technologies have nevertheless radically changed the framework in which the Italian production system operates. Both these phenomena have eroded the competitiveness of the smallest businesses. They are too small to fully exploit the opportunities offered by the world market, and are often too poorly equipped in terms of human resources to be able to exploit the new technologies.

The economic policy pursued hitherto has helped small businesses mainly with fiscal, administrative and financial measures. This has created a system of thresholds which discourages expansion in terms of company size. We now have to encourage companies that wish to grow, ensuring that they do not forfeit the existing incentives precisely as a result of growing. In addition to reforming the incentives we also have to cut the red tape involved in expanding plant and facilities (which are equally, if not more, burdensome than the bureaucratic formalities involved in setting up new plant), encourage the development of innovative financial instruments (bolstering the establishment of venture capital funds and a fund of funds, as has been done in the United States), encourage internationalisation, support the creation of corporate networks (by, for example, promoting the establishment of service consortia to internationalise small businesses) and review and upgrade business support instruments (focusing on markets with a high expansion potential, investing in the strategically most important areas in terms of innovation and development, encouraging the most dynamic firms).

Infrastructure, mobility and public capital expenditure

After having fallen to an average annual 3.1% between 1992 and 1996, public capital expenditure rose again by 3.1% between 1996 and 2000 and by 2.6% during the next five years. In terms of GDP, capital expenditure remains stable at around 4.2-4.3% compared with the European average of 3.6%. This difference is due entirely to the larger share of capital transfers to public and private businesses, whose function and effectiveness must now be carefully and systematically appraised.

The share of fixed public investment in physical and intangible infrastructure as a proportion of GDP is in line with the European average despite the gap in terms of the quality of public services in the past few years. It is therefore essential to improve the quality of investment expenditure by adopting measures, agreed upon between different tiers of government, that will ensure compliance with the number of essential conditions: they must have structural and lasting effects, and be able to meet real needs, with certainty regarding implementation times, and the estimated financial requirement must be reliable covering the whole period of time needed to complete them. A policy to simply start-up works without an appraisal process and serious financial planning will merely squander the already scarce resources available and jeopardise the balancing of public accounts. Clear priorities must be laid down on the basis of a careful assessment of available financial resources and sectoral plans, in the field of transport for example, to which the individual projects must be related, whether in the railways, highways, ports or maritime sectors.

Infrastructure problems and segments exist, which have fallen behind in terms of modernisation or upgrading, and which today are threatening the country with the risk of saturation and bottlenecks. Absolute priority must be given to these projects, by agreement between all the tiers of government concerned. It is equally important for the country to link the infrastructure to be implemented to the European TEN networks, to guarantee horizontal and vertical links between different parts of Italy in order, among other things, to improve the mobility of factors of production and reduce the supplemental costs incurred by the industrial system as a result of inefficient logistics in certain areas and because of their reduced accessibility. Aspects relating to the efficiency of expenditure and the timeframe for implementation must therefore form part of the selection criteria, so that compliance with these priorities can be linked to the needs connected with scheduling resources for capital expenditure. Optimising private co-financing and adjusting tariffs will make therefore it possible to anticipate or expand priorities.

By ensuring this kind of appraisal and evaluation, the government intends to deal with the issue of major infrastructure construction using a specific, pragmatic method, above all by taking into consideration the resources already provided or which are reasonably available, and progress with implementation.

Particular attention must be given, primarily, to the works for which the building sites are already open, and then those for which the tender contracts have already been concluded, and the others for which the bids are still awaiting adjudication.

A specific separate document of the Ministry of Infrastructure sets out the list and a brief description of these public works, following this logical and practical order. However, the same document also contains other works which could be undertaken subsequently, necessarily taking a forward view, and with the prospect of developing that particular sector. Particular attention is also devoted to the infrastructure system for Rome.

Relaunching the infrastructure sector – with positive spin-offs in economic terms – will also depend on overhauling the system of public franchises, which the government intends to address. It will introduce a reform, for which the measures will have to be more closely geared to the timing, intensity and effectiveness of the investments which the franchisees are required to make. Procedures will also be improved to guarantee a more coherent and accurate linkage between the forecasts and the actual investment plans of each franchisee. A specific corrective measure will also be introduced for recourse to the ordinary channels for the environmental impact assessment of the high-speed line in Val di Susa.

Corrective measures are also required in relation to the role and function of the motorway franchisee, ANAS S.p.A., for which the present combined responsibilities for highway infrastructure construction and oversight system is no longer coherent or relevant today.

Further positive effects, particularly those which give an economic impetus, will also be forthcoming in the next phase to correct the legal system of public tendering according to the new code. This revision – implementing the delegated powers and under special delegated legislation – will address all the legislation governing this field, and will be driven by the Ministry of Infrastructure taking account of all the inputs collected on this subject both from the world of production and the entities responsible for enforcing it, and then in the context of the measures approved by Parliament.

Energy policy

The liberalisation of the electricity and natural gas markets continued across these years against the background of increased energy demand in excess of supply, and delays in adjusting infrastructure and demand containment policies.

The opening up of this market has given a boost to an important cycle of investment in the electricity industry. Despite the market entry of new producers there is still inadequate internal competition, correlated to the high level of concentration on the supply side. Despite this, Italian electricity prices have risen much less steeply than in the rest of the EU countries, both as a result of the regulation of the industry and because of the delay in passing on the costs of implementing the Kyoto Protocol to energy prices.

In the natural gas sector, where the main/dominant company controls the import and storage infrastructure, less progress has been made with diversifying the supply and adjusting the infrastructure facilities.

It is therefore absolutely essential to upgrade the networks and build new production, import and storage infrastructure, not only to encourage the market entry of new operators but also to guarantee the security of the system, adjusting it to meet the new needs.

To guarantee the security of supplies Italy, like the other European countries, must encourage the diversification of primary energy sources and create new natural gas supply infrastructure facilities, such as LPG terminals, gas pipelines, and underground storage. In order to facilitate acceptance of the infrastructure by the local communities, they will have to be informed in advance about the work to be implemented and their environmental impact, and economic signals must be sent out to the local communities, particularly designed to reduce the cost of supplies.

The government intends to continue liberalising energy utilities. It will pursue the principle of neutrality of access to the networks and grids by implementing the forms of corporate, organisational and decision-making separation provided by Community directives and, where necessary, with demergers to ensure separate ownership and capping the equity holdings in the companies which own the national electricity grid and the natural gas transport and storage systems.

A regulatory framework will also be laid down that will guarantee non-discriminatory access conditions not only to the transport networks and supply infrastructures but also to the electricity metering, looking ahead to the complete opening up of the market after on July 2007. In the gas industry, moreover, civil customers' supplies will be secured by the introduction of transitional measures to optimise the use of storage facilities.

With regard to the dismantling of decommissioned nuclear power stations, the closure of the fuel cycle and allied and consequential activities, the Electricity and Gas Regulatory Authority will reorganise the economic regulatory system by introducing regulation methods in line with those used in other energy sectors, ensuring equitable returns on capital invested.

For energy distribution, operations will be fostered for the territorial pooling of local networks and utilities to reduce service costs.

Once the market is fully opened up, the organisation of the public corporations working in the electricity industry will be rationalised and simplified.

Particular care will be taken to guarantee the security of supplies for the final consumers and to protect the purchasing power of families by setting out the public service obligations in the deregulated sectors, and completing the revision of the "social tariff" to meet the criteria of actual economic need and social deprivation.

To reduce dependency on foreign suppliers, the government considers it necessary to take decisive action regarding the energy mix, exploiting domestic resources, and efficiently promoting renewable energy sources on an industrial scale, focusing on advanced low-cost and low environmental impact technologies, and supporting forms of distributed production. One particularly important area is the development of "Agro-energy" sources, which will be obtained by enhancing the potential of Law 81/2006.

Reducing energy demand growth and emissions will be pursued by improving the energy and environmental efficiency of the energy cycle, stepping up the market instruments (energy efficiency securities) and sending out economic signals to steer the demand, by revising energy taxes on transport among other things, to obtain the same overall tax revenues.

In discussions with the regional governments, the central government will adopt and lay before Parliament new general principles and instruments to promote competition in the fuel distribution market.

Environment

Environmental protection is an essential component of the strategy to heighten Italian competitiveness. Environmentally sustainable development guarantees that the benefits of economic growth can also be enjoyed by future generations. Environmental protection, as decided by the European Union, must be integrated into sectoral policies.

To continuously monitor progress in this area, traditional macroeconomic indicators will be combined with further environmental indicators. A possible system of environmental accounting will also be examined for adoption, to apply to central and regional government budgets.

The government's action will pursue a five main avenues.

- Affirming Strategic Environmental Evaluation. The SEA directive, 2001/42 EC, applies to plans and programmes including those co-financed by the EU (drafted and/or adopted nationally, regionally or locally) which are likely to have significant impacts on the environment. The directive specifically indicates agriculture, forestry, fisheries, energy, industry, transport, waste management, water management, telecommunications, tourism, town and country planning and land use. It should be borne in mind that SEA is not a matter of assessing only the environmental aspects (which include biodiversity, and hence flora and fauna, the soil, water, air and climatic factors), but also human health, population, cultural, architectural and archaeological heritage, landscape and the inter-relationship between these factors. This makes it possible to move beyond the rationale of the individual project or measure.

- Water management. The problem of protecting the soil must also be addressed in terms of institutional coordination and the sharing of the chosen strategies. In view of the scarcity of available funding, it is essential to involve regional governments, local authorities and private stakeholders in playing their part in financing commonly agreed projects. For water management, directive 2000/60 must be fully and thoroughly implemented, requiring a comprehensive approach to watersheds and water resources, and linking the issues of safeguarding the soil with water quality protection goals. Soil protection actions and measures, and sound water management measures must be designed to combat the desertification now taking place in Puglia, Basilicata, Calabria, Sicily and Campania; the measures must be consistent with the provisions of the International Convention on Desertification to which Italy is party, and must therefore form part of an international strategy to strengthen Italy's role in this sphere.
- Safeguarding the natural environment. Italy has signed the International Biodiversity Convention, and also within the Community it agreed on 2010 as the deadline date by which to halt the loss of animal and vegetable species. Conservation work must also move beyond protected areas, and an overall approach to the land must be adopted.
- Reclamation and waste. With regard to reclamation, the environment must be effectively restored in the affected places. There are 54 sites of national interest requiring reclamation at he present time. Lastly, waste management measures must be strengthened to increase selective waste collection, and reduce waste production and the hazardous nature of waste. The government's commitment is to move beyond the present phase in which five regions have been placed in administration, aiming at making the waste cycle management a matter of routine. The government is committed to taking decisive action to combat the Mafias controlling waste disposal and polluting the environment because they not only criminally threaten the environment but they also increase the economic and financial costs of the whole sector.
- The sea. Italy's geographical position requires her to act robustly to protect and manage the sea. The full application of the International Barcelona Convention, developing agreements to reduce environmental impacts (from the traffic in hazardous substances and certain methods of fishing), closer attention to safeguarding and the integrated management of the coasts (seeking to combat serious forms of erosion, to which Italy is exposed), reducing land-based sources of sea

pollution, more effective management of protected maritime areas – these are all aspects which form part of a policy to protect the environment and to preserve this resource of crucial importance to the Italian economy.

UPDATE ON THE KYOTO PROTOCOL FORMALITIES

By ratifying the "United Nations Framework Convention on Climate Change" of 11 December 1997 (Law 120, 1 June 2002) Italy undertook to contribute to a global programme to reduce gases affecting the climate, responsible for the so-called greenhouse effect, which requires Italy to reduce emissions during the period 2008-2012 by 6.5% below the 1990 emission levels. One important element in this programme is that the countries may comply with the Treaty both by reducing emissions or, through the CDM - Clean Development Mechanisms - acquire emission rights (CER – Certified Emission Rights) from countries or parties whose emissions are below the targets assigned to them.

With the decision by the Interministerial Committee for Economic Planning (CIPE) n.123 of 2002, the Italian government approved the first "National Greenhouse Gas Emission Reduction Plan" (PNR) to identify national strategies and international cooperation steps to be undertaken in order to comply with the Kyoto Protocol objectives. These objectives must be considered as boundary conditions for the modernisation and the increase in efficiency of the Italian economy. In this respect, the Plan defined the maximum emission limit in the period 2008-2012. At the same time, it estimated the average annual gap between the target and the trend at current legislation.

Identifying national actions to reduce greenhouse gas emissions was undertaken assuming as a starting point the high standards of energy efficiency and the low intensity of carbon emissions of the Italian economy, taking into account the need to avoid a negative impact on Italy's competitiveness. Among the actions indicated in the PNR, there is the possibility to buy emission certificates abroad.

With the approval by European Council and Parliament of the directive 2003/87/CE of 13 October 2003, which set up a trading scheme for greenhouse emission certificates within the European Union, market operators within the sectors regulated by the directive[2] were not expected to release CO_2 without the related authorisations. Without these authorisations (so-called emission certificates) to be assigned by a National Authority[3] or purchased in the market, specific sections apply for defaulting operators.

Developments in greenhouse emissions in the national territory over the past few years and the projected trends imply for Italy a constant attention to the instruments and objectives of emission reduction. The compliance with Italy's obligations under the Kyoto Protocol and from the emission trading directive could imply an increase of the costs of energy supply with unfavourable repercussion on final prices.

Against this background, the government intends to resume the process of updating and revising the "National Greenhouse Gas Emission Reduction Plan" in order to ascertain the real state of progress towards the Protocol targets and identify

[2] Energy and industry are the main regulated sectors; for instance both non-industrial (i.e. household heating) and transport emissions (car gases) are not included.
[3] In Italy, the National Authority is composed by MATT and MSE acting together.

the measures needed to minimise the overall costs of complying with the Treaty obligations, taking into account the need to maximise the spin-offs on the national economy.

Agri-food system

The improvement and development of the agri-food system is of strategic importance for the economic development of a country such as Italy. The government's economic policy has a double goal: to foster the growth of enterprises which, in terms of professionalism and size, have significant competitive potential; and to provide the necessary social protection for the weakest categories in the agricultural sector. Increased competitiveness requires measures and initiatives to encourage exports (for example, by protecting trade marks) and more effective support from export promotion bodies, to increase the size of enterprises in the sector by fostering cooperation and concentration processes and the consolidation and merging of land holdings to promote new start-ups and facilitate generational turnover (along with a production quota policy that facilitates the entry of new businesses). A stable tax system is a significant factor in boosting the competitiveness of the sector. Another key factor is the stability of the network of protection mechanisms against natural disasters and market crises.

Tourism and cultural assets

Our country has long paid insufficient attention to its cultural assets and shown only a passing concern for tourism policies.

The government today considers investment in culture as a priority task since it touches on a key factor in national identity and can act as a vehicle to assert Italian civilisation and values throughout the world, and as a significant driver of economic growth, quality jobs and the development of new enterprises.

The government, well aware of the need to gradually reinstate the necessary financial resources, needs to lay the foundations to enable the private sector, individual citizens included, to play a larger role in protecting and enhancing our heritage, through innovative forms of incentives. Culture also makes a decisive contribution to the international "recognisability" of Italian products. It is in this light that the delegated authority for tourism entrusted to the Deputy President of the Council of Ministers and Minister for Culture should be seen: it is indeed necessary to provide and guarantee strategic guidance over time for the activity of the executive with respect to an economic sector that is highly exposed to international competition but also characterised by a strong intersectoral dimension. We also need to work towards a more effective linkage with the Regions, not least to prevent inefficiencies, waste, and duplication. The central government's competence in the area of tourism needs to respect regional prerogatives and comply with the rulings of the Constitutional Court, which has clarified its spheres of competence, including its binding responsibilities.

The promotion of the "Made in Italy" brand needs to be seen as an opportunity, for the Regions also, to foster local as well as national interests. Tourism in Italy needs to play a significant part in the resumption of healthy, stable economic growth. It therefore needs to be supported, from the cultural and economic points of view, by a stronger and more widespread awareness of its importance as a factor for production, competitiveness and the attractiveness of the country and its economic system.

Italy's enormous cultural, artistic and natural heritage, and its high quality wine and food production, have allowed the idea that tourism flows into our country were an independent variable that was bound to increase or at the very least remain stable over time to gain a strong hold. We are now becoming aware of this error of judgement: the flows entering our country will not necessarily grow "naturally", and are becoming increasingly variable in terms of both quantity and quality, in relation to the ability of the country's tourism system to promote and select the characteristics of inward flows.

The Italian economy needs to equip itself, just as our principal competitors have done, in terms of:

- product strategies, to identify the most appropriate avenues to be followed by the Italian tourism industry;
- coordinated policies, with comprehensive actions in the many sectors connected with the development of tourism;
- support for the decisions made by entrepreneurs and private-sector operators.

The competitiveness of the system assumes a series of activities (from market analysis to innovation and quality on the supply side, and from lifelong learning for tourism workers to the achievement of the highest standards of service, to targeted promotion policies) with timely support in the form of sufficient financial resources for the most significant legislative provisions currently in force (Law 488/92; Law 135/2001; and Law 80/2005).

On the demand side, one priority is to “regain” the domestic market, which is essential in terms of the economic and employment implications of the decisions made by consumers in the form of increased numbers of trips and holidays taken in our country.

On the supply side, actions will be studied to encourage an increase in the average size of operators, with incentives to foster cooperation and/or aggregation.

The improvement of the products on offer from the cultural point of view will be promoted, with a particular focus on small towns and on historic-cultural-religious itineraries. It is essential that, in the presence of a renewed commitment by the government, operators should seek to provide better value for money and more innovative products.

As regards government initiatives in the field of culture, the need remains for ordinary spending to protect the country’s historic-artistic heritage to be pitched at a sufficiently high level and for the re-financing of the Single Fund for Entertainment to be completed at levels that are in keeping with the event production capability expected of our country. The current public budgetary difficulties should go hand in hand with a strong commitment to increase the efficiency of management and investment spending and promote a rigorous reform of the funding criteria for the cinema and theatre. A technical committee has been set up by Ministry for Cultural Activities and Assets and Ministry for Economy and Finance to study and propose instruments to find new resources for the sector.

Quality, effectiveness and modernisation of government

The modernisation of government departments, the simplification of processes and organisation, as well as higher quality regulation are key factors for the competitiveness and development of the country.

A drastic reduction in the bureaucratic burden on businesses and citizens is one of the government's priority actions to be achieved through cooperation by the government, Regions and autonomous bodies in consultation with the social partners. A long-term programme will be drawn up to simplify and cut red tape, with the aim of bringing the time and costs involved in bureaucratic procedures into line with the best European and OECD standards, in keeping with the provisions of the Lisbon strategy review and more specifically the lines of action indicated in the National Reform Plan and those agreed under Initiative 2010.

The government intends to focus on specific priorities and sectors for action, such as taxation, construction, town planning, the environment, energy, health, security and privacy, through the integrated use of the gamut of instruments and actions such as cutting red tape, streamlining and reorganising the legal system (legal codes and "law-cutting"), regulatory impact analysis, organisational innovation, process re-engineering, the adoption of methodologies to evaluate the cost, timescales and effectiveness of administrative activities, and *ex ante*, *in itinere* and *ex post* monitoring. Tests carried out on new methods of administering and governing public funds and the use of structural funds and funds for under-developed areas, both in the South and in the Centre-North of the country, provide clear pointers that should be extended to the full range of government action.

Technological innovation is an essential component of the government reform process and, in the wider sense, in the achievement of more efficient services to business and citizens. The construction of a secure, reliable, multi-channel connectivity infrastructure that can be accessed by the different levels of government is a nodal point on which to build e-government services. This infrastructure will be used to build a system open to the various levels of government so that it will be possible to share, with due respect for the various autonomies and responsibilities involved, the enormous resources present in central and local government in terms of data and skills.

The actions to be undertaken therefore concern the secure identification of government employees and citizens on line, the development of broadband, the construction of infrastructure for cooperation in the use of applications, the management of public records and flows of legally valid documents, the dissemination and simplification of arrangements for the use of digital signatures and certified mail, the strengthening of back office structures and web site accessibility.

Tax wedge, employment and productivity

Relaunching growth will also require an increase in the employment rate, which in Italy continues to be lower than the European average, in spite of the progress achieved over the last nine years. Italy has the lowest rate of youth employment in Europe. The government's efforts to bring actions into play to combat the labour market exclusion and disadvantage experienced by young people, and in particular by young women, is therefore of primary importance.

One factor weighing on the demand for labour is the tax and contributions wedge, defined as the difference between the cost of labour borne by the employer and the net pay received by workers. In Italy this differential is higher than the average for developed countries, although it is in line with France and Germany. A reduction in the tax and contributory burden could therefore bring the Italian situation more into line with the situation found, on average, in competitor countries. A reduction in the tax wedge would bring benefits in terms of both employers' costs and the cost borne by workers, with the aim of improving Italian businesses' ability to compete – through a reduction in labour costs per unit of product – while providing workers with higher rates of take-home pay. Action on the tax wedge will not affect the contribution rates applied by the national insurance scheme for invalidity, old age and survivors' pensions, or contributory pensions. To encourage the stable inclusion of young people in the labour market, a selection criterion will need to be chosen in drawing up the provision that rewards enterprises that make permanent current workers temporary contracts.

Action on the tax wedge needs to be accompanied by measures to relaunch productivity growth as described above. In the absence of such actions, the reduction in the tax wedge would risk being cancelled out by a productivity trend that would settle out at an even lower level that the one of the other industrialised countries and, more specifically, those of the euro area, to which we are linked by price trends and exchange rates.

The reduction of the tax wedge provides an initial impetus to the competitiveness of the Italian economy, to which will be added the drive for reforms in the market for goods and services with a view to achieving lasting increases in productivity growth. Only in this way will it be possible, as mentioned earlier, to reconcile the double objective of a sustainable increase in real wages and a reduction in the cost of labour per unit of production, with positive effects on the competitiveness of the economy.

The reduction of the tax wedge will focus on workers on permanent contracts, with a view to fostering standard contracts of employment, a priority aim of the European Union's programme and a central plank of its guidelines.

Action on the tax and contribution wedge as experienced by workers on permanent contracts will be accompanied by measures to increase the pension contributions of subscribers to the INPS fund referred to in Art. 2.26 ff of Law 335/1995 (known as the Contract Workers Fund). This will apply only to project workers and those employed on "coordinated and continuous" projects and certain other non-standard forms of employment, and those categories of workers who are not paying into other forms of compulsory social insurance or funds reserved for professionals. The measures will make it possible, at one and the same time, to ensure that these workers receive an adequate pension and also to reduce the contributory differential compared with workers in standard forms of employment. This differential is a by no means secondary factor in the use of the forms of employment under consideration. Naturally, these provisions will be integrated with other provisions based on Legislative Decree 276/2003, as anticipated in the government's programme.

More generally, on the subject of work and employment, the government will focus on three lines of action, in implementation of the provisions envisaged by its programme:

- the promotion of permanent, or standard, employment contracts;
- the reduction of job insecurity;
- more intensive action to combat the black economy and undeclared work;
- improved workplace health and safety.

The first line of action would see the measures to reduce the tax and contributory wedge for those in standard employment accompanied by a review of Law 30 of 2003 and Legislative Decree 26/2003. This would involve action on critical issues such as job on call and staff leasing, which can more easily give rise to job insecurity. Instruments will also need to be identified to promote the employment of women and the over-50s, not least in implementation of the Lisbon strategy. Training policies should also be relaunched along these same lines.

As far as measures to combat undeclared and submerged employment are concerned, we need to take strong measures to combat an ill that has grown to an intolerable extent and which damages workers as well as law-abiding businesses, since it distorts competition; and, through evasion, the tax and contributions system. Appropriate instruments should be adopted to bring about the emergence of undeclared work, especially as it affects women working as carers.

These actions should be implemented through synergistic initiatives by the various bodies involved to increase the effectiveness of the instruments used to "bring out" undeclared employment, along with more incisive repressive action by the appropriate bodies. These bodies should be provided with the necessary conditions to enable them to operate fully, with the adoption of a number of regulatory initiatives designed, for example, to give added weight to the document certifying compliance with contributory requirements and the declaration required to establish new employment contracts in the most vulnerable sectors.

This area of action is closely connected with the third line of action, designed to improve workers' health and safety in the workplace, where non-compliance with the rules often goes hand in hand with undeclared employment. In this area the legislative framework will be reviewed through the adoption of a Consolidated Text, which will enable the rationalisation, improved coordination and easier application of the rules in question.

Regulatory actions to combat undeclared employment and eliminate or reduce the possibility of avoidance will also be adopted. These might include the adoption of workers' ID cards for sectors at particular risk, such as construction; a review of the rules on tenders with a view to creating greater transparency and guarantees of compliance with the rules governing employment, to avoid the negative repercussions of downward pressure on bids, prices and wages and the whole sub-tender supply chain.

IV.2 Public finance consolidation

In 2006 the budgetary balance net of interest charges will be 0.5% and the debt will amount to 107.7% of GDP, up for the second year running. The comparison with 1992 is emblematic. In that year, the primary balance amounted to 1.8% of GDP, and the debt/GDP ratio to 105.2%.

Between 1992 and 2000, the increase in the primary surplus, the reduction in interest charges and the privatisation programme enabled a marked improvement in the public finance equilibrium.

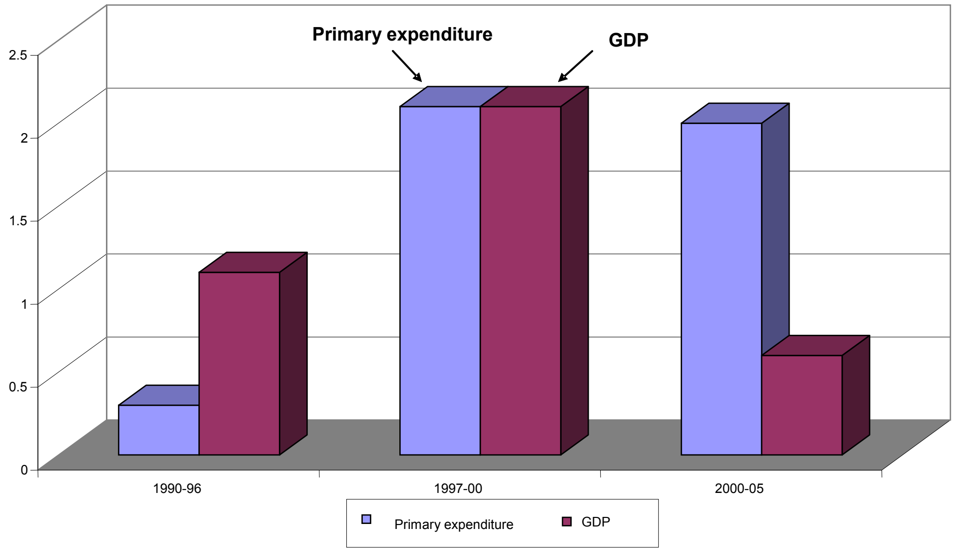
Today, in 2006, the range of options available to us to improve the public accounts is more limited. The potential contribution of privatisation programmes to the debt reduction process is, inevitably, more limited than in the past. Above all, unlike in the 1990s, interest charges look set to grow rather than fall, as there is a strong likelihood of increased interest rates at the international level.

Improving the public accounts will require an increase in the primary balance, which in the space of just a few years needs to be restored to the best levels of the 1990s. Only in this way will it be possible to achieve a lasting reduction in the weight of the public debt. For reasons of equity and efficiency, the build up of a substantial primary surplus should essentially be the result of two lines of action: a fairer tax system swept clean of the ills of tax evasion and avoidance, and a marked reduction in the inefficiencies of the central and local government machine, with resulting public spending economies.

The pursuit of these two lines of action can and must play a significant part in restoring equilibrium in the public accounts. The corrective adjustment has already moved in this direction.

But it would be illusory to think that, taken alone, these measures can correct the underlying performance of Italy’s public accounts. The sheer size of the imbalance means that action must also be taken on structural trends in public spending, which are becoming more and more unfavourable. Between 1990 and 1996, primary public spending in real terms increased at an average annual rate of 0.3% and GDP by 1.1% (see Fig. IV.4); primary expenditure as a proportion of revenue therefore diminished. Between 1997 and 2000, the trend in primary spending reached 2.1 per cent (in line with GDP growth), with the result that the ratio of spending to GDP stabilised. Between 2000 and 2005, primary spending continued to increase at the same rate as in the previous four years, while GDP growth settled at 0.6 per cent; this resulted in an increase in the ratio of primary expenditure to GDP.

Figure IV.4 –Spending and revenue growth rates



The actions required to lift growth and productivity should therefore be accompanied by structural measures designed to curb public spending. To do this, action must be taken not just on the revenue side, but also on the sectors giving rise to the lion's share of public spending: public administration and, consequently, public sector employment; the pension system, both public and complementary; the national health service; and finances of decentralised bodies.

To think that the public accounts can be re-balanced without taking action on the essential components making up its basic structure would be entirely illusory. But it would also be a serious mistake to think – or to lead others to believe – that taking action on the essential structure of government means detracting from its function of social cohesion, promoting growth, and providing citizens with essential public services such as justice, security and education. Rather, the contrary is true: only if the public finances are fully restored to health will central and local government authorities be able to perform their economic and social function in full. This is all the more true since those four sectors show intrinsic imbalances, inefficiencies, duplication and backwardness which in themselves require – and offer ample space for – corrective action. If, moreover, we did not reduce the deficit and lighten the weight of the debt, we would still need to adopt measures in these areas to reduce fiscal pressure and free up resources to develop infrastructure and public services, create new opportunities for young people, and promote growth and equity.

The rest of this section provides a more detailed analysis, segment by segment, of the need, potential for and direction of the corrective measures. For each of the four headings, studies and consultations are currently under way, within the government and in collaboration with representatives of local government and the social partners, to identify the most appropriate steps to take. The preparatory work will continue after the presentation of the government's Economic and Financial Planning Document and will be completed in September with the presentation of the Forecasting and Planning Report (RPP) and the Budget Law.

Responsible, informed budgetary policies require a more appropriate budget structure, more effective controls on spending and full transparency. The government plans to introduce a reform to review the budget structure, enable closer monitoring of the accounts in the course of the year, and ensure the independency of the National Statistics Institute.

CONTROL, MONITORING, RELIABILITY AND TRANSPARENCY OF THE PUBLIC ACCOUNTS SYSTEM

1. The system of public accounts is a concise expression of the whole set of public policies, in terms of authorisation to spend and to raise taxes. Although budgetary decisions concern the activity of the government, they also encompass the allocation decisions of the entire government system through the definition of financial relations with the other actors in the system. The reconstruction of the overall framework and the break-down of the objectives by sub-sector is important, both to allocate public resources efficiently and to verify that annual decisions are in line with targets. Today the system of public accounts is experiencing three types of problem, which are set out as follows.

Transparency in allocation. The significance of the current budgetary model is not clear in terms of decision-making and understanding of the policies adopted each year through the Budget. This largely depends on the fact that the accounting structure of the government budget, like the underlying documentation, reflects management rather than economic policy criteria.

Definition of responsibilities. With the present structure of the budget documentation, it is not possible to identify responsibility for the decisions made by and *conduct of the various actors in government departments. Even if the annual decision in Parliament only concerns the central government budget, the reconstruction of the overall public policy framework and the breakdown of objectives by sub-sector continues to be decisive both in terms of an improved allocation of resources and in verifying that the annual decisions are in line with overall objectives. The difficulty of defining the spheres of responsibility also applies to financial flows between central government and other bodies, which cannot yet be fully linked up as a result of the different accounting systems currently in use. This creates very real difficulties in consolidating the public accounts.*

Transposition of transactions in ESA 95 terms. The structure of the budget does not enable the immediate transposition of transactions in ESA 95 terms. This can be explained by three factors: there is no standardised economic classification currently applied; spending (or revenue) is not tracked in such a way as to identify its ultimate impact on the economic system; there are shortcomings in the classification of operations in economic terms (financial operations, government guarantees, etc).

2. In the light of these considerations, the Ministry for Economic Affairs and Finance will be promoting a review of the budgetary process, which will take into account the most recent experience in other countries. This could be conducted as follows:

- *a review and overhaul of the government budget classification structure to achieve a better understanding of the policies underlying the presentation of spending authorisations in the accounts;*
- *a clearer focus on responsibility for policies for economic sectors (the linkage between functions and the administrative structures responsible for them), by establishing a clear linkage between the aggregates normally used in public finance documents and the sub-sectors used in the national accounts (central and local government, social insurance bodies);*
- *more scope to manage budget items flexibly, the focus being the optimal achievement of specific objectives authorised by Parliament;*
- *transposition of transactions in ESA 95 terms to be achieved through a clear and agreed linkage between cash data and national accounts data, and between flows and stock;*
- *the creation of clear mechanisms for information and monitoring purposes throughout the year, based on checks by segment and sector and published on a regular basis and discussed with stakeholders. The priority here will be the completion of the Information System on the Operations of Government Bodies (Italian acronym SIOPE), both by extending its operations to all actors involved and by ensuring complete accessibility, using procedures still to be defined, for other public actors such as the Parliament and the Court of Accounts;*
- *improvements to the methods used and enhancing the human resources engaged in the analyses conducted by the State General Accounting Department (Ragioneria generale dello Stato) in checking the reports submitted by the different Departments on the quantification of definite or possible spending items deriving from legislative texts.*

3. The model described here will be accompanied by the promotion of institutional changes concerning public finance decision makers, to ensure that the change is fully sustainable. The aim here will be to develop institutions that encourage greater accountability in the decision-making processes and greater control over trends in the public accounts. These institutions will need to be authoritative and should adopt *transparent methodology and be prepared to challenge and discuss the information concerned.*

4. To this end, the government will examine and if necessary amend the remit of the Watchdog Guarantee on Statistical Information to ensure that it monitors SISTAN data with a view to guaranteeing the reliability and transparency of these data for public finance decision makers. The Commission will respond to Parliament and will be equipped with the informational and operational instruments it requires to perform its role effectively. ISTAT will be made autonomous with respect to the Executive and its independence assured. The government will also review the tasks of the High Commission on Federalism, to evaluate whether and how it should be transformed into a technical body to coordinate and monitor financial relations between the different levels of government and the National Stability Pact.

5. Finally, the government would view in a favourable light any reinforcement of the technical structures in Parliament which examine and monitor public finance trends. This reinforcement would take whichever organisational form the two Houses, acting with full autonomy, considered to be most effective. In this light, the government intends to cooperate as fully as possible to ensure that the information and data are fully accessible and disseminated as widely as possible.

State functions and their organisation

Public spending on the fundamental functions of government accounts for the lion's share of total public spending. But any idea of limiting this spending in terms of imposing ceilings or cutting staff costs implies a failure to take full advantage of the real scope available to improve the public accounts. It is only by starting from the functions of government, and creating a modern structure for them that makes full and skilled use of the new technologies and is freed from any ties to redundant organisational systems, that it will be possible in one single process to lighten the structure, cost, and burden of government on each individual citizen. Containing expenditure should be the result of a reform in the way the functions – large and small – of government are carried out.

A project to reorganise the functions and administrative apparatus of government could be a means of improving the way those functions are performed, bringing government closer to citizens and businesses and achieving significant economies in terms of resources. A central plank in such a project should be the implementation of Article 118 of the Constitution. This means resuming the orderly transfer of administrative functions to local councils and to the provinces, metropolitan areas and regions, on the basis of principles of subsidiarity, differentiation and adequacy of means and resources.

A system of government that is effective, streamlined and efficient in its organisational structure acts as a friend of citizens and businesses and a key factor in the development and competitiveness of the country. In the world of the new technologies and international competition, government systems need to be transformed so that they can carry out their tasks to the best of their ability and regain their pride in their functioning; this will also lead to lower costs for services provided and lower public spending. The enhancement of human resources through training and, in the context of contractual negotiations, new and more effective ways of recognising merit, along with a reorganisation of production processes (by increasing mobility and exploiting more fully the existing investment in technological modernisation), are key elements in a strategy designed to increase the modernity and effectiveness of the public sector.

Solving the problems of the Italian justice system, for example, largely depends on the solution of related organisational and management issues. The efficient use of resources is the keystone of a process that should include an overhaul of the organisational structure of the central and peripheral structures of the Ministry and better coordination of the courts, along with agreements and understandings with local bodies and with the regions to capitalise on the potential for synergies between central and local government resources.

A reorganisation of the way government functions are carried out could be facilitated by the fact that staff turnover for retirement reasons will increase significantly in coming years. This process needs to be managed carefully and wisely to ensure that it is accompanied by an overhaul of the processes involved, measures to limit the overall expenditure, an inflow of new skills to government, and a resumption of public recruitment competitions. This process will draw on the wider population outside the public sector, and on the young people who have been working in government for some time but have not yet been appointed to permanent positions. In this context it will be possible and necessary to restrict the use of external consultants, whose cost and effectiveness should be evaluated using appropriate mechanisms.

The question of the overall structure of government will, therefore, be addressed through agreement on the decisions and arrangements for action. Within each institution, those non-essential micro-functions that all too often translate into nothing more than an added cost will need to be identified. This will enable the merging, rationalisation and consequent elimination of those bodies, organisations and structures that duplicate existing activities or perform activities that are no longer necessary. The entire process of transferring functions between public institutions, or to the private sector, or between the centre and the local levels, will need to take place in a context of full and reliable economic sustainability. The first, immediate initiative will be to re-assign staff to essential functions, with a minimum proportion being retained in back office services.

To enable the development process to get fully under way in a context where contractual negotiations can be conducted in an orderly fashion, a stronger effort will need to be made in terms of pay moderation. In this respect, reward mechanisms linked to assessments and management tools that have been honed by years of practice will need to be identified. The use of these instruments could also enable the construction of career paths that provide public sector employees with adequate incentives and a framework of certainty.

Pension system

As an effect of the important reforms introduced in previous Parliaments, pensions spending has been relatively more restrained than other types of spending. The average annual growth rate fell by 2.1% between 1997 and 2000 and 1.4% over the last five years. However, pensions spending has further increased as a proportion of GDP. Moreover, under the existing legislation demographic trends point to a further, albeit relatively limited, increase in the ratio of pensions spending to GDP.

Pensions expenditure projections based on the projected macro-economic framework envisage a slow-down in the trend over the period 2006-2011, and starting in 2009. This is a result of the progressive entry into play of the 2004 reform[4] (Table IV.2). In spite of this, pensions spending will continue to grow in the medium term in relation to GDP as an effect of the ageing of the population, and will peak in the period 2035-2040 at about 1.2 percentage points above the 2005 level. It is true that this is low when compared with the European level[5], but the ratio itself is one of the highest in

[4] The effects in terms of lower termination payments to public sector employees can be also be seen in the trend for other monetary social benefits.

[5] For Italy the increase in the period 2004-2030 is 0.8 percentage points compared with 1.4 for EU15 and 1.3 for EU25; in the period 2004-2050 the figure is 0.4 percentage points compared with 2.2 for EU15

Europe, considering that in 2004 it was 14.2% compared with a European average of 10.6%.

The only way to achieve balance without reducing payments is to increase the active population, including through measures to bring undeclared workers into the contributory system and increase the employment rate. This applies in particular to women and older people, especially if we take into account the fact that improvements in human health and longer average lifespan make it possible for people to remain active well after the current pensionable age.

The elimination of the continuity gap (the so-called "step") produced by the pensions reform of 2004 will in any case involve the need to find the necessary cover.

Table IV.2 – Pensions spending, Government Departments (absolute values in millions of euros)

	Actual	Projections					
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Pensions (*)	198.872	207.440	215.910	224.960	231.250	238.350	246.250
% change		4,3%	4,1%	4,2%	2,8%	3,1%	3,3%
% of GDP	14,0%	14,1%	14,3%	14,4%	14,3%	14,3%	14,3%

(*)Pension spending is incorporated in the total spending for monetary social benefits.

The principle of actuarial equity introduced to the pensions system by the Dini reform will be defended and reinforced. The reduction of the tax wedge will be financed in a way that does not draw on social insurance contributions. The review of the transformation coefficients, which does not involve a reduction in individuals' total contributions, will help preserve the financial stability of the system and of the public finances as a whole (see Boxed text).

The lines of action to be adopted to fully balance the pensions system will be studied, discussed and defined in the light of the forthcoming Budget Law. Consultation with the social partners will help the government identify the most appropriate course of action to achieve the objectives imposed by the state of the public accounts.

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and 2.1 for EU25. With respect to the recent EPC-WGA report, the figures for the expenditure/GDP ratio indicated in this document include the effects of the GDP revision carried out by ISTAT with the National Accounts Notification of 1 March 2006.

MEDIUM- TO LONG-TERM TRENDS IN THE ITALIAN PENSION SYSTEM

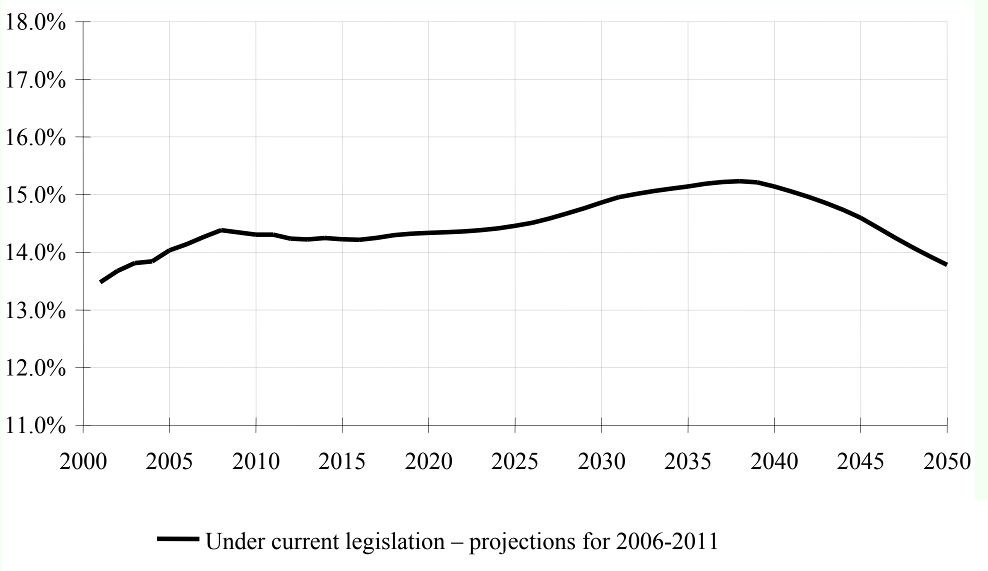
The following section illustrates the medium- to long-term trends in pensions spending in relation to GDP in the light of the implementation of the provisions of Article 1.5 of Law 335 of 1995.

The projection takes into account the expected migratory flows and fertility and mortality rates underlying the central scenario drawn up by Istat taking 2005 as base year. As regards the macro-economic scenario, productivity by worker averages around 1.7% per year (a gradual rise to 1.8% from 2026, after a gradual rise to that level in the previous years) while labour market projections suggest that for the 15-64 age group the employment rate will rise from 57.5 in 2005 to 67.8 in 2050. The endogenous trend in GDP resulting from the macro-economic and demographic projections adopted is around 1.4-1.5% per year on average over the entire period. The initial GDP values take into account the review conducted by ISTAT with the National Accounts Notification of 1 March 2006. For the period 2007-2011, the projection adopts the macro-economic hypotheses set out in the DPEF.

After a slight decrease in the period 2008-2015 as an effect of the legislative provisions raising the minimum requirements envisaged by Law 243/2004, the expenditure/GDP ratio will begin to rise again as a result of the deterioration in the demographic situation. The effects of this will in part be limited by the increase in the requirements for access to retirement pensions provided for by the above-mentioned law, in both the mixed and contributory systems. The curve peaks at around 15.2% in 2038 or thereabouts and then declines to 13.8% by 2050. The improvement in the ratio in the final part of the projection period is essentially a result of the transition from the mixed calculation system to the contributory system and the decreasing impact of the baby boom generation.

In the absence of the ten-year review of the transformation coefficients, the ratio would be essentially unchanged until 2015, about 1.5% higher at the peak and just under 2% higher at the end of the projection period.

Figure 1 – Public expenditure on pensions
(as percentage of GDP)



(1) Unlike the information published in RGS report no. 7 of December 2005, the figures for the expenditure/GDP ratio reflect the review of GDP carried out by ISTAT in the National Accounts Notification of 1 March 2006. The macro-economic scenario reflects the projections given in the DPEF for 2007-2011.

SECOND PILLAR PENSIONS

The government has undertaken to adopt every initiative that might support the relaunch of privately funded pension schemes in the private and public sectors.

The general guidelines issued by the COVIP (the pension funds watchdog) enable all stakeholders – social partners, institutions, agencies, and market operators – to take the necessary steps and make the necessary adjustments for privately funded pension schemes to take off fully and as a consequence use the TFR (severance pay provisions) for second pillar pensions.

The government has confirmed the general framework resulting from the legislation which, starting with the welfare reforms of the 1990s, has governed the sector. It reserves the option of evaluating, subject to consultation with the social partners and operators, the timeliness of fine-tuning the rules in accordance with Legislative Decree 252/2005, with a view to maximising the incentives available for participation in privately funded schemes in a framework of transparency, stability and efficiency for all forms of pension.

The government has had to take note of the gaps in the regulatory framework governing the Guarantee Fund for access to credit for enterprises transferring the TFR (pursuant to Art. 10 of Legislative Decree 252/2005) and is working to achieve a rapid solution to the questions that have emerged.

As regards second pillar pensions for public sector employees, the government is committed to removing any specific obstacles that have thus far delayed the establishment of pension funds in those branches of the public administration, and in the regions, local authorities and the health service, that have already signed or are in a position to sign in the near future, the provisions establishing such schemes.

Finally, the government is engaged in issuing the secondary regulations for the establishment of the INPS (Italy's social insurance agency) Residual Pension Fund (pursuant to Article 9 of Legislative Decree 252/2005) as well as the inter departmental decree concerning pre-existing forms of pension.

National health system

Between 2000 and 2005 health spending by the public administration grew at an average annual rate of about 4% in real terms. As a proportion of GDP, health spending increased from 5.7 to 6.7%. Factors contributing to this trend include staff costs, the purchase of goods and services and spending on services purchased directly on the market.

The trend in health spending is determined by two key factors: the ageing of the population and progress in medicine, which leads to improvements in treatment but also a continuous rise in costs. The Italian health system can easily hold its own in international comparisons with respect to the protection of the health of the population and the overall quality of the service. This said, however, it suffers from a number of serious problems: the inappropriate use of certain services, such as hospital admissions and accident and emergency services, as a result of the still essentially bureaucratic organisational framework of primary care and the shortage of integrated services for care in the home; long waiting lists; the exorbitant level of pharmaceutical spending per inhabitant in some regions; and the unsatisfactory quality of the health service in certain regions, which leads their citizens to apply to health structures in other regions to gain access to suitable treatment. A breakdown of the regional distribution of health service deficits shows that there is room for improvement in the efficiency and manner with which health services are delivered.

It is therefore possible to maintain and if necessary improve the levels of health care and at the same time bring spending levels back within public finance constraints. Indeed, maximising efficiency in the use of resources is an essential condition if the health service is to play its full social and economic role – health spending is an essential form of investment in human capital.

In June the government began work, together with the regions, on drawing up a New Covenant for the health system. Its general lines are as follows:

- Reliable resources: the government has undertaken to define the resources allocated to the health service over the long-term – initially for the period 2007-2009 – in order to enable the regions to draw up medium-term plans of the actions needed to correct the inappropriate use made of the service and eliminate the inefficiencies that undermine the effectiveness of the services delivered to citizens and efforts to control spending;
- Autonomy and responsibility of the regions: the regions will operate in full autonomy and budgetary responsibility. If a region achieves greater economic efficiencies that those envisaged in the programme, it can use the resources thus freed up at its own discretion, on condition that the Essential Care Levels (ECLs) are guaranteed. If it does not achieve the planned efficiency gains, it will be required to finance the excess spending from its own resources, including through the confirmation of fiscal automatism instruments;
- Elimination of deficits by the end of 2009: for regions with large deficits, an extraordinary fund will be set up for the period 2007-2009. This fund will decrease over time and, together with enhanced supplementary measures, will support the regions in their own revenue adjustments with funding – subject to strict conditions – to support

a course of action that would cancel out these deficits by the end of 2009, thanks above all to more efficient management of resources.

The total resources made available to the National Health Service for the period 2007-2009 will need to be such that the health sector too can play a part in reducing spending trends with respect to GDP. The government is convinced that this requirement is compatible with maintaining the Essential Care Levels. In this way the spiral of increased spending that we have seen in recent years will be broken, while the system will be guaranteed the necessary resources to function more efficiently. The goal of targeting services more effectively and ensuring that they are both universal and accessible to those who really need them suggests that forms of co-payment by citizens should not be ruled out, even in regions that have not yet adopted forms of individual responsibility for health consumption.

The system for monitoring the actual delivery of ECLs and actions to improve the quality of the services and reduce their costs will be reinforced. To this end, initiatives to ensure uniform accounting principles at the national level will be continued. The set of indicators agreed with the regions to oversee the implementation of the planned lines of action with respect to the use of resources, the quality of output and organisational capacity, will be reinforced. The central level (both departmental and in terms of inter-regional coordination) will thus perform a role not just of monitoring but also of support and services for the regions.

Within the funding defined by the New Covenant, resources will need to be freed up to support research and innovation and activate instruments to support investment by health structures in the new technologies. In terms of achieving a better balance of equipment and structures in those regions with the most serious shortages, a re-allocation of any unused sums from the National Fund to co-finance investment in the reconstruction or up-grading and technological modernisation of the public health assets in accordance with Art. 20 of Law 67/1998 might be envisaged.

The improvement in the services provided will require more and better prevention activities, a reorganisation and improvement of primary care, and greater social-health integration.

For primary care, we are faced with at least two urgent problems: bringing primary care doctors on line using the information network currently being created through the use of the health card, with a view to bringing pharmaceutical spending under control; and reorganising primary care into groupings of associate medical practices, which would be provided with diagnostic equipment and entrusted with an intensive series of home care and “out-of-hours” services. This would ease congestion in accident and emergency services and reduce the number of inappropriate admissions.

Staying within the funding constraints referred to above, the government considers improved social-health integration to be a priority, starting with care for people who are not self-sufficient and for whom integrated home care needs to be encouraged, since this form of service is more appropriate for them than institutionalisation in residential structures. A significant corollary of this course of action is the considerably lower expenditure per beneficiary.

In recent years, care in the home has seen the establishment and spread of important public/private partnerships. These will be leveraged by setting up a national fund for the non-self-sufficient into which all the resources currently employed in this sector will flow, with due respect for public finance constraints. The Fund will co-finance actions and the resources at its disposal could gradually be increased as best practice spreads.

Local government and fiscal federalism

Between 2000 and 2005 the primary current expenditure of local government bodies increased in real terms at an annual average rate of 3.9%. For government as a whole this figure was 2.1%. During the period in question, GDP increased at an average rate of 0.6%.

Factors contributing to current spending trends at the local level include the transfer of functions to decentralised bodies and, taking functions as being equal, over-rapid spending trends.

Local government bodies perform essential tasks in the economic and social sphere. Large metropolitan areas and their related infrastructure attract significant flows of investment and services. 65.4% of capital spending is made at the local level. The health system is managed at the regional level. The lion’s share of environmental and non-pensions social expenditure (social protection, subsidised housing) is delivered at the local level. A fully implemented form of fiscal federalism has become a condition for achieving two key requirements: for local governments to be able to perform their functions in full; and for the system of public accounts to be balanced.

To enable the public administration as a whole to play a part in meeting the objectives set at the European level, Law 448/1998 (the Finance Act) established the National Stability Pact. In its original version, the Pact established that the regions and local authorities should play a part in reducing net public sector debt by improving their own accounts by at least 0.1 per cent of GDP. In subsequent years the National Stability Pact was subjected to a series of changes, which deprived local administrators of a stable framework of reference and created considerable difficulties in managing local authority budgets wisely and well.

If Italian fiscal federalism is to be implemented in full, it will be necessary to draw up a new framework of reference that includes stability, consistency, compliance with European parameters and respect for the administrative autonomy of the local authorities. The key features of the new architecture of the National Stability Pact should remain unchanged over time, even if its financial dimensions will necessarily be subject to decisions taken at the time of the annual Budget. In this context, the correct course of action appears to be to stop setting ceilings on specific categories of expenditure and to introduce constraints on the budgetary balance and the trend in the debt, in full implementation of the combined principle of autonomy/accountability.

The growth in the levels of local government debt should be brought within bounds that are compatible with national objectives and with the European regulations. Overall, the intensity of the recovery process would depend on the financial improvement objectives set at the national level and discussed with local government actors. A positive role could be assigned, and adequately rewarded, for divestment operations.

Courses of action to reduce the deficit that can be followed by each administration would then be constructed. One initial hypothesis is that the objectives could be set in terms of average per capita balance for each local authority population category.

To mitigate the problems arising from cash flow volatility, the possibility of using the three-year average of balances rather than the annual figure and allowing offsetting agreements between groups of bodies, especially to safeguard investment spending, will also be evaluated. To this end, specific incentive mechanisms could also be envisaged that would enable the Pact to act as a driver of growth. For the Regions, health spending would continue to be excluded and would be handled using specific instruments.

A credible and effective Pact should include adequate monitoring mechanisms and effective penalties, two functions which, without ruling out the participation of the local authorities for information purposes, are typically considered the sole remit of central government. In short, the National Stability Pact will be designed in keeping with the European Union's Stability and Growth Pact and will contain cogent provisions that are consistent with Art. 120 of the Constitution ("substitutive powers").

An essential element of the Pact, and a condition for subscribing to it, will be the creation of an information system for the public accounts that also extends to local government. This system can be implemented in full in a relatively short timescale by extending and completing works already under way. It will help control spending, facilitate the coordination of budgetary policies and enable transparency in the accounts and an improved flow of information to citizens. This project is of primary importance and requires the harmonisation of the accounting rules adopted by local government bodies: it is only by standardising the accounting principles and classifications that it will be possible to interpret budgets, their consolidation, and the effective control of spending trends in an integrated fashion. The compilation of full balance sheets based on common standards will be a part of the system. In terms of transparency, all actors in the institutional system will have access to the information base, for which the SIOPE and any additions to it will act as a fulcrum. More generally, the establishment of a body tasked with coordinating and monitoring financial relations between the different levels of government, including in relation to the new stage of implementation of the funding mechanisms envisaged by Art. 119, should be viewed in a favourable light.

On a more general level, the government's objective is to complete the fiscal federalism process while maintaining consistency between the decentralisation of functions and financial accountability. To this end, an agreed course of action needs to be established to define the resources that can be earmarked for expenditure on services for which regions and local authorities are responsible, in the light of the budgetary constraints to which the entire public sector is subject. This will provide local authorities with a stable, reliable framework over the long term that is consistent with balanced public finances. To achieve this goal we will need to increase the number of opportunities for discussion between central and local government, in such a way that the latter will be included in its own right in the process of forming budgetary policy. The definitive framework of financial relations between the different levels of government should envisage adjustment mechanisms that enable the essential services to be funded in full for all local governments. The scope available for fiscal autonomy at the local level should ensure sufficient margins for manoeuvre to tackle any excess spending on essential services and, by making whichever additional fiscal effort is needed, enable funding to be provided for any additional services that may be required.

Spending on goods and services

A programme to restrict public expenditure for the purchase on goods and services must operate on three levels if it is to be effective: the planning of requirements that is modelled on operational needs and priority objectives and is compatible with the available financial resources; the presence of efficient and effective public procurement centres that are able to guide business competitiveness in a way that satisfies the needs of government and ensures full transparency; and a system of controlling and monitoring consumption and services, which is vital if savings in public procurement processes, which could not be produced merely by lowering unit prices, are to be achieved.

The rationalisation project opened with the 2000 Budget Law specifically addressed the second of these issues by setting up a national procurement centre for which Consip S.p.A. is responsible. After an initial development period, the Consip project began to experience difficulties, mainly as a result of the constant changes in its political, strategic and operational leadership. More specifically, the continuous changes in the regulatory framework saw the role of the public procurement centre switching from pervasive, all-embracing tasks, with the consequent extension of compulsory constraints, to a mainly benchmarking role under which compliance was more or less optional.

Any new version of the programme must necessarily involve the creation of a coordinated "network system" linking the different levels of government with responsibility for public spending. The role of the central government procurement centre will need to be clearly identified. The regional dimension too will need to be enhanced by setting up regional procurement centres. This is the best way to interpret the needs of local authorities; govern the delivery of goods and services at the local level, especially in the health sector; increase the potential of businesses, especially small and medium-sized enterprises and those with high innovative capacity; and ensure that environmental protection needs are given due recognition in public sector procurement. In this context, Consip's mission follows a number of different directions: running the central government procurement centre with targeted actions on specific spending sectors; and facilitating the development of the regional centres, especially through the transfer of methodologies and know-how and a national observatory that enables the sharing of best practice; and promoting innovative public procurement technologies and procedures and acting as project leader to set up shared IT platforms, especially with reference to the electronic market.

The activity of the public procurement centres is necessarily linked to the planning of requirements and the monitoring of consumption. The planning function can only be developed within individual departments and should incorporate increasingly specialised content and expertise. In this process it should abandon any criteria based on the consolidation of traditional spending patterns. The monitoring of consumption, on the other hand, should be fully incorporated in the management control rules entrusted to a body with specific inspection and objective verification capacities such as the Ragioneria Generale dello Stato. The functions and methodology of the Ragioneria should be reviewed, starting with the procurement of goods and services, and fully superseding any approach based on formal or bureaucratic control and monitoring.

The entire public procurement process needs to be reviewed in a perspective that envisages a far-reaching review of the budgetary cycle. More functional arrangements need to be tested for the planning, management, control and monitoring of government resources and, more generally, the governance of public finances.

Revenue policy

The Executive's fiscal policy, as shown by the provisions of the Decree Law of 30 June 2006, is intended to promote three fundamental related and strongly synergistic objectives: equity, development and simplification. These objectives will be achieved in step with the reduction in fiscal pressure, to the degree and at the pace that are compatible with the adjustment of the public finances.

FISCAL MEASURES IN THE DECREE LAW OF 30 JUNE 2006

The government's fiscal policy is intended to achieve three fundamental objectives that are closely related and highly synergistic: equity, development and simplification of the bureaucratic burden on citizens and businesses. The provisions contained in the Decree Law of 30 June 2006 are the first steps in this Parliament to achieving these objectives.

One set of actions is designed to improve the equity of the fiscal burden in the field of real estate sales, VAT and direct taxes.

The most significant of these, with respect to property sales, include:

- *the tax system for real estate transactions (for residential and other use) has been standardised. All sales of buildings, with the exception of those made by construction companies, but only for buildings completed less than five years ago, are subject to registration tax and exempt from VAT. The VAT exemption system has been extended to include rent on all types of building;*
- *an obligatory requirement is envisaged to include the amount actually agreed in each deed of sale, as well as the arrangements for payment of the sum in question. The deed should also include a declaration of the amount charged by the intermediary, the payment arrangements and the ID details of the intermediary;*
- *at the same time all existing investigative powers have been extended to include verification of registration, mortgage and land register tax.*

In the sphere of VAT and direct taxes a number of provisions intended to ensure that procedures are managed correctly and combat widespread avoidance should be noted, along with parallel measures to reinforce the powers to collect taxes, inspect, and impose sanctions:

- *a requirement is envisaged for contractors in the construction sector to pay VAT on behalf of sub-contractors (reverse charge) as well as a shared responsibility between contractor and sub-contractor for the payment of withholding tax on income and compulsory employee contributions, which the sub-contractor is required to pay;*
- *criminal penalties have been extended to include non-payment of VAT; these are currently not envisaged;*
- *the indicators that identify non-operating companies and determine their taxable revenue have been amended. Such companies have also been prevented from offsetting VAT credits with debts in respect of other taxes, or transferring them to third parties. VAT credits can only be carried forward, in the absence of active operations, but for no more than three years;*

• a requirement has been introduced for practitioners of the arts and professions to keep dedicated current accounts into which their fees should be paid, solely through banking or postal channels;

• various other measures are intended to define cost management more strictly for companies and sole traders, with a stronger focus on the type of expenditure (for example the cost of vehicles clearly for private use). Other changes involve depreciation of company vehicles (for which advance depreciation is not possible), brands/trade marks (equated to start-up) and the cost of buildings for use in the business (from which the value of the land on which they are built has been hived off);

• increases in the value of stock options held by company executives have also been returned to ordinary taxation, since they are considered as income from salaried employment.

The provisions to promote equity also include further measures to combat avoidance in the field of direct taxation.

Other provisions are intended to rationalise the gambling sector, combat the spread of illegal and undeclared forms of gaming and provide greater protection of players. An increase in the VAT rate from 10% to 20% is also envisaged, but only for some products.

A strong incentive to investment in new technologies and development and research by enterprises is provided by two particularly significant initiatives: greater scope for deductions in respect of depreciation against the cost of industrial patents, know-how and the use of original works, and a more favourable tax treatment for development studies and research.

Finally, the provisions also include a number of important initiatives to simplify the obligations borne by citizens, businesses and the financial administration:

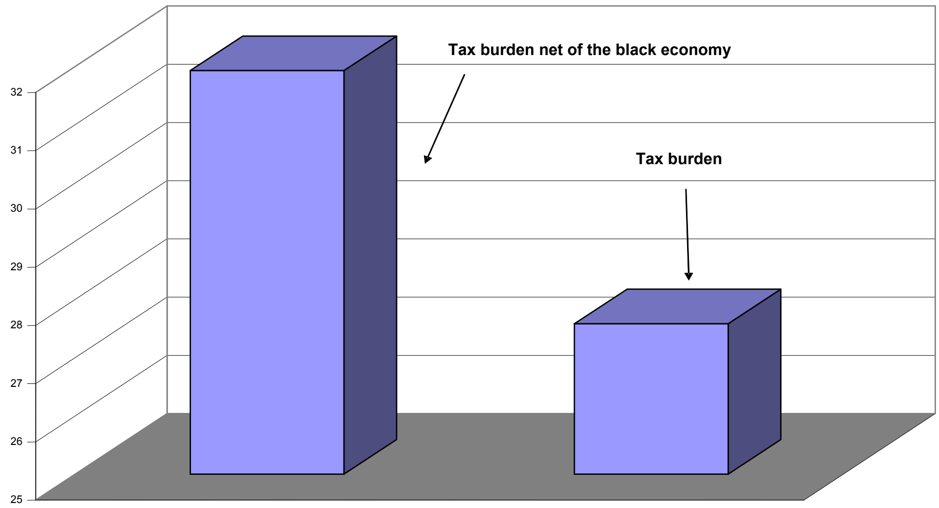
• natural persons with sales of no more than 7,000 euros are exempted from the VAT system and from a number of accounting procedures, and have the opportunity to be "tutored" by the offices of the Revenue Agency. The possibility of opting for the ordinary regime still remains in place;

• the requirement to present the ICI (municipal tax) declaration has been eliminated and the payment of this tax through the "Unico" and "730" tax declaration forms is now envisaged, with the possibility of offsetting against other payments due;

• a strong impetus has been given to the use of IT procedures to simplify a number of procedures (by all parties operating in the retail sector, banks and other financial intermediaries, insurance companies and chambers of commerce, industry, crafts and agriculture).

Equity: the government intends to redistribute the tax burden, initially through clearly defined, systematic and intelligent measures to combat evasion and avoidance. The tax and fiscal burden mainly weighs on the legal economy; net of the submerged economy, fiscal pressure reaches extremely high levels. And second, greater equity will be promoted through actions on direct taxes, social security contributions and indirect taxes, including for the purpose of rebalancing their input to overall tax revenues. In this context, the fiscal treatment of the various types of income will gradually be standardised, taking into account certain specific, unavoidable circumstances.

Figure IV.5 – Fiscal pressure on the economy as a whole net of the undeclared economy



Development: the fiscal system should increasingly focus on distinguishing between speculative and productive activities, in order to lighten the burden on businesses and workers engaged in production and in meeting the challenges posed by international competition.

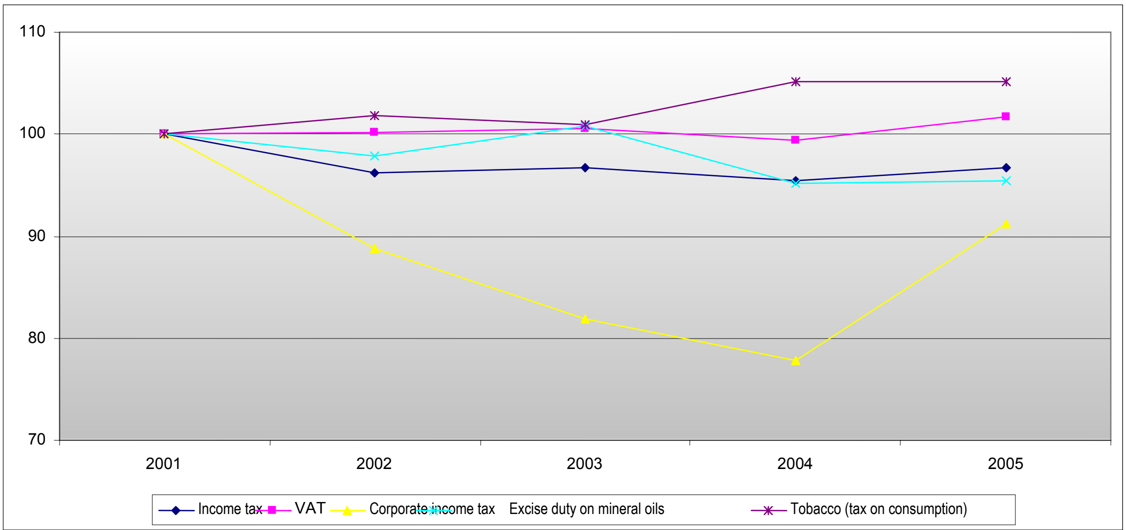
Simplification: the bureaucratic burden on households and businesses will be reduced to the minimum and the tax administration fine-tuned and reorganised so that it can be placed at the service of tax-payers. To achieve these objectives, the government will not only take action at the legislative level but also ensure that tax agencies are equipped with the human and technological resources to grasp the enormous opportunities provided by information and communication technologies. These innovations will make compliance with tax issues an easy routine task for the great majority of households and businesses.

The difficulties in achieving these objectives can be clearly seen in the light of the trend in total tax revenue and its composition in the period from 2001 to 2005. Current government sector tax revenues diminished by 1.3 percentage points of GDP. Factors contributing to this result include: i) an increase in revenue from indirect taxes, by nature regressive; ii) a slight reduction in revenue from direct taxes on natural persons, which was the result of a reform that was regressive in effect; iii) a slight reduction in revenue from taxes on business (for which, however, the Budget Law for 2006 envisages tax increases amounting to over 2 billion euros).

However, these headline figures mirror only in part the effect of the fiscal policies of the XIV Parliament. An analysis of the technical reports annexed to the provisions approved during the last Parliament shows, in fact, that the these provisions are essentially neutral in terms of their projected effects on revenue. In this context, the main cause of the fall in revenue recorded at the end of the period seems to be the expansion of the area of tax evasion/avoidance (of VAT in particular) rather than the adoption of tax cutting policies. In short, the predictable and expected systematic recourse to various forms of tax amnesty appears to have encouraged lower levels of tax compliance, for which Italy already has one of the lowest levels of the OECD countries.

To meet the objectives of equity, development and simplification, priority actions in the government's tax policy strategy to combat tax evasion/avoidance include: measures to simplify tax compliance requirements for households and business; recovery of the progressive element of taxation; a reduction of labour costs; reform of taxes on business income, especially with a view to fostering innovation, capitalisation and internationalisation; and a reform of the land register and reduction of ICI (municipal tax) rates.

Figure IV.6 –Fiscal pressure - principal taxes (as percentage of GDP)



Source: ISTAT.

Factors weighing considerably on government budgets include expenditure linked to current account and capital transfers to households and even more so to businesses, and decreased revenue resulting from various tax incentives. For 2005, according to the public expenditure classifications drawn up by ISTAT, expenditure for government transfers to business, equating to the sum of current expenditure (contributions to production) and capital expenditure (capital transfers) amounted to 28.8 billion euros, or 2% of GDP. Many of these items are merit based and are linked to Community spending programmes, local transport incentives, or activities with obvious external effects, such as investment in research and development. At the same time, the size of these items, the increasingly tight constraints on the overall public administration budget and the need for increasingly transparent public accounts mean that for all these items a comprehensive, up to date inventory needs to be drawn up. This would enable Parliament and the executive to evaluate rapidly the cost, timeliness and effectiveness of such expenditure and review it in the light of the priorities for government action.

IV.3 Policies for equity

The relative poverty index, measured using the Community methodology, is 19% in our country (proportion of the population living below the relative poverty line), compared with a European average of 15%. Recent years have seen an increase in the instability of income over time, a factor which goes hand in hand with an increased sense of vulnerability. More specifically, the relative positions of manual and clerical workers, single-income households or large families, or household in southern Italy, have all worsened significantly. Italian households also incur considerable costs for the care of the dependent elderly and for their children, including in many cases children of majority age (70% of young people aged 25-29 live with their parents, the highest percentage in Europe, since the difficulty of finding work and housing makes it almost impossible for them to leave home and set up on their own). The shortage of care facilities for children and the elderly play a part in keeping the female activity rate low (only 45% of women are in paid employment, and just 30% in the South), with negative effects on the potential growth rate of the economy, especially when taken with the corollary of the low birth rate.

The formulation of initiatives for growth as described earlier, the committed effort that will be made to improve education, and the impact of social inclusion actions in the additional initiative for Southern Italy all illustrate the choice to foster forms of growth and development which, by enhancing and capitalising on the skills and abilities of all citizens, in themselves ensure that the requirements of equity are met.

In addition to these lines of action, the government intends to implement a programme in the 15th Parliament that concerns the rights of citizenship and policies for the family with a view to progressively modifying the current situation. We are starting with a lower proportion than the European average of resources dedicated to support for those on low and uncertain incomes and for family responsibilities, and to the supply of social and housing services for families and the non-self-sufficient. Timely action is needed, with due respect for public finance constraints, on reform initiatives to increase the efficiency and effectiveness of our social policies. These actions will be universal in nature and will hinge on the Social Assistance Framework Reform Law (Law 328/2000) and act on the problem areas that have been revealed through its implementation. In the framework of the institutional responsibilities established by the new Title V of the Constitution, it is the central government's responsibility to: a) define the essential levels of assistance; b) create a coherent system of income support and support for family responsibilities; c) set up forms of funding that reward initiatives taken by local authorities by reorganising and boosting the National Fund for Social Policies and providing for a Fund for Family Policies, with a view to developing an integrated network of services.

Principal actions to be implemented in the course of the Parliament

1) Reinforcing the instruments available to reconcile work and family/personal time, by extending the possibility for both parents to use paid maternity and paternity leave, including with respect to children of adolescent age, and time off work for training, re-training and professional development activities; supporting the dissemination of local "time bank" experiments and encouraging the reorganisation of public service opening hours.

2) Establishing a coherent system of income support and support for individuals that hinges on the following instruments:

2a) Income support for those on discontinuous and/or low-paid jobs, by replacing the present Irpef (income tax) employment deductions, which those earning less than the tax threshold cannot take advantage of, with an employment-related tax allowance that people earning less than the minimum can use as a monetary transfer. The unification of the current monetary family support instruments – family allowance and income tax deductions for dependent children – in the form of a child allowance that provides a more substantial income supplement based on the number of family members will make it possible to increase the effectiveness of the support without placing additional burdens on the public finances. Both these forms of income support will be structured in such a way as to encourage employment and emergence from undeclared work and will not reward tax evasion. They will be mainly to the advantage of households with low and average income and, for the former, will provide a new form of "negative tax" (monetary transfer to the very poor). If public action is to be truly effective an initial action to combat tax evasion, which lessens the significance of any indicators of economic disadvantage, is essential.

2b) For those in particularly disadvantaged economic circumstances (Equivalent Economic Situation Indicator (Italian acronym ISEE) below a given threshold) and for whom avenues need to be created for social and employment inclusion, especially in southern Italy, the proposed “Minimum Inclusion Income” (Italian acronym RMI) should be taken up again, with new features. This is conditional upon participation by beneficiaries in employment inclusion initiatives and a “means test” (using the ISEE). To this end, a careful evaluation of the measures adopted thus far to combat poverty is of priority importance, to assess their effectiveness in relation to the financial burden on the population as a whole.

3) Reinforcing and improving the network of services, in particular for children and the dependent. The fees for such services must be accessible: to this end, co-payment by families should be differentiated in relation to their economic circumstances (ISEE). The desirability of using taxation to fund such activities should also be evaluated.

3a) Improving services for children through an action programme to develop the kindergarten system which leverages national and local resources and integration with the educational system. At the national level, part of the Social Policy Fund will be dedicated to the co-financing of running and investment costs, with a view to supporting best practice.

3b) A programme of initiatives for the non-self-sufficient, starting with a programme to develop integrated home care services. At the national level essential levels of assistance will be defined, in keeping with the limited financial resources available, and a National Fund for Dependent Persons will be set up, into which all the resources already committed to this category will flow. The Fund will co-finance initiatives and the resources at its disposal will gradually be increased as best practices spread. To ensure that domestic workers are absorbed into the legal labour market, a Framework Law on domestic helpers or carers will be drawn up. This will define the essential requirements to be met by these workers in terms of professionalism and reliability and guarantee employment continuity and security both for the families employing them and for the workers themselves.

4) Strengthening the instruments and provisions for the protection of children both in terms of justice and national and international adoptions: through a reform of the competencies of the ordinary courts and the juvenile courts to achieve more effective coordination in matters concerning relations between the family and the justice system, and through the establishment of a Guarantor for children and adolescents; simplifying adoption and fostering procedures; reorganising and reinforcing the current Observatory for the Prevention of Paedophilia in order to combat all forms of trafficking, abuse and sexual exploitation of children.

5) Relaunching housing policy. The increase in property prices and rents weighs heavily on the economic situation of low income households with no access to home ownership. Policies designed to support households experiencing difficulty are also a useful means of support for young couples and young students living away from home. These policies should however be integrated with policies to boost supply. The government has undertaken to put together a legislative framework, as part of the reform of the National Stability Pact, to facilitate public housing construction initiatives. These projects will provide selective low-cost rented housing for the most vulnerable groups and promote mobility by families, workers and university students. The initiatives will be implemented in part through public-private partnerships and project financing instruments.

6) Reinforcing the instruments and laws governing rights and equal opportunities, in line with the Community guidelines. More specifically, the government will promote provisions designed to progressively increase employment stability, including for women; extend maternity protection to all forms of contract in addition to open-ended contracts; provide for the expansion of services for the reconciliation of work and women's responsibilities (for example kindergarten services); and boost women's entrepreneurship by creating stronger incentives for new business start-ups.

7) Combating all forms of discrimination. As part of its stronger focus on the protection of human rights, the government will relaunch the role of the Inter-Departmental Committee for Human Rights and strengthen the Office for the Promotion of Equality and the Removal of Discrimination. It will also increase the number of social protection programmes for the victims of trafficking, including by enhancing the

role of the existing Commission, and will develop appropriate positive actions on behalf of the victims of female genital mutilation.

Feasibility

The programmes described above are intended to foster innovative public actions in such a way that the resources made available by central government:

- act as a driver for a fuller mobilisation of public resources, from the local government system; and private resources, from the third sector and from households themselves, which are required to make co-payments to help meet the cost of services at accessible prices differentiated on the basis of their economic circumstances;
- achieve the greatest possible efficiency in supporting personal and household income and combating poverty and social exclusion, and do so in ways that incentivise active rather than passive behaviour on the part of beneficiaries.

These two features of the programme make it possible to maximise the results for each given resources allocation by central government and so play a part in making the reform process financially sustainable. An essential condition for this financial feasibility is incisive, continuing action to improve the public finances, which will make it possible to use the resources currently committed to best effect.

With regard to income support initiatives, the net cost to the public finances will be defined in keeping with the budgetary strategy as a whole, since the new measures will replace existing ones and therefore create new uses for resources already allocated, with varying degrees of efficacy, for similar objectives. As regards the actions to improve and increase services, these will leverage, as mentioned earlier, the mobilisation of the resources of the local authorities and the third sector. Moreover, the resources made available by central government will also include resources already committed for similar purposes but in an unsystematic and wasteful fashion.

IV.4 Targets for 2007-2011

The targets illustrated below for the period 2007-2011 confirm the government's commitment to fostering a sustainable relaunch of economic growth in a context of structural improvements to the public finances and the pursuit of social equity. As is already the case with the measures recently adopted to increase competition and reduce regulation in various sectors of the economy, the development policies described in this document will translate, albeit gradually, into increased growth in coming years.

The Finance Act for 2007 will provide for initiatives amounting to about 20 billion euros (1.3% of GDP), net of new expenditure for development and equity objectives, which are estimated at around 15 billion euros (1% of GDP). The "gross" amount of resources to be found is therefore in the region of 35 billion euros, or 2.3% of GDP.

The budgetary strategy as a whole is intended to make our public finances sustainable in the long term in an unfavourable demographic context and, at the same time, enable expenditure for the modernisation of the country, the relief of social disadvantage and the future of the younger generations. Measures to contain the deficit will mainly involve the spending side and will consist of provisions of a structural nature within a framework of individual reform projects, which will act on the four main categories of public spending analysed previously.

Table IV.3 –Corrective Public Finance Adjustment

	2006	2007	2008	2009	2010	2011
% of GDP						
Net borrowing	-4,0	-4,1	-4,1	-4,1	-3,9	-3,8
Net corrective adjustment on primary balance		-1,3	-0,5	-0,5	-0,5	-0,5
Structural growth enhancing measures		1,0				
Gross corrective adjustment		-2,3	-0,5	-0,5	-0,5	-0,5
Interest savings deriving from the adjustment			-0,1	-0,1	-0,1	-0,1
Net impact on primary balance		-1,3	-1,8	-2,3	-2,8	-3,3
Net borrowing requirement, target		-2,8	-2,2	-1,6	-0,8	-0,1
Primary surplus, target	0,5	2,1	2,7	3,4	4,1	4,9

The adjustment will also include measures to increase competitiveness by strengthening the markets, reducing the tax wedge, and increasing the efficiency of public spending. Finally, it will at the same time devote resources to creating conditions of greater equity, including through a redistribution of the tax burden.

The envisaged reduction in public spending and its reorganisation and improvement, the fiscal measures and the measures to support the economy will be drawn up in full and fine-tuned over the next two months. To this end, the intensive work of dialogue and consultation with representatives of the local authorities, on the one hand, and the social partners, on the other, will continue. The measures will be implemented through the Budget Law, which will be presented in September.

Especially in matters of infrastructure investment, research and development, and the elimination of barriers to competition, the measures in question will in the medium term provide further vigour to GDP growth and output potential. At the same time, some provisions to reduce spending will inevitably exert opposing pressures in the short term. Therefore, notwithstanding the importance of the corrective adjustment to the public accounts, the target scenario envisages an economic recovery for 2007 that is marginally weaker than the current trend, with GDP growth falling from 1.5% to 1.2%. In the years following 2007, the lasting nature of the budgetary adjustment and the measures to foster growth will make it possible to achieve lasting development in the economy by more than the current projected levels, with the potential rate increasing to 1.7% towards the end of the projection period.

The government remains committed to the continuation of the privatisation policy that was a key feature of previous Parliaments. Privatisation measures are not explicitly quantified in this report because, in the absence of operations originally planned by the previous government, we need first to evaluate the strategic options for the divestment of the remaining state assets suitable for privatisation.

The government's targets do not involve any changes to the schedule of commitments entered into with the European Union in accordance with the Stability and Growth Pact. They envisage, therefore, that the ratio of net borrowing to GDP should return below 3% in 2007, with further structural adjustments of half a percentage point of GDP for each subsequent year, in line with the Recommendation issued to Italy in July 2005. The government reserves the right to evaluate more precisely the avenue to be followed to achieve this, with respect to the timescale for the structural effects of the measures to be adopted. This will not, however, affect its unswerving commitment to adopt through the forthcoming Budget Law all necessary actions to reduce the net borrowing below 3%.

Economic growth for 2007 reflects the negative impact of the corrective adjustment on consumption by both government and households. Conversely, the reform could begin to have a positive effect on exports and investments. Employment will continue the positive trend that has been under way since 2006, albeit with a slight decrease compared with the current trend.

Table IV.4 –Macro-Economic and Public Finance Targets

	2006	2007		2008		2009		2010		2011	
		DPEF Prog	DPEF Tend	DPEF Prog	DPEF Tend	DPEF Prog	DPEF Tend	DPEF Prog	DPEF Tend	DPEF Prog	DPEF Tend
INTERNATIONAL VARIABLES											
international trade	9.1	8.7	8.7	8.0	8.0	7.5	7.5	7.5	7.5	7.5	7.5
oil price (cif, OECD series)	70.0	71.0	71.0	71.0	71.0	71.0	71	71.0	71.0	71.0	71.0
euro/dollar exchange rate	1.254	1.277	1.277	1.277	1.77	1.277	1.277	1.277	1.277	1.277	1.277
MACRO ITALY (VOLUMES)											
GDP	1.5	1.2	1.5	1.5	1.2	1.6	1.2	1.7	1.3	1.7	1.3
imports	4.4	3.1	3.5	3.6	3.2	3.7	3.3	3.6	3.3	3.7	3.3
household consumption	1.3	0.8	1.3	1.3	1.2	1.5	1.2	1.6	1.3	1.6	1.3
public consumption	0.7	-0.6	0.2	0.0	0.6	0.2	0.4	0.2	0.4	0.2	0.4
investments	2.2	2.1	1.9	2.7	1.6	3.0	1.6	3.1	1.9	3.0	1.9
exports	4.7	4.0	3.7	3.4	3.0	3.4	3.2	3.3	3.1	3.3	3.1
note : BoP current account balance % GDP	*-2.1*	*-1.8*	*-2.1*	*-1.8*	*-2.0*	*-1.8*	*-2.0*	*-1,9*	*-2,1*	*-2.1*	*-2.1*
CONTRIBUTION TO GDP GROWTH											
net exports	0.0	0.2	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
changes in inventories	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.1
domestic demand	1.4	0.8	1,2	1.3	1,2	1.6	1.1	1,7	1,3	1.6	1,3
PRICES											
import deflator	7.6	2.2	2.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
GDP deflator	2.0	1.6	1.7	1.7	2.1	1.7	1.9	1.5	2.0	1.5	2.0
Nominal GDP	3.5	2.8	3.2	3.2	3.4	3.2	3.1	3.1	3.3	3.2	3.3
Consumption deflator	2.5	1.9	2.0	1.8	2.0	1.8	2.0	1.7	2.0	1.7	2.0
planned inflation	1.7	2.0	-	1.7	-	1.5	-	1.5	-	1.5	-
LABOUR MARKET											
labour cost	3.0	1.4	2.2	2.0	2.2	2.2	2.3	2.1	2.2	2.1	2.2
productivity (measured on GDP)	1.0	0.8	0.9	0.8	0.6	0.8	0.7	0.9	0.7	0.9	0.7
unit labour costs (measured on GDP)	2.0	0.6	1.3	1.2	1.5	1.4	1.6	1.2	1.5	1.2	1.5
employment (ULA)	0.5	0.4	0.6	0.7	0.6	0.7	0.5	0.8	0.6	0.8	0.6
unemployment rate*	7.6	7.5	7.5	7.4	7.5	7.2	7.5	7.0	7.5	6.7	7.4
employment rate (15-64 yeari)*	58.0	58.4	58.5	58.9	58.9	59.1	59.0	59,6	59.3	60.1	59,7
PUBLIC FINANCE											
general government net borrowing	-4.0	-2.8	-4.1	-2.2	-4.1	-1.6	-4.1	-0.8	-3.9	-0.1	-3.8
primary balance % GDP	0.5	2.1	0.8	2.7	0.8	3.4	1.1	4.1	1.3	4.9	1.5
Interest payments % GDP	4.6	4.8	4.8	4.9	5.0	5.0	5.1	5.0	5.2	5.0	5.3
general government debt % GDP	107.7	107.5	108.5	107.0	109.5	105.1	110.0	102.6	110.2	99.7	110.5
note: nominal GDP (euro millions)	*1466835*	*1508439*	*1513890*	*1556237*	*1564628*	*1606573*	*1613443*	*1657005*	*1666941*	*1710520*	*1721828*

Net of the cyclical component and one-off measures, the adjustment over the 2006-2007 period will amount to 1.6 percentage points of GDP.

Table IV.5 –Variation in debt adjusted for cyclical component and one-off measures

	2005	2006	2007	2008	2009	2010	2011
GDP growth at constant prices	0.0	1.5	1.2	1.5	1.6	1.7	1.7
Potential output	1.2	1.0	1.2	1.3	1.4	1.6	1.7
Output gap	-1.6	-1.2	-1.2	-1.0	-0.9	-0.8	-0.8
Cyclical budgetary component	-0.8	-0.6	-0.6	-0.5	-0.4	-0.4	-0.4
Net borrowing	-4.1	-4.0	-2.8	-2.2	-1.6	-0.8	-0.1
Cyclically-adjusted net borrowing	-3.3	-3.4	-2.2	-1.7	-1.1	-0.5	0.3
Cyclically-adjusted primary balance	1.3	1.1	2.7	3.2	3.8	4.5	5.2
One-off measures	0.5	0.3	0.1	0.1	0.0	0.0	0.0
Cyclically-adjusted budget balance net of one-off measures	-3.8	-3.8	-2.3	-1.8	-1.1	-0.5	0.3
Cyclically-adjusted primary balance net of one-off measures	0.7	0.8	2.6	3.1	3.8	4.5	5.2
Change in cyclically-adjusted budget balance net of one-off measures	-0.6	-0.1	-1.5	-0.4	-0.7	-0.7	-0.7

The budget consolidation strategy will have a moderating effect on inflation. As a consequence of the reduction in the tax wedge, labour costs will decline sharply in comparison with the trend followed under the current legislation. Inflation should therefore settle out essentially in line with the target of 2.0% in 2007.

But a recovery in growth assumes, quite apart from the reduction in social security contributions, a significant slowdown in unit labour costs compared with our competitor countries. This will be achieved through improved productivity growth and appropriate pay policies. Only in this way will the ground lost in recent years in terms of competitiveness be regained. The achievement of this result lies in the hands of enterprises and the social partners who work in them, and cannot be a task of the government.

In the four years following 2007, the initiatives planned by the government will enable an average development rate of just over 1.6% to be achieved. The increased competitiveness of the Italian economy will enable a stronger growth in exports compared with the current outlook. Growth will be sustained by domestic demand, and in particular by investment, and by a more favourable trend in household consumption, which will benefit from the effects of liberalisation policies and, therefore, weaker domestic inflationary pressures.

Employment is expected to increase by 0.7-0.8%, reflecting the effects of the economic cycle. The unemployment rate is projected to fall progressively and to settle out at 6.8% in 2011. That same year, the employment rate will be around 60%.

Wages will moderate in line with target inflation and with productivity gains generated by the improvement in the economic cycle. The consumption deflator will fall slowly over the envisaged timeframe, from 1.8% in 2008 to 1.7% in 2011, compared with target inflation rates of 1.7% in 2008 and 1.5% for the following three years.

As regards the government budget target, the main revenue and expenditure components will be illustrated once the actions to be adopted have been defined. The level of the net balance to be financed, net of accounting and debt adjustments, will be no higher than 29.5 billion euros for 2007, 19.5 billion for 2008 and 10.5 billion for 2009.