Italian Business Trends

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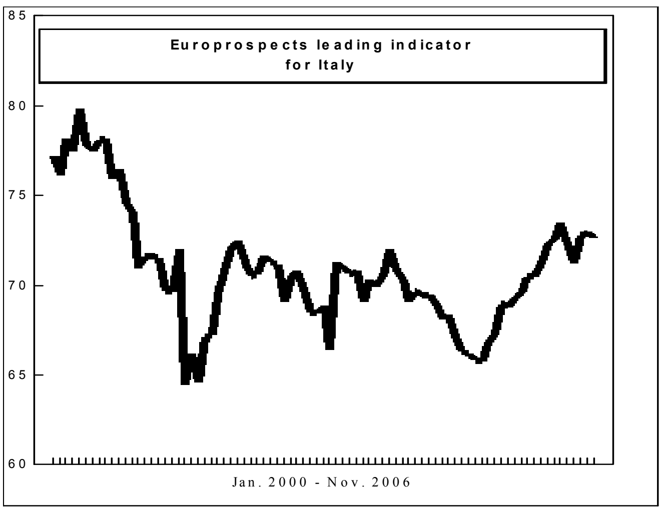
THE BATTLE OF THE TWO PRODIS

INSIDE THIS ISSUE:

There is a critical question that Romano Prodi, Prime Minister and leader of a composite coalition that goes from unreformed Communists to free market radicals, must settle. Does he want to be above all the linchpin of the coalition, or the architect of reform ? The two roles are alternative – they cannot be carried simultaneously by the same person. If he chooses the first role, Prodi can expect to be politically secure, at least in the short term. Reforms would be either greatly watered down or avoided altogether, maintaining the support of the left wingers, who oppose the social, labour market and public finance changes advocated by the reformists. The latter may be dissatisfied to the point of openly criticising the Government, but could they really rebel against the Premier and cause the collapse of the coalition and the early end of this Parliament ? On the other hand, if he chose to be the leader of reform, Prodi would become the declared head of the moderate wing of his majority and almost certainly go to a clash with the radicals which could unseat him as in 1998. In his battles, he would need the support of the reformist parties and their leaders. Perhaps because the choice is so lopsided, so far Prodi has always preferred the first option. This has been the case also in the design and conduct of the 2007 Budget strategy. The result has been a degree of unity, allowing the coalition to survive and to obtain the Budget's approval in spite of its tiny majority. But also, a general disappointment among those who expected incisiveness and political courage.

The reformers are now becoming restless, partly because of opinion polls showing a decline in Government popularity. Economically, there are fears that the revenue raising stance of the new Budget threatens to asphyxiate a recovery which is already running out of air.



The result is pressure for a new stage in Government policy, to begin in early January. There will be numerous opportunities. Talks between Unions, employers and the Government are set to start soon on pensions and the labour market, including reform of the civil service. Early in the new year Parliament will examine bold bills concerning local finance and the professions. Once the Budget is safely approved, Prodi could feel free to seize these opportunities to promote bold reforms. But he hesitates, and seems still more inclined to give priority to the continuing support of the radicals. He may soon find that, contrary to assumptions, the reformists can be no less demanding and determined than the radicals.

CAN PRODI DELIVER REFORM ?

It is true that the fiscal strategy for 2007 is disappointing in many respects. But it is also true that the Prodi Government had no real alternatives if it wanted its centre-left majority to approve a package large enough to achieve the required public deficit reduction and to finance key electoral promises and essential spending rises.

This lack of alternatives explains why the strategy has been widely supported by the entire Union coalition, including its reformist core. Many would have preferred a different package. But almost all accept that because of the budget deadlines and of the political make up of the Union a different strategy would not have been possible. For the moment the imperative is to achieve approval of the package before the end of the year. Then, however, a new stage will open. Either Prodi and his colleague show themselves able to put on the agenda a reformist programme, or the present majority will be face an early crisis.

The fiscal proposals are contained mostly in the Finance Bill and in an urgent decree introduced separately in Parliament. They implement choices which were outlined in in the Economic and Financial Planning Document (DPEF). This document recognised the need to keep the promise, made to the EU, to cut the public deficit to less than 3% of GDP next year, to refinance the public infrastructure programme, as well as regional and research policy programmes, and to carry out the reduction in labour costs that Prodi had promised during the election campaigns. Taken together, these objectives required a € 35 billion package, the DPEF estimated. The document was revised in September, mostly to take account of a larger than expected increase in tax receipts. During the preparation of the package and the Parliamentary debates there have significant changes, but the size remains close to the one initially planned.

Of the € 35 billion, € 15 billion (or 1% of annual GDP) are meant to cut the public deficit from an expected underlying figure of 3.8% of GDP in 2006 to 2.8% next year. The rest of the package, almost € 20 billion, is officially aimed at promoting growth. This second part includes the reduction in labour costs and the funds for infrastructures, regional policies and research, as well as other items, such as the funds needed to finance the renewal of contracts with central Government employees.

According to the official line, of these € 35 billion about 40 % will be generated by tax rises and 60% by expenditure cuts. The first criticism of the package is that in fact the overwhelming majority of the package will rest on rises in taxes. The second main criticism is that the Government has missed its first big chance of launching deep structural reforms, particularly regarding public spending. Thirdly, there are serious doubts about the wisdom or even the technical value of some of the principal components of the package. Lastly, many argue that the Government, whilst being careful to keep the Unions on board, has taken its decisions with little consideration for the business sector, and especially for small and medium sized enterprises and the self employed.

It is difficult to argue against these attacks. Each of them is grounded on good evidence. But it is also true that politically it would have been difficult if not impossible to make different choices. Of course, things could have been handled better. Important policy details were repeatedly changed, giving a impression of disorder and confusion. Presentation was almost always of poor. It would have certainly been better to consult much more widely and genuinely with small business representatives. It remains that there was no realistic hope of launching structural reforms and of relying much more on genuine expenditure cuts. There was not enough time, in view of the tight budget deadlines and of the need to carry the entire majority – inclusive of the left wingers who are determined to oppose spending cuts.

Each of the four principal criticisms deserves to be considered in some detail.

Firstly, why do critics deny that 60% of the package comes from spending cuts ? The short answer is that Government considers cuts reductions in central Government spending – what is being debated is, after all, the budget of the central Government budget – not the one of the entire public sector (although the deficit target does concern the entire public sector). What is a cut for the central Government may, and in this case probably will in most cases, cause a tax or contribution rise in a different part of the public sector. The central Government spending cuts concern mostly transfers to local Government, to the National Health Service and to the INPS, the principal Italian Social Security institution. But in each of these cases there is either the strong probability or the certainty of tax and contribution rises. The most obvious case is the one of INPS. The reduction in central Government transfers will be possible only because of rises in the Social Security contributions paid by employers and the self employed. These rises will total about € 5 billion. Another € 5 billion – or more – are expected from transfers to INPS of funds currently held by employers as employee severance pay provisions (of which more later). Similarly, the cuts in transfers to local Government could be matched by reductions in local Government spending, but are much more likely to be financed through higher local taxation. After all this is the reason why the 2007 fiscal package allows Communes to increase more, and more rapidly, their surcharge on personal income tax, to increase property taxation and to raise funds targeted to the financing of new project. As for National Health Spending, this is meant to rise less rapidly that it would otherwise, and to remain stable as a percentage of GDP. However, the ultimate sanction in case of excess spending could be – as has been the case this year – a rise in the taxation levied by the regions.

The second criticism, according to which the Government has missed a golden opportunity to make an early start in the reform of the public sector through an incisive intervention on spending, is closely linked to the first. It is because it decided to rely overwhelmingly on revenue that the Government gave a low priority to genuine spending cuts and to the fight against public sector waste. Again, the most obvious example is the one of the welfare system. None of the spending reduction measures that had been mentioned, such as a reduction in the opportunities for early retirement or a revision of the coefficients used to calculate pensions, has been included in the budget. No direct pressure will be applied to local Government spending. The spending increase caps that were applied by the Berlusconi Government have been abandoned. In the National Health System the Government has obtained the support of the Regions for the possibility of direct interventions if in future spending exceeds targets. But is it realistic to assume that these powers would be used when, at the same time the Government has also set aside € 1 billion to help the regions which have been exceeded spending targets in 2006 ?

The third criticism concerns mostly the fight against tax evasion and severance pay provisions. Almost € 8 billion of budgeted extra revenue is meant to be generated through the fight against tax evasion and tax elusion, and also through a revision of the sectoral coefficients used to monitor tax compliance by small and medium sized businesses. But this is a highly objectionable way of projecting revenue rises, since it is largely based on assumptions regarding the likely effectiveness of the fight against tax evasion. There are also serious doubts about the merits of the € 5 billion that employers are meant to transfer INPS next year. At present employers must set aside each year about 7% of employee gross pay as a severance pay provision. When the employee leaves, severance pay is liquidated but during the time of employment until then the provisions are in the employer balance sheet, where they are revalued at a modest rate. In order to promote the expansion of the complementary pension system, employees will soon be allowed to transfer newly maturing severance pay provisions to complementary funds. The reform has been in preparation for many years under different Governments. The Berlusconi Government had scheduled it to start in 2008. The Prodi Government has brought that forward to next year, making a very important innovation. Until now it was understood that employees could either maintain their maturing severance pay as at present, that is, as a slowly revaluing but fairly secure employer liability, or decide the transfer their credits to pension funds. Now the Prodi Government has been decided that if the employee does not choose a complementary pension fund, the employer will still lose control of the money. This will have to be transferred to INPS. Initially the forced transfer concerned all employers, but only half of the maturing provisions. After much lobbying, business representatives have obtained that INPS will receive the provisions only of businesses with 50 or more employees – but these businesses will have to transfer the entire new provisions, not just 50% as initially planned. Each new severance pay provisions amount to about € 15 billion, and the Government expects that of these € 5 billion will go to INPS. There are two problems with this project. The first one is that it too is based on assumptions whose realism is debatable. Employees could decide to transfer the provision to pension funds in a much greater measure than the Government assumes. Secondly, even assuming that the € 5 billion figure is correct, is it questionable that this money could be considered as an increase in public revenue, since it carries with it the obligation of a future refund. Some observers wonder whether the EU will accept the Italian Government's definition. From an economic point of view this is not more than the transfer or a liability, although in the short term the cash position of INPS will be improved.

The last of the four main criticisms concerns the contrasting way in which the Government has dealt with Unions and business representatives. There has been a big effort – and one broadly successful - to keep the Unions on board. By contrast, business organisations, with the partial exception of Confindustria, were at best informed, not really consulted on the fiscal plans. This is one of the main reasons why small business organisations, including some that have been traditionally close to the left, have been the principal critics of the manner and content of the 2007 fiscal package. The Government has delivered on the electoral promise to lower labour costs, but only 60% of the cuts have gone to employers, the rest being addressed to employees (who will reap the reductions through the newly introduced income tax changes). Furthermore at the same time small businesses and the self employed have been hit directly and indirectly. There will be a general 0.3 point rise on employer Social Security contributions. There will be big increases in the contributions paid by the self employed and by project workers. The increases in local Government and health charges will largely hit businesses. The fight against tax evasion is meant to be targeted principally to small and medium-sized businesses – not least through the revision of the sectoral coefficients used for tax assessments.

Business is unhappy also because of what it views as a wholly inadequate effort to master public spending. Why should the burden of fiscal adjustment lean so heavily on raising revenue, in particular on higher business taxes and contributions, when there remains so much inefficiency in the public sector ?

In fact, this discontent is far from being circumscribed to businesses. The lack of structural spending reforms was probably one of the main reasons that induced Standard and Poor's and Fitch to lower their Italian sovereign debt rating in October. Former EU Commissioner Mario Monti has given voice to a dissatisfaction which seems to be widespread to be shared by many of the reform minded supporters of Prodi and also by many majority politicians.

The principal cause of this failure is the lack of realistic alternatives. Prodi and his Ministers could have certainly handled matters better. They could have planned more carefully, moved more deliberately, communicated more orderly and consulted more widely. This would have eliminated or greatly reduced the impression (and reality) of confusion and disunity that has contributed to the decline in public confidence and support. But what could not be delivered in the short term was an energetic and far reaching approach to public spending.

This is partly for technical reasons. In the short term during which the Government must achieve the deficit reduction agreed with the EU revenue rises are much more likely to yield results than spending reduction efforts. Above all, however, there is the political imperative of keeping the majority together. The far left parties of the Union, already irked by foreign policy decisions, notably on Afghanistan, would not have supported an aggressive approach to public spending. And the tightness of the deadlines did not effort the time to negotiate, explain and counterbalance.

Because they are aware of these constraints, the reformist parties of the Union and their leaders have not tried to push Prodi toward a different strategy. However, they have intervened to ask Prodi to promise a second stage in his economic policy, to start in the new year, once the 2007 budget is safely approved.

This means that until early 2007 Prodi should be able to rely on the support of his entire alliance, of the radicals because he has taken full account of their priorities, of the reformists because they realise that his hands are tied. But soon in the new year Prodi will have to start showing that he can deliver on genuine reforms, starting with pensions, local Government and public employment.

Negotiations on pension reform have already agreed between the Government and the main Unions. According to a joint document signed in late September, the talks are meant to start in early January and to be completed by the end of March. The present pension rules were put in place as a result of an agreement between the main Unions and an earlier Government, in 1995. That agreement foresaw the need for a ten-year review of the pension coefficients – but this review has not yet been carried out. The September document is broad enough to allow an incisive reform. It mentions the need to complement the reform process started ten years ago by taking account of increased life expectancy, changes in economic conditions and in demographic trends. However, it also lists other priorities, including the widening of other types of welfare benefits. Thus, while the premises exist for a genuinely incisive reform, there is the potential for a stalemate.

Similarly, there exists among the Union leaders a readiness to negotiate a new type of public employment contract which puts new emphasis on accountability and results. Negotiations for the two-year pay period which started in January 2006 are well overdue (but for a long time late agreements have been the rules in the public sector). In recent weeks the Government agreed with the Unions the rules under which the talks will be held and the funding that will be available in 2007. In this domain too, there are opportunities for genuine novelties, but also a history of disappointed ambitions.

On local finance Regional Affairs Minister Lanzillotta has prepared several bill which will are likely to come in front of Parliament early in the new year.

The opportunities for a Phase Two economic policy – a period of structural reforms – exists. But whether Prodi can seize it, and whether he will be able to negotiate it successfully whilst retaining the support of the Union's far left parties remains very uncertain.

Italy's Agenda

A review of the current status of key projects, bills and debates

Phase Two to start with pension and labour market negotiations

'Phase Two' of the Prodi Government will start in early January with talks on pension reform. The talks and their broad content were agreed in late September between the Government and the four leading Unions (UGL, as well as the traditional three). The two-page document signed in September is vague enough to allow for a huge variety of outcomes. The leading idea is to adapt the present pension system, as profoundly reformed in 1995, to changing conditions – such as the increase in life expectancy. The singatories sides intend to reach an agreement by the end of March.

The reformist component of the ruling coalition aims for two principal results, an increase in the average retirement age and a reduction of the coefficient which links pension levels to pension contributions. The aim is not just to review the 1995 reform but also to make room for a key electoral promise of the Olive Tree: the abolition of the sudden jump in retirement age decided by the Berlusconi Government with the Maroni reform. According to the Maroni reform, from the start of 2008 the minimum retirement age will increase from 57 to 60 ('*scalone*'). This change is meant to achieve pension expenditure savings which will rise to € 9 billion a year and to counteract a spontaneous long term increase in pension expenditure as a percentage of GDP. If the Government maintains the promise to abolish 'scalone' but also wants to keep pension spending under tight control, it needs to find alternative reforms.

The leadership of the main Unions would accept incentives that induce workers to retire later and might be persuaded to accept a lowering of the pension coefficient. In the summer, an advisory committee chaired by a centre-right politician calculated the required coefficient cuts to a range between 6% and 8%. However, there will be serious political obstacles because the three far left parties of the Union coalition (*Rifondazione*, PDCI and the Greens) strongly reject any reform which results in a pension decrease. Their main arguments are that the 1995 reform is already producing satisfactory results and does not need to be modified (although some reject the 1995 reform itself, on grounds of equity) and that the electoral programme agreed by the Union last year did not contain a pension reform. It only promised to abolish '*scalone'*. The clumsy intervention of Reforms and Parliamentary Affairs Minister Chiti (according to whom the electoral programme 'is not the Gospel') and the determination to proceed with the reform shown by Prodi and others has been met with threats of rebellion in Parliament, and especially in the Senate. Both sides are entrenching themselves and one of the two will have to lose face – unless pension reform becomes the occasion for a political realignment.

In January Labour Minister Damiano will organise a separate negotiating round with the Unions, and also with employer representatives, concerning the future of the labour market. This will be the first opportunity for the Government to announce its precise intentions as to the future of the Biagi labour reform law, passed under Berlusconi. The official line of the Government is that it wants to amend that law but not to repeal it, as the left wing of the Union wants. The talks will also concern unemployment benefits and other welfare benefits targeted to the labour market. The Berlusconi Government had put this item on the agenda but made little progress because of the potentially heavy consequences for public finance. Negotiations carried out in parallel with those on pension reform could help in that the Government would seek to persuade the Unions to accept a downward revision of the pension system as part of a reshaping of the welfare system which includes better labour market provisions. Such a shift would also help to bring Italy in line with other European countries. While pension expenditure is comparatively high in Italy, total welfare spending is lower than that of comparable countries. Damiano also wants Unions and employers to include in these negotiations a review of fixed term labour contracts rules. The present rules were agreed only a few years ago, in 2001, and implement a EU directive. But in 2001 not all Unions agreed to the new rules. The largest (and the one in which Damiano started his career , CGIL) opposed the rules. Now the Minister argues that the 2001 agreement is no longer suitable to present conditions and wants Unions and employers to agree tighter restrictions on the use of fixed term contracts. There would have to be much more stringent reasons than are required at present to make fixed term contracts, and there would have to be ceilings on the maximum number of fixed term contracts that an employer can have as a percentage of total employment. While initially Unions and employers would be left to negotiate new rules, if no agreement is reached the Government would intervene with its own rules. Confindustria, small business representatives and the two main Unions that participated in the 2001 deal are very critical of the initiative but none has threatened to refuse the negotiations.

REFERENDUM PROJECT INCREASES STIR ON ELECTORAL REFORM

The official submission, at the end of October, to the Cassazione Court of a referendum project to modify the present electoral system has given added energy to the search for an agreement among majority and opposition. However, because of the complexity of the matter, of the divisions within both majority and opposition, and of the risk to Government stability, there is no early prospect of a reform.

The present electoral system was passed by the Berlusconi Government during the last months of the last Parliament. It has been much criticised for leaving the country without a strong Parliamentary majority, but this criticism is arguably misplaced. On the contrary, it could be argued that it is only because of the new election rules that Prodi has a strong majority in the Chamber, in spite of having obtained only 25,000 votes more than Berlusconi. It is true that in the Senate the majority is exceedingly narrow, but with different rules Prodi would not have had any majority at all in the Senate. The present system gives a big premium of seats to the most voted coalition. However, while in the Chamber the premium is calculated nationally, in the Senate it must be calculated separately in each region (doing otherwise could be against the Constitution). This means that there are large seat majorities in each region, but once these are added up nationally there is no certainty of a clear result. This shortcoming is due not to electoral reform but to the Constitutional requirement imposed on it.

The attempt to modify electoral rules again is motivated by different reasons. There are those who genuinely believe that the present rules have serious faults. Candidates can stand in many constituencies and then, if elected in several, select the one that they will represent in Parliament. Electors have no way of choosing among individual party candidates, since the vote goes to the party and the candidates obtain seats in the order in which they are listed.

However, most of the politicians that urge a change in electoral rules pursue the aim with a political agenda. The larger parties resent the influence of their smaller allies and seek new rules to fortify alliances and diminish or eliminate the veto powers of minorities. No reform can guarantee political and Parliamentary stability, especially as long as Governments need the support of two Chambers of Parliament elected separately and with different rules.

Referendum supporters want to make three changes. Firstly, in future the seat premium would go to the most voted individual party, not the most voted coalition as at present. This would create a huge incentive for parties to merge. It is no surprise that among the supporters of the project are those who champion the merger of DS and Margherita into a Democratic Party. Secondly, the present thresholds to obtain seats in Parliament (4% of votes in the Chamber and 8% in the Senate) would apply to parties not to coalitions. This would mean the disappearance of the smaller parties in the Senate and, probably, a serious pruning in the Chamber. Thirdly, candidates would not longer be allowed to stand in multiple constituencies.

The referendum initiative has been taken largely in order to force Parliament to change the law. This is because – assuming that the referendum is backed by enough electors – unless Parliament decides a reform, it will have a reform imposed on it. In order to avoid the referendum the electoral rules would have to be modified substantially, but not necessary in the way indicated in the referendum project. Even so, there is a big division between small and large parties. The latter are ready to seek a compromise, the former fear that any reform would be designed to diminish their influence and authority. The Northern League and UDC, in the opposition, are no less concerned than *Rifondazione*, PDCI, IDV and Udeur, in the majority.

Vannino Chiti has started consultations with both coalitions, but there is no narrowing of opinions, and, in spite of Prodi's intervention to urge a change in electoral rules, there is no prospect of a breakthrough.

Majority divided on local government reform

While talks about electoral reform and the negotiations on pensions and the labour market will take place outside, in Parliament the Second Phase of the Prodi Government will begin with a debate on local Government. One of the items in the summer liberalisation package was a bill requiring local authorities to privatise most of their utility services (Lanzillotta-Bersani Bill) . The bill contains not the final reform but general principles and power delegation for the Government to implement them by decree. The bill was introduced in the Senate shortly after the publication, in early July, but has not yet made any real progress. It remains at the committee stage. This is mostly because of disagreements between the Government and representatives of the Communes. The latter want to change the bill in order to allow local authorities to continue to carry out utility services in-house. In the present version of the bill, such a possibility would exist but only exceptionally – apart from for water services. That this reform is difficult and controversial can be appreciated by noting that the Berlusconi Government, faced with strong opposition, renounced carrying it out. Now again the issue is highly politicised, since it creates another clear division between reformist and radical parties of the majority. The reformist support the Lanzillotta-Bersani Bill, as recently highlighted by the fact that Deputy Prime Minister Rutelli included local service privatisation in his reform agenda for the new year. Against that, *Rifondazione* and the other radical parties strongly reject the bill. By itself this is not an issue that would be likely to break the majority, but it coming together with other highly controversial matters could cause a very serious internecine conflict.

The debate on the Lanzillotta-Bersani Bill is likely to take place at about the same time as two other important local Government reforms are introduced in Parliament. One would reform the present local Government Code (*Testo Unico*); the other would at last contain the provisions implementing fiscal federalism, the financial counterpart of devolution which has been on the agenda since the start of the decade, but which has not yet been implemented. On both bills the Government is carrying out consultations with local Government representatives and aims to introduce bills in Parliament early in the new year.

Mastella prepares for profession reform test

Justice Minister Mastella has completed the draft bill for the reform of professional orders. The bill has not yet been adopted by the Cabinet, but adoption should happen soon.

The bill contains the guidelines that the Government would have to follow to reform professional orders through delegated legislation within 18 months of the bill becoming law. Reforming the Orders has been attempted for about a decade. A majority bill came near approval at the of the last Parliament. Mastella has paid tribute to the predecessors of different majorities, describing his draft bill as a continuation of their work. The bill is also meant to complete the work initiated by this Government in the summer through the Visco-Bersani urgent decree, which was finally approved by Parliament in early August. That decree contained provisions which abolished minimum tariffs for services provided by members of professional Orders, allowed advertising and allowed professional services to be carried out by companies.

The obstacles facing Mastella are the same that have delayed the reforming process during the last decade. Professional Orders have a legal status recognised in the Constitution. They are set up to regulate and supervise the activities of professions providing services which affect vital interests, such as health and legal rights. They are meant to ensure proper standards and to protect the public. However, their activities also benefit members not least through a restriction of competition, and critics argue that radical reform is needed, partly in order to take account of changes in the country and of international trends. The professionals who are members of Orders carry out activities not all of which are reserved to them by law. These non-reserved activities can and are be carried out also by professionals who are not members of recognised Orders. Associations have sprung up to represent these categories of professionals, and these associations have long demanded to be given official recognition, so that membership is viewed by the public as a service quality guarantee. One of the most controversial points of the reform attempt concerns this recognition demand and the activities that it would cover – whether all the activities that are not *reserved* to professional Orders or only activities that are not *typically* provided by Order members.

Another reform item is access to the Professional Orders. The Orders have had a preponderant role in the State exams that must be passed to obtain Order membership, and have been accused of limiting access so as to limit competition. Also, new members are required to undergo a training period in existing professional practices, where they frequently end up doing unpaid or very low paid work – often with little genuine training.

Unlike Bersani, who in the summer launched his decree without any consultations, Mastella has consulted widely, and his draft bill, although criticised by many, is not bitterly opposed as the Bersani reforms were (and to a degree still are), partly because his text is rather broad, giving considerable latitude to the Government in exercising the delegated legislation powers that would be conferred by the reform bill. This means, however, that the debate and the lobbying will remain strong after approval of the bill.

The Mastella reform would allow official recognition of new professional associations, would reduce the role of the Orders in the State exam commissions, would seek to improve the conditions of Order trainees, and would allow Orders to be merged. The bill also specifies the general rules under which professional services could be carried out by companies.

NEW BROADCASTING RULES READY FOR DEBATE

The Government has introduced in Parliament its proposals for a new major reform of broadcasting, largely replacing the Gasparri reform approved during the last Parliament.

The reform would seriously hit Mediaset, the broadcasting group created and owned by opposition leader Berlusconi. Mediaset would be forced to abandon analogue broadcasting for one of its three national television, and would be forced to cut its advertising sales by up to a quarter. State-owned RAI would also have to abandon analogue broadcasting of one of its three national television channels.

The bill, authored by Communication Minister Gentiloni Silveri, was unanimously adopted by the Cabinet in mid-October and is now at the Committee stage in the Chamber of Deputies.

The Gasparri reform was built on the assumption of an early switchover to digital. It adopted the 2006 deadline, which had been chosen by the a centre-left Government in 2001. Because digital technology greatly expands broadcasting capacity, the assumption that it could soon become the sole broadcasting standard in Italy undermined the argument of those who wanted to force Mediaset and RAI to cease analogue broadcasting of one station each and make capacity available to competitors. The switchover deadline was moved to 2008 before the end of the last Parliament, but the new reform project moves it further, to 2012. This means that the present analogue media concentration could last another six years. To avoid this, the Gentiloni Silveri project requires broadcasters that operate three national television channels to move one of them to digital technology within 15 months of the bill's approval. Currently both RAI and Mediaset operate three national television stations on analogue frequencies.

The Gasparri reform promoted pluralism by setting a ceiling to the amount of revenue of any media group – the ceiling was 20% of the Integrated Communication System (SIC) a broadly defined aggregate which was recently officially estimated at about € 22 billion a year. That reform also prohibited media companies to establish dominant positions in the type of media in which they operate, but did not specify any dominance indicator, leaving the task of establishing dominance to the supervisory authorities. Gentiloni Silveri wants to replace SIC with a narrower concept (*Settore delle comunicazioni*) which has an annual value of about € 18 billion. He also wants to set up a 20% ceiling to the amount of digital broadcasting capacity that any individual group will be able to use. Most controversially, he wants dominance to be automatically assumed if a broadcaster has a share of more than 45% of national television advertising revenue. This is already the case of Mediaset – whose share is variously put at between slightly more than 50% and more than 60%. Critics argue that the choice of indicator has been made with the deliberate aim of hitting Mediaset. RAI derives much of its revenue from the licence fee, and if all types of revenue are taken into consideration Mediaset and RAI have a similar size and the Murdoch group's Sky Italia is not far behind.

Most of the opposition has accused the majority of designing a bill aimed at harming Berlusconi. According to the Government, its reform project is designed to promote greater pluralism and competition. New market entrants could use the frequencies freed by the shift to digital technology of the two analogue stations would free frequencies, and could sell advertising more easily because of the 45% ceiling.

The bill stops earlier projects (never implemented) for a partial privatisation of RAI but, apart from that, does not deal with the State broadcaster. The Minister has promised to publish soon a separate bill concerning RAI, and covering, among other matters, the way in which the board is appointed. However, coalition Governments have always had to thread softly on RAI, because of the difficulty of sharing influence among difference partners, and the separation of the two issues may be aimed at dealing with one at a time and at preventing dissent on RAI from spilling over the broader broadcasting reform.

Sectors and Companies

Shareholders free to launch Intesa-San Paolo merger

An agreement with Credit Agricole (Agricole) and successful resistance to the pressures of Santander Central Hispano (SCH) have allowed Banca Intesa and San Paolo IMI to obtain approval of their merger plan. The merger is now certain to happen from the start of 2007. However, there remain uncertainties about the shape of the future group, partly because the Competition Authority has not yet pronounced, partly due to the likely return of Nextra under the control of Intesa, and partly because of the possibility that a deal similar to the one with Agricole is agreed with SCH.

Agricole and SCH played an important part in the operation because of their prominent position in the equity of the two prospective partners. Agricole was particularly important as the largest shareholder of Intesa and the principal member of the bank's syndicate. Syndicate rules gave the French bank a veto power on the operation. SCH is the second-largest shareholder of San Paolo, after Compagnia di San Paolo. Its objection to the terms of the merger, and especially to the exchange rate of 3.115 Intesa shares for each San Paolo share, could have attracted support from other dissatisfied shareholders. If SCH had achieved enough support, it might have been able to reach a blocking minority, preventing the shareholders of San Paolo IMI from agreeing the merger.

However, Agricole chose a negotiated settlement which has given it a substantive direct base in Italian banking. The French bank will obtain two regional banks, Cassa di Risparmio di Parma e Piacenza (Cariparma) and FriulAdria People's Bank, as well as 193 branches of the Intesa group, for a total of about 600 branches. The deal, valued about € 6 billion, makes Agricole the third foreign bank (after ABN and BNP Paribas) with a substantial direct presence in the Italian retail market. The French will control about 80% of their new Italian activities, at a cost of about € 5 billion. As part of the agreement, Agricole, which will initially obtain about 9% of the merged bank, will eventually reduce its stake to only about 5%.

SCH, which kept its opposition almost to the end, failed to elicit sufficient support and, and decided to abstain rather than to vote against the project at the shareholder meeting. It too has now decided to consider its San Paolo stake a financial rather than a strategic asset.

The votes in favour at the two shareholders meeting have set in motion the final stage of the operation. The merged bank will be born at the start of January with a two board governance. The supervisory board, elected by shareholders, is headed by Intesa chairman Giovanni Bazoli. His two deputies will be Compagnia's Rodolfo Zich and Generali's Antoine Bernheim. The supervisory board will decide on group strategy and extraordinary operations, as well as management board appointments. The management board will be appointed in January, but it is already known that it will be chaired by San Paolo's chairman Enrico Salza and that the managing director will be Corrado Passera.

There remain uncertainties as to the precise shape of the future group. Firstly, it is possible that, as in the case of Agricole, SCH will negotiate an amiable separation from San Paolo, entailing the acquisition of assets – although the Spaniards may have considerably reduced their bargaining power by refusing to negotiate earlier and by maintaining an ultimately powerless opposition until the last stages. Secondly, there is a question mark on the future of the asset management business. Last year Intesa agreed to sell to Agricole a 65% stake in Nextra, its asset management subsidiary, in which it retains 35%. It also agreed to distribute through its network only the asset management products of the Agricole group and to extend this commitment to any future acquisition. However, San Paolo has its own asset management company, Eurizon, which it planned to list in the stock market before the merger plan took over. In their negotiations Intesa and Agricole did not settle this issue, but gave themselves until March 2007 to choose between two options. One would be to merge the asset management activities of the three groups (Intesa, San Paolo and Agricole), to form a jointly controlled major European player. The other would be a return of Nextra under the control of Intesa, by then merged with San Paolo. Thirdly, the Italian Competition Authority will have to pronounce on the merger. The Authority has already completed its preliminary assessment, looking at all the financial service markets in which the two banks operate, and taking account of the remaining links with Agricole and Generali. The final decision of the Competition Authority will probably be published only in late December, after other authorities, starting with insurance regulator ISVAP, have expressed their views on the draft.

The merged bank will be almost as big as Unicredit, with a market capitalisation of about € 60 billion. It will rank seventh in the EU, fifth in the eurozone and first in Italy, where 6,200 branches of its 7,700 branches are located and account for 20% of the country's total.

IS PRIVATISATION ALITALIA'S LAST CALL ?

The Government is unhappy about the conditions set by Air France and KLM for an integration of Alitalia in their group and is seeking an alternative. But it seems unable to confront the underlying causes of Alitalia's lack of appeal to potential investors.

Italy's national carrier is already a partner of the Franco-Dutch group. Four years ago it entered in the SkyTeam alliance, and signed a cooperation agreement which included the mutual acquisition of 2% stakes and the target of an eventual merger, without, however, setting a deadline for it. But the future of the partnership is threatened by the poor financial and commercial performance of the Italian company, and, largely as a result, but the tough terms under which the two prospective partners are prepared to consider full integration. Most cabinet members, trade union leaders and Alitalia managers have become doubtful about the prospect of such a merger, if not entirely hostile, believing that Alitalia would be reduced to a regional player with the principal function of channelling long-haul traffic to foreign hubs. The November Lucca Italo-French Government meeting failed to eliminate these doubts, in fact it strengthened them. The Government is now seeking alternatives.

This search is urgent because of Alitalia's difficulties and also because in mid-October Prodi promised a new industrial plan and a definite choice of international partners by the end of January. The intervention followed the publication of more disappointing figures and repeated strikes and strike threats aimed against management restructuring decisions. After the Prime Minister intervention, and the promise that planned externalisations would be suspended, the Unions agreed a truce until the end of January. The truce was later called off, when the board of Alitalia seemed to confirm, presumably with Government support, the previous restructuring strategy, without deciding any immediate implementation.

Strikes have been one of the reasons that have prevented Alitalia from recovering and from moving toward the profitability target that it had set itself for 2006. The target was announced a year ago, at the time in which the company carried out its last, € 1 billion, capital increase. It was confirmed in early 2006, but is now unachievable. During the first half year, instead of reducing its losses Alitalia increased them, from € 124 million to € 221 million, and that in spite of € 15 million capital gains. Revenue has risen less than budgeted, while costs have increased more than planned. During the first eight months of 2006 revenue was below target by € 82 million, while fuel costs were € 25 million above budget, and personnel costs € 40 billion above. Sales increased by comparison with 2005, but only by 2.8%, as opposed to a domestic market growth of 8.6%. The strikes were only one reason of the failure to expand sales as much as planned. There were also maintenance problems, following the externalisation of these activities, which reduced the availability of aeroplanes and caused a significant number of flight cancellations. Finally, there was continuous tension between management and Unions concerning the implementation of the industrial strategy announced a year ago and built on the model of the network carrier.

The fact that Alitalia's 10,000 unionised employees are divided among nine separate, and at times conflicting Unions does not help. But Government control is also, arguably, a serious problem, since it forces politicians to intervene and stop needed drastic decisions. Following last year's capitalisation the State lowered its stake to 49.9%, held by the Treasury, but, as Prodi's recent announcements show, political influence and accountability remains overwhelming. Several cabinet Ministers have gone on record to ask for the resignation of chief executive Giancarlo Cìmoli, and the only reason why this has remained in place is because other ministers (above all, the Treasury) support him. An additional complication is the close connection between Alitalia's problems and Italy's inability to choose a single national hub. At present traffic is concentrated on three airports, one in Rome and two in Milan, none of which has a size adequate to compete with the principal European hubs.

Most of the Government seems to agree that going ahead with the Air France – KLM alliance is unacceptable. Only the Treasury remains favourable to that option. The problem is that the alternatives are very difficult to find. There has been an attempt to seek Oriental allies. This option has been criticised with the argument that by its nature it could not provide the synergies that would be the principal aim of a partnership. Worse still, none of the eight Oriental carriers with which contacts were established was interested in the offer. The main remaining option is a national one, that is, selling majority control to a group of national entrepreneurs, possibly backed by leading banks. AirOne, the air transport group led by Carlo Toto (and allied to Lufthansa) has been mentioned as the most likely candidate. Other groups have denied rumours that they are willing to participate. The State would retain a minority stake, although less than the 30% that it is required to hold according to present rules.

Sale to a private group might be an innovative solution if it meant the end of, or, rather, a big decline in, political involvement and, therefore, the possibility of a more energetic restructuring. It may well be, as Deputy Prime Minister Rutelli recently said, Alitalia's last call.

ALBERTIS GOING NOWHERE ON AUTOSTRADE

Five months after being agreed by the two prospective partners, the merger between Spain's Albertis and Autostrade, the largest Italian motorway operator, is still waiting for a legal clearance by the Government. This is spite of a considerable shift in the Italian Government position. The initial obstacle, which would have prevented any construction company from participating in the control of Autostrade, would have blocked the operation since the Spanish ACS group is among the principal shareholders of Albertis. However, this obstacles was lifted by new provisions, included in the fiscal decree linked to the Finance Bill. The new rules allowed a construction company to own up to 5% of a motorway operator, but also modified the rules for fixing motorway tolls. Whilst applicable to all motorway operators and resisted by all, these rules would have been especially harmful to the Albertis-Autostrade project, since they would have profoundly affected the valuation of Autostrade and thus invalidated the premises on which the project has been built. During the course of the Parliamentary debate, the rules were changed again. The 5% ceiling was eliminated and the toll fixing innovations were largely abandoned. But at the same time ANAS, the agency through which the State concessions are given to motorway operators, was given the power to refuse applications to modify concession terms. In order to proceed, the merger project would require ANAS to agree to transfer the motorway concession agreed with Autostrade to the merged company. But the new rules introduced a big uncertainty on this point. At the same time, the Infrastructure Ministry and ANAS insist that motorway companies freeze in special provisions the extra profits generated by lower than agreed investment. The principal substantive accusation of Infrastructure Minister Di Pietro and of ANAS against Autostrade and its project is that in recent years the company – like other Italian motorway operators - has invested much less than it had undertaken to do under the terms of the concession. In November the Rome administrative tribunal rejected a request from motorway companies for a temporary suspension of the Government injunction to set aside the investment related provisional. Shortly thereafter ANAS requested Autostrada to reconsider its plan to pay an extraordinary dividend of € 2.1 billion, as agreed with Albertis. ANAS fears that the dividend payment will undermine the company ability to finance the additional investment that the Government requests.

The Government is divided on this issue. Di Pietro has led the attack against Autostrade (and other motorway companies) while European Affairs Minister Bonino has warned against the risk of breeching EU rules, a fear substantiated by the launch in November of EU infringement proceedings in view of the vagueness of the new blocking powers given to ANAS. Meanwhile, the Genoa Civil Tribunal has decided to ask the European Court of Justice for a pronouncement on the legality in European law of the fiscal decree provisions. Some Cabinet Ministers favour the Autostrade-Albertis operation and Prodi himself has stressed that he sees no obstacles to the merger, but the Prime Minister must avoid antagonising Di Pietro, a particularly mercurial politician. It may be thought that time works in favour of the merger project, but this was decided in June and is meant to be completed by December. Di Pietro seems to be unyielding, the rest of the Cabinet does not wish to confront him on this issue, and Albertis is losing patience.

Rossi delays Telecom Italia announcements

More than two months after the replacement of Mario Tronchetti Provera with Guido Rossi as chairman of Telecom Italia, there is still no final official word as to the future strategy of Italy's main telecommunication group. Tronchetti Provera resigned following a public clash with Prime Minister Prodi concerning the amount of information that the group had given the Government about its plans, and the involvement of the Prime Minister Office. At the time Tronchetti Provera was moving toward the separation of the mobile business from the rest of the group, with the intent to sell at least a large stake. The money was needed in order to help Telecom Italia finance its huge fixed line modernisation project as the group remains burdened by heavy indebtedness. Tronchetti Provera maintains that an alternative plan for the acquisition by public bodies of Telecom's fixed line had the backing of the Government, in spite of official denials.

Guido Rossi initially confirmed Tronchetti Provera's strategy of restructuring the group by setting up the fixed line and mobile telecom businesses as separate subsidiaries, in preparation to a possible partial or full disposal. But no decision has been taken and no proposal has been made to the board. Discussions have been held with the Communication Authority, but over time the plan seems to have changed. Not only selling control of the mobile business seems no longer on the agenda, but also on the fixed line business what Rossi is planning seems to be only a pale shadow of what Tronchetti Provera prepared. The restructuring would concern not the entire fixed line, but only the local loop. It might not consist in the setting up of the activities as a separate subsidiary but merely in a separation within the existing group – not leading to any asset sale. It is also unclear what exactly Rossi plans to do with the principal foreign assets of Telecom Italia, the two Brazilian subsidiaries, including the second largest mobile company in the country, for which unsolicited offers appear to have been made. Announcements may be made at the next board meeting, scheduled for December.

The principal group developments of recent weeks have occurred in the chain of control. As planned, the two banks (Intesa and Unicredito) which had helped Tronchetti Provera take effective control of Telecom through the holding Olimpia sold their shares in October, taking advantage of an option that protected them from large capital losses. Olimpia is the largest shareholder of Telecom, with 18% of equity, and, following the departure of the two banks, is 80% controlled by Pirelli (which purchased the banks' shares for a total of almost € 1.2 billion) and 20% by the Benetton group. Pirelli is controlled by Tronchetti Provera through a chain of participations. In order to ensure greater stability to the equity and governance of the group, recently Olimpia signed a consultation pact with two other leading shareholders of Telecom, Mediobanca and Generali. The pact members have direct control of 23.2% of the company. They have agreed to consult ahead of each Telecom shareholding meeting and to set up a co-ordinating committee which will be chaired by Tronchetti Provera himself. The pact is open to new members with stakes of at least 0.5%. Separately, Tronchetti Provera is also seeking new partners to acquire some of the shares that Pirelli holds in Olimpia – a particularly hard task, in view of the fact that Olimpia is not listed and remains a minority shareholder of Telecom.

BPI CHOOSES VERONA-NOVARA

With a majority of fourteen to two abstentions, the board of Banca Popolare Italiana (BPI) has approved a project to merge with Banca Popolare di Verona and Novara, to form Italy's largest co-operative banking group and the country's third largest bank by number of branches and capitalisation. However, there remain some uncertainties as to the future of the project, since this must be approved by cooperative members, among whom there is significant discontent at the merger prospect.

BPI is the new name of Banca Popolare di Lodi, the regional bank which under the leadership of Gianpiero Fiorani last year mounted an ill-fated attempt to take over Banco Antoniano in competition with the Netherlands' ABN Amro. Following the launch of judicial investigations on the methods used by Fiorani and his allies in order to obtain control of Antoniana, and the replacement of the top management, the Bank of Italy exercised moral suasion on BPI to consolidate its financial position through a merger with another bank. Four candidates, all cooperative banks, emerged: the Milan, BPU and Emilia Romagna cooperative banks, as well as Verona and Novara, which won by offering a price of € 12 per share, inclusive of a 30% cash component. BPI has a market capitalisation of € 7 billion, as compared to almost € 9 billion for Verona and Novara. There are no significant overlaps between the two branch networks and no asset sales are planned. The merged group would have a capitalisation of more than € 15 billion, 21,000 employees (but there would be incentives for 1,500 voluntary departures), 2,200 branches and a loan portfolio of € 70 billion.

Like Intesa – San Paolo, the merged bank would adopt a two-board model, with a supervisory board composed of 12 members appointed by Verona and Novara and 8 appointed by BPI, and a management board, whose 12 members would be appointed by the supervisory board.

The final decision on the project will be taken at the two bank's next shareholders meetings, scheduled for the spring.

Warning shot

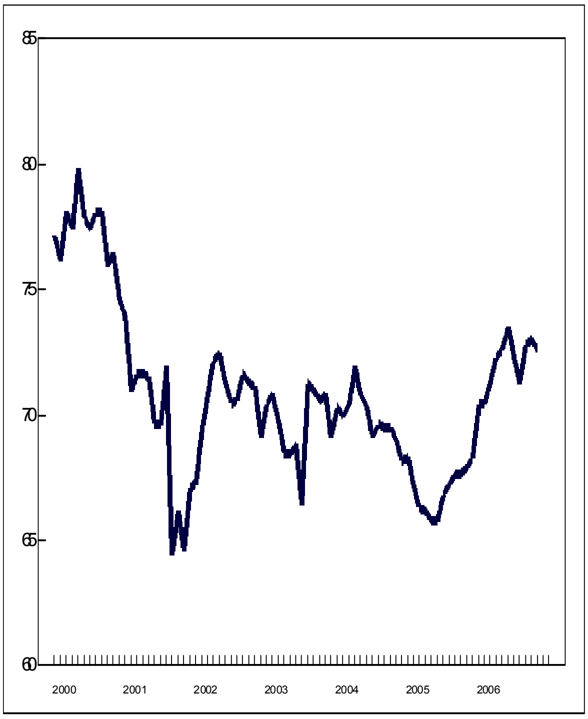
There are mitigations to the discomfort caused by paltry third quarter 0.3% GDP rise and the declines in exports and investment that led to it. At the start of that quarter the labour market was still growing vigorously, indicating a substantial degree of business confidence. Exports grew little over the quarterly average but that was because of a poor July figure, which was followed by a recovery in August and September. October-November figures for industrial production and car sales were rather good. Inflation has been declining, helping to increase company and household incomes. The price that Italian companies pay for imported raw materials has declined by 15% since the summer, while faster wage rises have been cushioned by slower increases in Social Security contributions. Consumer price inflation has declined just as wage growth accelerates reflecting new pay settlements.

But there are also figures which corroborate rather than qualify the sobering message of the quarterly GDP. Retail sales are little more than stagnant in nominal terms. In September turnover and new order figures fell quite heavily. Above all, Italy risks being caught between rising interest rates, the high euro, a tightening of fiscal policy just as tax revenue shows an unexpected vigour, and the questionable effects of Government policies on business confidence. Viewed from this angle, the 30% reduction of the Treasury cash deficit could be more a cause of concern than a reason of satisfaction. It may suggest that fiscal policy is turning out to be deflationary at a particularly delicate moment.

Europrospects forecast

Italian GDP

		2005	2006	2007
GDP	Volume, year-on-year %	0.1	1.8	1.7
Private consumption	Volume, year-on-year %	0.1	1.5	1.3
Fixed investment	Volume, year-on-year %	-0.4	2.6	2.7
Industrial production	Volume, year-on-year %	-0.9	1.9	1.4
Consumer prices	Year-on-year % growth	2.2	2.3	2.3
Exports (goods and serv.)	Volume, year-on-year %	0.7	5.1	4.3
Imports (goods and serv.)	Volume, year-on-year %	1.8	4.8	4.0
Trade balance	€ billion	-11	-18	-22
Current account	€ billion	-22	-24	-27
€ exchange rate	dollars per euro	1.24	1.25	1.25



Forecast prepared in September.
The next forecast will be in December

Recent Data

In the third quarter the gross domestic product grew by only 0.3% in spite of a 1.3% rise in domestic demand. The difference was caused by a 1.7% decline in exports while imports rose by 2.1%. The increase in domestic demand was mostly due to a massive rise in stock building. Consumer spending increased by 0.6% but fixed investment expenditure declined by 1.3% because of a 2.7% fall in machinery and equipment investment. Compared to a year earlier, the GDP was 1.7% higher, the same rate of increase as in the first two quarters.

In October seasonally-adjusted industrial production rose by 0.6% and was 3.1% higher than a year earlier. The rise followed two months of large swings, firstly a 1% rise in August, then a 1% decline in September. During the first ten months of 2006 seasonally-adjusted production rose on average by little more than 2%.

Manufacturing orders, which have been rising steadily since the autumn of 2005, marked another strong increase in the third quarter, when they were 4.2% higher than in the second quarter and 13% higher year on year. However, foreign orders declined slightly, the quarterly rise being entirely caused by home market orders. The quarterly rise occurred although in September orders declined in both home and export markets.

Like orders, seasonally-adjusted manufacturing turnover declined in September, but registered a good rise over the whole of the third quarter, due to particularly robust August data. In nominal terms, during the third quarter sales were 2.6% higher than in the second quarter and 7.9% higher year-on-year.

After stagnating between late 2005 and early 2006, in the second quarter construction output posted a 1.8% volume rise on the first quarter and was 2.4% higher than a year earlier.

Seasonally-adjusted retail sales confirmed their steady but moderate growth in the third quarter, when they were on average 0.5% higher than in the third quarter and 1.6% higher than a year earlier.

The Italian car manufacturers association ANFIA has revised to 3.5% its forecast of how much the domestic market will rise this year. The figure may seem conservative in view of the 4.1% average rise over the first eleven months. In November alone sales were 6.2% higher than a year earlier. The FIAT group kept regaining market shares with year-on-year rises of 14.9% over the first eleven and about 10.55 in November alone.

During the twelve-month period ending in the second quarter the Italian economy created more than 440,000 jobs, the highest figure in this decade, with a contribution of about 130,000 creations in the second quarter alone. Unemployment was 8.3% lower than in the second quarter of 2005 and the unemployment rate fell to 7.0%, from 7.3% in the first quarter and 7.8% a year earlier.

The prices in euros paid by Italian companies to purchase imported raw materials declined in six of the last known months, including the last, October, when they were 3.9% lower than in September. The year-on-year inflation rate has fallen to zero, as compared to more than 40% at the start of the year.

Between July and October the producer price inflation rate declined from 7.0% to 4.9%. This was caused almost exclusively by energy prices which declined in absolute terms and whose inflation rate dropped from 20.5% in July to 6.9% in October.

The early autumn settlement of national wage contracts for large economic sectors such as commerce and mechanical engineering has helped accelerate the rate of increase of contractual hourly wages. On average, these grew by 0.3% in both September and October, and their year-on-year rate of increased reached 3.3% in October, as compared to 2.1% in August.

Since late 2005, slow increases in Social Security contributions have allowed company hourly labour costs to rise less quickly than pay. In the third quarter while wages rose on average by 0.8% (3.4% year-on-year), contributions were only 0.3% higher (1.1%) and total hourly labour costs by 0.6% (2.8%).

In parallel with producer prices, consumer prices have also shown a slower inflation rate in recent months. Their year-on-year rate of rise fell from 2.4% in September to 2.0% in November, and in October and November monthly rises were only, respectively, 0.2% and 0.1%, according to the EU harmonised index.

In the third quarter while imports kept growing fast, marking a 4.0% rise on the previous quarter and a year-on-year rise of more than 14%, exports barely grew, and were less than 9% higher year-on-year. However, quarterly figures were marred by poor July data. In both August and September exports rose by more than 2%.

In November the Treasury cash deficit, at € 7.5 billion, was the same as a year earlier, but because between June and September each month this year had a smaller deficit or a bigger surplus than the corresponding one in 2005, during the first eleven months of 2006 the total cash deficit, at € 56.5 billion, was more than 30% lower than the one of the first eleven months of 2005.

Recent Data

Demand and output

GROSS DOMESTIC PRODUCT		2003	2004	2005	2005 q1	2005 q2	2005 q3	2005 q4	2006 q1	2006 q2	2006 q3
Total	Vol. index 2000=100	102.3	103.2	103.3	102.6	103.3	103.6	103.6	104.4	105.0	105.3
	Quarterly % rise				-0.4	0.6	0.4	0.0	0.8	0.6	0.3
	Year-on-year % rise	0.1	0.9	0.1	-0.3	0.0	0.1	0.5	1.7	1.7	1.7
Domestic Demand	Vol. index 2000=100	103.9	104.7	105.1	104.5	105.1	105.5	105.4	106.1	106.5	107.9
	Quarterly % rise				-0.5	0.6	0.4	-0.1	0.6	0.4	1.3
	Year-on-year % rise	0.9	0.7	0.4	-0.1	0.6	0.8	0.4	1.5	1.3	2.2
Private consumpt. expend.	Vol. index 2000=100	101.9	102.4	102.5	101.7	102.5	102.9	102.9	103.9	104.2	104.9
	Quarterly % rise				-0.8	0.7	0.5	-0.1	1.0	0.3	0.6
	Year-on-year % rise	1.0	0.5	0.1	-0.9	0.1	0.7	0.4	2.1	1.7	1.9
Public consumption	Vol. index 2000=100	109.9	110.6	111.9	111.8	111.8	112.0	112.0	112.2	112.4	112.2
	Quarterly % rise				0.8	0.1	0.2	0.0	0.2	0.2	-0.2
	Year-on-year % rise	2.1	0.6	1.2	1.0	1.2	1.5	1.1	0.4	0.5	0.1
Fixed investment	Vol. index 2000=100	105.0	106.9	106.5	104.5	106.7	108.2	106.5	108.9	110.1	108.6
	Quarterly % rise				-1.7	2.1	1.4	-1.6	2.3	1.1	-1.3
	Year-on-year % rise	-1.5	1.9	-0.4	-2.0	-0.9	1.3	0.1	4.2	3.1	0.4
of which: plant & machinery	Vol. index 2000=100	100.5	103.3	102.0	100.3	102.2	103.9	101.2	104.6	106.7	103.8
	Quarterly % rise				-1.8	1.9	1.7	-2.6	3.4	2.0	-2.7
	Year-on-year % rise	-3.9	2.9	-1.3	-2.6	-2.9	1.0	-0.9	4.3	4.5	0.0
of which: construction	Vol. index 2000=100	110.8	111.4	112.3	109.9	112.5	113.7	113.1	114.3	114.4	114.7
	Quarterly % rise				-1.6	2.4	1.0	-0.5	1.1	0.1	0.2
	Year-on-year % rise	1.5	0.6	0.8	-1.2	1.4	1.6	1.3	4.0	1.7	0.9
Change in stockbuilding	Percentage of GDP	0.2	-0.2	0.2	0.4	-0.3	0.0	-0.2	0.1	-0.2	1.5
Exports (goods and services)	Vol. index 2000=100	94.3	96.7	97.3	95.3	97.6	97.4	98.9	101.4	102.3	100.6
	Quarterly % rise				-1.7	2.4	-0.2	1.5	2.5	1.0	-1.7
	Year-on-year % rise	-2.2	2.5	0.7	0.6	0.3	-0.2	1.9	6.4	4.9	3.2
Imports (goods and services)	Vol. index 2000=100	100.4	102.2	104.1	102.0	104.5	104.5	105.5	107.6	107.8	110.1
	Quarterly % rise				-2.0	2.4	-0.1	1.0	1.9	0.2	2.1
	Year-on-year % rise	1.0	1.9	1.8	1.1	2.6	2.2	1.4	5.4	3.2	5.4

MANUFACTURING		2003	2004	2005	2005 q3	2005 q4	2006 q1	2006 q2	2006 q3	Sept.	Oct.
Production	S.adj. vol index 2000=100	96.8	96.6	95.9	96.8	96.2	97.4	97.5	98.1	97.8	98.4
	Quarterly/mthly rise				0.9	-0.6	1.2	0.1	0.6	-1.0	0.6
	Year-on-year % rise	-0.6	-0.2	-0.9	0.0	0.5	2.9	1.7	1.3	2.0	3.1
Turnover	S.adj. vol index 2000=100	101.4	104.5	107.6	110.5	110.5	112.5	116.2	119.2	117.7	
	Quarterly/mthly rise				4.4	0.0	1.8	3.3	2.6	-5.9	
	Year-on-year % rise	-1.0	3.1	2.9	5.2	5.3	8.7	9.8	7.9	8.3	
New orders	S.adj. vol index 2000=100	95.1	99.5	102.8	105.7	104.9	109.1	114.6	119.4	118.0	
	Quarterly/mthly rise				4.4	-0.8	4.0	5.0	4.2	-5.2	
	Year-on-year % rise	-3.7	4.6		6.8	3.5	9.8	13.2	13.0	14.2	
	S.adj. vol index 2000=100	93.6	97.3	98.9	100.8	100.7	104.8	107.5	114.8	113.8	
	Quarterly/mthly rise				3.7	-0.1	4.1	2.6	6.8	-3.8	
	Year-on-year % rise	-3.6	4.0	1.6	3.6	3.8	8.3	10.6	13.9	14.9	
	S.adj. vol index 2000=100	98.3	104.4	111.6	116.7	114.3	118.7	130.6	130.1	127.5	
	Quarterly/mthly rise				5.9	-2.1	3.8	10.0	-0.4	-8.1	
	Year-on-year % rise	-4.2	6.2	6.9	13.3	2.6	12.8	18.5	11.5	12.6	
CONSTRUCTION											
Production	S.adj. vol index 2000=100	113.8	116.7	118.4	119.8	119.0	119.3	121.5			
	Quarterly/mthly rise				0.9	-0.7	0.3	1.8			
	Year-on-year % rise	1.9	2.5	1.5	1.2	2.2	3.8	2.4			
OTHER ACTIVITY INDICATORS											
Retail sales	S.adj. val index 2000=100	107.3	106.9	107.1	107.2	107.8	108.0	108.4	108.9	109.0	
	Quarterly/mthly rise				0.4	0.5	0.2	0.4	0.5	0.1	
	Year-on-year % rise	2.0	-0.4	0.2	0.5	1.2	1.2	1.5	1.6	1.5	
	thousands	2,250	2262.0	2237.3	500.6	509.0	704.0	623.5	472.6	183.7	187.8
	Year-on-year % rise	-0.9	0.6	-1.1	5.3	2.2	9.6	6.5	-5.6		

The labour market

The national labour market

			2003	2004	2005		2005				2006
			year	year	year	q4	q1	q2	q3	q4	q1
Labour force		thousands	24289	24,360	24,462	24433.	24460.	24422.	24538.	24662.	24747.
		Qly/mtly % change				0.0	0.1	-0.2	0.5	0.5	0.3
		Year-on-y. change	1.3	0.3	0.4	0.7	0.5	0.0	0.5	0.9	1.2
Employed	Total	thousands	22241	22,404	22,571	22523.	22561.	22564.	22688.	22872.	23006.
		Qly/mtly % change				0.1	0.2	0.0	0.5	0.8	0.6
(Seas. adj.		Year-on-y. change	1.5	0.7	0.7	1.2	0.8	0.4	0.8	1.5	2.0
figures)	Agriculture	thousands	967	990	949	945.0	956.0	946.0	964.0	982.0	977.0
		Year-on-y. change	-2.3	2.4	-4.2	-3.6	-3.4	-7.1	-1.4	3.9	2.2
	Manufacturing	thousands	5080	16,527	5,030	5029.0	5012.0	5019.0	5044.0	5030.0	5026.0
		Qly/mtly % change				-0.3	-0.3	0.1	0.5	-0.3	-0.1
		Year-on-y. change	1.0	225.3	-69.6	0.4	-0.7	0.2	0.0	0.0	0.3
	Construction	thousands	1742	1,832	1,913	1897.0	1928.0	1906.0	1915.0	1910.0	1889.0
		Qly/mtly % change				1.3	1.6	-1.1	0.5	-0.3	-1.1
		Year-on-y. change	4.1	5.2	4.4	9.0	5.7	1.0	2.2	0.7	-2.0
	Services	thousands	14452	14,555	14,680	14651.	14666.	14693.	14764.	14951.	15115.
		Qly/mtly % change				0.3	0.1	0.2	0.5	1.3	1.1
		Year-on-y. change	1.6	0.7	0.9	0.8	0.9	0.9	1.1	2.0	3.1
Unemployed	Total	thousands	2048	1,956	1,891	1911	1899	1859	1851	1789	1741
	(seas. adj.)	Qly/mtly % change				-1.0	-0.6	-2.1	-0.4	-3.3	-2.7
		Year-on-y. change	-0.7	-4.5	-3.3	-4.4	-2.9	-3.9	-4.1	-6.4	-8.3
	Previously	thousands	782								
	employed	Year-on-year %	-3.9								
	First job	thousands	843								
	seekers	Year-on-year %	-3.4								
	Willing to join	thousands	471								
	labour force	Year-on-year %	-1.3								
Unemployment rate		(Seas. adj.)	8.4	8.1	7.7	7.8	7.8	7.6	7.5	7.3	7.0

Large company employment

* Net of partial unemployment

	Indices 2000=100	2003	2004	2005	05q1	05q2	05q3	05q4	06q1	06q2
MANUFACTURING										
Number of employees*	(seas. adj)	90.5	87.7	85.8	86.5	85.7	85.4	85.6	85.3	84.7
Quarterly/monthly rise					-0.3	-0.9	-0.4	0.2	-0.4	-0.7
Year-on-year % rise		-3.2	-3.1	-2.2	-2.5	-2.3	-2.3	-1.4	-1.4	-1.2
Hours wkd per empl.*	Year-on-year %	0.3	-0.4	-0.3	-1.4	0.5	-0.1	-0.2	1.5	-2.5
Overtime in % of total work		4.7	4.6	4.7	4.6	4.5	4.8	4.8	4.6	4.9
Partial unemployment	hours/000 worked		27.2		31.6	34.7	35.3	31.5	29.0	28.0
SERVICES										
Number of employees*	(seas. adj)	98.8	99.5	98.7	98.4	98.7	98.7	98.8	98.6	99.1
Quarterly/monthly rise					0.5	0.3	0.0	0.1	-0.2	0.5
Year-on-year % rise		0.3	0.7	-0.8	-0.5	0.5	0.5	0.9	0.2	0.4
Hours wkd per empl.*	Year-on-year %	0.7	-0.7	-0.1	-1.7	0.2	1.5	-0.4	2.3	-0.9
Overtime in % of total work		5.4	5.9	5.9	5.5	5.3	6.1	6.6	6.0	5.8
Partial unemployment	hours/000 worked	0.3	1.9	0.7	0.9	0.9	1.0	1.2	1.6	1.4

Inflation indicators

		2003	2004	2005	2005 q3	2005 q4	2006 q1	2006 q2	2006 q3	2006 Oct.	2006 Nov.
Consumer prices	Index 1996=100	95.7	97.8	100.0	100.2	101.2	100.6	102.5	102.5	103.1	103.2
(harmonised)	Quarterly/mly % rise				0.0	1.0	-0.6	1.9	0.0	0.2	0.1
incl. temporary price cuts	Year-on-year % rise	2.8	2.2	2.2	2.2	2.4	2.2	2.3	2.3	1.9	2.0
Producer prices	Index 2000=100	103.7	106.5	110.8	111.3	112.5	114.4	116.8	118.4	118.1	
	Quarterly/mly % rise				1.1	1.1	1.7	2.1	1.3	0.3	
	Year-on-year % rise	1.6	2.7	4.0	3.7	4.0	4.8	6.1	6.4	4.9	
Imported raw material prices	Lira/€ index, 1977=100	189.4	218.6	284.1	315.4	307.2	341.4	352.4	346.3	311.0	
	Quarterly/mly % rise				16.4	-2.6	11.1	3.2	-1.7	-3.9	
	Year-on-year % rise	-5.3	15.4	30.0	35.1	31.8	40.5	30.1	9.8	0.0	
Hourly wages	Index Dec2000=100	106.3	109.4	112.8	113.2	113.5	114.8	115.5	116.8	117.2	
Whole economy	Quarterly/mly % rise				0.6	0.3	1.1	0.6	1.1	0.3	
	Year-on-year % rise	2.3	2.3	3.1	3.0	2.7	2.9	2.9	2.9	3.3	

Company labour costs

Seas. adj. full time equivalent

		2003	2004	2005	05q1	05q2	05q3	05q4	06q1	06q2	06q3
INDUSTRIAL COMPANIES											
Gross wages	Index 2000=100	107.7	111.5	114.0	112.5	113.6	114.6	115.9	117.5	118.8	120.0
	Year-on-year % rise	2.2	3.5	2.2	2.1	2.6	2.9	3.4	4.4	4.6	4.7
Social security contributions	Index 2000=100	107.7	111.2	116.6	114.9	116.0	117.1	118.3	118.6	119.1	119.7
	Year-on-year % rise	3.2	3.2	4.8	3.8	3.8	3.7	3.8	3.2	2.7	2.2
Total	Index 2000=100	107.2	110.6	114.7	113.2	114.3	115.3	116.6	117.8	118.9	120.0
	quarterly % rise				0.5	1.0	0.9	1.1	1.0	0.9	0.9
	Year-on-year % rise	1.9	3.2	3.7	2.6	2.9	3.1	3.6	4.1	4.0	4.1
SERVICES COMPANIES											
Gross wages	Index 2000=100	106.6	108.6	111.9	110.6	111.5	112.2	113.3	113.8	114.1	114.5
	Year-on-year % rise	1.4	1.9	3.0	2.8	3.0	2.8	3.3	2.9	2.3	2.0
Social security contributions	Index 2000=100	107.3	111.9	113.8	112.5	113.3	114.0	114.9	114.5	114.1	114.0
	Year-on-year % rise	2.7	4.3	1.7	4.1	3.9	3.4	3.2	1.8	0.7	0.0
Total	Index 2000=100	107.6	111.9	112.3	111.0	111.9	112.6	113.7	113.9	114.1	114.4
	quarterly % rise				0.8	0.8	0.6	1.0	0.2	0.2	0.3
	Year-on-year % rise	2.3	4.0	0.4	3.1	3.2	2.9	3.3	2.6	2.0	1.6
ALL COMPANIES											
Gross wages	Index 2000=100	107.4	110.4	113.4	111.9	112.9	113.8	115.0	116.0	116.8	117.7
	quarterly % rise				0.7	0.9	0.8	1.1	0.9	0.7	0.8
	Year-on-year % rise	1.8	2.8	2.7	2.6	3.0	3.1	3.5	3.7	3.5	3.4
Social security contributions	Index 2000=100	106.3	109.8	115.0	113.4	114.4	115.3	116.3	116.2	116.3	116.6
	quarterly % rise				1.0	0.9	0.8	0.9	-0.1	0.1	0.3
	Year-on-year % rise	1.7	3.3	4.7	3.9	3.9	3.7	3.6	2.5	1.7	1.1
Total	Index 2000=100	106.5	108.9	113.8	112.3	113.3	114.2	115.3	116.0	116.7	117.4
	quarterly % rise				0.7	0.9	0.8	1.0	0.6	0.6	0.6
	Year-on-year % rise	1.5	2.3	4.5	2.9	3.3	3.2	3.4	3.3	3.0	2.8

The trade balance

€ billion Monthly averages

	2003	2004	2005	2005 q3	2005 q4	q1	q2	2006 Sept.	Oct.
Exports (fob; seasonally-adjusted)									
to EU countries	13.4	13.9	14.6	15.1	14.9	15.8	16.2	16.5	
quarterly/monthly % change				2.5	-1.5	6.3	2.3	1.9	
year-on-year percentage	0.5	3.8	5.0	5.7	6.9	10.2	9.7	12.2	
to non-EU countries	8.7	9.5	10.2	10.7	11.1	11.4	11.2	11.6	11.2
quarterly/monthly % change				2.5	4.1	3.0	-2.3	4.5	-3.4
year-on-year percentage	-4.7	9.6	7.1	10.3	15.0	13.0	7.3	10.6	9.8
TOTAL, seasonally-adjusted	22.0	23.4	24.8	25.8	26.0	27.3	27.3	28.0	
quarterly/monthly % change				2.5	0.9	4.9	0.1	2.6	
year-on-year percentage	-1.8	6.2	5.9	7.6	10.4	11.5	8.6	11.1	
Imports (cif; seasonally-adjusted)									
from EU countries	13.5	14.1	14.7	15.1	15.5	16.1	16.5	16.4	
quarterly/monthly % change				0.9	2.2	4.1	2.3	-0.6	
year-on-year percentage	1.4	4.6	4.2	3.5	9.6	11.2	9.8	10.1	
from non-EU countries	8.5	9.4	11.0	11.9	12.6	12.7	13.5	13.5	13.5
quarterly/monthly % change				4.7	5.8	1.6	5.9	-1.5	0.0
year-on-year percentage	-0.5	11.5	16.3	19.6	24.4	20.7	19.1	17.4	16.4
TOTAL, seasonally-	21.9	23.5	25.7	27.0	27.9	28.9	30.1	30.0	
quarterly/monthly % change				2.7	3.3	3.5	4.0	-1.0	
year-on-year percentage	0.7	7.3	9.1	10.1	15.4	15.4	14.2	14.1	
Trade balance (s.adj)									
with EU countries	-0.1	-0.2	-0.1	0.0	-0.6	-0.3	-0.3	0.1	
with non-EU countries	0.3	0.1	-0.8	-1.2	-1.5	-1.3	-2.3	-1.9	
TOTAL	0.1	-0.1	-0.9	-1.2	-1.9	-1.6	-2.7	-2.0	

Balance of payments -€ mill

	2003	2004	2005	2004 q4	2005 q1	2005 q2	2005 q3	2005 q4	2006 q1
Current account— receipts	388534	411824	441011	104075	102421	112570	111642	114379	115348
Current account— payments	405885	424295	463067	110331	110329	119288	112754	120696	127354
Current account— balance (a)	**-17352**	**-12471**	**-22056**	**-6256**	**-7908**	**-6718**	**-1112**	**-6317**	**-12006**
Intangibles * & capital transfer bal. (b)**	**2251**	**1822**	**1779**	**1360**	**356**	**382**	**173**	**868**	**893**
FINANCIAL ACCOUNT									
Direct investment— from Italy to	-8037	-15513	-33575	-3464	-4002	-2592	-4030	-22951	-5535
Direct investment— from abr. to Italy	14544	13542	16019	2975	2748	2258	1344	9669	9770
Direct investment— balance (c1)	6507	-1971	-17556	-489	-1254	-334	-2686	-13282	4235
Portfolio investment— from Italy to	-51068	-21065	-87028	-6501	-22906	-13659	-25803	-24660	-28771
Portfolio investment— from abr. to Italy	54437	47512	130426	4941	50168	38741	10678	30839	50833
Portfolio investment— balance (c2)	3369	26447	43398	-1560	27262	25082	-15125	6179	22062
Other investment***— from Italy to	-19390	-38667	-77983	-14962	-46370	-43187	6593	4981	-40778
Other investment***— from abr. to Italy	33066	18324	68040	18049	24232	26016	11121	6671	26429
Other investment*— balance (c3)**	13676	-20343	-9943	3087	-22138	-17171	17714	11652	-14349
Sales of derivatives — balance (c4)	-4827	1833	2332	573	3217	-546	-345	6	224
Change in official reserves ** (c5)**	-1406	2262	810	318	-9	811	419	-411	47
Financial acc. bal. (c=c1+c2+c3+c4+c5)	**17319**	**8228**	**19041**	**1929**	**7078**	**7842**	**-23**	**4144**	**12219**
Errors and omissions = -(a+b+c)	**-2218**	**2421**	**1236**	**2967**	**475**	**-1506**	**962**	**1305**	**-1106**

* mostly purchase and sale of copyrights and patents. ** includes capital transfers from the EU (Italy's - much larger - contributions to the EU are included in the current account), aid and debt forgiveness. *** mostly deposits and loans . **** a negative sign indicates an increase in reserves. Data source: Europrospects elaborations on Supplemento al Bollettino della Banca d' Italia.

Treasury borrowing requirement

(€ billion)

	Monthly balances 2003	2004	2005	2006	Cumulative balances (since beginning of year) 2002	2003	2004	2005	2006
January	-1.1	-3.1	-1.3	-4.6	-3.3	-1.1	-3.1	-1.3	-4.6
February	-4.4	-8.2	-7.4	-5.9	-6.5	-5.5	-11.3	-8.7	-10.5
March	-14.3	-16.3	-17.9	-15.7	-21.0	-19.8	-27.6	-26.6	-26.2
April	-13.4	-10.6	-14.0	-8.0	-27.6	-33.2	-38.2	-40.6	-34.2
May	-3.8	-9.8	-14.4	-14.7	-38.0	-37.0	-48.0	-55.0	-48.9
June	11.1	8.0	4.4	12.0	-28.6	-25.9	-40.0	-50.6	-37.0
July	-1.3	0.6	1.8	7.2	-31.1	-27.2	-39.4	-48.8	-28.6
August	-6.4	-5.1	-9.1	-7.3	-34.1	-33.6	-44.5	-57.9	-35.9
September	-10.6	-8.9	-10.7	-8.1	-40.9	-44.2	-53.4	-68.6	-44.0
October	-10.7	-7.1	-6.8	-4.7	-49.2	-54.9	-60.5	-75.4	-49.1
November	0.1	0.3	-7.5	-7.5	-49.1	-54.8	-60.2	-82.9	-56.5
December	12.4	14.0	23.3		-26.0	-42.4	-50.1	-59.6	

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