Key findings

To improve Italy’s long-term growth prospects, comprehensive structural reforms are needed to boost competitiveness and support job creation. Prime Minister Matteo Renzi’s government has set out an ambitious structural reform agenda across many policy areas including product markets, labour markets, taxation, public administration and civil justice, among others. Some reforms have already been made, such as new provisions for labour contracts, revisions to unemployment benefits, some corporate tax reforms, and measures to improve administrative justice and anti-corruption policies. Others are under way but not complete, such as plans to improve active labour market policy, further administrative simplification and tax reforms. Still more are in the pipeline, such as further liberalisation and strengthening of competition, measures on education, public administration and criminal justice.

There has been an increased focus in Italy on rapid implementation: significant parts of the labour market reform were in place by the beginning of 2015. In addition, the backlog of subsidiary legislation from laws passed in 2012 and 2013 has been reduced significantly. Moreover, the government has also started to put great emphasis on changes in the political and institutional frameworks and judicial system to remove impediments to full implementation of reforms. Such institutional impediments in the past often deprived the economy of the full benefits of good reform projects due to a lack of their full implementation.

Drawing on the 2015 OECD Economic Survey of Italy, this paper provides a snapshot of the government’s reform agenda. It also assesses the impact on productivity, employment and GDP of the reforms that have been introduced since 2012, which is estimated to have been significant. After five years, GDP will be 3.5% higher than would otherwise be the case in the absence of the reforms. This means that GDP will grow 0.7% faster per year on average over this period thanks to the reforms. The number of additional jobs created over that period is estimated at 340,000. In the following five years a further gain of similar magnitude can be expected. These estimates assume swift and full implementation of the reforms - delays, or less than full implementation, would reduce the gains.

- The product market reforms are estimated to boost GDP by around 1.5% after five years and 2.6% after ten years. This GDP increase is driven by higher productivity growth as lighter regulation encourages competition, which in turn speeds up the pace of convergence in productivity levels to the most technologically advanced economies. Lighter regulation also encourages firms to experiment with new ideas and technologies and improves facilitates the shift of resources from slow- to fast-growing sectors.

- The labour market reforms that the government is implementing as a result of the Jobs Act that was adopted in December 2014 are expected to boost GDP by 0.6% after five years and 1.2% after ten years. The positive GDP effect comes through higher employment, with 150,000 new jobs created after five years and 270,000 new jobs created after ten years. The reforms focus on four key areas: rationalising employment protection, expanding active labour market policy, making social protection more effective, and boosting female labour force participation.

- The tax reforms are expected to boost GDP by 0.7% after five years and 1.6% after ten years. The effect of the personal income tax cut for low-income earners will come through higher employment, which is estimated to increase by 180,000 jobs after five years and 380,000 jobs after ten years. The 10% cut in the tax on productive activities affecting businesses, the exclusion of workers’ pay from the base of that tax, and the strengthening of the tax credit for hiring personnel with a PhD or engaged in R&D activities will affect GDP through higher productivity.

- The government is also making wide-ranging reforms to the public administration and the judicial system, which will boost GDP both directly by reducing administrative burdens on firms and indirectly by securing the timely and complete implementation of other reforms. Among the various reforms in this area, only the impact of the creation of single access points for foreign investors can be quantified in this paper. The reform is expected to increase the level of GDP by 0.6% after five years and 0.9% after ten years by easing the entry of foreign firms.
Quantifying the effects of the reforms: details and analyses

After a long period of stagnation, Italy has started to undertake ambitious reforms to boost growth. This paper offers an estimate of the impact of improving the countries’ product and labour market regulations, the structure of its tax system as well as its public administration and judicial system on productivity, employment and GDP. The assessment suggests that the reforms could increase the level of GDP by 3.4% within five years and by 6.3% within ten years (Table 1). At the 10-year horizon, about 40% of the effect is due to higher employment, while the remaining part is due to higher productivity. Details on the reforms considered are found in Annex 1.

Table 1. Impact of reforms on the level of productivity, employment and GDP

<table>
<thead>
<tr>
<th>Product market reform</th>
<th>Impact after five years</th>
<th>Impact after ten years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Via employment growth</td>
<td>Via productivity growth</td>
</tr>
<tr>
<td></td>
<td>GDP</td>
<td></td>
</tr>
<tr>
<td>Product market reform</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Labour market reform (Jobs Act)</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Tax reform</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Public administration and judicial system reform</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Total</td>
<td>3.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Average annual growth</td>
<td>0.7</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Notes:

1. OECD estimates for the impact of product market reform include the results of reforms from 2012 onwards. Approximately two thirds of the quoted impact are due to measures taken in 2012-13.

2. The impact of the labour market reform is based on a judgement, based on the Jobs Act Legge Delega (enabling law), although not all details are defined yet.

3. Reforms that are planned (and announced) for 2015 and 2016, or in 2014 but not yet legislated in detail, have not been included, with the exception of those under the Jobs Act as described in note 2.

4. The employment effects assume that all persons entering the labour market find work.

Source: OECD calculations.

The quantitative assessment is based on a previous work by the OECD for the G20 which evaluated the Comprehensive Growth Strategy by the Italian government. This previous work looked at the reforms announced and adopted in 2014. This time, the quantitative assessment broadens the scope so that it also includes:

- past reforms for which the current government is responsible in their implementation;
- additional measures which have been announced and adopted since the previous work for the G20 (among others, the 2015 budget as well as the Jobs Act enabling law and its application decrees).

The quantitative assessment therefore adopts the same methodology as in the previous work for the G20. It investigates the expected effects from each reform measure. First, each reform measure is evaluated in terms of quantifiable variables, including standard OECD indicators where necessary. These indicators are typically the Product Market Regulation (PMR) indicators and the Employment Protection Legislation (EPL) indicators. Then a series of equations relate each reform measure or packages thereof to their expected effects on productivity and/or employment. These effects are added up to produce the total effects.
The quantitative assessment primarily focuses on reform measures for which the estimated effects are relatively well-established and straightforward to be understood. It relies on existing OECD empirical studies of the links between structural policies and productivity or employment, and covers the following areas: i) product market reform; ii) labour market reform (employment protection legislation, unemployment benefits, active labour market policies, female labour force participation), and iii) tax reform. Reforms of the public administration and the justice system are taken into account where possible (for example, those which apparently improve the functioning of the product or labour market and are possible to be interpreted in terms of the standard OECD indicators).

**Product market reform**

Reforming product market regulation (PMR) in a way to enhance competition can speed up the pace of convergence in productivity levels to the most technologically advanced economies. More competition encourages firms to pursue efficiency and invest in innovation and knowledge-based capital. Lowering barriers to entrepreneurship facilitates the entry of firms that experiment with new ideas and technologies. PMR reforms can also boost aggregate productivity by raising the capacity of the economy to allocate capital and labour resources to fast-growing sectors. Product market competition can also be good for jobs by encouraging the creation of new companies and the expansion of existing ones that can take advantage of new markets, products or processes.

Italy’s product market does not seem to function in a competitive way, given the limited number of start-ups. The resource allocation mechanism is impaired, as it does not channel resources to the most productive firms. To tackle this issue, a number of reforms to the competition and regulatory frameworks were launched. Specifically, the government significantly extended the powers of the Antitrust Agency and established new independent regulators in transport sectors. In addition, regulatory restrictions in professional services and retail trade were eased, market access in the telecom sector was improved and the unbundling requirements in the gas sector were strengthened. Italy is also committed to implement reforms as part of the completion of the European Telecom Single Market, the Third EU Energy Package and the EU’s commitment to open the railway market for competition. Together, the already implemented reforms and the reforms to which Italy is committed because of EU membership should boost productivity and GDP by around 1.5% within the first five years after the reforms and by another 1.1% within the following five years.

**Labour market reform**

With the Jobs Act adopted in December 2014, the government has a mandate to introduce measures to rationalise employment protection, expand active labour market policy, make social protection more effective, and boost female labour force participation:

- **Less stringent employment protection legislation** (EPL) promotes an efficient allocation of labour resources by making it easier for firms to respond quickly to changes in technology or product demand that require reallocation of staff or downsizing. Therefore, EPL reforms that reduce the costs of hiring and firing can support higher productivity. Indeed, stringent EPL has been found to weaken productivity in sectors where labour turnover is “naturally” high (Bassanini et al., 2009). To rebalance job protection, a standard contract with employment protection increasing with tenure was introduced in early 2015. This new arrangement implies quite radical changes for Italy and to avoid unwarranted disruption, it is applied only to new employment contracts (“grandfathering” existing rights). As part of the Jobs Act the government also introduced a new form of out-of-court procedure for dismissals, under which the employer pays the worker an indemnity equal to 1 monthly wage per year of service. The acceptance of this transaction prevents any further dispute by the worker. Both parties have a strong incentive to settle the dispute through this procedure, since the sum paid is not subject to social contribution or fiscal taxation.

- **Active labour market policies** (ALMPs) aim to improve the efficiency of the matching process in the labour market, reducing frictions in vacancy filling by assisting job seekers. ALMPs act on recruitment costs (through job counselling, placement services, etc.) as well as on after-tax wages (making work pay). Such

1. The Jobs Act also foresees the introduction of a legal minimum wage, but no details have yet been announced.
measures encourage firms to open new vacancies and unemployed workers to accept jobs. The Jobs Act will strengthen ALMPs and create a National Employment Agency, which will be responsible for coordinating ALMP policy. So far, only parts of the reform have been legislated.

- An efficient **social benefit system** is important so that displaced workers are protected against poverty and given facilities to help finding new jobs, while avoiding pervasive disincentives for labour supply. In Italy, the unemployment benefit system has been very generous for certain workers, notably those in the industrial sector, while other workers have had little cover. As part of the Jobs Act the coverage of unemployment benefits was extended, bringing Italy closer to a “flexicurity” approach. Moreover, the “Assicurazione Sociale per l’Impiego” (ASpl) and mini-ASpl which were introduced in 2012 were integrated, thus harmonising their different eligibility requirements and durations. The new legislation also introduced conditionality for unemployment benefits, requiring recipients to participate in activating measures proposed by the employment service, and reforms the social assistance provided to vulnerable people.

- The **female labour force participation** rate has been increasing steadily, due to the cohort effect reflecting higher educational attainment of the current generation, and is expected to continue doing so. However, its level still remains well below the OECD average. Encouraging greater participation is very important for Italy, since the working age population will soon begin to diminish due to demographic factors, while immigration is expected to have a very limited influence over the long run. Family-friendly policies and working conditions which enable fathers and mothers to balance their working hours and their family responsibilities facilitate women’s labour force participation or longer working hours. To encourage female labour force participation, the Italian government is planning to reshape tax deductions for dependent spouses, reform maternity allowances and improve the availability of care facilities. Moreover, it has introduced a tax credit for low- and medium-income families with children.

Many of the above listed elements of the Jobs Act can be quantified in terms of their impact on productivity, employment and GDP. This includes all EPL reforms with the exception of the new out-of court settlement procedure, all ALMPs reforms, the strengthening of the link between unemployment benefits and individual job-search efforts, and all measures to foster female labour force participation. Together, these reforms will boost GDP by 0.6% in the first five years after the reform. In the following five years an effect of similar magnitude is expected, so that the total GDP effect after ten years amounts to around 1.2%. The majority of this effect comes through higher employment. The Jobs Act is estimated to create around 150,000 new jobs in the first five years after the reform and another 120,000 jobs in the following five years. This assumes that the ALMP that have not been legislated so far and the reforms to strengthen the participation of women will be legislated in due course.

**Tax reform**

High taxes on labour income depress labour supply and can reduce firms’ labour demand by driving up the cost of labour (due to high employers’ contributions or payroll taxes). Such detrimental effects are stronger for young and low-skilled workers facing foremost labour demand-side obstacles, and second earners and lone parents often facing high disincentives for full-time labour participation. Therefore, reforms that reduce the labour tax wedge can increase employment and also reduce labour informality (Bassanini and Duval, 2006). As part of its reform agenda, the government cut the personal income tax for low-income earners. The reform will create around 180,000 jobs within the first five years of the reform and additional 200,000 jobs within the next five years. The greater labour supply will boost GDP by 0.3% within the first five years and by another 0.9% within the following five years.¹

Tax reforms can impact economic growth also via private investment and productivity (Arnold et al., 2011; Bouis et al., 2012). A more growth-friendly tax system can be achieved by shifting the tax burden away from

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1. The contribution of employment growth to GDP growth is disproportionately larger at the 10-year horizon than at the 5-year horizon despite the similar pace of employment growth because the 10-year effect assumes that the capital stock increases by as much as employment to recover the pre-reform level of the return to capital.

2. The much larger contribution of employment growth to GDP growth at the 10-year horizon relative to the 5-year horizon is again due to the capital stock adjustment that feeds through only in the long run.
direct income toward consumption, immovable property and the environment. In this spirit, the Italian government cut the regional tax on productive activities (IRAP) affecting businesses by 10% in 2014, from 3.9% to 3.5%. In addition, the 2014 Budget Law strengthened the tax credit for hiring personnel with high skills to facilitate the employment of persons with a PhD or engaged in R&D activities and extended the tax credit for investments in R&D. The government is also working to pass a law (“delega fiscale”) aimed at reforming the cadastre and defining a more equitable, transparent, simplified and growth-oriented tax system, while ensuring stability and legal certainty. The measures to modernize and make the tax code more growth friendly are needed complements to the crowding in effect from the spending review. Together, these measures are estimated to raise the levels of productivity and GDP by 0.4%, with the full impact of the reforms seen already after five years. This assumes that also the “delega fiscal” will be rapidly and fully legislated.

Reform of the public administration and the judicial system

Important steps have been taken to improve the efficiency of the judicial system. The government has modified the application of the statute of limitations to reduce the incentive to prevarication and took measures to gain economies of scope and scale through the amalgamation of small courts, thus allowing some specialisation by judges. Other measures already legislated include the strengthening of mechanism of alternative dispute resolution and making greater use of ICT to simplify judicial processes and make them more efficient. The government is also planning to establish specialised business courts.

The government is also planning to reform the public administration, progressively lowering the mean working age of civil servants, launching a new system for public management and a national plan for workers’ mobility and adopting measures to enhance integrity. In addition, the public administration is to be reorganized to achieve cost savings, the efficiency of public procurement is to be strengthened, and governance is to be simplified and improved to attract more foreign direct investment.

As the quantitative assessment only considers reforms which directly impact productivity and/or employment, the coverage of reforms related to the efficiency in public administration and the justice system is limited. The only reform that is taken into account is the creation of single access points for foreign investors, which increases productivity by facilitating the dialogue with the public administration in the preparation of investment solutions as well as by guaranteeing the legality of investment-related regulatory practices at all stages of the investment process and the stability of contracts. Assuming that that the measure is fully implemented in due course, it will boost GDP by almost 0.6% within the five years of the reform and by an additional 0.3% within the following five years.
The impact of reforms on the public debt-to-GDP ratio

The reform package can be considered in an integrated macroeconomic framework, using the OECD Economic Department’s long-term baseline model. This framework allows computing the trajectories of GDP, public finances and the current account balance in a consistent way, while taking into account the reform measures jointly with other macroeconomic forces.

In association with higher growth rates, the reforms will lower the debt-to-GDP ratio. The path of the debt-to-GDP ratio is now lower compared with the baseline scenario in each period, with the difference narrower as the 60% target is being reached. This difference arises to a large extent from the employment side. The result is underpinned by a long-term equality between government and private sector wages, as well as program expenditures that are linked to economic growth through indexation on wage increases (for details, see Chapter 4 in OECD, 2010).

Figure 1. The reforms will accelerate the reduction in the debt-to-GDP ratio

A. Potential GDP in billion EUR (constant 2005 prices)

B. Debt-to-GDP ratio in %
## Annex 1. Reforms taken into account in the quantification exercise

<table>
<thead>
<tr>
<th>Reform area</th>
<th>Reform content</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product market reforms</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Antitrust Agency</strong></td>
<td>The powers of the Antitrust Agency (AGCM) have been significantly extended. It can now appeal through the regional administrative court (TAR) against the actions of any public administration at the national, regional or local level violating the principles of competition. To raise the incentives of local authorities to award services through public tender, exclusive contracts for local public service provision in municipalities with more than 10 000 inhabitants have been subjected to a mandatory opinion by the AGCM regarding the existence of suitable and sufficient reasons for assigning such exclusive rights.</td>
</tr>
<tr>
<td><strong>Regulatory oversight</strong></td>
<td>In transport, the Cresci Italia law from March 2012 legislated to establish a new independent regulatory authority, to be responsible for highways, airports, ports, taxis and railways both at the national and local level. The surveillance of the water and postal sectors has been assigned to the Energy and Communication Authorities, respectively.</td>
</tr>
<tr>
<td><strong>Telecom sector</strong></td>
<td>The Communications Authority (AGCOM) approved the break-up of the fixed telecommunications infrastructure owned by Telecom, in order to ensure to all operators access to the network at non-discriminatory rates.</td>
</tr>
<tr>
<td><strong>Gas sector</strong></td>
<td>The further unbundling of the gas network operator (SNAM) from the incumbent gas operator (ENI) should create more effective competition and transparency in the market for natural gas.</td>
</tr>
<tr>
<td><strong>Professional services</strong></td>
<td>Some restrictions to professional services have been reduced. For example, standard pricing has been eliminated and it has become easier for young people to begin practising, by allowing them to complete part of the compulsory practical training in parallel with university education. Pharmaceutical distribution services have been enhanced through an increase in the number of pharmacies (one per 3 300 inhabitants), and allowing the sale of certain pharmaceuticals outside pharmacies. On the other hand, the period within which a person inheriting a pharmacy, but who is not enrolled in the profession’s register, must sell the property was shortened from 2 years to 6 months, providing members of the register with greater leverage in sales negotiations.</td>
</tr>
<tr>
<td><strong>Retail trade</strong></td>
<td>In retail trade, the Salva Italia law has extended the freedom of opening hours to all shops, not only those located in tourist resorts or artistic cities, and has reduced unjustified restrictions on the exercise of a business activity, such as minimum distances between commercial outlets. Fuel distribution at the retail level has been substantially deregulated by allowing petrol stations to source part of their supply from producers other than their mother company, removing limitations to self-service at stations outside cities and to locating near supermarkets, and expanding the range of articles that are allowed to be sold at petrol stations.</td>
</tr>
<tr>
<td><strong>EU commitment on Single Telecom Market</strong></td>
<td>A legislative package for the completion of the European Telecom Single Market was voted by the European Parliament in April 2014 and has to be approved by the EU Council. The proposed package would strengthen network neutrality rules across borders and cut international roaming charges in the EU. Following an agreement reached with the EP in February 2014, the Council adopted the Directive on broadband cost reduction on 8 May. EU Member States must now adopt national provisions to comply with the new Directive by 1 January 2016 and they must apply the new measures from 1 July 2016.</td>
</tr>
</tbody>
</table>
### EU commitment in the energy sector

In the energy sector the priority for the coming years should be the completion of the energy internal market through the transposition and implementation of the Third Energy Package, which should be achieved by the end of 2014. Its major elements concern the unbundling of networks, the strengthening of the independence and power of national regulators, and the improvement of the functioning of retail markets. Fees for the purchase of natural gas have also been made more competitive, and the Electronic Markets Operator (GME) is developing a platform for the logistics market for oil and mineral oils to bolster competition in the oil industry.

### EU commitment in rail transport

In transport, the main priority is the opening of the railway market for competition through, among other things, the separation between infrastructure and services and open procedures for public service obligations. These issues are addressed by the Fourth Railway package proposed by the European Commission. In June 2014, the Council reached political agreement on the draft directives on the interoperability and safety of European railways and the draft regulation on the European Railway Agency. Together, these three legislative acts make up the technical pillar of the Fourth Railway package. The rules regarding the fees for access to the railway network have changed so as to guarantee to all competitors non-discriminatory access to the market.

### Labour markets reforms

**Active Labour Market Policies**
The Jobs Act strengthens employment services and active policies by: a) establishing a National Employment Agency for the integrated management of active and passive labour policies; b) strengthening and enhancing public-private partnerships; c) ensuring a proper division of labour between the national level, in charge of defining the basic level of assistance, and the local authorities, in charge of planning active labour market policies; d) ensuring the active involvement of job seekers; e) improving the IT system for managing and monitoring purposes.

**Unemployment Benefits**
Taking over the previous reform in 2012, the Jobs Act ensures the unification of the standard unemployment benefit and some specific benefits (*Indennità di Mobilità* for collective dismissal, for example). It will also phase out other specific benefits (for example, *Cassa Integrazione Straordinaria*, for those who work in firms facing crisis and/or restructuring in the industry sector or other designated sectors, whose replacement ratio and duration have been more generous than the standard unemployment benefit).

**Employment Protection Legislation**
For fixed-term contracts lasting up to 3 years (instead of 1 year before the reform), employers no longer need to specify the reason of the termination of the contract.

For businesses employing more than a certain number of employees, the maximum share of the total workforce that can be subject to this contract is 20 per cent; for businesses employing less than a certain number of employees there is no limit to the use of this contract typology. The ability to modify the quantitative limit of 20 per cent and the possibility of deviating from the 20 per cent threshold for reasons connected with replacement and seasonality are left to collective bargaining. The possibility to extend the duration of the contract period within the limit of 36 months was also extended from one to eight times.

A new standard employment contract was introduced, implying less rigid dismissal protection than the previous open-ended contract. This new standard contract limits further the possibility of reinstatement of workers following unfair dismissal and excludes this possibility for the case of redundancy (dismissal for objective reasons “motivo oggettivo”). Instead, workers unfairly dismissed for objective reasons receive monetary compensation. This monetary compensation increases with tenure: equal to 2 monthly wages per year of service (a minimum amount equivalent to 2 months and a maximum amount equivalent to 24 monthly wages).
### Labour force participation

The Jobs Act aims at: a) introducing a universal maternity allowance (guaranteeing the right to mothers working under a non-standard contract to benefit from a maternity allowance even in the event of non-payment of contributions by the employer); b) introducing a tax credit for low- and medium-income families with little children; c) supporting collective agreements designed to facilitate flexible working conditions; d) facilitating an integrated provision of services to childhood by companies within the public-private system of personal care services.

### Tax Reforms

#### Labour tax wedge

The government introduced a EUR ten billion overall tax reduction benefitting low-income dependent workers with an annual labour income of less than EUR 26000. A lump sum tax reduction equivalent to EUR 80 per month is paid on incomes up to EUR 24000, and gradually phased out as labour income attains EUR 26000. This tax reduction is estimated to benefit about ten million employees (those with a take-home pay of less than EUR 1500 per month). The government financed this measure broadly in a finance-neutral way. This measure is extended to the year 2015 and will become permanent.

#### Tax structure

The tax on productive activities (IRAP) (affecting businesses) was cut by ten percent. The 2015 Budget Law a) strengthened the tax credit for hiring personnel with high skills and b) extended the tax credit for investments in R&D.

The government is also working to pass a law (“delega fiscale”) aimed at reforming the cadastre and defining a more equitable, transparent, simplified and growth-oriented tax system, while ensuring stability and legal certainty.

#### Reform of the Public Administration and Judicial System

The administrative burden will be reduced through the creation of a single access point to facilitate entry of foreign investors: facilitating the dialogue with the public administration in the preparation of investment solutions, and guaranteeing the legality of investment-related regulatory practices at all stages of the investment process and the stability of contracts.
References


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