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III. Product market competition and economic performance in Italy

Overview

The OECD (2001b) *Review of Regulatory Reform in Italy* acknowledged the vast distance that has been covered since Italy began liberalising product markets at the start of the 1990s. This entailed a sustained programme of privatisation, market opening, and deregulation followed by appropriate re-regulation and institution building. However, there is still considerable scope for further improvement, and raising growth will depend critically on removing the impediments and distortions to competition. Rigidities and protections have a large influence on the structural features of the Italian economy impacting upon, amongst other things, the intensity of product market competition, size and growth of firms, innovative activity, the capacity to attract foreign direct investment and employment growth. Problems with productivity and growth, and low R&D spending, are linked to an industrial structure heavily weighted towards small enterprises. Despite the large number of firms, the intensity of competition and rivalry is particularly weak in retail distribution and in professional services. Without the elimination of entrenched positions and an easing of barriers to entry and firm growth, innovative activity, one of the main engines of economic growth, is unlikely to thrive in Italy.

The chapter looks at what role product market competition, and the policies that impact upon competition, may have played in the performance of the Italian economy over the past decade. While recognising that considerable progress has been made, the analysis primarily seeks to identify areas where policies continue to impair performance. The first section briefly looks at Italy's economic performance at the aggregate and sectoral level. With an emphasis on the manufacturing sector, it examines the interplay between economic performance, product market competition and industrial structure and the role of policies and institutions, including labour market policies, bankruptcy law and the administrative burden on firms. Several policy areas that directly impact upon the intensity of competition in product markets are examined next, including competition legislation and enforcement and regulatory policies in service industries. This includes service industries that are intrinsically competitive, such as retail distribution and

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professional services, and network service industries containing non-competitive segments, such as telecommunications, electricity and gas. A concluding section draws on the analysis to provide a set of policy recommendations aimed at increasing product market competition.

Product market competition and macroeconomic performance

There is a well-identified empirical connection between the intensity of competition in product markets and better productivity outcomes (OECD 2002f). In addition, product market competition can have significant effects on employment not only due to increases in real wages but also through improvements in the functioning of labour markets. Over the past decade Italy has had comparatively poor economic performance (Table 9). At the aggregate level, average GDP growth between 1990 and 2001 was one of the lowest of the G7 countries, and well below the OECD and European Union averages. While the level of GDP per capita and GDP per hour are higher than average, the poor growth performance can be explained by weak employment growth over this period as a whole. Moreover, weak employment growth may have in particular affected low-productivity workers, implying that underlying productivity growth was probably worse than the headline numbers. A sectoral breakdown shows that labour productivity growth was relatively weak in manufacturing. In contrast, performance was relatively better in electricity, gas, water, transport and communications.

Indicators of product market competition in manufacturing

The poor performance of the Italian economy, and in particular the manufacturing and distribution sectors, may be due in large part to a lack of competitive forces. This section looks at indicators of competition in the manufacturing sector, while the retail distribution sector is discussed in detail in a separate section below. Although it is difficult to classify markets according to the strength of market forces, the strength of product market competition may be gauged from jointly considering a number of imperfect proxy measures.

In general, mark-ups, a frequently used gauge of competitive pressures, appear to be relatively low in Italy compared with other countries (Figure 16). According to this indicator, competition pressures seem to be quite intense in segmented industries (*i.e.* more concentrated industries characterised by relatively large firms). Lower than average estimated mark-ups could imply that Italian firms in these sectors have relatively little market power. However, somewhat higher than average mark-ups in low R&D, fragmented industries (*i.e.* less concentrated industries characterised by a large number of small firms), could indicate that there are problems with competitive pressures in these industries. While fragmented sectors have a large number of firms, these firms may not be competing very aggressively.

Import penetration ratios indicate that Italian producers face weaker competitive pressure from foreign firms than their counterparts in other large Euro-

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Table 9. **Output, employment and productivity**

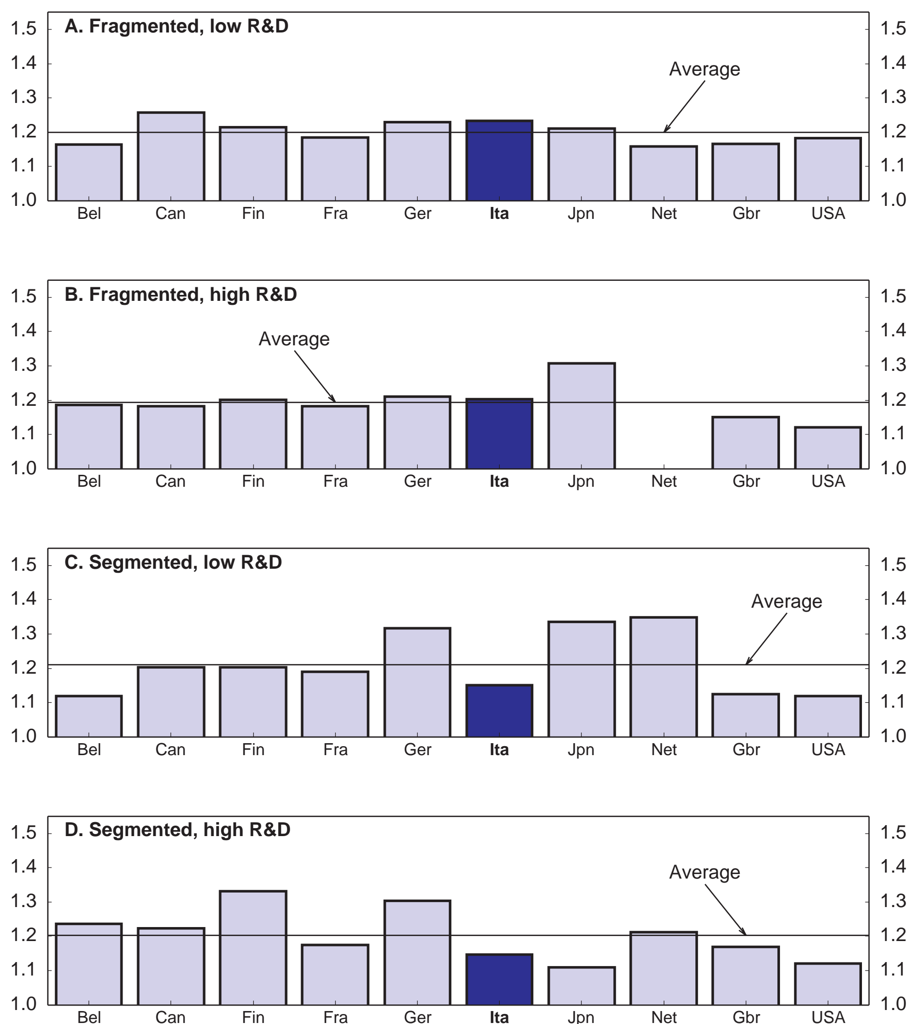
1990 to 2001[1]

	United States	Japan	Germany	France	Italy	United Kingdom	Canada	OECD	European Union
Average GDP growth	2.8	1.7	1.5	1.9	1.7	2.2	2.5	2.6	2.1
of which:									
Productivity	1.3	1.3	1.4	1.2	1.4	1.9	1.2	1.6	1.5
Employment	1.5	0.4	0.1	0.7	0.2	0.3	1.3	1.0	0.6
of which:									
Unemployment[2]	0.0	-0.2	-0.2	0.1	0.1	0.1	0.0	0.0	0.0
Labour force	1.3	0.6	0.3	0.7	0.2	0.2	1.2	1.5	0.6
Demographics[3]	1.2	0.7	0.2	0.8	0.1	0.2	1.3	1.6	0.4
Participation rates[4]	0.0	-0.1	0.2	-0.1	0.0	0.0	0.0	-0.1	0.2
Labour productivity growth									
In selected industries[5]									
Total manufacturing	3.8	2.2	2.7	3.5	1.9	2.7	2.2	n.a	n.a
Electricity, gas and water supply	2.2	2.5	5.1	3.7	3.1	10.5	0.9	n.a	n.a
Construction	0.1	-2.0	0.1	-0.5	0.1	2.4	-0.5	n.a	n.a
Wholesale and retail trade; restaurants and hotels	3.4	1.4	-0.6	0.7	1.1	1.8	1.9	n.a	n.a
Transport and storage and communication	2.8	0.6	7.6	2.9	3.2	4.3	2.4	n.a	n.a
Memorandum items:									
MFP growth[6]	0.9	0.1	0.6	0.5	0.7	1.1	0.9	n.a	n.a
GDP per capita[7]	100.0	75.7	74.8	75.0	74.6	75.0	82.2	71.7	72.7
GDP per hour worked[7]	100.0	75.1	98.2	109.9	102.6	85.1	87.6	83.1	94.9

1. Except for Germany, OECD and European Union: 1992-2001.
2. A positive sign indicates that unemployment has declined and contributed to boost output growth.
3. The contribution for demographics comprises changes in the size and age composition of the working age population.
4. Measures the effect from changes in age specific participation rates.
5. 1990-2000. Except for Canada and France 1990-99, Japan 1990-98 and Germany 1992-2000.
6. Total economy.
7. 2001 levels, PPP based, USA =100.

Source: OECD.

Figure 16. **Average mark-ups by market structure, 1981 to the latest available year**[1]



1. The average mark-up is an unweighted average of the available mark-ups, based on Roeger's method (Oliveira Martins *et al.*, 1996). *ISIC, Rev3 classification.* 1981-2000: Belgium and Finland, 1981-99: France, Netherlands and United States, 1981-1998: Italy, Japan and United Kingdom, 1981-96: Canada, 1992-99: Germany.

Source: OECD STAN database.

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pean countries (Table 10). Only Japan and the United States have lower import penetration rates in total manufacturing.[45] A sectoral breakdown shows that the lack of competitive pressure is not across the board. Import penetration rates in segmented industries are comparable with other OECD countries. However, in "traditional" industries (*i.e.* fragmented, low R&D industries) Italy often has the

Table 10. **Import penetration by manufacturing industry**
Latest available year

	Canada	France	Germany	Italy	Japan	United Kingdom	United States
	1999	2000	2000	2000	2001	2000	2001
Total manufacturing	55.4	36.6[3]	40.8[3]	30.6	11.6	44.8	23.1
Fragmented, low R&D							
Textiles	65.0	52.1[3]	88.1	20.0	35.6	54.0	27.2
Wearing apparel	42.7	53.4	77.1	23.2	33.8	65.2	53.3
Leather products and footwear	81.8	80.6	89.2	37.9	57.2	86.2	79.5
Wood products	19.3	22.9	20.7	17.8	25.6	32.0	12.7
Paper and pulp	..	38.9	42.7	27.4	4.6	35.2	10.4
Printing and publishing	..	9.0[3]	7.1	7.0	1.8	8.0	2.5
Non-metallic products	40.9	18.9[3]	18.4	8.7	4.8	17.9	13.5
Fabricated metal products	35.8	14.3	15.0	7.3	3.9	16.7	8.9
Fragmented, high R&D							
Medical precision and optical instruments	..	44.7	58.9	59.9	68.1	63.5	22.7
Machinery and equipment	84.1	54.0	36.2	37.4	8.3	57.0	26.4
Other manufacturing	56.8	33.4	38.8	19.5	9.9	38.8	38.5
Segmented, low R&D							
Refined petroleum, coke	13.2	18.1[3]	33.2	17.1	10.8	21.4	17.9
Basic metals	41.9	45.7	47.5	42.7	6.7	46.9	22.0
Shipbuilding and repairs	52.9	11.8	32.4[4]	18.9[4]	2.9[1]	21.0	6.8
Rubber and plastic[1]	46.3	30.9	29.2	22.0	4.7	26.6	12.1
Food, beverages, tobacco[1]	18.6	18.5[3]	19.0	19.0	11.2	20.5	6.3
Segmented, high R&D							
Chemicals	60.3	49.9	53.2	44.5	12.1	53.3	20.4
Pharmaceuticals	56.6	42.6	60.3[4]	33.1[4]	8.8[2]	63.1	18.7
Office and computing machines	113.9	110.6	107.3	97.8[4]	28.8[2]	105.7	68.2
Electrical machinery	91.0	47.5	33.1	20.7[4]	12.0[2]	53.6	46.6
Radio, TV and communication equipment	67.4	73.6	97.5	61.0	14.7[2]	90.8	41.8
Motor vehicles	77.3	36.5[3]	34.6	58.5	3.7[2]	59.0	36.5
Aircraft	87.3	49.4	120.2[4]	69.5[4]	43.6[2]	87.4	30.2
Railroad equipment	36.6	51.7	39.7[4]	29.8[4]	186.9[2]	43.6	20.3
Other transport equipment	70.2	43.3[3]	98.3	54.6	32.6[2]	72.2	25.4

Note: Imports as a percentage of domestic demand (estimated as production minus exports plus imports). Values greater than 100 can occur when exports exceed production because of the inclusion of re-exports, *i.e.* products that are imported and then re-exported without any further transformation.
1. Mix of fragmented and segmented sectors.
2. 2000.
3. 2001.
4. 1999.
Source: OECD STAN database.

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lowest import penetration ratios of all the G7 countries. The low import penetration rates in these industries, in conjunction with stable higher than average mark-ups, would seem to suggest a lack of rivalry amongst firms in these sectors. Alternatively, it could suggest that Italian firms in "traditional" industries are more efficient than competitors in world markets and so enjoy unusually high margins. However, export rates are also comparatively low (Table 11).[46]

Table 11. **Export ratio by manufacturing industry**
Latest available year

	Canada	France	Germany	Italy	Japan	United Kingdom	United States
	1999	2000	2000	2000	2001	2000	2001
Total manufacturing	55.1	37.7[3]	47.6[3]	34.2	16.3	39.9	16.8
Fragmented, low R&D							
Textiles	48.6	47.6[3]	86.5	36.2	22.7	38.9	12.9
Wearing apparel	28.9	37.4	57.1	37.4	1.0	37.0	10.1
Leather products and footwear	44.9	73.3	77.5	59.8	4.3	66.8	29.4
Wood products	67.9	17.5	15.9	8.7	0.2	5.4	3.7
Paper and pulp	..	31.3	44.9	20.3	2.9	18.0	8.5
Printing and publishing	..	7.5[3]	9.7	7.4	0.7	8.6	3.8
Non-metallic products	33.6	18.7	20.9	23.6	7.2	16.2	7.5
Fabricated metal products	28.6	13.8	20.6	16.5	5.5	14.5	6.2
Fragmented, high R&D							
Medical precision and optical instruments	..	40.6	67.7	52.2	77.3	62.5	26.3
Machinery and equipment	73.1	52.2	56.2	59.9	25.2	57.6	27.5
Other manufacturing	56.0	24.3	33.8	49.6	7.2	23.2	15.1
Segmented, low R&D							
Refined petroleum, coke	24.8	14.9[3]	23.1	16.6	1.3	26.7	4.7
Basic metals	52.0	41.8	48.5	27.5	9.9	42.3	12.8
Shipbuilding and repairs	67.4	35.9	53.5[4]	51.4[4]	60.5[2]	22.6	9.2
Rubber and plastic[1]	42.6	30.8	37.8	33.4	17.9	22.2	11.0
Food, beverages, tobacco[1]	21.7	22.7[3]	17.4	15.1	1.1	14.9	5.8
Segmented, high R&D							
Chemicals	49.9	53.9	61.8	36.1	16.7	56.2	20.3
Pharmaceuticals	29.4	46.8	72.1[4]	31.0[4]	5.5[2]	68.6	15.5
Office and computing machines	136.9	118.0	113.3	94.4	34.1[2]	107.9	58.2
Electrical machinery	80.5	50.8	38.8	24.7[4]	25.0[2]	51.3	37.6
Radio, TV and communication equipment	56.2	74.7	97.4	47.6[4]	29.2[2]	89.6	37.4
Motor vehicles	81.6	42.5[3]	53.3	51.0	25.6[2]	50.5	18.7
Aircraft	89.2	63.2	119.0[4]	68.2[4]	26.7[2]	88.4	44.1
Railroad equipment	44.0	47.0	30.0[4]	39.2[4]	107.5[2]	17.2	10.8
Other transport equipment	74.6	58.5[3]	98.3	62.5	61.4[2]	72.8	35.4

Note: Exports as a percentage of production. Values greater than 100 can occur when exports exceed production because of the inclusion of re-exports, *i.e.* products that are imported and then re-exported without any further transformation. ".." indicates not available.
1. Mix of fragmented and segmented sectors.
2. 2000.
3. 2001.
4. 1999.
Source: OECD STAN database.

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Fragmented low R&D sectors make up the backbone of the Italian industrial structure and account for 41.5 per cent of value added in total manufacturing. The seeming lack of competitive pressure in these sectors is likely to contribute to the poor performance of the Italian economy. It appears that the large number of

Table 12. **Herfindahl-Hirschman indices of industry concentration**[1]

	1996	1999
MANUFACTURING		
Fragmented, low R&D		
Food products	6.4	6.2
Textiles	4.0	4.2
Wearing apparel	3.9	4.4
Leather products	11.8	13.8
Footwear	6.4	8.9
Wood products	3.7	3.1
Paper and pulp products	25.5	26.6
Publishing and printing	11.9	13.3
Plastic products	6.5	6.6
Non-metallic products	8.1	9.1
Fabricated metal products	1.2	1.2
Furniture	3.9	5.3
Segmented, low R&D		
Beverages	38.4	56.2
Tobacco products	423.8	840.0
Refined petroleum products	318.0	274.0
Rubber products	83.4	84.5
Glass products	68.2	85.4
Basic metals	23.2	22.2
Iron and steel	57.6	61.1
Non-ferrous metals	131.6	119.0
Shipbuilding and repairs	195.2	88.0
Fragmented, high R&D		
Machinery and equipment	3.7	3.2
Medical appliances	17.9	17.6
Other manufacturing	10.5	10.7
Segmented, high R&D		
Coke and petroleum products	294.3	256.2
Chemicals products	17.0	16.5
Drugs and medicines	60.0	60.7
Office & computing machinery	530.8	271.7
Electrical machinery	11.2	10.8
Radio, TV and communication equipment	53.0	38.9
Optical and photographic equipment	85.0	78.6
Watches and clocks	1 531.4	585.4
Motor vehicles	36.6	34.6
Other transport equipment	76.1	73.0
Railroad equipment	498.1	463.6
Aircraft	635.0	689.7

1. The Herfindahl-Hirschman index is the sum of the squared market shares of firms and thus combines elements of both firm numbers and inequality. The value declines with increases in the number of firms and increases with rising inequality among any given number of firms.

Source: OECD, Statistics on enterprises by size class (SEC database).

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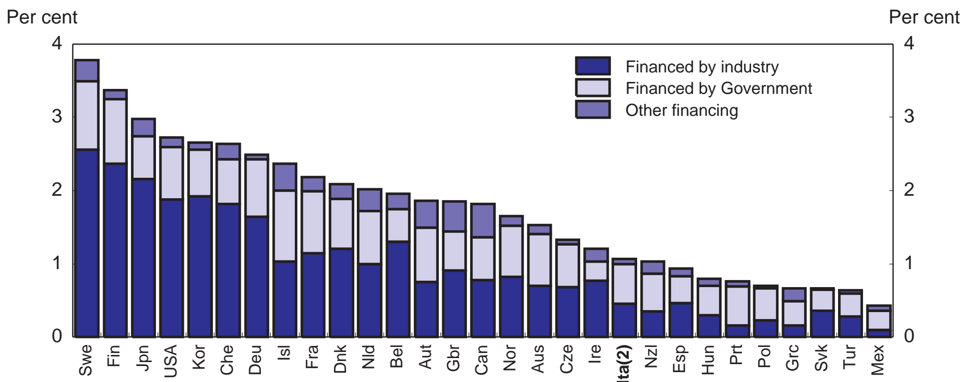
firms is not sufficient to bring about intensive product market competition and that rivalry amongst firms is not that strong. Indeed, it may be that the lack of economies of scale may be inhibiting more "efficient" or aggressive competition from emerging. A recent report by the Italian statistical office finds that Italian firms are too small, failing to benefit from economies of scale which could lead to more "efficient" competition (ISTAT, 2002c). However, concentration rates in manufacturing, as measured by the HHI, have generally risen over the second half of the 1990s (Table 12), suggesting that Italian enterprises may be moving towards a more efficient business model.

Economic performance and industrial structure

A more competitive environment tends to strengthen R&D and diffusion of technologies, both of which are primary factors contributing to economic growth (Ahn, 2002; OECD, 2003b). Italy's low R&D expenditure (Figure 17), both private and public, therefore, may in part be explained by a lack of competitive pressures. Indeed, regulatory restrictions to competition account for a large part of Italy's deviation of R&D intensity from the OECD average (Figure 18). Foreign direct investment (FDI) is also a major source of innovative activity through technology transfer and FDI in Italy (both inward and outward) is very low (Figure 19). However, intra-EU FDI

Figure 17. **Gross domestic expenditure on R&D**

Per cent of GDP, 2000[1]



1. Except Belgium, Denmark, Greece, Iceland, Ireland, Mexico, Netherlands, New Zealand, Norway, Portugal, Sweden: 1999.
2. The breakdown between private and public expenditure for Italy was unavailable. The 2000 figure was estimated using weights from 1996, which was the latest year for which the breakdown is available.

Source: OECD, *Main Science and Technology Indicators*, November 2002.

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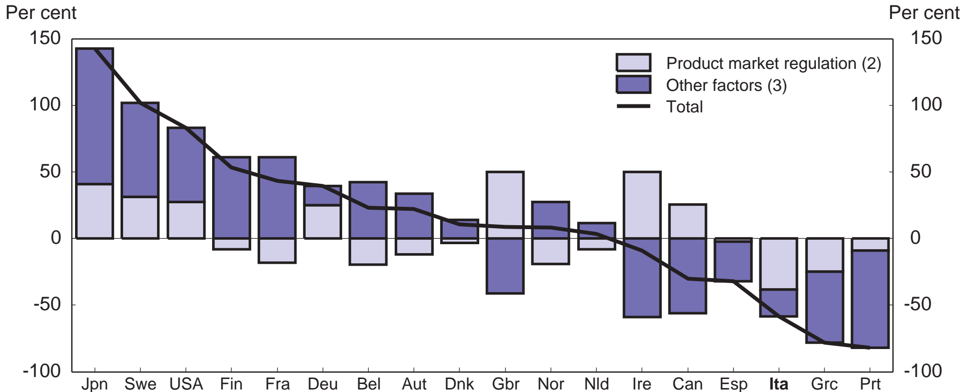
Figure 18. **The contribution of product market regulation to differences in R&D intensity across countries**

Percentage deviations from OECD average[1]



1. Adjusted for industry composition.
2. Includes administrative and economic regulations.
3. Includes EPL, other controls, and country-specific effects.

Source: OECD (2002), *Economic Outlook*, No. 71.

increased considerably between 2000 and 2001: inward FDI from 0.47 per cent to 1.17 per cent of GDP and outward FDI from 0.40 per cent to 1.76 per cent.

In Italy, as in other countries, the manufacturing sector accounts for the largest share of private R&D expenditure. However, output in Italy's manufacturing sector is heavily weighted towards low-technology industries, accounting for a higher share of manufacturing production than in all other G7 countries (Figure 20). Indeed, Italy's manufacturing sector has a larger share of "traditional" industries whose production requires technologies operated by low-skilled workers *e.g.* textiles, clothing, leather products, furniture, etc. (ISAE, 2003b). This higher weight of "traditional" industries, combined with the seeming lack of competitive pressures may therefore be a factor hindering aggregate growth performance.

Firm size seems to matter for R&D. Italy's low level of R&D expenditure is therefore likely to be explained, not only by the sectoral specialisation pattern and the limited competitive pressure to innovate but also by the size distribution of firms (Nicoletti *et al.*, 2001; Foresti, 2002). Italy's industrial structure is heavily weighted towards small and medium sized enterprises (SME's), more so than any of the G7 countries, with 98 per cent of all Italian firms having between 0-49 employees (Figure 21). The small size of firms discourages innovative activity since it is usually

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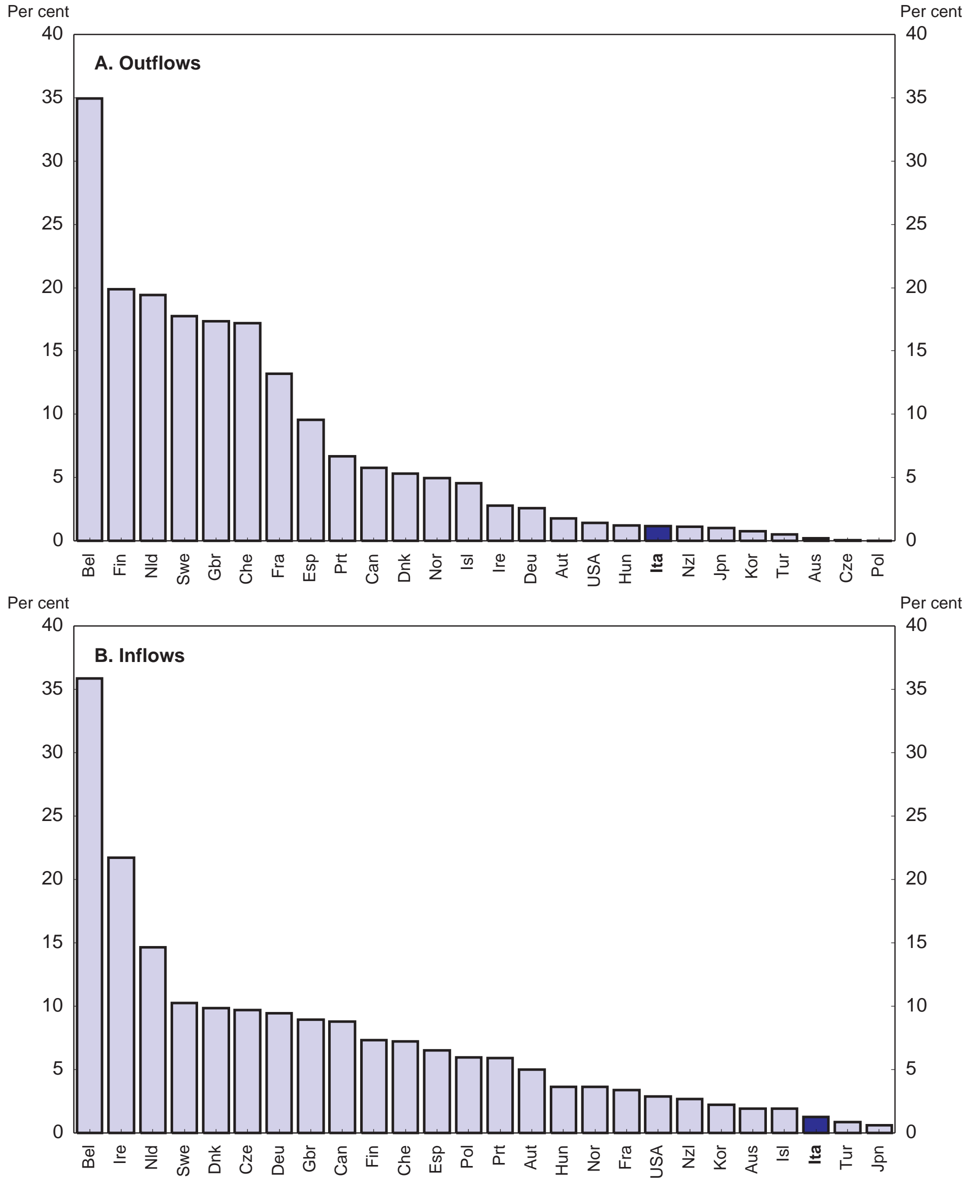
Figure 19. **Foreign direct investment outflows and inflows**
Per cenf of GDP, 2000



Source: OECD (2001), *International Direct Investment Statistics Yearbook.*

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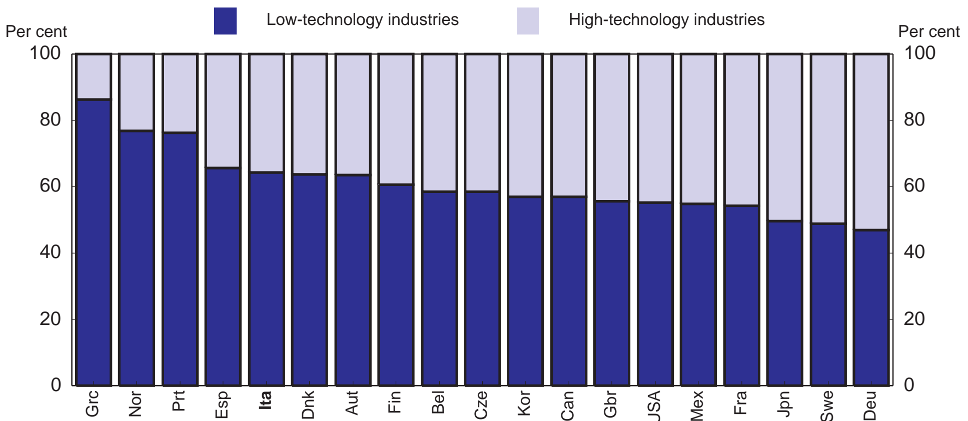
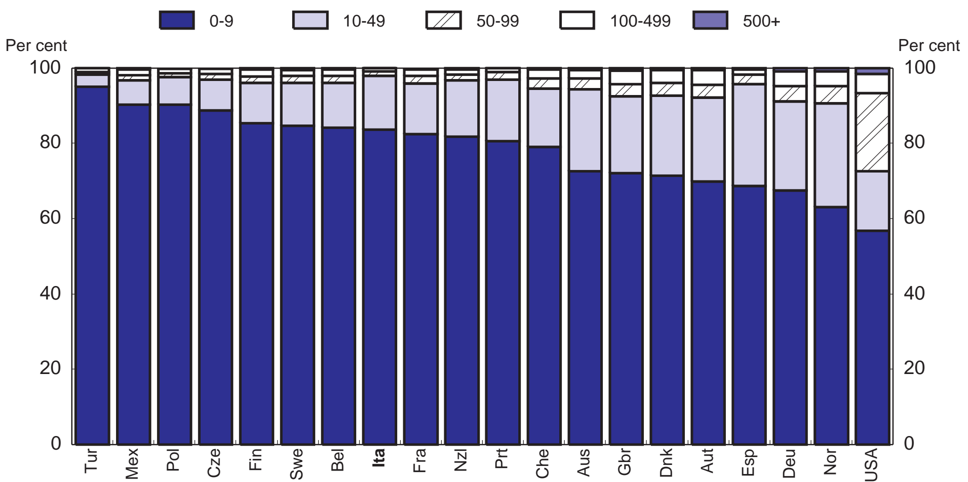
Figure 20. **Share of production in manufacturing sector by technology intensity**[1]



1. Latest available year: Denmark and United States: 2001, Belgium, Czech Republic, France, Mexico, and United Kingdom: 2000, Austria, Canada, Finland, Germany, Greece, Italy, Norway, Portugal, Spain and Sweden:1999, Japan and Korea: 1997.

Source: OECD, STAN database.

Figure 21. **Distribution of enterprises, by size class**
Total economy, 1999 or nearest year



Source: OECD (2002), *Small and Medium Enterprise Outlook*.

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large firms that have the available resources and can exploit the economies of scale needed for R&D. Recent studies by the Italian statistical office find that problems with productivity, growth and low R&D spending are linked to the industrial structure being heavily weighted towards small enterprises (ISTAT, 2002b).

Even after correcting for the sectoral composition of output and the size distribution of firms, work by Foresti (2002), Nicoletti *et al.* (2001) and Confindustria (1995) find that Italian firms engage in less innovative activity than comparable firms in other countries.[47] These studies confirm that a large part of the difference in R&D spending between Italy and other G7 countries can be attributed to the low level of R&D undertaken and financed by manufacturing firms in Italy.[48] Indeed, Italian enterprises with fewer than 100 employees contribute less to R&D expenditure than in all other OECD countries, with the exception of Sweden and Korea (Table 13).

Policies, institutions and industrial structure

The seemingly weak competitive pressure in fragmented low-R&D manufacturing industries in Italy is a puzzling feature. However, both industry structure and the intensity of product market competition can be affected by policies. Institutional and regulatory arrangements in Italy may therefore help to shed some light on this issue.

There are important interactions between product and labour markets. Numerous labour market policies and institutions such as the industrial relations systems and employment protection legislation (EPL) are potentially relevant for explaining the size distribution and innovative activity of firms, (Nicoletti *et al.*, 2001). For example, EPL that only applies to firms of a certain size of more than 15 employees may be one factor contributing to an industrial structure heavily weighted toward small firms, and can impinge upon firm growth. This may partly explain the apparent weakness of competitive forces in fragmented sectors where the lack of economies of scale is inhibiting more "efficient" competition from emerging. Moreover, enhanced flexibility in the labour market can accelerate the positive effects of product market reforms and facilitate the re-structuring of industries in response to competitive forces, while at the same time ensuring a more rapid reallocation of labour between companies and sectors. In the last few years, Italy has made considerable progress in reducing hiring costs for firms.[49] However, legislation on firing procedures has hardly changed since the seventies, contrary to developments in most OECD countries.

The efficiency of bankruptcy legislation and the development of financial markets can also impact upon product market competition, the size distribution and innovative activity of firms.[50] The current Italian bankruptcy law, dating from 1942, treats bankruptcy as an event mainly due to reprehensible behaviour by the debtor, rather than a possible outcome of normal business risks. It is extremely harsh to

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Table 13. **Total business R&D broken down by size classes of firms, 1999**
(percentage of total)

	Employees			
	Fewer than 100	100 to 499	500 to 999	1 000 or more
Canada[1]	16.8	15.8	10.1	57.4
Mexico[2, 3]	13.8	24.5	61.6	→
United States[4]	10.4	8.3	3.8	77.5
Australia[5]	29.2	20.7	12.3	37.8
Japan[6]	←	7.2	10.7	82.1
Korea[7, 8]	4.1	8.8	8.2	78.9
Belgium[3]	19.0	17.3	12.3	51.4
Czech Republic	10.5	24.3	12.5	52.6
Denmark[1, 9, 10]	16.1	23.4	13.2	47.4
Finland	14.0	15.0	9.6	61.4
France[1]	6.8	14.3	9.2	69.7
Germany[8, 9]	5.8	9.3	5.7	79.2
Hungary	16.3	13.7	15.2	54.7
Iceland	38.6	56.8	2.8	1.8
Italy[1]	5.4	18.9	12.3	63.4
Netherlands[1, 11]	10.6	18.2	71.2	→
Norway[3, 9, 12]	25.8	29.4	44.8	→
Poland	11.2	50.6	8.4	29.8
Portugal	25.7	41.2	9.9	23.3
Spain	18.0	26.2	16.5	39.3
Sweden[13]	3.8	14.0	9.6	72.6
Switzerland[10, 14, 15]	10.1	20.3	11.3	58.3
Turkey[14]	6.0	31.5	13.2	49.2
United Kingdom	8.0	17.2	13.3	61.5

1. 1998.
2. 51 to 100 employees.
3. 1995.
4. Lower cut-off point is 5 employees.
5. Excludes agriculture.
6. Fewer than 300 and 300 to 399.
7. Companies only.
8. 1997.
9. Excludes institutes.
10. Lower cut-off point is 6 employees.
11. 10 to 99 employees
12. Total manufacturing and mining only.
13. 50 to 99 employees.
14. 1996.
15. Excludes banks.

Source: OECD (2001), STI *Scoreboard*.

debtors, imposing personal and potential criminal liability on borrowers.[51] The punitive nature of bankruptcy procedures, by discouraging entrepreneurial activity and risk-taking, can impinge on both firm entry and growth. In addition, although aimed at satisfying creditor's claims, the current law offers little protection to credi-

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tors as their claims are usually achieved through a compulsory sale of the enterprises assets carried out by bankruptcy officials. Indeed, scant consideration is given for the protection of the enterprise as a going concern and no room for a potential re-organisation is provided for in the law (Cappiello, 2002). On top of this, the very lengthy judicial process usually results in the disappearance of any company value remaining for creditors in the end.[52] This lack of creditor protection can impinge on the availability and type of financing (*e.g.* creditors may be less willing to lend for riskier R&D projects). Although reforms are currently under consideration, given the large costs that the current law may be imposing, reform of bankruptcy legislation is a key structural reform that should be undertaken forthwith.

Administrative burdens on firms and red tape remain comparatively high in Italy and can discourage entry by both domestic and foreign firms. A recent study by the EC shows that, despite recent reforms, Italian firms had the third highest costs (after Austria and Greece) and still faced the longest waiting times for starting up a new business (EC, 2002a). Benchmarking reports on the quality of public administration show that Italy is among the countries with the lowest ranking as regards the quality of bureaucracy and the highest with respect to administrative burden, and that these factors are a major obstacle to firms' activities (Confindustria, 2002). Restrictive product and labour market regulations have also led to an inhospitable market environment making Italy relatively unattractive for inward FDI, and account in large part for its comparatively low level of FDI (Nicoletti *et al.*, 2003). Recent programmes are producing their first effects (Coco and Ferrara, 2003), but the margins for improvement in this area still remain large.

Competition legislation and enforcement

Italy was a latecomer in adopting competition legislation, which it did in 1990. However, it was among the first EU countries to bring the complete system of EU competition law into its national law, including both the prohibitions against restraints and abuse of dominance from the Rome Treaty and criteria for merger control modelled on EU merger regulation.[53] Basing the national law on the European model implies that elaboration of Italian competition policy depends upon European institutions and reinforces the independence of competition policy in Italy. Enforcement of Italy's Competition Act by the Antitrust Authority (*Autorità Garante della Concorrenza e del Mercato*) has been challenged from the start by long-term patterns of entrenched monopoly, direct government control, regulatory protection and industry co-operation. In spite of this, the Antitrust Authority has been promoting competition in product markets by actively enforcing competition legislation.

Institutional setting

The Antitrust Authority is a separate and independent agency, with unusually broad freedom of action and strong protection of its decision-making

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independence within the government structure. Unlike many other countries, it does not share competencies with a ministry secretariat for investigation or prosecution. The Authority, like the European Commission, acts both as the initiator and investigator and as the first-instance decision-maker in law enforcement matters. In Italy, the risks that are commonly associated with the combination of these functions have been checked so far by vigorous oversight from the courts. The Authority's five members are appointed by the Parliament for non-renewable seven-year terms. The members have mostly been experts from outside the government. The law provides no avenue for political control or influence, both in general or over particular decisions, beyond the appointment process itself. The budget is a separate line item in the law, approved by Parliament and subject to inflation adjustment, so ministries cannot exert indirect pressure by that means.

After vigorous increases in staff and budget while the Authority was becoming established, its resources have levelled off in the past few years. The total staff, currently about 190, is somewhat lower than in Germany, France, and the United Kingdom, and it is even lower than staff numbers in some smaller economies with active competition policy regimes, such as the Netherlands and Australia (Table 14). Some of the staff resources are allocated to deceptive advertising and marketing practices (as is also true for the United Kingdom, Canada and Australia). Although funding has been adequate so far, the statutory ceiling on the staff level could impair the Authority's ability to handle cartel enforcement and the responsibilities that could follow from the EU's modernisation programme.

Table 14. **Competition Agency resources, 2001**

	Staff	Budget[1]
Australia	540	62.4
Canada	383	30.8
France	380	20.2
Germany	225	17.8
Italy	180	24.9
Japan	607	39.4
Korea	416	34.5
Mexico	195	9.7
Netherlands[2]	255	28.9
Poland	188	6.2
Spain	100	6.2
Turkey	318	24.0
United Kingdom	232	34.5
United States	1 165	160.0
European Union	570	

1. US$ millions, PPP.
2. 2002.
Source: OECD.

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Key features of the competition legislation framework

Substantive law

In principle, Italy has adopted the European legal framework of prohibition, notification, and exemption, but in practice the Authority has focused on enforcement marked by an emphasis on economic analysis of causes and effects. *Per se* prohibitions, obviating economic assessment of the particular case, are generally limited to horizontal cartels. Vertical restraints are subject to a rule of reason approach, and the requirement that a restraint have an "appreciable" impact is in Italy's statute.[54] Indeed, even resale price maintenance does not appear to be treated as *per se* illegal. In general, there have been comparatively few cases about vertical restraints. Unless they are part of an industry-wide pattern with horizontal effects, vertical restraints are usually of interest only if they involve an abuse of dominance. Hence, Italy applies a market power screen regarding vertical restraints, and it does so more explicitly than the EU's treatment of vertical restraints.

In its application of merger control, Italy's practice contrasts with that of its neighbours. Decisions are based on the competition issues, and other policies are not considered. A never-used provision of the Competition Act (Sec. 25.1) could permit balancing competition considerations against other national interests, but the regulations needed for the Authority to do so have not been promulgated. As mentioned above, the Authority also combines its antitrust duties with responsibilities for advertising and unfair competition that arise under different legislation.[55] The rules concerning deceptive and comparative advertising follow from EU directives that have been enacted into Italian law. These matters represent a large part of the Authority's workload, measured by the number of actions – several hundred per year – if not by resources employed. In 2001 the Authority was given some role in claims about the abuse of "economic dependence", such as refusal to deal, burdensome or discriminatory contract conditions, and termination of trading relations. The Authority may authorise Competition Act sanctions against abuse of economic dependence where this conduct "is relevant to the protection of competition and the free market."[56] The breadth of its responsibilities underscores the concern that the Authority's staff is comparatively small.

Coverage

The Competition Act promotes competition as a general, horizontal principle, with virtually no explicit exclusions. However, sectoral laws set special rules or limits based on market share in several areas, mostly involving the media and utilities sectors. While these may be aimed at competition-policy goals, such as eliminating or reducing dominant positions, they may dampen competition among the firms that remain, encouraging a comfortable oligopoly instead of

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rivalry amongst firms. Entities with ties to the state are fully subject to the Competition Act. Because many of them are traditional infrastructure monopolists whose markets have been opened to competition in recent years, and which have resisted competitive entry, they have been principal enforcement targets. In some areas other legislation or regulations create immunities or distortions inhibiting competition. The most important problems arise from local-level regulations constraining competitive entry, which are discussed in further detail below. In a test case that may set an important precedent for competition policy in Europe, the Authority has argued for an extension of EU treaty principles about competition to counter anti-competitive regulations.[57]

The banking sector is the only sector where enforcement is not under the jurisdiction of the Antitrust Authority. Banking is not exempt, but the Bank of Italy rather than the Authority enforces the Competition Act in this sector. This approach is a way of institutionalising the concern that system stability factors in banking are unusually important to the economy at large. It also allows for some benchmarking between the competition enforcement bodies, as the Authority comments on the Bank of Italy's initiatives and has enforcement power over other financial products such as insurance. However, such benchmarking could also be attained by other means, *i.e.* benchmarking at the European level. Price fixing and market sharing agreements tend to be the major antitrust problems in banking, and the Bank of Italy has been a comparatively active competition enforcer, tackling collusive agreements and abuses of dominant position. Still, the Bank of Italy's concern regarding financial stability may be taken into consideration when making antitrust decisions, possibly inhibiting the development of a more dynamic sector. For example, while there have been numerous mergers and acquisitions in the sector there have been no hostile take-overs. However, this is hardly conclusive evidence since hostile take-overs are extremely rare in the banking sector worldwide.

Enforcement

The courts in Italy are unusually important and active, both in reviewing and correcting the Authority and in providing an alternative outlet for complaints. Appeals from the Authority are taken to the Administrative Court and then to the Council of State. Thorough, effective judicial oversight is particularly important whenever an agency, like the Authority, combines the functions of initiation or prosecution and first-instance decision-making. The Authority's actions were often rejected at first – indeed, the Authority appeared to be treated more like a prosecutor or litigant than an independent decision-maker – but its record on appeal has improved over time. The review process had typically taken much too long, but recently adopted rules have accelerated it. Both stages of appeal can now be completed within about a year after the Authority's decision. This is substantially

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faster than the comparable process of appeal of European Commission decisions to the Court of First Instance and the European Court of Justice.[58] Italy's merger review timetable, which is now shorter than the EU deadline of 4 months, may be too fast to allow for a careful assessment of the competition issues involved.

The Authority currently does not have the power to grant interim relief pending final action. Some interim relief can be obtained from the courts, but only through a private lawsuit, to which the Antitrust Authority is not a party. Providing for interim relief power in conjunction with the Authority's enforcement of the Competition Act could be particularly significant in cases alleging abuse of dominance through denial of access to a network facility. The Authority has the power to order access after finding a violation. Giving it the power to order access provisionally, pending the final decision, could speed up the development of competitive markets. The revised EU competition enforcement regulation (Art. 8) gives the European Commission interim relief power. As the EU system moves toward decentralised application of common rules though national processes, consistency would support extending this power, in parallel, to the national competition enforcement body.

In Italy, private parties can bring independent suits in the civil courts, either for damages or, more importantly, for orders and interim relief to protect the party's interests. Since 1994, about 80 private suits have been reported under the Competition Act.[59] Filings peaked in the mid-1990s as parties were testing what could be done with the new law, falling off thereafter, as few complaints were successful. They have revived since 1999 (averaging around 11 cases per year) probably because complaints, building on experience and guidance, have focused more carefully on what the law can and cannot do. Most of the unsuccessful early actions involved ordinary commercial relationships, and the courts were probably leery of extending the new legal principles to such ordinary contract matters. Recent suits have sought access to infrastructure monopolies and challenged anti-competitive actions by public officials. If the Authority had the power to order interim relief, private actions for that purpose would decline, although the courts could presumably still intervene to correct abuses of that power.

Sanctions

To enforce compliance and deter violations, the principal sanction under the Competition Act is a financial penalty. There are no provisions for criminal penalties or for sanctions against individuals. So far, the Authority is not concerned that deterrence is weakened by the lack of penal or individual sanctions.[60] However, the threat of criminal penalties provides an important complement to financial penalties and may act as a stronger deterrent than financial penalties alone. The lack of individual sanctions may also pose particular problems in some areas such as professional services (see below). After amendments to the Competition Act in 2001,

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Italy's basic sanctions system, permitting fines of up to 10 per cent of overall turnover, is now generally comparable to that of the European Union and other European jurisdictions.[61] The Authority has been unusually aggressive. Even before the amendments that increased the potential fine, the Authority imposed the highest fines against horizontal price fixing of any national enforcer in Europe: €360 million against tying and information exchange in the insurance industry. The only competition enforcers to have imposed higher sanctions in such matters are the United States, the European Commission and Germany. And in a current case against airlines for strategically targeting new entrants, the Authority had imposed higher fines (which have, however, been annulled on appeal) than the European Commission and other national authorities in similar cases.

The Authority's powers of sanction, however, may be too limited for violations achieved *via* an association. Professional associations or self-regulatory bodies are often the means for reaching and implementing the most serious restrictive agreements. Evidence of such agreements often appears in the associations' activities. However, associations typically have little or no turnover on which to base a fine, so a sanction based on turnover would necessarily be small and therefore not an effective deterrent. Basing sanctions on the turnover of the associations' individual members, and making the members liable for the fines, would make the sanction fit the offence. Sanctions of this kind are provided for in several other jurisdictions that use the EU model. Though Italy does not have a formal leniency programme, the recent amendment that increased possible financial penalties also increased the Authority's sanctioning flexibility in the other direction by permitting it to impose a fine of zero (*i.e. de facto* leniency), even in the case of a serious violation. A clear and explicit leniency programme, to encourage conspirators to come forward with evidence, would be a valuable additional enforcement tool.[62]

Regulatory policies

Focusing on regulations that restrict competition and market mechanisms, OECD indicators of regulation show that in 1998 Italy's economy-wide regulatory environment and regulatory settings in the non-manufacturing (service) sectors was one of the most restrictive in the OECD area. Accounting for reforms undertaken during the 1998-2000 period shows that while Italy's market environment improved, its gap with respect to countries with the least restrictive environments (such as the United Kingdom, United States, Canada and Australia) remains large (Figure 22).[63] While the recent reforms provide a formal framework of competition, they do not always implement the structural changes and regulatory provisions that are needed for actual competitive pressures to arise (Nicoletti, 2002).

While Italy was a latecomer in opening up its network industries and introducing competition, it has embraced regulatory reforms and implemented many best practices. However, more recently, it seems that the pace of reforms is slow-

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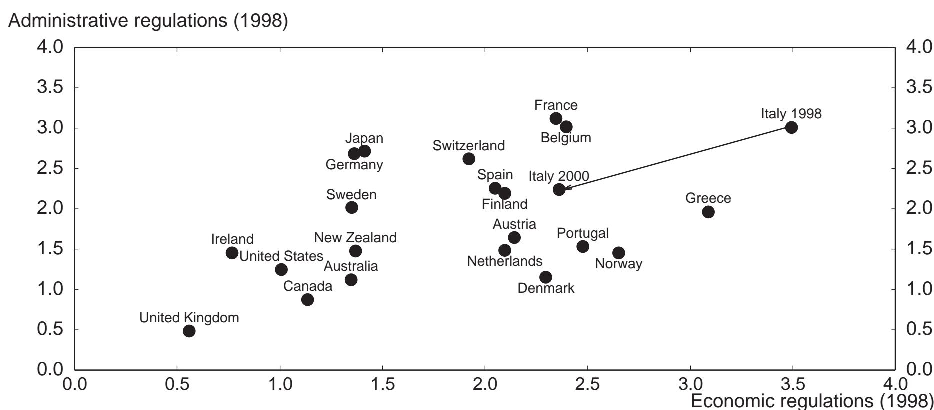
Figure 22. **Recent reforms in Italy, 1998-2000**[1]

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



1. The indicator for Italy in year 2000 is based on information provided by Italian authorities. It does not show if Italy has advanced relative to other OECD countries, who may also have implemented reforms during the 1998-2000 period.

Source: OECD (2001b); Nicoletti (2002).

ing and further privatisation also seems to be on hold. The introduction of *sportelli unici* or "one-stop-shops" aimed at reducing the administrative burden on enterprises does not seem to have introduced major advantages for existing companies. The administrative burden and red-tape associated with running a business in Italy are still high by international standards. However, the *sportelli unici* have significantly reduced waiting times for opening new businesses. In potentially competitive service industries, such as distribution and professional services, a satisfactorily competitive environment has yet to emerge even though these industries have been involved in reform processes for the past 3 to 5 years (Ministero dell'Economia e delle Finanze, 2001). National legislation is quite advanced but implementation at the local level is difficult because of the devolution process, requiring an adequate level of good regulatory practices at the regional level. Some regions and local authorities are beginning to introduce streamlined regulations.

Competitive industries

While retail distribution and professional services are inherently competitive sectors, regulation of entry conditions can impinge upon competition and result in higher prices and lower productivity. In comparison to other OECD coun-

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tries, Italy's distribution and professional services sectors are highly regulated and characterised by measures restricting market entry. In addition to direct entry barriers, restrictions are often imposed, for example, on the range of products to be sold, opening hours, advertising, prices and tariffs.

Retail distribution

While the retail distribution sector is considered to be conducive to strong competition, the sector benefits from economies of scale and scope. In many countries, this is manifest in the ongoing process of structural change involving larger retail outlets, consolidation into retail chains and greater concentration and vertical integration.[64] Regulatory easing in many countries (*e.g.* Japan) has reinforced these structural changes, involving the closing down of scale-inefficient outlets and improvements in productivity (OECD, 2002j). This has not, however, been the experience in Italy.

Compared to other OECD countries, Italy's retail distribution sector is characterised by a large number of small firms and low concentration. In food retailing, the combined market shares of the five largest retailers in Italy is 17.6 per cent, the lowest ratio in the EU, and considerably lower than the EU average of around 50 per cent (Figure 23). While market concentration increased somewhat during the 1990s, Italy's restructuring of the sector lagged behind that of Greece and Spain, countries that also had comparatively low market concentration at the beginning of the 1990s.

Other characteristics of the Italian retail sector include its comparatively high outlet density (only Portugal and Spain have higher density) with an average number of employees per enterprise that is the lowest in the EU (Table 15). This reflects the absence of medium and large retail outlets, which is also manifested by the comparatively low average surface area per 1 000 inhabitants. These features would not be of concern if sectoral performance were relatively good. However, it seems that the market structure of Italian retailing has had a notably negative impact upon performance in the sector. Productivity, both in the retail sector as a whole and in non-specialised large outlets, is the lowest in the EU and 20 to 30 per cent lower than the EU average. In addition, estimated mark-ups in wholesale and retail distribution in Italy are the highest for OECD countries for which data are available (Figure 24). The high mark-ups suggest a lack of effective competition in this sector in spite of the large number of firms.

The poor performance of the sector is likely to be the result of prevailing regulatory policies. Retail distribution in Italy has traditionally been subject to more extensive regulation than in other OECD countries and is hindered by numerous restrictions that do not seem to be motivated by any general interest (Boylaud, 2000). For example, entry in pharmacies is restricted by numerical limits that are established on the basis of very strict parameters[65] and beauty parlours

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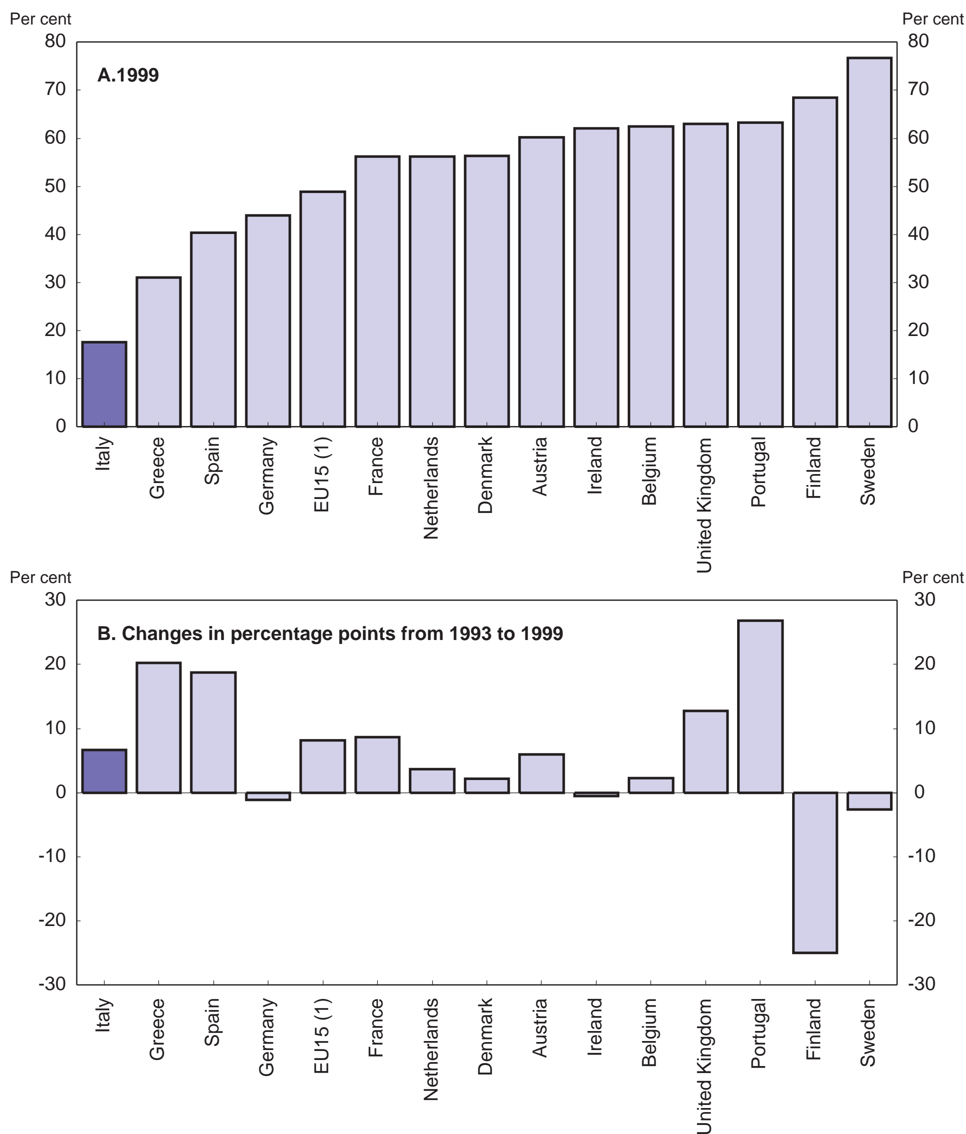
Figure 23. **Five-firm market concentration in grocery and daily goods retailing in EU countries**

1993-1999



1. Weighted average.

Source: Estimates based on data from Corporate Intelligence on Retailing's European Retail Handbook, reported in Dobson *et al.* (2001).

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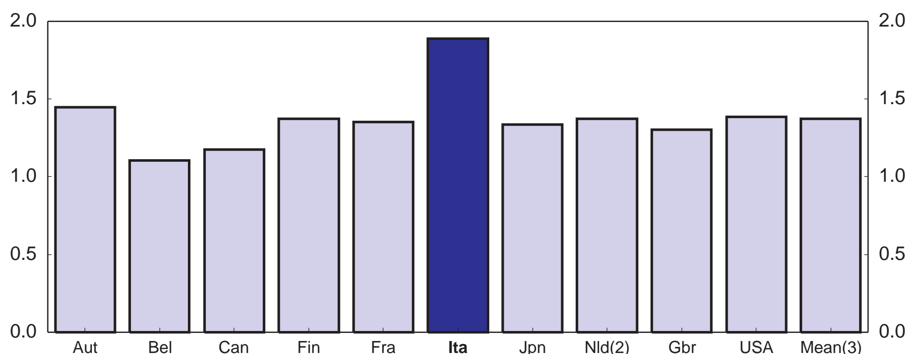
Table 15. **Key structural features of the retail distribution sector, 2000**

	Retail distribution, total				Non-specialised stores[3]			
	Outlet density[1]	Employees per enterprise	Value added per employed person[2]	Value added per unit of labour costs[2]	Value added per unit of labour costs[2]	Hypermarkets[4]	Supermarkets[4]	Free service[4,5]
Austria	43	7.7	108	98	86			
Belgium	80	3.5	109	95	96	47	148	236
Denmark	47	8.1	103	99	95			
Finland	46	5.0	132	110	108			
France	64	4.2	133	104	109	109	122	255
Germany	35	9.0	113	116	107	56	83	204
Ireland	36	9.3	95					
Italy	130	2.2	81	72	79	17	81	118
Netherlands	54	8.5	80	117		24	184	264
Portugal	150	2.5	44	81	98			
Spain	133	2.8	73	97	106	54	85	165
Sweden	65	4.3	130	88	89			
United Kingdom	36	14.2	99	123	127			
European Union	71	6.3	100	100	100			
Norway	68	6.0	112	98	100			
Switzerland	56	6.8	201					

1. Number of enterprises per 10 000 inhabitants.
2. EU = 100.
3. Includes large-format outlets such as hypermarkets and department stores.
4. Square meters per 1 000 inhabitants in 1999.
5. Free service areas are those outlets with size greater than 400 square meters.

Source: Eurostat, New Cronos.

Figure 24. **Mark-ups in wholesale and retail distribution in selected OECD countries**
1981 to the latest available year[1]



1. Austria, Finland and France: 1981-00, Netherlands and United States: 1981-99, Italy and Japan: 1981-98, Canada: 1981-97, Belgium: 1996-00 and United Kingdom: 1993-96.
2. Including restaurants and hotels.
3. Unweighted average of available countries.

Source: OECD.

cannot open within 250 meters of another beauty parlour. National legislation, *Legge* 114/1998, implemented in 1999, liberalised the opening, relocation and expansion of small sized outlets.[66] The 1998 reform also included the abolition of the system of commercial licenses for small retail business, and a notification to the local authority is now the only requirement for starting such a business. In spite of these reforms, Italy's retail sector is still subject to more extensive regulation than in many other OECD countries (Boylaud and Nicoletti, 2001). Implementation at the regional level has effectively entailed that new commercial establishments, rather than being subject to regulation on commercial activities, are now subject to regulations on urban planning. In practice this has meant that authorisation for medium and large outlets is required (and rarely granted) in order to integrate them into urban development plans, while the opening of small shops has been liberalised.

Regulations on large-scale outlets often aim at promoting non-economic objectives such as protection of the urban environment or to protect small shopkeepers. A recent study by ISAE (2002c), looking at the effects of the 1998 reforms, shows that efficient competition in the retail distribution sector has not emerged and that the devolution process is not consistent with competition objectives in this sector. The devolution of regulatory powers to the regional lev-

els has been problematic for the liberalisation process in that local governments are even more susceptible than national government to blocking pressure by incumbent firms and other vested interests. In addition, the study finds that a multitude of regulatory constraints on pricing, entry and product or service quality persists, mainly imposed at the regional level. While there are very few restrictions left on small format shops, medium-sized shops still have their opening hours regulated, but often local authorities relax these limits. And entry for large formats has become almost impossible as local authorities rarely grant planning permission.

The observed trends in restructuring in Italy are of concern in that they are going in the opposite direction of the modernisation that has been emerging in other countries. During the 1990s, retail distribution in Italy witnessed more closures than openings. However, following the 1998 reform, there has been substantial growth with openings outnumbering exits. Entry has been almost exclusively confined to small format shops (Table 16). In 2001, small retailers accounted for 97.2 per cent of all entry, whereas medium and large formats accounted for 2.6 per cent and 0.2 per cent respectively. The mode of entry also differs significantly between small retailers and medium and large retailers. New openings accounted for around 80 per cent of entry by small retailers whereas takeovers accounted for only 20 per cent. Reflecting the fact that new openings are difficult for medium and large formats (due to difficulties in obtaining authorisation at the local level), they accounted for less than 40 per cent of entry, whereas entry by takeovers accounted for over 60 per cent. While in general entry or the easy possibility thereof is a good thing, entry by small retail shops does not intensify competition in this sector since these shops are unable to reap the advantages of economies of scale and scope required for effective competition to emerge (Dobson *et al.*, 2001).

Table 16. **Entry in retail distribution, 2001**
(broken down by dimension, as a percentage of total)

	Small	Medium	Large
Entry	97.2	2.6	0.2
Method of entry:			
mergers	0.0	0.8	0.0
new opening	79	36.6	37.4
take-over	21	62.6	62.6
Total	100	100	100

Source: Ministry for Productive Activities.

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Professional services

Professional services in Italy are subject to pervasive regulation, including the exclusive exercise of certain functions, entry and access requirements, minimum price determination, and restrictions on advertising and business structure. Barriers to entry in Italy also arise from mandatory membership in professional orders, quantity restrictions (*e.g.* the number of notary seats is fixed), and nationality or residency requirements. Restrictions on competitive practices such as price competition and advertising or nationality requirements do not explicitly address the issue of quality, and there is little empirical evidence to suggest that these restrictions improve consumer welfare. In practice these restrictions have been correlated with higher prices and less innovation, without improving quality and it appears that the principal beneficiary of such restrictions is the profession itself.[67]

Competition in the professional services sector in Italy is rather weak due to oversight by professional bodies. Such self-regulation can be in the interests of both consumers and the profession if it improves service quality and prevents market failure.[68] But it also raises concerns regarding independence and the effectiveness of such regulatory bodies since the risks of regulatory capture are high. The Italian professional services sector is characterised by active trade associations and very strong ties with political bodies, in which the interests of incumbents are often represented in national legislative bodies. For example, according to law, minimum fees for various services are set by a ministerial decree after hearing the recommendations of professional associations. Although in practice the Minister formally takes the final decision on fee level and structure, professional associations have been able to "impose" their proposals. In 1998, the Antitrust Authority found against two professional bodies for co-ordinating tariffs, but the decision was reversed on appeal, since the professional bodies have an obligation to fix a tariff according to the law. Given the extent and nature of state involvement and regulation in this sector, room for enforcement of competition law is therefore rather limited.

Several attempts have been made in recent years to deregulate the professional service sector in Italy. The system of market entry has been liberalised to some extent. The same is true for regulations on marketing and advertising, as well as for the system of fee setting. While the prohibition on advertising has been relaxed, restrictions still exist and the current codes provide guidance on the forms and mean that have to be respected. Regulatory reforms in the latter part of the 1990s also eased restrictions regarding business structure but they have not as yet been adopted, so that for the moment neither incorporation or limited liability partnerships nor inter-professional co-operation is possible. In spite of recent reforms, the overall regulatory system is still rather rigid.

Paterson *et al.* (2003), in a recent study for the European Commission, examine the differences in a host of regulations governing a range of professional

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services (accountancy, legal, architecturals, engineering, and pharmaceutical) across the EU member states. They differentiate between two different groups of regulations: regulations on market entry and those on market behaviour or conduct[69] and construct an overall index for the degree of regulation. Despite recent reforms, Italy is one of the few countries with a high degree of regulation in all professions, the only other countries being Austria and Luxembourg (Table 17). In pharmaceutical services Italy has the highest degree of regulation after Greece, and particularly restrictive market entry regulations in architectural and engineering services give rise to a comparatively high overall index. Italy also has a highly restrictive environment in legal and accountancy services due to regulations on entry and some of the most restrictive regulations on conduct in the European Union.

The authors find that countries with a high degree of regulation tend to have relatively higher turnover from fees, indicating higher mark-ups.[70] They also found a negative correlation between productivity and the degree of regulation, and no evidence that less restrictive regulation led to a lower quality of services. Their results support the view that restrictive regulatory frameworks, rather than supporting the needs and interests of consumers, are often used by the professions to obtain economic rents. Lastly, they found that countries with a low level of regulation have also witnessed a tendency of a market "shake-out", allowing the formation of larger enterprise units. In Italy, however, regulatory restrictions, par-

Table 17. **Regulation indices in professional services**[1]

	Accountants	Legal	Architects	Engineers	Pharmacists
Austria	6.2	7.3	5.1	5	7.3
Belgium	6.3	4.6	3.9	1.2	5.4
Denmark	2.8	3.0	0	0	5.9
Finland	3.5	0.3	1.4	1.3	7.0
France	5.8	6.6	3.1	0	7.3
Germany	6.1	6.5	4.5	7.4	5.7
Greece	5.1	9.5	n.a.	n.a.	8.9
Ireland	3.0	4.5	0	0	2.7
Italy	5.1	6.4	6.2	6.4	8.4
Luxembourg	5	6.6	5.3	5.3	7.9
Netherlands	4.5	3.9	0	1.5	3.0
Portugal	n.a.	5.7	2.8	n.a.	8.0
Spain	3.4	6.5	4.0	3.2	7.5
Sweden	3.3	2.4	0	0	12.0
United Kingdom	3.0	4.0	0	0	4.1

1. The higher the degree of regulation (intensity), the higher the respective figure (within a range from 0 to 12). All the regulation indices with a value of 5 or higher are shown in dark grey boxes, indices between 2.5 and 4.9 are in light grey boxes, and, those below 2.5 have a white background.
Source: Paterson *et al.* (2003).

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ticularly those on business structure, have hindered this restructuring process. The professional service sector in Italy is characterised by low concentration, and the recent trend has been towards even less concentration.

A number of proposals to reform professional services are currently being considered by the parliament. The proposed reforms include, in general, a relaxation of restrictions on advertising, on the choice of business structure so that professionals may set up a partnership, and mandatory indemnity insurance by professionals against the risks stemming from their activity. These proposals, particularly the one on mandatory insurance, indicate a trend towards more pro-active forms of consumer protection and quality management. However, the current proposals do not substantially change regulation of entry and only make minor improvements with regard to conduct regulation, *e.g.* minimum tariffs would still be set by the Minister on the basis of proposals where the views of professional associations are represented.

In the current regulatory setting, the role of professional associations enables incumbents to successfully hinder reforms aimed at relaxing entry restrictions and eliminating rent opportunities. In this respect, the role of self-regulatory bodies should be reduced and limited to evaluation of professionals' capacity. More importantly, the determination by law of minimum fees or recommended price schedules should be removed and restrictions on truthful advertising and on business structure should be eliminated. A problem in Italy is that regulatory changes take a very long time to be decided and, if they are decided, it takes even longer to implement them. For example, the 1997 reforms on business structure and inter-professional co-operation have yet to be implemented. This leads to a considerable lack of transparency and uncertainty, and it is unclear how a more dynamic market can evolve in such a situation. Legislation should permit a wide range of organisational solutions and ease the rigid rules on the incompatibility between professions, as these restrictions contribute to the perpetuation of a rather small-scale market structure that may be sub-optimal since economies of scale and scope remain unused. Given current trends in this sector in other countries, it is likely that in the long run, and where an increasingly internationalised market may emerge, the rather small-scale structure of some professional services sectors in Italy will not be competitive.

Network Industries

There is now a solid body of cross-country evidence that liberalisation policies in network industries have led to higher productivity, better quality and, often, lower prices.[71] However, capturing these benefits is not straightforward and close attention needs to be paid to the design of reforms (Gonenc *et al.*, 2001). Reflecting problems with market power that are inherent in these industries, about half of the Antitrust Authority's actions over the 1990-2001 period have dealt

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with the network sectors such as telecommunications, energy, and transport. This is consistent with a strategy of focusing on sectors or issues with the largest overall economic impact, as network sectors account for 18 per cent of GDP and for a large share of intermediate inputs.

Regulatory reforms in Italy have opened up these sectors to competition and the government has privatised previously state owned enterprises in electricity (ENEL), gas (ENI) and telecommunications (*Telecom Italia*). Privatisation plays an important role in eliminating possible conflicts of interest between regulators and the firms they are regulating. However, the government retains a controlling interest in electricity and gas and golden shares in both these industries and telecommunications.[72] Golden shares, by hindering the market for corporate control, strongly reduce the positive effects of privatisation and are a strong disincentive to investment. For these reasons, the European Commission has repeatedly called upon the Italian government to justify its golden shares.[73] A recently issued recommendation by the Privatisation Advisory Committee urged the government to reduce the breadth of golden share powers and to define more narrowly and transparently the requirements and the criteria by which such powers can be exercised. The Italian government recently sold its remaining stake of 3.46 per cent in *Telecom Italia* and confirmed its intention to reduce its holdings in ENEL, pending favourable market conditions. With the aim of reducing monopoly power, vertical restructuring has also taken place. However, full ownership (vertical) separation, which would eliminate the incentive for firms who own the network facility to engage in abusive exclusionary or discriminatory conduct, has as yet not taken place, though there are plans to do so.[74] The government is currently considering further reforms involving vertical separation and putting a limit on the shareholdings by ENEL and ENI in the network companies to 10 per cent within 3 years.

A recent amendment to the Competition Act gives the Antitrust Authority additional legal tools aimed at controlling abuse in these sectors by preventing anti-competitive cross-subsidisation. It requires legal separation between operations in competitive and non-competitive markets or services of general economic interest such as essential facilities. In addition, if owners of essential facilities supply goods or services to their own subsidiaries in different markets, then they must make those available to competitors on the same terms. The last rule, in particular, may lead to private suits and Antitrust Authority enforcement actions.

Telecommunications

Since the mid 1990s, the reform of the Italian regulatory framework in telecommunications has been driven by the implementation of the European Directives into national legislation. The communications regulator, *Autorità per le Garanzie nelle Comunicazioni* (AGCOM) was established in 1997 as an independent body responsible for implementation the regulatory framework. However, a lack of clarity

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in the assignment of regulatory tasks has necessitated coordination between the Ministry and the regulator (EC, 2002b).[75] The regulatory framework provides for a dispute/complaint procedure involving AGCOM and for AGCOM to act as a mediator between the parties. AGCOM's interventions have helped reduce the number of court cases with the incumbent, and where operators fail to comply with its decisions, AGCOM can impose penalties. While the responsibility for awarding licenses originally rested with AGCOM, in 2001 this task was given back to the Ministry of Communications. The government should consider giving this responsibility back to AGCOM as soon as possible.[76] However, a reform of the legislative framework that assigns new regulatory competencies to the Ministry is currently under discussion. Compared with other EU countries, AGCOM appears to be well staffed and funded. Its responsibilities include the communications sector, including the press, and not just telecommunications so that it is well positioned to deal with issues of convergence between broadcasting and telecommunications (Table 18).

The Italian regulatory regime in telecommunications is one of the most pro-competitive in OECD countries. The market is very dynamic and labour productivity growth over the 1990s has been relatively good. However, there is still considerable room for improvement, as prices in both fixed and mobile telephony and for internet access remain comparatively high (Figures 25 and 26). This is gradually changing as the pro-competitive regulatory framework has resulted in

Table 18. **Competencies and resources of telecommunications sector regulators, 2002**

	Licensing	Price controls/Access	Staff numbers	Budget (€ m)
Belgium	R	R/R	39	36.3
Denmark	M and R	R/R	236	29.8
Germany[1]	R	R/R	1 859	139.9
Greece	R	R/R	61	16.5
Spain	M and R	M and R	114	19.1
France	M	M/R	149	16.1
Ireland	R	R/R	102	23.6[2]
Italy	M	R/R	225[3]	44.5
Luxembourg	M	R/R	30[2]	3.5[1]
Netherlands	R	R/R	107[2,3]	13.3[2]
Austria	R	R/R	60	7.9
Portugal	R	R/R	396	78.6
Finland	M	R/R	249	28.0
Sweden	R	M and R/R	204	23.9
United Kingdom	M	R/R	236	27.9

Note: R-regulator responsible, M-ministry responsible.
1. The regulatory authority regulates both the telecommunications and postal services.
2. 2001.
3. Includes staff working on other matters than telecommunications (audio-visual, publishing etc.).
Source: EC (2002), Eighth Report on the Implementation of the Telecommunication Regulatory Package, Annex II.

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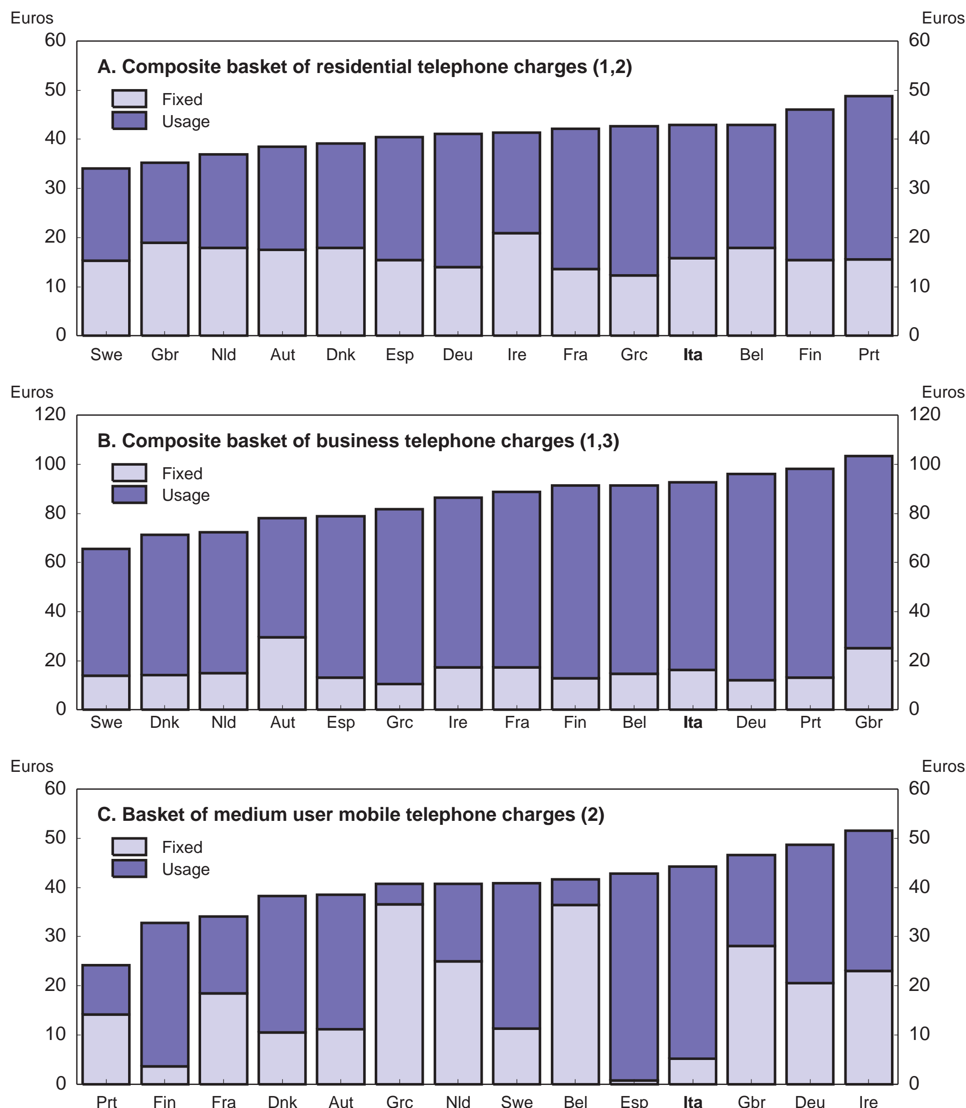
Figure 25. **Average monthly telephone charges**

August 2002



1. Composite basket includes international calls and calls to mobile networks.
2. Including tax.
3. Excluding VAT.

Source: OECD (2003), *Communications Outlook.*

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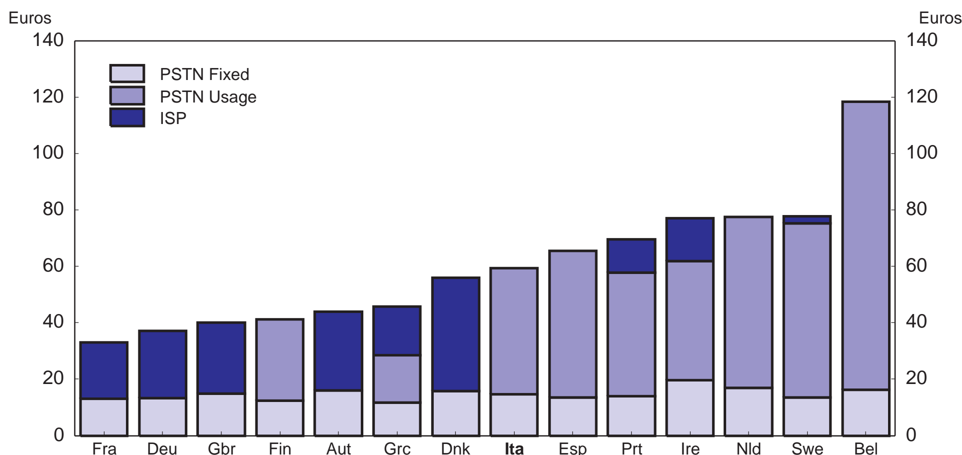
Figure 26. **Internet access basket**[1]
September 2002



1. For 40 hours at day-time discounted PSTN rates, including VAT.
Source: OECD (2003), *Communications Outlook*.

important benefits for consumers in both fixed and mobile telephony. The regulatory regime for retail tariffs is based on a price-cap system and has brought about a general reduction in average consumer expenditure.[77] Average fixed telephony tariffs in Italy have fallen by 44 per cent since 1998 and mobile telephony tariffs by 33 per cent since 1995 (AGCOM, 2002).

Other structural measures that have been taken in order to improve competition include the introduction of long-run incremental costs (LRIC) for determining interconnection charges (which have not been applied yet), carrier preselection (for local and long-distance calls, and for fixed to mobile calls), number portability for fixed numbers and local loop unbundling. Interconnection charges are important for determining the prices set by new entrants and are now below the EU average for all three levels of termination. This difference is particularly marked at the local level where reductions imposed by the regulator were designed to foster competition in this market segment (Figure 27). There has also been a notable fall in interconnection charges for call termination from fixed to mobile. Previously Italy had been one of the EU Member States with the highest mobile termination charges and is now around the EU average (EC 2002b).

Local loop unbundling has progressed significantly and Italy now has the second highest number of unbundled lines in the EU after Germany. Operators

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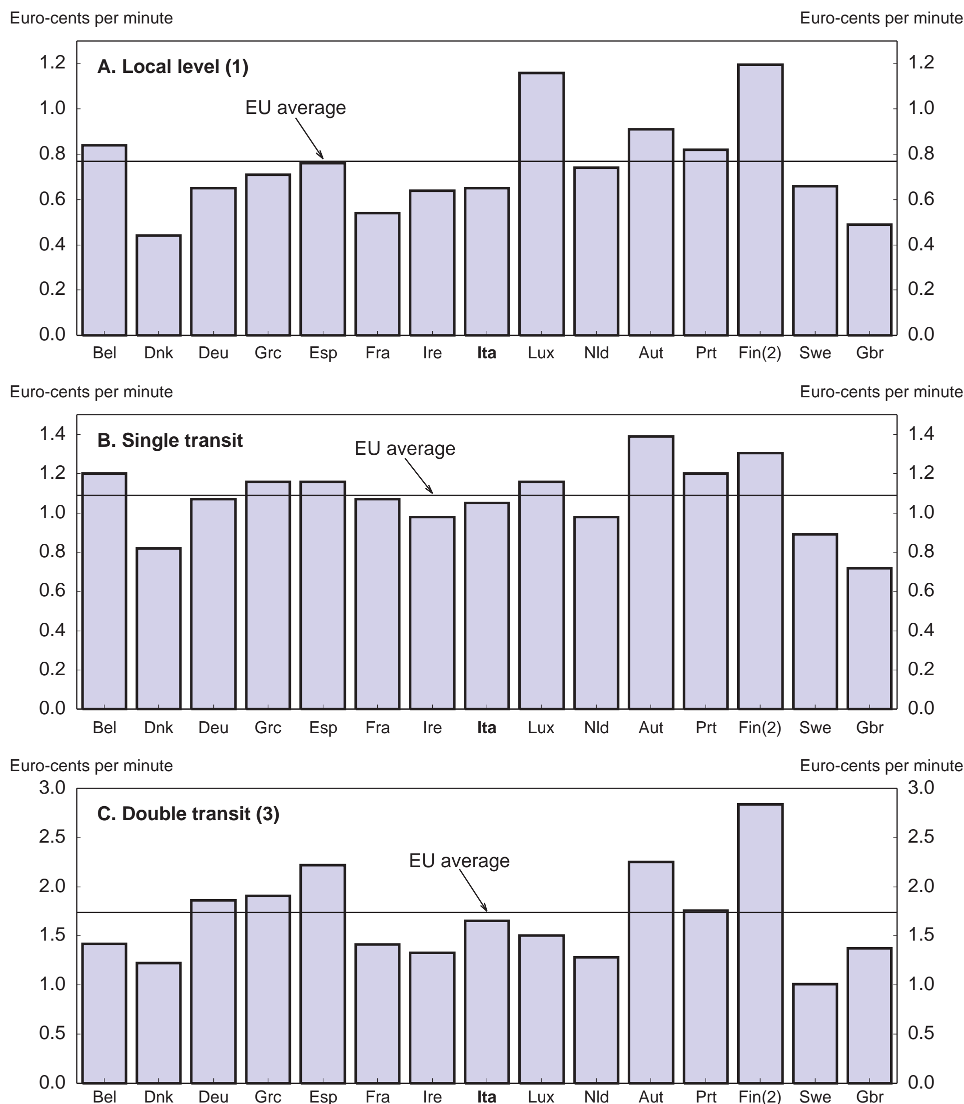
Figure 27. **Interconnection charges for call termination on fixed networks**
2002



1. In Luxembourg there is no distinction between local and long-distance domestic calls.
2. The charges refer to an unweighted average of the charges applied by the two major operators Sonera and Elisa.
3. Data for United Kingdom refers to a 100-200km connection length.

Source: EC (2002), *Eighth Report on the Implementation of the Telecommunications Regulatory Package*.

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identified with significant market power (SMP) must offer fully unbundled access, where the entire line is rented to a new entrant, as well as shared access, where the new entrant only rents the high frequency part suitable for high speed internet. SMP operators must publish a reference unbundling offer (RUO). The price of full unbundling has fallen in the past year to well below the level of the line rental for both residential and business customers. Italy now has the lowest price in the EU for shared access and the connection and monthly charges for the full unbundled loop are below the EU average (Table 19). These prices should encourage entry in local access and help competition to develop particularly in the market for high-speed internet access since 60 per cent of unbundled lines are used for the provision of DSL services. Italy's broadband growth has been quite slow and Italy's broadband penetration is the lowest among G7 countries, despite government incentives, because of the lack of alternate infrastructures in Italy, notably cable television networks.[78]

Despite these reforms, competition may be hindered to the extent that Telecom Italia has maintained a dominant position in all markets (Figure 28). Furthermore, Telecom Italia has actively obstructed competitors through both anti-competitive behaviour and legal action.[79] However, in 2001 entrants have started to erode its monopoly position thanks to the introduction of unbundled local loop. Charges for interconnection and the local loop set the terms for competitive

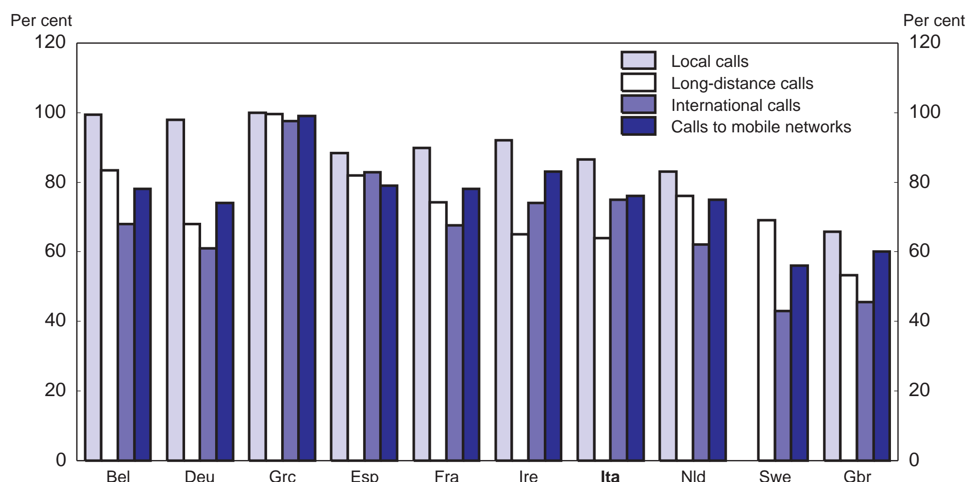
Table 19. **Prices for unbundled local loop, 2002**

Euro

	Full unbundling		Share access	
	monthly rental	connection	monthly rental	Connection
Belgium	13.3	79.9	3.2	86.5
Denmark	8.3	45.4	4.1	178.4
Germany	12.5	70.6	4.8	74.9
Greece	11.5	123.4	6.9	141.9
Spain	12.6	20.0	4.8	27.0
France	10.5	78.7	2.9	78.7
Ireland	16.8	121.5	9.0	123.4
Italy	11.1	91.4	2.8	81.0
Luxembourg	15.8	185.6	7.5	196.2
Netherlands	13.5	79.0	5.6	89.2
Austria	10.9	54.5	5.5	109.0
Portugal	13.8	82.9	7.9	173.8
Finland	14.7	216.0	7.0	160.0
Sweden	11.3	165.2	5.4	118.0
United Kingdom	16.2	140.3	7.0	186.5
EU average	12.8	103.6	5.6	121.6

Source: EC (2002), *Eighth Report on the implementation of the Telecommunication Regulatory Package*, Annex I.

Figure 28. **Estimates of incumbent operators' market share, 2001**
Retail revenue



Source: EC (2002), *Eighth Report on the Implementation of the Telecommunications Regulatory Package*.

tariff offers by new entrants. The low level of tariffs set for these intermediate services should encourage entry and result in further reductions in the final prices that consumers and businesses face in both fixed and mobile telephony and for internet access. Indeed, over 40 per cent of subscribers now use an alternative provider to Telecom Italia for local calls and over 50 per cent for long-distance and international calls (EC, 2002b).

Energy sector

Significant progress has been made in liberalising, restructuring and privatising the energy sector. These reforms have contributed to the comparatively high productivity performance in this sector, especially in the second half of the 1990s (Table 9). Both the EU Electricity and Gas Directives have been transposed into Italian law and considerable progress has been made in opening up these sectors to competition. However, in spite of the legislative decrees that Italy has passed to liberalise the energy sector and to implement the EU Directives, effective competition in these markets still has to be established. A legal framework alone does not bring about effective competition.

An independent regulatory authority for electricity and gas (*Autorità per l'Energia Elettrica e il Gas*, AEEG) was formally established in 1995, and began oper-

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ating in 1997. Its regulatory powers include the setting of tariffs (including network access tariffs), service quality standards, implementing unbundling obligations and conditions governing access and interconnections to the network. In general, the AEEG has enjoyed a high degree of autonomy from the government. The AEEG can employ up to 120 employees and in December 2000 a law was passed providing the AEEG with up to 30 additional staff to cope with the extra duties associated with implementing the EU Directives. The Energy Authority is funded through annual contributions paid by the service providers and, compared to other EU countries, seems to be well funded (Table 20).[80]

Reflecting an industrial structure of primarily small firms with low energy intensity, and imports of many goods whose production is energy intensive, Italy has one of the lowest energy intensities in the world, and less than half the OECD average (OECD, 2002e). It is also the result of past energy efficiency efforts. In the gas sector prices are around the EU average whereas electricity prices in Italy are generally higher than in other EU countries (Table 21). While in part this is due to a lack of competition, it is also the result of past decisions regarding the development of the sector. Strong environmental opposition to coal and nuclear power has led to high costs due to the structure of generation (*i.e.* mostly oil). Energy prices in Italy are also generally higher than in the rest of OECD Europe due to the relatively high level of taxes compared with other countries.[81] While reforms in these sectors are still too recent to evaluate, they seem to be producing some result as electricity and gas prices have fallen in the past year (Figure 29).

Table 20. **Competencies and resources of energy sector regulators**

	Network access conditions	Dispute settlement	Staff number	Annual budget 2002 (€m)
Austria	R(elec)/R (gas)	R/R	45	9
Belgium	R/R	R/R	68	15
Denmark	R/R	R/R	30	3
Finland	R/R	R/R	15	1
France	R/R	R/n.a.	80	9
Germany	N/N	C/C	n.a.	n.a.
Greece	M/n.a.	R/n.a.	43	4
Ireland	R/R	R/R	31	6
Italy	R/R	R/R	86	18
Luxembourg	M and R	R/R	2	n.a.
Netherlands	R/H	C/C	55	6
Portugal	R/n.a.	R/n.a.	52	7
Spain	M/M	R/R	153	19
Sweden	R/R	R/R	33	3
United Kingdom	R/R	R/R	330	58

Note: R – regulator responsible, M – ministry responsible, C – competition authority, N – not regulated, H – hybrid, n.a. – no regulator.
Source: EC (2002*c*).

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Table 21. **Electricity and gas retail prices**

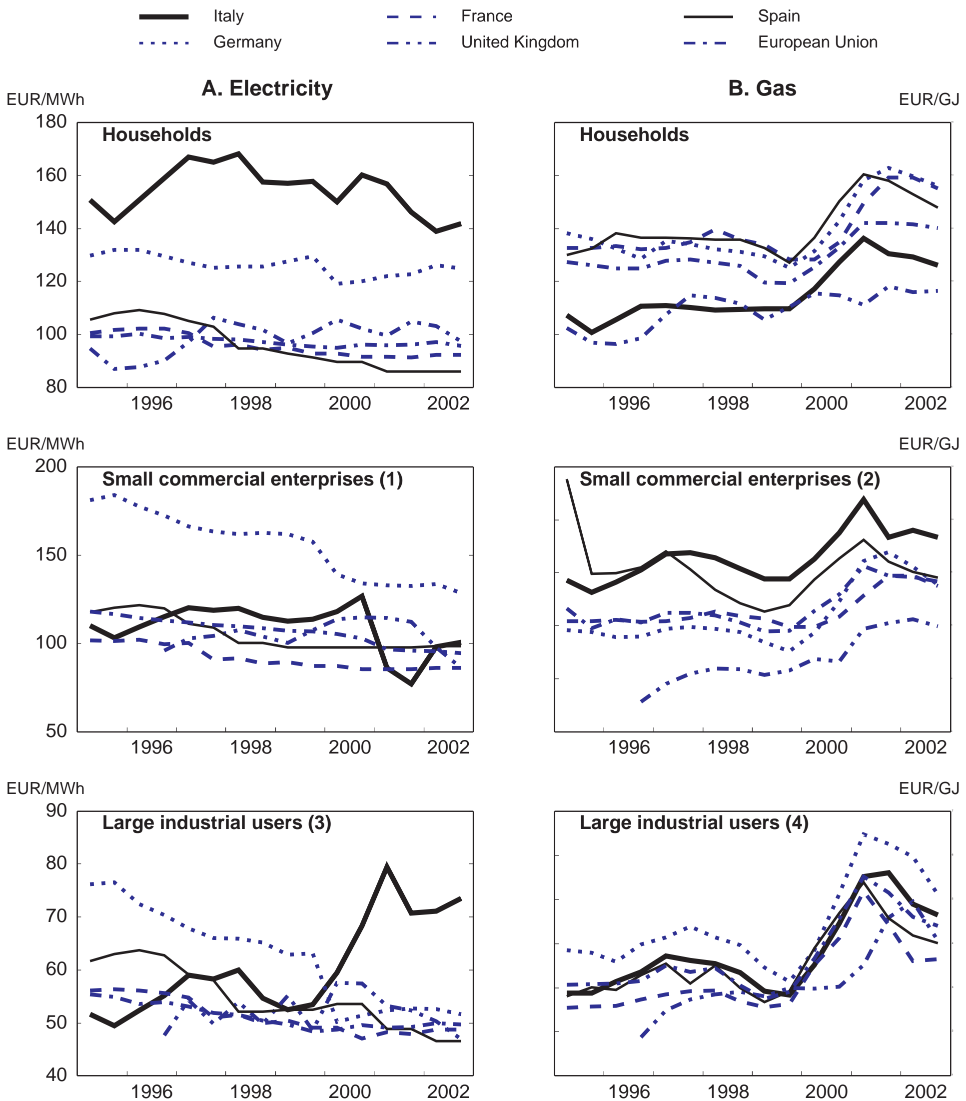
2002h2

	Electricity (euros/MWh)			Gas (euros/GJ)		
	Households	Industry		Households	Industry	
		Large industrial users[1]	Small commercial enterprises[2]		Large industrial users[3]	Small commercial enterprises[4]
Austria	93.1	59.8[5]	96.5	11.6	4.8	8.1
Belgium	111.1	58.1	129.9	13.8	4.3	7.4
Denmark	84.4	43.3	66.6	8.1	4.3	8.1
Finland	70.2	36.5	56.6	nd	4.4	nd
France	92.3	48.7	86.1	13.5	3.7	7.5
Germany	124.9	51.7	128.6	13.6	5.1	7.5
Greece	58.0	50.0	87.0	nd	nd	nd
Ireland	88.3	64.8	127.4	14.4	4.6	7.1
Italy	141.8	73.5	100.6	10.6	4.6	9.3
Luxembourg	115.1	38.3	121.7	11.6	5.4	6.5
Netherlands	98.2	48.5[6]	106.4[7]	9.9	2.8[8]	6.1[7]
Portugal	122.3	55.6	99.9	15.0	4.4	9.6
Spain	85.9	46.6	98.6	12.8	4.0	7.8
Sweden	68.8	25.8	35.7	11.6	3.5	7.1
United Kingdom	97.4	47.0	86.1	9.6	4.1	6.0
European Union[9]	96.8	49.9	95.2	12.0	4.3	7.5

1. Eurostat category Ig (Annual consumption: 24000 MWh).
2. Eurostat category Ib (Annual consumption: 50 MWh).
3. Eurostat category I4-1 (Annual consumption: 418600 GJ).
4. Eurostat category I1 (Annual consumption: 418.6 GJ).
5. 1999h1.
6. 1999h2.
7. 2001h2.
8. 2000h1.
9. Unweighted average.

Source: Eurostat.

Figure 29. **Prices of electricity and gas, 1995-2002**



1. Eurostat category Ib (Annual consumption: 50 MWh).
2. Eurostat category I1 (Annual consumption: 418.6 GJ).
3. Eurostat category Ig (Annual consumption: 24000 MWh).
4. Eurostat category I4-1 (Annual consumption: 418600 GJ).

Source: Eurostat.

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Compared with other European countries, Italy has done rather well in implementing the electricity Directive and introducing competition (Table 22). Electricity generation, transmission and distribution are separate legal entities under common ownership. In addition to legal unbundling of transmission, a transmission system operator (*Gestore Rete Trasmissione Nazionale*, GRTN) was established in 2000 as a state-owned company. Although ENEL still owns the transmission assets, the GRTN is independent and has control over the use, maintenance and development of the transmission system. It even has the authority to build new lines and, due to continued delays on the part of ENEL, has chosen this strategy with respect to an interconnection line with Switzerland. The parliament is currently discussing a comprehensive energy sector reform (the "Marzano decree"), including plans for the reunification of the transmission ownership and management under a single (separate) company to be listed on the stock exchange.[82] Other measures in the upcoming energy sector reform include *i*) a more market-oriented tariff regime for access to the electricity transmission grid, *ii*) an acceleration of demand-side electricity liberalisation, *iii*) streamlined decision making procedures for investments in the energy networks, *iv*) strengthened incentives for projects in interconnection capacity in electricity, and *v*) a clearer definition of local authorities' powers and responsibilities regarding permission for new energy projects. While these are steps in the right direction, the government also needs to proceed quickly with the introduction of an electricity exchange market. Its launch has been delayed for some time because of concerns regarding incumbents' abilities to act strategically. It is envisaged that ENEL will sell an additional 15GW of capacity, thereby reducing its influence on pool prices. The launch of the pool is now envisaged for the latter part of 2003.[83]

Wholesale market concentration in electricity remains an issue in most Member states with Italy being one of the few countries where progress has been made recently. Competition in generation is slowly emerging and ENEL recently divested itself of an additional 15GW of generation capacity. Cross country comparisons of three firm concentration ratios show that Italy's electricity generation market is less concentrated than that of other European countries. However, the Herfindahl-Hirschman index (HHI) for generation is higher than most European countries, reflecting the unequal distribution of market shares.[84] Paradoxically, the Decree implementing the EU Gas Directive (see below) may have more immediate effects on competition in the electricity generation market by providing an incentive for ENI to expand its use of gas in electricity. The introduction of competition in generation, and divestiture of some the distribution grid in the larger municipalities, has also led to the progressive increase in customer switching, with over 50 per cent of large industrial users switching suppliers. As a result, ENEL group's total sales declined by 8 per cent between 2001 and 2002 (AEEG, 2002).

The Decree implementing the EU Gas Directive is in many important respects more pro-competitive than the minimum requirements of the EU Gas Directive (Table 23). Despite this, the development of a competitive market is still

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Table 22. **Electricity market indicators and implementation of the EU Directive, 2002**[1]

	Date of full opening of demand	Unbundling		Large users switching Suppliers[4]	Concentration (CR3)		Concentration HHI[5]	Potential competition from imports[6]	Network access charge[7]	
		Transmission[3]	Distribution[3]		Generation	Retail sales			Medium voltage	Low voltage
Austria	2001	L	A	20-30%	45	67	2 028	21	20	65
Belgium	2003	L	L	2-5%	96	53	6 118	25	15	n.a.
Denmark	2003	L	L	n.a.	78	38	4 018	39	15	25
Finland	1997	O	M	n.a.	45	33	2 472	22	15	35
France	–	M	A	10-20%	92	90	9 606	12	15	50
Germany	1999	L	A	20-30%	64	50	1 756	11	25	55
Greece	–	L	A	0%	97	100	10 000	12	15	n.a.
Ireland	2005	L	M	10-20%	97	90	9 418	7	10	40
Italy[2]	2004	L	L	>50%	69	72	5 560	14	10	n.a.
Luxembourg	–	M	A	10-20%	n.a.	100	8 158	100	20	n.a.
Netherlands	2003	O	M	20-30%	59	48	1 814	19	10	35
Portugal	2003	L	A	5-10%	82	99	4 008	30	15	n.a.
Spain	2003	O	L	10-20%	83	94	2 466	4	15	45
Sweden	1998	O	L	n.a.	90	47	2 538	29	10	40
United Kingdom	1998	O	L	>50%	36	42	1 044	3	n.a.	40

1. The information refers to 2002, except for concentration measures, 2000.
2. The market opening in 2004 concerns non-household customers only.
3. Unbundling concerning operators. A = Accounting, L = Legal, M = Management and O = Ownership.
4. Switching estimates for the period 1998-2001.
5. HHI in electricity generation. A market is generally considered competitive with a HHI<1000; moderately concentrated with 1000 < HHI <1800; and highly concentrated with a HHI > 1800.
6. Per cent of domestic generating capacity.
7. Estimated average charge, €/MWh.

Source: EC (2002*c*), AEEG (2002).

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Table 23. **Gas market indicators and implementation of the EU Gas Directive, 2002**[1]

	Date of full opening of demand	Unbundling		Large users switching Suppliers[3]	Concentration		Gas release programme	Network access charges
		Transmission[2]	Distribution[2]		% of available gas (CR1)	HHI[4]		Large users (€/mwh)[5]
Austria	2002	L	L	<2%	80	7 598	NO	n.a.
Belgium	2003	L	L	n.a	n.a.	10 000	NO	1.0 – 2.0
Denmark	2004	L	L	2-5%	90	2 841	NO	2.5
France	–	A	A	20-30%	90	5 932	NO	2.0 – 5.0
Germany	2000	A	A	<2%	54	2 405	Planned	2.0 – 7.5
Ireland	2005	M	M	20-30%	n.a.	5 883	NO	1.5 – 2.5
Italy	2003	L	L	10-20%	75	4 916	YES	2.0 – 4.0
Luxembourg	–	A	A	5-10%	100	10 000	NO	1.0 – 1.0
Netherlands	2003	M	A	30-50%	80	2 634	NO	0.5 – 1.0
Spain	2003	O	L	20-30%	57	9 761	YES	2.0 – 2.5
Sweden	2006	A	A	<2%	100	10 000	NO	3.5
United Kingdom	1998	O	O	>50%	50	894	YES	1.5 -3.0

1. The information refers to 2002, except for the concentration measures (2000).
2. Unbundling concerning operators. A = Accounting, L = Legal, M = Management and O = Ownership.
3. Switching estimates for the period 1998-2001.
4. A market is generally considered competitive with a HHI<1000; moderately concentrated with 1000 < HHI <1800; and highly concentrated with a HHI > 1800.
5. Estimated range, rounded to the nearest €0.5/mwh.

Source: EC (2002*c*), AEEG (2002).

far off. One requirement for competition to emerge is non-discriminatory access to the network at competitive prices. However, unlike electricity, the gas transmission network is both owned and controlled by a subsidiary of ENI. Network access charges still tend to be on the high side as compared to other European countries, possibly indicating the need for stronger regulatory oversight and unbundling between transmission and distribution networks (EC, 2002c).[85] The other requirement for competition is ending the monopoly on the import and sale of gas. Recently the Antitrust Authority found ENI S.p.A. was abusing its dominant position and required the company to upgrade its transportation network. The ENI group also owns 98 per cent of storage facilities.[86] Access to storage facilities is key for effective competition against ENI to emerge and vertical separation would be highly desirable. Failing this, at a minimum, legal separation of storage is needed. While the gas market for final consumers has been completely liberalised, in many instances there is still only one firm to "choose" from, especially at the local level where many markets continue to be supplied by only one firm. Public tendering for gas distribution, also foreseen in the Legislative Decree, will not begin before 2005. Furthermore, the devolution of powers to local authorities will push the ending of monopoly provision by incumbent operators even further into the future (AEEG, 2002).

The Italian government has tended to focus on concentration on the domestic supply side, with obligatory divestiture of electricity generation capacity and ceilings on the market shares for gas.[87] However, electricity and gas markets in Italy are to some extent cut off from the other European markets, and insufficient attention has been paid to potential competition from abroad *e.g.* reducing ENI's controls over gas interconnections and increasing interconnection capacity in electricity (though the latter will be partially addressed by the Marzano decree). In addition, devolution of powers to local authorities has created particular problems for the energy sector, as this has introduced uncertainty regarding permission for new energy projects, slowing down the pace of investment in infrastructure (IEA, 2003). This has happened in spite of the "*sblocca centrali*" decree introduced in 2002 to streamline the decision making process for energy projects through an accelerated 180-day procedure.

Independence of regulatory authorities

Experience from OECD countries shows that independence of regulators reduces uncertainty and enhances performance (Gonenc *et al.*, 2001; OECD, 2002i). Though Italy was quite advanced as compared to other European countries when it created its regulatory bodies, there are currently some tensions regarding the role and independence of the regulators. More recently, the powers of the sectoral regulators have been clawed back somewhat. For example, the power to issue licences has been taken away from the Communications regulator and transferred

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back to the Communications Ministry. In the electricity sector, the introduction of a wholesale pool has been delayed and in 2002, the government blocked a decision by the electricity regulator to increase electricity prices, citing concerns over inflation. The government now has the over-riding authority to approve tariffs. In addition, while the gas sector is regulated by the AEEG, overall policy regarding the sector is set by the Ministry of Industry.[88] The government is currently reviewing the role of regulatory authorities in general and a reform of the legislative framework that assigns new regulatory competencies to the Ministries is currently under discussion. Government intervention in the regulators' decisions creates uncertainty and is a step in the wrong direction.

Summary and recommendations

Product market competition increased in the past decade thanks to a sustained programme of privatisation, market opening, and deregulation followed by appropriate re-regulation and institution building. Despite liberalisation, important product market regulations still exist and, in combination with strict labour market regulations, may hinder the development of firms and reduce growth potential. There is considerable scope for further improvement and raising growth will depend critically on removing barriers to entry and distortions to competition. Reducing regulatory complexity, administrative burdens and red-tape would lift major impediments to firm entry and growth, innovative activity and foreign direct investment. While there are no general exemptions to Italy's Competition Act, anti-competitive conduct is often authorised or required by other laws or government regulations. Implementation of many reforms is hampered in some areas by the fact that local authorities, who have substantial regulatory powers, are more exposed to the pressure of established local businesses that stand to lose from greater competition. Box 4 provides a summary of recommendations that follows from the findings presented in this chapter.

The Antitrust Authority has been active in competition advocacy and enforcement. However, it lacks some of the enforcement powers of antitrust regulators in other countries and needs to be given a wider range of sanctions including more effective sanctions against restraints through associations and against individuals. For example, some countries have applied criminal penalties in the case of hard-core cartels. Entry barriers remain substantial in the distribution and professional services sectors even though these sectors have undergone regulatory reform processes in the past few years. Further reforms in these sectors are particularly warranted given the poor performance of these sectors compared to other OECD countries. The decentralisation process has also hindered competition in retail distribution where a host of local regulations have prevented the opening of large retail outlets. And in professional services, recent reforms still allow for the involvement of professional associations in the tariff setting process.

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Box 4. Recommendations for increasing product market competition

Product market competition has increased in the past decade due to extensive privatisation, liberalisation and regulatory reform of network industries and local services, and the introduction and active enforcement of competition legislation. However, there is still much to do and, based on the analysis presented in the chapter, policy initiatives are needed to both ensure and increase competition in product markets.

Competition legislation and enforcement

While the Antitrust Authority has been an active advocate and enforcer of competition legislation there is scope for improvement. In particular:

- Aspects of the sanctions system should be strengthened. Providing for individual sanctions would improve enforcement in areas such as professional services. Where restraints are imposed *via* an association, the Authority should have the power to assess fines on their members themselves since the associations typically have no turnover to speak of.
- A clear and explicit leniency programme should be adopted to strengthen deterrence and enforcement, and criminal penalties against hard-core cartels should be considered.

Regulatory policies

Competitive industries

Regulatory reforms in distribution and professional services are particularly warranted given the poor performance of these sectors compared to other OECD countries. While there are no general exemptions to the Competition Act, other legislation or regulation often creates immunities or distortions inhibiting competition. In particular:

- Further deregulation of retail distribution is required to ensure effective competition. While regulatory reforms have led to a removal of restrictions on small shops, entry barriers and restrictions on the opening of large retail outlets need to be reduced.
- The devolution of regulatory powers to regional and local levels has been problematic for the liberalisation process. A greater effort is needed to ensure that the devolution strategy does not hinder competition in retail distribution. Better co-ordination of competition policy objectives across different levels of government is required.
- Regulatory reforms in professional services need to go further than current proposals if competition objectives are to be attained. The role of professional associations should be reduced and limited to evaluation of professionals' capacities.

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Box 4. **Recommendations for increasing product market competition** (*cont.*)

- The determination by law of minimum fees or recommended price schedules should be abolished.
- While restrictions on advertising have been eased in the past few years, the changes do not go far enough. While regulatory reforms easing restrictions on business structure were passed in 1997, they have yet to be implemented and should be executed forthwith.

Network industries

While great strides have been made in liberalising network industries, and many best practices have been implemented, obstacles to competition remain. Priorities in this area include:

- Continue with privatisation by selling the remaining government holdings in electricity and gas and eliminate the golden share in both these industries and telecoms.
- In all network industries more restructuring of the dominant firms and reduction in their market shares is needed. Create more competition in network industries through vertical separation. Vertical separation is desirable to ensure non-discriminatory access to essential facilities and the current use of legal separation may be insufficient, if not coupled with strong and independent regulatory oversight.
- In electricity, combine the ownership and control of transmission into a single entity, vertically separated from generation. In gas, vertical separation of storage facilities is desirable. Failing that, at a minimum legal separation should be undertaken.
- Proceed quickly with the introduction of an electricity pool.
- Ensure the independence of the sectoral regulators. Responsibility for licensing should be given back to the Communications regulator.

While incumbents retain dominant positions in network industries, and further restructuring is warranted, competition is slowly emerging as regulatory reforms have opened up these sectors to competition. The liberalisation of telecommunications in particular has been a success and the market is very dynamic. While electricity prices are comparatively high, this is due in part to strong environmental opposition to coal and nuclear power that has led to high costs in generation. Privatisation of network industries should be speeded up. The government retains a controlling interest in electricity and gas and still holds golden shares in both these industries and in telecommunications, despite

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repeated requests from the European Commission to justify these shares and, in some cases, to terminate them. More recently, the independence of the sectoral regulators seems to have been weakened somewhat. The power to issue licences has been taken away from the Communications regulator and transferred back to the Communications Ministry. The introduction of an electricity pool has been delayed and the government has also stepped in with respect to recent tariffs set by the energy regulator. These actions risk a backsliding on earlier competition progress and should be reversed. In particular, the independence of the regulatory authorities in issuing licenses and setting tariffs free of political influence has to be insured.

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Notes

1. Trend GDP per hour worked in 2000 was on a par with that of the United States, data from OECD (2003b), Table A5.1.
2. The steep downtrend in the indicator of consumer confidence appears to have stabilised in the first five months of 2003, albeit oscillating around historic lows, while that in business confidence continued. Hence, a more significant recovery may not begin until much later in the year.
3. Notably, the exchange rate risk appears to be already materialising: at the time of writing, the euro-dollar parity is 1.9 per cent stronger than assumed in OECD (2003a), which contains a complete discussion of the Italian and OECD projections and risks.
4. See Banca d'Italia (2003a), Figures 28 and 29 and Table 16.
5. That is, assuming that these were not already picked up by Istat's estimates of underground employment which form part of the normal labour market statistics.
6. A study by the Banca d'Italia suggest that the euro-changeover shock was larger in Italy than in the rest of the euro area. See Banca d'Italia (2003a), pp. 52-53.
7. See Ferri and Inzerillo (2002) and ISAE (2003b); also *Indagine Sole-24 Ore – Banca d'Italia sulle aspettative di inflazione e crescita*, *www.bancaditalia.it/pubblicazioni/statistiche*
8. The aforementioned surveys list an insufficiency of demand as the primary factor holding back investments recently, followed by lack of financing.
9. The cyclically adjusted primary balance will have declined by a cumulative 3 per cent points of GDP between 1998 and 2004 (OECD projection), of which almost half occurs in 2004 as previous tax cuts register their full impact. The decline would be even steeper if real estate securitisations and other "one-off" measures – which exert nugatory effects on domestic demand – are removed from the measure of the fiscal stance (see Figure 5).
10. Had Italy stuck to the 5 per cent structural primary balance targeted in each medium term plan (DPEF) since 1997, instead of falling to 2 per cent by 2004 as projected by the OECD, debt would have been considerably lower.
11. See OECD (2003b) for a fully-fledged analysis of growth performance across OECD countries.
12. *Ibid.*
13. Assuming that the potential productivity of those not in the labour force is about half of that of those who are currently employed.
14. Nicoletti and Scarpetta (2003) estimate that a move of some EU countries, including Italy, towards an OECD average share of state-owned firms in value added would lead

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to 0.7 percentage points higher MFP growth. A move towards an OECD average of entry liberalisation would turn into 0.2-0.4 percentage points higher MFP growth.

15. See OECD (2001b).
16. OECD estimates that with unchanged policies the estimated cohort effect on labour force participation would be negative at around –0.15 percentage points already in 2008 and progressively increasing (in absolute terms) to reach –4.1 percentage points in 2030.
17. Competitiveness benchmarking studies as of 2001 placed Italy in the following rankings: Merril Lynch, 17th place out of 18 countries; World Economic Forum, 24th out of 58 countries in the overall ranking and among the very last as regards bureaucratic red tape and the efficiency of the justice system; and IMD of Lausanne, 32nd out of 49 countries. See Ministero delle Attività Produttive (2003). For the 2002 IDM rankings, see *Il Sole* 24 *Ore* "Competitività, l'Italia arretra ancora", 14 May 2003.
18. This might suggest to some that Italy entered the euro-area at a "disadvantageous" exchange rate. However, a similar observation is often made about Germany, whose negative growth gap *vis-à-vis* the euro-area is even larger, but the statements are somewhat inconsistent since Germany is Italy's largest trading partner. A cheaper exchange rate peg might have bought Italy more time to make the required structural adaptation, but it may have just as easily delayed it.
19. See Nicoletti *et al.* (2003).
20. See *Il Sole* 24 *Ore*, 3 March 2003, p. 17.
21. See Nicoletti *et al.* (2003)
22. The authorities' medium-term objective has been to achieve sustained annual growth rates in the South of 4-5 per cent.
23. See Comitato di Sorveglianza QCS (2003).
24. The chief incentive has been a performance reserve allocation, amounting to nearly 5 billion euro in 2003; see *www.dps.tesoro.it/uval_linee_premialita.asp*
25. Within overall capital spending in the South, the share going to infrastructure rose from 44 per cent in 1998 to 60 per cent in 2002; conversely the share going to state aids fell.
26. See Ministero dell'Economia e delle Finanze (2003).
27. For an overview of the credit subsidies in Italy see Gobbi (1996). Econometric evidence of a positive correlation between credit subsidies and poor credit quality can be found in Bonaccorsi di Patti and Gobbi (2001).
28. In carrying our their assigned role in evaluating investment projects eligible for public investment subsidies (as by Law 488/92, DLS 297/99) banks have apparently applied "soft" criteria quite different from those used when considering the use of their own money, so as to maximise the number of eligible programmes and their own fees. See Da Rin *et al.* (2000).
29. Bofondi and Gobbi (2003) present empirical evidence supporting this standard theoretical result using data on Italian local credit markets.
30. ISTAT's estimates of the underground economy are obtained through the "production approach" mainly based on the use of the labour input method (see OECD, 2002h). By using the currency demand approach, the estimates of the shadow economy are higher (around 27 per cent of the official GDP in the period 1996-1997 according to

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Schneider and Enste, 2000). Part of the difference between these estimates might be explained by the inclusion of illegal activities in the currency demand approach.

31. ISAE (2002a).
32. CNEL (2002).
33. Boeri (2002).
34. See Figure 33. It should be noted that this figure underestimates fiscal pressure to the extent that workers pay a 20 per cent VAT when buying goods and services. Although this cannot be a differentiating factor between regular and irregular employment, in 1998 the effective VAT rate was 8½ per cent suggesting that compliance might be a problem also for indirect taxes. See Joumard (2002). In addition, employers pay a 5 per cent indirect tax on business value added, a large component of which is wage costs, and which is paid on regular workers only, but not reflected in the above wedge.
35. In the mid-1990s, the Gini indicator before taxes and transfers was 51 for Italy and 45 for the United States. After taxes and transfers, they were both around 34. See Burniaux *et al.* (1998), Table 3.2.
36. See OECD (1994).
37. See Chapter IV on pension reform.
38. During 2003, the parliament transformed the Decree into an ordinary law so that the spending control procedures introduced by the Decree now represent a permanent feature of the Italian public finance monitoring mechanism.
39. There might however be limits on the capacity of this measure for controlling expenditures by public institutions as these can draw financing not only from budget appropriations but also from the cash balances they have at the Treasury accounts. See Giarda and Goretti (2003).
40. During 2002, EUROSTAT identified the conditions under which the receipts from securitisations could be used to reduce the general government net borrowing. In particular, the assets' price paid by the Special Purpose Vehicule to the government needs to be at least 85 per cent of the market price. Securitisations in 2002 passed these conditions, whereas securitisations in 2001 did not. In any case all securitisations and sell off of real estate assets contributed to reduce the general government stock of gross debt.
41. The Budget law also froze the tax rates that regions and municipalities could add on top of the regular income tax rates. On the other hand, the share of the total income tax they are receiving from the state increased. In addition, current and capital transfers to municipalities and provincial administrations were cut and increased, respectively.
42. The current OECD growth projection for 2003 is 1 per cent, 1.3 per cent lower than the initial official one, as is that of the EU Commission. The current official projection assumes a 1.1 per cent growth rate in 2003.
43. The 0.8 percentage points increase in the revised budget deficit target consists of a 0.9 percentage points reduction in total receipts and a 0.4 percentage points increase in total expenditures net of interest payments, whereas a reduction of 0.5 percentage points in interest payments partly offset the rise in the budget deficit.
44. See ISAE (2003c).

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45. The import penetration rates are unadjusted for structural factors such as country size, GDP per capita or transportation costs. These factors, particularly transportation costs, may explain some of the difference in the lower penetration rates for Japan and the United States.
46. A better comparison would be export market shares since export rates could be low due to a higher level of domestic production.
47. Formal measures of innovative activity tend to be biased downwards both by the sectoral composition of output and by the large number of small firms. This is because innovative activity in small firms in 'traditional' industries is principally of the incremental type undertaken in a non-formalised way, and not formal R&D projects that occur in other sectors.
48. Nicoletti (2002) also looks at how institutional arrangements in labour and product markets have conjured to produce a situation in which Italy has relatively low competitive pressures, and a distorted industry structure (both in terms of specialisation and firm size) and employment structure (in terms of skills, wages, and share of self-employed).
49. See previous OECD *Economic Surveys of Italy* and Chapter IV of the present *Survey* for a review of labour market reforms.
50. An in-depth discussion of how financial markets in Italy, including corporate governance and bankruptcy law, impacts upon firm performance and growth can be found in Chapter IV of this *Survey*.
51. The bankrupt debtor is dispossessed of all his real and personal property which is entrusted to a receiver/trustee under the supervision of a judge. Inscription in the Bankrupt Debtors' Registrar triggers severe civil sanctions for the bankrupt debtor (such as limitations on freedom of movement and loss of mail privacy). The debtor is also subject to criminal prosecution not only in case of fraud but even if the business failure is due to mere negligence.
52. The direct costs of bankruptcy procedures are also high and involve huge losses to creditors (see Chapter IV of this *Survey*).
53. That the Italian law is to be interpreted in accordance with the principles of EU competition law appears in the statute's instructions (Sec. 1.4). The reference to EU principles includes secondary legislation, Commission decisions, and jurisprudence of the European Court of Justice. Thus, Italy immediately absorbed 30 years of doctrinal tradition and avoided the delays and uncertainties that would have resulted from the process of establishing such concepts under Italian law.
54. Italy's law varies slightly in some details from parallel provisions of EU law. For example, in the criteria for exempting a prohibited restraint, Italy's Competition Act requires that a claimed consumer benefit be "substantial", implying some scepticism about such claims, but it does not require that consumers get a "fair share" of those benefits, implying a willingness to consider a total-surplus standard.
55. Some other countries that combine these duties include Canada, Poland, United Kingdom, and United States.
56. The Authority had opposed adding the principle to the Competition Act as the concern in these matters is about fair dealing and not market impact. The Authority was concerned that these claims, which are mostly decided through arbitration or private lawsuits, could be used to impede competition and undermine efficiency. With the Authority now empowered to apply this principle (but within the context of its effects

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on the public interest), the courts will most likely look to its decisions for policy direction when deciding private lawsuits.

57. The Authority argues that this result follows from Art. 10 of the EU treaty, which provides that "Member States shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty, " and Art. 3, which includes among the Community's activities "a system ensuring that competition in the internal market is not distorted". The Authority found that the market division and exclusive supply arrangements of a match industry consortium violated Art. 81 and that the consortium's conduct was not excused by the State's involvement. The Authority's decision was in July 2000; an appeal was taken, and the question has been referred to the European Court of Justice, where it is pending decision.

58. Parties may, and usually do, request suspension of fines pending appeal. When appeals took years, the decision on the *sospensiva* could be outcome-determinative. Now that appeals can be finally decided much more quickly, distortion of the *sospensiva* process should be less of a concern.

59. This is non-trivial by international standards. In many countries there are either very few (single digits) or no private action suits. Other countries besides the United States where private actions do play a role in competition enforcement include Canada, Germany, France and Ireland.

60. The Authority does have a powerful weapon in reserve, though. It can punish repeated violations by requiring the enterprise to cease operations for up to 30 days. Up till now, this deterrent has never actually been used.

61. The basis for computing financial penalties used to be the relevant market affected by the restraint or abuse instead of the firm's total turnover. This change in the law follows the recommendation of the 2001 OECD *Review of Regulatory Reform in Italy*.

62. The Authority has not set up a formal leniency programme because it believes that clearer legislative authorisation is needed before it can issue what would look and act like regulations, that is, commitments and rules of general application for the future.

63. The comparison is made between Italy's position in 2000 and other OECD countries' positions in 1998, which shows that Italy still has a highly restrictive environment compared to other countries. If reforms implemented by other OECD countries during the same period were included than it is likely that Italy's comparative position would be even worse.

64. The link between concentration and competitive pressure is complex in retail distribution and differs from other industries. Dobson *et al.* (2001) argues that greater concentration may benefit consumers through lower retail prices owing to increased monopsony power of the retail sector *vis-à-vis* manufacturing producers with (otherwise) dominant positions. The scope for anti-competitive behaviour is also often limited by the threat of entry and by increasingly mobile consumers.

65. A pharmacy for every 5 000 (or 4 000) inhabitants in municipalities with a population of up to 12 500 (in other municipalities), and pharmacies must be separated by a distance of at least 200 metres.

66. For example, rules regarding opening hours have been made more flexible. Shops can be opened for a maximum of 13 hours (between 7 am and 10 pm) excluding Sundays. Sunday openings are restricted to 8 times per year, plus the December Sundays prior to Christmas.

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67. See OFT (2001) for a review of the empirical evidence. Recent studies include Nguyen-Hong (2000), who examined the effects of regulations on price-cost margins in engineering services and found that they led to an increase in prices on the order of 10 to 15 per cent in countries with the most restrictive regulations. And in Italy, Bortolotti and Fiorentiniti (1997) found that controls served to preserve monopoly rents in the accountancy profession.
68. For example, when self-regulatory bodies are involved in the evaluation of professionals' capacity.
69. Entry regulations include qualification requirements, membership in a professional body, and rules on reserved areas of practice. Conduct regulations include regulations on prices or fees, advertising, location and diversification restrictions, and restrictions on forms of business practice.
70. In the absence of specific profit data, the higher volume of turnover per professional associated with more restrictive regulatory regimes can be indirectly taken as an indicator of excess profit.
71. See OECD (2001) *Economic Studies: Special Issue on Regulatory Reform*, No. 32 which thoroughly reviews the literature and adds more evidence on the relationship between regulation and performance in these sectors. The OECD Reviews of Regulatory Reform also constitute a rich source of information on the effects of industry-specific reforms on performance.
72. The government currently has a 67 per cent stake in ENEL and a 30 per cent stake in ENI. The government also holds golden shares (special powers present in the by-laws) in both these companies and in *Telecom Italia*.
73. In February 2003, the European Commission again requested that Italy justify its privatisation legislation giving the government special powers in privatised companies. The position of the Commission is that these special powers are disproportionate and in violation of Treaty rules.
74. Vertical separation does not remove the incentive for the network firm to engage in monopoly pricing and hence strict regulation of the network is still required to ensure against the abuse of monopoly power.
75. Wide delegation of legislative powers at the local level will require further coordination between central and regional/local authorities to ease concerns regarding the number of authorities involved in the regulatory process.
76. The responsibility to issue licenses includes TV licenses. While giving this responsibility to the Ministry may be less of a problem in the telecommunications sector, where a large number of licenses has already been granted, it is more of a problem in the media sector where such licensing control could underpin the existing weakness of effective competition. One private holding (Mediaset) has a 43 per cent market share of the television audience, and the only competition comes from state television, with a 48 per cent market share (AGCOM, 2002). Unlike most EU countries, there are no developed cable TV networks in Italy (EC, 2002b).
77. In practice, the increase in the line rental and activation fees has been offset by more than proportionate reductions in call prices. Mobile operators are not subject to any specific regulation in fixing final prices, but they have to notify the regulator of each new tariff they introduce. In February 2003, AGCOM imposed a new pricing regime for fixed-to-mobile interconnection on the mobile operators. They will be required to reduce fixed-to-mobile termination charges by 12 per cent from 1 June 2003, followed by a further cut of 20 per cent by the end of 2005.

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78. Unbundling of the local loop and relatively low prices for unbundling are particularly important for the development of competition in this sector due to the lack of alternative infrastructure. Competition in the market for internet services therefore comes almost exclusively from new entrants using the incumbents' local loop facilities.
79. Telecom Italia has gone to court against almost all regulatory rulings made by the regulator, which is unusual by OECD standards (OECD, 2001b).
80. However, the current staff levels of 86 are well below the maximum of 150 that AEEG is allowed to hire.
81. Italy applies different rates of VAT, and excise taxes on a national basis to all energy sources (including electricity), with regions then adding their own taxes (IEA, 2003).
82. This makes sense, as incentives for investment in transmission would most likely improve once ownership and control are combined and are vertically separated from generation.
83. One of the reasons for delay is that there is not enough competition in generation. Although ENEL has a 50 per cent market share, it has engaged in strategic selling of generation plants so that it still controls 80 per cent of the mid-level plants.
84. ENEL's market share is around 50 per cent, while the second largest firm, Edison, has a market share of 9.4 per cent.
85. Currently, only legal separation exists between distribution and transmission.
86. Storage facilities are currently considered a legal monopoly and are destined to remain so for several years to come (AEEG, 2002).
87. A key aspect of the Decree implementing the EU Gas Directive entails the imposition of temporary "antitrust limits" on the shares that any single company can have of potentially competitive activities. However, these limits of 75 per cent (or 61 per cent by 2010) are high if the intent is to create a market structure where prices are relatively competitive.
88. Under the Legislative Decree n. 164 liberalising the gas sector, the Ministry of Industry retains significant regulatory power (OECD 2001b).
89. See, for example, Garibaldi (2002).
90. See Ministero del Lavoro e delle Politiche Sociali (2002a) and Cipollone and Guelfi (2002). From 2003 the credits are granted only under certain conditions rather than automatically as in the past.
91. Vamvakidis (2002).
92. OECD (2002d) shows that inter-regional mobility is among the lowest in the OECD.
93. OECD data show that Italy is among the countries with the lowest proportion of children in the 0-3 age range in day care facilities (amounting to slightly more than 5 per cent). However, the participation of children in the 3-6 age range is more than 90 per cent. Del Boca (2002) finds evidence that limited availability of affordable childcare services (together with relatively low use of part-time contracts) is one of the reasons for both low labour force participation and low fertility rates among Italian women.
94. The statistical classification by ISTAT currently identifies 38 different kinds of contracts.
95. Bernardi (2001) points out that in mid-2001 temporary workers below 30 years of age represented 60 per cent of the total. Barbieri (2001) shows that in the period 1996-2001 the probability of fixed-term workers to be still in work after 12 months was

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between 80 and 86 per cent. The probability of still being in work with a permanent contract was between 33 and 38 per cent.

96. According to OECD (2002a), public resources devoted to adult training, young workers and subsidised employment were 0.60 per cent of GDP in 2000 compared to 0.68 for Germany in 2001, whereas in the same period France (the United Kingdom) had much higher (lower) resources devoted to active labour market policies.
97. "Job on call" refers to the possibility for firms to use workers only when needed in exchange for an indemnity. "Staff leasing" refers to the liberalisation on the use of workers from *ad interim* agencies in terms of duration of contracts, number of workers required and types of skills requested.
98. ISFOL (2002).
99. "Just cause" refers to unfair behaviour of the worker while "justified reason" refers to excess of workforce. See Bertola and Garibaldi (2002).
100. Iacus and Porro (2002) point out the risk that for profitability reasons, private temporary work agencies might limit services to the low-skill.
101. In 1998, the government and the social partners started giving greater consideration to *conciliazione* (a bilateral procedure involving also a multilateral Committee) and *arbitrato* (a more rapid judicial system) for solving labour dispute resolutions but without taking decisive steps for a more pervasive role of these institutions.
102. See also Forster and Pearson (2002). Among other evidence of increasing poverty in the mid-nineties compared to the mid-eighties, they point out that Italy is one of the countries where, during this period, families in the bottom income quintile significantly lost their shares of national income. Finally, EUROSTAT's indicators show that, despite wage compression, in 1998 the ratio of the fourth and the first income quintile in Italy was higher than in the EU on average (5.9 compared to 5.4). Notably, using this indicator income inequality was higher in Italy than in the UK where wage dispersion is significantly higher.
103. Dipartimento Politiche di Sviluppo (2002).
104. For more details, see the special chapter "Public spending in Italy: policies to enhance its effectiveness" in the 2002 OECD *Survey*.
105. See Ministero del Lavoro e delle Politiche Sociali (2002b) and EC (2002d). In addition, the 2002 budget law introduced a measure aimed at guaranteeing a minimum pension of around € 515 monthly to the elderly. The estimated cost of this measure is an annual 0.15 per cent of GDP.
106. EUROSTAT data show that in 1999 the shares of total social protection expenditure devoted to unemployment and social exclusion were 2.2 per cent and 0.1 per cent, respectively, compared with an EU average of 6.8 and 1.6 per cent.
107. See EUROSTAT's structural indicators at http://europa.eu.int/comm/eurostat
108. See Ministero del Lavoro e delle Politiche Sociali (2002a).
109. For more details on the functioning of the single fund see Commissione Tecnica per la Spesa Pubblica (2002) and Da Roit (2002).
110. Paolini (2002).
111. See for example Berliri and Parisi (2002).
112. Baldini and Bosi (2002) show that as a consequence of the tax cuts introduced by the 2003 Budget law the effective tax rate would decrease by around 1 per cent on average for the Italian families. However, the decrease for families in the first income

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decile would be only 0.4 per cent. According to the authors, the reform mainly benefits families in the range of income between the third and the seventh deciles. See also ISAE (2002b).

113. At the end of the nineties, a system of benefit eligibility based on the families' wealth was introduced replacing the former system mainly based on income. The old system could lead to misallocation of public resources because of income underreporting in tax files, mainly used in the evaluation of families' needs.

114. Increasing the generosity of some of the existing shock absorbers might become a more compelling priority if the framework bill on pensions currently under discussion by the parliament is approved, introducing the obligation of transferring the *trattamento fine rapporto* to private pension funds (see the section on pension system).

115. See OECD (2002c).

116. ISTAT (2002a).

117. The average graduation age is 26½ years.

118. In 2001, the share of the population in the 15-19 age range neither in education nor in employment was 12 per cent. The share of the population in the 20-24 age range in the same condition was 25 per cent. See OECD (2002c).

119. Until recently the minimum compulsory age in school was 14 years. The 2000 reform of primary and secondary education increased compulsory age to 16 years.

120. See Blondal, Field and Girouard (2002). Despite low quality and low returns, entry levels in tertiary education are high as fees are relatively low and, in general, participation is not conditional on rigorously adherance to a specified schedule of courses and exams.

121. In addition, pupils will start primary school once they have reached at least 5½ years of age.

122. The vocational track lasts 4 years with an additional one, in case students intend to apply for tertiary education. Pupils are also given the choice of moving from the vocational schools to the *licei* (or *vice versa*) at any time during the upper secondary career.

123. OECD (2003b) estimates that the long-run effect on per-capita GDP level of one additional year of education ranges between 4 and 7 per cent.

124. Checchi (2003) finds that early tracking is strongly correlated with parents' education, *i.e.* the choice of academic oriented secondary schools by pupils is highly influenced by having parents with higher degree of education. The possibility of moving from vocational training to *licei* in later years or applying to university directly after vocational training is unlikely to counterbalance this effect. In fact, after being channelled in a school track, the transition to more advanced education is mainly dependent on past schooling. Moreover, ISTAT (2002a) data show that a small share of professional/technical students deciding to undertake university studies completes them (23-31 per cent compared to 55 per cent of *licei* students). Furthermore, PISA results suggest that greater differentiation between different types of schools and early tracking can lead to both lower average students' performance and higher variation.

125. See Bertola and Checchi (2001).

126. See *e.g.* Tsuru (2000) and Leahy *et al.* (2001) for literature reviews and analysis of the impact of financial development on economic growth.

127. In the case of the domestic food processing company, some banks shifted their own heavy risk exposures to the troubled company onto to their customers by selling to

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them junk-quality bonds issues of the same company, the proceeds of which were then used to repay the company's loans to the banks.

128. Schleifer and Vishny (1997) show that a partial alleviation of agency conflicts between controlling and non-controlling shareholders may come from concentrated ownership.
129. See Barontini and Caprio (2002). However, a subsequent paper by Brunello *et al.* (2003) shows that firm performance is negatively related to CEO turnover if (and only if) the controlling shareholder is not the CEO, so that non-CEO controlling shareholders are a governance mechanism substituting for outside members on boards of directors in lowering agency costs.
130. This practice is often referred to as "tunnelling"– *i.e.*, the transfer of assets and profits out of firms for the benefit of the controlling shareholders. See Johnson *et al.* (2000).
131. See Dyck and Zingales (2002); also Zingales (2000).
132. See CONSOB (2002).
133. Dyck and Zingales (2002) suggest that there may be other institutional factors besides the legal framework at work here. According to their empirical findings, a high level of press diffusion and of tax compliance seem to be the most cogent factors curbing private benefits of control. Italy, however, ranks at the bottom among the OECD countries included in their country sample on both indicators. Moreover, in countries where a controlling party can appropriate a large share of the value of a company, entrepreneurs will be more reluctant to take their companies public. Hence, an important conclusion of the paper is that improving tax enforcement can indirectly enhance financial development.
134. See Pagano and Volpin (2000).
135. See Dyck and Zingales (2002), who also note that competitive product markets make prices more transparent, which would curtail the abusive use of transfer pricing to tunnel assets out of the firm.
136. See Giavazzi (2003a).
137. These industries promise future monopoly profits no longer available in these firms' traditional sectors which are increasingly subject to intense global competition. As a result, Benetton group now has a major stake in Autostrada, Fiat group in telecommunications, and Pirelli in energy.
138. See Brunello *et al.* (2003).
139. A severe crisis in the 1930s resulted from the close linkages between banks and firms, and subsequent laws made sure that such linkages were broken. Also, unlike in Germany, banks are prohibited to vote for the shares in custody or to solicit proxy votes (*ibid.*).
140. From the viewpoint of banks, exposure to default risk of any individual company is thus reduced, and from the point of view of firms, the cost of credit they face is reduced *via* "competition" among their multiple creditors. Multiple bank relationships are also (surprisingly) common in Germany; see Hellwig (2003). However, with bank consolidation and despecialisation (universal bank model) of the last decade, the number of multiple bank relationships is declining in Italy.
141. See Brunello *et al.* (2003).
142. According to the data published by Bank of Italy, only 46 per cent of corporate borrowers entertain relationships with more than one bank and just 25 per cent with

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more than two. The large majority of small unincorporated firms have a single-bank relationship.

143. Short-terms loans represent around 23 per cent of total loans for France and above 17 per cent for Germany.

144. See Bonaccorsi di Patti and Gobbi (2001) and Bonaccorsi di Patti and Gobbi (2003). Ferri and Inzerillo (2002) show, on the basis of survey data, that there may have been a transitional period of credit rationing due to interruption in bank/firm relations following the restructuring, but that in the medium and longer-runs, the increased efficiency of banks operating in the South should bring permanent benefits to firms. The same study concludes, however, that banking system restructuring "seems to have produced few of the expected benefits for small and medium-sized firms in terms of innovative financing and internationalisation support" (p. 3).

145. At end-2002, the ratio of non-performing to total loans to companies was 13 per cent in the South v. 3.6 per cent in the Centre-North; for single-owner firms it was 24.4 against 7.7 per cent (Banca d'Italia, 2003b).

146. See the results of the investigation by *Il Sole* 24 *Ore*, "In banca muoiono le idee. Ai nuovi business non si dà credito", 5 May 2003.

147. See Messori (2002b).

148. See Bianchi and Enriques (2001); CONSOB (2002).

149. Bank ownership of insurance companies is also likely to give rise to maturity mismatch problems, in that insurance companies have mostly long-term assets, whereas banks' liabilities are short term (see Giavazzi, 2003b).

150. The adaptation of the dualistic model raises similar issues. The supervisory council does not participate, as in Germany, in strategic decisions of the company, but once again, rather exercises management control functions typical of the former *collegio sindacale*. At the same time, it approves the budget in place of the shareholders' assembly without being affected by changes in company ownership. The budget ends up being approved by a body which carries out systematic internal control functions, and which hence could act as a barrier to the contestability of property rights of the firm. See Messori (2003).

151. *Ibid*.

152. Having to provide information is already a major hindrance to listing. A recent survey by the Stock Exchange shows that 1000 firms in Italy have all the requirements to list, but do not do so.

153. See, for example, the interview by Economics Minister Tremonti in Il Sole 24 Ore, 25 April 2003; Minister Tremonti obtained agreement from other finance ministers at the 17 May 2003 summit of Deauville to "monitor" the work of the technicians regarding the transition to Basle 2 (see Baglioni, 2003). The government has also pointed out that the Basle 2 rules fail to acknowledge the pooling of risks via the system of multiple creditor relationships used by many Italian enterprises. See, for example, *Corriere della Sera*, "Tremonti: troppa tecnocrazia", 16 May 2003.

154. The share of total assets attributable to banks in which the government or foundations held majority interests has fallen to 10 per cent, from 58 per cent in the mid 1990s. The number of listed banks has increased and now account for 80 per cent of the system's total consolidated assets. The share of activity of foreign intermediaries in total assets is 7 per cent, even larger is specific areas of business, such as services to firms, asset management, and consumer credit. In the capital of the major

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banking groups there are significant interests of foreign intermediaries (banks and insurance firms). The degree of entry of foreign institutions into the Italian banking industry, both in term of market shares and shareholding in the largest group mirror the ones of the larger partners in the euro area.

155. Although the intensive banking consolidation process of the 1990s was accompanied by gains in efficiency and competitiveness, it implied increasing distortions in bank ownership structures as competition has been crucially missing in the market for property rights. Banks may also be non-competitive in non-bank services, notably asset management, with their position of strength being sustained by the existence of a large stock of wealth previously invested in government securities. See Messori (2003).
156. According to the October 1999 *Istruzioni di Vigilanza per le Banche*, if a subject wants to acquire at least 5 per cent of a bank, either directly or indirectly, it must notify the Banca d'Italia at least 7 days before even its own board of directors has met to decide whether or not to make the purchase. Furthermore, the Banca d'Italia is to follow a rather vague "financial soundness" principle in approving the purchase. The reporting requirement is harsh, and may discourage banks from applying in the first place, while the criteria for approval are rather vague.
157. See Cappiello (2002), who also notes that direct costs of bankruptcy proceedings are high (more than 20 per cent of bankruptcy assets) and involve huge losses to creditors (80 per cent of claims on average).
158. Cercone (2001).
159. Some of the harsher civil sanctions such as loss of mail privacy and limitations of movement are widely acknowledged to be "excessive", but the law that would repeal them has not yet been approved. See Cappiello (2002).
160. See Marcucci (2001).
161. Santella (2003).
162. Cappiello (2002).
163. See Joumard (2002) for a description of the EU tax systems.
164. IMF (2002b).
165. The 2003 Budget Law took some initial steps in reducing the burden of the IRAP by decreasing the rate for the agricultural sector, eliminating fellowships and training contracts from the tax base and introducing a deduction of € 2 000 for each employee up to 5 employees for companies with a turnover below € 400 000. Saving for companies will amount to more than € 400 million.
166. See Chapter II for the recent developments in the area of regional and local government finances.
167. For example, an individual will become liable to tax of 1.25 euros on interest received by lending 100 euros to an Italian corporation at an interest rate of 10 per cent; but deducting the interest payment of 10 euros against corporation tax at a rate of 33 per cent, the company reduces its tax liability by 3.3 euros. This transaction, then, improves the cash position of the private sector by 2.05 euros, at the expense of government. See IMF (2002b).
168. ISAE (2002b).
169. See OECD (2002d) for details.
170. See de Perris and Leone (2000).

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171. Other objectives for the Mezzogiorno mainly include: implementing 'territorial pacts' – *i.e.* agreements involving local authorities, social partners, and other public and private actors – providing for the implementation of a programme of local interventions to promote development; policies promoting the location of production facilities in the South; upgrading the agriculture and agro-industry sector and encouraging new models of organisation; and simplifying procedures to provide business with credit with the involvement of banks.

172. See, for example, DPEF 2003-2006 for more information on these agencies.

173. IMF (2002a).

174. See also the special chapter "Coping with the ageing problem" in the 2000 Italy's *Survey* for a comprehensive assessment of the Italian pension system and the reforms of the 1990s.

175. Nucleo di Valutazione della Spesa Previdenziale (2002).

176. Data from COVIP – the Authority monitoring private pension funds – show that at the end of 2001 the number of funds was 718 and the number of workers involved was less than 2 million, *i.e.* slightly more than 9 per cent of all workers (employees and self employed).

177. For projections of public pension spending in the medium-long term see Ragioneria Generale dello Stato (2002).

178. The contribution-based method of calculation applies fully only to workers hired after 1995. To the persons already working in 1995 but with less than 18 years of contributions, a "*pro-rata*" system will apply mixing the earnings-based and the contribution-based methods of calculation.

179. See Brugiavini and Peracchi (2001).

180. The pension system currently in force is characterised by the presence of both old age and seniority pensions. Eligibility requirements for old age pensions are 65 years of age for males and 60 years of age for females and at least 20 years of contributions for both. Eligibility requirements for seniority pensions are being increased to 57 years of age (58 for the self-employed) and 35 years of contributions, or 40 years of contributions regardless of the age. For new workers after 1995, only one regime will be available allowing retirement between 57 and 65 with at least 5 years of contributions and with a minimum pension entitlement of at least 1.2 times the social pension (a social assistance benefit to the old poor). In this new regime, a progressive upward adjustment is applied to replacement rates through higher transformation coefficients if workers decide to postpone their retirement after 57 until 65 years of age.

181. See Ministero del lavoro e delle politiche sociali (2002b).

182. Reyneri (2003).

183. In the longer run, such tampering was already considered to be a risk with the 10-yearly recalculation of the benefit formula (see below section on sustainable retirement income).

184. A further priority is represented by the setting up of limits for re-investment of the pension funds in the companies' share and, more generally, of an appropriate regulatory framework for the funds avoiding excessive risks for the workers in case of companies' bankruptcy.

185. Ministero del Lavoro e delle Politiche Sociali (2002b) shows that with the new contribution-based regime a worker at 65 years of age and with 40 years of contributions

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the replacement rate will be 63.4, whereas for a worker at 60 years of age and with 35 years of contributions the replacement rate will be 48.1. These estimates assume that the transformation coefficients are going to be adjusted consistently with the latest projections on life expectancy. This is the reason why they differ from the ones in the following section, which are based on current transformation coefficients.

186. IMF (2002a).

187. Another goal of the measure is to limit the widespread phenomenon of informal employment by retirees, with favourable impact on the participation to regular markets. It should be noted, however, that as long as ISTAT includes an estimation of the informal and irregular workers in their employment series, the impact on the older worker employment ratio as currently measured might be negligible. However, the impact on public finances might be significant.

188. OECD (2002b).

189. See Ministero del Tesoro, I*taly towards* EMU, 1998.

190. Ministero del Lavoro e delle Politiche Sociali (2002b).

191. In the notional defined contribution system, an account is kept of the annual contributions (from both the employer and employee) made by an individual to the pension system. Contributions are capitalised at the nominal growth rate of GDP. Contributions for the individual's entire working life are then summed to create a "notional" capital sum. This is then converted into a pension using a factor that is determined from the expected average individual's probability of receiving a pension in future years, discounted at a rate of interest of 1.5 per cent. This factor is expressed as the "yield" that the individual will receive from the "notional" capital. This yield increases for each year of additional work until the age of 64, in line with the falling expected duration of pension payments. As well, the "notional" capital increases in line with additional contributions. Finally, the transformation coefficients will be adjusted every ten years in line with new estimates of life expectancy.

192. These results are based on a male Average Production Worker using the following assumptions: *a*) growth rate of real wages and GDP at 1.75 per cent; *b*) inflation rate at 2 per cent; *c*) real interest rate at 2 per cent; d) age of entry in the labour force at 20; *e*) mortality tables from 2000 World Health Organisation. On the other hand, under different assumption the National strategy report on pensions (Ministero del Lavoro e delle Politiche Sociali, 2002b) shows that for individuals with high disutility to work the change in pension wealth is negative if they decide to continue working at age 57 in the earnings-related schemes currently in place but it is positive in the new contribution-based scheme. These results are based on a male worker with the following assumptions: *a*) growth rate of real wages and GDP at 1.5 per cent; *b*) inflation rate at 2 per cent; *c*) real interest rate at 2 per cent; *d*) age of entry in the labour force at 22; *e*) mortality tables from 2000 Eurostat. Moreover, the National strategy assumes that the transformation coefficients with which the pension annuities are calculated are adjusted so as to reflect the higher life expectancy in 2000 compared to the one used in the 1995 reform.

193. The extent of the imbalance between contributions and benefits is also supported by estimates of intergenerational accounts (Sartor *et al.*, 2001).

194. TFR was first introduced in 1982 to improve the coverage of the unemployment benefit system. Since then, the conditions for the attribution of unemployment benefit are being changed in a way that could remove the original reason for the introduction of the leaving-payment scheme.

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195. If the contributions to this system were to be redirected to a fully funded pension system, then eventually it would provide benefits equal to half of those offered under the current state system, provided that future real financial returns are 1 percentage point above the growth of productivity (Sartor *et al.*, 2001).
196. Contributions are exempt from income tax, investment income is taxed at 11.5 per cent and only the capital element of the pension is taxed. Such a system provides a greater tax incentive than a classic EET system provided that the marginal income tax rate is above 11.5 per cent. It could also provide a greater return than normal saving, given that the latter is taxed at 12.5 per cent.
197. The 2002 OECD *Survey on Italy* already analysed the main challenges facing the Italian health care system, especially in the context of the ongoing reform towards fiscal federalism. In particular, it pointed out the wide margins for improvement as far as quality of care is concerned together with the increasing pressure on expenditures after the squeeze experienced during the 1990s.
198. The figure for Italy is high also because it refers to physicians entitled to practice, *i.e.* enrolled in registry, unlike other OECD countries that report data on practising physicians only.
199. Agenzia per i servizi sanitari regionali (2002).
200. Ragioneria Generale dello Stato (2002).
201. The estimate of Ragioneria generale dello Stato (2002) includes only the demographic effects of an increasing share of older people in the population. It does not account for other likely causes of rising demand for healthcare, notably technology.
202. A recent debate concerns the possible lifting of the “exclusive commitment” (*rapporto di esclusivitá*), which doctors are currently required to undertake with public hospitals. In other words, doctors are now required to choose whether or not they want to work only for the public hospitals. If they decide to work only for the public hospitals, they get a wage premium and the opportunity to undertake a career inside the hospital. Moreover, they can also exercise a private activity but only beyond their normal work schedule and using the infrastructure available in public hospitals, which in exchange will retain part of their profits. According to Cestone (2003), this arrangement might reduce moral hazard and information asymmetry problems that especially arise when doctors simultaneously work in public and private hospitals. On the other hand, imposing too many constraints on doctors’ contracts might lead the best ones to migrate to private hospitals, unless the incentives introduced exceed the expected loss of income from not working in private hospitals. Regions and, especially, hospitals seem to be better placed than the central authorities in assessing the benefits and costs of contractual arrangements with their doctors.
203. See Docteur and Oxley (2003) for a comprehensive assessment of reform efforts in OECD countries, including attempts at enhancing competition among insurers and among providers.
204. Planned works on the cross-border transmission grid are expected to reduce annual national emissions by around 2 per cent and private companies can now construct new transmission lines. One planned transmission line will add 2.3 GW of capacity. Given excess demand for capacity on trans-frontier links, the regulator auctioned capacity on the links. However, this auction was cancelled by the courts that ordered a pro-rata allocation of capacity.
205. Solar, biomass and waste plants were guaranteed a price of 15 cents per KWh, wind 10.5 cents and small hydro plants 8.5 cents. Against this, independent producers of

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gas were guaranteed a price of € 0.03 per KWh. Given that gas-fired electricity plants emit 400 grams of carbon dioxide per KWh, the saving in emissions was valued at up to € 1 100 per tonne of carbon saved.

206. Some credit should also be given for reduced air pollution costs. However the externalities for gas plant are between 0.3 and 0.4 eurocents per kilowatt-hour.
207. Lombardia, Emilia Romagna, Veneto and Umbria regions.
208. At 31 kg/ha in 1995-97, the nitrogen surplus was well below the EU average (58 kg/ha) but higher than the OECD average (23 kg/ha).

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List of acronyms

ACRI	Associazione delle Casse di Risparmio Italiane
AEEG	Autorità per l'Energia Elettrica e il Gas
AGCOM	Autoritá per le Garanzie nelle Comunicazioni
APAT	Agenzia Nazionale per la Protezione dell'Ambiente e per i Servizi Tecnici
ATO	Optimal management areas
CNEL	Consiglio Nazionale dell'Economia e del Lavoro
CONSIP	Concessionaria Servizi Informativi Pubblici
CONSOB	Commissione Nazionale per le Società e la Borsa
COVIP	Commissione di Vigilanza sui Fondi Pensione
Dit	Dual income tax
DPEF	Documento di Programmazione Economico-Finanziaria
DRGs	Diagnostic related groups
DSL	Digital subscriber line
EC	European Commission
EMU	European Monetary Union
ENEL	Ente Nazionale Energia Elettrica
ENI	Ente Nazionale Idrocarburi
EPL	Employment protection legislation
EU	European Union
FDI	Foreign direct investment
GDP	Gross domestic product
GHG	Greenhouse gas
GRTN	Gestore Rete Trasmissione Nazionale
GW	Gigawatt
HHI	Herfindahl-Hirschamn index
IEA	International Energy Agency
IMF	International Monetary Fund
IRAP	Imposta regionale sulle attività produttive
IRPEF	Imposta sul reddito delle persone fisiche
IRPEG	Imposta sul reddito delle persone giuridiche
IRPET	Istituto Regionale per la Programmazione Economica della Toscana
ISAE	Istituto di Studi e Analisi Economica
ISFOL	Istituto per lo Sviluppo della Formazione dei Lavoratori
KWh	Kilowatt hour
LRIC	Long-run incremental costs
MECT	Marginal effective rate of corporate taxation
MFP	Multi-factor productivity
Mt	Million tonnes

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OFT	Office of Fair Trading
PES	Public employment service
PPP	Purchasing power parity
PPPs	Public-private partnerships
QCS	Quadro Comunitario di Sostegno
R&D	Research and development
RUO	Reference unbundling offer
SMEs	Small and medium enterprises
SMP	Significant market power
Srl	Sociétà a responsabilità limitata
Spa	Sociétà per azioni
TFR	Trattamento di fine rapporto
TWh	Terawatt hour

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BASIC STATISTICS OF ITALY

THE LAND

Area (thousand sq.km.)	301.3
Agricultural area (thousand sq.km, 1995)	165.2
Population of major cities (thousands, 20.10. 2001)	
Rome	2 547
Milan	1 256
Naples	1 005
Turin	865

THE PEOPLE

Population , 1.1.2001, thousands	57 844
Number of inhabitants per sq. km	192
Net natural increase, 2000, thousands	-17
Net rate per 1000 inhabitants, 2001	-0.2
Labour force, 2002, thousands	23776
Employment, 2002, thousands	21 612
In agriculture	1 096
In industry	6 932
In services	13584

THE PRODUCTION

Gross domestic product in 2002, billions of euros	1258.3
GDP per head (2002, US $)	18 795
Gross fixed capital formation	
Per cent of GDP in 2002	19.7
Origin of gross domestic product in 2002 at market prices, per cent of total	
Agriculture	2.2
Industry	23.9
Construction	4.8
Other	69.1

THE PUBLIC SECTOR

Current expenditure in 2002 (percentage of GDP)	47.7
Current revenue in 2002 (percentage of GDP)	45.2
Gross financial liabilities in 2001 (percentage of GDP)	106.7
General government investment in 2002 (percentage of total investment)	9.3

THE FOREIGN TRADE

Exports of goods and services, as a percentage of GDP, 2002	26.9
Main export categories, as a percentage of total exports, 2001	
Manufactured goods	36.6
Fabric and textile goods	15.9
Chemical products	9.2
Transport equipment	10.6
Mineral fuels	2.0
Imports of goods and services as a percentage of GDP, 2002	25.8
Main import categories, as a percentage of total imports, 2001	
Foodstuffs	6.9
Manufactured goods	26.8
Metal, ores and scrap	9.7
Chemical products	12.9

THE CURRENCY

Monetary unit: Euro

Currency units per US$, average of daily figures:	
Year 2002	1.0611
June 2003	0.8569

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