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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Italy

and delivering a Council opinion

on the updated Stability Programme of Italy, 2011-2014

{SEC(2011) 720}

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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 policies¹, and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission²,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

- (1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.
- (2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States,³ which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

¹ OJ L 209, 2.8.1997, p. 1.

² OJ C , , p. .

³ Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

- (3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.
- (4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programme and National Reform Programmes.
- (5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.
- (6) On 6 May 2011, Italy submitted its 2011 Stability Programme update covering the period 2011-2014 and its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.
- (7) The Italian economy had been affected by structural weaknesses long before the current global economic and financial crisis. Between 2001 and 2007, average real GDP growth was around 1%, i.e. only half the euro-area average, due mainly to sluggish productivity growth. As these developments affected the whole country, the large regional economic disparities were not reduced. Although the economy was not marked by large private sector internal imbalances, it was seriously affected by the global crisis. A collapse in exports, and subsequently in investment, produced a sharp contraction of around 7% in real GDP between the second quarter of 2008 and the second quarter of 2009. After having steadily fallen in the previous decade, government gross debt increased to 119% by end-2010, also reflecting the sharp decline in GDP. Employment declined much less, supported by a government-sponsored scheme to reduce hours worked, and therefore the unemployment rate increased only moderately over 2008-09. Led by exports, the economy started to recover in the second half of 2009, albeit at a slow pace. The labour market situation remained fragile in 2010, with the unemployment rate stabilising at around 8.5% by the end of the year. Given the very high government debt ratio, Italy kept an appropriately prudent fiscal stance during the crisis, refraining from undertaking a large fiscal stimulus, and thus keeping the government deficit below the euro-area average in 2009-10.
- (8) Based on the assessment of the updated stability programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underlying the programme is plausible. The programme plans to bring the general government deficit below 3% of the GDP reference value by 2012, based on further expenditure restraint and additional revenues from improved tax compliance. Following the correction of the excessive deficit, the programme plans to achieve the medium-term objective (MTO) of a balanced budgetary position in structural terms by the end of the programme period (2014), backed by a commitment to further restrain primary expenditure. The programme projects the government debt ratio to peak in

2011 and to decline at an increasing pace thereafter, as the primary surplus increases. The planned average annual fiscal effort over the period 2010-2012 is above the 0.5% of GDP recommended by the Council under the EDP, and the envisaged pace of adjustment after 2012 is well above the provisions in the Stability and Growth Pact. Reaching the above deficit and debt outcomes will require a strict budgetary implementation, while more information on the planned consolidation measures is needed to increase the credibility of the programme.

- (9) Given the very high government debt, which stands at around 120% of GDP in 2011, the pursuit of a durable and credible consolidation and the adoption of structural measures to enhance growth are key priorities for Italy. For the period until 2012, the achievement of the targets for the general government deficit set in the stability programme, and thus the correction of the excessive deficit by 2012, relies on the full implementation of the measures already adopted. Additional action would be required if, for instance, revenues from improved tax compliance are lower than budgeted or if difficulties arise in achieving the planned restraint in capital expenditure. For 2013-14, the new three-year budgetary framework prescribes that the concrete measures underpinning the consolidation effort be adopted by October 2011. Although the budgetary framework has been strengthened considerably in recent years, the introduction of binding expenditure ceilings and further improvements to budgetary monitoring across all government sub-sectors is intended to foster fiscal discipline and strengthen the credibility of the medium-term budgetary strategy.
- (10) Despite relatively strong job creation in the years preceding the crisis, Italy's labour market exhibits some structural weaknesses. Workers on open-ended contracts enjoy more protection than workers with little work tenure or on temporary contracts, especially when they are officially registered as self-employed, but are actually in a standard subordinate working relationship. For the former, labour legislation allows collective dismissals and dismissals for economic reasons in a very limited number of cases. At the same time, not all workers who lose their job receive adequate income support, as labour market segmentation is accompanied by a fragmented system of unemployment benefits. The level of unemployment among workers below 25 years of age reached 27.8% in 2010, with an uneven distribution across the country, and youth unemployment in southern regions was double that in northern regions. The role of apprenticeships and vocational training is not sufficiently emphasised. Although very useful and necessary, there is currently no single system of skill certification and recognition of vocational and training standards that is acknowledged across the country, thus hampering labour mobility and employment opportunities throughout Italy. There is room to strengthen the effectiveness of employment services, especially in regions with high unemployment. Finally, undeclared work remains an important phenomenon in Italy.
- (11) Aligning wage developments with productivity growth is important in view of Italy's constant loss of competitiveness since the late 1990s; in this regard, bargaining at firm level can play a significant role, which may also help to address regional labour market disparities. The 2009 reform of the bargaining framework introduced, among other things, the possibility of opening clauses (i.e. derogations from the sectoral wage agreed at national level), but they have not yet been widely used.
- (12) The employment rate of women lags behind that of men by over 20 percentage points across the whole territory. Barely one third of women between 20 and 64 were

employed in the southern regions in 2009, due to both relatively lower activity rates and higher unemployment. Italy's relatively high taxation of labour reduces incentives to labour supply, especially for dependent spouses, and adversely affects labour demand by firms. To help boost female employment, the National Reform Programme looks to the plan adopted in 2010 to coordinate efforts across the layers of government to promote the reconciliation of work and family life. The government recently introduced a tax incentive for companies hiring disadvantaged workers, including those who work in a sector or occupation where the gender imbalance is particularly pronounced, in regions with high unemployment. The Programme also announces a reform of the taxation system with a view to gradually shifting the tax burden from labour to consumption, which might help increase employment.

- (13) Compared to EU standards, the cost of doing business in Italy remains high, in particular in southern regions, despite recent measures to improve the business environment and to enhance the performance-orientation and accountability of the public administration. There is still ample scope for removing regulatory and administrative barriers in product and services markets, particularly in professional services. An Annual Law on Competition was introduced in 2009 as a legislative tool to enhance the competitive environment and consumer protection, but it has not yet been adopted. Lengthy contract enforcement procedures are a further weakness of Italy's business environment. Non-banking channels for financing the growth of firms are still comparatively rare in Italy, especially for SMEs. Equity financing and venture capital, in particular, continue to play only a limited role, despite their potential for promoting growth in firm size, outreach to new global markets and improved corporate governance.
- (14) R&D expenditure posted only a modest increase over the past ten years. Consequently, R&D intensity remains low, at around 1.27% of GDP, and well below the EU average (1.90%). This gap is mainly due to a low level of industrial research, as business R&D intensity stands at 0.64% of GDP compared to an EU-27 average of 1.23%. Venture capital intensity also remains very low. A number of measures, including time-limited tax breaks for companies investing in research projects carried out by universities or public-sector entities, are presented in the NRP, but the target of 1.53% of GDP set for R&D intensity is barely above current levels.
- (15) Italy is the third-largest beneficiary of EU cohesion policy funds, having received around 8% of the total EU cohesion policy budget during the period 2007-2013. Halfway through the programming period, the share of EU funds actually mobilised is only 16.8% and it is much lower in the southern Convergence regions.
- (16) Italy has made a number of commitments under the Euro Plus Pact⁴. The National Reform Programme mentions some recently adopted measures and broadly outlines plans for future reform to address public finance sustainability and financial stability, foster competitiveness and increase employment, in line with the principles of the Euro Plus Pact. A new major commitment specifically undertaken to respond to the Pact is the government's intention to amend the Constitution in order to reinforce budgetary discipline. These elements have been assessed and taken into account in the recommendations.

⁴ More details on the commitments made under the Euro Plus Pact can be found in SEC(2011) 720.

- (17) The Commission has assessed the Stability Programme and National Reform Programme, including the Euro Plus Pact commitments for Italy⁵. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Italy, but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU level input into future national decisions. In this light, the Commission considers that Italy's consolidation plan for 2011-14 is credible until 2012, whereas it should be underpinned by concrete measures for 2013-14, so as to put the very high government debt on a steadily declining path. The NRP outlines a comprehensive set of initiatives across all dimensions of the Europe 2020 Strategy, but further measures are considered necessary in order to address long-standing structural weaknesses exacerbated by the crisis. To enhance Italy's growth and job-creation potential, and promote the catching-up of southern regions, further steps should be taken in 2011-2012 to improve the functioning of the labour market, open up services and product markets to greater competition, improve the business environment, strengthen research and innovation policy and promote faster and better use of EU cohesion funds.
- (18) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) Treaty on the Functioning of the European Union of 2 June 2010, the Council has examined the 2011 update of the Stability Programme of Italy and its opinion⁶ is reflected in particular in its recommendation under (1) set out below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Italy,

HEREBY RECOMMENDS that Italy should take action within the period 2011-2012 to:

- (1) Implement the planned fiscal consolidation in 2011 and 2012 to ensure correction of the excessive deficit. Fully exploit any better-than-expected budgetary developments for faster deficit and debt reduction and stand ready to prevent slippages in budgetary implementation. Back up the targets for 2013-14 with concrete measures by October 2011 as provided for in the new multi-annual budgetary framework. Strengthen the framework by introducing binding ceilings on expenditure and improving monitoring across all government sub-sectors.
- (2) Take measures to combat segmentation in the labour market, by reviewing selected aspects of employment protection legislation and reforming in a comprehensive manner the currently fragmented unemployment benefit system. Step up efforts to fight undeclared work. In addition, take steps to promote greater participation of women in the labour market, by increasing the availability of care facilities throughout the country and providing financial incentives to second earners to take up work in a budgetary neutral way.
- (3) Take steps, based on the 2009 law reforming the collective bargaining framework and in consultation with the social partners in accordance with national practices, to ensure that wage growth better reflects productivity developments as well as local and firm level conditions.

⁵ SEC(2011) 720.

⁶ Foreseen in Article 5(3) of Council Regulation (EC) No 1466/97.

- (4) Introduce measures to open up the services sector to further competition, in particular in the field of professional services. Adopt in 2011 the Annual Law on Competition, taking into account the recommendations presented by the Anti-trust Authority. Reduce the length of contract law enforcement procedures. Take steps to promote the access of SMEs to capital markets by removing regulatory obstacles and reducing costs.
- (5) Improve the framework for private sector investment in research and innovation by extending current fiscal incentives, improving conditions for venture capital and supporting innovative procurement schemes.
- (6) Take steps to accelerate growth-enhancing expenditure co-financed by cohesion policy funds in order to reduce the persistent disparities between regions, by improving administrative capacity and political governance. Respect the commitments made in the national Strategic Reference Framework in terms of the amount of resources and quality of expenditure.

Done at Brussels,

*For the Council
The President*