October 2002
IMF Country Report No. 02/231

Italy: Report on the Observance of Standards and Codes—Fiscal Transparency Module

This Report on the Observance of Standards and Codes on Fiscal Transparency for **Italy** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **October 9, 2002.** The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Italy** or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

ITALY

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

Prepared by the Fiscal Affairs Department

Approved by Mr. Deppler and Mrs. Ter-Minassian

October 9, 2002

Executive Summary

This report provides an assessment of fiscal transparency practices in Italy in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency*, based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (http://www.imf.org/external/np/fad/trans/manual/ should be consulted for further explanation of the terms and concepts discussed in this report.

The report finds that significant progress has been made in budget management, especially in recent years, and that Italy meets the standards of the code in many respects. In particular, the roles of various branches of government are clearly defined, and in most state-owned or participated enterprises, noncommercial activities have been identified and reflected in the budget. Intergovernmental fiscal relations are evolving, following recent constitutional reform. Procurement practices meet European Union (EU) standards. However, the quality of fiscal data falls short of the code standards. While information on fiscal operations of the state is plentiful, the timeliness and quality of data on other parts of the public sector should be improved. Furthermore, data from different sources are at times not easily reconcilable because of different accounting practices across levels of government. Budget processes are relatively open, but their main focus remains legal compliance rather than an efficient allocation of resources. The same focus characterizes audit and control mechanisms, although efficiency considerations are increasingly being taken into account.

The staff commentary notes the need to put in place mechanisms for coordinating budgetary management that would ensure, in a context of increasing decentralization, an appropriate contribution of each level of government to macroeconomic objectives and fiscal sustainability, within the framework of the Stability and Growth Pact (SGP). The early specification and enforcement of transparent common accounting rules for all general government entities would be an essential step in this direction.

The report also recommends a number of specific measures to (a) increase the influence of the initial budget on strategic policy choices and resource allocation by amending processes for in-year spending legislation and carry-forward of unspent appropriations which are out-of-line with international practice; (b) shift the focus of budget preparation, execution, and control from legal compliance to efficiency in the use of public resources, including through a carefully prepared move to a program-based budget classification; and (c) improve the quality and transparency of fiscal information, through systematic reconciliation of above- and below-the-line data; more detailed analysis of fiscal risks in budget documents; the completion of an integrated financial management information system for the state budget, and the development of on-line channels of reporting by other government entities, cross-checked with information from the banking network; and periodic reporting by the state on developments in the finances of remaining state-owned enterprises (SOEs). On September 6, 2002 the government introduced by decree significant modifications in budget execution procedures aimed at eliminating overruns on nonmandatory expenditures and reducing the period of carry-forward of unspent commitments. This decree was effective immediately, but requires parliamentary approval to be converted into law.

Contents Page

Boxes

ABBREVIATIONS AND ACRONYMS

ARAN	Agenzia per la Rappresentanza Negoziale della Pubblica Amministrazione
BOI	Banca d'Italia
CDP	Cassa Depositi e Prestiti
CIPE	Comitato Interministeriale per la Programmazione Economica
CONSOB	Commissione Nazionale per le Societa' e per la Borsa
DPEF	Documento di Programmazione Economica e Finanziera
EMU	European Monetary Union
ENEL	Ente Nazionale per l'Energia Elettrica
ENI	Ente Nazionale Idrocarburi
ESA 95	European System of Accounts
EU	European Union
GFS	Government Finance Statistics
ISAE	Istituto di Analisi e Studi Economici
ISTAT	Istituto Nazionale di Statistica
MEF	Ministero dell'Economia e delle Finanze
QFAs	Quasi-Fiscal Activities
RGS	Ragioneria Generale dello Stato
RPP	Relazione Previsionale e Programmatica
RUPA	Rete Unificata per la Pubblica Amministrazione
SACE	Societá per l'Assicurazione del Credito all'Esportazione
SCIP	Societá Cartolarizzazione Immobili Pubblici
SDDS	Special Data Dissemination System
SGP	Stability and Growth Pact
SOEs	State-Owned Enterprises

I. INTRODUCTION[1]

1. This draft report provides an assessment of fiscal transparency practices in Italy against the requirements of the IMF *Code of Good Practices on Fiscal Transparency.* The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Italy.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **General government is defined in line with the *1995 European System of Accounts* (*ESA 95*).** The National Institute of Statistics (ISTAT) is responsible for the compilation of general account statistics in line with *ESA 95* as established by the 1996 EU regulation 2223.[2] A list of all general government entities is established by ISTAT, in consultation with the Bank of Italy (BOI), and the Ministry of the Economy and Finance (MEF), and is updated annually. The general government is divided into the central and local administrations, and social security institutions, as indicated in ISTAT publications and on its website http://www.istat.com.[3] The general government is also defined by legislative decree No. 165 issued in 2001. ISTAT is also responsible for the calculation of the general government balance relevant for the monitoring of the SGP.

3. Intergovernmental fiscal relations are evolving, including the allocation of responsibilities between different levels of government. This largely reflects the amendment to the Title V of the Constitution passed in October 2001 (fiscal decentralization is discussed

---

[1] Discussions on fiscal transparency were held in Rome during July 4–19, 2002. The staff team, comprising Mrs. Ter-Minassian (head) and Messrs. Cangiano, Brumby, and Desai, met with officials from the ministry of the economy and finance, including the departments of the treasury, fiscal policy, debt management, and the *Ragioneria Generale dello Stato* (RGS), the ministry of education, the *Agenzia delle Entrate, Corte dei Conti*, BOI, the national institute of statistics, *Conferenza Stato Regioni, regional administrations of Campania, Lazio*, and *Lombardia*, the *Autorità Garante della Concorrenza e del Mercato*, the *Concessionaria Servizi Informativi Pubblici* (CONSIP), ISAE.

[2] According to this regulation, general government should include all institutional entities producing market and nonmarket goods and services that are primarily financed by mandatory payments and/or whose main function consists in redistributing the nation's income and wealth. The distinction between market and nonmarket goods and services is based on whether the share of sale income covering production costs exceeds 50 percent.

[3] The central administration includes ministries and state organs, such as office of the president and the two chambers (deputies and senate); a number of regulatory authorities and agencies producing services for the public administration and research institutes. Local governments consist of 15 regions with ordinary statute, comprising about 85 percent of the population, five regions with special statute, one of which (Trentino-Alto Adige) divides into two provinces, each with its own special statutes; 102 provinces; 8,100 municipal governments, ranging from 70 to 3,300,000 inhabitants; some 100 mountain communities (*comunità montane*) run by representatives of the participating municipal governments.

Box 1. Fiscal Decentralization and the 2001 Constitutional Reform

The Italian system of intergovernmental fiscal relations is defined in the Constitution and in 55 years of ordinary legislation designed to implement constitutional principles. There are four layers of government: state, regions, provinces, and municipalities. Each is run by political bodies elected with a variety of electoral systems, ranging from pure proportional to first-past-the-post rules. Subnational governments now account for about 40 percent of total general government employment and almost 60 percent of total expenditure. One basic characteristic of the system is the limited degree of hierarchical dependency of lower levels of governments from the higher ones.

Over the years, regions, which were activated only in 1970, have received new responsibilities. Following the "Bassanini laws," of 1997 the government launched a third phase of regional decentralization (after the two phases of 1972 and 1977) the so-called "administrative federalism," whereby regions were assigned all administrative powers that were not explicitly allocated to other levels of government. In March 2001, the parliament approved an important constitutional reform moving further toward a federal structure based on the subsidiarity principle. This bill was confirmed by a popular referendum last October that modified the Title V of the 1948 Constitution, whereby only the functions explicitly stated in the constitutional law are excluded from the power transfer. In particular, article 117 establishes that the central government will retain legislative jurisdiction over some strategic areas, such as foreign affairs, justice, defense, monetary policy, electoral rules, social security, and other sectors that have to be dealt with nationwide, including coordination of statistical information for the general government. Besides establishing regions' income and financial autonomy, the new article 119 establishes both "an equalization fund, without allocation commitments, for territories having lesser fiscal capacities per inhabitant" as well as the possibility for the government to allocate "additional resources" to specific areas.

Recent years have seen a progressive increase in the role and power of regions and local governments to influence central government policies. A consultative body has been established (the state/regions conference) for all legislative projects that touch upon matters directly related to regions and on the administrative decisions directed to implement national legislation of regional interest. Members of the conference are all the regions' presidents and selected central government cabinet members. De facto, if not by statute, all legislative projects having regional consequences are referred to the conference, if only for information purposes. In many cases an agreement has to be reached before parliament begins examination of any bill proposed by the central government affecting regional interests. Intergovernmental bodies are not confined to the State/Regions Conference since, after long debate, the state/cities and local autonomies conference was set up in 1996 and, for certain duties, the two conferences can join together in the so-called unified conference.

In 2000, decree No. 56 replaced transfers from the central to the local governments with shared revenues (*compartecipazione*). The new financing arrangement includes an increase in the excise on gasoline (from lit. 242 per liter to 250); an increased share of personal income tax (IRPEF) from 0.5 percent to 0.9 percent; and 38.55 percent of the national value added tax (VAT), with the contemporaneous elimination of the national fund for health (Fondo Sanitario Nazionale). As to the VAT, the law envisages an equalization fund across regions so that they would initially receive the same amount previously transferred through the national health fund. The equalization mechanism is based on regions' fiscal capacity and on historical trends, with initial weight set at 95 percent in the formula. Between 2002 and 2013, this weight will be progressively reduced (initially by 5 percent and later by 9 percent per annum) until its elimination in 2013 when equalization would be exclusively based on regions' relative fiscal capacity. The equalization transfers will be established by the *Comitato Interministeriale per la Programmazione Economica* (CIPE).

In February 2002, the government presented to parliament proposals aimed at limiting the extent to which the finance bill can be amended; transforming the finance law into a fiscal stability law, that would define coordinating mechanisms across general government entities to ensure compliance with the SGP targets; and moving towards common full accrual accounting. Some of these proposals have been later formalized in resolution 7–00122, dated June 4, 2002, of the budget commission in the House of Representatives.

in more detail in Box 1). The new article 117 lists the areas in which the central government has exclusive legislative authority and those subject to shared jurisdiction, in which the state is attributed the power to legislate general principles. Thus, while the state retains exclusive authority on its own tax and accounting systems, harmonization of accounting principles and coordination of the public finances and tax systems are subject to shared legislative authority, with the state indicating general principles. The central government's control over regional budgets has been abolished (abrogated article 124), along with regions' controls over the budgets of provinces, municipalities, and other local entities. The new article 119 establishes revenue raising and spending autonomy for regions, municipalities, provinces, and metropolitan cities within the framework of general principles set by the state. It also allows local governments to borrow—without state guarantee—to finance investment. In addition, law 281 of 1970 limits local government borrowing to 25 percent of own revenues.

4. **Since 1999, regions, provinces, and municipalities have been requested to adhere to an internal stability pact** (law No. 448/1998, article 28 and subsequent amendments). This pact commits them to respect certain limits on deficits and spending agreed with the central government which are broadly consistent with the EU SGP. For the moment, however, there are no effective sanctions, nor clear mechanisms to allocate deficits among regions and other local governments to ensure compatibility with the SGP.[4] In 2000, decree No. 76 introduced principles of budgeting and accounting for regions, in line with those of the central government. However, in practice the accounting laws passed by regions differ in the way budget chapters are grouped into cost centers—some regions have grouped chapters on a functional basis—as well as in accounting procedures.[5]

5. **Government activities are clearly distinguished from those of public financial institutions and nonfinancial public enterprises**. Most state-owned enterprises (SOEs) undertaking commercial activities have been corporatized, and the largest among them have been publicly listed.[6] Arm's length corporate structures, distinct and independent from the state administration have been set up, though *golden share* powers have been retained, but so far these privileges have not been exercised.[7] Specific public interests are largely pursued via regulation rather than via corporate governance. SOEs that also perform public service tasks,

---

[4] This internal stability pact is determined on a cash basis, and excludes spending on capital, interest, and health. Accordingly, it is not directly aligned to the SGP. The regulation states that should the EU Council penalize Italy for having an excessive deficit, this sanction will, pro quota, be charged to the entities that did not adhere to the budgets established by the internal stability pact.

[5] Beginning 1995 (decree No. 77), municipalities, provinces, and health units were given the option to adopt accrual accounting practices similar to those generally accepted by the Italian private sector and regulated by the civil code. While all health units, including hospitals, have done so, the situation among municipalities and provinces differs.

[6] There are number of minor SOEs, managed by line ministries, that remain to be corporatized and eventually privatized.

[7] These privileges are in practice established via limits to share ownership (typically 3 percent) for a certain duration; approval of material acquisition of shares and of shareholders' agreements; veto over material changes; and appointment of a board member and statutory auditor. In some cases, these privileges have been lifted.

such as the state-owned railway enterprises and the postal service operator, have already undergone an organizational and accounting separation of commercial from noncommercial activities. As to the railway enterprise, public service tasks and investment requirements for the infrastructure grid are periodically identified through mutual agreements and their costs are covered by transfers from the budget. The postal service operator retains a residual element of fiscal activity and bears the cost related to providing noncommercial services. These costs are clearly identified in these companies' financial reports, as are the state transfers to meet them in the budget law. Fiscal activities are also carried out by the *Cassa Depositi e Prestiti* (CDP) and the export credit insurance company (*Societá per l'Assicurazione del Credito all'Esportazione* or SACE). The structure and activities of the CDP are described in Box 2. SACE is a public institution that insures risk associated with international commerce. In June 1999, the *Comitato Interministeriale per la Programmazione Economica* (CIPE), listed the risks and operations that SACE can cover. Its activity is not included in the general government. Only payments for guarantees are considered in the state budget and limits to the issuance of such guarantees are clearly indicated every year in the budget law.

6. **Privatization processes are established in legislation and carried out transparently.** The 1994 legislation (law No. 474) governing privatizations contemplates a variety of methods of sale, including public and employee offerings, public auctions, private placements, management buyouts, and also allows the creation of stable core shareholder groups.[8] Consultants and advisors are also hired through a competitive bidding process. The government is responsible for choosing the sale methods for each operation, taking into account the advisor's due diligence and opinion. However, in the case of privatization of public utilities, the relevant parliamentary commission is called to express its advice on the modalities and criteria of the operation. The law mandates the government to submit twice a year a detailed report on the privatization activity undertaken in the period.[9] The success of the privatization program is also largely attributable to capital market reforms, to the implementation of a clear regulatory framework, and to the increased interest by retail investors in the equity market. The Italian Stock Exchange was privatized in 1997, and initiatives have been introduced to protect minority shareholders, promote transparent corporate governance, and eliminate barriers to take over activities.

[8] Exceptionally, trade sales have been carried out through negotiations with a strategic buyer in light of the small size of the asset and the presence of very few potential buyers.

[9] Since 1994, Italy has realized a program of privatization second only to the United Kingdom among advanced countries. To achieve the public finance objectives established with the Maastricht Treaty, all proceeds of the privatization of entities directly owned by the treasury transit through the budget and are deposited into a fund established in 1993 (*Fondo per l'ammortamento dei titoli di stato*) for the purchase or repayment of outstanding treasury securities. Between 1995 and July 2001, the treasury redeemed approximately €74 billion of outstanding bonds, significantly contributing to the reduction in the debt-to-GDP ratio. See also the *Libro Bianco sulle Privatizzazioni*, published by the ministry of the treasury, budget, and economic planning in April 2001.

Box 2. The Cassa Depositi e Prestiti

The Cassa Depositi e Prestiti (CDP) was established in 1850 to use liquid funds made available to the state through the postal savings system to finance public investments. Since 1875, the CDP has been funded by the savings collected by the post office network through savings deposits and, from 1924 onwards, also through interest-bearing postal bonds. For over a century it operated as a department of the ministry of the treasury, but with separate accounting system and balance sheet.

In 1983, the CDP was granted operational autonomy (law No. 197) followed, in 1993, by independent legal status (law No. 68). The CDP is not subject to the provisions of the banking and credit law consolidation act. Accordingly, the European Community legislation expressly excludes the CDP from the sphere of application of its banking and credit directives. For the purposes of drawing-up financial and economic statements in accordance with ESA 95 criteria, the CDP is classified under the general government. The CDP is subject to the control of a supervisory parliamentary commission and its accounts are audited by the state supreme audit court (Corte dei Conti). The number of persons employed by the CDP is currently around 500. The CDP is a member of the *Centre international pour le crédit communal,* an international association whose membership consists of credit institutions operating in the area of local authorities financing.

The activities and services managed by the CDP can be grouped in three major areas: (i) receiving deposits from public bodies and, in those cases regulated by law, from private parties as well; (ii) granting loans to the state, and financing and supporting the investments of public bodies; and (iii) managing resources on behalf of the state or other public administrations. In addition to its own assets, the CDP also utilizes the following resources: administrative and judicial deposits; postal savings deposits, interest-bearing postal bonds and other state-guaranteed financial products; and borrowing from financial markets.

The parties that can access CDP credit are the state, regions, local authorities, other public bodies, operators of public services, companies in which the CDP is a partner, and other parties specified by law. As a public service activity, the CDP's loans are granted to all such bodies who apply and meet the requirements established by law, without any differentiation being made on the basis of credit-worthiness. At the end of 2001 the amount of the CDP's total assets was more than €241 billion with an increase of more than 12 percent over the previous year. The main priority in lending was to fund infrastructure investments by local authorities.

The postal saving system consists of savings books, showing deposits payable at sight, and postal bonds. At end-2001, the total amount of postal savings, inclusive of capital and interest, exceeded €175 billion. Postal bonds have typically thirty-year maturity. The holder is entitled, in any case, to withdraw from the investment at any time and obtain the reimbursement of the capital subscribed, plus, after the first 12 months, interest up to the last applicable two-month period. As the bonds are issued "on tap," the total amount of each issue is not established in advance. For further details, see CDP's website at http://www.cassaddpp.it/.

7. **The boundary between the public and the private sector risks being blurred by new initiatives related to project financing and private/public partnership.** Most recently, the government has established two new companies, the *Patrimonio S.p.A.* and the *Infrastrutture S.p.A.*, both fully owned by the MEF. The former is being structured as an asset management company whose purpose is to manage real estate and heritage assets,[10] and possibly to initiate securitization operations (see next paragraph), as indicated in law No. 410 of 2001 (article 2), except for assets that by their nature (e.g., natural resources or cultural heritage) cannot be privatized. *Patrimonio* will not be allowed to borrow, and will be part of the central government administration on a national account basis. The *Infrastrutture* is a financial intermediary created and owned by the CDP on the basis of article 47 of the 2002 financial law. Its main purpose is to provide long-term lending to help finance major infrastructure projects jointly with private sector companies, either directly or indirectly via the issuance of state guarantees. After CDP provides the start up capital, *Infrastrutture's* capital requirements will be determined by the size of its investment plan and by the aim to receive a high rating on its lending.[11] The legislation envisages the possibility for the *Patrimonio* to transfer or sell assets to the *Infrastrutture.*[12] The CIPE will express an opinion on the investment plan and the MEF will approve its financing plan. As a financial intermediary, *Infrastrutture* should be subject to supervision by the BOI. A number of issues remain to be defined to ensure full transparency of these schemes, proper evaluation of the fiscal risks, and appropriate accounting treatment in the budget of the costs and likely contingent liabilities.

8. **The government has also initiated a number of securitization operations aimed at transferring the ownership of real estate to private sector institutions.**[13] A given bloc of properties was sold to an independent private company especially created for the operation, *Societá Cartolarizzazione Immobili Pubblici* (SCIP), whose quota capital is owned by two Dutch foundations. SCIP is allowed to use the real estate properties as collateral in issuing bonds (asset-backed securities) to the general public on its own account to pay the government. The government transferred the properties at a below-market price, to promote a

---

[10] From this viewpoint, *Patrimonio* will de facto take over this task from the agency for managing the state patrimony (*Agenzia del Demanio*) established in 1999.

[11] Injections of capital from the state or the CDP will affect the general government's borrowing requirement and its debt, but not its deficit on a national accounts basis (which excludes net lending). By contrast, if the state chose to contribute to the funding of a specific infrastructure project through a capital transfer to *Infrastrutture*, this transfer would increase the general government deficit.

[12] For instance, properties could be initially transferred at book value but, as they start generating a stream of revenue, they would be revalued at approximate market value.

[13] Previous attempts to sell public properties were disappointing. An amount of 6 trillion lira (about a quarter of a point of GDP) had been included in the budget for 2000 but was never realized. A major impediment has been the need to update the inventory of properties, partly because ownership is split across various entities of the general government. Even more critically, the decision to sell properties individually has magnified the veto power of the authorities at lower levels of government, which own most of the properties and feel concerned about the prospect of lower rental income.

higher rating for the bond issuance.[14] Similar securitization operations were used for future revenue from lottery and uncollected social security institutions' credits. While the former types of operations brought forward future revenue with a negative impact on future budgets, the latter ones are a standard procedure to collect portions of overdue credits otherwise deemed uncollectible.

9. **Government equity holdings are still extensive and are clearly reported in the government financial statement published within six months after the end of the year**. All government equity holdings are identified as required by the 1978 law No. 468 (art. 22), although they are reported at book value.[15] Commercial SOEs are subject to the general reporting requirements and transparency and accounting standards set up by the Italian civil code. The ones publicly listed are also subject to the accounting and reporting requirements set by the Italian stock exchange commission (CONSOB). Italian government equity holdings in publicly listed stock companies amount to roughly €50 billion, or about 8.5 percent of Italian stock market capitalization (at April 2001 market values).[16] Italy successfully completed the privatization program in the financial sector, and therefore the state has only minor equity participation in financial institutions. Banks and other financial institutions are subject to regulation and supervision by the BOI and by the CONSOB.

10. **Government regulation of nonbank private sector is implemented with clear regulations, open regulatory processes, and in accordance with non-discriminatory criteria, as mandated by the EU legislative framework**. Private sector commercial activities are regulated by the civil code and monitored through a number of independent authorities acting either on a functional or sector basis. The antitrust authority (*Autoritá Garante del Mercato e della Concorrenza*) was established in 1990 (competition and fair trading act No. 287). It is responsible for controlling agreements that impede competition, abuses of dominant position, and mergers and acquisitions which create or strengthen a dominant position. Its decisions are taken on the basis of the act, without any possibility of

---

[14] SCIP is a limited liability company incorporated under article 2 of decree law No. 351. Properties sold to SCIP had a value estimated by an independent assessor at €3.7 billion. SCIP issued bonds worth €2.2 billion which were transferred to the government. The government initially booked on the budget the expected sale value of the properties as a negative expenditure item. The prospect that the SCIP would resell the collateral at a higher price is equivalent to insuring the bond holder against the risk of default, thus enhancing both the attractiveness of the operation to the purchasers and the likelihood that the bonds will receive a high rating. Indeed, SCIP bonds were given a AAA rating. The sale of these properties could have been legitimately used for the purpose of meeting the deficit targets agreed with the EU under the *Stability Program*. However, on July 3, Eurostat ruled against this operation on the ground that "whenever the difference between initial payment and the observed market price is higher than 15 percent, the transaction has to be treated as government borrowing." As a result, bonds issued by the SCIP have to be counted as public debt and the sale of properties will be recorded on the budget when it takes place.

[15] *Bilancio Consuntivo dello Stato. Conto patrimoniale.*

[16] Publicly listed state-participated joint companies are the following: ENEL (electricity sector) for 67.25 percent; FINMECCANICA (aerospace and defence sector) for 32.34 percent; ENI (oil integrated sector) for 30.33 percent; ALITALIA (airlines) for 50.01 percent; and TELECOM ITALIA (telecommunication sector) for a remaining 2.67 percent.

interference by the government.[17] The authority is a collegiate body, consisting of a chairman and four members appointed jointly by the speakers of the senate and of the chamber of deputies for a seven-year nonrenewable term. The authority is funded by the state budget; within the limits of these funds, it is responsible for managing its operating expenses, which are audited by the *Corte dei Conti*. The electricity and gas authority (*Autorità per l'Energia Elettrica ed il Gas*) regulates electricity activities and natural gas distribution, to promote competition while ensuring adequate levels of service quality. The authority, led by a board of three members appointed by parliament, became operational in 1997. It has a large degree of independence and significant powers, including those to establish base tariffs and criteria for tariff adjustments, and to issue fines and other sanctions.[18] The *Autorità per le garanzie nelle comunicazioni* (AGCOM), is the regulator for the broadcasting sector whose regulatory process is based on the compliance and enforcement of the EU directives. Normally, a public consultation is published in the official journal and on its website (http://www.agcom.it). Public works are regulated by another authority (Autorità per i Lavori Pubblici) established in 1998 (law No. 415) to monitor public works procurement (http://www.autoritalavoripubblici.it/).

11. **The central bank is independent and does not carry out quasi-fiscal activities (QFAs).** Italy is a member state of the European Monetary Union (EMU) and the BOI is part of the European System of Central Banks (ESCB), whose main objective is maintaining price stability within the euro area. BOI retains its role as lender of last resort for Italian banks and of banker for the government. In this regard, the functions performed by the BOI in running the treasury payment system is stipulated in a contract between the MEF and the BOI, dated October 1998, whereby the BOI will perform these services until 2010, subject to tacit renewal. Government deposits with BOI are remunerated, as are services provided by the BOI to the government.[19]

12. **The relative roles of the executive, legislative, and judicial branches are clearly defined in the Constitution.** Article 81, comma 1, states that "the parliament approves every year the budgets and the accounts submitted by the government." The same article (comma 2), establishes that "a provisional budget is not allowed, except by law and for periods not exceeding a total of four months," within which monthly spending will be authorized on the basis of 1/12 of the previous approved budget, as specified in the 1978

[17] The authority is also empowered to enforce Section 11(2) of law No. 57/2001, on abuse of economic dependence, and has responsibility for ruling on misleading and comparative advertising under legislative decree No. 74 of January 1992, as amended by legislative decree No. 67 of February 2000, which were issued to implement specific EU directives. See also its website http://www.agcm.it .

[18] See also the authority's website at http://www.autorita.energia.it. While several companies operate in the gas distribution market, ENI still accounts for 95 percent of natural gas imports, and 90 percent of national production. A government decree issued in May 2000, in line with EU directives, provided for a partial liberalization of the natural gas market. Pursuant to that decree, no single operator will be allowed to control more than 75 percent of gas imports and production, with a further yearly reduction of 2 percentage points, until the threshold is reduced to 61 percent in 2010.

[19] *Convenzione tra il ministero del tesoro, del bilancio e della programmazione economica e la Banca d'Italia per l'affidamento del servizio di tesoreria centrale dello stato*, October 9, 1998.

accounting law (law No. 468 of 1978, article 16). This has two consequences: first, the parliamentary procedure for examining the budget is governed by parliamentary rules, and approval must come from the parliament, so that fast-track approval in legislative committee is expressly prohibited; and, second, amendments may be proposed either by deputies and senators, or by the government itself. Article 81 (comma 3) also states that "it is not possible to introduce new taxes and new expenditures in the law approving the budget," implying that the budget cannot modify the fundamental content of pre-existing legislative acts. In this sense, in the Italian judicial system, the budget is considered a formal law. Finally, comma 4 of article 81 establishes that "any other law involving new or increased expenditures must specify the resources to meet these expenditures." This requirement, however, has never been interpreted as an obligation to have a balanced budget, as financial coverage is regulated by the accounting law (article 11-ter) and by the jurisdiction of the Constitutional Court. All spending has to be established by law and has to indicate the source of its funding, as discussed in Box 3.

13. **The 1978 accounting law, along with its subsequent amendments, defines and formalizes budget and financial management.** Law 468 of 1978 defines the budget's requirement of universality, integrity, and unity.[20] It also establishes the deadlines for submission to parliament and for final approval of various budget documents. Articles 7 through 9 regulate the use of reserve funds; article 24 calls for certification (*parificazione*) by the *Corte dei Conti*. To address the rigidity of the provisions in article 81 of the Constitution, parliament also introduced the financial law (*legge finanziaria*), in which new spending and tax initiatives can be introduced, and a multiyear budget. In 1988, law 362 introduced the requirement for the Medium-Term Economic and Financial Plan (*Documento di Programmazione Economico Finanziaria* or DPEF), along with government's procedures for its formulation, and formalized the budget discussion or summer session. The accounting law also regulates the interim budget, the amendments to approved budgets, and the statement of account (*rendiconto*). Amendments must meet the following principles: first, current expenditures must be funded with no recourse to borrowing (paragraph 5 of article 11); and, second, the financial law cannot increase expenditures or reduce revenue above what is specified in the DPEF as endorsed by parliament (paragraph 6 of article 11).

[20] Universality refers to the need to consider all of the state's expenses and revenues in the budget to provide an exhaustive picture of fiscal activity. This principle is limited by the fact that much public activity is no longer carried out by the state, but by various public entities which are both territorial (municipalities, provinces, regions) or economic, and by entities having the status of legal persons under private law (such as the railways companies, and the postal service). Unity requires that revenue and expenditure be considered together to determine an annual budget target.

Box 3. Legislative Framework for Authorizing Spending

In the Italian budget system, laws authorizing expenditures have the following characteristics:

- laws which define and quantify expenditure—expenditure in the budget is identical to expenditure established in the expenditure law;
- laws which define expenditure and quantify only its parameters (such as compensation paid to employees, for whom the law determines the mean compensation for various qualifications and positions)—calculation of the appropriation is based on parameters which are set in advance by law;
- laws which define expenditure, while leaving quantification to the budget, either explicitly or implicitly—appropriations depend upon the valuation which are made during the budget process;
- laws which only define expenditure in a generic way. In this case, the purpose of expenditure must be specified subsequently in the budget law, along with the estimates of their cost.

In budgetary terminology, the first category of expenditure includes obligations that are predetermined by legislation, since they can be changed only through legislative amendment; the second category comprises irreducible charges, since their formulation depends upon preestablished legislative mechanisms. The last two categories include discretionary charges that can be modified, such as adjustments of necessary amounts. More than 85 percent of the expenditure recorded in the budget is nondiscretionary (wages and salaries, pensions, interest, repayment of loans), or obligations that are predetermined through legislation.

Since 1988, a technical report is required for every bill, legislative decree, and amendment presented by the government that has financial consequences. These technical reports, which have to be approved by the general accounting office (*Ragioneria Generale dello Stato*, RGS), should provide a breakdown of costs and indicate the total number of beneficiaries, the impact of each measure, the duration of the benefit, and the overall outlay. It should cover three years; in the case of pensions, regulations must be valid for ten years. Similar reports are required to justify bills introducing new or higher revenues, to avoid unjustified increases in the tax burden. Parliamentary initiatives do not require a technical report, although the competent parliamentary or budget committee can request a report from the government (which has to be prepared within 30 days), when called on to express their opinion. This task then falls on the relevant ministry, with the MEF responsible for verification. Budget offices in the House and the Senate have been created to verify data contained in the technical reports, but the two offices operate under different guidelines. In the House, every technical report is checked, while the Senate office checks only those having to do with measures for which parliamentary committees have requested such a check. The resolution of the budget commission adopted on June 4, 2002 by the House of Representatives stressed the need for expanding the role of the technical reports accompanying legislation requiring financial resources.

Even though the process of quantifying the costs of legislative initiatives has improved from a technical standpoint, it has not yet attained the desirable degree of reliability and accuracy, as suggested by the ongoing criticisms in the reports on expenditure legislation issued every four months by the Audit Court (*Corte dei Conti*). According to the latter, the quality of the technical reports on spending legislation varies significantly, with still some cases in which either basic information is missing, or the methodology is inadequate. Of particular importance is the fact that many new spending initiatives are financed through the use of special funds. Also, there are still cases where the financing of permanent spending programs is covered by the elimination of temporary ones.

Source: Vegas, G., D. Da Empoli, and P. De Ioanna, *Il bilancio dello Stato. La finanza pubblica tra governo e parlamento*, Le Guide Il Sole 24 Ore (Milan: 2000).

14. **Mechanisms for the coordination and management of budgeted and extrabudgetary activities are well defined**. The budget is managed by RGS or State General Accounting Office of the MEF. RGS is responsible for the central government budget preparation and execution, the collection of data on expenditure for the central and general government, and the compilation of the annual final accounts. Following the adoption of law No. 559 of 1993,[21] all extrabudgetary activities have been progressively abolished. Integrated management of the budget has also been facilitated by the merger of three economic ministries—treasury, budget, and economic planning, and finance—with the first two merged in 1997 and with the ministry of finance merged into the new structure of the ministry of economy and finance in 1999 (decree No. 300). At the same time, the former ministry of finance was reorganized into four agencies carrying out tax administration, custom administration and management of the state territory and properties. The tax policy department of the MEF is responsible for tax policy design and legislation, as well as for setting broad objectives for the four agencies. The latter carry out technical functions in the public interest and provide services to the public administration while enjoying budget, accounting, and organizational autonomy.[22]

15. **Legislative basis for taxation, regulation, and administrative procedures are clear but not always observed in practice**. The Constitution (art. 23) states that taxes and other obligations of financial nature can only be established by law. Tax laws are published in the official gazette. Administrative directives, both in terms of legislative interpretation and enactment, are made public through the official gazette, explanatory memoranda, or through other forms of communication, such as the revenue agency's website http://www.fiscooggi.it. Over the last few years, regulations have focused on taxpayers' services and advance rulings (*diritto di interpello*). Beginning 1997 (law No. 218), a series of important measures was taken to reduce the backlog of appeals and to encourage taxpayers to resolve disputes without recourse to judicial appeals.[23] In 2000, a taxpayer statute was introduced (law 212) that codifies the taxpayers' right to access to information, and customer service offices have been set up in every public office. If rules and regulations are not observed properly, disciplinary sanctions may be applied. In serious cases there may also be penal consequences. Despite substantial progress, there is room to further simplify the tax system, eliminate the recourse to repeated tax amnesties, which result in unpredictable gaps

---

[21] *Disciplina sulle soppressione delle gestioni fuori bilancio nell'ambito delle amministrazioni dello stato.*

[22] The main functions are: increasing tax compliance and simplify relations with taxpayers, either domestically and in an international context; developing a census and integrated register of state properties across the national territory; and managing state real estates while developing an information system. More specific task are stated in an annual contract (convenzione) between the MEF and each agency, which include financial incentives. Although fully financed by the state budget, these agencies have adopted accruals accounting and their financial statements are subject to external audit.

[23] The first is the assessment with approval (*accertamento con adesione*). This mechanism provides for a reduction in penalties if the taxpayer settles his outstanding debt with the tax administration without appealing the additional assessment. The second measure allows for the correction of mistakes on tax returns at the local offices (autotutela). The third measure is the judicial agreement (conciliazione giudiziale), which provides for the resolution of disputes between the taxpayers and the tax administration at the first stage of the legal process (e.g., at the provincial tax commissions).

between statutory and actual tax liabilities, and improve tax compliance as existing estimates of tax evasion range from 15 percent to 20 percent of GDP.

16. **Public servants are subject to ethical standards of behavior.** In November 2000, a new code of conduct replaced the 1994 code via a decree of the department of public administration (*funzione pubblica*).[24] The code establishes, in line with the principles of impartiality and proper management of public offices required by Article 97 of the Constitution, principles of impartiality, efficiency, confidentiality, and responsibility in carrying out tasks assigned and in relations with the public. It also stresses the principle of simplification and subsidiarity. Some categories of public servants (military personnel, state police, prison guards, magistrates, and state lawyers) are excluded from the application of the code but have separate specific ethical codes. The new revenue agencies (revenue, customs, territory, and patrimony) adopted their own code in 1999, establishing the autonomy and technical independence of their employee and defining cases of conflict of interest.[25] In August 1995 the antitrust authority adopted its own code of conduct establishing not only general principles, but also practical measures relating to conflict of interest and gifts. The enforcement of the code of conduct is the responsibility of a magistrate, who is appointed by the antitrust authority for seven years, with no possibility of a new mandate.

17. **State employment arrangements are undergoing significant change.** Traditionally, the department of public administration (dipartimento della funzione pubblica), which reports directly to the prime minister, was the central control authority for public employment. It has retained a role as the watchdog for public employment practices, and can also report to the *Corte dei Conti* its findings on misbehaviors. Hirings are made by open competition. In recent years, the negotiation of public employment contracts has been centralized with the *Agenzia per la Rappresentanza Negoziale della Pubblica Amministrazione* (ARAN), which represents central and local administrations. Performance pay has been introduced for many employees, with more pay at risk, the higher the staff member's level. There is now a once-off revocation order of several hundred top management positions to allow an overhaul of contracts. Italy has recently adopted measures that affect employment conditions at senior levels, as discussed in Box 4.

---

[24] *Codice di comportamento uniforme,* Ministerial Decree 28/11/2000, adopted by the *Dipartimento della Funzione Pubblica* to implement article 58 bis of Legislative Decree 29/1993 (now known as Legislative Decree 165/2001 article 54).

[25] Presidential decree of January 16, 2002, No. 18 (published on Official Gazette No. 49, February 17, 2002), *Regolamento recante norme in tema di indipendenza e autonomia tecnica del personale delle Agenzie fiscali, da emanare ai sensi dell'articolo 712 del decreto legislativo 30 luglio 1999, No. 300.*

Box 4. Changes to Employment Conditions at Senior Levels

Italy has introduced three major initiatives relating to the employment of senior public servants:

- A "spoil system" has been introduced whereby the government of the day will have the right to appoint people to the very top positions (about 25 positions).
- Appointments made during the six months prior to the natural end of parliament or during the month preceding any anticipated end of parliament may be confirmed, revoked, modified, or renewed within six months. This provision relates to boards of governors of public bodies, state owned enterprises, agencies or other organs nominated by government. This provision will apply also to future parliaments.
- There will be a once-only revocation of all general directors of the state (about 440 managers), which will also apply to the directors of public bodies which are overseen by the state (about 200 bodies). The final composition of these bodies is yet to be determined. This revocation is to support a changeover in contractual terms to contracts with a maximum duration of three years, and an increased component of performance-related pay.

B. Public Availability of Information

18. **The budget documents focus on the operations of the state and provide only partial and fairly aggregate information on the rest of general government.** The budget preparation, approval, and the reporting of its execution are marked by the publication by the MEF of a number of documents, listed in Box 5.[26] Although there has been an increasing focus on the general government, particularly in the budget proposal (*Relazione Previsionale e Programmatica* or RPP), the publication of information on subnational activities is still limited by availability of timely, and at times reliable information.

19. **There are a number of other publications, issued by various institutions, that report fiscal developments and aggregates, but they differ in terms of coverage and accounting criteria.** There is no consolidated presentation of government finance statistics and users must obtain data from various sources that are compiled on different bases and are not completely consistent. ISTAT publishes annually statistics on the general government accounts on a national accounts basis. It has also begun to produce, on an experimental basis, and is planning to publish quarterly accounts on the same basis, starting in 2004. In its annual report and in the semi-annual *Economic Bulletins*, the BOI publishes statistics on a more broadly defined aggregate (public sector) including the general government plus the noncommercial operations of the railways and postal system.[27]

[26] Some of these documents will be described in some detail in the next two sections of this report.

[27] For a description of the different coverage of various fiscal aggregates, see the methodology section in the appendix of the BOI Annual Report.

Box 5. Major Documents for Budget and Fiscal Reporting, Issued by the MEF

Timing	Document	Purpose
March	*Relazione Generale sulla Situazione Economica del Paese, vol. I-III*	Overview of developments and prospects in the economy and the public finances.
Monthly	*Conto Risassuntivo del Tesoro*	Monthly report on budget cash execution and treasury operations.
Quarterly	*Relazione Trimestrale sulla Stima del Fabbisogno di Cassa*	Quarterly report on cash accounts on the basis of treasury operations and general government.
June	*Rendiconto Generale della Amministrazione dello Stato*	Annual statement of budgetary outturns.
	Disposizioni per l'Assestamento del Bilancio dello Stato e dei Bilanci delle Amminstrazioni Autonome	Revised budget.
	Relazione sul Rendiconto Generale dello Stato	Report by Auditor General (*Corte dei Conti*) on the budget outcome.
July	*Documento di Programmazione Economico-Finanziaria*	Medium-term plan for the budget and prospects for the economy.
September	*Relazione Previsionale e Programmatica*	Draft fiscal program with estimates and description of new policies proposed. Includes draft finance law and supporting documents from each ministry.
December	*Disposizioni per la Formazione del Bilancio Annuale e Pluriennale dello Stato (Legge finanziaria)*	Finance law—to put into law new budget proposals.
	Bilanco di Previsione dello Stato per l'Anno Finanziario e Bilancio Pluriennale per il Triennio	Budget law—to authorize all revenue and spending consistent with existing law.
January	*Bilancio per Capitoli*	To inform line ministries of their budget broken down by chapters.
	Bilancio dello Stato per Centri di Costo	State budget costs (accrual by cost centers).

20. **Both the budget proposal submitted to parliament and the approved budget law present the main fiscal aggregates for one year prior to the budget year, and two years beyond the budget year**. The national budget is divided into four parts. The first contains the text of the articles of the budget law itself, setting forth the authorization to assess and collect taxes and duties followed by articles authorizing payments. The second contains the general summaries of the *competenza*[28] and cash budgets of the state; three-year rolling budgets under existing legislation for the state and for autonomous agencies; and the programmatic budget. The third and most voluminous part of the budget consists of budget

[28] As discussed in the next section, the *competenza* budget is based on legal criteria, reporting revenue assessments and expenditure commitments for the relevant fiscal year.

estimates for revenues and expenditures.[29] Finally, numerous papers, which can be grouped into four series of documents—attachments, lists, appendices, and annexes—are attached to the draft budget.[30]

21. **Along with the draft budget, the 1978 accounting law requires the MEF to submit simultaneously a finance law to parliament.**[31] Contrary to the budget law, this is an ordinary law that contain all the measures that have to be included in the three-year programmatic budget. The financial law (article 1) sets limits in terms of *saldo netto da finanziare* (difference between revenue and expenditure, including net lending) and *ricorso al mercato finanziario* (gross borrowing requirement) for the state on a commitment basis (*competenza*) for every year covered by the multi-year budget. The finance law also establishes, inter alia, allocations for new or incidental revenues and outlays; for reappropriation of capital expenditure laws; and for a fund to renew state employees' contracts. It also provides a table showing reductions in legislative expenditure authorizations. The finance law cannot contain regulatory or administrative provisions that have no significant effect on balances nor local or sector-specific provisions or provisions that delegate power to the government.

22. **Budget documents do not contain a statement of fiscal risks.** As required by the 1978 accounting law (article 13), a list of state guarantees to agencies and other entities is attached as a memorandum item to the draft budget of the MEF. However, this list does not report the amounts guaranteed, nor does it provide a maturity profile. There is no information on the amounts of guarantees called during previous years, except in the government final accounts (*rendiconto*). The same applies to costs incurred on account of litigation, and to Constitutional Court's rulings. Quasi-fiscal activities are not extensive, and their estimated cost is included in the budget documents and also reflected in SOEs budgets.

23. **Budget documents do not contain a systematic presentation of tax expenditures.** The quantification of the cost and proposed funding of measures that qualify as tax expenditures are made available in the technical report attached to each measure's legislative

[29] Defense expenditures are clearly reported in the budget. They are reported ex ante on a functional basis (COFOG) and under the administrative classification (ministries of defense and interior). They are also clearly identified in the state final accounts and subject to the general auditors' scrutiny.

[30] The attachments (*allegati*) itemize sources of revenue and expenditures and the calculation of estimates for particular chapters such as, for example, those related to the salaries of employees. The lists attached to the tables define the items for which special powers can be excercised by the respective ministry during the budget execution. The appendices contains the budgets of the state's autonomous agencies, reported in an attachment to the budget estimates of the expenditure of the ministries responsible for managing, overseeing, and monitoring them. The annexes identify the budgets and the operations of entities subject to oversight by several departments, which are provided to parliament for information.

[31] The finance law has undergone changes over time. Initially, the finance law had an omnibus structure. As a result, the number of concepts dealt with in this law skyrocketed, making it virtually impossible to approve the budget in time. As a reaction to this state of affairs, the scope of the finance law was thus drastically reduced in 1988 (law No. 362). This, however, resulted in excessive fragmentation of the process of approval of revenue and spending measures, and a loss of perspective on their interrelations. In 1999, a decision was therefore made to revert to the old version, which once again imparted a "broad" meaning to the finance law.

bill, is required by the article 81 of the Constitution. These reports do not generally provide a detailed analysis of the economic impact of the tax expenditures. A list of the tax expenditures authorized during the year is also attached to the MEF's draft budget. However, these estimates only cover those that take the form of tax credits. There is no comprehensive list of outstanding tax expenditure and their estimated cost.

24. **Information on gross public debt and financial assets is published regularly.** Information on the level and composition of general government debt is provided in the DPEF. Data on central government debt are published on a quarterly basis by the Public Debt Management Department (see also http://www.debitopubblico.it) and are also presented in the *Relazione Trimestrale di Cassa*. The same figures are provided for the IMF Special Data Dissemination System (SDDS). BOI publishes data on the financing of the borrowing requirement and on gross debt, with all the standard breakdowns (subsector, instrument, holder); financial flows and stocks (flow of funds) are also published according to the *ESA 95* framework. ISTAT presents the data according to the *ESA 95* framework. Generally, financial flows comprise only cash transactions and, in accordance with EU guidelines and *GFSM 1986*, debt liabilities are recorded at face value rather than market value. However, BOI also publishes financial flows which include accrual adjustments and stocks valued at market value; this work is carried out in close cooperation with ISTAT. Stock data are also fully consistent with EU regulations. Information on financial assets is published yearly in the state financial accounts, in the general statement of assets and liabilities (*conto patrimoniale*), in accordance with article 22 of the 1978 accounting law.

25. **Legal requirements for regular publication of fiscal data are in place, and there are advance release date calendars for most data**. The terms and conditions for the compilation and dissemination of statistics by ISTAT are available through the *Sistema Statistico Nazionale* (SISTAN) website. The dissemination calendar of statistics released by BOI is available on BOI website. Law 468/1978, as amended by law 208/1999, which governs the collection and dissemination of data by the MEF, is also publicly available. The actual date of publication generally meets the pre-announced schedule, with the notable exception of data on monthly central government operations. Accordingly, with the latter exception, the data meet the timeliness and even exceed the periodicity standards of the IMF SDDS.

C. Open Budget Preparation, Execution, and Reporting

26. **The major stages of the annual budget preparation process are clear.** In 1999 (Law No. 208), the budget calendar was rationalized.[32] The budget process is articulated in a number of documents subject to parliamentary approval: the DPEF, to be presented by end-June; the draft budget on current legislation and a financial law (*legge finanziaria*) containing new measures for the following three years, both to be presented to parliament by end-September; measures associated with the financial law (*provvedimenti collegati*), to be approved by mid-November; and the enactment of the final budget and financial laws in December. In January, the budget is re-presented separately by chapter and by cost center.

[32] In Italy, the fiscal year coincides with the calendar year.

The adjustment (*assestamento*) budget is presented by mid-year, at about the same time that state financial accounts for the previous fiscal year are presented to parliament.

27. **The budget presentation focuses on legal compliance and the core budget classification is bridged to support reporting which meets international standards.** The budget documentation now presents budget information by function and by economic classification. The budget appropriation structure, however, is not based on standard economic or functional classification but on *unità previsionali di base* (UPB). The adoption of UPBs, which were introduced with the 1997 reform of the structure of the budget and its approval (law No. 94, also known as Ciampi reform) considerably reduced the budget items from 6,000 chapters to about 1,000 units. Each UPB was assigned to a specific manager,[33] but without functional or programmatic purpose and, in many cases, no obvious economic intent. The law also established the introduction of economic (in 1999) and functional (in 2000) budget classifications. However, the 1997 reform fell short of its original intentions as audit functions as well as basic reporting requirements (*rendicontazione*) were not changed, and remain focused on traditional budget chapters, as discussed in Box 6. Their purpose is solely to provide the minimum level of parliamentary allocation. Accordingly, there is a general prohibition on transferring budgetary appropriations between UPBs, except for the office of the prime minister.[34] The large number and considerable heterogeneity in content and size of UPBs make the budget documents somewhat inaccessible to the public. Underpinning each UPB allocation are one or more chapters. These chapters are used to derive the functional and economic information for presentation consistent with national accounting.[35] The RGS also prepares, for information purposes, an accrual estimation of budget expenses by ministry and economic costs, based on bridging the data from chapters to full costs (including depreciation) and making necessary adjustments.[36]

28. **The budget approval process, although clearly defined in law, is complex.** The DPEF is submitted separately to both houses, and requires a parliamentary resolution. The financial law cannot increase expenditures or reduce revenue above the levels specified in the DPEF, as approved in the parliamentary resolution. Accordingly, the resolution constrains both parliament and the executive to these levels, unless there is a notice of variation presented by the government along with the RPP. The resolutions do not put any limit on specific line ministries or sectors. The formal budget is shepherded through the approval process via a sequence of votes. The vote on the draft budget under existing legislation is followed by the vote on the financial law. Finally, there is the vote on the variation note that transfers the financial law's measures into the budget bill. Formal allocations by UPB are

[33] This was consistent with the Bassanini reform of the public administration, the main objective of which was to introduce a clear separation between the political and the bureaucratic spheres.

[34] Offsetting transfers across chapter within the same UPB are allowed, but need the approval of the minister of the economy and finance.

[35] Requirements are specified in law No. 94 of 1997 (article No. 6) of supported by legislative decree No. 279 of 1997 and circular letter No. 65 August 22, 1997 of the Ministry of the Treasury.

[36] This is referred to as the "economic budget" and is produced by the General Inspectorate for Budget Policies of the RGS, *Budget dello Stato*, January 2002.

made for the budget year only. Although these procedures appear to be designed with the goal of limiting imprudent budgeting decisions, the complicated process makes it difficult for the public at large to understand how the budget is formulated. Budget authority is provided both on entering commitment and using cash, as described in Box 7.

Box 6. Budget Structure and Classification

The basic unit of budget classification remains the chapter (capitolo), although, following the 1997 Ciampi reform, the budget is now appropriated on the basis of UPBs (*unitá previsionali di base*). Each UPB is an aggregation of one or more chapters and appears to have little economic meaning. Each chapter is mapped to standard economic and COFOG functional classification and the substantive laws which give rise to them. Each chapter has a four digit code, with the first number indicating whether it is for current payments (numbers 1 to 6); capital payments (numbers 7 and 8); or for payments with respect to financial transactions (number 9). A chapter may be prorated across as many as ten functions (at the third level), but map to one economic object. UPBs may be very significant in budgetary terms (UPB 4.1.7.1 for interest payments to CDP associated with its funding of the treasury amounted to €7.9 billion) or relatively trivial (UPB 5.2.3.9 for a specific matching program of only €899).

For example, in the ministry of productive activities (*Ministero delle Attivitá Produttive*), chapter 1041 is supported by law 335 of August 8, 1995. It is fully apportioned to the economic classification of employer contributions to social security (*contributi sociali effetivi a carico del datore di lavoro*), which corresponds to the economic code 1.3.1 economic and apportioned across eight functions, with the largest share of 39.6 percent being charged to code 4.4.2.91 (*oneri sociali a carico dell'amministrazione sulle retribuzioni corrisposte ai dipendenti*). Table 3 of the 2002 budget proposal documents also shows that this particular chapter is one of the many chapters subsidiary to UPB 1.1.1 covering administrative corporate costs (*spese di funzionamento*) of the ministry. This UPB falls under the center of responsibility 1 under the office of the minister (*gabinetto e uffici di diretta collaborazione all'opera del ministro*).

As this ministry is newly created, the draft budget also maps all chapters to their predecessors in other ministries (*Ministero dell'Industria, del Commercio e dell'Artigianato, and Ministero del Commercio con l'Estero*). Chapter 1041 maps to two chapters (1041 and 1022) relating to the similar purpose in those two ministries in the previous year. Every chapter is cross-referenced to the one or more supporting laws or regulations, some of the enactment dates being from early last century. Chapters covering similar transactions may have different codes in different ministries and over time.

Resolution 7-00122 (June 4, 2002) of the budget commission in the House of Representatives emphasizes the need to complete the 1997 Ciampi reform by developing, among others, clear responsibility and accountability lines.

Box 7. Authorities to Commit and Spend

Italy appropriates to UPBs on a commitment basis (*competenza*) which limits actual commitments (*impegno*) and on a cash basis (*autorizazione di cassa*) which limits payments (*pagamenti*). Under the cash authority, there is provision for liquidating residual authority. However, this residual authority is not explicitly estimated in the budget law, although there is estimation in the budget proposal to the chapter level of this carry-forward amount. Residual authority can be carried forward for up to two years for current spending and for five or seven years for capital spending. Cash authorization in the budget proposal is determined by applying a realization coefficient to the sum of the expected carry-forward at the beginning of the year and the new *competenza*. There are three forms of carry-forwards (*residui*)—*residui propri*, appropriations against which commitments have been made; *residui di stanziamento*, appropriations against which commitments have not been made; and *residui perenti*, carry-forwards which have passed their prescribed period, but can be reactivated by a special procedure with authorization of the ministry of the economy and finance, and which draws on a reserve fund. Residuals can only be cancelled by the prime minister, who makes cancellations in January. In January 2002, €66.3 billion of such carry-forwards were canceled.

Notwithstanding these cancellations, the residual carry-forwards are extensive. They are subsequently listed at a ministry level in the final accounts (*rendiconto generale*) showing residuals carried forward from prior years, amount of residual used in the year being reported on and the amount of new *competenza* carried forward. They are also reported in the supplementary budget (*l'assestamento del bilancio*). At the end of 2001, total *residui passivi* carried forward amounted to €135 billion, representing 21.8 percent of all commitments made, with the amount split 17 percent of current spending (€64 billion) and 126 percent of capital (€68 billion), up from about 60 percent in 1996.

Subsequent to the IMF fiscal transparency mission, the government issued a decree (No. 194, September 6, 2002), effective immediately and subject to parliament's conversion into formal law within 60 days, that reduces from three to one year the carry-over period for uncommitted capital spending. The same decree also introduces two other substantial changes to budget management: the first measure establishes that budget appropriations cannot be exceeded without parliamentary approval, even in the case of obligations and irreducible charges predetermined by earlier legislation; the second grants the minister of the economy and finance the authority to unilaterally reduce budget appropriations, except for mandatory spending (e.g., wages and salaries, pensions, and interest expenses) when overall spending exceeds the limit set in the budget law. The first measure, which was dictated by the need to ensure compatibility between the approved budget and actual spending, may give raise to a conflict between the requirements placed on government under substantive laws (such as those specifying entitlements) and the resource limitations of the budget law.

29. **The overall balance of general government is one of the main indicators of the fiscal position in the budget, and steps are being taken to improve the monitoring of the general government balance during the year.** Italy's membership of the EMU encourages a concentration on the presentation of budget data consistent with *ESA 95*, which requires consolidation of all general government activity on an accrual basis.[37] Section II of the budget proposal (RPP) provides fiscal information for the central government and general government, including some projections of subnational activity. The primary and structural

[37] This is quite different from reporting on *competenza*, which is often described as accrual in Italy. The criteria currently utilized in the compilation of accrual accounts are explained in Box 12 below.

balances are also reported, along with debt sustainability analysis. There is no consolidated reporting ex ante or ex post of the wider public sector, including the commercial activity or equity transactions of SOEs.

30. **Budget forecasts are clearly presented in the budget documents, and some underlying macroeconomic assumptions are disclosed in the budget documentation.** The main supporting document with the budget proposal is the RPP. This contains information on the international economy and the expected performance of the Italian economy over the medium term. There is no detailed specification of the underlying basis to the development of the forecasts for the economy or the public finances, although the DPEF provides some description. The models underlying the expenditure and revenue forecasts are not generally available, and are not subject to independent evaluation. These forecasts, which are characterized as the government's baseline forecasts, are ultimately compiled by the RGS with inputs from all the other departments (treasury, debt management, and fiscal policies) of the MEF.

31. **A statement on medium-term fiscal policy objectives is included in the budget documents.** The DPEF includes estimates of the unchanged policy fiscal path, and the target fiscal outcome being sought for the budget year plus at least three years. Accordingly, it highlights the contribution which is required from policy change. However, it does not explicitly detail the elements of those policy changes. Italy also updates its stability program each October to meet its commitments under the SGP. The 1978 accounting law (article 2, comma 2) requires the DPEF to provide "timely and annotated evaluation of actual trends and eventual discrepancies from the goals set in preceding DPEF documents." However, the most recent DPEF does not appear to do this.[38] The RPP updates the medium-term macrofiscal projections and, if needed, the amount of the proposed fiscal adjustment, including its expected impact on the budget year plus two out years. Information for these years is also supplied in each of the line ministry documents produced with the RPP.

32. **The forecasts formulated by the executive and published in the DPEF are not subject to formal external verification, although they are subjected to considerable parliamentary scrutiny.** Key assumptions underpinning the budget are reviewed by the budget committees of the two houses of parliament. Experts are called before these committees to report on their analysis of the government's forecasts. The MEF, as the agency responsible for the generation of the forecasts, consults with some private and other public sector agencies, such as the *Istituto di Studi e Analisi Economica* (ISAE).

33. **Budget preparation has an incremental and legal compliance focus.** In preparing the budget, the RGS transmits the budget preparation circular to line ministries at the end of March.[39] This calls for the submission from line ministries by end May of their respective budget projections on unchanged legislation for the subsequent three years. The circular is a substantial document, with more than 150 pages of instructions and proformas. Specific

---

[38] *Documento di programmazionne economico-finanziaria 2003–2006*, July 5, 2002.

[39] *Previsioni di bilancio per l'anno 2003 e per il triennio 2003–2005 – Budget per l'anno 2003*, Circular No.16, March 25, 2002. provided as a supplement to the official gazette dated April 4, 2002.

guidelines are provided for discretionary categories of expenditure.[40] In addition, ministries seek resources for new policy initiatives through two methods: either by proposing that they be included in the finance law; or by proposing an allocation for the special funds (*fondi speciali*). In formulating their budget bids for new initiatives, line ministries reflect the policy priorities outlined in the government program, and seek to influence the announcement of new sectoral policy proposals outlined in the DPEF. This appears a rather unconstrained bidding process, with individual ministries placed under no ceilings in developing these proposals. Bilateral negotiations between the MEF and other ministries take place in June through September. In the end, the RGS advises the detailed amounts going into the draft budget proposal and provides the final drafts[41] that accompany them for the consideration of CIPE and then of the cabinet as a whole. These drafts have a legalistic, rather than economic, focus.[42] Shortly after the enactment of the budget, each ministry distributes to its offices a directive on administrative activities for the year.

34. **Estimates of new initiatives and ongoing costs of government legislation are clearly distinguished in the budget documents.** The finance law contains details of the costs of each of these initiatives for the budget year plus two years, with a specified date for termination, when applicable.[43] The finance law also specifies the amounts to be included in the special funds for each ministry.[44] These funds, which are to be reported in tables annexed to the financial law—Table A for current expenditure and Table B for capital expenditure—and are intended to cover new policy initiatives that are not ready to be included in the finance law. Thus, while they can provide an ongoing source of authority for new commitments and spending during the budget year as new legislation is passed by parliament, the intended use of these funds is not specified in the budget presentation. As the budget law provides separate authorizations to disburse cash and to commit, a mechanism is needed to provide some flexibility on the liquidation rate. A UPB for "other funds in reserve"

[40] For instance, the circular for 2003 requires a reduction of one percent in total personnel, a 10 percent reduction in most discretionary spending, and a 10 percent reduction in cash spending.

[41] "It should be noted that despite the fact that the law assigns each ministry the task of preparing its own budget, the drafting of the Preliminary Note, the selection of the base estimate units and the distribution of the related appropriations, in reality the General Accounting Office accomplishes all of these operations. And while the General Accounting Office uses the texts proposed by the ministries as a starting point, it reserves the right to radically modify them before arriving at the final draft." Quote from Vegas, G., D. Da Empoli, and P. De Ioanna, *Il bilancio dello Stato. La finanza publica tra governo e parlamento*, Le Guide Il Sole 24 Ore (Milan: 2000), p. 174.

[42] This focus on laws rather than on policy objectives, inputs, outputs, or outcomes was also commented upon in the most recent report of the *Corte dei Conti* to parliament on the annual accounts.

[43] The finance law for the current year (*legge finanziaria 2002*) was gazzetted as law No. 448 of 2001 on December 28, 2001. The budget law (*bilancio di previsione dello Stato*) was law No. 449.

[44] In 2002, 14 ministries received special fund allocations for current spending totaling €1.0 billion and 12 ministries received similar allocations for capital spending, totaling €6.5 billion, of which €5.3 billion was to cover regional debts in the health sector.

in ministry of economy and finance provides a large cash allocation to meet higher than forecast liquidation of commitments made under other UPBs.[45]

35. **A limited analysis of sensitivity of the estimates to changes in economic variables is published.** The DPEF has traditionally contained some information on sensitivities to economic variables. For instance, in 2001 the DPEF provided a brief discussion of the effect of potential favorable and unfavorable developments in the macroeconomy on the budget. The 2002 DPEF does not do this. However, as member of the Euro area, Italy is required to provide the EU with a sensitivity analysis, with the update of the stability program. This sensitivity analysis will provide a set of first round effects on the budget aggregates for changes in certain prescribed variables. There has been a separate effort to examine the long-term effects of the pension system out to 2050 using alternative demographic assumptions.[46]

36. **Objectives of major programs are not specified in detail and actual progress is not reported against these objectives.** The introduction of UPBs was meant to coincide with a sharper focus on performance in budgetary preparation, presentation, and execution. However, requirements in the law about performance information have not been implemented to date.[47] Agencies describe their operating plans in annexures to the budget proposal, but this is at a general level and is not well aligned to the budget structure, making accountability difficult to establish.

37. **The budget is subject to a mid-year review.** The executive provides a draft revised budget to the parliament (*Disposizioni per l'assestamento del bilancio dello Stato e dei bilanci delle Amministrazioni autonome per l'anno finanziario*) prior to the end of June. This bill frequently remains open until November.[48] The final passing of the revised budget late in the year allows a tidying-up of budget appropriations, reducing the chances of unlawful overruns. As well as providing for legal variations in UPB allocations, the revised budget also provides information on *residui*, and updates the revenue estimates. It is notable that the revised budget shows only variations in appropriations, rather than the revised total.

38. **As indicated above, many new policy initiatives are authorized outside the regular budget cycle, thereby reducing the meaningfulness of the budget as an instrument of resource allocation.**[49] The creation of special funds for most ministries

---

[45] In the 2002 budget, this allocation is more than €10 billion, or over 0.8 percent of GDP.

[46] Ministero del Tesoro, del Bilancio e della Programmazione Economica, *Medium and long term trends of the Italian pension system year-2000 update of the projections based on the RGS model*, November 2000, available at http://www.tesoro.it.

[47] Article 2, paragraph 4 of law No. 468 of 1978.

[48] During this period, the parliament also has to consider the annual accounts from the previous year, a new DPEF, and the draft budget for the following year.

[49] The *Corte dei Conti* reported that in 2001 there were 79 new spending laws put into effect outside the consideration of the budget. Of these, 30 were initiated by the parliament rather than the executive.

encourage requests for budget support for many initiatives during the year, rather than having them considered simultaneously in the budget.

39. **Most taxes are now collected through the banking system, allowing for a rapid verification and classification of revenues.**[50] Tax compliance costs have been substantially reduced with the single payment system (form F24) introduced with two legislative decrees in 1997 (No. 241 on the simplification of taxpayers obligations, and No. 314 on the harmonization of tax and social security tax bases). Important innovations are also the joint payment of all taxes and social security contributions due in a single payment while allowing for the offsetting of tax debts and credits. The new system of tax collection links the taxpayer register (*anagrafe tributaria)* with commercial banks, licensed tax collectors, the postal service, all regional administrations, and the largest social security institutions in addition to the BOI branch network and the RGS system. Data are now available to the RGS seven calendar days after actual payment and after most errors have been corrected automatically by commercial banks and post offices. Within five working days, banks and post offices transmit all funds collected to accounts held at BOI treasury account in Rome in the name of the revenue agency. Data on taxpayer declarations are sent in parallel to the revenue agency. The revenue agency matches tax declarations with actual payments and credits the funds collected to the (ledger) accounts of social security institutions and regions, and sends the information to the RGS.

40. **Expenditure commitments against budget appropriations and the prescribed cash limits for each chapter (*capitolo*) are centrally controlled at the RGS.** Spending units of the line ministries process—on line or by paper documents—expenditure commitments and payment claims after verification of supplies, for pre-approval and registration by the RGS. The verification stage is administered internally at the spending units and not separately registered at the RGS. No report on the stock of payment arrears is generated. Actual payments against all claims on the state are made by the treasury branches in the BOI, based on payment orders (*mandati di pagamento*) used in the RGS.[51] All cash operations pass through the unified treasury account (*tesoreria unica*) maintained at the BOI. The functioning and the coverage of the unified treasury account are described in Box 8.

41. **The internal financial control processes within the line ministries are overseen by officials of the RGS in their accounts department.** In addition, Legislative Decree 286/1999 has introduced internal audit for all the line ministries. Internal audit departments report directly to their ministers and coordinate their work plan with the *Corte dei Conti.* Presently they focus mainly on compliance with budget implementation procedures and financial regulations, but may undertake special audit in selected cases on request from the *Corte.*

[50] The newly established revenue agency collects revenue on behalf of a large number of institutions, including social security institutions and most local governments.

[51] For payments originating in the provinces, the RGS credits periodically the special accounts of the respective offices in the provincial treasury branches at the BOI with an amount (*fondo di accreditamento*) on which individual payments orders issued by the office are drawn.

42. **In recent years, there have been efforts to reorient expenditure control processes from legalistic compliance with budget provisions to monitoring of results from budget implementation against declared objectives.** The 1999 decree mentioned above prescribed four control objectives in broad terms: (i) administrative and accounting regularity; (ii) efficiency and effectiveness of management; (iii) managerial capacity to achieve target goals; and (iv) strategic control over the realization of goals specified in the annual budget. When fully implemented, administrative reforms along these lines could substantially refocus the budget management process. These reforms are, however, still at an early stage. One of the factors hindering progress in this area is the limited usefulness of the budget classification by UPB.

43. **Italy has adopted all the major EU directives on purchasing and procurement.**[52] Within this framework, agencies may use open procedures, restricted procedures or negotiated procedures depending on the circumstances. The overriding criteria is "the economically most advantageous tender." The authorities have recently established a commercial entity (*Concessionaria Servizi Informativi Pubblici* or CONSIP S.p.A.) to be responsible for the rationalization of public procurement, with the aim to reduce costs through lower priced frame contracts for common items, and by making available transparent e-procurement procedures.[53]

44. **Accounts of government budget operations and cash operations of the state treasury are compiled from primary transaction records maintained at the RGS.** The basis of the accounts is defined in law as "accrual and cash," as discussed earlier. The principal accounts statements generated at the RGS are: monthly summary on the treasury accounts (*Conto Riassuntivo del Tesoro)*, quarterly cash report (*Relazione Trimestrale di Cassa*), and the annual General Statement of Accounts (*Rendiconto Generale della Amministrazione dello Stato)*. Box 9 describes their respective contents.

[52] Regulations DL 157/95 and DL 358/92 have adopted 92/50/CEE, 77/67/CEE, 80/767/CEE, 88/295/CEE concerning open tenders for public supply of goods.

[53] The e-procurement platform involves a common portal with three main functions: electronic catalogues which support purchasing within the "frame" contract; on line auctions which address specific procurement needs and a market place for frequently purchased low price goods. CONSIP has now launched its own website, at http://www.consip.it.

Box 8. The Unified Treasury Account

The state treasury operations are conducted by the BOI on an agency basis through a central treasury in Rome and its branches in the provinces (*Tesoreria Centrale and Tesoreria Provinciale)*. A unified treasury account (*tesoreria unica)* is maintained at the BOI for the state sector (*settore statale*). The legal basis for the initial establishment of the treasury is found in law No. 720 of October 29, 1984; since then, a number of laws were enacted further amplifying its coverage and the responsibilities of the BOI. The reforms leading to the incorporation into the BOI of all the state treasury cash functions, and the consolidation of administrative responsibility for the management of the state budget on a cash basis at RGS, have significantly streamlined the budget payment and cash management processes.

The unified treasury account maintains cash resources of the state budget, as well as those of subnational governments and a large number of public corporate and autonomous institutions including the CDP. Under law No. 720, the coverage of the institutions other than the state is specified in two tables. Table A comprises relatively smaller institutions which must deposit within three days all their cash resources into the treasury account. This list contains subnational governments (with some exceptions), and autonomous institutions such as ARAN, CONSOB, and ISTAT. Table B covers the large state, public corporate entities including: *Ente Nazionale per le Strade* (ANAS), *Istituto Nazionale per l'Assicurazione contro gli Infortuni sul Lavoro* (INAIL), *Istituto Nazionale di Previdenza per i Dipendenti della Pubblica Amministrazione* (INPDAP), and SACE, and regions. The institutions (other than regions) are allowed to administer 3 percent of their own revenues through their own bank accounts in commercial banks, but must deposit the rest of the resources in the treasury account. Moreover, they must exhaust their balances with the commercial banks before accessing the treasury account.

With the 2001 financial law (law No. 388 of 2000, article No. 61), the financing arrangements between the treasury system and regions has also changed. Beginning March 2001, all shared revenues, transfers from other public administrations (with the exception of EU funds), and state guaranteed borrowing are to be deposited with no interest in BOI provincial branches. At the same time, the required 3 percent balance with commercial banks has been abolished, and regions can deposit with their treasurer own revenues, with the exception of the regional tax on valued added (*Imposta Regionale sulle Attivitá Produttive,* IRAP). However, regions have to utilize idle balances with their treasurers prior to withdrawing funds from the BOI provincial accounts.

The reports generated by the RGS (described in Box 9) incorporate transactions only when cash flow results. All revenues deposited at the commercial banks (except by the regions, as mentioned above) must move to the treasury account within three days. All state budget payments require authority from the RGS. Payments for salaries and pensions are made directly by the treasury through the postal system or direct disbursements.

The state cannot borrow from the BOI, and must maintain positive balance of at least €15 billion in the treasury account. The Public Debt Department in the General Directorate of Treasury in the MEF carries out government borrowing and debt management operations.

45. **As presently structured, the accounting systems at RGS do not generate timely in-year reports on the implementation of the state budget on a *competenza* basis**. The budget reports and cash accounts statements, while containing much information, are not formatted for timely monitoring of government fiscal operations. The only report on a monthly basis—report on treasury account—is available after a lag of two months. As discussed in Box 9, this report is devoted to treasury cash (*incassi* and *pagamenti*) operations. There is no monthly report dealing with expenditure commitments made by the line ministries against appropriations and *residui di stanziamento*. The accounts statements generated at the RGS (*Rendiconto*) provide voluminous data but only on an annual basis, some six months after the end of the budget year. Contents of the *Rendiconto* are classified principally to comply with the regulatory provisions of cash and commitment appropriations.

Box 9. Principal Accounts Statements Generated by the RGS

Monthly report on treasury account (*Conto Riassuntivo del Tesoro*): The state treasury publishes a monthly report on its cash operations in the official gazette (*Gazzetta Ufficiale*). The law requires this report to be published within 20 days of the end of each month. The report, however, is published with a lag of 2–3 months. This report is the only monthly source of information on, among other matters, the treasury cash operations relating to the government budget, *settore statale*, subnational governments (only to the extent they are reflected in the treasury account), and treasury financing and currency emission operations,[1/] Cash based operations in aggregate are reported in separate tables by ministry, and by economic and functional classification. For state budget operations it provides separate aggregates for cash operations arising from liquidation of commitments and *residui*. These tables are disaggregated by line ministries, functional, and economic classifications. Fully classified information on revenues and other cash receipts is available. For institutions outside the state budget (including subnational governments) but served by the state treasury, and for assorted special accounts (*Contabilitá Speciali*), aggregate data on cash flows and balances with the treasury are provided. The monthly report, however, does not cover operations of the institutions and subnational governments from their own bank accounts in commercial banks. The quarterly issue of the monthly report provides full details on outstanding public debt stock (*Situazione Trimestrale dei Debiti Pubblici*).

Quarterly Cash Report (*Relazione Trimestrale di Cassa*): These reports of the state treasury are required to be submitted under law 468/1978 to the parliament within two months of end of each quarter, and generally meet this deadline. The focus of these reports centers on consolidated cash flows as well as estimates of anticipated cash requirement within the state sector and estimates of the annual government sector (*ESA 95*). The report for the last quarter of the fiscal year, submitted to parliament in March of the following year, contains information on public administration, government sector and public sector accounts, with analysis of each sector. Consolidated data are also provided on the cash operations for the general government for the preceding three years with economic classification and aggregate estimates for the new fiscal year including the key indicators of primary and overall balance and net lending/borrowing. As indicated in Section B, the definition of general government differs slightly from that adopted by ISTAT and BOI. Unlike the monthly reports, the Quarterly Cash Reports include operations of state institutions and subnational governments financed by their accounts in commercial banks. The Quarterly Reports also provide information on the state budget execution, aggregate data on *Settore Statale*, state health entities, and subnational governments. A number of tables provide extensive data on treasury operations including cash operations of the *Cassa Depositi e Prestiti*, and treasury borrowing and debt servicing operations. The Quarterly Report is cast in a more user-friendly format than the monthly report, and uses charts to illustrate movement in important financial variables. However, it uses different formats for presentation and aggregation of data from those seen in the corresponding monthly accounts, making cross comparison of data difficult.

General Statement of Accounts (*Rendiconto Generale della Amministrazione dello Stato*): These annual reports represent the formal state accounts compiled by the RGS and approved by the parliament after audit by the *Corte de Conti* around June-July of the following fiscal year. The accounts are presented in two volumes consolidating the accounts statements of the line ministries and other noncommercial state entities. Volume I contains the details of the budget provisions and outturns in a simple, uniform format providing for each line ministry: initial and final aggregates of budget appropriations in terms of opening balance of *residui*, competence and cash, outturn against these during the year, and closing balance—unused commitments—in terms of *residui*. This provides enough information to parliament to adjust the current year's budget by including in the revised budget the stock of *residui*. Apart from the information needed for appropriation management, Volume I provides no information for an analysis of the budget outturn.

Volume II of the General Statement of Accounts—*Conto Generale del Patrimonio dello Stato*—is in essence a statement on the stock of state assets and liabilities at the start of the year, changes during the year, and closing balances. It is a voluminous report containing hard-to-follow details. A slimmer user-friendly volume is published providing summary information presented in tables and charts. The data on stock of assets and liabilities are historically derived and do not reflect depreciation or revaluation. The stock of liabilities includes those arising from the issue of coins by the treasury, as well as *residui* of all categories including *residui perenti*. The *Corte dei Conti* certifies the accounts before submission to the parliament.

As the final accounts are not prepared following standard accrual-based criteria, and in particular assets and liabilities are valued at historical cost, their usefulness for analytical purposes is limited. The *Rendiconto* also treats *residui*, including *residui impropri*, as a financial liability, which is questionable since only economic flows can be recognized in formal accrual accounts and not the budgetary commitments that have yet to give rise to such flows.[2/]

[1/] The state treasury has the responsibility for the issue of coins ranging about €0.01–2.

[2/] If formal accounting of verifications took place, unpaid verifications could be legitimately treated as liabilities for accrual-based accounting.

D. Assurances of Integrity

46. **The initial budget provisions, both for commitments and cash limits, are subject to significant within year adjustment when the budget undergoes revision during the period June–November**. The intricate legal provisions require formal inclusion of *residui* in the adjustment budget only after the accounts for the past fiscal year are closed and approved by parliament. There is little readily available data which demonstrate the reliability of the budget estimates through time. The main source of outturn data is the *Rendiconto*, which generally concentrates on one year only.

47. **Since the centrally controlled accounting system at the RGS is geared to ensuring that the approved appropriations are not exceeded, procedures of reconciling the accounts with budget appropriations are effective. By contrast, reconciliation of the cash deficit with its "below-the-line" components has proved to be more problematic**. A high level commission headed by the chairman of ISTAT has been working on reconciling the differences between the above- and below-the-line aggregates for the *settore statale*, which were of the order of €6 billion for the year 2000. The report of the Commission, which is nearing finalization, has been able to reconcile most of the difference by matching individual transactions appearing in the books of the RGS and BOI and only about €600 million remains to be reconciled. Among the factors contributing to the discrepancies, as identified by the Commission, are underreporting of financial transactions by the RGS on the asset side, differing record of transactions between the government and the banking sector in the respective account books, and methodological differences on coverage issues between the two institutions. The commission is expected to make recommendations for methodological changes to prevent the reemergence of large discrepancies in the future.

48. **Problems have also emerged in reconciling the cash-based general government borrowing requirement (*fabbisogno*) as calculated by the MEF and ISTAT's accrual-based general government balance (*indebitamento netto*)**. After two revisions, this difference (about €20 billion or 1.7 percent of GDP) was eventually reconciled and published at the end of June, along with revisions of the 2001 fiscal accounts. [54] Details on data sources and adjustments carried out in moving from the cash-based general government borrowing requirement to its accrual-based balance are summarized in Box 10.

---

[54] *Conti aggregati economici delle amministrazioni pubbliche. Serie SEC95—Anni 1998–2001*, June 25, 2002, Table 10–12. According to this revision, the 2001 budget deficit is €2.4 billion higher than estimated in March (1.64 percent of GDP as compared to the 1.44 percent estimated in March and to the 1.1 percent expected at the beginning of the year). The revision was mainly due to higher health and capital spending; lower EU cofinancing; and changes in classification of transfers to railways and of minor revenue items.

Box 10. The General Government Accounts

General government sector statistics are compiled and published by ISTAT on an accrual basis in the context of the national accounts. These data are used to compile the general government deficit (net borrowing) required for reporting on Italy's compliance with the SGP targets. ISTAT's work is guided by EU regulations and Eurostat's *Manual on Deficit and Debt*. BOI is responsible for compiling financing and debt data for the general government sector which are also used for reporting on Italy's compliance with the SGP.

ISTAT estimates the nonfinancial transactions of government on an accrual basis. Generally, revenue is estimated by using techniques that time-adjust the cash data. In so doing, ISTAT takes account of the different timing characteristics of the cash flows for a wide range of revenue items. Expenditures are estimated from information on cash execution for the previous year—on accrual (*competenza*) data for the earlier years as they become available—as reported by the MEF and also on the basis of a number of specific agreements for the exchange of data. Reporting of data by local health units provides an exception to these general approaches in that they report to ISTAT (via the ministry of health) directly on an accrual basis. Interest expense is estimated on an accrual basis using the original terms of the contract to adjust for premia or discounts. Consumption of fixed capital is estimated using a perpetual inventory model based on a very long time series of asset holdings.

All government agencies, bodies and administrative offices are required to supply to ISTAT any data and information that is requested of them for surveys that are part of the National Statistical Program (article 7 of law 322/1989). ISTAT also combines the MEF budget data with annual censuses of the other general government units. The censuses collect comprehensive information on revenue (assessments and cash receipts), expenditure (commitments and cash payments) and financial transactions. Owing to the long delays experienced with reporting by some municipalities, ISTAT introduced a "rapid reporting" system in 2000 to collect information from a stratified random sample of municipalities. The survey provides for electronic reporting and is benchmarked against the latest fully enumerated census results.

The MEF uses administrative sources to obtain timely coverage of general government cash based transactions. In addition to data on budgetary central government, which are available monthly, public entities outside the budget—social security institutions, regional, provincial and local government units—are required by law to report to the MEF on a quarterly basis according to the provisions of law 468/1978, as amended by law 208/1999. As a result, according to the MEF, data are reported for all but 5 percent of local governments and the small mountain communities. Information is available from the accounting system to enable the consolidation of transfers among different levels of government.[1/] Similarly, the MEF (Debt Management Department) publishes only central government financing data because the coverage and reporting of such data to them by local governments is deficient.[2/] The full cost information in the so-called economic budget does not seem to be used in generating accrual data for national accounting purposes.

Various financial operations are included in the *fabbisogno* but excluded from *indebitamento netto*. These are also detailed in the MEF's quarterly cash reports (*Relazione Trimestrale di Cassa*, Table 4). For example, capital injections to state-owned firms by the government would be classified as financial operations, enlarging the *fabbisogno* but leaving the *indebitamento netto* unaffected. Privatization operations are instead classified below the line also for the purpose of calculating the *fabbisogno*. Among the financial operations are reimbursements with bonds of outstanding tax credits (see the footnote to the attached table). The remainder of such reimbursements is classified under "other accounts payable" (*altri conti passivi*) as difference between cash and accrual measures of reimbursements of tax credits. In the past couple of years, reimbursements of tax credits have accounted for a nontrivial part of the difference between *fabbisogno* and *indebitamento netto*.[3/] Differences also arise because of the classification of interest payments—on zero-coupon bonds, all cash payments basically occur at reimbursement but the interest expenditure is imputed annually, in line with *ESA 95*. Another source of difference between the two measures of the deficit is the different treatment of certain operations in public accounts with respect to national accounts. Reconciling the two sets of accounts requires therefore the re-classification of certain measures, including debt consolidation operations, which are indicated in the published reconciliation table.

[1/] However, the build up of arrears at the local government level confirms that arrears are not directly measured in the cash accounting system used by the MEF, although data become available at a later stage.

[2/] Local governments can finance capital spending by direct borrowing but are not required to report these data. A decree to strengthen the reporting of borrowing by local governments has been drafted and is currently subject to comment.

[3/] In 2001, for instance, there was also a substantial repayment of past debts of local authorities relating to health expenditure (€5 billion).

49. **The *Corte dei Conti* is a constitutional body entrusted with the responsibility for *a priori* audit of the regularity of government acts, and *a posteriori* audit of the state budget management**. Independence of the *Corte dei Conti* from the executive branch of the state is established by the Constitution (article 100, comma 3). While the President of the court and its senior judicial functionaries are appointed by the President of the Republic on the advice of the government, they cannot be removed from their office except by a presidential decree endorsed by a commission composed of the presidents and vice-presidents of the senate and of the chamber of deputies of parliament. Within the constraints of its budgetary allocation, the court enjoys administrative and financial independence, and functional and judicial autonomy in the discharge of its responsibilities. The court is served by approximately 500 judges and 2,500 other staff, and maintains regional courts in the country. Of the judges, about 130 are engaged on judicial duties while another 200 undertake investigative work.

50. **The role of the *Corte dei Conti* has evolved over the years, with reduced emphasis on the traditional ex ante oversight of the financial operations of the general government**. In pursuance of the fiscal decentralization, articles 125 and 130 of the Constitution that empowered the court to exercise ex ante financial audit of subnational governments have been abrogated. Some uncertainties have also emerged in the statutory provisions relating to the role of the court in ex post audit of the subnational governments. Parliament is presently considering a draft law clarifying the responsibilities of the court in this respect. Ex ante audit appraisal of the state fiscal operations is now limited to expressing an opinion on the financial laws under consideration and grant of visa for supply contracts of value exceeding €200,000. The court has, however, unfettered authority to conduct ex post audit of financial operations of the general government. It reports directly to parliament on the *Rendiconto*. Apart from the audit of the *Rendiconto*, the court also undertakes special audits of selected government activities. Parliamentary budget committees seek the opinion of the court on specific financial laws. The reports of the court are publicly available, and the court is at liberty to express its opinion in public.

51. **There is no legally sanctioned procedure that requires parliament to formally review the audit reports and initiate appropriate legislative or other action for compliance by the administration**. Legal provisions are in place requiring audited agencies to report to the court on remedial action taken in response to the audit findings. However, compliance with these provisions has been more formal than substantive.

52. **In tune with the legal orientation of the budget management processes, external audit also tends to be substantially focused on the formal aspects of budget management, and much less on performance audit.** The composition of professional skills at the disposal of the court points to the preponderance of legal-juridical expertise and relatively thin presence of qualified accountants and financial auditors.

53. **The Central Statistical Institute (ISTAT) is technically independent.** Legislative Decree 322/89 (Regulations on the national statistics system and reorganization of ISTAT). states that ISTAT is only subject to control and verification by the Commission for the Guarantee of Statistical Information in respect of the quality of information produced. Article 12 of the same decree established this Commission to "guarantee the principles of

impartiality and completeness of statistical information." In addition, this Commission "contributes to the correct implementation of the provisions that regulate the protection of confidentiality of information provided to ISTAT and other agencies of the National Audit System." It supervises "the quality of the statistical methodologies and information techniques used in the gathering, maintenance and release of data" as well as "conformity in recording with the directives issued by international and European Community agencies."

III. Staff Commentary

54. **In recent years, Italy has made significant progress in fiscal management**. Efforts have been made to modernize the budget system, and to improve transparency, efficiency, and accountability in the use of public resources. The relative roles of various branches of government are clearly defined, and in most state-owned or participated enterprises, noncommercial activities have been clearly identified and reflected in the budget. Information on fiscal operations of the state is released to the public on a regular basis. Procurement practices meet EU standards. New codes of conduct and ethical standards of behavior have been adopted across the public sector. Taxpayers' rights have also been strengthened and further clarified.

55. **As a result of these reforms, Italy meets the standards of the code in many respects, although the quality of fiscal data still falls short of the code standards**. The availability of timely and reliable information on activities of subnational governments is still limited. In addition, data from different sources are sometimes not easily reconcilable because of different accounting practices across levels of government. Different publications referring to different definitions of key fiscal aggregates, released with different periodicity and time lags, may result in conflicting signals on fiscal developments, and statistics that are not easily reconcilable. Budget processes are relatively open, but their main focus remains legal compliance, rather than ensuring an efficient allocation of resources. The same focus has historically characterized audit and control mechanisms, although efficiency considerations are increasingly taken into account.

56. **Despite significant progress, fiscal management still reflects a number of historical influences, which have limited the pace and effectiveness of the reforms**. Among these factors, the following can be briefly noted here:

- the constraints posed by **Article 81** of the Constitution on the budget law and the in-year new spending authorization process;
- **the traditional focus of Italian budget management on compliance with legal requirements**, rather than on efficiency in the allocation and utilization of public funds, and on the quality of services provided by the public administration (value-for-money); and
- the emphasis placed during the 1990s on the containment of the **borrowing requirements by the state sector in cash terms**, which at the time—given the broad coverage of the single treasury system—was an adequate, albeit imperfect, proxy for the general government borrowing.

57. **These historical influences are, however, increasingly at odds with new realities and prospective trends** which can be expected to affect budget management in Italy in the foreseeable future. Specifically,

- Italy's **adherence to the euro area and to the SGP requires fiscal policy to focus on the general government balance** (on a national accounts basis), rather than the state sector borrowing requirements, which in turn will require an early definition and enforcement of transparent common accounting rules for all general government entities;
- **the recent reform of Title V of the Constitution can be expected to lead over time to increased financial autonomy of the regional and local governments**—including a constitutionally sanctioned authority to borrow to finance investment—that will require intergovernmental mechanisms for coordinating budgetary policies and management to ensure an appropriate contribution of each level of government to macroeconomic objectives and fiscal sustainability; and, finally,
- **the SGP targets**—together with the government's objective of a gradual reduction of the tax burden—**require sustained efforts to contain primary spending** at all levels of government, both through structural reforms in the pension and health systems and the civil service, and **through improved prioritization and increased efficiency of discretionary spending programs.**

58. **Against this background, there appears to be a clear need to accelerate and broaden the scope of the ongoing budget management reform efforts**, with a view to making budgets at all levels of government more transparent and effective policy instruments, from both the macroeconomic and the resource allocation standpoints.

59. **From a general government perspective, the priority would seem to be to put in place intergovernmental mechanisms of coordination of budgetary policies and management**. In a context of increasing decentralization, these mechanisms would ensure an appropriate contribution of each level of government to macroeconomic and fiscal sustainability within the framework of the SGP. The recent government and parliamentary initiatives (mentioned in the text above)[55] calling for the inclusion in the annual finance law of specific targets for the balances of various levels of government and a **reformulation of the internal stability pact** attest to increasing awareness of the importance of these issues. As the parliamentary resolution emphasizes, it will be essential both to support any "rules of the game" in this area with clear and effective sanctions for non-compliance, and to put in place timely and reliable mechanisms to monitor developments in the finances of the subnational governments. This in turn will require the specification of transparent common accounting rules and the establishment of efficient (preferably on-line) channels of reporting. The cross-checking of the information "above the line" reported by the individual government entities with "below-the-line" information from the banking system would

[55] These are the government proposals presented to the House and Senate budget committee in February 2002, and resolution 7-00122 of the budget commission adopted by the House of Representatives on June 4, 2002. Both initiatives stressed, among others, the need to improve the quality and coverage of fiscal data, and to strengthen accounting practices by moving toward accrual accounting.

provide the needed guarantees of integrity of data. In this regard, completing the computerized system of reporting by general government entities (*Rete Unificata per la Pubblica Amministrazione* or RUPA), and developing its interface with the banking system network are clear priorities.

60. **At the state budget level, a comprehensive reform could, in the staff's view, usefully focus on three main objectives**:

- strengthening the roles of the DPEF and the budget law in determining strategic policy choices and resource allocation;
- shifting the focus of budget preparation and execution from legal compliance to efficiency in the use of public resources and accountability for results; and
- improving the quality of fiscal information.

Successful reforms of the state budget in these areas would constitute a model for the regional and local governments as well.

61. **As regards the first objective, the best approach would involve a fundamental reform**—probably including a change of Article 81 of the Constitution—which, in line with internationally prevailing practices, would **make the annual budget law** (including any allowed supplementary budget) **the sole source of spending authority for the year** (with provision for a limited carryover of committed but unspent authorizations). Such a reform would have **several advantages**, the key one being that it would focus the annual budget discussion on the strategic priorities of the government. New spending initiatives would need to be accommodated within existing appropriations (with somewhat increased scope for *virement* (*storno*) by the Executive) or within a supplementary budget involving corresponding expenditure cuts or revenue increases. This would obviate the need for most of the multiple reserve funds which currently cloud the transparency of the budget as an instrument of public resource allocation.

62. **If such a fundamental reform were to prove politically unfeasible at the present time, a number of steps could still be taken to improve the budget process:**

- **identifying explicitly new spending initiatives, with preliminary estimates of their respective resource envelopes, in the DPEF**. This would require, inter alia, a more proactive "top-down" approach, with the issuance (say in April) by the prime minister—on the advice of the minister of economy and finance—of guidelines, including the specification of preliminary resource ceilings, for line ministries for the preparation of their inputs into the DPEF;
- **reducing drastically the size of the special funds** currently appropriated to cover new spending legislated during the year. This would promote a sharper focus by both the executive and parliament on trade-offs among spending options during the budget preparation and approval process;
- **requiring that all new spending proposals during the year**—including those initiated by parliament—**be accompanied by a detailed technical report**

quantifying their projected annual cost, outlining the methodology used to calculate this cost, as well as the proposed funding source(s);

- **strictly limiting** (e.g., to three months for current expenditures and one year for investment) the **carry-forward period for unpaid commitments** (*residui propri*) **and eliminating it altogether for uncommitted appropriations** (*residui di stanziamento*). This change—which would bring Italy more in line with established international practice—would facilitate greater convergence between the execution of the budget on the *competenza* and the cash basis; increase the predictability of the latter, thereby removing the need for a large cash reserve fund and would be in line with the ongoing government efforts to streamline administrative procedures (including for procurement and verification of deliveries of goods and services) and reduce "red-tape." If converted into law, the government decree issued on September 6, 2002 reducing from three to one year the carry-over period for uncommitted capital spending would be a significant step in the right direction.

63. **Steps that could be taken to promote the second objective** include:

- building on the spirit of the 1997 reform, **moving to a (carefully prepared) budget classification by programs** (rather than UPBs), possibly articulated in sub-programs or activities, and allowing ministries increased flexibility to shift funds for non-mandatory expenditures among activities, and to a lesser extent among programs, during the execution of the budget;

- accelerating efforts to **develop and apply specific performance indicators for budget programs**, to be effectively utilized in the annual assessment of the managers of these programs, in line with the objectives of the Bassanini and Ciampi reforms. These efforts should also include—as noted in recent reports of the *Corte dei Conti*—a **refocusing of the current mechanisms of internal audit and control** in individual ministries. It would also be important to promote managerial accountability through **systematic surveys of citizens' satisfaction** with the quality of services provided by the individual public administrations, especially those which regularly interface with the public;

- over the medium term, **moving to full accrual accounting**. This will require the development of a new chart of accounts, consistent with the new budget classification suggested above. This move would be facilitated by requiring spending units to begin recording and reporting to the RGS the verification (*liquidazione*) stage of the expenditure process. Information on verifications should also be used for the preparation of the general government accounts on a national accounts basis.

64. As regards the **quality and transparency of fiscal data**, the staff recommend that:

- high priority be given to the **finalization and publication by ISTAT of timely quarterly accounts** for the general government, as they are essential for timely monitoring of developments in the target indicator for the SGP, and to enable a prompt policy response in the event of threatened deviations from this target;

- **full reconciliation of above-the-line and below-the-line cash accounts** be conducted as a matter of routine at least monthly for the state sector and on a quarterly basis for the general government. Both tasks would be greatly facilitated by the development of an **integrated financial management information system** for the state sector and of the planned computerized system of reporting by general government entities (RUPA), and its interface with the banking system network;
- **budget documents include a more detailed discussion of the methodology and assumptions underlying the macroeconomic and fiscal projections** and a **full-fledged sensitivity analysis** of these assumptions, to facilitate enhanced scrutiny and debate in parliament, among academics, and by the interested public at large, of the risks attached to the projections. It would also be desirable that these documents routinely include **updated medium- to long-term projections for the pension system** under current policies, with detailed discussion of the underlying methodology and assumptions. Lastly, it would be desirable, in line with best international practices, to include in the budget documents an annex with quantified **estimates of existing tax expenditures**, with an explanation of the methodology utilized for their quantification;
- **budget documents for all general government entities include a full list of guarantees provided by them to other entities**, either inside and outside the public sector, with specification, as far as possible, of the amount at risk. At present such a list (with very limited quantification) is only included in the state budget;
- the MEF (or ISTAT) compile and publish in a single document relatively aggregated (e.g., on the economic and functional classification basis) **budget and quarterly individual outturn data for the larger nonstate entities of the general government** (the main social security institutions; the regions; and the larger municipalities) to supplement the consolidated information provided in the quarterly cash reports by the treasury (*Relazione di Cassa*). This would allow more timely monitoring by parliament and the public at large of developments in the finances of these entities; and finally
- the MEF prepare a **quarterly report on developments in the finances of public sector entities outside the general government in which the state** (or state-sector entities such as the CDP) **maintains a stake.** This is especially important in view of the trend, evident in recent years, to corporatize enterprises (such as the railways and postal services) previously included in the public sector, while maintaining full or partial ownership of them; and to create new enterprises, such as the *Infrastrutture S.p.A* with public capital, to carry out—in partnership with private entities—functions which are essentially of a public nature, such as investment in infrastructures. A timely, detailed and transparent report on the performance of these enterprises would allow public assessment of the associated financial risks.