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**Assessment of the 2014 national reform programme and stability programme for
ITALY**

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

**on Italy's 2014 national reform programme and delivering a Council opinion on Italy's
2014 stability programme**

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EXECUTIVE SUMMARY

The crisis has exposed and intensified the weaknesses of the Italian economy. Between 2007 and 2013, Italy's real GDP contracted by 8.7 %, compared to just 1.7 % for the euro area as a whole. Employment did not fall as much as in some other euro-area Member States but there was a sharp reduction in working hours and the unemployment rate doubled from 6.1 % to 12.2 % over that period. According to the Commission 2014 spring forecast, economic growth is expected to turn positive with a modest 0.6 % in 2014 and accelerate to 1.2 % in 2015. The labour market is set to adjust with a lag to the improving economic conditions, starting with a rise in working hours. As the labour supply slightly increases, the unemployment rate is expected to reach its peak this year at 12.8 % to then marginally decline in 2015. The general government debt-to-GDP ratio, after increasing by over 26 percentage points between 2008 and 2013 - also due to the financial assistance to euro-area countries (3.6 % of GDP) - is expected to peak at above 135 % in 2014.

Italy has made limited progress in addressing the 2013 country-specific recommendations. With regard to public finances, the stability programme postpones the achievement of the medium-term objective to 2016, whereas, in July 2013, Italy was recommended to achieve it by 2014. Substantial progress was made in improving the functioning of the gas market. Some steps were taken to reduce the tax burden on labour and implement labour market reforms, ease firms' access to credit, and address the weaknesses of civil justice. Limited progress was made in the other areas. The 2014 national reform programme presents a comprehensive, ambitious and time-bound plan for action over the programme horizon. Implementation of all measures, also those adopted in previous years, needs to be carefully monitored.

Restoring robust growth and reducing the high level of government debt-to-GDP ratio remain the key objectives for Italy. The in-depth review of the Italian economy published in March 2014 highlighted that Italy's low productivity growth over the last fifteen years has contributed significantly to the emergence of the two identified macroeconomic imbalances: the high level of public indebtedness and the loss of external competitiveness. Weak institutional capacity weighs on competitiveness and growth and is causing delays in the implementation of necessary reforms. Against this backdrop, the challenges for the country have remained broadly unchanged since 2013 while becoming more pressing on the back of the past implementation record.

- **Public finances:** The high government debt-to-GDP ratio remains a major burden and a source of financial vulnerability for the Italian economy. While low growth makes it more difficult to put the public finances on a sustainable path, the high public debt may hamper growth prospects, dampen domestic demand and crowd out productive public spending.
- **Taxation:** The tax burden in Italy weighs heavily on production factors, leaving considerable scope for improving the efficiency of the tax system by shifting the tax burden away from labour and capital. Low tax compliance, associated with a strong presence of underground economy and undeclared work, further exacerbate the distortive impacts of taxation on the economy.

- **Financial sector:** Non-performing loans have increased strongly during the protracted crisis, eroding banks' profitability and discouraging banks from extending credit, especially to small and medium-sized enterprises. Capital markets in Italy remain insufficiently developed, rendering it difficult for firms to access alternative forms of financing, in particular for innovation. Furthermore, there are concerns for some segments of the banking sector regarding weaknesses in corporate governance and cost efficiency.
- **Labour market.** The employment rate is well below the EU average and is still far from the national Europe 2020 employment target. Also, labour market participation of women remains low. Unemployment continued to increase on the back of the protracted recession and youth unemployment is among the highest in the EU. Sluggish labour productivity growth sustains unit labour cost growth, thereby weighing on cost competitiveness. The high tax wedge on labour further adds to labour costs.
- **Education.** High drop-out rates and the low level of tertiary education attainment, indicate substantial shortcomings in the education system. Skill gaps in the adult population limit the innovation capacity of the economy. The transition from education to the labour market remains difficult, including for highly-skilled people.
- **Social cohesion.** Since the onset of the crisis, Italy has seen one of the largest increases in the share of people living at risk of poverty and social exclusion in the EU. Due to the strong bias towards pensions, the fragmentation of non-pension expenditure and the lack of effective activation and enabling services, the social protection system is not well equipped at tackling poverty.
- **Services and network industries.** Italy has substantially improved its product market regulation over the past 15 years. Acceleration of its effective implementation would help to ensure the beneficial impact of reforms on the ground. Furthermore, competition restrictions in important sectors of the economy remain (including professional services, postal services, insurance, transport and telecommunication, retail and fuel distribution, and local public services). There are infrastructure bottlenecks in energy, transport and telecommunication.
- **Public administration and business environment.** Weaknesses in public administration continue to contribute to an unfavourable business environment, discourage foreign direct investment, and hamper the swift implementation of reforms and the proper management of EU funds, notably in southern regions. The main shortcomings include a cumbersome legal framework at various government levels, long-standing weaknesses in the civil justice system (notwithstanding recent progress) and inefficiencies in public procurement. High levels of corruption further weigh on the economy.

1. INTRODUCTION

In May 2013, the Commission proposed a set of country-specific recommendations for economic and structural reform policies for Italy. On the basis of these recommendations, the Council of the European Union adopted six country-specific recommendations in the form of a Council Recommendation in July 2013. These country-specific recommendations concerned public finances, the implementation of past reforms and the public administration, the financial sector, the labour market, education, social policies, taxation, and market opening in services and network industries. This staff working document assesses the state of implementation of these recommendations in Italy.

This staff working document assesses policy measures in light of the findings of the Commission's 2014 Annual Growth Survey¹ and the third annual Alert Mechanism Report², which were published in November 2013. The Annual Growth Survey sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2014. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation, restoring normal lending to the economy, promoting growth and competitiveness for today and tomorrow, tackling unemployment and the social consequences of the crisis, and modernising public administration. The Alert Mechanism Report serves as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. The Alert Mechanism Report found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, Italy and 15 other Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014 along with a Commission communication.³

Against the background of the 2013 Council Recommendations, the Annual Growth Survey, the Alert Mechanism Report and the in-depth review, Italy submitted updates of its national reform programme and its stability programme on 22 April 2014. These programmes provide detailed information on progress made since July 2013 and on the plans of the government for the period 2014-2018. The information contained in these programmes provides the basis for the assessment made in this staff working document. The programmes went through a consultation process involving Italian major stakeholders and regional authorities, and were formally endorsed by the national parliament before their submission to the European Commission.

1 COM(2013) 800 final

2 COM(2013) 790 final

3 Aside from the 16 Member States identified in the Alert Mechanism Report, Ireland was also covered by an in-depth review, following the conclusion by the Council that it should be fully integrated into the normal surveillance framework after the successful completion of its financial assistance programme.

2. ECONOMIC SITUATION AND OUTLOOK

Economic situation

After a severe recession, Italy's growth continues to be sluggish. The protracted contraction in output came to a halt in the last quarter of 2013, when GDP increased by 0.1 %. However, according to preliminary estimates, this was followed by a further mild fall in the first quarter of 2014. Over 2013, real GDP has fallen by 1.9 % (after 2.4% in 2012). The strong fall in domestic demand acted as a drag on the economy due to persistently tight financing conditions and high uncertainty holding back consumption and investment. On the back of a stable activity rate, employment fell in 2013, with the unemployment rate on average reaching 12.2 % of the labour force in 2013 (40 % for the youth unemployment rate).

Economic outlook

A slow recovery is expected in 2014 and 2015, mainly driven by external demand. The Commission 2014 spring forecast projects real GDP to grow by 0.6 % in 2014. As external demand strengthens — including demand from euro-area trade partners — industrial activity is expected to increase and the service sector is set to follow suit. Due to persistently difficult labour market conditions, private consumption is expected to rise only gradually, supported by the cut to the labour tax wedge. For 2015, the ongoing consolidation of Italian banks' balance sheets is set to pave the way for more favourable credit conditions, supporting domestic demand and ultimately output growth, expected to accelerate to 1.2 %. As both exports and imports rise, the current-account surplus is forecast to stabilise at 1.5 % of GDP in 2014-2015. Consumer inflation is expected to reach a historical low in 2014 at 0.7 %, also due to decelerating energy prices, before recovering to 1.2 % in 2015.

Headcount employment is forecast to continue falling in 2014 and then increase slightly in 2015. The labour market is set to adjust with a lag to the improving economic conditions, starting with a rise in working hours. Headcount employment is expected to fall further in 2014, although only marginally, implying a modest increase in labour productivity. As the labour supply slightly increases, the unemployment rate is expected to peak this year. The slack in the labour market is expected to restrain wage growth, resulting in a moderate increase in nominal unit labour costs. For 2015, as the economy strengthens, employment is set to expand and unemployment to fall marginally.

Italy's macro projections for 2014-2015 in the stability programme and the national reform programme are broadly in line with the Commission 2014 spring forecast. Italy's stability programme covers the period 2014-2018. The macroeconomic projections are marginally above the Commission 2014 spring forecast for 2014 and 2015. They appear slightly optimistic for the 2016-2018, when real GDP growth is projected to be supported by the impact of the adopted structural reforms. In line with the underlying macroeconomic scenario, the programme projects employment to recover as from next year and the unemployment rate to peak at 12.8 % in 2014 and then to fall progressively. The programme outlook also implies a current account surplus of around 1.5 % of GDP over the programme's horizon. HICP inflation is expected to be at 0.9 % in 2014 and 1.2 % in 2015, before

stabilising at 1.5 % until 2018. The national reform programme and the stability programme share the same macroeconomic outlook.

The stability programme and the national reform programme include an estimation of the impact of structural reforms. The two programmes include an estimation of the impact of selected structural reform on real GDP, private consumption, fixed investment and employment as well as on the general government primary balance and debt ratio. The selected reforms are: (i) the labour market, product market and the business environment reforms adopted in 2012 (after factoring in their delayed implementation relative to the impact estimated in the 2013 national reform and stability programmes) as well as in 2013; (ii) the 10% reduction in the regional tax on economic activities (IRAP) and its financing through the increase in the withholding tax on households' financial income adopted in 2014; and (iii) the announced spending review and the reduction in the tax burden on low-income employees (so far adopted only for 2014). The overall impact of those reforms, assuming their full implementation, on the real GDP level is estimated at 0.3 percentage point by 2014, 0.8 percentage points by 2015 and 2.2 percentage points by 2018. Only the impact of the first set of reforms (see point (i) above) is factored in the macroeconomic scenario of the two programmes (with an impact on the real GDP level of 0.3 percentage points for 2014, 0.6 percentage points for 2015, gradually reaching 1.7 percentage points in 2018). With regard to the additional payment of commercial debt arrears announced for 2014 (EUR 13 billion), only the impact on public debt is factored in. The national reform programme includes also an estimation of the impact of the payment of commercial debt arrears and of the measures to prevent their accumulation in the future on the other variables, which is however not considered in the macro-scenario of the two programmes. All estimations are carried out using well-established macroeconomic models.⁴ The modelling choices and assumptions are detailed.

3. CHALLENGES AND ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

In 2013, despite a sharp economic contraction, the headline deficit remained stable at 3% of GDP thanks to the fiscal adjustment enacted over 2011-2012, slightly short of the 2.9% of GDP targeted in the 2013 programme. The Commission forecast projects the deficit to decline to 2.6% of GDP in 2014 and to 2.2% in 2015. The 2.6% is in line with the stability programme target, which in turn is 0.1 percentage point of GDP higher than in the 2014 Draft Budgetary Plan submitted in October 2013. The integration in the forecast of the impact of the labour tax wedge cut adopted by decree law⁵ after the adoption of the stability programme leads to lower revenue and expenditure projections for 2014. For 2015, the Commission forecast, based on a no-policy-change assumption, does not incorporate the tax cut to low-income employees and expenditure savings announced in the stability programme, as details have not been specified yet. A similar approach is used for the additional fiscal

⁴ The estimations are carried out using the macro-economic models ITEM, IGEM and a country-specific version of the European Commission's QUEST III.

⁵ Decree law 66/2014

adjustments (0.3 percentage point of GDP) foreseen in the stability programme but still to be enacted and the € 3 bn fiscal adjustment adopted with the 2014 budget law, which has not yet been detailed. The further improvement in the general government balance planned in the stability programme over 2016-2018 is based on an additional 0.3 percentage point of GDP permanent fiscal adjustment planned as of 2016 (still to be specified), declining interest expenditure in 2017-2018, as well as a sustained economic growth.

The expenditure ratio is projected to decline over the programme period. The stability programme trend projections (based on unchanged legislation) point to an overall decline in the expenditure ratio of 3.5 percentage points of GDP over the 2014-2018 programme period, also thanks to a sustained economic growth. Compensation of employees displays the largest decline (-1.4 percentage points of GDP) also as a result of the unchanged legislation assumption, which implies no further increases in public sector wages up to 2017.⁶ The decline in the expenditure ratio is supported by lower interest expenditure, following the assumption of continued decline in spreads between yields on Italian and German 10-year bonds (to 150 bps in 2015 and 100 bps as of end-2016). Over the programme period, the revenue-to-GDP ratio is expected to decline slightly (by 0.8 percentage point), mainly due to the projected fall in social contributions and direct taxation. Relative to last year's stability programme, the fiscal adjustment is backloaded, as the lower deficit reduction projected in 2014 is only partly explained by lower than expected growth.

⁶ The programme also presents a no-policy-change projection for some expenditure items, which shows a smaller decline in the overall expenditure ratio (-2.8 percentage points of GDP) and in compensation of employees (-0.9 percentage point of GDP).

Box 1. Main budgetary measures

Revenue	Expenditure
2014	
<ul style="list-style-type: none"> • Increase in stamp duty on households' financial assets (0.07% of GDP) • Increase in taxation on financial sector (0.16% of GDP) • Increase in tax allowances on employees' PIT (-0.1% of GDP) • Reduction in social contributions for labour accidents and sickness (-0.06% of GDP) • Reduction in property taxes (-0.07% of GDP) 	<ul style="list-style-type: none"> • De-indexation of higher pensions (-0.03% of GDP) • Additional investment expenditure (0.2% of GDP)
2015	
<ul style="list-style-type: none"> • Increase in tax allowances on employees' PIT (-0.1% of GDP) • Reduction in social contributions for labour accidents and sickness (-0.06% of GDP) • Reduction in property taxes (-0.07% of GDP) 	<ul style="list-style-type: none"> • De-indexation of higher pensions (-0.12% of GDP)
2016	
<ul style="list-style-type: none"> • Increase in tax-base deductions for financial sector's losses on loans (-0.11% of GDP) • Increase in tax allowances on employees' PIT (-0.1% of GDP) • Reduction in social contributions for labour accidents and sickness (-0.06% of GDP) • Reduction in property taxes (-0.07% of GDP) 	<ul style="list-style-type: none"> • De-indexation of higher pensions (-0.18% of GDP)
<p>Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

The objective of the budgetary strategy outlined in the 2014 stability programme is the achievement of the medium-term objective of a balanced budgetary position in structural terms by 2016, while complying with the minimum linear structural

adjustment required by the debt reduction benchmark (forward-looking element) over the 2013-2015 transition period. The programme confirms the medium-term objective of a balanced budgetary position in structural terms, which reflects the objectives of the Stability and Growth Pact. However, the stability programme postpones the achievement of the medium-term objective to 2016, whereas, in July 2013, the Council recommended Italy to achieve it by 2014. The justification of the postponement is argued on the basis of Regulation 1175/2011 (Article 5), in particular the severe economic conditions (i.e. a largely negative output gap, at a level in 2014 still much worse than the Representative Output Gap – ROG7) and unfavourable firms' liquidity conditions, which have pushed the government to accelerate the settlement of commercial debt arrears. The latter is resulting in a further increase in the debt level and, to a lesser extent, in the deficit. The stability programme also advocates the "structural reform clause", given the government's intention to implement several structural reforms eventually leading to a positive impact on potential economic growth and reducing the debt-to-GDP ratio in the coming years. Those reforms would also imply the need of additional resources (already financed and incorporated in the budgetary projections).

The structural balance further improved in 2013 but the adjustment path towards the medium-term objective is projected to slow down in 2014. In 2013, the structural balance is estimated to have improved by 0.6 percentage point, to -0.9% of GDP, although the 2013 stability programme planned a larger structural adjustment (of 0.9 percentage point, to -0.5% of GDP) against the background of a projected milder real GDP contraction (-1.3% vs. -1.9%). For 2014, the (recalculated) structural adjustment planned in the stability programme is only 0.2 percentage point of GDP. In 2015, the stability programme plans a 0.4 percentage point of GDP (recalculated) improvement in the structural balance. This compares with the 0.1 percentage point projected on a no-policy-change basis in the Commission forecast, which highlights the risk of significant deviation from the required structural adjustment towards the medium-term objective in 2015. The expenditure benchmark shows a risk of significant deviation in 2015 according to both the stability programme and the Commission forecast. In the case of the stability programme, this is also explained by the fact that expenditure figures provided in the programme are trend projections not consistent with the budgetary targets that include further fiscal adjustment still to be enacted.

The stability programme budgetary targets are subject to downside risks. The main risk comes from the need to identify and implement through the on-going spending review sizeable and permanent expenditure savings at all levels of government, which will also be needed to finance the announced permanent cut to the personal income tax on low-income employees. In addition, the macroeconomic scenario underpinning the budgetary projections in the programme is slightly optimistic, in particular for the outer years of the programme when growth is projected to be well above the current estimate of potential growth based on the Commission forecast. It is however true that a full and fast implementation of the planned structural reforms could help achieve a real GDP growth close to the projections put forward in the programme (see also below Box 4 "Potential impact of structural reforms on growth – a benchmarking exercise").

7 For an explanation see Public Finance Report 2013

The stability programme projects a further increase in 2014 in the general government gross debt ratio followed by accelerating decline to reach 120.5% of GDP in 2018. In 2014, the debt ratio is projected to reach around 135% of GDP mainly due the on-going settlement of commercial debt arrears. As of 2015, the stability programme projects a steadily and accelerating decline in the debt ratio (to 120.5% of GDP in 2018) thanks to increasing primary surpluses, falling interest expenditure coupled with sustained nominal growth as well as an ambitious privatisation plan of 0.7% of GDP per year over 2014-2017. The Commission forecast points to a somewhat higher debt ratio in 2014, essentially explained by the lower real GDP growth. The lower decline in the debt ratio forecast in 2015 is mainly explained by higher interest expenditure and lower primary surplus, based on a no-policy-change assumption. In addition, the Commission forecast incorporates lower privatisations proceeds (only 0.5% of GDP used to reduce the debt in 2015).

The Commission 2014 spring forecast points to a risk of non-compliance with the debt rule. The (recalculated) structural adjustment planned in the programme to comply with the minimum linear structural adjustment required for the debt reduction benchmark over the 2013-2015 transition period and based on the stability programme debt-to-GDP projections is around 0.3 percentage point of GDP in 2014 and 0.5 percentage point in 2015. This would allow Italy to comply but only thanks to the allowed annual deviation of 0.25 percentage point of GDP. However, the debt projections in stability programme heavily rely on the implementation of the ambitious privatisation plan and sustained economic growth. The Commission spring 2014 forecast points to a risk of non-compliance with the debt reduction benchmark in 2014. The expected structural adjustment (only 0.1 percentage point of GDP) falls short of the required minimum linear structural adjustment that, according to the forecast, would be of around 0.7 percentage point of GDP. This risk of non-compliance with the debt benchmark was already highlighted in the Commission's Opinion on Italy's 2014 Draft Budgetary Plan issued on 15 November 2013.⁸ Risks to the stability programme debt projections (above those related to possible higher deficits) are mainly related to the implementation of the ambitious privatisation plan, which remains largely unspecified.

The exemption requested by Italy to deviate from the required path towards the medium-term objective cannot be granted because of the risk of non-compliance with the debt-reduction benchmark, as currently projected in the Commission 2014 spring forecast. The Commission forecast projects a structural adjustment of only 0.1 percentage point of GDP in 2014, as it classifies as one-off some of the taxes (mainly from the banking sector) used by the government to finance the enacted cut to the personal income tax on employees in 2014. This falls short of the minimum linear structural adjustment of 0.7 percentage point of GDP in 2014 that, based on the Commission 2014 spring forecast, is needed to comply with the debt benchmark.

Fiscal framework

Following a rapid progress in the development of Italy's fiscal framework, the pace of reforms has slowed down in the recent past. In particular, there has been a significant delay in setting up the board of the parliamentary budget office, which will act as independent Fiscal Council in Italy, a key part in delivering on Italy's commitments in particular in the context of the "Two-pack" and the Fiscal Compact. The board was appointed by Parliament

⁸ C(2013) 8005 final. http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/it_2013-11-15_co_en.pdf

only at the end of April 2014 after the stability programme adoption; therefore, the projections underpinning the programme have not been endorsed by an independent institution as requested by the two pack. Additional steps are needed to make the Fiscal Council fully operational by September 2014, i.e. in time for the assessment of the 2015 Draft Budgetary Plan. Meanwhile, previous reforms notably aiming at improving coordination between levels of government are yet to fully deliver their expected benefits.

The launch of a comprehensive spending review sets high expectations. With the nomination of a dedicated Commissioner leading the spending review on a tight schedule, far-reaching scope and aggressive targets, Italy is set to address head-on the quality and efficiency of its public expenditure; however the review will have to demonstrate the feasibility of delivering rapid results in the short term and inscribe them in long-lasting impactful reforms.

Long-term sustainability

Risks to the sustainability of Italy's government debt are medium-to-low provided that the current fiscal stance is not eased. Government debt (132.6% of GDP in 2013 and forecast to rise to 133.9% in 2015) is currently above the 60% of GDP Treaty threshold, and projected to fall by 2030 although remaining above the reference value. The full implementation of the stability programme would accelerate the decreasing path of the debt-to-GDP ratio, although it would remain above the 60% reference value in 2030. In the medium-term, Italy appears to face medium fiscal sustainability risks. The medium-term sustainability gap,⁹ showing the adjustment effort up to 2020 required to bring debt ratios to 60 % of GDP in 2030, is at 1.5 percentage points of GDP, primarily related to the high level of government debt forecast for 2015. In the long-term, Italy appears to face low fiscal sustainability risks, primarily related to the structural primary balance forecast in 2015. The long-term sustainability gap¹⁰ shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at -1.6 percentage points of GDP. Risks would be significantly higher in the event of the structural primary balance reverting to lower values

⁹ See Table V in Annex. The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced until 2020, and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year until 2020 after the last year covered by the autumn 2013 forecast (year 2015) is required (indicating a cumulated adjustment of 2.5 percentage point), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

¹⁰ See Table V in Annex. The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

observed in the past, such as the average for the period 2004-2013. It is therefore appropriate for Italy to continue to implement measures that reduce government debt.

Tax system

The tax burden in Italy weighs heavily on productive factors and significant less than the EU average on consumption. In 2013, Italy was recommended to shift the tax burden away from labour and capital onto consumption, property and the environment in a budgetary neutral manner, also by reviewing VAT and direct tax expenditures and by reforming the cadastral system. Italy was also recommended to pursue the fight against tax evasion, shadow economy and undeclared work, and enhance tax compliance. The analysis in this staff working document leads to the conclusion that Italy has made limited progress in addressing the 2013 recommendation in these areas (for the full assessment of Italy's response to country-specific recommendations see the overview table in Section 4). Italy continues to face tax-related challenges, which are relevant for the 2014 Annual Growth Survey priorities of growth-friendly fiscal consolidation, tackling unemployment, promoting growth and competitiveness and modernising public administration.

Italy has shifted taxation away from productive factors to a limited extent. This was done in three steps: first, after the 1 percentage point increase enacted in September 2011, the standard VAT rate was further increased from 21 % to 22 % in October 2013, while leaving the scope and level of reduced rates unchanged; second, a small reduction in taxes on labour was included in the 2014 budget (amounting to around 0.15 % GDP as from 2015); and third, a further reduction in the labour tax wedge was enacted in April 2014 in the form of a cut in the personal income tax for low taxable incomes and a 10 % decrease in the regional tax on economic activities (IRAP). While the IRAP cut is stipulated to be permanent, the personal income tax cut was enacted only for 2014 and the national reform programme commits to making it permanent but not before having identified the financing resources. The reduction in the personal income tax is intended primarily to support private consumption, but in the short term its impact on growth could be offset by the spending savings needed to finance it. The expenditure savings will instead have no negative impact on long-term growth if the on-going spending review manages to effectively tackle the inefficiencies of Italy's public expenditure at all levels of government, preserving growth-enhancing spending like R&D, innovation, education and essential infrastructure projects. The cut to the personal income tax could also have a positive impact on labour demand and competitiveness to the extent that it translates into lower wage claims. In 2013, the recurrent taxation on property, considered the least detrimental to medium/long-term growth, was reformed again after the increase adopted at in end-2011, with revenue expected to decline slightly (the share of revenue from recurrent taxes on immovable property was 1.6 % of GDP in 2012, i.e. broadly in line with the EU average of 1.5 %).

High tax evasion, associated with a strong presence of shadow economy and labour market irregularities, exacerbate the distortive impact of taxation on the economy. The VAT gap is estimated at 28% in 2011, among the highest in the EU.¹¹ The Italian statistical

¹¹ CASE (2013), Study to quantify and analyse the VAT gap in the EU-27 Member States. Tax gap is defined as the difference between the theoretical tax liability according to the tax law and the actual revenues collected, as a share of theoretical tax liability.

institute (ISTAT) estimated that in 2008 the non-observed economy accounted for about 17% of GDP. Italy has taken some additional tax enforcement measures but decisive action to improve the relationship between taxpayers and the tax administration and to prevent tax evasion is still needed. The 2014 Stability Law provided for the increase of labour inspectors and raised both the minimum and maximum amount of fines for employers employing undeclared workforce. The Italian tax administration has obtained increased access to information on taxpayers' bank accounts and assets, even those abroad. However, processing all this new information is proving difficult.¹² Few measures have been taken to improve tax compliance, modernise the tax administration or speed up the recovery of tax debts. One step taken in this direction is a pilot cooperative compliance programme for high taxpayers. However, tax compliance costs remain high (tax compliance takes 269 hours versus 178 hours on average in the EU for mid-sized companies in 2013), mainly because of burdensome tax obligations and frequent adjustments of tax rules via ministerial decrees instead of systemic tax reform. The burdensome tax obligations also imply that assessments often result in contentious cases, which reduces the credibility and effectiveness of the efforts to fight tax evasion. Uncollected fines, taxes and social security contributions have accumulated over the years and amount now to a stock at face value of EUR 600 billion, signalling difficulties with enforced tax debt recovery.¹³ The rate of enforced recovery of tax arrears was put at 1.94% for 2012, showing a declining trend since 2010.¹⁴ In 2013, the government released a comprehensive report on tax evasion and measures taken to address it.¹⁵ The report confirms the declining trend in enforced tax debt collection.¹⁶

The enabling law on taxation adopted by the Italian Parliament in February 2013 could represent a significant step forward, once implemented. The enabling law mandates the government to review cadastral values according to current market values, which would increase the fairness of property taxation. It also foresees a revision of tax expenditures,

¹² Corte dei Conti (2013), Rapporto 2013 sul coordinamento della finanza pubblica.

¹³ The figure includes all amounts, accumulated over the years that have been contested by the public administration, including those to companies gone out of business and those for which an appeal may have been lodged. Data are quoted in the 2013 annual report of the Court of Auditors on the coordination of public finances, p. 21:

http://www.corteconti.it/_documenti/controllo/sezioni_riunite/sezioni_riunite_in_sede_di_controllo/2013/28_maggio_2013_rapporto_2013_finanza_pubblica.pdf.

¹⁴ Ibid. The Italian Court of Auditors argues that there are two main explanations for the decline in enforced tax recovery yield: on the one hand, tax debt collection has been affected by the economic crisis, which has made several taxpayers unable to pay taxes due; on the other hand, the Court points that recent changes made to the Italian tax debt collection system have weakened tax administration' powers to enforce tax recovery.

¹⁵ Ministero Economia e Finanze (2013), Rapporto sui risultati conseguiti in materia di misure di contrasto dell'evasione fiscale. Allegato alla Nota di Aggiornamento del Documento di Economia e Finanza 2013. http://www.dt.tesoro.it/export/sites/sitodt/modules/documenti_it/analisi_programmazione/documenti_programmatici/Rapporto_evasione.pdf.

¹⁶ Ibid. p. 37. Enforced tax debt recovery decrease by 7% over the period 2011-2012, from EUR 4.5 billion (2011) to EUR 4.2 billion (2012). According to the same report, in 2012 Italy recovered in total EUR 12.5 billion from the fight against tax evasion. This figure covers both enforced tax payments ("ruoli") and voluntary payments of overdue tax obligations ("versamenti diretti").

including VAT reduced rates, which would help reducing distortions. It further aims at simplifying the tax system through the use of pre-filled tax returns, modernising tax litigation and reforming direct tax expenditure. The enabling law also provides for a rationalisation and increase of environmental and energy taxation, with the twin aim of better protecting the environment and reducing income taxes. Environmental taxation increased by 0.3 % of GDP and, at 3 % in 2012, is only slightly above the EU average. A recent study indicates that there is still scope for additional revenue from environmental taxes, notably with regard to pollution and resource taxes (at 0.03 % of GDP in 2012, among the lowest in the EU ranking), and alignment of fuel taxation according to energy content of fuels. The study also finds scope for removing environmental harmful subsidies, in particular: the preferential treatment of company cars; the reduced rates for gas oil used in agriculture, horticulture, forestry and aquaculture; and the fuel exemptions for the transportation of goods and passengers along national waterways and within EU waters.¹⁷ All secondary legislation implementing the enabling law is to be adopted by end of March 2015.

Box 2: Conclusions from the March 2014 in-depth review on Italy

The third in-depth review on Italy under the Macroeconomic Imbalances Procedure was published on 5 March 2014 along with a Commission communication.¹⁸ On the basis of the review, the Commission concluded that Italy is experiencing excessive macroeconomic imbalances, which require specific monitoring and strong policy action. The main observations and findings are:

- Persistent low productivity growth is at the root of the country's declining competitiveness and weighs on the sustainability of public debt.
- The very high government debt is a heavy burden for the Italian economy and a major source of vulnerability.
- The correction of Italy's current account is mostly driven by falling imports, while export competitiveness has not improved.
- Remaining barriers to competition, inefficiencies in public administration (including justice), and governance weaknesses hinder resource reallocation to more productive firms and sectors. Insufficient development of capital markets holds back technology absorption and innovation further.
- Italy's human capital endowment is not adapting to the needs of a modern competitive economy, partly due to the difficulty of transition from education to work. Its wage structure favours seniority and thus reduces the return on education for younger cohorts in Italy compared to the rest of the EU.
- The crisis has eroded the initial resilience of the Italian banking sector and has weakened its capacity to support the economic recovery.

¹⁷ Eunomia research and consulting and Aarhus University (2014), 'Study on environmental tax reform potential in 12 EU Member States. See also: OECD (2013), *OECD Environmental Performance Reviews: Italy 2013* (the study notes that environmental taxes in Italy do not sufficiently reflect environmental externalities); Institute for European Environmental Policy (2013), *Steps to greening country report: Italy*. Report for the European Commission, pp. 15-16.

¹⁸ EC (2014), Macroeconomic Imbalances. Italy, European Economy, Occasional paper 82, March 2014.

- Italy's macroeconomic imbalances have adverse effects on the rest of the euro area. Italy's slow growth acts as a drag on the recovery of the euro area as a whole and its high debt could impact on the euro area by affecting financial market sentiment and confidence.

The in-depth review also discusses the policy challenges stemming from these imbalances and possible avenues for action. In particular, the following points are made:

- Italy has for too long postponed much-needed structural reforms. The decline in financial market pressures and the gradual improvement of the economic outlook represent a window of opportunity to accelerate the pace of reforms.
- Robust productivity-enhancing reforms are necessary to ensure sustainable recovery and unleash Italy's growth potential. As productivity-enhancing measures take time to bear fruit, levers to address cost pressures in the economy could be explored.
- Reducing the high government debt at a satisfactory pace requires sustained fiscal discipline. Reaching the medium-term objective (MTO) of a structurally balanced budget and achieving and maintaining sizeable primary surpluses for an extended period are essential to put Italy's high government debt on a steadily declining path while preserving investor confidence.

3.2. Financial sector

The capacity of the Italian banking sector to support the economic recovery and adjustment has been eroded by the protracted crisis. The long recession has taken its toll on Italian banks' balance sheets, in particular through a strong increase in non-performing loans (16.7% of customer loans in December 2013), mainly concentrated in non-financial firm exposures. High credit risk and elevated bank funding costs, owing partly to euro-area financial market fragmentation, in addition to common factors such as the phase-in of stricter capital requirements, continue to keep credit conditions tight, affecting small firms in particular. Furthermore, some segments of the banking sector still display weaknesses in corporate governance practices and cost efficiency. Capital markets in Italy, in particular equity markets, are insufficiently developed, rendering it difficult for firms to find adequate external financing for innovative activities and maintaining the dependence of the corporate sector on banks.

The analysis in this staff working document leads to the conclusion that Italy has made some progress in addressing the recommendation Italy received in 2013 (for the full assessment of Italy's response to country-specific recommendations see the overview table in Section 4).

Some progress has been made in addressing the problem of deteriorating asset quality, in line with the priorities set in the 2014 Annual Growth Survey. From the second half of 2012 until mid-2013, the Bank of Italy conducted a targeted loan-portfolio quality review of 20 large and medium-sized domestic banking groups with lower non-performing loan coverage ratios. This exercise led in particular to an increase in loan-loss provisions. For eight banks, on-site inspections were extended to the entire loan portfolio. The 2014 Stability Law enhanced the tax deductibility of loan-loss provisions and loan write-offs. This is likely to foster a further increase in non-performing loan coverage ratios and limit the impact of deteriorating asset quality on profits. In addition, some large Italian banks have recently announced initiatives to repair their balance sheets, mainly by selling their distressed assets or setting up defeasance structures. Finally, the ongoing comprehensive assessment by the European Central Bank, which includes 15 Italian banking groups, is expected to further

increase transparency as to the quality of banks' balance sheets. The assessment has also triggered the announcement of capital increases by several banks and extra loan-loss provisioning at the end of 2013.

Progress in tackling relative weaker cost efficiency has been limited, but some steps has been taken in strengthening corporate governance. The combination of the Italian banking sector's relatively lower cost efficiency – linked in particular to high branch density – and subdued profitability has led the Bank of Italy to call on banks to increase their internally generated resources by reducing costs, and to limit dividend payments and executive remuneration. Although banks have made efforts to reduce operating costs and improve efficiency, further steps may be needed to support profitability. As to banks' corporate governance, the Bank of Italy has issued new provisions on the composition and functioning of the banks' management bodies, the self-evaluation process that must be carried out by these bodies, the role of the chairman of the board of directors and the transparency of the procedure to appoint of board members. These provisions are welcome but their effect will depend on their concrete application by the banks and enforcement by the supervisor. Furthermore, a legislative proposal which transposes the new EU Capital Requirements Directive includes provisions aimed at strengthening the Bank of Italy's supervisory powers and rules applicable to transactions which may imply a conflict of interest for shareholders or board members. The proposal also provides for a more thorough and comprehensive framework for the independence, experience and integrity requirements for board members. There has been virtually no progress on the role of bank foundations – which despite their positive role as long-term investors – continue to exert significant and at times opaque influence on banks, partly because of shareholder coalitions, voting right ceilings and cross-holdings. Furthermore, supervision over foundations is also still provisionally in the hands of the Italian Ministry of Economy and Finance, and the foundations' self-regulatory charter could be strengthened. Finally, corporate governance features such as the one-shareholder-one-vote principle, share ownership ceilings and membership constraints typical of cooperative banks may not be appropriate in the case of large (listed) cooperative banks (namely 'banche popolari') as they may discourage large shareholders from exerting influence and active oversight of management and also represent obstacles to raising new capital. New corporate governance principles specifically targeted at 'banche popolari' to ensure broad shareholder representation have been introduced, but their impact needs to be closely monitored.

Access to finance

Some steps have been made in diversifying firms' access to finance and reducing their bias towards debt financing – both priorities set in the 2014 Annual Growth Survey. Several measures have been taken to diversify firms' sources of external funding away from bank loans. The 2014 Stability Law provides for an increase in the notional return on new equity capital or reinvested earnings (allowance for corporate equity – ACE), which firms can deduct from taxes from the initial 3% introduced in 2012 to 4% in 2014, 4.5% in 2015 and 4.75% in 2016. This could contribute to reducing the relatively high leverage of Italian firms by strengthening their capital base. While recent surveys indicate that the take-up of allowance for corporate equity so far has been modest, enhancing demand prospects and reduced uncertainty are expected to spur equipment investment in the coming months and thus the need for new capital. Nevertheless, there still seems to be some scope for further reducing the debt bias in taxation. The framework for mini-bonds established in 2012 to diversify access to finance of (small) firms has been finalised with the necessary

implementing decrees. The take-up of mini-bonds – still limited, in particular by small firms – might benefit from recent measures extending Italy's securitisation framework to bonds and fostering their acquisition by institutional investors. Other positive steps include the entering into force of tax incentives for investing in the capital of innovative start-ups, and the issuing by the Italian financial market regulator (Commissione Nazionale per le Società e la Borsa - CONSOB) of instructions for using equity crowd-funding and of a memorandum of understanding with initiatives to foster the further development of Italian stock markets. As regards funding through traditional financial intermediaries, several initiatives have been taken to ease (small) firms' access to finance. The Guarantee Fund for small and medium-sized enterprises is being further refinanced for the period 2014-2016, while access conditions for firms have been eased and its functioning has been improved. It has also been integrated into the new National Guarantee System and has supported the recapitalisation of Italian collective loan guarantee institution (*confidi*). In addition, the publicly-controlled bank Cassa Depositi e Prestiti (CDP) has made available EUR 5 billion extra resources to support lending in view of investment by small and medium-sized enterprises, while eligibility criteria have been broadened. Furthermore, a new debt moratorium was agreed in 2013, extending previous measures to temporarily suspend loan payments and lengthen maturities for viable but financially distressed small and medium-sized enterprises. Other actions include the creation of the 'Fondo di Valorizzazione' which will temporarily invest in and support viable but financially distressed firms, and the refinancing of Italy's Fund for Sustainable Growth for the period 2014-2015. Overall, these measures are helpful but limited in scope, and most maintain the focus on debt financing. The government has made some progress with the repayment of commercial debt arrears, providing liquidity relief to firms (EUR 23.5 billion disbursed at the end-March of 2014 out of EUR 47 billion made available in 2013). The national reform programme includes plans to disburse an additional EUR 13 billion in 2014 and accelerate repayments through financial intermediaries.

3.3. Labour market, education and social policies

Labour market

The unemployment rate has doubled since 2007 and labour market participation remains very low, while still increasing unit labour costs weigh on competitiveness. The unemployment rate rose from 6.1 % in 2007 to 12.2 % in 2013. The situation is particularly worrisome for young people. Youth unemployment (age 15-24) reached 40 % in 2013, and the proportion of young people aged 15-29 not in education, employment or training was 24 % in 2012, among the highest in the EU, reaching 50% in the South and 33.6% for non-EU born. The employment rate of 20-64 year-olds (59.8 % in 2013) is well below the EU average and the national Europe 2020 target of 67-69 %. Labour market participation continues to be low among women and young people, especially in southern regions, and the number of persons available for work but not actively seeking it – commonly referred to as 'discouraged workers' thereby implying a wider measure of under-employment than the measure of unemployment alone – also increased substantially during the crisis. The gender employment gap is the second highest in the EU and parenthood still reduces employment among women, especially after the second child. Finally, Italy's low productivity growth is sustaining unit labour costs, leading to cost competitiveness losses.

In 2013, Italy received a country-specific recommendation concerning the labour market and education. Italy was recommended to ensure the effective implementation of the labour

market and wage-setting reforms, take further action to foster labour market participation, especially of women and young people, and improve public employment services. These actions are also in line with the priorities set out in the 2014 Annual Growth Survey. Italy was also recommended to strengthen vocational education and training, improve career and counselling services for tertiary students, step up efforts to prevent early school leaving and improve school quality and outcomes. However, the analysis in this staff working document leads to the conclusion that Italy has made limited progress on measures taken to address these recommendations (for the full assessment of Italy's response to country-specific recommendations, see the overview table in Section 4).

Disentangling the impact of the 2012 labour market reform from that of the crisis is difficult. The 2012 reform of the labour market aimed to address the rigidities and dualism of the labour market by enhancing exit flexibility for workers on permanent contracts through amendments to the rules and procedures regulating dismissals, while regulating entry flexibility by reducing incentives to hire workers on non-permanent contracts. It also introduced a more inclusive insurance-based system of income support for the unemployed, which is gradually entering into force and will be fully operational as of 2017. Italy produced a first monitoring report on the impact of the reform at the beginning of 2014. It shows evidence of enhanced exit flexibility, with reductions in both the length of dismissal procedures and the number of compulsory reinstatements of dismissed workers in firms. While economic uncertainty related to the crisis has contributed to a steady decline in hires on permanent contracts, the use of atypical contracts has also declined somewhat, in line with the aim of the reform. At the same time, a substantial increase in fixed-term temporary contracts¹⁹ in combination with still incomplete access to unemployment benefits, notably for semi-dependent, own-account workers and the self-employed, suggest that segmentation remains a challenge for the Italian job market. Furthermore, the new unemployment benefit system is being put under strain by the increase in unemployment and is not supported by effective activation policies.

The government intends to introduce additional measures on contractual simplification, active labour market policies, unemployment benefits, and disincentives to work. The government has also put forward a draft enabling law aimed at, *inter alia*: further streamlining the existing contractual forms, including by introducing a new permanent contract with increasing entitlements, extending the coverage and duration of unemployment benefits, strengthening conditionality and activation by better linking active and passive labour market policies, preventing moral hazard in the use of wage supplementation schemes (*Cassa Integrazione Guadagni*) by adjusting the contributions paid into such schemes to companies' actual use of them (across and within industries). While many of the proposed actions appear adequate to address Italy's labour market challenges, their effectiveness will depend greatly on their design and subsequent implementation.

Positive steps towards further decentralisation of wage bargaining could be conducive to greater responsiveness of wages to productivity developments and local labour market conditions. In a country like Italy, characterised by great dispersion in productivity and labour market outcomes across geographical areas and firms, decentralised bargaining can

¹⁹ In 2012, 1.7 million activated fixed-term contracts (17.4% of the total) had a duration of 1 to 3 days. The level of short-lived temporary contracts increased further up to mid-2013. Source: Ministero del Lavoro e delle Politiche Sociali, 'Il primo anno di applicazione della legge 92/2012', *Quaderno* No 1, January 2014.

play an important role in strengthening wage responsiveness to productivity as well as to local labour market conditions. Important agreements were signed by the social partners in 2009, 2011 and 2012, the latter with the support of the government through temporary tax rebates on productivity-related wage increases. A further important agreement was signed in early 2014 to define trade unions' representativeness in collective bargaining, at both sectoral and firm level, but only for the manufacturing sector. The available evidence shows that firm-level contracts still concern a minority of workers and firms, with the share being particularly low in southern regions and having actually decreased during the crisis.²⁰ The recent 2014 agreement on trade union representativeness could further bring stability in industrial relations and foster decentralisation in the industrial sector. A close and effective monitoring of the impact is necessary.

Action has been taken to tackle youth unemployment but its scope is limited and its effectiveness uncertain. In June 2013, a package of measures was introduced with the aim of fostering employment, especially among young people, centred on an incentive scheme to hire disadvantaged young people aged 18-29 on permanent contracts. However, the measures are fragmented and of limited scope, compared to the size of the challenge. Six months after the introduction of the schemes, their take-up was still limited. The government has submitted an implementation plan for the Youth Guarantee initiative, worth EUR 1.5 billion. Its effectiveness depends greatly on the employment services and on the coordination of the various stakeholders.

Box 3: The delivery of a Youth Guarantee in Italy²¹

The most important challenges to deliver a Youth Guarantee in Italy are:

- Lack of sufficient resources in public employment services, foreseen as the main service provider for the Youth Guarantee, to provide homogeneous service delivery across the country, coupled with limited use of public employment services in job search by jobseekers;
- Unclear structure of incentives for non-registered youth not in education, employment or training to register for the services and the ensuing need for a pro-active outreach strategy tailored to the different subgroups;
- Need for effective and continuous coordination between national and regional levels in the delivery of Youth Guarantee measures;
- Necessity to raise the commitment of the private sector and to step up cooperation with education institutions in delivering quality apprenticeships and traineeships.

Although the level of commitment is high, there are substantial concerns that the sustainability of the Youth Guarantee is compromised by the lack of a long-term implementation perspective.

²⁰ Available evidence from OCSEL-CISL suggests that the number of second-level agreements has decreased by around 15% from 2011, and 61% of the agreements reached in 2013 were supported by the tax rebates made available in January 2013. For a more detailed analysis, see Italy's 2014 in-depth review.

²¹ Italy presented a Youth Guarantee Implementation Plan, entitled "Piano di attuazione italiano della Garanzia per i Giovani" in December 2013:
http://www.lavoro.gov.it/Notizie/Documents/01_08_2014%20%20Piano%20di%20attuazione%20italiano%20della%20Garanzia%20per%20i%20Giovani.pdf

The conditions for the use of temporary contracts have been partially relaxed. A decree law²² adopted in March and transformed into law in May 2014 increases entry flexibility compared to the 2012 labour market reform by allowing temporary contracts to be renewed up to five times and for a maximum duration of three years, and removing the obligation to explicit the justification of renewal. At the same time, the decree also introduces a limit of 20% to the proportion of temporary contracts in the total number of permanent employees in firms with more than 5 workers²³. This limit, however, can be amended under national collective agreements and exceeded upon the payment of a fine by the employer.²⁴ A monitoring report by the Ministry of Labour on employment developments, especially focusing on temporary and apprenticeship contracts, is foreseen after one year. Overall, these provisions are intended to respond to the current juncture of labour market weakness and uncertain economic prospects which do not favour the use of permanent contracts. However, they have to be followed by other measures to enhance the take up of permanent contracts to avoid the risk of exacerbating labour market segmentation.

The very low take-up of apprenticeship contracts prompted the government to relax some of its requirements. The 2012 labour market reform included a reform of apprenticeship contracts to increase youth employability. However, the take-up of this type of contract has been very low.²⁵ To remedy to this, the March 2014 decree law relaxes the obligation to convert apprenticeship contracts into open-ended contracts before hiring new ones to 20% of the total number of apprentices in firms with more than 50 employees. However, this limit can be amended under national collective agreements. For professional apprenticeships (*apprendistato professionalizzante*), the training plan that the employer is required to draft has been simplified, while for training apprenticeships (*apprendistato per la qualifica e il diploma professionale*), the salary paid to the apprentice for hours spent in off-the-job training can be reduced up to 35 % of the contractual wage. All these amendments simplify apprenticeship contracts and make them more flexible. In line with the 2012 labour market reform, in January 2013 a legislative decree set up a national system for the certification of skills, including the identification and recognition of non-formal and informal learning. The implementation of this new system requires a nationwide recognition of the existing regional qualifications. The 2013 decree law on education provides for a national register of regional qualifications, but this has not yet been put in place.

Despite the recently announced measures, policy action to increase women's participation in the labour market has been limited so far. Affordable childcare is still

²² Decree law 34/2014

²³ Administrative sanctions will apply on firms that do not respect the limit.

²⁴ Public and private research institutes are exempted from this limit as well as from the 3-year maximum duration limit.

²⁵ The number of apprenticeship contracts has decreased from 528 183 in 2010 to 469 855 in 2012. In particular, the share of young workers aged 15-29 with an apprenticeship contract has decreased from 14.7% to 13.9% in the same period. Source: Ministry of Labour – ISFOL – INPS (2013) 14th Monitoring Report on Apprenticeship. <http://www.isfol.it/highlights/xiv-rapporto-di-monitoraggio-apprendistato/xiv-rapporto-di-monitoraggio-apprendistato.-3-i-numeri-dell2019apprendistato>

insufficient and attendance is low among children under three years old.²⁶ This remains an obstacle to labour market participation, especially for low-income households. Moreover, there has been no significant improvement in the long-term care system, particularly for those with severe care needs. The Stability Law 2014 introduced limited measures to reduce fiscal disincentives for second earners (particularly in ‘disadvantaged’ southern regions) and the draft enabling law on the reform of the labour market discussed in the previous paragraph provides for additional measures to further support working parents and to reduce fiscal disincentives.

The strengthening of public employment services is lagging behind. Public employment services in Italy are organised at the regional level. This decentralised system has produced disparities in the quality of services provided, with some regions representing best practice and others struggling to fulfil their function of matching supply and demand for labour. In particular, in regions where labour market conditions are the most difficult,²⁷ the number of competent staff may be inadequate. The online platform ‘Clicklavoro’ and the creation of a comprehensive database of active and passive labour policy measures are useful tools that may complement public employment services’ efforts, while the specific division set up in the Ministry of Labour to coordinate the action of the different bodies managing employment measures (*struttura di missione*) may improve overall governance. The first monitoring report on public employment services, published in October 2013, is a starting point to identify gaps and take action to comprehensively address their weaknesses.

Education

Education and human capital endowment are weak. Italy’s Public expenditure on education as a share of GDP is below EU average (4.2% vs. 5.3% in 2012), notably at tertiary level. Although moderately declining, the early school leaving rate (17.0 % in 2013) remains well above the EU average (11.9% in 2013) and the national Europe 2020 target of 16%. The rate is especially high in southern regions, and reaches 40% among non-EU born.²⁸ Particularly worrying are the low education attainment rates compared to other EU Member States. Italy has one of the highest shares of population aged 25-34 with low education levels across the EU and the share of population with tertiary education in the 30-34 year age group (22.4 % in 2013) is among the lowest in the EU and well below the national Europe 2020 target of 26-27 %. Adult literacy and numeracy skills also underperform the OECD average across all age groups.²⁹ Italy has a very low share of young people studying and working at

²⁶ <http://www.minori.it/minori/rapporto-di-monitoraggio-del-piano-nidi-al-31-dicembre-2012>.

²⁷ Indagine sui servizi per l’impiego 2013: rapporto di monitoraggio, Ministry of Labour, December 2013.

http://www.cliclavoro.gov.it/Barometro-Del-Lavoro/Documents/Rapporto_monitoraggio_SPI_2013.pdf.

²⁸ Early school leaving rate is defined as the share of the population aged 18-24 with at most lower secondary education and not in further education or training.

²⁹ OECD Programme for the International Assessment of Adult Competencies (PIAAC)

the same time.³⁰ The transition from education to work is particularly difficult for young graduates. The employment rate of young tertiary graduates (aged 25-29) is well below the EU average and that of young people with upper secondary education.

Some progress was made in improving career and counselling activities and reducing the dropout rate in secondary and tertiary education. Starting from 2013–2014, career and counselling guidance for prospective tertiary students became compulsory from the penultimate year of upper secondary education, with some additional resources allocated (EUR 7 million in 2013–2014). This is a positive step towards helping students make a more informed choice and thus contributing to reducing tertiary dropout rates and increasing Italy's tertiary attainment rate. Furthermore, in September 2013, a decree law on education introduced an integrated programme to counter early school leaving in problematic areas, which also extended schools' opening hours.³¹ In the medium term, European structural and investment funds are expected to contribute significantly to the fight against early school leaving in southern regions in the 2014-2020 programming period.

The initiatives to strengthen the vocational education and training system are limited in scope. As from August 2013, some limited additional funding (around EUR 14 million) has been provided for some traineeship schemes. The September 2013 decree law on education introduced: (i) a pilot project for 2014-2016 allowing students in the last two years of upper secondary education to participate in on-the-job training periods in companies, using apprenticeship contracts; (ii) the possibility of using the higher apprenticeships (*apprendistato di alta formazione e ricerca*) in study programmes of universities and higher technical institutes (tertiary-level vocational education and training institutions). These measures, however, require implementing acts. Furthermore, their potential impact in promoting effective work-based learning (i.e. traineeships and apprenticeships) at upper secondary level and enhancing the higher technical institutes as an alternative to academic studies at tertiary level is expected to be small.

Monitoring of school quality is still at an early stage and there is no effective progress in diversifying teachers' careers. In a medium- to long-term perspective, improving school quality and outcomes may help reduce early school leaving. In March 2013, Italy established a national system to evaluate school institutions under the coordination of the school evaluation agency (INVALSI). The system requires each school to present a self-evaluation report (using a common framework and quantitative data on pupils' performance provided centrally) and a plan for improvement (in cooperation with local stakeholders), and to publish a report on the outcome. However, the system is not yet operational. The national reform programme plans to implement it as from the 2014-2015 school year. With regard to teaching, the September 2013 decree law on education included a three-year plan for teacher recruitment but no action has been taken as to teachers' career development. The issue of raising the status of the teaching profession thus remains largely unaddressed.

Action to improve the quality of universities is hampered by slow implementation. In 2010, a Self-Evaluation, Evaluation and Accreditation System for universities was introduced

³⁰ 3.7% of 15-29 year-olds in 2012 as against an EU average of 12.9%.

³¹ Decree law 104/2013 converted into Law 128/2013

with a view to allocating an increasing share of institutional funding for universities on the basis of research and teaching performance. In July 2013, the university and research evaluation agency (ANVUR) published its report on the evaluation of universities' and public research institutes' research quality covering the 2004-2010 period. The share of institutional funding allocated on the basis of performance criteria rose from 7% in 2009 to 13.5% in 2013 and is set to increase further in the coming years. However, effective implementation is very difficult, due to the overall decrease in higher education funding and the restrictive rules that limit the yearly change in the amount of funds allocated to each university. In the medium- to long-term, a proper and adequately funded evaluation system is key to improve the performance of Italy's tertiary education sector.

Awareness of the digital skills gap is rising, but no effective action has been taken. A working group was set up by the Agency for the Italian Digital Agenda (*Agenzia per l'Italia Digitale*) composed of all major stakeholders (public administrations, business and workers' associations, media) with the task of drafting a national plan for digital competencies. This was supplemented by the digital school programme and other initiatives at local level but overall these efforts are not sufficient to substantially improve digital literacy and skills.

Social policies

The share of people at risk of poverty and social exclusion is rising fast and the social protection system is not well equipped to address this problem. Italy has seen the number of people at risk of poverty and social exclusion increase from 17.1 million in 2011 to 18.2 million in 2012, one of the largest increases in the EU, and to a level that is well above the 12.9 million Europe 2020 target. Also, the level of gross household disposable income further deteriorated. The share of people affected by severe material deprivation more than doubled between 2010 and 2012,³² particularly affecting children under 16 years. In-work poverty also increased in recent years.³³ Social expenditure in Italy is largely oriented towards the elderly and dominated by pension expenditure, which represented 17% of GDP in 2012, the highest share in the EU. This leaves little scope for the other functions of social protection, namely to support families and children and address the risk of social exclusion and poverty. Social assistance expenditure is fragmented and there is no nation-wide minimum income scheme in place. As a result, Italy has the third highest share of people living in poor or jobless households that are not covered by social transfers, and a large share of the working age population is dependent on the pension income of a family member.

Following the 2013 country-specific recommendation, the steps taken towards a strengthened protection against poverty go in the right direction, but close monitoring is warranted. An updated and nationally harmonised criterion informing the means-testing system was approved in December 2013 to improve the selection of those most in need of social assistance. The government has taken further action to facilitate access to housing for people in difficult economic conditions.³⁴ A new measure — Support for Active Inclusion —

³² The percentage increased by over 7 percentage points from 6.9% in 2010 to 11.2% in 2011 and 14.5% in 2012.

³³ From 2008 to 2012, the percentage of employed people at risk of poverty increased by 1.1 percentage points, to 11.1%.

³⁴ Decree Law 47/2014 ("*Urgent measures for housing emergency*")

was also introduced as a pilot project to support those in the most disadvantaged situations by means of the ‘new social card’, already in use in the 12 largest cities and in southern areas. It is expected to gradually replace the old support (purchase card) in force since 2008 with an approach combining monetary support with compulsory activation and social services programmes. The new scheme represents a significant step in the right direction. However, its strict eligibility requirements, which limit it to households with children and with recent employment spells, and the uneven quality of services provided by the public employment and social services across different regions, limit its effectiveness as a social safety net and activating tool. Given Italy's important budgetary constraints, the extension of this measure to the entire Italian territory, as announced in the national reform programme, requires adequate and efficient allocation of the available financial resources through a recalibration of the social expenditure and appropriate targeting of the beneficiaries, in particular families with children.

3.4. Structural measures promoting sustainable growth and competitiveness

In 2013, Italy received a country-specific recommendation to improve competition and reduce bottlenecks in services and network industries. Resource allocation inefficiencies are at the root of Italy's growth gap, as shown by the in-depth review of the Italian economy. While Italy has substantially improved its product market regulation over the past 15 years, the implementation of the measures taken is often ineffective, partly due to insufficient coordination between central and local authorities. In addition, inefficiencies and restrictions to competition remain in important service and network industries. Infrastructure bottlenecks further hamper the efficient functioning of the market in telecommunications, transport and energy. Finally, low research and innovation capability contribute to maintaining Italy's specialisation in low-technology products and weigh on growth potential and external competitiveness.

The analysis in this staff working document leads to the conclusion that Italy has made limited progress in addressing this recommendation (for the full assessment of Italy's response to country-specific recommendations, see the overview table in Section 4).

Market opening in services

The reform of regulated professions is being implemented but competition-restricting provisions remain, particularly with regard to the legal profession. The adoption of the implementing measures required by the 2012 reform of regulated professions was completed in May 2013. The professional orders concerned are gradually applying them within their organisations. Competition among pharmacies and notaries is expected to gradually intensify in 2014 as a result of the easing of quantitative and/or territorial limits. It is crucial that these processes and their effects are effectively monitored. In addition, remaining restrictions to competition in professional services need to be tackled. First, requirements on the minimum share of capital that professionals must hold in companies offering the services of regulated professions are still in force. Second, the provisions requiring that professional pay is commensurate to the work and dignity of the profession may result in minimum tariffs being reintroduced de facto.³⁵ Third, there are serious concerns regarding the 2012 reform of the

³⁵ Article 9 of decree law 1/2012 and Article 2233 of the Civil Code. See also: Autorità Garante per la Concorrenza e il Mercato (2012), *Proposta di riforma concorrenziale ai fini della legge annual per il mercato e la concorrenza 2013*.

legal profession, particularly with regard to the reserves of activity (whereby the exercise of a specific activity is restricted to specific professionals only, in this case the lawyers), the stricter conditions for setting up professional law firms than for other professions, and the parameters set by the Ministry of Justice in the event of litigation, which could also translate into de facto minimum tariffs. Finally, a law adopted in January 2013 regulates the formation of associations on a voluntary basis for non-regulated professions and allows self-certification of skills based on technical standards set at national level. This should improve transparency and consumer protection. However, the development of professional associations and voluntary standards based on national technical norms could create informal barriers to non-member service providers, particularly professionals qualified in other Member States.

The potential for further competition-enhancing measures remains considerable. Since 2009, the government is required by law to present a draft law to Parliament each year (*Legge annuale per il mercato e la concorrenza*) taking into account measures recommended by the Italian Competition Authority. In its last report of October 2012, the Italian Competition Authority identified important competition-restricting barriers in important sectors of the economy.³⁶ The Competition Authority highlighted that the efficiency of and competition in the Italian postal market are still hampered by the remaining exclusive rights of *Poste Italiane*, the incumbent national postal operator, and by unclear conditions of access to *Poste Italiane*'s network. In the insurance sector, the Authority highlighted the need to eliminate remaining obstacles to the mobility of customers, including those clauses that may underpin *de facto* exclusive relationships between companies and agents. With regard to fuel distribution, the Authority called for addressing the restrictions to the opening of fuel stations, in particular at regional level, and to their automation. The national report programme foresees the adoption of the *Legge Annuale* by September 2014. The adoption of such law (for the first time since 2009) would be an important step, also setting in motion a positive mechanism for the future. Italy's retail sector warrants close monitoring of the effectiveness of its regulatory framework, notably at local level. The sector displays the third most restrictive regulation in the EU, according to the indicator of the OECD product market regulation for 2013, as well as low productivity growth and rising unit labour costs.³⁷

Limited progress was made in local public services. The Italian Court of Auditors (*Corte dei Conti*) reports that in 2010 municipal and provincial governments owned stakes in 4 942 bodies, of which 3 153 limited companies.³⁸ The companies supply services of general economic interest (notably waste and water management, local transportation, energy and gas distribution) and/or services to the public administration itself (*società strumentali*) or are active in other sectors of the economy (from agriculture to construction), often operating under in-house contracts (78 %). Regional governments own stakes in a further 403 bodies (including limited companies) which also are often loss-making and operating under in-house contracts.³⁹ For the former group, the Court reports that average wages increased by 13 %

³⁶ AGCM (2012), *Proposte di riforma concorrenziale ai fini della legge annuale per il mercato e la concorrenza, anno 2013*.

³⁷ OECD (2014) *Going for growth, Interim report 2014*.

³⁸ Corte dei Conti (2012), *Rapporto 2012 sul coordinamento della finanza pubblica*. The survey covered 7 200 local authorities out of the more than 8 000.

³⁹ Corte dei Conti (2014), *Rapporto 2014 sul coordinamento della finanza pubblica*.

from 2010 to 2012 (as compared with 4 % in the economy as a whole) and that around 35 % of the companies recorded losses in at least one financial year over the period 2008-2010.⁴⁰ Around 60 % of the total losses (EUR 1.4 billion) were borne by companies that do not provide services of general economic interest. Furthermore, there is scope for improving the transparency of public service contracts, notably with regard to the definition of service operators' responsibilities and their compensation, thereby increasing service operators' accountability. After legislation passed in 2012 to contain the use of in-house providing to very specific cases, was repealed by the Constitutional Court in 2012⁴¹, the current Italian legislation requires that: (i) those local authorities which have recourse to in-house provision publish a report explaining the rationale behind their choice and demonstrate that requirements under EU public procurement law were met; (ii) existing contracts not complying with EU law are rectified by 31 December 2013 (extended *de facto* to 31 December 2014 by the Stability Law 2014); and (iii) the budget of each authority and of the entities it holds stakes in are consolidated. If concretely applied, these provisions may significantly contribute not only to ensuring compliance with EU law, but also to fostering market openness and competition. On a positive note, the national reform programme foresees the rationalisation of the legislation on local public services by September 2014, also with the view to improving efficiency and fostering competition and market access, and the setting up of instruments for the market valorisation of enterprises controlled by regional and local governments.

Inefficiencies are particularly critical in local and regional transport services. Local public transport services account for around 28% of companies in local public services. Recent research show ample evidence of inefficiencies, in terms of substantial oversupply, high ticket evasion, fragmentation as well as of underinvestment in the fleet.⁴² With regard to road transport alone, data also show that Italian companies have lower revenues per km than their counterparts in the UK, Germany, France, Sweden, Belgium and the Netherlands (EUR 1.08 per km versus average of EUR 1.34 per km) and receive higher public subsidies (EUR 2.2 per km versus average of EUR 1.4 per km).⁴³ The national reform programme foresees a package of measures to be adopted by December 2014, which includes the increasing use of open tendering and standard costs in public procurement and of intelligent transportation systems. If correctly designed and swiftly implemented, the package could considerably contribute to address the structural weaknesses of the sector.

The system of authorisation/concessions, notably for hydroelectric and maritime activities, hinders domestic market access and departs from internal market principles. For hydroelectric activities, current authorisation schemes are not in line with the rules established by the EU Services Directive. Competitive procedures for their attribution have not been put in place yet and the impartiality and transparency of the procedure is hindered by the duration of the concessions. In maritime concessions, their long duration (also due to

40 Autorità Garante per il Mercato e la Concorrenza (2013), *Audizione presso la IX Commissione della Camera dei Deputati — Indagine conoscitiva sul settore del trasporto pubblico locale*.

41 Corte Costituzionale (2012), Sentenza 199/2012.

42 Cassa Depositi e Prestiti (2013), *Mobilità urbana*, Studio di Settore 04.

43 Autorità Garante per il Mercato e la Concorrenza (2013), *Audizione presso la IX Commissione della Camera dei Deputati - Indagine conoscitiva sul settore del trasporto pubblico locale*.

repeated extensions) limit consumer choices and increase the cost of services. Also affecting tourism, exceptions to the recent liberalisation of tourist guide services continue to restrict competition.

Network industries

In telecommunication, limited progress has been made in rolling out the fixed high-speed broadband network. Fixed high-speed broadband coverage, penetration and average speed are among the lowest in the EU. The limited availability of broadband contributes to the low take up of e-commerce, with only 20 % of Italian consumers buying goods or services online in 2013, among the lowest percentages in the EU.⁴⁴ Following the Commission approval of the framework notification for the ultra-broadband strategic plan in December 2012, procedures for publicly funded next-generation access projects have been launched in several regions (mainly in convergence regions, through structural fund allocations for the 2007-2013 period). Progress is, however, slow due to insufficient political commitment from regional authorities. So far, only in one major project (Campania), contracts have been awarded. With regard to private investments, projects extending optic fibre cable closer to customers are being implemented by the incumbent and some alternative operators and some legislative and implementing measures reducing the cost of deployment have been adopted. However, alternative operators still face difficulties in accessing the existing fixed infrastructure on the terminating segment in the absence of fully alternative infrastructure (such as cable) and pending final decisions on access conditions and functional unbundling of this legacy network from the incumbent operator. Furthermore, national regulatory requirements are imposed on cross-border information society service providers, which may limit the freedom of establishment. With regard to mobile broadband, deployment of 4G mobile networks is progressing according to plan.

A fully operational Transport Authority needs to deliver on its mandate, including the opinion on the unbundling in the railway sector. The Transport Authority, legally established in 2011, was set up in September 2013. However, it is not fully operational since a large part of the envisaged staff has yet to be recruited. It is important that the Transport Authority swiftly submits its opinion on the separation of infrastructure management and transport operations (unbundling) in the railway sector, which was expected to be delivered already in June 2013 and also foreseen in the national reform programme. The sector still shows important weaknesses. Railway network length per 1 000 inhabitants is among the lowest in the EU while its utilisation rate is among the highest. Despite an infrastructure investment rate above the EU average, bottlenecks remain in some regions, particularly in the south of the country. Customer satisfaction is among the lowest in the EU.⁴⁵

Weak management and lack of interconnections at ports hamper Italy's trade potential. Italy's trade would greatly benefit from better ports. The lack of intermodal connections with the hinterland remains one of the major causes of inefficiency. Furthermore, lengthy and costly administrative and customs procedures, insufficient coordination and strategic planning of port development also affect their functioning. The processing speed of extra-EU export by

⁴⁴ Eurostat (2013), Community Survey on ICT usage in household and by individuals.

⁴⁵ Italy ranked 3rd lowest EU-wide in an aggregate index of satisfaction with railway stations and travels. See European Commission (2013), Flash Eurobarometer 382a, http://ec.europa.eu/public_opinion/flash/fl_382a_en.pdf.

seaports was in 2012 19 days against the EU average of 11.4 days, when the best performers in the EU (DK, EE) handle export processing within 5 days. Respectively import processing speed was 18 days against the EU average of 10.9 days.

The competition framework for electricity is sound and substantially improved for gas, but electricity prices remain high. In the gas sector, the unbundling of the incumbent operator from the network manager was completed as planned in 2013, which is an important milestone in the sector's market opening process. At the same time, since October 2013, the reference price for gas has been set on the basis of spot-market prices alone and no longer on oil indexation. According to the Italian Energy Authority, this has brought about a reduction in gas prices to end users of about 7%. In electricity, while the competition framework is already well advanced, end users' prices are, however, among the highest in Europe, which weigh on the cost-competitiveness of Italian firms. The high electricity prices result primarily from a combination of elevated energy supply costs (due mainly to heavy reliance on imported gas) and high taxes and levies. The latter include subsidies for renewables and other unrelated taxes and levies (*oneri impropri*) added to the electricity bill. To alleviate cost pressures on firms', the national reform programme sets the objective of reducing by 10% the electricity bill for small and medium-sized enterprises through a budgetary-neutral rationalisation of the charges in the electricity bill, but details are not specified.

Infrastructure bottlenecks hamper the proper functioning of energy market. Insufficient grid capacity reduces liquidity in the electricity market and contributes to higher wholesale prices. In the gas sector, security of supply is at risk at certain times due to insufficient storage capacity. The national strategy for energy adopted in 2013 required the government to approve a list of strategic infrastructures⁴⁶, which is still pending mainly due to the difficulty of coordinating regional and central governments. *Terna*, the electricity transmission system operator, has projects for an amount of EUR 1.4 billion currently awaiting authorisation, although the situation has somehow improved since 2011, when pending projects amounted to more than EUR 2 billion.

Italy aims at over-achieving the EU 2020 climate and energy targets but the greenhouse gases target will be missed based only on existing measures. According to the national energy strategy, the EU 2020 targets are set to be over-achieved.⁴⁷ Indeed, the target for energy efficiency has been achieved and some progress has been made for renewable energy.⁴⁸ The Fifth Energy Account reached its cap of EUR 6.7 billion for photovoltaic in June 2013; regarding other renewable sources (cap of EUR 5.8 billion), the support within this instrument reached EUR 4.6 billion in December 2013. Other measures included the reinforcement of the white certificate scheme, and new tax incentives for energy efficiency measures and biogas. Concerning greenhouse gases, emissions in non-ETS sectors in 2012

⁴⁶ Decreto Interministeriale 8 Marzo 2013.

⁴⁷ The national energy strategy sets the following targets: 21% reduction of greenhouse gas emissions compared to 2005 (original objective set for Italy: 18% for total ETS and non-ETS emissions); 19-20% energy from renewable sources (original objective set for Italy: 17%) and 24% reduction of primary energy consumption (original objective: 20% reduction at EU level).

⁴⁸ The share of renewables in gross final energy consumption increased from 12.3% in 2011 to 13.5% in 2012 against the Europe 2020 target of 17%. The level of primary energy consumption stood at 155.2 Mtoe in 2012, below the Europe 2020 target.

were 16.8 % lower than in 2005. However, national projections foresee that emissions will increase again and the 2020 target would be missed by about 3.5 % in a scenario with existing measures only. New actions have been foreseen within the updated national plan for the reduction of greenhouse gas emissions approved in 2013. Furthermore, waste management (particularly in southern Italy) and water infrastructure show serious shortcomings. Similarly, land management and environmental protection remain challenging, with substantial costs from air pollution and floods. 49

Research and innovation

Some recent steps may contribute to a more open and competitive research system, in line with the objectives of the European Research Area. Institutional funding is increasingly distributed on the basis of the results of the quality evaluation of research carried out by the university and research evaluation agency (ANVUR), although with the significant limitation discussed under Section 3.2 (education). Moreover, international peer review was introduced for evaluating open calls for proposals and is now widespread. A national system for the certification of the applications to professorship was set up to improve transparency and merit-based recruitment in universities, an area in which Italy is particularly lagging behind other European Research Area countries. The steady decrease in funding allocated through open calls and the lack of career opportunities for young researchers limit, however, the potential beneficial effects of these reforms.

However, limited progress was made in fostering Italy's research capacity in the private sector. In 2012, research and development as a proportion of GDP was 1.27 %, still below the national Europe 2020 target of 1.53 %, with the largest gap in the private sector (0.69 % of GDP compared with an EU average of 1.30 %). Cooperation between private businesses and public institutions is also much lower than the EU average. Further to the measures discussed in Section 3.2 to facilitate the financing of innovation, research and development tax credits (EUR 600 million per year for the period 2014-2016) and incentives for hiring highly-qualified staff were introduced. In addition, eight technological clusters were identified in key research areas with 30 projects selected through calls for proposals. These measures go in the right direction, but their potential impact is limited also due to delays in implementation. For instance, the calls for proposals for the technological clusters took 2.5 years to be completed and the definition of smart specialisation strategies needed to implement European structural and investment funds over the 2014-2020 period is behind schedule.

Box 4: Potential impact of structural reforms on growth – a benchmarking exercise

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as tax reform, product market regulation and labour market participation. Improvements on

49 For floods: Risk and Policy Analysts (2014), Study on Economic and Social Benefits of Environmental Protection and Resource Efficiency related to the European Semester, Report for the European Commission, DG Environment; for air pollution: Impact Assessment of the Commission Integrated Clean Air Package (2013), see: http://ec.europa.eu/environment/air/clean_air_policy.htm.

these indicators could raise Italy's GDP by about 4.2 % in a 10-year period. Some reforms could have an effect even within a relatively short time horizon. The model simulations corroborate the analysis of this staff working document, according to which the largest gains would likely stem from shifting taxation away from labour and increasing women's participation in the labour market. The simulations also confirm the importance of reducing entry costs for businesses and opening markets to competition, as indicated in Section 3.4. In the very long run, moreover, improving education could also have a noticeable impact on GDP, yielding a potential benefit of 11.8% over a 50-year horizon (see note).

Table: Structural indicators, targets and potential GDP effects⁵⁰

Reform areas		IT	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.16	0.13	0.2	0.3
Market regulation	Entry costs	18.2	0.13	0.1	0.4
Tax reform	Implicit consumption tax rate	17.4	28.6	0.5	0.7
Skill enhancing reforms*	Share of high-skilled	4.1	10.7	0.1	0.1
	Share of low-skilled	42.8	7.5	0.0	0.2
Labour market reforms	Female non-participation rate (25-54ys):			0.5	1.2
	- low-skilled	50.1	26.4		
	- medium-skilled	27.7	10.5		
	- high-skilled	16.8	4.3		
	Low-skilled male non-participation rate (25-54ys)	13.8	7.7	0.2	0.3
	Elderly non-participation rate (55-64ys):			0.3	0.6
	- low-skilled	20.6	13.4		
	- medium-skilled	7.9	4.8		
	- high-skilled	4.7	3.3		
	ALMP (% of GDP over unemployment share)	8.8	37.4	0.3	0.3
Benefit replacement rate**	9.2	52.6	0.0	0.0	
Total				2.2	4.2

Source: Commission services. Note: Simulations assume that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. If the country is above the benchmark for a given indicator, we do not simulate the impact of reform measures in that area; however, the Member State in question can still benefit from measures taken by other Member States.⁵¹ * The long-run effect of increasing the share of high-skilled labour in the population could be 4.2% of GDP and of decreasing the share of low-skilled labour could be 7.6%. ** EU average is set as the benchmark.

50 Final goods sector mark-ups is the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme. For a detailed explanation of indicators see Annex.

51 For a detailed explanation of the transmission mechanisms of the reform scenarios see: European Commission (2013), 'The growth impact of structural reforms', Chapter 2 in QREA No 4. December 2013. Brussels;

http://ec.europa.eu/economy_finance/publications/qr_euro_area/2013/pdf/qrea4_section_2_en.pdf

3.5.Modernisation of public administration

Despite efforts, inefficiencies in the public administration, including the judicial system, continue to weigh on Italy's competitiveness and growth and slow down the implementation of reforms. Italy's performance on the indicators of the World Bank relating to the business environment, government effectiveness, the quality of regulation and the rule of law are among the lowest in the EU.⁵² Critical issues concern the heavy backlog of cases and long duration of court proceedings in civil justice, inefficiencies in public procurement and in the management of EU funds in southern Italy, as well as the unclear and inefficient coordination and allocation of competences among the different layers of government. As discussed in the in-depth review on the Italian economy, these inefficiencies weigh on cost competitiveness and public finances, thus reinforcing Italy's imbalances, and slow down the implementation of reforms.

The analysis in this staff working document leads to the conclusion that Italy has made limited progress in addressing the 2013 recommendation in these areas (for the full assessment of Italy's response to country-specific recommendations, see the overview table in Section 4).

Efficiency of the public sector and business environment

Implementation remains challenging, despite recent initiatives. Some efforts have been made to limit the need for secondary legislation, which slows down the implementation of provisions. For laws and decrees enacted by the Letta government, 82 % of provisions were directly applicable.⁵³ Furthermore, a law adopted in August 2013 introduced financial penalties for administrations responsible for delays in administrative procedures and reinforced the use of digital technologies for administrative acts.⁵⁴ Overall, however, implementation remains challenging. The monitoring report published in December 2013 by the Italian government shows that, of the 313 implementing acts required by legislation that entered into force from April to December 2013, only 15 % had already been adopted. One in five had not yet been adopted despite the terms having expired. Furthermore, as discussed in other parts of this report, very important pieces of legislation introduced in 2011 and 2012, for instance to improve the business environment, the labour market, or reform taxation, have not yet been implemented.

The coordination between the various layers of government still needs to be clarified. The implementation of the adopted measures has often been hampered by insufficient coordination between the central and local levels of government and lack of clarity on the division of responsibilities among them. Relevant examples are discussed in other parts of this report with regard to job placement services, infrastructures in network industries, research and education policies, implementation of product market reforms, and the management of EU funds. Building on the 2001 reform of Title V of the Italian Constitution, which governs the allocation of regulatory and spending powers across government levels, a draft constitutional amendment bill was adopted by the government in March 2014, with the

⁵² World Bank (2013), 2013 Worldwide Governance Indicators; World Bank (2014), Doing Business 2014.

⁵³ See: http://www.governo.it/Presidenza/UPG/monitoraggio/ReportAttuazione_20131231.pdf.

⁵⁴ Decree law 69/2013 (*decreto 'del Fare'*), converted into Law 98/2013

ambition of further revising this chapter of the Constitution. In particular, the draft constitutional amendment bill brings some competences back to the central level and strives to reduce conflicts over the division of responsibilities. According to the national reform programme, the bill is expected to be finally approved by the Italian Parliament by the end of the 2015.

Limited simplification measures to improve the business environment were taken and their impact is hampered by slow implementation and difficult coordination between regional and central governments. Italy's business environment remains very unfavourable. Starting up a business is very costly and getting a construction permit is cumbersome.⁵⁵ Some simplification measures were taken in two successive packages (June 2013 and February 2014).⁵⁶ Their scope is, however, rather limited. The government estimates the cumulative savings of the first package at EUR 500 million per year.⁵⁷ A more comprehensive draft law on simplification was presented in Parliament in June 2013 but has not yet been adopted. The unclear division of responsibilities between the central and regional governments continue to hamper the effectiveness of the simplification measures taken at central level. To address this issue, the government is working with the regions and other local entities on an 'Agenda for simplification', but this has yet to prove its effectiveness. Article 1 of Law 24/2012 intended to eliminate all restrictions to economic activity (permits, authorisations, planning provisions) that were not justified by the general interest pursued (or were disproportionate) on the basis of a thorough scrutiny of existing legislation by the government. The article also included some reward mechanisms for those regional and local authorities that promptly adapted their legislation and administrative procedures to the principles of the law. However, implementing legislation has not been adopted.

Steps are being taken to reduce the payment delays of the public administration. In April 2014, the government adopted a decree law, included in the national reform programme, setting forth measures to reduce the time delays related to payments by the public administration.⁵⁸ An electronic platform is set up where, starting from July 2014, all public administrations will be obliged to register any outstanding debt arisen since January 2014 and to update monthly the payment status (with sanctions in case of no compliance). The platform also makes possible the introduction of e-invoicing, which is expected to be fully operational as of March 2015. This is expected to contribute to reducing payment times and ensuring the transparency of public accounts. The harmonization of the accounting system across all layers of public administrations, started in 2009 and expected to be fully operational in 2015, should increase transparency and certainty on public expenditure. Until then, however, the existing accounting system of public administrations will not allow for a detailed and timely recognition of the current stock of commercial debt and the residual amount of arrears to be paid will still be unknown.

The reform of public employment and the quality of regulation have yet to be comprehensively tackled. The number of public employees has fallen by over 6 % over the

⁵⁵ World Bank (2014), Doing Business 2014, available at <http://www.doingbusiness.org>

⁵⁶ Decree law 69/2013, converted into Law 98/2013; Decree law 145/2013, converted into Law 9/2014.

⁵⁷ http://www.funzionepubblica.gov.it/media/1066528/semplificazione_amministrativa_aprile2013.pdf.

⁵⁸ Decree law 66/2014 (not yet converted into law).

period 2007-2012 and is broadly in line with the OECD average as a percentage of the labour force. The strongest reduction was in the education sector. The containment of the number of public employees took place primarily through controlled turn-over, as it happened already during the run-up to the introduction of the euro. This resulted in an increase of the average age of civil servants, which is now among the highest across the OECD countries.⁵⁹ Issues related to geographical distribution of public employees, performance valuation and accountability persist.⁶⁰ A wide-ranging reform adopted in 2009 is largely unimplemented.⁶¹ The national reform programme announces an ambitious plan to reduce average age, enhance staff mobility, introduce a new system of incentives linked to the appraisal of staff performance, enhance managerial responsibility and accountability, and contain the pay of top management. The level of detail is, however, insufficient for a full assessment. As for quality of regulation, enhancing the capacity for evidence-based policy-making is crucial. Quantified impact assessment and other evidence-based approaches such as systemic evaluations may support an analysis of the root causes of systemic administrative shortcomings, an assessment of the impact of current reforms and, on this basis, the design of new schemes.

Public procurement needs to be improved in a systemic manner. Enhanced capacity building and further rationalisation of public procurement, notably through the use of central purchasing bodies, can improve Italy's public procurement systemic issues and can generate significant savings in the public sector. The Commission estimated that e-procurement can generate 5 % to 20 % of savings in total public procurement expenditure. ⁶² The take-up of e-procurement in Italy in 2011 was estimated between 0% and 5% (while the EU average is above 10 % and leading countries such as Portugal, United Kingdom or Sweden show take-up of 30 to 50 %).⁶³ Currently many Italian regions, counties and towns are building their own e-procurement systems. These are numerous and often non-interoperable, while there is little coordination at national level to avoid duplications. The process of transposition of the new EU public procurement and concessions directives ⁶⁴ and subsequent implementation represents an ideal opportunity for a strategic, systemic and in-depth review of the Italian public procurement system. In April 2014, the government adopted a decree law with measures that, if correctly implemented, may contribute to gradually improve the efficiency

⁵⁹ OECD (2013), Government at a Glance.

⁶⁰ Consiglio Nazionale dell'Economia e del Lavoro (2012), Rapporto sul mercato del lavoro 2011-2012.

⁶¹ Consiglio Nazionale dell'Economia e del Lavoro (2012), Rapporto sul mercato del lavoro 2011-2012.

⁶² European Commission (2013), A strategy for e-procurement, COM/2013/0179, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0179>. E-procurement is defined as the use of electronic communications and transaction processing by public sector organisations when buying supplies and services or tendering public works.

⁶³ European Commission (2012), End-to-end e-procurement to modernise public administration, COM/2012/0453, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52013DC0453>. Take-up is estimated as the value of public procurement for which companies submitted offers electronically in the country, divided by the total value of procurement in the country.

⁶⁴ Directives 2014/23/EU; 2014/24/EU; and 2014/25/EU.

of public procurement, including through the use of central purchasing bodies, better control and reduction of purchasing price differences.⁶⁵

Justice and corruption

Some steps have been taken in civil, commercial and administrative justice but their impact on the efficiency of the system needs to be monitored. The reorganisation of courts prompted by the September 2011 law was completed by the end of 2013, which should optimise the scale of law courts, allow specialisation and create economies of scale. Some initial positive impact has been noted. The courts' capacity to resolve civil and commercial cases has increased (except for the highest court) but the number of pending cases remains very high. ⁶⁶ In late 2013, compulsory mediation was introduced for some specific matters in both civil and commercial procedures.⁶⁷ Evidence to date shows, however, that in half of the mediation procedures started, the respondent did not attend the mediation meeting. Further measures were included in a draft law in December 2013, which is now being discussed in Parliament. Overall, the impact of the range of measures taken to improve the efficiency of the justice system should be felt over time and will need to be carefully monitored. The national reform programme announces further measures for improving the functioning of civil as well as administrative justice to be adopted by June 2014. The level of detail does not allow a proper assessment of the measures at this stage.

The anti-corruption law of 2012 is slowly being deployed. The government adopted a number of implementing decrees for the 2012 anti-corruption law. The code of ethics for the public administration was also a relevant step. Other parts of the law are encountering more implementation difficulties. First, the National Anti-corruption Authority for the Evaluation and Transparency of Public Administrations (ANAC), in charge of coordinating preventive anti-corruption policies nation-wide, of which members have been increased from three to five in 2013⁶⁸, counts only limited staff and lacks sanctioning powers. Second, the obligation on all administration bodies to submit draft three-year national anti-corruption plans and integrity action plans, albeit a positive step, runs the risk of turning into a bureaucratic process focused on stylised documents and institutional settings rather than on putting targeted measures into action to address vulnerabilities.

Italy has not yet revised the statute of limitations. Lengthy court proceeding in combination with the Italian statute of limitations (notably the short prescription period with an absolute time bar that cannot be interrupted or suspended) can represent a serious problem

⁶⁵ Decree law 66/2014 (not yet converted into law)

⁶⁶ The clearance rate – the ratio of the number of resolved cases over the number of incoming cases in a year – for litigious civil and commercial cases at first instance increased from 118 % in 2010 to 131 % in 2012. The total number of pending civil and commercial non-litigious cases on 1 January 2012 in First Instance was 3 796 202. *Sources:* European Commission, *The 2014 EU Justice Scoreboard* & Council of Europe (CEPEJ), *Study on the functioning of judicial systems in the EU Member States: Facts and figures from the CEPEJ 2012-2014 evaluation exercise*, prepared for the European Commission.

⁶⁷ Mandatory mediation was firstly introduced in 2011 but the law was declared unconstitutional in 2012 (however not for reasons pertinent to the institution itself), leading to a significant decrease in the number of mediation decisions. It was then reintroduced in 2013.

⁶⁸ Law 125/2013.

in the fight against corruption in Italy, as recognized by the Group of States against Corruption of the Council of Europe (GRECO).⁶⁹ According to Transparency International's 2010 study on the impact of statutes of limitations on prosecution of corruption in the EU, in Italy, roughly one in ten proceedings in criminal cases had been closed because the statute of limitations expired over the period 2005-2010. The situation does not appear to have improved, in spite of the 2013 country-specific recommendation and of the concerns expressed repeatedly by the GRECO and the OECD since 2009. The national reform programme foresees a revision of the statute of limitations by June 2014, without specifying, however, the details of the measure.

Structural funds

Limited have been taken to date to improve the management of EU funds. At the end of 2013, a new Agency for territorial cohesion with specific powers to manage structural funds was set up. This decision is a welcome first step. However, operational delays, a lack of clarity about the actual mandate of the agency in relation to the regional authorities and uncertainties about its staff cast doubts on the agency's ability to bring about the change required. Moreover, the Agency cannot be a substitute for decisive action to tackle the problem of administrative capacity, primarily at regional level and, to some extent, within a certain number of national bodies. The national reform programme and the draft Partnership Agreement for the 2014-2020 period, officially submitted by Italy on 22 April 2014, both outline a series of measures aimed at strengthening capacity, including the need for all managing authorities to prepare an administrative reinforcement plan, endorsed at the highest administrative and political level, and defining the minimum level of structure and competences necessary to manage the significant level of resources entrusted to them. Both documents, however, fail to explain the concrete steps envisaged at central level to steer and follow the overall process. Furthermore, lack of human resources in the public administration is identified as one of the main, though not the only one, reason for the existing weaknesses with the risk that, at operational level, additional recruitment might, in the end, be seen as the only and easier solution to the problem.

4. CONCLUSIONS

Long-standing weaknesses weigh on the Italian economy. The very high public debt represents a heavy burden and a major source of vulnerability for the Italian economy, particularly in a context of protracted slow growth and low inflation. Productivity growth is sluggish, rooted in an inefficient public administration and taxation system, weak human capital endowment and unfavourable business environment. Labour market participation continues to be very low among women and young people, especially in southern regions, which is an important untapped source of growth. Declining cost and non-cost competitiveness adversely affect Italy's export performance. The pace of reform is insufficient to address these challenges and the implementation of past reforms is lagging in many areas.

⁶⁹ This has already caused GRECO to issue a relevant recommendation to Italy in the context of the Joint First, Second and Third Round Evaluation Report, available at http://www.coe.int/t/dghl/monitoring/greco/evaluations/index_en.asp.

The analysis in this staff working document leads to the conclusion that Italy has made limited progress in addressing the 2013 country-specific recommendations. The headline deficit remained at 3% of GDP despite the sharp contraction in output. However, the adjustment path towards the medium-term objective has slowed down. A new spending review has been launched, but needs still to be enacted. Substantial progress was made to improve the functioning of gas market with the unbundling of the incumbent operator from the network manager. Some steps were taken to reduce the tax burden on labour and to ease and diversify firm's access to finance. With regard to civil justice, the geographical re-organisation of courts was completed, which should help reaping economies of scale, and a new law on mediation was introduced as an alternative means of dispute settlement. The labour market and wage-setting reforms are being implemented at uneven pace, with delays in the area of activation and some steps were taken to better target social expenditure. Limited progress was made in all the other areas covered by the 2013 recommendations.

The priorities presented in the 2014 national reform programme echo the main challenges identified in the 2014 in-depth review on Italy and this staff working document. The national reform programme presents a comprehensive, ambitious and time-bound plan for action over the programme horizon aimed at: reviewing and enhancing the efficiency of public expenditure; reviewing the institutional setting in order to streamline law-making and facilitate implementation; reforming the taxation system; further improving product and labour markets; improving the education system; simplifying the regulatory environment; and modernising the public administration, including justice. The measures envisaged in the plan signal welcome reform intentions, which could help to effectively tackle the challenges faced by Italy, if appropriately designed, implemented in a rigorous manner and in respect of the timetable set in the programme.

The stability programme postpones the achievement of the medium-term objective to 2016, whereas in July 2013 Italy was recommended to achieve it by 2014. This slower adjustment path is justified in the programme by the severe economic conditions and the effort needed to implement an ambitious programme of structural reforms. The stability programme targets would allow Italy to comply with the debt reduction benchmark over the 2013-2015 transition period, partly thanks to an ambitious privatisation plan to be implemented over 2014-2017. Greater details on the further fiscal consolidation measures required to achieve the targets of the programme would further enhance the robustness of the document. Broad coherence between the national reform programme and the stability programme has been ensured.

OVERVIEW TABLE⁷⁰

	Commitments	Summary assessment
1	<i>Ensure that the deficit remains below 3 % of GDP in 2013, by fully implementing the adopted measures. Pursue the structural adjustment at an appropriate pace and through growth-friendly fiscal consolidation so as to achieve and maintain the MTO as from 2014. Achieve the planned structural primary surpluses in order to put the very high debt-to-GDP ratio on a steadily declining path. Continue pursuing a durable improvement of the efficiency and quality of public expenditure by fully implementing the measures adopted in 2012 and taking the effort forward through regular in-depth spending reviews at all levels of government.</i>	<p>Italy has made limited progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • The 2013 deficit remained at 3% of GDP. In the Commission 2014 spring forecast, the headline deficit is projected to decline to 2.6 % of GDP in 2014. However, the achievement of the medium-term objective is now targeted for 2016, as compared with 2014 planned in April 2013 and recommended in July 2013 by the Council. • Italy risks non-compliance with the Stability and Growth Pact rules. In particular, the annual structural adjustment of only 0.1 percentage point of GDP forecast for 2014 falls short of the 0.7 percentage point of GDP minimum linear structural adjustment that, according to the Commission forecast, would be required to comply with the debt benchmark in the 2013-2015 transition period. • A spending review has been launched. It now needs to be adopted and implemented also to finance the announce cut to the personal income tax for low-income employees.
2	<i>Ensure timely implementation of on-going reforms by swiftly adopting the necessary enacting legislation, following it up with concrete delivery at all levels of government and with all relevant stakeholders, and monitoring impact. Reinforce the efficiency of public administration and improve coordination between layers of government. Simplify the administrative and regulatory framework for citizens and business and reduce the duration of case-handling and the high levels of litigation in civil justice, including by fostering out-of-court settlement procedures. Strengthen the legal framework for the repression of corruption, including by revising the rules governing</i>	<p>Italy has made limited progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • Some progress in improving the functioning of civil justice. The geographical re-organisation of courts has been implemented. Other measures were taken including a new law on mediation and a December 2013 bill to improve the functioning of the justice system. Despite these measures problems persist (lengthy duration of proceedings, high number of pending cases). • Limited progress in addressing implementation gaps. Measures were taken to contain the need for secondary legislations and monitor implementation of past reform, but implementation gaps remains very important. • Limited progress towards administrative simplification.

70 The following categories are used to assess progress in implementing the 2013 country-specific recommendations of the Council Recommendation: **No progress**: The Member State has neither announced nor adopted any measures to address the country-specific recommendation. This category also applies if a Member State has commissioned a study group to evaluate possible measures. **Limited progress**: The Member State has announced some measures to address the country-specific recommendation, but these measures appear insufficient and/or their adoption/implementation is at risk. **Some progress**: The Member State has announced or adopted measures to address the country-specific recommendation. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. **Substantial progress**: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the country-specific recommendation. **Fully addressed**: The Member State has adopted and implemented measures that address the country-specific recommendation appropriately.

	<p><i>limitation periods. Adopt structural measures to improve the management of EU funds in the southern regions with regard to the 2014-2020 programming period.</i></p>	<p>Piecemeal measures with limited impact were taken but a draft law on simplification presented to the parliament in June 2013 has not been adopted yet and major reforms undertaken in 2012 are not being implemented.</p> <ul style="list-style-type: none"> • Limited progress in the fight against corruption. The anti-corruption agency was reformed but remains understaffed and no notable action was taken to revise the statute of limitations. • Limited progress was made regarding the upgrading of administrative capacity for the management of EU funds. Italy. A new Agency for territorial cohesion was set up but operational delays and uncertainties about its personnel and competences cast doubts on its capacity to bring about the change required by the challenge. The draft Partnership Agreement for the 2014-2020 programming period outlines a series of measures at national level but does not address the need to improve the administrative capacity of the bodies in charge of funds.
3	<p><i>Extend good corporate governance practices to the whole banking sector conducive to higher efficiency and profitability to support the flow of credit to productive activities. Take forward the on-going work as regards asset-quality screening across the banking sector and facilitate the resolution of non-performing loans on banks' balance sheets. Promote further the development of capital markets to diversify and enhance firms' access to finance, especially into equity, and in turn foster their innovation capacity and growth.</i></p>	<p>Italy has made some progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • Some progress in easing firms' access to credit. This includes in particular a strengthened loan guarantee scheme and a renewal of the existing debt moratorium. • Some progress in developing non-bank funding. The main measure is the strengthening of the allowance for new corporate equity. Other measures (mini-bonds, tax incentives for investment in innovative start-ups) were taken, but their impact remains to be seen. • Some progress on asset quality screening: the Bank of Italy conducted a thorough asset quality review of 20 Italian banks over 2012–13. The 2014 Stability Law enhanced the tax deductibility for banks' loan-loss provisions, which should contribute to an increase in non-performing loan coverage. • Some progress on corporate governance in banks. The Bank of Italy has issued new corporate governance principles for banks, but their impact depends on actual implementation and enforcement..
4	<p><i>Ensure the effective implementation of the labour market and wage setting reforms to allow better alignment of wages to productivity. Take further action to foster labour market participation, especially of women and young people, for example through a Youth Guarantee. Strengthen vocational education and training, ensure more efficient public employment services and improve career and counselling services for tertiary students. Reduce financial disincentives for second earners to work and improve the provision of care, especially child- and long-term care, and out-of-school services. Step up efforts to prevent early school leaving. Improve school quality and outcomes, also by enhancing teachers' professional development and diversifying career development. Ensure</i></p>	<p>Italy has made limited progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • Some progress in implementing the labour market and wage-setting reforms. Most implementing legislation of the 2012 labour market reforms has been adopted. The March 2014 decree law further simplifies the regulation of fixed-term and apprenticeship contracts. Criteria for representativeness in collective bargaining were set in January 2014, which may foster decentralisation of bargaining. The measures to upgrade public employment services however still need to be implemented and the effectiveness of active labour market policies remains low. The national reform programme announces further measures as regards to contractual simplification, the reform of unemployment benefits and the systematisation of active labour market policy. • Limited progress has been made in addressing youth

	<p><i>effectiveness of social transfers, notably through better targeting of benefits, especially for low-income households with children.</i></p>	<p>unemployment. Some measures were taken but their scope and the resources allocated are limited. The Youth Guarantee Implementation Plan is being examined by the Commission.</p> <ul style="list-style-type: none"> • Limited progress on women's labour market participation, with regard to both childcare and long-term care and disincentives to work for second earners. Some measures to reduce disincentives to work for second-earners and foster parenthood are included in an enabling law adopted by the government in April 2014. • Some progress on the effectiveness of social transfers. A 'social inclusion card' pilot project targeted to low-income households with children is in place and is planned to be extended to the whole territory. • Limited progress on education. Measures have been taken on career guidance and early school leaving. Initiatives to strengthen vocational education and training are of limited scope and impact. The issue of enhancing the teaching profession remains largely unaddressed.
5	<p><i>Shift the tax burden from labour and capital to consumption, property and the environment in a budgetary neutral manner. To this purpose, review the scope of VAT exemptions and reduced rates and of direct tax expenditures, and reform the cadastral system to align the tax base of recurrent immovable property to market values. Pursue the fight against tax evasion, improve tax compliance and take decisive steps against the shadow economy and undeclared work.</i></p>	<p>Italy has made limited progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • Some progress in shifting the tax burden away from productive factors. The 2014 Stability Law decreased the tax burden on labour and further measures were taken in April 2014 to reduce the tax wedge, but fully financed only for 2014. The standard rate of VAT was raised but VAT exemptions and reduced rates have not been reviewed. Furthermore there has been no structural reform of direct tax expenditure and cadastral values have not been updated to reflect real market values (an enabling law to these purposes was adopted in March 2014). • Limited progress to reform taxation, improve tax compliance and reducing tax evasion. The government has undertaken additional enforcement measures but decisive action to improve tax compliance and reduce tax evasion is missing. The March enabling law on taxation includes measures that, once implemented, could represent a significant step forward. Progress on reducing the shadow economy and undeclared work has been limited.
6	<p><i>Ensure the proper implementation of the measures aiming at market opening in the services sector. Remove remaining restrictions in professional services and foster market access for instance in the provision of local public services where the use of public procurement should be advanced (instead of direct concessions). Pursue deployment of the measures taken to improve market access conditions in network industries, in particular by setting-up the Transport Authority as a priority. Upgrade infrastructure capacity with focus on energy interconnections, intermodal transport and high-speed broadband in telecommunications, also with a view to tackling</i></p>	<p>Italy has made limited progress in addressing this recommendation:</p> <ul style="list-style-type: none"> • Limited progress in fostering market access in services. Some efforts have been made to open up and modernise the services sector, particularly a reform of professional associations (implementation is proceeding, with some challenges for the legal profession). However as stressed by the Italian Competition Authority, the issue of procurement and provision of local public services remains high on the agenda and needs to be addressed. • Substantial progress in improving market access conditions in energy; some progress in the transport sector. The Transport Authority has been set up and started work in January 2014 but is not yet fully

the North-South disparities.

operational: procedures for staff recruitment are ongoing. Inefficiencies in local transport services remain however to be addressed. In the energy, unbundling in the gas sector is complete and the functioning of gas and electricity markets has improved, although prices remain high.

- Limited progress in addressing infrastructure gaps. Weaknesses in energy interconnections and intermodal transport, notably at ports, are still a major bottleneck. Gaps remain also in telecommunications: existing investment plans seem insufficient to ensure that Digital Agenda objectives for high-speed broadband coverage are met.

Europe 2020 (national targets and progress)	
Employment rate target set in the 2012 NRP: 67-69 %	The employment rate was 61.2 % in 2011, 61 % in 2012 and 59.8 % in 2013. No progress has been achieved towards meeting the target.
research and development target set in the 2012 NRP: 1.53 % of GDP	Gross domestic expenditure on research and development was 1.25 % in 2011 and 1.27 % in 2012 (provisional). Very limited progress has been achieved towards meeting the target.
Greenhouse gas emissions target -13 % (compared with 2005 emissions); ETS emissions are not covered by this national target.	Non-ETS greenhouse gas emissions declined by 16.8 % between 2005 and 2012, which thus meets the 2020 target. However, according to the latest national projections submitted to the Commission and taking into account existing measures, emissions will increase again and it is expected that the target will be missed: -9.5 % in 2020 as compared with 2005 (i.e. a projected shortfall of 3.5 percentage points).
Renewable energy target: 17 %	Renewables' share of gross final energy consumption was 12.3 % in 2011 and 13.5 % in 2012. Some progress has been made towards the target.
Energy efficiency: absolute level of primary energy consumption of 158 Mtoe	In 2012, primary energy consumption in Italy stood at 155.2 Mtoe, which is within the 2020 target. This progress needs to be sustained over time.
Early school leaving target: 16 %	The early school leaving rate (the percentage of the population aged 18-24 with at most lower secondary education and not in further education or training) was 18.2 % in 2011, 17.6 % in 2012 and 17.0 % in 2013. Some progress has been made towards meeting this target.
Tertiary education target: 26-27 %	The tertiary educational attainment rate was 20.3 % in 2011, 21.7 % in 2012 and 22.4 % in 2013. Some progress has been made towards meeting this target.

<p>Target on the reduction of population at risk of poverty or social exclusion in number of persons:</p> <p>-2 200 000 (compared to 2008, thus corresponding to 12 899 0000 people at risk of poverty or social exclusion in 2020)</p>	<p>People at risk of poverty or social exclusion: 17 112 000 in 2011, 18 194 000 in 2012. No progress has been made in meeting this target.</p>
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ANNEX

Standard tables

Table I – Macro-economic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
Core indicators								
GDP growth rate	1.9	1.0	-0.2	0.4	-2.4	-1.9	0.6	1.2
Output gap ¹	1.0	1.4	0.5	-1.4	-3.0	-4.3	-3.6	-2.5
HICP (annual % change)	2.4	2.4	2.0	2.9	3.3	1.3	0.7	1.2
Domestic demand (annual % change) ²	2.4	1.2	0.0	-1.0	-5.0	-2.7	0.3	1.3
Unemployment rate (% of labour force) ³	10.9	8.3	7.2	8.4	10.7	12.2	12.8	12.5
Gross fixed capital formation (% of GDP)	19.6	20.7	20.5	19.1	18.0	17.3	17.5	18.1
Gross national saving (% of GDP)	21.6	20.5	18.7	16.7	17.6	18.1	19.0	19.4
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-3.0	-3.6	-3.6	-3.7	-3.0	-3.0	-2.6	-2.2
Gross debt	114.8	105.4	110.3	120.7	127.0	132.6	135.2	133.9
Net financial assets	-102.4	-94.4	-97.4	-97.8	-113.2	n.a	n.a	n.a
Total revenue	45.8	44.1	45.9	46.1	47.7	47.7	47.7	47.6
Total expenditure	48.9	47.6	49.5	49.8	50.7	50.8	50.3	49.8
<i>of which: Interest</i>	8.3	5.3	4.8	5.0	5.5	5.3	5.2	5.2
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-0.7	-0.7	-1.4	-0.6	1.3	1.3	1.0	1.2
Net financial assets; non-financial corporations	-89.6	-109.3	-126.4	-115.7	-119.3	n.a	n.a	n.a
Net financial assets; financial corporations	-7.7	-10.2	9.8	30.9	30.9	n.a	n.a	n.a
Gross capital formation	10.6	11.3	11.0	10.6	9.4	9.0	9.2	9.2
Gross operating surplus	23.9	23.6	21.8	20.9	20.1	20.3	20.0	20.4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	5.7	4.0	2.7	1.2	1.4	2.5	3.0	2.3
Net financial assets	197.1	203.1	190.2	166.0	177.8	n.a	n.a	n.a
Gross wages and salaries	28.7	29.1	30.6	31.1	31.4	31.4	31.3	31.0
Net property income	18.2	15.3	13.9	11.9	11.6	10.9	10.8	11.1
Current transfers received	20.7	20.9	22.5	23.9	24.4	25.0	25.2	25.2
Gross saving	12.8	11.5	10.2	8.3	8.0	9.0	9.6	9.6
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	1.9	-0.3	-2.2	-3.0	-0.2	0.9	1.5	1.5
Net financial assets	4.5	12.9	27.5	23.2	30.6	n.a	n.a	n.a
Net exports of goods and services	2.9	0.7	-0.9	-1.4	1.1	2.5	3.0	2.9
Net primary income from the rest of the world	-0.9	-0.5	-0.4	-0.6	-0.5	-0.6	-0.5	-0.5
Net capital transactions	0.2	0.1	0.0	0.0	0.2	0.0	0.0	0.0
Tradable sector	47.0	44.6	42.0	40.8	40.4	40.5	n.a	n.a
Non tradable sector	42.6	45.4	47.7	48.6	49.0	49.2	n.a	n.a
<i>of which: Building and construction sector</i>	4.6	5.2	5.6	5.3	5.3	5.0	n.a	n.a
Real effective exchange rate (index, 2000=100)	92.0	94.5	103.8	104.3	102.5	105.6	107.1	106.3
Terms of trade goods and services (index, 2000=100)	103.4	101.8	97.9	94.8	93.7	95.6	96.7	96.7
Market performance of exports (index, 2000=100)	126.6	107.3	94.9	91.9	93.8	93.0	92.7	91.9

Notes:

¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

² The indicator on domestic demand includes stocks.

³ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or

Source:

Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.

Table II – Comparison of macroeconomic developments and forecasts

	2013		2014		2015		2016	2017	2018
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	-1.9	-1.9	0.6	0.8	1.2	1.3	1.6	1.8	1.9
Private consumption (% change)	-2.6	-2.6	0.4	0.2	0.8	0.9	1.2	1.6	1.6
Gross fixed capital formation (% change)	-4.7	-4.7	1.6	2.0	4.0	3.0	3.6	3.8	3.8
Exports of goods and services (% change)	0.1	0.1	3.3	4.0	4.3	4.4	4.2	4.1	4.0
Imports of goods and services (% change)	-2.8	-2.8	2.7	2.8	4.8	4.4	4.1	4.2	4.2
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	-2.6	-2.6	0.4	0.5	1.3	1.1	1.3	1.6	1.7
- Change in inventories	-0.1	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0
- Net exports	0.8	0.8	0.2	0.5	0.0	0.2	0.2	0.1	0.1
Output gap ¹	-4.3	-4.4	-3.6	-3.6	-2.5	-2.7	-1.7	-0.9	0.0
Employment (% change)	-2.0	-2.0	-0.3	-0.6	0.5	0.8	0.8	1.1	1.0
Unemployment rate (%)	12.2	12.2	12.8	12.8	12.5	12.5	12.2	11.6	11.0
Labour productivity (% change)	0.0	0.1	0.4	1.4	0.8	0.5	0.7	0.7	0.9
HICP inflation (%)	1.3	1.3	0.7	0.9	1.2	1.2	1.5	1.5	1.5
GDP deflator (% change)	1.4	1.4	0.9	1.0	1.3	1.2	1.5	1.5	1.5
Comp. of employees (per head, % change)	1.4	1.4	1.1	1.0	1.3	1.4	1.3	1.3	1.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.9	0.9	1.5	1.5	1.5	1.5	1.5	1.6	1.7
<u>Note:</u>									
¹ In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the									
<u>Source:</u>									
Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.									

Table III – Composition of the budgetary adjustment

(% of GDP)	2013	2014		2015		2016	2017	2018	Change: 2013-18
	COM	COM	SP	COM ¹	SP	SP	SP	SP	SP
Revenue	47.7	47.7	47.9	47.6	47.8	47.5	47.2	46.9	-0.8
<i>of which:</i>									
Taxes on production and imports	14.5	15.0	15.0	14.7	15.1	15.0	14.9	14.9	0.4
Current taxes on income, wealth, etc.	15.3	14.9	15.3	15.3	15.2	15.1	15.1	15.0	-0.3
Social contributions	13.8	13.7	13.6	13.6	13.6	13.5	13.4	13.4	-0.4
Other (residual)	4.2	4.1	4.0	4.0	3.9	3.9	3.8	3.6	-0.6
Expenditure	50.8	50.3	50.6	49.8	49.9	49.0	48.1	47.3	-3.5
<i>of which:</i>									
Primary expenditure	45.5	45.1	45.4	44.7	44.9	43.9	43.2	42.5	-3.0
<i>of which:</i>									
Compensation of employees	10.5	10.3	10.3	10.1	10.0	9.7	9.4	9.1	-1.4
Intermediate consumption	5.6	5.3	5.4	5.4	5.3	5.2	5.2	5.2	-0.4
Social payments	23.3	23.4	23.5	23.2	23.4	23.1	23.0	22.8	-0.5
Subsidies	1.1	1.1	1.1	1.0	1.0	1.0	0.9	0.9	-0.2
Gross fixed capital formation	1.7	1.6	1.6	1.5	1.5	1.5	1.4	1.4	-0.3
Other (residual)	3.4	3.4	3.5	3.4	3.6	3.5	3.2	3.1	-0.3
Interest expenditure	5.3	5.2	5.2	5.2	5.0	5.1	4.9	4.8	-0.5
General government balance (GGB)	-3.0	-2.6	-2.6	-2.2	-1.8	-0.9	-0.3	0.3	3.3
Primary balance	2.2	2.6	2.6	2.9	3.3	4.2	4.6	5.0	2.8
One-off and other temporary measures	0.2	0.2	0.0	-0.1	-0.1	0.0	0.0	0.0	-0.2
GGB excl. one-offs	-3.3	-2.8	-2.6	-2.1	-1.7	-0.9	-0.3	0.3	3.6
Output gap ²	-4.3	-3.6	-3.6	-2.5	-2.7	-1.7	-0.9	0.0	4.3
Cyclically-adjusted balance ²	-0.7	-0.7	-0.6	-0.9	-0.3	0.0	0.2	0.3	1.0
Structural balance (SB)³	-0.9	-0.8	-0.6	-0.7	-0.2	0.0	0.2	0.3	1.2
<i>Change in SB</i>	<i>0.6</i>	<i>0.1</i>	<i>0.2</i>	<i>0.1</i>	<i>0.4</i>	<i>0.3</i>	<i>0.1</i>	<i>0.2</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>1.4</i>	<i>0.3</i>	<i>0.4</i>	<i>0.1</i>	<i>0.3</i>	<i>0.3</i>	<i>0.2</i>	<i>0.1</i>	<i>-</i>
Structural primary balance ³	4.4	4.4	4.6	4.4	4.8	5.1	5.1	5.1	0.8
<i>Change in structural primary balance</i>		<i>0.0</i>	<i>0.2</i>	<i>0.1</i>	<i>0.2</i>	<i>0.4</i>	<i>-0.1</i>	<i>0.1</i>	<i>-</i>
Expenditure benchmark									
Applicable reference rate ⁴	n.a.	-1.06	-1.06	-1.07	-1.07	n.a.	n.a.	n.a.	-
Deviation ⁵ (% GDP)	n.a.	-0.2	-0.1	-1.0	-0.5	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	0.6	0.5	-0.6	-0.3	n.a.	n.a.	n.a.	-
Notes:									
¹ On a no-policy-change basis.									
² Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.									
³ Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.									
⁴ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.									
⁵ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.									
<i>Source:</i>									
<i>Stability programme (SP); Commission 2014 spring forecast (COM); Commission calculations.</i>									

Table IV – Debt dynamics

(% of GDP)	Average 2008-2012	2013	2014		2015		2016	2017	2018
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio¹	117.9	132.6	135.2	134.9	133.9	133.3	129.8	125.1	120.5
Change in the ratio	4.7	5.7	2.6	2.3	-1.3	-1.6	-3.5	-4.7	-4.6
<i>Contributions² :</i>									
1. Primary balance	-1.1	-2.2	-2.6	-2.6	-2.9	-3.3	-4.2	-4.6	-5.0
2. “Snow-ball” effect	4.7	5.8	3.3	3.0	1.9	1.8	1.1	0.9	0.7
<i>Of which:</i>									
Interest expenditure	5.0	5.3	5.2	5.2	5.2	5.1	5.1	4.9	4.7
Growth effect	1.5	2.4	-0.7	-1.0	-1.6	-1.7	-2.1	-2.3	-2.3
Inflation effect	-1.8	-1.8	-1.2	-1.2	-1.7	-1.6	-1.9	-1.7	-1.7
3. Stock-flow adjustment	1.1	2.1	1.9	1.8	-0.2	-0.1	-0.4	-1.0	-0.3
<i>Of which:</i>									
Cash/accruals diff.	0.0	0.7	2.2	2.2	0.1	0.1	-0.3	-0.6	-0.8
Acc. financial assets	1.0	1.4	-0.3	-0.2	-0.3	-0.4	-0.4	-0.5	0.2
<i>Privatisation</i>	<i>-0.1</i>	<i>-0.1</i>	<i>0.0</i>	<i>-0.7</i>	<i>-0.5</i>	<i>-0.7</i>	<i>-0.7</i>	<i>-0.7</i>	<i>0.0</i>
Val. effect & residual	0.0	0.0	0.0	-0.2	0.0	0.1	0.1	0.2	0.2
		2013	2014		2015		2016	2017	2018
			COM	SP	COM	SP	SP	SP	SP
Gap to the debt benchmark^{3,4}		n.r	n.r	n.r	n.r	n.r	-2.1	n.a	n.a
Structural adjustment⁵		0.6	0.1	0.2	0.1	0.4	n.r	n.r	n.r
<i>To be compared to:</i>									
Required adjustment⁶		0.7	0.7	0.3	1.4	0.5	n.r	n.r	n.r
Notes:									
¹ End of period.									
² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of									
³ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of									
⁴ Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-									
⁵ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP									
⁶ Defines the remaining annual structural adjustment over the transition period which ensures that - if followed –									
<i>Source :</i>									
Stability programme (SP); Commission 2014 spring forecasts (COM); Commission calculations.									

Table V – Sustainability indicators

	Italy			European Union		
	2013 scenario	No-policy-change scenario	Stability programme scenario	2013 scenario	No-policy-change scenario	Stability programme scenario
S2*	-1.8	-1.6	-2.5	2.4	2.4	0.7
<i>of which:</i>						
Initial budgetary position (IBP)	-2.4	-2.4	-3.5	0.5	0.4	-1.3
Long-term cost of ageing (CoA)	0.6	0.9	1.0	1.9	2.0	2.0
<i>of which:</i>						
pensions	-0.4	-0.2	0.0	0.7	0.8	0.9
healthcare	0.6	0.6	0.6	0.9	0.9	0.8
long-term care	0.6	0.6	0.6	0.6	0.6	0.6
others	-0.3	-0.2	-0.2	-0.4	-0.4	-0.3
S1**	1.2	1.5	0.5	1.5	1.7	-0.2
<i>of which:</i>						
Initial budgetary position (IBP)	-2.3	-2.9	-4.1	-0.2	-0.4	-2.0
Debt requirement (DR)	4.0	4.6	4.8	1.5	1.8	1.5
Long-term cost of ageing (CoA)	-0.5	-0.3	-0.2	0.2	0.3	0.3
S0 (risk for fiscal stress)***	0.22	:	:	:	:	:
Debt as % of GDP (2013)	132.6			88.9		
Age-related expenditure as % of GDP (2013)	27.8			25.8		
<i>Source : Commission; 2014 stability programme.</i>						
<i>Note :</i> The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.						
* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.						
** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.						
*** The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.						

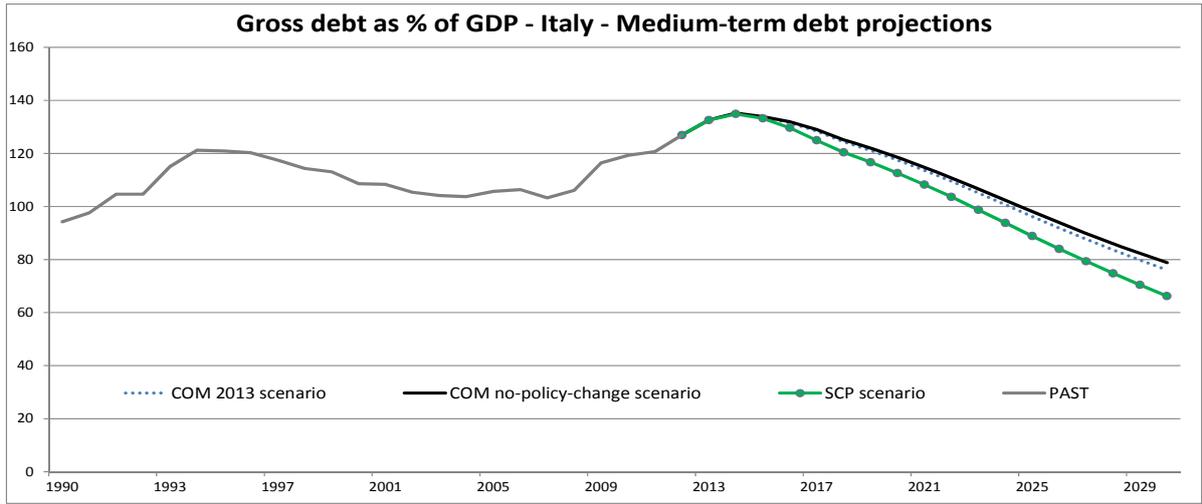


Table VI – Taxation indicators

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	40.5	41.7	42.7	42.5	42.4	44.0
Breakdown by economic function (% of GDP) ¹						
Consumption	10.6	10.8	10.2	10.8	10.8	10.9
of which:						
- VAT	6.2	6.2	5.9	6.3	6.2	6.1
- excise duties on tobacco and alcohol	0.7	0.8	0.8	0.8	0.8	0.8
- energy	2.3	2.2	1.9	2.0	2.1	2.3
- other (residual)	1.5	1.6	1.6	1.7	1.7	1.6
Labour employed	18.0	18.1	19.3	19.4	19.2	19.6
Labour non-employed	2.2	2.3	2.5	2.8	2.8	2.9
Capital and business income	7.3	8.2	8.6	7.4	7.2	7.6
Stocks of capital/wealth	2.4	2.3	2.0	2.2	2.4	3.0
<i>p.m.</i> Environmental taxes ²	2.9	2.8	2.5	2.6	2.7	3.0
VAT efficiency ³						
Actual VAT revenues as % of theoretical revenues at standard rate	43.1	42.8	40.6	41.6	41.3	38.8

Notes:

1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.

2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.

3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.

Source: Commission

Table VII – Financial market indicators

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	246.5	244.8	257.1	269.4	259.5
Share of assets of the five largest banks (% of total assets)	31.0	39.8	39.5	39.7	-
Foreign ownership of banking system (% of total assets)	12.1	13.2	13.4	13.5	-
Financial soundness indicators:					
- non-performing loans (% of total loans) ^{1),2)}	9.4	10.0	11.7	13.7	15.1
- capital adequacy ratio (%) ¹⁾	11.7	12.1	12.7	13.4	13.8
- return on equity (%) ^{1), 3)}	4.0	3.7	-13.0	-0.9	0.7
Bank loans to the private sector (year-on-year % change)	2.4	3.9	1.0	1.5	-3.3
Lending for house purchase (year-on-year % change)	5.9	7.5	4.4	-0.5	-1.1
Loan to deposit ratio	131.2	119.2	125.7	117.2	111.4
CB liquidity as % of liabilities	0.9	1.6	6.5	8.0	7.4
Banks' exposure to countries receiving official financial assistance (% of GDP) ⁴⁾	4.7	4.2	4.1	3.5	3.3
Private debt (% of GDP)	125.2	126.3	125.8	126.4	-
Gross external debt (% of GDP) - Public	52.2	52.1	42.5	45.7	47.6
- Private	25.0	25.6	25.0	27.3	28.5
Long term interest rates spread versus Bund (basis points)*	109.1	129.3	281.6	399.8	274.7
Credit default swap spreads for sovereign securities (5-year)*	98.6	135.9	242.6	323.2	199.7
Notes:					
¹⁾ Latest data 2013Q2.					
²⁾ Non-performing loans include bad, substandard, restructured and past due loans.					
³⁾ After extraordinary items and taxes.					
⁴⁾ Covered countries are CY, EL, ES, LV, HU, IE, PT and RO.					
* Measured in basis points.					
Source :					
Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).					

Table VIII – Labour market and social indicators

Labour market indicators	2008	2009	2010	2011	2012	2013
Employment rate (% of population aged 20-64)	63.0	61.7	61.1	61.2	61.0	59.8
Employment growth (% change from previous year)	0.3	-1.6	-0.7	0.3	-0.3	-2.0
Employment rate of women (% of female population aged 20-64)	50.6	49.7	49.5	49.9	50.5	49.9
Employment rate of men (% of male population aged 20-64)	75.4	73.8	72.8	72.6	71.6	69.8
Employment rate of older workers (% of population aged 55-64)	34.4	35.7	36.6	37.9	40.4	42.7
Part-time employment (% of total employment, 15 years and more)	14.3	14.3	15.0	15.5	17.1	17.9
Part-time employment of women (% of women employment, 15 years and more)	27.9	27.9	29.0	29.3	31.1	31.9
Part-time employment of men (% of men employment, 15 years and more)	5.3	5.1	5.5	5.9	7.2	7.9
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	13.3	12.5	12.8	13.4	13.8	13.2
Transitions from temporary to permanent employment	29.1	24.2	25.0	21.7	17.5	:
Unemployment rate ¹ (% of labour force, age group 15-74)	6.7	7.8	8.4	8.4	10.7	12.2
Long-term unemployment rate ² (% of labour force)	3.1	3.5	4.1	4.4	5.7	6.9
Youth unemployment rate (% of youth labour force aged 15-24)	21.3	25.4	27.8	29.1	35.3	40.0
Youth NEET rate (% of population aged 15-24)	16.6	17.7	19.1	19.8	21.1	22.2
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	19.7	19.2	18.8	18.2	17.6	17.0
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	19.2	19.0	19.8	20.3	21.7	22.4
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	12.0	9.0	6.0	9.0	10.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	16.0	16.0	16.0	17.0	11.0	:
Labour productivity per person employed (annual % change)	-0.8	-2.7	2.8	0.3	-1.3	0.0
Hours worked per person employed (annual % change)	-0.7	-1.7	0.1	0.0	-1.1	0.0
Labour productivity per hour worked (annual % change; constant prices)	-0.7	-2.2	2.4	0.2	-1.0	0.1
Compensation per employee (annual % change; constant prices)	1.2	-0.4	2.4	-0.1	-0.5	0.0
Nominal unit labour cost growth (annual % change)	4.5	4.0	-0.2	1.0	2.2	:
Real unit labour cost growth (annual % change)	2.0	1.9	-0.6	-0.3	0.6	:
Notes:						
¹ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.						
² Long-term unemployed are unemployed persons for at least 12 months.						
Sources: Commission (EU Labour Force Survey and European National Accounts)						

Expenditure on social protection benefits (% of GDP)	2007	2008	2009	2010	2011
Sickness/Health care	6.6	6.9	7.3	7.3	7.1
Invalidity	1.5	1.6	1.7	1.7	1.6
Old age and survivors	15.5	16.1	17.1	17.4	17.4
Family/Children	1.2	1.3	1.4	1.3	1.4
Unemployment	0.4	0.5	0.8	0.8	0.8
Housing and Social exclusion n.e.c.	0.0	0.0	0.0	0.0	0.0
Total	25.4	26.4	28.5	28.6	28.4
of which: means tested benefits	1.7	1.8	2.0	1.8	1.8
Social inclusion indicators	2008	2009	2010	2011	2012
At-risk-of-poverty or social exclusion ¹ (% of total population)	25.3	24.7	24.5	28.2	29.9
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	29.1	28.8	28.9	32.2	33.8
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	24.4	22.8	20.3	24.1	25.2
At-Risk-of-Poverty rate ² (% of total population)	18.7	18.4	18.2	19.6	19.4
Severe Material Deprivation ³ (% of total population)	7.5	7.0	6.9	11.2	14.5
Share of people living in low work intensity households ⁴ (% of people aged 0-59)	9.8	8.8	10.2	10.4	10.3
In-work at-risk-of poverty rate (% of persons employed)	8.9	10.2	9.4	10.7	11.0
Impact of social transfers (excluding pensions) on reducing poverty	20.1	20.7	21.9	19.7	20.5
Poverty thresholds, expressed in national currency at constant prices ⁵	9 194	8 878	8 982	8 855	8 637
Gross disposable income (households)	1 095 209	1 065 582	1 073 937	1 096 845	1 077 446
Relative median poverty risk gap (60% of median equivalised income, age: total)	23.0	22.6	24.5	26.0	25.4
Notes:					
¹ People at-risk-of poverty or social exclusion (AROP): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
² At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.					
³ Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.					
⁴ People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.					
⁵ For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)					
Sources:					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					

Table IX – Product market performance and policy indicators

Performance indicators	2004-08	2009	2010	2011	2012	2013
Labour productivity ¹ total economy (annual growth in %)	0.0	-4.0	2.5	0.3	-1.9	n.a.
Labour productivity ¹ in manufacturing (annual growth in %)	1.1	-12.4	11.7	2.2	-1.8	n.a.
Labour productivity ¹ in electricity, gas, water (annual growth in %)	3.1	-1.5	-6.7	4.0	0.1	n.a.
Labour productivity ¹ in the construction sector (annual growth in %)	-1.6	-7.1	-1.2	-1.9	-0.4	n.a.
Patent intensity in manufacturing ² (patents of the EPO divided by gross value added of the sector)	195.5	174.2	164.9	154.1	n.a.	n.a.
Policy indicators	2004-08	2009	2010	2011	2012	2013
Enforcing contracts ³ (days)	1282	1210	1210	1210	1185	1185
Time to start a business ³ (days)	12.4	10	6	6	6	6
R&D expenditure (% of GDP)	1.1	1.3	1.3	1.3	1.3	n.a.
Tertiary educational attainment (% of 30-34 years old population)	17.6	19.0	19.8	20.3	21.7	22.4
Total public expenditure on education (% of GDP)	4.5	4.7	4.5	4.3	n.a.	n.a.
(Index: 0=not regulated; 6=most regulated)	2008	2009	2010	2011	2012	2013
Product market regulation ⁴ , Overall	1.5	n.a.	n.a.	n.a.	n.a.	1.3
Product market regulation ⁴ , Retail	4.1	n.a.	n.a.	n.a.	n.a.	3.2
Product market regulation ⁴ , Network Industries ⁵	2.4	n.a.	n.a.	n.a.	n.a.	2.0
Notes:						
¹ Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
² Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
³ The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology .						
⁴ The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1.00.html .						
⁵ Aggregate ETCR.						
Source:						
Commission, World Bank - <i>Doing Business</i> (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						

Table X – Green growth

Green Growth performance		2003-2007	2008	2009	2010	2011	2012
Macroeconomic							
Energy intensity	kgoe / €	0.15	0.14	0.14	0.14	0.14	0.13
Carbon intensity	kg / €	0.45	0.42	0.40	0.40	0.39	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.64	0.60	0.56	0.53	0.56	n.a.
Waste intensity	kg / €	n.a.	0.14	n.a.	0.13	n.a.	n.a.
Energy balance of trade	% GDP	-1.7%	-2.2%	-2.7%	-3.3%	-3.8%	-4%
Energy weight in HICP	%	7	8	8	8	8	10
Difference between change energy price and inflation	%	2.3	7.4	-5.8	-3.3	5.0	9.2
Environmental taxes over labour taxes	ratio	13.8%	11.6%	12.2%	11.9%	12.8%	n.a.
Environmental taxes over total taxes	ratio	6.8%	5.9%	6.2%	6.2%	6.5%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.15	0.13	0.13	0.13	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	9.5	9.6	8.4	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	n.a.	n.a.	0.11	0.12	0.12
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.04	0.03	0.03	0.03	0.04
Public R&D for energy	% GDP	n.a.	0.04%	0.03%	0.04%	0.04%	0.04%
Public R&D for the environment	% GDP	n.a.	0.03%	0.02%	0.02%	0.02%	0.02%
Recycling rate of municipal waste	ratio	31.0%	37.1%	44.4%	48.2%	54.4%	58.0%
Share of GHG emissions covered by ETS*	%	n.a.	40.8%	37.7%	38.3%	39.0%	38.9%
Transport energy intensity	kgoe / €	0.47	0.44	0.44	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	1.33	1.24	1.24	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	85.1%	85.7%	83.3%	84.4%	81.9%	80.8%
Diversification of oil import sources	HHI	n.a.	0.13	0.13	0.11	0.09	n.a.
Diversification of energy mix	HHI	0.36	0.34	0.34	0.33	0.31	0.30
Share renewable energy in energy mix	%	6.3%	7.4%	9.3%	10.3%	11.5%	12.7%
Country-specific notes:							
The year 2012 is not included in the table due to lack of data.							
General explanation of the table items:							
Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below							
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)							
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)							
Carbon intensity: Greenhouse gas emissions (in kg CO ₂ equivalents) divided by GDP (in EUR)							
Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)							
Waste intensity: waste (in kg) divided by GDP (in EUR)							
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP							
Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP							
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)							
Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"							
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)							
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP							
Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.							
Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste							
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP							
Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)							
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)							
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector							
Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers							
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin							
Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels							
Share renewable energy in energy mix %-share in gross inland energy consumption, expressed in tonne oil equivalents							
* Commission and EEA.							
** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.							
*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.							

List of indicators used in Box 4 on the potential impact on growth of structural reforms.

Final goods sector mark-ups: Price-cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities⁷¹).

Source: Commission services estimation using the methodology of Roeger, W. (1995). "Can imperfect Competition explain the Difference between primal and dual Productivity?" *Journal of Political Economy* Vol. 103(2) pp. 316-30, based on EUKLEMS 1996-2007 data.

Entry costs: Cost of starting a business in the intermediate sector as a share of income per capita. The intermediate sector is proxied by the manufacturing sector in the model.

Source: World Bank, Doing Business Database. www.doingbusiness.org. 2012 data.

Implicit consumption tax rate: Defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes. The implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced so that the combined impact is ex-ante budgetary neutral.

Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013. 2011 data.

Shares of high-skilled and low-skilled: The share of high skilled workers is increased, the share of low-skilled workers is reduced (halving the gap vis-à-vis the best performers). Low-skilled correspond to ISCED 0-2 categories; high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.

Source: EUROSTAT. 2012 data or latest available.

Female non-participation rate: Share of women of working age not in paid work and not looking for paid work in total female working-age population

Source: EUROSTAT. 2012 data or latest available.

Low-skilled male non-participation rates: Share of low-skilled men of working age not in paid work and not looking for paid work in total male working-age population

Source: EUROSTAT. 2012 data or latest available.

Elderly non-participation rates (55-64 years): Share of the population aged 55-64 years not in paid work and not looking for paid work in total population aged 55-64 years.

Source: EUROSTAT. 2012 data or latest available.

ALMP: Active Labour Market Policy expenditures as a share of GDP over the share of unemployed in the population.

Source: EUROSTAT. 2011 data or latest available.

⁷¹ The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.

Benefit replacement rate: Share of a worker's pre-unemployment income that is paid out by the unemployment insurance scheme. Average of net replacement rates over 60 months of unemployment.

Source: OECD, Benefits and Wages Statistics.

www.oecd.org/els/benefitsandwagesstatistics.htm. 2012 data.