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COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Italy

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(Only the Italian text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission.[3] As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance,[5] Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the European Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU,[6] alongside the proposal for the reinforced long-term budget of the EU for 2021-2027.[7] This proposal includes the establishment of a Recovery and Resilience Facility offering large-scale financial

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[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[2] The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[3] https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis

[4] Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

[5] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

[6] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING ITALY

5. On 19 October 2020, Italy submitted its Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Italy[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Italy to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Italy's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value and Italy did not comply with the debt reduction benchmark in 2019. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled and that there was no sufficient evidence that the debt criterion was or was not complied with. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the Italian economy is expected to contract by 9.9% in 2020 and grow by 4.1% in 2021. According to the Draft Budgetary Plan, the Italian economy is expected to contract by 9% in 2020 before rebounding by 6% in 2021. According to the Draft Budgetary Plan, private consumption will be a key growth driver in the second half of 2020 and in 2021. Investment is also projected to rebound strongly and to sustain the recovery in 2021. The macroeconomic scenario for 2020 does not fundamentally differ from the Commission 2020 autumn forecast, while the Commission forecast is significantly more pessimistic for 2021. The differing outlook in that year is owed to the fact that the latter does not include the impact on growth from not yet defined investments financed by the Recovery and Resilience Facility, and the authorities could not factor in the recent resurgence of the pandemic. Italy complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently-endorsed macroeconomic forecasts. In its endorsement of the forecasts, the Parliamentary Budget Office (UPB) signalled that the projections were subject to downside risks, linked to the uncertain evolution of the pandemic and potential financial tensions.

8. The Plan projects the general government headline deficit to increase from 1.6% of GDP in 2019 to 10.5% of GDP in 2020, due to the revenue loss caused by the drop in economic activity and the sizeable cost of the policy response. The Commission

[8] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Italy and delivering a Council opinion on the 2020 Stability Programme of Italy, OJ C 282, 26.8.2020, p 74.

2020 autumn forecast projects a slightly higher government deficit in 2020, due to the different macroeconomic scenario and despite the inclusion of higher tax revenue because of a different treatment of tax payments deferred to 2021 and 2022. In fact, the corresponding revenues of around 0.4% of GDP are expected to be recorded in 2020 based on the accrual principle for statistical recording, implying higher revenues in 2020 and lower ones in 2021 compared to the government projections.

9. In 2021, the Draft Budgetary Plan projects the government headline deficit to decline to 7% of GDP, thanks to the expected recovery in economic activity and the phasing out of most emergency measures implemented in 2020 to address the COVID-19 pandemic. The Commission forecast projects a higher government headline deficit in 2021, at 7.8% of GDP. The difference to the Draft Budgetary Plan is due to the lower projected rebound in economic activity and to the above-mentioned differences in the assumptions on the statistical recording of tax deferrals. The Draft Budgetary Plan assumes additional investments financed by grants under the Recovery and Resilience Facility amounting to 0.6% of GDP, with a neutral budgetary impact. For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes in the budgetary projections for 2021 the 10% pre-financing of Recovery and Resilience Facility grants and treats it as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. In the case of Italy, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 7.1 billion[9]. On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast.[10] The evolution of the deficit in 2021 could turn out more favourable as a result of the higher growth from the implementation of measures financed by the Recovery and Resilience Facility.

The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will increase from 134.7% in 2019 to 158% in 2020 and will decline to 155.6% in 2021, below the Commission projection of 159.5% in 2021.

As in other countries, the government has provided public guarantees to sustain economic activity and sectors particularly hit by the pandemic. Should these guarantees be called, this will be reflected in public debt and deficits in the future. The Draft Budgetary Plan also includes medium-term economic projections showing that the debt-to-GDP ratio will decline to below its 2019 level by 2031, based on the government budgetary strategy and specific assumptions on macroeconomic developments and the expected use of resources from Next Generation EU.

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9 Indicative number based on the Council Presidency compromise proposal for the RRF regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament

10 The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of the Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

10. The Draft Budgetary Plan includes references to discretionary fiscal measures adopted in 2020 in response to the COVID-19 outbreak and its economic effects. Overall, the direct budgetary impact of these measures is estimated at around 6.1% of GDP according to the Draft Budgetary Plan, which are assessed to be temporary. Expenditure measures include resources for healthcare, civil protection and local governments to address the medical emergency (1.3% of GDP) as well as support for employment and households, including the extension of wage supplementation schemes and financial transfers to self-employed workers (2.1% of GDP). They further include various forms of support for firms, including partial compensation of incurred losses (0.7% of GDP), subsidies to specific sectors (0.5% of GDP) and budget provisions for guarantees (0.5% of GDP). On the revenue side, the main measures include the abolition for 2020 of the regional tax on productive activities (0.2% of GDP), the reduction of social security contributions in poorer regions for the last three months of 2020 and for new long-term employment contracts signed by the end of 2020, and the deferral of several tax payments, mostly targeting firms. In addition to the measures with a direct budgetary impact, Italy also adopted sizable liquidity measures in 2020, mainly in the form of government guarantees. Although no details are included in the Draft Budgetary Plan, the maximum size of contingent liabilities possibly arising from the guarantee schemes adopted in 2020 can be estimated at around 30% of GDP. Based on available information, actual requests for these guarantee schemes concerned a loan volume of around 7% of GDP by the end of October 2020. Other liquidity measures adopted by Italy include the payment of trade debt arrears of local administrations (0.1% of GDP) and the creation of two funds for the capitalisation of firms (2.9% of GDP), which will increase government gross debt when the specific operations of capitalisation will take place. Overall, the measures taken by Italy in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

11. On 27 October and 10 November 2020, Italy adopted two additional packages of measures to address the economic fallout related to the resurgence of the pandemic with a total budgetary impact of 0.3% of GDP in 2020, which is not considered in the Draft Budgetary Plan or the Commission forecast.

12. For 2021, the Draft Budgetary Plan presents a set of additional measures aimed at supporting the economic recovery, amounting to 1.4% of GDP. Revenue measures imply a budgetary impact of 0.5% of GDP and include the extension of the tax credit on employment income, the extension of the cut in social security contributions in poorer regions, as well as tax credits for investment in the same regions. Among financing measures, the Draft Budgetary Plan also reports revenues for 0.2% of GDP from Next Generation EU, in addition to grants from the Recovery and Resilience Facility, which are not considered in the Commission forecast as the corresponding expenditure measures are not specified. Expenditure measures imply a budgetary impact of 1.1% of GDP in 2021 and include a streamlined family bonus, additional funds for different ministries, including education, research and health care, financial support for firms operating in sectors most affected by the pandemic as well as additional resources for local public services and for public investment. The Draft Budgetary Plan also reports that several measures aimed at supporting liquidity to the corporate sector, including government guarantees, will be extended to 2021, but no details are provided. The extension of wage supplementation schemes in light of the emergency is currently in place until January 2021, although several incentives for firms have been introduced to encourage the phasing-out of those schemes. At the

same time, some measures set out in the Draft Budgetary Plan, while supporting economic activity against the background of considerable uncertainty, appear not to be temporary or matched by offsetting measures. According to the Commission forecast, while measures amounting to 0.3% of GDP are temporary, another 1.1% of GDP appear not to be temporary or matched by offsetting measures. These in particular include the cut in social security contributions in poorer regions, the extension of the tax credit on employment income, the introduction of a family bonus as well as the higher resources allocated to ministries and other public services.

13. The Commission is of the opinion that the Draft Budgetary Plan of Italy is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Italy are supporting economic activity against the background of considerable uncertainty. However, some measures do not appear to be temporary or matched by offsetting measures. Given the level of Italy's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, it is important for Italy to ensure that, when taking supportive budgetary measures, fiscal sustainability in the medium term is preserved. Italy is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

It is anticipated that Italy will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

Done at Brussels, 18.11.2020

For the Commission
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Member of the Commission