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**NOTE**

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From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. Cion doc.:	9936/19 - COM(2019) 512 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2019 National Reform Programme of Italy and delivering a Council opinion on the 2019 Stability Programme of Italy

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Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2019) 512 final.

## COUNCIL RECOMMENDATION

of ...

### on the 2019 National Reform Programme of Italy and delivering a Council opinion on the 2019 Stability Programme of Italy

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<sup>1</sup>, 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<sup>2</sup>, and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

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,

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Italy as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area<sup>3</sup> ('2019 Recommendation for the euro area') which sets out five euro-area recommendations ('the euro-area recommendations').
- (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 2019 Recommendation for the euro area, as reflected in recommendations (1) to (5) below. In particular, measures in the area of public administration, justice and competition will help address the first euro-area recommendation as regards resilient product markets and the quality of institutions; focusing economic policy related to investment in the specified areas and using windfall gains to reduce public debt will help address the second euro-area recommendation as regards supporting investment and rebuilding buffers; measures to improve employability and shift the tax burden away from productive factors will help address the third euro-area recommendation as regards the functioning of the labour market, and measures to improve banks' balance sheets will help address the fourth euro-area recommendation as regards the reduction of non-performing loans.

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<sup>3</sup> OJ C 136, 12.4.2019, p. 1.

- (3) The 2019 country report for Italy was published on 27 February 2019. It assessed Italy's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018<sup>4</sup>, the follow-up given to the country-specific 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 27 February 2019. The Commission's analysis led it to conclude that Italy is experiencing excessive macroeconomic imbalances. In particular, high government debt and protracted weak productivity dynamics imply risks with cross-border relevance. The need for action to reduce the risk of adverse effects on the Italian economy and on the economic and monetary union, given the size and cross-border relevance of Italy's economy, is particularly significant.
- (4) On 19 April 2019, Italy submitted its 2019 National Reform Programme and its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. Italy's 2019 National Reform Programme only partly addresses the structural issues raised by the 2018 country-specific recommendations, and details on the few new commitments it contains, as well as on the timeline for their implementation, are often missing. However, its reform strategy builds on major reforms already in the pipeline in different areas, showing broad continuity compared to past National Reform Programmes.

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<sup>4</sup> OJ C 136, 12.4.2019, p. 48.

- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council<sup>5</sup>, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

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<sup>5</sup> 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 and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

- (6) Italy is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme the government expects the headline deficit to increase from 2,1 % of gross domestic product (GDP) in 2018 to 2,4 % in 2019, and to gradually decline thereafter to 2,1 % in 2020 and 1,5 % by 2022. These projections assume a VAT hike (1,3 % of GDP in 2020 and 1,5 % of GDP from 2021) legislated for as a 'safeguard clause' to achieve the budgetary targets from 2020. Based on the recalculated structural balance<sup>6</sup>, the medium-term budgetary objective – which has been changed from a balanced budgetary position in structural terms in 2019 to a surplus of 0,5 % of GDP in structural terms as of 2020 – is not planned to be reached within the programme period. After having increased in 2018 (to 132,2 % of GDP, from 131,4 % in 2017), the general government debt-to-GDP ratio is projected in the 2019 Stability Programme to increase by 0,4 percentage point of GDP to 132,6 % in 2019, and to decline to 128,9 % by 2022. These projections assume privatisation proceeds of 1 % of GDP in 2019 and 0,3 % in 2020. The macroeconomic scenario underpinning those budgetary projections is plausible. However, in recent years the VAT hikes legislated for as 'safeguard clauses' have been systematically repealed without adequate alternative financing measures, and privatisation targets have been underachieved. Based on unchanged policies, the Commission 2019 spring forecast expects lower nominal GDP growth and a higher government deficit for 2020 than the ones expected in the 2019 Stability Programme. The Commission forecast does not incorporate the VAT hike legislated for as a 'safeguard clause' in 2020.
- (7) On 5 June 2019, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty due to Italy's non-compliance with the debt rule in 2018. The report concluded, following an assessment of all the relevant factors, that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as not complied with, and that a debt-based excessive deficit procedure is thus warranted.

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<sup>6</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(8) Following the request made in the revised 2019 Draft Budgetary Plan, the 2019 Stability Programme confirms that the budgetary impact of the collapse of the Morandi bridge in Genoa and of exceptionally adverse weather conditions that occurred in 2018 was significant and provides adequate evidence of the scope and nature of these additional budgetary costs. In particular, the 2019 Stability Programme indicates that the 2019 budget comprises exceptional expenditure amounting to about 0,2 % of GDP in relation to an extraordinary maintenance programme for the road network and a preventive plan to limit hydrogeological risks. Due to the direct link with the collapse of the Morandi bridge in Genoa and the adverse weather conditions of 2018, the specific treatment of expenditure for extraordinary road-maintenance and hydrogeological risk prevention could be considered in application of the 'unusual event clause'. According to the Commission, the eligible additional expenditure in 2019 amounts to 0,18 % of GDP for these measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the collapse of the Morandi bridge in Genoa and the exceptionally adverse weather conditions are considered 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. A final assessment, including on eligible amounts, will be made in spring 2020 on the basis of observed data for 2019 as provided by the Italian authorities.

- (9) On 13 July 2018, the Council recommended Italy to ensure that the nominal growth rate of net primary government expenditure<sup>7</sup> does not exceed 0,1 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019. That conclusion would not change even if the budgetary impact of the extraordinary maintenance programme for the road network following the collapse of the Morandi bridge in Genoa and of a preventive plan to limit hydrogeological risks following exceptionally adverse weather conditions were subtracted from the requirement of the preventive arm of the Stability and Growth Pact in 2019.
- (10) In 2020, in view of Italy's general government debt ratio above 60 % of GDP and projected output gap of -0,1 %, the net primary government expenditure should decline by 0,1 % in nominal terms, in line with the structural adjustment of 0,6 % of GDP stemming from the matrix of requirements under the Stability and Growth Pact. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from the requirement in 2020. Italy is prima facie not forecast to comply with the debt rule in 2019 and 2020. Moreover, at around 132 % of GDP, Italy's high public debt ratio implies that large resources are earmarked to cover debt servicing costs, to the detriment of more growth-enhancing items including education, innovation and infrastructure. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact. It would be important to use any windfall gains to further reduce the general government debt ratio.

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<sup>7</sup> Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out



(11) Italy's tax system continues to weigh heavily on the factors of production, to the detriment of economic growth. The high tax burden on labour and capital discourages employment and investment. The 2019 budget has lowered taxation on self-employed workers and small businesses. However, it has also temporarily raised the tax burden on firms at aggregate level, in particular on financial institutions. Tax bases less detrimental to growth, such as property and consumption, are underused, leaving room to shift the tax burden away from labour and capital in a budgetary neutral way. The recurrent property tax on first residences was repealed in 2015, including for wealthier households. In addition, land and property values (or 'cadastral' values), which serve as the basis for calculating property tax, are largely outdated, and a reform to align them with current market values is still pending. The number and size of tax expenditures, in particular in the case of the reduced rates for value added tax, are high, and their streamlining has been systematically postponed in recent years. There is also scope to alleviate the burden on compliant firms and households by reducing the complexity of the tax code and increasing the overall level of tax compliance. In particular, the VAT gap (the difference between theoretical VAT revenues and those actually collected) is among the highest in the Union. One of the reasons for this is the high level of tax evasion, which is especially related to omitted billing and invoicing. The mandatory electronic transmission of receipts for all commercial transactions with final consumers is a positive step in remedying the gap. However, legal thresholds for cash payments have been increased in recent years, which could discourage the use of electronic payments. Encouraging electronic payments instead could raise incentives to issue bills and invoices and thus improve tax compliance.

(12) Italy's expenditure on pensions, at around 15 % of GDP in 2017, is among the highest in the Union, and is expected to increase in the medium term due to the worsening old-age dependency ratio. The 2019 budget and the decree law implementing the new early retirement scheme in January 2019 backtrack on elements of past pension reforms, worsening the sustainability of public finances in the medium term. These new provisions will further increase pension expenditure in the medium term. Between 2019 and 2021, the new early retirement scheme ('quota 100') will allow people to retire at the age of 62 if they have paid 38 years of contributions. In addition, the scope of the existing provisions for early retirement has been extended, including by suspending until 2026 the indexation to life expectancy of the required minimum contribution, which past pension reforms had introduced. For those provisions, the 2019 budget earmarked funds worth 0,2 % of GDP in 2019 and 0,5 % of GDP in 2020 and 2021, but additional costs are also expected in the following years. The high public spending for pensions restrains other social and growth-enhancing spending items like education and investment, and limits margins to reduce the overall high tax burden and the high public debt. Furthermore, broadening the possibility for early retirement might negatively affect labour supply, in a context where Italy is already lagging behind the Union average for the participation of its older workers (55-64) in employment, thereby hampering potential growth and worsening the sustainability of public debt. To limit the increase in spending on pensions, previously adopted pension reforms to curb implicit liabilities arising from population ageing should be fully implemented. Furthermore, savings could be achieved by intervening on the high pension entitlements not matched by contributions, while respecting the principles of fairness and proportionality.

(13) Despite the economic slowdown, employment continued to increase in 2018, albeit at a slightly slower pace than in the previous year. The number of persons in employment reached 23,2 million at the end of the year, exceeding pre-crisis levels. The employment rate (20-64 years) rose to 63 % last year, but is still far below the Union average (73,2%). Moreover, regional gaps are substantial and the labour market remains segmented, with the share of temporary contracts having further increased in 2018. The unemployment rate declined to 10,6 %. Long-term and youth unemployment remain high, weighing on potential growth and social cohesion. Inactivity is prevalent among women, the low-skilled and young people. Moreover, the share of young people (15-24) neither in employment nor in education or training, at 19,2 % in 2018, is the highest in the Union. Involuntary part-time is also widespread, pointing to persisting slack in the labour market.

(14) Income inequality and risk of poverty are high, with wide regional and territorial disparities. In 2017, 28,9 % of the population was at risk of poverty or social exclusion, above both the pre-crisis levels and well above the 2017 Union average (22,4 %). Children, especially those with a migrant background, are particularly affected. In-work poverty is high and rising, in particular among temporary workers and people with a migrant background. The self-employed, who represent 20,8 % of the workforce (against the Union average of 13,7 %), are generally less protected against social risks than employees. Access to affordable and adequate housing is also a challenge and the provision of social services remains underdeveloped and fragmented. The impact of social transfers on reducing poverty and inequality reduction is one of the lowest in the Union. The anti-poverty scheme introduced in 2018 has been replaced by a new major scheme (citizenship income), which keeps an active inclusion approach, subject to certain conditions. The considerable administrative burden on employment and social services represents a challenge for the implementation of the reform. Its actual impact will depend on how effective policies are in getting people into work or training, the extent to which personalised social services are provided and on controls. In particular, the actual capacity to reach out to those most in need will influence the impact on the reduction of poverty and social exclusion. The outcome of the health system is overall good, despite below-Union average spending. Nevertheless, the provision of healthcare largely varies across regions, affecting access, equity and efficiency, and could be improved through better administration and by monitoring the delivery of standard levels of services. More home and community-based care and long-term care is key to provide support to people with disabilities and other disadvantaged groups.

- (15) Undeclared work is widespread in Italy, especially in the southern regions. According to the estimates of the National Institute of Statistics, the unobserved economy was worth about EUR 210 billion (12,4 % of GDP) in 2016. Around 37,2 % of it is attributable to undeclared work. This affects in particular vulnerable groups, such as migrants, women and minors. The new Labour Inspectorate Agency, operational since 2017, devoted particular attention to the phenomenon of "*caporalato*" in the agriculture sector, characterised by a high incidence of irregularity and by a risk of labour exploitation, especially for irregular migrants. A close monitoring of the measures recently adopted as well as additional steps are needed to tackle and prevent undeclared work and labour exploitation and to ensure fair and safe working conditions. Finally, it is important to ensure that the operationalisation of the citizenship income maximises the incentives to regular work and the transformation of undeclared work into regular employment, both through close monitoring and positive incentives.
- (16) Improving public employment services, by providing more resources and better quality services, is crucial for implementing the reform on the new citizenship income scheme. In this context of the new citizenship income scheme for low-income earners and unemployed persons, effective active labour market policies are an important tool for reducing labour market frictions and incentivising people to look for a job. In this respect, it is critical that employment services be equipped with sufficient and qualified staff. Effective job search assistance aiming to enhance training and upskilling is crucial to improve labour mobility and provide workers with the right skills for future labour market challenges and an increasingly challenging and competitive working environment. Some steps to make active labour market policies more effective have been recently taken, such as the definition of monitoring indicators and minimum standards, the adoption of a strategy for the long-term unemployed and the development of a qualitative profiling tool. Nonetheless, the overall efficiency of public employment services and their capacity to find jobs for people remain weak, performance varies widely between regions and integration with social and educational policies is limited. Cooperation with employers is also weak.

- (17) The gender employment gap in Italy remains one of the highest in the Union and the employment rate of women, albeit slightly increasing, is substantially lower than the Union average (53,1 % against 67,4 % in 2018). Investment in care services and women's participation in the job market remains insufficient, as well as measures to promote equal opportunities and adequate work-life balance policies. However, a comprehensive strategy to promote women's participation in the labour market is still missing. While the compulsory paternity leave was marginally extended from 4 to 5 days, the parental leave system remains inadequate. This, together with underdeveloped childcare and long-term care services, tends to prevent women with children or other family members in need of care from working. In 2017, only 28,6 % of children under three years of age were in formal early childhood education, well below the Union average. Investment in childcare, health and long-term care should take into account the wide geographical disparities in the availability of services. Furthermore, a high tax wedge for second earners reduces the financial incentive for women to take up work. Higher labour-force participation of women, as much as higher participation rates in general, could foster economic growth by lifting labour supply, alleviate poverty and mitigate the social and financial risks rising from population aging.
- (18) The initially envisaged reform of the collective bargaining framework aimed to bring wages and salaries more in line with economic conditions at the regional and firm level. In March 2018, Confindustria signed a framework agreement with the three major Italian trade unions (Cgil, Cisl and Uil) in order to expand second-level bargaining. Moreover, the agreement increases legal certainty by setting clearer rules for the representation of social partners at negotiations and establishes an improved algorithm for setting wage minima. The first implementation agreement on representativeness, health and work safety was signed at end of 2018 by the employers' association and the three major trade unions.

(19) Investment in education and skills is crucial to promote smart, inclusive and sustainable growth. Italy's sluggish productivity trend is affected by the weaknesses of the education and training system and the weak demand for high skills. Improving the quality of the education and training system is a major challenge. The school drop-out rate (early school leaving) remains well above the Union average (14,5 % versus 10,6 % in 2018) and there are wide regional and territorial disparities in educational outcomes. While the share of funding allocated to primary and secondary education is broadly in line with the Union average, further efforts to attract, effectively recruit and motivate teachers could contribute to improve learning outcomes. The recruitment system is too knowledge-based rather than skills-based, while the training component is limited. Moreover, Italian teachers' salaries remain low compared to international standards and relative to workers with tertiary education. Salary increases are slower than among international peers and career prospects are more limited, based on a single career pathway. Furthermore, promotions are based exclusively on seniority rather than merit. This results in a very low attractiveness of the teaching profession for highly qualified persons and discouragement of the teaching staff, which in turn has a negative impact on the learning outcomes of students. The apprenticeship system was gaining momentum in recent years, but adopted measures have scaled it down. Italian students and adults are amongst the worst performers in the Union in key competences and basic skills. Adult participation in learning is very limited and decreasing, in a context where the employment gap between the high- and low-skilled is among the highest in the Union. Upskilling is particularly needed for digital skills. So far there has been limited progress in developing digital skills and infrastructure. Investment in human capital is a pre-requisite for boosting public and private investment and current measures to boost digital skills and adult learning lack a comprehensive approach. Basic and advanced digital skill levels are below the Union average – only 44 % of individuals between 16 and 74 years have basic digital skills (57 % in the Union).

- (20) Weak investment in skills is slowing down Italy's transition to a knowledge-based economy, holding back productivity growth and limiting the potential to improve non-price competitiveness and GDP growth. Education gaps also help to explain the lower productivity of Italy's micro and small firms compared to peer countries. Tertiary education is underfinanced and understaffed, and the scope of vocational-oriented higher education is limited despite high employability rates. The proportion of university graduates remains low (27,9 % of the population aged 30 to 34 in 2018) and is coupled with a relatively low availability of tertiary graduates, especially in scientific and technical fields, targeted investments in skills are a pre-requisite to boost both public and private investment, particularly in intangibles. There is a need to boost studies in fields relevant to knowledge-intensive sectors and to strengthen specific skills, such as digital and financial ones.
- (21) The adoption by smaller firms of strategies to increase productivity, such as product, process and organisational innovation, remains limited, particularly in southern Italy. Investment in intangibles has been considerably below the Union average since the early 2000s. Business expenditure on research and development is almost half the average level of the euro area. Public support for business expenditure on research and development remains low, although it is improving thanks to the increased role of tax incentives. Public expenditure on research and development is also below the euro area average. Low innovation could also slow down the transition to a green economy. Improving Italy's innovation performance requires further investment in intangibles, as well as a stronger focus on technology transfer, taking into account regional weaknesses and the size of the firms. Some measures have been recently announced in the budget to promote innovative technologies. Public support for business expenditure on research and development can be improved through a balanced mix of direct and indirect measures and an in-depth assessment of the existing temporary tax incentives, to make the most efficient ones permanent. Measures to support knowledge (such as technological clusters) and cooperation among firms help smaller firms in particular to tackle these difficulties and increase their low productivity.



(22) Investment is needed to raise the quality and sustainability of the country's infrastructure. In the transport sector, Italy has not delivered on its infrastructure investment strategy (*Connettere l'Italia*). Very limited progress has been made in implementing the planned investments in rail, road and sustainable urban mobility. This is due to administrative delays, spending inefficiencies, incomplete implementation of the Code on procurement and concessions and litigation. The Union transport scoreboard shows that the quality of Italy's infrastructure is below the Union average. The state of repair is a clear source of concern, as shown by the collapse of the Morandi bridge in Genoa. The government has prioritised maintenance and safety with a plan to monitor the maintenance status of all infrastructure and the creation of a new agency in charge of safety of rail and road infrastructure. In this respect, for 2019 Italy was granted an allowance of EUR 1 billion under Union fiscal rules for an investment plan to secure road infrastructure similar to the Morandi bridge. Investing in sustainable transport and infrastructure is also a way of tackling environmental challenges. Sustained green investment is needed to achieve the ambitious 2030 Union energy and climate targets. The Integrated National Energy and Climate Plan is a key source of guidance to establish investment needs in the area of decarbonisation and energy. Investments are needed to improve the energy infrastructure, which would contribute to a more resilient, clean, secure and flexible energy system, while enhancing market integration and reducing price gaps. The Italian electricity grid is not yet sufficiently equipped to cope with increased exchanges across borders and to cope with the magnitude of variable renewables as projected for 2030. Investment in prevention for hydrogeological and seismic risks is needed to reduce emergency expenditure, including for infrastructure. For 2019, Italy was granted an allowance of EUR 2,1 billion with respect to Union fiscal rules to ensure prevention against major hydrogeological risks. Lastly, insufficient effective investment is being made in waste management and water infrastructure in southern Italy, while scarcity and drought risks continue. The fragmentation of the sector, together with the weak credit profile of smaller operators, remains a barrier to investment. Investment, including in climate change response, environmental sustainability and risk prevention as well as rural connectivity would also contribute to address regional disparities. In rural areas, the broadband network is also less advanced. On ultrafast (100 Mbps and above) broadband coverage, Italy still lags behind (only 24 % compared to the Union average of 60 %) and ranks near the bottom (27<sup>th</sup>) with a still very moderate growth rate. Both ultrafast broadband coverage and take-up show results much below the Union averages.

(23) The weak capacity of the public sector, especially at the local level, to administer funding represents an investment barrier across sectors, due to complex procedures, the overlapping of responsibilities and poor management of public employment. Inadequate skills in the public sector constrain the capacity to assess, select and manage investment projects. This also undermines the implementation of Union funds, where Italy lags behind compared to the Union average. The lower quality of governance in southern Italy seriously limits its spending and policy-making capacity. Improving the administrative capacity is a pre-condition for the effective delivery of public investment and the use of Union funds, with positive spillovers on private investment and GDP growth. Such improvements could give more impact to investments in broadband, transport, water management and the circular economy, especially in southern Italy. The latter lags behind mainly in terms of intangible investment. The improvement of administrative capacity of central and local bodies would have positive impact on the planning, evaluation and monitoring of investment projects, as well as on identifying and addressing possible bottlenecks.

(24) Increasing the efficiency of Italy's public administration and its responsiveness to business would have a positive impact on the business environment, investment and the ability of firms to exploit innovation opportunities. In 2015, a comprehensive enabling law reforming the public administration was adopted. The reform tackled most sources of inefficiency such as the length and complexity of procedures, the lack of transparency, the ineffective management of public employment, the inefficient management of public-owned enterprises, and low digitalisation. By the end of 2017, most of the reform was implemented and enforcement is ongoing, supported by the new "*Concretezza*" law. However, inconsistent planning, scarce financial resources and insufficient coordination are delaying the implementation of digital public services in key areas like online payment systems, which would help reducing complexity and increasing transparency. The high average age and low average digital skills of public employees are further slowing down the process. Nevertheless, when clear goals and effective enforcement are combined, results are evident as was the case for the rapid development of the electronic market for public administrations and e-invoicing. The 2015 public administration reform also envisaged a new framework reforming the management of local public services. However, in November 2016 Italy's Constitutional Court declared the procedure followed to adopt a number of legislative decrees, including the one on local public services, unconstitutional. A new legislative initiative is thus needed to promote the efficiency and quality of local public services, including by prioritising competitive bids over in-house solutions or direct grants.

- (25) The update to Economic and Financial Document 2018 (NADEF 2018) identified project preparation and quality improvement of the project cycle as critical factors for relaunching effective investment spending in Italy. In the same document, the constitution of a specific grant fund for project preparation and project review of key infrastructure projects was reported. Another grant fund was foreseen for preparation of smaller projects implemented by local bodies. However, implementing decrees on both funds have not been issued yet, and the allocation assigned to these funds may be lower than the one initially presented in the DEF 2018. In the budget law for 2019, the creation of a "*Centrale per la progettazione*" is mentioned but this body is not operational yet and its creation seems to require a longer-term effort. In terms of functionality, it is not clear how the *Centrale per la progettazione* will interact with municipalities and other local bodies.
- (26) Improvements to the business environment would facilitate entrepreneurship, and better framework conditions for competition would favour a more efficient allocation of resources and productivity gains. The 2015 annual competition law, adopted in August 2017, needs to be properly implemented. Moreover, significant barriers to competition persist in certain sectors, such as business services and retail. Improving the quality of the regulatory framework would ensure a level playing field for both innovative platforms and traditional operators, unleashing the full potential of the collaborative economy and fairer competition in all sectors. Increasing competitive processes to award public service contracts and concessions for access to public goods would positively affect the quality of services. Lack of regulatory stability in the public procurement system could jeopardise some key benefits of previous reforms and contribute to defer investment. Market surveillance of products is spread over various organisations, has many overlaps and lacks systems for efficient coordination. This reduces the effectiveness of controls in preventing unfair competition from non-compliant business.

- (27) The low efficiency of Italy's civil justice system remains a source of concern. In 2017, the time needed to resolve civil and commercial litigious cases in Italy was still the highest in the Union at all instances. While the length of proceedings showed an increase in first instance compared to 2016, past reforms are starting to positively affect trial length at higher instances, but there is still room to limit abuses of the trial and ensure a more efficient functioning of courts. At the Supreme Court of Cassation, a high number of incoming cases coupled with lower clearance rates of its tax section negatively affects the Court's efficiency and raises concerns about the tax justice system at first and second instance. Overall, adequate enforcement of simpler procedural rules could help to decisively speed up civil trials. In this regard, a reform to streamline the civil procedure has been announced, but has not yet been presented to the Parliament. Other challenges are the still limited and inconsistent use of the inadmissibility filter for appeals in second instance, the numerous vacancies for administrative staff, and the remaining differences across courts in the effectiveness of case management.
- (28) Italy has recently made some progress in improving its anti-corruption framework, including through better protection for whistle-blowers, a stronger role of the National Anti-corruption Authority in implementing it, and a new anti-corruption law of January 2019. The latter aims to boost the detection and repression of corruption through stricter penalties, better investigation techniques and a leniency scheme for those who denounce corruption. The law also suppresses prescription terms after a first-instance conviction, but only as of 2020. The latter is a long-awaited positive step in line with international standards. However, the repression of corruption remains ineffective in Italy, mainly because the length of criminal proceedings remains excessive in the absence of a much-needed reform of the criminal trial, including the appeal system to avoid abuse of litigation. Moreover, gaps persist in the prosecution framework for specific offences, such as embezzlement of public money.

(29) Italian banks have continued to make good progress in repairing their balance sheet despite renewed market pressure. However, due to their high exposure to the sovereign bonds, market volatility has adversely affected their capital positions, putting pressure on funding costs and making their access to unsecured wholesale funding more difficult. Continued reduction of the legacy stock of non-performing loans and unlikely-to-pay loans remains warranted especially for small and second-tier banks, in order to further safeguard financial stability and strengthen credit extension to the economy. Having banks, especially smaller ones, advance on meeting regulatory funding requirements would also boost the system's resilience to external shocks. Addressing banks' structurally low profitability by increasing efficiency and business model optimisation is also important. A timely implementation of the insolvency reform decrees would help accelerate the still slow foreclosure and collateral enforcement procedures and further boost the resilience of the banking sector. Any compensation granted by the State to shareholders and retail holders of subordinated debt of banks subject to past administrative liquidation procedures should be strictly targeted at addressing the social effects of past mis-selling. Governance in the banking system should be further improved, by promptly completing the 2015 reform of the large cooperative banks after legal clarity has been established.

- (30) Bank credit remains the dominant source of corporate financing. However, smaller and innovative firms still struggle to access credit, especially in southern Italy. The capital market is underdeveloped in comparison to other Member States, also due to factors constraining demand, such as low financial education, fear of losing control over the business and burdensome administrative requirements. Several measures were introduced in the last few years to improve access to finance, mostly focusing on the bank credit channel, although market-based measures such as mini-bonds, the alternative investment market, venture capital and direct public support also helped smaller and innovative firms to gain access to finance. The abolition of the allowance for corporate equity by the 2019 budget may reduce incentives for firms to use equity financing. Effectively boosting non-bank access to finance requires taking into account the needs of smaller and innovative firms as well as the capacity of investors to evaluate investment projects. Diversifying financing sources would better protect firms' investment from shocks in the banking sector, while supporting innovation and growth.
- (31) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Italy to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (32) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Italy's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Italy in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Italy, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(33) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion<sup>8</sup> is reflected in particular in recommendation (1) below.

(34) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below. Those recommendations also contribute to the implementation to the first four euro-area recommendations. Fiscal policies referred to in recommendation (1) contribute inter-alia to address imbalances linked to high government debt,

HEREBY RECOMMENDS that Italy take action in 2019 and 2020 to:

1. Ensure a nominal reduction of net primary government expenditure of 0,1 % in 2020, corresponding to an annual structural adjustment of 0,6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio. Shift taxation away from labour, including by reducing tax expenditure and reforming the outdated cadastral values. Fight tax evasion, especially in the form of omitted invoicing, including by strengthening the compulsory use of e-payments including through lower legal thresholds for cash payments. Implement fully past pension reforms to reduce the share of pensions in public spending and create space for other social and growth-enhancing spending.
2. Step up efforts to tackle undeclared work. Ensure that active labour market and social policies are effectively integrated and reach out in particular to young people and vulnerable groups. Support women's participation in the labour market through a comprehensive strategy, including through access to quality childcare and long-term care. Improve educational outcomes, also through adequate and targeted investment, and foster upskilling, including by strengthening digital skills.

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<sup>8</sup> Under Article 5(2) of Regulation (EC) No 1466/97.



3. Focus investment-related economic policy on research and innovation, and the quality of infrastructure, taking into account regional disparities. Improve the effectiveness of public administration, including by investing in the skills of public employees, by accelerating digitalisation, and by increasing the efficiency and quality of local public services. Address restrictions to competition, particularly in the retail sector and in business services, also through a new annual competition law.
4. Reduce the length of civil trials at all instances by enforcing and streamlining procedural rules, including those under consideration by the legislator and with a special focus on insolvency regimes. Improve the effectiveness of the fight against corruption by reforming procedural rules to reduce the length of criminal trials.
5. Foster bank balance sheet restructuring, in particular for small and medium-sized banks, by improving efficiency and asset quality, continuing the reduction of non-performing loans, and diversifying funding. Improve non-bank financing for smaller and innovative firms.

Done at Brussels,

*For the Council*

*The President*

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