



Bankpedia Review

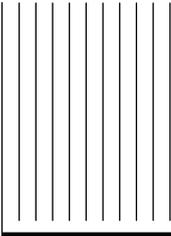
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Editor's preface

Chiara OLDANI¹

Editor's preface

This issue of Bankpedia Review collects interesting contributions in the broad field of public global economics; growth, information, investments and the structure of the State are pieces of the economic puzzle that we present to our readers. 2012 and probably 2013 will be years of slow recovery for some countries, and still of recession for others, like Italy; after the peak of 2009-11 public spending has been reduced, but investments should be sustained in order to guarantee stable growth and development. Structural reforms are needed in most countries, and unconventional examples can be a source of inspiration.

Pancino and Blasi describe the Green Growth strategy launched by the OECD in 2009 that has been one of the first steps toward a more sustainable economic development approach at the international level. Bertucci explains the relevance of public interventions to support investments in industrialize countries; recent years of sovereign debt crisis had a negative contribution to the growth rate of investments, and damaged productivity and wealth. Pisano introduces the quality disclosure as an information problem that is of special relevance in the choice between alternative consumption or investment goods. Information is one of the most precious good in industrialized economies, but its quality is still controversial. Aversa brings our attention toward a successful example of public management, the Chinese case.

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GREEN GROWTH, OECD STRATEGY

Barbara PANCINO¹, Emanuele BLASI²

Abstract

Initiative launched by OECD in 2009 to respond to the economic and financial crisis and to restore growth on a more sustainable path, by ensuring new development opportunities to limit the impact on environmental resources and on ecological services from which derives much of human well-being.

Green Growth Strategy is an initiative launched by **OECD** in 2009 to respond to the economic and financial crisis, and to restore growth on a more sustainable path, both under the social and environmental point of view.

Drawn up on behalf of the Council of Ministers of the 40 member States, the Strategy was published in May 2011 under the title of "*Towards Green Growth*", with the aim of providing member Countries with some useful guidelines in order to develop their strategies and national policies in the green growth field. As it is clear enough from the headline, the OECD considers **sustainable development** and **Green Economy** primarily as engines of growth and sources of new development opportunities, able at the same time, to limit the impact on environmental resources and on ecological services from which derives much of human well-being.

The sustainable development, the efficient use of resources, the fight against **climate change** and environmental degradation are pursued by spreading an improved production model, new work opportunities and innovative technologies.

Creating favorable conditions for investment and competitiveness, promoting innovation, encouraging new markets for "*green*" products and services, introducing en-

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vironmental tax measures, removing subsidies prejudicial to the environment, establishing a climate of stability and trust: these are the keys on which it is necessary to leverage in order to overcome the current crisis in a perspective of sustainability. A green growth strategy requires in particular, a mix of tools derived from wide intervention packages. The first one includes the framework conditions that can strengthen the economic growth while ensuring the preservation of the natural capital. These involve basic tax and regulatory devices and traditional tools of economic policy and competition. The second package includes *ad hoc* tools, based on prices and on other strategic mechanisms, capable of promoting the efficient use of resources and the internalization of environmental pressures: taxes, tradable permits, voluntary approaches and public-private partnerships. Explicit reference is made in this context, to taxations of CO₂ as alternative to taxes on corporate income, on work or cuts down public expenditure.

OECD believes that the key area on which to focus is innovation that, understood in its broadest sense (technological, organizational, behavioral), is the main motor of *green economy* and plays an essential role in promoting a structural change in the economy and in the society with a positive impact on employment too. Green technology is already facing an expansion phase, as evidenced by the increase in the number of patents in the field of renewable energy, electric and hybrid vehicles as well as the energy efficiency in the construction and lighting industry. Technological innovation must be supported by targeted trade policies, such as the reduction in trade and investments barriers and an adequate protection of intellectual property rights. Furthermore, innovation alone is not enough: it requires the development of appropriate infrastructures for next generation technologies, especially in areas like energy, water supply, telecommunications and transport networks.

OECD pays particular attention also to employment, not only because does green growth create new job opportunities, but also because in transition, some jobs, tied to the old unsustainable production model, are at risk: political efforts should therefore be addressed to ensure that companies and workers quickly adapt to changes

and seize new opportunities, easily moving from sectors in contraction towards those in expansion.

The Strategy also deals with some aspects of international cooperation, that should be strengthened in order to ensure an appropriate management of “global common goods”, such as climate and biodiversity and to address financial flows, global trade and investments. In this context, reference is also made to the need to prevent, through adequate control measures, the development prospects of poorer economies which could be compromised by blatantly protectionist measures established in many developed countries with the excuse of green growth.

All in all, the strategy stresses the importance of ensuring appropriate monitoring of the transition of the economy and society towards a green model. For several years, OECD has started reviewing the traditional methods by which we measure the growth and well-being, pointing out the inadequacy and the incompleteness of GDP as indicator or reference, while giving importance also to values non closely-linked to economic production, such as quality of life, environmental health and access to education. As regards to Green Growth, specifically, some peculiar indicators, which should be alongside the traditional macro-economic ones, have been identified and divided into four interlinked micro-areas with the aim of:

- Monitoring the productivity of natural capital and resources, and therefore verifying the difference between the rate of economic growth and the rate of growth of the environmental pressures caused by the adoption of production and consumption systems. Indicators in this case are, for example, CO₂ emissions, water consumption, generated waste, and natural resources used for production.
- Describing the basic environmental heritage. Such indicators are the renewable resources available and their extraction, the condition of endangered species and the number of the existing forests.
- Monitoring the environmental dimension of the quality of life. Indicators of this type are, for instance, the health problems pollution-related and the access to sewage and purification systems.

- Identifying political responses and economic opportunities. This category includes indicators such as the percentage of green investments, the rate of employment in the environmental sector and the patents of green technologies.

As indicated in the guidebook of the Strategy (Towards Green Growth: Monitoring progress – OECD Indicators), for each of these groups, a list of possible indicators is presented. This list is reviewed as soon as new data become available and these concepts are developed further. At the moment, 25 indicators have been identified, however, not all are currently quantifiable.

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PUBLIC INTERVENTION TO SUPPORT INVESTMENTS IN INDUSTRIALISED COUNTRIES

Irene BERTUCCI¹

Abstract

The main challenge the traditionally developed countries have to face today is competition from the newly industrialized countries. As the engine of development and the means for infusing and diffusing technological progress, and therefore for the growth of productivity in the system, levels of investment are crucially important. This article considers the tools for public intervention that can affect business investment decisions. It underlines the importance of interventions that reduce the tax wedge and the quasi-fiscal burden on labor costs.

The main difficulty lies in finding cover within public budgets to compensate for the loss of revenue and/or the additional expenditure required for these incentives. The answers are to be found in reducing the less productive parts of the public expenditure, in modifying the composition of the fiscal and parafiscal levy, and in interpreting the constraints of the Stability Pact in a less "accounting-orientated" way based more on economic effects.

1. Background

In growth models a key role is played by capital and investments, whether to increase manufacturing capacity, infusing technological progress or enhancing skills (human capital).

Reflecting on the causes of the great crisis of 1929-1930, Keynes warned that it is difficult to identify the determinants of investment decisions since they are linked to

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the subjective expectations of entrepreneurs (“animal spirits”). Whilst he recognized the influence of capital costs on these decisions, he also warned that manipulating the interest rate may not be sufficient to stimulate recovery of investment if the expectations of investors remain negative.

The recent economic crisis, which hit hard the traditional industrialized countries² and holds out for them the prospect of greater difficulties as growth resumes, makes Keynes topical again³. But his neoclassical synthesis (the well-known IS/LM Model) offers no explanation for the fact that although interest rates in the European Union today have fallen to historically extremely low levels, and the recovery of investment we would expect to occur when there is a normal relationship between investment and the cost of capital is not taking place.

Without doubt, this is a question whose relevance goes beyond theoretical debate. The governments that are attempting to promote a recovery of investment are encountering difficulties in finding ways of doing so, other than the solution already attempted: reducing interest rates. As is well known, Keynes suggested that as a way of restarting the expenditure-manufacturing-income mechanism and encouraging a more favorable outlook on the part of the private sector, governments should implement programs of direct public investment and/or to sustain levels of domestic consumption.

But under today's conditions, when public finance tends to go out of balance due to inbuilt factors that relate to increasing public expenditure for purposes of redistribution, in many countries the Keynesian prescription (public investment and government support for consumption) looks dangerous for the monetary and financial balance of the system⁴. Furthermore, experience suggests that as and when the economic recovery gets under way, political decision-making mechanisms will make it difficult to reduce many categories of public expenditure (such as transfers to

² Hereinafter referred to as TI Countries.

³ See the considerations set out in *The Economist* (18/07/2009).

⁴ Above all because of the high levels of public and private indebtedness already built up in most countries (particularly in Italy, so far as public debt is concerned).

households and business, net remuneration to employees, and "tax expenditures")⁵. Nor can it be overlooked that in recent decades the prevailing economic ideology has tended to take an unfavorable view of expanding public intervention in the economy and has counted instead on liberalizing private markets by allocating resources more efficiently, in the expectation that this would favor a higher rate of economic growth⁶.

Naturally it has to be added that whilst in Keynes's time the model of the substantially closed economy might have been an adequate representation of reality, in today's global economy a recovery of internal demand will not be enough to increase levels of manufacturing and income within any one country if differentials in manufacturing costs make it cheaper to shift manufacturing abroad.

In this picture it would appear difficult to identify what instruments would be appropriate for publicly sustaining investment in a TI country; we therefore need to reconsider the variables affecting decisions about which types of public investments can be encouraged.

The literature offers numerous schemes, some of them very sophisticated, for economically assessing investments, and any modern state should certainly take these into account when deciding its direct investment programs. On the other hand in the operational real world of private entrepreneurs, above all of **small and medium enterprises** (and also some large enterprises⁷ where the ownership is centralized and retains control over company decisions) the schemes used for assessing the advisability of investments are frequently structurally simple and even crude, but suitable enough for synthesizing the entrepreneur's intuitive reasoning process, based on

⁵ In reality even a significant reduction in public investment, where economic recovery has been initiated, may face political obstacles due to rigidities and frictions in the processes of reconvertng firms that previously served the public demand to obtaining commissions from the private demand. These rigidities include not only a production - product sector content but also a territorial location content.

⁶ See ALESINA A. et al (2006); HOI et al (2006); even after the outbreak of the world financial and economic crisis, in advancing its recommendations on fiscal policy within the "European Economic Recovery Plan" (ERRP) the European Commission still refers back to the Lisbon Strategy, which aims at improving the functioning of markets (including the labour market) in a pro-competition sense. See EUROPEAN COMMISSION (2009).

⁷ This excludes firms in the financial and insurance sectors, which operate structurally using schemes for analyzing financial investments that can be very sophisticated.

just a few essential points of reference and using whatever information the entrepreneur believes s/he can master and use sufficiently well.

Normally the intuition of the entrepreneur (and this is a characteristic of Keynes's "animal spirits") concerns the probability (subjectively estimated) that within a given time span, after deducting direct and indirect manufacturing costs, repayments of loans in relation to the desired amortization period for the investment, and all related taxes and charges, a given initiative will generate a revenue stream that will make it possible to realize returns on the (financial and entrepreneurial) capital invested such as will be likely to cover normal return on the capital, and compensate for the **risk**.

As a way of identifying what opportunities exist for public intervention to incentivize entrepreneurs to invest, the decisional variables generally taken into consideration by entrepreneurs are highlighted below.

2. Investment decisions and public intervention

The literature offers many sophisticated and also evaluation schemes convenience of investments, of which the modern State certainly should be taken into account to establish their own programs for direct investment. On the other hand, in real operations of private businesses and especially small and medium-sized enterprises (and even some large when the property is centralized and retains control of the decisions of the enterprise) is common to use patterns of investment appraisal structurally simple, even crude formally, but that can be adapted to synthesize the intuitive reasoning of the entrepreneur, which takes a few essential points of reference uses information it considers to possess and to use in appropriate measure.

Normally intuition (an aspect of the "animal spirits") of the likelihood of the entrepreneur (assessed subjectively) to achieve a given initiative and on a given period of time a stream of revenues, minus the direct production costs and indirect depreciation as a function of the recovery period required investments, and all taxes related,

realize returns on invested capital (financial and human) that it finds, to cover the normal return on capital and to compensate for the entrepreneurial risk.

We highlight the following decision variables generally considered by entrepreneurs summarized above, so as to identify opportunities for public interventions that encourage investment decisions.

2.1 Prospects for generating revenue

In the normally accepted terms of Keynesian economics, the advisability at the “macro” level of increasing market sales, and thereby justifying new investments, is a function of the expected level of demand, which can be controlled by governments⁸ via the well-known instruments of macroeconomic policy. By taking a disaggregated intersectoral approach, information about trends within particular manufacturing sectors and their interdependencies makes it possible to calibrate the action to be taken.

As mentioned in the introduction, the present difficulties derive from the fact that an increase in domestic demand, induced by fiscal policy and aimed at some or all manufacturing sectors, could prove largely ineffective for stimulating domestic investment, particularly in the TI countries, if business predicts that the resulting increases in internal demand are likely to be met mainly by producers located in other countries⁹.

In this situation, which is new as compared to what Keynes was able to observe, we need to ask what instruments for public intervention in a TI country are still available for improving the prospects for business to achieve adequate returns from new investments.

⁸ As already warned, this affirmation holds true for an essentially closed economy or for an open economy whose businesses are sufficiently competitive to meet the bulk of the increase in domestic demand.

⁹ This includes domestic entrepreneurs who relocate their manufacturing to companies based abroad.

In debates around this issue the responses are usually worried with the high manufacturing costs in the already industrialized countries as compared to those in the emerging countries. These issues are examined below in the section dealing with manufacturing costs.

But so far as the returns expected by business are concerned, there is in fact considerable other space (particularly in the EU countries) for intervening on the net revenues from VAT and other taxes on consumption. Taxes on final consumption introduce a tax wedge between the prices paid by domestic consumers and the net revenues received by entrepreneurs. But since VAT and other excise duties apply equally to imports, a reduction in VAT and other taxes on final consumption would reduce the tax wedge not only to the benefit of domestic producers but also to that of foreign producers exporting to the country of reference. All the same, it is possible to suppose that when consumers at the upper end of real purchasing power in countries with a long industrial tradition weigh up the relationship between price and quality, they will give more weight to the quality factor, since there is a tendency to presume that the quality of their own national products is higher¹⁰. Reducing taxes on final consumption could therefore encourage such consumers to choose national products and thus stimulate internal investment.

Since VAT is an indirect tax whose revenue goes partly to finance the EU budget¹¹, any reductions in VAT would need to be agreed at the EU level (where currently the expected standard minimum rate is 15%). Since with a certain degree of diversity the current economic difficulties are shared in common by all EU countries, it might be worth considering manipulating the standard rate of VAT at the European level.

But as part of a strictly national public budget, "funding" a reduction in VAT is quite a different matter. In theory, the possibilities are: increase other taxes; reduce public

¹⁰ Well aware of this argument, firms in the TI Countries including Italy are calling for greater protection of trademarks, quality certifications, and secure indication of the actual country of manufacture (such as requests for protection of the "Made in Italy" mark).

¹¹ If the rate reduction has to fall below the levels provided for by Community agreements (currently 15%). One of the fiscal stimuli to economic recovery provided by the European Commission (2008) is "temporary rate reductions" to sustain consumption. But if (as that text says) we take into account the investment decisions of entrepreneurs, it appears unlikely that temporary restrictions with no certain end date can have any significant effect.

expenditure (or some items thereof); or widen the public deficit. Since this affects any proposal to encourage public investment that involves reducing the tax levy or levy and/or increasing public spending, at least in the short term until the economy recovers, this aspect of financing incentives to encourage investment will also be considered in paragraph 3.

2.2 Incentives for innovation

In debates about the outlook for manufacturing and as a consequence, for investment in the TI countries, which have to face growing competition from the emerging countries, it is often asserted that these countries (in particular those in the EU) ought to orientate their strategic investment decisions towards products that use more advanced technologies. It is believed that technological innovation ought to give these countries a competitive advantage both in their manufacturing processes and in their ability to offer new products which (in the perceptions of consumers) will be of better quality. In pursuing these objectives it is held that the more industrialized states should increase and coordinate their expenditure on basic and applied research, and should incentivize decisions that encourage any innovative outcomes from this research to be infused into the manufacturing system. This strategy offers considerable scope for public intervention to support and organize research, support investments that incorporate innovative outcomes from this research, and demonstrate to business the advantages of making use of these outcomes.

These are certainly important indications but as experience is showing, they are far from simple to put into effect. Before looking for spaces in which to finance, to any significant degree, new public spending on research and as support for investment to incorporate its outcomes, there are other public budget decisions that have to be taken under conditions of constraint on balances in which the most important items of expenditure¹² (staff costs, pensions, interest on the debt) remain inflexible.

¹² In public budget decisions, allocations for scientific research that can be used by the production system also encounter the obstacle of the natural reluctance of researchers to work "on commission"

Furthermore, particularly in Italy, there are efficiency problems within the agencies that are responsible for basic and applied research and for disseminating it into the manufacturing system, not least the frequently unjustifiable complexities of the procedures, and overlapping or interference between public agencies or between one program and another.

Bearing in mind that by now the major emerging countries (for instance China and India) have reached a level of scientific knowledge comparable to that in the countries of traditional industrialization, a second critical aspect is the amount of capital required for major programs of innovative research. Whether for reasons of cost or the effectiveness of this research, it seems plausible to assert that major research programs ought to be organized and promoted, including financially, at the scale of large geographical areas, (e.g. the EU as a whole)¹³.

Another critical aspect is that scientific and technological innovation is only infused into the industrial system after entrepreneurs have accepted it.

For a long time business theory has recognized that entrepreneurship is a scarce factor that is difficult to divide. Some innovations can be immediately incorporated into a manufacturing process or product that already exists and that the entrepreneur can therefore recognize, evaluate, and accept positively and quickly. But in the case of an innovation that would require major changes to a manufacturing process or an existing product, or the immediate creation of new business activity, the (scarce and indivisible) "entrepreneurship" factor can become a limit that prevents the innovation from being absorbed into the manufacturing system at the right time.

It must also be considered that if an innovation has been created as a result of investment, in some situations this would require the obsolescence of previous investments, not yet fully depreciated, to be brought forward; but in the absence of

or in any case on themes and for purposes declared as priorities by government authorities; it can in fact be argued that research should be free and funded in all directions as an instrument of cultural progress, not made to serve shorter term objectives aimed at improving the competitiveness of the manufacturing system. This is a very complex issue because it involves ideological aspects that concern the nature of social organization and the meaning of individual freedom within it.

¹³ See MONTI (2010).

any public form of compensation, to the entrepreneur it might seem anti-economic to reorganize a manufacturing process to accommodate the innovation.

Finally, public schemes that incentivize investment in technological innovation and increase business productivity might come up against the well-known difficulties that derive from information asymmetry (between principal and agent) and **moral hazard**¹⁴.

In conclusion, the route of stimulating and promoting basic and applied scientific research, and incentivizing investments whose outcomes can be infused into the manufacturing system, is certainly an obligatory one for the TI countries – but is not so much to be pursued separately by individual countries as based above all on strategies that take in extensive geographical areas. This is the road to take if those countries intend to maintain their historic position of primacy in the world economy and along with it, their pre-eminent levels in the average standard of living of their inhabitants. But it does not seem like an easy or obstacle-free way to go, and the outcomes that can be expected will only come over the medium/long term. So in a situation of economic crisis it seems necessary, not least for reasons of political and institutional stability, that nation states should also use other tools to incentivize other types of investment that can generate short-term effects.

I mentioned earlier the advisabilities of manipulating VAT and other taxes on consumption to create positive revenue expectations. In the next section I consider the advisability of incentivizing investments by manipulating the structure of the costs that entrepreneurs take into consideration when considering an investment.

2.3 The prospects for reducing costs

Even in the most favorable hypothesis that public policy can succeed in raising the rate of technological and organizational innovation in the manufacturing system of the TI countries, it is unlikely that the outcomes could suffice (at least in the short

¹⁴ On this issue, see in particular the work of LAFFONT, J.J., MARTIMORT, D. (2001); LAFFONT, J.J., TIROLE, (1993).

term) to resolve the crucial issue of the differentials between the manufacturing costs in the economies of the TI countries and those in the economies of the emerging countries.

In fact in today's global economy and global information transfer, technological innovations tend to spread rapidly from their country of origin to the others whilst as experience shows, the legal protections afforded by patents tend to be quickly circumvented.

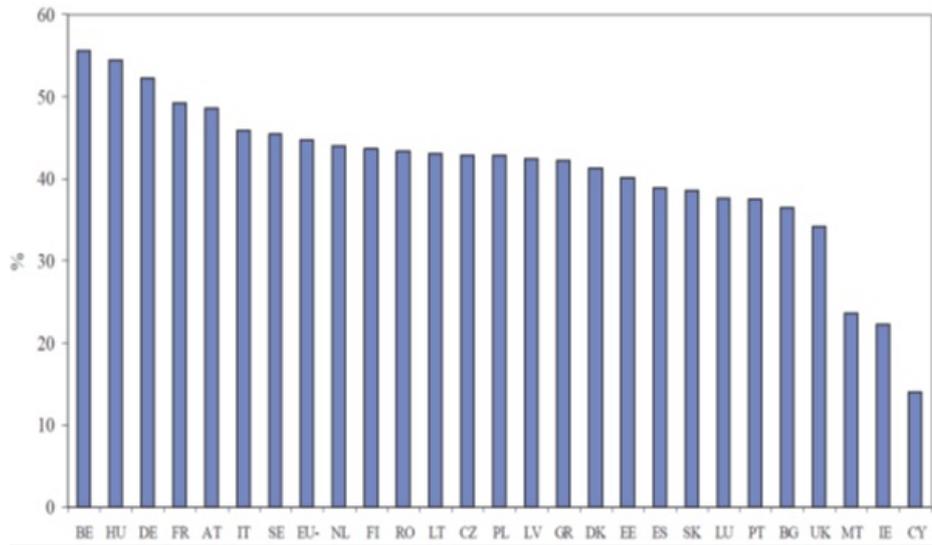
This means that any competitive advantages generated by technological innovation often prove to be of short duration. Not only: the fact that firms are aware of the high risk that innovation in one country will be quite quickly transmitted to the manufacturing systems of other countries means that when firms based in the TI countries decide to invest in innovation they also consider whether it would not be more opportune to make this investment directly into the other countries where costs are lower. Apart from the hypothetical case of a highly significant technological innovation, when the entrepreneur, comparing expected costs with expected revenues to determine the profit margin in relation to capital invested, assesses the advantages of making an investment referred to manufacturing costs at normally expected levels, the crucial variable of reference will be whether this can be considered satisfactory. As previously mentioned, in today's ever more internationally integrated economy a Keynesian stimulation of internal demand within an IT country may not be sufficient to promote growth in that economy if the demand is largely to be met by manufacturing located outside that country, where costs are lower.

In almost all the manufacturing sectors of the TI countries, labor is the most important cost item; and in open international markets the differential between this cost in the TI countries and in competing manufacturing sectors in the emerging countries is the main factor that contributes to the loss of competitiveness of the TI countries.

So in the TI countries, what instruments can a state use to reduce labor costs? As can be seen from Tables 1 and 2, simple observation of the structure of labor costs in the TI countries shows that the fiscal and quasi-fiscal levy is an essential compo-

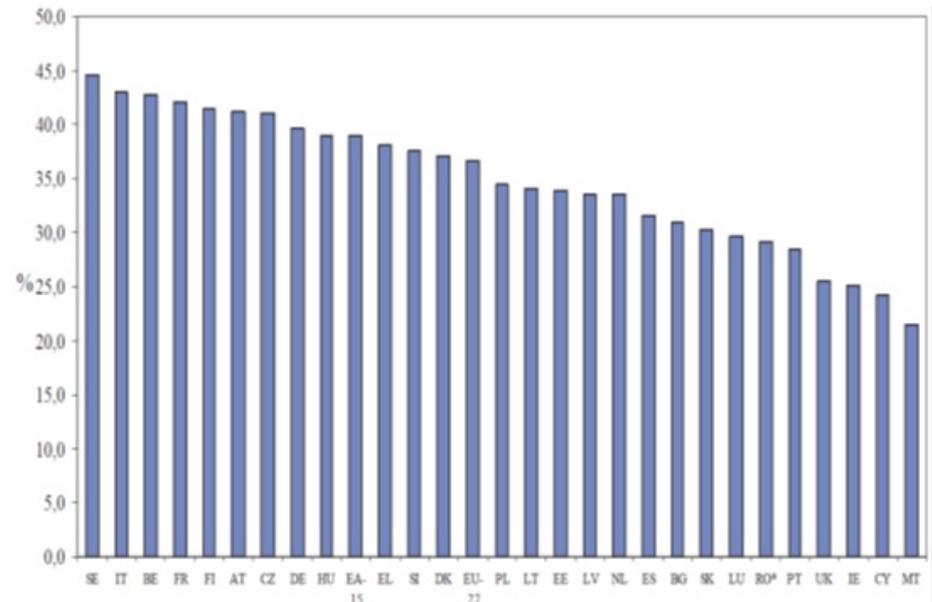
ment of these costs, represented in the EU countries respectively by the “tax wedge” in the average wage and the implicit rate of the levy on employee incomes.

Table 1 – Total (average) tax wedge, single worker; 100% average wage



Source: European Commission

Table 2 – Implicit tax rate on wages (%), 200



Source: European Commission

Note: data for Romania (RO*) refers to 2005

To use language that is familiar to entrepreneurs, these tables suggest that in order to pay a worker a given wage or salary, the entrepreneur has to bear a cost that is increased by the extent of the fiscal and quasi-fiscal levy. Since as shown in Table 1, the wedge for most EU countries is between 40% and 50% (or more) of the average wage, it is evident that reducing this could have a significant effect on the competitiveness of firms in the TI countries as compared to those in the emerging countries. Noting that “the average tax (and quasi-fiscal) burden on labor is very high in Europe”¹⁵, the previously mentioned recent report of the European Community deduces that heavy taxation “is one of the factors underlying the poor occupational levels in Europe in recent years, which take the form of high rates of unemployment, low rates of participation, and low numbers of hours worked” adding that other significant factors may be the minimum wage and poor flexibility in the labor market.

The main conclusion that can be drawn from this is that if in governmental budgets there were no difficulties in finding cover for reducing a significant part of the proceeds of the fiscal and quasi-fiscal levy on labor, thus reducing the public components of labor costs in the TI countries, there would be immediate prospects for effectively improving the competitiveness of their national products.

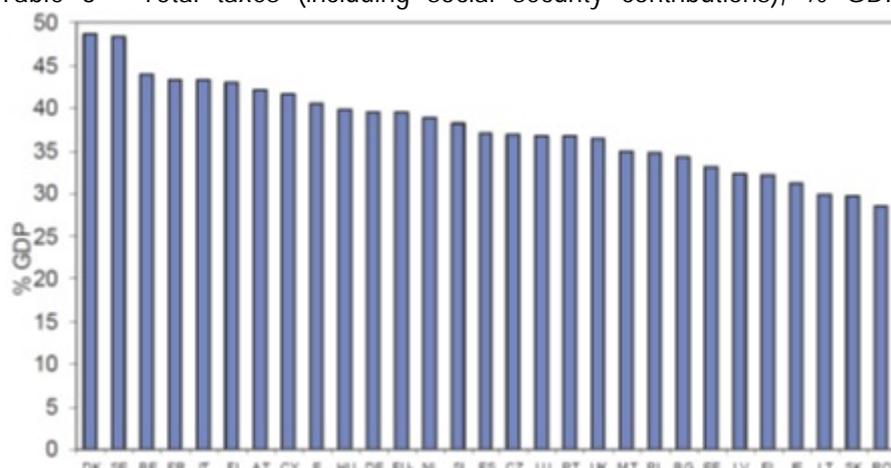
In this regard, which is crucial for the recovery of competitiveness in the TI countries and thus for the prospects of investment in them, it is worth reiterating that with respect to the emerging countries (but also with respect to the other industrialized countries) the EU is a high tax area (measured in relation to GDP)¹⁶. Unfortunately, the difficulty for governments of covering such operations to reduce taxes and levies on labor costs would seem to preclude their widespread use¹⁷.

¹⁵ EUROPEAN COMMISSION (2009) pp.43- 44. The Commission also notes that taking together the aggregate rate of tax on labor and the benefits offered by social assistance schemes, in the EU countries there are high disincentives to employment, to participating in the world of work, and to any increase in working hours and effort. It therefore calls on Member States to reform their disincentivising institutions: pp. 50-54.

¹⁶ See EUROPEAN COMMISSION (2009).

¹⁷ In relation to this issue, see par. 3.

Table 3 - Total taxes (including social security contributions), % GDP, 2007



Source: European Commission

Note: data for Romania (RO*) refers to 2006.

As can be seen from Table 3, in the EU as a high tax area (in which the average total tax take for all 27 Countries is 39.5% of GDP) Italy, specifically, is one of the highest taxing countries (at no. 4 with France).

In this regard it has been noted that the relatively high level of the tax and quasi-fiscal take in the EU reflects the greater robustness and extent of the systems of social protection in those countries as compared to countries outside the EU. The solidity and wide coverage of these systems of social protection, it is argued, have provided decisive support for the social coherence of the EU as a community against the effects of the recent severe economic crisis.

It should be added that the purpose of levying social welfare contributions is to fund the costs of social security (pensions, subsidies, social benefits)¹⁸ and that reducing these contributions would pose with great immediacy the problem of financing these expenditures. One option might be to reduce inefficiencies and abuses caused by information asymmetries and social resistance, but this in any case would encounter technical difficulties. And the social importance of these expenditures (which include expenditures for social safety nets) is well known.

¹⁸ In countries such as Germany that have maintained the insurance-based healthcare system (the "Bismarck model"), social contributions also fund most expenditure on health.

From a methodological point of view this issue is similar to that rose earlier in relation to proposals for reducing VAT and other taxes on consumption; such operations have to be covered by reducing some items of public expenditure and/or increasing other forms of taxation. Thus, see once again paragraph 3 below.

It should be noted that arguing here in favor of reducing the fiscal and quasi-fiscal burden on employed work may appear to run counter to a theoretical (and fiscal policy) approach that has come to the fore in recent decades, on the basis of which it is thought that income from capital should be taxed to a lesser extent¹⁹ than income from work, as is in fact the case of the Nordic DIT and of the significant reliefs on income from capital that are permitted under the laws of most TI countries²⁰.

Whilst the theoretical debate on the merits or otherwise, in terms of fairness and efficiency, of taxing income from capital at a lower rate remains open²¹, so far as tax policy is concerned - and as has been recognized by the creators of the DIT model - the winning argument has been that in today's highly integrated international economy and its high capital mobility, taxing income from capital at a higher level in one country than in competitor countries would provoke a substantial outflow of capital from the higher-taxing country.

But in my opinion this argument is gradually losing the power it has had over the past twenty years. Fundamentally this is because cooperation between states, above all within the EU, to enable the authorities to track international capital movements, is being strengthened and expanded, and this is also opening up new possibilities for states to apply the "principle of residence", and to more effectively combat tax avoidance and evasion.

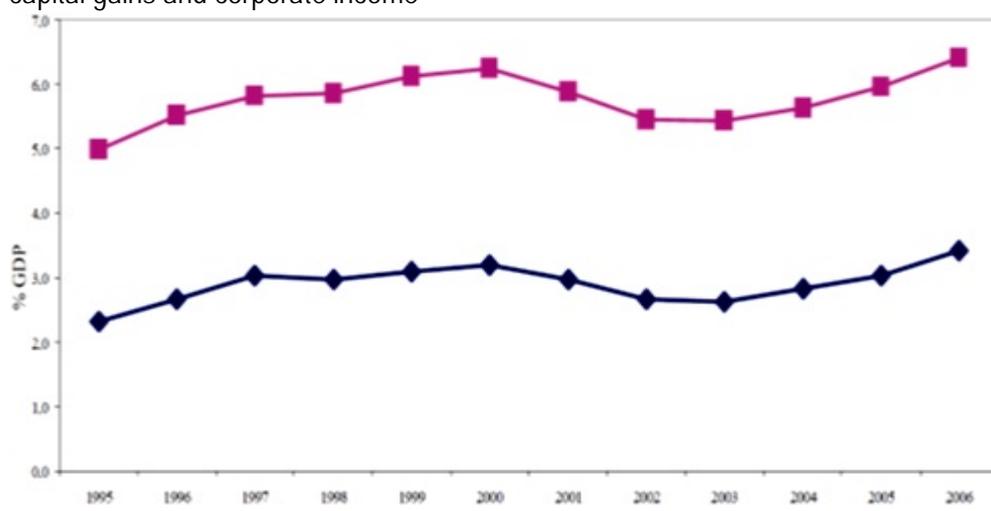
¹⁹ Indeed there is a school of thought that has been arguing since the 19th century that ordinary income from capital should not be subjected to income tax at all. For a discussion of these topics and the "intermediate" solution represented by the Nordic DIT, I refer to my previous article (BERTUCCI, 2007) and the references cited therein.

²⁰ On this issue of the preferential treatment of capital gains as compared to those from work, including in jurisdictions that have not explicitly adopted the Nordic DIT, see EGGERT (2005) and the references cited therein (see bibliography).

²¹ See SORENSEN (1994; 2005a; 2005b; 2006), BOADWAY (2004) and my article, Irene Bertucci (2007).

Furthermore, in the **European Commission** report previously referred to²², the statistics show that the far-reaching economic integration that has taken place in recent years, and the great increase in the international mobility of capital associated with it, have so far not led to any significant reduction of the tax take on income from capital.

Table 4 – Tax revenue from corporate tax against percentage of tax revenue from capital gains and corporate income



Source: European Commission

This is explained by other three other factors (in addition to those given above in relation to the extension of controls as a result of the greater international cooperation between states). The Commission notes, in fact, that enlargements of declared taxable income have accompanied the observed reduction in the rates of business income. Furthermore, the reduction of business tax rates appears to have incentivized an increase in taxable business income at the expense of personal incomes. In its role as a backstop to compensate for reduced personal income, business taxation has begun to lose its strength.

In particular, increasing global competition should induce us to consider that whilst on the one hand because of its lower international mobility, labor cannot to any sig-

²² EUROPEAN COMMISSION, (2009), pp. 57-60.

nificant extent avoid higher internal taxation levels by moving out of the country²³, on the other hand it is equally true that if firms in countries where labor is taxed at higher rates find their costs are not competitive, this will push them to reduce their activity in the higher-taxing country and/or move it somewhere else.

This consideration, which seems necessary to support proposals that favor DIT or similar schemes, is not intended to immediately mean that financing the detaxation of work has to be done by increasing capital gains tax.

The proposal here is to reduce labor costs in the TI countries, for obvious reasons that relate to their competitiveness with the emerging countries. As to how this can be covered financially, see paragraph 3 below.

2.4 Other possible action

Revising the current tax system to improve the competitiveness of firms in the IT countries should also extend to other taxes, as a way of reducing the tax burden on the manufacturing costs of firms within each of those countries.

It is not possible here to go into specific technical issues as they apply to each tax.

With specific reference to the Italian system, let it suffice to recall the taxes that would be candidates for any such revision:

- IRAP [Imposta Regionale sulle Attività Produttive, or Regional Tax on Manufacturing]. This tax on manufacturing bears directly on the user cost of the manufacturing factors (capital and labor) by introducing the tax wedge between the gross and net remuneration of these factors;
- A whole range of other tax charges levied on a variety of documents required for business transactions and business life (registration tax, stamp duty, and other similar charges).

Obviously these proposals for review should be balanced by giving some indication of how the losses of revenue would be covered (par. 3).

²³ See GORDON (2000).

It is generally accepted, particularly in Italy, that there are ample margins for increasing the efficiency of the action of the public administration (whose inefficiencies have a negative knock-on impact on business costs and business activity). But as experience so far has shown, there are technical difficulties associated with reorganizing the workforce and departments within the public administration; frictions can be generated by resistance to innovation and vested interests representing particular groups and categories have the power to block efforts to increase the efficiency of many of the actions the public administration could take to increase efficiency.

Of course there remains the crucial matter of increasing overall productivity in all sectors of the economy. This will depend on technological innovation and on effectively diffusing it throughout the industrial system. The question of the inefficiency of the public administration cannot be addressed here.

3. Financial cover for the lower revenue and the higher public expenditure required to fund a program of significant investment incentive

In relation to the proposals outlined in previous paragraphs for incentivizing investment in the manufacturing system by reducing the fiscal and quasi-fiscal levy and/or greater public expenditure, we have had to point out that the current conditions of the public finances in most of the TI countries appear to place insurmountable obstacles in the way of finding new financial resources for such public incentive programs²⁴.

In fact any program of public incentive of significant size that would be effective for reaching the goal of recovering economic growth does not appear feasible unless the conundrum of how to cover it financially is resolved.

In particular, I noted above that the high level of the fiscal and quasi-fiscal levy on incomes from employment offers very ample margins for relaunching the competitiveness of the TI countries by taking measures to reduce it. But the preponderant

²⁴ Recalling the constraints on the deficit ratio imposed within the EU by the Stability Pact, and recently reaffirmed and strengthened to defend the value of the Euro.

weight of these levy items as part of the total revenue of the public administrations highlights the difficulty of substituting a significant proportion of these revenues with increases in revenues from other taxes, and/or with corresponding reductions of certain items of public expenditure (and so far as social security expenditure is concerned, the relationship between social contributions and expenditure spending is institutionalized).

Table 5 – Income of the public administration under existing legislation. Final 2008 and forecasts 2009-2013

GENERAL GOVERNMENT ACCOUNT AT UNCHANGED LEGISLATION PRIOR TO DECREE LAW No, 78/2009 (in € mn)						
	2008	2009	2010	2011	2012	2013
BALANCES						
Primary balance	37,912	-5,590	2,589	17,927	28,801	37,805
(% of GDP)	2.4	-0.4	0.2	1.1	1.7	2.2
Current account balance	12,487	-20,061	-22,884	-20,749	-18,409	-15,059
(% of GDP)	0.8	-1.3	-1.5	-1.3	-1.1	-0.9
Net borrowing	-42,979	-81,313	-76,959	-70,853	-69,086	-66,187
(% of GDP)	-2.7	-5.3	-5.0	-4.4	-4.1	-3.8
Nominal GDP	1,572,243	1,521,262	1,549,570	1,606,113	1,666,930	1,731,275

Source: Program and forecast report for 2010 - Chapter 4. Balances of public finance for 2009 and 2010– Table no. 8 – p. 15.

The European Commission²⁵ recognizes that “shifting the levy from employment taxation to taxes on consumption could have positive effects on employment and development.” And yet it also affirms that these effects “tend to be modest in size”; warns that they may create inflationary pressures; and finally that in the current macroeconomic situation it would not be advisable to impoverish the purchasing power of low-income families, and that therefore any increase of taxation on consumption should be accompanied by compensatory measures in favor of low incomes. The

²⁵ EUROPEAN COMMISSION (2009), p. 47, and see also EUROPEAN COMMISSION (2008).

Commission goes on to express a (cautious) preference for greater reliance on environmental taxation, to which less importance has been given in the EU in recent years, and on property taxes, which are also mentioned as an instrument for introducing taxation based on its benefits at the local level²⁶.

Currently, economic experts and the governmental authorities responsible for the economies of the various countries are in discussion about the difficulties of identifying financial cover for reductions to the various types of levy (taxes on consumption, business income, and company documentation) and for increasing expenditure on incentives (grants and "tax expenditures" for investment, research costs, and similar).

One argument that is put forward with great force by some countries but not others²⁷ concerns the possibility of recovering sufficient revenue from fiscal and quasi-fiscal evasion and avoidance, and using it to finance the types of incentivisation programs mentioned above. Certainly, since violating or exploiting loopholes in laws that ought to be respected by everyone perpetrates avoidance and evasion, it is the duty of individual countries to combat them. As the European Commission also underlines²⁸, combating avoidance and evasion is beginning to produce appreciable outcomes because (a) the state of their public finances has made it necessary for them to make greater efforts in this regard (b) information technology is offering new instruments to finance ministries, and (c) the growing cooperation between Member States to improve the effectiveness of investigations, and with states outside the EU, is beginning to produce its first results. The prospect of increasing the efficiency of tax investigations, thereby finding new fiscal and quasi-fiscal resources that can be

²⁶ In Italy, as compared to the past and in the prospect that federalism is likely to be implemented, it would make sense to pay more attention to tax contributions that are commensurate with the principle of benefit and those that are commensurate with the principle of scope.

²⁷ In Italy, controversies about the high levels of tax evasion and avoidance have become an historical fact. In a brilliant article in "Il Corriere della Sera" the economist Alberto Quadro Curzio recently reiterated that as well as generating efficiency savings in public spending, the new Italian option of fiscal federalism, if used properly, could also mean that submerged revenue and income would be brought to the surface in sufficient quantity to produce very large new revenue streams for the public purse, thus making it possible to cover incentivisation programs for economic recovery.

²⁸ As evidenced by Quadro Curzio (2009).

used to finance incentive programs, introduces a potentially optimistic note to the future possibilities for public incentive of the competitiveness of firms in the TI countries.

However for some countries and some particular manufacturing sectors, and for many SMEs, we should warn that the emergence of this “submerged fiscal activity” will have to be accompanied by simultaneous rate reductions and a start to the incentive programs. Many entrepreneurs (above all SMEs) even warn that this “submerged economy” must be maintained not only because levels of taxation are excessive but more generally because of the pressure of competition due to the lower costs sustained by firms in the emerging countries. This is to say that in a situation of global competition the danger must be avoided that a rapid emergence of tax revenues from the hidden economy, if not accompanied by lower rates of taxation and other incentives, could price firms in the TI countries out of the market, inducing them to cut back their activity, shut it down, and/or outsource it to countries where manufacturing costs are lower and where in general, taxes and levies are also less onerous (and where there are fewer regulatory constraints on manufacturing and on care for the environment).

Even with those qualifications, the prospect of covering the costs of future incentive programs by clawing back avoided or evaded taxes is not an insignificant one.

There is a further argument in favor of programs for reducing the fiscal and quasi-fiscal cost of labor, which I suggest has not been brought to the debate with sufficient insistence. In entrepreneurial decisions about the organization of manufacturing, the high labor costs caused by taxation and the quasi-fiscal wedge are also a disincentive to occupation. As economic theory already highlighted many years ago²⁹, in the economic accounts of governments, the lower revenue resulting from reducing the fiscal and quasi-fiscal levy on labor, to increase employment, is at least partly offset by costs that are lower than those that the public administration, for obvious socio-political reasons, would have to bear to support the unemployed (various

²⁹ For all of these, see STEVE (1976).

forms of unemployment subsidy, implicit or explicit subsidies to firms to encourage them to retain jobs, free social services for the poor, and pressure on public offices to hire unnecessary staff who would otherwise be unemployed). So in accounting properly for social costs the greater "tax expenditures" to reduce labor costs must be compared with the consequent lower need for public expenditure in favor of the unemployed and for providing assistance to the poorest segments of the population.

Furthermore, the current economic crisis has given new voice to those who warn that the "new orthodoxies" concerning the relationships between public debt and GDP³⁰ must be interpreted according to economic logic and not merely in accounting terms. It is well known that the performance of the relationship between public debt and GDP depends not only on the performance of the numerator but also that of the denominator. The economic recession tends structurally to increase this relationship. So in economic terms the proposal of using budget policies to incentive and stimulate investment so that this relationship is allowed to further increase in periods of crisis would appear to be correct so long as later on, additional public intervention generates recovery of investment and growth of GDP. It can be argued that - *mutatis mutandis* and thinking essentially in terms of a closed economy - Keynes in his time was lucidly opposed to the orthodoxy of balancing the public budget, and (despite the limitations of his model) showed that investments would themselves generate the savings necessary to finance them.

Taking up the Keynesian lesson again and adapting it to the new constraints imposed by competitiveness in a global economy, it would appear that adhering too formally to the rules of the new orthodoxy of public finances, and in conceptual terms too statically, could prove to be highly negative for the economic prospects of the TI countries.

So whilst not underestimating the difficulties discussed above, margins do exist for a fiscal strategy that improves the competitiveness of products manufactured in the TI countries. In any case there do not seem to me to be any viable alternatives for in-

³⁰ As in the EU Stability Pact.

tervention if the goal is to stimulate the recovery of rates of growth in the TI countries in such a way as to (at least) maintain the current average living standards of their citizens.

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QUALITY DISCLOSURE

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Abstract

Information plays a prominent role in socio-economic systems and it can have a strategic value in relation to the decision-making process of economic agents. Due to asymmetric information, the true quality could be hidden in the market. Prices usually do not convey full information; thus, other forms of information dissemination are needed. The quality of information strongly depends on the credibility of its contents and on the reliability of the source. These problems could be mitigated by quality disclosure practices, which can be defined as the effort of an organization to systematically measure and report quality, provided that the disclosed information can be independently verified by third-party certifiers. Quality disclosure can be voluntary or mandatory and it takes many forms. Certifying firms are usually independent from the individual firms they assess, but a conflict of interest may arise when certifiers are private organizations in a competitive market, where firms pay a fee for certification services.

1. Introduction

Information plays a prominent role in socio-economic systems, but its relevance has not always been fully recognized in economic models. In 1961, George Stigler argued that «one should hardly have to tell academicians that information is a valuable resource: knowledge is power. And yet it occupies a slum dwelling in the town of economics». Although well-known, the implications of imperfect information have been ignored and have not been incorporated in economic models for a long time.

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Most of traditional settings are based on the assumption of perfect information, which means that economic operators have all information to observe the true quality and make the optimal choice. If they are also rational, they will choose the best products, and markets will reward those who make the best products with higher sales. The competitive general equilibrium model (Arrow and Debreu, 1954) is built on this setting.

A first attempt to remove the assumption of perfect information was carried out by Stigler (1961) and the Chicago School. The limit of their approach was to consider the problem only in terms of transaction costs, while holding substantially valid the results of classical theory.

The innovative work of George Akerlof (1970) brought to the attention the implications of asymmetric information in terms of **market efficiency**. He showed that imperfect information might lead to incomplete markets or, at worst, to their collapse. When quality is lacking, some participants in market are unable to make the best choice, i.e. to select the options, which best match their preferences and meet their needs. The link between quality and price breaks: they can no longer be considered the two sides of a coin. Price does not convey all information required by market. Actions and expectations become crucial.

The original results of Akerlof's research have greatly influenced the economic theory of the last 40 years and they contributed significantly to the so-called "economics of information", i.e. the strand of the economic literature, which studies how information (and information systems) may affect economic decisions.

The attention is paid not only to the amount, but also to the quality of information, which determines also its value. Quality of information may differ in consideration of some key characteristics, and notably reliability, topicality and significance. Reliability affects the confidence level of an individual in fairness and accuracy of information and it strongly depends on the credibility and reputation of the issuer. Significance deals with the perceived, pragmatic utility of information in satisfying a desire for understanding. It depends on the content of information and on the ability to influence the decision-making process of economic agents. Topicality concerns the

synchronic availability of information in relation to the occurrence of receiver's needs: information should be available when required.

2. Asymmetric information, adverse selection and moral Hazard

Asymmetric information is generally approached through the principal-agent model, where the agent has more information, which could be partially or totally unknown to the principal. This represents a key element, which may cause two important effects: the **adverse selection** and the **moral hazard**, which can undermine market efficiency. They usually arise when agents and principals' incentives are not aligned. In particular, adverse selection can be defined as the situation in which one party in a transaction (the agent) knows some crucial elements, which the other party (the principal) ignores. These elements exist prior to the transaction and are beyond the control of the agent.

Moral hazard is a situation in which, after the conclusion of the contract, the party with more information behaves inappropriately from the perspective of the party with less information (the principal) who is not able to prevent or control the detrimental intentions and actions of the agent.

As a consequence of adverse selection and moral hazard, the average quality level in the market may fall and/or the prices increase, so that the perfect combination of quality and price breaks. Price does not convey full information and less informed individuals - who are supposed to be rational and are aware of their limited information and of the negative consequences from agents' opportunistic behaviour - may decide to exit the market.

The information problem that markets have to solve is twofold: on one hand, they need to increase the amount of available, significant information; on the other hand, they need to reach equally distributed information.

3. Information process

But, what is information and how can we define it? The origin of the word comes from the Latin *informare*, which means to shape/model something. Therefore, information can be assumed as the representation of facts based on an abstract code, which can be understood by one or more receivers to which it is addressed. The representation shapes an idea, a concept or a notion, which are intended to manifest themselves, through the information, as hallmarks of the facts which characterize the observed object.

The basic communications model, suggested in 1949 by Shannon and Weaver, is represented by the following sequence: source → message → channel → receiver (SMCR).

The information flow starts from the source, who encodes the message and transmits it to the receiver through a channel. The message is the “logical box” or the package of meaning intended from the source. In other words, it represents what the source wants the receiver to hear and understand in a particular way. The channel identifies the means through which the message is transmitted. The receiver is the person who is at the other end of the communication and to whom the information is addressed.

The message needs to be encoded by the source and decoded by the receivers, who deduce their own meaning. The same information can be derived from multiple sources (producers, regulatory and supervisory authorities, associations, consumer and business groups, retailers, experts and individuals). It generally gets transmitted to more receivers through personal or impersonal channels.

With regard to the first type, the information flow is direct from the source to the receiver: it can be conveyed through the product² or the attached/connected elements

² We define product as the good or service produced by a public or private (or private-public) organization. It is the bundle of attributes and services that are exchanged with the good/service itself, e.g. the warranty or the post-selling assistance.

(e.g. price, brand, warranty, guarantee, balance sheet, institutional communications).

In impersonal channels, communications are mediated by the interposition of other players (the intermediaries). They promote the dissemination and distribution of information, so that it can reach parties not directly connected to the source (e.g. television, newspaper, web, word of mouth). It must be stressed that the intermediaries could modify, filter and change the content (and thus the meaning) of the message. It must also be taken into account that the content of the information may be (and usually is) subject to regulatory constraints.

Information impacts on consumer perception, by influencing the decision-making criteria and modifying consumers' values and habits, and thus their willingness to pay. The information process is generally unidirectional, from the source to the receiver³, but quality and marketing models clearly indicate the usefulness and the need to implement tools to listen to the market response: the information flow becomes thus bidirectional. Organizations take into account customers' needs and expectations in designing business processes and products. In addition, regulators may be influenced by market feedback in designing rules and standards too.

4. Definition and forms of quality disclosure

A special case of information transmission is represented by quality disclosure. It can be defined as the effort by an organization to systematically measure and report quality for a nontrivial percentage of products in a market (Dranove and Jin, 2010). Generally, this activity is carried out by third-party quality certification agencies, but we can also include direct quality disclosure by sellers in the definition above, provided that the disclosed information can be independently verified. This is a key point that allows to distinguish quality disclosure from broader marketing efforts by

³ Some authors make a difference between information and communication on the basis of information flows direction. In the information process, the flow is unidirectional (from the source to the receiver), while in communication process it is bidirectional, as it also includes feedback from receivers.

sellers or other organizations to disseminate information which cannot be assessed by a third-party certifier.

In this regard, quality ratings based on consumer feedback (see, for example, TripAdvisor) cannot be considered a mechanism of quality disclosure, essentially because ratings may be noisy or biased and consumer feedback is unverifiable. Different consumers may use different criteria to measure quality and these criteria are often implicit and unstable. In addition, those who report quality may not represent all consumers (some of them may be reluctant to leave feedback).

From disclosers' point of view, quality disclosure performs two crucial functions: (i) informing and (ii) influencing individuals to whom the information is addressed. The term "informing" underlies the effort of the issuer in transferring information about a specific fact so that receiver has access to it. The term "influencing" means the willingness to change values and behaviors of receivers.

Quality disclosure modifies the information environment of market players. Its role is especially significant when information is related to "credence" attributes, i.e. the quality attributes which the buyer cannot evaluate even after purchase and use⁴. Disclosure may be crucial in transforming attributes from "credence" to "search"⁵, and in reducing information costs when attributes are of "search" type (Caswell and Anders, 2011). But, it must be stressed that not all the tools of quality disclosure are suitable for transforming the attributes in the sense indicated above, at least not with equal effectiveness. Some information can only be verified by having access to production methods or organizational models (Albersmeier *et al.*, 2009): in these cases, the use of third-party certification appears inevitable, provided that it is allowed to observe and assess the internal processes .

Quality disclosure can take many forms, which present some common characteristics (Dranove and Jin, 2010): «First, disclosure systematically measures and dis-

⁴ Recalling Lancaster's approach to demand characterization and the classification of goods by Nelson (1970) and Darbi and Karni (1973), a difference could be made between search, experience and credence attributes: search attributes are those where quality can be evaluated prior to purchase, while experience attributes are those where the buyer can evaluate quality after purchase and use.

⁵ Search attributes are ones that can be verified prior to purchase, through direct inspection or readily available sources. Experience attributes are ones that can be verified only after using the product.

seminates information about product quality, which makes it attractive when other mechanisms for quality assurance are inadequate and the value of quality information when aggregated across all consumers is large relative to the costs of information collection. Second, disclosure is usually conducted via third-party certifier(s) that identify themselves separately from manufacturers. This may give consumers an impression that the disclosed information is trustworthier than seller advertising. Third, disclosure standardizes quality assessment so that results are readily comparable across sellers. Instead of granting the power of licensing to government officials, disclosure empowers consumer with information with the expectation that consumer choice will provide sufficient incentives to assure quality».

Some authors point out the conceptual differences between quality disclosure (through a credible direct claim) and quality signaling/assurance (via producer actions that influence buyers' beliefs about quality) on the basis of the marginal costs of quality information: disclosure usually does not imply significant production and issuance costs; when they exist, they are independent of quality. On the contrary, quality signaling and assurance generally assume that products of different quality are not equally expensive and that the cost of the signal is higher for low-quality producers than for the high-quality ones. But, non-disclosure firms must not be necessarily seen as low-quality firms.

In the context of this analysis, we are assuming that signaling is one of the available forms of quality disclosure. This may be mandatory or voluntary. The first case occurs when a regulator authority requires market players to provide certain information about one or several specific product attributes, in a standard format, usually verified by a designated agency (a public inspection body or a private third-party organization to which public authority is given).

As regards to public services, an example of mandatory quality disclosure is given by the "quality service charters", which represent written statements of the commitment of an organization to provide its customers with a quality public service. Quality charters inform the public about the services that are available and how they can be accessed, and set the quality standards that customers can expect to find in those

services. Reference may also be made to the reports of a government agency (the Anvur in Italy), which sets quality standards for universities and research bodies, assesses their performances and provides indication for the allocation of public funds. With regards to food products, an example of mandatory disclosure is given by the nutritional information which producers must report on the product label.

Voluntary disclosure means that market players arbitrarily reveal information on the quality of their supply. Also in this case, the intervention of a third-party may be required, notably when disclosure is related to the compliance with private or public standards. Examples are given by the EU Protected Designation of Origin (PDO) and the Protected Geographical Indication (PGI) for agricultural products and foodstuffs; the EU EMAS quality and environment regulations for the improvement of environmental performances of organizations; the ISO process and product certification schemes. In financial markets, reference can be made to the rating report released by a credit rating agency to attest the financial sustainability and the creditworthiness of an organization.

Sellers usually decide to disclose in order to distinguish themselves from low-quality producers, assuming that consumers will infer non-disclosure as having lower quality. But, they have interest in disclosing only the information about one or some attributes, and in particular that information which may strongly influence demand. Consumers, for their part, might not be interested in all the information, especially if they bear a cost or a disadvantage from collecting, processing and storing it, but they would know some specific attributes.

Thus, it may happen that some information is hidden from the market, even though it is needed. In this case, regulatory authority could intervene to compel sellers to disclose information about selected quality dimensions, e.g. safety, health, financial sustainability...

However, finding an economic rationale to mandatory disclosure is not so easy. A wide strand of literature has extensively explored this issue, but the arguments do not converge. Information efficiency and a higher social utility are the most common theoretical justifications to mandatory disclosure. However, regulatory authorities of-

ten make use of it as an alternative type of regulation⁶, in order to ensure that public policy objectives are more effectively reached. Caswell (2006) identifies four government approaches in market information⁷:

(i) "need to know": governments may judge that the public needs to know some information (e.g. safety requirements, credit rating ...) in the decision-making process.

In this case, information disclosure is usually mandatory;

(ii) "right to know": government may judge that the public has a right to know other information. In this case, quality disclosure is usually mandatory, by defining the minimum level of information that must be provided;

(iii) "want to know": governments may judge that the public wants to know other information. In this case, regulatory authorities may actively oversee the provision of this information when they believe that doing so will increase market efficiency. Generally, this implies the definition of standards or of minimum requirements, as the basis for voluntary disclosure;

(iv) "fraud protection": governments are responsible for protecting consumers against market deception and fraud in firms' disclosure. They may decide to monitor voluntary disclosure or enforce mandatory disclosure.

5. The role of third-party certifiers

When a third-party certifier is involved, not only should the incentives for firms to voluntarily disclose quality information be taken into account, but also those for certifiers to provide an unbiased and accurate assessment.

Recent events have put a spotlight on the potential conflict of interest in certifiers. In particular, reference may be made to the controversial role of impartial arbiter played

⁶ There are different approaches on the definition of regulation. A large part of literature tends to embrace a broad concept of regulation, which includes laws, formal and informal rules issued at different levels of government, private standards issued by non-governmental bodies to whom governments have given regulatory and supervisory powers.

⁷ The paper refers to quality information disclosure in food markets, but the fundamental intuitions may be generalized.

by credit rating agencies in releasing bond ratings⁸. As known, the global financial crises of 2007-2009 (**Subprime crisis**) was fuelled by subprime mortgage lending, encouraged by the **securitization** of the subprime mortgage loans, and crucial for the securitization were the favorable ratings that were bestowed on these **mortgage**-related securities by the main credit rating agencies. The debacle has been discussed extensively in several works, and notably in Acharya and Richardson (2009) and Brunnermeier (2009). In general, a conflict of interest may arise when the assessed organization selects the certification agency and pays a fee for its services. This may motivate the certifier to give excessively generous ratings in order to secure future business with customers.

Some authors stressed the role of market competition in enhancing quality ratings; others come to the conclusion that competition may even worsen the problem, because the presence of multiple certifiers encourages firms to exercise a fee pressure on certifiers.

Also, reputation may have a controversial role in solving conflicts of interest. When certifiers are numerous and certification fees tend to be the same for all of them, firms could be attracted by other attributes, such as credibility and reputation, in selecting their auditors. Reputation requires a long time to be built, but a single negative event could be sufficient to considerably damage the positive image perceived by customers. If the expected reputation costs are lower, moral hazard from certifiers prevails. It also should be underlined that, even if customers can evaluate disclosed information, they could never realize honesty and accuracy of certifiers. In addition, it should be considered that it may take a long time to distinguish errors in assessment from the intentional (strategic) manipulation, which leads to an equilibrium where certifiers take advantage of their reputation and adopt undesirable behaviors towards firms.

Sometimes reputation concerns may even drive certifiers to report biased information (Dranove and Jin, 2010). This is the case of some prudential negative ratings

⁸ See Masera (2012).

assigned to Italian public debt in the last two years by the main international credit agencies.

The business strategy of unraveling quality is usually driven by the availability of credible and low-cost mechanisms of disclosure in markets. Economic theory shows that firms are more likely to disclose if disclosure cost is lower, product quality is higher, or the expected benefits from disclosure are conditioned by quality and disclosure cost. But experience suggests that unraveling may fail to occur even at zero-cost.

6. Concluding remarks

To sum up, quality disclosure is an important tool for facilitating decision-making processes when other forms of quality signaling (for example price) are not adequate. Two fundamental conditions are required for its proper functioning: (i) the quality of information transmitted and (ii) the credibility of the source. Third-party certification may support the process, but it may face relevant complications with reference to information selection and measurement errors, consumer misunderstanding and inspector bias. There is no evidence that quality disclosure increases the quality of supply in markets, but – when the incentives are correctly addressed – it may mitigate the deleterious effects of asymmetric information.

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SOCIALIST MARKET ECONOMY

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Abstract

The term socialist market economy indicates the Chinese economic structure, characterized by a mixed system presenting the typical features both of market and planning economies. In this type of system, the political authoritarianism, due to the 1949 socialist regime, matches with a market economy developed by the reform process of the eighties. The similarity can be especially identified in the gradualism with which China has started restructuring a Marxist economic kind of system according to the market rules. This gradualism has undoubtedly been an essential factor in order to achieve any kind of success as a consequence of these reforms, but it has also caused some instability factors. For instance, it has created a system in which private and public companies, market prices and planning prices, protection of private property and communist ideology, competition and state intervention, simultaneously coexist.

The term "socialist market economy" was used for the first time in 1992, during the XIV Congress of the Chinese Communist Party to outline the new goals of the economic reforms.

This concept was institutionalized by the introduction of constitutional changes and so, the socialist market economy became the official term to define the current Chinese economic and social system.

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China's economy can be considered as a closed and planned one, inspired by the Soviet model of development²: starting from the Chinese Communist revolution in 1949 until the Maoist era³ and up to 1978.

The birth of the socialist market economy, which dated back since the modernization processes in 1978, represented a breakthrough for the Maoist period, in the changing international background of the seventies and of the eighties which testified the failure of Soviet Communists regimes. The integration of developing countries into the world economy, forced the CCP to start seeking for a national path which would have led to socialism.

Since the eighties, although the firm intention to maintain a socialist economic system, it was launched a program of structural reforms that generated a gradual abandonment of the Marxist planned system. In the following twenty years, China would have undertaken radical changes in the economic system.

The structural reforms, started in 1978, did not directly lead to a capitalist and market economy, but eventually to a mixed system that kept being characterized by an autonomy from the market that continuously collided with the omnipresence of the bureaucracy of the Party, in all of the territorial aspects.

This also led to a "double face" of the Country: the first one was characterized by a Party-State with the role of manager and controller of the economic life; while the second one was represented by the social economic changes that occurred over time, and which could be considered as an expression of a more and more dynamic society as a direct consequence of these reforms.

The Chinese socialist market economy overcame the dichotomous schema of mere juxtaposition (aut ...aut) between socialism and capitalism by reaching an approach which could be compatible with both. In the institutional framework of a communist regime, this kind of compatibility took place, at the very beginning, only in certain ar-

² Model based on central planning and allocation of administrative resources.

³ Mao Tse-tung's CCP leadership (1943-1976).

eas, like trade and services, but afterwards, in an ever more widespread way, in the development focused on prices, markets, businesses and profits. These are the basic elements for the existence of a market economy. The promulgation of the "Law on industrial property of the people" in 1988, can be considered as a case in point. In fact, it adjusted the model of **corporate governance** of Chinese enterprises to the standards of the Western market economy by binding them to the achievement of the capitalist profit "but also" to the satisfaction of the socialist planning duties.

Elements of different ideological nature merged in the term socialist market economy, prima facie contradictory, by forcing the hammer and sickle symbol to walk hand in hand with the surplus value, profit and financial returns.

Another aspect of the compatibility between the market logic and the Marxist ideology concerns the distribution of wealth. In fact, this concept has occupied a key role in the economic theory since the nineteenth century. In literature, a closed and planned economy, tends to have a more egalitarian distribution of wealth; on the contrary, in an open and liberal economy the effects of the market distort such distribution.

The Chinese case is emblematic. As a nation that declares itself as a Communist one, it has the highest income inequality of the world. As a matter of fact, in 2010, the Gini index amounted to 0.61 upwards of the world average level of 0.44.

These elements, along with the institutionalization of private property protection in a socialist system, the presence of both public and private companies together with the price system "dual track"- that managed to merge capitalist matrix elements (**market prices**) with others of socialist nature (planned prices) - represent some of the peculiarities of the socialist market economy.

This kind of economic policy strategies, in the Chinese developmental model, exhibits many similarities but also many aspects that deviate from the traditional econom-

ic and political strategies of the liberal States as well as from those characterized by a "Developmental" State.

The aspects that distinguish the socialist market economy can be found in pragmatism, gradualism, in the authority of the state intervention in the economy and in the market needs, which take priority over the creation of a democratic system. Besides, for this reason, it is not possible to regard China just as a Country in transition, because considering all of the former socialist economies, China's economic modernization is not characterized by any kind of institutional modernization⁴, in contrast with the Western model, which requires a free market system combined with a liberal democratic one.

The Chinese institutions repeat some of the successful factors typical of a system in an open economy, such as the adaptation of the system of market prices, the acquisition of corporate governance models of enterprises, exports and receiving of foreign investments. However, these institutions also adapt and safeguard the socialist ideology in favor of the legitimacy of the CCP, finding a meeting point between economic growth and political stability.

The new Chinese ruling class understands that just a part of the western modernity can be considered useful, since it guarantees to the authoritarian regime the possibility to gain legitimacy and consensus to be effectively used in the markets to create wealth.

The State is in China the main "helmsman" that leads the country straight towards the economic modernization, in a historical period in which it is losing its role as the main actor in the international system. The integration into the world economy has been carried out thanks to the initiative of the Chinese party-state and under its control, mainly by denying the neoclassical paradigm which states that it is hard to assert that deviations from the perfect market model may be beneficial in the long run, for any economic system.

⁴ The institutional framework is defined by the Chinese constitution "people's democratic dictatorship"

The current China's political-economic structure is a mixed system in which, in addition to the growing position reserved for the market and the role played by the authorities at the national level, keeps being present and relevant, especially locally speaking.

Major economic reforms of the new developmental model

The choices of economic policy adopted in China since 1978, have contributed to change the Maoist socialist model introducing a gradual restructuring of the traditional planned economic system about the market rules.

This gradual process invests mainly the sector of state-owned enterprises, the agricultural sector, banking, foreign markets and devolution.

In the public enterprises sector, the compatibility of private initiative with socialist ideals has been recognized at a constitutional level, paving the way to a system of non-state firms devoted to profit maximization and no longer characterized by a soft budget constraint,⁵ exonerating administrators from any kind of responsibility. The general policy in this field has gradually reduced the weight of public enterprises, by allowing the private or collective companies to quickly increase their market share.

In the agricultural sector, communes⁶ have been gradually abolished since 1978, proceeding to the redistribution of lands, which up to that moment, were totally owned by the State and finally creating a family responsibility system. These agricultural reforms represented a great incentive for peasantry, who could finally benefit from land concession as well as from the possibility to privately sell part of the agricultural production directly on the market. The liberalization of rural markets has led

⁵ Kornai (1979) defines soft budget constraint the typical situation of socialist economies, in which the State participates to cover the excess of expenses over the incomes of public enterprises.

⁶ Basic structures of Chinese society established in the Country in 1958 because of the initiative of Mao Tse-tung. They were mostly based on the collective ownership of lands, where they used to carry out mainly agricultural activities.

to a partial abandonment of the old prices system, which had to coexist with different system of market prices, the so-called "dual track" system.

In 1983, the "dual track" also became a two-tier banking system. China separated the Central Bank (People's Bank of China) from the second-tier banks. The Central Bank has been entrusted exclusively with macroeconomics tasks, while the second-tier banks are: the Agricultural Bank, the Industrial and Commercial Bank, the Bank of China and Construction Bank. These are the four main public banks that are allowed to compete in different sectors since 1986. As a result of these reforms, the banking system has become the primary channel to achieve funding for investment, since the modernization process significantly reduces the ability of the state budget to mobilize and allocate resources.

However, in the foreign markets sector, the opening takes place under the pressure of international exports and through the establishment of Special Economic Zones⁷ for the import of capitalist models and foreign direct investments. The exports have become one of the main causes of China's growth, spreading the competitiveness of exported products from intensive work sectors, to the ones with an higher degree of specialization, such as electronics. The Chinese economy shifted from being mostly a "factory of the world"⁸ towards occupying the brand-new role of exporter of High Tech.

Furthermore, in the eighties, it took place a transition from an highly centralized economy, to a more decentralized one, in which the local politicians of the main cities of each province, as well as private and foreign operators, had a considerable action-taking faculty. The businesses and local administrative authorities established the profits to be realized, and also the state contributions. Not only did not this administrative decentralization limit the strong public power on the economic process-

⁷ Special Economic Zones were created in order to attract foreign investments and located in the eastern part of the country.

⁸ China is often defined as the "factory of the world" especially in regard to some sectors, such as toys or textiles and clothing; the local manufacturing ability merge with the foreign technology, creating products at more favorable prices than in the Western markets.

es based on the programming of the central state, but also on those based on the control of local political authorities, such as provinces, cities and villages. At the end of the eighties, the majority of the public enterprises were under the direct control of local authorities. In China, therefore, everything is now formalized with a dual government system of the Country at peripheral, central, local and national level. Therefore, there is not a real separation between the State and the Party.

Private ownership and socialist economy. Legal adjustment to market needs

The characteristics of the new Chinese model of development emphasize the importance of private economic initiative carried out through the institution of private ownership which is generally considered the fundamental basis of two contrasting market representations: capitalism and socialism. The first emphasizes the sacredness of private ownership in opposition to the public good, while the second aims to its total abolition.

The institution of property right is the cornerstone of the main changes in the Chinese economic system as it represents the link between a planned economy and the choice of a socialist market one.

In 1982, thirty years after the Communist revolution of 1949, the Constitution incorporated into its system, the fundamental principles regarding the economy and the property system. The Articles 10, 11, 13 and 15 of the constitution were gradually modified, introducing, for the first time ever, the strengthening of each kind of promotion and protection of private enterprise, the right transfer to exploit the lands. The State was also entrusted with the task of carrying out a system based on the socialist market economy.

The existence of private enterprises and their development were finally recognized to be accessory to the socialist public economy. Property rights were also protected.

The presupposition of this constitutional adjustment process lies in China's interest to facilitate, even through legal instruments, the transition from a centrally planned economy to a socialist market one. With Articles 11, 12, 13 and 15 of the Chinese Constitution, it was introduced for the very first time, the concept of private property, which used to be considered as a dangerous institution for the consolidation of the socialist ideology, becoming the most obvious example of a "mixed" system defined, by the Chinese constitution, as a socialist market economy.

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