Investment, NGUE funds and fiscal rules, is there room for manoeuvre ?

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Ministero dell'Economia e delle Finanze

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Preliminary/Background Remarks
not covered in the presentation

Role and Impact of Public Investment

- Macro effect: Multiplier (demand side) / Productivity (supply side)
- With respect to private investment: crowd in (complementarity) / crowd out

Data and conceptual issues

- Need to have homogenous series for all EU-countries
- Relevant aggregate: Gross investment / Net investment
- Defining a perimeter (capital / current) for growth enhancing expenditures

Sizeable investment needs when looking ahead

Public vs Private

Aim of the presentation

Analise two partially overlapping aspects:

Fiscal rules and NGEU, with the effort to highlight their interaction

In the background:

Gradual decline of public investment/GDP ratio, reverted as a result of the EU level policy response to the Covid-19 crisis

Fiscal rules

Should Protect and/or favour public investment

Incumbent rules arguably deemed not to have been adequate

NGEU

Grants (and loans) awarded over a six year period

Conditionality (milestones and targets); *not covered*

Issues covered *where possible, with illustrative simulations*

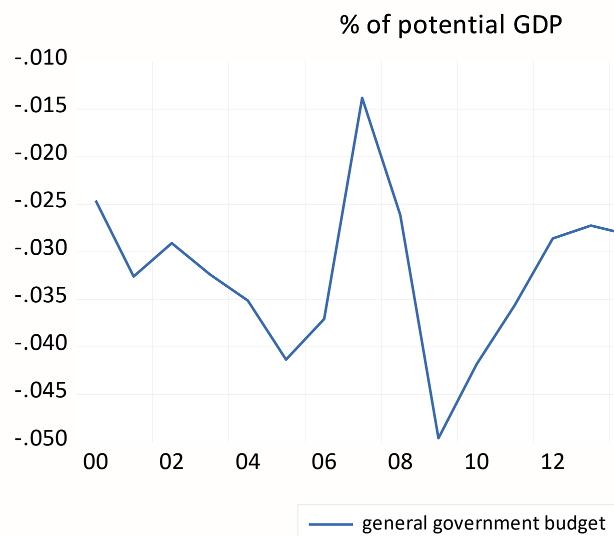
- Counter-cyclicality of fiscal rules (protection of investment)
- How NGEU funds interact with compliance with fiscal rules?
  - They easy compliance
  - Not enough (at the current juncture) to preserve investment and recovery; fiscal guidance for 2023: current expenditure benchmark
  - Cliff edges after 2026?
- "NGEU legacy", how challenging is to maintain the 2026 levels of I/GDP ratio?

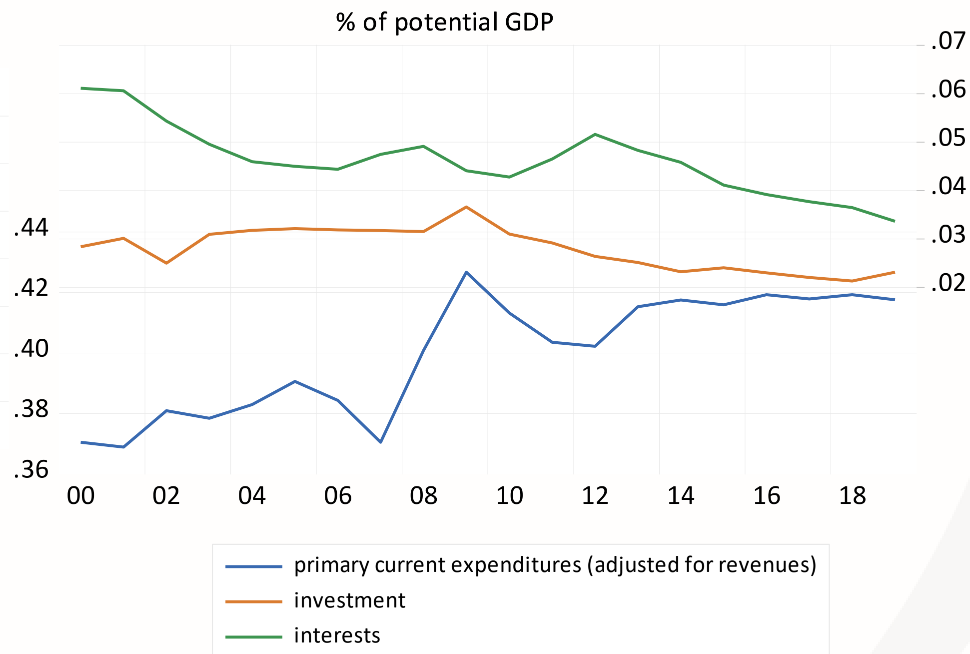
  …given incumbent fiscal rules
- Which role new rules (or provisions) can have in incentivising investment?

The case of Italy before the covid 19 shock

Main features of the gradual fiscal consolidation :

- "Current expenditure benchmark" overall respected over the last decade
- Reduction of investment and interest expenditures





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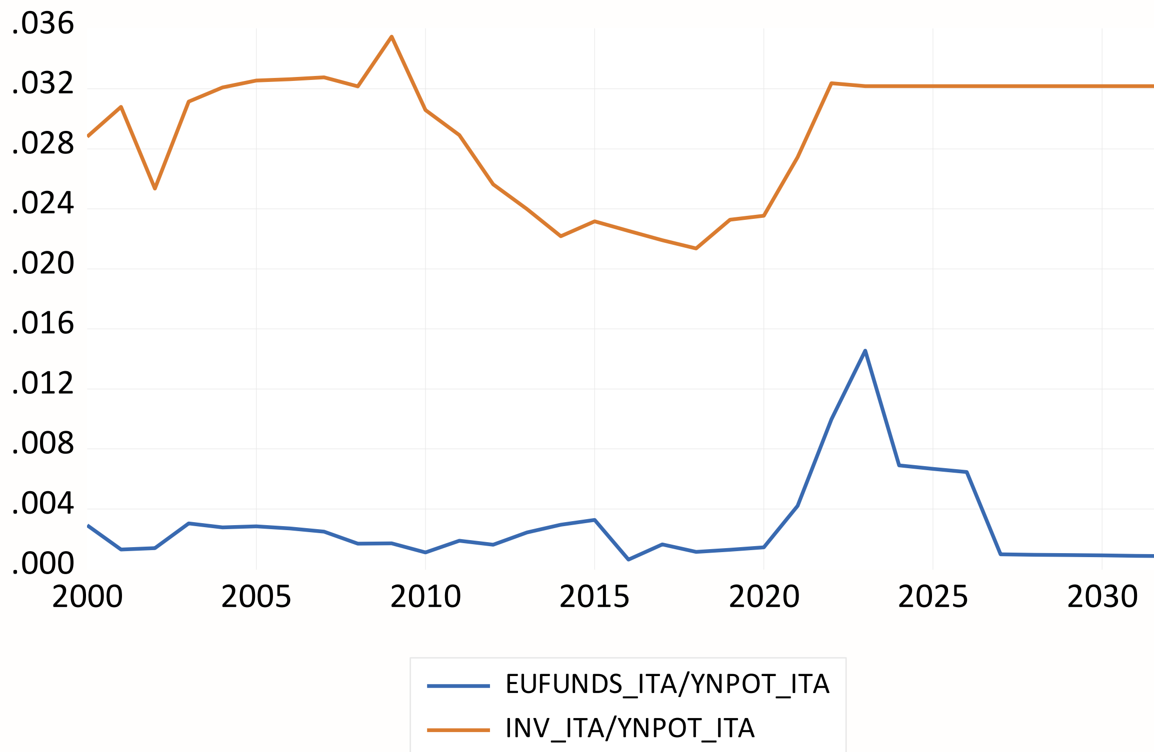
The case of Italy: NGUE and beyond

- In the 2021-2026 period planned surge of investment, also thanks to NGEU
- To what extent compliance with fiscal rules can put under strain the plans?
- How challenging is to sustain the achieved I/GDP level after 2026?



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Data and Model used

Baseline - EU commission “toolkit” used in DSA framework

- Projections from 2023 to 2032
- Autumn forecasts from AMECO (t+2 ends in 2023)
- T+10 Medium term projections (e.g. OG closes at t+5, potential output growth,…)
- Exogenous interest rates, Debt and interest payments endogenous
- Public finance: structural balance “frozen” at 2023 value (= "unchanged policy")

➢ Grants: until 2026 data from operational agreements, from 2027 NGEU funds = 0

➢ Investment is exogenous, from 2024 projected at 2023 level as a ratio to pot. GDP

Ex-ante simulation approach

- Alternative scenarios with respect to the baseline

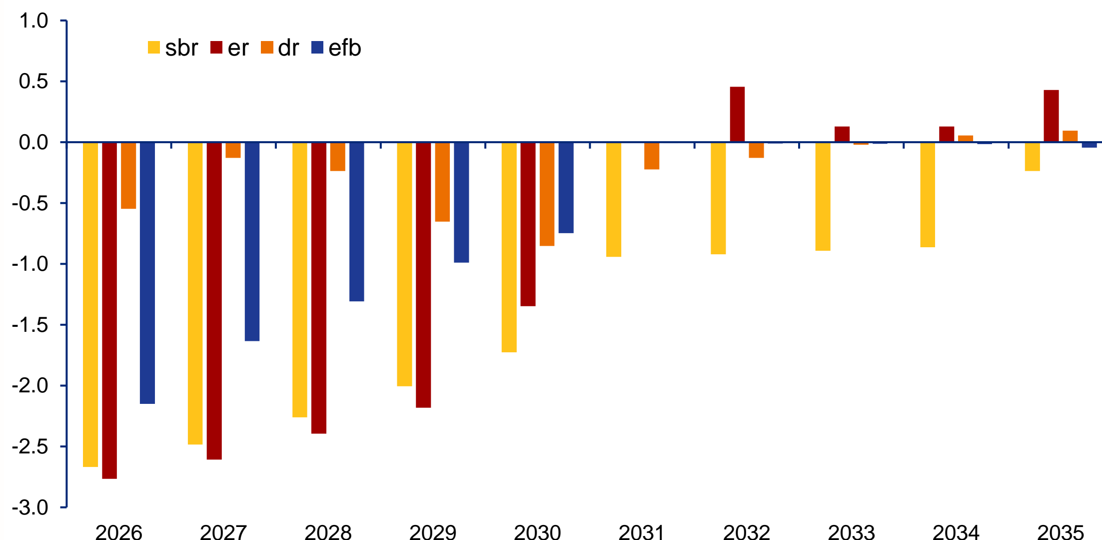
Investment protection and fiscal rules

To what extent are current rules – not procyclical?

Reaction of SGP rules (and EFB) to a cyclical shock, allow for a worsening of the deficit

Key assumption: no change in potential output

Difference between primary balance (%GDP) projected in the shocked scenario and in the no-shock scenario



If the country is not at its MTO, MTO targeting rules allow for higher temporary worsening of the deficit. No other relevant difference if above assumption holds.

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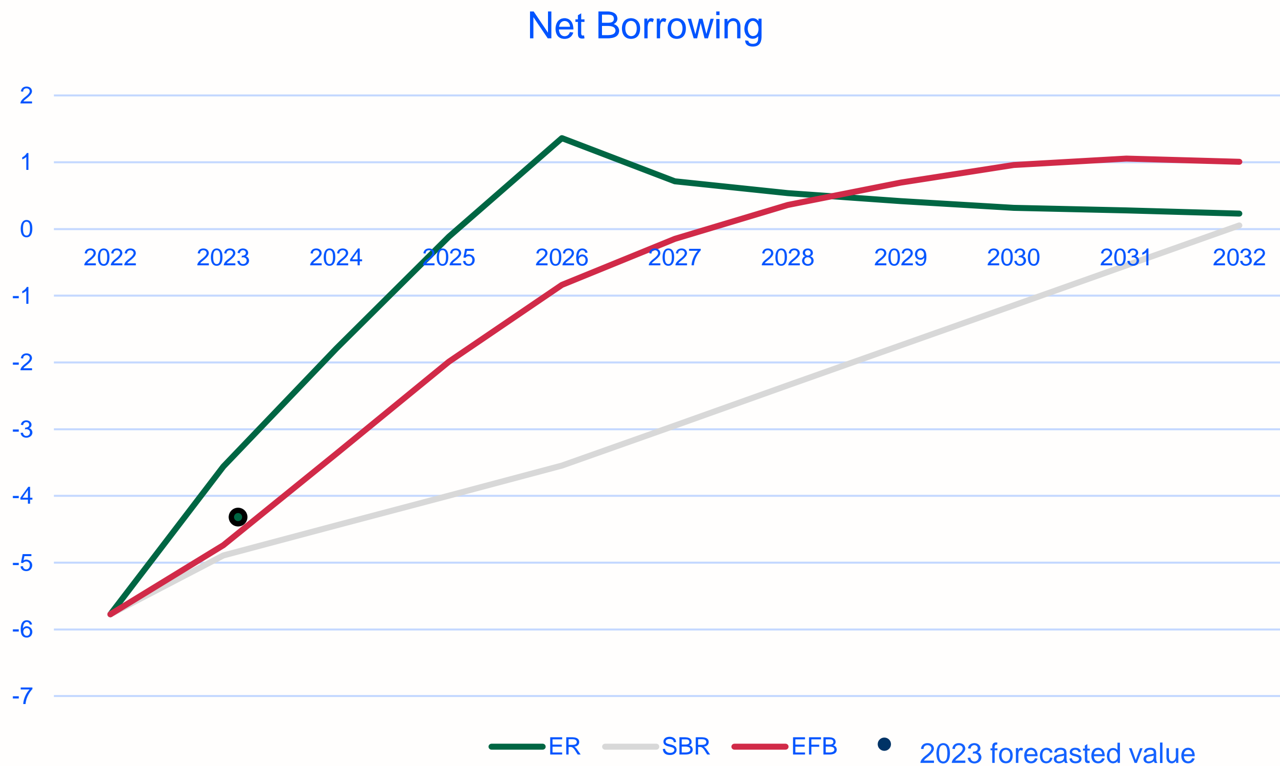
Fiscal adjustment induced by rules

Fiscal compliance:

Budget balance paths compliant with the rules



Downward pressure on current expenditure

Fiscal compliance:

nominal current expenditure growth compliant with the rules and nominal benchmark

Current Primary expenditure growth

6
5
4
3
2
1
0

2023 2024 2025 2026 2027 2028 2029 2030 2031 2032

ER SBR EFB nominal potential growth

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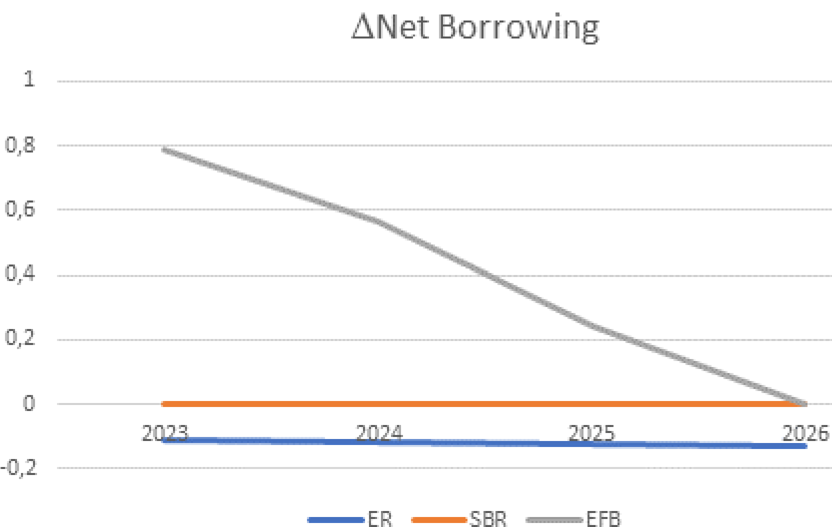
Leeway insured by NGEU funds

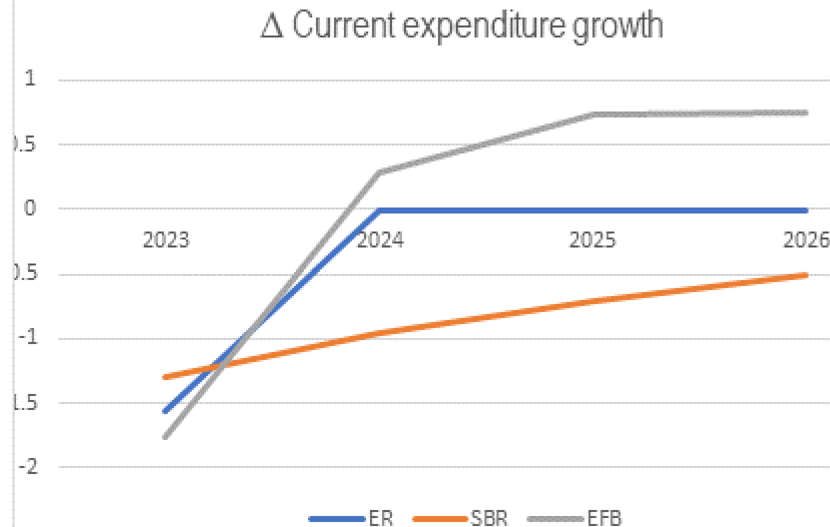
Fiscal compliance:

Assuming no NGEU related grants from 2023 to 2026

Difference between primary balance (%GDP)



Different path of nominal current expenditure



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Pressure on public investment after NGEU

Fiscal compliance after 2026:

Assuming investment/GDP ratio to move back to 2018 levels

The new investment path would be compatible with a higher growth rate of current expenditures, while holding revenues to GDP ratio constant.

This shows – with the opposite sign – the effort required in terms of expenditure growth to keep investment at the NGUE programme level.

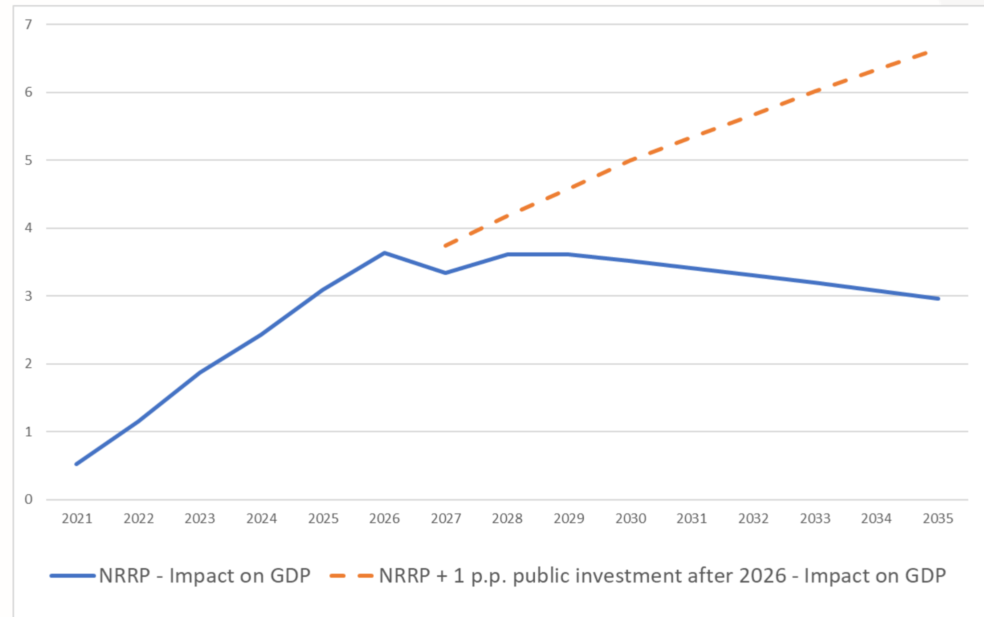
SIMULATION RESULTS ARE STILL WORK IN PROGRESS

But something is not yet considered in the analysis

Is the baseline right?

With investment at permanently higher levels, should GDP be higher in the medium term ?

- The NRRP will boost public investment and GDP along the NGUE time horizon
- However, the impact could slowly fade-out after 2026, the end-year of the programme
- A permanent increase in the share of public investment to GDP after 2026, instead, would steer the economy toward a higher and long-lasting growth path

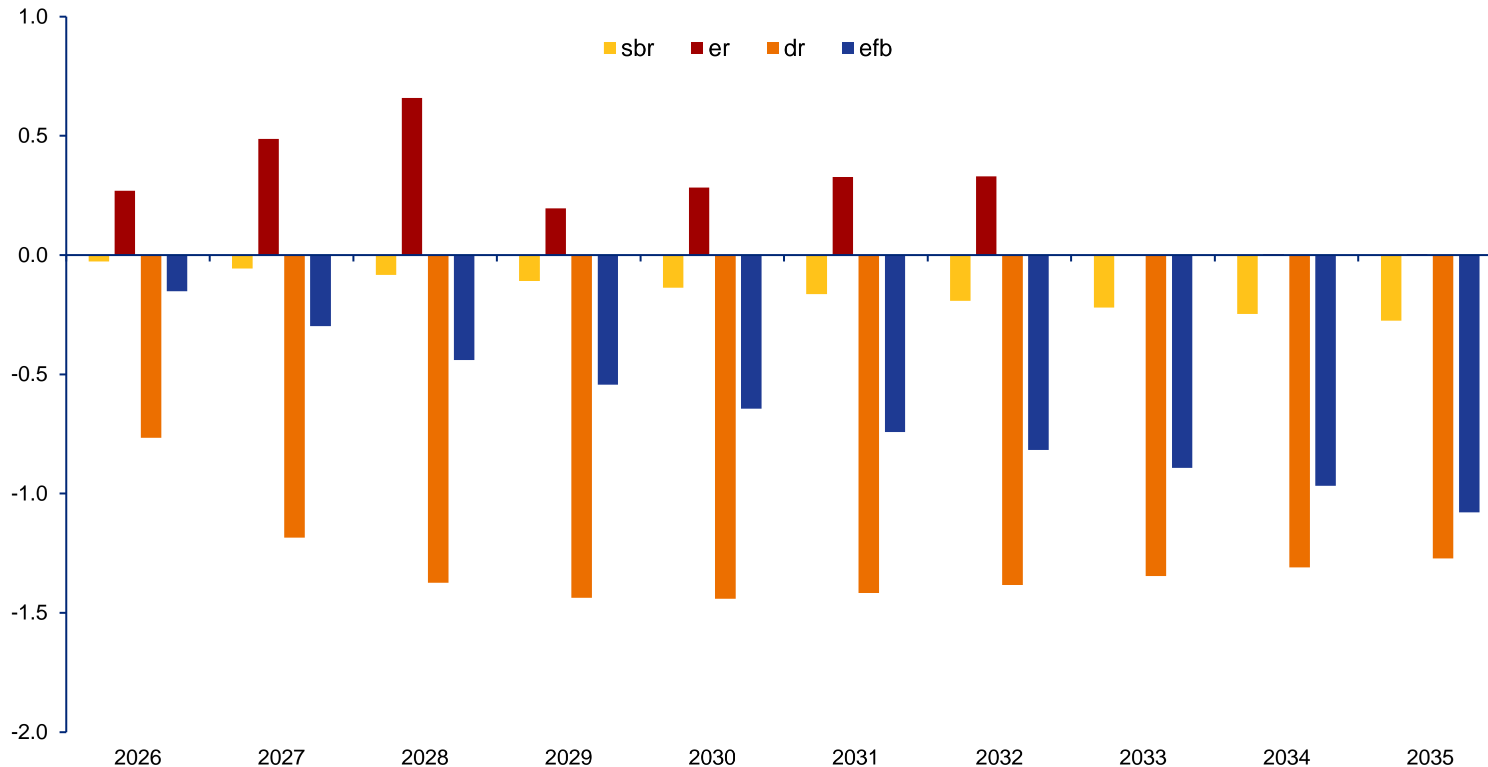


Note: the figure shows the impact of the Italian NRRP (blu line) on GDP and the impact of the Italian NRRP plus a permanent increase in the share of public investment to GDP equal to 1 p.p. after 2026 (orange-dashed line); %-deviation of real GDP level from baseline. Source: MEF, QUEST-III R&D model for Italy.

With more investment and/or successful impact of PNRR reforms, to what extent would "pressure" be released

Impact on fiscal compliance requirements if higher potential growth:

Difference between primary balance (%GDP)



Overall rules targeting a debt level would provide more leeway

Fiscal rules and "degree" of investment incentivization.

- There are several proposals aimed at protecting public investment
- Golden rule type are generally not compatible with debt rules or do not provide a “real incentive”
- Namely: if investment are excluded from the deficit but a debt rule is fully operational, then higher pressure is put on expenditure dynamics (unless taxes are raised).
- There are intermediate proposals arguing that investment generated debt could be reduced at lower speed.