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BASIC STATISTICS OF ITALY

(Data refer to 2017 or latest available. Numbers in parentheses refer to the OECD average)[1]

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	62.0		Population density per km²	205.3	(37.2)
Under 15 (%)	13.8	(17.9)	Life expectancy (years, 2016)	83.3	(80.6)
Over 65 (%)	21.9	(17.0)	Men	81.0	(77.8)
Foreign-born (%, 2016)	9.6		Women	85.6	(83.2)
Latest 5-year average growth (%)	0.4	(0.6)	Latest general election	March	2018
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	1 944		Primary sector	2.1	(2.5)
In current prices (billion EUR)	1 726		Industry including construction	24.1	(27.0)
Latest 5-year average real growth (%)	0.4	(2.1)	Services	73.8	(70.5)
Per capita (000 USD PPP)	40.9	(44.3)			
GENERAL GOVERNMENT					
Per cent of GDP					
Expenditure	48.8	(41.0)	Gross financial debt	154.0	(109.5)
Revenue	46.4	(38.8)	Net financial debt	125.0	(70.8)
EXTERNAL ACCOUNTS					
Exchange rate (EUR per USD)	0.89		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.70		Machinery and transport equipment	36.3	
In per cent of GDP			Miscellaneous manufactured articles	17.9	
Exports of goods and services	31.3	(55.4)	Manufactured goods	17.7	
Imports of goods and services	28.4	(51.0)	Main imports (% of total merchandise imports)		
Current account balance	2.8	(0.4)	Machinery and transport equipment	28.7	
Net international investment position	-6.7		Chemicals and related products, n.e.s.	15.6	
			Manufactured goods	15.5	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate for 15-64 year-olds (%)	58.0	(67.7)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	11.2	(5.8)
Men	67.0	(75.4)	Youth (age 15-24, %)	34.8	(11.9)
Women	48.9	(60.1)	Long-term unemployed (1 year and over, %)	6.5	(1.7)
Participation rate for 15-64 year-olds (%)	65.4	(72.1)	Tertiary educational attainment 25-64 year-olds (%)	18.7	(36.9)
Average hours worked per year	1 723	(1 744)	Gross domestic expenditure on R&D (% of GDP, 2016)	1.3	(2.3)
ENVIRONMENT					
Total primary energy supply per capita (toe)	2.5	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes, 2016)	5.3	(9.1)
Renewables (%)	17.0	(10.2)	Water abstractions per capita (1 000 m³, 2008)	0.9	
Exposure to air pollution (more than 10 g/m3 of PM2.5, % of population, 2015)	97.2	(75.2)	Municipal waste per capita (tonnes, 2016)	0.5	(0.5)
SOCIETY					
Income inequality (Gini coefficient, 2016)	0.328	(0.313)	Education outcomes (PISA score, 2015)		
Relative poverty rate (%, 2016)	13.7	(11.7)	Reading	485	(493)
Median disposable household income (000 USD PPP, 2016)	22.8	(23.1)	Mathematics	490	(490)
Public and private spending (% of GDP)			Science	481	(493)
Health care	8.9	(8.8)	Share of women in parliament (%, 2016)	31.0	(28.7)
Pensions (2015)	17.1	(8.5)	Net official development assistance (% of GNI)	0.30	(0.38)
Education (primary, secondary, post sec. non tertiary, 2015)	3.0	(3.5)			

Better life index: www.oecdbetterlifeindex.org

1. Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

Executive summary

After a modest recovery, the economy is weakening

- *In recent years, supportive global economic conditions, expansionary monetary policy, structural reforms and prudent fiscal policy supported Italy's gradual economic recovery.*
- *However, the recovery has slowed.*

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

- *Real GDP per capita is roughly the same as in 2000 and well below its pre-crisis peak.*
- *Absolute poverty rates for young people rose sharply as a result of the crisis and remain high.*
- *The already large regional differences in GDP per capita and employment rates have widened over recent decades.*
- *Renewable energy capacity has expanded rapidly from 2000 to the mid-2010s but has since stalled.*

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

- *Italy faces the double challenge of reviving growth and making it more inclusive while putting the public debt on a steady downward path.*
- *Increasing productivity growth is key to raising living standards and to offsetting the large negative effect of demographics and a shrinking labour force.*
- *A credible medium-term plan to reduce the debt-to-GDP ratio will improve fiscal credibility and help contain the risk premium on government debt.*
- *Public spending needs to become more efficient and better targeted with a fairer tax system.*
- *The health of the banking system has improved but challenges remain.*

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

- *A key part of making growth stronger and more inclusive involves increasing formal employment.*
- *The success of any guaranteed minimum income scheme will hinge on improving job-search and training programmes.*

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

- *Rationalising and improving coordination among the bodies involved in regional development policies by strengthening the role and expertise of central-government bodies would make regional policies more effective.*

After a modest recovery, the economy is weakening

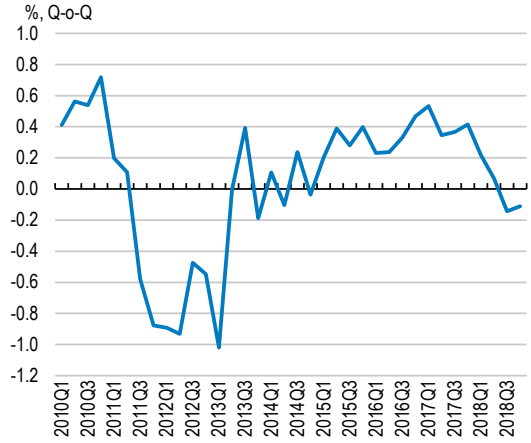
In recent years, supportive global economic conditions, expansionary monetary policy, structural reforms and prudent fiscal policy supported Italy's gradual economic recovery. Exports, private consumption and more recently investment drove growth, buttressed by a shift of export industries towards higher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

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

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

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

Figure A. GDP growth has slowed



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

StatLink https://doi.org/10.1787/888933947692

Table A. The economy is projected to recover gradually

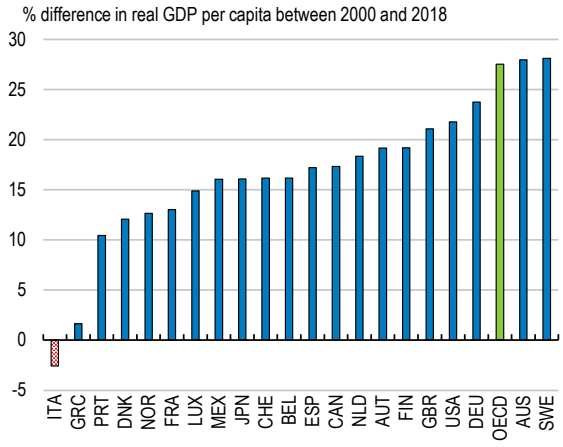
Annual % change, unless otherwise indicated

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

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

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

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



Source: OECD *Economic Outlook 104* database, including more recent information.
StatLink https://doi.org/10.1787/888933947787

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

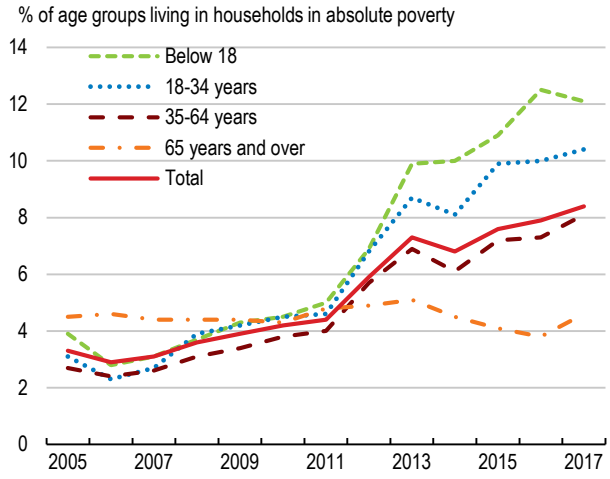
Renewable energy sources have expanded rapidly from 2000 to the mid-2010s but have stalled since then. Air pollution is high in some area, resulting in high mortality and harming well-being. Other environmental challenges result from weaknesses in public administration, reflected in patchy waste collection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

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

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

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

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



Source: ISTAT *Poverty* database.
StatLink https://doi.org/10.1787/888933947711

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

A credible medium-term plan to reduce the debt-to-GDP ratio will improve fiscal credibility and help contain the risk premium on government debt. Without sustainable fiscal

policy, the room to enhance infrastructure, help the poor and deliver the public services people expect will inevitably narrow. Designing budgets within the EU Growth and Stability Pact, which should be implemented in a pragmatic way, would help to strengthen fiscal credibility by providing an anchor to fiscal policy. If fiscal credibility can be improved rapidly, a falling risk premium on government debt would accelerate the reduction of the debt ratio.

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

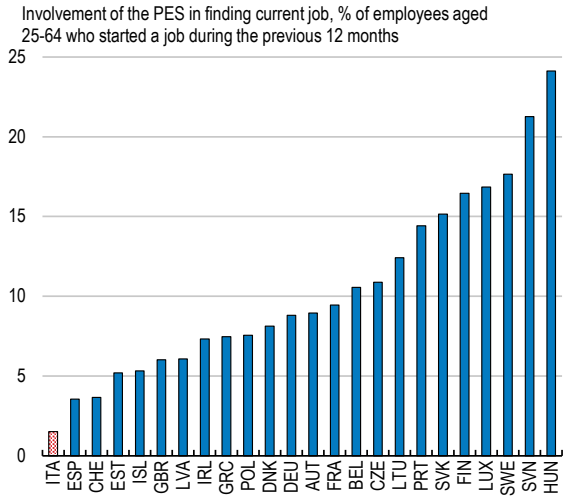
The health of the banking system has improved but challenges remain. The government strategy to deal with insolvent banks through a mix of resolutions, recapitalisations and acquisitions has yielded fruit. Banks' capital ratios are above minimum requirements. The stock of nonperforming loans in banks'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

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

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

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

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

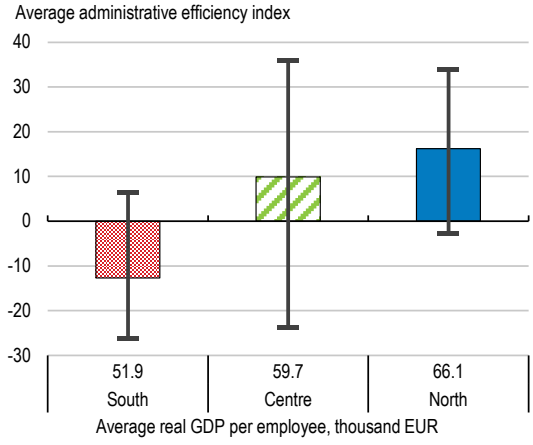


Source: Calculations based on EU-LFS 2014.
StatLink https://doi.org/10.1787/888933947730

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

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

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



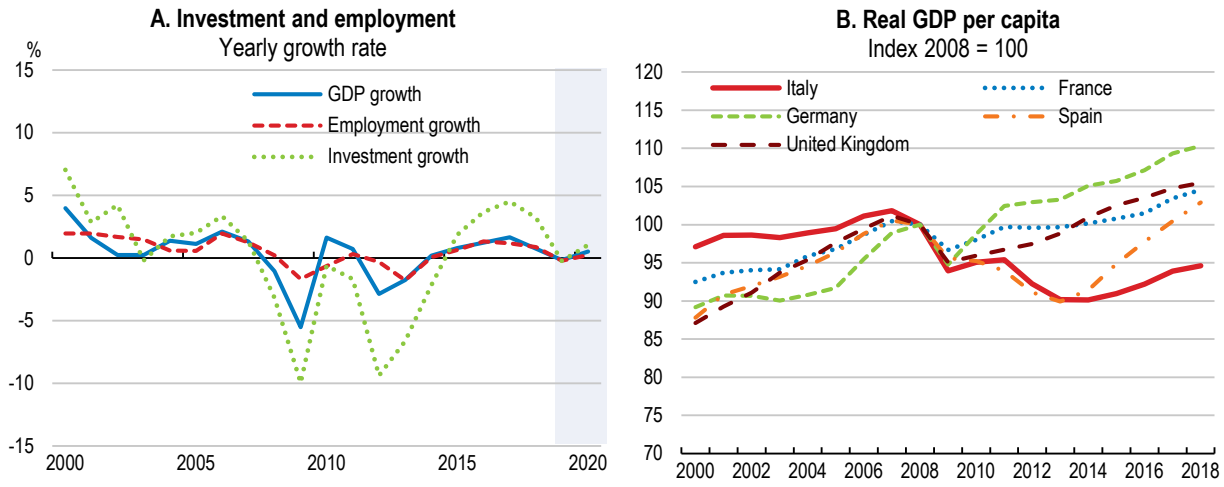
Note: The administrative efficiency index is the percentage difference between assessed spending needs given conditions and actual spending. A higher value indicates greater efficiency.
Source: OECD *Regional Statistics* database; and OpenCivitas.
StatLink https://doi.org/10.1787/888933947749

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

Key policy insights

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

Figure 1. Italy's economic recovery has been weak



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

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

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

- Developing and implementing a credible medium-term programme of deep structural reforms is key to boosting productivity, raising employment and job

quality, and reducing poverty, alongside strengthening the fiscal balance. Further progress on raising public administration efficiency, reducing administrative barriers and raising competition would help to achieve this. Tax and government spending policies should focus on raising tax compliance, boosting efficient investment programmes and ensuring social spending is sustainable, well targeted and fair across generations.

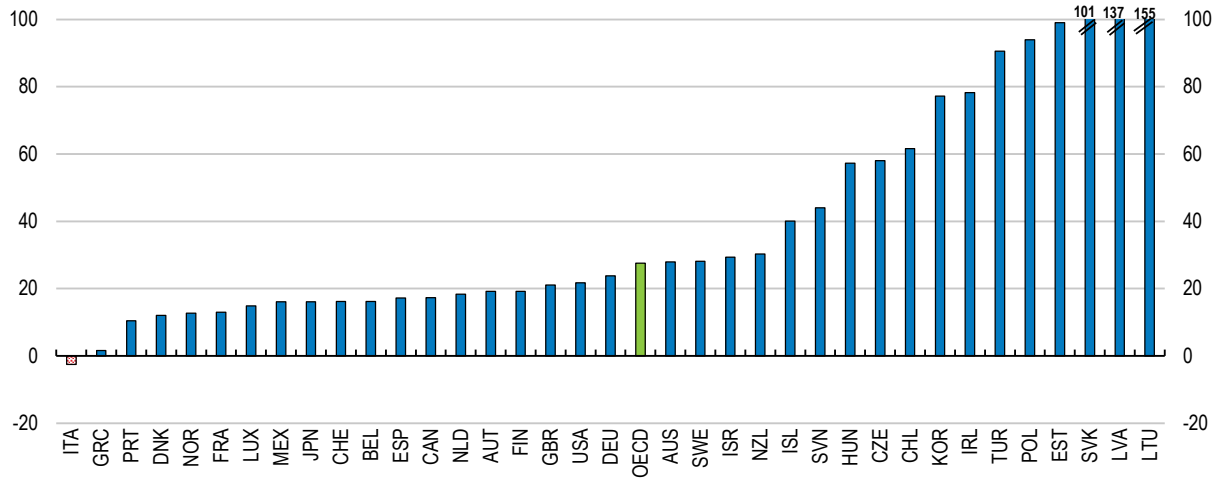
- Tackling the large social and regional divides hinges on raising employment in the formal sector and enhancing skills. Introducing in-work benefits along with a moderate guaranteed minimum income, such as the Citizens' Income, would strengthen work incentives. Drastic improvements in job-search and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

Growth has stalled amid persistent economic and social challenges

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

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

Percentage difference in real GDP per capita between 2000 and 2018



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

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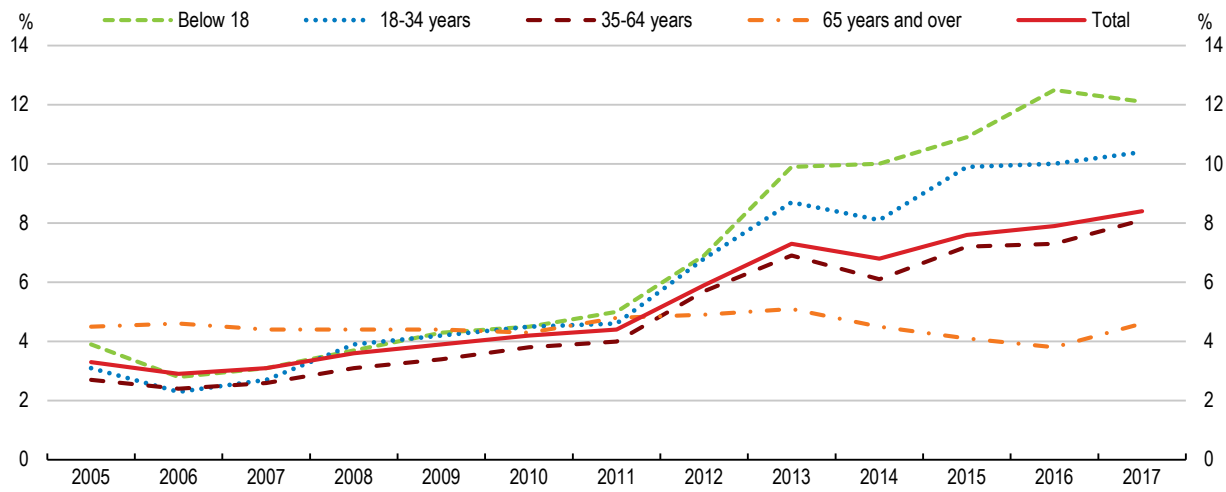
Figure 3. Poverty rates rose during the crisis and remain high, especially for the young[1]

% of age groups living in households in absolute poverty



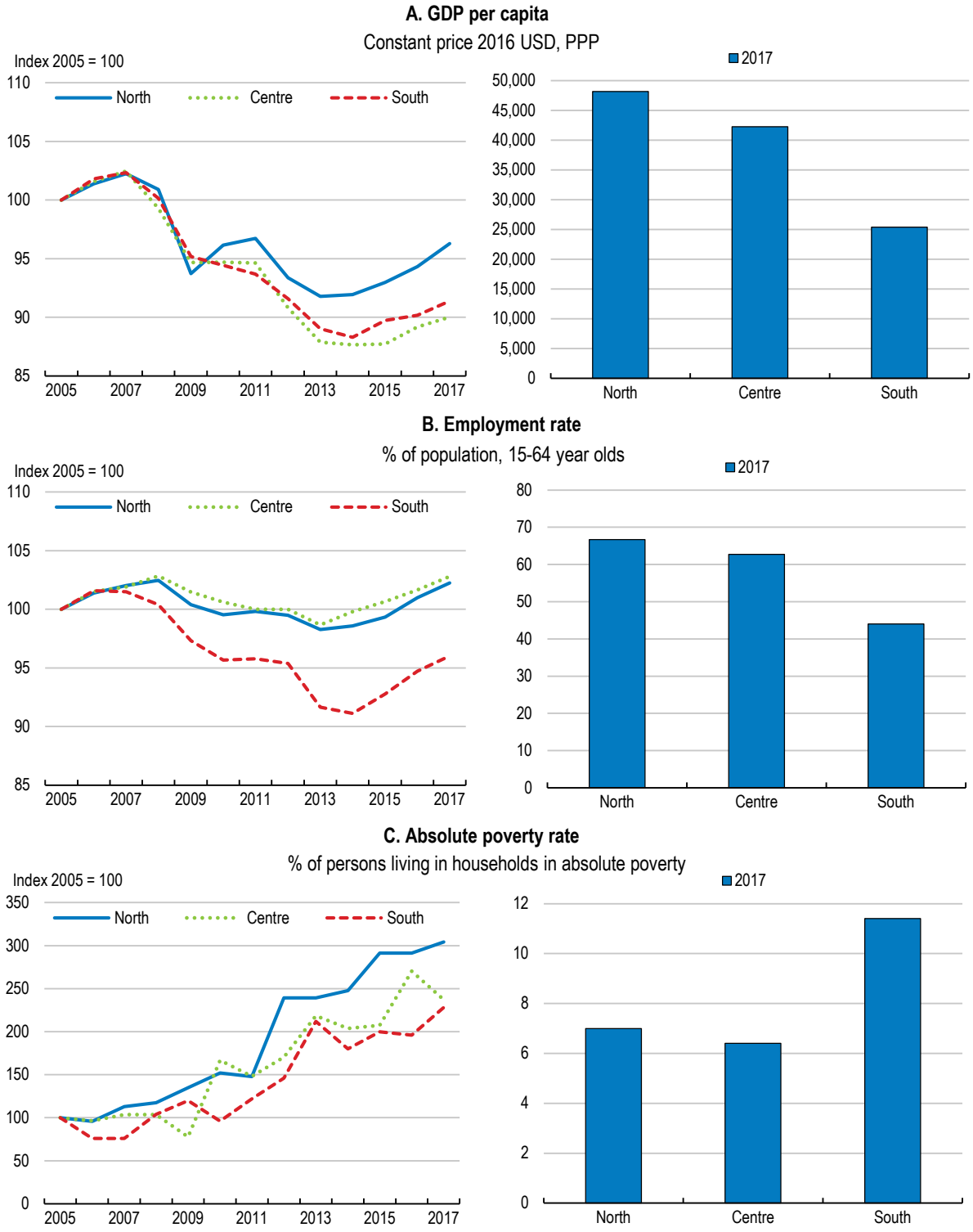
1. The ISTAT absolute poverty measure reports the share of individuals belonging to households with overall consumption expenditure below a socially necessary minimum, adjusting for the number and age of household members and price levels in the household's location.
Source: ISTAT *Poverty* database.

StatLink https://doi.org/10.1787/888933947806

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

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

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



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

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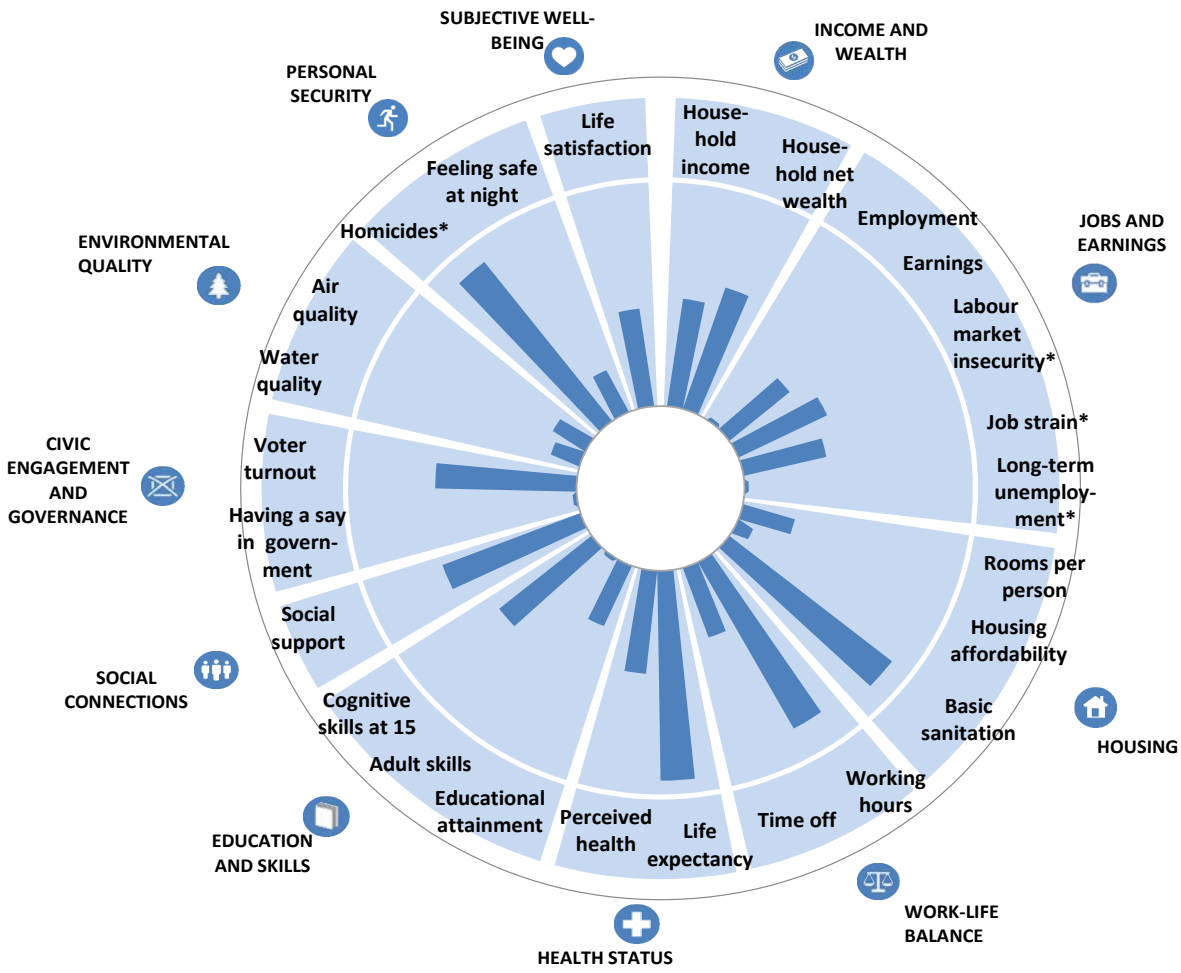
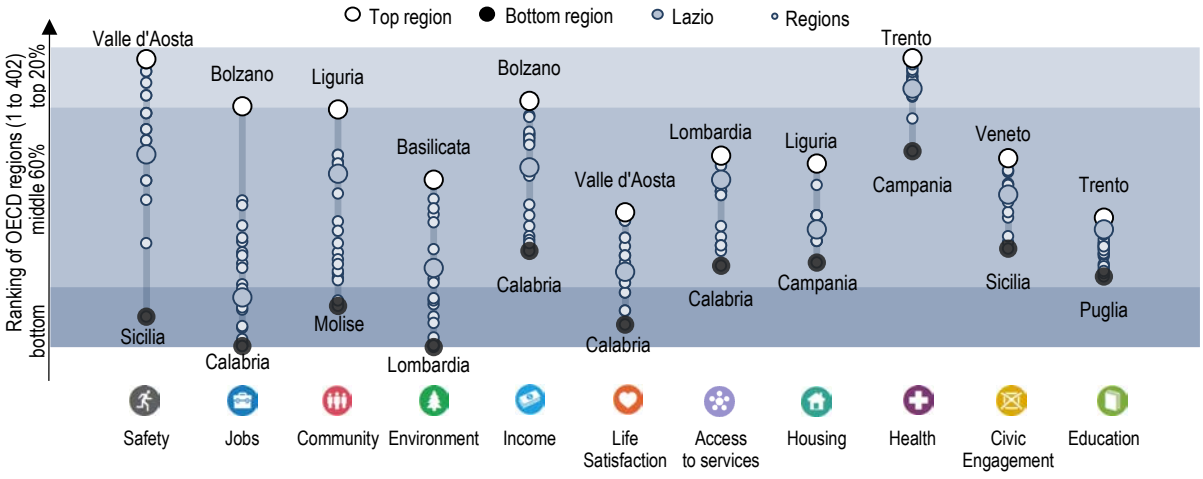
Figure 5. Italy's wellbeing continues to lag peers in many dimensions



Note: This chart shows Italy's relative strengths and weaknesses in well-being when compared with other OECD countries. For both positive and negative indicators (such as homicides, marked with an "*"), longer bars always indicate better outcomes (i.e. higher well-being), whereas shorter bars always indicate worse outcomes (i.e. lower well-being). If data are missing for any given indicator, the relevant segment of the circle is shaded in white.
Source: OECD (2017) *OECD Better Life Index*.

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



Source: OECD *Regional Well-Being* database.

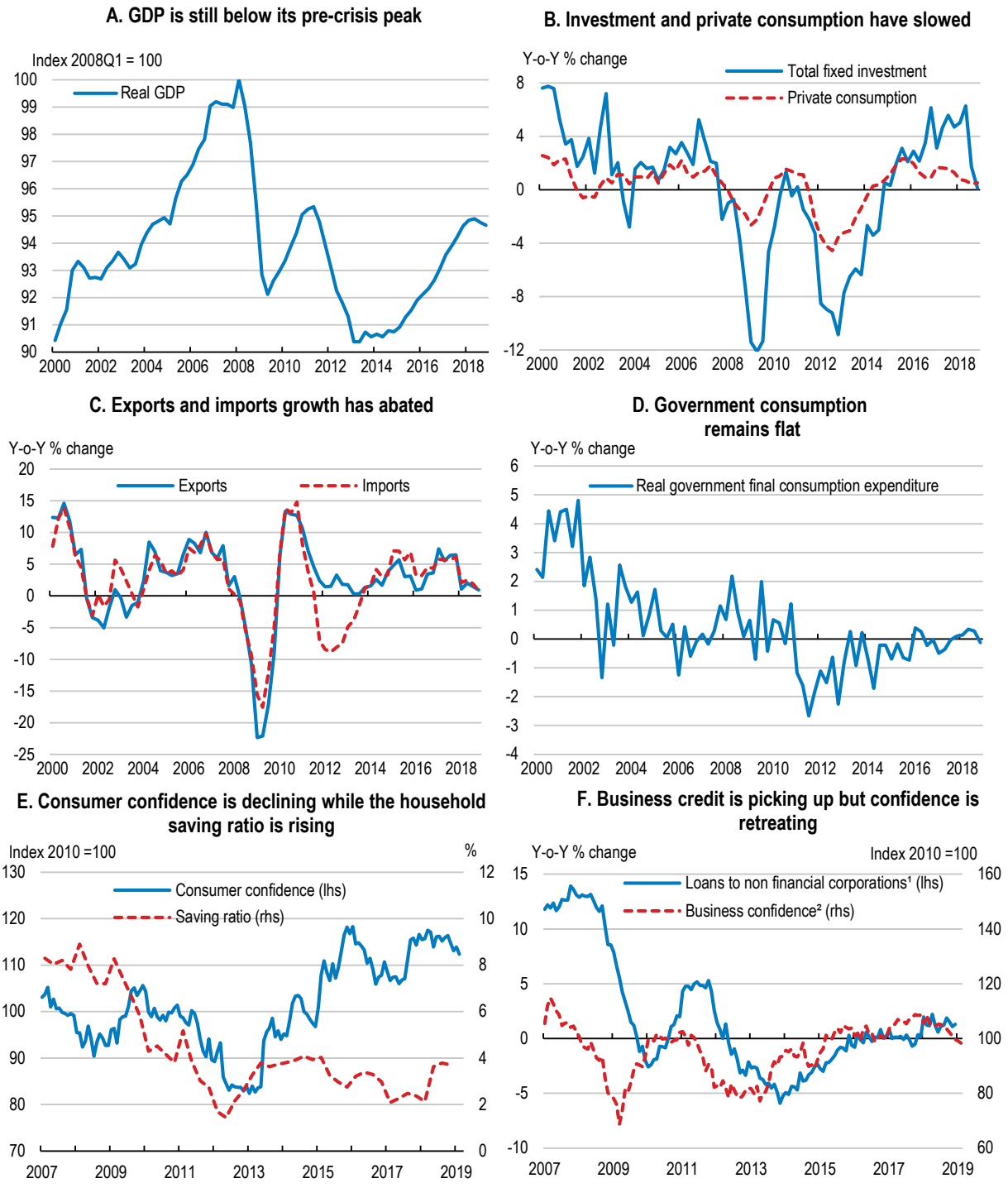
Growth has stalled

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

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

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

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



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

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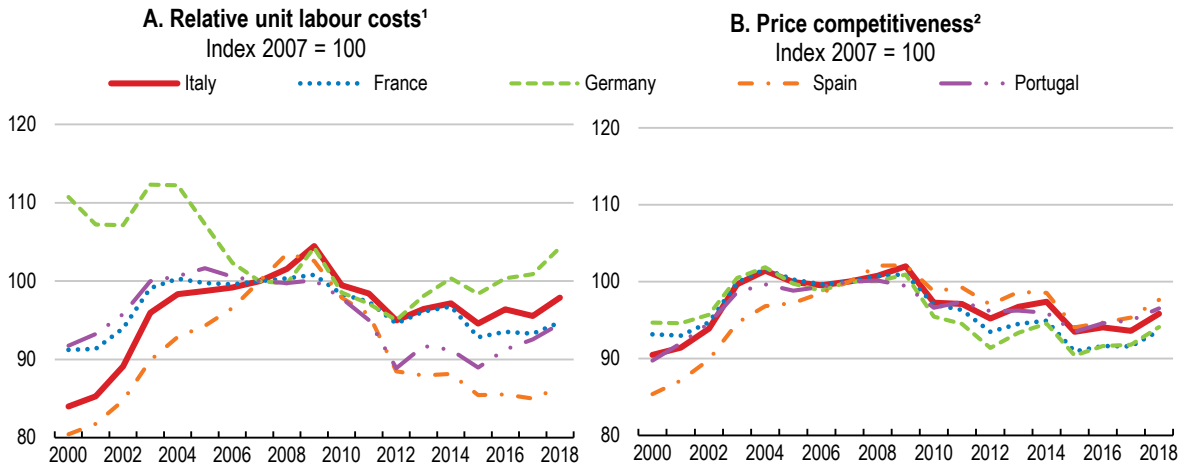
Figure 8. Relative unit labour costs and price competitiveness are flat



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

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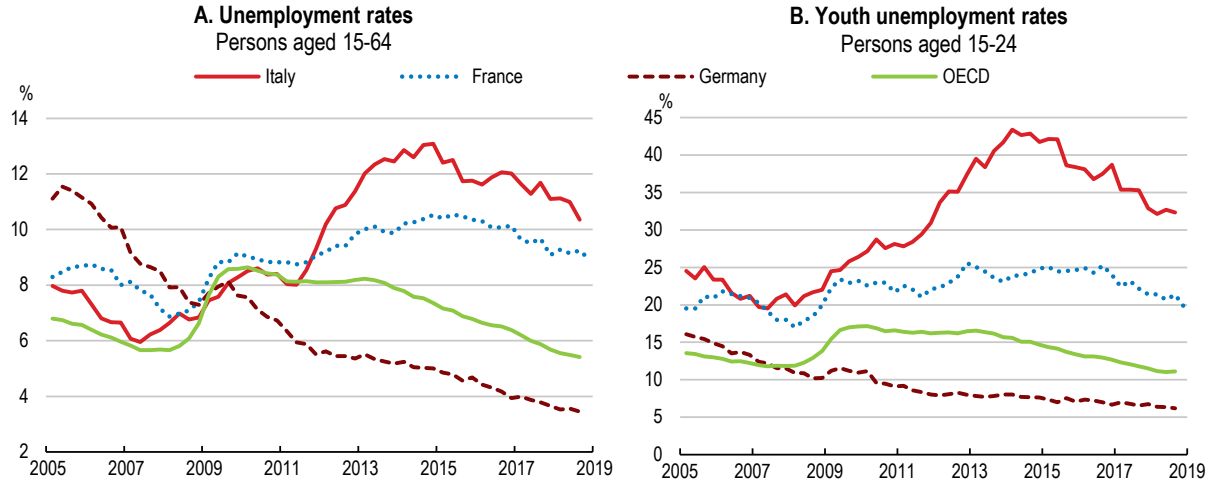
Figure 9. Unemployment has fallen but remains high, especially for the young



Source: OECD *Labour Force Statistics* database.

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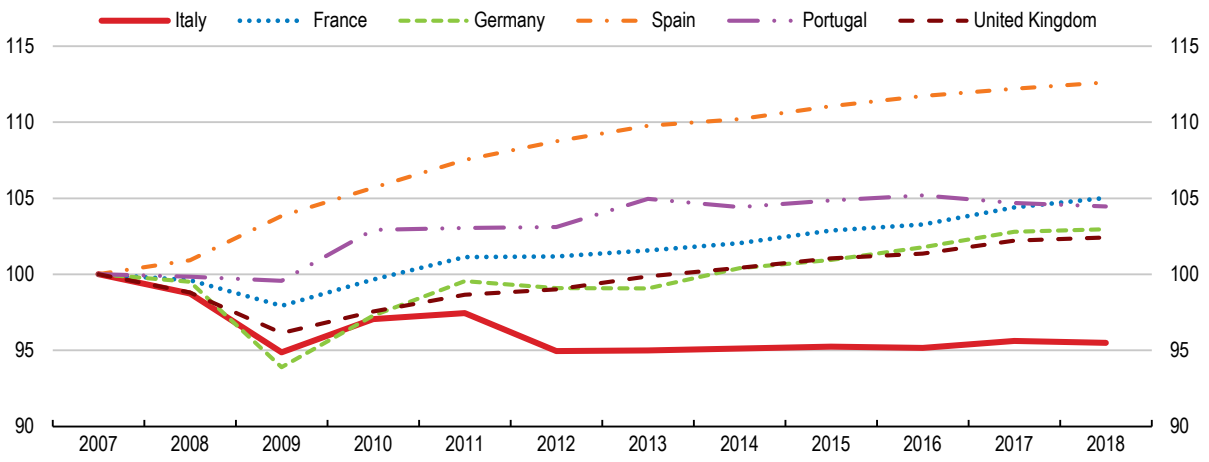
Productivity growth has remained sluggish since the early 2000s (Figure 10). An encouraging sign is that private investment has expanded since 2015, from a very low level, supported recently by fiscal incentives for private investment linked to the Industry 4.0 Plan and renewed bank lending to non-financial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

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

Index 2007 = 100



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

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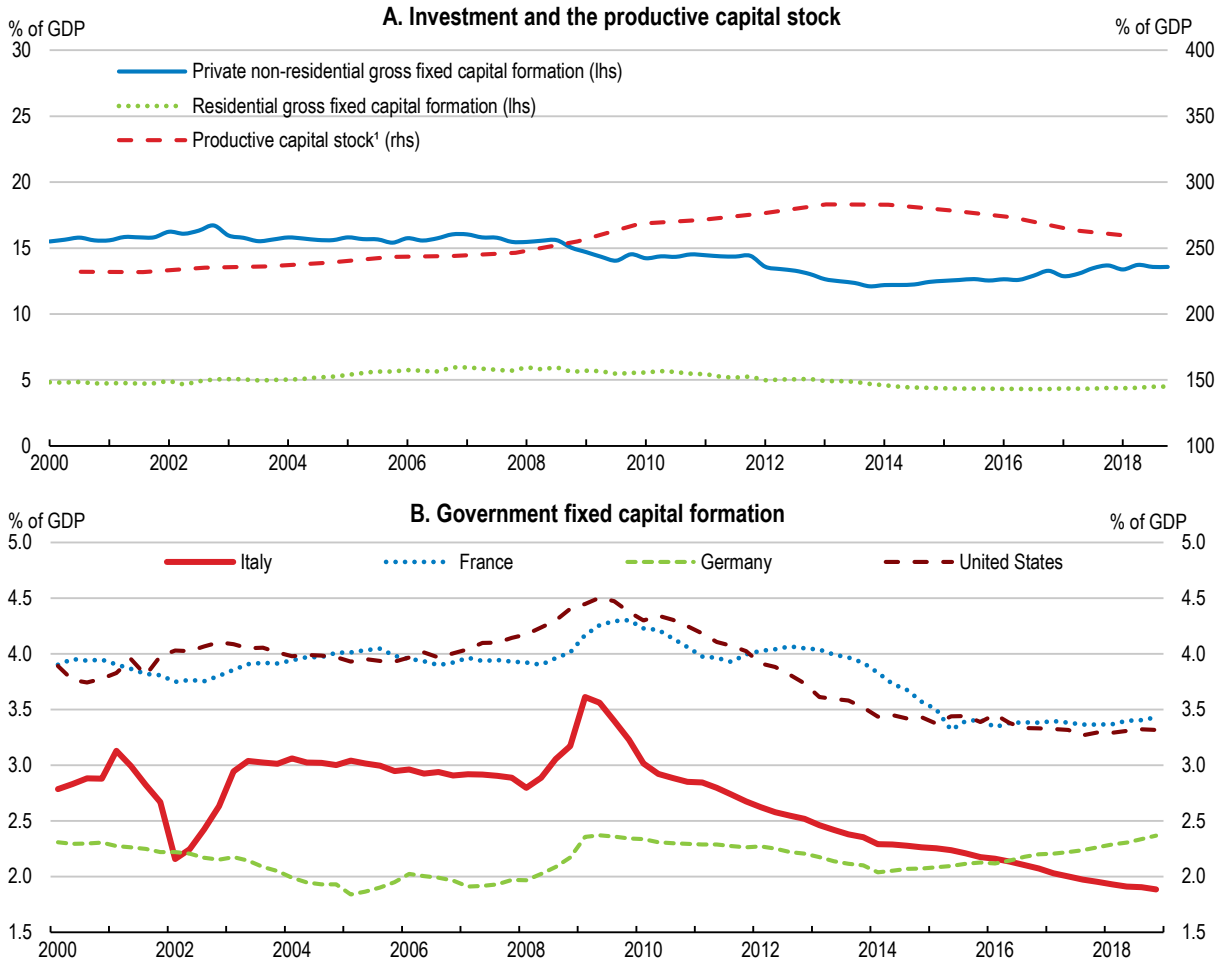
Public investment continues to fall, hampered by long-standing planning and execution delays that result in unspent funds. Public investment has dropped to less than 2% of GDP and is now at its lowest level in 25 years (Figure 11, Panel B). Since early 2015, construction activity has been hovering at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

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

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

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



1. Total economy less housing.
Source: OECD *Economic Outlook 104* database, including more recent information; and OECD *National Accounts* database.

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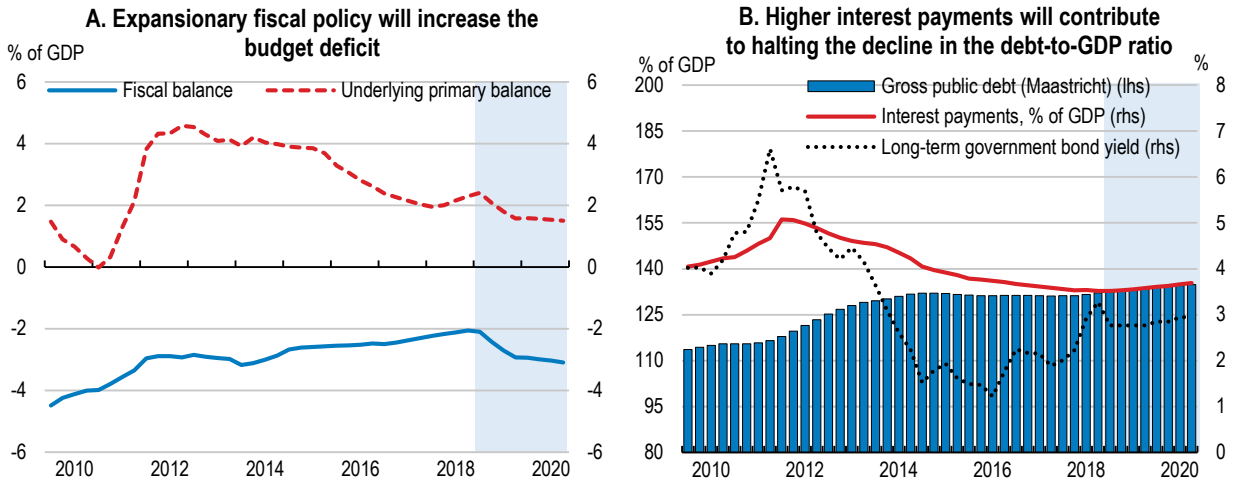
According to the projections presented in this *Survey*, the general government budget deficit will rise from 2.1% of GDP in 2018 to 2.5% in 2019 (Figure 12, Panel A). The difference with government's projections is attributable to the projected fall in real GDP in 2019 (-0.2%) and lower increase in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

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



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

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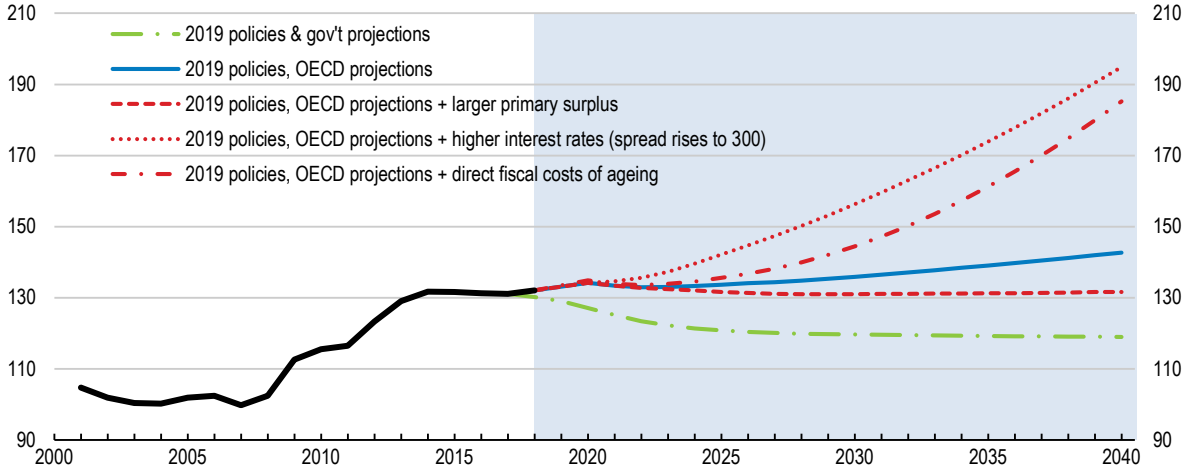
Figure 13. Under current policies the debt to GDP ratio will remain high and vulnerable to risks

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



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

Source: OECD calculations

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Table 1. Assumptions of 2019 budget debt sustainability scenarios

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

Source: OECD.

Box 1. 2019 budget: main measures

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

- Cancelling the automatic increases in VAT rates: The 2019 budget law cancels the increase in VAT rates planned for 2019, amounting to about 0.7% of GDP. At the same time, it introduces new VAT safeguard clauses for 2020 and 2021 that will raise the standard VAT rate to 25.2% in 2020 and 26.5% in 2021 (from the current 22%), unless compensatory measures are undertaken.
- Guaranteed minimum income: A guaranteed minimum income scheme (the Citizen's Income) is introduced to replace the existing programme, which was introduced in 2018 (the REI). The new guaranteed minimum income is more generous than the REI as it is expected to pay up to EUR 780 per month to singles with no income, with the benefit adjusted to take into account family composition according to an equivalence scale (like the REI). This new measure is conditional

on participating in job-search and training policies, and community jobs. The government allocated 0.3% of GDP from 2019 to 2021 for the Citizen's Income.

- New early retirement scheme: Workers aged 62 years and with 38 years of contributions will be allowed to retire with a reduced pension. This scheme is valid for three years. This measure will be partly financed with a reduction of the adjustment to inflation for pension above EUR 1 500 and a solidarity tax on high pensions. However, these two measures are expected to raise only 0.02% of GDP in 2019 and about 0.05% in 2020 and 2021. For 2019, the extra spending on the new early retirement scheme will depend on the take up rate and is expected not to exceed 0.2% of GDP in 2019 and 0.3% of GDP in 2020 and 2021. The 2019 budget also discontinue until to 2026 the link between the updates of early retirement contribution requirements and developments in life expectancy.
- Flat tax: It raises the income thresholds from EUR 45 000 to EUR 65 000 of the simplified tax regime that applies a 15% tax rate to the income of self-employed and micro-enterprises. The budget also introduces from 2020 onwards a new bracket in the simplified tax regime between EUR 65 000 and EUR 100 000 of income that will be taxed at 20%. Eligibility is based on the previous year's income. This measure will reduce tax revenues by less than 0.1% of GDP yearly in 2019-2021.
- Tax changes for businesses: The budget repeals the allowance for corporate equity (which was introduced to restore the neutrality between debt and equity financing) and the tax on entrepreneurial income (IRI) that was scheduled to enter into force in 2019 and to apply the corporate income tax rate (24%) to all business incomes irrespective of the business's legal form. The budget also lowers tax incentives linked to the Industry 4.0 plan while it increases the hyper-amortization scheme from 150 to 170% for investments up to 2.5 million euros.
- Digital services tax: 3% tax rate on revenues from online advertising, sales and data processing. The tax applies to companies with a total amount of global revenues above EUR 750 million and revenues from digital services realized in Italy above EUR 5.5 million.
- Measures to deal with tax debts. The extension of the "rottamazione cartelle" (file-shredding) measures (started by previous governments) allows the tax debtor to pay the tax debt in instalments over 5 years; fines and interest charges relating to the tax debt are written off. Other forms of tax amnesty are new and involve not only fines and interest charges but also the tax debt: "condono" writes off tax debts (including interest charges and fines) relating to motor taxes and fines, and local taxes incurred between 2000 and 2010 and up to EUR 1 000; "saldo e stralcio" writes off the tax debt (relating to personal income taxes and including social security contributions) incurred between 2000 and 2017 by paying a share (from 16% to 35% according to personal economic conditions) of the tax debt (including interest charges and fines); "liti pendenti", allows taxpayers to terminate ongoing court disputes by paying a share of the tax debt (40% if the debtor won a first instance judgment, falling to 5% when the dispute is at the final appeal and the debtor all lower instance judgments; the debtor can write off also the debt by paying 90% of it if he is waiting for the first instance judgment).

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

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

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

Given Italy's ageing demographics, health and long-term care spending needs will rise alongside pension costs. Italy has improved management of health and long-term care policies in recent years, compared with many countries, which will limit the increase in the costs of these policies to 0.6% of GDP between 2020 and 2030 (European Commission, 2018[5]). Nonetheless, if the rising costs from ageing are not offset through spending cuts or revenue measures they will threat the sustainability of the public debt (Figure 13).

The digital services tax envisaged by the 2019 budget (Box 1) has not yet been introduced as it needs implementing regulations. This type of tax follows several other countries introducing similar initiatives, and the European Parliament voting to support a similar EU-wide directive (European Parliamentary Research Service, 2018[6]). Many of the enterprises that would be subject to the digital services tax are headquartered in the United States. A G20/OECD process is developing measures that adapt existing approaches to taxing firms to the challenges of digital technologies. These technologies allow firms to undertake significant business in a country without being physically present, make intangible sources of value more important, and increase risks from aggressive tax planning (OECD, 2018[7]). Members of the G-20/OECD process are committed to reaching a consensus-based, long-term solution in 2020, and have not reached a consensus about the need or merit of interim measures (OECD, 2019[8]).

Past recommendations on fiscal issues

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

Growth will remain weak in the next two years

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

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

Table 2. Macroeconomic indicators and projections
Annual percentage change, volume (2010 prices)

	2015 Current prices (EUR billion)	2016	2017	2018	2019	2020
Gross domestic product (GDP)	**1 651**	**1.2**	**1.7**	**0.8**	**-0.2**	**0.5**
Private consumption	1 007	1.3	1.5	0.6	0.5	0.5
Government consumption	312	0.1	-0.2	0.2	0.4	0.6
Gross fixed capital formation	279	3.7	4.5	3.2	-0.2	1.1
Housing	72	1.5	3.1	3.4	1.0	0.9
Final domestic demand	1 598	1.5	1.7	1.0	0.3	0.6
Stockbuilding[1]	5	0.2	-0.4	-0.1	-0.7	0.0
Total domestic demand	1 603	1.6	1.3	0.9	-0.4	0.6
Exports of goods and services	493	2.3	6.4	1.4	2.7	2.3
Imports of goods and services	446	3.8	5.8	1.8	2.1	2.7
Net exports[1]	48	-0.4	0.4	-0.1	0.2	-0.1
Other indicators (growth rates, unless specified)						
Potential GDP	. .	0.1	0.2	0.3	0.3	0.4
Output gap[2]	. .	-3.4	-2.0	-1.5	-2.0	-1.9
Employment	. .	1.3	1.2	0.9	-0.2	0.2
Unemployment rate	. .	11.7	11.3	10.6	12.0	12.1
GDP deflator	. .	1.2	0.4	0.8	0.9	1.0
Consumer price index (harmonised)	. .	-0.1	1.3	1.2	0.9	0.8
Core consumer prices (harmonised)	. .	0.5	0.8	0.6	0.3	0.8
Household saving ratio, net[3]	. .	3.2	2.3	3.3	3.8	4.2
Trade balance[4]	. .	3.4	3.2	2.8	. .	. .
Current account balance[4]	. .	2.5	2.8	2.6	2.7	2.4
General government fiscal balance4	. .	-2.5	-2.4	-2.1	-2.5	-3.0
Underlying general government fiscal balance[2]	. .	-0.7	-1.4	-1.4	-1.5	-2.0
Underlying government primary fiscal balance[2]	. .	2.9	2.2	2.1	2.0	1.5
General government gross debt (Maastricht) [4]	. .	131.3	131.1	132.1	133.8	134.8
General government net debt[4]	. .	127.4	125.0	125.2	126.8	127.9
Three-month money market rate, average	. .	-0.3	-0.3	-0.3	-0.2	0.2
Ten-year government bond yield, average	. .	1.5	2.1	2.6	2.8	2.9

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

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

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

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

Source: OECD.

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

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

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

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

The progress in reducing NPLs is attributable to effective policy actions. The state-sponsored Guarantee on Securitization of Bank Non Performing Loans introduced in 2016 (OECD, 2017[9]) – which thus far has covered EUR 42 billion of securitised NPLs and has cost nothing to the Treasury – has been instrumental in developing a growing market for non-performing loans. In 2018 total NPL transactions in the secondary market were expected to be four times above those in 2017 and 20 times more than in 2013 (PWC, 2018[10]). Supervisors have undertaken robust and intrusive actions to accelerate NPL disposals. Significant banks submitted NPL-reduction plans and in 2018 banks' disposals of NPLs were in line with those plans. Going forward, NPLs are expected to decline further. In March 2018, the eleven significant banks submitted updated NPL-reduction plans for the 2018-2020 period. At the end of 2018, the less significant banks with high NPLs also submitted plans according to the guidelines issued by the Bank of Italy in January 2018 to reduce NPLs (Bank of Italy, 2018[3]).

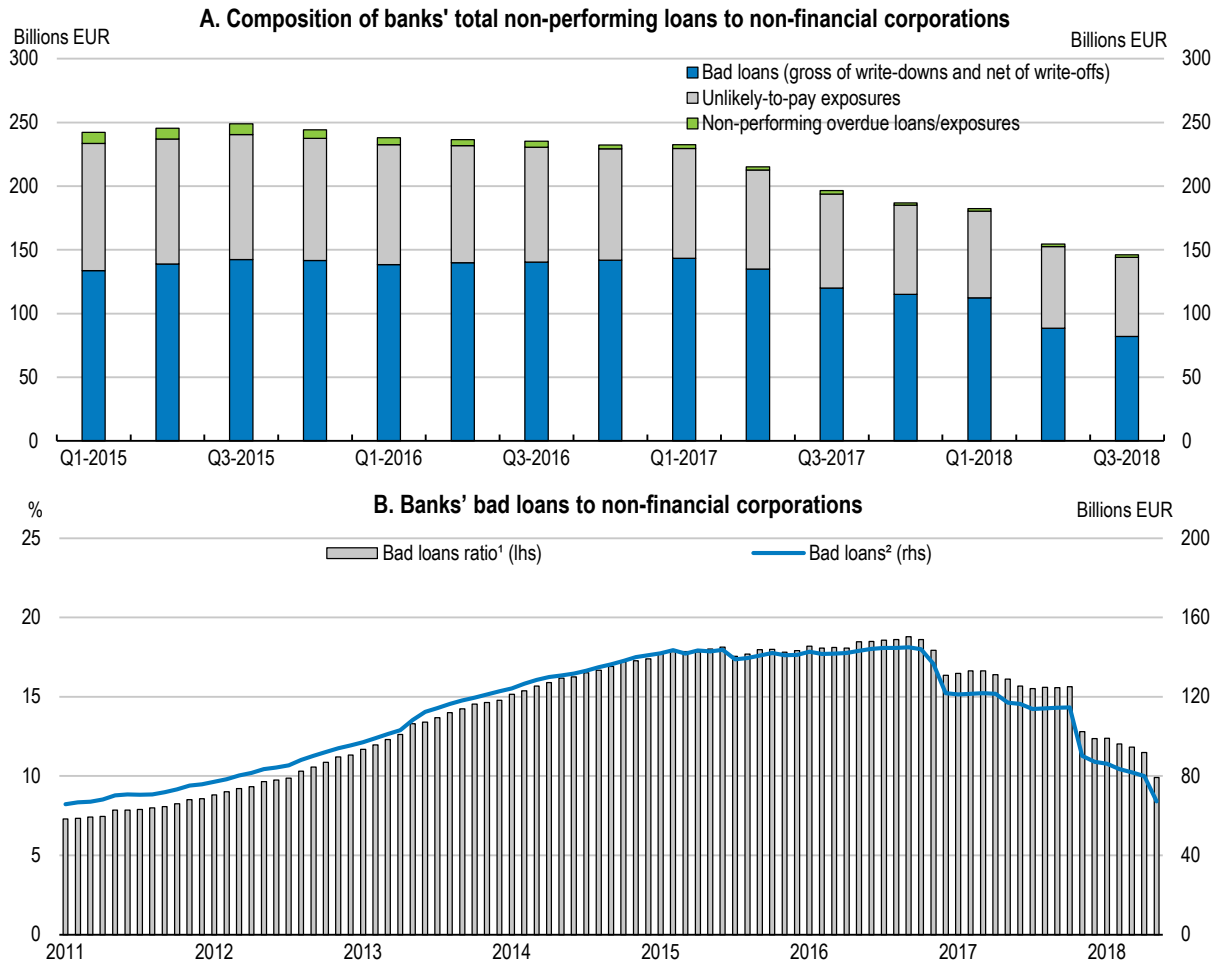
The rise in Italian government bond yields in 2018 has so far had only a limited effect on bank funding costs, though banks credit default swap (CDS) and banks' bond yields have risen substantially and are now above those of European peers (Bank of Italy, 2018[3]). Banks have been increasingly relying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

Though banks' funding costs remain low for the time being, there is the risk they may rise considerably. The Italian government 10-year bond spread spiked in 2018. Though it receded from the peak in October 2018, it is still about 130 basis points higher than in April 2018. Estimates relating to the 2010-2011 period suggest that a 100 basis points increase in the 10-year government bonds' spread could raise interest rates on fixed-term deposits and repos by about 40 basis points and yields on new bond issues by around 100 basis

points (Bank of Italy, 2018[3]). Over the past two years, Italian banks have issued markedly fewer bonds, especially to households. The share of bonds in total bank funding dropped to just above 10% in late 2018 from 15% in late 2016. This share is lower than that of German and French banks (13.7% and 16.4% respectively) (Bank of Italy, 2018[3]). Italian banks' recourse to international bond markets is especially limited.

Moreover, the end of the TLTRO II scheduled for 2020-21 and the introduction of the minimum requirement for own funds and eligible liabilities for bail in (MREL) will put additional upward pressures on banks' funding costs. The introduction of the MREL might compel banks to issue large amounts of MREL-eligible bonds at the same time. Simulations by the EBA and ECB suggest that the cost of meeting MREL requirements will be limited for the whole banking sector but it could be high for smaller banks (ECB, 2017[11]; EBA, 2016[12]). In this context, the capacity of banks to issue large amount of MREL-eligible securities to investors other than households, while containing a general increase in funding costs, may depend on improving banks' ability to sell these securities to international investors.

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



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

StatLink https://doi.org/10.1787/888933947977

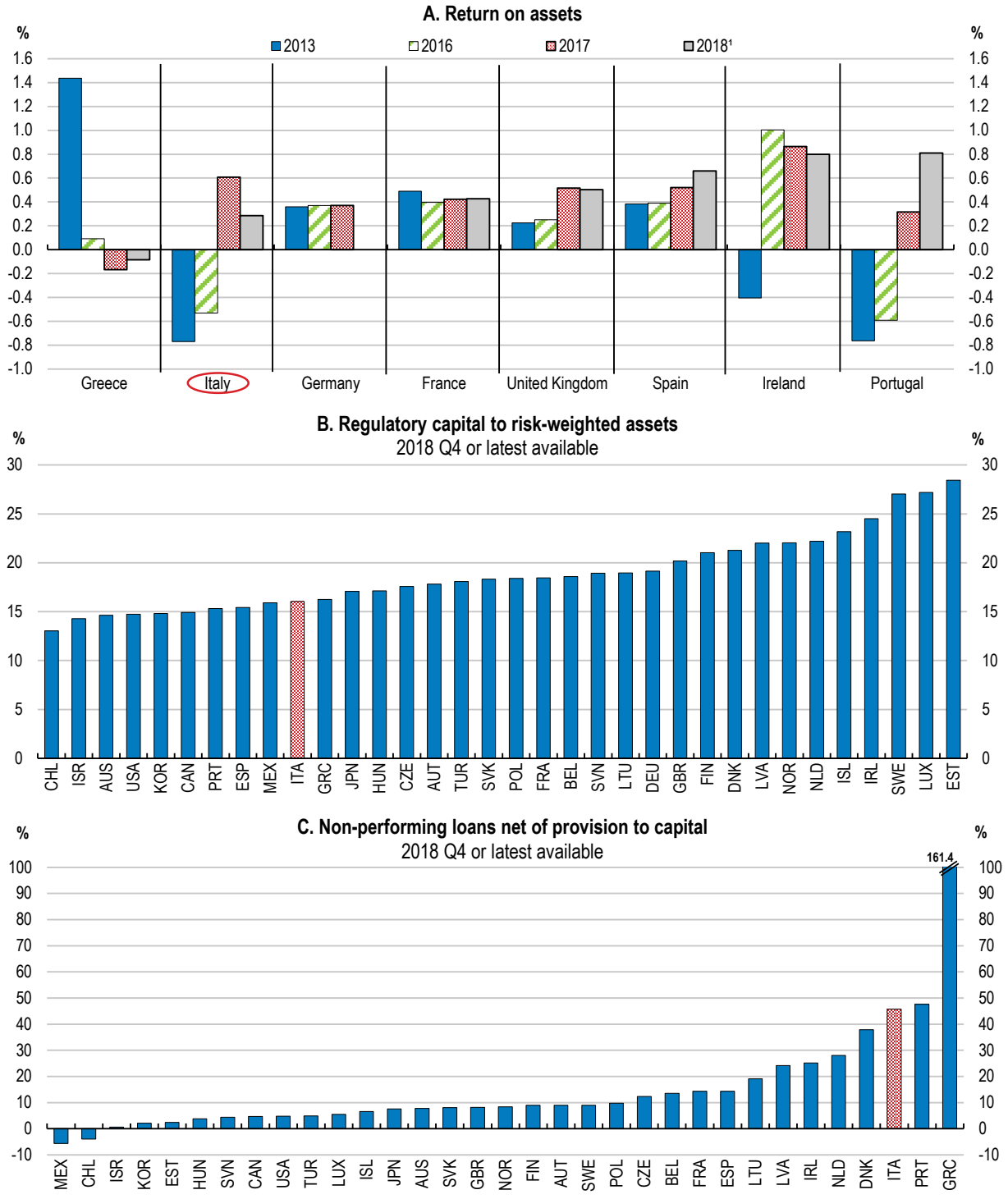
Italian banks' return on asset has markedly improved and in 2017 it was above peers in Europe, though it weakened in 2018 (Figure 15, Panel A). Banks' capital ratios have increased and are well above regulatory thresholds (Figure 15, Panel B), though the common equity tier 1 ratio of Italy's banking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

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

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

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

Figure 15. Banks' health has improved but risks remain



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

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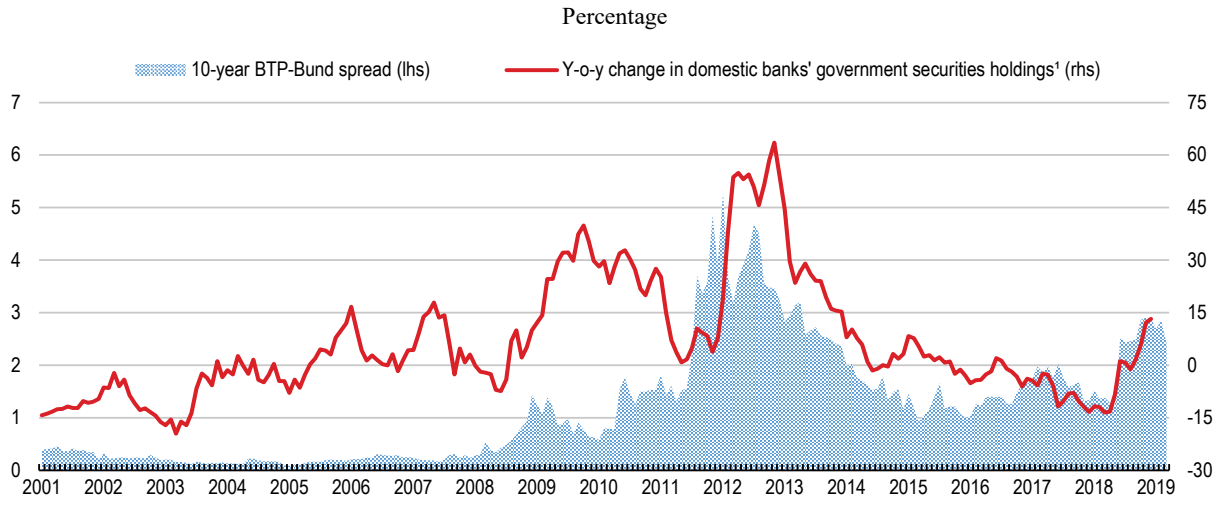
While the larger banks appear sufficiently robust to withstand significant pressures from higher government bond yields, it may be more difficult for some smaller banks as government bonds account for a larger share of their assets. As at June 2018, the share in total assets of Italian sovereign bonds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

In the context of banks' low equity prices, if government bond spreads were to rise durably, restoring capital ratios through recapitalisation operations would be expensive. This could lead to a feedback mechanism as banks' losses and higher funding costs, engendered by higher government bond yields, might induce banks to reduce the supply of credit and increase lending rates, thus further slowing economic activity and undermining government revenues. Bofondi, Carpinelli and Sette (2017[14]) show that a similar process was at work during the 2011 European sovereign crisis, as Italian banks reduced credit supply – mostly because of an increase in funding costs – leading to a shortage of bank credit. Such a process, if protracted, could weaken the economy and lower confidence in the banking system, imperilling financial stability.

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



1. Data refer to the "Deposit-taking corporations, except the central bank" sector (S122, as defined by the System of National Accounts 2008) and the "Cassa Depositi e Prestiti".
Source: OECD calculations based on Thomson Reuters and Bank of Italy.

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Past recommendations on the financial sector

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

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

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

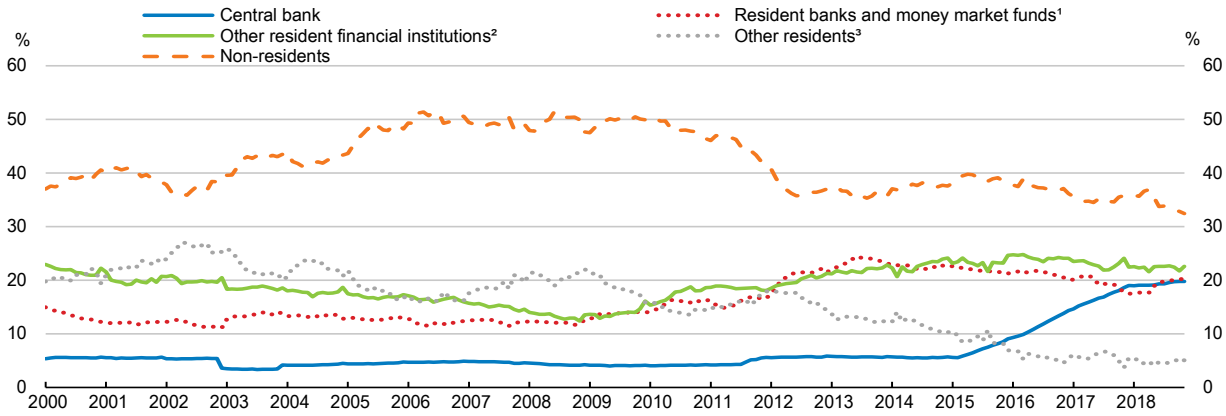
High government debt is a source of risks and limits fiscal policy choices

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

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

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

Share of total general government debt securities



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

StatLink https://doi.org/10.1787/888933948034

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

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

All these factors underline that fiscal policy is vulnerable to changes in interest rates limiting fiscal policy choices to boost growth and pursue social goals. Without sustainable fiscal policy, the room for the public sector to enhance infrastructure, provide benefits and help the poor will inevitably narrow. A medium-term plan to reduce the debt-to-GDP ratio

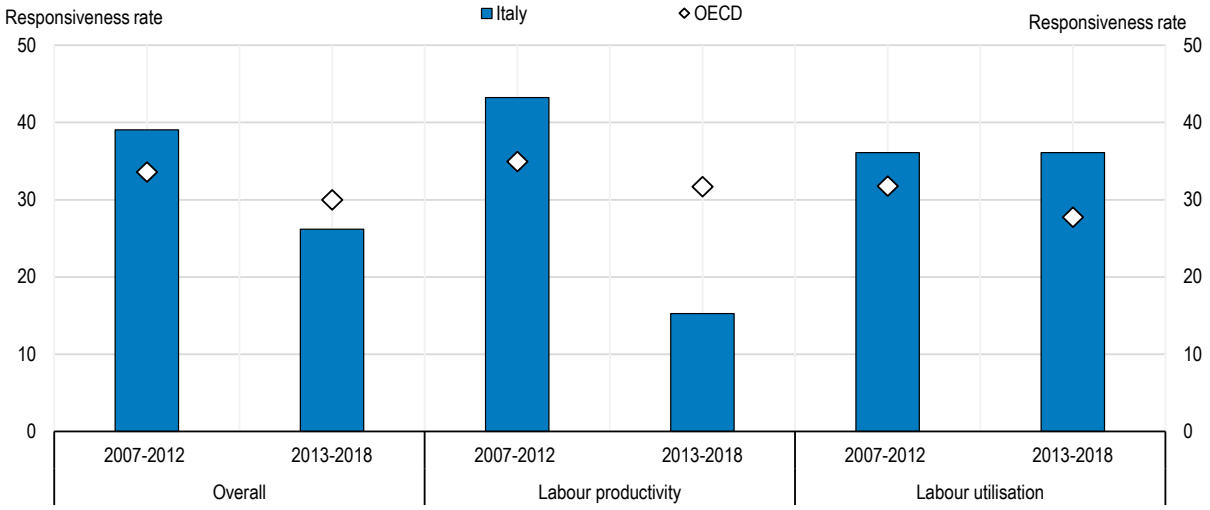
is a prerequisite to improve fiscal credibility and reduce the large risk premium on government borrowing. This should be based on the following:

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

Structural reforms are needed to strengthen social inclusion and boost growth

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

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



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

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

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

The current government has expressed its intention to continue the process of reforming the public administration that previous governments have started. This is welcome, but at the same time, the government should not underestimate the challenges and degree of commitment needed to achieve results. As underlined by a recent white book on public administration reforms that has collected suggestions from a wide range of experts and civil society (ForumPA, 2018[15]), public administration reforms should enhance transparency and accountability and focus on the following:

- Reducing the number of laws and regulations and more extensive use of single codes and manuals, accompanied by more reliance on clear outcomes and targets rather than procedural rules.

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

The justice system plays a crucial role in upholding the rule of law and enhancing mutual trust. Reforms have been focussing on the use of digital technologies, including the e-trial (allowing parties to submit documents in electronic forms), increasing court specialisation, improving administrative procedures to increase courts' efficiency and addressing staffing shortages. The Criminal Procedural Code was reformed in 2017. Following these reforms, which are still ongoing, Italy's justice system has reduced the sizeable backlog of unresolved administrative and civil cases. The time needed to resolve litigious civil and commercial cases has been declining since 2014, though it is still among the longest in the EU. Cases reaching second and third instances courts are exceptionally long. While public spending on the justice system is near the European average, the number of judges is comparatively low and residents have less confidence in the justice system than in most EU countries (European Commission, 2018[16]).

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

Public administration reforms must go hand-in-hand with continued efforts to fight corruption. The legislative framework on anti-corruption has evolved remarkably since the systematic intervention in 2012, which established a path for reforms that are still ongoing. The Anti-corruption Authority (ANAC), which is independent from the government, was established in 2014. Since then, it has gradually gained a prominent role by offering advice to central and sub-national governments and agencies on adopting and strengthening corruption-preventing measures, managing the electronic platform to collect information from whistle-blowers and issuing guidelines and regulations on public procurement contracts. ANAC can apply administrative sanctions to public officials not complying with the obligation of adopting anti-corruption plans or codes of conduct. Through its experience with hosting the Expo 2015, Italy has developed with the OECD a model to manage large and ad hoc procurements while minimising corruption risks (United Nations, 2009[17]). Besides having significant powers regarding transparency, integrity and anti-corruption plans, ANAC is responsible for issuing the implementing regulation of the 2016 public procurement code and overseeing public procurement and contracts

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

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

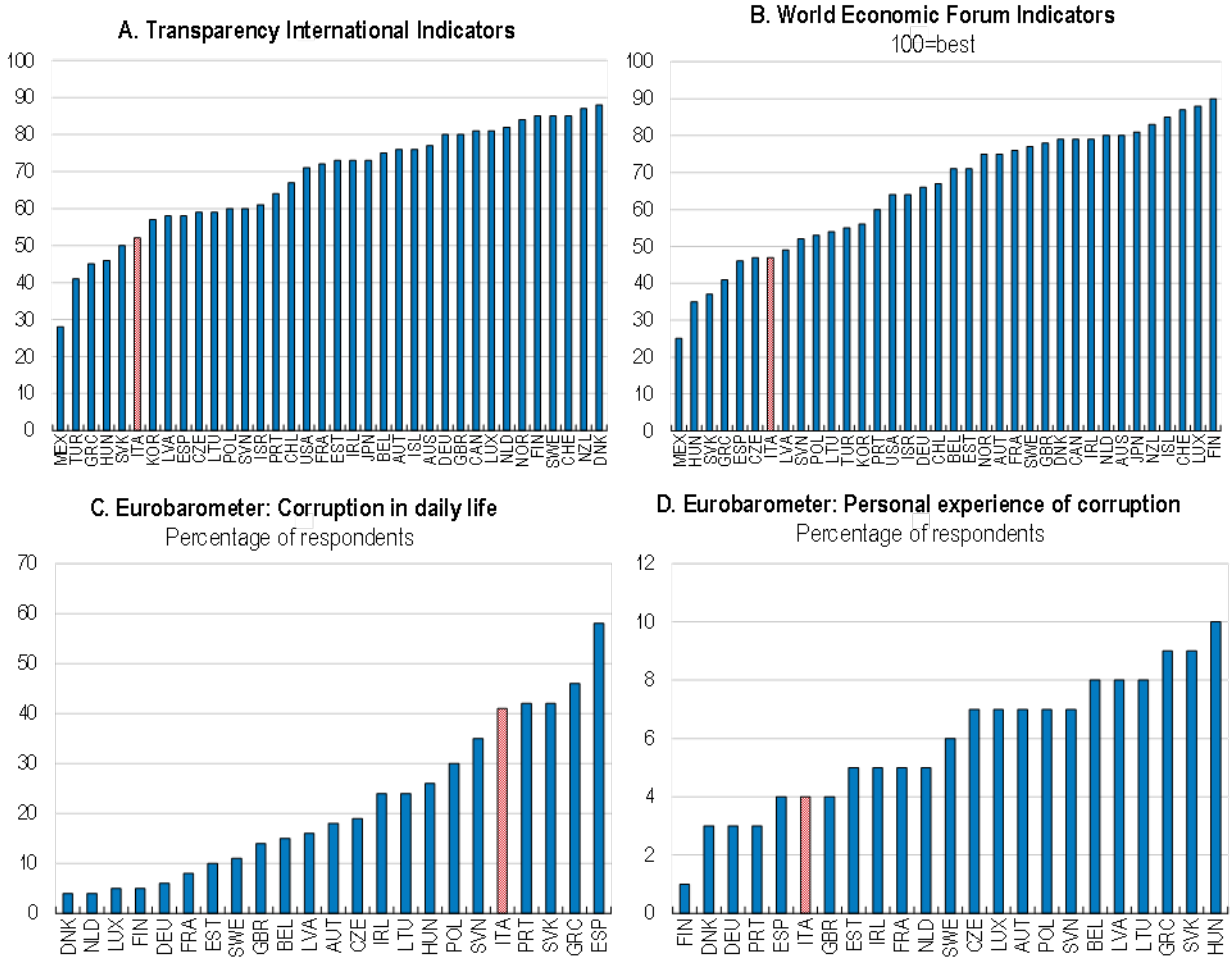
The reforms undertaken in the past ten years to fight corruption and improve public procurement go in the right direction and show the seriousness and determination of Italy's successive governments on this issue. Despite this, indexes of perceived corruption are still generally high compared to other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

Measuring corruption, and more generally the efficiency of the public administration, on a more objective basis is key to designing and implementing effective anti-corruption measures and enhance trust in the government. To this end, Italy is actively participating in different international initiatives, at the G20, UN and the OECD, aiming at developing indicators to measure corruption and progress in reducing it more objectively. The OECD has been working on open data, quantitative analysis and the use of data analytics to combat fraud, waste and abuse, and to promote public integrity and improved government performance (High-Level Advisory Group, 2017[18]).

Past recommendations on public sector efficiency

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

Figure 19. Indicators of perception of corruption



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

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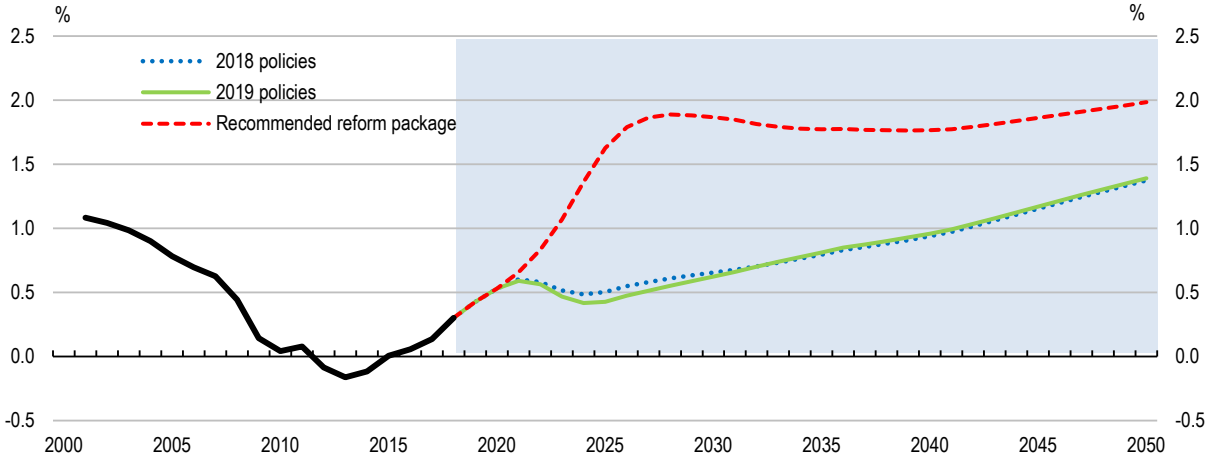
Figure 20. Reforms to raise participation and improve the business climate would lift Italy's growth prospects

Trend annual real GDP growth rate, alternative policy scenarios



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

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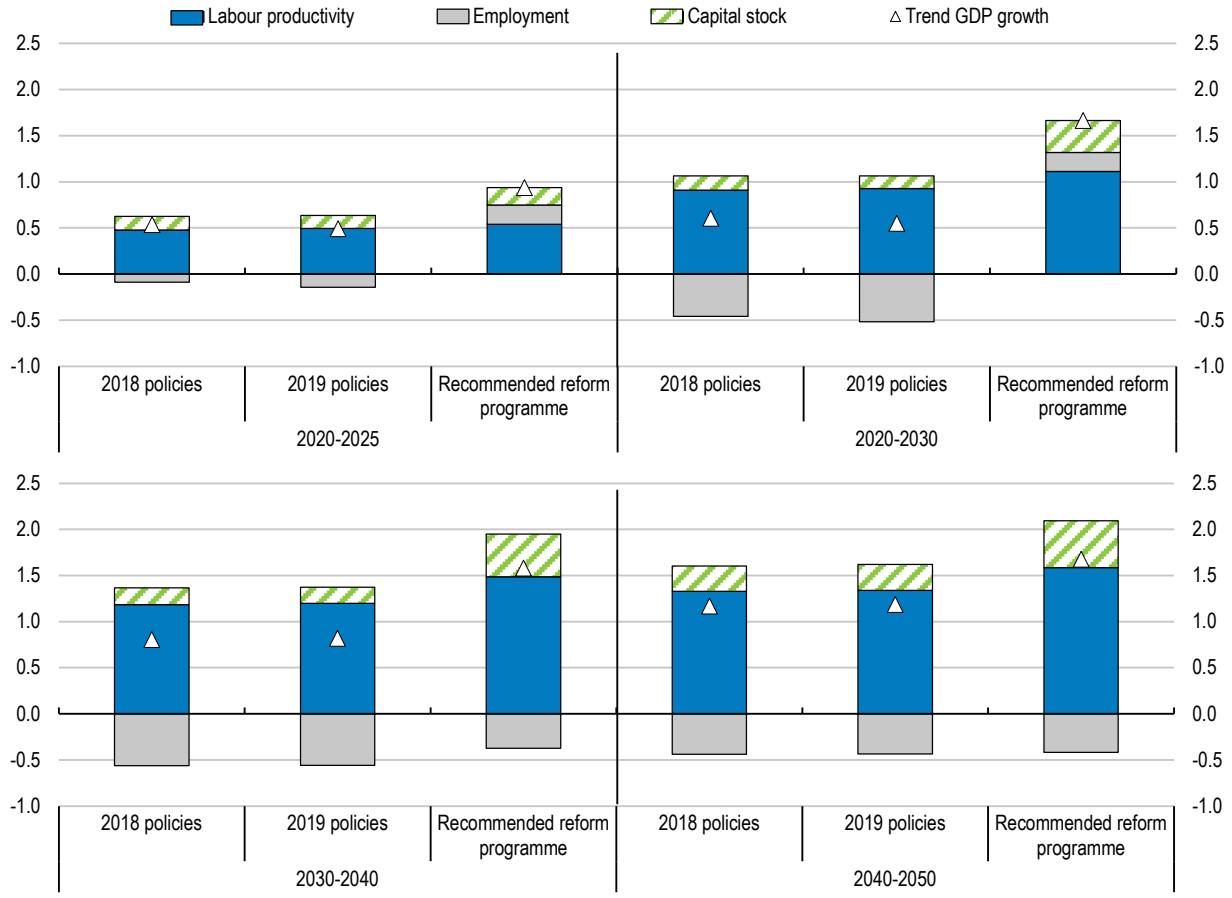
Table 4. Effects of reforms on real GDP growth

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

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

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

GDP growth, annual average and contributions



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

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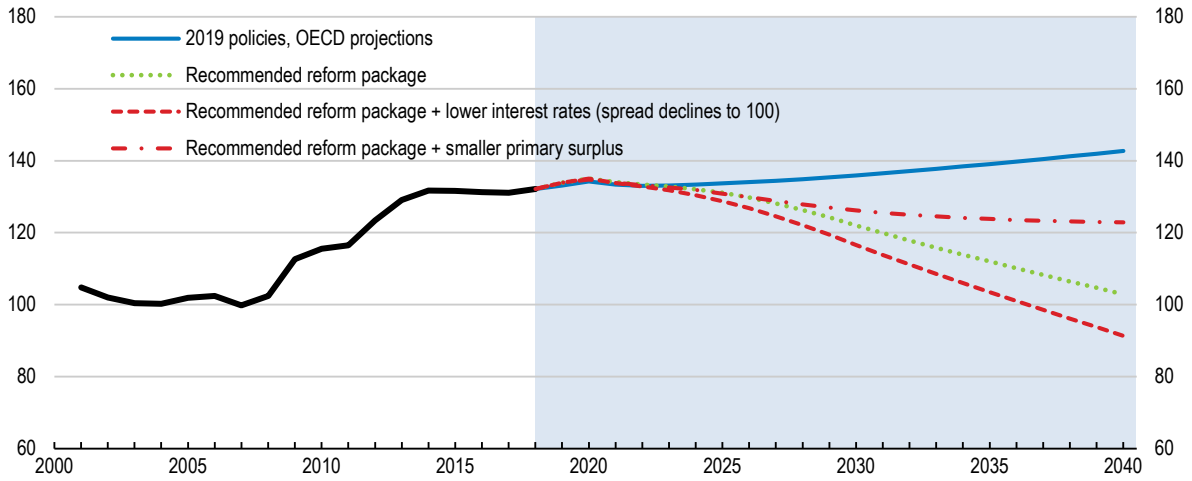
Box 2. Italy's Digital Transformation Team

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

Figure 22. The recommended reform package would improve debt sustainability

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



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

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Table 5. Assumptions of recommended reform package debt sustainability scenarios

		2020	2025	2030	2035	2040
2019 policies, OECD projections						
Real GDP growth	%, annual	0.5	0.5	0.6	0.8	1.0
Primary fiscal balance	% GDP	0.6	1.6	2.0	2.0	2.0
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
Recommended reform package						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	3.3	3.3	3.3
GDP deflator growth	%, annual	1.4	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150
Recommended reform package + lower interest rates (spread declines to 100)						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	3.3	3.3	3.3
GDP deflator growth	%, annual	1.0	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	3.5	4.1	4.3	4.5
Spread between effective interest rate and risk-free rate	bps	219	100	100	100	100
Recommended reform package + smaller primary surplus						
Real GDP growth	%, annual	0.5	1.3	1.7	1.6	1.6
Primary fiscal balance	% GDP	0.6	1.8	1.8	1.8	1.8
GDP deflator growth	%, annual	1.4	2.0	2.0	2.0	2.0
Implicit effective nominal interest rate	%	2.9	4.0	4.6	4.8	5.0
Spread between effective interest rate and risk-free rate	bps	219	150	150	150	150

Source: OECD.

Box 3. Quantifying the fiscal impact of structural reforms

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

Table 6. Illustrative fiscal impact of recommended reform package

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

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

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

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

Protecting the environment

Improving well-being for current and future generations depends on higher growth but also on better protecting the environment and limiting global warming in line with the Paris Agreement's targets. In Italy, CO_2 emissions per unit of GDP are below the OECD average (Figure 23, Panel A). The energy intensity of the economy has fallen little and the expansion of renewable energy production has stalled due mostly to large drop in hydroelectric energy production because of scarce rainfall. Nevertheless, Italy records a better performance in terms of both energy intensity and renewable energy than the OECD average (Figure 21, Panels B and C). According to recent projections (European Environment Agency, 2018[19]), Italy is on track to achieve the national climate and energy targets for 2020. However, according to the European Environment Agency (2017[20]) on current policies Italy will not reach its target to reduce its greenhouse-gas emissions outside the EU Emissions Trading System (ETS) by 33% relative to 2005 levels.

The share of the population exposed to very high levels of small particle emissions is higher in Italy than the OECD average (Figure 23). Mortality from outdoor particulate matter is unusually high among OECD countries and has risen markedly since 2015 (Roy and Braathen, 2017[21]). Urban sprawl around Italian cities has contributed to an increase in built-up areas (discussed in the thematic chapter). Population density in Italian metropolitan areas has diminished and fragmentation of urban settlements has increased (OECD, 2018[22]). Urban sprawl fosters car dependency and traffic congestion, raising pollution, energy consumption and CO_2 emissions (OECD, 2018[22]). It also raises the cost of deploying electricity and water infrastructure as well as public transport.

Water extraction, mostly in agriculture, amounts to 45% of total renewable water resources, implying a high level of water stress. The latest Environmental Performance Review (OECD, 2013[23]) recommends formulating a strategic vision for the water sector and streamlining institutional arrangements for managing river basins. Though waste management has improved, waste collection is at times irregular even in some large cities and illegal dumping is a serious health concern in some areas.

Much municipal waste is recycled, helping to avoid landfill and its risks for air and water pollution. However, the rate of recycled waste varies greatly among regions as practices and capacity differ. In 2016, northern regions recycled about 64% of their urban waste against 49% for central regions and 38% for southern ones. Good policies can make a difference. For instance, Sardinia increased the share of recycled urban waste from 28% in 2007 to 60% in 2016 and Apulia from 9% to 34% (ISPRA, 2017[24]). As underlined by the Anti-corruption Authority (ANAC, 2018[25]), the fragmentation of responsibilities over waste management among regions, provinces and municipalities leads to weak coordination and lack of synergies, heightening corruption risks. ANAC (2018[25]) highlighted several critical aspects of waste management. These include insufficient waste management facilities in many regions, which results in transfers of waste among regions

and waste collection problems; long delays in issuing and implementing waste management regional plans; and, awarding of waste management service contracts inconsistently across regions and in ways that often contravene laws. The government could develop a national plan for waste collection that, while respecting sub-national governments' responsibilities in this area, improves synergies and complementarities. The policies and operations of sub-national governments that repeatedly fail to reach targets for waste collection and recycling should undergo a review and restructuring process aiming at adopting best practices and enhancing accountability at the local level.

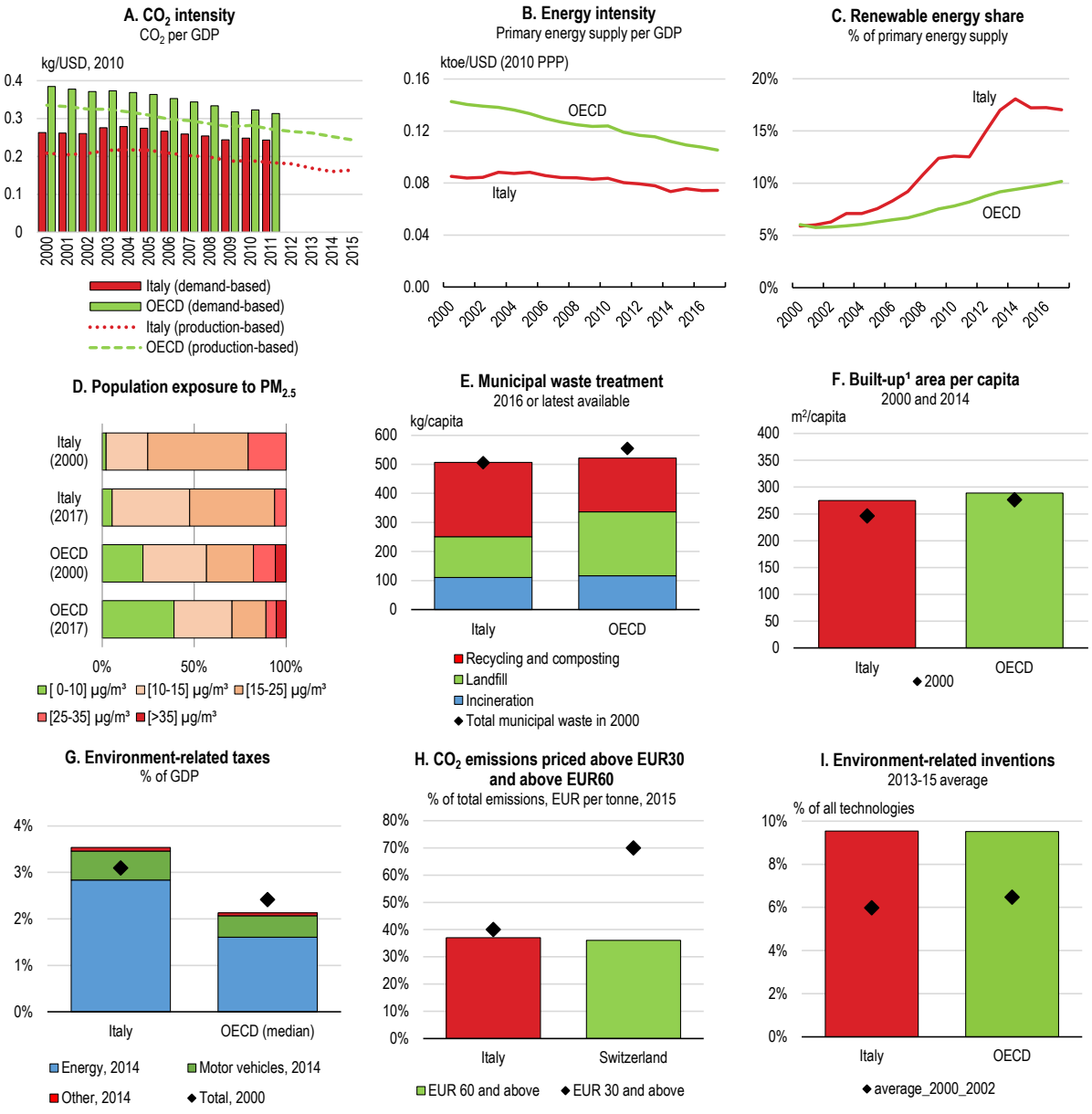
Environmental tax revenues are substantial relative to other OECD countries, reflecting high taxes on fossil fuel use in transport and residential use. However, the tax burden is uneven, reducing efficiency in CO_2 emission abatement. Natural gas is taxed less, in terms of carbon content, than petrol. Fossil fuel use in industry is taxed much less than in residential and commercial use while coal use in industry is tax exempt (OECD, 2018[26]). Diesel is taxed less than petrol, even though it causes more small-particle pollution. More consistent carbon pricing and higher public funding for R&D could also boost environmental innovation, which remains relatively weak. Higher public funding for low-carbon R&D would have substantial economic benefits, because innovation can be applied across a broad range of sectors and tends to have substantial knowledge spillovers for domestic firms (Dechezleprêtre, Martin and Bassi, 2016[27]). Italy could reduce the economic burden of environmental regulations without compromising their stringency, thereby boosting competition, innovation and performance, in particular by better evaluating regulations' effectiveness (Koźluk, 2014[28]).

Improving metropolitan governance (as detailed in the thematic chapter) can improve green growth outcomes in Italy's cities. In particular, this requires defining metropolitan governance structures based on travel-to-work areas and integrating urban planning, housing and public transport policies. This can help densify cities, improve access of commuters to jobs as well as reduce energy consumption, pollution and CO_2 emissions. It can also boost productivity (OECD, 2015[29]). Investing in alternatives to road transport, especially in Southern Italy, would reinforce the environmental effect of transport fuel taxes (OECD, 2013[23]).

Past recommendations on environmental policy

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

Figure 23. Green growth indicators for Italy



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

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

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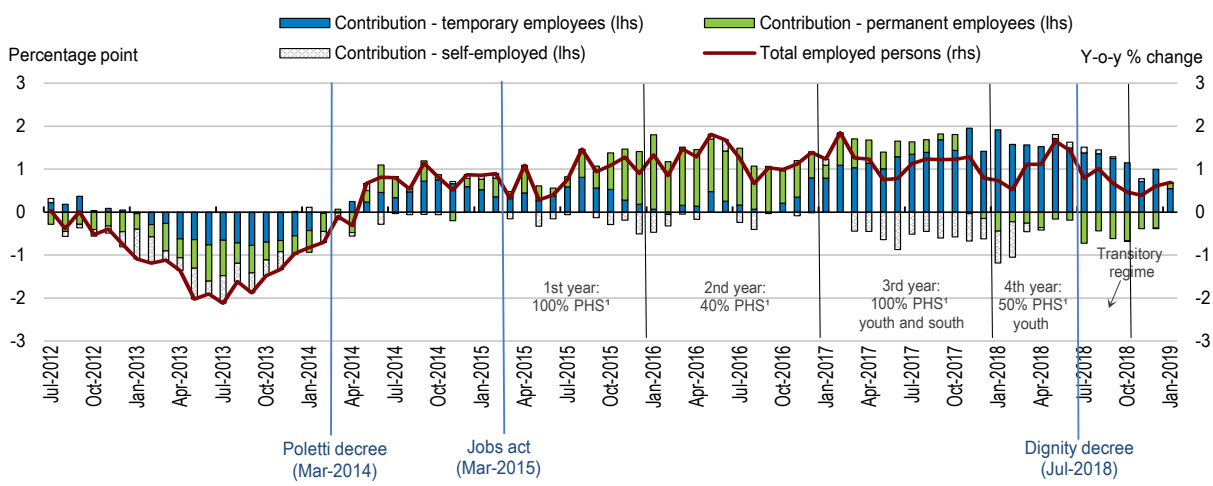
Boosting job creation

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

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

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



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

StatLink https://doi.org/10.1787/888933948167

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

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

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

Increasing employment rates also hinge on markedly improving public employment services (PES), and active labour market programmes (ALMPs) (OECD, 2018[1]). The previous government sought to build the capacities of Italy's ALMPs, but they still underserve the 16.7 million out-of-work population, especially in lagging regions. Modest increases in spending and participation in ALMPs, accompanied by organisational and efficiency improvements, can bring high returns and improve jobseekers' likelihood of finding work (OECD, 2015[30]).

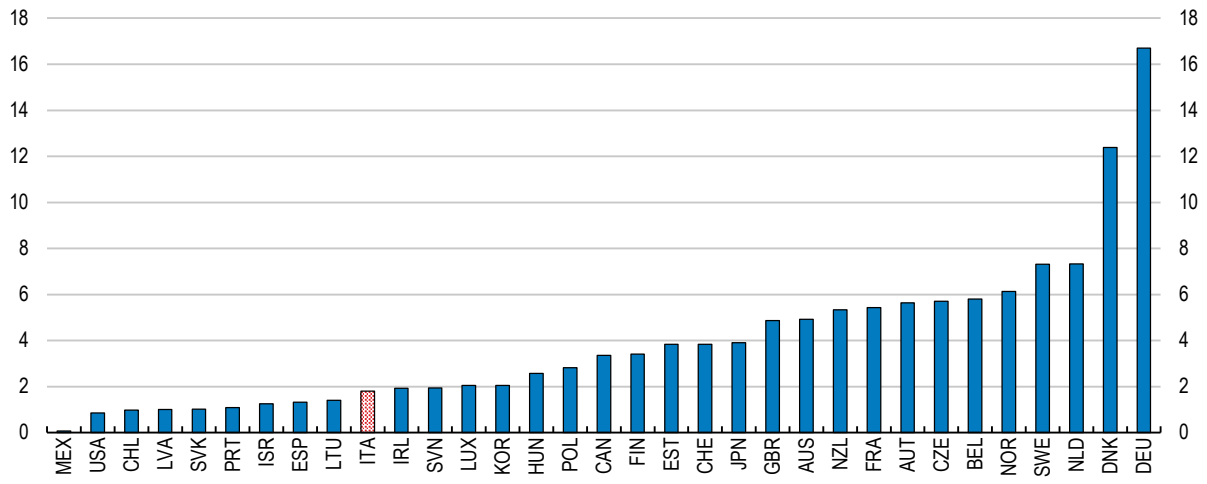
The introduction of the Citizen's Income scheme makes improving the public employment services even more urgent as this benefit is administered by the PES and most beneficiaries will be required to engage in job-search and training programmes (as discussed in the thematic chapter). The 2019 Budget allocates about EUR 900 million over 2019-20 to reinforce the staff of PES and additional EUR 500 million to hire professionals to improve

the efficiency of job-matching activities of PES. These are positive steps and long overdue but a detailed plan on how to improve PES is yet to be defined.

As highlighted in the previous OECD Economic Survey (OECD, 2017), employing more specialised counsellors and profiling tools based on digital technologies is key to make progress in this area. PES spending (Figure 25) and staff numbers and skills are low, especially in lagging regions (OECD, 2019, forthcoming[4]). Other countries' effective PES reforms, such as in Portugal in the early 2010s, provide good examples on how to reform Italy's PES. Their experience demonstrates that improving vacancy registration and access via online databases, along with more skilled counsellors to better engage with the unemployed in PES offices can improve outcomes (OECD, 2017[31]; Martins and Pessoa e Costa, 2014[32]; Behncke, Frölich and Lechner, 2007[33]). The government's intention to create a Single Information System for Labour Policies (SIUPL) where companies can post vacancies is a welcome step. Given the size of Italy's SME sector, the PES could also develop specialised support services for SME employers, following the British PES example.

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

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



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

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

Enhancing job-search and training policies is key to containing the costs of the Citizen's Income and avoiding the creation of poverty traps. In Italy, private-sector agencies and

public employment services (PES) provide job-search and training services. About 1 100 private-sector job-search and training agencies are accredited with ANPAL, allowing them to cash in a training voucher if they find a job for an unemployed person holding a voucher. The amount of the voucher varies with the employability profile, and can be spent in training or education at public or private employment services. As many PES are ineffective, especially in lagging regions, and reforming them will take some time (OECD, 2019, forthcoming[4]), further developing partnerships with private-sector job-search and training agencies and extending the existing training voucher scheme to also include Citizen's Income beneficiaries is key for an effective implementation of the Citizen's Income.

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

Past recommendations on active labour market programmes

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

The power and coordination role of ANPAL needs to be strengthened for the new PES system to produce results. ANPAL has already the responsibility of monitoring the implementation of the plan to strengthen active labour market policies that was approved by the State-Regions Conference in late 2017. However, it has little power to undertake corrective actions in those regions that do not achieve the agreed service standards. ANPAL could be tasked with the responsibility of developing and implementing special restructuring programmes for those public employment services that fail to reach the agreed

service standards within a certain time. Such restructuring programmes could include management changes, structural reorganisation of the employment centre and requalification of the personnel based on an analysis of needs. Strengthening accountability and incentives for regional public employment services to adopt best practice and improve performance would also help. Clarifying who is responsible for what and publishing data on the activities and performance of all public employment centres would go in this direction by strengthening accountability and yardstick competition.

Italy has rapidly expanded access to adult education and training over the past decade, using also EU funds. Yet, participation remains well below many other OECD countries and high rates of job skill mis-match and skill shortages in high-skilled occupations show the need for continued efforts (OECD, 2017[9]). Expanding resources for Italy's Joint Inter-professional Funds (JIPF) to provide access to training to those out-of-work can expand the workforce's skills. Strong evaluation and certification of courses' quality would improve their effectiveness. Continuing to deepen social partners' role in designing and providing training courses would improve the effectiveness of courses, and particularly benefits new entrants to the job market. In this context, in 2018 the Ministry of Education set up a network of lifelong learning bodies, which is expected to lead to the design of National Plan for Skills for the adult population.

Adult education reforms can also help to better integrate immigrants into the Italian labour market. Certifying migrants' skills, and encouraging them to enrol in formal vocational education and training programmes, rather than in informal programmes, would improve integration (Jeon, 2019, forthcoming[34]). Italy is committed to providing access to formal education for immigrant students. In the 2016/2017 school year, 92% of immigrants graduating from secondary schools enrolled in formal education and training programmes. The enrolment of students with non-Italian citizenship in secondary school has been expanding and in the 2016/2017 school year it reached 7% of total students.

Monitoring individual immigrants' workforce outcomes can guide resources towards the most effective education and training programmes. Access to Italy's Protection System for Refugees and Asylum Seekers (SPRAR) has been restricted for asylum seekers since December 2018. In the absence of formal transitional and adult education programmes similar to those in Sweden, Switzerland or Germany, the SPRAR system has played a crucial role in Italy to help integrate new arrivals into vocational education and workplaces, as well as access to basic social support (Bergseng, Degler and Luthi, 2019, forthcoming[35]; Kuczera and Jeon, 2019, forthcoming[36]).

Past recommendations on skills and education

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

Enhancing entrepreneurship and helping small and innovative firms to grow

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

The weak association between firms' market share and productivity (high resource misallocation) reflects the many obstacles Italian small and productive firms face to expand. As reported in the previous Survey (OECD, 2017[9]), labour productivity of Italy's manufacturing sector is only 15% higher than if firms' market shares were allocated randomly; in comparison, in Spain and France higher market share for more productive firms leads to productivity being 25% higher than if greater productivity was not associated with greater market share, while in Germany it is (more than 50% higher).

Policy action to reduce resource misallocation is urgent. Andrews and Cingano (2014[37]) find that across countries and industries barriers to entry and cumbersome insolvency

procedures are associated with a high degree of resource misallocation. Therefore, the government should focus on the following:

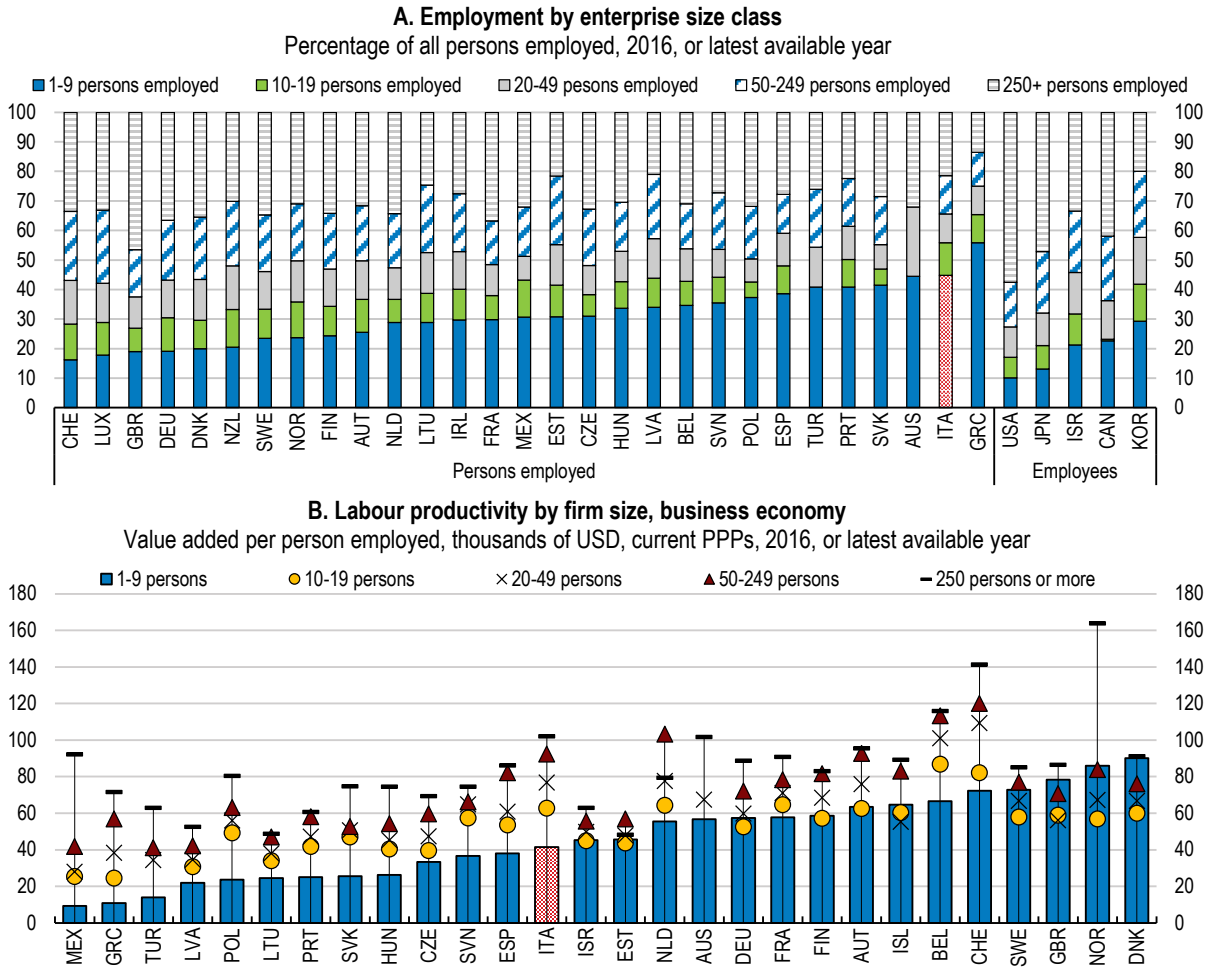
- Continuing to open markets to competition, heeding the advice of the Competition Authority. The process of rationalising local utilities and opening local public services to competition would also be helpful.
- Reforming insolvency procedures that, as reported in the previous Survey (OECD, 2017), are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

Revitalising Italy's innovative entrepreneurial activity and business growth requires improved access to finance combined with management and strategic support. Debt contributes more to Italian firms' financing than in other European countries (OECD, 2019, forthcoming[38]). Overall, Italian firms remain slightly more leveraged than in other large European economies. As underlined in the previous Survey (OECD, 2017[9]), the notional interest rate applied to the injections of new equity (allowance for corporate equity, ACE) has contributed to reducing the debt-to-equity ratio of Italian firms. The 2019 budget has abolished the ACE. Reintroducing it would be help to continue strengthening the capitalisation of Italian firms.

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

Improving the business environment would support access to finance and especially benefit innovative firms in high-growth and volatile sectors (Calvino, Criscuolo and Menon, 2016[39]) and those setting up in lagging regions. Difficult operating environments and market failures raise new firms' operational risks, leading funders to be less willing to provide finance. Pertinent obstacles include poorer judicial efficiency and more costly contract enforcement, as well as the uncertainty engendered by frequent policy change or ambiguous application of policies (Bobbio, 2016[40]; DeStefano et al., 2019[41]). These horizontal constraints are even stronger in lagging regions (OECD, 2017[9]).

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



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

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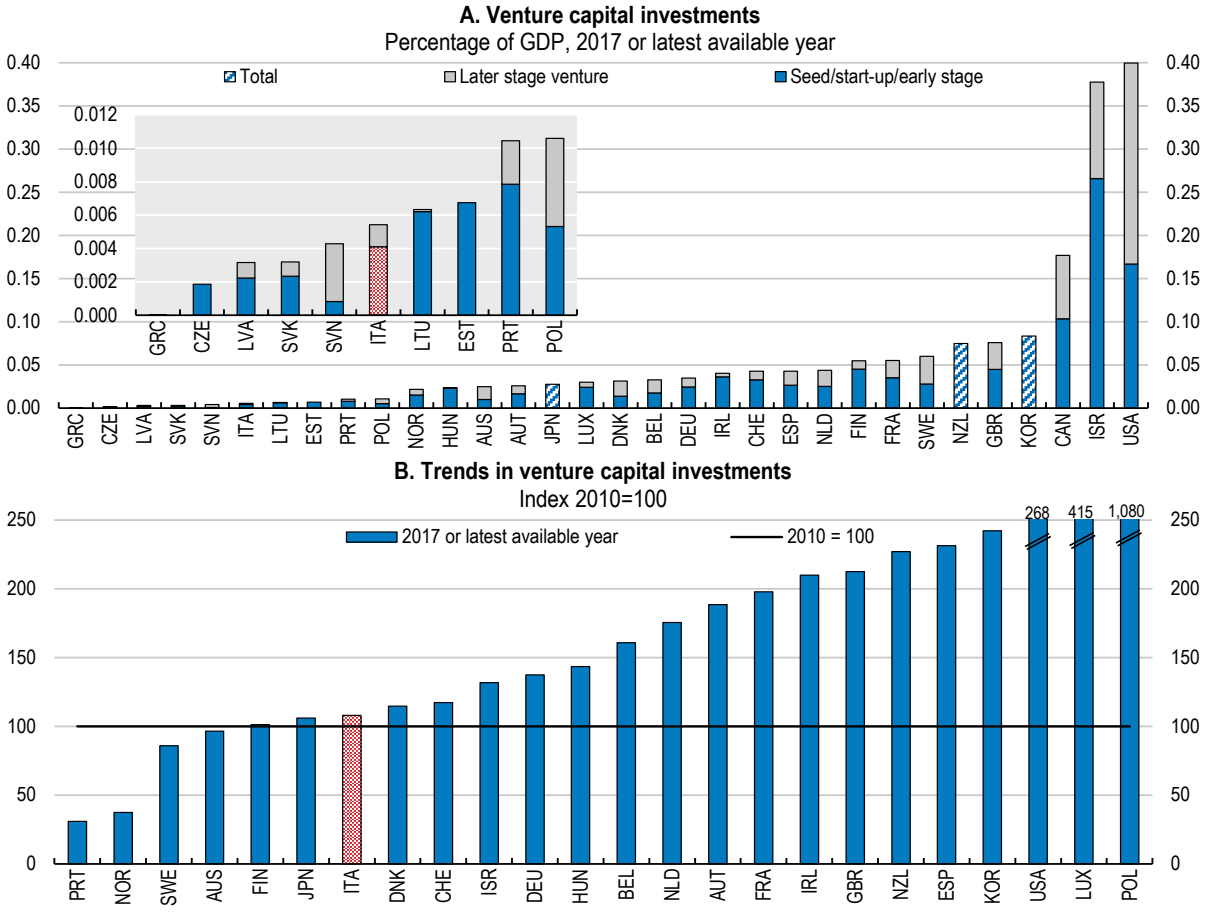
High-growth, high-risk firms are better suited to equity than to debt financing. Equity provides a smaller share of Italian firms' financing than in other European countries (OECD, 2019, forthcoming[38]). Venture Capital (VC) is equity financing that particularly supports young companies with innovation and growth potential but untested business models and no track record by providing financing coupled with management and strategic guidance that is rarely available with debt lending. In Italy, VC-financed start-ups were found to grow faster and be more innovative compared with a control group of similar start-ups (Bronzini, Caramellino and Magri, 2017[42]).

Italy's VC sector expanded rapidly in the first half of 2018, but remains notably under-developed (Figure 27). The limited number of VC investments are mostly modest and focused on early-stage ventures (OECD, 2017[43]), while only government-financed

VC funding is comparable in size with other large European countries. Meanwhile alternative sources of financing, such as peer-to-peer lending and crowdfunding, are growing but are very small and do not provide substantive management support.

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



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

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Most of Italy's VC activity is based in Milan. In other regions, entrepreneurs rely more on local banks for financing. Two-thirds of start-ups funded by a VC firm are in the same municipality as the VC in Italy (Menon et al., 2018[44]), similar to OECD countries Where the entrepreneur and bank have ongoing relationships this can be a reliable source of financing, even during downturns (Banerjee, Gambacorta and Sette, 2017[45]), but it rarely provides the level of management and strategy support provided by VC investors. Relying on financing through relationship lending ahead of VC may explain the lower share of students and researchers among entrepreneurs in Italy than other OECD countries (Menon et al., 2018[44]). It also adds a barrier to talented business people using entrepreneurship to overcome fewer established opportunities in lagging regions (DeStefano et al., 2019[41]).

The 2012 Start-up Act is improving access to finance and reenergising innovative entrepreneurial activity. Firms that qualify to participate in the Start-up Act record higher revenue and capital, notably intangible capital related to patents and intellectual property, after controlling for relevant factors. Many achieve this by accessing government

guarantees against bank borrowing, which reduces their collateral needs and loan costs and increases lending among firms in need of external financing (Menon et al., 2018[44]). Between the start of the scheme in 2013 and June 2018, 2 148 start-ups received a guarantee, with only 2.9% defaulting. However greater use of bank loans may exacerbate any bias in Italy against equity financing (Giraudo, Giudici and Grilli, 2016[46]), which brings a risk of slower long-term growth. To counter-balance this, other Start-up Act policies favour access to equity. Participating firms were more likely to receive VC financing, although this is likely to be from existing VC funds rather than expanding the amount of VC financing available in Italy (Menon et al., 2018[44]).

Past recommendations on product markets

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

Italy's limited equity financing for start-ups primarily reflects limited supply of funds (Menon et al., 2018[44]; Calvino, Criscuolo and Menon, 2016[39]). One cause is investors' perception of limited domestic demand for innovative goods and services, reducing the perceived returns from investments in innovative start-ups. To address this, 'fast-track' access to public procurement and to pre-commercial procurement of innovative goods and services would provide some assurances of demand and would be in line with EC guidelines. This can be particularly effective in areas where the government is a large buyer, such as in health services. (European Commission, 2018[47]). Increasing supply of public VC funding may crowd out private VC funds. The benefits of publically financed

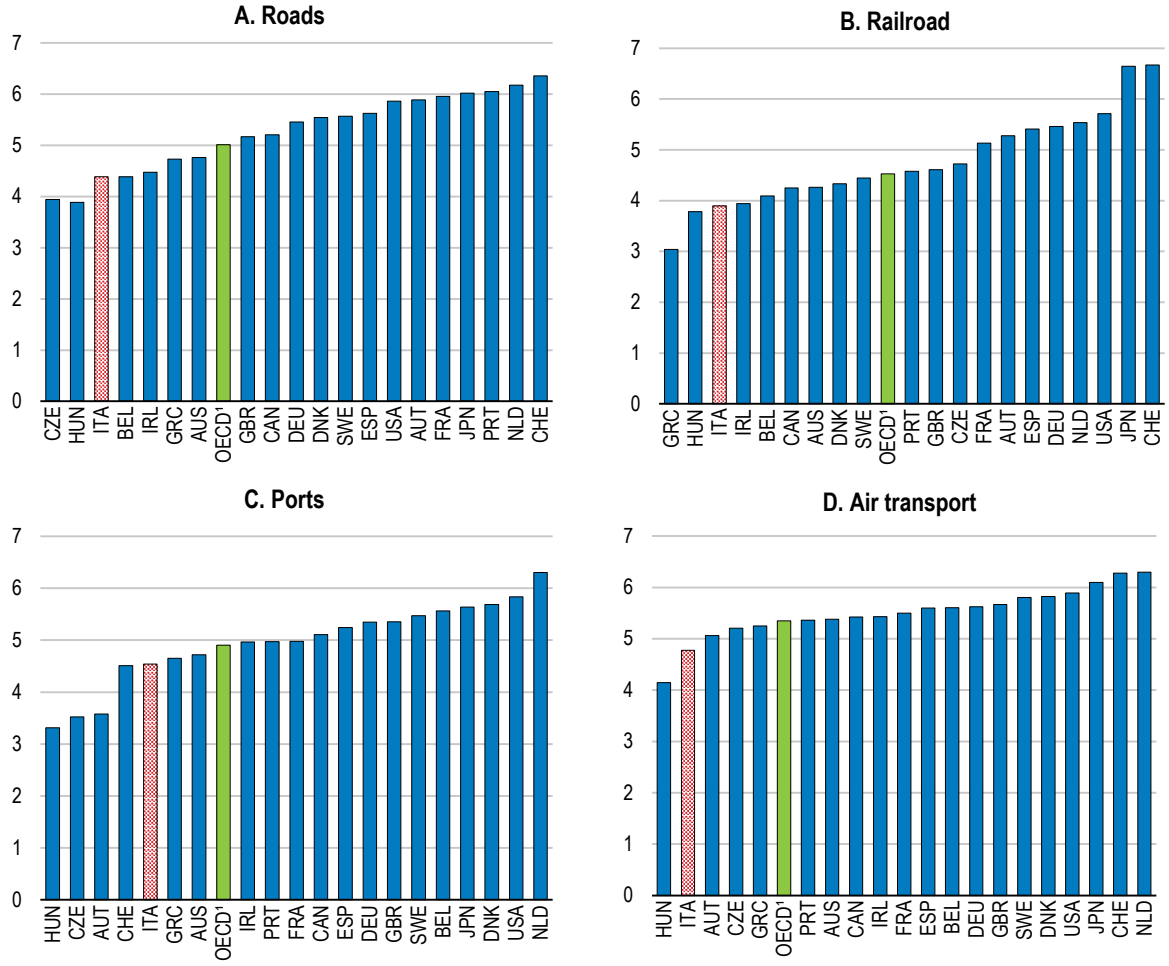
VC are likely to be lower when public institutions' effectiveness is patchy. Instead, addressing other barriers to the supply of credit may be more effective.

Improving the quality of public investment and infrastructure management

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

Figure 28. The perceived quality of infrastructure is low

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



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

StatLink https://doi.org/10.1787/888933948243

Better transport infrastructure would also reduce commuting times, contributing to well-being (OECD, 2014[48]). Geographical and social segregation – and the ensuing crime – often result from insufficient transport infrastructure and people with longer commuting time report systematically lower subjective well-being (Stutzer and Frey, 2008[49]).

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

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

Enhancing infrastructure governance and strategic planning

OECD countries' experience shows that shortcomings in a country's infrastructure management framework jeopardise infrastructure projects' timeframe, budget and service delivery targets (OECD, 2017[50]). Effective infrastructure management hinges on a clear regulatory and institutional framework, robust co-ordination across levels of government and sustainable performance throughout the life cycle (Table 8) (OECD, 2018[51]). The OECD Survey of Infrastructure Governance (OECD, 2017[50]) reveals some good aspects of Italy's infrastructure management framework, which concerns mostly the transport sector. Italy is one of about half of OECD countries reporting to have a long-term strategic infrastructure plan cutting across all sectors. Italy is also one of the 16 OECD countries reporting to compile a short list of priority projects (i.e. project pipeline) that complement the long-term plan.

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

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

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

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

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

Source: (OECD, 2017[52]).

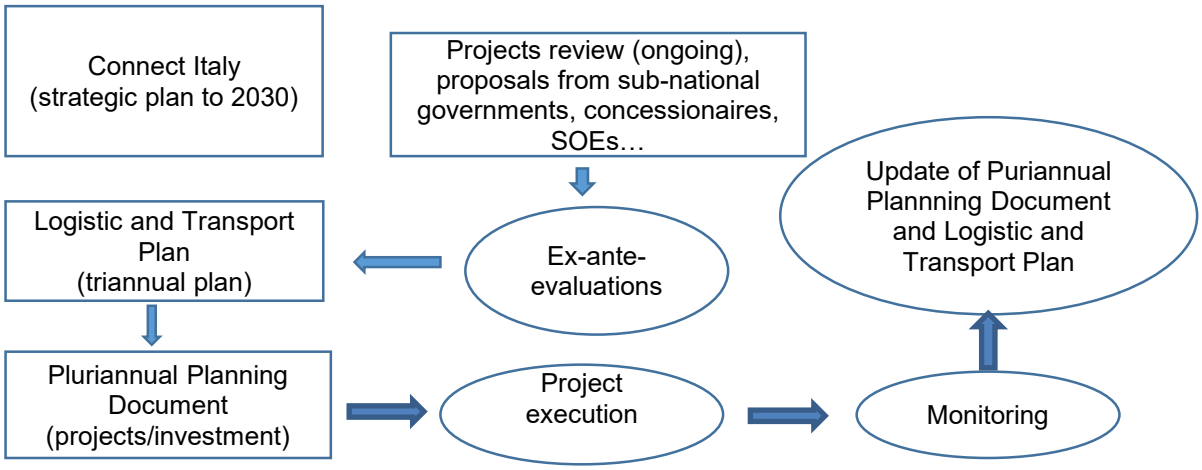
These are positive steps but the new planning and programming process is not fully operational as the DPPs have not been published. Moreover, the government is still reviewing existing infrastructure project proposals based on an assessment of needs, updated demand forecasts, ex-ante evaluations and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

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

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

the regional offices of the Ministry of Transport and Infrastructure and local contracting authorities would go in this direction.

Figure 29. Scheme of infrastructure strategic planning in Italy



Source: OECD from DEF documents.

Integrating land use management with infrastructure planning would go a step further as it would allow the government to reduce and better manage hydrological risks, which are high in many parts of Italy. Several studies point to the link between changes in land use and hydrological risks (OECD, 2018[22]; Lerner et al., 2018[53]; McColl and Aggett, 2007[54]). In this respect, some OECD countries offer concrete examples for Italy:

- In 2016, the UK created the independent Infrastructure and Projects Authority (IPA) by merging Infrastructure UK and the Major Projects Authority. The National Infrastructure Delivery Plan 2016-2021 (IPA, 2016[55]) covers not only transport, but also energy, digital communications, flood and coastal erosion, housing, and social infrastructure. It coordinates between planning, economic and financial concerns to align infrastructure projects with climate and development goals (OECD/The World Bank/UN Environment, 2018[56]). Such a general plan is also more likely to attract the interest of institutional investors as it provides a full overview of the infrastructure investment opportunities the country offers.
- The Netherlands has instituted an advanced strategy for infrastructure and spatial planning. This integrates infrastructure planning with land use management at central and sub-national levels to: enhance competitiveness by strengthening infrastructure; improve door-to-door accessibility by developing a robust and coherent intermodal transport system; and guarantee a safe environment and preserve natural and cultural heritage sites (Ministry of Infrastructure and Environment, 2011 Summary National Policy Strategy for Infrastructure and Spatial Planning).
- Infrastructure Australia is an independent agency with a mandate to prioritise and progress nationally significant infrastructure. It provides independent advice to all levels of government in addition to investors and owners of infrastructure. Infrastructure Australia is responsible for auditing Australia's nationally significant infrastructure, and developing 15-year rolling Infrastructure Plans that specify

national and state level priorities. It also determines which projects should enter the Infrastructure Priority List.

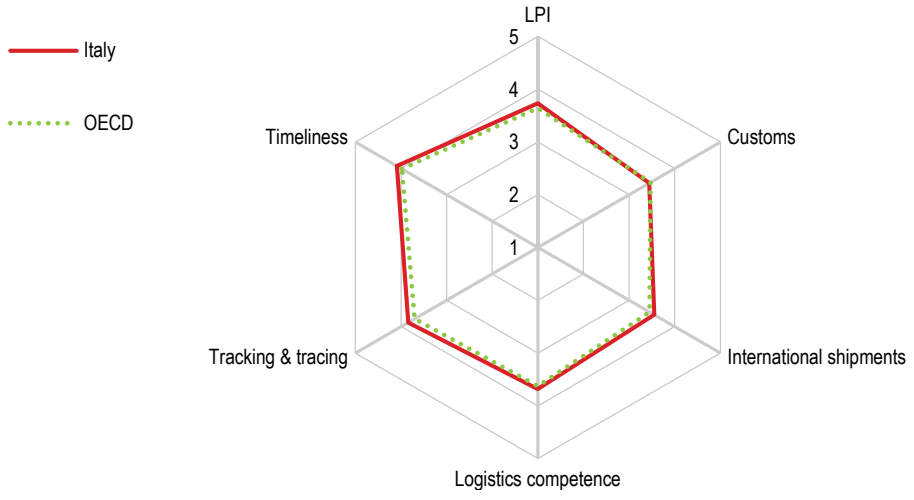
Enhancing transport and improving accessibility

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

Yet, according to the World Bank Logistic Performance Index, logistic professionals indicate that access to the infrastructure network is more expensive in Italy than in other OECD countries and that maritime transhipments is a major source of delays (World Bank, 2018[57]). This might be partly attributable to the traditional fragmentation of the Italian port system resulting in scale inefficiency and long waiting times (Ferrari, Tei and Merk, 2015[58]). The reform of the port system approved in 2016 aims to tackle these problems. An important step in this direction was achieved with the 2016 port reform, which aimed at reducing fragmentation and strengthening port authorities (Box 4).

Figure 30. Italy performs well in international trade logistics

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



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

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Box 4. The 2016 reform of the Italian port system

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

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

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

The government could make additional progress in improving intermodal transport by further empowering the Authority for Transport Regulation (ATR). This was established in 2011 and started operating in 2014. ATR has responsibilities over all transport sectors (roads, airports, railways, ports, local public transport) and covers all issues relating to access to the infrastructure network, services regulation and protection of passenger rights (ATR, 2018[59]). As such, the ATR is well placed to promote and improve multimodal transport. The ATR has gradually built enough expertise and capacity in different transport sectors to take additional responsibilities. This is in line with the government's vision of enhancing intermodal transport and a key step to strengthen the current regulatory framework.

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

Improving central-subnational fiscal relations to boost subnational investment

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

Many have ascribed the contemporaneous fall in subnational governments' debt and investment to the Internal Stability Pact (ISP). Studies show that ISP has helped to control municipal debt but has also caused a sharp drop in investments, especially among compliant municipalities (Monacelli, Pazienza and Rapallini, 2016[60]; Chiades and Mengotto, 2016[61]; Viesti, 2011[62]).

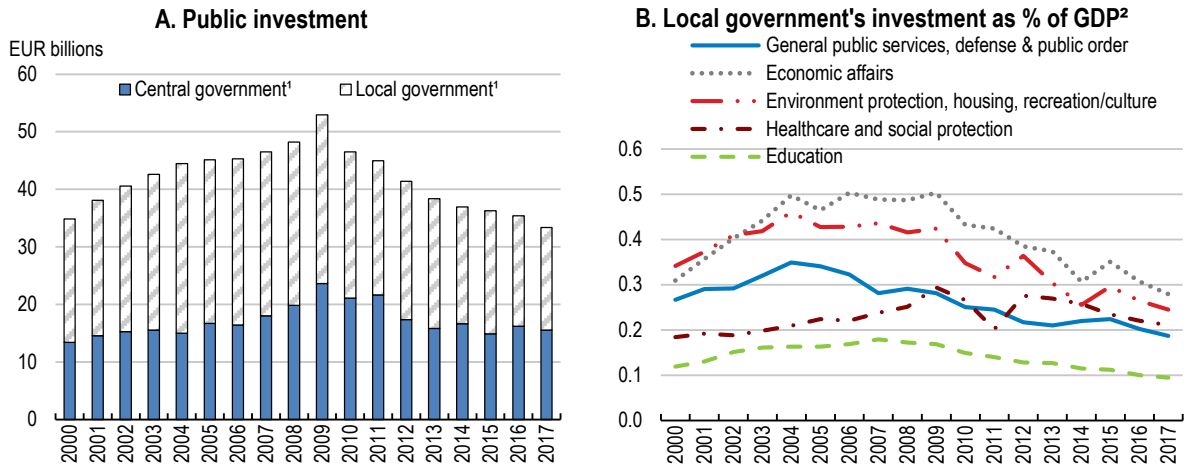
However, the dearth of resources for investment imposed by the ISP while relevant in some cases does not seem to be the main cause of low investment at sub-national governments. Sub-national governments have repeatedly failed to use the available investment funds. When the government in 2011 allowed sub-national governments to exclude from the Internal Stability Pact rules spending to co-finance EU projects (amounting to EUR 1 to EUR 2 billion annually from 2012 to 2014) some regions failed to use the released funds (Court of Auditors, 2018[63]). In 2016 sub-national governments used only partially the fiscal space created in the ISP for boosting investment. For instance, municipalities have spent less than half of the funds available for investment in schools. Also, at the end of the year capital spending by municipalities, metropolitan cities and provinces was below 50% of the planned spending. Small municipalities have more difficulties in planning and spending the available funds for investment than large ones (Court of Auditors, 2018[63]).

To support investment by sub-national governments and foster regional convergence, the governments should maintain recent changes to the ISP to create fiscal space for investment. Also, allowing different municipalities within the same region to offset their budget surplus and deficit positions, which is in line with Article 112 of the Constitution, would also help to smooth regions' investment spending and foster coordination among municipalities. Finally, the rules of the ISP have changed virtually every year since its introduction as they can be changed in the budget law. More stability along with the clear intention of increasing investment spending at central and sub-central levels would strengthen credibility and facilitate medium and long-term planning by sub-national governments, which is key for investment (OECD/The World Bank/UN Environment, 2018[56]).

Past recommendations on subnational fiscal relations

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

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



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

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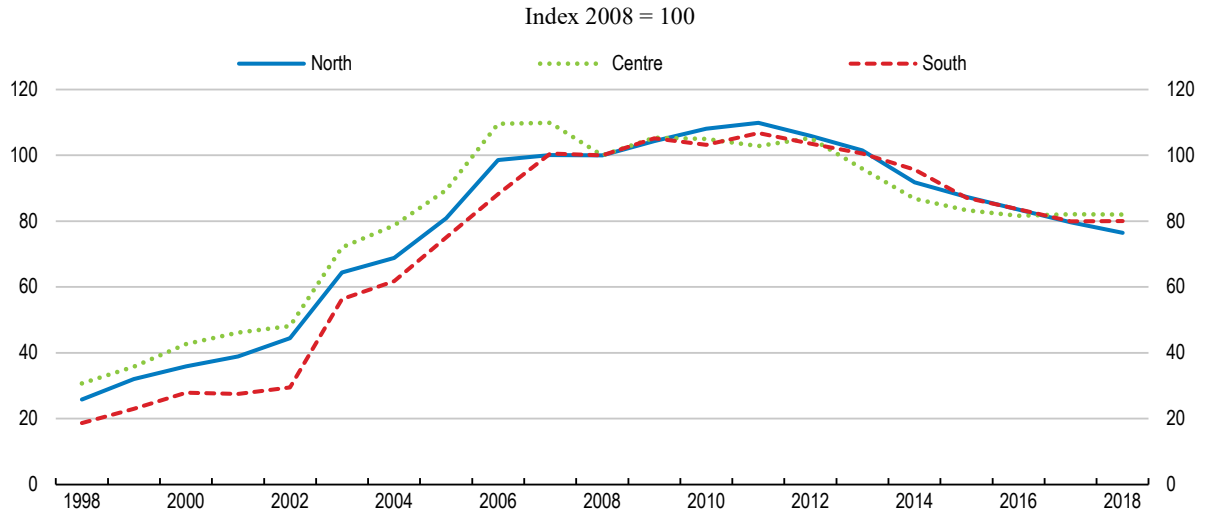
Figure 32. The stock of sub-national government debts has declined



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

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Improving the tax system

Italy's tax system is complex contributing to low tax compliance. According to the World Bank and PwC (2018), the time necessary to comply with tax laws is considerably longer in Italy (238 hours) than in peer countries (218 hours in Germany, 140 in France and 105 in the United Kingdom). Recent estimates by the Ministry of Finance (2018[64]) indicate that the tax gap (the difference between the theoretical revenues the government should have collected assuming perfect compliance and the revenues actually collected) amount to more than EUR 100 billion per year. The tax gap (as a percentage of theoretical revenues) is largest for the personal income tax of self-employed business income (nearly 70%) and VAT (26%), and is larger in lagging regions (Carfora, Pansini and Pisani, 2016[65]).

In the past few years, governments have pursued efforts to improve tax compliance. In 2016, the government started publishing an annual report on tax compliance (as an annex to the yearly Update to the Stability Programme). Recent measures to improve voluntary compliance, through for instance sending reminders in case of delays in presenting tax declarations and to remedy errors and omissions in tax declarations go in the right direction and have yielded fruit. The Ministry of Finance (2018[64]) estimates that initiatives to improve voluntary compliance generated EUR 1.3 billion of additional revenues in 2017. The government's plan to pursue these efforts are therefore welcome. Other recent and useful initiatives to reduce the tax gap have involved the extension of the reverse charges and split payments for VAT. The 2018 decision to abolish the split payments for the self-employed goes against the need to reduce the large tax evasion among this category of taxpayers. The introduction of the e-invoicing system in 2018, which from January 2019 will be extended to all transactions, is a key step to improve tax compliance. The government has decided to suspend penalties relating to delays, errors and omissions in issuing e-invoices until mid-2019. The government should ensure the e-invoice system is widely adopted and introduce a system of checks and sanctions for non-compliant businesses.

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

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

The government should act on these assessments and rationalise tax expenditures. Previous attempts to cancel some tax expenditures yielded no results. For instance an ex-commissioner for the spending review identified 52 tax expenditures with no economic and

social justifications that in 2017 amounted to EUR 2.2 billion of lost revenues (Perotti, 2018[66]), but no actions were taken.

An in-depth OECD report on Italy's tax administration (OECD, 2016[67]) underlines its high fragmentation and the need to develop a comprehensive strategy encompassing all tax administration agencies. It consists of the Revenue Agency, responsible for the administration and collection of the main taxes and duties and maintaining property registers; the Customs and Monopolies Agency, responsible for gaming and administering excises; the Italian Social Security Institute, responsible for social security contributions and welfare payments; and the Guardia di Finanza, responsible for conducting civil and criminal tax investigations.

This fragmentation is at variance with practices observed in tax administration of other advanced OECD countries. In OECD countries, the tax administration is often unified into a single revenue agency, which enjoys substantial autonomy, especially in financial matters and human resources policies. This creates the conditions for a more strategic approach to the management of the overall tax administration. For instance, since 2009 Belgium has been integrating different fiscal and non-fiscal collection and recovery services, engendering synergies and improving the effectiveness and efficiency of debt recovery (OECD, 2017[68]).

In the recent past, successive governments have taken actions to reduce the tax administration fragmentation and efforts are under way to improve its strategic governance and enhance coordination among the different tax agencies (Ministry of Finance, 2018[64]). In 2012, the Land Registry Agency was incorporated into the Revenue Agency and the Autonomous Administration of State Monopolies into the Customs Agency (now named Custom and Monopolies Agency). The latest reform has concentrated all tax collection activities into the Revenue Agency to improve coordination between tax assessment and tax collection activities. As regards the governance of the tax system, a technical coordination table has been established among the different agencies.

Many OECD countries are increasingly relying on digital technologies to detect and prevent tax evasion and build synergies within the tax administration. These tools have proved useful in reducing tax evasion and the shadow economy (Box 5). The OECD report *Reducing Opportunities for Tax Non-compliance in the Underground Economy* (OECD, 2012[69]) encouraged OECD countries' tax administrations to use digital records to identify unreported income.

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

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

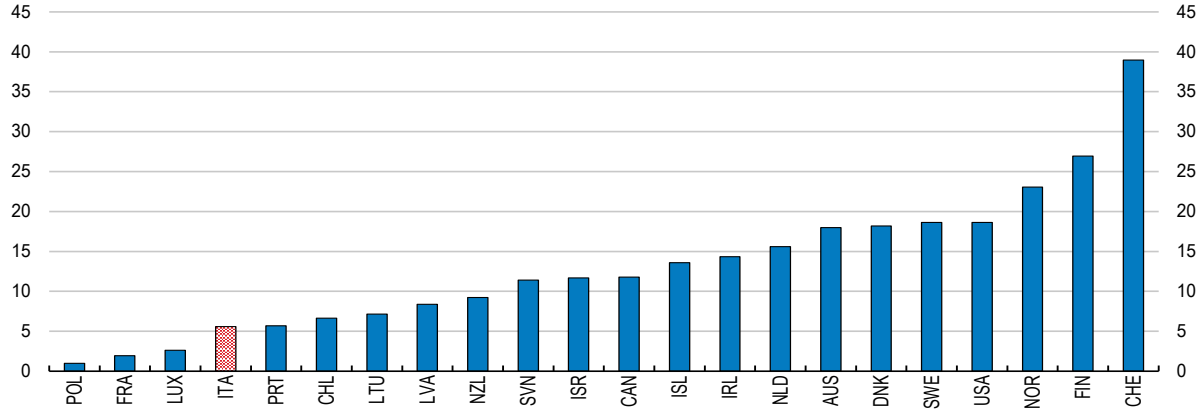
- The share of cash payments remains markedly higher in Italy than in most EU countries (OECD, 2017[70]). Lowering the cash payment threshold from the current level of EUR 3 000 to EUR 1 000, the level in France, would greatly help in the fight against tax evasion.
- The sharing economy is developing fast in Italy as elsewhere. The sharing economy can facilitate tax evasion as it can make it more difficult to identify business activities. The use of data analytics and international co-operation amongst tax authorities are likely to help in this area.

In the past, successive Italian governments have implemented tax amnesties. There have been overall 80 tax amnesties in the 150 years of the Italian State. These have brought in additional tax revenue but have also nurtured a culture of non-compliance with tax laws (OECD, 2016[67]; Ministry of Finance, 2014[71]). The current government has introduced new tax amnesties in 2019 (Box 1) that will write off not only fines and interests but also the tax debt in some cases.

Evidence from the experience of different countries confirms that any temporary benefits are offset by weaker tax compliance and that successful tax amnesties are the exception rather than the rule (Baer and Le Borgne, 2008[72]). Efforts to improve voluntary tax compliance – through encouraging a more co-operative relationships between taxpayers and revenue bodies based on commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies, and disclosure and transparency by taxpayers – need to be pursued and tax amnesties avoided in normal circumstances. Those tax amnesties involving tax debts and not just fines and interests are likely to have the most pernicious effect as they weaken the certainty of tax laws and are unfair towards compliant taxpayers.

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

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



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

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

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

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

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

Table 9. Example of digital technologies to fight sales suppression

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

Source: OECD (2017[68]).

Past recommendations on tax administration

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

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Annex. Progress in structural reform

This Annex reviews actions taken on recommendations from previous Economic Surveys that are not covered in tables within the main body of the Assessment and Recommendations. Recommendations that are new to this Survey are listed at the end of the Executive Summary and the relevant chapter.

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Fiscal issues	
Evaluate the effectiveness of recently introduced research and development tax credits and other fiscal incentives in terms of innovation outcomes and forgone tax receipts.	Extensive data being collected and analysed on firms benefiting Start-up Act (and Industry 4.0).
Stick to the planned fiscal strategy so as to bring the debt-to-GDP ratio onto a declining path.	The 2019 budget marks a significant departure from the previous fiscal strategy.
Promote greater use of centralised procurement, cost information systems and benchmarking.	Public procurement management continues to improve, through more contracting through central authority. Procurement agencies' capacity is improving. IT systems are facilitating comparisons of prices paid by difference agencies. ANAC is taking a stronger role in supervising and authorising contracting.
Strengthen the coordinating role of the central government to set and enforce minimum standards in project preparation and execution and to enhance the administrative capacity of all agencies using national and European funds for investment.	The Government has proposed the creation of a task force to centralise information on ongoing projects through the active management of a centralized database and direct links with the expense terminals, systematically promoting the monitoring, evaluation and coordination of investments. The Government will also create a central unit with the task of offering technical assistance to ensure quality standards for the preparation and evaluation of programs and projects by central and peripheral public administrations are met.
Continue to assess the magnitude of budgetary contingent liabilities, including the vulnerability of public finances to risks associated with the financial sector.	New contingent liabilities are being accounted for correctly. The interventions in the banking sector have generated some contingent liabilities that have been audited by Eurostat and ECB and reflected in budget documents following their advice. Less than 3% of new firms with bank finance guaranteed through the Start-up Act have needed to call on this guarantee.
Fully legislate and implement the already planned nationwide anti-poverty programme, target it towards the young and children and ensure it is sufficiently funded.	A guaranteed minimum income programme, the REI, was rolled out nationally in Jan 2018 to all households with low income and assets conditional on participation in job search or other social services criteria. The delivery of REI social services builds on municipalities' existing social protection services. The 2019 budget introduces a new guaranteed minimum income scheme (Citizen's Income) to replace the REI that increases significantly the financial resources allocated to anti-poverty programmes and will to a large extent rely on Public Employment Services for job-search activation programmes.
Financial sector	
Set gradual, credible and bank-specific targets to reduce banks' non-performing loans (NPLs) consistently with recent ECB's Draft Guidelines. **When banks deviate from targets, bank supervisor should require remedial actions such as additional capital requirements, sales of assets, suspension of dividend payments, and reduction of staff costs.**	NPLs have fallen following pro-active, robust and intrusive regulation and supervision. In March 2018, the four significant banks submitted updated NPL-reduction plans for 2018-2020, and, by the end of 2018, the less significant banks with high NPLs will have to submit plans for reducing NPLs.
Continue to develop the secondary market for NPLs.	A secondary market for NPLs has taken off with the participation of foreign and domestic investors. Banks and other financial institutions made large sales of NPLs into the secondary market in 2017 and first half of 2018, leading the stock of banks' non-performing loans to decline.
Use debt-equity swaps more frequently by allowing for cram down of creditors.	No progress. The ongoing reform of the bankruptcy law should address this issue.
Set clear guidelines for the valuation of collateral.	The Single Supervisory Mechanism (SSM) issued guidelines for significant institutions in March 2017 and the Bank of Italy issued guidelines for less significant institutions in January 2018, for the treatment of NPLs, including collateral valuation.
Public sector efficiency	
Approve and fully implement the public administration reform to open up to competition local public services.	Public administration reform has been approved and implemented. The opening to competition of some local public services is still. The reform of local state owned enterprises is ongoing but has been delayed.
Ensure that legislation is clear, unambiguous and supported by improved public administration, including through reduced use of emergency decrees.	The use of emergency decrees has declined. The public administration reform has been approved and implemented and measures are ongoing. A Freedom of Information Act (FoIA) was approved, which establishes a general civic access: citizens are allowed to access data and documents of the Public Administration even if those are not made public. The same Decree that introduced the FoIA, sets an obligation for Public Administrations to publish their data bases.

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Make more extensive and better use of regulatory impact analyses, especially by engaging with stakeholders in ex-ante consultative processes.	The anti-corruption agency (ANAC) provides guidance on various issues relating to the prevention of corruption. Its regulations have the power of soft laws. As regards whistle-blower protection in the public and private sector, ANAC has become the main channel for receiving the reports. In the public sector ANAC is not only a reporting channel, but also the governance and regulatory authority. No change on Regulatory Impact Assessment
Further streamline the court system, with more specialisation where appropriate; increase the use of mediation; enhance monitoring of court performance.	Continued judicial system reforms, although performance remains uneven, and times to resolve cases is significantly slower in southern regions.
Consider establishing a Productivity Commission with the mandate to provide advice to the government on matters related to productivity, promote public understanding of reforms, and engage in a dialogue with stakeholders.	No progress.
Reducing corruption and improving trust must remain a priority. For this, the new anti-corruption agency ANAC needs stability and continuity as well as support at all political levels.	ANAC continues to operate and has gained a prominent role in corruption prevention activities. It as an importation in public procurement procedures and responsible for issuing implementing regulation concerning the 2016 public procurement code. The code has yet to be implemented in full. In 2018 the government put forward and the parliament approved a new law (Corruption-Sweeping Law, "Spazzacorrotti") lengthening prison sentences for corruption convictions, eliminating the statute of limitations after a first degree judgment (for all judicial cases not just for corruption), allowing for undercover agents in corruption investigations and setting a measure of debarment (so called Daspo) for both public officials and private individuals, as well as companies, convicted for corruption, which will be banned from contracting with public administrations. The reform of the Criminal Codes, entered into force in August 2017 includes a reform of the time limitation regime, thus enhancing the capability of the criminal system to fight corruption. As for the Civil Code, an important step forward has been made with the introduction of innovative provisions regarding corruption in the private sector
Reduce public ownership, especially in TV media, transport and energy utilities, and local public services. Privatise and liberalise energy and transport sectors. Complete framework for regulation of water and other local public services, ensuring regulatory independence. Introduce national oversight of regional regulatory competences (e.g. retailing, land-use planning).	Privatisation programme has made little progress. The latest large privatisation concerns the disinvestment of 46.6% equity stake in the air traffic controller (ENAV) in 2016. A 2018 decree (Mille Proroghe decree) postponed the price liberalisation for gas and electricity by one year to 1st July 2020.
Environmental policy	
Make taxation more environmentally-friendly by reducing the gap between duties on diesel and petrol.	No progress
Shift the tax burden from electricity to the energy products used to generate it, with the respective rates set to reflect the carbon emissions and other pollutants associated with each fuel.	No progress
Active labour market programmes	
Fully implement the unified unemployment benefit system. Require recipients to actively seek work, and to accept employment or training when offered.	The new system has been implemented.
Encourage social partners to allow modification of national wage agreements at the firm level, through agreement with representatives of a majority of the firm's employees	Fiscal incentives to encourage firm-level wage bargaining are in places and yielding fruit. Social partners are negotiating additional benefits for employees, generally in workplaces with higher productivity and margins. But use overall remains limited.

Past Survey Recommendations (Key recommendations of the 2017 *Survey* are in bold)	Actions taken since 2017 Survey
Raise the efficiency of public employment services by decreasing job seeker-to-staff ratio. Employ profiling tools and specialised counsellors. Ensure ANPAL has the powers to coordinate local employment services offices and set national standards on job search and training policies.	Public employment services continue to be managed by regions. In December 2017 the State-Regions Conference approved a plan to strengthen active labour market policies based on further developing profiling tools, integrating IT systems and improving public employment services. ANPAL has the responsibility of monitoring the plan's implementation and reporting progress once per year. The government has set minimum quality standards for public employment services. ANPAL is expected to supervise the implementation of such standard but has very limited power. The 2019 budget allocates EUR 1 billion for 2019 to the reform of PES including to increase staffing by 125% and invest in processes.
Implement a systematic assessment of the labour market impact of activation programmes and focus funding on those that are performing well.	INAPP has broadly evaluated labour market skill needs, and conducted deeper evaluation of apprenticeship programmes.
Facilitate labour mobility between regions, occupations and sectors through skills recognition and the use of skills assessment.	Skills certification is growing among participants in joint inter-professional funds. A process has started to define the Guidelines for a National Skill Certification Sytem ("Linee guida del Sistema Nazionale di Certificazione delle Competenze") as envisaged by a 2013.
Skills and education	
Strengthen the post-secondary vocational education and training (VET) system following the example of Istituti Tecnici Superiori.	The government has allocated up to EUR 50 million to reorganise the vocational education and training system in order to better respond to the business sector's needs. The reform come into effect for the school years 2018/2019 and 2019/2020. A 2017 Ministerial Decree introduces for the first time the possibility for Universities to set up, from 2018/2019, three-year experimental programmes at first cycle of higher education known as professional degrees ("laureee professionalizzanti"). The content of the courses are defined at national level in cooperation with professional bodies ("Ordini Professionali"), and with enterprises.
Establish a national body on VET involving the business sector and key stakeholders to link the training component of VET with apprenticeships, ensure high-quality workplace training and identify skills needed in the labour market.	A national body has not been established. However links between businesses and key stakeholders to link the training component of VET with apprenticeships are being strengthened.
Introduce minimum training quality standards to the firms proving traineeships, internships and apprenticeships.	No progress
Target the low skilled in lifelong learning by facilitating integration into formal education through part-time programmes in post-secondary education and vocational training.	A pilot programme is ongoing in public employment services and in provincial centres for adult education for the self-assessment of adults' skills based on PIAAC.
Develop digital skills at all levels of education and training.	Digital skills are being developed into context of National Plan for Digital Education and Industry 4.0. Resources have been allocated to create dedicated teams to implement the Plan for Digital Education over 2019-2021. ANAPL
Develop a career-based system for teachers based on a well-functioning system for evaluating teachers to attract and retain the best qualified teachers and improve career development.	The government reiterated its intention to improve the training system for new teachers in lower and upper secondary schools. Funds have been allocated for the training needs of teachers and to support their professional development Moreover, a digital system has been established that provides more than 30 000 training courses for teachers.
Create partnerships between schools and the business sector to create quality work-based learning opportunities for students as envisaged by the Good School reform.	The total number of hours for work-based learning foreseen by the 'Good School' reform have been reduced according to the specific educational path. The government intends to create a 'National Network of Vocational Schools' to strengthen links with the labour market, regularly updating career and professional profiles and facilitate the transition from school to work.

Product markets	
Employ public funds to help develop a private venture capital industry by crowding in private investors and adopting strict investment selection criteria.	Invitalia SGR is a public-private venture capital fund started in 2015. It has EUR 86 million under management of which EUR 50 million from the state and the remainder from private investors. It invests in innovative start-ups and SMEs. A new public-private fund (Italia Venture II) was established in 2018 with EUR 150 million seed funds from the government to invest in innovative start-ups and SMEs in southern regions. No private investors have yet joined this fund. The 2019 budget law introduced the possibility for the government the government to participate in venture capital funds. To this end, a Venture Capital Support Fund has been set up, with a yearly allocation of EUR 30 million for the 2019-2021 period and EUR 5 million yearly for 2022-2025. The dividends and distributed profits received from SOEs can be invested in venture capital funds.
Maintain current policies to diversify sources of business finance, especially for SMEs such as allowance for corporate equity, the tax advantages and streamlined procedures to issue bonds by unlisted SMEs (minibonds).	The 2019 budget will abolish the allowance for corporate equity that have proved effective in reducing the debt bias and contribute to the capitalisation of Italian firms. The Start-up Act is supporting access to finance but largely through bank loans.
Target research and development incentives towards innovative start-ups and small and medium enterprises. Make them refundable.	Industry 4.0 and the Start-up Act made progress in this area. Some of the incentives are targeted and refundable.
Increase as planned the share of research funding allocated through competitive procedures; publish clear guidelines to allocate research funds to universities and public research institutes based on research assessment.	Pools of funds are allocated to universities on the basis of research results. Funding shares are published.
Approve the competition law being discussed by parliament so as to increase competition into professional and services sectors.	Law approved August 2017. Reformed merger notification requirements. Opening of retail gas and electricity markets postponed to 1 July 2019 from 30 June 2017. Introduced measures in regulated professions, the insurance sector, the telecommunications industry. Increased supply of notaries reduced some exclusive functions of Poste Italiane. Anti-trust arrangements [strengthened?–need to assess] by January 2017 Legislative Decree. Some key provisions of the law were softened during parliamentary approval process, something that was criticised by the Competition Authority.
Reform the bankruptcy legislation in an organic and comprehensive way as envisaged by the enabling law being discussed by parliament.	The enabling law for a comprehensive reform of the bankruptcy code became effective November 2017. The government has yet to issue the implementing decrees that will need to be approved by parliament.
Subnational fiscal relations	
Follow through the reform of parliament and the re-assignment and clarification of competences between the central and sub-national governments.	After the proposed constitutional reform failed to pass, various levels of government are reaching agreements on managing certain subjects, such as active labour market programmes (ALMPs), in the current institutional setting.
Tax administration	
Improve tax collection by investing more in IT systems and updating cadastral values used for properties taxes. **Use additional tax receipts to permanently lower social security contributions for new permanent contracts.**	E-invoicing system was introduced to all transaction from Jan 2019. Some smaller steps were completed. For example, digitalisation of tax trials was extended to the whole country. Comprehensive reforms of tax administration and enforcement is yet to progress. Cadastral value reforms are yet to be designed and implemented. Reduced social security contribution rates are only temporary or limited to some categories of workers (the young). In 2018, split payments to combat VAT evasion were abolished for self-employed.

Thematic chapter

Chapter 1. Tackling Italy's social and regional divide

Disparities in income and well-being in Italy are large, and follow regional lines more closely than in most OECD countries. Differences in employment rates, especially among women, explain much of regional disparities, while differences in labour productivity play a smaller but not negligible role.

These problems, long-standing and deep-rooted, are partly attributable to tax and benefit policies and labour market institutions, which discourage employment, especially of second earners in regions where wages and productivity are lower. The labour income tax wedge is high, curbing job creation, especially of low income jobs. At the same time, benefit policies offer little protection against poverty and labour market risks for many people. To redress this, the guaranteed minimum income scheme implemented in 2017 and 2018 and strengthened in 2019 through the Citizen's Income is an important and welcome step. However, the success of this initiative will hinge on greatly enhancing job-search and training policies along with other social inclusion services. Fiscally sustainable reforms to tax and benefit policies should aim at maintaining progressivity, better supporting poor households, and encouraging labour force participation especially of low income workers, thus benefitting lagging regions.

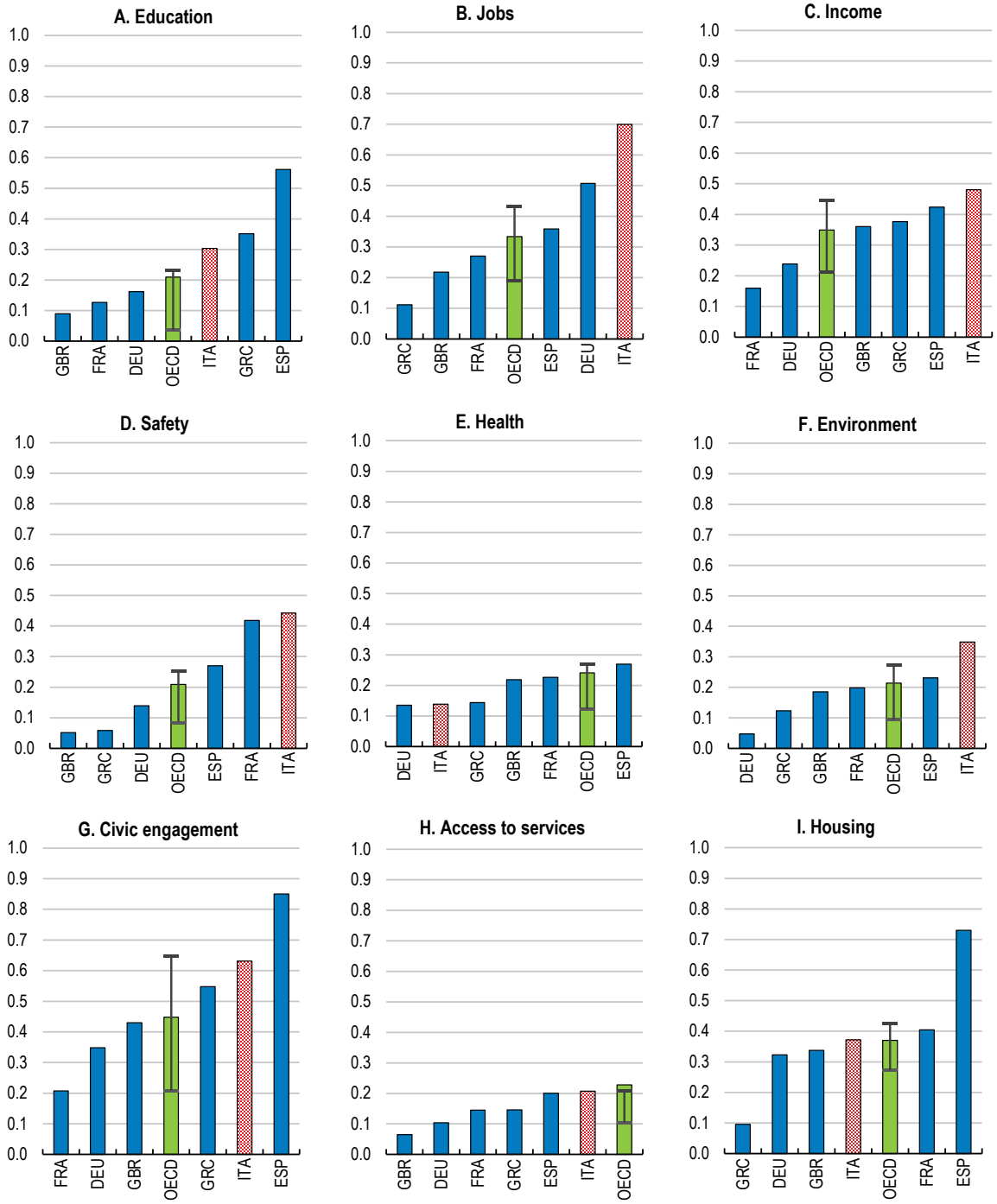
Ineffective regional development policies and low efficiency of local public administrations in poorer regions contribute to regional disparities. Rationalising and improving coordination among the different bodies involved in regional development would make regional development policies more effective. Funds for regional development policies need to add to and not to substitute for those of ordinary administration. More effective regional development policies need to be flanked by initiatives aiming at raising the effectiveness of poorer performing local public administrations, thus enhancing the local provision of public goods and services, and better supporting disadvantaged households.

Italy's large disparities in income and well-being follow regional lines

Italy's social disparities are large. Italy's well-being outcomes lag other OECD countries in several dimensions, as was presented in the *Key Policy Insights*. In Italy, social and economic disparities follow regional lines more closely than in other OECD countries (Figure 1.1). Regional disparities are especially marked for employment and income as well as safety, the environment and civic engagement. Regional disparities follow the historical north-south divide (Figure 1.2). Some regions in the South have among the lowest well-being outcomes across the OECD, while the best performing regions in the North are among the best performers in the OECD (Figure 1.3). Regional disparities are entrenched and in some dimensions, such as employment rates and relative poverty, they have widened over time (Figure 1.4).

Figure 1.1. Disparities among regions are high across many well-being dimensions in Italy

Scale 0 (lowest) to 1 (highest dispersion), 2014



Note: The indicator measures the dispersion in components of the well-being index across regions within a country. For each dimension, countries with the lowest and the highest dispersion levels in the OECD take values 0 and 1 respectively. The value for OECD is an unweighted average across the 31 available countries. The 25th and the 75th percentiles of the distribution are also indicated.
Source: Calculations based on OECD *Regional Well-being* database.

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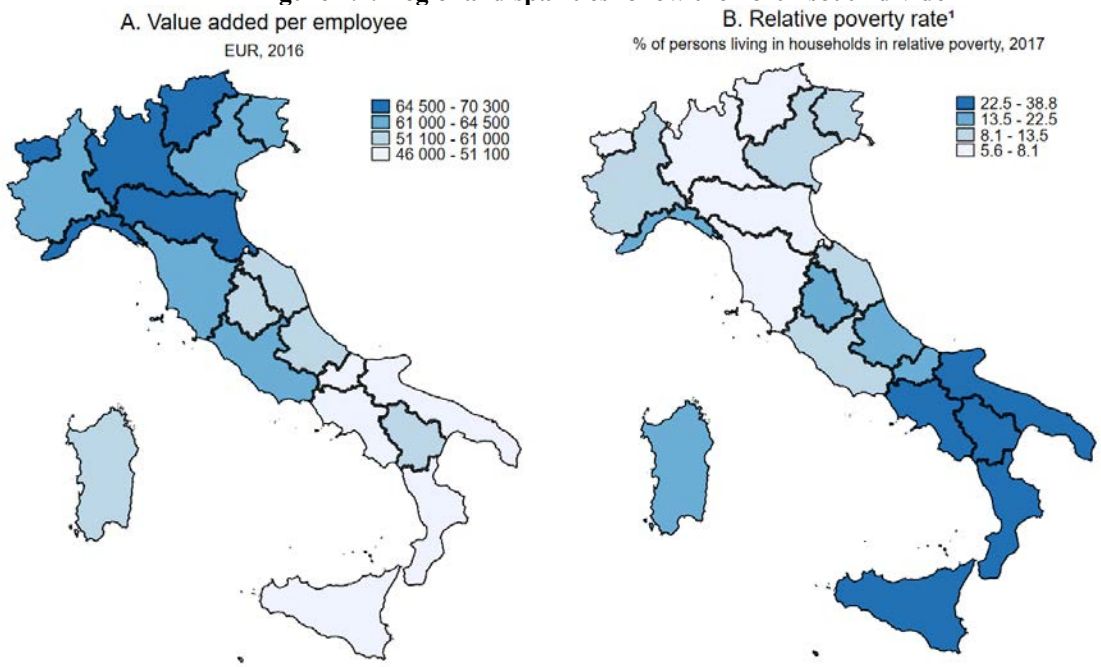
Figure 1.2. Regional disparities follow the north-south divide



1. The ISTAT relative poverty rate is based on the International Standard Poverty Line. ISTAT uses the Carbonaro equivalence scale to adjust household size. The rate is the ratio between the number of individuals living in households in poverty and the number of resident individuals.
Source: ISTAT *Regional* database.

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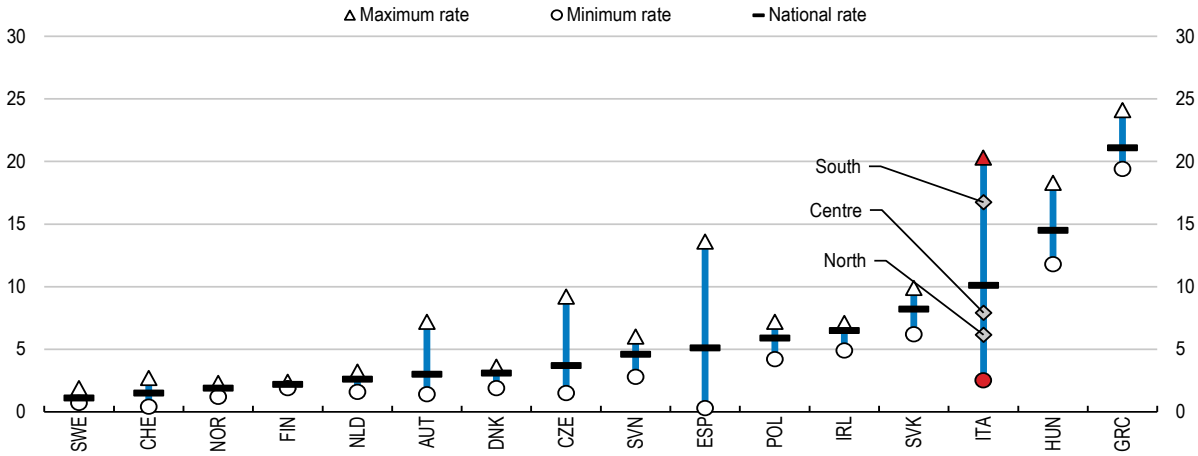
Figure 1.3. Deprivation rates in Italy's poorest regions are among the highest among EU OECD members

Severe material deprivation rate, from minimum to maximum rate as percentage of regional (NUTS 2) population, 2017 or latest available



Note: Latest available year shown, either 2017, 2016 or 2015. The severe material deprivation rate is the proportion of the population living in households unable to afford at least four of the following items: unexpected expenses, a one-week annual holiday away from home, a meal involving meat, chicken or fish every second day, the adequate heating of a dwelling, durable goods like a washing machine, colour television, telephone or car, or are confronted with payment arrears.
Source: Eurostat *Statistics on Income and Living Conditions* database.

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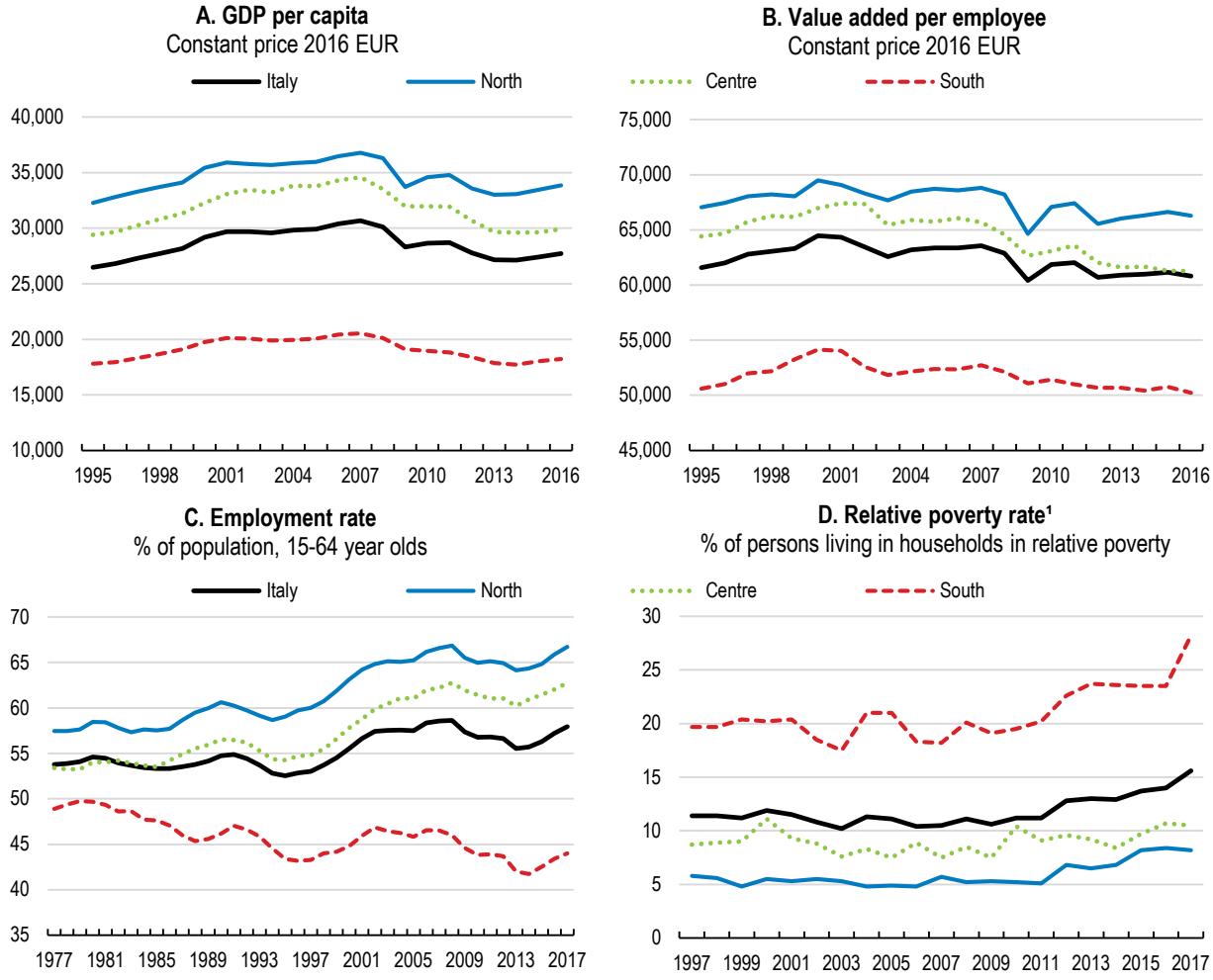
Figure 1.4. Regional disparities in GDP per capita are large and persistent



1. The ISTAT relative poverty rate is based on the International Standard Poverty Line. ISTAT uses the Carbonaro equivalence scale to adjust household size. The rate is the ratio between the number of individuals living in households in poverty and the number of resident individuals.
Source: ISTAT *Regional* database.

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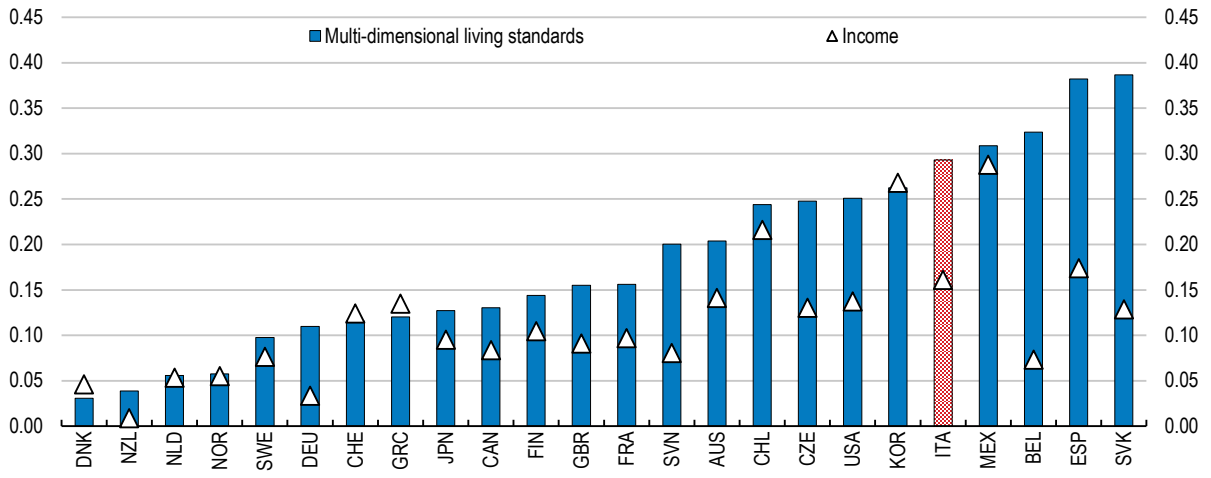
Improving prospects for disadvantaged social groups and lagging regions would generate large gains in national income and well-being. High and persistent regional inequalities in economic, social and well-being dimensions coupled with the lack of prospects and opportunities in lagging regions weaken social cohesion, fostering resentment and creating political tensions. This chapter identifies reform priorities of Italy's tax and benefit system and regional development policies to foster access to jobs in the formal economy, boost work incentives and reduce poverty.

Regional dispersion in well-being is markedly higher than in income alone, (Figure 1.5). Using subjective measures of well-being, individuals in the South report lower well-being than those with the same income living in the Centre and North (D'Alessio, 2017[1]). This gap between regional dispersion measures of income and of well-being is larger in Italy than in most other OECD countries for which data are available (Veneri and Murtin, 2016[2]). All this points to the strong role played by factors other than income in determining large regional disparities in the quality of life in Italy.

Figure 1.5. Dispersion among regions in well-being is wider than for income alone

Coefficient of variation, 2012



Note: Higher values mean larger disparities. The multi-dimensional living standards measure is a composite measure of regional income, unemployment and health.
Source: Veneri, P. and F. Murtin (2016), "Where is inclusive growth happening? Mapping multi-dimensional living standards in OECD regions", *OECD Statistics Working Papers*, No. 2016/01

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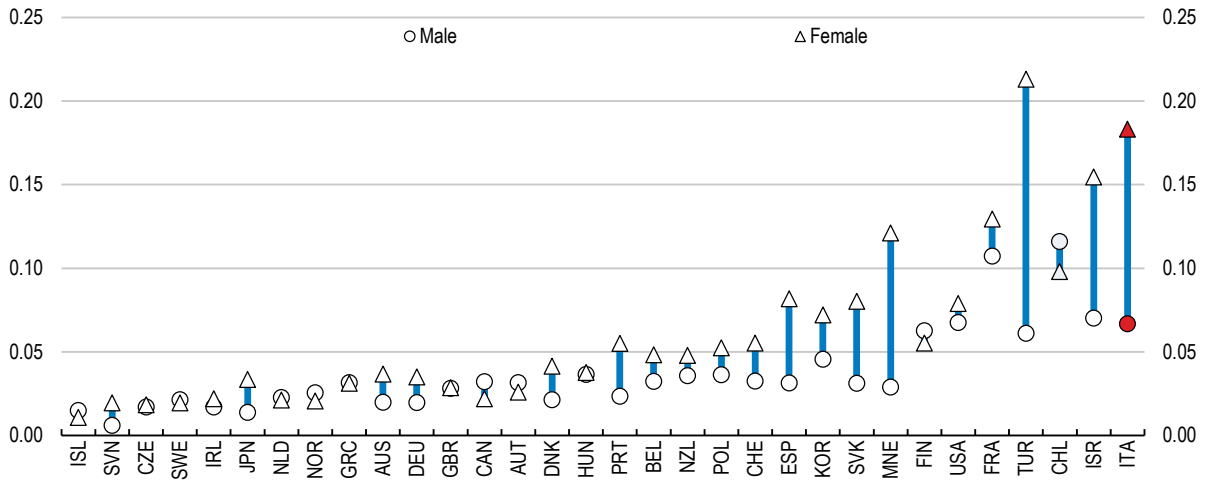
Regional differences in GDP per capita in Italy primarily reflect differences in employment rates, especially among women (Figure 1.6). This is unlike most OECD countries where productivity disparities play a much larger role in explaining differences between regions in GDP per capita (Figure 1.7). Moreover, wages in Italian lagging regions are lower than in more advanced ones. In southern regions, average wages are around 14% below the national average, while labour productivity is 20% lower, while in the North-west wages are 8% above the national average and labour productivity is 12% higher. The average wage in southern regions is around the 30-40th percentiles of the national full-time wage distribution while the average wage in most northern regions are near the 60-80th percentile (Figure 1.8).

Lower wages combined with low employment rates lead to lower household earnings in lagging regions. Though a large share of workers in lagging regions gain some income from informal work (Figure 1.9), such jobs are often associated with lower productivity and poorer working conditions and income.

Poverty rates vary widely among Italy's regions and across socio-demographic groups (Figure 1.10). Disparities in poverty follow the north-south divide as poverty rates – in both absolute and relative terms – are generally higher in southern than in central and northern regions across all household types. Southern regions have among the highest poverty rates across all regions in OECD countries at the NUTS-2 level, while some northern regions are well below the OECD average (Figure 1.3). Poverty is especially high for families with children and increases with the number of children, while it is lowest among retirees. Though poverty rates are highest among the unemployed, at about 25%, in-work poverty has also risen (Figure 1.11).

Figure 1.6. Differences in employment rates across regions are high in Italy, especially among women

Coefficient of variation across regions in employment rates of 15-64 year-olds, 2016 or latest available



Note: Countries are sorted by the coefficient of variation of total employment. The coefficient of variation is the ratio of the standard deviation to the mean across regions at NUTS 2 level. For the United States, relates to persons aged 15 and over.
Source: OECD *Regional Statistics* database. Eurostat data for France.

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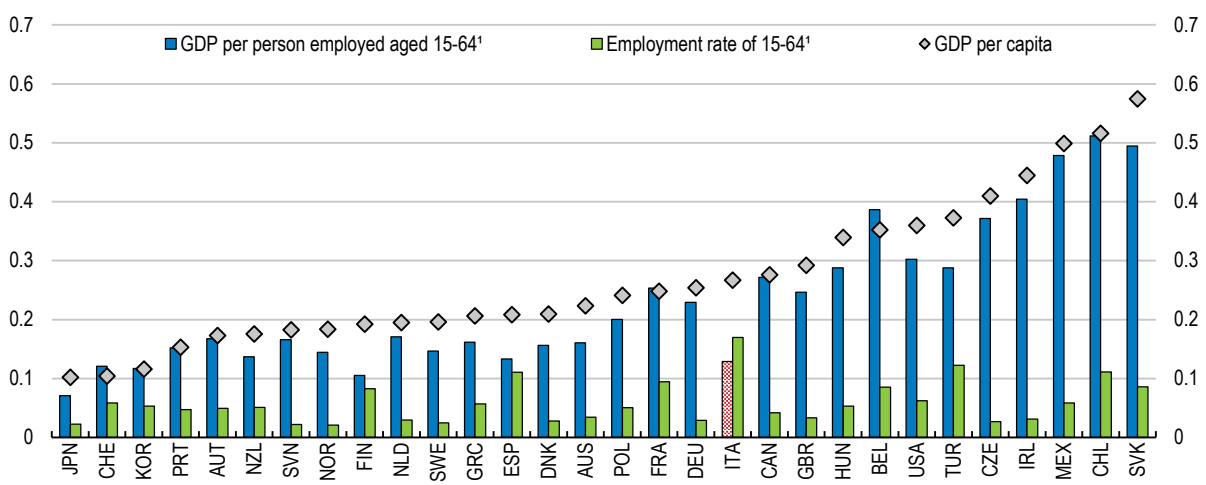
Figure 1.7. In Italy, differences in employment rates among regions explain more of the regional differences in income

Coefficient of variation across regions, 2016 or latest available



Note: The coefficient of variation is the ratio of the standard deviation to the mean across regions at NUTS 2 level. GDP data for each regions are expressed in USD PPP at constant prices.
1. For the United States, concerns persons aged 15 and over.
Source: OECD *Regional Statistics* database.

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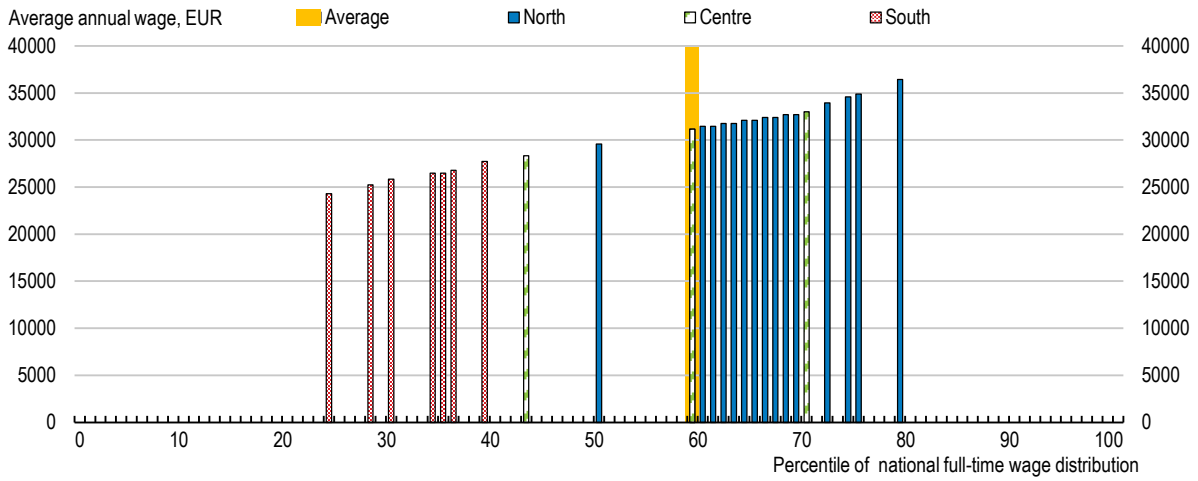
Figure 1.8. Average wages in southern regions are around the bottom third of the national wage distribution

Average annual full-time wage by region, Euros, arranged by national wage distribution, 2017



Source: ISTAT *Regional* database and OECD calculations.

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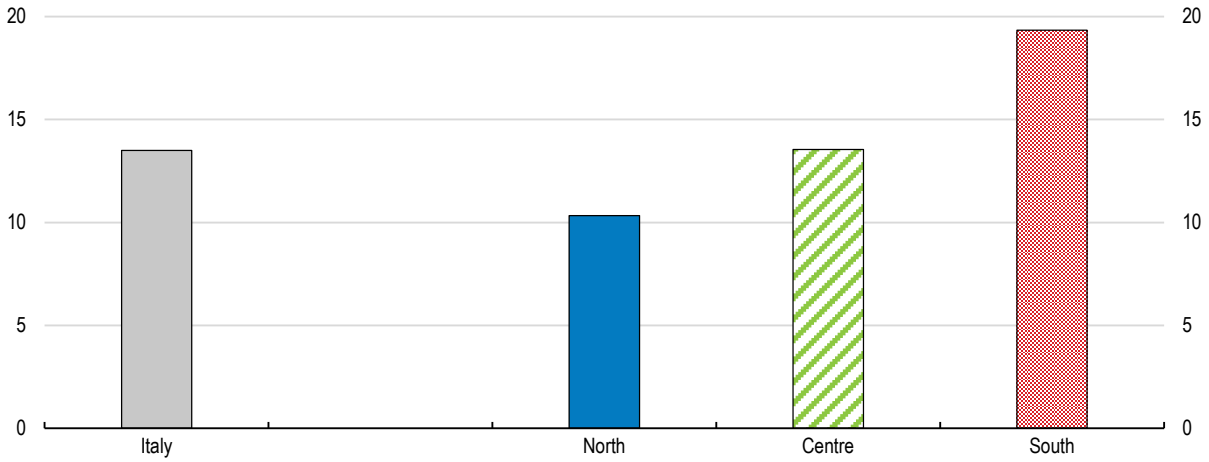
Figure 1.9. Informal work is more common in low-income regions

Undeclared work, % of total employment, 2016



Source: ISTAT *Regional* database.

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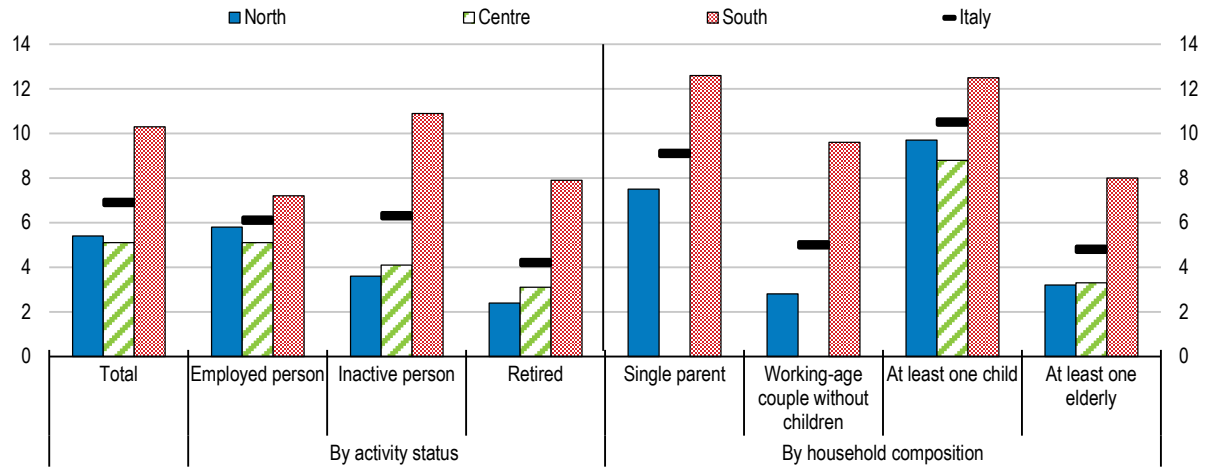
Figure 1.10. Poverty is more common in Italy's South, particularly among families with children

Percentage of households in absolute poverty, 2017



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

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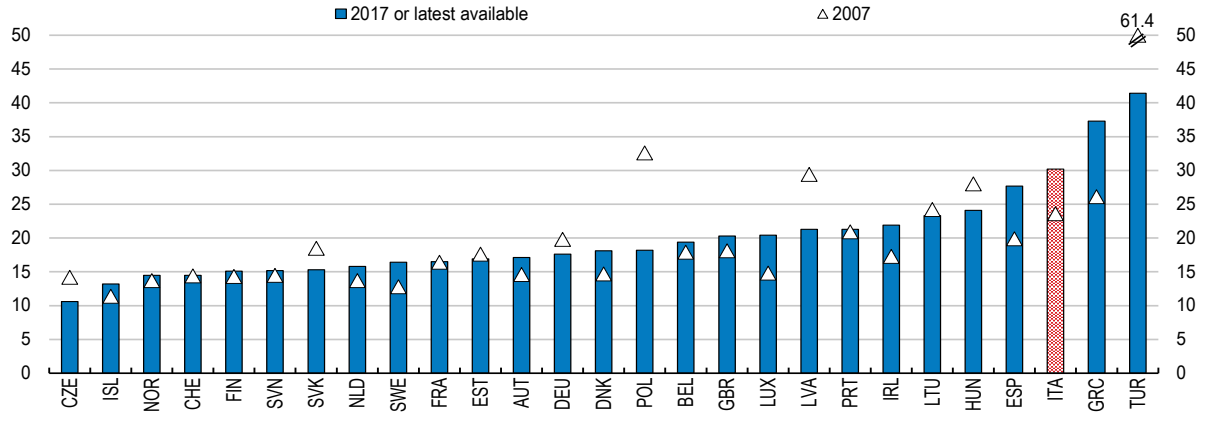
Figure 1.11. A high and rising share of Italian workers is at risk of poverty

At risk of poverty or social exclusion, employed persons aged 25-54



Source: Eurostat

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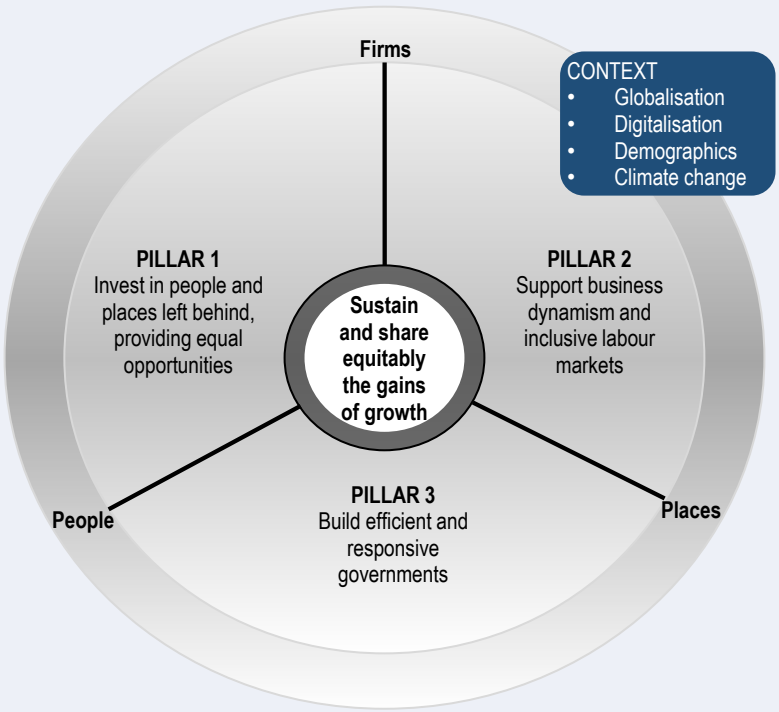
Reducing Italy's social disparities requires addressing its large regional inequalities by improving welfare and supporting sustained growth. This chapter identifies reform priorities of Italy's tax and benefit system and regional development policies to boost growth and share more equitably its gains by fostering inclusive access to good quality jobs in the formal economy, strengthening work incentives and reducing poverty. These ambitions and policy measures apply the OECD's *Framework for Policy Action on Inclusive Growth* (Box 1.1) (OECD, 2018[3]).

Box 1.1. Applying the OECD's *Framework for Policy Action on Inclusive Growth* to Italy's social and regional disparities

In 2018 the OECD Ministerial Council adopted a *Framework for Policy Action on Inclusive Growth*, to guide policies to better achieve growth that benefits all and that allow for people, regions and business to fulfil their potential. The framework is not prescriptive, instead emphasising specific policy options that can adapt to Italy's circumstances. It is centred on three broad principles (Figure 1.12):

1. Invest in people and places that have been left behind through (i) targeted quality childcare, early education and life-long acquisition of skills; (ii) effective access to quality healthcare, justice, housing, infrastructures; and (iii) optimal natural resource management for sustainable growth.
2. Support business dynamism and inclusive labour markets through (i) broad-based innovation and technology diffusion; (ii) strong competition and vibrant entrepreneurship; (iii) access to good quality jobs, especially for women and underrepresented groups; and (iv) enhanced resilience and adaptation to the future of work.
3. Build efficient and responsive governments through (i) aligned policy packages across the whole of government; (ii) integration of distributional aspects upfront in the design of policy; and (iii) assessing policies for their impact on inclusiveness and growth.

Figure 1.12. The OECD Framework for Policy Action on Inclusive Growth

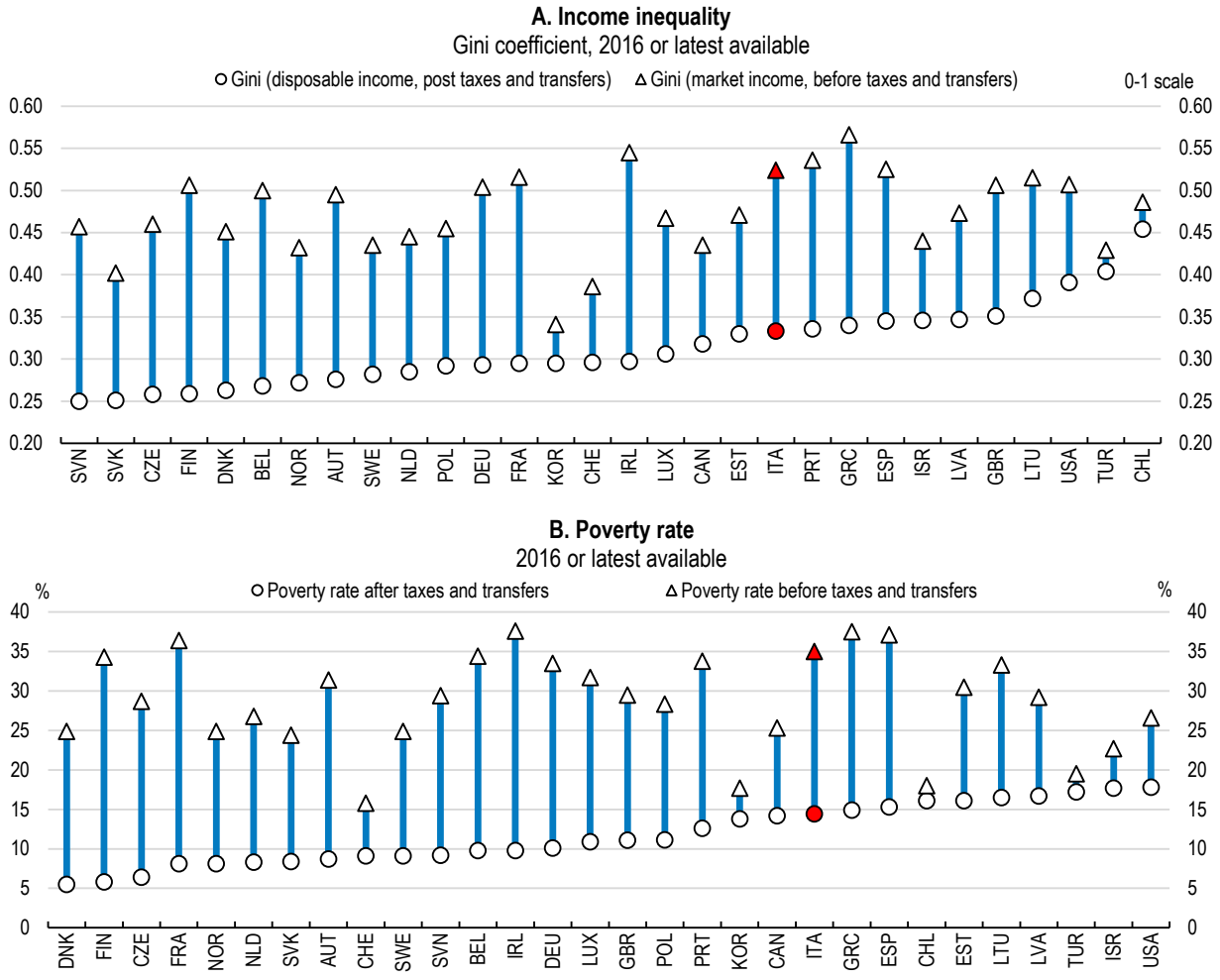


Source: (OECD, 2018[3])

Italy's tax and benefit system can do more to support employment and to lower poverty

In Italy, inequality and poverty are above the OECD average (Figure 1.13). Italy's indicators of disposable income inequality in Italy are below those of the United Kingdom but significantly higher than those of France or Germany. This reflects the large inequality in market income (the fourth highest among OECD countries), which the tax and benefit system only partly offsets. After taxes and transfers, Italy's poverty rate remains among the top half of OECD countries. Italy's high pension spending and limited social protection favours older people ahead of the young. As discussed below, well-designed reforms of the personal income tax and social benefit system would improve jobseekers' ability to find work and better protect young and working age people from poverty.

Figure 1.13. Inequality and poverty are comparatively high



Note: Poverty line is at 50% of the median equivalised income.
Source: OECD *Income Distribution* database.

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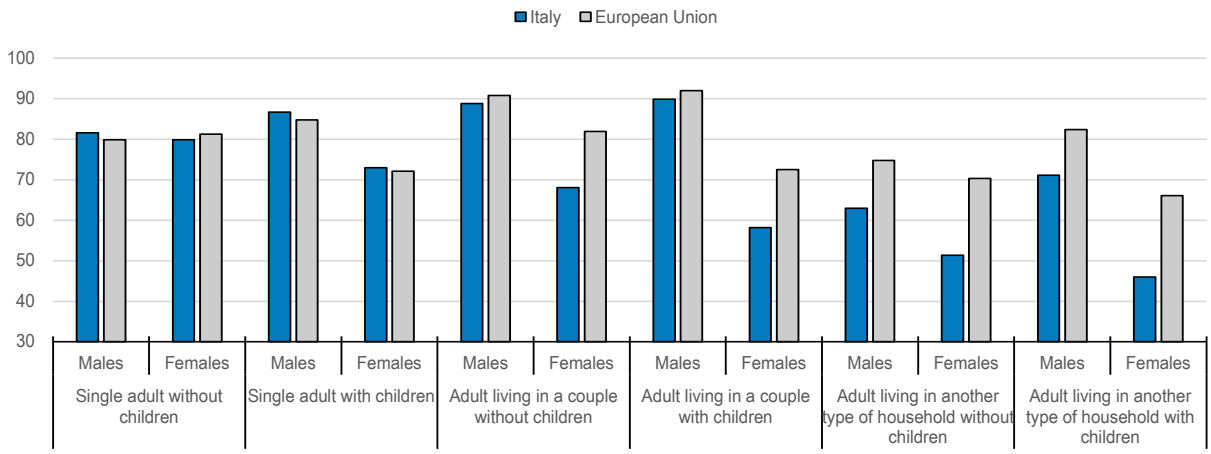
Italy's tax and benefit system discourages work

The size and structure of Italy's tax and benefit system discourage employment, especially among low wage earners and second earners in couples. This is especially problematic in lagging regions where wages tend to be lower than in more developed ones. The shares of single men and women who work in Italy are similar to other European countries. However, among members of a couple, Italy's employment rates fall below European averages, especially among women and in households with caring needs (Figure 1.14). Second earners' decisions to seek employment tend to be more sensitive to work incentives and expected disposable income than primary earners (OECD, 2011[4]), especially in Italy (Bargain and Peichl, 2013[5]; Bargain, Orsini and Peichl, 2013[6]; Immervoll et al., 2011[7]). As the female spouse is usually the second earner in Italy, like in most OECD countries (Thomas and O'Reilly, 2016[8]), weak work incentives and low expected income discourage employment among women. Employment rates are markedly lower among women with less education and in regions with lower average wages (Figure 1.15).

Figure 1.14. Members of couples and especially women are less likely to work in Italy than in other European countries

Employment rate, population aged 25-54 years, 2017



Source: Eurostat.

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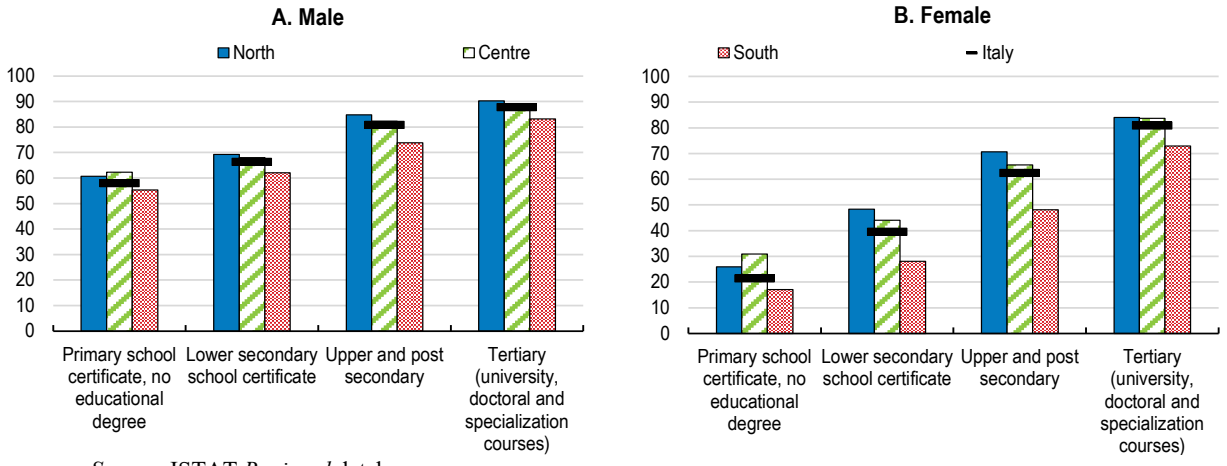
Italy's tax share is among the highest relative to GDP across OECD countries (Figure 1.16, Panel A). Personal income taxes and social security contributions amounted to 24% of GDP in 2016. Corporate income and indirect taxes generate smaller shares of overall revenues than in most OECD countries, even if they too are large relative to GDP. High employer social security contributions and personal income taxes make Italy's labour income tax wedge one of the widest of any OECD country (Figure 1.16, Panel B). This curbs labour demand especially in low productivity areas.

Figure 1.15. Employment rates vary greatly with education levels and across regions

Activity rates, % of population, 20-64 year olds, 2017



Source: ISTAT *Regional* database.

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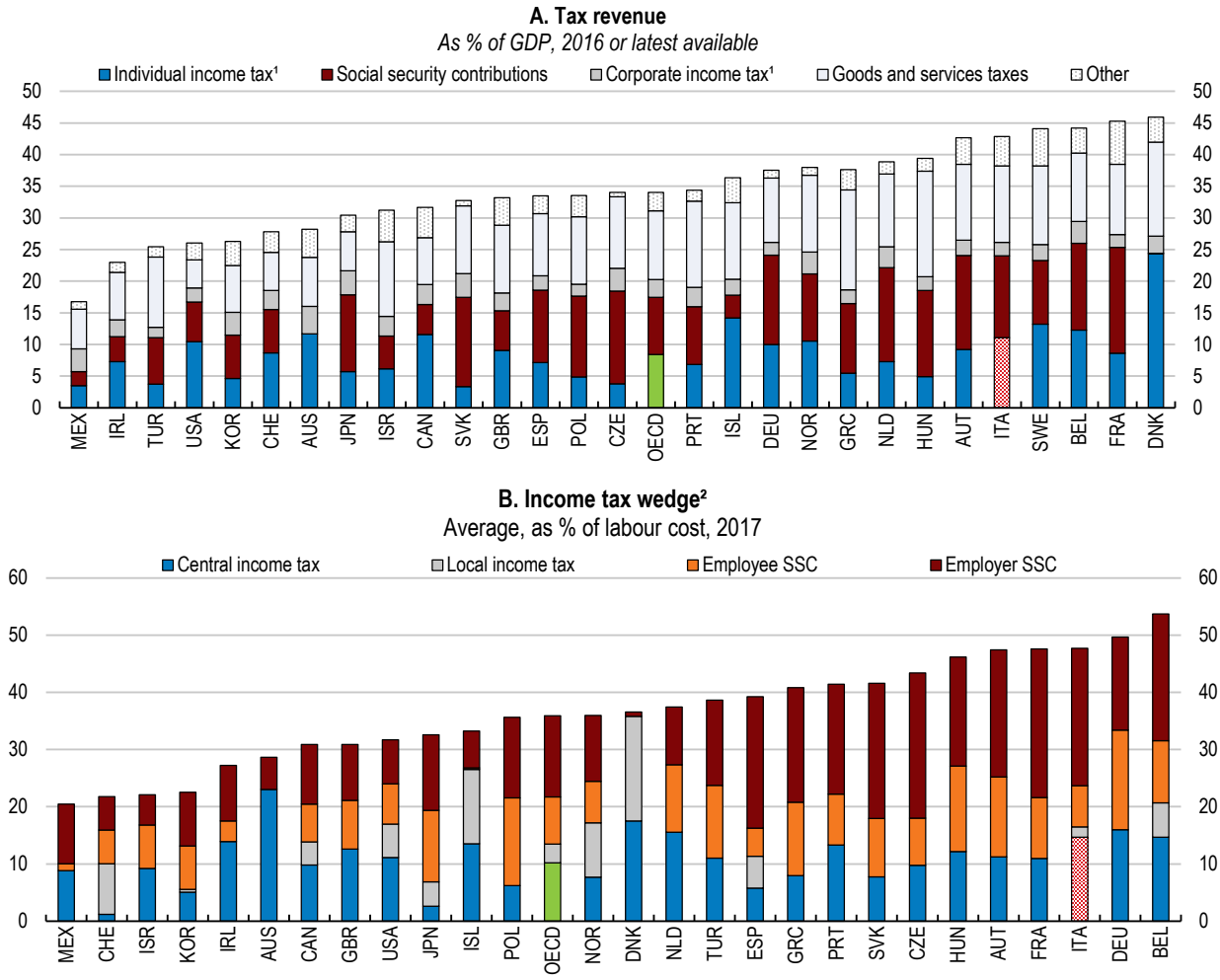
Temporary cuts in employer social security contributions over 2015-2018 for new permanent contracts and for targeted workers, such as the young, boosted job creation over this period (Table 1.1). The 2019 Budget introduces corporate income tax breaks for firms expanding employment. However, these tax breaks are likely to have a narrower effect in encouraging employment than a cut in social security contributions as only firms liable to pay corporate income tax will benefit from these tax breaks. Permanently reducing employer social security contribution rates, particularly for low income jobs, would better improve Italy's competitiveness and boost job creation for a given reduction in revenues (Johansson, 2016[9]; De Mooij and Keen, 2012[10]).

Italy's statutory personal income tax rates are also high (Figure 1.17). Taxpayers with very low incomes are liable to income tax, unlike many OECD countries where they benefit from a zero tax rate. Instead, in Italy low-income taxpayers and taxpayers supporting dependants benefit from tax credits, transfers and allowances. This system limits tax liabilities for very low income households without dependent children, largely through family tax benefits, and supports very low income households with dependent children through family benefits and transfers (Figure 1.18 and Table 1.2).

The various benefits, credits and transfers mean that in Italy an individual's effective tax rate depends on their household's composition and income. The current system penalises households with a second earner and poor households with children by excluding low income households from some tax credits, resulting in higher average effective tax rates (Figure 1.18). The difference in household tax burdens among household types is larger at lower incomes than at higher incomes. Other OECD countries, whether they assess tax liabilities against individual or household income, also adjust effective tax rates according to household composition. How these adjustments are made brings trade-offs between equity and efficiency. In general, the more dependent an individual's effective tax liability is on other household members' incomes, the greater the disincentive for the second earners to seek employment (Box 1.2).

Figure 1.16. Italy's employer social security contributions and on personal income tax revenues are higher than most OECD countries, and create a wide labour income tax wedge



1. Includes taxes on profits and capital gains.
2. The tax wedge is personal income tax, employer and employee social security contributions and payroll taxes less benefits relative to labour costs, for a single childless worker earning 100% of average earnings. Labour costs include the employee's gross wages plus employer social security contributions and, where relevant, payroll taxes.
Source: OECD *Revenue Statistics* database; and OECD *Taxing Wages* database.

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In Italy, earners lose eligibility for many tax credits, allowances and transfers when their incomes are at relatively low levels, raising their effective marginal tax rate (Table 1.2). For example, the in-work benefit of EUR 80 per month phases in at moderate wage levels (higher than the wage rates of the working poor) and then phases out sharply as incomes rise from EUR 24 600 to EUR 26 600, raising the marginal effective tax rates markedly. In lagging regions, where more jobs are paid at lower wages, a larger share of households face these high effective marginal tax rates, which weakens work incentives (Figure 1.19). The tapering in the effective tax rate is not smooth, as households gain and then lose eligibility for specific transfers or benefits as their income rises through thresholds that differ between different tax credits and transfers (Figure 1.19, Panel B). This can create inconsistencies between otherwise similar households.

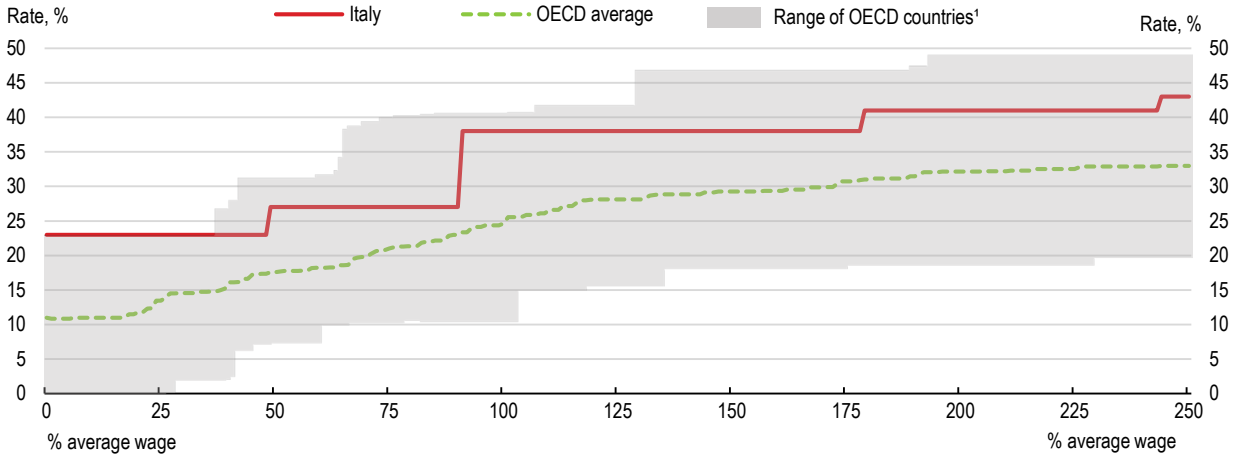
Table 1.1. Recent measures to reduce Italy's high labour income tax wedge

Target groups	Specific measures
Unemployed women, especially disadvantaged areas	50% rebate for 18 months when hiring women who have been out of work for more than 24 months, or 6 months in disadvantaged areas, for new open-ended contracts or for conversions of short-term contracts for 12 months.
Younger employees with children	Hiring bonus of EUR 5 000 for each new employee aged up to 35 years with dependent children.
Youth, southern regions	"Youth bonus" of EUR 8 060/year for hiring young (aged 15 to 24) NEETs in southern regions, for new open-ended or apprenticeship contracts. Half subsidy for fixed-term contracts. Extended to 2020.
Younger long-term unemployed; southern regions	50% rebate for 36 months, up to EUR 3 000 / year when hiring employees aged up to 35 years who have never worked, for new open-ended contracts or for conversions of short-term contracts. Also for southern residents over 35 if not regularly employed during the previous 6 months.
Other 2019 budget measures	Corporate income tax credits for firms increasing employment Social Security Contribution exemption to private employers who hire young graduates or PhD on a permanent basis (up to 1 year and capped at EUR 8 060).

Source: OECD *Tax and Benefit* database; European Commission (2018[82]).

Figure 1.17. Italy's statutory marginal tax rates are higher than most OECD countries

Statutory national marginal tax rates, 2017



1. The tax rates are the basic central government statutory marginal tax rate that applies to a given level of taxable income, with the level of taxable income expressed as a percent of the average wage. The OECD range illustrates 10th to 90th percentile of statutory marginal tax rates across OECD countries.
Source: OECD calculations based on OECD *Tax* database; and OECD (2018), *Taxing Wages 2018*, OECD Publishing, Paris.

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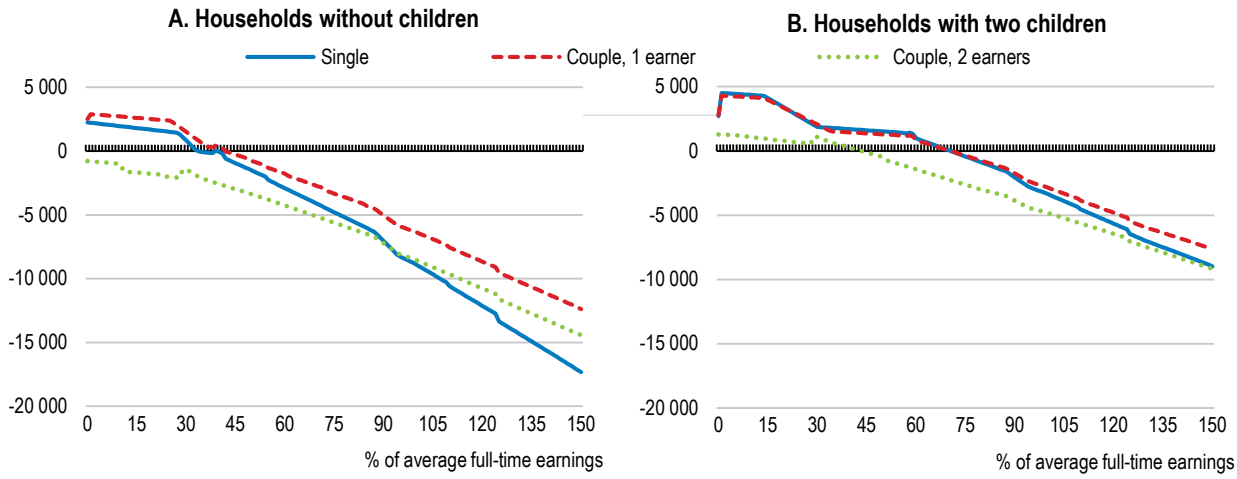
Figure 1.18. Taxes and benefits support low income couples and households with children
Difference between gross income and net disposable income for various household types, per household member, 2018 policies, Euros



Note: The horizontal axis shows the wage of the primary earner as % of the average full-time earnings. Second-earner's earnings is fixed at 50% of the average earnings. Total household income is adjusted for household size by the OECD equivalence scale, i.e., divided by 1.4 for a couple, 2 for a couple with 2 children, and 1.7 for a single adult with 2 children.
Source: Calculations based on OECD Tax-benefit model.

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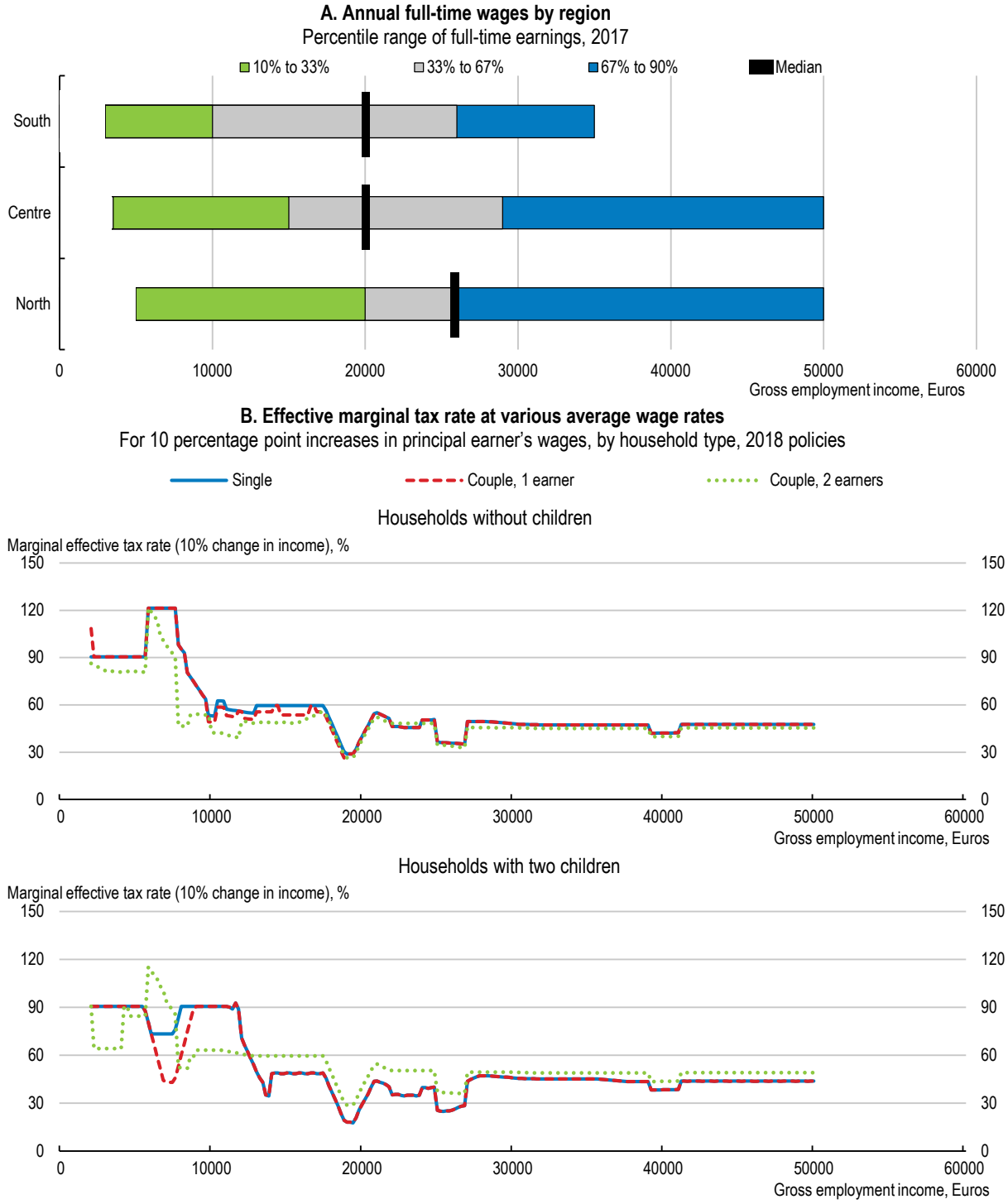
Table 1.2. Selected tax credits and allowances in Italy, 2018

Low income tax credit	Non-refundable tax credit of EUR 1 880 for dependent employment incomes below EUR 8 000. Credit declines as income rises up to EUR 55 000. Other income sources, such as self-employment and old age pension receive specific tax credits. The credit declines in proportion to the number of days worked per fiscal year. The tax credit cannot be lower than EUR 690 (EUR 1380 for temporary contracts).
Family tax credits	Applies for the taxpayer's dependents provided their income is below EUR 2841. Dependent children: for children under three years of age the tax credit is computed as EUR 1 220*(95 000–taxable income)/95 000; for children over three years of age it is computed as: EUR 950*(95 000–taxable income)/95 000. Amounts are increased by EUR 15 000 for the 2nd and 3rd child and by more for additional children. For two-earner couples, the tax credits are equally shared between the parents. However, if the second earner's tax liability after the income-related tax credit is less than their half of the child tax credit, the entire child tax credit is allocated to the other partner. Dependent spouse: For main earner with income up to EUR 15 000, the main earner gains a credit of EUR 800 – 110*taxable income/15 000. The credit declines to 0 at an income of EUR 80 000. The dependent's annual taxable income must not exceed EUR 2 840.
Fiscal bonus	Income up to EUR 8 145: bonus of EUR 0. Income EUR 8 146-24 600, credit of EUR 960 (EUR 80 per month). Credit declines to 0 between incomes of EUR 24 600 and EUR 26 600. For less-than full-time workers, the bonus is scaled by the number of days worked per fiscal year. Only applies when there is a tax liability after other tax credits.
Housing rental tax credit	Income below EUR 15 493.71: credit of EUR 300. If income below EUR 30 987.41, credit EUR 150.
Childcare tax credit	Tax rebate of 19% of childcare expenses, up to a EUR 120.08 per child.
Family allowance	Non-taxable cash transfers to employees, unemployment benefit recipients, project workers, and former-employee pensioners; does not cover the self-employed. At least 70% of income must come from employment (including unemployment benefits).
Large family allowance	Non-taxable cash transfer. For at least 3 children. EUR 141.30 per month, and EUR 500 additional allowance if more than 4 children. ISEE[1] value below EUR 8 555.
Baby bonus	Non-taxable transfer of EUR 160 per month if the ISEE value is below EUR 7 000 or EUR 80 per month if the ISEE value is below EUR 25 000, per child for 12 months

1. Box 1.4 describes Italy's Equivalent Income Situation Index (ISEE) calculation.
Source: OECD *Tax and Benefit policy* database.

Figure 1.19. Effective marginal tax rates are high at low wages, which are more common in lagging regions



Note: In Panel B the vertical axis shows the effective marginal tax rate in % for 10 percentage point increases in principal earner's wages at various gross employment income levels. The second earner's wage in two-earner couples is assumed to be 50% of the average wage.
Source: OECD calculations from OECD Tax-benefit model, OECD *Tax and benefit* database, and ISTAT *Regional* database.

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Box 1.2. Whether personal income tax rates are assessed at the individual or the household level affects work incentives for second earners

In 29 out of 36 OECD countries, personal income tax (PIT) is assessed against an individual's income. Seven countries require and another four give taxpayers the option of assessing their PIT on a couple's joint income, or even on the income of all members of the household. Some countries, including Italy, with personal income assessments in practice have a hybrid system, as they provide tax relief or allowances based on joint or household income or provide credits that can be transferred between spouses.

The choice of tax unit entails a trade-off between equity between families, equity between family structures (e.g., singles relative to couples), marriage neutrality (not providing an incentive or penalty when two individuals marry) and progressivity across income levels. No tax structure can simultaneously achieve all objectives.

Whether the individual or the couple is the tax unit affects the neutrality of the tax and benefit system between singles and couples, and the incentives for the second earner in a couple to enter work. When the couple or family is the tax unit, families earning similar total income pay similar levels of taxes, regardless of how earnings are distributed within the couple, improving horizontal equity across families. However assessing income jointly combined with progressive tax rates discourages second earners, as the second earner will face a marginal tax rate equal to that of the primary earner, which is likely to be higher than if the second earner was assessed independently. A larger difference between spouses' incomes will amplify this disincentive.

Tax and benefit systems that assess income individually but provide tax credits, allowances and transfers on the basis of joint or household incomes, such as Italy, generate high marginal participation tax rates for the household as the second earner enters employment, especially in low-income families that benefit from these allowances.

Similar trade-offs apply to the design of working or earned income tax credits, such as in Italy's system. These supplement incomes when employment pay is low. Eligibility thresholds that are based on total household income and circumstances can discourage second earners from entering low-income work, as the additional income may reduce the tax credit paid to the household. Eligibility criteria based solely on the individual's income would avoid this disincentive, but may lead to individuals in high-income households benefiting from the transfer.

Family policies can offset the employment disincentives for second earners of family-based tax assessment systems. For example, in France, income tax is assessed jointly and then adjusted for the number of family members, lowering marginal rates as family size grows. To encourage spouses to enter employment, the French government provides capped allowances, tax credits and subsidies for childcare and household assistance. Social benefits, such as subsidised access to childcare or children's meals, can further reduce work disincentives.

Sources: (Thomas and O'Reilly, 2016[8]; Colonna and Marcassa, 2015[12]; Luca, Rossetti and Vuri, 2014[13]; Alm, 2005[14])

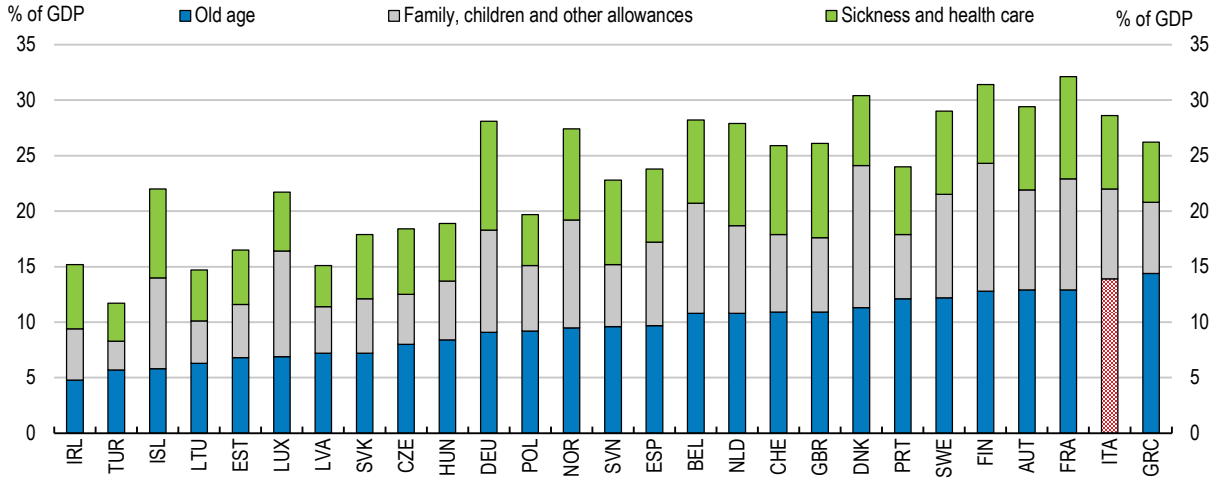
The structure and withdrawal of family tax credits favours households with an inactive second earner, especially when the second earner can only access low wage work. A household with one earner receiving the average full-time salary is entitled to a tax credit of EUR 710 if the second earner's annual income is below EUR 2 840. The household becomes ineligible for this credit once the second earner's income rises above this level, leading to high effective tax rates for the household as the second earner enters work at low wages or part-time. This loss of the tax credit adds to other costs faced by the household as the second earner starts working, such as childcare (discussed below). This further discourages labour force participation of second earners especially in lagging regions where wages are lower. In contrast, in many other OECD tax systems the second earner faces a lower effective tax rate than the first earner at most wage rates.

The benefit system inadequately addresses poverty and social disparities among the young and the working age population

Pensions account for about half of total social protection spending, a higher share than in most OECD countries (Figure 1.20). As a result, spending as a share of GDP on family benefits, active labour market, disability and housing programmes is lower than elsewhere (Figure 1.20). Furthermore, social transfers to the working age population are poorly targeted as only a small share of them reach the poorer households (Figure 1.21).

Figure 1.20. Italy's high spending on pensions reduces space for other social protection programmes

Social protection expenditure by function of social protection, 2016 or latest available



Note: Social protection encompasses interventions from public or private bodies intended to relieve households and individuals of the burden of a defined set of risks or needs, provided that there is neither a simultaneous reciprocal nor an individual arrangement involved. The eight main risks or needs are: old age, sickness/healthcare, survivors, disability, family/children, unemployment, housing, and social exclusion not elsewhere classified (n.e.c). 2014 data for Poland and Turkey. The category family, children and allowances includes social expenditure on unemployment, housing and social exclusion n.e.c.
Source: Eurostat *Social Protection Statistics* database.

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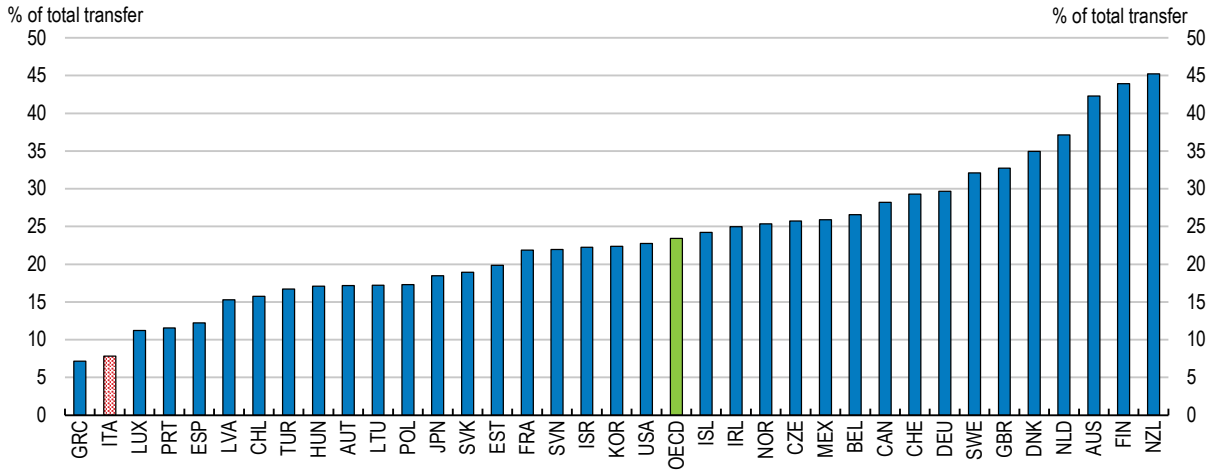
Social spending does little to reduce regional disparities. Municipal authorities are responsible for implementing social protection programmes but capacity and resources vary with the prosperity of the region (Figure 1.22). Lagging regions have larger

populations with social needs, but fewer resources and less capacity to address these (Frazer and Marlier, 2009[15]).

Figure 1.21. A small share of transfers benefits Italy's poorest households

Transfers to poorest 20% of working age population, 2016 or latest available year



Note: Public social transfers received (from public social security) by working-age individuals in low-income groups (equivalised disposable income). Age group 18-65, 18-62 in France.
Source: OECD calculations based on the OECD *Income Distribution* database.

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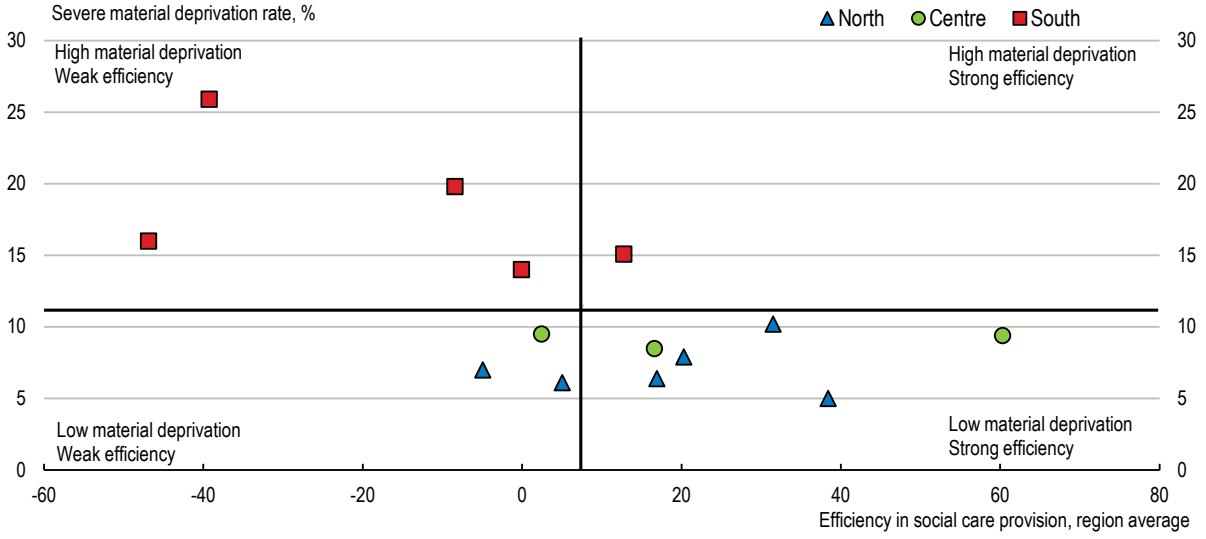
Figure 1.22. Poorer regions have lower social spending and less capacity

Share of total population reporting severe material deprivation and efficiency in social care provision, region averages, 2016



Note: The social care provision index is the percentage difference between spending needs given a region's characteristics and actual spending in the region. The index is computed considering spending per capita at municipal level and computing the arithmetic averages by region.
Source: ISTAT; Eurostat; OpenCivitas; and OECD calculations.

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Italy's pension spending is high and new policies will raise it further

Italy's pension spending is the highest across OECD countries and absorbs more than half of Italy's total social spending (Figure 1.20). Reforms since the mid-1990s have helped to contain rising pension spending, slowing it to below nominal GDP growth. The 2012 Fornero reform extended contribution periods by increasing the retirement age of women to that of men, accelerated the transition to a notional defined contributions system, delayed when a worker would be eligible for pensions and strengthened the link of retirement age to life expectancy. Following this reform, older workers extended their working lives, although they are still shorter on average than in most OECD countries. According to the European Commission, without considering the effect of the retirement policy changes introduced with the 2019 budget, pension spending will rise by 2040, because of the fast ageing process, to the highest level of any European country at any point in the European Commission's 50-year projection framework, before falling to below 2016 levels by 2060 (European Commission, 2018[16]).

The changes to retirement rules provided in the 2019 budget will lower the effective retirement age. Workers who are aged at least 62 and with at least 38 years of contributions will be allowed to retire with a reduced pension. The changes also weaken the link between life expectancy and retirement age by discontinuing until to 2026 the link between the updates of early retirement contribution requirements and developments in life expectancy. The 2019 reforms also expand access to early retirement for women. These changes reforms follow 2016 reforms that allowed workers to retire earlier by borrowing against future pension benefits (Iudicone, 2017[17]; Ministry of Economy and Finance, 2017[18]).

The 2019 changes to retirement rules are expected to result in up to 300 000 additional retirees in 2019, 330 000 in 2020 and 355 000 in 2021. Pension spending will rise by up to EUR 4 billion (about 0.2% of GDP in 2019) and by about EUR 8 billion yearly in 2020 and 2021, depending on how many eligible workers take-up the scheme. A worker accessing early retirement may lose between 2% and 16% of their standard pension.

Closing the early retirement scheme that the 2019 Budget introduced and reallocating the financial resources to growth-enhancing and social inclusion policies, such as the in-work benefit scheme discussed below, innovation policies and education would preserve the sustainability of the pension system and lead to a faster debt reduction. The sustainability of the pension system crucially also depends on raising the employment rate towards the EU average, and on stronger productivity growth. A sustained increase of 0.4 percentage points in total factor productivity growth would reduce pension spending by 1.1% of GDP from 2050.

Reforming tax and benefit policies to better fight poverty, encourage employment and improve inclusiveness

Over the past few years, introducing a guaranteed minimum income has become a priority of Italian governments (Sacchi, 2018[19]), in line with past OECD Surveys' recommendations (OECD, 2013[20]; OECD, 2015[21]; OECD, 2017[22]). Guaranteed minimum income schemes act as last-resort safety nets for very low-income and-low wealth households. Design choices for guaranteed minimum income schemes centre eligibility thresholds and transfer amounts as well as the associated requirements of engaging in job-search, training, and other social programmes. As benefits are generally low and well below national poverty lines, such schemes by themselves reduce the depth of poverty, rather than lifting households out of poverty. That eligibility to guaranteed minimum income schemes is conditional on actively seeking work or joining training

programmes and that benefits are often limited in time distinguishes guaranteed minimum income from universal basic income schemes, which are universal and unconditional (Box 1.3).

Sustained employment is the best antidote to poverty (Causa, Hermansen and Ruiz, 2016[23]). While the income transfers provided by guaranteed minimum income schemes can be effective in the short term in alleviating poverty, there is a trade-off between the transfer generosity and the incentive for beneficiaries to find work. To help beneficiaries move into employment, many guaranteed minimum income schemes require beneficiaries to actively seek work or take part in training or other social support programmes. To ensure that work pays for beneficiaries, some schemes reduce transfer amounts gradually as beneficiaries start gaining employment income, and a growing number of OECD countries provide in-work benefits to top-up the incomes of low-wage earners.

This section assesses three scenarios based on planned and hypothetical tax and benefit policy reforms in Italy to reduce poverty and expand employment. The reform options are compared with Italy's tax and benefit policies at the end of 2018, following the July 2018 expansion of the Inclusive Income Scheme (REI). The reform scenarios are:

1. Citizen's Income scenario. The Citizen's Income (Reddito di Cittadinanza) will be introduced from April 2019 and will replace the REI. Its transfers and eligibility thresholds will be more generous than those of the REI. Overall, the Citizen's Income could lower poverty rates and the poverty gap substantially. Beneficiaries will only retain a small share of any gains in employment income, and only for the length of an existing Citizen's Income agreement. This, interacting with other aspects of the tax and benefit system, risks discouraging recipients from obtaining full-time employment in the formal sector. Job search and other obligations of Citizen's Income beneficiaries are intended to offset these disincentives but will need improved capacity.
2. Citizen's Income and hypothetical flattened personal income tax rates scenario. Flatter personal income tax rates and reduced steps have been discussed for some time in Italy and have been considered by the current government. The effects of a flatter income tax rate schedule in conjunction with the Citizen's Income warrant assessing, as these measures are likely to be highly costly. Without changes in deductions and allowances to maintain the progressivity of personal income tax, flatter income tax schedules will largely benefit high income households without improving work incentives for low-income households.
3. Recommended reform package. This would consist of a guaranteed minimum income, together with in-work benefits for low-wage earners, and a simpler system of personal income tax rates and credits. This system may better protect households from poverty and encourage formal sector employment, especially among second earners, at a moderate net cost for public finances. This policy mix draws on many countries' approaches to addressing the same objectives.

Reforming Italy's tax and benefit policies will affect households' incomes and work incentives in addition to social and regional disparities, and public finances. The policy scenarios are modelled using the OECD's Tax-Benefit model (Bulman et al., 2019, forthcoming[94]; Browne et al., 2019, forthcoming[95]). Simulations of the direct household-level effects are aggregated to regional and national level with the EUROMOD model. EUROMOD incorporates the population's characteristics (Sutherland and Figari, 2013[26]) and enables to estimate the direct effect of the reform scenarios on tax revenues and benefit

spending. All EUROMOD simulations take into account only the immediate effect of policy reforms given households' existing compositions and characteristics, and do not allow for behavioural responses. In the longer-term, policy reforms may lead to behavioural changes, for example as reduced effective tax rates lead individuals to start working, which can effect employment rates, income and spending.

Box 1.3. Universal basic incomes in the OECD

Universal basic income (UBI) schemes provide a uniform benefit to all, regardless of individual earnings, labour-market status or family or other circumstances. In contrast, guaranteed minimum income (GMI) benefits are conditional on recipients' income and assets being below a certain limit and recipients are typically required to engage in job search and training programmes.

By being universal and unconditional, UBI recipients do not lose benefits as they gain income, limiting effective tax rates at low incomes as they start working. However being universal means that the UBI transfers are not targeted to those in greater need. This means that UBI schemes require much greater resources than GMIs to ensure that poor households can access a minimum income. Raising these funds requires much higher tax rates or very substantial cuts to existing social benefits (Browne and Immervoll, 2017[27]).

UBI proposals generally envisage transforming existing social payments and tax credits into a flat payment to all adults. The size of benefits is debated. Simulations find that transforming the existing GMI provided in most countries into a UBI, while ending existing social protection programmes would require large increases in tax revenues, and may lead in many countries to higher poverty rates as targeted benefits are converted to a universal income available to all.

UBIs have gained greater attention in recent years. Many see them as the right response to changing forms of employment that break down traditional, long-term employer-employee relationships, to fears of automation causing large-scale job losses, and to greater recognition of gaps in existing social protection systems' coverage. UBIs have the attractions of being simpler than traditional tax and benefit systems and of avoiding high effective marginal tax rates as means-tested benefits are withdrawn as income rises.

The Netherlands and Finland have trialled UBI-like programmes, although they have been limited to particular groups – generally the unemployed – or regions – smaller towns (Pareliussen, Hwang and Viitamäki, 2018[28]). Livorno, in central Italy started a small 6-month trial in June 2016, providing 200 of the poorest households with EUR 500 per month, conditional on completing community service and showing that they are actively searching for work.

The effects of the three policy scenarios are presented across several Figures and Tables. Table 1.6 reports the effect of the policy scenarios on poverty rates, poverty depth (i.e., the gap between their incomes and the poverty line), inequality, tax rates at various income levels, and the net effect on public finances. Figure 1.23 illustrates the income out-of-work households would receive, relative to the national average full-time wage and compared with other OECD countries, under the 2018 Inclusive Income Scheme (REI), the Citizen's

Income and the recommended reform package's guaranteed minimum income scheme. Figure 1.25 shows the change in income across the various policy scenarios relative to the 2018 REI for different household types across wage levels. Figure 1.26 illustrates the effects of the various policy scenarios on net earnings, and its components, for families with 2 dependent children and with either one or both adults working at different wage levels. Figure 1.27 shows the participation tax rates of the various policy scenarios of moving into work at different wage levels and household situations, compared with other OECD countries. Figure 1.31 shows the long-run macroeconomic effects of the recommended reform package on labour productivity and activity. Bulman, et al, (2019, forthcoming) provide additional results across a wider range of household types.

The REI introduced a national guaranteed minimum income to Italy

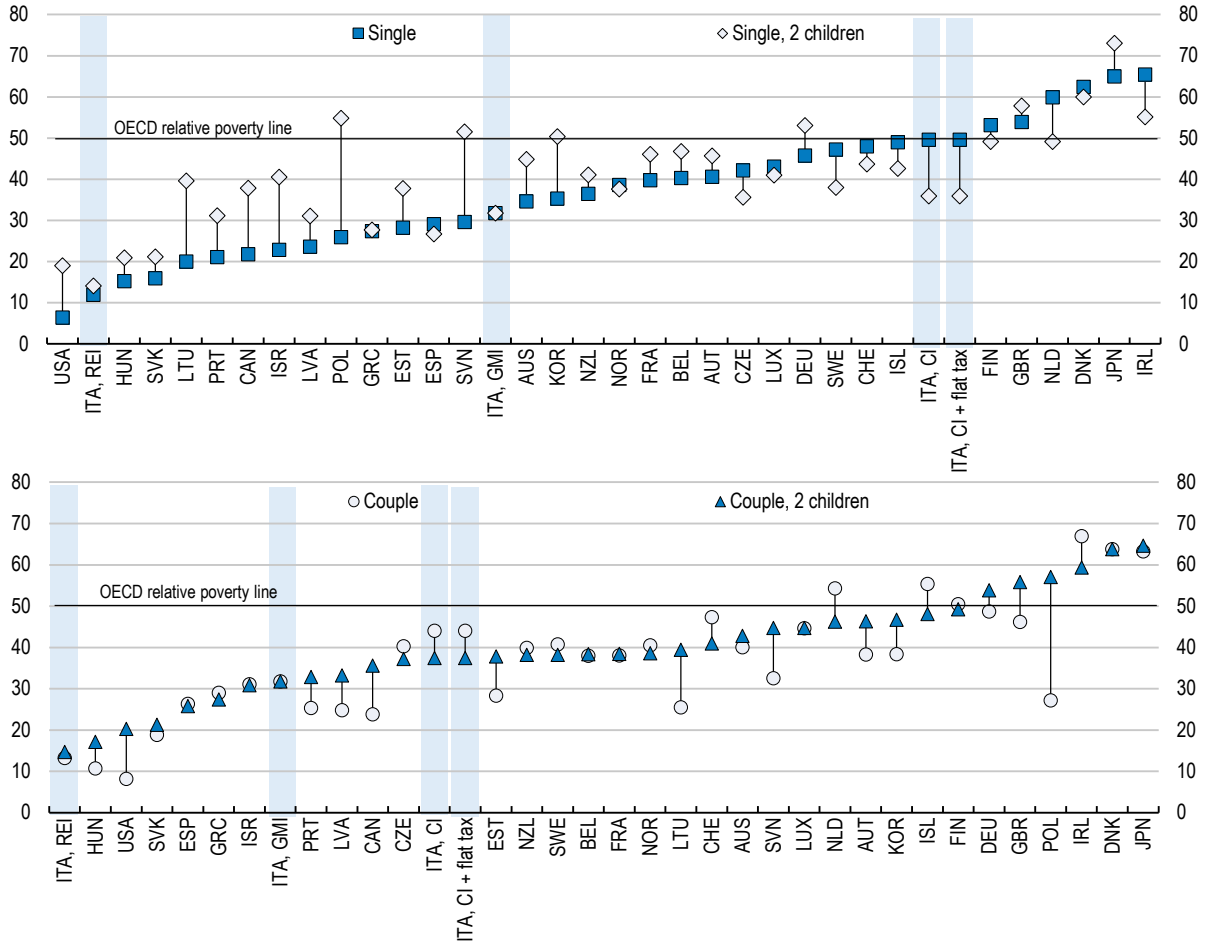
The Inclusive Income Scheme (Reddito di Inclusione, REI) was first introduced in early 2018 and was Italy's first nationwide guaranteed minimum income scheme. Previously, some Italian municipalities provided local guaranteed minimum income programmes, and the REI had absorbed them. Eligibility to the REI was determined by the household's income, assets and compositions, as measured by the Equivalent Economic Situation Indicator (ISEE). The ISEE is a synthetic measure of a household's income and assets adjusted for the household's composition and whether household members need special care (Box 1.4). As the REI was operating at the end of 2018, it is included in the baseline against which the Citizen's Income and two hypothetical tax and benefit reform scenarios detailed below are compared.

The REI's transfers and eligibility thresholds were low relative to other countries (Figure 1.23; Table 1.3). The REI's cash transfers topped up eligible recipients' very low incomes. This reduced the depth of poverty they faced – i.e., the gap between their incomes and the poverty line – without raising their incomes above the poverty line (Figure 1.23), similarly to most countries' guaranteed minimum income programmes. Reflecting its low benefits and strict eligibility thresholds, the budgeted cost of the REI was small, at 0.1% of GDP.

The REI's low eligibility thresholds and transfers mean it had minimal negative effect on employment incentives. Participation tax rate for beneficiaries moving into low-wage work were among the lowest across the OECD. In addition, REI beneficiaries were required to engage in job-search, training or other social programmes tailored to recipients' needs.

Figure 1.23. Italy's REI provided relatively modest transfers, while the Citizen's Income is relatively generous for smaller households

Net household income for households receiving guaranteed minimum income, as a % of median disposable income in the population, 2018 policies



Note: "ITA, REI" shows the policy rules relating to the 2018 "Reddito di inclusione", the guaranteed minimum income implemented in 2018; "ITA, CI" reflects the Citizen's Income policy rules prescribed by the decree of January 2019; and "ITA, GMI" reflects the policy rules relating to the hypothetical 'Guaranteed minimum income' in the recommended policy package presented in Table 1.8.
Source: Calculations based on OECD Tax-benefit model.

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Table 1.3. Italy's expanding guaranteed minimum income programmes

	1. 2018 Inclusive Income Scheme (REI)	2. 2019 Citizen's Income
Maximum transfers (single adult)	EUR 187.50 / month EUR 2 250 / year	EUR 500 / month or EUR 6 000 / year, scaled by household size. For households with all members aged 67 or older, EUR 630 / month or EUR 7 560 / year. In addition, renters may access up to EUR 280 / month against rental costs; and residents of a mortgaged property EUR 150 / month against their mortgage costs. These are not scaled by household size. For elderly households, EUR 150 / month against mortgage or rental costs.
Scale to adjust base income transfer and income eligibility threshold for household size	Basic ISEE scale: Household size to the power of 0.65, with some specific adjustments if for household members requiring greater care. Scale capped at 5.	0.4 for each additional member aged 18 or older and 0.2 for each additional child, to a maximum of 2.1.
Withdrawal rate	100% withdrawal rate against ISEE value	100% withdrawal rate against total household income at the time the transfer amount is assessed at the start of the Citizen's Income "pact". 80% withdrawal rate against additional household income gained after the household starts receiving the Citizen's Income for the remainder of the Citizen's Income "pact".
Income eligibility definition	ISEE indicator below EUR 6 000; Income component of ISEE below EUR 3 000.	Household income below EUR 6 000, scaled for household size, plus EUR 3 360 or EUR 1 800 if eligible for rent or mortgage support. ISEE value below EUR 9 360. Abolishes ISEE EUR 3 000 income eligibility requirement.
Asset eligibility thresholds	Nonfinancial assets below EUR 20 000 and financial assets below between EUR 6 000 and EUR 10 000, depending on household size. No household members with a registered vehicle or boat in the previous 24 months.	Value of real estate assets (excluding the residence) below EUR 30 000. Does not own a vehicle. Moveable property assets below EUR 6 000 for single persons, EUR 2 000 more for additional family members up to EUR 10 000 and EUR 5 000 more for each disabled household member.
Activity requirements	Must engage in customised programme of job search, training or other social support.	Beneficiaries must either declare themselves ready for work and enter an employment "pact", or enter a social inclusion "pact" if their needs are greater or multi-dimensional, and must work up to 8 hours per week on municipal projects.
Residency requirements	Resident of Italy for at least 2 years at the time of submitting application.	Resident in Italy for at least 10 years, and continuously for the previous 2 years.
Duration	18 months. Renewable for an additional 12 months after 6 months' waiting period.	18 months. Renewable for an additional 18 month periods after 1 month pause.
Interaction with other benefits	Unemployment Insurance benefit recipients cannot access the REI. They can claim the REI three months after the UI has expired. Non-contributory means tested benefits received at the same time as the REI are not part of the means test's income definition; these amounts are subtracted from the final REI entitlements.	Unemployment Insurance benefit recipients can access unemployment insurance (NASpI). Non-contributory means tested benefits received are included in the Citizen's Income means test. Beneficiaries remain eligible for reduced electricity and gas tariffs.
Penalties or sanctions	Benefit is reduced or withdrawn if the beneficiary does not participate in the activities set out in the programme. If a declared beneficiary's income is inconsistent with their actual income, then benefit may be reduced or withdrawn and a fine imposed if they would not be eligible for the benefit.	Benefit is reduced or withdrawn if the beneficiary fails to comply with the employment or social inclusion "pact". Criminal penalties, including imprisonment for 1 to 6 years, for presenting false statements or documents or omitting to provide or update information that relates to eligibility and benefits.
Tax treatment	Not taxable	Not taxable

Note: The ISEE calculation is discussed in Box 1.4.

Box 1.4. Means-testing welfare benefits: Italy's Equivalent Economic Situation Indicator

Italy's main instrument to means-test eligibility for social benefits is the Equivalent Economic Situation Indicator (ISEE – Indicatore della Situazione economica Equivalente). Households apply to the national social security institute (INPS) for an ISEE value. INPS calculates the ISEE value from information provided by the household and tax authorities. The household's ISEE value determines whether its members can access non-contributory social benefits, ranging from the REI to subsidised childcare places.

The ISEE calculation is standard across Italy, while eligibility thresholds based on ISEE for specific benefits can vary between regions. Nationally, 23.4% of the population had an ISEE value at the end of 2016, with higher shares in southern than in northern regions, ranging from one-third of the population in Sardinia to 9.8% in Trentino. Requests for ISEE values peaked in 2010 and 2011 during the economic downturn.

The ISEE value for a household is calculated from the household's income (Income Situation Index, ISR) and assets (Asset Situation Index, ASP), adjusted for the number and characteristics of household members:

ISEE = (ISR + 20% ASP)/(Equivalence scale)

The ISR covers all income sources from all household members, allowing for specific deductions, over the previous 12 months. These deductions include 20% of income from employment or similar sources, including unemployment insurance benefits, up to EUR 3 000, or, alternatively, 20% of the income from non-taxable benefits or pensions up to EUR 1 000. A family's rental costs can be deducted up to EUR 7 000 per annum and by EUR 500 more for the third and additional children. Income and health expense allowances for each disabled household member can be deducted. These deductions lead to around 10% of households' ISEE value to be zero in 2016.

The Asset Situation Index sums household wealth, including both movable and immovable properties, subtracting deductions and allowances. These rules favour renters over homeowners, as rent expenses are deductible from income, while home ownership increases the ISEE value.

Household sizes are adjusted to equivalent sizes by scaling the number of members to the power of 0.65, for up to 6 members. From 2019, households with more than two children can make additional deductions from their income and asset values.

A household's initial ISEE value is calculated from the previous year's taxable income and assets. An asset-poor household may only be eligible for social protection the year after losing their income. Conversely, the household will remain eligible for ISEE-assessed benefits even as they restart work. Reforms introduced in 2019 allow a household which already holds a current ISEE to request that it be recalculated based on their previous two months' situation if a household member's work situation changes and the household's total ISR falls by at least 25%.

The ISEE has been criticised for how it weighs incomes and assets, and for applying the same equivalence scale to different types of benefits. However, individual benefits may apply specific eligibility thresholds. In practice, regions and local communities may adjust the criteria by applying discretion in valuing and calculating the components.

Sources: Motta (2011[29]); Ghetti (2012[30]).

The Citizen's Income raises support for low incomes but risks weakening incentives to work

The Citizen's Income scheme will replace the REI from April 2019. Table 1.3 summarises this scheme. It will provide a transfer to top-up poor households' income to a minimum level. The income transfer is higher for larger households, although the scaling factor is capped, penalising large households. The Citizen's Income will also provide transfers to cover rental or mortgage expenses, though this rental or mortgage allowance does not vary with the household's size. The Citizen's Income applies to households with working-age members, while a new "Citizen's Pension" provides a safety net for very low income households made up of only people aged 67 or above. Households will be eligible for the Citizen's Income if they have been resident in Italy for at least 10 years and continuously for the previous 2 years. The benefit is conditional on participating in municipal works and employment or social inclusion "pacts". The public employment services will be responsible for administering the scheme. Beneficiaries that fail to provide complete or updated information on their eligibility or to comply with the employment or social inclusion "pacts" risk penalties ranging from retrospective forfeiting of the benefit to up to 6 years' imprisonment.

The Citizen's Income transfers will be considerably more generous than the REI. For smaller households, it will be more generous than similar schemes in most other OECD countries relative to the national average income (Figure 1.23). Simulations suggest that the direct effects of the Citizen's Income will reduce the depth of poverty by 25%, the poverty rate by 2.8% (when poverty is measured against a national relative poverty line), and inequality by 8.9% (when measured in terms of the ratio between the 80th and the 20th income percentiles) (Table 1.6). The income transfer alone is below relative and absolute poverty thresholds, but when the income transfer is combined with the rent or mortgage allowance the total transfer rises above some relative and absolute poverty thresholds for smaller households and those living in low cost areas (Table 1.4). At least one-third of households at risk of relative poverty rent a residence at market rates, while about 16% own their residence with a mortgage (Figure 1.24).

The Citizen's Income's transfer rules risk accentuating the tax and benefit system's disincentives for low-income households to work, and could lead to poverty traps. The transfer is intended to ensure that beneficiaries achieve a minimum income, which is set at EUR 500 per month (without the rental or mortgage allowance). The transfer value is calculated as the difference between this minimum income and the recipient household's existing income, allowing for some exclusions such as a carer's allowance. If the household receiving a Citizen's Income transfer starts earning additional income and remains eligible for the Citizen's Income, the transfers would be reduced by 80% of the additional income until their Citizen's Income employment or social inclusion "pact" expires. If they renew their participation in the programme, their transfer amounts would be fully reduced by the gain in income. These withdrawal rates are visible in Figure 1.26 (Panel B) as the net income (solid back line) remains flat as gross earnings rise up to 36% of the average full time gross wage for a single person. It is also evident in the high participatory tax rates at low wages – the effective tax rate from moving into employment (Figure 1.27).

Table 1.4. The rent and mortgage allowances raise the Citizen's Income above some poverty lines

Annual values, Euros

	Guaranteed minimum income anti-poverty programmes				Poverty lines				
							ISTAT absolute consumption poverty (2017)*		
Household type	REI (2018)	Citizen's Income	Citizen's Income incl. mortgage support	Citizen's Income incl. rent support	Eurostat 60% median income (2017)	OECD 50% median income (2017)	South & islands, municipalities smaller than 50 000	North, central metropolitan	ISTAT relative poverty (2017)
Singe adult	2 250	6 000	7 800	9 360	9 925	8 271	6 730	9 921	7 814
2 adults and 2 children under 14.	5 535	10 800	12 600	14 160	20 843	17 369	13 401	20 962	21 227

Note: The Eurostat, ISTAT and OECD relative poverty lines do not include the cost of housing in the measure of income. The ISTAT absolute poverty line includes an allowance for housing costs. The absolute poverty line depends on the household members' ages, the macro-region and the municipality type.
Source: ISTAT; Eurostat; and OECD 2018 *Tax and benefits* database.

Table 1.5. The Citizen's Income transfers penalises large households

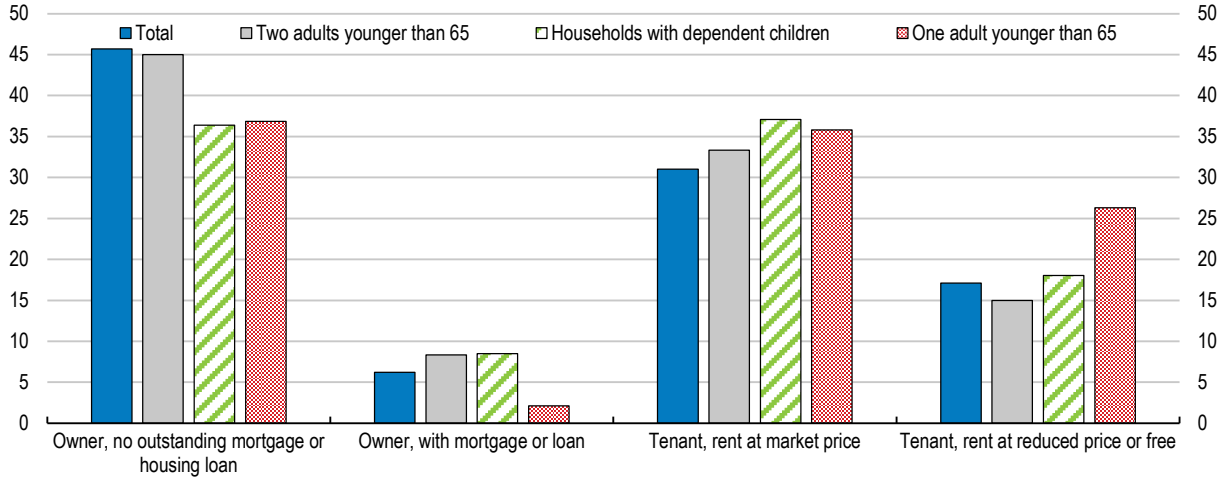
Equivalence scales for household size, ratio to a single person household

	ISEE* and REI	OECD ('Square root scale')	Eurostat ('OECD modified')	Citizenship Income	
				Tenants	Homeowners
Overall rule	Household size to the power of 0.65	Household size to the power of 0.5	1 for household head, 0.5 for each additional adult; 0.3 for each child under 14	0.4 for each additional adult and 0.2 for each additional child; capped at 2.1. Rent costs not scaled for ownership.	
2 adults	1.57	1.41	1.50	1.26	1.40
2 adults + 2 children	2.46	2.00	2.10	1.51	1.80
3 adults + 2 children	2.85	2.24	2.60	1.71	2.10
2 adults + 4 children	3.20	2.45	2.70	1.71	2.10

* The ISEE equivalence scale provides additional allowances for certain household circumstances, such as single parents or disabled members.
Note: The implicit equivalence scale is calculated as the benefit entitlements of a household with more than one person to the entitlements of a single person. Results in the table refers to a jobless household without any other income sources. Where applicable, children are assumed to be younger than 14.
Source: OECD calculations, OECD *Tax and Benefits* database, Eurostat.

Figure 1.24. Many low-income households live in housing rented at market rates

Housing tenure, by household type, population with equivalised disposable income below 60% of median



Note: Households eligible for the Citizen's Income will have lower incomes than the population shown in this graph, who have equalised disposable incomes of up to 60% of the median.
Source: Eurostat and OECD calculations.

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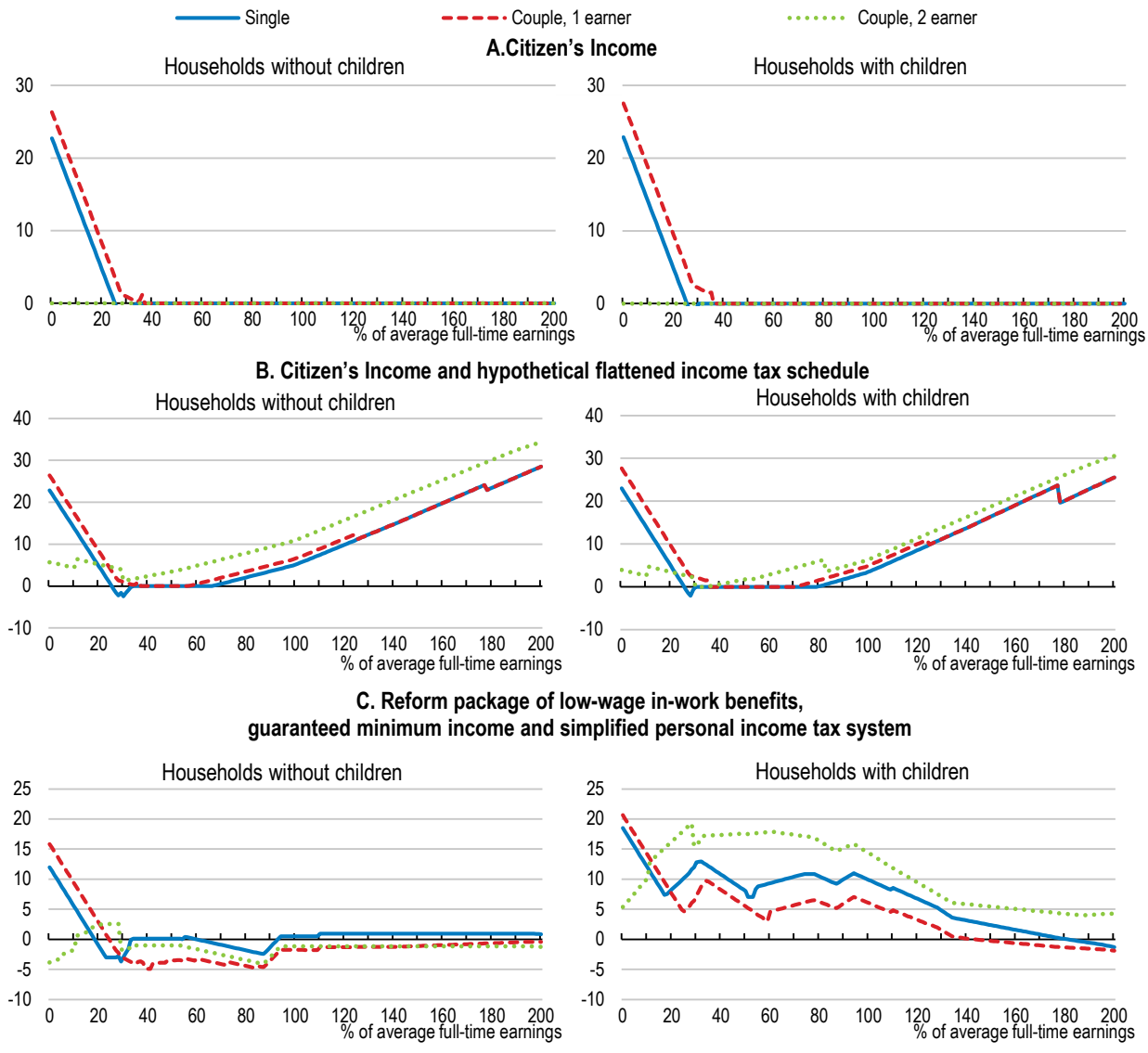
The Citizen's Income risks entrenching regional disparities in employment rates. In lagging regions, a larger share of the population will be eligible for the Citizen's Income (Figure 1.28), but they face labour market and economic conditions that are likely to discourage them from gaining formal-employment income. Overall, the Social Security Institute (INPS) estimates that 45% of private sector employees in the South earn net labour income below the Citizen's Income transfers (Commissione 11a del Senato della Repubblica, 2019[31]; Boeri, 2019[32]). For example, almost one-third of jobs in the South pay wages that are below the Citizen's Income's income eligibility thresholds of EUR 9 360 for a single person household who rents (Figure 1.8). At the same time, in lagging regions lower living costs (Figure 1.29) boost the purchasing power of Citizen's Income benefits, in addition to there being more opportunities to supplement transfers with undeclared work.

The Citizen's Income will particularly benefit single-person households, the unemployed and students (Figure 1.30). The Citizen's Income equivalence scale is capped and below the cap it increases only modestly the benefits and income eligibility thresholds for larger households (Table 1.5). This limits transfers and imposes relatively stricter income-eligibility thresholds for larger households, even though absolute poverty rates are higher among larger households. This low scaling for larger households may encourage households to split, at least for the purposes of their Citizen's Income applications, though the government is putting in place a system to discourage couples from legally separating to receive higher payments. Greece, which recently introduced a guaranteed minimum income programme similar in many respects to the Citizen's Income, has experienced an increase in the numbers of households splitting. Greece's scheme follows the Eurostat equivalence scale, which is somewhat more generous to larger households and does not cap the scaling of benefits. The share of single person households accessing Greece's programme is 10 percentage points higher than the national average, without other significant differences in the households' needs. This experience suggests applications

from single person households need careful verification. To discourage households from splitting, benefit parameters should be less generous to single households and more generous to larger households (Marini et al., 2019[33]).

Figure 1.25. The Citizen's Income benefits poorer households, flatter tax rates benefit higher incomes, while a comprehensive reform would support low and middle income households

Simulated percentage gains in net income relative to 2018 policies



Note: Total household income is adjusted for household size by the OECD equivalence scale, i.e., divided by 1.4 for a couple, 2 for a couple with two children, and 1.7 for a single adult with 2 children. In two-earner couples in these simulations, the second earner earns 50% of the average wage.
Source: Calculations based on OECD Tax-benefit model.

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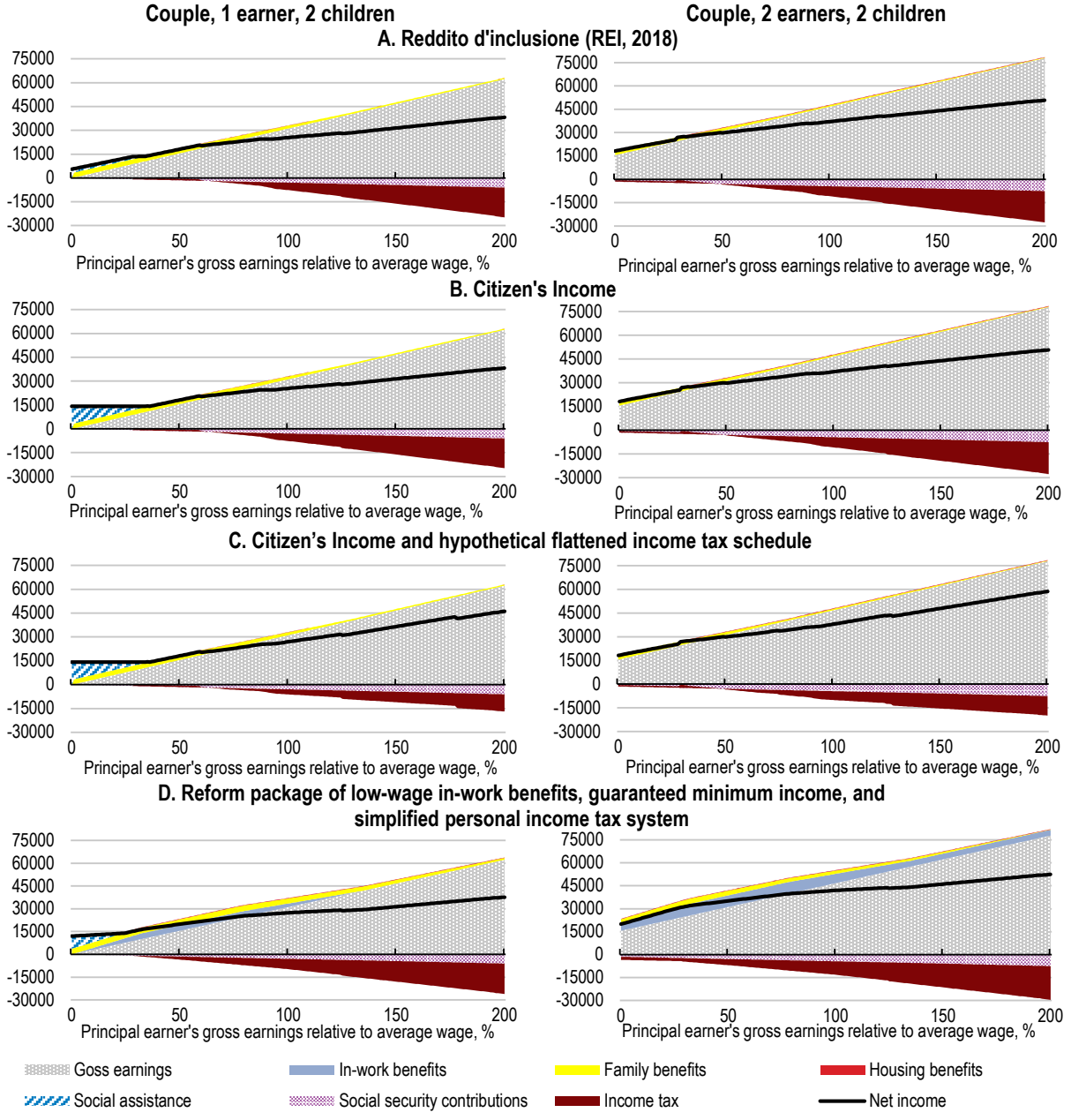
Figure 1.26. The proposed Citizen's Income raises many poor households' incomes but lowers incentives to work, while a guaranteed minimum income with in-work benefits would strengthen incentives

Contributions of gross wages, benefits, taxes and transfers to net wages under alternative policies; Euros



Note: These graphs show the contribution to net income of employment earnings, benefits and deductions from taxes and social security contributions at various percentages of the average wage. The solid black line shows the final net or 'take home' earnings. Each row shows the results under a set of policy rules. The columns compare the situation of a couple with two children with one earner (left column) and two earners (right column), where the second earner is assumed to earn 50% of the average wage. The household is assumed to pay a rent of EUR 6 200 / year. The ISEE indicator used for the current REI takes into account the ISEE 'rent' and the 'earnings-related' deductions provided in the ISEE law. The accompanying working paper (Bulman, et al., 2019, forthcoming) presents simulations of policies on other household types.

Source: Calculations based on OECD Tax-benefit model.

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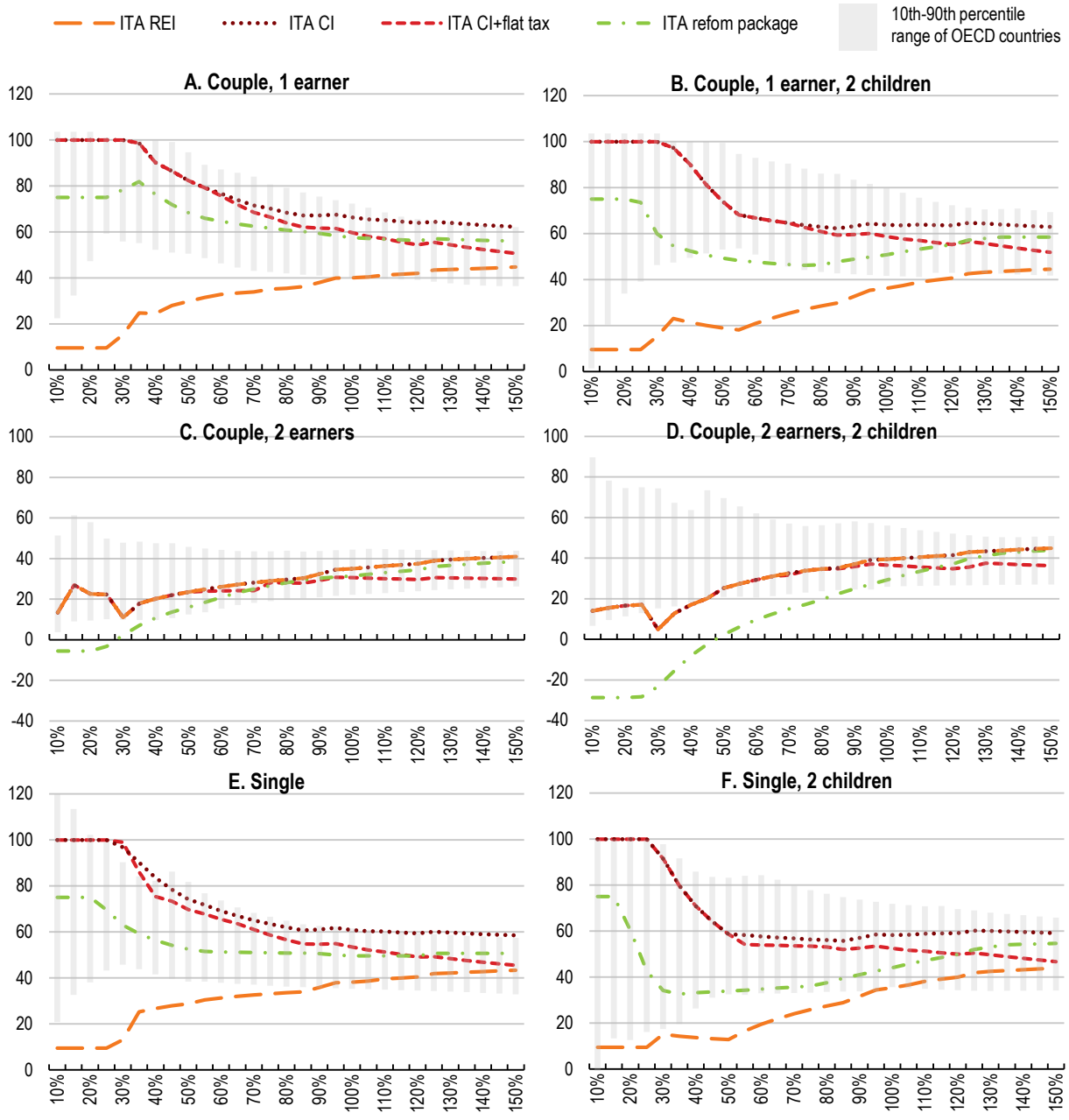
Figure 1.27. The Citizen's Income leads to high participation tax rates at low incomes

Effective tax rate when moving into work at various wage levels, expressed as % of average wage



Note: the lines show the overall net effective tax rate as a percent of gross income faced by the earner as they move from no income into work at various wage rates, where those wage rates are expressed as a percent of the average wage. "ITA REI" shows the policy rules relating to the 2018 "Reddito di inclusione", the guaranteed minimum income implemented in 2018; "ITA CI" reflects the Citizen's Income policy rules prescribed by the decree of January 2019; and "ITA, GMI" reflects the policy rules relating to the hypothetical recommended policy package proposed in Table 1.8.

Source: Calculations based on OECD Tax-benefit model.

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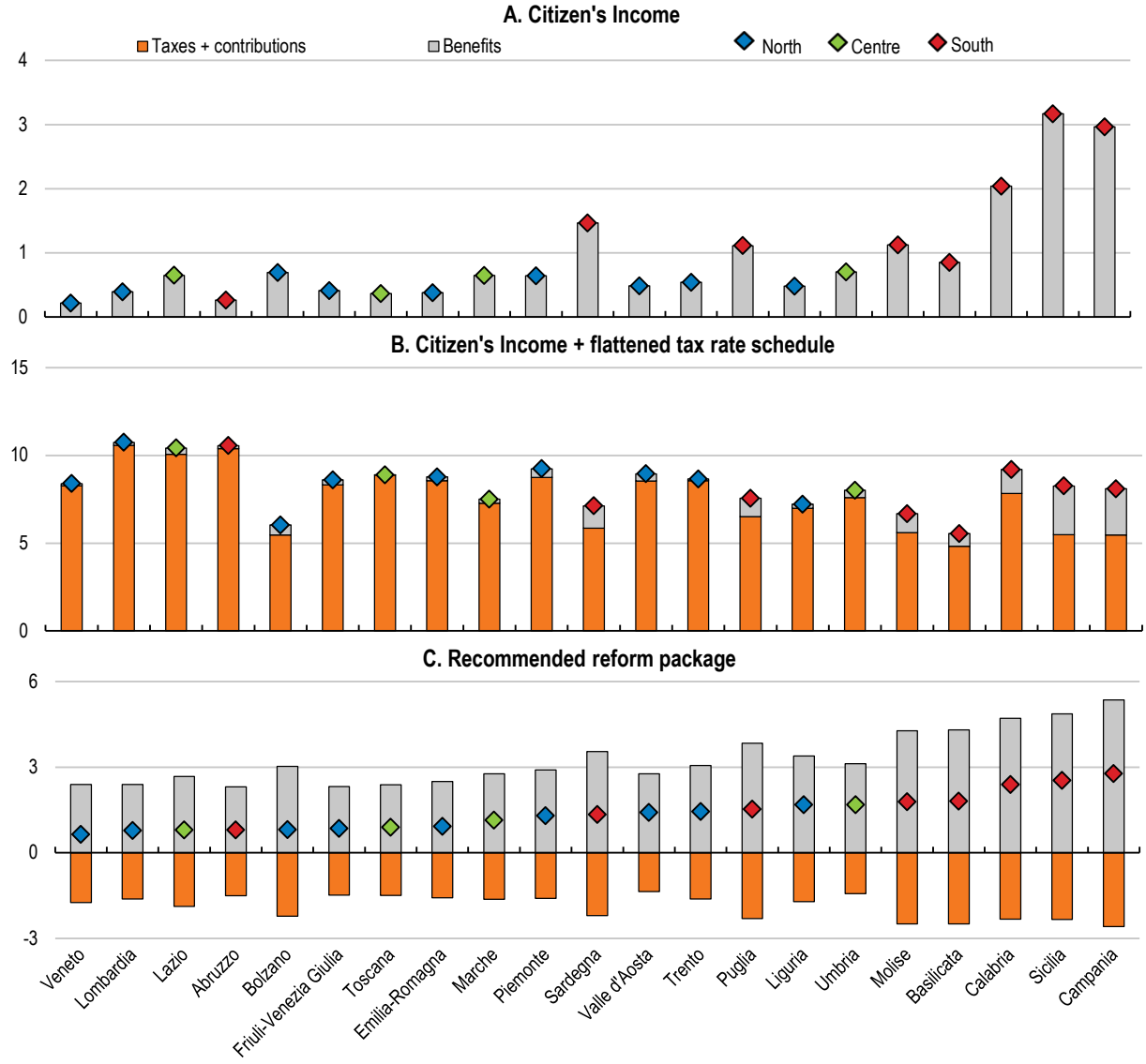
Figure 1.28. Targeted income support is likely to particularly benefit residents of southern regions

% change in net equivalised disposable income, alternative policy reform scenarios



Note: In the recommended reform package, the earned income tax credit is classified as a benefit. The EUROMOD simulations include all population groups, and households with all members aged 67 or older are assumed to receive the Citizen's Pension, if eligible.

Source: OECD calculations using EUROMOD, version I1.0+. EUROMOD is maintained, developed and managed by the Institute for Social and Economic Research (ISER) at the University of Essex, in collaboration with national teams from the EU member states. The European Union Programme for Employment and Social Innovation 'Easi' (2014-2020) financially supports extending and updating EUROMOD. The results and their interpretation are the authors' responsibility. The EUROMOD simulations presented here use the Italian version of the EU Statistics on Incomes and Living Conditions made available by Eurostat and ISTAT (166/2015-EU-SILC).

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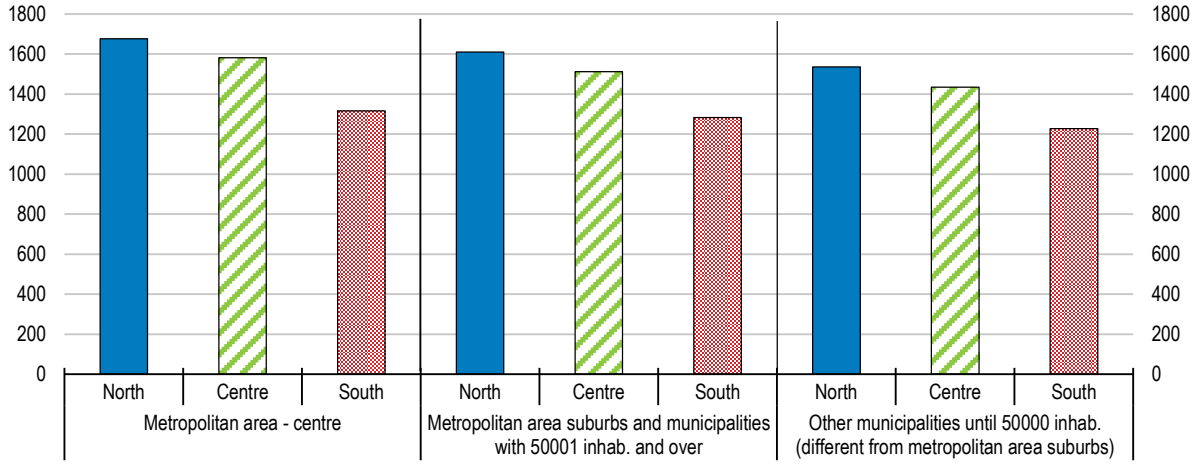
Figure 1.29. Living costs are lower for low-income households in southern and rural areas

Monthly cost of a set of goods and services at the poverty threshold for a family of 2 adults and 2 children, by geographical location, Euros, 2016



Note: The children are aged between 4 and 10 years and 11 and 17 years.
Source: ISTAT.

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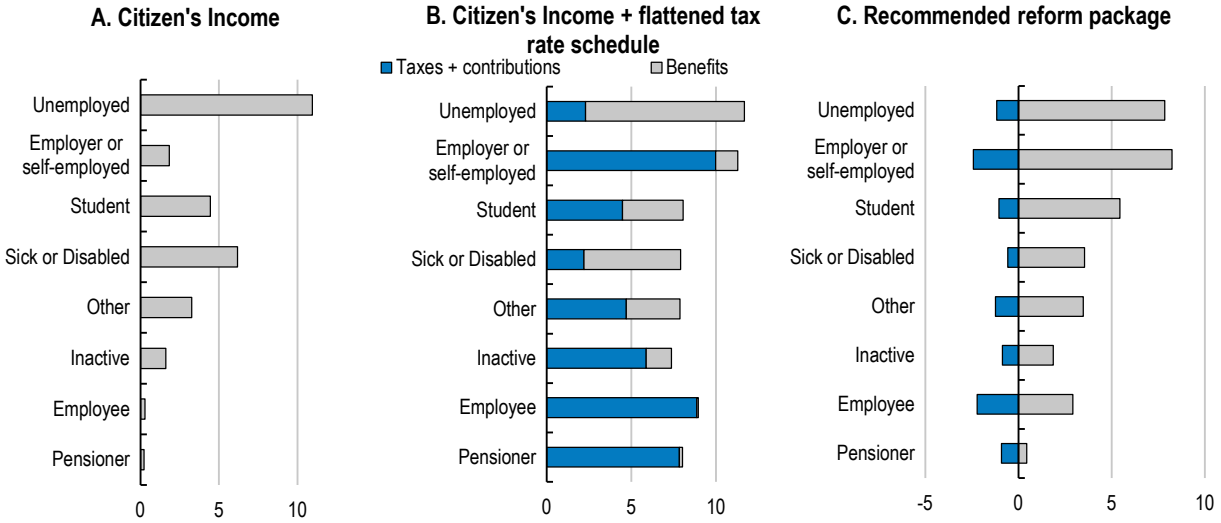
Figure 1.30. Households headed by the unemployed, sick or disabled and students particularly benefit from guaranteed minimum income policies

% change in net equivalised disposable income, compared with 2018 REI policies



Note: In the recommended reform package, the earned income tax credit is classified as a benefit. The EUROMOD simulations include all population groups, and households with all members aged 67 or older are assumed to receive the Citizen's Pension if eligible.
Source: OECD calculations using EUROMOD. See source notes to Figure 1.28.

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Eligibility criteria limit the cost of the Citizen's Income by excluding some households that would be eligible given their low incomes and assets. Recipients must have ten years' residency in Italy and have been continuously resident for the two years before their

applications. The government estimates that this restriction will exclude 87 000 households (6.5% of the total) that otherwise would be eligible, saving about EUR 0.5 billion from the cost of the programme. This restriction will also exclude these households from benefiting from the Citizen's Income employment and social support.

Table 1.6. Effects of tax and benefit policy reforms on poverty, inequality, public expenditure, and work incentives

Change in indicator relative to baseline of 2018 policies

Scenario	Fiscal impact (change in revenues less change in transfers, EUR billions)	Poverty gap index (index poin t change)	Poverty rate (percentage point change; at national relative poverty line)[1]	Inequality in disposable income		Marginal effective tax rate (%)[2]		Second earner participatory tax rate (%)[3]
				Change in Gini coefficient (0-100)	Change in quantile rat io, S80/S20	67% average wage	150% average wage	
Baseline level, 2018:	--	5.5	13.5%	31.5	5.62	39.1	53.7	29.2
Citizen's Income:	-5.2	-1.4	-0.4	-0.8	-0.50	39.1	53.7	29.2
Citizen's Income and hypothetical flattened income tax rates	-66.1	-1.1	0.7	2.0	0.25	39.1	27.2	28.8
Components:								
- Citizen's Income	-5.2							
- Flattened income tax rate schedule	-60.9							
Recommended reform package:	-7.9	-1.5	-1.2	-1.2	-0.62	39.8	59.6	4.6
Components:								
- Low-wage in-work benefits, guaranteed minimum income and reformed family benefit	-19.2							
- Simplified progressive personal income tax	11.4							

Notes: 1. The poverty line is 50% of the median household disposable income, equivalised using the square root of the household size. 2. One-earner couple with two dependent children. The marginal effective tax rate is measured at income moving from 50% to 67% of the average wage, and 133% to 150% of the average wage. 3. Two earner couple with two dependent children. Primary earner earns 67% of average wage. Secondary earner moves from no income to 50% of average wage. The EUROMOD simulations include all population groups, and households with all members aged 67 or older are assumed to receive the Citizen's Pension, if eligible.

Source: OECD calculations using EUROMOD (see source notes to Figure 1.28) and OECD Tax-benefit model.

Requirements that beneficiaries participate in activation or other social support programmes, and in municipal work, are intended to help beneficiaries move into work and to counter the disincentives to gaining work income. Citizen's Income beneficiaries will be required to complete an assessment of needs and then to engage in employment or social inclusion "pacts". This is similar to the REI's requirements and many other countries' guaranteed minimum income schemes. Beneficiaries able to work will sign an employment "pact", requiring them to engage in job search and training activities. They will be obliged to accept one of three "fair" job offers where 'fairness' is defined with respect to the job offer's distance from the beneficiary's residence. Beneficiaries will also be required to work 8 hours per week for municipalities' social and development projects. For these requirement to be effective, job search and training programmes need to be effective and accessible (as discussed below).

The Citizen's Income strict conditions and penalties, intended to encourage beneficiaries to enter work, may discourage take-up among the neediest population. Effective social protection programmes engage all eligible recipients, especially those with high needs, but this is a challenge especially when schemes are complex (Frazer and Marlier, 2009[15]; Bodewig et al., 2016[34]). Attaching punitive conditions to welfare benefits may discourage the households with the greatest needs from applying for or maintaining the benefit. Several assessments found that to be the case with the UK's 'Universal Credit' reforms (Wright et al., 2016[35]; Work and Pensions Committee, 2018[36]). Highly vulnerable beneficiaries have greater difficulties both complying with job search, training and social programmes and demonstrating that they have done so, increasing the risk they either drop out or not apply for the Citizen's Income (Crepaldi et al., 2017[37]). Following the UK reforms, the beneficiaries with the greatest needs (the homeless, mentally ill and those with poor literacy) were least able to meet benefit conditions, most likely to be sanctioned for failing to do so, and suffered most from those sanctions, even while those engagement conditions can also improve behaviour for other households (Batty et al., 2015[38]). Proactively engaging with potential beneficiaries, such as contacting them directly and guiding them through the programme's application and requirements can be effective but requires tailored efforts that may be best undertaken by municipalities' social services.

The cost of the Citizen's Income is in line with similar schemes in other countries but it risks rising if beneficiaries do not move into employment as expected and the benefit's take-up improves over time. The 2019 Budget allocates EUR 5.6 billion or about 0.3% of GDP to fund the Citizen's Income, and between EUR 7.1 billion and EUR 7.4 billion annually from 2020. The REI, itself heavily expanded in July 2018, was allocated 0.1% of GDP in 2018 (European Commission, 2018[11]). The government's cost estimates of the Citizen's Income is consistent with OECD simulations using EUROMOD. It is within the range of other European countries' guaranteed minimum income schemes (Baldini et al., 2018[39]). For example, Greece's 2017 GMI, similar in many respects to the Citizen's Income, is projected to cost near 0.4% of GDP when fully implemented (OECD, 2018[40]; European Commission, 2018[41]). The government expects the Citizen's Income cost to decline in later years as beneficiaries graduate out of the scheme into employment. However, experience in Italy and elsewhere shows that awareness and participation in such schemes take time to grow. For example, in the early 2010s the municipality of Turin trailed a minimum income programme and found that it reached less than two-thirds of the eligible population. A similar share of the anticipated eligible beneficiaries had taken up the REI by January 2019. More than a year after Greece's guaranteed income scheme was rolled out nationally, 60% of households in the poorest income decile had not applied (Bodewig et al., 2016[34]).

Flattening personal tax rates would benefit high-income households and involve high costs

Reducing taxes on lower incomes is a powerful instrument to achieve inclusive growth. Improving the incentives to work and to earn, particularly for people with lower skills and in lagging regions, requires adjusting the tax systems, along with benefits. Lowering the tax rate for low earners would bring Italy's tax schedules closer into line with other OECD countries (Figure 1.17). The current government has considered simplifying Italy's multiple personal income tax rates into two tax rates and rationalise tax expenditures while ensuring the personal income tax system remain progressive. However, the 2019 budget included no such proposals. Table 1.7 presents one hypothetical reform to the personal income system going in this direction and compares it the 2018 system.

Table 1.7. Hypothetical flatter-personal income tax scenario

National personal income taxes, credits and allowances for employees

	A. 2018 system	B. Hypothetical flatter income tax rates
Tax rate schedule:	Below EUR 15 000: 23% EUR 15 000-EUR 28 000: 27% EUR 28 000-EUR 55 000: 38% EUR 55 000-EUR 75 000: 41% Above EUR 75 000: 43%	Below EUR 80 000: 15% Above EUR 80 000: 20%
Subnational income taxes:	Regional taxes : Income below EUR 15 000 : 1.73% Income EUR 15 000 or higher: 3.33%. Local taxes 0.2%, ranging up to 0.9%.	Maintain existing rates
Social security contributions	Income up to EUR 46 630: 9.49% Income EUR 46 630 to EUR 101 427: 10.49% Income above EUR 101 427: Fixed EUR 10 173.39	Maintain existing rates
Family credits":	Family tax credits are granted to taxpayers living with a dependant spouse, children, and other relative, provided the dependent's annual income does not exceed EUR 2 840.51 Spouse/other dependent relatives: EUR 800/EUR 750 decreasing to EUR 0 for net income over EUR 80 000. Children under 3/over 3: EUR 1 220/ EUR 950 decreasing to 0 for net income over EUR 95 000. Credits are higher for families with disabled children or 4+ children	Deduct from family taxable income, for family taxable income: - Below EUR 35 000: EUR 3 000 x number of family members; - EUR 35 000-EUR 50 000: EUR 3 000 x number of dependents; - Above EUR 50 000: zero.
Other credits:	Tax credits generally at 19% of an expense: interest, medical, education, rent, childcare, life and accident insurance expenses.	Maintain existing tax credits
Other:		Tax liability is the least of Scenario A and B.

Note: A family member is dependent if their annual taxable income is below EUR 2851.
Source: OECD *Tax and benefit* database and authors' simulations.

The hypothetical flatter income tax, with the Citizen's Income in place, would raise disposable incomes across household types, especially among high income households (Figure 1.25; Figure 1.26, Panel B). The ratio of the disposable income of well off households (those in the fourth quintile of the income distribution) relative to the less-well off households (those in the first quintile) would increase by 4.4%.

Flattening personal income tax rates would involve large fiscal costs. Simulations suggest a direct cost of EUR 61 billion annually, before accounting for changes in employment rates and productivity that would follow the reforms (Table 1.6). In addition, flattening the personal income tax rates risks entrenching social and regional disparities. For low income households, which may be near eligibility thresholds for the Citizen's Income, flattening the personal income tax rates would not improve incentives for second earners to move into employment. For high income households, which are not eligible for the Citizen's Income, reducing marginal tax rates and making them less progressive would further encourage households to increase their already high work hours, such as by second earners entering the workforce.

In-work benefits, a guaranteed minimum income and personal tax income reforms would boost employment and raise poor households' income

This sub-section proposes a recommended reform package combining in-work benefits for low-income earners, a guaranteed minimum income with gradually decreasing transfers (as beneficiaries start working) and a simplified and progressive income tax system. The recommended reform package would adjust benefit rules and reform the personal income tax rate schedule to address the competing objectives of reducing poverty and encouraging

employment within limited fiscal space. Like the Citizen's Income, households who do not own their residence would receive an allowance for housing costs. Table 1.8 summarises the package. The recommended reform package would reduce income inequality and poverty by 10.5% and 8.6% respectively with respect to 2018 policies, and encourage employment and activity, at a net cost comparable to the Citizen's Income (Table 1.6).

The in-work benefits included in the recommended reform package would provide additional income for low wage earners and ensure that beneficiaries' net income rises as they earn greater employment income. This goes further than the existing system of tax credits. Among other benefits and credits, this would replace the existing low income tax credit and the EUR 80 per month fiscal bonus. This is visible in Figure 1.26 (Panel D) where the in-work benefits (light blue area) contribute to raise net income (solid back line) as gross earnings rise from zero to 50% of the average wage, resulting in low participatory tax rates at low wages (Figure 1.27; Box 1.5). This is in contrast with the Citizen's Income (Figure 1.26, Panels B and C) where the net income rises little as gross employment earnings increase, resulting in high participatory tax rates (Figure 1.27). In-work benefits would raise employment rates and incomes of poor households at lower cost than transfer systems that impose higher participatory tax rates.

In Italy, an in-work benefit programme should assess eligibility on the basis of the individual earner's salary level rather than their household's total income. If eligibility is assessed according to household income (such as through the ISEE value) the principal wage earner may lose access to in-work benefits if the second earner starts working, even at low wages. This has been found to reduce work by the second earner, and to reduce the household's overall employment levels (Brender and Strawczynski, 2018[42]). However, eligibility assessed according to household income would improve the targeting of in-work benefits to low-income households by ensuring that it does not benefit low-wage earners living in households with relatively high total income.

Reducing in-work benefits gradually as incomes rise would also improve incentives for beneficiaries with low incomes to increase their work effort and earn more. This approach would reduce the participation tax rate, the effective marginal tax rate and the tax wedge at lower and middle income levels, benefiting lower and even some middle income earners (Figure 1.26, Panel C). Macroeconomic simulations, based on Guillemette and Turner (2018[43]), suggest that reducing the tax wedge in this way, before taking into account other policies, would raise the employment rate by 2.6% in 2030 relative to 2018 policies, and lead to 2.4% higher GDP, which in turn would support public revenues. Strengthened active labour market policies and support for families would complement the positive effect of the recommended reform programme on employment and activity (Figure 1.31).

The proposed reform package would include a guaranteed minimum income for low income households. The transfers would be greater than those of the REI but somewhat lower than those of the Citizen's Income for single person households. They would be scaled by more than the Citizen's Income as household size increases and the scaling would not be capped. Overall transfers would decrease more gradually than under the Citizen's Income as a beneficiary starts to earn income. Modest benefits that gradually decline as gross earnings rise would better address the trade-off between reducing poverty and encouraging work than the Citizen's Income. Like the REI and Citizen's Income, receiving the recommended reform package's guaranteed minimum income would be conditional on participating in a tailored programme of job search and training programmes or other social support programmes.

Table 1.8. A recommended tax and benefit reform package introducing low-wage in-work benefits, a guaranteed minimum income scheme, and simpler personal income tax system

Low-income in-work benefits:	
	Replace all employment conditional benefits with a standard earned income tax credit scheme, based on the individual's earnings less social security contributions, excluding unemployment benefits. Transfers decrease as incomes rise up to incomes of EUR 25 000 (individuals without dependent children).
Guaranteed minimum income:	
Base transfer (single adult):	Income transfer of up to EUR 3 600 / year (single person). Housing cost supplement of up to EUR 2 400 / year.
Equivalence scale:	OECD equivalence scale of square root of number of household members, regardless of their age.
Duration	Indefinite subject to meeting requirements of participating in active labour market or social support programmes
Other benefits	Unemployment benefit recipients eligible if meet eligibility criteria.
Income eligibility	Household reference income based on the ISEE Income Situation Index before deductions included in the ISEE calculation. Abolish ISEE income EUR 3 000 eligibility threshold.
Asset eligibility	Same asset eligibility conditions as the Citizen's Income: value of real estate assets (excluding the residence) below EUR 30 000. Does not own a vehicle. Moveable property assets below EUR 6 000 for single persons, raised by EUR 2 000 for each additional family member up to EUR 10 000 (increased by EUR 1 000 for each child after the second) and EUR 5 000 more disabled household member
Residency:	Non-EU Citizens must have been resident for at least 5 years.
Personal income taxes:	
Simplifying the income tax system:	Abolish family-related tax credits (for dependent spouse, for dependent children, for large families and for childcare expenses). Abolish the fiscal bonus. Increase the two highest marginal tax rates (from 41 to 43% and from 43% to 45%)
Family allowances	Provide a family allowance, with the amount depending on the household's ISEE value. Replace tax credits for the dependent spouse, for dependent children, for large families, and family allowance for employees with the solo family allowance. Abolish the family allowance for employees as well as the allowance for large families, including the 'infant/bebé bonus' and 'new mothers bonus'.

Note: The ISEE calculation is discussed in Box 1.4. Detailed schedules of the proposed family benefits and in-work benefits are provided in the accompanying working paper (Bulman, et al., 2019, forthcoming).
Source: OECD.

The reform package proposes simplifying the tax system, notably by consolidating various tax credits into one that is linked to the individual's income and the household's structure. Along with the in-work benefits, the design of this credit would reduce the effective marginal tax rates for many households as they gain employment income at low wage rates. They would particularly reduce to negligible levels the participatory tax rate faced by a second earner moving into low-wage work (Table 1.6). The accompanying working paper (Bulman et al, 2019, forthcoming) presents the participation and effective tax rates. The relative generosity of the simplified family allowance and credit, with the guaranteed minimum income, would allow for the consolidation of other family benefits.

The recommend reform package's overall fiscal cost is estimated at under EUR 8 billion in the short-term relative to 2018 policies (Table 1.6). This is similar to the 2019 budget estimate of the full-year cost of the Citizen's Income. Within the recommended reform package, the guaranteed minimum income is estimated to cost about EUR 3 billion less than the Citizen's Income. This estimate does not account for the boost to revenues entailed by higher employment rates, greater economic activity and improved productivity that the recommended reform package are expected to generate in the long term, underpinning the reform's fiscal sustainability.

Box 1.5. Low-income in-work benefits: making work pay

To support low income households while encouraging household members to seek formal employment, a growing number of OECD countries have adopted in-work benefits. These are also known as 'make work pay' policies as they provide a net income transfer to individuals or to households working a minimum number of hours and with employment incomes below specified thresholds. Designed correctly, these measures can improve employment rates, support the progressivity of the tax and benefit system, and reduce poverty. They can achieve this at lower cost for public finances than direct transfers to households. They can also be more effective at raising well-being for poorer households than increasing the minimum wage, which may reduce the number of low-wage jobs available.

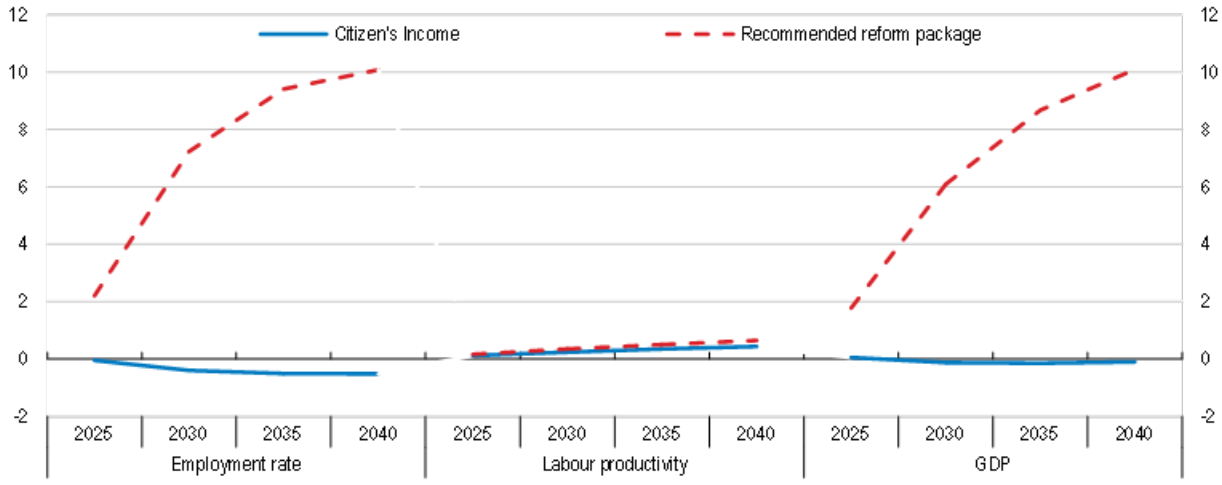
The effects of the in-work benefits on employment rates and on redistribution are determined by whether eligibility and the size of in-work benefits are assessed against household as opposed to individual income and circumstances. Assessing eligibility against household income ensures that the benefit spending is better targeted towards poorer households. Studies of in-work benefits in various countries find that in-work benefits increase employment levels of primary earners. But assessing benefits against household income can create a high participation tax rate when the second earner starts working, as their income would make all earners in the household ineligible for the benefit. Overall this can lead to lower employment levels among second earners and lower employment for the household overall. Basing eligibility of in-work benefits on individual rather than household's income and circumstance, as proposed in this *Survey*, has the advantage of generating stronger work incentives for second earners. This comes at the cost of poorer targeting of the benefit, as second earners who live in rich households and starting to work in low wage jobs would be able to claim the benefit.

Sources: Luca, Rossetti and Vuri (2014[13]), Eissa and Hoynes (2004[44]) Brender and Strawczynski (2018[42]).

Overall this section has shown that Italy can build on recent improvements in its social protection system to redress social and regional disparities by raising employment rates and incomes, and lowering poverty. Achieving this requires a reform package that provides a social safety net to low-income individuals while encouraging rather than penalising beneficiaries for moving into employment. A guaranteed minimum income combined with low-wage in-work benefits and reforms to the personal income tax can achieve this at modest fiscal cost. To be effective, tax and benefit policies need the support of effective administrative systems, capable of providing useful job-search and training policies as well as other social services.

Figure 1.31. By encouraging employment, the recommended reform package would lift activity

% difference from baseline of 2018 tax and benefit policies



Note: Simulations account for the long-run macroeconomic effects of the Citizen's Income policy package, and of the recommended reform package on disposable income inequality, on tax wedges at the average wage for singles and for couples with children, additional spending on active labour market programmes, and additional family benefits (see Table 4); they do not account for changes in pension and retirement policies.
Source: OECD simulations based on Guillemette and Turner (2018[43]).

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Reforming social policies to support inclusiveness, productivity and growth

Strengthening employment services

Strengthening Italy's public employment services (PES) is essential to improve job matching and labour market outcomes across the population. This has been made more vital by the PES having the lead role in implementing the Citizen's Income. The PES play a small role in job matching (Figure 1.32) and lack the capacity and experience to administer a broad social protection programme such as the Citizen's Income. Recognising these needs, recent government budgets allocated considerable additional resources to strengthen the PES's capacity, including EUR 950 million over two years in the 2019 budget and rapid reform programmes are being developed. This follows the central government's transfer in 2018 of EUR 235 million to regions for the PES. The increase in resources allocated to the PES is a positive step but a detailed multi-year plan on how to improve PES is yet to be defined.

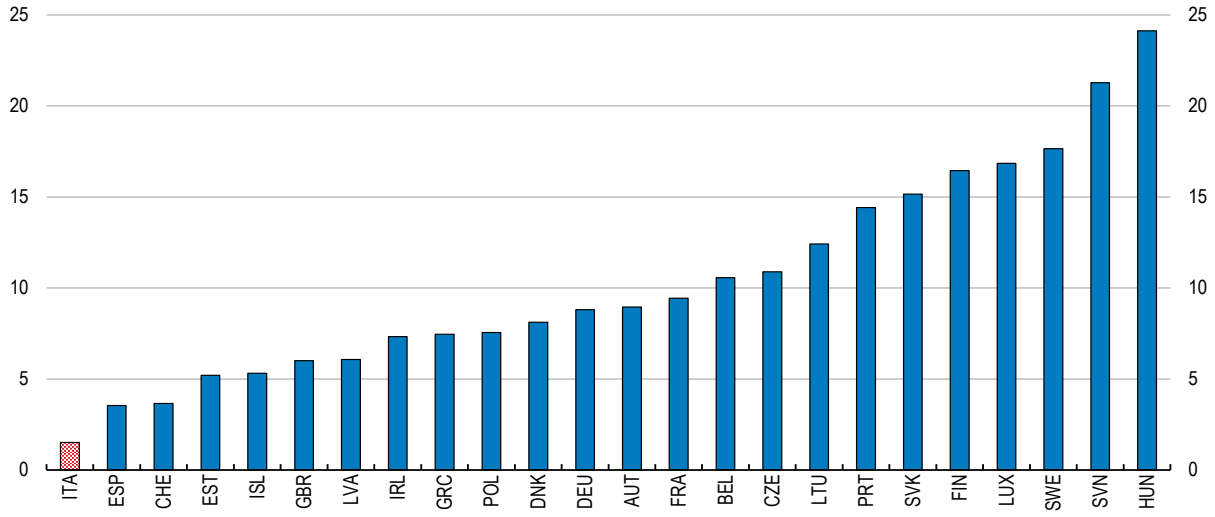
Currently, Italy counts 550 public employment service centres, which are managed by regional administrations. Many of these centres, especially in lagging regions, lack the staffing and organisational capacity to fill their core employment service function (Figure 1.32), or to administer a programme as complex as the Citizen's Income.

Citizen's Income beneficiaries that enter an employment "pact" and many entering a social inclusion "pact" will be required to have ongoing engagement with the PES. The PES will need to be able to monitor and report on beneficiaries' participation in their assigned programmes and take action if beneficiaries do not meet their obligations. In contrast, the REI operated through municipal social services, which would call on the PES to provide beneficiaries support with employment services, as part of a broader and package of

tailored support. The Citizen's Income encourages employers seeking staff to use the PES to fill their vacancies. If they hire Citizen's Income beneficiaries through the PES, the employer will receive a rebate on their social security contributions.

Figure 1.32. Italy's public employment services help few jobseekers find work

Involvement of the PES in finding current job, % of employees aged 25-64 who started a job during the previous 12 months, 2014



Source: Calculations based on EU-LFS 2014, in Pacifico et al. (2018[45]).

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Providing accessible and quality employment services across the country, especially in lagging regions, can contribute to reducing disparities and improving labour market outcomes for all people, including those not eligible for the Citizen's Income (OECD, 2018[46]). Employment service capacity could expand faster if private employment agencies can complement the PES' role in job matching. A trial programme provided job seekers with vouchers to use for employment services, including those provided by private agencies. The voucher's value reflected the difficulty for the job seeker to find work given their characteristics. The Citizen's Income rules restrict these vouchers to Citizen's Income beneficiaries, excluding other job seekers, such as unemployment benefit's recipients, reducing their access to employment services. Providing all unemployment benefit recipients with access to the vouchers may improve their prospects for finding work before their income loss leaves them eligible for the Citizen's Income.

Improving coordination between ANPAL, the central agency responsible for overseeing regional PES, and PES is crucial to ensuing eligible beneficiaries can access the Citizen's Income and receiving support to move into work. In 2017, regional and central governments agreed on minimum service standards, and regional governments must now provide performance data to ANPAL, which can identify where a region falls short. However, ANPAL lacks the power to enforce such standards as job-search and training policies fall within the remit of regional governments.

ANPAL needs additional power to strengthen regions' PES services for the Citizen's Income to produce results. For instance, ANPAL could have the responsibility of developing and implementing special restructuring programmes for those PES that repeatedly fail to reach the agreed standards. Such restructuring programmes could include

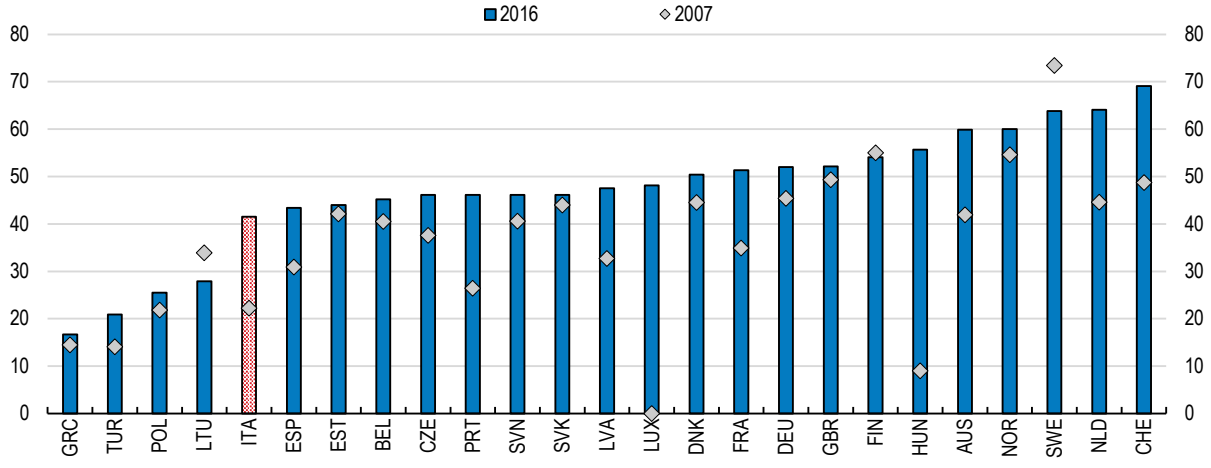
management changes, structural reorganisation of PES and requalification of personnel. Strengthening accountability and incentives for regional PES to adopt best practice and improve performance would also help. Clarifying who is responsible for what and publishing data on the activities and performance of all PES would go in this direction, strengthening accountability and yardstick competition. Successful strategies also include making sufficient case staff available and disseminating information about the programme, even by directly contacting potential beneficiaries (Frazer and Marlier, 2009[15]).

Improving skills and training to support employment and formalisation

Encouraging on-the-job training is crucial to expanding employment and raising productivity and incomes. It can help workers move into the formal sector, especially when formalisation requires educational qualifications. Italy has achieved rapid expansion in access to adult skill education and training over the past decade. However, average adult workplace skills and training rates remain below many other OECD countries (Figure 1.33), especially in lagging regions (Figure 1.34). Stronger skills are in demand and approximately six out of ten jobs facing skills shortages are in high-skilled occupations (OECD, 2017[47]).

Figure 1.33. Participation in adult learning still lags other OECD countries

Participation rate in education and training[1], population aged 25-64 (%)



1. Formal and non-formal education and training

Source: Eurostat.

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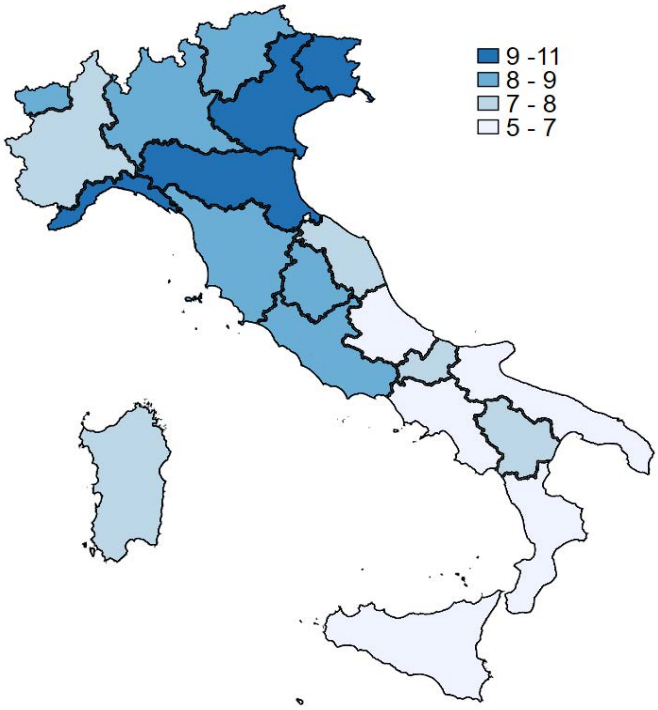
Technological change and automation, and Italy's ageing population, add pressure to training systems, especially in lagging regions. About 15% of jobs in Italy are at high risk of automation and 35.5% may experience significant changes (Nedelkoska and Quintini, 2018[48]). Low-skill and low-wage jobs are at greater risk from automation (OECD, 2018[49]) and constitute more of the workforce in lagging regions. IT and computer skills are weak across the population. Population ageing leads to shifts in the demand for skills and for workers to adapt their skills as their working lives extend. In Italy, participation of 50-60 year old workers in skill training has risen but is still low.

Figure 1.34. Adult participation in education and training tend to be low in southern regions
Percentage of adult population (25-64 years), 2017



Source: Eurostat.

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The formal sector can invest in workers' skills and readiness for new tasks and support formal employment by investing in on-the-job training. Strengthening apprenticeships is central, as has been outlined in previous Surveys (OECD, 2015[21]; OECD, 2017[22]). Training is particularly limited at SMEs, despite their skills needs. To improve workers' readiness for vocational training and re-skilling, the government is implementing new measures to develop adults' general and vocational skills (Box 1.6).

Italy's Training Funds (*Fondi Interprofessionali)* are designed to support in-work professional training and can provide disadvantaged groups with access to training. Training Funds are less well-funded than equivalent schemes in other OECD countries and the government has reduced their resources since the crisis (OECD, 2019[119]). While there remain large gaps between JIPFs training offerings and skills needs, the gap has been closing. JIPFs' role and management have been clarified by guidelines published in April 2018 by ANPAL.

Extending JIPFs' purview from employed workers to the unemployed is welcome and can support participants' entry into formal employment. This measure would be more effective if the quality of the courses and the skills gained by participants were certified, and if JIPFs were consolidated into funds linked with specific economic sectors. Stronger coordination with other stakeholders would better ensure that courses better reflect skills needs, and that programmes meet minimum operating standards.

Box 1.6. Adult learning in Italy

Provincial Centres for School Education for Adults (CPIAs) were developed from the early 2010s to provide school-level learning to adults, as well as Italian language courses to immigrants. They provide sequential courses and recognise students' progress through certificates and diplomas, including school-level diplomas. The Centres are usually organised by province and link with local authorities and the local labour market, and with regional educational institutions. 130 CPIAs operated across the country in 2018, and one CPIA in each region is mandated to research and develop adult education. A national monitoring system follows the centres and students, and found strong growth in enrolments, reaching 109 000 students, 14% of whom were aged 50 or older in the 2016/17 school year. Over 2 million Italians aged 25 to 64 have completed only primary school and 11 million have only a lower secondary school certificate.

Source: Benedetti (2018[50])

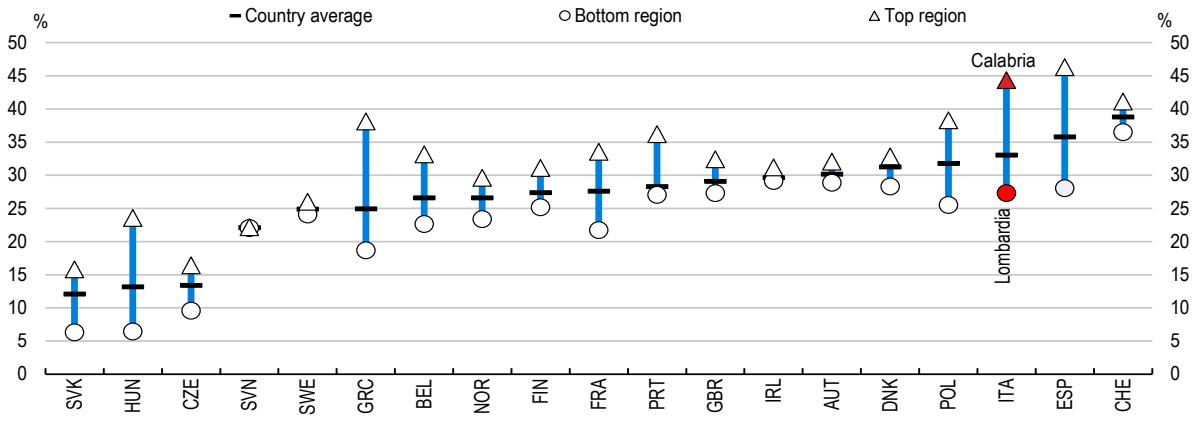
Lowering labour market informality and precarious employment

Increasing Italy's share of formal and permanent employment would improve job quality. Workers in non-standard employment generally have lower productivity, lack opportunities to build their human capital, have more volatile incomes and are less protected from labour market risks (OECD, 2018[49]; OECD, 2018[46]).

A relatively large and growing share of workers are employed on temporary contracts and other non-standard arrangements (Figure 1.35). Also, the Italian statistical office estimates that 13.5% of Italian workers were undeclared in 2015, rising to 20% in lagging regions. In addition, about one in five Italian workers is self-employed, above OECD averages although the share has declined since the start of the recession (Jessoula and Pavolini, 2017[51]) About 8% of the workforce were 'dependent self-employed' in 2015, among the highest shares of any EU country (Williams and Lapeyre, 2017[52]). These workers who have the legal statue of being self-employed lack many of the employment protection and benefits of employees without enjoying the flexibility or autonomy of self-employment, as they have only one client and no authority to hire staff or take other strategic decisions about their operations.

Inclusiveness, equity and incomes in Italy would be supported by encouraging formalisation and employment in larger firms. Legislation passed in 2017 aims to strengthen protection for dependent self-employed workers, such as measures to improve work/life balance through access to parental leave or protecting workers on sick leave, although it is unclear how enforceable these measures will be in practice (European Commission, 2018[11]). A regulatory environment and tax and benefit reforms that encourage formal dependent employment may be more effective at reducing informality and precarious self-employment than targeted measures. These measures are likely to benefit lagging regions more, given their higher incidence of informal work and self-employment.

Figure 1.35. Non-standard employment rates are high in Italy, especially in lagging regions
Share of temporary and part-time contracts across regions, 2016



Note: Non-standard employment accounts for individuals in temporary contracts (both full- and part-time) and workers in a permanent part-time employment relationship.
Source: OECD (2018), *Job Creation and Local Economic Development 2018: Preparing for the Future of Work*, OECD Publishing, Paris.

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Firms and workers will formalise if they perceive that formalisation brings greater benefits than costs. Italy's large tax wedge imposes a sizable cost to formalising, by reducing the income that formal employees retain relative to their employment cost, as well as lowering output (Akgun, Cournède and Fournier, 2017[53]). This adds to the costs of the regulatory environment and effectiveness of the public administration (OECD, 2017[22]).

The 2019 budget introduces a disincentive for the self-employed and small firms to grow and become part of larger organisations by decreasing the tax burden for low income self-employed and micro enterprises. The budget enlarges the simplified tax regimes (forfeit regime) available to self-employed and micro enterprises by raising to EUR 65 000 the income threshold taxed at 15%. The lower tax rate is applied to the gross turnover of the SME multiplied by a profitability index which is dependent on the firm's sector of activity. The 2019 budget also introduces a reduced tax rate at 20% for SMEs with turnover between EUR 65 000 and EUR 100 000, effective from 2020, with the purpose of flattening the marginal tax rates when the turnover rises above the EUR 65 000 threshold. Simplified tax regimes and reduced tax rates for self-employment or small businesses need to be carefully designed to directly address any market failures that affect the intended beneficiaries, otherwise they risk adding to the system's complexity or unintendedly discouraging businesses' growth (OECD, 2018[49]).

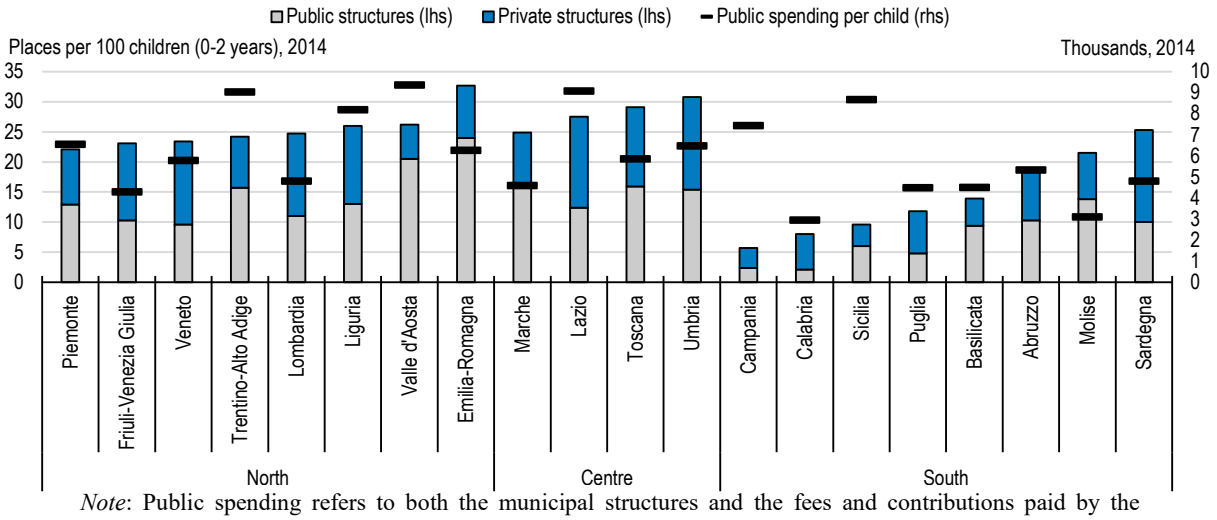
Greater access to quality childcare would strengthen work incentives and improve wellbeing

Access to care for very young children raises women's likelihood of seeking work (Olivetti and Petrongolo, 2016[55]; Figari and Narazani, 2017[56]; Tavora, 2012[57]). Also, childcare facilities improve children's performance through the course of their education and can particularly benefit disadvantaged households (OECD, 2017[58]). When affordable facilities are not accessible, families turn to family members to care for children. This may be less pedagogical, and relying on this care makes relocating to other regions with better employment opportunities more difficult (OECD, 2017[58]).

During the 2013/14 school year, less than a quarter of children under three had access to childcare facilities in Italy, less than in 2005 (OECD, 2017[58]). Far fewer places were available in lagging regions than in higher income regions (ISTAT, 2016[59]). The amount and share of total costs paid by parents vary considerably between regions, as does the total spending per child, which suggests that the quality of care varies considerably. From the age of three, children have access to 40 hours of free pre-primary education per week and all regions record near-universal enrolment.

Italy would benefit from following examples of other European countries which have expanded access to quality and affordable childcare (León and Pavolini, 2014[60]; Tavora, 2012[57]). These countries ensured that childcare places are widely accessible to all households, including those where the spouse is not currently in full-time employment, and that the places offer quality education and care for the children at a cost that is proportionate to the income that parents would gain from entering work (Colonna and Marcassa, 2015[12]). In Italy, a national plan was approved in late 2017 and established a national governing body to support, monitor and evaluate an integrated early childhood education and care system. It provides a small amount of additional funds to regions where enrolment rates are lower than the national average. Building on this step and monitoring its effectiveness are necessary complements to improve early childhood education while supporting families' participation in the workforce.

Figure 1.36. Childcare places are scarce in regions that are poorer and where fewer women work



Note: Public spending refers to both the municipal structures and the fees and contributions paid by the municipalities for users of private services. The definition of structure includes traditional nurseries, micronurseries, farm nests and spring sections.
Source: ISTAT (2017), "Nurseries and other socio-educational services for the early childhood", Press Release, 12 December 2017; and OECD calculations.

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Making regional development policy more effective to boost economic dynamism

Italy's regional development policies have not been effective at narrowing the large north-south divide in terms of income and well-being. Lagging regions' lower quality public administration hinders services for populations with the greatest needs, and impedes investments and productivity improvements. This section proposes possible remedies to

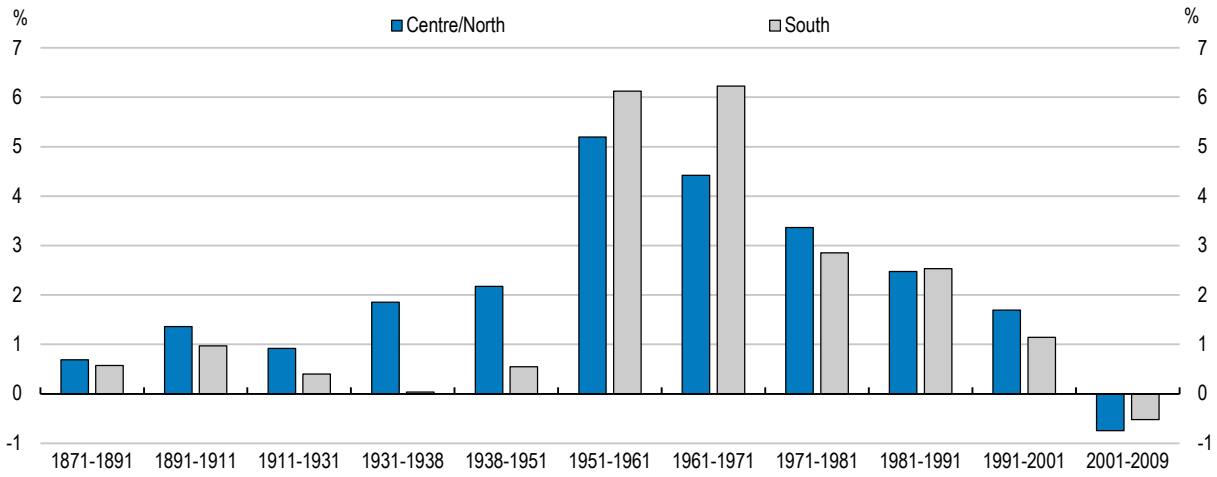
tackle regional divides while underlining that increasing the efficiency of the central and local public administrations is a necessary condition for more effective regional policies and to provide the public goods and services that people and firms rightly expect.

Policies have failed to narrow the long-standing and large regional divide

Italy's geographical inequalities are deeply entrenched and the debate about their causes and remedies is as old as the Italy unitary state (Felice, 2007[61]; Federico et al., 2017[62]). Italian policymakers have attempted to address the "Mezzorgiono problem" since the early 20th century. After World War II, the government allocated substantial resources to southern regions through the Extraordinary Intervention for the South programme. This programme was implemented by the agency "Cassa per il Mezzogiorno" and then AgenSud. It lasted until 1992 (Box 1.7). The 1950s and 1960s was the only period since unification when GDP per capita of southern regions grew substantially faster than in the Centre and the North (Box 1.8).

Figure 1.37. Incomes in southern regions converged with the rest of Italy only in the 1950s and 1960s

GDP per capita, annualised growth rates



Source: Felice, E. and G. Vecchi (2015[63]), "Italy's Growth and Decline, 1861–2011", *The Journal of Interdisciplinary History*, 4(5).

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As highlighted in the previous sections, differences in living standards between northern and southern regions are explained mainly by lower employment rates in southern regions. The Extraordinary Intervention for the South (EIS) programme and the "Cassa", along with AgenSud (discussed in Box 1.7), failed to create the conditions for a self-sustaining convergence process in employment and productivity growth rates. There are two main reasons for this:

- Firstly, focussing mostly on physical capital accumulation, the EIS failed to develop the technological and institutional capacity of southern regions. This would have required more investment in human and social capital, as well as other soft infrastructure, such as the efficiency of the public administration. Massive physical capital investment in the 1950s and 1960s failed to boost employment rates and entrepreneurship in southern regions (Felice, 2010[64]; Zamagni, 2010[65]).

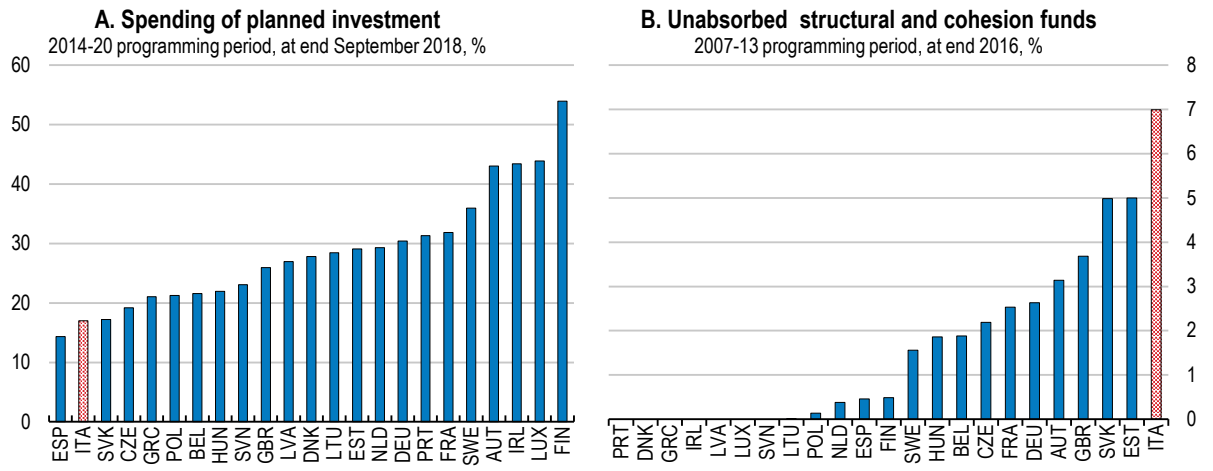
- Secondly, from the 1970s onwards, rising political interference and the curtailment of the autonomy of the "Cassa" led to resources being redirected from productive investment to redistributive programmes (Felice and Lepore, 2017[66]; La Spina, 2003[67]), contributing to halting the convergence process (Box 1.7). Moreover, the oil shock greatly diminished the comparative advantage of heavy industries, which was the basis of southern regions' convergence.

The current institutions managing Italian regional policy were developed in the early 2010s (Box 1.8). Two agencies are responsible for regional development: the "Dipartimento per le Politiche di Coesione" (Department of Cohesion Policies, DCP) and the "Agenzia per la Coesione Territoriale" (Territorial Cohesion Agency, TCA) The DCP plans investment strategies and policies for regional development and convergence, spanning physical infrastructure, social investments, such as education and skills, and wellbeing. It acts through the Territorial Cohesion Agency (TCA), which leads monitoring activities and provides support to 'managing authorities' of regional and national development programmes. Also, in 2016 the government created a new political-level coordinating committee within the Prime Minister's Office to facilitate the coordination of planning and monitoring of regional development funds among central and sub-national governments. Moreover, Invitalia – a company owned by the Ministry of Economy and Finance working in close cooperation with the Industry and Development Ministry – has responsibilities, among other things, to support the public administration for the effective management of EU structural funds. It also supports local cohesion policies developed by the public administration, and leads on public contracts.

Despite these changes, deficient planning and coordination as well as long delays in project execution still hamper the effectiveness of Italian regional policies and the utilisation of EU cohesion and social funds (Figure 1.34). Commitments and payments relating to the 2014-2020 programming period proceed slowly. As at end-2018, for the 2014-2020 programming period commitments amounted to 30.4% of the total allocated funds for the whole country and payments to just 12.2% (Figure 1.38). Southern regions are performing considerably worse than central and northern regions (Figure 1.39). Spending has mostly involved improving processes and institutions to manage projects, not the realisation of projects themselves (SVIMEZ, 2017).

Delays in committing and spending the available funds have several causes. The central governments still lacks much needed coordination powers and capacity to formulate and implement a coherent regional development strategy, as highlighted in the previous Survey (OECD, 2017[22]). This problem partly stems from the constitution (Art 117) as it grants regional governments large powers on issues relating to regional development, such as national energy and transport networks. However, many sub-national governments, especially in lagging regions, still lack the capacity to plan, select and execute projects of high quality and on time. Projects in lagging regions, where public administration is less efficient, suffer from longer delays than in more developed ones (Court of Auditors, 2018[68]). Also, as is shown below, local public administration in lagging regions tend to be less efficient than in more developed regions.

Figure 1.38. Italy's absorption of EU funds is low



Source: European Commission (2018), *Open Data Portal for the European Structural and Investment Funds* (https://cohesiondata.ec.europa.eu/).

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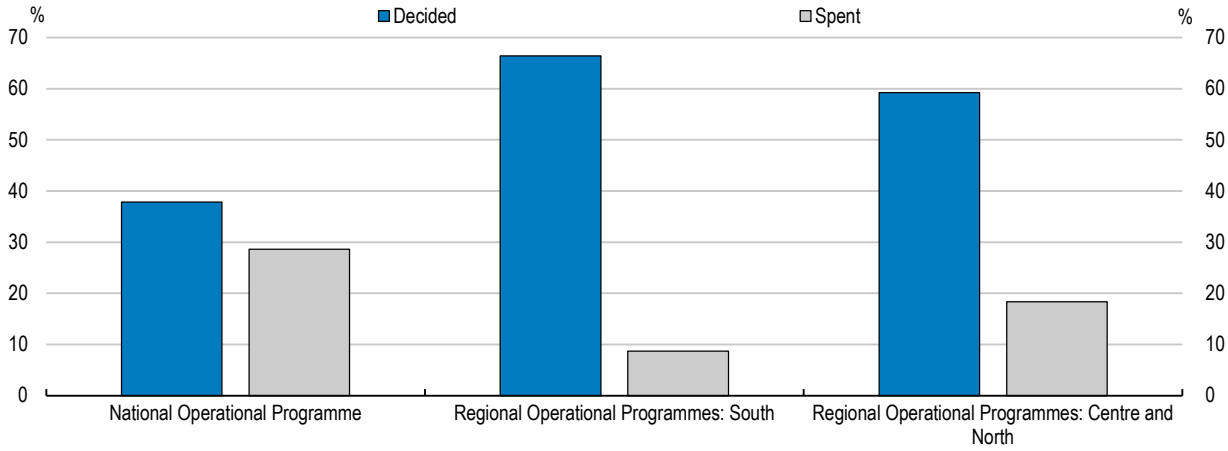
Figure 1.39. Southern regions lag in commitments and payments of EU funds

2014-2020 programming period, at end September 2018, % of planned investment



Source: European Commission (2018), *Open Data Portal for the European Structural and Investment Funds* (https://cohesiondata.ec.europa.eu/).

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Problems are not confined to sub-national levels. The shares of commitments and payments relating to the National Operational Programmes, which are managed centrally, are also low (Figure 1.39). By November 2017, the central government used only 42.5% of the funds shifted in the early 2010s – supposedly to accelerate spending – from the national co-financing quota of EU funds to the Actions and Cohesion Plan (Patto Azione Coesione, ACP) (Court of Auditors, 2018[68]).

Box 1.7. A brief history of "Mezzogiorno" policies

Italian regional development policies started in 1904 with special legislation promoting industrial activities in Campania and infrastructure investment, mostly in Basilicata and Calabria). These early interventions were limited however; in addition, the onset of World War I altered government policies and in the inter-war period the "Mezzogiorno" problem stopped being seen as priority. Overall, from unification up to World War II the gap in living standards between northern and southern regions increased. In 1951, GDP per capita in southern regions (including islands) was 60% the national average compared with 88% in 1891 (Felice, 2010[45]).

The development of southern Italy became one of the most important national policy objectives after World War II. In 1950, the government launched a large regional programme called the Extraordinary Intervention for the South (EIS) – implemented by the agency "Cassa per il Mezzogiorno" – possibly the largest of such programmes in western Europe. Overall, the EIS and the operation of the "Cassa" were inspired by the mainstream development theories of the day, which saw physical capital accumulation as key to economic progress. The operation of the "Cassa" mostly revolved around direct infrastructure spending and, after 1957, state subsidies for investment in capital-intensive industries. Also, state-owned enterprises were required to direct 60% of their new investments and more than 40% their total assets to the South (Felice, 2010[64]).

During its first two decades, the operations of the "Cassa" yielded fruit. During the 1950s and 1960s, GDP per capita in southern regions converged towards the Northern regions' levels, driven by labour productivity growth. This is the only period Italy experienced regional convergence since unification (Felice, 2010[64]), driven by large physical capital accumulation, especially in heavy industries. However, during the same period, the employment rate in southern regions declined even further from the national average (from 89% to 77%) as the EIS neglected labour intensive industries.

Yet, by the 1970s, southern regions' convergence started reversing. The oil shock played an important part in this as it hurt the comparative advantage of heavy industries. Yet, purely domestic causes also contributed. The "Cassa" lost most of its autonomy in the mid-1960s. The creation of the regions in the early 1970s aggravated political interference with the result that fund allocation decisions were increasingly driven by political clientelism and based on distributional rather than development motives (Felice and Lepore, 2017[66]; La Spina, 2003[67]). Also, from the mid-1970s most of the subsidised credits provided by the "Cassa" was redirected to industries in the North-West.

The "Cassa per il Mezzogiorno" closed in 1983 and was replaced by AgenSud, though this was no longer the only agency charged with the development of Southern Italy (Felice and Lepore, 2017[66]). AgenSud was plagued by similar problems that affected the "Cassa" in its last decades. In 1992 the government closed Agensud, formally ending the Extraordinary Intervention for the South. In its place the government ushered in a new system of ordinary programmes targeting all lagging areas and not just the South (La Spina, 2003[67]).

Execution problems at central and sub-national levels concerning large projects and deficient coordination of sub-national governments and agencies lead to too many small projects. This results in excessive fragmentation and lower synergies, in addition to heightening risks of corruption (ANAC, 2018[69]). Delays are especially pronounced for infrastructure projects and those above EUR 5 million, underlining the difficulties in completing complex projects. In addition to engendering inefficiencies and waste, long delays also mute the effects of regional development funds on the economy as funds are spent over longer periods (Court of Auditors, 2018[68]).

The practice of overbooking and attaching EU funds to past projects already completed or funded by the national resources remain far too common. Overbooking consists in proposing many small projects with a total value higher than the available funds so as to have a large pool of reserve projects to replace those that may be rejected or turn out impossible to execute. For instance, 44% of allocated EU funds for the 2007-2013 regional operational plan of Calabria concerned past projects (Court of Auditors, 2018[68]). EU rules allow for the practice of attaching structural and cohesion funds to retrospective projects, provided that these funds are spent on alternative projects in line with the pre-agreed objectives and in the same geographical area.

Overbooking and retrospective projects enable regions to maximise the rate of absorption of EU funds. Yet, they undermine the unity of the national development strategy and the quality of projects by increasing fragmentation and reducing synergies, even if consistent criteria are applied in selecting projects. Overbooking and retrospective programmes also weaken appreciably the principle of additionality of EU funds. As at the end of 2015 (the end of the 2007-2013 EU programming period), the contribution of national resources was EUR 15 billion (nearly 1% of GDP) lower than originally planned (Court of Auditors, 2018[68]).

Improving the planning, execution and monitoring of regional development funds is imperative for narrowing the regional divide. The government should rationalise the institutional framework of regional development policies by clarifying responsibilities. The roles and responsibilities of the DCP with the TCA, alongside Invitalia and the political coordination committee overlap to a large extent, generating administrative complexity and blurring responsibilities. A simpler institutional framework, remaining centred in the Prime Minister's Office would enable closer links between programming and monitoring activities, improve coordination of sub-national governments and agencies managing projects, enhance accountability and clarify the chain of command. Wales provides a good examples of a streamlined institutional framework that has succeeded in absorbing EU funds (Box 1.9). A simpler institutional setting will also make it easier to institute effective mechanisms to identify and disseminate best practices the use of EU funds. Creating a databank and network of experts in EU funds from different central and sub-national bodies to identify and disseminate best practices would go in this direction.

Box 1.8. Italian regional development policies after the Extraordinary Intervention for the South

The Extraordinary Intervention for the South (EIS) ended in 1992 and was replaced by a new system of interventions targeting all lagging areas and not just the South of Italy. The new system was shaped around the EU social and cohesion policy programmes and

consistent with EU competition and state aid rules. It however lacked a clear strategy and objectives. The government underestimated the resources and time needed to comply with the administrative and financial rules attached to EU funds (Ismeri Europa, 1992). Thus, Italy failed to use on time a large part of the EU cohesion policy funds during the 1994-1999 programming period. The same problem persists nowadays.

In the late 1990s, the government attempted to reform the regional development policies with the "Nuova Programmazione" (New Programme, NP). The NP was meant to break with past practices and shift Italy's regional policy towards a place-based approach (Barca, 2009[12]). The NP rightly aimed at diminishing subsidies and contributions to firms while increasing spending on infrastructure, research and development, and education, aiming at providing essential public goods and services tailored to the needs of lagging regions.

The participation of local governments and agencies in the NP was key to this process. Regions acquired further responsibilities, in line with the constitutional reform of 2001 that devolved additional powers to sub-national governments. In the late 1990s the government created the Department of Development and Cohesion Policies (Dipartimento per le Politiche di Coesione e Sviluppo), within the Ministry of the Economy, to better coordinate central and sub-national governments and agencies and improve programming and monitoring. In the early 2000s, a new single fund Fund Aree Sottoutilizzate (FAS) was established to fund all regional development policies and co-finance EU funded projects as well as ensuring that EU funds do not replace ordinary administration expenditure but add to it (i.e. additionality).

Overall, the NP did not live up to expectations (Barca, 2010[70]). The shift from contributions and subsidies towards infrastructure investment, research and development and education has been partial and incomplete. Increasingly, EU and national regional-development funds substituted for ordinary administration funds, which questions the very existence of a regional policy in Italy. The central and local government have not acquired the capacity and willingness to evaluate policies and projects proposed by central and sub-national bodies and select only the most effective ones. Often funds have been redirected to objectives reflecting social assistance and political criteria rather than development objectives. For instance, FAS funds were used to help farmers fined by the EU for exceeding milk quotas in the 1990s (Viesti, 2011[71]; La Spina, 2003[67]).

The onset of the global financial crisis in the late 2000s caused a break in Italian regional development programmes. Regional programmes were halted and funds suspended. Over 2008 and 2009, because of severe budget constraints, the government shifted most of the EUR 64 billion allocated to FAS over the EU 2007-2013 period to other uses that had nothing to do with regional development. As a result, the 2007-2013 National Strategic Plan was dismantled in all but name (SVIMEZ, 2001; 2015). In the end, the FAS was closed and replaced by Fondo per lo Sviluppo e la Coesione (Cohesion and Development Fund). Two agencies – the "Agenzia per la Coesione Territoriale" (Territorial Cohesion Agency, TCA) and the "Dipartimento per le Politiche di Coesione" (Department of Cohesion Policies, DCP) – were established within the Prime Minister's Office (Presidency of the Council of Ministers) to oversee regional development policy.

Box 1.9. Use of European funds in Wales

Wales has been highly successful in attracting EU structural funds and the Welsh European Funding Office (WEFO) has played a key role in this. The WEFO is a division of the Welsh Government and is in charge of selecting public and private-sector projects to be funded with EU structural funds. To this end it provides a range of guidance to help ensure projects' proposals are in line with EU programmes' requirements and EU regulations on evaluation, audit and publicity. The Programme Monitoring Committee (PMC) plays also an important role. The PMC comprises public and private sector representatives and is responsible for regularly monitoring the effective delivery of EU structural funds and considering how to use funds to achieve maximum impact.

WEFO conducts open call to the public and private sectors for projects' proposals. Projects need to be consistent with guidelines established by the European Union and WEFO and are overseen by a project-sponsor organisation. The guidance offered by WEFO spans different areas, such as compliance, eligibility, procurement, economic priorities, cost accounting, monitoring and evaluation. This information is all publicly available.

Projects need to go through a competitive procurement processes. Project sponsors register their idea on the 'Expressions of Interest' section on the government internet portal. They have to indicate how and what the project will deliver taking into consideration the programme's indicators and how proposed operations would align with the Economic Prioritisation Frameworks. To choose among projects, WEFO employs a set of multiple criteria including: strategic fit, delivery, finance and compliance, outcomes, value for money and long-term sustainability. When the project is accepted for funding, WEFO delivers the grant, monitors progress, evaluates its impact and makes sure that the project conforms with regulations.

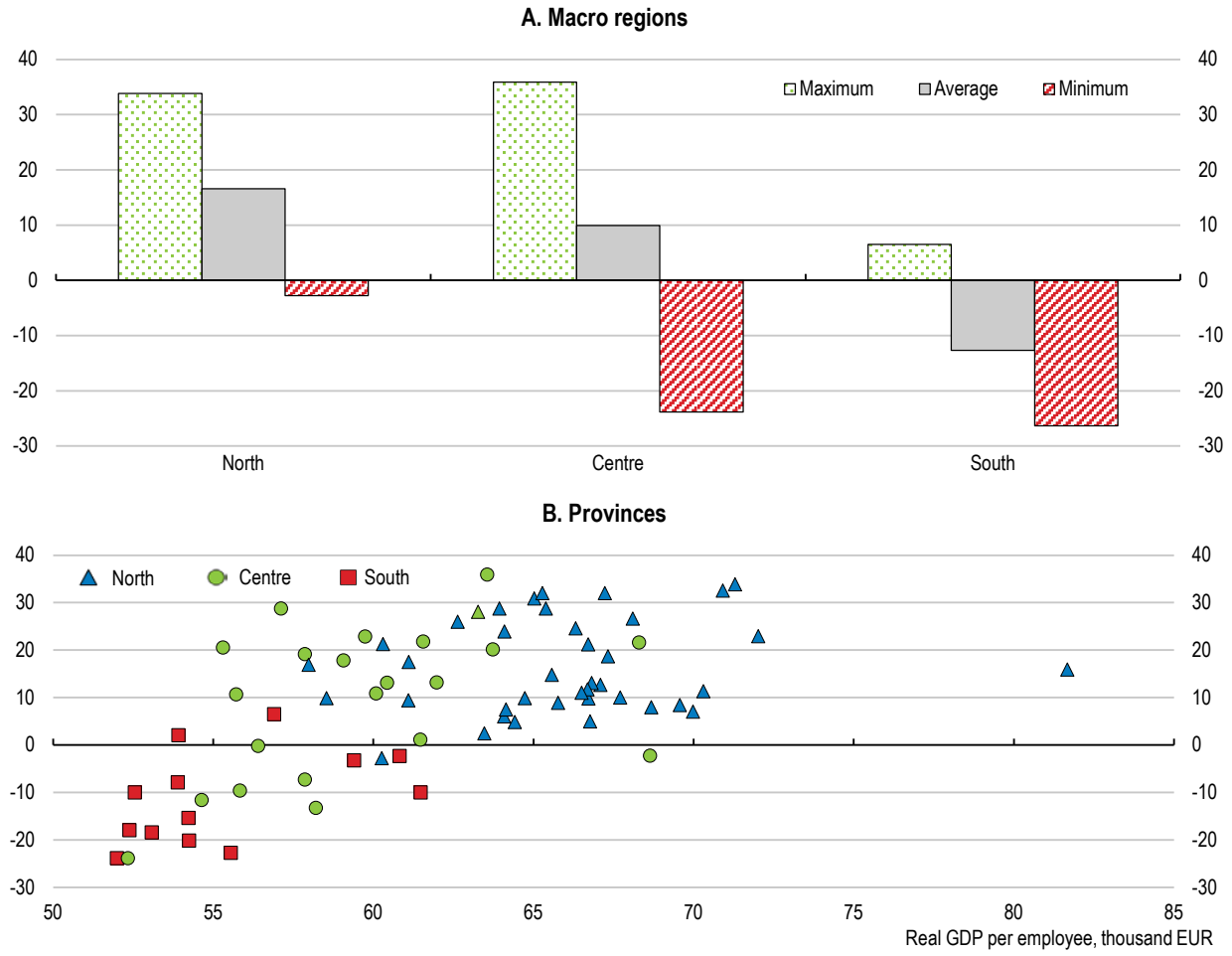
Local public administrations are key to effective regional policies

Improving the quality of subnational public administration is crucial for redressing Italy's social and regional divide. Local public administrations in lagging regions are less efficient (Figure 1.40) and provide fewer essential public goods and services. As a result, these regions experience lower productivity and living standards. Empirical evidence indicates that public administration efficiency leads to higher firm-level productivity growth (Garda, Fadic and Pisu, 2019).

In Italy, sub-national governments are responsible for providing many public goods and services, though these are often funded by central government transfers (Table 1.10). While the regional development policies provide some additional resources, public spending on standard public goods and services dwarfs these additional resources. Regional development policies alone, given their limited budget and reliance on implementation by subnational governments, are unlikely to offset the inefficient and insufficient provision of basic public goods and services and promote regional convergence (Cannari, Magnani and Pellegrini, 2009[72]).

Figure 1.40. Higher efficiency of municipalities is associated with higher productivity

Average administrative efficiency index, 2015



Note: The administrative efficiency index is the percentage difference between assessed spending needs given each region's conditions and realised spending.
Source: OECD *Regional Statistics* database; and OpenCivitas.

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Improving the efficiency of the central and local public administration is then crucial to promote regional convergence (Barca, 2009[73]; OECD, 2009[74]). Local underdevelopment may reflect either lack of the capacity or the unwillingness of local elites to tackle the sources of persistent underutilization of resources and social exclusion. One approach is for central government to focus on achieving needed improvements to local governance and public administration and to improve the choices of local governments (Barca, McCann and Rodríguez-Pose, 2012[75]). This was found to be effective for the US (Glaeser and Gottlieb, 2009[76]; Austin, Glaeser and Summers, 2018[77]). In France, better regulations that promotes growth in lagging cities (such as more efficient local public administration) was found to raise aggregate productivity and welfare whereas subsidies to encourage firms to locate in such places have the opposite effect (Cecile Gaubert, 2018[78]).

Increasing transparency and accountability will help. Building platforms and networks of experts for the identification and dissemination of best practices and further promoting yardstick competition at central and sub-national levels may make politicians and public

managers more accountable to the population and the population more aware of available best practices. Those public administration agencies at central and local levels that repeatedly fail to reach minimum standards or agreed targets should undergo a reorganisation process involving, if necessary, management changes and requalification of personnel.

Harnessing agglomeration economies to promote regional development

In Italy and other advanced countries, cities are an important driver of growth and innovation, and they account for a large share of economic activity and employment. Across OECD countries, metropolitan areas (defined as urban agglomerations with more than 500 000 inhabitants) account for roughly half of the population and more than half of GDP. Various factors affect the economic and social performance of cities, but there are some broad patterns across most cities. For instance, larger cities (in terms of population) are generally more productive. Cities' higher productivity and prosperity also raise the economic performance of their hinterlands up to a distance of 200-300 kilometres (OECD, 2015[79]).

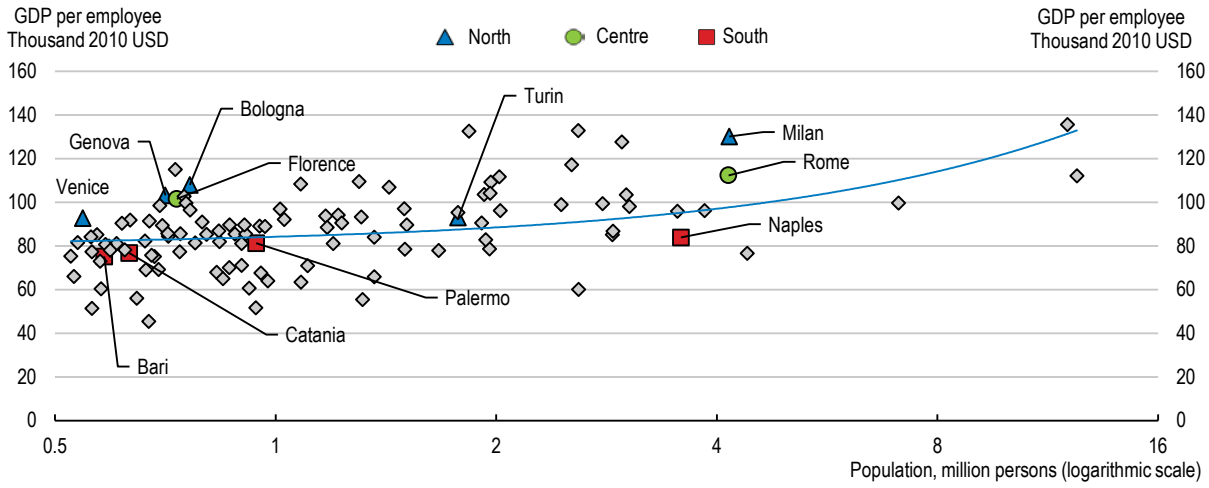
Large compact cities engender environmental benefits. Larger cities perform well in terms of per capita contributions to soil sealing or climate change. Spreading populations over larger areas would not generate systematic ecological benefits. Urban sprawl around Italian cities has contributed to an increase in built-up areas. Population density in Italian metropolitan areas has diminished and fragmentation of urban settlements has increased (OECD, 2018[80]). In Italy, the share of urban populations residing outside of the centres of functional urban areas is higher than the OECD average (OECD, 2018[80]). Residents of peripheral municipalities are more likely than in the past to work in the urban centres, raising commuting. Rising urban sprawl fosters car dependency and traffic congestion, raises pollution, energy consumption and CO_2 emissions markedly (OECD, 2018[80]) It also raises the cost of providing electricity and water infrastructure as well as public transport.

In Italy, metropolitan areas' productivity advantage is no different from European peers (Figure 1.41). However, Italian metropolitan areas in the southern regions have lower labour productivity levels than those in northern ones, given the same population, indicating weaker agglomeration economies. Metropolitan areas in the South have similar population density to those in the North, suggesting that cities' population density or structure of cities does not explain the differences in productivity (Figure 1.42). Giovanelli and Pisu (2019) show how the efficiency of local public administration is positively associated with the strength of agglomeration economies.

OECD research has shown that the governance structure of metropolitan areas is an important determinant of their economic, social and environmental performance. Italian metropolitan governance bodies are weak. This is because their establishment is incomplete as with the rejection of a constitutional change in December 2016 provinces retained the functions that should have been transferred to metropolitan bodies (Box 1.11). Given this institutional setup, three factors handicap the operations of metropolitan governance bodies: responsibilities overlapping with those of regions and municipalities (Table 1.9); administrative borders not coinciding with the functional urban areas (Figure 1.43); and low budgets.

Figure 1.41. Metropolitan areas and labour productivity in Europe

2014 or latest available



Note: Metropolitan areas have a population of 500 000 or more and are from over 30 OECD countries, defined following a harmonized functional definition developed by the OECD, in cooperation with the European Commission.
Source: OECD *Metropolitan Areas* database; and OECD *Regional Statistics* database.

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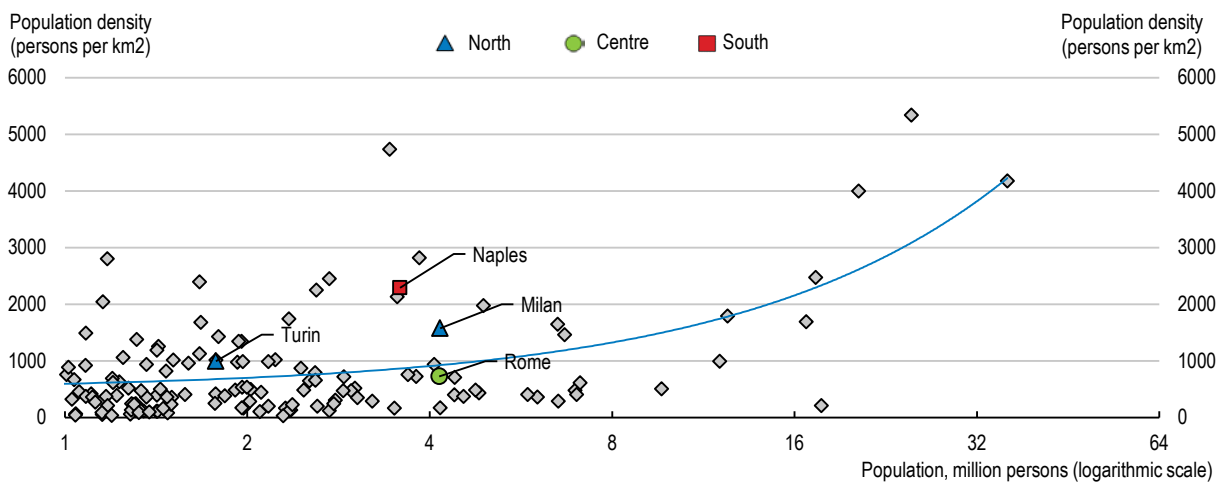
Effective governance arrangements would improve coordination of policies across municipalities. Coordinating policies is especially important in metropolitan areas where municipal borders do not correspond to today's functional urban area but to past administrative borders. This mismatch contributes to coordination problems and increases the need for effective governance structures (Box 1.10).

Figure 1.42. Densities of metropolitan areas

2014 or latest available year



Note: Metropolitan areas have a population of 500 000 or more and are from over 30 OECD countries, defined following a harmonized functional definition developed by the OECD, in cooperation with the European Commission.
Source: OECD *Metropolitan Areas* database; and OECD *Regional Statistics* database.

StatLink https://doi.org/10.1787/888933949098

Table 1.9. In important areas metropolitan bodies' responsibilities overlap with those of regions and municipalities

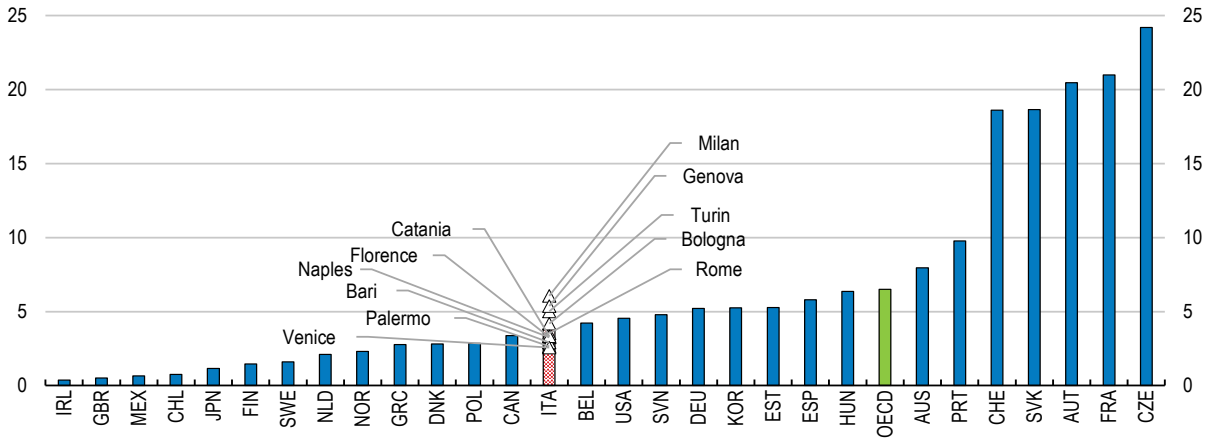
Function	Clashing and overlapping competences
Strategic planning	Strategic plans are generally promoted by the municipalities or by regions.
Economic and social development	Regions are mostly responsible for managing European structural funds.
General spatial planning	Metropolitan bodies develop metropolitan general spatial plans that become effective after being approved by regional laws.
Mobility and transport infrastructures	At present, metropolitan bodies can only manage suburban roads and on-road public transport (i.e. busses), while regions manage metropolitan railways (the main transport service at this scale).
Coordination of public services	Regions manage most supra-municipal public services (professional education and training, water supply, waste disposal, park management etc.); they can transfer these services to metropolitan bodies with special agreement.
Coordination of ICT infrastructures	Regions manage ICT broadband infrastructure and related services.

Source: Adapted from Crivello and Staricco (2017[81]).

Progress in this area will hinge on regions and municipalities deciding to share some of their functions with metropolitan bodies. So far, regions have been reluctant to transfer some of their competences; in a few cases (Turin, Milan, Florence and Bologna) cooperative frameworks have been set up; in others (Venice, Naples and Bari), regions have shown less willingness to establish a cooperative approach (Crivello and Staricco, 2017[81]). Introducing incentives to foster cooperation between regions and metropolitan governance bodies would go in the right direction.

Figure 1.43. Administration of Italy's metropolitan areas is somewhat fragmented

Number of local governments per 100 000 inhabitants in metropolitan areas, 2014



Note: The OECD-EU definition of functional urban areas (FUA) has not been applied to Iceland, Israel, New Zealand and Turkey. Metropolitan population figures are estimates based on municipal figures for the last two censuses available for each country.
Source: OECD *Metropolitan Areas* database; and OECD *Regional Statistics* database.

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Box 1.10. Effective governance reform for metropolitan areas

OECD research has identified the following elements to improve the governance arrangements of metropolitan areas:

- Encourage long-term co-operation: There is no one-size-fits-all model of metropolitan governance; however, experience suggests that metropolitan governance reforms need to go beyond purely institutional changes and build a long-term process of co-operation. Central governments can play a central role in this process by providing leadership and incentives.
- Fit governance arrangements to local conditions: The presence of a metropolitan authority does not alone guarantee better policy co-ordination; even once well-functioning governance structures may eventually need to evolve. A risk commonly encountered is that governments may attempt to replicate a specific type of metropolitan governance arrangement that is considered successful in one place, but which may not be entirely transferable into a different socio-economic context.
- Focus not only on the outcome of the governance reform but also on its process: When looking to adopt a metropolitan governance arrangement, governments should assess not only the trade-offs associated with each reform, but also the process of designing, implementing and sustaining the reform.

Source: OECD (2015[82])

Box 1.11. The birth of metropolitan bodies in Italy

A 2001 constitutional change raised metropolitan governance bodies to the rank of constitutional entities alongside regions, provinces and municipalities. However, they remained only on paper until 2014 when a law tried to reorder the responsibilities of provinces and metropolitan governance bodies. This law transferred to metropolitan governance bodies all functions of provinces; and set the borders of metropolitan governance bodies to follow those of provinces. Also, metropolitan governance bodies gained additional responsibilities covering: strategic development of the metropolitan areas; development and integrated management of services, infrastructure and communications network; and, international relations.

The 2014 law was linked to a broad constitutional reform that aimed, among other things, at suppressing provinces and transferring their funds and responsibilities to metropolitan bodies. However, the constitutional reform was rejected in a referendum in December 2016 and the provincial administrations retained their functions and funds, undermining the role of metropolitan governance bodies.

Governance and outcomes are likely to be better when administrative boundaries match the functional urban area. However, this is only the case in Bologna and Florence. For most other cities, the functional urban area is smaller than the administrative metropolitan area; in Milan, Rome and Naples the city is smaller than the functional area. Metropolitan governance bodies can have difficulty managing metropolitan development in areas outside their administrative borders. Stronger incentives to use territorial pacts (agreements to coordinate local policies and actions to promote economic development), and "accordi di programma" (agreements favouring institutional cooperation in implementing policy decisions) would help overcome this problem.

Funding sub-national governments according to needs and capacity

The allocation of resources across regions is an important lever for regional development and creating potential incentives for local administrations to improve their performance. The 2009 legislation on fiscal federalism introduced a new mechanism for horizontal fiscal equalisation based on sub-national governments' expenditure needs and fiscal capacity, replacing the historical expenditure approach (Box 1.12). The share of funds allocated to local governments based on needs (rather than historical spending) rose to 45% in 2018 from 20% in 2015. In 2019 it will rise further to 60% and reach 100% in 2021 (SOSE, 2018[83]).

The new system holds the promise of strengthening accountability at local levels and should be pursued as planned. This can result in stronger pressures on local politicians to increase public administrations' efficiency and effectiveness. The data, methodology and results of this exercise are available on the website www.opencivitas.it. In addition to allowing the central government to set transfers to local governments based on actual needs, the volume of data available and ease of access enable the benchmarking of local administrations across several dimensions, thus promoting yardstick competition.

Box 1.12. Fiscal federalism in Italy

Following Law 42/2009 on fiscal federalism, the government is implementing a new fiscal equalisation mechanism based on actual expenditure needs. The 2009 law follows the 2001 Constitution constitutional change in the same direction. The aim of this reform is to grant more responsibilities to and enhance tax autonomy of sub-national governments (regions, provinces, municipalities, and metropolitan areas), while guaranteeing national solidarity and cohesion. The reform also aims at promoting public administration efficiency through stronger accountability. Policies under the remit of sub-national governments vary but they are important, covering education, labour market polies, health and others (Table 1.10). Subnational governments are responsible for about 26% of total public spending and slightly less than 20% of total revenues (Figure 1.44).

The new system is based on information collected by sub-national governments to estimate standard expenditure needs, standard levels of services and fiscal capacity. The fiscal gap is computed as the difference between standard expenditure needs and fiscal capacity. Transfers are then determined based on the fiscal gap. The estimation of standard expenditure needs and services levels considers the geographic and socio-

demographic characteristics of the resident population. For instance, at the municipal level the overall standard expenditure need is based on: population and demographic characteristics, levels of services provided (number of students, and assistance to children with handicaps), geographic features (earthquake risks, altitude, surface area), input prices (rental housing index), social hardships (number of families in absolute poverty), traffic and vehicles, tourism (number of tourists and museum visitors), investment over the past five years and other factors. Brunello et al. (2014) and Ballanti et al. (2014) provide a detailed explanation of the methodology.

Table 1.10. Area of responsibilities of sub-national governments and share of spending

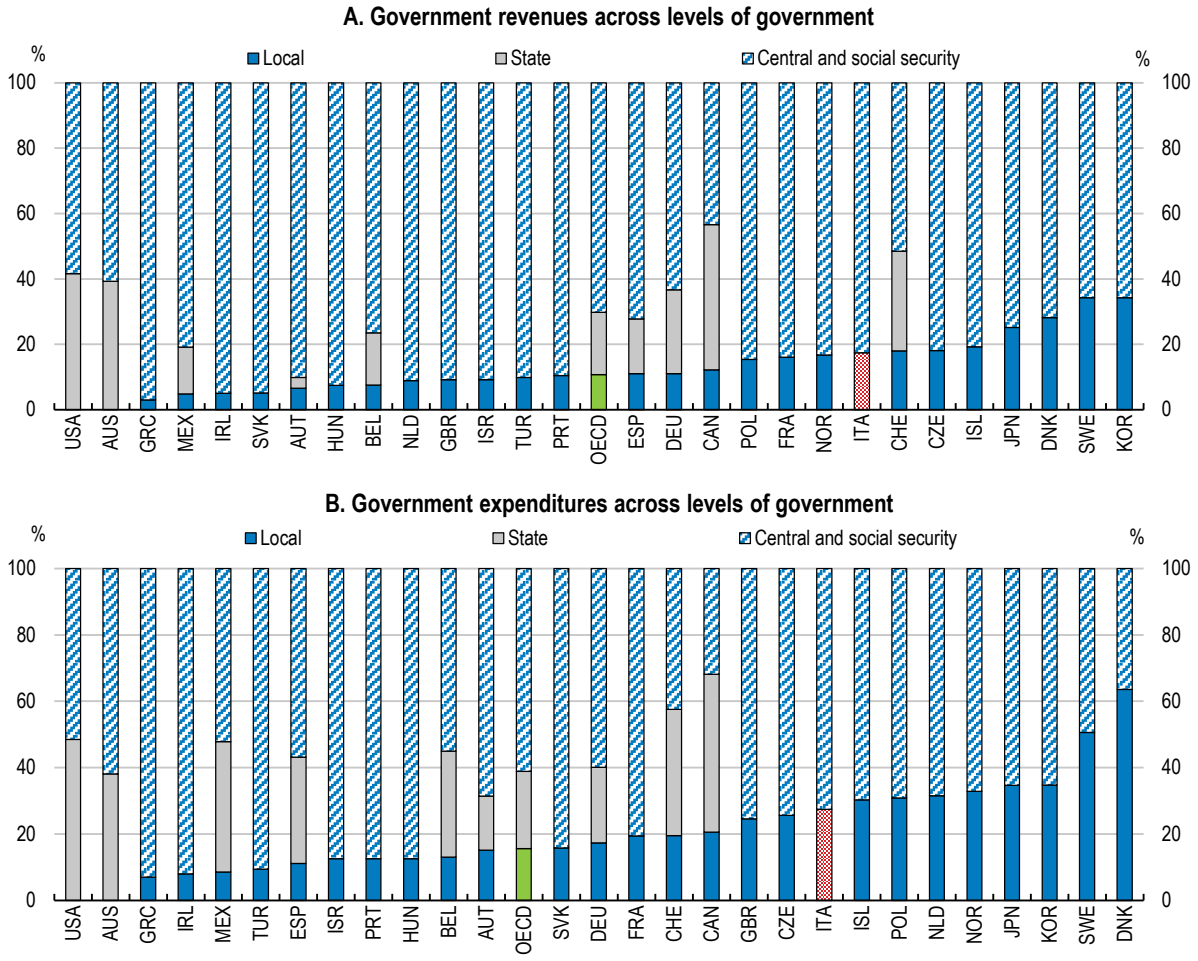
	Main areas of responsibilities	Share of total public spending
Regions	Protection of health; Public transport; Complementary social welfare; Higher education and vocational training.	19%
Provinces and metropolitan areas	Management of provincial road network; Management of public high school buildings; Environmental protection; Delegated functions by regions in local public transport and vocational training.	0.8%
Municipalities	Environment protection and waste management; Social services, childcare and nursery schools; School-related services; Local police; Local transport and maintenance of local roads; Registry, Town planning and Central administration, Culture and recreation, Economic development.	6.8%

Source: SOSE (2018)

Sub-national governments' efficiency indices are computed combining the expenditure gap and the output gap. The expenditure gap is the difference between actual expenditure and the estimated standard expenditure needs. This can be considered as an input-oriented efficiency index. The output gap is the difference between the actual level of services provided and the estimated standard level of services. This can be considered as an output-oriented efficiency index. Italy is not the first country to adopt such a methodology to assess the performance of local governments or agencies – especially with regard to expenditure needs. Recent examples include the Comprehensive Performance Assessment in England, the Australian Review of Government Service Provision and Norway's KOSTRA system (e.g.: Mizel, 2008). The methodology adopted by Italy is the most advanced across OECD countries.

Figure 1.44. Responsibilities of regional governments are large in some areas

Percentage, 2016 or latest available



Source: OECD (2018), *Subnational governments in OECD countries*: *Key data* (brochure); OECD (2017), *Government at a Glance 2017*, OECD Publishing, Paris.

StatLink https://doi.org/10.1787/888933949136

Policy recommendations

- Reduce the labour income tax wedge on low-income workers and second earners through lowering employer social security contributions and tax and benefit reforms, while maintaining the personal income tax system's progressivity.
- Taper off Citizen's Income benefits as incomes rise to encourage beneficiaries to seek employment in the formal sector and introduce an in-work benefit for low-income earners.
- Simplify personal income tax credits and family benefits, while maintaining the progressivity of the personal income tax and a simplified family benefit.
- Ensure capacity to administer the Citizen's Income by building on, and strengthening, where necessary, municipalities' social assistance services and establishing strong collaboration with public employment services.
- Develop and implement a multi-year plan to revamp public employment services based on enforcing essential service standards and higher investments in IT systems, profiling tools and human resources.
- Grant to ANPAL the power to restructure public employment services that repeatedly fail to meet commonly agreed performance targets.
- Expand access to training and re-training courses for adults that provide certification and are developed with employers to meets local labour market needs.
- Provide more quality child infant care places at a low cost relative to average wages, prioritising regions with low female employment.
- Rationalise and improve coordination among bodies involved in regional development policies by strengthening the role and expertise of central government bodies.
- Build platforms and networks of experts for the identification and dissemination of best practices in different policy areas and further promoting yardstick competition at central and sub-national levels.
- Empower metropolitan governance bodies with the transfer of some of the powers of regions and provinces.
- Restructure operations relating to waste management of those sub-national governments that repeatedly fail to reach targets for waste collection and recycling.

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