



Vysoká škola ekonomická v Praze

Fakulta managementu v Jindřichově Hradci

Bakalářská práce

Petr Jaďud'

2008

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Zadání práce: Cílem této práce bude popsat a zhodnotit současnou politickou a ekonomickou situaci v Itálii. Dále se tato práce bude zabývat změnami, které nastaly po vstupu Itálie do EU. Práce se také pokusí popsat dopad členství v EU na ekonomiku této země.

Jméno studenta: Petr Jaďud'

Ročník: 2.

Obor: MANAGEMENT

Vedoucí práce: PhDr. Bohumil Kopřiva

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Ing. Vladimír Příbyl

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Vysoká škola ekonomická v Praze

Fakulta managementu v Jindřichově Hradci

Katedra společenských věd

Italy – its Economy and Position in the European Union

Vypracoval:

Petr Jačud'

Vedoucí bakalářské práce:

PhDr. Bohumil Kopřiva

Trutnov, duben 2008

Prohlášení

Prohlašuji, že bakalářskou práci na téma
»Italy – its Economy and Position in the European Union«
jsem vypracoval samostatně.

Použitou literaturu a podkladové materiály
uvádím v příloženém seznamu literatury.

Trutnov, duben 2008

.....
podpis studenta

Anotace

Italy – its Economy and Position in the European Union

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duben 2008

Poděkování

Za cenné rady, náměty a inspiraci

bych chtěl poděkovat

PhDr. Bohumilu Kopřivovi

z Vysoké školy ekonomické v Praze,

Fakulty managementu v Jindřichově Hradci

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1 Introduction

I have chosen this topic of my Bachelor work in connection with my profound interest in Italy, its culture, language and, last but not least, its economic position in Europe. I think that Italy is one of the most powerful countries which influence the world's economic growth. I should not forget to mention the participation in the Group of Eight (G8), which involves seven countries of the world and Russia. Together these countries represent about 65% of the world economy.

Still more and more foreign investors are interested in our country, the Czech Republic. Some of them come from Europe. Example of this is a huge government contract on revitalization of railway stations in the whole of the Czech Republic which was won by an Italian company. Italy or Italian work environment represent for me possible work opportunities in my future life. This is another important reason why I have decided to deal with the economy of this country in my Bachelor's work.

At the beginning of my Bachelor's work I have briefly described Italy's history and geography. I have focused on the current political scene in Italy and on the development of its membership in the European Union. I have tried to find some advantages of its participation in the European Union which brought a certain benefit to the country. On the other hand, there are also disadvantages which are necessary to be mentioned as well. In conclusion I have summarised the gathered information and pointed out important industrial branches for the Italian economy.

2 Italy

2.1 Country profile¹

Full name:	Italian Republic
Population:	58.9 million
Political system:	Republic
Capital:	Rome
Area:	301,338 sq km
Major language:	Italian
Major religion:	Christianity
Life expectancy:	78 years (men), 83 years (women)
Monetary unit:	1 euro = 100 cents
Main exports:	Machinery and transport equipment, chemicals, clothes, wine
Main imports:	energy products, minerals and nonferrous metals, beverages, tobacco
Natural resources:	coal, mercury, zinc, potash, marble
GNI per capita:	US\$ 30,010
Major industries:	fashion, tourism, automobiles, agriculture
Trading partners:	Germany, France, U.S., Spain, UK, Switzerland, Netherlands
Membership in international organizations:	EU, NATO, G8, OECD



Picture No. 1: Map of Italy

¹ http://news.bbc.co.uk/2/hi/europe/country_profiles/1065345.stm#facts

2.2 Geography

2.2.1 Surface²

Italy is situated in southern Europe, including the major islands of Sicily and Sardinia. The boot-shaped Italian mainland extends into the Mediterranean Sea. It is bordered on the north by Switzerland and Austria, on the north-east by Slovenia, on the east by the Adriatic and Ionian seas, on the west by the Tyrrhenian and Ligurian seas, and on the north-west by France. Situated off the toe of the Italian boot, Sicily has a surface area of 25,708 sq km. Sardinia, which is about 320 km north-west of Sicily, covers an area of some 24,090 sq km. Within the frontiers of Italy are the sovereign Republic of San Marino, and the sovereign state of Vatican City. Italy's capital city, Rome, is located in the west-central part of the country.

The north is dominated by the Alps. The highest mountain of Italy is called Monte Bianco, (Mont Blanc) which is situated on the French-Italian frontier. With its height of 4,810 m, it is the highest mountain of the Alps and of Europe as well. The Italian spine is the mountain range called the Apennines which begins near Genoa and extends in the length of 1350 km to the toe of the Italian boot. The highest peak is Monte Corno.

The longest river is the Po, with 652 km long. Other important rivers are the Arno which flows through Florence and the Tevere which flows through the capital Rome.

² <http://www.nationsencyclopedia.com/Europe/Italy.html>

2.2.2 Population³

The population of Italy is around 59,5 million with the density of almost 200 inhabitants per sq km, which makes Italy the fifth most densely populated country in Europe. As in most countries, however, the population is unevenly distributed and of the 110 provinces, only some 40 have a density higher than the national average. The largest cities are Rome, Milan and Naples.

In general, the birth rate and average family size are higher in the South of Italy than in the North. The mortality rate is slightly lower in the south than in the north, and in certain northern regions populations are beginning to decrease because the birth rate is falling faster than the mortality rate.

In recent years, Italy's rapid economic growth has attracted many immigrants to the country, mainly from North and sub-Saharan Africa,. Illegal immigration has led to tougher immigration rules and a more forceful programme of expulsion.

2.2.3 Agriculture⁴

Italy's agriculture is typical of the difference between the agricultures of the northern and southern countries of the European Union. The northern part of Italy produces primarily grains, sugarbeets, soybeans, meat, and dairy products, while the south specializes in fruit, vegetables, olive oil, wine, and

³ <http://www.justlanded.com/english/layout/set/print/content/view/full/455708>

⁴ <http://www.state.gov/r/pa/ei/bgn/4033.htm>

durum wheat. Even though much of its mountainous terrain is unsuitable for farming, Italy has a large work force (1.4 million) employed in farming. Most farms are small, with the average size being only seven hectares.

2.2.4 Industry⁵

As in all other advanced Western economies, the Italian industrial sector is declining, decreasing the level of employment in industry and affecting the sector's contribution to the GDP. However, manufacturing was the key to Italy's post-World War II economic boom and remains important. The steel industry in particular allowed the country to become one of the strongest economies in the world. All branches of the industrial sector grew very quickly, and Italian exports soared. Then, in the second half of the 1980s, the industrial sector went through a crisis, while the service sector expanded. With the onset of the second millennium, the loss of jobs in the industrial sector seems to have stabilized, and although facing tough international competition, Italian companies appear ready for the challenge.

2.3 History⁶

By 500 BC, a number of groups shared the territory of the present-day Italy. Small Greek colonies dotted the southern coast and island of Sicily. Gauls, ancestors of today's modern French, roamed the mountainous north. While the

⁵ <http://www.lifeinitaly.com/history/>

⁶ GARDNER, Filip, et al. *Encyclopaedia of World Geography*. RNDr. Jiří Tomeš; Marta Bušková. Praha : Columbus & Knižní klub, 1994. 512 p.

Etruscans, a group originally hailing from somewhere in western Turkey, settled in central Italy, establishing a number of city-states, including what is now modern-day Bologna. Little is known about the Etruscans except that they thrived for a time, creating a civilization that would pass down a fondness for bold architecture (stone arches, paved streets, aqueducts, sewers) to its successor, Rome.

According to a legend, Rome was founded on April 21, 753 BC by Romulus and Remus, twin brothers who claimed to be sons of the war god Mars and to have been raised as infants by a she-wolf. Romulus considered himself a descendant of the defeated army of Troy, and wanted Rome to inherit the fame of that ancient city, if not surpass it. When Remus laughed at the idea, Romulus killed his brother and declared himself the first king of Rome.



Picture No. 2 : She-wolf

Rome went through seven kings until 509 BC when the last king was overthrown and the Roman Republic was declared. Rome then came to be ruled by two elected officials (known as consuls), a Senate made up of wealthy aristocrats (known as patricians), and a lower assembly that represented the common people (plebeians) and had a limited power. This format of government worked well at first, but as Rome expanded beyond a mere city-state to take over territory not just in Italy, but overseas as well, the system of government came under severe strain. By the 1st century BC, Rome was in crisis. Spartacus, a slave, led the common people in a revolt against the rule of the aristocratic patricians. Rome was able to put down the rebellion, but at great

cost, as the Republic dissolved into a series of military dictatorships that ended with the assassination of Julius Caesar.

In 29 BC, after a long power struggle, Julius Caesar's nephew, Octavius, seized power and declared himself Emperor Augustus. The Roman Empire was born. For the next two hundred years, Rome thrived, ruling over a vast territory stretching from Britain and the Atlantic coast of Europe in the north and west and to North Africa and the Middle East in the south and east.

This *Pax Romana*, a time of peace, ended in 180 AD with the death of Marcus Aurelius, Rome's last great emperor. A combination of economic problems, barbarian invasions, domestic instability, and territorial rebellions, combined with a lack of strong leadership, resulted in the slow and gradual decline of Rome. In 380 AD, after three hundred years of persecution,



Picture No. 3: Coliseum

Christianity became the one and only official religion. By the end of the 4th century AD, the Roman Empire split into two. The East, with the newly-built capital of Constantinople, in what is now Turkey, thrived, eventually becoming the long-lasting Byzantine Empire.

Rome, capital of the West, continued to decline.

In 410 AD, Rome itself was sacked by barbarian hordes. The Eastern Empire invaded but failed to restore order and had to withdraw. The Roman Empire in the West completely collapsed. For the next thousand years, Italy once again became a patchwork of city-states, with Rome, home to the Catholic Church, being the most powerful. This long period of quiet stagnation was known as the Dark Ages.

Prosperity did not return to Italy again until the 14th century, when city-states such as Florence, Milan, Pisa, Genoa, and Venice became centers of trade. The influx of wealth and increased trade contact with foreign lands, transformed Italy into Europe's prime centre of culture. Funded by wealthy patrons, personalities such as Leonardo da Vinci, Michelangelo, Dante, Machiavelli, and Galileo, among others, revolutionized the fields of art, literature, politics, and science. Italian explorers, such as Marco Polo and Christopher Columbus, introduced Italy and Europe to the rest of the world.

Italy remained a centre of power until the 16th century, when trade routes shifted away from the Mediterranean. Weakened, the various Italian city-states became vulnerable to conquest by Spain, France, and



Picture No. 4: The Trevi Fountain

Austria. Italy remained a patchwork of principalities controlled through proxy by various European powers until the 19th century, when the French leader Napoleon supported the unification of Italy as a way of creating a buffer state against his many enemies. With the backing of France, Italian nationalist Giuseppe Garibaldi led a popular movement that took over much of Italy, ending in 1870 with the fall of Rome and complete unification of Italy.

Plagued by internal political divisions and with an economy devastated by war, the new Kingdom of Italy was no Roman Empire. In 1919, frustrated that Italy had received few gains despite having been a victor in World War I, a politician named Benito Mussolini launched a movement that called for the restoration of Italy as a great power. In 1922, impatient with electoral politics, Mussolini led his supporters, known as fascists, on a march on Rome to seize

power directly through a coup. Spooked, the Italian king did not put up a fight and allowed Mussolini to become supreme ruler of Italy.

Mussolini spent the next twenty years consolidating power and building up the Italian economy, but he never gave up on the idea of restoring Italy as a great power. Calling himself "Il Duce" (meaning Leader), Mussolini dreamed of leading a new Roman Empire. In the 1930s, he indulged his dreams of conquest, by invading Ethiopia and Albania. When World War II broke out, Italy remained neutral at first. However, once it appeared through the Fall of France that Germany would win, Mussolini eagerly joined Hitler, a fellow Fascist and long time ally, in the war effort and rushed to invade Greece, the Balkans, and North Africa. Overextended and unprepared for such a large-scale effort, Italy quickly found that it could not maintain its military position and had to ask Germany for help. Before long, Mussolini saw himself losing control of North Africa, the Mediterranean, and eventually his very own country to the Allies. Fleeing Rome, Mussolini tried to set up a puppet state in Northern Italy but failed. Abandoned by a disgusted Hitler, "Il Duce" and his mistress were captured and executed by Italian partisans.

After World War II, Italy abolished the monarchy and declared itself a republic. With the strong support of the United States, Italy rebuilt its economy through loans from the Marshall Plan, joined the North Atlantic Treaty Organization and in the same years Italy also became a member of the European Economic Community, which later transformed into the European Union. Today, Italy is one of the most prosperous and democratic nations in Europe.

3 Political System

3.1 Introduction⁷

Italy has been a democratic republic since June 2, 1946, when the monarchy was abolished by a popular referendum. The constitution was promulgated on January 1, 1948.

Italy has a bicameral Parliament (Chamber of Deputies and Senate), separate judiciary, and an executive branch composed of a Council of Ministers which is headed by the prime minister. The president of the republic is elected for 7 years by the Parliament sitting jointly with a small number of regional delegates. The president nominates the prime minister, who chooses the other ministers. The Council of Ministers must gain the confidence of both houses.

The president of Italy is elected by both houses of Parliament. The minimal age limit for the post of President is 50. He appoints the prime minister, who forms the government.

The prime minister governs a national policy and is the most important person in the Italian government. Members of the cabinet are chosen by the prime minister, and usually are the members of Parliament. The president then appoints the members of the cabinet, and they are approved by Parliament. The Italian prime minister and the cabinet are officially called the government.

⁷ <http://www.traveldocs.com/it/govern.htm>

http://library.thinkquest.org/J0112187/italy_government.htm

Italy has an independent judiciary. Judges of courts are appointed. The President of the Parliament chooses five of the judges from the constitution court, and 5 are by judges of other courts. The courts work under a national ministry for a justice panel of the judges.

3.2 Chamber of Deputies⁸

The Chamber of Deputies, also called the upper house of Parliament, has 630 members who are elected by voters from 27 voting districts. Voters must be full aged. A condition for candidature is the age over 25 years. Deputies are elected on the basis of voting districts. The number of deputies of each district is proportional depending on the number of inhabitants of each region. The number of population is taken from the latest population census. The number of 618 seats is divided according to the domestic results and remaining 12 seats are for deputies who have been elected abroad. The Chamber and the Senate both share equal power to pass laws.

3.3 Senate⁹

The Senate is, in contrast to the Chamber of Deputies, elected according to the number of population in particular regions. According to the Constitution a candidate for a senator is obliged to be older than 40 years. A person who wants to vote in senatorial elections must be older than 25 years.

⁸ http://www.camera.it/serv_cittadini/559/documentotesto.asp

⁹ <http://www.senato.it/istituzione/29374/29384/genpagina.htm>

315 senators are elected to the Senate. The number of 309 seats is divided between regions in proportion with the number of inhabitants. Remaining 6 seats, according to the Constitution, are assigned to regions abroad.

The electoral term lasts 5 years. The president of the republic can dissolve one of the chambers before the end of the electoral term. The electoral term is the same for the lower house and for the upper house. The houses differ in arrangement and in the way of election.

3.4 Current Political Scene

3.4.1 Important Political Events¹⁰

May 1998

Italy has been accepted as a member of the Economic and Monetary Union (EMU) since January 1st 1999.

May 2001

Silvio Berlusconi's *Casa delle Libertà* alliance wins a clear majority in both houses of parliament in the election on May 13th. His government is sworn in a month later.

June 2003

The government rushes controversial legislation through parliament to grant immunity from legal prosecution to Italy's top-five officials, including the prime minister. As a result, Mr Berlusconi's trial on charges of bribing judges in

¹⁰ Country Report 2007. The Economist Intelligence Unit. London: Patersons Dartford, 2007. 59p. Available at WWW: <www.eiu.com>

the mid- 1980s is suspended during Italy's presidency of the EU in the second half of 2003. In January 2004 the Constitutional Court declares the law invalid. Mr Berlusconi's trial resumes, but is later dismissed because of the statute of limitations.

June-July 2004

Defeat in the June European parliament and local elections brings the Casa alliance to the brink of collapse. The powerful economy minister, Giulio Tremonti, is forced to resign, to be replaced by Domenico Siniscalco (an independent).

April 2005

The Casa suffers a heavy defeat in regional and local elections. Mr Berlusconi is forced by his coalition partners to resign and form a new cabinet.

July-December 2005

The Italian Central Bank governor, Antonio Fazio, becomes embroiled in two bank takeover battles. On September 22nd Italy's economy minister, Mr Siniscalco, resigns over the government's failure to act to restore the Central Bank's credibility.

Mr Tremonti returns as economy minister. The governor, Mr Fazio, who is accused of favouring Italian bidders over two foreign banks, eventually resigns in December.

December 2005

The Berlusconi government pushes through a reform of the electoral system, returning Italy to a system of proportional representation.

April 2006

Romano Prodi's left-of-centre Union coalition narrowly wins the general election. He wins a comfortable majority in the Chamber of Deputies (the lower

house of parliament), but just a two-seat advantage in the Senate (the upper house).

May 2006

The formation of the new government has to await the election by parliament of a new president of the republic. Giorgio Napolitano, a veteran member of the Democratici di Sinistra (DS), the largest party in the Union, becomes president, but without bipartisan support. He designates Mr Prodi as prime minister, and on May 23rd the new government takes office.

February 2007

Following a surprise defeat in the Senate on a foreign-policy vote, Mr Prodi resigned, only to win a vote of confidence and a fresh mandate several days later.

May 2007

Mr Prodi's coalition suffers heavy losses in the local elections, exacerbating tensions within the coalition.

3.4.2 The Latest News

3.4.2.1 January 2008¹¹

On December 21st the Senate, in which the fragile left-of-centre Union coalition lacks a clear majority, gave its final approval to the government's 2008 budget and its welfare reform bill. However, as with so many of the previous Senate votes that the prime minister, Romano Prodi, has faced since winning

¹¹ Country Report. The Economist Intelligence Unit. London: Patersons Dartford, January 2008. 23p. Available at WWW: <www.eiu.com>

the April 2006 general election, the budget and welfare package were approved in tight confidence votes, which would have forced the prime minister to resign had he lost them. In just 19 months in power, Mr Prodi has used parliamentary confidence votes about 30 times to force his unruly allies to toe the line. During these tense votes, he has also had to rely frequently on the backing of the majority of seven unelected life senators to ensure the government continued survival. After the approval of the budget and welfare reform, about ten Union senators, who voted with the government, signalled that they were no longer certain that they would continue to support Mr Prodi in 2008, paving the way for a showdown between the Italian premier and his allies in January. In addition, public support for Mr Prodi and his government plunged to fresh lows, according to an opinion poll published on December 23rd, just two days after the Senate votes. Mr Prodi, however, appeared to have lost none of his characteristic optimism and dogged determination, saying in late December that his government still has a majority in parliament and can only be brought down by a vote of no confidence.

3.4.2.2 February 2008¹²

On February 6th Italy's president, Giorgio Napolitano, dissolved parliament and called an early general election for April 13th-14th, three years before the end of the parliamentary term. The decision to hold a snap election followed the resignation on January 24th of the Prime Minister, Romano Prodi, and an unsuccessful attempt in early February by the centrist speaker of the

¹² Country Report. The Economist Intelligence Unit. London: Patersons Dartford, February 2008. 21p. Available at WWW: <www.eiu.com>

Senate (the upper house of Parliament), Franco Marini, to form an interim government with a limited mandate to reform the electoral laws. The collapse of Mr Prodi's nine-party Union coalition government, ranging from Catholic centrists to radical leftists, was triggered by the withdrawal from the government of a tiny centrist party, the Union Democratici per l'Europa, led by Clemente Mastella, who was the minister of justice until he resigned on January 16th.

3.4.3 Political Prognosis

I expect Silvio Berlusconi's right-of-centre *Partito del Popolo della Libertà* to become the new Prime Minister after the general election. However, it will be a close contest as Walter Veltroni of the centre-left Partito Democratico (PD) has narrowed the gap since the campaign started in early February. As a result, the outcome of the vote could well be similar to that of the April 2006 election when Romano Prodi beat Mr Berlusconi by the smallest of margins. This was enough to give his Union coalition all the bonus seats and a comfortable majority in the Chamber of Deputies, but because bonus seats are allocated on a regional basis in the Senate he had just a razor-thin majority there. During his previous five-year spell as prime minister his government did little to reform the economy, the public finances deteriorated sharply and he introduced laws intended to protect his own interests or those of his close allies. Mr Berlusconi's coalition is still deeply divided on aspects of fiscal policy and institutional reform.

Whoever wins in April will be unable to ignore the issue of electoral reform. Referendums on amending the existing electoral laws, approved by the constitutional court in mid-January, were scheduled to take place in May, but because of the snap election they have been postponed, probably until the first

half of 2009. Opinion polls suggest that they are likely to be approved. If so, the next government would be under intense pressure to stand down so that an election could be held under the new system.

There is a possibility that Italy's complex electoral system will produce different majorities in the two houses of parliament, making it impossible for either political bloc to govern. If this were to happen the president, Giorgio Napolitano, would seek to put in place an interim government with a limited mandate to reform the electoral system before calling another general election.

3.4.4 Evaluation of the Political Scene

After dissolving Parliament because of a corruption scandal of one of the members of government, after that followed the lost of a vote of confidence, was announced the term of the early election. Due to the situation which is continuing in Italy for several months has been established a new party called the Democratic Party led by the former Lord Mayor of Rome Walter Veltroni. This candidate is the opposite candidate to Silvio Berlusconi, who has put up as candidate for the post of Prime Minister already for the third time.

The question is not whether Italy is in a crisis. The question is whether Italy will ever overcome it. In my opinion it does not depend on who wins the election. In both cases the result will be very close and the mandate of the government will remain too weak. Yet there will not be sufficient power to enforce the most important reforms. Electoral, pension, as well as educational systems are in dismal condition in Italy.

In my opinion the worst influence has the electoral law. Present electoral system does not allow to create strong coalition. That is the reason why there has not been efficient government for many years.

I would like to say that neither recently elected government will be able to govern effectively. Italy needs a change mainly in electoral law.

Then an efficient and strong government could be elected.

In conclusion I would like to quote one sentence said by the political scientist Pavoncello: *“Italy may be on the edge of an abyss. But never underestimate any Italian looking into the abbyss.”*

4 Economy

4.1 Introduction¹³

Italy’s overall economic structure is comparable to that of most other advanced OECD economies, with a small and diminishing primary sector and services that contribute close to two-thirds of gross value added, but apart from tourism and design, it is not internationally competitive in most services sectors. The economy’s main strength has been in manufacturing, especially small and medium-sized firms specialising in products that require high-quality design and engineering. Manufacturing accounts for about 25% of GDP and about 90% of total merchandise exports. Enormous differences still exist between the regions, the north-east being by far the most dynamic.

The Italian underground economy is extensive. According to the National Bureau of Statistics it accounts for about 15% of GDP. Underground

¹³ Country Report 2007. The Economist Intelligence Unit. London: Patersons Dartford, 2007. 59p. Available at WWW: <www.eiu.com>

businesses are widespread in agriculture, construction and services. There are few large private companies in operation compared with other major economies. However, those that exist, including FIAT, Pirelli and Fininvest, play a major role in the economy

According to Istat, in 2003 Italian firms employed an average of 3.8 workers in the non-primary sectors (industry, building and construction, and services). 94.5% of firms in these sectors employed fewer than ten workers, and 97.7% had fewer than 20 workers. The state's direct involvement in the economy was considerable at the beginning of the 1990s. However, encouraged by EU restrictions on state aid to industry and the need to reduce public-sector debt, this was greatly reduced by a wide ranging privatisation programme, most of which was carried out between 1993 and 2004.

4.2 Economic Policy¹⁴

Economic policy in the period of 20 to 30 years before 1992 was characterised by sound monetary policy conducted by the Central Bank. This stable policy contrasted with the much more erratic fiscal policy pursued by weak governments. In 1992-97, when participation in the Economic and Monetary Union (EMU) was seen as a national imperative, consensus was achieved on narrowing the budget deficit and public debt, both by reducing spending and by increasing revenue. Once the EMU membership had been confirmed in 1998, priorities other than fiscal consolidation were emphasised,

¹⁴ Country Report 2007. The Economist Intelligence Unit. London: Patersons Dartford, 2007. 59p. Available at WWW: <www.eiu.com>

most notably reducing unemployment and taxation and increasing investment in infrastructure. This led to a relaxation of fiscal policy, which combined with a prolonged period of weak economic growth, caused a steady deterioration in the public finances between 2001 and 2006.

4.2.1 Fiscal Policy

Failure to control the public finances in 1970s and 1980s led to the accumulation of high levels of public debt, which peaked at about 125% of GDP in 1994. From 1992 onwards, reducing the budget deficit and the public debt became priorities, and successive governments adopted a consistent strategy aimed at joining the EMU from its launch in 1999. In the last effort to qualify, the government introduced a fiscal package in the 1997 budget with corrective measures of US\$ 37bn. Helped by a sharp reduction in interest rates and a degree of creative accounting, the 1997 budget deficit narrowed by over 4 percentage points to bring it below the 3% ceiling laid down in the Treaty on European Union (Maastricht Treaty) for qualification for the EMU. Fiscal loosening and weak economic growth led to a renewed deterioration in the public finances from 1999. As a result, the deficit has been 3% or over every year since 2000, except in 2002, and the public debt remains by far the largest in the EU in absolute terms and one of the highest in GDP terms at 107% at the end of 2006, still well over the 60% of GDP ceiling for euro area countries. In July 2005 the EU's Council of Economy and finance ministers approved the European Commission's recommendations on the existence of an excessive deficit in Italy. As a result, the Italian government agreed to reduce the deficit to below 3% of GDP by 2007. The underlying fiscal outlook improved in 2006, but the deficit rose to 4.4% of GDP as the positive impact of stronger growth was

offset by two one-off expenditure items. The measures contained in the 2007 budget approved by Parliament in December - mainly tax increases rather than long overdue expenditure cuts - and the positive impact on revenue of stronger than expected economic growth is expected to bring the deficit comfortably below 3% of GDP once more. However, the government has yielded to pressure to spend the bulk of the additional revenue rather than use them to reduce government deficit and debt. Although the deficit is projected to remain under 3% of GDP in 2008, the government's medium-term planning document published at the end of June does not envisage any further budget adjustment until 2009 and points to the possibility of tax cuts being introduced in 2008.

4.2.2 Monetary Policy

As part of the preparations for the EMU, the independence of the Central Bank was bolstered in 1992, when it was given full responsibility for setting the discount rate, and again in 1993, when the ability of the Treasury to compel it to assist in funding the budget deficit was ended. On January 1st 1999 Italy, together with ten other EU countries, adopted the euro as its new currency, and Greece followed at the beginning of 2001. On January 1st 2002 euro notes and coins were introduced, and by February 2002 the national currencies of the 12 EMU members ceased to be legal tender. When the euro was launched in 1999, monetary policy was taken over by the European Central Bank. Since taking control of interest rate policy, the ECB has set rates with the objective of maintaining inflation across the euro area at between 0% and 2%.

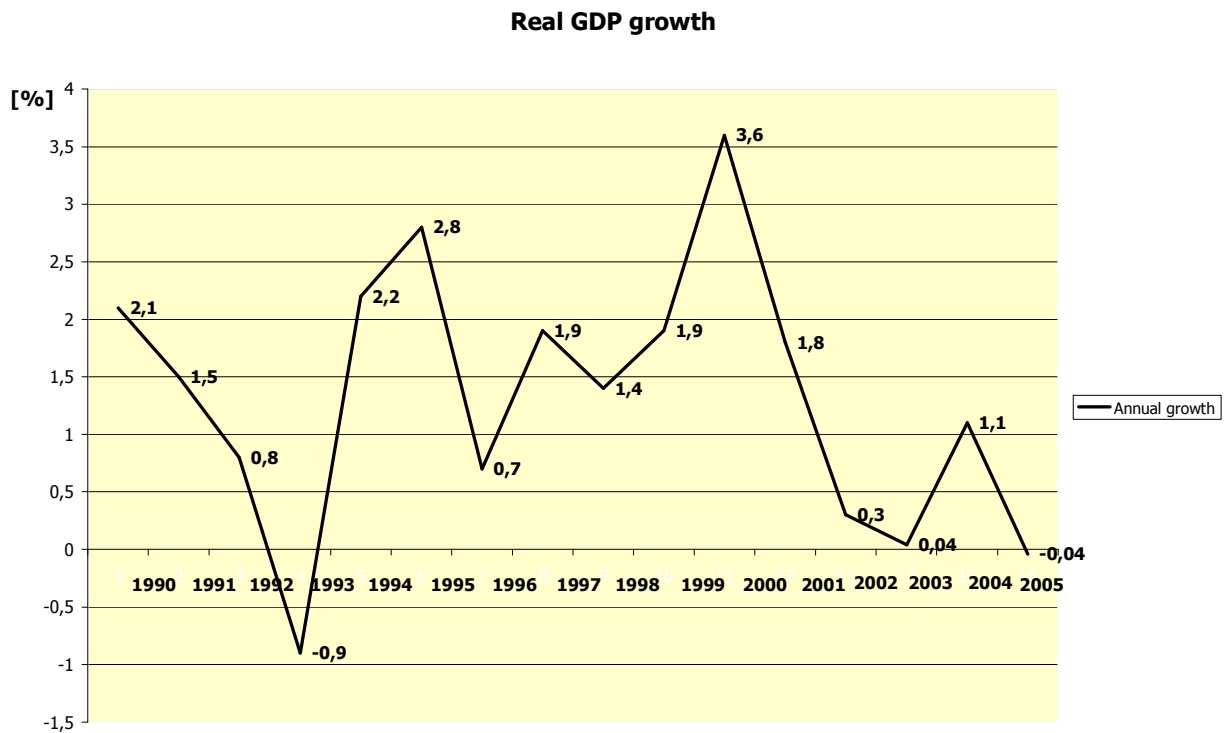
4.3 Gross Domestic Product¹⁵

“GDP is defined as the total market value of all final goods and services produced within a given country in a given period of time. It is also considered the sum of value added at every stage of production of all final goods and services produced within a country in a given period of time, and it is given a money value.”¹⁶

In 2000, as fiscal policy was eased, real GDP grew by 3.8%, the best performance since 1988. However, economic growth slowed sharply in 2001 to 1.7%, and further, to 0.3% in 2002 and 0.1% in 2003, reflecting the overall deceleration of the world economy, when GDP for the euro area as a whole rose by just 1.9% in 2001, 0.9% in 2002 and 0.8% in 2003. The pace of expansion showed a modest acceleration in 2004 to 1%, mainly driven by export growth in the middle of the year. However, in the fourth quarter of 2004 and in the first quarter of 2005 the Italian economy contracted on a quarter-on-quarter basis as a result of falls in fixed investment and exports. Despite a surprisingly sharp quarter-on-quarter recovery in the second and third quarters of 2005, driven by a rise in exports, as well as in fixed investment in machinery and equipment, and in construction, overall growth in 2005 was a mere 0.2%.

¹⁵ Country Report 2007. The Economist Intelligence Unit. London: Patersons Dartford, 2007. 59p. Available at WWW: <www.eiu.com>

¹⁶ http://en.wikipedia.org/wiki/Gross_Domestic_Product



Graph No. 1: Real GDP growth: Factbook 2007: Economic, Environmental and Social Statistics

In 2006 GDP growth was 1.9%, boosted by a surge in the final quarter, driven mainly by strong export demand, particularly from Germany, Italy's single largest export market. Although this was the country's best performance since 2000, it was still well below the euro area average of 2.8%. The pace of GDP growth slowed down in the first quarter of 2007, but was still solid at 2.3%.

4.4 Inflation¹⁷

“Inflation is a phenomenon caused by the increase of money supply relative to the growth of production capacity for goods and services. It may also refer to a rise in the prices of a specific set of goods or services. In either case, it is measured as the percentage rate of change of a price index.”¹⁸

Wage indexation and prolonged fiscal laxity combined with global price pressures to generate high inflation in Italy in the 1970s and 1980s, when the annual rate of increase in consumer prices averaged 13.2% and 11.1% respectively. When the lira joined the ERM in 1979, some inflation-dampening effects occurred as a result, although a series of devaluations offset much of the benefit. In 1992 the lira was suspended from the ERM and depreciated sharply, triggering a tighter fiscal and monetary policy mix in order to contain inflation. In the same year the trade unions agreed to abolish wage indexation and in 1993 signed up to a wage-dampening incomes policy, which kept wage rises in line with government annual inflation targets. Together with low international inflation and participation in the EMU, these changes have kept inflation in low single-digit figures since then, but price instability has not been eradicated.

As in other euro area countries, consumer price inflation gradually edged up between mid-1999 and April 2001, when it reached 3%, driven mainly by higher international oil prices and the continued weakness of the euro against

¹⁷ Country Report 2007. The Economist Intelligence Unit. London: Patersons Dartford, 2007. 59p. Available at WWW: <www.eiu.com>

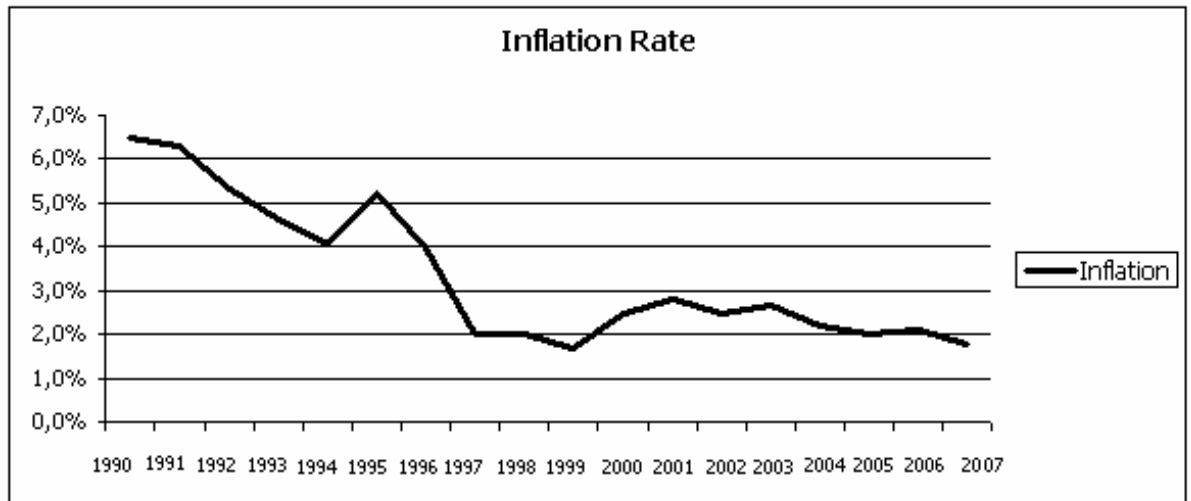
¹⁸ <http://en.wikipedia.org/wiki/Inflation>

the US dollar. Price increases slowed during the rest of 2001, mostly as a result of falling oil prices. Between mid-2002 and mid-2003 inflation accelerated again, driven at least in part by the effect of the changeover to euro notes and coins. In 2004 it eased to 2.3% and in 2005 remained stable at around the same rate, as weak domestic demand offset soaring international oil prices. Inflation remained marginally above 2% in the first three quarters of 2006, but moderated towards the end of the year, reflecting the fall in international oil in the second half of 2006. In the first half of 2007 falling telecommunications prices and moderating commodity prices drove the rate of inflation as low as 1.5% in May, but rising energy prices have pushed it back up to 1.7% in June.

Annual Inflation

Annual Inflation				
1990	6.5%		1999	1.7%
1991	6.3%		2000	2.5%
1992	5.3%		2001	2.8%
1993	4.6%		2002	2.5%
1994	4.1%		2003	2.7%
1995	5.2%		2004	2.2%
1996	4.0%		2005	2.0%
1997	2.0%		2006	2.1%
1998	2.0%		2007	1.8%

Table No. 1: Annual Inflation: <http://www.istat.it/>



Graph No. 2: Inflation Rate

4.5 Dual Economy¹⁹

The basic economic characteristics of Italy is an essential difference in economic level between the richer northern part compared to the poorer southern part. Northern Italian provinces belong to the most developed regions of the European Union and we can compare them with such regions like Paris or Hamburg.

On the other hand the southern regions, (for example Sicily), belongs to the less developed in the whole European Union. Poorer are only Greek regions or some territories of Spain.

“Dual economy” has in Italy a historic tradition. Over the long-term effort of Italian government (and last decades the EU as well) to reduce economic difference between the North and the South it manages very little.

¹⁹ http://www.tesionline.it/_PDF/2424/2424p.pdf

The difference falls off very little and in some cases it even grows. That is why we can still note sharp differences in economic growth rate or the unemployment rate for the benefit of Northern provinces.

One of the causes of slow levelling differences between the North and South is using financial subsidies from the state or from the European Union. In the South there is still high level of corruption behaviour than in the North.

4.5.1 Solution to the Crisis²⁰

The economic difference between North and South Italy is an old and huge unsolved problem that has been dealt with and still being dealt with by the Italian government, the European Union and especially the local authorities. The South has suffered enormous underdevelopment, while the North has enjoyed prosperity. Italy is a noteworthy representative of the North - South Gap, not only because of the Mezzogiorno, but also because it can be considered part of the southern example of this economic gap within the European Union.

In 1933 was established an institution the aim of which was to restore Italian industry. After World War II, this attitude of supporting the development of the South with taxpayers' money pushed the government to design a very large programme. This project was called the Fund for the South. This fund was the worst political scandal. For more than 40 years it wasted

²⁰ LOTTIERI, Carlo, STAGNARO, Carlo. North and South: The Tragedy of Equalization in Italy. Istituto Bruno Leoni. Winnipeg : Frontier Centre for Public Policy, 2007. 6 p. Available at: WWW: <www.fcpp.org>

Unemployment rate-Total %



Graph No. 4: Total unemployment: Office for Official Publications of the European Communities, 2003

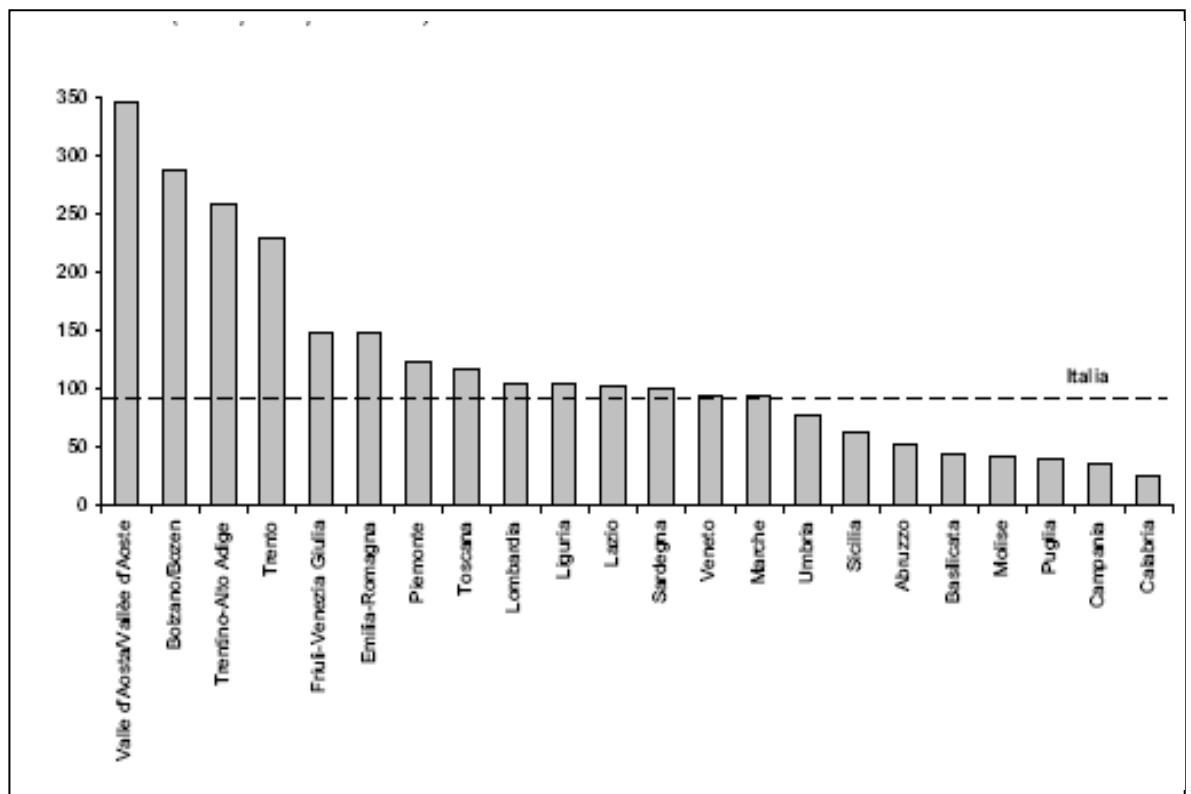
The unemployment rate is varied depending on the location. The industrial North, especially in the “Industrial Triangle” offers many job opportunities and the unemployment rate in these regions fluctuates about 6%. However, there is just the opposite situation in the South. The unemployment rate in southern provinces peaks about 17%.

In my opinion the solution of this consists in social reforms and in creation of job positions and also in financial help from the government and from the EU funds. Some reforms of employment policy have been introduced and now it depends on the approach of the new government.

4.6.2 Household Incomes and Expenditures

Spending for goods and services of particular communities divided into regions – Year 2004

(value per capita in euro)

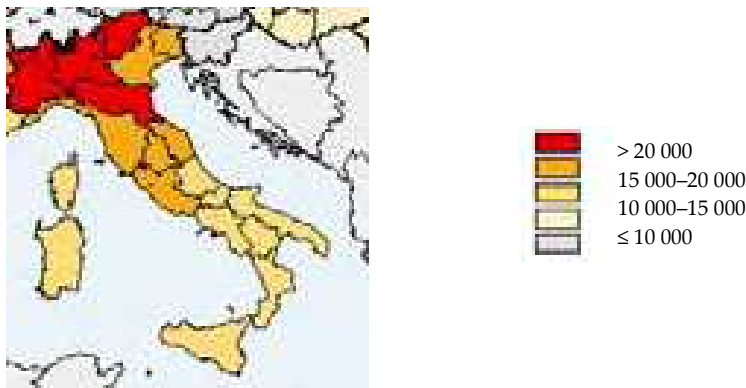


Graph No. 5: Spendings: Istituto nazionale di statistica: RAPPORTO ANNUALE 2006

From the graph above results that there are different living standards in Italy. People living in northern regions have several times higher spendings on goods and services. In my opinion everything is the result of still deeper gaps in economy between the South and the North. Regions in the south are very poor. Several of them are very deep under the average value of the whole country.

I think that this kind of problem should be very alarming for the Italian government, because it supports migration and illicit trade.

Primary income of households per capita, in PPCS



Graph No. 6: Income in PPCS: Total unemployment: Office for Official Publications of the European Communities, 2003

From the graph above we can see sharp differences. The value of income in any northern part of Italy is, in some cases, even twice as high as that in Calabria. Regional GDP per capita is an important indicator in determining European structural policy. Regions receive regional aid when their regional GDP is below 75 % of the EU average.

4.6.3 Regional GDP

GDP per inhabitant in EUR

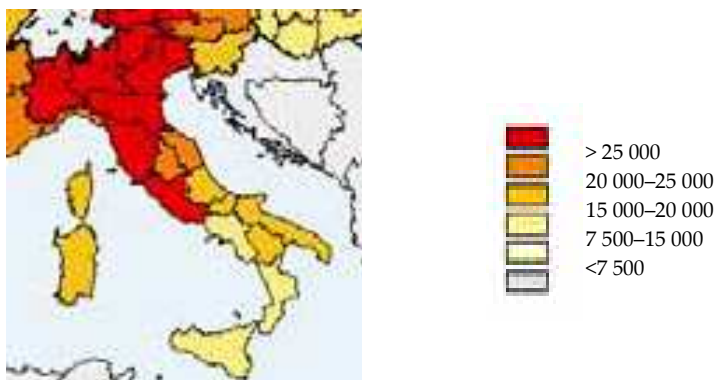


Graph No. 7: GDP in EUR: Total unemployment: Office for Official Publications of the European Communities, 2003

The average level of GDP in the European Union is €22.603. From the graph we can deduce, that only regions in the North and also Lazio, the province with the capital Rome, exceed this level. I think that Italy is the only country in the European Union where the proportion of the GDP is divided so strictly half to half.

For comparison I have mentioned also the graph showing the GDP in regions, but in PPS. When these values are converted into PPS, the GDP per capita for Europe's regions is as follows: the range of values is lower, i.e. the difference between the regions is larger in monetary units than in volume comparisons. A large amount of regional aid is based on the concept of PPS, while member states' contributions are determined on the basis of figures expressed in euro.

GDP per inhabitant in PPS



Graph No. 8: GDP in PPS: Total unemployment: Office for Official Publications of the European Communities, 2003

5 European Union

5.1 History

The first ideas about the “united Europe” appeared in 1713 by publishing abbot de Saint Pierre’s plan like an instrument to keep peace in Europe. Further mentions about taking up the European unification process are known after World War II period. Avoiding another war conflict and keeping relations between the individual states on the basis of cooperation and economic competition, led to searching for an optimal order which, over the years, resulted into the process of global integration.

Previous forms of the current European Union are three institutions established in the 50’s.

- The European Coal and Steel Community (ECSC)
- The European Economic Community (ECC)
- The European Atomic Energy Community (EURATOM)

All these communities were founded with one aim and it was the unification of interests of the member countries in the particular spheres. The process of unification was long-term and quite difficult. Its culmination was in 1993, when the Maastricht Treaty came into effect, which led to the creation of the European Union.

First the European Union had only 12 countries. In 1995 Finland, Austria and Sweden joined this community. Nowadays the European Union consists of 27 independent sovereign countries which are known as member states.

5.2 European Integration Process

The European integration process is generally understood like a merging of markets into upper units by general accepting of particular rules. The new market differs from the previous one by extensity, because existing barriers of free movement of persons, money and goods are cleared. The integration process is a very dynamic part.

5.2.1 Free Trade Range

The free trade range gives Italy an advantage in a zero or highly low rate of duties in mutual businesses with member states, in comparison with making business with non-member countries.

5.2.2 Customs Union

There are many advantages of membership in the Customs Union. Within the Customs Union does not exist regular customs control of goods on

borders with member states. Every kind of trade with a member state is considered being “intra-union trade”. The goods are not liable to taxes. The goods flow over the frontier freely.

5.2.3 Economic and Monetary Union

The European Economic and Monetary union is a political and economic structure, which supports Euro and unified European market. The Economic and Monetary union provides a low inflation rate and interest rates for the benefit of consumers and trading companies and supports public finance. Due to the single currency costs on exchange of different currencies were nullified. The trade for member countries became much easier.

5.3 Evaluation of the EU Membership

In this chapter I would like to summarize advantages and disadvantages of the individual countries’ membership in the European Union.

Citizens of the European Union have possibilities to travel, live and work in the country of the EU which they choose. The EU offers freedom of movement, various choices of products and services and provides a high level of safety and health care. We can live, work or study in any country of the European Union. Since 1993 the EU guarantees the following four freedoms: free movement of persons, goods, services and capital.

The idea of the common market consists in the fact that the EU is considered as one large territory where the main emphasis is put on free movement of persons, capital, goods and services; it should stimulate economic competition and trade to improve its efficiency. An extensive choice of goods

and services leads to the improvement of quality and price cut. The advantage for firms, having an open admission to domestic markets, consists in higher sales, the possibility to achieve economy of scale and also to gain more money for investments and innovations.

But the abolition of clearing direct barriers has brought about many unpredictable restrictions of administrative character, such as different rate of consumer taxes and other taxes.

The common market has contributed to the prosperity of the European Union by more than €800 billion and helped to create more than 2.5 million job positions.

The level of the possession of real estates in the European Union is very different. The priority of the common market is providing people within the European Union with the cheapest mortgages under the best conditions. The European Union has reduced bank charges for payments and withdrawals in euro.

As the currency instability affects trade and cash flow from particular countries, the key point of the EU has been a single currency. For firms, trading between two countries within the euro zone, it means the elimination of costs and hazard of trades in two different currencies. The Economic and Monetary Union has abolished inaccuracies caused by instability of exchange rates and has provided stability in economy with a low rate of inflation and interests. Citizens within the European Union do not have to change money and can thus save the charges for exchange rates. People when purchasing various goods via the Internet can directly compare the prices of the specific items of goods in various countries.

In my opinion, the common market is the best success of the European Union and the most exact expression of its goal. The aim is to increase the prosperity and assure stability for all its citizens. The main principle of this aim is to promote improving living standards within the whole Union. In this context the European Union supports many policies.

I think that the most interesting point are structural funds of the European Union out of which one third of the year budget flows to the economic and social development of poorer regions. This helped Italy in case of different economy levels between the South and the North. In the past there was even a threat of splitting the Italian territory up and again the European Union offered a help to the Italian economy from its structural funds.

The European Union guarantees people working in another member country the identical rights including social insurance or the right to a pension as if they were natives of this country.

The existence of the European Commission brings a lot of advantages. The Commission protects the big companies from abusing their status on the market so that they cannot charge their customers high prices or keep down their competitors. The Commission supervises the economic competition in the branch of public services where an earlier state monopoly has been eliminated.

6 Conclusion

I have already mentioned in the introductory chapter that I am interested in Italy. Italy became my hobby about three years ago when I started with learning Italian at the Faculty of Management. I love the Italian language and I

am still trying to improve it. Working on the project concerning Italy was a big challenge for me.

When I started working on it, I thought that it might be an easy task. Contrary was the case! My task was to sum up current economic and political situation and to evaluate the contribution of Italy's joining the European Union. I started with gathering information from various articles in order to find out what situation there really is. I had to search on original Italian servers and process and evaluate the gained information. I can say that this helped me better understand the specific language used in economic texts.

I have found out that Italy is going through a political and also an economic crisis. Current political situation does not allowed the government to make stronger mandate and it hinders any progress and that is why the economy is on the level of stagnation. This situation does not allow the government to focus on solving the "Mezzogiorno problem". From my point of view, the only solution would be an electoral reform which would help to make a stronger government.

Italy, as a founding member, has achieved a very high position in the European Union. In the past, there occurred such a serious situation, when the industrially highly developed North wanted to create a new sovereign state and separate itself from the South. The European Union solved the problem with extra subsidies. Accepting the euro currency has had just a slight impact on the economic indicators. As to the advantages, I would like to point out the opening of the labour market.

The option to elaborate my Bachelor work in a foreign language was a big contribution for me. I am glad that I could gather information and explore Italy in great detail. For me this knowledge is very valuable because of my

interests. I will definitely keep an open eye to the following development of political and economic affairs in Italy.

I firmly believe that once I will be able to make full use of the gathered findings from this project in my future life.

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