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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Italy

{SWD(2024) 612 final}

Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Italy

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investment, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it helps achieve the economic and social recovery and implement sustainable reforms and investment, in particular to promote the green and digital transitions and make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the EU and support the continued implementation of the European Pillar of Social Rights.

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1 OJ L 2024/1263, 30.4.2024. ELI: http://data.europa.eu/eli/reg/2024/1263/oj

2 OJ L 306, 23.11.2011, p. 25. ELI: http://data.europa.eu/eli/reg/2011/1176/oj

3 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17). ELI: http://data.europa.eu/eli/reg/2021/241/oj

(2) The REPowerEU Regulation[4], adopted on 27 February 2023, aims to phase out the EU's dependency on Russian fossil fuel imports. This would help achieve energy security and diversify the EU's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Italy added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

(3) On 16 March 2023, the Commission issued a Communication on the 'Long-term competitiveness of the EU: looking beyond 2030'[5], in order to inform policy decisions and create the framework conditions for increasing growth. The Communication frames competitiveness along nine mutually reinforcing drivers. Among these drivers, access to private capital, research and innovation, education and skills, and the single market emerge as paramount policy priorities for reform and investment to address current productivity challenges as well as to build up the long-term competitiveness of the EU and its Member States. On 14 February 2024, the Commission followed this Communication with the Annual Single Market and Competitiveness Report[6]. The report details the competitive strengths and challenges of Europe's Single Market, tracking yearly developments according to the nine competitiveness drivers identified.

(4) On 21 November 2023, the Commission adopted the 2024 Annual Sustainable Growth Survey[7], marking the start of the 2024 cycle of the European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 22 March 2024. On 21 November 2023, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2024 Alert Mechanism Report, in which it identified Italy as one of the Member States that may be affected or may be at risk of being affected by imbalances, and for which an in-depth review would be needed. On the same date, the Commission adopted an opinion on the 2024 draft budgetary plan of Italy. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which the Council adopted on 12 April 2024, as well as the proposal for the 2024 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 11 March 2024.

(5) On 30 April 2024, the EU's new economic governance framework came into force. The framework includes the new Regulation of the European Parliament and of the Council (EU) 2024/1263 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97. It also includes the amended Regulation (EC) No 1467/97 on the implementation of the excessive deficit procedure and the amended Directive 2011/85/EU on the budgetary frameworks of Member States[8]. The objectives of the

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4 Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1). ELI: http://data.europa.eu/eli/reg/2023/435/oj

5 COM(2023) 168 final.

6 COM(2024) 77 final.

7 COM(2023) 901 final.

8 Council Regulation (EU) 2024/1264 of 29 April 2024 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L, 2024/1264, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1264/oj) and Council Directive (EU) 2024/1265 of

new framework are public debt sustainability and sustainable and inclusive growth through gradual fiscal consolidation as well as reforms and investments. It promotes national ownership and has a greater medium-term focus, combined with more effective and coherent enforcement. Each Member State should submit to the Council and to the Commission a national medium-term fiscal-structural plan. National medium-term fiscal-structural plans contain the fiscal, reform and investment commitments of a Member State, covering a planning horizon of 4 years or 5 years depending on the regular length of the national legislature. The net expenditure[9] path in the national medium-term fiscal-structural plans should comply with the requirements of Regulation (EU) 2024/1263, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period at the latest, or for it to remain at prudent levels below 60% of GDP, and to bring and/or maintain the government deficit below the 3% GDP reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in Regulation (EU) 2024/1263, the adjustment period may be extended by 3 years at most. For the purpose of supporting the preparation of those plans, on [21 June] 2024 the Commission is set to provide Member States with guidance on the content of the plans and the subsequent annual progress reports that they will need to submit and, in accordance with Article 5 of Regulation (EU) 2024/1263, will transmit to them technical guidance on the fiscal adjustments (reference trajectories and technical information, where applicable). Member States should submit their medium-term fiscal-structural plans by 20 September 2024, unless the Member State and the Commission agree to extend the deadline by a reasonable period of time. Member States should ensure the involvement of their national parliaments, and the consultation of independent fiscal institutions, of social partners and other national stakeholders, as appropriate.

(6) In 2024, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. The 2019, 2020, 2022 and 2023 country-specific recommendations remain equally relevant also for recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(7) On 30 April 2021, Italy submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines of Annex V to that Regulation. On 13 July 2021, the Council adopted its Decision on the approval of the assessment of the

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29 April 2024 amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (OJ L, 2024/1265, 30.4.2024, ELI: http://data.europa.eu/eli/dir/2024/1265/oj).

9 Net expenditure as defined in Article 2 of Council Regulation (EU) 2024/1263 of 29 April 2024 (OJ L 2024/1263, 30.4.2024. ELI: http://data.europa.eu/eli/reg/2024/1263/oj). Net expenditure means government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by Union funds revenue, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure, and (vi) one-offs and other temporary measures.

recovery and resilience plan for Italy[10], which was amended on 8 December 2023 following Article 18(2) of Regulation (EU) 2021/241 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[11]. The release of instalments is conditional on a decision by the Commission, taken in accordance with Article 24(5) of Regulation (EU) 2021/241, that Italy has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement presupposes that the achievement of preceding milestones and targets has not been reversed.

(8) On 30 April 2024, Italy submitted its 2024 National Reform Programme and its 2024 Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. In accordance with Article 27 of Regulation (EU) 2021/241, the 2024 National Reform Programme also reflects Italy's biannual reporting on the progress made in achieving its recovery and resilience plan.

(9) The Commission published the 2024 country report for Italy[12] on 19 June 2024. It assessed Italy's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2023 and took stock of Italy's implementation of the recovery and resilience plan. Based on this analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Italy's progress on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

(10) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Italy. The main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Italy for the purposes of that Regulation were published in April 2024[13]. On 19 June 2024, the Commission concluded that Italy is experiencing macroeconomic imbalances after being identified with excessive imbalances in 2023. In particular, Vulnerabilities related to high government debt and weak productivity growth in a context of labour market fragilities and some residual weaknesses in the financial sector, which have cross-border relevance, remain. Italy's public debt-to-GDP ratio markedly declined since its peak during the COVID-19 pandemic crisis, principally due to strong nominal GDP growth. However, the public debt ratio is still high, at over 137% of GDP in 2023, and the downward trend is projected to reverse this year and next. This reversal is attributed to a large debt-increasing stock-flow adjustment, still sizeable, though decreasing, government deficits, as well as lower nominal GDP growth. Productivity growth has overall and on average been positive but limited, which confirms the need of reforms and investment to overcome structural shortcomings and to foster favourable conditions to productivity growth. Labour market conditions have improved in recent years and did not translate into wage pressures. Labour participation rates have risen to record levels

[10] Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Italy (ST 10160/21 INIT; ST 10160/21 ADD 1; ST 10160/21 ADD 1 REV 1; ST 10160/21 ADD 1 REV 2; ST 10160/21 ADD 1 REV 2 COR 1).

[11] Council Implementing Decision of 8 December 2023 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Italy (ST 16051 2023 INIT).

[12] SWD(2024) 612 final.

[13] SWD(2024) 104 final.

though these are still comparatively low. The financial sector has further strengthened with improvements in bank asset quality and profitability, while Italian banks are still considerably exposed to the sovereign and to state-guaranteed loans in their balance sheets. Policy action has been favourable to tackle the vulnerabilities, including through the RRP implementation, which inter alia promote productivity and potential GDP growth to help reduce the public debt ratio over the longer term. Keeping up the pace of RRP implementation remains essential and additional policy efforts would be beneficial. More action is clearly needed to reduce the high public debt ratio. The reformed Stability and Growth Pact, including the application of the Excessive Deficit Procedure, offers a suitable and strong surveillance mechanism to address the fiscal sustainability risks, and to complement surveillance under the MIP.

(11) Based on data validated by Eurostat[14], Italy's general government deficit decreased from 8.6% of GDP in 2022 to 7.4% in 2023, while the general government debt fell from 140.5% of GDP at the end of 2022 to 137.3% at the end of 2023. As announced in the fiscal policy guidance for 2024[15], the Commission is taking the first step for the opening of deficit-based excessive deficit procedures on the basis of the outturn data for 2023, in line with existing legal provisions. On 19 June 2024, the Commission adopted a report under Article 126(3) of the TFEU[16]. That report assessed the budgetary situation of Italy, as its general government deficit in 2023 exceeded the reference value of 3% of GDP. The report concluded that in the light of this assessment, and after considering the opinion of the Economic and Financial Committee as established under article 126(4) TFEU, the Commission intends to propose in July to open excessive deficit procedure, by recommending to the Council to adopt a Decision under Article 126(6) establishing the existence of an excessive deficit for Italy.

(12) On 12 July 2022, the Council recommended[17] that Italy ensure in 2023 a prudent fiscal policy, in particular by limiting the growth of nationally financed primary current expenditure below medium-term potential output growth[18], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. At the same time, Italy was recommended to stand ready to adjust current spending to the evolving situation. Italy was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. In 2023, according to the Commission estimates, the fiscal stance[19] was slightly

14 Eurostat-Euro Indicators, 22.4.2024.

15 COM(2023) 141 final.

16 Report from the Commission, prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, 19.6.2024, COM(2024)598 final.

17 Council Recommendation of 12 July 2022 on the National Reform Programme of Italy and delivering a Council opinion on the 2022 Stability Programme of Italy OJ C 334, 1.9.2022, p. 96.

18 Based on the Commission Spring 2024 Forecast, the medium-term potential output growth of Italy in 2023 is estimated at 5.9% in nominal terms, based on the 10-year average real potential growth rate and the 2023 GDP deflator.

19 The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures (and excluding temporary emergency measures

expansionary, by 0.3% of GDP, in a context of high inflation. The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 provided a contractionary contribution to the fiscal stance of 1.0% of GDP and was in line with the Council recommendation. The contractionary contribution of nationally financed primary current expenditure was due to the reduced costs of the emergency support measures (targeted and untargeted) to households and firms in response to energy price hikes (by 1.4 percentage points of GDP). Pensions and cuts to the labour tax wedge were the main drivers of growth in nationally financed primary current expenditure (net of discretionary revenue measures). Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 0.8% of GDP in 2023. Nationally financed investment amounted to 2.9% of GDP in 2023, representing an increase of 0.3 percentage points as compared to 2022. Italy financed additional investment through the Recovery and Resilience Facility and other EU funds. It financed public investment for the green and digital transitions, and for energy security, such as the strengthening of smart grids, the construction of the "Tyrrhenian link", the development of rapid mass transport systems, the production of hydrogen in brownfield sites, fast internet connections and the digitisation of the public administration, which are partly funded by the Recovery and Resilience Facility and other EU funds.

(13) The key projections in the 2024 Stability Programme can be summarised as follows. The macroeconomic scenario underpinning the budgetary projections foresees real GDP growth at 1.0% in 2024 and 1.2% in 2025, while it projects HICP inflation at 1.2% in 2024 and 1.8% in 2025. The general government deficit, under the unchanged legislation scenario, is projected to decrease to 4.3% of GDP in 2024 and to 3.7% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase by 0.5 pp, to 137.8% by the end of 2024 and, subsequently, increase to 138.9% by the end of 2025. After 2025, the general government deficit is projected to decrease to 3.0% of GDP in 2026, and 2.2% in 2027. Therefore, the general government deficit is projected to not exceed the 3% of GDP deficit reference value from 2026. In turn, after 2025, the general government debt-to-GDP ratio is projected to further increase to 139.8% in 2026, and to decrease marginally to 139.6% in 2027.

(14) The Commission Spring 2024 Forecast projects real GDP to grow by 0.9% in 2024 and 1.1% in 2025, and HICP inflation to stand at 1.6% in 2024 and 1.9% in 2025.

(15) The Commission Spring 2024 Forecast projects a government deficit of 4.4% of GDP in 2024, while the general government debt-to-GDP ratio is set to increase to 138.6% by the end of 2024. The projected decrease of the deficit in 2024 mainly reflects the complete phase-out of energy support measures and the much lower budgetary cost of tax credits for housing renovation (¼% of GDP from around 3½% in 2023), due to changes in legislation which also led to the statistical classification of new tax credits as "non-payable" (while earlier tax credits were classified as "payable"). The increase of the debt-to-GDP ratio in 2024 reflects the strong increase in the stock-flow adjustment due to the delayed impact of 2021-2023 tax credits for housing renovation on the cash flow. Based on the Commission's estimates, the fiscal stance is projected to be contractionary at 3.1% of GDP in 2024.

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related to the COVID-19 crisis) and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

(16) Expenditure amounting to 0.6% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2024, compared to 0.8% of GDP in 2023, according to the Commission Spring 2024 Forecast. Expenditure financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Italy. Expenditure amounting to 1.3% of GDP is expected to be backed by loans from the Recovery and Resilience Facility in 2024, compared to 0.3% of GDP in 2023, according to the Commission Spring 2024 Forecast.

(17) On 14 July 2023, the Council recommended[20] that Italy ensure a prudent fiscal policy, in particular by limiting the nominal increase in net nationally financed primary expenditure[21] in 2024 to not more than 1.3%. When executing their 2023 budgets and preparing their Draft Budgetary Plans for 2024, Member States were invited to take into account that the Commission would propose to the Council the opening of deficit-based excessive deficit procedures based on the outturn data for 2023. According to the Commission Spring 2024 Forecast, Italy's net nationally financed primary expenditure is projected to decrease by 2.8% in 2024[22], which is below the recommended maximum growth rate. This lower spending over the recommended maximum growth rate in net nationally financed primary expenditure corresponds to 2.0% of GDP in 2024. However, net expenditure in 2023 was higher than expected at the time of the recommendation (by 2.9% of GDP). Therefore, as the recommendation for 2024 was formulated as a growth rate, the assessment of compliance also needs to take into account the base effect from 2023. Had net expenditure in 2023 been the same as expected at the time of the recommendation, the resulting growth rate of net expenditure in 2024 would have been above the recommended growth rate by 0.9% of GDP. Therefore, net nationally financed primary expenditure is assessed as at risk of being not fully in line with the recommendation.

(18) Moreover, the Council recommended that Italy take action to wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. The Council further specified that, should renewed energy price increases necessitate new or continued support measures, Italy should ensure that these were targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

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20 Council Recommendation of 14 July 2023 on the 2023 National Reform Programme of Italy and delivering a Council opinion on the 2023 Stability Programme of Italy, OJ C 312, 1.9.2023, p. 105.

21 Net primary expenditure is defined as nationally financed expenditure net of (i) discretionary revenue measures, (ii) interest expenditure, (iii) cyclical unemployment expenditure, and (iv) and one-offs and other temporary measures.

22 This takes into account 0.04% of GDP one-off measures in 2024, relating to various withholding taxes and revenues related to taxpayers voluntarily regularising their past tax position (so-called "tregua fiscale") with reduced sanctions and fines compensated by interventions related to the floods which hit Italy in May 2023 (as well as 0.3% of GDP in 2023, relating to various withholding taxes and revenues related to taxpayers voluntarily regularising their past tax position (so-called "tregua fiscale") with reduced sanctions and fines only partly compensated by interventions related to the floods which hit Italy in May 2023). On 14 July 2023, the Council also referred to the devastating floods that hit Italy in May 2023 and agreed that the cost of direct emergency support related to those floods would be taken into account in subsequent assessments of compliance and would, in principle, be considered as one-off and temporary measures.

According to the Commission Spring 2024 Forecast, the net budgetary cost[23] of energy support measures is estimated at 1.0% of GDP in 2023 and projected at 0.0% in 2024. If the related savings were used to reduce the government deficit, as recommended by the Council, these projections would imply a fiscal adjustment of 1.0% of GDP in 2024, whereas net nationally financed primary expenditure[24] provides a contractionary contribution to the fiscal stance of 2.7% of GDP in that year. However, the latter is driven by the contractionary contribution of other capital expenditure of 3.2% of GDP, which is mainly related to the above-mentioned sharp reduction of subsidies related to tax credits for housing renovation in 2024. At the same time, the contribution of net nationally financed current primary expenditure to the fiscal stance, which is affected by the phase-out of current energy support measures, is projected to be expansionary by 0.4% of GDP, pointing to the full use of the 0.8% of GDP savings from those current energy support measures for expansionary policies increasing net current spending in 2024, including labour tax wedge cuts. The emergency energy support measures are projected to be wound down as soon as possible in 2023 and 2024. This is in line with what was recommended by the Council. However, the related savings are not projected to be fully used to reduce the government deficit. This risks being not in line with what was recommended by the Council.

(19) In addition, the Council also recommended that Italy preserve nationally financed public investment and ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds, in particular to foster the green and digital transitions. According to the Commission Spring 2024 Forecast, nationally financed public investment is projected at 2.8% of GDP in 2024 from 2.9% of GDP in 2023[25]. This is in line with the Council recommendation. In turn, public expenditure financed from revenues from EU funds, including Recovery and Resilience Facility grants, is expected to decrease to 0.8% of GDP in 2024 (from 1.2% of GDP in 2023), mainly in relation to ReactEU.

(20) Based on policy measures known at the cut-off date of the forecast and on a no-policy-change assumption, the Commission Spring 2024 Forecast projects, a government deficit of 4.7% of GDP in 2025. The increase of the deficit in 2025 mainly reflects the expected prolongation of the labour tax wedge cuts and a further increase in interest expenditure. The general government debt-to-GDP ratio is set to further increase to 141.7% by the end of 2025. The projected increase of the debt-to-GDP ratio in 2025 mainly reflects a less favourable interest-growth-rate differential and a debt-increasing stock-flow adjustment related to the delayed cash impact of government-supported housing renovation.

(21) Italy's tax revenues in relation to GDP are relatively high in comparison to peer Member States, with the main contribution coming from labour taxation. Following parliamentary approval of an enabling law that provides for a broad mandate to reform

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23 The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

24 This contribution is measured as the change in general government primary expenditure, net of (i) the incremental budgetary impact of discretionary revenue measures, (ii) one-offs, (iii) cyclical unemployment expenditure and (iv) expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate, expressed as a ratio to nominal GDP.

25 When rounding at the first decimal, the difference of nationally financed public investment between 2024 and 2023 is 0.0.

the tax system, the government adopted several implementing decrees. However, the measures adopted so far do not address the key challenges of the taxation system, and the cuts to the labour tax wedge, legislated only until 2024 and financed via temporary provisions, are quite limited in scope. In addition, the extension of flat-rate tax regimes, including for the self-employed, worsen the horizontal equity and efficiency of the tax system by reducing redistribution, favouring specific taxpayers' categories and disincentivising business growth. Furthermore, while several important measures on tax administration and simplification are being implemented as part of the recovery and resilience plan, such as pre-filled VAT declarations, other recent measures risk producing adverse effects on tax compliance. These include the 5-year term for collecting tax bills, the reduction of sanctions related to the evasion of taxes and social security contributions, and the renewal of measures similar to tax amnesties. The effect on tax compliance of the system of prior agreement between the taxpayer and the administration on tax liabilities for small businesses also warrants close monitoring. Overall, a more structural and growth-friendly reform of the tax system would require a budgetary neutral shift of the tax burden from productive factors to other sources less detrimental to growth. In this regard, no details are yet known on the planned streamlining of value-added tax, while the update of cadastral values, which are largely outdated and divergent from market values, was not included in the enabling law for the tax reform. In addition, significant revenue losses are observed in relation to public concessions, including beaches. Furthermore, despite relatively high revenues from environmental taxes, Italy's tax system could better support the green transition, in particular by aligning taxation to the level of CO_2 emissions of energy sources and vehicles, including for company cars.

(22) In accordance with Article 19(3), point (b), and Annex V, criterion 2.2 of Regulation (EU) 2021/241, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, proceeding swiftly with the effective implementation of the plan, including the REPowerEU chapter, is essential to boost Italy's long-term competitiveness through the green and digital transition, while ensuring social fairness. To deliver on the commitments of the plan by August 2026, it is essential for Italy to continue the implementation of reforms and to accelerate investments by addressing emerging delays while ensuring strong administrative capacity. Investments in particular are highly concentrated towards the end of implementation of the recovery and resilience plan and merit special attention. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(23) As part of the mid-term review of the cohesion policy funds, in accordance with Article 18 of Regulation 2021/1060, Italy is required to review each programme by March 2025, taking into account, among other things, the challenges identified in the 2024 country-specific recommendations, as well as its national energy and climate plan. This review forms the basis for the definitive allocation of the EU funding included in each programme. While Italy has made progress in implementing cohesion policy and the European Pillar of Social Rights, challenges remain and regional disparities persist between the centre-north and the south. Accelerating the implementation of cohesion policy programmes, coupled with the strengthening of administrative capacity, at national and particularly at subnational level, is crucial. The priorities agreed in the programmes remain relevant. Beyond the administrative

capacity measures, it is particularly important to see fast implementation of investments in research, innovation and competitiveness, notably in the less developed regions, in tandem with infrastructure development plans and regional smart specialisation strategies. Italy should continue raising the quality of essential public services in the south, in particular water and waste services, including by promoting single operators at regional level. It continues to be important to promote upskilling and reskilling, including for the green transition, by increasing tertiary education attainment and the share of adults enrolled in training. Reducing the number of young people not in education, employment or training by improving the educational system and better targeting active labour market policies remains a priority, particularly in the south. Furthermore, it is necessary to continue supporting the employment of women by increasing the supply of affordable and quality early childcare. Italy could also make use of the Strategic Technologies for Europe Platform initiative to support the transformation of industrial ecosystems, in particular in the south. Effective intervention could entail integrated industrial policies that support the development and application of strategic technologies, especially in the areas of digital innovation, clean energy and resource efficiency, in particular in the sectors that already have a strong presence in the south, such as the automotive and aeronautics industries. The strategic plan for the new single Special Economic Zone for the South could become a coherent framework to boost business innovation and productivity by targeting critical projects and strengthening integration across value chains.

(24) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Italy faces several additional challenges related to taxation, demography, including its implications for fiscal sustainability, industrial strategy and competition policy.

(25) Italy is one of the EU Member States with the oldest population, the lowest birth rate and a higher-than-average age of women giving birth to their first child. The migration balance remains positive, but no longer offsets the low birth rate. As a result, the working age population continues to shrink, limiting potential growth. Unfavourable demographic developments are set to increase pension expenditure as a share of GDP up to 2040, further exacerbated by early retirement schemes introduced in recent years. In the longer term, pension expenditure is expected to progressively decline, also thanks to the 2011 pension reform provided it is implemented in full, including by limiting early retirement schemes. A stronger and more inclusive labour market for women and young people, together with higher job quality, including in terms of lower levels of in-work poverty and better access to social protection for non-standard workers, can help mitigate the demographic challenge. To this end, family-related policies, including measures to promote work-life balance, equal opportunities as well as accessible and high-quality care services, could also play an important role. Furthermore, migration could be also used to counteract the demographic decline, particularly in the short and medium term. Although measures taken in 2024 increase the number of non-EU nationals admitted to Italy and simplify the recognition of foreign educational titles, a comprehensive strategy to attract and retain high-skilled workers and students remains key to fighting the brain drain and counteracting demographic trends. In this context, all these measures would also contribute to

supporting upward social convergence, in line with the Commission services' second-stage analysis based on the features of the Social Convergence Framework[26].

(26) The economy of the south contributed to the post-COVID recovery. Nonetheless, southern regions remain characterised by economic activities with lower added value than in the regions of the centre-north. Furthermore, the south's exports are expected to be affected in particular by decarbonisation efforts. Several policy measures are supporting economic activities in the south, in particular tax incentives. In 2023, Italy created a single Special Economic Zone for the south, transferring the responsibility for the previous zones under a single body within the Presidency of the Council of Ministers. The strategic plan for this zone is still to be approved. The Recovery and Resilience Facility and other EU funds contribute to investments and reforms in southern regions. An industrial and development strategy for the south is needed to better target existing policy measures and improve the value added of EU and national investments. In this respect, the south has considerable potential in a number of sectors, such as logistics in the Mediterranean and renewable energy value chains. Furthermore, strengthening science-business linkages to turn scientific knowledge into practical solutions is key to industrial revitalisation and to positioning the south in global value chains. To this end, further institutionalising the role of technology transfer offices, especially in the south, for example by strengthening administrative capacity, will be instrumental. The identification and selection of these strategic sectors in a development strategy is a relevant factor in increasing the competitiveness of southern regions, with a positive impact at national level. Targeting existing policy measures and focusing planned investment on these sectors can further increase their economic impact.

(27) Improvements to the business environment would facilitate entrepreneurship, and better framework conditions for competition would favour a more efficient allocation of resources and lead to competitiveness and productivity gains. Greater competition and improved sectoral regulation would also benefit consumers and improve government finances, helping address Italy's vulnerabilities of high government debt and weak productivity growth as mentioned in recital (10). The 2022 annual competition law, adopted in December 2023, will need to be properly implemented. In line with Italian legislation, the Italian recovery and resilience plan envisages the adoption of a competition law on an annual basis. However, it does not specify all sectors to be covered by the annual competition laws. A legislative initiative is particularly warranted for retail trade, notably concerning the regulation on opening shops and running sales promotions, for regulated professions, particularly to ease the conditions for accessing them, as well as for railways, where the award of contracts for regional transport and intercity services needs to be competitive. Moreover, according to the Italian competition authority, significant barriers to competition persist in a number of other sectors, such as postal services, pharmaceuticals, chambers of commerce and private hire vehicle services.

In view of the close interlinkages between the economies of euro area Member States and of their collective contribution to the functioning of the Economic and Monetary Union, in 2024 the Council recommended that the euro area Member States take action, including through their recovery and resilience plans, to implement the recommendation on the economic policy of the euro area. For Italy, recommendations

[26] SWD(2024)132 final.

(1), (2), (3) and (4) help implement the first, second, third and fourth euro area recommendations.

(28) In light of the Commission's in-depth review and its conclusion on the existence of imbalances, recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1), (2), (3) and (4) below. Policies referred to in recommendation (1) help to address vulnerabilities linked to high government debt. Policies referred to in recommendations (2), (3) and (4) help to address vulnerabilities linked to weak productivity growth, which by extension supports potential GDP growth, and as a result also contribute to address recommendation (1). Recommendations (1), (2), (3) and (4) contribute to both addressing imbalances and implementing the recommendation for the euro area, in line with recital 27.

HEREBY RECOMMENDS that Italy take action in 2024 and 2025 to:

1. Submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure[27] in 2025 to a rate consistent with putting the general government debt on a plausibly downward trajectory over the medium term and reducing the general government deficit towards the 3% of GDP Treaty reference value. Make the tax system more supportive to growth, with a focus on reducing the tax wedge on labour and in line with fiscal sustainability objectives, including by reducing tax expenditures and updating cadastral values, while ensuring fairness and progressivity and supporting the green transition.

2. Strengthen administrative capacity to manage EU funds, accelerate investments and maintain momentum in the implementation of reforms. Address emerging delays to allow for continued, swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter, ensuring completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of their mid-term review continue focusing on the agreed priorities, while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.

3. In order to mitigate the effects on potential growth, tackle negative demographic trends including by attracting and retaining high-skilled workers and by addressing labour market challenges, in particular with regards to women, young people and in-work poverty, notably of workers with non-standard contracts.

[27] According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

4. Define an industrial and development strategy to reduce the territorial divide by streamlining current policy measures and by taking into account key infrastructure projects as well as strategic value chains. Address restrictions to competition, in particular in the retail sector, regulated professions and railways.

Done at Brussels,

For the Council
The President