



“Better Policies” Series

ITALY

REVIVING GROWTH
AND PRODUCTIVITY

SEPTEMBER 2012



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OECD “Better Policies” Series

The Organisation for Economic Co-operation and Development (OECD) aims to promote better policies for better lives by providing a forum in which governments gather to share experiences and seek solutions to common problems. We work with our 34 members, key partners and over 100 countries to better understand what drives economic, social and environmental change in order to foster the well-being of people around the world. The OECD Better Policies Series provides an overview of the key challenges faced by individual countries and our main policy recommendations to address them. Drawing on the OECD’s expertise in comparing country experiences and identifying best practices, the Better Policies Series tailor the OECD’s policy advice to the specific and timely priorities of member and partner countries, focusing on how governments can make reform happen.

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Foreword

Over the past two years, Italy has made a tremendous effort to speed up long overdue structural reforms. These reforms have been courageous, ambitious and wide-ranging. They include key improvements of the medium-term fiscal framework and the labour code, some important liberalisation and simplification measures in product market regulation, and the anti-corruption bill, which is currently before parliament.

These reforms have been necessary given the impact of the financial crisis in Italy at a time of already underlying weak growth, waning competitiveness and high public debt. They are essential for Italy to succeed in the immense challenge of simultaneously putting public finances on a sounder track, reviving and modernising its economy, restoring competitiveness and promoting social cohesion. Success is not only essential for Italy but for Europe as whole. Conversely, as Italy is deeply affected by the wider euro area crisis, steps to improve co-ordination and expand the range of options available to the EU and the European Central Bank would strongly benefit Italy and amplify the impact of these reforms.

As the overall economic outlook is deteriorating again and Italy's economic situation is weaker than expected a few months ago, the resolute implementation and continuation of these reforms, as well as continued fiscal consolidation efforts, will be essential.

Drawing on OECD member countries' experiences, this brochure presents an update of key OECD policy advice in areas that are critical to Italy's future. They include restoring public finance sustainability; facilitating the implementation of reforms; boosting productivity through better competition policies and regulations, including in the financial sector; promoting public sector integrity; making innovation and education policies more effective; and improving social cohesion through a better functioning labour market, stronger social mobility and higher female participation in the labour force.

This brochure also presents some analysis of the likely payoff of the ongoing reforms in productivity enhancement, economic growth, jobs and competitiveness. The reforms already approved could add up to an estimated 4% to GDP over the next 10 years. Continuing these reforms would bring even stronger gains. It is therefore essential not only to avoid the unravelling of already approved reforms but also to ensure continuity in the reform agenda going forward.

The OECD looks forward to continuing to work with Italy to design and implement these policies and make the post-crisis world economy stronger, cleaner and fairer.



Angel Gurría
Secretary-General, OECD

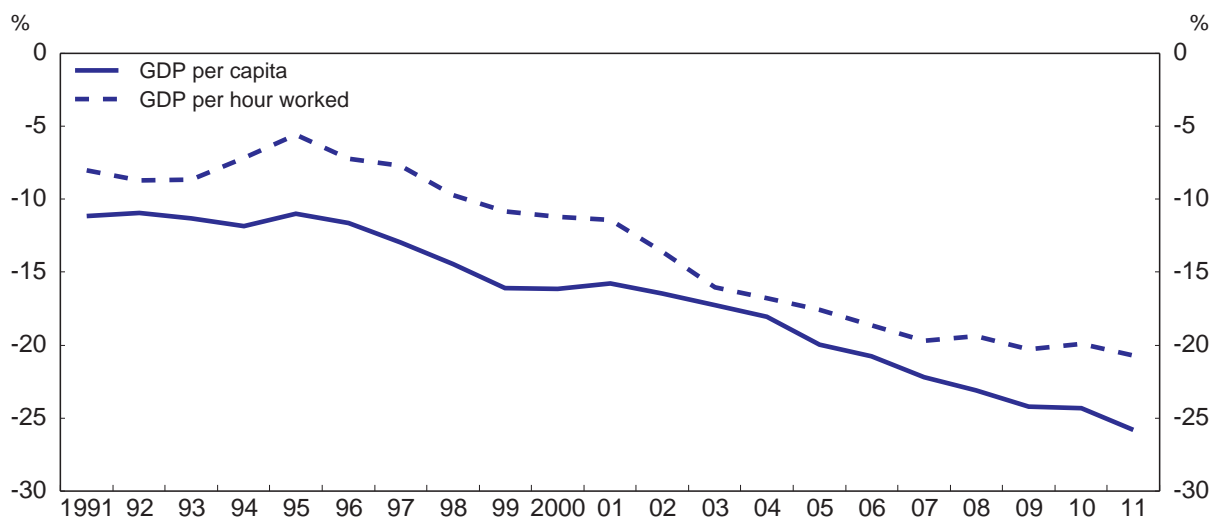
Maintaining the momentum for reforms

The global crisis has highlighted Italy's long-standing weaknesses. Its economy is currently suffering from a combination of intertwined difficulties that are fuelling each other: a poor underlying growth rate, high public debt, and limited lending power of its financial institutions. This is compounded by weak demand in trading partners and the persisting confidence crisis in the European monetary union, which is feeding negative feedback loops. In this context and as the pace of population ageing is accelerating, it is important to act quickly in a wide range of policy areas.

Since the current government took office a year ago, it has taken decisive and wide-ranging steps to deal with these difficulties and also improve Italy's longer-term prospects. Still the crisis has not yet

subsided and the economy is now looking weaker than expected a few months ago. The success of Italy in overcoming these challenges will be decisive not only for the Italian people but for Europe as a whole.

Figure 1. Income and productivity have fallen behind the average of more affluent OECD countries



Note: Percentage gap with respect to the simple average of the highest 17 OECD countries (in constant 2005 PPPs).

Source: OECD National Accounts Database.

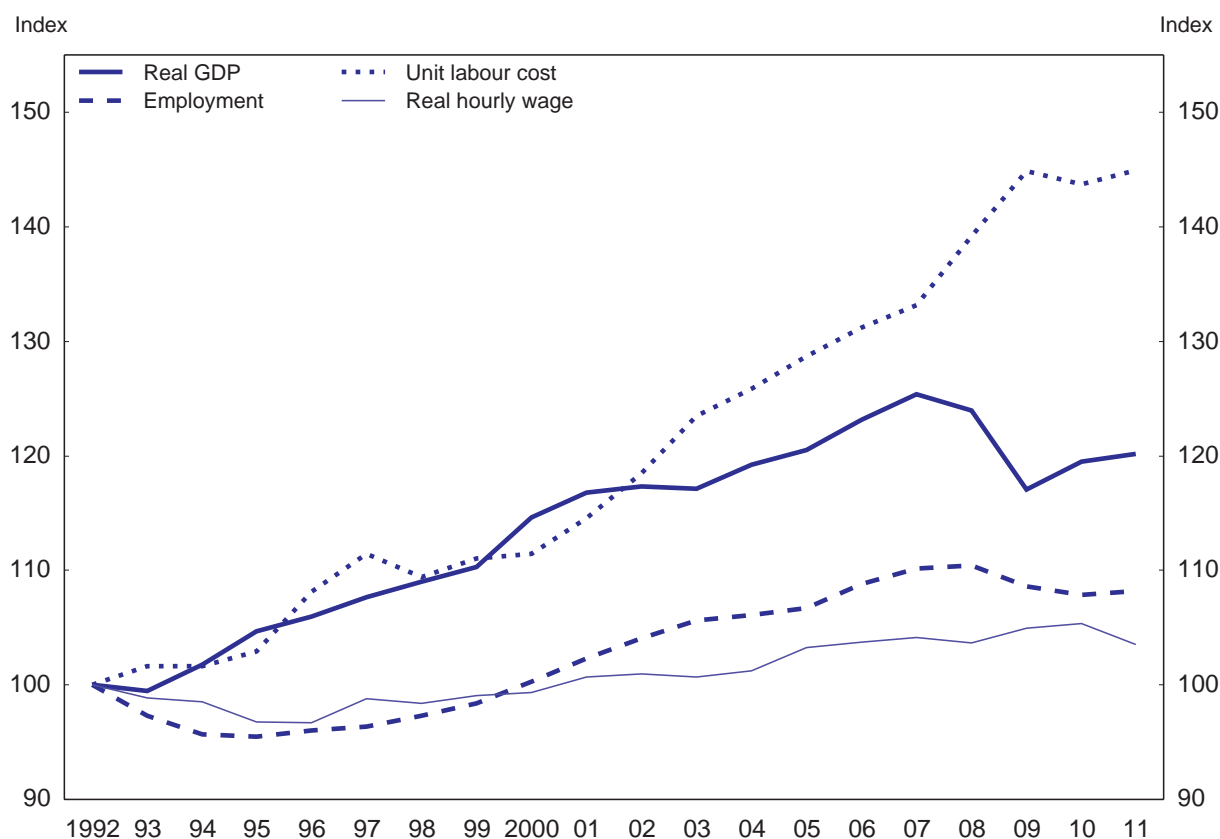
A long-term relative decline compounded by the crisis

The global crisis hit Italy at a time when it was already experiencing a protracted period of very low growth and persistently high public debt. After a fast catch-up towards the richest OECD countries between 1970 and 1995 (when GDP per capita rose 86%, significantly above the 67% increase in the richer half of the OECD) convergence has reversed, and Italy has been falling steadily further behind the more affluent OECD countries (Figure 1). This relative decline is largely explained by extremely weak labour productivity growth which was held back by an unfavourable innovation and business environment and insufficient human capital

accumulation. From the late 1990s until the crisis, progress to address these weaknesses was slow, and often resisted and undermined by interest groups. With stagnant or negative productivity growth not fully reflected in wages dynamics, unit labour costs (ULC) were on a rising trend up to the crisis, undermining the competitiveness of the Italian economy and fuelling its external deficit (Figure 2). These issues of sluggish productivity growth and deteriorating competitiveness are explored further in the next chapter.

Figure 2. Change in GDP, unit labour cost, employment and wages in Italy ¹

Base 100 in 1992



1. Hourly wage rate is the ratio of total wages deflated by the consumer price index (base 100 in 2005) and divided by total hours worked. Unit labour cost is calculated as the ratio of total real labour costs to real output.

Source: OECD calculations based on the OECD Annual National Accounts Database.

Although short-term and part-time work supported employment up to the crisis while allowing for some flexibility, it has contributed to further segmentation of the Italian labour market, and has amplified the impact of the crisis on the most vulnerable groups, especially the youth.

On joining the euro in 1997, Italy committed to reducing the ratio of public debt to GDP from over 110% to 60%. However, progress has been slow, following a period of rapid decline in public debt, despite a large bonus in terms of reduced interest payments. Although efforts to tackle the fiscal situation resumed after the breakout of the global crisis, public debt remains among the

highest in the OECD (see chapter on “Securing fiscal sustainability”). In a context of a weak external environment and financial tensions in the euro area, negative feedback loops between the economic, fiscal, and financial difficulties have appeared. These weighed on growth and pushed Italy back into recession from late 2011. The persisting confidence crisis in the Euro area has added to the risk premium on Italian public debt. These developments have also put the banking system under stress. Reduced access to interbank markets have led to liquidity shortages and higher funding costs, requiring Italian banks to rely heavily on ECB financial support.

A comprehensive strategy ...

Against this backdrop and with the risk of contagion from the euro area crisis, fiscal consolidation and pro-growth structural measures must go hand-in-hand. The interconnection of fiscal, social, and growth challenges underlines the need to make progress on several fronts simultaneously to reap mutually reinforcing effects of different measures. Indeed, the impact of increased competition and better regulation would be magnified if a better functioning labour

market and more efficient training system facilitated the reallocation of resources across sectors and firms. Stronger and sustainable growth is necessary to create jobs, while at the same time generating public revenues and supporting fiscal consolidation. Restoring growth and sustainability is key, but preserving social cohesion is also essential. The burden of the adjustment should be shared in an equitable way. This requires favouring fiscal consolidation measures that are least harmful

to growth and social cohesion, as well as structural policy actions with least short-term and social costs.

Over the past year, major policy actions have also been devoted to enhancing growth potential, with some attention being paid to improving social protection. Recent reforms measures are in line with past OECD recommendations (see table below). They include restructuring regulatory bodies in network industries, increasing the powers of the competition authority, easing planning restrictions in retail distribution, reducing regulation of retailing and some services, rebalancing employment protection away from permanent jobs while giving relatively more protection for shorter-term employees, supporting apprenticeships, the phased introduction of wider social protection for the unemployed, as well as

... with potentially large benefits

The benefits of structural reforms are potentially large. If forcefully implemented recent reforms of the product and labour markets can produce significant payoffs. In a detailed analysis in its National Reform Programme (NRP), the Italian government has estimated that, over the period to 2020, the key measures to improve competition, cut regulatory costs and improve public administration efficiency taken up to the spring of 2012, could increase GDP growth by around 0.3% per year. OECD estimates suggest the impact, including some further measures taken after the NRP was published, might be slightly higher, 0.3-0.4% on the average growth potential over the same period,

Effective implementation of approved reform is essential

Overall, both fiscal and structural policies are on track to produce a gradual improvement in Italy's situation. Wider gains could be expected from continuing ongoing reforms which should be seen as a decisive, but only first, step forward. Further measures will also be needed to ensure these reforms are followed through and become effective, and that they help to reduce inequities in the labour market and promote greater social mobility.

While reforms of legislation are a major step forward, the next challenge will be implementation. Product market reforms provide an example of the challenge of effective reform implementation. OECD indicators

measures to improve public sector efficiency and integrity.

Along with continued fiscal restraint, these measures will help to reverse the negative feedback loop between growth, deficits and the cost of borrowing. Recent progress in strengthening the euro area crisis resolution mechanisms as well as progress towards banking and fiscal integration provides an important benefit in term of lower systemic risk which is reflected in lower spreads and financing costs. Reaping this benefit in full will, however, require the continued commitment to consolidation and reform from this and future governments. A comprehensive solution to the euro crisis including major improvements in the institutional design of the euro area, is essential for Italy to reap the benefits of these efforts.

though when the impact might be felt on actual growth is more difficult to determine. Combined with the labour reform, and the ongoing efforts to improve the quality of education and human capital, these reforms could add up to 4 percentage points to the level of GDP over a decade. Continuing these reforms would bring even stronger gains.

As productivity bounces back, and provided that wage moderation continues, lower unit labour costs could improve competitiveness. Enhanced competition, by lowering prices and business costs, should also contribute to this improvement. Non-cost competitiveness that depends on structural factors, innovation and specialisation should also improve.

of the degree of regulation in the Italian economy show that, in some policy areas, following reforms in the past two decades Italy has already – on paper – a relatively low burden of regulation compared with many OECD countries (see chapter on Strengthening competition and reducing regulation). On the other hand, these improvements do not seem fully reflected in measurements of perceptions and practical experience of the entrepreneurial environment.

First, there are some barriers to entrepreneurship, including those due to regional and local regulations, which are not well captured by the indicators and may limit the impact of reforms. These barriers are likely

one of the reasons why small firms in Italy, many of which are quite successful, rarely grow into larger companies. A significant factor, not reflected in the product market regulation (PMR) indicators, is the slow pace of civil justice. The length of time to settle a typical business dispute through the normal courts in Italy is much longer than in nearly all other OECD countries, increasing the cost of risk-taking and undermining confidence. An overhaul of the judicial system is essential to increase its efficiency. The use of mediation and arbitration, already provided in some cases by chambers of commerce, could be expanded. An important step already underway is restructuring the geographical organisation of the courts to take advantage of economies of scale. More specialisation of courts and judges, as currently planned by the government, should also improve efficiency. Further measures to reduce litigation and the backlog of cases are needed, and will need to take account of the drivers of supply and demand for civil justice, including incentives to prolong trials and the use of appeals. Improved court statistics, a removal of unnecessary restrictions on the use of electronic submission of claims and documents, and an improved system of evaluation of the courts would also contribute. Reducing the administrative burden of businesses would also help (see chapter on reaping the potential benefits of public administration reform).

Just passing legislation may be insufficient if it is not clearly written or if it depends on implementing regulations that may be delayed or which require action by other levels of government such as the regions. A stronger co-ordination between central and regional governments is essential to ensure that government legislation is fully implemented. There have sometimes been long delays between enabling legislation and its full implementation because necessary subsidiary legislation or regulation is controversial. The adoption by the government of the “chronoprogramma” which sets a timeline for the adoption of secondary legislation foreseen in the various Law Decrees (Salva Italia, Cresci Italia, etc...) to be adopted in the next 3 months is a step forward. At the same time, many policy areas, such as the environmental policy, have been subject to frequent changes which undermine effectiveness. A smaller number of more self-contained legislative acts, with fewer decree laws, could produce more progress and improve transparency, through better drafting and increased time for parliamentary scrutiny.

Ensuring more effective implementation of reforms will require more clearly-written and well thought-out drafting of legislation, less reliance on subsequent implementing regulations (which are sometimes never introduced), more transparency in the public administration and clear follow-up to ensure that practical improvements are achieved.

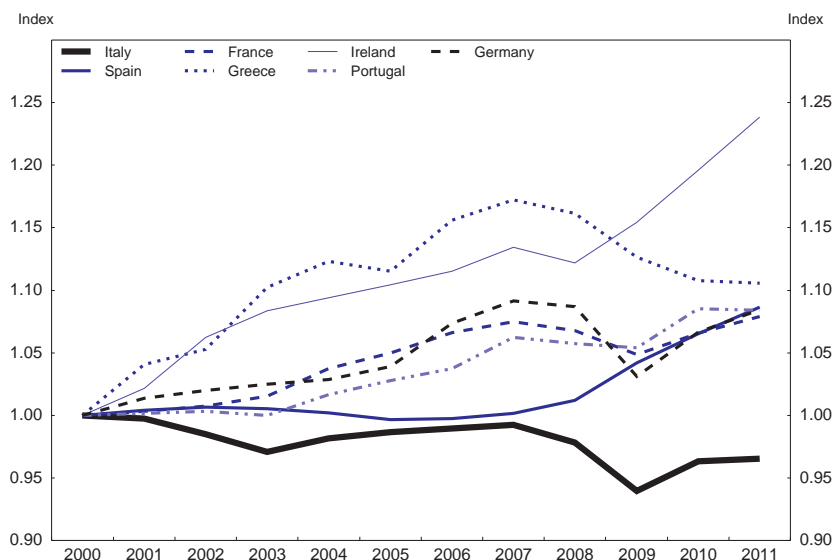
Policy areas, main recent OECD recommendations	Recent action (2012 unless otherwise indicated)
<p>Public sector efficiency</p> <p>Ensure competition for provision of public services.</p> <p>Widen use of performance indicators in public administration.</p> <p>Reinforce auditing mechanisms for regulatory and spending decisions.</p> <p>Improve efficiency in civil justice administration.</p> <p>Embed integrity and anticorruption tools within current structures of the Italian public administration</p> <p>Consolidate technical expertise in Italy’s Better Regulation bodies. Control the dynamics of regulatory inflation at regional level and focus on continuity and implementation of regulatory reforms.</p> <p>Monitor and evaluate progress towards administrative simplification, including through greater use of perception surveys.</p>	<p>Some measures in all these areas. In particular:</p> <p>Anti-Corruption bill before Parliament and creation of the Joint Committee among States, Regions and local authorities (2011).</p> <p>Changes in civil justice: (2011) increased court fees; monetary and other incentives to reduce backlog of court cases; (2012) creation of 20 specialised courts for some company law issues; introduction of some restrictions on appeals to appeal courts and supreme courts; reorganisation of judicial districts in order to close small courts and reduce public expenditure; more stringent conditions for awarding penalties for excessive length of trials.</p> <p>Restructuring of bankruptcy procedures, to better facilitate the continuation of business activity.</p> <p>Public administration in State and local governments are being restructured and employment is to be reduced. Use of performance management is to be expanded.</p> <p>Bureaucratic procedures for citizens and business are to be simplified, including by wider use of e-government tools, new administrative burdens to be avoided.</p> <p>Administrative reviews to improve the quality of public services and facilitate more rational spending within the public administration (2012)</p>

<p>Product markets</p> <p>Increase powers of competition agency. Reduce public ownership, especially in TV media, transport and energy utilities, local public services. Privatised and liberalise in energy and transport sectors. Remove unnecessary licensing in professional services. Remove quantitative restrictions on supply in services. Introduce national oversight of regional regulatory competences (e.g. retailing, land-use planning).</p>	<p>Competition agency has greater powers, new or overhauled regulators in network industries. Separation of ownership in gas supply and distribution Reduction of restrictions for some professional services. Relaxation of planning procedures in retailing.</p>
<p>Education</p> <p>Ensure the development of a comprehensive evaluation and assessment framework. Strengthen teacher quality. Improve the performance of vocational education and training system and provision of post-secondary vocational education. Improve business-academic research links. Increase student contribution to the cost of tertiary education, provide income-contingent-repayment loans. Support innovation in education. Promote early access to care of good quality. Prevent school failure and reduce dropouts</p>	<p>Improved sample testing of school students being progressively introduced (since 2010). Increased share of university funding allocated on performance indicators. Significant cuts in overall spending (since 2009). Recent experimentation with teacher evaluation schemes. National plan for the introduction of digital technologies in schools (ongoing).</p>
<p>Labour market</p> <p>Increase participation Reform permanent employment protection Reduce labour market duality Reduce tax wedge on labour income. Promote greater wage responsiveness to productivity</p>	<p>Tax incentives for female and youth participation. Comprehensive labour market reform (to be monitored) including: relaxation of employment protection rules, reduced incentives to hire on non-permanent contracts, stronger framework for apprenticeships, gradual introduction of a universal unemployment benefit. Social partners agreed in principle on greater wage differentiation (2009).</p>
<p>Boosting innovation</p> <p>Make science, technology and innovation policy more business-oriented and receptive to the varied needs across the whole spectrum of firms, including SMEs. Simplify and rationalise public support for business R&D and innovation, by achieving an appropriate mix of direct and indirect measures. Improve linkages between the business sector, universities and the public research system, including through mobility of researchers. Foster the creation and growth of start-up firms, by lowering regulatory barriers, simplifying bureaucracy, and supporting the collateralization and securitisation of innovation-related assets (e.g., through adhesion to the European Unitary Patent).</p>	<p>Announcement of a review of firm incentives (“Misure urgenti per la crescita” decree). Reduction of costs of starting a new enterprise (“Decreto sviluppo”, which was recently adopted). Simplification of bureaucratic and public administration procedures, both for citizens and businesses (“Decreto semplifica Italia”, approved in April 2012).</p>
<p>Other</p> <p>Enhance corporate governance, protection of small shareholders. Encourage mergers, including cross-border mergers, in financial sector governance. Reform bankruptcy legislation.</p>	<p>Measures to reduce cross-ownership in banks</p>

Productivity and competitiveness challenges

The relative decline in Italy's GDP per capita since 1995 is largely explained by low productivity growth. In particular, the growth rate of Italian productivity has been the weakest in the OECD. While relative labour productivity picked up in other Southern European countries following the crisis, it has barely changed in Italy (Figure 1). This slow productivity growth is broad-based affecting most sectors of the economy. It results from negative multi-factor productivity (Figure 2), which takes into account the contribution of not only labour, but also capital stock, to overall productivity of the economy.

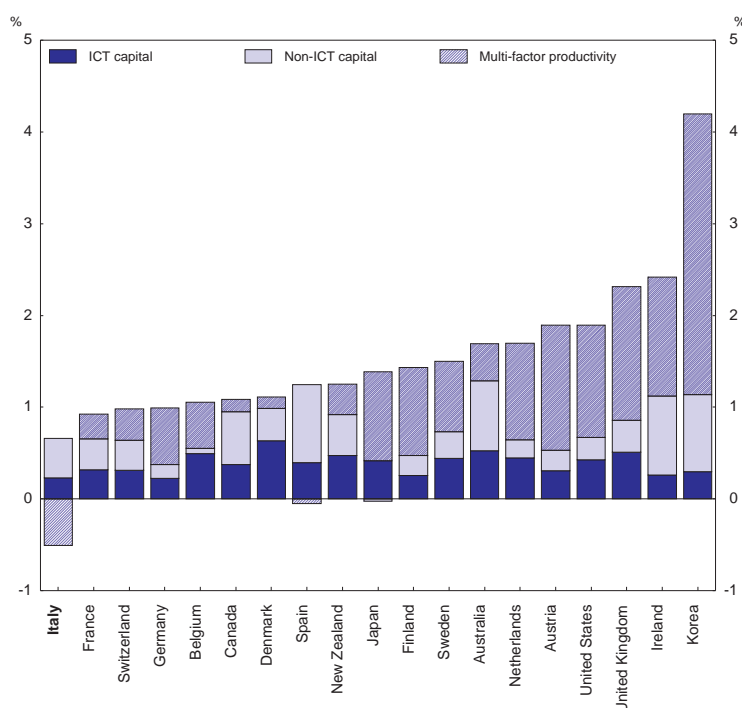
Figure 1. Labour productivity (2000=1)



Total economy. Labour productivity measured as GDP per person employed.

Source: OECD Economic Outlook database.

Figure 2. Contribution to labour productivity growth
Average annual growth in percentage, 2000-10 (or closest comparable period)



Note: 2000-04 for Belgium; 2000-07 for Austria, Denmark, the Netherlands, and the United Kingdom; 2000-08 for Australia and Japan; 2000-09 for France and Sweden.

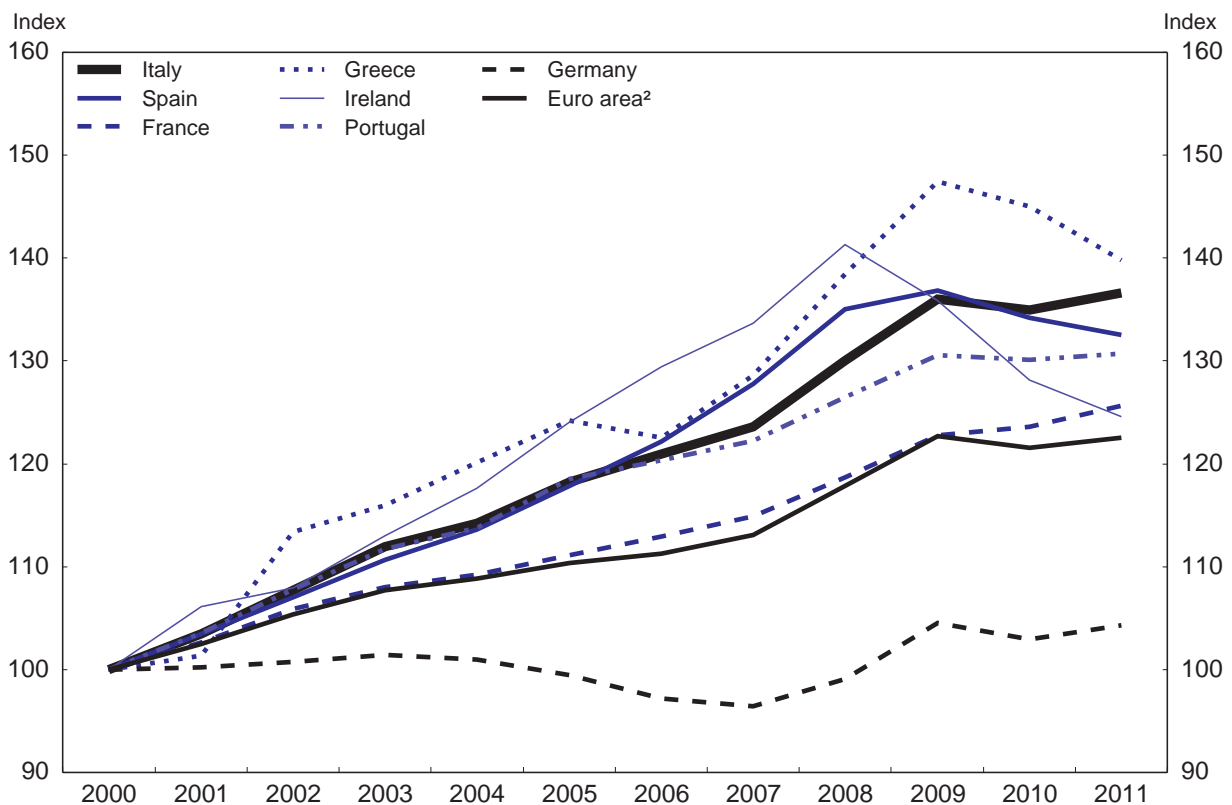
Source: OECD Productivity Database.

Italy faces a serious competitiveness challenge. Stronger competitiveness is key in fostering stronger growth. Competitiveness can be improved by three channels: wage moderation, stronger productivity growth and lower labour taxes.

Persistent weak and at times negative labour productivity growth up to the global crisis meant that even stagnant real wages were conducive to rising unit labour costs (ULCs). This damaged Italy's external competitiveness and fuelled the current account deficit. Since the break-out of the crisis, other southern European countries and Ireland recorded sizeable corrections in ULCs

generally induced by sizeable wage restraints. In Italy, however, no such correction occurred and ULCs continued to follow a diverging path (Figures 3 and 4). This reflects a more limited response of real wages to the recession and suggests a downward rigidity in wage formation, despite the successive wage agreements which sought to ensure that wages would move more closely in line with productivity. Italy's real wages declined by 1.3% in 2011 -- with the available evidence suggesting that this dynamic is likely to continue this year and the next -- but this was not enough to curb ULCs, given the very weak productivity performance.

Figure 3. Unit labour costs¹ (2000=100)

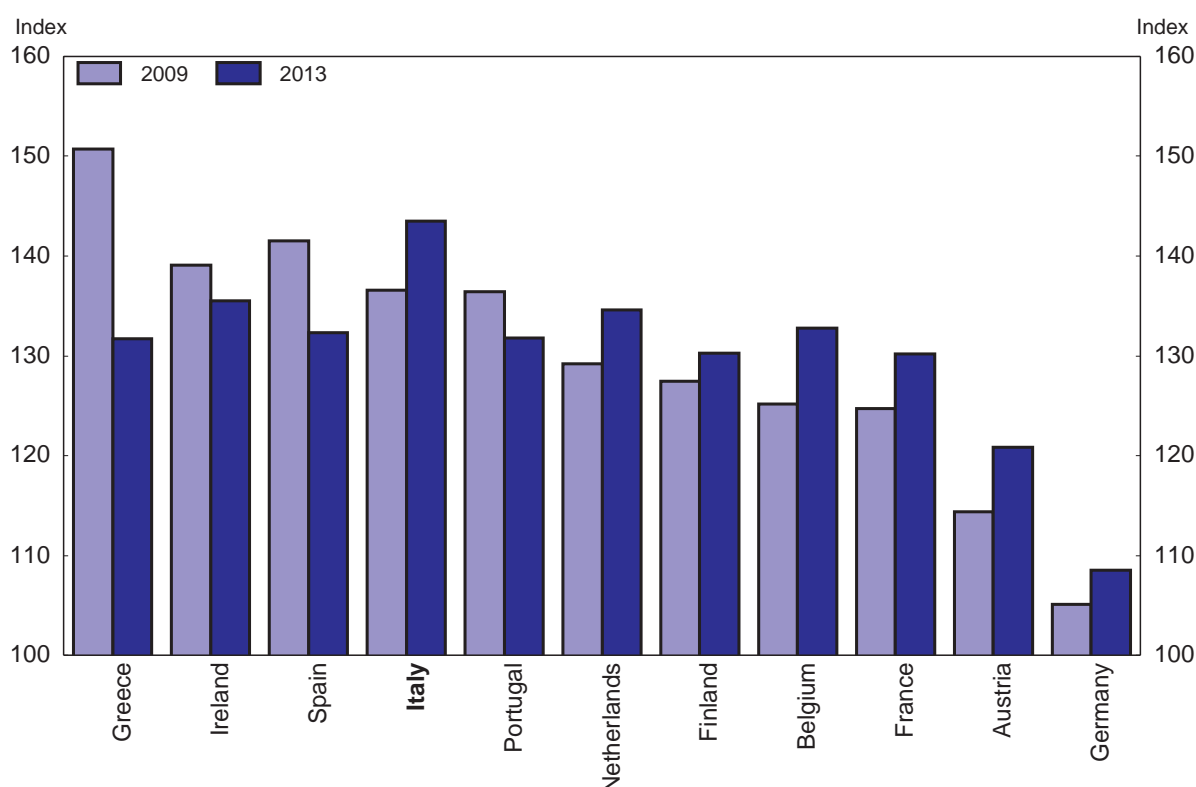


1. Total economy.
2. Excluding Malta and Cyprus.

Source: OECD Economic Outlook database.

Figure 4. Unit labour costs have begun to adjust in other southern European countries

Unit labour cost index, 1999 = 100



Source: OECD Economic Outlook 91 database.

The rigorous implementation of the adopted reforms is essential to boost productivity. They include structural reforms of labour and product markets, innovation, education and public sector efficiency, not only at national level but also, crucially, at the regional and local levels. These policies are detailed in the subsequent chapters.

Actions in all these areas can also improve competitiveness through lower unit labour costs. But improvements in the external competitiveness of the Italian economy relative to its trading partners could be helped by measures to alleviate the pressure stemming from the cost side. As noted above, some of the countries that have witnessed a recent improvement in their ULCs positions have done so via cuts in nominal wages and prices, either through administrative decree or a centralised social dialogue. In Italy more needs to be done to reconcile wage and productivity dynamics. An additional approach could be to target a reduction of the tax wedge, provided that it was implemented in a “revenue-neutral” fashion. This could be achieved, for example, by reallocating the fiscal burden away from labour income onto other sources of income and wealth

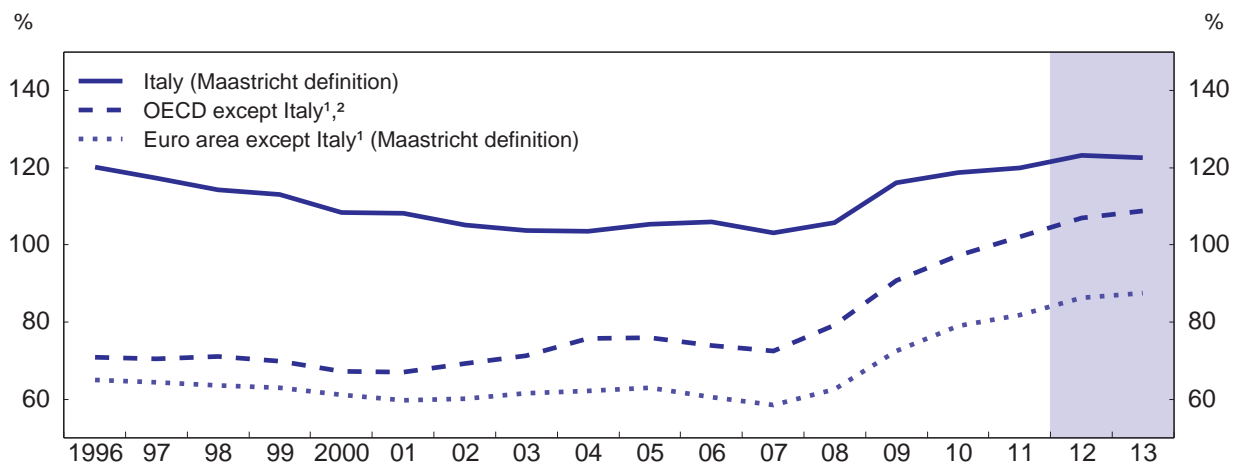
or by rebalancing direct and indirect taxation (see chapter on Securing fiscal sustainability).

Further progress in wage setting mechanisms with greater role played by firm-level bargaining can play an important supportive role strengthening the responsiveness of wages to productivity. Experience from other countries suggests that on top of ensuring more sustainable improvements in external competitiveness, decentralised wage bargaining also helps to cushion the unemployment costs of worsening economic conditions, such as in the current global crisis. Unfortunately, little progress has been made so far to implement the 2011 agreement with the promotion of the so called second-tier (firm-level) wage bargaining. This might be because the agreement is very recent and not much time has been available to implement it. However, a careful evaluation of how effective the recent measures have been could be useful, including an assessment of possible areas for further improvements. Overall, while the gains in external competitiveness determined by wage moving more closely with productivity are potentially vast, a broader and bolder approach than currently envisaged might be needed if Italy’s policymakers and social partners wish to push them ahead.

Securing fiscal sustainability

Italy's public debt is among the highest in the OECD in percentage of GDP (Figure 1). According to projections in the OECD Economic Outlook from May, gross government liabilities would be set to peak at 123% of GDP (Maastricht definition) in 2012. The target of structural balance by 2013 is welcome and the government should act decisively to achieve it. Financial markets are nervous about the systemic euro problems adding to country risk and still require a large premium on Italian public debt, though this declined substantially following the recent announcement of the ECB Outright Monetary Transactions programme.

Figure 1. General government gross financial liabilities (% of GDP)



1. Weighted average using 2011 GDP expressed in PPP.

2. National account definition

Source: OECD Economic Outlook 91 Database.

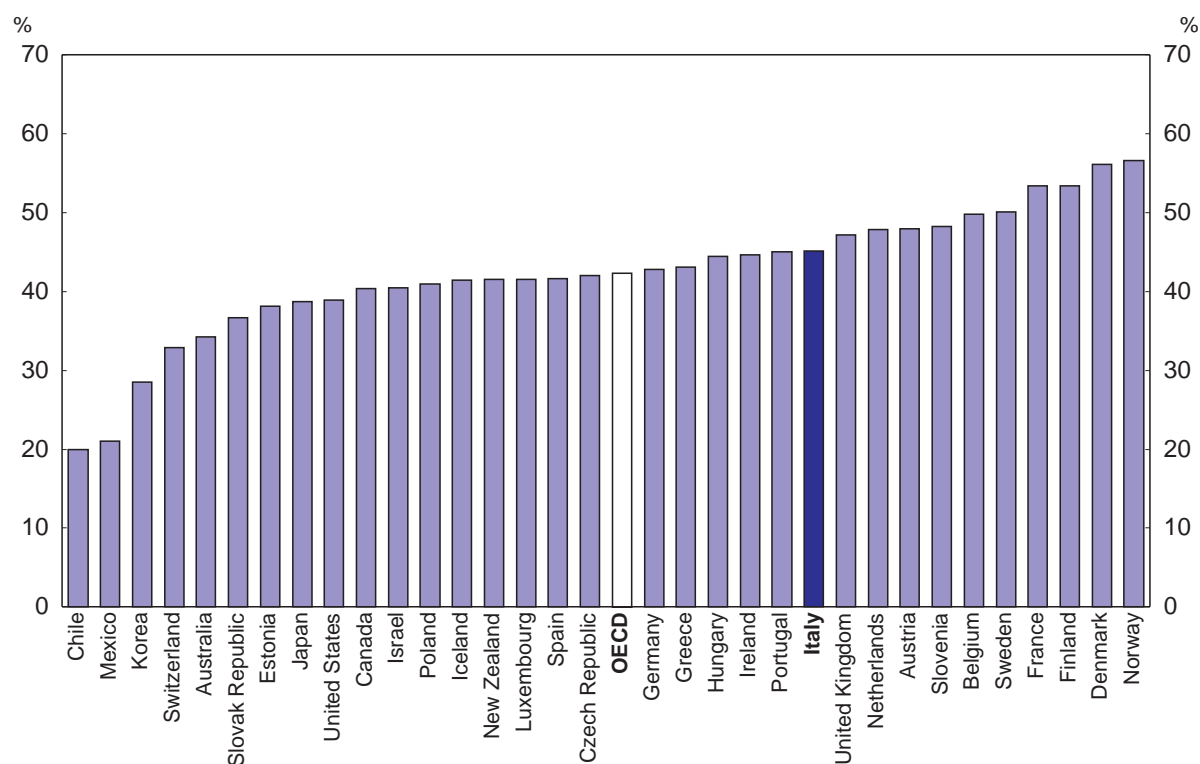
Fiscal adjustment should continue

The government's fiscal plans envisage a deficit reduction of about 4% of GDP during the period 2012-14, which is necessary to reduce the stock of debt to be issued. Nominal budget targets could be difficult to attain in the face of rising unemployment and weak private and external demand. The government must continue to aim to bring the cyclically adjusted budget into overall balance by 2013. If growth is lower than planned, additional tightening should be undertaken to offset part of the impact of lower growth on the headline deficit; this would likely imply a structural surplus in 2014.

The need to make rapid progress in reducing the budget deficit has meant that tax increases have to date played the major part in the fiscal adjustment. However, the aggregate tax burden in Italy is fourth highest in the OECD (2010). It is therefore important that efficiency savings receive stronger priority in fiscal adjustment.

Public spending --other than interest payments-- as a share of GDP is indeed above the OECD average (Figure 2) and social spending the seventh highest in the OECD (as a share of GDP in 2011). The 2011 pension reform is a key step in this direction. Moving forward will imply some choices that policy making institutions have tended to avoid in the past. In this context the recent spending review is a welcome major step in shifting the burden of consolidation towards lower spending and away from higher taxation. The Ministry of Finance and spending ministries need to make this process of identifying least efficient areas of spending a routine process.

Figure 2. General government expenditure¹ in 2011 or latest year available (% of GDP)

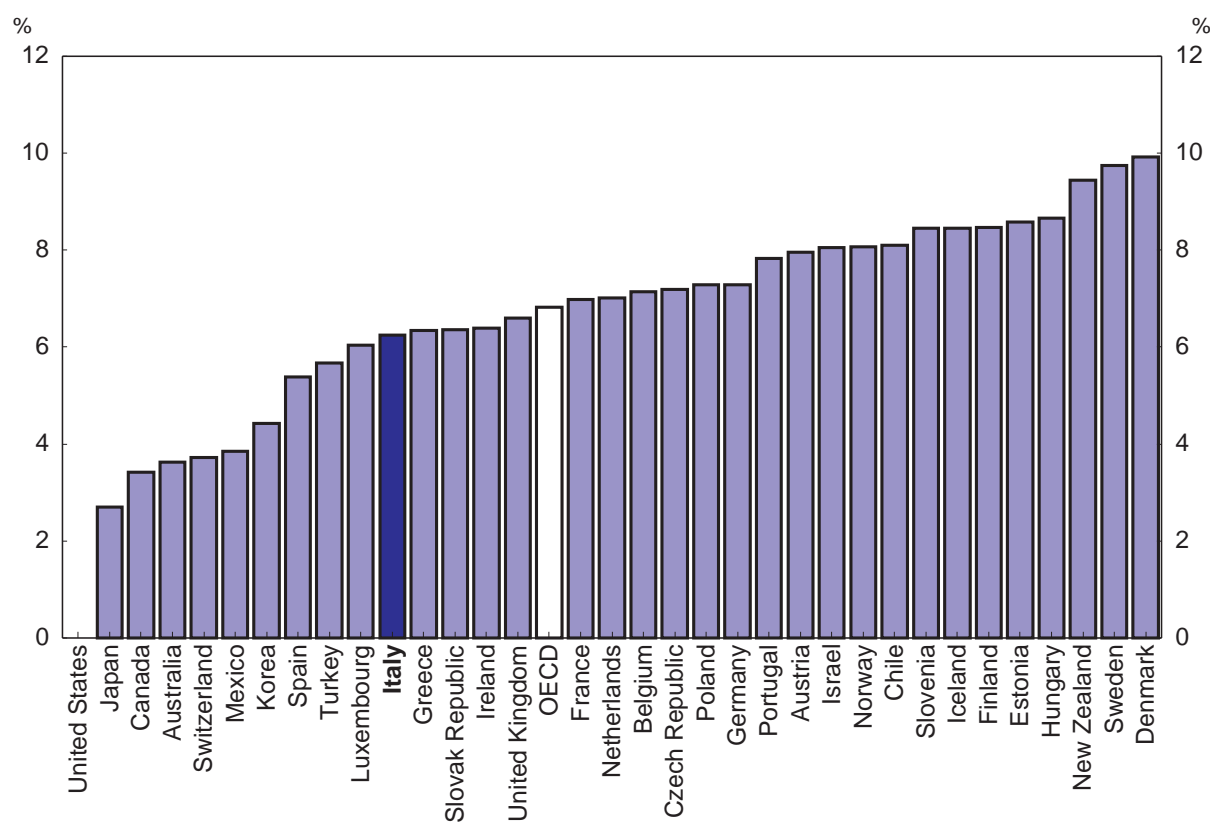


Note: Data for Norway refer to the mainland. OECD area is the simple average of countries for which data are available.

1. Excluding interest payments.

Source: OECD, National Accounts and Economic Outlook database.

Figure 3. VAT revenue (% of GDP)



Notes: The OECD area is the simple average. 2010 data except for Australia, Greece, the Netherlands, Poland 2009.

Source: OECD Revenue Statistics Database

A strong fiscal framework can support longer-term commitment to debt reduction

Successive governments have made important improvements to the medium-term fiscal framework: budgetary plans cover a three-year period since 2008, and most recently there have been moves to adopt an independent fiscal council and a fiscal rule has been adopted in the constitution. Timely and appropriate operationalisation of these new institutions will be essential.

In addition, with the current high interest rate premium on borrowing, the privatisation programme will help to reduce pressure on the market for Italian debt, provided the programme meets its target of raising 1% of GDP per year. Privatisation can also be an important structural measure to improve productivity and the competitive environment. An example of an opportunity to combine efficiency improvements with financial benefit would be to enhance the proposal to rationalise airports by privatising them. Establishing an agency with responsibility for a coherent privatisation programme can help to achieve rapid and efficient sales. The debate on this is advancing though some specific proposals need to be discussed in more detail.

Besides the fiscal measures outlined in this chapter,

raising the competitiveness of the economy and prospects for potential growth through continued structural reforms, especially those stressed in the following chapters, would enhance the sustainability of public finances.

The planned tax reform, which must be designed without jeopardizing overall revenue targets, can also help to support growth. Many corporate and personal income tax incentives could be revisited. Despite having an above average standard rate, VAT revenues in relation to GDP are lower than in most OECD countries (Figure 3), reflecting both non-compliance and a wide range of reduced rates. The government should raise the reduced rates and avoid introducing new exemptions. More efficient means, e.g. direct transfers, can achieve redistributive goals. Higher consumption tax revenues would allow for a reduction in labour income taxes and/or social security contributions, which are very high in OECD comparison. Such action would lower the tax wedge on labour income, supporting growth and boosting competitiveness. Taxes on environmentally damaging activities, whose revenues are below the EU average, could be expanded.

Key OECD recommendations

- **Maintain the structural budget deficit targets set out in the Stability Programme**, tightening if necessary to offset part of the effects of shortfalls in growth.
- **Broaden tax bases**, in particular by cutting the number of tax expenditures. Cut tax rates, only when the fiscal situation permits, giving priority to reducing the tax wedge on labour.
- **Incorporate a spending review process into the normal budget and expenditure control systems.**
- **Operationalise the rules for a balanced budget and fiscal council in a timely and appropriate manner.**
- **Enhance the privatisation programme** to contain growth in debt if fiscal targets are substantially overshoot.

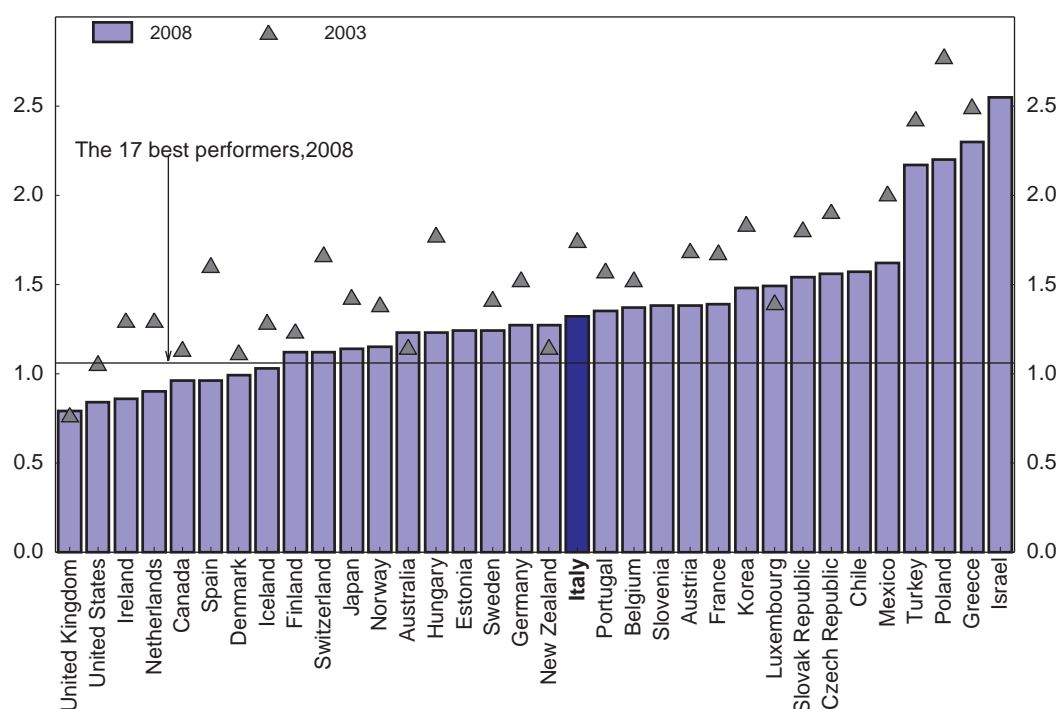
Strengthening competition and reducing regulation

Boosting growth requires the removal of numerous impediments to competition, including legislation and legal procedures, ownership structures, protection of economic rents. Increased competition would not only support innovation and productivity but also increase choices for consumers as well as lower prices and contribute to improve competitiveness. The OECD's measure of the restrictiveness of regulation in Italian product markets is close to the OECD average and has been decreasing (Figure). However, the OECD measures only the strength of formal restrictions on competition, and understates the true difficulties faced by businesses entering some markets. Moreover, restriction to competition persists in several key areas. In January 2012, the Italian competition authority published a comprehensive set of proposals to address these restrictions.

The current administration has removed several regulatory bottlenecks to economic activity which could increase GDP growth by around 0.3%-0.4% per year over a decade (see table in the Introduction). Many pieces of legislation, including the “Salva Italia” Decree-law (December 2011), the “Cresci Italia” and

the “Semplifica Italia” Decree-laws (February 2012) as well as the Sviluppo Decree (converted into law in August) should simplify rules, liberalise regulated professions and ease bureaucratic burdens on citizens and SMEs (see also next chapter).

Regulation in the product market could be further reduced
Scale of 0-6: from least to most restrictive



Source: OECD Product Market Regulation (PMR) Database.

Further reforming regulation to increase competition in key markets

In late 2011, the Italian government established an independent Transport Authority to promote competition and efficiency in the transport sector and guarantee fair and non-discriminatory access to transport infrastructure. The Authority will also establish criteria to set tariffs and minimum quality standards. It should be made operational as quickly as possible and provided with adequate resources.

In the railway sector, for example, the Authority will have to ensure that the incipient competition between alternative operators on specific high-speed routes is not impeded by a biased allocation of the existing infrastructure. The Authority will also play a role in increasing competition in the taxis sector (where previous measures were strongly resisted and abandoned) notably by increasing the number

of licenses. The Authority should also be given responsibility to regulate highways.

Competition in network industries remains weak, although there has been some progress. In the gas sector, for example, competition is fostered by unbundling the ownership of the storage and transportation businesses from other (competitive) segments now operated by the incumbent operator ENI. In May 2012 the Italian government issued a decree mandating the structural separation of the transportation business (operated by Snam, a subsidiary of ENI) within 18 months. Snam's sale by ENI to Cassa di Risparmio di Venezia – a financial institution controlled by the Italian Treasury – took place in the same month. Building additional gas import facilities could also help Italy become a major trading hub between gas importers in Europe and gas-exporting countries in Northern Africa. More competition in the gas sector could also lead to lower electricity prices, and in turn foster Italy's competitiveness. The role of the state is still prevalent in many sectors of the economy, such as transport (including airports) and energy could be reduced. In TV broadcasting, the Italian Competition Authority is defining the tender procedures for the auction of TV

frequencies but there is no fixed schedule regarding when the sale will take place.

Despite the recent progress, related for instance to an increase in the number of public notaries and the abolition of minimum tariffs for professional services, there are still formal restrictions to competition in professional services. Restrictions on marketing activities and access to the professions should be eased and there is scope for more competition in local public services.

There is also room to increase competition in the pharmaceutical market, where the liberalisation of over-the-counter products introduced in 2006 has already led to sizeable discounts. Further savings could be obtained if the recent decree of April 2012 – allowing medicines included in the category C (i.e. that have to be prescribed by a doctor but fully paid by the patient) to be sold in other outlets in addition to pharmacies – were to be promptly implemented. More competition could also result from the recent abolition of restrictions on the opening of new pharmacies; the maximum number of licenses a single person can hold could also be eased.

Improving the overall competition and regulation environment

Italy is characterised by a complex layering of regional and state competencies. Much of the regulatory restriction on competition arises at regional and local levels, as is for instance illustrated by the case of petrol stations, where regional legislations limit competition and contribute to higher petrol prices than in other European countries. Reforms allowing the Italian competition authority to challenge regional regulations are welcome. Ministries, states and municipalities should be encouraged to use the OECD's Competition Assessment Toolkit to screen laws and regulations

that unnecessarily restrict competition. Some useful examples of good practices in terms of multi-level governance can be found in Germany and Australia. Last, accountability mechanisms to encourage administrations to deliver better regulatory management (e.g. regular monitoring of results and performance indicators) are weak, as are consultation and communication on regulatory activity. The example of Sweden which has a robust system for public communication of regulations, including the Swedish Code of Statutes could be useful.

Tackle risks to integrity in public procurement, including bid-rigging and corruption

There is some evidence that the Italian public administration pays significantly more than the private sector for the purchase of the same goods and services. Accordingly, the Authority for Supervision of Public Contracts has implemented a national database on public contracts, including data on dysfunctions, anomalies such as possible corruption and collusion. This may be due to several factors, including that

public agencies are relatively less vigilant about the degree of competition existing among suppliers, e.g. in respect of detecting and preventing bid rigging. There may be scope to better manage risks to integrity in public procurement and adopt the OECD Recommendation on Enhancing Integrity in Public Procurement as well as the Guidelines to Fight Bid Rigging in Public Procurement.

Key OECD recommendations

- **Continue the liberalisation of professional services.**
- **Ensure that the newly-established Transport Authority is made operational** as quickly as possible.
- **Open up network industries to competition**, and reduce the role of the state in the economy.
- **Implement stronger mechanisms and incentives to control the dynamics of regulatory inflation at regional level.**
- **Strengthen monitoring and evaluation capacities** to assess the progress of burden reduction initiatives
- **Tackle risks to integrity and bid rigging in public procurement** and encourage the adoption of the OECD Recommendation on Enhancing Integrity in Public Procurement as well as the Guidelines to Fight Bid Rigging

Reducing administrative burden by public administration reforms

Public administration reforms can help Italy in the challenge of simultaneously putting public finances on a sounder track and reviving and modernising its economy. First they can help achieve the efficiency savings and higher government productivity that can improve fiscal sustainability. In addition, by reducing time and financial costs for citizens and businesses, it can contribute to unleashing resources for consumption and investment and improving the business climate.

Administrative burdens are being reduced

The burden reduction programme has already led to substantial gains. For instance, the government estimates that it has led to savings of EUR 8.1 billion per year for SMEs, which are the backbone of the economy. Moreover, through the “Semplifica Italia” Decree of February 2012, converted into law in April 2012, Italy has already continued to move forward on cutting red tape and reducing the administrative burden imposed on citizens and businesses. Further major simplifications concern the one-stop shop for building permits and construction activities, as well as the single environmental license for

SMEs. This legislative action will nonetheless need to be accompanied by robust implementation follow-up and quick action to address immediate concerns of citizens and businesses. It will also be important to tackle a major concern expressed by businesses concerning late payments by the public administration, which is creating significant liquidity problems. In addition, it will be important to ensure appropriate monitoring and evaluation, as well as measure and reduce administrative burdens at the local level and communicate results widely.

Promoting e-government

E-government can also be a powerful tool to reduce administrative burdens, as shown by the success of these reforms in Korea and Denmark. Italy has invested significantly in this tool. To be effective, however, e-government cannot be limited to investing in infrastructure and hardware. It is essential that both citizens and businesses rely on e-services in their daily interactions with the public administration. In 2010, 82% of businesses used internet to interact with the public administration, 2 percentage points above the OECD average, a notable achievement. However, use by citizens appears to be more limited. In 2010, only 17% of citizens used internet to interact with the public administration, 25 percentage points below the OECD average. Action is being taken to address this challenge, deepening the use of electronic tools both within the public administration and between the public administration and citizens. The exchange of about 7 million administrative

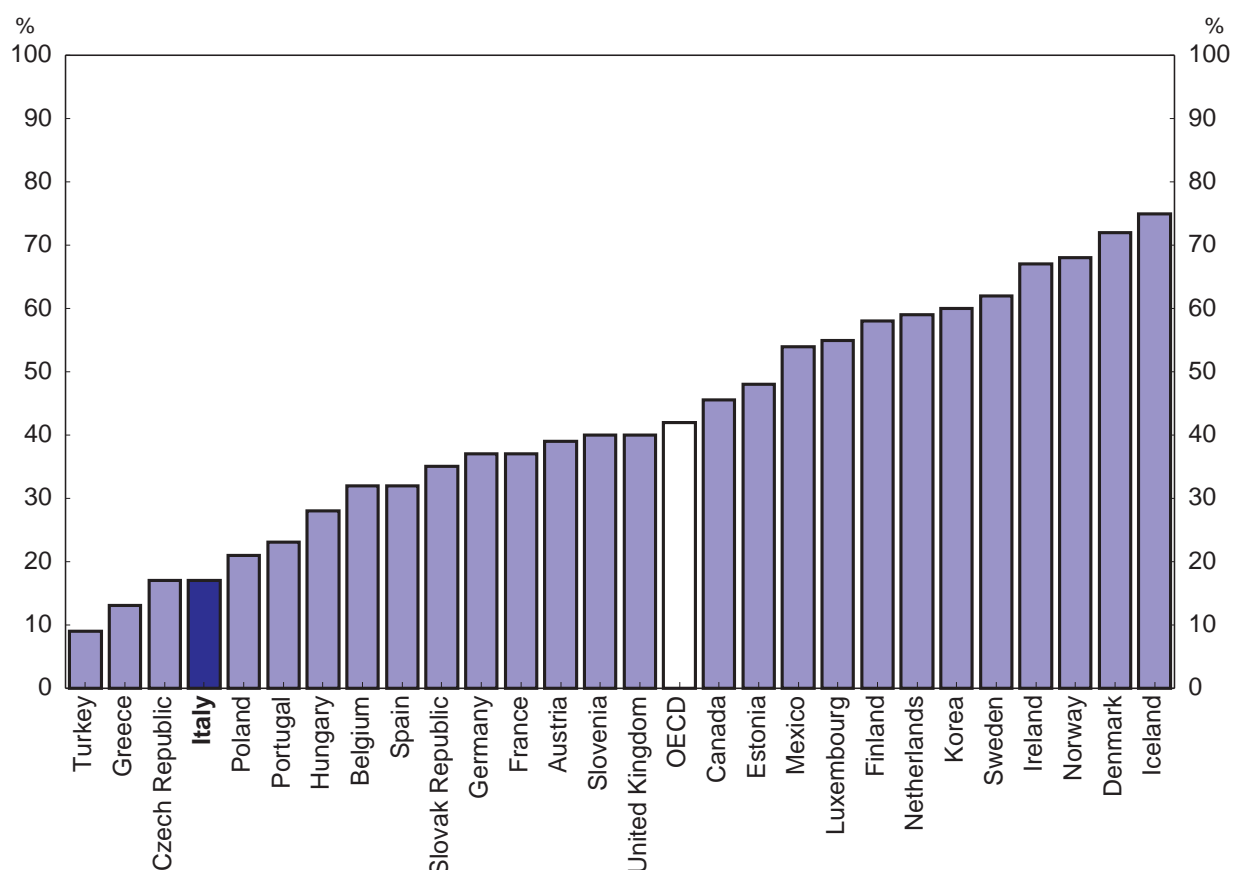
documents between different branches of the public administration is being transferred online, with estimated savings of about EUR 10 million. A number of interactions of citizens with the public administration are being moved online, including the use of electronic payments. This is a positive development that will need to be sustained in the future to continue improving uptake by citizens of e-government services.

Translating public administration reform into an improved business climate will also require the participation of citizens and businesses. The monitoring and evaluation of administrative simplification will in particular need to include surveys of burden perceptions by citizens and businesses, as done for instance in the Netherlands and Denmark. Perceptions are indeed key to determine the confidence of businesses and citizens in the capacity of the public administration to deliver. At the same time, they can feed precious information into implementation. Measuring

perceptions will need to be accompanied by structured and transparent consultation with a wide range of partners which can help ensure reform buy-in and improve the quality of policies. A clear move in this direction is represented by the public consultation “Burocrazia Diamoci un

Taglio!” that has facilitated the identification of key simplification measures. The Department of Public Administration is also envisaging the use of administrative reviews linked to the spending reviews to monitor the quality of public services and facilitate a more efficient public spending.

Figure 1. Citizens’ uptake of e-government services (2010)



Note: data are not available for Australia, Japan, New Zealand, Switzerland, United States.

Source: OECD (2011), *Government at a Glance 2011*. OECD Publishing.

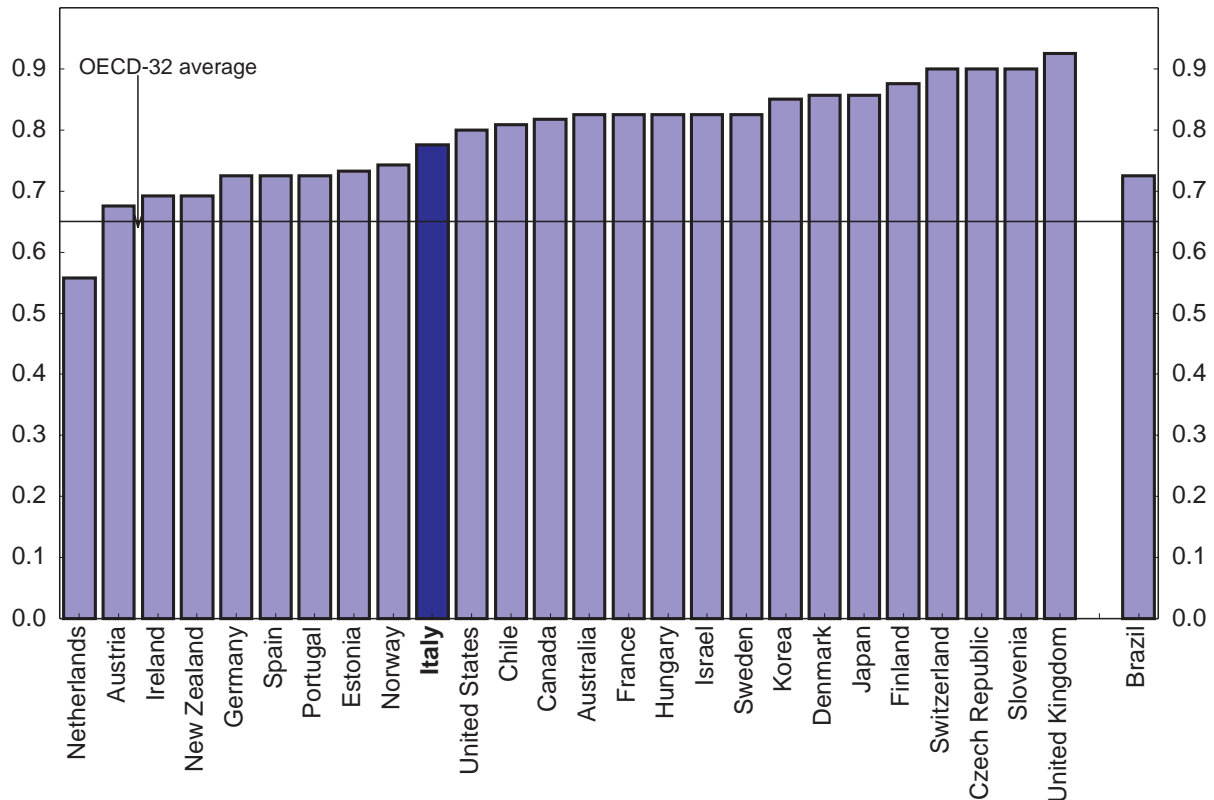
Promoting a stronger focus on performance across the public administration

Since 2009, Italy has launched a set of reforms aimed at enhancing the productivity of the public administration through a strong focus on performance. These reforms have also the potential of increasing accountability of the public administration and improving trust of the citizens in the ability of the public administration to deliver. To reap their full benefits, however, it is paramount to sustain implementation over time and continue advancing on the reform path that has been launched. Italy’s central government at the senior and middle manager levels is relatively well paid in comparison to other OECD countries, an asset to attract and retain talent. At the same time,

it is important that human resources management and compensation, especially at the senior level is linked to performance. Italy is moving in this direction through “executive accountability” introduced in 2009 and some progress has been made in advancing performance-based HR management (Figure 2).

To scale up reform and ensure that performance-based HR management deliver for the public administration and the citizens, it is important to rely on high-quality performance indicators that appropriately track output and outcomes and provide important tools to assess the public administration performance.

Figure 2. Extent of the use of performance-related pay in central government (2010)



Source: OECD (2011), *Government at a Glance 2011*. OECD Publishing.

Key OECD recommendations

- **Continue to monitor and evaluate progress in administrative simplification** at the central and local level and communicate results widely.
- **Ensure that investment in e-government services is geared towards increasing users' uptake** by systematically linking simplification of procedures with opportunities to carry out administrative practices online.
- **Measure perceptions of burden reduction by business and citizens** and use this opportunity to engage in consultations with business and citizens to fine-tune implementation of administrative simplification.
- **Identify quick, immediate action for reform and advance the implementation of the EU Directive 2011/7** to combat late payment in commercial transactions.
- **Sustain the effort towards a more effective public administration** through the systematic use of administrative reviews to balance quality of service delivery and efficient public spending.
- **Continue moving towards a performance-focused public administration** through high-quality indicators that systematically track public administration performance.

Strengthening public sector integrity

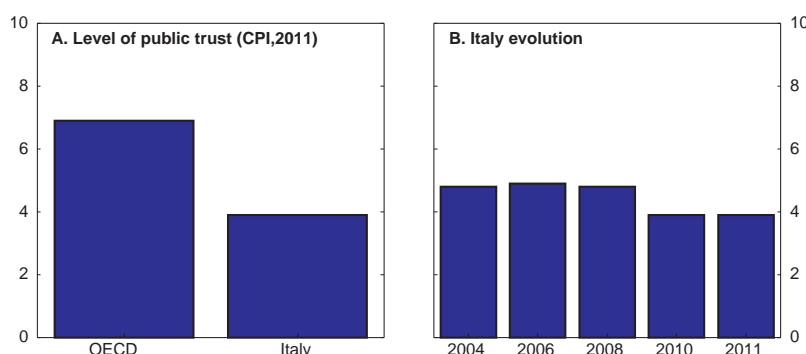
The promotion of integrity and transparency in the public sector is a key component of the ambitious structural reform programme to support long-term growth and also restore trust in government. Corruption was identified by companies and citizens as a key factor that exacerbated the debt crisis. This issue has become a priority in the government of Prime Minister Monti.

Among OECD countries, Italy has a high level of perceived corruption (Figure), and indicators show a negative trend in the perception of corruption in Italy from 2008 to 2011, a gap confirmed by other available data.

To revert this trend, recent reforms in Italy, particularly under the “Brunetta reform”, have significantly

advanced the country’s transparency agenda as a key corruption prevention instrument, setting new standards and obligations, including multiannual transparency plans and better access to information in an open data format via the web. Italy is now among OECD leaders in terms of disclosure of public information.

Public trust in government



Note: A lower index indicates a lower public trust

Source: Transparency International

Continuing and strengthening reforms

The current administration is continuing and strengthening reforms to promote public sector integrity. A key initiative is to advance with the draft law for the prevention and repression of corruption and illegality in public administration “Anticorruption Bill” (of which implementation will be supported by a joint OECD and Italy’s Department of Public Administration study). The issues regulated by the Anticorruption Bill -- whistleblower protection, code of conduct, integrity risk management, coordination of a national anticorruption policy, strengthening the regulation on conflict of interest, and transparency reforms -- are appropriate to Italy’s level of perceived corruption and the maturity of its corruption prevention

measures. They will address current integrity gaps and enhance implementation of international commitments and standards (e.g. OECD Principles, G20 commitment, United Nations Convention against Corruption, and Council of Europe).

If successfully implemented, the Anticorruption Bill will provide much needed continuity to and a strong foundation for broader public sector reforms. The institutions set up by previous reforms (especially the Commission for Evaluation, Transparency and Integrity, CIVIT) will play a critical role in the implementation of the Anticorruption Bill. Moreover, successful implementation of the Bill has the potential to channel a true cultural change within the Italian public administration.

Key OECD recommendations

- **Embed -including by the adoption of the “Anticorruption Bill”- integrity and anticorruption tools within current structures of the Italian public administration by:**
 - clearly defining roles and responsibilities for implementation of integrity measures among complementary functions, as well as monitoring compliance and evaluation of impact;
 - developing supporting mechanisms to further instill a culture of integrity among civil servants by updating the code of conduct and providing effective protection for whistleblowers in light of existing international good practice; and
 - further enhancing the capacity of the management to mitigate risk of fraud and corruption through the development of an integrity risk management system.

Strengthening the Italian financial system

The euro area financial turmoil has put Italian banks under stress, as limited access to interbank markets, drawdown of deposits and higher funding costs have led to liquidity shortages. Thus, Italian banks had to rely extensively on ECB financial support. On average, banks now fund more than 6% of their assets through central bank borrowing, compared to just around 1% about a year ago. Banks also hold a large quantity of Italian sovereign government debt and have sizable holdings of non-performing loans relative to their capital base

Strengthening banks' capital bases

Non-performing loans in banks' portfolios are large by international comparison. It is important that banks recognize all losses as they occur, but this will put their capital base under pressure. Italian authorities should therefore encourage banks to meet their capital needs by raising equity or by disposing noncore assets rather than restricting lending. As

Italian banks primarily lend to domestic households, small and medium-sized enterprises (SME) and other domestic corporate entities, tighter lending conditions would weaken real activity growth going forward and further deteriorate the quality of banks' existing loan books.

Limiting the sovereign-banking sector debt linkages

The substantial deterioration in the assessment of the quality of Italian sovereign debt affected sharply the market assessment of the value of the banking sector debt. This is due to the effects of the sovereign stress on the outlook for banking activities as well as the significant holdings of sovereign debt by banks, the connections between bank and sovereign credit ratings created through current rating agency practises, and the effect of a change in the guarantor's strength on the value of government explicit and

implicit guarantees for bank debt. The latter channel is illustrated by the decline in the incidence of implicit guarantees on banks' ratings (to so-called uplift) in countries like Italy where the credit assessment of the sovereign has weakened (Figure). Fiscal and structural economic reforms advocated in the other chapters will help the sovereign regain a stronger status in debt markets and limit its debt-servicing costs as well as any adverse feedback effects to the banking sector.

Encouraging banks to adopt specific corporate structures

Another important interconnection between the value of bank and sovereign debts results from the too-big-to-fail status of some financial institutions. Making failing institutions more easily resolvable and resolving institutions in distress can reduce these links. Italy already has a state-of-the-art resolution regime, and that regime had been used successfully in a few high-profile cases in the 1990s. The Italian authorities have decided to use the instruments available to them when required, regardless of the size of the bank.

A further step to consider would be structural reforms to the organisation of banks and, in particular, separating out securitisation from traditional commercial and retail banking. Three

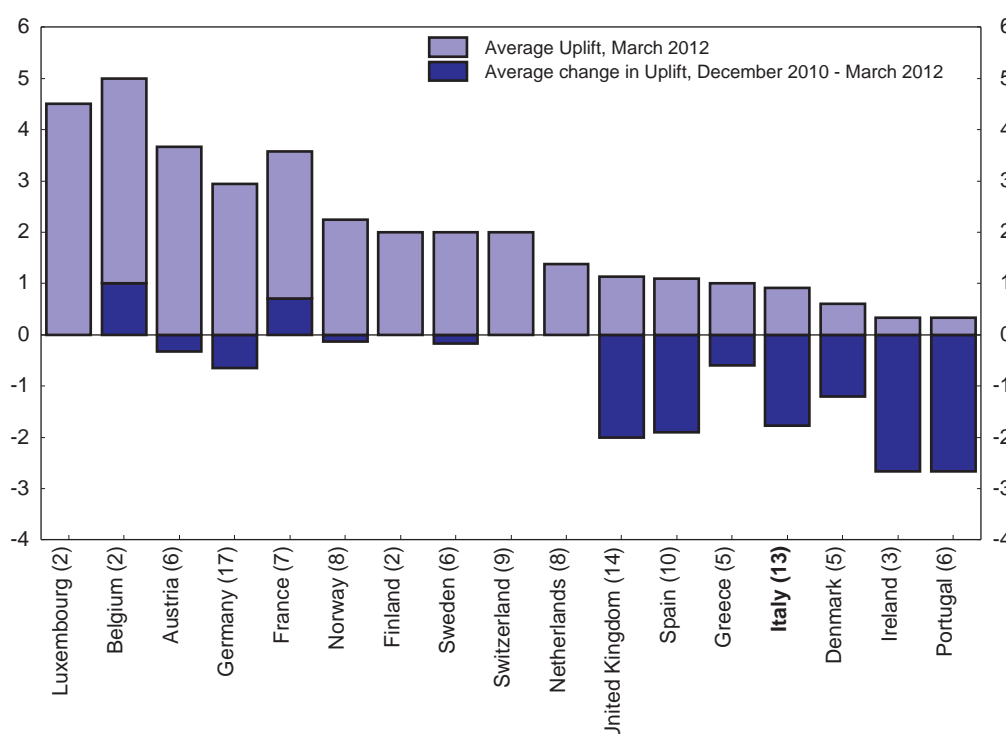
specific approaches stand out: the Volcker rule (United States); the Vickers separation of retail and investment banking (United Kingdom); and the non-operating holding company structure (NOHC) proposed from the outset of the crisis by the OECD and adopted by Macquarie Bank in Australia.

In the NOHC structure the parent of the financial group is a non-operating holding company raising equity it invests in the separated subsidiaries. The operating subsidiaries are divided (at minimum) into: (i) the retail bank which is a deposit-taking entity, to which deposit insurance and strong capital and liquidity rules apply; and (ii) the securities businesses to which more limited regulation and no deposit insurance apply. The retail banks' main

activities are deposit taking and lend to households and enterprises. These activities are valued with amortised cost accounting as opposed to mark-to-market fair value through profit or loss in the securities businesses. The risks in the retail bank are mainly related to events in the domestic economy. The securities businesses deal in global capital markets with highly interconnected counterparties, including in the so-called shadow-banking sector. These subsidiaries should be ring-fenced, with the

parent requiring regulatory approval to shift capital and assets between them. This structure prevents the creditors of one affiliate pursuing the creditors of the others in the group in the event of failure, thereby removing the potential for contamination effects. The structure also removes the cross-subsidisation of investment banking via the guarantees implicit in the too-big-too-fail status. Adopting the NOHC structure would help to strengthen the structural resilience of the banking system.

Implicit guarantees for unsecured debt of large European banks
(Numerical equivalents of credit rating uplifts due to assumed external support)



Notes: The credit rating uplift is a measure of the perceived external support from public authorities for bank debt. The average uplift for each country is calculated as the difference, on average for all banks headquartered in that country, in notches (one notch is the difference between subsequent rating categories, e.g. between AA and AAA) between a debt issuers' "all-in credit rating" (that reflects assumptions about potential external support from public authorities for the debtor) and its adjusted "stand-alone credit rating" (that abstracts from such support). Sample consists of 123 large European banks. Number of banks headquartered in countries shown in parentheses. As of spring 2012.

Source: "Implicit Guarantees for Bank Debt: Where Do We Stand?", S. Schich and S. Lindh, *OECD Journal: Financial Market Trends*, Volume 2012/1, June 2012, (available at <http://www.oecd.org/dataoecd/16/25/50586138.pdf>).

Key OECD Recommendations

- **Strengthen banks' capital bases** in relation to assets by raising equity, or by disposing noncore assets rather than restricting lending.
- **Sever the adverse feedback from the sovereign to the banking sector** by continuing both fiscal consolidation and structural measures.
- **Use, as planned, the bank failure resolution instruments available when required**, regardless of the size of the bank.
- **Encourage banks to adopt a ring-fenced non-operating holding company structure** to strengthen the structural resilience of its banking system.

Boosting innovation

One important factor behind lagging productivity in Italy is its weak innovation performance. The scope and the effectiveness of Italian innovation appear to be among the weakest in the OECD area and Italy risks falling further behind both leading and emerging economies. Stepping up innovation is crucial for boosting Italy's competitiveness and achieving sustainable growth in the longer term.

A modest level of science technology and innovation (STI) activity

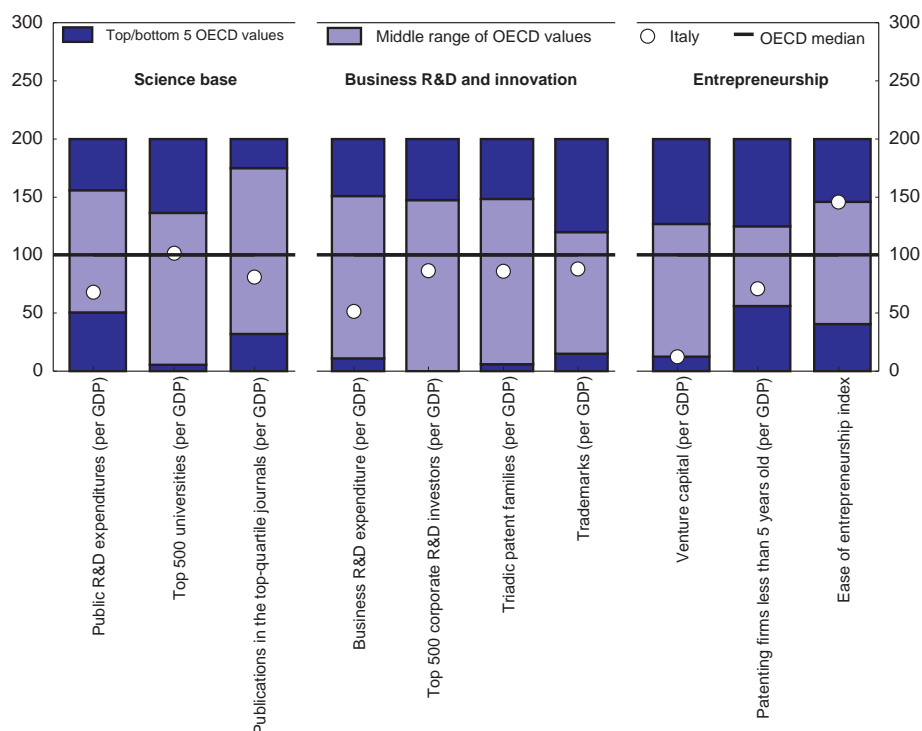
Several indicators point to this weak performance. In 2010 gross expenditure for R&D (GERD) was just 1.3% of GDP, about half of the OECD average, and more in line with the R&D intensity of emerging market economies (Figure). At 0.7% of GDP, business expenditure on R&D (BERD) also lags far behind the OECD average, with business sector innovation performance varying across regions and firms. A segment of innovative firms, including flexible SMEs, coexists with many non-innovative

firms operating at low levels of productivity. Venture capital is in short supply and the patenting rate by young firms is low. The low share of industry-financed public R&D is indicative of weak industry-science linkages. In general, Italy tends to perform better on indicators of non-R&D-based innovation (for example, it leads in Community designs). The lack of strategic orientation of public institutes and the limited opportunities for young talents also limit the dynamism of public research.

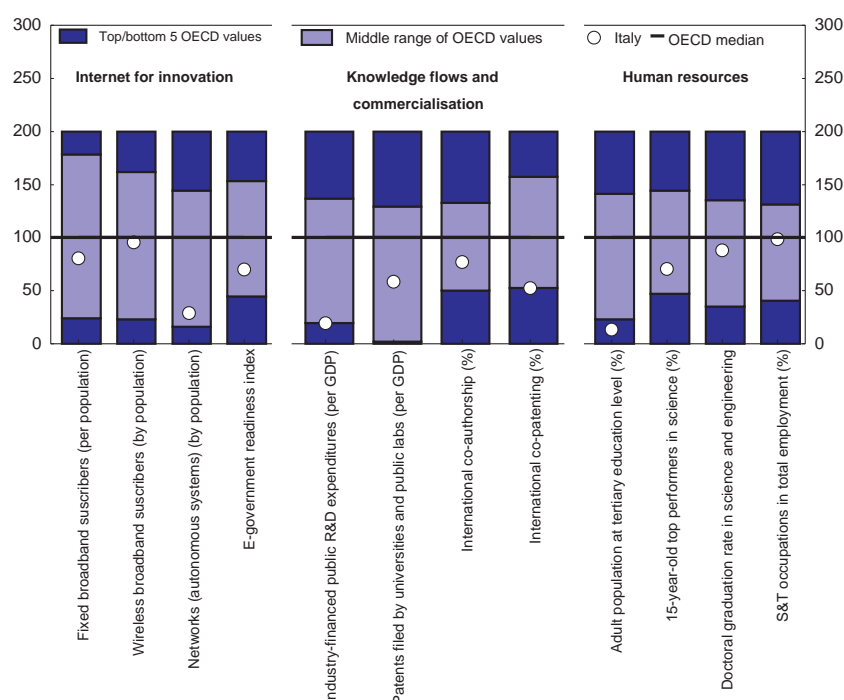
Comparative performance of national science and innovation systems, 2011

Normalised index of performance relative to the median values observed in the OECD area (Index median=100)

A. Competences and capacity to innovate



B. Interactions and human resources for innovation



Source: OECD (2012), *OECD Science, Technology and Industry Outlook 2012*, OECD, Paris (forthcoming).

Enhancing the innovation policy mix

This weak performance reflects partly inadequate framework conditions for entrepreneurship and general impediments for firm growth that have to be addressed. But improving innovation outcomes also requires a better innovation policy mix. Other OECD countries have already adapted their innovation policy mix to better meet the needs of the business sector and have improved the design of both direct support measures (e.g. grants, loans) and fiscal incentives. Over the past two decades, many countries have put in place a variety of new incentives and frameworks for enhancing cooperation between

industry and universities and other institutions of tertiary education and research, including: career path rewards and incentives; more conducive intellectual property and funding regimes; and programmes supporting various types of industry-academic cooperation, ranging from project-based to long-term strategic PPPs. Finally, evaluation has become common practice and is widely embedded in support programmes and in institutional assessment and often includes cooperation-related performance criteria. Italy should draw on the experiences of other OECD countries to enhance its innovation policy mix.

Key OECD recommendations

- **Make science, technology and innovation policy more business-oriented and receptive to the varied needs across the whole spectrum of firms, including SMEs.**
- **Improve the efficiency of public support for business R&D and innovation** by implementing, for example, an appropriate mix of fiscal incentives and direct support for business R&D and innovation activities and the evaluation and assessment of their impact.
- **Improve linkages between the business sector, universities and the public research system**
- Continue reforms to **remove the underlying constraints to the emergence of a more dynamic and merit-based public research system.**
- **Improve mobility of researchers between the public research and business sectors**, e.g. through collaborative R&D programmes, company placement schemes and joint sponsorship of PhD students.
- **Continue improving the monitoring and evaluation of the research system and tie funding allocation to performance**, which should be framed in terms of both excellence and relevance.

Improving the quality of education

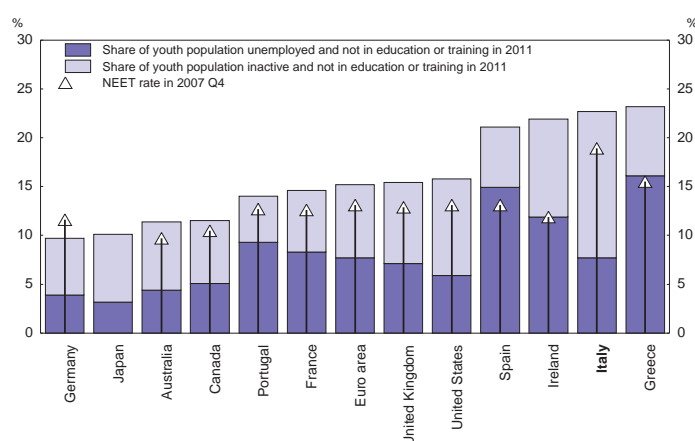
Educational performance has improved in recent years, but there is much scope for further improvement. The performance of Italian 15-year-olds in reading, mathematics and science in PISA still lags behind the OECD average. A large share of students fails to reach the baseline level in reading (21% in Italy against an OECD average of 19%). Completion of upper-secondary education is below average (71% of 25-34 year-olds in comparison to an OECD average of 82%). Moreover, while attainment of tertiary education has doubled for younger age cohorts it remains below OECD average (21% of 25-34 year-olds in Italy, 38% on average in the OECD).

OECD analysis (documented in the study on “The high cost of low educational performance” in 2010) shows that improvements in the quality of schooling outcomes by 25 PISA score points – which is what Poland achieved over a six-year-period, could raise economic output by over \$5 trillion over the lifetime of today’s students in school. A better performing education system could also foster social mobility which is especially low (see chapter on Strengthening social cohesion through social mobility). Education reforms are taking place in a difficult context of budget cuts since 2009. While there is clear room for efficiency gains in education spending, the budget constraints make the reform even more challenging. The current difficulties of Italian youth in transitioning from education to employment are particularly worrying.

Almost one in five young Italians is neither in education or employment (23% of 15-29 year-olds; Figure); in Italy, ensuring healthy labour market outcomes is a challenge at all levels of educational attainment. If skills acquired in education are not quickly put to the task, they may become rapidly obsolete, produce discouragement and reduce the appetite for education. The difficulties of young people in finding suitable work also raise questions about the quality of learning and skill development in school and university.

For the education system, the priorities are to strengthen accountability and improve the quality of learning at all levels, and to strengthen the links between vocational education, university education, and labour markets. Italy has taken important steps in these directions.

Increase in the share of youth population not in employment, education or training (NEET)
Percentage of population (aged 15-29), 2007-2011¹



Note: Countries shown by ascending order of the NEET rates in 2011.

1. Youth aged 15-24 for Australia and Japan; 2007 Q2-2012 Q2 for Australia and 2012 Q1 for Japan.

Source: OECD estimates based on national labour force surveys and Eurostat, dashboard on EU youth indicators.

Strengthening accountability and school improvement

Recent reforms have been in line with OECD recommendations to raise education performance by enhancing school autonomy and accountability and

raising the quality of teaching and school leadership. They should also lead to higher efficiency of the spending in education. In 2008, Italy implemented

national assessments at the primary and lower secondary education to be shared with school administrators and education authorities with a view to provide formative feedback to improve instruction. There is an ongoing process to hire 2 000 new principals to start in September 2012. School inspectors will also be in charge of organizing school evaluations.

In order to build career progression for teachers, Italy has also recently started to experiment with teacher evaluation schemes and stakeholder discussions have been opened towards this end. This focus on teachers is welcome, as PISA shows that high-performing education systems invest in teachers and prioritise teaching quality. Currently teachers have a relatively long hike to the top of their salary scale with salary steps granted solely on the basis of seniority without consideration of performance. Lower-secondary school teachers reach the top of the salary scale only after 35 years of service, compared to the OECD average of 24 years. Teachers in Italy also earn around 40% less than other professionals with comparable education.

Yet, implementation of the evaluation system reforms is a challenge and school/teacher evaluation has previously turned out to be unpopular and ineffective. Italy needs to find appropriate methods

for assessing and preparing school inspectors and school leaders for the new evaluation system. Successful implementation will also require building stakeholder engagement and support for reform. Scotland and Sweden could provide models of good practice regarding accountability and improvement. For example external school evaluation in Scotland aims to challenge the school's self-evaluation procedures in a way that minimises intrusion to schools, but drives improvement at the national level. Innovation plays also an important role in improving learning outcomes, equity, or cost-effectiveness in education and technology may provide promising avenues towards that end. Italy is currently taking important steps in this direction. With the national plan for the introduction of digital technologies in schools, 51 000 classrooms have been equipped with interactive whiteboards. Over 400 of these classrooms (classi 2.0) serve as innovation labs for the possible uses of digital technology, and are networked together at regional level and with the local university. During the 2012-2013 school year the first cohort of school-wide innovation labs (scuole 2.0) will also start. It will be important to draw from the diversity of local solutions to scale-up this process.

Strengthening connections with the labour market

Youth have been strongly affected by crisis and many are unemployed or locked into precarious career paths. Education has a key role to play to improve their prospects on the labour market. The restructuring of primary and secondary education levels has to improve the links from secondary schooling into the labour market and tertiary education. In addition, the reform of the apprenticeship system is a major step for enhancing the impact on job creation of the vocational education and training systems (see chapter on Implementing the labour market reform). Yet, more could be done to strengthen the vocational education and training system and improve transitions to the labour market. Recent reforms are a step in the right direction and could be further strengthened by drawing on OECD experience in this area.

Less than half the students who enter tertiary education eventually graduate, and only about one-quarter of them graduate within the statutory length of time. In addition, tertiary graduates aged 25-34 years are more likely to be unemployed than those with only upper secondary school – in sharp contrast to the trend across most other OECD countries – suggesting that the tertiary education system is not preparing students well for the labour market. Despite the 2010 law on University Reform providing for changes in governing bodies, recruitment, funding and salaries, more is needed regarding tertiary education to improve its cost effectiveness, enhance the performance of universities and better bridge tertiary education with the labour market.

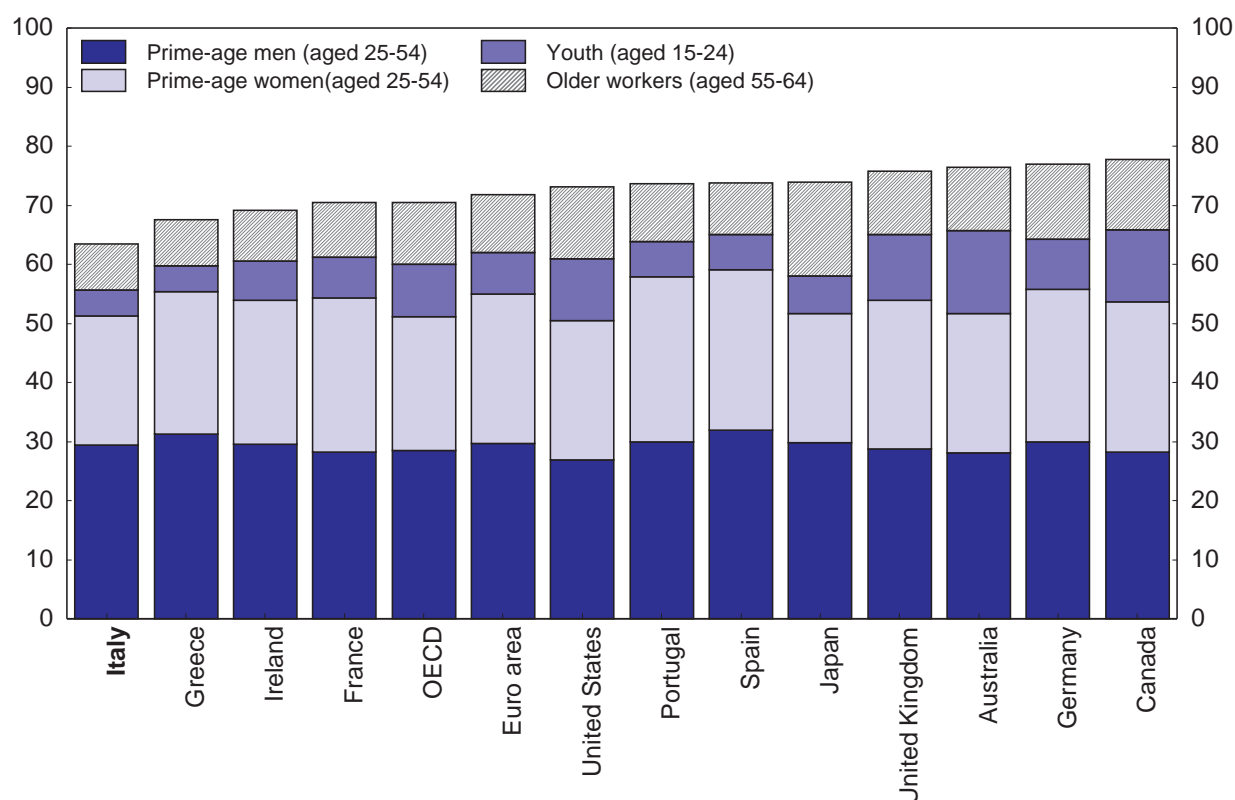
Key OECD recommendations

- **Ensure the development of a comprehensive evaluation and assessment framework**, building on stakeholder engagement, school leadership capacity and adequate evaluation and assessment procedures.
- **Improve teaching quality** through strengthening the professionalism of teachers, fostering teacher evaluation with the aim of improving standards, and rewarding teacher performance.
- **Support innovation in education** by building the capacity and developing incentives to learn from and scale up what works among the diversity of local solutions.
- **Improve the vocational education and training system** through more employer engagement and work-based training to better bridge education with the labour market.
- **Improve the performance and cost-effectiveness of universities** by incentivizing higher and faster completion rates, rationalization of courses offered and greater attention to developing skills for the labour market.

Implementing the labour market reform

The recently approved labour market reform is an integral part of the structural reform efforts that the Italian government is implementing. It aims at addressing the long-standing and severe challenges that characterise the Italian labour market. Italy stands out in international comparison for its highly segmented labour market (Figure 1). While gaps in participation rates between prime-age men, on the one hand, and other socio-demographic groups (i.e., youth, older workers and women), on the other, are observed in most OECD countries, in the case of Italy they are significantly wider.

Figure 1. Labour force participation rates by socio-demographic characteristics in selected OECD countries
Percentage of the working-age population (aged 15-64) in 2012 Q1



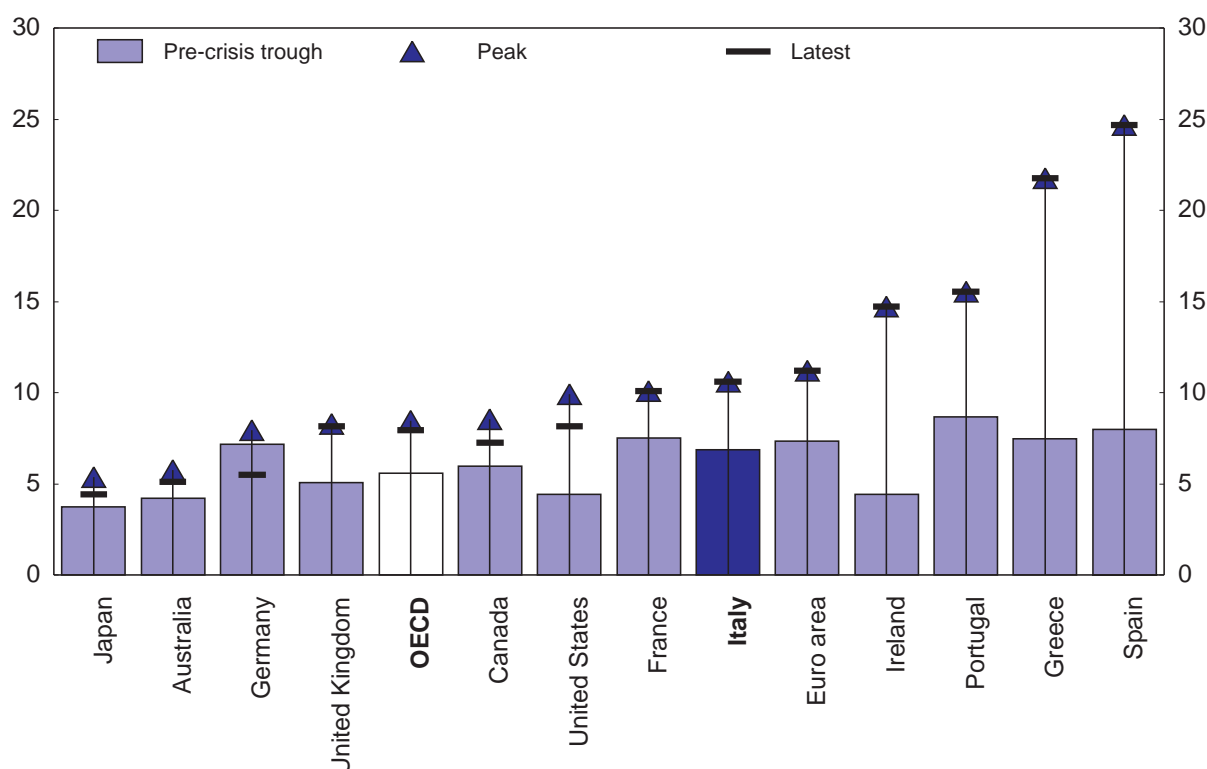
Note: Countries are ordered by ascending order of the working-age labour force participation rates.

Source: OECD calculations based on OECD Short-term Statistics Database.

The crisis has led to a further deterioration of labour market conditions with job losses concentrated on those on temporary and other atypical jobs, including many youth, unskilled and immigrants. At the same time, total unemployment is well above the OECD average (10.6% in the second quarter of 2012 against

an OECD weighted average of 7.9%, Figure 2) and youth unemployment is more than double the OECD average (36% in Italy, 16.1% in the OECD). In addition, the unemployed who were previously on precarious jobs are generally not eligible to standard unemployment benefits or other forms of income support.

Figure 2 . The labour market impact of the crisis and early recovery periods
Unemployment rates before the crisis, at its peak and its latest value ¹



Note: Countries are shown in by ascending order of by the unemployment rate at its peak.

1. Trough (peak) dates are defined as the start of the longest spell of consecutive increase (decrease) of the quarterly unemployment rates since 2007 Q1.

Source: OECD calculations based on the OECD Short-Term Labour Market Statistics (cut-off date: 7 September 2012).

The OECD indicators of the strictness of employment protection provide a useful yardstick for gauging the areas where labour market regulatory improvement was particularly needed in Italy (Figure 3). Before the reform, Italy's employment protection was stricter than the OECD average in several areas. Among regulations governing individual dismissal from permanent contracts, two areas stand out. First, the trial period, which is around 1-2 weeks for blue collar workers and 3-8 weeks for white collar workers, compared with an OECD average of around four months. A second area is the practice of reinstatement in the case of unfair dismissal. Although this practice exists in many OECD countries, it is rarely used and limited to the most severe cases of unjust dismissal (e.g., discriminatory practices).

One further area concerns the rules governing collective dismissals. In companies with 15 or more employees, substantial additional notification and consultation procedures, and in some cases additional severance costs, are required when dismissing five or more employees. In many OECD countries, collective dismissal rules apply only for dismissals of more than 10 or 20 employees in smaller firms, or around 30 employees or a fixed percentage (typically 10%) in larger firms. The administrative

rules governing collective dismissals are also quite onerous, encompassing consultation, legal criteria on the social and economic criteria used to decide on which workers are dismissed, and additional severance pay (financed by firm contributions to the Cassa Integrazione Guadagni, followed by firm-financed mobility allowances).

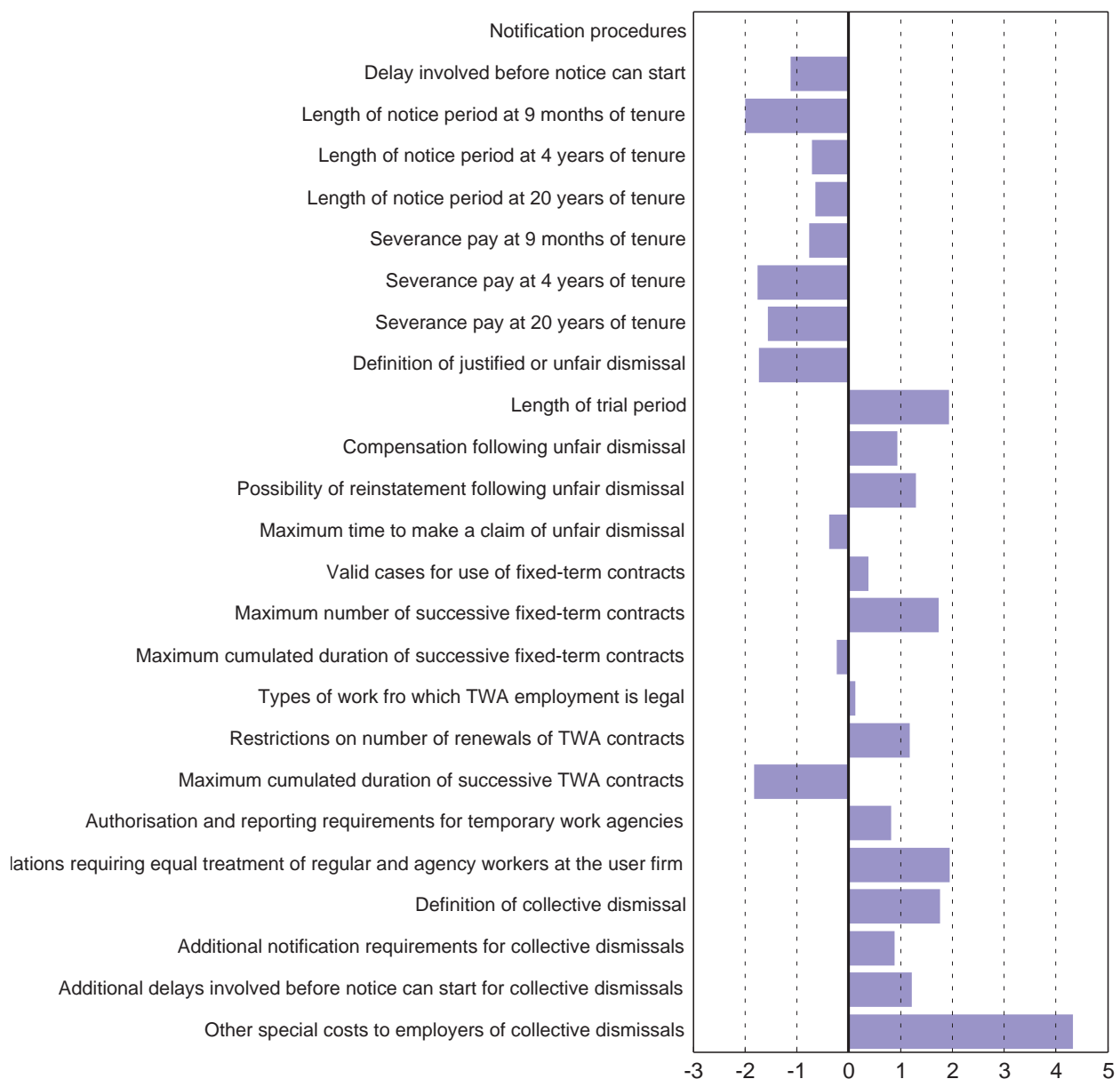
Italy also performs badly by comparison with other OECD countries in the functioning of its labour court system. Typically, the Italian labour courts take much longer to decide on cases than most other countries for which data allow such a comparison, and a large proportion of cases are appealed, which delays final decisions for firms and workers even longer. On average, the length of the process of dispute resolution is about 23 months in first level court (while e.g. only 4 in Germany) and the number of dismissal cases appealed is very large (about 59% compared with e.g. 3% in Germany).

The comprehensive labour market reform approved by the Parliament in June 2012 aims to tackle some of the above discussed issues. The reform is built on four main pillars: i) some relaxation of dismissal restrictions and simplification of procedures for dispute resolution; ii) the creation of an easier route for the insertion of youth in

the labour market, including via apprenticeship programmes; iii) the reduction of the incentives for atypical labour contracts, such as collaborators; and iv) some rationalisation and expansion in coverage of the unemployment benefit system. This comprehensiveness is required to tackle the complex problems in the Italian labour market. In particular, these measures should improve the

adaptability of the labour market while reducing its duality. Nevertheless, the reform must be implemented swiftly, which should be supported by the permanent monitoring and evaluation system designed in conjunction with the reform package. Careful monitoring will be needed to identify areas for further actions to improve the functioning of the labour market.

Figure 3. Difference in employment protection sub-indicators between Italy and OECD average, 2008



Source: OECD Indicators on Employment Protection.

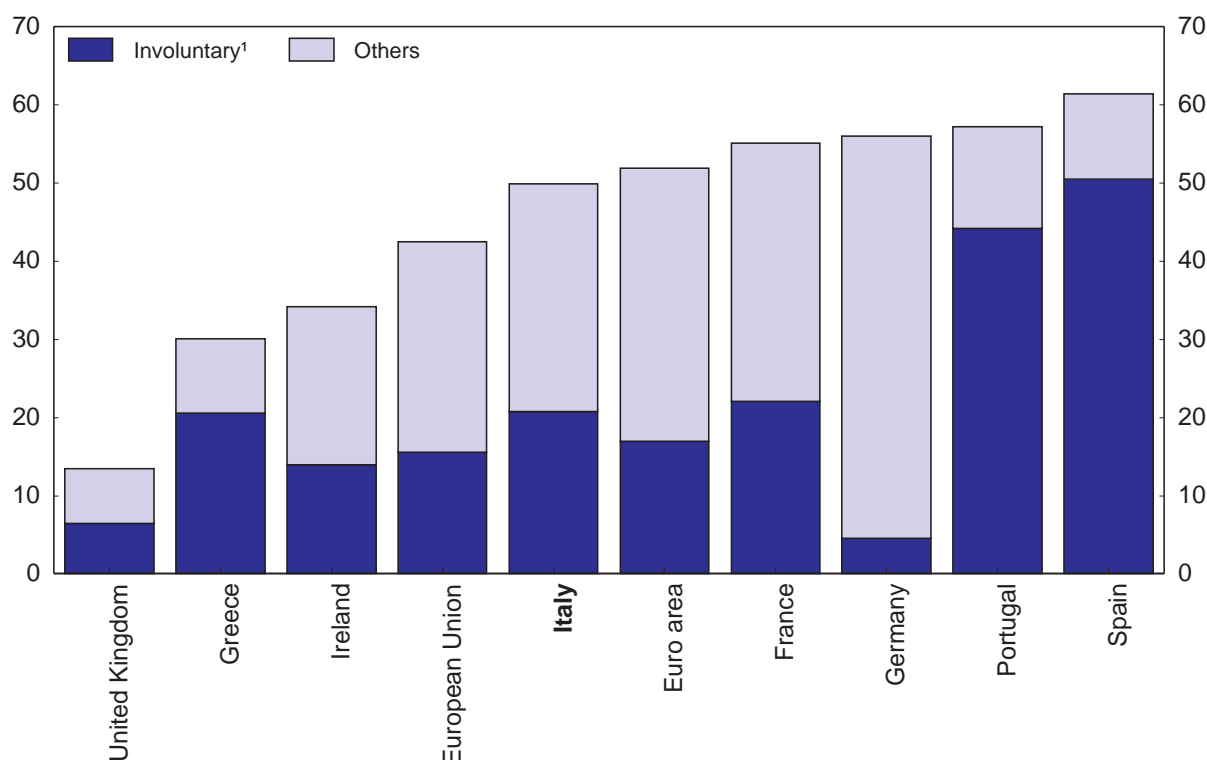
Reducing labour market duality while improving adaptability

A key step in the recently approved labour market reform to address labour market duality is the reduction of incentives to hiring workers on non-permanent contracts. The cooling-off period between two fixed-term contracts has been extended, the fiscal incentive for some types of non-permanent contracts has been reduced and tests to re-classify independent

contractors as employees have been introduced. If enforced appropriately, these measures will bring Italy close to best practice among OECD countries and should help reduce the share of precarious jobs. At present most youth in Italy declare to accept a temporary position because they lack other more stable work opportunities (Figure 4).

Figure 4. Involuntary temporary work among youth in selected European countries

Percentage of youth in temporary employment, 2011



Note: Countries are shown by ascending order of the incidence of temporary employment among youth.

1. The figures refer to the share of youth who reported being in temporary jobs because they could not find a permanent job.

Source: OECD calculations based on the European Union labour Force Survey (EULFS).

In addition, some relaxation and streamlining of employment protection rules for permanent contract have been introduced. First, the circumstances in which judges can order reinstatement following unfair dismissals have been circumscribed. As courts order reinstatement with back pay under cases of unfair dismissals considerably more often than in the other OECD countries, this element of the reform addresses one of the main weaknesses in Italian employment protection legislation. However, the fact that monetary compensation for unfair dismissal in the absence of reinstatement remains high is a concern. Compensation was raised to up to 24 months of wages in the case of large companies. Since back pay was suppressed by the reform in the case of large companies, this would not necessarily represent a net increase in compensation, compared with the pre-reform case when the worker decided for the compensation instead

of reinstatement. However, the new compensation is the third most generous in the OECD, after Sweden and Turkey, and going forward consideration should be given to reducing it, especially if unemployment benefits are made more generous. Second, the reform simplifies the procedures for dispute resolution, through the introduction of mandatory conciliation and simplified court procedures for dismissal cases. This is also an important step – even though its impact will need to be carefully monitored – given the costly dismissals procedures with uncertain consequences for both employers and employees.

These measures have been complemented by modifications of the apprenticeship system to facilitate the insertion of youth in the labour market and reduce precariousness. They include the temporarily exemption from the payment of contributions for small enterprises hiring apprentices

and the introduction of tax incentives for companies investing in training programmes. The overall number of apprentices that an employer can hire has been increased. To keep the apprentice after completion of the process of apprenticeship -- set to a fixed term of 3 years under the new regulation --

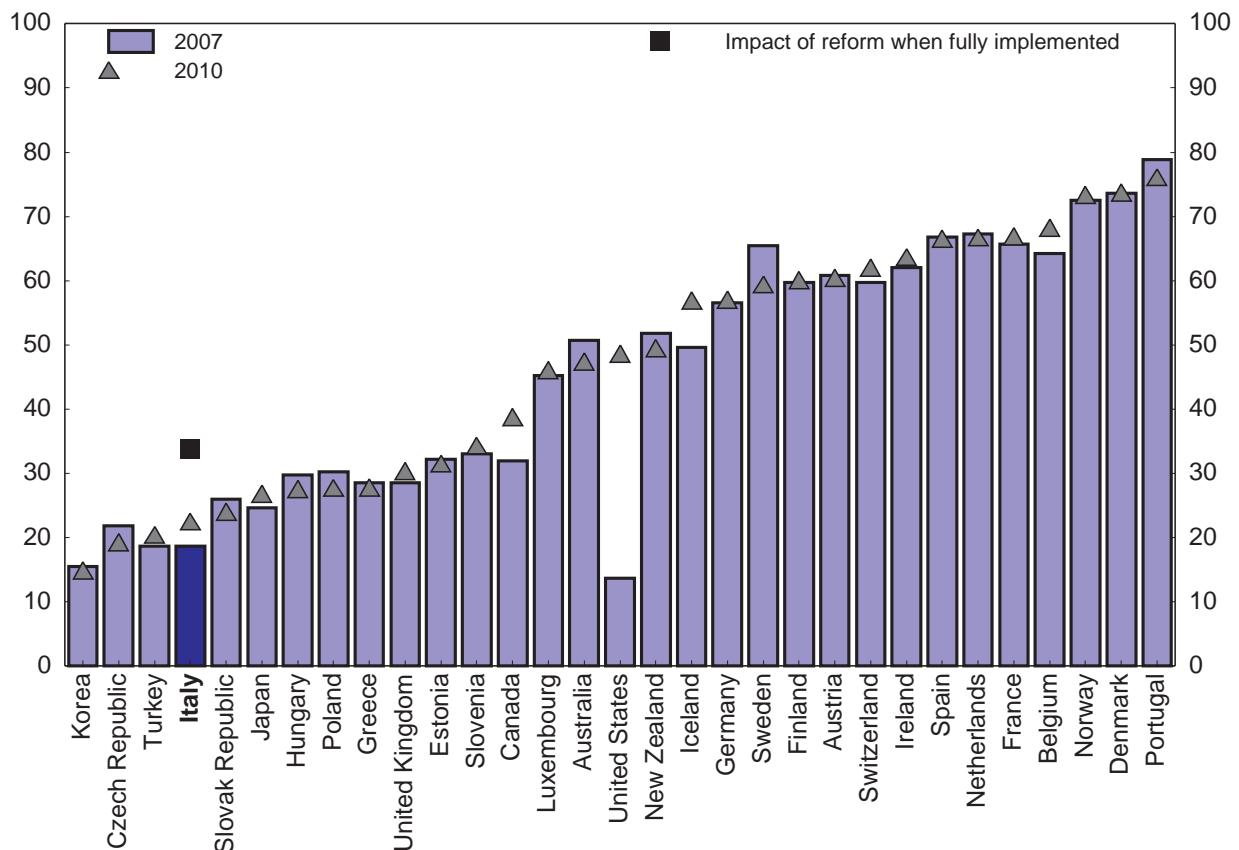
the employer will have to convert the apprenticeship contract into an indefinite contract. Looking forward, the implementation and facilitation of competency based, rather than time based, completions of apprenticeships could be contemplated, following for example the Australian approach.

Towards a more comprehensive unemployment benefit system

The reform is also a step towards a more universal unemployment benefit system which the OECD has urged Italy to establish for many years. It extends the pool of workers eligible to standard unemployment benefits and involves a moderate increase in the level of the unemployment benefits. OECD estimates suggest that these changes would result in a significant

increase of the net average replacement rate over the first two years of an unemployment spell – i.e., from the current comparatively low level of 22.5% to close to 34%. Assuming that the other countries do not change their system, Italy would gain some 7 positions in the ranking when the reform will be fully implemented (Figure 5).

Figure 5. Impact of changes in the level and duration of unemployment benefits on overall generosity
Average net replacement rates at different points for a two-year unemployment spell



Notes: Ascending order of the 2010 generosity measure. See *OECD 2007, Benefits and Wages 2007* for full details on the calculations.

Source: OECD calculations.

The introduction of adequate unemployment benefits needs to be complemented with an effective activation strategy to get people off benefits and back to work. The expansion of active labour market policies is therefore a priority for future reforms. Good OECD performers in this area are characterised by a strong integration of the agencies in charge of benefit administration and employment services, including placement and training (e.g. Germany, New Zealand, the United Kingdom and the United States). An integrated system promotes a quick return to work by strengthening the monitoring of job-search efforts and allowing for

better administered sanctions. The recent efforts to strengthen the role played by the public employment services, particularly their capacity to provide career orientation services, and to foster the conditionality of social benefits are steps in the right direction. Even so, achieving such a stronger integration in Italy remains a challenge, especially given the regions' responsibilities in the implementation of active labour market policies. Moreover, the unemployed are not required to provide regular proofs of job search in order to receive benefits. These challenges have not been tackled by the recent reform.

Key OECD recommendations

- **Implement the labour market reform without delays, while also introducing an effective monitoring system.** This will allow both keeping progress in check and identifying outstanding gaps where further improvements are needed.
- **Monitor new procedures for dispute resolution concerning dismissals.**
- **Consider reducing new compensation for unfair dismissals,** especially if unemployment benefits are made more generous.
- **Consider improving the regulatory framework on conciliation,** especially by increasing the incentives for parties to reach an agreement and avoid appealing to courts.
- **Continue the effort to reduce labour market segmentation,** by further extending unemployment benefit coverage and monitoring enforcement of regulation concerning independent contractors.
- **Expand active labour market policies,** in a way that ensures that public resources are concentrated on most effective measures (e.g. by identifying them through experimentation and monitoring).

Supporting female participation in the labour market by social policy reforms

Italy is characterised by a relatively low participation of women in the labour market. This is due to a large extent to the fact that families, and especially women, have always played a key role in the provision of care functions, mainly reflecting cultural and social traditions. But the social role of the family will be challenged going forward by the pressures stemming from population ageing, which greater female labour force participation could help mitigate.

An increase in the hours worked by Italian women has already helped compensate for income declines due to male job losses during the crisis. This new path could be consolidated if increased attention

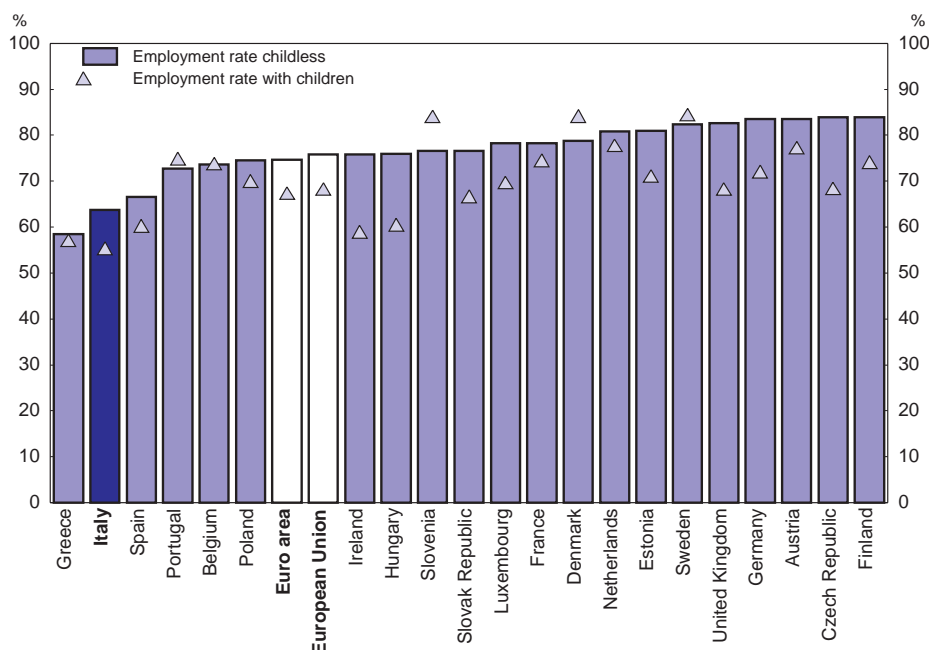
were paid to the child care and care-for-the-elderly angles of the social agenda. Affordable and effective policy solutions are available, drawing from the best practices and lessons in other countries.

Enhancing female labour market participation is a key priority

Women find it very difficult to combine family responsibilities with paid employment. In 2011, only 55% of Italian mothers with children aged less than 15 were employed, the second lowest among the European Countries of the OECD for which data is available (Figure 1), many of whom more than one third working part-time. This reflects a lack of childcare options. In 2009, Italy spent only 1.6% of GDP for families with children, well below the 2.4% OECD average; the share of public social

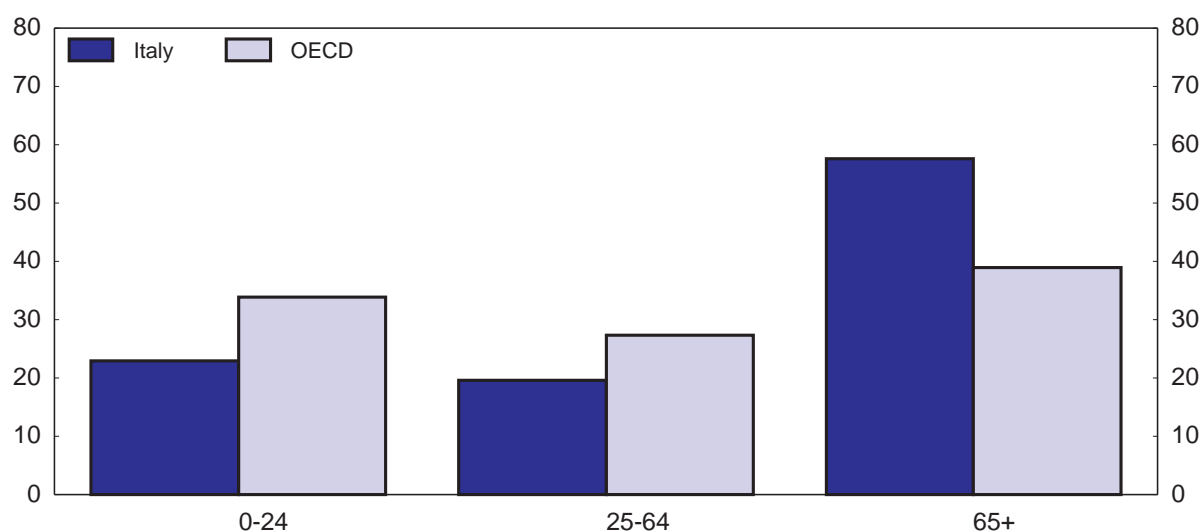
expenditure benefitting children and youth is significantly lower than the average in the OECD (Figure 2). Only about 29% of the children under age 3 participated in formal childcare, and only 6% of children age 6 to 11 used out-of-school hours care. There are, however, very large regional variations in terms of provision, financing and take-up of care. The North benefits from a high level of publicly subsidised provision and high take-up of formal childcare. In the South both supply and take-up are low.

Figure 1. Female employment rates,
Percentage of women aged 25-54 (childless/with children under 15), 2011



Source: Eurostat, European Union Labour Force Survey

Figure 2. Distribution of public social expenditures across the life cycle (% of total spending)¹



¹ Data are for 2009 and also include education spending.

Source: Preliminary data, OECD Social expenditure Database (SOCX)

In addition to childcare, many women also grant care to elderly relatives. In Italy, as in other countries of Southern Europe, more than 30% of family carers provide informal intensive care. Women providing

intensive unpaid care – especially those older than 50 years – are more likely to withdraw from the labour market, often permanently or returning to precarious jobs and low earnings.

Helping families reconcile work and care responsibilities

The availability of affordable and good quality childcare services plays a key role in the decision to return to work after childbirth. Support to public and private supply of early childcare services and out-of-school hours need to be strengthened, although there are Italian regions where significant progress has been made over the past decades. The funds recently allocated to increase coverage and quality of childcare services in the South are a move in this direction. Measures to expand the provision of child minders -- i.e., qualified professionals providing home assistance to a limited number of children (*nidi domiciliari*) – are also considered. This is welcome as child minders not only can increase childcare supply but also provide greater service flexibility (for example in terms of hours). However, the enforcement of the licensing system, alongside the monitoring of service adequacy, is essential. With the international experience suggesting that child minders can be relatively expensive, public assistance may be needed. Furthermore, the development of child minders needs to be seen as part of a network of formal childcare services integrating early childcare and childhood education services. The experience of OECD countries shows the importance of maintaining an integrated approach to in-kind services. On funding, Italy is considering to introduce a new social card that would grant a small income support to low income families with care needs. One complementary option would be to provide a tax incentive in the form of a tax deduction for care expenditures, as done in France, for example. Italy might also consider granting the

exclusive right to part of the parental leave to fathers, as Iceland, Norway or Sweden have done, to achieve greater paternal involvement in childcare and promote labour force participation among mothers, through a more equal division of paid and unpaid work.

Informal care provided by grandparents is an important part of work/family reconciliation strategies. Some countries have started to make care supports and/or leave entitlements available to grandparents. Parental benefits can be taken by Czech and Slovenian grandparents if they provide childcare and the parents agree to transfer their entitlement.

More generally, family-friendly measures for intensive informal care can yield high returns, provided that they foster participation in the labour market. Flexibility in the use of cash benefits could be a viable option for Italy, as long as the relatives who qualify as family carers are not trapped in low-paid employment. Another risk with cash benefits is the emergence of a grey market, where families use allowances to hire untrained non-family members at the detriment of formal care services. An alternative option is tax-incentives to support family caregivers (such as tax-exemptions for carer's allowance as in the Czech Republic or Ireland or tax-credit in Canada and the United States). Respite care and counselling services for carer can help reduce stress levels and increase the well-being of carers. Increasing the flexibility of workplace solutions is another important element. Working time flexibility and teleworking could be promoted among employers, as an alternative to part-time employment.

Main OECD policy recommendations

- **Increase supply and coverage of childcare** for children under the age of 3.
- **Increase public support for out-of-school hours care.**
- **Redistribute the rights to parental leave** to fathers, and to grandparents.
- **Promote working time flexibility** to help parents reconcile their work and care commitments.
- **Allow greater flexibility in use of cash benefits**, after careful design.
- **Provide respite care and counselling** services to reduce stress levels and increase well-being of carers.

Strengthening social cohesion through social mobility

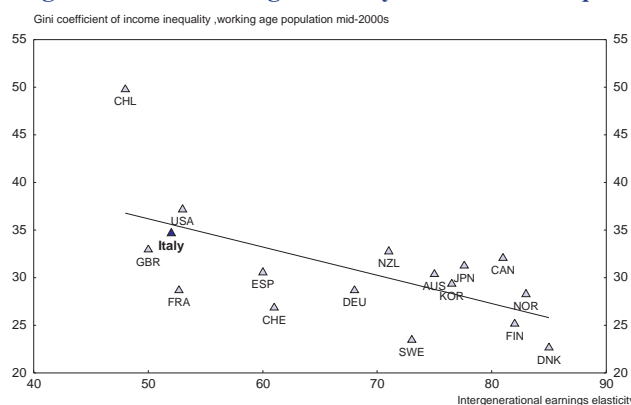
Social cohesion is a major policy concern in Italy as in most OECD countries because of the increasing social and ethnic diversity characterising modern societies and rising economic and social inequalities even before the crisis. Given its multidimensional nature, promoting social cohesion requires a combination of social, education and labour market policies already covered in previous chapters. An important aspect though is the extent to which the key characteristics and outcomes of individuals differ from those of their parents i.e. the degree of intergenerational social mobility. Societies where people believe that they can move up the social ladder thanks to their abilities, talents and efforts, rather than opportunities arising from their socio-economic background, are more likely to achieve social cohesion. Higher intergenerational mobility may also improve economic efficiency through a better allocation of talents. Intergenerational mobility is particularly low in Italy, and policies are needed to support it.

Low intergenerational earnings mobility

According to OECD analysis based on measures of intergenerational earnings mobility, Italy is among the most immobile OECD countries. Italy along with France, the United States and the United Kingdom have very low intergenerational earnings mobility elasticities at around 55 or less. An elasticity of around 50 implies that, on average, nearly 50% of the relative difference between Italians parents' earnings is transmitted to their children. On the other hand Denmark, Norway, Finland, and Canada display much higher mobility across generations – with less than 20% of the relative difference transmitted across generations.

There seems to be a link between income inequality and intergenerational income mobility, as reflected by a strong positive relation in a cross-section of twelve OECD countries between the extent of intergenerational earnings mobility and income inequality (Figure). Italy exhibits both very low levels of intergenerational mobility and high levels of income inequality measured with the Gini coefficient, which in turn increases the overall effect of low mobility. Social mobility is also particularly low in the extreme ranges of the income distribution (the bottom and the top deciles), ultimately strengthening the transmission of poverty and wealth over time.

Intergenerational earnings mobility and income inequality



Source: OECD (2008), "Growing Unequal?", www.oecd.org/els/social/inequality/GU, Paris; D'Addio A.C. (2012), "Fostering social mobility improving equality of opportunities across generations", forthcoming.

Investing in equitable education

Low intergenerational mobility in Italy starts with education. 21% of 15 year olds do not master basic skills (as measured by the PISA reading scale) and most of the variation in student performance in PISA can be explained by differences in average performance between schools rather than by differences in the performance of students within the same schools. Moreover, Northern regions tend to outperform Southern regions by a remarkably wide margin: for example, the mean score in reading was 522 for Lombardy and

448 for Calabria. A performing education system should sever the link between social background and educational outcomes so that most students have the opportunity to achieve their educational potential in a fair manner, regardless of their own personal and socio-economic circumstances. The key role education could play in enhancing mobility is illustrated by its impact on employment opportunities and earnings. Over their lifetimes, Italian men with a tertiary education can earn more than USD 300 000 more than men without that