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OVERVIEW

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BETTER POLICIES FOR BETTER LIVES

This Overview is extracted from the Economic Survey of Italy. The Survey is published on the responsibility of the Economic and Development Review Committee (EDRC) of the OECD, which is charged with the examination of the economic situation of member countries.

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Executive summary

After a modest recovery, the economy is weakening

Italy continues to suffer from long-standing social and economic problems

A comprehensive reform package holds the key to stronger growth and social inclusion

In-work benefits and a moderate guaranteed income scheme would boost employment and reduce poverty

More effective regional development policies and strengthening capacity at the local level would help to narrow the regional divide

After a modest recovery, the economy is weakening

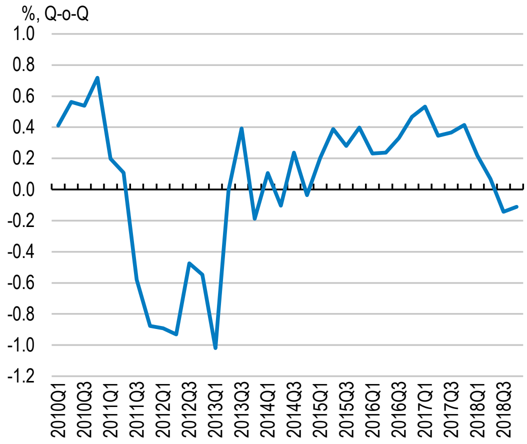
In recent years, supportive global economic conditions, expansionary monetary policy, structural reforms and prudent fiscal policy supported Italy's gradual economic recovery. Exports, private consumption and more recently investment drove growth, buttressed by a shift of export industries towards higher value added products. The employment rate has increased by 3 percentage points since 2015 and the health of the banking system has improved.

However, the recovery has slowed. GDP is projected to contract by 0.2% in 2019 and expand by 0.5% in 2020. Expansionary fiscal policy and low growth will push the general government budget deficit to 2.5% of GDP in 2019 from 2.1% in 2018. The 2019 budget rightly aims to help the poor but its growth benefits are likely to be modest, especially in the medium term. The new guaranteed minimum income (Citizen's Income), which replaces the Inclusive Income Scheme (REI), allocates significant additional funds to anti-poverty programmes, but its effectiveness will depend critically on marked improvements in job search and training programmes. The reduction in the retirement age – to 62 years with at least 38 years of contributions – will lower growth in the medium run by reducing work among older people and, if not actuarially fair, will worsen intergenerational inequality and raise the public debt.

Italy continues to suffer from long-standing social and economic problems

Real GDP per capita is roughly the same as in 2000 and well below its pre-crisis peak. Though the employment rate has risen, it is still one of the lowest among OECD countries, especially for women. Job quality is low and the mismatch between people's jobs and their skills is high by international comparison. Productivity growth has been sluggish or negative for the past 20 years.

Figure A. GDP growth has slowed



Source: OECD *Economic Outlook 104* database, including more recent information.

Table A. The economy is projected to recover gradually

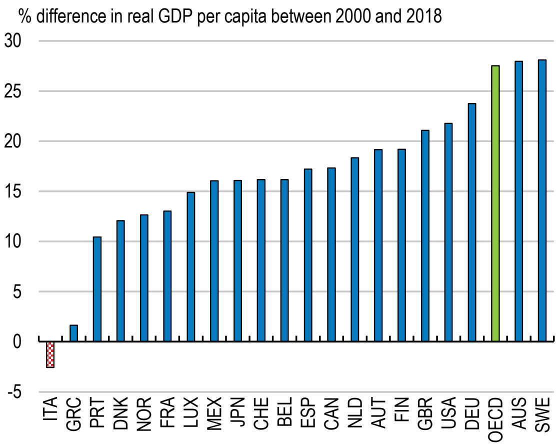
Annual % change, unless otherwise indicated

	2018	2019	2020
Gross domestic product	0.8	-0.2	0.5
Private consumption	0.6	0.5	0.5
Gross fixed capital formation	3.2	-0.2	1.1
Exports	1.4	2.7	2.3
Imports	1.8	2.1	2.7
Unemployment rate (%)	10.6	12.0	12.1
Consumer price index	1.2	0.9	0.8
Fiscal balance (% GDP)	-2.1	-2.5	-3.0
Public debt (gross, % of GDP)	132	134	135
Current account (% of GDP)	2.6	2.7	2.4

Source: OECD *Economic Outlook 104* database, including more recent information.

Absolute poverty rates for young people rose sharply as a result of the crisis and remain high. Poverty rates vary widely between regions and in southern regions are among the highest in the EU. Only a small share of social benefits (excluding pensions) for the working age population go to the people most in need. The dearth of job opportunities pushes many young people to emigrate, exacerbating Italy's already fast population ageing.

Figure B. Italy's GDP per capita is at the same level as 20 years ago



Source: OECD *Economic Outlook 104* database, including more recent information.

The already large regional differences in GDP per capita and employment rates have widened over recent decades. Regional disparities in employment rates explain much of the difference in living standards among regions.

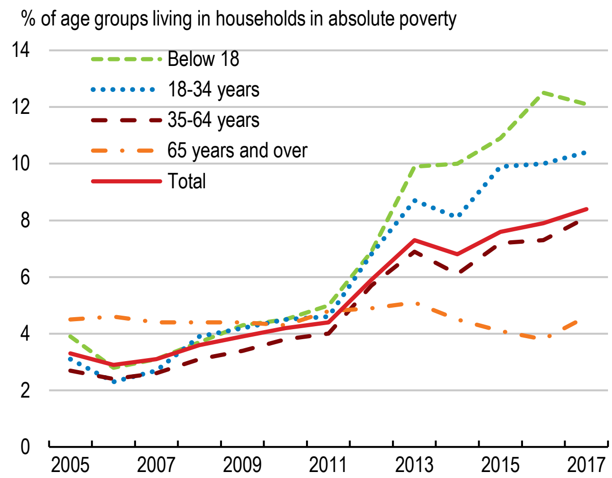
Renewable energy sources have expanded rapidly from 2000 to the mid-2010s but have stalled since then. Air pollution is high in some area, resulting in high mortality and harming well-being. Other environmental challenges result from weaknesses in public administration, reflected in patchy waste collection and management and deficient hydrological risk management. The administrative fragmentation and limited power of metropolitan bodies is an obstacle to the integration of land use and transport policies, hampering the design of low-emission growth policies.

A comprehensive reform package holds the key to stronger growth and social inclusion

Italy faces the double challenge of reviving growth and making it more inclusive while putting the public debt on steady downward path. Tackling Italy's structural challenges requires a multi-year reform package to achieve stronger and more inclusive growth, and revive confidence in the reform capacity of the country.

The ambitious reform package proposed in this Survey would support stronger employment, improve well-being and raise productivity growth. By 2030, annual trend GDP growth would increase from 0.6% under current policies to above 1.5%. If accompanied by a rise of the primary surplus to above 2%, the proposed reform package would help to put the debt-to-GDP ratio on a downward path.

Figure C. Absolute poverty rates rose during the crisis and remain high, especially for the young



Source: ISTAT *Poverty* database.

Increasing productivity growth is key to raising living standards and to offsetting the large negative effect of demographics and a shrinking labour force. This will require: enhancing competition in markets that are still protected, such as professional services and local public services; raising innovation and business dynamics, including through targeted incentives connected to the Industry 4.0 plan; removing obstacles hampering the growth of SMEs; and enhancing the efficiency of public administration by raising accountability and transparency and pursuing the digitalisation of the public sector.

A credible medium-term plan to reduce the debt-to-GDP ratio will improve fiscal credibility and help contain the risk premium on government debt. Without sustainable fiscal policy, the room to enhance infrastructure, help the poor and deliver the public services people expect will inevitably narrow. Designing budgets within the EU Growth and Stability Pact, which should be implemented in a pragmatic way, would help to strengthen fiscal credibility by providing an anchor to fiscal policy. If fiscal credibility can be improved rapidly, a falling risk premium on government debt would accelerate the reduction of the debt ratio.

Public spending needs to become more efficient and better targeted with a fairer tax system. Designing thorough spending reviews during the preparation of the yearly budget and effectively implementing them would promote priority-setting and spending re-allocation, contributing to free up resources for effective public programmes and public investment. Improving voluntary tax compliance and vigorously fighting tax evasion are key for tax revenues and allow for a reduction in tax rates, making the tax system fairer.

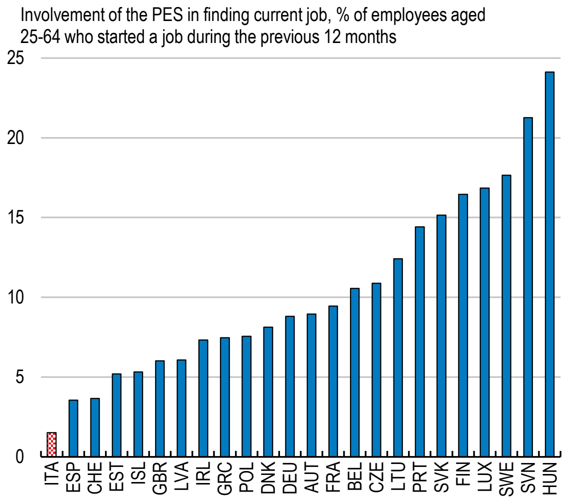
The health of the banking system has improved but challenges remain. The government strategy to deal with insolvent banks through a mix of resolutions, recapitalisations and acquisitions has yielded fruit. Banks' capital ratios are above minimum requirements. The stock of nonperforming loans in banks' balance sheets has fallen markedly over the last two years and profitability has returned, though it remains low. The banking sector is undergoing a rationalisation and consolidation process, but the reform to cooperative banks is still to be fully implemented. The health of the banking sector is closely linked with public finance and its effects on government bond yields. Lower government bond yields would help to safeguard the stability of the banking sector.

In-work benefits and a moderate guaranteed income scheme would boost employment and reduce poverty

A key part of making growth strong and more inclusive involves increasing formal employment. Italy's tax and benefit system and social services can do more to support employment in low-wage regions and for second earners. The transfer and eligibility rules of the Citizen's Income will need to ensure work incentives are strengthened and not weakened because of higher transfers. The level of the transfer provided by the current plan for the Citizen's Income risks encouraging informal employment and creating poverty traps. Ensuring transfers are conditional on well designed and monitored employment and social inclusion "pacts" is key to supporting beneficiaries to move into employment. Introducing an in-work benefit system and lowering the Citizen's Income benefit to about 70% of the relative poverty line (50% of the median equivalised household income) would contribute to raising employment, especially in lagging regions, and protecting households from poverty.

The success of any guaranteed minimum income scheme will hinge on improving job-search and training programmes. This will depend on implementing a multi-year plan to revamp public employment services based on higher investments in IT systems, profiling tools and human resources, especially in lagging regions where social needs are greater and more urgent. Developing strong partnerships with private-sector job-search and training agencies and extending the existing training voucher to include both Citizen's Income beneficiaries and other job seekers would improve their job prospects. Stronger collaboration and coordination between public employment service and municipalities' social assistance programmes would help to achieve the Citizen's Income objectives. Integration of immigrants through language and professional training courses and certifying immigrants' skills would support social inclusion, and boost labour force participation.

Figure D. Italy's public employment services help few jobseekers find work

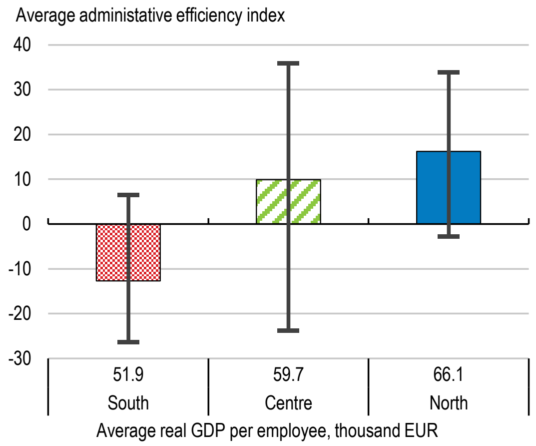


Source: Calculations based on EU-LFS 2014.

More effective regional development policies and strengthening capacity at the local level would help to narrow the regional divide

Rationalising and improving coordination among the bodies involved in regional development policies by strengthening the role and expertise of central-government bodies would make regional policies more effective. Funds for regional development policies need to add to, and not to substitute for, ordinary spending. The ordinary public administration needs to offer a more similar level of essential services across the whole country. Setting and enforcing minimum performance standards for services provided by sub-national administrations, such as active labour market policies or waste management, would go in the right direction. Local public administrations that repeatedly fail to achieve these minimum standards should undergo a restructuring programme in collaboration with better performers and the central government to strengthen capacity, reorganise processes and enhance accountability and transparency. Improving the governance of metropolitan areas would enhance agglomeration economies and strengthen the role of metropolitan cities as engines of green growth. Progress in this area will hinge on regions and municipalities sharing some of their functions and budget with metropolitan bodies.

Figure E. Higher efficiency of municipalities is associated with higher productivity



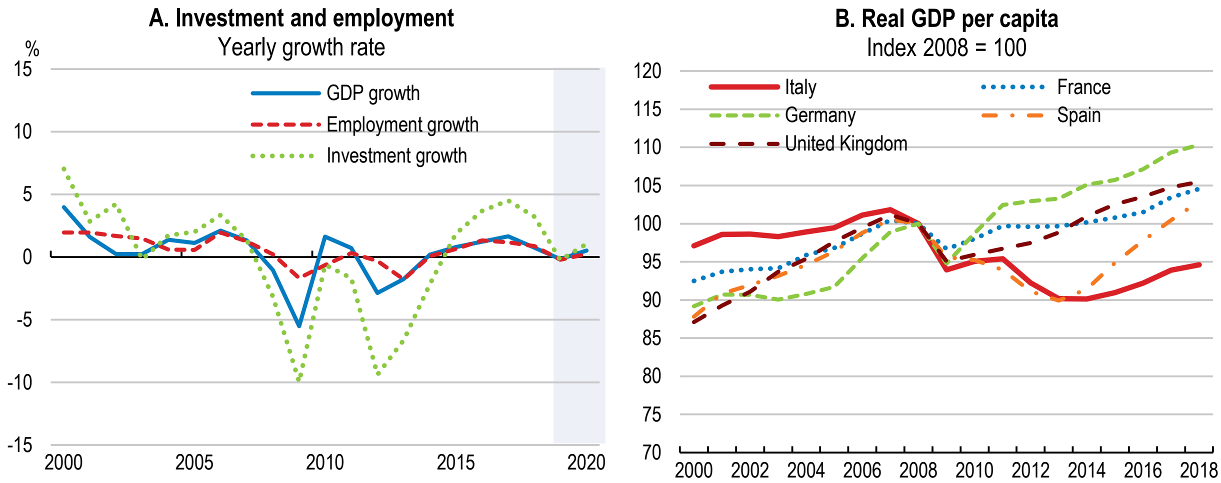
Note: The administrative efficiency index is the percentage difference between assessed spending needs given conditions and actual spending. A higher value indicates greater efficiency.
Source: OECD *Regional Statistics* database; and OpenCivitas.

MAIN POLICY FINDINGS	KEY RECOMMENDATIONS
Boosting sustained and inclusive growth	
After a modest economy recovery, real GDP per capita is still lower than in 2000 and the economy is now slowing. The health of the banking system has considerably improved but challenges persist. Poverty remains high especially among the young. The 2019 budget introduced a fiscal easing, mostly through higher current spending (especially social transfers). The relaxation of early retirement rules will raise already high pension spending. The debt to GDP ratio will gradually increase and public finances remain vulnerable to higher interest rates.	Develop a multi-year programme of institutional, economic and social reforms and do not reverse important measures taken in recent years. Boost fiscal credibility by setting out a medium-term fiscal plan within the EU Growth and Stability Pact, aiming to steadily raise the primary surplus. Continue to pursue reforms to boost productivity including measures to improve the efficiency of the judicial system through improvements in administration processes and greater use of alternative dispute resolution. Fully implement the reforms of cooperative and of mutual banks, and complete the reform of the insolvency regime. Reverse the changes in early retirement rules introduced in 2019 and preserve the link between retirement age and life expectancy.
The tax system is complex and tax administration highly fragmented. Many tax expenditures are poorly targeted. Despite recent progress, tax evasion remains high and cash payments are used more than elsewhere.	Continue to improve voluntary tax compliance and avoid repeated tax amnesties. Lower the maximum threshold for cash payments. Abolish tax expenditures that are poorly targeted or have outdated objectives. Continue to improve coordination across tax administration agencies.
Public investment has fallen as a share of GDP. The central and sub-national governments have failed to use all available funds for public investment due to poor project preparation and slow execution. The new public procurement code is well thought out but its slow implementation has hindered public investment.	Create, as planned, a technical support unit for public investment using existing administrative structures and ensure it is well staffed. Simplify the most complex aspects of the public procurement code but protect the powers of the anticorruption authority. Develop a comprehensive public investment and spatial plan linking infrastructure developments with land use management.
Tax and benefits reforms to reduce poverty and encourage employment	
Poverty remains high, especially in lagging regions and among families with children while in-work poverty is rising. The new guaranteed income scheme (Citizen's Income) will greatly increase resources to fight poverty but its sustainability and effectiveness hinge on significantly improving public employment and social services. Adults out of work have little effective support from public employment services to prepare for and find stable formal sector jobs.	Implement a multi-year plan to revamp public employment services based on enforcing essential service standards and higher investments in IT systems, profiling tools and human resources. Ensure capacity to administer the Citizen's Income by building on and strengthening, where necessary, municipalities' social assistance services and establishing strong collaboration between them and public employment services. Provide more quality infant care places at a low cost relative to average wages, prioritising regions with low female employment.
The employment rate, while at a record high, is low by international standards. Informal work is high, especially in lagging regions. Current tax and benefit rules are complex and lead to high effective tax rates, especially for low wage earners and second earners, weakening incentives to find jobs in the formal sector. The Citizen's Income risks weakening work incentives further.	Reduce the labour income tax wedge on low-income workers and second earners through lowering employer social security contributions and tax and benefit reforms, while maintaining the tax system's progressivity. Lower and taper off Citizen's Income benefits to encourage beneficiaries to seek employment in the formal sector and introduce an in-work benefit for low-income earners.
More effective investments in regional development and strengthening capacity at the local level	
Institutional setting of regional development policies is complex and coordination between bodies, at central and local level, is weak, leading to poor disbursement of regional development and EU cohesion funds and contributing to regional disparities.	Rationalise and improve coordination among bodies involved in regional development policies by strengthening the role and expertise of central government bodies.
Metropolitan governance bodies have little power, limiting agglomeration economies.	Empower metropolitan governance bodies with the transfer of some of the powers of regions and provinces.
The agency (ANPAL) to coordinate active labour market polices has little power to ensure regional agencies achieve essential service standards.	Grant to ANPAL the power to restructure public employment services that repeatedly fail to meet commonly agreed performance targets.
Much municipal waste is recycled but the rate of recycled waste varies greatly among regions, generating health hazards in some areas and harming green growth.	Restructure operations relating to waste management of sub-national governments that repeatedly fail to reach targets for waste collection and recycling.

Key policy insights

Supportive global economic conditions, expansionary monetary policy, structural reforms and prudent fiscal policy bolstered Italy's gradual economic recovery for the past 4 years. Exports, private consumption and more recently investment were the main drivers of the recovery supported by rising external demand, a shift of export industries towards higher value added products and labour market reforms that contributed to raise the employment rate by 3 percentage points (Figure 1, Panel A).

Figure 1. Italy's economic recovery has been weak



Source: OECD *Economic Outlook 104* database, including more recent information.

However, the recovery is now slowing, after having been weaker than in other countries, and real GDP per capita is still below its pre-crisis peak (Figure 1, Panel B). Moreover, the social and economic wounds inflicted by the crisis have not yet healed. Poverty rates remain high, especially among the young, and real GDP per capita is roughly the same as 20 years ago. Low productivity growth and large social and regional disparities are long-standing challenges. While Italy does well in some areas of well-being, such as work-life balance, social connections and health status, it underperforms in others, such as environmental quality, education and skills, with Italian poorer regions performing markedly worse than more advanced ones.

Raising economic growth, reducing regional and social divides, and ensuring future generations enjoy the same environmental services as those of today will be challenging and require vigorous policy actions. Against this background, the main messages of this Survey are:

- Developing and implementing a credible medium-term programme of deep structural reforms is key to boosting productivity, raising employment and job quality, and reducing poverty, alongside strengthening the fiscal balance. Further progress on raising public administration efficiency, reducing administrative barriers and raising competition would help to achieve this. Tax and government spending policies should focus on raising tax compliance, boosting efficient investment programmes and ensuring social spending is sustainable, well targeted and fair across generations.

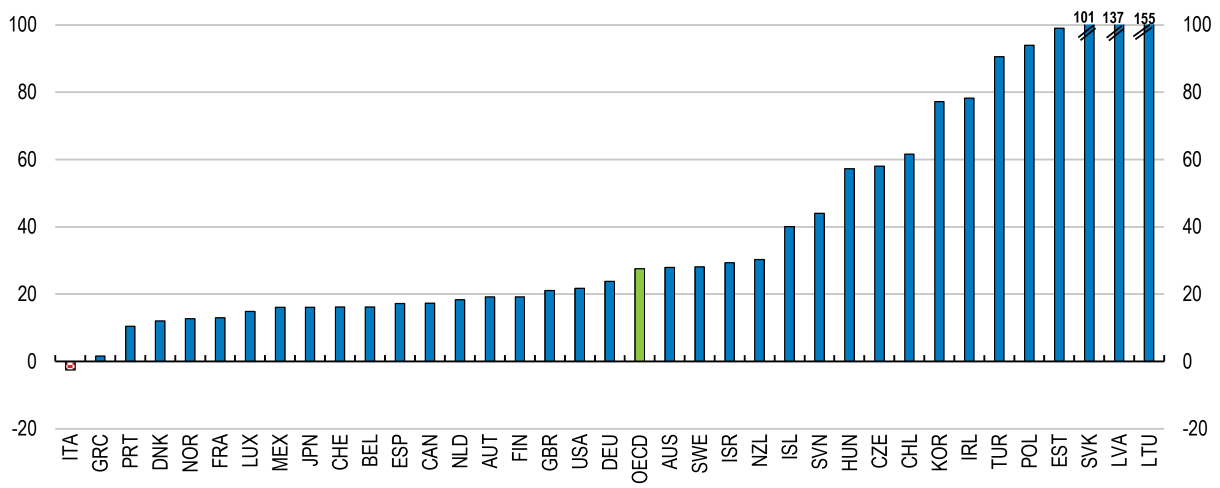
- Tackling the large social and regional divides hinges on raising employment in the formal sector and enhancing skills. Introducing in-work benefits along with a moderate guaranteed minimum income, such as the Citizens' Income, would strengthen work incentives. Drastic improvements in job-search and training programmes are necessary to improve job prospects, reduce job-skills mismatch and poverty.
- Improving the efficiency and effectiveness of the public administration and of regional policies is a pre-requisite to provide basic public goods and services across the whole country, protect the environment, and engender better opportunities and more economic and social security for all.

Growth has stalled amid persistent economic and social challenges

Italy continues to suffer from long-standing social and economic issues. Material living standards, as measured by GDP per capita, are about the same as in the year 2000 (Figure 2) and 8% below the pre-crisis peak. Absolute poverty rates for young people rose sharply in the aftermath of the crisis and remain high (Figure 3). Though the employment rate has increased, it is still one of the lowest among OECD countries. Job quality, as gauged by OECD Job Quality Framework is low (OECD, 2018[1]) and the mismatch between people's jobs and their skills is high by international comparison. The level of investment, though recovering, is only 80% of the 2005-2008 average, while productivity growth has been sluggish or negative for the past 20 years.

Figure 2. Italy's GDP per capita is at the same level of 20 years ago

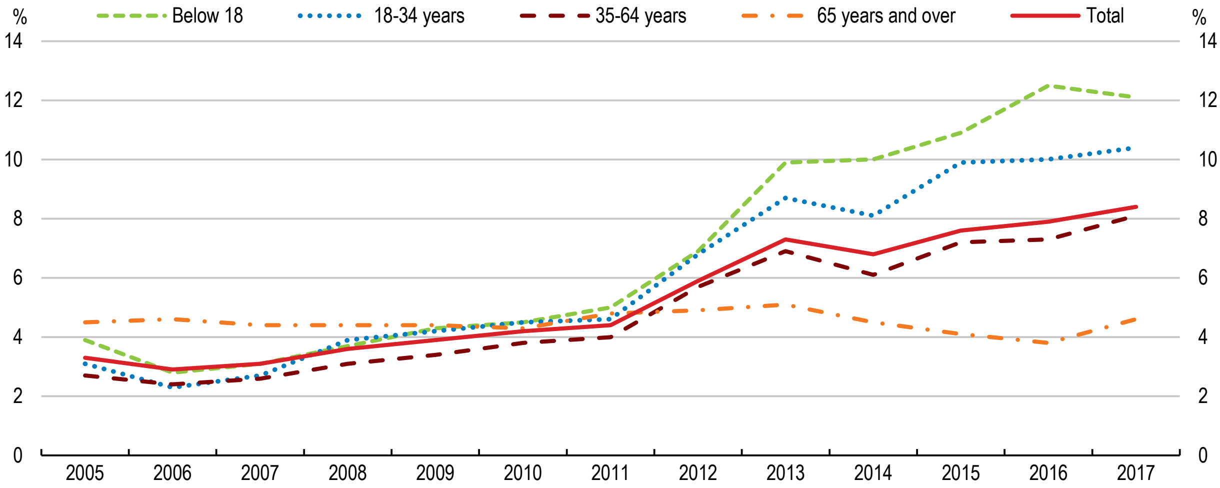
Percentage difference in real GDP per capita between 2000 and 2018



Source: OECD *Economic Outlook 104* database, including more recent information.

Figure 3. Poverty rates rose during the crisis and remain high, especially for the young[1]

% of age groups living in households in absolute poverty

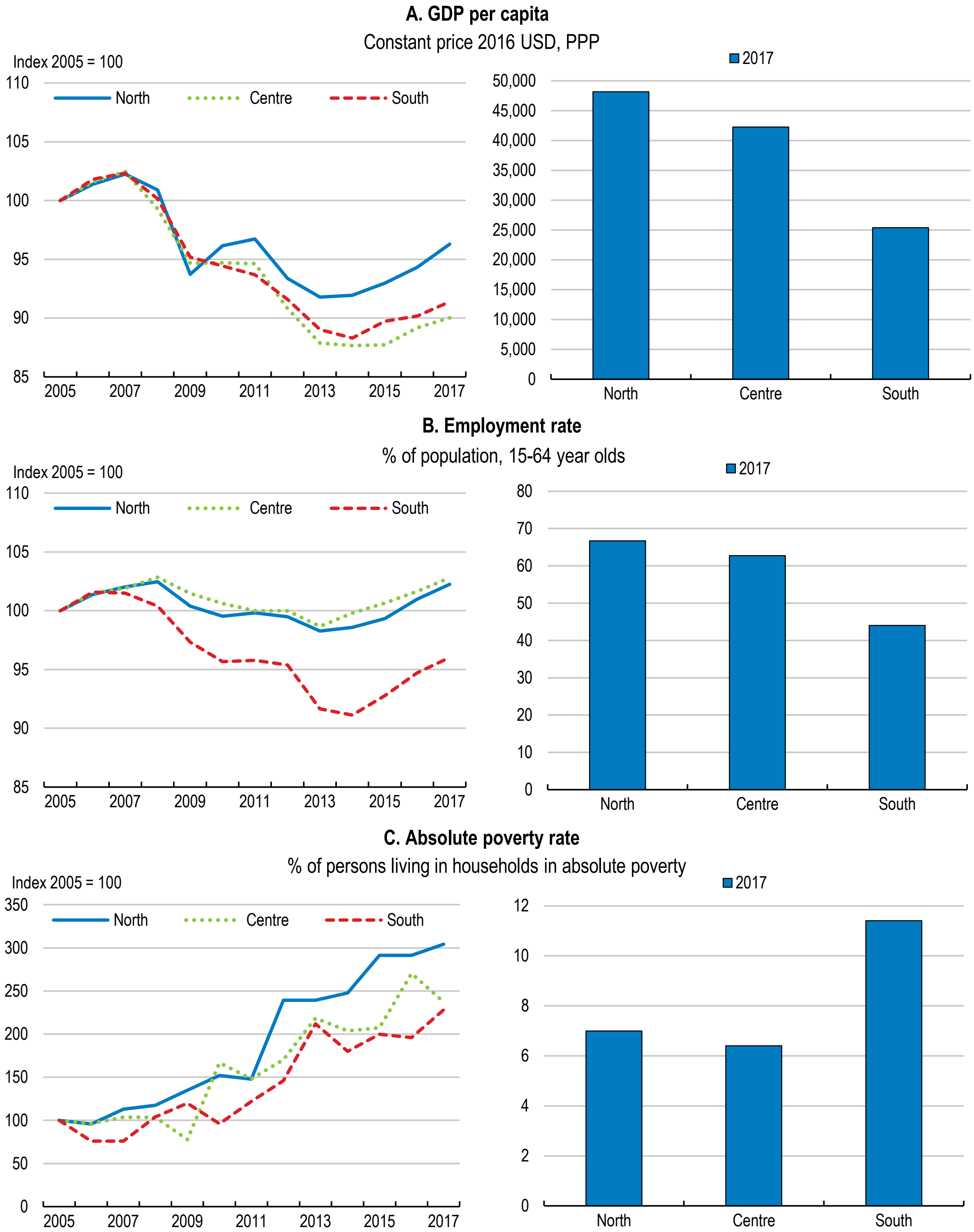


1. The ISTAT absolute poverty measure reports the share of individuals belonging to households with overall consumption expenditure below a socially necessary minimum, adjusting for the number and age of household members and price levels in the household's location.
Source: ISTAT *Poverty* database.

Italy's society continues to be riven by large regional disparities. Large regional differences in GDP per capita and employment have widened further over the last 20 years while poverty rates spiked over the crisis also in northern regions and remain high (Figure 4) as detailed in the thematic chapter. Regional disparities in employment rates, which are especially pronounced for women, largely explain the differences in living standards between the richest and poorest regions. A high share of the young, especially in lagging regions, is not in employment, education or training, reducing human capital and damaging job prospects. The dearth of job opportunities pushes many young people to emigrate exacerbating Italy's already fast population ageing and depriving the country of energy, talent and entrepreneurship.

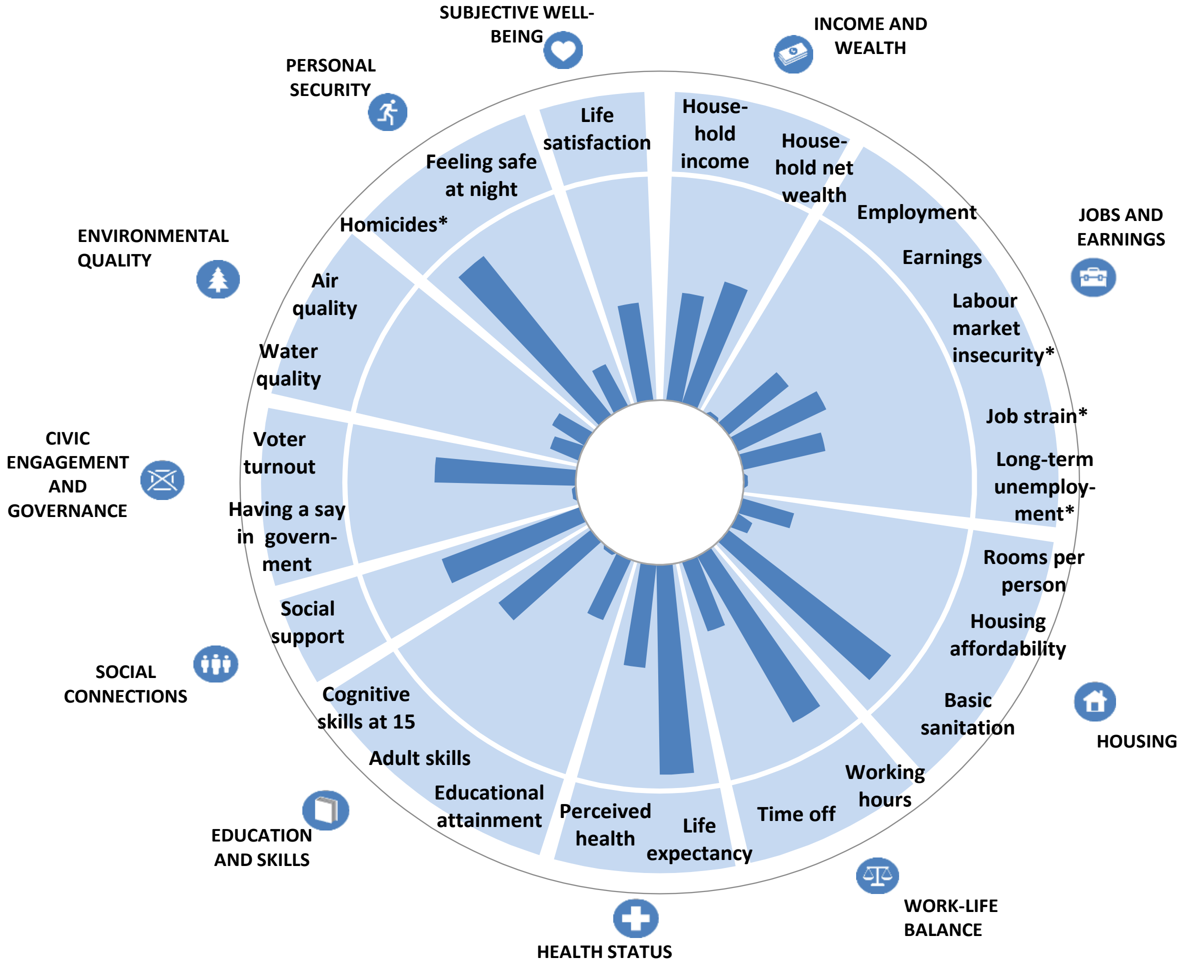
Italy's well-being indicators continue to lag those in other countries in several dimensions, reflecting social, economic and environmental problems (Figure 5). While Italy performs better than the OECD average with respect to work-life balance, social connections and health status, it continues to underperform in other areas, especially subjective well-being, environmental quality, jobs and earnings, housing, and education and skills. Regional disparities are greater for wellbeing than income alone, with southern regions performing worse than northern ones with the exception of areas such as environment and to some extent civic participation (Figure 6).

Figure 4. Regional disparities in GDP per capita, poverty and employment are large and increasing



Source: OECD calculations; and ISTAT *Regional* database.

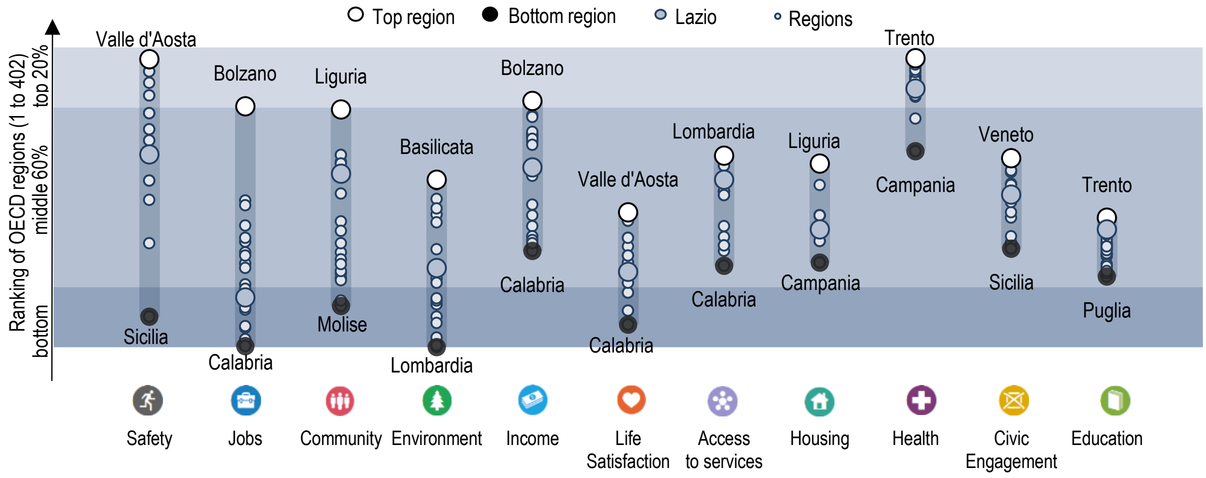
Figure 5. Italy's wellbeing continues to lag peers in many dimensions



Note: This chart shows Italy's relative strengths and weaknesses in well-being when compared with other OECD countries. For both positive and negative indicators (such as homicides, marked with an "*"), longer bars always indicate better outcomes (i.e. higher well-being), whereas shorter bars always indicate worse outcomes (i.e. lower well-being). If data are missing for any given indicator, the relevant segment of the circle is shaded in white.

Source: OECD (2017) *OECD Better Life Index*.

Figure 6. Italy's regional dispersion in well-being is high



Source: OECD *Regional Well-Being* database.

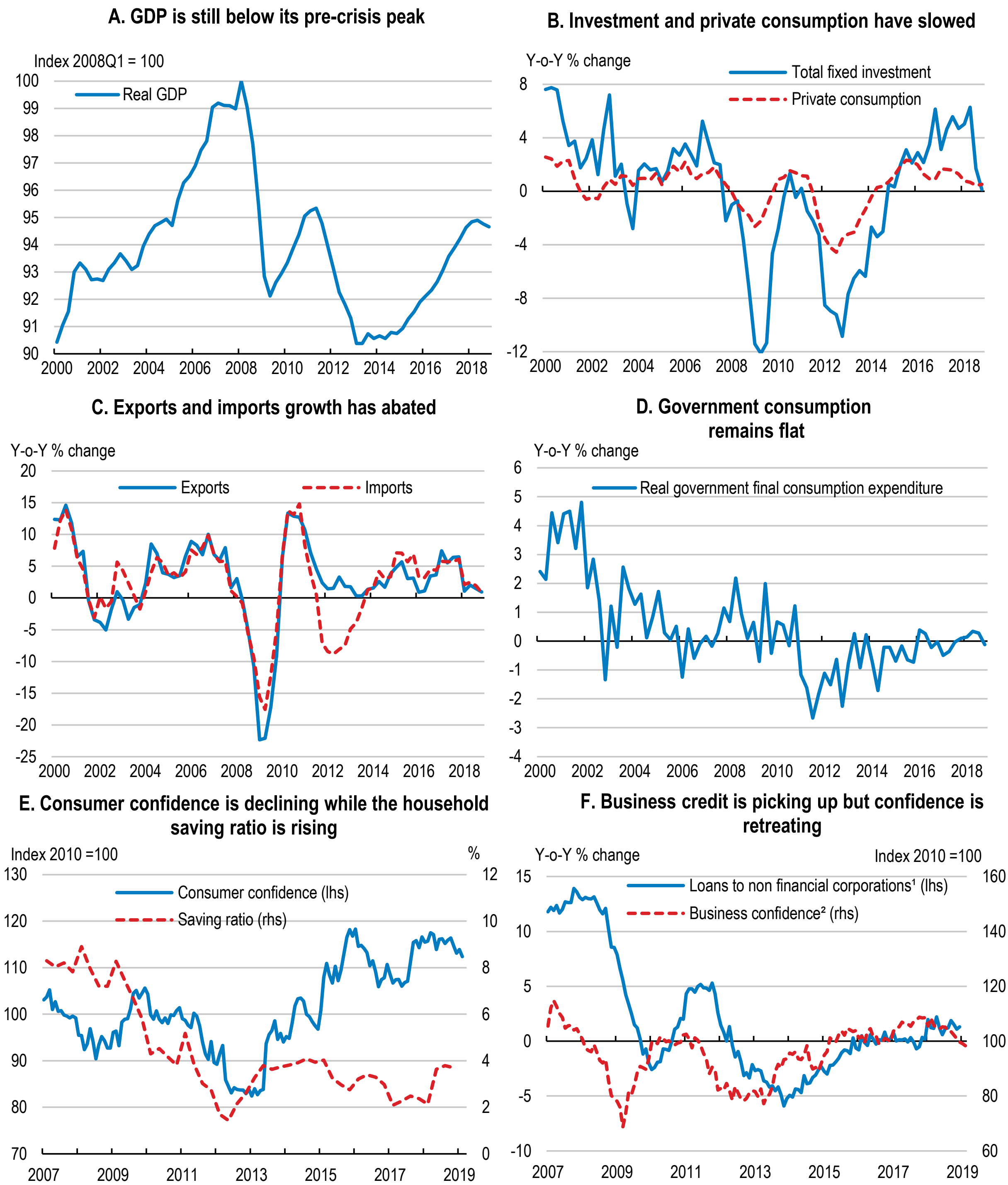
Growth has stalled

Exports and private consumption growth have weakened (Figure 7). Waning external demand and uncertainties about global trade arrangements have hurt exports (Figure 7, Panel C). Analysis suggests that since 2010 Italian exports have shifted to higher value added sectors, less exposed to competition from low cost countries (Bugamelli et al., 2017[2]). Relative price- and cost-based indicators have varied little since 2011 (Figure 8), suggesting that changes in prices and production costs have played only a minor role in the rise and fall of exports. Exports dropped in the first half of 2018 but recovered somewhat afterwards.

Slowing job gains and lower real wages have moderated private consumption growth, and along with rising uncertainty, helped raise the household saving rate (Figure 7, Panel E). Job quality is low (OECD, 2018[1]). An increasing share of new jobs is temporary following the expiration of social security contribution exemptions for permanent contracts. Unemployment has dropped but remains high, especially for youth and women (Figure 9), while discouraged job seekers have started to leave the labour force. At the same time, in 2018 energy prices pushed up consumer price inflation, which has risen slightly above private-sector wage growth, curtailing household purchasing power gains. While public sector wages increased significantly in 2018Q2, after 10 years of wage freeze, private sector wage growth remains modest and below consumer price inflation.

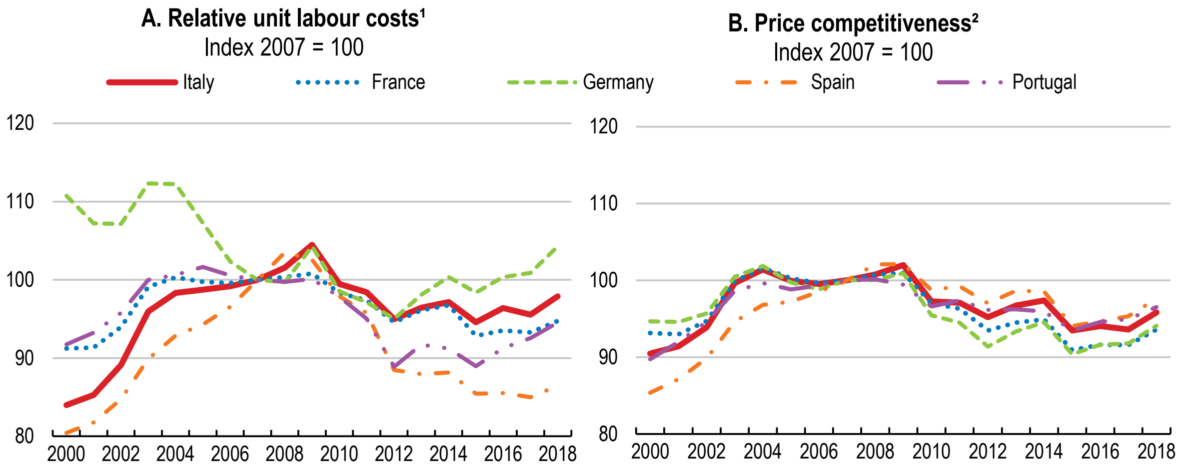
Household debt remains stable at about 60% of gross disposable income, nearly 40 percentage points below the Euro area average. Moreover, the share of household debt held by vulnerable households (defined as those with a debt-service ratio above 30% of their disposable income and with disposable income below the median) is lower than in the past – about 11% against 24% in 2008 (Bank of Italy, 2018[3]).

Figure 7. The recovery has weakened as export and private consumption growth have abated



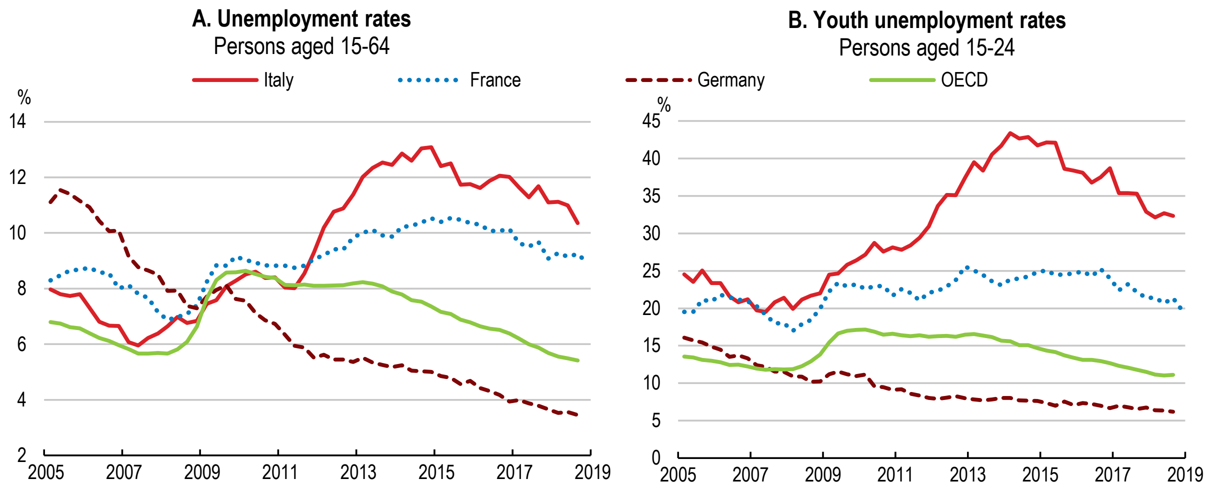
1. Adjusted for securitisation.
2. Manufacturing, construction, services and retail trade sectors.
Source: OECD *Economic Outlook 104* database, including more recent information; ISTAT; and Bank of Italy.

Figure 8. Relative unit labour costs and price competitiveness are flat



1. Ratio of own unit labour costs against those of trading partners. An increase corresponds to lower competitiveness.
2. Real effective exchange rate, CPI weights. An increase corresponds to lower competitiveness.
Source: OECD *Economic Outlook 104* database, including more recent information.

Figure 9. Unemployment has fallen but remains high, especially for the young

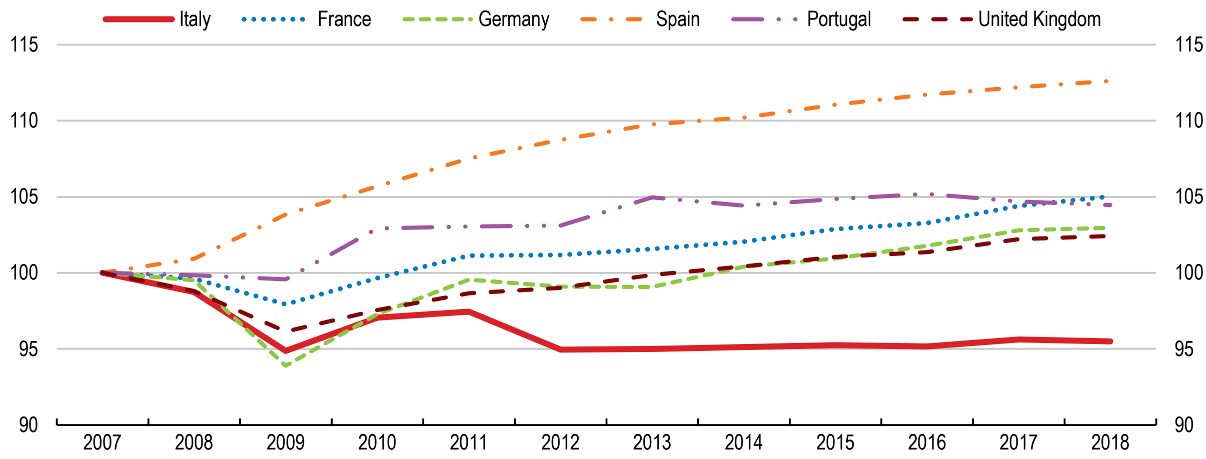


Source: OECD *Labour Force Statistics* database.

Productivity growth has remained sluggish since the early 2000s (Figure 10). An encouraging sign is that private investment has expanded since 2015, from a very low level, supported recently by fiscal incentives for private investment linked to the Industry 4.0 Plan and renewed bank lending to non-financial corporations (Figure 7, Panel F; Figure 11, Panel A). Bank lending rates have remained low, although they have started to rise since mid-2018 as government bond yields have risen. Bank lending to the manufacturing and services sectors has increased since late 2017, albeit recently at a more moderate pace, due to improving profitability and balance sheets. Bank lending to the construction sector is still falling, reflecting the sector's still depressed conditions and low profitability.

Figure 10. Aggregate productivity[1] has not increased for many years

Index 2007 = 100



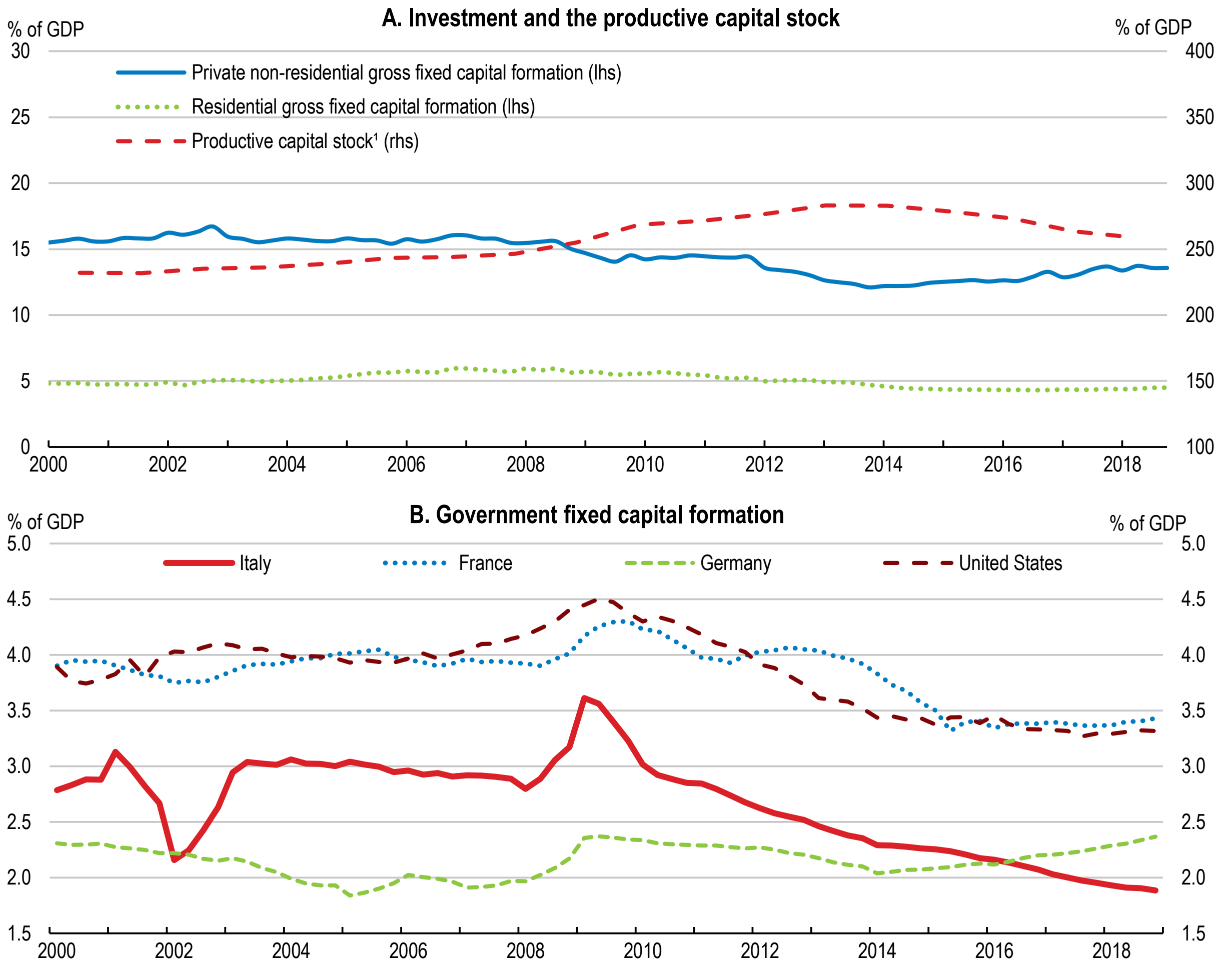
1. Real GDP per worker.
Source: OECD *Economic Outlook 104* database, including more recent information.

Public investment continues to fall, hampered by long-standing planning and execution delays that result in unspent funds. Public investment has dropped to less than 2% of GDP and is now at its lowest level in 25 years (Figure 11, Panel B). Since early 2015, construction activity has been hovering at levels 10% below mid-1990s levels, and 40% below the pre-crisis peak. However, some indicators point to an incipient recovery as the demand for mortgages and the number of building permits are rising, while house prices have stopped falling.

Expansionary fiscal policy and low growth increase the risks from high public debt

The 2019 budget involves net new measures amounting to 0.6% of GDP, mostly consisting of higher social spending (Box 1). After discussions with the European Commission, the government decided to lower the budget deficit target for 2019 from 2.4% to 2% of GDP, assuming GDP would grow by 1% in 2019. Following this decision, the Commission decided to stop the process of opening an excessive deficit procedure against Italy. The main measures for 2019 include repealing the planned VAT hike, lowering the early retirement age (for a three year period), introducing a new and more generous guaranteed minimum income scheme (the Citizen's Income), and a reduction in the tax burden for the self-employed and micro-enterprises through the extension of the simplified tax regime (i.e. flat tax). These expansionary policies will be only partly offset by some spending cuts and higher business income taxes mainly through revenue-raising measures on banks and insurance companies, the abolition of the allowance for corporate equity and of the new entrepreneurial income tax and of the investment super-amortisation scheme. The budget law also foresees large hikes in VAT rates amounting to about 1.3% of GDP in 2020 and 1.6% in 2021, leading to a decline in the budget deficit, according to government projections, to 1.8% of GDP in 2020 and 1.5% in 2021.

Figure 11. Private investment is rising whereas public investment has fallen to record low levels

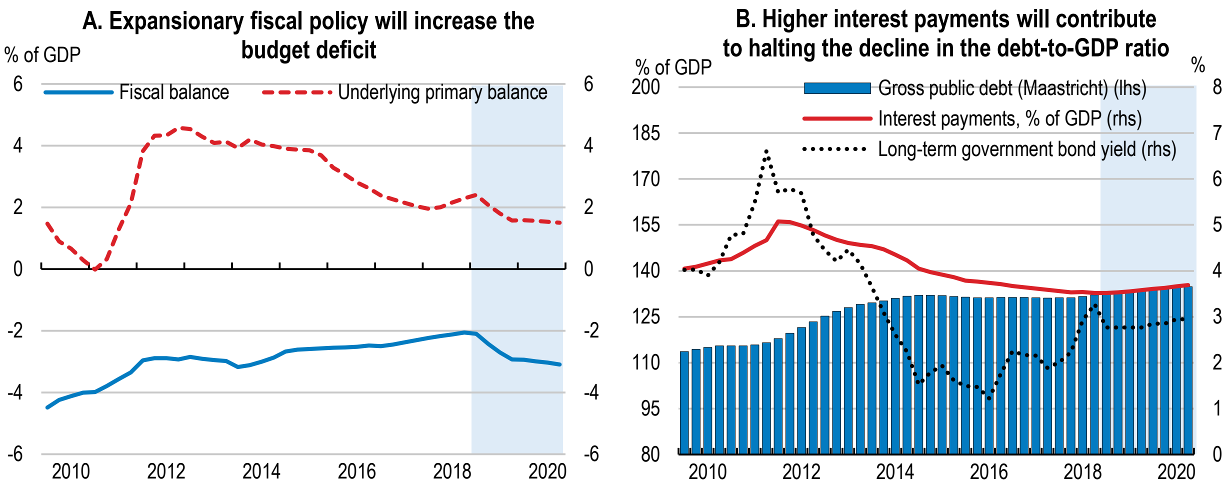


1. Total economy less housing.

Source: OECD *Economic Outlook 104* database, including more recent information; and OECD *National Accounts* database.

According to the projections presented in this *Survey*, the general government budget deficit will rise from 2.1% of GDP in 2018 to 2.5% in 2019 (Figure 12, Panel A). The difference with government's projections is attributable to the projected fall in real GDP in 2019 (-0.2%) and lower increase in the GDP deflator. These projections also assume that the government will not implement the planned VAT hike for 2020-21. For this reason, and assuming no other major policy change, the budget deficit is projected to rise further to 3% of GDP in 2020. Given slow growth, low inflation and rising interest costs and a larger deficit, the public debt ratio (on a Maastricht basis) will cease to decline and increase to 135% of GDP in 2020 (Figure 12, Panel B). In the longer-term, under current policies the debt will gradually rise. If spreads widened again, the increase in the debt ratio would be considerably faster (Figure 13).

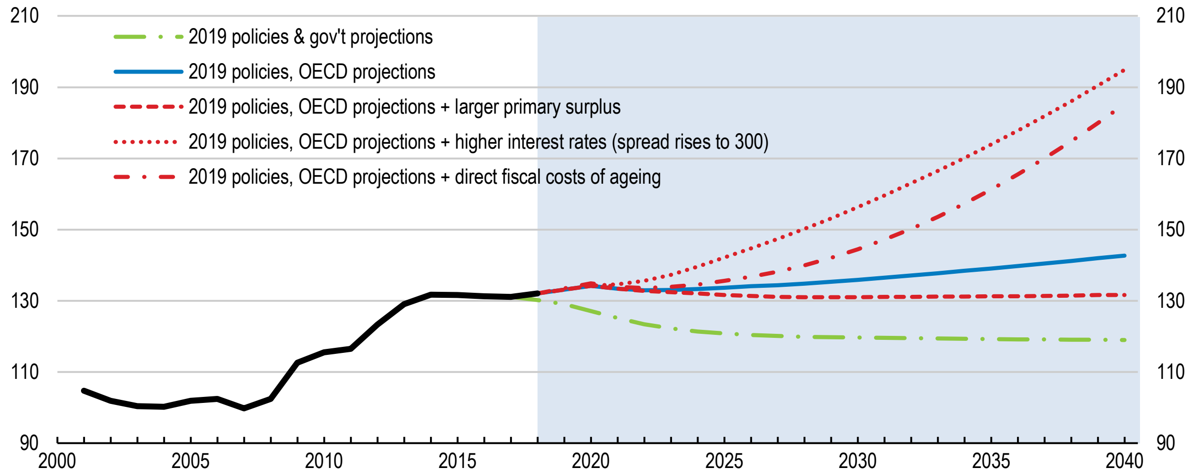
Figure 12. Fiscal policy will turn expansionary and the debt ratio will barely decline



Source: OECD *Economic Outlook 104* database, including more recent information.

Figure 13. Under current policies the debt to GDP ratio will remain high and vulnerable to risks

Projected public debt under 2019 policies and budget and interest rate scenarios, percent of GDP



Note: The "direct fiscal costs of ageing" scenario assumes that ageing-related costs (pension spending, health care, long term care, less reduced spending on education as the school-age population declines) greater than the spending incurred in 2020 are funded through debt. Assumptions underlying each debt scenarios are summarised in Table 1.

Source: OECD calculations

Table 1. Assumptions of 2019 budget debt sustainability scenarios [table edits not tracked]

		2020	2025	2030	2035	2040
2019 policies & gov't projections						
Real GDP growth	%, annual	1.1	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	2.0	2.4	2.4	2.4	2.4
GDP deflator growth	%, annual	1.8	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
2019 policies, OECD projections						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.6	1.6	2.0	2.0	2.0
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
2019 policies, OECD projections + larger primary surplus						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.6	2.4	2.5	2.5	2.5
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
2019 policies, OECD projections + higher interest costs (spread remains at 300)						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.6	1.6	2.0	2.0	2.0
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	5.5	6.1	6.3	6.5
Spread between effective interest rate and risk-free rate	bps	219	300	300	300	300
2019 policies, OECD projections + direct fiscal costs of ageing						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.3	1.0	0.3	-0.9	-1.8
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150

Source: OECD.

Box 1. 2019 budget: main measures

According to the government’s budget documents and the Parliamentary Budget Office, the 2019 budget consists of measures that will increase spending by 0.4% of GDP and reduce revenues by 0.2% of GDP. The main measures are the following:

- Cancelling the automatic increases in VAT rates: The 2019 budget law cancels the increase in VAT rates planned for 2019, amounting to about 0.7% of GDP. At the same time, it introduces new VAT safeguard clauses for 2020 and 2021 that will raise the standard VAT rate to 25.2% in 2020 and 26.5% in 2021 (from the current 22%), unless compensatory measures are undertaken.
- Guaranteed minimum income: A guaranteed minimum income scheme (the Citizen’s Income) is introduced to replace the existing programme, which was introduced in 2018 (the REI). The new guaranteed minimum income is more generous than the REI as it is expected to pay up to EUR 780 per month to singles

with no income, with the benefit adjusted to take into account family composition according to an equivalence scale (like the REI). This new measure is conditional on participating in job-search and training policies, and community jobs. The government allocated 0.3% of GDP each year, from 2019 to 2021, for the Citizen's Income.

- New early retirement scheme: Workers aged 62 years and with 38 years of contributions will be allowed to retire with a reduced pension. This scheme is valid for three years. This measure will be partly financed with a reduction of the adjustment to inflation for pension above EUR 1 500 and a solidarity tax on high pensions. However, these two measures are expected to raise only 0.02% of GDP in 2019 and about 0.05% in 2020 and 2021. For 2019, the extra spending on the new early retirement scheme will depend on the take up rate and is expected not to exceed 0.2% of GDP in 2019 and 0.3% of GDP in 2020 and 2021. The 2019 budget also discontinue until to 2026 the link between the updates of early retirement contribution requirements and developments in life expectancy.
- Flat tax: It raises the income thresholds from EUR 45 000 to EUR 65 000 of the simplified tax regime that applies a 15% tax rate to the income of self-employed and micro-enterprises. The budget also introduces from 2020 onwards a new bracket in the simplified tax regime between EUR 65 000 and EUR 100 000 of income that will be taxed at 20%. Eligibility is based on the previous year's income. This measure will reduce tax revenues by less than 0.1% of GDP yearly in 2019-2021.
- Tax changes for businesses: The budget repeals the allowance for corporate equity (which was introduced to restore the neutrality between debt and equity financing) and the tax on entrepreneurial income (IRI) that was scheduled to enter into force in 2019 and to apply the corporate income tax rate (24%) to all business incomes irrespective of the business's legal form. The budget also lowers tax incentives linked to the Industry 4.0 plan while it increases the hyper-amortization scheme from 150 to 170% for investments up to 2.5 million euros.
- Digital services tax: 3% tax rate on revenues from online advertising, sales and data processing. The tax applies to companies with a total amount of global revenues above EUR 750 million and revenues from digital services realized in Italy above EUR 5.5 million.
- Measures to deal with tax debts. The extension of the "rottamazione cartelle" (file-shredding) measures (started by previous governments) allows the tax debtor to pay the tax debt in instalments over 5 years; fines and interest charges relating to the tax debt are written off. Other forms of tax amnesty are new and involve not only fines and interest charges but also the tax debt: "condono" writes off tax debts (including interest charges and fines) relating to motor taxes and fines, and local taxes incurred between 2000 and 2010 and up to EUR 1 000; "saldo e stralcio" writes off the tax debt (relating to personal income taxes and including social security contributions) incurred between 2000 and 2017 by paying a share (from 16% to 35% according to personal economic conditions) of the tax debt (including interest charges and fines); "liti pendenti", allows taxpayers to terminate ongoing court disputes by paying a share of the tax debt (40% if the debtor won a first instance judgment, falling to 5% when the dispute is at the final appeal and the

debtor all lower instance judgments; the debtor can write off also the debt by paying 90% of it if he is waiting for the first instance judgment).

The 2019 budget rightly aims to help the poor but given its composition, the growth benefits are likely to be modest, especially in the medium term. The guaranteed minimum income (the Citizen's Income) strengthens anti-poverty programmes significantly by targeting transfers toward poor households. The transfer is conditional on individuals engaging in job-search and training programmes and community jobs. However, as discussed below and in the thematic chapter, the job-search and training programmes are inadequate in many regions, risking to blunt the effectiveness of the Citizen's Income in reducing poverty and to inflate its costs.

The network of regional public employment services (PES) will be responsible for administering the Citizen's Income. This contrasts with the administration of the Inclusive Income Scheme (REI), expanded in 2018, as municipalities' social services were responsible for administering it and developing personalised social-inclusion projects in collaboration with the health services, the school system, public employment services and non-profit organisations offering services to poor individuals. To fulfil these responsibilities, many municipalities have strengthened their social services. Ensuring that PES closely and effectively collaborate with municipal social services, as planned, will deliver better and faster results.

The budget introduces a new early retirement scheme for people with 62 years of age and at least 38 years of contributions. This scheme is temporary and will expire in 2021. Those opting to retire earlier will receive a lower pension than what they would have received with pre-existing requirements. However, the planned reduction in the pension will not necessarily be actuarially fair with the result that the new scheme may increase pension spending permanently. The new early retirement scheme measure will lower growth in the long run by reducing the number of older people in work. If not actuarially fair it will worsen intergenerational inequality and add to already high pension spending.

Given Italy's ageing demographics, health and long-term care spending needs will rise alongside pension costs. Italy has improved management of health and long-term care policies in recent years, compared with many countries, which will limit the increase in the costs of these policies to 0.6% of GDP between 2020 and 2030 (European Commission, 2018[4]). Nonetheless, if the rising costs from ageing are not offset through spending cuts or revenue measures they will threat the sustainability of the public debt (Figure 13).

The digital services tax envisaged by the 2019 budget (Box 1) has not yet been introduced as it needs implementing regulations. This type of tax follows several other countries introducing similar initiatives, and the European Parliament voting to support a similar EU-wide directive (European Parliamentary Research Service, 2018[5]). Many of the enterprises that would be subject to the digital services tax are headquartered in the United States. A G20/OECD process is developing measures that adapt existing approaches to taxing firms to the challenges of digital technologies. These technologies allow firms to undertake significant business in a country without being physically present, make intangible sources of value more important, and increase risks from aggressive tax planning (OECD, 2018[6]). Members of the G-20/OECD process are committed to reaching a consensus-based, long-term solution in 2020, and have not reached a consensus about the need or merit of interim measures (OECD, 2019[7]).

Past recommendations on fiscal issues

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Evaluate the effectiveness of recently introduced research and development tax credits and other fiscal incentives in terms of innovation outcomes and forgone tax receipts.	Extensive data being collected and analysed on firms benefiting Start-up Act (and Industry 4.0).
Stick to the planned fiscal strategy so as to bring the debt-to-GDP ratio onto a declining path.	The 2019 budget marks a significant departure from the previous fiscal strategy.
Promote greater use of centralised procurement, cost information systems and benchmarking.	Public procurement management continues to improve, through more contracting through central authority. Procurement agencies' capacity is improving. IT systems are facilitating comparisons of prices paid by difference agencies. ANAC is taking a stronger role in supervising and authorising contracting.
Strengthen the coordinating role of the central government to set and enforce minimum standards in project preparation and execution and to enhance the administrative capacity of all agencies using national and European funds for investment.	The Government has proposed the creation of a task force to centralise information on ongoing projects through the active management of a centralized database and direct links with the expense terminals, systematically promoting the monitoring, evaluation and coordination of investments. The Government will also create a central unit with the task of offering technical assistance to ensure quality standards for the preparation and evaluation of programs and projects by central and peripheral public administrations are met.
Continue to assess the magnitude of budgetary contingent liabilities, including the vulnerability of public finances to risks associated with the financial sector.	New contingent liabilities are being accounted for correctly. The interventions in the banking sector have generated some contingent liabilities that have been audited by Eurostat and ECB and reflected in budget documents following their advice. Less than 3% of new firms with bank finance guaranteed through the Start-up Act have needed to call on this guarantee.
Fully legislate and implement the already planned nationwide anti-poverty programme, target it towards the young and children and ensure it is sufficiently funded.	A guaranteed minimum income programme, the REI, was rolled out nationally in Jan 2018 to all households with low income and assets conditional on participation in job search or other social services criteria. The delivery of REI social services builds on municipalities' existing social protection services. The 2019 budget introduces a new guaranteed minimum income scheme (Citzen's Income) to replace the REI that increases significantly the financial resources allocated to anti-poverty programmes and will to a large extent rely on Public Employment Services for job-search activation programmes.

Growth will remain weak in the next two years

GDP growth is projected to contract by 0.2% in 2019 and expand by 0.5% in 2020. Rising uncertainty and higher interest rates will lower the propensity of households and firms to consume and invest, offsetting the effects of the fiscal expansion on activity. Slowing growth in Italy's main trading partners will hinder export growth. Moderate investment growth will support weak import growth. Low inflation will result in modest real wage gains, which will only partly offset the negative effect of slowing employment growth and a rising household saving rate on private consumption.

The risk of renewed financial market turmoil would accelerate the expected gradual rise in borrowing costs for households and firms and sap confidence, reducing investment and consumption growth. Further spikes in government bond yields would hurt banks' balance sheets and capital ratios, which could lead to lower lending. The aggravation of protectionism would harm international trade, lowering export growth and leading firms to cut back their investment plans. On the other hand, investment could prove more resilient than projected if the residential sector and construction recover faster than expected. Lower energy prices would boost household purchasing power and private consumption.

Table 2. Macroeconomic indicators and projections

Annual percentage change, volume (2010 prices)

	2015 Current prices (EUR billion)	2016	2017	2018	2019	2020
Gross domestic product (GDP)	**1 651**	**1.2**	**1.7**	**0.8**	**-0.2**	**0.5**
Private consumption	1 007	1.3	1.5	0.6	0.5	0.5
Government consumption	312	0.1	-0.2	0.2	0.4	0.6
Gross fixed capital formation	279	3.7	4.5	3.2	-0.2	1.1
Housing	72	1.5	3.1	3.4	1.0	0.9
Final domestic demand	1 598	1.5	1.7	1.0	0.3	0.6
Stockbuilding[1]	5	0.2	-0.4	-0.1	-0.7	0.0
Total domestic demand	1 603	1.6	1.3	0.9	-0.4	0.6
Exports of goods and services	493	2.3	6.4	1.4	2.7	2.3
Imports of goods and services	446	3.8	5.8	1.8	2.1	2.7
Net exports[1]	48	-0.4	0.4	-0.1	0.2	-0.1
Other indicators (growth rates, unless specified)						
Potential GDP	. .	0.1	0.2	0.3	0.3	0.4
Output gap2	. .	-3.4	-2.0	-1.5	-2.0	-1.9
Employment	. .	1.3	1.2	0.9	-0.2	0.2
Unemployment rate	. .	11.7	11.3	10.6	12.0	12.1
GDP deflator	. .	1.2	0.4	0.8	0.9	1.0
Consumer price index (harmonised)	. .	-0.1	1.3	1.2	0.9	0.8
Core consumer prices (harmonised)	. .	0.5	0.8	0.6	0.3	0.8
Household saving ratio, net3	. .	3.2	2.3	3.3	3.8	4.2
Trade balance4	. .	3.4	3.2	2.8	. .	. .
Current account balance4	. .	2.5	2.8	2.6	2.7	2.4
General government fiscal balance4	. .	-2.5	-2.4	-2.1	-2.5	-3.0
Underlying general government fiscal balance2	. .	-0.7	-1.4	-1.4	-1.5	-2.0
Underlying government primary fiscal balance2	. .	2.9	2.2	2.1	2.0	1.5
General government gross debt (Maastricht) 4	. .	131.3	131.1	132.1	133.8	134.8
General government net debt4	. .	127.4	125.0	125.2	126.8	127.9
Three-month money market rate, average	. .	-0.3	-0.3	-0.3	-0.2	0.2
Ten-year government bond yield, average	. .	1.5	2.1	2.6	2.8	2.9

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of household disposable income.
4. As a percentage of GDP.

Source: OECD *Economic Outlook 104* database, including more recent information.

Table 3. Low probability events that could lead to major changes in the outlook

Vulnerability	Possible outcome
Slowing down of the reform process and confrontations with the EU in a context of slow global growth leading to a loss of confidence and downgrade of sovereign debt ratings	Sovereign bond yields would rise markedly, pushing up debt servicing costs and leading to a debt crisis.
Banks continue to increase sovereign bond holdings, aggravating the sovereign-bank loop in the context of political fragmentation and rising government bond yields	Prolonged increase in government bond yields cause banks balance sheet losses, requiring banks to limit lending and seek recapitalization, and leading to lower equity values, loss of confidence and economic crisis.
A steep rise in protectionism globally markedly reduces trade and the demand and prices for Italy's exports	A large and prolonged reduction in export production activity leads to lower investment and job losses, harming incomes and government revenues.

Source: OECD.

Banks' health has improved but is exposed to risks around the public finances

The improved health of the banking system is supporting private investment but its links with the public finances remain a risk. The government strategy to restore the banking sector to health based on a mix of resolution, recapitalisation and acquisitions has yielded fruit. The cost of the government intervention in the financial sector to date has been limited to about 0.3% of GDP, or 1.3% accounting for the assumption of some contingent liabilities. This compares favourably with the financial sector support offered by the government in other euro area countries (5.9% of GDP in Germany, 4.4% in Spain and 0.1% in France)

The stock of non-performing loans (NPLs) on banks' balance sheet is falling (Figure 14). Loan quality has improved and the ratio of new non-performing loans to outstanding loans has dropped to pre-crisis level (2.8% for loans to non-financial corporations and 1.5% for loans to households). The reduction of the ratio of new non-performing loans is attributable to the 2015-18 economic recovery but also to a cautious approach by banks. In 2016-18, bank lending increased for firms in sound condition, while it continued to fall for riskier firms (Bank of Italy, 2018[3]).

The gross value of banks' bad loans (the more severe type of NPLs) to non-financial corporations declined by almost 45% since its peak in February 2017 with banks disposing EUR 42 billion of bad loans in 2017 and nearly EUR 40 billion in 2018. From the late 2015 to the mid-2018, the coverage ratio for bad loans increased from 59 to 68% (from 45% to 54% for NPLs). Collateral and personal guarantees amounted to about 68% of the gross value of bad loans, in the mid-2018, as in the late 2016.

The progress in reducing NPLs is attributable to effective policy actions. The state-sponsored Guarantee on Securitization of Bank Non Performing Loans introduced in 2016 (OECD, 2017[8]) – which thus far has covered EUR 42 billion of securitised NPLs and has cost nothing to the Treasury – has been instrumental in developing a growing market for non-performing loans. In 2018 total NPL transactions in the secondary market were expected to be four times above those in 2017 and 20 times more than in 2013 (PWC, 2018[9]). Supervisors have undertaken robust and intrusive actions to accelerate NPL disposals. Significant banks submitted NPL-reduction plans and in 2018 banks' disposals of NPLs were in line with those plans. Going forward, NPLs are expected to decline further. In March 2018, the eleven significant banks submitted updated NPL-reduction plans for the 2018-2020 period. At the end of 2018, the less significant banks with high NPLs also submitted plans according to the guidelines issued by the Bank of Italy in January 2018 to reduce NPLs (Bank of Italy, 2018[3]).

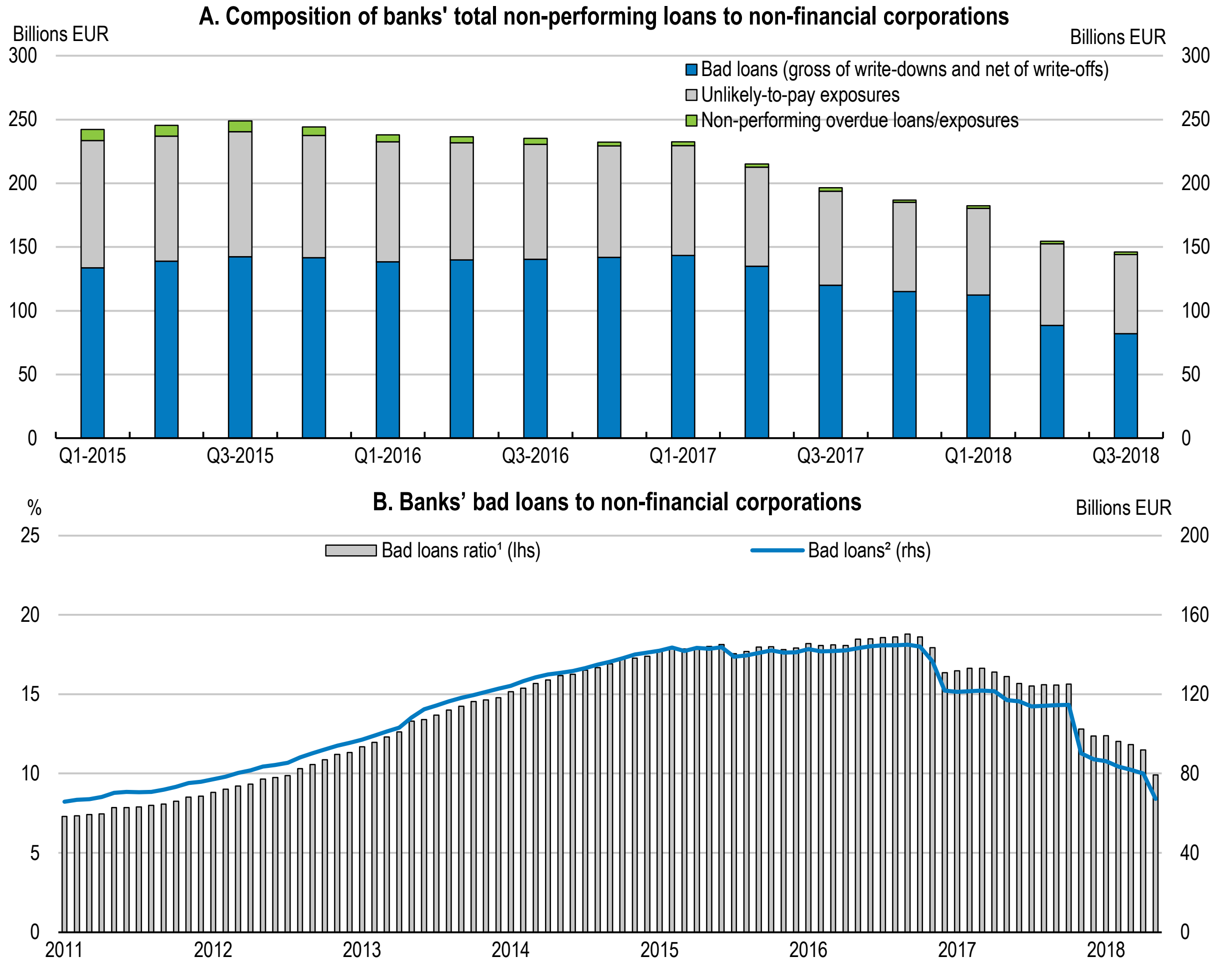
The rise in Italian government bond yields in 2018 has so far had only a limited effect on bank funding costs, though banks credit default swap (CDS) and banks' bond yields have risen substantially and are now above those of European peers (Bank of Italy, 2018[3]). Banks have been increasingly relying on deposits to satisfy their funding needs. Recourse to the Eurosystem has remained stable since March 2017 after the last longer-term refinancing operations (TLTRO II).

Though banks' funding costs remain low for the time being, there is the risk they may rise considerably. The Italian government 10-year bond spread spiked in 2018. Though it receded from the peak in October 2018, it is still about 130 basis points higher than in April 2018. Estimates relating to the 2010-2011 period suggest that a 100 basis points increase in the 10-year government bonds' spread could raise interest rates on fixed-term deposits and repos by about 40 basis points and yields on new bond issues by around 100 basis points (Bank of Italy, 2018[3]). Over the past two years, Italian banks have issued markedly fewer bonds, especially to households. The share of bonds in total bank funding dropped to just above 10% in late 2018 from 15% in late 2016. This share is lower than that of German and French banks (13.7% and 16.4% respectively) (Bank of Italy, 2018[3]). Italian banks' recourse to international bond markets is especially limited.

Moreover, the end of the TLTRO II scheduled for 2020-21 and the introduction of the minimum requirement for own funds and eligible liabilities for bail in (MREL) will put additional upward pressures on banks' funding costs. The introduction of the MREL might compel banks to issue large amounts of MREL-eligible bonds at the same time. Simulations by the EBA and ECB suggest that the cost of meeting MREL requirements will be limited for the whole banking sector but it could be high for smaller banks (ECB, 2017[10]; EBA, 2016[11]). In this context, the capacity of banks to issue large amount of MREL-eligible securities to investors other than households, while containing a general increase in funding costs, may depend on improving banks' ability to sell these securities to international investors.

Italian banks' return on asset has markedly improved and in 2017 it was above peers in Europe, though it weakened in 2018 (Figure 15, Panel A). Banks' capital ratios have increased and are well above regulatory thresholds (Figure 15, Panel B), though the common equity tier 1 ratio of Italy's banking system decreased by 60 basis points between the late-2017 and the mid-2018. The latest EU-wide stress tests indicate Italian systemic banks could withstand severe economic shocks. Declining NPLs on banks' balance sheets, and increased provisioning and capital have reduced the ratio of NPLs (net of provisions) to capital by more than 40 percentage points since 2016 to less than 50% (Figure 15, Panel C), though it remains large.

Figure 14. Banks' non-performing loans to non-financial corporations have declined



1. Bad loans as share of banks' total lending.
2. Level.
Source: Bank of Italy.

Despite this progress, banks still faces challenges. The banking sector is still downsizing and total bank assets declined by about 5% (EUR 200 billion) over 2017-2018. Profitability though improving remains low. In 2019, renewed tensions in the government debt market (if they were to materialise) and the slow-down in the economic recovery could weigh on it. Banks are aware of these challenges and are implementing reorganisation strategies aiming at improving efficiency. As part of these reorganisation strategies, the number of banking sector employees relative to the population has continued declining and in 2017 it was 30% below the EU average (against 26% in 2015). However, though the number of bank branches relative to the population has also decreased, it is still the third highest in the EU (and 62% above the EU average). Bank branches are small, employing about 10 people on average – 63% below the EU average. Continuing banks' reorganisation strategies is key to lowering operating costs and improving profitability durably.

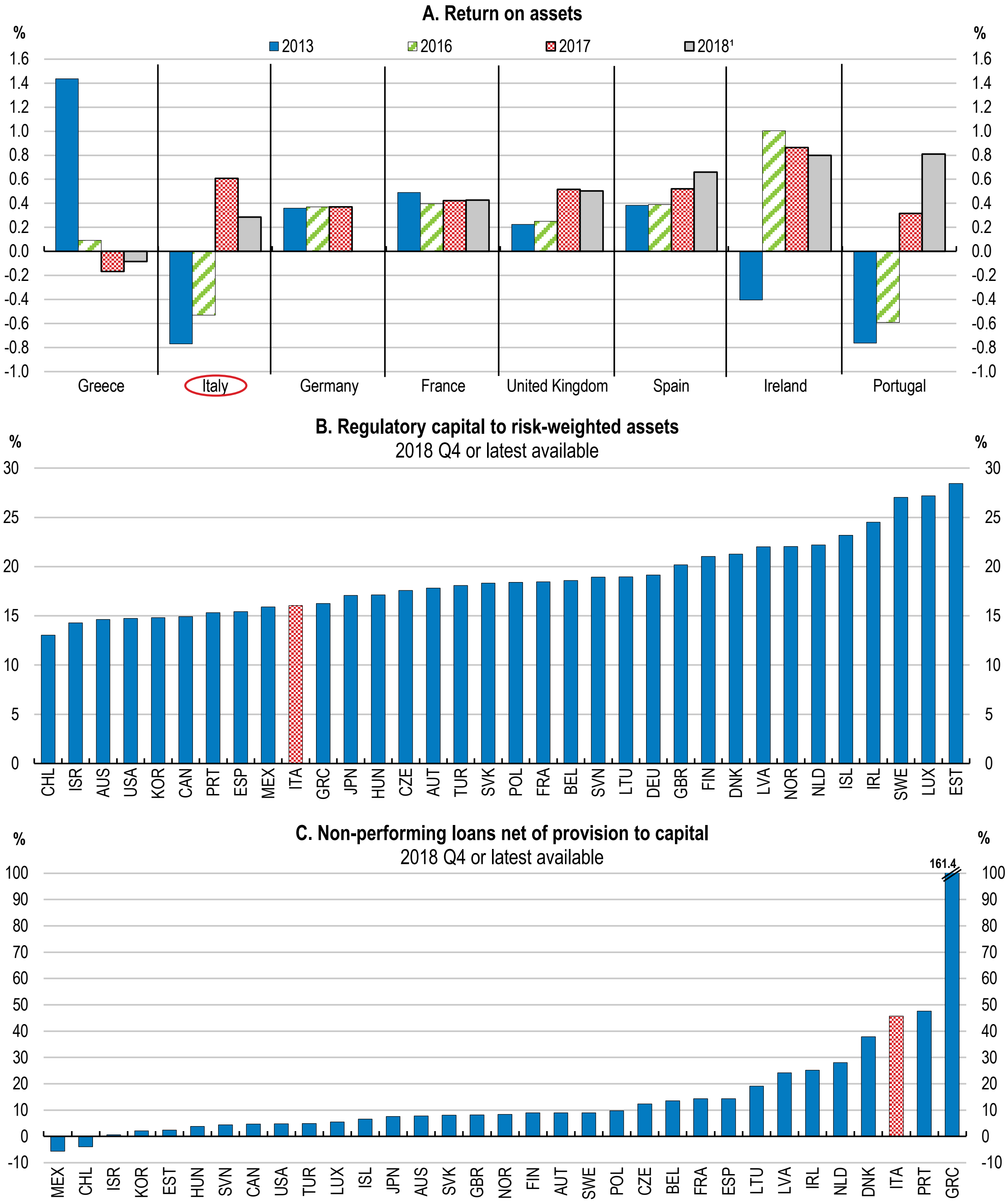
The reduction in non-performing loans have been uneven across banks. Improvements have been slower for small and medium-sized banks. The reform of cooperative and mutual banks, which requires that the largest cooperative banks turn into joint-stock companies and that mutual banks consolidate or join an Institutional Protection Scheme (a closely integrated network of mutual banks) – is still to be fully implemented. Two cooperative banks that had to turn into joint stock companies did not comply (one case was deferred to the European Court of Justice). About 230 mutual banks are expected to consolidate into 3 new banking groups. One of them started operations in early 2019. Two of them will be significant banking groups and as such will fall under supervision of the Single Supervision Mechanism and be subject to an asset quality review in 2019. Fully implementing the reforms of cooperative and mutual banks will strengthen smaller banks and help allay concerns over their viability.

The health of Italian banks' balance sheets remains closely linked to risks around public finances through public finances' effects on sovereign bond yields and sovereign ratings. Italian banks have often acted as shock absorbers in the Italian sovereign bond market, buying sovereign bonds as yields rose (Figure 16). The surge in Italian sovereign yields in mid-2018 fits this pattern, with banks' holding of Italian sovereign bonds rising by 0.7 percentage points compared with late 2017 to 9.5% of total assets. Large and sustained increases in sovereign bond yields can negatively impact banks through three main channels. First, higher government bond yields generally result in higher interest rates on deposits and yields on new bond issues, raising banks' funding costs. Second, an increase in sovereign bond yields reduces the value of eligible collateral for Eurosystem refinancing operations, reducing banks' liquidity. Third, the drop in government bonds' prices valued at fair value reduces capital ratios (Bank of Italy, 2018[3]).

While the larger banks appear sufficiently robust to withstand significant pressures from higher government bond yields, it may be more difficult for some smaller banks as government bonds account for a larger share of their assets. As at June 2018, the share in total assets of Italian sovereign bonds priced at fair value was 11.3% for less significant banks and 4.7% for significant banks. The Bank of Italy's simulations suggest that an upward shift in the sovereign yield curve by 100 basis points would reduce the Common Equity Tier 1 (CET1) ratio by 90 points for less significant banks and 40 points for significant ones (Bank of Italy, 2018[3]).

In the context of banks' low equity prices, if government bond spreads were to rise durably, restoring capital ratios through recapitalisation operations would be expensive. This could lead to a feedback mechanism as banks' losses and higher funding costs, engendered by higher government bond yields, might induce banks to reduce the supply of credit and increase lending rates, thus further slowing economic activity and undermining government revenues. Bofondi, Carpinelli and Sette (2017[12]) show that a similar process was at work during the 2011 European sovereign crisis, as Italian banks reduced credit supply – mostly because of an increase in funding costs – leading to a shortage of bank credit. Such a process, if protracted, could weaken the economy and lower confidence in the banking system, imperilling financial stability.

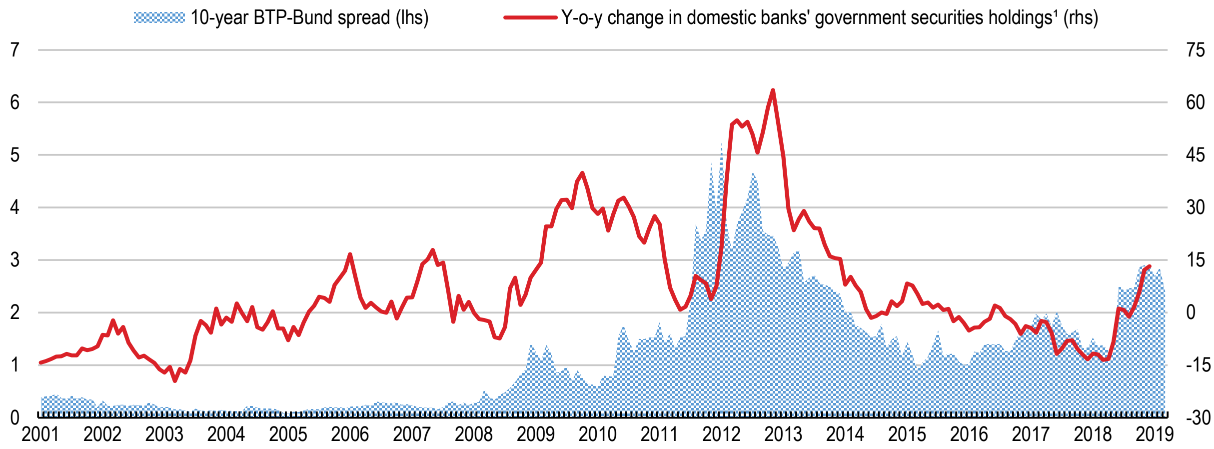
Figure 15. Banks' health has improved but risks remain



1. Data for 2018 refer to either Q1 (United Kingdom), Q2 (France and Italy) or Q3 (Greece, Ireland, Portugal and Spain), depending on data availability.
Source: IMF *Financial Soundness Indicators* database.

Figure 16. Italian banks have acted as countercyclical investors in Italian sovereign bonds

Percentage



1. Data refer to the "Deposit-taking corporations, except the central bank" sector (S122, as defined by the System of National Accounts 2008) and the "Cassa Depositi e Prestiti".

Source: OECD calculations based on Thomson Reuters and Bank of Italy.

Past recommendations on the financial sector

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Set gradual, credible and bank-specific targets to reduce banks' non-performing loans (NPLs) consistently with recent ECB's Draft Guidelines. **When banks deviate from targets, bank supervisor should require remedial actions such as additional capital requirements, sales of assets, suspension of dividend payments, and reduction of staff costs.**	NPLs have fallen following pro-active, robust and intrusive regulation and supervision. In March 2018, the four significant banks submitted updated NPL-reduction plans for 2018-2020, and, by the end of 2018, the less significant banks with high NPLs will have to submit plans for reducing NPLs.
Continue to develop the secondary market for NPLs.	A secondary market for NPLs has taken off with the participation of foreign and domestic investors. Banks and other financial institutions made large sales of NPLs into the secondary market in 2017 and first half of 2018, leading the stock of banks' non-performing loans to decline.
Use debt-equity swaps more frequently by allowing for cram down of creditors.	No progress. The ongoing reform of the bankruptcy law should address this issue.
Set clear guidelines for the valuation of collateral.	The Single Supervisory Mechanism (SSM) issued guidelines for significant institutions in March 2017 and the Bank of Italy issued guidelines for less significant institutions in January 2018, for the treatment of NPLs, including collateral valuation.

Improving well-being and boosting growth requires credible fiscal policies and ambitious structural reforms

Italy faces the double challenge of raising short and long-term growth and strengthening social inclusion and well-being, while at the same time reducing the high debt-to-GDP ratio to a more prudent level. Meeting these challenges requires a comprehensive reform programme spanning multiple policy areas – including employment and social policy, entrepreneurship, innovation and education, public administration and environmental management – while shifting government spending from current to capital expenditure and putting the public debt ratio on a gradual but steady downward path.

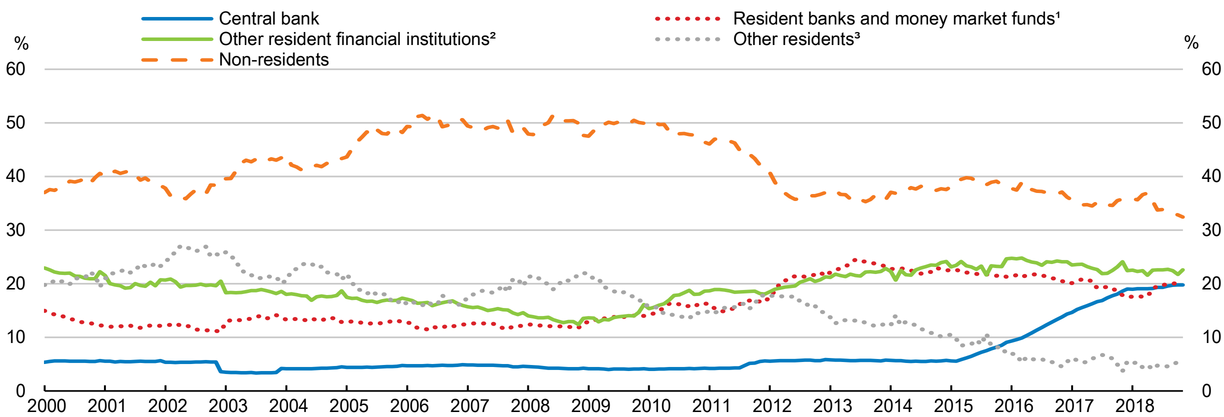
High government debt is a source of risks and limits fiscal policy choices

Italy's government debt-to-GDP ratio is the third highest in the OECD, after Japan and Greece. Government borrowing costs rose sharply in 2018 following policy announcements concerning the planned large increase in the budget deficit – significantly deviating from EU fiscal rules – and policy choices partially reversing previous reforms, especially on pensions and the labour market. The 10-year sovereign yields reached over 3% in 2018 (1.5 percentage point above the level in early 2018) (Figure 16), far above peers.

The high debt-to-GDP ratio leaves Italy vulnerable to increases in interest rates. In 2019, the government expects to issue debt securities for about EUR 380 billion, similar to 2018, and consisting of EUR 345 billion of redemptions and the rest of additional issues. The ECB's quantitative easing (QE) policy has facilitated public debt refinancing and the share of the Italy's sovereign debt securities held by the Bank of Italy rose from about 5% to nearly 20%, while that held by retail investors dropped to just 5% (Figure 17). In 2016, the central bank bought on the secondary market the equivalent of around 45% of the new medium- and long-term issues. In 2018, this share will fall to 24% and in 2019 it is expected drop to 9.5% as the ECB's net purchases will fall to zero. The tapering of QE in 2019 means that the market will have to absorb larger shares of debt securities, which could put upward pressure on sovereign bond yields.

Figure 17. The ownership of government debt securities has changed significantly

Share of total general government debt securities



1. This category corresponds to the "Deposit-taking corporations, except the central bank" sector (S122) and the "Money market funds" sector (S123), as defined by the System of National Accounts 2008 (2008 SNA).
2. This category corresponds to the following sectors (as defined by the 2008 SNA): "Non-money market funds" (S124); "Other financial intermediaries, except insurance corporations and pension funds" (S125); "Financial auxiliaries" (S126); "Captive financial institutions and money lenders" (S127); "Insurance corporations" (S128); and "Pension funds" (S129).
3. This category corresponds to the following sectors (as defined by the 2008 SNA): "Non-financial corporations" (S11); "Households" (S14); and "Non-profit institutions serving households" (S15).
Source: Bank of Italy.

Markets have proved highly sensitive to uncoordinated fiscal policy announcements since mid-2018 and rising tensions with the European Commission, leading to spikes in bond yields. The 10-year government bond yield dropped by 90 basis points in December 2018 as tensions between the European Commission and the government over fiscal policy abated. The agreement on the 2019 Budget has stopped the opening of an excessive deficit procedure against Italy. Keeping clear communication on fiscal policy choices and a constructive and open-minded dialogue with the European Commission is key to maintaining investors' confidence and avoiding drastic increases in bond yields, increasing further debt servicing costs and imperilling debt sustainability.

Italian public debt is currently just above the thresholds for investment grade of several major ratings agencies. On current OECD projections, the public debt ratio will cease to decline and rise to 134% of GDP on a Maastricht basis over the next two years. In addition, as in other countries, Italy faces over the medium-long run significant increases in public expenditure due to ageing population. The decision to partially reverse the 2012 pension reform by creating a new early retirement scheme (though only for the 2019-2021 period) will raise pension costs in the short-term, as well as in the longer-term if the new early retirement scheme is not actuarially fair. This may endanger the sustainability of the pension system and worsen intergenerational equity as discussed in the thematic chapter. Closing this new temporary early retirement scheme and ensuring that actuarial fairness is maintained also by keeping the link between retirement age and life expectancy are key to dealing with ageing population and ensuring the sustainability of the pension system.

All these factors underline that fiscal policy is vulnerable to changes in interest rates limiting fiscal policy choices to boost growth and pursue social goals. Without sustainable fiscal policy, the room for the public sector to enhance infrastructure, provide benefits and help the poor will inevitably narrow. A medium-term plan to reduce the debt-to-GDP ratio is a prerequisite to improve fiscal credibility and reduce the large risk premium on government borrowing. This should be based on the following:

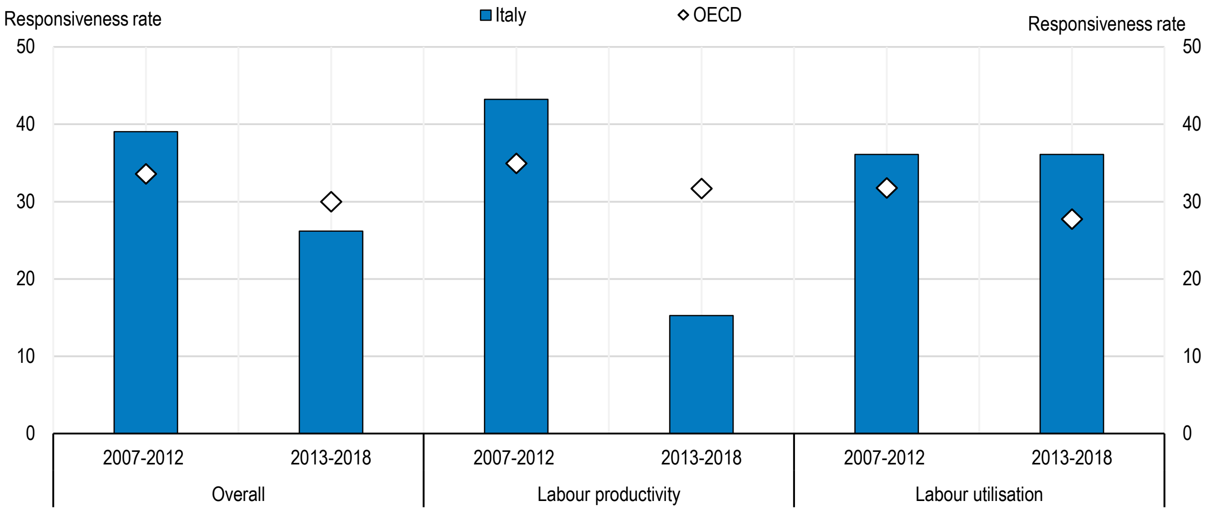
- Steadily raising the primary surplus to above 2% would help to put the debt-to-GDP ratio on a stronger downward path (see next section). Lower borrowing costs and improved confidence would likely offset the dampening effect on activity.
- The advice of the independent Italian Parliamentary Budget Office should help to frame policy and to ensure forecasts are realistic. Designing budgets within the EU Growth and Stability Pact, which should be implemented in a pragmatic way, would help to strengthen credibility by providing an anchor to fiscal policy.
- Incorporating thorough and effective spending reviews in the annual budget, as the 2016 reform of the budget making process allows, would help to develop a culture of performance in line ministries, reallocate spending towards most effective programmes and curtail current spending growth.

Structural reforms are needed to strengthen social inclusion and boost growth

The numerous and long-standing challenges Italy faces require reforms spanning several policy areas. Developing a multi-year reform package is a prerequisite to address these challenges and restore confidence in the reforming capacity of the country. Reforms undertaken in recent years have started to address some of these challenges. These include the Good School (Buona Scuola) reform (increasing resources and autonomy for schools and introducing school-to-work experience for students), the pension reform (linking retirement age with life expectancy), the Industry 4.0 plan (boosting investment and innovation), the public administration reform, the Jobs Act and the national antipoverty programme. Overall, reforms over the past 10 years – as gauged by the OECD reform responsiveness index – have focused on labour market issues (Figure 18). This reflects the right priority of tackling the long-standing challenges of the Italian labour market as highlighted by the low employment rate and job quality, although recent decisions and a Constitutional Court pronouncement have partially reversed these reforms. Going forward, it will be important not to reverse such reforms further while also boosting productivity growth by increasing competition in markets that are still protected, such as local public services, raising innovation and business dynamics, enhancing public administration efficiency and reducing administrative barriers to entrepreneurship and business dynamism.

Figure 18. Reforms in the past 5 years have focused on labour issues

Reform responsiveness rate



Note: The responsiveness rate is calculated as the average ratio of reforms undertaken to reform opportunities.
Source: OECD calculations based on OECD (2018) *Going for Growth*.

OECD estimates suggests the reform package proposed in this Survey would lift growth and reduce poverty by increasing employment, raising productivity and strengthening incentives to invest (Figure 20 and Figure 21). By 2030, trend GDP growth would increase from 0.6% under current policies to above 1.7 2% under the reform package recommended below (Figure 20 and Table 4). Between the end of the 2020s and 2040, trend growth will decline mainly because of ageing, which will continue to shrink the working age population. Increasing productivity growth is therefore key to offsetting the large negative effect of demographics and to boost growth.

The proposed reform package is wide ranging. Among the proposed reforms, the strengthening of the effectiveness and efficiency of public administration and the justice system, the expansion of active labour market programmes, better-targeted social benefits that reduce inequality and the tax wedge would bring the greatest benefits. Those concerning the reform of public administration and justice system would have the largest impact on GDP growth as they are key to strengthening the rule of law, but would also be the most challenging to implement. However, the new early retirement scheme, if not actuarially neutral, and the temporary break (up to 2026) of the link between the updates of early retirement contribution requirements and developments in life expectancy, as done by the 2019 budget, will offset some of the benefits of the proposed reforms (Table 4).

The current government has expressed its intention to continue the process of reforming the public administration that previous governments have started. This is welcome, but at the same time, the government should not underestimate the challenges and degree of commitment needed to achieve results. As underlined by a recent white book on public administration reforms that has collected suggestions from a wide range of experts and civil society (ForumPA, 2018[13]), public administration reforms should enhance transparency and accountability and focus om the following:

- Reducing the number of laws and regulations and more extensive use of single codes and manuals, accompanied by more reliance on clear outcomes and targets rather than procedural rules;
- Building platforms and networks of experts for the identification and dissemination of best practices and further promoting yardstick competition at central and sub-national levels; those public administration agencies at central and local levels that repeatedly fail to reach minimum standards or agreed targets should undergo a reorganisation process involving if necessary management changes and requalification of personnel;
- Increasing efforts to digitalise the public administration adopting a horizontal approach following the positive example of the Digital Transformation Team (see Box 2); to ensure continuity and a strong mandate, the government should turn the Digital Transformation Team into a permanent body in the Prime Minister's Office rather than disbanding it as currently planned;
- More effective human resource management through hiring procedures and allocation of staff based on skills needed in each job vacancy, more training and learning opportunities at different stages of careers, and raising accountability by clearly identifying who is responsible for what.

The justice system plays a crucial role in upholding the rule of law and enhancing mutual trust. Reforms have been focussing on the use of digital technologies, including the e-trial (allowing parties to submit documents in electronic forms), increasing court specialisation, improving administrative procedures to increase courts' efficiency and addressing staffing shortages. The Criminal Procedural Code was reformed in 2017. Following these reforms, which are still ongoing, Italy's justice system has reduced the sizeable backlog of unresolved administrative and civil cases. The time needed to resolve litigious civil and commercial cases has been declining since 2014, though it is still among the longest in the EU. Cases reaching second and third instances courts are exceptionally long. While public spending on the justice system is near the European average, the number of judges is comparatively low and residents have less confidence in the justice system than in most EU countries (European Commission, 2018[14]).

Italy should continue to reform and modernise its justice system. Given the complexity of the justice system, the reform effort will have to be sustained over years and results will appear gradually. The government's intention to reform the civil procedural code and streamline civil trials based on case-management system (Ministry of Justice, 2019) is welcome. More could be done to promote alternative resolution dispute methods, which are still too little used in Italy, especially in labour, civil and commercial disputes.

Public administration reforms must go hand-in-hand with continued efforts to fight corruption. The legislative framework on anti-corruption has evolved remarkably since the systematic intervention in 2012, which established a path for reforms that are still ongoing. The Anti-corruption Authority (ANAC), which is independent from the government, was established in 2014. Since then, it has gradually gained a prominent role by offering advice to central and sub-national governments and agencies on adopting and strengthening corruption-preventing measures, managing the electronic platform to collect information from whistle-blowers and issuing guidelines and regulations on public procurement contracts. ANAC can apply administrative sanctions to public officials not complying with the obligation of adopting anti-corruption plans or codes of conduct. Through its experience with hosting the Expo 2015, Italy has developed with the OECD a model to manage large and ad hoc procurements while minimising corruption risks (United Nations, 2009[15]). Besides having significant powers regarding transparency, integrity and anti-corruption plans, ANAC is responsible for issuing the implementing regulation of the 2016 public procurement code and overseeing public procurement and contracts

The 2016 public procurement code is innovative and well-designed. The new code has enhanced transparency of contracting authorities and contracting entities relating to public procurement. The code sets standard timeframes and conditions for participation in public tenders, awarding tender criteria, legal recourse and appeal processes. The code also establishes a register for members of public-tender boards, which is expected to enter into force in 2019. To enhance general transparency and integrity of procurement, ANAC collects, analyses and publishes all relevant procurement data.

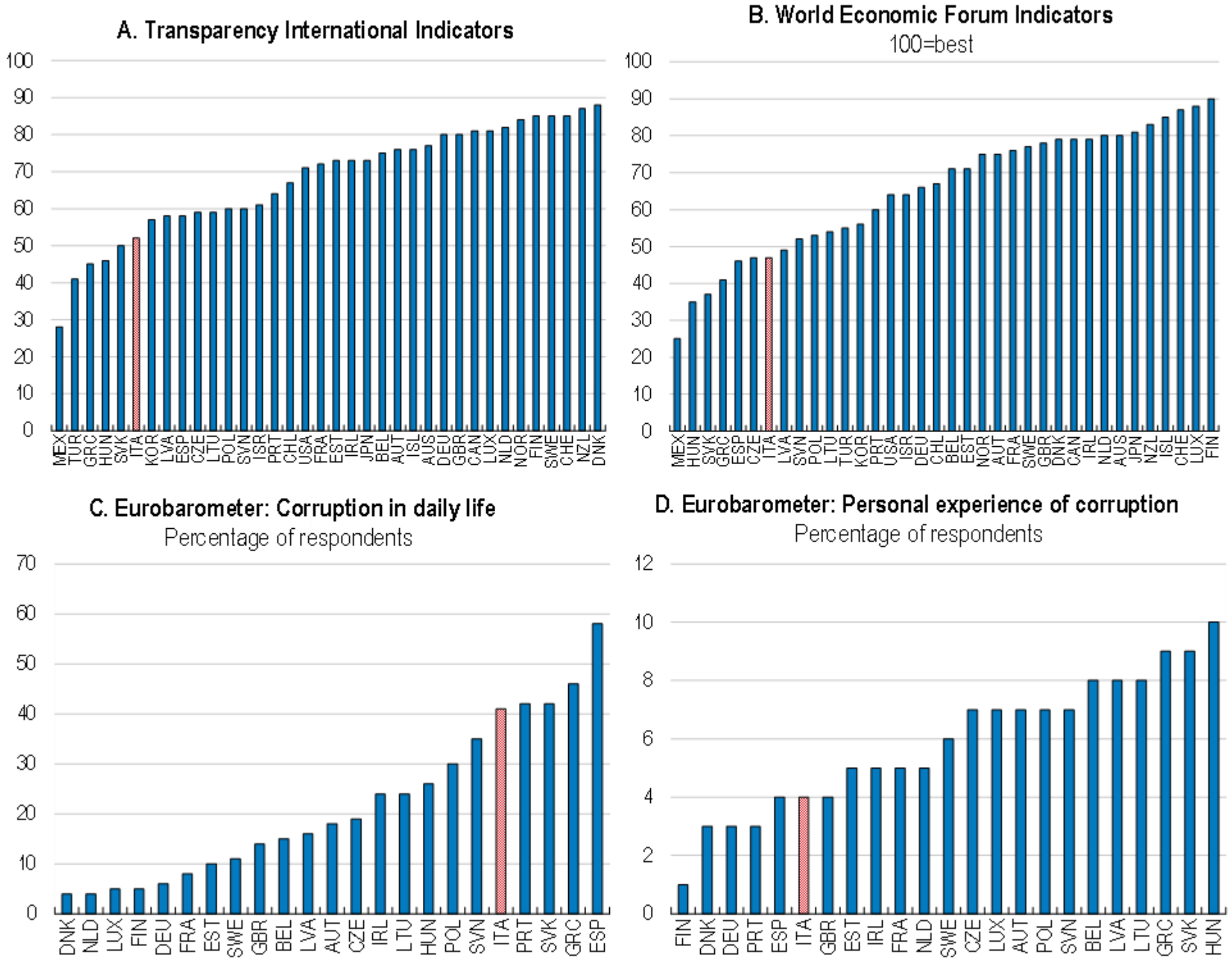
While some aspects of the Public Procurement Code may need to be streamlined, the role and power of ANAC should be protected. The Code’s implementation delays are not attributable to ANAC. They are instead due to the novel aspects of the Code aiming at lowering corruption risks, and enhancing competition in bidding processes and project quality. However, these innovative aspects also require some time for all stakeholders to understand them and to provide feedback to ANAC before it issues implementing regulations. To expedite the implementation of the new Code, the government should issue the implementing decree that sets the criteria to identify the qualifying contracting authorities for public procurement contracts on which ANAC already provided advice. The government should follow up on ANAC’s Triannual Plan to Prevent Corruption (updated annually), as it contains useful recommendations to reduce corruption risks in different policy areas at sub-national and central levels. The latest plan focuses on revenue agencies, use of European funds and waste management (ANAC, 2018). The government should also stagger the appointment of the ANAC’s board members to avoid replacing all board members at the same time.

The reforms undertaken in the past ten years to fight corruption and improve public procurement go in the right direction and show the seriousness and determination of Italy’s successive governments on this issue. Despite this, indexes of perceived corruption are still generally high compared to other countries (Figure 19). This could be due to two not mutually exclusive reasons. First, the reforms of the past ten years have not yet produced the expected benefits as implementation and following due processes take time. Second, perception indexes may not adequately measure corruption. For instance, according to the Eurobarometer survey, Italy has a high percentage of respondents reporting a high level of corruption in daily life but at the same time the percentage of respondents reporting to have personal experience of corruption is low.

Past recommendations on public sector efficiency

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	**Actions taken since 2017 Survey**
Approve and fully implement the public administration reform to open up to competition local public services.	Public administration reform has been approved and implemented. The opening to competition of some local public services is still. The reform of local state owned enterprises is ongoing but has been delayed.
Ensure that legislation is clear, unambiguous and supported by improved public administration, including through reduced use of emergency decrees.	The use of emergency decrees has declined. The public administration reform has been approved and implemented and measures are ongoing. A Freedom of Information Act (FoIA) was approved, which establishes a general civic access: citizens are allowed to access data and documents of the Public Administration even if those are not made public. The same Decree that introduced the FoIA, sets an obligation for Public Administrations to publish their data bases.
Make more extensive and better use of regulatory impact analyses, especially by engaging with stakeholders in ex-ante consultative processes.	The anti-corruption agency (ANAC) provides guidance on various issues relating to the prevention of corruption. Its regulations have the power of soft laws. As regards whistle-blower protection in the public and private sector, ANAC has become the main channel for receiving the reports. In the public sector ANAC is not only a reporting channel, but also the governance and regulatory authority. No change on Regulatory Impact Assessment
Further streamline the court system, with more specialisation where appropriate; increase the use of mediation; enhance monitoring of court performance.	Continued judicial system reforms, although performance remains uneven, and times to resolve cases is significantly slower in southern regions.
Consider establishing a Productivity Commission with the mandate to provide advice to the government on matters related to productivity, promote public understanding of reforms, and engage in a dialogue with stakeholders.	No progress.
Reducing corruption and improving trust must remain a priority. For this, the new anti-corruption agency ANAC needs stability and continuity as well as support at all political levels.	ANAC continues to operate and has gained a prominent role in corruption prevention activities. It as an importation in public procurement procedures and responsible for issuing implementing regulation concerning the 2016 public procurement code. The code has yet to be implemented in full. In 2018 the government put forward and the parliament approved a new law (Corruption-Sweeping Law, "Spazzacorrotti") lengthening prison sentences for corruption convictions, eliminating the statute of limitations after a first degree judgment (for all judicial cases not just for corruption), allowing for undercover agents in corruption investigations and setting a measure of debarment (so called Daspo) for both public officials and private individuals, as well as companies, convicted for corruption, which will be banned from contracting with public administrations. The reform of the Criminal Codes, entered into force in August 2017 includes a reform of the time limitation regime, thus enhancing the capability of the criminal system to fight corruption. As for the Civil Code, an important step forward has been made with the introduction of innovative provisions regarding corruption in the private sector
Reduce public ownership, especially in TV media, transport and energy utilities, and local public services. Privatise and liberalise energy and transport sectors. Complete framework for regulation of water and other local public services, ensuring regulatory independence. Introduce national oversight of regional regulatory competences (e.g. retailing, land-use planning).	Privatisation programme has made little progress. The latest large privatisation concerns the disinvestment of 46.6% equity stake in the air traffic controller (ENAV) in 2016. A 2018 decree (Mille Proroghe decree) postponed the price liberalisation for gas and electricity by one year to 1st July 2020.

Figure 19. Indicators of perception of corruption

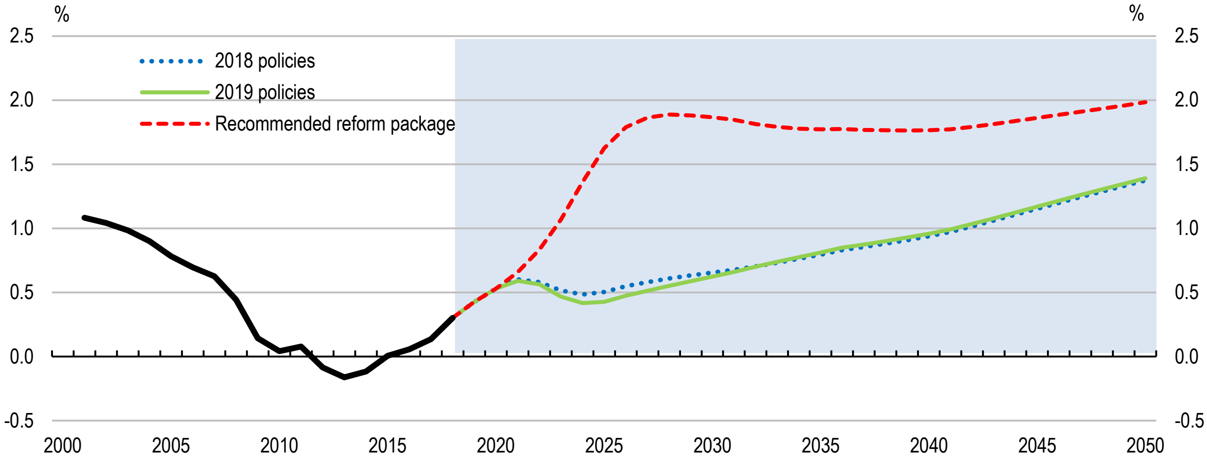


Note: "Transparency International indicators" refers to the average of five sub-indicators available for all OECD countries in the "Corruption Perception Index"; "World Economic Forum indicators" refers to the World Economic Forum's Executive Opinion Survey; "Eurobarometer: corruption in daily life" refers to the share of respondents who agreed with the statement "You are personally affected by corruption in your daily life"; "Eurobarometer: experience of corruption" refers to the share of respondents who answered positively to the question "In the last 12 months have you experienced or witnessed any case of corruption?".
Source: Transparency International; World Economic Forum; and Eurobarometer.

Measuring corruption, and more generally the efficiency of the public administration, on a more objective basis is key to designing and implementing effective anti-corruption measures and enhance trust in the government. To this end, Italy is actively participating in different international initiatives, at the G20, UN and the OECD, aiming at developing indicators to measure corruption and progress in reducing it more objectively. The OECD has been working on open data, quantitative analysis and the use of data analytics to combat fraud, waste and abuse, and to promote public integrity and improved government performance (High-Level Advisory Group, 2017[16]).

Figure 20. Reforms to raise participation and improve the business climate would lift Italy's growth prospects

Trend annual real GDP growth rate, alternative policy scenarios



Note: Policy scenarios are described in Table 4.
Source: OECD calculations based on Y. Guillemette, et al. (2017), "A revised approach to productivity convergence in long-term scenarios", *OECD Economics Department Working Papers*, No. 1385, OECD Publishing, Paris.; M. Cavalleri, and Y. Guillemette (2017), "A revised approach to trend employment projections in long-term scenarios", and *OECD Economics Department Working Papers*, No. 1384, OECD Publishing, Paris.; Y. Guillemette, A. de Mauro and D. Turner (2018), "Saving, Investment, Capital Stock and Current Account Projections in Long-Term Scenarios", *OECD Economics Department Working Papers*.

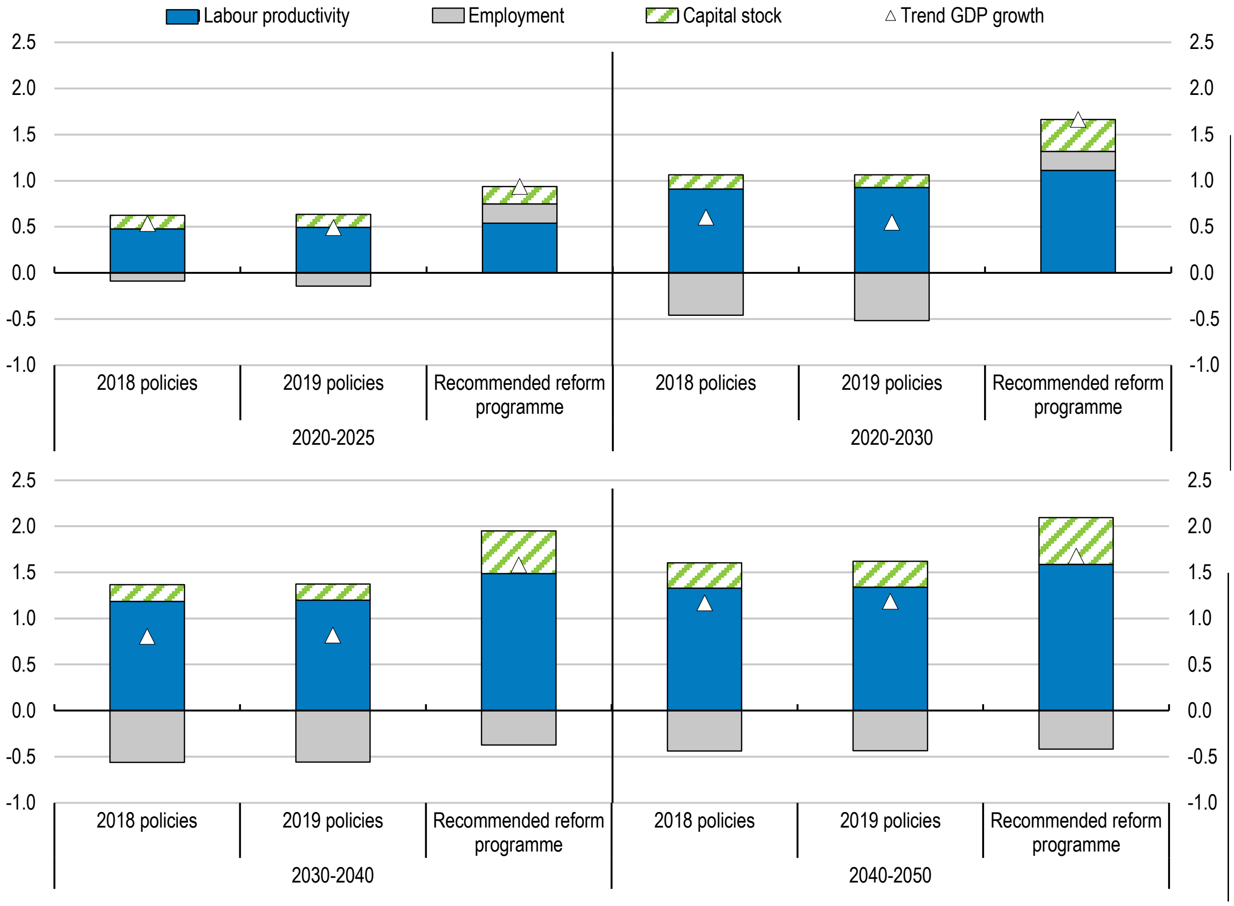
Table 4. Effects of reforms on real GDP growth

	2025	2030	2040
	% difference in level of real GDP, relative to 2018 policies:		
2019 policies			
Pension reform reduce effective retirement age by 3 years in 2021, declining to 1.4 years in 2024, and by 0.8 years from 2032	-0.3%	-0.4%	-0.3%
Citizen's Income reduces inequality by 0.81 points on the Gini coefficient and increase the labour tax wedge on singles at 100% of the average wage by 2.2 percentage points.	-0.2%	0.9%	2.1%
Active labour market programme spending increased by 25% per unemployed person in 2025, then returns to baseline by 2025	0.1%	0.0%	-0.1%
Overall effect	-0.2%	-0.5%	-0.4%
Recommended policy package			
Guaranteed minimum income scheme, in-work benefits, and tax and social security contribution reforms reduce inequality and the tax wedge	0.9%	2.4%	3.8%
Active labour market programme spending increased by 9% points per unemployed person in 2021 then by an additional 37% points by 2025 to be 130% above baseline	0.9%	3.7%	6.3%
R&D spending rises from 1.3% of GDP to 2.0% of GDP by 2025, to near the average of other G7 countries	0.0%	0.1%	0.6%
Family benefits in-kind increase by 40% by 2030, to reach OECD average relative to GDP	0.0%	0.2%	0.5%
Reform of public administration and justice system (rule of law rises gradually to close half of Italy's gap with the OECD average by 2030)	0.2%	1.1%	4.4%
Overall effect	2.0%	7.6%	16.2%

Note: Reduced tax expenditure and tax evasion, increased and more effective public investment and more efficient public procurement and asset management, presented in the fiscal impact table, is not included in these estimates of the effects of the recommended reform package on real GDP growth.
Source: OECD calculations.

Figure 21. The recommended reform package would help to offset the growth effects of ageing and the decline in the working age population

GDP growth, annual average and contributions



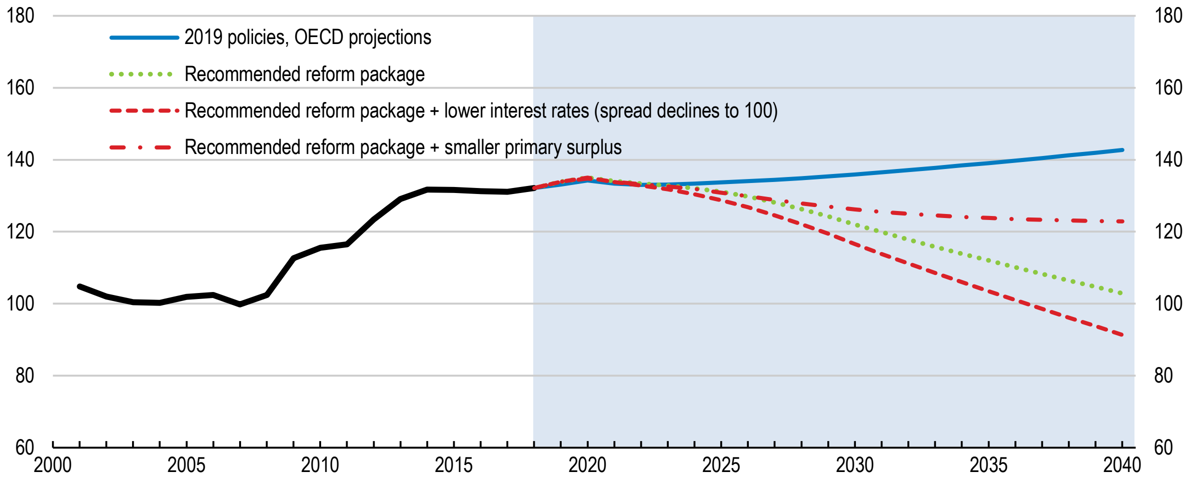
Note: Growth rates and contributions are the average of annual log changes.
Source: OECD calculations based on OECD *Economic Outlook 104*, including more recent information; and Guillemette, Y. and D. Turner (2018), "The Long View: Scenarios for the World Economy to 2060", *OECD Economic Policy Papers*, No. 22, OECD Publishing, Paris.

Box 2. Italy’s Digital Transformation Team

Italy’s Digital Transformation Team is an agency created in 2016 on a temporary basis to accelerate the implementation of the government’s digital agenda. In addition to completing the long overdue three-year Plan for Digital Transformation, the Team has developed digital platforms to simplify interactions with the public administration concerning: the digital identity, the national resident population register, the electronic identity card and digital payments. In addition the Digital Transformation Team has offered its expertise to various municipalities, and public administration bodies, including the Court of Auditors, the Revenue Agency and the National Social Security Institute on specific projects. The Team is scheduled to be disbanded in 2019.

Figure 22. The recommended reform package would improve debt sustainability

Projected public debt under various reform and growth scenarios, percent of GDP



Note: Assumptions underlying each debt scenarios are summarised in Table 5.
Source: OECD calculations.

Table 5. Assumptions of recommended reform package debt sustainability scenarios

		2020	2025	2030	2035	204 0
2019 policies, OECD projections						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.6	1.6	2.0	2.0	2.0
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
Recommended reform package						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	3.3	3.3	3.3
GDP deflator growth	%, annual	1.4	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
Recommended reform package + lower interest rates (spread declines to 100)						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	3.3	3.3	3.3
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	3.5	4.1	4.3	4.5
Spread between effective interest rate and risk-free rate	bps	219	100	100	100	100
Recommended reform package + smaller primary surplus						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	1.8	1.8	1.8
GDP deflator growth	%, annual	1.4	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150

Source: OECD.

Box 3. Quantifying the fiscal impact of structural reforms

Table 6 presents estimates of the fiscal effects of the recommended reform package. The fiscal effects do not allow for behavioural responses. The recommended reforms with minor fiscal impacts are not presented. Reforms assessed for fiscal impact are the same as those simulated for long-term GDP effects in Table 4.

Table 6. Illustrative fiscal impact of recommended reform package

Fiscal savings (+) and costs (-), % current year GDP

	2020	2025	2030
Boosting sustained and inclusive growth			
Close the early retirement scheme introduced in the 2019 budget and keep the pre-2019 link between retirement age and life expectancy.	0.2	0.1	0.1
Reduce tax expenditures.	0.1	0.1	0.1
Continue the fight against tax evasion.	0.3	0.8	0.8
Improve the effectiveness of public investment and public procurement.	0.2	0.3	0.3
Tax and benefits reforms to reduce poverty and encourage employment			
Permanently reduce employer social security contributions to encourage employment.	-0.2	-0.2	-0.2
Rationalise personal income tax credits, adjust tax rates, introduce low-income in-work tax benefits, ensure the Citizen's Income encourages work.	-0.4	-0.4	-0.4
Strengthen active labour market programmes, public employment services and social services capacity.	-0.1	-0.3	-0.5
Expand access to childcare and other family support programmes.	-0.1	-0.1	-0.1
More effective investments in regional development and strengthening capacity at a local level			
Increase public investment to a level to maintain existing capital stock, while improving the efficiency of public investment and public infrastructure management.	0.0	-0.1	-0.3
Streamline regional development governance and processes, strengthen capacity, and improve planning	0.0	0.0	0.0
Revenue gain from recommended reform package			
Increase in overall revenues.	0.0	1.0	3.1
Overall budget impact of specific measures of recommended reform package	0.0	1.2	2.6
Memo: % difference in GDP compared with baseline	0.0	2.3	8.1

Note: 1) The 2019 adjustment to retirement ages, with a budget allocation of EUR 7 billion, is assumed to be temporary and apply only to the cohort eligible in 2019. 2) Savings on tax expenditures are based on estimates by Perotti (2018), adjusted for projected price growth. 3) Potential revenue gains from reducing tax evasion are based on (OECD, 2017[8]) estimates of the gap between realised and potential VAT revenues, adjusted for projected nominal GDP growth. Measures are expected to collect 10% of this gap in 2020, rising to one-third by 2030. 4) Estimates are based on the 2019 Budget's projected savings from rationalising ministries' expenditure in 2019, continued and expanded over subsequent years. 5) Based on previous Budget allocations for temporary reductions in employers' social security contributions of a similar scale, adjusted for projected nominal GDP growth. 6) Estimated with Euromod for the direct costs and revenues from the tax and benefit reform programme recommended in Chapter 1. 7) Additional to the EUR 1 billion allocated in the 2019 Budget, these measures raise spending on active labour market programmes to 1% of GDP by 2030, bringing Italy into line with other large European countries. 8) Bring Italy's spending on early childhood and preschool education and care into line with the OECD average relative to GDP from 2020. 9) Raises public investment to a level to maintain a stable stock of public capital relative to potential GDP. 10) Gain in public revenues to due to the projected expansion in GDP associated with the reform programme, calculated as the difference in projected nominal GDP between the recommended reform programme and 2019 policies, multiplied by the estimated ratio of revenues to potential output.

The proposed reform package would help to lift growth and raise the primary surplus, putting the debt-to-GDP ratio on a firm downward path. If fiscal credibility could be improved rapidly, a falling risk premium on government debt would accelerate the reduction of the debt ratio (Figure 22). Table 6 provides fiscal estimates of the proposed reform package. The reforms to tax and benefits to improve incentives and protection for low income household would generate the largest fiscal costs through reduced receipts and higher transfers. This could be funded by improving tax compliance and by ensuring that the pension system remain sustainable.

Protecting the environment

Improving well-being for current and future generations depends on higher growth but also on better protecting the environment and limiting global warming in line with the Paris Agreement's targets. In Italy, CO_2 emissions per unit of GDP are below the OECD average (Figure 23, Panel A). The energy intensity of the economy has fallen little and the expansion of renewable energy production has stalled due mostly to large drop in hydroelectric energy production because of scarce rainfall. Nevertheless, Italy records a better performance in terms of both energy intensity and renewable energy than the OECD average (Figure 21, Panels B and C). According to recent projections (European Environment Agency, 2018[17]), Italy is on track to achieve the national climate and energy targets for 2020. However, according to the European Environment Agency (2017[18]) on current policies Italy will not reach its target to reduce its greenhouse-gas emissions outside the EU Emissions Trading System (ETS) by 33% relative to 2005 levels.

The share of the population exposed to very high levels of small particle emissions is higher in Italy than the OECD average (Figure 23). Mortality from outdoor particulate matter is unusually high among OECD countries and has risen markedly since 2015 (Roy and Braathen, 2017[19]). Urban sprawl around Italian cities has contributed to an increase in built-up areas (discussed in the thematic chapter). Population density in Italian metropolitan areas has diminished and fragmentation of urban settlements has increased (OECD, 2018[20]). Urban sprawl fosters car dependency and traffic congestion, raising pollution, energy consumption and CO_2 emissions (OECD, 2018[20]). It also raises the cost of deploying electricity and water infrastructure as well as public transport.

Water extraction, mostly in agriculture, amounts to 45% of total renewable water resources, implying a high level of water stress. The latest Environmental Performance Review (OECD, 2013[21]) recommends formulating a strategic vision for the water sector and streamlining institutional arrangements for managing river basins. Though waste management has improved, waste collection is at times irregular even in some large cities and illegal dumping is a serious health concern in some areas.

Much municipal waste is recycled, helping to avoid landfill and its risks for air and water pollution. However, the rate of recycled waste varies greatly among regions as practices and capacity differ. In 2016, northern regions recycled about 64% of their urban waste against 49% for central regions and 38% for southern ones. Good policies can make a difference. For instance, Sardinia increased the share of recycled urban waste from 28% in 2007 to 60% in 2016 and Apulia from 9% to 34% (ISPRA, 2017[22]). As underlined by the Anti-corruption Authority (ANAC, 2018[23]), the fragmentation of responsibilities over waste management among regions, provinces and municipalities leads to weak coordination and lack of synergies, heightening corruption risks. ANAC (2018[23]) highlighted several critical aspects of waste management. These include insufficient waste management facilities in many regions, which results in transfers of waste among regions and waste collection problems; long delays in issuing and implementing waste management regional plans; and, awarding of waste management service contracts inconsistently across regions and in ways that often contravene laws. The government could develop a national plan for waste collection that, while respecting sub-national governments' responsibilities in this area, improves synergies and complementarities. The policies and operations of sub-national governments that repeatedly fail to reach targets for waste collection and recycling should undergo a review and restructuring process aiming at adopting best practices and enhancing accountability at the local level.

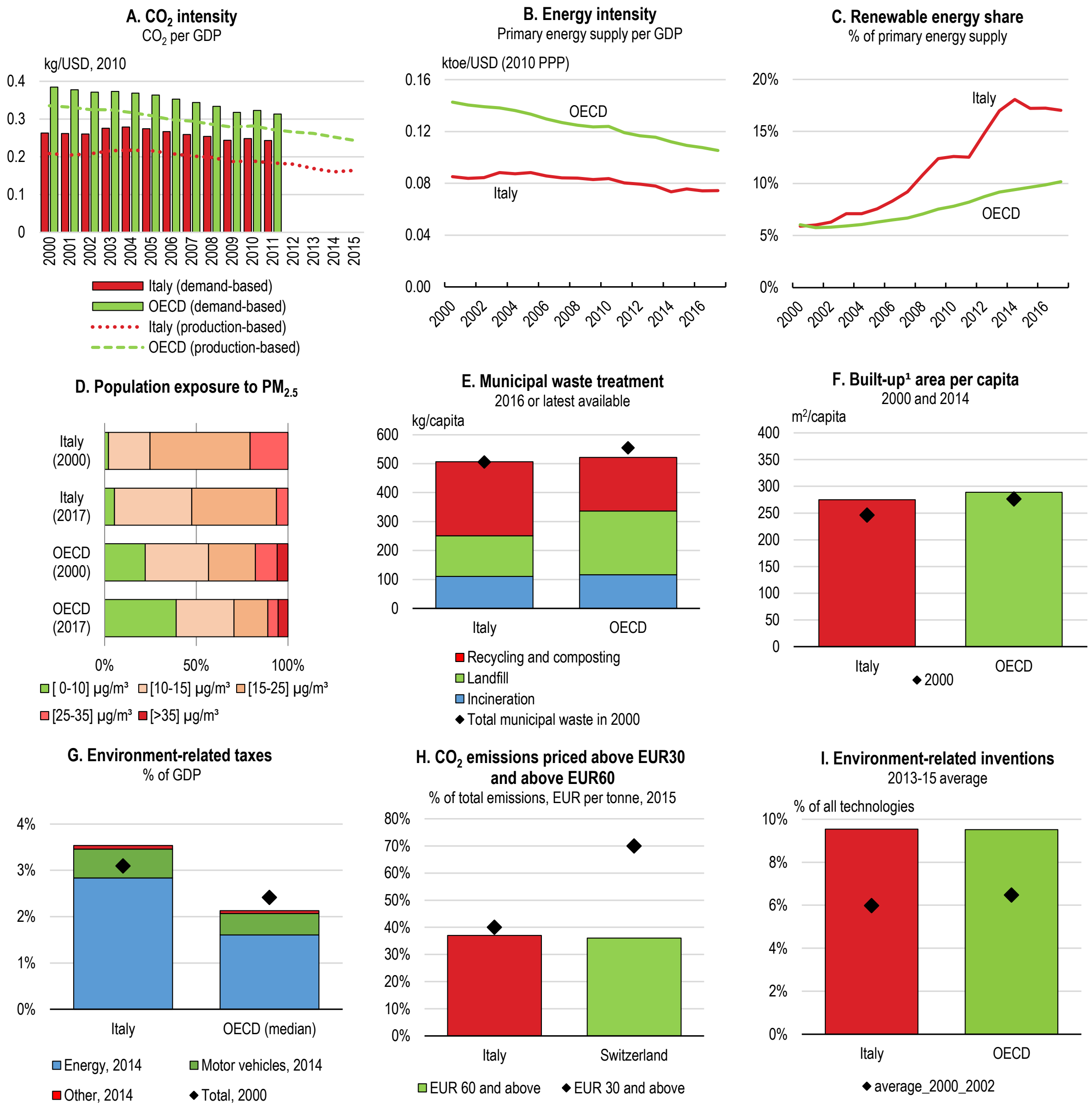
Environmental tax revenues are substantial relative to other OECD countries, reflecting high taxes on fossil fuel use in transport and residential use. However, the tax burden is uneven, reducing efficiency in CO_2 emission abatement. Natural gas is taxed less, in terms of carbon content, than petrol. Fossil fuel use in industry is taxed much less than in residential and commercial use while coal use in industry is tax exempt (OECD, 2018[24]). Diesel is taxed less than petrol, even though it causes more small particle pollution. More consistent carbon pricing and higher public funding for R&D could also boost environmental innovation, which remains relatively weak. Higher public funding for low-carbon R&D would have substantial economic benefits, because innovation can be applied across a broad range of sectors and tends to have substantial knowledge spillovers for domestic firms (Dechezleprêtre, Martin and Bassi, 2016[25]). Italy could reduce the economic burden of environmental regulations without compromising their stringency, thereby boosting competition, innovation and performance, in particular by better evaluating regulations' effectiveness (Koźluk, 2014[26]).

Improving metropolitan governance (as detailed in the thematic chapter) can improve green growth outcomes in Italy's cities. In particular, this requires defining metropolitan governance structures based on travel-to-work areas and integrating urban planning, housing and public transport policies. This can help densify cities, improve access of commuters to jobs as well as reduce energy consumption, pollution and CO_2 emissions. It can also boost productivity (OECD, 2015[27]). Investing in alternatives to road transport, especially in southern Italy, would reinforce the environmental effect of transport fuel taxes (OECD, 2013[21]).

Past recommendations on environmental policy

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	**Actions taken since 2017 Survey**
Make taxation more environmentally-friendly by reducing the gap between duties on diesel and petrol.	No progress
Shift the tax burden from electricity to the energy products used to generate it, with the respective rates set to reflect the carbon emissions and other pollutants associated with each fuel.	No progress

Figure 23. Green growth indicators for Italy



1. "Built-up" is defined as the presence of buildings (roofed structures). This definition largely excludes other parts of urban environments and the human footprint such as paved surfaces (roads, parking lots), commercial and industrial sites (ports, landfills, quarries, runways) and urban green spaces (parks, gardens). Consequently, such built-up area may be quite different from other urban area data that use alternative definitions.

Sources: OECD *Green Growth Indicators* database; OECD *Environment Statistics* database; OECD *National Accounts* database; IEA *World Energy Statistics and Balances* database; OECD *Exposure to air pollution* database; OECD *Municipal waste* database; OECD *Land cover* database; OECD *Effective Carbon Rates* database; and OECD *Patents in environment-related technologies: Technology indicators* database.

Boosting job creation

Raising the employment rate is paramount to reducing poverty and social exclusion and improving well-being in addition to raising the potential level of economic activity. The employment rate has reached a record high level (58%) but is still among the lowest of OECD countries. The new OECD *Jobs Strategy* (OECD, 2018[1]) highlights reforms that support growth of high quality jobs, protect individuals from labour market exclusion and risks, and prepares the workforce for future opportunities.

In the past few years, governments passed a number of labour market reforms, some of which were subsequently undone (Table 7). Lowering employer social security contributions on permanent contracts has contributed to increase the share of permanent contracts and total employment (Figure 24). In 2018, the Dignity Decree has raised already high severance payments to among the highest in the EU. Moreover, the Constitutional Court has declared as unconstitutional the determination of severance payments for unfair dismissals based solely on job tenure (as mandated by the Jobs Act). The decision gives judges ample discretion again in deciding severance payments on a case-by-case basis. According to the relevant legislation in force before the Jobs Act (the 2012 Fornero reform), the judge will have to decide based on different criteria such as the job tenure, the size of the company, number of employees and parties' behaviour. The undoing of recent labour market reforms may discourage companies from hiring workers with permanent contracts and entrench labour market duality. The contribution of permanent contracts to net employment growth has indeed declined and the number of permanent contracts has declined throughout 2018 (Figure 24).

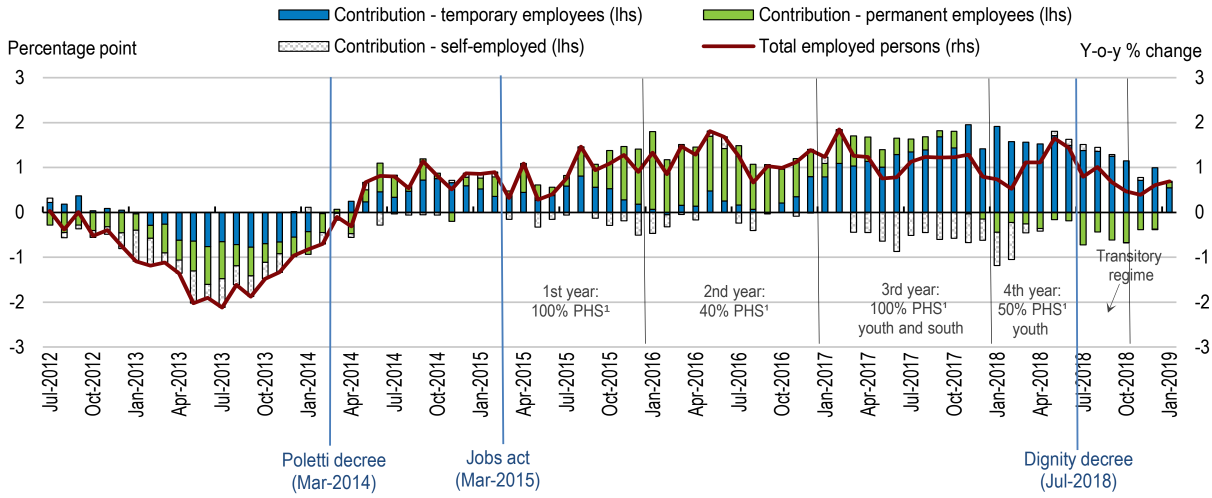
To encourage hiring of workers with permanent contracts, the government should define more precise criteria on how to determine severance payments, in a way that is consistent with the Constitutional Court's decision. This would prevent a steep rise in disputes that are litigated in courts and the uncertainty generated by judges' margin of discretion (OECD, 2018[1]). For instance, the legislator could link severance payments to a minimum-and-maximum range increasing with tenure, as the recent reform in France does.

Increasing employment rates also hinge on markedly improving public employment services (PES), and active labour market programmes (ALMPs) (OECD, 2018[1]). The previous government sought to build the capacities of Italy's ALMPs, but they still underserve the 16.7 million out-of-work population, especially in lagging regions. Modest increases in spending and participation in ALMPs, accompanied by organisational and efficiency improvements, can bring high returns and improve jobseekers' likelihood of finding work (OECD, 2015[28]).

Table 7. The doing and undoing of labour market reform in Italy

Open-ended contracts	Fixed term contracts
Jobs Act (2015): organic reform of the labour market, which included: further reduction of judicial discretion in setting the compensation for unfair dismissals (following the 2012 Fornero reform); set rules, for newly hired workers in firms with more than 15 employees, determining severance payments increasing with job tenure in cases of unfair dismissal.	Fornero reform (2012): introduced a new type of temporary contract that does not require any justification but limited to the first job relationship and could not exceed 12 months. However, the same reform added a levy to social security contributions on fixed term contracts that was earmarked to fund unemployment insurance and partly redeemable in case of conversion to permanent contracts. The Fornero reform followed a trend started in the mid-1990s with the Treu package, which attempted to facilitate the use of temporary contracts by allowing temporary work agencies to operate. In 2001 a generic motive ("any technical, production, organizational and substitution reason") replaced a list of specific cases that could be used to justify temporary contracts.
Social security contribution exemptions (2015-present): introduction of employers' social security contribution exemptions – on a temporary basis – on new permanent contracts: for contracts signed in 2015 exemptions were capped at EUR 8 060 annually for the first 3 years; for contracts signed in 2016 exemptions were capped at EUR 3 250 for 2 years only; in 2017 social security exemptions were restricted to employers who hire students who completed an apprenticeship or traineeship with the same employer (up to EUR 3 250). Social security exemptions for firms located in southern regions were introduced to hire unemployed young workers with permanent or apprentice contracts (up to EUR 8 060); from 2018 there is a 3-year contributions reduction (capped at EUR 3 000) for new hires aged under 35.	Poletti decree (2014): the aim was to facilitate the use of fixed-term contracts: through: abolishment of justifying reasons for fixed-term contracts and increase of the maximum number of contract's extensions from 1 to 5; shortening the interval between two consecutive fixed term contracts with the same employer from 60 to 10 days (for contracts shorter than 6 months) and from 90 to 20 days (for contracts longer than 6 months); allowing collective agreements to extend the length of fixed-term contracts above the statutory maximum (36 months). To counterbalance these measures the decree introduced a 20% cap on the share of temporary employees in the workforce – excluding firms with less than 5 employees and start-ups. The Poletti decree followed several previous reforms that since the mid-1990s attempted to facilitate the use of temporary contracts.
Dignity Decree (2018): Increase severance payments for dismissal without any just motive; the minimum payment was increased from 4 to 6 monthly salary the maximum from 24 to 36 monthly salary Constitutional Court pronouncement (2018): the Constitutional Court declared that determining the severance payment in case of unfair dismissals based solely on job tenure (as mandated by the Jobs Act) is unconstitutional.	Dignity Decree (2018): made it more difficult to sign temporary contracts by: allowing temporary contracts longer than 12 month only in cases of: 1) temporary and objective needs unrelated to ordinary administration; 2) replacements; 3) temporary and significant increments in activity impossible to forecast (any temporary contract not respecting these criteria is converted to a permanent contract after 12 month); limiting the length of temporary contracts without any motive to 12 months; reducing the maximum number of renewals of temporary contracts from 5 to 4; further increasing social security contributions on temporary contracts (an additional levy of 1.4% compared to permanent contract) by 0.5% at each renewal of the temporary contract.

Figure 24. The temporary cut in social security contributions temporarily boosted job creation through permanent contracts



1. Temporary subsidies to permanent hiring (PHS) consisted in a three-year exemption from social security contributions.
Source: ISTAT *Labour and Wages* database

The introduction of the Citizen's Income scheme makes improving the public employment services even more urgent as this benefit is administered by the PES and most beneficiaries will be required to engage in job-search and training programmes (as discussed in the thematic chapter). The 2019 Budget allocates about EUR 900 million over 2019-20 to reinforce the staff of PES and additional EUR 500 million to hire professionals to improve the efficiency of job-matching activities of PES. These are positive steps and long overdue but a detailed plan on how to improve PES is yet to be defined.

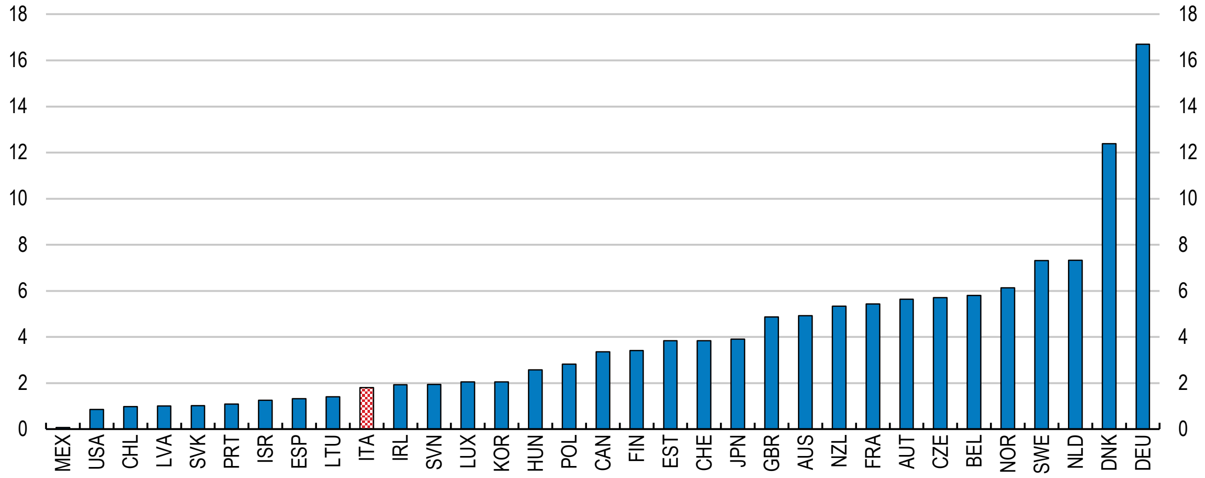
As highlighted in the previous OECD Economic Survey (OECD, 2017), employing more specialised counsellors and profiling tools based on digital technologies is key to make progress in this area. PES spending (Figure 25) and staff numbers and skills are low, especially in lagging regions (OECD, 2019, forthcoming[29]). Other countries' effective PES reforms, such as in Portugal in the early 2010s, provide good examples on how to reform Italy's PES. Their experience demonstrates that improving vacancy registration and access via online databases, along with more skilled counsellors to better engage with the unemployed in PES offices can improve outcomes (OECD, 2017[30]; Martins and Pessoa e Costa, 2014[31]; Behncke, Frölich and Lechner, 2007[32]). The government's intention to create a Single Information System for Labour Policies (SIUPL) where companies can post vacancies is a welcome step. Given the size of Italy's SME sector, the PES could also develop specialised support services for SME employers, following the British PES example.

The Citizen's Income will also significantly raise demands on social assistance programmes. The Citizen's Income is supposed to replace the Inclusive Income scheme (Reddito d'Inclusione, REI) – the social assistance programme rolled out in early 2018. Many cities have already made changes and invested resources to deliver the social assistance services linked with the REI whereas PES have little or no experience in social assistance programmes and in many regions already struggle to deliver effective job-search and training services. The effective implementation of the Citizen's Income will then hinge on stronger collaboration and coordination between PES and municipalities' social assistance programmes. To this end, the government plans to establish the Single Information System for Social Services ("Sistema Informativo Unitario dei Servizi Sociali") to facilitate the sharing of information among municipal social services and PES.

Enhancing job-search and training policies is key to containing the costs of the Citizen's Income and avoiding the creation of poverty traps. In Italy, private-sector agencies and public employment services (PES) provide job-search and training services. About 1 100 private-sector job-search and training agencies are accredited with ANPAL, allowing them to cash in a training voucher if they find a job for an unemployed person holding a voucher. The amount of the voucher varies with the employability profile, and can be spent in training or education at public or private employment services. As many PES are ineffective, especially in lagging regions, and reforming them will take some time (OECD, 2019, forthcoming[29]), further developing partnerships with private-sector job-search and training agencies and extending the existing training voucher scheme to also include Citizen's Income beneficiaries is key for an effective implementation of the Citizen's Income.

Figure 25. Italy's public employment services are under-resourced

Spending on public employment services per unemployed person as % of GDP per capita, 2016 or latest available, unit



Source: OECD *Labour Market Programmes* database; and OECD *National Accounts* database.

Improving PES requires strengthening the role of ANPAL, the agency established in 2016 to coordinate active labour market policies and the network of regional PES. Regional governments are responsible for developing and implementing active labour market policies. Their quality and effectiveness vary greatly across regions. In 2017, regional and national governments agreed on minimum levels of services that PES are expected to provide. Regional governments are also obliged to share data with ANPAL about their activities. However, compliance with such minimum levels of services is patchy. ANPAL has the capacity to identify regions falling short of agreed standards but has no power to compel regions to address their shortfalls and adopt best practices.

The power and coordination role of ANPAL needs to be strengthened for the new PES system to produce results. ANPAL has already the responsibility of monitoring the implementation of the plan to strengthen active labour market policies that was approved by the State-Regions Conference in late 2017. However, it has little power to undertake corrective actions in those regions that do not achieve the agreed service standards. ANPAL could be tasked with the responsibility of developing and implementing special restructuring programmes for those public employment services that fail to reach the agreed service standards within a certain time. Such restructuring programmes could include management changes, structural reorganisation of the employment centre and requalification of the personnel based on an analysis of needs. Strengthening accountability and incentives for regional public employment services to adopt best practice and improve performance would also help. Clarifying who is responsible for what and publishing data on the activities and performance of all public employment centres would go in this direction by strengthening accountability and yardstick competition.

Past recommendations on active labour market programmes

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Fully implement the unified unemployment benefit system. Require recipients to actively seek work, and to accept employment or training when offered.	The new system has been implemented.
Encourage social partners to allow modification of national wage agreements at the firm level, through agreement with representatives of a majority of the firm's employees	Fiscal incentives to encourage firm-level wage bargaining are in places and yielding fruit. Social partners are negotiating additional benefits for employees, generally in workplaces with higher productivity and margins. But use overall remains limited.
Raise the efficiency of public employment services by decreasing job seeker-to-staff ratio. Employ profiling tools and specialised counsellors. Ensure ANPAL has the powers to coordinate local employment services offices and set national standards on job search and training policies.	Public employment services continue to be managed by regions. In December 2017 the State-Regions Conference approved a plan to strengthen active labour market policies based on further developing profiling tools, integrating IT systems and improving public employment services. ANPAL has the responsibility of monitoring the plan's implementation and reporting progress once per year. The government has set minimum quality standards for public employment services. ANPAL is expected to supervise the implementation of such standard but has very limited power. The 2019 budget allocates EUR 1 billion for 2019 to the reform of PES including to increase staffing by 125% and invest in processes.
Implement a systematic assessment of the labour market impact of activation programmes and focus funding on those that are performing well.	INAPP has broadly evaluated labour market skill needs, and conducted deeper evaluation of apprenticeship programmes.
Facilitate labour mobility between regions, occupations and sectors through skills recognition and the use of skills assessment.	Skills certification is growing among participants in joint inter-professional funds. A process has started to define the Guidelines for a National Skill Certification Sytem ("Linee guida del Sistema Nazionale di Certificazione delle Competenze") as envisaged by a 2013.

Italy has rapidly expanded access to adult education and training over the past decade, using also EU funds. Yet, participation remains well below many other OECD countries and high rates of job skill mis-match and skill shortages in high-skilled occupations show the need for continued efforts (OECD, 2017[8]). Expanding resources for Italy's Joint Inter-professional Funds (JIPF) to provide access to training to those out-of-work can expand the workforce's skills. Strong evaluation and certification of courses' quality would improve their effectiveness. Continuing to deepen social partners' role in designing and providing training courses would improve the effectiveness of courses, and particularly benefits new entrants to the job market. In this context, in 2018 the Ministry of Education set up a network of lifelong learning bodies, which is expected to lead to the design of National Plan for Skills for the adult population.

Adult education reforms can also help to better integrate immigrants into the Italian labour market. Certifying migrants' skills, and encouraging them to enrol in formal vocational education and training programmes, rather than in informal programmes, would improve integration (Jeon, 2019, forthcoming[33]). Italy is committed to providing access to formal education for immigrant students. In the 2016/2017 school year, 92% of immigrants graduating from secondary schools enrolled in formal education and training programmes. The enrolment of students with non-Italian citizenship in secondary school has been expanding and in the 2016/2017 school year it reached 7% of total students.

Monitoring individual immigrants' workforce outcomes can guide resources towards the most effective education and training programmes. Access to Italy's Protection System for Refugees and Asylum Seekers (SPRAR) has been restricted for asylum seekers since December 2018. In the absence of formal transitional and adult education programmes similar to those in Sweden, Switzerland or Germany, the SPRAR system has played a crucial role in Italy to help integrate new arrivals into vocational education and workplaces, as well as access to basic social support (Bergseng, Degler and Luthi, 2019, forthcoming[34]; Kuczera and Jeon, 2019, forthcoming[35]).

Past recommendations on skills and education

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Strengthen the post-secondary vocational education and training (VET) system following the example of Istituti Tecnici Superiori.	The government has allocated up to EUR 50 million to reorganise the vocational education and training system in order to better respond to the business sector's needs. The reform come into effect for the school years 2018/2019 and 2019/2020. A 2017 Ministerial Decree introduces for the first time the possibility for Universities to set up, from 2018/2019, three-year experimental programmes at first cycle of higher education known as professional degrees ("laureee professionalizzanti"). The content of the courses are defined at national level in cooperation with professional bodies ("Ordini Professionali"), and with enterprises.
Establish a national body on VET involving the business sector and key stakeholders to link the training component of VET with apprenticeships, ensure high-quality workplace training and identify skills needed in the labour market.	A national body has not been established. However links between businesses and key stakeholders to link the training component of VET with apprenticeships are being strengthened.
Introduce minimum training quality standards to the firms proving traineeships, internships and apprenticeships.	No progress
Target the low skilled in lifelong learning by facilitating integration into formal education through part-time programmes in post-secondary education and vocational training.	A pilot programme is ongoing in public employment services and in provincial centres for adult education for the self-assessment of adults' skills based on PIAAC.
Develop digital skills at all levels of education and training.	Digital skills are being developed into context of National Plan for Digital Education and Industry 4.0. Resources have been allocated to create dedicated teams to implement the Plan for Digital Education over 2019-2021. ANAPL
Develop a career-based system for teachers based on a well-functioning system for evaluating teachers to attract and retain the best qualified teachers and improve career development.	The government reiterated its intention to improve the training system for new teachers in lower and upper secondary schools. Funds have been allocated for the training needs of teachers and to support their professional development Moreover, a digital system has been established that provides more than 30 000 training courses for teachers.
Create partnerships between schools and the business sector to create quality work-based learning opportunities for students as envisaged by the Good School reform.	The total number of hours for work-based learning foreseen by the 'Good School' reform have been reduced according to the specific educational path. The government intends to create a 'National Network of Vocational Schools' to strengthen links with the labour market, regularly updating career and professional profiles and facilitate the transition from school to work.

Enhancing entrepreneurship and helping small and innovative firms to grow

Small firms are the backbone of the Italian economy. Micro firms (those with up to 9 employees) account for 45% of total employment while those with up to 20 employees for more than 50%, significantly more than in most OECD countries (Figure 26, Panel A). Italian small firms are markedly less productive than larger ones (Figure 26, Panel B). While this is common to many OECD countries, in OECD countries where small firms have similar productivity levels to those in Italy (e.g. Czech Republic, Estonia, the Netherlands, Israel, Spain, Slovenia), small firms account for considerably lower shares of total employment.

The weak association between firms' market share and productivity (high resource misallocation) reflects the many obstacles Italian small and productive firms face to expand. As reported in the previous Survey (OECD, 2017[8]), labour productivity of Italy's manufacturing sector is only 15% higher than if firms' market shares were allocated randomly; in comparison, in Spain and France higher market share for more productive firms leads to productivity being 25% higher than if greater productivity was not associated with greater market share, while in Germany it is (more than 50% higher).

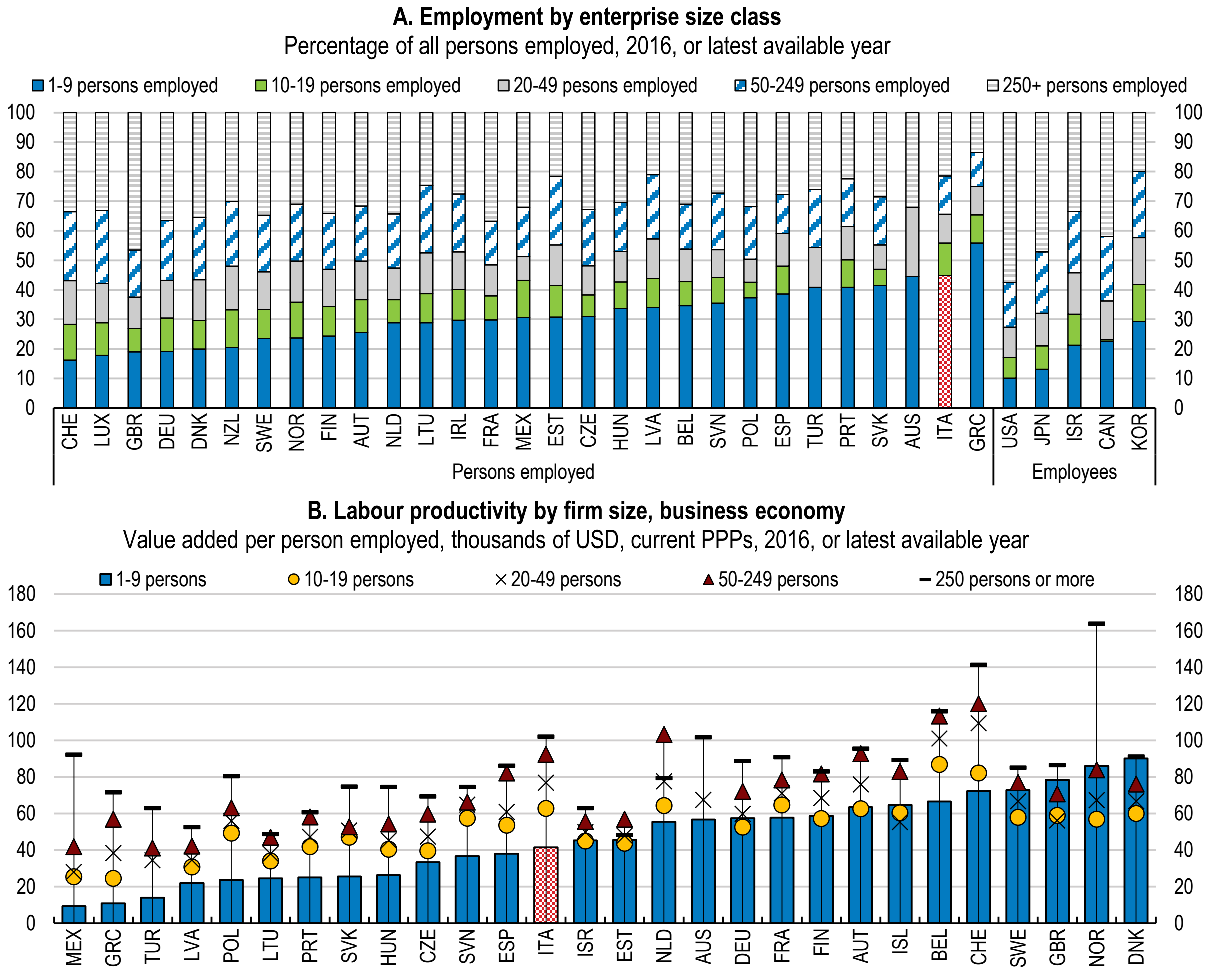
Policy action to reduce resource misallocation is urgent. Andrews and Cingano (2014[36]) find that across countries and industries barriers to entry and cumbersome insolvency procedures are associated with a high degree of resource misallocation. Therefore, the government should focus on the following:

- Continuing to open markets to competition, heeding the advice of the Competition Authority. The process of rationalising local utilities and opening local public services to competition would also be helpful.
- Reforming insolvency procedures that, as reported in the previous Survey (OECD, 2017), are slow and costly with liquidation being by far the most common form of insolvency. The government should complete the insolvency reform that the previous Parliament started in 2017 when it approved an enabling law to organically reorganise insolvency procedures. The principles of the enabling law are sound. They are based on the recommendations of a high-level commission ("Commissione Rodorf") and consistent with the 2014 European Commission recommendations on business failures and insolvencies. The enabling law aims to make it easier for insolvent firms to emerge as going concerns through restructuring agreements, encourage the use of out-of-court restructuring procedures (by lowering the required share of creditors who must agree), enhance court specialisation and introduce a procedure to signal, early on, crisis situations so that the firm and creditors might prevent the start of judicial insolvency.

Revitalising Italy's innovative entrepreneurial activity and business growth requires improved access to finance combined with management and strategic support. Debt contributes more to Italian firms' financing than in other European countries (OECD, 2019, forthcoming[37]). Overall, Italian firms remain slightly more leveraged than in other large European economies. As underlined in the previous Survey (OECD, 2017[8]), the notional interest rate applied to the injections of new equity (allowance for corporate equity, ACE) has contributed to reducing the debt-to-equity ratio of Italian firms. The 2019 budget has abolished the ACE. Reintroducing it would be help to continue strengthening the capitalisation of Italian firms.

For Italy's established firms, financial conditions and access to finance generally improved in 2017 and 2018 but remains vulnerable to downturns in profitability and indebtedness remains high in weaker sectors such as construction or small businesses (Bank of Italy, 2018[3]). Medium-size and larger companies with a moderate risk profile are diversifying their sources of finance and are raising more finance through issuance of corporate bonds and stock market equity. Robust growth in investment funds supports this diversification (Bank of Italy, 2018[3]). Changes in securitisation laws have supported the growth of Italy's private debt market and direct lending. This has complemented the growth of corporate bonds and mini-bonds.

Figure 26. Small firms employ most workers but their productivity is low



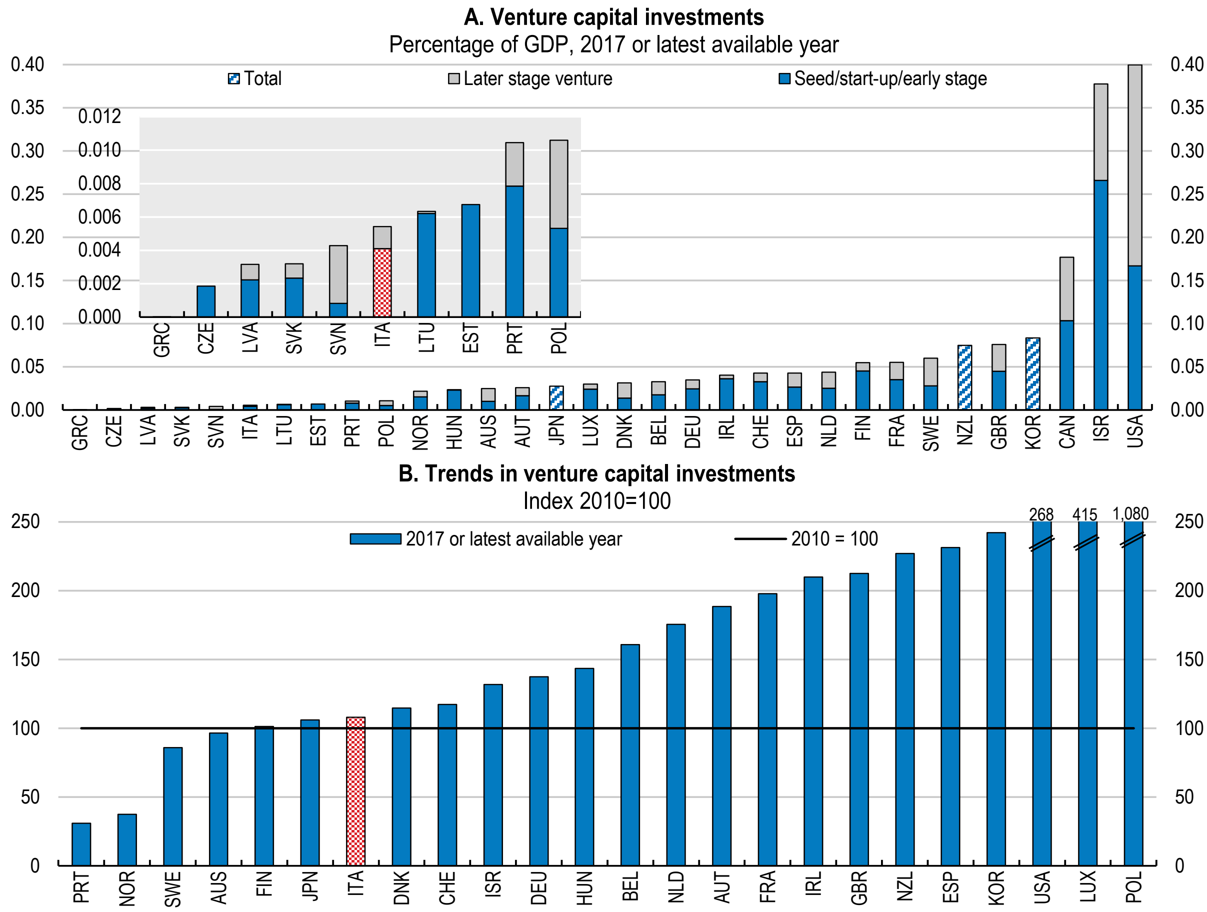
Note: The size-class breakdown 1-9, 10-19, 20-49, 50-249, 250+ persons employed provides for the best comparability given the varying data collection practices across countries. Some countries use different conventions: for Australia, the size class "1-9" refers to "1-19", "20-49" refers to "20-199", "250+" refers to "200+"; for Mexico, "1-9" refers to "1-10", "10-19" refers to "11-20", "20-49" refers to "21-50", "50-249" refers to "51- 250", "250+" refers to "251+"; for Turkey "1-9" refers to "1-19". Data for the United Kingdom exclude small unregistered businesses; these are businesses below the thresholds of the value-added tax regime and/or the "pay as you earn (PAYE)" (for employing firms) regime.
Source: OECD (2018), *Entrepreneurship at a Glance Highlights*.

Improving the business environment would support access to finance and especially benefit innovative firms in high-growth and volatile sectors (Calvino, Criscuolo and Menon, 2016[38]) and those setting up in lagging regions. Difficult operating environments and market failures raise new firms' operational risks, leading funders to be less willing to provide finance. Pertinent obstacles include poorer judicial efficiency and more costly contract enforcement, as well as the uncertainty engendered by frequent policy change or ambiguous application of policies (Bobbio, 2016[39]; DeStefano et al., 2019[40]). These horizontal constraints are even stronger in lagging regions (OECD, 2017[8]).

High-growth, high-risk firms are better suited to equity than to debt financing. Equity provides a smaller share of Italian firms' financing than in other European countries (OECD, 2019, forthcoming[37]). Venture Capital (VC) is equity financing that particularly supports young companies with innovation and growth potential but untested business models and no track record by providing financing coupled with management and strategic guidance that is rarely available with debt lending. In Italy, VC-financed start-ups were found to grow faster and be more innovative compared with a control group of similar start-ups (Bronzini, Caramellino and Magri, 2017[41]).

Italy's VC sector expanded rapidly in the first half of 2018, but remains notably under-developed (Figure 27). The limited number of VC investments are mostly modest and focused on early-stage ventures (OECD, 2017[42]), while only government-financed VC funding is comparable in size with other large European countries. Meanwhile alternative sources of financing, such as peer-to-peer lending and crowdfunding, are growing but are very small and do not provide substantive management support.

Figure 27. Venture capital is little used to finance Italy's SMEs and entrepreneurs



Source: OECD (2018), *Entrepreneurship at a Glance Highlights*.

Most of Italy's VC activity is based in Milan. In other regions, entrepreneurs rely more on local banks for financing. Two-thirds of start-ups funded by a VC firm are in the same municipality as the VC in Italy (Menon et al., 2018[43]), similar to OECD countries Where the entrepreneur and bank have ongoing relationships this can be a reliable source of financing, even during downturns (Banerjee, Gambacorta and Sette, 2017[44]), but it rarely provides the level of management and strategy support provided by VC investors. Relying on financing through relationship lending ahead of VC may explain the lower share of students and researchers among entrepreneurs in Italy than other OECD countries (Menon et al., 2018[43]). It also adds a barrier to talented business people using entrepreneurship to overcome fewer established opportunities in lagging regions (DeStefano et al., 2019[40]).

The 2012 Start-up Act is improving access to finance and reenergising innovative entrepreneurial activity. Firms that qualify to participate in the Start-up Act record higher revenue and capital, notably intangible capital related to patents and intellectual property, after controlling for relevant factors. Many achieve this by accessing government guarantees against bank borrowing, which reduces their collateral needs and loan costs and increases lending among firms in need of external financing (Menon et al., 2018[43]). Between the start of the scheme in 2013 and June 2018, 2 148 start-ups received a guarantee, with only 2.9% defaulting. However greater use of bank loans may exacerbate any bias in Italy against equity financing (Giraudo, Giudici and Grilli, 2016[45]), which brings a risk of slower long-term growth. To counter-balance this, other Start-up Act policies favour access to equity. Participating firms were more likely to receive VC financing, although this is likely to be from existing VC funds rather than expanding the amount of VC financing available in Italy (Menon et al., 2018[43]).

Past recommendations on product markets

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Employ public funds to help develop a private venture capital industry by crowding in private investors and adopting strict investment selection criteria.	Invitalia SGR is a public-private venture capital fund started in 2015. It has EUR 86 million under management of which EUR 50 million from the state and the remainder from private investors. It invests in innovative start-ups and SMEs. A new public-private fund (Italia Venture II) was established in 2018 with EUR 150 million seed funds from the government to invest in innovative start-ups and SMEs in southern regions. No private investors have yet joined this fund. The 2019 budget law introduced the possibility for the government the government to participate in venture capital funds. To this end, a Venture Capital Support Fund has been set up, with a yearly allocation of EUR 30 million for the 2019-2021 period and EUR 5 million yearly for 2022-2025. The dividends and distributed profits received from SOEs can be invested in venture capital funds.
Maintain current policies to diversify sources of business finance, especially for SMEs such as allowance for corporate equity, the tax advantages and streamlined procedures to issue bonds by unlisted SMEs (minibonds).	The 2019 budget will abolish the allowance for corporate equity that have proved effective in reducing the debt bias and contribute to the capitalisation of Italian firms. The Start-up Act is supporting access to finance but largely through bank loans.
Target research and development incentives towards innovative start-ups and small and medium enterprises. Make them refundable.	Industry 4.0 and the Start-up Act made progress in this area. Some of the incentives are targeted and refundable.
Increase as planned the share of research funding allocated through competitive procedures; publish clear guidelines to allocate research funds to universities and public research institutes based on research assessment.	Pools of funds are allocated to universities on the basis of research results. Funding shares are published.
Approve the competition law being discussed by parliament so as to increase competition into professional and services sectors.	Law approved August 2017. Reformed merger notification requirements. Opening of retail gas and electricity markets postponed to 1 July 2019 from 30 June 2017. Introduced measures in regulated professions, the insurance sector, the telecommunications industry. Increased supply of notaries reduced some exclusive functions of Poste Italiane. Anti-trust arrangements [strengthened?– need to assess] by January 2017 Legislative Decree. Some key provisions of the law were softened during parliamentary approval process, something that was criticised by the Competition Authority.
Reform the bankruptcy legislation in an organic and comprehensive way as envisaged by the enabling law being discussed by parliament.	The enabling law for a comprehensive reform of the bankruptcy code became effective November 2017. The government has yet to issue the implementing decrees that will need to be approved by parliament.

Italy's limited equity financing for start-ups primarily reflects limited supply of funds (Menon et al., 2018[43]; Calvino, Criscuolo and Menon, 2016[38]). One cause is investors' perception of limited domestic demand for innovative goods and services, reducing the perceived returns from investments in innovative start-ups. To address this, 'fast-track' access to public procurement and to pre-commercial procurement of innovative goods and services would provide some assurances of demand and would be in line with EC guidelines. This can be particularly effective in areas where the government is a large buyer, such as in health services. (European Commission, 2018[46]). Increasing supply of public VC funding may crowd out private VC funds. The benefits of publically financed VC are likely to be lower when public institutions' effectiveness is patchy. Instead, addressing other barriers to the supply of credit may be more effective.

Improving the quality of public investment and infrastructure management

The perceived quality of the overall infrastructure stock is low in Italy (Figure 28). Perceived low-quality of domestic infrastructure and expensive access to it can weigh on Italy's competitiveness. In Italy, the export lead time (the time between placing an order and receipt of the goods) is 3 days for port and airport supply chains and 5 days for land supply chains, against a median of 2 and 3 days for all OECD countries (World Bank, 2018). Similar gap exists for import lead times.

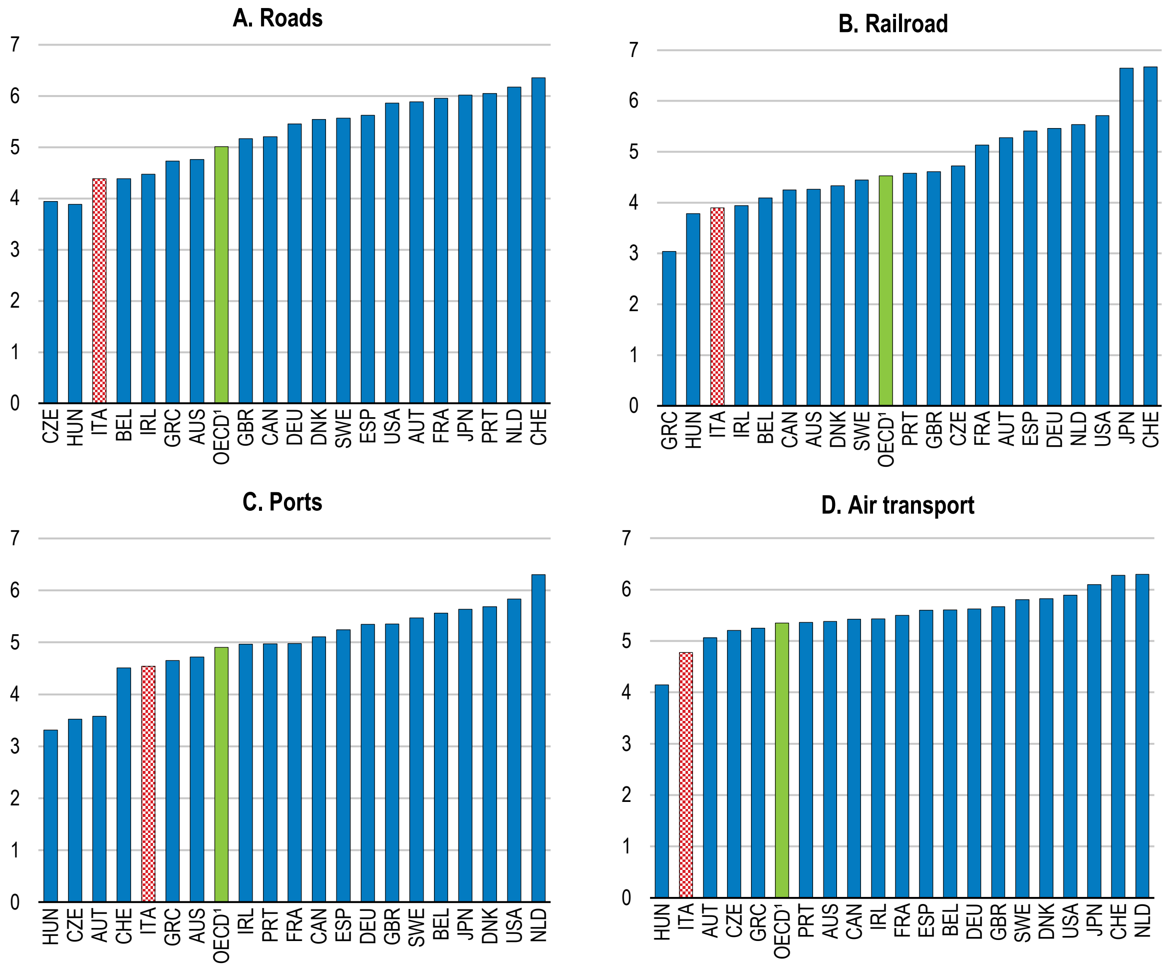
Better transport infrastructure would also reduce commuting times, contributing to well-being (OECD, 2014[47]). Geographical and social segregation – and the ensuing crime – often result from insufficient transport infrastructure and people with longer commuting time report systematically lower subjective well-being (Stutzer and Frey, 2008[48]).

Low public infrastructure investment over the past 10 years may have contributed to worsening perceived infrastructure quality in Italy. Public investment has continued to decline and is now below 2% of GDP. That the 2019 budget allocates less resources to public investment in 2019 than in 2018 (Box 1) is therefore concerning.

However, higher spending must be accompanied by reforms to improve the effectiveness of spending by enhancing the infrastructure governance framework, expediting project delivery and improving project quality. Poor project quality, haphazard ex-ante evaluation and delays in project delivery have been long-standing obstacles to good-quality infrastructure development as much as low spending. An analysis of 20 strategic transport projects indicates that, from the start of the planning process, it takes more than 15 years to deliver large projects (above EUR 2 billion). For smaller projects, it takes 6 years. Planning and public tenders take about two-thirds of the total time while project execution the remaining time. As highlighted in the thematic chapter delivery times are longer in lagging regions.

Figure 28. The perceived quality of infrastructure is low

Global Competitiveness Index, scale from 1 to 7 (best), 2018



1. Unweighted average.

Source: World Economic Forum (2018), *The Global Competitiveness Report 2018*.

Enhancing infrastructure governance and strategic planning

OECD countries' experience shows that shortcomings in a country's infrastructure management framework jeopardise infrastructure projects' timeframe, budget and service delivery targets (OECD, 2017[49]). Effective infrastructure management hinges on a clear regulatory and institutional framework, robust co-ordination across levels of government and sustainable performance throughout the life cycle (Table 8) (OECD, 2018[50]). The OECD Survey of Infrastructure Governance (OECD, 2017[49]) reveals some good aspects of Italy's infrastructure management framework, which concerns mostly the transport sector. Italy is one of about half of OECD countries reporting to have a long-term strategic infrastructure plan cutting across all sectors. Italy is also one of the 16 OECD countries reporting to compile a short list of priority projects (i.e. project pipeline) that complement the long-term plan.

Yet, much remains to be done to establish a robust infrastructure governance framework. The new Public Procurement Code (approved in 2016) has introduced, among other things, a new form of strategic infrastructure planning (Figure 29). The new approach is trying to overcome the weakness of the previous one, which mainly consisted of a long list of priority projects formulated in 2001 ("Legge Obiettivo") and updated later. This list included mainly large projects that often lacked any ex-ante evaluation. Links between national and regional projects were weak or absent.

The new infrastructure planning process builds on Connect Italy, the long-term strategic transport plan published in 2016 aiming to build an integrated transport system by 2030. It is expected to be complemented by operational triannual programming documents: the Logistics and Transport Plan ("Piano Generale dei Trasporti e della Logistica", PGTL) and the Pluriannual Planning Document ("Documento Pluriennale di Pianificazione", DPP). All ministries are required to submit a DPP.

The new planning and programing process sets important new rules covering: public consultations, ex-ante evaluation and public-private partnerships (PPPs). Public debates are compulsory for large projects or when central or sub central governments or at least 50 000 citizens ask for it. As regards ex-ante evaluations, the Ministry of Transport and Infrastructure issued in 2017 new guidelines to evaluate public investment ("Linee Guida per la Valutazione degli Investimenti in Opere Pubbliche") based on cost-benefit analyses taking into account social and environmental impacts. PPPs have also been standardised across all central and sub-national governments.

Table 8. The ten key infrastructure governance challenges and policy options

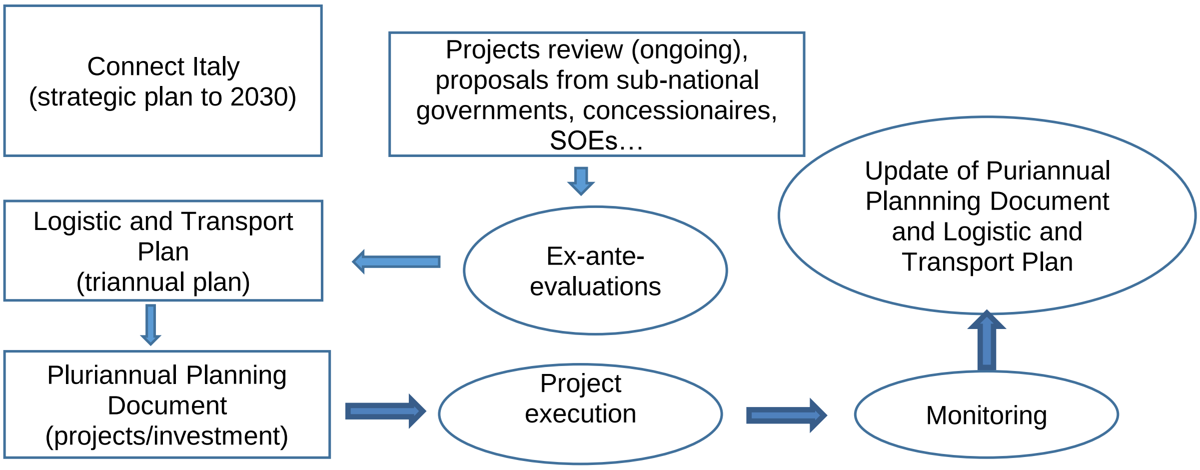
Issue	Solution
A strategic vision for infrastructure	The strategy should provide guidance on how to meet the country's infrastructure needs; the strategy should be politically sanctioned, coordinated across levels of government, take stakeholder views into account and be based on clear assumptions.
Threats to integrity	Corruption risks should be mapped at each stage of public infrastructure projects, and integrity and anticorruption mechanisms be enhanced. A whole of government approach is key to addressing integrity risks.
Delivery mode of infrastructure projects	When choosing how to deliver an infrastructure service, i.e. delivery modality, government should balance the political, sectoral, economic, and strategic aspects. Legitimacy, affordability and value for money should guide the decision on how to deliver an infrastructure service.
Regulatory design	Good regulatory design is key to ensuring sustainable and affordable infrastructure over the life of the asset.
Consultation processes	Consultation processes should be proportionate to the size of the project and take account of the overall public interest and the views of the relevant stakeholders. The process should be broad-based and draw on public access to information and users' needs.
Co-ordination across levels of government	There should be robust co-ordination mechanisms for infrastructure policy within and across levels of government.
Affordability and value for money	Governments must ensure that infrastructure projects are affordable and sustainable.. This requires dedicated processes, a capable organisation and relevant skills to ensure assets provide value for money.
Generation, analysis and disclosure of useful data	Infrastructure policy should be based on data. Governments should put in place systems that ensure a systematic collection of relevant data, dissemination, and learning from this data. Relevant data should be disclosed to the public in an accessible format and in a timely fashion.
Value throughout the lifecycle	The performance of the asset needs to be based on its lifespan.
Resilience	Infrastructure should be resilient and adaptable to new circumstances. Critical risks materialise and technological change can fundamentally disrupt sectors and economies

Source: (OECD, 2017[51]).

These are positive steps but the new planning and programming process is not fully operational as the DPPs have not been published. Moreover, the government is still reviewing existing infrastructure project proposals based on an assessment of needs, updated demand forecasts, ex-ante evaluations and budgetary constraints. Projects offering value for money are supposed to enter the DPPs.

For the new planning and programming process to come to fruition and yield results, the government should hasten the completion of the project review and issue the DPPs. Using cost-benefit analysis more systematically and transparently, as the government intends, will improve the quality of infrastructure spending by enabling it to select projects offering the best value for money. The government should also use public debates whenever possible. These are useful to elicit stakeholder preferences in early phases and allow the government to adjust project proposals if necessary, thus reducing the risk of protests and litigations in later phases.

Figure 29. Scheme of infrastructure strategic planning in Italy



Source: OECD from DEF documents.

The government also plans to strengthen planning and execution capacity by creating a central unit dedicated to public investment with 300 staff. This would be welcome as enhanced capacity at central and local levels is a pre-requisite to improving project planning and expedite project execution. Moreover, creating a new public investment unit to centralise expertise now dispersed in different ministries and agencies can broaden strategic infrastructure planning to sectors other than transport, such as energy, communications and social infrastructure. To avoid increasing administrative complexity the new public investment central unit should rely as far as possible on existing administrative structures. Creating a small central unit while strengthening the capacity of the regional offices of the Ministry of Transport and Infrastructure and local contracting authorities would go in this direction.

Integrating land use management with infrastructure planning would go a step further as it would allow the government to reduce and better manage hydrological risks, which are high in many parts of Italy. Several studies point to the link between changes in land use and hydrological risks (OECD, 2018[20]; Lerner et al., 2018[52]; McColl and Aggett, 2007[53]). In this respect, some OECD countries offer concrete examples for Italy:

- In 2016, the UK created the independent Infrastructure and Projects Authority (IPA) by merging Infrastructure UK and the Major Projects Authority. The National Infrastructure Delivery Plan 2016-2021 (IPA, 2016[54]) covers not only transport, but also energy, digital communications, flood and coastal erosion, housing, and social infrastructure. It coordinates between planning, economic and financial concerns to align infrastructure projects with climate and development goals (OECD/The World Bank/UN Environment, 2018[55]). Such a general plan is also more likely to attract the interest of institutional investors as it provides a full overview of the infrastructure investment opportunities the country offers.

- The Netherlands has instituted an advanced strategy for infrastructure and spatial planning. This integrates infrastructure planning with land use management at central and sub-national levels to: enhance competitiveness by strengthening infrastructure; improve door-to-door accessibility by developing a robust and coherent intermodal transport system; and guarantee a safe environment and preserve natural and cultural heritage sites (Ministry of Infrastructure and Environment, 2011 Summary National Policy Strategy for Infrastructure and Spatial Planning).
- Infrastructure Australia is an independent agency with a mandate to prioritise and progress nationally significant infrastructure. It provides independent advice to all levels of government in addition to investors and owners of infrastructure. Infrastructure Australia is responsible for auditing Australia's nationally significant infrastructure, and developing 15-year rolling Infrastructure Plans that specify national and state level priorities. It also determines which projects should enter the Infrastructure Priority List.

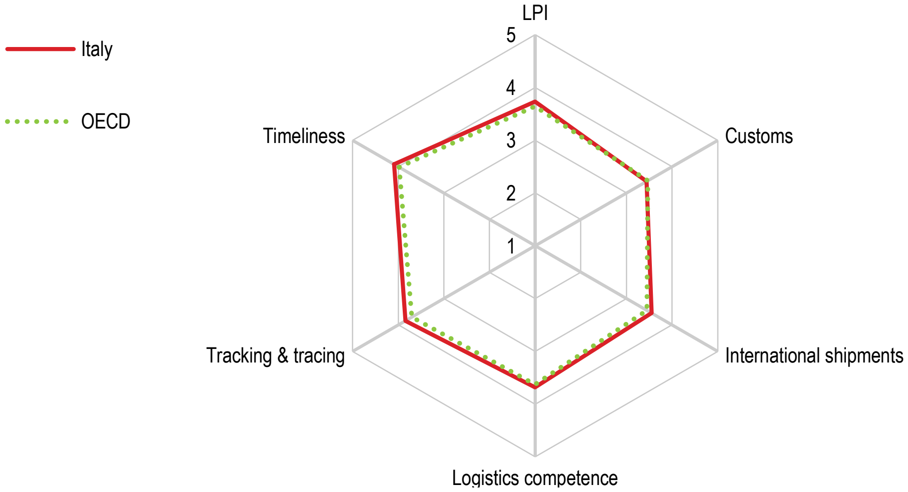
Enhancing transport and improving accessibility

The perceived quality of Italy's international-trade logistics – encompassing measures such as the efficiency of customs checks and the quality of logistics services – is close to the average of high income OECD countries and has marginally improved since 2007 (Figure 30). The strategic plans 'Connect Italy' and the Logistics and Transport Plan are important first steps to enhance intermodal transport in Italy. They provide a comprehensive overview of the strengths and weaknesses of intermodal transport and ways to improve it.

Yet, according to the World Bank Logistic Performance Index, logistic professionals indicate that access to the infrastructure network is more expensive in Italy than in other OECD countries and that maritime transhipments is a major source of delays (World Bank, 2018[56]). This might be partly attributable to the traditional fragmentation of the Italian port system resulting in scale inefficiency and long waiting times (Ferrari, Tei and Merk, 2015[57]). The reform of the port system approved in 2016 aims to tackle these problems. An important step in this direction was achieved with the 2016 port reform, which aimed at reducing fragmentation and strengthening port authorities (Box 4).

Figure 30. Italy performs well in international trade logistics

World Bank International Logistics Performance Index (LPI) and its components, 2018



Note: The World Bank International Logistics Performance Index is a composite indicator capturing the quality of international logistics. It provides qualitative evaluations of a country in six areas by its trading partners—logistics professionals working outside the country. The six areas are: customs (the efficiency of customs and border management clearance; infrastructure (the quality of trade and transport infrastructure); ease of arranging shipment (ease of arranging competitively priced shipments); quality of logistics services (the competence and quality of logistics services—trucking, forwarding, and customs brokerage; tracking and tracing (the ability to track and trace consignments); timeliness (the frequency with which shipments reach consignees within scheduled or expected delivery times).

Source: World Bank.

Box 4. The 2016 reform of the Italian port system

The recent 2016 Reform of Port Sector and Logistics reorganized and simplified the National Port System. The reform has consolidated responsibilities over port management by creating 15 new Port System Authorities (PSAs), replacing the more numerous old port authorities. Also, the reform has simplified procedures for passenger and cargo transit and strengthened the central coordination of the Ministry of Transport and Infrastructure. The National Coordination Conference has been established within the Ministry of Infrastructure and Transport as a coordinating committee of PSAs.

The new PSAs are non-economic public entities based on the 15 Italian core ports (Genova, La Spezia, Livorno, Civitavecchia, Cagliari, Napoli, Palermo, Augusta, Gioia Tauro, Taranto, Bari, Ancona, Ravenna, Venezia and Trieste) and will have a strategic role in policy, programming and coordinating the 58 main Italian the ports falling in their geographic area. Their responsibilities cover ordinary and extraordinary maintenance of the common parts of ports, the provision of port servicers, the power to grant concessions and improvement of port connections with the broad transport network.

The reform has established the “Customs and controls single window”, under the coordination of the Customs Agency, and the “Single administrative window”, a front office dealing with all administration and authorization for non-commercial and non-industrial activities. These two “single windows” replace the 23 offices which in charge of more than 100 port-related administrative processes to accelerate custom clearance and administrative processes. The new PSAs have also a simpler governance structure than the old port authorities, which is expected to speed up decisions making.

The government could make additional progress in improving intermodal transport by further empowering the Authority for Transport Regulation (ATR). This was established in 2011 and started operating in 2014. ATR has responsibilities over all transport sectors (roads, airports, railways, ports, local public transport) and covers all issues relating to access to the infrastructure network, services regulation and protection of passenger rights (ATR, 2018[58]). As such, the ATR is well placed to promote and improve multimodal transport. The ATR has gradually built enough expertise and capacity in different transport sectors to take additional responsibilities. This is in line with the government's vision of enhancing intermodal transport and a key step to strengthen the current regulatory framework.

More specifically, the ART should substitute for the Ministry of Transport and Infrastructure in all transport concessions. Previous governments have often awarded and extended concessions without public tenders (especially for motorways) and concession contracts have not been publically disclosed for a long time. Following the collapse of a motorway bridge in Genoa in 2018, the government disclosed the contract with the concessionaire. Though the ART is the transport regulator, its remit does not cover the motorway concessions that were signed before it started operating, which concerns most of the existing motorway concessions. The Court of Auditors announced in early 2018 the start of a comprehensive audit of motorway concessions focusing on the public administration's double role as regulator and owner, among other things.

Improving central-subnational fiscal relations to boost subnational investment

Sub-national governments have reduced investment while also reducing their debt levels. Sub-national governments account for more than half of total public gross fixed investment (Figure 31, Panel A), a larger share than in most OECD countries. Since the onset of the crisis, gross fixed investment by subnational governments has fallen by considerably more than for the central administration (Figure 31, Panel B). The fall in investment by sub-national governments explained 70% of the fall in total public investment between 2008 and 2017. Over the same period, the stock of sub-national government debt declined by more than 20% while the general government debt increased by 35% (Figure 32). As a result, the share of the general government debt traceable to sub-national governments diminished from nearly 7% to less than 4%.

Many have ascribed the contemporaneous fall in subnational governments' debt and investment to the Internal Stability Pact (ISP). Studies show that ISP has helped to control municipal debt but has also caused a sharp drop in investments, especially among compliant municipalities (Monacelli, Pazienza and Rapallini, 2016[59]; Chiades and Mengotto, 2016[60]; Viesti, 2011[61]).

However, the dearth of resources for investment imposed by the ISP while relevant in some cases does not seem to be the main cause of low investment at sub-national governments. Sub-national governments have repeatedly failed to use the available investment funds. When the government in 2011 allowed sub-national governments to exclude from the Internal Stability Pact rules spending to co-finance EU projects (amounting to EUR 1 to EUR 2 billion annually from 2012 to 2014) some regions failed to use the released funds (Court of Auditors, 2018[62]). In 2016 sub-national governments used only partially the fiscal space created in the ISP for boosting investment. For instance, municipalities have spent less than half of the funds available for investment in schools. Also, at the end of the year capital spending by municipalities, metropolitan cities and provinces was below 50%

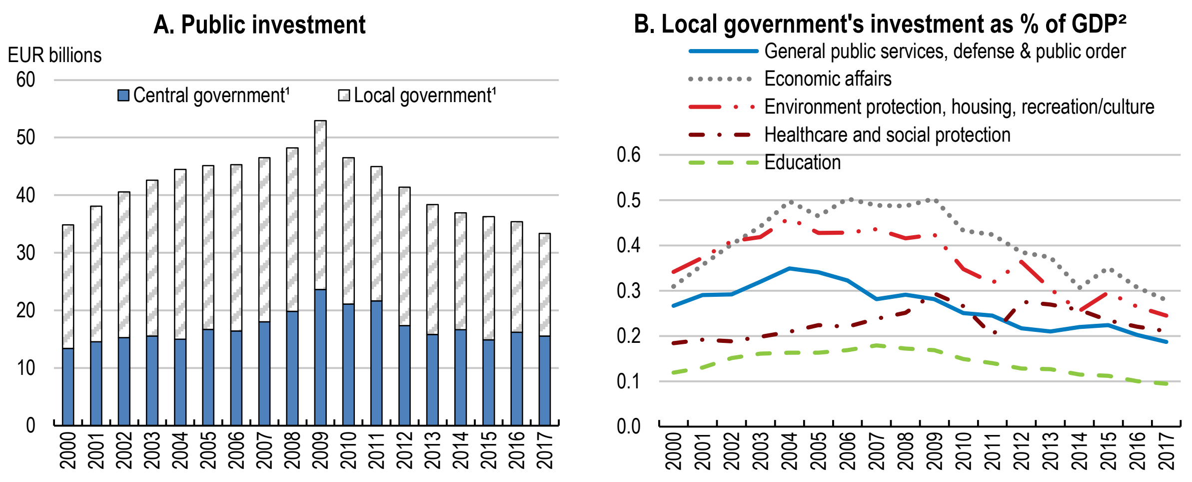
of the planned spending. Small municipalities have more difficulties in planning and spending the available funds for investment than large ones (Court of Auditors, 2018[62]).

To support investment by sub-national governments and foster regional convergence, the governments should maintain recent changes to the ISP to create fiscal space for investment. Also, allowing different municipalities within the same region to offset their budget surplus and deficit positions, which is in line with Article 112 of the Constitution, would also help to smooth regions' investment spending and foster coordination among municipalities. Finally, the rules of the ISP have changed virtually every year since its introduction as they can be changed in the budget law. More stability along with the clear intention of increasing investment spending at central and sub-central levels would strengthen credibility and facilitate medium and long-term planning by sub-national governments, which is key for investment (OECD/The World Bank/UN Environment, 2018[55]).

Past recommendations on subnational fiscal relations

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Follow through the reform of parliament and the re-assignment and clarification of competences between the central and sub-national governments.	After the proposed constitutional reform failed to pass, various levels of government are reaching agreements on managing certain subjects, such as active labour market programmes (ALMPs), in the current institutional setting.

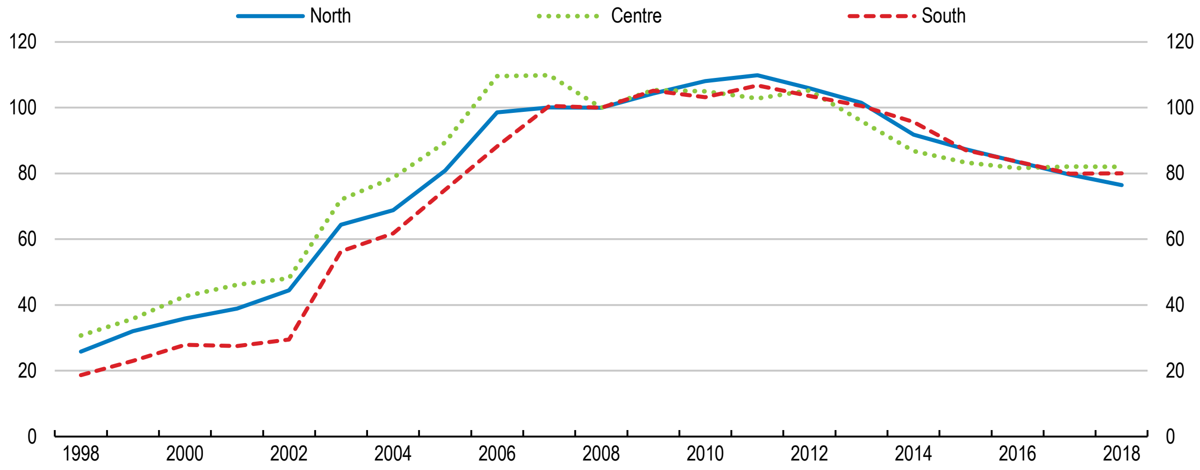
Figure 31. Sub-national governments have contributed to the fall in public investment



1. Excluding social security.
2. Data refer to local government's gross fixed capital formation as percentage of GDP.
Source: OECD *General Government Accounts* database.

Figure 32. The stock of sub-national government debts has declined

Index 2008 = 100



Note: Consolidated debt of sub-national governments (regions, provinces, cities and metropolitan cities).
Source: Bank of Italy; and OECD calculations.

Improving the tax system

Italy's tax system is complex contributing to low tax compliance. According to the World Bank and PwC (2018), the time necessary to comply with tax laws is considerably longer in Italy (238 hours) than in peer countries (218 hours in Germany, 140 in France and 105 in the United Kingdom). Recent estimates by the Ministry of Finance (2018[63]) indicate that the tax gap (the difference between the theoretical revenues the government should have collected assuming perfect compliance and the revenues actually collected) amount to more than EUR 100 billion per year. The tax gap (as a percentage of theoretical revenues) is largest for the personal income tax of self-employed business income (nearly 70%) and VAT (26%), and is larger in lagging regions (Carfora, Pansini and Pisani, 2016[64]).

In the past few years, governments have pursued efforts to improve tax compliance. In 2016, the government started publishing an annual report on tax compliance (as an annex to the yearly Update to the Stability Programme). Recent measures to improve voluntary compliance, through for instance sending reminders in case of delays in presenting tax declarations and to remedy errors and omissions in tax declarations go in the right direction and have yielded fruit. The Ministry of Finance (2018[63]) estimates that initiatives to improve voluntary compliance generated EUR 1.3 billion of additional revenues in 2017. The government's plan to pursue these efforts are therefore welcome. Other recent and useful initiatives to reduce the tax gap have involved the extension of the reverse charges and split payments for VAT. The 2018 decision to abolish the split payments for the self-employed goes against the need to reduce the large tax evasion among this category of taxpayers. The introduction of the e-invoicing system in 2018, which from January 2019 will be extended to all transactions, is a key step to improve tax compliance. The government has decided to suspend penalties relating to delays, errors and omissions in issuing e-invoices until mid-2019. The government should ensure the e-invoice system is widely adopted and introduce a system of checks and sanctions for non-compliant businesses.

Tax expenditures can be useful tool to pursue economic and social objectives and increase welfare. However, in Italy, as in many other countries, numerous tax expenditures have accumulated over time and a thorough rationalisation is now needed. The original economic and social objectives that justified certain tax expenditures may be no longer valid or the same objectives could be achieved more efficiently and effectively in different ways, such as through spending programmes. Tax expenditures may also overlap with spending programmes.

Recently, Italian governments have started reviewing tax expenditures on a regular basis. The government has to publish an annual report on tax expenditures, which feeds into the yearly Update to the Stability Programme. The 2018 review reports that Italy has 466 tax expenditures, amounting to foregone tax revenues equal to EUR 54 billion. Tax expenditures relating to the personal income tax account for 66% of this value. The personal income tax also accounts for the largest number of tax expenditures (26% of the total), followed by stamp duties and property taxes, and VAT (16%). Many tax expenditures are small. Over 25% of them amount to less than EUR 10 million each. The government has yet to compare, as mandated by the law, tax expenditures (more than 5 years old) with spending programmes in the same area so as to identify possible overlap.

The government should act on these assessments and rationalise tax expenditures. Previous attempts to cancel some tax expenditures yielded no results. For instance an ex-commissioner for the spending review identified 52 tax expenditures with no economic and social justifications that in 2017 amounted to EUR 2.2 billion of lost revenues (Perotti, 2018[65]), but no actions were taken.

An in-depth OECD report on Italy's tax administration (OECD, 2016[66]) underlines its high fragmentation and the need to develop a comprehensive strategy encompassing all tax administration agencies. It consists of the Revenue Agency, responsible for the administration and collection of the main taxes and duties and maintaining property registers; the Customs and Monopolies Agency, responsible for gaming and administering excises; the Italian Social Security Institute, responsible for social security contributions and welfare payments; and the Guardia di Finanza, responsible for conducting civil and criminal tax investigations.

This fragmentation is at variance with practices observed in tax administration of other advanced OECD countries. In OECD countries, the tax administration is often unified into a single revenue agency, which enjoys substantial autonomy, especially in financial matters and human resources policies. This creates the conditions for a more strategic approach to the management of the overall tax administration. For instance, since 2009 Belgium has been integrating different fiscal and non-fiscal collection and recovery services, engendering synergies and improving the effectiveness and efficiency of debt recovery (OECD, 2017[67]).

In the recent past, successive governments have taken actions to reduce the tax administration fragmentation and efforts are under way to improve its strategic governance and enhance coordination among the different tax agencies (Ministry of Finance, 2018[63]). In 2012, the Land Registry Agency was incorporated into the Revenue Agency and the Autonomous Administration of State Monopolies into the Customs Agency (now named Custom and Monopolies Agency). The latest reform has concentrated all tax collection activities into the Revenue Agency to improve coordination between tax assessment and tax collection activities. As regards the governance of the tax system, a technical coordination table has been established among the different agencies.

Many OECD countries are increasingly relying on digital technologies to detect and prevent tax evasion and build synergies within the tax administration. These tools have proved useful in reducing tax evasion and the shadow economy (Box 5). The OECD report *Reducing Opportunities for Tax Non-compliance in the Underground Economy* (OECD, 2012[68]) encouraged OECD countries' tax administrations to use digital records to identify unreported income.

Italy's tax administration has increased its use of digital technologies over the past few years. For instance, the prefilled declaration for individual tax payers was introduced in 2015 and its number of users has been increasing rapidly since then. Moreover, The electronic invoicing became mandatory also for private transactions in January 2019. This is an important step forward to contrast tax evasion and simplifying tax obligations. The government should pursue these efforts vigorously and increase the tax administration spending on IT, which is still significantly lower than in other OECD countries (Figure 33). Effective use of IT systems in all agencies involved in tax administration and reinforcing interoperability are crucial to foster inter-agency cooperation and a whole-of-government approach against tax evasion. This point is especially salient in Italy given the fragmentation of its tax administration system.

Increasing reliance on digital technologies to lower tax evasion must be accompanied by flanking policies to reduce cash payments and manage tax obligations arising from the sharing economy:

- The share of cash payments remains markedly higher in Italy than in most EU countries (OECD, 2017[69]). Lowering the cash payment threshold from the current level of EUR 3 000 to EUR 1 000, the level in France, would greatly help in the fight against tax evasion.
- The sharing economy is developing fast in Italy as elsewhere. The sharing economy can facilitate tax evasion as it can make it more difficult to identify business activities. The use of data analytics and international co-operation amongst tax authorities are likely to help in this area.

In the past, successive Italian governments have implemented tax amnesties. There have been overall 80 tax amnesties in the 150 years of the Italian State. These have brought in additional tax revenue but have also nurtured a culture of non-compliance with tax laws (OECD, 2016[66]; Ministry of Finance, 2014[70]). The current government has introduced new tax amnesties in 2019 (Box 1) that will write off not only fines and interests but also the tax debt in some cases.

Evidence from the experience of different countries confirms that any temporary benefits are offset by weaker tax compliance and that successful tax amnesties are the exception rather than the rule (Baer and Le Borgne, 2008[71]). Efforts to improve voluntary tax compliance – through encouraging a more co-operative relationships between taxpayers and revenue bodies based on commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies, and disclosure and transparency by taxpayers – need to be pursued and tax amnesties avoided in normal circumstances. Those tax amnesties involving tax debts and not just fines and interests are likely to have the most pernicious effect as they weaken the certainty of tax laws and are unfair towards compliant taxpayers.

Box 5. Examples of using digital technologies to fight tax evasion

Sales suppression and over-reporting of deductions through false invoicing are common forms of tax evasion. Cash transactions and the sharing economy facilitate these types of tax evasion but digital technologies now exist to reduce and eliminate them. They include electronic cash registers connected to fiscal control units and e-invoicing systems. This reduces the risk of underreporting sales by securing sales data as transactions occur and store them in a way that cannot be manipulated with external software.

The selected examples in Table 9 from some OECD countries highlight the benefits of introducing electronic cash registers connected to fiscal control units.

Table 9. Example of digital technologies to fight sales suppression

Country	Policy and results
Austria	Results from the electronic sales suppression tools are expected to be an additional EUR 900 million in tax revenues.
Belgium	Initial comparisons shows an 8% increase in restaurant sales reported after installation of electronic cash register.
Canada (Quebec)	As at 31 March 2016, the government recovered EUR 822 million in taxes following the introduction of sales recording modules into the restaurant industry. The government expected to collect an additional EUR 1.44 billion over 2018-19. In 2008 the Canadian Revenue Agency criminally charged the owners of four restaurants with tax evasion involving the digital tampering of nearly 200 000 cash transactions, totalling EUR 3.1 million.
Hungary	Electronic cash registers connected with fiscal control units have allowed VAT revenue to increase by 15% in the concerned sectors.
Sweden	In 2010 Sweden introduced electronic cash registers connected to fiscal control units for traders (also those selling goods and services paid in cash). The government has supported the new system with complementary measures. These include unannounced inspections, undercover purchases and customer verifications, a simplified accounting system for businesses and prefilled annual returns. According to estimate of the Swedish Tax Agency the new approach helped to increase VAT and income tax revenues by EUR 300 million per year since its introduction.

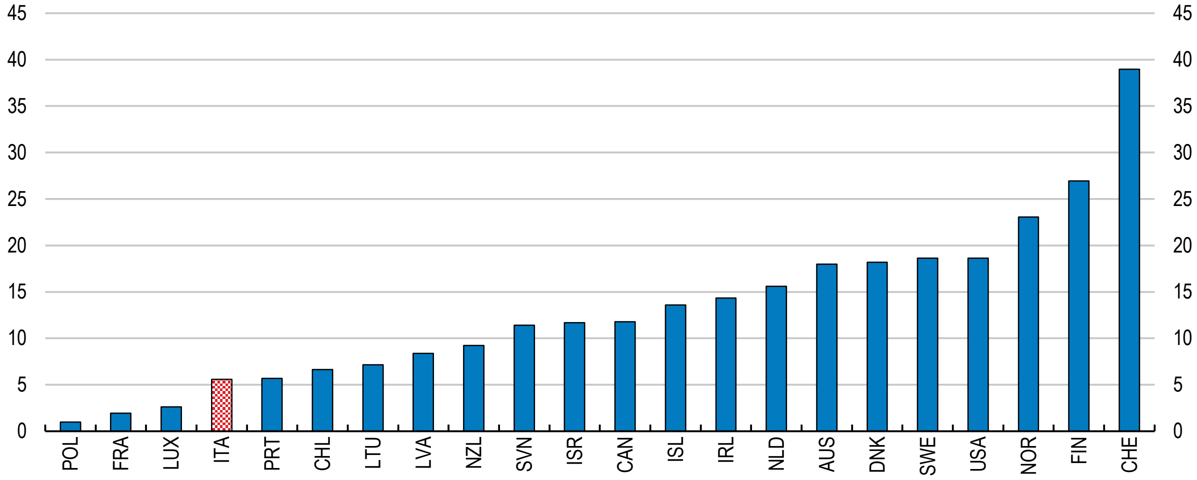
Source: OECD (2017[67]).

Past recommendations on tax administration

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Improve tax collection by investing more in IT systems and updating cadastral values used for properties taxes. **Use additional tax receipts to permanently lower social security contributions for new permanent contracts.**	E-invoicing system was introduced to all transaction from Jan 2019. Some smaller steps were completed. For example, digitalisation of tax trials was extended to the whole country. Comprehensive reforms of tax administration and enforcement is yet to progress. Cadastral value reforms are yet to be designed and implemented. Reduced social security contribution rates are only temporary or limited to some categories of workers (the young). In 2018, split payments to combat VAT evasion were abolished for self-employed.

Figure 33. Italy's tax authority spends less on IT systems than other countries' agencies

Recurrent IT budget in percent of total recurrent budget of the administration, 2015



Note: For France: excluding staff working in the Public Accounting Directorate. For Luxembourg: this refers to the IT budget that is included in the overall budget of the tax administration. The major part of the tax administration's IT budget, however, passes through the budget of another administration, i.e. the "Centre des technologies de l'information de l'Etat".

Source: OECD (2017), "Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies", OECD Publishing, Paris.

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