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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2016 national reform programme of Italy and delivering a Council opinion on the 2016 stability programme of Italy

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 332 final.

COUNCIL RECOMMENDATION

of …

on the 2016 National Reform Programme of Italy

and delivering a Council opinion on the 2016 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[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,

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,

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.

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 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission 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 day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016[3]. As a country 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.

(2) The 2016 country report for Italy was published on 26 February 2016. It assessed Italy's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Italy's progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that Italy is experiencing excessive macroeconomic imbalances. In particular, the sluggish productivity growth hampers the recovery of competitiveness and makes it more difficult to reduce the high public debt ratio. The need for action to reduce the risk of adverse effects on the Italian economy and, given its size, of negative spillovers to the economic and monetary union is particularly important.

[3] OJ C 96, 11.3.2016, p. 1.

(3) On 28 April 2016, Italy submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[4], 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 this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) Italy is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule over 2013-15 and to the debt rule as of 2016. According to the Stability Programme, the government debt-to-GDP ratio is projected to peak in 2015 at 132,7 % and to gradually decline to 123,8 % in 2019. The Commission 2016 spring forecast expects the debt-to-GDP ratio to stabilise in 2016 and start a slight decline only as of 2017. The implementation of the substantial privatisation programme presented by the Italian authorities is a key challenge for Italy, given its expected contribution to the debt-reduction effort. While privatisations were implemented in line with the plans in 2015, the target of 0,5 % privatisation proceeds per year over 2016-2018 and of 0,3 % in 2019 seems very ambitious, also given the delays incurred by some privatisation projects. The macroeconomic scenario underpinning the budgetary projections is plausible.

4 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) On 18 May 2016, the Commission issued a Report under Article 126(3) TFEU, as Italy did not make sufficient progress towards compliance with the debt rule in 2015. The analysis included all the relevant factors and concluded that the debt criterion should be considered as complied with. The Commission will review its assessment in a new report under Article 126(3) of the Treaty based on the Commission 2016 autumn forecast, as further information on the resumption of the adjustment path towards the medium-term budgetary objective for 2017 becomes available.

(7) In spring 2015, Italy was granted a temporary deviation of 0,4 percentage points of GDP from the required adjustment path towards the medium-term budgetary objective in 2016 to take account of major structural reforms with a positive impact on the long-term sustainability of public finances. In its 2016 Draft Budgetary Plan, Italy requested an additional deviation of 0,1 percentage points of GDP from the required adjustment path towards the medium-term budgetary objective in 2016 to take account of other structural reforms with a positive impact on the long-term sustainability of public finances. The details underpinning all these reforms have been set out in Italy's 2016 National Reform Programme, which broadly confirms the reform agenda. The areas of reform put forward in the programme as having an impact on public finance sustainability include: (i) public administration and simplification; (ii) product and service markets; (iii) the labour market; (iv) civil justice; (v) education; (vi) a tax shift; (vii) measures to reduce the stock of non-performing loans and reform insolvency procedures; and (viii) spending review as financing measure. The impact of all these reforms on real GDP is estimated by the authorities at 2,2 percentage points by 2020, which seems to be plausible. If fully implemented in a timely manner, these reforms will have a positive impact on the sustainability of public finances. Italy can currently be assessed as qualifying for the full requested temporary deviation of 0,5 percentage points of GDP in 2016, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester, and subject to the conditions outlined in recital 10.

(8) In its 2016 Draft Budgetary Plan, Italy requested an additional deviation of 0,3 percentage points of GDP from the required adjustment path towards the medium-term budgetary objective in 2016 to take account of national investment expenditure in projects co-financed by the EU. The information provided by the 2016 Stability Programme seems to confirm that Italy's deviation from the adjustment path towards the medium-term budgetary objective in 2016 is being effectively used for the purposes of increasing investments. However, there are still some doubts on the feasibility of the whole projected amount of co-financed investment in the course of 2016. Italy can currently be assessed as qualifying for a temporary deviation of 0,25 percentage points of GDP in 2016, provided that it adequately carries out the intended investments and subject to the conditions outlined in recital 10. The Commission will carry out an ex-post assessment in order to verify the actual amount of the national expenditure in co-financed investment projects and of the related allowance to which Italy is eligible under the so-called "investment clause".

(9) The 2016 Stability Programme indicates that the budgetary impact of the exceptional inflow of refugees as well as of exceptional security measures is significant and that these should be considered as an unusual event outside the control of the Government, as defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. According to the Commission, the additional impact is in line with the estimations provided by the Stability Programme and amounts to 0,03 % of GDP in 2015 and 0,04 % in 2016 for refugee-related expenditure and at 0,06 % of GDP in 2016 for security measures. In relation to this, Italy requested a temporary deviation from the adjustment path towards the medium-term budgetary objective. The provisions defined 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 as well as the severity of the terrorist threat are exceptional events, their impact on Italy's public finances is significant and sustainability would not be compromised by allowing for a deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2015 has been reduced to take into account additional refugee-related costs. Regarding 2016, a final assessment, including on the eligible amounts, will be made in spring 2017 on the basis of observed data as provided by Italian authorities.

(10) In its opinion on Italy's 2016 Draft Budgetary Plan, the Commission indicated that, in the context of the 'overall assessment' of a possible deviation from the adjustment path towards the medium-term budgetary objective, it would take into account Italy's possible eligibility for flexibility under the Stability and Growth Pact, paying particular attention to whether a deviation from the adjustment path would be effectively used for the purposes of increasing investments; to the existence of credible plans for the resumption of the adjustment path towards the MTO; and to progress with the structural reform agenda, taking into account the Council recommendations. The Commission assesses that Italy is eligible for a further allowance of 0,35 percentage points of GDP for 2016, taking into account the progress with the structural reform agenda, the planned investments, as well as the government commitment to ensure compliance with the adjustment path towards the MTO in 2017, which the Commission will reassess in the autumn.

(11) Based on the Commission 2016 spring forecast, the projected structural deterioration of -0,7 % of GDP in 2016 points to a risk of some deviation from Italy's obligations under the preventive arm of the Stability and Growth Pact, after taking into account the deviation allowed for investments and the implementation of structural reforms. In 2017, under the no-policy-change assumption, the Commission's forecast shows a zero structural effort in 2017, as a result of which there would be a risk of significant deviation from the required 0,6 % of GDP structural adjustment. Italy is forecast not to comply with the debt rule in 2016 and in 2017.

(12) Overall, based on its assessment of the 2016 Stability Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that Italy is at risk of non-compliance with the provisions of the Stability and Growth Pact. The Commission will reassess Italy's compliance with the required adjustment towards the medium-term budgetary objective based on its 2016 autumn forecast as further information on Italy's resumption of the adjustment path towards the MTO for 2017 becomes available, including the 2017 Draft Budgetary Plan.

(13) Although initiatives to reform the fiscal framework are under way, only limited steps have been taken so far to secure the contribution of the spending review to fiscal consolidation. In particular, the spending review targets have been further reduced and the fact that the spending reviews are not fully integrated into the budgetary process weighs on the overall efficiency of the exercise. The finalisation of the comprehensive reform of the budgetary process in the making since 2009 is expected to address this shortcoming and to endow the budgetary process with a more performance-oriented approach. To improve public debt sustainability, it is also important to accelerate the deployment of the privatisation plan. Italy's taxation system hinders economic efficiency and continues to face several challenges. These are linked to very low tax compliance and an overdue reform of tax expenditures, in particular with respect to the reduced value-added tax rates, and of the old system of cadastral values. These were all aspects of the enabling law for the reform of the tax system that have not been implemented, or have been implemented only partially. In addition, recent developments such as the abolition of the property tax on first residences, appear at odds with the goal of broadening the tax base and shifting the tax burden from productive factors onto property and consumption.

(14) The reform of the public administration is an important step which, if the required legislative decrees are adopted and implemented, would allow Italy to grasp the expected benefits in terms of increased efficiency and quality in the public sector. The legislative decrees proposed by the Government in January 2016 on state-owned enterprises and local public services, as well as the forthcoming decree on public employment, are of particular importance for addressing the root causes of inefficiencies. While recent measures have been taken to step up the fight against corruption, including by raising penalties and prescription terms for specific corruption offences, the long-recommended systematic revision of the statute of limitations is still on hold. Accounting fraud is also an important issue. In the justice system, lengthy court proceedings and a high number of pending civil and commercial cases remain major challenges. Closely monitoring the impact of the measures taken in recent years to address these issues will help the assessment of whether it is necessary to complement them by additional action.

(15) Some progress has been made towards improving asset quality in the banking sector. Although the inflow of new non-performing loans has slowed down in recent months, their stock remains at a very high level and continues to put pressure on profitability and banks' resources. In addition, Italy's insolvency system and debt collection frameworks are insufficiently conducive to a swift work-out of impaired loans. Since mid-2015, several laws were adopted to simplify and accelerate insolvency and foreclosure procedures, and a draft enabling law for an organic reform of the bancruptcy framework has been proposed. However, the effects of these reforms on the length of procedures and recovery values are still to be seen. Since the beginning of 2015, Italy has adopted several measures to tackle weaknesses in the corporate governance of its banks, particularly regarding larger cooperative banks, banks with foundations as shareholders and small mutual banks. Fully implementing these reforms would help to make the sector more resilient and ensure a more efficient allocation of credit to the real economy. Whereas low cost efficiency in the banking sector hinders profitability and internal capital generation, the low-growth low-interest rate environment constitutes an additional challenge. The new EU bank resolution framework[5] has changed the risk profile of bonds issued by banks, of which significant amounts are held by Italian retail clients, underlining the importance of financial literacy among the general public.

[5] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

(16) In 2015, Italy deeply reformed its labour market rules and institutions through the so-called "Jobs act" reform. Implementing the reform of active labour market policies is key to activating those further away from the labour market, in particular the long-term unemployed and young people. There is currently a range of administrative, political and resource-related challenges. In particular, this requires a strengthening of public employment services and close monitoring of service delivery. The apprenticeships system has been reformed to also include adults made redundant and to broaden opportunities for young people, but implementation is still under way. Second-level bargaining is not sufficiently developed in Italy, hampering the adoption of innovative solutions at firm level that could improve productivity and make wages more responsive to labour market conditions. Action in this area needs to be taken in consultation with social partners and in accordance with national practices. Social partners have not yet reached an agreement on the reform of collective bargaining. A reform is expected by the end of 2016, according to the National Reform Programme. The labour participation rate of women is one of the lowest in the EU. Women are predominant in atypical and precarious jobs, constitute the majority of non-standard workers and risk being particularly affected by the informal economy. The tax and benefit system discourages second earners from working and the Jobs Act did not address this issue effectively. The limited availability of affordable care services also hampers participation in the labour market by women with children and elderly relatives. Poverty levels are high – more than a quarter of Italians are at risk of poverty or social exclusion – and the provision of social assistance remains weak and fragmented. Adopting and implementing the national antipoverty strategy and rationalising social spending could be first steps towards a gradual roll-out of a minimum income scheme based on the principle of active inclusion, at the national level in an overall budgetary neutral way. Substantial progress has been made on the reform of education. The school reform was adopted in July 2015 and implementing decrees are to be adopted by January 2017.

(17) Limited progress has been made towards fostering competition in services. The 2015 annual competition law is currently still under discussion in the Parliament. A number of provisions, for instance on legal professions, have been weakened during the parliamentary process. A number of areas are still over-protected or regulated, in particular the regulated professions, the health sector, local public transport and taxis*,* ports and airports. The retail sector is hampered by a number of inefficiencies caused by the strictness of market regulation. The public process of granting rights on public domain for economic activities does not promote competition, in particular due to the awarding of permit schemes without competitive and transparent procedures. Market-opening measures need to be supported by a business-friendly environment. Some progress has been made on simplification under the 2015-2017 simplification agenda, which allows for easier and more streamlined cooperation between central and regional governments. However, the Italian business environment is still not sufficiently conducive to growth and investment and suffers from a fragmented and stratified system of laws and regulations emanating from different levels of government. The administrative and regulatory burden still weighs on economic operators. Strengths in terms of starting a company or insolvency resolution are offset by weaknesses in terms of dealing with construction permits, contract enforcement, tax payment or getting credit. The implementation of the national public procurement strategy adopted in early 2016 could also help to tackle some systemic and widespread weaknesses.

(18) 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 2016 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. The recommendations under the European Semester are reflected in recommendations (1) to (5) below.

(19) In the light of this assessment, the Council has examined the Stability Programme and its opinion[6] is reflected in particular in recommendation (1) below.

(20) 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 (5) below,

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

HEREBY RECOMMENDS that Italy take action in 2016 and 2017 to:

1. In 2016, limit the temporary deviation from the required 0,5 % of GDP adjustment towards the medium-term budgetary objective to the amount of 0,75 % of GDP allowed for investments and the implementation of structural reforms, subject to the condition of resuming the adjustment path towards the medium-term budgetary objective in 2017. Achieve an annual fiscal adjustment of 0,6 % or more of GDP towards the medium-term budgetary objective in 2017. Finalise the reform of the budgetary process in the course of 2016 and ensure that the spending review is an integral part of it. Ensure the timely implementation of the privatisation programme and use the windfall gains to accelerate the reduction of the general government debt ratio. Shift the tax burden from productive factors onto consumption and property. Reduce the number and scope of tax expenditures and complete the reform of the cadastral system by mid-2017. Take measures to improve tax compliance, including through electronic invoicing and payments.

2. Implement the reform of the public administration by adopting and implementing all necessary legislative decrees, in particular those reforming publicly-owned enterprises, local public services and the management of human resources. Step up the fight against corruption including by revising the statute of limitations by the end of 2016. Reduce the length of civil justice proceedings by enforcing reforms and through effective case-management.

3. Accelerate the reduction in the stock of non-performing loans, including by further improving the framework for insolvency and debt collection. Swiftly complete the implementation of ongoing corporate governance reforms in the banking sector.

4. Implement the reform of active labour market policies, in particular by strengthening the effectiveness of employment services. Facilitate the take-up of work for second earners. Adopt and implement the national antipoverty strategy and review and rationalise social spending.

5. Swiftly adopt and implement the pending law on competition. Take further action to increase competition in regulated professions, the transport, health and retail sectors and the system of concessions.

Done at Brussels,

For the Council

The President