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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Italy

and delivering a Council opinion on the 2017 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 16 November 2016, the Commission adopted the Annual Growth Survey,[5] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,[6] in which it identified Italy as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2017) 511 final.
4 P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
5 COM(2016) 725 final.
6 COM(2016) 728 final.

Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March 2017.[7]

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Italy should ensure the full and timely implementation of the Recommendation for the euro area which is reflected in recommendations 1 to 4 below.

(3) The 2017 country report for Italy[8] was published on 22 February 2017. It assessed Italy's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Italy's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 22 February 2017.[9] The Commission's analysis leads it to conclude that Italy is experiencing excessive macroeconomic imbalances. High government debt and protracted weak productivity dynamics imply risks with cross-border relevance, in a context of high non-performing loans and unemployment. The need for action to reduce the risk of adverse effects on the Italian economy and, given its size and cross-border relevance, on the economic and monetary union, is particularly important.

(4) On 27 April 2017, Italy submitted its 2017 National Reform Programme and its 2017 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time. Italy's National Reform Programme includes commitments both for the short and medium term. In the short term, the final adoption of the pending laws concerning competition and the reform of criminal process and the statute of limitations, the implementation of the anti-poverty law as well as measures related to firm-level bargaining, tax shift and privatisation are planned. In the medium term, measures concern public finances, taxation, labour market, the banking and credit system, competition, public administration and justice, and investment. The National Reform Programme also covers the challenges identified in the 2017 country report and the Recommendation for the euro area, including the need to re-launch investment and ensure the sustainability of public finances. If fully implemented within the indicated timelines, these measures would help address Italy's macroeconomic imbalances and country-specific recommendations. Based on the assessment of Italy's policy commitments, the Commission confirms its previous assessment that at this stage no further steps are warranted in the framework of the Macroeconomic Imbalances Procedure. The implementation of the policy reform agenda will be followed closely by means of specific monitoring.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[10] where it is necessary to support the implementation of relevant country-

[7] OJ C92/01, 24.3.2017, p. 1.

[8] SWD(2017) 77 final.

[9] COM(2017) 90 final.

[10] Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime

specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[11]

(6) Italy is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2017 Stability Programme, the government plans an improvement in the headline deficit from 2.4% of GDP in 2016 to 2.1% in 2017, 1.2% in 2018, and a broadly balanced budgetary position by 2019. The medium-term budgetary objective, set at a balanced budgetary position in structural terms, is planned to be reached by 2019 and maintained in 2020, whereas the recalculated[12] structural balance points to a small structural deficit (0.3% of GDP) in both years. After having further increased in 2016 (to 132.6% of GDP, from 132.1% in 2015), the general government debt-to-GDP ratio is projected in the Stability Programme to broadly stabilise in 2017 and to then decline as of 2018, reaching 125.7% in 2020. The uncertainty on the composition and implementation of the medium-term budgetary strategy of the Stability Programme entails downside risks for both the growth projections and the achievement of the budgetary targets. In particular, the Commission 2017 spring forecast expects almost the same real GDP growth for 2018 as the 2017 Stability Programme, in spite of a significantly higher deficit. In fact, the Commission forecast does not incorporate a VAT hike (0.9% of GDP) legislated as "safeguard clause" to achieve the budgetary targets in 2018, also because the 2017 Stability Programme confirms the intention of not activating it without providing details about alternative compensating measures. Furthermore, the 2017 Stability Programme indicates the intention to find additional room for reducing the tax burden.

(7) The 2017 Stability Programme indicates that the overall budgetary impact of the exceptional inflow of refugees and security-related measures in 2016 and 2017 is significant and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2016 amounted to 0.06% of GDP for the exceptional inflow of refugees and to 0.06% of GDP for security-related measures. For 2017, the eligible expenditure related to exceptional inflow of refugees is preliminarily estimated at 0.16% of GDP.[13] Moreover, the Italian authorities invoked the unusual event clause in 2017 for exceptional seismic activity. The eligible expenditure related to exceptional seismic activity is preliminarily estimated at 0.18% of GDP in 2017.[14]

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and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320.

[11] COM(2014) 494 final.

[12] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[13] This amount is based on the 0.25% of GDP overall budgetary cost estimated in the 2017 stability programme from which the temporary deviations of 0.03% of GDP and of 0.06% already granted in 2015 and 2016, respectively, are deducted. In its opinion on the 2017 Draft Budgetary Plan of Italy the Commission announced that it would stand ready to consider an additional deviation due to the persistent exceptional inflow of refugees in Italy also in light of the European Council of October 2016 which recognised "the significant contribution, also of financial nature, made by frontline Member States in recent years".

[14] In its opinion on the 2017 Draft Budgetary Plan for Italy, the Commission considered that expenditure earmarked for emergency management and the preventive investment plan for the protection of the national territory against seismic risks could be considered of integrated nature. For the following years only positive incremental changes in resources earmarked for this purpose would be considered eligible for further possible temporary deviations.

The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees, the severity of the terrorist threat and the exceptional seismic activity are unusual events, their impact on Italy's public finances is significant, and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2016 has been reduced by 0.12% of GDP to take into account additional refugee-related and security-related costs. Regarding 2017, a final assessment, including on the eligible amounts, will be made in spring 2018 on the basis of observed data as provided by the Italian authorities.

(8) For 2016, Italy was granted a temporary deviation of 0.5% of GDP from the required adjustment path towards the medium-term budgetary objective to take account of major structural reforms with a positive impact on the long-term sustainability of public finances and a further 0.25% of GDP to take account of national investment expenditure in projects co-financed by the EU. As regards the investment clause, one of the eligibility criteria is the increase in public investment. Outturn data for 2016 showed a decline in public investment in 2016 compared to 2015 (by EUR 1.6 billion). However, the Council acknowledges that there are specific factors which constrained public investment last year. One factor was uncertainty associated with the transition to the new code of public procurement and concessions, which was revised in line with the 2016 country-specific recommendations. Moreover, and even more importantly, in 2016 there was a sharp fall in investment financed through EU funds as a result of the start of the new programming period, while nationally financed investment marginally increased (by EUR 1.1 billion). Therefore, as nationally financed investment rose in 2016 and the expenditure related to the investment clause did not substitute for it, a temporary deviation of 0.21% of GDP can be granted to Italy in relation to the investment clause, corresponding to national expenditure eligible for co-financing as reported in the 2017 Stability Programme. Once the overall additional flexibility of 0.83% of GDP under the unusual event, structural reform and investment clauses is taken into account, the Commission 2017 spring forecast points to some deviation from the recommended adjustment path towards the medium-term objective in 2016.

(9) On 12 July 2016, the Council recommended Italy to achieve an annual fiscal adjustment of 0.6 % or more of GDP towards the medium-term budgetary objective in 2017. Based on the Commission 2017 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term objective in 2017 and for 2016 and 2017 taken together. That conclusion would however change to a risk of some deviation, if the temporary allowance for the unusual event clause related to the exceptional inflow of refugees and to the preventive investment plan for the protection of the national territory against seismic risks (preliminarily estimated at 0.34% of GDP, overall) is deducted from the requirement in 2017.

(10) In 2018, in the light of its fiscal situation and notably of its debt level, Italy is expected to further adjust towards its medium-term budgetary objective of a balanced budgetary position in structural terms. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal rate of reduction of net primary government expenditure by at least 0.2 % in 2018. It would correspond to an annual structural adjustment of at least 0.6 % of GDP. Under unchanged policies, there is a risk of a

significant deviation from the requirement in 2018. Italy is prima facie not forecast to comply with the debt rule in 2017 and 2018. Overall, the Council is of the opinion that Italy needs to stand ready to take further measures to ensure compliance in 2017 and that further measures will be needed in 2018 to comply with the provisions of the Stability and Growth Pact. However, as foreseen in Regulation (EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in the light of the cyclical conditions. As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal to achieve a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Italy's public finances. In that context, the Commission intends to make use of the applicable margin of appreciation in the light of the cyclical situation of Italy.

(11) Due to Italy's prima facie non-compliance with the debt rule in 2015, on 22 February 2017 the Commission issued a report under Article 126(3) of the TFEU, which concluded that "Unless the additional structural measures, worth at least 0.2% of GDP, that the government committed to adopt at the latest in April 2017 are credibly enacted by that time in order to reduce the gap to broad compliance with the preventive arm in 2017 (and thus in 2016), the current analysis suggests that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as currently not complied with. However, a decision on whether to recommend opening an excessive deficit procedure would only be taken on the basis of the Commission 2017 spring forecast, taking into account outturn data for 2016 and the implementation of the fiscal commitments made by the Italian authorities in February 2017." In April 2017, the Italian government adopted the requested additional consolidation measures. Therefore, no further steps are deemed to be necessary for compliance with the debt criterion in 2015 at this stage. The Commission will reassess Italy's compliance with the debt criterion in autumn 2017, based on notified data for 2016 and the Commission 2017 autumn forecast, which will incorporate new information on budgetary implementation in 2017 and actual budgetary plans for 2018.

(12) Italy's high public debt ratio is set to stabilise, but not decrease, due to the worsening of the structural primary balance and current macroeconomic conditions. At more than 130 % of GDP, this implies that significant resources are earmarked to cover debt servicing costs, to the detriment of more growth-enhancing items including education, innovation and infrastructure.

(13) Italy's tax system is not supportive of economic growth and efficiency on several grounds. Despite a recent modest reduction, the tax burden on factors of production remains among the highest in the EU. There is scope to shift further towards taxes less detrimental to growth, in a budgetary neutral way. The first residence tax was repealed in 2015, which was a step back in the process of achieving a more efficient tax structure. In spite of national legislation requiring it on an annual basis, the long-awaited revision of tax expenditures, in particular with respect to the reduced value added tax rates, was further postponed. A reform of outdated cadastral values in line with current market values is still pending. Low tax compliance and the complex tax code increase the burden on compliant firms and households. Recent measures, such as mandatory electronic invoicing and the 'split payment' for purchases by government bodies, go in the right direction. However, electronic invoicing is not

compulsory for private sector transactions and limits on using cash have recently been raised, so that the use of electronic payments remains well below the EU average, to the detriment of tax compliance.

(14) As regards the budgetary process, a comprehensive reform was passed in 2016. The Commission will continue to monitor implementation of the reform, which would make the spending review a more integral part of the budgeting process.

(15) Italy's framework conditions, public administration and business environment are still affected by a number of structural inefficiencies. These inefficiencies continue to slow down implementation of reforms, deter investment, create uncertainty and open opportunities for rent-seeking. The reforms of the civil justice system adopted over the past years to increase the efficiency of the justice system, improve case management and ensure procedural discipline, are only very slowly starting to show results. The length of civil justice proceedings remains a major challenge. Although decreasing slightly at lower instances, both the disposition time and the backlog for civil and commercial lawsuits continue to be among the highest in the EU at all instances. A pending reform of civil proceedings provides for a further tightening of admissibility criteria for appeals, streamlined civil procedures at all instances and disincentives against vexatious litigation.

(16) Several indicators confirm that corruption is still a major problem in Italy, despite the reforms adopted so far. The long-overdue reform of the statute of limitations to step up the fight against corruption has been pending since 2014. In its current form, the statute of limitations leads to a high proportion of cases getting time-barred after first-instance conviction. Moreover, the national anti-corruption authority has limited financial and human resources to exercise its powers, and the prevention framework remains fragmented.

(17) A comprehensive enabling law reforming the public administration was adopted in 2015. It has the potential to improve the efficiency and effectiveness of the public administration. However, following the November 2016 Constitutional Court ruling that declared the procedure followed for the adoption of some implementing legislative decrees unconstitutional, the implementation of key parts of the reform is still pending. In particular, the ruling concerns three key areas of the reform: local public services, public employment, and publicly-owned enterprises. New legislative initiatives are needed to reform the local public services and public employment at management level, as the deadline for their decrees expired in November 2016. Regarding publicly-owned enterprises, the decree adopted before the ruling needs to be amended. The reform aims to reduce the number of publicly-owned enterprises, improve their efficiency, and ensure that they operate under the same rules as privately-owned entities. The implementation of the planned privatisations would also contribute to the rationalisation of publicly-owned enterprises.

(18) Framework conditions for competition also remain unfavourable. In particular, the 2015 annual competition law has not yet been adopted. Significant barriers to competition persist in certain sectors, such as regulated professions, concessions, public procurement and the system of authorisations as well as local public services, including transport. In particular, progress in fostering an efficient, transparent and competition-driven functioning of the public transport market, notably for railways under government concessions, is still very limited. According to a new indicator developed by the Commission, the level of restrictiveness is higher in Italy than the EU-weighted average for most of the professions analysed. As part of a package of

measures to tackle barriers in services markets,[15] in January 2017 specific guidance by profession to address this issue was made in a Communication from the Commission on reform recommendations for regulation in professional services.

(19) The banking sector's large stock of non-performing loans remains a drag on bank profits and their ability to generate capital internally. This weighs on credit supply, in particular to small firms. The policy initiatives taken so far have not yet resulted in a significant reduction in non-performing loans. Supervisory guidance on non-performing loan management at national level remains underdeveloped. Medium-sized and small banks continue to be more vulnerable than large credit institutions. The Commission will therefore monitor the implementation of the corporate governance reform of the largest *popolari* banks and small mutual banks, which is key to the consolidation of the banking system. The insolvency and collateral enforcement framework continues to be insufficiently supportive of swift non-performing loan work-out and restructuring, especially in relation to small and micro-firms. A draft enabling law aiming at overhauling and streamlining insolvency and enforcement tools, currently under discussion in Parliament, could help to overcome the existing inefficiencies and contribute to the development of a secondary market for distressed debt in Italy.

(20) Despite the gradual improvement of the labour market, supported by reforms, long-term and youth unemployment remain high (6.7% and 38% respectively in 2016) and more than 1.2 million young people are not in education, employment or training. While the implementation of Youth Guarantee has progressed a lot, some challenges remain to ensure a more effective and a full-scale implementation. The number and quality of offers remain low and regional differences in the delivery are high. The reform of the active labour market policies, including its governance system, is still at an early stage and employment services remain weak, with wide regional disparities. Adult learning is not sufficiently developed, which may negatively weigh on labour market outcomes of low-skilled people.

(21) The participation of women in the labour market and their labour force potential remains largely underutilised. The female employment rate is one of the lowest in the EU. Some features of the tax-benefit system continue to discourage second earners from participating in the labour force while access to affordable care services (for children and the elderly) remains limited, with wide regional disparities. Paternity leave is among the lowest in the EU.

(22) Second-level bargaining is not broadly used. This hampers the efficient allocation of resources and the responsiveness of wages to local economic conditions. This is also due to the existing framework rules and practices for collective bargaining, which entail uncertainty in industrial relations and leave limited scope for local-level bargaining. Tax rebates on productivity-related pay increases have not proved effective in extending the use of second-level bargaining significantly.

(23) The rate of people at risk of poverty or social exclusion is well above the EU average, especially for children and people with a migrant background. There are also substantial regional disparities. Some progress has been made regarding the national anti-poverty strategy. The recently adopted Inclusion Income scheme is a positive step towards establishing a single comprehensive scheme against poverty. Its effectiveness will depend on its proper implementation with the mobilisation of

[15] COM(2016) 820 final, COM(2016) 821 final, COM(2016) 822 final, COM(2016) 823 final, COM(2016) 824 final.

adequate resources (including through the streamlining of various social allocations), appropriate targeting through means-testing and priority allocation to families with children and effective procedures on the ground, both in delivering income support and in providing well integrated services. At this stage, it is unclear whether the financial resources will be sufficient to address Italy's poverty challenge. Catering for additional resources while respecting the budgetary targets, reducing the fragmentation of the social assistance system, rationalising social spending, and addressing its current bias towards pensions, remain key challenges.

(24) 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 2017 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 socioeconomic policy in Italy, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.

(25) In the light of this assessment, the Council has examined the Stability Programme and its opinion[16] is reflected in particular in recommendation 1 below.

(26) 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 made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 to 4 below,

HEREBY RECOMMENDS that Italy take action in 2017 and 2018 to:

1. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which translates into a substantial fiscal effort for 2018. When taking policy action, consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Italy's public finances. Shift the tax burden from the factors of production onto taxes less detrimental to growth in a budgetary neutral way by taking decisive action to reduce the number and scope of tax expenditures, reforming the outdated cadastral system and reintroducing the first residence tax for high-income households. Broaden the compulsory use of electronic invoicing and payments.

2. Reduce the trial length in civil justice through effective case management and rules ensuring procedural discipline. Step up the fight against corruption, in particular by revising the statute of limitations. Complete reforms of public employment and improve the efficiency of publicly-owned enterprises. Promptly adopt and implement the pending law on competition and address the remaining restrictions to competition.

3. Accelerate the reduction in the stock of non-performing loans and step up incentives for balance-sheet clean-up and restructuring, in particular in the segment of banks under national supervision. Adopt a comprehensive overhaul of the regulatory framework for insolvency and collateral enforcement.

4. With the involvement of social partners, strengthen the collective bargaining framework to allow collective agreements to better take into account local

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

conditions. Ensure effective active labour market policies. Facilitate the take-up of work for second earners. Rationalise social spending and improve its composition.

Done at Brussels,

For the Council
The President