

PRODI GOVERNMENT: GRADUAL REFORMS

- *Potential growth, of 1.25%, is constrained by slack demography (though sustained recently by successive waves of immigration) and by the small productivity gains, largely due to excessive red tape, a faulty education system and deficiencies in innovation and research.*
- *Since it came to power in April 2006, the Prodi government has launched several packages of reforms to target increased long- and medium-term productivity and, eventually, to expand the growth potential. The most notable concern the liberalisation of services and the reform of the State.*
- *The divisions of a diverse government coalition, however, tend to slow the reform movement. Consequently, the results as concerns pensions are fairly mixed. As for the upcoming labour market reform, it must be hoped that it will not solely be devoted to eliminating the least secure contracts introduced by the so-called "Biagi" law. This would be to the detriment of the issues surrounding the qualification of the work force and the rate of female and youth employment, which appear much more crucial.*

A true reforming intent ...

Despite the improvement in the economy seen in 2006 and 2007, Italian economic growth continues to be undermined by a variety of structural handicaps: low population, competitiveness, insufficient investment in human capital, too much red tape. Confronted with these handicaps, the Prodi government has, since it came to office in May 2006, demonstrated real reforming intent.

➤ Three waves of liberalisation: the Bersani decrees

The very first economic measures taken by the Prodi government intended to liberalise many business sectors, such as retail trading, taxis, pharmaceuticals, the liberal professions, the local public services and retail banking. This wave of liberalisation took place in several phases. An initial decree was published on 3 July 2006 (law 248 dated 4 August 2006), and then a second on 25 January 2007 (law 40 dated 2 April 2007). A final third package of measures is presently being debated. These decrees are generally associated with the name of their promoter, Pier Luigi Bersani, the minister of economic development.

The implementation of these liberalising measures is proving difficult in some spheres. There has been a significant protest movement: strikes by taxi drivers, demonstrations by the liberal professions, strikes by petrol station attendants. Those sectional movements has led to limitations being put on the scope of the reforms: the abolition of minimum tariffs is being slow to be put into effect by attorneys; taxi drivers have managed to make the allocation of licences be under the jurisdiction of local government; the liberalisation of the petrol trade has been postponed, and the list goes on.

These measures, though sometimes having just symbolic significance, are displaying significant benefits, nonetheless, including, in particular, those of not excessively dividing the parties of the government coalition and of having almost zero cost of implementation for unarguable economic efficiency. The intended goal is to reduce rents in the protected sectors, so that greater choice is available to consumers at better prices. By encouraging competition and therefore the emergence of new players, the goal is also to increase employment (cf. in France, the report by P. Cahuc and F. Kramarz, which recommended tackling the regulated professions, and the work by the Attali Commission).

Initial results are quite encouraging. In July the Ministry of Industry published a second assessment of the measures of the first wave of liberalisation and an initial assessment of the second wave. These assessments show that five of the 30 liberalisation measures already in effect (medicines without prescription, mobile telephones, airline prices, car insurance, bank current accounts) have led to savings in expenditure for consumers of the order of € 2.4 – 2.8 billion over a full year. (continued on p. 28)

The first package (1st decree, July 2006)

Retail

- lifting of restrictions on the amount of bread that can be produced; furthermore, a permit is no longer needed to open a bakery

Liberal professions

- Minimum tariffs for all professional services are abolished
- taxi licences are somewhat liberalised
- non-prescription medicines can now be sold in supermarkets and specialist stores
- it is no longer required that a notary certify the sale of a used car

Public service

- private bus companies are allowed to compete with the public transport service in towns
- contracts with local government authorities must be allocated via a tender process

Financial services

- if contract conditions are changed, the banks may not charge fees on the closure of a current account
- minimum 30 days advance notice for any economic amendment to the contract

The second package (2nd decree, January 2007)

Financial services

- mortgage loans become portable
- penalties for early repayment of housing loans abolished on loans taken out after 2 February 2007
- car insurance: insureds are compensated for a loss directly by their company; obligation to give reasons for the downgrading of insurance rating, etc.

Retail

- transparency for fuel prices (signage, etc.)
- airlines must list all the components of the cost of the ticket and state the all-inclusive price
- the fixed fee taken by mobile telephone operators on recharging mobile phones is abolished; contracts may be transferred to another operator (operators cannot require a notice period of more than 30 days)
- hairdressers allowed to open on Mondays
- minimum distance between cinemas abolished

Liberal professions

- free access to the businesses of hairdressing, driving schools, beauticians, cleaning, disinfection, door-keeping

Corporations

- creation of companies: introduction of a one-stop-shop, the chief expression of which is a web portal, which will simplify the administrative steps, which will now be able to be completed in one week, rather than 35 days previously.

Additionally, the liberalisation measures affecting the sale of medicines, the pricing of mobile telephone services and of air travel have reportedly led to a reduction in the rate of inflation by a little more than 0.2 of a percent.

Furthermore, these measures have enabled new businesses to start up. In a little less than a year, 1,148 businesses were registered with the ministry of health to sell non-prescription medicines. Between July 2006 and July 2007 3,793 bakers opened.

The third package (under debate in the Senate)

Financial services

- abolition of fees on maximum overdrafts (*Massimo scoperto*¹). In debates in the Chamber, the banks gained the possibility of replacing the abolition of maximum overdraft fees with an alternative mechanism (reducing the cost to €2.2 billion, as opposed to €3 billion in the original draft)

Transportation

- liberalisation of rail transport services with a guarantee of universal service

Retail

- telecommunications: transparency in billing, reduction of roaming prices, strengthening of the powers of the regulator to promote competition in the Internet market

- opening rules (days and times) of bakers put in line with other shops

- liberalisation of book prices: elimination of the ban on allowing a discount in excess of 20% during the first two years after publication

- pharmacies: institutions that were permitted by the first liberalisation package to sell non-prescription medicines will also be able to sell category "C" products (ones that require a prescription, but are not paid for by the health care system) on the condition that the customer be assisted by a pharmacist; reduction in requirements for being the owner of a pharmacy

Energy

- fuel: abolition of the minimum distance between petrol stations; fuel stores are allowed to sell other types of products; introduction of a kind of floating domestic tax on petroleum products

- incentives to encourage the expansion of gas distribution companies

Liberal professions

- open access to the specialties of real estate agent, broker, business agent or retail representative

Corporations

- various measures to cut red tape

Buoyed by these successes, the government launched a third wave of liberalisation. The draft law was adopted in June by the Chamber, but is still in debate in the Senate. This third package puts back on the table the issue of liberalising the petrol trade (leading to a strike by petrol station attendants from 10 to 12 October), includes new measures to liberalise financial services and telecommunications, as well as transportation and energy.

➤ Lightening of the tax burden on work

The 5% reduction of the tax on labour (*"cuneo fiscale"*) was the leading light of Romano Prodi's *Unione* coalition's programme. This measure was introduced in the 2007 finance law. To limit its cost, it was nonetheless targeted at permanent employment contracts and on poor regions. In addition, its implementation did not involve a direct lessening of social security levies.

¹ Banks used to calculate overdraft fees by applying the debit rate on the maximum overdraft reached over the period.

The reduction of the tax on labour is predominantly beneficial for corporations via the reduction of the regional tax on productive activities: €2.5 billion in 2007, and €4.6 billion for the whole year of 2008. The reform takes the form of a €5,000 reduction per year and per employee on a permanent contract, this financial benefit being doubled for companies in Mezzogiorno. It is, however, of benefit to households via deductions of income tax and increases in family allowances for around €3 billion in 2007 and 2008. The drop in the tax on labour over the whole year is therefore split 60% for companies and 40% for households.

➤ Reform of the State

In 1993 ("privatisation of the public service"), and then from 1997 to 1999, with Franco Bassanini, Italy carried out significant reforms of the public sector, which resulted in payroll savings valued at nearly 2 percentage points of GDP. A new stage of modernisation of the public sector will be achieved with the "memorandum on the reorganisation of the public administration", signed on 18 January this year. This agreement has three objectives: to increase mobility, reduce "insecurity" and strengthen the individualisation of careers.

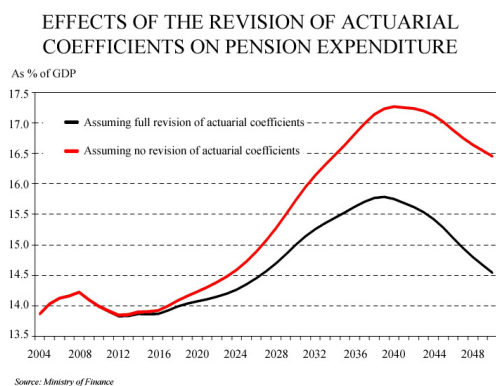
To reduce "insecure" employment (non-permanent jobs with an uncertain future) in the public service, the minister for reforms of the public administration announced that, within the next six or seven years, 500,000 temp staff would be made permanent. In recognition of the government's desire to reduce employment insecurity in the public sector (the number of temp staff grew under the Berlusconi government), the unions agreed to important changes: territorial mobility on the basis of economic incentives, compensation and promotion by merit, as well as a reduction in staff. The government plans not to replace 40% of retirees (two out of ten in the 2008 budget) and in this way to reduce the staffing levels of the public sector by more than 300,000 positions over the next seven years.

➤ Pension reform

To ensure that the public finances will be sustainable over the long term, Italy – like other European countries – has had to review its system for financing pensions. The reforms made since 1992 already make it possible, if fully implemented, to contain the rise in expenditure on pay-as-you-go public pensions. Whereas, if the reforms had not taken place, these expenses would have been in excess of 23% of GDP by 2040, they should now rise from a present level of 14% to a peak of 16-17% between 2030 and 2040. Despite this positive financial aspect, the implementation of the previous reforms has been disputed. The unions are seeking to overturn the 2004 reform put through by the Berlusconi Government. It raised the retirement age from 57 to 60 in 2008 (with 35 years of contributions), which unions see as too abrupt a change. In the electoral campaign, the *Unione*, the coalition led by Romano Prodi, had also denounced this ladder step (*"scalone"*). An agreement was reached on 20 July this year. The *"scalone"* was put in jeopardy in favour of a more gradual increase. The retirement age would rise from age 57 currently to 58 in 2008 and will then be extended to age 61 in 2013². On the other hand, the government has not managed to obtain the principal quid pro quo that it was seeking from the negotiation with the unions, i.e., the revision of the transformation ratios that determine the pensions in

² The system is in reality a little more complex. Starting in mid-2009, a points system will be implemented. The points are obtained by adding up the retirement age and the number of years of contributing to the pension system. Starting in mid-2009, you will need 95 points (59 years of age + 36 years of contributions or 60 years of age + 35 years of contributions); from 2011, you will need 96 points; and from mid-2012, 97 points will – in principle – be necessary (61 years of age + 36 years or 62 years of age + 35 years).

the system introduced by the 1995 reform³.



The review every 10 years that was planned by the 1995 reform never took place. This raises a problem, since life expectancy has increased by more than two years over the last 12 years. The government fears that if the ratios are not revised, pension expenditure will explode by more than 3% of GDP by 2040. With a revision of the ratios, the rise would be half as much. The outcome of the negotiations on the transformation ratios has been postponed until the end of next year and, in any case, the new ratios would only apply starting in 2010.

The Prodi government has, however, launched the second leg of the reform (one year ahead, compared with the schedule set out by Berlusconi) towards a funded pension scheme. On the basis that “silence is consent” (*“silenzio assenso”*), the reform means that for employees who have not explicitly made a different selection prior to 30 June 2007, their pension compensation (*“Trattamento di Fine Rapporto”* or *“TFR”*) will be automatically transferred into a supplemental pension fund. Italians can opt for one of the large pension fund families, by joint membership (funds attached to branch-based collective bargaining agreements, i.e., “closed”) or individual membership (open funds which all workers can join without discrimination, or individual pension policies taken out by the worker on a personal basis). For situations that do not correspond to any of the above situations, the TFR will be paid into a fund managed by the State (via the INPS, the Italian social security system).

The outcomes of the reform are mixed, with a slightly larger proportion of employees than expected having preferred to retain their retirement savings (*“TFR”*) in their own company⁴. However, there is a strong increase in the number of members of pension funds. The COVIP (*Commissione di vigilanza sui fondi pensione*), the authority that regulates pension funds in Italy, estimated in a report published in mid-September that over the first six months of the year 900,000 private sector employers joined a supplemental pension scheme. This is a 50% increase over the end of 2006: Italy now has 2.7 million members of a pension fund, as opposed to 1.8 million at the end of 2006⁵.

³ In 1995, the principle of a pension calculated on the basis of the last salaries (*“sistema retributivo”*) was eliminated in favour of a system with defined contributions (*“sistema contributivo”*). This is a pay-as-you-go pension system based on individual notional accounts, similar to the one previously introduced in Sweden. A transformation ratio is applied to this lump sum accumulated over the working life to produce the pension amount. This ratio should increase with the age of retirement and decrease with life expectancy.

⁴ At the start of August, the ministry of employment published the following results: 64% of employees choose to retain their TFR in their company; 34-35% are putting it into a pension fund (10-15% due to the “silence equals consent” clause).

⁵ 2.7 million out of just more than 12 million employees affected by the reform (i.e., those who have a TFR). However, four million of them were already able to take out a supplemental pension fund before 31 December 2006. Therefore, the figure of 900,000 new subscribers could be compared with the 8 million employees who did not have access to a pension fund prior to the end of 2006.

Out of the 900,000 subscribers, 600,000 opted for a closed fund, 190,000 for an open fund, and 110,000 for an individual policy (*“PIP”*) with tax-advantaged status.

➤ Towards new labour market reforms

Several labour market reforms have been undertaken in Italy since the early 1990s. Since the elimination of the *“scala mobile”* – indexation of salaries on prices – in July 1992, the reforms have followed one after the other: *Pacchetto Treu* in 1997, the “Christmas pact” in 1998, the “Biagi” law in 2003. These reforms aimed to free up the jobs market by encouraging the use of temporary and/or part-time work and by introducing (with the “Biagi” law) new types of contracts (project contract; long-term interim contract or staff leasing; on-call job; intermittent contract, without any determination of length of time, renewable at the request of the employer; job sharing; and so on).

These reforms did give a boost to employment, but also increased the dualism of the labour market, since protection of permanent work was not relaxed. Additionally, despite these reforms, the rate of active participation in employment has been stagnant for the past three years. Labour force participation of people aged 15-64 is 62.5% in Italy, compared with nearly 70% in France, and more than 70% in the EU15. The labour force participation rate is particularly low for women and at the two extremities of the age pyramid.

Working from this finding, the authorities, in a memorandum of understanding dated 23 July 2007 on pensions, employment and competitiveness, laid down three themes to deal with in the labour market: increase the participation of women and young people in the labour market; the major role of the negotiation among the social partners with respect to the operation of the labour market; restrict and better structure use of temporary labour. It is thus proposed, among other things, that the following be reformed:

- incentives to encourage employment of young people, women and workers aged over 50;
- short-term employment agreements: review the regulation to make the rule that limits presence on a short-term contract to 36 months in the same company more stringent;
- part-time work: strengthen collective bargaining in the management of part-time, by giving unions the possibility of introducing more elastic and flexible clauses. Introduce incentives for long part-time contracts (25-30 hours);
- Employment on demand and staff leasing: plan to repeal the rules concerning employment on demand and discussion with the social partners about these kinds of contracts;
- apprenticeships: strengthen the role of collective bargaining in the definition of the national standards of professional qualification and training paths.

... slowed down by the divisions of a multivariate coalition

The Prodi government has begun many reforms. However, the reforming zeal of the moderate wing of *Unione* is constantly disputed by the left wing of the coalition, which relies on social movements (especially on the strongest union, the Cgil). Each reform, each budgetary arbitrage, gives rise to intense negotiations within the coalition. In addition to slowing down the move, it is also clear that these jostlings could threaten the very balance of a reform, when it comes to pensions (the non-revision of the actuarial ratios).

Early elections, from 2008, are not out of the question⁶.

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⁶ Walter Veltroni, the mayor of Rome, has just succeeded Romano Prodi as leader of the left-center coalition: it is thus him who would lead the campaign against the coalition led by Silvio Berlusconi.

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