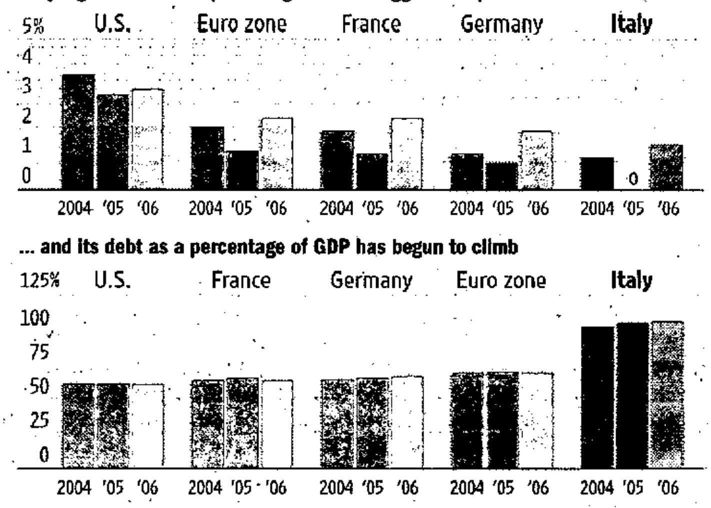
Italian official defends budget as country's cure

Deficit dilemma

Italy's gross-domestic-product growth is sluggish compared with others ...



Note: 2006 figures are forecasts   Source: International Monetary Fund's World Economic Outlook

Finance chief says bill will address ills of growth, spending

By Gabriel Kahn And Luca Di Leo

ROME—Despite international concerns about the Italian economy, Finance Minister Tommaso Padoa-Schioppa brushed off recent downgrades of the country's debt and said the coming budget bill would do much to fix Italy's twin ills of slow growth and bloated public spending.

In an interview, Mr. Padoa-Schioppa said downgrades to Italy's sovereign credit rating from Standard & Poor's and Fitch Ratings last week were both based on out-of-date assessments. Rating agencies are limited in their ability to accurately understand Italy's situation because few analysts who work at the companies speak Italian, added Mr. Padoa-Schioppa, a former European central banker.

JOURNAL EXCLUSIVE

"I don't welcome these [downgrades], but I would not say it makes my job more difficult because they were widely discounted by the market and myself." Standard & Poor's downgraded Italy's debt to A-plus with stable outlook from AA-minus. Fitch downgraded to AA-minus with stable outlook from AA.

The minister said the budget bill he drafted, which must be approved by Parliament by the end of the year, marks a crucial step toward improving the economy and getting credit ratings back up.

"With this budget, we have eliminated the risk of being left behind," Mr. Padoa-Schioppa said, noting, however, that "more time and more measures are needed to reach the front of the group of runners."

The European Union has a lot riding on Mr. Padoa-Schioppa's ability to turn around Italy's finances. Italy, the seventh-largest economy in the world and the third-largest in the euro zone, has been among the worst performers in the EU over the past 10 years, dragging down overall growth on the Continent. At the same time, its debt—now at 108% of gross domestic product—is the highest among the 12-nation euro zone and is rising again after shrinking for a decade.

Italy's debt has made it the weak link in the monetary union. Coupled with its slow growth rate, the country is increasingly out of whack with the euro zone, meaning that it is straining more than others under the common monetary policy set by the European Central Bank. That has begun to hurt broader confidence in the monetary union.

Criticism of the budget bill has risen since the draft was approved by the government at the end of last month. The budget aims to raise €35 billion ($44.2 billion) through revenue-generating measures and spending cuts.

Rating agencies, business groups and Italy's central bank have criticized the bill for relying too heavily on new tax revenue, which curbs growth drivers such as spending and investment, to bring the deficit in line with EU budget rules, and for being too timid in tackling waste in Italy's public spending, which accounts for about 50% of all economic activity.

"Criticisms of the budget are not based on an accurate reading of the facts," Mr. Padoa-Schioppa said. He said only €5 billion in this budget come from new taxes, while more than €8 billion will be generated from measures to improve tax collection and fight tax evasion.

Rating agencies say his prediction of recouping money from tax evasion—a problem that has bedeviled Italian governments for decades—is unrealistic.

Though he acknowledged that increased revenue-generating measures in his budget could slow Italy's growth rate next year slightly, he said the long-term benefits of bringing public finances under control would greatly improve the overall economy. Most importantly, he said, the budget would put Italy's deficit, expected to total 4.8% of gross domestic product this year, on track to return within the 3% ceiling set by the monetary union by 2007.

The EU has been the only authoritative voice to speak in favor, provisionally, of the Italian budget so far.

As Mr. Padoa-Schioppa spoke, Finance Ministry employees gathered in the ministry's courtyard and protested a measure in the budget that is aimed at reducing the number of Finance Ministry offices.

Public protests against the budget and other economic measures passed by Prime Minister Romano Prodi's center-left government, which holds a razor-thin majority in Parliament, are increasing. Thousands of self-employed workers took to the streets last week and bigger demonstrations against the budget are slated for later this month.

Though criticism of the budget is straining relations within Mr. Prodi's fractious eight-party coalition, Mr. Padoa-Schioppa said he was confident the budget would be approved by Parliament without significant changes.

Once the budget is approved, Mr. Padoa-Schioppa said his main objective would be to reach an agreement with the country's labor unions early next year on getting Italians to work longer.