

The Tax Burden and Economic Crisis

1. The structural weakness of the Italian economy

The current rigidity of the government budget and the consequent impossibility of using fiscal policy to govern the economic cycle and remove the bottlenecks that constrain Italy's economic development is one of the obstacles to the growth of employment, especially youth employment. For many years the centre of a lively debate, the problem was addressed once again in the *Review* in 1992 in a statement by Antonio Fazio, then the Deputy Director General of the Bank of Italy, to the V Committee (Budget, Treasury and Planning) of the Chamber of Deputies on the debt-reduction plan contained in the Government Planning Document for the years 1993-1995. Fazio began by analyzing the relationship between Italy and the international economy. After discussing the recession of 1991-1992 and the forecasts for a recovery in world economic activity in 1993, he underlined the fact that the Italian economy had developed in line with the rest of the world except for inflation, which averaged 5.6 per cent per annum between 1985 and 1991 compared with an average of 3.9 per cent in the other industrial countries. The balance of payments on current account, which had been close to balancing in 1986 after the fall in oil prices, had also performed worse, despite the favourable terms of trade.

The current-account deficit was 26 trillion lire in 1991 and was forecast to rise to 30 trillion in 1992. At the end of 1992, achieving balance was complicated by the fact that imports rose more rapidly than exports (51 per cent compared with 27 per cent) and interest payments on about 180 trillion lire (excluding gold) in net foreign debt amounted to about 23 trillion lire, and were tending to increase.¹

Fazio pointed out that the structural weakness of the Italian economic system was caused by the difficult situation of the public finances: only readjustment of the finances and more efficient public services would enable the economy to be relaunched. He challenged the assumptions underlying the government's Economic and Financial Planning Document, arguing that it underestimated the level of interest rates and that, while talking about "the primary deficit, that is net of interest, is a useful scheme for isolating in our analysis a category of expenditure that, in the immediate term, seems to be largely outside the control of the government", the true condition of the public finances could only be assessed by referring to the overall balance, i.e. including interest payments. The burden of interest payments in 1992 was anything but negligible: at the end of the year they amounted to more than 2 trillion lire and would likely increase

¹ Antonio Fazio, "The public finance manoeuvre for the year 1993-1995", *Review*, XLVI, 2 (May-August 1992), pp. 141-142.

in the coming years.² A slight decline in the rate of growth in interest payments was expected in 1994, but, without adequate counter-measures, the budget on a current programmes basis would generate a deficit of 324 trillion lire in 1995, equal to 18.2 per cent of GDP.

In order to avoid such a disaster and achieve objectives set out in the planning document, Fazio argued that it was necessary to take action on both the revenue and expenditure sides of the budget. On the revenue side, he noted that, in macroeconomic terms, the tax burden in Italy in 1991 was 2.8 percentage points less than in Belgium, 6.6 points less than in the Netherlands, 2.1 points less than in Germany and 4.8 points less than in France. He attributed the difference to the widespread use of subsidies for special situations or particular categories and to tax evasion. In other words, both the type of taxes imposed and the tax rates applied needed reform, and the administration of the tax system required reorganization. In any case "further taxes of a general nature on financial activity, which is already taxed heavily in Italy," had to be ruled out because of the adverse repercussions on saving, capital movements and financial intermediation.³

It was on the expenditure side, however, that measures were most urgently required. Expenditure had long been the weak point of the budget and since the 1970s continually rising social spending had been the main cause of deficits and the steady rise in the public debt. In 1992 the breadth of Fazio's analysis and the authority of his position lent infinitely greater weight to worries that had been expressed on previous occasions. Fazio pointed out that many spending mechanisms were linked to outdated macroeconomic and demographic variables that had been selected when the rate of economic growth was nearly twice that of the 1990s and the population was much younger.⁴ It was therefore vitally important to reorganize the pension system.

In Fazio's view, the measures that the government intended to take to lighten the pension burden were not sufficient. Raising the retirement age would produce savings only decades later. Under certain conditions some benefit would come from calculating pensions on the basis of workers' wages in the last ten years of their working lives and from increasing the minimum level of contributions needed to qualify for a pension. However, the proposal to revise the income limits for access to welfare assistance would actually increase spending.⁵ It was

² *Ibid.*, p. 143.

³ *Ibid.*, p. 146.

⁴ The population had gradually aged in the post-war years. Massimo Livi Bacci observed that in 1950 for every 100 people under the age of 15, there were 40 aged 60 and over in Spain, 46 in Italy, 63 in Germany, 70 in the United Kingdom and 71 in France. Twenty or so years later, the scenario had changed radically. The number of people over the age of 60 equalled the number of young people in about 1977 in Germany, in 1981 in the United Kingdom, in 1986 in Italy, in 1991 in Spain and in 1995 in France. In other words, the ageing process had been more rapid in Italy and Spain, countries in which the birth rate had fallen more rapidly than in the rest of Europe. Massimo Livi Bacci, "Demographics and the pension system", *Review*, XLIX, 1 (January-February 1995), p. 12.

⁵ Fazio, "The public finance manoeuvre", pp. 147-149.

a complex problem, one that was addressed by Andrea Monorchio, the Accountant General, who not only agreed on the urgency of the situation but also warned that it was useless to continue promising everything to everyone when it was already clear that such promises could not be kept.⁶

No less in need of reform was the health service. According to Monorchio, health expenditure had increased between 1980 and 1991 to 17.4 per cent of current spending,⁷ and was considerably higher than in France and the United Kingdom. Health spending in France and the United Kingdom amounted to \$42 billion and \$45 billion respectively, compared with \$53 billion in Italy.⁸ Fazio proposed a number of measures and insisted on the need for firm action to reorganize hospitals and increase the productivity of medical staff. In order to make certain and permanent cuts in health spending, he argued that it was necessary to abandon the principle that all hospital services should be provided free of charge.⁹ On his part, Monorchio judged the medical system to be inadequate on the whole and, like Fazio, emphasised the need to give greater responsibility to the regions, establish national standards for health care and reduce the number of health-service staff.¹⁰

The finances of local authorities and general government were the other two sectors that weighed heavily on the budget. Both Fazio and Monorchio offered proposals to reduce their impact on the public finances.¹¹ Nevertheless, the public debt was the greatest burden borne by the public finances.¹² At the end of 1991 the debt amounted to 104 per cent of GDP, but Fazio feared that without adequate reforms it would reach 143 per cent in 1995, compared with a forecast of 116 per cent with the measures proposed by the government.¹³ Only Belgium and Greece had a larger public debt as a proportion of GDP.¹⁴

2. The EEC and the problems of Italy

The problem of Italy's public debt acquired special importance and urgency within the framework of the changes under way in the EEC. In order to

⁶ Andrea Monorchio, "The requalification of public spending and the control over its principal components: Health service, pensions, local authorities, education", *Review*, XLVI, 2 (May-August 1992), p. 172. On the legislation regarding pensions, see also Luciano Bontempi, "The impact of recent legislation on supplementary retirement provisions", *Ibid.*, pp. 255-274, and Sandro Gronchi, "Demographic changes and pension reform in Italy", *Review*, XI, 1 (January-June 1996), pp. 107-117.

⁷ Monorchio, "The requalification of public spending", p. 165.

⁸ *Ibid.*, p. 167.

⁹ Fazio, "The public finance manoeuvre", pp. 149-150.

¹⁰ Monorchio, "The requalification of public spending", pp. 165-168.

¹¹ Fazio, "The public finance manoeuvre", pp. 150-152 and Monorchio, "The requalification of public spending", pp. 174 *et seq.*

¹² R. Onofri, "The state deficit and measures for its cure", *Review*, XLIV, 2 (May-August 1990), pp. 251-274; G. Salerno, "The reform of the institutional aspects that underline the formation of expenditure, the controls and the acquisition of the means for financing it", *Ibid.*, pp. 235 *et seq.*

¹³ Fazio, "The public finance manoeuvre", pp. 153.

¹⁴ *Ibid.*, p. 155.

understand the events of recent years in the monetary, credit and financial sectors it is necessary to begin with the Wall Street crash in 1987 and, above all, the rising tide of indiscriminate deregulation that preceded it, especially from 1985 onwards, when oil prices returned to their pre-1973 levels.

The crisis made it clear that the progressive broadening of the markets had turned traditional procedures and the existing regulatory framework into an obstacle to the development of financial activity in the industrial countries. It was therefore necessary to simplify existing rules. This led to the EEC directive of 24 June 1988 (88/361/EEC), which was incorporated into Italian law on 14 May 1990, laying down the foundations for the dismantling of foreign-exchange controls that, in one form or another, had been in place since 1934. With the new law the process of exchange liberalization was completed¹⁵ and Italy took its place in the "competition between systems",¹⁶ the essential condition for the creation of an integrated Community financial market as from 1 January 1993. In order to meet the challenge of foreign competition, Italy was forced to abandon controls on exchange rates and promote incentives to strengthen and modernize its financial structures, thus improving the quality of services offered. Deregulation meant that households and firms could invest freely in any currency, hold accounts abroad or in foreign currency in Italy and cover themselves against exchange-rate risk.

First and foremost, the new regulations opened a vast range of new business opportunities for the banks, enabling them to offer lira loans to non-residents, make loans abroad and offer products to hedge exchange-rate and interest-rate risks. Having previously been hindered by regulatory obstacles that had forced them to limit their presence in the markets, causing them to lose an important source of revenue, Italian banks could now expand their international rôle. However, in order to exploit the new opportunities they had to equip themselves properly by modifying procedures and products, acquiring lire and foreign currencies, organizing for international operations, opening offices in

¹⁵ On 7 January 1990 the lira passed from the wide to the narrow fluctuation band of the Exchange Rate Mechanism (ERM) of the European Monetary System; the permitted range of fluctuation was reduced from 6 per cent to 2.25 per cent, and the lira's central rate *was* aligned with the other currencies of the ERM. The change did not harm the lira since the German mark, which traded at 716 lira in August 1989 and rose to 750 lire at the end of that year after the rise in German interest rates, gained ground only after 14 May 1990, the date the directive came into force, partly owing to the rise in interest rates. Faced with the inflow of foreign capital, the monetary authorities were forced to intervene in the market to prevent the lira from rising too much and stem the emergence of tensions in the EMS. In addition, a month and a half before the 1 July deadline laid down in the EEC directive, despite the fact that the lack of harmonization of tax treatment of interest on bank deposits and securities with other European countries penalized Italian markets, market participants were allowed to purchase short-term foreign securities and open foreign-currency accounts. See Mario Arcelli, "Currency liberalisation and changes in monetary policy", *Review*, XLIV, 2 (May-August 1990), pp. 141-143.

¹⁶ Lamberto Dini, "The liberalisation of Italian foreign exchange controls: constraints and opportunities", *Ibid.*, p. 157.

the foreign financial centres where business was strong and closing those in markets where it was weak. Nor could they fail to increase their efficiency in the domestic market, since the Second Banking Directive granted EEC banks the freedom to operate in all member states as from 1 January 1993 and established the principle of mutual recognition of laws in this field. As the Delors Report pointed out, the absolute jurisdiction of each central bank over banking in its territory was due to end. Banks operating in a foreign country would be subject to the control of their home country central bank.

The internationalization of banking was not a new phenomenon in Italy but it definitely intensified between 1985 and 1990. Between 1988 and 1989 the international operations of Italian banks increased by 15 per cent, although the initiatives taken appeared to be oriented more towards medium-term goals rather than immediate objectives. Nevertheless, the then Director General of the Bank of Italy, Lamberto Dini, judged the international operations of Italian banks to be still relatively small at just over 4 per cent of turnover, while international business at French banks accounted for 8 per cent of their operation.¹⁷

January 1993 was therefore a radical turning point for the Italian banking system. It was even more radical for the monetary authorities, who could no longer use exchange-rate policy. This meant that closer coordination between the monetary policies of the EEC member states was a necessity, at least until a European central bank could begin operations.¹⁸ It was envisaged that "the Committee of Central Bank governors should formulate opinions on the overall orientation of monetary and exchange-rate policy, as well as on measures taken in these fields by individual countries. In particular, the Committee would normally be consulted in advance of national decisions on the course of monetary policy, such as the setting of annual domestic monetary and credit targets".¹⁹ As Mario Arcelli wrote, the centre of gravity of monetary policy would shift to the European level and Italy would have to "become accustomed to coordinating its monetary objectives with those of the other countries of the EEC and to renouncing autonomous powers of monetary manoeuvre". The impact of the change would also affect the public finances, especially the taxation of capital movements and the management of the public debt.²⁰

3. The Maastricht Treaty

The process of European economic integration received a further boost with the signing on 7 February 1992 of the Maastricht Treaty, which would enter into force on 1 November 1993.²¹ The Treaty provided for the creation of a single

¹⁷ *Ibid.*, p. 162.

¹⁸ Arcelli, "Currency liberalization", pp. 144-145.

¹⁹ Quotation from the Delors Report, *Ibid.*, p. 145.

²⁰ *Ibid.*, pp. 141-142.

²¹ Law 454 of 3 November 1992. See *Gazzetta Ufficiale*, supplemento, n. 274 of 24 November 1992.

currency managed by a European Central Bank (ECB) as from 1 January 1999 as a necessary step in the economic unification of Europe. The currency project was to be implemented in three stages. Within the framework of meetings of the Committee of Central Bank Governors, the first stage would involve identifying the functions and laying the technical foundations of the European Monetary Institute (EMI), the proposed forerunner of the ECB. The EMI began operations on 1 January 1994, marking the beginning of the second stage of monetary union. Its powers are limited to the technical and analytical aspects of the transition, and it has no influence on national monetary policies. It conducts studies of the economies of the member states, defines instruments and operating procedures and, with the help of its considerable professional resources, plays a stimulative role in the preparations for the third stage of monetary union and the creation of the ECB.²²

Ratifying the Treaty proved difficult. In June 1992 Denmark put the question to a popular referendum and, after it passed, declared that it would nevertheless not participate in monetary union. The United Kingdom had demanded and obtained the addition of a protocol to the Treaty that recognized the right of Parliament to opt out of participation in Stage 3 of monetary union. The persistence of the recession had an equally adverse impact.

In addition to respecting normal fluctuation margins for two years, aspiring participants in monetary union must have an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of the three best performing member states in terms of price stability, a budgetary deficit of no more than 3 per cent of GDP and a ratio of public debt to GDP that does not exceed 60 per cent, unless the excess is only exceptional and temporary and is sufficiently diminishing and approaching the reference value at a satisfactory pace.²³

When it signed the Treaty in 1992 Italy was a long way from satisfying the Maastricht criteria. Its public debt had grown rapidly from the mid-1980s onwards and in 1989 was already about 98 per cent of GDP, before rising to about 104 per cent in 1991 and more than 111 per cent in 1992. It would reach 119.4 per cent in 1993 and 124 per cent in 1994.²⁴ In 1995 the budget deficit reached about 9-10 per cent of GDP, while the rest of Europe had managed to limit the deficit to about half that level. Given the size and short maturity of the public debt, interest rates were also considerably higher than elsewhere. In the 1980s both nominal interest rates and inflation were 7.4 points higher than in Germany, for example.²⁵ In short, Italy seemed unlikely to qualify for the third stage of monetary union.²⁶

²² I. Angelone, "L'Istituto monetario europeo e la preparazione dell'Unione monetaria", *Economia Italiana*, 3, September-December 1995.

²³ Luigi De Rosa, "Oltre Maastricht", in M.R. Saulle (ed.), *Il Trattato di Maastricht*, (E.S.I., Naples), 1995, p. 255.

²⁴ Michele Fratianni, "Monetary policy needs an anti-inflation anchor", *Review*, IX, 2 (July-December 1995), p. 165.

²⁵ *Ibid.*

²⁶ De Rosa, "Oltre Maastricht", pp. 260-262.

The adverse economic situation in which Europe found itself after the third oil crisis did not make the task any easier. On 16 September 1992 the United Kingdom was forced out of the EMS and on 19 November Sweden cut its ties with the ecu, the accounting unit of the EEC. Between 16 September and 3 December 1992 sterling depreciated by 13 per cent and the peseta and escudo fell by 6 per cent. In May 1993 the peseta and escudo fell by a further 8 and 6.5 per cent respectively. After Italy suspended its participation in the ERM, the lira began to depreciate and inflationary tensions rose. As the exchange rates of the various currencies lost credibility, capital inflows declined and expectations of new devaluations rose, speculative attacks against the currencies intensified.²⁷ The crisis that shook the EMS between June 1992 and July 1993 exposed the contradictions between the needs of the different member countries.²⁸ Thus Italy, whose exports had benefited considerably from the depreciation of the lira in the 1970s and 1980s but then lost ground from 1990 onwards,²⁹ saw its trade balance improve after the devaluation and subsequent depreciation in 1992.³⁰

The exchange rate fluctuations caused by inflation in Italy, Portugal, the United Kingdom and Spain complicated the operation of the single market. In order to restore currency stability and overcome the crisis, the Community decided to widen the fluctuation band from 2.25 per cent to 15 per cent, given that the currencies that had left the ERM would not be able to return to the system at their previous levels (partly because Germany had to support the costs of unification after the fall of the Berlin Wall).³¹ Nevertheless, Italy and some of the other countries that had left did not immediately re-enter the system.

The exchange rate of the lira continued to fluctuate and the inflation rate continued to rise "despite the Bank of Italy's repeated declarations of anti-inflationary rigour".³² In fact, "the conclusion is that monetary policy is not restrictive enough". According to Michele Fratianni, the monetary squeeze came "in February but this was much too late to reverse the acceleration of prices in 1995".³³ In 1995 inflation in Italy, Spain and Portugal was above the level permitted by the Maastricht criteria, unlike that in France and Germany. Only during 1996 did Italian inflation decline significantly,³⁴ and towards the end of the year Italy

²⁷ G. Corsetti and N. Roubini, "The Maastricht Treaty: A look at the fiscal aspects", *Review*, XLVI, 3 (September-December 1992), p. 415.

²⁸ Giacomo Vacago, "Exchange rate stability and market expectations: the crisis of the EMS", in *Review*, XLVII, 1 (January-April 1993), p. 27.

²⁹ Fabrizio Onida, "Does there still exist an external constraint on Italian economic growth?", *Ibid.*, p. 50.

³⁰ *Ibid.*, p. 59.

³¹ De Rosa, "Oltre Maastricht", p. 263.

³² Fratianni, "Monetary policy", p. 170.

³³ *Ibid.*, p. 173.

³⁴ M. Bagella, "Monetary convergence, unemployment and growth in the European Union: A comparison with the United States and Japan", *Review*, I, 2 (July-December 1996), pp. 176 *et seq.*

resumed its participation in the ERM at a new central rate, thus recognizing the depreciation in the lira since it had left the system.

4. The EEC and banking legislation

We now return to our discussion of EEC measures in banking, measures that had a considerable impact on the Italian banking system, which had been undergoing continuous change for years.³⁵ Progress away from the specialisation forced upon banks by law was well under way and in 1985 an additional barrier had fallen when the freedom to engage in banking was granted to would-be new entrants, thus eliminating the freeze on the establishment of new banks in place since 1966.³⁶ However, deregulation, technological innovation, new financial products and globalization had exposed the problem of the size of banks and their capital,³⁷ as well as underlining the need to increase organizational efficiency.³⁸

Against this background, Law 218 of 30 July 1990, the so-called Amato Law, and the subsequent Decree 356 of 20 November 1990 were enacted. Both measures encouraged Italian banks to transform themselves into limited companies with issued shares, thereby becoming truly entrepreneurial undertakings and allowing them to increase their size through mergers and additional capital and to form operating groups that could offer a wide range of financial services. They also enabled medium-term credit institutions to broaden their sectorial and geographical reach.³⁹

Law 287 of 10 October 1990, the "anti-trust" law, introduced measures safeguarding bank independence, including rules governing bank shareholders and restrictions on lending to connected individuals and corporate bodies. It also allowed banks to take stakes of up to 15 per cent in non-financial companies. Law 1 of 2 January 1991 allowed the establishment of firms managing the investment of securities, permitting them to engage in a variety of activities that made such firms a universal intermediary in the area of government and private securities and allowed them to maintain a specialized focus by joining other groups. Law 287 and Ministerial Decree of 5 June 1991 permitted insurance companies to acquire majority interests in credit institutions. This was followed by Legislative Decree 87 of 27 January 1992, which incorporated Community legislation concerning the publication of balance sheets into Italian law, specifying the approach that banks and other financial institutions would have to follow when preparing their consolidated accounts.

³⁵ See Chapter XVIII, Section 5.

³⁶ Michele Barbato, "Banking in the Eighties", *Review*, XLIV, 3 (September-December 1990), p. 460 *et seq.*

³⁷ See Chapter XVIII, Section 8.

³⁸ Barbato, "Banking in the Eighties", pp. 501 *et seq.*

³⁹ Rainer Masera, "The universal bank and the credit group: Solicitations from the market and prudential regulation", *Review*, XLVI, 3 (September-December 1992), pp. 343-344.

The flood of financial legislation followed the enactment of Directive 89/646/EEC – the second major directive after that liberalizing foreign exchange⁴⁰ – which was translated into Italian law only on 14 December 1993. The directive sought to coordinate the laws, regulations and administrative procedures relating to the taking up and pursuit of the business of credit institutions, laying the foundations for a single European market in banking and affirming the principles of mutual recognition and home member state control.

These reforms paved the way for the accepting of the concept of the universal bank. Nevertheless, both Guido Carli and Rainer Masera,⁴¹ echoing a widely held view, appeared reluctant to abandon the old philosophy of specialized banking. Carli seemed in favour of allowing both the universal bank and the multifunctional banking group, considering them complementary rather than contradictory, and permitting operators to choose freely the approach they preferred.⁴² This stance was undoubtedly rooted in his attachment to the past, a past that he himself, perhaps unwittingly, had helped to change.⁴³

The universal, or “mixed”, bank had been eliminated from banking law in Italy and elsewhere after the great crash of 1929. In Italy the lion’s share of the blame was placed on the collapse in banking after the first World War, with the failure of the Banca Italiana di Sconto at the end of 1921, the crisis at the Banco di Roma between 1922 and 1923 and the problem of non-performing assets at the Banca Commerciale Italiana and the Credito Italiano, which, together with the Banco di Roma, were taken under the wing of IRI in 1933. The universal bank model did not meet the same fate everywhere, however. In Germany, for example, the model continued to operate and support German industry before and after Hitler came to power and again during the difficult process of rebuilding the country after the war. Today, following the collapse of the Berlin Wall, it is deeply involved in the economic unification of the country.

Given the German success, could the banking crisis really be blamed on the type of banking system in place? It is difficult to say. Nevertheless, when Italy began to take the first tentative steps towards a return to the universal bank model, which was already in wide use in France and the United States, more than one qualified observer raised the spectre of a recurrence of the dramatic situation of the banking system between the wars. Marcello De Cecco, for example, concluded his article on the issue, saying that “the challenge that lies ahead is great; the chances of winning it are matched by those of entering a disastrous crisis. It only remains to wish Italy good luck as it embarks on this adventure, which follows from the country’s (perhaps obligatory) decision to continue to count among the key economies of Europe”.⁴⁴

⁴⁰ See Section 2.

⁴¹ Rainer Masera, *Intermediari, mercati e finanza d’impresa*, (Laterza, Rome-Bari, 1991).

⁴² Masera, “The universal bank”, p. 347.

⁴³ See Charter XVIII, Section 11.

⁴⁴ Marcello De Cecco, “The Italian banking system at the historic turning point” *Review*, XLVIII, 1 (January-June 1994), p. 66.

In 1993 the new Banking Law was enacted, the fourth in the economic and political history of unified Italy after those of 1874, 1893 and 1936. The new law not only coordinates all existing banking legislation, amending laws that have fallen into disuse or been superseded by others, but also sets out new principles and confers new powers in line with directives enacted at the European level. As Vincenzo Desario, the current Director General of the Bank of Italy, wrote, "the new banking law completes a process of adjusting the Italian banking order to a profoundly altered economic and social reality. It incorporates and strengthens the basic principles that characterized the long, multifaceted evolution of the Italian financial system, summarized above. It preserves the previous legislation's elasticity and flexibility".⁴⁵

What new principles does the Banking Law establish? First, it narrows differences in the legislative treatment of cooperative and mutual banks and ordinary banks (although their mutual nature is strengthened by restrictions on cooperative banks, limiting their power to change their legal form, requiring them, above all, to operate with their own members) and of different types of bank in general. With regard to customer protection, the Bank of Italy is charged with monitoring the content of contracts. The law preserves the supervisory role of the Interministerial Committee for Credit and Saving, the Minister of the Treasury and the Bank of Italy. It does not cover non-bank financial intermediation, acknowledging that intermediaries subject to special regulations (investment trusts, leasing and factoring companies, etc.) do not fall within the scope of its powers. However, the acquisition of financial companies, consumer credit and the transfer and trade in foreign currencies are subject to Bank of Italy regulation. The new law clarifies that the control function is directed at enabling intermediaries to benefit as far as possible from the opportunities offered by the law. Its objective is to improve relations between industry and finance and, although not explicitly stated, envisages the withdrawal of the government from the management of most of the productive and financial system, a greater role for institutional investors, an increasingly effective stock market and more scope for firms to issue bonds directly.⁴⁶ In short, the law has a pronounced liberal stamp.

5. Privatization

The Community had for some time been moving towards liberalization⁴⁷ and this orientation was transmitted to Italy by means of directives that were translated into Italian law. This policy forced the authorities to sever the complicated tangle of bonds between government and economy that had developed over the years.

⁴⁵ Vincenzo Desario, "The 1993 Banking Law: The new configuration of supervisory controls", *Review*, XIV/II, 2 (July-December 1994), p. 180.

⁴⁶ *Ibid.*, pp. 179-190.

⁴⁷ See Section 2.

If Europe was to become a single market and people and capital were to be free to move from one country to another without impediment in order to improve their lot, it was necessary to remove laws and institutions that hindered this movement and frustrated this aspiration. At least two conditions had to be met for this to occur: monopolies had to be eliminated and public enterprises, which often held monopoly positions, had to be privatized. The will to build a Europe on all fronts, the political included, was to be measured by efforts to eliminate any residual nationalistic instincts.

Pursuing these objectives was no easy task in Italy. Government monopolies existed, even before Unification, being exercised either directly or by granting concessions: the monopoly on salt and tobacco products is one example. Nevertheless, both public monopolies and private monopolies, which flourished under the protectionist tariffs adopted in 1888, rapidly increased in number in the early part of the twentieth century. The process began with the railways in 1905 and continued with life insurance in 1911-1912 and the telephone service in 1925-1926. These were followed by the creation of IRI and the resulting indirect control exercised by the government over a variety of sectors essential to economic development, ranging from the major banks to shipyards, the steel industry and the metal and mechanical-products sector. Nor did the trend come to a halt after the fall of the Fascists: in 1953 the National Hydrocarbon Authority (ENI) was created and granted a predominant role in the energy sector, leaving only marginal room for private enterprise. In 1962 the electricity companies were nationalized and ENEL emerged in their place. At the beginning of the 1960s, SIP (the telephone operator), Italcable and Telespazio, all owned by IRI and hence firmly in the public sector, obtained a monopoly on the installation of telephone equipment and the operation of domestic and international telephone services. Meanwhile, local public utilities (water, transportation, milk production, etc.) had gradually been taken over by municipalities since the beginning of the century.

Certainly, the authors of nationalization and "municipalization" considered the technique to be a means for redistributing income and for installing a new system of industrial relations.⁴⁸ However, as Filippo Cavazzuti and Giovanni Moglia astutely pointed out, the policy gradually began to reflect political and cultural backwardness. Faced with market failure in a number of sectors, the standard response was to shift the burden of the failing firm or sector onto the central government or local municipality. Government take-over of economic enterprises was not a solely Italian phenomenon. Other countries on more than one continent did not hesitate to make use of the instrument. It was, in fact, the key element of the programmes of many governments in Europe and elsewhere. Nevertheless, as time passed, public enterprises became increasingly less able

⁴⁸ Filippo Cavazzuti and Giovanni Moglia, "Regulation, control and privatization of Italian public services", *Review*, XLVIII, 1 (January-June 1994), pp. 12-14.

to use resources efficiently and more rationally than their private-sector counterparts. Often, especially in recent years, rather than improving income distribution, public enterprises actually destroyed wealth.

Safe from shareholder pressure, many public enterprises became prime examples of inefficiency, low productivity and poor product quality and were slow to introduce innovations, if not incapable of doing so altogether. Since public-sector managers in Italy were political appointees there were frequent cases of corruption and illegal financing of political parties, and public enterprises were transformed into a source of jobs that were either unnecessary or even harmful to the firms themselves.⁴⁹

The de-nationalization of public enterprises and the transfer of ownership to the private sector began in the 1970s and was eventually carried out in countries as diverse as Bangladesh, Jamaica and Turkey. However, the greatest wave of privatizations came in a number of EEC countries, such as the United Kingdom, France and Spain. Having joined the nationalization bandwagon late, the United Kingdom was the most determined in disposing of government-owned companies, largely owing to the firmness of Margaret Thatcher. Privatization not only generated revenues but also encouraged millions of ordinary savers to take an interest in the management of the former public enterprises, thus increasing national income indirectly. As an instrument for the decentralization of economic power, it was also an opportunity to introduce reforms of great political scope.⁵⁰

Although the form in which they occurred may have differed, privatizations also took place in Eastern Europe and the former Soviet Union beginning in 1989. In Italy, no privatization measures were taken for most of the 1980s, although the adverse impact of the pervasive government presence in the market on the country's economic development had been clear for some time. A number of publicly-owned firms, including Alfa Romeo and Lanecrossi, had been sold to a single buyer, often without returning any profit whatsoever to the government. In fact, some of the transactions could probably be more accurately described as abandonments rather than sales. Nothing of any real consequence was accomplished, however, especially if compared with the United Kingdom,⁵¹ France and Spain, countries with economic and social characteristics similar to Italy's.

As shown in the report by Carlo Scognamiglio, the chairman of the Committee for Privatization at the Treasury Ministry, at the close of the 1980s discussions were still underway on the criteria to be used for privatization, the speed with which public enterprises were to be sold, sale procedures and the

⁴⁹ *Ibid.*, pp. 18-19.

⁵⁰ Carlo Scognamiglio, "Report to the Minister of the Treasury by the Committee for Privatization: Summary and Commentary on the Laws Under Discussion", *Review*, XIV, 1 (January-April 1991), p. 12.

⁵¹ For more on the British privatizations, see M. Vitale, L. Van Lancker and L. De Vecchi, "Privatization and financial markets. Absorption capacity of the Italian and International stock markets in the face of major policies of privatization", *Review*, XIV, 1 (January-April 1991), pp. 56-58.

ways in which Parliament was to decide. Examining the different parliamentary bills promoted by the deputies Forte, Malagodi, Martinazzoli and Cavazzuti, the Committee for Privatization opted for the formula proposed by the latter,⁵² which envisaged the transformation of the public enterprises into companies limited by shares and recommended that the government retain a golden share rather than continue to own a majority of the equity.⁵³ The Committee also expressed its views on the measures needed in a number of specific cases. For example, it agreed that the government should continue to hold at least a minority interest in ENEL and that it should reserve certain rights for itself, such as the right to appoint non-executive directors, and introduce a number of restrictions in its bylaws. The Committee ruled out any immediate privatization of the railways. It also raised the issue of the Bank of Italy, which, being controlled by a group of publicly-owned banks and institutions, risked ending up in the hands of those who would eventually control the Bank's shareholders once they were privatized. The Committee did not express an opinion with regard to the privatization of Italian State Television or AGIP, the oil company, proposing only that any political interference in the appointment of their managers be avoided.

The philosophy of the Report viewed privatization as an additional instrument to prevent any form of concentration or undue market influence. In cases where economic interests of national importance were felt to be in play, as with ENEL and ENI, the Report recommended that the law authorizing their disposal should limit individual shareholdings to 2-3 per cent of the capital.⁵⁴ Cavazzuti himself underscored another aspect of the privatizations, namely that in addition to their beneficial impact on the public finances, they would have the merit of strengthening the stock market by broadening the range of listed companies,⁵⁵ thus improving the distribution of market risk, as Italy had committed itself to doing in 1983 at the urging of the FEC. The legal framework for the establishment of investment trusts was put in place and instruments to stimulate demand for securities were created.⁵⁶ The powers of the Companies and Stock Exchange Commission were defined, especially with regard to ensuring the transparency of the markets and the protection of savings.⁵⁷ The Parliament also approved the anti-trust law regulating competition and market control,⁵⁸ which authorized measures to combat monopolies and monopolistic concessions and laid down

⁵² *Atti Parlamentari, Senato, Documenti*, n. 2320 of 19 June 1990.

⁵³ Scognamiglio, "Report to the Minister", pp. 19-22.

⁵⁴ *Ibid.*, pp. 21-22.

⁵⁵ Cavazzuti pointed out that there were just over 200 companies listed on the Milan Stock Exchange, not even two thirds the number in Spain (370), one third that in France (about 600) and Germany (640) and less than a tenth that in the United Kingdom (about 2,600). Filippo Cavazzuti, "Privatization: a 'laboratory' for developing a capital market", *Review*, XIV, 1 (January-April 1991), p. 31.

⁵⁶ Law 77 of 23 March 1983.

⁵⁷ Law 281 of 4 June 1985.

⁵⁸ Law 287 of 10 October 1990.

regulations governing relationships between banks and industry. Yet another law regulated the transformation of public banks into limited companies with shares,⁵⁹ while another laid down a series of regulations regarding the organization of the stock markets, market transparency, prevention of conflict of interest, concentration and so on.⁶⁰

Other measures aimed at strengthening the stock market included rules issued in February 1991 by the committee appointed to reform the 1936 Banking Law that facilitated relations between banks and industry by encouraging the specialization of financial intermediaries and emphasizing the stock market rather than the credit market.⁶¹ It was, nevertheless, argued that, given its lack of experience, Italy should proceed with caution in privatizing its public enterprises, avoiding any massive flood of shares onto the market that would drive down prices. However, it was also recognized that, in the long term, privatization was the only way to revive the stock market, the public finances and the national economy.⁶²

The fact that Italy had long resisted the incorporation of EEC Directive 723 of 25 June 1980 on the transparency of financial relations between the government and public enterprises (imposing equal treatment for public and private enterprises), even bringing the case to the European Court of Justice, was a sign that the country had not accepted privatization easily and was not fully convinced that the government had to choose between exercising public power and acting as an entrepreneur.⁶³ Although Italy eventually lost its case, years passed without any progress being made on privatization. In vain Cavazzuti and Moglia also warned that the countries that had begun to move before Italy had established an effective system of government regulation of privatized monopolies. This was the case in France, where the powers of ministries already in possession of adequate technical and economic resources were revised and strengthened to deal with the new situation, and in the United Kingdom, which instituted independent authorities with broad regulatory powers. Italy was the only country to approach privatization – as in the case of the telecommunications industry – without having defined the range of possible regulatory powers or created the institution authorized to exercise them.⁶⁴

The warning sounded by Cavazzuti and Moglia was prompted in part by the fact that Law 359 of 8 August 1992, which authorized the transformation of IRI, ENI, INA and ENEL into limited companies, required the government to grant concessions of “no less than 20 years for the activities previously assigned

⁵⁹ Law 218 of 30 July 1990

⁶⁰ Law 1 of 2 January 1991.

⁶¹ Cavazzuti, “Privatization”, pp. 27-29.

⁶² *Ibid.*, pp. 34-35.

⁶³ *Ibid.*, p. 37.

⁶⁴ Cavazzuti and Moglia, “Regulation”, p. 11.

or reserved by law or administrative order to those bodies". A similar concession was granted to the state railways, while that for ENEL was to have a duration of 99 years! The Finance Law for 1994 extended the principle of concessions to motorway-operating companies and was also proposed for airport service companies. Cavazzuti and Moglia pointed out that such concessions were awarded on a competitive basis in many countries.⁶⁵ The result was that, in the absence of new rules, there was a "consolidation of the pre-existing legal monopolies, not any movement towards liberalization in those industries".⁶⁶ In other words, the country was deprived of the opportunity to enhance the competitiveness of industries dominated by legal monopolies or near monopolies and ensure market access to new firms by revising existing concessions, especially in sectors where technological progress had removed any previous justification for granting a monopoly.⁶⁷

Law 537 of 24 December 1994, which accompanied the Finance Law for 1994, gave the government nine months to establish rules for the creation of authorities charged with regulating essential public services and resolving any conflicts between suppliers and users. The government was also directed to specify the attributes of such authorities in order to enable the transfer of functions previously carried out by ministries or other bodies. Some action was subsequently taken, and in a few cases shares were floated on the market. Nevertheless, significant progress of the sort achieved in other countries has still not been made in Italy. This is despite the fact that privatization and the creation of regulatory authorities to ensure the existence and competitiveness of markets are part of the transformations imposed by European integration and by the globalization of the world economy.

6. Conclusions

In the extraordinary period of transition that Italy is currently experiencing, the measures adopted by a succession of governments to ease the process of change have not been sufficient to satisfy all the needs of the community and the economy as a whole. This has proved to be the case with the measures adopted since 1996 to bring Italy into line with the Maastricht criteria, measures that, at least since 1992 (with a brief interruption in 1994), have been based on sharply increasing revenues yielded by a variety of direct and indirect taxes with no significant cuts in government spending. Such limitations were especially apparent in sectors beset by waste, abuse and privileges that may have gone virtually unnoticed during the years of rapid economic expansion and population growth but could no longer be afforded today, when trade is increasingly

⁶⁵ *Ibid.*, p. 21.

⁶⁶ *Ibid.*, pp. 21-22.

⁶⁷ *Ibid.*, p. 25.

competitive and the population gradually ageing. As Fazio argued, such inefficiencies are a key factor in a more rapid process of decline.⁶⁸

Although the rapid and significant erosion of taxpayers' disposable income has increased government revenues, it has also led to a sharp contraction in private consumption and therefore a pronounced decline in trade and production. By the same token, the failure to introduce greater elasticity into government expenditure has blocked the measures required to give Italy the infrastructure it needs to stimulate development and thereby reduce the excessive unemployment that afflicts the country, especially in the South.

The hesitation shown in privatizing public enterprises and restoring more elastic public finances is a sign that Italy has yet to realize that the longer any readjustment of its economic and financial position is delayed, the more difficult it will be to take an active role in the economic integration of Europe and the globalization of the world economy. As Mario Sarcinelli has commented, in addition to the speed of communication and transportation, the progress of globalization depends on the state of economic development,⁶⁹ and as long as the firm, courageous and responsible decisions needed to boost the Italian economy are not taken, it is unlikely that Italian consumers will be able to demand that Italian suppliers of goods and services achieve the standards of quality and price set elsewhere. Privatization, liberalization, a significant reduction in the tax burden, elastic public finances and globalization are, in essence, different aspects of the same underlying process, one in which a more efficient allocation of resources will tend to maximise output and welfare in the pursuit of peaceful coexistence among peoples.

⁶⁸ See Section 1.

⁶⁹ Mario Sarcinelli, "Has a global world market really been achieved?", *Review*, XLEX, 2 (July-December 1995), pp. 213-217.



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