THE BERLUSCONI GOVERNMENT'S ECONOMIC POLICY DURING THE FIRST YEAR OF OFFICE

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During 2002, total employment in Italy rose by 1.4 percent compared with the previous year, while GDP increased by 0.4 percent. Figures for the other European countries were very different, however: a growth of 0.7 percent in GDP was accompanied by only a slight rise in total employment of 0.3 percent. The peculiarity of the Italian economy from this point of view could be seen, paradoxically, as a change from a phase during which growth in GDP failed to generate additional employment (1996–1998) to one in which the stagnation of production did not prevent the continued growth in employment that had previously been triggered. Moreover, the additional employment created in 2001 was less precarious than it had been before. That is, the newly employed included a higher percentage of full-time workers than had been the case in previous years: 92 percent of the newly employed in 2001 were full-time employees, compared with 96 percent in 2002.

The fact is that we are not talking about an economic system in which companies behave in an irrational manner, but one in which their actions are the result of a precise calculation based on the tax credits due for newly employed full-time workers as provided for by the December 2000 budget. The latter envisages a contribution of 413 euro

a month for each additional employee at the end of 2003, which goes up to 620 euro in the case of the newly employed in the South of Italy. This governmental measure has not only led to increased employment, but can reasonably be believed to have been useful in getting irregular employment to “come out” into the open.

The measures adopted by the Berlusconi government in mid-2002 took away these incentives from companies, though it had already become clear that the regulations governing the provision of incentives toward a reduction in irregular employment, which had been in force since November 2001, were not furnishing any tangible results. Even the contents of the “White Paper on Employment in Italy” concerning the “significant reduction in the number of full-time employees”¹ failed to convince the government to maintain the existing tax credits for new employment.

The abolition of these employment incentives and then their reinstatement at one-quarter of their previous level (suspended, however, for the period from July 2002 to April 2003) have modified their value to companies. In fact, in October 2002, the increase in the total number of full-time workers accounted for 81 percent of the total increase in employment, compared with an average of 96 percent for the previously mentioned year. Despite the predictable negative results, the government also tried to abolish tax incentives for new investment in the South of Italy, then subsequently modified this line by instead proposing an upper limit on the total tax credit accruable by companies, accompanied by a more complex series of procedures for those wishing to benefit from such tax credits.

Once again, the case in hand is not one of irrationality on the part of the policy-maker. The implicit design of the center-left government’s policies was to create a tax regime that encouraged both regular new employment (the envisaged duration of the measure was three years) and the formation of new capital (the respective measure was to last a period of six years) in the least developed areas of the country. The two periods envisaged were designed to give sufficient time with which to gradually reduce payroll taxes on the income of all employees in the case of the first measure (the planned reduction was 0.8 percent a year for three years starting from 2001) and, in the case of the second measure, to concentrate investment in the South of Italy prior to the revision of the European Union’s expenditure programs. In fact, after 2006, with the entry to the EU of the new member countries from Central Europe, it is likely that funding for the development of the Italian South will be reduced. Moreover, the same six-year period would have been enough to witness the effects of the reduction in the company tax rate implemented with

the dual system of profits taxation. At the end of the six-year period, productive capacity in the South would have increased, and all companies would have paid a little less business tax and less employees' national insurance contributions.

The new center-right government has focused its attention on this "little less," which it deems to be too little and, above all, something that was somebody else's idea, regardless of how rational that idea might have been. The political objectives of making a clean break with the past and of offering business operators measures that bear the hallmark of the new government have been given precedence over the economic objective of adopting measures that do not disrupt either the national budget or the plans of companies.

In this sense, the legislative wrangling over tax credits for new employment and new capital investment are emblematic of the formulation of economic policy during the first two years of the Berlusconi government. The predominance of the political target of discontinuity at all costs has jeopardized the achievement of those economic objectives that the same government had set itself.

There was a need to find space within the national budget for measures of a totally unrealistic nature promised to the public during the electoral campaign: a reduction in taxation, an increase in pensions and in spending on the country's infrastructures, together with the reduction of the public debt. This need forced the government to cancel measures that were already in force, and to destructure the already formulated design of economic policy. It is doing so even though it cannot prevent this from leading to permanent additional expenditure within the framework of the national budget, mainly to be covered by one-off measures or financial advances. The scarce attention paid to the state of the long-term public debt heightens the precarious nature of public accounts, which in turn exacerbates the effects of the recession. This, then, further restricts the range of measures the government wishes to introduce, or, as happened in the above-mentioned case of the tax credits, forces it to abandon a programmatic design (in the case in hand, that for the South) without there being any possibility of replacing it with another, equally systematic design.

The "First One Hundred Days" Measures and the So-Called Budget "Deficit"

Whereas the responsibility for the formulation of economic policy and its consequent results in the year 2001 was shared between the Amato government and the second Berlusconi government (with the

former largely responsible for the formulation and the latter mainly responsible for the results), 2002 was the first year in which the Berlusconi government was entirely responsible for the management of the country's economic policy. However, any analysis of the economic policy implemented during 2002 by the Berlusconi government necessarily needs to begin from the premises established during the course of 2001 by the so-called "first one hundred days" provisions.

Legislative activity in the summer to autumn of 2001 immediately focused on a number of strictly personal problems ("club" questions) that were quickly and efficiently resolved. The government and Parliament were equally quick to resolve a series of other, interrelated problems of a sectorial nature, such as the abolition of estate duty on large estates and the return and regularization of capital previously exported illegally (together with a cut-price tax amnesty for the equivalent evasion of personal income tax). These are once again problems of minor importance to the population as a whole, and their solution could have strengthened existing income and capital inequalities.

On the other hand, the Berlusconi government would appear to have created the premises both for a rapid implementation of a number of public works programs for the construction of urgently needed infrastructures—in the form of the so-called "objective law" designed to streamline the bureaucracy involved—and for the reduced burden of the said works on the national budget through the foundation of two entirely public corporations: *Patrimonio S.p.a.*, which should guarantee the more efficient management of public assets, and *Infrastrutture S.p.a.*, which should perform the function of channeling public and private moneys into the creation of public infrastructures. I say "should" because more than a year later, the procedural problems have yet to be properly ironed out, while the two companies appear to have been burdened with additional objectives that could overshadow the raising of private funding for the projects in question. These additional objectives include public property operations aimed at reducing the current public debt and budget deficit, even if this leads to a greater budgetary burden in the years to come.

Immediate government intervention in the field of taxation has destroyed the existing company tax system and replaced it with the temporary abatement (the Tremonti *bis* law, which expired at the end of 2002) of tax on company profits according to investments made, while postponing the introduction of new permanent company gains tax provisions until the decree law on tax reform and the respective legislative decrees are approved. In trying to widen the tax base—a prerequisite for the promised reduction in the tax rate and in company gains tax—the government has introduced measures designed

to reduce the level of irregular employment (involving the regularization of those already doing “black” work), which in truth have failed to generate company involvement.

The 2001 budget, formulated by the Amato government, envisaged a reduction in the public administration’s annual running costs of 5,500 billion lire (about 2.8 billion euro), to be achieved by means of the centralization of public administration purchasing, online auctions, and the introduction of the Internal Stability Agreement (whereby both regions and local authorities aim to reduce the public administration’s deficit). From the point of view of public expenditure, therefore, the government had already announced at the end of June 2001 that it had introduced measures to reduce ministerial spending on goods and services by 10 percent. In August of the same year, an agreement was reached with the regions to increase the national health service fund, while at the same time the regions agreed to work harder to avoid exceeding spending targets, as this invariably means increasing local taxes or reintroducing payment for medical prescriptions and services.

The same Amato government, in its 2001 budget, envisaged the sale of property belonging to national insurance funds for a total of 7,500 billion lire (approximately 3.8 billion euro). The Berlusconi government has tried to speed up receipt of this sum by arranging for the financial system to advance income from future sales (in technical terms, the securitization of property values). Moreover, in attempting to contain the 2001 deficit, the government has obtained the financial markets’ agreement to advance the earnings from the state lotteries envisaged for the 2002–2004 period.

Given that the European Commission has since intervened in these operations, further technical details are required at this point. As regards the above-mentioned properties, in order that it be in financial brokers’ interest to advance the said sums, a discount on the value of the properties themselves has to be offered. Due to the excessive discount offered to the brokers, Eurostat (the European Union’s statistical institute) has deemed such an operation to be a financial rather than a real transaction (the latter being one in which ownership of the property is actually transferred from the state to a new owner). In July 2002, Eurostat consequently ruled that the operation is to be considered a reduction of the debt as a result of the funds received, but not a reduction of the budget deficit; it will be considered a reduction in the deficit only in the year in which ownership of the property actually changes hands.

As regards the advance against lottery revenue, in the same July 2002 ruling, Eurostat declared this to be a method of reducing the

public debt—since it constituted the exchange of present revenue against entitlement to future revenue from lotteries—but could not be deemed a method of reducing the budget deficit. In reality, this advance differs from the advance against revenue from the sale of state property in that it clearly constitutes an extreme form of “creative” accounting. Surely, the public debt is the transfer of the right to receive a part of future revenue without specifying which form of revenue in particular.

As a consequence of Eurostat’s decision, the Italian public administration’s accounts at the end of 2001 showed a deficit of 2.6 percent of GDP, compared with the 1 percent initially forecast by the Amato government and the 2.0 percent forecast by ISTAT in February 2002, net of the above-mentioned operations. In order to correctly evaluate a fundamentally important political step in our analysis of the Berlusconi government’s economic policy, we need to estimate just how much of the public sector deficit in 2001 can be ascribed to the policy of the previous Amato government.

Of the above-mentioned 2.6 percentage points, 0.4 is due to the failure to calculate the sale of the said state properties. A further 0.4 of a percentage point is accounted for by the slower growth in GDP.² From this we can deduce that the deviation from the deficit target set by the Amato government that is specifically attributable to management of the budget amounts to 0.8 percent of GDP, that is, approximately 9.5 billion euro. In my opinion, this is the actual figure of the so-called budget “gap,” rather than the 19 billion euro referred to on various occasions by Berlusconi’s government in an attempt to explain why all of the measures promised in the electoral program have not been implemented as such.

The main reason for the increased deficit is the fact that expenditures, of which approximately one billion euro can be accounted for by increased health service spending on medicines due to the abolition of prescription charges, have been greater than what was forecast.

The First Year of Full Responsibility for Economic Policy: 2002

Paradoxically, 2002 was a year in which the budget benefited from Eurostat’s ruling on financial advances against future revenue. In fact, the advances collected in 2001 against the future sale of properties were not registered in the accounts for that year, but in those for 2002 when the properties themselves were in fact sold. The latter sales were added to the revenue from the financial advances against

further property sales already planned for 2002, which, having been obtained in the way prescribed by Eurostat, can be calculated as a reduction of both the public debt and the budgetary deficit.

Despite this encouraging aspect, the government's objectives remain at odds: a reduction in taxation and an increase in expenditure are incompatible with a reduction in the budget deficit. In fact, this is exactly what has emerged: during the course of 2002, the public administration's deficit amounted to about 2.3 percent of GDP, just a little lower than it had been in 2001. This occurred despite the presence of "extraordinary" revenue amounting to almost 1 percent of GDP: 2.2 billion euro in tax amnesty payments on returning capital, and 6.6 billion euro of advanced revenue against the sums due from the sale of properties envisaged in 2002 and the collection of payment for those sales programmed for 2001 and carried out in 2002. Without these transitional measures, the public sector deficit for 2002 would have been 3 percent of GDP. Nevertheless, account must also be taken of the fact that economic growth in 2002 was significantly slower than had been forecast by the government when it was drawing up its budget. As already indicated, GDP in 2002 grew by approximately 0.4 percent. Originally a growth of 2.2 percent had been forecast; this figure was subsequently lowered to 1.3 percent and then, in November, to 0.6 percent. A drop in GDP of 1.8 percentage points means a public sector deficit that is 0.9 percentage points higher. From this we may deduce that during the course of 2002, the structural public sector deficit, net of the effects of the negative economic trend and without taking into account the "extraordinary" revenue, was 2.1 percent of GDP. In other words, this is what we are left with at the end of 2002, regardless of the economic situation in general.

This was the development of budget policy during the course of 2002. The legislative measures by means of which this policy was implemented derive from the 2002 budget passed in December 2001. This budget remodeled the income tax allowance—introduced by the previous government—for the year 2002; it raised the monthly pension of nearly one and one-half million pensioners to 516 euro, nearly half of whom already received approximately 480 euro a month; it implemented the reform of those procedures whereby various public administrations purchase goods and services; it introduced measures designed to contain health authority and local authority spending.

The budget was accompanied by a number of associated decree bills; those dealing with the reform of the tax system and of social security have yet to be passed. The government introduced a number of

measures during the course of the year designed to keep the formation of the public sector deficit under control and to provide much-needed support to business. These measures included the following: additional incentives to those persons scrapping non-eco-friendly cars and buying new eco-friendly models; a government option to impose restrictions on centralized and decentralized government spending during the course of the year; the abolition of company tax incentives; and the abolition of incentives to employment and investment in the South of Italy (mentioned above).

In general, the government has managed budget policy with a mixture of naiveté and nervousness, and has upset companies' and families' expectations for the future more than the general economic situation itself seems to have done. At the same time, in trying for almost a year to elude its pledge to contain public spending, it has generated the suspicion that it was involved in unusual financial practices when it gave the go-ahead to instruments (of a plausible nature, in theory) such as the two above-mentioned corporations, Patrimonio S.p.a. and Infrastrutture S.p.a.

The Role Played by the Budget in the Berlusconi Government's Approach to Economic Policy

The features of the budget mentioned so far would seem to suggest that the pursuit of discontinuity with the actions of the previous government as an aim in itself has had a certain cost in terms of the public spending deficit, and it appears to have drawn public attention toward the need for a new phase of public spending reorganization. In fact, measures have been introduced for further permanent expenditure or relief that is not covered by an increase in other revenue or by permanent reductions in other areas of public spending, as government is counting on the fact that the economic "machine" will turn up a gear and increase the growth rate, thus providing substantial additional revenue. At the same time, it has been announced that the previous government left a "gaping hole" in public accounts. The present government, however, has not taken any consequent steps to remedy this, but has simply announced that the 2001 budget targets would nevertheless be achieved, and that in any case the public sector deficit would be cancelled within the year 2003. However, the forecast for 2003 sees a deficit, net of extraordinary revenue, of between 3 percent and 3.5 percent.

This discontinuity, which sees existing regulations eliminated without being replaced with an alternative framework, together with doubts

about the trend followed by the public sector deficit, could lead to the disorientation of companies' investment plans and families' consumption choices. We have already looked at the question of companies. As far as families are concerned, they have seen the problem of public finance maneuvering reappear on the horizon; in the last resort, this means either higher taxation or fewer services in the future. In truth, they had been promised a large-scale operation at zero cost—a "freebie" that, due either to short-sightedness or connivance with vested interests, previous governments had failed to see. Now the same Ministry of Economic Affairs that made this assertion is the one acknowledging that the dividend of economic growth is in reality of an extremely modest nature.

In fact, as is rightly claimed in the basic analyses underlying the 2003–2006 economic plan, the dividend of growth is that which derives from an increase in the growth of the *potential* product—not just that of the *actual* product. A 1 percent reduction in fiscal pressure, according to the Ministry of Economic Affairs' calculations, has to be covered by a permanent 0.92 percent reduction in expenditure;³ if the deficit has to be reduced, then the reduction in expenditure needs to be greater. In other words, a permanent reduction in taxation of, say, 13 billion euro, could be considered compatible with a constant deficit after a few years were public expenditure to be permanently reduced by 12 billion euro.

Declaring that the cancellation of the public spending deficit necessarily implies a reduction in the standard of living of families would certainly be a controversial move. Nevertheless, it is also true that in the past, announcements of governmental financial maneuvers invariably worsened (at least in the short term) families' faith in the economy and made them more cautious in their spending. Current announcements of a possible reduction in taxation tend both to generate greater uncertainty about the costs that families are going to have to bear and to lead one to envisage a redistribution of families' incomes, which would almost certainly be to the disadvantage of those with lower incomes.

At this point, what is left of the strategy for growth that the government intended to adopt? The original plan involved strong support for demand through tax cuts and investment in infrastructures, which in turn would also have legitimized the objective of eliminating the budget deficit as a result of accelerated growth. The revision of the quantitative and qualitative terms of that approach is contained in the "Pact for Italy" signed at the beginning of July 2002, and in the 2003–2006 economic and financial plan approved by Parliament at the end of that same month.

The “Pact for Italy”

The government's approach to the economy as a whole has been characterized by its intention to direct proceedings through the formulation of projects whereby the actions of independent market regulatory bodies are to be incorporated within government ministries. The government is also working toward the control of bank foundations by local authorities. Compared to the first of these two maneuvers, which is still in the planning stage, the second is already at an advanced stage, even though the objections to this plan submitted by the foundations themselves are much stronger than the government had originally expected.

Other measures adopted during the course of 2002 have seen the government declare an amnesty for a certain number of illegal immigrants living in Italy (approximately 700,000), its intention being eventually to create a situation wherein immigration itself becomes a temporary institution. From a strictly economic point of view, the effects of this measure need to be analyzed carefully in order to see whether they actually hinder the integration of those immigrants living and working regularly in Italy—in other words, to see that they do not act as a disincentive to the formulation of life plans by those immigrants, but on the contrary ensure that immigration contributes not only to the productive capacity of the economy but also to overall demand.

After the government had stated, during the course of 2001, its intention to formulate and introduce “new” economic policies, without having discussed the matter at all with the unions or the employers' organizations, it then proceeded to act in a rather “generous” manner when it came to pure wage negotiations, albeit in an attempt to try to obtain the necessary support for the formulation of its social policy lines. It also took advantage of the chance it had, on the one hand, of dividing the unions on the proposed modification of article 18 of the Workers' Statute and, on the other hand, of obtaining some form of exchange involving union support for its social policy and its own willingness to offer the CISL and the UIL (two of the three main trade union federations) a role in the distribution of social benefits. In doing so, it hoped to give the overall impression that the said unions were to have a functional role within the greater social body.

The two fundamental moments in this discourse consisted of the agreement on the increase in funds to be made available for the renewal of public service employment contracts at the beginning of 2002, and the “Pact for Italy,” which was signed at the beginning of July 2002. The second significant element of discontinuity in the

government's management of economic policy emerges when reading between the lines of the "Pact for Italy."

During the 1980s, the abolition of the sliding wage scale, the suspension of company-level wage bargaining, and the blocking of wage increases in the public sector together constituted the premises for the 1992–1993 agreements establishing the procedures for national and company-level wage bargaining, which entailed the acceptance of wage-claim moderation (designed to encourage disinflation) in exchange for participation in the choice of economic policies to be adopted. The latter was to involve the sharing of the objectives and instruments set out each year in the economic plans and the sharing, in extraordinary circumstances, of specific decisions concerning the reform of the labor market, of health care, and of the pensions system.

During the 1996–1997 period, the principal common objective underlying the agreements reached between the government and the unions was that of the single European currency. The same period saw the growing involvement of representative groups. The various associations representing craftspersons, shopkeepers, small companies, and farmers were all involved, from September 1996 onwards, in talks on a jointly agreed modification of the tax system and the creation of increased loyalty to such a system on the part of these professional groups.

Once the single European currency had been agreed upon, unanimity on which macro-economic objectives to pursue began to crumble, although the planning framework itself was further enlarged to take in a wide range of representative bodies. A compromise was reached in the form of the Employment Pact signed on Christmas 1998. The unions accepted wage-claim moderation in exchange for a planned reduction in income tax and a series of measures designed to aid employment. Small and large employers' associations were offered a program designed to reduce gradually the cost of employment by 0.8 percent a year for at least three years, together with a reduction in business income tax rates and a series of incentives to investment, which were to be re-enforced in the case of investment in the South of Italy. All of these measures were adopted with the approval of the 1999, 2000, and 2001 budgets.

The Pact for Italy (or "pact for competitiveness"), signed after the government had submitted delegated bills to Parliament on tax reform, employment, and social security, appears at least to be proceeding along the same lines of 1998. In truth, apart from the multitude of generic terms it uses in referring to a multiplicity of topics, only three immediate specific targets of a rather limited nature are in fact mentioned: a slight reduction in taxation, an increase in unemployment

benefits, and the revision of article 18, together with a hint of a medium-term measure—the abolition of the public sector's role as social insurance intermediary.

The reduction in personal income tax, in addition to the reduction already due, amounts to approximately two billion euro. Of the 5.5 billion euro envisaged by the agreement, 3.5 billion were already due as a result both of the previously planned reductions contained in the 2001 budget and of the effect of fiscal drag deriving from the fact that inflation in 2002 once again exceeded 2 percent. As far as companies are concerned, the 2 percent reduction in business income tax is an increase of 1 percentage point on that already envisaged by existing legislation, while the reduction in regional taxes appears a merely symbolic measure. Overall, the new resources made available by the government amount to approximately 3.3 billion euro. Such a generalized form of action can hardly be conceived of as being actually capable of stimulating consumption and reducing income disparity. A little more uncertainty about the future and a slight increase in the propensity to save for that future would automatically nullify the effects of this small increase in disposable income.

The other concrete measure, that is, the increase in unemployment benefits of up to 700 million euro, not only forces the government not to pay the hypothetical contributions beyond the sixth month of unemployment, but also fails to get to the very heart of the problem. Despite the well-meaning intentions contained in the wording of the pact, this measure fails to change the prospective beneficiaries of unemployment benefits. If there is a problem that needs to be resolved regarding the present social benefits system in Italy, it is the segmentation of the mass of potentially insured parties and the need to provide coverage from the risk of unemployment to the growing numbers of casual workers.

Conclusions

The economic policy framework submitted by the center-right to the electorate and accepted by them is summarized in the first official document presented by the new government, the 2002–2006 economic plan entitled “From Decline to Growth.” Growth was to be the result of shock therapy: fewer taxes designed to free the economic system from the burden of taxation, together with increased public spending on infrastructures (both these factors, in fact, slow the economy) and higher minimum pensions, intended to win the support of the poorer segments of society.

Growth perceived in this way was to provide the means with which to pay for the reduction in taxation and increased public spending without worsening the plight of the national budget. The project was probably more desirable than plausible, and this has since proven very much to be the case. The “excessive deficit” that the present government declares it inherited from the previous one, together with the rapid worsening of the economic situation, although constituting contraindications to the implementation of this project, only partially justify the emergence of its impossibility.

In the 18 months between the May 2001 elections and the end of 2002, the government, by persisting with an impossible program, has lost the chance it had at the beginning of the present parliamentary term to implement structural public spending cuts designed to create the necessary breathing space for permanent reductions in taxation. In order to honor its pledge to reduce the public deficit and debt, the government will have to take these measures as of the next budget (for the year 2004).

However, 2004 marks the beginning of a three-year period in which there are to be European elections (2004), regional elections (2005), and a general election (2006). For this reason, a rational analysis of the objective role of government has led some observers to conclude that it would be in the government’s best interest to create the premises for an early general election (in 2004). Nonetheless, there are no signs at present to suggest that such a linear approach is being taken.

— Translated by Patrick John Barr

Notes

1. Ministero del Lavoro e delle Politiche Sociali, *Libro bianco sul mercato del lavoro in Italia* (Rome, 2001), 9.
2. In fact, during the course of 2001, GDP grew by 1.8 percent, compared with 2.5 percent under the Amato government, a difference of 0.7 percentage points. Given that a deficit elasticity of 0.5 in the presence of failed growth is normally taken into account, the trend would explain 0.3–0.4 percentage points of the increased deficit.
3. $0.92c = 1 - (0.2 \times 0.4)$, where 0.2 is the increase in potential GDP resulting from a 1 percent reduction in taxation, and 0.4 is fiscal pressure.