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# **The sustainability of the Italian public finances: an overview**

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## **Abstract**

The Italian international reputation is mainly related to the high level of its public debt. During the Great Recession, this fact, associated to the stagnation of productivity, raised serious doubts on its economic and financial sustainability. The doubts are legitimated also by the fact that Italy is a net borrower of capitals from abroad, as its Net International Investment Position (NIIP) is negative. The statistical analysis of the Italian public finances suggests how the deep causes of the Italian financial and economic fragility rest in the malfunctioning of the institutional (public and private) and economic framework. The Italian economy should manage its structural weaknesses: i) by maturing a long term view able to involve the capital stocks in the economic reasoning; ii) by enabling SME and citizens' participation in all the economic activities; by empowering the third sector and more in general non profit activities in order to facilitate the formation of social capital.

**Keywords: Debt-GDP ratio, spending review, economic inclusion.**

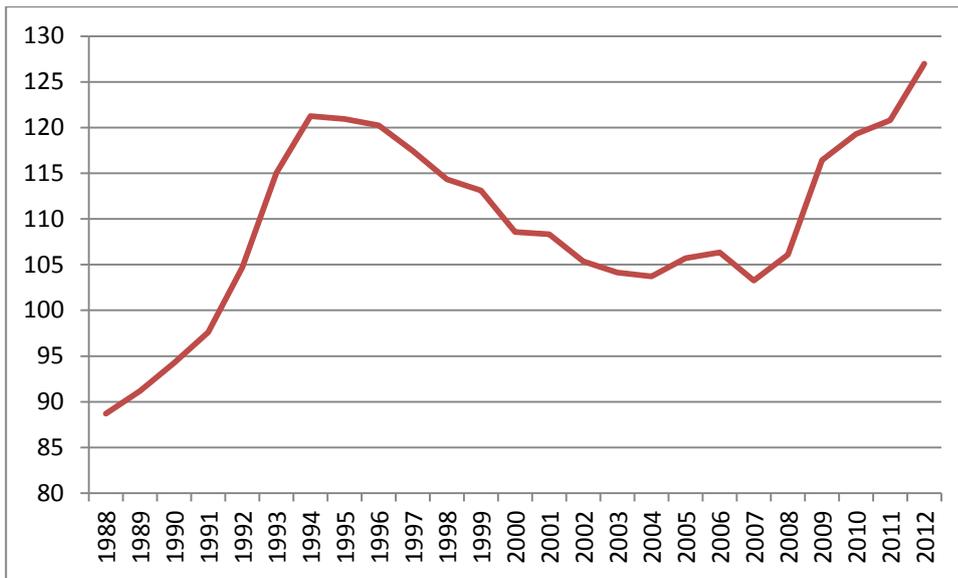
## **1. Introduction**

Italy is a High Income OECD Country, at stage 3 of development, nonetheless its international reputation is more related to the fragile financial outlook, mainly due to the level reached by the public debt, among the highest in the OECD, as in the last two decades it exceeded 100% of GDP. This fact, associated to the decline in productivity observed since 2000, one of the main causes of the substantial stationarity of the real GDP and of the loss of international competitiveness, raised serious doubts on Italy's financial and economic sustainability.

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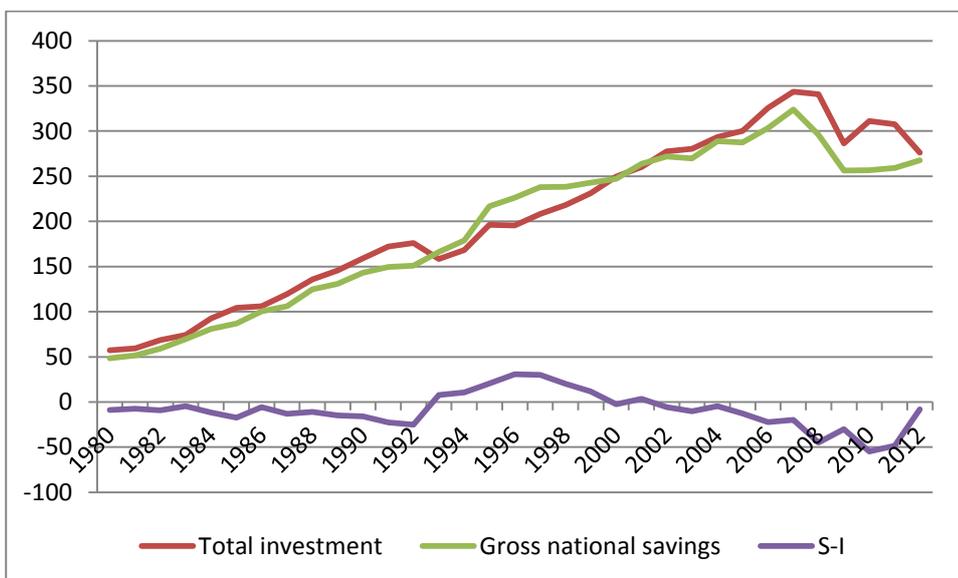
**Figure 1 – General Government Gross Debt (% of GDP)**



Source: Our elaboration on IMF Data (2013).

The doubts are legitimated also by the fact that Italy is a net borrower of capitals from abroad, as its Net International Investment Position (NIIP) is negative. Specifically, the level of total investments is higher than the Gross National Savings since 2002 (see Figure 2).

**Figure 2 – Total Investment and Gross National Savings**



Source: Our elaboration on IMF Data (2013).

The main international indicators do not provide positive signals for the Italian economy, even if, as it emerges also in the IMF forecasts, the positive results obtained in the last years at macroeconomic level raise new hopes for the future.

Specifically, in 2012/2013 Italy ranked 42<sup>nd</sup> in the Global Competitiveness Index, obtaining a score of 4,42 over 7. With respect to 2006/2007 Italy improved its rank of 5 positions, and the result seems to be mainly linked to the improvements in innovation and sophistication of factors. In both years, innovation and sophistication have been the main determinants of the Italian competitiveness, while efficiency and the overall assessment of public and private institutions was relatively less positive, in comparison with the other countries, and the gap increased during the period.

**Table 1 – Global Competitiveness Index: Summary Statistics for Italy**

Year	Series	GCI Global Competitiveness Index	A - Basic requirements	B - Efficiency enhancers	C - Innovation and sophistication factors
2012-2013	Rank	42	51	41	30
	Value	4,46	4,81	4,44	4,24
	Best performer	Sui (5.72)	Sin (6.34)	Sin (5.65)	Sui (5.79)
2006-2007	Rank	47	49	37	32
	Value	4,37	4,73	4,40	4,07
	Best performer	USA (5.8)	Den (6.26)	USA (5.88)	Jap (5.82)

Source: WEF (2013)

More in detail, the GCI highlights how Italy has a comparative advantage in the sophistication of its businesses (28th), “producing goods high on the value chain with one of the world’s best business clusters (2nd). Italy also benefits from its large market size—the 10th largest in the world—which allows for significant economies of scale”. However, Italy’s overall performance is hampered by the critical structural weaknesses of its economy: “...its labor market remains extremely rigid – it is ranked 127th for its labor market efficiency, hindering employment creation”, and “..Italy’s financial markets are not sufficiently developed to provide needed finance for business development (111th)”. Institutional weaknesses include, instead, “..high levels of corruption and organized crime and a perceived lack of independence within the judicial system, which increase business

costs and undermine investor confidence—Italy is ranked 97th overall for its institutional environment” (WEF, 2013).

The lack of efficiency that characterizes the Italian economy is confirmed by the Ease of Doing Business Survey. In 2013, Italy ranks 73<sup>rd</sup> (75<sup>th</sup> in 2012) over 185 economies and 30<sup>th</sup> in the OECD High Income Countries (31 Member States). The negative score, if compared to the size and the importance of the Italian economy, is mainly due to the negative score obtained in “enforcing contracts” (160/185 worldwide and 31/31 in the OECD High Income Countries), in “paying taxes” (131/185 and 31/31 respectively), in “Getting Electricity” (107/185 and 27/31) in “Dealing with Construction Permits” (103/185 and 28/33), and in “Getting Credit” (104/185 and 29/33).

**Table 2 - Ease of Doing Business: Summary Statistics for Italy**

Year	2012		2013	
	Overall	OECD H.I.	Overall	OECD H.I.
<b>Ease of Doing Business</b>	75	30	73	30
<b>Starting a Business</b>	76	20	84	22
<b>Dealing with Construction Permits</b>	100	27	103	28
<b>Getting Electricity</b>	109	28	107	27
<b>Registering Property</b>	47	17	39	15
<b>Getting Credit</b>	97	29	104	29
<b>Paying Taxes</b>	133	31	131	31
<b>Enforcing Contracts</b>	160	31	160	31
<b>Resolving Insolvency</b>	32	20	31	20

Source: Doing Business (2013).

Finally, in the Corruption Perception Index, with a score of 42/100, Italy ranks 72<sup>nd</sup> over 174 countries worldwide and 28/30 in the Regional rank.

**Table 3 - Corruption Perception Index: Summary Statistics for Italy (2012).**

Country Rank (* /174)	Regional Rank (* /30)	CPI 2012 Score (* /100)	Surveys Used	Standard Error	90% C. I.		Scores range		Data sources						
					Lower	Upper	MIN	MAX	BF (SGI)	IMD	ICRG	WEF	WJP	EIU	GI
72	28	42	7	2,4	38	46	37	55	41	39	41	37	55	38	42

Source: CPI (2012).

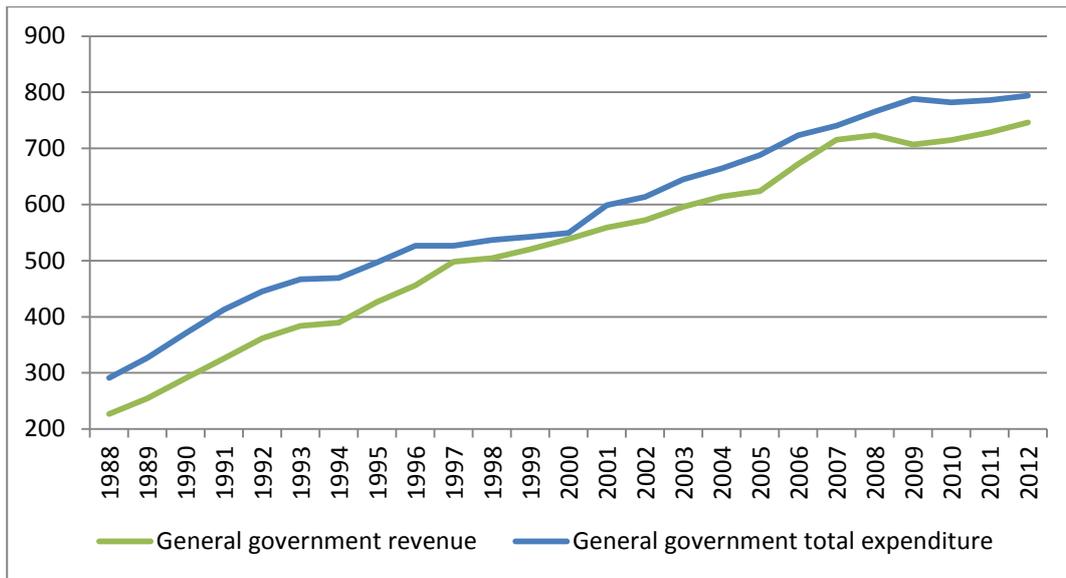
Overall, it seems how, while the main threats for the Italian economy belong from the financial dimension, the causes of the Italian fragility are deeply rooted in the malfunctioning of the social, institutional (public and private) and economic framework.

The following paragraphs provide an in depth analysis of the main features of the Italian public sector and of the market of goods and services, in order to highlight the most relevant stylized facts and draw some policy recommendations on how to revive growth and development.

## **2. The public sector**

The general government balance is characterized by a significant increasing trend of both revenues and expenditures (see Figure 3).

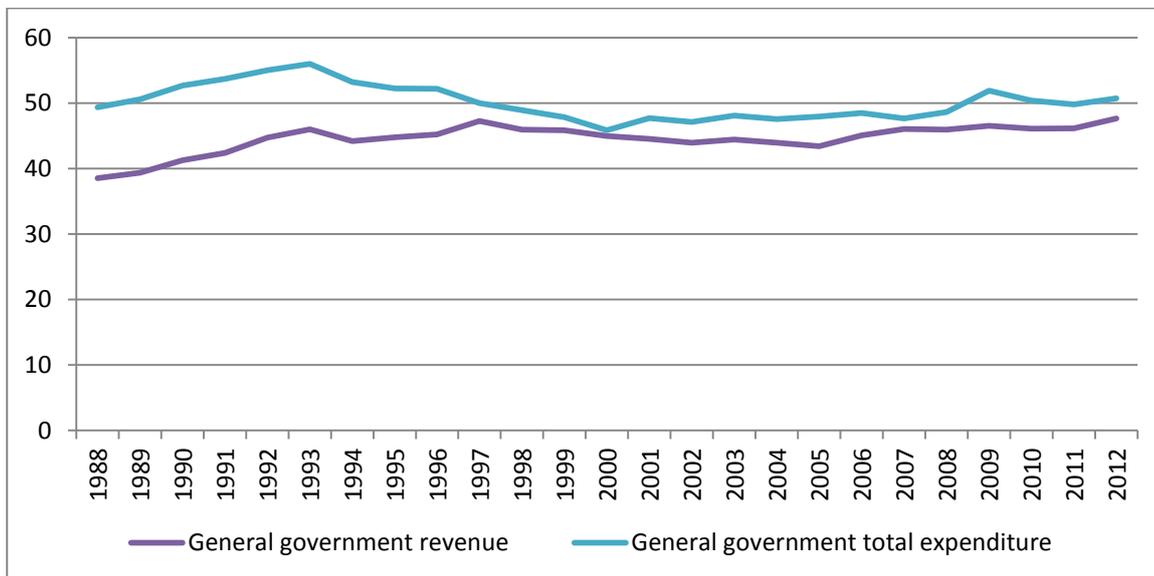
**Figure 3 – General Government revenues and expenses: absolute values.**



Source: Our elaboration on IMF Data (2013).

However, if General Government's revenues and expenses are compared to GDP, it can be noticed how, while the expenditure remained substantially close to a value of 50%, in the last 25 years the revenues raised from less than 40% to almost 50%.

**Figure 4 – General Government revenues and expenses in % of GDP.**

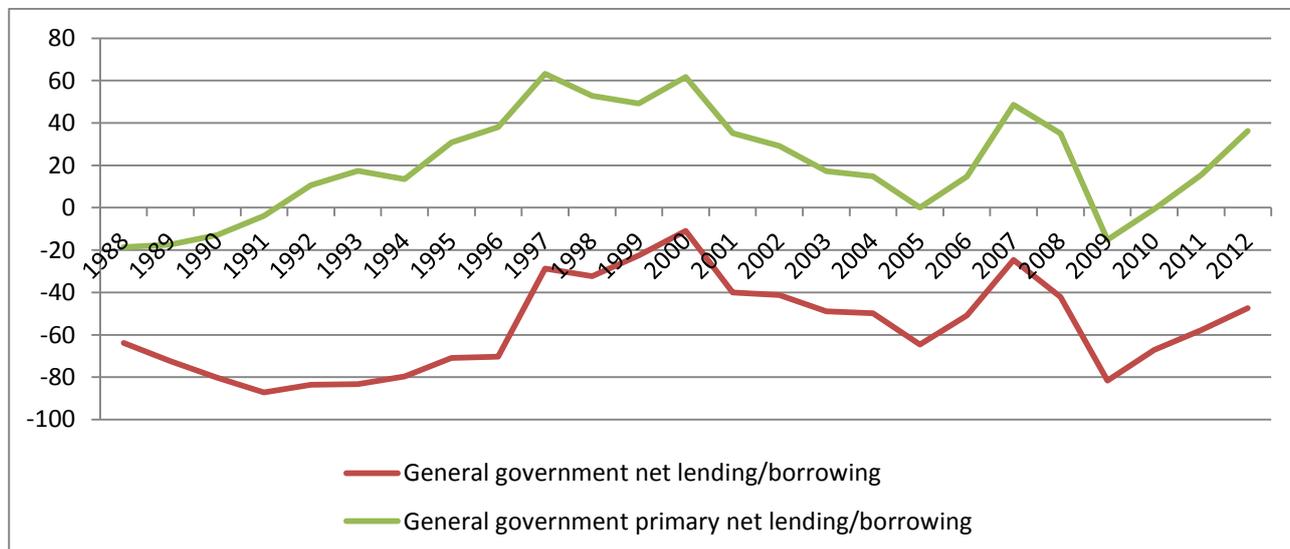


Source: Our elaboration on IMF Data (2013).

According to this perspective, the Government should have acted as a net lender for the Italian economy. However, as it is illustrated in Figure 5, while the General Government net balance is negative along all the period of analysis, the General Government primary

balance is positive since 1992, except that for 2009 and 2010, due to the net interests paid on the debt.

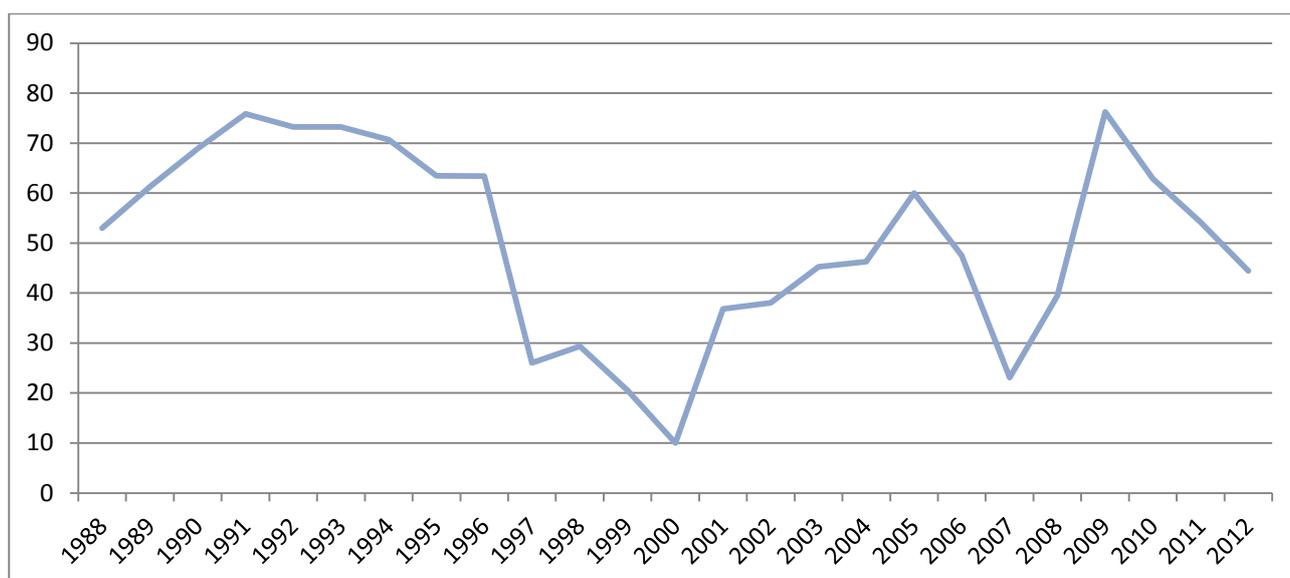
**Figure 5 – General Government financial balances**



Source: Our elaboration on IMF Data (2013).

The historical trend of the net interests is illustrated below (Figure 6). It can be noticed how, from 1992, the net interests paid by the General Government decreased since 2000. After 2000, they raised sharply until 2009, and they declined again below 50 billions of euros in 2012. In percentage terms, it means that the Italian Government paid in interests on average an amount equal to the 5% of the Italian GDP along all the period of observation (1988-2012).

**Figure 6 – Net Interests paid by the Central Government**



Source: Our elaboration on IMF Data (2013).

#### *A qualitative analysis of the Italian public expenditure*

The Italian public expenditure is among the highest at international level and its structure has several peculiar features. Specifically, the expenditure for the production of public services, and for industrial and welfare policies is lower than that of the other OECD countries, but the expenditure for repaying interests and for pensions is much higher.

As documented in the Giarda Report (2012), the structure of the Italian expenditure net of interests is presented in Table 4. The most relevant component is the expenditure in consumption goods and services (that is, the sum of the labour cost and of the endowment of goods and services used in the production and distribution of public services to the collectivity), with a share of 45,3% of the total. The second one is the expenditure for pensions (32,8%), the third one is family transfers (9,8%), the fourth one is firms transfers (4,6%), and finally the expenditure for investments and contributions in capital account to firms (7,5%).

**Table 4 – Structure of the Italian expenditure**

Expenditure by category	Billions of euros	Percentage share
Net public consumption	327,7	45,3
Family and social institutions transfers	71,2	9,8
Production and firms transfers	18,6	2,6

Other expenditures	14,8	2,0
Pensions	237,0	32,8
Total current expenditure	669,2	92,5
Expenditure in direct investments	32,1	4,4
Family and enterprises subsidies	22,0	3,0
Total capital expenditure	54,1	7,5
Total expenditure net of interests	723,3	100,0
Interests	70,2	

Source: Giarda Report (2012)

It must be noticed how the total amount of interest and pensions expenditure is worth 307,2 billions of euro, posing serious constraints to the adaptive capabilities of the public balance to the issues that belongs from the economy (Giarda Report, 2012). On the other hand, the public expenditure dynamics has been strongly conditioned from the characteristics of the production of public services (public consumption absorbs the 39,4% of the overall expenditure). ISTAT data show that the costs of production of the public services grew much rapidly than the production costs of the consumption goods.

**Table 5 – Cost of public services: a relative price index**

	1980	1985	1990	1995	2000	2005	2010
Private and collective consumption							
Private consumption, current prices	98,9	229,1	375,3	518,9	686,6	820,0	914,9
Private consumption, constant prices	465,4	504,8	601,7	627,6	709,8	736,6	741,2
Deflator	0,21	0,45	0,62	0,83	0,97	1,11	1,23
Price index (1980=100)	100	214	294	389	455	524	581
Collective consumption, current prices	27,9	73,0	125,5	163,5	210,0	281,5	324,3
Collective consumption, constant prices	163,7	188,6	216,4	208,6	219,7	248,3	254,1
Deflator	0,17	0,39	0,58	0,78	0,96	1,13	1,28
Price Index (1980 = 100)	100	227	340	460	561	665	748
Relative price index	1,00	1,06	1,16	1,18	1,23	1,27	1,29

Source: Giarda Report (2012)

The structural changes of the public expenditure are partly due, as the increments in the pension expenditure, to the changes in the demographic structure of Italy, that is now characterized by the increment of the elders and form the decrement of the youths. But the demographic trends are not sufficient to explain the changes in the public expenditure.

A serious anomaly of the Italian public financial system is the insufficient share of the own revenues of the Commons, Provinces and Regions with respect to the total of their expenditures. Given a total expenditure of the local administrations equal to 240 billions of euros, the share of the own revenues (excluding the shareholdings on the central fiscal revenues, that the beneficiaries administrations cannot use in the exercise of their financial autonomy) is equal to almost 100 billions of euros. It means that proper revenues cover a share of less than 40% of the total expenditure, with another 10% that is financed using the shareholdings on the central fiscal revenues (Giarda Report, 2012).

**Table 6 – Revenues and expenditures at different government levels**

	Central administration	Local administrations	Social security	Total
Own revenues (without shareholdings on central fiscal revenues)	410,4	100,0	211,8	721,5
Expenditure (net of interests)	183,3	240,4	299,6	723,3
Primary balance	227,1	-140,4	-87,8	-1,8
Interests expenditure	67,5	3,1	0,3	70,2
Government balance	159,5	-143,5	-88,1	-72,0

Source: Giarda Report (2012).

A significant amount of the overall public expenditure net of pensions depends on the activities of the decentralized level, Regions and local entities (almost 60%). The other 40% is of competence of the State, of the entities of the Central Administration and of the Social security (of this share almost a quarter is relative to activities that take place in the territory of Rome). The remaining part, almost three quarters (30% of the overall expenditure), is of competence of the State and Social security, and it is distributed on the whole national territory (Giarda Report, 2012).

At local level, another peculiar anomaly of the Italian public financial system can be easily recognized. Specifically, the local administrations are characterized by deep territorial differences in terms of population and surface. These differences are present also in many other countries, but the Italian public system is based on the uniformity of the functions assigned at all the entities. Secondly, an overall assessment of the presence of the public sector in the different Italian Regions is provided in the following table. By limiting the analysis of the expenditure to the payment of wages and to the endowment of good and services (that is to say, to an estimate of the public expenditure for the production and distribution of services) it can be observed a strong heterogeneity in the presence of the

public sector on the national territory. Specifically, in territories of the Region with Ordinary Statute (excluding Lazio), the average expenditure of all the public administrations is equal to 4.063 euros per inhabitant. In Lazio the expenditure amounts to 5.555 euros, while in the territories of the Region with Special Statute the average expenditure is equal to 4.892 euros (Giarda Report, 2012).

In brief, the Giarda Report stresses the excessive amount of the public expenditure, and its unbalanced composition characterized by the significant share assigned to the payment of interests and pensions. Moreover, territorial imbalances emerge in the analysis of its distribution at regional and local level. These findings raise the need to review and possibly cut its amount, but not all the public expenditure can be reviewed. As illustrated in the Giarda report, beginning with the expenditure net of interests, Table 7 shows the components that cannot be reviewed. First of all, the transfers to EU and the other intervention on the international sector (16,3 billions of euros) cannot be revised. For political reasons, also the expenditure for pensions and for social intervention must be excluded, as well as the expenditure for public investment and for state and regional contributions that are part of the non renegotiable obligations. It remains an expenditure of 364,9 billions of euros. After the necessary adjustments to account for the share of capital depreciation, for social contribution and for the indirect taxes, net of a part of the public expenditure that is instead included in private consumptions, the reviewable expenditure is of almost 295 billions of euros.

**Table 7 - The spending review in brief**

Expenditure by category	Value
Total expenditure	793,5
Interests	-70,2
EU and foreign sector	-16,3
Pensions	-237
Public investments	-32,1
Non reviewable contributions	-13
Social expenditure	-60
Private consumption	29,7
Capital depreciation	-31,3
Social contributions	-50,2
Indirect taxes	-18,1
Reviewable expenditure	295,1

Source: Giarda Report (2012).

The Giarda Report provides also a decomposition of the reviewable expenditure by category and government level. It emerges how the most important component is the share of the expenditure in goods and services (135,6 b€.), followed by wages (122,1 b€), transfers to firms and contribution to production (24,1 b€), contribution to households and social institutions (13,2 b€). In terms of government levels, the highest share is that of the local health institutions (33,1%), followed by Regions, Commons and Provinces (24,3%), State, Central Administration and Social Security (37,4%) e Universities and local institutions (5,2%) (Giarda Report, 2012).

*The public expenditure during the crisis: divided we stand.*

While the Giarda Report provides a seminal analysis of the public expenditure at general level, the DPS yearly report (2013) collects analytical issues regarding the changes in the main component of the public expenditure (capital and current expenditure) and in its territorial distribution, also in the light of changes in the revenues collected and of other variables of interest (as an example, the level of population and the level of economic activity). Specifically, in the DPS report it is documented how the Italian total primary public expenditure (net of interests service) measured in per capita values at current prices decreased from 2009 to 2011 by 5%, falling to a value of 10.160 €, with strong territorial

differences (10.650 in the Center-North, 8.735 in Southern Italy). This findings determine a consistent change with respect to the long run increasing trend of growth at the yearly rate of 1,4% observed in the period 1996-2008. Moreover, the negative change has been strongly unbalanced in its composition, as the major reductions belong from the capital expenditure. It is worth noticing also how the stationarity of the current expenditure has not been sufficient to guarantee an adequate selectivity in public choices or at least the invariance of the resources dedicated to the relevant sectors for collective services (DPS, 2013).

The capital expenditure is the only component that has marked a more significant reduction of the product: at national level its ratio on GDP moves from the 4,1% in 2009 to 3,4% in 2010 and to 3,1% in 2011, while in the levels its amount is now comparable to that one of 2000. The capital expenditure, then, seems to have lost that role of riequilibrium of the territorial imbalances that had in the period 1996-2006, when the level of per capita expenditure was always higher in Southern Italy with respect to the Center-North. This fact raises the issue of the structural imbalances of the Italian public expenditure, that presents a territorial distribution unfavorable to the areas that has the higher need of intervention (DPS, 2013).

The level of revenues instead seems to be always more correlated to the level of wealth of the territories. In 2011, the share of revenues in the Center-North has been equal to the 77%, while that one of the Southern Italy has been equal to the 23%, reflecting the contribution of the two areas to the national GDP. To the threatening effects of these factors it must be added the lower availability of additional resources explicitly assigned to the development, specifically the FAS resources (“Fondo aree sottoutilizzate”, recently renamed FSC, “Fondo per lo sviluppo e la coesione”). The negative trend of the public expenditure of the Public Administration between 2009 and 2011 is confirmed also for the Enlarged Public Sector, as, to the factors already mentioned, it must be added the decrease of the expenditure in investments of some National Public Companies (DPS, 2013).

Even if the capital expenditure decreased, there is evidence of an improvement of the *policy mix* either at Enlarged Public Sector level, either at Public Administration level in Southern Italy. Specifically, as regards the Enlarged Public Sector, transfers share decrease from the 38,9% in 1996 to 25,5% in 2011 on the total capital expenditure, while investments raise symmetrically from 61,1% to 74,5%. Also at Public Administration level, the transfers share of the total expenditure decrease from 44% to 37,1%, while the

investments increase from 55,6% to 62,8%. Consequently, the transfers in capital account to firms (public and private) decreased along all the period of the crisis (specifically, in 2011 they decreased at national level of 18,0%). The decrease depends exclusively from the contraction of the transfers to private firms (from 15.716 billions of euro in 2010 to 10.877 billions of euro in 2011), while in 2011 transfers to public firms begin to grow again (+34% with respect to 2010) (DPS, 2013).

**Table 8 – Capital transfers from the public sector to private sector**

	2006	2007	2008	2009	2010	2011
<b>Tax credit</b>	1.258	867	1.153	1.320	3.459	930
<b>Firms' facilitation</b>	2.185	1.830	1.292	2.264	1.090	1.046
<b>Young entrepreneurship</b>	595	482	379	321	252	14
<b>Aeronautics facilitation</b>	177	212	1.197	1.362	1.744	1.993
<b>Fiscal paybacks</b>	0	0	4.796	837	566	115
<b>Mobility</b>	937	1.075	870	979	1.009	732
<b>Agriculture</b>	256	367	351	228	236	204
<b>R&amp;D</b>	470	330	971	653	511	413
<b>Culture &amp; Entertainment</b>	106	176	192	231	101	105
<b>Industry</b>	444	489	164	493	709	210
<b>Specific Interventions</b>	465	680	836	1.028	1.186	697
<b>Total</b>	6.893	6.508	12.200	9.715	10.864	6.460

Source: DPS on CPT data (2013).

At regional and local level, the implementation of the fiscal federalism determined, with different results, a substantial change in the relations among the center and the periphery, especially with respect to the fiscal autonomy. With respect to the fiscal independence of the decentralized territorial institutions, the proper and devolved revenues are on a long run trend since more than a decade. However, significant differences among the Center-North and the Southern Italy persist. Specifically, in the Center-North there is a clear spread among proper taxes (included IRAP and additional IRPEF) on one hand, and tributes devolved and transfers from the State on the other, as a consequence of a more consistent taxable base in the Regions of that area. In Southern Italy, instead, the weakness of the productive sector and of the labour market determines a lower capability

of fiscal revenues. In this area, apart from transfers, also the level of devolved tributes is significant, and they include the redistributive effect introduced by law (DPS, 2013).

At national level, beginning from 2001, the increase in proper tributes of the local Administrations in percentage of GDP is correlated to the decrease of the public tributes of the Central Administrations for an equal amount. In the last three years, the local tributes seem to have reached a stationary level. It is worth noticing how, even if the distribution of the fiscal imposition among Local and Central Administration is changing, the principle of invariance of the total fiscal pressure on the contributors has not been implemented, while instead a general increase of the fiscal revenues can be observed, and then of the fiscal pressure on citizens and firms (DPS, 2013).

### *The level of welfare in Italy*

The level of welfare in Italy has been measured in a comparative analysis of EU-27, Italy and Southern Italy, developed using a set of indicators presented in the reports “Noi Italia” and “BES” (ISTAT, 2013) and published in the SVIMEZ Annual Report for 2013. The indicators have been grouped in five major topics regarding the demand and supply of public services (“Security”, “Healthcare and social assistance”, “Education and Human Capital”, “Environment and local public services”, “Transport and Infrastructure”). The analysis stresses the best performance of the Italian public sector with respect to the EU-27 average in terms of security and transports, but also the worst performance in terms of healthcare and social assistance, education and human capital, environment and local public services. Moreover, the analysis highlights the worst performance of Southern Italy with respect to the national average in all the fields considered. Such differences can explain the spread in the expectation of life among the Center-North and Southern part of the country, that anyway is among the highest values at EU-27 level (SVIMEZ, 2013).

#### *2.1. The actors of the public sector*

The preliminary data of the “9<sup>th</sup> Industry and Services Census” show a consistent drop in the number of employees and of institutions operating in the public sector with respect to the past decade, even if disaggregated data for geographical areas highlight diverging trends. In general, the data presented are not surprising, given the heterogeneity of the territorial area and of the share of total population of the regions compared. However, it is worth noticing the concentration of the public institutions in the Center-North part of the country (North-West, North-East and Center-Italy), in terms of active units and of

employees, workers and volunteers.

*TAB. 1. Public Institutions: active units and human resources*

Geographical areas	Active Units (n.)		Employees (n.)		External workers (n.)		Occasional workers (n.)		Volunteers (n.)	
	2001	2011	2001	2011	2001	2011	2001	2011	2001	2011
	North-West	5.458	4.069	409.406	356.331	19.157	23.127	2.104	3.433	19.716
North-East	3.261	2.390	353.098	348.246	18.363	21.461	1.525	2.533	11.070	30.924
Center	2.334	1.865	1.913.380	1.653.953	38.197	32.522	6.713	2.267	123.034	9.210
South	2.991	2.612	337.082	283.391	13.129	24.897	2.757	1.654	3.130	4.496
Islands	1.536	1.247	196.159	198.924	9.742	14.422	1.521	1.619	2.303	1.785
Italy	15.580	12.183	3.209.125	2.840.845	98.588	116.429	14.620	11.506	159.253	68.801

*Source: ISTAT, 9th Census on Industry and Services and Census on Non Profit Institutions, 2013.*

On the other hand, the NGOs are expanding their presence in Italy, and data show a significant growth rate of their activities in all the geographical areas. Also the NGOs activities are concentrated in the Center-North, both in terms of human resources (employees, workers, volunteers) and active units. The different share of total surface and of total population can explain a consistent part of the territorial heterogeneity between Center-North and Southern Italy, however the data indicate also a different degree of participation in civil society, partly due to the worst performance of welfare and to the less individual well-being observed in Southern Italy.

*TAB. 2. Non Profit Institutions: Active Units and Human resources*

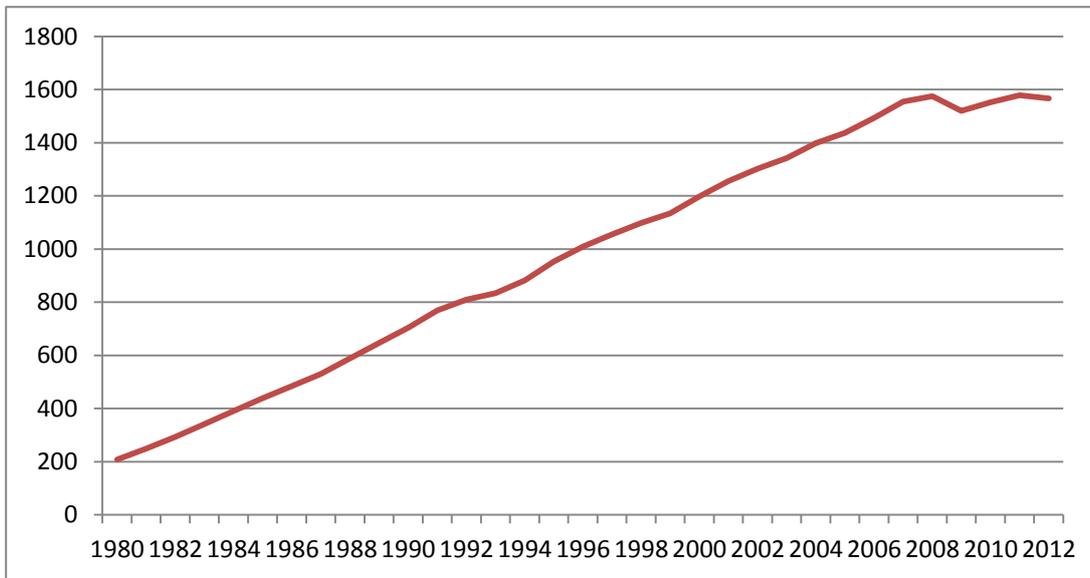
Geographical areas	Unità attive (n.)		Addetti (n.)		Lavoratori esterni (n.)		Lavoratori temporanei (n.)		Volontari (n.)	
	2001	2011	2001	2011	2001	2011	2001	2011	2001	2011
	North-West	235.232	301.191	488.523	680.811	100.525	270.769	3.743	5.544	3.315.327
North-East	62.590	82.883	166.653	245.862	31.766	80.664	1.292	2.107	969.609	1.406.415
Center	58.383	74.314	103.468	161.408	21.959	62.046	926	1.007	893.963	1.311.600
South	48.719	64.677	111.671	147.456	25.188	67.959	793	1.082	648.761	1.090.250
Islands	40.741	49.855	61.717	69.441	13.850	37.427	412	832	499.998	584.964
Italy	24.799	29.462	45.014	56.644	7.762	22.673	320	516	302.996	365.393

*Source: ISTAT, 9th Census on Industry and Services and Census on Non Profit Institutions, 2013.*

### 3. The private sector

The Great Recession interrupted the long run trend of growth of the Italian GDP measured at current prices. As it can be noticed, indeed, since 2007 the Italian nominal GDP is stationary around an average level of 1.557,5 billions of euro.

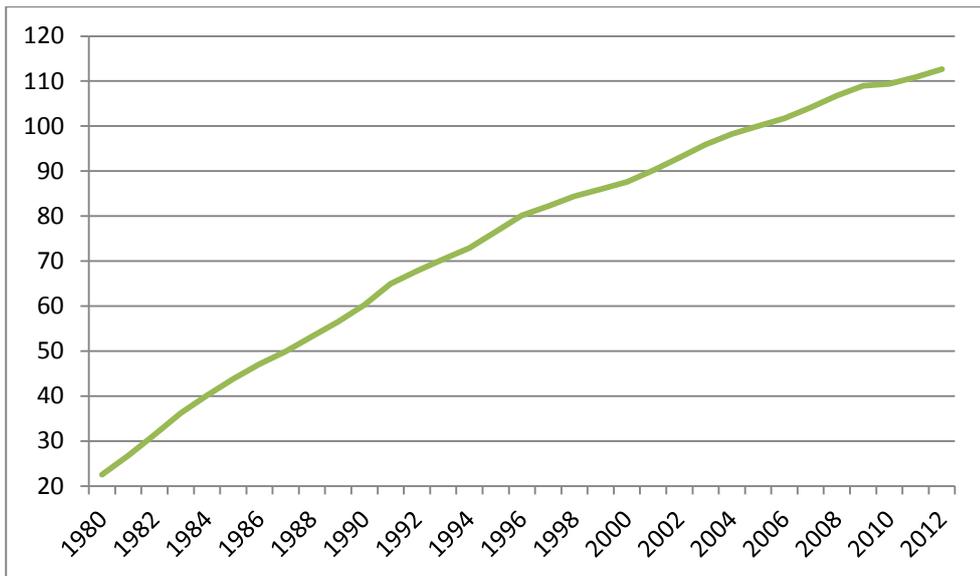
**Figure 7 – The Italian GDP measured at current prices**



*Source: Our elaboration on IMF Data (2013).*

The identity  $Nominal\ GDP \equiv P \times per\ capita\ real\ GDP \times Population$  provides a simple criterion to analyze qualitatively the Italian GDP dynamics. As illustrated in Figure 8, the level of prices increased along all the period of observation, even if the growth trend is decreasing.

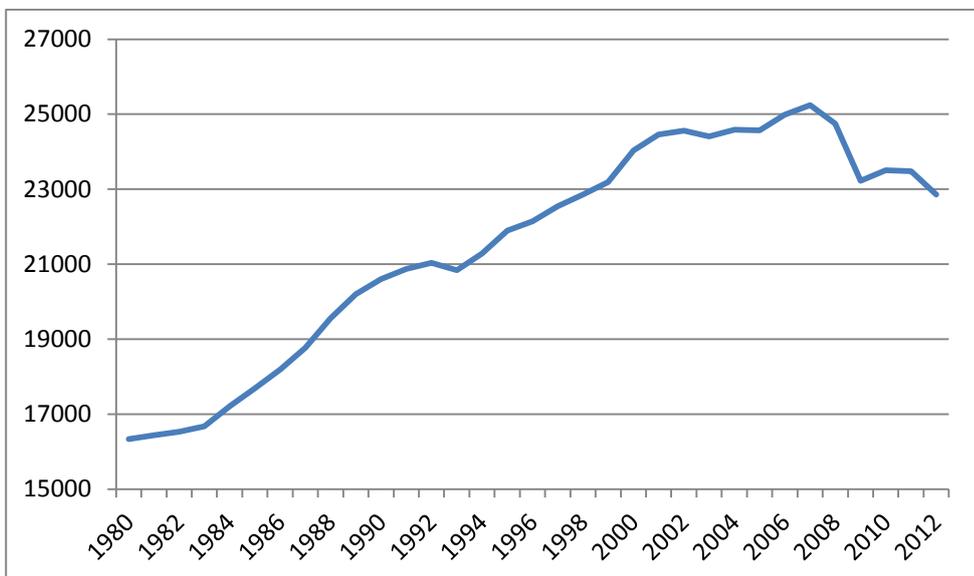
**Figure 8 – GDP deflator (2005 = 100)**



*Source: Our elaboration on IMF Data (2013).*

What is more striking, instead, is the negative trend of the per capita real GDP since 2007, with a cumulative drop in five years of 2.390 € (from 25.243,34 € in 2007 to 22.853,21 € in 2012), completely unexpected if compared to the previous long run positive trend.

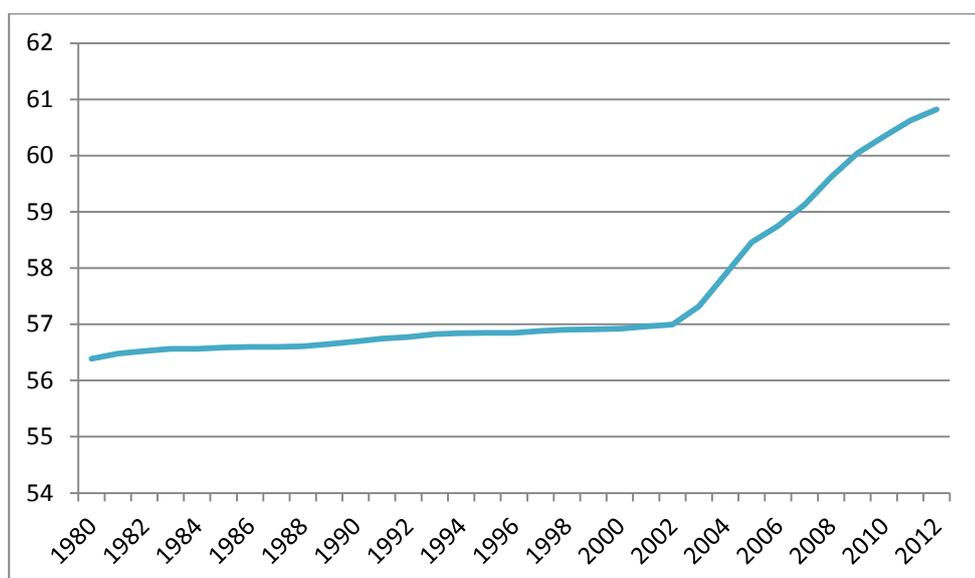
**Figure 9 – Per capita GDP, measured at constant prices**



*Source: Our elaboration on IMF Data (2013).*

Finally, as illustrated in figure 10, since the beginning of 2000 the Italian population, after several decades of stationarity, entered in phase of rapid growth, mainly due to the increasing affluence of migrants.

**Figure 10 - Italian demographic trend**



*Source: Our elaboration on IMF Data (2013).*

This simple decomposition of the GDP determinants stresses how the nominal GDP stationarity has even more worrisome consequences in terms of welfare, as especially in the light of a partial deceleration of prices, it implies a significant drop in per capita GDP, in front of an increasing population that instead raises the need for more growth and jobs.

**Table 4 – Nominal GDP growth decomposition (percentage values)**

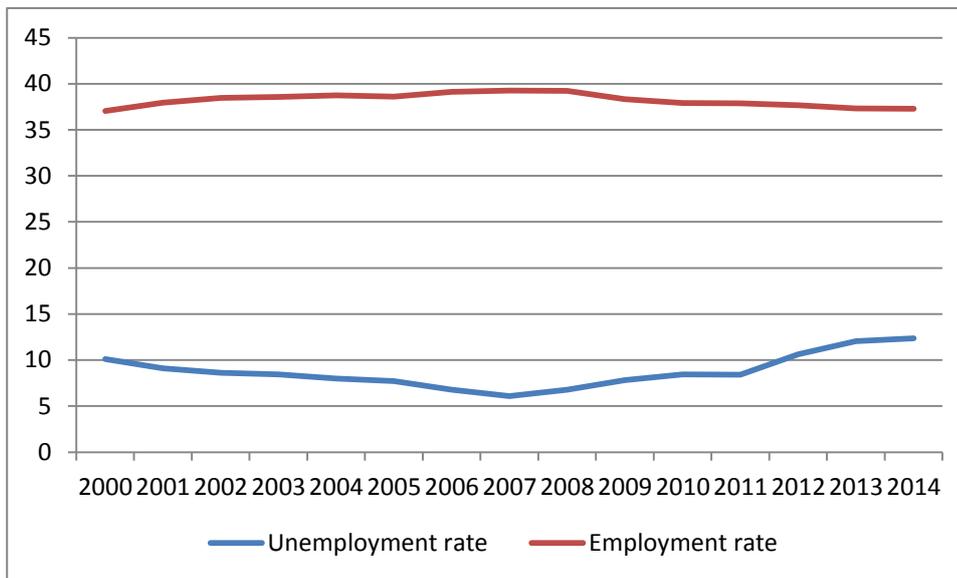
Year	Nominal GDP	GDP deflator	Per capita real GDP	Population
2001	0,0479	0,0288	0,0180	0,0006
2002	0,0367	0,0321	0,0039	0,0006
2003	0,0307	0,0312	-0,0062	0,0057
2004	0,0416	0,0239	0,0073	0,0099
2005	0,0277	0,0182	-0,0006	0,0099
2006	0,0394	0,0171	0,0170	0,0050
2007	0,0410	0,0237	0,0103	0,0065
2008	0,0135	0,0253	-0,0197	0,0083
2009	-0,0352	0,0209	-0,0616	0,0071
2010	0,0212	0,0039	0,0123	0,0049
2011	0,0171	0,0134	-0,0010	0,0047
2012	-0,0080	0,0161	-0,0268	0,0032

*Source: Our elaboration on IMF Data (2013).*

### 3.1 The labour market

The main aggregates regarding the labour market confirm this preliminary issues. Specifically, the Great Recession determined a significant increase in the unemployment rate (from 6,1% in 2006 to 10,63 in 2012), accompanied by a decrease in the employment rate (from 39,67% in 2007 to 37,65% in 2012). The level of social exclusion, also in the light of the increasing demographic trend, rose significantly during the crisis, worsening the reputation of the public and private Italian institutions.

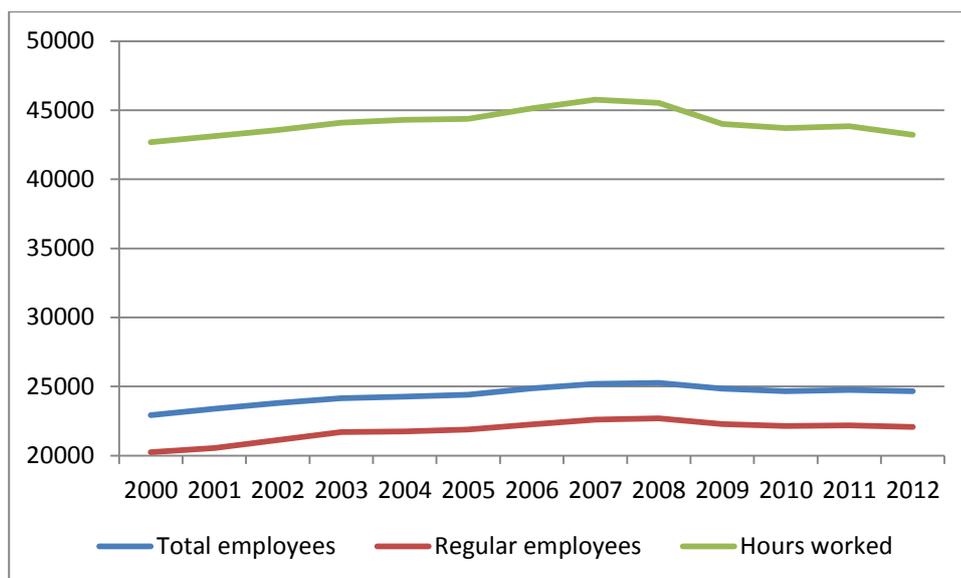
**Figure 11 – Unemployment and employment dynamics in Italy.**



*Source: Our elaboration on IMF Data (2013).*

It can be noticed also how, while the ratio between total workers and regular workers remained constant along all the period of observation (the informal economy weighted, in terms of irregular work, almost 11% of the total economy), and particularly during the crisis, the total amount of hours worked reached a peak in 2007 (45,75 millions), then declined sharply until in 2012 (43,21 millions, 5,55% less). It seems, then, that the negative impact of the crisis on the level of employment was partially absorbed by reducing the number of hours worked per employee (from 35,8 in 2000 to 33,7 in 2012).

**Figure 12 – Employees, regular employees, hour worked.**

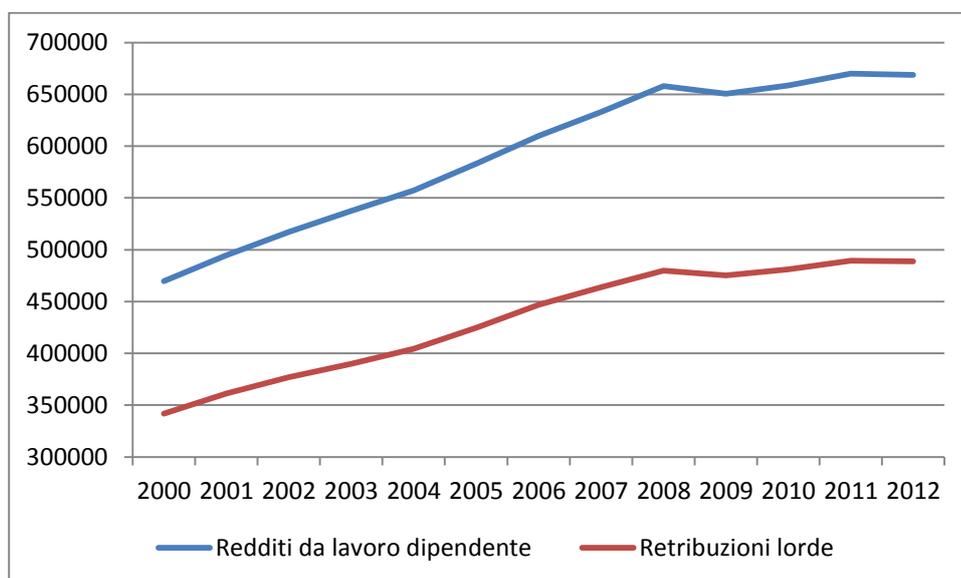


Source: Our elaboration on ISTAT Data (2013).

On the other hand, the dynamics of labour compensation and labour compensation net of contributions exhibit increasing trends along the whole period of observation, but their yearly growth rates are strongly influenced by the crisis. Specifically, the two yearly growth rates are above 3,5% until 2009, then they decelerate sharply below 1.5% until 2012.

Moreover, the proportion between the two values are almost constant along the whole period of observation, so while in absolute values the level of contribution charged to the employers is increasing, in proportional terms it is almost constant.

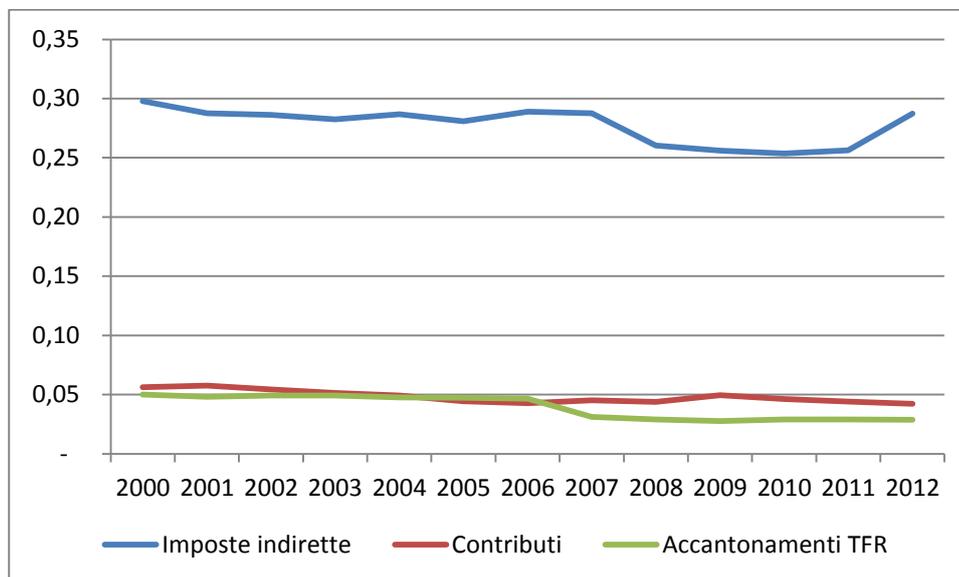
**Figure 13 – Level of wages and salaries and gross income.**



Source: Our elaboration on ISTAT Data (2013).

Finally, the level of the indirect taxes is almost constant from 2001 to 2008 (28-29% of gross income), sharply decreases from 2007 to 2008 (-6,2% in absolute values), it is almost constant until 2011 (25-26% of gross income), and then increases between 2011 and 2012 (+11,9% in absolute values). The level of contributions decreases at the same rate along the whole period of observation, while the level of the TFR is almost constant from 2000 to 2006 (around 5% of gross income), sharply decreases from 2006 to 2007 (-30,3%), then it is again almost constant until 2012 (almost 3% of gross income).

**Figure 14 – Indirect taxes, contributions, and TFR (?) (% of gross income).**



*Source: Our elaboration on ISTAT Data (2013).*

The table below summarizes the main findings of this paragraph. The total amount of wages, of the gross available income and of the net available income followed an increasing trend along the whole period of analysis, more pronounced until 2008, and almost stationary from 2009 to 2012. While the total amount of wages and the gross available income exhibit similar growth trends, the total amount of net available income grew more rapidly along the whole period, but suffered the major contraction in 2012 (-4,4%).

**Table 5 – Labour market: summary statistics**

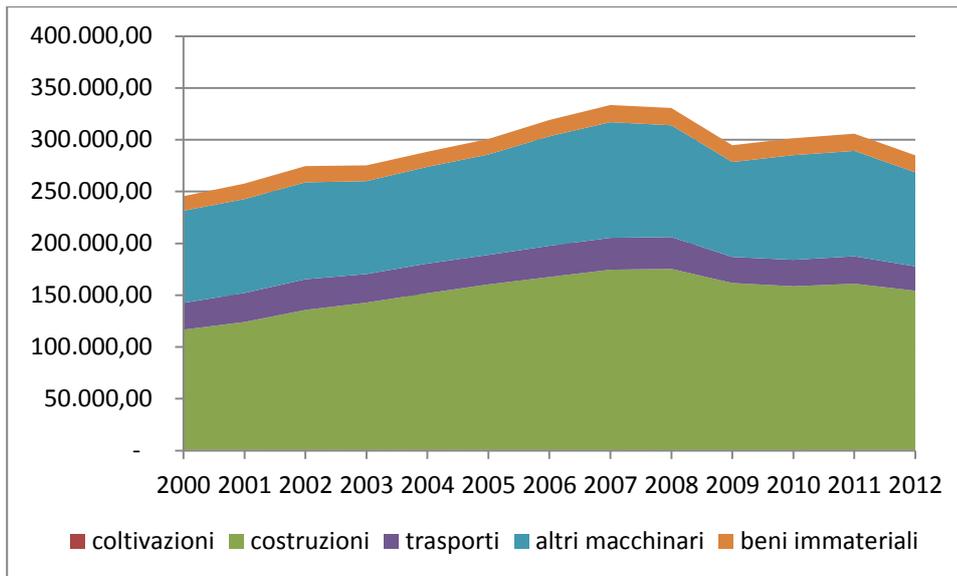
	Redditi da lavoro dipendente (a)	Retribuzioni lorde (b)	Retribuzioni nette (c)	Tasso di crescita (a)	Tasso di crescita (b)	Tasso di crescita (c)
2001	494.724	0,729849	0,442766	0,053043	0,056776	0,075387
2002	517.138	0,728971	0,44475	0,045307	0,044049	0,049989
2003	537.521	0,725366	0,447589	0,039415	0,034274	0,046051
2004	557.193	0,72566	0,447381	0,036598	0,037018	0,036116
2005	582.939	0,728677	0,457059	0,046206	0,050557	0,068837
2006	609.900	0,73259	0,455506	0,04625	0,051869	0,042695
2007	633.052	0,732436	0,465794	0,03796	0,037742	0,061405
2008	658.042	0,729384	0,486201	0,039475	0,035143	0,085015
2009	650.489	0,730389	0,486939	-0,01148	-0,01011	-0,00998
2010	658.427	0,730421	0,490318	0,012203	0,012247	0,019228
2011	669.955	0,730267	0,489857	0,017509	0,017295	0,016552
2012	668.859	0,730607	0,468863	-0,00164	-0,00117	-0,04442

Source: Our elaboration on ISTAT Data (2013).

### 3.2. Investments and competitiveness

The level of gross fixed investments, as partially pointed out in [1], follows an increasing trend until 2008 (+32,67% since 2000), then declines sharply between 2008 and 2009 (-10,88), and between 2011 and 2012 (-6,83%). However, by observing data it is not clear if the two years of contraction have determined the inversion of the long run growth trend, or if they constitute only short term accidents due to the global recession, as in the period between the two negative changes the level of investment continued to rise, even if more slowly.

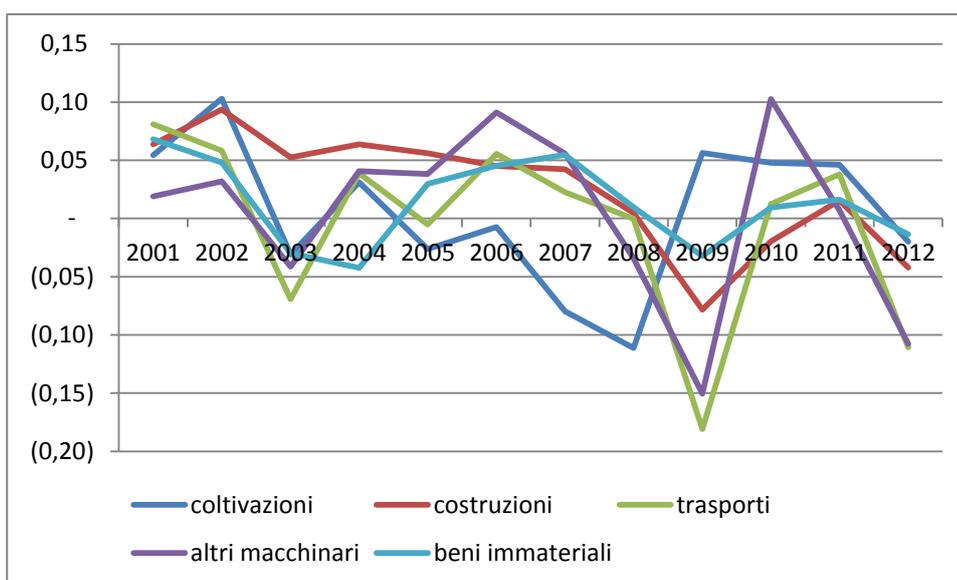
**Figure 15 – Gross fixed investment dynamics**



Source: Our elaboration on ISTAT Data (2013).

By observing the main components of the gross fixed investments, a certain degree of heterogeneity among the growth trends emerges. Specifically, the investments in construction exhibit a constant deceleration in the growth trend, that become negative after 2008, while the investments in “altri macchinari”, “beni immateriali” and “transports” exhibit more cyclical dynamics (a negative change in 2003, then a partial recovery until 2007, again a negative change in 2008, a recovery phase until 2009, and a final drop in 2012).

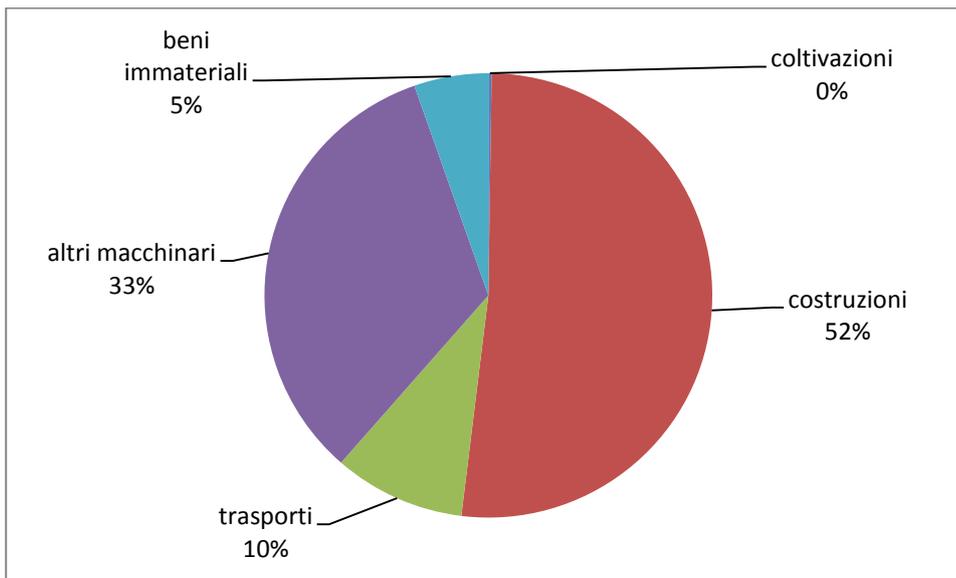
**Figure 16 – Growth trends of the main gross fixed investment components**



Source: ISTAT, (2013).

On the other hand, the qualitative composition of the gross fixed investments remains almost constant along the whole period of observation. The investments in construction are those with the highest share on the total (more than 50% on average), followed by the investments in “altri macchinari” (around 33%), in transports (9-10% on average), in “beni immateriali” (4-5%) and in “coltivazioni” (less than 1%).

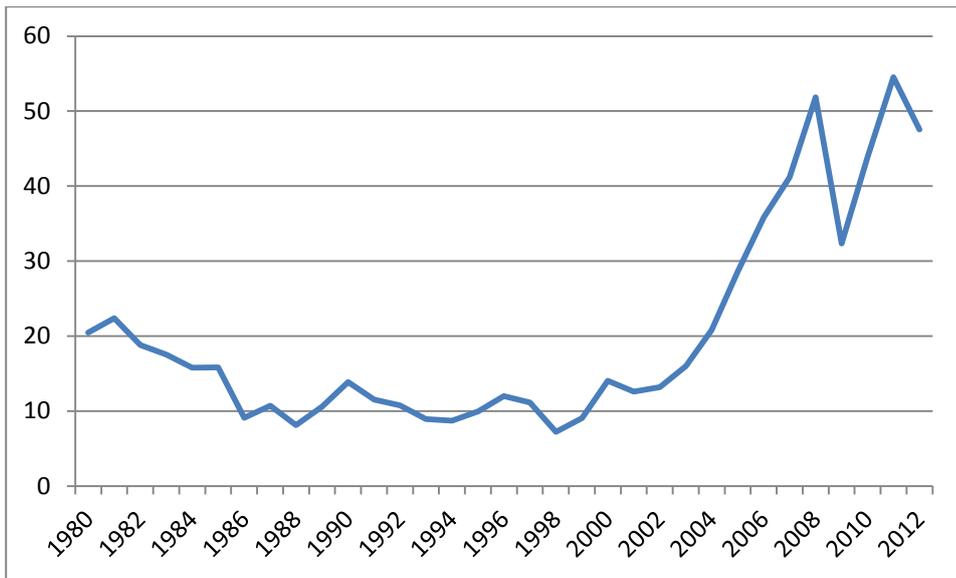
**Figure 17 – Gross fixed investment average composition**



*Source: ISTAT, (2013).*

Figure 18, instead, highlights the sharp increase of the oil’s net imports. Since 1999, the value of oil net imports began to increase in 1999 (9,04 billions of euros) and reached a peak in 2008 (51,827 billions of euros). After a shock in 2009, it rose again until 2011, reaching the value of 54,539 billions of euros.

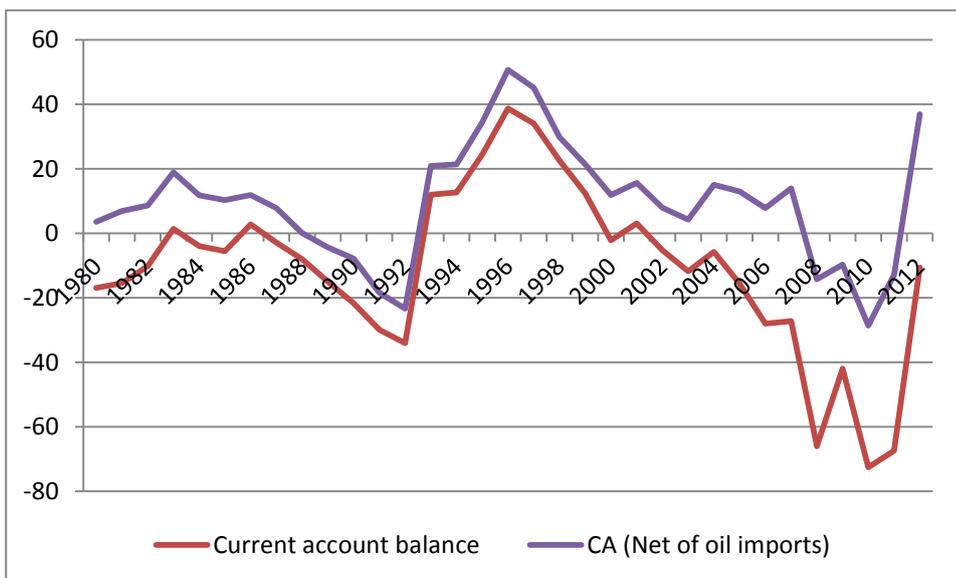
**Figure 18 – Value of oil net imports**



*Source: our elaboration on IMF data (2013).*

This evidence can, at least partially, help to explain the persistent deficit in the Italian current account balance. It can be noticed, indeed, how, the Italian current account balance has been negative since 2001. However, net of oil imports, the Italian current account deficit would have been decreasing but positive since 2008, negative from 2008 to 2011, and positive again in 2012.

**Figure 19 – Italian current account balance dynamics**



*Source: our elaboration on IMF data (2013).*

### *The economic characteristics of the Italian productive sector*

According to the ISTAT data, in 2010 there were more than 63,5 firms per 1,000 inhabitants in Italy (64,2 in 2001), one of the highest levels in Europe, with an average of 3,9 employees (3,8 in 2001). In the same year, the birth rate of firms was at 6,7 (in 2001 it was 7,8), while the death rate of firms was at 7,7 (in 2000 it was 7,0). As a result, the gross turnover rate passed by 14,8 in 2001 to 14,4 in 2010. Even if with substantial differences in the number of firms and in the average number of employees per firm, the data collected for Centre-North and Southern Italy highlight similar trends.

**Table 6 – The economic structure of Italy: demographic trends.**

GEOGRAPHICAL AREAS	Number of firms (per 1.000 inhabitants)		Employees per firm (average values)		Birth rate		Death rate		Gross turnover rate	
	2001	2010	2001	2010	2000	2010	2000	2010	2000	2010
Centre and North	72,3	69,8	4,3	4,3	7,3	6,3	6,6	7,3	13,9	13,6
South and Islands	49,8	51,4	2,6	3,0	9,0	7,5	8,0	8,8	17,0	16,3
Italy	64,2	63,5	3,8	3,9	7,8	6,7	7,0	7,7	14,8	14,4

Source: ISTAT (2013).

On the other hand, data highlight how the Italian entrepreneurial structure is mainly service-oriented, and characterized by the presence of a myriad of micro-firms. Specifically, in the Centre and North, a share of 59% of firms operates in the service sector, while in Southern Italy the percentage raises to 63,5%. Moreover, in Center and North of the Country micro-firms are the 42,4% of the total, while in Southern Italy they are 60,5%.

**Table 7 – Composition of the Italian economic structure (year 2010, %values).**

Geographical areas	Industry micro-firms	Industry small firms	Industry medium firms	Industry large firms	Service micro-firms	Service small firms	Service medium firms	Service large firms
Centre and North	13,2	11,7	7,6	8,7	29,2	9,5	5,7	14,5
South and Islands	17,9	10,6	4,5	3,5	42,6	11,1	4,8	5,0

Source: ISTAT (2013).

These findings stress the effect of the Great recession in terms of lower economic dynamism (lower gross turnover rate), but also the significant fragmentation of the Italian

economic structure, that might find a counterpart in the lack of competitiveness. On the other hand, the massive presence of micro-firm might constitute a fertile entrepreneurial environment for “grassroot innovation” processes, that might contribute to revive development and economic growth. More in general, participation of small firms to the economic life of the Country becomes a necessary ingredient of every economic policy, due to the relevance of their share of activity.

### **Concluding remarks**

The Italian economy is characterized by a high public debt, and the decline in productivity observed in the last two decades raised serious doubts on its sustainability. The doubts have been legitimated also by the fact that Italy is a net borrower since 2002. However, the main international surveys seem to suggest how, even if the main threats for the Italian economy belong from the financial dimension, the causes of the Italian fragility are deeply rooted in the malfunctioning of the social, institutional (public and private) and economic framework.

The analysis of the Italian public finances highlighted how, due to the net interests paid on its debt, the public sector acted as a net borrower instead of being a net lender. Specifically, the General Government paid every year on average an amount equal to the 5% of the Italian GDP during the period 1988-2012. Moreover, even if the level of the public expenditure net of interests is among the highest at international level, the budget for the production of public services, and for industrial and welfare policies is lower than that of the other OECD countries, whereas the expenditure for pensions is much higher. Finally, it has been highlighted how the costs of production of the public services grew much rapidly than the production costs of the consumption goods, posing serious challenges to the efficiency of the welfare policies.

At territorial level, the main threats to the well-functioning of the Italian public sector are: i) the insufficient share of own revenues of Commons, Provinces and Regions with respect to their expenditures; ii) the territorial differences in terms of population and surface of the local administrations, in contrast with the homogeneity of the functions assigned to them; iii) the high territorial heterogeneity in the per capita expenditure of the public sector observed at regional level.

Apart from qualitative issues the public expenditure should be revised and potentially reduced due to its consistent amount. After the necessary adjustments, it has been estimated that in a mid-term horizon the reviewable expenditure is of almost 295 billions of

euros. It is worth noticing how from 2009 to 2011 the Italian total primary public expenditure (net of interests service) already decreased consistently, but the negative change has been strongly unbalanced in its composition, as the major reductions have interested the capital expenditure, that seems to have lost its role of riequilibrium of the territorial imbalances. Even if the capital expenditure decreased, there is evidence in Southern Italy of an improvement of the *policy mix* in favour of investments, due to the decrement of the capital transfers to firms (public and private).

But the main features of the public expenditure should be commented also in the light of the level of fiscal imposition. Specifically, the level of revenues seem to be always more correlated to the level of wealth of the territories. Moreover, at regional and local level, the implementation of the fiscal federalism determined, with different results, a substantial change in the relations among the center and the periphery, especially with respect to the fiscal autonomy. Even if the distribution of the fiscal imposition among Local and Central Administration has been changing, the principle of invariance of the total fiscal pressure on the contributors has not been implemented, while instead a general increase of the fiscal revenues can be observed. These findings are useful to show how, even if in absolute terms the public expenditure seems to have lost his redistributive role between Center-North and Southern Italy, by taking into account the asymmetries on the revenues side this function is still implemented.

As regards the presence of the private sector on the national territory, it has been stressed the concentration of the public institutions in the Center-North part of the country, and, more in general, the contraction of the number of active units and of employees. On the other hand, the NGOs are expanding their number and their dimension in all the geographical areas, even if they are still more concentrated in the Center-North.

Finally, as regards the goals of the public action, the best performance of the Italian public sector with respect to the EU-27 average in terms of security and transports has been stressed, but also its worst performance in terms of healthcare and social assistance, education and human capital, environment and local public services. It has been highlighted also the worst performance of Southern Italy with respect to the national average in all the fields considered.

Also the analysis of the private sector highlights some peculiar characteristics of the Italian economy. Specifically, the nominal GDP stationarity is having negative consequences in terms of welfare, as in the light of a partial deceleration of prices, it implies a significant

drop in per capita real GDP, in front of an increasing population that instead raises the need for more growth and jobs.

Moreover, in the labour market, the Great Recession determined a significant increment in the unemployment rate, accompanied by a decrease in the employment rate. The negative impact of the crisis on the level of employment was partially absorbed by reducing the number of hours worked per employee. Consequently, the total amount of wages, of the gross available income and of the net available income followed an increasing trend along the whole period of analysis, more pronounced until 2008, and almost stationary from 2009 to 2012. However, while the total amount of wages and the gross available income exhibit similar growth trends, the total amount of net available income grew more rapidly along the whole period of analysis, but suffered the major contraction in 2012.

On the capital market, instead, it is not clear if the observed two years of contraction have determined the inversion of the long run growth trend of the level of gross fixed investments, or if they can be considered as short term accidents due to the Great recession. At disaggregate level, while a certain degree of heterogeneity among the growth trends of the main categories of gross fixed investments emerges, it can be noticed how the qualitative composition of the gross fixed investments remains almost constant along the whole period of observation. As regards the raw materials, the sharp increase of the oil's net imports has been highlighted. This evidence can, at least partially, help to explain the persistent deficit in the Italian current account balance, that, net of oil imports, would be instead positive.

Finally, data highlight how the Italian economic structure is mainly service-oriented, and characterized by the presence of a myriad of micro-firms. The Great recession had an impact in terms of lower economic dynamism (lower gross turnover rate), but the lack of competitiveness that characterizes the Italian economy might be attributed also to the significant fragmentation of its economic structure. On the other hand, the massive presence of micro-firm might constitute a fertile entrepreneurial environment for "grassroot innovation" processes, that might contribute to revive development and economic growth.

The facts highlighted can at least partially explain the financial fragility of the Italian economy, especially in comparative terms. Specifically, the following table summarizes the main data analyzed in this report for the G7 economies. The choice of this benchmark depends on the common perspective that these economies matured during time, sharing a common history. A comparison with the other advanced economies also might be of

interest especially with OECD countries and BRICS, but differences in value observed might reflect different stories rather than different performances.

Given these premises, Table 8 highlights the long run persistence of the GDP ranking, dominated by USA, even in the light of significant changes in the absolute values. Germany and Japan have the best NIIP (Net International Investment Position), while Canada lost its positive balance during the Great Recession. However, Canada is the only country that has a negative balance in the net oil exports (the second best result is that of UK, but is positive), and has a primate in the low level of net interests on its public debt. Japan, instead, reached a primate in the low level of unemployment, and surprisingly, given the high level of public debt, has paid the lowest level of net interests on its debt on average in the three years observed. By considering the difference between the net interests on debt and the net oil exports, Canada and UK have the best ranking in all the three years considered, while Japan has the primate in the average ranking in all the dimensions considered.

It can be noticed how, instead, Italy has the worst rankings in all the major fields considered. Specifically, among the G7 economies, in 2012 Italy ranked 6<sup>th</sup> in the level of GDP, 5<sup>th</sup> in the value of the net oil exports, 7<sup>th</sup> in the level of unemployment, and 7<sup>th</sup> in the level of net interests paid on debt, but it succeeded in obtaining the 3<sup>rd</sup> position in the NIIP. In the overall ranking, however, Italy has been 7<sup>th</sup> in all the three years considered.

**Table 8 – A comparative analysis of the Italian economy**

	year	Canada		France		Germany		Italy		Japan		United Kingdom		United States	
GDP (b\$)	2002	752,6	7	1457,1	5	2013,7	3	1229,5	6	3980,8	2	1604,2	4	10642,3	1
	2007	1458,0	7	2586,1	5	3328,6	3	2130,2	6	4356,3	2	2826,6	4	14028,7	1
	2012	1819,1	7	2608,7	5	3400,6	3	2014,1	6	5964,0	2	2440,5	4	15684,8	1
S-I	2002	1,666	3	1,259	4	2,002	2	-0,433	5	2,832	1	-2,097	6	-4,036	7
	2007	0,779	3	-0,998	4	7,449	1	-1,282	5	4,868	2	-2,278	6	-5,019	7
	2012	-3,683	7	-2,332	4	7,013	1	-0,529	3	0,989	2	-3,504	6	-3,029	5
Net oil exports	2002	2,688	1	-1,010	4	-1,388	7	-1,072	5	-1,183	6	0,480	2	-0,875	3
	2007	3,139	1	-1,656	3	-2,397	6	-1,933	4	-2,986	7	-0,333	2	-2,202	5
	2012	3,245	1	-1,794	3	-2,753	6	-2,361	5	-3,302	7	-0,920	2	-1,994	4
Unemployment	2002	7,667	4	8,908	7	8,700	6	8,608	5	5,358	2	5,199	1	5,783	3
	2007	6,058	4	8,383	6	8,783	7	6,100	5	3,833	1	5,400	3	4,617	2
	2012	7,292	3	10,225	6	5,458	2	10,633	7	4,350	1	8,020	4	8,075	5
Net interests on debt	2002	2,494	4	2,719	6	2,547	5	5,404	7	0,702	1	1,400	2	2,008	3
	2007	0,582	2	2,498	6	2,485	5	4,714	7	-0,023	1	1,580	3	1,992	4
	2012	0,574	1	2,469	6	2,212	4	5,340	7	0,870	2	2,215	5	2,047	3
Net interest - net export	2002	-0,194	1	3,729	5	3,935	6	6,476	7	1,885	3	0,920	2	2,883	4
	2007	-2,557	1	4,154	4	4,882	6	6,647	7	2,963	3	1,913	2	4,194	5
	2012	-2,671	1	4,263	5	4,965	6	7,701	7	4,172	4	3,135	2	4,041	3
Average ranking	2002	3,75	3	5,25	6	4,25	5	5,75	7	2,00	1	3,25	2	3,75	3
	2007	3,75	2	4,75	6	4,25	5	5,75	7	2,00	1	3,75	2	3,75	2
	2012	4,50	5	5,00	6	3,00	2	5,75	7	2,25	1	4,00	4	3,50	3

Source: our elaboration on IMF data (2013).

It seems then that the facts highlighted, specifically, the high level of the net interests paid on debt for the public sector, the high level of the net oil imports for the private sector, the high level of unemployment for the real economy, and the negative NIIP for the financial sector might contribute to explain the fragility of the Italian economy, either at domestic and at international level.

If this is the malaise, what is the cure? As suggested by the analysis of the international surveys (GCI, Doing Business, CPI), the Italian economy should manage its structural weaknesses by maturing a long term view able to involve also the capital stocks in the economic reasoning. Specifically, if the NIIP is negative, it is also true that the net financial wealth of the Italian households is among the highest in the world, as it has been recently documented by the Bank of Italy. Then, crowdfunding procedures might help to mitigate the credit crunch and the high cost of capital that thwarts the Italian economy. Moreover, if the unemployment rate is high due to lack of resources and high labour costs, crowdsourcing procedures might favour grassroot innovations and the autonomous employment of high skilled labour force at the local scale, improving at zero costs the

economic dynamism, and offering a chance to reduce the fiscal wedge without reducing the fiscal revenues due to a higher level of taxable income. Thirdly, the empowerment of the third sector might help to cover some of the public expenditure aimed at providing collective services, contributing to the spending review process and redirecting the private sector through more sophisticated and innovative economic activities. Fourthly, the widespread of green innovations (renewable resources, and energetic efficiency) might contribute to reduce the high dependence on raw materials of the Italian economy, improving its current account balance and its cost competitiveness.

If this is what emerges at aggregate level, it is also true that, due to the high level heterogeneity of the Italian economy, in the mid-term, both at territorial level and at sectorial level, a screening of the territorial districts and of the economic sectors might help to single out the malfunctioning and the excellences of the public sector and of the private sector. Then, in depth analyses might allow to formulate local strategies to improve the sustainability of the malfunctioning public administrations and economic sectors, and to boost the efficiency and the best performers. In the short-run, the resources should be reallocated from the malfunctioning units to the most efficient public administrations and economic sectors.

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