



MINISTERO DEL TESORO, DEL BILANCIO
E DELLA PROGRAMMAZIONE ECONOMICA

Italy's Stability Programme

Update December 1999



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I. INTRODUCTION

The updated Italy's Stability Programme has been adopted in implementation of art.4 of the EU Council Regulation 1466/97 of 7 July 1997. This Regulation requires each Union member state to submit an annual update of the Stability Programme to the European Union Council and to the European Commission.

The updated Programme is based on the *Economic and Financial Planning Document 2000-2003 (Documento di Programmazione Economico-Finanziaria per gli anni 2000-2003 - DPEF 2000-2003)* adopted by the Italian Parliament on 29 July 1999, its update Note, the *Forecast and Planning Report 2000 (Relazione Previsionale e Programmatica per il 2000 - RPP 2000)* which the Italian government submitted to Parliament at the end of September 1999, and the *Financial Law 2000* which was enacted on 18 December 1999.

The first part of the update of the Programme describes the macroeconomic situation and the state of public finance in 1999 and the objectives set by the government for the next four years. The second part describes the measures that have been scheduled by the Italian government to foster the growth of southern Italy.



II. THE STABILITY PROGRAMME

II.1 The macroeconomic framework

By the end of 1999, GDP is expected to have risen by 1.3 percent in real terms (the same growth rate as in 1998). Italy's Stability Programme submitted in December 1998 forecast a GDP growth of 2.5 percent for 1999, but already indicated that the estimate might have to be revised downwards. The causes for the downward revision of the growth rate forecast in 1999 have been the worsening of output in view of the deteriorating international situation, the unfavourable developments in exports, the decline in industrial output and cautious households' spending behaviour.

As in the previous two-year period, growth was driven by domestic demand in 1999. Household expenditure should have increased by 1.7 percent, mainly as a result of increased disposable income. Investment in equipment is expected to have grown by 3.7 percent, and by 3.9 percent in construction. Exports should have remained unchanged while the growth rate of imports is expected to have slowed down to 3.5 percent from the 6.1 percent recorded in 1998 because of the completed adjustment in the inventory stocks and the end of the effect of the government incentives to boost car sales.

Total employment continues to grow (at an average annual rate of 0.7 percent) mainly in the private services sector. One of the main reasons for this development has been the widespread use of fixed-term and part-time job contracts. The unemployment rate has fallen from 11.8 in 1998 to 11.4 percent.

The slowdown in inflation was halted in 1999 largely due to increased oil prices on the international markets, further compounded by the fall in the euro exchange rate. Moderate wage growth in the past few years has contributed to maintain price stability. The increase in household expenditure deflator is expected to fall from last year's 2.3 percent to 1.9 percent by the end of 1999.

Over the next four years the recovery in world trade and economic activity in Europe should foster growth in Italy to reach 2.2 percent in 2000, and 2.6 percent, 2.8 percent and 2.9 percent in each of the



following three years. Economic expansion should continue to be driven by increased domestic demand.

Household expenditure is estimated to be rising and should increase from a rate of 2.2 percent in 2000 to 2.5 percent in 2003. This rise reflects the increased disposable income as a result of a rise in real compensations and in employment.

Beginning next year, the accumulation process is expected to accelerate: gross fixed investment should rise at a rate of 5.3 percent in 2000 and above 6 percent on average, over the period 2001-2003. Public intervention policies to encourage private investment and accelerate public capital accumulation should further boost investment growth.

While net foreign demand is recovering, it is expected to make a marginally negative contribution to GDP growth. An expansion in world trade should lead to a recovery in the volume of exports, driving up the growth rate from 3.8 percent in 2000 to 6.2 percent in 2003. Import growth is expected to increase from 5.2 percent in 2000 to 6.4 percent in 2003.

Employment is forecast to rise by 0.8 percent in 2000, 1 percent in 2001 and an average annual rate of 0.9 percent over the period 2002-2003. This growth rate should reduce unemployment to 11.1 percent in 2000, declining further during the following years to reach 9.4 percent in 2003.

Cost and productivity forecasts are consistent with the reduction in the growth rate of the household expenditure deflator to 1.7 percent in 2000 and its stabilisation around 1.5 percent afterwards.

Assumptions regarding interest rates have been changed since the 1998 Stability Programme to take account of more recent trends. More specifically, the 12-month BOT interest rate is assumed to gradually rise from 3.7 percent at the end of 1999 to 5 percent in 2003.



Table II.1.1 MACROECONOMIC FRAMEWORK (percentage values)

	1998	1999	2000	2001	2002	2003
Real GDP growth rate	1.3	1.3	2.2	2.6	2.8	2.9
Growth rate of households' consumption deflator	2.3	1.9	1.7	1.6	1.5	1.5
Growth rate of GDP deflator	2.8	1.7	1.7	1.7	1.7	1.6
Employment growth rate	0.7	0.7	0.8	1.0	0.9	0.9
Unemployment rate	11.8	11.4	11.1	10.5	10.0	9.4
12-month Bot interest rate (year-end)	3.2	3.7	3.7	4.2	4.7	5.0
Current account balance (as a percentage of GDP)	1.7	1.3	1.3	1.4	1.5	1.8

Source: For 1998, ISTAT and Bank of Italy. For 1999-2003, official Italian Government estimates and projections.

Table II.1.2 COMPOSITION OF REAL GDP (percentage changes at constant prices)

	1998	1999	2000	2001	2002	2003
GDP	1.3	1.3	2.2	2.6	2.8	2.9
Households' consumption	1.7	1.7	2.2	2.4	2.5	2.5
Consumption of general government and of N.P.I.S.H.'s (*)	1.3	1.5	0.2	0.2	0.2	0.2
Fixed investments - equipment	6.1	3.7	6.2	6.7	7.0	6.5
Fixed investments - construction	0.1	3.9	4.0	5.0	5.5	6.0
Changes in inventories and valuables	0.6	0.1	0.1	0.1	0.1	0.1
Exports	1.2	0.0	3.8	5.2	6.2	6.2
Imports	6.1	3.5	5.2	6.0	6.8	6.4

(*) N.P.I.S.H. = No Profit Institutions Serving Households.

(**) Contribution to GDP growth.

Source: For 1998, ISTAT. For 1999-2003, official Italian Government estimates and projections.

II.2 Public finance results in 1998 and estimates for 1999

In 1998, the general government net borrowing as a percentage of GDP fell to 2.7 percent from 2.8 percent in 1997. The December 1998 Stability Programme forecast a further reduction to 2.0 percent in 1999. In May 1999, by agreement with the ECOFIN Council, the net borrowing estimate for 1999 was revised upwards to a maximum of 2.4 percent of GDP to take account of the impact on public finances of the lower economic growth in 1998 and the lower growth forecast for 1999.

Preliminary year-end data on the state sector alone indicates a borrowing requirement for 1999 of 1.5 percent of GDP, which is substantially lower than the 2.5 percent originally forecast. This is due both to higher-than-forecast revenues and a more favourable trend in the cost of public debt service.

Data on general government net borrowing for 1999 will be available in February. However, a preliminary estimate on the basis of the data on the state sector suggests that the net borrowing/GDP ratio is likely to be lower than the 2.4 percent estimate and the actual 1998 figure (2.7 percent).

The primary surplus should fall from 5.2 percent of GDP in 1998 to 4.9 percent in 1999. The current surplus of 0.3 percent of GDP in 1998 is expected to improve further in 1999 to around 1.6 percent of GDP. The capital account deficit should reverse the downward trend recorded over the past few years and increase from 3 percent in 1998 to 3.6 percent in 1999.

Interest payments fell from 9.5 percent of GDP in 1997 to 8 percent in 1998. In 1999 debt service payments are expected to fall further to 6.9 percent, 0.6 percentage points below the forecast set out in last year's Stability Programme.

The public debt/GDP ratio fell to 116.8 percent in 1998 from 120.2 percent in 1997, and is expected to fall still further to 114.7 percent by the end of 1999, in line with last year's Stability Programme. The lower reduction of the ratio due to the fact that GDP grew more slowly than forecast was offset by increased revenues from privatisation (see the Box for a description of the privatisation programme).

Table II.2.1 GENERAL GOVERNMENT MAIN AGGREGATES (as a percentage of GDP)

	1995	1996	1997	1998	1999(*)
Revenues					
Current	44.7	45.5	47.3	45.9	46.4
Capital account	0.8	0.4	0.9	0.6	0.3
Total	45.5	45.9	48.1	46.5	46.7
Expenditures					
Primary current	37.0	37.7	38.0	37.6	37.9
Capital account	4.6	3.7	3.5	3.7	4.0
Total expenditures (net of interest)	41.6	41.4	41.5	41.3	41.9
Interest payments	11.5	11.5	9.5	8.0	6.9
Total	53.2	52.9	50.9	49.2	48.7
Current balance	-3.9	-3.7	-0.2	0.3	1.6
Capital account balance	-3.8	-3.3	-2.6	-3.0	-3.6
Primary balance	3.9	4.5	6.7	5.2	4.9
Net borrowing	-7.7	-7.0	-2.8	-2.7	-2.0

(*) Preliminary estimates based on results for the State Sector borrowing requirement.



An analysis of the sectoral breakdown of net borrowing shows that the central government has continued to make a significant contribution to the process of financial consolidation. In 1998, central government net borrowing fell to 2.6 percent of GDP from 2.9 percent in 1997, and this figure is expected to improve still further in 1999. The local government balance, which was virtually in break-even in 1998, is expected to show a slight deficit in 1999, while social security institutions should end the year in break-even after the temporary deficit recorded for 1998.

Table II.2.2 GENERAL GOVERNMENT NET BORROWING BY SUB-SECTOR (as a percentage of GDP)

	1995	1996	1997	1998	1999 (*)
Central government	-7.7	-7.0	-2.9	-2.6	-1.6
Local government	0.0	-0.3	-0.2	0.1	-0.4
Social security funds	0.1	0.2	0.3	-0.2	0.0
General government	-7.7	-7.0	-2.8	-2.7	-2.0

(*) Preliminary estimate based on provisional data December 1999.

The privatisation programme

In October 1999, the Treasury sold off a first tranche of its holding in ENEL through a global offering equivalent to 32 percent of the share capital, raising a gross 16.5 billion euros (over 32,000 billion lire, equivalent to 1.5 percent of GDP in 1999). The flotation of the ENEL holding was possible thanks to decree No.79 of 1999 which became effective on 1 April 1999, taking up the EU directive 96/1992 on the liberalisation of the electricity industry.

ENEL has taken on the function of the holding company, controlling electricity generation and distribution companies and the sale of electric power to suitable customers, while retaining its own transmission network. Since August 1999, the network has been managed by a newly incorporated public corporation operating in accordance with guidelines laid down by the Minister of Industry. As far as electricity generation is concerned, after 2003 ENEL will no longer be able to control more than 50 percent of the electric power produced in or imported into Italy. ENEL is therefore required to sell off facilities with an overall capacity of not less than 15,000

Megawatts over the next three years. As far as electric power distribution is concerned, in order to streamline the management of the infrastructure and the service, only one government franchise per municipality is to be permitted.

One of the other privatisation operations that has now been completed is the sale to Banca di Roma of the government's entire holding in Mediocredito Centrale through direct negotiations. During the preparatory operations for privatisation, Mediocredito Centrale was assigned the Treasury's direct holding in Banco di Sicilia (22.37 percent of the share capital).

II.3 Public finance objectives for the period 2000-2003

Budgetary policy for the period 2000-2003 continues to hinge around a twin strategy: to pursue the reduction of the government deficit and to foster the growth and fair distribution of incomes.

Table II.3.1 PUBLIC FINANCE TARGETS: GENERAL GOVERNMENT (as a percentage of GDP)

	2000	2001	2002	2003
Current balance	2.0	2.4	2.8	3.1
Capital balance	-3.5	-3.4	-3.4	-3.2
Primary balance	5.0	5.1	5.1	5.2
Interest payments	6.5	6.1	5.7	5.3
Net borrowing	-1.5	-1.0	-0.6	-0.1
Public debt	111.7	108.5	104.3	100.0

General government net borrowing is expected to fall by about 0.5 percent points in each of the next four years to reach break-even by 2003. These objectives are in line with those set out in the December 1998 Stability Programme.

Compared with the previous Programme, the present one has lower interest payments and a lower primary surplus in terms of GDP. The continuing decline in interest payments from 6.5 percent of GDP in 2000 to 5.3 percent in 2003 is steeper than expected initially, as a result of the revised assumptions regarding interest rates based on recent finance market trends.

The primary surplus is stabilised at about 5 percent of GDP. This choice is consistent with the government's intention to allocate more

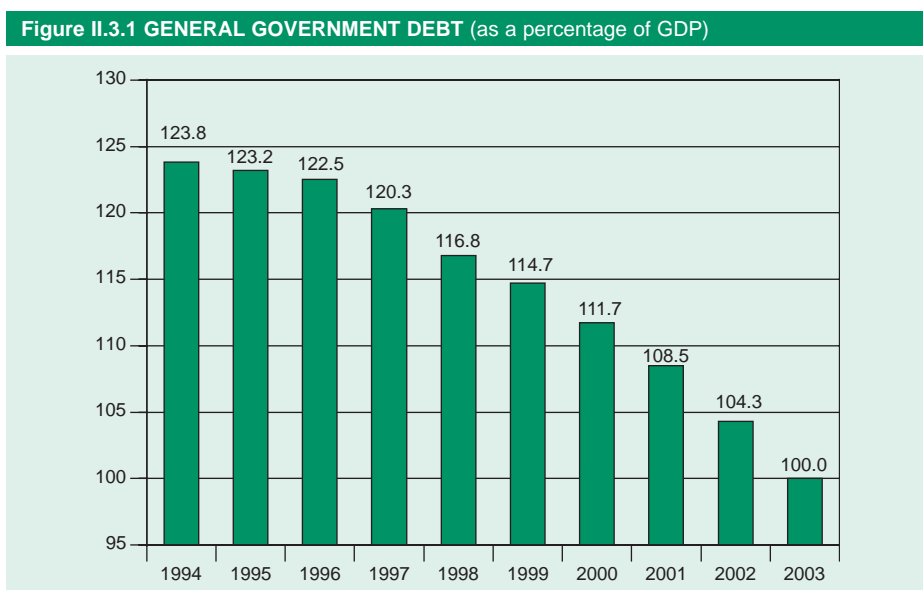


resources to development, both by reducing taxes and increasing public investments to foster economic growth with the aim of bridging the gap between the growth rate in Italy and that of the rest of the European Union. The current surplus will continue to rise, and by the end of the 4-year period will reach 3.1 percent of GDP. The capital account deficit, after peaking at 3.5 percent in 2000, will gradually fall to 3.2 percent in 2003.

The central government net borrowing is expected to fall gradually to break-even in 2003. The local government net borrowing is expected to rise slightly to around 0.4 percent of GDP by 2003. Lastly, the social security institutions are expected to have a surplus of about 0.2 percent of GDP over the period under consideration.

Table II.3.2 GENERAL GOVERNMENT NET BORROWING BY SUB-SECTOR (as a percentage of GDP)				
	2000	2001	2002	2003
Central government	-1.6	-0.9	-0.5	0.1
Local government	-0.2	-0.3	-0.3	-0.4
Social security institutions	0.3	0.2	0.2	0.2
General government	-1.5	-1.0	-0.6	-0.1

The public debt/GDP ratio, illustrated in Figure II.3.1, will continue to fall along the lines indicated in the December 1998 Stability Programme to reach 100 percent in 2003.





The structural public finance balances corresponding with the aforementioned objectives are illustrated in Table II.3.3.

Over the period under consideration, the real GDP is assumed to remain below the potential even though the output gap will be narrowed. Consequently, in 2000 the structural deficit will fall short by over one percentage point of the official target and will be virtually in break-even (-0.1 percent of GDP). In the following years the structural balance will be in surplus, reaching around 0.1 percent of GDP in the biennium 2001-2002 and 0.3 percent in 2003.

Table II.3.3 STRUCTURAL PUBLIC FINANCE DEFICIT (-) OR SURPLUS (+) (as a percentage of GDP)

	Structural balances (*)	Official targets
2000	-0.1	-1.5
2001	+0.1	-1.0
2002	+0.1	-0.6
2003	+0.3	-0.1

(*) Structural balances are calculated by using estimates of potential output and the elasticity of the deficit/GDP ratio to the output gap from the OECD.

The consequences of population ageing

The following figure shows expenditure on pensions as a percentage of GDP in the forecast period 1999-2045 ⁽¹⁾.

The real GDP growth rate throughout the whole period is assumed to average 1.5 percent. The growth rate will exceed this value in the first ten years of the forecast period, but will be slightly lower during the following period to converge to the assumed average figure around 2045. After 2020, the real GDP growth rate will be the result of an increased average labour productivity growth rate of 2 percent and approximately -0.5 percent change in employment.

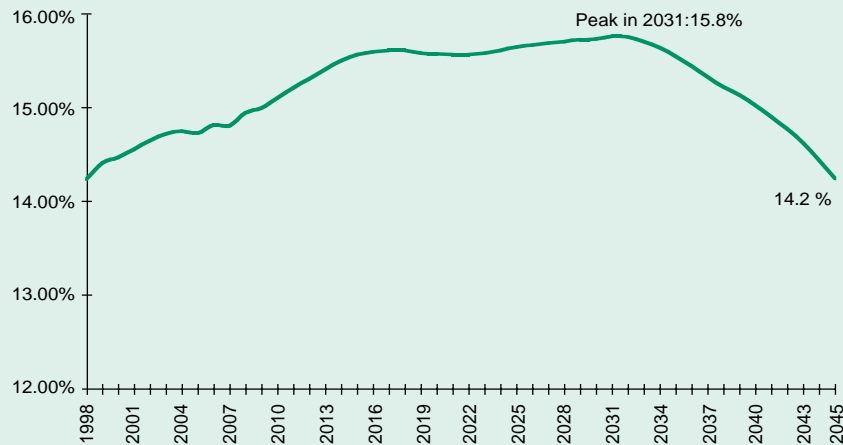
As far as the legislative and institutional framework is concerned, current legislation has been taken into account in both the transitional phase and when fully implemented according to the reform law No.335 of 1995 and the subsequent supplements enacted in law No.449 of 1997.

Pension expenditure as a percentage of GDP rises in the first 17 years of the forecast period by 1.4 percent of GDP, from 14.2 percent in 1998 to 15.6 percent in 2015.

⁽¹⁾ Dipartimento della Ragioneria Generale dello Stato (1999): *Aggiornamento del modello di previsione del sistema pensionistico della RGS: Le previsioni '99*, Roma.



PENSION EXPENDITURE AS A PERCENTAGE OF GDP (*)



(*) Including "pensioni sociali"


This increase is due both to a rise in the number of pensioners in excess of the employed, and an increase in the size of the average pension which is virtually equal to that of productivity of labour.

The rise of the pension spending/GDP ratio will continue in the following years after 2015 at a much lower rate to reach its peak at 15.8 percent in 2031 (1.6 percent above 1998).

The slowdown in the growth of the pension spending/GDP ratio is due to a fall in the average pension/productivity ratio. This result depends on a sharp reduction in the average pension growth rate as a result of the gradual introduction of the contribution-based calculation method: in fact, it is over these periods that most pensioners will be those insured under the mixed regime. The effect will be so pronounced that it will offset the sharp rise in the proportion of pensioners to the size of the population in employment.

In the final phase of the forecast period, total expenditure rapidly declines to reach 14.2 percent in 2045. This is due to the gradual switchover from the mixed regime to the full contribution-based regime, with an initial slowdown and then a reversal of the proportion of pensioners to people employed.

The new pension spending forecast, formulated in 1999, is very similar to the last year's forecast. The most important differences are



found in the first 20 years of the forecast period due to a slower GDP growth rate according to the 1999 forecasts compared with 1998. Conversely, expenditure remains virtually the same. In the central and final part of the forecast period, the different combination between productivity and employment used for the new scenario leads to a slight reduction in expenditure, which will offset a slightly lower GDP growth rate.

II.4 Public finance measures for 2000

The *DPEF 2000-2003* indicated corrective measures for the year 2000 totalling 15,000 billion, and measures to foster growth for 3,500 billion lire.

The updated Note of the Economic-Financial Programme Document 2000-2003 revised the trend tax revenues taking account of the higher-than-expected tax revenues. A 0.4 percentage point of GDP increase is forecast for each year during the 4-year period 2000-2003. The increased primary surplus, therefore, makes available additional resources of about 9,300 billion lire while maintaining the initially planned net borrowing targets.

Measures to finance programmes to reduce taxation and reform the markets, originally set at 3,500 billion lire, have been increased to 12,800 billion. These measures are intended to hasten the pace of economic growth.

The primary surplus and the general government net borrowing indicated in the *DPEF 2000-2003* (respectively, 5.0 and 1.5 percent of GDP) remain unchanged. The *Financial Law 2000* of 18 December 1999 took up the indications of the *DPEF 2000-2003* and the update Note. In particular, it confirmed measures totalling 15,000 billion lire comprising 11,000 billion in expenditure cuts and 4,000 billion in increased revenues.

Table II.4.1 shows the situation envisaged for the 4-year period 2000-2003. Current expenditure net of interest payments will fall by about one percentage point over the four years (from 37.2 percent in 2000 to 36.2 percent in 2003). The reduction in primary current expenditure will make it possible to simultaneously reduce total revenues as a proportion of GDP from 46.2 percent in 2000 to 45 percent in 2003. Capital account expenditure as a proportion of GDP will peak at 4 percent in 2000, after which it will gradually fall to 3.6 percent by 2003.



Table II.4.1 THE 2000 - 2003 PUBLIC FINANCE PLAN (values as a percentage of GDP)

	2000	2001	2002	2003
Revenues				
Current	45.8	45.4	45.0	44.6
Capital account	0.6	0.4	0.3	0.3
Total	46.3	45.8	45.3	44.9
Expenditures				
Primary current expenditures	37.3	36.9	36.5	36.2
Interest payments	6.5	6.1	5.7	5.3
Total current expenditures	43.8	43.0	42.2	41.5
Capital account	4.0	3.9	3.6	3.5
Total expenditures net of interest	41.3	40.8	40.1	39.8
Total expenditures	47.8	46.9	45.8	45.0
Current surplus	2.0	2.4	2.8	3.1
Primary surplus	5.0	5.1	5.1	5.2
Net borrowing	-1.5	-1.0	-0.6	-0.1

II.4a Revenue side measures

The purpose of the budgetary policy on the revenue side is to gradually reduce the level of taxation and social security contributions, using the recovered tax revenues resulting from tax evasion measures. Taxes will be lowered mainly by providing tax relieves to families and companies, consistent with the commitments undertaken in the December 1998 Social Pact for Development and Employment.

More specifically, the measures will reduce the second personal income tax (IRPEF) bracket from 27 to 26 percent, raise taxable allowances for poorer families, reduce VAT in the building industry, consolidate the measures introduced to ease taxes on first homes and on rents which were initially only introduced for 1999, lower inheritance taxes and extend the Dual Income Tax to individual firms and partnerships.

Higher revenues, equal to 4,000 billion lire, will be guaranteed by the introduction of a new system for managing State-owned real estate, particularly the real estate of the social security institutions. The privatisation programme will be implemented in different ways, ranging from direct sales, to the institution of public real estate funds. The real estate will be sold off as an exception to state accounting rules, either individually or in one or two batches, to real estate brokers. The latter



must pay the amount initially agreed, and then sell the real estate and pay the difference on the amount raised from the sale, after deducting a commission. If the real estate brokers do not re-sell the property, they are required to pay the difference between the market value of the property indicated by a Treasury consultant and the purchase price. The Treasury is responsible for overseeing the implementation of the programme, and to intervene in place of the brokers in the event of inertia or delays.

Alternative forms of sale are also introduced, including the assignment of the property to real estate funds or the securitisation of the property rent. In this case, once again, the Treasury is responsible for laying down the rules for the operations and for their enforcement.

II.4b Expenditure side measures

On the expenditure side, the planned measures, worth a total of 11,000 billion lire, are designed to reduce current expenditure.

The measures refer to the public employment sector, the pension sector, the purchase of goods and services by the general government, the local finance and the management of public debt.

As far as public sector employment is concerned, the additional effort to rationalise expenditure is designed to guarantee more careful planning of staff turnovers and of internal competitive examinations, and to encourage part-time work and mobility.

The measures for the pension sector are designed to rebalance expenditure, partly by rationalising the management of the special pension funds. More particularly, the law has abolished the pension fund for electrical and telephone workers which had privileged treatment. The positive effects on public finances come from the introduction of a three-year contribution from employers taking account both of the share of pension expenditure related to the difference between the general pension rules and the specific rules of the abolished funds, and of the asset and financial situation of each fund.

Savings are also expected as a result of the co-ordinated management of goods and services purchases by the general government. It is now possible to sign contracts with suppliers (selected by European Union tender) who commit to supply the public sector with specific volumes of products at an agreed price for a period of time



agreed upon in advance. In this way, individual government institutions can take on supplies simply upon request, without having to implement tenders each time.

Further savings will stem from the gradual reduction in the use by government institutions of privately-owned rented buildings.

In line with the process that began last year, these measures are designed to improve co-ordination between central, regional, and local government finances by strengthening the 'internal stability pact'. The regional, provincial, municipal and Mountain Community authorities will be required to act more strictly in compliance with the public finance targets compatible with Italy's participation in the Economic and Monetary Union.

Current expenditure reduction measures, lastly, relate to an accurate and detailed management of the debt of all government institutions.

II.5 The sensitivity of the targets to the macroeconomic assumptions

This Section updates the estimates of the sensitivity of the public finance targets to the macroeconomic assumptions.

II.5a Sensitivity to interest rates

The estimates of interest expenditure sensitivity to changes in the assumptions regarding interest rates (given in Section II.1) have been updated since they were presented in the December 1998 Stability Programme. There are two reasons for the updating. Firstly, the interest rate assumptions underlying the basic scenario have since changed. Secondly, the composition of public debt is now different: the fixed yield securities as a percentage of the whole have risen from 59 percent at the end of 1998 to 63 percent at the end of August 1999. The average maturity of public debt has increased from 5.15 years in December 1998 to current 5.6 years.

Given the different composition of the debt, with a higher proportion of fixed-yield securities and longer maturities, the time required for increased rates to be fully reflected in interest expenditure is also longer.



The shift of the whole yield curve upwards by one percentage point over the basic scenario taken for the period 2000-2003 would increase the ratio between interest expenditure and the GDP by about 0.1 percentage points in 2000, 0.3 in 2001, 0.32 in 2002 and 0.35 in the last year of the simulation. The deficit/GDP ratio would continue the downward trend to reach 0.5 percent in the final year of the forecast (Table II.5.1). A one percent fall in interest rates in relation to the basic scenario would generate an interest expenditure reduction of practically the same amount.

Table II.5.1 SENSITIVITY TO INTEREST RATES (percentage values)		
	Interest expenditure/GDP 2003	Deficit/GDP 2003 (**)
Estimate with higher interest rates	5.7	0.5
Central estimate (*)	5.3	0.1
Estimate with lower interest rates	4.9	-0.3

(*) See interest rate assumptions in Table II.1.1
(**) The minus sign indicates a surplus.

The effect of a 0.5 percent increase of short term interest rates over the basic scenario has also been simulated, accompanied - as occurred in November 1999 - by an increase in the interest rates on securities maturing up to three years and a slight reduction in interest rates on securities maturing beyond three years as a result of market expectations. This exercise does not therefore implies a rise in the whole of the yield curve as it did in the previous case, but a rotation of the curve on the three year maturity axis.

The results of the simulation show that the impact on interest expenditure is 0.03 percent of GDP in 2000, 0.10 percent in 2001, 0.12 percent in 2002 and 0.16 percent in 2003.

II.5.b Sensitivity of the deficit/GDP ratio to economic growth

The GDP growth forecasts set out in Section II.1 are consistent with those suggested by the main international institutions, and take account of a gradual reduction of the output gap for Italy. The following



Table illustrates the effect on the deficit/GDP ratio of two different assumptions relating to GDP growth. In the assumption of lower (higher) growth, a half percentage point lower (higher) rate is assumed for each year in the period 2001-2003 with respect to the basic assumption illustrated in Section II.1.

The results of the simulation are given in the following Table.

	Average GDP growth rate 2001-2003	Deficit/PIL 2003 (*)
Estimate with lower growth	2.3	0.85
Baseline estimate	2.8	0.10
Estimate with higher growth	3.3	-0.65

(*) The minus sign indicates a surplus.

If growth is lower than forecast by 0.5 percentage points per year throughout the period 2001-2003, the deficit/GDP ratio would be 0.85 percent of GDP in the final year of the simulation. This scenario is given purely to illustrate the effects of the impact of an economic slowdown on net borrowing. It does not affect the government's commitment to reaching zero balance in the medium-term as specified in the Stability Programme.

III. MEASURES TO FOSTER THE GROWTH OF SOUTHERN ITALY

The general objective of all the measures introduced for southern Italy is to enable the area to achieve a significantly higher rate of growth than the European average, based on a substantial rise in productivity, and a resulting reduction in poverty and an increase in the number of people in regular employment by the middle of the period 2000-2006.

The national policy for southern Italy is based on a set of highly integrated sectoral measures, of which the core element is increased (and higher standards of) public investment.

The instrument selected for planning this policy is the Southern Italy Development Programme (PSM) for the use of community Structural Funds for the years 2000-2006.

In order to guarantee financial certainty and consistency among all the measures undertaken, the *DPEF 2000-2003* sets out a seven-year financial framework for all public resources available for Southern Italy. This comprises both ordinary and supplementary (EU and national co-financed) resources, and gives the breakdown by individual Region.

On the basis of this framework, over the period 2000-2006 the share of capital account expenditure in southern Italy as a percentage of the total Italian capital account expenditure will rise from about 44 percent in 2000 to around 47 percent in 2002, and then gradually decline to under 45 percent in 2007.

Table III.3.1 PUBLIC ADMINISTRATION CAPITAL ACCOUNT EXPENDITURE: 2000-2007

	Italy thousand billion	South thousand billion	Share of South percentage value
2000	88.8	39.3	44.3
2001	95.9	43.9	45.8
2002	101.8	47.6	46.8
2003	107.1	49.7	46.4
2004	111.2	51.2	46.1
2005	116.2	52.8	45.4
2006	121.2	54.3	44.8
2007	126.5	56.5	44.6

Source: Documento di Programmazione Economico-Finanziaria 2000-2003.



The Programme comprises seven main areas to guarantee integrated measures designed to exploit local resources: natural resources, cultural resources, human resources, local development systems, towns and cities, local institutions and associations, service networks and hubs. Within each area specific objectives have been identified, to which effectiveness indicators have been associated for monitoring purposes.

In view of the urgent need to start the Programme, a number of measures have been identified which, following a survey conducted by the regional and central government institutions, will make it possible to begin implementing projects in the first few weeks of 2000.

The success of the PSM depends on the simultaneous implementation of three other sectoral policies:

- to strengthen competition;
- to improve and enhance the effectiveness of labour market allocation mechanisms;
- to improve efficiency of the public administration.

As regards the utility supply, it is necessary to proceed with greater determination to create a regulatory framework to foster competition. Stepping up competition in the main network services, local utility services and public and private corporate services is a necessary precondition if the supply-side policy is to produce its effects.

The magnitude of regional differences on the Italian labour market demonstrates the urgent need to pursue an employment policy in southern Italy which is consistent with the local starting conditions. It is therefore essential to guarantee a high level of consistency between labour policies and the full set of development policies. Labour policies are designed to match labour supply and demand more flexibly. They are also designed to encourage the rapid introduction of modern public and private job placement services, and to gear vocational training more closely to meet the demand.

These measures cannot be effective unless the modernisation of public administration is accelerated. For this reason, the government intends to couple the devolution of responsibilities and powers to local government with the technical enhancement, rationalisation and reorganisation of all government institutions.