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ITALY: Local Public Shareholdings under Review

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THE ITALIAN GOVERNMENT is about to introduce a first set of measures to make last year's reform of the public administration effective. Two measures should be particularly relevant for the revision of public shareholdings: (1) reshaping of the regulation and governance related to state-owned enterprises at different levels of government and (2) reorganisation of the functions and funding of Chambers of Commerce, Industry, Handicrafts and Agriculture.

There is a huge potential for restructuring, streamlining, downsizing which, together with mergers and acquisitions, should allow a number of companies owned by local governments to be privatised over time or closed down. This will not only lead to a reduction in the stock of public debt but, more importantly, to less corruption and bad management, as well as higher economic efficiency.

Beyond the actual economic impact, it would be a key signal—a confirmation that the government is committed to continue the reform process, notwithstanding growing political uneasiness.

Reform process loses momentum, although…

The Italian Government is setting aside delicate reforms and spending cuts amid growing political concerns. PM Renzi is increasingly under pressure and consensus in opinion polls is declining, challenged by both centre-right groupings, led by the Northern League, and the Five Star Movement.

A number of external events are effectively triggering a much more confrontational stance towards Europe, the European Commission, and EU fiscal rules, on the one hand, and a more cautious domestic approach on controversial issues such as immigration and civil rights, on the other.

The casualty of this political struggle are key reforms, which have faced postponement, sharp downsizing, or both. One example is the much-diluted spending review that produced only a fraction of the savings originally projected. The insistence for budget flexibility is also a by-product of this new attitude.

However, there is a simultaneous attempt to move important reform processes from the political level to the technocratic/implementation level, deflecting public attention and thus potential opposition from interest groups. Away from the spotlight, the reform process is continuing with decent results, but forthcoming decrees will be important for signalling ongoing commitment.

… reform decision can now enter the implementation phase, away from the political spotlight

In mid-January, the Italian Government is expected to approve an implementing decree under the heading of 'reform of the public administration' that could have important consequences. Back in August, the Government obtained approval from Parliament on an enabling Law for the reform of the public administration, effectively a mandate to act according to specific guidelines. Now, it can introduce implementing decrees without going back to Parliament. Parliamentary Commissions can only issue non-binding opinions within 30 days of approval and then let the Government finalise.

In the implementing decree, due to be approved in mid-January, the Government should include two measures that could potentially have important repercussions on the privatisation process and the opening up of the economy: (1) reshaping of the regulations and governance related to state-owned enterprises at different levels of government, and (2) reorganisation of the functions and funding of the Chambers of Commerce, Industry, Handicrafts and Agriculture (CoCs).

Governance changes and new ways to make the privatisation process at local level more effective

The first piece of legislation on which the Government is expected to decide in mid-January is related to the reduction in shareholdings by local governments, including disposal by law of shareholdings in companies that do not comply with specific cost/return guidelines or institutional goals. In recent years, there have been many attempts to push local governments to reduce their shareholdings in the local economy, favour streamlining and mergers & acquisitions, and prepare for privatisation. So far, results are disappointing due to resistance at the local level and local government constitutional rights.

A census done at the end of 2013 (latest available) shows that entities within the perimeter of the general government (i.e. local and central governments according to ESA95) owned 10,964 companies. These companies employed 953,100 workers. In 57.6% of the cases, governments owned a stake greater than 50%, i.e. a controlling stake. Changes over the previous two years have been minimal, with only a 0.5% reduction in the number of companies owned or partly owned by governments and a 2.5% reduction in the number of employees.

The number of active enterprises is somewhat smaller, i.e. 7,767 with a total employment of 927,559 (the difference is represented by companies not recorded in the industry/services registry, i.e. small agricultural companies, not-for-profit organisations etc., or companies that have not issued annual accounting statements). 54.4% of persons employed are in central Italy, with a significant number in Lazio (Rome), which houses 751 companies and 431,195 workers, almost half the total. This figure, however, is heavily distorted by ENI (30.1% in public hands directly and indirectly through CDP) and ENEL (25.5% owned by the Ministry of Economy and Finance), which are efficient large companies run as private entities and based in Rome.

Publicly controlled companies (i.e. stake greater than 50%) total 4,715 (60.7% of active companies) with 661,919 workers. Professional/scientific/technical services account for 13.9% (only 2.7% of workers), and local utilities (i.e. water, sewerage, gas, waste management etc.) 11.6% (10.2% of workers). Most employment, instead, is in transport and storage, with 37.4% of employed persons, and the financial sector and insurance (3.8% of companies and 18.0% of workers).

Some companies operate in capital-intensive sectors such as energy and infrastructures. In electricity and gas, fully or partly government-owned companies produce 60.6% of the value added of the sector. This number reaches 61.5% in water, sewage, and waste management. In the financial and insurance sectors, these companies generate 57 billion of value added, i.e. about 11% of what is generated by the business sector in Italy. It is a big chunk of the economy. Companies with more than 100 workers total 871, employing 838 thousand workers. In other words, there is a high concentration, and thus potential for putting some of these companies on the market.

Restricting the analysis to companies where local governments have a stake, out of the 7,767 active companies, 6,120 are fully or partly owned by local governments, with 486,676 workers. This clearly leaves out large companies such as ENI and ENEL, which are partly owned by central government entities. It is interesting to notice that there are 197 companies in the financial and insurance sector, with 144,404 workers. Moreover, there are 578 companies in the electricity and gas sector, with 20,540 workers and 811 companies in water, sewerage, and waste management, with 85,766 workers, providing ample scope for consolidation. In 2013, the number of companies has even increased by 1.6%, while the number of workers declined by 2.4%.

Finally, the productivity of enterprises partly of fully owned by government entities is relatively high due to their size and sector composition, which is highly skewed towards the production of electricity. Cost of labour is also much higher than the rest of the economy. 23% of companies recorded a loss in 2013, especially in the transportation sector. For companies fully government controlled, total losses amounted to about 1 billion and total profits about 2 billion, leaving a net outcome of only about 0.9 billion. Privatising those companies that are not strictly related to the provision of public goods and services would certainly improve these figures.

Chambers of Commerce will sharply reduce their stakes in the local economy

CoCs have an important role in the local economy and provide vital services to businesses. However, in Italy, they have also taken on unusual roles as shareholders of public, quasi-public, and private companies. Minority interests typically represent a big chuck of their portfolio, and their stakes are rather small most of the time. Usually, no control is involved.

However, sometimes the stake is sizeable, especially in companies that are perceived as strategic for the local economy or that provide services to the CoCs. Examples of these stakes include research institutes, universities, job placement services, motorways, service providers, and key infrastructures such as ports. Occasionally, they also hold stakes in local banks. Most important, they are significant shareholders in local airports.

A law introduced in 2014 (as part of the annual Stability Law) asked CoCs (and all local government entities) to prepare plans for the rationalisation and possible divesting of stakes in local companies. A number of plans are now available online. The aim was to reduce stakes in companies and divest those "not strictly needed to pursue institutional goals" by December 2015. As a result, many plans consider the majority of current shareholdings as necessary, essential, and strategic and in line with institutional goals. There is thus a need to clarify the institutional goals of CoCs.

The new pieces of legislation should favour divestment unless CoCs claim that shareholding is strategic and in line with their institutional goals, or if the process faces difficulties due to lack of private interest and public auction procedures are exhausted. It should also allow for mergers of CoCs to reduce their total number and overlapping responsibilities vis-à-vis other local public entities. It should also introduce ways to eliminate or sharply reduce board members' pay, achieve savings, and cut the cost of CoCs services to the local economy. Finally, there should be a new governance framework.

From an economic point of view, shareholdings by CoCs are not sizeable, but they are highly symbolic. In some cases, they represent indirect ways to pursue public interest at local level.

The signalling would be powerful

There is a huge potential for restructuring, streamlining, and downsizing, which, together with mergers and acquisitions, should allow a sufficiently large number of companies owned by local governments to be privatised or even go public at some point. This will not only lead to a reduction in the stock of public debt but, more importantly, to less corruption, bad management, and higher economic efficiency. The starting point must be a new governance framework and a single legal text regulating shareholding by public entities.

The government is expected to find more powerful ways to force local governments to dispose of assets not strictly related to the provision of public goods and services, while preserving their constitutionally guaranteed rights. If the government effectively delivers (we will see soon), it would be a very important step.

In fact, various governments have already picked up low-hanging fruits. In order to reduce public spending and enhance efficiency and productivity, there is currently no solution other than reviewing the way the public administration delivers public goods and services to citizens and businesses, directly or indirectly through companies owned by different levels of government.

Beyond any actual economic impact, the signalling and confirmation that the government is committed to continue in the reform process would be key, notwithstanding growing political uneasiness.