1. Key policy insights

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The Italian economy has weathered recent crises well, but growth is now slowing amid tightening financial conditions. Public debt is among the highest in the OECD, limiting the space for continued fiscal policy support. With substantial fiscal pressures related to population ageing, debt servicing costs and the climate transition on the horizon, tax and spending reforms are needed to put public debt on a more prudent path. The ambitious package of structural reforms and public investment in the National Recovery and Resilience Plan is a major opportunity to reinvigorate growth and make fiscal pressures more manageable. This will require consolidating and expanding major recent reforms in the areas of civil justice, public administration and competition; equipping the workforce with the skills needed to succeed in the digital and green transitions; and raising labour market participation, especially of women.

1.1. Introduction

The Italian economy has proved resilient to recent crises, with relatively robust domestic demand, significant gains in competitiveness and unemployment at historically low levels. However, financial conditions have tightened and public debt remains among the highest in the OECD, limiting the space for continued fiscal policy support. The phase-out of energy crisis support measures will improve the fiscal balance 2024 but more fiscal consolidation will be needed to bring the public finances on a more prudent path. The revised National Recovery and Resilience Plan (NRRP) – which is largely financed by Next Generation EU (NGEU) funds and foresees an ambitious package of structural reforms as well as a major ramp-up in public investment – will support the economy over the coming years. Recently legislated reforms include major civil justice, public administration and competition reforms that will improve the framework conditions for private investment and growth, and public investment is increasing.

Looking ahead, Italy's main challenges are to reinvigorate economic growth and accelerate the climate transition. Potential output growth is around 1% and will decline further due to rapid population ageing unless productivity growth is lifted and labour market participation is enhanced. The transition to an innovation-led high-productivity growth model has been hindered by inefficiencies in the justice system and the public administration, weak competition in services, sub-par workforce skills and a rigid labour market. Italy's per capita carbon emissions are below the OECD average, but progress in emissions reduction has slowed over the past decade, partly due to the slow adoption of renewable energies.

Against this background, the main messages of the Survey are:

- Public debt is high and on an upward trajectory under existing tax and spending policies, accounting for planned changes over 2024-25, with rising ageing and debt servicing costs putting pressure on the public finances. Public debt should be put on a more prudent path by steadily consolidating the public finances over a number of years using a mix of revenue and spending measures. Decisively tackling tax evasion, while shifting the burden of taxation from labour to property and consumption, will be essential. Raising the ambition of spending reviews and reducing the generosity of pensions for higher-income households could limit spending growth while maintaining adequate public services and social protection.
- Economic growth is facing headwinds from poor productivity growth and rapid population ageing. Productivity growth, which has been stagnant over the past decade, could be reinvigorated by enhancing competition in services, continuing to improve tertiary education, and swiftly implementing the public investment projects in the NRRP. Bringing more women into the labour market and strengthening work incentives for social benefit recipients would support employment growth in the face of a shrinking working-age population.
- The climate transition is underway, but a strengthening of existing policy measures and additional policies are needed to meet emissions reduction targets. Excise taxes could be better aligned with the carbon content of consumption to strengthen incentives for emissions reductions, as foreseen by the ongoing tax reform. Authorisation procedures for renewable energy investments and the expansion of the electricity grid could be simplified to reduce the dependence on natural gas and accelerate the electrification of the economy. Continuing the strengthening of public transport and the regional train network, as well as updating the system of car purchase subsidies and scrapping policies, would help reduce vehicle emissions. Further reforming the system of tax incentives for energy efficiency building renovations would improve cost efficiency.

1.2. GDP growth is slowing

1.2.1. The recovery from the pandemic was robust but activity is weakening

Before the energy crisis, the economy was recovering strongly, with large fiscal support and gains in competitiveness helping real GDP to rebound to its pre-pandemic level by mid-2021. Despite the sharp slowdown in activity since the second half of 2022, the level of real GDP relative to the last quarter of 2019 is similar to the euro area average (Figure 1.1, Panel A), reflecting particularly strong performance of investment (Figure 1.1, Panel B). The investment rate is back to the euro area average after a decade well below it (Figure 1.1, Panel C) and exports have performed well.

Figure 1.1. Investment has driven growth but is slowing

A. Real GDP
Index 100 = Q4 2019
Italy
France
Germany
Spain
Euro area 17

B. Aggregate demand components, Q3 2023
Index 100 = Q4 2019
ITA | EA17: Private consumption, Investment, Government consumption, Exports, Imports

C. Investment rate
% of GDP
Italy
France
Germany
Spain
Euro area 17

D. Total investment and housing investment
Index 100 = Q4 2019
Business investment
Housing investment

Note: EA17 denotes OECD euro area countries.
Source: OECD Economic Outlook database.

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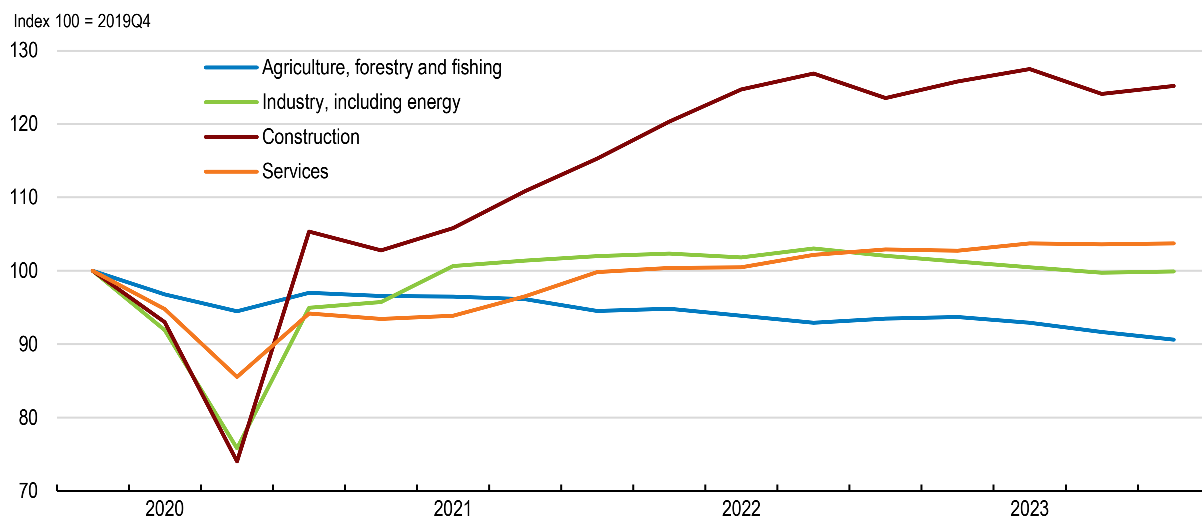
The recovery in investment has partly been driven by generous tax incentives for housing investment. The so-called *superbonus* tax credit for energy efficiency home improvements that was introduced in 2020 amounted to 110% of expenditure (subject to caps related to the nature of the renovation project) and was untargeted in terms of household income. Before the tightening of rules in early 2023, construction firms

could sell the tax credits on the secondary market – mainly to banks – as soon as the renovation contract was signed. This gave them instant access to liquidity and allowed them to offer 100% rebates, implying an overly generous tax incentive by making the renovation works cost-free for clients. However, the superbonus alone cannot explain the strong performance of investment. Assuming that around one-half of the investment directly financed by the superbonus would otherwise not have taken place as suggested by preliminary studies conducted by the Bank of Italy (2023c), the tax credit boosted cumulated post-pandemic investment growth by about 10 percentage points. Given that cumulated post-pandemic investment growth exceeded 20% (Figure 1.1, Panel B), this implies that, even without the tax credit, investment growth would have been well above the rest of the euro area, where investment growth over the period was negative. This suggests that investment may also have been supported by structural improvements in the business environment and tax incentives for capital equipment related to the digital and green transitions (*Transizione 4.0*; Bratta et al., 2022).

High inflation and the increase in borrowing costs in the wake of the energy crisis led to a slowdown in activity in the second half of 2022, but services activity has held up relatively well. Rapid increases in imported energy prices triggered wider price pressures, eroding real household income. Tightening of euro area monetary policy raised borrowing costs for households and businesses, further squeezing household income available for consumption and curtailing private investment. Manufacturing and construction were initially hit hard, but services continued to grow robustly despite these headwinds (Figure 1.2), as vigorous fiscal support to households and firms helped cushion the effect of the energy crisis. Activity in the services sector was also supported by the rebound in tourism after the pandemic and the resilience of private consumption, which was, in turn, partly explained by the robustness of household wealth. Excess household savings accumulated during the pandemic still amount to about 7½ percent of GDP and the softening of the housing market has been moderate despite higher interest rates.

Figure 1.2. Services growth has held up well

Real gross value added by industry



Source: OECD National Accounts Database.

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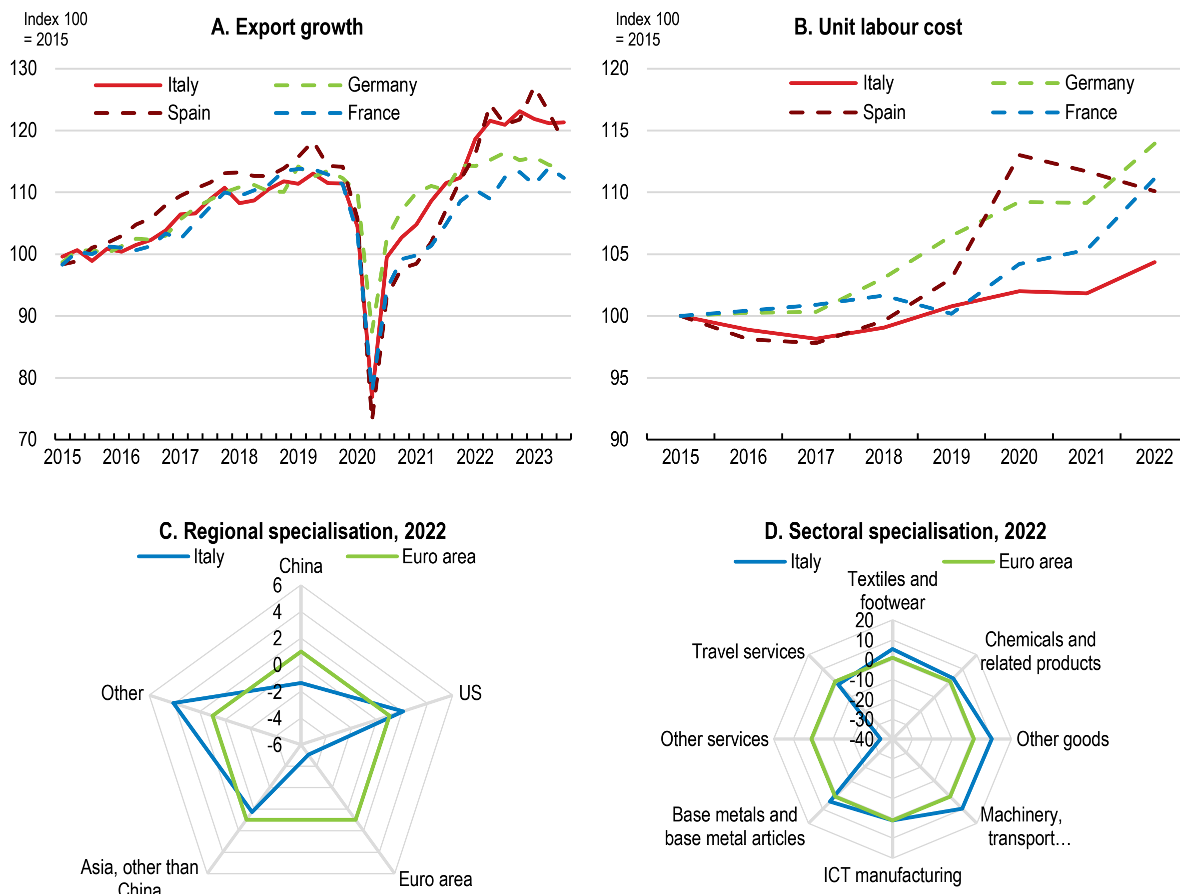
1.2.2. Competitiveness has improved

Exports have performed well compared with other large euro area countries, mainly reflecting gains in market shares on the back of low growth in unit labour costs (Figure 1.3). Italy's geographical and sectoral specialisation shielded it somewhat from global supply chain disruptions in the wake of the COVID-19 pandemic. Compared with other euro area countries, the geographical structure of Italy's exports is skewed towards Türkiye, United Kingdom, United States and Switzerland, which were more resilient to the COVID-

19 pandemic than China (Figure 1.3). Italy is also less specialised in energy-intensive industries and high-tech industries that were hit by the energy crisis and supply chain disruptions (Haramboure et al., 2023; Giglioli and Giordano, 2023). But good export performance is also explained by low growth in unit labour costs relative to its main competitors, which has allowed Italian exporters gain market shares. Low growth in unit labour costs, in turn, has resulted from subdued wage growth rather than high productivity growth. Going forward, boosting productivity, while keeping wage growth aligned with productivity growth, will be essential to further enhance export competitiveness and living standards.

Figure 1.3. Exports have been resilient as relative unit labour costs have declined



Note: Panel B: Unit labour cost in the non-agriculture business sector excluding real estate; Panel C: Percentage point deviation of export shares from the euro area average; Panel D: Percentage point deviation of export shares from the OECD average.
Source: OECD Economic Outlook database; OECD International Trade database.

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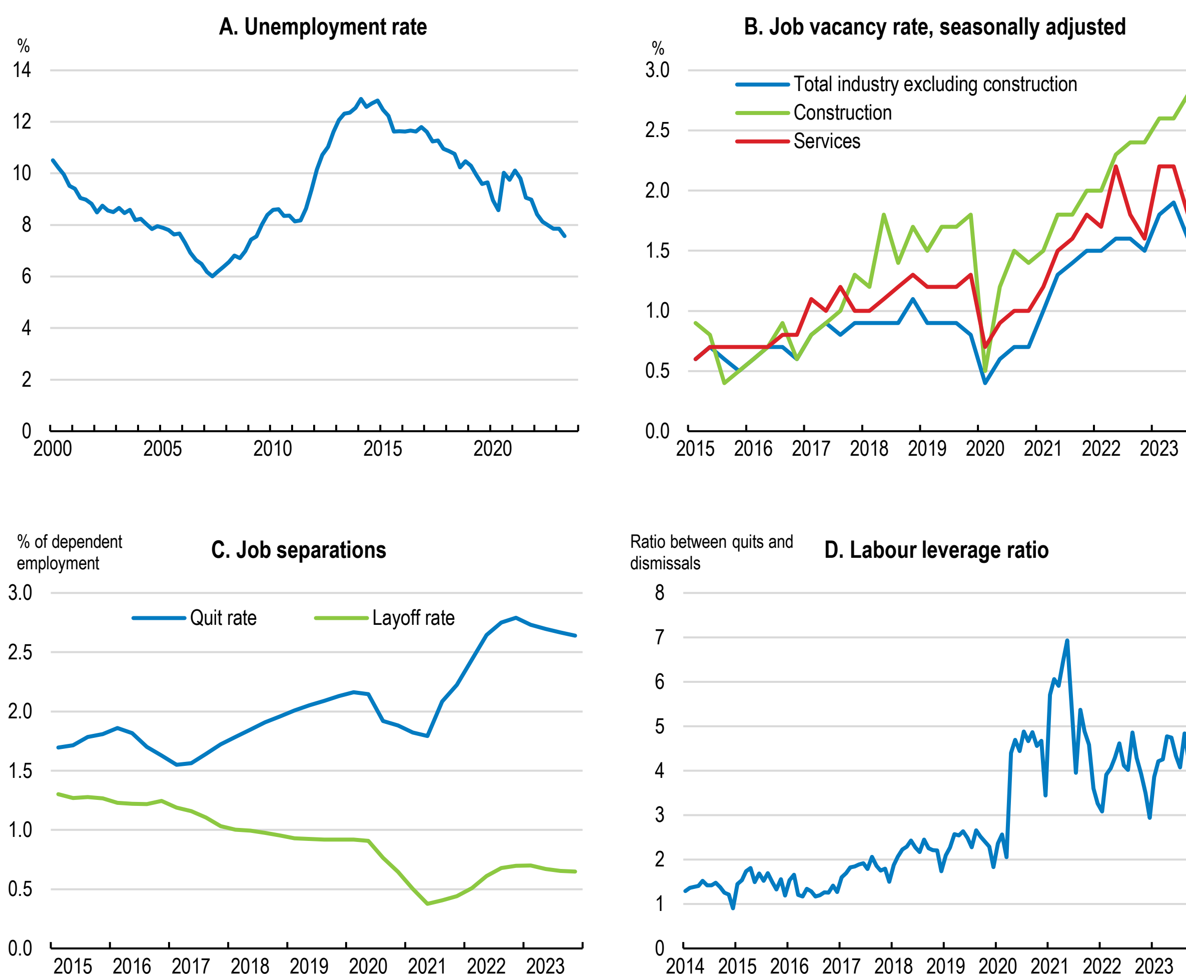
1.2.3. Unemployment is low by historical standards

Despite the slowdown in economic activity, the unemployment rate is close to its lowest level over the past 20 years (Figure 1.4). The job vacancy rate is above its pre-pandemic level and an increasing share of businesses has difficulties to find qualified staff. This partly reflects population ageing, with the working-age population having declined by about 2% over the past decade, but also occupational mismatches. Background analysis conducted for this Survey based on data from the global jobs site Indeed suggests that occupational mismatches are substantial. About one-quarter of labour supply, as measured by job seekers' clicks, would have to be re-allocated to perfectly match the distribution of labour demand, as

measured by businesses' job postings (Box 1.1) The level of occupational mismatch estimated from *Indeed* data may be somewhat over-estimated due to differences in representativeness of postings and clicks across occupations. However, the evidence for significant occupational mismatches is broadly consistent with past OECD analyses documenting large skill mismatches in the Italian labour market (Adalet McGowan and Andrews, 2015). Estimated changes in mismatch in the wake of the pandemic, which are less affected by representativeness issues, suggest that the Italian labour market has weathered substantial reallocation of jobs in the wake of the pandemic well, with current mismatches slightly below the pre-pandemic level.

Figure 1.4. The labour market has performed strongly



Note: Panel B: The job vacancy rate is calculated as the ratio of job vacancies to the sum total employment and job vacancies. Panel C: The quit and layoff rates are calculated as the ratios of quits and layoffs to total employment. Panel D: The labour leverage ratio is calculated as the ratio of quits to layoffs.
Source: OECD Economic Outlook database; Istat.

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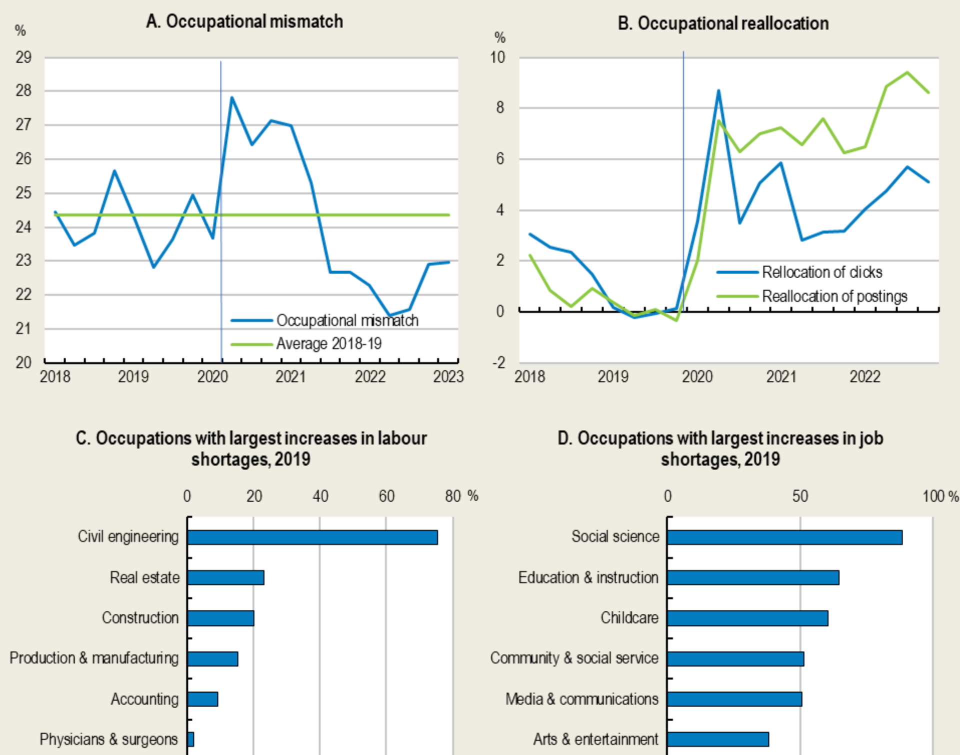
Box 1.1. Occupational mismatch based online job postings and clicks

A near-real time indicator of occupational mismatches between labour demand and labour supply can be constructed by using proprietary data on businesses' online job postings and job seekers' clicks from *Indeed*, the world's largest jobs site. The indicator is based on the methodology proposed by Lazear and Spletzer (2012) and measures the dissimilarity in the distribution of job postings and clicks across occupations. It can be interpreted as the share of clicks that would have to be reallocated to perfectly match the distribution of postings. Analogously, the dissimilarity between the distribution of clicks in a given period relative to a base period can be interpreted as the share of clicks that would have to be reallocated to perfectly match its initial distribution, that is a measure of reallocation of clicks.

Figure 1.5. Occupational mismatch is substantial and has increased in some sectors



Note: Mismatch in Panel A is defined as $mismatch_t = 1/2 \cdot \sum_i |c_{it}/C_t - p_{it}/P_t|$, where c_{it} is the number of clicks in occupation *i* at month *t*; C_t is the overall number of clicks in period *t*; p_{it} is the number of postings in occupation *i* at month *t*; and P_t is the overall number of postings in month *t*. The mismatch indicator measures the dissimilarity of clicks and postings. Analogous dissimilarity indicators can be constructed separately for clicks and postings by comparing the distribution of clicks in month *t* with the distribution of clicks before the pandemic. These indicators can be interpreted as measures of occupational reallocation (Panel B). Panel C shows growth rates of postings shares minus growth rates of clicks shares by occupation since the end of 2019, and Panel D shows growth rates of clicks shares minus growth rates of postings shares (Panel D).
Source: Indeed.

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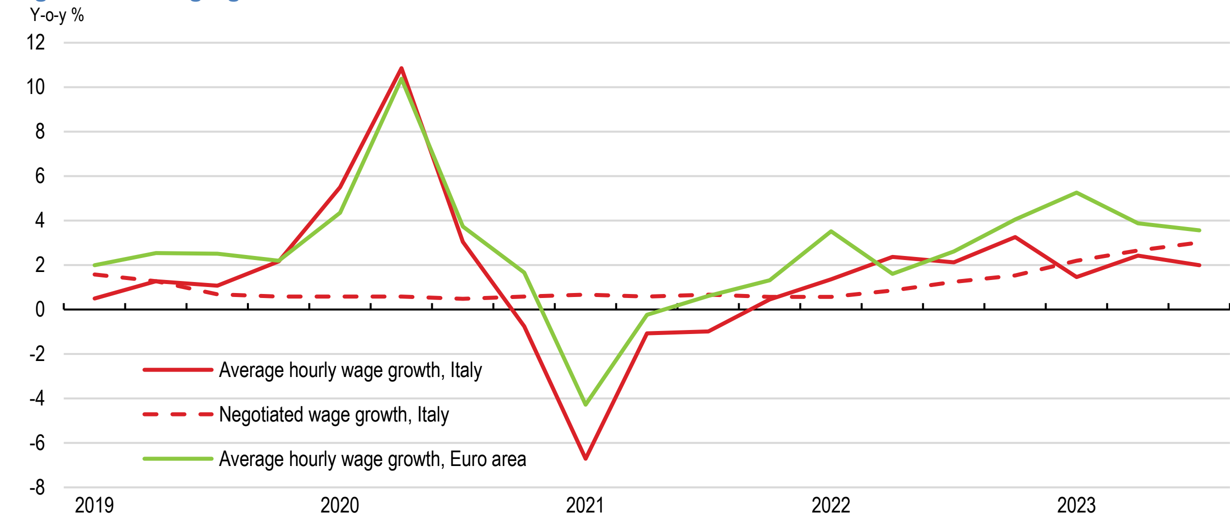
The analysis suggests that around one-quarter of clicks would have to be reallocated to perfectly match the distribution of job postings across occupations (Figure 1.5, Panel A). To some extent, the level of mismatch may be influenced by differences in representativeness of job postings and clicks across occupations on *Indeed*. Changes in mismatch should be less affected by representativeness issues and suggest that aggregate occupational mismatches are broadly back to pre-pandemic levels despite

significant and durable reallocation of clicks and postings in the wake of the COVID-19 pandemic (Figure 1.5, Panel B). Increased mismatch in some occupations was offset by decreased mismatch in others. This is consistent with evidence from online job postings in the United States (Sinclair, 2022) and labour force surveys in the United Kingdom and the United States (Pizinelli and Shibata, 2023). The sectors where postings growth significantly outstripped clicks growth since the start of the pandemic (increased labour shortages) include civil engineering, real estate, construction and manufacturing (Figure 1.5, Panel C). This is broadly in line with Italian business surveys suggesting that labour shortages are particularly pronounced for specialised ICT staff, health and social workers, as well as skilled construction workers (Unioncamere-Anpal, 2023). The sectors where clicks growth significantly outstripped postings growth (increased jobs shortages) include education, childcare and community and social services (Figure 1.5, Panel D).

Even though overall occupational mismatch has slightly declined in the wake of the pandemic, there are labour shortages in a number of sectors that will be essential for the implementation of the National Recovery and Resilience Plan (NRRP), including civil engineering and construction (Figure 1.5, Panel C). Consequently, many businesses are holding on to their existing staff, with the layoff rate well below the pre-pandemic level (Figure 1.4, Panel C). The ratio of quits to layoffs – which can be viewed as a measure of worker leverage (Sojourner and DiVito, 2022) – is now well above its pre-pandemic level. In this context, the authorities' decision to raise the number of work permits for non-EU workers from about 70,000 in 2022 to about 165,000 in 2025 is a welcome step and may ease labour shortages, including in construction, which will be critical to contain costs and limit delays in NRRP projects. However, in 2023, employers filed about four times as many pre-applications for work permits than the quota foreseen for 2024, suggesting that increased immigration quotas will only partially address labour shortages. Raising labour market participation, especially of young people and women, and strengthening active labour market policies to achieve a better matching of workers and jobs would further contribute to easing labour shortages (see section 0).

Despite the strong labour market and high inflation, the pick-up in wage growth has been modest. Average wage growth in the first quarter of 2023 was around 2%, but negotiated wage growth has picked up to 3% in the third quarter (Figure 1.6). Collective wage negotiations are anchored on expected inflation net of imported energy over the next year. The increase in inflation net of imported energy – which is estimated by the national statistical institute in June of each year – was not fully anticipated in 2022 but expected inflation net of imported energy estimated in June 2023 came in at 6.6% for 2023 and 2.9% for 2024. Even though negotiated wage growth may thus pick up substantially, it is unlikely that it will reach 6.6%. In case unions and employer associations cannot reach an agreement, the non-renewal of a collective agreement would imply zero nominal wage growth, giving employers significant bargaining power (Garnero, 2023).

Figure 1.6. Wage growth has so far been subdued

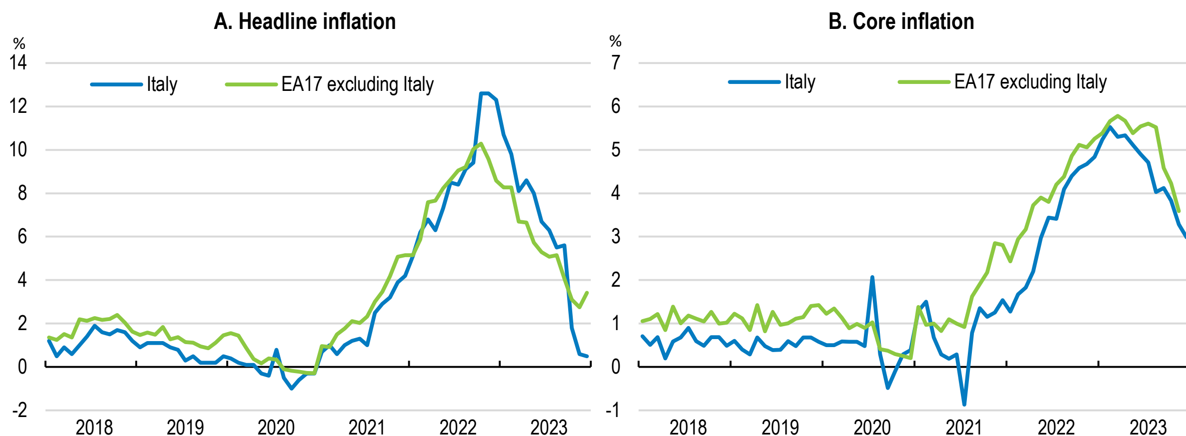


Source: OECD Analytical database, Istat.

1.2.4. The decline in inflation has been quick

Headline inflation surged in late 2022 and gradually fed into the broader economy. The surge of headline inflation was initially largely driven by energy price inflation, which rose by significantly more than in the rest of the euro area, mainly due to Italy's high share of gas in the energy mix (Figure 1.7). Headline inflation has come down rapidly from 12½ percent in November 2022 to 0.5% in December 2023. Core inflation and services inflation – which can both be viewed as measures of underlying price pressures – were around 3-3½ percent. Manufacturing and services businesses gradually passed on increases in the costs of energy-intensive inputs to consumers, with the burst in core inflation in late 2022 and early 2023 mainly being explained by the transmission of higher energy input prices to higher output prices (Box 1.2).

Figure 1.7. Headline inflation has come down but core inflation remains elevated



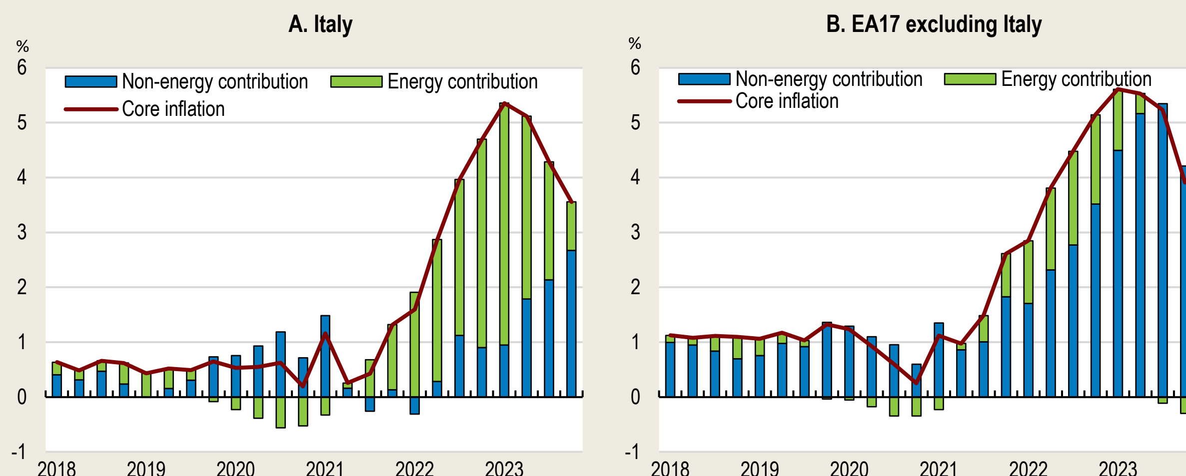
Note: The aggregate for the euro area excludes Italy.
Source: OECD.

There is limited pressure from higher unit profits on core inflation, but unit labour cost inflation is picking up. While unit profit inflation increased sharply in 2022 and remained high in the first half of 2023, the increase mainly reflected developments in the energy ("mining & utilities"), financial and agricultural sectors, which are outside the scope of core inflation and thus have no direct bearing on it (Figure 1.9, Panel A). The energy sector comprises renewable energy producers that were not exposed to higher prices for imported energy, as well as oil, gas and electricity companies that had locked in low energy prices through long-term contracts. Across sectors, unit profit growth tended to be lower in Italy than in the rest of the euro area, except for the energy and financial sectors (Figure 1.9, Panel C). Average unit labour cost inflation remained muted at around 2% in 2022 but has picked up to close to 5% in the third quarter of 2023 (Figure 1.9, Panel B).

Box 1.2. Accounting for the transmission of higher energy prices to core inflation

Core inflation is determined by changes in intermediate input costs, including energy and energy-intensive inputs, wages, and profit margins. Background analysis conducted for this Survey uses information on the energy intensity of production across industries from input-output tables to statistically decompose core inflation into an energy component and a residual component attributable to wages and profit margins. Assuming full pass-through over a period of 6 months, the results suggest that the burst of core inflation in Italy was largely been driven by energy price inflation (Figure 1.8). Strikingly, the contribution of energy price inflation to core inflation is significantly larger in Italy than in the rest of the euro area, where energy price inflation was lower. These results are broadly in line with results from econometric approaches that estimate the response of core inflation to energy price shocks (Corsello and Tagliabracci, 2023).

Figure 1.8. The burst in core inflation mainly reflected higher costs of energy inputs



Note: The estimates account for higher direct energy costs (electricity, gas and fuels) and higher indirect energy costs embodied in energy-intensive intermediate inputs. The estimates assume energy inputs are non-substitutable in the short term and that higher energy costs are fully passed on to consumer prices over a period of 6 months. Alternative assumptions on the duration of pass-through do not fundamentally change the results. The figure refers to quarterly averages.
Source: OECD calculations.

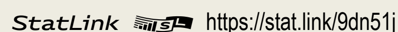


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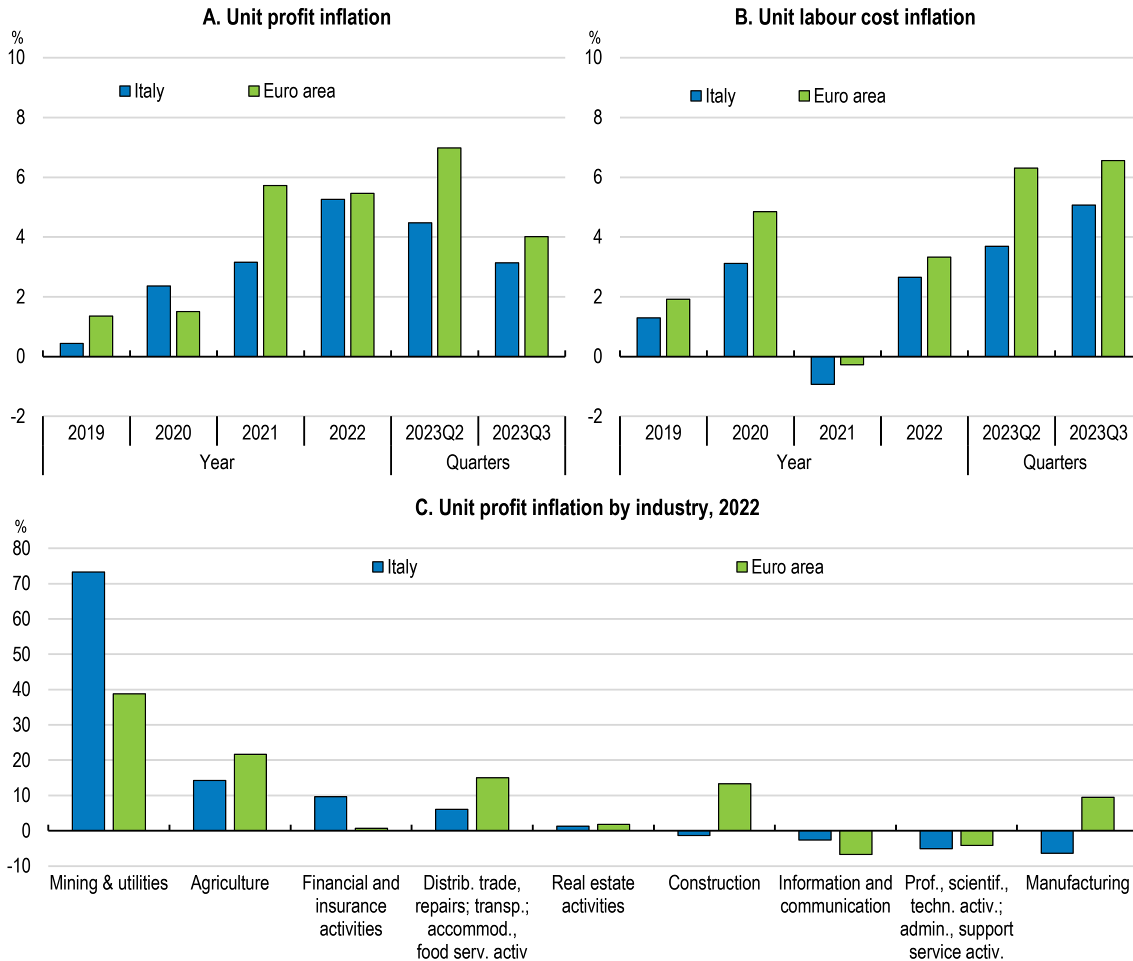
Figure 1.9. Unit profits are moderating, while unit labour costs are picking up



Note: Unit profits are defined as gross profits per unit of output and unit labour costs as labour compensation per unit of output.
Source: OECD National Accounts Database.

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1.2.5. The economy is facing several headwinds

Real GDP is expected to grow 0.7% in 2024, before picking up modestly to 1.2% in 2025 (Table 1.1). Low wage growth and high inflation have eroded real incomes, financial conditions have tightened, and most of the exceptional fiscal support related to the COVID-19 and energy crises has been withdrawn, weighing on private consumption and investment. The projected decline of inflation, targeted income tax cuts and the pick-up in public investment related to Next Generation EU (NGEU) funds will only partly offset these headwinds. Inflation is expected to come down gradually over 2024-25 on the back of fading base effects from the energy price shock of late 2022 and moderate nominal wage growth. Overall, tight financial conditions and a broadly neutral fiscal policy in 2024 should lead to a gradual easing of inflationary pressures, while growth will remain modest.

Risks to growth are tilted to the downside. The main downside risk is a larger-than-expected tightening of financial conditions, which could arise from tighter euro area monetary policy or a higher premium on Italian government securities. Moreover, Italy is exposed to a range of longer-term vulnerabilities that could lead to major changes in the outlook (Table 1.2). On the upside, a more rapid fall in interest rates as euro area inflation declines could boost domestic demand and growth in 2024 and 2025.

Table 1.1. Growth and inflation are projected to ease

	2020	2021	2022	2023	2024	2025
	Current prices EUR Billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 659.8	8.3	3.9	0.7	0.7	1.2
Private consumption	963.9	5.3	5.0	1.2	0.7	1.0
Government consumption	343.5	1.5	0.7	-0.2	-0.4	-0.2
Gross fixed capital formation	298.0	20.7	10.1	0.8	0.5	1.6
Final domestic demand	1 605.4	7.3	5.2	0.8	0.4	0.9
Stockbuilding[1]	-4.4	1.0	-0.6	0.1	0.1	0.0
Total domestic demand	1 601.0	8.4	4.5	0.9	0.5	0.9
Exports of goods and services	485.8	14.0	10.7	0.4	1.3	2.0
Imports of goods and services	427.0	15.2	13.1	1.0	0.9	1.2
Net exports [1]	58.9	0.2	-0.5	-0.3	0.2	0.4
Memorandum items						
GDP deflator	_	1.3	3.0	4.2	2.9	2.6
Harmonised index of consumer prices	_	1.9	8.7	5.9	2.6	2.3
Harmonised index of core inflation[2]	_	0.8	3.3	4.5	3.1	2.5
Unemployment rate (% of labour force)	_	9.5	8.1	7.6	7.8	7.6
Household saving ratio net (% of disposables income)	_	8.1	1.8	-0.7	1.9	280
General government financial balance (% of GDP)	_	-8.8	-8.0	-5.4	-4.2	-3.6
General government primary financial balance (% of GDP)		-5.5	-4.0	-1.8	-0.3	0.4
General government gross debt (% of potential GDP)		172.9	148.5	148.2	148.3	147.4
General government debt, Maastricht definition[3](% of GDP)	_	147.2	141.6	141.4	141.4	140.5
Current account balance (% of GDP)	_	2.4	-1.5	-0.2	0.3	0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD

Table 1.2. Events that could entail major changes to the outlook

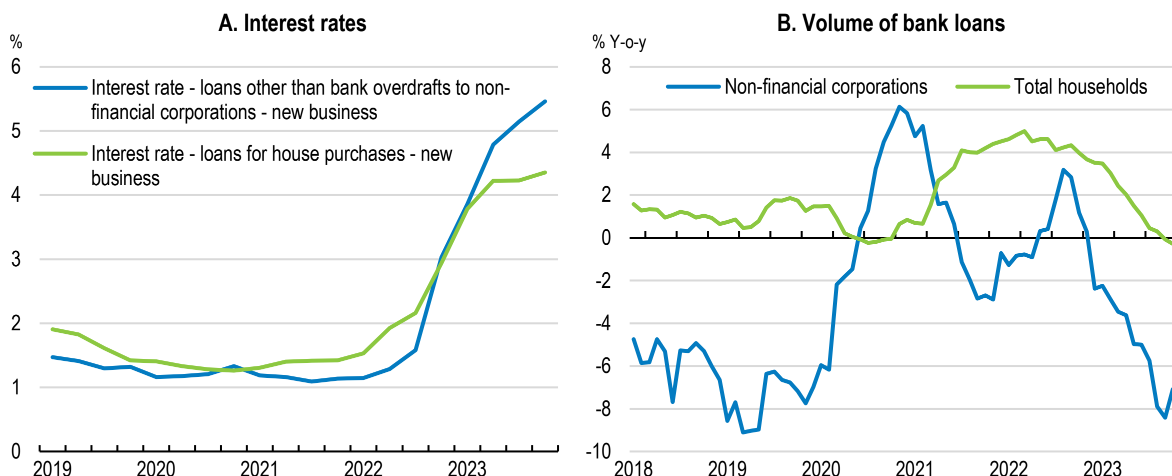
Shock	Likely impact	Policy response options
Delays in the implementation of public investment plans in the NRRP or implementation of projects with high cost-benefit ratios.	Partial implementation of growth-enhancing public investment projects would limit improvements in living standards and complicate the task of bringing the debt ratio on a more prudent path.	Implement the public investment plans in the NRRP by 2026 while conducting thorough cost-benefit analysis.
Higher risk aversion in capital markets	A durably wider interest rate spread between Italian and German government bonds would raise the government's debt servicing costs and could impact banks' balance sheets.	Gradually but sustainably consolidate the public finances from 2025 to maintain investors' trust and take a cautious approach to debt management.
Durably lower growth in the euro area due to higher energy prices and global trade tensions.	Lower euro area growth would reduce export growth, with knock-on effects on GDP growth, as the rest of the euro area remains the main destination of Italian exports.	Strengthen the competitiveness of Italian exports by fully implementing productivity-enhancing structural reforms and keeping real wage growth aligned with productivity growth.

1.3. The financial sector has held up well, but risks are rising

1.3.1. Borrowing costs for households and businesses are rising but appear manageable

As euro area monetary started to tighten in mid-2022, borrowing costs for households and businesses surged (Figure 1.10, Panel A). Bank lending growth slowed as lending standards tightened and credit demand declined, with annual loan growth to non-financial corporations starting to decline and loan growth to households moderating in the second half of 2022 (Figure 1.10, Panel B). Both corporate and household indebtedness are moderate compared with the OECD average, suggesting that the rise in borrowing costs should remain manageable. In particular, a major correction in the housing market is unlikely despite the rise in borrowing costs, as house price growth over the past decade has been among the lowest in the OECD and house prices relative to rental income are below their long-term averages.

Figure 1.10. Financial conditions are tightening



Note: Panel B shows annual growth rates.
Source: Bank of Italy Statistical Database, OECD Housing Prices.

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1.3.2. The strength of banks has improved, but funding costs are rising

The financial strength of banks has improved over the past decade. Non-performing loans (NPLs) have come down from more than 10% of total loans in 2015 to less than 2% in 2022 (Figure 1.11), partly due to large-scale securitisation of NPLs supported by government guarantees for senior loan tranches (OECD, 2021a). While the share of NPLs remains somewhat above the OECD average, it is now below the levels before the economic and financial crisis of 2008-09. More than half of the remaining NPL stock in Italy is made up of unlikely-to-pay (UTP) loans, a segment where sales and securitisation transactions tend to be more complex, since they relate to highly heterogeneous loans and may require further financial support to borrowers. Liquidity positions remain adequate and capital positions are close to the euro area average, partly reflecting prudential regulatory measures and robust profitability (Figure 1.11). Stress tests conducted by the European Banking Authority in 2023 suggest that most banks' capital positions under an adverse macroeconomic scenario would be similar to the euro area average, although some banks would be vulnerable to a prolonged downturn (European Banking Authority, 2023).

Figure 1.11. The financial strength of banks has improved

Note: Lithuania is excluded from the averages in Panel C.
Source: International Monetary Fund, European Central Bank.

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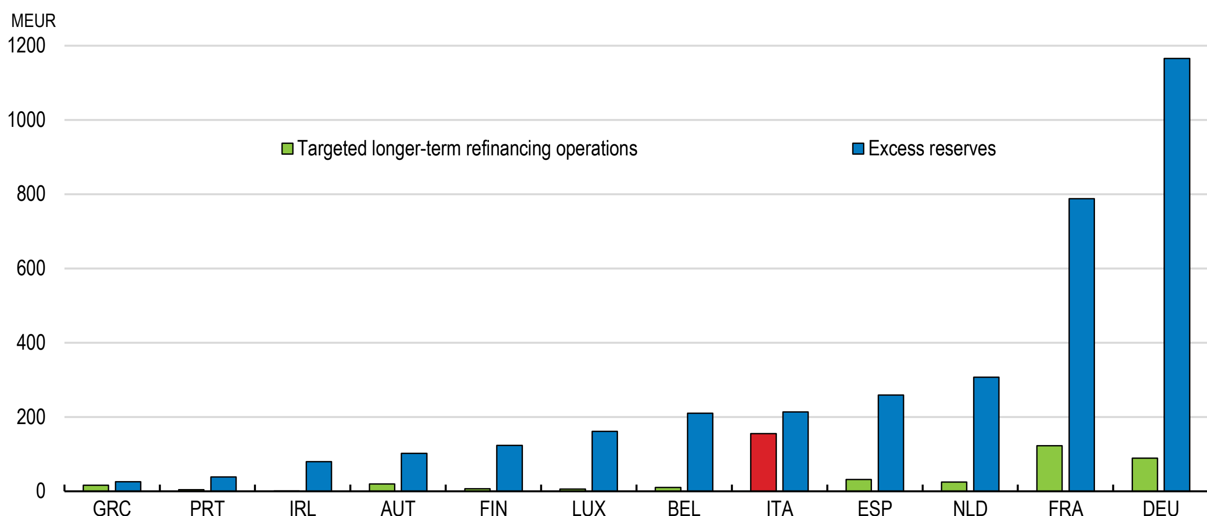
Bank profitability has been boosted by rising interest rates and widening net interest margins, but risks are rising. Going forward, the positive effect of rising interest rates on net interest margins and capital is likely to be offset by the tightening of financial conditions and the projected slowdown in economic activity, which will reduce lending growth. Despite strengthened capacities of Italian banks to select and manage credit risk, partly due to higher supervisory standards (Visco, 2023), credit risk could rise as some borrowers may find it more difficult to service their debts in a context or rising interest rates and slowing demand. This may particularly be the case in the construction sector, where the phasing out of the transferability of the superbonus tax credit to third parties in early 2023 will reduce liquidity and activity, although a pick-up in NRRP-related spending may limit the downturn. Developments in non-performing loans, including the unlikely-to-pay segment, should be closely monitored. The authorities should also continue to carefully monitor the performance of securitised non-performing loans. The performance of securitised non-performing loans has thus far been satisfactory (Bank of Italy, 2021), but pressures on borrowers are rising as financial conditions are tightening and the economy is slowing.

The phase-out of the ECB's Targeted Long-Term Refinancing Operations (TLTROs) over 2023-24 will require banks to tap costlier sources of funding, such as deposits or bonds. Some banks may be able to repay maturing TLTROs by reducing excess reserves, as in the banking sector as a whole excess reserves exceed TLTROs (Figure 1.12). But, according to estimates by the Bank of Italy (2023b), about half of Italian banks have insufficient reserves to repay TLTROs. This is unlikely to lead to liquidity issues since banks with high-quality collateral will be able to borrow from the ECB in the short term. A sizeable TLTRO repayment in June 2023 has not had any significant effect on banks' liquidity positions, mainly due to offsetting bond issuance. But over the medium term, banks will need to tap costlier sources of funding: this could reduce the return on equity by about 130 basis points on average (Bank of Italy, 2023b). Similar pressures on profitability may be experienced by banks that still have to issue instruments compliant with minimum requirements for own funds and eligible liabilities (MREL).

Figure 1.12. Excess reserves are lower than TLTRO funding



Note: Data refer to November 2023.
Source: European Central Bank.

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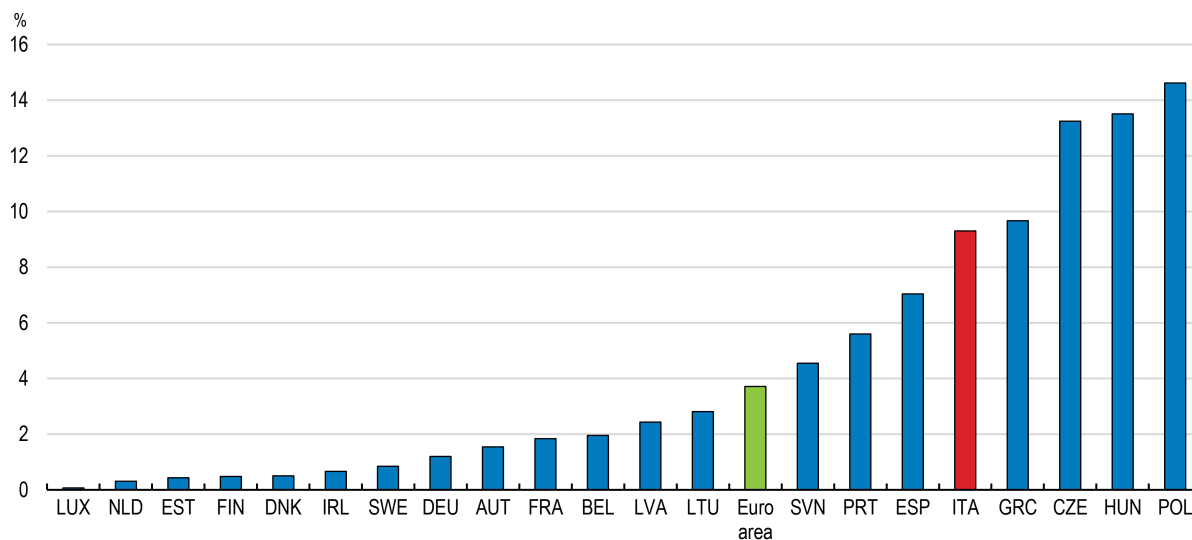
Against the background of rising risks due to the weakening economic outlook, rising funding costs, and continued large holdings of domestic sovereign debt (Figure 1.13), it appears appropriate to focus on capital preservation while profitability is elevated. Large holdings of domestic sovereign debt can make banks vulnerable to interest rate risk: further euro area monetary policy tightening or a widening interest spread between Italian and German government bonds would reduce the value of sovereign bonds on banks' balance sheets, thereby reducing capital positions. Interest rate risk appears manageable for Italian banks, given that only about 30% of government bonds on banks' balance sheets are priced at fair value and adequate liquidity positions make it unlikely that banks will have to sell government bonds at a loss. But it suggests that a continued focus on preserving capital positions while profitability remains elevated may be appropriate to prevent problems from materialising in the medium term, especially in weaker banks. The establishment of a macroprudential authority with a leading role for the Bank of Italy is near completion and constitutes a useful measure to strengthen the macroprudential policy framework.

Figure 1.13. Holding of domestic sovereign debt remains elevated

Share of domestic government bonds in total bank assets, Novembert 2023, in %



Source: European Central Bank.

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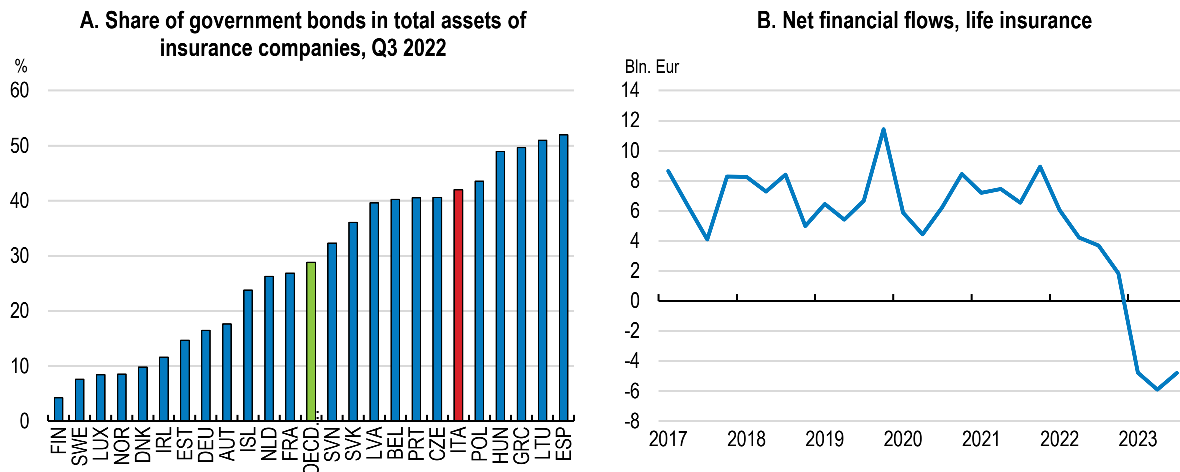
1.3.3. The insurance sector is well capitalised, but the life insurance segment is weakening

The insurance sector is well capitalised but exposed to domestic government bonds and to the early redemption of contracts in the life insurance sector. At the end of 2022, the solvency ratio was about 250%, similar to the European average (EIOPA, 2023). Risk from exposure to domestic government bonds is generally manageable, given the low duration mismatch between assets and liabilities, but it may be more pronounced in the life insurance sector. Investors purchase life insurance contracts as standard financial products, with some contracts allowing early redemption while guaranteeing the invested capital. Insurance companies, in turn, invest the proceeds from these contracts in government bonds of varying maturity. Given the increase in short-term interest rates over the past year, the attractiveness of existing life insurance contracts has declined relative to other financial products of comparable risk, such as savings accounts or certificates of deposit. The rate of redemptions of existing life insurance contracts has increased significantly over the past months, driving net financial outflows from life insurers (Figure 1.14), which may force some insurance companies to tap into their reserves or realise losses on their government bond portfolios that have thus far been notional. In the near term, capital preservation will be key to maintain the health of the insurance sector, with the recent recommendation by the insurance supervisor to limit the distribution of profits being an appropriate measure.

Figure 1.14. The life insurance sector is experiencing financial outflows



Source: European Insurance and Occupational Pensions Authority (Panel A); Ania (2023) (Panel B).

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1.4. Reforms are needed to put the public finances on a more sustainable path

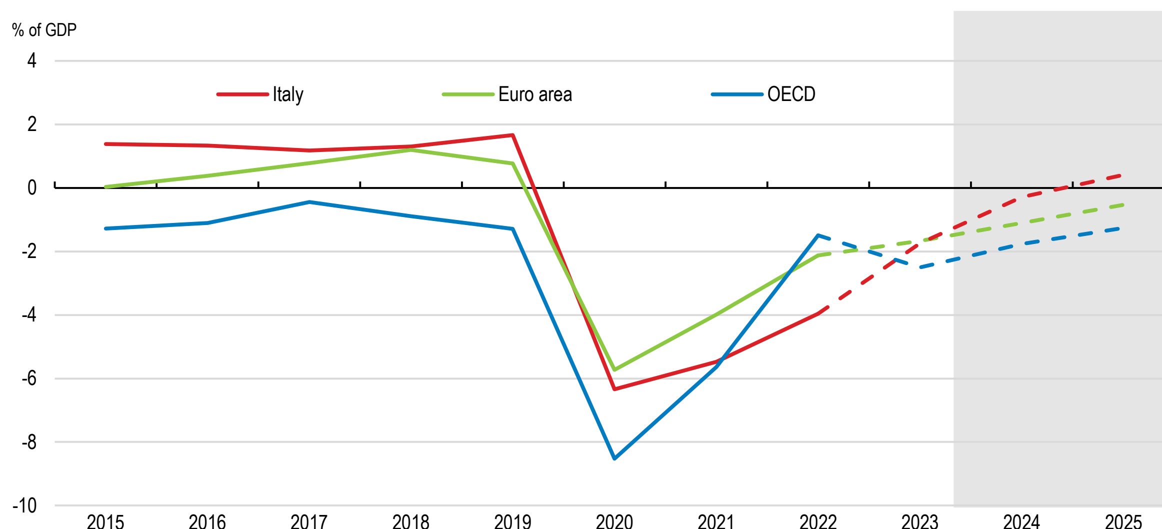
1.4.1. Fiscal policy has supported the economy

Italy provided generous fiscal support during the energy crisis, including through the reduction in excise taxes on fossil fuels, tax credits for businesses' electricity expenditure, reductions of fixed charges on gas and electricity, as well as targeted cuts in social security contributions and income support for low-income households. Overall, energy crisis support adopted in the wake of the Russian aggression against Ukraine in February 2022 was relatively well targeted in international comparison (OECD, 2023c). Cost-inefficient and untargeted price measures were limited and most of them were phased out at the beginning of 2023, including the reduction in excise duties on fossil fuels. Targeted income support for low-income households; the untargeted suspension of fixed charges on gas bills; as well as the untargeted reduction in value added taxes on gas used for combustion, district heating and thermal energy were extended to the end of 2023. The government plans to phase out these measures in 2024.

The stance of fiscal policy will be broadly neutral in 2024. The recent Eurostat-mandated change in the treatment of building renovation tax credits, including the superbonus, shifted fiscal expenditure from the date when the tax credit is claimed to the date when the renovation contract is signed. This means that the recent tightening of tax credits for home improvements will improve the 2024 accrual government budget balance but not the cash balance, which is largely determined by tax credits granted over 2021-23 that are claimed in later years. Energy crisis support has been scaled back in the course of 2023, but some measures were extended to the fourth quarter, including targeted income support for low-income households, the suspension of fixed charges on gas bills and the reduction in value added taxes on gas. The government plans to phase out these measures in the course of 2024, which should provide fiscal savings of around 1% of GDP. These savings will be broadly offset by targeted income tax cuts for low and middle-income households and the expected ramp-up of spending related to Next Generation EU (NGEU). In 2025, the targeted income tax cuts introduced in 2024 and the targeted social security contribution cuts introduced in 2023 are scheduled to expire under current legislation, implying a mild fiscal tightening and an improvement in the primary fiscal balance of about ½ percent of GDP (Figure 1.15).

Figure 1.15. The headline primary fiscal balance is projected to improve, driven largely by the treatment of building tax credits

Government primary balance, as a percentage of GDP

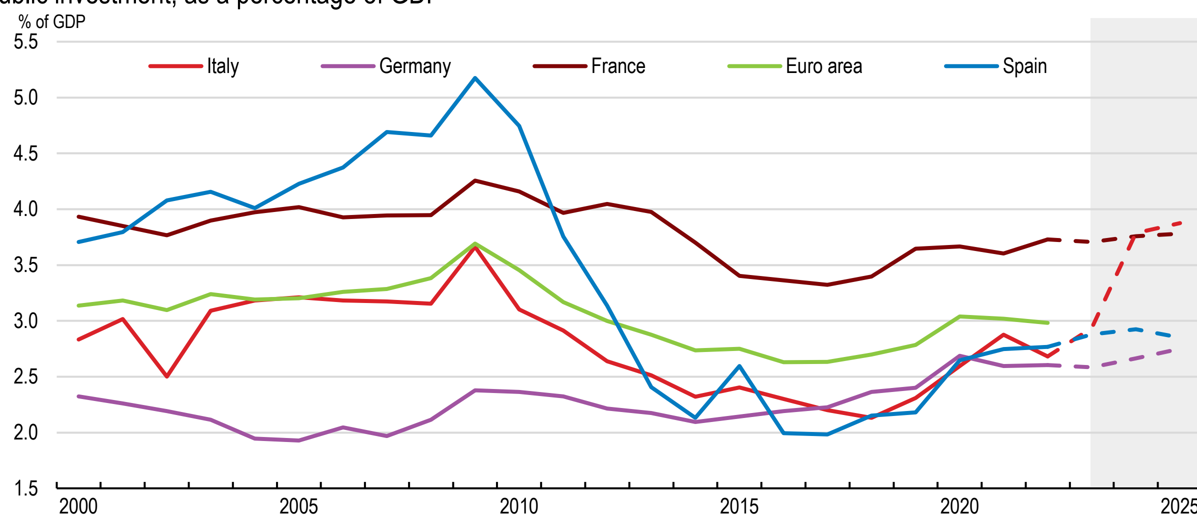


Source: OECD Economic Outlook database.

Public spending is being supported by the National Recovery and Resilience Plan (NRRP) that is financed through grants and low-interest loans from the European Union (Box 1.3). About one-third of the funding is budget balance-neutral grants and two-thirds are loans. The NRRP could give a major impulse to public investment, which was weak over the past two decades (Figure 1.16). Total funds allocated to the Plan over 2021-26 amount to a total of about 10% of annual GDP, with about 60% allocated to public investment. The additional spending could significantly boost real GDP growth, both by stimulating aggregate demand in the short term and raising labour productivity in the medium term. Recent model simulations from the Government suggest that full implementation of the planned additional public spending could boost the level of real GDP by 1.8-3.4% by 2026, largely due to demand effects and depending on the efficiency of public investment (Ministry of Finance, 2023b; Di Bartolomeo and D'Imperio, 2023).

Figure 1.16. Public investment was weak but is picking up, supported by the NRRP

Public investment, as a percentage of GDP



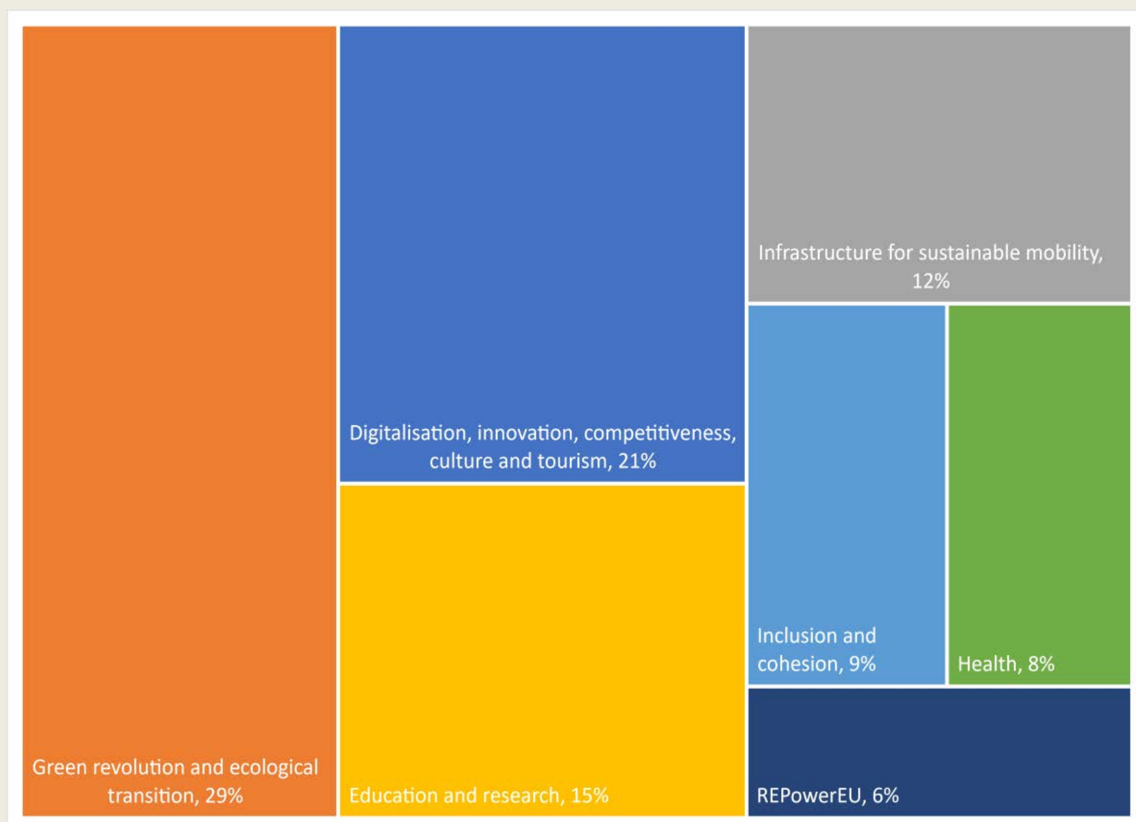
Source: OECD Economic Outlook database.

Box 1.3. The National Recovery and Resilience Plan

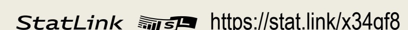
The Italian National Recovery and Resilience Plan (NRRP) was approved by the European Commission in July 2021 (Presidenza del Consiglio, 2021; European Parliament, 2022). It provides financial support from the EU from 2021 to 2026 subject to progress on implementation of agreed investment and structural reforms. Following a revision of the Plan that was endorsed by the European Commission in November 2023, Italy was allocated €194.4 billion (European Commission, 2023a), which amounts to about 10% of 2022 GDP and about one-quarter of the entire European Recovery and Resilience Facility. Italy topped up the resources allocated from the European Union with national funds amounting to €30.6 billion (about 1.5% of 2022 GDP).

The available resources provide an opportunity to address structural weaknesses of the Italian economy that have held back growth and social inclusion over the past two decades, and to support the digital and green transitions, including through public investment. In the revised Plan, policy measures are organised into seven main areas, with the digital and green transitions accounting for about 50% of the entire NRRP resources (Figure 1.17).

Figure 1.17. Policy areas and resources of the NRRP



Source: European Parliament (2022).

StatLink  https://stat.link/x34gf8

The disbursement of European Union funds is conditional on meeting a pre-defined set of qualitative milestones (for example, judicial reform) and quantitative targets (for example, reduction in the duration of trials), with structural reforms being frontloaded in 2021-22, while most investments are scheduled for 2023-26. Disbursement of funds is organised in semi-annual tranches, with full disbursement of allocated funds requiring the Plan to be completed by mid-2026.

The structural reforms in the NRRP are classified along two main axes. The first axis consists of horizontal reforms aiming to improve performance across all policy areas of the Plan and facilitate its implementation. This includes judicial reform to reduce the duration of civil and criminal trials; measures to increase the efficiency of the public administration; as well as the annual adoption of a competition law. The second axis consists of sectoral reforms to improve the impact of public investment within each policy area, such as the digitalisation of the public administration and the justice system.

In terms of public spending, about 60% of spending is on public investment projects, including on high-speed internet, high-speed railways, early childhood education facilities, and schools; about 20% consists of tax incentives for businesses, including for investments in intangible assets through the Transition 4.0 plan for industry; and the remaining 20% is accounted for by current expenditure, transfers to households and reduced employer social security contributions (Presidenza del Consiglio, 2021). The revised NRRP reallocates about €21 billion to public investment, including the Transition 5.0 plan (the follow-up of Transition 4.0) and energy infrastructure projects. By December 2023, the European Commission had approved four payment requests, amounting to about 54% of the whole NRRP resources (about €102 billion).

Following changes in the governance structure of the Plan in early 2023, a high-level Steering Committee at the Prime Minister's Office provides strategic guidance; coordinates with line ministries and local administrations responsible for implementation; and is the single contact point for reporting to the European Commission. The Ministry of Economy and Finance is tasked with monitoring, reporting and control. Line ministries and local administrations manage the implementation of reforms and investment projects, with local administrations being responsible for about half of the investment projects under the Plan. The national development bank (*Cassa Depositi e Prestiti*, *CDP*) is tasked with directly managing a number of funds (including the new Green and Digital Transition Funds) and provide technical assistance to public administrations.

The full implementation of public investment projects is key to realise the expected benefits of the NRRP. Italy has made significant progress in implementing the NRRP, including by legislating ambitious structural reforms in the areas of public administration, civil justice and competition as discussed below. In December 2023, the European Commission approved the fourth payment tranche corresponding to the milestones and targets of the first half of 2023. However, a number of challenges have emerged with respect to the implementation of public investment projects, including the tight timeframe for project execution, price increases for energy and raw materials, and supply chain disruptions. At the end of 2022, cumulated NRRP spending was about 50% below the original schedule. Spending on energy efficiency and sustainable mobility was above the original spending plan, which mainly reflects the superbonus and other building renovation tax credits rather than public investment (Court of Auditors, 2023). By contrast, the implementation of public investment projects was behind schedule, with implemented public investment in 2022 amounting to less than one-quarter of the initially expected amount (0.2% of GDP as opposed to 0.9%; Ministry of Finance, 2022a; 2023a).

The authorities have taken measures to speed up the implementation of the public investment projects in the NRRP, including by allowing for streamlined public procurement procedures through the relaxation of rules on public tenders and the shift in civil servants' liability from acts taken to deliberate inaction. The authorities have also scaled up capacity building measures for local administrations. While being responsible for about 50% of NRRP spending, local administrations often lack the capacity to plan, monitor and execute the public investment projects in the NRRP. For instance, municipalities' funding requests were well below NRRP funds available for the construction of new early childhood education centres (Openpolis, 2023). The central government is providing technical assistance and leveraging the expertise of the national investment bank (*CDP*) and the national agency for inward investment and economic development (*Invitalia*). It is also hiring personnel specialised in the planning and management of public investment projects. These efforts should be focused on the south of the country, where capacity appears to be particularly weak (OECD, 2021a).

The revised NRRP endorsed by the European Commission in November 2023 may speed up the implementation of the public investment component of the NRRP. The revised plan re-focuses the NRRP on projects that are achievable by 2026, which implies a stronger focus on large and centrally-managed infrastructure projects and, in some cases, reduced funding for locally-managed projects that have little chance of being implemented before 2026 (European Commission, 2023a). The revision further reshapes and adjusts milestones and targets to account for the changed economic environment, including higher input costs. It further abandons some of the pre-existing investment projects that may not be eligible under the Recovery and Resilience Facility, as well as projects that may be better accomplished using the Cohesion Fund or national funding. This allows to free resources to include the new REPowerEU chapter in the NRRP, which focuses on large and centrally managed investment projects related to renewable energy, green skills, energy efficiency and electricity infrastructure. The focus of the revised NRRP on large and centrally-managed public investment projects and the re-allocation of projects that may be infeasible to execute by mid-2026 towards the Cohesion Fund or national funding improves the prospects of fully implementing the NRRP. This could be complemented with a more general re-allocation of projects to the most effective and highest-capacity administrations.

The ongoing public administration reform is key to make the implementation of the NRRP more effective

The public administration is perceived as less effective than in most other OECD countries despite past and ongoing reforms (Figure 1.18). A comprehensive strategy to tackle regulatory complexity and sub-par organisational practices would raise the capacity of the public administration to implement structural reforms and complex public investment projects, including the NRRP. A number of ongoing reforms aim to reduce regulatory complexity and improve human resource management. Promising initiatives include the simplification of 600 regulatory procedures in the areas of energy, labour, taxation, and social policy by 2026. This could be complemented by institutionalising the systematic assessment of existing and planned regulations, as done, for instance, by the Australian and New Zealand Productivity Commissions (OECD, 2020a). The launch of a single recruitment platform for civil servants and the recent introduction of a ceiling of 180 days for the duration of selection procedures is helping to identify competent candidates and reduce the duration of recruitment procedures, while the plan to provide training to 750,000 civil servants by 2026 as well as the revamp of the e-learning platform (*Syllabus 2.0*) should raise human capital. Ongoing reforms also aim to strengthen digital services provision and the digitalisation of internal public administration processes. Noteworthy projects include the roll-out of new tools that allow citizens to pay digitally for services and the establishment of the new digital platform (*PA digitale 2026*) that provides tools to local public administrations to apply for tenders and manage projects related to the NRRP.

Enhancing the efficiency of public procurement will be a crucial element of public administration reform. The ongoing reform of the public procurement code is based on three key pillars. The first pillar focuses on fully digitalising public procurement processes. The second pillar focuses on strengthening capacity of contracting administrations by establishing a certification procedure. Only certified administrations will be able to procure public works above €500,000 and goods and services above €140,000. The aim is to promote the consolidation of small, local public administrations that are often lacking capacity into larger procurement entities. Promoting information exchange and coordination between procurement entities, as done in Australia, would further help build capacity (OECD, 2021a). The third pillar allows for procurement procedures other than public auctions for public works of up to €5.3 million and goods and services up to €140,000. The impact on competition and corruption of the new thresholds should be monitored and should be adjusted if necessary. While the current focus on speeding up public procurement in the context of accelerating the implementation of the NRRP is relevant, it should also be taken into account that competitive auctions tend to lead to price rebates of 2-4% relative to non-competitive procurement (Bank of Italy, 2023d).

More progress is needed in the areas of performance pay and professional mobility of civil servants. The key priority should be to modernise performance assessment systems with the aim to better link civil servants' pay and career progression to performance. Over the past years, progress has been achieved in collective bargaining agreements, which allow for one-off performance bonuses and recognise grades on the individual performance assessment as significant factors in decisions over permanent pay increases. These initiatives should be strengthened and expanded, including by raising the share of pay that is linked to performance and sufficiently differentiating grades in the performance assessment. Costs to the public finances could be limited by reducing automatic pay increases linked to seniority, as already done for civil servants at the management level. Another priority is to promote mobility, which could raise human capital, facilitate the reallocation of staff to public administrations with high labour demand, and reduce the risk of civil servants becoming entrenched in positions with excessive discretion over administrative procedures. Significant progress has been achieved in this area over the past years, including by the creation of a single platform for all vacant positions across central and local public institutions and by the suppression of the obligation for civil servants to obtain a mobility authorisation from the public administration of origin. Further progress could be achieved by sharing the outcomes of performance assessments across administrations and limiting the duration that civil servants can remain in the same position (Gerson, 2020; OECD, 2019a; Cotarelli, 2018).

Figure 1.18. The efficiency of the public administration is lower than in most other OECD countries

A. Government Effectiveness Estimate, 2022

B. Duration of public procurement procedures, 2020

C. E-government maturity score, average 2020-21

Note: Government Effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The estimate gives the country’s score on the aggregate indicator and has been rescaled by adding the global minimum to all values, so that it ranges approximately from 0 to 5.

Source: World Bank Governance Indicators, EU Single Market Scoreboard, European Commission E-government benchmark report 2022.

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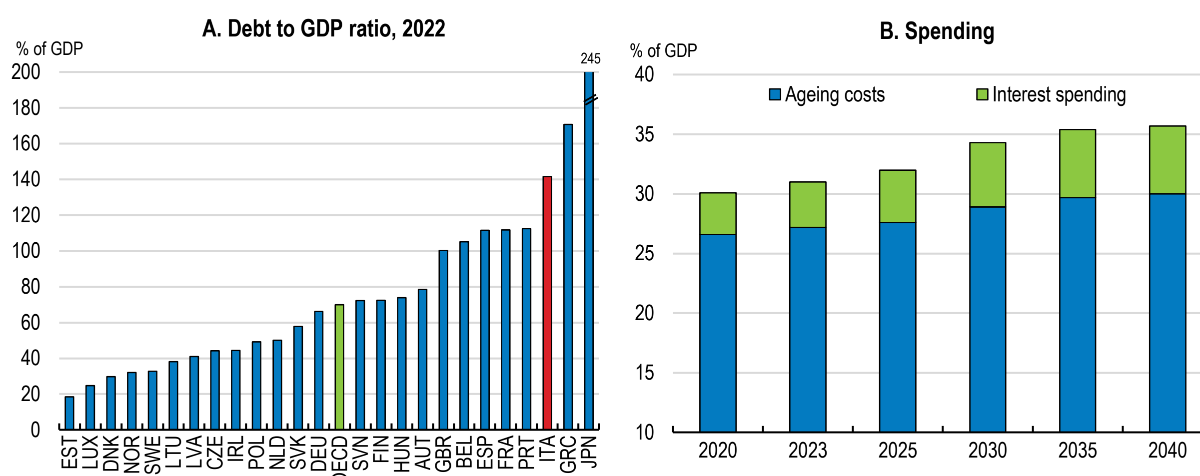
Table 1.3. Past OECD recommendations to enhance the efficiency of the public administration

Recommendation	Action taken
Undertake stocktake reviews of regulations, starting with sectors that will be priorities for the post-COVID crisis recovery.	The simplification of 600 regulatory procedures in the areas of energy, labour, taxation, and social policy by 2026 is ongoing.
Rejuvenate the public sector workforce, through more agile recruiting, training and career management, with a particular focus on filling skill needs such as those for the digitalisation of the public sector.	A single recruitment platform for civil servants has been launched. The authorities plan to provide training to 650,000 civil servants by 2026.
Clarify competencies of different levels of government, supported by bodies that identify, disseminate and support effective practices.	The NRRP foresees the simplification and streamlining of procedures to better define the role of the various levels of government.

1.4.2. *Fiscal consolidation needs are substantial*

In a context of rising age-related spending over the next two decades, increasing debt servicing costs and large public investment needs to achieve the green and digital transitions, reaching a more sustainable debt path should be the key medium-term priority for fiscal policy. Italy's debt-to-GDP ratio is among the highest in the OECD. It surged to just under 155% of GDP in 2020 due to high public spending and the fall in nominal GDP during the pandemic, but it has come down to around 140% of GDP in 2023, aided by the large negative differential between the effective interest rate on debt and nominal GDP growth. Even though public debt is expected to remain broadly constant over 2024-25, in the medium term it is on an upward trajectory under current legislation according to simulations conducted for this Survey (Figure 1.19, Panel A; Figure 1.20, Panel A). Gross ageing-related expenditure (pensions, health and long-term care) is expected to increase by about 2½ percent of GDP by 2040 due to rapid population ageing before the effects of past pension reforms fully kick in (European Commission, 2021), although lower education spending due to smaller birth cohorts may slightly mitigate this pressure. If the recent increase in euro area interest rates proves to be persistent, debt servicing costs as a share of GDP will eventually increase substantially given the high debt ratio. Overall, increased gross expenditure on ageing-related items and debt servicing will put upward pressure on public spending of around 4½ percent of GDP by 2040 (Figure 1.19, Panel B).

Figure 1.19. The debt to GDP ratio is high, with pension and interest spending set to rise



Note: Ageing costs in Panel B include old-age and survivors' pensions, health and long-term care.
Source: OECD Analytical database; European Commission (2021); OECD LTB database.

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At unchanged tax and spending policies, the increase in pension, health and long-term care spending, as well as rising debt servicing costs, would lead public debt to reach around 180% of GDP by 2040 and continue to rapidly increase thereafter (Figure 1.20, Panel A). Such an increase would leave Italy increasingly vulnerable to fiscal shocks and would likely imply a further increase in the risk premium on government debt. Reverting to the average pre-pandemic primary budget balance of 2012-19 of 1.5% of GDP by 2026 – which would require a substantial improvement in the primary balance of about 2% of GDP relative to the projected balance in 2024 (Table 1.1) in a context of rising ageing costs – would not be sufficient to bring debt on a declining path in the medium term.

However, the debt-to-GDP ratio could be put on a declining path by 2031 and reach about 130% of GDP by 2040 (Figure 1.20, Panel A) if Italy undertakes a seven-year fiscal adjustment from 2025 that is consistent with a stylised implementation of the new EU fiscal rules for countries undertaking structural reforms (European Commission, 2023). This would require substantial fiscal consolidation in the years

ahead, especially when accounting for national financing needs to replace NGEU grants when they end in 2026, and running a large primary budget balance over the medium term.

Figure 1.20. Bringing debt on a more sustainable path will require substantial fiscal adjustment

A. Public debt

% of GDP

200
180
160
140
120
100
80
60

2023 2025 2030 2035 2040 2045 2050 2055 2060

Existing tax and spending policies
Pre-pandemic primary surplus (1.5% of GDP)
Proposed EU fiscal rules (primary surplus of 3% of GDP by 2031)
Proposed EU fiscal rules + structural reforms

B. Total tax and spending measures required over 2025-31 to meet the proposed EU fiscal rules

6
5
4
3
2
1
0

Underlying primary balance adjustment
Net ageing costs
Total tax and spending measures

Note: Panel A: The "Existing tax and spending policies" scenario assumes that the structural primary fiscal balance before accounting for net ageing-related costs remains constant at 2025 levels. Net ageing costs are defined as changes in expenditure on old-age pensions, health and long-term care minus changes in expenditure on education. The "Pre-pandemic primary surplus" scenario assumes that the primary budget surplus between 2012-19 (1.5% of GDP) is reached by 2026 and maintained until 2060, which requires tax and spending measures after 2026 to offset rising net ageing costs. The "Proposed EU fiscal rules" scenario is based on a stylised version of the European Commission's reform proposals of April 2023 (European Commission, 2023). It assumes that (a) the primary balance is raised by 0.5% GDP when the headline budget deficit exceeds 3% of GDP; (b) public debt as a share of GDP is lower in 2031 than in 2024; and (c) public debt as share of GDP is on a declining path in 2031. However, it does not account for any assessment of the debt path needed to ensure the debt ratio falls in various risk scenarios. This simulation requires a primary budget surplus of 3% of GDP by 2031. It is assumed that after 2031 tax and spending policies remain unchanged and changes in ageing costs are not offset, implying a deterioration in the primary budget balance when net ageing costs rise (until about 2040) and an improvement when net ageing costs decline (after about 2040). The "Proposed EU fiscal rules + structural reforms scenario" additionally assumes higher GDP growth from the implementation of the ambitious package of structural reforms reported in Table 1.6 below.
Panel B: The underlying primary fiscal balance is defined as the primary balance minus NGEU grants (see OECD, 2023, Annex 1.A. for the treatment of the NGEU grants in the OECD projections). Due to uncertainties around the level of the output gap in the wake of the COVID pandemic, for the purposes of the simulations, the underlying primary fiscal balance is not adjusted for the economic cycle. Given that the projected output gap is around 1% of potential GDP in 2024, adjusting the underlying balance for the cycle would imply a slightly larger required adjustment over 2025-31. NGEU grants are expected to amount to 0.8% of GDP in 2024.
Source: OECD calculations based on OECD Economic Outlook database and OECD Long-Term Model.

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Under the proposed reforms to the European fiscal rules (European Commission, 2023b), the overall required improvement in the structural primary budget balance over 2025-31 could amount to about 4% of GDP over the period (Figure 1.20, Panel B). Additional fiscal pressures will arise from the fact that, in a context of rising ageing costs, even maintaining a constant primary structural balance will require additional tax and spending measures. By 2031, the underlying primary budget balance would need to reach a 3% of GDP surplus. After 2031, there would be no additional need to consolidate and the proposed new EU fiscal rules would not require offsetting rising ageing costs, so the primary surplus could modestly decline over 2032-40 but nonetheless remain high at 2½ percent of GDP.

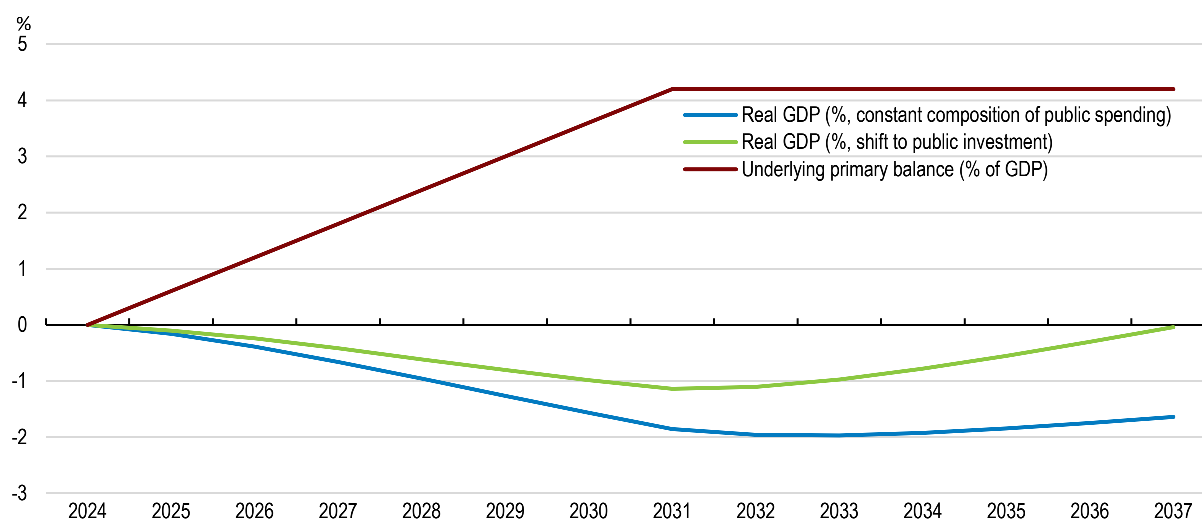
The scale of the required initial fiscal adjustment will be very challenging given its size, limited room to raise tax rates and the composition of government spending. Maintaining large primary budget surpluses after the initial adjustment, which would still need to exceed 2½ percent of GDP on average for the decade following the adjustment programme, would be particularly challenging. While an initial adjustment on this scale is not unprecedented for Italy, with similar adjustments achieved in the 1990s ahead of the adoption of the euro and in the early 2010s in the wake of the euro area crisis, only few OECD countries over the past 30 years have maintained primary surpluses above 1½ percent of GDP for sustained periods (OECD, 2023b; Eichengreen and Panizza, 2016). Achieving a surplus of this size requires sustained policy action to raise revenues, including by strengthening tax compliance, and to raise the efficiency of spending, as well as structural reforms to support growth.

Reforms that boost growth could play a key role in improving debt dynamics. The package of reforms recommended in this Survey (see Table 1.9) would reduce the debt-to-GDP ratio by 20 percentage points by 2060 by raising the level of GDP (Figure 1.20, Panel A), or would allow for lower primary budget surpluses to bring debt on a declining path. Raising net immigration by one-third relative to the baseline – which is consistent with recent population projections published by Eurostat (2023) – would reduce the debt-to-GDP ratio by an additional 10 percentage points by 2060. But policies to boost GDP growth need to be complemented with continued ambitious fiscal reforms to help improve the public finances, which will be essential to maintain credibility with investors.

The adverse effects of the required initial fiscal adjustment on aggregate demand would be dampened under the proposed EU rules by spreading the fiscal consolidation each year over 2025-31 and by Italian plans to shift the composition of public spending to public investment that tends to boost demand in the near term and raises potential output. The total required adjustment in the underlying primary budget balance would amount to about 4% of GDP over 2025-31). Background analysis conducted for this Survey based on the National Institute Global Econometric Model (NiGEM) suggests that a gradual fiscal adjustment of around 0.6% of GDP per year without change in the composition of public spending would reduce the level of real GDP by about 2% relative to a baseline without fiscal adjustment by the early 2030s (Figure 1.21). The baseline without fiscal adjustment implies rising debt levels, which could have adverse feedback effects on growth that are not fully accounted for in the simulations and would require an even larger fiscal adjustment in the future to stabilise debt. Furthermore, with the planned shift in composition of public spending towards public investment in line with NRRP plans, the negative impact on the level of real GDP by the early 2030s is limited to about 1% at its peak. The design of this gradual consolidation effort would need to ensure that there is no adverse impact when the NGEU grants end in 2026. Taken together, this suggests that a gradual fiscal adjustment that spreads the consolidation over several years and preserves public investment would subtract only about 0.15 percentage points from annual growth over 2025-31, while putting the public finances on a more sustainable path. This contrasts with consolidation efforts following the euro crisis that were much more frontloaded and undertaken by cutting investment, leading to a more dramatic impact on activity.

Figure 1.21. Limited adverse effects of the required fiscal adjustment on real GDP growth

Effects of an increase in the primary fiscal balance of 0.6% per year over 2025-31, deviations from NiGEM baseline



Note: Both scenarios assume an increase in the primary fiscal balance of 0.6% per year, with half of the required fiscal consolidation achieved by higher taxes and half by lower spending. The scenario "constant composition of public spending" assumes that the composition of public spending is unchanged relative to the NiGEM baseline. The scenario "shift to public investment" assumes that public spending is shifted from government consumption to public investment so that public investment increases by 0.5% of GDP in 2025 and 2026 and declines by 0.5% of GDP in 2027, implying that public investment is 0.5% of GDP higher than in the baseline from 2027 onwards. NiGEM simulations with model-consistent expectations (forward-looking mode).
Source: OECD.

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Table 1.4. Past recommendations to bring public debt on a more prudent path

Recommendation	Action taken
Improve the composition of public spending to promote growth and job creation. Improve coordination across agencies implementing public investment projects to raise disbursement levels. Consolidate smaller agencies' public procurement activities into higher capacity bodies.	Spending under the NRRP is expected to support growth and job creation. To solve coordination problems, the new governance of the NRRP includes a steering committee to gather central and local governments responsible for implementation. Certification requirements in the new public procurement code provide for incentives for consolidation of procuring entities.
Contain pension spending by allowing the early retirement scheme (Quota 100) and the so-called women's option to expire in December 2021, and immediately re-establish the link between life expectancy and retirement age.	Early retirement schemes have become stricter and less generous.
Improve the allocation of resources and the effectiveness of spending through strengthened expenditure reviews also taking into account a succinct set of policy performance indicators.	A unit overseeing expenditure reviews has been set up at the Ministry of Finance. Guidelines for line ministries on the formulation and monitoring of spending review plans have been published.
Implement a holistic tax reform that reduces complexity and permanently lowers taxes on labour, financed through improved compliance, lower tax expenditures and higher taxes on immovable property and inheritance.	The enabling law to reform the tax system contains elements to reduce the complexity of the system (e.g. the rationalisation of tax expenditures) and strengthen compliance (e.g. through the digitalisation of the tax administration).

Implementing fiscal adjustment will require difficult choices to be made

Improving the underlying primary fiscal balance over 2025-31 by around 4% of GDP requires a major change to existing tax and spending policies, ambitious measures to reform the tax system, and improvements in the efficiency and prioritisation of spending beyond those already implemented or planned

by the authorities. If implemented entirely through spending measures, the required adjustment would be equivalent to freezing or modestly cutting primary spending in real terms or maintaining nominal primary spending growth around 2 percentage points below nominal GDP growth.

A key challenge is that about half of total public spending is currently committed to pensions, social assistance and debt servicing costs (Figure 1.22, Panel A). Debt servicing costs are not under direct control of the government and are set to increase over the coming years because of higher expected interest rates. If pensions and social assistance programmes are protected in any adjustment, the required real cuts in other areas could be very large and impactful. Health, education and other social spending are already low in international perspective (Figure 1.22, Panel B).

Figure 1.22. Pensions, social assistance and debt servicing account for 50% of public spending

A. Public spending (% of total spending)

Pensions 31%
Interest payments 6%
Other social 12%
Education 7%
Health 14%
Other 30%

B. Public spending (% of GDP)

%
Italy
Euro area
OECD
Interest payments
Education
Other social
Health
Other
Pensions

Note: Figures refer to general government expenditure in the year 2021. “Pension” expenditure includes old-age and survivors’ pensions. "Other social" expenditure includes sickness and disability pensions, family, unemployment,, housing and other income maintenance and social assistance benefits.

Source: OECD National Accounts database; OECD Analytical Database.

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The focus on the public spending side should be on prioritisation and further increases in efficiency to create cost savings while improving public services. Italy has conducted multiple spending reviews since the global economic and financial crisis of 2008-09. The NRRP foresees the establishment of an annual spending review process, with a unit at the Ministry of Finance co-ordinating the process in close coordination with a scientific committee. Spending reviews have been integrated into the budget process, with upfront funding provided to line ministries to hire evaluation experts. This should help to achieve more targeted spending changes than the across-the-board spending cuts in the wake of the spending reviews of the early-2010s (European Commission, 2020), even though some cuts may need to be implemented in a more across-the-board way, so the impact is shared across a range of areas. The institutional framework of the new spending reviews is in line with best practice and the recommendations in the previous Survey (OECD, 2021a; Tryggvadottir, 2022).

However, the target of annual fiscal savings averaging around 0.4% of total public expenditure over 2023-25 (about 0.2% of GDP) appears unambitious given the required medium-term fiscal consolidation needs. The evidence suggests that efficiency and value-for-money focused spending reviews without ambitious reallocation or savings targets can lead to mixed results (Tryggvadottir, 2022). Ambitious spending reviews can contribute to successful fiscal consolidation, as suggested by the 2010 comprehensive spending review in the Netherlands that aimed at expenditure reductions across a broad range of policy areas and amounted to about 10% of overall public expenditure and 5% of GDP (Kabel, 2015). Gradually raising the efficiency of public spending (output per unit of expenditure) in Italy by 4% over the next years, including by further digitalising the public administration and public procurement, would yield fiscal savings of around 2% of GDP (Table 1.6).

Maintaining the high share of public spending on pensions, among the highest in the OECD at around 16½ percent of GDP (when accounting for old-age and survivors' pensions), would make it difficult to adjust overall spending without squeezing economically and socially important education spending and public investment. The defined benefit pension scheme was reformed in 1995 and replaced by a notional defined contributions scheme (Franco and Tommasino, 2022), which will lead to growing savings in the future compared to the old scheme. However, there is a long transition period, with workers who started working before 1995 being covered by the legacy defined benefit scheme on a pro-rata basis and only workers who started working after 1995 fully covered by the new notional defined contribution scheme. The legacy defined benefit scheme will only be fully phased out around 2040, when most people who started working before 1995 will have retired. Since 2012, the statutory pension age is linked to life expectancy to limit increases in pension spending in the legacy defined benefit regime. But, with rapid projected population ageing and generous pension levels in the legacy defined benefit scheme (OECD, 2021b), pension expenditure will nonetheless keep increasing until 2040 (European Commission, 2021).

The post-1995 notional defined contribution pension system is a substantial improvement with respect to the legacy defined benefit scheme and will ensure that future pensions are closely linked to contribution histories, but the full implementation of the 2012 pension reform has been postponed through the adoption of *ad hoc* early retirement schemes, most recently in the 2023 Budget Law. The temporary 2023 rules allow workers above age 62 with at least 41 years of pension contributions (*Quota 103*) to retire early and are expected to cost about 0.1% of GDP in 2023 (Ciotti et al., 2023). New early retirement schemes should not be introduced.

Given the need to consolidate public finances and reprioritise spending towards growth-friendly areas, the government should look again at options to limit spending on pensions in the current decades, focusing on the generous rules in the legacy defined benefit system. The legacy pension system is comparatively generous, with the average income of people above age 65 who benefited extensively from this system 3% above the population-wide level, whereas it is about 14% lower on average in the OECD (OECD, 2023d). The one-off reduction in the indexation of high pensions in the 2023 Budget Law is expected to reduce spending on current pensions by about 0.4% of GDP in both 2023 and 2024 (Ciotti et al., 2023). However, maintaining the reduced indexation for a protracted period of time may pose constitutional issues

as it would curtail acquired rights of some pensioners and would provide significantly smaller savings when inflation returns to more normal levels.

Options to contain spending on current pensions include a solidarity contribution from high pensions that are not linked to past contributions and introducing an age condition for eligibility to survivors' pensions. The solidarity contribution could take the form of a progressive tax on pensions that exempts pensions below a specific threshold and could be based on the difference between currently received pensions and pensions calculated using the defined contribution rules (Patriarca et al., 2014). Reducing the generosity of current pensions raises equity issues and low pensions should be protected, but given the need to contain overall spending growth, a contribution from current pensioners needs to be envisaged. This would help to manage the overall costs of the scheme, while targeting wealthier households who are likely to have more private savings. By reducing only the part of current pensions that is unrelated to past contributions, constitutional issues posed by the curtailment of acquired rights may be avoided. Spending on current pensions could also be reduced by tightening eligibility for survivors' pensions, which are the highest in the OECD, amounting to about 2½ percent of GDP in 2019. High spending partly reflects the absence of an age condition for eligibility. Introducing an age condition that would restrict pension eligibility to survivors' pensions to around the legal retirement age would contain costs and may limit adverse effects on recipients' labour market participation (OECD, 2019d).

The planned tax reform should focus on making the tax system more growth-friendly while preserving revenues

Protecting tax revenues will be crucial given fiscal pressures, and there is room to make the tax system more growth friendly. At about 43% of GDP, tax revenue as a share of GDP is among the highest in the OECD and well above the OECD average of about 34% of GDP, limiting the room to raise tax revenues without hurting growth. However, taxes are heavily skewed towards labour, with a strikingly low revenue share of indirect consumption taxes (Figure 1.23, Panel A), which are generally viewed as being less harmful to growth than labour taxes (Arnold et al. 2011). The enabling law for the reform of the tax system aims to reduce the tax burden on labour, while rationalising the system of tax expenditures and strengthening tax compliance, including through the increased use of digital tools (Table 1.5). Although detailed estimates of revenue effects are not yet available, these objectives are broadly in line with recommendations in previous Surveys to lower the tax burden on labour, reducing poorly targeted tax expenditures (for example, by limiting the coverage of the "dependent spouse" tax deduction that disincentives female labour market participation to people above the legal retirement age), and tackle tax evasion (OECD, 2021a).

However, the reforms aim to gradually move towards a flat personal income tax that could reduce progressivity and lead to significant revenue losses (OECD, 2006). International experience suggests that flat income tax systems are in place only in very few countries with relatively limited social welfare systems and, depending on design, put the burden on middle-income earners while low- and high-income earners tend to benefit (OECD, 2006; Bank of Italy, 2023). The income tax base has already been eroded by the proliferation of flat tax regimes, including a 15% flat tax on earnings of up to 85 000 euros of the self-employed. The introduction of a flat tax on bonuses and extraordinary earnings of dependent employees risks further eroding the personal income tax base and violating the principle of vertical equity (equity between high- and low-income individuals).

While the planned suppression of the regional tax on production (IRAP) will simplify the tax system by eliminating the calculation of an additional tax base, the planned introduction of a corporate income surtax to offset this change will amplify differences between debt financing relative to equity financing, which will also be widened by the introduction of an exemption threshold for interest expenses in the corporate tax. This is because the tax base of IRAP (gross profits) includes interest payments, whereas the tax base of the corporate income tax excludes them.

Table 1.5. Main measures in the enabling law for the reform of the tax system

Tax Policy area	Main measures
Personal income tax	Restructuring of tax brackets and modification of exemption threshold.
	Introduction of a flat tax for bonuses and extraordinary earnings of dependent employees.
	Rationalisation of tax expenditures.
Capital income tax	Unification of "capital income" and "other financial income" for tax purposes, including for profit-loss offsets.
Corporate income tax	Introduction of a preferential rate or other tax incentives for retained profits that are used for investment, hiring or establishment of stable profit sharing schemes in subsequent years.
	Introduction of a surtax related to the suppression of the regional tax on production (IRAP).
	Introduction of an exemption threshold for interest expenses.
Value added tax	Harmonisation with European rules and rationalisation of system of reduced rates.
Environmental taxes	Enhanced accounting for environmental impact of excise taxes and fossil fuel subsidies.
Tax compliance, administration, and collection	Reduction of compliance burden, including through extension of pre-filled tax declaration (including for VAT).
	Enhanced use of digital tools for risk profiling, including merging of databases.
	Expansion of the cooperative compliance programme.
	Establishment of a system of prior agreement between the taxpayer and the administration on tax liabilities ("concordato preventivo biennale") for small businesses.

Source: Ministry of Finance

A comprehensive reform to make the tax system more growth-friendly should consider re-introducing recurrent property taxes on first residences and updating the property tax base calculations; as well as raising inheritance taxes. From the perspective of horizontal equity, linking cadastral values more closely to current market values would be preferable to an across-the-board increase in the property tax base, but possible adverse impacts on low-income households would have to be addressed. Revenues from taxes on immovable property are around the OECD average (Figure 1.23), but this is explained by very high home ownership rates rather than high taxes. Inheritance taxes are among the lowest in the OECD (Figure 1.23). Raising them would raise revenues with limited adverse side-effects on economic growth and may help intergenerational income mobility. The evidence generally suggests that inheritance taxes have positive effects on labour supply of heirs (OECD, 2021d). Political opposition to these measures could partly be overcome by protecting low- to medium-income households, including by ensuring that modest levels of inheritances are not taxed, targeted income tax cuts and making the temporary reduction of social security contributions for low- and middle-wage workers in 2023-24 permanent.

Figure 1.23. There is room to shift taxes from labour income to consumption and property

A. Deviation of tax revenue shares from OECD average, 2021

B. VAT compliance gap, percent of the theoretical VAT base, 2021.

C. Revenue from recurrent taxes on immovable property, % of total tax revenue, 2021

D. Revenue from inheritance tax, % of total tax revenue, 2021

Note: Panel A shows the deviation of tax revenue shares (in total tax revenue) from the OECD average.
Source: OECD Revenue Statistics; Centre for Social and Economic Research; European Commission.

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A significant boost to tax revenues and growth could come from tackling tax evasion, which is estimated to amount to about 5% of GDP (Ministry of Finance, 2022b). Revenues from value added taxes (VAT) are well below the OECD average (Figure 1.23, Panel A). This partly reflects the VAT compliance gap that remains among the highest in the European Union, despite a large decrease in 2021 (Figure 1.23, Panel B). The VAT compliance gap (the difference between the tax revenue that would be collected under full compliance and the actual revenue collected), in turn, reflects tax evasion, which reduces tax revenues at any given statutory rate and distorts competition between tax compliant and non-compliant businesses. In the light of empirical evidence indicating that lower ceilings for cash transactions reduce the size of the underground economy and tax evasion (Giammatteo et al., 2022; Russo, 2022; Bernardini and Renzi, 2022), the increase in the ceiling for cash payments from €1000 to €5000 legislated in the 2023 Budget Law appears counter-productive and should be reversed. Ex-ante cooperative compliance agreements can have positive effects on tax compliance and certainty (OECD, 2013; OECD, 2016b), but their planned extension should not come at the expense of ex-post controls that have contributed to the significant reduction in tax evasion over the past years, with the overall tax gap having declined by around 0.4% of GDP over 2016-19. Reducing excise tax rebates and subsidies on fossil fuels could also contribute to raising revenues (see Chapter 2). Overall, the ambitious package of tax and spending reforms recommended in this Survey could raise the fiscal balance by about 4.3% of GDP (Box 1.6).

Box 1.4. Budgetary impact of recommended fiscal and structural reforms

The following estimates are based on a variety of sources and OECD calculations. The total impact on the fiscal balance of the tax and spending measures in Table 1.6 matches the fiscal adjustment required by the simulation of a stylised version of the proposed new European fiscal rules (3½ percent improvement in the headline primary balance plus 0.8% of GDP related to the end of NGEU grants; Figure 1.20, Panel B).

Table 1.6. Illustrative fiscal impact of selected reforms

Recommendation	Scenario	Impact on fiscal balance (annual, % of GDP)
Revenue measures		
Strengthen tax compliance, especially for VAT	Reduce VAT compliance gap to EU average	+1.0
Raise property and inheritance taxes	Raise inheritance taxes to OECD average	+0.5
Phase out or re-design tax expenditures that lack economic or distributional justification, including by re-designing support for building retrofitting.	Reduce tax expenditures by 10%	+0.4
Reduce excise tax rebates on fossil fuels	Bring excise taxes in road and offroad transport to the standard rate on gasoline	+0.4
Reduce the tax wedge	Reduce income taxes and social security contributions for low-income workers	-1.2
Total revenue measures		+1.1
Spending measures		
Raise the ambition of spending reviews	Target gains in the efficiency of public spending of about 4%	+2.6
Introduce a solidarity contribution on high pensions and tighten eligibility for survivors' pensions	Progressive tax on high pensions not due to high contributions as in Patriarca et al. (2014) and introduction of age condition for survivors' pensions.	+0.5
Do not extend early retirement schemes	Based on Ciotti et al. (2022)	+0.2
Give people with very low employment prospects access to social assistance (Adi)	Based on Maitino et al. (2023)	-0.1
Total spending measures		+3.2
Total impact on fiscal balance		**+4.3**

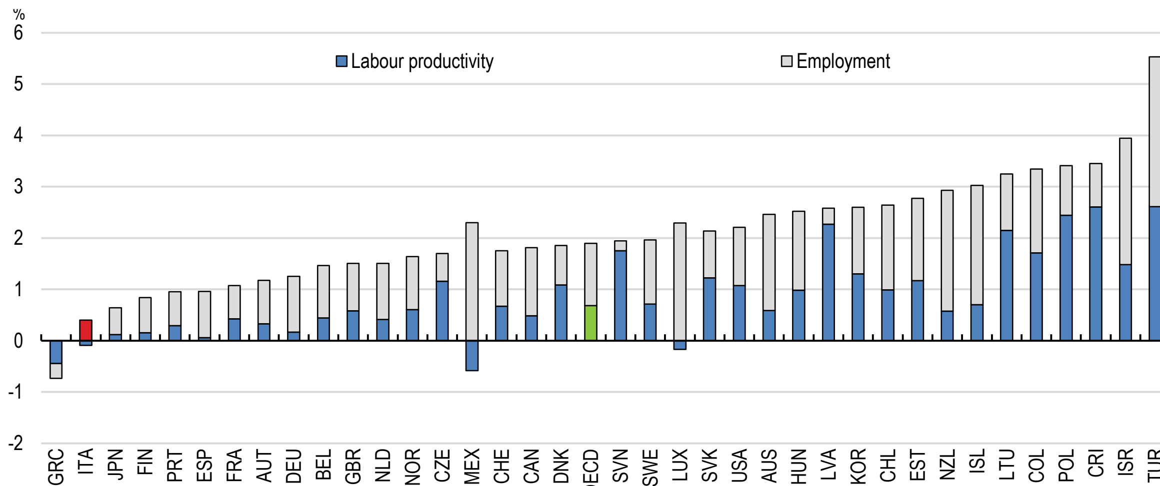
Source : Ciotti et al. (2022) ; Maitino et al. (2023) ; OECD calculations.

1.5. Structural reforms are needed to reinvigorate economic growth

Real GDP growth over the past decade has been poor, with labour productivity at the end of 2021 below the level of 2010 (Figure 1.24). Over the past decade, weak productivity growth has partly been explained by weak investment and low capital deepening, but multi-factor productivity growth has been stagnating for the past three decades (OECD, 2021a). The main issue appears to be the inability of the Italian economy to transition from catch-up growth through imported innovation over the 1950-1970s to endogenous innovation-led growth (Codogno and Galli, 2022), especially in southern regions where labour productivity remains around 20% lower than in the northern part of the country (Boeri et al., 2021).

Figure 1.24. Productivity growth has stagnated

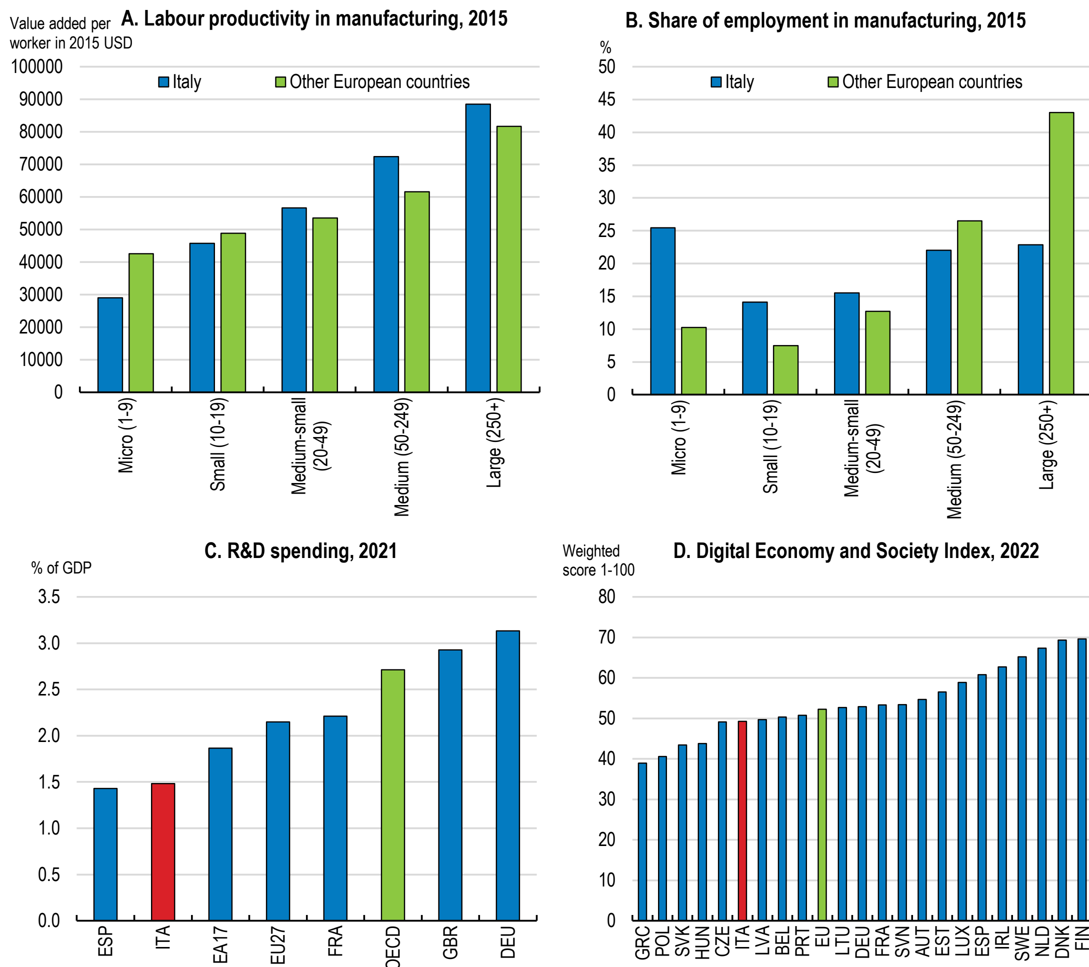
Contributions to real GDP growth, 2010-23



Note: The GDP growth decomposition is based on a Cobb-Douglas production function.
Source: OECD Economic Outlook database.

Weak innovation-led growth reflects an unusually high employment share of low-productivity micro businesses, low research and development (R&D) spending, and below-average digitalisation (Figure 1.25). While large Italian businesses are more productive on average than their counterparts in other European countries, Italian micro enterprises are about 30% less productive than their peers. At the same time, the employment share of micro businesses is about 15 percentage points larger than in other European countries while the employment share of highly-productive large businesses is about 20 percentage points lower. Small family-managed businesses often lack the scale for efficient R&D, as well as management skills and incentives for technology adoption (Pellegrino and Zingales, 2017). This contributes to low overall R&D spending in the economy and lagging digitalisation, implying foregone productivity gains from the ongoing digital revolution. Transitioning to innovation-led growth will require an ambitious package of structural reforms that encourages small firms to grow or exit the market. In this respect, the ongoing reform of capital markets is a first step to promote growth of small and medium-sized enterprises and encourage companies to get listed and access financing from capital markets, but the recent OECD Capital Market Review suggests that there is room for further initiatives in this direction (OECD, 2020c). The remainder of this section focuses on the need to further strengthen product market competition and improve incentives for technology adoption, including by enhancing legal certainty and worker skills.

Figure 1.25. The predominance of micro businesses hampers innovation-led growth



Note: Panels A and B show the productivity and employment distribution by firm size class in the manufacturing sector.
Source: OECD MultiProd database; OECD Main Science and Technology Indicators; European Commission Digital Economy and Society Index.

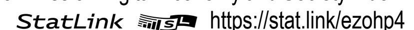


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Table 1.7. Past recommendations to enhance growth and inclusiveness

Recommendation	Action taken
Increase resources for courts to better manage backlogs and improve the speed and efficiency of civil justice court procedures.	A trial office to support judges with legal work has been created. The ongoing civil justice reform includes the strengthening of out-of-court settlement procedures.
Reduce regulatory barriers to entering professional services, including replacing licensing systems with less distortionary certification schemes. Introduce a national productivity board to identify and communicate the costs and benefits of reforms, and build a national consensus.	New regulations aim to simplify and speed up the access to some professions by waiving the requirement to pass a state exam on top of obtaining a university degree.
Increase access to adult skills attainment, with improved Training Fund application processes and better coordinated public employment services.	Additional resources have been allocated to the Training Fund over the 2021-2027 programming period of the European Cohesion Policy.
Lower the marginal effective tax rates for secondary earners. Improve access to quality childcare across all regions.	The introduction of the unified child benefit (“Assegno Unico”) has reduced the marginal effective income tax rate for secondary earners.
Set a long-term plan to harmonise and gradually raise carbon prices, with policies and time to ease social and competitiveness transition costs.	Some exemptions and rebates on fossil fuel excise taxes have been eliminated. There are plans to eliminate others.

1.5.1. The justice system needs to become more efficient

The justice system is comparatively inefficient, which raises the cost of doing business and acts as a brake on investment. An efficient justice system with adequate contract enforcement and vigorous property rights protection supports investment, financial development, the efficient allocation of labour and capital, and ultimately aggregate productivity growth (Ciapanna et al., 2020). Evidence suggests that weak contract enforcement may also be one factor behind the large share of micro businesses in Italy (Giacomelli and Menon, 2017). Perception-based indicators of judicial efficiency generally indicate that Italy is among the countries with the lowest levels of rule of law among OECD countries (Figure 1.26). To a large extent, this reflects the comparatively long duration of trials. While past reforms have reduced the expected duration of trials and the backlog in court cases, the expected duration of civil trials remains the highest in the European Union (Figure 1.26).

The ongoing civil justice reform constitutes a major step towards a more efficient judicial system. It consists of three major elements. First, it strengthens the digitalisation of the court system by introducing remote trials, with completely digitalised case files and video hearings. Second, it streamlines procedures, including by simplifying procedures for manifestly ungrounded cases and speeding up the submission of evidence to the courts. Further streamlining will be achieved by incentivising pre- or out-of-court settlements; expanding the jurisdiction of Justices of the Peace; and creating new courts for juvenile and family cases to unburden ordinary civil courts and promote specialisation. Third, the reform creates new trial offices to assist judges with legal work, which should allow them to focus on complex tasks while leaving lower-complexity tasks to legal clerks. By January 2023, 8000 clerks had been hired, with the NRRP foreseeing the hiring of another 8000 before 2026. This should help clear the backlog of cases and allow for higher judicial efficiency even once NRRP are no longer available.

The civil justice reform will also strengthen performance incentives for judges and courts, which are currently weak. Currently, there are large differences in efficiency across judges and courts, even when accounting for the average complexity of cases (Cugno et al., 2022). Highly efficient judges resolve about 700 cases per year, whereas less efficient ones resolve only about 400 cases per year (Figure 1.27), with no evidence that shorter trials reduce the quality of sentences as measured by the rate of successful appeals (Cugno et al., 2022). The efficiency of judges and courts differs significantly across regions, with efficiency significantly lower in the south of the country than in the centre-north. While the experience of Portugal suggests that judicial reforms focusing on digitalisation and the streamlining of procedures can have large positive effects on judicial efficiency (OECD 2019c; OECD, 2020b), there may also be a need to tighten performance requirements for underperforming judges and courts by revamping current performance evaluation schemes and linking evaluation to pay and career advancement. Until recently, the performance evaluation scheme allowed for insufficient differentiation between high and low-performing judges, with more than 99% of judges receiving positive evaluations over the period 2017-21 (Cartabia, 2021). Pay and promotion of judges were mostly related to seniority rather than performance, with judges facing little incentives to raise performance (Cepej, 2022).

Figure 1.26. The justice system is less efficient than in most other OECD countries

A. Rule of law index, 2022

Scale from 0 - 5

B. Disposition time, number of days, 2020

Number of days

Note: Rule of Law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. The original indicator is expressed in units of a standard normal distribution, i.e. ranging from approximately -2.5 to 2.5). To improve readability the indicator in the figure has been re-scaled by subtracting the global minimum (Venezuela) from all values, i.e. it ranges from approximately 0 to 5. Disposition Time (DT) is the calculated time necessary for a pending case to be resolved, considering the current pace of work. It is reached by dividing the number of pending cases at the end of a particular period by the number of resolved cases within that period, multiplied by 365. More pending than resolved cases will lead to a DT higher than 365 days (one year) and vice versa.

Source: World Bank Worldwide Governance Indicators; European Commission for the Efficiency of Justice.

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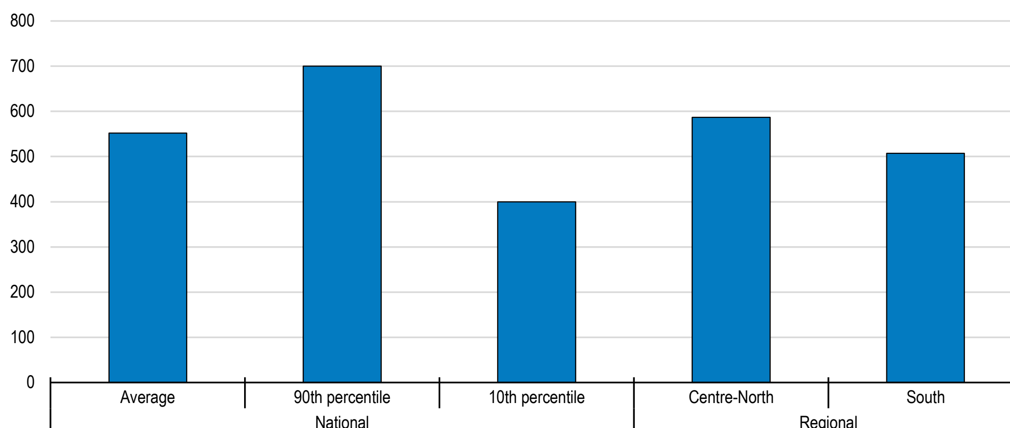
Figure 1.27. There are large differences in the productivity of judges

Annual resolved cases per judge, 2015-19



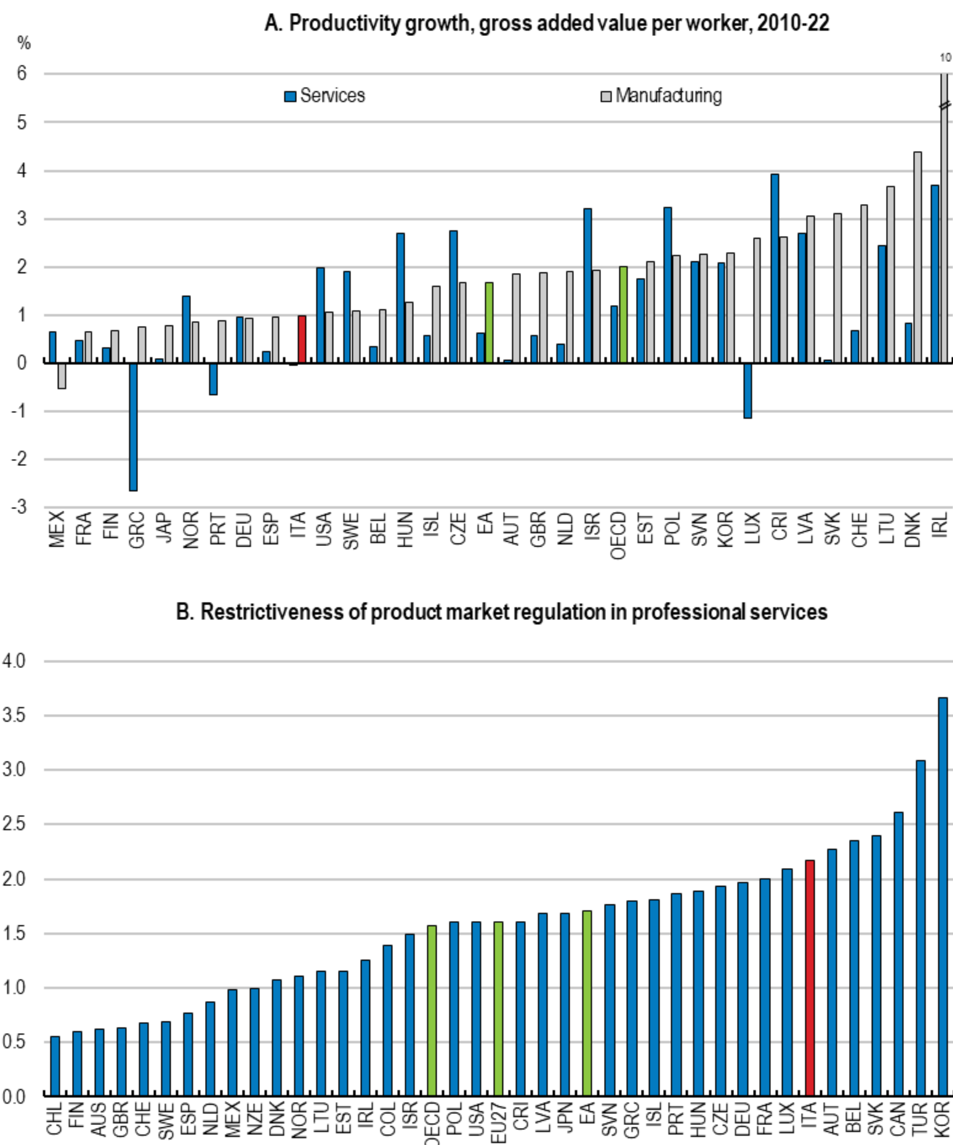
Source: Cugno et al. (2022)

Key measures in the civil justice reform to strengthen performance incentives for judges and courts include a major redesign of the performance assessment scheme as well as the strengthening of the link between performance, remuneration and career progression. The criteria for assessing the performance of judges will become more stringent and account for judges' attainment of objectives in the annual case management programmes prepared by the heads of courts. Grades in the performance assessment scheme will be differentiated by allowing for three grades ("pass", "good" or "very good") that will specifically account for judges' organisational skills. The heads of courts will be required to constantly monitor the performance of the court and the individual judges. In case of large increases in pending cases or underperformance by individual judges, the head of the court will be required to draw up a plan to remedy the situation. Performance of individual judges will be linked to career progression and remuneration, with underperformance delaying career progression and related salary increases. Appointment decisions for heads of courts will explicitly account for the organisational skills of candidates. Moreover, failure of the heads of courts to comply with monitoring and intervention obligations and failure of individual judges to cooperate with the heads of courts may constitute disciplinary offences. Overall, these measures are significant steps to strengthen performance incentives for judges and courts. Successful implementation will require allowing for sufficient differentiation between high- and low-performing judges, including by ensuring that only a limited share of judges attains the highest grade in the performance assessment system. An exceedingly high share of judges attaining the highest grade would risk making promotions and related salary increases fixed elements of careers rather than performance incentives (European Commission, 2022).

1.5.2. Remaining barriers to competition in services should be lifted

Vigorous competition is a key driver of productivity growth, strengthening firms' incentives to adopt organisational and technological innovations, as well as improving the allocation of resources in the economy (OECD, 2015). In Italy, the main competition-related issues are barriers to competition in the services sector, where productivity growth has been particularly low (Figure 1.28). While this is partly explained by sectoral specialisation within the services sector, including the large weight of tourism, it also reflects remaining barriers to competition, especially professional services and local public services, such as water, transport and waste disposal. To the extent that services are used as inputs by businesses in other sectors, these barriers to competition hinder productivity growth more widely. For instance, high barriers to entry in legal services raise the cost of legal services used by businesses across the economy, thereby limiting the productivity benefits from the ongoing reform of the judicial system.

Figure 1.28. Pro-competition reforms are needed in the services sector



Note: The preliminary 2023 Product Market Regulation data suggest that regulation of professional services in Italy remains among the most restrictive in the OECD.
Source: OECD Productivity database, OECD 2018 PMR database.

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The competition reform legislated in 2022 goes some way towards reducing entry barriers in services, including by mandating competitive auctions for public goods. An annual law to strengthen competition is a key requirement of the NRRP, with the 2022 reform subjecting concessions for hydro-electric power generation, beaches, and street trading (such as markets and fairs) to competitive auctions at expiry rather than automatic renewal. These measures should be implemented swiftly, and any backtracking should be avoided.

“Fair compensation” rules in professional services risk limiting market entry and post-entry growth of high-productivity businesses. A recent reform has expanded the scope of “fair compensation” rules from lawyers to all professions (including accountants, architects, civil engineers, real estate agents, and notaries) and from contracts between professionals and the public administration or large businesses in the financial sector to all contracts with medium-sized and large businesses. These risk being perceived more widely

as minimum tariffs by market participants. “Fair compensation” rates will be set between professional associations and business associations representing medium-sized and large businesses. This risks limiting room for high-productivity businesses to set lower rates in order to gain market shares, while favouring incumbents that have an established client base (Competition Authority, 2017). The determination of services rates should be left to negotiations between the contracting parties.

The market for local public services, such as transport, water and waste management, is highly fragmented, with small and cost-inefficient providers co-existing with larger ones that benefit from economies of scale (Refricerche, 2023). In many cases, local public entities award contracts for service provision in-house to firms they fully or partially own, favouring incumbents while excluding potentially more efficient external providers. This contributes to low efficiency and poor services, for instance in municipal waste collection or public bus services. Legislation adopted in 2023 tightens the rules on in-house provision, including by requiring local administrations to provide proof of the beneficial effects on investment, cost efficiency, and service quality after the contract has been awarded. The competition authority has been tasked with the monitoring of the new contracts and has been granted access to the anti-corruption agency’s database of all public procurement contracts. The new rules are a positive step to make the market for local public services more contestable, but the impact on in-house provision needs to be closely monitored. In case the new rules do not curb the prevalence of in-house provision, the rules may need to be tightened, including by requiring local administrations to provide proof of the beneficial effects before the contract is awarded rather than ex-post.

While there has been progress in reducing operational restrictions in the retail sector, restrictions on promotional sales of physical outlets and the opening of outlets remain comparatively high. Rules on opening hours have been completely liberalised at the national level, but rules on promotional sales and sales periods for physical retail outlets remain stringent relative to rules for online retailers. This may give an undue regulatory advantage to online retailers irrespective of their competitive position and thereby negatively impact productivity. Red tape regarding the opening of new businesses has been cut significantly through the digital “business in one day” platform, but the size threshold above which an administrative authorisation is needed to establish an outlet is relatively low compared to the OECD average.

1.5.3. Boosting the efficiency of the tertiary education system

Long-standing weaknesses in tertiary education and basic research prevent Italy from fully taking advantage of potential productivity gains from ongoing technological change. The share of young people who are neither in education, employment or training (NEET) is among the highest in the OECD, with adverse effects on labour-market relevant skills in the long run (Figure 1.29, Panel A). The share of university graduates in the population aged 25-34 years is the second-lowest in the OECD after Mexico, and many recent graduates emigrate. Between 2011-2021, cumulated net emigration of recent university graduates amounted to about 110,000 people, equivalent to around one-third of an annual graduate cohort. Temporary professional spells abroad can enhance skills and result in a net brain gain when temporary emigrants return. But in Italy emigration at younger ages does not appear to be reversed by net return migration at older ages (Figure 1.29, Panel B), suggesting that there is significant brain drain. Despite some progress over the past years, the quality of Italian universities, as measured – albeit imperfectly – by the number of universities among the global-200, lags behind other large European countries, most notably France, Germany, and the United Kingdom (Figure 1.29, Panel C). Poor outcomes from tertiary education partly reflect low levels of funding, with expenditure per student being about 30% lower than the OECD average (OECD, 2022), but there is also scope to make the system more efficient. For instance, Portugal achieves substantially better outcomes at broadly equivalent per-student funding rates.

Figure 1.29. Low skills are holding back innovation and digitalisation

A. NEET rate, 15-29 year old, 2022

B. Net emigration of Italian university graduates

Age < 40 Age > 40

C. Number of universities among top-200 universities, 2024

Source: OECD (2022b); Istat; QS World University Rankings.

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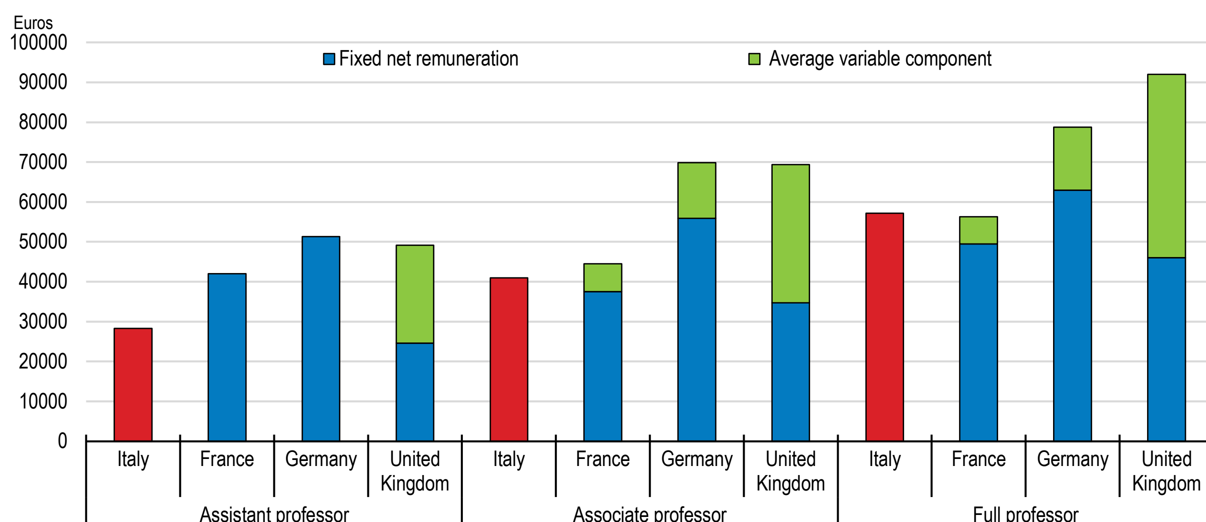
A renewed focus on developing high-quality post-secondary technical education, including dual education models, enhancing student orientation and increasing alignment of tertiary education curricula with labour market needs would increase the efficiency of tertiary education spending. This includes the expansion of advanced technical schools (*ITS Academy*) that provide 2 or 3-year professionally-oriented technical programmes in close cooperation with regional businesses. The *ITS Academy* schools, if well-resourced and run, have the potential to attract into education youth populations who are currently unable or not interested in attending university and may also be able to address issues around low technical skills and contribute to improving job prospects for tertiary graduates. Moreover, they allow students to enrol in universities after graduation, building a bridge between educational paths. The employment rate of graduates from the *ITS Academy* schools is about 90% one year after graduation. To increase enrolment from the currently low levels (around 20,000 registered students in 2022), available funding in the NRRP should be fully used.

While employment rates of tertiary graduates have continued to increase over the past years, ongoing measures to improve the job prospects of recent graduates should be continued and strengthened. This includes ongoing measures to improve students' orientation, initiatives to provide students with psychological support, and a reform of degrees aimed at introducing more flexibility and multidisciplinarity

in the academic path. The recent reform of doctoral programmes to respond to current innovation needs, promote researchers' recruitment by businesses and make educational paths increasingly oriented to labour market needs is a further positive step that should be continued. In the medium term, the authorities could also consider re-allocating funds from parts of the tertiary education system that lead to poor graduate labour market outcomes despite recent reforms to the *ITS Academy* to durably raise capacity.

Universities would also be improved by further strengthening evaluation mechanisms and expanding initiatives to attract more research talent from abroad, including Italian researchers working in foreign research institutions. Evaluation criteria for universities increasingly account for excellence and relevance of research, such as the size of awarded competitive international grants and technological transfers to universities. Since 2018, the Departments of Excellence programme awards dedicated funding to public universities to support the strategic development of their best departments. This will require more attractive working conditions and a substantially stronger link between performance and pay. Average pay of Italian researchers is low compared with France, Germany, and the United Kingdom, especially at the entry level (Figure 1.30). This discourages talented researchers from entering academic careers, depriving Italian universities of top research talent. Moreover, Italy's university system is unique among its peers in offering no variable pay component (Civera et al., 2023). Introducing a pay supplement linked to performance in research and other core activities would raise average pay and strengthen performance incentives at limited cost. Differentiating salaries to account for large cost-of-living differences across the Italian territory would raise the attractiveness of taking up research and academic positions in the country's north.

Figure 1.30. Performance incentives of university professors are weak



Note: Assistant professor: Ricercatore a tempo determinato B (Italy); attaché temporaire denseignement / recherche (France); Junior Professor (Germany); lecturer (United Kingdom); Associate professor: Professore Associato (Italy); maître de 55nclusion55s (France); W2 Professor (Germany); senior lecturer / associate professor (United Kingdom); Full professor: Professore Ordinario (Italy); professeur des universités (France); W3 Professor (Germany); professor (United Kingdom)
Source : Istat (2023) ; Civera et al. (2023)

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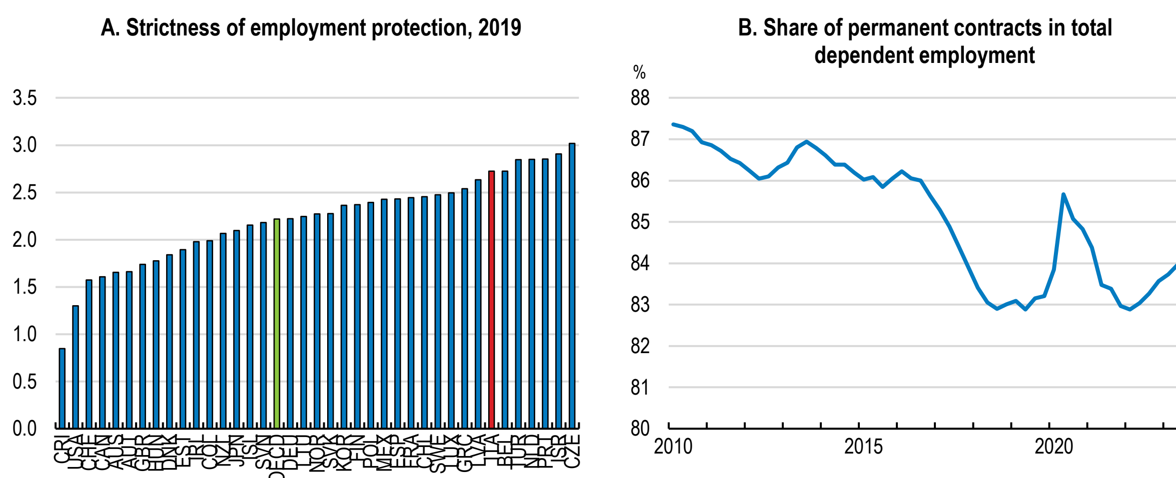
1.5.4. Re-deploying workers to high-productivity businesses

Improving the allocation of labour would raise productivity growth by allowing the most innovative businesses to expand and attract workers from low-productivity ones. In Italy, employment protection of regular workers remains strict, especially in businesses with more than 15 employees (Figure 1.31, Panel A). While the automatic re-instatement of workers in case of unfair dismissal was abolished by the Jobs Act of 2015, the Constitutional Court ruled against new rules establishing a linear link between years of

service and compensation for unfair dismissal (2 months of salary for each year of service). The ruling gives judges discretion over the amount of compensation within a range set by the law that is independent of length of service. For firms with more than 15 employees the range is set between 6 and 36 months, which re-introduces an element of legal uncertainty and reduces larger businesses' incentives to hire on permanent contracts while discouraging smaller firms from growing. Overall, the share of permanent contracts in early 2023 was lower than in 2015 (Figure 1.31, Panel B). Linking the range of compensation for unfair dismissal to length of service – the minimum and maximum amount of compensation should increase with length of service – would allow judges some discretion over the amount of compensation and may thus be in line with constitutional rules. Providing that the ranges are set sufficiently narrowly, this setup would allow for more legal certainty than the current one. By contrast, easing the rules on the extension of temporary contracts beyond a duration of 12 months, as recently legislated, may further aggravate the duality of the labour market, trapping some temporary workers in low-productivity and low-wage jobs (OECD, 2018a).

Figure 1.31 .The share of permanent contracts in total employment is below the level in 2015

Share of permanent contracts in total employment, %



Note: The OECD indicators of employment protection legislation evaluate the regulations on the dismissal of workers on regular contracts. Panel A shows the values for individual dismissals.
Source: OECD Employment Protection Legislation Database; Istat.

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The use of non-compete clauses in employment contracts may prevent workers from moving to competing businesses. Italian legislation provides for clear limits on the use of non-compete clauses, with undue use being legally unenforceable. Despite this, recent evidence based on a small survey of 2000 workers suggests that about 16% of Italian workers are subject to non-compete clauses in employment contracts, most of which would be legally unenforceable (Boeri et al., 2023). This may nonetheless deter some workers with insufficient information about enforceability from moving to competing businesses. More comprehensive surveys will be needed to draw firm conclusions, but if this estimate proved accurate, it would represent a strikingly high proportion of workers. While non-compete clauses may be justified for highly specialised workers to prevent the leakage of trade secrets, it is highly implausible that they are needed for a significant proportion of the workforce, including low-qualified and low-wage workers. A range of OECD countries, including Portugal, the United Kingdom and the United States, have issued guidelines on non-compete clauses for employers in order limit their use to justified cases. The Italian competition authority could be tasked with issuing similar guidelines and strengthen advocacy in this area.

1.6. Raising labour market participation and making growth more inclusive

The poverty rate is above the OECD average, partly reflecting low employment rates, especially of young people and women, and the traditional weakness of the social safety net (Figure 1.32). The youth unemployment rate has come down to about 23% since the mid-2010s but remains among the highest in the OECD, while the female labour market participation rate (about 52%) remains well below the OECD average, despite the significant increases over the past two decades. The Citizen's Income (*Reddito di cittadinanza*), a minimum income programme that was rolled out in 2019, played a useful role in protecting vulnerable households from falling into extreme poverty during the COVID-19 pandemic (Istat, 2022). However, it lacked well-developed activation measures to encourage and support people to return to work, and the social benefits were insufficiently targeted to those who were most in need of support (Pacifico and Scarpetta, 2021; Hyee et al., 2020). Effective tax rates of taking up employment at low earnings levels were 100%, much higher than in other countries with large minimum income schemes, such as France and the United Kingdom, where the tax and benefit system provides better incentives for labour market participation. The recent replacement of the existing minimum income scheme (Citizen's Income) with a new scheme that aims to improve the targeting of the national social assistance programme and strengthen work incentives. The new scheme includes two new separate programmes: a social assistance scheme for households with specific care responsibilities (minors, seniors or disabled people) called *Adi* and a training allowance for adults aged 18-59 who actively participate in an active labour market programme, called *Sfl* (Box 1.5).

Figure 1.32. Employment is low and the poverty rate is above the OECD average

Source: OECD Income Distribution database, OECD Annual Labour Force Statistics database.

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Box 1.5. Recent reforms to social assistance

The new social assistance scheme (*Assegno di inclusione*, Adi) for those with specific care responsibilities will be similar to the previous Citizens' Income introduced in 2019 (Table 1.8). The benefit will amount to €500/month multiplied by an equivalence scale that accounts for household size plus a rent supplement of up to €280/month. As in the Citizen's Income, only the household member with "intense" care responsibilities will be exempted from activation and work availability requirements. The maximum duration of Adi will be 18 months, with illimited possibilities for renewal for periods of 12 months. According to simulations in Maitino et al. (2023), about 50% of current Citizen's Income recipients will be eligible for the new Adi.

For low-income households and adults without care responsibilities, the reform foresees the introduction of a training allowance (*Supporto per la formazione e il lavoro*, Sfl). The allowance is paid only while participating in an active labour market programme. It amounts to €350/month and can be claimed by several individuals within the same household. Additional labour income related to the take-up of employment during the year will be exempted from the calculation of benefit eligibility up to an annual ceiling of €3000. The benefit will be subject to strict conditionality, both in terms of participation in activation measures and availability for work. The maximum duration of the benefit will be 12 months with no possibility for renewal.

Table 1.8. Recent reforms to social assistance

		Previous Reddito di cittadinanza (RdC) scheme	New Assegno di inclusione (Adi) regime	New Supporto per la formazione e il lavoro (Sfl) regime
Eligibility	Demographic characteristics	None	At least one household member <18 years, >60 years, or disabled	Age 18-59, no disability, no specific care responsibilities
	Equivalised household income ceiling (ISEE)	<9360€	<9360€	<6000€
	Wealth ceiling[1]	Secondary residence<30000€, other wealth<10000€	Primary residence<150000€, other immovable property <30000€, other wealth<10000€	Primary residence<150000€, other immovable property <30000€, other wealth<10000€
	Residence requirements	>10 years	>5 years	>5 years
Conditionality	Work availability	Registration with the public employment service for employable household members and acceptance of suitable job offers	Same as RdC but stricter definition of suitable job offer: a/ wage>minimum collectively bargained wage; b/ distance<80km; c/ duration>1 month; hours>60% of full-time job	Same as RdC but stricter definition of suitable job offer: a/ wage>minimum collectively bargained wage; b/ distance<80km; c/ duration>1 month; hours>60% of full-time job
	Participation in ALMP	Yes, depending on the activation plan	Yes, depending on the activation plan	Yes
Benefit	Maximum benefit before multiplication with equivalence scale	500€/month + 280€/month rent supplement	500€/month + 280€/month rent supplement	350€/month
	Equivalence scale (adjustment for household structure, ES)	<2.2	<2.3	=1 (each household member between 18-60 years can receive the benefit)
	Effective monthly benefit	500€*ES + 280€ rent suppleme–t - household income	500€*ES + 280€ rent suppleme–t - household income	350€/month
	Treatment of additional labour income related to take-up of employment	Earnings disregard of up to 20% of additional income in calculation of effective benefit	Suspension of benefit in case of short-term contract (1-6 months); earnings disregard of 3000€ in calculation of effective benefit	Suspension of benefit in case of short-term contract (1-6 months); earnings disregard of 3000€ in calculation of benefit eligibility

1. The ceiling for "other wealth" refers to a 3-person household.
Source: OECD Tax-Benefit database.

The non-renewability of the Sfl benefit, regardless of the recipient's level of economic vulnerability, and the requirement to participate in an active labour market programme imply that, in contrast to the Citizen's Income, the Sfl is a training participation allowance rather than a standard minimum income benefit. Sfl recipients do not automatically become eligible for the Adi once the Sfl expires. According to simulations in Maitino et al. (2023), about 20% of current Citizen's Income recipients will be eligible for the Sfl for 12 months.

The introduction of the training allowance (Sfl) that will replace the Citizen's Income for employable people – people aged between 18-59 and without specific care responsibilities – may strengthen work incentives by reducing benefit generosity and duration, as well as by imposing strict conditionality. It could also result in fiscal savings of about 1% of GDP in the short term (Maitino et al., 2023). But the Sfl risks doing so at the cost of increased poverty of beneficiaries, especially those who cannot access suitable training or who have reached the maximum duration of the benefit. The unavailability of a rent supplement in the Sfl may also have adverse effects on poverty. In order to strengthen the reform's impact on labour market participation while mitigating the risk of higher poverty, the authorities should improve work incentives and activation policies while maintaining access to social protection for those unable to find employment.

Financial incentives to take up work should be strengthened. Lifting the suspension of both *Adi* and *Sfl* for recipients taking up short-term jobs and making the withdrawal of benefits in case of increased earnings more gradual, as for instance in the United Kingdom's Universal Credit system, would reduce the effective tax rate on taking up work. The fiscal cost of these measures would be modest, given benefit recipients' limited average earnings potential. Financial incentives for taking up work could further be improved by linking the size of the benefit to the local cost of living, which varies widely across Italian regions. According to data by the social security institute, in the south of the country the Citizen's Income benefit was higher than the net labour income of 45% of private sector employees (INPS, 2019). A first step would be to link the ceiling for the housing benefit to the local cost of living, as is for instance the case in Finland and Sweden.

A key issue for the success of the reform will be to strengthen active labour market policies to reduce barriers to employment for vulnerable people. This will require decisively boosting the training system (OECD, 2019b). The creation of a new digital platform (*Sistema Informativo per l'Inclusione Sociale e Lavorativa*, SIISL) is a positive step that may facilitate the matching of job seekers and employment service providers by consolidating databases, including by unifying regional databases on job and training offers and making them available to social benefit recipients. The funding of about 2½ percent of GDP available through the NRRP for a new programme (*Garanzia occupabilità dei lavoratori*, GoI) to strengthen lifelong learning is a positive step but needs to be complemented with rigorous quality control for training providers (OECD, 2021e). In particular, the authorities should consolidate the 21 regional-level accreditation frameworks for employment service providers in a single national-level one to ensure that providers active on the new SIISL platform meet minimum quality standards. Moreover, the existing *Assegno di ricollocamento* programme – that provides labour agencies with a voucher that increases with individuals' distance from the labour market and that can only be cashed if the individual finds a job for a minimum period of time – should be improved and expanded. More generally, the training requirements for Sfl recipients should be ambitious and account for both job seekers' skills and labour market needs. Currently, participation in any training course, irrespective of the number of monthly hours or labour market prospects, qualifies as satisfying the training requirements of the Sfl. Training courses that amount to few hours per month or that do not improve the employability of the recipient should not qualify as satisfying the training requirements of the Sfl.

Access to social protection could be improved by better accounting for benefit claimants' labour market prospects. The reform deems any person between ages 18-59 years without disabilities and without specific care responsibilities employable. But only about 20% of Citizen's Income recipients who were employable according to this definition had a job in 2022 and about 60% had not been employed over the

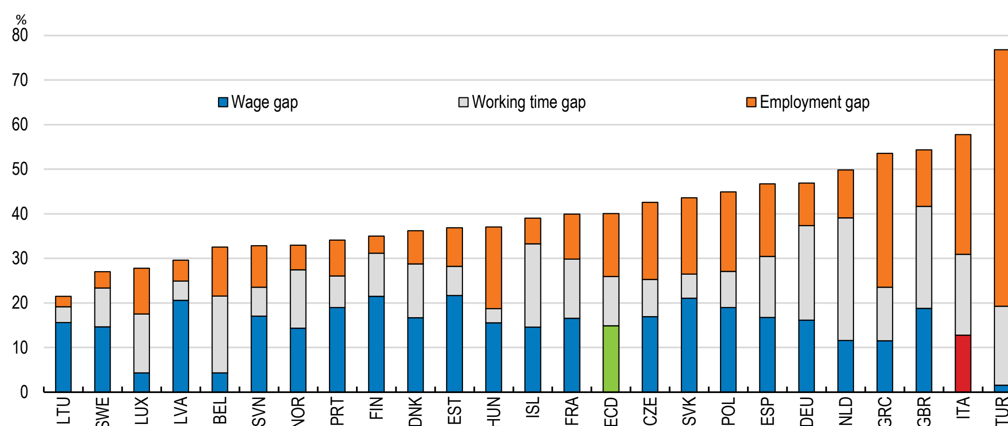
previous 3 years (Anpal, 2022). This suggests that a large share of Citizen’s Income recipients who are deemed employable by the reform are actually very distant from the labour market. To address this issue, the authorities could use existing quantitative profiling tools (Anpal, 2023) to estimate individual-level employability scores and direct people with very low scores to the social services for an in-depth multidimensional assessment. If the social services confirm the profiling tool’s estimate, claimants could be given access to the Adi, possibly at a lower benefit level, irrespective of whether they have specific care responsibilities. All other claimants could be directed to the employment services and apply for the Sfl. Beneficiaries of the Sfl who are unable to find employment after 12 months could be re-assessed by the social services and either granted access to Adi at a lower benefit level or directed to re-apply for the Sfl. This setup would ensure that limited funds available for training are targeted to employable people while ensuring that non-employable people are covered by the social safety net. Streamlining the application process for the Sfl that currently requires registration across a variety of agencies and websites would limit the risk that vulnerable people with low digital skills are inadvertently excluded from the benefit.

Specific measures will be needed to raise the labour market participation of women. Female labour market participation is among the lowest in the OECD, especially in the south of the country (OECD, 2019a), and many women work part-time and earn lower hourly wages than men with similar qualifications (Figure 1.33). To some extent this may reflect gender stereotypes that may influence educational and occupational choices (Bertrand, 2020), or employers’ conscious or unconscious biases that may lead to the perception that the average woman is less productive than the average man. According to this explanation, gender gaps reflect “sticky floors”, for example. persistent disadvantages over women’s working lives from labour market entry to retirement (Ciminelli et al, 2021). In Italy, girls choose high school tracks and university majors with significantly worse labour market prospects than boys, even though they outperform boys in education (Carta et al., 2023). These choices largely reflect cultural norms and gender stereotypes and could be addressed by exposing students to positive role models (women working in STEM jobs or occupying high-level positions) and raising awareness of parents and teachers to stereotypes in the media and in the materials that parents and educators use to raise children. A number of European countries, including Belgium, Finland, France, Norway and the United Kingdom, have introduced legislation that aims to limit the use of gender stereotypes in advertising.

Family and labour policies also contribute to the prioritisation of unpaid home work over formal employment, especially where social norms and gender stereotypes still view women as the primary caregivers. In Italy, access to early childhood education is limited, with enrolment at around 26% well below the OECD average of 36% (OECD, 2023a), which makes it challenging for women to return to work after childbirth. Women are also over-represented in informal long-term care for the elderly, accounting for about two-thirds of informal caregivers (Brugiavini et al., 2023). Moreover, female career paths may not allow them to accumulate human capital at the same rate as men, e.g. because they interrupt their careers after childbirth, spend less time at the workplace than their male peers or forego promotions. While income taxes based on individual income rather than joint income of the household and the recent introduction of a cash benefit for parents with a supplement for second earners (*Assegno Unico Universale*) incentivise female labour market participation, the tax and benefit system as a whole remains favourable to single-earner households (Carta et al., 2023). This largely reflects social benefits that are conditional on household income and the dependent spouse tax credit, which should be phased out.

Figure 1.33. The labour income gap between men and women is among the highest in the OECD

Men – women, %, 2018



Note: The labour income gap is defined as the sum of differences in female hourly earnings, hours worked and employment rates relative to men.
Source: Eurostat Structure of Earnings Survey; OECD Labour Force Statistics.

Box 1.6. Estimated GDP impact of selected structural reforms

The following estimates quantify the cumulative GDP impact of reform scenarios by 2050 and are illustrative.

Table 1.9. Illustrative GDP impact of selected recommendations

Structural reform	Scenario	Long-run effect on the level of GDP per capita (2050)
Improve the efficiency of civil justice	Close half of the gap with the OECD average by 2060.	+1.6%
Improve the efficiency of the public administration	Close half of the gap with the OECD average by 2060.	+1.3%
Strengthen product market competition, especially in services	Close half of the gap with the top-5 performers by 2031.	+1.6%
Strengthen enrolment and quality of tertiary education	Raise educational attainment by 0.5 years by 2060 relative to the baseline.	+1.5%
Improve the quality of active labour market policies	Spending per unemployed increases by 10% by 2031 relative to the baseline.	+1.0%
Raise female labour market participation	Female employment rate increases by 1.5 percentage points by 2050 relative to the baseline.	+1.0%
Total		**+8.0%**

Source: OECD Long-term Model.

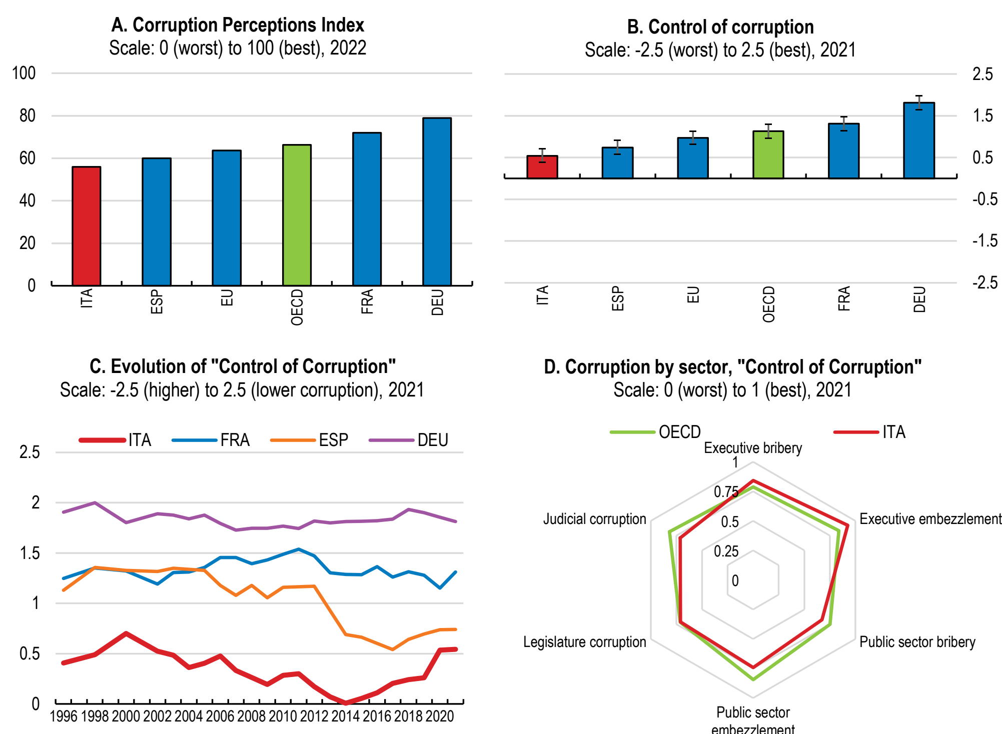
Narrowing gender gaps in the labour market is a priority of the NRRP. Plans in the revised NRRP to construct new early childhood education centres for 150,000 children should be swiftly and fully implemented. Reaching an early childhood education coverage of 45% by 2030 may require an additional expansion of early childhood education on top of that planned in the revised NRRP. Fiscal savings should be identified elsewhere to cover additional funding needs and the centres' operating costs in the medium term. There may also be a need to ramp up training to ensure that a sufficient number of teachers is available once the new childhood education centres become operational. Assuming class sizes of 7-10 children, between 15,000-21,000 new teachers may be needed to meet the objectives of the revised

NRRP. The authorities could also introduce measures to further incentivise paternity leave, including by introducing a “father quota” in the shared parental leave entitlement (currently 10 months) that can be used only by the father, or extending the number of “bonus months” if the father takes a minimum proportion of the family entitlement. The current Italian legislation already provides for 1 month of additional parental leave if the father takes at least three months of leave. This could help to share the burden of childcare, allowing both parents to work, as well as changing perceptions of the role of men and women. Public and private training providers could be required to provide training courses specifically targeted to women wishing to return to work after an extended maternity leave. Focusing on digital skills can be crucial in that respect, as barriers to access and low affordability of digital education as well as inherent biases and socio-cultural norms often limit girls’ and women’s scope to benefit from the opportunities offered by the digital transformation (OECD, 2018b). Expanding long-term care facilities for the elderly would further reduce informal caregiving responsibilities, which could reduce barriers to female labour market participation, although the impacts on the public finances would have to be taken into account.

1.7. Efforts to fight corruption need to be continued

Corruption reduces fiscal revenues and holds back productivity growth by distorting the allocation of resources. Recent evidence suggests that sales and employment growth in politically-connected Italian businesses is higher than in politically-unconnected ones, but productivity growth is not (Akcigit et al., 2023). While administrative measures to control corruption may lead to the re-allocation of resources to the most productive firms rather than politically connected ones, excessively stringent administrative measures for corruption control risk raising the cost of doing business, especially for small and medium-sized businesses that have limited capacity to navigate complex administrative systems.

Figure 1.34. Perceived corruption is above the OECD average



Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the “Control of Corruption” indicator by the Varieties of Democracy Project.
Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v12.

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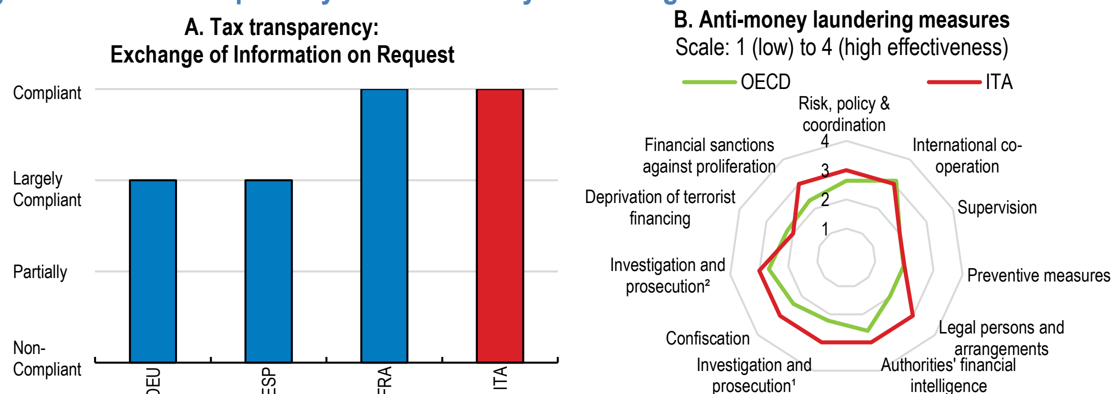
Perceived corruption in Italy is above the levels in other EU and OECD countries (Figure 1.34) While perceived corruption increased from the early 2000s to the mid-2010s, there has been a marked improvement thereafter that coincided with the creation of the independent anti-corruption agency (ANAC) in 2014. Perception-based indicators do not provide a comprehensive picture of corruption, since they can be influenced by cross-country differences in the interpretation of what constitutes corruption and are heavily influenced by media coverage of corruption around the date of the survey (Rizzica and Tonello, 2020). While there is thus some uncertainty around the precise country ranking of Italy in terms of corruption, the overall picture suggests that corruption is likely to be somewhat higher than in most western and northern European countries.

Figure 1.35. Tax transparency and anti-money laundering measures are effective



Note: Panel A summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdicti'ns' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows results from the ongoing second round when available, otherwise first round results are displayed. Panel B shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a coun'ry's measures are effective against 11 immediate outcome". "Investigation and prosecuti"n1" refers to money launderin". "Investigation and prosecuti"n2" refers to terrorist financing.

Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

https://stat.link/nyvljh

The authorities' two-pronged anti-corruption strategy combines a focus on prevention with repression. The prevention strategy builds on strengthening transparency on public accounts, including public procurement, and the appointment of civil servants. The independent anti-corruption agency (ANAC) is tasked with monitoring, sanctioning, and the definition of a national three-year anti-corruption plan. In terms of tax transparency, which reduces the scope for tax evasion, Italy is fully compliant, and anti-money laundering rules are effective (Figure 1.35). The prevention strategy is complemented with a repression strategy that provides for penalties for a broad range of corruption offences. While the overall framework is broadly in line with best practice, more could be done to mandate the disclosure of ultimate beneficiaries of public procurement contracts. On the repression side, recent legislation to strengthen whistle-blower protection is welcome and should be fully implemented. One useful approach to tackling the root causes of corruption would be to require mandating the mobility of public servants to reduce entrenchment in positions with excessive discretion over administrative procedures, including at local level where this not the norm. In addition, simplifying and digitalising administrative procedures as much as possible could help to reduce bureaucrats' discretionary room for manoeuvre. Re-assessing the public procurement thresholds above which public auctions become mandatory in the recent public procurement reform (Section 1.4.1) may reduce risks of corruption and collusion among bidders to which public procurement, including in the context of infrastructure projects, is vulnerable (OECD, 2016a).

1.8. Key Policy Insights recommendations

MAIN FINDINGS	RECOMMENDATIONS
Transition from fiscal policy support to fiscal prudence	
Public debt is on an upward trajectory at 2024 policies, limiting fiscal policy space.	**Steadily consolidate the public finances starting in 2025 to put debt on a more prudent path.**
Delays in the implementation of public investment projects under the NRRP risk reducing growth. Authorities have taken action to speed up implementation.	**Re-focus the NRRP on large and centrally managed investment projects that can be delivered, as foreseen by the revised NRRP.** Continue expanding technical assistance to local administrations and the hiring of specialised personnel.
The financial health of banks has improved over the past decade, but risks are rising. Banks and insurance companies remain exposed to domestic sovereign debt, with the life insurance segment of the insurance sector experiencing net financial outflows.	Continue to closely monitor rising interest and credit risk as financial conditions tighten and activity slows. Continue to monitor the evolution of securitised NPLs.
Bring debt on a more prudent path	
Fiscal consolidation will require measures to limit the growth of public spending and enhance its efficiency over the coming years. Public spending is heavily skewed towards pensions and interest payments, which are set to increase over the next two decades.	Phase out early retirement schemes. **Introduce a solidarity contribution for high pensions that are not due to high contributions.** **Make the fiscal savings targets of the forthcoming spending reviews more ambitious.**
The share of labour taxes in total revenue is higher than in OECD peers, while VAT collected and inheritance taxes are lower. A significant share of revenues is lost to tax evasion. The income tax base is eroded by costly tax expenditures. A recent enabling law foresees a comprehensive tax reform.	**Shift taxes from labour to property and inheritance, while ensuring that revenue is maintained or increases.** Update the property tax base calculations, taking into account distributional impacts. **Continue to tackle tax evasion, including by continuing to promote the use of digital payments and reversing the increase in the ceiling on cash transactions.** **Phase out costly tax expenditures that lack economic or distributional justification, including, for instance, by limiting the coverage of the dependent spouse deduction.**
The public administration is perceived as less effective than in most other OECD countries despite past and ongoing reforms. Ongoing reforms aim to improve human resources management and to reduce the administrative burden, including in the area of public procurement.	Continue strengthening the link between civil servants' performance, career progression and pay.
Raise potential GDP by enhancing productivity growth	
The efficiency of the judicial system is weak, contributing to low productivity growth. The ongoing comprehensive civil justice reform aims to promote digitalisation, streamline procedures, and unburden judges through the creation of trial offices.	**Continue strengthening the links between judges' performance, career progression and pay, and ensure that performance evaluation is thoroughly implemented.**
Productivity growth is particularly weak in services, partly reflecting regulations that stifle competition, especially in professional services.	Implement the competition reform legislated in 2022, including by submitting concessions to public tenders at expiry. **Reduce the scope of "fair compensation" rules in professional services.**
Low tertiary education enrolment and graduation rates hold back innovation and digitalisation.	**Continue to expand technical tertiary schools (ITS Academy).** Continue improving student orientation and aligning curricula with labour market needs.
The labour market does not sufficiently support the allocation of workers to high-productivity businesses, with micro businesses accounting for a large share of employment.	Reduce legal uncertainty for employers by linking the range of compensation for unfair dismissals to length of service.

MAIN FINDINGS	RECOMMENDATIONS
Raise labour market participation and make economic growth more inclusive	
Employment rates are low, partly due to weak financial incentives for social benefit recipients to take up employment. A reform of social assistance is underway.	**Make the withdrawal of benefits under the Adi and Sfl programmes more gradual in case of taking up employment.** Link the ceiling of the rent supplement to the local cost of living. Require beneficiaries of the training allowance (Sfl) to spend a minimum number of hours in training. **Expand access to the new social assistance benefit (Adi), including for people with very weak labour market prospects.**
Vulnerable people face barriers to employment, partly due to weaknesses in active labour market policies. The NRRP provides funding for a new lifelong learning programme.	Improve quality control for training providers by introducing a national-level certification scheme.
Labour market participation of women is among the lowest in the OECD, partly reflecting low availability of early childcare, parental leave policies and weaknesses in active labour market policies.	**Significantly expand coverage of early childhood education.** **Incentivise paternity leave by introducing a "father quota" or increasing the number of "bonus months" for leave taken by fathers.**
Continue to fight corruption	
Perceived corruption has declined markedly since the creation of the independent anti-corruption agency in 2014 but remains an issue.	Assess the impact on corruption of the new thresholds above which public procurement auctions become mandatory and reduce them if necessary. **Mandate the mobility of public servants within their administration, including local administrations.**

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