

A liberal puzzle

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Romano Prodi tries to combine economic reforms with higher taxes

EMPLOYEES of Italy's flag-carrier, Alitalia, are seething over the apparent readiness of Romano Prodi's centre-left government to let the airline go bust. Many Sicilians are furious that the government has scrapped the planned Messina bridge to link their island to the mainland. And last week, tens of thousands of irate, grey-suited members of the professions marched through Rome to demonstrate against liberalisation measures.

At first glance, all these protests sound promising enough. Mr Prodi won power in April with pledges of real reform. Italy badly needs less regulation, more competition, lower taxes and less public spending. That the government is now under fire from all sides might be seen as evidence that it is giving the country some of the reforms that it needs.

Its popularity has plummeted, of course. Earlier this month, a poll in *La Repubblica* showed the government's approval rating had collapsed since July, from 59% to 39%. But, as Mr Prodi himself said in an interview with *El País*, a Spanish newspaper, the trick with unpopular reforms is to get them out of the way as soon as possible before the next election.

His government is unquestionably doing some things right. It has shown itself ready to take on some of Europe's most cosseted professional groups. On October 12th it approved a bill to erode the near-monopoly over private television exercised by the opposition leader, Silvio Berlusconi, who controls three of Italy's four main private channels. The proposed law, decried as "banditry" by Mr Berlusconi, would require one of his channels to go digital, together with a publicly owned one; and would offer the frequencies this frees up to new entrants.

There has been a welcome whiff of liberalism too in the government's approach to Alitalia, whose huge losses have previously been meekly underwritten by successive administrations, including that of the supposedly free-market Mr Berlusconi. "The situation is totally out of control and I don't see any parachutes," Mr Prodi told the trade unions last week. Even his transport minister, a communist, is against further subsidies. Nor has the cabinet balked at axing infrastructure plans such as the Messina bridge and funding for a barrier scheme to protect Venice.

Its biggest reform, though, may be one taking place silently and without high-profile legislation: a clampdown on tax evasion. The government hopes that this will net more than €7 billion (\$9 billion) next year. "The future of the country is at stake in the war on tax-dodging," Mr Prodi said this week. "All else is secondary."

That may seem absurdly hyperbolic. But the drive against tax dodging has a political significance that could outstrip its revenue-yielding capacity. In a country where the self-employed have traditionally declared a small fraction of their earnings, it is potentially powerfully redistributive. What really brought many of last week's protesting professionals out on the streets was the threat of having to pay taxes that employees cannot escape. Their ire helps to comfort the powerful left of Mr Prodi's heterogeneous administration, and may even give him enough leeway to pass other liberalising reforms.

Yet there are risks in all this. The most obvious is that the attack on tax evasion will be no more successful than previous crackdowns in getting Italians to start paying their taxes in full. But another risk is that, if it does work, it could induce the government to keep relying on

higher tax revenues not spending cuts to sort out its public finances. If that happens, it could hold back growth.

The warning signs are all there in the draft 2007 budget. Mr Berlusconi claims to have found 67 new taxes hidden in the small print. In his evidence to parliament on October 12th, the governor of the Bank of Italy, Mario Draghi, said gloomily that the budget left the trend of current spending "substantially unchanged", an implicit criticism. Is it possible to be a "tax and spend" liberal reformer? Romano Prodi seems determined to give it a try.