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Recommendation for a

COUNCIL RECOMMENDATION

on Italy's 2014 national reform programme

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

{SWD(2014) 413 final}

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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, which will focus 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, adopted a decision on guidelines for the employment policies of the Member States, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2014) 413 final.
4 P7_TA(2014)0128 and P7_TA(2014)0129.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on Italy's national reform programme for 2013 and delivered its opinion on Italy's stability programme for 2012-2017. On 15 November 2013, in line with Regulation (EU) No 473/2013[5], the Commission presented its opinion on Italy's draft budgetary plan for 2014[6].

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[7], marking the start of the 2014 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.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for Italy[9], 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 specific monitoring and strong policy action. In particular, the persistently high level of the public debt coupled with weak external competitiveness on account of sluggish productivity growth, and further exacerbated by protracted dismal growth, warrant decisive policy action and attention.

(8) On 22 April 2014, Italy submitted its 2014 national reform programme and its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) The objective of the budgetary strategy outlined in the stability programme is the achievement of the medium-term objective of a balanced budgetary position in structural terms by 2016, while complying with the debt rule in the 2013-2015 transition period. The programme confirms the medium-term objective of a balanced budgetary position in structural terms, which reflects the requirements of the Stability and Growth Pact. The (recalculated) structural adjustment planned in the programme is 0.2 percentage point of GDP in 2014 and 0.4 percentage point in 2015. According to the programme, this limited adjustment towards the medium-term objective is justified by the severe economic conditions and the effort needed to implement an ambitious programme of structural reforms. In particular, several structural reforms are planned, which would have a positive impact on potential economic growth and eventually reduce the government debt-to-GDP ratio in the coming years. The structural adjustment planned in the programme would allow Italy

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5 OJ L 140, 27.5.2013, p.11.
6 C(2013) 8005 final.
7 COM(2013) 800 final.
8 COM(2013) 790 final.
9 SWD(2014) 83 final.

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 (amounting to 0.7 percentage point of GDP each year). The macroeconomic scenario underpinning the budgetary projections in the programme, which has not been endorsed by an independent body, is slightly optimistic, in particular for the later years of the programme. A deviation from the adjustment path towards the medium-term objective is planned in 2014; if repeated the following year, it could be assessed to be significant, including on the basis of the expenditure benchmark. Moreover, the achievement of the budgetary targets is not fully supported by sufficiently detailed measures, in particular as of 2015. The Commission 2014 spring forecast points to non-compliance with the debt reduction benchmark in 2014 as the projected structural adjustment (only 0.1 percentage point of GDP) falls short of the required structural adjustment of 0.7 percentage point of GDP. Based on the assessment of the programme and the Commission forecast pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that additional efforts, including in 2014, are needed to be in compliance with the requirements of the Stability and Growth Pact.

(10) Recent action to alleviate taxation on the factors of production has been somewhat limited. There is thus scope to further shift the tax burden towards consumption, property and the environment, in strict compliance with the budgetary targets. As regards consumption, improving the structure of the tax system also crucially requires a revision of VAT reduced rates and of direct tax expenditures, with due attention to the need to lessen possible distributional impact. As regards property, a revision of cadastral values in line with current market values would allow for fairer recurrent taxation on immovable property. A recently adopted enabling law for tax reform represents an opportunity to carry out such necessary reforms. Given the size of the challenge, action on the composition of the tax structure needs to be complemented by additional measures to improve tax administration and tax compliance and decisive measures to combat tax evasion, the shadow economy and undeclared work, which continue to weigh both on public finances and on the tax burden for compliant taxpayers. In this respect, the enabling law for tax reform foresees several measures to strengthen tax administration – comprehensive estimation and monitoring system of the tax gap, simplification measures, actions to improve relationship with taxpayers, measures to improve local tax debt recovery and reinforcement of tax controls. The decision to introduce pre-filled tax returns as from 2015 is an additional positive step to enhance tax compliance.

(11) Thorough and swift implementation of the measures adopted remains a key challenge for Italy, both in terms of addressing existing implementation gaps and preventing the accumulation of further delays. One of the key levers to improve the implementation performance of the country, and more generally ensure smoother policy action, lies in enhanced coordination and a more efficient allocation of competences among the various levels of government. This could in turn be beneficial for the management of EU funds, where only partial and incomplete action has been undertaken so far, especially in southern regions. The management of EU funds also continues to suffer from deficient administrative capacity and lack of transparency, evaluation and quality control. The quality of public service would also gain from increased efficacy and service orientation, and corresponding changes in human resource management. Corruption continues to weigh significantly on Italy's productive system and on trust in the political and institutional landscape. There is a need to review the statute of limitations. An effective fight against corruption also requires adequate empowering of the National Anti-Corruption Authority for the

Evaluation and Transparency of Public Administrations. Inefficiencies in civil justice persist and the impact of the measures adopted needs to be carefully monitored.

(12) Drawing on the targeted asset quality review carried out last year under the patronage of the Bank of Italy, it remains important to improve the management of impaired assets and foster their disposal to revive banks' capacity to expand the supply of credit to the real economy. As regards access to finance, the main action taken so far has focused on easing firms' access to credit, but the development of funding instruments other than bank loans remains limited, especially for small and medium-sized enterprises. The initiatives taken in the field of banks' corporate governance – in particular the new principles issued recently by the Bank of Italy – are welcome. At the same time, their impact will depend on their proper implementation by the banks and enforcement. In particular, close monitoring of some of the largest cooperative banks ('banche popolari') remains warranted.

(13) The labour market situation further deteriorated in 2013, with unemployment rising to 12.2% and youth unemployment reaching 40% in Italy. Ensuring proper implementation and careful monitoring of the effect of the labour market and wage-setting reforms adopted is key to guaranteeing that the expected benefits in terms of enhanced exit flexibility, better regulated entry flexibility, a more comprehensive system of unemployment benefits and better alignment of wages on productivity materialise. Plans for improving effectiveness of placement services through the reinforcement of public employment services have been subject to delays and need to be accelerated. Measures aimed at fostering job creation in the short term need to be complemented with measures addressing segmentation. Globally, the Italian labour market continues to be marked by segmentation and low participation, which affects women and young people in particular. Therefore, the limited steps taken so far need to be extended, including in line with the objectives of a youth guarantee. Italy is witnessing declining household disposable income combined with rising poverty and social exclusion, affecting families with children in particular. Social expenditure in Italy remains largely oriented towards the elderly and with little focus on activation, limiting the scope to address the risk of social exclusion and poverty. The pilot social assistance scheme recently introduced aims at providing a social safety net. Its envisaged extension to the whole country will require improving the effectiveness of social spending and services throughout the territory.

(14) Efforts to upgrade educational performance and human capital endowment need to be made at all educational levels, i.e. primary, secondary and tertiary. The teaching profession is characterised by a single career pathway and currently offers limited prospects in terms of professional development. Diversifying teachers' careers and better linking their career trajectories to merit and performance, coupled with the generalisation of school evaluation, could translate into better school outcomes. To ensure a smooth transition between education and the labour market, strengthening and broadening practical training, through increased work-based learning and vocational education and training, appear crucial at the upper secondary and tertiary levels. Following the 2013 legislative decree on this issue, establishing a national register of qualifications is essential in order to ensure the nation-wide recognition of skills. Building on initial action in this direction, bringing forward the allocation of public funding to universities on the basis of research and teaching performance would have the merit of both contributing to upgrading the quality of universities and potentially increasing research and innovation capacity in the country, where it is still lagging behind.

(15) Some steps were made to achieve a more business- and citizen-friendly environment, but their impact is hampered by delays in their final approval and implementation gaps. There are still a number of bottlenecks to competition (reserved areas of activity, concessions/authorisation schemes, etc) in professional services, insurance, fuel distribution, retail and postal services. A series of weaknesses affecting the public procurement system also need to be tackled. Enhancing competition in the area of local public services is another priority. In particular, the current legislation stipulating that existing contracts not complying with EU law on in-house criteria need to be rectified by 31 December 2014 needs to be implemented.

(16) Infrastructure bottlenecks hamper the proper functioning of the energy market. In transport, the lack of intermodal infrastructure and the shortage of synergies and connections with the hinterland for Italian ports warrant particular attention and action. In terms of broadband coverage, Italy has underserved non-urban areas.

(17) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Italy's economic policy. It has assessed the stability programme and the national reform programme. 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 reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (8) below.

(18) In the light of this assessment, the Council has examined Italy's stability programme, and its opinion[10] is reflected in particular in recommendation (1) below.

(19) 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 (8) below.

(20) 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 within the period 2014-2015 to:

1. Reinforce the budgetary measures for 2014 in the light of the emerging gap relative to the Stability and Growth Pact requirements, namely the debt reduction rule, based on the Commission 2014 spring forecast. In 2015, significantly strengthen the budgetary strategy to ensure compliance with the debt reduction requirement. Thereafter, ensure that the general government debt is on a sufficiently downward path; carry out the ambitious privatisation plan; implement a growth-friendly fiscal adjustment based on the announced significant savings coming from a durable improvement of the efficiency and quality of public expenditure at all levels of government, while preserving growth-enhancing spending like R&D, innovation, education and essential infrastructure projects. Guarantee the independence and full operationalisation of the fiscal council as soon as possible and no later than in September 2014, in time for the assessment of the 2015 Draft Budgetary Plan.

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

2. Further shift the tax burden from productive factors to consumption, property and the environment, in compliance with the budgetary targets. To this end, evaluate the effectiveness of the recent reduction in the labour tax wedge and ensure its financing for 2015, review the scope of direct tax expenditures and broaden the tax base, notably on consumption. Consider the alignment of excise duties on diesel to those on petrol and their indexation on inflation, and remove environmentally harmful subsidies. Implement the enabling law for tax reform by March 2015, including by adopting the decrees leading to the reform of the cadastral system to ensure the effectiveness of the reform of immovable property taxation. Further improve tax compliance by enhancing the predictability of the tax system, simplifying procedures, improving tax debt recovery and modernising tax administration. Pursue the fight against tax evasion and take additional steps against the shadow economy and undeclared work.

3. As part of a wider effort to improve the efficiency of public administration, clarify competences at all levels of Government. Ensure better management of EU funds by taking decisive action to improve administrative capacity, transparency, evaluation and quality control at regional level, especially in southern regions. Further enhance the effectiveness of anti-corruption measures, including by revising the statute of limitations by the end of 2014, and strengthening the powers of the national anti-corruption authority. Timely monitor the impact of the reforms adopted to increase the efficiency of civil justice with a view to securing their effectiveness and adopting complementary action if needed.

4. Reinforce the resilience of the banking sector and ensure its capacity to manage and dispose of impaired assets to revive lending to the real economy. Foster non-bank access to finance for firms, especially small and medium-sized businesses. Continue to promote and monitor efficient corporate governance practices in the whole banking sector, with particular attention to large cooperative banks ('banche popolari') and foundations, with a view to improving the effectiveness of financial intermediation.

5. Evaluate, by the end of 2014, the impact of the labour market and wage-setting reforms on job creation, dismissals' procedures, labour market duality and cost competitiveness, and assess the need for additional action. Work towards a comprehensive social protection for the unemployed, while limiting the use of wage supplementation schemes to facilitate labour re-allocation. Strengthen the link between active and passive labour market policies, starting with a detailed roadmap for action by September 2014, and reinforce the coordination and performance of public employment services across the country. Adopt effective action to promote female employment, by adopting measures to reduce fiscal disincentives for second earners by March 2015 and providing adequate care services. Provide adequate services across the country to non-registered young people and ensure stronger private sector's commitment to offering quality apprenticeships and traineeships by the end of 2014, in line with the objectives of a youth guarantee. To address exposure to poverty and social exclusion, scale-up the pilot social assistance scheme, in a fiscally neutral way, guaranteeing appropriate targeting, strict conditionality and territorial uniformity, and strengthening the link with activation measures. Improve the effectiveness of family support schemes and quality services favouring low-income households with children.

6. Implement the National System for Evaluation of Schools to improve school outcomes in turn and reduce rates of early school leaving. Increase the use of work-based learning in upper secondary vocational education and training and strengthen

vocationally-oriented tertiary education. Create a national register of qualifications to ensure wide recognition of skills. Ensure that public funding better rewards the quality of higher education and research.

7. Approve the pending legislation aimed at simplifying the regulatory environment for businesses and citizens and address implementation gaps in existing legislation. Foster market opening and remove remaining barriers to, and restrictions on competition in the professional and local public services, insurance, fuel distribution, retail and postal services sectors. Enhance the efficiency of public procurement, especially by streamlining procedures including through the use of e-procurement, rationalising the central purchasing bodies and securing the proper application of pre- and post-award rules. In local public services, rigorously implement the legislation providing for the rectification of contracts that do not comply with the requirements on in-house awards by 31 December 2014.

8. Ensure swift and full operationalisation of the Transport Authority by September 2014. Approve the list of strategic infrastructure in the energy sector and enhance port management and connections with the hinterland.

Done at Brussels,

For the Council
The President