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COMMISSION OPINION

of 14.12.2022

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 outlook of the general government and its subsectors for the forthcoming year.

3. The general escape clause of the Stability and Growth Pact has been active since March 2020.[1] On 23 May 2022, the Commission indicated, in its Communication on the European Semester,[2] that heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023 and it considered that the conditions to deactivate it as of 2024 were met. The continued activation of the general escape clause in 2023 will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability.[3]

4. The Recovery and Resilience Facility, as established by Regulation (EU) 2021/241, provides financial support for the implementation of reforms and investment, 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 Union. Together with cohesion policy funds and the Just Transition Mechanism, the RRF is supporting a fair and inclusive recovery in the EU in line with the European Pillar of Social Rights. It also boosts growth and job creation in the medium and long term, and thereby strengthens sustainable public finances. According to the Commission

[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, COM(2020) 123 final of 20 March 2020.

[2] COM(2022) 600 final.

[3] On 17 June 2022, the Council agreed its recommendations on the 2022 National Reform Programmes and the opinions on the 2022 Stability and Convergence Programmes, which takes into account the continuation of the Stability and Growth Pact's general escape clause into 2023. (See: https://www.consilium.europa.eu/en/meetings/ecofin/2022/06/17/)

proposal of 18 May 2022,[4] the Facility should also aim at increasing the resilience of the Union energy system by reducing dependence on fossil fuels and diversifying energy supplies at Union level ('REPowerEU objectives').

5. On 12 July 2022, in the recommendations delivering Council opinions on the 2022 Stability Programmes,[5] the Council recalled that the overall fiscal stance is currently best measured as the change in primary expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis), including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds, relative to medium-term potential growth.[6] Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is consistent with the green and digital transitions, energy security and ensuring social and economic resilience, attention is also paid to the evolution of nationally financed[7] primary current expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) and investment.

6. The shocks unleashed by the Russian invasion of Ukraine are impacting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. Intensifying and broadening inflationary pressures have been prompting faster normalisation of monetary policy in the euro area. Public spending on measures containing the social and economic impact of high energy costs, on security and defence and on humanitarian assistance to the displaced persons from Ukraine is weighing on public finances. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. A broad-based fiscal impulse to the economy in 2023 does not appear warranted. The focus should instead be on protecting the vulnerable, allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine, while maintaining the agility to adjust, if needed. Fiscal policy should combine higher investment with controlling the growth in nationally-financed primary current expenditure. Full and timely implementation of the Recovery and Resilience Plans is key to achieving higher levels of investment. Fiscal policies should aim at preserving debt sustainability as well as raising the growth potential in a sustainable manner, thus also facilitating the task of monetary policy to ensure the timely return of inflation to the ECB's 2% medium-term target. Fiscal plans for 2023 should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to GDP levels that have increased further due to the pandemic as well as reforms and investment challenges associated with the twin transition, energy security and social and economic resilience.

7. Russia's war of aggression against Ukraine has resulted in substantial additional increases in and volatility of the prices of energy. The price shock in imported energy

[4] COM(2022) 231 final.

[5] Council Recommendation of 12 July 2022 on the National Reform Programme of Italy and delivering a Council opinion on the 2022 Stability Programme of Italy, OJ C 334, 1.9.2022, p. 96.

[6] The estimates on the fiscal stance and its components in this Opinion are Commission estimates based on the assumptions underlying the Commission ad hoc forecast. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

[7] Not financed by grants under the Recovery and Resilience Facility or other Union funds.

implies a substantial terms-of-trade loss to Member States' economies. In parallel, the exceptionally high temperatures in summer 2022 pushed up demand for electricity, while, at the same time, energy production from certain technologies has been significantly below historical levels due to technical and weather-dependant circumstances. All Member States have been negatively affected by the current energy crisis, albeit to a different extent, calling for a rapid and coordinated response.

8. Given that budgetary resources are limited and need to be used in the most efficient way, in order to manage a durable and equitable adjustment across society, the quality and design of the policy response is highly important. Therefore, also in line with the Council Regulation on an emergency intervention to address high energy prices adopted on 6 October 2022, measures should focus on providing temporary support, targeted to households and firms most vulnerable to energy price increases, while maintaining the right incentives to reduce energy demand and increase energy efficiency, in line with the European Green Deal.[8] Policies should also help reducing the energy consumption and develop the energy autonomy of the Union.

CONSIDERATIONS CONCERNING ITALY

9. On 10 October 2022, Italy submitted a Draft Budgetary Plan for 2023 adopted by the outgoing government on the basis of unchanged policies; therefore, the figures shown for the 2023 government deficit and other fiscal variables did not represent policy targets. On 24 November 2022, Italy submitted an updated Draft Budgetary Plan for 2023 adopted by the new government (hereafter, "Draft Budgetary Plan"). On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

10. On 12 July 2022, the Council recommended Italy[9] to take action to ensure in 2023 a prudent fiscal policy, in particular by limiting the growth of nationally financed primary current expenditure below medium-term potential output growth,[10] taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Italy should stand ready to adjust current spending to the evolving situation. Italy was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. For the period beyond 2023, Italy should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring credible and gradual debt reduction and fiscal sustainability in the medium term through gradual consolidation, investment and reforms.

11. On 23 May 2022, the Commission issued a report under Article 126(3) Treaty.[11] That report assessed the budgetary situation of Italy, as its general government deficit

[8] Communication from the Commission, the European Green Deal, COM(2019) 640 final.

[9] Council Recommendation of 12 July 2022 on the National Reform Programme of Italy and delivering a Council opinion on the 2022 Stability Programme of Italy, OJ C 334, 1.9.2022, p. 96.

[10] Based on the Commission ad hoc forecast, the medium-term (10-year average) potential output growth of Italy is estimated at 3.7% in nominal terms. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

[11] Report from the Commission prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, COM(2022) 630 final of 23 May 2022.

in 2021 exceeded the Treaty reference value of 3 % of gross domestic product, while its general government debt exceeded the 60 %-of-GDP Treaty reference value and did not respect the debt-reduction benchmark. The report concluded that the deficit and debt criteria were not fulfilled.

12. According to the Commission ad hoc forecast[12], the Italian economy is expected to grow by 3.8% in 2022 and by 0.6% in 2023, while inflation is forecast at 8.5% in 2022 and 5.9% in 2023. According to the Draft Budgetary Plan, Italy's economy is expected to grow by 3.7% in 2022 and 0.6% in 2023, while inflation is projected at 8.5% in 2022 and 5.5% in 2023. The growth profile in the two projections is broadly similar, with the weakening of domestic demand as the main reason for the slowdown in growth in 2023. In contrast, the Plan projects a notably higher GDP deflator in 2023 than the Commission forecast, to a large extent due to the expectation of more favourable terms of trade developments.

Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible both in 2022 and 2023.

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

13. The Draft Budgetary Plan assumes that expenditure amounting to 0.3% of GDP in 2022, 0.9% in 2023 and 0.6% of GDP in both 2024 and 2025 and tax cuts amounting to 0.2% of GDP in each year in the 2022-2025 period will be financed by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt of Italy. The plan also assumes expenditure funded through loans from the Recovery and Resilience Facility, with a direct impact on the general government deficit and debt amounting to 0.3% in 2022, 1.0% in 2023, 1.4% in 2024 and 1.5% of GDP in 2025. The Commission ad hoc forecast includes a similar amount of measures financed by Recovery and Resilience Facility grants.

14. In its 2023 Draft Budgetary Plan, Italy's general government deficit is planned to decrease from 5.6% of GDP in 2022 to 4.5% of GDP in 2023. The general government debt ratio is projected to decrease from 145.7% of GDP in 2022 to 144.6% of GDP in 2023. The deficit projections are broadly in line with the Commission ad hoc forecast, while the debt projection in 2023 is lower compared to the Commission ad hoc forecast due to a higher GDP deflator in the Draft Budgetary Plan. The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including macroeconomic risks related to the Russian invasion of Ukraine, energy price hikes and continued supply chain disturbances.

15. The Draft Budgetary Plan reports new fiscal policy measures for both 2022 and 2023.

For 2022, additional expansionary measures were included in the Decree Law "Aiuti Quater" of 18 November, amounting to 0.5% of GDP. Around 0.3% of GDP of these

[12] In order to assess the Draft Budgetary Plan, the Commission produced an ad hoc forecast by taking into account the information on new policy measures that are mentioned in the Plan. All other information and forecast assumptions remained unchanged, in line with the Commission autumn 2022 forecast and its cut-off date. The ad hoc forecast is published in the accompanying Fiscal Statistical Tables.

measures are aimed at supporting households and firms coping with high energy prices, in particular extending until year end the reduction of excise duties on fuel prices and the tax credits to electricity and gas companies. The remaining resources, around 0.2% of GDP, are allocated to purchases of gas stocks to be used in the first quarter of 2023.

For 2023, the Draft Budgetary Plan includes new measures with a net deficit increasing impact of around 1.1% of GDP. Deficit-increasing measures in 2023 amount to almost 1.8% of GDP, partly compensated by offsetting measures for 0.7% of GDP. Around two thirds of the deficit-increasing measures, or about 1.1% of GDP according to the Draft Budgetary Plan, are aimed at supporting households, firms and the healthcare sector to cope with high energy prices in the first quarter of 2023, mainly by prolonging previously adopted measures.

The Draft Budgetary Plan includes also several other deficit-increasing measures accounting for 0.7% of GDP, mainly announced to be of a temporary nature. They include, among others: (i) measures in favour of households, including a reduced VAT rate of 5% for baby products, the increase of the single allowance for children up to one year old and for large families, the increase by one month of parental leave for female workers and other support to households; (ii) additional funds for the healthcare system; (iii) a prolongation, with modifications, of the temporary reduction of the tax wedge for low income earners; (iv) an increase in the turnover threshold for self-employed and others entitled to the 15% flat income tax regime and the introduction of a flat tax on income increases for other individual firms; (v) the renewal, with stricter age criteria, in 2023 of several temporary early retirement schemes. These interventions are financed with offsetting measures of around 0.7% of GDP in 2023. While the details of these financing measures are not specified in the Draft Budgetary Plan, based on the draft budget law submitted to the Parliament on 1 December, they include: a revision of the extraordinary tax on extra profits of energy companies and additional revenues related to compensation mechanisms in the electricity sector, reduced coverage of the citizenship income, a lower indexation mechanism for pensions exceeding four times the minimum pension benefit, the rationalisation of current expenditure, the implementation in 2022 of capital transfers to the national railway company that had previously been expected in 2023, and the revision of tax credits related to the revaluation of land, shareholdings and retained earnings. Overall, the Commission assessment of the budgetary impact of the fiscal policy measures is broadly in line with that of the government.

The budgetary cost of the measures adopted to counter the economic and social impact of the exceptional increases in energy prices is projected in the Commission ad hoc forecast to amount to 3.3% of GDP in 2022 and 1.2% of GDP in 2023[13]. They consist of measures reducing government revenue, namely measures to control general system charges in the electricity and gas sectors, reduction of the VAT rate on gas, reduction of excise duties on fuel prices, reduction of social security contributions for workers below a certain income threshold, and increasing expenditure, such as subsidies to electricity and gas companies, expansion of the 'social bonus' for electricity and gas bills for low-income households and means tested allowances for workers, pensioners and unemployed persons. Finally, old-age pensions have been increased by 2% in October 2022, in advance of the statutory inflation-related indexation normally due in 2023. The cost of these measures is

[13] Deficit developments in 2023 are also affected by the complete phasing out of COVID-19 emergency temporary measures, which are estimated in the Commission ad hoc forecast at 1.1% of GDP in 2022.

partly offset by new revenue measures of around 0.4% of GDP in 2022 and 0.2% of GDP in 2023. They consist in new taxes on windfall profits of energy producers, and revenues from the offset mechanism on the price of electricity produced from renewable sources and from the application of a compensation mechanism in the electricity sector, deemed to implement Council Regulation on an emergency intervention to address high energy prices adopted on 6 October 2022. Taking these revenues into account, the net budgetary cost of the energy measures in the Commission ad hoc forecast is estimated at 2.9% of GDP in 2022 and 1.0% of GDP in 2023.[14] These measures have been announced as temporary, expiring by the end of the first quarter of 2023. Around one-half of the measures do not appear targeted to vulnerable households or firms,[15] and most of them do not fully preserve the price signal to reduce energy demand and increase energy efficiency.[16] As a result, the amount of temporary and targeted support to households and firms most vulnerable to energy price hikes, that can be taken into account in the assessment of compliance with the fiscal country-specific recommendation for 2023, is estimated in the Commission ad hoc forecast at 1.6% of GDP in 2022 and 0.7% of GDP in 2023.

The government deficit is also impacted by the costs of offering temporary protection to displaced persons from Ukraine, which in the Commission ad hoc forecast are projected at 0.1% of GDP in 2022 and 0.1% in 2023.

16. Based on the Commission ad hoc forecast and including the information incorporated in Italy's 2023 Draft Budgetary Plan, gross fixed capital formation is expected to amount to 2.6% of GDP in 2022 and 3.1% of GDP in 2023, compared to 2.9% of GDP recorded in 2021. This includes investment for the green and digital transitions and for energy security, such as investments in the rail network, renewable energy, hydrogen, electricity grids and sustainable mobility, the protection of land and water resources as well investments related to the cloud infrastructure for the public administration, which are partly funded by the Recovery and Resilience Facility and other EU funds.

17. In 2023, the fiscal stance is projected in the Commission ad hoc forecast to be broadly neutral (+ 0.0% of GDP[17]). This follows an expansionary fiscal stance in 2022 (- 4.4% of GDP)[18].

The growth in nationally financed primary current expenditure (net of new revenue measures) in 2023 is projected to provide a contractionary contribution of 0.9 percentage points.[19] This includes the reduced impact from the support measures adopted to counter the economic and social impact of the exceptional increases in energy prices by 2.0% of GDP,[20] with temporary and targeted support measures to

[14] The figures represent the level of annual budgetary costs of those measures taken since autumn 2021, including current revenue and expenditure as well as – where relevant – capital expenditure measures.

[15] Targeted measures amount to 1.6% of GDP in 2022 and 0.7% of GDP in 2023, while untargeted measures amount to 1.7% of GDP in 2022 and 0.5% of GDP in 2023.

[16] Income measures amount to 0.9% of GDP in 2022 and 0.4% of GDP in 2023, while price measures amount to 2.4% of GDP in 2022 and 0.8% of GDP in 2023.

[17] A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy. The fiscal stance includes the fiscal impulse funded by the Union.

[18] This is well above the expansionary fiscal stance in the euro area as a whole (-2.3% of GDP in 2022).

[19] This follows an expansionary contribution from this component of 4.0 percentage points in 2022.

[20] The budgetary impact of targeted price and income measures is projected to decrease by 0.5% and by 0.4% of GDP respectively, while the budgetary impact of untargeted price and income measures is projected to decrease by 1.1% of GDP and remain stable (at 0% of GDP) respectively.

households and firms most vulnerable to energy price hikes accounting for 0.9% of GDP of this reduction. The increase in other primary current expenditure not related to energy measures, including pensions' indexation to 2022 inflation, is set to provide a further expansionary contribution of 0.9% of GDP in 2023, following an expansion of 1.4% of GDP in 2022.

The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.9 percentage points of GDP in 2023 compared to 2022. Nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0.1 percentage points in 2023.[21]

18. The Draft Budgetary Plan includes medium-term budgetary projections until 2025. The government deficit is projected to decrease to 3.7% of GDP in 2024, which is mainly explained by the expiring of temporary energy measures, and 3.0% in 2025. These plans would imply, according to the official estimates, an overall structural cumulative adjustment of 1.2% of GDP in 2024-2025 relative to 2023.[22] The government debt is envisaged to decline to 141.2% of GDP by 2025. According to the Draft Budgetary Plan, the reduction of the debt-to-GDP ratio would be driven by nominal GDP growth and an increasing headline primary government surplus.

19. On 12 July 2022 the Council also recommended that Italy, in order to further reduce taxes on labour and increase the efficiency of the system, adopt and appropriately implement the enabling law on the tax reform, particularly by reviewing effective marginal tax rates, aligning the cadastral values to current market values, streamlining and reducing tax expenditures, also for VAT, and environmentally harmful subsidies while ensuring fairness, and by reducing the complexity of the tax code. The draft enabling law, tabled by the government in October 2021, outlined the key principles for a general reform of the tax system. It provided for several structural changes, such as: a review of personal and corporate taxes, including the gradual elimination of the tax on productive activities; a reform of cadastral values together with a mechanism for regular adjustments; a rationalisation of VAT rates and tax bases; and a revision of environmental taxes in line with the principles of the European Green Deal. It also mandated the government to simplify the tax system and to harmonise tax legislation in a single legal code. However, the enabling law has not been approved by the Parliament. The Draft Budgetary Plan includes measures that are not consistent with past country-specific recommendations. On 9 July 2019 the Council, among others, recommended Italy to fight tax evasion, especially in the form of omitted invoicing, including by strengthening the compulsory use of e-payments including through lower legal thresholds for cash payments as well as to implement fully past pension reforms to reduce the share of pensions in public spending. Measures included in the Draft Budgetary Plan that are not in line with these country-specific recommendations concern in particular: (i) a provision that raises the ceiling for cash transactions from the current EUR 2,000 to EUR 5,000 in 2023; (ii) a measure equivalent to a tax amnesty which allows for the cancellation of past tax liabilities related to the period 2000-2015 and not exceeding EUR 1,000; (iii) the possibility to refuse electronic payments below EUR 60 without

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21 Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.2 percentage points of GDP also due to the projected sale of gas stocks bought at the end of 2022.

22 This adjustment is driven by the phasing out of temporary energy measures amounting to 1.0% of GDP in 2023.

sanctions; and (iv) the renewal, with stricter age criteria, in 2023 of early retirement schemes which expired at end-2022.

20. In 2023, based on the Commission ad hoc forecast and including the information incorporated in the Draft Budgetary Plan, the growth of nationally-financed current expenditure is projected to be below medium-term potential output growth. Therefore, the growth of nationally financed primary current expenditure is in line with the recommendation of the Council. Italy plans to finance additional investment through the RRF and other EU funds and it plans to preserve nationally-financed investment in 2023. It plans to finance public investment for the green and digital transitions, and for energy security.

Overall, the Commission is of the opinion that the Draft Budgetary Plan for Italy is in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.

While Italy rapidly deployed energy measures as part of the emergency policy response to the exceptional energy price hikes, a prolongation of existing and/or an enactment of new support measures in response to high energy prices would contribute to higher growth in net nationally financed current expenditure and to an increase in the projected government deficit and debt in 2023. Therefore, it is important that Member States better focus such measures to the most vulnerable households and exposed firms, to preserve incentives to reduce energy demand, and to be withdrawn as energy price pressures diminish.

The Commission is also of the opinion that Italy has not yet made progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 12 July 2022 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2023 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2023.

Done at Brussels, 14.12.2022

For the Commission
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