MEF Dipartimento del Tesoro

CSRs for Italy and Common Challenges in the European Semester

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'Close Monitoring' health check (October 2014)

According to the EC: "Reform momentum has picked up but progress remains uneven and implementation crucial"

On track	Uncertainty	Wait & see	Wanted
• First step tax wedge reduction • Operationalisation Fiscal Council • Network industry reforms • Firms' access to finance	• Spending review (quality of cuts) • Privatisation delays and uncertain returns • Full operationalisation of judicial system reforms	• Labour market reform *(promising, but final details crucial)* • Education system reform *(promising; under consultation)* • Modernisation of the public administration *(under adoption)* • Institutional reform *(under adoption)*	• Further tax wedge reduction • Full implementation of enabling law to reform the tax system *(incl. tax expenditure, environmental taxation)* • Annual competition law & local public services reform • Business environment simplification

The tsunami effect and good results on implementation

- According to the EC, "**progress in the coming months** will be crucial to evaluate Italy's success in implementing measures to address its imbalances".
- According to the EC, "the **beneficial effects** of structural reforms will be delayed and reduced if the many institutional bottlenecks, implementation barriers and the weak enforcement capacity are not tackled as a matter of priority".
- **Italy has delivered**: inevitably my presentation is simplified and incomplete; I will mention only a few initiatives.

CSR 1: main recommendations on the fiscal side

- Ensure that the **general government debt** is on a sufficiently downward path.
- Carry out the ambitious **privatisation plan**.
- Improve the efficiency and quality of **public expenditure** at all levels of government.
- Preserve **growth-enhancing spending** like R&D, innovation, education and essential infrastructure projects.
- Guarantee the independence and full operationalisation of the **fiscal council**.

Stability Law 2015: going for growth

- **Net borrowing/GDP:** at 2.6% in 2015, close-to-balance in 2018; debt/GDP to decline from 2016.
- **Reduction in structural deficit:** 0.3pp of GDP in 2015, 0.5pp in 2016, 0.4 in 2017 when balance budget is projected, i.e. temporary deviation from the MTO path.
- **Flexibility clauses:** activation for deep recession and reforms.
- Permanent reduction in the **tax wedge on labour**.
- New spending instrumental to **support the reform process**.
- Significant **spending cuts** to provide financing.

Privatisation plans broadly on track

- Rules to divest initial tranches of **ENAV** (up to 49%) and **Poste Italiane** (up to 40%) already set.
- Ongoing work related to other companies directly or indirectly owned by the State (i.e. 5% **ENEL** in 2015 and **FS** in 2016).
- **Fincantieri** already listed (€1.3bn cap., initial share offering of €350mn) and **RaiWay** (€1.1bn cap., i.s.o. of €300mn).
- 35% of **CDP Reti** (30% of Terna and 30% of SNAM) for €2.1bn.
- **Expected income** from privatisation schemes and disposal of real estate assets: **0.7% GDP yearly from 2015 onwards.**

Health Pact+Spending Review+PBO: ongoing

- The DBP sets cumulative savings targets up to 11.3 bn in 2015, 12.4 bn in 2016, 13.4 bn in 2017 and 15.6 bn in 2018.
- A 3-year **Pact for a sustainable health care system**: €337bn of resources for the NHS in 2014–2016 allocated taking into account cost and need standards.
- The **Spending Review** has been increasingly integrated within the annual budget process. Stability Law 2015 calls for a deeper spending review at all levels of government.
- The **Parliamentary Budget Office** (PBO) is fully operational.

CSR 2: tax reforms

- Further **shift the tax burden** from productive factors to consumption, property and the environment.
- Evaluate the effectiveness of the recent reduction in the **labour tax wedge** and ensure its financing for 2015.
- Reform the **cadastral system** to ensure the effectiveness of the reform of immovable property taxation.
- Further improve **tax compliance** and fight against tax evasion.

Tax reform: March's enabling law, decrees are coming

- Measures are being introduced to: i) updating **cadastral values**; ii) strengthening regulations to curb tax abuse and increase tax compliance; iii) enhancing tutoring and **tax simplification**; iv) revising the system of sanctions, checks and inspections; v) reviewing local collections procedures; vi) modernising corporate income taxes; vii) facilitating compliance for smaller taxpayers through lump-sum taxation; vii) harmonising taxes on gambling and lotteries; viii) revising environmental taxes.

Tax reform: March's enabling law, decrees are coming

- So far **three legislative decrees** (Simplifications, Cadastral Committees, Tobacco Products) have been translated into law (reform for small self-employed in the 2015 Stability Law.
- **In the making**: i) strengthening regulations to curb tax abuse and increase tax compliance; ii) enhancing tutoring and tax simplification; iii) revising the system of sanctions, checks and inspections; iv) reviewing local collections procedures; v) modernising corporate income taxes; vi) facilitating compliance for smaller taxpayers through lump-sum taxation; vii) harmonising taxes on gambling and lotteries; viii) revising environmental taxes.

Shifting the tax burden

- **Reduction in the tax wedge:** i) cuts in personal income tax (<€26,000); ii) severance pay (TFR) can be cashed in advance; iii) deduction of labour cost for open-ended contracts from the local business tax; ii) 36-month full exemption from social security contributions for new hiring on open-ended contracts.
- **Simplification and tax compliance**: extension of favorable fiscal regime for small self-employed; regional business tax cuts for corporate entities without organisational autonomy.
- **Taxation of returns on financial assets:** from 20 to 26%, with Government bonds and postal savings at 12.5%.

Business environment for domestic and foreign investors

- **Patent box:** attractive tax regime for potential revenue of patents and trademarks and support R&D in intangible assets.
- Firms benefit from a 25% tax credit on **incremental R&D investment** (50% for universities, research centres and start-ups). The measure is valid from 2015 up to 2019.
- 50% tax credit for private investment in **ultra-broadband** networks (part of the 'digital agenda').

Business environment for domestic and foreign investors

- **'Investment Compact'** (January 2015) introducing a number of initiatives including a broadening of benefits for innovative startups.
- **Tax agreements** with foreign investors.
- Dedicated **foreign investors desk** at the Revenue Agency.
- Dedicated **business courts** for proceedings involving foreign business.

Fight against tax evasion

- **Fight against tax evasion strengthened** (split-payment system for PA, reverse charge mechanism extended).
- **Voluntary disclosure** of financial information related to undeclared taxable revenue or income held abroad or in Italy.
- **Foreign Account Tax Compliance Act** (FATCA) between US and IT underagreement with Switzerland on fiscal cooperation signed.
- Multilateral agreement to automatically exchange financial information based on **OECD standards**, beginning 2017.

CSR 3: Efficiency of Public Administration and Justice

- Clarify **competences at all levels of Government**.
- Ensure better management of **EU funds**.
- Further enhance the effectiveness of **anti-corruption measures** and strengthening the powers of the national **anticorruption authority**.
- Monitor the impact of the reforms adopted to increase the efficiency of **civil justice**.

Modernising the Public Administration

- **Main areas**: public employment, organisation of different levels of government, simplification for citizens and businesses, digitalisation.
- Already delivered: 1) Encouragement of **part-time employment** and **territorial mobility**; 2) enhancement in **digitalisation** of administrative procedures (electronic invoicing) and legal proceedings.
- The Draft Law is under discussion at committee level at the Senate.

The **Constitutional reform**: to be completed by end-of-2015

- The Council of Ministers approved **the Draft Constitutional Reform Bill** in March. It will: i) improve stability by limiting 'balanced bicameralism'; ii) contain institutional costs also by reducing the number of senators; iii) rationalise the legislative procedure; iv) eliminate the National Economic and Labour Council; v) revise Title V of the Constitution.
- The **Constitutional Bill**, approved by the Senate in August, is under debate at the Chamber of Deputies.
- A draft Law on **electoral reforms** is also under discussion in Parliament (to be approved soon).

Reform of local government

- In April 2014, a major reform entered into force which aims to: i) contain costs, ii) achieve economies of scale in public services; iii) improve the quality of services provided to citizens.
- Key objectives: i) rationalise responsibility of **Metropolitan cities**; ii) redefine **Provinces** as wide-area entities with limited planning functions; iii) strengthen **coordination** among different level of government; iv) regulatory simplification to favour **Unions of Municipalities**.
- Following the approval of the constitutional reform, Provinces will remain non–constitutional entities with limited functions.

Cohesion Policy: getting things done

- The Partnership Agreement 2014–2020 identifies **expected results and specific actions** for the use of €42bn of EU funding (ERDF, ESF, EARDF, EMFF), plus €20bn of **national co-funding**.
- **Certified expenditure** of EU Funds for 2007–2014 reached almost 78% of total planned resources (January 2015).
- The **Territorial Cohesion Agency** has become operational. The Agency's Statute was approved last August.

Civil Justice: approved reforms starting to produce results

- Pending backlog of **civil cases** sharply reduced.
- The **length of proceedings**, in cases in which mediation led to agreement, is about 70 days against 1,132 days for ordinary procedures in Court.
- The increase in court fees applied by the Justice of the Peace in cases where **administrative sanctions** are challenged, reduced the number of pending cases by 70%.
- Starting July 2014, **injunction proceedings** take 6 days (versus previous 15 days) thanks to the introduction of new on line procedures.

Reforming civil justice

- Decree Law converted into Law in November 2014.
- **Out-of-court proceedings** enhanced and access to **Alternative Dispute Resolution** procedures expanded.
- For legal separation and divorce, easier access to out-of-court proceedings and other **simplifications for minor cases**.
- A pending **draft enabling law** contains: i) measures strengthening special courts for companies; ii) special courts for human rights and family-related issues; iii) increased certainty on length of proceedings.

CSR 4: Access to Finance and Capital Markets

- Reinforce the resilience of the **banking sector** and ensure its capacity to manage and dispose of impaired assets to revive lending to the real economy.
- Foster **non-bank access to finance** for firms, especially small and medium-sized businesses.
- Continue to promote and monitor efficient **corporate governance practices** in the whole banking sector, with particular attention to large cooperative banks (**'banche popolari'**) and foundations, with a view to improving the effectiveness of financial intermediation."

Finance for growth and 'investment compact' (1)

- Measures directed at **easing lending constraints** to the economy and boosting investments.
- **Access to finance** improved with structural measures fostering bonds issuing by unlisted companies and opening the credit market to new players: non-bank credit channels (insurance companies) and foreign investors.
- Guarantees and tax credits to support **investment activity**.
- **Access to capital markets** and strengthening of business capital structure further facilitated.

Finance for growth and 'investment compact' (2)

- **Tax credit** for social security funds (6%) and pension funds (9%) when they invest in the real economy (offsetting an increase in taxation from 20 to 26%).
- **Incentives** for machinery and equipment upgrading.
- New '**Sabatini Law**' offers financing to SMEs for investment in new equipment (max €2mn for 5 years). Fund endowment raised from €2.5 to €5 bn.
- 15% tax credit on incremental **investment in machinery and capital goods** undertaken by June 2015.

Measures for the resilience of the banking sector

- **Sales of NPLs are now easier** due to: i) improved tax treatment of write-downs and credit losses; ii) time saving judicial reforms for bankruptcy procedures and credit recovery.
- **Reinforced corporate governance regulation.**
- **Tighter procedures** especially for cooperative banks (*banche popolari)* and banks in which Foundations have a large stake.
- **Cooperative banks**: mandatory" transformation into joint-stock companies of cooperative banks (assets > €8 bn).

Specific measures for the banking sector

- Bank of Italy's **surveillance powers strengthened**.
- Bank account portability introduced.
- **Governance reform for cooperative banks**: change for the 10 large cooperative banks with assets worth more than €8 bn will have to transform into joint-stock companies within 18 months, removing their 'one share one vote' governance rule. Enacting measures to be prepared by the Bank of Italy.

CSR 5: labour market

- Evaluate **impact** of the labour market/wage-setting reforms.
- Work towards a **more comprehensive social protection**.
- Strengthen the link between **active and passive LMP**.
- Adopt effective action to promote **female employment**.
- Provide adequate services across the country to non-registered **young people** (youth guarantee).
- Scale-up the new pilot **social assistance scheme/activation**.
- Improve effectiveness of **family support schemes**.

Jobs Act: becoming operational

- Jobs Act: i) new regulatory framework for **entry flexibility**; ii) more inclusive **social safety net**; iii) stronger coordination between **active and passive labour market policies**; iv) rationalised and targeted system of **tax incentives**; v) **procedural simplifications**.
- In December 2014 Parliament approved the Enabling Law: **two enabling decrees** already approved and currently under discussion at Parliament (new open-ended contracts with increasing level of protection; new unemployment benefit scheme).

CSR 6: Education

- Implement the National System for **Evaluation of Schools**.
- Increase the use of **work-based learning** in upper secondary vocational education and training.
- Strengthen vocationally-oriented **tertiary education**.
- Create a national **register of qualifications** to ensure wide recognition of skills.
- Ensure that public funding better rewards the **quality of higher education and research**.

CSR 7: Liberalisation and Simplification

- Simplify the **regulatory environment** for businesses and citizens and address implementation gaps in existing legislation.
- Remove **remaining barriers to, and restrictions on competition** in the professional and local public services, insurance, fuel distribution, retail and postal services sectors.
- Enhance the efficiency of **public procurement**.
- In **local public services**, rigorously implement the legislation.

Simplification and better legislation

- A **Simplification Agenda** for 2015-2017 approved in December 2014: digital citizenship, health and welfare, taxation, construction, and business.
- **Unified and standardised application forms** for citizens and firms.
- Speeding up of **e-invoicing** for commercial transactions between the PA and suppliers.
- **Implementation rate** of the norms approved under the previous governments proceeded at fast pace.

CSR 8: Network Industries

- Ensure swift and full operationalisation of the **Transport Authority**.
- Approve the list of **strategic infrastructure** in the energy sector.
- Enhance **port management and connections** with the hinterland.

Best policy for an indebted country in a severe recession?

- Many targets: balancing public finance objectives, supporting the economy, respecting fiscal rules and maintaining credibility in financial markets.
- But one priority: **structural reforms** to boost confidence and change expectations of economic agents and investors, although the effects can take time to bear fruits.
- The ultimate goal must be **sustainable economic growth and prosperity**.

Where do we get growth from?

- **Lack of aggregate demand:** Is the current policy mix a correct stance for the Euro Area and the EU?
- **Supply-side reforms:** what can be done to strengthen them? How can we provide incentives for reforms within the existing fiscal framework?
- Are European **fiscal rules** appropriate for the current economic environment? Can we overcome the moral hazard issue?

Need to have a unified approach to surveillance

- Who decides what is the best approach to a problem? Economic literature? Development of common principles? **Legalistic/contractual approach** tends to forget economics.
- Tradeoffs/complementarities make it difficult to clearly disentangle **different procedures** (and different legal basis), but up to now not enough **joint assessment**.
- The **European semester** should be about economic policy coordination more than just surveillance. Its streamlining would help; **common reporting** on its different streams would help as well.

Streamlining the Semester: a step in the right direction

- March: the EC publishes a **single analytical document** (economic situation, reform agendas, possible imbalances) and the Council makes fiscal, macroeconomic and structural reforms recommendations. Streamlining meetings as well?
- April: **SCPs + NRPs**. Streamlined as well?
- May: the EC proposes CSRs
- June/July: Council discussions and endorsement by the European Council.
- Despite different legal basis, all different work streams should be **fully integrated in surveillance**.

Does it make sense to allow **flexibility** for structural reforms?

- Structural reforms increase **potential growth** over the medium-long run and thus lower the **structural part of the deficit**.
- Structural reforms often imply either near-term recessionary effects or need to compensate losers with **a negative impact on public accounts**.
- What really matters is **long-term sustainability of debt**: supporting reforms makes sense also from a fiscal point of view. **Building a growth-friendly fiscal framework** (interpretative Communication 13/1/2015).

Alert Mechanism Report: Scoreboard Comparison

	Spain		Italy	
	2014*	2015**	2014*	2015**
CURRENT ACCOUNT	-2,5	-0,7	-2,3	-0,9
NIIP	**-90**	**-92,6**	-28,6	-30,7
REER	-5,3	-0,4	**-6,2**	0,0
EXPORT MARKET SHARES	**-15,2**	**-7,1**	**-24,8**	**-18,4**
NOMINAL ULC	-5,6	-4,6	2,7	4,1
HOUSE PRICES	-16,8	-9,9	-5,4	-6,9
PRIVATE SEC. CREDIT	-9,9	-10,7	-0,9	-3,0
PRIVATE DEBT	**184,8**	**172,2**	120.8	118,8
PUBLIC DEBT	**84,4**	**92,1**	**122,2**	**127,9**
UNEMPLOYMENT RATE (3y ave)	**22,0**	**24,1**	9.2	**10,4**
FINANCIAL SECT. LIABILITIES	2,8	-10,2	7,4	-0,7
TOTAL (flashing indicators)	**5**	**5**	**3**	**3**

* 2012 Data ** 2013 Data

MIP: the Trojan horse for surveillance on reforms?

- Lack of **economic growth** and **high debt** are the overreaching criteria.
- More than addressing macroeconomic imbalances the MIP is a way to **enforce compliance with reform requirements** and make surveillance more effective.
- Not enough consideration for **integration and spillovers:** countries are still considered as **stand-alone entities**.
- Subjectivity of criteria (e.g. current account); not enough reference to **evidence-based criteria** (starting or relative position of a country). The principles supporting the application of the rules could be further strengthened.