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Lessons from Two Public Sector Reforms in Italy

by Nazim Belhocine and La-Bhus Fah Jirasavetakul

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I N T E R N A T I O N A L M O N E T A R Y F U N D

IMF Working Paper

European Department

Lessons from Two Public Sector Reforms in Italy¹

Prepared by Nazim Belhocine and La-Bhus Fah Jirasavetakul

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Abstract

The reform of the Italian public administration has been a priority for at least two decades, with several major initiatives undertaken toward modernization and simplification. Notwithstanding laudable intentions, however, progress remains limited. This analysis is a case study of two reforms since 2016—on the rationalization of state-owned enterprises and of public procurement. It finds that original reform provisions were weakened or overturned, regulatory complexity and uncertainties in the application of the reforms blunted their impact, and enforcement mechanisms were inadequate. Addressing these gaps will be essential for successfully modernizing Italy’s public administration.

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Keywords: Italy, public administration reform, public sector, state-owned enterprises, public procurement.

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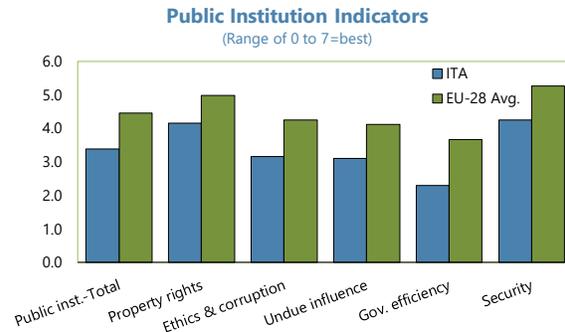
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I. INTRODUCTION

In recent decades, successive Italian governments have legislated reforms of almost every aspect of the public administration (EC, 2018). Nearly a dozen major initiatives have been adopted toward modernization and simplification. Notwithstanding laudable intentions, however, reform implementation has been slow and has not yielded the desired economic results; the public sector is still widely considered by and large to be inefficient, hindering competition and adding considerable administrative burdens to the private sector (EC, 2019; OECD, 2019). Compared to the EU average, Italy's public sector performance is relatively weak.



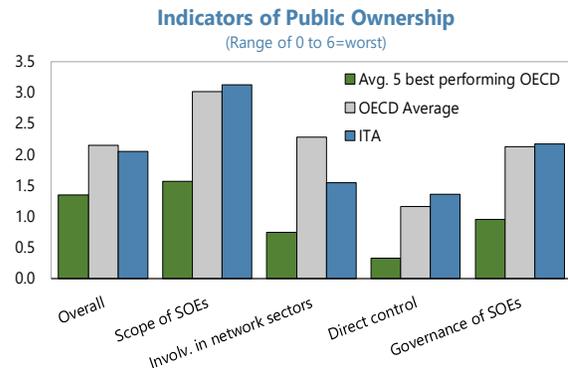
Source: Global Competitive Index 2017-18, World Economic Forum.
Note: The scores range from 0 (worst) to 7 (best).

This paper documents two specific public sector reforms initiated in 2016, namely, the rationalization of state-owned enterprises (SOEs) and public procurement reform. These two reforms are important for the following reasons. First, Italy has a large number of local SOEs, many of which operate inefficiently in sectors with high barriers to competition. The rationalization of SOEs is therefore complementary to product market reforms that aim to reduce impediments and barriers to competition (see Lanau and Topalova, 2016; Belhocine and Garcia-Macia, 2020). Second, the Italian public procurement system has also been viewed as inefficient, owing to a fragmented legal framework, weak administrative capacity, and a lack of coordination among institutions. Among other factors, this hinders the effectiveness of public investment. Finally, lessons from these two case studies may be applicable to other public administration reforms insofar as they relate to avoiding pitfalls in the design and implementation of reforms.

The paper is organized as follows. The first part introduces the case study on the rationalization of SOEs by describing the divestment of public shareholding law, the results of the application of the law, the challenges that were identified, and the policies that could support better outcomes. The second part discusses the public procurement reform by outlining the recent history of changes, the performance of public procurement in Italy and its impact on public investment, and measures that can be implemented to improve procurement outcomes. Finally, the conclusion draws broader implications for reforms based on these two case studies.

II. RATIONALIZATION OF PUBLIC SECTOR SHAREHOLDINGS

There is a large number of SOEs in Italy that employ a sizable number of workers and operate across the range of economic sectors (Table 1 and 2).² A majority of them are owned by local public administrations (PAs)—such as regional governments, cities and provinces, and municipalities—and had not been subject to a comprehensive review exercise prior to the 2016 reform. There was some evidence indicating that these local SOEs were often protected from competition, were awarded service contracts without an open tender, and were inefficient, with around one-third incurring losses (Karantounias and Pinelli, 2016). The rationale for public sector involvement in so many areas of the economy is also not obvious, while it carries potentially adverse impacts on competition. Barriers to competition related to public ownership in Italy are significantly higher than the average of the five best performing OECD countries, suggesting considerable room for improvement.



Source: OECD's Indicators of Product Market Regulation (2018).
Note: The scores range from 0 (best) to 6 (worst).

This part of the paper reviews the recent reform of public shareholdings, describes key characteristics of public shareholdings, discusses progress towards reform implementation and remaining challenges, and provides recommendation towards a potentially successful way forward for the reform. It is based largely on MEF (2019a).

A. Overview of the Reform of SOEs

With the aim to reduce the large number of local SOEs and thereby increase competition and public sector efficiency, the Consolidated Law on SOEs (part of the Madia reform, after Marianna Madia, then the Minister of Public Administration) was enacted in mid-2016.³ It integrated existing fragmented legislations and defined qualitative and quantitative criteria for the establishment, acquisition, and retention of shareholding in SOEs. These criteria include that PAs ensure a direct link with the institutional goals of the public sector, that is, that they provide services of a public good nature in a cost-effective and financially sustainable manner. Major rationalization criteria included:

² In this paper, we depart from the standard definition of SOEs (more than 50 percent of state shareholding) by referring to SOEs as companies in which public administrations, both central and local, have any level of shareholdings.

³ Legislative decree no. 175/2016.

- Companies that are not classified as being indispensable for the purposes of pursuing institutional public goals and/or providing services of general interest;⁴
- Companies that do not have employees or have more directors than employees;
- Companies that perform similar activities to those carried out by other publicly owned companies or by instrumental public agencies;
- Companies of which an average turnover, over the previous three years, is less than a certain threshold;⁵
- Companies that have been loss-making for four out of the five preceding years;
- Companies that need to contain operating costs.

According to the law, PAs were mandated with carrying out an Extraordinary Review of their shareholdings by September 2017, identifying those investments that should be rationalized and completing the rationalization by September 2018. However, the rationalization deadline was subsequently extended until end-2021 for companies that had been profitable on average over the three years preceding the Extraordinary Review. The law established annual progress reviews, supervised directly by the Ministry of Economy and Finance (MEF), with inputs from the Competition Authority, and a sanction system linked to the prerogatives of the Court of Auditors.

B. The Review of Public Sector Shareholdings

Out of the 10,695 PAs required to participate in the Extraordinary Review, about 87 percent (9,341 PAs) provided information about their shareholdings as of September 2017.⁶ Out of the PAs that responded, nearly 90 percent, or some 8,200 PAs, held stakes in companies while the remaining PAs declared not owning any shares.⁷ The review established holdings of more than 32,000 shares in nearly 5,700 companies. The shareholdings spanned all sectors of the economy with an emphasis on the tertiary sector, including professional and business services (Table 1) where barriers to competition are relatively high (OECD, 2019). The fact that SOEs (even if many are small) operate across all sectors of the economy raises questions about their public sector rationale as well as their impact on market competition.

⁴ Note that there are no specific activities to which the definition of services of general interest applies (MEF, 2019a).

⁵ The original decree set the turnover threshold at €1 million. However, the amendment decree (no. 100/2017) reduced this threshold to €500,000 during the transition period until end-2019. Lowering the threshold meant limiting the number of SOEs whose shareholdings would need to be rationalized.

⁶ Non-reporting PAs were mostly small municipalities with less than 5,000 inhabitants.

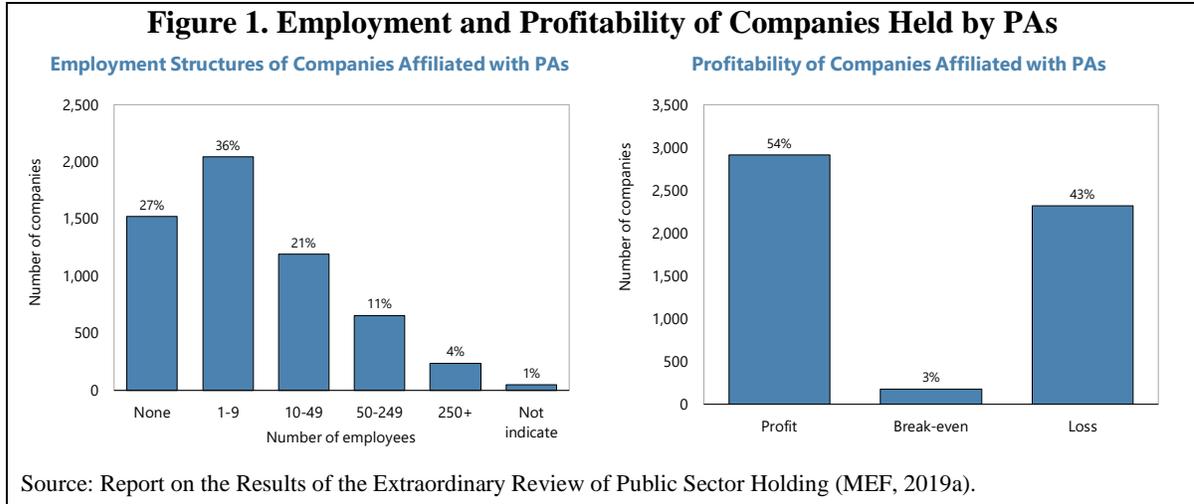
⁷ It is important to note that shares have different values across companies and hence adding up the number of shares held by PAs across companies should be interpreted with caution.

	Companies held		Shares held		Shares subject to rational.	
	Number	Percent	Number	Percent	Number	Percent
Primary sector	70	1.2	210	0.6	100	1.3
Agriculture, forestry, and fishing	70	1.2	210	0.6	100	1.3
Secondary sector	1,761	30.9	14,408	44.4	2,632	33.6
Mining and quarrying	9	0.2	9	0.0	4	0.1
Manufacturing	213	3.7	385	1.2	193	2.5
Electricity, gas, steam and AC supply	494	8.7	2,510	7.7	491	6.3
Water supply, sewerage, waste mgmt	719	12.6	10,366	32.0	1,531	19.5
Construction	326	5.7	1,138	3.5	413	5.3
Tertiary sector	3,862	67.8	17,809	54.9	5,113	65.2
Wholesale and retail, repairs	366	6.4	567	1.7	130	1.7
Transportation and storage	554	9.7	2,680	8.3	721	9.2
Accommodation and food services	87	1.5	174	0.5	56	0.7
Information and communication	245	4.3	2,156	6.6	412	5.3
Financial and insurance activities	181	3.2	1,082	3.3	526	6.7
Real estate activities	220	3.9	1,050	3.2	384	4.9
Professional, scientific, and technical act.	1,101	19.3	5,825	18.0	1,781	22.7
Rental, travel agency, business support	557	9.8	2,679	8.3	595	7.6
Public admin and defence, social insurance	30	0.5	139	0.4	51	0.7
Education	112	2.0	397	1.2	112	1.4
Human health and social work activities	97	1.7	223	0.7	58	0.7
Arts, sport, entertainment, recreation	192	3.4	408	1.3	159	2.0
Other service activities	119	2.1	428	1.3	128	1.6
Activities of extraterritorial org.	1	0.0	1	0.0	0	0.0
Total	5,693	100	32,427	100	7,845	100

Source: Report on the Results of the Extraordinary Review of Public Sector Holding (MEF, 2019a).

With regard to the employment profile of surveyed companies affiliated to the PAs, 84 percent had less than 50 employees (Figure 1). Large-scale enterprises (with more than 250 employees) represented about 4 percent of the companies held; however, the number of employees of such companies represented around 64 percent of the total. About ¼ of the affiliated companies (or 1,522 companies) had no employees, out of which 43 percent were inactive, closed, or currently undergoing insolvency or liquidation proceedings.⁸ In terms of profitability, about 54 percent of the surveyed companies affiliated to the PAs were profitable on average over the period 2011–15, and total annual profits amounted to €1.9 billion per year. Over the same period, 3 percent of companies broke even, and 43 percent registered losses with total annual losses of €1.8 billion per year (Figure 1). This implies total annual profits of €36 million per year (or an average annual profit of around €25,000 per company), indicating a limited fiscal risk from these activities in aggregate. About 43 percent of the affiliated companies for which turnover data were available had a three-year average turnover below the €500,000 threshold.

⁸ These could be “pure” holding companies or consortia, generally on a small scale, or the absence of staff might just be due to incorrect data submission (MEF, 2019a).



Of this substantial number of shareholdings, PAs declared that they intend to divest only about 25 percent of their total holdings or 7,845 shares (Table 2). Nearly 10 percent of the total shareholding are in companies already undergoing liquidation. The rest, which constitutes about 65 percent of the total shares, are shares that PAs indicated their intention to retain.

Table 2. Summary of the Extraordinary Review

	Number of PAs	Number of companies	Number of shares	Number of Employees
Perimeter of the exercise	10,695			
PAs that disclosed	9,341			
PAs that hold shares in companies	8,201	5,693	32,427	299,902
PAs reporting they will rationalize	3,479	2,586	7,845	130,851
PAs reporting they will not rationalize	7,607	3,312	21,037	226,943
PAs with shareholdings in listed companies (exempted)	430	48	471	N/A
PAs with shareholdings in companies already undergoing liquidation	2,020	790	3,074	11,794

Note: Data contain duplications as each PA can hold participations which can be both rationalized and maintained. Data on number of companies has duplications as there are PAs that would rationalize their shareholdings and PAs that would maintain their shares in the same company.

Source: Report on the Results of the Extraordinary Review of Public Sector Holding (MEF, 2019a).

Rationalization methods indicated by PAs are summarized in Table 3. They fall into two broad categories, namely (i) transfer of the holdings, which comprises about 40 percent of the total shares to be rationalized, and (ii) change in the structure of the company such as merger, liquidation, or winding up.

Table 3. Rationalization Methods Considered by the PAs

	Number of shares	Percent of total
Disposal of the holding (selling)	3,065	39.1
Retention of the holding with company rationalization actions	1,204	15.4
Merger of the company by incorporation in another company	1,014	12.9
Liquidation (through insolvency proceedings)	941	12.0
Withdrawal from the company	792	10.1
Merger of the company by amalgamation with another company	388	5.0
Winding up of the company	235	3.0
Free transfer of the holding	143	1.8
Loss of the indirect share due to the transfer or liquidation in the intermediate company	63	1
Total	7,845	100.0

Source: Report on the Results of the Extraordinary Review of Public Sector Holding (MEF, 2019a).

C. Progress and Challenges in Public Shareholding Rationalization

Interpretation of the Law

In addition to PAs' own assessment, the MEF conducted its own analysis of the required rationalization based on the information submitted by PAs and applied the criteria specified in the law.

Table 4. The MEF's Assessment vs PA Intentions

	Number of PAs	Number of companies	Number of shares	Number of Employees
PAs reporting they will rationalize	3,479	2,586	7,845	130,851
MEF: PAs required to rationalize	6,478	4,377	18,124	172,841
Ratio (percent)	54	59	43	76

Source: Report on the Results of the Extraordinary Review of Public Sector Holding (MEF, 2019a).

According to the MEF, the number of shares to be rationalized should be about 18,000, more than twice the number reported by PAs, affecting nearly 4,400 companies (Table 4). Among the 21,037 holdings that PAs intend to retain, nearly 40 percent of them (or around 8,000 shares) do not appear to comply with the legal criteria. These so-called non-compliant shares fail at least one of the three main criteria on (i) the type of company (Article 3); (ii) the provision of a service of general interest, public work, and some other strictly necessary service (Article 4); and (iii) the quantitative and efficiency criteria (Article 20).⁹ In particular, nearly 80 percent of non-compliant cases are due to a violation of the quantitative and efficiency criteria, about 11 percent are due to non-compliance with the scope of services of general interest, and another 10 percent are due to a failure to meet both criteria.

⁹ To meet the efficiency criteria (Article 20), companies must (i) not have more directors than employees, (ii) not duplicate the activities of other SOEs, (iii) achieve an average turnover greater than €500,000 in the previous three years; and (iv) not be loss making for four out of the five preceding years.

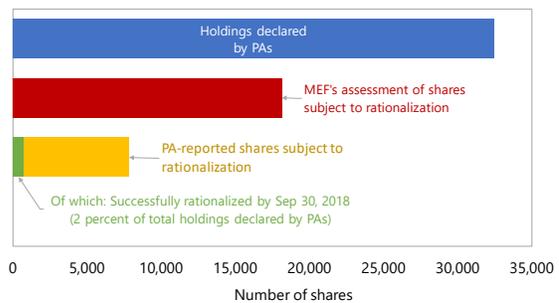
Technical explanations for non-compliance include the absence of a clear definition of “turnover” in the law and of the concept of services of general public interest. MEF (2019a) reports that the turnover definition adopted by some PAs were inconsistent with the instructions issued by the MEF. On the interpretation of services of general interest, PAs applied their own judgement and there existed some contradictory assessments.¹⁰

It is worth noting that the criterion related to the provision of a service of general interest substantially limited the number of SOEs to be rationalized and weakened the reform’s intended effects on competitiveness and efficiency as it supersedes the other criteria for rationalization. Even if an affiliated company had no employee, or more directors than employees, or was loss-making over a long period, PAs could still retain their shares in the company if it considered it strictly necessary for the pursuit of the institutional purpose or the provision of services of general interest. Among those companies to be retained, about 20 percent were loss-making and about 60 percent had a three-year average turnover of less than the €500,000 threshold.

Implementation of the Reform

In terms of implementation, the law stated that the transfers of the shareholdings subject to rationalization should be completed by end-September 2018. However, the PAs declared their intention to rationalize less than half of all identified shares by that date (3,463 shares out of 7,845 shares the PAs committed to rationalize).¹¹ Even with this less ambitious target, progress was limited by the target deadline, with only 750 shares in 392 companies rationalized successfully, or just about 2 percent of the total shareholdings (Table 5).¹² The associated divestment revenues were around €430 million. The rationalization process was also completed without successful results (i.e. fail to divest) for another 591 shares, covering 323 companies.

Summary of the Extraordinary Review of Public Sector Holdings



Source: Report on the Results of the Extraordinary Review of Public Sector Holdings (2019).

¹⁰ From the review, contradictory assessments often emerged from data submitted by different PAs on the same company held and on different companies that carry out the same activity.

¹¹ Out of the 3,463 shares reported by the PAs to be rationalized by end-September 2018, 2,923 shares were intended for holding transfers and the rest were intended for withdrawal from the companies.

¹² The number of employees in companies that were successfully rationalized account for about 9 percent of total employees in companies with shares held by PAs.

Table 5. Rationalization Progress

	Number of PAs	Number of companies	Number of shares	Amount (mil, €)	Number of Employees
PAs reporting intention to rationalize	3,479	2,586	7,845		130,851
<i>by September 30, 2018</i>	1,792	1,454	3,463		63,898
<i>Procedures completed positively</i>	553	392	750	431	27,677
<i>Procedures concluded negatively</i>	388	323	591		13,328
<i>Procedures in progress</i>	578	497	839		17,213
<i>Procedures not yet started</i>	784	723	1,283		36,560

Source: Report on the Results of the Extraordinary Review of Public Sector Holding (MEF, 2019a).
Note: Negative conclusion represents cases where PAs failed to transfer or withdraw their holdings after rationalization procedures were completed.

MEF (2019a) identified the lack of specific procedures in the transfer of holdings as one of the potential factors holding up progress. More specifically, the law only (i) required “the principles of opening to the public, transparency, and non-discrimination” suggesting the use of open public procedures such as auctions, but also (ii) allowed the use of negotiated sales under exceptional factors such as “the social economic context, the outlook for the market, or the need for aggregation”. Most PAs reported difficulties in identifying appropriate divestment procedures and reconciling transparency rules with market practices.

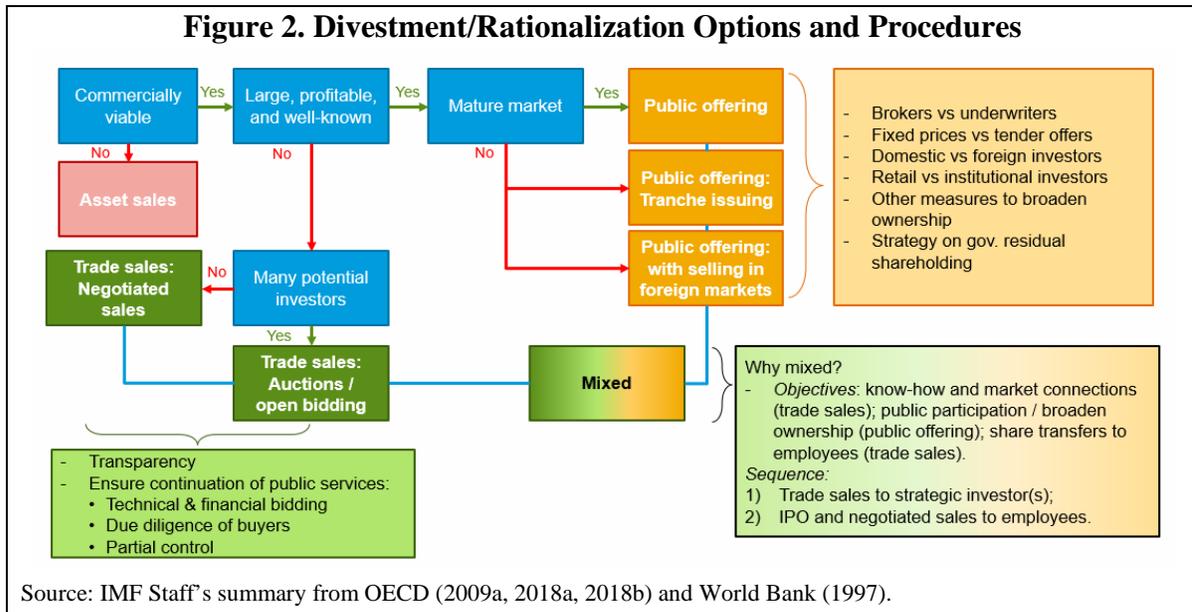
Looking ahead, progress is likely to remain slow owing to the amendment introduced in the 2019 budget to allow PAs to retain their shares until end-2021 in companies that had been profitable, on average, over the three years preceding the Extraordinary Review. The MEF estimates that this would further reduce the number of cases subject to rationalization by one-third. Furthermore, notwithstanding the system of sanction in place, enforcement has been limited and there has been very little progress in dealing with the PAs that have not abided by the law.

D. Recommendations for Successful Implementation

The reform to rationalize public shareholding could, if implemented fully, ultimately help enhance competitiveness and efficiency. However, implementation and enforcement has been challenging. As discussed, potential factors hindering progress include uncertainties around the interpretation of both qualitative and quantitative criteria, lack of clarity in operational practices related to rationalization methods and procedures, limited actions so far on non-compliant PAs or towards PAs that have not submitted enough information, and legislative amendments that weaken or delay implementation. Steps to foster the reform effectiveness would therefore include:

- *Ensure transparent and consistent applications of shareholding rules, especially those related to the definitions of services of general interest and business turnover. This could be done by issuing clear guidelines and applying them consistently across PAs and affiliated companies.*

- *Provide clear divestment options and procedures.* The MEF should stand ready to extend further support to PAs by providing technical guidance on divestment options, their associated costs and benefits, required procedures, as well as mitigating measures to address any potential issues such as employment.¹³ In this regard, the guidance should discuss how different sale methods are suitable for companies differing in their characteristics, desired ownership structure, and other government objectives (Figure 2).



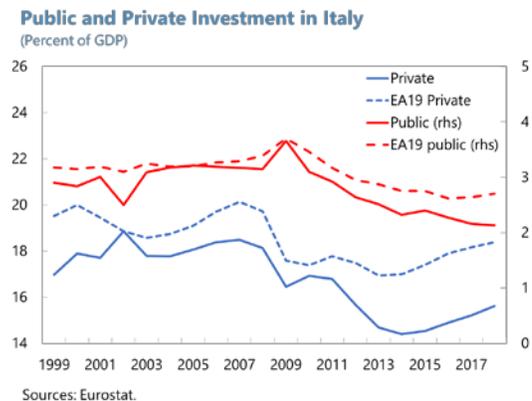
- *Strengthen the enforcement mechanism.* Both the direct and indirect monitoring and supervisory authorities (the MEF, the Competition Authority and the Court of Auditors) need to take a stronger role in ensuring that PAs provide the required information, comply with the identification criteria set by the law, and follow up on the implementation of their rationalization plans. Sanctions should be applied in a systematic and consistent manner, as opposed to case-by-case, so that PAs are motivated to improve their compliance.

¹³ Experience from various countries underlines the importance of consultation and negotiation with the labor groups at the earliest possible stage (OECD, 2018a). Identification of the issues at the outset, establishment of a framework for mitigating against possible adverse effects, communication of the benefits of privatization and explanation of government plans for mitigating the negative effects of privatization helps to dispel employee concerns, gain labor support, and ultimately leads to better privatization outcomes. As discussed in OECD (2009a; 2018a, 2018b), general practices include, but are not limited to, (i) resisting unconditional grandfathering of civil servant rights; (ii) honoring existing contracts, but not those covered by collective agreements; and (iii) providing employment and benefit protection over a transitory period (if fully disclosed and reflected in privatization proceeds). They should also be accompanied by appropriate retraining to help workers regain relevant skills and social safety nets to mitigate net welfare losses of workers. It should be noted, however, that these do not apply for the many SOEs (over ¼ of the total) that have no employees.

- *Do not backtrack on or weaken reform objectives.* While inevitably there is learning by doing and the need to adapt policies and procedures to new issues or obstacles that may arise, care needs to be taken to not weaken the overall reform objectives. Consideration could be given to reviewing experience and contemplating changes on a periodic basis, say every 5 years, rather than during the budget or other legislative discussions.
- *Develop or Strengthen complementary policies to enhance SOEs' performance.* In parallel to the reform, policies should be adopted to improve efficiency of existing SOEs. Steps include: 1) facilitating consolidation of local public services, where appropriate; 2) enhancing governance and performance reporting of these companies; and 3) ensuring a level playing field between public and private businesses.

III. PUBLIC PROCUREMENT REFORM

Italian public investment a share of GDP has decreased steadily over the past few years, falling from 3 percent of GDP in 2008 to 2 percent of GDP in 2017—against a euro area average of 2.6 percent of GDP. Moreover, while private investment has been recovering since 2014, public investment has continued to decline. Beyond the fall in budgetary allocations, two other factors are believed to have contributed to this trend (EC, 2018a and MEF, 2019b): (i) central and sub-national governments have failed to use all available funds for public investment owing to slow execution; and (ii) an inefficient public procurement system, with repeated changes to the procurement code and an uneven and slow reform implementation that have created difficulties in project preparation and execution. This part of the paper reviews recent changes to the Italian public procurement system; discusses how it compares to other EU countries; analyses its effects on public investment; and provides policy recommendations to address remaining challenges.



A. Recent History of Public Procurement Reforms

The Italian public procurement system has suffered from fragmentation of the legal framework, low administrative capacity and lack of coordination among institutions (EC, 2016). As a result, public procurement procedures have been complex and lengthy with an insufficient degree of competition in tendering procedures and a high usage of negotiated procedures without the publication of a notice.¹⁴

¹⁴ For example, according to the EC's Single Market Scoreboard for public procurement, in 2015, many public procurement procedures were finalized with only one offer (30 percent, compared to the EU median of 23.6 percent); decision periods were long (210 days, compared to the EU average of 89 days); and the value of tender calls published in the Official Journal of the European Unit was low (just above 2 percent of GDP, compared to the EU average of 3.8 percent of GDP). See Section II.B for further discussion.

Over the past four years, there have been three significant changes to the public procurement legislation for public works and associated services in Italy.¹⁵ First, the transposition of the 2014 EU Directives on procurement and concession led to sweeping and far-reaching changes with the adoption of a new public procurement code in 2016. Second, this new legislation was subsequently revised in 2017 to address various challenges that arose in the first year of the implementation of the new code. Third, additional legislative changes were introduced in 2019 with the aim of accelerating public investment, which continued to be low notwithstanding the reform process.

The 2016 Public Procurement Code

To improve efficiency while transposing the 2014 EU Directives, the new code set standard time frames and conditions for participation in public tenders, criteria for awarding tenders, legal recourses, and appeal processes.¹⁶ To enhance general transparency and integrity of procurement, the anti-corruption agency, ANAC, was given powers to: 1) oversee public procurement and contracts; 2) collect, analyze and publish all relevant procurement data; and 3) issue implementing regulation with the power of soft laws.¹⁷ All provisions of the new code are focused on quality: quality of planning, quality of contracting authorities, quality of businesses, quality in the methods for selecting contractors, with the most economically advantageous offer identified as the preferred criterion for adjudication. Key changes to the public procurement landscape could be divided into those related to public demand, tendering of services (or supply), and implementing instruments (PBO, 2019).

Changes to the Public Demand Side

- *Increased independence over procurement procedures and awarding criteria.* The new code aims to strengthen the programming and design phases of public works by increasing the margins of discretion of contracting authorities over the choice of procedures and awarding criteria. Under the new code, contracting authorities can choose their own tendering procedures among open, restricted, and negotiated procedures (with competitive bids). Moreover, only under some exceptional circumstances are contracting authorities allowed to use negotiated procedures without previous publication of a call for tender. In accordance with EU Directives, the new code promotes the use of the “most economically advantageous tender”

¹⁵ These changes were introduced via legislative decrees No. 50/2016, 56/2017, and 32/2019.

¹⁶ EU provisions were contained in Directives 2014/24/EU and 2014/25/EU for public procurement and Directive 2014/23/EU for awarding concession contracts.

¹⁷ ANAC (Autorità Nazionale AntiCorruzione) was established in 2014 as an independent agency from the government. Its mandate is to offer advice to central and sub-national governments and agencies on adopting and strengthening corruption-preventing measures, managing the electronic platform to collect information from whistle-blowers and, since 2016, issuing guidelines and regulations, and overseeing public procurement. ANAC can apply administrative sanctions to public officials not complying with the obligation of adopting anti-corruption plans or codes of conduct.

(MEAT) awarding criterion over the “lowest price” criterion. As such, decisions are based on the price-quality ratio or on a cost efficiency comparison criterion, such as life-cycle costing.¹⁸ The low-price criterion was then allowed only in certain cases, such as for contracts with value less than €1 million. To strengthen transparency and accountability, an assessment of MEAT awarding is conducted by a board of experts chosen from a register of public-tender board members.¹⁹

- *Enhanced qualification criteria of contracting authorities.* To meet the levels of qualification required to leverage these new discretionary instruments, the code introduces a system of qualification, managed by ANAC, where the operational autonomy of contracting authorities is assessed according to the authorities’ professional capacity. ANAC assesses the capacity of the contracting authorities to manage the three major steps of public contracts, namely: programming and design, allocation, and verification of the contract execution. An implicit goal of this professionalization drive is to concentrate expertise over fewer contracting authorities, with a view of aggregating public demand to take advantage of economies of scale and lowering costs. The qualification is applied for a five-year period with some contracting authorities considered to be qualified by right (the Ministry of Infrastructure and Transport, the Italian Public Procurement Central Authority (CONSIP S.p.a), the National Agency for the Attraction of Investments and Business Development (INVITALIA S.p.a) and the regional aggregating agencies). Ideally, once the financing has been assigned, a contracting administration must follow the entire work till its finalization, accompanying the company in any difficulties with the administrations and monitoring its proper execution.
- *Improved execution and quality of work.* The new code requires contracting authorities to establish a detailed plan of public works, including preliminary technical and financial feasibility studies, execution plans and verification of the final product. The design and execution of public works are set to be provided by separate parties, except for special cases specified in the code. While a “joint-contract” may be associated with simpler procedures, the code provides significant discretion to contractors to adjust various elements of the contract once the contracting authority has been “locked-in”. On the other hand, contracts for execution-only could potentially help control the quality of work, costs, and time frames.²⁰

¹⁸ This includes both the internal costs (borne by the contracting authority) and the external costs (borne collectively because of externalities) over the entire life of the public work.

¹⁹ The establishment of a register for members of public-tender boards has been delayed by ANAC to mid-2019.

²⁰ Decarolis and Palumbo (2011) show that completion of public works often exceeds the planned deadlines, requiring time horizons of up to three times longer than expected and cost overruns of as much as 50 percent higher.

Changes to the Tendering of Services (Supply Side)

To reduce the incidence of asymmetric information and the risk of moral hazard of the parties holding contracts, the new code establishes a rating system of companies based on their past performance (e.g., adherence to time frames and costs, and the frequency of disputes). The goal is to incentivize quality of execution of public works for the purpose of awarding future contracts. The rating is assigned at the voluntary request of the companies. Contracting authorities are tasked with providing a performance assessment of companies that were awarded contracts using a methodology established by ANAC. Subsequently, ANAC releases the final rating that is then used as an input during the qualification phase of a tendering process.

Changes to the Regulating Instruments

The new code envisages the use of more flexible legislative instruments for secondary legislation through guidance documents, or guidelines of general nature, known as soft laws. This represents the main feature of the legal framework of the new code, which departs from the previous system based on a strict, very detailed set of rules, containing a single regulation for the execution and implementation of procurement. This was thought to provide flexibility to the involving nature of procurement with multiple references to the details of a total of roughly 50 supplementary soft law acts. On top of this flexibility, the code allowed the use of other guideline models, classified into three types: 1) decrees approved by a ministry (primarily by the Ministry of Infrastructure and Transport); 2) binding guidelines adopted by ANAC; and 3) nonbinding guidelines adopted by ANAC.

The 2017 Amendments

Overall, the new code sought to enhance transparency of contracting authorities and contracting entities, while improving competition in bidding process and project quality. However, upon its entry in force, procurement procedures slowed down significantly. In the three months following the code's adoption, supplies and service contracts dropped respectively by about 30 percent and over 40 percent in value and volume, while the decrease of public works contracts was about 52 percent in value and 62 percent in volume (ANAC, 2016a). This drop was expected to be temporary and gradually fade away when the code was fully implemented, and the local authorities became more familiar with it (ANAC, 2016b). Nonetheless, the hoped-for recovery did not materialize for several reasons. First, procedures remained cumbersome owing to a tension between a simplified procedure versus a corruption-proof procedure. Second, legal guidelines are viewed as being uncertain because some provisions are "soft laws", which are perceived as good practice but not binding. Soft laws are also not easily distinguishable from those that are binding requirements and punishable by law. Third, some soft laws were viewed as lacking coordination and overlapping, complicating the interpretation and undermining the objective of a single set of regulations in summary form. Finally, critical implementing measures were still missing,

creating uncertainty in the application and effective use of the new code, in particularly the one that sets qualifications of contracting authorities.

To address some of the impediments experienced with the 2016 code, several adjustments were made in the 2017 amending decree, including by:²¹

- Increasing the threshold of a contract value for using the low-price criterion from €1 million to €2 million.
- Expanding the circumstances under which joint contracts are allowed, such as public works with a high technological knowhow or innovation content, while allowing joint contracts in cases where the final design was approved 12 months before the 2016 code was adopted. The latter was viewed as necessary to introduce a transition period with respect to contracts whose preliminary or definitive projects had already been approved as of the date when the code went into effect.
- Increasing the period for documentation of compliance with requirements from 5 to 10 years for the certification of a contractor.
- Requiring the company rating mechanism to be used at the stage of tender assessment as opposed to at the qualification stage, as specified in the 2016 code.
- Setting a maximum weight of 30 percent for the price component under the MEAT system.
- Authorizing ANAC to take legal action for challenging tenders, whenever it deems that procedures violate the laws and regulations governing public contracts. In addition, ANAC may take legal action with respect to the challenge: if the contracting authority does not comply with ANAC's opinion within the deadline assigned by ANAC (and, in any case, within a maximum of 60 days from the transmission of the opinion), ANAC has the option of appealing the matter to an administrative judge within the 30 days thereafter.

The 2019 “Unblocking Construction Works” (Emergency) Decree

Even after these amendments, many critical issues remained unresolved. Implementation progress has been slow, with only half of the approximately 60 acts provided by the 2016 code and the 2017 amending decree having entered into force (PBO, 2019). Given the uncertainty over implementation, some public administrations have reportedly been waiting for the full implementation of the reform to resume public investment (EC, 2016; 2017a). The lack of clarity on the binding nature of soft laws has not been fully resolved. Furthermore, there has been resistance to the qualification system of contracting authorities.

²¹ The amending decree introduced 450 changes to the 2016 code (PBO, 2019).

Absent adequate human resources, public investment activities of smaller local agencies slowed down significantly after the introduction of qualification requirements while no other agency stepped in to consolidate or undertake planned investment projects (PBO, 2019).

These factors have continued to weigh on the recovery of public investment. As a result, two further changes were made to the public procurement code. First, as part of the 2019 budget, contracting authorities were temporarily allowed to allocate public works for low-value contracts between €40,000 and €150,000 without competitive procedures, subject to consultations with three experts.²² The rules for allocating public works with greater values were also relaxed.²³ Second, an “emergency decree” was adopted with the aim to speed up procurement by simplifying procedures and temporarily suspending some regulations until December 2020. Key changes were as follows:

- A return to a single regulation for the execution, implementation and integration of the procurement code, in replacement of ANAC’s guidelines and of individual ministerial decrees.
- The threshold for using the low-price criterion, set at €2 million in the 2017 decree, was cancelled. Contracting authorities could choose to award contracts based on either the low-price or MEAT criterion without the need to justify their choice.
- The obligation to choose experts from the ANAC register of public-tender board members to assess MEAT procedures is suspended until December 2020. The ban of joint contracts is also suspended. By November 2020, the Government shall submit a report to Parliament on the effects of the suspension to enable it to appraise whether the suspension should be maintained.
- The temporary changes introduced by the 2019 budget were made permanent, with a further simplification allowing for contracts valued between €150,000 and the EU thresholds to be carried out without publication of a contract notice.²⁴
- The period of validity of a contracting authority certification was increased further from 10 to 15 years.
- The share of contracts that can be subcontracted by contractors was raised from 30 to 40 percent. Some procedures to choose subcontractors were suspended, such as the obligation to identify three subcontractors during the tender and the obligation to verify specific requirements for hiring subcontractors.

²² This exemption was temporary and only applied to 2019. Around 48 percent of public works contracts fell in this range in 2018 with a value of about 5 percent of total public works (PBO, 2019).

²³ For example, public works valued between €150,000 and €350,000 could be allocated through negotiated procedures, as in the 2016 code, but the number of experts to be consulted was temporarily reduced from 15 to 10.

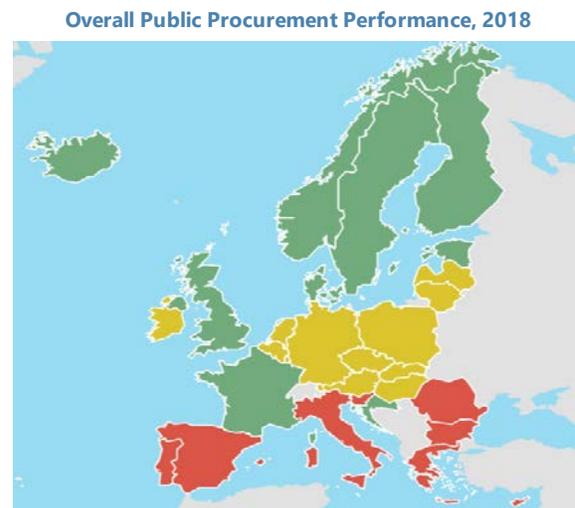
²⁴ As in the 2016 code and the budget, negotiated procedures are allowed for public works valued between €150,000 and the EU threshold of €5.6 million.

B. Public Procurement Performance in Italy

Despite several reforms and subsequent amendments, Italy's public procurement performance lags other EU countries. This can be seen in the EC's Single Market Scorecard of public procurement performance, an index composed of 12 sub-indicators measuring various key aspects of public procurement—such as competition, transparency, and market access. For each of the sub-indicators, a score of one is associated with a satisfactory performance (based on good practices), zero for an average performance, and minus one for an unsatisfactory performance. To construct the overall index, each indicator is weighed by its relative importance in the principles of good procurement.²⁵ With different weights across individual indicators, the overall indicator could range between -14 and 14 and its interpretation is as follows: countries that score below -3 are viewed as having weak public procurement performance, those between -3 and 3 are viewed as being average, and those above 3 as good performers. In recent years, Italy had an overall score of around -3.33 and is among the countries in which public procurement performance is considered weak.

Looking at the breakdown of the overall index, Italy under-performs in several dimensions (Figure 3):

- First, Italy is a major outlier in the category of decision speed where it takes about half-a-year between the deadline for receiving offers and the date a contract is awarded. This compares negatively to the EU average of just above three months and to the threshold for good performance of four months. Despite a mild declining trend in recent years, the decision speed has worsened in 2018 by about 10 days. Lengthy procedures raise costs, inefficiency, and uncertainty of public contracts for both public buyers and bidding companies.

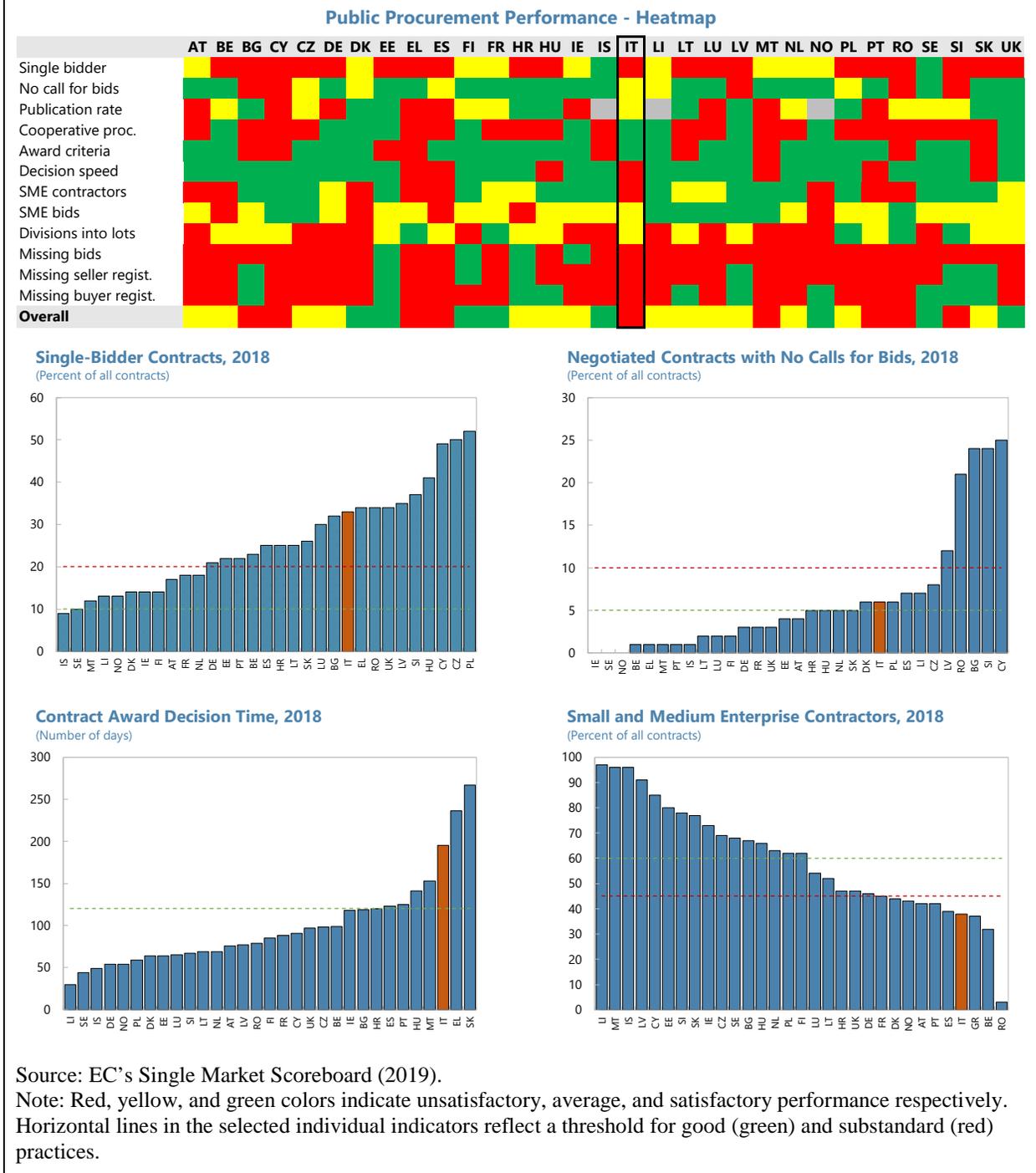


Source: EC's Single Market Score Board (2019).

Note: The score could range between -14 to 14. Green color represents the overall score above 3, yellow color for between 3 and -3, and red color for below -3.

²⁵ Relatively higher weights are assigned to individual indicators related to competition and transparency—including the shares of single-bidder contracts, negotiated contracts without a call for bids, and the value of public procurement advertised on the tender electronic database—which are the pillars of good public procurement. Lower weights are assigned to individual indicators related to participation of SMEs and data quality—such as sufficient information on procurement processes, sellers, buyers, and services under contract—as they measure the same concepts from different perspective. The remaining indicators are assigned a standard weight of one.

Figure 3. The EC’s Single Market Scoreboard of Public Procurement Performance



- Second, Italy has a relatively high and increasing share of single-bidder contracts, with a share of about 1/3 of total awarded contracts—5 percent higher than the EU average and more than 20 percent higher than the threshold considered as good practice. This suggests limited competition and cumbersome bureaucracy.

- Third, the share of public procurement procedures that were negotiated with a company without a call for bids is still slightly higher than the good practice threshold.
- Last, there are only a small share of SME contractors in Italy, at about 38 percent, or $\frac{2}{3}$ of the EU average, which is also a threshold for being a good performer. The limited share of SME contractors could indicate the presence of barriers preventing smaller firms from participating in public procurement procedures—such as red tape, biased calls for tender, and also low capacity among smaller firms to compete.

C. Impact of Public Procurement on Government Investment

Drivers of Public Investment Identified in the Literature

Discussions on the role and determinants of public investment have come to the forefront with relatively modest growth and the decline of public capital stocks in many countries.²⁶ As such, an extensive empirical literature has examined drivers of public investment in both advanced economies (AEs) and emerging markets (EMs), comprehensively reviewed by de Haan et al. (1996) and more recently by EC (2017b). These drivers belong to three main categories: macroeconomic factors, fiscal policy levers, and political economy considerations.

Much of the early work focused on macroeconomic factors, such as economic growth, public capital stocks, and demographic changes. Public investment is found to be large during periods of rapid growth and depressed during recessions (Turrini, 2004; Mehrotra and Valila, 2006; Kappeler and Valila, 2008).²⁷ It can also be influenced by the level of public capital stock and past public investment, owing to diminishing marginal returns and the time-to-build effect of investment (Heinemann, 2006; Kappeler and Valila, 2008; Keman, 2010). Changes in demographic patterns, such as population growth and an expanding share of younger population, could also raise public investment owing to the associated life-time payoffs (Heinemann, 2006; Jager and Schmidt, 2016).

However, since the global financial crisis, there has been a growing emphasis on the correlation between public investment and fiscal conditions. Perceived risks to fiscal sustainability were found to restrict public investment in high-debt countries (Mehrotra and Valila, 2006; Bacchiochi et al, 2011; EC, 2017b). Even for countries with low debt, efforts to reduce budget deficits have impacted negatively on public investment (Bacchiochi et al, 2011).

Several studies have looked at the role of political economy factors on public investment. The variables used range from political orientation to election cycles (Van Dalen and Swank,

²⁶ On the role of public investment, see for example: Alfonso and Furceri (2010); EC (2014); G20 Communique (2014); IMF (2014); and Abiad et al (2016).

²⁷ The correlations are robust to both cyclical and structural developments, such as real GDP growth, the output gap, the unemployment rate, real GDP per capita, and the inflation rate.

1996; de Hann et al, 1996; Sturm, 2001; Heinemann, 2006; Keman, 2010; Gupta et al, 2015; EC, 2017b). However, empirical results that link political economy variables to public investment remain inconclusive.

On top of these factors, some studies have found that strengthening public investment efficiency could significantly improve public investment (IMF, 2015). Efficiency could be comprehensively assessed by evaluating key steps of the investment cycle, namely, planning, prioritization and allocation, implementation, and evaluation.²⁸ However, most empirical studies use broad measures of institutional quality and/or governance as proxies for public investment efficiency.²⁹ These studies confirm that better-quality institutions and/or governance lead to higher, less volatile, and more efficient public investment (Dollar and Levin, 2005; Denizer et al, 2013; Grigoli and Mills, 2014; Bulman et al, 2015; Presbitero, 2016; EC, 2017b). While there is no explicit link, some of these studies subsequently provide policy recommendations related to public investment processes. For example, and most relevant to this paper, EC (2017b) identifies a positive role of governance in supporting public investment in the Euro area and then highlights factors such as more careful planning and a better design of procurement procedures as governance indicators.

The empirical part of this paper departs from this literature by examining the direct relationship between the quality of public procurement (which is one of the main aspects of the implementation step), and public investment for European countries. To do so, the paper uses the overall index of public procurement performance from the Single Market Scoreboard described in the previous section. It then uses the estimated model to measure the gains for Italy of achieving better procurement scores.

Empirical Analysis and Gains from Improving Public Procurement for Italy

The impact of public procurement performance on public investment is examined in a standard reduced-form model of public investment, widely used in the literature. The baseline regression can be written as:

$$\ln Public\ inv_{i,t} = \beta \ln Public\ inv_{i,t-1} + \gamma PP_{i,t-1} + \alpha X_{i,t-1} + \theta_t + \epsilon_{i,t}$$

where public investment, $Public\ inv_{i,-}$, is measured by the gross fixed capital formation of the government sector as a share of GDP. As common in the literature, the lagged public investment variable is used as a control to capture persistence of public investment. $PP_{i,-}$ represents the overall public procurement performance score from the EC's Single Market Scoreboard. $X_{i,-}$ is a vector of controls, following the specification in EC (2017b) that was

²⁸ For example, the Index of Public Investment Management (PIMI) (Dabla-Norris et al, 2011) and the Public Investment Management Assessment (PIMA) scores (IMF, 2015; IMF, 2016).

²⁹ For example, the World Bank's Country Policy and Institutional Assessment (CPIA) scores and the worldwide governance indicators (WGIs).

based on an extensive review of the literature. These controls include macroeconomic factors (e.g. real GDP growth, output gap, GDP per capita), fiscal conditions (e.g. public debt, long-term sovereign borrowing costs, primary balance), demographic characteristics (share of old-age population), and political economy variables (e.g. political orientation and election cycle). In some specifications, additional controls to capture institutional quality and effectiveness are also included. θ_t is a non-linear time trend. Given the limited time series for the public procurement performance score, the regression is estimated over a panel of 30 European countries (EU-28, Liechtenstein, and Norway) observed over the period of 2015–2018, as well as a cross-section of three-year average data.³⁰

Regression results are displayed in Table 6, with columns 1–4 and 5–8 presenting the baseline regression results from the panel and three-year average data respectively. Most of the explanatory variables have the expected sign. In particular, the positive relationship between public procurement performance and public investment is statistically significant.

From the regressions, a one-point increase in the overall public procurement performance score is associated with an increase in public investment of about 0.05 to 0.07 percentage points of GDP. Given that public procurement performance could impact public investment through investment efficiency, results from additional specifications with a control for public investment efficiency (measured by the IMF's Public Investment Efficiency (PIE-X) scores) and its interaction with the public procurement performance scores are shown in columns 3–4 and 7–8.³¹ Results are broadly robust and show that better public procurement helps support the positive impact of public efficiency on public investment.

Moving to potential gains in public investment for Italy, the model shows that they could be significant. At the current overall public procurement performance score of -3.33, an improvement in public procurement performance towards the best performer (Sweden for 2018 at a level of 6.7) is associated with 0.4–0.7 percentage points of GDP increase in public investment, depending on the specification used. A less ambitious improvement towards the median performer (Belgium for 2018 at a level of 1.3) would still give a positive gain in public investment of around 0.2–0.3 percentage points of GDP.³²

³⁰ With the limited number of observations, empirical results should be interpreted with caution. A specification with country fixed effects would be too stringent. To control for country-specific characteristics, as much as possible, additional controls beyond those used in the literature (such as GDP per capita, and governance, institutional, and political factors) are added.

³¹ PIE-X scores measure relative levels of infrastructure coverage and quality (output) for given levels of public capital stock (inputs). Countries score between 0 and 1 based on their distance to the frontier relative to best performers (see IMF (2015) for more details). As a result, procurement efficiency is not a direct sub-component of the overall investment efficiency measured by PIE-X scores.

³² It is important to note that the estimated potential gains represent an average impact. Given heterogeneity across countries, the same procurement performance indicators may have a different impact on raising public investment given country-specific institutional characteristics.

Table 6. Public Investment Regression Results

	Public investment (percent of GDP)							
	Pooled				3Y-average			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.Public investment (percent of GDP)	0.526*** (0.124)	0.527*** (0.128)	0.491*** (0.131)	0.478*** (0.133)				
L.Public procurement performance Score	0.046** (0.022)	0.052* (0.030)	0.049** (0.020)		0.071** (0.032)	0.076* (0.041)	0.060* (0.033)	
L.Public investment efficiency			1.610 (1.288)	1.545 (1.267)			0.175 (1.695)	-0.006 (1.658)
L.Public procurement performance Score x L.Public investment efficiency				0.066** (0.025)				0.084* (0.041)
L.Output gap (percent)	-0.239*** (0.069)	-0.241*** (0.074)	-0.189** (0.090)	-0.190** (0.089)	-0.611*** (0.107)	-0.616*** (0.111)	-0.531*** (0.128)	-0.535*** (0.124)
L.Real GDP growth (percent)	0.000** (0.000)	0.000* (0.000)	0.000* (0.000)	0.000* (0.000)	0.000** (0.000)	0.000** (0.000)	0.000** (0.000)	0.000** (0.000)
Ln(L.GDP per capita in USD)	-0.049 (0.179)	0.030 (0.321)	-0.057 (0.199)	-0.083 (0.201)	-0.339 (0.296)	-0.283 (0.538)	-0.143 (0.301)	-0.211 (0.302)
L.Real long-term bond yield (percent)	-0.107* (0.059)	-0.094 (0.062)	-0.051 (0.073)	-0.052 (0.073)	-0.218* (0.117)	-0.170 (0.133)	-0.117 (0.156)	-0.134 (0.153)
L.GG Gross debt (percent of GDP)	-0.008* (0.004)	-0.008* (0.005)	-0.005 (0.005)	-0.006 (0.005)	-0.027*** (0.005)	-0.029*** (0.006)	-0.028*** (0.005)	-0.027*** (0.005)
L.GG primary balance (percent of GDP)	0.031 (0.036)	0.030 (0.039)	0.101 (0.065)	0.099 (0.064)	-0.014 (0.076)	-0.021 (0.081)	-0.024 (0.091)	-0.021 (0.089)
Ln(L.Share of old age: percent of total pop.)	-0.849 (0.769)	-0.783 (0.796)	-1.808** (0.865)	-1.875** (0.857)	-2.245* (1.190)	-2.135 (1.277)	-2.950** (1.225)	-3.072** (1.197)
Constant	-35.127 (23.693)	-34.211 (23.213)	-29.086 (21.660)	-24.737 (22.185)	14.025** (5.621)	12.782 (7.392)	13.621** (5.815)	14.848** (5.805)
Additional controls for governance and institutional quality	No	Yes	No	No	No	Yes	No	No
Observations	90	90	81	81	30	30	27	27
# countries	30	30	27	27	30	30	27	27
R2	0.654	0.656	0.670	0.675	0.787	0.797	0.832	0.841

Note: 1/ * p<0.1 ** p<0.05 *** p<0.01.
2/ Other controls are years remaining in the government's term, political orientation of the ruling party, and time trend for the pooled regression.
3/ Governance and institutional quality are measured by the World Bank's Worldwide Governance Indicators (WGI).

D. Overcoming Public Procurement Challenges

Almost four years after the introduction of sweeping reforms to public procurement which was meant to improve efficiency, enhance transparency and eliminate complexity, the 2019 emergency decree to unblock investment has reversed several of these major provisions. The temporary suspensions of specific regulations of the original code add complexity as well as uncertainty over the strategic direction of the reform and weaken its effectiveness. These arguably could have been avoided through steadfast implementation of the original legislation and elimination of inconsistencies that resulted in subsequent delays in public works.

As a general point, therefore, it is critically important not only to design well the reform but to follow through consistently and speedily. Piecemeal amendements to fix implementation problems risk reversing the broad direction of reforms and need to be avoided (see also PBO (2019), BoI (2019) and European Commission (2019)). Specifically in regard to procurement reform, among the most urgent tasks are to:

- Resolve the opposition to the system of contracting authorities through financial support and technical guidance in hiring qualified staff by local authorities. The professionalization of public demand forms the basis of the 2016 code and its starting point. This step will support the contracting authorities' ability to develop effectively the required knowledge and skills. These are crucial for a successful implementation of the more complex elements of the new public procurement system;
- Clarify the binding nature of some soft laws to reduce legal uncertainties by clearly identifying those that have the force of law. This should support increased discretion of contracting authorities by establishing the rules and limits within which their new powers may be exercised;
- Streamline soft laws issued by ANAC in consultation with the operators that are concerned about undue complexity. In addition, regardless of the regulatory framework used (i.e. soft laws vs a single binding legislation), a careful balance needs to be struck between simplifying complex procedures and safeguarding transparency;
- Implement the enterprise rating system by supporting contracting authorities with instrumental and professional resources;
- Require that the board members for tender selection be drawn from the national register of ANAC;
- Return to the ban of negotiated procedures without prior publication of a contract notice;
- Re-establish the primacy of MEAT over the lowest price criterion; and
- Suspend the prohibition of joint contracts.

IV. LESSONS AND OVERALL RECOMMENDATIONS

The two select case studies highlight some broader conclusions regarding the pitfalls facing public administration reforms. Although legislative and reform intentions were good, follow-up and implementation were lacking. In particular, legislative amendments weakened and, in some cases, overturned, original provisions. Another dimension that has limited the impact of reforms was regulatory complexity and uncertainties in the application of the legislation. This highlights the weak design and the uneven implementation across various levels of government and authorities due to a fragmentation of responsibilities, lack of coordination and policy incoherence (OECD, 2009b). Finally, enforcement mechanisms were weak, including in systematically challenging and sanctioning non-compliance (European Commission, 2019; OECD, 2019; PBO, 2019).

To address these shortcomings, it would be advisable to build political momentum and consensus for reforms by fostering consultation by ministries and regulatory agencies with stakeholders, publishing the results of consultations, revealing the parties consulted, and using impact analyses and other benchmarking tools to better communicate the need for and benefits of reforms. Well-designed reforms that get at the root of the inefficiency or problems in the public sector should strive for simplicity and clarity. Follow-up (e.g., secondary) legislation should be implemented expeditiously. Key performance indicators should be published transparently and backtracking should be avoided, while periodic reviews (say every 5 years) could be considered as an oversight instrument to assess progress and make changes as needed. Enforcement mechanisms should be considered during the design phase and implemented with due attention to coordination across agencies or levels of the public administration. Addressing these gaps would seem essential for Italy to successfully modernize its public administration.

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