EUROPEAN PARLIAMENT

ECONOMIC DIALOGUE WITH ITALY

ECON Committee, 21 January 2013

This note presents selected information on the current status of the EU economic governance procedures and related relevant information, in view of the invitation to the Italian Minister of Economy Vittorio Grilli for an Economic Dialogue, in particular under Article 2a of *EDP-Regulation 1177/2011*.

1. Recent developments

- On 21 December 2012, the **Government of Mario Monti resigned**, after 13 months in its office. The elections for the two chambers of the parliament will take place on 24 and 25 February.
- The **Bank of Italy** estimates (in January 2013) that the **GDP declined** by just over 2 per cent for 2012 as a whole, essentially in line with the projection made in July. The estimate of the contraction in GDP for 2013 has been revised from 0.2 to 1.0 per cent as a consequence of the worsening international context and the persistent sluggishness of activity in recent months.
- The Bank´s forecasting scenario nevertheless suggests the **possible return to expansion in the second half of the year,** albeit at a slow pace and subject to very considerable uncertainty. The cyclical upturn will depend on gradual recovery in investment once credit conditions return to normal and on a pick-up in demand in the euro area and some improvement in the climate of confidence. In this scenario GDP growth would still remain negative year-on-year in 2013 and be slightly positive in 2014.
- According to the Bank of Italy, the number of Italian companies reporting an improvement in **confidence** at the end of 2012 is only 3.8%, half that in September. The 57.5% of firms said confidence decreased compared to 50.6% in September.
- According to **ISTAT,** the **industrial production** has fallen by 7.6% in November compared with November 2011, and 1% compared with the previous month. This figure marked the 15th consecutive year-on-year drop in industrial output.
- According to **ECB bulletin** of January 2013, "Increased political uncertainty in Italy led to some flight-to-safety flows into bonds issued by AAA-rated countries"
- Ten-year **treasury bonds yields** have decreased from 7.06 in November 2011 to 4.54 in December 2012. **Spreads** have reached the minimum value of 254 basis points (bp) on 4January 2013, down from 517 in July 2011 and 537 in July 2012.

2. Economic situation and outlook

According to Eurostat the **GDP** in **Italy** fell by 0.2% in the third quarter of 2012, compared to the previous quarter. In the third quarter of 2012, the euro area as a whole fell by 0.1, when Germany and France were growing (both at 0.2%), and Spain declined by - 0.3%.

According to its autumn 2012 forecasts, the European Commission's (EC) expects that the Italian **GDP** contracts by 2.3% in 2012 and by 0.5% in 2013, with a weak growth of 0.8% in 2014. The OECD forecasts are slightly more pessimistic, as it sees a contraction of GDP by -1% in 2013, with a growth of 0.6% in 2014.

According to Eurostat, in November 2012 the **unemployment** rate was 11.1% and 37.1% among people younger than 25 years. In the second quarter of 2012, the long-term unemployed were 5.1% of active population. The EC estimates unemployment to be 10.6% in 2012 and according to forecasts it will increase to 11.5% in 2013 and to 11.8% in 2014.

According to the EC, the Italian **inflation,** measured by the Harmonized Consumer Price Index (HICP), is expected to be 3.3% for 2012, decreasing to 2.0% in 2013 and 1.7% in 2014: both IMF and OECD expect lower rates of inflation for 2013 and 2014.

According to the EC, the Italian **public deficit** is expected to be 2.9% of GDP in 2012, decreasing to 2.1% in 2013 and 2014. The general **government gross debt** (totalling 2 021 bn Euros in November 2012) is expected to increase from 126% of GDP to 127.6% in 2013 and fall back to 126.5 in 2014. Debt increased by €113.9bn in the first 11 months of 2012. Italy paid €23bn in contributions to the EFSF and ESM. The EC estimates that 5.5% of Italian GDP is spent in interests on its debt, this percentage being projected to 5.5% in 2013 and 5.8% in 2014.

3. Public. Finances

Italy has been subject to an **Excessive Deficit Procedure (EDP) since 2009**, when the Council issued a recommendation calling for the excessive deficit to be corrected by 2012. In 2010, the Council shared the EC's view that, according to the information then available, Italy had acted in accordance with its recommendations and that no additional step in the procedure was therefore necessary.

Italy's Stability Programme of April 2012 includes **a medium-term budgetary objective (MTO)** aiming for a balanced budgetary position in structural terms to be achieved by 2013, i.e. one year earlier than targeted in the previous Stability Programme. Recital 10 of the Council recommendation of July 2012 includes the assessment that the envisaged pace of adjustment in structural terms allows Italy to achieve the MTO in 2013.

Also in April 2012, the Italian Parliament adopted a law introducing a **balanced budget rule** in the Constitution, with effect from 2014. The Presidential assent to the "Treaty on Stability, Coordination and Governance in the EMU was given on 23 July. The CSR2 adopted by the Council in July 2012 stipulates that "*Implementing legislation will be needed to specify key features of the rule, i.e. the modalities of application and the appropriate correction mechanisms and escape clauses as well as the necessary coordination between the different levels of government.*" The Italian Senate has approved the implementing legislation on 20 December 2012, while the legislation is still pending in the Chamber of Deputies.

In November 2012, the EC autumn forecasts projected the **structural balance** to improve from -1.4% of GDP in 2012 to -0.4% of GDP in 2013.. The expected level in 2013 is considered to be close to balance. Under a no-policy-change assumption, the structural balance is anticipated to depart from this position in 2014 (-0.8% of GDP is expected). The structural primary surplus is estimated to rise to above 5% of GDP in 2013 and broadly stabilise in 2014.

In December 2012, the Parliament adopted the so-called "stability law" for **budgets over the period 2013-2015.** It amended the government proposal of October 2012: the 2 percentage point increase in both the intermediate (10%) and standard (21%) VAT rates that were previously envisaged will not be implemented; only the upper rate will rise, by just one percentage point, to 22% as of July 2013. The stability law also foresees additional tax deductions for households, as well as spending cuts, including in the areas of local administration and health care.

According to the **fiscal sustainability report** by the EC (December 2012) Italy:

- does not appear to face a risk of fiscal stress in the short-term;
- has medium sustainability risks in the medium run;
- shows low sustainability risks in a long-term perspective, conditional upon the full implementation of the planned ambitious fiscal consolidation and on maintaining the primary balance.

The **government debt** would be, on the basis of current policies, on a declining path over the medium term and beyond. But it also considers that, as the improved structural primary fiscal position expected

to be reached by 2014 is rather demanding from both international and country-specific historical standards, strong determination is needed to avoid slippages in the fiscal stance. The focus should, therefore, be on resolutely continuing to implement sustainability-enhancing measures and reduce government debt. The EC assessment is consistent with the one of the OECD of October 2012, according to which weak growth might (in 2014) require further fiscal tightening in 2014 to achieve the planned debt reduction path.

See Country Specific Recommendations 1 and 2 for Italy as adopted by the Council in July 2012 (in Annex 4).

4. Macro-economic imbalances

In the in-depth review of May 2012, the EC had concluded that Italy was experiencing serious imbalances, in particular as regards the export performance, competitiveness and the implication of high government debt. The Country Specific Recommendations adopted by the Council in July 2012 (see CSR 1, 4, 5 and 6 in Annex 4) reflect the EC assessment. They focused on: consolidation of public finance, labour market reforms, fight against evasion and shadow economy; implementation of the already adopted liberalisation and simplification measures in the service sector.

On 28 November 2012, the EC presented the Alert Mechanism Report 2013. It identifies Italy as one of the 14 Member States whose macroeconomic situation needs to be scrutinised in-depth, in order to identify actual or potential imbalances and the possible macroeconomic risks based on the following preliminary assessment by the EC:

According to the updated scoreboard (see Annex 2), two indicators for Italy are above the indicative thresholds, namely **losses in export market shares** and **general government debt**. Cost and non-cost competitiveness losses have built since the euro adoption of the euro and this is reflected in a significant **loss of export market shares**. Italy's current account deficit is, however, narrowing and the trade balance is expected to record a surplus in 2012. This is mainly explained by the sharp fall in imports, given the weakness in domestic demand in the current recession, and also by a positive export performance, especially towards non-EU partners. Weak productivity developments remain the main obstacle to a lasting improvement in Italy's competitiveness position and economic growth outlook. The recently-adopted structural reforms – aimed at fostering market competition, addressing labour market segmentation, making the tax system more growth-friendly and improving business environment – should help revive productivity growth in the medium term. Meanwhile, wages are still not sufficiently responsive to productivity developments. Nominal unit labour costs are expected to increase in the years to come at a rate close to the euro area average.

The **high government debt** remains a major burden for the Italian economy, especially against the background of slow growth prospects. While low growth rates make it more difficult to achieve and maintain the large primary surpluses required to put the government debt-to-GDP ratio on a steadily declining path, the present and expected high tax burden which is needed to service the high debt hampers domestic demand and economic activity. In addition, in the context of a financial market that is fragmented across national borders, the relatively high interest rates associated with the government risk premium affect the private sector's financing conditions and exacerbates the funding problems of the domestic banking sector.

On the positive side, **private sector indebtedness** remains relatively contained in Italy. In particular, the financial position of Italian households is relatively strong, while their savings ratio has been on a downward trend for over two decades.

5. Reforms under the Europe 2020 strategy for smart and sustainable growth

Over 2012, the Italian parliament has adopted reforms of the product and labour markets (including the pension reform), but the current political uncertainty raises doubts on their full and consistent implementation.

The partial shift of the tax burden away from production to consumption and property has made Italy's system more growth-friendly; however, according to the EC's analysis of the National Reform Programme 2012, further steps are needed in this direction.

Youth unemployment and employment rate of women (46% in 2011, against the EU average of 58) require decisive action, as well as the school leaving rate, which is at 18.8% against the euro-area average of 13.3 %. The proportion of the Italian population at risk of poverty was 18.2% in 2010, compared to 16.1% in the euro area.

Other areas where the regulatory framework requires improvement and simplification include business environment, judiciary system and access to financing of SMEs.

Employment, Social Developments and Gender Gap

The EC Report of January 2013 on Employment and Social Developments in Europe states that in the first half of 2012, labour productivity growth in the EU continued to weaken with sharp falls, among others, in Italy. Labour costs in Italy have also risen due to an increased tax wedge, a development which is unhelpful in a country facing high unemployment. As to unemployment benefits, there is a growing gap between the number of unemployed and the number of benefit recipients, which seems to indicate that more and more people are not covered by any scheme at all. Italy has been among those EU countries where income inequality during the recent financial crisis affected mostly its middle class (predominantly workers), while in some other EU member states inequality was more evenly distributed across the population

In December 2012, OECD published its report on "Closing the Gender Gap", where it points to losses for the Italian economy due to many women being outside the labour force. After Turkey and Mexico, Italy has the third lowest labour force participation rate of women (46% in 2011) among OECD countries. Less than 30% of children under three years of age attend day-care services and about one-third of Italian working women works part-time (the OECD average is 24%). Projections show that if female participation rates converged to those of men by 2030, the Italian labour force would increase by 7% and GDP per capita by 1 percentage point a year for the next 20 years.

According to OECD Italy has made a tremendous effort over the past two years to speed up long overdue structural reforms. OECD advices restoring public finance sustainability; facilitating the implementation of reforms; boosting productivity through better competition policies and regulations, including in the financial sector; promoting public sector integrity; making innovation and education policies more effective; and improving social cohesion through a better functioning labour market, stronger social mobility and higher female participation in the labour force. According to OECD's analysis, the reforms already approved could add up to an estimated 4% to GDP over the next 10 years.

According to IMF 2012 Article IV report of July 2012, the difficult business environment, fragmented labour market, and limited service competition have contributed to Italy's weak growth performance and loss in competitiveness. The 2012 World Bank Doing Business survey ranked Italy 30 out 31 OECD countries in the ease of doing business, with Italy faring poorly particularly in the areas of contract enforcement, tax payments, and getting electricity. According to IMF comprehensive structural reforms are needed to raise productivity and participation. Labour reforms should aim to bridge the gap between permanent and temporary workers, reduce the tax wedge, and decentralize wage setting. Accelerating product market reforms in the energy, local public, and professional service sectors would drive down rents and lower the cost of business. To support growth, the composition of adjustment should be rebalanced more towards expenditure cuts and lower taxes.

Italy – Spillovers from a Potential Intensification of the Euro Area Crisis (IMF, July 2012)

Despite strong efforts to stabilize the fiscal position and implement growth-enhancing reform, Italy remains vulnerable to an intensification of the euro area crisis. Shocks could propagate through Italy's sizeable trade and financial links with other euro area countries:

About 8 percent of Italy's total exports is directed to the periphery (Greece, Ireland, Portugal, and Spain), and 40 percent to the euro area. A steeper euro area recession could therefore delay an export-led recovery in Italy.

Italian banks' direct exposure to the periphery is relatively limited (2.4 percent of GDP) but that to euro area countries is considerable (25% of GDP), with the largest exposure to Germany and Austria. Italian banks' funding is also concentrated, with most interbank loans coming from Europe (4.5% of GDP) and primarily from Germany and France (3% of GDP, combined). Non-European interbank funding is relatively limited (less than 1 percent of GDP) and is mostly from the United States.

Italy has also provided guarantees for funding to Greece, Ireland, and Portugal through the Greek loan facility and the EFSF, amounting to around €35 billion (2.2% of GDP).

6. Financial Stability

In its document accompanying CSRs 2012, the EC reported that the **Italian banks** struggled with severe stress in the euro-area interbank market and sharply increased retail and wholesale funding costs in 2011. This, coupled with the increase in loan-loss provisions as asset quality deteriorated, has contributed to a fall in banking sector profitability. In December 2011, the European Banking Authority (EBA) had established the need for four Italian institutions (*Unicredit, Monte dei Paschi di Siena, Banca Popolare, Unione Banche Italiane*) to further increase capital and by February 2012, all banks concerned submitted their compliance plans, on which the EBA expressed an overall favourable opinion. In addition, the funding pressure on Italian banks was alleviated by the two long-term refinancing operations by the ECB, which led to a substantial improvement of the financing conditions for banks.

In its 2012 Global Financial Stability Report, the IMF concludes that the injections of central bank liquidity have benefited not only banks, but also the debt servicing capacity of Italian non-financial corporations (NFCs).

However, the ECB in its latest Financial Stability Report of December 2012 concluded that the financial crisis has significantly affected the balance between debt and equity finance in Italy, where the equity share in **financing of non-financial corporations** is traditionally low. Record high bond issuance by some large Italian firms immediately following the announcement of the ECB's new Outright Monetary Transactions (OMT) program suggests that some firms could substitute bank financing with capital market financing, but the majority of firms reliant on bank financing are unlikely to benefit to a great extent. Trade credit payable is especially important for Italian NFCs.

In its regular survey on access to finance for SMEs, the ECB concludes that in the period from April to September 2012 there was a general deterioration of the availability of new **bank credit** for SMEs , with net percentage decrease of 42% over the preceding 6 months. The IMF also indicates that the recent fall in bank credit to SMEs in Italy is broadly consistent with a path of deleveraging that would bring credit-to-GDP ratios back to 2003–04 levels by 2017. In addition, Italy was faced with a large-scale capital outflows amounting to €235 billion (15% of GDP) in the 12 months to June 2012. Foreign investors retreating from Italy's bond market represented a large share of these flows.

Measures recently adopted by the government (an allowance for new corporate equity, which should encourage firms to increase their capital base, refinanced SMEs Guarantee Fund, funds of € 5.7 bn for the payment of old trade credits to suppliers to the central public administration) can improve firms' financial conditions and avert the risks of credit crunch.

ANNEXES:

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- ANNEX 1.b Current economic situation: comparison of forecasts for 2012, 2013 and 2014
- ANNEX 2 Scoreboard used in the surveillance of macro-economic imbalances
- ANNEX 3 Targets and current situation in the context of the Europe 2020
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ANNEX 1.a: Key Macro-Economic indicators and EC forecast 2012-2014

	2008	2009	2010	2011	2012 (f)	2013 (f)	2014(f)
GDP Growth (%)							
Italy	-1.2	-5.5	1.8	0.4	**-2.3**	**-0.5**	**0.8**
Euro area	0.4	-4.4	2.0	1.4	**-0.4**	**0.1**	**1.4**
Government balance (% of GDP)							
Italy	-2.7	-5.4	-4.5	-3.9	**-2.9**	**-2.1**	**-2.1**
Euro area	-2.1	-6.3	-6.2	-4.1	**-3.3**	**-2.6**	**-2.5**
Structural balance (% of GDP)							
Italy	-3.7	-4.3	-3.7	-3.7	**-1.4**	**-0.4**	**-0.8**
Euro area	-2.9	-4.6	-4.4	-3.5	**-2.2**	**-1.3**	**-1.5**
Government debt (% of GDP)							
Italy	106.1	116.4	119.2	120.7	**126.5**	**127.6**	**126.5**
Euro area	70.2	80.0	85.6	88.1	**92.9**	**94.5**	**94.3**
Inflation							
Italy	3.5	0.8	1.6	2.9	**3.3**	**2.0**	**1.7**
Euro area	3.3	0.3	1.6	2.7	**2.5**	**1.8**	**1.6**
Unemployment (% of labour force)							
Italy	6.7	7.8	8.4	8.4	**10.6**	**11.5**	**11.8**
Euro area	7.6	9.6	10.1	10.1	**11.3**	**11.8**	**11.7**
Current account balance (% of GDP)							
Italy	-2.9	-2.0	-3.5	-3.3	**-1.2**	**-0.4**	**-0.3**
Euro area	-0.7	0.1	0.3	0.3	**1.1**	**1.5**	**1.6**
Exports (% change)							
Italy	-2.8	-17.5	11.4	6.0	**1.1**	**3.0**	**4.1**
Euro area	1.1	-12.4	11.2	6.3	**2.5**	**3.2**	**5.2**
Imports (% change)							
Italy	-3.0	-13.4	12.5	0.6	**-7.2**	**1.4**	**5.0**
Euro area	0.9	-11.1	9.6	4.2	**-0.5**	**2.1**	**5.0**
Domestic demand (% change)							
Italy	-1.2	-4.4	2.1	-1.0	**-4.7**	**-1.0**	**1.1**
Euro area	0.3	-3.8	1.3	0.5	**-1.8**	**-0.5**	**1.2**
Investments (% change)							
Italy	-3.7	-11.7	2.1	-1.8	**-8.1**	**-2.1**	**2.6**
Euro area	-1.4	-12.7	-0.1	1.5	**-3.5**	**-0.6**	**2.5**
Unit labour cost (% change)							
Italy	4.7	4.6	-0.4	0.9	**2.2**	**0.8**	**0.8**
Euro area	3.8	4.3	-0.7	0.9	**1.4**	**1.2**	**0.9**

Source: EC Autumn Forecast, November 2012

ANNEX 1.b: Current economic situation: comparison of forecast for 2012, 2013 and 2014

	EC 7 November 2012			IMF 9 October 2012			OECD 28 November 2012		
	2012	**2013**	**2014**	**2012**	**2013**	**2014**	**2012**	**2013**	**2014**
GDP Growth (%)									
Italy	-2.3	-0.5	0.8	-2.3	-0.7	0.5	-2.2	-1.0	0.6
Euro area	-0.4	0.1	1.4	-0.4	0.2	1.2	-0.4	-0.1	1.3
Government balance (% of GDP)									
Italy	-2.9	-2.1	-2.1	-2.7	-1.8	-1.6	-3.0	-2.9	-3.4
Euro area	-3.3	-2.6	-2.5	-3.3	-2.6	-2.1	-3.3	-2.8	-2.6
Government debt (% of GDP)									
Italy	126.5	127.6	126.5	126.3	127.8	127.3	127.8	130.4	132.2
Euro area	92.9	94.5	94.3	93.6	94.9	94.7	100.6	102.5	103.4
Inflation (%)									
Italy	3.3	2.0	1.7	3.0	1.8	1.0	3,2	1,9	0,9
Euro area	2.5	1.8	1.6	2.1	1.7	1.4	2.4	1.6	1.2
Unemployment (% of labour force)									
Italy	10.6	11.5	11.8	10.6	11.1	11.3	10,6	11,4	11,8
Euro area	11.3	11.8	11.7	11.2	11.5	11.2	11.1	11.9	12.0
Current account (% of GDP)									
Italy	-1.2	-0.4	-0.3	-1.5	-1.4	-1.3	-0.9	0.3	0.7
Euro area	1.1	1.5	1.6	1.1	1.3	1.4	1.4	1.9	2.2

Sources: EC Forecast November 2012; IMF; OECD .

Note: estimates for 2012 and forecast for 2013 and 2014 of the three institutions have different "cut-off"-dates and are made under different sets of assumptions about policies and underlying economic and financial conditions.

ANNEX 2: Scoreboard used in the surveillance of macro-economic imbalances for Italy

		Thresholds	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
External imbalances and competitiveness	3 year average of **Current account balance** as % of GDP	**-4/+6%**	0.4	-0.1	-0.3	-0.5	-0.7	-0.9	-1.2	-1.9	-2.0	-2.8	-2.9
	Net international investment position as % of GDP	**-35%**	-5.8	-12.4	-13.6	-15.8	-16.8	-22.2	-24.5	-24.1	-25.3	-24.0	-20.6
	% change (3 years) of **Real Effective Exchange Rate** with HICP deflator	**±5% & ±11%**	-5.7	-2.0	8.8	9.9	6.9	1.1	0.7	3.2	3.9	-0.9	-2.1
	% change (5 years) in **Export Market Shares**	**-6%**	-18.5	-14.2	-13.4	-7.4	-5.2	-12.5	-9.3	-16.3	-17.9	-19.2	-18.4
	% Change (3 years) in **Nominal unit labour cost**	**+9% & +12%**	4.8	7.0	10.7	9.8	8.7	6.5	6.1	8.3	10.5	8.1	4.4
Internal imbalances	% y-o-y change deflated **House prices**	**+6%**	5.4	6.5	7.4	7.1	5.2	3.2	2.6	-0.4	-0.3	-1.5	-2.0
	Private sector credit flow as % of GDP	**15%**	8.4	6.4	7.0	8.3	9.4	10.9	13.1	6.7	1.3	3.8	2.6
	Private sector debt as % of GDP	**160%**	87	90	93	98	104	110	118	122	128	129	129
	General government gross debt (EDP) as % of GDP	**60%**	108	105	104	103	106	106	103	106	116	119	121
	3 year average of **Unemployment rate**	**10%**	10.0	9.2	8.6	8.3	8.1	7.5	6.9	6.5	6.9	7.6	8.2
	%y-o-y change in **Total Financial Sector Liabilities**, non consolidated	**16.5%**	-3.0	3.9	11.6	7.2	12.1	10.5	0.5	-2.7	5.7	1.7	3.8

Source: EC, ECFIN Alert Mechanism Report 2013

Imbalances (above threshold)

ANNEX 3: Targets and current situation in the context of the Europe 2020

Indicator		EU27	ITALY
Employment rate (% of population)	**target**	**75**	**67**
	2010	68.6	61.1
	2011	68.6	61.2
Expenditure on R&D (% of GDP)	**target**	**3**	**1.53**
	2010	2.01	1.26
	2011	2.03	1.25
CO2 emission reduction	**target**	**80 (1990=100)**	**87 (2005=100)**
	2010	85	97
	2011	n.a.	n.a.
Share of renewable energy (%)	**target**	**20**	**17**
	2010	12.5	10.1
	2011	n.a.	n.a.
Primary energy consumption (1 000 tonnes of oil equivalent-TOE)	**target**	**1 474 000**	**n.a**
	2010	1 646 839	165 955
	2011	n.a.	n.a.
Early school leaving (% of population aged 18-24)	**target**	**10**	**15**
	2010	14.1	18.8
	2011	13.5	18.2
Tertiary educational attainment (% of population aged 30-34)	**target**	**40**	**26**
	2010	33.5	19.8
	2011	34.6	20.3
Population at risk of poverty or social exclusion (thousands of people currently at risk of poverty)	**target**	**reduce by 20 million**	**reduce by 2.2 million**
	2010	116 300	14 757
	2011	n.a.	n.a.

Source: Eurostat (accessed on 17.01.2013), European Commission

ANNEX 4: Country Specific Recommendations adopted under the European Semester Cycles in 2011 and 2012: Comparison Table

Country Specific Recommendations 2011	Assessment of implementation of CSR 2011 (Summary of the Commission Staff Working Papers published in May 2012)	Country Specific Recommendations 2012 **MIP: 1, 4, 5, 6**
1. Implement the planned fiscal consolidation in 2011 and 2012 to ensure **correction of the excessive deficit** in line with the Council recommendations under the EDP, thus bringing the high public debt ratio on a downward path. Building on recently approved legislation, fully exploit any better-than-expected economic or budgetary developments for faster deficit and **debt reduction** and stand ready to prevent slippages in budgetary implementation. Back up the targets for 2013-2014 and the planned achievement of the medium-term objective by 2014 with concrete measures by October 2011 as provided for in the new multi-annual budgetary framework. Further strengthen the framework by introducing enforceable ceilings on expenditure and **improving monitoring across all government subsectors**.	**1. Italy has partially implemented the CSR.** Three packages were adopted in 2011 on fiscal consolidation. The Italian Parliament has adopted a balanced budget rule in the Italian Constitution. Effective ordinary legislation will need to be designed, specifying the balance to be considered, application arrangements (e.g. cyclical conditions) and appropriate correction mechanisms, as required by the fiscal compact.	**1.** Implement the budgetary strategy as planned, and ensure that the **excessive deficit is corrected in 2012**. Ensure the planned structural primary surpluses so as to put the **debt- to-GDP ratio on a declining path by 2013**. Ensure adequate progress towards the MTO, while meeting the expenditure benchmark and making sufficient progress towards compliance with the debt reduction benchmark. **2.** Ensure that the specification in the implementing legislation of the key features of the balanced budget rule set out in the Constitution, including appropriate **coordination across levels of government**, is consistent with the EU framework. Pursue a durable improvement of the efficiency and quality of public expenditure through the planned spending review and the implementation of the 2011 Cohesion Action Plan leading to improving the absorption and management of EU funds, in particular in the South of Italy.
2. Reinforce measures to **combat segmentation in the labour market**, also by reviewing selected aspects of employment protection legislation including the dismissal rules and procedures and reviewing the currently fragmented unemployment benefit system taking into account	**2. Italy has partially implemented the CSR**. It did not adopt key policies to fight undeclared work and provided limited support for female employment. The labour market reform presented by the government aims to comprehensively address the rigidities and asymmetries of	**4.** Adopt the **labour market reform** as a priority to tackle the segmentation of the labour market and establish an integrated unemployment benefit scheme. Take further action to incentivise labour market participation of women, in particular through the provision of childcare and elderly care.

the budgetary constraints. Step up efforts to **fight undeclared work**. In addition, take steps to promote greater participation of women in the labour market, by increasing the availability of care facilities throughout the country and providing financial incentives to second earners to take up work in a budgetary neutral way.	employment protection legislation while moving towards a more integrated unemployment benefit scheme. This should improve the balance between flexibility of entry into and exit from the labour market.	Monitor and if needed reinforce the implementation of the new **wage setting framework** in order to contribute to the alignment of wage growth and productivity at sector and company level.
3. Take further steps, based on the 2009 agreement **reforming the collective bargaining framework** and in consultation with the social partners in accordance with national practices, to ensure that wage growth better reflects productivity developments as well as local and firm conditions, including clauses that could allow firm level bargaining to proceed in this direction.	**3. Italy has partially implemented the CSR**. A social partners' agreement was reached in June, allowing firm-level bargaining to derogate from labour law (including on dismissal procedures and type of contracts to be used in the firm). Implementation of the agreement on collective bargaining will crucially depend on the behaviour of the social partners.	
4. Extend the process of **opening up the services sector to further competition**, including in the field of professional services. Adopt in 2011 the Annual Law on Competition, taking into account the recommendations presented by the Anti-trust Authority. Reduce the length of contract law enforcement procedures. Further strengthen actions to promote the access of SMEs to capital markets by **removing regulatory obstacles** and reducing costs.	**4. Italy has partially implemented the CSR.** Rules were adopted to liberalise local public services, lift rigidities in professional services, strengthen the Antitrust Authority's powers and abolish disproportionate bans, restrictions and authorisations on economic activity from 2012 (this requires further legislative measures to be taken by the end of 2012). Sectoral liberalisation was launched, and reforms of the judicial system were adopted, to improve its efficiency by reducing case-handling duration and backlogs.	**6.** Implement the adopted **liberalisation and simplification measures in the services sector**. Take further measures to improve market access in network industries, as well as infrastructure capacity and interconnections. Simplify further the regulatory framework for businesses and enhance administrative capacity. Improve access to financial instruments, in particular equity, to finance growing businesses and innovation. Implement the planned reorganisation of the civil justice system, and promote the use of alternative dispute settlement mechanisms.
5. Improve the framework for private sector **investment in research and innovation** by extending current fiscal incentives, improving conditions for venture capital and supporting	**5. Italy has partially implemented the CSR**. Some measures have been taken, notably the refinancing of the tax credit for research for companies. The level of ambition and effectiveness	

innovative procurement schemes.	is, however, insufficient. There has been no significant improvement on promoting venture capital.	
6. Take steps to accelerate in a cost-effective way **growth-enhancing expenditure** co-financed by cohesion policy funds in order to reduce the persistent disparities between regions, by improving administrative capacity and political governance. Respect the commitments made in the national Strategic Reference Framework in terms of the amount of resources and quality of expenditure.	**6. Italy has partially implemented the CSR**. Measures to speed up the absorption of structural funds started in March 2011 and culminated in the November Cohesion Action Plan. Major deficiencies in the capacity of the public administration continue to hamper programme implementation, notably in the convergence regions.	
		3. Take further action to **address youth unemployment**, including by improving the labour-market relevance of education and facilitating transition to work, also through incentives for business start-ups and for hiring employees. Enforce nation-wide recognition of skills and qualifications to **promote labour mobility**. Take measures to **reduce tertiary education dropout rates** and fight early school leaving.
		5. Pursue the **fight against tax evasion**. Pursue the shadow economy and undeclared work, for instance by stepping up checks and controls. Take measures to reduce the scope of tax exemptions, allowances and reduced VAT rates and simplify the tax code. Take further action to shift the **tax burden away from capital and labour to property and consumption as well as environment**.