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SECTORAL REGULATORY REFORMS IN ITALY: FRAMEWORK AND IMPLICATIONS

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ABSTRACT/RÉSUMÉ

This paper discusses product market regulatory reforms in Italy over the past decade. Special attention is given to the underlying macroeconomic context for sectoral reforms and the role played by such reforms in consolidating the gains of macroeconomic convergence for entry into the European Monetary Union. The paper suggests that the shift towards more market-oriented and less interventionist policies, has allowed Italy's legal and institutional framework to come closer to the mainstream of good regulatory practices in the OECD countries. With Italy having been initially a laggard on the regulatory reform front, recent achievements have been remarkable. They are, however, incomplete. A major challenge is the need to secure competition in the sheltered sectors of the economy, where inflation inertia raises costs and affects the exposed sectors, thereby weakening international competitiveness.

JEL Classification: H3, L51, L6, L8, K23.

Keywords: Macroeconomic convergence, regulatory reforms, competition policy, Italy.

Ce document traite des réformes réglementaires du marché des produits en Italie au cours de la décennie passée. Une attention spéciale a été donnée au contexte macro-économique sous-jacent pour les réformes sectorielles et le rôle joué par de telles réformes dans la consolidation des gains en matière de convergence macro-économique dans la perspective de l'entrée dans l'Union Monétaire européenne. Le document suggère que la transition vers des politiques économiques plus orientées vers le marché et moins interventionnistes a permis à l'Italie de se doter d'un cadre institutionnel et juridique plus conforme au courant des bonnes pratiques réglementaires au sein des pays de l'OCDE. Étant donné que l'Italie accusait un retard initial sur le front de la réforme réglementaire, les réalisations récentes ont été remarquables. Elles sont, cependant, incomplètes. Un défi important réside dans la nécessité d'une concurrence assurée dans les secteurs protégés de l'économie, où l'inertie de l'inflation augmente les coûts et affecte les secteurs exposés, affaiblissant de ce fait la compétitivité internationale.

Classification JEL: H3, L51, L6, L8, K23.

Mots clés : Convergence macro-économique, réformes réglementaires, politique concurrentielle, Italie.

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SECTORAL REGULATORY REFORMS IN ITALY: FRAMEWORK AND IMPLICATIONS

Alessandro Goglio¹

Introduction

1. In the pre-qualifying period for EMU, Italy faced a strong incentive for extensively reassessing its economic policies, in the form of the Maastricht convergence criteria for entry into the European Monetary Union (EMU). The macroeconomic requirements focused on the need to create the foundations for sustainable growth, through an ambitious programme of stabilisation. Keeping inflation on a downward path and rolling back the huge budget deficit became the two key macroeconomic policy objectives of the 1990s. Consistent with these objectives, monetary policy remained committed to rooting out inflationary expectations over the period and inflation itself. On the fiscal side, the adjustment process, though hesitant initially, eventually gained in credibility during the second half of the 1990s, as evidenced by the declining trend of risk premia on Italy's sovereign bonds, alongside a stable exchange rate within the ERM since 1996. In 1998 Italy became one of the eleven countries which adopted the euro in stage three of EMU.

2. Concomitantly, there was a rapid and profound reorientation in institutional, legal and economic policies. A broad range of microeconomic policies were implemented with a view to raising the efficiency of markets, for both products and labour. Moreover, increasing attention has been paid recently to eliminating Italy's marked territorial income disparities, Italy's most persistent economic policy problem. The various policy domains are linked and mutually reinforcing. Privatisation and product-market liberalisation cannot sustainably increase productive efficiency if the rigidities of the labour market are not eliminated, and the functioning of the labour market in the Italian context depends heavily on policies capable of tackling the wide gap in living standards between the Centre-North and the South, the *Mezzogiorno*. These policy changes have the potential to alter fundamentally the relationship between the state, the market, and its citizens.

3. This paper discusses the scope, speed and consistency of product market regulatory reform in Italy. It first sets out the economic context for regulatory reform at the beginning of the 1990s, emphasising the close links between macroeconomic stabilisation and the programme of structural reforms. It then moves on to discussing several sector-specific features of reforms and the progress made so far. A separate section looks at the economic significance of regulatory reforms, notably their positive

1. This paper reflects the contribution of the OECD Economics Department to the *OECD Regulatory Reform in Italy* which was published in April 2001 as part of a series of country reports carried out under the OECD's Regulatory Reform Programme launched in 1998. The author is an economist on the Italy/Turkey Desk in the Economics Department. He is indebted to Scott Jacobs and Robert Price for substantial drafting contribution and Alexandra Bibbee, Andrew Dean, Giuseppe Nicoletti and Ignazio Visco for valuable comments. Giuseppe Nicoletti also contributed to the background work on regulatory indicators. Special thanks go to Jean-Marie Strub for technical assistance and to Janice Gabela and Laura Schaub for technical preparation. The paper has benefited from numerous Italian experts in the private sector, as well as in ministries and government agencies responsible for policy-making in this area.

interactions with the aggregate growth performance of the economy. The final part of the paper outlines several outstanding restructuring and competition issues.

The macroeconomic context for sectoral regulatory reforms

Structural factors and economic performance

4. From the early 1950s to the first oil shock in 1973, Italy's real GDP per person increased by an average of about 5 per cent a year, more than twice as rapidly as in the years from the oil price shock to today (*Table 1*). A number of self-reinforcing forces bolstered the performance of Italy during this "golden age". The first was a pattern of industrial relations broadly supportive of moderate wage growth and of improved labour utilisation. This framework permitted the achievement of high profit margins which increased the amount of financial resources readily available for private capital formation. Second, the extent of the initial "technological gap" *vis-à-vis* many advanced economies favoured the achievement of rapid productivity gains. Operating together, these forces greatly amplified the opportunities provided by the spectacular growth of world trade, with strong export revenues acting as a channel to support capital investments without putting the balance of payments at risk. As would be expected from a country that was "catching up", the Italian economy was capable of expanding at a much stronger pace than the rest of the EU area, so that its overall productive system underwent a radical process of modernisation.

Table 1. Main macroeconomic indicators

	1951-60	1961-73	1974-90	1991-95	1996-2000
Per capita GDP ¹					
Italy	1366	3873	16382	20119	21531
EU	1494	4179	16190	19494	22203
Per capita GDP ²					
Italy	5.2	4.7	2.5	1.0	1.8
EU	4.1	4.0	2.0	1.1	2.5
Labour productivity ²					
Italy	5.8	5.2	2.2	2.4	1.0
EU	4.4	4.3	1.5	2.0	1.3
Inflation ²					
Italy	2.9	4.9	12.7	5.5	2.3
EU	..	4.7	8.8	3.7	1.8
Budget deficit ³					
Italy	-0.9	-6.5	-11.1	-7.6	-0.1
EU	0.8	-0.4	-3.5	-5.4	0.7
Public debt ³					
Italy	..	51.3	98.0	123.1	112.0
EU	..	35.2	55.2	75.2	70.3

1. In US dollars at 1995 prices using PPPs; end-of-period data, except for the last column where 1999 figures are shown.

2. Average annual rates of change.

3. As a percentage of GDP; end-of-period data. Deficit and debt figures for 2000 are OECD estimates. The figures for the general government deficit in 2000 include, for Italy, and the other concerned countries in the EU aggregate, one-off revenues from the sale of the mobile telephone licenses.

Source: *Bank of Italy; OECD.*

The changing interactions between microeconomic behaviour and macroeconomic context

5. By the end of the 1960s, the “virtuous circle” of strong micro- and macroeconomic performance was operating less fully -- and after 1973 hardly at all. This was partly because the first oil shock was superposed on several increasingly tight constraints on economic performance. After two decades of robust output growth, industrial relations came under pressure, so that wages started to move decisively out of line with national productivity trends. Tensions emerged first (and most obviously) in the mainstream regions of the Northwest which had achieved a situation of virtual full employment, while rapid urbanisation brought important changes in households’ life-styles and aspirations. On the other hand, the scope for raising productivity through “catching up” with the major European countries was largely exhausted for the North; accordingly, the room for absorbing wage increases via productivity gains was small by the mid-1970s. Elsewhere too, the limited capacity of collective bargaining to generate wage settlements within margin provided by the growth of productivity caused harmful effects. Particularly severe in this respect were the effects on the economy of the *Mezzogiorno*, which given lower labour productivity than in the North was burdened with excessively high unit labour costs - making the South less attractive to business capital investment. Moreover, these developments were superimposed to a situation characterised by the presence of sizeable sectoral differences in labour productivity levels, with wage hikes extending to sectors with little or no potential for strong productivity growth, including a sizeable public enterprise sector (see below).

6. While the rate of increase in per capita GDP dropped in all OECD countries, the adverse effects of the oil crisis were particularly strong for Italy. This was because of its greater dependence on imported energy, so that a serious imbalance in the external current account emerged. However, the direct consequences of the oil shock were also compounded by the effects of full backward looking indexation of wages (*scala mobile*) - further exacerbating the underlying strong inflationary tendencies in the country.

7. The advent of an international environment less capable of absorbing Italy’s excess output capacity also meant that the country’s efficiency problems were magnified. In product markets, difficulties were visible in the hesitancy with which large firms undertook major programmes of modernisation, involving wide-scale investment in both more advanced technologies and marketing practices. As a result, output, investment and productivity of large companies expanded at a significantly slow pace until well into the 1980s. Notwithstanding the expansion of small firms which cushioned, in part, the impacts of these developments on employment, problems in the labour market were revealed by the increasing time lag needed for labour resources to be redeployed between uses.

8. Currency devaluation helped to counteract the recessionary effects of the crisis, but at the expense of price stability. In addition, deficit spending was boosted, and considering that the revenue side did not adjust as quickly the budget shifted into structural deficit. By failing to secure early enough the financing of such structurally higher public expenditures, Italy prepared the ground for the accumulation of a stock of debt that left no room for budgetary flexibility later on, including that required for counter-cyclical purposes. The new course of policy also created the conditions for a significant contraction in the finance available for capital accumulation, thereby further complicating the business climate. Thereafter, the financing requirements of the public sector continued to expand, notably as monetary policy shifted towards a less accommodating stance. Fiscal policy did so more slowly, however.

The 1990s: policy responses and successful stabilisation

9. By the early 1990s the levels of the general government deficit and public debt were extremely high by OECD standards, at some 10 per cent and 90 per cent, respectively. Concomitantly, the average annual rate of inflation was running at nearly 6½ per cent, based on the consumer price index, compared

with approximately 4½ per cent for both the EU and the OECD area. The stage was set for painful adjustment, which came in following the currency and financial crisis of end 1992, when the lira had to drop out from the European exchange rate mechanism. High real interest rates implied that the level of public sector debt continued to increase for some time after the process of stabilisation was started. In turn, the primary surplus needed for the restoration of sound public finances was much higher than in most other OECD countries due to the heavy debt service burden.

10. Radical reforms in industrial relations assisted stabilisation, with a major step in policy having been the final abolition of backward indexation. Monetary policy remained targeted towards bringing actual and expected inflation down towards the levels of the European countries and as progress was made towards these objectives, key official rates were reduced gradually from 1996 onward. This eased the process of meeting the Maastricht fiscal targets.²

The need to consolidate the gains of macroeconomic convergence with regulatory reforms

A dominant public enterprise sector

11. The background to regulatory reform was one where the Italian public enterprise sector played a dominant role in the supply process, ranking high by the OECD comparison both in terms of its size and scope. By the end of the 1980s, state-controlled enterprises employed some 1½ million workers, accounting for 15 per cent of non-agriculture employment, 20 per cent of aggregate value added and almost 25 per cent of total fixed investment.³ At the same time, public sector borrowing absorbed roughly three-quarters of overall households' savings, the counterpart being a tendency for the public enterprises' to over-invest and be overmanned. While public enterprises operated in all sectors of the economy, their presence was particularly pronounced in service-production, the state controlling two thirds of the banking system, three fourth of transportation and communication and nearly the totality of energy-related activities (electricity, natural gas and also water). The pervasiveness of state ownership was compounded by a control and organisational structure which was highly non-transparent and prone to political interference.

12. The performance of the Italian public enterprise sector was highly disappointing to make it financially viable. Also, by international comparison, the efficiency gap between Italy and the major OECD countries was marked, particularly as concerns the inflation-prone public utility services (except electricity, perhaps). Under these circumstances, the public enterprise sector has been, for many years, a drag on the overall productivity performance of the country and a source of inflation inertia in the sheltered sectors.⁴ The drive for large scale privatisation, initially motivated by the need to limit the extent of state aid and to arrest the rapid rise of public debt, has increasingly been seen as a key to improving overall supply conditions.

13. As concerns the banking system, more specifically, regulatory barriers between types of banks were very rigid -- strongly hindering their diversification capacities, both across typologies of loans and customers. This implied the formation of a highly segmented credit market which comprised a large number of small, inefficient, local banks. At the other extreme, the few "big" banks which operated in Italy at the beginning of the 1990s were not large enough to compete internationally.

2. See for a wider discussion Signorini and Visco (1999). For a discussion of Italy's monetary policy at a turning point of its stabilisation effort, see Visco (1999).

3. See OECD (1991), p. 65. See also Goldstein and Nicoletti (1996).

4. See Barca and Visco (1993).

The income gap between northern and southern regions

14. Given that the state-owned enterprises have been required to invest large portions of their capital in the South, a further feature of Italy's approach to state intervention has been to harm the long-run economic performance of the *Mezzogiorno*. With state firms having traditionally used high capital-intensive techniques, the related employment creating effects have been weak. Furthermore, their effect on the development of local businesses also tended to be small, as links with (upstream) small and medium enterprises were generally tenuous.

15. By the early 1990s, the South was a structurally dependent economy, with large transfers of resources from outside being needed to keep artificially high consumption levels. With 36 per cent of Italy's population, the South accounted for roughly one fourth of the country's aggregate GDP, one-third of total employment and 54 per cent of unemployment. The share of agriculture in its total output, though declining, was still above 7 per cent, mainly to the detriment of the manufacturing sector. The share of the latter has consistently remained below 20 per cent over the post-war period, well below the corresponding share of the North (more than 30 per cent). With labour supply expanding more rapidly than in the North over the 1980s, the geographical dispersion of unemployment was unusually pronounced by international standards.

16. A new development since the beginning of the 1990s, has been the growing differentiation of economic conditions within the *Mezzogiorno*, reflecting, in part, the expansion of the so-called "industrial districts" (*distretti industriali*, see below) from their traditional locations in the north to several easy to access regions of the *Mezzogiorno*. However, the overall reliance upon public transfer payments of the most remote regions of the South, alongside several large metropolitan areas (Naples, Catania, Palermo and Bari), has not rapidly eased.

Barriers to competitive service markets

17. Alongside a pervasive and largely deficient public sector, the Italian productive system has been characterised by a slowly expanding private service sector - comprising many activities which are typically less exposed to international competition than the manufacturing ones.⁵ Overall, the size of Italy's service sector is modest compared with the other major OECD countries, a particularly wide gap being observed for retail and distribution, business services and services to the community, all of which involve the recourse to highly labour-intensive technologies. In general, these sectors have been earmarked by a considerable degree of fragmentation and high market inefficiencies, a situation which has often been exacerbated by the presence of strong barriers to competition.

18. Many sectors are protected from market competition through regulation. The self-regulatory role played by professional orders (business consultants, lawyers, fiscal experts, for example) and small business associations (driving schools, taxis, trucks, beauty salons, cinemas, to take a few examples) has been (and still is) very extensive, without being justified by reasons of general interest. In these sectors, tariffs have usually been established on the basis of self-imposed internal and anti-competitive criteria.

Failure of smaller firms to grow

19. Another salient feature of the Italian corporate system has been its dualistic industrial structure, and notably, the coexistence of a small number of large corporations with an extensive number of small-

5. See Barca and Visco (1993) and Signorini and Visco (1999).

and medium-sized firms. The over-representation of small firms, sometimes grouped in the *distretti industriali*, partly reflects the structure of manufacturing arising from a specialisation in labour- and resource-intensive industries. It has long been considered a factor of relative strength for the Italian economy, small firms being widely thought to be characterised by a high degree of flexibility.

20. Nevertheless, a long-lasting and puzzling aspect of the Italian small enterprise network has been the marked propensity of such firms to remain small and mostly family-owned, which is quite anomalous from the perspective of the major OECD countries. Since the early 1990s, various *OECD Economic Surveys of Italy* have associated this situation with the influence of a legacy of unfriendly rules and institutions, including burdensome administrative costs; an excessively strict job-protection legislation that only small-scaled firms are in a position to circumvent; a legacy of laws adopted since the early 1950s providing special credit facilities for small-sized companies, and the greater opportunities of small firms for tax evasion.⁶

Absence of a market for corporate control

21. Finally, the case for regulatory structural reforms has also been magnified over the years by the need for a well-functioning mechanism for the transfer of ownership. In the absence of such mechanisms, the capacity of the business sector to respond to external or domestic macroeconomic changes and technological developments is greatly reduced. The market for corporate control has traditionally been quiescent in Italy, which is somewhat at odds with the evidence of fairly widespread cases of property reallocations involving small- and medium-sized companies.⁷ These typically take the form of family transfers (such as bequests, donations or family sales, for example), while only a relatively small proportion of such operations is made through the market. Family transfers allow the accumulation and preservation of human capital but restrict transactions to agents with inside information or enjoying informal relationships.

22. By the early 1990s, the companies listed in the Milan stock exchange amounted to less than a third of those listed in Paris, with daily trading activities, together with the ratio of market capitalisation to GDP, being the lowest among the major six OECD countries. Mergers and acquisitions were scant, compared to those occurring in other European countries, while hostile take-over bids were almost non-existent. Controls on capital outflows were only finally abolished in 1990 and were for a long time responsible for holding back foreign direct investment, thereby further weakening the drive towards mergers and acquisitions and the diffusion of new technologies.

23. The expansion of the market for corporate governance has been traditionally inhibited by a mix of weak institutions and rules.⁸ A dominant aspect of the Italian corporate sector in the early 1990s was the high degree of concentration of its ownership structure, with a small core of pyramidal groups accounting for the bulk of the overall stock market capitalisation. Reflecting the diffusion of inter- and intra-group cross-shareholdings, control over the firms belonging to the group is exercised with a minimum amount of capital invested. Chains of equity holdings linked together the top and the bottom of the pyramid, effectively discouraging take-over bids, discriminating against minority shareholders, and shielding management from undesired changes. More importantly, perhaps, cross-shareholdings have facilitated the formation of strategic alliances, therefore increasing the potential for collusive behaviour.

6. OECD (1991), p. 61.

7. See for a wider discussion, OECD (1995), p. 79. See for a background analysis of these issues, Barca *et al.* (1994a) and Barca *et al.* (1994b).

8. OECD (1995), p. 80.

24. Furthermore, the imposition of severe restrictions to the realisation of ownership linkages between banks and corporations have also mattered. An important counterpart to such restrictions was the strong dependence on short-term bank finance and the lack of specialised financial intermediaries, such as merchant banks and venture capital institutions. Through limiting access to much needed long term credit facilities and qualified consultancy supports, this situation may have compounded impediments to the expansion of small firms.⁹

The role of the institutions

25. It is not surprising, therefore, that in the early 1990s improvements in the long-run economic performance of Italy had become conditional upon the elimination of major macroeconomic and microeconomic impediments, often highly interconnected. Better budget management was a key requisite for dealing with a spiralling public sector debt, for tackling the high inflation problem and for recreating business confidence. In addition, the case for regulatory reforms was very strong, a key precondition for improving overall economic performance being a reduction in the pervasive and badly-administered state role in the economy. It was important, moreover, to accompany the process of fiscal consolidation and the related “crowding-in” of private resources, with the creation of a market-friendly and well-functioning regulatory framework. Understanding the challenges involved requires answers to such major questions as: why, in spite of long-lasting signs of inefficiencies in the public sector and the related mounting stock of public debt, did it take as long before the value of Italy’s state property was put into serious doubt? What lay behind the evolution over time of the share of the public enterprises in economic activity? What are the peculiar features of the Italian regulatory infrastructure model from an international perspective?

The rise and fall of the Italian model of public enterprises

26. The historical roots of state intervention in the business sector have been discussed at length in past OECD *Economic Surveys of Italy*. Particular emphasis has been placed on the following macroeconomic factors:¹⁰

- The presence, until the 1960s, of sizeable public current account savings, implying that a large amount of resources could be made available for public investment;
- An underdeveloped financial market, which limited the ability of firms to raise funds directly from households;
- A rigid separation between the banks and the industrial sector under the 1936 Banking Law, which prevented ordinary banks from acquiring shares and extending long-term credit

27. The main public conglomerate *Istituto per la Ricostruzione Industriale* (IRI) was created in 1933 in order to avoid the collapse of the financial system. It initially performed the role of a financial holding, taking over temporarily three major all-purpose banks, as well as the entirety of their stakes in industrial firms. Eventually, IRI was made permanent, in contrast with the initial plan according to which all its constituent entities were to be given back to the private sector as soon as the crisis was over. With this,

9. A noteworthy exception is to be found in the role played by *Mediobanca*, which thanks to the loopholes in the existing legislation was able to achieve an almost exclusive role in merchant banking activities. See OECD (1995), p. 77.

10. See more specifically, OECD (1994), pp. 116-125. See also the background contributions by Barca and Trento (1997), Barca (1999) and Salvati (2000).

Italy took a road which differed markedly in direction from those followed in the US and Germany. With institutional impediments limiting not just the supply of risk capital to private entrepreneurs (as in the US) but also the development of a structured system of universal banks (as in Germany), the role of financial intermediary, needed to ensure an adequate level of overall capital formation, fell largely upon IRI, i.e. the state.

28. IRI's managers, as well as the those of its sub-holdings, conducted their businesses in a technically competent and responsible manner, maintaining themselves insulated from the influence of the private lobbies. Thanks to the special status with which they were entrusted, the public companies (*enti a statuto speciale*) enjoyed a high degree of autonomy, despite the fact that they continued to receive generous public funds.¹¹

29. Thereafter, the model of the autonomous conglomerates operating in a number of areas was reinforced over the years, and produced its best achievements during the post-war reconstruction period. As was the case with the major European countries, public enterprises were managed with a view to supporting a host of strategic objectives: the balance of payments; regional development; the development of the steel and energy industries. The oil and gas conglomerate, *Ente Nazionale Idrocarburi* (ENI), was created in 1953. The nationalisation of electricity in 1962, with the establishment of *Ente Nazionale per l'Energia Elettrica*, ENEL), was based on a combination between strategic and industrial development reasons and social equity motivations.

30. Nevertheless, IRI expanded markedly throughout the post-war period as was the case, later on, with *Ente per il Finanziamento dell'Industria Manifatturiera* (EFIM, which was created in 1962 and liquidated in 1994) and *Società di Gestioni e Partecipazioni Industriali* (GEPI, the smallest conglomerate created in 1971). Progressively, however, the conglomerates extended their responsibilities so as to operate in an increasingly widespread range of economic activities, essentially acting as safety nets for ailing private banks and industries, rather than being the outcome of an explicit industrial policy design. Sooner than later, the *problem of control* typically faced by the private corporates, resulted compounded within the public enterprises by a more complex hierarchy of principal-agents relationships involving the additional interests of politicians and bureaucrats. Boards of directors were inflated with a large number of representatives designated by political parties. The operational decisions of the managers were therefore taken in collusion with the politicians.

31. Political control was exerted through an intricate system of overlapping decision making levels, all enjoying cross-veto powers. Monitoring the performance of public enterprises was difficult in the absence of incentive mechanisms that normally influence the management of private companies, including the threat of hostile take-overs and bankruptcies.¹² Thus a soft budget constraint was the norm, with the financing of the operations of the public enterprises being facilitated by government guarantee and other forms of state aid, such as the so called endowment funds, for example (*fondi di dotazione*). Under the circumstances, non-economic goals usually came ahead of corporate strategic objectives, particularly during periods of economic downturns.

The regulatory framework

32. As the process of world trade liberalisation gathered speed in the initial post-war period, powerful incentives to change began to operate: incentives to build larger, more efficient plants; incentives

11. Barca (1999), p. 8.

12. Public and autonomous agencies, the main form of public enterprises until 1992, were exempt from the provisions of the civil code regulating bankruptcies. See OECD (1994), p. 120.

to shift to more specialised products; and incentives to invest in developing new processes. The responses were visible by the shift in many advanced countries to more active competition friendly policies.¹³ Italy's responses were not fully appropriate, however. Also because it was poorly endowed with natural resources, Italy was not a laggard on the external trade liberalisation front. This was evidenced in its active involvement in all important international agreements that were conceived since the early post-war period to sweep away many barriers to trade. The formation of the European Economic Community, provided further impetus to the dynamic of market opening.

33. In retrospect, the lack of market-oriented policies found partial support in a particular interpretation of the post-war Constitution.¹⁴ Despite the fact that the Constitution enshrines the principles of private economic initiative and private property (Art. 41 and 42), business practices have been hindered, at times, by the highly discretionary criteria with which the state has often exerted its rights of intervention in the economic domain via the use of the instrument of the administrative concession (*concessione*). Article 43, in particular, explicitly recognises that restrictions to the number of suppliers operating in a particular domain of activity, be it a product or a geographical area, can be justified by making appeal to the argument of "general interest". However the evidence collected by the Antitrust Authority points to the fact that in most situations the authorisation of a concession involves the limitation of a fully legitimate market activity.¹⁵ Furthermore, an important aspect of the Italian legislation is the imposition of rigid rules of incompatibility between private service activities, a factor which explains the high degree of fragmentation characterising the sector and tends to perpetuate existing market inefficiencies.

34. The adverse consequences of the lack of a market friendly environment have also been compounded by an over-regulated administrative decision making system. The functions covered by the public administration have widened over time and the related proliferation of procedural formalities, has resulted in an excessive number of bodies and offices necessitated to carry them out. Such a rigid administrative system placed unnecessary costs on citizens and business making, a consequence of growing uncertainty as to rights and the associated mounting number of legal disputes.

35. It is difficult to estimate the extent to which price signals were distorted, but one further significant factor stands out: the traditional fragmentation of the country into autonomous power centres. Reflecting the geographical shape and surface of the territory, regional markets were heavily segmented, making it fairly expensive to connect local markets to each other. The need to reduce local barriers to national product market competition, and the high perceived returns from doing so, was a prominent rationale for the *regulatory* role of the state.

The drive for large-scale sectoral reforms

Sources of pressure

36. Following a sequence of failed restructuring attempts, by 1991 the combined net financial debt of EFIM and IRI amounted to over 5½ per cent of GDP. Notwithstanding these mounting difficulties, no coherent privatisation policy existed in Italy until the early 1990s, with sales of state assets remaining

13. Eventually these incentives tended to disappear in the aftermath of the first oil shock. Until they remained in operation, however, competition policies underwent positive changes – reinforcing a world climate of confidence and strong investment.

14. See *Autorità garante della concorrenza e del mercato* (1996), pp. 12-16.

15. See *Autorità garante della concorrenza e del mercato* (1996), pp. 13.

sporadic and below the number of new state acquisitions. One factor behind the delay is to be found, perhaps, in the fact that the consolidated accounts of the public conglomerates masked a high degree of cross-subsidisation. As concerns IRI, its loss-making activities included plant-engineering; rail and sea transportation; iron, steel and shipbuilding. Losses were also incurred by ENI's mining, manufacturing and publishing branches. Most of these areas could survive because of sustained support from a number of profitable sub-holdings in the oil and gas conglomerate and the telecom subsidiary of IRI.

37. Domestic pressure on the government to act on the privatisation front was mounting, however, as part of the wider programme of structural adjustment which was imposed by the currency and financial crisis of 1992.¹⁶ On top of this primary factor of change, the damaging consequences for the reputation of the public enterprises of the corruption scandals, in which many of them were found to be involved, also played a role. By serving to make the public opinion fully aware of serious underlying accountability and management problems, the scandals indirectly contributed to reinforce the consensus for broad-based structural reforms.

38. Another concomitant source of change was the tightening by the European Commission of its standards for state aid to public enterprises. Notable in this respect was a dispute over state aid spurred by the financial strains of EFIM and IRI. This contentious issue originated from the fact that the Italian civil code entitled the state to guarantee the debt of its fully-owned public enterprise, but the EC saw this as a violation of European provisions against state aid. To resolve the controversy the Italian government agreed in 1993 to reduce its holdings in all public enterprises and IRI's debt to "levels acceptable to a private investor operating in a market economy", de facto implying an end to large transfers of public funds and the sudden appearance of a hard budget constraint.¹⁷ As bankruptcy became a serious threat for public operations, Italy's commitment to the implementation of privatisation came to sound more credible.

39. Beyond the influence of initial short-term sources of stress, continued pressure to expose Italy to greater competition has arisen during the 1990s from two main sources, EU directives and intervention of the Antitrust Authority which has been operational from 1990 (*Autorità garante della Concorrenza e del Mercato*, see below). While acknowledging the role of the government in establishing the ground rules, the key elements of the EU approach have been:

- privatisation and the lowering of existing barriers to foreign ownership;
- regulatory sectoral liberalisation of both financial and non-financial activities so as to accelerate the adoption and implementation of European liberalisation directives ;
- diminished recourse to public financial aid.

40. In a country long accustomed to large *ad hoc* interventions by the public sector, the vigorous intervention of the Antitrust Authority has been concentrated on assessing and evaluating both pre- and post-liberalisation conducts. With many of the companies involved by the process of liberalisation having a widespread presence in vertically- and horizontally-related markets, before liberalisation intervention has remained focussed on preventing actions that could hinder the creation of competition in such complex sectors as transport, gas, electricity and postal services, for example. As concerns post-liberalisation intervention, the Authority's actions have been typically being oriented towards promoting entry, increasing the transparency of the concession process, and making universal service obligations more consistent with competition.

16. OECD (1994), p. 123.

17. OECD (1995), p. 68-69.

41. For most of the 1990s, actions of the Antitrust Authority have focussed mainly on sectors occupied by traditional monopolies undergoing important restructuring deregulation (transport and telecom, for example), or private sectors prone to the introduction of anti-competitive practices (retail distribution, agriculture and professional services, for example). In many instances, the Authority's interventions have been instrumental in accelerating the adoption and implementation by the Italian government of EU directives and of new regulations.

Earlier measures taken to prepare the stage for structural reforms

42. Exposing Italy's economic system to greater competition took time, however. Many state-owned firms needed to restructure their balance sheets and were not readily saleable in the absence of a co-ordinated framework. In this situation one peculiarity of the Italian approach to reforms rested on the increasing propensity of the government to issue decree laws, sometimes putting them under the umbrella of framework laws. In a country with a long tradition of over-legislated public policies, which had resulted in many excessively detailed and in effect anti competitive rules, this practice has at times helped to reduce the viscosity of legislative procedures.¹⁸

Competition policy and privatisation

43. The first relevant piece of legislation, which was passed in 1990, established the Antitrust Law on the "promotion and safeguard of competition and the market". Although the last-but-one OECD country to adopt a competition law, Italy managed to introduce in one go a full set of rules, covering cartels, abuses of dominant positions and mergers. EC rules and the experience of other countries served as a guide in this respect. The law covered all firms, including public undertakings, while the responsibility for wetting mergers and investigating and sanctioning restrictive practices was entrusted to a newly-established Antitrust Authority. The Authority was given power as a collegial independent body responsible for enforcing the new law, with associated powers of investigation and decision-making. In addition, it was conferred the right to initiate investigations into the competitive practices of any sector of the economy and to impose substantial fines, with such investigations being started at its own initiative, or at the request of the government. In the case of insurance companies, the law established that merger control is to be exercised by the Authority, but in consultation with a special body responsible for the supervision of the insurance sector (ISVAP). On the other hand, the responsibility for avoiding restrictive practices in the banking system was entrusted to the Bank of Italy, although decisions have to be taken in consultation with the Antitrust Authority.

44. Another milestone in the Italian process of reforms occurred in 1992, with the submission to parliament of a wide-ranging medium-term plan for the reorganisation of all major conglomerates. Under the plan a two-pronged divestiture strategy was envisaged, with the first pillar resting on the identification of a new organisational framework, within which to limit the operations of the public enterprises. This necessitated the corporatisation of the public enterprise sector, by which both state banks and non-financial state-owned enterprises were to be transformed into joint-stock companies and placed under the provisions of the civil and commercial law. The responsibility for appointing the managers of these companies fell upon the Ministry of Treasury, which became the single shareholder and used this prerogative to significantly shrink the board of directors of the new joint-companies. This helped to insulate the public enterprises from political influence. The plan also affirmed the economic goals to be achieved through privatisation, although it paid little or no attention to the need for increasing market competition in sheltered and public utility sectors.

18. OECD (2001b), Chapter 2.

45. In order to enhance the credibility of the overall process of state retrenchment, a decree law of 1992 sanctioned the end of extraordinary interventions in favour of southern regions and the abolition of the two institutions responsible for such intervention, the *Dipartimento per gli interventi straordinari nel Mezzogiorno* and *AgenSud*. Thereafter, the resources destined to regional development have been disbursed through a fund at the Ministry of Treasury, which was also made responsible for defining the priorities concerning their distribution to the other ministries.

Decentralisation and the reform of the public administration

46. The reorganisation of public services in Italy also involved the public utilities under municipal or provincial authority (*comuni* and *province*), including energy, water and public transports, for example. Important steps were undertaken at the beginning of the 1990s with the aim of enhancing the freedom of decision making within such sectors along with improving management procedures and accountability of managers. Law 142 of 1990, in particular, affirmed the principle of having an independent balance sheet for the public activities directly managed by a local administrative body. Even though the new law was not intended to force the local authorities to place their productive entities on the market rapidly, it laid down the ground for allowing the participation of private capital in such corporates.

47. The year 1990 also saw the launching of the programme of public administration reform, without which any progress in the process of decentralisation was considered unlikely to be achieved. Law 241 set out general principles governing the activities and functioning of the public administration (openness transparency, predictability). The introduction of this new set of administrative procedures was subsequently complemented by crucial provisions in the matter of simplification, rights and participation of citizens, and accountability mechanisms.¹⁹

Financial markets and corporate governance

48. Meanwhile, major impetus to the reform of the financial sector was arising from the single market. The most important EU directives set out a range of policies to promote a stronger harmonisation among countries participating in the Maastricht agreement as to their banking activities. Using the opportunities granted by the 1993 Banking Law, the Interministerial Committee for Credit and Savings enlarged the range of operations which ordinary banks (*aziende di credito*) and special credit institutions may conduct. Thus, ordinary banks were permitted to issue bonds and to extend medium- and long-term credit, thereby paving the way for the formation of a system of universal banks in Italy. Another relevant innovation was the partial removal of the norms sanctioning the separation between banks and non-financial corporations, including the limited possibility for the former to acquire participation in the latter.

49. The processes of privatisation and liberalisation being expected to induce sizeable compositional changes in the overall financial portfolio of households, via a rise in share-holding, new laws and rules aimed at broadening the undersized stock market were also required. The new legal framework for the organisation and functioning of the securities market was set out in the stock-market law of early 1991, which sanctioned the creation of a new legal entity, the multi-functional investment firm (SIM). A Settlement and Guarantee Fund (*Cassa di compensazione e garanzia*) placed under the supervision of the Bank of Italy and Consob, the Stock Exchange Commission, began operations in 1994. The 1992 law concerning take-overs made bids compulsory. Safeguards for minority shareholders were strengthened and shareholders were granted a more effective representation on governing bodies. Notification of all agreements among shareholders was made mandatory.

19. See for a deeper discussion of these issues OECD (2001b), Chapter 2.

Privatisations: framework and results

50. A blueprint establishing the procedural aspects of privatisation was not ready until late 1993. Although final decisions for each privatisation were delegated to the Treasury, a committee of economic ministers -- Treasury and Industry -- was given the power to formulate proposals and define the general guidelines about privatisation. A privatisation division at Treasury was created to give technical support. To make the privatisation process more transparent, a special Advisory Committee was established, composed of the Treasury Director and four independent experts, while the preference for public offers was made explicit. The programme also defined the powers to be retained by the state in strategic sectors (the electricity and the telecom companies, for example), in which the government retained special voting rights (*golden share*). Sales of public utilities were made conditional upon the creation of independent regulatory authorities.

51. Following a long period of gestation, massive privatisations took a fast start in 1993.²⁰ Since then and until 1999, the overall amount of privatisation disposals managed by IRI and ENI groups, alongside the ones accrued by the Treasury for debt reductions, equalled more than L 152 trillion, or some 8 per cent of the period's average GDP (*Table 2*). This made Italy one of the largest privatisers in the OECD area. By way of comparison, during the most intensive period of privatisation in the UK, notably between 1985 and 1995, annual revenues averaged 1.2 per cent of GDP. It is also notable that in contrast with practices in many other OECD countries, privatisation proceeds were fully earmarked for debt reduction (through creation of a special debt-redemption fund). The tempo of privatisation gathered an especially strong momentum from 1997.

52. In many instances, however, privatisation has been tempered with a protracted desire of the state to retain important control stakes over the privatised companies, which may have slowed market development.²¹ The state presence in the telecommunication and energy sectors has been prolonged by the special powers applying to the golden share, which have been found by the European Commission to violate competition. Italy has repeatedly been requested by the Commission to terminate this practice.

20. See for a background reading, Macchiati (1999).

21. Malgarini (2000), p. 98.

Table 2. Main privatisations in Italy in the 1990s

	Corporation (Group)	Method of sale	Percentage sold	Gross proceeds in billions of lire
1993	Italgel (IRI)	Private agreement	62.12	431.1
	Cirio-Bertolli-DeRica (IRI)	Private agreement	62.12	310.7
	Credito Italiano	Public offering	58.09	1801.1
	SIV (EFIM)	Auction	100.00	210.0
	Total for year			2752.9
1994	IMI - 1st tranche	Public offering	32.89	1794.0
	COMIT (IRI)	Public offering	54.35	2891.2
	Nuovo Pignone (ENI)	Auction	69.33	699.0
	INA - 1st tranche	Public offering	47.25	4530.0
	Acciai Speciali Terni (IRI)	Private agreement	100.00	624.0
	SME - 1st tranche (IRI)	Private agreement	32.00	723.0
	Other companies (ENI)			1087.0
		Total for year		
1995	Italtel (IRI)	Auction	40.00	1000.0
	Ilva Laminati Piani (IRI)	Private agreement	100.00	2514.0
	Enichem Augusta	Auction	70.00	300.0
	Other companies (ENI)			336.0
	IMI - 2nd tranche	Private agreement	19.03	913.
	SME - 2nd tranche	Accept takeover bid	14.91	341.4
	INA - 2nd tranche	Private agreement	18.37	1687.0
	ENI - 1st tranche	Public offering	15.00	6299.0
	ISE (IRI)	Auction	73.96	370.0
		Total for year		
1996	Dalmine (IRI)	Auction	84.08	301.5
	Italimpianti (IRI)	Auction	100.00	41.6
	Nuova Tirrena	Auction	91.14	548.0
	SME - 2nd tranche (IRI)	Accept takeover bid	15.21	120.9
	INA - 3rd tranche	Conv. Bond issue	31.08	4200.0
	MAC (IRI)	Auction	50.00	223.0
	IMI - 3rd tranche	Public offering	6.94	501.2
	Montefibre (ENI)	Public offering	65.00	183.00
	ENI - 2nd tranche	Public offering	15.82	8872.0
		Total for year		
1997	ENI - 3rd tranche	Public offering	17.60	13231.0
	Aeroporti di Roma (IRI)	Public offering	45.00	594.0
	Telecom Italia	Core investors + public offering	39.54	22883.0
	SEAT editoria	Core investors + public offering	61.27	1653.0
	Banca di Roma (IRI)	Public offering + bond issue	36.50	1898.0
	Ist. Bancario S.Paolo di Torino	Public offering	3.36	286.0
		Total for year		
1998	SAIPEM (ENI)	Public offering	18.75	1140.0
	ENI - 4th tranche	Public offering	14.83	12995.0
	BNL	Public offering	67.85	6707.0
	Total for year			20842.0

Table 2. Main privatisations in Italy in the 1990s (continued)

1999	Enel	Public offering	31.70	32045.0
	Autostrade (IRI)	Auction + public offering	82.40	13016.0
	Mediocredito Centrale	Auction	100.00	3944.0
	UNIM	Accept takeover bid	1.90	41.0
	Aeroporti di Roma	Auction	3.00	100.0
	Total for year			49146.0
2000	Aereoporti di Roma	Direct sale	51.2	2569.0
	Finmeccanica	Secondary public offer	43.7	10660.0
	Credito Industriale Sardo	Direct sale	53.3	41.0
	Meliorbanca	Direct sale	7.3	82.0
	Mediolombardo	Direct sale	3.4	79.0
	COFIRI	Direct sale	100.0	975.0
	Banco di Napoli	Tender share to takeover bid	16.2	955.0
	Total for year			15361.0
	Total 1993-2000			169746.7

Source: "Italy's Report on Economic Reform- November 2000", Ministero del Tesoro, Bilancio e Programmazione Economica.

53. A key issue, typically faced by countries having adopted ambitious privatisation programmes, is the sequencing of sales. With Italy's state controlled banks still accounting for about three-quarters of total banking credit activities at the beginning of the 1990s, privatisation of such banks was a priority. Moreover, this decision was made paramount by the relaxation of the old ban on banks' shareholdings, which encouraged the banks to acquire ownership shares in some state owned enterprises, or to convert into equity the debt of several ailing private groups. These responses would have compromised the success of the overall privatisation approach had public banks not been sold in the first place.

54. Large stakes in the three major profit-making public banks were therefore sold over the 1993-94 period, alongside INA, an insurance company. Thereafter, other four major banks have been sold off, as well as 2 major ones in which the state had a minority holding, and some smaller ones. About half of total privatisation revenues came from the sales of these public banks. All in all, by 2000 the market share of public banks in total banking activities had become negligible. Problems remain, however, due to the persistence of large shares of credit institutions still owned by the so called public foundations (see below).

55. Highlights of non-banking privatisations during the 1990s include, *inter alia*, the totality of state-owned food and steel companies, together with major state retrenchments in such sectors as telecom, chemicals, electricity, oil and gas and transports, for example (Table 2). For many of the companies concerned restructuring prior to privatisation involved a combination of legal reorganisations, consolidation of balance sheets, changes in management, labour-shedding and rehabilitation or replacement of capital goods. ILVA, the iron and steel sub-holding of IRI, was liquidated in 1993 and its industrial activities were transferred to two new companies. *Bagnoli*, a major public steel plant, was closed down, partly in response to the European Commission call for policies more consistent with the EU-wide restructuring of the steel sector.

56. Important measures were also required to facilitate the privatisation of the old four telecommunication companies (SIP, fixed network continental operator, Italcable, fixed network intercontinental operator, Sirm, naval communications and Telespazio, satellite telecommunication) which were merged together into *Telecom Italia* in 1994. In turn, *Telecom Italia* was merged with its financial controlling holding STET and privatised in 1997.²² The oil and gas conglomerate, ENI underwent major cut-backs of its non-core activities, while more recently, significant efficiency gains were achieved ahead of the privatisation of the first tranche of the electricity concern ENEL, mainly via labour shedding in overstaffed activities. In the domain of transports, the partial privatisation of the national air carrier (*Alitalia*) took place after intense restructuring and a subsequent return to profitability in late 1997. As to transport infrastructures, preparing the privatisation of the Roman airport also entailed a deep restructuring phase, as it was the case also for the motorway company *Autostrade* which has been sold out only recently (*Table 3*).

22. Earlier in 1996 both STET and Telecom Italia were transferred to the Treasury, a measure needed to put IRI's debt on a downward trend.

Table 3. Sectoral regulatory reform in Italy

Industry	Key legislation /regulatory framework	Recent and outstanding reforms	Price regulation	Regulation of entry and exit	Other regulations which may affect competition	Future reforms needed
Telecommunications	Legislative Decree 103/95, Legislative Decree 55/97 and President of the Republic Decree 318/97 implemented the main liberalisation directives. Law 249/97 established the sectoral authority (AGCOM).	Telecom Italia was created in 1994 by merging into one company four major public Italian companies (SIP, Italcable, Sirm, Telespazio) and one state entity (ASST). Telecom Italia was privatised in 1997 without vertical separation. All telecommunications services were liberalised in 1995, except fixed voice telephony, mobile and satellite services and network installations, which were liberalised in 1997. New regulations enables carrier pre-selection, and will enable service provider portability and unbundled access to the local loop (AGCOM, Decisions 4/00, 4/99, 2/00). As concerns the mobile market, Telecom Italia Mobile (TIM) started its services in 1992, Omnitel in 1995, Wind in 1999, and Blu in 2000. Five UMTS licences were awarded at the end of 2000.	In 1999 a price cap regulation was introduced (in place until 31 Dec 2002) and applied to a basket of TI's voice telephony services. Sub caps are applied to residential voice telephony services, access charges and local calls. Cost oriented prices for interconnection are imposed to operators with significant market power. There are no specific price regulations for mobile, data and value added services. Fixed to mobile prices are regulated by the AGCOM.	The access market system is based on individual licenses for fixed and mobile voice telephony services, including the installation and provision of networks. All other services are subject to authorisation. Special and exclusive rights were abolished in 1997 and the concessions for mobile services, are being transformed in licences. Local municipalities have the authority to grant rights of way. If rights of way cannot be granted to a new operator, AGCOM and the municipalities can order facility sharing. The Ministry for Communications is responsible for spectrum planning for telecommunications, while spectrum allocation is under the responsibility of the AGCOM.	Individual licence holders are required to pay licence fees calculated as a percentage of turnover.	Competition should be enhanced for local calls. All remaining concessions should be transformed into licences. The relationship between the Communications Authority and the Ministry of Communications needs better definition.

Electric power	Law 481/95 established the Authority for electricity and gas; Legislative Decree 79/99 liberalised the sector, introducing competition into generation and supply to liberalised customers.	Production, import/export and distribution of electricity were nationalised in 1962, and all activities were attributed to a public body (ENEL). Until 1991 the electricity sector was a public legal monopoly. The liberalisation process started in 1991 for cogeneration and generators using renewable energy and ENEL became a joint-stock company. In March 1999 the EU electricity liberalisation directive was enacted by Legislative Decree 79/99. The following key elements of reform were introduced: functional unbundling of the industry; limit to generation and import of a single company to 50% from Jan. 2003 (implying that ENEL has to sell 15 000 MWh of its capacity so as to comply with this limit); management and dispatch of transmission lies with a public company (Transmission System Operator). At the same time, ownership of the transmission network is retained by ENEL. In addition, the reform also allows for only one concession for distribution on the territory of each municipality. It requires the market to be organised on the basis of a pool system (from 2001). It gradually opens the market to liberalised consumers (eligible consumers).	Tariffs have been uniform throughout the country since 1961. The principle of uniform tariff is now applied only for captive consumers. The Energy Authority regulates tariffs using a price-cap mechanism for captive consumers, transmission and distributors.	The Ministry of the Industry is responsible for issuing authorisations/concessions. - The authorisation system applies to the following domains: generation and building of new direct lines, as well as import capacity. - The concession system applies to the following domains: electricity generation plants, transmission and dispatching (to the Transmission System Operator), along with to distribution.	Stranded costs (monetary compensation to generation companies to compensate for the decrease in revenues due to market liberalisation). Reciprocity clause for importing energy produced in an EU Country.	Concessions for distribution have to be eliminated (Antitrust Authority). Rules concerning the concession to the Transmission System Operator have to be approved (<i>disciplinare di concessione</i>). Rules for activating the Single Buyer have to be defined. Participation in the regulation rule-making process have to be further refined.
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Natural gas	Law 481/95 established the Authority of electricity and gas. Delegated legislative Decree 625/96 eliminated the legal monopoly and all legal advantages of ENI, the public monopolist. Delegated legislative Decree 164/00 liberalises the gas sector.	DLgs. 164/2000 liberalises more than 60% of demand starting from January 2001. Small customers and households will be free to choose suppliers from 2003. From 2003, no single firm can exceed a ceiling of 75% of total imports and production (decreasing by 2% a year, down to a 61% ceiling in 2010) nor to exceed a ceiling of 50% of the sales to final consumers. Both ceilings will be finally removed in 2010. The Energy Authority regulates Third Party Access to essential infrastructures (storage, transmission and distribution networks). It fixes tariffs for transmission, distribution and (until 2003) captive customers.	The price for distribution to civil consumers is fixed by the operators according to the costs orientation principle. Prices for industrial consumers are determined through agreements between the operators' and suppliers. From January 2001, the Energy Authority fixes transport, dispatching and storage tariffs, as well as tariff for captive consumers, on the basis of price caps.	Import from non-EU Countries must be authorised by the Ministry of Industry. The Ministry also authorises storage and production concessions. Concessions for distribution activities are issued by the Municipalities through auctions.	Any importer from outside the EU is requested to ensure that 10% of its annual import be stored within Italian territory for precautionary motives.	The legal separation of ENI's competitive activities and natural monopoly activities (e.g. Transmission) is insufficient to guarantee effective competition. The legal requirement to store 10% of annual usage within Italy should be eased.
Insurance	Law 576/82, Law 742/86, Delegated legislative Decree 175/95, Delegated legislative Decree 174/95, Law 385/94, Delegated legislative Decree 373/98.	Until the mid-1980s, regulatory powers were shared among CIPE (the inter-ministerial committee for economic planning), the Ministry of Industry, and the Regulatory Insurance Authority (ISVAP). In 1994, life insurance and vehicle tariffs were liberalised, and almost all powers were transferred to ISVAP.	In 1994 price controls were removed in application of EU directives. In March 2000, the motor-vehicle tariff was frozen for one year, following sharp price rises and signals of collusive agreements among companies.	No entry or exit restriction is in vigour. If an Italian company wants to open a subsidiary in another European country, the related authorisation has to be granted by ISVAP and be communicated to sectoral regulatory body of the recipient country.	Premiums are calculated on the basis of an actuarial formula which includes requirements set out by ISVAP.	Strengthening ties between banking and insurance activities imply that the separation between supervisory institutions, the Bank of Italy and ISVAP, may be no longer justified. In perspective, a solution could be the consolidation with existing banking functions of the regulatory supervision activity, while maintaining competition oversight with the Antitrust Authority. The legal monopoly of INAIL on work accidents and occupational diseases is not economically justified.

Table 3. Sectoral regulatory reform in Italy (continued)

Railways	<p>President of the Republic Decree (DPr.) 277/98 grants access to international operators and requires accounting separation.</p> <p>DPr. 146/99 implements directives 95/18 and 95/19 on criteria for licencing and allocation of infrastructure capacity.</p>	<p>In 1992 Ferrovie dello Stato, the integrated Italian monopolist, was transformed into a joint stock company under control of the Ministry of Treasury.</p> <p>The accounting separation was introduced in 1999 followed in 2000 by the legal separation between the network operator (FS-Infrastrutture) and the service company (Trenitalia). The State responsibilities for local railways have been decentralised to the regions. Competition for local services will be introduced in 2003.</p> <p>The international freight segment has been liberalised during 2000 (6 licences have been granted). All other segments have been liberalised with the Budget Law of 2000 and 4 licences already issued for the international segment have been extended. In October 2000 the network operator has adopted a Network Code for non-discriminatory access.</p>	<p>The Ministry of Transport and CIPE (Interministerial Committee for Economic Planning) fix maximum prices for freight services.</p> <p>A price-cap system has been introduced in 1999 for long distance passenger services (CIPE Decision 173/99). Tariff increases are conditioned on the achievement of quality targets (mainly punctuality). Local service prices are defined in each regional franchising contract.</p> <p>CIPE and the Ministry of Transport also fix the access charges to the infrastructure.</p>	<p>A concession is needed for networks activities and a license for services (granted by the Ministry of Transport).</p> <p>There exists a concession system also for local services. From 2003, concessions will be allocated on the basis of competitive auctions.</p>	<p>The incumbent (Ferrovie dello Stato) allocates the slots.</p>	<p>In order to prevent discriminatory behaviour, infrastructure capacity should not be allocated by a subsidiary of the incumbent.</p>
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Table 3. Sectoral regulatory reform in Italy (continued)

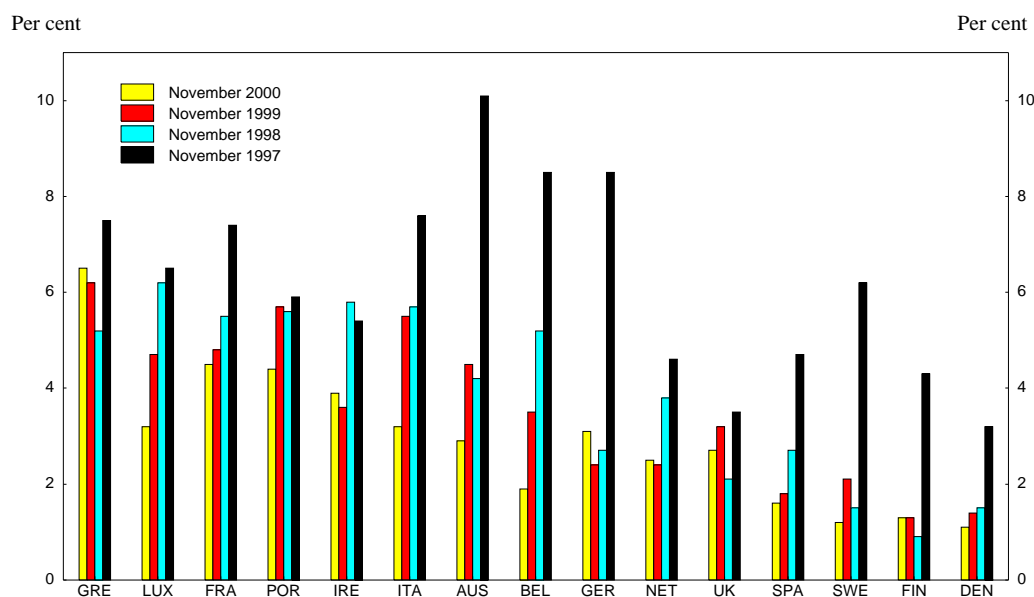
<p>Air transport</p>	<p>EC regulation 2407-8-9/92 setting out the liberalisation of air transport at the European level;</p> <p>EC regulation 95/93 for slot allocation;</p> <p>Law 537/93 concerning the privatisation of airport management;</p> <p>Delegated legislative Decree 250/97 setting out the responsibilities of ENAC (Ente Nazionale per l'Aviazione Civile);</p> <p>Delegated legislative Decree 18/99 providing for the transposition into Italian law of EC regulations 67/96 on handling</p>	<p>Until 1997, the airport clearance was granted to the flag company (Alitalia).</p> <p>The 1992 "Alitalia's concession" recognises to the flag company the exclusive right of "cabotage" and the right of first refusal for intercontinental services.</p> <p>EU regulations liberalised the intra-European services in 1992.</p> <p>The extra-European services are regulated by bilateral agreements.</p> <p>In 1995, all airport concessionaires were transformed into joint-stock companies and an account separation between handling and other airport services was imposed.</p> <p>The internal "cabotage" and handling services were liberalised respectively in 1997 and 1999 by EU regulation.</p> <p>Originally predominantly owned by IRI, Alitalia is now under restructuring.</p>	<p>No specific price regulations are applied with regard to scheduled and non-scheduled market (i.e. charters), handling and commercial services.</p>	<p>Access to the non-scheduled market is governed by the licensing system.</p> <p>As concerns the scheduled market:</p> <p>(i) Licenses are required for the domestic and intra-European services;</p> <p>(ii) Concessions and bilateral agreements regulate access to international markets.</p>	<p>Access to airport infrastructures remains largely governed by the concession system.</p>	<p>A reciprocity clause limits access to the airport slots. In perspective, the concession system for airports has to be suppressed.</p>
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57. Doubts were cast initially over the capacity of Italy's thin and undeveloped equity market to effectively compete with a sizeable government debt market which was a necessary pre-condition to support the achievement of widespread shareholdings. As it turned out, however, public offerings were often largely oversubscribed, with a comparatively limited recourse to the technique of underpricing and without huge tax incentives. Despite the fact that there continues to remain wide scope for a further deepening of the activities of the new institutional investors, such as the private pension funds, for example, recent official figures suggest that contribution of small shareholders in Italy's privatisations has been important, with public offerings having accounted for close to 90 per cent of total placements, so far.

Structural policies for more efficient non-financial markets

58. European Commission figures show that Italy's product market reforms have gathered significant pace during the last few years. While a number of directives still await transposition, the translation of internal market directives into domestic legislation has intensified since 1997 (*Figure 1*) and transposition delays have reduced. As has been the case in other countries, Italy's experience with product market liberalisation corroborates the view that competition policies entail positive direct consequences, which are increasingly visible in terms of price cuts and improvements in the quality of services, particularly in the telecommunications sector.²³

Figure 1. Progress in transposition of internal market directives
Percentage of directives overdue

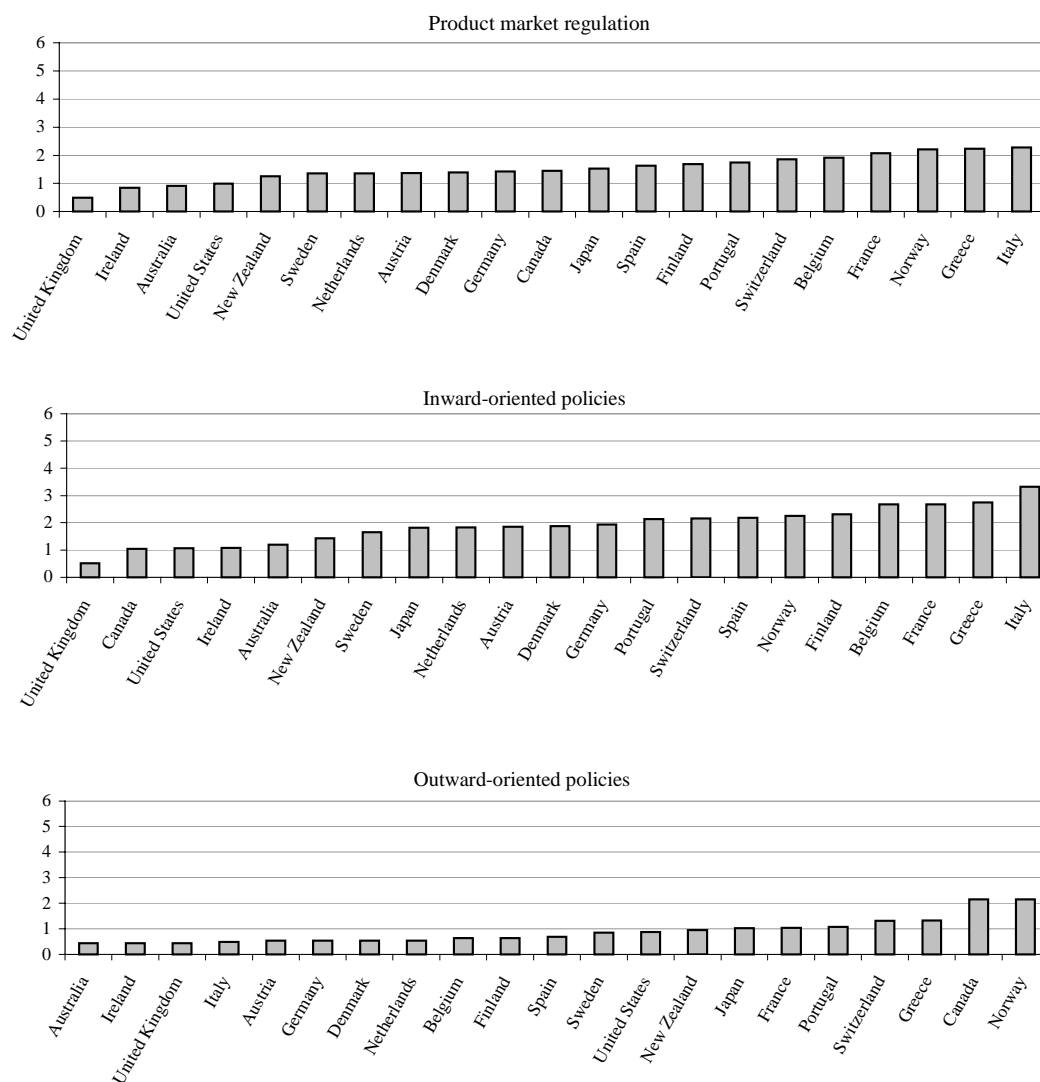


Source: European Union (2000), 'Single Market Scoreboard', November.

23. See for a wider discussion OECD (2000a), and Gonenc, Maher and Nicoletti, (2000). A survey of the economic impacts of sectoral regulatory reform experiences within selected OECD countries can be found in OECD (2001a).

59. Progress made to date can be understood only in light of a clear sense of how far Italy had to come. International comparative indicators, which combine measures of different kinds of regulation across the economy, indicate that, by the end of 1997, Italy still was one of the most regulated countries in the OECD (*Figure 2*). The synthetic indicators suggest that on a series of dimensions Italy suffered from a relatively highly restrictive regulatory environment. Its most restrictive regulatory patterns could be seen in the areas of state controls (mostly ownership), barriers to entrepreneurship, and regulatory restrictions on entry and exit (economic regulation). Italy also ranked very high in the level of administrative burdens on businesses.

Figure 2. **Comparative indicators of product market regulation in OECD Countries, 1998**
Overall regulatory approaches¹



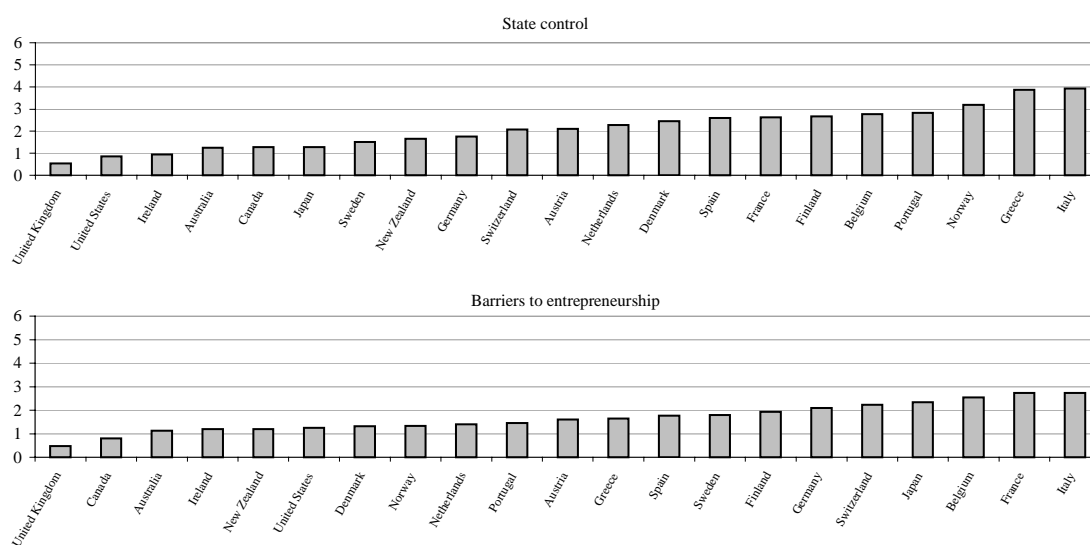
1. The scale of indicators is 0-6 from least to most restrictive.

Source: OECD (1999). Indicators are based on available comparative information and on information provided by Member countries through a survey conducted in March 1998. Since 1998, many countries have implemented reforms. For some individual countries, more information on recent progress in regulatory reform (including an update of the indicator) can be found in the OECD Reviews of Regulatory Reform.

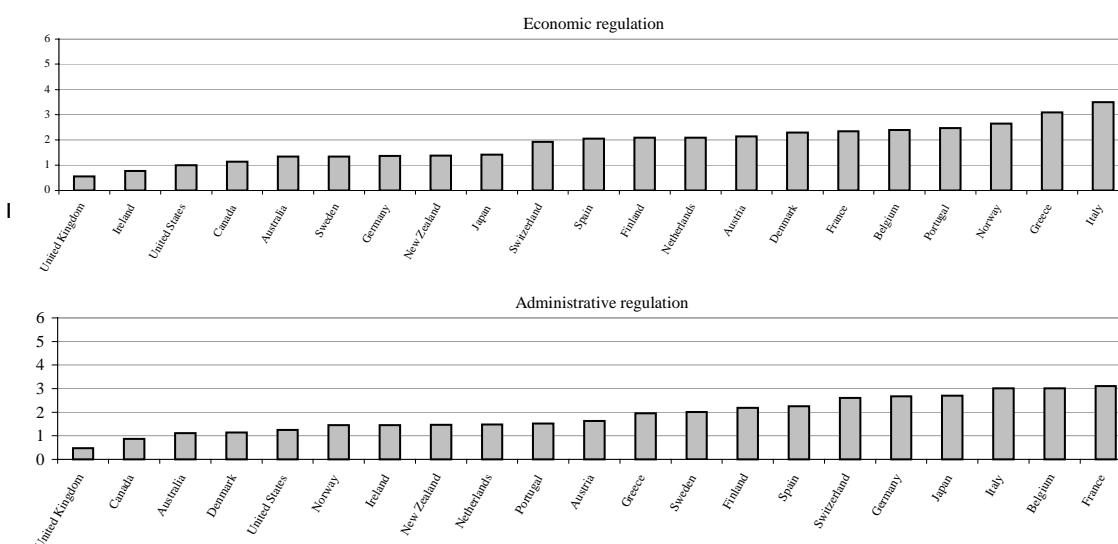
Figure 2. Comparative indicators of product market regulation in OECD Countries, 1998 (cont.)

Inward-oriented regulations¹

A. Thematic



B. Functional



1. The scale of indicators is 0-6 from least to most restrictive.

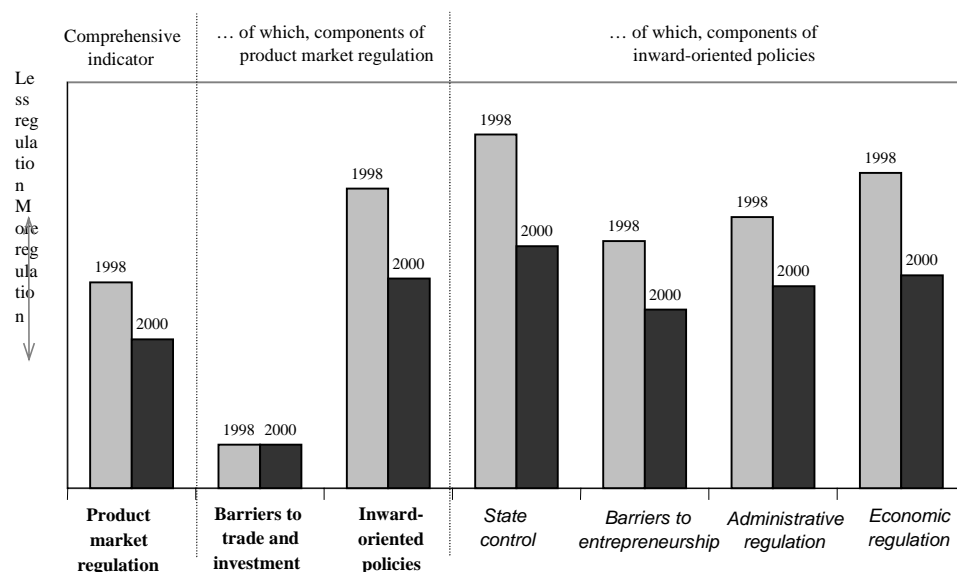
Source: OECD (1999). Indicators are based on available comparative information and on information provided by Member countries through a survey conducted in March 1998. Since 1998, many countries have implemented reforms. For some individual countries, more information on recent progress in regulatory reform (including an update of the indicator) can be found in the OECD Reviews of Regulatory Reform.

60. Reversing such a pervasive pattern of market intervention, cutting across the entirety of state policies and across the whole of the economy, cannot be done overnight. The regulatory state has enormous inertia. Disentangling legitimate market interventions from the host of harmful interventions requires sustained effort, backed up by political support at the highest levels. Moreover, culture in the public and private sectors must change.²⁴ But, over time, a reform programme picks up momentum as attitudes change, and as new allies and pro-reform interest groups emerge. As noted, the period of the largest privatisation revenues was not until 1997-99, several years after privatisation began.

61. By the end of 2000, broad efforts to liberalise the market and reduce regulatory burdens were bearing fruit. Policy reforms taken across a number of sectors and policy areas were having clear impacts on the overall regulatory stance of Italy. That is, regulatory reform was no longer episodic and specific, but had become general and systematic.

62. The positive direction of regulatory reform in Italy is suggested by recent indicators shown in *Figure 3*. It shows that, in every category of regulation affecting domestic producers (called “inward-oriented policies”), Italy had improved by end-2000, including state controls, barriers to entrepreneurship, administrative regulation, and economic regulation. These indicators do not measure concrete impacts in the market, and they do not show if Italy has advanced relative to other OECD countries (who have pursued their own reform programmes). However, they suggest that underlying market policies have substantially improved potential market performance.

Figure 3. **Synopsis of summary indicators of product market regulation by domain**
Evolution for Italy (1998-2000)



Sources: Year 1998 indicators are from OECD (1999) based on available comparative information and on information provided by Member countries through a survey conducted in March 1998. Year 2000 indicators are based on information provided by Italy, using the 1998 OECD methodology, with assistance from the OECD secretariat.

24. For a discussion, see OECD (2000b).

Opening up the telecom sector

63. Despite several remaining transposition and implementation problems, the telecommunications sector has undergone an especially intense regulatory reform process during the 1990s.²⁵ Driven by the European Commission's effort to liberalise the European telecommunications market, the public monopoly in the mobile phone segment came to an end in 1994, with the authorisation of a private provider (*Omnitel*) (*Table 4*). The telecommunications regulatory Authority became operational in 1998, during which year the fixed-line telephone voice service was liberalised. Although interconnection charges still entail difficulties in the domain of the fixed-to-mobile segment of the market, many interconnection agreements have been signed so far, with the telecommunications authority being concerned to ensure as open a regime as possible. Facing a rapidly expanding market for value added services (Internet, satellite television and voice telephony, for example), Italy is giving priority to the unbundling of the local loop, while the licences for the third-generation mobile phone (UMTS) have been awarded. A fourth mobile phone provider was authorised in 2000 (*Blue*).

25. See for a detailed discussion OECD (2001b), Chapter 6.

Table 4. Impacts of regulatory reform in Italy

Industry	Industry structure and competition	Industry profits	Impact on output, price, and relative prices	Impact on service quality, reliability & universal service	Impact on sectoral wages and employment	Efficiency: productivity and costs
Telecommunications	By the end of 1999, Telecom Italia had a market share of 68%, 93% and nearly 100%, respectively, in international, long distance, and local calls markets. In the mobile sector, TIM had a share of 48.8%, Omnitel 38.7%, Wind 11.1% and Blu 1.5%. In the leased lines sector, Telecom Italia had a 100% market share. As of June 2000 122 individual licences had been granted. Between 1998 and 1999, the internet market increased by 150%, largely reflecting entry by operators offering service access without subscription (Tiscali, Infostrada, Telecom).	Between 1995 and 1998, vocal services revenues decreased from 77.8% to 67.2%. Revenues from mobile services increased from 12.5% in 1995 to 26% in 1998.	Between 1997 and 2000 the average price of a 3-minute and a 10-minute long-distance call has fallen by 19% and 26% respectively, whilst the average price of international calls has fallen by 30% for residential users and by 36% for business users. On the contrary, the line rental charge and the cost of local calls have both risen (+7% for a 10-minute local call between 1997 and 2000), as a part of the tariffs' cost orientation process. International call charges have fallen over the same period (by 43%), as well as national long distance call charges (by 42%).	General and specific standards of quality are provided by the Communications Authority and each operator has to adopt a "Charter of services" (automatic damages are granted for infringements). The Communications Authority provides health and environment standards regarding infrastructures and equipment.	The increase in the number of enterprises (with over 100 licences for network and voice telephony services having been granted so far), has had a net positive impact on employment.	

Electric power	By mid-2000 ENEL controlled about 73% of the generation capacity and around 93% of distribution. ENEL maintains a dominant position in the generation and sell markets, as well as in the free market.	In 1999, ENEL's profit increased of 2% with respect to 1998.	Between 1995 and 1999, electricity prices for households fell by 9.2% in nominal and 17.5% in real terms. In perspective, the tariff component related to transmission, distribution and supply costs of electricity is bound to decrease in real terms by 4% per annum from 2001 to 2003 (as a result of the price-cap mechanism defined by the Energy Authority).	General and specific quality standards (provided by the Energy Authority, Decision 201/99) will be binding only for operators serving more than 5000 users. For 1999, there has been a decline in the number of infringements to the "Charter of services" adopted by each operator. As concern service continuity, a gap is still present between Northern and Southern Italy and rural and urban area.	In 1999, employment in the electricity sector has decreased (-5.7%). ENEL employees (including production, transmission and distribution) have decreased by 7.5%.	
Natural gas	Around 70% of total Italy's natural gas is imported, with ENI accounting for 95% of total imports. ENI owns 99% of storage facilities. SNAM (which is controlled by ENI) is the dominant transmission company and owns 96% of the national high-pressure gas transmission network. A very large number of local distribution companies are active in the gas distribution market, with local authorities directly managing more than 60% of such a market. The largest, Italgas, is a subsidiary of ENI.	Profits have increased in the last years. Returns on equity are much higher in the upstream segments than in distribution where average size of firms is small. ROE has increased for all firms in the sector in recent years.	Prices are comparatively high by international standards for both households, and industries. However, since 1998, price levels for household clients decreased 4% annually. Demand is expected to increase from 68.7 (billion MC) in 2000 to 89.7 in 2008, according to the Energy Authority.	From 2001, the general and specific standards of quality which have been set in by the Energy Authority (Decision 47/00) will be binding for all operators serving more than 5000 users (except the municipalities). Each operator has to adopt a "Charter of services". Between 1997 and 1998, the number of infringements to the standard has decreased from 14 265 to 12 366.	From 1997 to 1998 employment in the 4 largest firms in the sector (SNAM, Italgas, Camuzzi and AEM) decreased, a result of restructuring processes. Employment is expected to increase as new operators increase their scale due to SNAM's divestiture to comply with the antitrust ceilings.	

Insurance	As of September 2000, the Italian insurance market was made up of 201 national companies and 9 foreign branches. Concentration in the "vehicle insurance" market is higher than in "other non-life classes". Concentration is lower in the "life insurance" sector, which in the last few years has witnessed the entry of new bank insurance companies.	Notwithstanding tariff liberalisation, the damage insurance premiums have increased (in particular for vehicles) and losses are frequent. The life insurance sector is more efficient and gains positive and increasing profits, thanks to the expansion of new distributive channels.	Price liberalisation was not followed by a widening of the range of services offered, and improvements of their quality. As it turns out, prices moved up steadily. Moreover, there remains a scarce diffusion of "personalised" insurance contracts. The exclusive distribution system is an important obstacle to competition, especially as concerns the vehicle insurance market.	A State monopoly (INAIL) insures at national level the services insurance for accidents at work and occupational diseases. The quality of this service remains insufficient.	From 1994 to 1998, employment decreased from 48523 to 42 609 units. The total labour costs increased from 3 819 billions of lira in 1994 to 4 349 in 1998.	During the period 1994-1998, the life sector enjoyed notable efficiency increase, reflecting mainly, better products and a more efficient distribution system. In the damage sector, however, firms remain highly inefficient (distribution cost have increased and product innovations remains scarce).
Railways	In May 2000 the existing concession to Trenitalia (the service company controlled by Ferrovie dello Stato, the former monopolist) has been replaced by a licence. Six new licences have been issued already by the Ministry of Transport for international freight and 4 new licences for all other segments.	Between 1990 and 1999, the State contributions for passenger services to the incumbent (Ferrovie dello Stato) decreased from 3080 to 2806 (Billion Lira). Contributions for freight have increased from 90 in 1993, to 123 (Billions) in 1999.	Rail prices are the lowest in Europe, with the difference between revenues and costs being typically covered by public contributions. The gradual rationalisation of the current under-priced passenger fare system started in January 1999. However, short distance fares continue to be largely influenced by social policy consideration.	The Ministry of Transport issues safety certificates (necessary to network access) to companies satisfying safety standard. As a result of incentive measures (price cap) punctuality measures have improved in the last years for the long distance segment.	The State railway has traditionally paid relatively high wages. The protocol agreement signed by Treasury, Unions and F.S. in 1999 included the stipulation of a new labour contract, according to which future wage increases would be linked to productivity gains and employment conditions become gradually more flexible.	Operating costs per unit of traffic have been falling during the nineties (more than 10% between 1990 and 1996), as a result of several steps taken by the government to harden budget constraints. However, they remain high compared to international standards.

<p>Air transport</p>	<p>In Italy, as in many other OECD countries, new entrants access is blocked by different factors, such as the need of a slot, the “fidelisation” systems (<i>e.g.</i> “frequent flyer”), the strategic agreements (<i>e.g.</i> the code sharing accords), the need to access at the computerised system for reservation.</p> <p>Despite the fact that the number of airline companies in the national market increased from 8 in 1992 to 21 in 2000, many of these are subsidiaries or code-sharers with Alitalia. Competition has increased only in a limited number of routes (for instance the one between Rome and Milan).</p>	<p>Alitalia RPK grew from 23 586 millions in 1992 to 34 556 in 1997; revenues decreases from \$ 5 511 millions in 1992 to 5 064 in 1997.</p>	<p>At the national level, prices have declined only for some routes, so far (<i>i.e.</i> Rome-Milan). Connections served by the sole incumbent are usually characterised by significantly higher prices.</p>	<p>ENAC (Ente Nazionale per l’Aviazione Civile) is a public body controlling the quality of transport and airport services. Since 1999, ENAC is ruling the airport services access. The Ministry of Transport can impose public service obligations for airport traffic serving less developed regions, or characterised by low traffic density.</p>	<p>Employment levels have decreased from 18 828 in 1992 to 17 871 in 1997.</p>	
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64. As the number of participants in both the fixed and mobile segments of the market has expanded, the range of alternatives made available to households has increased and significant gains have become visible in terms of lower voice telephony tariffs, for international and long-distance phone calls, alongside fixed-to-mobile calls. Likewise, as far as access to high value added services is concerned, the business sector can now count on a wider spectrum of products for the satisfaction of specific and increasingly sophisticated corporate requirements. These developments have been accompanied by a falling market share for the incumbent in outgoing international and long-distance calls, despite the fact that there may be some room for speeding up the process of market liberalisation by further simplifying the licensing regime.²⁶ Moreover, as other countries, Italy is late in implementing the EC directives requiring open access to the local loop.

The need to consolidate the liberalisation of the energy sector

65. One of the most salient events of the last few years in the area of regulatory reform has been the transposition into Italian law of EC directive 96/92 on the liberalisation of the internal electricity market (March 1999). From 2003 no operator will be allowed to retain (directly or indirectly) control over more than 50 per cent of the electricity produced or imported, and in order to meet this requirement ENEL has been requested to divest at least 15GW of its generation capacity by 2002.²⁷ Under the plan agreed with the government, ENEL's plants should be divested as three separate companies, while ENEL is also expected to implement a limited unbundling of its vertically-integrated structure. The controlling stake of ENEL is still in public hands.

66. As of April 2000, a new separate joint stock company entirely owned by the Ministry of Treasury is in charge of the transmission network and dispatching (*Gestore della Rete di Trasmissione Nazionale*, or Transmission System Operator, TSO). On the demand side, the electricity market is to be split into two parallel segments. As to the first free segment of the market, a provision allows for the identification of a gradually increasing number of big clients (*clienti idonei*) which are eligible to choose their electricity suppliers. The second segment of the market, composed of non-eligible consumers (notably, households and business buyers which are too small to stipulate direct purchasing contracts with domestic or international suppliers) will rely upon the services of a "single buyer", which will make both purchase contracts with the generators and sales contracts with the distributors for resale to the franchise market. The TSO will be majority owner of the "single buyer".

67. More recently, the Italian government has been praised for its capability to transpose the Commission's directive on natural gas quickly into law (May 2000). Particularly extensive regulatory revisions have been introduced on the demand side. As with electricity, the provision establishing the criteria for the identification of big clients is well defined, but the liberalisation of consumption is intended to be rapid: by 2003 a unique and free market will become operational for all customers. With the gas industry being even more strongly concentrated than that for electricity, a key feature of the new framework is the separation of the most relevant activities involved, transport, distribution and sale. As regards the liberalisation of supply, which is to take place over a period of eight years, from 2003 to 2010, the imposition of two ceilings is foreseen. No operator may exceed a ceiling of 50 per cent of the total amount of sales; at the same time, no company may exceed 75 per cent of total imports and domestic production, this limit declining by 2 per cent per year until it reaches 61 per cent in 2009.

26. See OECD (2000c).

27. For a detailed discussion of regulatory reforms in the domains of electricity, gas and railways, see OECD (2001b), Chapter 5.

68. The expected benefits for Italy of greater competition in the energy sector are large, given high average prices and marked regional disparities in the quality of the services provided. Partly in response to a rapidly expanding free customer market, average electricity prices fell prior to the recent tensions in the international oil market. Barring further exogenously-caused rises in oil prices, similar price declines should soon become visible in the gas sector. The regulatory Authority estimates that electricity prices could fall in real terms by as much as 4 per cent annually for a period of five years, with a price-cap mechanism to promote efficiency gains assisting the downward trend.

Tackling the inefficiencies in transport ...

69. Progress made thus far to introduce competition into the transport sector has been exceedingly slow to implement and uneven across transport modes, despite the fact that reforms have gained considerable momentum, recently. Measures taken over the past few years were based upon a three-pronged strategy of *privatisation* (motorways, maritime and air transports), *liberalisation* (railways and trucking) and *decentralisation* (local transport). Nevertheless, the transport reform programme still does not exploit the full range of opportunities for kindling competition. As concerns local transport, for example, an already lengthy period for introducing competitive forces is at times extended by the resistance of local authorities to liberalisation. Slow and complex processes, in turn, tend to grant undue advantages to incumbents. In the air transport sector, the privatisation of Alitalia is lagging. In addition, the national carrier continues to enjoy significant economic advantage in the airport slot allocation system, which remains largely based on “grandfather” rights. Furthermore, the airport concession regime is still not competitive, except for some minor services within the concession (baggage handling, for example). As regards motorways, the government granted a twenty-year extension of *Autostrade Spa*’s concession, thereby ignoring the view expressed by the Antitrust Authority, which recommended more transparent and competitive sale procedures.

70. The railways have long suffered from market share losses *vis-à-vis* road transport.²⁸ Measures with respect to the railways initially concentrated, from 1997, with the so called *Direttiva Prodi*, on the need to improve organisational efficiency, via changes in the relationship between the state and the railway company (*Ferrovie dello Stato*, FS). Thereafter, the senior management of FS has been renewed and managerial pay has become more closely related to performance indicators. Actions have also been taken to align new wage contracts to productivity gains and to make employment conditions more flexible, despite the fact that the defensive role of the trade unions makes changes in labour relations slow and difficult. In turn, this has altered the FS’s capability to achieve greater price flexibility.

71. Notwithstanding a slow start, in 2000, Italy took several major reform steps in the rail sector that significantly reduced legal barriers to entry. It approved a network code for third-party non-discriminatory access to the infrastructure, legally unbundled the network from services, liberalised all passenger and freight segments of rail transport, and tightened the incumbent firm’s budget constraint. Consistent with these developments, FS was split into two sub-holdings, transport infrastructure and services. The separation goes beyond the EU directive, which only calls for separate accounting operations. *Trenitalia*, the new service company, operates under a licence, which abolishes the old concession granted to FS, while six other licenses have been assigned so far. Meanwhile, the devolution of state responsibilities for the local railways to the regions (which will be implemented in 2003) is being prepared. Several regions have already stipulated plans with the government setting the targets for regional transportation. Under the planned stepwise decentralisation process, the regions will become responsible for the whole range of local transportation services. To this end they will have to enter into a contract with the state.

28. See OECD (1998), and OECD (2001b), Chapter 5.

...and postal services

72. The postal service has long been loss-making, being over-staffed and burdened with relatively high costs, an inefficient delivery system and a lack of product diversification. Under the restructuring programme begun in early 1998, the old politically-controlled postal company was turned into a joint stock corporate entity (*Poste Italiane*, PI). The EU Commission directive on the liberalisation of the service was approved in 1999, at which time the full range of services that PI will continue to run for a period of fifteen years was specified (*riserva*). A wide margin of discretion has been used in defining the services subject to restrictions, and in what could be a backward step the list appears to include several activities previously opened to competition. Included among these, against a recommendation by the Commission and the Antitrust Authority, is the delivery of “hybrid services”. This restriction, which is largely determined by the need to improve the financial situation of the incumbent, guarantees PI a competitive advantage in electronically generated correspondence.

Towards a more competitive retail distribution system

73. Since 1998, a major attempt to de-restrict the service sector has involved liberalising commercial licensing requirements in the retail sector, together with an easing of the rules governing product and hours restrictions. The ceiling on the number of small shops was removed, while for medium-sized retail operations authorisation procedures for the opening of new outlets were also greatly simplified. In the case of large retail shops, regions were required to issue new rules on opening hours and to accompany the formulation of such rules with plans for urban development. Subsequent experience suggests that the latter provision has conferred an excessively high degree of discretion to the regions, leading to the undesired result of replicating at the regional level many of the obstacles to competition that the legislation intended to overcome. Several regions have been late in setting their urban development plans, suspending *de facto* the market entry of large retailers. As concerns the liberalisation of the vehicle fuel distribution network, that is progressing at a very slow pace, although it is much needed considering the high degree of fragmentation of the firms operating in this market.

The promotion of competition in financial services*Restructuring the banking sector*

74. Legislative change and privatisation have triggered an important transformation in Italy’s financial markets, by removing substantial entry barriers and exposing the national banking system to potential new entrants. An initial impetus to the process of consolidation arose in the early 1990s from the rapid decline in the profitability of Italian banks on traditional banking business, as a consequence of high labour costs and widespread operational inefficiencies. Over the past few years, the pressure to restore profitability has increased with the steep fall in market interest rates and the growing presence of foreign banks in Italy.

75. Structural changes came in quickly: Between 1990 and 2000, there were more than 500 bank mergers in Italy, in connection with the considerable expansion of banking groups. At present, the five principal banking groups control about half of total credit intermediation, compared with 36 per cent in 1996. These developments were accompanied by the entry of new players, both Italian and foreign. A total of 165 new banks were created in the course of the 1990s, with foreign banks increasing from 40 to 65. In 1999, the acceptance of Italy as a participant to stage three of EMU has further enlarged the exposure to foreign competition.

76. Consolidation has helped to contain costs, essentially by permitting the achievement of important economies of scale in the production and distribution of new services, and widening the opportunities for risk diversification.²⁹ Furthermore, intensive reorganisation plans were launched in its wake, helping to improve the operating efficiency of the banking system at large. Reflecting measures to reduce overstaffing, the total number of employees fell by 20 000 during the 1995-2000 period. Unit labour costs have since stabilised and profitability has improved. At the same time, the spread between deposit and lending rates has tended to fall in response to the process of rationalisation. In the Southern regions, where spreads were initially wider, the reduction has been more rapid than in the North, pointing to a lowering of the degree of market segmentation also in the *Mezzogiorno*.

77. A further relevant issue for competition and bank performance relates to bank control. Despite the introduction of tax incentives in 1998 to encourage charitable foundations to sell their shareholdings in many formerly state-owned banks, such foundations still play a major role in the ownership of 23 of the top 50 banks. The foundations were established in 1990, at the time of the transformation of the public saving and credit institutions into joint-stock companies. Despite being granted a public entity status, the foundations were authorised to have important stakes in the banks, raising controversies as to the effectiveness of the privatisation process in the banking sector. The foundations are not exposed to the pressure of market forces, which raises concerns as to their capabilities to effectively contribute to the goals of improving productive and allocative efficiency.

Reforming the insurance sector

78. More than six years after the transposition into Italian law of the EC directive aiming at the liberalisation of the insurance industry, progress made in introducing competition has been rather modest, especially for the motor vehicle segment of the market. Prior to liberalisation, insurance premia and general insurance conditions were subject to approval by the *Comitato Interministeriale dei Prezzi*, the special committee responsible for nation-wide price interventions. However, the gains generally expected from the process of liberalisation, notably improved service quality and a lowering of tariffs, have not materialised, so far. Premia have been steadily increasing since the launch of liberalisation so as to allow for significant rises in the amount of technical reserve holdings -- the money which companies set aside in order to meet accident-related repayments. In a system where car insurance is compulsory, the industry has always assumed it could bail itself out of difficulties posed by fraudulent claims with higher prices, rather than by becoming more efficient and widening the range of products offered. The current pricing system leaves room for a very limited degree of transparency in the way premia are fixed. In part, this reflects the fact that brokers play a marginal role in contract intermediation. Indeed, the market for car insurance contracts is kept under the strict control of the insurance companies, with most resale agents servicing one company exclusively.

79. In 1999 the Antitrust Authority began an investigation into the motor vehicle insurance market following evidence that the 15 leading motor vehicle insurers imposed identical terms and conditions of insurance. Investigations subsequently revealed that the insurance companies had been exchanging large volumes of strategic information through a third party. The Authority therefore extended the ongoing investigation, finding the companies liable for anti-competitive behaviour.

80. With insurance premia continuing to move decisively out of line with underlying inflation developments, in March 2000 the government intervened by decree, ordering a one-year freeze on all motor insurance tariffs. Although such action was in open violation of the EU competition principles, it

29. See the Address by the Governor of the Bank of Italy on the occasion of the celebrating conference for the first ten years of the Competition Law (Fazio, 2000).

was seen as key to alleviating inflationary pressures until the new provisions for the liberalisation and regulation of the market could be approved by parliament. The new law, which at the time of writing has been approved by the Lower House, envisages measures to increase transparency, essentially by means of advertisement and other promotional materials, as well as greater disclosure of records of companies). In addition, it attempts to introduce stricter control over claims for bodily injuries (the so-called biological damage), an area where fraud is particularly frequent in Italy. However, to the extent that the new norms do not clearly specify the underlying objective criteria needed to assess how serious such injuries are, risks of frauds are not removed fully. Under the circumstances, there are several uncertainties surrounding price behaviour following the lift of the temporary price freeze.

81. Institutional arrangements could be a continuing problem in this sector. One source of difficulty is that banking and insurance activities are merging, but the supervisory institutions, the Bank of Italy and the insurance industry agency, ISVAP, are separate bodies. Hence, supervisory functions may not take full account of important impacts. In recognition of this, the Bank of Italy and ISVAP recently set up a co-ordination committee. Another problem is that ISVAP exercised its competition policy functions to promote the health and solvency of firms in the industry, rather than consumer welfare.³⁰ A solution that may merit consideration in terms of both sector performance and regulatory coherence is consolidation of regulatory oversight of insurance with existing banking and competition functions.

Reducing the burden of government

82. Improving the business environment is closely linked to the success of the ongoing process of administrative de-regulation, which has been gathering significant momentum since 1997. Within the general framework of the so-called *Bassanini reforms*, a recent landmark in this strategy was the final approval in November 2000 of the law on “Rules in the matter of Simplification”. Applying the principle of simplification entails, *inter alia*, major cuts in the number of administrative steps required for the creation of a business, along with the administrative bodies involved. It shortens the terms for carrying out a procedure and applies the “silent consent” principle for simple administrative proceedings. It also sets down a uniform code for procedures of the same kind carried out by different ministries. In order to ensure continuity to the process, the government is required to announce annual simplification targets and to report to Parliament about the achievements of its previous year’s targets. Consistent with the 1995 *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, such targets are to be supported and justified by a rigorous regulatory impact analysis, containing *ex ante* evaluations of the new measures being proposed by the government.

83. A recent important development, affecting small- and medium- sized companies, was the introduction from 1999 of “one-stop shops” for companies willing to expand their business. Local municipal authorities are made responsible for the creation of such services, while the law also encourages consortia of suppliers so as to limit costs. By the end of 2000, some 40 per cent of all municipalities had opened a “one-stop shop”, serving 60 per cent of total population, while the newly released simplification decree of November 2000 is expected to result in a further boost to their expansion. Prospectively, the “one-stop shop” could contribute to fostering business initiatives not just by reducing red tape, but also by providing information and advice for economic agents willing to invest. Other changes have included the implementation of “self-certification” which obviates the need for obtaining many personal certification documents from various administrative departments. Due to these changes, there has been a drop of 50 per cent in the issuing of certificates as compared to 1996. Overall, since 1997, legislative powers for over 200 administrative procedures have been devolved and are being simplified, making it much easier to adapt regulations to changing needs.

30. See OECD (2001b), Chapter 3.

Economic significance of regulatory reforms

The labour market has improved...

84. Following a protracted period of slow growth, a recovery in economic activity has been under way from the closing months of 1999. The strength of demand, initially stimulated by a rebound in exports and supported by the weakening of the euro, later spread to investment and consumption of households. Firming demand has underwritten a significant pick-up in employment growth, which has been similar to the euro area, despite a slower pace of expansion. Employment gains have been most notable in private services to households and corporations, more than offsetting a continued contraction of employment in the industrial sector.

85. There is quite firm evidence that the surge in economic activity has been associated with a trend lowering in structural employment. Nominal wage growth has remained moderate despite the absorption of cyclical slack in the economy. The background to these developments is to be found in the income policy agreements of the early 1990s, which forged a new framework of industrial relations and established the mechanism of concertation (*concertazione*) between government and social partners as a mean of moderate wage growth. In turn, this has created favourable conditions for expanding the employment capacity of the economy.

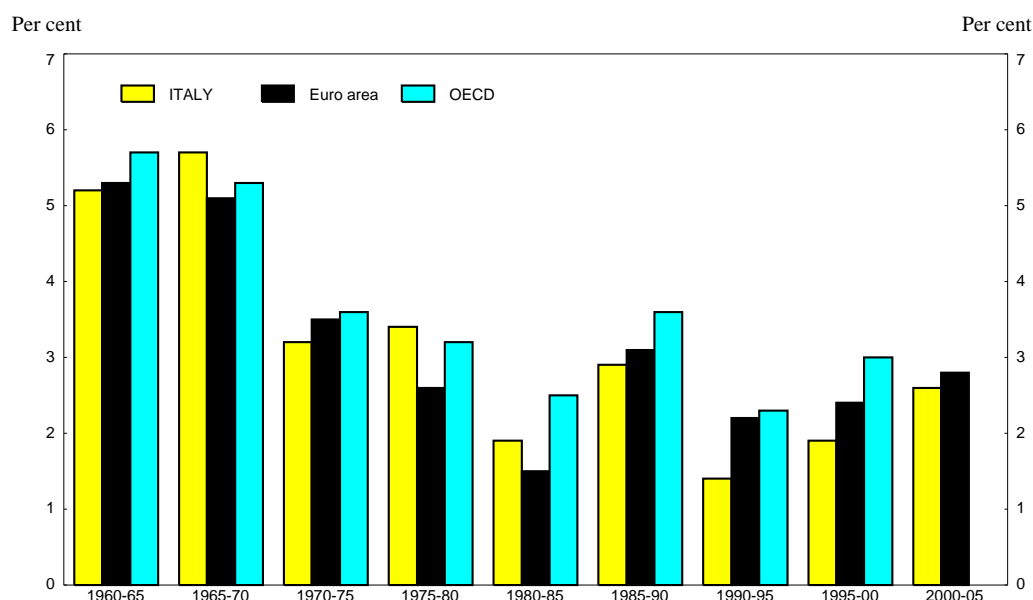
86. The new climate of less conflictual industrial relations has also facilitated a more flexible use of the labour force in terms of types of employment contracts, the organisation of production and working hours. Employment conditions have been derestricted under the so-called *Treu Package* of 1997, and have been reflected in the introduction of temporary employment agencies and the reform of apprenticeship regulations. Responsibilities for public employment agencies have been transferred from the Ministry of Labour to the local authorities. After a slow start, significant progress also appears to have been made recently in negotiations to extend fixed-term and part-time work.

87. Most regulatory reforms in Italy are too recent, or too incomplete, for their economic effects to be apparent. Nevertheless, the evidence available suggests that several of the sectors more intensively affected by the process of deregulation have so far contributed positively to the rebound in aggregate productivity. Better quality electricity and telecommunication services, for example, have been associated with a labour productivity performance which has for some time been stronger than in the overall industrial sector. As concerns the telecom sector, more specifically, the recent interest in acquiring licences for operating third-generation mobile telephones bears witness to the vibrancy of this segment of the industry.

...but evidence of a marked change in growth potential has yet to emerge

88. Assessing the underlying momentum of the Italian economy from a longer-run perspective is, in light of the above trends, is quite difficult, particularly with respect to the strength of forces acting on the supply side, which determine the current level and growth rate of potential output in Italy. It has been a matter of concern that Italy has been and still remains one of the slowest-growing economies of the EMU (*Figure 4*), despite having benefited from substantial cuts in real interest rates. From 1995 to 2000 the economy expanded by only 1.9 per cent a year compared with some 2.4 per cent for the average of the euro area. Real GDP per person has grown by approximately 1 per cent per year, which is also a significantly slower pace than the euro area average.

Figure 4. Real GDP developments compared
Average percentage change over period



Source: OECD.

89. Part of the reason for the slow pick up may be the aggressive fiscal policy tightening which was needed in order to meet the convergence criteria for EMU participation. The accompanying declines in public investment certainly helped to impede capital accumulation, while lower disposable incomes have resulted in depressed private consumption for several years. As the demand side of the economy normalises, the forces endogenous to the regulatory reform process should become more dominant, depending on the speed at which the economy reorganises its productive activities, on the introduction of desired innovations and new technologies and on the related generation of new products and profit opportunities. There are potential synergistic effects, both between sectors and between reforms in individual product markets and labour.

90. The OECD medium-term reference scenario presented in the December 2000 edition of the *Economic Outlook*, which covers the period between 2002 and 2006, is conditional upon the assumption that the structural reform measures which have been approved in the last few years will translate into stronger supply side conditions over the medium-term.³¹ Having been a laggard on the regulatory reform front, Italy should see the growth rate of potential output tending to converge with that of other European partners. Potential output growth, which in the OECD estimates averaged less than 2 per cent during the 1995-2000 period, is seen to increase to approximately 2½ per cent by the end of the medium-term scenario.

31. See OECD (2000d).

Competitiveness could be fostered...

91. At the same time, Italy's declining market share in world trade over the past decade has called into question the competitive strength of Italian exports, as such contractions have been much sharper than the ones suffered by the other euro area countries. In part, this situation reflected the extent of the price competitiveness losses suffered by the Italian exporters in the second half of the 1990s, particularly against Germany and France. Moreover, Italy was relatively badly hit by the crisis in the emerging markets of East Asia of 1997, as the composition of its exports makes it more exposed to a rise in competitiveness in the emerging economies. While exports have re-accelerated in East Asia, more recently, in volume terms the amount of Italian exports destined to the region is still far below pre-crisis levels. But the explanations go beyond compositional factors. Above all, however, deteriorating trade performance has been due to the limited capability of Italian exporters to diversify exports into sectors characterised by the highest rates of growth in world demand. It also appears that Italy shows a comparatively strong reliance on exports of traditional products which has been growing more marked over time.³² This pattern of specialisation does not appropriately fit the underlying comparative advantage of the country, so that judged from a long run perspective, supporting the robustness of the Italian economy is contingent upon a permanent turnaround in net exports.

...necessitating greater efficiency in the sheltered sectors...

92. In a global marketplace characterised by rapid changes in market structure and modes of corporate organisation, it is essential to remove structural problems which reduce growth potential by impinging on the competitiveness of the exporting sectors. And this depends, in turn, upon the speed at which the economic rents accruing to the sheltered sectors can be eliminated. The erosion of hidden costs, in the form of high relative prices in the sheltered sectors would help further to reduce non-factor input costs, reinforcing aggregate productivity performance, in part by allowing resources to be switched to investment in product or process innovations in the exporting sectors. The extraordinary development of information and communication technologies is a key underlying feature of the strong economic performance of the US during the 1990s. Although the boost to productivity growth emanating from these forces has begun to be felt in the other leading European economies, it is still less visible in Italy. It would therefore be a cause of further export market share losses if Italy did not eventually benefit from the diffusion of new technologies.

...and greater foreign direct investment

93. An increase in competition within sectors that are less open to foreign trade, and the ensuing decline in the burden of non-factor input costs on the corporations that use such services intensively, will also be necessitated to attract a larger share of foreign direct investment in Italy. Italy is among the few European countries to receive a negligible amount of foreign direct investment as a percentage of GDP, and there is also a growing tendency for one of its traditionally abundant resource, financial savings, to be utilised abroad. Though partly a reflection of the convergence of Italy's interest rates to the European average, and part of a trend towards international portfolio diversification, the investment abroad of Italy's financial wealth is the counterpart of the still limited development of its capital markets.

32. OECD (2000b), pp. 49-51.

The economic case for accelerating the pace of regulatory reform

94. The above longer-run economic considerations suggest that the current pace of structural regulatory reforms should be maintained or even accelerated. Recent work carried out in the OECD suggests that easing product market regulations and administrative burdens is associated with accelerating multifactor productivity growth.³³ For Italy, while the underlying assumption of improving supply conditions has made the macroeconomic environment less sensitive to short-run demand fluctuations, price- and profit margin pressures are likely to intensify as spare capacity is exhausted. Furthermore, while restructuring has negative sectoral effects on employment, the net economy-wide employment effects have usually been positive in most OECD countries. Permanent employment losses usually occur in sectors characterised by oligopolies or regional monopolies prone to overstaffing; but negative effects are mitigated in the medium-run by the expansionary consequences on domestic and export demand of falling prices and product innovation within the reformed sectors, and the consequent boost to productivity at large. From this perspective, creating the right broad economic environment for reinforcing the exporting sectors, while encouraging the diffusion of new technologies and attracting a bigger amount of direct investment is likely to continue to involve the integration of policies across a broad range of sectors.

Towards more effective sectoral regulatory reform policies: specific concerns

Unsettled restructuring and competition issues in network industries

95. As noted above, the 1992 privatisation plan and subsequent initiatives provided the conditions for a thorough overhaul of the role of public intervention in the Italian economy. As concerns the public utility sectors, however, their privatisation can hardly be conducive to allocative efficiency if it is not matched by the creation of a high degree of product market competition. As shown by the experience of other countries, public enterprises need to be broken up, clearly separating their functions between competitive and non-competitive activities. The former can be immediately sold, while at the same time reorganising and reinforcing regulatory bodies. Unfortunately, insufficient attention has been paid so far in Italy to the trade-off between the exercise of market power in vertically integrated industries and productive efficiency, so that progress has been exceedingly slow. Priority has generally been given to maximising the revenues accruing from privatisation, a consequence, perhaps, of the need for rapid fiscal consolidation.

96. An example of these difficulties is offered by the national electricity sector, which, as discussed above, necessitated intense restructuring prior to privatisation. One option used by the government was the creation of a new public company entrusted with responsibilities for the management and dispatch of the national transmission system (*Gestore della rete di trasmissione nazionale*). However, contrary to the opinions of both the Energy Authority and the Antitrust Authority, the government decided to maintain the common ownership over generation and transmission operations. Chapter 5 of the *Regulatory Reform Survey* observes that in this way a serious impediment to non-discriminatory and efficient access to the transmission grid was erected. Consequently, the Chapter recommends the complete ownership separation of transmission from generation, which would amount to taking a courageous step in the direction of liberalisation.³⁴

97. The electricity concern ENEL, which is still 68 per cent state owned, retains incentives to discriminate against non-integrated rivals, and to exercise market power. Another possible source of

33. See for an in-depth investigation of these issues Bassanini, Scarpetta and Visco (2000). See also, Bassanini, Scarpetta and Hemmings (2001).

34. See OECD (2001b).

concern is the recent expansion of ENEL outside its core business activities, which could further hinder the creation of competition in Italy and redirect capital investment from electricity, where it is much needed to enhance efficiency, to other sectors. ENEL already controls Italy's second-largest telecom group *Wind*, while it also holds another controversial stake in an important southern Italian water company (*Acquedotti Pugliesi*). In the gas sector, the reorganisation of SNAM will remain confined to the management structure, leaving unchanged its vertically-integrated ownership structure. Also the railways and the postal system continue to be vertically integrated.

98. In principle, the most appropriate ownership structure for a vertically-integrated public enterprise targeted for privatisation should primarily reflect efficiency and competition considerations, rather than industrial policy objectives.³⁵ For this reason, privatisation procedures should incorporate an advisory role for the Antitrust Authority. In co-ordination with the competent sectoral regulatory authorities, the Antitrust Authority should be allowed to give suggestions as to the modalities and extent of the necessary restructuring. There are developments suggesting that the advocacy activity of the Antitrust Authority has already started to become more broadly-based. Such activity increasingly encompasses the preparation of horizontal reports recommending the introduction of much-needed legislative reforms to restrict the use of administrative concessions. These reports are being issued in a political environment which has become more hospitable to sectoral regulatory reform.

99. More generally, regulatory reform progress has been clearest where the call for pro-competitive reform has also relied on EU authority and guidance.³⁶ However, in Italy, as in several other countries, EU directives are often interpreted as implying a ceiling for market openness. A case in point is postal services, where the number of activities subject to restriction (*riserva*) has not been reduced, but widened during the transposition into Italian law of the related EU directive. More generally, if Italy is to converge with the frontrunners rather than the laggards in Europe, EU directives should be interpreted as floor requirements for liberalisation, and Italy should go further, as it is doing in the sector of gas and rail.

Increasing local autonomy...

100. As part of an ongoing broader process of decentralisation, one key area of product market reform is that of local public utilities under municipal and provincial authority (*comuni* and *province*). Service provision in these domains has long been beset by structural weaknesses, including overstaffing, industrial unrest and obsolete capital stock, especially in the South. Important measures have already been introduced recently so as to force the local authorities to limit the length of the concessions and to make the authorisation procedures for obtaining such concessions more transparent. A draft law which was finalised by the government and submitted to Parliament aims at a further deepening of this approach. More specifically, local service activities would be separated into two businesses; of these, infrastructure planning would continue to be run by the municipalities, while use and management would be open to private companies, with access based upon concessions assigned through open auctions. Only joint stock companies would be eligible to apply for a concession, with no restriction as to the origin of the applicant.

101. When completed, the new institutional setting will have major impacts on the structure of local utilities, where important merger and acquisition operations are likely to arise. In addition, the government expects that the local administrations will face a strong incentive to maintain a rapid pace of liberalisation, in the possibility of improving their access to much-needed resources for infrastructure investment. Furthermore, such reforms will support and complement other nation-wide sectoral reforms, such as those in electric power and transport. However, the new approach also suffers from grey areas and possible

35. See the recent OECD (2000e) document on vertical separation.

36. See OECD (2001b), Chapter 3.

contradictions. According to one provision, small local municipal authorities would be allowed to request an exemption from the new rules and authorised to maintain direct controls on public utility companies (*gestione in economia*). Considering that about 86 per cent of Italian municipalities – of which there are 8100 – serve less than 10 000 inhabitants, if approved this provision would tend to reduce the extent of the reform. In addition, introducing competition under the new framework would be handicapped by an excessively lengthy transitional period.

... and a new approach to regional development...

102. Although the evidence of many OECD countries suggests that product market liberalisation entails strong economy-wide efficiency gains, such gains have often been distributed unevenly within national territories. In Italy, in particular, the consequences of a drastic reduction in the economic role of the state, together with the related lowering of (direct and indirect) subsidisation to private business, can be expected to be felt more strongly in the poorest regions of the *Mezzogiorno*.³⁷ As a means of counteracting these adverse changes, a major shift in policy occurred in 1998 with the development of a new strategic approach, valid nationally but with a special focus on the South, aimed at improving the environment for private investment. The new approach is built upon several pillars, notably better evaluation of and accountability for public infrastructure projects, greater autonomy for local authorities and reinforced competition for resources among local administrations.

103. After a slow start, the number of projects under implementation in the *Mezzogiorno* has increased sharply, accompanied by a marked improvement in the ability to spend public funds effectively, both national and EU. Company start-ups have risen, even though signs of recovery have remained localised, so far. At the local level, new methods for promoting private investment and co-operation between the private and public sectors are in use in economically depressed regions (*patti territoriali*), and for easing the stipulation of special agreements with respect to employment arrangements, credit and public order (*contratti di area*). But the lower quality of transport, power, banking, insurance and public administration all continue to add to business costs, hampering development. And the southern regions are still marked by the size of their underground economy, although progress has been made in fighting organised crime.

104. The government considers that in tackling infrastructure and governance problems, policies need to be tailored to the specific needs of the South. However, they also need to be underpinned by improvements in the quality and efficiency of the public administration, and in the general regulatory environment, including greater scope for a more flexible use of working time and increased wage- and labour-cost flexibility, so as to match actual productivity differentials.

...need to be buttressed by further labour-market reforms and skill development

105. From a forward-looking perspective, the political economy of reforms is also very important.³⁸ Italy's EMU-entry strategy during the late 1990s highlighted the essential role of social consensus in successfully implementing a broadly-based convergence strategy which has required the combination of both macroeconomic and structural elements of microeconomic reforms. Maintaining this consensus requires that improved labour market flexibility be complemented, as it has been planned by the government, by the harmonisation of benefits in the unemployment insurance scheme, which at present is

37. Barca (2000).

38. European Commission (1999). For a wider discussion of the links between sectoral regulatory reforms and labour-market developments in the European Union, see Nicoletti, Haffner, Nickell, Scarpetta and Zoega (2001).

skewed towards a minority of highly-protected beneficiaries. Participation rates for women and young people have increased recently, but the under-utilisation of these resources remains considerable in Italy. Female participation remains low nation-wide, and long-duration unemployment is still very high, suggesting that important regulatory restraints are still acting to inhibit the performance of the labour market. It would be inappropriate, however, if the burden of future reforms were to remain concentrated on enhancing flexibility in the labour-market, as reliance on this alone would create a “duality” of insiders in permanent contracts and growing number of outsiders on undetermined contracts.

106. Policies to increase labour force participation and to assist sectoral regulatory reforms need also to embrace skill development. Spending on active labour market policies currently totals some 1 per cent of GDP and is somewhat higher than the OECD average, but would benefit from redesigning. This would include the simplification of activities and tailored measures to meet the needs of various at-risk categories (women and youths) and long-term unemployed (but not specific sectors which would have adverse allocative effects). The pace of reform also needs to be accelerated in education and training, and with this aim a long-term plan has been designed with the aim of responding to these needs (*Masterplan*).

The liberal professions need to be opened to competition

107. Entry restrictions are still important in the professions. Having long been postponed, the reform of the professional orders is being stepped up. A draft law is under preparation by the government. The outcome is uncertain, but if the EU Commission’s directives and the opinions submitted by the Antitrust Authority are complied with, an important reorganisation of the rules determining access to the professions can be expected. Quantitative ceilings would be eliminated, while fees would be established on a consensual basis between the client and the professional, taking into account market criteria. The publication and dissemination of quality standards for services and codes of conduct would be guaranteed, along with a softening of demarcation rules between professions.

Capital markets need deepening

108. From a medium-term financial market perspective, prospects of increasingly competitive banks and the related widening range of financial services offered can be expected to induce customers to look for new alternative means of financing. Evidence supporting this expectation is provided by a recent increase – though from a low basis - in the amount of resources invested in unlisted companies by investment funds, investment banks and equity-financing institutions. Venture capital has also started to expand quite briskly from a low level, while project financing is also quite undeveloped in Italy. A recent interesting development has been a significantly accelerating availability of funds for seed capital and start-up programmes in the domain of the “new economy”.

109. Following its privatisation in 1997, and the implementation of the new law on financial intermediation in 1998, which derestricted the managed saving industry and simplified procedures for take-over bids, *Borsa Italiana* has undertaken several attempts to bring to the market the potentially vast “equity reservoir” of Italy's small and medium-sized enterprises. The *Nuovo Mercato* (New Market, operational since 1999), is specifically dedicated to such companies with strong growth prospects. *Borsa Italiana* also provides services to its clients with a view to encouraging links between investors and potential candidates for listing. As it turns out, however, the pattern of privatisation, along with a recent surge of take-over bids and mergers and acquisitions, has not reduced the already predominant role of the large corporations and the pyramidal groups in the Italian stock market. Indeed the Milan stock exchange has experienced a fall in the number of listed companies over the last few years. By the end of 2000, privatised corporations still exceeded 50 per cent of overall market capitalisation.

Concluding remarks

110. The shift towards more market-oriented and less interventionist policies, described above, has allowed Italy's legal and institutional framework to come much closer to the mainstream of good regulatory practices in OECD countries. With Italy having been initially a laggard on the regulatory reform front, and having been forced to speed up the process by the urgency of meeting the requirements for participation to stage three of EMU, recent achievements have been remarkable. They are, however, incomplete. A major challenge is the need to secure competition in the sheltered sectors of the economy, where inflation inertia raises costs and affects the exposed sectors, thereby weakening international competitiveness. A further major challenge still exists in eliminating Italy's still marked territorial income disparities, market-friendly reforms having not yet had any noticeable impact in terms of regional convergence. EMU membership is bringing further convergence at the European level, but often EU deregulatory requirements have been interpreted as implying a maximum rather than a minimum degree of market openness. Above all, it is important to note that progress made in the respective domains of deregulation are self-reinforcing in terms of improving competitiveness, potential output, employment and national welfare. Maintaining an ambitious reform programme will help to secure the achievement of further improvements in all of these domains.

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