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**COMMISSION STAFF WORKING PAPER**

**Assessment of the 2011 national reform programme and stability programme for  
ITALY**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**on the National Reform Programme 2011 of Italy and delivering a Council Opinion on  
the updated stability programme of Italy, 2011-2014**

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## **1. INTRODUCTION**

Structural weaknesses had affected the Italian economy long before the global economic and financial crisis, resulting in weaker growth than for the euro area as a whole. Sluggish productivity growth was the key factor dragging down economic growth throughout the country. As a consequence, the large regional economic disparities remained broadly unchanged. The crisis hit Italy severely despite the absence of large private sector internal imbalances. A slow recovery is now underway. In view of the high public debt, the government kept an appropriately prudent fiscal stance during and after the crisis. Reducing public debt and addressing the long-standing structural problems that weigh on the economy's medium-term growth potential are key priorities for Italy. To address these bottlenecks to growth and achieve the goals of the Europe 2020 strategy, Italy set out its reform agenda in the National Reform Programme (NRP) and in the Stability Programme (SP), adopted by the government on 13 April 2011.

## **2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK**

### **2.1. RECENT ECONOMIC DEVELOPMENTS**

The global crisis produced a sharp contraction of around 7% in Italy's real GDP between the second quarter of 2008 and the second quarter of 2009, as exports and subsequently investment collapsed. Compared to the severe contraction in output, headcount employment was less affected by the crisis. Also due to outflows from the labour force in response to depressed labour market prospects, the unemployment rate increased only moderately over 2008-09.

The economy started recovering in the second half of 2009, albeit slowly. Industry, which drove the 2008-09 output contraction, led the recovery, mainly thanks to a rebound in exports. The labour market situation, however, remains fragile, with working hours recovering while headcount employment is still suffering from the lagged effects of the crisis. As a result, the unemployment rate stabilised at around 8.5% by the end of 2010.

Having fallen from a peak of 122% in 1994 to below 105% in 2003, government gross debt as a share of GDP remained broadly stable in subsequent years, reflecting the erosion of the primary surplus on account of a significant increase in current primary expenditure. Given the very high debt ratio Italy refrained from undertaking a large fiscal stimulus during the crisis, allowing the government deficit to remain below the euro-area average in 2009-10. Still, the debt ratio climbed to 119% of GDP by end-2010, also reflecting the sharp decline in GDP, and spreads on 10-year sovereign bond yields relative to Germany rose to a peak of 210 bps at end-November 2010. Spreads eased somewhat thereafter, but at around 150-180 bps they remain well above their pre-crisis level of around 30 bps. The financial situation of Italian households remains generally sound, thanks to low indebtedness. Finally, although the financial sector has weathered the financial turmoil relatively well and did not require significant government intervention, the quality of credit worsened significantly as a consequence of the economic crisis.

### **2.2. OUTLOOK**

According to the Commission services' spring 2011 forecast, the Italian economy is expected to return in 2011-12 to the moderate growth rates experienced before the crisis (see Table I in the Annex). This growth outlook is assumed to translate first into an expansion of hours

worked (also to fully utilize the workers that were retained during the crisis), and only at a later stage in additional headcount employment. As the improving prospects for employment could bring more job-seekers back into the labour market, the unemployment rate is expected to decline very slowly. Reflecting an expenditure-based fiscal consolidation, the general government deficit as a share of GDP is expected to fall gradually in 2011-12, while debt is projected to peak at around 120% of GDP in 2011 and slightly decline in 2012.

In the medium term, the country's potential GDP growth is bound to remain low, unless bold structural reforms supporting a durable recovery in productivity growth are adopted.

### 3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE

After consulting the regions and other stakeholders, the Italian government adopted and made public its SP and NRP on 13 April 2011. The documents were endorsed by Parliament, with two resolutions voted by the Chamber of Deputies on 28 April and the Senate on 5 May, and formally transmitted to the European Commission on 6 May. Parliament did not propose amendments to the NRP, but stressed the need for a broader involvement of stakeholders in the future and encouraged the government to flesh out and rapidly approve the structural reforms necessary for boosting competitiveness, employment and growth.

Consistency across the SP and the NRP, notably in terms of macroeconomic scenario and inter-linkages between fiscal and other macroeconomic areas, is ensured by the integration of the documents within the Document on the Economy and Finance (*Documento di Economia e Finanza*, DEF) which also includes, in a third section, the analysis of trends in public finances. In the new budgetary cycle adopted by the Italian government in 2011 with a view to adapting it to the requirements of the European semester, the DEF has become the centerpiece of Italy's multiannual economic policy and budgetary planning.

Italy has set national targets for all the Europe 2020 headline targets (Table 1). For some of them a mid-term review is announced.

**Table 1: Italian Europe 2020 targets**

Europe 2020 targets	Current situation in Italy <sup>1</sup>	Italian Europe 2020 target in the NRP
R&D investment in % of GDP	1.27%	1.53%
Employment rate (in %)	61.1%	67-69%
Early school leaving (in %)	19.2%	15-16%
Tertiary education attainment (in %)	19.0%	26-27%
Number of people in or at risk of poverty or exclusion	14.8 million people	2.2 million people lifted out of poverty
Energy efficiency - – reduction of energy consumption in MToe <sup>2</sup>		Reduction in primary energy consumption: 27.9 Million tons of oil equivalent
Reduction in greenhouse gas	-5% <sup>3</sup>	-13% <sup>4</sup>

<sup>1</sup> Eurostat figures

<sup>2</sup> As estimated by the European Commission.

<sup>3</sup> This quantity corresponds to the 2005-2008 evolution of the emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

emission reduction targets (from sources not covered by the Emissions Trading System)		
Renewable energy (% of total energy use)	6.8%	17% of energy from renewable sources in gross final consumption of energy by 2020

In line with the focus placed on the need to bring the debt ratio on a sustainable path, the NRP estimates that the programme would have a net positive effect on the public finances, as the expected savings are larger than the additional estimated costs of the planned and ongoing policy interventions. With regard to the potential economic impact of structural reforms, model-based simulations estimate that the aggregate impact of the policy measures presented in the NRP could add up to 0.4 pp. on average to annual real GDP growth in 2011-2014.

#### 4. POLICY CHALLENGES, AGENDA AND ASSESSMENT

##### 4.1. CHALLENGES

Given the persistently high government debt and lagging productivity growth over the past decade, Italy faces public finance and wide ranging structural challenges and bottlenecks to growth. The latter, generally more severe in the Southern regions, are related to: competitiveness; the labour market; the business environment; education; and research and innovation. These challenges coincide with those acknowledged by the Italian authorities in the NRP. Tackling them would be consistent with the policy priorities included in the Annual Growth Survey (AGS) adopted by the Commission in January 2011 and with the commitments under the Euro Plus Pact agreed in March 2011 (see Box 1).

##### Box 1. The Euro Plus Pact

In the specific section devoted to the EPP, the NRP mentions some recently adopted measures and broadly outlines some future reform plans, consistent with the pact's principles. They can be summarised according to the main EPP objectives:

**Foster competitiveness:** The NRP recalls the 2009 reform of the wage bargaining framework, that is expected to be conducive to better alignment of wages and productivity; the initiatives taken in recent years to improve the business environment; and the successive reforms of the education system with a view to modernising it and improving its cost-efficiency.

**Foster employment:** The text outlines the main initiatives taken by the government in the labour market area that are discussed in section 3.2: the 3-year plan for the labour market; the plan adopted in 2010 coordinating efforts across government layers to promote reconciliation of work and family life; and the plan to expand apprenticeship schemes. The envisaged reform of the taxation system with a view to shifting the tax burden from labour to consumption is broadly outlined, but no concrete details and timeline are provided.

**Enhance the sustainability of public finances:** Besides recalling the successive pension reforms already adopted, including the latest one linking retirement age to life expectancy as from 2015, the NRP highlights the ongoing implementation of fiscal federalism as a means for improving accountability and efficiency of public expenditure and states the intention to amend the constitution to reinforce budgetary discipline.

Overall, while already adopted measures may help address some of Italy's main policy challenges, future commitments appear fairly modest, especially in the competitiveness area, or still rather vague, as in the case of the taxation reform.

<sup>4</sup> The national emissions limitation target defined in Decision 2009/406/EC (or "Effort Sharing Decision") concerns the emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels.

As regards public finances, in the context of high risk aversion and renewed tensions in the sovereign bond markets, pursuing a durable fiscal consolidation, while improving the efficiency and effectiveness of spending across all government layers in order to safeguard an adequate level of public services, remains a key priority. Although fiscal governance has significantly improved in recent years, Italy's medium-term budgetary framework is still not a genuinely binding one.

Italy's losses in competitiveness over the decade before the crisis (see Box 2) implied a marked slowdown in the dynamics of exports, although subdued domestic demand and slow import growth partly contained the resulting deterioration in the trade balance and the external balance. Increasing productivity growth, and aligning wage growth to it, will be important to improve competitiveness. In this regard, strengthening firm-level wage bargaining could play a significant role.

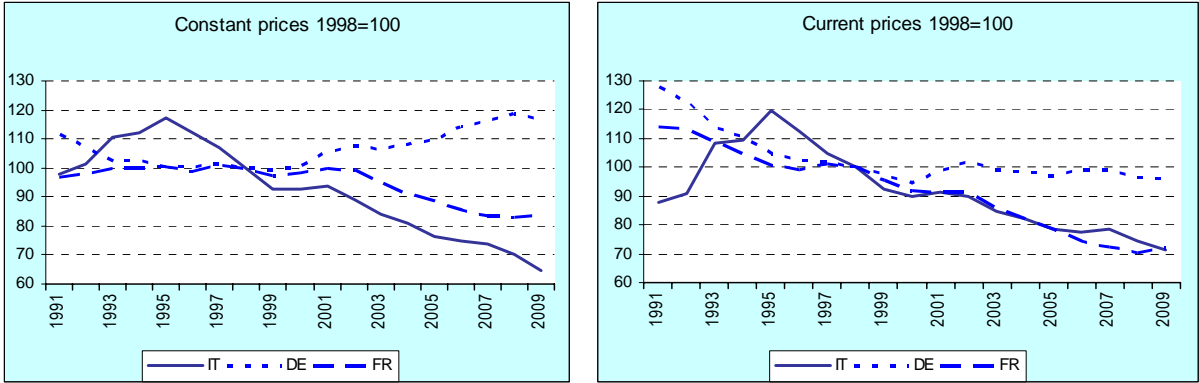
**BOX 2. Italy's competitive position**

Italy's competitive position deteriorated steadily during the first ten years of euro-area membership. Cost competitiveness, measured by the real effective exchange rate (REER) based on unit labour costs (ULC) and, to a lesser extent, the GDP deflator, worsened significantly against the rest of the euro area.

With wage developments broadly in line with the euro-area average, stagnation in productivity since the end of the 1990s is the key factor behind the rise in Italy's ULC. This was especially evident in manufacturing, the sector most exposed to international competition, but was also widespread in the non-tradable sector.

The most striking evidence of the deterioration in competitiveness is Italy's steady loss of market shares since the mid-1990s (Figure 1). When measured in volume terms, Italy's market shares for goods and services over 2000-2009 contracted by almost 3.5% per year on average. This contrasts with the export performance of Germany, which recorded a market share gain of almost 1.75% per year over the same period, whereas France lost only 1.5% per year. When measured at current prices, the contraction in Italy's export market share appears somewhat more contained, broadly in line with the trend for France but markedly worse than that for Germany.

**Figure 1. Export performance at constant and current prices\***



\*Performance of exports of goods and services relative to the rest of 35 industrial countries; double export weights. Source: Commission services' calculations

The product specialisation and geographical destination of Italy's exports is another important factor in this regard. With an export product mix which is rather similar to that of emerging economies, Italy may have been exposed more than other euro area countries to increasing global competition. As a partial response to these competitive pressures, restructuring has started in the tradable sector in recent years. While maintaining its specialisation in labour-intensive sectors, Italy's trade has moved up the quality ladder. Nonetheless, during the crisis, the plunge in global demand for some of the products in which Italy is specialised, most importantly textiles and clothing, leather and footwear, furniture and wood products, as well as mechanical engineering products, hit exports hard and resulted in a further loss of market shares. Concerning geographical orientation, the share of Italy's exports to fast-growing emerging markets (especially in Asia), despite some increase recently, remains relatively low.

Regarding labour market trends, despite considerable progress over the past decade, participation and employment rates in Italy have remained well below the EU average, reducing growth potential and weakening social cohesion. In addition to persistent disparities between the northern and southern regions,<sup>5</sup> the employment gap with the EU and the euro area for the country as a whole remains particularly large for women, youth and older workers. The female employment rate still trails that of men by over 20 percentage points across the whole territory. Barely one-third of women aged between 20 and 64 were employed in the southern regions in 2009, due both to relatively lower activity rates and higher unemployment. As regards youth employment, one-quarter of the labour force below the age of 25 was unemployed in 2009 and the rate kept increasing in 2010. The situation is again rather uneven across the country: youth unemployment in the southern regions is double that in the northern ones. Just over one-third of the population between 55 and 64 was employed in 2009, reflecting early exit from the labour market as well as low female participation. Italy's relatively high taxation of labour may help to explain this unsatisfactory employment performance by reducing incentives to labour supply, especially for dependent spouses, negatively affecting labour demand by firms and encouraging resort to the shadow economy. Undeclared work remains a substantial phenomenon in Italy in spite of the increased flexibility of labour contracts.<sup>6</sup>

The remaining weaknesses of the business environment, notably barriers to entry into services and network industries and inefficiencies in public administration, hinder investment, including from abroad,<sup>7</sup> and reduce the competitiveness of Italian companies, especially those located in Southern regions. Several institutions have highlighted the high cost of doing business in Italy and the lack of competitiveness.<sup>8</sup> In the energy and environmental policy areas, regulatory constraints and infrastructure bottlenecks generate high energy prices for business and households and hamper the achievement of sustainable "green" growth.<sup>9</sup> Lower barriers to new entrants in product and services markets and fewer obstacles to entrepreneurship could also generate greater opportunities for social and spatial mobility of highly skilled young people.

As regards human capital, despite some progress, Italy still has a relatively high number of early school leavers and low tertiary education attainment levels. Moreover, Italian students score poorly on the OECD Programme for International Student Assessment (PISA), with performance in the northern regions in line with or above the EU average but significantly

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<sup>5</sup> In 2009, all northern regions had higher employment rates than the national average (some even higher than the EU average, e.g. Emilia-Romagna with 73% and Lombardia with 70%), while all southern regions had below-average rates, with a low of 45% in Campania and as many as four regions below 50%.

<sup>6</sup> Around 3 million full-time equivalent jobs, or 12% of total jobs (i.e. regular and irregular), are estimated to be irregular. See ISTAT, [http://www.istat.it/dati/dataset/20100414\\_00/](http://www.istat.it/dati/dataset/20100414_00/).

<sup>7</sup> According to the most recent UNCTAD *World Investment Report*, the stock of inward foreign direct investment for Italy was just 18.6% of GDP in 2009, the lowest value among large EU countries.

<sup>8</sup> The World Bank's *Doing Business 2011* report underlines weaknesses in Italy's regulatory framework and administrative efficiency; the most critical category is contract enforcement, as it requires on average 1210 days and 41 procedures (see also Table VIII in the annex). The OECD indicators on product market regulation point to ample scope for further opening up Italy's services, notably professional services, as in 2008 the country ranked 19<sup>th</sup> out of the 20 surveyed by the "Regulation in professional service indicator". Moreover, data from the Italian Antitrust Authority show that price restrictions and minimum tariffs have an inflationary effect and tend to reduce competition.

<sup>9</sup> For example, in 2008-09 Italy had the highest number of infringements to environment-related legislation. According to the Platts database, over the last decade Italy had the one of the lowest shares of low-carbon plants in newly-built plants. Moreover, with one of the lowest Emissions Trading Scheme coverage in the EU, Italy faces a relatively big challenge to reduce greenhouse gas emissions in sectors such as agriculture and transport.

worse in the South. Resources devoted to higher education are low compared to the EU average.<sup>10</sup> Participation in lifelong learning is still lagging behind the EU average and is particularly low for older and low-skilled workers.

Promoting innovation capacity to support investment and a re-focusing on high value-added production and services appears essential to ensure higher productivity growth. Italy's expenditure on R&D was just 1.27% of GDP in 2009 (Table VIII in the annex). The private sector accounted for less than half of this share, reflecting the prevalence of small and medium enterprises (SMEs)<sup>11</sup> but also inefficiencies in the capital market, notably with regard to enabling the expansion of companies through third-party capital and venture capital investments.

#### **4.1. ASSESSMENT OF THE POLICY AGENDA**

##### **4.2.1. Macroeconomic policies**

###### **4.2.1.1. Public finances**

The macroeconomic outlook underlying the SP, which also underpins the NRP, envisages real GDP to grow moderately in 2011-12, at broadly the same pace as in the Commission services' spring 2011 forecast (see Table II in the annex). Compared with the forecast, the SP assumes somewhat stronger growth in private consumption, while it projects gross fixed capital formation to increase more slowly and the contribution to growth from net exports to be smaller. In 2011-12, employment is expected to recover slowly both in the programme and in the Spring Forecast, whereas wages are projected to grow more moderately in the programme. Inflation is expected to pick up less rapidly in the programme, but to remain slightly higher in 2012. For 2013-14, the programme projects mildly stronger real GDP growth, driven by domestic demand. Overall, the programme's macroeconomic scenario seems plausible.

The negative output gap is rather wide at the start of the programme period but it is assumed to narrow gradually. With an average potential growth of around 0.6% per year over the period, the negative output gap, as recalculated by Commission services based on the information in the programme, following the commonly agreed methodology, would narrow from 3.4% of potential output in 2010 to 0.4% in 2014.

In 2010, the general government deficit turned out better than the target set in the previous programme and confirmed in subsequent national planning documents (4.6% of GDP versus 5.0%). The better-than-planned outcome is mainly explained by lower-than-planned expenditure across all main spending categories. As a result, overall expenditure declined by 0.6% year-on-year instead of rising by 0.9% as planned. Capital spending fell significantly (-18.5%) and also interest expenditure dropped (-0.4%), while current primary expenditure rose by 1.2% year-on-year, i.e. less than nominal GDP, thanks to restrained growth of wages and intermediate consumption. Revenues rose in line with GDP, as some measures boosting current taxes broadly offset the fading proceeds from one-off measures introduced in 2009.

Despite a better-than-expected outcome in 2010, the programme leaves the deficit target for 2011 unchanged at 3.9% of GDP. Expenditure and revenues projections, however, are

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<sup>10</sup> Both in terms of share of GDP (0.76% vs. 1.12% of GDP in 2007) and as measured by per student spending (7211 EUR vs. 9101 EUR in PPS in 2007).

<sup>11</sup> A large number of SMEs and micro firms are in low knowledge-intensity sectors, such as footwear, textiles and clothing, other machinery, basic metal products and non-metallic mineral products.

significantly different, as they now incorporate the consolidation package for 2011-12 that was approved in May 2010, after the submission of the previous programme. Around one-third of the targeted reduction in the deficit ratio is planned to be achieved by improving tax compliance. On the expenditure side, investment and capital transfers are further cut relative to 2010 along with a wages freeze and a restraint on recruitment in the public sector, the postponement of access to retirement by some months for workers who become eligible and some cuts to intermediate consumption. The 2011 deficit projection in the Commission's spring forecast, incorporating these measures, is in line with the target set in the stability programme.

The programme confirms the government's commitment to bringing the deficit below the 3% reference value by 2012, which is the deadline for the correction of the excessive deficit. It confirms the previous update's target of 2.7% of GDP and describes the main measures to achieve it, which were adopted in May 2010 as part of the 2011-2012 package mentioned above. These measures are officially estimated to raise around 0.25% of GDP additional revenue, mostly thanks to continued fight against tax evasion. The share of expenditure in GDP is projected to fall by around 0.5 percentage point due to further cuts to investment and capital transfers and the impact of previously introduced measures to curb wage and pension increases.

After correcting the excessive deficit in 2012, the programme aims to reduce the deficit ratio further, to a broadly balanced budgetary position by 2014 in both headline and structural terms (as recalculated by the Commission), thus achieving the MTO by the end of the programme period. To this end, the programme plans an additional reduction in the deficit ratio by 2.5 pps, but this reduction is not yet backed up with concrete measures. The detailed revenue and expenditure projections for 2013-14 are based on the assumption of unchanged legislation and, therefore, they are not consistent with the deficit targets. On the expenditure side, the government is committed to curbing primary spending relative to GDP by around 4 pps over the programme horizon, thus keeping expenditure growth below nominal GDP growth in the medium term.

Over 2010-12, the structural balance relative to GDP, as recalculated by the Commission services based on the information in the programme and the commonly agreed methodology, is projected to improve on average by around 0.7 percentage point per year. The fiscal policy effort is planned to continue thereafter, with the recalculated structural deficit ratio falling by a further 1.7 percentage points cumulatively over 2013-14, implying an even larger improvement in the primary structural balance (around 2 percentage points). Taken at face value, the budgetary stance in the programme would thus be more demanding than the provisions on the adjustment towards the MTO of the Stability and Growth Pact. As the expenditure projections in the programme assumes an unchanged legislation basis and thus do not correspond to the deficit targets, it cannot be assessed whether, in the light of the projected rate of medium-term potential output growth and taking into account discretionary revenue measures, they ensure an appropriate adjustment path towards the MTO. However, as mentioned above, the government is committed to further curbing primary spending relative to GDP, by around 4 pps over the programme horizon.

However, the budgetary outcomes could be worse than targeted from 2012 onwards. While for the period 2011-12 the underlying corrective measures have already been adopted, there could be slippages in budgetary implementation. In particular, the envisaged retrenchment of capital spending in 2012 may prove difficult to enact after two years of severe restraint across all layers of government, while the gains from the stepped-up efforts to improve tax



compliance may fall short of expectations. Given a more cautious assessments in these two areas the Commission services' spring 2011 forecast projects the 2012 deficit at 3.2% of GDP. For the period 2013-14 the programme does not spell out the corrective measures needed to underpin the envisaged ambitious consolidation. According to the new national fiscal framework these measures are expected to be adopted by October 2011.

### Box 3. Main measures

The programme presents the main consolidation measures for 2011-12 adopted in May 2010 and largely confirmed in the 2011-13 budget, which are officially estimated to have a net deficit-reducing impact of around 1.5% of GDP relative to the unchanged legislation scenario. Around two-thirds of the effort falls on expenditure, mainly through cuts to transfers from central to sub-national governments and the postponement of access to retirement. The remaining third is accounted for by revenues raised through measures aimed at improving tax compliance, but their effectiveness is difficult to assess ex ante.

#### Main budgetary measures (% of GDP)

Revenue <sup>1</sup>	Expenditure <sup>1</sup>
<b>2011</b>	
<ul style="list-style-type: none"> <li>Measures to improve tax compliance (0.15%)</li> <li>Postponement to 2012 of the payment of some 2011 personal income taxes (-0.1%)</li> </ul>	<ul style="list-style-type: none"> <li>Cuts to transfers to regional and local authorities, capital expenditure and intermediate consumption (-0.4%)</li> <li>Public sector wages freeze and restrictions on recruitment (-0.1%)</li> <li>Postponement of retirement by 12 to 18 months (-0.05%)</li> <li>Cuts to discretionary ministerial spending (-0.1%)</li> </ul>
<b>2012</b>	
<ul style="list-style-type: none"> <li>Measures to improve tax compliance (0.5%)</li> <li>Postponement to 2012 of the payment of some 2011 personal income taxes (0.1%)</li> </ul>	<ul style="list-style-type: none"> <li>Cuts to transfers to regional and local authorities, capital expenditure and intermediate consumption (-0.5%)</li> <li>Public sector wages freeze and restrictions on recruitment (-0.2%)</li> <li>Postponement of retirement by 12 to 18 months (-0.2%)</li> <li>Cuts to discretionary ministerial spending (-0.1%)</li> </ul>
<b>2013</b>	
N. a.	
<b>2014</b>	
N. a.	

Note:

<sup>1</sup> Estimated cumulative impact on general government revenue / expenditure as foreseen in the programme.

The programme also reports the budgetary impact of the macro-structural measures that are included in the national reform programme, adopted since 2008. They include savings on pension and health expenditure, higher transfers to firms and workers, measures to increase energy and environmental efficiency and incentives to R&D and human capital. They were included in subsequent consolidation packages and are expected to improve the government deficit by around 0.25 % of GDP in 2011 and 0.75 % in 2012, and close to 1 % in 2014 relative to the unchanged legislation scenario. However, the budgetary impact of future reforms is not quantified.

After rising by 12.5 p.p. during the 2008-09 crisis, general government gross debt as a share of GDP increased by around 3 p.p. in 2010, reaching 119% (Table IV in the annex). The main contributor was a large "snow-ball" effect, i.e. the impact of the difference between the real interest rate paid on debt and real GDP growth, as the latter was considerably negative over 2008-09. Another factor was the significant accumulation of liquid financial assets held by the Treasury with the Bank of Italy to around 2.7% of GDP by end-2010 to allow smoother debt management in an environment of high risk aversion in financial markets. At the same time,

the average maturity and financial duration of State securities were raised further to limit the sensitivity of interest expenditure to market interest rates; an unexpected permanent increase of 1 pp in the entire yield curve at the beginning of 2011 is thus estimated to raise interest expenditure by 0.5 pp. of GDP in 2014.

The programme projects the debt ratio to peak at 120% of GDP in 2011 and to decline at an increasing pace afterwards as the primary surplus increases, to just below 113% in 2014. The debt outcomes could be worse than targeted because the deficit could be higher than planned, as highlighted above. Unless these issues are properly addressed, the budgetary stance in the programme may not suffice to bring the debt ratio back on a firmly downward path. The debt projections for 2011-12 in the Commission services' spring 2011 forecast are marginally higher than those in the programme mainly because of a lower GDP deflator in 2011 and a lower primary surplus in 2012. The small difference in the stock-flow adjustment in 2011 reflects different assumptions regarding the repayment of the 0.3% of GDP government capital injections into the banking sector made in 2009.

Italy is at medium risk with regard to the long-term sustainability of public finances (Table V and Figure in the annex). The expected long-term increase in age-related spending as a share of GDP, even before taking into account the additional measures adopted in 2010, is significantly below the EU average (only 1.5 p.p. compared to 4.6 p.p. of GDP). Based on the current fiscal position, debt would increase to 137.5% of GDP by 2020. The full implementation of the programme, however, would be sufficient to put the debt on a downward path by 2020, even though it would still remain above 60% of GDP in 2020. Given the high debt, ensuring high primary surpluses would be important to reduce the risks to the long-term sustainability of public finances.

Italy's fiscal framework improved significantly in recent years, notably thanks to the reform of the budgetary process that introduced a three-year horizon for budgetary planning and further measures to improve the monitoring and accountability of public finances. Notwithstanding these improvements, several aspects of the reform remain to be implemented and some of the weaknesses of the fiscal framework that resulted in poor fiscal performance since euro adoption are yet to be addressed. These include the lack of effective enforcement mechanisms to control primary expenditure and weak coordination among the different levels of the general government in the budgetary process. The latter is particularly important given the ongoing reform of intergovernmental fiscal relations (fiscal federalism). With regard to the enforcement, the programme mentions the government's intention to amend the constitution with a view to reinforcing budgetary discipline.

#### **4.2.1.2. Financial sector**

Financial market issues were not identified as a bottleneck to growth for the Italian economy and are not covered in the NRP. Nevertheless, also in light of the expected results of the new round of EU-wide stress tests released later in 2011, Italian banks are progressively strengthening their capital base to improve their capacity to withstand adverse shocks. Although rising since 2007, the capital ratios of large Italian banks, as a percentage of risk-weighted assets, are still relatively low in international comparison (see Table VI in the annex). Furthermore, higher funding costs together with increased loan-loss provisions have led to a decline in profitability. Against the backdrop of moderate growth prospects, banking sector profitability is expected to remain subdued in the coming years.

#### **4.2.1.3. Other macroeconomic issues**

The 2009 reform of the bargaining framework envisages centrally-negotiated wage increments consistent with expected HICP inflation excluding imported energy goods, while leaving some scope for firm-level negotiation of productivity-related pay. It also introduced the possibility of opening clauses (i.e. upward and downward derogations with regard to the sectoral wage agreed at the national level), but so far their implementation does not appear to have been very effective. The government does not envisage any further policy action to increase the importance of firm-level bargaining beyond the tax incentives to private employees on performance-related pay introduced in 2008, but highlights the role of the social partners in implementing the new framework.

#### **4.2.2. LABOUR MARKET POLICIES**

##### **Making work more attractive**

Italy set out a target for the employment rate of the age group 20-64 ranging between 67% and 69% by 2020. This target requires creating about 1.6-1.8 million new jobs and implies annual employment growth of 0.87%. Considering that between 2000 and 2008 the employment rate rose by about 5.6 pps, and stood at 61% in 2010 (see Table VII in the annex), Italy's employment rate target seems within reach. The NRP gives priority to measures to encourage participation in the labour market, with a focus on young people and women. The need to raise the employment rate of older workers is acknowledged, but no specific actions are detailed to accompany the increase in the retirement age implied by the successive pension reforms.

As regards specific measures for young people, the government plans to expand apprenticeship schemes in order to boost the employment prospects of vocational trainees and early school leavers. The key measure is the expansion of the opportunities for apprenticeship, by giving students the opportunity to work as an apprentice in a firm as an alternative to classroom learning during the last year of compulsory education. Measures are also foreseen to improve education and training policies with a view to facilitating the transition from school to work, better matching skills to job requirements and reducing the school drop-out rate,<sup>12</sup> which currently stands at 19.2%. These measures seem consistent with the planned target of reducing the school drop-out rate to 15-16% by 2020. However, no strategy for reducing the high early school leaving rate seems to have been put in place, as the NRP does not indicate which specific factors driving early school leaving will be addressed and how. Furthermore, the NRP does not clarify whether a system of skill certification and vocational training standards at national level, to which the government committed, is going to be put in place. The absence of such a system hampers the recognition of training qualifications from one region to another.

To help raise female employment, the NRP refers to a plan adopted in 2010 coordinating efforts across government layers to promote reconciliation of work and family life, as well as to a plan on childcare services launched in 2007.<sup>13</sup> Other foreseen measures rely on European Social Fund spending targeting female job-seekers.

The overall impact of these measures is difficult to assess given that neither the time-frame for their planned implementation nor their expected contribution to youth and female employment are clearly specified. No information is provided on the internal monitoring

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<sup>12</sup> Measured as the percentage of the population aged 18-24 with at most lower secondary education and not in further education or training.

<sup>13</sup> Only 15% of children have access to public child care.

mechanisms. The NRP emphasises the problem of the wide regional disparities in participation and unemployment, but does not outline a comprehensive strategy to tackle it. The main measure in this area, adopted in May 2011, is a new tax incentive for firms hiring disadvantaged people<sup>14</sup> with permanent contracts in Southern regions.

In 2010, the government adopted a 3-year plan for the labour market, which includes fighting undeclared work as one of the main priorities. The NRP, however, does not specify concrete targets or mid-term deadlines for the 3-year plan and the measures to fight undeclared work are limited to a reference to increased surveillance and the promotion of specific atypical labour arrangements, which proved unable to curb the phenomenon in the past.

The NRP announces a reform of the taxation system with a view to gradually shifting the tax burden from labour to consumption,<sup>15</sup> which could help to increase employment. However, no concrete details or timeline are provided.

### **Balancing security and flexibility**

The NRP does not discuss dualism in the labour market because, according to the authorities, Italy does not suffer more than other EU countries from this problem. However, dualism does exist between workers with permanent contracts and workers with no or limited protection against unemployment risks. It is not so much workers on fixed-term contracts, who account for a share of total employment around the EU average (13%), that are poorly protected, but mainly workers officially registered as self-employed, but *are* in a standard subordinate working relationship (the so-called *para-subordinati* or *collaborators*). Their chances to become either employees or truly self-employed are much lower than the probability of workers on fixed-term contracts to move to a permanent job. Indeed, strict protection against firing, also through a very restrictive application of collective dismissals and dismissals for economic reasons, discourages the hiring of permanent workers and thus increases the use of more flexible contracts, including *para-subordinati*.

At the same time, not all workers who lose their job receive adequate income support, as labour market segmentation is accompanied by a fragmented system of unemployment benefits. During the crisis, the government widened the field of application of the wage supplementation scheme (CIG), whereby employees stop working or reduce hours worked, but keep their job at reduced pay. The coverage of benefits was extended to categories of workers previously ineligible by reason of sector, firm size or type of employment contract. Coverage still appears quite discretionary and, while the CIG scheme limited the rise in unemployment and supported households' purchasing power during the crisis, over the longer-term it may hamper occupational and sectoral mobility. The NRP does not indicate any plans to overhaul the unemployment benefit system.

Although pension expenditure as a share of GDP continues to be among the highest in the EU, pension reforms adopted in the last fifteen years have reduced the risks to the long-term sustainability of the system. The gradual increases in the retirement age provided for by the 2010 reform are expected to help ensure future adequacy of pensions.

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<sup>14</sup> This category mainly includes people working in a sector or occupation where the gender imbalance is particularly marked, the long-term unemployed, and workers over 50 or with low skills.

<sup>15</sup> In Italy, the implicit tax rate on consumption is the third-lowest in the euro area, after Spain and Greece. This is due to the erosion of the tax base through exemptions, reduced rates, poor compliance and/or poor tax administration.

## **Combat poverty and promote social inclusion**

Italy has a high risk of poverty and social exclusion (24.7% against 23.1% at EU level), mainly affecting people with low educational attainment, children, women, large households and households whose head is unemployed. In addition, Italy has one of the highest rates of in-work poverty in the EU (10.4% in 2009). The Italian target for 2020 is to lift 2.2 million people out of poverty or exclusion. The NRP identifies three main instruments to reduce poverty: some targeted monetary transfers (the so-called "social card"), a higher involvement of charities and NGOs and policies to promote integration in the labour market.

## **Invest in education and training**

The education system has undergone a series of reforms with a view to modernising it and improving its cost-efficiency. The reform of primary education implemented in 2009 led to a significant cut in the number of teachers. Part of the reduction in current expenditure is meant to be redirected to finance investments in school infrastructure, especially ICT. A reform of upper secondary education is being implemented as from the current school year and will be completed in 2015. It provides for simplification of the school curricula (fewer options; fewer overall classroom hours but more foreign-language teaching), entailing also a reduction in the number of teachers.

Improving the performance of the tertiary education system is considered in the NRP as a priority for Italy, also in order to reach the 2020 target of a 26-27% tertiary attainment rate for the 30-34 age group. The December 2010 reform of universities concerns three key areas: governance, funding and recruitment. In particular, financial/administrative management is now clearly separated from management of teaching and research activities. Furthermore, a growing share of funding is to be allocated to universities on the basis of teaching and research performance. A newly established National Agency for the Evaluation of the University and Research (ANVUR) will evaluate research and education institutions. Last, recruitment and career mechanisms are to be made more transparent and merit-based. The reform thus tackles some of the key weaknesses of the Italian university system, although a successful implementation will take time and require the cooperation of all actors involved.

### **4.2.3. Growth-enhancing structural measures**

The NRP acknowledges that structural reforms and fiscal consolidation can reinforce each other, as the growth-enhancing effect of the former can make a durable fiscal consolidation easier to achieve. To respond to Italy's key structural challenge of enhancing productivity growth, the NRP presents a range of measures which are already adopted or in the pipeline.

## **Competition**

With regard to services and product markets, the NRP focuses on measures to take deregulation further, building on the actions undertaken in previous years in network industries and services, most recently including local public services. A key role is assigned to the implementation of the Services Directive, which was transposed into national legislation in March 2010 and is expected to reduce barriers in a number of sectors and harmonise procedures applicable across the country, although there have been delays in the establishment of the electronic "point of single contact" for business.

The NRP reports on progress in transposing the third energy package with a view to further opening gas and electricity markets to competition. Further integration into a pan-European energy market via the removal of bottlenecks and increasing cross-border capacity, both for the electricity and gas markets, as well as an improved infrastructure network should increase Italy's resilience to supply disruptions and be conducive to more competitive energy prices, which remain significantly higher in Italy than on average in the EU.

Overall, a fast and correct implementation of EU internal market legislation could yield benefits in terms of reduction of barriers, lower costs and greater legal certainty. However, reversing previous progress, Italy is again accumulating a significant backlog in transposing EU internal market legislation, which is compounded by a high rate of incorrect transposition of EU directives.<sup>16</sup> The NRP does not mention this issue.

The NRP identifies the Annual Law on Competition, which has to take account in legislation of the recommendations issued by the national Antitrust Authority,<sup>17</sup> as the main vehicle for addressing barriers to competition and protecting consumers. However, more than one year after the Antitrust Authority's recommendations were issued (concerning postal and transport services, energy distribution and financial intermediaries), the first Annual Law on Competition still has to be adopted. Moreover, the NRP does not envisage specific initiatives aimed at liberalising professional services, while a reform of the legal profession, currently discussed in Parliament, is set to reverse a previous liberalisation by, inter alia, reintroducing minimum fees for lawyers' services.

## **Business environment**

To further improve the business environment, the government has recently streamlined the procedures involved in starting up new firms by abolishing the requirement of ex-ante administrative authorisation. The NRP also highlights progress made on regulatory simplification and the reduction of administrative burden. Finally, the NRP presents the measures that were adopted in May 2011 to speed up public works and infrastructure projects by simplifying public procurement procedures. While these measures address an important issue, at this stage it is not yet possible to assess their economic impact.

The NRP reports on the important reform of the public administration that was launched in 2009 with the aim to increase its efficiency, performance focus and accountability.<sup>18</sup> So far, however, only some progress has been made implementing the reform due to difficulties as regards key issues such as linking rewards to performance.

Access to finance is particularly relevant for Italy because its productive system is dominated by small and medium enterprises (SMEs) and non-banking means for financing firms' growth are relatively scarce. In particular, equity financing continues to play a modest role in the Italian context compared to other EU countries<sup>19</sup> despite its potential for promoting firm size growth, outreach to new global markets and improved corporate governance. The NRP

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<sup>16</sup> Adding the number of directives not transposed to the number of directives not correctly transposed, Italy has a transposition deficit which is double the EU average. Likewise, Italy ranks third in the scoreboard on the number of infringement proceedings open in relation to internal market legislation.

<sup>17</sup> Foreseen by Law 99 of 23 July 2009.

<sup>18</sup> Furthermore, the *e-Government 2012 Plan*, launched in 2009, aims to promote innovation in public administration through a wider use of ICT.

<sup>19</sup> See, for instance, the 2010 *Annual Report* by the public authority responsible for regulating the Italian security markets (CONSOB) and the 2010 *Innovation Union Scoreboard*.

outlines several initiatives that have been implemented in this field, including the creation of the Italian Investment Fund to boost the equity capital of medium-sized companies and the Bank for Southern Italy to supply medium- to long-term credit to SMEs in the southern regions.

### **Research and innovation**

R&D expenditure increased modestly over the past ten years. Consequently, R&D intensity remains low, at around 1.27% of GDP. This is mainly due to a low level of industrial research, as business R&D intensity stands at 0.64% of GDP compared to an EU average of 1.23%. The NRP sets the R&D intensity target for Italy at 1.53% in 2020, well below the current EU average (1.90%) and the target of 3% at EU level.<sup>20</sup> A number of measures are outlined to support progress towards the target, which, however, is reachable by maintaining the same R&D growth trend experienced in the 2000s, even in the absence of additional measures.. The main new measure, adopted in May 2011, is a tax incentive for companies investing in research projects carried out by universities or public sector entities, which has the dual purpose of fostering innovation expenditure and strengthening the links between industry and university. No new measures are outlined to enhance venture capital intensity, currently very low.

### **Energy and climate change**

The recent trend in greenhouse gas emissions in Italy appears broadly consistent with the 2020 national target (-13% compared to 2005 levels), but it has to be taken into account that the economic crisis has tended to temporarily reduce emissions. The NRP does not assess the existing and proposed emission-reducing measures to reach the 2020 target and does not provide operational targets (such as domestic, intermediate or sectoral targets). With regard to energy efficiency, the NRP sets the target to reduce primary energy consumption by 13.4% by 2020 and relies on the implementation of the National Energy Efficiency Plan adopted in 2007, while a new comprehensive plan is expected for 2011. To achieve the renewable energy target of 17% by 2020, the NRP refers to the 2010 National Renewable Energy Action Plan, which outlines measures for developing renewable energy sources and sets sectoral targets. A stable and adequate framework for renewable energy support schemes is also important to preserve investment levels in the sector and promote new renewable energy projects

### **Cohesion Funds**

A final structural issue for Italy is the effectiveness in using EU cohesion policy funds to support growth and jobs creation. Cohesion policy represents a significant potential resource injection in the regions where investment needs are most acute<sup>21</sup> and an opportunity to expand investment in Europe 2020-related areas, such as R&D, innovation and entrepreneurship, employment, renewable energy or human capital. The NRP highlights, for instance, the importance of the effective implementation of the National Research Programme which - by

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<sup>20</sup> The 2009-2013 National Research Programme acknowledges the critical weaknesses of Italy's research policy and proposes some actions to address them, while also taking into account the specific features of the country's productive structure.

<sup>21</sup> Currently, Italy is the third largest beneficiary of EU cohesion policy funds, after Poland and Spain, being entitled to receive EUR 28.8 billion over 2007-2013, (8.2% of the total EU cohesion policy budget), which, added up to national co-financing, reaches a total amount of EUR 60.1 billion. A large part of these funds (71.6% of total) goes to four Convergence objective regions in Southern Italy (Campania, Apulia, Calabria and Sicily).

making a better use of European Cohesion funds - could represent a breakthrough in terms of research and education outcomes. Halfway through the 2007-2013 programming period, however, the amount of structural funds actually mobilised reached 16.8%<sup>22</sup> and it is much lower in the Convergence regions than in the other regions (15.2% and 22.3%, respectively). While recognising the potential role of EU funds in the achievement of the Europe 2020 targets and the need to speed up project implementation, the NRP does not present a comprehensive strategy to overcome the difficulties encountered during the current programming period.

## 5. SUMMARY

Italy is making its way out of the crisis, as the recovery slowly begins to take hold. The crisis exacerbated long-standing structural weaknesses, which in the previous decade had significantly affected economic growth. These problems are set to weigh on Italy's ability to swiftly adjust to the post-crisis environment. Italy's medium-term growth performance will thus depend on mutually reinforcing strategies to put the public debt on a firmly downward path and overcome structural obstacles to growth.

Italy's stability programme sets out an ambitious fiscal consolidation plan. Starting from a general government deficit of 4.6% of GDP in 2010, it plans to achieve a broadly balanced budgetary position by 2014 and thus put the very high public debt on a steadily declining path. This plan is backed up with concrete measures until 2012, aimed at further restraining spending growth and higher revenue from stepped-up efforts to improve tax compliance. For the outer years, the consolidation strategy is backed by a commitment to further curb primary expenditure growth. The deficit and debt outcomes could be worse than planned in the programme. Up to 2012 there could be slippages in budgetary implementation, while beyond 2012, the consolidation plans are not yet backed up by concrete measures. However, these are expected to be announced by October 2011 in the context of Italy's new three-year budgetary framework. While the move to a three-year horizon has significantly improved Italy's fiscal framework, introducing binding expenditure ceilings and quickly implementing the foreseen mechanisms to ensure monitoring of public finances across all government sub-sectors would further enhance the credibility of the medium-term budgetary strategy.

The NRP recognises that to raise potential growth while pursuing a durable fiscal consolidation, Italy has to address a set of wide-ranging structural challenges, covering competitiveness, labour and product market regulation, the business environment and access to finance, the quality of education and research and the promotion of innovation. Moreover, the South has considerable scope for catching up with the rest of the country, which would enhance Italy's overall economic performance. Most of the measures presented, however, have already been adopted or are in the pipeline. The only new major policy initiative announced in the NRP is a tax reform that would shift the tax burden from labour to consumption. While this would undoubtedly be an important reform, at this stage only a broad outline is offered. Overall, given the scale of the structural challenges Italy has to face, the reform agenda does not appear sufficiently ambitious to significantly enhance Italy's growth potential and boost job creation in the coming years.

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<sup>22</sup> European Commission, Infoview database.



## STATISTICAL ANNEX

### Table I. Macro economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012
<b>Core indicators</b>							
GDP growth rate	1.7	1.5	0.7	-5.2	1.3	1.0	1.3
Output gap <sup>1</sup>	-0.1	1.3	1.7	-4.3	-3.4	-2.8	-1.9
HICP (annual % change)	3.0	2.5	2.5	0.8	1.6	2.6	1.9
Domestic demand (annual % change) <sup>2</sup>	2.1	1.6	0.7	-3.9	1.6	0.7	1.2
Unemployment rate (% of labour force) <sup>3</sup>	11.2	8.8	6.8	7.8	8.4	8.4	8.2
Gross fixed capital formation (% of GDP)	19.2	20.5	20.9	19.1	19.5	19.8	20.3
Gross national saving (% of GDP)	21.8	20.4	19.3	15.9	16.0	17.0	17.6
<b>General Government (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>-4.3</b>	<b>-2.8</b>	<b>-3.0</b>	<b>-5.4</b>	<b>-4.6</b>	<b>-4.0</b>	<b>-3.2</b>
Gross debt	<b>117.8</b>	<b>106.4</b>	<b>105.6</b>	<b>116.1</b>	<b>119.0</b>	<b>120.3</b>	<b>119.8</b>
Net financial assets	<b>-103.2</b>	<b>-94.6</b>	<b>-90.3</b>	<b>-100.0</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	46.1	44.7	45.4	46.5	46.0	45.9	46.1
Total expenditure	50.5	47.5	48.4	51.9	50.6	49.9	49.2
<i>of which: Interest</i>	9.4	5.6	4.9	4.6	4.5	4.8	5.1
<b>Corporations (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>-1.2</b>	<b>-1.9</b>	<b>-2.9</b>	<b>-1.9</b>	<b>-2.9</b>	<b>-2.7</b>	<b>-3.0</b>
Net financial assets; non-financial corporations	<b>-84.7</b>	<b>-105.4</b>	<b>-109.7</b>	<b>-113.0</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net financial assets; financial corporations	<b>3.3</b>	<b>-3.0</b>	<b>2.6</b>	<b>17.9</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	11.1	12.1	12.2	10.3	11.9	12.3	12.7
Gross operating surplus	23.5	23.5	21.8	20.5	20.6	20.7	20.8
<b>Households and NPISH (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>7.9</b>	<b>4.5</b>	<b>3.9</b>	<b>4.2</b>	<b>3.2</b>	<b>3.1</b>	<b>2.9</b>
Net financial assets	<b>181.2</b>	<b>193.2</b>	<b>184.8</b>	<b>180.0</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	28.8	28.9	30.0	31.2	31.0	30.8	30.7
Net property income	18.8	15.6	14.4	12.6	12.0	12.3	12.6
Current transfers received	20.6	20.7	21.5	23.9	23.9	24.0	23.8
Gross saving	14.3	11.1	10.6	10.5	9.3	9.2	9.1
<b>Rest of the world (% of GDP)</b>							
Net lending (+) or net borrowing (-)	<b>2.4</b>	<b>-0.2</b>	<b>-1.9</b>	<b>-2.9</b>	<b>-4.2</b>	<b>-3.5</b>	<b>-3.2</b>
Net financial assets	<b>5.4</b>	<b>11.7</b>	<b>15.3</b>	<b>19.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	3.5	0.9	-0.5	-0.4	-1.8	-1.9	-1.7
Net primary income from the rest of the world	-0.9	-0.7	-0.7	-1.5	-1.3	-0.6	-0.6
Net capital transactions	0.2	0.1	0.1	0.0	0.0	0.0	0.1
Tradable sector	46.4	43.7	41.0	38.9	38.9	n.a	n.a
Non tradable sector	43.4	46.2	48.5	51.1	50.7	n.a	n.a
<i>of which: Building and construction sector</i>	4.6	4.9	5.4	5.6	5.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	107.2	107.3	119.9	125.6	122.2	123.0	123.5
Terms of trade goods and services (index, 2000=100)	104.2	102.4	100.1	105.2	101.6	100.3	100.8
Market performance of exports (index, 2000=100)	114.4	95.2	79.5	70.4	70.1	70.4	70.3
<b>Notes:</b>							
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
<sup>2</sup> The indicator on domestic demand includes stocks.							
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.							
<i>Source:</i>							
Commission services' spring 2011 forecast							

**Table II. Macro economic scenario for the budgetary projections**

	2010		2011		2012		2013	2014
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	1.3	1.3	1.0	1.1	1.3	1.3	1.5	1.6
Private consumption (% change)	1.0	1.0	0.6	1.1	1.1	1.2	1.3	1.5
Gross fixed capital formation (% change)	2.5	2.5	2.2	1.8	3.1	2.5	2.7	3.0
Exports of goods and services (% change)	9.1	9.1	6.0	4.8	5.7	4.3	4.5	4.8
Imports of goods and services (% change)	10.5	10.5	4.6	4.5	5.1	3.9	4.2	4.6
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	0.9	0.9	0.7	1.0	1.3	1.2	1.5	1.7
- Change in inventories	0.7	0.7	-0.1	0.2	-0.1	0.0	0.0	0.0
- Net exports	-0.4	-0.4	0.3	0.0	0.1	0.0	0.0	0.0
Output gap <sup>1</sup>	-3.4	-3.4	-2.8	-2.8	-1.9	-2.0	-1.2	-0.4
Employment (% change)	-0.7	-0.7	0.1	0.3	0.4	0.5	0.5	0.6
Unemployment rate (%)	8.4	8.4	8.4	8.4	8.2	8.3	8.2	8.1
Labour productivity (% change)	2.0	2.0	0.6	0.8	0.5	0.8	1.0	1.0
HICP inflation (%)	1.6	1.6	2.6	2.2	1.9	2.0	1.9	1.9
GDP deflator (% change)	0.6	0.6	1.6	1.8	1.8	1.8	1.8	1.8
Comp. of employees (per head, % change)	2.0	2.0	1.5	1.2	1.8	1.5	1.5	1.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-4.2	-4.2	-3.5	-3.5	-3.2	-3.3	-3.0	-2.9
<u>Note:</u>								
<sup>1</sup> In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.								
<u>Source:</u>								
Commission services' spring 2011 forecasts (COM); Stability programme (SP).								

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2010	2011		2012		2013	2014	Change: 2010-2014
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>46.0</b>	<b>45.9</b>	<b>45.8</b>	<b>46.1</b>	<b>46.2</b>	<b>46.0</b>	<b>45.9</b>	<b>-0.2</b>
<i>of which:</i>								
- Taxes on production and imports	14.0	14.2	14.2	14.1	14.2	14.2	14.2	0.2
- Current taxes on income, wealth, etc.	14.6	14.4	14.4	14.7	14.8	14.8	14.7	0.1
- Social contributions	13.8	13.8	13.8	13.7	13.7	13.6	13.5	-0.3
- Other (residual)	3.6	3.5	3.4	3.5	3.5	3.5	3.4	-0.2
<b>Expenditure</b>	<b>50.6</b>	<b>49.9</b>	<b>49.7</b>	<b>49.2</b>	<b>48.9</b>	<b>48.7</b>	<b>48.5</b>	<b>-2.2</b>
<i>of which:</i>								
- Primary expenditure	46.1	45.1	44.9	44.2	43.8	43.3	42.9	-3.2
<i>of which:</i>								
Compensation of employees	11.1	10.7	10.7	10.4	10.4	10.1	9.8	-1.3
Intermediate consumption	5.9	5.8	5.7	5.6	5.5	5.4	5.4	-0.5
Social payments	22.2	22.2	22.2	22.1	22.0	22.1	22.2	0.0
Subsidies	1.0	1.0	0.9	0.9	0.8	0.8	0.8	-0.2
Gross fixed capital formation	2.1	1.9	2.0	1.7	1.6	1.6	1.6	-0.5
Other (residual)	3.8	3.5	3.5	3.5	3.4	3.3	3.2	-0.7
- Interest expenditure	4.5	4.8	4.8	5.1	5.1	5.4	5.6	1.0
<b>General government balance (GGB)<sup>1</sup></b>	<b>-4.6</b>	<b>-4.0</b>	<b>-3.9</b>	<b>-3.2</b>	<b>-2.7</b>	<b>-1.5</b>	<b>-0.2</b>	<b>4.4</b>
<b>Primary balance</b>	<b>-0.1</b>	<b>0.8</b>	<b>0.9</b>	<b>1.9</b>	<b>2.4</b>	<b>3.9</b>	<b>5.2</b>	<b>5.3</b>
One-off and other temporary measures	0.2	0.1	0.1	0.1	0.1	0.0	0.0	-0.2
<b>GGB excl. one-offs</b>	<b>-4.8</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-3.2</b>	<b>-2.8</b>	<b>-1.6</b>	<b>-0.3</b>	<b>4.6</b>
Output gap <sup>2</sup>	-3.4	-2.8	-2.8	-1.9	-2.0	-1.2	-0.4	3.0
Cyclically-adjusted balance <sup>2</sup>	-2.9	-2.6	-2.5	-2.2	-1.7	-0.9	0.0	2.9
<b>Structural balance<sup>3</sup></b>	<b>-3.1</b>	<b>-2.7</b>	<b>-2.6</b>	<b>-2.3</b>	<b>-1.8</b>	<b>-1.0</b>	<b>-0.1</b>	<b>3.0</b>
<i>Change in structural balance</i>		<i>0.4</i>	<i>0.5</i>	<i>0.4</i>	<i>0.8</i>	<i>0.8</i>	<i>0.9</i>	
Structural primary balance <sup>3</sup>	1.4	2.1	2.2	2.8	3.3	4.4	5.4	4.0
<i>Change in structural primary balance</i>		<i>0.7</i>	<i>0.8</i>	<i>0.7</i>	<i>1.1</i>	<i>1.1</i>	<i>1.0</i>	
<b>Notes:</b>								
<sup>1</sup> GGB on a no-policy-change basis until 2012. For 2013-14, government targets.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<b>Source :</b>								
<i>Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations</i>								

**Table IV. Debt dynamics**

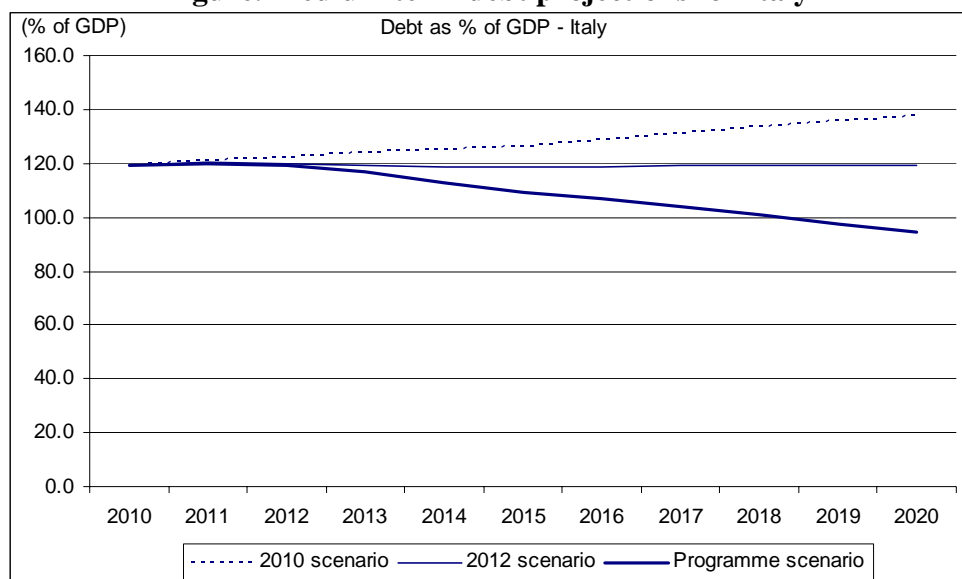
(% of GDP)	average 2005-09	2010	2011		2012		2013	2014
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>107.7</b>	<b>119.0</b>	<b>120.3</b>	<b>120.0</b>	<b>119.8</b>	<b>119.4</b>	<b>116.9</b>	<b>112.8</b>
Change in the ratio	2.4	2.9	1.3	1.0	-0.5	-0.6	-2.5	-4.1
<i>Contributions<sup>2</sup>:</i>								
<b>1. Primary balance</b>	<b>-1.4</b>	<b>0.1</b>	<b>-0.8</b>	<b>-0.9</b>	<b>-1.9</b>	<b>-2.4</b>	<b>-3.9</b>	<b>-5.2</b>
<b>2. "Snow-ball" effect</b>	<b>3.0</b>	<b>2.4</b>	<b>1.9</b>	<b>1.5</b>	<b>1.4</b>	<b>1.6</b>	<b>2.8</b>	<b>4.0</b>
<i>Of which:</i>								
Interest expenditure	4.8	4.5	4.8	4.8	5.1	5.1	6.6	7.9
Growth effect	0.6	-1.5	-1.1	-1.2	-1.5	-1.5	-1.8	-1.8
Inflation effect	-2.4	-0.7	-1.9	-2.1	-2.1	-2.1	-2.0	-2.0
<b>3. Stock-flow adjustment</b>	<b>0.8</b>	<b>0.5</b>	<b>0.2</b>	<b>0.4</b>	<b>0.1</b>	<b>0.3</b>	<b>-1.4</b>	<b>-2.9</b>
<i>Of which:</i>								
Cash/accruals diff.	0.2	-0.7	-0.3	-0.3	0.1	0.1	-0.4	-0.4
Acc. financial assets	0.6	1.2	0.5	0.4	0.0	0.3	0.1	-0.1
<i>Privatisation</i>	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Val. effect & residual	0.0	0.0	0.0	0.3	0.0	-0.1	0.2	0.0

**Notes:**  
<sup>1</sup>End of period. On a no-policy-change basis until 2012. Targets for 2013-14.  
<sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.  
**Source:**  
*Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations*

**Table V. Long-term sustainability indicators**

Italy	Baseline scenario (2010)			Programme scenario		
	S1	S2		S1	S2	
Value	3.3	2.3		-1.1	-1.9	
<i>of which:</i>						
Initial budgetary position (IBP)	0.8	0.8		-3.4	-3.4	
Debt requirement in 2060 (DR)	1.0	-		0.8	-	
Long-term change in the primary balance (LTC)	1.5	1.5		1.5	1.5	
	2010	2015	2020	2010	2015	2020
Debt as % of GDP	119.0	126.5	137.5	119.0	109.4	94.2

**Figure. Medium term debt projections for Italy**



**Table VI. Financial sector indicators**

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	182.4	201.5	229.1	246.0	250.5
Share of assets of the five largest banks (% of total assets)	26.2	33.1	33.0	34.0	...
Foreign ownership of banking system (% of total assets)	13.9	17.4	14.6	13.4	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1), 2)</sup>	4.9	4.6	4.9	7.0	7.6
- capital adequacy ratio (%) <sup>1), 3)</sup>	10.7	10.4	10.8	12.1	...
- profitability - return on equity (%) <sup>1), 4)</sup>	14.3	12.8	4.5	3.6	...
Private credit growth (annual % change)	9.7	11.0	7.6	2.2	5.3
Residential property prices (y-o-y % change)	5.8	5.0	2.6	-0.4	0.1
Exposure to countries receiving/repaying official financial assistance (% of GDP) <sup>5)</sup>	2.0	3.7	3.9	3.2	2.7
Private debt (% of GDP)	94.2	100.1	103.4	109.5	116.6
Gross external debt (% of GDP)					
- Public	45.4	42.3	47.7	50.7	51.9
- Private	23.5	23.3	24.3	24.2	24.4
Long term interest rates spread versus Bund (basis points)*	28.5	27.0	69.7	109.1	129.3
Credit default swap spreads for sovereign securities (5-year)*	...	...	88.4	108.2	164.4
<b>Notes:</b>					
<sup>1)</sup> Latest available September 2010.					
<sup>2)</sup> Exposure to borrowers in a state of insolvency plus exposures to borrowers in a temporary situation of difficulty.					
<sup>3)</sup> The capital adequacy ratio is defined as total capital divided by risk weighted assets.					
<sup>4)</sup> Net income to equity ratio. After extraordinary items and taxes.					
<sup>5)</sup> Covered countries are IE, EL, PT, RO, LV and HU.					
* Measured in basis points.					
<b>Source:</b>					
<i>Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).</i>					

**Table VII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Employment rate (% of population aged 20 - 64)	61.6	62.5	62.8	63.0	61.7	61.1
Employment growth (% change from previous year)	0.6	2.0	1.3	0.3	-1.6	-0.7
Employment rate of women (% of female population aged 20 - 64)	48.4	49.6	49.9	50.6	49.7	49.5
Employment rate of men (% of male population aged 20 - 64)	74.8	75.5	75.8	75.4	73.8	72.8
Employment rate of older workers (% of population aged 55 - 64)	31.4	32.5	33.8	34.4	35.7	36.6
Part-time employment (% of total employment)	12.8	13.3	13.6	14.3	14.3	15.0
Fixed term employment (% of employees with a fixed term contract)	12.3	13.1	13.2	13.3	12.5	12.8
Unemployment rate <sup>1</sup> (% of labour force)	7.7	6.8	6.1	6.7	7.8	8.4
Long-term unemployment <sup>2</sup> (% of labour force)	3.9	3.4	2.9	3.1	3.5	4.1
Youth unemployment rate (% of youth labour force aged 15-24)	24.0	21.6	20.3	21.3	25.4	27.8
Youth NEET <sup>3</sup> rate (% of population aged 15-24)	17.0	16.8	16.2	16.6	17.7	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	22.0	20.6	19.7	19.7	19.2	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	17.0	17.7	18.6	19.2	19.0	:
Labour productivity per person employed (annual % change)	0.5	0.5	0.5	-0.9	-2.6	2.0
Hours worked per person employed (annual % change)	-0.4	-0.2	0.1	-0.7	-1.7	0.3
Labour productivity per hour worked (annual % change; constant prices)	0.5	0.3	0.1	-0.8	-2.0	1.7
Compensation per employee (annual % change; constant prices)	1.1	0.8	-0.2	1.0	-0.7	1.4
Nominal unit labour cost growth (annual % change)	2.8	2.1	1.9	4.7	3.7	-0.2
Real unit labour cost growth (annual % change)	0.7	0.3	-0.6	1.8	1.4	-0.8

**Notes:**<sup>1</sup> According to ILO definition, age group 15-74)<sup>2</sup> Share of persons in the labour force who have been unemployed for at least 12 months.<sup>3</sup> NEET are persons that are neither in employment nor in any education or training.**Sources:**

Commission services (EU Labour Force Survey and European National Accounts)

**Table VII. Labour market and social indicators (continued)**

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Sickness/Health care	6.55	6.78	6.88	6.64	6.99
Invalidity	1.54	1.52	1.51	1.53	1.58
Old age and survivors	15.31	15.39	15.47	15.58	16.09
Family/Children	1.13	1.11	1.15	1.22	1.26
Unemployment	0.50	0.51	0.51	0.45	0.51
Housing and Social exclusion n.e.c.	0.06	0.07	0.07	0.07	0.08
<b>Total</b>	<b>25.1</b>	<b>25.4</b>	<b>25.6</b>	<b>25.5</b>	<b>26.5</b>
of which: Means tested benefits	1.16	1.17	1.59	1.67	1.73
<b>Social inclusion indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Risk-of-poverty or exclusion <sup>1</sup> (% of total population)	25.0	25.9	26.1	25.3	24.7
Risk-of-poverty or exclusion of children (% of people aged 0-17)	27.6	28.4	29.4	29.1	28.8
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	25.2	24.6	25.3	24.4	22.8
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	18.9	19.6	19.9	18.7	18.4
Value of relative poverty threshold (single HH per year) - in PPS	8208	8328	8640	9156	9120
Severe Material Deprivation <sup>3</sup> (% of total population)	6.4	6.3	6.8	7.5	7.0
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59 not student)	10.3	10.8	10.0	9.8	8.8
In-work at-risk-of poverty rate (% of persons employed)	8.9	9.7	9.9	9.0	10.2

**Notes:**

<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

<sup>2</sup> At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.

<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone

<sup>4</sup> People living in households with very low work intensity: Share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.

**Sources:**

For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

**Table VIII. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	-0.3	0.0	0.4	-1.4	-4.1	2.2
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	-0.7	2.5	1.4	-4.0	-12.1	8.7
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	4.3	-0.2	1.6	8.8	-9.5	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	-0.9	0.4	-2.6	-3.2	-6.6	-2.1
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	2.1	2.1	1.1	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Enforcing contracts <sup>3</sup> (days)	n.a.	1210	1210	1210	1210	1210
Time to start a business <sup>3</sup> (days)	n.a.	13	13	10	10	6
R&D expenditure (% of GDP)	1.1	1.1	1.2	1.2	1.3	n.a.
Tertiary educational attainment (% of 30-34 years old population)	14.4	17.7	18.6	19.2	19.0	n.a.
Total public expenditure on education (% of GDP)	4.6	4.7	4.3	4.6	n.a.	n.a.
	<b>2003</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Product market regulation <sup>4</sup> , Overall (Index: 0=not regulated; 6=most regulated)	1.8	n.a.	n.a.	1.4	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index: 0=not regulated; 6=most regulated)	2.5	n.a.	n.a.	2.6	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>5</sup> (Index: 0=not regulated; 6=most regulated)	2.9	2.0	2.0	2.0*	n.a.	n.a.
<b>Notes:</b>						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications designated to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, of this indicator is presented in detail at the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the Product market regulation indicators are presented in detail at the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html</a> . The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.						
<sup>5</sup> Aggregate ETCR.						
*figure for 2007.						
<b>Source :</b>						
Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						