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Prime Minister

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PRIME MINISTER

VISIT TO ITALY : 1-2 OCTOBER 1984

I visited Rome on 1 and 2 October to have discussions on UK-Italian industrial and commercial relations and EC issues with members of the Italian Government and business community.

2 This proved to be a useful visit. Despite Italy's economic difficulties (with concern centring on unemployment, running officially at just over 10 per cent; inflation at 11-12 per cent; and a high PSBR), and the political strains inevitable in a five-party coalition (albeit a relatively stable one), the market is large and well worth exploiting. By any test, our export performance is disappointing: we provide only some 4 per cent of Italy's visible imports, compared with France's 13 per cent and the Federal Republic of Germany's 16 per cent. Our deficit in visible bilateral trade for 1983 was £895 million. There are structural problems for our exporters in penetrating a very fragmented wholesale and retail market, which local business people were convinced could only be solved if companies employed locally-based representatives. I know that, following his visit earlier this year, George Jellicoe and the British Overseas Trade Board are pursuing a number of valuable leads and I am sure our Posts in Italy - and Ministers here and in other Departments - will do all they can to support this.

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3 My discussions with Signor Altissimo, Minister of Industry and Commerce, Signor Darida, Minister of State Participation (an imposing and depressing portfolio covering almost all Italy's state-owned enterprises) and Professor Prodi, the President of IRI (one of the state holding companies) ranged widely. An important theme was the Italian enthusiasm for industrial collaboration, particularly in the fields of defence and aerospace. There seemed considerable goodwill, some of it based on the conclusion of the agreement between Westlands and Agusta on the EH 101 helicopter. We discussed a range of promising possibilities, including UK-Italian collaboration on development of their G222 aircraft and further helicopter projects. I stressed the importance of collaboration as a means to an end, rather than an end in itself: the problems we have encountered in selling the Tornado to third markets underline the need to establish that markets outside the participating countries exist for such projects before they get too far advanced. This point was well taken in respect of the proposed five-nation collaboration on the European Fighter Aircraft, about which the Italians are very keen. I was able to visit two Italian electronics companies, Elettronica and Selenia, both of which have concluded important co-operative agreements with British companies (Plessey and Racal respectively), and was impressed by their sophisticated range of products.

4 I had encouraging discussions with Altissimo on EC matters. He is beginning to focus on the themes he would like to pursue during the forthcoming Italian Presidency, and showed heartening signs of a desire to start planning in advance. It would be unrealistic to expect any significant progress under the Italians on internal market



questions, but Altissimo expressed his particular interest in reaching agreement on telecommunications equipment standards, with a view to liberalising the Community market for his equipment. The Italians are concerned, as we are, about the increasing dominance of US companies in this field, and believe the answer is to develop viable European alternatives. I am sure this is a course worth pursuing (although it will not find favour with the French), and I hope it can be touched upon in the Summit talks on 18/19 October.

5 On other Community matters, the Italians see eye to eye with us on the shipbuilding intervention fund and on vehicle emissions. On the enlargement discussions, the Italians are as concerned as we are about unfair competition from protected Spanish manufactured goods, and believe this is an issue which has not received due attention in the talks to date.

6 I was struck by the entrepreneurship of a number of the Italian businessmen I met, including many of those in public sector companies. Genuine efforts seemed to be being made to run these companies more efficiently (for example, by taking steps towards rationalisation and restructuring in the steel industry), although Signor Darida showed absolutely no enthusiasm for privatisation. Professor Prodi confirmed that it was his objective to run the state-owned sector in a cost-effective way, and impressed me as a thoughtful economic liberal with a strong pragmatic streak. He showed considerable scepticism about the importance of a common company law regime as an engine of EC development, making it clear that the prime movers of transnational co-operation were a common commercial strategy and mutual benefits. Interestingly, Professor Prodi was sympathetic to our aims of



liberalising European air services, though he felt that Italy would have to be cajoled into liberalisation gradually.

7 The main lessons from this visit were two: first, there is scope for our exporters who will need to be actively encouraged to regard Italy as a sophisticated and valuable extension of our home market. This is something our Posts, and our commercial staff at home, will need to pursue imaginatively. Second, while we have a number of differences with the Italians on questions of commercial and industrial co-operation, there are substantial areas of common interest which I believe can be exploited to our advantage.

8 I am sending copies of this minute to Geoffrey Howe, Michael Heseltine, Nicholas Ridley and Michael Jopling.

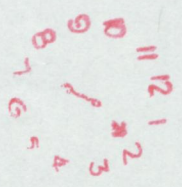
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8 October 1984

Department of Trade and Industry

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10 DOWNING STREET

From the Private Secretary

15 October 1984

Mr. Tebbit's Visit to Italy

The Prime Minister read with interest your Secretary of State's note of 8 October on his visit to Italy.

I am sending copies of this letter to Colin Budd (FCO), Richard Mottram (Ministry of Defence), Dinah Nichols (Department of Transport) and Ivor Llewelyn (MAFF).

(C.D. POWELL)

M.C. McCarthy, Esq.,
Department of Trade and Industry

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BY BAG

FROM ROME

TO FCO

SAVING NO 29

8 OCTOBER 1984

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FRAME ECONOMIC

TO FCO SAVING TELEGRAM NO 29 OF 8 OCTOBER 1984 AND INFORMATION
SAVING WASHINGTON, UKDEL IMF/IBRD, UKDEL OECD, PARIS, BONN,
CONSULATES IN ITALY

MONTHLY ECONOMIC REPORT FOR ITALY: GENERAL

1. Main developments in August and September in the Italian economy
have been:

- the unveiling of a package of fiscal reforms by the Finance Minister, Visentini, on 3 August (in the form of a draft Bill which must now be approved by Parliament);
- continuing edging down of the inflation rate;
- worsening outlook for the balance of payments;
- a temporary interruption of the trend towards falling interest rates, with a 1% rise in the discount rate on 3 September (my telno 572);
- a big surge in credit expansion to the private sector (+20% on 1983)
- the restoration of 3 measures of some economic importance thrown out by Parliament unexpectedly at the beginning of August as a

result of the departure of large numbers of coalition MPs on holiday;
- tough negotiations for virtually the whole of the month of September between the coalition parties, and between spending Ministries and the Treasury, on the 1985 budget which was agreed at the eleventh hour by the Cabinet on 28 September (my telno 657) and presented to Parliament on 1 October.

2. Main indicators, including electricity consumption, suggest that the recovery may be flattening out, with a slowdown in the rate of increase in industrial production only partly accounted for by the summer shut down. But it is clear that the recovery is now much more general, and the industrial north is confident that it will continue well into 1985. There are continuing signs of recovery in investments, but these are thought to be mostly substitutive rather than for new capacity. Unusually good results from the car giant Fiat, which has boosted its turnover, profits and return on capital in the half year to June (benefitting from a record six months for car sales in Italy in the first half of this year) are taken as a paradigm of the changed outlook for enterprises. Even the giant state industry groups IRI and ENI are predicting significant reductions in expected losses over the year.

3. The recovery is also fuelling the beginnings of a consumer boom, after the remarkable fall in personal consumption in 1983. The boom is expected to gather pace into 1985, particularly if inflation rate

expectations continue downward. Inflation by end September was down to single figures (9.3%) for the first time for 12 years, though still expected to be 11% for the year as a whole. The current account of the balance of payments is heading for an expected deficit of some 2,500 billion lire (\$1.4 billion) this year, partly because of the continuing strength of the dollar, partly because of a higher than expected stock-building of semi-finished products in expectation of further increase in activity. The rate of growth of exports has also slackened off, though it surged in the normally quieter month of July. Tourist earnings, moreover, are fractionally down on last year. The lira has weakened slightly in the EMS, while falling almost 10% against the US dollar since the end of July alone.

4. In the labour field the PCI's campaign for a referendum to revoke the 4-point cut in wage indexation (scala mobile) caused by the Government's pay Decree has been the main issue, although the referendum itself would not take place until late spring 1985 (assuming the proposal cleared a number of potentially hazardous political and constitutional hurdles in the first place). The effect of the PCI's move has been to deepen the rift within the trade union movement between on the one hand the supporters of the Decree, CISL and UIL, who oppose the referendum, and on the other CGIL, who fought the Decree, have reservations about a referendum, but are unwilling to oppose an important tactical ploy of their political allies the PCI. (CGIL support the aims of the referendum but have

qualms about setting a precedent on matters of collective bargaining). The agreement of a common union platform for the reform of the wage indexation formula has therefore been delayed. The employers, though willing to negotiate, see no point in doing so with divided unions and under the threat of a referendum which, if successful, would add 1.5% - 2% to wage costs in 1985, whatever might be agreed with the unions in the interim. The resumption in 1985 of local collective bargaining, after a 2-year moratorium, adds to the complexity of the situation, making the outlook for pay in 1985 more than usually uncertain. But these linked issues are unlikely to come to a head before the end of the year and spoil what has been by Italian standards a remarkably strike-free year so far.

5. In the meantime the latest (June) figures, showing an 11.8% increase in manufacturing industry hourly wage rates over the previous 12 months (of which 6.4% was attributable to wage indexation), bear out the useful if unspectacular effect of the Pay Decree in bringing the rise in wages closer to (though still above) that of prices. Together with a strong recovery in labour productivity in 1984 after 1983's unprecedented decline (Confindustria talk of an increase of over 6% in per capita output in 1984) this should ensure that labour costs per unit of output are contained this year. Wage rates in Italy's large civil service, however, have risen by rather more (14.6% in the 12 months to June), mainly because of a generous 3-year contractual settlement conceded by the Government shortly before the

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- 5 -

1983 elections, which, if implemented in full in 1985, would breach the 7% ceiling on public sector pay assumed in the Budget. The signs are that working hours and monthly earnings are also moving ahead rapidly (hours by 2.2%, earnings by 17.3% in large scale manufacturing industry in the 12 months to May). But employment prospects show no sign of benefitting from recovery: measured unemployment remains above 10%, employment in manufacturing continues to fall and lay-offs supported by Italy's massive short-time working scheme (Cassa Integrazione) continue to grow well above last year's (record) levels. A pragmatic, if ambitious, discussion document on short and medium term employment policy produced by De Michelis, the Minister of Labour, has been well received, but the process of translating thoughts into deeds has yet to begin.

6. Visentini's proposed tax reforms (details by bag) fulfil the government's undertaking to act on tax evasion at the time of the issue of their pay decree in February. They now join the 1985 Budget and Finance Bill in setting the framework for the Italian economy in 1985. VAT bands are reduced from the current 8 to 3: there are swingeing provisions for presumptive tax assessments from shopkeepers and other self-employed. Many Christian Democrats will offer fierce if covert parliamentary opposition, and Visentini has many times threatened resignation if he does not get his way.

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- 6 -

7. The 1985 budget framework offers only a modest improvement on the current year, and there is some distance between its promises and the measures needed to realize them. GDP has been revised downwards from the government's optimistic earlier assumption of 3% for 1985 to 2.5%, in line with most recent outside forecasts. But the inflation target is kept at 7% (which becomes the guide figure for growth in expenditure and wages) when few outside forecasters expect inflation to fall below 9%. Indeed the IMF expects it to remain at around this year's level of 11%. The main question marks remain on public expenditure where the government's intentions are still ill-defined, though they aim to reduce the PSBR from 15.7% of GDP this year to 14.3% in 1985.

8. At this stage the Government expect to be able to secure agreement of the Finance Bill and associated measures before the end of the year. The difficulty will be to keep the coalition together when it comes to the chapter and verse necessary to put the intentions described in the budget document into effect.

9. For details see MIFST.

BRIDGES

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ECD (1)

	<u>1984</u>	<u>1983</u>
GDP (constant prices) Q2/Q1	+0.7*	-1.2
Industrial Production (July) (unadjusted)	100.6*	96.4
Unemployed (April)	2,348,000	2,263,000
Exports (billion lire) (July)	12,019*	9,630
Imports (billion lire) (July)	11,317*	9,729
Trade balance (billion lire) (July)	+702*	-91
Cumulative total (billion lire) (Jan-July)	-9,433*	-6,022
Balance on Current Account (billion lire) (April)	-751	+120
Cumulative total (billion lire) (Jan- April)	-4,386	-2,353
Balance of Payments (billion lire) (August)	+1,762*	+1,463
Cumulative total (billion lire) (Jan-August)	-748*	+4,227
Exchange Rate £ 23/9	2,346.3	2,394.95
Exchange Rate \$ 23/9	1,883.25	1,597.5
Exchange Rate DM 23/9	622.2	605.79
Official net reserves (billion lire) (August)	78,665*	72,041
Year on year growth in money supply (monetary base) excluding postal deposits (June)	11.7%*	17%
Annual rise in retail prices (September)	9.3%	13.6%
Annual rise in wholesale prices (July)	10.6%	9.5%
Annual rise in hourly (industrial) pay rates (June)	11.3%	14.3%
Interest rates:		
1) 3-month Treasury Bills (average yield, simple interest)(end September)	14.55%	16.06%
2) Illustrative (average) bank interest charges (July)	21.76%	23.2%

*Provisional