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COMMISSION OPINION

of 24.11.2021

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 that 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]

4. On 3 March 2021, the Commission adopted a Communication providing further policy orientations to facilitate the coordination of fiscal policies.[4] In that Communication, the Commission set out its view that the decision on the deactivation or continued application of the general escape clause should be taken on the basis of an overall assessment of the state of the economy, with the level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) as a key quantitative criterion. On 2 June 2021, on the basis of the Commission's 2021 spring forecast, the Commission considered that the conditions to continue to apply the general escape clause in 2022 and to deactivate it as of 2023 were met.[5] Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.

5. Next Generation EU, including the Recovery and Resilience Facility, supports a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 established the

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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 to the Council on one year since the outbreak of COVID-19: fiscal policy response, Brussels, 3.3.2021, COM(2021) 105 final.

[5] Communication from the Commission on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021) 500 final.

Recovery and Resilience Facility[6] which provides financing support for the implementation of reforms and investments, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the EU budget. By contributing to economic recovery and to strengthening long-term growth, it supports public finances, growth and job creation in the medium and long term.

6. On 2 June 2021, the Commission emphasised in its communication that the coordination of national fiscal policies remains crucial to underpin the recovery. In this context, the Commission set out its view that the overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. Fiscal policy should remain agile and adjust to the evolving situation as warranted, and a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Finally, with economic activity gradually normalising in 2021, Member States' fiscal policies should become more differentiated in 2022, taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. All Member States should preserve nationally financed investment. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

In its recommendations on the 2021 Stability Programmes on 18 June 2021, the Council also recommended that, when economic conditions allow, Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, investment should be enhanced to boost growth potential.

The Council, on 13 July 2021, further recommended to euro area Member States[7] to take action, individually and collectively within the Eurogroup, in the period 2021–2022 to ensure a policy stance that supports the recovery from the COVID-19 crisis. When the epidemiological and economic conditions allow, emergency measures should be phased out while combatting the social and labour-market impact of the crisis. Recalling the need for prudent medium-term fiscal positions and debt sustainability, while enhancing investment, the Council also called for particular attention to the quality of budgetary measures.

The recovery of the European economy has been strengthening, thanks to the improved health situation and easing of pandemic control restrictions. The volume of output in the euro area is expected to return to its pre-pandemic level by the end of the year. However, bottlenecks in global supply, rising energy and commodity prices are increasingly weighing on activity in the EU. This together with production bottlenecks, due to the shortage of some input components and raw materials, and capacity constraints vis-à-vis booming demand both in the EU and internationally have been putting upward pressure on consumer prices.

7. On 18 June 2021, in its recommendations on the 2021 Stability Programmes, the Council highlighted that the established indicators of fiscal adjustment set out in Regulation (EC) No 1466/97 need to be considered in the context of the current

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[6] OJ L57, 18.2.2021, p.17.

[7] Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1.

circumstances. Specifically, the assessment of the overall fiscal stance at the current juncture should take into account the transfers from the EU budget (such as those from the Recovery and Resilience Facility). Furthermore, the assessment also needs to take into account the phasing-out of crisis-related temporary emergency measures that were designed to support health systems and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions, while their withdrawal is accompanied by the easing of lockdown restrictions that will support growth.

Accordingly, the fiscal stance in 2021 and 2022 is measured by the change in primary expenditure (net of discretionary revenue measures), excluding crisis-related temporary emergency measures but including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth[8]. Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed primary current expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) and investment.

CONSIDERATIONS CONCERNING ITALY

8. On 20 October 2021, Italy submitted the Draft Budgetary Plan for 2022. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

   Italy did not comply with the 15 October deadline foreseen in Article 6 of Regulation (EU) No 473/2013, thereby not respecting the common budgetary timeline.

9. On 18 June 2021, the Council recommended that in 2022 Italy[9] uses the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Moreover, it should preserve nationally financed investment. The Council also recommended Italy to limit the growth of nationally financed current expenditure.

   The Council also recommended to pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the national budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery; to prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition; and to give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy and sustainability of health and social protection systems for all.

   On 2 June 2021, the Commission issued a report under Article 126(3) TFEU.[10] This report discussed the budgetary situation of Italy, as its general government deficit in 2020 exceeded the 3% of GDP Treaty reference value, while its general government

[8] The Commission's estimates of medium-term potential growth do not include the positive impact of reforms that are part of the Recovery and Resilience Plan and can boost Italy's potential growth.

[9] Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Italy, OJ C 304, 29.7.2021, p. 53.

[10] Report from the Commission prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, Brussels, 2.6.2021, COM(2021) 529 final.

debt exceeded the 60% of GDP Treaty reference value and did not respect the debt reduction benchmark. The report concluded that the deficit criterion was not fulfilled and the debt criterion was not complied with.

10. According to the Commission 2021 autumn forecast, the Italian economy is expected to grow by 6.2% in 2021 and by 4.3% in 2022, while inflation is forecast at 1.8% in 2021 and 2.1% in 2022. Domestic demand is set to rebound also thanks to strong investment spending, which benefits from an improved demand outlook, favourable financing conditions and the support from the Recovery and Resilience Facility. Exports, especially of goods, are forecast to regain some market shares in 2021 and to grow in line with world trade thereafter. Services exports are likely to be affected by the more gradual recovery in tourist flows, which are not assumed to normalise prior to 2023.

The macroeconomic scenario underpinning the Draft Budgetary Plan expects real GDP to rise by 6% in 2021 and by 4.7% in 2022, while inflation is forecast at 1.6% in both 2021 and 2022. The growth estimates for next year include a stronger impact from the expansionary 2022 budget than the Commission forecast and project a somewhat higher growth rate for investment spending.

Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible in 2021 and 2022.

Italy complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently-endorsed macroeconomic forecasts.

11. Italy submitted its Recovery and Resilience Plan on 30 April 2021. The Council approved the assessment of Italy's Recovery and Resilience Plan on 13 July 2021. A pre-financing payment of Recovery and Resilience Facility grants of 0.5% of GDP was made to Italy in August 2021. The Draft Budgetary Plan assumes that expenditure amounting to 0.3% in 2021, 0.7% in 2022, 0.8% in 2023 and 0.5% in 2024 will be funded by non-repayable financial support (grants) from the Recovery and Resilience Facility. Tax cuts amounting to 0.1% in 2022, 0.2% in 2023 and 0.2% in 2024 will also be funded by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by RRF grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt. The Draft Budgetary Plan also assumes expenditure financed through loans from the Recovery and Resilience Facility, with a direct impact on the general government deficit and debt amounting to 0.1% in 2020, 0.4% in 2021, 0.7% in 2022, 0.8% in 2023 and 1.5% in 2024. The Commission 2021 autumn forecast includes a similar amount of expenditures financed by RRF grants and loans in its budgetary projections. Simulations by the Commission services show that the Recovery and Resilience Plan, together with the rest of measures of the European Union Recovery Instrument, has the potential to increase the GDP of Italy by 2.5% by 2026, not including the possible positive impact of structural reforms, which can be substantial [11].

12. In the 2022 Draft Budgetary Plan, Italy's general government deficit is planned to decrease from 9.4% of GDP in 2021 to 5.6% of GDP in 2022. The reduction of the deficit is supported by the economic recovery and the phasing out of government's temporary emergency support, while new measures announced in the 2022 Draft

[11] These simulations reflect the overall impact of NGEU, which also includes funding for ReactEU, and increased funding for Horizon Europe, InvestEU, JTF, Rural Development and RescEU.

Budgetary Plan are expected to weigh on the government deficit. In addition, expenditure for compensation of employees is expected to increase significantly next year, also due to the retroactive renewal of public contracts for the period 2019-2021, for which a substantial part (amounting to ¼% of GDP) will be recorded in 2022. The general government debt ratio is planned to decrease from 153.5% of GDP in 2021 to 149.4% of GDP in 2022. These projections are broadly in line with the Commission 2021 autumn forecast. The Commission 2021 autumn forecast projects a slightly higher government deficit in 2022, due to the different macroeconomic scenario. Namely, the Commission forecasts less dynamic employment and nominal household consumption compared to the Draft Budgetary Opinion. The higher deficit and lower growth translate in a higher 2022 debt-to-GDP projection in the Commission forecast, at 151.4%, compared to the Draft Budgetary Plan.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including risks related to the evolution of the pandemic and possible scarring effects. Italy provided significant liquidity support to companies and households, such as guarantees and tax deferrals. This support does not have a direct or immediate budgetary impact, but guarantees represent contingent liabilities for the general government sector, except for standardized guarantees for which an estimated cost of 0.7% of GDP was already reflected in the 2020 deficit. The Commission estimates that the guarantees taken up amounted to around 8.8% of GDP in mid-October 2021.

13. Measures on the revenue side, as reported in the Draft Budgetary Plan, will have a deficit increasing impact of 0.2% of GDP in 2022. They include the first phase of a tax reform, amounting to 0.3% of GDP, aimed at reducing personal income taxes and the regional tax on production, as well as the renewal of the tax incentives to private investment (in particular for building renovations). These are partly compensated by revenue-increasing measures amounting to 0.2% of GDP in 2022, whose details are not specified in the Draft Budgetary Plan. Based on the draft budget law submitted to the Parliament, these measures appear to be related to a revised time profile for the use of tax credits for business assets. Measures on the expenditure side, amounting to 1.1% of GDP, include a reform of the welfare system aimed at increasing the number of workers potentially covered by the permanent short-time work schemes (0.1% of GDP), increased flexibility for early retirement schemes (0.03% of GDP) and additional resources for the citizenship income schemes (0.04% of GDP). Public support to private investment is further increased through the extension of incentives for innovative equipment (including *"Transition 4.0"*) (0.2% of GDP). The Draft Budgetary Plan also provides additional resources for the SMEs Guarantee Fund (0.2% of GDP) as the draft budget law prolongs the eligible period for emergency-related guarantees from December 2021 to June 2022. Additional funds are allocated to contain the effects of price increases in the electricity and natural gas bills in 2022 (0.1% of GDP) and to extend incentives for low-emissions vehicles. Additional resources are also budgeted for the healthcare sector (0.2% of GDP), including for the purchase of COVID-19 vaccines, as well as for public investments and local authorities' spending (0.1% of GDP). Overall, the measures included in the Draft Budgetary Plan are expected to have a deficit-increasing impact of 1.2% of GDP in 2022, in line with what was included in the Commission forecast. Most of the measures are envisaged to have a non-temporary impact.

Based on the Commission forecast, the crisis-related temporary emergency measures will decrease from 5.2% of GDP in 2020 and 2021, respectively, to 0.8% in 2022.

According to the Draft Budgetary Plan, general government gross fixed capital formation is expected to increase further in 2022, to 3.1% of GDP from 2.8% in 2021. These projections are in line with the Commission 2021 autumn forecast. This is mainly driven by additional investment financed by the Recovery and Resilience Facility. Further investment measures consist mainly of the relaunch of public investment, including those of local authorities, also to improve public infrastructures and the refinancing of the Development and Cohesion Fund for poorer regions (0.1% of GDP).

Some of the measures in the Draft Budgetary Plan, such as the extension of tax incentives for building renovations, the prolongation of incentives for innovative equipment (*"Transition 4.0"*) and the renewal of incentives for low-emissions vehicles, are aimed at supporting the green transition as recommended by the Council on 18 June 2021.

The temporary early retirement scheme, which will end in 2021, will be replaced by a temporary measure in 2022, with stricter conditions in terms of retirement age. The costs of the measures reported in the Draft Budgetary Plan aiming at increasing flexibility in the pension system are limited in the short term but are expected to increase over time. While limited details of the planned tax reform are provided in the Draft Budgetary Plan, it has the potential to shift the tax burden away from labour.

The Draft Budgetary Plan also includes several measures that are expected to enhance economic growth and resilience. In particular, the prolongation of the eligible period for emergency-related public guarantees, the prolongation of public incentives for firms' innovation and investment and for households' energy efficiency building renovation, as well higher funds for education and research.

The Draft Budgetary Plan includes several measures aimed at fostering inclusive growth, namely a reform of short-time work schemes to increase the number of beneficiaries and strengthen active labour market policies. Several smaller schemes introduced during the pandemic in the area of active labour market policies are also refinanced. Moreover, higher resources are allocated to the citizenship income. At the same time, the design of the scheme is changed to avoid misuse, by introducing more stringent criteria to maintain the benefits and reducing disincentives to work.

The Italian Recovery and Resilience Plan contains relevant fiscal-structural reforms that are expected to contribute to the sustainability of public finances. In particular, the plan includes measures to improve tax collection and step up the fight against tax evasion, as well as measures to enhance the efficiency of public expenditure through a strengthened spending review framework and the completion of the reform of fiscal relations across different levels of government. The structural measures to improve the framework for public procurement are also expected to contribute to the quality of public finances. Overall, these measures are expected to reduce the revenue-gap related to tax evasion and to improve the efficiency of public expenditure in the medium term, contributing to increasing the structural primary balance in a permanent way and thus improving fiscal sustainability.

A complete assessment of the fiscal-structural reforms implemented by Italy will be done in the context of the assessment of the implementation of the Recovery and Resilience Plans and the 2022 Country Report.

14. The fiscal stance, which excludes crisis-related temporary emergency measures while including the impact on aggregate demand from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility, is projected in the Commission 2021 autumn forecast at -3.0% of GDP in 2022.[12] Italy is projected to use the Recovery and Resilience Facility in 2022 to finance additional investment in support of the recovery. The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.6 percentage points of GDP in 2022 compared to 2021. Nationally-financed investment is projected to provide an expansionary contribution to the fiscal stance of 0.3 percentage points in 2022.[13] The growth in nationally-financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide an expansionary contribution of 1.5 percentage points to the overall fiscal stance.

15. The Draft Budgetary Plan of Italy includes medium-term budgetary projections until 2024. The government deficit is planned to decrease gradually to 3.9% of GDP in 2023 and to 3.3% of GDP in 2024. These plans would imply, according to the official estimates, an overall structural cumulative adjustment of 1.6% of GDP in 2023-2024. This structural adjustment includes a projected reduction in interest expenditure of 0.4 percentage points of GDP and the phasing out of the temporary emergency measures still affecting 2022 (0.8% of GDP, based on the Commission forecast). In turn, the government debt ratio is projected to decline to 146.1% of GDP by 2024. The projected decline of the debt-to-GDP ratio would build on the rather high GDP growth expected also in the medium term, resulting from the combined effect of investments and reforms foreseen by the Italian Recovery and Resilience Plan. The Draft Budgetary Plan confirms the general intention to improve the structural balance as well as the commitment to bring the debt ratio below its 2019 level by 2030. The government indicates that the reduction of the debt-to-GDP ratio beyond 2024 will mainly be based on GDP growth, spurred by investments and reforms included in the Recovery and Resilience Plan, but also on adequate primary surpluses. These primary surpluses will be achieved, according to the information available in the Draft Budgetary Plan, thanks to a moderation of the dynamics of current public spending and an increase of tax revenues through the fight against tax evasion.

16. In 2022, based on the Commission's forecast and including the information incorporated in Italy's Draft Budgetary Plan, the fiscal stance, including the impulse provided by the Recovery and Resilience Facility, is projected to be supportive. As recommended by the Council, Italy plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. As recommended by the Council, Italy also plans to preserve nationally financed investment. At the same time, Italy does not plan to sufficiently limit the growth of nationally financed current expenditure. In order to contribute to the pursuit of a prudent fiscal policy, the Commission invites Italy to take the necessary measures within the national budgetary process to limit the growth of nationally financed current expenditure. Given the level of Italy's government debt and high sustainability challenges in the medium term before the outbreak of the COVID-19

[12] A negative sign of the indicator corresponds to an excess of primary expenditure growth compared with medium-term economic growth, indicating an expansionary fiscal policy.

[13] Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.6 percentage points of GDP.

pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.

The Commission recalls the importance of the composition of public finances and the quality of budgetary measures, including through growth-enhancing investment, notably supporting the green and digital transition. In this regard, measures contained in the Italian Draft Budgetary Plan contribute to fulfilling the Council recommendation of ensuring a sustainable and inclusive recovery, while prioritising the green and digital transition.

Taking into account the strength of the recovery, 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.

Done at Brussels, 24.11.2021

For the Commission
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