BANCA D'ITALIA

# ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY 1999

**THE GOVERNOR'S CONCLUDING REMARKS**

Ladies and Gentlemen,

As Head of State during a seven-year term that was marked by economic and institutional instability in Italy, Oscar Luigi Scàlfaro worked, as the country's supreme guarantor, to ensure Italy's prestige in the international community.

He defended the Constitution.

In times of difficulty for the central bank, he reaffirmed its function and independence. He upheld the sound management of the currency and the protection of savings, a constitutional obligation.

The Bank of Italy pays homage to him and to his achievements.

On 13 May Parliament elected as President of the Republic Carlo Azeglio Ciampi, Governor of the Bank from 1979 to 1993.

His appointment to the highest office of State crowns a life committed to serving public institutions and the common good.

As it strives to complete and consolidate the economic renewal which he helped to formulate, the country can yet again rely on his eminent gifts of wisdom, balance and rectitude.

The Bank of Italy, which he led with authority, is confident that in performing his role as guarantor of the Constitution he will inspire confidence in the civil and economic progress of the country.

The euro has been the single currency of eleven European Union countries since the beginning of this year. The Bank of Italy is an integral part of the European System of Central Banks. Our institutional responsibilities are becoming more demanding and complex.

In monetary and exchange rate policy, the Bank is called upon to perform a dual function: to take part in the deliberations and decisions of the System and to implement measures at national level in accordance with the principle of subsidiarity.

The coming into force of the Consolidated Law on Financial Intermediation has widened and increased the Bank's responsibilities for the supervision of intermediaries and market surveillance.

In the payment system, the national gross settlement procedures were swiftly and efficiently integrated into the European TARGET system between the end of 1998 and the beginning of this year. The systems for recording and monitoring payments have been overhauled. The Bank is preparing for the production of banknotes denominated in euros, which will come into circulation on 1 January 2002.

In the autumn of last year the Bank took on responsibility for central treasury operations on behalf of the State. During the same period government securities were dematerialized.

We have carried out a wide-ranging reorganization of the Bank's central administration in the areas of central banking, markets and payment systems. The importance attaching to the independent protection of competition in the banking sector, supervision of the payment system, market surveillance, support for international relations and research in the field of economic law has been confirmed and emphasized.

The Italian Foreign Exchange Office has become an agency of the Bank for the management of the official foreign exchange reserves. The measures required to consolidate the new relationship between the Bank and the Office have been completed.

All sectors of the economy have to take effective action to adapt their data-processing systems and procedures to cope with the change of millennium. The Bank of Italy has long urged and encouraged banking and financial institutions to take steps in this direction.

The transfer of important departments to the Donato Menichella Centre in Frascati is nearing completion. The area in which the Centre is situated boasts several authoritative academic and research institutions; it is becoming a magnet for the development and production of advanced services. The complement of infrastructure, which the public authorities will not fail to complete, will contribute to the development of Rome and its metropolitan area.

The Bank is contributing expertise and ideas on an increasing scale in domestic and international fora. It is playing a valuable part in the reform of company law.

The Bank systematically reports on its actions and the reasons for its decisions to Parliament and other official institutions and in its publications.

The staff of the Bank, both at Head Office and in the branches, have once again demonstrated their ability to meet demanding objectives. The Directorate and the Board of Directors extend their sincere thanks to all the Bank's employees at every level and grade.

## *The world economy*

The growth of the world economy, which came to 2.5 per cent in 1998, is still being held back by the effects of the crisis that erupted in Asia in 1997. Spreading to Russia and Latin America, the crisis led to a discernible slowdown in growth in Europe as well from the middle of last year onwards.

The epicentre of the instability is Japan. In the nineties the rate of growth of the Japanese economy fell sharply, and grave problems emerged in the banking system. The launch of a rigorous plan for the structural adjustment of the public finances led to a contraction of domestic demand in the second quarter of 1997. Industrial output fell by 7 per cent in 1998. Gross domestic product declined at an annual rate of 4 per cent in the first half of the year in relation to the preceding period and 2 per cent in the second. Deflation became more pronounced.

Short-term interest rates were brought down to almost zero, and long-term rates fell to 1.3 per cent. A switch to an expansionary fiscal policy and an increase in liquidity brought relief for the banks but failed to revive investment and consumer demand.

The other Asian economies, which for several years had displayed external payments deficits, rigidity in exchange rate policy and shortcomings in corporate governance and banking supervision, sought to achieve new equilibria by curbing domestic demand and drastically devaluing their currencies. Their current accounts returned to surplus in 1998, helping to arrest the crisis in financial markets.

The slowdown in world demand induced a sharp fall in the prices of raw materials, adversely affecting the income of producer countries.

The economy of the United States, in its eighth year of uninterrupted expansion, grew by 3.9 per cent in 1998. Employment increased by 2.6 per cent and the unemployment rate declined to 4.2 per cent, its lowest level since the seventies.

The source of this good performance is a virtuous combination of rapidly growing high-technology investment, productivity gains, ample resources and labour market flexibility. The growing US current account deficit was readily financed, thanks partly to monetary expansion in Japan and capital inflows from the areas in crisis.

The dollar has appreciated steadily since the end of 1996; share and bond prices have risen very substantially; the cost of finance for productive investment has fallen.

Inflation diminished still further in 1998. Some pressures emerged in the early months of this year in connection with the rise in oil prices, the further expansion of domestic demand and a tightening of the labour market.

After decades of deficits, the federal budget recorded a surplus, thanks primarily to continuing economic growth.

Monetary policy became more expansionary in the latter part of 1998, easing strains in the international markets and helping to defuse the crisis in Latin America. Economic activity also strengthened. The recent upward pressure on prices and costs led to the announcement of a possible raising of interest rates by the Federal Reserve.

World economic growth was nearly 2 percentage points less than in 1997, owing to a contraction of about 3 per cent in Japanese GDP, slower growth in the rest of Asia and in Latin America, and difficulties in the countries of Eastern Europe.

World trade rose by 3.3 per cent, compared with 10 per cent in 1997.

Gross domestic product in the euro area increased by 2.9 per cent, compared with 2.5 per cent in 1997. Inflation slowed further as a consequence of the fall in commodity prices. The unemployment rate declined but remains two-and-a-half times as high as that of the United States.

A cyclical slowdown began to be perceptible in Europe in the second half of 1998, especially in Germany and Italy, and has become more pronounced in the first few months of this year. Following the interest rate reductions of 1998, the Eurosystem lowered the refinancing rate further in April, from 3 to 2.5 per cent.

The sluggishness of economic activity is having an adverse effect on the public finances. It must not be allowed to postpone achievement of the budgetary balance required by the Stability and Growth Pact, which is necessary to the stability of the currency.

Forecasts indicate a slowdown in the growth of activity in the industrial countries this year. In Europe the growth rate is expected to decline to 2 per cent. The world economy appears to have reached the bottom of the cycle during the last few months.

A definitive resolution of the financial crisis and a return to higher rates of world economic growth can be achieved only if there is an acceleration in activity in the European Union, continued growth in North America, albeit inevitably at a slower rate, and above all the beginnings of recovery in Japan.

International economic organizations forecast an acceleration in the pace of economic activity and world trade in 2000.

As the Finance Ministers and central bank Governors of the Group of Seven countries emphasized at their meeting in Washington last October, investment spending in Europe must be increased. Structural budget reforms and the elimination of labour market rigidities are indispensable. In Japan, domestic demand needs to be revived by means of effective expansionary fiscal measures.

## *The problems of the European economy*

The robustness of growth in the United States and the weakness of the European and Japanese economies, and the disparity in their respective abilities to generate output and employment are reflected in the nature and growth of investment.

Between 1990 and 1998 gross fixed investment in the United States increased at an average annual rate of 5.8 per cent, more than twice the pace of the previous decade, and rose from 13 to 17 per cent of GDP. In Japan investment contracted by 1.8 per cent a year, compared with an average annual increase of 6.8 per cent in the eighties. In the euro area investment growth had been rapid in the eighties, but it slowed to 0.6 per cent a year in the nineties. The gap between the United States and Europe in investment in machinery, equipment and transport equipment is even wider.

The capital stock per employee has risen only slightly in the United States, since employment has increased. In Europe, where employment has stagnated, it has risen considerably, although it is still lower than in the United States. Capital intensity is especially high in Japan.

In the United States the number of persons in employment has risen by 1.8 per cent a year in the nineties. In the euro area it has remained broadly unchanged; in Germany and Italy it has declined. Between 1990 and 1997 Japan recorded an average annual increase in employment of 0.7 per cent; in 1998 there was a contraction for the first time in decades.

In the three largest continental European economies, investment began to decline in relation to GDP at the end of the sixties. A contributory factor was the steady reduction in construction investment. Productive investment was concentrated in manufacturing, which accounted for about 40 per cent of the total.

In the United States 30 per cent of investment is in industry, while the share in services is very high. In all sectors investment in information technology is increasing rapidly and now accounts for about 30 per cent of the total.

In Japan the ratio of investment to GDP touched 33 per cent in the past and is still very high at around 30 per cent, comparable to the levels witnessed in many Asian countries during the phase of rapid industrialization.

Japan appears to have an excess of productive capital, due partly to the low cost of borrowing over many years. Enormous productivity gains averaging 5.6 per cent a year from 1950 to 1990 enabled the country to increase its share of total world exports very considerably, leading to the progressive accumulation of net financial assets vis-à-vis the rest of the world. The outlook for growth is more uncertain now, given the slower growth of world demand and the steadily increasing proportion met by the newly industrializing economies.

The European economy, given the size of its medium-technology industries, is more vulnerable to competition from these countries, which can take advantage of their much lower labour costs, lower taxes and less restrictive regulation of economic activity.

In Italy, as in Germany and France, the cost of labour is affected not only by higher net wages but also by a tax wedge of about 50 per cent consisting of income taxes plus employers' and employees' social security contributions. In Spain the tax wedge is smaller, at 40 per cent; in the United Kingdom and the United States it is lower still. It is high in the Scandinavian countries, which like the three large continental countries provide a high level of social protection.

In Europe, in response to the oil shocks and wage pressures of the seventies and eighties, investment was directed largely towards restructuring plant. In the long run it became evident that the economy was incapable of creating jobs. The inadequacy of measures to remove structural rigidities and the lack of flexibility in the utilization of productive factors impeded the deployment of the resources released by the reduction of budget deficits.

The uncertain prospects for growth have lowered the propensity to invest. The decline was due in part to slower demographic growth and the ageing of the population. Terms of employment, labour costs and high taxation are reflected in Europe's low participation rate of 68 per cent for the population of working age. The United States has a far higher rate of 79 per cent; Italy's rate of 59 per cent is one of the lowest in the industrial world.

Economic growth in Europe and in Italy depends crucially on the ability to compete within the global economy.

Competitiveness cannot be improved by emulating the kind of social and economic arrangements to be found in emerging countries. Greater resources must be allocated to investment in research and technological innovation and to training. Output must be shifted towards services. The size and composition of government budgets must reinforce the potential for economic growth. The regulations governing business activities must be streamlined. The efficiency of the public administration must be increased.

## *International liquidity and finance*

Global financial assets have grown much more swiftly than the world economy since the second half of the eighties.

Between 1985 and 1990 the volume of bonds in circulation, consisting largely of government securities, doubled to $15,000 billion in the Group of Ten countries. The value of listed shares increased more rapidly, from $2,800 billion to $6,300 billion, reflecting the rise in stock exchange indices. The combined value of bonds and shares rose from 122 to 134 per cent of the GDP of these countries. The pace has accelerated in the nineties: in 1997 the ratio rose to 220 per cent and the value of shares to $16,000 billion.

Held in check by increasingly stringent monetary policies, money supply growth in the industrial countries has been broadly in line with the increase in output.

The restrictive stance of monetary policies in the nineties, the far faster expansion in financial assets than in the money supply, the growth in financial transactions and greater asset price volatility have fostered a rapid increase in derivative products, the notional value of which rose from 26 per cent of world GDP in 1990 to 128 per cent in 1997.

Derivatives increase the ability to manage risk; they augment the velocity of circulation of domestic and international monetary instruments and hence the liquidity of the world economy; they have provided scope for a large increase in trading in the securities and foreign exchange markets. In the event of a crisis, they can heighten systemic instability.

The improvement in public finances, the reduction in expected inflation and, in the last two years, the slowdown in economic activity have caused nominal and real interest rates to fall throughout the world.

Declining bond yields and increased liquidity partly explain the high levels that share prices have reached. The low cost of capital and the inflow of financing have contributed to the growth of productive investment in the United States.

During the eighties the liberalization of short-term capital movements fueled a surge in cross-border bank deposits; an abrupt halt occurred at the beginning of the nineties in conjunction with the slowdown of the world economy and the drastic fall of share and property prices in Japan.

The decline in nominal short and medium-term interest rates in the early nineties was more pronounced in Japan and the United States. In the four years from 1991 to 1994 net outflows of bank capital from Japan amounted to $220 billion, equal to around half of the surplus on the current account of the balance of payments. The industrial countries absorbed half of these funds; the other half was redistributed to the emerging countries by the seven offshore centres reporting to the Bank for International Settlements.

Beginning in 1995, after the Mexican crisis, monetary expansion was boosted in Japan in order to correct the excessive appreciation of the yen and the depreciation of the dollar. The further reduction in interest rates and the increase in the supply of yen caused the Japanese currency to fall sharply and the dollar to rise from the summer onwards.

In the three years from 1995 to 1997 the net flow of financing in the form of Japanese bank loans to offshore centres and industrial countries amounted to $110 billion and $100 billion respectively. Almost all of these funds were redistributed to the emerging economies, first and foremost those in Asia.

The increasing indebtedness of those economies, the fall in demand in Japan in mid-1997 and the appreciation of the dollar sowed the seeds of the Asian crisis.

Monetary impulses are transmitted worldwide by the major players in the global market, which raise funds where liquidity is most abundant and invest them in bonds and shares, partly through the use of derivative products. Highly leveraged institutions have become especially important. Changes in the composition of their portfolios can destabilize even medium-sized economies. The withdrawal of the funds invested in the emerging economies of Asia aggravated the crisis and further increased the value of dollar-denominated assets.

In the first half of 1998 capital outflows from the emerging countries intensified, with those of bank capital reaching $30 billion. The outflow from

Japan also increased. The funds were absorbed primarily by the United States.

The rouble crisis in August led to a further contraction in the flow of financing to the areas in difficulty, accentuating the pressure on the currencies and financial markets of Latin America. Over the summer funds continued to be withdrawn from the countries of Eastern Europe and to flow towards the United States; the outflow from Japan abated.

The financial turmoil in late August also affected the European currencies.

The signs of recovery in Asia strengthened in late 1998 and the early months of this year, whereas the crisis in Latin America had not yet been fully overcome. Monetary conditions began to be eased in the countries with the highest interest rates.

## *The architecture of the international financial system*

Global finance, with its enormous volume of transactions, is a key factor of efficiency in the allocation of resources, but it can also be a source of instability for the world economy.

The interventions by the International Monetary Fund in Korea and other Asian countries in 1997 and in Brazil in 1998 and at the beginning of this year, and the concerned attention it has paid to the development of the grave situation in Russia have prevented the crises from deepening and spreading, and thus from affecting world financial stability.

The action of the IMF has been aimed first of all at eliminating each economy's imbalances in its public finances and towards the rest of the world. Increasing weight is being attributed to the correct allocation of credit, to be achieved and maintained through the separation of banking from the productive sector and the public authorities. Countries are being asked to establish effective systems of banking and financial supervision and adequate corporate governance and bankruptcy procedures.

The activity of the Basle Committee for Banking Supervision has intensified since the Mexican crisis. The proposals for revising the Accord on banks' capital adequacy seek to allow a more precise measurement of credit risk by using methods developed by banks themselves or ratings from specialized firms. Criteria for the internal organization of banks and for the public disclosure of information have been defined.

A coordinated effort is being made by the Basle Committee, the IMF and the World Bank to encourage the introduction and ascertain the application of the international supervisory standards in all countries, and particularly in the emerging economies.

The rapid growth in the use of derivative products has made the situation of some categories of institutional investor precarious by allowing high degrees of leverage to be reached. In order to limit the systemic risk, banks must assess the creditworthiness of these investors carefully; it will be necessary to ensure the transparency of the total risk assumed. These are the requirements for preventing such investors from being transformed from agents of global resource allocation into causes of instability.

The debate on the appropriate degree of regulation and supervision is under way.

The new forms of intermediation are often based in offshore centres, where rules and prudential supervision are either lacking or absent and taxation is low.

The Group of Seven countries has established a Forum for world financial stability, in which representatives of the financial ministries, central banks and market supervisory authorities of these countries will take part. The offices of the chairman and secretariat are at the Bank for International Settlements in Basle.

Attention is being focused on the behaviour of highly leveraged institutional investors, short-term capital movements and offshore centres.

The results will be examined at the forthcoming meeting of the International Monetary Fund in the autumn.

In response to the need to give preventive support to economies that are at risk of contagion but are still basically sound, a new precautionary intervention instrument has been created at the IMF. The available credit will be disbursed at punitive interest rates. The direct involvement of the private sector will be a condition for the granting of credit.

In the background there remains the problem of the size and responsiveness of international financial flows, of the potentially unlimited ability of the financial markets to multiply credit and money.

The structure of international finance is evolving along lines that we prefigured and that recall the developments in the national financial and banking systems in the early decades of this century. Those developments led to a redefinition of central banks' responsibilities, instruments and sphere of autonomy. In the appropriate international fora and on other occasions, we have called for a strengthening of the analytical and operational functions of the IMF and the World Bank.

The creation of the European System of Central Banks and the single currency can make a significant contribution to monetary stability in Europe and consequently at the global level. It is essential that the structure of the budgets and the flexibility of the participating economies be consistent with this objective.

### *The banking and financial system*

The Italian banking and financial system is becoming ever more integrated into the world economy, although it still differs in size from those of other industrialized countries.

The ratio between gross financial assets and GDP in 1985 was 5.7 in the United States, 6.4 in Japan and 7.6 in the United Kingdom; it rose considerably in subsequent years. For the four largest countries in the euro area the ratio averaged 4.5 in 1985 and gradually rose to 6.8; in Italy it is 5.5.

The growth of the Stock Exchange is still constrained by the low propensity of medium-sized and large firms to seek listing and the large number of small firms that do not raise finance in the market. The value of listed shares is equal to 45 per cent of GDP, compared with 48 per cent in Germany, 65 and 69 per cent in France and Spain respectively and 140 per cent in the United States.

In view of the limited recourse to supplementary pensions and the still high proportion of securities held directly by private investors, there is scope for an increase in intermediation. The high level of households' savings permitted the placement of a substantial and expanding volume of government securities; however, the growth of government expenditure and the rise in the budget deficit crowded out investment, especially in the eighties, with adverse effects on growth.

### *The balance of payments and capital flows*

The surplus on the current account of the balance of payments amounted to 62 trillion lire in 1996 and 61 trillion in 1997, or 3.2 and 3.1 per cent of GDP respectively. In both years the surplus was only partially matched by an improvement in the external position, as half of it was absorbed by the errors and omissions item. The composition of this item cannot be identified precisely; it consists partly of holdings created abroad by residents and not recorded in capital flows.

The current account surplus declined last year to 39 trillion lire, affected by lower net income from merchandise trade. It was completely offset by the errors and omissions item.

The abundance of liquidity in the international markets at a time of wide interest rate differentials was reflected in recent years in a sharp rise in foreign investment in Italian securities. In 1995 this amounted to 61 trillion lire, with the inflow occurring mainly in the second half of the year after the worst of the lira crisis had been overcome; it rose to 125 trillion lire in 1996 and remained close to that figure in 1997. Last year non-residents' purchases of Italian securities reached 188 trillion lire.

The fall in yields on Italian government securities, the narrow range of financial instruments available in the domestic market and the tendency for investors to diversify their portfolios have gradually led to an increase in outflows of capital.

Portfolio investment abroad by non-banks, which was insignificant in 1995, rose to 52 trillion lire in 1996 and 113 trillion in 1997. The balance between inflows and outflows was positive from 1995 onwards but was gradually eroded, turning negative last year.

Direct foreign investment by Italian firms is also increasing: from 9 trillion lire in 1996 to 17.5 trillion in 1997 and 19 trillion last year. Inward direct investment amounted to 4.5 trillion lire last year, a decline in comparison with previous years. At the end of 1998 the stock of direct investment abroad by Italian firms stood at 273 trillion lire, against investment in Italy by non-residents of 174 trillion.

Italian firms are displaying their ability to diversify and showing interest in markets with lower production costs and more favourable prospects for an expansion in sales; however, this also to some extent entails a relocation of production, even to advanced economies. Italy's ability to attract investment remains poor.

As in Germany, there are differences in costs and taxation even vis-à-vis other European countries. In Italy conditions are affected by the complexity of regulations on business activities, the poor level of infrastructure, shortcomings in public services and the low efficiency of the public administration.

In an economy that is totally integrated in the European and international financial system, the abundance of savings that has always been a distinguishing feature of the Italian economy is declining in importance as a factor for growth.

The ability to turn savings, whether formed in Italy or abroad, into productive investments able to guarantee the security of those savings, generate adequate yields and encourage growth and employment is even more important than it was in the past.

The persistent weakness of domestic demand, pockets of unemployment, the surplus on the external current account and the growing capital outflows point to the presence of structural factors hindering the use of savings for investment purposes.

## *The equity market*

The smallness of the stock market is an indicator of the shortage of securities representing the ownership of firms and limits opportunities for portfolio diversification.

The strong growth in managed savings has fostered capital investment abroad. In 1998 residents' share transactions abroad generated a net capital outflow of 19 trillion lire. Italian investment funds are investing one third of their assets in the international markets and 60 per cent of the shares they hold are foreign.

The increase in the capitalization of the stock exchange from 31 to 45 per cent of GDP last year can be attributed essentially to the rise in share prices. Issues of new shares by existing listed companies amounted to 0.7 per cent of GDP, compared with an average of 0.4 per cent in the three years from 1995 to 1997.

The value of Italian firms admitted to listing last year, excluding those migrating from the second market or emanating from changes in the structure of listed companies, amounted to 0.8 per cent of GDP, compared with an average of 1.2 per cent in the three previous years. At the end of last year the number of listed firms was 223, the same as in 1994.

Important regulatory changes have been made in recent years to foster the expansion of the Stock Exchange and tax incentives have been granted to encourage listing. Far-reaching measures affecting the organization of the market have been taken; the transparency and liquidity of operations have increased considerably.

The commencement of trading on the recently established market for small innovative firms, which forms part of a wider European network, will help to increase the supply of securities.

The capital market needs to expand further and the stock exchange must be adapted to the importance of the economy.

Steps must be taken to remove the competitive disadvantages, most of which are of a tax nature, that have induced many intermediaries, including a number of major banks, to invest heavily in and move highly skilled staff to other financial centres within the euro area.

Italy’s complete openness to international competition means that firms and banks must react swiftly to the new scenario.

## *The structure of the banking system*

The relative underdevelopment of the Italian financial system is also reflected in the volume of banking business in relation to the real economy.

The ratio of banks’ assets to GDP is 145 per cent, and it has fluctuated around this figure since the beginning of the eighties. In Germany the ratio was 140 per cent in 1980 and is now almost 270 per cent; in France it rose from 180 to 240 per cent over the same period. One of the reasons for the larger volume of business in other banking systems is a higher level of interbank activity; the disparity nonetheless remains considerable even when the comparison is based only on the volume of deposits and loans.

The number of banks has declined throughout Europe. In Italy there were 1,156 in 1990; today there are 921.

Consolidation in the banking sector has intensified in the nineties. Excluding operations carried out within existing groups, mergers and acquisitions up to 1998 involved 432 banks accounting for one third of total bank assets. Another 25 banks were involved in similar operations in the first five months of this year.

Despite these operations, the major Italian banks are still small by international standards. Within the European Union the five largest Italian banking groups have a market share of 5.3 per cent, far smaller than those of the leading German, French and British groups, which are 13, 12 and 10 per cent respectively.

In view of the need to create Italian banks able to compete in the euro area, we have consistently encouraged mergers between leading intermediaries. Spurred by competition, three such operations between highly efficient and profitable large banks were completed in the last two years. Two major operations were carried out in the South to deal with situations of instability.

Foreign banking and insurance groups have invested significant amounts of capital in mergers and privatizations. The entry of leading German, French, Spanish and Dutch companies not only strengthens the capital base but also fosters the exchange of financial skills and techniques that can benefit innovation and the growth of the market.

Foreign capital has contributed to the creation of stable and sufficiently broad core groups of controlling shareholders able to define effective strategies.

The process of concentration between major banks must continue; it must make it possible, on the basis of adequate negotiating strength, to establish equity and operational links with leading European banks in order to permit an expansion of business in the international market.

The sale of controlling or significant shareholdings in banks owned by the State and banking foundations continued at a rapid but orderly pace. The market share of banks in the public sector has fallen from 68 per cent in 1992 to 17 per cent.

Of 70 banks that were formerly savings or pledge banks, 38 are still controlled by the original foundations. Almost all are small and their volume of business amounts to 7.7 per cent of the total.

The new regulations for restructuring the foundations allow an appropriate period for them to relinquish control. Privatization can be accomplished in the time and manner deemed most favourable. As with earlier major operations, it can increase their capital base by bringing in new shareholders.

## *Profitability and prospects*

The advent of the euro has further increased competition in the collection and lending of savings. The sound and prudent management of banks calls for the supply of high quality services at competitive costs.

In the last two years progress has been made in the management of households' savings. There remains scope for significantly greater earnings from business services.

In order to increase profitability and strengthen the stability of the banking system, two years ago we took a special initiative to heighten management's awareness of the need to reduce labour costs, both overall and per unit of output.

In February of last year, the Italian Bankers' Association and the trade unions reached an agreement aimed at reducing costs to the average for the other leading European countries over the four following years.

Ensuring the operational efficiency and soundness of broad sections of the banking system and safeguarding an adequate level of employment in the sector require firm action to reduce costs and increase competitiveness. It is necessary to complete negotiations on contracts that expired some time ago and closely correlate costs per employee to the productivity and profitability of each bank.

The Italian banking system, which is well-capitalized overall, was able to weather a period of serious instability in the nineties. The banking systems of many industrial countries had to cope with similar difficulties. In Italy the cost to the public purse of covering losses was small by comparison with that borne by other governments.

Although there was marked and asymmetric dispersion around the mean, banks' return on equity fell from 10 to 1.7 per cent between 1990 and 1997. The 1993 recession, the suspension of special assistance for Southern Italy, the crisis in the southern economy, loan losses and the lag in reducing costs in the face of rising competition all played a role in the decline.

The figures for 1998 show a recovery in the rate of return to 7.8 per cent, with about one percentage point of the increase being attributable to recent tax changes. A number of non-recurring factors also contributed, such as the realization of large capital gains on government securities. Income from asset management services for households also increased sharply.

Net interest income was affected by a further narrowing of the spread between lending and deposit rates, which was partly offset by an increase in lending. The average rate on short-term loans fell from 9 per cent at the end of 1997 to 5.7 per cent in April of this year.

Loan quality improved.

The flow of bad debts fell from 2.0 to 1.6 per cent of lending. Although credit risk for banks in the South was considerably lower than in the recent past, it is still higher than in the rest of the country; new bad debts in the region equaled 3.4 per cent of lending.

Operating costs continued to rise in 1998, despite a 1.3 per cent reduction in bank staff. The number of employees has fallen by 6 per cent from its peak in 1993 to 338,000 at the end of last year.

The reduction took place in the context of mergers and restructuring operations; to a large extent it involved voluntary incentive schemes for personnel close to retirement.

Annual labour costs per employee amounted to 118.4 million lire in 1997, 25 per cent higher than the average for the other European banking systems. In 1998 they declined to 114.2 million; the abolition of health service contributions, which were incorporated into the regional tax on productive activities, generated savings of 6.6 million.

The rationalization plans launched by major banks set ambitious objectives for the years to come. Achieving these goals will require a significant reduction in unit labour costs and a considerable increase in revenues from services.

Two years ago we indicated that Italian banks should aim to raise their return on equity towards the median for the other leading continental European countries, which was then around 7.5 per cent. In the meantime profitability in other major industrial countries has increased. The Italian banking system must consolidate the results obtained in 1998 and make further progress.

## *Supervision*

The complex nature of the organizational arrangements and the financial instruments used in banking have made it necessary to refine the prudential rules and the methods for measuring risks, including those arising from organizational inadequacies. Regulations laying down the criteria which banks' internal systems of control must satisfy have been adopted.

In the three years from 1996 to 1998, a total of 534 banks accounting for 35 per cent of the system's total assets were inspected; in 395 cases the inspections were conducted independently by Bank of Italy branches. Assessments cover loan quality, credit disbursement and monitoring procedures, liquidity, capital adequacy, organizational structure, costs and profitability.

The assessment was entirely favourable for 231 banks and partly favourable for 161; it was unfavourable for 142, most of them small banks, with 3 per cent of total assets.

Between 1993 and 1995 inspections had been carried out at 546 banks accounting for 40 per cent of total assets. The assessment was entirely favourable in 194 cases and partly favourable in 186; it was unfavourable for 166 institutions, representing 13 per cent of the system, including the large southern banks.

In the long run the stability and growth of the banking system depend on the vitality and expansion of the economy and on corporate profitability.

If Italy's abundant savings are to be fully harnessed to generate growth and employment, strategic decisions on the allocation of credit have to be based on a thorough knowledge of the economy's productive structure and growth potential.

Significant advances have been made in the privatization, capitalization and size of Italian banks. The links established with important foreign institutions will permit major Italian banks to participate in the formation of large European groups able to compete in the new international setting.

Intensified merger activity under the impetus of competition has led in some cases to prospective takeover bids whose merits we could not examine because of the inconsistency between the purportedly amicable nature of the proposals and the opposition displayed by the governing bodies of the target banks.

In the United States and the leading European markets over a long span of time, nearly all mergers between banks have taken place on a friendly or agreed basis.

Supervisory rules and practice do not exclude hostile takeovers. However, operations of this kind give rise to processes of organizational integration and rationalization that are very laborious and not guaranteed to succeed, especially when the banks involved have a complex structure and are of comparable size. This can have repercussions on the management of credit, the intermediation of savings and the value of the companies itself.

The 1993 Banking Law, which complies with the European Community Directive of 1989, lays down procedures to be followed in order to safeguard the sound and prudent management of intermediaries and the integrity of credit and savings when the ownership of bank shares is transferred.

In Italy, the protection of savings is enshrined in the Constitution.

The very existence of prudential supervision stems from the acknowledged special nature of banks. Official controls and measures are intended to protect the stability of intermediaries and the integrity of the funds they administer, which are equal to a high multiple of capital and reserves.

As in the most important financial systems, each significant acquisition of bank equity must be examined and authorized in advance by the supervisory authorities.

The law requires a bank's leadership to provide information during the initial stage so that the authorities can establish, as a preliminary step, before any public announcement is made, that no impediment exists. Failure to follow the procedures can cause fluctuations in the market price of the securities involved.

The project is then examined to ascertain whether it is consistent with the objectives pursued and to evaluate its effects on the sound management of the funds under administration. Modifications are sometimes suggested in order to facilitate the success of the operation.

In performing this function we authorized the large number of concentrations mentioned earlier, with positive results for the strengthening of the system. In some cases, to avoid violations of banks' bylaws or to prevent instability, we denied authorization for acquisitions of significant equity interests.

The criteria and procedures for authorization are spelt out in the secondary legislation. As we announced to the Interministerial Committee for Credit and Savings, the prior notification procedure will be supplemented, so as to make it more stringent and correspond more closely in terms of swiftness and efficacy to the needs of intermediaries and the progress of the financial market.

## *The Italian economy*

Output in the euro area increased by 2.9 per cent in 1998. Economic activity slowed down in the second half. Consumption rose steadily during the year, while the growth in investment decelerated in the last quarter.

After increasing rapidly in 1997 and continuing to grow for most of 1998, the area's exports fell in the final months of the year. Imports followed a similar pattern.

The German and Italian economies were especially affected by the weakness of economic activity, with output contracting in the fourth quarter.

The expectations of euro area firms were coloured by pessimism in the second half of the year and the first few months of 1999. Households remained moderately optimistic.

The twelve-month rate of inflation gradually declined to 0.8 per cent in the fourth quarter before rising to just over 1 per cent in March of this year. Inflation is higher in the economies experiencing the strongest growth.

The area's surplus on the current account of the balance of payments remained high at nearly 80 billion euros, or 1.4 per cent of GDP, thanks in part to an improvement in the terms of trade. The behaviour of capital movements resembled that which we have already described with regard to Italy. The errors and omissions item is large. Outward foreign direct investment by residents of the area exceeded inward investment by non-residents by 100 billion euros. Portfolio investment outside the area amounted to 307 billion euros and inward portfolio investment to 216 billion.

Remaining in close step with each other, the currencies of the eleven countries depreciated by nearly 20 per cent against the dollar between mid-1996 and mid-1997; they then strengthened markedly until the autumn of 1998 before falling back to the very low levels recorded in the summer of 1997.

## *Economic activity and monetary policy*

In Italy output increased by 1.3 per cent in 1998. The stimulus imparted by the government incentives introduced in 1997 to encourage purchases of transport equipment faded in the early months of the year.

The consequences of the exceptional effort to reduce the budget deficit in the last few years continued to weigh on the economy. Structural reforms to reduce current spending in relation to output have not been introduced. Cash disbursements were cut back, impinging on the activities of local authorities, public investment and the launch of programmes for Southern Italy.

The rate of increase in consumption fell from 2.6 per cent in 1997 to 1.7 per cent last year, reflecting the slowdown in spending on durable goods. Household confidence deteriorated in the second half of 1998. No longer restrained by tax increases as in previous years, disposable income grew more rapidly despite the slow growth in gross earnings. The rise should help sustain demand this year.

Investment in construction increased slowly, while that in machinery and equipment accelerated after two years of moderate growth.

Firms' spending plans were influenced by the strength of production and orders in 1997, the high level of capacity utilization and the sharp fall in interest rates. Investment was primarily focused on rationalizing production processes.

Fixed capital formation slowed down during the year in connection with the deterioration in the international and domestic situations.

After increasing in late 1997 and the first few months of 1998, inflation progressively declined to about 1 per cent at the end of the year.

The fall in the prices of imports, especially energy products, was a contributory factor. Excluding this component, the inflation rate fell by less, to just under 2 per cent. The decrease was confirmed by the fall in producer prices and an improvement in inflation expectations, which were consistently below 2 per cent.

Although wage increases were small, unit labour costs in manufacturing rose further as productivity gains were modest; in the other European countries, where wage increases were similar, labour costs continued to decline.

After reducing the discount rate by 0.75 points at the end of 1997, in January 1998 we stated that the primary objective of monetary policy for the year would be the exchange rate of the lira in the European Monetary System.

The continued turbulence in international markets was a concern. In Italy the money supply, especially the more liquid components, continued to grow too rapidly, exceeding target rates and the pace of expansion in the other European countries.

The European Monetary Institute's Convergence Report, which was approved unanimously by the fifteen central bank Governors and the President of the Institute and published on 25 March, recognized that Italy had complied with the convergence criteria for inflation, long-term interest rates and the budget deficit. The stability and persistent appreciation of the lira in relation to its central parity prefigured substantive compliance with the exchange rate requirement.

The Report called for additional rigorous measures to lend credibility to the objective of reducing the public debt to below the limit of 60 per cent of gross domestic product, albeit over a particularly long period.

In April the weakness of economic activity, the satisfactory behaviour of inflation and the public finances and the strength of the exchange rate made it possible to reduce the discount rate again.

We judged that expectations of a positive outcome to the verification of compliance with the criteria for participation in monetary union would prompt the markets to react favourably to the reduction in official rates.

In the following months the appreciation of the dollar facilitated cohesion between the EMS currencies.

The onset of the Russian crisis in August triggered speculative attacks, initially against the currencies of European countries outside the EU or which are not participating in monetary union. Speculators subsequently shifted their attention to a number of countries in the euro area, including Italy.

The rigour of monetary policy, the market's perception of the determination to defend the exchange rate and the approach of the definitive fixing of parities and the launch of the single currency made it possible to overcome the tensions by making modest interventions in the market.

At the beginning of the autumn the domestic political situation became more uncertain, notably with regard to the approval of the budget.

The threat that the financial crisis would spread to Latin America cast its shadow over the international monetary system.

The political crisis, which was rapidly defused, did not have a significant impact on the financial market or the exchange rate. The international tensions eased.

At the end of October we lowered the discount rate by one percentage point to 4 per cent.

At the meeting of the Governing Council of the European Central Bank in early December, given the absence of inflationary pressures and the rapid deterioration in economic conditions, we agreed that each country in the area would reduce official rates to 3 per cent, partly with a view to ensuring a stable market environment for the imminent launch of the single currency.

In Italy, the fact that official rates were higher than in the other countries made a gradual approach appropriate. We accordingly reduced the discount rate from 4 to 3.5 per cent and made the remaining adjustment in the final days of the year.

## *Employment and growth*

The Economic and Financial Planning Document of last spring set a target of an increase in employment of about 600,000 labour units between

1998 and 2001. On the basis of expected growth of 2.5 per cent in 1998, GDP was forecast to rise by 2.7 per cent in 1999 and 2.9 per cent in each of the two subsequent years.

Gross fixed investment in machinery, plant and transport equipment was expected to grow at an annual rate of more than 7 per cent in 1998 and the subsequent three years.

We deemed the forecast for employment growth to be optimistic. Without major structural changes, empirical analysis suggested that the increase would be about half the size of that indicated in the Planning Document.

The gradual spread of the effects of the international crisis to the Italian economy made it necessary to revise growth forecasts repeatedly downwards.

On several occasions and in statements to Parliament on the state of the economy and the public finances we argued that a return to more rapid, stable growth called for a revival in public and private investment and structural changes. We insisted on the need to increase flexibility in the use of productive factors and to link labour costs more closely to productivity and corporate profitability.

The Planning Document envisaged an increase of 0.5 per cent in employment in 1998. Despite the fact that output growth was only half the forecast rate, the increase in the number of labour units employed was 0.7 per cent on the basis of the new national accounts.

Employment in services grew by less than expected and there was no increase in employment in construction. By contrast, employment in manufacturing rose by 1.5 per cent, well above expectations.

Employment growth in all sectors is closely dependent on the introduction of greater flexibility, which is gradually being incorporated into legislation and collective labour contracts.

The number of persons engaged on fixed-term contracts was very high. Employee turnover rose in industrial firms; in the largest, the increase in the number of temporary positions involved contracts of six months or less.

Fixed-term positions accounted for 8.9 per cent of total salaried employment in 1998, compared with 6.2 per cent in 1993. The average for the European Union is 13 per cent.

The proportion of part-time workers, currently 7 per cent, is also increasing, but it remains well below the European average; in France and Germany the share is equal to 17 and 18 per cent respectively.

The number of apprentices increased markedly, rising by about 30,000 during the year. Temporary employment is becoming more common. The number of persons employed in community service jobs increased by about 20,000.

The changes occurring in the labour market appear to constitute a structural adjustment.

With the number of hours worked per capita in industry higher than in previous years, the spread of more flexible contractual arrangements creates scope to increase employment and curb irregular work even at a time of slow economic growth. The emerging picture of labour market trends shows a decline in the number of full-time, permanent positions and an increase in less stable forms of employment.

Only sustained economic growth can reduce the precariousness of such forms of contractual relationship.

Employment in Italy, as in other countries with a relatively short industrial tradition, is characterized by a large number of self-employed workers and a high proportion of small firms.

Self-employment, which is especially common in the distributive trades, accounts for more than 25 per cent of total non-farm employment, or nearly twice the European average. The figure is 20 per cent in Portugal and Spain and rises to 33 per cent in Greece.

According to the 1996 census of industry and services, firms with fewer than 10 employees account for 95 per cent of the total in Italy and provide 47 per cent of all employment. At the beginning of the nineties the share of employment provided by such firms was equal to 21 per cent in Germany, 22 per cent in France and 27 per cent in the United Kingdom.

Large firms with more than 250 employees provide 20 per cent of employment in Italy and more than twice this figure in France and the United Kingdom. In Germany firms with more than 500 employees account for one third of employment.

Small firms sometimes display considerable expertise and innovative ability; above all, they offer larger ones the possibility of indirectly using organizational and, in many cases, contractual working arrangements that are flexible and less costly.

Small production units enhance the ability of the economy to respond to sudden changes in market conditions. In the last twenty years they have slowed the fall in industrial employment. Their contribution to exports is substantial, amounting to just under half the total in the manufacturing sector.

Many small firms are members of one of the 199 specialized industrial districts which have been identified in Italy — 59 in the North-West, 65 in the North-East, 60 in the Centre and 15 in the South — and which together account for 40 per cent of total manufacturing employment.

The concentration of particular activities in such districts stimulates product and process innovation, increases the professional skills and mobility of workers within the area and encourages the birth of new businesses. Operational and informational advantages increase the ability to adjust output to fluctuations in demand.

Pay is more closely related to productivity and the quality of work. The supply of labour adjusts promptly to changes in the business cycle and the situation of firms. There tends to be de facto employee participation in the fortunes of the firm, with resulting benefits for the return on capital and investments.

Compared with other countries, Italy has only a small number of medium-sized firms, the natural next stage in the growth of smaller firms. The obstacles to their development are legal, fiscal and financial.

The dearth of medium-sized and large firms limits the ability of the economy to make major investments that would expand production, improve competitiveness in international markets and sustain growth.

From the seventies onwards the Italian economy, like those of Spain and Portugal, has specialized in a small number of low and medium-technology sectors. Firms in Germany, France and the United Kingdom have expanded their already considerable presence in branches with a large technological content and high value added.

By increasing competition and the mobility of capital, the single currency may lead to productive activity being concentrated in the areas offering the best conditions for technological progress and the most robust financial and productive systems.

Growth requires firms producing innovative goods that can make their mark in international markets. This must be the leitmotif of the policies to provide incentives and support for research and the development of human capital.

Forecasts for the year 2000 show that the world economy could expand by up to 3 per cent; the growth of the eleven euro area countries would be significantly higher than the 2 per cent expected this year.

The expectations of a moderate recovery at the global level are based on the assumption that the Asian crisis will be overcome, that growth will resume in Japan, that the financial tensions in Latin America and Russia will abate and that cyclical conditions in Europe will improve. The economy of the United States appears set to slow down.

In Italy industrial production has continued to decline in the early months of this year. The figures for the first four months show a further fall in both exports and imports compared with the last part of 1998.

On the basis of firms' investment plans, the growth in capital spending seems likely to decelerate. The rise in exports will again be modest, despite their benefiting from the improvement in world demand and the lower exchange rate of the euro; it may pick up in the following years. Consumption is likely to expand by 2 per cent.

Gross domestic product cannot grow by much more than 1 per cent, partly owing to the unsatisfactory performance in the early months of the year. There is a risk that investment will remain weak in the years to come. The increase in employment is likely to continue to be modest.

It is necessary to launch a recovery in the second half of the year.

Growth closer to 1.5 per cent may be achieved if measures are taken to improve confidence and boost investment. This would create the conditions for a larger increase in GDP of around 2.5 per cent in 2000.

The flexibility introduced into employment contracts increased the number of jobs in industry last year and allowed the rise in value added to be distributed among a larger pool of workers.

Further steps can and must be taken. It is necessary to differentiate labour costs more clearly and structurally in relation to productivity, in part by redefining the content and role of national and company-level settlements.

If they are seen as permanent, such changes can increase business confidence.

The stimulus to growth must come from a substantial revival in private and public investment.

The growth potential of Southern Italy is considerable. The large increase in the number of construction contracts awarded last year must be followed by the commencement of work and the completion of projects.

The Government's plans for reviving productive activity must be implemented more rapidly. Projects must be finalized promptly, the efficiency of central and local government improved, Community funds utilized in full, public financing disbursed without delay and the private sector involved on a significant scale.

Infrastructure in the more developed parts of Italy is inferior to that in other European countries. The shortcomings are more severe in the South; often they concern essential services.

There has been an improvement in the utilization of funds made available by the European Union, but it is still limited; 55 per cent of the resources allocated for the period 1994-99 have been used.

In 1998 the European Investment Bank financed infrastructure projects in Italy costing 2.5 billion euros. In recent years other important Community countries have received a proportionally larger volume of loans. The amounts granted to Italy are limited by local authorities' inadequate ability to plan and carry out projects.

A start has been made on coordinating the various investment planning bodies more effectively. The involvement of the private sector in financing and operating infrastructure needs to be increased; project financing will provide a stimulus in this direction.

## *The public finances*

The role of the public sector and the size and structure of the budget are fundamental in establishing the guidelines for the development of the Italian economy in the coming years.

The efforts to reduce the budget deficit, which were initiated with determination in the early nineties, were intensified in the run-up to the adoption of the single currency. The adjustment was based on an increase in revenue: the ratio of taxes and social security contributions to GDP rose from 39 to 44.8 per cent between 1989 and 1997 and then declined last year to 43.6 per cent.

Between 1989 and 1998 the average ratio for the other European countries rose by 0.7 percentage points to 43.5 per cent.

Expenditure excluding interest payments rose in Italy from 43.1 per cent of GDP in 1989 to 45.7 per cent in 1993; the ratio then declined to just over 42 per cent in the last four years. The fall that occurred between 1989 and 1998 was roughly equal to that in the ratio of public investment to GDP.

The pension reforms of 1992 and 1995, combined with cuts in transfers to non-state public bodies, have prevented primary current expenditure from rising faster than GDP in recent years. Public sector wages and salaries have been held in check by the incomes policy introduced in the early nineties and restrictions on recruitment.

Under present legislation, the rapid ageing of the population will cause spending on pensions to rise steadily in relation to GDP. The ratio of the population aged 65 and over to that aged between 15 and 64 has doubled since the beginning of the sixties and now stands at 25 per cent.

Action must be taken in good time to forestall the difficulties that will otherwise inevitably begin to arise in the second half of the next decade. It is necessary to act promptly to reduce pension benefits in relation to GDP from then onwards.

An early start on reform will have a positive effect on expectations. The measures will need to avoid disappointing the expectations of workers approaching retirement and creating major disparities of treatment between successive generations of pensioners. Workers will be able to obtain the cover they desire by taking out supplementary pensions.

The ageing of the population also increases the demand for health and welfare services. At present expenditure in these fields is curbed by restrictions on cash disbursements, with adverse effects on the quality and availability of services. In the medium term, keeping expenditure within limits compatible with the growth in national income and the supply of adequate services will require a socially acceptable revision of rights of access to benefits. Supplementary private insurance can make a contribution.

A slowdown in economic activity reduces government revenue, and in the medium term it tends to increase expenditure.

A rate of growth below that on which the Government based its medium-term plan last year raises the problem of formulating suitable measures to keep the public finances under control.

Budgetary policy in the next three years will have to confirm the guidelines laid down in last year’s Economic and Financial Planning Document. In the medium term, the primary surplus will have to be large and stable.

The level of interest payments depends on interest rates in international markets; by its very nature, the recent downward trend is reversible.

If the undertakings entered into at European level are to be fulfilled, the budget must be balanced rapidly. The way to achieve this cannot involve a further increase in the ratio of taxes and social security contributions to GDP.

Major areas of public expenditure need to be reformed so as to lower the ratio over the medium term.

It is necessary to return to faster growth. Public investment programmes must be implemented rapidly, especially those that are part of plans for supporting the economy in the South.

It is essential to ensure permanently greater flexibility in the use of productive factors.

These are conditions for improving the climate of confidence and strengthening the expansion of private investment as well.

The annual average growth of the Italian economy during the nineties was a percentage point less than that for the euro area. In the three years from 1996 to 1998 gross domestic product increased by 2.6 per cent a year in the other ten countries of the area, whereas in Italy output rose by only 1.2 per cent a year.

This slower growth is reflected in the unsatisfactory employment figures, in a large surplus on the external current account that is completely offset by net capital outflows, and in the difficulties being encountered in reducing the budget deficit.

Last year the spread and continuation of the international crisis took their toll. The bottom of the economic cycle has been reached in recent months, but the recovery has yet to materialize in any strength.

Italy has the technical resources, entrepreneurs, manpower and savings to support greater investment, more vigorous growth and a recovery in employment. The weakness of effective demand is preventing the utilization of further potential resources, especially savings, that would contribute to the growth of the economy.

The propensity to invest remains tentative, despite the fact that conditions are now more favourable than in the recent past in terms of the cost and availability of credit and the level of taxation.

Changes in the public pension and health systems will ensure that over the medium term expenditure will be compatible with the growth in national income, the equilibrium of the pension funds and the safeguarding of benefits for all citizens, first and foremost those in greatest need or on low incomes.

Current expenditure must be reduced in order to permit a gradual easing of the tax burden and create scope for increased spending on infrastructure and investment in research, training and education.

Planned investment must be implemented swiftly, especially in the South, in order to revive demand and employment and ensure a greater supply of essential public services. The obstacles to the growth of small enterprises must be removed.

A functional and efficient public administration is indispensable for growth, but growth and employment must not and, more fundamentally, cannot be guaranteed by the public sector. It is firms that must provide them.

Industrial relations based on agreements between employers and trade unions must assign higher priority than in the past to the link with productivity and corporate profitability, even where permanent employment contracts are concerned.

It is necessary to create a regulatory, economic and social environment favourable to growth.

Frankness about economic policy matters and the conditions needed to improve the prospects for our country does not blind us to the fact that the economy is operating in a context in which grave acts of terrorist violence have recurred. Peoples who are geographically close to us, in the heart of Europe, are being ravaged by acts of war and genocide which we thought had been eradicated from our history.

A renewed spirit of cooperation among the political parties on major institutional decisions can be extended to the definition of economic policy strategies acceptable to all.

The right to work, which was made one of the cornerstones of the Italian Republic, is implemented by providing the necessary education and training to the willing and able, to the young people seeking opportunities in the labour market to participate fully in the economic and civil life of the country. It is implemented by fostering the economic conditions for sustained growth.

We are confident that the resources at our disposal can be harnessed to promote the economic and civil progress of our society.