Brussels, XXX
COM(2015) 262 provisoire

Recommendation for a

COUNCIL RECOMMENDATION

on the 2015 National Reform Programme of Italy

and delivering a Council opinion on the 2015 Stability Programme of Italy

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission[3],

Having regard to the resolutions of the European Parliament[4],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, *Europe 2020*, based on enhanced coordination of economic policies. The strategy focuses on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and on 21 October 2010 it adopted a decision on guidelines for the employment policies of the Member States. Together these form

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2015) 262..
4 P8_TA(2015)0067, P8_TA(2015)0068, P8_TA(2015)0069..

the ‘integrated guidelines’ which Member States were invited to take into account in their national economic and employment policies.

(3) On 8 July 2014, the Council adopted a Recommendation on Italy’s National Reform Programme for 2014 and delivered its opinion on Italy’s updated Stability Programme for 2014. On 28 November 2014, in line with Regulation (EU) No 473/2013[5], the Commission presented its opinion on Italy’s draft budgetary plan for 2015[6].

(4) On 28 November 2014, the Commission adopted the Annual Growth Survey[7], marking the start of the 2015 European Semester of economic policy coordination. On the same day, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[8], in which it identified Italy as one of the Member States for which an in-depth review would be carried out.

(5) On 18 December 2014, the European Council endorsed the priorities for boosting investment, accelerating structural reforms and pursuing responsible growth-friendly fiscal consolidation.

(6) On 26 February 2015, the Commission published its 2015 country report for Italy[9]. This assessed Italy’s progress in addressing the country-specific recommendations adopted on 8 July 2014. The country report also includes the results of the in-depth review under Article 5 of Regulation (EU) No 1176/2011. The Commission’s analysis leads it to conclude that Italy is experiencing excessive macroeconomic imbalances which require decisive policy action and specific monitoring. In particular, it is essential to tackle the root cause of persistently low labour productivity and weak competitiveness and to put the national debt on a downward trajectory. The need for action to reduce the risk of adverse effects on the Italian economy and, given its size, on the economic and monetary union more widely, is particularly great.

(7) On 28 April 2015, Italy submitted its 2015 National Reform Programme and its 2015 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(8) Italy is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule over 2013-2015. On 27 February 2015, the Commission issued a Report under article 126(3) of the TFEU, as Italy was not expected to make sufficient progress towards compliance with the debt rule in 2014-2015. The analysis concluded that the debt criterion should be considered as complied with at that time.

(9) On 30 April 2015, after the cut-off date of the Spring Economic Forecast, the Italian Constitutional Court ruled as unconstitutional a temporary non-indexation of higher pensions in 2012-2013. The exact budgetary impact of this ruling will depend on the Italian government's operationalisation thereof, which has still to be clarified. In view of the new information, the issuance of a Report under article 126(3) of TFEU may be deemed warranted at a later stage. In the absence of this new element and pending

[5] OJ L 140, 27.5.2013, p. 11.
[6] C(2014) 8806 final.
[7] COM(2014) 902 final.
[8] COM(2014) 904 final.
[9] SWD(2015) 31 final.

its further clarification the conclusions from the February report can be considered as still broadly valid at this stage.

(10) In its 2015 Stability Programme, Italy has requested a temporary deviation of 0.4 percentage points of GDP from the required adjustment path towards the medium-term objective in 2016 to take account of major structural reforms with a positive impact on the long-term sustainability of public finances. The details underpinning these reforms have been set out in Italy's 2015 National Reform Programme. The areas of reform put forward in the programme as having an impact on public finance sustainability include: (i) public administration and simplification; (ii) product and service markets; (iii) labour market; (iv) civil justice; (v) education; (vi) a tax shift; and (vii) spending review as financing measure. The impact of the reforms on real GDP is estimated by the authorities at 1.8 percentage points by 2020, which seems to be plausible. If fully and timely implemented and on time, these reforms will have a positive impact on the sustainability of public finances. Conditional on the Italian government taking the necessary measures in 2015 to appropriately compensate for the permanent impact of the above-mentioned ruling of the Constitutional Court so as to ensure that: (i) Italy remains under the preventive arm of the Stability and Growth Pact; (ii) an appropriate safety margin with respect to the Treaty reference value is preserved; and (iii) the medium-term objective is reached within the four-year horizon of the Stability Programme. Italy can currently be assessed as qualifying for the requested temporary deviation in 2016, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester.

(11) The 2015 Stability Programme plans gradual improvement of the headline deficit to 2.6% of GDP in 2015 and further to 1.8% of GDP in 2018. In its 2015 Stability Programme, the government plans to reach the medium-term objective – a balanced budgetary position in structural terms – by 2017. However, the recalculated structural balance[10] reaches the medium-term objective in 2018. The achievement of the medium-term objective by 2017 seems appropriate, taking into account the application for the structural reform clause as well as the commitments enshrined in the 2015 Stability Programme.

(12) The government debt-to-GDP ratio is projected to peak in 2015 at 132.5% and to gradually decline to 120.0% in 2019. The macroeconomic scenario underpinning the budgetary projections is plausible. The government has yet to specify the additional expenditure cuts that will allow it to avoid implementing the legislated VAT increase in 2016.

(13) Italy should improve its structural balance by 0.25% of GDP in 2015. Based on the Commission's 2015 spring forecast, the projected structural adjustment towards the medium-term objective of 0.3%of GDP in 2015 is in line with Italy's obligations under the preventive arm of the Stability and Growth Pact. In 2016, Italy should improve its structural balance by at least 0.1% of GDP, taking into account the allowed deviation based on the structural reform clause. However, under the no policy change assumption the Commission's forecast shows a deterioration of 0.2% of GDP as a result of which there is a risk of some deviation. Therefore, further measures will be needed. Based on its assessment of the Stability Programme and

[10] The structural balance as recalculated by the Commission based on the information in the Stability Programme, following a commonly agreed methodology.

taking into account the Commission's 2015 spring forecast, the Council is of the opinion that there is a risk that Italy will not comply with the provisions of the Stability and Growth Pact.

(14) Despite its expected contribution to the debt-reduction effort, which is a key challenge for Italy, the implementation of the ambitious privatisation programme presented by the Italian authorities has incurred some delays in 2014; as a result, privatisation proceeds in 2014 amounted to 0.2 % of GDP, short of the target of 0.7 % per year.

(15) Over the last year, Italy has taken significant steps to alleviate the tax burden on labour, which nevertheless remains high. The number and scope of tax expenditures, in particular VAT reduced rates, are still excessively high. On property taxation, only slow progress has been made on cadastral reform, under which it is particularly necessary to revise outdated cadastral values. In addition, the revision of environmental taxation and the removal of environmentally harmful subsidies have remained unaddressed. Italy has set up a Committee on environmental taxation. These various dimensions are covered by the enabling law for tax reform, whose implementation has, however, been delayed by a lack of legislative decrees. Despite some action in this area, the efficiency of the tax system in Italy is also undermined by persistently low and costly levels of tax compliance and high tax evasion (estimated by the government at EUR 91 billion annually or 5.6 % of GDP). The government has put forward measures to ensure the accuracy of tax returns that now need to be made fully operational.

(16) Only limited steps have been achieved toward a lasting improvement in the efficiency and quality of public spending in all layers of the government. The budget savings legislated for, including at the regional and local levels, fall short of what was envisaged in the 2014 National Reform Programme. That the spending review is not yet an integral part of the budgetary process weighs on the overall, long-term efficiency of the exercise. Serious weaknesses continue to affect the management of EU funds, in particular in southern regions. A national strategic plan for ports and logistics is being prepared but only partial steps have been taken to upgrade the management of ports and their connections with the hinterland.

(17) Italy's public administration is still characterised by significant inefficiencies which weigh on the business environment and on the country's capacity to implement reform effectively. Efforts to improve the institutional framework and the overall quality of the public administration have been made and are continuing. An ambitious reform of the Constitution, aimed particularly at clarifying the division of responsibilities between the various layers of government, is expected by the end of 2015. A comprehensive reform of the public administration addressing staff turnover, mobility and compensation is pending. Although a number of steps have been taken to foster transparency and empower the national anti-corruption authority, the revision of the statute of limitations — also considered by other international organisations as a pillar of the fight against corruption in Italy — has still not taken place. Important steps have been taken in recent years both to improve the supply of justice, by revising the geography of courts and creating specialised courts, and to reduce the demand for it, by promoting out-of-court dispute settlements. The length of proceedings remains a major problem and the reforms undertaken still need to bear fruit.

(18) Since the end of 2008, the non-performing loan ratio of the Italian banking sector has sharply increased, mainly in relation to banks' corporate exposures. So far the work-out rate of impaired assets has been too low, and their disposal has remained limited. This is partly due to the underdevelopment of Italy's private distressed debt market. Recent legislation has addressed weaknesses in the corporate governance of the largest cooperative banks (*banche popolari*), but the role of foundations and the role of small cooperative banks (*banche di credito cooperativo*) are being addressed through agreements of a non-binding and self-regulatory nature. Further restructuring and consolidation of the Italian banking sector is warranted to improve the effectiveness of financial mediation and support the economic recovery.

(19) A broad-ranging enabling law for reforming the labour market, the 'Jobs Act', was adopted in December 2014 and maintains the direction of previous reforms. It provides in particular for changes in employment protection legislation, the unemployment benefit system, the governance and functioning of active and passive labour market policies and the balance between family and working life. The effective implementation of this law will depend crucially on the necessary legislative implementing decrees being adopted. These address the use of wage supplementation schemes, the revision of contractual arrangements, work-life balance and the strengthening of active labour market policies. Second-level bargaining, which could help to better align wages with productivity and encourage the adoption of innovative solutions within firms, still concerns only a minority of companies. The January 2014 agreement laying down the procedures for measuring trade union representativeness in the manufacturing sector could help to promote second-level bargaining but is not yet operational. The labour market participation of women, although growing, remains among the lowest in the EU. In addition, youth unemployment reached almost 43 % in the third quarter of 2014, and the proportion of young people aged between 15 and 24 not in employment, education or training is the highest in the EU. Some of the causes are to be found in the education system, which is still characterised by below-EU average school outcomes, and relatively high early school leaving rates. Only 54.6 % of those aged 15-34 who graduated from the first and second stages of tertiary education within the previous three years were employed, against the EU average of 78.6 %. Italy has witnessed one of the highest increases in poverty and social exclusion rates in the EU, with a particular impact on children. Social assistance schemes remain fragmented and ineffective in tackling this challenge with resulting substantive cost inefficiencies.

(20) A range of restrictions on competition still hamper the proper functioning of product and services markets. A law addressing certain barriers in a number of sectors, including insurance, telecommunications and fuel distribution, is pending in Parliament. Significant barriers remain in other important sectors, including local public services, airports and ports, legal services, banking, pharmacies and healthcare. Significant weaknesses remain in public procurement despite wider use of centralised procurement. Local public services, which show clear signs of inefficiency, remain sheltered from competition, and this has adverse effects on public finances as well. Open tendering is used for a small proportion of contract awards, while the vast majority of contracts are done through in-house awards or similar procedures.

(21) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Italy's economic policy and published it in the 2015 country report. It has also assessed the Stability Programme and the National Reform

Programme and the follow-up given to the recommendations addressed to Italy in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Italy but also their compliance with EU rules and guidance, given the need to strengthen the overall economic governance of the European Union by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations 1 to 6 below.

(22) In the light of this assessment, the Council has examined Italy's Stability Programme, and its opinion[11] is reflected in particular in recommendation 1 below.

(23) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 to 6 below.

(24) In the context of the European Semester, the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations for the Member States whose currency is the euro. Italy should also ensure the full and timely implementation of these recommendations,

HEREBY RECOMMENDS that Italy take action in 2015 and 2016 to:

1. Achieve a fiscal adjustment of at least 0.25% of GDP towards the medium-term objective in 2015 and of 0.1% of GDP in 2016 by taking the necessary structural measures in both 2015 and 2016, taking into account the allowed deviation for the implementation of major structural reforms. Swiftly and thoroughly implement the privatisation programme and use windfall gains to make further progress towards putting the general government debt ratio on an appropriate downward path. Implement the enabling law for tax reform by September 2015, in particular the revision of tax expenditures and cadastral values and the measures to enhance tax compliance.

2. Adopt the planned national strategic plan for ports and logistics, particularly to help promote intermodal transport through better connections. Ensure that the Agency for Territorial Cohesion is made fully operational so that the management of EU funds markedly improves.

3. Adopt and implement the pending laws aimed at improving the institutional framework and modernising the public administration. Revise the statute of limitations by mid-2015. Ensure that the reforms adopted to improve the efficiency of civil justice help reduce the length of proceedings.

4. Introduce binding measures by end-2015 to tackle remaining weaknesses in the corporate governance of banks, particularly the role of foundations, and take measures to accelerate the broad-based reduction of non-performing loans.

5. Adopt the legislative decrees on the use of wage supplementation schemes, the revision of contractual arrangements, work-life balance and the strengthening of active labour market policies. Establish, in consultation with the social partners and in accordance with national practices, an effective framework for second-level contractual bargaining. As part of efforts to tackle youth unemployment, adopt and

[11] Under Article 5(2) of Council Regulation (EC) No 1466/97.

implement the planned school reform and expand vocationally-oriented tertiary education.

6. Implement the simplification agenda for 2015-2017 to ease the administrative and regulatory burden. Adopt competition-enhancing measures in all the sectors covered by the competition law, and take decisive action to remove remaining barriers. Ensure that local public services contracts not complying with the requirements on in-house awards are rectified by no later than end-2015.

Done at Brussels,

For the Council
The President