EUROPEAN
COMMISSION

Brussels, 18.11.2020
SWD(2020) 860 final

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Italy

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Italy

{C(2020) 8510 final}

EN EN

Table of Contents

EXECUTIVE SUMMARY

- After growing by 0.3% in 2019, economic activity is set to contract sharply in 2020, by 9% according to the Draft Budgetary Plan and by 9.9% according to the Commission 2020 autumn forecast. For 2021, the Draft Budgetary Plan projects real GDP to expand by 6.0%. In turn, the Commission projects GDP to grow by 4.1% in 2021.
- Based on the Draft Budgetary Plan, the government headline deficit is expected to increase sharply from 1.6% of GDP in 2019 to 10.5% of GDP in 2020, before declining to 7% of GDP in 2021. In 2021, the Draft Budgetary Plan assumes grants from the Recovery and Resilience Facility (RRF) amounting to 0.6% of GDP, which are included in both the expenditure and the revenue projections, and are assumed to have a positive impact on growth. In the Commission forecast, Italy's headline deficit is projected to increase to 10.8% of GDP in 2020 and to decline to 7.8% of GDP in 2021. Since the measures expected to be financed by grants from the Recovery and Resilience Facility are not sufficiently specified in the Draft Budgetary Plan, the Commission forecast includes only the corresponding pre-financing and treats it as a financial transaction with no impact on the budget balance, but with a debt-reducing impact in 2021.
- Government debt stood at 134.7% of GDP at end of 2019. On 20 May 2020, the Commission has prepared a report under Article 126(3) TFEU analysing whether Italy was compliant with the deficit and debt criteria of the Treaty. Overall, the analysis suggested that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 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, including for designing a credible path for fiscal policy, the Commission considered that at this juncture a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken. According to the Draft Budgetary Plan, the government debt-to GDP ratio is expected to increase to 158% in 2020 and to decline to 155.6% in 2021. In the medium term, the debt ratio is expected to decline below its 2019 level by 2031, based on the assumptions and the budgetary policy outlined in the Draft Budgetary Plan. The Commission forecast projects the debt-to GDP ratio to increase more strongly in 2020, to 159.6%, and to decline only marginally in 2021, to 159.5%.
- In 2020 Italy adopted a sizable fiscal response to the COVID-19 emergency, implementing a wide range of measures to support workers and firms, with a direct budgetary impact of 6.1% of GDP in 2020 according to the Draft Budgetary Plan (5.5% of GDP based on the Commission forecast). Italy also adopted several measures to support corporate liquidity, such as government guarantees and funds for firms' capitalisation. 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.
- The Draft Budgetary Plan includes new measures to support the economic recovery, with a budgetary impact of 1.4% of GDP in 2021 according to the Plan. While measures amounting to 0.3% of GDP are temporary, another 1.1% of GDP are assessed as not temporary. 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. When taking into account also the budgetary impact in 2021 of measures adopted in 2020 in response to the COVID-19 emergency, the total cost of fiscal measures adopted by Italy since the beginning of the pandemic is estimated at 2.6% of GDP in 2021 based on the Commission forecast.

- Overall, most measures set out in the Draft Budgetary Plan of Italy are supporting economic activity against the background of considerable uncertainty. However, some measures appear not 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. At the same time, it would be useful to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2021 Draft Budgetary Plans of Italy (hereafter called the Plan), which was submitted for 2021 on 19 October 2020. 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.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact and on 23 March 2020 the Ministers of Finance of the EU Member States agreed with the Commission assessment. The clause facilitates the coordination of budgetary policies in times of severe economic downturn. As indicated in the Annual Sustainable Growth Strategy 2021[1] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance,[2] the activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, which should continue to provide targeted and temporary fiscal support in 2021, provided that this does not endanger fiscal sustainability in the medium term. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

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

[2] 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

Public finances in 2021 are also expected to be influenced by the proposed establishment of the Recovery and Resilience Facility (RRF), alongside the proposal for the reinforced long-term budget of the EU for 2021-2027. The RRF is envisaged to provide a total envelope of EUR 672.5 billion in loans and non-repayable financial support (grants) to support the implementation of investments and reforms in the EU Member States. The 2021 Draft Budgetary Plan of Italy takes into account the implementation of the reforms and investments, and their associated costs, envisaged under the RRF.

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 continues to consider that at this juncture a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.]

As the general government debt-to GDP ratio was 134.7% at the end of 2019, exceeding the 60% reference value of the Treaty, Italy also needs to comply with the debt reduction benchmark.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

Italy was among the first EU Member States that were hit by the COVID-19 pandemic. To contain the spread of the virus, the government announced a nationwide lockdown on 9 March that was further extended on 21 March by shutting down all non-essential businesses and industries. Those measures were being gradually relaxed starting from 4 May. The pandemic and associated restrictions pushed the Italian economy into a sharp and deep recession. After expanding by 0.3% in 2019, the Plan forecasts a GDP contraction of 9.0% in 2020. These projections reflect a 1-percentage-point downward revision to GDP growth compared to the 2020 Stability Programme. For 2021, the Plan projects real output to expand by 6%. The macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic and its economic consequences.

The sharp output drop in the first two quarters of 2020 is expected to have been followed by a steep technical rebound, led by industrial production and construction. According to the Plan, the strong rise in retail sales and passenger car registrations suggest that private consumption will be a key growth driver in the second half of 2020 and in 2021, fuelled by the gradual winding-down of forced savings, accumulated over the first semester of 2020. In addition, investment is also projected to rebound strongly and to sustain the recovery in 2021.

This scenario for 2020 does not fundamentally differ from the Commission 2020 autumn forecast, which projects real GDP to decline by 9.9% in 2020. Given that the authorities could not take fully into account the impact of the most recent resurgence of the pandemic, the Commission estimate for real output growth of 4.1% in 2021 is sizeably lower than that of the government. On the other hand, both the government and the Commission underestimated the strength of the rebound in Q3-2020. According to the Commission forecast, private consumption and investment are set to be the backbone of the recovery in 2021, with additional support from net exports.

The Parliamentary Budget Office (PBO), Italy's independent fiscal monitoring institution, endorsed both the trend and the programme scenario of the Plan,[3] observing that the estimates were within the acceptable range given the information available at the moment. The PBO also highlights that the projections were subject to downside risks, linked to the uncertain evolution of the pandemic and potential financial tensions.

[3] The endorsement of the trend scenario took place on 21 September 2020 (https://www.upbilancio.it/wp-content/uploads/2020/10/Lettera-valid_QMT_NADEF-2020-con-Alllegato.pdf) and the one of the programme scenario on 12 October 2020 (https://www.upbilancio.it/wp-content/uploads/2020/10/UPB_Lettera-validazione-QMP-NADEF-2020.pdf)

Table 1. Comparison of macroeconomic developments and forecasts

	2019	2020			2021		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.3	-8.0	-9.0	-9.9	4.7	6.0	4.1
Private consumption (% change)	0.4	-7.2	-8.8	-10.5	4.0	5.7	3.8
Gross fixed capital formation (% change)	1.6	-12.3	-14.0	-13.6	4.3	10.6	7.2
Exports of goods and services (% change)	1.0	-14.4	-17.3	-16.7	13.5	9.6	10.3
Imports of goods and services (% change)	-0.6	-13.0	-13.8	-14.1	10.0	8.8	9.9
Contributions to real GDP growth:							
- Final domestic demand	0.5	-6.5	-7.4	-8.4	3.3	5.5	3.5
- Change in inventories	-0.7	-0.7	-0.1	-0.2	0.2	0.2	0.2
- Net exports	0.5	-0.8	-1.5	-1.3	1.2	0.3	0.4
Output gap[1]	0.5	-7.2	-8.8	-9.5	-3.1	-2.9	-5.4
Employment (% change)	0.5	-2.2	-2.2	-1.3	1.0	0.5	-0.5
Unemployment rate (%)	10.0	11.6	9.3	9.9	11.0	9.8	11.6
Labour productivity (% change)	0.0	-1.8	3.9	0.5	1.0	0.5	-1.9
HICP inflation (%)	0.6	-0.2	-0.2	-0.1	1.7	0.7	0.7
GDP deflator (% change)	0.7	1.0	1.1	1.3	1.4	0.8	1.0
Comp. of employees (per head, % change)	1.5	0.7	2.0	0.9	1.0	1.3	0.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.8	2.6	2.4	2.7	3.3	2.6	2.9

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

On 20 July 2020 the Council addressed recommendations to Italy in the context of the European Semester. In the area of public finances and in line with the general escape clause, the Council recommended Italy to take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery, when economic conditions allow, Italy should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

3.1. Deficit developments

The Plan projects the general government headline deficit to increase from 1.6% of GDP in 2019 to 10.5% of GDP in 2020, broadly in line with the forecast of the Stability Programme (10.4% of GDP).[4] As reported in the Plan, the cost of the additional fiscal package adopted in August 2020 (1.6% of GDP) was offset by better-

[4] Italy's 2020 Stability Programme included a deficit projection at unchanged policies of 7.1% of GDP in 2020 and 4.2% of GDP in 2021, as indicated in table 2. However, it also reported that, when taking into account the additional fiscal package which was still in preparation, the projected government deficit would amount to 10.4% of GDP in 2020 and 5.7% of GDP in 2021. The additional fiscal package was adopted on 19 May and its budgetary impact corresponded to the announcement of the Stability Programme.

than-expected revenue developments until September 2020, and lower-than-expected expenditure, including for the emergency measures. The macroeconomic scenario for 2020 was not subject to significant revisions. Conversely, the Commission 2020 autumn forecast projects a slightly higher government deficit, at 10.8% of GDP in 2020, due to the different macroeconomic outlook. The Commission forecast projects a sharper drop in nominal GDP, and in particular private consumption, resulting in lower revenues from indirect taxes. The Commission forecast also takes a slightly more conservative approach concerning revenues from direct taxes and social security contributions. In fact, despite the relatively positive revenue developments observed over July-September 2020, the implications for the last months of the year remain uncertain, in light of in-year tax deferrals and the enhanced possibility for self-employed and firms to make advance payments based on income and profits expected in 2020. At the same time, based on the accrual principle for statistical recording, the Commission forecast assumes that the deferral of tax payments to 2021 and 2022 will not affect the 2020 deficit, while the Plan expects a negative impact of 0.4% of GDP (see section 4). Neither the Plan nor the Commission forecast take into account the additional fiscal packages adopted by Italy on 27 October and 10 November 2020, which imply an additional budgetary impact of 0.3% of GDP in 2020.

Overall, both the Plan and the Commission forecast expect government revenues to decline less than economic activity in 2020, thereby increasing as a share of GDP. Such increase is even stronger for government expenditure, which is expected to rise significantly also in nominal terms. Both effects are more pronounced in the Commission forecast, especially concerning expenditure. This is due to the stronger projected decline in nominal GDP, while projected expenditure in nominal terms is broadly in line with the Plan.

In 2021, the Plan projects the government headline deficit to decline to 7% of GDP, due 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 2021 deficit target in the Plan is above the projection of 5.7% of GDP included in the Stability Programme.[5] The revision is due to the budgetary impact of the fiscal package adopted in August 2020 (amounting to 0.3% of GDP in 2021 compared to the baseline) and to the measures included in the Plan, corresponding to a fiscal expansion of 1.4% of GDP in 2021 according to the Plan. At the same time, the projected growth in economic activity has been revised significantly upwards compared to the Stability Programme, as the Plan takes into account the expected impact from the Recovery and Resilience Facility. In particular, the Plan assumes grants under the Recovery and Resilience Facility amounting to 0.6% of GDP, which are included within the revenue and expenditure projections.[6]

The Commission 2020 autumn forecast projects a higher government deficit in 2021, due to the lower projected rebound in economic activity (also when abstracting from the Recovery and Resilience Facility, which in the authorities' forecast adds further to

[5] See footnote 7.

[6] The statistical treatment of the financial support provided by the Recovery and Resilience Facility is subject to confirmation by Eurostat.

growth but not revenues, see below) and to different assumptions on some policy measures. In particular, the different treatment of tax deferrals implies lower revenues by 0.2% of GDP in 2021 compared to the government. Furthermore, in addition to the grants under the Recovery and Resilience Facility, the Plan assumes other revenues related to Next Generation EU amounting to 0.2% of GDP in 2021, which are not considered in the Commission forecast as the corresponding expenditure measures are not specified in the Plan. 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 projection for 2021, the 10% pre-financing of the Recovery and Resilience Facility grants,[7] and treats them as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure expected to be financed by grants under the Recovery and Resilience Facility, as the corresponding measures are not yet sufficiently specified.

Overall, the Plan and the Commission forecast project a similar decline in government expenditure as a share of GDP in 2021. However, while the Commission forecast projects a decline also in the revenue-to-GDP ratio, the latter is expected to remain constant in the Plan.

The Plan and the Commission forecast assume a similar deterioration in the structural balance[8] in 2020, while in 2021 the Commission forecast expects a somewhat stronger structural improvement. However, a mechanical reading of traditional indicators is not well suited at the current juncture to assessing the fiscal stance. The introduction and subsequent withdrawal of sizeable temporary emergency measures distort the picture, as the corresponding changes in the level of public spending from one year to the next affect the indicators used to assess the fiscal stance. Excluding the temporary emergency measures from the calculation of the fiscal stance indicators provides a more representative assessment of the underlying fiscal support to economic activity.[9]

Besides the high uncertainty associated with projected macroeconomic developments, the main risk both for the Plan and the Commission forecast stems from the sizable government guarantees issued in response to the crisis (see section 4). Although significant budgetary provisions have been included in the deficit projections for 2020, it cannot be excluded that the extraordinary macroeconomic developments might result in a higher-than-projected rate of calls on these guarantees. In addition, given the statistical recording of the budgetary provisions, government guarantees imply stronger risks to the debt projections (see section 3.2).

[7] The amount of the pre-financing is still under negotiation, but the draft Regulation quantifies the grants' pre-financing at 10% of the legal commitment in 2021, which can be assumed to be 10% of the first envelope for grants (70% of the total Recovery and Resilience Facility allocation). For Italy, it is estimated at 0.4% of GDP.

[8] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology. The estimates of the structural budget balance are affected by high uncertainty due to the economic consequences of the COVID-19 pandemic.

[9] The measure of the output gap is complicated in the face of a sharp economic turnaround and very high level of economic uncertainty.

At the same time, some factors represent upward risks to the Plan and the Commission budgetary projections. Second-round revenue effects stemming from economic growth triggered by the Recovery and Resilience Facility are not considered in 2021. This corresponds to a prudent approach in the Plan and is coherent with the treatment of the Recovery and Resilience Facility in the Commission forecast. In addition, although Italy has implemented sizable financial incentives to electronic payments in order to encourage tax compliance (amounting to 0.1% of GDP in 2021) no additional revenues are included in the projections, implying an upward risk.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2019		2020			2021			Change: 2019-2021
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**47.0**	**47.0**	**47.7**	**47.7**	**48.0**	**48.0**	**47.7**	**47.3**	**0.7**
of which:									
- Taxes on production and	14.4	14.4	14.2	13.9	13.8	15.6	14.4	14.1	0.0
- Current taxes on income,	14.4	14.4	14.4	14.9	15.0	14.2	14.6	14.7	0.2
- Capital taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- Social contributions	13.5	13.5	13.8	13.7	13.8	13.4	13.1	13.4	-0.4
- Other (residual)	4.7	4.7	5.2	5.1	5.2	4.7	5.5	4.9	0.8
Expenditure	**48.6**	**48.6**	**54.8**	**58.2**	**58.8**	**52.3**	**54.8**	**55.0**	**6.2**
of which:									
- Primary expenditure	45.3	45.3	51.2	54.7	55.2	48.7	51.5	51.7	6.2
of which:									
Compensation of employees	9.7	9.7	10.6	10.8	10.8	10.3	10.5	10.7	0.8
Intermediate consumption	5.7	5.7	6.4	6.7	6.7	6.0	6.2	6.3	0.5
Social payments	22.7	22.7	26.1	27.6	28.0	24.6	25.3	26.0	2.6
Subsidies	1.6	1.6	1.7	2.4	2.5	1.6	1.8	2.0	0.2
Gross fixed capital formation	2.3	2.3	2.5	2.7	2.6	2.6	3.4	2.7	1.1
Other (residual)	3.3	3.3	3.9	4.5	4.5	3.6	4.3	3.9	0.9
- Interest expenditure	3.4	3.4	3.6	3.5	3.6	3.6	3.3	3.4	-0.1
General government balance (GGB)	**-1.6**	**-1.6**	**-7.1**	**-10.5**	**-10.8**	**-4.2**	**-7.0**	**-7.8**	**-5.4**
Primary balance	**1.8**	**1.8**	**-3.5**	**-7.0**	**-7.2**	**-0.6**	**-3.7**	**-4.4**	**-5.5**
One-off and other temporary measures	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1
GGB excl. one-offs	**-1.7**	**-1.7**	**-7.3**	**-10.7**	**-11.0**	**-4.4**	**-7.2**	**-8.0**	**-5.5**
Output gap[1]	0.5	0.4	-7.2	-8.8	-9.5	-3.1	-2.9	-5.4	-3.3
Cyclically-adjusted balance[1]	-1.9	-1.8	-3.2	-5.7	-5.6	-2.5	-5.4	-4.8	-3.6
Structural balance (SB)[2]	**-1.9**	**-1.9**	**-3.4**	**-5.9**	**-5.8**	**-2.7**	**-5.6**	**-5.0**	**-3.7**
Structural primary balance[2]	1.4	1.5	0.2	-2.4	-2.2	0.9	-2.3	-1.7	-3.8

Notes:

[1] Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/Programme as recalculated by Commission on the basis of the DBP/Programme scenario using the commonly agreed methodology.

[2] Structural (primary) balance corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

The Plan includes medium-term economic projections until 2031, which provide important indications in the framework of the 2020 Council recommendation to "pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability". In particular, macroeconomic and budgetary projections are extended until 2026, in order to fully take into account the expected impact of the Recovery and Resilience Facility and the medium-term budgetary strategy. The expected impact from the Facility is added to a baseline scenario, in which economic growth is projected to converge to its potential by 2026. The national budgetary strategy would resume fiscal consolidation from 2023, which would increase the primary budgetary surplus from 0.1% of GDP in 2023 – implying a headline deficit of 3.0% of GDP that year – to 2.5% of GDP in 2026. The corresponding budgetary adjustment compared to the baseline scenario is estimated at 0.3% of GDP in 2023, 0.4% of GDP in 2024 and 0.5% of GDP in 2025 and 2026. Over 2027-2031, the structural primary surplus is assumed to remain stable and economic growth to be in line with its potential, while interest rates are estimated based on the latest market developments. On the basis of these assumptions, the debt-to-GDP ratio is projected to decline to below its 2019 level by 2031, which is the objective of the Plan.

Although the Plan does not include elements related to green budgeting, Italy is well advanced in the practice of identifying green expenditure items, and an annexed green budget is normally annexed to the Budget Law.

3.2. Debt developments

In the Plan, the government debt-to-GDP ratio is expected to rise by 23.3 percentage points in 2020, reaching 158%. The increase is driven by the fall in economic activity, implying a large debt-increasing snow-ball effect. The primary balance, which is expected to turn negative for the first time since 2009, will also entail a sizable contribution to the debt increase. In 2021, the Plan projects a decline of the debt-to-GDP ratio by 2.4 percentage points, driven by the economic recovery, with a lower debt-increasing contribution from the primary deficit. A substantial debt-increasing stock-flow adjustment is expected both in 2020 and 2021, partly related to several liquidity measures adopted in 2020. These include the government funds for the recapitalisation of strategic firms (2.9% of GDP), which will increase government gross debt when the corresponding operations will take place, and the fund for the payment of trade debt arrears, which, despite the allocation of 0.7% of GDP, has been used only up to 0.1% of GDP due to low demand from local administrations during the relevant period. In addition, as part of the fiscal response to the emergency, Italy allocated resources amounting to 0.2% of GDP for the creation of a State airline company, which will increase government gross debt in 2020. At the same time, most budgetary provisions for government guarantees are recorded as part of the government deficit but not as part of the government debt, partly offsetting the impact of other measures on the stock-flow adjustment in 2020.

Table 3. Debt developments

	2019	2020			2021		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**134.7**	**151.8**	**158.0**	**159.6**	**147.5**	**155.6**	**159.5**
Change in the ratio	0.2	17.1	23.3	24.9	-4.3	-2.4	-0.1
Contributions[2]:							
1. Primary balance	**-1.8**	**3.5**	**7.0**	**7.2**	**0.6**	**3.7**	**4.4**
2. "Snow-ball" effect	**2.0**	**13.8**	**15.0**	**16.3**	**-5.0**	**-6.7**	**-4.3**
Of which:							
Interest expenditure	3.4	3.6	3.5	3.6	3.6	3.3	3.4
Real growth effect	-0.5	11.6	13.2	14.5	-6.7	-8.9	-6.2
Inflation effect	-0.9	-1.4	-1.7	-1.8	-1.9	-1.1	-1.5
3. Stock-flow adjustment	**0.0**	**-0.2**	**1.2**	**1.3**	**0.2**	**0.6**	**-0.1**
Of which:							
Cash/accruals difference		0.0	0.0		0.0	0.0	
Net accumulation of financial		0.0	1.1		0.0	0.9	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		0.0	0.1		0.0	-0.3	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

The Commission forecast projects a stronger increase of the debt ratio in 2020, mainly due to the more pronounced decline projected for economic activity. In 2021, differently from the Plan, the debt ratio is expected to decline only marginally in the Commission forecast, due to the lower projected rebound in economic activity and the higher primary deficit, which more than offset the significantly lower stock-flow adjustment. The latter results from the assumptions made on the pre-financing of grants under the Recovery and Resilience Facility, and on the recording of tax payments deferred to 2021 and 2022, which, compared to the accrual impact, imply lower cash receipts in 2020 and higher ones in 2021.

Risks to both the Plan and the Commission forecast stem from contingent liabilities related to the sizable guarantees issued in response to the crisis. Given that most budgetary provisions are recorded exclusively in the government deficit, there are lower margins for the possible impact on government debt, which is thus subject to higher risks. In addition, a higher recourse to the funds for the capitalisation of strategic firms than assumed in the Plan and the Commission forecast would imply higher government debt over 2020-2021.

4. MEASURES UNDERPINNING THE DRAFT BUDGETARY PLAN

The Plan focuses on the policy response undertaken in the context of the COVID-19 outbreak and the measures planned to sustain the recovery in 2021. Supportive fiscal measures should be tailored to the specific situation of each Member State, but as a rule, they should be well targeted and temporary. Their use and effectiveness should be regularly reviewed by the national authorities. Depending on the development of the pandemic, emergency fiscal measures should to be adjusted and combined with other measures that improve economic fundamentals, support the green and digital transition and have a positive impact on demand.

4.1. Measures in 2020

Since February 2020, Italy has put in place a substantial fiscal response to the crisis, through direct support and liquidity measures that aim to address the socio-economic consequences of the COVID-19 pandemic. These measures were included in four law decrees adopted until August with a direct budgetary impact of EUR 100 billion (6.1% of GDP) and sizable liquidity measures.[10] The direct fiscal response was mostly on the spending side, with revenue measures representing a relatively small share. However, the Plan provides limited details on already adopted measures, except for measures on the revenue side. The following paragraphs on measures implemented in 2020 are based on information included in the relevant decrees.

Expenditure for healthcare and civil protection as well as budgetary transfers to regional and local governments have been increased in order to address the medical emergency (1.3% of GDP). Expenditure measures also provided for the wide extension of wage supplementation schemes and various financial support schemes for households and self-employed workers (2.1% of GDP). Although the Plan reports that expenditure for wage supplementation schemes in 2020 was lower than expected by 0.2% of GDP, it does not include revised estimates for the cost of the measures taken. Support for firms includes a partial compensation for losses incurred during the pandemic (0.7% of GDP), budget provisions for guarantees (0.5% of GDP), support for investment and for recapitalisation, and the financing of a variety of funds for supporting specific sectors, mostly in the form of subsidies (0.5% of GDP). On the revenue side, government measures included the abolition of the regional tax on productive activities (IRAP) for 2020 (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 some other tax cuts, mostly targeting firms. In addition, payments for half of the tax liabilities due over March-September 2020 have been postponed to 2021 and 2022 for firms most affected by the crisis. According to the government, this is expected to imply lower

[10] The Plan reports that this amount corresponds to the estimates produced “ex ante”, as some savings have been observed after the adoption of the measures. The amount of these savings is however not specified in the Plan, which only reports that expenditure for wage supplementation schemes in 2020 was lower than expected by 0.2% of GDP in 2020.

tax revenues by 0.4% of GDP in 2020 and higher ones by 0.2% of GDP in 2021 and 0.1% of GDP in 2022.

In the Commission forecast, the impact of the government measures adopted in response to the COVID-19 crisis amounts to around 5.5% of GDP in 2020. The difference from the government is mainly due to the different treatment of tax deferrals, which, under a no-policy-change assumption, are not expected to affect the 2020 deficit based on the accrual principle for statistical recording. In addition, the Commission forecast considers the savings of 0.2% of GDP for wage supplementation schemes reported in the Plan as lower spending for the measures taken in 2020.

Although no information is reported in the Plan, in the Commission forecast the measures adopted in 2020 in response to the COVID-19 crisis are expected to imply a budgetary impact of around 1.0% of GDP in 2021 and 0.4% of GDP in 2022 compared to the baseline. Overall, these measures are assessed to be temporary, as the projected costs in 2022 are largely related to the budgetary impact of tax incentives implemented until the end of 2021.

On 27 October and 10 November 2020, Italy adopted two additional fiscal packages worth in total 0.3% of GDP in 2020, in order to provide further support to workers and firms in light of the new lockdown measures adopted on 25 October and 3 November 2020. These packages mainly consist of emergency measures, such as financial transfers to firms operating in the sectors and regions most affected by the new lockdown measures and the further extension of wage supplementation schemes. Given the time of adoption, these measures are not considered neither in the Plan nor the Commission forecast.

In terms of liquidity measures, Italy adopted large guarantee schemes in order to support the provision of credit to the corporate sector. Although the Plan does not include a table on the adopted guarantees in response to COVID-19 outbreak, the information reported below is available from public official sources. The scope and coverage of the existing “SMEs guarantee fund” was increased, which, according to the government estimate, is expected to concern a credit volume of around 7.4% of GDP, with the guarantee-share varying depending on the scheme, up to 100%. Italy also implemented a loan moratorium for SMEs from March 2020 to January 2021, partly covered by government guarantees (with total contingent liabilities estimated at 1.8% of GDP). Finally, a new guarantee fund was created for bank credits to larger firms with a significant turnover loss due to the pandemic and to those focusing on exports, up to a loan volume corresponding to 24.5% of GDP (20.8% of GDP in contingent liabilities). Budgetary provisions for these guarantee schemes correspond to a budgetary impact of 0.5% of GDP in 2020, mainly relating to the extension of the “SMEs guarantee fund”. By 28 October 2020, applications from financial intermediaries to the “SMEs guarantee fund” amounted to EUR 95.8 billion (5.9% of GDP), while the take-up of the scheme for larger firms was relatively low, at EUR 16.1 billion (1% of GDP). No information is available on guarantees relating to the loan moratorium. Other liquidity measures include the creation of funds for the capitalisation of firms (2.9% of GDP) and for the payment of trade debt arrears of the local administrations (0.7% of GDP, of which only 0.1% of GDP has been used by local authorities during the relevant period).

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.

4.2. Measures in 2021

For 2021, the Plan presents a set of additional measures aimed at supporting the economic recovery, both on the revenue and the expenditure side. Overall, the planned measures imply a budgetary impact of 1.4% of GDP in 2021 (1.6% of GDP in the Commission forecast). When taking into account also the budgetary impact in 2021 of measures adopted in 2020 in response to the COVID-19 emergency, the total cost of fiscal measures adopted by Italy since the beginning of the pandemic is expected to decline from 5.5% of GDP in 2020 to 2.6% of GDP in 2021, based on the Commission forecast.

Revenue measures included in the Plan imply a budgetary impact of 0.5% of GDP in 2021 and include the extension of the tax credit on employment income (0.1% of GDP), the extension of the cut in social security contributions in poorer regions, as well as tax credits for investment in the same regions (0.4% of GDP) and other small measures, including the extension of tax incentives for building renovations. Among financing measures, the Plan reports revenues for 0.2% of GDP from Next Generation EU, in addition to grants from the Recovery and Resilience Facility. However, given that the corresponding expenditure measures are not specified, the Commission forecast did not take these revenues into account, leading to a higher deficit impact from planned measures compared to the Plan. The extension of the tax credit on employment income and the cut in social security contributions in poorer regions do not represent temporary measures, as their budgetary impact extends at least until 2023. In 2021, the budgetary impact of these measures amounts to around 0.4% of GDP.

Expenditure measures included in the Plan imply a budgetary impact of 1.1% of GDP in 2021 and include a streamlined family bonus (0.2% of GDP), additional funds for different ministries, including for education, research and health care (0.3% of GDP), financial support for firms operating in sectors most affected by the pandemic (0.3% of GDP), additional resources for local public services (0.1% of GDP), support for public investment (0.1%) and refinancing of several other public funds. Other small COVID-related emergency measures adding up to 0.1% of GDP are also planned, including additional resources for the healthcare system and an extension of wage supplementation schemes. The new family bonus does not represent a temporary measure and creates entitlements with a permanent effect on public finances. Furthermore, according to the Plan, the corresponding budgetary impact will further increase to 0.4% of GDP from 2022 when the bonus will be integrated into a wider tax reform. In addition, the higher resources allocated to ministries and other public services, while potentially supporting economic activity, do not represent temporary measures either, as their budgetary impact ranges at least until 2023. In 2021, the budgetary impact of these measures amounts to around 0.6% of GDP.

Overall, the budgetary impact of fiscal measures included in the Plan which appear not to be temporary amount to 1.1% of GDP in 2021. Italy expects that the costs of these measures will be partly financed from 2022 by second-round revenue effects from the impact of the Recovery and Resilience Facility and the measures included in the Plan on economic growth. These second-round revenue effects are estimated at 0.7% of GDP in 2022. Although the Recovery and Resilience Facility is expected to substantially contribute to the economic recovery of Member States, also providing a positive impact on public finances, the corresponding second-round revenue effects are currently uncertain in light of sizable implementation risks. In addition, it remains uncertain to what extent these revenue effects will be sufficiently structural to finance permanent expenditure measures.

Table 4.1. Main discretionary measures adopted with budgetary impact reported in the Draft Budgetary Plan

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year) positive sign for deficit-increasing measures	
					2021
1	Tax incentives poorer regions	Revenue	Planned		0.4
2	Tax credit for employment income	Revenue	Planned		0.1
3	Family bonus	Expenditure	Planned		0.2
4	Resources for healthcare, education and research	Expenditure	Planned		0.3
5	Support to firms most affected by the pandemic	Expenditure	Planned		0.3
6	Resources for public investment	Expenditure	Planned		0.1
7	Resources for local public services	Expenditure	Planned		0.1
8	Emergency healthcare	Expenditure	Planned		0.1

	measures				
9	Other EU revenues in the framework of Next Generation EU	Revenue	Planned		-0.2
				Total	**1.4**

Wage supplementation schemes have been extended with the various decrees adopted in response to the emergency, and currently can be used until January 2021 also by firms that have reached their limits based on standard provisions.[11] However, the latest government decrees included several provisions to encourage the phasing-out of the schemes, such as higher social security contributions for firms extending their use and lower ones for those which stop using them before reaching their limit. In addition, the dismissal ban will continue to apply to firms continuing to use the schemes in 2021.

The Plan reports that several measures aimed at supporting liquidity to the corporate sector will be extended to 2021, such as support to firms' capitalisation and government guarantees. These measures are listed among the additional support to firms in light of the COVID-19 pandemic, for which additional resources amount to 0.3% of GDP in 2021. However, no details are reported in the Plan.

The Plan assumes the use of EUR 10 billion in grants and EUR 11 billion in loans from the Recovery and Resilience Facility in 2021. While the measures expected to be financed by the Facility are not mentioned in the Plan, the Plan indicates that all grants are allocated to public investment, amounting to 0.6% of GDP (on top of the 0.1% of GDP in public investment support financed with an increase in the deficit). Taking into account resources already allocated to public investment with previous budget laws, this would lead to a 33% increase in government expenditure for gross fixed capital formation in 2021, which is expected to increase as a share of GDP to 3.4% from 2.7% in 2020 and 2.3% in 2019. Although the decreasing trend in government investment observed in recent years was successfully reversed in 2019, the increase planned in 2021 is highly ambitious and will require a strong administrative effort.

Overall, based on the information presented in the Plan and taking into account the Commission 2020 autumn forecast, most of the measures planned by Italy in 2021 are supporting economic activity against the background of considerable uncertainty. However, some measures appear not 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. At the same time, it would be useful to

[11] At the beginning of November 2020, the government announced that the extraordinary use of wage supplementation schemes will be further extended until March 2021.

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.

5. ANNEX

Mandatory variables not included in the Draft Budgetary Plan

The Plan includes all mandatory variables for the basic assumptions allowing the Commission to assess the Draft Budgetary Plan based on the plan's assumptions.