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OECD ECONOMIC SURVEYS

1994-1995

ITALY

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Publié également en français.

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BASIC STATISTICS OF ITALY

THE LAND

Area	301.3	Inhabitants in major cities, 1.1.90, thousands:	
Agricultural area (1 000 sq. km), 1982	236.3	Rome	2 804
		Milan	1 449
		Naples	1 204
		Turin	1 003

THE PEOPLE

Population, 1.1.93, thousands	56 960		Thousands
Number of inhabitants per sq. km	189	Labour force, 1993	23 138
Net natural increase average (1988-92, thousands)	29	Employment, 1993	20 244
Net rate per 1 000 inhabitants (1988-92)	0.6	In agriculture	1 508
		In industry	6 737
		In services	11 999

PRODUCTION

Gross domestic product, 1993 (trillion of lira)	1 560	Origin of gross domestic product in 1993 at market prices, per cent of total	
GDP per head (1993 US$)	17 423	Agriculture	4.1
Gross fixed capital formation		Industry	29.2
Per cent of GDP in 1993	17.1	Construction	5.7
Per head in 1993 (US$)	2 977	Other	61.0

THE PUBLIC SECTOR

Public consumption in 1993 (percentage of GDP)	17.9	Growth financial liabilities in 1993 (percentage of GDP)	119.4
Current revenue of general government in 1993 (percentage of GDP)	46.8	General government investment in 1993 (percentage of total investment)	15.5

FOREIGN TRADE

Exports of goods and services as percentage of GDP, 1993	21.4	Imports of goods and services as a percentage of GDP, 1993	18.6
Major export categories, as a percentage of total exports, 1992 (SITC)		Main import categories, as a percentage of total imports, 1992 (SITC)	
Machinery (71 to 77)	29.2	Food stuffs (0)	8.1
Fabric and textile goods (65)	5.3	Machinery (71 to 77)	20.9
Chemical products (5)	7.9	Metal, ores and scrap (67 + 68)	8.5
Automobiles and parts (78 + 79)	4.4	Mineral fuels (3)	10.7
Mineral fuels (3)	2.1	Chemical products (5)	12.5

THE CURRENCY

Monetary unit: Lira	Currency units per US$, average of daily figures:	
	Year 1993	1 572
	October 1994	1 549

Note: An international comparison of certain basic statistics is given in an Annex table.

This Survey is based on the Secretariat's study prepared for the annual review of Italy by the Economic and Development Review Committee on 10th October 1994.

•

After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 18th November 1994.

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The previous Survey of Italy was issued in January 1994.

Introduction

Over the past two years, Italy's political and economic landscape has been redrawn: in the general elections of March 1994 non-traditional parties (Forza Italia, the Northern League and the National Alliance) won a majority in Parliament. The new coalition has been given a decisive mandate to continue the process of rebuilding confidence in Italian politics and institutions, and to implement the economic policies necessary for the achievement of this aim. Such policies involve both a restructuring of government finances, in order to eliminate waste and inefficiency and contain the spiralling burden of debt, and a reframing of the institutional and regulatory base of the enterprise sector, so as to reduce the interference of the state and reassert the influence of the market in economic and commercial governance. At the same time, progress has to be made on the macroeconomic policy front, towards inflation convergence with Italy's European partners while maintaining the momentum of the economic recovery.

When the new government took office in May, the reform process was already well under way, following initiatives taken by the Amato and Ciampi administrations (described in previous *Surveys*). Such steps had begun to move the Italian economy towards a more market-oriented structure, based on new competition laws, privatisation and ongoing financial liberalisation. As in other EC members, European integration has exerted a beneficial influence in these respects. Moreover, the macroeconomic background was becoming more propitious, inflation having declined significantly, interest rates having fallen, the current account being in substantial surplus and signs of the economy pulling out of the recession becoming more numerous.

The *Survey* opens with a review of recent developments, paying special attention to the factors explaining the process of disinflation and the improvement in Italy's current account position (Part I). Fiscal and monetary policies are then evaluated in Part II, against the background of the problems faced in containing the huge and rapidly-rising stock of public debt – the uncertainties attaching to which have led to exchange-rate depreciation and upward pressure on interest rates. Corporate governance is the subject of the special chapter (Part III). Given the measures of economic liberalisation already undertaken and planned, Italy needs to develop a framework of corporate governance and finance capable of increasing the capacity of the economy to exploit investment and growth opportunities. A summary of the key points of the Survey is provided in the Conclusions (Part IV), together with policy considerations.

I. Recent developments

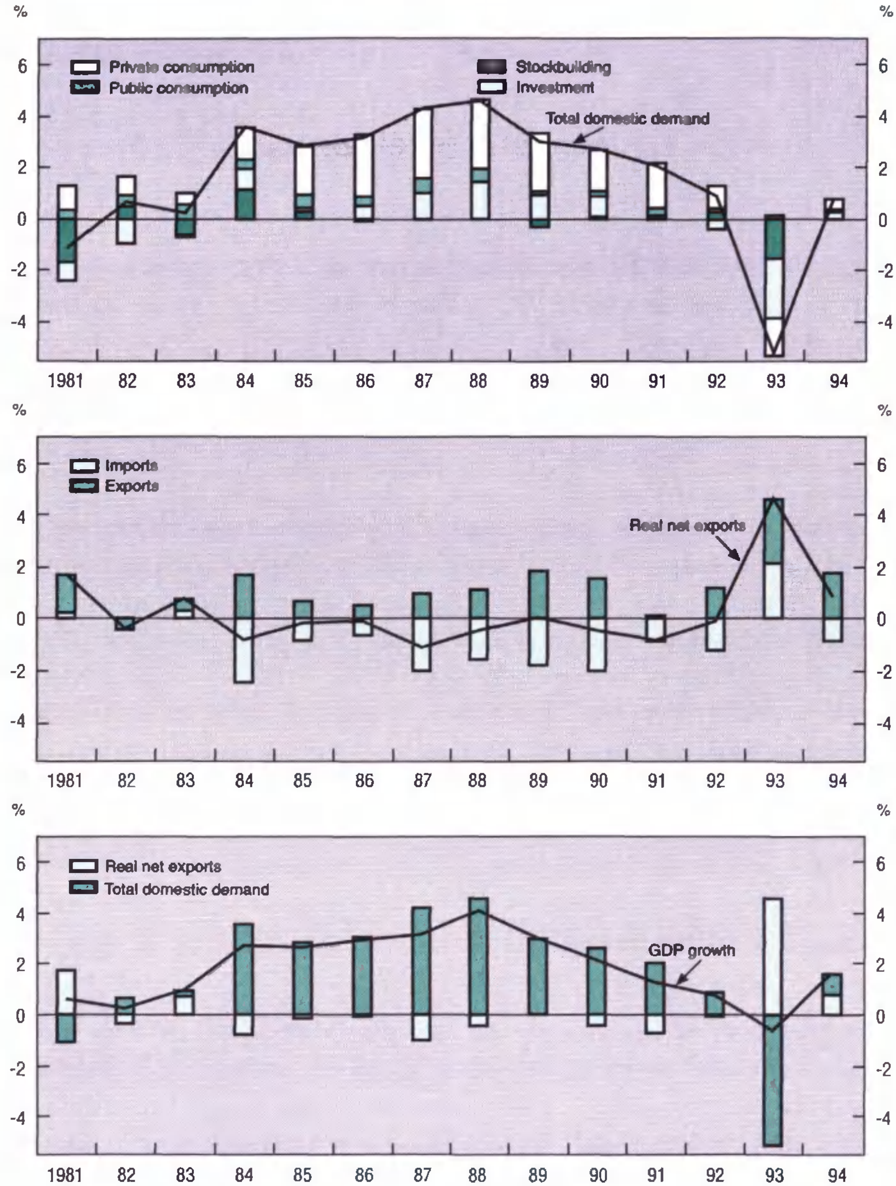
The 1992-93 recession was the most severe since 1975 and in many respects unique. For the first time since World War II, the level of private consumption contracted and employment losses extended to all the major sectors of the economy, resulting in a boost to labour productivity. At the same time, overall output losses were damped by a surge in net exports, mainly linked to the depreciation of the currency since September 1992. This external impulse has remained the most important source of output gains throughout 1993 and 1994 and was instrumental in pulling the economy out of recession in the second half of 1993, as the plunge in domestic demand came to an end. Private consumption growth has since resumed, stock-building has increased and gross fixed investment has picked up, underpinning the revival of domestic demand growth. In response, import volumes began rising from depressed levels, reducing the positive contribution to output growth from the net foreign balance. But, based in part upon an improving inflation performance, the trade and current account surpluses have continued to rise. Overall, real GDP is estimated to have risen by 2¼ per cent in 1994, the best performance since 1989.

Climbing out of the recession

Output dropped by 0.7 per cent in 1993, a steep fall in total domestic demand (5 per cent) being largely offset by net export buoyancy (Diagram 1). Virtually all sectors suffered from output declines, production shrinking by 2.4 per cent in industry and by 1.3 per cent in market services. Within the industrial sector, small and medium-sized firms with fewer than 200 employees cut back output by disproportionate amounts, partly reflecting particularly adverse trends in the chemical and metal industries.[1]

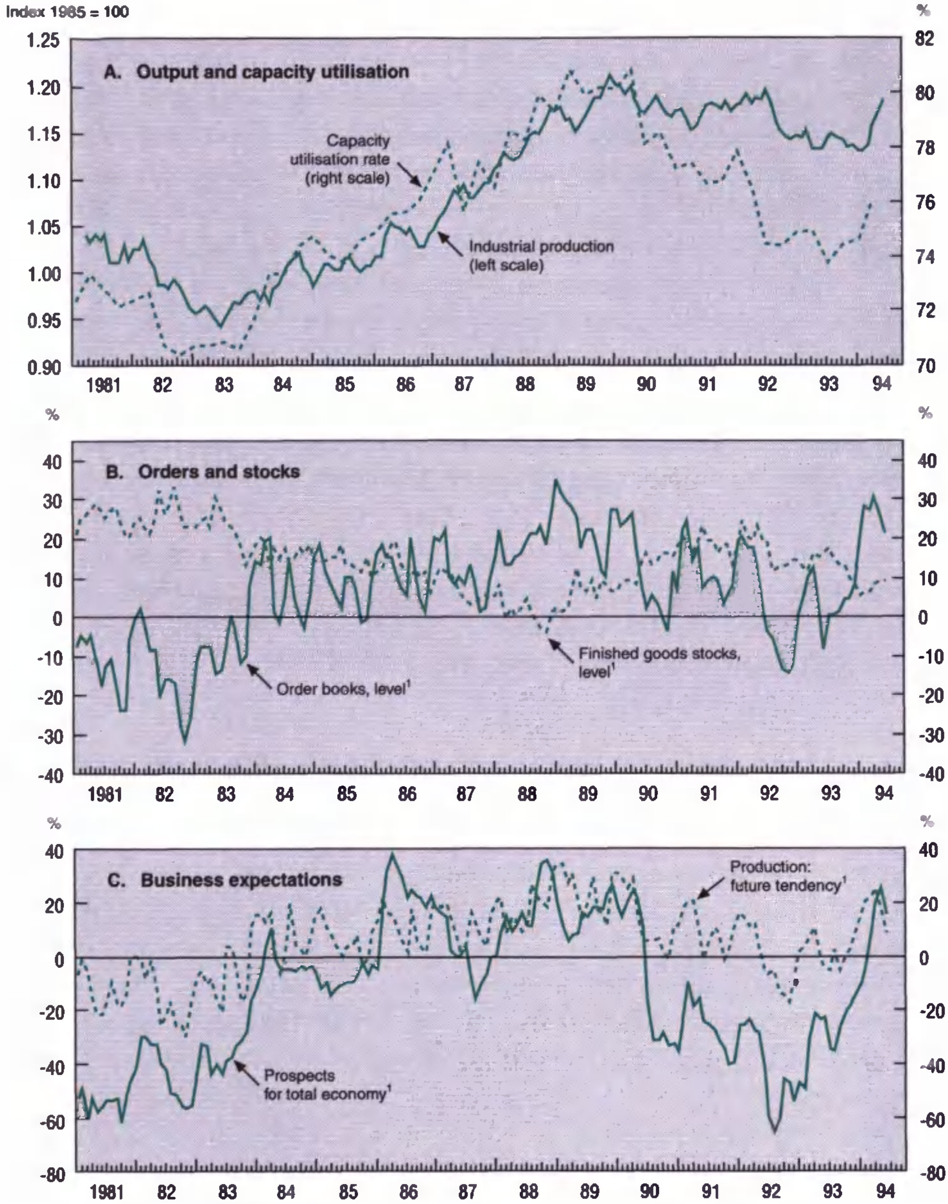
Diagram 1. **CONTRIBUTIONS TO GDP GROWTH**

As a percentage of GDP in the previous year



Source: OECD, *National Accounts.*

Diagram 2. **BUSINESS INDICATORS**



1. Per cent balance of positive and negative answers.
Source: OECD, *Main Economic Indicators.*

A fall in real wages and income from self-employment combined with higher taxes and waning consumer confidence to reduce private consumption expenditure by about 2 per cent in 1993. Gross fixed investment plunged by 11 per cent, pulled down by declining profitability, worsening output prospects and a *de facto* freeze on public investment as a consequence of the corruption scandal. Investment in machinery and equipment and non-residential structures, in particular, were hard hit by the recession. Overall output losses were cut by surging net exports, which added almost 5 points to GDP growth (Diagram 1). Imports of goods and services contracted in volume terms, while real export growth doubled, stimulated by strong gains in competitiveness and depressed domestic demand.

Falling interest rates, a surprisingly good inflation performance and signs of stronger market growth abroad were crucial elements in turning economic activity around, reviving business and consumer confidence in the closing months of 1993. By the autumn of 1994, most conjunctural indicators pointed to a vigorous economic expansion being well established: car sales had picked up from depressed levels; industrial output gains had firmed for several months, pushing up rates of capacity use by more than 1 percentage point: stocks were being rapidly rebuilt, and domestic orders were improving (Diagram 2, panel A and B).

Labour market shake-out and counter-cyclical productivity gains

The revival in economic activity brought some relief to the labour market, where the fall in employment slowed in the first half of 1994. Although hirings resumed in industry, the number of jobs in large firms (employing 500 persons and more) was an estimated 11 per cent lower in mid-1994 than two years earlier, when the recession began. The labour market shake-out was not confined to industry: market service jobs fell by 2.2 per cent in 1993, with larger losses taking place among the self-employed as a result of keener competition in the wholesale- and retail sector. The only service sector to have been spared employment losses was that of banking and insurance, thanks partly to the progressive reform of financial markets (see below) (Table 1). For the first time, public employment also contracted.

Overall, around 1 million jobs were lost between mid-1992 and mid-1994. The rise in recorded unemployment, though, was comparatively small: in

Table 1. **Sectoral employment trends**[1]
Percentage change from previous period

	Employment share[2]	Total employment			Dependent employment		
		1991	1992	1993	1991	1992	1993
Agriculture	8.8	0.1	-4.7	-6.9	-3.9	0.5	-8.6
Industry	28.6	-0.8	-2.7	-4.1	-1.4	-3.2	-5.2
Market services	43.5	2.0	-0.1	-2.2	2.9	0.8	-1.1
Commerce, hotels	21.7	1.5	-0.2	-2.3	1.8	1.9	-0.2
Transport and communication	6.4	0.4	-0.4	-2.0	0.3	-0.9	-1.4
Credit institutions and insurance	1.9	2.7	1.1	0.2	2.7	1.1	0.2
Other	13.2	3.5	..	-2.5	6.3	0.4	-2.3
Non-market services	19.1	1.1	1.2	-0.2	1.1	1.2	-0.2
Total	100.0	0.8	-1.0	-2.8	0.6	-0.5	-2.6

1. Expressed in standard labour units.
2. Percentage share in 1993.
Source: ISTAT (1994), *Rapporto Annuale.*

July 1994, the rate of unemployment stood at 11 per cent, up from 9.7 per cent in October 1992, the first date at which newly defined unemployment data became available (Table 2). Three principal factors explain the difference between large job losses and small additions to unemployment:

- recession-induced withdrawals from the labour force (see below);
- lay-offs financed by the Wage Supplementation Fund (CIG),[2] amounting to an extra 50 000 full-time workers in 1993. Recipients of such payments, which were extended in 1993 to include employees from large and medium-sized firms in many service sectors, are counted as employed persons in the labour force survey;
- and early retirement schemes, which have been an important element in restructuring the car, steel, defence industries, as well as chemicals, shipbuilding and railways.

Notwithstanding these developments, about 30 per cent of young people (less than 25 years) were unemployed in 1993, the third highest rate in Europe after Spain and Finland, while female unemployment totalled 15 per cent of the female labour force, almost twice as high as the European average.[3]

Table 2. **Unemployment rate**

	1990	1991	1992	1993[1]	1994[1]
January	12.0	11.3	11.3	9.4	11.3
April	11.0	10.9	10.8	10.5	11.6
July	11.3	10.6	11.0	10.3	11.0
October	11.3	11.0	13.1 9.7[1]	11.3	

1. Based upon new definitions of the labour force. Methodological changes include an extension of the list of branches of economic activity, a more detailed questionnaire and a redefinition of "job-seekers", counting as unemployed persons only those aged more than 15 who were available for work and took at least one initiative to find a job in the 30 days preceding the quarterly labour force survey.

Source: ISTAT, *Indicatori Mensili*, August 1993.

Assessing the behaviour of regional, age- and sex-specific unemployment rates in the last recession has been made difficult by methodological changes in the measurement of unemployment. Introduced in the autumn of 1992,[4] the new procedures implied a downward revision of the unemployment rate by about 2 points, translating into a drop in the participation rate. Being larger for the south than for the north, the statistical adjustment narrowed the huge regional unemployment gap. In addition, the 1993 recession led many young persons and women to quit the labour force. The "discouraged worker effect" has been powerful in the south, where the restructuring of State-owned enterprises involved larger job losses than in the north, an atypical feature for Italian recessions. The weight of State-owned enterprises is strong in the south,[5] whereas private industry, concentrated in the north, has normally been more vulnerable to cyclical downturns. According to the new unemployment data, the southern unemployment rate stood at 17.7 per cent in 1993, more than 10 points higher than in the north reflecting exceptionally high joblessness among women and young people (Table 3).

In June 1994, as part of an overall package to revive the economy, the new government took direct action to stimulate labour demand, introducing the following measures:

- the granting of tax breaks to firms which hire young people, unemployed or disadvantaged persons. This "hiring premium" (*premio di assun-*

Table 3. **Regional unemployment and participation rates**

	1990	1991	1992[1]	1993[2]
Unemployment rate				
North	5.1	5.1	5.9	6.2
Centre	9.8	9.6	9.9	8.8
South	19.7	19.9	20.4	17.7
Italy	11.0	10.9	11.5	10.4
Employment/population ratio				
North	44.4	45.1	45.1	44.2
Centre	43.0	43.8	43.6	41.6
South	38.6	38.6	38.7	35.6
Italy	42.0	42.4	42.4	40.6

1. Based upon old definition of labour force.
2. Based upon new definition of labour force adopted in October 1992.
Source: Bank of Italy (1994), *Statistical Annex to Annual Report*, Table AB26.

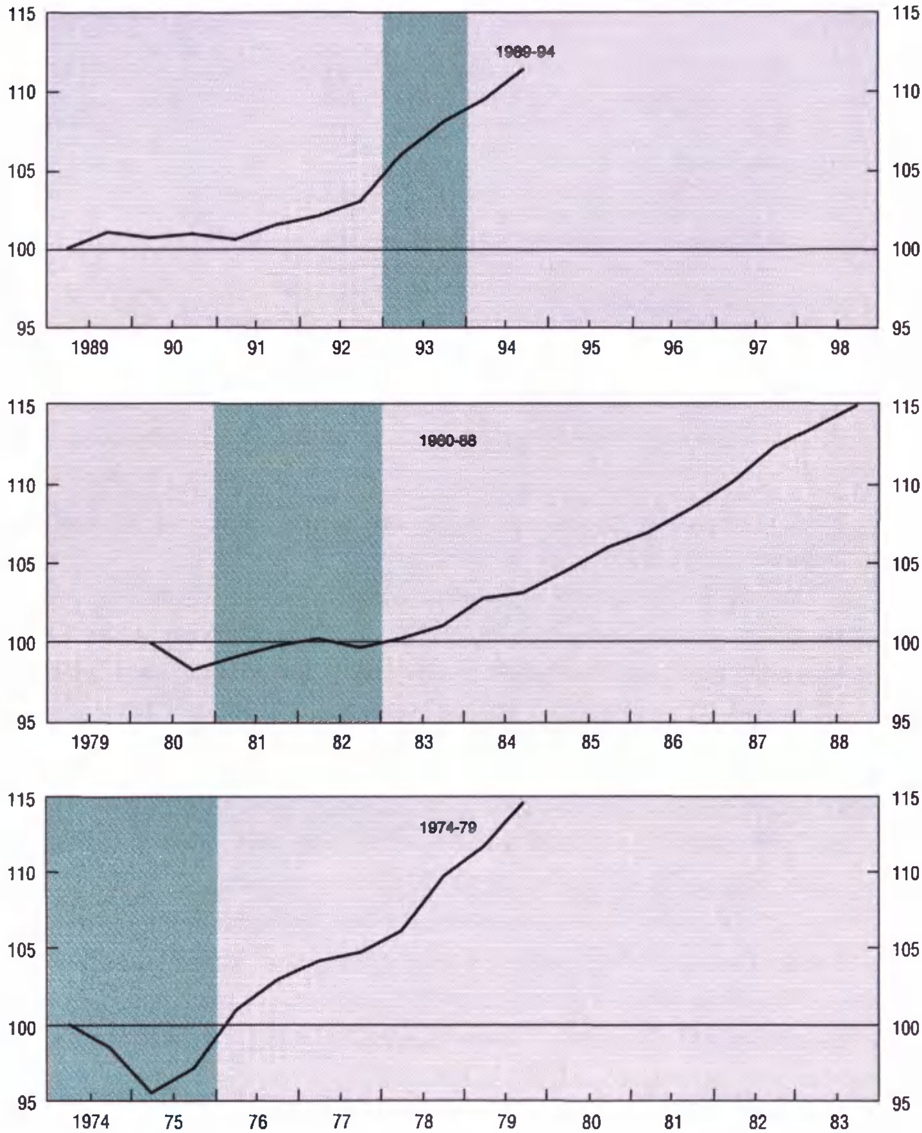
zione) is equal to 25 per cent of the entry wage, subject to a ceiling, and is available until the end of 1996;

- giving tax incentives to firms established by young entrepreneurs (less than 32 years old), unemployed and disadvantaged people. Over a three-year period, these firms would only pay a flat global tax, replacing a variety of taxes including the personal and local income taxes;
- ending a temporary ban on local government recruitment.

In addition, draft legislation presented to Parliament in June proposes to relax restrictions governing temporary employment. The bill also differentiates between entry wages for different categories of wage earners.

One result of the labour shakeout has been exceptionally large gains in labour productivity, a feature which has no precedent in previous post-war recessions. Although output contracted in 1993, economy-wide labour productivity growth accelerated (Diagram 3), with Italy displaying the best productivity performance among major OECD countries. Counter-cyclical gains in labour productivity were wide-spread, largely flowing from the drive to restore profitability (see below) (Table 4). They may also have reflected the effects of the structural reforms of the last few years, which have introduced greater competition into the sheltered sector:[6] The rapid advances of large retail- and wholesale

Diagram 3. **LABOUR PRODUCTIVITY GROWTH: A CYCLICAL COMPARISON**[1]
Cyclical peak = 100



1. Coloured area indicates years of recession or slow economic growth.
Source: OECD.

Recent measures of labour market reform

The following is a record of structural policy measures taken in recent years, with a view to enhancing labour market flexibility.

- The job allocation scheme (*richiesta numerica*) was terminated in July 1991, allowing enterprises with up to fifteen persons to recruit labour without recourse to state employment agencies.
- The Incomes Policy Accord of July 1992 abolished the wage indexation scheme (*scala mobile*), 46 years after its introduction. The subsequent Incomes Policy Accord of July 1993 established a two-tier wage bargaining system, with a four-year national labour contract governing labour relations and a two-year settlement regulating nominal pay increases in line with the inflation target set by the government in agreement with the social partners (national component of wage increases). At firm level, over and above inflation-determined pay increases, individual companies may raise wages only to reflect higher profits and productivity gains (company-component of wage increases).
- Draft legislation (June 1994), awaiting approval by Parliament, relaxes restrictions on temporary employment as well as rules governing part-time employment. The bill also differentiates between entry wages for different categories of wage earners.
- Legislation issued in 1993 terminated special government intervention in the south, a region plagued by high unemployment. Support to disadvantaged areas is now given on the basis of common nation-wide criteria, in conformity with EC rules.
- Access to payments from the Wage Supplementation Fund (CIG) was widened in 1993 to include large and medium-sized firms in some service sectors.
- A decree approved in June 1994 and enacted in August introduced a series of selective tax breaks aimed at stimulating job creation among the unemployed, disadvantaged people and young entrepreneurs.
- From 1994 negotiations about the renewal of wage contracts in the public sector are conducted by a special agency (*Agenzia per le relazioni sindacali*) on behalf of the government, subject to guidelines imposed by budgetary targets.

Table 4. **Sectoral productivity and unit labour costs**

Percentage change from previous period

	1990	1991	1992	1993
Productivity				
Manufacturing	1.6	1.8	4.1	2.8
Construction	0.3	–1.7	–2.0	–2.6
Market services	1.3	–0.5	1.9	3.6
Unit labour costs				
Manufacturing	6.8	7.4	2.8	1.6
Construction	10.6	9.8	6.8	3.0
Market services [1]	6.6	8.8	4.1	–0.1

1. Excluding rental services.
Source: Banca d'Italia (1994), *Relazione Annuale*, p. 102.

outlets contributed to a surge in labour productivity growth to 3.6 per cent in marketable services, surpassing efficiency gains in industry, a novel phenomenon for Italy.[7]

Reduced wage- and consumer-price inflation

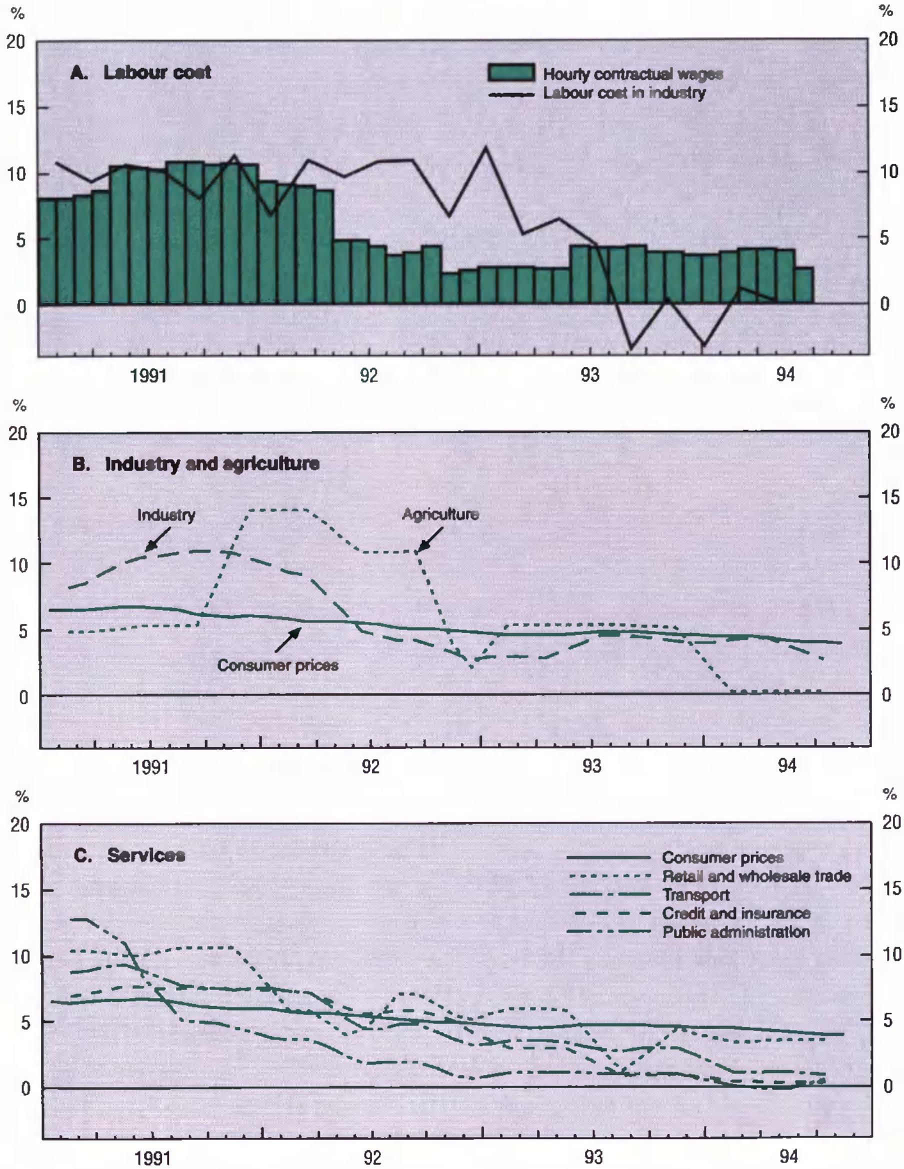
Nominal wage growth remained subdued in the first half of 1994, constrained by continued employment losses, public pay restraint and the labour agreement of July 1993.[8] In August 1994, the 12-month increase in the hourly wage rate stood at 2.2 per cent, half a point lower than a year earlier and 1.5 point below the rise in consumer prices (Diagram 4, panel A). Real wage losses, particularly strong in the agricultural, financial and public sectors, spread to nearly all sectors of the economy[9] (panels B and C). New wage settlements in the chemical and metal-working industries (May and July 1994) provide for moderate pay increases in line with the 1993 labour agreement, which was endorsed by the Berlusconi administration in June 1994. The metal-working pay agreement also envisages the creation of a supplementary pension fund. In the public sector, negotiations about the renewal of wage contracts resumed in July 1994, conducted by a special agency on behalf of the government (*Agenzia per le relazioni sindacali*), established in 1993,[10] subject to the constraints imposed by budgetary targets, which imply a rise in public pay in 1995 in line with the inflation target set by the government in agreement with unions and employers.

Low nominal wage growth accompanied by the above-noted strong gains in labour productivity reduced the annual rise in economy-wide unit labour costs to 1.7 per cent in 1993 and to less than 1 per cent in the first half of 1994, significantly below the rise in the GDP deflator. In market services, unit labour costs stopped rising. The resultant widening of profit margins, atypical for a recession, cushioned the fall in the rate of return on capital that normally derives from reduced capacity use. The 1993 rate of return on capital in the business sector was thus higher than in the two previous recessions of 1975 and 1983, implying that the required rate of return on capital has risen over time in partial response to higher real interest rates[11] (Diagram 5).

The rise in both manufacturing producer- and wholesale prices quickened in the wake of currency depreciation in 1993, but diminished, falling to 3.2 per cent at an annual rate in July 1994 (Diagram 6, panel A). This outcome was better

Diagram 4. **SECTORAL WAGE DEVELOPMENTS**[1]

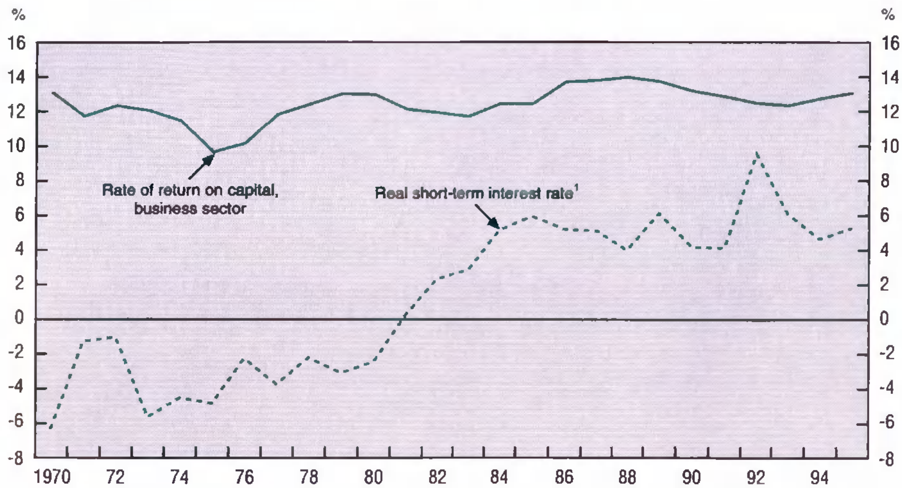
Year-on-year growth rate



1. Contractual hourly earnings.

Source: ISTAT, *Monthly indicators*, various issues.

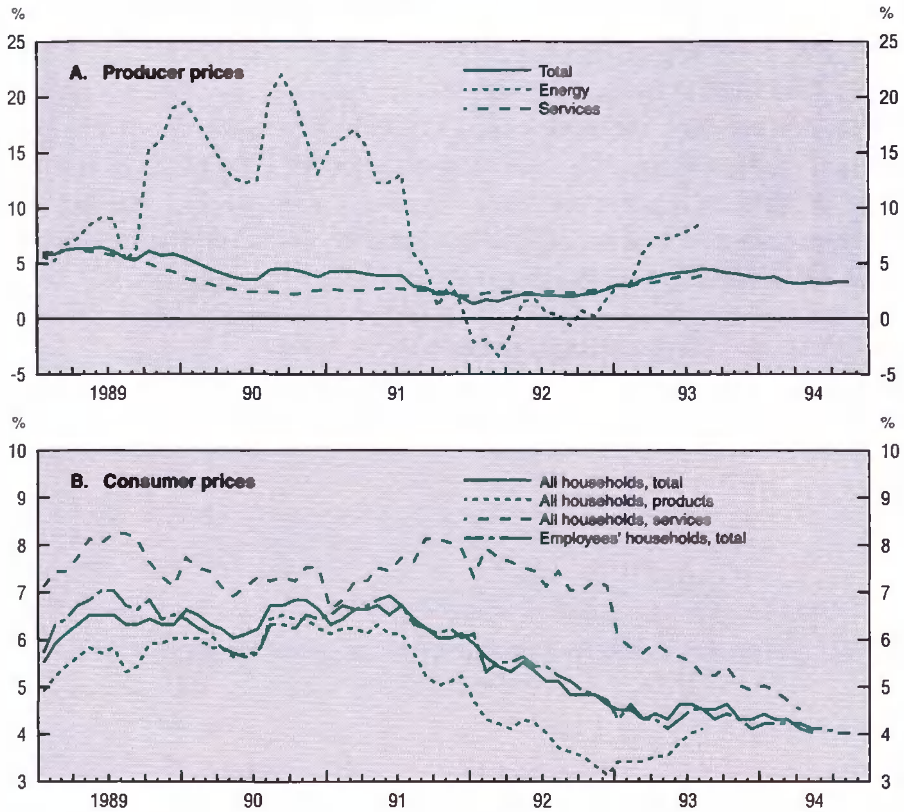
Diagram 5. **RATE OF RETURN ON CAPITAL AND REAL INTEREST RATE**



1. Deflated by GDP deflator.
Source: OECD.

than expected a year earlier.[12] However, due to higher transportation fares and public utility charges and the partial liberalisation of rent controls, these favourable price developments were slow to show up at the consumer level (panel B). It was only in July 1994 that the 12-month rate of consumer price increases, after holding steady at just over 4 per cent for nearly a year dropped to 3.6 per cent, the lowest rate since October 1969 and 1½ point below the pre-devaluation level of August 1992. Thus, despite steep currency depreciation, Italy's inflation has eased, assisted on the domestic side by income policy measures and keener competition in the private service sector. Indeed, in 1993, consumer-price inflation fell in the private service sector, but accelerated in the goods sector (excluding food), reducing the internal inflation differential to 1 point, the lowest gap in many years (Table 5). However, over the summer of 1994 with the economic expansion gathering pace and the lira depreciating, consumer-price inflation reaccelerated, rising to 3.8 per cent in October.

Diagram 6. **PRODUCER AND CONSUMER PRICES**
Year-on-year percentage change



Source: ISTAT, ISCO.

Table 5. **Consumer prices**
Percentage change from previous period

	1992	1993
Consumer prices	5.2	4.5
Food products	5.3	2.2
Non-food, non-energy products	4.1	4.7
Energy products	0.6	5.5
Services (uncontrolled prices)	7.3	6.1
Goods and services subject to control	5.1	3.8

Source: Bank of Italy (1994), *Annual Report*, p. 106.

Improvement in the external balance

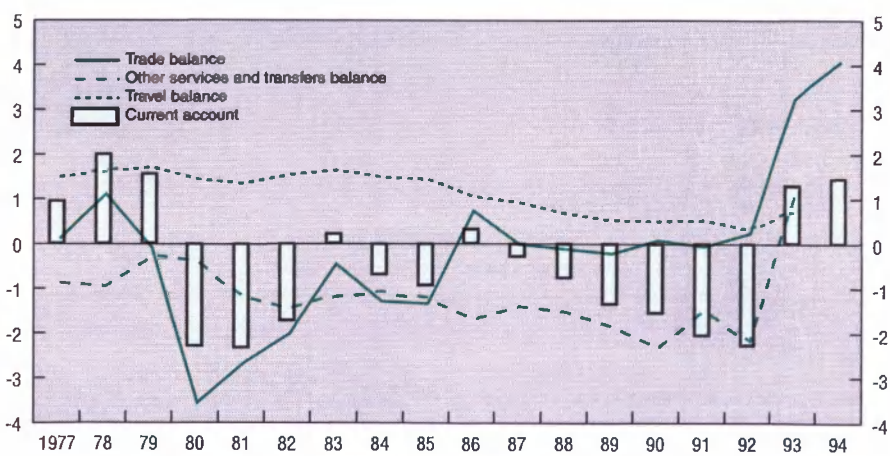
Italy's external balance has strongly improved since the second half of 1992, when the lira was forced out of the ERM. The trade surplus widened to around 4 per cent of GDP in the first half of 1994 (annual rate), the most positive result in more than 20 years, the current account surplus reaching 1.2 per cent of GDP (Diagram 7). Notwithstanding some worsening in the terms of trade, as a consequence of currency depreciation, Italy's current account position has thus shown no apparent negative J-curve effects following the lira's fall. The main elements behind this surprising outcome are analysed in the following section.

The fall in the nominal and real exchange rate

The nominal exchange rate fell by about 25 per cent in effective terms over the two years to August 1994, while the real effective exchange rate, measured by relative export prices in manufacturing, depreciated by 10 per cent (Diagram 8). Measured by relative unit labour costs in manufacturing, the fall in the

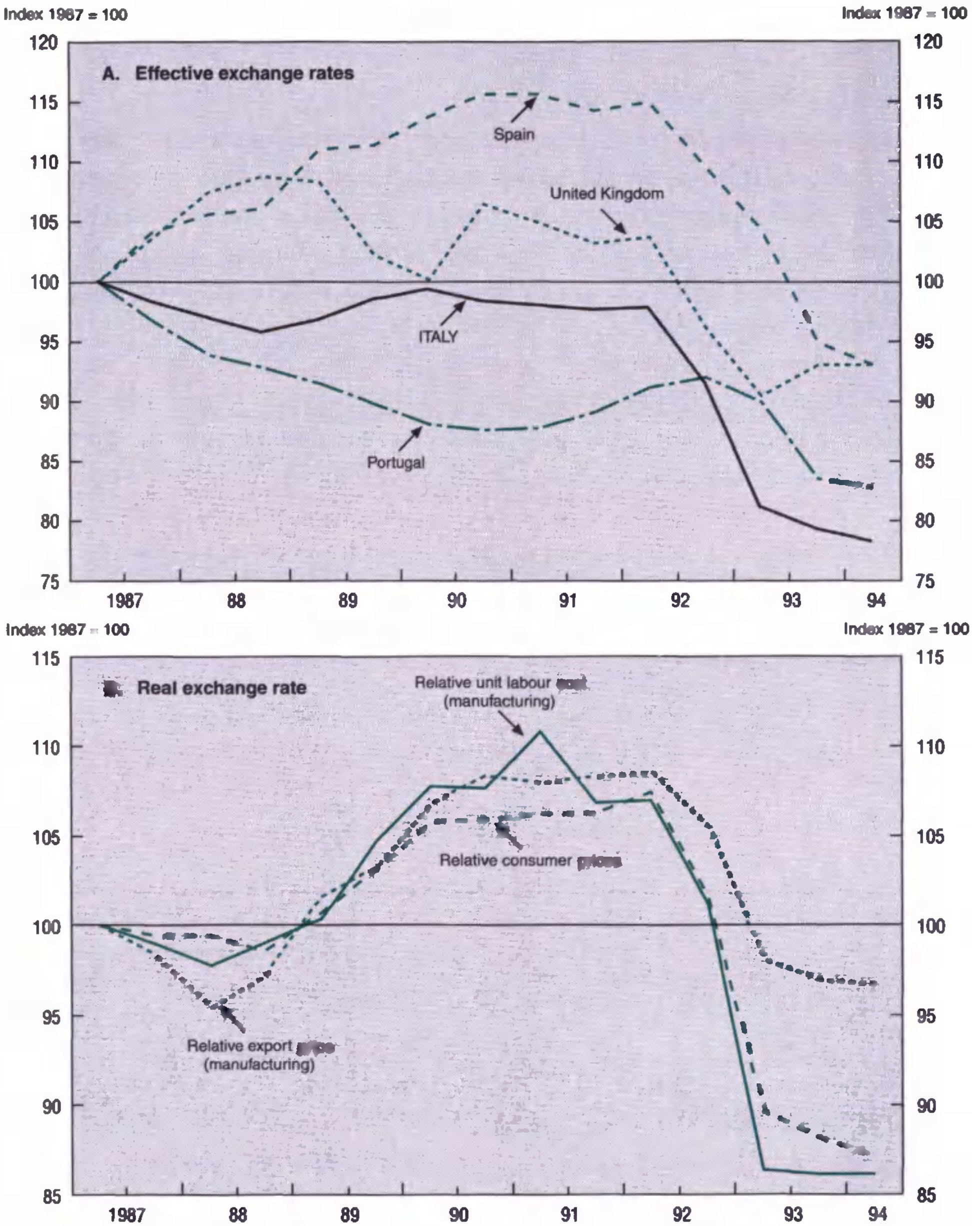
Diagram 7. **CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS**

As per cent of GDP



Source: OECD.

Diagram 8. NOMINAL AND REAL EXCHANGE RATES



Source: OECD.

real effective exchange rate was much larger, exporters having succeeded in boosting profit margins, while nominal wage growth has moderated significantly. Overall, the slide in the real exchange rate, however measured, exceeded the cumulative loss in cost competitiveness incurred since 1987.

Prices of imported goods have ultimately responded almost as strongly to currency depreciation as would have been expected from past experience. By mid-1994, the cumulative rise in import prices (17 per cent) amounted to a pass-through of over 80 per cent of the lira's fall (Table 6). Initially, though, the pass-through was much lower (55 per cent), as foreign exporters, fearful of losing market shares, cut prices of goods destined for Italian markets. The rise in export prices has shown a similar profile, gradually gathering pace. In this case, however, the cumulative rise in export prices over the two years to mid-1994 (15 per cent), was unusually strong by past standards, corresponding to roughly two thirds of currency depreciation. This exceeded consumer-price inflation by a wide margin. Thus, only one third of the lira's decline translated into improved price competitiveness. As a result, losses in the terms of trade incurred since the lira's exit from the ERM in September 1992 were relatively small, damping the influence that normally tends to push up trade deficits in the wake of currency depreciation (Diagram 9).

Table 6. **Currency depreciation and foreign trade prices**

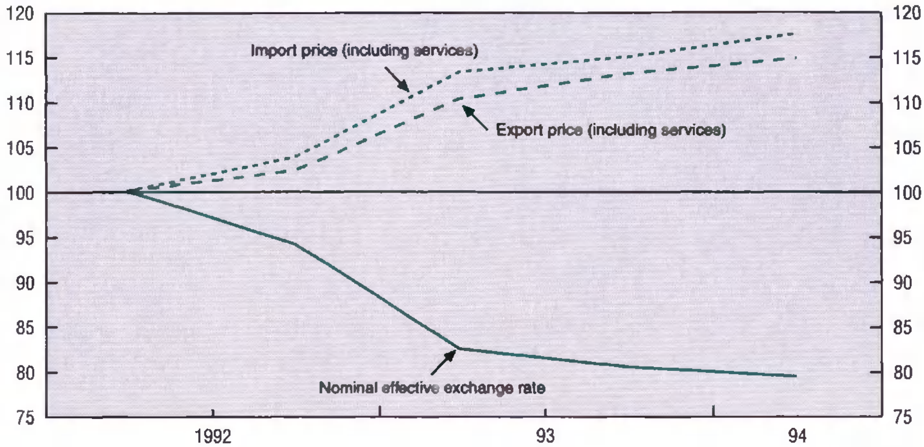
Percentage

		1992 II	1993 II	1994 I	Cumulative
Nominal effective exchange rate	(a)	–5.9	–14.2	–0.7	–19.8
Import prices	(b)	3.4	11.0	2.2	17.3
Foreign competitor's export price in foreign currency	(c)	–0.3	0.4	0.5	0.6
Exchange rate effect on import prices	(b-c)	3.7	10.6	1.7	16.7
Rate of pass-through, cumulative	(b-c)/a				84.3
Export prices					
Export price		2.1	10.9	1.4	14.8
Relative export price		–3.5	–3.7	0.2	–6.9

Source: OECD estimates.

Diagram 9. **EXCHANGE RATE AND EXTERNAL PRICES**

First half 1992 = 100

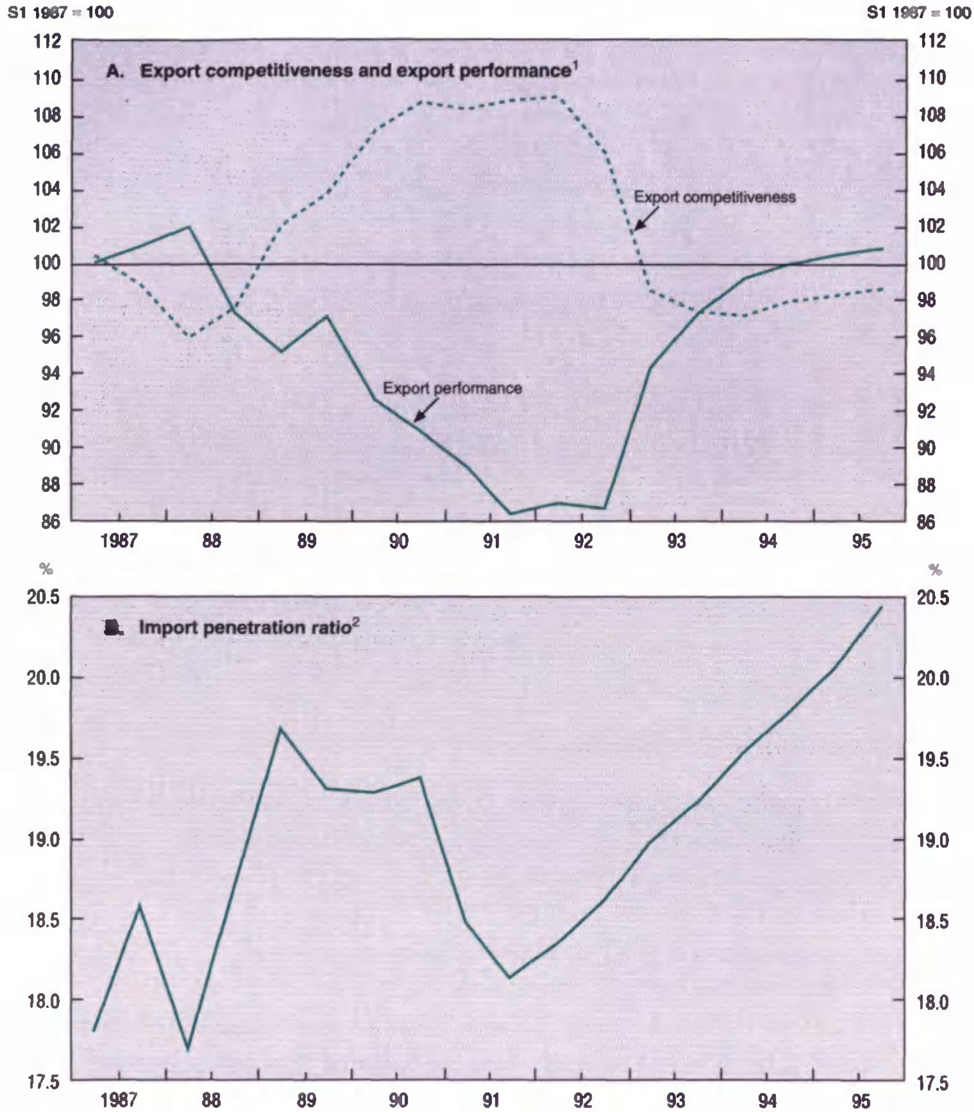


Source: OECD.

The response of trade volumes

While higher export prices limited losses in the terms of trade, the volume of exports and imports reacted quickly and strongly to the shift in relative prices and the new cyclical environment. Within the space of only two years, Italian exporters of manufactures have regained the whole of the market share lost over the five-year period between 1987 and 1991 (Diagram 10, panel A). This development has been all the more impressive in that it took place against the background of a trend decline in market shares for other industrialised countries, due to the arrival of new competitors. Indeed, econometric analysis suggests that the rise in competitiveness caused a much stronger reaction from Italy's manufactured exports than could have been expected from past experience (see Technical Notes). Manufacturing export volumes grew by nearly 3 percentage points more in 1993 than would have been predicted on the basis of these past relationships with world market growth and relative export prices – an unusually large unexplained component (Table 7). The improvement of Italy's export performance

Diagram 10. **EXPORT PERFORMANCE AND IMPORT PENETRATION**



1. Export competitiveness is measured by relative export unit value of manufactured goods. Export performance is the ratio of Italy's export of manufactures to its export markets. From first half-year 1994 data are projections.
2. Imports of goods and services at current prices as a percentage of total domestic demand.

Source: OECD.

Table 7. **Determinants of manufacturing trade volumes**[1]

Per cent change from previous year

	1991	1992	1993
Export volumes	0.0	2.6	10.1
Determined by:			
Export market growth	3.8	3.0	–0.2
Relative price effect	–4.9	0.4	7.4
Unexplained	1.1	–0.8	2.9
Import volumes	7.4	6.8	–2.4
Determined by:			
Domestic demand	3.1	2.9	–3.9
Relative price effect	4.2	3.8	1.6
Unexplained	0.1	0.1	–0.1
Memorandum item:			
Export market growth	4.6	3.7	–0.3

1. See Annex I.
Source: OECD estimates.

also compares well with that of the United Kingdom and Portugal, two other countries with a depreciating exchange rate (Table 8). Spanish exporters of manufactures were also able to achieve large gains in market shares.

While since 1992 significant uncertainties surround the split between price- and volume changes in foreign trade, the improvement of Italy's export performance is widely viewed as being genuine. Among the main factors explaining this outcome have been the increased profitability of exports and the slump in domestic demand, prompting Italian firms to channel resources abroad. The search for

Table 8. **Currency depreciation and manufacturing export performance**

Index: first half 1994/first half of 1992

	Italy	United Kingdom	Spain	Portugal
Nominal effective exchange rate	79.4	88.2	79.7	90.1
Relative unit labour costs	79.8	86.9	76.9	97.3
Relative export prices	91.1	97.9	87.4	93.2
Export performance[1]	114.1	102.9	120.0	109.3

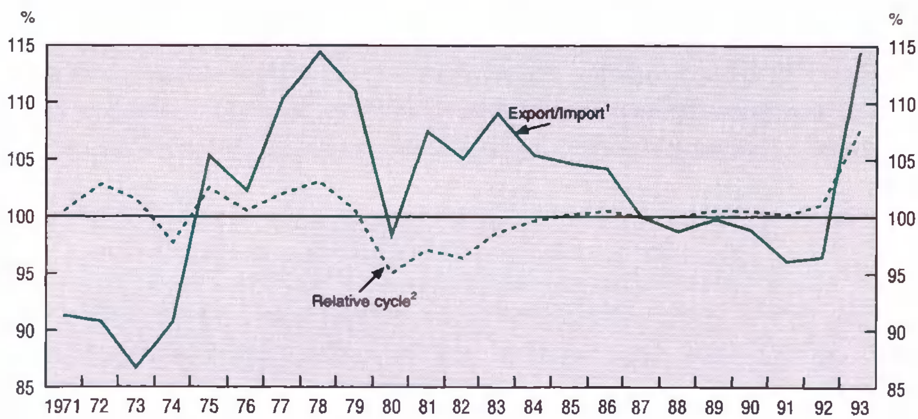
1. Ratio of export volumes to export market growth.
Source: OECD estimates.

market outlets abroad has been accentuated by the fact that the cyclical downturn in Italy has been relatively severe: the fall in total domestic demand in 1993 has been four times larger than in the rest of Europe, while domestic demand expanded elsewhere, both inside and outside the OECD area. Switching output from domestic to foreign markets has thus been facilitated by the comparatively favourable external environment.

The importance of the relative cyclical effect is brought out by Diagram 11, which shows some correlation between Italy's net exports of goods and relative domestic demand conditions in Italy and abroad. The ease with which Italian firms have traditionally re-directed output from domestic to foreign destinations must partly reflect a flexible supply response on the part of small- and medium-sized firms which predominate in Italy (see Part III). On the import side, the steep fall in import volumes in 1993 stemmed mainly from the plunge in domestic demand. In volume terms, imports of goods and services contracted more strongly than total domestic demand in 1993, interrupting the rising trend of import penetration. In nominal terms, however, imports of goods and services

Diagram 11. **EXTERNAL INDICATORS**

1987 = 100



1. Index of exports divided by the index of imports of goods, at constant prices.
2. Index of domestic demand of OECD countries (excluding Italy) divided by the index of Italian demand at constant prices.

Source: Banca d'Italia (1994), *Abridged Report for the year 1993*, p. 60.

kept on growing relative to total domestic demand, as import prices surged (Diagram 10, panel B).

Direction of trade

With exports buoyed by surging sales to dynamic markets such as the United States, East Asia, Latin America and Eastern Europe (37 per cent), the value of merchandise exports rose by 23 per cent in lira terms in 1993 (Table 9). Exports to the EC advanced less rapidly, reflecting the weak state of the European economy (12 per cent). The sharp geographical differentiation of export growth has probably diminished during 1994, due to the economic revival in Europe. Exports of investment goods (notably machinery and equipment) displayed greater buoyancy in 1993 than those of consumer goods, while, on the

Table 9. **Geographical composition of foreign trade**

Trillions of lire

	1991	1992	1993
Exports to:			
EC	123.7	126.5	141.2
Eastern Europe and China	7.6	9.9	14.6
United States	14.4	15.3	20.5
OPEC	10.0	11.3	13.0
Other	54.0	56.4	75.8
Total	209.7	219.4	265.1
Imports from:			
EC	130.3	136.5	128.8
Eastern Europe and China	11.6	12.9	16.3
United States	12.6	12.1	12.4
OPEC	16.1	14.3	15.2
Other	55.1	56.3	59.6
Total	225.7	232.1	232.3
Trade balance			
EC	–6.6	–10.0	12.4
Eastern Europe and China	–4.0	–3.0	–1.7
United States	1.8	3.1	8.1
OPEC	–6.2	–3.0	–2.2
Other	–1.1	0.1	16.2
Total	–16.0	–12.7	32.8

Source: Banca d'Italia (1994), *Annual Report.*

import side, purchases of investment goods fell more strongly than those of consumer goods, a feature which is normal for a recession. The effect was the appearance of a sizeable trade surplus in 1993, a switch from deficit to surplus in the trade with the EC and a quadrupling of the surplus in the trade with East Asia and Latin America. These surpluses amounted, respectively, to 0.7 and 0.9 per cent of GDP. The improvement in merchandise trade was visible in all categories, except in fuel and energy. Trade in investment- and consumer goods each yielded surpluses of around 1 per cent of GDP.

The current account surplus and the capital account

Sharply increased surpluses on trade- and tourism accounts shifted the current account into surplus to the value of 1.2 per cent of GDP in 1993 following a deficit of 2.2 per cent in 1992 (Table 10). In the invisibles account, the traditional deficit narrowed, thanks to net receipts from tourism which, stimulated by the lira's fall, rose for the first time in eight years. The deficit on investment income remained broadly unchanged, while that for other items (official transfers, and business services) widened. The structural deficit in business services reveals both a lack of advanced services in Italy and the general back-

Table 10. **Current account of the balance of payments**

Trillions of lire

	1989	1990[1]	1991	1992	1993
Exports (f.o.b.)	192.2	202.6	208.9	218.8	269.7
Imports (f.o.b.)	195.1	202.0	209.8	215.7	215.7
Trade balance	–3.0	0.6	–0.9	3.1	54.0
Investment income, credits	14.5	19.4	25.2	30.5	31.4
Investment income, debits	25.9	35.3	45.2	56.2	58.1
Investment income, net	–11.4	–15.9	–20.0	–25.7	–26.7
Foreign travel, net	7.2	7.1	8.4	6.0	12.6
Other services, net	–5.2	–5.7	–11.6	–8.9	–9.5
Private transfers, net	1.8	1.0	–1.5	–2.3	–1.1
Official tranfers, net	–4.8	–4.0	–5.8	–5.0	–9.5
Current balance	–14.8	–17.6	–26.3	–32.3	18.3

1. Liberalisation of capital control has induced a break in 1990 for the series of foreign travel and other services.
Source: Bank of Italy (1993), *Assemblea Generale Ordinaria dei Partecipanti, May.*

Table 11. **Net capital movements**

Trillions of lire

	1990	1991	1992	1993
Total capital movements	52.1	29.0	10.7	10.8
Bank capital flows	23.0	39.4	25.3	–53.5
Non-bank capital flows	29.2	–10.3	–14.7	64.2
Foreign direct investment in Italy	7.6	3.1	4.0	5.9
Italian direct investment abroad	–9.1	–9.1	–7.3	–11.4
Foreign portfolio investment in Italy	23.0	23.2	13.0	96.9
Italian portfolio investment abroad	–23.3	–30.8	–24.4	–14.9
Foreign loans	36.2	13.4	9.1	0.4
Italian loans	–4.8	–7.7	–6.2	–4.8
Commercial credits and other items	–0.4	–2.8	–2.8	–7.9
Errors and omissions	–19.1	–10.6	–9.0	–26.5
Change and official reserves [1]	–15.2	8.6	32.5	–2.2

1. Minus sign indicates an increase in reserves.
Source: Bank of Italy (1994), *Annual Report* (abridged version) pp. 67, 191.

wardness in research and development (see Part III).[13] In the first half of 1994, the current account surplus amounted to nearly 1 per cent of GDP (annual rate), reflecting a large trade surplus.

The capital account closed with a surplus of L 10.8 trillion in 1993, broadly the same amount as in the previous year (Table 11). A net inflow of non-bank capital (L 64.2 trillion) mainly reflected purchases of long-term securities, stimulated by expectations of falling interest rates and related capital gains. Government securities continued to attract the bulk of inward portfolio investment, while strong outflows of bank capital were largely associated with foreign currency transactions. The structure of capital inflows appears to have changed in the first half of 1994, with net outflows of portfolio investment by both resident and non-residents coinciding with a return of bank capital. Confidence losses precipitated capital outflows in August, causing risk premia in domestic interest rates to rise. As a result, the nominal exchange rate has displayed great variability and eventually trended downward in the course of 1994, undercut by waning market confidence.

II. Macroeconomic policies and prospects

Macroeconomic policy developments were less favourable in 1994 than during the previous year, when significant progress was made towards fiscal retrenchment and interest-rate reduction. The initial gains in market confidence which followed the general elections in March 1994 were rapidly eroded, as the coalition came under internal strain and doubts increased about the implementation of fiscal policy. The prospective deficit overshoot for 1994 enlarged the necessary fiscal adjustment. Italy's commitment to the strategy of fiscal consolidation was restated in the convergence programme of the 22nd July, and the budget goals set for 1995 are consistent with this. But risk premia on domestic interest rates, initially stable in the first few months of the year, widened during the summer, while the lira drifted down, returning to its pre-election low in early July. In response to the potential implications for inflation, the central bank raised the discount rate in mid-August, suspending its policy of cautious easing. Money market conditions have subsequently calmed, but apprehensions about the budget have continued and risk premia on domestic interest rates have remained large.

Monetary policy

The lira's exit from the ERM has not implied any change in the primary objective of monetary policy, which remains that of achieving inflation parity with the best-performing European countries, as a precursor to membership of the European Monetary Union. The framework of policy-making has altered, however. Legislation enacted in the last few years has given the central bank greater independence and, in exercising it, greater attention has been paid to monitoring monetary trends since the exit from the ERM in September 1992. For 1994, the target range for M2 growth was set at 5 to 7 per cent, unchanged from the previous year.[14] In addition, the secondary market in government securities has expanded over the past few years, enhancing the information content of the yield curve. At the beginning of 1994 the curve was relatively flat, three-month interbank rates being just between 9 per cent and 10-year bond yields just above; the latter representing a real, inflation-adjusted rate of around 5 per cent. Based on the assumptions of a further fall in inflation, the adopted monetary stance was seen as consistent with the intermediate aim of steering interest rates down to levels more commensurate with a resumption of economic growth.

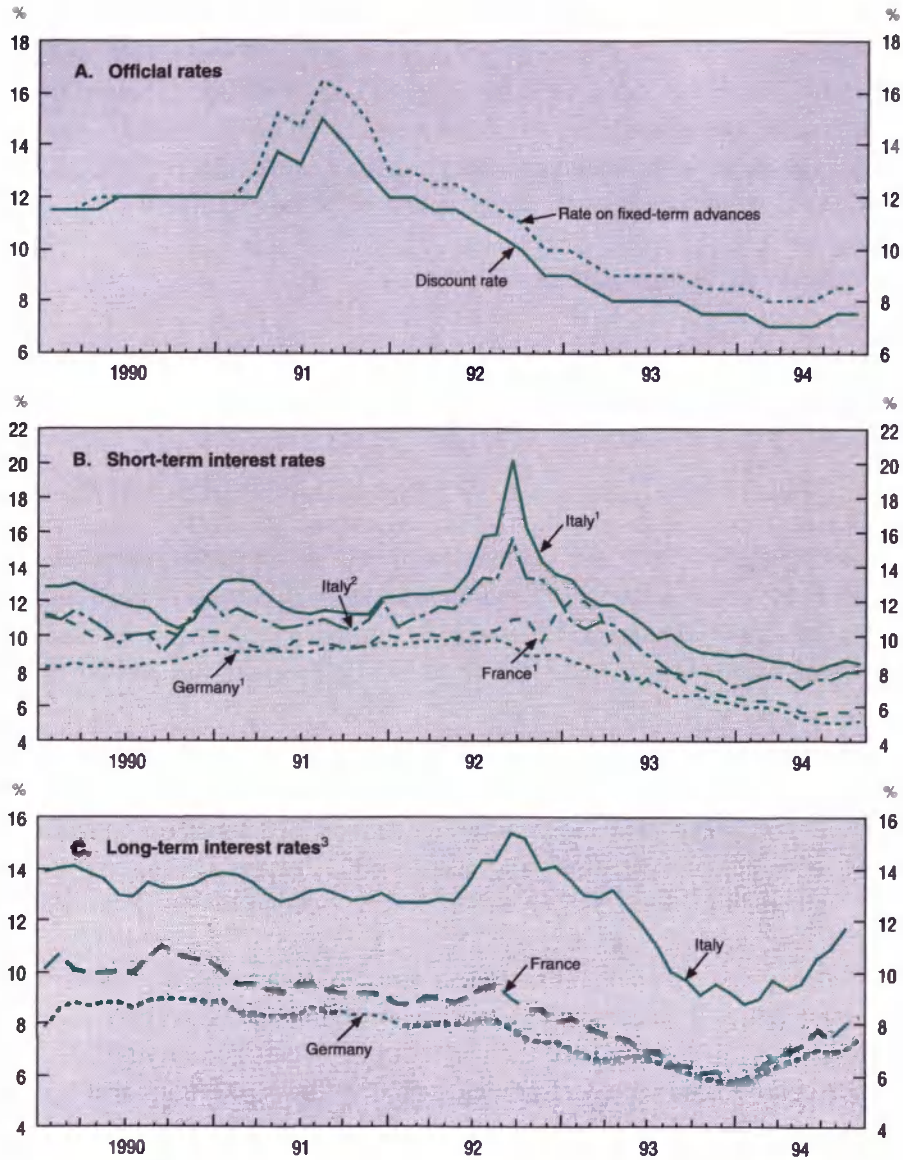
Interest and exchange rate developments

Regarding short-term interest rates, however, a different sequence of events unfolded, complicating the conduct of monetary policy. Following the German rate cuts, in February 1994, the central bank lowered the discount rate to 7.5 per cent and the rate of fixed-term advances (*anticipazioni a scadenza fissa*) to 8.5 per cent (Diagram 12, panel A). This move was followed in May by a cut in the discount rate to 7 per cent, the twelfth reduction since the lira's exit from the ERM in September 1992, and a reduction in the rate on fixed-term advances to 8 per cent. However, while inter-bank interest rates continued to ease in the early months of 1994[15] (Diagram 12, panel B), growing apprehensions about the conduct of fiscal policy caused the three-month Treasury bill rate to firm. In addition, with capital outflows rising more rapidly than the surplus on current account, the lira lost ground on foreign-exchange markets.

In this situation, and notwithstanding further disinflation gains, the Bank of Italy was no longer able to engineer reductions in short-term interest rates through open-market operations and cuts in official rates. During the summer, money and credit market conditions tightened in response to both external developments and increased uncertainty about the course of fiscal policy, which caused risk premia on domestic interest rates to widen again. Together with heightened political uncertainty, these negative influences pushed the three-month interbank deposit rate and the rate for three-month Treasury bills to 10 per cent in August. Faced with accelerating capital outflows, the Bank of Italy lifted the discount rate to 7.5 per cent.

Swings in the exchange rate have continued to be closely associated with shifting expectations about Italy's political future and the pace of fiscal consolidation. After firming in early 1994 following the adoption of the 1994 budget, the lira sank to its previous historical low of L 1 000 per Deutschemark, on the eve

Diagram 12. **INTEREST RATES**



1. Inter-bank rate.
2. 3-month Treasury Bills.
3. 10-year government bonds.

Source: OECD.

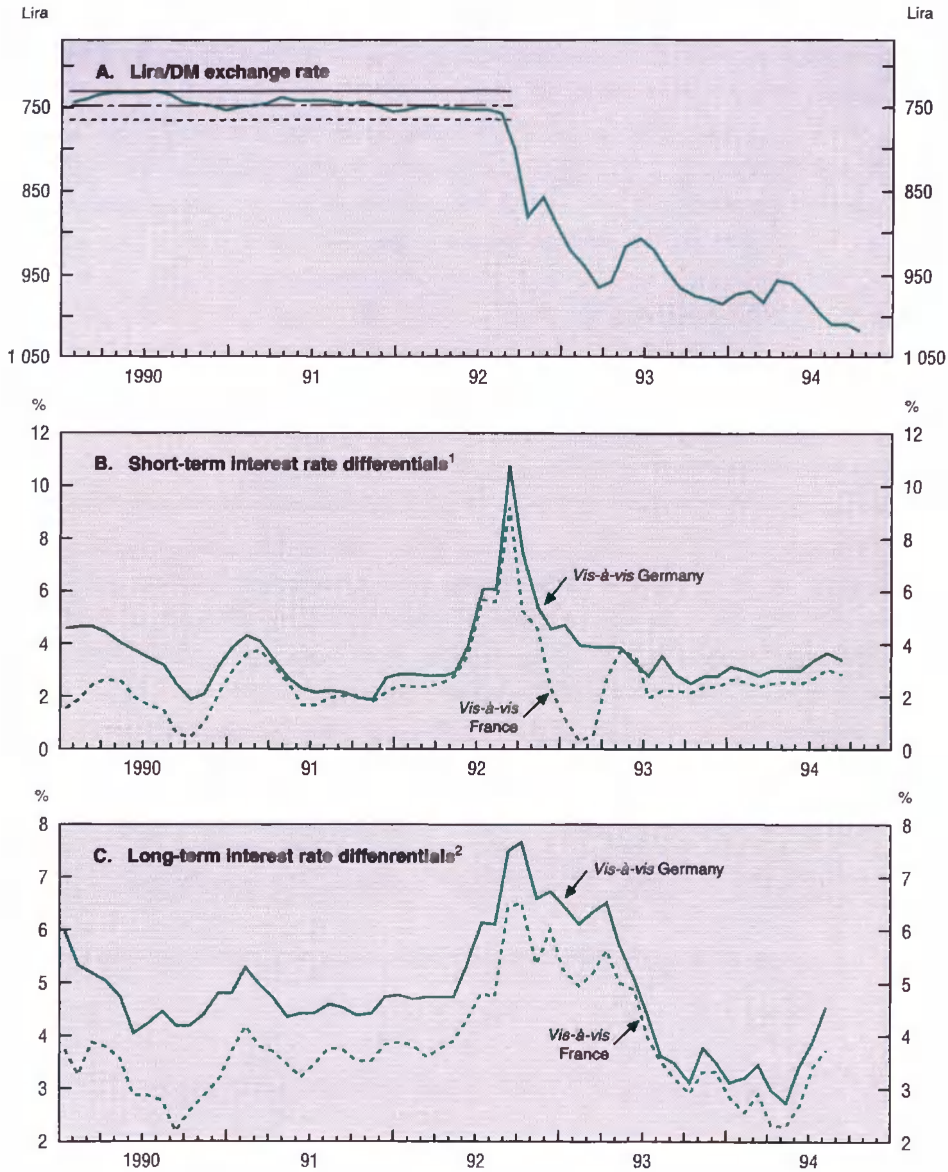
of the March elections, (Diagram 13, panel A). Its subsequent recovery to around L 950 in April was mild and short-lived. With no decisive measures being taken to rein in a growing overshoot of the budget deficit, and perceptions of political instability spreading, the lira weakened, sinking once again to L 1 000 per Deutschemark in July. The loss of market confidence eventually pushed the lira/DM rate down to L 1 032 in August, a record low, compared with a rate of L 901 per Deutschemark in June 1993, when the previous government had taken swift action to rein in the budget deficit. The short-term interest differential *vis-à-vis* Germany (interbank deposit rates), after remaining broadly stable in the first half of 1994, widened to over 4 points in August, exceeding the gap observed in mid-1992 prior to the departure of the lira from the ERM (Diagram 13). It narrowed subsequently, as financial markets reacted favourably to the 1995 budget proposals (see below) and the Bank of Italy cut the rates on repurchase-agreements.

In line with developments abroad, long-term interest rates began to firm in the first months of 1994 (Diagram 12, panel C), the yield curve steepening as a consequence: by June 1994, the rate for ten-year government bonds exceeded the three-month Treasury bill rate by 209 basis points, a large differential by Italian standards. Nevertheless, unlike developments at the short end of the market, the long-term interest rate differential *vis-à-vis* Germany and France initially narrowed to around 2.5-2.8 points in the first five months of 1994, before widening sharply to 4.5 points in August.[16] Fostering expectations of further inflation convergence was the success of the Labour Accord of July 1993, which provided for greater flexibility in wage bargaining (see Part I), but this was not enough to offset the growing negative effects of fiscal slippage. The real long-term interest rate, though declining, remained comparatively high in the first half of 1994. At 4½ to 5 per cent it exceeded the French equivalent by 1 point and the German one by nearly 3 points.

Money and credit

The monetary base, adjusted for the effects of the large cut in the average compulsory reserve ratio from 19 to 14 per cent in February 1993,[17] expanded by 7.2 per cent in 1993, almost the same rate as in 1992. The foreign sector, following its strongly negative contribution in 1992, added to monetary creation in 1993 (L 2.4 trillion), as foreign exchange reserves increased, while net direct

Diagram 13. **EXCHANGE RATE AND INTEREST RATE DIFFERENTIALS**



1. Inter-bank rate.
2. 10-year government bonds.

Source: OECD.

financing of the Treasury by the central bank was negative as had been the case in the three previous years. For the first time in more than a decade the Treasury made net deposits to its current account with the Bank of Italy (4.6 trillion).

In contrast to the monetary base, however, M2 growth gathered speed in 1993. Banks' fund-raising operations, combined with shifts in the composition of households' financial portfolios, pushed M2 growth to 7.9 per cent over the twelve months to December 1993 – 0.9 points above the upper bound of the 5 to 7 per cent target range and nearly 2 points higher than in 1992 (Table 12). Less liquid components, notably certificates of deposit with maturities of more than 18 months, fuelled the expansion of M2 during much of 1993. Overshooting also occurred in the first half of 1994, but this time centred on more liquid assets. Over the summer, with capital outflows gathering speed, M2 growth subsided, falling to 4 per cent over the 12 months to September. Domestic credit growth eased as well, held back by the contraction in credit to the non-state sector. In contrast, the expansion of credit to the state sector remained vigorous, reflecting the large budget deficit.

Table 12. **Money and credit aggregates**

Percentage change from previous period

	1990	1991	1992	1993	1994
Total domestic credit	13.1	12.6	9.8	6.4	5.4[1]
Credit to the non-State sector	16.0	14.0	7.0	1.7	–2.0[1]
Money supply (M2)	9.6	8.3	6.0	7.9	5.4[2]

1. July (12-month rate).
2. September (12-month rate).
Source: Bank of Italy (1994), *Annual Report* (abridged version) p. 81.

Financial reform

Monetary management has been affected by legislation passed in November 1993, bringing Italy into line with Article 104 of the EC Treaty, as modified at Maastricht, which precludes the extension of credit or overdrafts by the Bank of

Italy to the Treasury.[18] A new interest-bearing account has been opened with the central bank, initially credited with the receipts from an issue of L 31 trillion lire of government securities sold to the Bank of Italy.[19] The central bank's financial claims against the Government, accumulated since 1948 under the previous overdraft facility and amounting to L 95 trillion or 6 per cent of GDP, will be transformed into long-term government securities, carrying an interest rate of 1 per cent per year. In addition, since January 1994 the Bank of Italy no longer acquires Government paper at issue nor supplies temporary financing for Treasury bills purchased at issue by the market.[20]

The legislation of November 1993 also empowers the Bank of Italy to modify minimum reserve requirements, recognizing their function as a tool of monetary policy. Accordingly, in July 1994 the Bank of Italy lowered marginal minimum reserve requirements from 17.5 to 15 per cent[21] and the rate of remuneration of reserves from 6.5 per cent to 5.5 per cent for all deposits.[22] Incremental liquidity raised through issues of certificates of deposit with an original maturity of at least 18 months are no longer subject to any reserve requirement. The exemption also applies to the first L 200 billion in deposits of any credit institution. On the other hand, the Bank of Italy widened the scope of financial institutions subject to reserve requirements, to include, for example, special credit institutions (ICS). Banks' capital will no longer be deductible from the aggregate subject to reserve requirements as of August 1995. The above modifications are unlikely to affect bank lending rates in the short run.[23] They should, however, lead to a gradual release of liquidity over time so that bank lending rates might eventually decline, especially as the fall in effective reserve requirements gathers speed.[24]

At the same time, using the opportunities granted by the 1993 Banking Law, the Inter-ministerial Committee for Credit and Savings enlarged the range of operations which banks (ex-*aziende di credito* and ex-*istituti speciali de credito*) may conduct. Subject to certain limits, banks are now permitted to issue bonds and to extend medium- and long-term credit, while an ICS may grant short-term credit.[25] Italy's banking system has thus been brought in line with the EU Second Banking Directive. In addition, the primary market for private bonds became screen-based in July 1994, following a series of initiatives taken in 1992 and 1993 to strengthen the secondary market for Government securities.

Fiscal policy

Budget policy and outturn for 1993

The State budget deficit fell to L 154.4 trillion (new definition)[26] in 1993 (9.9 per cent of GDP) from L 155.9 trillion in 1992, the first absolute decline in many years (Table 13). The budget outturn exceeded the original target by L 10 trillion, a much smaller overshoot than that recorded in the previous year[27] (Diagram 14). Considering the unexpected depth and length of the recession, the budgetary outcome is all the more impressive: instead of growing by 1.5 per cent as originally projected, real GDP shrank by 0.7 per cent in 1993 year-on-year.[28] The new measures of fiscal restraint adopted in May 1993,[29] along with unanticipated savings on interest payments, were instrumental in keeping fiscal slippage to a minimum. However, the deficit overrun would have been larger if the local authorities had not made a deposit of L 10 trillion with the government.

While Italy's fiscal imbalance is still more than twice as large as the OECD average, the pace at which the structural budget deficit (as estimated by OECD) has been reduced during the 1991-93 downswing has been faster than in other major OECD countries. On a cyclically-adjusted basis, the general government deficit shrank to 6.9 per cent of GDP in 1993, 1.6 point lower than in 1992 and 3.6 points lower than in 1989, the year of the last cyclical peak (Diagram 12, panel B). For the second year in a row, the primary balance showed a surplus, which, in cyclically-adjusted terms, amounted to 4 per cent of GDP, the best result in over 20 years.[30]

Embodying the effects not only of one-off receipts, but also of structural measures, the 1993 budget represented a landmark in Italy's recent budget history. Thanks to the Delegation Law of 1992, which conferred special powers on the Government, primary spending began to be cut back in four major areas: public employment, pensions, health and local authorities' finance. Relative to estimated spending on unchanged policies, the largest cuts were made in the areas of public pay, which fell in real terms, and transfers to local authorities, reduced by revenues from the new municipal tax on buildings (ICI). Current outlays evolved broadly in line with appropriations, except in the health sector, where reform measures proved less effective than envisaged.[31] In addition, the weakening labour market caused other transfer payments to diverge from target, notably unemployment-related payments.[32] In contrast to the above develop-

Table 13. **Public sector budget deficits**

Trillions of lire

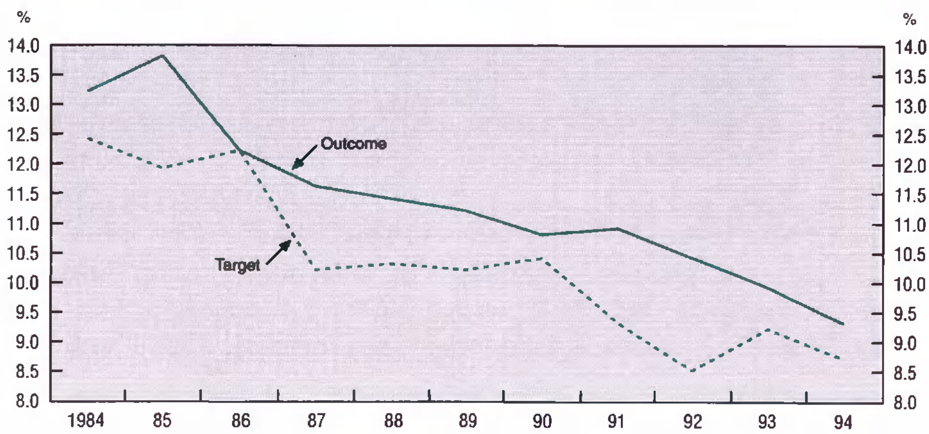
	1992	1993	1994
State budget deficit[1] (new definition)[2]	155.9	154.4	154.0
Net borrowing of State sector	148.8	146.2	141.9
of which:			
Deficit of autonomous companies and other affiliated entities[3]	–1.6	–3.5	0.0
Other adjustments	–7.1	3.1	8.7
Net borrowing of central government	140.1	145.8	150.6
General government budget deficit[4]	143.4	148.2	158.9
of which:			
Local authorities budget deficit and net borrowing of social security	0.7	3.6	2.9

1. The State sector, (settore statale), includes the central government, autonomous companies, (aziende autonome), and other State agencies.
2. Excluding deficits of autonomous companies, the legal status of which was changed to that of a joint-stock companies in 1992, *i.e.* State monpolies for salt and tobacco (MS), State telephone service (ASST) and State railways (FS).
3. *Aziende autonome statali e enti assimilati.*
4. The general government, (*amministrazioni pubbliche*), includes central government, local government and social security institutions, but excludes State agencies and some of the other affiliated entities.

Source: Ministero del Bilancio (1994), *Relazione generale sulla situazione economica del paese*; Bank of Italy (1994), *Annual Report, Statistical Annex*, May; and data supplied by the Italian authorities.

Diagram 14. **STATE SECTOR DEFICIT: TARGETS AND OUTTURN**[1]

Per cent of GDP

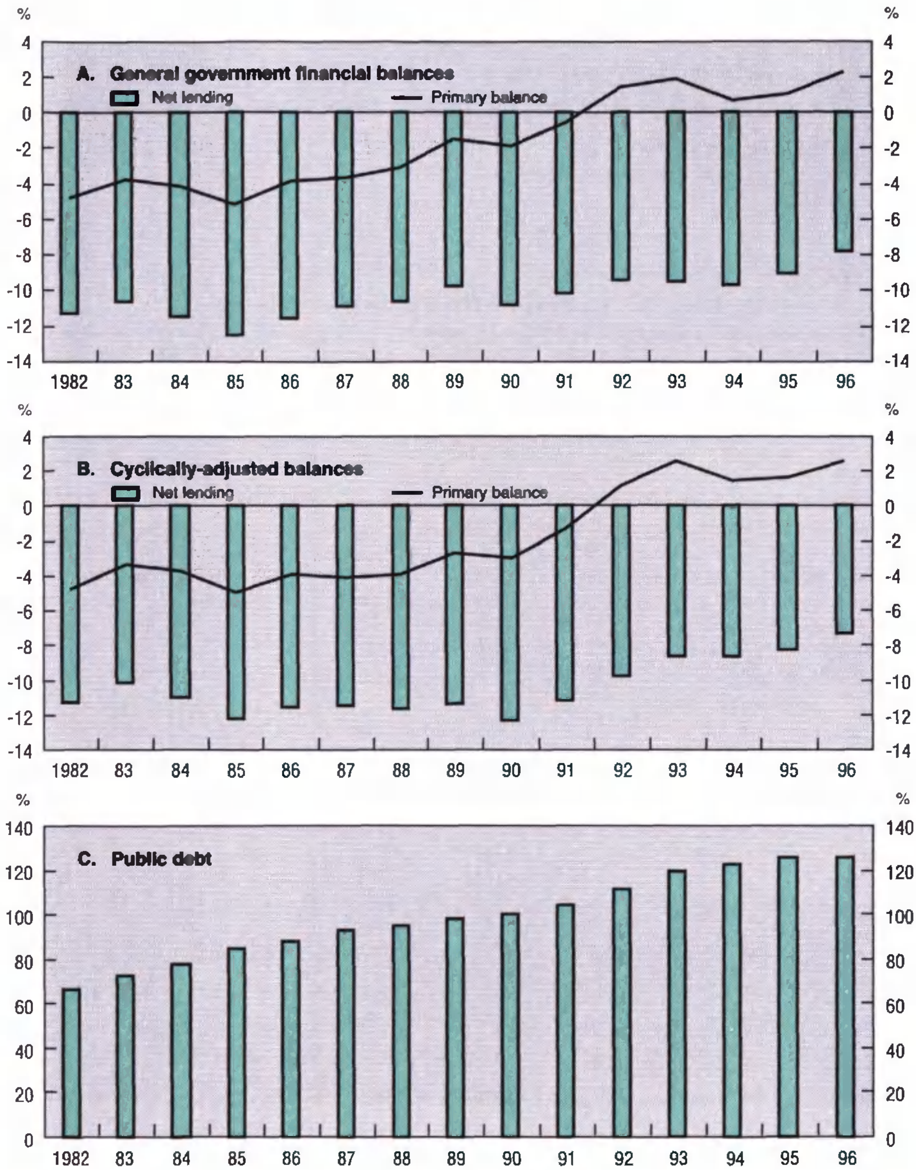


1. The targets for each calendar year are as presented in the Budget Ministry's Relazione Previsionale e Programmatica (RPP) for that year which is published in September of the previous year.

Source: Ministero del Bilancio, RPP.

Diagram 15. **FISCAL INDICATORS**[1]

In per cent of GDP



1. Figures for 1995 and 1996 are projections.

Source: OECD.

ments, capital expenditure remained well below budgetary appropriations, as the corruption scandals delayed investment projects. Interest payments on public debt were also substantially smaller than budgeted. At 10.6 per cent, the weighted average issue yield on Treasury bills was about 4 points lower than in 1992 and 1 point lower than assumed in the summer of 1992 when the 1993 budget was prepared: the lira's exit from the ERM in September 1992, declining inflation and

Table 14. **General government income statement**

	Trillions of lire			Per cent changes		
	1992	1993	1994[1]	1992/1991	1993/1992	1994/1993[1]
Expenditure						
Wages and salaries	190.4	196.0	199.3	4.8	2.9	1.7
Intermediate consumption	75.6	81.0	86.7	8.0	7.2	7.1
Social transfers	290.5	301.6	322.9	11.2	3.8	7.1
Production subsidies	31.2	34.5	36.9	–4.2	10.6	6.8
Debt interest	172.1	186.9	175.3	18.0	8.6	–6.2
Other	15.6	20.8	22.1	15.6	33.3	6.3
Total current expenditure	775.4	820.8	843.2	10.0	5.9	2.7
As a per cent of GDP	51.5	52.6	51.5	..	..	..
Investment						
Total capital expenditure	64.3	71.6	70.7	–0.9	11.4	–1.3
Total expenditure	839.7	892.5	913.9	9.0	6.3	2.4
As a per cent of GDP	55.8	57.2	55.8	..	..	..
Revenue						
Direct taxes	221.3	250.5	253.3	6.9	13.2	1.1
Indirect taxes	167.0	186.0	196.5	5.0	11.4	5.6
Social security contributions	226.2	238.8	249.2	7.7	5.6	4.4
Other	81.8	68.9	52.6	71.5	–15.8	–23.7
Total current revenue	662.5	728.7	751.6	7.1	10.0	3.1
Capital revenue	33.7	15.5	3.4	550.4	–54.0	..
Total revenue	696.3	744.2	755.0	11.6	6.9	1.4
As a per cent of GDP	46.3	47.7	46.1	..	..	..
Budget balance						
Net borrowing	143.4	148.2	159.0	..	..	..
As a per cent of GDP	9.5	9.5	9.7	..	..	..
Primary balance	–28.8	–38.7	–16.4	..	..	..
As a per cent of GDP	–1.9	–2.5	–1.0	..	..	..

1. Projections established in May 1994.

Source: Ministero del Bilancio (1994), *Relazione generale sulla situazione economica del paese*, Vol. 2, p. 4 and data supplied by the Italian authorities.

the authorities' prompt action to limit the deficit overrun in 1993 all combined to set the stage for an unexpectedly sharp fall in interest rates.

Overall, the rise in general government spending was limited to 6.3 per cent in 1993, compared with 10 per cent in 1992 (Table 14). Even so, total expenditure edged up to a record level of 57.2 per cent of GDP, 1.4 point higher than in 1992. Sharply augmented revenues from direct taxation pushed up the ratio of general government revenues to GDP by a similar amount, also to an all-time high of nearly 48 per cent of GDP. Boosted by the new municipal tax on buildings, tighter tax rules for the self-employed, reduced tax expenditures and exemptions and receipts from the fiscal amnesty, the growth of direct taxation receipts almost doubled, more than offsetting cyclical revenue effects. In contrast, the recession depressed receipts from other sources, notably social security contributions. As a result, the general government borrowing requirement (including central government, local government and social security institutions, but excluding state agencies) totalled L 148.2 trillion in 1993 or 9.5 per cent of GDP, which was unchanged from 1992.[33] The primary surplus rose to L 38.7 trillion or 2.5 per cent of GDP.

Budget policy for 1994

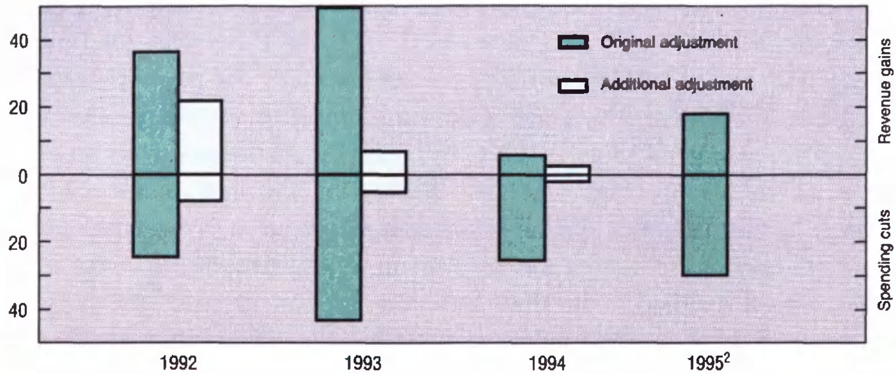
In line with the July 1993 medium-term convergence programme, the State budget for 1994 targeted a cut in the borrowing requirement to L 144.2 trillion (8.7 per cent of GDP) from L 154.4 trillion in 1993, excluding receipts from privatisation.[34] To achieve this, the original budget plan embodied a fiscal adjustment of L 38.5 trillion, the budget deficit being set to rise to L 182.5 trillion or 10.6 per cent of GDP on unchanged tax and spending assumptions. Thanks to the structural nature of the budget reforms taken in 1993, this proposed fiscal adjustment was much smaller than had been required in previous years (Diagram 16).

In contrast with past budgets, the reduction was to be achieved in large part through public spending cuts, the consolidation measures relying predominantly on economies in primary spending, totalling L 26.3 trillion relative to trend level. Savings were based upon the following measures:

- cuts in public investment, transfers to local authorities, public agencies and firms (L 12.9 trillion);

Diagram 16. **STATE BUDGET: PROPOSED FISCAL ADJUSTMENTS**[1]

Trillions of Lire



1. Revenue gains and spending cuts relative to trend level based upon unchanged tax-and spending provisions.
2. Budget proposals.

Source: OECD.

- reductions in State pension payments (L 2.2 trillion), reflecting cuts in new seniority pensions for public employees having less than 35 years of service, suspension of automatic adjustment of disability pensions and a postponement of the commencement date for new pensions under the general scheme for the private sector;
- a restructuring of government departments and social security institutions and reform of the Government contract system, designed to eliminate overpricing (L 4.6 trillion). In what constitutes the most sweeping reform of public works contracts since 1865, legislation passed by Parliament in December 1993 (the so-called Merloni Law) established a supervisory authority for public work contracts, requiring most contracts to be awarded through tendering as distinct from direct negotiations, and holding suppliers responsible for cost overruns.[35]
- cuts in health spending (L 4.0 trillion), largely reflecting a reclassification of drugs into three categories: "essential" or life-saving drugs or those for chronic illnesses, for which users pay a fixed fee; an intermedi-

ate group, requiring co-payment of 50 per cent of the price; and a residual group to be paid in full. A fixed fee is paid on each prescription. Total spending by the national health-care system on drugs is subject to a ceiling of L 10 trillion;

– continued public pay restraint (reduced real public pay, a hiring freeze and cuts in outside consultants and temporary employment) and enhanced efficiencies in the public labour market (L 2.5 trillion). As agreed under the labour agreement of July 1993,[36] new public wage settlements can be concluded following a 2-year suspension in 1992-93.[37] But if no agreement is reached, basic public pay was to be raised by 1 per cent in March 1994 or 30 per cent of the 1994 official target rate of inflation of 3.5 per cent and by a further 0.7 per cent in June 1994 or 20 per cent of that target rate. Overall, the rise in public wages in 1994 is to be limited to 2.5 per cent, implying a further cut in real public pay.

On the tax side, the new measures, projected to yield a total net revenue gain of L 5 trillion, included reduced tax expenditures and higher indirect taxes, resulting from a revamping of the VAT regime, a rise in the intermediate VAT rate and a higher production tax on gasoline. The 1994 budget also granted direct tax relief, taking the form of lower advance income tax payments, reduced taxation of imputed rents and enhanced compensation for fiscal drag. Together with the planned cuts in primary spending, the net revenue gain was projected to yield savings on interest payments of about L 7 trillion. Overall, tax revenue was expected to fall by 1½ per cent of GDP, the first such decline in ten years, tax receipts having been temporarily augmented in 1993 by once-and-for all measures.[38]

Underlying the original budget proposals were projections of real GDP growth rebounding to 1.6 per cent in 1994 (subsequently scaled down to 1.4 per cent), consumer-price inflation easing to 3.5 per cent and the effective interest rate on public debt dropping to 9 per cent from 10.7 per cent in 1993. In March 1994, six months after the 1994 budget had been prepared, the budget deficit projected for 1994 was revised upward to L 159 trillion, partly due to the unexpectedly weak state of the economy in the second half of 1993[39] (Table 14). In addition, the deficit threatened to widen in response to several new developments, most notably:

- the rise in interest rates which took place over the summer, linked to both external and internal developments, following a period in the first five months of 1994 when interest rates had been lower than anticipated in the 1994 budget;
- a surge in applications for early retirement benefits, partly as a consequence of the restructuring of public companies. Projections established in mid-1994 put the 1994 deficit of the national pension fund (INPS) at L 72 trillion or 4 per cent of GDP, up from L 59.1 trillion in 1993;
- the employment-stimulation package announced in June, which used temporary tax credits as a means of directly stimulating dependent employment and self-employment (see Part I) and of raising fixed investment.[40]

Given the prospect of a large deficit overshoot, the Government announced supplementary measures of fiscal restraint in July, essentially transfer cuts and one-off action, aimed at containing the 1994 deficit to its 1993 level of L 154 trillion, still L 10 trillion above the initial target (see below).

Public debt and debt management

The growth of public debt

Despite the fiscal consolidation process, but as foreseen in the 1993 medium-term convergence programme, Italy's public debt position continued to deteriorate sharply in 1993, the public debt/GDP ratio jumping by 6 points to 119.9 per cent of GDP (Diagram 15, panel C). According to the 1993 convergence programme, the primary surplus would need to reach 3.5 per cent of GDP (approximately L 66 trillion) to stabilise the public debt/GDP ratio,[41] since under the growth and interest-rate assumptions adopted debt service alone would automatically tend to raise the ratio by this amount. With debt servicing costs amounting to 12 per cent of GDP, Italy's fiscal position has remained unsustainable even after the cut in the structural budget deficit.[42]

Allowing for unfunded pension liabilities, the gap between revenues and outlays is even larger than reflected in the budget accounts. Despite the reform initiated by the Amato government,[43] net public pension liabilities are estimated at 39 per cent to 101 per cent of 1990 GDP, depending upon the assumed discount rate (Table 15). With inflows covering only 50 per cent of potential

Table 15. **Estimated net public pension liabilities**

Present value of current rights and future liabilities as of 1990
Per cent of 1990 GDP

	United States	Japan	Germany	France	Italy	Italy [1]	United Kingdom	Canada
Case A: Discounted at 4 per cent from 1990 to 2010 and at rates thereafter which decline to 3 per cent in 2050								
Accrued rights	113	162	157	216	259	242	156	121
Future rights less future contributions	–46	56	4	0	–25	–141	31	130
Total net liabilities	66	218	160	216	233	101	186	250
Case B: Discounted at 5½ per cent from 1990 to 2010 and at rates thereafter which decline to 4½ per cent in 2050								
Accrued rights	89	128	125	171	213	201	121	92
Future rights less future contributions	–74	–36	–63	–106	–99	–162	–65	–7
Total net liabilities	15	92	62	65	114	39	56	85
Memorandum items:								
Existing assets in public pension systems	23	18	0	0	0	0	0	8

1. Taking into account the announced increase in pension age by five years

Source: Van den Noord, P. and Herd R. (1993), "Pension liabilities in the seven major countries", OECD, *Economics Department Working Papers*, No. 142.

obligations, Italy's pension position remains unsustainable. In the public sector, civil servants and local government officials are entitled to retirement benefits after, respectively, 20 and 25 years of employment. In the private sector, employees may retire after 35 years of contributions to INPS (seniority pension or *pensione di anzianità*), while rates of accrual of future benefit claims are equal to 2 per cent of assessed income per year of contribution with a maximum of 80 per cent. By international standards, these provisions are generous. To restore the pension system's equilibrium, the government announced a set of structural measures in September 1994, including a cut in the rate of accumulation of pensions, a lengthening of the time for eligibility at full benefits, a harmonisation of public and private pension provisions, and cost-of-living adjustment based on target inflation (see below).

The build-up of public debt over the past two years would have been bigger without large-scale privatisation. Sales of three major banks, the second largest insurance company and a number of enterprises belonging to IRI and ENI, the huge public conglomerates, yielded more than L 17 trillion (or 1.2 per cent of GDP) over the 1992-1994 period (see Part III). Proceeds earmarked for public debt reduction, which accrued to the debt amortisation fund, totalled L 7 trillion, while the remainder were used to restructure ailing public companies. The new government, though privatising the insurance company (INA) within the stated deadlines, has subsequently postponed planned sell-offs of the IRI-owned Sme-GS, a distribution company, and Stet, the giant telecommunication company, as well as ENEL, the electricity concern. Under legislation passed in July 1994, sales of public utilities are conditional upon the creation of independent regulatory authorities, which have still not been set up. In September, the government established a new calendar for 1994 and 1995 in conjunction with the 1995 budget (see Part III).

Debt management

The fact that one half of Italy's public debt is of a short and medium-term denomination makes the rate of debt accumulation extremely sensitive to interest rates (Table 16). In this respect, however, the structure of public debt has improved, with issues of medium-and long-term instruments (three years and over) covering more than 90 per cent of public sector borrowing requirements in 1993, up from 56 per cent in the previous year (Table 17). Given large place-

Table 16. **Structure of total public debt**[1]

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Total public debt (trillions of lire)	561.5	683.0	793.5	910.5	1 035.8	1 168.4	1 318.9	1 485.7	1 675.3	1 862.9
	Percentage composition									
Medium- and long-term securities	37.0	43.2	47.2	47.2	46.7	45.8	46.8	47.9	46.1	49.8
Ecu and lira Treasury bills	27.2	22.1	20.1	21.0	23.1	24.4	24.2	22.5	23.0	20.9
Post Office funds	9.0	8.7	8.9	9.2	9.1	9.4	9.3	9.1	8.7	8.6
Lending by banks	6.9	5.3	4.8	4.5	4.4	4.6	4.6	5.4	5.6	5.7
Other domestic debt	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Foreign debt	2.9	2.7	2.2	2.6	2.8	3.0	3.7	3.7	3.9	4.6
Borrowing from Bank of Italy	16.6	17.6	16.5	15.2	13.6	12.6	11.2	11.2	12.5	10.2

1. Including borrowing from the Bank of Italy.

Source: Bank of Italy (1994), *Annual Report, Statistical Annex*, May.

Table 17. **Financing of public sector borrowing requirements, 1988-1993**

Percentage shares

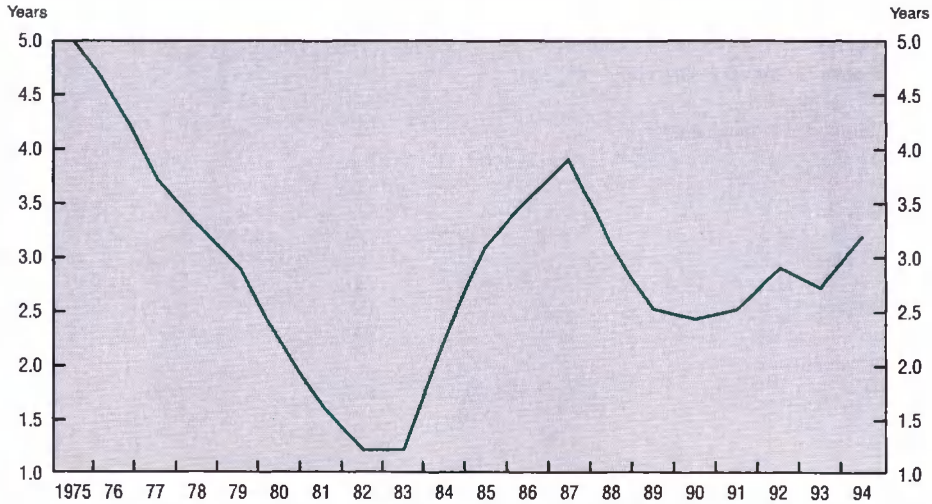
	1989	1990	1991	1992	1993
Medium- and long-term securities	44.5	49.1	70.0	56.0	90.7
Treasury bills	32.9	29.1	7.7	28.2	2.9
Post office deposits	11.8	9.2	7.4	7.0	7.7
Foreign loans	6.5	10.8	3.4	0.1	6.9
Other	4.3	1.8	11.5	8.7	–8.2

Source: Bank of Italy (1994), *Annual Report, Statistical Annex*, May.

ments of medium-term securities, the share of short-term borrowing (Treasury bills with a maturity of up to one year) in total borrowing dropped to 2.9 per cent from 28.2 per cent in 1992. This pushed the share of long-term securities in total public debt to nearly one half in 1993, a rise by almost 4 points. Within the category of medium- and long-term debt instruments, issues of fixed-rate securities soared to L 158 trillion in 1993 from L 118 trillion in 1992. Postal savings and foreign loans became more important as a source of funds. The range of public debt instruments was enlarged with issues of 30-year Treasury bonds and Euro-bonds denominated in yen. Recourse to temporary central-bank financing decreased. Given these relative shifts, the average maturity of the public debt has lengthened by almost one year since 1990 to three years and two months in August 1994 (Diagram 17).

During 1994, public debt management has continued to concentrate on lengthening the maturity of public debt. Large amounts of medium- and long-term securities were issued, most of them carrying fixed rates. A calendar introduced at the end of 1993 facilitated issues of domestic debt.[44] Issues of foreign debt have been facilitated by a more rapid reimbursement of the withholding tax to non-residents, an administrative change which helped to reduce the interest spread on foreign issues (see above). Finally, issuing public debt also became easier with the creation of a debt amortization fund, which accords the Treasury a more active role in debt management.[45] Potentially large receipts earmarked for debt redemption should enable the Treasury to smooth the pattern of monthly debt issues, which average more than 4 per cent of GDP. Receipts accruing to the fund would come from three main sources: revenues from privatisation and sales

Diagram 17. **AVERAGE MATURITY OF PUBLIC DEBT**



Source: Banca d'Italia (1994), *Relazione Annuale* p. 137.

of public assets other than State-owned enterprises, *i.e.* land and buildings; dividends from State-owned joint stock companies,[46] previously subject to a different legal regime; and profits of public entities (including profits of the Bank of Italy). In the first nine months of 1994, receipts of the debt amortization fund totalled L 7 trillion.

The new convergence programme and the 1995 budget

The three-year convergence programme of July 1994 sees economic growth firming to 2.7 cent in 1995 and 2.8 per cent in 1996, about half a point more per year than projected a year earlier, rising to 3.1 per cent in 1997 (Table 18). Official inflation targets have been kept unchanged, the rise in the private consumption deflator easing to 2 per cent in 1996. Even so, fiscal consolidation targets have been loosened, reflecting the deficit overshoot in 1994. The new plan targets a reduction in the State budget deficit to L 138.6 trillion in 1995 (8.0 per cent of GDP, excluding proceeds from privatisation), falling to L 120.9 trillion in 1996 and L 107 trillion in 1997 (5.6 per cent of GDP). The projected rise in the

Table 18. **Medium-term targets**[1]

	1993	1994	1995	1996	1997
Fiscal targets (in trillion of lire, ratios to GDP in brackets)					
State borrowing requirements					
1991 plan	110.1	97.3			
	(6.7)	(5.5)			
1992 plan	148.2	125.0	87.0		
	(9.2)	(7.4)	(4.9)		
1993 plan	151.2	144.2	127.8	106.4	
	(9.7)	(8.7)	(7.4)	(5.8)	
1994 plan		154.0	138.6	120.9	107.0
		(9.3)	(8.0)	(6.6)	(5.6)
Primary surplus					
1991 plan	48.9	64.4			
	(3.0)	(3.7)			
1992 plan	39.2	66.8	105.0		
	(2.4)	(4.0)	(6.0)		
1993 plan	31.5	31.8	46.1	65.5	
	(2.0)	(1.9)	(2.7)	(3.6)	
1994 plan		15.7	34.2	54.4	77.6
		(0.9)	(2.0)	(3.0)	(4.1)
State government debt (in per cent of GDP)					
1991 plan	104.4	103.6			
1992 plan	110.9	113.6	113.5		
1993 plan	119.1	121.4	123.3	123.2	
1994 plan		123.6	124.2	123.5	121.6
Macroeconomic targets (percentage changes)					
Real GDP					
1991 plan	3.2	3.5			
1992 plan	1.6	2.4	2.6		
1993 plan		.1.6	2.1	2.4	
1994 plan		1.6	2.7	2.8	3.1
Consumption deflator					
1991 plan	4.0	3.5			
1992 plan	3.5	2.5	2.0		
1993 plan		3.5	2.5	2.0	
1994 plan		3.5	2.5	2.0	2.0

1. Three-year macroeconomic and budget projections.

Source: Data provided by the Italian authorities.

primary surplus to L 54.4 trillion (3 per cent of GDP) in 1996 would put the public debt/GDP ratio on a downward path, which would be the first decline since 1980.

In accordance with the new medium-term plan, the 1995 budget, presented by the government at the end of September, targets a reduction in the state deficit to L 139 trillion (around 8 per cent of GDP), from an estimated L 154 trillion in 1994 and from a projected level of L 189 trillion in 1995 on unchanged tax legislation and spending policies (''trend'' deficit). The primary surplus is budgeted to rise to L 37 trillion, from an estimated L 8 trillion surplus in 1994.

The proposed fiscal adjustment of L 50 trillion combines primary spending cuts of L 27 trillion and revenue increases of L 21 trillion.

On the spending side, the budget proposals involve:

- pension reform, including the blocking of early retirement on state pensions in 1995 and cuts in benefits from 1996; the reduction in the rate of accumulation of pensions and cost-of-living adjustments based on target inflation; and the lengthening of the time for eligibility at full benefits and a suspension of indexation payments in 1995. The savings associated with these measures are estimated at L 9 trillion;
- a reduction in health expenditure, including cuts in procurement contracts, reductions in the availability of free prescriptions and medical treatment, and the closure or sale of small hospitals, with savings estimated at L 6.5 trillion;
- a hiring freeze in the public sector for the first half of 1995;
- other spending cuts, including subsidies, education, personnel, local government and defence;
- savings on interest payment (L 2 trillion).

On the tax side, the measures proposed are:

- the speeding of settlement of tax and social security claims, with estimated extra revenues for L 12.8 trillion;
- a one-time amnesty for building infractions, estimated at L 5.9 trillion;
- a reduction of deductions and higher property taxes, with revenue gains estimated at L 1.5 trillion.

In addition, the Italian government counts on privatisation proceeds worth L 10 trillion earmarked for debt reduction.

The balance between spending cuts and extra revenue is in line with that envisaged in the three-year convergence programme, with slightly higher tax increases than originally planned. One-off effects, account for more than 90 per cent of the tax measures, although the tax amnesty components may have a lasting impact on the tax base. Underlying the budget proposals are projections of real GDP growing by 2.7 per cent in 1995, of consumer price inflation falling to 2.5 per cent, and of unchanged interest rates (Diagram 16).

The outlook to 1996

Given the past record of deficit overshooting, OECD projections embody a slower pace of fiscal consolidation than envisaged by the 1994 medium-term stabilisation programme (Table 19). Deficit overshoots of L 13 to 17 trillion are projected for 1995 and 1996, mainly reflecting uncertainty about the yields from one-off measures, delays in implementing planned cuts in transfer payments, notably in the area of pensions and health, and payment of pension arrears.[47] As a result, the general government borrowing requirement is projected to ease to only 9 per cent of GDP in 1995, falling to 7¾ per cent in the following year. Despite further disinflation gains, progress towards budget consolidation may be insufficient to allow any marked convergence of Italian interest rates with German rates.

Forward-looking indicators point to a vigorous expansion of overall activity, with domestic orders and production prospects showing signs of a healthy recovery and foreign orders exhibiting continued buoyancy. A strengthening of manufacturers' confidence is signalled by the latest business opinion surveys. With real disposable income beginning to grow, private consumption should recover, gathering speed, as improving consumer sentiment causes the saving ratio to decline. Along with continued export buoyancy and rising profitability, stronger domestic sales are likely to stimulate gross fixed investment. In this environment, output growth is expected to rise above 2 per cent in 1994, gathering speed thereafter.

Despite prospects of robust output growth, the rate of unemployment is expected to remain in the region of 11 to 11½ per cent. This should ensure

Table 19. **Short-term projections**

Percentage changes from previous period

	1992	1993	1994	1995	1996
Demand and output					
Private consumption	1.4	–2.1	1.6	1.5	2.6
Public consumption	1.0	0.8	0.0	0.5	0.5
Gross fixed investment	–2.0	–11.1	0.9	4.7	5.0
Machinery and equipment	–1.9	–15.6	4.2	5.9	7.4
Construction	–2.1	–6.2	–2.3	3.5	2.5
Final domestic demand	0.6	–3.5	1.2	2.0	2.7
Stockbuilding [1]	0.3	–1.6	0.4	0.0	0.0
Total domestic demand	0.8	–5.0	1.7	2.0	2.7
Exports of goods and services	5.0	10.0	9.6	7.8	6.7
Imports of goods and services	4.6	–7.3	7.7	5.4	6.2
Foreign balance [1]	–0.1	4.6	0.5	0.7	0.2
GDP at market prices	0.7	–0.7	2.2	2.7	2.9
Prices					
GDP price deflator	4.5	4.4	3.1	3.0	3.4
Private consumption deflator	5.3	4.7	3.9	3.3	3.1
Unemployment rate [2]	11.6	10.4	11.3	11.2	11.0
Current account balance [3]	–2.2	1.2	1.6	2.1	2.6
General government financial balance [3]	–9.5	–9.6	–9.7	–9.1	–7.8

1. As a percentage of GDP in the previous period.
2. Number of unemployed as a percentage of the labour force.
3. As a percentage of GDP.

Source: OECD (1994), *Economic Outlook* No. 56.

continued wage moderation, holding nominal wage growth to historically low levels. In this setting, consumer price inflation should continue to ease, falling below 3 per cent in the course of 1996. Reduced inflation differentials *vis-à-vis* Italy's main trading partners should maintain earlier gains in competitiveness, helping, with stronger export market growth, to enlarge the trade surplus, notwithstanding weaker terms of trade. The current account surplus could then widen to around 2½ per cent of GDP.

The principal risks attaching to the projections concern fiscal policy, the exchange rate and interest rates. Delays in implementing measures of fiscal restraint could continue to destabilise market sentiment, driving down the exchange rate, putting upward pressure on interest rates and making fiscal consolidation even more difficult. Spiralling debt could then exacerbate exchange rate pressures, rekindling inflationary expectations. In these circumstances, increased job insecurity could lead to larger precautionary savings than allowed for in the projections, undermining the recovery in domestic demand. On the other hand, the external stimulus to economic growth could turn out to be stronger than expected; if combined with full implementation of the proposed fiscal adjustment, this could give an additional boost to business confidence, resulting in stronger gross fixed investment and employment growth. The pace of the economic expansion could then be faster than implied by the projections, reducing disinflation gains.

III. Corporate governance in Italy

Introduction

Recent *Surveys* have reviewed the progress made in Italy towards competition law reform (*OECD Economic Survey of Italy 1990-91*) and privatisation (*OECD Economic Survey of Italy 1993-94*). In the last five years, initiatives taken in these fields, in conjunction with steps aimed at creating a more liberal financial environment, have substantially increased the market orientation in the Italian economy and, in so doing, altered the framework for corporate decision-making (see box). Such reforms have, in turn, raised questions about the adequacy of the existing system of corporate governance – by which is meant the regulatory and institutional arrangements governing the establishment and transfer of ownership rights and the monitoring of corporate managers – and the patterns of business organisation and finance to which this system has given rise. The principal issue to arise is whether the Italian model of corporate governance and finance is evolving in a way which increases the capacity of the economy fully to exploit investment and growth opportunities.

This chapter begins with a description of the structure of corporate ownership and control in Italy, focusing on the role of pyramidal groups and independent small- and medium-sized firms.[48] It then discusses the system of corporate finance and the very limited role played both by banks and the stock market in the corporate monitoring process. These two sections draw to a large extent on recent studies by the Bank of Italy.[49] The third section suggests possible links between the governance structure and some of the determinants of economic performance, particularly in relation to the cost of funds, relationships between firms and their suppliers, labour relations, innovation and internationalisation. The final section assesses the effectiveness of current policies towards corporate governance in Italy and the need for further reform.

Recent measures of structural reform

The following is a record of structural policy measures taken in recent years, with a view to reducing impediments to non-inflationary growth.

Competition policy and privatisation

- Until 1990, Italy was the only major OECD country without any competition law. This gap was filled with the adoption of the law on the "protection of competition and the market" (October 1990). Enforced by the newly-established Antitrust Authority (*Autorita Garante della Concorrenza e del Mercato*), the law covers all firms, including public undertakings in legal monopoly situations, in which the monopolists may abuse their dominant positions.
- In July 1992, the legal status of four major state entities (IRI and ENI, the main public holdings; ENEL, the electricity company; INA, an insurance firm; and IMI and BNL, two major public banks) were transformed into joint-stock corporations (SpA). By the end of 1993, most other public banks had also been turned into joint-stock corporations in accordance with the Amato Law of July 1990. EFIM, the third largest public conglomerate, was liquidated in July 1992.
- The privatisation law of December 1992 established the legal basis for selling majority stakes in important state-owned companies, utilities and financial institutions. With a view to making the privatisation process more transparent, a special Advisory Committee (*comitato permanente di consulenza globale e di garanzia*) composed of the Treasury Director and four independent experts, was set up in June 1993. The September 1993 decree paved the way for sales by public offer and defined the powers to be retained by the State in "strategic" sectors. Under the privatisation law of June 1994, the government retains special voting rights in the electricity and telecommunication companies (ENEL and IRI-owned Stet). Sales of public utilities are conditional upon the creation of independent regulatory authorities, which have not yet been established. Proceeds earmarked for public debt redemption accrue to the Debt Amortisation Fund, set up in October 1993.

Financial markets and corporate governance

- In May 1990, after the incorporation of the lira into the narrow band of the EMS, all remaining external capital controls were removed. Banks were permitted to operate nation-wide.
- Legislation of January 1992 gave the Bank of Italy full independence in setting the discount rate and the rate on fixed-term advances (Lombard rate), previously

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set by the Treasury acting on advice from the central bank. Legislation of November 1993 put an end to the extension of credit or overdrafts by the Bank of Italy to the Treasury, a facility introduced in 1948. This move brought Italy in line with Article 104 of the EC Treaty, as modified at Maastricht.

- With a view to reaching full harmonisation with the EC, the Bank of Italy modified the compulsory reserve system in several steps (October 1990, May and October 1991, February 1993 and July 1994). The coefficient on the increase in bank deposits was reduced to 15 per cent in July 1994, easing the comparative cost disadvantage of Italian banks. Incremental liquidity raised through issues of certificates of deposit with an original maturity of at least eighteen months are no longer subject to any reserve requirement.
- 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. Subject to certain limits, ordinary banks are now permitted to issue bonds and to extend medium- and long-term credit. Special credit institutions (ICS) may grant short-term credit. Italy's banking system has thus been brought in line with the Second EC Banking Directive.
- The Stock Market Law of January 1991 reformed the legal framework for the organisation and functioning of the securities markets and created a new legal entity, the multi-functional investment firm (SIM). The SIMs Act of January 1991 laid out the rules governing SIMs, which have the exclusive right of trading in organised security markets. 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 operation in September 1992. The stock-market settlement system has been modernised in successive steps, with screen-trading completed in April 1994.
- The 1992 law concerning take-over bids (OPAs), makes bids compulsory. Small investors are now able to obtain benefits of the controls premium normally paid to majority shareholders. A new law (July 1994) strengthens safeguards for minority shareholders by making mandatory the notification of all agreements among shareholders in listed companies and by granting them more effective representation on governing bodies.
- Ten-year futures on Government bonds (BTP) began to be traded on the newly established Italian Futures Market (MIF) in September 1992, about one year after such instruments were introduced on the London International Financial Futures Exchange (LIFFE) and the Marché à Terme International de France (MATIF). New investment funds were established in 1992 (SICAV) and closed-end funds in 1993. Using powers under the Delegation Law of October 1992, in April 1993 the government laid down the rules concerning the creation of voluntary private pension funds. A primary market for private bonds, based upon screen-trading, opened up in July 1994.

Corporate governance and industrial structure[50]

Systems of corporate governance differ according to the regulations and arrangements governing the dispersion and diffusion of corporate ownership and the methods for monitoring managers and enforcing shareholders' rights (Table 20). These, in turn, affect and are affected by both corporate financing patterns and industrial structure. Where, as in the United States, public companies are widespread and equity and bonds issued on a liquid securities market represent the primary source of long-term external financing, firms are subject to wide disclosure requirements and managers face the risk of hostile takeovers. In such "market-based systems", monitoring is exercised by the market for corporate control, which acts as an indirect mechanism for aligning the behaviour of managers with the interest of shareholders, as well as by a strict enforcement of the fiduciary duties of directors to represent all shareholders. At the same time, banks are generally prohibited from owning shares in industrial companies on their own account, and those financial institutions that are allowed to do so (mutual and pension funds, insurance companies) were discouraged by laws and regulations from exercising a supervisory role over the way firms are run.[51] By contrast, in countries such as Japan and Germany, banks and other financial institutions play a large role ("institution-based systems"). Long-term loans constitute the main source of external finance for enterprises and banks are often major and stable shareholders in firms. Although the market for corporate control is quiescent and hostile take-overs are few, internal monitoring of enterprises by banks is continuous.[52] As will be shown below, the Italian corporate governance structure is different both from that prevailing in the United States and from the ones prevailing in Germany and Japan. In most Italian companies there is a shareholder, or coalition of shareholders, who exercises a majority control on the firm, and, therefore, is able to choose the management and to remove it. For those companies without a clear majority control, the absence of a developed stock market has hampered the development of hostile takeovers. Moreover, legal constraints and the absence of specialised institutions have hindered the kind of monitoring by banks that is one of the crucial features of the institution-based governance structure.

Corporate governance systems, in turn, help to shape industrial organisation, the mechanisms for allocating funds to investment and the relations between the

Table 20. **Summary features of corporate governance and industrial structure in selected OECD countries**

Private sector

	Italy	United States	Japan	Germany
Corporate governance				
Ownership and control patterns				
Ownership concentration	High	Low	Low	High
Separation ownership/control	Weak	Strong	Weak	Weak
Constraints on bank ownership	Strong	Strong	Weak	Very weak
Dominant control model	Hierarchical groups	Public company	Associative or hierarchical group	Hierarchical group
Cross-shareholdings	Large	Small	Large	Medium
Inter-group	Large	–	Small	Medium
Intra-group	Large	–	Large	Small
Corporate monitoring				
Board composition	Insider	Mixed	Insider	Insider
Large shareholders	Yes	No	Yes	Yes
Other stakeholders	No	No	Yes	Yes
Board power over management	High	Low	Medium	High
Independence of management	Low	High	Low	Low
Public disclosure requirements	Medium	High	Medium	Low
Role of financial intermediaries	Low	Low	High	High
Role of stock market	Low	High	Low	Low
Corporate financial patterns				
Self-finance	Medium	High	Low	Medium
Leverage	High	Low	High	Medium
Industrial structure				
Sectors of specialisation	Capital intensive Labour intensive	R&D intensive Capital intensive	R&D intensive Capital intensive	Capital intensive R&D intensive
Average firm size	Small	Large	Medium	Large
Diffusion of business groups	High	Low	High	Medium
Producer/supplier relationship[1]	Formal/relational Medium-term	Formal Short-term	Relational Long-term	Formal/relational Medium-term
Employer/employee relationship	Medium-term Internal mobility	Short-term External	Long-term Internal mobility	Long-term Internal mobility
R&D intensity	Low	High	High	Medium
Internationalisation of firms	Low	High	Medium	Medium

1. Nature and duration of contracts in the automobile industry.
Source: OECD.

firm and its customers, suppliers and subcontractors.[53] In market-based systems, commercial linkages tend to be internalised within multidivisional companies, or else are at arms' length when autonomous firms are involved. Business groups – economic entities composed of a set of autonomous firms connected through equity linkages which jointly guarantee common control over all group assets – are generally composed of fully-owned subsidiaries and serve the purpose of sharing out legal responsibility for financial liabilities. On the other hand, in institution-based systems, business groups tend to be more diffused and reflect different economic motivations.[54] In Japan, for example, *keiretsu* typically include manufacturing firms, at various levels of vertical and horizontal integration, as well as financial institutions, which perform the role of "main banks" for the group, and trading companies. In Germany, where the three universal banks (Deutsche, Dresdner and Commerzbank) play a similar key role as *Hausbanken* extending investment funds and monitoring firms, industrial groups are usually more specialised in core manufacturing activities. Business groupings are also the most widespread form of enterprise organisation in Italy. However, large groups, which are relatively small in number, are predominantly pyramidal, with widespread intergroup shareholdings, and a single bank (Mediobanca) has played a role in supporting business strategies.

Italian industry is dualistic in nature. A small number of large corporations coexist with a vast network of small- and medium-sized firms, often combined within so-called "industrial districts".[55] Measured by the number of employees, non-financial firms (defined as autonomous legal entities) are on average smaller in Italy than in other major EC countries and Japan (Table 21). This also partly reflects the Italian pattern of manufacturing specialisation (in terms of both production and exports) in labour- and resource-intensive industries, such as textiles and ceramics, which are characterised by fragmentation of production units and low product differentiation (Diagram 18).[56] As measured by the ratio of the export and production shares, Italy also enjoys a comparative advantage in capital-intensive industries, such as electrical and non-electrical machinery, which are highly fragmented but highly differentiated, and, to a lesser extent, motor vehicles, in which concentration, entry costs and scale economies are large. Overall, judged by the ratio of value added to sales, Italian industry is, on average, less vertically integrated than other major European economies.[57]

Table 21. **Distribution of manufacturing firms by size in selected OECD countries**

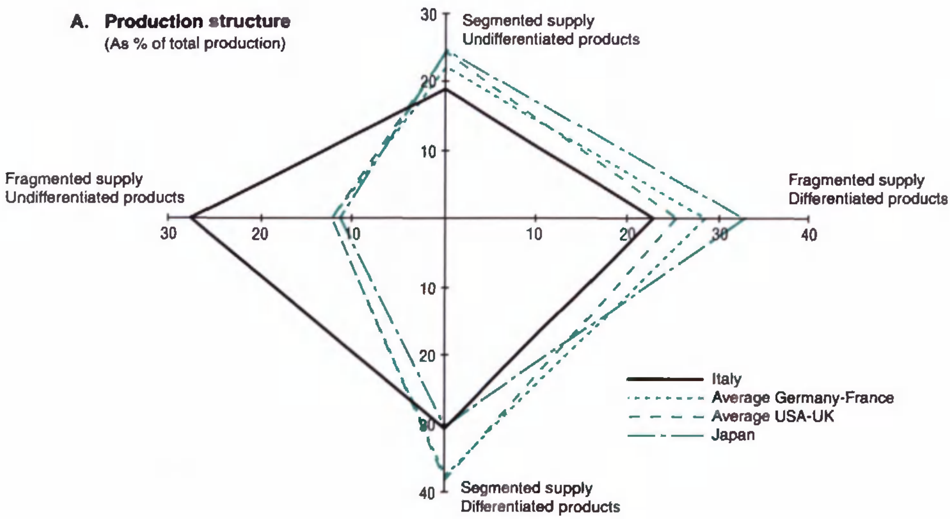
Per cent

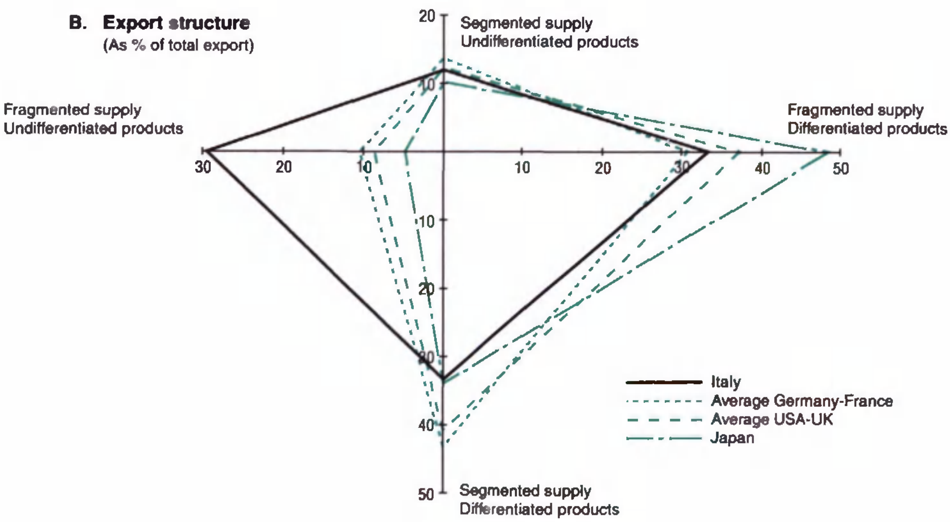
Number of employees	Italy [1]		Japan [2]		Germany [3]		France [4]	
	Firms	Employees	Firms	Employees	Firms	Employees	Firms	Employees
50-99	55.8	19.1	55.2	17.6	46.7	9.7	53.2	13.4
100-199	25.9	17.7	25.8	16.5	26.4	11.1	24.8	12.4
200-499	13.0	19.3	13.3	18.3	17.3	15.9	14.5	15.8
500-999	3.2	11.0	3.3	10.6	5.3	11.1	4.4	10.9
1 000-1 999	1.2	8.0					1.9	9.7
2 000-4 999	0.6	8.4	2.0	17.9	4.3	52.2	0.9	10.5
5 000+	0.3	16.5	0.3	19.1			0.4	27.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

1. 1991.
2. 1986.
3. 1987.
4. 1990.

Source: Barca F., M. Bianco, L. Cannari, R. Cesari, G. Manitta, G. Salvo and F.L. Signorini (1994), *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane*, il Mulino; Japanese Statistics Bureau; Statistisches Bundesamt; Insee.

Diagram 18. **SECTORAL STRUCTURE OF PRODUCTION AND EXPORTS IN MAJOR OECD COUNTRIES**





Note: Fragmented supply: number of firms grows with sectoral output (*e.g.* textiles, computers).
Segmented supply: number of firms independent from sectoral output (*e.g.* steel, aircraft).
Source: OECD.

Structure of corporate ownership and control in Italy

Aside from the extremely large public enterprise sector, the distinguishing feature of the structure of corporate ownership in Italy is the small role played by financial institutions (Table 22). Banks, insurance companies and pension and investment funds own only 11 per cent of shares in listed firms, the second-smallest share, after France, among the major six OECD countries. By contrast, the domestic non-financial sector owns almost 90 per cent of the capital of listed firms. Households directly own 34 per cent of shares, far less than in the United States but well above Germany, France, Japan and the United Kingdom.[58] As in France, Germany and Japan, non-financial enterprises own a sizeable stake of capital, largely due to group holdings and cross-holdings, both among firms belonging to the same group and across top holdings of different groups. Foreign ownership (5 per cent) is quite small by international standards, partly as a consequence of capital controls, which were fully removed only in May 1990.

Corporate ownership is much more concentrated in Italy than in other major OECD countries.[59] Single majority stakes account for about 60 per cent of total stock market capitalisation (Diagram 19), while the largest five shareholders hold

Table 22. **Ownership of listed firms**

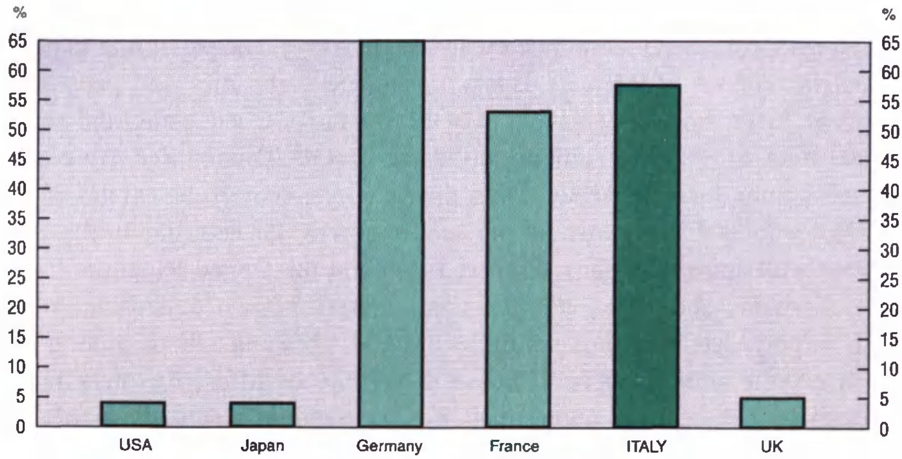
Per cent

	Italy	United States	Japan	Germany	France	United Kingdom
Financial institutions	11.3	31.2	48.0	22.0	6.5	58.8
Banks	9.9	0.3	26.7	10.0	4.3	0.9
Insurance firms	0.8	23.9[1]	17.2	12.0[1]	2.2	18.4
Other	0.6	7.0	4.1	–	1.9	39.5
Non-financial institutions	88.7	68.8	52.0	78.0	93.5	41.2
Households	33.9	48.1	22.6	17.0	20.7	21.3
Non-financial enterprises	23.0	14.1	24.8	42.0	54.5	3.6
Public authorities	27.0	–	0.7	5.0	4.5	3.9
Non-residents	4.8	6.6	3.9	14.0	11.9	12.4

1. Including pension funds.

Source: Barca F., M. Bianchi, F. Brioschi, L. Buzzacchi, P. Casavola, F. Filippa and M. Pagnini (1994), *Struttura di gruppo, concentrazione della proprietà e modelli di controllo nelle imprese italiane medio-grandi*, il Mulino; Federal Reserve Board; Japan Securities Research Institute; Bundesbank; Banque de France; Central Statistical Office.

Diagram 19. **MAJORITY STAKES AS A PERCENTAGE OF TOTAL LISTED STOCKS**[1]



1. Largest owners' share over 50%.
Source: OECD and Consob.

on average nearly 90 per cent of outstanding shares of listed companies, compared with 25 per cent in the United States and just over 40 per cent in Germany (Table 23).[60] Small shareholders with no direct influence on managerial and control decisions of the firm are estimated to hold financial claims only in a small minority of listed firms, representing 2 per cent of total capital, and cases in which they own the majority of the firm's capital (so-called "public companies") are extremely rare. Table 24 (column A) shows that the percentage of shares owned by small shareholders is insignificant, except in the motor vehicle and data processing sectors. Reflecting the high concentration of ownership, survey-based results show that majority control is exercised by a single entity (an individual or a legal person) in half of industrial firms, representing up to 70 per cent of their total employment. Coalition control – ensured by either voting trusts or family ties – is also common, prevailing in around 60 per cent of small- and medium-sized firms. Conversely, minority control is only exercised in 13 per cent of firms, reflecting the low number of firms whose ownership is widespread across small shareholders.

Table 23. **Ownership concentration in non-financial corporations**

Percentage of outstanding shares owned by the largest five shareholders

	Italy	United States	Japan	Germany	United Kingdom
Mean	86.9	25.4	33.1	41.5	20.9
Median	99.9	20.9	29.7	37.0	15.1
Standard deviation	19.7	16.0	13.8	14.5	16.0
Minimum	n.a.	1.3	10.9	15.0	5.0
Maximum	100.0	87.1	85.0	89.6	87.7

Note: United States: 457 non-financial corporations in 1980; United Kingdom: 85 manufacturing corporations in 1970; Japan: 143 mining and manufacturing corporations in 1984; Germany: 41 non-financial corporations in 1990; Italy: 734 non-financial corporations in 1993.

Source: Barca F., M. Bianchi, F. Brioschi, L. Buzzacchi, P. Casavola, F. Filippa and M. Pagnini (1994), *Struttura di gruppo, concentrazione della proprietà e modelli di controllo nelle imprese italiane medio-grandi*, il Mulino.

Table 24. **Shares held by small shareholders by sector**[1]

Industry	Non-integrated ownership share[2]	Integraded ownership share	Ratio of direct total share
	Per cent		
	A	B	B/A
Motor vehicles	60.8	82.2	1.4
Data processing	37.1	38.1	1.0
Cables and wires	5.1	37.8	7.4
Cement	18.3	30.9	1.7
Synthetic fibres	9.3	30.4	3.3
Tyres	2.3	26.5	11.5
Bulk chemicals	2.6	21.6	8.3
Electrical products	6.3	16.5	2.6
Aerospace	13.3	16.3	1.2
Farm machinery	10.8	14.3	1.3
Primary metals	9.5	12.4	1.3
Other mechanical machinery	6.1	10.9	1.8
Electronics, telecommunications and medical electronic equipment	2.0	10.4	5.2
Pharmaceutical	3.6	10.3	2.9
Motor vehicle parts	3.3	10.3	3.1
Printing and publishing	4.5	10.1	2.2
Paper and paper products	7.0	10.0	1.4

1. Small shareholders are defined as agents which hold freely transferable claims but do not exert any control over the firm's management. Only sectors where direct share holdings exceed 10 per cent are reported.
2. Ownership shares derived without netting out equity linkages among firms.

Source: Buzzacchi, Luigi and Massimo G. Colombo (1994), "Business groups and the determinants of corporate ownership", *Cambridge Journal of Economics*, forthcoming.

In integrating ownership and control, key roles are played by the financial mechanism of the pyramidal group (see below) and by formal and informal relationships among shareholders, such as family ties, voting trusts or strategic agreements (Table 25). In manufacturing, pyramidal groups are estimated to control one third of firms, representing one half of total employment. High ownership concentration partly reflects the wide diffusion of these groups, in which "upstream" firms along the chain of control directly own majority stakes in "downstream" firms.[61] Any (direct) shareholding in firm A also gives rise to a (indirect) shareholding in firm B, and this cascading effect increases the measured degree of concentration.[62] Without this cascading effect, the proportion of small shareholdings would be greater in most sectors (Table 24, column B). Nearly as important as pyramidal groups is joint (majority or minority) control by members of the same family, prevailing in another third of firms, which represent 17 per cent of total employment.[63] This illustrates the large role of family-run businesses in the Italian economy. Finally, a large number of firms are jointly controlled by partners having no family ties, through explicit or implicit voting trusts, or by single individuals holding the absolute majority of shares (representing 9 per cent of total employment). Overall, separation between share ownership and control is apparently weaker than in other major OECD countries, where

Table 25. **Control models in manufacturing firms**

Percentage shares in 1993

Control model	Firms with more than 50 employees [1]	Firms with 20 to 500 employees [2]
Pyramidal groups	33.3	12.5
Family	32.1	55.2
Single person	13.8	19.5
Coalition without family ties	11.6	10.3
State	6.9	1.8
Pseudo-public company [3]	2.1	0.0
Financial institutions	0.2	0.7
Total	100.0	100.0
(Number of firms)	*(973)*	*(272)*

1. Population estimates from random sample.
2. Actual statistics from non-random sample.
3. Fragmented ownership with no free transferability of shares (*e.g.* co-operatives).

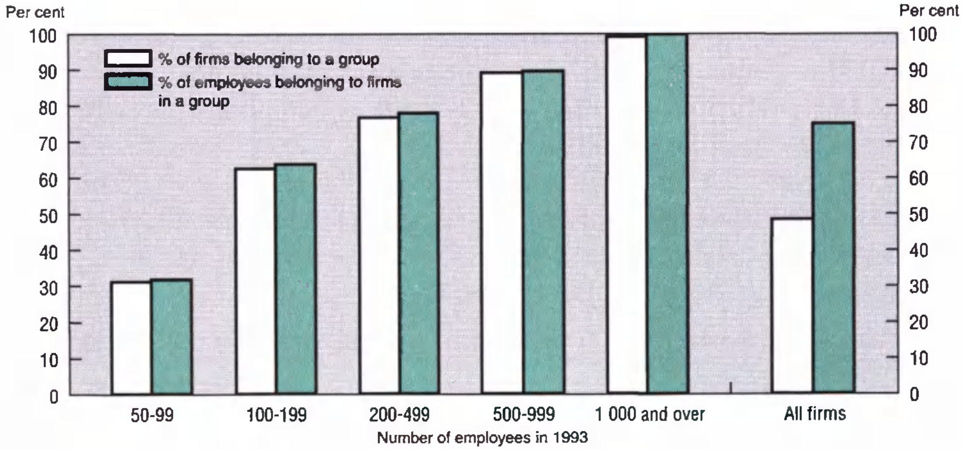
Source: Barca F., M. Bianco, L. Cannari, R. Cesari, G. Manitta, G. Salvo and F.L. Signorini (1994), *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane*, il Mulino.

minority control is more widespread and coalition control through informal arrangements is less common.[64]

The role of pyramidal groups

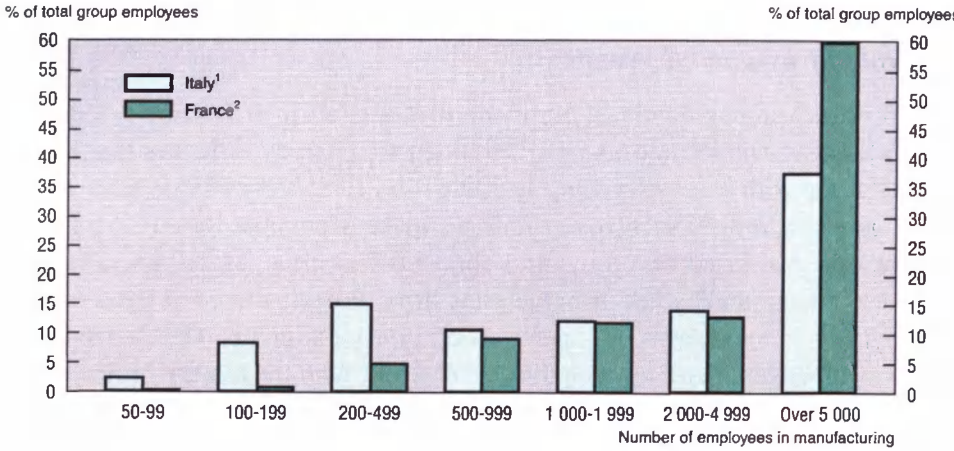
Business groups dominate corporate organisation in Italy. Equity linkages are widespread within industry: the 1991 industrial survey estimates that 87 per cent of firms with sales exceeding L 500 billion (US$333 million) have equity stakes in other firms.[65] Such equity linkages make it possible for the 151 groups with at least one listed firm to control almost 6 500 firms. More generally, it is estimated that around half of manufacturing firms, covering three quarters of total employment in these firms, are members of a business group. The frequency of group membership increases with the size of firms, with the totality of firms with more than 1 000 employees being members of a group (Diagram 20). But, in contrast to other countries, group membership is also widespread among smaller firms (Diagram 21).

Diagram 20. **DIFFUSION OF GROUPS AMONG MANUFACTURING FIRMS**[1]



1. A group is defined as a set of individual firms controlled directly or indirectly by the same private or public entities.
Source: Banca d'Italia (1994*a*).

Diagram 21. **SIZE DISTRIBUTION OF GROUPS IN ITALY AND FRANCE**

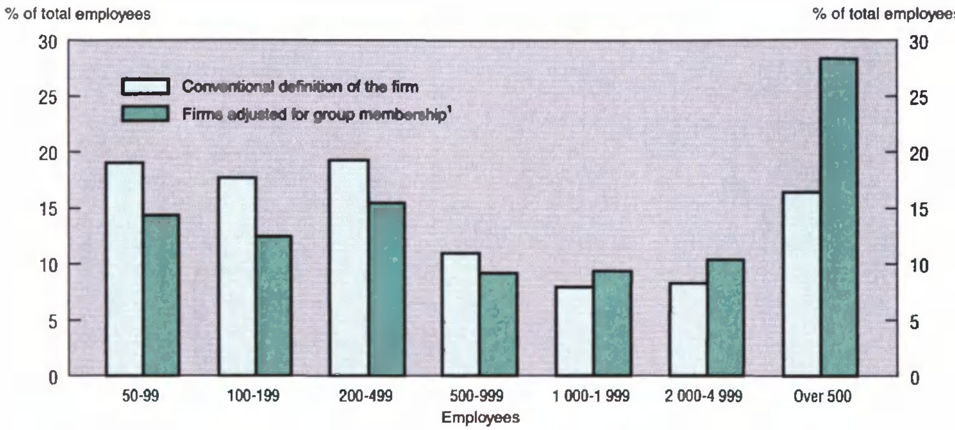


1. 1993.
2. 1991.

Source: Banca d'Italia (1994*a*) and INSEE.

The principal business groups are composed of a small number of large firms and a plethora of small firms. Firms with fewer than 50 employees represent as many as one third of the total number of firms in groups with more than 5 000 employees, though only a limited share of total employment. Many other groups are composed of small and medium-sized firms only. The size distribution of firms is thus significantly affected by the group system itself.[66] Taking all individual firms belonging to the same group as a single unit, the ''dwarfism'' of Italian firms appears less pronounced (Diagram 22). This adjustment, however, does not increase the share of medium-sized firms, which remains lower than in other OECD countries.

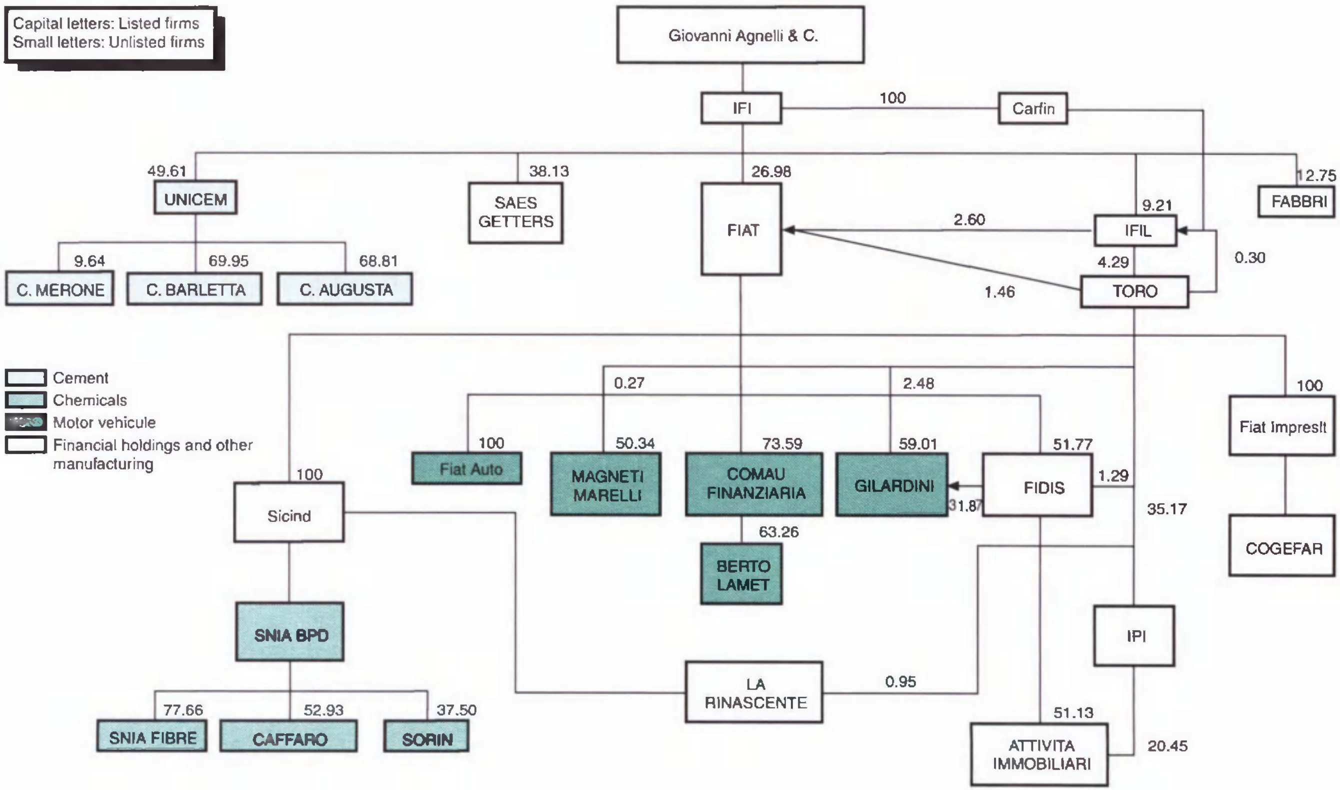
Italian groups are mostly hierarchical, organised as a pyramid of juridically-autonomous firms linked by one or more chains of equity holdings, originating from a financial holding which controls (either directly or indirectly) all firms belonging to the same group. Within a given group, equity linkages are vertical and unidirectional, *i.e.* at each level of the pyramid, firms own a control stake in firms belonging to the immediately lower level.[67] For instance, in the Fiat group, Diagram 22. **SIZE DISTRIBUTION OF FIRMS BY NUMBER OF EMPLOYEES**



1. Firms are redifined considering all individual firms belonging to the same group as a single unit.
Source: Banca d'Italia (1994*a*).

the Agnelli family (through a majority-owned financial holding, IFI) holds a 27 per cent control stake in the listed holding Fiat, which, in turn, owns over 50 per cent of shares in Magneti Marelli (a producer of electrical components) (Diagram 23).[68] Reciprocal shareholdings are, on the other hand, quite common between different groups, being generally motivated by the desire to establish mutual influence or control as well as, to a lesser extent, by the wish to diversify portfolios. These cross-shareholdings represented in 1987 over 5 per cent of total market capitalisation of Italian groups and in 1993 over 8 per cent of total shares of non-financial firms which are either listed or controlled by a listed firm.[69] These features contrast with Japanese associative groups, where intra-group equity linkages are generally bidirectional, large shareholdings in downstream firms are uncommon and inter-group cross-shareholdings are small. They also contrast with French hierarchical groups, in which downstream firms frequently own large stakes in the group holding, and German groups, whose member companies engage in fairly extensive reciprocal shareholdings.

Diagram 23. **THE TYPICAL ITALIAN GROUP: FIAT**



Source: OECD.

Unidirectional equity linkages are a powerful means of ensuring stable control over all firms belonging to the pyramidal group, while inter-group cross-shareholdings might facilitate strategic alliances and, in some cases, collusive behaviour among different groups.[70] Through the chain of equity holdings linking the top of the pyramid to lower levels, control over all firms belonging to the group is exercised with a minimum amount of capital invested. In an extreme case, in a four-level pyramidal group, control of the last-level subsidiary can be ensured indirectly with as little as 7 per cent of shares, provided subsidiaries (or sub-holdings) at each intermediate level own 51 per cent of shares in the firm at the following level. Through this kind of equity linkage, both strategic and operational decisions of subsidiaries are overseen by the group holding. At the same time, both the group holding and lower-level holdings and subsidiaries are shielded from hostile takeovers and undesired changes in management. Therefore, for large and medium-sized companies, the pyramidal group tends to perpetuate family or coalition control over all group subholdings and subsidiaries, often at the expense of non-controlling shareholders.

Pyramidal groups thus perform an important role in shaping the strategic framework of corporate governance in Italy:

- Through stock market listings of member firms, minority shareholdings can be used at all levels of the pyramid to provide the controlling individual or coalition with wide access to risk capital, without jeopardising control.[71] On average, the top shareholders of private non-financial groups are estimated to control seven lira of capital for each lira invested in equity, with this kind of financial gearing ranging from 2.5 for the Berlusconi group to 19 for the Agnelli group (see Annex Table A1). Differences in the incidence of groups across sectors may partly reflect this ''fund-raising'' role, being largest in capital-intensive sectors (such as high technology and economies of scale sectors) and lowest in traditional sectors (Table 26).
- The centralisation of decision-making also provides the opportunity to exploit internal capital markets, the share of external funds in total resources being matched by the share of funds provided by intra-group financial transactions. Such transactions may comprise internal transfers of fixed assets and shareholdings, underwriting of private placements by subsidiaries having easier access to capital markets and intra-group loans at rates more favourable than on external financial markets.[72]

Table 26. **Incidence of groups as a control model by sector**[1]
Firms with more than 50 employees

Sector	Scale economies	High technology	Specialisation	Traditional
Members of group (share of firms, per cent)	67.0	71.4	47.5	43.4
of which:				
Members of foreign groups	24.5	25.8	18.2	7.8
Control model (share of employment, per cent)				
Group	60.3	50.8	43.8	39.3
Coalition without family ties	6.8	12.5	9.6	10.2
Single person or family	14.3	3.7	31.5	41.4
Other[2]	18.6	32.9	15.2	9.0

1. 1993.
2. Including state.
Source: Barca, F., M. Bianco, L. Cannari, R. Cesari, G. Manitta, G. Salvo and F.L. Signorini (1994), *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane*, il Mulino.

– Pyramidal groups may provide a way of limiting the potential liabilities of the controlling individual or coalition: since member firms are juridically autonomous, in the event of bankruptcy of a subsidiary, the coalition controlling the group is liable only for the (often minority) indirect stake it holds in the firm.
– In the absence of a comprehensive legislation on groups (see below), the group structure has been used to reduce transparency (relative to a multidivisional firm) *vis-à-vis* regulatory authorities, banks, small shareholders and the fiscal administration. The fragmentation of business into a large number of companies and the complex linkages between company- and group-level accounts enhance the opportunities for withholding relevant information from stakeholders, for escaping existing disclosure regulations (especially those aimed at providing safeguards to uninformed shareholders) and for exploiting fiscal opportunities and loopholes.[73]

Overall, the pyramidal group ensures the benefits of diffused ownership while minimising the agency costs usually arising from the monitoring of management, boards of directors being, in effect, dominated by the controlling individual or coalition.

Governing bodies and internal monitoring[74]

As in other major European countries, company law provides for two main forms of limited liability company: the joint-stock company (*società per azioni*), widespread among listed and large-sized firms, and the private limited company (*società a responsabilità limitata*), which is suitable for small-scale privately-held firms.[75] The governance structure of corporations is two-tiered: the managing board (*consiglio d'amministrazione*), which appoints a chairman and a chief executive officer (*amministratore delegato*), is supplemented by a board of auditors (*collegio sindacale*), which is responsible for internal monitoring and whose members cannot belong to the managing board. Both the managing board and the board of auditors are elected for a three-year term with a simple majority vote by the assembly of shareholders.[76] While members of the managing board can be revoked at any time with a simple majority vote, members of the board of auditors cannot be revoked without cause before the end of the term.

The powers of the managing board are broadly similar to those prevailing in Anglo-American countries: it controls decisions taken by the CEOs, sets their compensation and defines dividend policies.[77] The powers of the board of auditors include control over both the decisions of the managing board and the company's accounts. However, in contrast to German and French supervisory boards, the boards of auditors have generally failed to achieve their statutory aims. Given the dominant role of large shareholders in general meetings and their extensive presence in managing boards, auditors are often appointed by the very people they are supposed to monitor.[78] In addition, due to extensive cross-shareholdings among business groups, auditors are usually chosen from a small set of business and legal consultants who sit on several boards at once, helping to interlock the governance structures of different firms. Finally, due to the ambiguity of company law, auditors are generally confined to the role of accountants, a task that is difficult to perform in large and complex corporations and which became redundant in 1974, when external auditing was made compulsory for listed firms.

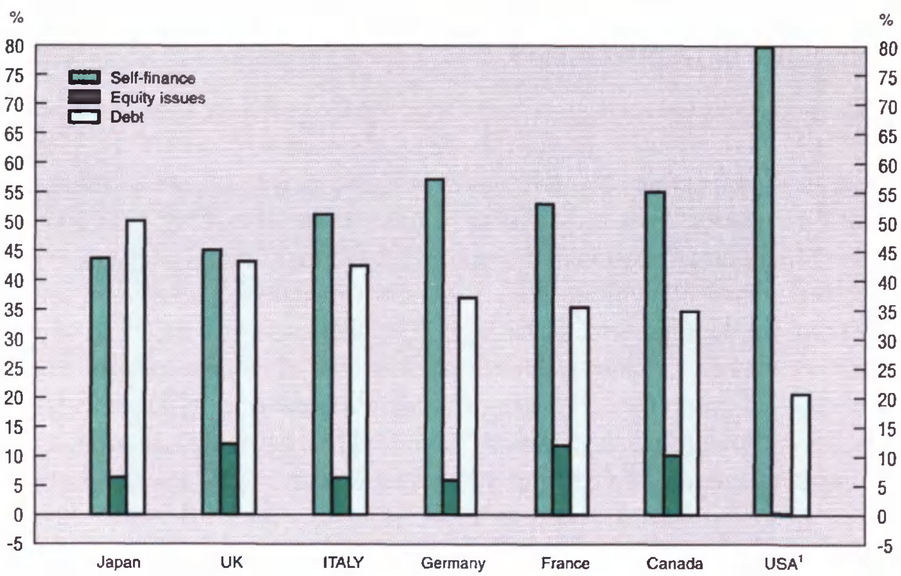
The structure of corporate finance

Sources of funds

In recent years, Italian corporations have occupied an intermediate position within the spectrum of corporate financial structures in major OECD countries (Diagram 24). As in all G7 countries except Japan and the United Kingdom, retained earnings are by far the largest source of finance, although their share in total financial resources is lower than elsewhere in continental Europe and North America. At the same time, the dependence on debt finance is relatively high while, as in Germany and Japan, equity issues are a minor source of financing. Overall, in spite of extensive balance-sheet restructuring during the 1980s, lever-

Diagram 24. **CORPORATE FINANCE STRUCTURE, 1989-1992**

Per cent of total financial resources



1. Data on net equity issues in the US reflects conjunctural factors and a strong wave of mergers and acquisitions.
Source: OECD and Bundesbank.

age ratios are higher than in other major OECD countries (Table 27), particularly with respect to small- and medium-sized enterprises.[79]

Relatively strong reliance on own funds, limited recourse to equity issues, large borrowing flows and little securitisation are the result of several factors, ranging from fiscal distortions and regulatory constraints to the features of corporate structure and control outlined above. Preference for high earnings retention rates and reluctance to raise risk capital through the stock market may reflect the wish to maintain corporate control, especially in small- and medium-sized firms. Thus, the low number of firms listed in the stock market, which is well below that observed in other major OECD countries, reflects not only market inefficiencies (see below) but also the aversion of medium-sized firms to stock-market listing, deriving from a fear of losing control.[80] Overall, it is estimated that the number of medium-sized firms which would satisfy stock exchange requirements is around five times the number of listed firms.[81] This cautious attitude of entrepreneurs towards the stock market may also explain the diffusion among listed firms of dual-class shares deprived of voting rights, which is widespread by international standards.[82]

High levels of borrowing also reflect the preferential fiscal treatment of debt relative to equity and, especially in medium- and large-sized firms, a tendency to favour the interests of creditors over shareholders in relatively risk-free sectors.[83] Due to comparatively high average corporate income tax rates, distortions in the taxation of returns from equity and low average taxation of debt interest, borrowing enjoys a clear fiscal advantage over equity (as is the case in many OECD economies). The estimated after-tax return for each lira of profits is 0.8 lira when

Table 27. **Leverage ratios of non-financial firms**

Ratio of gross debt to total assets

	Italy	United States	Japan	Germany[1]	France	United Kingdom
1982	0.82	0.32	0.83[2]	0.59	0.72	0.52[3]
1992	0.76	0.51	0.80	0.61	0.57	0.56[4]

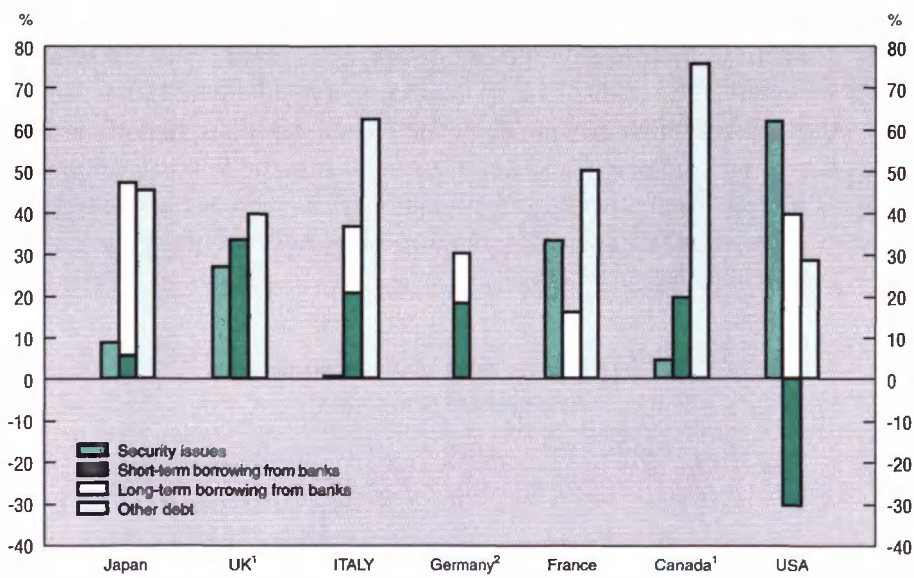
1. Data for Germany may be downward-biased due to equity holdings on account of pension funds.
2. 1984.
3. 1983.
4. 1990.

Source: OECD (1993), *Financial Statistics*, part 3.

it is financed through debt, as against 0.45 lira when the investment is financed through retained earnings or equity.[84] Highly-leveraged firms usually belong to sectors which are more regulated, such as pharmaceuticals, and more mature, such as food and beverages and textiles. Returns in these sectors are less risky and the probability of bankruptcy is low, thus favouring unsecured debt over equity finance.[85]

While, as in Japan and Germany, corporate debt consists mainly of borrowing from banks, a distinguishing feature of Italian corporate finance is the wide recourse to short-term bank loans and the virtual absence of securitised debt (Diagram 25). The issuance of short-term securities by firms was severely restricted until recently (see below), while resort to private bonds was hampered by a thin primary market, and, as in other countries, an unfavourable fiscal

Diagram 25. **CORPORATE DEBT STRUCTURE, 1989-1992**
Per cent of total debt



1. Data on long-term debt missing.
2. Data on securities and other debt missing.

Source: OECD and Bundesbank.

regime.[86] On the other hand, with the right to offer long-term bank loans largely confined to a few large special credit institutions (see below), the bulk of firms' borrowing from commercial banks has usually taken the form of short-term loans renewed on a regular basis.

The role of banks and other intermediaries

Market intermediaries – commercial banks, merchant banks, venture capital institutions, investment funds, and business, legal and fiscal consultants – may influence corporate behaviour by acquiring stakes, by monitoring the performance of firms and by contributing to the efficient working of the market for corporate control. In Italy, though, the active role of banks in corporate governance has been discouraged both by their small average size and, in the case of commercial banks, by severe legal restrictions. Compared to other major European countries, banks are undersized relative to the largest corporations (Table 28). Equity acquisition and ongoing monitoring by banks has been restricted by the 1936 Banking Law, which generally forbade managers of banks to sit on boards of non-financial firms and also established a rigid separation between short- and long-term deposit gathering and lending (Table 29). Until 1993, when radical changes to the law were made in order to conform with EC-wide regulations (see below), the extension of long-term credit was largely confined to a few special credit institutions, while purchase of shares was limited

Table 28. **The banking sector**
1991; billion dollars

	Italy	United States	Japan	Germany
Assets of the largest bank	178	216	435	267
(relative to the assets of the largest automaker)	(3.1)	(1.2)	(7.9)	(5.5)
Assets of the three largest banks	411	424	1 345	600
Assets of the ten largest banks	949	922	3 233	1 385
(of the ten largest non-bank financial institutions)	(83)[1]	(1 202)	(1 799)	(298)
[Relative size of the banking sector (total assets/ GNP %)]	106	62	167	145

1. Five largest, in 1992.
Source: OECD; *The Banker*, *Fortune*.

Table 29. **Regulations governing the ownership and control of non-financial firms by financial institutions**

Institution	Italy	United States	United Kingdom	Japan	Germany
Commercial banks	Prior to 1993, stock ownership was prohibited or required prior approval (in special cases) by the Bank of Italy; proxy voting is still prohibited, while the presence of banks' employees on non-financial firms boards is allowed since 1992.	Stock ownership prohibited or requires prior approval of Federal Reserve Board and must be "passive".	Bank of England may discourage ownership on prudential grounds. Capital adequacy rules discourage large stakes.	Prior to 1987 banks could hold up to 10 per cent of a firm's stock. After 1987 can hold up to 5 per cent.	No restrictions, apart from some generous prudential rules.
Life insurance companies	Can hold up to 5 per cent of a firm's stock.	Can hold up to 2 per cent of assets in a single company's securities. Can hold up to 20 per cent of assets in equities.	Self-imposed limits on fund assets invested in any one company stemming from fiduciary requirement of liquidity.	Can hold up to 10 per cent of a firm's stock.	Can hold up to 20 per cent of total assets in equities.
Other insurers		Control of non-insurance company prohibited.			
Mutual funds	No more than 5 per cent of a listed firm's stock (10 per cent if unlisted). Proxy voting prohibited.	Tax penalties and regulatory restrictions if ownership exceeds 10 per cent of a firm's stock.	Cannot take large stakes in firms.	–	No more than 5 per cent of fund assets in one company; no more than 10 per cent of the total voting rights from the stock of the same issuer.

Table 29. **Regulations governing the ownership and control of non-financial firms by financial institutions** *(cont'd)*

Institution	Italy	United States	United Kingdom	Japan	Germany
Pension funds	Limits on fund assets invested in one company (5 per cent if quoted, 10 per cent otherwise) and in the sponsoring company and its subsidiaries (20 per cent).	Must diversify (ERISA).	Self-imposed limits on fund assets invested in one company stemming from fiduciary requirement of liquidity.	–	–
General	Consob[1] notification required for 2 per cent ownership in listed firms and 10 per cent ownership in unlisted firms by listed ones.	SEC[1] notification required for 5 per cent ownership. Insider trading laws discouraging active shareholding.	Insider trading laws discourage large stakeholders from exerting control. Regulatory notification required for 3 per cent ownership.	–	Regulatory notification required for 25 per cent ownership.[2]

1. Stock exchange commission.
2. Reform under study, which would lower the limit to 5 per cent and outlaw insider trading.

Source: OECD from various national sources.

for all categories of banks. The 1936 Banking Law required commercial banks to request authorisation from banking supervisors for any acquisition of shares in non-financial firms or for any waiver to the incompatibility of holding positions as bank manager and board member in a firm. Given the more stable nature of their liabilities and their rather specialised area of activities in financing capital formation, special credit institutions were not subjected to the same authorisation procedures with respect to the acquisition of shareholdings in non-financial firms. In practice, with the important exception of Mediobanca (see below), this prerogative was seldom used.[87]

Italian banks have failed to develop an investment-bank culture. Moreover, proxy voting mechanisms have been prohibited.[88] As a result, equity holdings by banks have always remained well within legal boundaries, amounting to no more than L 15 trillion in 1993, around 4 per cent of their total financial market investment. As for long-run credit, this has been mainly provided by special credit institutions, largely specialised in the management of subsidised loans for regional or sectoral development, and, to a lesser extent, by special departments of banks (Table 30).[89] Both kinds of institutions have extensively relied on the provision of collateral (such as real estate, capital goods or State guarantees). Credit analysis has been based on the replacement cost of the firm's assets rather than on the expected value of the firm.[90]

In this setting, short-term credit has become the dominating financial investment of banks in non-financial firms, mainly through bank affidavits and check-

Table 30. **Bank lending to non-financial enterprises**

Per cent of total loans

Year	Banks			Special credit institutions			Total short-term loans	Total long-term loans
	Total loans (lira billion)	Short-term	Long-term	Total loans (lira billion)	Short-term	Long-term		
1990	448 219	90.0	10.0	253 235	11.1	88.9	61.5	38.5
1991	516 370	89.6	10.4	291 312	9.3	90.7	60.6	39.4
1992	591 977	89.1	10.9	328 019	7.5	92.5	60.0	40.0
1993	632 416	88.6	11.4	359 299	6.3	93.7	58.8	41.2

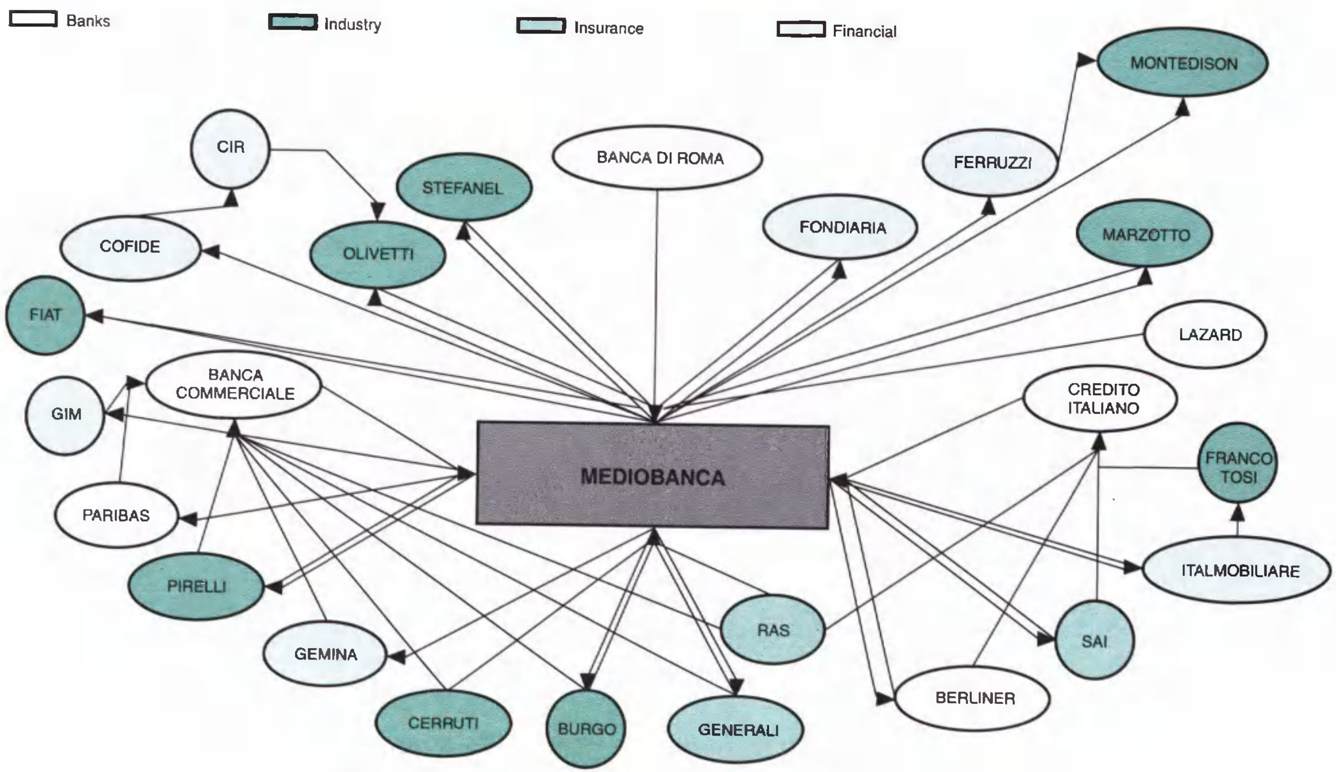
Source: Banca d'Italia.

ing-account overdraft facilities. Partly due to the small average size of banks, it has also been common practice for banks and firms to engage in multiple cross-relationships: small-and medium-sized firms are estimated to have, on average, credit lines with more than eight different banks, while banks normally extend short-term credit to a multitude of firms.[91] In this way firms multiply their financing opportunities and decrease their transparency, while banks attempt to diversify risk. By repeatedly renewing short-term credit, with loans not earmarked for any specific use by the firm, commercial banks and firms have overcome to some extent the constraints imposed on long-term lending.

While there is no evidence that banks have systematically failed to screen debtors, this kind of bank-firm relationship has not led to any form of *interim* bank monitoring of corporate performance, either with respect to the supervision of business results and strategies or to changes of control. With firms enjoying multiple credit lines, both information flows and monitoring activities have been hampered. In addition, lack of monitoring and reliance on multiple credit lines may have induced opportunistic behaviour by firms, increasing the likelihood of bad loans. Finally, acquisitions of shares by banks have rarely spurred active monitoring.[92] In this environment, banks have developed little know-how in the field of corporate finance, devoting insufficient human resources to financial analysis and crisis management.[93]

Only two special credit institutions, IMI and Mediobanca, have developed wide-ranging merchant banking activities. However, with IMI specialising in asset management and rarely involved in corporate governance and mergers and acquisitions, most merchant banking activity has been performed by Mediobanca alone, which has an almost exclusive role in relational banking and, until recently, a towering position in underwritings.[94] Using loopholes in the 1936 Banking Law, which allowed special credit institutions to own significant amounts of equity in the non-banking sector (see above), Mediobanca acquired large and stable shareholdings and has usually participated in controlling coalitions in all major industrial and insurance groups, mostly established in the northern part of the country. In turn, most major private groups, as well as a few foreign banks, have shareholdings and a seat in the governing bodies of the bank, which thereby constitutes a clearing house and repository for all the interwoven shareholdings in key private enterprises (Diagram 26).[95] Despite its small size (total assets were in 1990 half those of IMI and 5 per cent of the assets of the

Diagram 26. **THE ROLE OF MEDIOBANCA**
Ownership structure and cross-shareholdings



Source: OECD.

Industrial Bank of Japan) and the lack of branching, Mediobanca has acquired great placing power, partly due to its strategic alliance with three of the country's largest commercial banks, which also provide funding and a suitable distribution network.[96] As a result, it has established itself as a sort of "main bank" for certain sections of industry, involved in formulating long-run financial strategies, enlisting and coordinating financial support and masterminding mergers and acquisitions.

Institutional investment has been traditionally dominated by a smaller number of insurance companies and investment funds, as compared to other OECD countries. Their role in monitoring corporate performance is extremely passive, since they have small shareholdings and are often owned by the industrial and banking groups representing the bulk of stock market capitalisation. Regulatory constraints on proxy voting further limited their role in shareholders' meetings. The number of institutional investors is likely to grow after recent financial market reforms which enhanced the opportunities for establishing investment trusts and pension funds (see below).

The market for corporate control

Transfer of ownership is a way of responding to macroeconomic changes and to technological developments which may be either internal or external to the firm. The objective of the market for corporate control is to achieve the efficient reallocation of managerial and financial resources by providing information to potential sellers and buyers, as well as by providing technical and financial means for mergers and acquisitions. In Italy, 45 per cent of firms with more than 50 employees are estimated to have been reallocated at least once since foundation.[97] However, as in Germany and Japan, the market for corporate control has been quiescent. As regards small- and medium-sized firms, only half of reallocations went through the market, the rest being family transfers, such as bequests, donations or family sales. Family transfers allow the accumulation and preservation of human capital but restrict transactions to agents with inside information or enjoying informal relationships. Moreover, mergers and acquisitions have remained scant, compared to those occurring in other European countries. Over the 1990-1992 period, mergers and acquisitions amounted to only 947 in Italy, against 3 816 in the United Kingdom, 3 245 in Germany and 2 595 in France.[98]

Hostile takeovers have been almost non-existent, partly due to the extensive web of cross-shareholdings locking in control of the major business groups.

The market for corporate control has been inhibited by the structure of ownership and control as well as by the weakness of institutions and rules. As noted, there is a high concentration of ownership, the large diffusion of pyramidal groups effectively discouraging takeover bids by minority shareholders in subsidiaries. The diffusion of inter- and intra-group cross-shareholdings also helps to lock in control within a closed set of shareholders, as do family coalitions with or without explicit clauses which prevent transfer of control to outsiders. The weakness of institutions and rules is manifest in the lack of specialised intermediaries (such as merchant banks and venture capital institutions), a conservative use of obsolete bankruptcy procedures and the narrowness and inefficiency of the stock market.

Specialised intermediaries may perform three major functions in the market for corporate control: providing credit to finance transactions, giving the advice and consulting services which make such transactions possible, and acquiring equity holdings.[99] With direct bank participation in corporate capital severely constrained in Italy, only finance and consulting services have been possible. However, in both these respects, the role of financial intermediaries has been limited by the scarcity of specialised institutions and weak demand on behalf of firms.[100] It is estimated that an intermediary has participated in only 17 per cent of market reallocations of small- and medium-sized industrial firms. In all other cases, the transaction was carried out through direct contact between buyers and sellers, who had often been interacting in the market well before the reallocation took place (*e.g.* as suppliers and assemblers, competitors, or employers and employees). Therefore, market reallocations appear to have largely been made in an insider environment.[101] In addition, over 80 per cent of reallocations of small- and medium-sized manufacturing companies have been financed using the resources of the buyer (family funds or sales of personal assets), the contribution of risk capital or debt (such as bank credits or bond issues) being minimal.

Given the lack of merchant banking services and the narrowness of the market for corporate control, advisory services in mergers and acquisitions have been usually provided by business consultants, lawyers and fiscal experts, who have assisted in over half of ownership transfers involving small- and medium-sized firms. These professionals, who often sit on managing boards or on boards

Table 31. **Stock market statistics in 1993**

	Italy	United States[1]	Japan[2]	Germany	France[3]	United Kingdom[4]	Canada[5]
Number of listed companies	246	1 946	1 775	1 297	934	2 412	1 193
of which:							
Foreign	4	158	108	633	208	485	69
Newly listed	5	225	23	68	14	186	153
Market capitalisation (billion US dollar)	144	4 221	2 906	461	455	1 199	327
Turnover value (billion US dollar)	66	2 283	793	595	172	857	114
Turnover velocity (in per cent)	48.6	50.8	25.4	150.3	43.2	40.9	38.7
Market concentration (value)[6]	51.9	49.3	50.2	67.2	49.3	68.1	53.5
Market concentration (trading)[7]	62.5	38.6	42.9	85.9	60.8	34.8	57.3
Gross amount of new capital raised by domestic companies (billion US dollar)	10	102	7	9	21	26	9
of which:							
Initial public offerings (per cent)	1.4	56.4	n.a.	n.a.	46.0	28.1	35.9
Number of bond issuers	62	574	643	712	639	1 527	n.a.
of which:							
Domestic private sector	41	529	583	193	443	899	n.a.
Market value of bonds listed (billion US dollar)	584	2 528	1 599	1 546	655	876	2
of which:							
Domestic private sector	4	215	159	767	117	182	0
Price-earnings ratio	58.6	23.4	64.9	24.5	19.0	24.8	24.6

1. New York Stock Exchange.
2. Tokyo.
3. Paris.
4. London.
5. Toronto.
6. Market concentration of the 5 per cent of the largest companies by market value compared with the market value of domestic shares.
7. Market concentration of the 5 per cent of the largest companies by trading value compared with the trading value of domestic shares.

Source: Fédération Internationale des Bourses de Valeurs (1994), *Statistics 1993*.

of auditors and provide legal and fiscal advice to firms on a continuing basis, have access to the kind of insider information needed. However, since the scale of their operations is narrower than for merchant banks, the likelihood of missed opportunities and market inefficiencies is high.[102]

Transfer of ownership within the private sector has also been hampered by the growing reluctance to acknowledge business failures. The half-a-century old bankruptcy law, which was originally designed to favour creditors over other stakeholders, has been repeatedly amended in recent decades in order to avoid plant closures and protect employment levels, especially through government intervention (see Annex II). This has prevented the maximisation of the net worth of the firms involved, infringed the rights of shareholders and creditors and ultimately led to companies being taken over by the public sector.[103]

The economic and institutional factors discussed above have restricted the development of the stock market relative to other major OECD countries (Table 31).[104] The number of listed companies in the Milan stock exchange is less than one third that of Paris, the next-smallest stock market in the G7 countries, while foreign companies are virtually absent and new listings are very few. Besides the fear of losing control, entrepreneurs are reluctant to go public because underpricing (*i.e.,* the difference between issue price and the first trading price) in Italian initial public offerings is particularly high.[105] Total market capitalisation and turnover are low and excessively concentrated around a few large groups. According to McKinsey's estimates, in 1991 the top five groups of the Milan stock exchange accounted for over 70 per cent of market capitalisation, while in London and Paris the figure was 17 per cent. Partly for this reason, the market is widely perceived as favouring insiders and manipulated in the interests of major shareholders, deterring the participation of small investors. Overall, equity listings, issues and transactions still lack transparency, and the rights of minority shareholders are often disregarded. Laws and initiatives aimed at modernising, disciplining and expanding the stock market are relatively recent (see below).

Economic implications of the governance structure

Corporate governance systems help to mould the contractual governance structure of a country – *i.e.* the relationships within and between firms – thereby affecting its industrial organisation and its overall economic performance.[106] While evidence on the overall economic implications of different corporate governance systems is scattered and inconclusive, some potential channels of influence can be singled out:

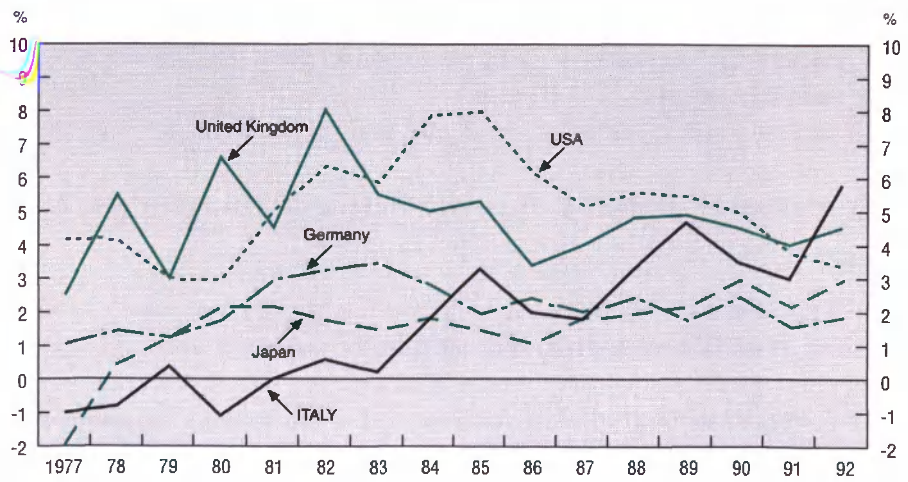
- links between corporations, financial institutions and shareholders influence the cost, type and availability of finance, thereby directly affecting investment and growth;
- aside from direct ownership links between different companies, vertical integration – which may help to produce efficiency gains by ensuring quality and consistency of supply – may also be achieved through long-term contractual relations between firms and their suppliers (implicit or explicit, with or without the practice of mutual stockholding); but long-term business relationships between buyers and suppliers, when exclusive, may sometimes impede competition, resulting in inefficiencies arising from hidden barriers to entry;
- corporate governance may have effects on remuneration and tenure which affect the objectives of management and labour, hence influencing an economy's flexibility to adapt and respond to adverse shocks;
- in systems where control is tightly exercised either by banks or by majority shareholders, managers may enjoy greater freedom to pursue longer-run goals, arguably leading to greater innovation and product differentiation, although R&D, and its exploitation, may be held back where the structure of corporate finance does not include a venture capital market;
- the absence of an effective equity and takeover market may lead to difficulties in achieving an international production base, while the absence of takeover activity may prevent foreign firms from entering and expanding through domestic acquisitions.

In Italy, the wide diffusion of both business groups and small family-run companies, often benefiting from the synergies of industrial districts, appears to have an important bearing on corporate finances, the size distribution of firms, and the pattern of sectoral specialisation, as well as the ability to adapt quickly to changing market trends and technologies. The dominant group structure may also have constituted a framework in which flexible inter-firm and labour relationships could be established, providing smaller firms with an efficient long-run structure of incentives to suppliers, managers and workers alike. But, lacking adequate banking support as well as incentives to dilute ownership, small- and medium-sized firms may also find it difficult and even undesirable to grow, while participation in industrial districts may discourage internationalisation.[107] These issues are discussed below.

The cost of funds

The cost of raising funds, an important determinant of the user cost of capital, varies widely across OECD countries, reflecting the cost of equity issues and borrowing as well as leverage ratios (Diagram 27).[108] While both these costs and the leverage ratios are affected by macroeconomic developments and tax regimes, they also reflect different relationships between banks and industry. Close links between banks and firms may reduce lending risks and abate distress costs since, when a corporate borrower faces difficulty, the leading bank can act as insurer for all firms belonging to the same business group, spreading out the adjustment costs.[109] Because proprietary information (especially with respect to

Diagram 27. **REAL AFTER-TAX COST OF FUNDS**



Source: McCauley and Zimmer (1992) and Confindustria.

competitively-sensitive longer-term strategic investments) is more readily made available to banks, institution-based systems may also place less emphasis on short-term performance, although the issue is controversial.

The cost of funds in Italy has increased over the last fifteen years, showing a strong volatility. Starting from the lowest level among the major OECD countries, the cost of funds reached an intermediate level in the early 1990s, and almost doubled in a year in the wake of the 1992 devaluation. The level and dynamics of the cost of funds have been heavily influenced by macroeconomic factors. The cost was held down in the 1978-1982 period by high and unexpected inflation and high household saving rates, but grew rapidly thereafter in response to rising nominal interest rates. Moreover in the first part of the period, the wide diffusion of subsidised bank loans and little recourse to indexed debt, held back the cost of borrowing.[110] A number of structural features, only partly related to corporate governance, may have contributed to moderate the increase in the cost of funds:

- in the first part of the period, extensive government intervention (see Annex II), lowered and dispersed the costs of corporate distress, reducing risk premia on bank loans;
- since the mid-1980s, the liberalisation of capital markets and the development of the stock market widened financing opportunities.

Overall, the evidence is ambiguous, but it appears unlikely that Italy has enjoyed an advantage with respect to the overall cost of capital to offset the potential distortions caused by the relatively small equity market and by the weak monitoring exercised by banks.

Relations between firms

Different organisational structures provide enterprises with alternative ways of co-ordinating the complex set of contracts governing the production of goods and services, having an important impact on transactions costs. In Japan, for example, the group structure and the existence of trust-based, long-term relationships allow suppliers to be organised in multiple-tier structures with contracts deliberately left vague but also more flexible. The number of final suppliers is correspondingly lower, suppliers of parts to each major assembler being grouped in relatively stable formal associations, and the assembler holding substantial shares in many of its suppliers.[111] The key motives to carrying on such transactions are usually quality and reliability. Those between manufacturers and component suppliers, especially, can produce efficiency gains from information-sharing and just-in-time inventory control, compared with purchases made on the open market, based on a vertically separate organisation. In some activities, especially where model changes are frequent, there can be a significant amount of contestability in such relations; but in others, where significant amounts of specific investment are involved, they may be less contestable, calling for close monitoring by the competition authorities to ensure competitive fairness.

Evidence about the impact of Italian organisational structures on transactions costs and the contestability of the component-supplier market is sparse. However, as in other EC countries, the Italian car industry (*i.e.*, the Fiat group) is moving towards a system sharing some of the features of Japanese industrial organisation (Table 32). The percentage of components produced in-house is relatively low, although higher at the group level, and the number of suppliers is limited, with a multiple-tier structure that allows those at the top to be tied to the assembler by long-term relationships based on mutual trust.[112] This move towards

Table 32. **Supplier-assembler relationships in the automobile industry**

	Italy	United States			Japan
	Fiat	GM	Ford	Chrysler	
In-house supplying ratio (per cent)[1]	35	70	50	–	30
plus					
Intragroup	18	–	–	–	60[2]
Tiering of suppliers	Yes		No		Yes
Number of suppliers	550[3, 5]	2 000[4]		750[4]	220[4, 5]
Type of supplier-assembler contract	Long-term extended relations		1 year spot-type		Long-term extended relations

1. Value of parts supplied in-house as a share of total production costs.
2. Nissan (1982).
3. 1993.
4. 1988-1990 average.
5. First-tier suppliers.

Source: OECD (1992), *Long term relationships between automobile assemblers and component suppliers*, ECO/CPE/WP1(92)7/ANN10; Asanuma, A. (1989), "Manufacturer-Supplier Relationships in Japan and the Concept of Relation-Specific Skills", *Journal of the Japanese and International Economies*, Vol. 3, No. 1; and Volpato, G. (1994), "Il settore automobilistico", *L'Industria*, Vol. 15, No. 1.

a more flexible production strategy may have been facilitated by group organisation based on mutual trust relationships.[113]

Labour relations

Corporate governance also has implications for employment tenure, career paths and the structure of compensation. These, in turn, affect the accumulation of human capital and the level and type of labour market flexibility. Institution-based systems, such as Japan and Germany, protect managers from the short-term pressures of the stock market and allow them to nurture long-term trust relationships with workers. An internal labour market for both management and employees tends to emerge, based on quasi-lifetime employment, internal and firm-specific career developments, a salary schedule strongly rewarding loyalty and a narrow compensation range (Table 33).[114] As in Japan and Germany, in Italy average employment tenure is relatively long; earnings dispersion, and executive compensation, are low, while the wage profile is seniority-based. Moreover, the structure of management compensation relies only to a small degree on long-term incentives, such as stock options (Diagram 28).[115]

The characteristics of the Italian labour market owe more to employment legislation than corporate governance. Although small firms show a high mobility of labour, a long average duration of employment and a relatively flat earnings distribution may partly reflect the wide diffusion of family-run businesses, based on trust relationships and employee loyalty, while steep wage profiles confirm the reward given to seniority and suggest the prevalence of internal career developments in medium- and large-sized firms.[116] The relatively low ratio of executive compensation to production wages may be explained by the reduced risk of hostile takeovers. Given the absence of an active take-over market, stock-options and other forms of long-term compensations are not needed to tie managers to the firm. Incentives to quit are low and spins-offs, resulting in diversification of the group, are encouraged, with managers often associated, as ordinary shareholders, in the control of the firm.[117] At the same time, in sectors where Italy enjoys comparative advantage, the fragmentation of the workforce into small productive units operating within a same group may have lessened unions' bargaining power, making it easier to align the behaviour of the workforce with the interests of the firm.

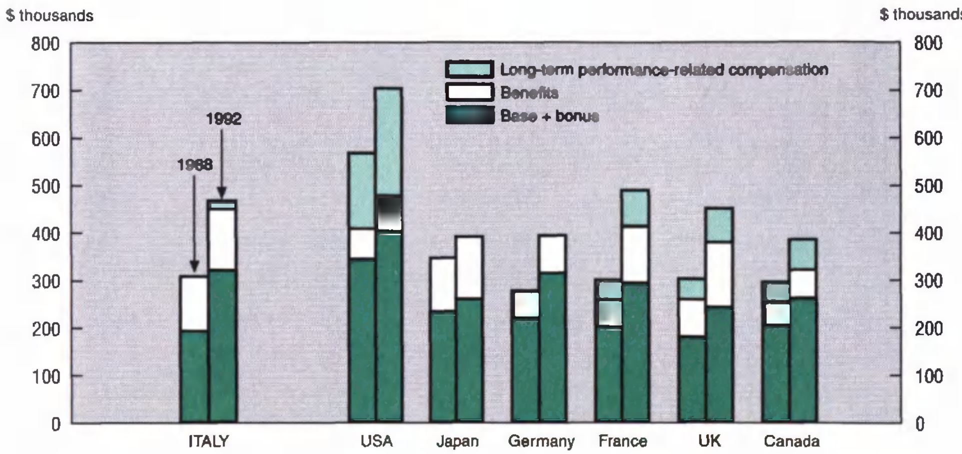
Table 33. **Human resources management**

	Italy	United States	Japan	Germany	France	United Kingdom	Canada
Average working hours	1 764[1]	1 769[2]	2 023[3]	1 557[4]	1 666	..	1 709[2]
Average duration of employment (years)	14.0	6.7	10.9	10.4	10.1	7.9	7.8
Wage profile (production workers)[5]	1.09	0.95	1.26	0.95	–	–	–
Wage profile (office workers)[5]	1.42	1.03	1.50	1.00	–	–	–
Earnings dispersion[6]	1.56[7]	2.14[8]	1.73[3]	–	–	1.99[9]	–
Ratio of CEO compensation over manufacturing worker's compensation[3]	14.20	25.02	13.01	9.95	16.94	16.43	12.45

1. 1983.
2. 1992.
3. 1990.
4. Dependent employment only, 1991.
5. Ratio of wage for employees aged 50-54 years to wage of employees aged 30-34.
6. Ratio of ninth over fifth decile.
7. 1987.
8. 1989.
9. 1991.

Source: OECD; Abowd, D. and M. Bognanno (1993), *International Difference in Executive and Managerial Compensation,* mimeo.

Diagram 28. **STRUCTURE OF MANAGEMENT COMPENSATION**
In 1990 US dollars



Source: Abowd, D. and M. Bognanno (1993), International Difference in Executive and Managerial Compensation, mimeo.

Innovation

By affecting the amount and the composition of external finance, as well as average firm size, corporate governance system may influence the ability of firms to invest in fixed and intangible assets, including research and development. Italy devotes a smaller amount of resources to innovation than its major trading partners. Although R&D spending grew rapidly in the 1980s, R&D intensity, measured by the ratio of business enterprise R&D and production, is the lowest among G7 countries, with the share of R&D spending financed by industry being particularly low (Table 34). Patenting abroad by Italian firms is also low, contributing to the largest deficit in the technology balance of payments among G7 countries.[118] Since Italian industry is characterised by a large number of small- and medium-sized firms and a correspondingly large role of traditional sectors – where the propensity to file patents is typically low – the use of R&D and patent data may underestimate the size of innovative activities.[119] However, Italy's disadvantage in R&D spending is particularly worrying precisely in those

Table 34. **Basic indicators of innovation activity**[1]

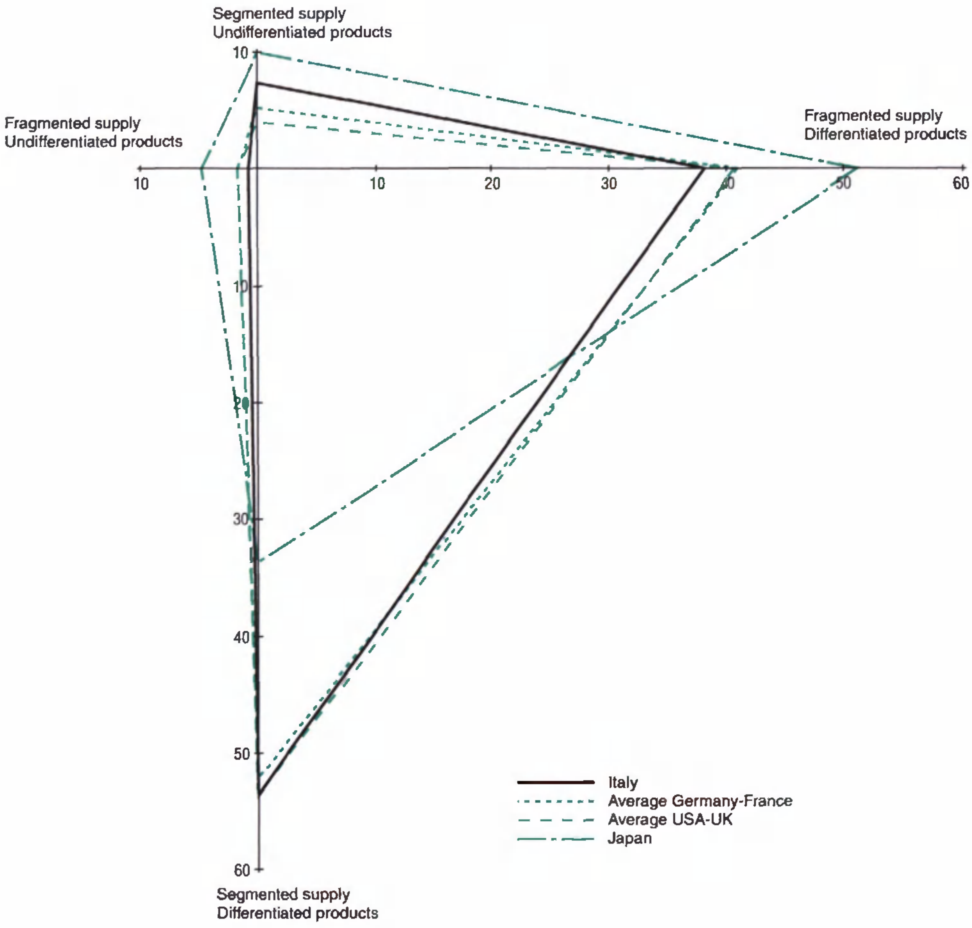
Per cent

	Italy	United States	Japan	Germany	France	United Kingdom	Canada
Gross domestic R&D spending % of GDP	1.38	2.68	2.99	2.53	2.36	2.12	1.51
Share in total OECD industrial R&D spending	3.0	45.1	20.5	9.8	6.2	5.8	1.7
Share in total OECD business R&D personnel	2.1	50.5	21.8	7.9	3.8	5.9	2.0
Share of R&D spending financed by industry	44	51	78	62	44	50	41
R&D intensity (total manufacturing)[2]	0.9	3.4	2.3	2.4	2.2	2.0	1.0
Technology balance of payments (coverage ratio)[3]	0.58	5.26	0.91	0.87	0.76	0.96	0.93
Number of patents filed in the United States	2 313	115 557[4]	35 771	13 747	5 673	6 946	3 683

1. 1992
2. Business-enterprise R&D spending/sales.
3. Receipts/payments.
4. Total number of patents filled in the other major industrialised countries.

Source: OECD (1993), *Industrial Policy in OECD Countries*, and OECD (1993), *Basic Science and Technology Indicators*.

Diagram 29. **R&D STRUCTURE IN SELECTED OECD COUNTRIES**
As a percentage of total R&D expenditure



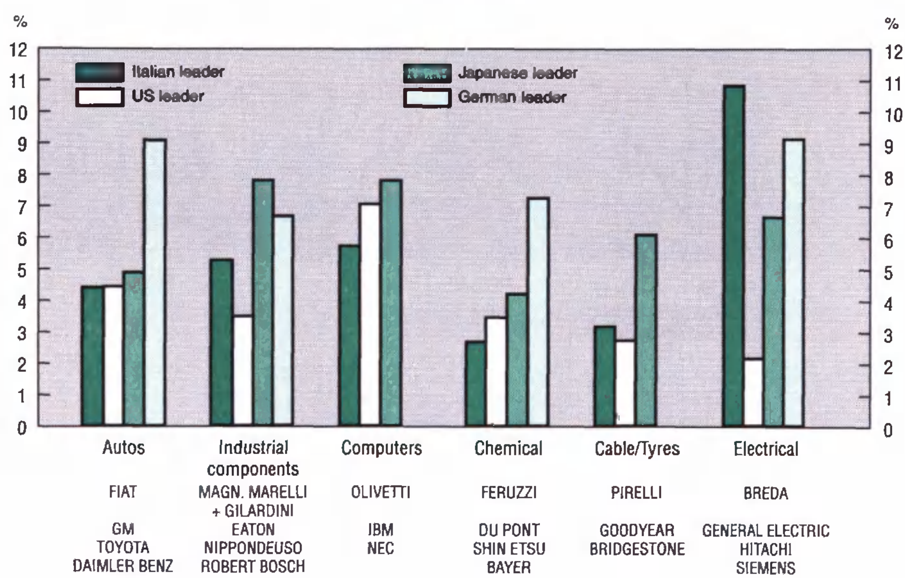
Note: Fragmented supply: number of firms grows with sectoral output (*e.g.* textiles, computers).
Segmented supply: number of firms independent from sectoral output (*e.g.* steel, aircraft).
Source: OECD.

sectors in which it is a world market leader, such as industries producing traditional goods (*e.g.* clothing, ceramics, lenses and frames) (Diagram 29). Using a wider definition of innovation activities, which includes R&D, design and engineering, production and investment (the acquisition of embodied technology), and marketing, Italy remains at a relative disadvantage, though smaller than according to the standard OECD definition.[120]

State-owned enterprises contributed more than private firms to R&D growth in the last decade, with public support for R&D in business enterprises significantly increasing.[121] Innovation activity is particularly low in the private sector, where it is concentrated in a small core of oligopolistic firms, often spending less on R&D than their foreign competitors (Diagram 30).[122] The lack of institutions specialised in the financing of venture capital may have affected the ability of small- and medium-sized firms to start up new lines of business, despite the

Diagram 30. **R&D SPENDING BY INDUSTRY LEADERS OF SELECTED OECD COUNTRIES, 1993-1994**

Per cent of sales



Source: Business Week, June 27 1994.

potential technological and human capital spillovers existing in industrial districts.[123] Greater access to venture capital is needed to support the creation and growth of innovating units in technological districts, but the development of such funds hinges on the overall expansion of the capital market.[124]

Internationalisation

The extent to which the Italian corporate sector has become internationalised bears a direct relation to firm size. A small core of large economic groups has targeted foreign markets, establishing overseas manufacturing units, from the 1920s onwards. Thus, the degree of internationalisation of firms such as FIAT, Olivetti or Pirelli is comparable to that of their major international competitors (Annex Table A1). Similarly, ENI, the state-owned energy concern, has always been massively present abroad through its subsidiary Agip. As a result, foreign direct investment (FDI) by the six largest economic groups accounts for 70 per cent of total foreign employment by Italian multinationals. At the same time, the families who control Italian private groups have established long-term and stable strategic ties with foreign partners, often in the form of interlocking shareholdings.[125] At the other end of the spectrum, a growing number of medium-sized groups have vigorously increased their presence abroad in the 1980s, contributing to the substantial growth of outward foreign direct investment (18 per cent per year over the 1982-1992 period) (Table 35).[126] The balance of inward and outward foreign direct investment flows has been positive in most of these years and in 1992, for the first time, employment abroad by Italian firms equalled that of foreign firms in Italy.[127] Mutually reinforcing influences have been the creation of the European Single Market and the opening of Eastern European markets, the need to fine-tune supply with local tastes, the rise of a managerial culture even in medium-size groups, and the increasing cost of local inputs – labour in particular.

Despite these positive developments, competitive medium-sized firms – in specialised sectors such as machine tools and household appliances and in traditional ones such as clothing and textiles – display a lower presence abroad than large business groups operating in scale-intensive sectors (as measured by employment in foreign subsidiaries as a share of total sectoral employment) (Annex Diagram A1). This may have resulted from a shortage of funds due to an undersized stock market, as well as from a lack of support and advice by

Table 35. **Foreign direct investment flows in major OECD countries**

US$ million

		Average 1981-1990	Per cent GDP	1991	Per cent GDP	1992	Per cent GDP
Italy	Inflow	2 489	0.4	2 481	0.2	3 161	0.3
	Outflow	2 871	0.4	7 326	0.6	5 956	0.5
United States[1]	Inflow	36 831	0.8	25 446	0.5	3 388	0.1
	Outflow	17 163	0.4	32 098	0.6	37 122	0.6
Japan	Inflow	328	0.0	1 368	0.0	2 728	0.1
	Outflow	18 583	0.8	30 726	0.9	17 222	0.5
Germany	Inflow	1 783	0.2	3 723	0.2	3 869	0.2
	Outflow	8 651	0.9	22 334	1.4	17 987	1.0
France	Inflow	4 319	0.5	11 073	0.9	15 928	1.2
	Outflow	8 581	1.0	20 529	1.7	18 816	1.4
United Kingdom	Inflow	13 048	1.8	15 933	1.6	18 156	1.7
	Outflow	18 603	2.8	15 597	1.5	16 543	1.6
Canada[1]	Inflow	1 145	0.2	6 544	1.1	4 963	0.9
	Outflow	3 957	1.0	5 409	0.9	3 723	0.7

1. Including reinvested earnings.
Source: OECD.

financial institutions in targeting foreign markets. At the same time, the lack of a takeover market may also have held back direct investment from abroad.

Policies affecting corporate governance

Reforming the stock market and widening the access to equity

The Milan stock exchange was severely affected by foreign competition in the early 1990s, with an increasing share of trading in Italian "blue chips" shifting to London.[128] Reforms introduced in 1992 were intended to provide capital markets with the instruments to improve both their technical efficiency and their transparency. A new type of multi-functional investment firm (*società di intermediazione mobiliare*, or SIM) became operational, the settlement system being modernised in successive steps and the move to cash settlement being expected by 1995. By April 1994, trading was also made fully on-screen, while equity derivatives will be introduced soon.[129] As a result of such reforms, the share of Italian equities traded in Milan recovered from 64 per cent in 1991 to 72 per cent in 1993. Insider trading was also made legally punishable and a special law concerning take-over bids (*offerte pubbliche d'acquisto*, or OPAs) was issued in 1992 (see Annex). The OPA law was intended to provide equal treatment to all shareholders, making bids compulsory in order to allow small investors to reap the benefits of the control premium paid to majority shareholders. Most of the eighteen such bids launched so far have been "successive", made by investors that had already bought privately a controlling stake in a listed firm.[130] Only in two cases has a quoted firm been bought through a public take-over bid, with one of them being an intra-group acquisition.

While technical improvements have largely aligned the Italian stock market to international standards, two major problems remain in the domain of transparency. The OPA law clearly states that bids are mandatory when a group of investors act together – through a formalised voting trust – to gain control of a firm, but it leaves it to the stock exchange commission to decide what to do when several investors act with the same purpose without formalising their agreement.[131] The recent French experience, which equates the *action de concert* to a formal voting trust, could constitute a working model for Italian authorities, making it more difficult to circumvent OPA obligations. This provision has been included in the May decree law, but concerns only privatised enterprises (see below).[132] A second problem arises when a subsidiary is bought through the purchase of a controlling holding company and both firms are listed, a frequent case given the large diffusion of pyramidal groups. Since a take-over bid on the subsidiary is not mandatory, minority shareholders are deprived of the control premium which the raider pays to the controlling shareholder in the top holding.

Initiatives have been undertaken in both the regulatory and tax domains in order to enhance corporate finance opportunities and increase the number of listed firms. In an attempt to reduce the share of short-term bank credit to firms, the Ciampi government removed fiscal and regulatory constraints on fund-raising by firms. In the context of the new banking law (see below), new financial instruments were allowed, such as commercial paper (*cambiale finanziaria*) and longer-term investment certificates (*certificati d'investimento*), for both listed firms and unlisted firms which have shown sufficient profitability and enjoy bank guarantees.[133] Despite these measures, securitisation of small- and medium-sized firms has been thwarted by the absence of rating agencies and secondary markets for these securities. In order to encourage small- and medium-sized firms to list, the new government granted a three-year reduction in corporate tax rates in June 1994 (from 36 per cent to 20 per cent) for companies entering the stock market before the end of 1996. Regulations concerning a new nationwide network of local markets for small companies with trading conducted on a screen circuit similar to the US NASDAQ, have been issued recently by the stock exchange commission. Finally, equity demand has been encouraged by modifying the fiscal regime of dividends paid out by listed firms, while it is proposed to lower the tax rate on bonds issued by non-listed companies to 12.5 per cent.[134]

The changing role of banks

The Italian banking industry is marked by a considerable degree of fragmentation and by the extensive role played by public institutions. The 1990 Amato law, which allows public-law credit institutions to be transformed into joint-stock companies and to float up to 49 per cent of the capital of their banking operations, aims at rationalising the banking system, improving capitalisation ratios and reinforcing banks' bargaining power with non-financial enterprises. However, the considerable number of mergers and acquisitions concluded since 1990 have concerned mostly small, local banks, the main exceptions being the merger of three medium-sized banks into Banca di Roma and the acquisition of the largest special credit institution (Crediop) by Istituto Bancario San Paolo.[135]

The new banking law, which entered into effect in 1994, has substantially relaxed constraints on shareholding by banks in non-financial firms and eliminated the requirement for matching the maturity of financial resources and uses.[136] By allowing banks to engage directly in activities such as leasing, factoring and merchant banking, the new legislation has moved Italy towards a model of universal banking. The law is too recent for any concrete effect on bank behaviour to have become visible. Potentially, the new investment possibilities opened to banks, which concern up to L 240 trillion (around 40 per cent of their financial investment in 1993), may substantially affect their investment behaviour. So far, banks have used the new provisions in the case of debt-restructuring.[137] Prospectively, the extensive use of short-term credit to finance long-term investment by firms may give way to a closer match between the maturity of bank credit and investment by firms. At the same time, acquisition of shares by banks may lead to a deeper monitoring involvement in, and influence over, business strategies. Whether or not this is the case, however, for banks to play a larger role in corporate governance, investment in human capital is necessary in order to acquire the skills needed to perform ongoing monitoring of non-financial firms.

Privatisations

The rationales behind the policies of privatisation followed in recent years were reviewed in *OECD Economic Survey of Italy 1994*. While Italy is a latecomer in this area, more than L 15 trillion (over 1 per cent of 1993 GDP) have been raised through privatisations since 1992 (Table 36), while the value of

Table 36. **Privatisations in Italy, 1992-1994**

Company	Main activity	Date	Gross proceeds (lira billion)
IRI			
Cementir	Cement	1992	480
Pavesi	Food	1992/93	256
Italgel	Food	1993	387
Tubi Ghisa	Steel	1993	121
Credito Italiano	Banking	1993	1 750
Cirio-Bertolli-De Rica	Food	1993	310
Acciaierie Terni	Steel	1994	600
Banca Commerciale Italiana	Banking	1994	3 000
ENI			
Agip Argentina	Gas	1993	113
Nuovo Pignone	Mechanics	1993	1 077
Mineral assets	Mineral	1994	356
Liquipibigas	Gas	1994	158
A.M.PL.	Chemicals	1994	136
Agipcoal USA	Coal	1994	239
Others	–	1993/94	648
EFIM			
SIV	Glass	1993	210
IMI	Banking	1994	2 384
INA	Insurance	1994	4 800
Total			17 025
Memorandum item:			
1993 GDP			1 560 100

Source: OECD.

planned Italian privatisations ranks second in the OECD area. A lengthy and politically-charged debate has arisen over the choice of sale procedures, with the government ultimately opting for a case-by-case approach. A number of non-financial enterprises were sold through private placements, while three major banks and INA, the second-largest insurance company, were sold through public offers (Table 37). Largely oversubscribed, these sell-offs benefited from falling interest rates, redirecting savings from bonds into shares.[138] The government imposed ceilings on single shareholdings in order to spread out ownership rights among small investors. In the case of Credito Italiano and Banca Commerciale, however, a core of big investors with strong Mediobanca links emerged as controlling shareholders (see Diagram 26 above), appointing all directors. As noted, a new law, approved in July 1994, aims at providing better safeguards for shareholders through greater transparency and a more effective representation on governing bodies. The law requires notification of all agreements among shareholders in listed firms – including both voting and consultation trusts. It also imposes new rules, applied for the first time in the sell-off of INA, giving small shareholders a voice on the board through a proportional representation voting system for electing directors (*voto di lista*), and limits the ability of a few large investors acting in concert to exercise control by forcing them to launch a partial take-over bid (for the same number of shares that they already hold).

Following this rapid sequence of sales, the privatisation process is now concentrating on the procedures for selling public utilities and ailing manufacturing enterprises. As concerns the electricity and telecommunication companies

Table 37. **The three banking privatisations**

	Percentage sold	Percentage still state-owned	Date	Gross proceeds (lira billion)	Discounts (%)		Times subscribed
					(a)[1]	(b)[2]	
Credito Italiano	52.5	3.3	Dec. 93	1 750	14.2	11.4	7
IMI	36.3	27.4	Jan. 94	2 384	21.1	n.a.	10
Banca Commerciale Italiana	54.3	28.0	Feb. 94	3 000	10.6	11.5	9

1. End of first day.
2. Average first month.
Source: OECD.

Table 38. **Timetable of planned privatisations**

Company	Main activity	Date
SME	Catering and distribution	End-1994
ILVA Laminati Piani	Steel	End-1994
IMI[2]	Banking	End-1994 to beginning 1995
INA[2]	Insurance	Spring 1995
ENEL[1]	Electricity	First half of 1995
STET[1]	Telecommunications	First half of 1995

1. First tranche.
2. Second tranche.
Source: OECD.

(ENEL and IRI-owned Stet, respectively), it is still unclear whether the government will choose to create a hard core of stable shareholders, but, in any case, according to the June 1994 privatisation law, the government will maintain special voting rights in both utilities through the use of a "golden share".[139] Privatisation of utilities has been delayed by the lack of a clear regulatory framework, including the choice of the price-setting formula, the creation of authorities responsible for monitoring, and the eventual break-up of the electricity utility and liberalisation of production and distribution services.[140] For ailing enterprises, the government has adopted a pragmatic approach. In the case of the iron and steel concern (Ilva), which was split into several companies in the context of EC-wide restructuring, immediate sale was sought.[141] On the other hand, prior restructuring has been sought for the airline (Alitalia). A new timetable for privatisations, including major public utilities, has been announced in September 1994 (Table 38).

Enhancing the role of institutional investors

The announced cuts in public pension benefits (see Part II), together with the need to expand the stock market, were instrumental in the adoption of legislation in 1993 setting up and regulating private pension funds.[142] As in other countries, such institutions might contribute to a more efficient allocation of resources, to financial innovation and to an increase in demand for assets with medium- and long-term maturities. International experience suggests that the transition from a public to private pension system can be stimulated by tax incentives. However, under a tight public finance constraints, the new law does not offer such funds benefits sufficient to offset the favourable treatment given to competing instruments such as life insurance policies. With the new regulatory agency still to become fully operative, and faced with an unfavourable tax treatment, private pension funds are unlikely to become large-scale investors before the end of the century. The recently-proposed removal of tax disincentives should stimulate the expansion of such funds.

The need for further steps

Governance in the Italian business sector has been plagued by a lack of transparency and a neglect of the rights of minority shareholders. While crises and scandals have involved only a handful of firms, the repercussions in terms of reputation have negatively affected all enterprises, making foreign institutions reluctant to invest on the Italian stock exchange.[143] To correct these deficiencies, legislation is required to extend proportional shareholders' representation in the boards of all listed firms, thereby making it possible for minorities to sit on corporate boards; to separate the tasks of external and internal auditors, the latter being best suited for management supervision by minority shareholders, and to enforce the fiduciary duties of directors, facilitating, in particular, liability actions in case of bankruptcy.[144] To improve the qualitative contribution of Italian financial institutions as well-informed, long-term investors, ownership of institutional investors by business groups and the financial-services industry need to be diluted, and proxy voting by institutional investors must be made easier and possibly extended to banks.

At the enterprise level, ensuring better information flows between boards and external auditors is also needed, as is the establishment of separate committees responsible for auditing and remuneration practices. In addition, limiting the number of directorships held by an individual would restrict multiple tenures, which are not conducive to tight monitoring.[145] Finally, the role of the stock exchange commission, Consob, needs to be redefined. Compared to surveillance institutions in other OECD countries, Consob has a relatively large formal role, often imposing a heavy burden on firms, but is virtually inactive on substantial issues.[146] As in more advanced financial markets – *e.g.* the United Kingdom and France – reforms should be envisaged which would transfer formal and technical duties to self-regulatory institutions, leaving Consob to defend transparency and strengthen monitoring in listed firms.

Transparency and stronger defence of minority shareholders also call for legislation on business groups, which Italian corporate law does not currently recognise as autonomous entities.[147] Conflicts of interest are particularly likely to arise because controlling shareholders care for the performance of the group as a whole, while small investors are concerned about that of single firms of the group, in which they hold shares. As seen above, the law gives insufficient protection to shareholders in subsidiary companies in the case of take-over bids and intra-group capital transactions: for instance, small investors can be adversely affected by transfers of funds within the group. To prevent this would require independent auditing for all reallocations within groups and tighter control on their pyramidal structure, in order to remove the listing of firms whose only assets are shareholdings in other listed firms (the so-called ''chinese boxes'' phenomenon). Transparency is also needed *vis-à-vis* the fiscal administration, calling for a reform of the taxation regime of business groups in such areas as VAT and corporate income taxation, the treatment of intra-group dividends and transfer pricing of internal transactions of goods, services and capital.

Finally, reforms are needed to smooth bankruptcy procedures. Italian laws have put more emphasis on protecting shareholders, managers and employees rather than creditors, and courts have resorted more frequently to reorganisation rather than to liquidation processes (see Annex II). By preventing changes in ownership in ailing firms, this policy has hindered the market for corporate control and may have led to the demise of firms which could have been possibly rehabilitated under different owners. Reforms should make the choice among bankruptcy procedures more clearly dependent upon technical features such as the causes of business crises (internal or external to the firm), the degree of their reversibility and the submission to courts of detailed rehabilitation plans.[148] Given the slowness of formal court processes, a more frequent recourse to private arrangements among creditors, often involving banks, should also be encouraged.

IV. Conclusions

With net exports spurred by the steep fall in the lira, and rising business and consumer confidence arresting the decline in domestic demand, output growth resumed in the closing months of 1993, bringing the worst recession since 1975 to an end. Most conjunctural indicators point to a healthy recovery of economic activity taking root. Stronger domestic demand and continued export buoyancy may translate into an output gain of more than 2 per cent in 1994, rising to 3 per cent in 1995.

While the economic expansion has brought some relief to the labour market as employment losses have slowed, unemployment reached 11 per cent in July 1994, 1½ point above pre-recession levels. Conversely the 12-month rate of consumer price inflation fell to 3.6 per cent in July, a 25-year low and 1½ point below the pre-devaluation level of August 1992. Slack labour demand and new rules governing wage settlements (particularly the abolition of wage indexation in 1992 and the establishment of a two-tier wage bargaining system in 1993) have been instrumental in keeping nominal wage growth below the rate of consumer-price inflation. At the same time, an unprecedented labour market shake-out, affecting virtually all sectors of the economy, has boosted labour productivity, making for a negligible rise in unit labour costs. As a result, the nominal effective exchange rate depreciation of 25 per cent compared with two years ago has translated into a substantial and sustained real depreciation. In response, the trade balance has displayed a surprisingly rapid and strong reaction, assisted by the ability of Italian producers to redirect sales from domestic to foreign markets, especially dynamic ones, at a time when domestic demand was weak. Over the two years to mid-1994, this switch of resources has been sufficiently strong to recoup losses in market shares accumulated over the previous five-year period. The current account swung into surplus in early 1993, reaching an estimated annual rate of 1.2 per cent of GDP for the first half of 1994.

Despite the improvement in the external account, speculative swings in capital movements have been substantial enough to induce marked fluctuations in the exchange rate, which have hampered the implementation and reduced the effectiveness of monetary policy. Until the end of 1993, differentials with Germany declined markedly, as the central bank was able gradually to ease monetary policy while moving towards its objective of inflation convergence. However, market optimism, having strengthened following the general elections in March 1994, waned from June onwards, giving way to a confidence crisis in August, which pushed the lira down to a new historical low. The potential implications for inflation caused the Bank of Italy to raise the discount rate to 7.5 per cent. While market interest rates have subsequently eased, short- and long-term interest rate differentials *vis-à-vis* Germany have moved up, being 1 to 1 to 1½ point larger than in May when the new government took office.

The renewed financial market disturbances were not due to any weakening in the anti-inflationary stance of monetary policy. While the loss of a nominal anchor, in the form of ERM membership, might have been expected to make inflation expectations more volatile since September 1992, the central bank's task of reducing inflation has been supported by legislative moves to establish its independence and the removal of the Treasury's overdraft facility. The central bank's enhanced independence, along with the positive climate generated by the deindexation of wages and a new wage bargaining system, allowed the re-establishment of financial market stability up to the spring of 1994. Problems have subsequently arisen from uncertainties attaching to the fiscal situation. These have destabilised long-run expectations about the exchange rate and inflation, forcing the central bank to suspend its policy of cautious easing. Current long-term interest differentials, in the context of a recent strengthening in activity, indicate that financial markets are still discounting the possibility of a pick-up in inflation, for which they are demanding a substantial risk premium. Against this background, the discount rate increase was a clear and useful interest-rate signal to the financial markets that the Bank was determined to use its newly established independence to maintain the momentum of disinflation in line with the Maastricht criteria.

The fiscal situation has become particularly disturbing to financial markets. The state borrowing requirement was reduced to L 154.5 trillion for 1993 or 9.9 per cent of GDP, the underlying structural deficit falling faster than in any other major economy. The primary balance moved into surplus, as most elements of public spending were brought under control. The exceptions are pensions, health and debt interest. For 1994 the fiscal situation is less satisfactory: while the initial budget aimed at continuing the consolidation process, and the budget reforms taken in 1992 and 1993 will have a continuing beneficial effect on primary spending, an overshoot is expected. This is substantially attributable to the fact that activity has been lower and interest rates higher than expected, but is also due to the less-than-full effectiveness of the public spending control and rationalisation measures provided for in the Finance Law for 1994 in reducing expenditure. The new three-year convergence programme presented in July is consistent with medium-term convergence objectives, targeting a reduction in the State budget deficit to L 138.6 trillion in 1995 (excluding receipts from privatisation) or 8 per cent of GDP. This target implies a fiscal adjustment of at least L 50 trillion or 3 per cent of GDP, focusing on cuts in discretionary spending, notably health care and pension benefits.

In line with the new convergence programme, the 1995 budget proposals envisage a cut in the State budget deficit to L 138.6 trillion, entailing a primary surplus of L 37.7 trillion or 2 per cent of GDP. Reductions in primary spending relative to baseline constitute L 27 trillion of the L 50 trillion adjustment. Concentrated in the area of pensions and health care, the proposed expenditure cuts are predominantly of a structural nature. The tax proposals (amounting to L 21 trillion) also contain elements of a permanent nature. But receipts for 1995 depend mainly on the one-off effects of some of the measures proposed, which are intrinsically subject to greater uncertainty. These measures should be treated as interim steps towards more lasting, structural reform, aimed at increasing the efficiency and fairness of the tax system. Such reform, which is already under consideration, should fulfil the joint objective of making tax gains more permanent and the tax structure more broadly based, and hence more equitable.

The widening risk premium on domestic interest rates has demonstrated the vulnerability of an economy burdened with a debt ratio of 124 per cent of GDP and annual public interest payments equivalent to 12 per cent of GDP. Significant steps have been made in recent years to increase the maturity structure of Italian public debt so as to reduce the short-term vulnerability. But given the short-term sensitivity of debt-interest payments to changes in interest rates, the deficit remains particularly susceptible to market perceptions about its sustainability.

The past five years have shown on numerous occasions that there is a strong link between credible fiscal action and declining Italian interest rate differentials, the last example having been the 1993 budget. As noted in the July medium-term planning document, further substantial cuts in spending are required if the objective of stabilising the debt/GDP ratio by 1996 is to be achieved. In the meantime, OECD projections embody an overshoot of the deficit targets, ruling out a resumption of interest convergence. In this case, and insofar as the principal risk attaching to the projections is that renewed fiscal slippage could lead to a further upward twist in the interest-rate/debt spiral, it is imperative that the 1995 budget proposals and subsequent planned cuts be implemented as fully as possible.

The budgetary situation is all the more disturbing because, despite the reform initiated by the Amato government, Italy's pension position has remained non-viable, contributions covering only one half of potential obligations. In 1994, the deficit of the public pension fund (INPS) increased to an estimated L 72 trillion in 1994 or 4 per cent of GDP, reflecting revenue shortfalls from weak economic growth and higher payments for early retirement schemes, a consequence of severe labour shedding. Faced with the danger of spiralling pension payments, the government has put forward proposals to tighten pension provisions for future retirement benefit recipients. This is to take the form of a more rapid rise in the pensionable age than had been planned by the Amato government, the introduction of stronger disincentives for early retirement and a tighter monitoring of claims. For the short term, such measures would stabilise the pension system. For the medium-to-long term, further measures are envisaged and should be introduced as soon as possible. These should include the abolition of the 15 per cent tax on private pension contributions.

The rate of unemployment may be slow to fall to 11 per cent, as previously discouraged workers re-enter the labour force, calling for further progress in the domain of structural and institutional reform. As underlined in last year's *Survey*, removing the wage indexation system and establishing a new wage bargaining structure have been milestones in improving the functioning of the labour market. Persisting high unemployment, however, calls for additional measures, aimed at making regional, sectoral and firm-specific wage differentials more responsive to market forces. The draft legislation of June 1994, proposing to relax restrictions in temporary employment, to extend part-time work and to ease barriers to employment, represents a step in the right direction.

Structural reforms have also been introduced in other areas, notably in the financial sector, where the 1993 Banking law removed some of the operational and maturity restrictions on credit institutions, moving Italy in the direction of universal banking, and reduced minimum reserve requirements for banks and other financial institutions, helping to alleviate the comparative cost disadvantage of Italian banks. These reforms have been introduced against the background of large-scale privatisations which have served to stimulate an array of important measures in the sphere of capital-market liberalisation, especially the institutional framework in which shares are traded. Amid growing concerns about corruption, questions have been raised about the need to overhaul the whole apparatus of financial regulation and supervision in Italy, especially that governing the creation and transfer of ownership rights and the monitoring of corporate managers.

The Italian corporate sector has shown considerable dynamism over the last few decades, as exemplified by its swiftness in responding to the new opportunities provided by the 1992 lira's devaluation, so that the governance structure has not necessarily detracted from overall economic performance. However, there are three main points of concern:

i) small and medium-sized companies, which are the backbone of the Italian economy, have had little recourse and inadequate access to equity and longer-term finance, potentially impeding their capacity to expand;

ii) lack of effective monitoring of large firms by corporate boards and institutional lenders, or by a well-functioning market for corporate control, may make it difficult to assess whether assets are being appropriately valued or resources efficiently used;

iii) inadequate disclosure requirements and insufficient safeguards for minority shareholders may have slowed down the development of the securities market and prevented the emergence of a consistent code of corporate ethics.

Small and medium-sized enterprises, often located in "industrial districts", have consolidated Italy's comparative advantage in the traditional goods sector over the last few decades. However, confronted with intensified international competition, it is not clear that the corporate finance and governance structure provides adequate scope for such firms to expand their production base. In many of these small- and medium-sized firms the owners (generally the founder or his descendants) have shied away from stock market listing, due both to the inefficiency of the stock market , especially with regard to the pricing of new offers, and to difficulties in preventing conflicts of interest between controlling and other shareholders. At the same time, for the vast majority of firms, debt financing has mostly taken the form of short-term borrowing from several banks. Venture capital has remained scarce, while fiscal and regulatory disincentives, as well as competition from public issuers, have stifled the development of a corporate bond market. Better access to long-term finance could widen investment opportunities, possibly raising spending on research and development, which is rather low by international standards, as well as increasing investment abroad.

The vast network of small and medium-sized enterprises coexists with a narrow set of large corporations organised in hierarchical groups, making for an unusually dualistic industrial structure. Such groups have extensively tapped into the equity market, listing a large number of subsidiaries – which account for the bulk of capitalisation – while intra-group equity linkages and both implicit and explicit agreements among controlling shareholders have resulted in maximum control with a minimum of own capital. Both in small and large Italian companies there is a shareholder, or coalition of shareholders, often composed of members of a single family, that exercises a majority control on the firm. In this way, firms have been shielded from hostile take-overs. Unlike some other countries where the market for corporate control is undeveloped, no satisfactory supervisory mechanisms have operated in Italy to ensure the continuous external monitoring of non-financial corporations. The internal monitoring system of state-owned enterprises established after the banking crisis in the 1930s has become largely ineffective. Until 1993, bank shareholdings in non-financial firms were negligible, reflecting severe restrictions dating back to the 1936 banking law, as well as the asset preferences of the banks themselves. The business of extending long-term credit was confined to specialised institutions and merchant banking activities were lacking. Moreover, a pro-debtor bias in the bankruptcy law, along with the pro-employment bias of state intervention in the event of corporate failures, may, in principle, have impeded the process of reallocating capital and human resources to their best use.

Inadequate disclosure requirements, the lack of institutions performing external monitoring and the malfunctioning of corporate bodies responsible for internal monitoring have all contributed to make equity-market transactions opaque. As a result, the system has failed to provide sufficient safeguards for the interests of minority shareholders, deterring investors from buying shares. Equity demand has also been held back by the absence of pension funds and the low propensity of life insurance companies to invest in shares, features which have been only partly offset by the growth of mutual funds. Given the dearth of listed firms, the opaqueness of transactions and the neglect for the rights of minority shareholders, the stock market has remained narrow and illiquid. These defects need to be addressed if shareholding is to become more dispersed and the privatisation process carried through effectively.

The policy response has been wide-ranging and eclectic, aimed at expanding both the equity market and institutional involvement in the supervision process. Reforms have included new stock market laws aiming at strengthening and more vigorously enforcing safeguards for market participants; fiscal and regulatory measures to widen corporate finance instruments and to encourage firms to list, and the introduction of new institutional investors such as pension funds and closed-end mutual funds. The new banking law offers the prospect of closer links between credit institutions and non-financial enterprises, while the wave of large-scale privatisations is increasing both the number of shareholders and stock market capitalisation. These reforms, however, still need to be fully implemented and backed up by further regulatory initiatives to enhance the transparency of business group activities, whose legal status should be properly defined, and to defend minority shareholders' rights, by ensuring their adequate representation on corporate boards and better monitoring of listed firms.. Greater transparency, in particular, would seem to require more effective auditing procedures, together with reforms to strengthen the role of the stock exchange commission in dealing with substantive issues. Some of its more formal and technical duties might be transferred to self-regulatory institutions. Finally, reforms are needed to the bankruptcy laws, aimed at smoothing administrative procedures and making the protection of creditors *vis-à-vis* shareholders, managers and employees more effective.

In sum, the last twelve months have seen a continuing improvement in many of Italy's macroeconomic fundamentals: output growth, inflation and the current account position have all performed better than had been expected a year ago. While this represents a satisfactory outcome for stabilisation policies, this improvement has been overshadowed by an unexpected overshoot in the budget deficit and a corresponding build up in public debt. The negative effects on financial market confidence have pushed down the exchange rate and forced up interest rates. Thus, to a larger extent than at any time since World War II, expectations about Italy's medium-term economic and political future will be shaped by the speed with which the government deals with the problem of high and spiralling public debt. Since delay carries a much larger cost now than before, there is little choice but to continue with the course adopted by the government, of pruning public spending, including unpopular cuts in social transfers. Prompt and decisive action to implement the new convergence programme, together with further progress in implementing structural reforms, are essential to secure a period of continuing growth and stability in the Italian economy.

Notes

1. ISTAT (1994), *Rapporto Annuale*, p. 41.

2. The Fund pays compensation to ''temporarily'' laid-off employees. ''Ordinary'' recourse applies only to firms in conditions of ''temporary'' difficulties. Payments by the Fund cover 80 per cent of weekly wages based on a 40-hour working week, subject to a monthly ceiling (L 1.5 million in 1994. The Fund applies to both blue and white-collar workers and involves payments at times of sectoral or local crises or during the process of restructuring of certain industries.

3. OECD (1994), *The OECD Jobs Study*, p. 11.

4. Methodological changes included an extension of the list of branches of economic activities, a more detailed questionnaire and a re-definition of ''job seekers'', counting as unemployed persons only those aged more than 15 who were available for work and took at least one initiative to find a job in the 30 days preceding the quarterly labour force survey.

5. Among the factors depressing labour demand in the south have been generous transfer payments to large segments of companies, high relative labour costs and restrictive employment rules. While absolute labour costs in the south are lower than in the north, the differential is smaller than that between levels of labour productivity. Padoa-Schioppa Kostoris F. (1994), ''Excess and limits of the public sector in the Italian economy. The ongoing reform'', *mimeo*, February.

6. Banca d'Italia (1994), *Relazione Annuale*, pp. 91-110.

7. Brunetta R. and L. Tronti (1993), ''The Italian crisis of the 1990s: European convergence and structural adjustment'', *Rivista di Politica Economica*, Vol. 83, No. 11.

8. The labour accord of July 1993, signed by the Government, trade unions and the employers' organisation, covers both the private and public sector. Concluded one year after the formal abolition of the wage-indexation scheme (*scala mobile*), the labour agreement established a new framework for industrial relations, providing for greater flexibility in wage bargaining. Under the new two-tier system of wage determination, national contracts are under negotiation in 1994 and 1995, with the timing of firm-level negotiations being set by national contract. See OECD (1994), *Economic Survey of Italy*, pp. 19-20.

9. Trade union militancy has weakened over time. In the 1983-93 period, working membership in the three main trade unions (CGIL, CISL and UIL) has fallen by 800 000 persons. During the same period, the number of pensioner members rose by 2.6 million.

10. The labour accord of July 1993 provides for diminishing step-wise increases in nominal wages if new contracts are not negotiated within certain time limits after the termination of old settlements. The wage adjustment is equal to 30 per cent of the projected rate of inflation for a three-month delay, rising to 50 per cent after six months.

11. In 1992-93, rates of return on capital declined with falling rates of capacity utilisation. Profit margins widened thanks to nominal wage moderation and counter-cyclical gains in productivity (see below).

12. Zuliani A. (1993), *Audizione sul Documento di programmazione economica e finanziaria relativo alla manovra di finanza pubblica per gli anni 1994-96*, ISTAT, pp. 7-10.

13. Banca d'Italia (1994), *Relazione Annuale*.

14. Given recent changes in the composition of the M2 aggregate, the Bank of Italy also monitors a Divisia index, in which the components are weighted by degree of liquidity. Looking ahead, bank lending may become more important as a short-term indicator, provided the pace of structural change of credit markets slows. Banca d'Italia (1994), *Abridged Report for the year 1993*, May, pp. 77-78.

15. In response to money market developments, the minimum bank lending rate also stopped falling in the first few months of 1994, while a sharp decline in private credit growth kept the average bank lending rate on a downward course until mid-1994. The average deposit rate also eased during this period, albeit less than the average bank lending rate, implying a reduced intermediation margin.

16. The premium on Italy's foreign currency issues compared with those of other sovereign borrowers also diminished up to mid-1994, thanks to the faster repayment of the withholding tax to non-residents; at 0.10 to 0.20 basis points in mid-1994, the interest rate spread was about half the differential observed in 1993.

17. OECD (1994), *Economic Survey of Italy*, pp. 33-35.

18. Banca d'Italia (1994), *Economic Bulletin*, No. 18, February, p. 37.

19. The Treasury deposit with the central bank serves to ensure flexibility in the management of payments and receipts, subject to a number of provisos. If the end-month balance on the Treasury payments account drops below L 30 trillion for three consecutive months or below L 15 trillion at the end of one month, the Treasury must explain to Parliament the reasons for such shortfalls, suggesting lines of corrective action.

20. Since the end of February 1994, in order to absorb or inject banks' reserves, the Bank of Italy has supported the traditional repurchase agreements with outright operations in Treasury bills on the secondary markets. These operations are conducted with the primary dealers of the screen-based market for Treasury securities (MTS) on the basis of multiple price auctions. In order to improve the market structure of the MTS, the Minister of the Treasury and the Bank of Italy have prepared a set of measures aimed at broadening foreign investors' access to the market; at redefining the obligations and functions of primary dealers and at widening the range of products and services offered by the circuit linking of the MTS and the Italian futures market (MIF). Banca d'Italia (1994), *Economic Bulletin*, No. 18, pp. 52-53.

21. From February 1993 to July 1994, marginal reserve requirements for other liabilities were subject to a ceiling of 17.5 per cent, the ratio varying with the type of bank deposits. OECD (1993), *Economic Survey of Italy*, p. 33.

22. Under Law 483/93, the rate of return on compulsory reserves cannot exceed the official discount rate, which stood at 7 per cent in July 1994.

23. Banca Commerciale Italiana (1994), *Economia e mercati finanziari*, June, pp. 8-9.

24. Gross effective reserve requirements are expected to fall by 0.7 point in the second half of 1994 and by nearly 2 points in 1995. See Credito Italiano (1994), *Osservatorio sui Mercati*, June.

25. Medium- and long-term loans will be limited to 20 per cent of the value of deposits, except for large banks.

26. Under the new definition, the state deficit excludes deficits of all autonomous companies, *aziende autonome*, the legal status of which was changed to that of a joint-stock company in 1992 and 1993. Including settlements of past debts, the State deficit totalled L 163 trillion in 1993.

27. OECD (1992), *Economic Survey of Italy*, p. 47.

28. According to official estimates, a one point shortfall of real GDP growth tends to raise State spending by L 5.5 trillion relative to baseline, while depressing State revenues by L 4.5 trillion. The induced rise in the budget deficit amounts to 0.6 per cent of GDP.

29. See OECD (1994), *Economic Survey of Italy*, p. 47 for details.

30. The primary surplus was moderately lower than the target set by the EC-loan agreement of January 1993 (L 31.5 trillion or 2 per cent of GDP).

31. For a discussion of Italy's health reform, see OECD (1992), *Economic Survey of Italy*, pp. 68-97.

32. Banca d'Italia (1994), *Economic Bulletin*, No. 18, February, p. 37.

33. The deficit is moderately lower than State borrowing requirement, due to capital receipts (*rimborsi di crediti d'imposta*), which are excluded from the State budget.

34. In contrast to previous practice, privatisation revenues were deliberately excluded from the 1994 budget figures. Over the four months to March 1994, privatisation proceeds from the sale of three state banks totalled L 7 trillion or 0.4 per cent of GDP.

35. The official list of "Recognised Suppliers" is to be abolished in 1997.

36. OECD (1994), *Economic Survey of Italy*, pp. 19-20.

37. A special autonomous body endowed with negotiation powers was set up in 1993 so as to ensure consistency between public pay rises and fiscal consolidation targets. In February 1993, public sector labour agreements were changed from administrative into civil law.

38. OECD (1994), *Economic Survey of Italy*, p. 46.

39. Under the EC loan agreement of January 1993, an unforeseen cyclical rise in the budget deficit requires no offsetting fiscal measures. The conditional loan is payable in four tranches of ECU 2 billion, of which the first two were disbursed in 1993. The deadline for

requesting the release of the third instalment expired by the end of June 1994, which means that Italy's budgetary programmes are no longer subject to periodic EC reviews.

40. Investment in plant and machinery in excess of the average level of the five past years will be exempt, until 1995, from direct tax payments.

41. OECD (1994), *Economic Survey of Italy*, p. 48.

42. Banca d'Italia (1994), "Considerazioni finali", *Assemblea generale ordinaria dei Partecipanti*, p. 18.

43. Under the 1992 pension reform, the compulsory retirement age will be gradually raised to 65 years for men and to 60 years for women, a rise by one year every second year beginning 1993. The reference period for calculating pension rights has been lengthened from five to ten years and the minimum number of years of contribution required to be entitled to pension payments raised from 15 to 20 years. For new employees, the whole working period will be used to calculate pension rights. See OECD (1994), *Economic Survey of Italy*, pp. 47-47.

44. Setting out amounts and types of regular debt instruments to be issued as well as providing details every three months on issue conditions, the calendar enhanced transparency of debt management, thereby lowering the effective interest rate on public debt.

45. Padoa-Schioppa Kostoris (1994), *op. cit.*

46. In 1992, the legal status of state monopolies for salt and tobacco (MS), telephone service (ASST) and railways (FS) was changed to that of a joint-stock company.

47. A constitutional court decision requires the government to make up the difference between reduced benefits and full pension entitlements, allegedly denied to 600 000 pensioners since 1983. Official estimates put the total cost at L 32.5 trillion or 2 per cent of GDP after capital revaluation and interest charges. Arrears should begin to be paid in 1995.

48. An important feature of corporate governance in Italy is the large share of financial and non-financial enterprises controlled by the State. A detailed description of ownership and control linkages in public enterprises is contained in OECD (1994), *Economic Survey of Italy.*

49. See Barca F., M. Bianco, L. Cannari, R. Cesari, G. Manitta, G. Salvo and F.L. Signorini (1994), *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane* [henceforth Banca d'Italia (1994*a*)]; Barca F., M. Bianchi, F. Brioschi, L. Buzzacchi, P. Casavola, F. Filippa and M. Pagnini (1994), *Struttura di gruppo, concentrazione della proprietà e modelli di controllo nelle imprese italiane medio-grandi* [henceforth Banca d'Italia (1994*b*)]; and Capra L., N. D'Amico, G. Ferri and N. Pasaresi (1994), *Le banche, il credito e la riallocazione proprietaria in Italia,* [henceforth Banca d'Italia (1994*c*)]. The three reports are being published by il Mulino.

50. In this chapter, firms are defined as autonomous legal entities producing goods and services in the non-financial sector. Unless stated otherwise, data concern firms with more than 50 employees. Small- and medium-sized firms are defined as those with 20 to 500 employees. Unless stated otherwise, the source of empirical evidence is Banca d'Italia (1994*a, b, c*). See Annex I for a more detailed account of the data sources and the estimation methodology used therein.

51. However, in more recent years public pension funds – such as CALPers in the United States and Postel in the United Kingdom – have been active in monitoring firms, inducing changes in the regulatory framework. A necessary condition for activist institutional investors to play a role in corporate governance is that they are independent from listed firms.

52. Banks' representatives are present in enterprises' board of directors, with banks' personnel sometimes seconded directly to debtor firms in cases of financial distress.

53. The network of informal linkages and explicit contracts between firms gives rise to a "contractual governance" system. See Kester, C. W. (1992), "Industrial groups as systems of contractual governance", *Oxford Review of Economic Policy*, Vol. 8, No. 3.

54. Business groups can be either associative or hierarchical. Associative groups tend to simply coordinate decisions of member firms, while hierarchical groups are managed in a top-down manner, with no *de facto* independence for formally-autonomous member firms. See Goto, A. (1982), "Business groups in a market economy", *European Economic Review*, Vol. 19, No. 1.

55. Following Brusco, S. (1982), "The Emilian model: productive decentralisation and social integration", *Cambridge Journal of Economics*, Vol. 6, No. 2, industrial districts are defined as "monocultural industrial areas in which all firms have a very low degree of vertical integration and the production process is carried on through the collaboration of a number of firms".

56. For a taxonomy of industries according to intensity in resource, labour, capital and R&D utilisation, see OECD (1992), *The OECD STAN database for industrial analysis*. For a taxonomy of industries according to the degree of fragmentation of production units and product differentiation, see Oliveira Martins, J. (1993), "Market structure, international trade and relative wages", OECD *Economics Department Working Papers*, No. 134.

57. In countries where business groups are widespread, such a ratio might be underestimated.

58. Equity holdings of Italian households are overestimated since all holdings falling short of 2 per cent are attributed to them (see Annex I).

59. Concentration refers to ownership structure within single companies.

60. As a result, 77 per cent of total manufacturing employment is controlled with a single absolute majority stake, while the first three equity stakes control up to 96 per cent of employment.

61. Given that the frequency of group membership increases with the size of firms (see below), direct ownership concentration also tends to rise along with firm size.

62. If an agent owns a 51 per cent stake in firm A, which in turn owns a 51 per cent stake in firm B, direct ownership concentration will be high. However, indirect concentration is lower, since the agent only owns a 26 per cent stake in firm B, the remainder being owned by non-controlling shareholders of both A and B.

63. The share of firms with more than 50 employees controlled by members of the same family is 37 per cent, representing 20 per cent of total employment in these firms.

64. With private pyramidal groups generally controlled by families or coalitions, these arrangements are estimated to concern 76 per cent of firms with more than 50 employees, representing 73 per cent of total employment. Furthermore, in 41 per cent of cases they are

supplemented by explicit impediments to transfer ownership rights, such as clauses preventing the sale of shares to third parties by members of the controlling coalition (see Table A1 in Annex III).

65. See ISTAT (1994), *Statistiche Industriali.*

66. For a justification for extending the economic definition of firms beyond the confines of the legal definition, see Milgrom, P. and J. Roberts (1992), *Economics, Organization and Management*, Prentice Hall.

67. See Annex II for the regulation of voting rights in cross-shareholdings.

68. The ownership of 27 per cent of shares, coupled with participation in a voting trust, is sufficient for controlling the holding Fiat, given its high stock market capitalisation.

69. See Brioschi, F., L. Buzzacchi and M. G. Colombo (1990), *Gruppi d'imprese e mercato finanziario*, La Nuova Italia Scientifica and Banca d'Italia (1994*b*).

70. In accordance with EC competition law, the Italian competition authority considers juridically distinct companies which belong to the same group and are controlled by the same entity as a single independent firm. Moreover, cross-shareholdings between independent firms may constitute presumptive evidence of collusive behaviour between firms operating on the same market.

71. In unlisted groups of small firms, this result can also be achieved through joint ventures or by associating minority shareholders in the ownership and control of subsidiaries.

72. See Buzzacchi, L. and M. Pagnini (1994), "Gruppi di imprese e mercati interni del capitale", *mimeo*, Banca d'Italia. Trade credit, such as delayed payment to suppliers, may provide a further means of internal financing. The average delay in Italy is higher than in other EC countries, with only 50 per cent of payments made within a fifteen day period as against an EC average of 60 per cent (*Mondo Economico*, 16 July 1994).

73. For example, business fragmentation and complexity of accounts may be used to minimise capital gains taxation, avoid inheritance taxes or, until recently, enjoy different kinds of subsidies aimed at small and medium-sized firms (such as subsidised loans), notably in the south of Italy. Concentrating loss-making activities in group subsidiaries may facilitate the obtention of state aid or even favour state bail-out of the ailing firms.

74. For a cross-country comparison of governance structure of companies in major OECD countries, see Annex Table A2.

75. Some financial holdings, including (unlisted) Giovanni Agnelli & C. and (listed) Pirelli & C., are incorporated as limited share partnerships (*società in accomandita per azioni*), in which some shareholders are given the right to manage the company, but are at the same time held responsible for it without limit.

76. Among major OECD countries, these practices differ only in Germany, where an important role in appointing the board and its chairman is played by employees.

77. However, in contrast to practices prevailing in the United States and the United Kingdom, directors' compensations are set by the general shareholders' meeting.

78. In the boards of public enterprises, this problem was compounded by the large presence of political appointees [see OECD (1994), *Economic Survey of Italy*].

79. The ratio of gross debt to total assets in large private non-financial enterprises was estimated to be only 0.33 in 1992. See Mediobanca (1993), *Dati cumulativi di 1807 società italiane.*

80. Results from a questionnaire distributed to a sample of these firms showed that this was the main motivation restraining their owners from stock market listing. See Mariani, M. (1993), ''Imprese e borsa: risultati di un'indagine su un campione di società non quotate'', in Assogestioni, *Borsa e opportunità di sviluppo delle imprese italiane* , Quaderni di documentazione e ricerca, No. 10.

81. See Massari, M. (1992), *Le imprese che possono accedere alla Borsa Valori in Italia,* Il Sole 24 Ore Libri.

82. See Rydqvist, K. (1992), ''Dual-class shares: a review'', *Oxford Review of Economic Policy,* Vol. 8, No. 3, Table 2.

83. Empirical support for these explanations of high leverage ratios in Italian firms is provided by Bonato, L., R. Hamaui and M. Ratti (1991), *Come spiegare la struttura finanziaria delle imprese italiane?,* Banca Commerciale Italiana, Collana ricerche, No. R91-18.

84. As in most other OECD countries, the fiscal disadvantage of retained earnings contrasts with the prevalence of internal over external funds [see Mayer, C. P. (1990), ''Financial systems, corporate finance and economic development'', in G. Hubbard (ed.) *Asymmetric information, corporate finance and investment,* NBER]. With informational asymmetries between existing and new shareholders implying large discounts on share issues, a large recourse to profit retentions can be viewed as a device to finance all profitable projects without having to send signals to the market. Signalling theories of corporate finance are reviewed by Browne, F. X. (1994), ''Corporate finance: stylized facts and tentative explanations'', *Applied Economics,* Vol. 26, No. 5.

85. Shareholders have an incentive to finance risky projects since all the upside return accrues to them if the project is successful but the law of limited liability places a floor on their losses if the project fails.

86. Interest income on private bonds issued by listed and unlisted firms is taxed at 12.5 per cent and 30 per cent rates, respectively. Differential treatment was established in order to prevent tax avoidance practices on behalf of unlisted firms. Interest on government securities was tax exempt until 1986, when their fiscal treatment was levelled with that of private bonds of listed firms.

87. The purpose of the 1936 Banking Law was to ensure the stability of the financial system, shaken at the beginning of the decade by the deep crisis of universal banks. Severe restrictions on shareholdings by commercial banks were aimed at preventing a balance-sheet structure characterised by short-term liabilities and long-term, illiquid assets.

88. Banks who exercise proxy voting rights are often also creditors of firms, giving rise to a potential conflict of interest with shareholders. Due to insufficient safeguards for shareholders, proxy voting was abolished in 1974 amid growing complaints about collusion between banks and firms' management.

89. Special departments of banks were required to be legally and budgetarily autonomous with respect to the main body of the bank.

90. The increasing share of state-guaranteed subsidised loans provided over the years by special credit institutions has negatively affected their ability to assess the creditworthiness of borrowing firms. Often, their monitoring would only concern the formal prerequisites needed by the firm in order to access the subsidised loans.

91. See Barca F. and G. Ferri (1994), "Crescita, finanziamento e riallocazione del controllo: teoria e prima evidenze empiriche per l'Italia", in Banca d'Italia, *Il mercato della proprietà e del controllo delle imprese: aspetti teorici e istituzionali.*

92. "Active" equity holdings by banks were estimated not to exceed L 2 trillion in 1993.

93. Subdued risk-taking behaviour on behalf of special credit institutions and special departments of banks has greatly reduced the need for and the incentives to monitoring the use of long-term loans. At the same time, bank managers had few incentives to take risks or monitor firm behaviour more closely. Compared with other EC countries, seniority plays a larger role in career advancement than on-the-job evalutation. See Prosperetti, L. and G. Durante (1994), *Retribuzioni e costo del lavoro nelle banche italiane ed europee*, Assicredito.

94. Mediobanca was set up in 1946 by the three IRI-owned banks (Banca Commerciale Italiana, Credito Italiano and Banco di Roma) with the aim of boosting post-war reconstruction. The three banks reduced their shares in Mediobanca from around 60 per cent to 25 per cent in 1987, the remaining shares being owned by private foreign and domestic investors. Banca Commerciale and Credito Italiano were subsequently privatised. The statute of Mediobanca made it possible for it to own equity participations of up to one third of its capital and reserves, with no more than 10 per cent invested in the shares of a single firm. Since 1955, the bank has been controlled by a voting trust pooling the main (public) banking and (private) industry shareholders, with management preserving a rather wide margin of independence. It was responsible for virtually all major reorganisations in Italian corporate history – such as the mergers between Montecatini and Edison and between Pirelli and Dunlop – as well as for most of debt reschedulings. It is currently involved in managing equity issues and debt restructurings for all major groups – such as Fiat, Ferruzzi, Ciga, GFT, Generali, Pirelli and La Fondiaria. Its dominant role in underwritings was shaken by the recent wave of privatisations, which brought in a number of other foreign and domestic financial advisors. IMI, a government-owned special credit institution, has managed some business crises, such as those of IRI's subholdings for iron and steel, Ilva, and civil engineering, Iritecna. It was partly privatised in January 1994. Another public institution, Mediocredito Centrale, has specialised in credit to small- and medium-sized firms. For details on merchant banking activities in Italy see De Cecco, M. and G. Ferri (1994), "Origini e natura speciale delle attività di banca d'affari in Italia", mimeo, Banca d'Italia.

95. In 1987, the stakes of Mediobanca in other major groups accounted for 40 per cent of the market value of total inter-group shareholdings. See Brioschi, F. *et al.* (1990), *op. cit.*

96. The three banks – Banca Commerciale Italiana, Credito Italiano and Banca di Roma – have a long-standing agreement to sell Mediobanca's certificates of deposit through their branch networks with an exclusivity clause and for a relatively low selling commission (0.6 per cent). In 1992, 64 per cent of the bank's funds were raised through certificates of deposit.

97. This figure excludes reallocations within groups, which account for almost a third of the total but do not imply a change in ownership, and falls to 33 per cent over the 1980-1992 period.

98. See Commission of the European Communities, "Competition and integration, Community merger control policy", *European Economy*, No. 57 (1994). The data include management buy-outs, reverse takeovers, divestments, strategic alliances, stakes and private and public deals involving both large- and small-sized enterprises.

99. In providing credit and acquiring shares, intermediaries also provide signals to market participants based on the bank's reputation.

100. Only 9 per cent of small- and medium-sized firms are estimated to have ever used services offered by banks and only 4.5 per cent have ever used services offered by other financial institutions. Consulting mostly concerned liquidity or debt management. Interestingly, recourse to intermediation services by banks and specialised institutions is much more frequent among firms located in the centre and north of Italy. See Banca d'Italia (1994*c*).

101. However, over the 1991-1993 period, as much as 18 per cent of the 565 concentrations monitored by the Italian competition authority were acquisitions of control stakes by foreign companies. Over the 1990-1992 period the share of acquisitions by foreign firms was larger in Italy than in other major European countries. See *European Economy* (1994), *op. cit.*

102. The limited advisory role of banks and other institutions does not seem to depend on dissatisfaction with the quality of existing bank services: in answering to a Bank of Italy questionnaire, the vast majority of small- and medium-sized firms judged this quality to be good or excellent. In addition, the limited contribution of specialised institutions is not seen as a factor hindering reallocations. This confirms the peculiar nature of these reallocations, which are made in a closed environment, often without concern for interests of minority shareholders and non-controlling partners (see Banca d'Italia, 1994*a*). For further discussion of the features of the market for corporate control in Italy, see also Cybo-Ottone (1993), "Capital structure and the performance of family-held business groups. An empirical analysis of the case of Italy", unpublished Ph.D. dissertation, New York University.

103. See OECD (1994), *Economic Survey of Italy*, Annex I.

104. See also OECD (1994), *Economic Survey of Italy*, pp. 95-99.

105. See Cherubini, U. and M. Ratti (1991), "Quanto valgono le matricole? L'*underpricing* nelle prime quotazioni: teorie economiche e analisi empirica", in A. Penati (ed.), *Il rischio azionario e la borsa*, EGEA, and Buzzacchi, L. and M. G. Colombo (1994), "Business groups and the determinants of corporate ownership", *Cambridge Journal of Economics*, forthcoming.

106. Since the 1980s, many comparative analyses of market economies have attempted to explain the erosion of US high-tech dominance in terms of Japan's and Germany's superior corporate governance systems which, by restricting takeovers, are seen as allowing managers to emphasise longer-run performance over short-run returns. See, for example, Porter, M. (1992), *Capital Choices: Changing the Way America Invests in Industry*, Harvard Business School and Fukao, M. (1995), *Financial integration, corporate governance and the performance of multinational firms*, The Brookings Institution. A brief summary of this literature is provided in OECD (1993), *Economic Survey of the United States*, pp. 96-102. For a

critical assessment of the German system, see Edwards J. and K. Fischer (1993), *Banks, finance and investment in Germany*, Cambridge University Press.

107. On the incentive structure of smaller firms, see Brosco, S. (1994), ''Una ricerca della Banca d'Italia sulle caratteristiche dell' industria manifatturiera italiana'', *Economia e Politica Industriale* No. 83. According to a study based on a sample of medium-sized firms, these often prefer to follow a second-best (''satisfactory'') growth strategy. Firms prefer to stop growing when further expansion would require stock market listing and dilution of ownership, potentially entailing loss of control by the family. See Forti, A. *et al.* (1994) ''Proprietà familiare e ruolo della borsa'' in *L'impresa motore dello sviluppo,* Confindustria.

108. The user cost of capital is obtained from the cost of funds by adjusting it for the full effects of inflation and corporate taxation as well as for differences in depreciation schedules and investment tax incentives across capital goods. Although statements about relative costs of capital cannot safely be based on the relative cost of funds, differences between costs of capital do usually reflect differences in the cost of funds. See McCauley, R. and S. Zimmer (1989), ''Explaining International Differences in the Cost of Capital'', *Federal Reserve Bank of New York Quarterly Review*, Vol. 14, No. 2.

109. Distress costs are also reduced by public policies aimed at transferring part of the burden associated with corporate failure from creditors and employees to consumers and taxpayers.

110. The lack of floating rate instruments may have been compensated by the short-term nature of bank loans (see above), which makes it possible to renegotiate loans frequently. Indexed bonds became more widespread since the mid-1980s.

111. See Asanuma, A. (1989), ''Manufacturer-Supplier Relationships in Japan and the Concept of Relation-Specific Skill'', *Journal of the Japanese and International Economies*, Vol. 3, No. 1.

112. An important element of the Fiat strategy since the late 1980s has been to ask suppliers to self-certify the quality of the components they produce.

113. For instance, Magneti Marelli sells 67 per cent to car assemblers other than Fiat.

114. See Kato, T. and M. Rockel (1992), ''Experiences, Credentials, and Compensation in the Japanese and U.S. Managerial Labor Markets: Evidence from New Micro Data'', *Journal of the Japanese and International Economies*, Vol. 6, No. 1.

115. In market-based systems, as a result of the working of the market for corporate control, management and employee turnover is high and wage dispersion is wide. In order to strengthen their loyalty to the firm, top managers, often selected from outside of the firm, receive a large share of their compensation in long-term components (*e.g.* stock-options and stock-appreciation rights) and earn much more than their counterparts in institution-based systems.

116. Internal managerial careers are also common within business groups.

117. Managers may either be associated as minority shareholders within the group or they may be full-fledged partners of a family business. Low incentives to quit the business make it possible to preserve human capital within the group.

118. The technology balance of payments is defined as the ratio between receipts and payments in operations relative to elements of industrial property and services with a technical and intellectual content. See OECD (1993), *Industrial Policy in OECD Countries*, p. 128, box 11.

119. R&D spending, the most often used indicator, tends to underestimate the innovation activity in small- and medium-sized firms, where R&D is comparably less important than investment in equipment, vocational training, and incremental, unformalised innovations. On the other hand, patent data may be distorted by the varying propensity to patenting in different sectors, by the fact that not all patented inventions are commercialised and result in innovations, and by the considerable heterogeneity of their economic impact. See OECD (1992), *Reviews of National Science and Technology Policy: Italy* and Malerba, F. (1993), "The National System of Innovation: Italy", in R. Nelson (ed.), *National Innovation Systems*, Oxford UP.

120. See Archibugi, D., R. Evangelista and R. Simonetti (1993), "Concentration, firm size, and innovation. Evidence from innovation costs", *Rivista internazionale di scienze economiche e commerciali,* Vol. 110, July, which use data from the CNR-ISTAT survey of innovative activity. Formal R&D constitutes only a limited share of total innovation spending: in only three industries (computers, electronics, and rubber and plastics) is R&D almost as relevant as the acquisition of embodied technology.

121. Public procurement (including military demand) has rarely been used as a deliberate stimulus to innovation. Furthermore, despite the large role played by state-owned enterprises and subsidies in channelling resources to the south, most of technological activity remains located in the north. Over the 1983-1992 period, only around a quarter of total loans by *Fondo IMI per la ricerca applicata*, the main instrument for financing business R&D investment, went to firms in southern Italy, [(Cer/Irs (1993), *La transformazione difficile*, il Mulino, p. 130, Table 5.1)].

122. In 1992, there was only one Italian firm (Montedison) among companies to have been granted a large number of patents in the U.S. (see *Business Week*, 9 August 1993). The low number of large firms has hindered the creation of innovative small-sized ("Schumpeterian") firms, which depend on demand for specialised capital goods by final producers. See Dosi, G. and M. Moggi (1992), "Piccole e medie imprese e innovazione in Italia", *L'industria*, Vol. 13, No. 3.

123. Evidence on credit rationing of small-sized firms is provided by Becchetti, L. (1993), "Gli ostacoli all'innovazione tecnologica in Italia", *mimeo*, CNR Strategic Project and, for credit rationing in the south, by Faini R., G. Galli and C. Giannini (1992), *Finance and development: the case of Southern Italy*, Banca d'Italia, Temi di discussione, No. 170. The portfolio of Italian venture capital institutions amounted to less than L 2.5 trillion in 1992, with only 25 per cent of these funds devoted to start-up innovating activities. Analysis in Audretsch, D. B. and M. Vivarelli (1994), "Small firms and R&D spillovers: evidence from Italy", *CEPR Discussion Paper*, No. 927, shows that, in industrial districts, small firms innovate by exploiting knowledge created outside of the firms and transferred through the mobility of human resources.

124. Cross-country evidence points to a correlation between financial and technological development. See Greenwood, J. and B. Jovanovic (1990), "Financial development, growth and the

distribution of income'', *Journal of Political Economy*, Vol. 98, No. 5, and Jovanovic, B. (1993), ''Innovation, technology and finance: a cross-country analysis'', *mimeo*, CNR Strategic Project.

125. Strategic ties of this kind are particularly widespread with French groups. For example, Alcatel and FIAT, and IFI (the largest shareholder in FIAT) and Danone have mutual shareholdings; moreover, the Agnelli family has, under different forms, important interests in many leading French firms such as Accor, Club Med, Saint Louis, Rhone-Poulenc and Worms). See Morin F. (1991), *Le cœur financier italien et ses alliances avec les groupes français*, LEREP, Université de Toulouse.

126. See Onida, F. (1994), ''La crescita multinazionale dei gruppi italiani di medio-grande dimensione'', in *L'impresa motore dello sviluppo*, Confindustria.

127. The OECD area – the EC in particular – accounts for the largest, and fastest-growing share of cumulated FDI flows. Outside the OECD, Italian firms have traditionally invested more in Latin America and less in Asia than multinationals of other EC countries, partly reflecting cultural and ethnic ties. In recent years, Italian firms have made major inroads in the former centrally-planned economies, achieving for example the second position in the ranking of foreign investors in Russia. Italian investors in Eastern Europe have been facilitated by the existence of previous investments; FIAT, in particular, has had a well-established manufacturing presence in Poland and Russia, dating back from the 1950s.

128. See Panetta, F. (1991), *Gli effetti della quotazione internazionale: il caso delle azioni italiane a Londra*, Banca d'Italia, Temi di discussione, No. 156.

129. A screen-based secondary market in government securities (*mercato telematico dei titoli di Stato*) was introduced in 1988, and since February 1994 bidders in auctions of medium- and long-term securities can also submit their bids on screen.

130. Voluntary bids have been made in three cases only, by controlling shareholders wishing to delist quoted firms.

131. Until recently, the existence and composition of voting trusts has had to be communicated to Consob, which was not authorised to reveal their content. The March 1994 decree-law on privatisation has made the public notification of voting trusts mandatory for quoted firms.

132. This decree law, however, does not apply to previous privatisations. In particular, it does not apply to the sale of Credito Italiano and Banca Commerciale.

133. In the past, the use of such instruments was hindered by both high stamp duties (amounting to 1.2 per cent of the face value of the IOU) and the restrictive stance of monetary authorities *vis-à-vis* non-equity financing of firms with the general public. The new banking law clearly states ways in which firms can raise funds by issuing short-term securities, while stamp duties have been reduced to 0.01 per cent.

134. Shareholders now have the option of excluding dividends from their taxable income and paying instead a 12.5 per cent flat tax rate (*cedolare secca*). This is attractive to those in the two highest personal tax brackets, who would otherwise face effective marginal tax rates on dividends (inclusive of tax credits available to offset the imputed corporate tax paid) of 14.1 or 21.9 per cent.

135. There have been 179 mergers during this time. Banca di Roma was created in 1992 from the merger of two IRI-owned banks, Banco di Roma and Banco di Santo Spirito, and a major saving bank, Cassa di Risparmio di Roma.

136. The law, approved in September 1993, transposed the Second EC Banking Co-ordination Directive into Italian legislation. New provisions concerning bank shareholdings only entered into force in early 1994. The only sectors in which banks cannot operate directly (but only through subsidiaries) are insurance, mutual funds and SIMs. For more details see OECD (1994), *Economic Survey of Italy.*

137. A financial institution (bank or merchant bank) takes the leadership of the process and constitutes the reference for the Bank of Italy supervision; under this leadership a consortium of creditors is formed which replaces management, handles financial restructuring and ensures placements or acquisitions of shares; acquisition of shares by financial institutions is allowed provided restructuring is approved by the Bank of Italy. Following the financial collapse of the Ferruzzi group and the restructuring plan prepared by Mediobanca, four credit institutions, including three public banks, control directly or indirectly 26 per cent of the capital in Ferruzzi Finanziaria, the group's top holding.

138. Furthermore, Cariplo, the world's largest savings bank, is scheduled to be listed on the stock market within 1994 with a L 1 650 billion initial public offer.

139. "Golden shares" provide the Treasury with the power to veto acquisition of large shareholdings by any single investor and to forbid the breaking-up, liquidation or transfer abroad of the company. Restrictions on the duration of these powers, which were originally set to last at most five years, have been relaxed by the new privatisation law.

140. The privatisation law conditions the privatisation of public services to the creation of independent regulatory agencies. A decree-law presented by the Berlusconi government establishes a regulatory agency for electricity and gas production and distribution.

141. So far, only one company (Acciaierie Terni) has been sold, raising L 600 billion through a private placement, while IRI was compelled to delay the other sales given unsatisfactory bids.

142. At present, the only pension funds are those of banks, including the Bank of Italy. They invest on average 7 per cent of their assets in equities.

143. A group of American institutions abstained at the first shareholders' meeting of Banca Commerciale after privatisation, expressing their disappointment for the lack of information conveyed by management.

144. Italian courts have not been consistent in defending minority interests and censoring conflicts of interest, a factor which makes clear legislative action all the more needed. See Magnani, M. and D. Preite (1994), "Linee di riforma dell'ordinamento societario nella prospettiva di un nuovo ruolo degli investitori istituzionali", *mimeo*, Banca d'Italia.

145. Increasing the number of non-executive directors – *i.e.,* individuals who do not have connections with the company which can conflict with their ability to exercise independent judgement on matters brought to the board – has been proposed in other countries. This would not help in the Italian situation as long as appointments are made solely by majority shareholders.

146. See Nardozzi G. and G. Vaciago (1994), ''Introduzione e principali risultati'', in G. Nardozzi and G. Vaciago (eds.), *La riforma della Consob nella prospettiva del mercato mobiliare europeo*, il Mulino.

147. Exceptions to this general rule regard specific regulations on publishing and banking as well as competition law, where business groups are considered as relevant entities. See Barca, F., P. Casavola and M. Perassi (1993), *Controllo e gruppo: natura economica e tutela giuridica*, Banca d'Italia, Temi di discussione, No. 201.

148. See Boccuzzi, G. and R. Cercone (1994), ''Spunti di riflessione per un dibattito sulla riforma della disciplina della crisi d'impresa'', *mimeo*, Banca d'Italia.

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Annex I

Technical notes

The results presented in Table 7 are based on equations for import and export volumes in manufacturing as used in OECD's INTERLINK model.

In the model specification for Italy, changes in manufacturing export volumes are determined by changes in export-market growth and by current and lagged changes in export-price competitiveness; the latter is measured by the difference between growth in Italian export prices and that of its competitors, with a long-run price elasticity of –1.24.

Similarly, changes in manufacturing import volumes are determined by changes in import-weighted demand components and current and lagged import-price competitiveness; the latter is measured by the difference between the producers' market price and that of their foreign competitors, with long-run price elasticity of –0.67.

The residual shown in Table 7 represents that part of the growth in export and import volumes which is not explained by the price-competitiveness and demand effects. The large positive residual for manufacturing export volumes in 1993 indicates that the response of exports has been stronger than predicted on the basis of past relations.

Annex II

A synopsis of the Italian corporate governance system[1]

General governance structure of companies

Italian company law provides for two main forms of limited liability: the joint-stock company (*società per azioni* or Spa) – which is suitable for large-scale firms – and the limited liability company (*società a responsabilità limitata* or Srl) – which is suitable for small-scale privately-held firms with a maximum number of shareholders.[2]

Most listed firms are indeed incorporated as joint-stock companies: however, some financial holdings – among them (unlisted) Giovanni Agnelli & C., which is the largest shareholder of Ifi, and (listed) Pirelli & C. – are incorporated as Sapa (*società in accomandita per azioni*). In this case, some shareholders (*soci accomandatari*) are given the right to manage the company, but are at the same time held responsible without limit. The remaining shareholders (*soci accomandanti*) are treated as any other in limited liability companies.

The articles of association of a joint-stock company may provide that the corporation be managed by a board of directors, which can then delegate some or all of its duties and powers to an executive committee. A second board (*consiglio sindacale*) is responsible for periodically auditing the company's accounts. In the case of listed firms, however, a second independent audit is required.

Both boards are appointed by shareholders at the annual ordinary meeting, for a period of no more than three years. Directors can be revoked by the general meeting at any time; their compensation is usually decided by the general meeting, except for the *amministratore delegato* – an office which broadly corresponds to that of CEO in Anglo-American countries – in which case the decision is made by the board itself.

Transferability of shares

A corporation can insert into its charter, in particular circumstances, reasonable restrictions on the transfer of its shares. When the consent of the board is required, a shareholder may request the company to designate a buyer of its shares. Transferability may also be limited by specific contracts concluded among shareholders.

Voting rights of shareholders

A corporation can issue different classes of non-ordinary shares, among which the following are the most frequent:

- preferred stocks (*azioni privilegiate*), which enjoy preferential treatment concerning dividends payments and reimbursement of paid-in capital and which retain voting rights;
- saving stocks (*azioni di risparmio*), which can only be issued by listed firms and enjoy preferential divident treatment while forfeiting voting rights.

Monitoring rights of shareholders

Beside the ordinary meeting, Italian company law allows for extraordinary meetings, which revolve around the amendments to the Articles of Association, the issuance of debentures and the appointment and powers of the liquidators. In both cases, shareholders' meetings are called by directors. The notice must clearly and unambiguously indicate the agenda, in order to safeguard the interest of shareholders to receive adequate information.

The shareholders whose names have been entered in the corporate shareholders' book at least five days prior to the date of the meeting, and who have deposited their shares as indicated in the notice of convocation, are entitled to participate in the meeting. Proxy voting is allowed, unless the Articles of Association explicitly exclude it. The proxy, however, can only be granted in connection with a specific meeting and must include the name of the representative, who cannot be a director, auditor or employee of either the company or one of its subsidiaries. In the case of listed companies, the number of shareholders who can be represented by the same person varies from 50 to 200 depending on the company's capital. While solicitation of votes by shareholders or through an extensive mail or press campaign is not prohibited, it is not customary.

Shareholders representing at least one-fifth of the company's capital may request a meeting, which the directors are obliged to call. Expenses connected therewith are borne by the company. Shareholders have also the right: *a)* to examine the draft balance sheet and the directors' and auditors' reports during the fifteen days preceding the meeting and until the balance sheet is approved; *b)* to inspect and to obtain excerpts from the main corporate books; *c)* to report to the auditors facts regarding the management of the company which are deemed censurable; and *d)* to file a complaint with the local court, reporting facts which imply material violation by directors and auditors of their duties.

Regulations on banks shareholdings in non-financial companies

The 1936 Banking Law has generally prevented banks from owning shares in non-financial enterprises, except where they are underwriting new issues as members of placement syndicates. Until 1974, banks were allowed to act as proxy voters, but this was prohibited with the 1974 reform.

In June 1993, the Bank of Italy, pursuant to a legislative decree implementing the EC Second Banking Co-ordination Directive, issued new regulations which allow banks to acquire an equity interest in non-financial firms. Most banks are now subject to an overall investment limit of 15 per cent of their capital base, and to a concentration limit restricting a bank's holdings in an individual firm or group to 3 per cent of the bank's own funds. Those banks which – by virtue of their size and proven stability – are deemed to be better endowed to face the additional risks implicit in equity financing, are subject to less stringent limits (respectively 50 and 6 per cent for leading banks, and 60 and 15 per cent for specialized institutions).

Consistent with the principle of separation between banking and commerce, a further limit restricts a bank's investment in any non-financial corporation to 15 per cent of that company's capital. Such limits may only be overcome by leading banks and specialised institutions, and this only under particular circumstances and for limited amounts (2 per cent of the bank's own funds). Debt/equity swaps involving non-financial firms in financial distress are only allowed when the underlying problems are temporary: the Bank of Italy is entitled to verify that the temporary nature of such operations is objectively ascertainable.

Rules and practice of acquisitions

The take-over bid (*offerta pubblica d'acquisto* or OPA) law was enacted in January 1992, with the aim of providing equal treatment to all the shareholders of any one company. OPAs are usually voluntary, but they were made compulsory in four cases, in order to protect minority shareholders:

- a "pre-emptive" OPA is required when a potential raider sets out to buy stock; in this case, a bid must be made for a number of shares sufficient to acquire the control. Such a threshold is decided by the stock market commission (Consob) for each quoted firm;
- a "successive" OPA obliges an investor who has bought a majority shareholding outside the stock market floor to purchase an amount of securities at least equal to those already acquired, at a price equal to the average one paid for becoming the majority shareholder;
- a "residual" OPA must be made by a company's controlling shareholder for the entire capital when the shares in public hands (*flottante*) drop below 10 per cent. In this case, the bid price is decided by the Consob;
- an "incremental" OPA must be made by an investor who already holds half the amount of shares necessary to control a firm, whenever he or she intends to increase his/her holdings by one fifth or, in any case, by 2 per cent of the total share capital in the following twelve months.

Regulations on interlocking shareholdings

Majority-owned subsidiaries are forbidden to hold shares in their parent companies, unless the purchase is carried out using corporate reserves. In this case, shareholdings cannot exceed 2 per cent of the parent companies' capital if listed (otherwise 10 per cent) and voting rights are always forfeited.

Regulations on insider trading

Insider trading, as well as other behaviours such as tipping (*i.e.*, disclosing confidential knowledge), counselling (*i.e.*, indicating profitable transactions, without specifying on what grounds), and artificial trading to create the false impression of price movement, has been prohibited in Italy since 1991. Infringements are investigated by the stock market commission and prosecuted as criminal offences. The application of sanctions extends to the recipient of confidential information.

Restrictions on payments to shareholders and accounting rules

Corporations are required to retain at least 5 per cent of their annual profit as legal reserves not available for future dividends up to a limit of one-fifth of capital. In principle, the buy-back of own shares is prohibited, unless it is approved by the general meeting and accomplished using net earnings. Accounting rules are oriented towards protecting stakeholders, including creditors and employees, by conservatively measuring the net assets of a company and restricting dividend payout.

Bankruptcy procedures for corporate failures

The 1942 Italian bankruptcy law contains both liquidation (*fallimento, concordato preventivo per cessione dei beni*, and *liquidazione coatta amministrativa*) and reorganisation (*amministrazione controllata, concordato preventivo per garanzia*) procedures. The discipline attaching to these procedures depends on the party initiating the process (the debtor or the creditor), on the viability of the recovering of the firm, and on the percentage of creditors whose approval is requested.

In principle, the bankruptcy law puts more weight on protecting creditors than debtors and other stakeholders. Since the 1970s, however, the balance has shifted to the protection of employment, as shown by *a)* the increasing recourse to reorganisation processes, *b)* the introduction in 1979 of a special reorganisation procedure (*amministrazione straordinaria*) for large-scale enterprises, and *c)* the enactment – in the absence of a coherent legal structure for smoothing the ownership transfer of ailing enterprises – of special laws concerning public intervention in the bankruptcy area. Creditors have hence been penalised, since the building-up of operating losses has often translated into an erosion of assets' value. The contractual order of priority among stakeholders has also been highly distorted, since during the reorganisation period the firm is allowed to contract new debt, and new creditors are given priority (*consecuzione delle procedure*).

Major revisions of the bankruptcy law have been under discussion since the early 1980s.

Notes

1. This annex is based on Banca Commerciale Italiana (1992), *Selected Issues*, No. 16; Boccuzzi, G. and R. Cercone (1993), *Tutela dei creditori e riallocazione dell'impresa nella normativa fallimentare*, Banca d'Italia, Temi di discussione, No. 204; Consob (1993), *Relazione annuale*; Ferrara, F. (1984), *Gli imprenditori e le società*, Giuffrè; Gianni, F. and A. Giuliani (1991), "Italy", in J. Lufkin and D. Gallagher (eds.), *International Corporate Governance*, Euromoney Books.
2. Unlike the arrangements in force in other OECD countries, foreign investors in Italy follow the same registration procedure (notarised deeds, registration with the commercial court) as domestic ones.

Annex III

Data sources on corporate ownership and control

Most data used in Chapter III are extracted from three reports:

- Banca d'Italia (1994*a*), *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane* [Ownership, Control and the Market for Corporate Control of Italian Industrial Firms] written by F. Barca, M. Bianco, L. Cannari, R. Cesari, G. Manitta, G. Salvo, F.L. Signorini;
- Banca d'Italia (1994*b*), *Struttura di gruppo, concentrazione della proprietà e modelli di controllo nelle imprese italiane medio-grandi* [Hierarchical Groups, Concentration of Ownership and Control Models of Large Italian Firms] written by F. Barca, M. Bianchi, F. Brioschi, L. Buzzacchi, P. Casavola, L. Filippa, M. Pagnini.
- Banca d'Italia (1994*c*), *Le banche, il credito e la riallocazione proprietaria in Italia* [Banks, Credit and Ownership Transfers in Italy] written by Capra L., N. D'Amico, G. Ferri and N. Pesaresi.

The first report is based on two sources:

- A survey based on a questionnaire sent to a representative sample of approximately 1 200 manufacturing firms with more than 50 employees (*INVIND*). Firms were asked questions concerning their ownership and control structure, as to whether they belonged to hierarchical groups, and whether ownership had been transferred since 1980. A further survey was conducted on one firm from each hierarchical group in the survey, with the aim of appraising the number of firms belonging to the group and their size.
- A survey based on interviews with about 300 manufacturing firms with more than 20 and less than 500 employees, located in five Italian regions (Lombardia, Emilia, Toscana, Puglia, Sicilia) (*ESETRA*). Interviews were used to gather information on ownership and control structure, on the relevance and causes of transfers of control, on the intergenerational transfer of control, on the role of intermediaries in the market for corporate control.

The second report is based on a data set created jointly by the Bank of Italy and the Stock Exchange Commission (Consob) covering all firms "linked" to quoted firms (approximately 7 000). The link is established – and data are collected by Consob – whenever an agent holds, directly or indirectly, more than 2 per cent of a quoted company and whenever a listed company holds, directly or indirectly, more than 10 per cent of an unlisted firm. This information made it possible to ascertain the ownership and control structure of large Italian firms, to obtain concentration indexes, to draw the maps of the largest hierarchical groups, to measure the degree of separation between ownership and control and to assess the relevance of alternative models of control.

The third report is based on a questionnaire distributed to banks, which were asked to give information about their role in assisting firms in transactions occurring on the market for corporate control.

Annex IV

Supporting statistical material to Part III

Table A1. **The 20 largest domestic economic groups in Italy (1992)**

Name	Rank	Sales [1]	Quoted subsidiaries	Main activities	Internationa-lisation [2]	Financial gearing [3]
IRI [4]	1	75 912	18	Steel, machinery, financial services	18	2.2
FIAT [5]	2	54 790	14	Transport equipment, financial services	44	18.9
ENI [4]	3	49 779	8	Oil, machinery, media	23	1.2
Ferruzzi [6]	4	19 900	7	Chemicals, food, general trading	46	7.3
Fininvest [7]	5	10 036	2	Retailing, media, financial services	n.a.	2.6
Pirelli [8]	6	8 252	2	Tyres, cables	77	5.2
Olivetti [9]	7	8 025	3	Office equipment, electronics	36	15.9
Fintermica [10]	8	4 252	0	Energy	n.a.	1.0
Barilla	9	3 327	0	Food	15	1.0
SMI [11]	10	3 112	2	Steel	81	n.a.
Rizzoli [12]	11	2 922	0	Media	34	1.0
Benetton Group	12	2 513	2	Clothing, footwear	50	n.a.
Marzotto	13	1 952	5	Clothing, textiles	30	3.4
Italcementi [13]	14	1 713	3	Cement	n.a.	3.1
Parmalat	15	1 637	1	Food	47	n.a.
Gruppo PAM	16	1 626	0	Retailing	n.a.	1.0
Cartiere Burgo [14]	17	1 570	1	Paper	n.a.	n.a.
GFT [6]	18	1 555	0	Clothing, textiles	46	1.0
Piaggio	19	1 431	0	Transport equipment	35	1.0
Merloni	20	1 307	1	Domestic appliances	35	n.a.

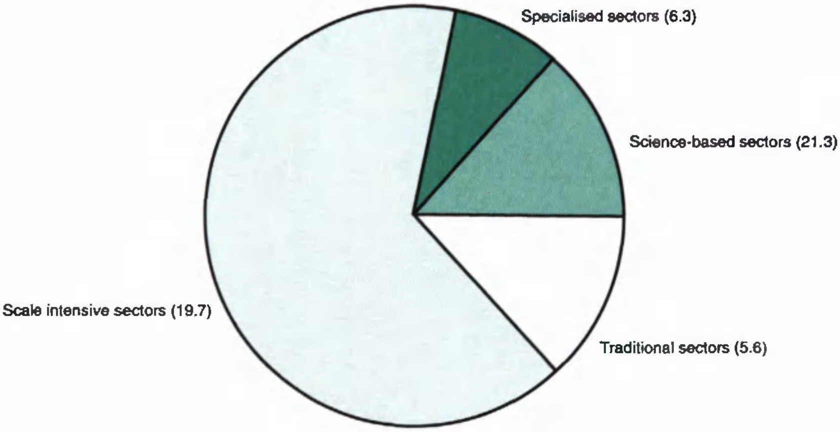
1. Lira billion.
2. Employment abroad as a per cent of total group employment.
3. Capital controlled for each lira invested by controlling shareholder.
4. State-owned.
5. Agnelli family (IFI) – through a voting trust with Mediobanca, Deutsche Bank, Generali and Alcatel. Does not include firms controlled by the Agnelli family outside the FIAT group.
6. Currently in bank-led debt-restructuring process.
7. Berlusconi.
8. Pirelli family – through a voting trust with Mediobanca, GIM (Lucchini), SAI (Ligresti) and CIR (De Benedetti).
9. De Benedetti family (Cofide, indirectly through CIR) – through a voting trust with Mediobanca, IMI, Crediop, Pirelli and Turis. Does not include firms controlled by De Benedetti family outside of the Olivetti group.
10. Jacorossi.
11. Orlando family – through a voting trust with De Benedetti, Pesenti and Pirelli families.
12. Owned by Gemina, a financial holding controlled by FIAT, Mediobanca, Ferruzzi, Generali and Pesenti.
13. Pesenti family.
14. Controlled through a voting trust among Gemina, Mediobanca, Pesenti, Generali and Pirelli.

Source: Mediobanca (1993), *Le principali società italiane;* Onida, F. (1994) "La crescita multinazionale dei gruppi italiani di medio-grande dimensione" in *L'impresa motore dello sviluppo,* Confindustria; Banca d'Italia (1994*b*).

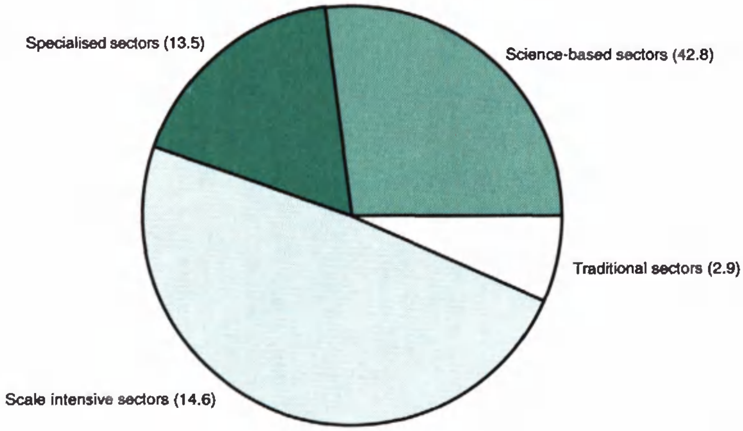
Diagram A1. **FDI BY SECTOR IN PERCENTAGE OF TOTAL**

Degree of internationalisation in parentheses

A. Italian investment abroad



B. Foreign investment in Italy



Note: Degree of internationalisation refers to employment in *a)* foreign subsidiaries of Italian companies, or *b)* Italian subsidiaries of foreign companies, as a share of total sectoral employment in Italy.

Source: Onida, F. (1994), "La crescita multinazionale dei gruppi italiani di medio-grande dimensione", in *L'impresa motore dello sviluppo*. Confindustria.

Table A2. **General governance structure of companies in major OECD countries**

	Italy	United States	Japan	Germany	France	United Kingdom
Types of companies	Joint-stock company (Spa) Private limited company (Srl)	Defined by state laws	–	Joint-stock company (AG) Limited liability company (Gmbh)	Joint-stock company (SA) Simplified joint-stock company (SAS) Private limited company (Sarl)	Public limited liability company (Plc) Private limited liability company
Board structure	Two-tiered Managing board (MB) and executive committee Board of auditors (BA)	One-tiered MB and executive committee[1]	Two-tiered MB and executive committee BA[2]	Two-tiered (large firms only) Supervisory board (SB) MB	One- and two-tiered One-tiered: MB and executive committee Two-tiered: SB and MB	One-tiered MB and executive committee
Board powers	MB: management, compensation of CEO BA: control over MB decisions and company's accounts	Management, compensation of MB members, dividends	All decisions may be upheld by shareholders	MB: management SB: controls decisions of MB	One-tiered: control decisions and sets compensation of executive committee Two-tiered: SB controls decisions and sets compensations of MB	Management, compensation of MB members,[3] dividends
Board appointment	MB and BA elected by general shareholders' meeting (GSM) for up to 3-year term	Elected by GSM for up to 3-year term	Elected by GSM for 2-year term	Half of SB elected by shareholders, half by employees for up to 4-year term MB appointed by SB for up to 5-year term	One-tiered: MB elected by GSM for up to 6-year term Two-tiered: SB elected by GSM for up to 6-year term, MB appointed by SB for up to 4-year term	Elected by GSM for 3-year term

Board removal	MB members by simple majority BA members cannot be removed without cause	With or without cause by simple majority	With or without cause by two-thirds majority	SB members by three-fourths majority MB members by SB only exceptionally	One-tiered: MB members by simple majority Two-tiered: SB members by simple majority, SB members by GSM upon proposal of SB	By simple majority
Conflicts of interest	Not possible to be member of both MB and BA, no provisions for "common directors"[4]	Strict code of conduct in case of "common directors"[4]	No provisions for "common directors"[4]	Not possible to be member of both MB and SB, no provisions for "common directors"[4]	Not possible to be member of both MB and SB, no provisions for "common directors"[4]	–
Board liability	Courts sometimes recognise "business judgment rule"[5]	Courts recognise "business judgment rule"[5]	Courts recognise "business judgment rule"[5]	–	Courts may nullify decisions of MB or GSM	–
Labour representation	None	None	None	50 per cent of SB members	In two-tiered companies attend all meetings of SB and MB in advisory capacity	None
Presence of large shareholders on board	Always	Rarely	Sometimes	Always	Always	Rarely
Share of executive directors on board	Low	Low	High	Low	Low	High
Voting restrictions[6]	Rarely	Only for foreigners in strategic sectors	Yes	Yes	No	No

1. An increasing number of firms have created "overview" committees (for nominating, auditing and compensation purposes), typically composed of outside (non-executive) directors.
2. Non-voting board members whose role is to ensure that companies are run in a legal manner. A 1993 law requests all corporations to appoint at least one outsider to such boards.
3. To be decided by a remuneration committee composed wholly of non-executive directors.
4. Board members sitting on boards of other companies.
5. Shareholders of a publicly-traded companies cannot dictate to management on issues related to business judgement.
6. Restrictions to shareholders' voting rights.

Source: OECD and Fukao, M. (1995), *Financial integration, corporate governance and the performance of multinational firms*, The Brookings Institute.

Annex V

Calendar of main economic events

BUDGET POLICY

1993

December

The government increases gasoline prices and the special tax on monthly banking account statements. The tax on trading of government securities is abolished.

1994

January

The government approves a plan to cushion the effects of rising unemployment, including an increase in the unemployment allowance and the extension to small and medium-sized enterprises of benefits paid by the Wage Supplementation Funds.

The Ciampi government resigns.

May

A new government is formed, headed by Mr. Berlusconi, following the general elections held in March, based upon the new system of majority representation.

June

The government issues a decree law, granting tax breaks for firms hiring new workers and reinvesting earnings.

The Constitutional Court orders the government to pay pension arrears not later than 1995, estimated at L 30 trillion.

July

The government approves the 1995-97 medium-term economic plan, targeting a budget deficit of L 138.6 trillion for 1995. The government also introduces new part-time and short-term labour contracts, as well as a tax amnesty for persons having erected buildings without a permit.

September

The government presents the 1995 budget law, broadly in line with the objectives of the medium-term economic plan. The budget, which aims at a deficit of L 139 trillion in 1995, combines spending cuts of L 27 trillion (including cuts in pensions and health expenditure) and tax increases of L 21 trillion (mainly one-off measures).

MONETARY POLICY AND FINANCIAL MARKETS.

1993

October

The Bank of Italy reduces the discount rate from 8.5 to 8 per cent and the rate on fixed-term advances from 9.5 to 9 per cent.

1994

February

The Bank of Italy reduces the discount rate from 8 to 7.5 per cent, the lowest level since 1976, and the rate on fixed-term advances from 9 to 8.5 per cent.

April

Floor trading on the Milan stock exchange is replaced by a screen-based system.

May

The Bank of Italy reduces the discount rate from 7.5 to 7 per cent and the rate on fixed-term advances from 8.5 to 8 per cent.

July

The Bank of Italy reduces marginal reserve requirements from 17.5 to 15 per cent.

August

The Bank of Italy raises the discount rate from 7 to 7.5 per cent. and the rate on fixed-term advances from 8.5 to 8 percent.

PRIVATISATION

1993

December

ENI sells Nuovo Pignone to a group of foreign investors.

IRI sells its shareholdings in Credito Italiano through a public placement.

1994

January

The Treasury sells its shareholdings in IMI through a public placement.

February

IRI sells its 51 per cent shareholding in Banca Commerciale Italiana through a public placement.

June

The Treasury sells its shareholdings in INA through a public placement.

July

The Parliament approves a new decree law on privatisation, which introduces proportional representation on the board of privatised companies.

A new telecommunications company (Telecom Italia) is created through the merger of Sip, the old domestic operator, and Italcamble, the old international operator.

September

The government presents a new timetable for privatisation; it envisages the privatisation of ILVA and SME before the end of 1994, and of IMI, INA, ENEL and STET during 1995.

STRUCTURAL REFORMS

1994

January

The Parliament approves the reform of public procurement (Merloni law), envisaging the creation of a special authority to ensure transparency.

The new Banking Law goes into effect.

February

The government abolishes thirteen special inter-ministerial committees, including CIP (prices) and CIPI (industrial planning).

March

Competition is introduced in the cellular telephone market, with a second licence awarded to a consortium led by Olivetti.

May

The government suspends until the end of 1994 the Merloni law, which lays out new rules for public procurement.

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STATISTICAL ANNEX AND STRUCTURAL INDICATORS

Table A. **Selected background statistics**

	Average 1984-93	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
A. Percentage changes from previous year at constant 1985 prices											
Private consumption	2.3	2.0	3.0	3.7	4.2	4.2	3.5	2.5	1.0	1.4	–2.1
Gross fixed capital formation	1.4	3.6	0.6	2.2	5.0	6.9	4.3	3.8	0.6	–2.0	–11.1
Residential	0.1	–0.5	–2.8	–2.1	–2.4	1.3	2.4	2.8	3.1	0.3	–0.8
Non-residential	2.0	5.5	2.2	4.0	7.9	9.0	4.9	4.1	–0.2	–2.8	–14.6
GDP	2.2	2.7	2.6	2.9	3.1	4.1	2.9	2.1	1.2	0.7	–0.7
GDP price deflator	7.1	11.6	8.9	7.9	6.0	6.6	6.2	7.6	7.7	4.5	4.4
Industrial production	1.7	3.4	1.4	4.1	2.6	6.9	3.9	–0.6	–0.9	–1.3	–2.1
Employment	0.1	0.4	0.9	0.8	0.4	0.9	0.2	0.9	0.8	0.9	–4.7
Compensation of employees (current prices)	8.7	11.6	11.7	8.0	8.6	10.0	9.5	12.1	9.2	5.1	1.1
Productivity (GDP/employment)	2.0	2.3	1.7	2.1	2.7	3.1	2.8	1.2	0.4	–0.1	4.2
Unit labour costs (compensation/GDP)	6.4	8.7	8.8	5.0	5.3	5.7	6.4	9.8	7.9	4.4	1.7
B. Percentage ratios											
Gross fixed capital formation as % of GDP at constant prices	21.1	21.1	20.7	20.5	20.9	21.5	21.8	22.1	22.0	21.4	19.1
Stockbuilding as % of GDP at constant prices	1.2	1.6	1.8	1.7	1.6	1.5	1.1	1.1	0.9	1.2	–0.4
Foreign balance as % of GDP at constant prices	–2.8	–1.7	–1.9	–2.0	–3.0	–3.3	–3.2	–3.7	–4.4	–4.5	0.1
Compensation of employees as % of GDP at current prices	45.0	46.2	46.1	44.9	44.6	44.2	44.3	45.1	45.2	45.2	44.0
Unemployment as % of total labour force	11.2	10.1	10.2	11.2	12.1	12.	12.1	11.4	10.9	11.5	10.4
C. Other indicator											
Current balance (US$ billion)	–8.1	–2.3	–4.0	2.0	–2.0	–6.3	–11.8	–17.0	–23.6	–27.8	11.4

Source: Relazione Generale sulla Situazione Economica del Paese (1993).

Table B. **Expenditure on gross domestic product, current prices**

Trillions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Private consumption	507.8	559.5	614.0	676.2	744.5	810.5	889.6	949.3	973.2
Public consumption	135.5	148.4	166.3	187.0	201.4	231.6	253.2	267.9	279.8
Gross fixed investment	167.6	177.7	194.1	219.3	241.0	265.9	281.9	286.7	266.6
Final domestic demand	810.9	885.6	974.5	1 082.4	1 186.9	1 308.0	1 424.7	1 503.9	1 519.6
	11.8	*9.2*	*10.0*	*11.1*	*9.7*	*10.2*	*8.9*	*5.6*	*1.0*
Stockbuilding	15.0	10.7	12.4	15.4	13.8	9.4	10.2	4.9	–3.2
	0.1	*–0.5*	*0.2*	*0.3*	*–0.1*	*–0.4*	*0.1*	*–0.4*	*–0.5*
Total domestic demand	825.9	896.3	986.9	1 097.8	1 200.7	1 317.4	1 434.9	1 508.7	1 516.4
	11.8	*8.5*	*10.1*	*11.2*	*9.4*	*9.7*	*8.9*	*5.1*	*0.5*
Exports	169.0	167.2	176.4	193.8	226.6	249.2	257.0	274.2	333.2
Imports	184.3	163.6	179.4	199.8	233.9	254.5	262.5	278.6	289.5
Foreign balance	–15.3	3.6	–3.1	–6.0	–7.3	–5.3	–5.5	–4.4	43.7
	–0.3	*2.3*	*–0.7*	*–0.3*	*–0.1*	*0.2*	*–0.0*	*0.1*	*3.2*
GDP (market prices)	810.6	899.9	983.8	1 091.8	1 193.5	1 312.1	1 429.5	1 504.3	1 560.1
	11.7	*11.0*	*9.3*	*11.0*	*9.3*	*9.9*	*8.9*	*5.2*	*3.7*

Note: Figures in italics are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Source: ISTAT.

Table C. **Expenditure on gross domestic product, constant 1985 prices**

Trillions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Private consumption	507.8	526.6	548.6	571.5	591.7	606.3	623.0	631.5	618.0
Public consumption	135.5	139.0	143.8	147.8	149.1	150.9	153.2	154.7	155.9
Gross fixed investment	167.6	171.3	179.9	192.4	200.7	208.2	209.5	205.3	182.6
Final domestic demand	810.9	836.9	872.2	911.7	941.4	965.4	985.7	991.4	956.4
	2.5	*3.2*	*4.2*	*4.5*	*3.3*	*2.6*	*2.1*	*0.6*	*–3.5*
Stockbuilding	15.0	13.8	13.9	13.6	10.1	10.3	8.9	11.4	–3.7
	0.3	*–0.1*	*0.0*	*–0.0*	*–0.4*	*0.0*	*–0.1*	*0.3*	*–1.6*
Total domestic demand	825.9	850.7	886.1	925.2	951.5	975.8	994.7	1 002.8	952.7
	2.8	*3.0*	*4.2*	*4.4*	*2.8*	*2.5*	*1.9*	*0.8*	*–5.0*
Exports	169.0	173.2	181.3	191.1	207.9	222.4	223.5	234.8	258.4
Imports	184.3	189.6	207.0	221.0	237.7	256.8	265.5	277.8	257.6
Foreign balance	–15.3	–16.5	–25.6	–29.8	–29.8	–34.4	–42.0	–43.0	0.8
	–0.2	*–0.1*	*–1.1*	*–0.5*	*0.0*	*–0.5*	*–0.8*	*–0.1*	*4.6*
GDP (market prices)	810.6	834.3	860.4	895.4	921.7	941.4	952.7	959.8	953.4
	2.6	*2.9*	*3.1*	*4.1*	*2.9*	*2.1*	*1.2*	*0.7*	*–0.7*

Note: Figures in italics are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Source: ISTAT.

Table D. **Gross domestic product, by kind of activity**

Trillions of lire and percentage changes

	1985	1986	1987	1988	1989	1990	1991	1992	1993
At 1985 prices (trillions of lire)									
Agriculture	36.3	37.0	38.4	37.2	37.6	36.5	39.2	40.1	38.8
Industry[1]	234.0	241.5	249.9	266.1	275.4	281.7	281.7	283.2	278.7
Energy	37.5	39.7	40.5	41.2	42.2	43.9	44.5	46.0	46.1
Manufacturing	196.5	201.8	209.5	224.9	233.3	237.7	237.2	237.2	232.6
Construcion	51.0	51.3	52.0	53.4	55.3	56.7	57.3	56.8	54.2
Services	479.0	494.1	508.4	526.4	541.7	555.4	563.1	572.2	578.4
Market services	375.9	389.4	402.6	419.2	433.5	446.2	452.9	461.1	467.0
Non-market services	103.1	104.7	105.8	107.2	108.2	109.3	110.3	111.1	111.4
Subtotal	800.3	823.9	848.8	883.0	910.0	930.3	941.3	952.2	950.1
GDP (market prices)	810.6	834.3	860.4	859.4	921.7	941.4	952.7	959.8	953.4
At 1985 prices (percentage changes)									
Agriculture	0.8	1.9	3.7	–3.2	1.2	–2.9	7.3	2.3	–3.2
Industry[1]	2.7	3.2	3.5	6.5	3.5	2.3	0.0	0.5	–1.6
Energy	–0.5	5.8	2.0	1.8	2.4	4.1	1.3	3.4	0.1
Manufacturing	3.3	2.7	3.8	7.4	3.7	1.9	–0.2	–0.0	–1.9
Construcion	0.1	0.6	1.4	2.6	3.5	2.5	1.2	–0.9	–4.6
Services	3.1	3.1	2.9	3.5	2.9	2.5	1.4	1.6	1.1
Market services	3.5	3.6	3.4	4.1	3.4	2.9	1.5	1.8	1.3
Non-market services	1.7	1.6	1.0	1.4	0.9	1.0	0.9	0.8	0.2
Subtotal	2.7	3.0	3.0	4.0	3.1	2.2	1.2	1.2	–0.2
GDP (market prices)	2.6	2.9	3.1	–0.1	7.3	2.1	1.2	0.7	–0.7

1. Including mining.

Source: ISTAT.

Table E. **Household appropriation account**

Trillions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Compensation of employees	376.7	406.7	441.0	484.5	529.4	592.9	647.1	680.1	687.2
Property and entrepreneurial income	311.9	341.1	371.7	414.4	462.0	507.7	569.7	614.5	620.4
Transfers received	175.9	194.8	215.5	238.4	266.0	301.0	329.6	363.1	380.7
Gross total income	864.5	942.6	1 028.2	1 137.3	1 257.5	1 401.6	1 546.4	1 657.8	1 688.4
Direct taxes	81.6	87.5	95.1	112.3	124.7	138.2	152.1	168.3	187.1
Social security contributions	152.9	175.4	185.9	203.7	229.3	258.2	289.7	315.7	331.8
Disposable income	630.0	679.8	747.3	821.3	903.6	1 005.2	1 104.6	1 173.8	1 169.4
Consumption	507.8	559.5	614.0	676.2	744.5	810.5	889.6	949.3	973.2
Saving ratio[1]	19.4	17.7	17.8	17.7	17.6	19.4	19.5	19.1	16.8

1. As a percentage of disposable income.

Source: ISTAT.

Table F. **General government account**

Trillions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Current receipts	312.7	353.9	388.2	434.7	496.5	556.3	620.8	664.4	729.7
Direct taxes	105.5	115.9	130.6	145.7	170.7	189.1	207.1	221.3	250.5
Social security contribution	110.2	125.5	135.8	149.4	167.5	189.3	210.0	226.2	238.8
Indirect taxes	72.7	81.7	93.2	109.1	123.9	139.5	159.0	167.0	186.0
Other current receipts	24.3	30.8	28.6	30.5	34.5	38.4	44.7	49.9	54.4
Current expenditure	369.0	414.9	449.3	501.5	561.9	637.3	707.3	777.3	821.9
Expenditure on goods and services	135.2	148.1	166.0	186.6	201.0	230.4	251.8	266.0	277.0
Subsidies	22.9	27.7	26.1	26.6	29.8	29.6	32.6	31.2	34.5
Interest paid	65.1	76.4	78.2	88.9	106.6	126.3	145.9	172.1	186.9
Social benefits	139.1	154.8	170.5	189.1	210.0	238.6	261.3	290.5	301.6
Other current transfers	6.8	8.0	8.5	10.4	14.5	12.4	15.7	17.4	21.8
Saving	–56.3	–61.0	–61.1	–66.8	–65.3	–81.0	–86.5	–112.9	–92.1
Fixed investment	30.4	31.9	34.5	36.8	39.8	43.1	46.6	45.1	41.2
Capital transfers, net	–17.6	–14.2	–15.0	–21.5	–17.6	–22.8	–18.3	–19.2	–30.4
Consumption of fixed capital	2.3	2.3	2.5	3.2	4.5	3.4	5.2	33.7	15.5
Net lending	–102.0	–104.7	–108.1	–116.8	–118.2	–143.5	–146.3	–143.4	–148.2
(as a percentage of GDP)	–12.6	–11.6	–11.0	–10.7	–9.9	–10.9	–10.2	–9.5	–9.5

Source: Banca d'Italia.

Table G. **Price and wages**

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Indices 1985 = 100									
Consumer prices									
Total	100.0	105.8	110.9	116.5	123.8	131.8	140.0	147.2	153.8
Food products	100.0	105.3	109.2	112.9	120.0	127.2	135.3	142.1	145.0
Non-food products	100.0	106.0	111.5	117.7	125.1	133.4	141.8	149.3	156.6
Services (excluding rent)	100.0	108.9	114.9	122.4	132.1	141.9	153.2	163.8	173.1
Per capita compensatiom									
Total economy									
Nominal	100.0	107.5	116.4	126.5	137.4	152.2	165.2	174.6	181.0
Real	100.0	101.6	105.0	108.6	111.1	115.5	118.0	118.6	117.7
Industry									
Nominal	100.0	107.5	115.6	124.5	136.7	149.1	162.5	173.9	179.4
Real	100.0	101.6	104.3	106.9	110.5	113.2	116.1	117.6	116.7
Percentage changes									
Consumer prices									
Total	9.2	5.8	4.8	5.0	6.3	6.5	6.2	5.1	4.5
Food products	8.8	5.3	3.7	3.4	6.3	6.0	6.4	5.0	2.0
Non-food products	9.3	6.0	5.2	5.6	6.3	6.6	6.3	5.3	4.9
Services (excluding rent)	11.2	8.9	5.5	6.5	7.9	7.4	8.0	6.9	5.7
Per capita compensatiom									
Total economy									
Nominal	10.1	7.5	8.3	8.7	8.6	10.8	8.5	5.7	3.7
Real	0.8	1.6	3.3	3.4	2.3	4.0	2.2	0.5	–0.8
Industry									
Nominal	11.5	7.5	7.5	7.7	9.8	9.1	9.0	7.0	3.2
Real	2.0	1.6	2.7	2.5	3.4	2.4	2.6	1.3	–0.8

Source: Relazione generale sulla situazione economica del paese (1993).

Table H. **Employment indicators**

Labour units, thousands

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Total employment	22 612.7	22 786.3	22 877.5	23 087.6	23 122.6	23 327.3	23 515.6	23 276.4	22 621.8
Dependent employment	15 403.9	15 472.8	15 528.1	15 714.2	15 830.0	16 026.8	16 125.7	16 042.2	15 630.8
Agriculture	784.3	766.6	748.8	734.0	747.1	741.2	712.4	715.8	654.2
Total industry	5 614.3	5 544.1	5 500.2	5 569.8	5 592.8	5 647.0	5 570.7	5 392.3	5 113.9
of which: Manufacturing	4 280.9	4 228.4	4 211.8	4 278.4	4 316.2	4 339.5	4 244.7	4 062.0	3 840.8
Construction	1 140.8	1 120.1	1 089.1	1 092.2	1 808.3	1 110.2	1 130.5	1 138.3	1 089.2
Market services	4 967.1	5 091.0	5 149.7	5 213.0	5 268.6	5 387.0	5 543.9	5 585.8	5 523.4
General government	4 038.2	4 071.1	4 129.4	4 197.4	4 221.5	4 251.6	4 298.7	4 348.3	4 339.3
Self-employment	7 208.8	7 313.5	7 349.4	7 373.4	7 292.6	7 300.5	7 389.9	7 234.2	6 991.0
of which: Agriculture	1 796.4	1 795.5	1 759.0	1 635.1	1 529.7	1 493.8	1 524.5	1 416.3	1 329.9
Total industry	1 299.7	1 327.5	1 307.8	1 315.4	1 322.4	1 324.6	1 346.6	1 352.8	1 372.4
Market services	4 112.7	4 190.5	4 282.6	4 395.9	4 440.5	4 482.1	4 518.8	4 465.1	4 306.7

Source: Relazione generale sulla situazione economica del paese (1993).

Table I. **Money and credit**

a) The monetary base

Changes in billions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Origin of liquid assets									
Net impact of the foreign sector	–13 677	3 543	6 756	10 947	14 791	15 458	–8 674	–32 591	2 564
Net impact of the public sector	27 519	10 994	9 172	2 748	6 344	1 009	17 715	40 085	–17 476
Banks	5 880	–4 334	–729	–30	1 203	1 260	2 664	108	–6 451
Other sectors	–646	–1 004	–1 252	–709	–2 042	–4 027	–583	858	1 903
Total net impact	19 076	9 199	13 947	12 956	20 475	13 700	11 121	8 460	–19 460
Use of liquid assets	13 677	–3 543	–6 756	–10 947	–14 791	–15 458	8 674	32 591	–2 564
Liquidity in the hands of the public	4 004	3 140	4 382	4 449	10 477	1 805	6 906	9 263	4 152
Compulsory bank reserves	12 213	9 022	8 740	9 444	9 567	13 026	3 424	1 012	–24 131
Bank liquidity	2 839	–2 983	805	–957	411	–1 151	771	–1 835	499
Compulsory bank deposits	..	..	657	–657	..	..	..	..	..
Total	19 076	9 199	13 947	12 956	20 475	13 700	11 121	8 460	–19 460

Source: Banca d'Italia.

Table I. **Money and credit**

b) Selected indicators

Changes in billions of lire

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Money									
Currency in circulation	4 004	3 140	3 842	4 989	10 477	1 805	6 905	9 263	4 152
Sight deposits	23 638	31 873	22 776	23 557	34 446	30 380	45 909	1 780	30 413
Saving deposits	23 203	10 278	16 182	17 645	29 622	31 412	23 330	31 851	30 673
Money supply M2	50 845	45 291	42 800	46 191	74 545	63 597	76 144	42 894	65 238
Central bank									
Credit to Treasury	27 461	10 943	6 575	2 278	6 673	986	18 989	38 887	–17 539
Credit to banking sector	5 674	–3 360	328	477	920	1 620	1 056	557	–6 237
Banking sector									
Credit	–6 947	3 304	5 636	9 713	9 333	5 581	10 978	46 668	–21 739
Government securities shares and bonds	19 536	10 182	1 305	–5 825	–1 596	3 708	53 998	54 489	18 094
Special credit intitutions									
Credit	9 938	16 326	21 762	27 152	36 350	39 601	38 160	35 073	34 272
Total domestic credit	164 174	155 285	157 025	192 198	232 094	237 495	259 865	264 642	189 782
Private sector	38 858	40 718	49 688	64 410	122 933	127 851	121 758	101 349	71 733

Source: Banca d'Italia.

Table J. **Foreign trade by main commodity groups**

Billion of Lire

	1984	1985	1986	1987	1988	1989	1990	1991	1992
Imports, total	148 162	172 809	148 994	162 353	180 014	209 910	217 703	225 746	232 111
Agricultural products	11 848	14 258	12 866	13 271	14 045	15 164	14 314	15 955	14 828
Energy	41 825	46 224	23 853	22 698	19 095	24 234	27 460	26 894	24 807
Iron, steel and non-ferrous metals	13 703	14 976	13 805	13 959	17 561	22 709	20 569	19 446	19 625
Minerals and non-metallic mineral products	2 227	2 482	2 507	2 829	3 427	3 913	4 205	4 391	4 498
Chemical products	15 603	18 576	18 477	19 655	23 108	26 191	27 004	27 487	29 085
Manufactured goods	22 071	27 070	29 237	24 918	41 635	46 150	49 375	51 623	52 704
Transport equipment	11 043	13 306	13 744	16 481	18 539	22 839	25 823	28 803	32 551
Food, beverage and tabacco	11 705	15 052	13 804	14 169	15 228	16 971	16 766	18 002	18 799
Textile products	7 544	9 231	9 174	10 788	12 081	13 670	13 855	14 550	15 747
Other imports	10 593	11 634	11 527	13 585	15 295	17 969	18 332	18 575	19 767
Exports, total	129 027	149 724	145 331	150 879	166 380	192 813	203 515	209 728	219 436
Agricultural products	3 836	4 688	4 198	4 187	4 532	5 026	5 359	6 005	5 791
Energy	6 177	7 161	4 132	3 759	3 240	3 725	4 609	4 718	4 708
Iron, steel and non-ferrous metals	6 965	7 890	6 863	6 517	7 900	9 786	9 348	8 960	9 086
Minerals and non-metallic mineral products	5 431	5 771	5 702	6 065	7 123	8 183	8 491	8 665	9 144
Chemical products	11 056	12 785	11 698	12 397	14 823	15 646	15 445	15 620	17 346
Manufactured goods	39 394	46 044	46 986	49 569	55 112	65 490	69 026	71 990	75 181
Transport equipment	11 171	12 410	13 200	14 153	15 967	19 008	21 611	22 141	21 903
Food, beverage and tabacco	5 586	7 054	6 099	6 267	6 981	7 780	8 133	9 056	10 414
Textile products	24 571	28 983	29 764	30 272	30 872	34 565	37 202	36 952	38 582
Other exports	14 840	17 028	16 779	17 693	20 370	23 604	24 291	25 621	27 281

Source: Istituto nazionale per il Commercio Estero, Rapporto sul Commercio Estero, 1992.

Table K. **Geographical breakdown of foreign trade**

Million US dollars

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Imports total	90 506	99 976	124 682	138 984	162 269	193 541	189 576	188 339	147 546
OECD countries	58 126	73 839	94 060	107 250	123 398	147 857	145 211	145 536	110 644
EC	42 790	55 584	70 696	80 155	92 294	111 351	109 459	110 750	81 764
of which: Germany	15 179	20 625	26 489	30 480	34 626	41 255	39 657	40 609	28 575
Belgium-Luxembourg	3 360	4 641	6 197	6 795	8 033	9 854	9 245	9 120	6 873
France	11 281	14 559	18 203	20 631	23 842	27 541	26 857	27 224	20 105
Netherlands	4 606	5 883	6 971	7 957	8 915	11 098	10 897	11 127	8 402
United Kingdom	4 473	5 102	6 569	7 076	7 864	10 111	10 778	10 779	8 601
USA	5 392	5 685	6 650	7 791	8 846	9 868	10 596	9 855	7 847
Canada	526	574	827	975	1 217	1 546	1 449	1 470	1 218
Japan	1 481	2 093	2 668	3 512	3 742	4 504	4 640	4 402	3 804
Non-OECD countries	32 072	25 747	30 446	31 487	38 621	45 350	43 989	42 281	36 570
CEEC	4 810	3 979	4 918	5 394	6 446	7 056	7 347	7 719	7 777
OPEC	14 387	9 473	10 245	8 099	10 335	13 648	13 544	11 593	9 628
Other	12 874	12 295	15 283	17 993	21 840	24 646	23 099	22 969	19 165
Exports total	78 400	97 479	116 085	128 458	149 053	180 927	176 126	178 055	168 455
OECD countries	54 654	76 206	93 243	103 485	118 990	145 329	139 896	137 700	124 862
EC	37 941	52 395	65 350	73 771	84 615	105 755	104 070	102 829	89 823
of which: Germany	12 759	17 867	21 803	23 468	25 647	34 604	36 966	36 240	32 809
Belgium-Luxembourg	2 327	3 248	3 918	4 337	4 875	6 165	5 987	5 906	5 018
France	11 000	15 229	18 958	21 308	24 285	29 622	26 749	26 014	22 128
Netherlands	2 425	3 190	3 580	3 956	4 618	5 640	5 555	5 582	4 739
United Kingdom	5 459	6 908	8 636	10 323	11 756	12 803	11 731	11 678	10 776
USA	9 617	10 472	11 159	11 427	12 858	13 812	12 142	12 410	13 033
Canada	978	1 199	1 350	1 437	1 650	1 605	1 441	1 295	1 394
Japan	925	1 319	1 855	2 425	3 407	4 239	3 861	3 418	3 201
Non-OECD countries	19 969	20 730	22 322	24 431	29 481	34 890	35 465	39 739	42 765
CEEC	2 531	2 701	3 372	3 395	4 323	5 185	5 073	6 569	6 802
OPEC	7 262	6 210	5 867	6 020	7 130	7 397	8 372	9 178	8 215
Other	10 175	11 819	13 084	15 015	18 027	22 307	22 020	23 992	27 748

Source: OECD, Foreign Trade Statistics, Series B.

Table L. **Balance of payments**

Million US dollars

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Current account									
Merchandise exports	76 405	96 886	116 333	127 818	140 555	169 826	169 050	178 109	168 666
Merchandise imports	81 933	92 181	116 181	128 540	142 237	168 653	169 242	174 982	136 149
Trade balance	–5 528	4 705	152	–722	–1 682	1 173	–192	3 127	32 517
Services, net	571	–939	–1 274	–4 129	–7 535	–15 850	–17 514	–25 312	–15 687
Travel	6 474	6 944	7 634	6 414	5 214	6 329	6 772	4 807	7 989
Investment income	–3 978	–6 207	–6 567	–7 074	–8 282	–14 669	–17 465	–20 749	–16 240
Other services	–1 925	–1 676	–2 341	–3 469	–4 467	–7 510	–6 821	–9 370	–7 436
Transfers, net	969	–1 739	–891	–1 495	–2 597	–2 328	–5 940	–5 594	–5 386
Private	1 368	1 561	1 774	1 619	1 092	1 169	–277	–451	461
Official	–399	–3 300	–2 665	–3 114	–3 689	–3 497	–5 663	–5 143	–5 847
Current balance	–3 988	2 027	–2 013	–6 346	–11 814	–17 005	–23 646	–27 779	11 444
Capital account									
Long-term capital, net	2 645	–2 588	2 471	7 886	22 502	37 511	2 789	–14 163	41 890
Private, direct	–749	–2 673	1 805	1 328	46	–1 268	–4 845	–2 738	–3 480
Private, portfolio	375	–1 043	–7 413	318	3 409	–238	–6 177	–9 261	52 185
Public [1]	2 300	1 833	4 463	2 204	950	4 749	–1 404	106	–274
Short-term capital, net	–1 994	5 094	6 169	8 735	2 347	6 019	20 633	22 809	–35 047
Private non monetary	781	766	1 872	881	–1 684	1 513	–458	315	–2 870
Private monetary institutions	–2 775	4 328	4 297	7 854	4 031	4 506	21 091	22 494	–32 177
Miscellaneous official accounts	181	210	–115	–847	93	–1 207	–6 111	10 597	–3 436
Allocation of SDRs	0	0	0	0	0	0	0	0	0
Errors and omissions	–3 812	–2 192	–1 204	–1 898	–1 818	–13 878	–6 684	–7 285	–16 883
Change in reserves	–4 124	–437	4 573	8 270	9 983	11 201	–13 599	–8 389	–4 043

1. Excludes special transactions.

Source: OECD.

Table M. **Public sector**

Per cent of GDP

A. Budget indicators; general government accounts				
	1970	1980	1985	1990
Current receipts	27.9	32.3	37.3	41.1
Non-interest expenditures	31.3	36.5	42.9	43.6
Primary budget balance	–3.5	–4.2	–5.6	–2.4
Net income	–0.6	–4.3	–7.0	–8.5
General government budget balance	–4.0	–8.6	–12.6	–10.9
of which:				
Central government	0.0	–7.2	–12.6	–9.9
Social security	0.0	–0.2	0.1	0.3
General government gross debt	41.7	59.0	84.3	100.5

B. Structure of expenditure and taxation				
	1. General government expenditure			
	1970	1980	1985	1990
Expenditure total	33.0	41.9	50.9	53.2
Current consumption	13.3	15.0	16.7	17.6
Transfers to households	12.8	14.9	18.0	19.2
Subsidies	2.0	2.9	2.8	2.3
Fixed investment	3.2	3.2	3.7	3.3

	2. Tax structure			
	Italy		EC	
	1980	1989	1980	1989
Tax receipts	30.2	37.8	36.4	39.9
Income tax	9.4	14.0	12.5	13.8
of which:				
Personal income tax	7.0	10.1	10.6	10.4
Corporate profits tax	2.4	3.8	2.5	3.0
Social security contributions	11.5	12.5	10.5	11.3
Tax on goods and services	8.0	10.2	11.2	12.6

Source: OECD, National accounts; Revenue statistics of OECD countries.

Table N. **Financial markets**

	1970	1980	1985	1988
Financial institutions plus insurance sector[1]				
Sectoral employment over total employment (per cent)	1.0	1.6	1.7	1.7
Domestic net assets/GDP (per cent)	120.9	131.1	131.7	117.9
Structure of financial assets				
Share of financial institutions' financial assets in domestic assets (per cent)[2]	39.9	36.2	34.8	34.1
Share of Treasury securities in NFC total assets (per cent)[3]	0.5	1.9	3.6	5.7
Structure of NFC portfolios:				
Deposits (as per cent of total NFC financial assets)	57.4	29.2	19.5	18.2
Corporate bonds (as per cent of total NFC liabilities)	0.2	0.1	0.3	0.4
Mutual fund shares (as per cent of total NFC financial assets)[4]	–	–	–	–
Structure of non-financial corporate liabilities[5]				
NFC debt/equity ratio (per cent)				
Short term:[2] Securities and mortgages	–	0.7	0.1	0.1
Other	48.1	51.5	47.3	47.3
Long term:[2] Bonds	12.4	7.3	5.3	5.4
Other	37.1	39.8	32.6	33.0
Debt (per cent of GDP)				
Public sector				
Domestic	40.2	58.1	81.8	93.5
Foreign	1.1	0.9	2.2	2.7

1. Banca d'Italia, commercial banks, specialised credit institutions, finance companies, mutual funds, insurance companies.
2. Non-consolidated.
3. Including unincorporated enterprises.
4. Mutual fund certificates can be bought only by individuals and life insurance companies.
5. Excluding shares.

Source: Data submitted by national authorities.

Table O. **Labour market indicators**

	A. Evolution			
	Cyclical peak 1979	Cyclical trough 1982	1980	1990
Standardised unemployment rate	7.6	8.4	7.5	10.3
Unemployment rate				
Total	7.6	8.4	7.5	11.0
Male	4.8	5.6	4.7	7.3
Female	13.1	13.9	13.0	17.1
Youth [1]	25.6	28.0	25.2	31.5
Regional unemployment rate				
North-Centre	7.7	9.1	7.6	7.7
South	10.9	13.0	11.5	19.7
Share of long-term unemployment [2]	n.a.	n.a.	n.a.	69.3
Hours worked, 1980 = 100 [3]	98.3	99.2	100.0	103.3

	B. Structural or institutional characteristics			
	1970	1980	1985	1990
Participation rate [4]				
Global	59.5	60.8	59.8	61.1
Male	86.8	82.8	79.3	78.1
Female	33.5	39.6	41.0	44.5
Employment/population between 15 and 64 years	54.7	54.7	52.2	54.6
Part-time work [5]	n.a.	n.a.	5.3	n.a.
Non-wage labour costs [6]	21.4	21.8	22.0	22.8
Government unemployment insurance benefits [7]	4.6	7.9	10.1	4.7

	1970-80	1980-85	1985-90
Employment (yearly rates of change)			
Total (persons)	0.6	0.2	0.5
Total (labour units)	1.0	0.5	0.7
Agriculture	-2.3	-2.9	-3.8
Manufacturing	1.0	-3.2	0.0
Services	2.7	3.3	1.7
of which:			
Government	2.8	2.1	1.1

1. People between 16 and 24 years as a percentage of the labour force of the same age group.
2. People looking for a job since one year or more as a percentage of total unemployment.
3. Index of monthly hours effectively worked per worker in industry.
4. Labour force as a percentage of the corresponding population aged between 16 and 64 years.
5. As a percentage of dependent employment.
6. As a percentage of wages and salaries.
7. Unemployment benefits per unemployed worker as a per cent of compensation per employee.

Source: ISTAT and OECD.

Table P. **Production structure and performance indicators**

	GDP share (% of total)				Employment share (% of total)			
	1970	1980	1985	1989	1970	1980	1985	1989
Production structure (constant prices)								
Tradeable goods and services								
Agriculture	7.3	5.5	5.2	4.4	22.0	16.3	13.9	11.7
Manufacturing	24.0	28.6	28.2	28.8	31.5	32.4	27.3	26.6
of which:								
Food, beverage and tobacco	2.8	3.2	3.0	3.1	2.4	2.4	2.1	2.0
Textiles, wearing apparel and leather industries	4.7	5.3	4.9	4.7	7.8	7.4	6.4	6.1
Non-metallic mineral products except products of petroleum and coal	1.8	2.1	1.8	2.0	2.3	2.1	1.7	2.0
Basic metal industries	1.9	1.2	1.2	1.0	1.3	1.2	1.0	0.9
Fabricated metal products, machinery and equipment	10.2	11.7	9.7	9.4	10.2	11.7	9.7	9.4
Non-tradeable goods and services								
Electricity, gas and water	7.5	6.3	5.4	5.3	1.0	1.0	1.0	1.0
Construction	12.6	8.4	7.3	6.9	11.8	9.6	8.9	8.6
Wholesale and retail trade, restaurants and hotels	21.5	22.1	22.2	21.6	19.9	22.6	25.8	26.1
Transport, storage, communications	5.2	5.9	6.3	6.7	6.0	6.8	7.3	7.9
Finance, insurance, real estate and business sector	22.3	23.3	25.5	26.1	7.8	11.3	15.8	18.1

	Productivity growth (Sector GDP/sector employment) Average annual percentage growth		
	1971-80	1981-85	1986-89
Industrial sector (constant prices)			
Manufacturing	4.7	4.4	3.8
of which:			
Food, beverage and tobacco	4.5	2.9	4.0
Textiles, wearing apparel and leather industries	4.9	2.9	2.9
Non-metallic mineral products except products of petroleum and coal	6.1	1.9	1.9
Basic metal industries	-0.8	5.8	2.6
Fabricated metal products, machinery and equipment	4.5	4.6	4.3

Source: OECD, National Accounts.

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece	Iceland
Population												
Total	Thousands	1992	17 489	7 884	10 045	28 436	5 171	5 042	57 374	80 569	10 300	260
Inhabitants per sq. km	Number	1992	2	94	329	3	120	15	105	226	78	3
Net average annual increase over previous 10 years	%	1992	1.4	0.4	0.2	1.5	0.1	0.4	0.5	2.7	0.5	1.1
Employment												
Civilian employment (CE)[2]	Thousands	1992	7 637	3 546	3 724	12 240	2 613	2 163	22 032	28 708	3 634 (91)	140 (91)
Of which: Agriculture	% of CE		5.3	7.1	2.6	4.4	5.2	8.6	5.2	3.1	22.2 (91)	10.7 (91)
Industry	% of CE		23.8	35.6	27.7	22.7	27.4	27.9	28.9	38.3	27.5 (91)	26.4 (91)
Services	% of CE		71	57.4	69.7	73	68.7	63.5	65.9	58.5	50.2 (91)	62.9 (91)
Gross domestic product (GDP)												
At current prices and current exchange rates	Bill. US$	1992	296.6	186.2	220.9	563.7	141.6	106.4	1 322.1	1 801.3	77.9	6.9
Per capita	US$		16 959	23 616	21 991	19 823	27 383	21 100	23 043	27 770	7 562	26 595
At current prices using current PPPs[3]	Bill. US$	1992	294.5	142	181.5	536.8	91.2	73.2	1 063.7	1 328.2	85.1	4.4
Per capita	US$		16 800	18 017	18 071	19 585	17 628	14 510	18 540	20 482	8 267	17 062
Average annual volume growth over previous 5 years	%	1992	2	3.4	3.1	1.1	1.1	–0.1	2.4	4	2.2	–0.1
Gross fixed capital formation (GFCF)	% of GDP	1992	19.7	25	19.1	18.8	15.1	18.5	20	20.9	18	17.5
Of which: Machinery and equipment	% of GDP		9.3	9.9	8.6	6.2	6.8	6.8	8.8	9.2	7.9	5.3
Residential construction	% of GDP		5.1	5.7	4.6	6.4	3	4.6	5.1	6.1	3.8	4.8
Average annual volume growth over previous 5 years	%	1992	–1	5.1	7.1	1.4	–4.2	–4.3	3.3	5	4.9	–3
Gross saving ratio[4]	% of GDP	1992	15.6	25.1	21.3	12.8	18	12.1	19.8	22.1	15.5	14.3
General government												
Current expenditure on goods and services	% of GDP	1992	18.5	18.4	14.7	21.9	25.5	24.9	18.8	17.9	19.7	20.2
Current disbursements[5]	% of GDP	1992	36.9	46.2	54.6	49.2	58.2	56.1	48.4	44.1	47.1	32.1
Current receipts	% of GDP	1992	33.1	48.3	49.7	43.7	57.3	53.2	46.1	45	39.9	34.8
Net official development assistance	% of GNP	1992	0.33	0.3	0.39	0.45	0.98	0.61	0.63	0.42	..	..
Indicators of living standards												
Private consumption per capita using current PPPs[3]	US$	1992	10 527	9 951	11 420	11 863	9 120	8 285	11 144	11 186	5 929	10 557
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480	169	464
Telephones, per 1 000 inhabitants	Number	1990	448	589	546	570	972	530	482	671	458	496
Television sets, per 1 000 inhabitants	Number	1989	484	475	447	626	528	488	400	506	195	319
Doctors, per 1 000 inhabitants	Number	1991	2	2.1	3.6	2.2	2.8	2.5	2.7	3.2	3.4	2.8
Infant mortality per 1 000 live births	Number	1991	7.1	7.4	8.4	6.8	7.5	5.8	7.3	7.1	9	5.5
Wages and prices (average annual increase over previous 5 years)												
Wages (earnings or rates according to availability)	%	1992	5	5.4	4.1	4.4	4.7	7	3.9	5.1	17.7	..
Consumer prices	%	1992	5.2	3	2.7	4.2	3.3	5	3.1	2.8	16.6	14.3
Foreign trade												
Exports of goods, fob*	Mill. US$	1992	42 844	44 361	123 264[7]	134 696	39 732	23 956	235 911	429 727	9 541	1 571
As % of GDP	%		14.4	23.8	55.8	23.9	28.1	22.5	17.8	23.9	12.2	22.7
Average annual increase over previous 5 years	%		10.1	10.4	8.2	7.4	9.2	4.3	9.8	7.9	6.2	3
Imports of goods, cif*	Mill. US$	1992	40 751	54 038	125 133[7]	122 445	33 707	21 166	230 050	408 180	23 012	1 710
As % of GDP	%		13.7	29	56.6	21.7	23.8	19.9	17.4	22.7	29.5	24.7
Average annual increase over previous 5 years	%		8.6	10.7	8.4	6.9	5.8	2.4	8.5	12.4	10.7	1.6
Total official reserves[6]	Mill. SDRs	1992	8 152	9 006	10 037[7]	8 314	8 032	3 792	19 657	66 158	3 486	362
As ratio of average monthly imports of goods	Ratio		2.4	2	1	0.8	2.9	2.1	1	1.9	1.8	2.5

	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand	Norway
Population								
Total	3 547	56 859	124 320	390	89 540	15 184	3 443	4 287
Inhabitants per sq. km	50	189	329	150	45	372	13	13
Net average annual increase over previous 10 years	0.2	0	0.5	0.6	2.1	0.6	0.8	0.4
Employment								
Civilian employment (CE)[2]	1 113 (91)	21 271	64 360	162 (91)	23 403 (90)	6 576	1 467	1 970
Of which: Agriculture	13.8 (91)	8.2	6.4	3.7 (91)	22.6 (90)	4	10.8	5.6
Industry	28.9 (91)	32.2	34.6	31.5 (91)	27.8 (90)	24.6	22.6	23.5
Services	57.2 (91)	59.6	59	64.8 (91)	49.6 (90)	71.4	66.6	71
Gross domestic product (GDP)								
At current prices and current exchange rates	51	1 220.6	3 662.5	10.6	329.3	320.2	41.1	113.1
Per capita	14 385	21 468	29 460	27 073	3 678	21 089	11 938	26 386
At current prices using current PPPs[3]	45.3	1 005.9	2 437.2	8.5	493.1	257.2	49.2	75.7
Per capita	12 763	17 373	19 604	21 833	5 507	16 942	14 294	17 664
Average annual volume growth over previous 5 years	5.6	2.2	4.2	4.1	3.1	3	0.4	1.3
Gross fixed capital formation (GFCF)	15.9	19.1	30.8	27.7	20.8	20.3	16.4	19.2
Of which: Machinery and equipment	6.7	8.9	12.4	..	10.6	9.4	8.2	..
Residential construction	4.3	5.3	5.2	..	4.5	5	4.1	..
Average annual volume growth over previous 5 years	2.9	2.7	6.5	6.5	8.9	2.5	–1.3	–5.4
Gross saving ratio[4]	18.5	17.2	33.9	60.2	16.1	23.5	19.2	21
General government								
Current expenditure on goods and services	16.1	17.6	9.3	17.1	10.1[9]	14.5	16.3	22.4
Current disbursements[5]	..	51.5	25.9	..	..	55.3	..	..
Current receipts	..	43.6	34	..	..	54.1	..	..
Net official development assistance	0.14	0.34	0.3	0.34	..	0.86	0.24	1.13
Indicators of living standards								
Private consumption per capita using current PPPs[3]	7 443	10 936	11 191	12 285	3 978	10 213	8 769	9 189
Passenger cars, per 1 000 inhabitants	228	478	282	470	85	356	440	378
Telephones, per 1 000 inhabitants	279	555	421	413	118	462	430	502
Television sets, per 1 000 inhabitants	271	423	610	252	127	485	372	423
Doctors, per 1 000 inhabitants	1.5	1.3	1.6	2.1	1.1	2.5	1.9	3.1
Infant mortality per 1 000 live births	8.2	8.3	4.6	9.2	43	6.5	8.3	7
Wages and prices (average annual increase over previous 5 years)								
Wages (earnings or rates according to availability)	5.1	6.9	4	..	5.3	2.7	3.9	5
Consumer prices	3.2	5.9	2.2	3	35.8	2.1	4.3	4.2
Foreign trade								
Exports of goods, fob*	28 297	178 217	339 553	..[8]	46 196	140 234	9 831	35 140
As % of GDP	55.5	14.6	9.3	..	14	43.8	23.9	31.1
Average annual increase over previous 5 years	12.1	8.9	8.1	..	17.7	8.6	6.5	10.4
Imports of goods, cif*	22 467	188 524	233 100	..	62 129	134 578	9 159	26 057
As % of GDP	44	15.4	6.4	..	18.9	42	22.3	23
Average annual increase over previous 5 years	10.5	8.6	9.2	..	36.1	8.1	4.8	2.9
Total official reserves[6]	2 502	20 104	52 089	..	13 776	15 954	2 239	8 684
As ratio of average monthly imports of goods	1.3	1.3	2.7	..	2.7	1.4	2.9	4

	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population							
Total	9 858	39 085	8 668	6 875	58 400	57 998	255 610
Inhabitants per sq. km	107	77	19	166	75	237	27
Net average annual increase over previous 10 years	0	0.3	0.4	0.6	2.2	0.3	1
Employment							
Civilian employment (CE)[2]	4 498	12 359	4 195	3 481	18 600	25 175	117 598
Of which: Agriculture	11.6	10.1	3.3	5.6	43.9	2.2	2.9
Industry	33.2	32.4	26.5	33.9	22.1	26.5	24.6
Services	55.3	57.5	70.2	60.6	34	71.3	72.5
Gross domestic product (GDP)							
At current prices and current exchange rates	84.2	576.3	247.2	240.9	159.1	1 042.8	5 937.3
Per capita	8 541	14 745	28 522	35 041	2 724	17 981	23 228
At current prices using current PPPs[3]	95.9	500.2	143.3	152.8	297.3	941.1	5 953.3
Per capita	9 743	12 797	16 526	22 221	5 019	16 227	23 291
Average annual volume growth over previous 5 years	3.3	3.3	0.6	1.7	3.7	0.9	1.9
Gross fixed capital formation (GFCF)	26.2	21.8	17	23.7	23	15.6	15.6
Of which: Machinery and equipment	..	6.8	6.2	8	8.5	7.2	7.2
Residential construction	..	4.3	5.9	15.7[10]	7.6	3	3.7
Average annual volume growth over previous 5 years	6.8	6.2	–0.6	1.5	4.6	0.6	0.7
Gross saving ratio[4]	25.3	19.1	14.1	29.7	23.1	12.8	14.5
General government							
Current expenditure on goods and services	18.3	17	27.8	14.3	12.9	22.3	17.7
Current disbursements[5]	..	..	64.6	35.1	..	42.1	36.7
Current receipts	..	..	59.6	34.7	..	38	31.6
Net official development assistance	0.36	0.26	1	0.47	..	0.31	0.2
Indicators of living standards							
Private consumption per capita using current PPPs[3]	6 124	8 083	8 907	13 043	3 206	10 397	15 637
Passenger cars, per 1 000 inhabitants	260	307	418	441	29	361	568
Telephones, per 1 000 inhabitants	263	323	681	905	151	434	509
Television sets, per 1 000 inhabitants	176	389	471	406	174	434	814
Doctors, per 1 000 inhabitants	2.8	3.9	2.9	3	0.9	1.4	2.3
Infant mortality per 1 000 live births	10.8	7.8	6.1	6.2	56.5	7.4	8.9
Wages and prices (average annual increase over previous 5 years)							
Wages (earnings or rates according to availability)	..	7.7	7.3	..	..	8.3	2.9
Consumer prices	11.2	6	6.8	4.1	66.6	6.3	4.3
Foreign trade							
Exports of goods, fob*	17 990	64 509	55 980	65 478	14 853	190 103	448 033
As % of GDP	21.4	11.2	22.6	27.2	9.3	18.2	7.5
Average annual increase over previous 5 years	14.5	13.7	4.8	7.5	7.5	7.8	12
Imports of goods, cif*	29 588	99 659	49 916	65 587	23 267	220 994	531 070
As % of GDP	35.1	17.3	20.2	27.2	14.6	21.2	8.9
Average annual increase over previous 5 years	17.4	15.3	4.2	5.3	10	7.5	5.5
Total official reserves[6]	13 912	33 094	16 454	24 185	4 480	26 648	43 831
As ratio of average monthly imports of goods	5.6	4	4	4.4	2.3	1.4	1

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Including Luxembourg.
8. Included in figures for Belgium.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

November 1994

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- to prepare regular surveys of the economies of individual Member countries;
- to issue full twice-yearly reviews of the economic situation and prospects of the OECD countries in the context of world economic trends;
- to analyse specific policy issues in a medium-term context for theOECD as a whole, and to a lesser extent for the non-OECD countries.

The documents prepared for these purposes, together with much of the Department's other economic work, appear in published form in the *OECD Economic Outlook, OECD Economic Surveys, OECD Economic Studies* and the Department's *Working Papers* series.

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a) Solid competence in using the tools of both micro-economic and macro-economic theory to answer policy questions. Experience indicates that this normally requires the equivalent of a PH.D. in economics or substantial relevant professional experience to compensate for a lower degree.

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c) A keen interest in and knowledge of policy issues, economic developments and their political/social contexts.

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