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Monti cabinet agrees Italy austerity plans

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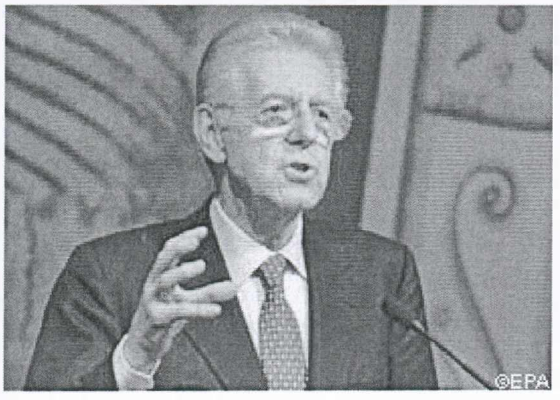

Italy's new technocratic government has approved tough austerity measures and economic reforms, kick-starting a pivotal week in Europe's campaign to shore up the single currency.

Mario Monti, prime minister, on Sunday night underlined the gravity of the crisis facing his country, but promised that the "multitude of sacrifices" he was implementing in his "Save Italy" decree would also be used to promote economic growth by reducing the cost of labour.

Italy's move, brought forward by a day, marks the first element of a sequence of choreographed steps Europe's leaders hope will build into a convincing resolution to the sovereign debt crisis at their summit on Friday.

What many are calling the week to save the euro continues on Monday when Nicolas Sarkozy, president of France, and Germany's chancellor Angela Merkel are to meet in Paris to try to narrow their differences over new rules to ensure budgetary discipline of the 17 eurozone members.

Tim Geithner, US Treasury secretary, will travel to Europe again to cajole leaders into striking a confidence-boosting deal to stabilise the eurozone's financial system.

Rome's planned tax increases, pension changes and spending cuts amount to a savings of €30bn over the next three years, of which about €10bn will be put back into the economy through measures to promote growth, including cuts in the cost of labour and incentives to get more women and young people into the workforce.

If extra measures are needed to ensure Italy remains on course to balance its budget by 2013 then the government proposes to increase value added tax in the second half of 2012.

The government's first macroeconomic forecasts project a fall in Italy's GDP in 2012 of 0.4 to 0.5 per cent and zero growth in 2013.

Initial market reaction was positive with the yield, which moves in the opposite direction to the price, on the 10-year government bond moving down 25 basis points, following a big drop last week, as investors welcomed signs that Rome is beginning to tackle its high levels of debt. The sovereign Italian CDS, which is a form of insurance against the country defaulting on its debt obligations, fell 14 basis points to 440 bps.

Italy's trade union leaders who were briefed on the plans in advance protested against the package, but Confindustria, the main business lobby, said they were vital "for the salvation of Italy and the euro".

Europe's efforts this week will culminate in a summit in Brussels of heads of government where agreement over long-term changes to the EU is seen as a prerequisite for the European Central Bank to intervene more forcefully on financial markets.

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Yet in spite of repeated discussions, Germany and France remain divided, according to diplomats. Germany is demanding changes to the European treaties that would concentrate unprecedented power in Brussels to scrutinise national budgets and sanction profligate governments. France wants to limit any treaty changes to the eurozone members, and retain more budget authority in national capitals.

As such, no announcements are expected to emerge from Monday's meeting, according to officials in Paris and Berlin. "Everyone's waiting for France and Germany, but they're a very long way from settling their differences on economic governance," said one EU official in Brussels.

Mr Monti, appointed last month, said his reforms were aimed at boosting competition, attacking "privileges and clientele-ism" and opening the labour market to more women and young workers. He said he would renounce his salary.

Stressing his commitment to fight tax evasion, Mr Monti said he would impose a retroactive tax of 1.5 per cent on capital that benefited from a tax amnesty under the previous government.

An emotional Elsa Fornero, minister for welfare, started crying as she outlined pension changes, including an increased retirement age. "We know we are asking for sacrifices, but we hope they will be understood in the name of growth and to avoid collective impoverishment," she said.