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TORONTO ECONOMIC SUMMIT: 3RD SHERPAS' MEETING

Our Embassy in Rome has received on a personal basis copies of two Italian papers prepared for the Sherpas' meeting on 19/21 May. You may like to glance at these before the meeting: one deals with the proposal for a commodity price indicator; the other with "micro-policies" or structural reform. My only comment on the latter - after spending four years in Rome - is that good intentions are likely to fall foul of the powerful special interest groups!

Yours ever,
Ton

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Economic Relations Department

Encs

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Sir G Littler

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COMMODITY PRICE INDICATOR

1. Italy views positively the development of an Indicator of Commodity Prices as an early warning of potential or latent inflationary/deflationary pressures, to serve as an additional indicator in the co-ordination process.

2. We have proposed a methodology which, in the light of (a) the technical and theoretical problems that are encountered in this field; and (b) the conviction that the index can best serve its purposes if, in addition to providing a G-7 global evaluation, also permits to assess differences between countries; leads to an indicator with the following features:

- . is both overall and decomposable, i.e. the global measure for the G-7 area can be separated into its national components;
- . is based on production weights and can be extended to include other inputs which would otherwise be ignored, e.g. unit labour costs;
- . permits to distinguish between inflationary/deflationary pressures which are due to changes in input prices measured at constant exchange rates; and price variations brought about by exchange rate movements.

3. In our view, this methodology can help to overcome some of the technical problems which appear to characterise the global indicator proposal. It would also lead to an indicator the features of which are attractive for the purposes of international co-operation and policy co-ordination.

4. Nevertheless, we are aware that the implementation of a "global and decomposable" index requires time because of the technical and practical arrangements that have to be settled. A trade-off, therefore, has to be made between the choice of an immediately operative global indicator and the more distant possibility of defining an index of the type suggested by the Italian authorities.

5. The above trade-off finds an easy answer if one believes, as we do, that a Commodity price indicator deserves prior consideration in the context of our efforts for concrete and effective international co-operation. Therefore, while reaffirming the opportunity to keep the matter under constant review and open to revision, we reckon that we can, as a first step, support the U.S. proposal to recommend to the Ministers at

Summit to add an Index of commodity prices to the agreed list of indicators.

6. In this perspective, and with reference to a Commodity Price Index used within the context of a "judgemental" approach, our suggestions regarding the key technical issues are as follows:

- (i) reference be made to IMF data;
- (ii) consumption weights be applied;
- (iii) prices be valued in SDRs because of the possible confusion that exchange rate variability can cause and the possible overstatement/understatement of inflationary pressures or hiding of latent inflationary movements that can result;
- (iv) two separate indices be monitored, one including oil with its effective consumption weight, and one excluding oil prices;
- (v) gold be treated separately since its weights can be either arbitrary -- which implies that the index would be difficult to interpret -- or negligible.

MICRO-POLICIES: ISSUES AND AREAS UNDER
CONSIDERATION FOR REFORM

1. Unlike the 1970s, when structural impediments built-up, hindered the adjustment process and obstructed economic growth and stability, the 1980s have witnessed rapid restructuring and adaptation of Italy's product and labour markets. In the first half of this decade, about 80% of all new investments (as against less than 30% in the 1970s) was used for plant modernization and rationalization and for the introduction of new technologies. In the labour market, early retirement and income support (i.e. Cassa integrazione guadagni) policies, together with changes in the rules for the inflation-proofing of wages and salaries have also contributed towards the reduction of market rigidities.

2. Even though the effects of structural adaptation are slow to show up and difficult to disentangle from other influences, its benefits have become clearly manifest in Italy in the last few years as, for instance, the association between trends in productivity and the recovery in economic performance appears to suggest.

3. In spite of achievements so far, too many impediments remain. In the view of the Italian government, these not only represent obstacles to growth potential which have to be removed, but also imply that Italy would not be in a position to enjoy the benefits which can be derived from the realisation of a European Common Market and from the increased general integration of the world market, to which the government is committed.

4. The Italian government is therefore engaged in implementing micro-economic reforms to improve the working of the system, to reduce barriers and foster adaptation to technological and socio-economic change. Within the E.E.C. it pledges full support to the programme to complete the internal market by the end of 1992. This will lead to the suppression of all internal market barriers among Community members and is based on the elimination of tariff and non-tariff barriers, the opening up on a non-discriminatory basis of public procurement, the liberalization of transport and telecommunication services, financial integration and the reform of the Common Agriculture Policy. Also envisaged by this programme is a common stand towards the problems discussed in the context of the Uruguay Round negotiations.

5. At present, the following areas for micro-policies

implementation are being considered at the national level:

(i) product markets. Important barriers and protectionist policies still hinder the efficient functioning of product markets (e.g. price control systems, non-competitive practices and assistance to industries). With the measures which are envisaged the government aims at:

. agriculture, reducing imbalances between supply and demand and increasing the role of the market via price support and production practices revisions, while developing new measures for non economic objectives. Progress in this sector rely not only on the measures agreed at the E.E.C. level, but also on non-E.E.C. countries following suit.

. industry, turning from the presently selective measures to a policy finalized at creating a more efficient environment, especially for small and medium size firms and for firms located in the Southern regions.

. trade, enhancing competitiveness in the belief that competition is the most powerful means to bring about structural adjustment and efficiency growth. To this end, the Italian government will do all it can to contribute to the success of the Uruguay Round.

(ii) labour markets. To increase employment requires more flexible labour markets, increased mobility and the removal of institutional obstacles to job creation. Towards this end, actions considered include the revision of labour legislation (e.g. legislation concerning part-time, fixed-term contracts and hiring procedures), the implementation of active policies vis-à-vis mobility (i.e. a mobility allowance for "Cassa integrazione" workers) and revived efforts in the field of training and re-training.

(iii) financial markets. Financial innovation and the internationalization of capital markets require a continuation of policies towards wider competition and further liberalization. In this perspective, the Italian government has undertaken important steps in the last few years (e.g. recognition of new forms of financial intermediaries, substantial reduction of

constraints on capital movements) and is considering further action along these lines (e.g. reform of the Stock Exchange and of the government security secondary market; and accomplishment of the process of liberalization of cross-border capital and monetary transactions).

(iv)

public services. Unlike other sectors of the economy, public services have recorded substantial efficiency losses and have burdened the State budget because of the increased transfer of resources required to cover their rising deficits. The malfunctioning of public services has also imposed important costs upon the economic system and hindered the efficient working of other sectors. To prevent any further deterioration in this area, the government is currently studying measures to regulate strikes in the public services and increase the role of market forces.

(v)

public sector. The following is being considered:

on taxation, ways to reduce the complexity of the income tax system and lower the number of tax brackets and the marginal tax rates on high incomes; ways to broaden the tax base, reduce differential treatment of incomes and increase the effectiveness of Inland Revenue in the fight against tax evasion.

As for indirect taxation, plans include increased reliance on this source by bringing the existing system more in line with those of the main EEC partners. As to social security financing, alternatives are sought to reduce reliance on social security contributions because of their possible negative effects on employment and international competitiveness.

on expenditure, real total public expenditure growth has been a cause and, in the last few years (due to the rising cost of servicing the debt), also a consequence of public sector deficits. Considering the growing share of the public sector in the Italian economy and the level reached by the public debt, it is essential to check real expenditure growth because of its possible negative effects on the efficient working of the economy and the stability of the financial market. The conditions and the policies required to achieve this aim are spelt out in a (forthcoming) document by the Minister of the Treasury.

6. In the Italian context, the responsibility for micro-policies lies with different ministries (e.g., Industry, Agriculture, Inland Revenue) and it is only in few instances that it falls upon the Treasury, so that co-ordination by the Government and within the Government is necessary.

7. At present, Government priorities include:

- . Revision of the income tax legislation and of V.A.T. categories and rates.
- . Agricultural policies.