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2020 Budgetary Policy Report

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SUMMARY

International economic conditions continue to weaken, in part reflecting trade restrictions. The slowdown in global activity has compressed the prices of raw materials and inflation, to which monetary policy authorities have responded proactively. In the last four quarters, the Italian economy has barely expanded. The uncertainty of firms and households is high and forecasts do not appear to signal any significant strengthening of output in the short term.

The Parliamentary Budget Office (PBO) endorsed the policy macroeconomic scenario for 2019-2020 in the Update to the Economic and Financial Document (the Update), which forecasts GDP growth of 0.1 and 0.6 per cent in those years, respectively. As customary, the endorsement exercise was conducted with the assistance of the PBO forecasting panel. The endorsement of the policy scenario was based on government forecasts that, for the main macroeconomic variables in the 2019-2020 period, fall within an acceptable forecasting range delineated by the panel's projections. The macroeconomic estimates of the Ministry for the Economy and Finance (MEF) for the years following the validation horizon (2021-2022) show non-negligible divergences with respect to the forecasts of the PBO panel.

Following the publication of the Update, a number of revisions were made to the quarterly national accounts data, by virtue of which this year GDP should expand by 0.2 per cent, marginally greater than the MEF estimates. Looking forward, however, strong downside risks remain, mainly due to the fragility of international economic conditions and the scope for economic policy-makers to intervene to address a possible crisis.

As in previous editions, in this Report the PBO assesses the impact of the budget package on economic activity in the next year, which is expected to induce a GDP stimulus of 0.2 percentage points, as also projected by the MEF. A box presents new models for estimating potential output and the output gap recently developed by the PBO.

As regards the policy public finance scenario, for 2020 the Government forecasts no change in net borrowing compared with the level expected for 2019 and that recorded in 2018 (2.2 per cent of GDP), while for the following two years it expects annual reductions of 0.4 percentage points, which would bring the deficit to 1.8 per cent in 2021 and 1.4 per cent in 2022. The structural balance is expected to deteriorate by 0.1 percentage points in 2020 and improve by 0.2 points in each of the next two years.

The ratio of public debt to GDP came to 134.8 per cent in 2018 after the revisions made by the Bank of Italy to adapt the calculation to the new Eurostat criteria and reflecting the new national accounts figures published by Istat. These revisions increased the debt/GDP ratio compared with the previous figure, although the dynamics of the ratio are now more favourable.

According to the scenario set out in the Draft Budgetary Plan (DBP), the debt/GDP ratio should begin a stable and progressive reduction in 2020, reaching 131.4 per cent in 2022, over 4 percentage points of GDP lower than the peak forecast for 2019 (135.7 per cent). The largest contribution to the decline comes from the primary surplus and the evolution of interest expenditure.

The 2019 Update envisages significant savings on interest expenditure over the next three years compared with the 2019 Economic and Financial Document (EFD), with the savings increasing over time to €17.6 billion in 2022 in the trend scenario and €17.2 billion in the policy scenario. More specifically, using the PBO model of interest spending, the savings on interest expenditure within the policy scenario that are attributable solely to domestic government securities would amount to around €5.6 billion in 2020, then grow over time to reach around €15.6 billion in 2022. It is also estimated that about half of the savings would be attributable to the broad decline in interest rates, measured by the variation in yields on German securities between March and September, while the other half is generated by the reduction in the country risk associated with Italy, measured by the spread between yields on Italian and German securities in the same period.

The budget package will produce a deterioration in general government net borrowing compared with the current legislation trend of 0.9 per cent of GDP in 2020, 0.7 per cent in 2021 and 0.5 per cent in 2022. The budget contains expansionary measures of 1.8 per cent of GDP in 2020 and 2021, declining to 1.5 per cent in 2022. However, net of adjustments to the indirect tax increases provided for in the safeguard clauses, the new measures will obviously have smaller but growing expansionary effects over the three-year period: from 0.5 per cent of GDP in 2020 to almost triple that in the following two years, at 1.3 per cent of GDP. The resources to fund the measures are less than the measures themselves including those impacting the safeguard clauses, and are broadly stable at around 1.0 per cent of GDP over the entire three-year period.

For 2020, the expansionary measures amount to about €32 billion, against which resources are expected to amount to about €16 billion, with a consequent increase of about €16 billion in the deficit. Among the measures, the most substantial one – as has been the case for five years now – is the complete deactivation of the revenue increase envisaged by the safeguard clauses from indirect tax hikes amounting to €23.1 billion. The other main measures are connected with the start of the reduction of the fiscal burden on payroll employees, measures to support the birth rate and access to childcare facilities, an increase in resources for public employment contract renewals for 2019-2021, as well as measures for central government, regional and municipal capital expenditure and tax credits for investment in capital equipment by firms in southern Italy.

Around three quarters of the resources to fund these measures come in the form of revenue increases. To begin with, additional revenue is generated for 2020 alone as a result of the restructuring of the two estimated tax instalments provided for with Decree Law 124/2019 for taxpayers subject to the new composite tax compliance indices. In addition, substantial revenue recovery is expected from measures to combat tax evasion and tax fraud, increases in revenue from companies, especially banks, the introduction of new taxes on the consumption of single-use plastic products and on the consumption of certain types of beverages, the revision of tax breaks for company cars, as well as an increase in taxes on gaming and tobacco products. Expenditure reductions mainly include not only the savings expected from the smaller-than-expected participation in the *"Quota 100"* early retirement mechanism compared with the estimates in the 2019 Update, but also a reduction in spending by ministries and additional defunding and reprogramming of measures contained in the second section of the Budget Bill (in particular, the Development and Cohesion Fund and funding for healthcare facility construction).

With regard to the uses of funds, for the 2021-2022 period, the partial deactivation of the safeguard clauses, which will reduce revenue by €9.8 billion and €3 billion respectively, and the more substantial effects of many of the expenditure increase measures – in particular those regarding public employment and capital expenditure – are accompanied by incentive measures to foster the use of electronic payment instruments, the larger impact of the reduction of the tax wedge as well as the extension of certain tax breaks and financing for SMEs, and the introduction of a universal family allowance. As regards the sources of funds, the proportion of the additional outlays covered by revenue increases rises compared with 2020 (from around 75 per cent in 2020 to around 80 per cent thereafter), due in particular to the smaller loss of revenue in 2022 connected with the repeal of the flat-tax mechanism (due to take effect as from the 2020 tax year) for self-employed workers and sole proprietorships with revenues of between €65,000 and €100,000, to the greater effects of both the measures for combating tax evasion and tax fraud in Decree Law 124/2019 and the new consumption tax on plastic products. With regard to expenditure savings, which are smaller in 2022, those connected with capital expenditure have been reduced while those impacting current expenditure have been increased, in particular those associated with the *"Quota 100"* early retirement mechanism.

In general terms, against the background of an improvement in the trend scenario compared with the EFD based in large part on the estimated decrease in interest expenditure linked to the expected reduction in rates on government securities, it should be emphasised that the budget package projects a decline in the policy deficit only from 2021, despite the considerable impact of the safeguard clauses. It combines an increase in net expenditure over the three-year period with a decrease in total revenue, net of the effect of the safeguard clauses, with no rebalancing of expenditure towards that on capital account. Half of the spending on the measures is deficit financed in the first year and more than a third in the following two, causing the balances to deteriorate compared with the trend.

The improvement in the deficit envisaged for 2021 and 2022 is solely attributable to the still significant impact of the indirect tax increases provided for in the safeguard clauses. Only one-third of the latter's impact is eliminated in 2021 and just one-tenth in 2022, and the remaining increases still represent 1.0 and 1.3 per cent of GDP respectively (in absolute value, €19 billion in 2021 and €25.8 billion in 2022). Excluding these revenues, the deficit – in purely mechanical terms – would be equal to 2.8 per cent of GDP in 2021 and 2.7 per cent in 2022, while the primary surplus would fall to 0.3 per cent and 0.2 per cent of GDP respectively. Neither the Update nor the DBP provide policy indications about the future treatment of the safeguard clauses.

Achieving the targets for the public finance variables programmed by the Government therefore depends on the presence of the safeguard clauses in 2021 and 2022, which in past years have always been deactivated. It also appears to be exposed to risks and uncertainties that essentially concern the macroeconomic environment. Risks of a sharp deterioration in the international context could adversely impact foreign demand for Italian output and therefore GDP growth, which could be slower than that envisaged in the policy scenario in the Update. Moreover, the favourable interest rate conditions created with their decline since the start of September are also exposed to uncertainty, as demonstrated by the recent increase in rate volatility, threatening to impact interest expenditure on the debt.

With regard to the fiscal stance, the policy scenario set out in the Update, which was retained in the DBP, has changed quite significantly from that outlined in the EFD published last April. The deactivation of the safeguard clauses for indirect taxes, which is only partially funded by alternative measures, is a decisive factor in altering the orientation of fiscal policy, which becomes expansionary in 2020 (with a reduction of the structural primary surplus of 0.3 points of GDP) and avoids the further tightening previously planned for the following two years. Since the estimates of the output gap contained in the Update continue to indicate an adverse phase of the cycle (which is especially intense in 2019-2020), the slightly expansionary fiscal stance planned for next year would be counter-cyclical. It would be substantially neutral in 2021-2022 in moderately unfavourable cyclical conditions. Using the PBO's estimates of the output gap, the counter-cyclical nature of the 2020 fiscal impulse would be less evident, while the neutral fiscal stance in 2021-2022 would be imparted in a moderately favourable cyclical context.

With regard to the sustainability of the public finances, the PBO has conducted a number of sensitivity exercises for developments in the debt/GDP ratio: if the PBO's nominal growth assumptions are used and privatization receipts are not considered, the ratio would rise slightly in 2020 and then begin to decline from 2021. The divergence between the trajectory in the PBO scenario and that in the Update would be equal to 2.3 percentage points in 2022. If the remaining safeguard clauses were not activated in 2021 and 2022, the debt/GDP ratio would be 134.2 per cent in 2022, only slightly below the 2018 level. Furthermore, the downward trend in the ratio set out in the Update appears to depend closely on the very favourable conditions currently prevailing in the financial markets, which make it possible to raise funds at historically low interest rates. A change in monetary policy to a less expansionary stance or a new increase in country risk would bring upward pressure to bear on rates and make the downward path of the debt/GDP ratio more uncertain.

As regards the fiscal rules, together with the Update the Government presented a Report to Parliament, pursuant to Law 243/2012, in which it asks for authorisation to revise the plan for returning to the path towards the medium-term objective (MTO) previously authorised with the 2018 Report to Parliament attached to the 2018 Update. The Report contains both a reference to the budget flexibility for exceptional events to be activated with a request to the European Commission and general arguments concerning economic conditions: growth below potential, failure to return to pre-crisis levels of per capita GDP, high unemployment, the downward revision of macroeconomic forecasts, the negative output gap estimated by the MEF.

With regard to the MTO plan, the Government declares in the Report to Parliament that it wishes to resume the path of convergence towards the MTO in the 2021-2022 period and to continue in the following years, without specifying, however, the time span following 2022 for achieving the MTO or the scale of the annual adjustment, unlike its practice on previous occasions, with the exception of the 2018 Report to Parliament.

Accordingly, taking account of the request for flexibility presented by Italy to the EU (equal to 0.18 percentage points of GDP in 2019 and 0.2 points in 2020), the public finance policy scenario was assessed in the light of the fiscal rules.

On the basis of the required adjustment reported in the Update, in 2019 Italy would comply with the structural balance rule in annual terms and present a non-significant risk of deviation in two-year average terms. However, based on the adjustment required under the Vademecum, 2019 would be at risk of a non-significant deviation in annual terms and one close to significance in two-year terms. According to the required adjustment given in the Update, for 2020 there would be a risk of a non-significant deviation in both annual and two-year average terms. However, based on the adjustment required under the Vademecum, there would be a risk of a deviation at the limit of significance in annual terms and significant deviation in two-year terms.

For the expenditure benchmark, it is first important to note that the policy documents do not contain all the information necessary to conduct a comprehensive assessment. On the basis of the partial information available, and considering the requested adjustment as reported in the Update, 2019 would be at risk of a non-significant deviation in annual terms and a significant deviation in two-year average terms. However, given the adjustment required by the Vademecum, there would be a risk of a deviation at the limit of significance in annual terms and a significant deviation in two-year terms. For 2020, there would be a risk of a significant deviation both in annual and two-year terms considering both the required adjustment as reported in the Update and that based on the provisions of the Vademecum.

Finally, despite the decline in the debt in 2020-2022, there is no compliance with the debt reduction rule over the period covered by the Update under any of the three criteria (backward-looking, forward-looking and adjusted for the cycle).

Note also that the overall assessment of compliance with the preventive arm of the Stability and Growth Pact (SGP) conducted by the European Commission in November – as part of the assessment of the DBP – found a risk of a significant deviation in 2019, even taking account of the request for flexibility submitted by Italy to the European Union.

The Commission underscores the risk of a significant deviation in 2020 for both the structural balance rule and the expenditure rule in annual and two-year terms, even taking account of the new request for flexibility presented by the Government. As for the numerical debt reduction rule, the Commission found that Italy will not be in compliance either this year or in 2020.

In the final part of this Report we assess the content of the budget package more specifically, analysing the effects of the main measures. In particular, the following topics are explored: corporate taxation and that for sole proprietors and self-employed workers; the restructuring of certain personal income tax credits based on taxpayer income; the permanent reduction of the flat-rate tax on rental income from rent-controlled properties to 10 per cent; the tax on plastic products; measures to combat tax evasion; measures to support families and those affecting pensions; healthcare measures; and measures concerning public investment and local government finance.

With regard to corporate taxation, the budget package adopts an approach similar to that employed in recent years: the increase in revenue in the first year is generated by one-off measures; investment incentives are extended and expanded to support firms (“super”- and “hyper”-depreciation and the investment tax credit); and finally, for the third time in a year, the IRES (corporate income tax) system has been modified. As from 2019 the Budget Bill reintroduces the ACE (allowance for corporate equity) system and at the same time repeals the reduced rate for the portion of profits allocated to reserves introduced with Law Decree 34/2019. Although the rules for 2019 have been amended three times, on a substantive level the ACE has remained in effect without interruption. The only difference is that the notional rate used to quantify the figurative return on capital has been reduced from 1.5 to 1.3 per cent.

Using its own microsimulation model, the PBO has quantified the redistributive effect of the changes in the IRES system and the extension of super- and hyper-depreciation on both non-financial and financial companies. The simulations show that in 2020 non-financial companies as a whole would experience a tax increase equal to 1.1 per cent of tax revenue. The additional tax deriving from the abolition of the reduced rate, amplified by the reduction in the notional rate of return on capital of the ACE, is only partially offset by the extension of super- and hyper-deprecation. Medium-sized and large non-financial companies would incur the greatest increase (around 1.3 per cent of tax revenue), despite being the enterprises that reap the greatest benefits from the extension of super- and hyper-deprecation (between 0.7 and 0.8 per cent of revenue). Symmetrically, smaller non-financial companies receive the greatest benefit (between 0.4 and 0.8 per cent), essentially due to the positive impact of the ACE (on the order of 3 per cent of tax revenue). Finally, financial companies, which did not qualify for the subsidised treatment of retained profits, fully benefit from the reintroduction of the ACE, although the impact is mitigated by the lower notional rate of return on capital (6.7 per cent of tax revenue).

In the light of the extension of super- and hyper-depreciation envisaged in the Budget Bill, the report outlines the characteristics of the firms that benefited from the relief measure in the past and quantifies the impact in 2017, the last figure for which administrative tax data is available and which also includes the effects of the increased depreciation allowances used in the 2015-2016 period.

For sole proprietors and self-employed workers, the Budget Bill introduces a number of amendments to the alternative tax mechanisms envisaged in the 2019 Budget Act. On the one hand, it repeals the mechanism for self-employed workers and sole proprietors with revenues of between €65,000 and €100,000 that was to come into force from 2020. On the other, it introduces a number of limits to reduce the scope for tax avoidance under the single-rate system for self-employed workers and sole proprietors with revenues of less than €65,000. Despite the measures introduced, the tax differential between self-employed workers and payroll employees remains very wide at any given income level. Furthermore, the contrast with the original spirit underlying the introduction of the initial single-rate mechanism – simplifying administration and reducing the tax burden for micro-enterprises only – persists.

Although for some time now tax expenditures have received particular attention both in legislation and in the policy debate, the budget for 2020-2022 shows no trace of any reorganisation or rationalisation of this form of tax relief. On the contrary, the budget package extends various tax expenditure programmes, increases the scale of certain others compared with current legislation and introduces new programmes. However, the budget measures do contain a tentative initial attempt to reduce tax expenditures connected with personal income tax. Specific assessments are conducted for the latter measure and the changes in the flat-rate taxation of rental income from rent-controlled properties.

For high-income taxpayers, the Budget Bill limits or eliminates the 19 per cent tax credit for most categories of expenditure and that for donations to non-profit organisations. For all taxpayers, the expenditures affected by the measure (i.e. the amounts on which the 19 per cent credit is calculated) amount to €23.5 billion. These correspond to tax credits (tax savings) of about €4.5 billion, 11.4 per cent of the total tax expenditures involving personal income tax, equal to €41.5 billion in 2020. The selection criterion adopted involves an extremely small group of high-income taxpayers, meaning that the measure does not significantly impact the overall value of tax credits. Those with an income exceeding €240,000 represent only 0.1 per cent of all taxpayers, while those with an income of between €120,000 and €240,000 represent 0.6 per cent. Accordingly, the tax credits affected by the reform represent only 2.9 per cent of the total, despite the fact that the share of taxpayers in these income brackets who benefit from the credits is almost double that for incomes below €120,000 (over 80 per cent, compared with 48 per cent) and that the average amount of the tax credits is much larger (double if not triple than that of taxpayers with incomes below €120,000).

The Budget Bill makes permanent the rate of the 10 per cent flat-rate tax on rental income from properties leased at controlled rents. The number of taxpayers with income taxed at a substitute flat rate (both ordinary and subsidised rates) has gradually increased over time. The pace of that growth is showing signs of slowing down, but does not yet appear to have ceased. Tax returns filed in 2018 indicate that in high-density municipalities taxpayers paying a reduced flat rate as a proportion of all taxpayers paying a flat rate is 38.3 per cent. The greatest proportion of taxpayers benefitting from the facilitated rate is found in the North-East (in particular, in the municipalities of Emilia-Romagna), where rent-controlled leases account for more than half of the total. The lowest proportion is found in the North-West and in the South and, in general, in municipalities that are not provincial capitals. Among provincial capitals, the facilitated mechanism generally seems less common in regional capitals, especially in the South. The use of flat-rate substitute taxation (at both ordinary and facilitated rates) mainly benefitted taxpayers with higher incomes: more than half of the taxable income under the flat-rate mechanisms is in fact received by the richest 10 per cent of taxpayers. The flat-rate system may however be less regressive if part of the tax savings has been passed through to rents, as would appear to be the case in a number of preliminary analyses.

With regard to the plastic tax, the Budget Bill provides for the introduction of a tax on all single-use packaging manufactured, even partially, of plastic materials, excluding compostable products and syringes. The tax is equal to 1 euro per kilogram of plastic contained in the packaging. The quantification of the expected tax revenue, which is constant over the years, does not incorporate the effects of possible reductions in the production and consumption of plastic packaging due to the disincentive effect produced by the measure, meaning that revenue is probably overestimated, at least for the years after 2021. In addition to a summary of the current state of European legislation in this area and of the main measures introduced in other countries, a number of general considerations on the new tax are offered. More specifically, the need for reflection on the advisability of introducing the tax more gradually is emphasised, starting at a lower level and progressively increasing it over time. This would allow companies in the plastic sector to adapt to the new tax and, plausibly, to view the measure more favourably.

Finally, an assessment of the macroeconomic effects of the plastic packaging tax using the MeMo-It econometric model is presented. The measure's impact on growth is estimated to be a cumulative decrease of one-tenth of a percentage point of GDP in 2020-2022. The slowdown in growth mainly reflects the more rapid rise in demand-side deflators: the change in the private consumption deflator would increase in cumulative terms by just under half a percentage point over the three-year period. The slower real growth would mainly reflect the lower pace of private consumption spending as well as a slightly negative contribution from net exports. The simulation incorporates a partial transfer of the increased excise taxes onto final prices: it would amount to about 50 per cent in the first year of the introduction of the tax and would rise to 70 per cent in the third. In essence, the simulation is consistent with a tax transmission mechanism in which most of the effects manifest themselves through an increase in prices.

With regard to the fight against tax evasion, the budget measures can be divided into four different types employed for four different purposes: 1) to counter specific areas of VAT and excise duty fraud; 2) to prevent undue tax offsetting; 3) to increase the amount and timeliness of the information available to the Revenue Agency and the *Guardia di finanza* (Finance Police); and 4) to encourage the use of non-cash forms of payment.

The new measures include a provision of the Budget Bill that would allow the Revenue Agency to supplement, after pseudonymisation of personal data, the databases it already maintains with data from the financial transactions database to develop risk profiles that can be used in identifying positions to be investigated or to encourage voluntary taxpayer compliance. The innovative scope of the provision lies in the possibility for the Revenue Agency to move from deductive reasoning to an inductive approach in its control activity, thanks to the automated processing of large volumes of data upstream of the determination of risk criteria. However, the effectiveness of the measure depends crucially on: 1) the ability of the Agency to exploit the information resources that it will have at its disposal, i.e. to have access to appropriate statistical-IT skills and staff suitably trained for these tasks; and 2) effectively resolving issues connected with the processing of personal data. With regard to the latter aspect, the Budget Bill would provide for the inclusion of activities to prevent and combat tax evasion among those for which the data rights of the parties involved may be restricted. Further investigation is required to determine whether the provision as drafted in the Budget Bill is sufficient to enable the limitation of rights, i.e. if all the conditions required by Article 23 of the General Data Protection Regulation are satisfied.

With the general obligation for the storage and electronic transmission of sales data, the entry into force of the receipt lottery, and the augmented chance to win the lottery when traceable payment methods are used, the establishment of penalties in case of avoidance of the obligation, the system continues in the direction of countering evasion by focusing attention on the last stage of the retail chain (final consumers). In particular, the provisions focus on the part of tax evasion connected with the omission of reporting tax returns.

All of these tools to expand the availability of information and increase its timeliness can help improve tax authorities' capacity for analysis and preventive control, improve the relationship between tax authorities and taxpayers and increase voluntary compliance. It will also lend impetus to the digitalisation of the country, reducing costs and enhancing the efficiency of corporate processes. However, such measures could encourage forms of collusion to commit tax evasion (consensual arrangements in which there is an agreement between buyer and seller), expanding rather than reducing evasion in transactions with final consumers. This type of evasion, which is certainly more difficult to combat, has not yet been tackled with determination. With the increase in reported costs fostered by mandatory electronic invoicing and the electronic transmission of sales receipt information, an increase in consensual tax evasion could even lead to a loss of tax revenue. This phenomenon should be countered by establishing appropriate mechanisms for monitoring the stability and credibility of margins.

A mechanism that exploits opposing interests to discourage collusion to commit tax evasion in the final stage of the transaction chain can only stem from substantial incentives to use means of payment other than cash and impose stringent limits on the use of the latter. In addition to lowering this limit, the budget package appropriates significant resources in a special fund to finance the grant of cash reimbursements for payments made using traceable payment systems. The cost and effectiveness of the incentive will depend crucially on the way in which the mechanism is designed as well as on its capacity to alter individual behaviour. We must first consider the possibility that, if not properly designed, most of these reimbursements will go to individuals who already make significant use of traceable payment methods without having an impact in terms of reducing tax evasion. To make the tool effective it would also be advisable to direct reimbursements towards purchases in merchandise categories most affected by tax evasion.

The Budget Bill contains various measures to support families, some of which are temporary (the "baby bonus" allowance and mandatory parental leave for fathers), while others are of a structural nature. Permanent measures include the establishment of a fund for the universal family allowance and the childcare services allowance, as well as an increase in the allowance for the payment of public and private childcare fees for families with a low equivalent economic status indicator (ISEE). Other indirect support for families is provided by the capital grant for municipalities to fund the construction, renovation and safety upgrading of childcare facilities. The need for coordination between the policies supporting demand for and public supply of childcare services should be underscored, with appropriate measures to reduce territorial differences in the supply of public childcare facilities in order to avoid the concentration of a double benefit, on both the supply and demand side, in favour of those residing in areas with childcare services to the detriment of those residing in areas without such services.

On the pension front, the Budget Bill provides for a one-year extension of the early retirement programme for hardship categories (*APE sociale*) and the “Women’s Option”, consistent with past efforts to maintain – compatibly with budget constraints – a degree of flexibility in retirement opportunities. It also revises the rules for indexing pensions to inflation. Furthermore, in addition to what was decided in July and with the 2019 Update, it allocates to the improvement of public finance balances further reduction in outlays for the “*Quota 100*” early retirement mechanism and for the temporary suspension of the progressive increase in age requirements for early retirement. Overall, the original estimates made in 2018 and at the beginning of 2019 have been lowered by €1.2 billion in 2019, €2.0 billion in 2020, €1.3 billion in 2021 and €0.5 billion in 2022, bringing them to €2.6 billion in 2019, €5.9 billion in 2020, €7.0 billion in 2021 and €7.4 billion in 2022.

The PBO has updated its estimates on spending for the “*Quota 100*” mechanism using the data published by INPS between March and November 2019 and those of the INPS Monitoring Report until the end of October. The PBO estimates confirm the order of magnitude of the reduction in expenditure expected in 2019 and 2020 (respectively, €1.2 billion and €2 billion). There is greater uncertainty for 2021, the year for which a forecasting range is provided that depends jointly on the rejection rate for applications submitted to INPS and the proportion of those who, for various reasons (the reduction in pension benefits, the absolute value of benefits, subjective and personal factors, etc.) and despite having become eligible for the “*Quota 100*” during the year or in previous years, decide to retire in 2021 (threshold/discontinuity effect). Given the official forecast of a reduction in expected spending for 2021 of €1.3 billion, the PBO has projected a range of between €0.9 billion and €1.2 billion. The threshold/discontinuity effect could be amplified if workers perceived a risk of further legislative regulatory changes that could reduce or eliminate access to the *“Quota 100”* mechanism after 2021 for those who become eligible by that year or even marginally lengthen the time to reach ordinary retirement channels.

In the healthcare field, the Tax Decree shifted the deadline to achieve an agreement on the 2019-2021 Health Pact to the end of December 2019. Such agreement is a requirement for an increase in the funding of the National Health Service (NHS) of €2 billion in 2020 and €3.5 billion in 2021 from its 2019 level (€114.5 billion). The Pact must contain various planning and improvement measures for the quality of care and services and increase the efficiency of the system, including a review of co-payment mechanisms in order to foster greater fairness of access. Pending this broader reform, the Budget Bill provides for the elimination as from September 2020 of the so-called “superticket” co-payment and of the alternative measures adopted by some regions. At the same time, the Superticket Reduction Fund, introduced with Law 205/2017 (the 2018 Budget Act), has been defunded. Excluding the elimination of this Fund, the cost of the measure is estimated in the Technical Report at €165 million for 2020 and €494 million as from 2021. The abolition of the superticket is intended to increase the equity of access to healthcare services and ensure the uniformity of co-payment systems at the territorial level, while eliminating a factor driving demand towards the private sector or prompting patients to forgo care.

The Budget Bill also increases appropriations for the long-term healthcare construction and technological modernisation programme from €28 billion to €30 billion. However, while the long-term funding will cover the years 2022-2032, a measure reprogramming (i.e. postponing) the resources previously allocated for healthcare construction shifts €400 million from the appropriation for 2020 and €1,420 million from that for 2021 to years subsequent to 2022. Almost €236 million from the funding already appropriated but not yet allocated among the regions will be earmarked for grants for the acquisition of medical equipment for general practitioners (with ownership remaining with local health authorities) in order to shift the delivery of certain services away from health service facilities, shorten waiting lists and facilitate the local provision of services by general practitioners.

The budget package envisages a reduction in the resources allocated for investment and investment grants of over €500 million in 2019 and €1.1 billion in 2020, while increasing appropriations in 2021 and 2022 by about €0.9 billion and €2.7 billion respectively. For 2020, the main impact will come from reductions in current-legislation appropriations provided for in the second section of the Budget Bill, in particular the defunding of the Development and Cohesion Fund, expenditure rationalisation measures (mainly at the expense of central government departments) and the rescheduling of resources for healthcare construction noted earlier, a number of investment programmes managed by the Ministry of Defence and capital transfers to the State Railways and the National Motorway Agency. By contrast, the measures concerning investment in the first section have an overall expansionary effect. The most significant of these – as with the 2019 Budget Act – include the establishment of a fund for the revival of central government investment, which is intended to finance investments to improve environmental sustainability and, more generally, foster innovation. A series of investment grants for local authorities – and municipalities in particular – are also envisaged, primarily targeting energy efficiency projects, sustainable territorial development, infrastructure development, enhancing the safety of local areas and buildings, and urban regeneration and redevelopment. In many cases, the legislation provides for mechanisms to ensure the rapid deployment of resources, the collateral effects of which could however penalise the institutions and areas of the country that most need resources (but which often lack the necessary administrative resources), thereby increasing regional disparities.

Although it has no impact on net borrowing, it should also be noted that an unallocated fund has been established, financed with the proceeds from the sale of CO_2 emission allowances, to be used to provide guarantees for consideration or to participate in the equity or debt capital of economically sustainable projects with objectives such as the decarbonisation of the economy, the circular economy or urban regeneration ("green new deal"). Finally, other notable measures concern expenditure for investments in research, such as the establishment of the National Research Agency, the concomitant establishment of a fund to strengthen the research carried out by universities, public and private research institutions and institutes, and the supplementation of resources financing space programmes at the national level, in international cooperative initiatives and within the European Space Agency.

In addition, the budget package contains provisions to strengthen the mechanism for allocating resources, based on population, for the ordinary capital expenditure of the regions of southern Italy in order to reduce regional disparities. The goal is to move from the essentially *ex-post* monitoring system introduced in 2016 to a more binding guide for central government in complying with the principle of territorial rebalancing when allocating resources for all ordinary capital spending programmes that are not subject to other allocation criteria or indicators.

An initial quantitative assessment of the operation of the "34 per cent criterion" through the identification in the Budget Bill of resources susceptible of "territorial allocation" among those appropriated for capital expenditure would lead, on the basis of a series of assumptions, to the identification of appropriations of close to €9 billion, or just over 17 per cent of the total resources allocated to the categories considered in the exercise (€52.2 billion). The application of the new measure would therefore ensure that at least 34 per cent of the €9 billion of such appropriations, or about €3 billion, would be allocated to the southern regions, part of which – based on historical data – would have gone to these regions anyway. It must be borne in mind, however, that the appropriation of resources in the State budget is not in itself a guarantee of actual disbursement, due to difficulties in the implementation of spending programmes by local authorities, in particular in these regions, where various indicators point to major implementation issues. Strengthening the efficiency and effectiveness of government entities in general, with specific attention to the South, therefore appears to be an essential element of any support programme in favour of the southern Italy.

In the area of local government finance, various measures in the Budget Bill are designed to increase the spending capacity of local authorities, both by giving them additional resources, mainly for capital expenditure, and by expanding their ability to use their own resources. In addition to the allocation of long-term State transfers for all categories of territorial entity noted earlier, the bringing forward from 2021 to 2020 of the option for ordinary statute regions (OSRs) to use surpluses generated in past years and the restricted long-term fund financed by debt, in compliance with accounting rules only (Legislative Decree 118/2011), can also be included among the measures to support capital expenditure. Accordingly, the OSRs (like other territorial authorities beginning in 2019) would therefore be freed of the constraints established with Law 243/2012 on the use of these resources, giving them the possibility to use the surpluses present in their balance sheets. Government forecasts suggest the measure will have a relatively modest impact on the public finances over the next three years. The measures providing for the allocation of transfers to certain groups of entities, consistent with past practice (restoration of forgone revenue from municipal property tax, IMU, and municipal services tax, TASI, on primary residences, the provision for disputes and relations with special statute regions and funds for other specific local situations), and other measures aimed at increasing the spending capacity of local authorities with no change in State transfers are intended to support current expenditure. Examples are measures to improve tax collection (and consequently reduce provisions for doubtful accounts) and those permitting the renegotiation of local authority debt, with a view to reducing their interest expenditure and free up resources for other purposes.

Other measures impacting municipalities concern the reorganisation and simplification of certain taxes (unification of IMU and TASI and unified public land use fee), measures to facilitate the payment of trade payables (increasing the ceiling on treasury advances and revision of the penalties for failure to meet payment deadlines) and a lengthening of the transition to an equalisation mechanism based on standard requirements and fiscal capacities.

1 THE MACROECONOMIC ENVIRONMENT

1.1 *Recent economic developments*

1.1.1 The international economy

According to leading international forecasters, this year will close with the slowest rate of global GDP growth since 2009. World economic activity was sharply affected by trade tensions, which both directly reduced the volume of trade due to price changes and indirectly impacted trade through increased uncertainty. The forecasts for 2019 of the OECD, the European Commission and the International Monetary Fund (IMF) are substantially in agreement in expecting GDP growth of about 3.0 per cent. Their forecasts for 2020 differ, with the IMF projecting a slight acceleration (to 3.4 per cent) and the OECD and the European Commission expecting roughly the same pace of expansion as this year.

In the first three quarters of 2019, the annualised quarter-on-quarter growth rate of US GDP decreased, falling from 3.1 per cent in the first quarter to 2.1 per cent in the summer. While consumption and public spending contributed positively to growth, in line with the recent past, capital accumulation stagnated and the foreign component had a negative impact overall. In Europe, while France and Spain have proved to be more resilient, economic activity in Germany and Italy decelerated. Euro-area GDP growth is expected to slow from 1.9 per cent in 2018 to just over 1 per cent in 2019. Growth has also slowed in China (at around 6.0 per cent), while in Japan it is expected to remain close to the pace registered the previous year (just under 1.0 per cent). Among the emerging economies, Argentina and Venezuela are projected to contract in 2019, while growth in all the other major countries of Latin America as well as Russia and India is forecast to slow down.

International trade is weakening, affected by the US trade policy of imposing duties on goods produced by the trade partners with which it has the most unfavourable current account balance. The world trade index compiled by the Dutch Central Planning Bureau (CPB) registered a deterioration in year-on-year growth, from 5.0 per cent at the beginning of 2018 to a contraction last summer. According to major international institutions, world trade in 2019 should grow by just over 1.0 per cent, thus displaying an apparent elasticity of between 1/3 and 1/2, compared with historical averages above 1 (Table 1.1). Talks between US and Chinese authorities, in order to prevent the imposition of additional duties by the United States in mid-December, have resumed in recent weeks. The American authorities are pushing for an agreement that will offer better protection for intellectual property rights and commit China to increasing imports of agricultural products. Negotiations are proceeding haltingly, marked by a series of interruptions and resumptions, so uncertainty remains high. However, both sides appear to be willing to come to an agreement.

Table 1.1 – World trade

	Percentage growth rates			Differences with previous forecasts		
	2019	2020	2021	2019	2020	2021
MEF [1] (15 October)	1.5	1.9	-	-0.8	-2.0	-
European Commission (7 November)	1.4	2.3	2.6	-1.6	-1.1	-
International Monetary Fund (15 October)	1.1	3.2	-	-1.4	-0.5	-
OECD (21 November)	1.2	1.6	2.3	-0.9	-1.5	-

Source: MEF, European Commission, IMF and OECD.
(1) For the MEF, the figures regard growth in Italy's key foreign markets. Differences with previous forecasts are calculated on the basis of the 2019 Update.

The international assumptions of the Ministry for the Economy and Finance (MEF) in the macroeconomic scenario in the DBP, which were unchanged respect to those adopted in the Update, took account of the slowdown in global production and trade, and thus show a revision of the projections for Italy's foreign demand downwards compared with the 2019 Economic and Financial Document (EFD).

Net of spikes connected with specific terrorist activity, since last spring oil prices have fallen by about 20 per cent, to just over $60 per barrel in November. The underlying dynamics reflected both the reduction in demand, which was affected by weakening economic growth, and the expansion of supply from alternatives to traditional extraction, in particular shale oil. In the DBP, the MEF assumed an average Brent price for 2019 of $63.3 per barrel, which appears close to the effective average in the first eleven months of the year ($64). Forward prices point to a weakening in Brent prices in 2020, but to a slightly higher level than the assumption in the DBP ($60.2 against $57.3 per barrel).

The euro depreciated slightly against the US dollar in 2019. The exchange rate went from $1.15 per euro in the early days of the year to €1.09 at the end of September; the European currency subsequently posted a small recovery (to almost €1.12 per euro), but in November the dollar strengthened again despite the additional cut in the target for the federal funds rate. For the first eleven months of the year, the dollar-euro exchange rate averaged €1.12, substantially in line with the value (€1.11) assumed in the DBP in October for the entire forecast horizon.

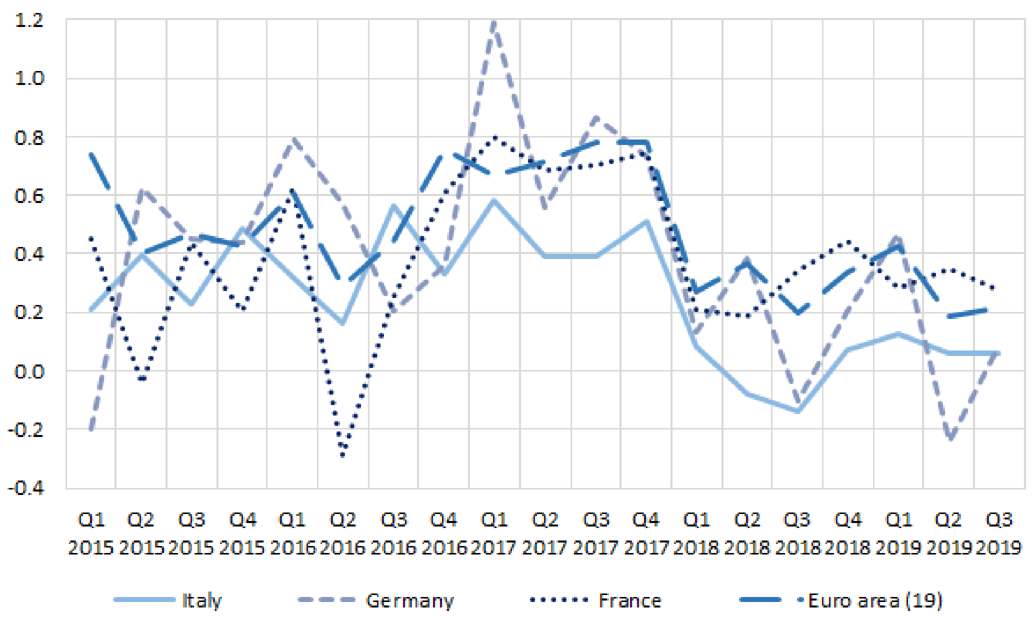
1.1.2 The Italian economy

In 2019, the Italian economy expanded very slowly, confirming the negative growth gap with the main European countries (Figure 1.1). On the supply side, Italy's national accounts data for the first three quarters show weak performance in industry excluding construction, compared with a slight recovery in services and a more marked improvement in construction. In the same period, private consumption increased at a slightly slower pace than in 2018, while investment spending slowed more significantly. The weakness of global trade has not led to a slowdown in exports, except for an interruption in the summer. However, the contribution of net foreign demand to growth was partially offset by the recovery in imports.

Industry excluding construction continued to weaken this year, continuing the trend under way since the end of 2017. At the same time, there has been a progressive decline in the number of sectors experiencing growth, as reflected by developments in the PBO's diffusion index. The deterioration in manufacturing activity also emerged in business surveys, both the confidence survey conducted by Istat and the for the PMI, both of which worsened during the year. In market services and construction, confidence remained at levels not far from those seen at the end of 2018, while confidence in the retail sector gradually strengthened.

The economic indicators developed by various institutions agree in delineating weak economic conditions. Since the beginning of the year, the Bank of Italy's coincident index of underlying growth (ITA-coin) has been constantly negative, while Istat's leading indicator has continued the decline under way since the end of 2017, although the trend has been less unfavourable recently.

Figure 1.1 – GDP growth in the euro area and in its three largest economies
(percentage change on previous period)



Source: Eurostat.

The weakness of cyclical conditions is reflected in short-term forecasts. For the final part of the year, the PBO models estimate slightly positive GDP growth on yearly basis, albeit with downside risks mainly attributable to the manufacturing sector. Overall, in 2019 GDP is forecast to increase by 0.2 per cent, marginally above the projections in the 2019 Update to the Economic and Financial Document (the Update). Taking account of these estimates, the statistical carry-over into 2020 would be 0.1 per cent. Next year, GDP growth as registered in the annual accounts will be sustained slightly by two additional working days.

Despite the modest pace of economic expansion, the labour market has continued to improve over the course of the year. The demand for labour, expressed in terms of the number of payroll employee positions on the basis of existing employment contracts, increased in the first ten months of the year compared with the average for 2018. Labour supply, measured by the total number of hours worked in the national accounts, showed positive growth in the third quarter of 2019, but expanded by less than the increase in the number of payroll employees. This development, together with the more modest increase in value added, produced a slight drop in productivity. Considering the evolution in compensation of employees and productivity, unit labour costs increased slightly compared with 2018.

Price inflation eased in Italy, remaining well below that for the euro area.[1] Consumer price inflation fell to very low levels in the summer, remaining low in November as well (0.4 per cent for the national index, up from 0.2 per cent in October).

Compared with October, the prices of processed food and non-durables accelerated and the decrease in durables prices slowed. The prices of transport services, which are more heavily influenced by seasonal factors, slowed down. The slight rise in core inflation that began at the end of the summer continues. The core inflation index, which is calculated net of the prices of energy products and unprocessed food, increased by 0.3 percentage points in November.

Inflation already acquired for 2019 as a whole amounted to 0.6 per cent for the general index and 0.5 per cent for core inflation. The stagnation in inflation also reflects the absence of pressure from the upstream segment of the production process: both import prices and producer prices in industry and construction have been falling since the summer. The inflation expectations of firms and households as measured in Istat’s confidence surveys remain cautious.

[1] An analysis of the determinants of Italian inflation in the last decade is provided in the box “A decade of low inflation in Italy: a counterfactual exercise” in the Report on Recent Economic Developments - October 2019 of the PBO.

1.2 The macroeconomic forecasts

1.2.1 The Government scenario

The macroeconomic scenario in the DBP confirms the policy scenario published in the Update in September: Italy's real GDP is forecast to increase by 0.1 per cent this year and 0.6 per cent in 2020 (Table 1.2). The macroeconomic data released after the publication of the Update confirmed earlier signs of cyclical weakness, albeit with some positive surprises. In the third quarter of the year, GDP increased by 0.1 per cent on the previous quarter (as indicated in the PBO's Report on Recent Economic Developments in October) and upward statistical revisions were made, thanks to which growth already acquired for 2019 increased.[2] The most recent economic indicators would seem to signal the continuation of very slow growth in the final part of the year (as reported in section 1.1.2), such that GDP growth for 2019 as a whole is expected to total 0.2 per cent, slightly higher than the Government's forecast.

In the DBP, GDP growth for 2019 is expected to be driven by both domestic demand net of inventories and net foreign demand (both would contribute 0.6 percentage points to growth), countered by a substantial decrease in inventories (which would subtract 1.1 points of GDP). As regards inflation, the GDP deflator is expected to rise by 0.9 per cent this year, a pace similar to that in 2018. Nominal GDP, a key variable for public finance measures, is projected to expand by 1.0 per cent. These estimates are broadly consistent with the information available about developments during the year in the components of demand and in inflation.

Table 1.2 – The macroeconomic scenario in the Update

	2019		2020		2021		2022	
	Trend	Policy	Trend	Policy	Trend	Policy	Trend	Policy
GDP	0.1	0.1	0.4	0.6	0.8	1.0	1.0	1.0
Contributions to GDP growth								
Net exports	0.6	0.6	0.1	0.1	0.0	-0.1	0.0	0.0
Inventories	-1.1	-1.1	-0.2	-0.2	0.1	0.1	0.1	0.2
Domestic demand net of inventories	0.6	0.6	0.5	0.8	0.7	0.9	1.0	0.8
GDP deflator	0.9	0.9	1.9	1.3	1.5	1.7	1.5	1.7
Nominal GDP	1.0	1.0	2.3	2.0	2.3	2.7	2.5	2.6

Source: 2019 Update.

[2] The Report on Recent Economic Developments – October 2019 of the PBO discusses the revisions made to the GDP time series and reports the figure for the third quarter.

For 2020, the MEF forecasts GDP growth of 0.6 per cent, two-tenths of a point more than the trend scenario. Stronger growth in both private consumption and investment contributes to the acceleration. Household consumption is expected to be buoyed by the improvement in real disposable income, mainly resulting from the impact on prices of the deactivation of the indirect tax increases provided for in the safeguard clauses (the consumption deflator falls by 1 percentage point compared with the trend macroeconomic scenario). Measures to support private investment (the national Enterprise 4.0 plan and tools to support innovation for small and medium-sized enterprises) and greater resources for public investment also help foster the process of capital accumulation (0.6 percentage points greater than the change indicated in the trend macroeconomic scenario), especially for machinery, equipment and transport equipment. The largest contribution to the growth in final domestic demand compared with the trend macroeconomic scenario is associated with an unchanged contribution from foreign demand. The deactivation of the safeguard clauses in 2020 affects the consumption and GDP deflators, which decrease, respectively, by one point and six-tenths of a point compared with the trend scenario. The combination of faster real growth and a lower GDP deflator produces a slightly smaller variation (by three-tenths of a point) in nominal GDP in 2020 compared with that in the trend macroeconomic scenario.

The DBP also confirms the forecasts in the Update's policy scenario for 2021-2022. Real GDP growth of 1.0 per cent is projected for both 2021 (two-tenths of a point faster than the trend) and 2022, which is in line with the trend figure despite the slight fiscal tightening. In 2021, the acceleration in foreign trade sustains exports. Imports expand more rapidly, boosted by the recovery in domestic demand, so the contribution of net exports to GDP growth is negative (-0.1 percentage points), compared with nil in the trend macroeconomic scenario. By contrast, the components of domestic demand make a larger contribution to growth in 2021 than in the trend scenario. Private consumption benefits from the partial deactivation of the safeguard clauses, and general government expenditure begins to increase again after a two-year decline. Investment expands considerably compared with the scenario on an unchanged legislation basis (0.6 percentage points), with both the machinery and construction components contributing. In 2022, consumption increases less than in the trend macroeconomic scenario, reflecting the loss of purchasing power attributable to the budget package and higher inflation. However, the contribution of inventories to growth compensates for the weaker impulse of household spending. Nominal GDP growth significantly outpaces that in the trend scenario (four-tenths of a point) in 2021, and is almost in line with it in 2022. In 2021, the faster nominal growth compared with the trend macroeconomic scenario reflects the more robust rises in both real GDP and consumer prices, resulting from the shifting forward of the safeguard clauses. The change in the GDP deflator is two-tenths of a percentage point greater than in the trend scenario in both 2021 and 2022.

1.2.2 *The endorsement exercise and the effects of the budget measures*

The PBO performed its regular endorsement exercise for the MEF's macroeconomic forecasts published in the 2019 Update, which comprised a trend scenario on a current legislation basis and a policy scenario that incorporates the effects of the economic policies that the Government will specify in the Budget Act. The exercise was conducted by the PBO with the usual methodology, based on a comparison of the MEF scenarios with four separate forecasts, using shared assumptions for the international exogenous variables and the public finance measures. The time horizon of the exercise includes the current year and the following one, while a non-binding assessment is provided for the 2020-2021 period.

The endorsement exercise for the Update is performed on the basis of a comprehensive analysis of the MEF's macroeconomic scenarios, drawing on a variety of information sources: 1) the PBO forecasts for short-term developments in GDP and the components of demand; 2) the annual forecasts obtained by the PBO using the PBO-Istat econometric model, applied within the scope of the framework agreement with that institution; 3) the annual forecasts produced by the independent forecasters (CER, Prometeia and REF.ricerche) that make up the PBO forecasting panel; and 4) monitoring of the most recent projections available from other national and international institutions. The overall assessment, based on these instruments, takes account of the uncertainty that characterises forecasting. In order to perform a like-for-like comparison with the MEF's projections, the forecasts of the PBO panel members (including the PBO's projections) are formulated on the basis of the same assumptions for exogenous international variables adopted by the MEF, whose reliability is also assessed. In addition, for the policy scenario, the PBO panel based their estimates on the same assumptions used for the budget package, developed by the PBO taking account of the Update and information received from MEF on the differences between the public finance assumptions incorporated in the policy scenario and those in the trend scenario.

The PBO transmitted its endorsement of the 2019-2020 trend macroeconomic scenario on 23 September,[3] emphasising however a number of factors of uncertainty concerning real GDP growth, in particular for 2020. This occurred after the PBO had communicated (on September 16) its findings regarding a provisional version of the MEF's trend scenario, which was followed by the preparation of a revised macroeconomic scenario, which was endorsed.

The growth forecast for the Italian economy in 2019 (0.1 per cent) falls at the upper bound of the panel's forecast range and is marginally higher than the median value. The MEF's trend forecast for GDP growth in 2020 (0.4 per cent) is substantially in line with the median of the PBO panel projections. In the two-year time horizon of the endorsement exercise, the developments in the main variables of the sources and uses account are broadly consistent with the expectations of the PBO panel forecasters, with the exception of investment in assets other than construction, for which the forecast variation for this year exceeds the upper bound of the panel estimates. The 2019

[3] The endorsement letter is available at: http://en.upbilancio.it/wp-content/uploads/2019/10/Lettera-di-Validazione-e-Allegato_EN.pdf.

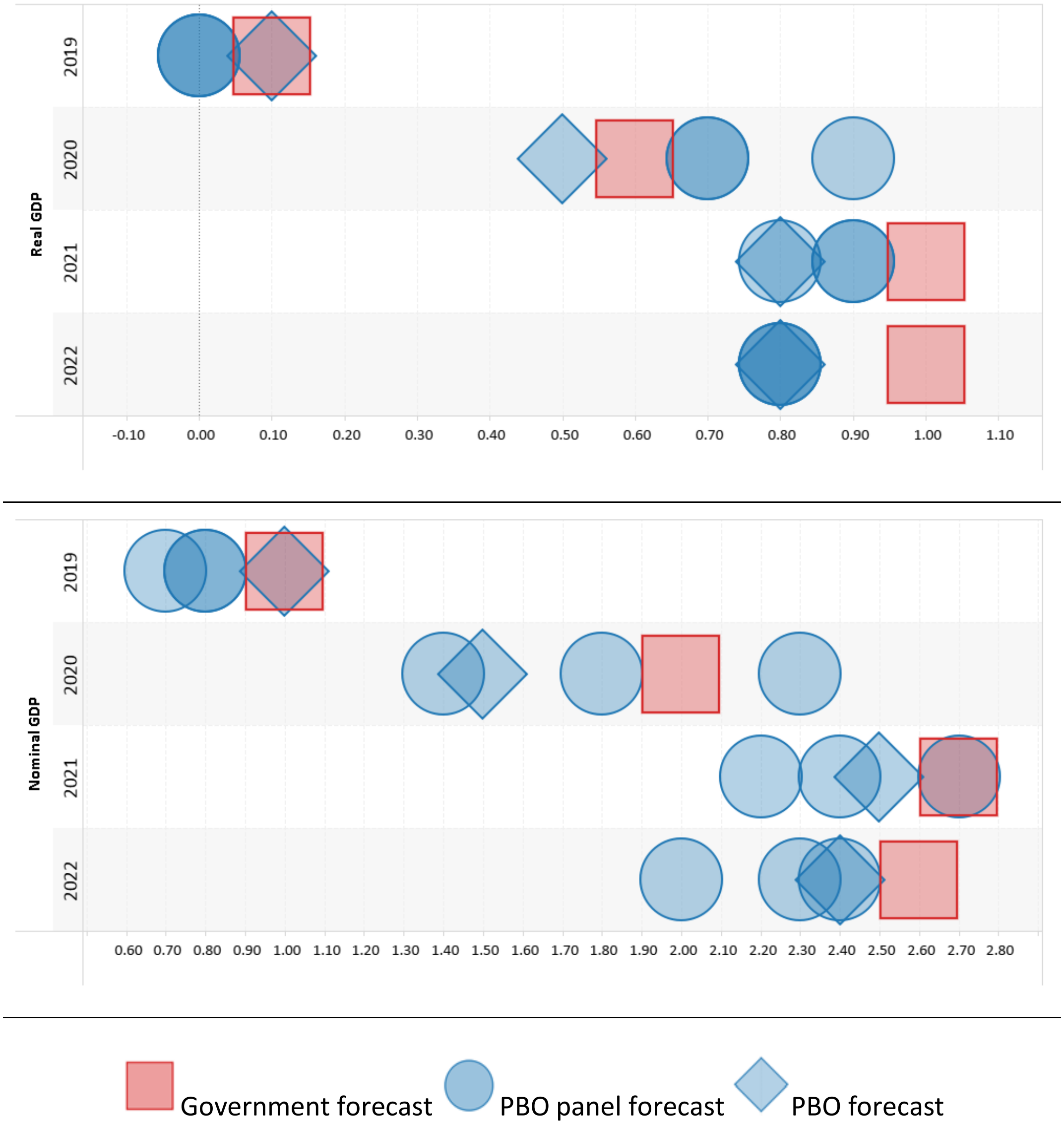
forecasts for labour market variables also fall within the range of variation of the PBO panel.

The forecasts for costs and prices in the Update's trend macroeconomic scenario of the Update are slightly optimistic for the two-year endorsement horizon. The change in the GDP deflator forecast for this year lies at the limit of acceptability of the PBO panel estimates. The result is a nominal GDP growth rate in the Update macroeconomic scenario – a variable directly relevant for the public finances – which lies at the upper bound of the PBO panel estimates. In 2020, the price variables of the MEF's trend macroeconomic scenario incorporate the impact of the activation of indirect tax increases provided for in current legislation. The forecast changes in both the GDP and consumption deflators fall within the interval of projections produced in the endorsement exercise, although they are higher than the PBO panel median value. The change in nominal GDP in the Update trend scenario also lies within the panel variation interval.

Overall, the trend scenario in the Update for 2019-2020 appears acceptable. However, there are risks, mainly on the downside, at both short and medium term. These risks are largely associated with developments in international variables attributable to uncertainty surrounding economic policies. The ongoing trade war between China and the United States appears to be continuing, although there have recently been some signs of an easing of strains. Europe remains affected by uncertainty over Brexit, although the forthcoming elections could stabilise expectations for the timing and implementation of the United Kingdom's exit. In the United States, investors continue to discount an end to the long real expansion, although there is uncertainty about its timing. The limited scope available for economic and monetary policies to counter a possible recession would induce a rapid increase in the risk aversion of investors. The consequent increase in risk premiums for issuers with low credit ratings would have a significant impact on the Italian economy.

The endorsement exercise for the policy scenario in the Update concerns 2020, when the budget measures would have an impact. The developments in the 2019 policy forecasts, which are not affected by the budget package, coincide with the trend developments. The Update's policy scenario was subsequently incorporated into the Draft Budgetary Plan (DBP). The PBO performed an overall assessment of the government's macroeconomic forecasts for next year, deciding to endorse the Update's policy scenario, which falls within an acceptable range (Figure 1.2). The policy forecast in the Update for the growth of the Italian economy in 2020 (0.6 per cent) is in in line with the projections of the panel of PBO forecasters and close to the median of the panel's forecasts.

Figure 1.2 – Update policy forecasts and PBO panel projections for real and nominal GDP growth



There are divergences among forecasters for certain components of GDP. The expansion of national final consumption spending (0.5 per cent) is similar to the median of the PBO panel forecasts. Investment in capital goods also falls within the range of panel projections, but a discrepancy emerges for investment excluding construction. An additional difference between the policy macroeconomic scenario of the Update and the forecasting range produced by the panel is found for imports of goods and services, where the projection appears to be beneath the lower bound of the panel range. With developments in exports in the Update's macroeconomic scenario that are compatible with the panel estimates, the contribution of net foreign demand to GDP growth is positive (0.1 per cent) in the macroeconomic scenario, but is negative for most of the panel forecasters.

The forecast for price developments in the policy macroeconomic scenario in the 2020 Update seems slightly optimistic. The rise in the GDP deflator is at the limit of acceptability of the PBO panel forecasts, although the latter have a relatively large dispersion due to the uncertainty of the impact of the safeguard clauses. The Update projection for the household consumption deflator is broadly in line with the median of the PBO panel. The optimistic assessment of the GDP deflator in the macroeconomic scenario of the Update would therefore seem to reflect the estimates for the terms of trade. The change in the export deflator is lower than the upper bound of the panel projections, while there is a divergence in that for the import deflator, where the variation exceeds the panel upper bound (by three-tenths of a percentage point). This contrasts with the deceleration (or relative stability) seen in the PBO panel consensus. Furthermore, the slight deterioration in terms of trade in conjunction with a larger variation in the GDP deflator than that in the consumption deflator (by three-tenths of a point) would indicate that the deflators of the other components of demand are accelerating sharply.

Overall, while real growth in the macroeconomic policy scenario of the 2020 Update is substantially in line with the median of the PBO panel projections, that in the GDP deflator is approaching the upper bound of the panel's forecasts. The result is a projection for nominal GDP growth in 2020 that lies midway between the median and the upper bound of the panel's forecasts.

Ultimately, the assessments in favour of the plausibility of the policy macroeconomic scenario of the Update appear supported by: a) a policy forecast in the Update for the growth of the Italian economy for 2020 that is in line with the estimates of the panel of PBO forecasters and close to median value of the panel forecasts; b) an estimate in the Update for the impact of the budget package on economic activity in 2020 that is similar to that produced by the PBO panel; and c) nominal GDP growth that is higher than the median of the panel forecasts but does not exceed the upper bound, thanks to a change in the GDP deflator that lies within the interval of acceptability delineated by the PBO panel forecasts.

Another consideration is that the government's forecast for GDP growth implies an acceleration between 2019 and 2020, an assessment shared by the PBO panel forecasters, albeit with appreciable differences in magnitude. The quarterly revenue and expenditure accounts released after the preparation of the macroeconomic scenarios of the Update and the PBO panel also led to a slight upwards revision of growth acquired for 2019 as a whole (as indicated in section 1.2.1).

This scenario is affected by a number of risk factors, which were discussed with reference to the trend scenario and whose potential impact is amplified in the Update policy forecasts for 2021-2022. This period, which lies outside the horizon of the endorsement exercise, shows non-negligible divergences in both real and nominal variables. In 2021, the Government's macroeconomic scenario puts real GDP growth above the upper bound of the PBO forecasters (by a tenth of a percentage point) and this gap widens in 2022 (two-tenths of a point). In the final year of the forecast, divergences also emerge for nominal variables. The increase in the consumption deflator exceeds the upper bound of the panel forecasts (by a tenth of a point), with an impact on the GDP deflator, which shows an equivalent disparity. The faster growth in real GDP and the corresponding deflator are combined in the rate of change in nominal GDP, which is above the upper bound of the PBO panel forecast (by two-tenths of a point).

Assessment of the macroeconomic impact of the budget package

The PBO has evaluated the impact of the budget package (Decree Law 124/2019 and the 2020 Budget Bill) on GDP growth, using the MeMo-It annual econometric model.

The measures considered are organised into six main categories: deactivation of the safeguard clauses, measures in support of firms and the self-employed, measures for families and the fight against poverty, expenditure on public investments and investment grants, measures to combat tax evasion and other fiscal measures. Measures not directly attributable to the above categories are grouped in a residual aggregate (other measures). In order to interpret the findings correctly, note that the resources to fund the measures are included within the categories indicated above. Accordingly the estimated macroeconomic effects regard the net balances for each category.

The first category contains the reprogramming of the indirect taxes included in the safeguard clauses, which are neutralised in full in 2020. The expansionary effect on GDP for next year is equal to 0.3 percentage points.

The measures in favour of firms and the self-employed stabilise the “Industry 4.0” tax incentives, including the extension of the tax credit for spending on training activities for employees and the refinancing of the tax relief envisaged under the “New Sabatini” investment grant mechanism. The measures also extend both the hyper-depreciation and super-depreciation mechanisms (which increase the depreciation allowance) to include 2020-2022. A number of the funding measures impact banks, with a freeze for the 2019 tax period of a series of deductions, while others include the revaluation of unlisted equity investments and land. In addition, the flat-rate taxation mechanism for self-employed workers and sole proprietors with revenues of between €65,000 and €100,000 is also repealed, while those who have received income from employment or comparable income in excess of €30,000 are no longer eligible. The impact of these measures on GDP growth in 2020 would be essentially neutral.

The measures regarding families and the fight against poverty include, among other things, the reduction of the tax wedge for workers, the unification of family support policies in a single allowance, measures to boost the birth rate, the facilitation of access to childcare, and assistance for disabilities and non-self-sufficiency. These would be funded by the savings from smaller-than-expected participation in the "*Quota 100*" mechanism introduced with Decree Law 4/2019 as well as the revision of tax relief on company cars. The effect on GDP growth of the measures for families would be negligible, while the set of measures for families and firms would increase GDP in 2020 by about half a tenth of a percentage point.

The resources for public investment and investment grants are intended to revive central government investment and increase the energy efficiency of schools and public buildings at the municipal level. The associated funding measures would reduce both the capital expenditure of ministries and financing for healthcare facility construction. The joint impact of these measures on real growth in 2020 is marginally negative.

The measures to counter tax evasion involve the fight against fraud and tax offenses relating to VAT and excise duties and provisions that make certain personal income tax credits conditional on making payments with traceable instruments. At the same time, greater resources are provided to foster the use of electronic payment instruments. The other tax measures considered in this category concern the extension of personal income tax credits for spending on building renovations and energy upgrading and a large credit for expenditure on building façade repairs. Funding measures include the introduction of new taxes on the consumption of single-use plastic products and sweetened beverages, and an increase in the taxation of gaming and tobacco products. Finally, other spending measures provide for an increase in various funds, including that for urgent interventions and, on the funding side, an increase in the savings deriving from the reduction of the current expenditure of ministries over the three-year programming period. Taken together, the measures to combat tax evasion and other measures (tax and non-tax) would decrease GDP by one-tenth of a percentage point next year.

Overall, these assessments show the budget measures adding about 0.2 percentage points to GDP in 2020, similar to the MEF estimate in the DBP.

Box 1.1 – A systemic approach to estimating the output gap of the Italian economy

Estimates of the potential output and the corresponding output gap of an economy play a key role not only in inflation forecasts and assessing the economic cycle, but also in the fiscal governance of the European Union. These variables are in fact essential elements of both the preventive and corrective arms of the Stability and Growth Pact.

National fiscal councils invest in analysing potential output and output gap for several reasons. The quantification of potential growth is helpful in assessing the long-term sustainability of the public debt. In the medium term, moreover, estimating the output gap is necessary to evaluate the fiscal stance of budget policy, as well as to obtain price forecasts. Finally, in the short term, the estimated gap identifies the cyclical position of an economy. In the specific case of the institutional duties of the PBO, although the estimate of potential output formulated by the Government is not subject to endorsement, as is the case with actual output, it still undergoes evaluation.

However, potential output is an unobservable variable for which statistical institutes do not issue official measures, and can only be estimated with a very large degree of uncertainty. Empirical measures vary widely depending on the econometric approach adopted, as well as the specification chosen and the data used, both historically and looking forward. To estimate potential output, it is possible to use purely statistical models, which do not involve strong hypotheses about economic relationships but rather focus on the properties of time series, as in the case of the Hodrick and Prescott filter (1997).[4] Alternatively, potential output can be estimated using models that incorporate economic theory, as in the case of methods based on the production function, or with structural models that consider short-term frictions (Paris and Siviero, 2001;[5] Vetlov et al., 2011[6]). The approaches can be combined, producing hybrid models in which, for example, the production function is estimated by jointly extracting the unobservable components of the time series (Proietti et al., 2007;[7] ECB, 2018[8]). Another strand of analysis, although less widely explored in the literature, is characterised by the use of large databases. For example, Szörfi and Tóth (2018)[9] use information drawn from short-term surveys on production capacity, Fantino (2018)[10] produces estimates for Italy using firm-level data, and Murray (2014)[11] uses principal components analysis to combine a large number of indicators.

For any given econometric approach, there are various possible combinations in the econometric specification, often equally acceptable from a statistical point of view, which lead to different estimates of potential output (Jarociński and Lenza, 2016;[12] Frale and De Nardis, 2018[13]). Finally, even with the same specification, the choices of the initial conditions of the estimates and the restrictions in stochastic processes may also lead to very different measures of potential output

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4 Hodrick, R. J., and Prescott, E. C. (1997, "Postwar US business cycles: an empirical investigation", *Journal of Money, Credit, and Banking*, 1–16.

5 Parigi, G., and Siviero, S. (2001, December), "An investment-function-based measure of capacity utilisation: Potential output and utilised capacity in the Bank of Italy's quarterly model", *Economic Modelling*, *18*(4), 525-550.

6 Vetlov, I., Pisani, M., Hlédik, T., Jonsson, M., and Kucsera, H. (2011), "Potential output in DSGE models" *Working Paper Series*, European Central Bank, No. 1351, June.

7 Proietti, T., Musso, A., and Westermann, T. (2007), "Estimating potential output and the output gap for the euro area: a model-based production function approach", *Empirical Economics*, 33(1), 85–113.

8 ECB (2018). *ECB economic bulletin*, 7 (Vol. 7). European Central Bank.

9 Szörfi, B., and Tóth, M. (2018). "Measures of slack in the euro area", *Economic Bulletin Boxes*, *3*.

10 Fantino, D. (2018,), "Potential output and microeconomic heterogeneity" Temi di discussione *Working Papers* No. 1194, November, Bank of Italy, Economic Research and International Relations Area.

11 Murray, J. (2014), "Output Gap measurement: judgement and uncertainty" *OBR Working paper* (5).

12 Jarociński, M. and Lenza, M. (2016), "An inflation-predicting measure of the output gap in the euro area", *Journal of Money, Credit and Banking*.

13 Frale, C. and De Nardis, S. (2018), "Which Gap? Alternative Estimations of the Potential Output and the Output Gap in the Italian Economy", *Politica economica*, *34*(1), 3–22.

(Fioramanti, 2015;[14] Fioramanti and Waldmann, 2017[15]). In addition to the econometric approach and specifications, the estimates of potential output are strongly influenced by the uncertainty deriving from both the historical data, which are periodically revised, and from the forecasts for the variables that may be used as inputs in the models for potential output. As a result, the use of the output gap for economic policy decisions could lead to choices that are inappropriate ex post (Orphanides and Van Norden, 2002).[16]

The output gap measures used at the European level by the Member States and by the European Commission, which are based on an agreed methodology that uses a production function (Common Agreed Methodology – CAM) also differ appreciably from those of other international organisations, such as the IMF and the OECD, which however use analogous approaches. The estimates obtained using the CAM have been criticised as excessively pro-cyclical and unstable in real time. In the specific case of Italy, the MEF observed that the values obtained with CAM are not always interpretable from the point of view of economic theory and also depend highly on the choice of parameters for the initialisation of the estimates (as documented in the box on potential output in the 2018 EFD).

The PBO has already conducted research into potential output in the past (Fioramanti et al.,[17] 2015; Frale and De Nardis, 2018[18]). With the experience of these studies, a research project was carried out to give the PBO its own model for estimating potential output and the output gap of the Italian economy.[19] Despite numerous attempts with different models and estimation methods, it has not been possible to identify a single instrument that is superior to the others in its statistical properties, economic interpretation or stability over time. It was therefore decided to select multiple instruments on the basis of performance in relation to different metrics. Specifically, five models were adopted. The simplest links the gap to inflation (a bivariate model, with decomposition into unobservable components augmented with the Phillips curve), the second considers unemployment (a trivariate model, which also represents Okun's law) and the third explicitly takes account of the structural changes that occurred during the double-dip recession in the Italian economy. A multivariate model with non-observable components was also adopted, which replicates the approach used with the CAM production function but differs in that the variables are estimated simultaneously. Finally, a univariate statistical filter was applied, the parameters of which were drawn from the estimation of the bivariate model on the Phillips curve.

The use of multiple tools makes it possible to take account of a variety of methods proposed in the literature and therefore to economically interpret the estimates obtained in the light of different theories. The heterogeneity of the estimates also enables the calculation of uncertainty measures. The econometric specifications were selected by taking account of statistical properties as well as real-time stability. Moreover, the estimates do not depend on constraints or parameters specified a priori.

Since it is necessary to make institutional economic policy choices on the basis of indicators that are subsequently revised as little as possible, the stability of the estimates produced by the models was assessed in real time, i.e. considering the set of information flows that became

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[14] Fioramanti, M. (2015), "Potential Output, Output Gap and Fiscal Stance: is the EC estimation of the NAWRU too sensitive to be reliable", *Italian Fiscal Policy Review* (1).

[15] Fioramanti, M. and Waldmann, R. J. (2017), "The Econometrics of the EU Fiscal Governance: Is the European Commission methodology still adequate".

[16] Orphanides, A. and Van Norden, S. (2002), "The unreliability of output-gap estimates in real time", *The Review of economics and statistics*, *84*(4), 569–583.

[17] Fioramanti, M., Padrini, F., and Pollastri, C. (2015), "La stima del PIL potenziale e dell'*output gap*: analisi di alcune criticità", *Nota di lavoro UPB* (1).

[18] See Note 10

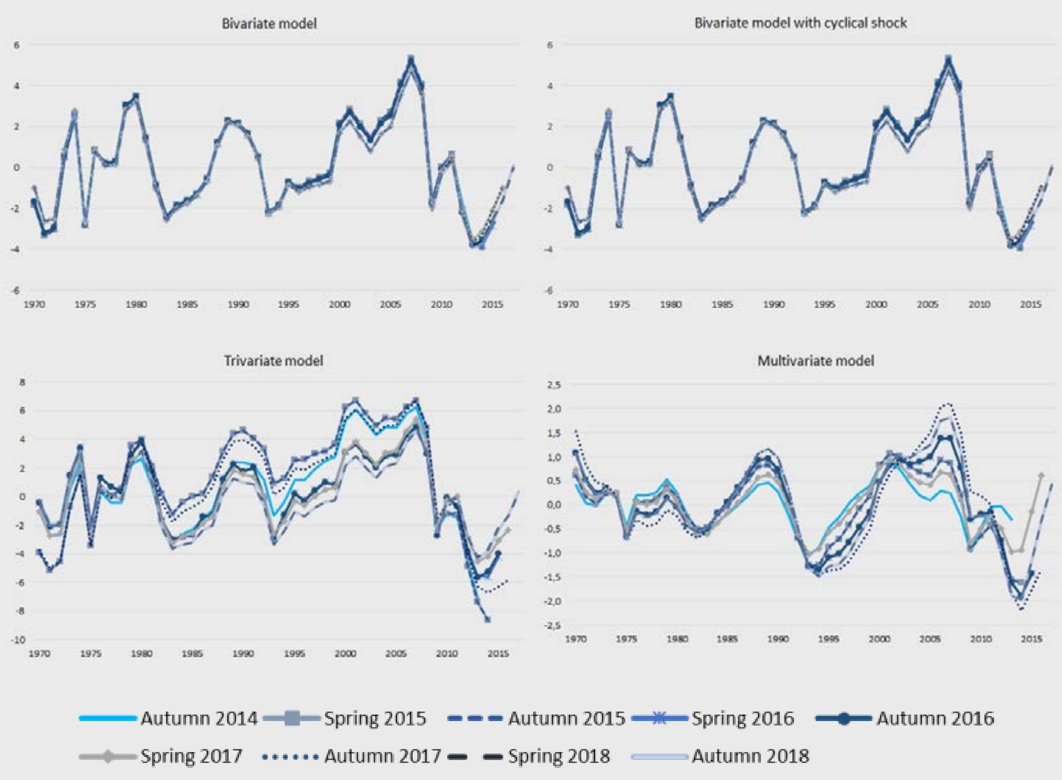
[19] The main results of the study are reported in Proietti, T., Fioramanti, M., Frale C. and Monteforte L. (2019) "Un approccio sistemico per la stima dell'output gap dell'economia italiana", *Nota di Lavoro UPB*, forthcoming.

available historically. Figure B1.1.1 clearly shows that the two bivariate models, with and without a temporal shock, are very stable. The unemployment rate series, on the other hand, is difficult to break down into a cyclical and trend component and therefore induces greater instability in the output gap in the models that include it, namely the trivariate and multivariate.[20]

All the proposed specifications are underpinned by an economic relationship, such as the Phillips curve or Okun's law.[21] A criterion for evaluating them can therefore be based on the ability of the different models to represent the underlying theory in a stylised manner and to project it forward.

Since the models share the fact that they consider the Phillips curve more or less explicitly, we performed a simple exercise to assess inflation forecasts, based on the different output gaps obtained. With the exception of the trivariate model, the models developed (Table B1.1.1) all predict better than the benchmark (random walk), while the most accurate model is the multivariate, especially after 2014. The forecasts appear distorted (ME), downwards in most cases, due to the sharp drop in inflation in the period under consideration.

Figure B1.1.1 – PBO estimation of the output gap with various real-time models



[20] The multivariate model is the least stable, especially in the last decade, when the volatility of the economic cycle increased. The complexity of the specification generally makes the estimations more difficult.

[21] There is a relationship with prices even in the case of the univariate filter, albeit an indirect one, as the filter parameters depend on the estimation of the Phillips curve.

Table B1.1.1 – Inflation forecast error for 2012-18 sample (1)

	Random Walk	Bivariate	Bivariate with shock	Trivariate	Multivariate
ME	0.5	-0.3	-0.2	-0.7	0.2
MAE	0.7	0.5	0.6	0.8	0.4
RMSE	0.9	0.6	0.7	1.0	0.5

Source: based on Istat/Eurostat data.
(1) ME – Mean Error; MAE – Mean Absolute Error; RMSE – Root Mean Squared Error.

In institutional use by the PBO, the potential output models incorporate the output of other internal tools. As part of the endorsement process, the PBO develops medium-term macroeconomic forecasts with the Memo-It econometric model, taking account of the short-term information from nowcasting modelling.[22] These forecasts for growth, inflation and the labour market are then incorporated in the estimates of potential output and the output gap.

The proposed models are also combined to quantify the uncertainty that characterises the individual measures obtained. Borrowing the method adopted for the endorsement of the macroeconomic scenario, it is in fact possible to obtain a range of variation defined by the maximum and minimum values, as well as a specific composite measure.

Figure B1.1.2 compares the output gaps recently obtained by major international institutions and the MEF with the median, maximum and minimum values of the PBO estimates. The underlying macroeconomic scenario is similar between the various institutions, especially in 2019, for which GDP growth (between 0.1 and 0.2 per cent) is estimated with only a minimal difference. The median of the estimates given by the PBO models does not differ considerably from the European Commission time series: the turning points are substantially aligned, but the output gap tends to be wider (both positively and negatively), since the PBO’s potential output is less pro-cyclical. However, the values estimated by the European Commission generally lie within the range between the maximum and minimum value of the PBO models.[23] The estimates of the MEF in the last Update, which are publicly available for a narrower time interval, lie within or only just outside the confidence interval up to 2019, while the differences with the PBO estimates widen starting from 2020.

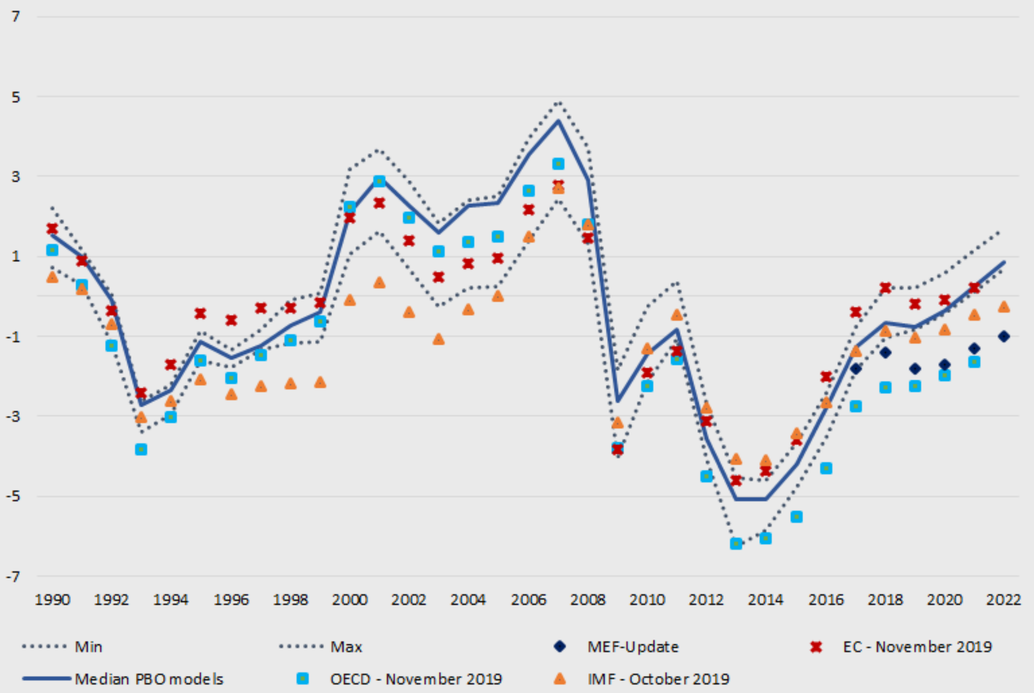
Finally, the time series of the OECD and IMF gaps are mainly located within the range delineated by the PBO models, in particular between the early 2000s and 2017 (in the previous period the fluctuation bands are very small). In the forecasting years, the OECD profile is more similar to that of the MEF, while the IMF’s estimates are close to the median values produced by the PBO models.

In conclusion, the new PBO models of potential output are characterised by the low pro-cyclicality of the estimates, which also explains their stability in respect of preliminary data. In addition, the output gap measures obtained make it possible to predict inflation with a limited error. The specifications adopted are parsimonious from an econometric point of view, but the multiple models make economic interpretation possible on the basis of more than one theory. The estimation techniques do not require special restrictions on the parameters. The estimates and forecasts of the output gap recently development by other organisations tend to lie within the confidence interval calculated on the basis of the proposed models.

[22] See “Gli strumenti di previsione macroeconomica dell’UPB” at (http://www.upbilancio.it/wp-content/uploads/2018/01/Nota-tecnica-previsione-macro-UPB.pdf .

[23] It should be noted that from the point of view of compliance with the recommendations of the preventive arm of the SGP, what counts is the adjustment towards the medium-term objective, which is measured by the change in the structural balance.

Figure B1.1.2 – A comparison of recent estimates of the output gap



Source: based on data from the European Commission, the IMF, the MEF and the OECD.

2 PUBLIC FINANCE POLICY SCENARIO AND COMPLIANCE WITH FISCAL RULES

2.1 The public finances in 2019-2022 and the budget measures for 2020

2.1.1 2019 and subsequent years

The deficit/GDP ratio for 2019 is expected to be the same level as the year before.

The new trend scenarios take account of the financial impact of legislative measures approved after the presentation of the Economic and Financial Document (EFD), in particular the 1 July package (Budget Adjustment Bill and Decree Law 61/2019), of the results of the MEF's monitoring of the public finances during the year and of the exceptional revisions made by Istat to actual macroeconomic and public finance data.

On 23 September Istat published the adjustments to GDP and the general government accounts consequent upon the exceptional revision, completing that carried out in 2014 to introduce the new version of the European System of Accounts (ESA 2010). The new national accounts estimates have resulted in an upward correction in net borrowing for 2018 from 2.1 to 2.2 per cent of GDP. Revisions were not made to interest expenditure, which remains at 3.7 per cent of GDP, but were made to various other items in the general government accounts. Overall the revisions reduced the primary surplus both in absolute value and as a proportion of GDP, which fell from 1.6 to 1.5 per cent. The fiscal burden was revised downwards, from 42.1 to 41.8 per cent, owing to the upward revision of nominal GDP in the denominator. The most substantial revisions concerned current expenditure, with an increase in compensation of employees and intermediate consumption. The former substantially reflected the effect of updating the data from local government accounts, while the second was mainly affected by a reclassification of expenditure, along with a reduction in other current expenditure.

The Government forecasts general government net borrowing for the current year to be equal to 2.2 per cent of GDP. Given the reduction in the primary surplus (from 1.5 to 1.3 per cent of GDP), the stability of the deficit/GDP ratio is maintained solely by a reduction in interest expenditure (from 3.7 to 3.4 per cent of GDP). The deterioration in the primary surplus is attributable to an increase in primary expenditure (from 44.7 to 45.3 per cent of GDP) in excess of the rise in revenue (from 46.2 to 46.5 per cent of GDP), with a fiscal burden that rises by one-tenth of a percentage point, to 41.9 per cent of GDP.

The increase in structural revenue for 2019 given in the DBP exceeds that indicated in the Update to the EFD by about €1.5 billion and is expected to improve the deficit this year to 2.1 per cent of GDP, taking account of the fact that the deferral of payment of this higher revenue to 2020 under Decree Law 124/2019 has been offset in 2019 by cutting budget appropriations. It remains to be seen whether these cuts, provided for at the end of October, will actually reduce expenditure this year.

Furthermore the Technical Note accompanying the 2020 Budget Bill, with reference to 2019, does not incorporate this new revenue in the trend scenario nor does it report the effects of the change in the composition of the items in the accounts arising from the measures for 2019 envisaged by Decree Law 124/2019. Indeed, the column of estimates of general government account items for 2019, for both the trend scenario and the policy scenario, is unchanged from that in the Update.

On the expenditure side, current primary expenditure is expected to rise from 41.4 to 41.9 per cent of GDP owing to the increase in social benefits in cash as a percentage of GDP from 19.8 to 20.3 per cent, due in part to new legislation concerning the "*Quota 100"* mechanism and the Citizenship Income (in which the amounts, based on the monitoring data, were reduced from those indicated in the EFD by €1.2 billion and €0.4 billion respectively). The other main items, relating to compensation of employees and intermediate consumption as a whole, are expected to decrease by 0.1 percentage points, to 9.7 and 8.2 per cent of GDP, respectively. Capital expenditure is expected to stay constant at 3.3 per cent of GDP, reflecting an increase in investment (from 2.1 to 2.3 per cent of GDP) offset by a reduction in other capital transfers. In particular, the increase in the value of investments (7.7 per cent compared with 2018) is attributable – as inferred from the Technical Note annexed to the Budget Act – to developments in those for both central (+10.6 per cent) and local (+5.8 per cent) government entities. The latter reflects the use by municipal and provincial governments of surpluses in previous years since the end of 2018.[24]

With regard to revenue, a 0.1 percentage point reduction in tax revenue (to 28.4 per cent of GDP), attributable to direct taxes, is accompanied by increases in both social contributions and other current revenue. The former (which rise from 13.3 to 13.5 per cent of GDP) reflect developments in total compensation for the overall economy, the end of the contribution relief measures provided for new permanent hiring, the effects of incentives for hiring young people introduced with the 2018 Budget Act and the impact of the reduction in INAIL rates in the 2019 Budget Act. Other current revenue – expected to grow from 4.3 to 4.4 per cent of GDP – reflects the Bank of Italy's high operating profit associated with the expansion of the central bank's balance sheet as a result of the Eurosystem's purchase of government securities (quantitative easing) and dividends from companies where MEF is a shareholder.

With regard to the policy scenario, the Government, as indicated in the Report to Parliament presented on 30 September, considers the most appropriate economic policy approach to be a gradual, structural improvement in the public finances and is committed to resuming the path of adjustment towards the MTO in 2021-2022 and then continuing thereafter.

The Update and the Technical Note envisage no change in net borrowing for 2020 from that expected for 2019 and that recorded for 2018 (2.2 per cent of GDP), with annual reductions of 0.4 percentage points in the subsequent two years (which would reduce the deficit to 1.8 per cent in 2021 and 1.4 per cent in 2022) (Table 2.1). Compared with the EFD, the net borrowing target is 0.1 percentage points of GDP higher next year, the same level in 2021 and 0.1 points lower in the final year of the planning period. An expected primary surplus of 1.3 per cent of GDP in 2019 falls under the policy scenario to 1.1 per cent in 2020, then rises again to 1.3 and 1.5 per cent of GDP, respectively, in the next two years. The fiscal burden is expected to rise by 0.1 points of GDP to 42 per cent in 2020 compared with the previous year, before reaching 42.5 and 42.4 per cent in 2021 and 2022 respectively. All these developments are influenced by the revenue generated by the safeguard clauses for indirect taxes, which are still active from 2021.

[24] See Ufficio parlamentare di bilancio (2019), "Gli avanzi spendibili degli Enti territoriali a seguito delle nuove regole sul pareggio", Focus Paper No. 3, 8 April.

Table 2.1 – Public finance indicators (1)
(percentage of GDP; plus sign = improvement in balance)

	2017	2018	2019	2020	2021	2022
Trend net borrowing (a)[(2)]	**-2.4**	**-2.2**	**-2.2**	**-1.3**	**-1.1**	**-0.8**
Change (a')		*0.2*	*0.0*	*0.9*	*0.2*	*0.3*
Trend one-off measures	0.0	0.1	0.1	0.2	0.1	0.1
Net measures (b)				**-0.9**	**-0.7**	**-0.5**
of which: *deactivation/new safeguard clauses (c)*				*-1.3*	*-0.5*	*-0.2*
Policy net borrowing (d=a+b)	**-2.4**	**-2.2**	**-2.2**	**-2.2**	**-1.8**	**-1.4**
Change (d')		*0.2*	*0.0*	*0.0*	*0.4*	*0.4*
Interest expenditure (e)	-3.8	-3.7	-3.4	-3.3	-3.1	-2.9
Change (e')		*0.1*	*0.3*	*0.1*	*0.2*	*0.2*
Cyclical component of policy budget balance (f)	-1.0	-0.8	-1.0	-0.9	-0.7	-0.5
Policy net borrowing adjusted for cycle (g=d-f)	-1.4	-1.4	-1.2	-1.2	-1.0	-0.9
Policy one-off measures (h)	0.0	0.1	0.1	0.1	0.1	0.1
Structural primary surplus (i)	2.4	2.1	2.2	1.9	1.9	2.0
Change (i')		*-0.3*	*0.1*	*-0.3*	*0.0*	*0.1*
Policy structural balance (l=g-h)	**-1.4**	**-1.5**	**-1.2**	**-1.4**	**-1.2**	**-1.0**
Change (l')	*-0.6*	*-0.1*	*0.3*	*-0.1*	*0.2*	*0.2*

Source: based on data from the 2019 Update and the 2020 DBP.
(1) Totals may not match due to rounding of decimals.

In general, it should be noted how the improvement in the trend scenario set out in the Update as compared with the EFD (of which about 60 per cent is attributable to lower interest expenditure in 2020 and about 95 per cent in the two years thereafter) makes it possible to arrive at policy targets that are similar despite the implementation and expectation of much more limited budget measures than in April's EFD.

Given the policy targets and considering the estimates for the output gap and one-off measures, the structural balance is expected to deteriorate by 0.1 percentage points in 2020 and to improve by 0.2 percentage points in each of the two subsequent years. The structural deficit, estimated at 1.2 per cent of GDP for the current year, is expected to reach 1.4 per cent in 2020 and then decline to 1.2 per cent in 2021 and 1.0 per cent in 2022 (Table 2.1). In addition to the revenues generated by the safeguard clauses in 2021-2022, these developments are helped along by the reduction in interest expenditure, which is expected to decline over the three-year period from 3.4 per cent of GDP in 2019 to 2.9 per cent in 2022. The structural primary surplus is expected to decrease from 2.2 per cent of GDP in 2019 to 1.9 per cent in each of the two following years, before rising slightly to 2.0 per cent in 2020.

The ratio between policy scenario debt and GDP is expected to increase this year by 0.9 percentage points of GDP (to 135.7 per cent), before declining steadily to 131.4 per cent in 2022, which is 4.3 percentage points of GDP below the high of 2019 and 1 percentage point higher than forecast for 2022 in the trend scenario laid out in the Update.

2.1.2 Developments in the debt/GDP ratio

On 23 September the Bank of Italy published the revised estimates of the debt in line with Eurostat's new Manual on Government Deficit and Debt.[25] Due to the changes in the debt valuation criteria, the debt includes interest that has accrued (but not yet paid) on the post office savings bonds (BPFs) assigned to the Ministry for the Economy and Finance following the transformation of Cassa Depositi e Prestiti into a limited liability corporation in 2003.[26] At the end of 2018, the principal value of these instruments was €12.8 billion, while the accumulated interest was €58.2 billion. The new statistical classification did not have an impact on general government net borrowing since the interest accrued on these products has always been included in the general government accounts.

In addition, the debt revisions published by the Bank of Italy on 23 September reflect the extension of the scope of the general government sector[27] in the amount of about €5.2 billion in 2015, €4.1 billion in 2016 and around €300 million in 2017 and 2018.

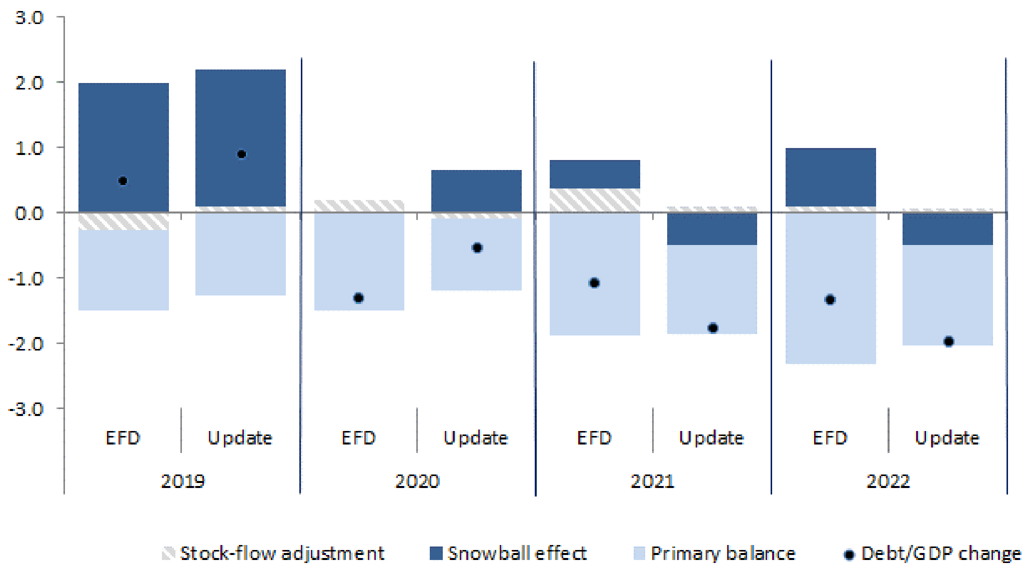
At the same time, Istat revised nominal GDP for years prior to 2019 upwards: by €3.3 billion in 2015, €5.8 billion in 2016, €9.2 billion in 2017 and €8.4 billion in 2018.

Considering the debt revisions by the Bank of Italy and the new national accounts data published by Istat, the debt/GDP ratio was 134.1 per cent in 2017 and 134.8 per cent in 2018. The revisions have produced a higher debt/GDP ratio, but its dynamics are now more favourable: compared with 2015, the year in which the debt/GDP ratio was equal to 135.3 per cent, the ratio fell in 2018 (-0.5 percentage points) instead of increasing (0.6 percentage points) as it did prior to the revision.

According to the scenario outlined in the DBP, which confirms the policy scenario in the Update, during the current year the debt/GDP ratio is expected to rise by about 0.9 points (instead of the 0.5 points forecast in the EFD) compared with 2018 (Figure 2.1). From 2020, a stable and gradual reduction in the debt/GDP ratio is expected, reaching 131.4 per cent in 2022, about 3.4 percentage points of GDP lower than in 2018 (a net reduction 0.1 percentage points greater than that in the EFD) and more than 4 percentage points of GDP below the peak forecast for 2019 (135.7 per cent). Breaking down this dynamic into its various components, the primary surplus always makes a positive contribution in the four-year forecast period, accounting for more than 5 percentage points of GDP (Table 2.2).

[25] Eurostat, Manual on Government Deficit and Debt — Implementation of ESA 2010 — 2019 edition.
[26] The latest series of BPFs will mature in 2033, but holders can postpone redemption until 2043. However the BPFs will not accrue interest in the ten years following maturity.
[27] For some units already included in April in the perimeter of general government as from 2017 (in particular Rete Ferroviaria Italiana SpA) the data was revised for less recent years.

Figure 2.1 – Determinants of the change in the debt/GDP ratio: comparison between the EFD and the 2019 Update



Source: based on data from the 2019 EFD, the 2019 Update and the 2020 DBP.

Table 2.2 – Determinants of the change in the debt/GDP ratio (1)
(percentage of GDP and change in rates)

	2017	2018	2019	2020	2021	2022
Level	134.1	134.8	135.7	135.2	133.4	131.4
Change on previous year	-0.7	0.7	0.9	-0.5	-1.8	-2.0
Factors determining changes in public debt						
Primary surplus (accrual basis)	**-1.3**	**-1.5**	**-1.3**	**-1.1**	**-1.3**	**-1.6**
Snow-ball effect (2) of which:	**0.6**	**1.5**	**2.1**	**0.7**	**-0.5**	**-0.5**
Interest expenditure/nominal GDP	*3.8*	*3.7*	*3.4*	*3.3*	*3.1*	*2.9*
Contribution nominal GDP growth	*-3.2*	*-2.2*	*-1.3*	*-2.6*	*-3.6*	*-3.4*
memo: Average cost of debt	*2.9*	*2.8*	*2.6*	*2.4*	*2.4*	*2.3*
Stock-flow adjustments	**0.1**	**0.7**	**0.1**	**-0.1**	**0.1**	**0.1**
Cash-accrual differences			0.1	0.3	0.2	-0.3
Net accumulation of financial assets, of which:			**0.3**	**0.0**	**0.0**	**0.2**
Privatisation receipts			*0.0*	*-0.2*	*-0.2*	*-0.2*
Effect of valuation of debt			*-0.3*	*-0.3*	*0.0*	*0.1*
Other (3)			*0.0*	*-0.1*	*-0.1*	*0.0*

Source: based on data from the 2019 Update and the 2020 DBP.
(1) Totals may not match due to rounding of decimals. – (2) The snow-ball effect is calculated as the sum of interest expenditure over nominal GDP and the contribution of nominal GDP growth, given by $(d_{t-1}/PIL_{t-1})*(-g_t/(1+g_t))$, where d_{t-1} is the debt at time t-1, and g_t is the nominal GDP growth rate at time t- (3) Includes changes in the liquidity holdings of the MEF, Eurostat reclassifications and statistical discrepancies.

The stock-flow adjustment and the snow-ball effect contribute to increasing the debt. The snow-ball effect is expected to increase the debt/GDP ratio by a total of 1.7 percentage points. Most of it is concentrated in 2019 owing to the slowdown in nominal growth (from 1.7 to 1 per cent), which is only partially offset by 0.2 per cent of GDP reduction in interest expenditure. In 2020, by contrast, the snow-ball effect is expected to fall below 1 percentage point thanks to a further decline in interest expenditure and a significant acceleration in nominal GDP (2 per cent). In the subsequent two years, this component's contribution turns favourable for debt reduction (by more than 1 point of GDP), thanks to the continuing decline in interest expenditure (equal to 0.2 points each year), along with an increase in the nominal growth rate (2.7 per cent in 2021 and 2.6 per cent in 2022). The downward revision of interest expenditure compared with the previous estimates in the EFD reflects the more favourable expected trend in interest rates observed in recent months.[28] The interest rate scenario used for the estimates is based on the implicit forecasts drawn from the yields on Italian government securities recorded during the period in which the Update was being prepared, which reached historic lows.

The stock-flow adjustment has an adverse impact of around 0.1 per cent of GDP during the four years, an improvement compared with the forecast in the EFD. The privatisation component favourably impacts the stock-flow adjustment, with planned receipts equal to 0.2 percentage points of GDP in each of the years in 2020-2022. The Update revised the targets for privatisation receipts, reducing them to nil for the current year (from 1 percentage point of GDP), and to 0.2 percentage points of GDP for 2020 (from 0.3 points). In addition, for 2021-2022, a target for receipts of 0.2 per cent of GDP per year was introduced (these targets include extraordinary dividends and other proceeds allocated to the Government Bond Sinking Fund). However, the Update and the DBP do not contain sufficient information to assess the feasibility of the plan. Therefore, it remains a risk factor in the policy scenario, as the PBO has already observed in recent years.[29]

The DBP provides an updated profile for the proceeds from the extraordinary plan for property disposals equal to €100 million in 2019, €1 billion in 2020 and €150 million in 2021. However, it should be noted that any proceeds from property disposals are recorded under net borrowing, and therefore they cannot also be recorded at the same time as privatisation proceeds within the stock-flow adjustment of the debt, unless there are certain conditions for treating them as financial transactions (and therefore not recognised under net borrowing).

Finally, the policy forecasts in the Update to the EFD reflect the assumption of a reduction in the MEF's liquidity holdings of about 0.1 per cent of GDP for each year of the 2019-2021 period.

[28] See Box 2.1 "The impact of the reduction of the spread on interest expenditure" for an analysis of the savings resulting from the generalised reduction in interest rates and the spread.
[29] See Ufficio parlamentare di bilancio (2019), "2019 Budgetary Planning Report", page 58, "The privatisation programme" for a comparison between the forecasts and the results regarding the privatisation receipts for past years.

Box 2.1 – The impact of the reduction of the spread on interest expenditure[30]

The improvement in the outlook for the public finances in recent months is closely tied to the reduction in interest expenditure compared with the estimates made in the first part of the year. Indeed, the 2019 Update and the 2020 DBP project that general government interest expenditure will gradually fall over the next three years. This should lead to greater savings than forecast in the 2019 EFD, which in 2022 are expected to reach €17.2 billion. Considering just the State securities component, the estimated savings using the PBO model for forecasting interest expenditure are equal to about €15.6 billion (Table B2.1.1).[31]

The significant reduction in the estimated interest expenditure compared with six months earlier is due in part to a generalised decline in interest rates – which can be measured by the change in German yields and, to a lesser extent, the change in Euribor for the securities indexed to it – and in part the reduction in the country risk associated with Italy, which can be measured by the spread between yields on Italian and German securities.

To estimate the cuts attributable to each of the two components using the PBO model, two alternative scenarios were constructed for developments in interest rates – and therefore interest expenditure – on Italian government securities compared with the baseline scenario, represented by the forecast made based on interest rates reported at the end of the August and start of September and used to assess the public finance scenario in the Update.

In the scenario designed to capture the impact of the generalised reduction in interest rates, the alternative forward curves for Italy are calculated by adding the absolute value of the change recorded between March and September in the forward curves for German securities to Italian forward yields estimated in September. Analogously, the second scenario was produced by adding the absolute value of the change in the spread between the Italian and German forward yield curves recorded between March and September to the forward yield curve for Italian government securities used in the benchmark scenario.[32]

Table B2.1.1 – Interest expenditure: PBO forecasts, Domestic government securities only *(millions of euros)*

	2019	2020	2021	2022
Change in PBO forecast September-April 2019, of which:	**-456**	**-5,560**	**-10,426**	**-15,625**
General change in interest rates	*-297*	*-2,491*	*-5,079*	*-7,705*
Change in spread	*-121*	*-2,200*	*-4,766*	*-7,184*
Residual (change in inflation assumptions, borrowing requirement and composition of issues)	*-38*	*-870*	*-580*	*-736*

Source: based on data from the MEF, Bank of Italy and Refinitiv.

[30] This box summarises the contents recently published in Ufficio parlamentare di bilancio (2019), "L'impatto della riduzione dello *spread* sulla spesa per interessi", Flash no. 3, November.

[31] The PBO model considers just the expenditure associated with domestic State securities (which represent about 80 per cent of the total gross debt currently in circulation) and, starting with the same assumptions about developments in interest rates adopted by the MEF, provides estimates similar to those in the Update and the EFD. For more details, see Ufficio parlamentare di bilancio (2017), "Il modello UPB di analisi e previsione della spesa per interessi", Working Paper no. 3, October.

[32] Using a conceptually analogous methodology (but which does not use the PBO forecasting model) it was also possible to disaggregate into two components the reductions in interest expenditure attributable to issues that were made from the start of April to the end of August 2019.

The result of this exercise is that almost half of the reduction of the interest expenditure on government securities that occurred between the EFD and the Update can be attributed to the reduction in the spread between March and September (Table B2.1.1). In particular, for 2022 €7.2 billion of the total €15.6 billion reduction in interest expenditure estimated using the PBO model is attributable to the smaller spread. The generalised decline in interest rates is expected to make a slightly larger contribution (€7.7 billion), while the remainder of the difference is attributable to variables other than interest rates (mainly different assumptions in the two forecast scenarios regarding developments in inflation, the borrowing requirement and the composition of the debt).

2.1.3 The budget package: Decree Law 124/2019 and the 2020 Budget Bill

The budget package

The public finance budget package is composed of Decree Law 124/2019 and the 2020 Budget Bill presented in Parliament and will be completed with other legislative measures, in particular those that will more specifically define the measures for reducing the tax wedge and those for supporting families.

Based on the technical reports accompanying the measures submitted to Parliament, the budget package will produce a deterioration in general government net borrowing, compared with the trend scenario with unchanged legislation, equal to 0.9 per cent of GDP in 2020, 0.7 per cent in 2021 and 0.5 per cent in 2022 (Table 2.1). The net borrowing projections in the Update are confirmed with the deficit in the policy scenario expected to remain stable at 2.2 per cent in 2020 and to then fall to 1.8 per cent in 2021 and 1.4 per cent in 2022.

Compared with trend scenario, the budget package contains expansionary measures (uses in Table 2.3) equal to 1.8 per cent of GDP in 2020 and 2021, falling to 1.5 per cent in 2022. However, net of the effects of the safeguard clauses regarding increases in indirect taxes, the new measures have expansionary effects that are obviously smaller but increasing over the three years, from 0.5 per cent in 2020 to almost triple that in the following two years, at 1.3 per cent of GDP. Funding resources are less than the uses including the effects of the safeguard clauses and are broadly stable at around 1.0 per cent of GDP for the entire three years (Table 2.3).

Table 2.3 – Decree Law 124/2019 and 2020 Budget Act: budget measures for 2019-2021 and impact of Decree Law 124/2019 on 2019
(millions of euros and percentages of GDP)

	2019	2020	2021	2022
USES [1]	**2,277.6**	**32,135.1**	**33,903.0**	**28,704.8**
As a % of GDP	*0.1*	*1.8*	*1.8*	*1.5*
Uses net of deactivation of safeguard clauses		**9,063.1**	**24,103.0**	**25,709.8**
As a % of GDP		*0.5*	*1.3*	*1.3*
Increases in expenditure	775.0	4,720.3	12,781.3	14,761.2
Current	*62.1*	*2,631.9*	*9,445.3*	*9,573.9*
Capital	*712.9*	*2,088.4*	*3,336.0*	*5,187.4*
Decreases in revenue	1,502.6	27,414.8	21,121.7	13,943.5
Deactivation of safeguard clauses		*-23,072.0*	*-9,800.0*	*-2,995.0*
As a % of GDP		*-1.3*	*-0.5*	*-0.2*
RESOURCES [1]	**2,277.7**	**15,877.9**	**21,157.2**	**18,234.2**
As a % of GDP	*0.1*	*0.9*	*1.1*	*1.0*
Increases in revenue	35.0	11,853.4	16,833.5	14,801.7
Decreases in expenditure	2,242.7	4,024.4	4,323.7	3,432.5
Current	*1,696.3*	*1,641.3*	*3,019.4*	*2,255.6*
Capital	*546.4*	*2,383.2*	*1,304.3*	*1,177.0*
NET REVENUE	**-1,467.6**	**-15,561.4**	**-4,288.2**	**858.1**
NET REVENUE net of safeguard clauses	**-1,467.6**	**7,510.6**	**5,511.8**	**3,853.1**
NET EXPENDITURE	**-1,467.7**	**695.9**	**8,457.7**	**11,328.7**
Current	*-1,634.2*	*990.7*	*6,425.9*	*7,318.3*
Capital	*166.5*	*-294.8*	*2,031.7*	*4,010.4*
NET BORROWING	**0.0**	**-16,257.3**	**-12,745.8**	**-10,470.6**
As a % of GDP	*0.0*	*-0.9*	*-0.7*	*-0.5*

Source: based on data from the summary schedules detailing the financial effects of Decree Law 124/2019 and the 2020 Budget Bill.
(1) Uses and resources for 2020-2022 are reported net of the Fiscal Burden Reduction Fund and the Fund for Discounting Long-term Grants.

In the tables, the value of uses and resources do not take account of a number of budget items that, in the overall assessment of the financial effects of Decree Law 124/2019 and the 2020 Budget Bill, have a net effect of zero. These are increases in the two funds (one for the reduction of the fiscal burden and one for long-term grants) provided for in Article 59(1) and (2) of the Tax Decree, which are reduced in the same amount by Article 99(3) of the Budget Act to be used for funding. Specifically, if such amounts are included, the increases and decreases in expenditure in Tables 2.3 and 2.5 would be €5.4 billion greater in 2020, €4.4 billion in 2021 and €4.2 billion in 2020.

In addition to these accounting transactions, uses and resources differ from those reported in the Technical Note to the Budget Bill as a result of the absence – in the summary schedule on the financial effects of the budget package – of detailed information on the measures in the second section of the Budget Bill. As already noted in the past, it would be advisable to publish this information with the summary schedule.

For 2020, the expansionary measures amount to €32 billion, for which resources of €16 billion are projected, with a consequent increase of €16 billion in the deficit (Table 2.3). Among the uses, the most significant – as has been the case for the last five years – is that completely deactivating the increase in indirect tax revenue under the safeguard clauses, equal to €23.1 billion. The other main uses of resources are measures to reduce the tax burden on employees, to support families in relation to the birth of a child and accessing childcare services, to provide greater funding for renewal of public employment contracts for 2019-2021, and funding for the capital expenditure of the central, regional and local governments and the tax credits for investment in capital equipment by firms in Southern Italy. As for funding measures, about three-quarters will come from revenue increases. First, for 2020 only, greater revenue will be generated by restructuring the two instalments of estimated tax payments as provided for by Decree Law 124/2019 for persons subject to the new tax compliance indicators (*indici sintetici di affidabilità fiscale* – ISA). In addition, substantial revenue is expected to be recovered through measures to combat tax evasion and tax fraud, increases in revenue from companies, especially banks, the introduction of new taxes on the consumption of single-use plastic products and on the consumption of certain types of beverages, the revision of tax breaks for company cars, as well as an increase in taxes on gaming and tobacco products. Expenditure reductions mainly include not only the savings expected from the smaller-than-expected participation in the *"Quota 100"* early retirement mechanism compared with the estimates in the 2019 Update, but also a reduction in spending by ministries and additional defunding and reprogramming of measures contained in the second section of the Budget Bill (in particular, the Development and Cohesion Fund and funding for healthcare facility construction).

With regard to the uses of funds for the 2021-2022 period, the partial deactivation of the safeguard clauses, which will reduce revenue by €9.8 billion and €3 billion respectively, and the more substantial effects of many of the expenditure increase measures – in particular those regarding public employment and capital expenditure – are accompanied by incentive measures to foster the use of electronic payment instruments, the larger impact of the reduction of the tax wedge as well as the extension of certain tax breaks and financing for SMEs, and the introduction of a universal family allowance. As regards the sources of funds, the proportion of the additional measures covered by revenue increases rises compared with 2020 (from around 75 per cent in 2020 to around 80 per cent thereafter), due in particular to the smaller loss of revenue in 2022 connected with the repeal of the flat-tax mechanism (due to take effect as from the 2020 tax year) for self-employed workers and sole proprietorships with revenues of between €65,000 and €100,000, to the greater effects of both the measures for combating tax evasion and tax fraud in Decree Law 124/2019 and the new consumption tax on plastic products. With regard to expenditure savings, which are smaller in 2022, those connected with capital expenditure have been reduced while those impacting current expenditure have been increased, in particular those associated with the *"Quota 100"* early retirement mechanism.

Resources include temporary measures or measures whose effects are concentrated in the first year. Specifically, these include a freeze on deductions of loan writedowns and losses, the rescheduling of estimated tax payments mentioned earlier and the revision of the timing of transfers to the State Railways and the use of the Cohesion and Development Fund.

Moreover, provisions have been recognised for ministry budgets, for both the item tax settlements, refunds and reimbursements and that regarding reserves and special funds. More specifically, a provision of €1 billion has been recognised for 2020 that, following an assessment of the consistency of developments in the public finances with policy objectives as reported in the 2020 EFD, can be drawn upon within the mid-year State budget adjustment act. For 2021 and 2022, smaller provisions of €900 million and €500 million have also been recognised for the same items, respectively, to guarantee the positive effects on the public finance balances of new savings expected from the "*Quota 100*" mechanism, pending confirmation of such savings.

Finally, regarding the use of financial resources, rising amounts (about €600 million in 2020, about €1 billion in 2021 and more than €1.2 billion the following year) have been appropriated on both current (over 80 per cent) and capital account to meet urgent expenditure needs, spending expected to be implemented in the current year and that relating to special statute regions.

The main measures of the budget package

Examining the budget package in greater detail, the main measures can be grouped by type (Table 2.4 for net amounts and Table 2.5 for a breakdown of gross amounts of uses and sources of funds).

As regard <u>uses</u>, as has already been noted, the safeguard clauses raising VAT rates and excise duties are expected to be fully deactivated in the first year and then partially sterilised in the years thereafter.

Among the other main measures, the most significant from a financial point of view concern *measures for families and fighting poverty*, with substantial resources dedicated to reducing the tax wedge for payroll employees; to unifying the various benefits provided to families to support the birth rate and for childcare services, and to providing aid for the disabled and those who are not self-sufficient; and to extending for one year the early retirement mechanisms for those in hardship categories ("*APE sociale*") and the so-called "Women's Option" (for a description of some of these measures, see sections 3.5 and 3.6).

Other resources are allocated to capital expenditure for *public investment and investment grants*. These resources are directed in large part to the establishment of a new fund to revive investment by the central government, to municipalities to secure and maintain schools, roads, public building and other municipal assets, to counter hydrogeological risks and for energy upgrading projects for schools, public buildings and other municipal assets. Funding has also been provided to support research by universities and public and private research institutes as well as for national space programmes (see section 3.8).

Table 2.4 – Impact of the main measures in Decree Law 124/2019 and the 2020 Budget Bill on the general government accounts
(net amounts in millions of euros)

		2019	2020	2021	2022
	NET REVENUE	**-1,468**	**-15,561**	**-4,288**	**858**
Safeguard clauses	Sterilisation of safeguard clauses		-23,072	-9,800	-2,995
	NET REVENUE NET OF SAFEGUARD CLAUSES		**7,511**	**5,512**	**3,853**
Measures for companies and self-employed workers	Freeze for 2019 tax year on deductions of loan writedowns and losses; deferral of deductions over ten years		1,644	0	0
	Extension of revaluation of unlisted equity investments and land		823	453	453
	Modification of depreciation of assets to be relinquished free of charge by motorway concession holders		341	170	170
	Repeal of flat tax for sole proprietors or self-employed workers with incomes between €65,000 and €100,000		109	1,131	858
	Web tax		108	108	108
	Extension of super- and hyper-depreciation		0	-566	-1,126
	Exclusion of individuals who received income from employment or similar income in excess of €30,000 from *regime forfettario* flat-tax mechanism		-4	594	350
	ACE (figurative return of 1.3%) with repeal of mini-IRES		-326	290	777
	Group total		***2,883***	***2,270***	***1,375***
IRPEF tax credits	Restructuring of 19% tax credit for eligible spending on basis of taxpayer income, with the exception of spending for serious pathologies		0	110	63
	Tax credits for building renovation, energy efficiency upgrading, façade repairs		23	-876	-1,101
	Group total		***23***	***-766***	***-1,038***
Countering tax evasion	Measures to fight tax fraud		832	832	832
	Reduction of unwarranted tax offsetting		836	878	878
	Extension of reverse charge mechanism to counter illegal temporary work		136	593	396
	Electronic reporting of accounting data of obligated taxpayers and distributors in the natural gas and electricity sectors		120	240	240
	Electronic submission of waybills for transport of products subject to excise tax		240	480	480
	Reduced offsetting for social security contributions in tenders and subcontracting to counter illegal temporary work - greater contribution revenue		317	317	317
	19% IRPEF tax credit for eligible spending granted only in case of payment with traceable payment instruments		0	868	496
	Expansion of analysis of risk of tax evasion and pseudonymisation of personal information		125	251	460
	Extension of requirement of electronic invoicing to taxpayers participating in preferential tax mechanism		51	147	106
	Group total	***35***	***3,236***	***4,999***	***4,590***
Measures for families and fighting poverty	Revision of company car fringe benefit for personal income tax purposes (IRPEF)		347	393	386
	Fund for the reduction of the tax burden on payroll employees		-3,000	-5,000	-5,000
	Group total		***-2,634***	***-4,576***	***-4,560***
Other tax measures	Estimated tax payments for taxpayers subject to tax compliance indicator (ISA)	-1460	1,460	0	0
	Tax on single-use plastic products		1,080	1,782	1,537
	Tax on sweetened beverages		234	262	256
	Increase in tax on gaming (PREU) and winnings		795	841	841
	Amendment of excise tax on tobacco products		88	88	88
	Reduction from 15% to 10% in flat tax on rent-controlled lease contracts		-202	-223	-212
	Group total	***-1,469***	***3,820***	***2,986***	***2,891***
Healthcare	Repeal of superticket co-payment on healthcare services		-185	-554	-554
Other measures			101	15	10
Employment contributions		-33	266	1,138	1,139

Table 2.4 – *(cont.)* Impact of the main measures in Decree Law 124/2019 and the 2020 Budget Act on the general government accounts
(net amounts in millions of euros)

		2019	2020	2021	2022
	NET EXPENDITURE	**-1,468**	**696**	**8,458**	**11,329**
Measures for families and fighting poverty	Fund for universal family allowance and childcare services allowance		0	434	1,033
	1-year extension of birth allowance granted on basis of equivalent economic status indicator (ISEE)		348	410	0
	Increase in childcare allowance		190	200	211
	Fund for the disabled and non-self-sufficient		50	200	300
	Additional *Quota 100* savings		-300	-900	-500
	Extension of early retirement mechanism for hardship categories (*APE sociale*)		108	219	185
	Extension of "Women's Option" early retirement mechanism		67	187	291
	Group total		***625***	***850***	***1,723***
Public employment	Additional resources for public employment contract renewals 2019-2021		225	1,400	1,400
	Peace-keeping missions		0	750	750
	Group total		***462***	***2,290***	***2,292***
Measures for companies and self-employed workers	SME fund	670	0	0	0
	Tax credit for purchase of capital equipment in Southern Italy		674	0	0
	Refinancing of "new Sabatini" capital equipment mechanism - Support for SME investment		105	97	97
	Tax credit for technology transformation to foster circular economy			140	280
	Group total	***713***	***848***	***1,199***	***1,229***
Public investment and investment grants	Investment grants to municipalities		235	478	1,170
	Use of surpluses and restricted long-term fund financed with debt of OSRs		155	312	120
	Fund for central government investment		112	400	767
	Fund to support research by universities and public and private research institutes		15	100	310
	Support for research - National Research Agency		10	200	210
	Cuts in ministry spending - capital account (DL 124/2019 and 2020 Budget Bill)	-456	-472	-469	-469
	Group total	***-546***	***-1,157***	***890***	***2,673***
Countering tax evasion	Superbonus incentives for use of electronic payment instruments			3,000	3,000
	Group total	***2***	***38***	***3,023***	***3,023***
Other measures	Fund for relations with special statute regions		250	359	359
	Fund for urgent interventions		214	305	305
	Fund for financing legislative provisions		139	341	565
	Restoration of forgone revenue to municipalities following introduction of municipal services tax		110	110	110
	Cuts in ministry spending (DL 124/2019 and 2020 Budget Bill)	-1,513	-510	-497	-483
	Inclusion of Single Justice System Fund in State Treasury - decrease in interest expenditure		-14	-178	-244
	Group total	***-1,636***	***-101***	***265***	***449***
Healthcare	Fund for reduction of co-payment on prescriptions		-20	-60	-60
	Group total		***-20***	***-60***	***-60***
	NET BORROWING	**0.0**	**-16,257.3**	**-12,745.8**	**-10,470.6**

Source: based on data from the financial schedules attached to the 2020 Budget Act and Decree Law 124/2019.

Table 2.5 – Impact of the main measures in the 2020 Budget Act and Decree Law 124/2019 on the general government revenue and expenditure account *(gross amounts in millions of euros)*

	2019	2020	2021	2022
USES (1) (2)	**2,278**	**32,135**	**33,903**	**28,705**
As a % of GDP	*0.1*	*1.8*	*1.8*	*1.5*
Increases in expenditure	**775**	**4,720**	**12,781**	**14,761**
Increases in current expenditure	***62***	***2,632***	***9,445***	***9,574***
1-year extension of birth allowance granted on basis of equivalent economic status		348	410	0
Increase in childcare allowance		190	200	211
Fund for universal family allowance and childcare services allowance			1,044	1,244
Additional resources for public employment contract renewals 2019-2021		225	1,400	1,400
Extension of early retirement mechanism for hardship categories (APE sociale)		108	219	185
Extension of "Women's Option" early retirement mechanism		67	187	291
Fund for the disabled and non-self-sufficient		50	200	300
Fund for relations with special statute regions		250	359	359
Increase in fund for urgent interventions		214	305	305
Superbonus incentives for use of electronic payment instruments		0	3,000	3,000
Refinancing - second section		222	1,177	1,284
International peace-keeping missions		*0*	*850*	*850*
Other		*222*	*327*	*434*
Other measures	62	958	944	995
Increases in capital expenditure	***713***	***2,088***	***3,336***	***5,187***
SME guarantee fund	670			
Investment grants to municipalities		235	478	1,170
Use of restricted surpluses for local governments running a deficit -OSRs		155	312	120
Fund for central government investment		112	400	767
Fund to support research by universities and public and private research institutes		15	100	310
Support for research - National Research Agency		10	200	210
Refinancing - second section		435	950	865
Calabria Forest Service personnel		*90*	*90*	*90*
Other		*345*	*860*	*775*
Other measures	43	1,126	896	1,745
Decreases in revenue	**-1,503**	**-27,415**	**-21,122**	**-13,944**
Sterilisation of VAT increases		-22,672	-9,450	-2,895
Sterilisation of petroleum product excise taxes		-400	-350	-100
Fund for reduction of tax burden on payroll employees		-3,000	-5,000	-5,000
Estimated tax payments for taxpayers subject to tax compliance indicator (ISA)	-1,460			
Restoration of ACE (figurative return of 1.3%) with repeal of mini-IRES - IRES		-420	-197	-197
Repeal of flat tax for sole proprietors or self-employed workers with incomes between €65,000 and €100,000. Tax in lieu and adjustment of VAT tax credit		-280	-1,918	-1,096
Repeal of superticket co-payment on healthcare services		-185	-554	-554
Reduction from 15% to 10% in flat tax on rent-controlled lease contracts		-202	-223	-212
Tax credits for eligible spending based on taxpayer income and for building renovation, energy efficiency upgrading, façade repairs		-151	-1,503	-722
Extension of super- and hyper-depreciation		0	-566	-1,126
Exclusion of individuals who received income from employment or similar income in excess of €30,000 from regime forfettario flat-tax mechanism - Tax in lieu and VAT		-4	-315	-182
Revision of INAIL fees - reduction in contribution revenue				-500
Other measures	-9	-81	-476	-744
Tax effects		-13	-563	-1,109
Tax credits for eligible spending based on taxpayer income and for building renovation, energy efficiency upgrading, façade repairs		*0*	*0*	*-316*
Tax on single-use plastic products - Consumption tax		*0*	*-410*	*-655*
Tax on sweetened beverages - as from 1 April 2020 - Consumption tax		*0*	*-89*	*-95*
Other		*-13*	*-63*	*-43*
Employment contributions	-33	-6.9	-6.9	-6.9
NET REVENUE	**-1,468**	**-15,561**	**-4,288**	**858**
NET EXPENDITURE	**-1,468**	**696**	**8,458**	**11,329**
Current	*-1,634*	*991*	*6,426*	*7,318*
Capital	*167*	*-295*	*2,032*	*4,010*
NET BORROWING	**0.0**	**-16,257.3**	**-12,745.8**	**-10,470.6**
As a % of GDP	*0.0*	*-0.9*	*-0.7*	*-0.5*

Table 2.5 – *(cont.)* Impact of the main measures in the 2020 Budget Act and Decree Law 124/2019 on the general govt. revenue and expenditure account *(gross amounts in millions of euros)*

	2019	2020	2021	2022
RESOURCES [(1) (2)]	**2,278**	**15,878**	**21,157**	**18,234**
As a % of GEP	*0.1*	*0.9*	*1.1*	*1.0*
Increases in revenue	**35**	**11,853**	**16,833**	**14,802**
Freeze for 2019 tax year on deductions of loan writedowns and losses; deferral of deductions over ten years		1,644	0	0
Estimated tax payments for taxpayers subject to tax compliance indicator		1,460		
Tax on single-use plastic products - Consumption tax		1,080	2,192	2,192
Tax on sweetened beverages - as from 1 April 2020 - Consumption tax		234	351	351
Reduction of unwarranted tax offsetting		836	878	878
Measures to fight tax fraud		832	832	832
Revaluation of unlisted equity investments and land		823	453	453
Increase in unified gaming tax (PREU)		499	525	525
Increase in tax on game winnings		296	317	317
Repeal of flat tax for sole proprietors or self-employed workers with incomes between €65,000 and €100,000 - Direct and indirect taxes		389	3,050	1,954
Revision of company car fringe benefit for personal income tax purposes (IRPEF)		347	393	386
Modification of depreciation of assets to be relinquished free of charge by motorway concession		341	170	170
Reduced offsetting for social security contributions in tenders and subcontracting to counter illegal temporary work - greater contribution revenue		317	317	317
Electronic submission of waybills for transport of products subject to excise tax		240	480	480
Extension of reverse charge mechanism to counter illegal temporary work		136	593	396
Expansion of analysis of risk of tax evasion and pseudonymisation of personal information		125	251	460
Electronic reporting of accounting data of obligated taxpayers and distributors in the natural gas and electricity sectors		120	240	240
Web tax		108	108	108
Extension of requirement of electronic invoicing to taxpayers participating in preferential tax mechanism		51	147	106
Restoration of ACE (figurative return of 1.3%) with repeal of mini-IRES - IRES		94	487	975
Modification of excise taxes on tobacco products		88	88	88
Exclusion of individuals who received income from employment or similar income in excess of €30,000 from regime forfettario flat-tax mechanism - IRPEF, surtaxes, IRAP			908	532
19% IRPEF tax credit for eligible spending granted only in case of payment with traceable payment instruments		0	868	496
Other measures	35	1,345	1,293	1,287
Tax effects:		176	749	114
Tax credits for eligible spending based on taxpayer income and for building renovation, energy efficiency upgrading, façade repairs		*174*	*737*	*0*
Revision INAIL fees - tax effects				*76*
Other		*2*	*11*	*38*
Employment contributions	0	273	1,145	1,146
Decreases in expenditure	**-2,243**	**-4,024**	**-4,324**	**-3,433**
Decreases in current expenditure	***-1,696***	***-1,641***	***-3,019***	***-2,256***
Cuts in ministry spending - current (DL 124/2019)	-1513	-5		
Additional Quota 100 savings		-300	-900	-500
Reduction in fund for universal family allowance and childcare services allowance			-610	-211
Inclusion of Single Justice System Fund in State Treasury - decrease in interest expenditure		-14	-178	-244
Diesel excise tax relief - Elimination of diesel fuel tax relief for transport of goods and passengers for vehicles in category Euro3 from March 2020 and Euro4 from January 2021		-80	-117	-117
Revision of tax relief for commercial diesel used as fuel - Excise taxes		-41	-81	-81
Defunding second section		-1,043	-929	-897
Cuts in ministry spending - current		*-505*	*-498*	*-484*
Other measures	-183	-159	-204	-206
Decreases in capital expenditure	***-546***	***-2,383***	***-1,304***	***-1,177***
Proceeds from auction of CO_2 emission allowances		-150	-150	-150
Cuts in ministry spending - capital (DL 124/2019)	-456	-10		
Defunding and reprogramming - second section		-2200	-1146	-1019
Reduction in Development and Cohesion Fund		*-761*	*-111*	*-86*
Cuts in ministry spending - capital account		*-472*	*-469*	*-469*
Other		*-1,222*	*-179*	*-66*
Other measures	-90	-24	-8	-8

Source: based on data from the financial schedules attached to the 2020 Budget Act and Decree Law 124/2019.
(1) Uses and resources are reported net of the fund for the reduction of the fiscal burden and for multi-annual grants. – (2) Totals may not match due to rounding of decimals.

Significant resources are also dedicated in 2021-2022 to measures to *counter tax evasion*, specifically to finance incentives to promote the use of electronic payment instruments.

Various measures regard *companies and self-employed workers*. The main provisions include: making permanent "Industry 4.0" tax incentives, with the refinancing of the SME Central Guarantee Fund to facilitate access to credit for small and medium-sized enterprises, with the extension of the tax credit for training expenses for employees, with the refinancing of the "New Sabatini" tax breaks, and with the extension to 2020 of the tax credit for purchase of capital goods for use in facilities in Southern Italy or in earthquake-hit areas of Central Italy. The measures also envisage the extension to 2020-2022 of both the "hyper-depreciation" mechanism, which permits the recognition of investments in capital goods that fall within the high-technology content category of the Industry 4.0 Plan at up to 170 per cent of their value (and the recognition of investments in intangible assets, software and IT systems at 140 per cent of their value), with a corresponding increase in depreciation and amortisation charges, and of the "super-depreciation" scheme for the recognition of investments in new capital goods (excluding vehicles) at 130 per cent of their value (for descriptions of some of the measures, see section 3.1).

Resources have also been appropriated for *public employment*, both to supplement the funding already included in last year's Budget Act for the renewal of the employment contracts of central government personnel for 2019-2021 and to fund international peace-keeping missions in 2021-2022.

IRPEF (personal income tax) *tax credits* have been extended for spending on building renovations and energy upgrading projects, and a credit of 90 per cent has been introduced for renovations of the external façades of buildings.

In the *healthcare* sector, measures include the reduction of the "superticket" co-payment for specialist visits and diagnostic services (see section 3.7).

Finally, *other measures* call for increasing various funds for urgent interventions (such as the extension of the state of emergency for the earthquake-hit areas in Central Italy, seismic risk prevention initiatives of the Civil Protection Department, Operation "Safe Roads") for current-year legislative measures, and for relations with special statute regions (the beneficiary regions and how the fund will be allocated among those regions will be set out in a prime ministerial decree to be issued by 31 March 2020).

With regard to the resources funding these measures, in addition to those provided for in the Tax Decree (Decree Law 124/2019), other measures impact firms, including sole proprietorships, and self-employed workers, or introduce new taxes. Other provisions provide for the defunding or reprogramming of existing programmes and other measures to rationalise spending.

Among the measures *to combat tax evasion* are provisions for combatting fraud and tax evasion, specifically involving VAT and excise duties in certain areas, provisions for preventing unwarranted offsetting of tax receivables and payables and illegal temporary work. In addition, the Budget Act contains other significant measures that limit the 19 per cent tax credit for certain types of spending to taxpayers who make those payments using traceable payment instruments, as well as provisions for increasing the amount and timeliness of information available to the Revenue Agency and the Finance Police for the performance of their audits (see section 3.4).

Measures for companies and self-employed workers include those affecting: banks, with a freeze for the 2019 tax year on a series of deductions (relating to value adjustments on loans resulting from the first year of application of International Financial Reporting Standard 9; the restructuring of the timing of deductions of amortisation charges for goodwill and other intangible assets and of writedowns of loans that in the past led to the recognition of deferred tax assets convertible into tax credits) and, in addition, the revaluation of unlisted equity investments and land, the repeal of the tax relief mechanism for self-employed workers and sole proprietorships with turnover of between €65,000 and €100,000, the exclusion from the flat-rate regime of taxpayers who receive income from employment or similar income exceeding €30,000, the change in the depreciation of assets to be relinquished free of charge for motorway concession holders (for descriptions of some of these measures, see section 3.1.2).

Other tax measures include: new taxes on the consumption of single-use plastic products and some types of beverages, the revision of tax relief on company cars, as well as increases in taxes on gaming and tobacco products. For 2020 only, revenue will be increased by the restructuring for some taxpayers (who are engaged in economic activities for which ISA tax compliance indicators have been approved, for those that hold interests in companies, associations and firms with turnover generated as an association, as well as flow-through entities) of the two instalments of estimated tax payments in the amount of 50 per cent each (instead of the previous 40 and 60 per cent), starting with the second instalment for 2019 as provided for by Decree Law 124/2019.

Among those *measures in support of families and to combat poverty*, additional savings are expected to be generated by the smaller-than-expected participation in the "*Quota 100*" early retirement mechanism provided for by Decree Law 4/2019.

The second section of the Budget Bill contains cuts to *investments and investment grants* in the form of the significant defunding and reprogramming of the Development and Cohesion Fund and financing for healthcare facility construction as well as cuts in the capital expenditure of ministries (see Section 3.8).

Finally, *other measures* include savings provided for in the second section of the Budget Bill as a result of the permanent reduction in the current expenditure of ministries for the three-year planning period (and those provided for in Decree Law 124/2019 for the current year to fund the decrease in revenue attributable to the restructuring of the two instalments of estimated tax payments referred to above), in addition to increasing reductions in interest expenditure attributable to the incorporation in the State Treasury of the Single Justice System Fund (which holds financial and insurance accounts subject to precautionary seizure or confiscation, and sums not collected after 5 years of completion of civil trials and bankruptcy proceedings).

An overview of the budget package and the risks to the policy scenario

Against the background of an improvement in the trend scenario compared with the EFD based in large part on the estimated decrease in interest expenditure linked to the expected reduction in rates on government securities, it should be emphasised that the budget package projects a decline in the policy deficit only from 2021, especially thanks to the considerable impact of the safeguard clauses. It combines an increase in net expenditure over the three-year period with a decrease in total revenue, net of the effect of the safeguard clauses, with no rebalancing of expenditure towards that on capital account. Half of the spending on the measures is deficit financed in the first year and more than a third in the following two, causing the balances to deteriorate compared with the trend.

More specifically, the budget measures improve the policy deficit starting in 2021 after three years with an estimated deficit of 2.2 per cent of GDP. The improvement in the deficit envisaged for 2021 and 2022 is solely attributable to the still significant impact of the indirect tax increases provided for in the safeguard clauses. Only one-third of the latter's impact is eliminated in 2021 and just one-tenth in 2022, and the remaining increases still represent 1.0 and 1.3 per cent of GDP respectively (in absolute value, €19 billion in 2021 and €25.8 billion in 2022; Table 2.6). Excluding these revenues, the deficit – in purely mechanical terms – would be equal to 2.8 per cent of GDP in 2021 and 2.7 per cent in 2022, while the primary surplus would fall to 0.3 per cent and 0.2 per cent of GDP respectively. In a further purely mechanical exercise, those clauses would also be responsible for more than half of the planned reduction in the debt/GDP ratio in 2021 and 2022 (about 56 and 65 per cent, respectively). Neither the Update nor the DBP provide policy indications about the future treatment of the safeguard clauses.

Compared with the trend scenario, the budget measures net of the deactivation of the safeguard clauses improve the deficit in the first year only (by €6.8 billion), but produce an increasingly marked deterioration in the two following years (by €2.9 and €7.5 billion respectively).

In addition, the budget measures show sharply divergent developments between total expenditure and revenue net of safeguard clauses: the measures lead to an increase in net revenues in 2020 (by €7.5 billion), with the additional revenue then gradually decreasing (€5.5 billion and €3.9 billion in 2021 and 2022, respectively), accompanied by increases in net expenditure that are much smaller in the first year (€0.7 billion) but rise

Table 2.6 – Activation and deactivation of safeguard clauses for VAT and excise duties
(millions of euros)

	2015	2016	2017	2018	2019	2020	2021	2022
2015 Stability Act (Law 190/2014)								
Activation	0	12,814	19,221	21,965	21,965	21,965	21,965	21,965
2016 Stability Act (Law 208/2015)								
Deactivation		-12,814	-4,088	-2,394	-2,394	-2,394	-2,394	-2,394
Net effect		0	15,133	19,571	19,571	19,571	19,571	19,571
2017 Budget Act (Law 232/2016)								
Deactivation			-15,133	0	0	0	0	0
Increase in clauses					3,679	3,679	3,679	3,679
Net effect			0	19,571	23,250	23,250	23,250	23,250
Decree Law 50/2017								
Deactivation				-3,828	-4,363	-4,088	-3,679	-3,679
Net effect				15,743	18,887	19,162	19,571	19,571
Decree Law 148/2017								
Deactivation				-835	-340	0	0	0
Net effect				14,908	18,547	19,162	19,571	19,571
2018 Budget Act (Law 205/2017)								
Deactivation				-14,908	-6,075	0	0	0
Net effect				0	12,472	19,162	19,571	19,571
2019 Budget Act (Law 145/2018)								
Deactivation					-12,472	0	0	0
Increase in clauses						3,910	9,182	9,182
Net effect					0	23,072	28,753	28,753
2020 Budget Bill								
Deactivation						-23,072	-9,800	-2,995
Net effect						0	18,953	25,758

Source: based on data from the texts of the legislation and the technical reports accompanying the various measures.

considerably in the second year (€8.5 billion) and still again in the third year (€11.3 billion), with a preponderance of current items. The budget measures produce a decrease in net capital expenditure in 2020 and increases of €2 billion and €4 billion in the following two years: the projected increases in the first section of the Budget Act are offset by the reductions envisaged in the second section.

The Government's public finance policy aggregates appear to be exposed to risks and uncertainties that essentially concern the macroeconomic environment. Risks of a sharp deterioration in the international context could adversely impact foreign demand for Italian output and therefore GDP growth, which could be slower than that envisaged in the policy scenario in the Update. Moreover, the favourable interest rate conditions created with their decline since the start of September are also exposed to uncertainty, as demonstrated by the recent increase in rate volatility, threatening to impact interest expenditure on the debt.

On the other hand, some of the uncertainties identified earlier appear to have diminished.

The recovery of tax revenue, for which the Update relied on measures to combat tax evasion to generate (0.4 per cent of GDP, around €7 billion), has been considerably reduced and is accompanied by more conservative estimates.

The Technical Report accompanying the Budget Bill quantifies the impact of expenditure for the renewal of public employee contracts (other than central government employees) on the general government accounts.[33] It is up to the decentralised entities to find this funding.

With regard to the effectiveness of measures to rationalise spending, the quantifications are corroborated by provisions in the ministries' expenditure budgets.

2.1.4 Analysis of the fiscal stance

The analysis of the fiscal stance consists of an assessment of the orientation of fiscal policy in relation to cyclical conditions in the economy. The latter is generally determined using the output gap (the difference between actual output and potential output as a ratio of the latter), while an indicator of the type of impulse (expansionary or restrictive) provided by fiscal policy and its intensity is given by the change in the structural primary balance (which measures the correction of public finance balances net of the cyclical component, temporary measures and interest expenditure). Comparing these two indicators therefore enables us to describe an expansionary budget (a decrease in the primary balance) as counter-cyclical or pro-cyclical depending on whether it occurs, respectively, during a contraction (a negative output gap) or an expansion (positive output gap) of the economy; the opposite holds for a restrictive budget.

With regard to the fiscal stance, the policy scenario set out in the Update, which was retained in the DBP, has changed quite significantly from that outlined in the EFD published last April. For 2019, in place of the deterioration of 0.2 percentage points in the structural primary balance, an increase of 0.1 percentage points is now expected: accordingly, while the EFD envisaged a counter-cyclical expansionary stance (given an estimated output gap of -1.7 percentage points of potential GDP, worsening by 0.1 points), the stance would be slightly restrictive (and pro-cyclical) under the new forecast. With regard to the next three years, the Update inverts the sign of the fiscal stance in 2020 (which, this time, goes from being restrictive to being expansionary) and avoids the tightening projected for the subsequent two-year period (panel (a) of Figure 2.2). In fact, while the EFD projected an increase in the structural primary surplus of 0.2 percentage points of GDP in 2020 and 0.4 percentage points in each of the two subsequent years with a negative output gap (therefore three years of pro-cyclical

[33] The contractual increases, to be defined by applying the same criteria envisaged for State sector employees, generate an expense of €940 million in 2019, €1,340 million in 2020 and €2,530 million from 2021.

restrictions), the Update envisages a 0.3 percentage point decrease in 2020, followed by no change in the two years thereafter.

It should be borne in mind that the EFD's policy scenario continued to include the assumption that the safeguard clauses would be activated, with an increase in indirect taxes – envisaged under current legislation – of 1.3 per cent of GDP in 2020 and about 1.5 per cent starting from 2021, although the Government had at that time stated that it planned to avoid doing so. The change in the fiscal policy stance implied by the Update is therefore mainly attributable to the decision, with the budget package for 2020, to completely deactivate the safeguard clauses in 2020 and partially deactivate in the two following years, offset only in part by new funding.

Based on the estimates used for the Update, the output gap continues to signal a particularly adverse phase in 2019-2020 (with values below the benchmark of -1.5 per cent of potential GDP that the European Commission uses to identify bad times) and, while showing a clear tendency to close in the two years thereafter (something that did not occur in the projections in the EFD), remains significantly negative at the end of the forecast period (-1 per cent in 2022). Therefore, in this scenario the stance currently projected would be clearly counter-cyclical in 2020 before turning neutral during adverse cyclical conditions in the two following years.

However, identifying the cyclical phase using the output gap estimate is subject to a wide margin of uncertainty (especially for the current year and the immediate future years) and different values for the output gap can lend a rather different connotation to the fiscal stance provided for in the Update.

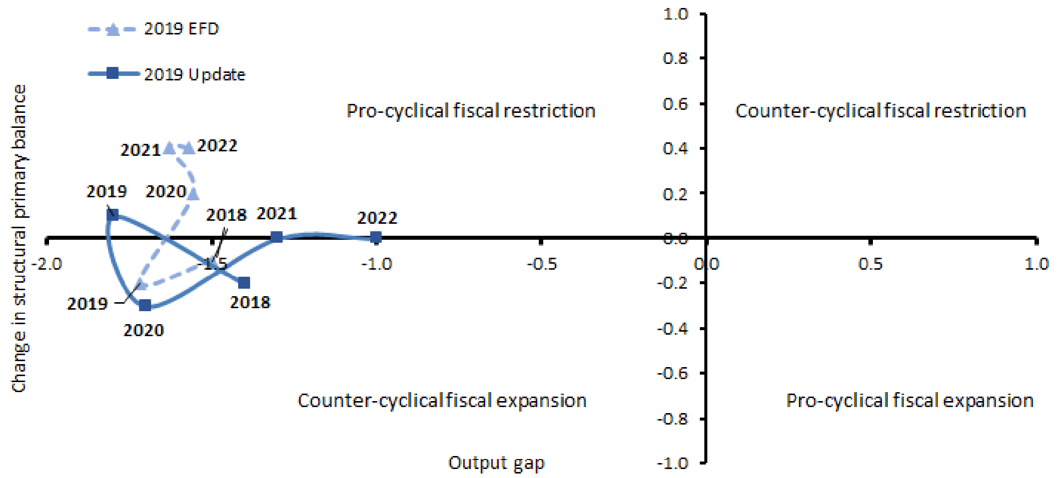
The PBO uses five different models to estimate potential GDP.[34] Figure 2.2 (panel b) offers the profile that the fiscal stance would have if the developments in the structural primary balance were those forecast by the Update, but the gap between actual output and potential output corresponded to the median value of the various PBO estimates.

The output gap estimated by the PBO's different models is therefore not used to recalculate the cyclical component of the budget balances. In fact, unlike the level of the structural primary balance, its change (that is to say, the fiscal stance) is not substantially affected by the output gap estimate. In terms of policy, maintaining unchanged the path of the structural balances is equivalent to assuming that the Government would follow the structural adjustment path in the Update even with a different macroeconomic scenario from that assumed in the document.

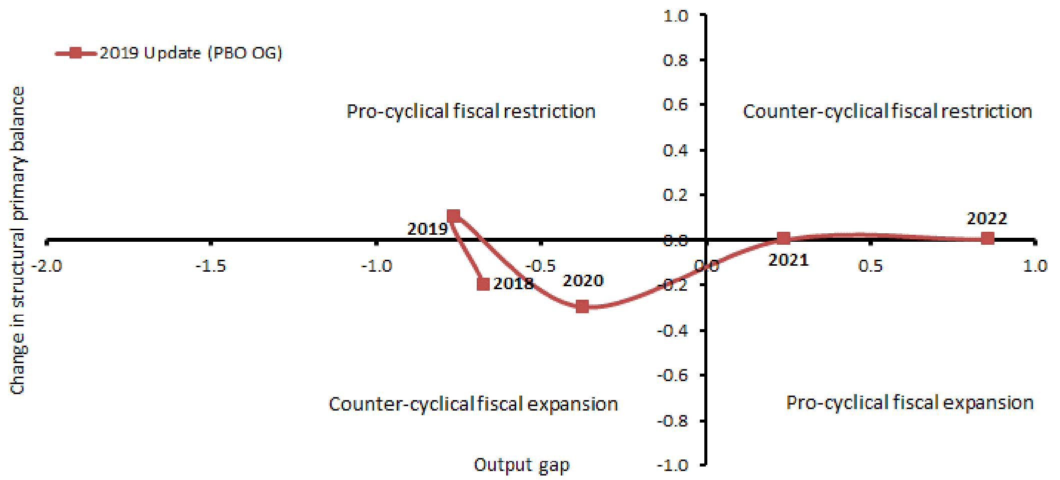
[34] See Box 1.1 for further details.

Figure 2.2 – Changes in the structural primary balance, EFD and the output gap
(percentage of GDP)

a) Policy scenarios in the 2019 EFD and Update



b) Policy scenario in the Update and the PBO's estimated output gap



Sources: based on data in the 2019 EFD and the 2020 DBP.

Using the PBO's estimates, the output gap would be -0.8 per cent in 2019 (a slight deterioration compared with the preceding year as in the estimate in the Update), and in 2020 there should be an improvement of 0.4 points and, starting in 2021, effective output should return to above the level of potential output (albeit by just 0.2 percentage points),[35] then exceed it by almost 1 percentage point in 2022. In this context, the assessment of the fiscal stance in 2019-2020 would be substantially confirmed, even if the pro-cyclical character of the restriction in 2019 would be less clear, as would the counter-cyclical nature of the expansionary stance in 2020. Finally, the neutral fiscal policy in 2021-2022 would be conducted in a favourable cyclical environment, rather than the unfavourable conditions projected in the Update.

[35] Given the uncertainty about the estimate of potential output, an output gap in the ±0.5 per cent band suggests that effective output is essentially in line with potential output, indicating a neutral cyclical phase (that is, neither favourable nor unfavourable).

2.2 The medium-term sustainability of the public finances

This section assesses the medium-term sustainability of the public finance policy scenario in the Update to the EFD, a scenario confirmed in the subsequent DBP. Consistent with the definitions of the European Commission and the International Monetary Fund, policy objectives are deemed sustainable if it is possible to maintain current fiscal policy in the future without causing a continuous and potentially explosive increase in debt relative to GDP.

In our baseline scenario, the fiscal policy stance corresponds to the strategy outlined in the Update for 2019-2022, which is extended to the medium term using ad hoc assumptions.

More specifically, the analysis of medium-term sustainability is divided into three parts: 1) a deterministic analysis with the formulation of a baseline scenario, in which the policy path of the debt/GDP ratio presented in the Update is extended until 2028 with ad hoc assumptions; 2) an analysis where the baseline scenario undergoes sensitivity analysis through 2022;[36] 3) a stochastic analysis, in which the variables that influence the dynamics of the debt/GDP ratio are exposed to temporary and permanent shocks in order to obtain a large number of scenarios for the ratio over the coming decade and determine their probability intervals.

2.2.1 Deterministic analysis

As noted earlier, through 2022 the baseline scenario in this part of the analysis corresponds to that in the Update. The ad hoc assumptions to extend the policy trajectory of the debt/GDP ratio in the Update from 2023 to 2028 are the following: 1) the gradual convergence of real growth to 0.5 per cent; 2) the gradual convergence of the inflation rate to 2 per cent, equal to the ECB's medium-term monetary policy target; 3) the gradual convergence of the short-term interest rate to 3 per cent, given the nominal GDP growth assumed, plus a risk premium of 50 basis points; 4) the gradual convergence of the long-term interest rate to 4.5 per cent, given by the sum of the short-term interest rate and a risk premium of 150 basis points, consistent with the average for Italy since its entry into the euro area until 2018; 5) a structural primary balance that remains constant at the level reached in 2022,[37] while the output gap

[36] See also Ufficio parlamentare di bilancio (2016), "2017 Budgetary Policy Report", Appendix 3.3. It should be noted that the methodology for estimating interest expenditure in alternative scenarios has been improved, revising how debt is broken down into its various components (securities indexed to inflation have been moved from the short-term to the long-term component) and introducing a link between the yield on indexed securities and the inflation differential between the baseline and the alternative scenarios.

[37] Note that the PBO's past projections were based on a different assumption for developments in the structural balance in the medium term, which imposed an adjustment of about 0.5 percentage points of GDP until the MTO is achieved.

closes by the end of 2025 so that from that year the cyclical component of the primary balance is equal to zero; and 6) a zero stock-flow adjustment.

Applying these assumptions in the baseline scenario, the debt/GDP ratio also continues to decline beyond 2022. However, by the end of the medium-term forecast period, in 2028, it would still be 123.8 per cent of GDP (Figure 2.3).

With regard to compliance with the debt rule with the backward-looking criterion, the scenario in the Update shows a debt/GDP ratio above the benchmark over the entire medium-term forecast period.

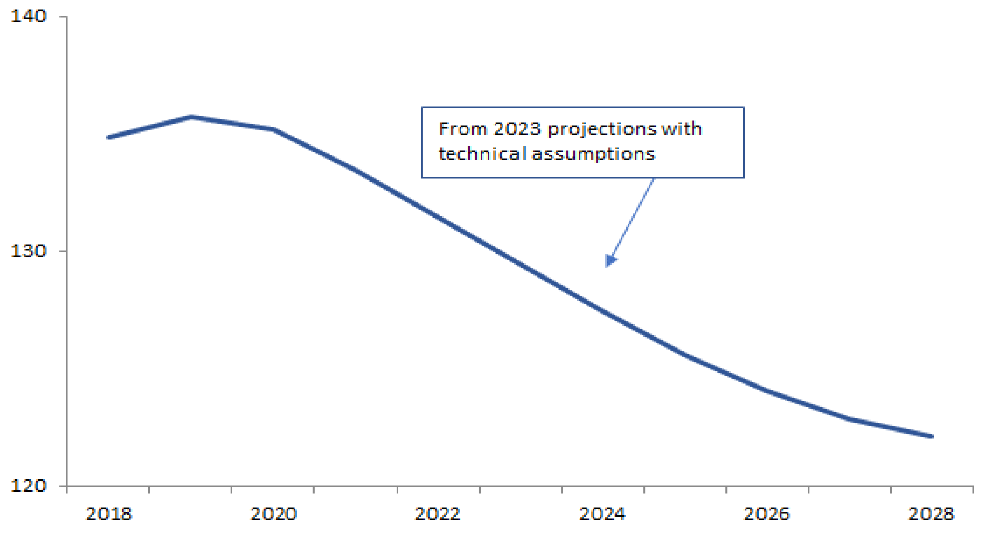
2.2.2 Sensitivity analysis of developments in the public debt

This section considers policy scenario in the Update as the baseline policy scenario and analyses the sensitivity of the debt/GDP ratio with respect to alternative scenarios for the assumptions underlying this scenario, limiting the focus to the time horizon in the policy document.

a) Development of the debt/GDP ratio using the PBO's macroeconomic forecasts

The trajectory of the debt/GDP ratio forecast in the Update is first compared with an alternative scenario based on the PBO's projections for real GDP growth and the GDP deflator.

Figure 2.3 – Developments in the debt/GDP ratio in the medium-term consistent with the policy scenario in the Update
(percentage points)

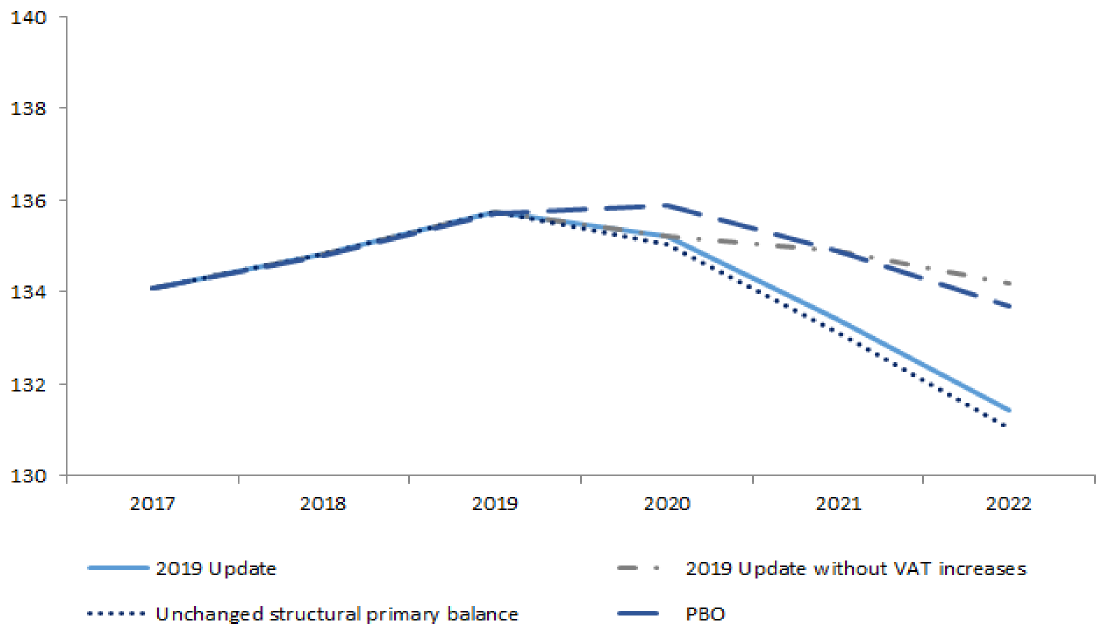


Source: based on data from the 2019 Update.

For the entire simulation period, the ratio between the primary surplus and GDP is calculated by applying an elasticity for this balance of 0.544[38] to the real growth differential between the PBO scenario and the scenario in the Update. Analogously, an elasticity for the primary balance of 0.15 is applied to the inflation differential between the two scenarios for the current year and for the two subsequent years.[39] In addition, it is assumed that a change in the inflation rate is partially translated onto interest rates. The stock-flow adjustment is changed from that in the policy scenario in the Update, assuming that there are no privatisation receipts (equal to 0.2 per cent of GDP per year from 2020 to 2022).

In the PBO scenario, the debt/GDP ratio continues to rise in 2020 (135.9 per cent) and then begins to decline in the subsequent two years, reaching 133.7 per cent in 2022. In that year, the divergence between the trajectory in the PBO scenario and that in the Update is equal to 2.3 percentage points (Figure 2.4).

Figure 2.4 – Medium-term developments in the debt/GDP ratio consistent with the policy scenario in the Update
(percentage points)



Source: based on data in the 2019 Update.

[38] In line with the European Commission's 2019 updated estimates. See Mourre *et al.* (2019), *The Semi-Elasticities Underlying the Cyclically-Adjusted Budget Balance: An Update & Further Analysis*, European Economy Discussion Paper, no. 098, European Commission.

[39] The impact of changes in the interest rate on the primary balance was estimated starting from Attinasi *et al.* (2016), "*The effects of low inflation on public finances",* Chapter 10 in *S.* Momigliano (Ed.), *"Beyond the austerity dispute: New priorities for fiscal policy",* Banca d'Italia, making some specific changes that take account of developments in Italian law concerning the indexing of certain major expenditure items in the years following those considered in the work. Moreover, in it 0.15 corresponds to the average (for the various countries analysed, namely Austria, France, Germany, Greece and Italy) of the semi-elasticity of the primary balance to inflation in the year of the shock.

a) Profile of the debt/GDP ratio with an unchanged structural primary balance

In this scenario it is assumed that the structural primary balance remains unchanged at the level estimated for 2019 (2.2 per cent of GDP) rather than following the policy

trajectory set out in the Update (1.9 per cent in 2020-2021 and 2 per cent in 2022).[40]

The exercise then considers a slightly more restrictive fiscal policy in the 2020-2022 period, the effects of which on real GDP growth are determined using the average multiplier from the PBO model, applied in each year to the difference between the alternative structural primary balance assumed and the baseline scenario. The growth differential that is calculated, impacting the cyclical component, is then reflected in the nominal primary balance through the semi-elasticity of that balance.

Based on these assumptions, the results show that the trajectory of the debt/GDP ratio would be just below that in the baseline scenario, since the structural improvement in the balances would only be partially offset by the deterioration in the cyclical component (the real growth rate would only be lower – by about half of one-tenth of a point – in 2020 and in 2021). Therefore, the debt would be equal to 131 per cent of GDP in 2022 (Figure 2.4).

b) Impact on the debt/GDP ratio of the deactivation of the safeguard clauses in 2021-2022

The Update indicates that the increases in indirect taxes in 2021-2022 would be only partially deactivated in the policy scenario. This scenario simulates the developments in the debt/GDP ratio by assuming the full deactivation of the remaining safeguard clauses following the budget measures, equal to €19 billion in 2021 and €25.8 billion in 2022, without providing for alternative funding to cover the shortfall (Figure 2.4).

The exercise assumes an expansionary impulse equal to the remaining amount of the safeguard clauses, whose effects on real GDP growth are determined through the indirect tax multiplier of the PBO model. The effect on inflation is also considered, applying the elasticity of the GDP deflator to a fiscal impulse through indirect taxes, also estimated by the PBO model. It is also assumed that a change in the growth of the GDP deflator is partially (50 per cent) passed through to interest rates.

The deterioration in the balances is only partially offset by the improvement in the cyclical component of those balances. Even the reduction in the cost of issuing public debt securities – determined by the lower inflation rate – is marginal. In this scenario, the debt/GDP ratio would continue to fall in 2021-2022, albeit to a lesser extent than in the policy scenario in the Update, reaching 134.2 per cent at the end of the planning period instead of 131.4 per cent.

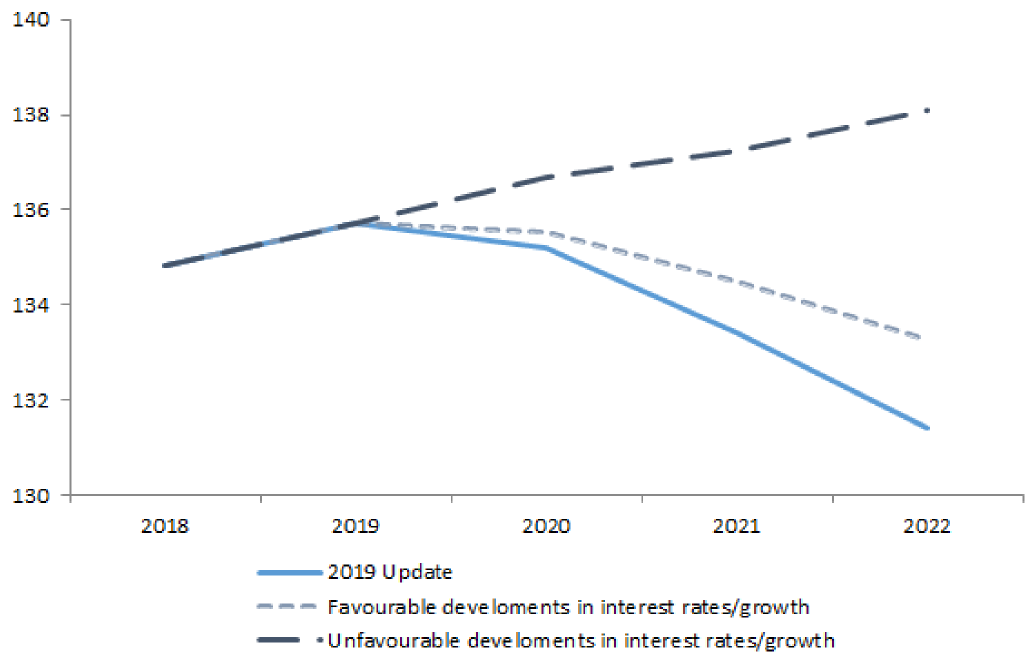
[40] Given this trend in the structural primary balance, the Update envisages a more marked improvement in the structural balance in 2021-2022, which is however attributable to the reduction in interest expenditure.

c) Impact on the debt/GDP ratio of an increase or a decrease in interest rates

In this exercise, two different scenarios relating to the interest rate curve are assumed: 1) a scenario in which the differential between the weighted average interest rate of new issues and nominal GDP growth is particularly unfavourable (75th percentile of the distribution of the difference between the interest rate and the nominal GDP growth rate in the last 20 years) and 2) a scenario in which the same differential is particularly favourable (25th percentile of the same distribution).[41]

The results of the simulation show that in both the relatively unfavourable scenario and the relatively favourable scenario the trajectory of the debt/GDP ratio is above that delineated by the policy scenario in the Update (Figure 2.5). This is because the macroeconomic scenario in the Update forecasts that in the next three years the differential between the interest rates on new issues and the nominal growth rate is much smaller than the value corresponding to the 25th percentile of the distribution. Therefore, even the relatively favourable scenario involves an assumption of higher interest rates than in the scenario in the Update.

Figure 2.5 – Alternative scenarios for the differential between interest rates and growth *(percentage points)*



Source: based on data from the Update to the 2019 EFD.

[41] The 75th percentile (unfavourable tail) of the distribution of the differential between the interest rate (weighted average of short-term and long-term interest rates) and the nominal GDP growth rate was registered in 2011 (when the differential was 1.7 percentage points); the 25th percentile (favourable tail) corresponds to 2018 when it was equal to about -0.8 percentage points.

In addition, while in the relatively more favourable scenario the debt/GDP ratio would still exhibit a descending trajectory over the next three years (going from 135.7 per cent in 2019 to 133.3 per cent in 2022), in the relatively unfavourable scenario the ratio would be rising, with the debt reaching 138.1 per cent of GDP in 2022 (6.7 percentage points more than in the baseline scenario).

From this exercise, it can be concluded that: 1) in conditions that are relatively unfavourable for interest rates and nominal GDP growth, the public finance strategy outlined in the Update would produce a non-negligible increase in the debt/GDP ratio; 2) current market conditions – with particularly low nominal and real interest rates –can be considered to be much more favourable than observed historically. The downward trajectory of the debt/GDP ratio envisaged in the Update is therefore strictly linked to the assumption that the cost of public debt will remain especially low in the coming years. This could happen if monetary policy continues to be particularly expansionary or if the country risk premium remains at relatively low levels.

2.2.3 Stochastic analysis

To take account of uncertainties in the estimates, the Government's policy scenario is compared with probability intervals obtained using statistical techniques in line with those used by the European Commission.[42] In this part of the analysis, the reference scenario is consistent with the PBO's macroeconomic scenario.

More specifically, we estimated 5,000 possible trajectories for the debt/GDP ratio, considering developments in the ratio that are consistent with the PBO macroeconomic forecasts (real GDP growth and GDP deflator). This enabled the construction of a probability fan chart under an assumption of temporary and permanent shocks to the variables that affect the behaviour of the debt (Figure 2.6).

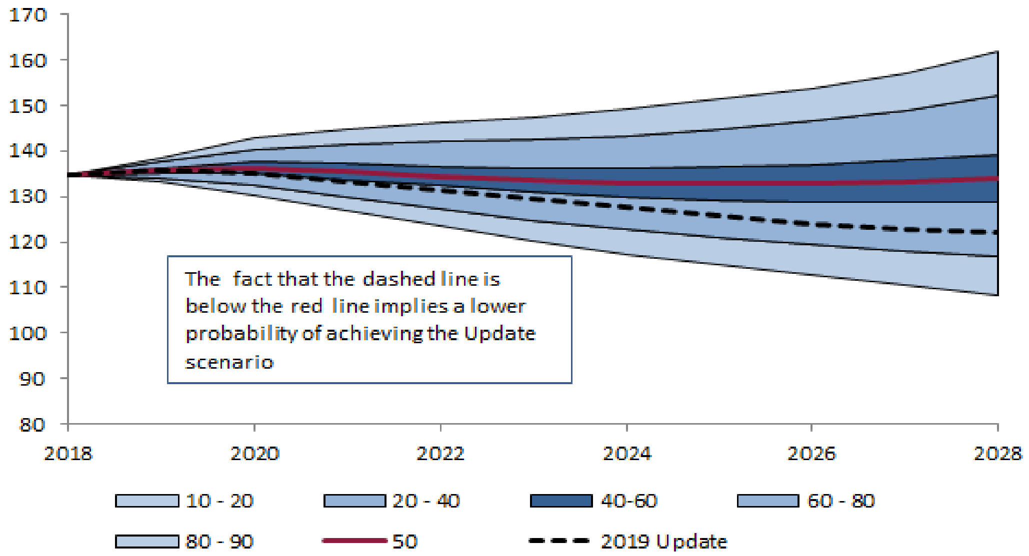
To extend the PBO's 2019-2022 scenario used in the sensitivity analysis in the previous section, we maintain the same assumptions used in the baseline scenario in the Update for developments in the real GDP growth rate, the inflation rate and the output gap. It is also assumed that a change in inflation is partially translated onto interest rates. The cyclical component of the budget balances is recalculated using the output gap estimates produced by the PBO.

Using the equation describing debt dynamics, alternative debt/GDP ratio scenarios are obtained by shocking the variables that characterise the equation itself: the real GDP growth rate, the GDP deflator growth rate, the short-term interest rate and spreads

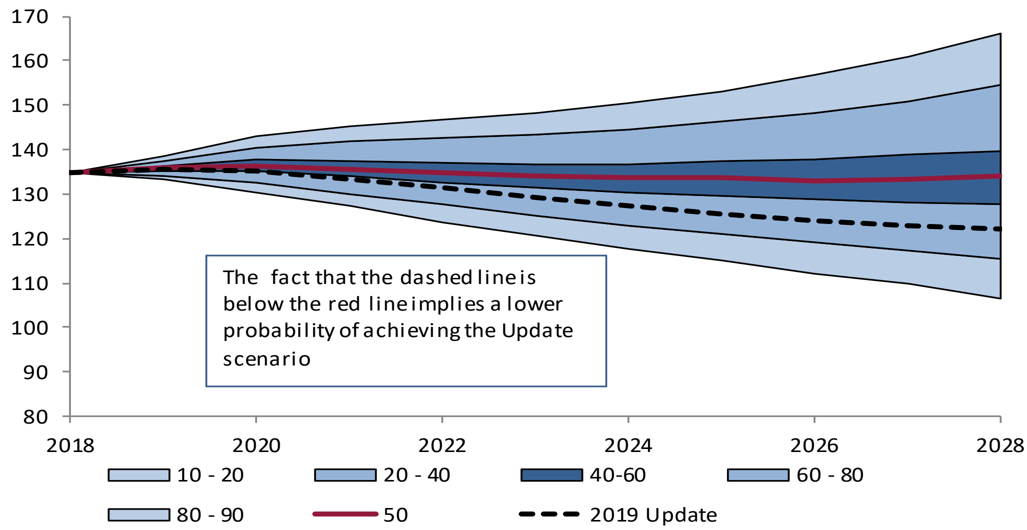
[42] See in particular Berti, K. (2013), "Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries", European Commission, *Economic Papers* 480, April.

Figure 2.6 – Stochastic analysis with temporary shocks: Update policy scenario compared with the PBO scenario
(percentage points)

a) Temporary shocks



b) Permanent shocks



Source: Based on data in the Update to the 2019 EFD.

between short- and long-term interest rates.[43]

Given the macroeconomic forecasts developed by the PBO, the distribution obtained in the case of temporary shocks puts the policy debt/GDP ratio in the Update close to the 40th percentile in the first few years of the forecast period, and to the 30th percentile in

[43] The assumption of temporary shocks provides for changes in the variables that determine developments in the debt/GDP ratio whose effects are limited to the year of the shock. The assumption of permanent shocks provides for persistent shocks over time with regard to interest rates.

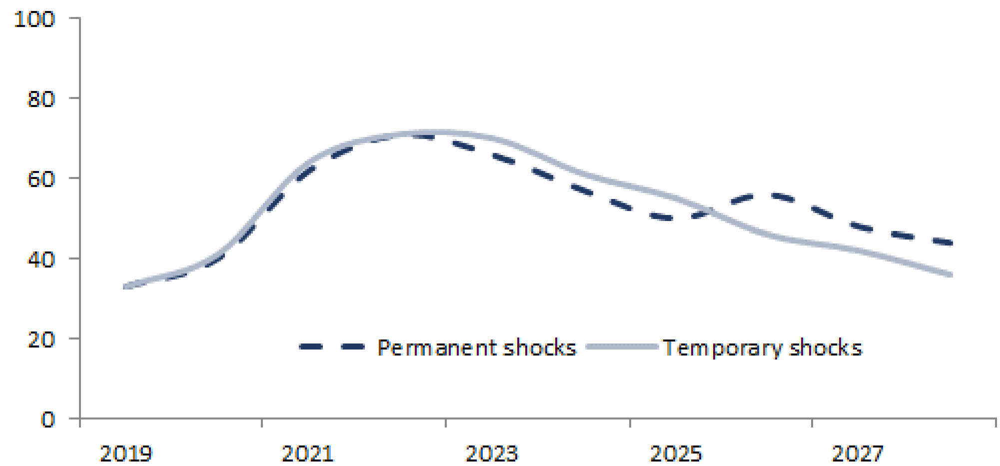
the years thereafter; in other words, in the medium term about 70 per cent of the scenarios generated put the debt/GDP ratio above than projected by the Update.

The assumption of permanent shocks produces a slightly wider distribution of the values for the debt/GDP ratio. More specifically, the difference between the 90th and 10th percentiles is equal to 54 percentage points in the case of temporary shocks, while it rises to 59 points in the case of permanent shocks. However, in the case of temporary shocks, the trajectory of the debt/GDP ratio in the Update is assigned a probability of occurrence of just below the 40th percentile of the distribution.

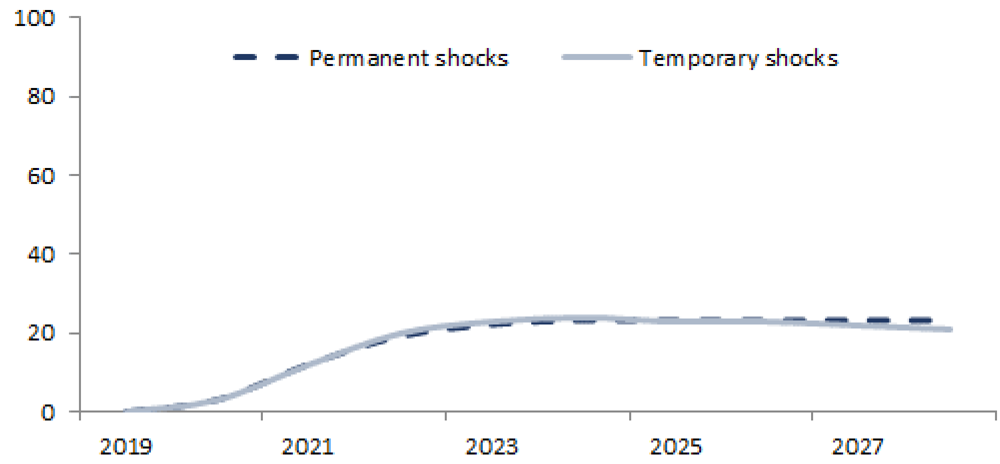
Figure 2.7 reports the likelihood of a decline in the debt for each year compared with the previous year (panel a) and compliance with the debt rule on a backward-looking basis (panel b) under temporary and permanent shocks.

Figure 2.7 – Stochastic analysis of temporary and permanent shocks: implicit probabilities
(percentage points)

a) Debt declines with respect to previous year



b) Compliance with the debt rule



Source: Based on data in the 2019 Update.

With temporary shocks, the probability of the debt/GDP ratio decreasing compared with the previous year is around 33 per cent in 2019, and then rises until 2022, the year in which it reaches 71 per cent; in subsequent years, this probability decreases, reaching 36 per cent in 2028. In the case of permanent shocks, the dynamic is fairly similar until 2026, the year in which the probability of a reduction in the debt bounces to 56 per cent, before declining again to 44 per cent in 2028.

For the debt rule with the backward-looking criterion, the results indicate for both scenarios that the probability of compliance with the rule is close to zero in the first two years. In subsequent years, these probabilities rise steadily, reaching 20 per cent in the final year of the forecast in the Update (2022) and rising to levels only slightly higher for the rest of the simulation period.

2.3 The public finance scenario in light of the fiscal rules

2.3.1 Report to Parliament under Law 243/2012

Along with the Update to the EFD, the Government presented a Report to Parliament in which it asked for authorisation to revise the plan for resuming the path towards the MTO already authorised with the 2018 Report to Parliament, annexed to the 2018 Update, presented to the Chamber of Deputies and approved with an absolute majority in October 2018. Subsequently, the 2019 EFD revised the path of adjustment towards the MTO, to make it more stringent than previously.

In the Report to Parliament, the Government refers to Article 6(5) of Law 243/2012, which allows the adjustment plan previously approved to be updated if the Government plans to change it in response to further exceptional events or developments in economic conditions.

Article 6 of Law 243/2012 provides that the Government can temporarily deviate from the policy objective in order to address unusual events with the prior authorisation of the Chamber of Deputies. Paragraph 5 of Article 6 establishes that the plan can be updated by the Government, after consulting with the European Commission, by submitting a Report to Parliament for approval by an absolute majority. The Report shall update the public finance policy objectives, indicating the duration and extent of the deviation, the purposes for which the resources rendered available by such deviation will be used and the plan for returning towards achievement of the policy objective, aligning the duration with the severity of the events. The plan for resuming the adjustment path shall be implemented the year following that for which the deviation is allowed.

The Report to Parliament pursuant to Law 243/2012 has been presented numerous times in the past by the Governments then in power, specifically upon the presentation of the 2014 EFD, the Update to the 2014 EFD, the Update to the 2015 EFD, the 2016 EFD, the Update to the 2016 EFD, the Update to the 2017 EFD and the Update to the 2018 EFD. Another Report was presented on 19 December 2016, on the occasion of Decree Law 237/2016 on providing support for the Italian banking system (Table 2.7). Law 243/2012 provides that, in the presence of unusual events, the Government can resort to borrowing to carry out financial operations.

The 2018 Update envisaged a structural deficit of 1.7 per cent in each year of the 2019-2021 period. The 2019 EFD tightened the structural balance policy objectives compared with the 2018 Update, with a deficit of 1.5 per cent in 2019, 1.4 per cent in 2020, 1.1 per cent in 2021 and 0.8 per cent in 2022. Furthermore, the 2019 EFD incorporated the new MTO valid from 2010, equal to a structural surplus of 0.5 per cent, as established on the basis of the methodology described in the Code of Conduct of the Stability and Growth Pact.[44]

[44] For an in-depth explanation of why the MTO was changed, see Ufficio parlamentare di bilancio (2019), “2019 Budgetary Planning Report”, pages 84 et seq.

Table 2.7 – The Report to Parliament under Law 243/2012

Report to Parliament	Legislative basis	Rationale	Achievement of MTO
2014 Report (2014 EFD)	Art. 6 Law 243/2012; Art. 3 paragraph 4 Law 243/2012; Art. 5 Reg. EU 1175/2011	Reduction in potential output in 2012-13 Fragile labour market conditions Output gap still sharply negative Liquidity conditions of firms not normalised Need to accelerate general government trade payables Need to implement structural reforms	Postponed from 2015 to 2016
2014 Report (2014 Update)	Art. 6 paragraph 5 Law 243/2012 Art.5 Reg 1466/97	Very large negative output gap in 2013-2014 and 2015 GDP contraction in 2014 Risk of further downward revisions of 2015 growth Risk of deflation	Postponed from 2016 to 2017
2015 Report (2015 Update)	Art. 6 paragraph 5 Law 243/	Despite recovery in first half of 2015, substantial decline in output in recent years GDP is still significantly below pre-crisis levels Inflation trend more unfavourable than expected Loss of nearly 20 points of output compared with pre-crisis trend of unprecedented severity Calculation method for potential output adopted by European Commission does not reflect lost output Significant risk of slower growth in international trade Financial repercussions of wave of immigration	Postponed from 2017 to 2018
2016 Report (2016 EFD)	Art. 6 paragraph 5 Law 243/	Recovery loses steam in second half of 2015 owing to deterioration in international economic conditions Consumer inflation rate recently fell below zero again Downward revision of growth forecasts for 2016-2018 Loss of nearly 20 points of output compared with pre-crisis trend of unprecedented severity Calculation method for potential output adopted by European Commission does not reflect lost output Use all flexibility permitted under SGP	In 2018 MTO not achieved, as previously envisaged. The MTO is essentially achieved in 2019 (-0.2 per cent)
2016 Report (2016 Update)	Art. 6 paragraph 5 Law 243/	Revision of estimated output gap for 2017 (from -1.1 per cent in 2016 EFD to -1.7 per cent in the Update) Occurrence of exceptional events: i) the earthquake of August 2016; need for comprehensive plan to secure territory and for reconstruction; ii) intensity of immigration crisis	For last year of planning (2019) the structural balance previously envisaged (-0.2 per cent) is not changed, while the adjustment path is modified
2016 Report (19.12.2016)	Art. 6 paragraph 6 Law 243/	In the case of adverse outcome of stress tests of banks, need to provide liquidity to the banking system with State guarantee of liabilities issued by Italian, and precautionary support of capital, as provided for by Directive 59/2014/EU. The Report was issued together with DL 237/2016	Plans for issue of up to €20 billion in government securities, with an impact on net balance to be financed in State budget, borrowing requirement and public debt. Update of policy objectives and adjustment plan postponed to 2017 policy documents, taking account of measures that will actually be adopted

Table 2.7 – *(cont.)* The Report to Parliament under Law 243/2012

Report to Parliament	Legislative basis	Rationale	Achievement of MTO
2017 Report (2017 Update)	Art. 6 paragraph 5 Law 243/	Despite the recovery under way, the pace of growth is still slower than that of main European partners Although falling, the unemployment rate remains high The effects of the reforms adopted by the Government have not yet manifested themselves fully Private investment is growing but is still below pre-crisis levels Public investment requires additional resources to revive The decision of the Commission to exercise its so-called degree of discretion for 2018	Budget balance, forecast for 2019 in the 2017 EFD, to essentially be achieved in 2020 (-0.2 per cent)
2018 Report (Update 2018)	Art. 6 paragraph 5 Law 243/	Real GDP has still not returned to its level prior to 2008 crisis Geographical gaps between the North, Centre and South have widened since 2008 The number of people living in poverty has increased In the first half of 2018, growth slower than forecasts owing to developments in exports Significant risks for the future, linked to developments in international scenario Trend growth rates for GDP and employment in the Update are unacceptably low Revival and expansion of public investment, extraordinary infrastructure maintenance programme Need to achieve faster GDP growth and reduce growth gap with the EU	The adjustment plan does not specify when the MTO will be achieved. Over the 2019-2021 planning horizon, the structural balance is constant at -1.7 per cent. The gradual adjustment process will resume in 2022 (Source: 2018 Update)
2019 Report (2019 Update)	Art. 6 paragraph 5 Law 243/	In 2019, growth below potential Unemployment, especially among young people and women, and social and territorial inequality still high Per capita GDP has still not returned to pre-crisis levels registered in 2007 In last 12 months, repeated downwards revisions of macroeconomic forecasts. According to new MEF projections, negative output gap widening in 2019 compared with previous year and does not close over the forecast horizon Unfavourable international conditions (trade and political tensions, with negative impact on international trade and oil prices) represent downwards risk for growth. Business and consumer expectations are deteriorating, with adverse impact on investment, inventories and consumption European Commission orientation in favour of expansionary fiscal stance for euro area, with more gradual fiscal consolidation on the part of Member States with large public debts Need to revive public investment, especially in environmental projects in view of climate change and the strategies that the new European Commission intends to adopt Request for flexibility worth two-tenths of a point of GDP for measures to counter hydrogeological instability and other measures to support environmental sustainability and increase the resilience of the country	Compared with 2019 EFD, the structural balance improves by three-tenths of a point in 2019, is unchanged in 2020, deteriorates by one tenth in 2021 and two tenths in 2022. In the new path towards the MTO (structural surplus of 0.5 per cent), in 2020 the structural balance would deteriorate by two tenths compared with 2019, while in 2021 and 2022 the structural balance would begin to improve again, with an adjustment of two-tenths of a point in each year. The Report does not specify the timing after 2022 of the achievement of the MTO or the size of the annual adjustment.

The Update and the Report to Parliament just published set the structural deficit at 1.2 per cent in 2019, 1.4 per cent in 2020, 1.2 in 2021 and 1.0 per cent in 2022. Compared with the 2018 Update, there is an improvement in the objectives for each year considered, while compared with the 2019 EFD, the structural balance improves in 2019, is unchanged in 2020 and deteriorates in 2021-2022.

Rationale and purposes of the measure

The reasons for updating the plan given by the Government in the Report are as follows.

1) First, in 2019 the Italian economy is still growing below its potential. Unemployment, especially among young people and women, is still high, as is social and territorial inequality. Per capita GDP has still not returned to 2008 pre-crisis levels: specifically, in 2007-2018 per capita GDP fell by 7 per cent, but rose by 5.4 per cent in the euro area.

2) Over the last 12 month, GDP growth forecasts have been repeatedly revised downwards. The MEF's new forecasts show a negative output gap that, in 2019, widened compared with the previous year and that will not close over the forecast period, reaching -1 per cent in 2022.

3) It is also important to take account of the unfavourable international context (trade and political tensions, with an adverse impact on international trade and oil prices), which carries downside risks for growth. Business and consumers expectations are deteriorating, which is having a negative impact on investment, inventories and consumption.

4) The Update also mentions of the European Commission's orientation towards an expansionary fiscal policy for the euro area, which would be the result of stimulus measures implemented by the Member States with budgetary flexibility and a more gradual consolidation of the high-debt countries.

In this environment, the Government deems it necessary to boost public investment, particularly in environmental projects, taking account of both climate change and the strategies that the new European Commission plans to adopt. The Government therefore intends to undertake a "Green New Deal" designed to combat climate change, protect biodiversity, support energy reconversion, promote urban regeneration and smart cities.

More specifically, the Government plans to adopt measures to fight the risks associated with hydrogeological instability and other measures to promote environmental sustainability and increase the country's resilience. These measures are connected with Italy's request for a temporary deviation from the adjustment path towards the MTO for next year, equal to 0.2 percentage points of GDP, as announced in the Report and effectively submitted to the EU in the context of the 2020 DBP.

The Government therefore invokes the unusual events clause provided for under EU law in Article 5(1) of Council Regulation No. 1466/1997: "In the case of an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective referred to in the third subparagraph, provided that this does not endanger fiscal sustainability in the medium term".

Note that this clause has never been applied in the EU for severe economic downturns, while with regard to exceptional events in recent years additional expenditure has been allowed to tackle natural disasters, including hydrogeological threats in Italy, the exceptional refugee inflows and the security costs to deal with the heightened terrorist threat to Member States.[45] However, up until now no degree of flexibility has been granted in connection specifically with the need to implement measures to improve environmental sustainability or the resilience of the country.

In the past, Italy took advantage of the exceptional events clause in relation to the inflow of refugees in 2015 (0.03 percentage points), in 2016 (0.06) and 2017 (0.16); for security in 2016 (0.06); for seismic events (emergency management and prevention of seismic risks) in 2017 (0.19 percentage points).[46] In 2018, the Government asked the European Commission for flexibility for 2019 in the amount of about 0.2 percentage points of GDP, in relation to an extraordinary maintenance programme for the road network, following events in Genoa, and a preventive plan to limit hydrogeological risks. In assessing the 2019 Stability Programme, the European Commission and the Council agreed on a preliminary basis to grant flexibility in the amount of 0.18 percentage points, deeming the request in line with the provisions of Regulation (EC) No. 1466/1997. The final assessment of the expenditure actually incurred will be conducted by the Commission in spring 2020, as usual, based on the actual data.[47]

In Italy, Article 6(5) of Law 243/2012 permits the Government to modify the plan for returning to the adjustment path, with the prior authorisation of Parliament, upon the occurrence of a new usual event, or in relation to developments in economic conditions. Article 6(2) defines an unusual event with reference to EU law, i.e. a severe economic downturn or unusual events outside the control of the Member State.

Finally, it should be noted that this Report contains both a reference to the EU clause allowing flexibility in the case of unusual events, to be activated through a request submitted to the European Commission, and general arguments relating to the economic cycle: growth that is below its potential, failure of per capita GDP to return to

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45 European Commission (2019), "Vade Mecum on the Stability and Growth Pact", *Institutional paper* 101/2019, page 27.

46 See the 2019 EFD, page 53.

47 European Commission (2019), *"Council Recommendation on the 2019 National Reform Programme of Italy and delivering a Council opinion on the 2019 Stability Programme of Italy",* COM (2019) 512 final.

pre-crisis levels, high unemployment, downward revision of macroeconomic forecasts, and the negative output gap in the MEF's estimates.

The plan for returning to the adjustment path

The Government states in its Report to Parliament that it wants to resume the adjustment path towards the MTO in 2021-2022 and to continue to do so in the following years. However, the Report does not indicate the timing of such resumption after 2022 nor does it specify the size of the annual adjustment to be made, unlike its practice on previous occasions, with the exception of the 2018 Report to Parliament.

In the 2018 Report the Government stated, in general terms, that it intended to resume the adjustment path towards the MTO only after solid economic growth had been achieved, in particular when the level of real GDP and the unemployment rate had returned to their pre-crisis levels. By contrast, in the reports prior to 2018 the new policy scenario submitted to Parliament for authorisation envisaged that achieving the MTO would be postponed by one year compared with the preceding timetable for the adjustment path (2014 EFD, 2014 Update, 2015 Update), or that the MTO would be substantially achieved one year behind schedule (2016 EFD and 2017 Update), or in the case of the 2016 Update, for the final policy year (2019) the structural balance envisaged previously (-0.2 per cent) was not changed, but the adjustment path was (Table 2. 7).

2.3.2 The structural balance rule

The policy scenario set out in the 2020 DBP differs from that outlined in the 2019 EFD of April owing to the acceleration in the adjustment path towards the MTO in 2019 and its slowing in 2020-2022.

The assessment of compliance with the fiscal rules in the autumn is structured as an in-year analysis for 2019 and an ex ante analysis for 2020 and the following two years. The evaluation by the European Commission will be based on the 2020 DBP presented by Italy in mid-October. It should be noted that, at the EU level the ex post analysis for 2018 was completed with the assessments of the Stability Programme by the Commission and the Council during the first half of this year.

Table 2.8 reports the values published in the Update to the EFD and consistent with the 2020 DBP for the assessment of compliance with the structural balance rule and those calculated by the PBO based on the public finance policy scenario in the 2020 DBP taking account of the European Commission's recommendations laid out in the Vademecum on the Stability and Growth Pact,[48] in particular regarding the required structural adjustment. The columns show for each year considered the main elements to be considered in assessing the structural balance adjustment rule and the conclusions to be drawn as to the risk of deviations (on a one- and two-year basis) from the fiscal rules.

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[48] See *Vade Mecum on the Stability & Growth Pact – 2019 Edition* (COM), available at https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.

Table 2.8 – Deviations and compliance with the structural balance adjustment rule (1) *(percentage of potential GDP)*

Structural balance rule	2018 (2)		2019		2020		2021	2022
	Update	Vademecum	Update	Vademecum	Update	Vademecum	Update	Update
Structural balance adjustment required excluding clauses (a) (3)	0.60	0.60	0.25	0.60	0.50	0.60	0.60	0.60
Flexibility for exceptional events (hydrogeological risk and road transport measures 2019 and 2020) (b)	0.00	0.00	0.18	0.18	0.20	0.20	0.00	0.00
Flexibility for margin of discretion (c)	0.30	0.30	0.00	0.00	0.00	0.00	0.00	0.00
Adjustment required including clauses, exceptional events and margin of discretion (e=a-b-c)	**0.30**	**0.30**	**0.08**	**0.42**	**0.30**	**0.40**	**0.60**	**0.60**
Annual structural adjustment (f)	**-0.12**	**-0.09**	**0.29**	**0.29**	**-0.13**	**-0.13**	**0.20**	**0.19**
Deviation from required adjustment on one-year basis (g=f-e) (4)	**-0.42**	**-0.39**	**0.22**	**-0.13**	**-0.43**	**-0.53**	**-0.40**	**-0.41**
Compliance on one-year basis	***Adj. not suff.***	***Adj. not suff.***	***Yes***	***Dev. not sign.***	***Dev. not sign.***	***Dev. close to sign.***	***Dev. not sign.***	***Dev. not sign.***
Deviation from required adjustment on two-year basis (4)			**-0.10**	**-0.26**	**-0.11**	**-0.33**	**-0.46**	**-0.40**
Compliance on two-year basis			***Dev. not sign.***	***Dev. close to sign.***	***Dev. not sign.***	***Sign. dev.***	***Sign. dev.***	***Sign. dev.***

Source: Based on data in the 2019 Update, the Technical Report annexed to the 2020 Budget Bill and European Commission estimates.
(1) Totals may not match due to rounding of decimals. – (2) The deviation for 2018 on a two-year basis is not reported as, following application of its "margin of discretion", the European Commission will assess that year only with regard to full compliance (i.e. with no scope for deviation) with the rule on a one-year basis. The structural adjustment and the associated deviation for 2018 in the "Vademecum" column were set based on the European Commission's spring 2019 forecasts. – (3) The adjustment required for a given year, according to the Vademecum on the SGP, is determined in the spring of the previous year based on the European Commission's spring forecasts. For 2021-2022 only the Update column is shown since the Commission's forecasts for those years are not yet available. – (4) Compliance is achieved if the deviation of the structural adjustment from the required effort is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and greater than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant. For 2018, following application of the margin of discretion, a smaller adjustment than that required is not considered sufficient.

For 2019, in annual terms, the Update to the EFD shows an improvement in the structural balance equal to around 0.29 percentage points of GDP. Based on the economic cycle forecasts contained in the Update, the adjustment required by the matrix would be 0.25 percentage points of GDP, reduced to 0.08 percentage points as a result of the request for flexibility relating to hydrogeological instability and road network maintenance. This would result in compliance with the rule and exceeding the required adjustment by 0.22 percentage points of GDP in annual terms, while there would be a risk of deviation of -0.1 percentage points of GDP, which is not significant, on average over two years. However, based on the Vademecum, which uses the European Commission's spring 2018 forecasts to determine the structural adjustment required for 2019, the improvement required by the matrix is equal to 0.6 percentage points of GDP, reduced to 0.42 points owing to the request for flexibility. This would lead to a risk of deviation of -0.13 percentage points of GDP in one-year terms, which would not be significant, and -0.26 on average in two-year terms, which would be close to being significant. This required structural adjustment would be reduced under the provisions of the Vademecum if the European Commission's spring forecasts for next year show negative growth or an output gap greater than -3 points.

For 2020, the Update sketches out a path for the structural balance that differs from that in the EFD. The structural adjustment in the EFD was equal to 0.2 percentage points of GDP, which does not represent a significant risk of deviation. The Update instead contains a planned deterioration in the structural balance of 0.13 percentage points of GDP. Based on the forecast for economic conditions contained in the Update, the adjustment required by the matrix would be 0.5 percentage points of GDP, reduced to 0.3 percentage points owing to the new request for flexibility announced in the Update and described in detail in the 2020 DBP. This would lead to a risk of a deviation of -0.43 percentage points of GDP in annual terms and -0.11 on average in two-year terms, neither of which is significant. However, based on the Vademecum, which uses the European Commission's spring 2019 forecasts to determine the structural adjustment required for 2020, this adjustment is equal to 0.6 percentage points of GDP, reduced to 0.4 points owing to the new request for flexibility. This would result in the risk of a deviation of -0.53 percentage points of GDP in annual terms, i.e. close to significant, and of -0.33 percentage points on average in two-year terms, which would be significant.

As for the 2021-2022 period, the policy scenario contained in the Update shows a structural adjustment of 0.2 percentage points of GDP in the first year and 0.19 points in the second. Based on the economic forecasts in the Update, since the adjustment required by the matrix is equal to 0.6 percentage points of GDP for each year, there would be a risk of a deviation in annual terms of -0.4 percentage points in 2021 and -0.41 in 2022, neither of which is significant. There would however be a significant risk of deviation over two years for both years (-0.46 in 2021 and -0.4 in 2022).

2.3.3 The expenditure benchmark

With regard to the expenditure benchmark, it should first be noted that it was not possible to verify the expenditure aggregate since the Update and the 2020 DBP do not contain all the information needed to calculate it. The assessment of compliance with the expenditure benchmark is therefore partial.

That said, Table 2.9 shows both the final figures published in the Update and those calculated by the PBO based on data set out in the Update and taking account of the Vademecum on the Stability and Growth Pact prepared by the European Commission.[49] Specifically, the difference relates to the maximum expenditure target (i.e. the expenditure benchmark), and as a result the deviation of net expenditure growth from

[49] See *Vade Mecum on the Stability & Growth Pact – 2019 Edition* (COM), available at https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.

the benchmark. In both cases, the benchmark is corrected based on the Government's request for flexibility for the three-year period.

For 2019, the Update reports a planned change in the expenditure aggregate (1.64 per cent) that exceeds the benchmark (1.3 per cent) calculated on the basis of the economic forecasts contained in the document. This would lead to a risk of deviation of -0.15 percentage points of GDP in one-year terms, which would not be significant, and -0.33 on average in two-year terms, which would be significant. However, under the Vademecum, the benchmark is set at 0.5 per cent. This would result in the risk of a deviation of -0.5 percentage points of GDP in annual terms, or close to significant, and one of -0.58 percentage points on average in two-year terms, which would be significant.

Finally, for 2020 the Update forecasts a nominal growth rate for the expenditure aggregate of 1.99 per cent, which is higher than the benchmark calculated based on the economic forecasts set out in the document, or 0.59 per cent. This would result in the risk of a deviation of -0.62 percentage points of GDP in annual terms and -0.39 on average in two-year terms, both of which are significant. Based on the Vademecum, the benchmark is equal to 0.37 per cent. This would result in a risk of deviation of -0.71 percentage points of GDP in annual terms and of -0.61 percentage points on average in two-year terms, both of which are significant, thereby reinforcing the results already observed based on the estimates in the Update.

Table 2.9 – Deviations and compliance with the expenditure benchmark (1)
(percentage points)

Expenditure rule	2018 (2)		2019		2020	
	Update	Vademecum	Update	Vademecum	Update	Vademecum
Nominal growth in expenditure corrected for one-off measures and DRMs (3)	1.67	2.02	1.64	1.64	1.99	1.99
Expenditure benchmark	0.50	0.50	1.30	0.50	0.59	0.37
Deviation on one-year basis (% GDP) (4)	**-0.51**	**-0.66**	**-0.15**	**-0.50**	**-0.62**	**-0.71**
Compliance on one-year basis	***Adj. not suff.***	***Adj. not suff.***	***Dev. not sign.***	***Dev. close to sign.***	***Sign. dev.***	***Sign. dev.***
Deviation on two-year basis (% GDP) (4)			**-0.33**	**-0.58**	**-0.39**	**-0.61**
Compliance on two-year basis			***Sign. dev.***	***Sign. dev.***	***Sign. dev.***	***Sign. dev.***

Source: Based on data in the 2019 Update, the Technical Report annexed to the 2020 Budget Bill and European Commission estimates.
(1) Totals may not match due to rounding of decimals. – (2) The deviation for 2018 on a two-year basis is not reported as, following application of its "margin of discretion", the European Commission will assess that year only with regard to full compliance (i.e. with no scope for deviation) with the rule on a one-year basis. The increase in net expenditure and the associated deviation for 2018 in the "Vademecum" column were set based on the European Commission's spring 2019 forecasts. – (3) The adjustment required for a given year, according to the Vademecum on the SGP, is determined in the spring of the previous year based on the European Commission's spring forecasts. – (4) Compliance is achieved if the deviation of net expenditure growth from the benchmark is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and greater than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant. For 2018, following application of the margin of discretion, a smaller adjustment than that required is not considered sufficient.

Given the deviations from both the structural balance rule and the expenditure rule, the Commission is expected to conduct an overall evaluation to determine whether there is a risk of non-compliance with the preventive arm of the Stability and Growth Pact (see Section 2.3.5).

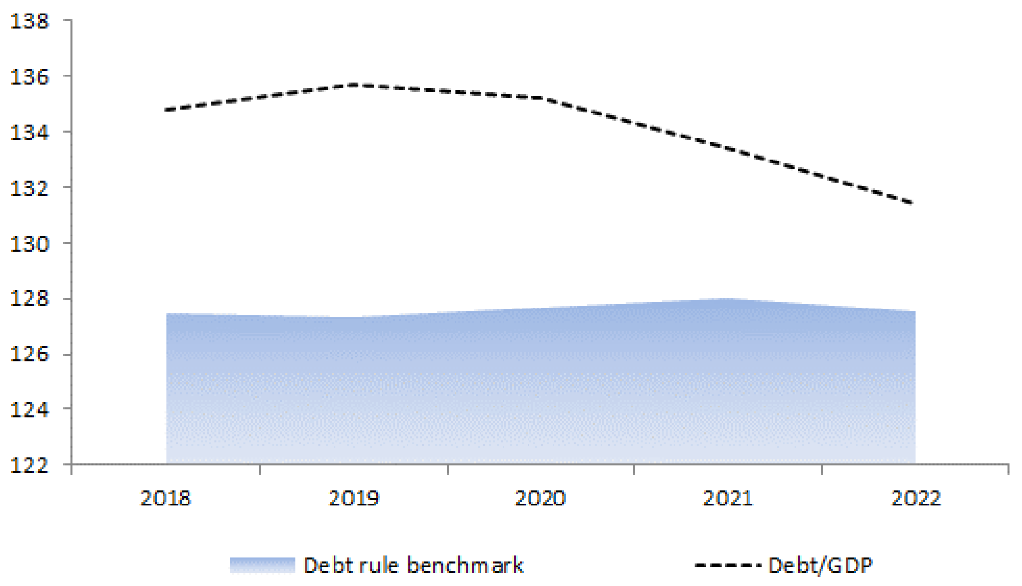
Note that the Update to the EFD emphasises the role of the expenditure benchmark in sharply reducing public investment. It is therefore important to revise the rule that excludes certain categories of investment, especially in the context of discussions about the reform of the EU's fiscal rules.

2.3.4 The debt reduction rule

The policy ratio between the public debt and GDP described in the Update to the EFD rises in 2019 (from 134.8 to 135.7 per cent), gradually declines in 2020 (to 135.2 per cent), to then falls more quickly over the subsequent two years (to 133.4 per cent in 2021 and to 131.4 per cent in 2022). Despite the decline in the debt, the debt reduction rule is not complied with in the policy period covered by the Update, either with the backward-looking benchmark until 2022 (Figure 2.8), or with the forward-looking benchmark until 2020, nor with the cyclically adjusted criterion.

As noted in previous PBO publications, compliance with the rule using the forward-looking method in a given year is the equivalent of complying with the rule using the backward-looking

Figure 2.8 – Compliance with the debt reduction rule
(percentage points of GDP)



Source: Based on data in the 2019 Update, the Technical Report annexed to the 2020 Budget Bill for the backward-looking rule.

approach two years after the reference year. For example, not complying with the rule using the backward-looking approach in 2022 implies non-compliance with the rule in 2020 using the forward-looking benchmark. This also means that given the current state of information it is not possible to assess compliance with the rule using the forward-looking approach for 2021-2022, because that would require projections for the debt/GDP ratio for 2023-24.

The gap between the trend in the debt/GDP ratio and the backward-looking benchmark is expected to widen from 7.4 points to 8.4 in 2019, to then fall gradually to 7.5 in 2020 and more markedly to 5.4 in 2021 and 3.9 in 2022.

2.3.5 The European Commission's assessment of Italy's compliance with the Stability and Growth Pact

Following the publication of the 2020 DBP, the European Commission sent a letter dated 22 October to the Minister of the Economy and Finance asking for clarification on the 2020 budget measures, noting that:[50]

1) the policy scenario in the DBP points to a risk of significant deviation in 2020 over one year and two years;
2) the plan does not comply with the debt reduction benchmark in 2020;
3) it took note of the Government's request for a temporary deviation from the path towards the medium-term objective for next year, to take account of unusual events (hydrogeological and seismic risk mitigation), equal to about 0.2 percentage points.

In his response, the Minister stressed that the fiscal policy stance is broadly neutral in 2020, in light of the need to rekindle economic growth and begin transitioning towards an environmentally sustainable and inclusive growth model. Italy will resume the structural adjustment path towards the MTO in 2021, with an annual correction of 0.2 percentage points in 2021 and in 2022.[51] The Government is also undertaking structural reforms, for example in the areas of justice and public sector services.

It is important to note that the European Commission's autumn forecast, published on 7 November,[52] expects a more unfavourable macroeconomic scenario than that presented

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[50] https://ec.europa.eu/info/sites/info/files/economy-finance/letter_it.pdf
[51] The letter is accompanied by two technical annexes that provide details on measures to combat tax evasion and tax fraud.
https://ec.europa.eu/info/sites/info/files/economy-finance/minister_gualtieri_-_letter_to_ec_23_10_2019_1.pdf
https://ec.europa.eu/info/sites/info/files/economy-finance/annex_1_relazione_tecnica_misure_anti_evasione_e_frodi_23_10_2019_0.pdf
https://ec.europa.eu/info/sites/info/files/economy-finance/annex_2_misure_contrasto_evasione_e_frodi_23_10_2019_0.pdf
[52] https://ec.europa.eu/economy_finance/forecasts/2019/autumn/ecfin_forecast_autumn_2019_it_en.pdf

in the DBP, with a deficit that is expected to be the same as indicated in the DBP for 2019, become slightly larger in 2020 – at 2.3 per cent of GDP – to then increase markedly in 2021 to 2.7 per cent of GDP. The difference compared with the DBP for 2010 is attributable to an overall higher revenue projection as a result of the Commission expecting nominal GDP to be lower as well as it expecting less revenue to be generated by the package of measures against tax evasion and tax fraud.[53] As for 2021, the difference with respect to the Government's forecasts is mainly due to the fact that the European Commission uses a different methodology for making its projections which does not include revenue linked to the safeguard clauses in the accounts. Using such deficit forecasts, and assuming lower nominal GDP growth in 2019-2021, the debt/GDP ratio would be higher and rising over the three-year period, not the reversal of the trend expected by the Government starting in 2020.

The European Commission's nominal GDP forecasts differ from those of the DBP because of different projections for real GDP growth and the increase in the deflator. The European Commission expects a real GDP growth that is always below 1 per cent, going from a projected 0.1 per cent in 2019, to 0.4 per cent in 2020 and to 0.7 per cent in 2021 (compared with 0.1 per cent in 2019, 0.6 per cent in 2020 and 1.0 per cent in 2021 in the DBP's forecasts). The GDP deflator is projected to be 0.6 per cent in 2019, 0.9 per cent in 2020 and 1.1 per cent in 2021 (compared with 0.9 per cent, 1.3 per cent and 1.7 per cent respectively in the DBP's forecasts). In addition to a different time horizon for nominal GDP and the deficit, the European Commission's projections for the debt also include a stock-flow adjustment that is less favourable than that underlying the Government's forecasts.[54]

In its assessment of the 2020 DBP published on 20 November,[55] the European Commission confirms a projected deficit of 2.3 per cent of GDP for 2020. The higher nominal deficit in 2020 forecast by the Commission and a different assessment of some one-off measures mean that in the Commission's projections the structural balance will deteriorate by 0.3 points next year, compared with 0.1 points forecast in the DBP.

As for its assessment of Italy's compliance with the SGP rules, the European Commission, based on its own projections, points to the risk of a significant deviation from the expenditure benchmark in 2019 in one-year and two-year terms. As for the structural balance, there is risk of a non-significant deviation over one year and of a significant deviation over two years. The Commission's overall assessment of Italy's compliance with the preventive arm confirms that there is a risk of a significant deviation in 2019, even taking account of the requested flexibility for 2019 equal to 0.18 per cent of GDP.

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53 The Commission incorporates in its estimates extra revenue that is equal to just two-thirds of the DBP's forecast, which is equal to 0.2 per cent of GDP.

54 European Commission (2019), "Commission Staff Working Document Analysis of the Draft Budgetary Plan of Italy", SWD (2019) 920 final.

55 European Commission (2019), "Commission Opinion on the Draft Budgetary Plan of Italy", C (2019) 9110 final.

For 2020, the European Commission points to the risk of a significant deviation for both the structural balance and the expenditure benchmark over both one and two years. The deviation from the provisions of the preventive arm of the SGP is confirmed by the overall assessment, even taking account of the Government's request for flexibility in the amount of 0.2 percentage points of GDP for next year.

According to the Commission, Italy is not expected to comply with the debt reduction rule for the debt/GDP ratio in either 2019 or 2020.

Overall, the European Commission is of the opinion that the 2020 DBP is at risk of non-compliance with the SGP and therefore invites the Government to take the necessary measures within the national budgetary process to ensure compliance with the fiscal rules.

3 COMMENTS ON SOME OF THE MAIN MEASURES OF THE BUDGET PACKAGE

3.1 *Measures concerning income tax*

3.1.1 Changes to corporate income tax

The budget package for 2020 produces an increase in ordinary corporate taxation on a cash basis of €1.9 billion in 2020. In the following years, the effects of the different measures substantially offset each other and starting from 2023 produce a reduction in tax revenue of €1.2 billion (Table 3.1).

In general, the budget adopts an approach similar to that employed in recent years. The increase in revenue is generated by one-off measures, while investment incentives to support firms are extended and expanded, such as the increase in allowable depreciation charges and the investment tax credit, measures that were first introduced with the 2016 Budget Act. Finally, for the third time in a year, the IRES (corporate income tax) system has been modified. More specifically, beginning from 2019, the reduced tax rate for retained earnings, introduced with the 2019 Budget Act and then extensively amended with Legislative Decree 34/2019 of last April, has been repealed and instead, the allowance for corporate equity (ACE), in force since 2011, has been reintroduced, thus maintaining its temporal continuity.

Table 3.1 – Corporate tax measures
(millions of euros)

	2020	2021	2022	2023
Repeal of tax relief on undistributed profits	1,730	1,549	2,037	2,228
General incentive for capitalisation of firms	-2,056	-1,260	-1,260	-1,260
Extension of super-depreciation	0	-178	-315	-259
Extension of hyper-depreciation	0	-388	-811	-778
Tax credit for environmental projects	0	-140	-280	-420
Tax credit for training	0	-150	0	0
Tax credit for investments in capital equipment and R&D in the South and the "earthquake tax credit"	-704	-75	0	0
Deferral of deduction of negative IRES items	1,644	0	0	-436
Revaluation of assets and unlisted equity investments and land and increase in tax in lieu on capital gains on property	860	487	479	-136
Municipal property tax deductible from corporate income	0	54	30	-442
Depreciation of assets for motorway concession holders	341	170	170	170
Web tax	108	108	108	108
Total	**1,923**	**177**	**159**	**-1,224**

Source: based on data drawn from summary financial schedules attached to the 2020 Budget Bill.

Measures to increase revenue, totalling about €2.9 billion, are mainly one-off provisions with financial effects in 2020. On the one hand, they tend to postpone losses of revenue from existing measures which mainly focus on the financial sector (around €1.6 billion), and on the other hand they seek to bring future revenue forward by incentivising the recalculation of the value of certain equity investments and the revaluation of company assets with the application of a substitute tax of ordinary taxation (€0.9 billion). On the basis of the estimates given in the Technical Report, starting from 2023, these measures will produce a loss of tax revenue of about €0.6 billion, and further losses are expected in subsequent years as deductible amounts will be charged off in instalments.

For IRES and IRAP purposes, banks and financial institutions shall defer the deductibility of: a) from 2019 to 2022, the stock of loan writedowns and losses; b) from 2019 to 2028, the value adjustments to loans and other financial assets deriving from recognition of the provision to cover expected losses as a result of the first year of application of International Financial Reporting Standard (IFRS); c) from 2019 to the 2025-2029 period, the depreciation charges on the value of goodwill and other intangible assets and loan writedowns that previously gave rise to the recognition of deferred tax assets convertible into tax credits.

All companies that do not adopt international accounting standards may revalue corporate assets and equity investments recognised in the financial statements from 2018, with the payment of a substitute tax at a rate of 12 per cent (instead of 16 per cent) for depreciable assets and 10 per cent (instead of 12 per cent) for non-depreciable assets, and a 10 per cent tax to discharge the tax liability on the gain from revaluation. The substitute tax can be paid in instalments over three years and the revaluation will have effects for tax purposes only after three years, with a reduction in tax revenue starting from 2023. For partnerships and sole proprietorships, the option of revaluing investments in unlisted companies and land (both agricultural land and land zoned for building), based on a sworn appraisal, has been extended. The higher value will be subject to an 11 per cent substitute tax, which can be paid in instalments over a period of three years, instead of the ordinary capital gains rate. The 11 per cent rate, already in force for qualifying equity investments, has been extended to non-qualifying investments that were subject to a 10 per cent rate. The revaluation of these assets was first introduced with the 2002 Finance Act and the time limits have since been extended each year. According to the Technical Report, a large proportion of taxpayers have participated in the last four fiscal years, confirming the attractiveness of the measure for firms. Finally, the rate of the withholding tax on capital gains on real estate realised on the sale of property purchased or built in the last five years has been raised from 20 to 26 per cent.

The measures for growth in the Budget Bill that would reduce tax revenues include the extension for 2020 of measures to support business investment (super- and hyper-depreciation) with financial effects in 2021 and in the following years up to 2027 (€0.7 billion in 2021, €1.4 billion in 2022 and 2023).[56]

The extension of super-depreciation gives firms a 30 per cent increase in the depreciation allowance for new capital equipment (excluding transport equipment) purchased in 2020 or for which an advance payment of at least 20 per cent has been made in the same period and the balance falls due by 30 June 2021 (€0.2 billion in 2021 and €0.3 billion from 2022). The super-depreciation allowance for 2020 has been further reduced from the original version introduced in 2015, with the additional depreciation allowance being lowered from 40 to 30 per cent and the

[56] An estimate of the effects of super- and hyper-depreciation on the tax liabilities of firms in 2017 is provided at the end of this section.

portion of investments exceeding €2.5 million being excluded from the tax benefit (recall that in 2019, the measure was extended with Decree Law 34/2019 of April 2019 and has therefore applied for 8 months only).

The continuation of "hyper-depreciation" for 2020 (€0.4 billion in 2020 and €0.8 billion from 2022) provides for an increase of up to 170 per cent in the depreciation allowance for goods classified as high-tech Industry 4.0 assets and one of 40 per cent for software purchases. For the former, the allowable increase declines as the cost of the investment rises to a limit of €20 million, beyond which the benefit is eliminated (in the first version, for 2016-2018, the increase was set at 150 per cent). In this case the subsidy is applicable to investments carried out up to December 2021 if an advance payment of not less than 20 per cent has been made by 2020. Furthermore, an additional tax credit of 10 per cent a year is granted for three years for these assets on the value of investments made starting from 1 January 2017 as part of a project with specific environmental objectives. In this case, the Technical Report estimates a pool of about 7,000 eligible companies and a total value for the tax credit of €0.4 billion over three years, with a cash impact of €0.1 billion in 2021, €0.3 billion in 2022 and €0.4 billion in 2023. The incentive measures also include the extension for 2020 of the tax credit, already introduced for 2016-2019 with the 2016 Stability Act, for investments in machinery, plant and equipment for new or existing production facilities and an increase in the tax credit for research and development costs from 25 to 50 per cent, both applying to investment in areas in southern Italy (€0.7 billion).

As from 2019, the Budget Bill reintroduces the ACE regime for companies and, at the same time, repeals the reduced tax rate on the portion of profits allocated to an available reserve introduced with Legislative Decree 34/2019. Although the rules for 2019 have been amended three times, on the substantive level the ACE has remained in effect without interruption. The only difference is that the notional rate used to quantify the figurative return on capital has been reduced from 1.5 to 1.3 per cent.

The ACE was introduced in 2011 and allows an amount corresponding to the figurative return on capital increases resulting from both the contribution of new capital and the allocation of profits to reserves to be deducted from corporate income. The notional rate has changed over time to take account, among other things, of actual developments in yields on government securities.

The preferential mechanism repealed by the Budget Bill, which came into force in 2019, provided for a dual system for the treatment of corporate profits, with a reduced rate for the portion of income for the year retained in available reserves. More specifically, the ordinary rate would be reduced by 1.5 percentage points in 2019, 2.5 points in 2020, 3 points in 2021 and 3.5 points as from 2022. Once fully implemented, the reduced rate for corporations would have been 20.5 per cent and for enterprises subject to personal income tax (including those in the tax transparency regime) it would have varied from between 19.5 and 39.5 per cent (the personal income tax rate of between 23 and 43 per cent minus 3.5 percentage points) depending on their marginal rate. This measure in turn repealed tax relief introduced with the 2019 Budget Act providing for retained earnings to be taxed at a rate reduced by 9 percentage points compared with the ordinary rate (15 per cent for corporations and from 14 to 34 per cent for enterprises subject to personal income tax), applying to the portion of taxable income corresponding to the sum of depreciation charges for incremental investments in capital equipment and the cost of personnel corresponding to the increase in employment in the company each year. Firms therefore benefitted from tax savings each year proportionate to their investment rate and the increase in employment.

On the financial level, official estimates indicate a net loss of tax revenues for all the measures of €0.3 billion in 2020 and an increase of €0.3 billion in 2021, €0.8 billion in

2022 and €1.0 billion in 2023. Note that the increase in revenue expected from 2021 appears to be overestimated, as the Technical Report does not take account of the increasing trend in the ACE linked to the change in equity compared with 2010. If an annual increase in the effective ACE (net of firms' fiscal capacity) of 7 per cent (prudentially, the lowest of the rates of increase recorded in 2016 and 2017 tax data, equal to 7 and more than 20 per cent respectively, has been applied), the overestimation of revenue from 2021 to 2023 would amount to €0.1 billion, €0.2 billion and €0.3 billion respectively.

While the ACE regime applies to all companies, the repealed system did not apply to financial intermediaries and banks, which remained subject to an IRES tax rate of 27.5 per cent (with an increase in the IRES surtax to offset the reduction of the ordinary rate). The reintroduction of the ACE therefore neutralises the negative impact on financial companies of the abolished preferential rate.

Moreover, frequent legislative changes generally produce uncertainty for businesses, with an adverse impact on financing and investment choices, which are made on the basis of tax regimes that may never actually enter into force.

Other revenue-increasing measures include changes in the deductibility of depreciation on the assets to be relinquished free of charge of motorway concession holders (€0.2 billion) and the entry into force from 2020 of the tax on digital services (the web tax; €0.1 billion). For more on this latter tax, see section 3.1.3.

General comments on the reintroduction of the ACE and the associated redistributive effects

The changes made to corporate taxation from the end of 2018 to April 2019 (the preferential treatment of reinvested profits envisaged in the 2019 Budget Act, replaced by the current system introduced with Legislative Decree 34/2019, which levies a reduced rate on the share of profits allocated to reserves) had a major impact, with substantially unchanged revenue, in terms of both the structure of taxation and the incentives and the distribution of tax revenue compared with the situation under the ACE system.

Effects on the structure of taxation and on the incentives. – With regard to the structure of taxation and the incentives, the three different preferential regimes are aimed at different objectives. The goal of the allowance for corporate equity (ACE) is to neutralise firms' funding choices with respect to taxation and to foster the financial balance of firms. The reinvested profit benefit, provided for in the 2019 Budget Act and repealed with the April decree, shifted the focus to investment incentives. Finally, the current system more generically delineates a dual taxation system that gives preferential treatment to retained income over distributed profits.

In the design of corporate taxation, debt financing normally receives more favourable tax treatment (which is amplified as the tax rate increases) due to the deductibility of interest expense from the tax base, creating an asymmetry with respect to equity financing. The ACE, introduced in 2011, was designed precisely to ensure that the marginal investment was neutral with respect to financing choices, allowing the deductibility of a figurative return on equity capital and thereby taxing the extra profits only.

By contrast, the current system creates an asymmetry in the tax treatment of funding sources and, in the choice of sources of funds, creates a new order of preference in favour of self-financing with potential effects on dividend policies/distribution of corporate profits, while leaving the tax advantage of debt (even if reduced by the deductibility limitations introduced in recent years) over new capital.

Redistributive effects. – The replacement of the preferential taxation of retained profits with the ACE gives rise to overall and redistributive effects that are substantially the opposite of those found in the evaluation of the effects of Decree Law 34/2019. However, these effects are accompanied by those engendered by the reduction of the notional rate of the ACE (from 1.5 to 1.3 per cent) and by the extension of the increases in allowable depreciation in 2020.

The redistributive effects were analysed using the MEDITA microsimulation model of the PBO,[57] which examines non-financial corporations, supplemented with a module simulating the taxation of financial intermediaries and banks.[58] We emphasise that this analysis of the impact effects does not take account of behavioural assumptions.[59] The differential effects on the tax liabilities of companies are estimated for both the 2019 legislation and the 2020 rules to take account of differences in taxation over the two years. The simulation takes account of not only the repeal of the preferential treatment of retained profits and the reintroduction of the ACE with the notional rate reduced from 1.5 to 1.3 per cent, but also of the extension of super- and hyper-depreciation.

For the 2019 tax year, the assessment of the effects of the measure in question on the tax burden solely reflects the replacement of the preferential rate on retained profits with the ACE. Table 3.2 shows that for all non-financial corporations, the reintroduction of the ACE increases taxation (by 0.3 per cent of tax revenue) compared with the preferential rate on retained profits, due to the reduction in the notional rate of the ACE.

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[57] For a description of the characteristics of the model, see Ufficio parlamentare di bilancio (2019), "MEDITA – A corporate tax microsimulation model at PBO".

[58] Non-financial companies in the PBO's MEDITA model do not include those in the Ateco K and M categories, which main comprise holding companies, whose structural characteristics differ from those of other companies. Financial intermediaries and banks include all sectors subject to the IRES surtax of 3.5 per cent. For the latter aggregate, the simulation was based on tax data, which, in the absence of firm-level data, do not allow performance of all the analyses presented for non-financial companies.

[59] The simulation is based on a number of assumptions. First, financial statement data for 2016 and 2017, the most recent years available, is used for the population of firms. Accordingly, the legislation in force in 2019 and 2020 is applied to constant 2016 and 2017 populations, respectively, in order to capture developments in the tax base for the ACE.

Table 3.2 – Impact of the repeal of the preferential tax rate and the reintroduction of the ACE in 2019 on corporate tax liabilities
(percentage change in tax revenue; turnover in thousands of euros)

	Total net effect (a+b)	Repeal of preferential tax rate (a)	ACE (1,5)	ACE (1,3)	Total ACE (b)	ACE/ Undistributed profits (b/a)
			Non-financial companies			
Individual firms	0.2	2.0	-2.1	0.3	-1.8	88.3
Up to 100	-1.4	1.5	-3.3	0.4	-2.9	188.9
From 100 to 250	-1.1	1.8	-3.2	0.4	-2.8	161.0
From 250 to 1,000	-0.5	1.8	-2.6	0.3	-2.3	127.2
From 1,000 to 2,000	-0.1	1.9	-2.3	0.3	-2.0	105.8
From 2,000 to 5,000	0.3	2.0	-1.9	0.2	-1.7	85.8
From 5,000 to 10,000	0.4	2.1	-1.9	0.2	-1.7	79.6
From 10,000 to 50,000	0.6	2.1	-1.7	0.2	-1.5	71.3
From 50,000 to 250,000	0.6	2.2	-1.8	0.2	-1.6	71.7
More than 250,000	0.3	2.1	-2.0	0.3	-1.8	85.3
Tax consolidation	**0.8**	**2.5**	**-2.0**	**0.2**	**-1.7**	**68.8**
Total	**0.3**	**2.1**	**-2.0**	**0.3**	**-1.8**	**83.7**
			Financial intermediaries and banks			
Individual firms	-7.9	0.0	-8.7	0.9	-7.9	
Tax consolidation	-6.5	0.0	-7.3	0.8	-6.5	
Total	**-6.7**	**0.0**	**-7.5**	**0.9**	**-6.7**	

Source: based on simulations conducted with the PBO's MEDITA model.

However, the pool of beneficiary firms is expanded. The reduction in taxation deriving from the reintroduction of the ACE (including the reduction in the notional rate) is 83.7 per cent of that produced by the preferential treatment of retained profits. By contrast, for the financial sector only, which was penalised by its exclusion from the preferential rate system for retained profits, the reintroduction of the ACE entails significant tax savings despite the reduction in the notional rate, reflecting among other things the relatively larger weight of the ACE deduction in this sector (6.7 per cent). For these companies, which represent about 1.5 per cent of all corporations and 15 per cent of total IRES revenues, the tax savings with the ACE are estimated to be equal to more than three times those for non-financial companies (more than four times those for individual companies and more than three times those for companies participating in a consolidated taxation mechanism).

Restricting the scope of the investigation to individual non-financial companies and excluding public services sectors, the impact of these measures can be assessed with respect to company size.[60] Overall, these companies experience a slight increase in taxation (0.2 per cent) due to the fact that the average benefit of the ACE is equal to

[60] In general, the effects produced by measures depend on the effective fiscal capacity of firms to reap the potential benefits (about 80 per cent of the firms considered have sufficient profits to benefit, with higher average percentages for medium-sized firms), with a naturally higher concentration of changes in total tax revenue among larger companies.

88.3 per cent of the benefit of the preferential rate. However, the effect differs considerably depending on the size of the company. The smallest individual companies obtain a net reduction of 1.4 per cent from the measures, thanks to an ACE benefit that is far greater than that they obtained from preferential rate regime (about 189 per cent). The benefit declines as company size increases, becoming a net tax increase for medium-sized and large companies (between 0.3 and 0.6 per cent of tax revenue) (Table 3.2).

In terms of changes in the implicit tax rate, for non-financial companies as a whole the simulation estimated an average rate increase of 0.1 percentage points, while it found a reduction of 1.7 points for companies in the financial sector. For individual non-financial companies, the rate profile corresponds to that for revenue: there is a decline in the average implicit rates for smaller companies (0.3 points) and a slight increase (0.1 points) for medium-sized and large enterprises (Table 3.3).

In order to evaluate the impact on 2020, in addition to the effects already mentioned it is necessary to take account of: 1) the greater advantages compared with 2019 of the preferential rate on retained earnings, which would have declined from 22.5 to 21.5 per cent in 2020; 2) the dynamic evolution of ACE, which is higher due to increases in equity between 2019 and 2020; and 3) the extension of super- and hyper-depreciation to 2020.

The simulations show that non-financial companies as a whole experience a significant tax increase, equal to 1.1 per cent of tax revenue (Table 3.4). The increase resulting from the abolition of the preferential rate, amplified by the reduction in the notional rate of the ACE, is only partially offset by the benefits of the extension of super- and hyper-depreciation.

On average, the set of measures considered in the simulation produces a larger tax liability for medium-sized and large non-financial companies (around 1.3 per cent of tax revenue), despite being the enterprises that reap the greatest benefits from the extension of super- and hyper-depreciation (between 0.7 and 0.8 per cent of tax revenue). Symmetrically, smaller companies receive the greater benefit (between 0.4 and 0.8 per cent of revenue), essentially due to the positive impact of the ACE (on the order of 3 per cent of revenue). Finally, financial companies, which as mentioned earlier did not qualify for the subsidised treatment of retained profits, fully benefit from the reintroduction of ACE, although the impact is mitigated by the lower notional rate of return on capital (6.7 per cent of tax revenue).

With regard to the implicit tax rate, the simulation estimated an increase in the average rate of 0.3 percentage points for non-financial companies and a reduction of 1.7 points for those in the financial sector. Among individual non-financial companies, only smaller firms benefit from a reduction in the implicit tax rate (0.2 percentage points) (Table 3.5).

Table 3.3 – Impact of the repeal of the preferential tax rate and the introduction of the ACE in 2019 on corporate tax liabilities
(percentage change in implicit tax rate; turnover in thousands of euros)

	Total net effect (a+b)	Repeal of preferential tax rate (a)	ACE (1.5)	ACE (1.3)	Total ACE (b)
			Non-financial companies		
Individual firms	0.1	0.5	-0.5	0.1	-0.4
Up to 100	-0.3	0.4	-0.8	0.1	-0.7
From 100 to 250	-0.3	0.4	-0.8	0.1	-0.7
From 250 to 1,000	-0.1	0.4	-0.6	0.1	-0.6
From 1,000 to 2,000	0.0	0.4	-0.5	0.1	-0.5
From 2,000 to 5,000	0.1	0.5	-0.5	0.1	-0.4
From 5,000 to 10,000	0.1	0.5	-0.5	0.1	-0.4
From 10,000 to 50,000	0.1	0.5	-0.4	0.1	-0.4
From 50,000 to 250,000	0.1	0.5	-0.4	0.1	-0.4
More than 250,000	0.1	0.5	-0.5	0.1	-0.4
Tax consolidation	**0.2**	**0.6**	**-0.5**	**0.1**	**-0.4**
Total	**0.1**	**0.5**	**-0.5**	**0.1**	**-0.4**
			Financial intermediaries and banks		
Individual firms	-2.1	0.0	-2.3	0.2	-2.1
Tax consolidation	-1.6	0.0	-1.8	0.2	-1.6
Total	**-1.7**	**0.0**	**-1.9**	**0.2**	**-1.7**

Source: based on simulations conducted with the PBO's MEDITA model.

Table 3.4 – Impact of the budget package on corporate tax liabilities in 2020
(percentage change in tax revenue; turnover in thousands of euros)

	Total net effect (a+b+c)	Repeal of preferential tax rate (a)	ACE (1.5)	ACE (1.3)	Total ACE (b)	Additional depreciation allowance (c)	ACE / Undistributed profits (b/a)
				Non-financial companies			
Individual firms	0.8	3.4	-2.2	0.3	-1.9	-0.6	57.1
Up to 100	-0.8	2.0	-3.0	0.3	-2.7	-0.1	131.7
From 100 to 250	-0.4	3.2	-3.9	0.5	-3.4	-0.2	105.6
From 250 to 1,000	0.1	3.2	-3.0	0.4	-2.7	-0.4	84.3
From 1,000 to 2,000	0.4	3.2	-2.5	0.3	-2.2	-0.6	67.7
From 2,000 to 5,000	0.8	3.4	-2.1	0.3	-1.9	-0.8	55.1
From 5,000 to 10,000	0.9	3.4	-2.0	0.3	-1.7	-0.8	49.9
From 10,000 to 50,000	1.2	3.6	-1.9	0.2	-1.6	-0.8	44.7
From 50,000 to 250,000	1.3	3.6	-1.9	0.2	-1.6	-0.7	45.3
More than 250,000	0.7	3.4	-2.5	0.3	-2.2	-0.6	63.9
Tax consolidation	**2.0**	**4.4**	**-2.2**	**0.3**	**-2.0**	**-0.4**	**44.6**
Total	**1.1**	**3.6**	**-2.2**	**0.3**	**-2.0**	**-0.6**	**54.1**
				Financial intermediaries and banks			
Individual firms	-7.5	0.0	-8.3	0.9	-7.4	-0.2	
Tax consolidation	-6.4	0.0	-7.2	0.8	-6.4	0.0	
Total	**-6.7**	**0.0**	**-7.4**	**0.8**	**-6.6**	**0.0**	

Source: based on simulations conducted with the PBO's MEDITA model.

Table 3.5 – Impact of the budget package on corporate tax liabilities in 2020
(percentage change in implicit tax rate; turnover in thousands of euros)

	Total net effect (a+b+c)	Repeal of preferential tax rate (a)	ACE (1.5)	ACE (1.3)	Total ACE (b)	Additional depreciation allowance (c)
			Non-financial companies			
Individual firms	0.2	0.8	-0.5	0.1	-0.5	-0.2
Up to 100	-0.2	0.5	-0.7	0.1	-0.6	0.0
From 100 to 250	-0.1	0.8	-0.9	0.1	-0.8	0.0
From 250 to 1,000	0.0	0.8	-0.7	0.1	-0.6	-0.1
From 1,000 to 2,000	0.1	0.8	-0.6	0.1	-0.5	-0.1
From 2,000 to 5,000	0.2	0.8	-0.5	0.1	-0.4	-0.2
From 5,000 to 10,000	0.2	0.8	-0.5	0.1	-0.4	-0.2
From 10,000 to 50,000	0.3	0.9	-0.4	0.1	-0.4	-0.2
From 50,000 to 250,000	0.3	0.9	-0.5	0.1	-0.4	-0.2
More than 250,000	0.2	0.8	-0.6	0.1	-0.5	-0.1
Tax consolidation	**0.5**	**1.1**	**-0.5**	**0.1**	**-0.5**	**-0.1**
Total	**0.3**	**0.9**	**-0.5**	**0.1**	**-0.5**	**-0.1**
			Financial intermediaries and banks			
Individual firms	-2.0	0.0	-2.2	0.2	-1.9	0.0
Tax consolidation	-1.6	0.0	-1.8	0.2	-1.6	0.0
Total	**-1.7**	**0.0**	**-1.9**	**0.2**	**-1.7**	**0.0**

Source: based on simulations conducted with the PBO's MEDITA model.

A preliminary assessment of the impact of the additional depreciation allowance on non-financial corporations in 2015-2017 period

The measures granting an additional depreciation allowance on capital equipment (super-depreciation) and the even larger allowance on high-tech assets in order to foster the Industry 4.0 transformation (hyper-depreciation) were introduced, respectively, with the 2016 Stability Act and the 2017 Budget Act and have been extended each year – most recently with the 2020 Budget Act – restructuring and expanding the benefit based on the type of assets involved. Table 3.6 summarises the measures introduced since 2015, including the latest extension. The introduction of these measures, which are tax relief mechanisms for personal income tax (IRPEF) purposes for sole proprietorships using ordinary accounting and partnerships and for corporate income tax (IRES) for corporations, was prompted by the economic conditions prevailing after 2008 economic crisis, a period characterised by especially weak business investment.

In the light of the extension provided for in the 2020 Budget Bill, this section first offers a number of general remarks on the characteristics of these preferential measures. Subsequently, the characteristics of the companies that benefited from the mechanisms in the past are outlined and the impact in 2017 is quantified, that year being the most

Table 3.6 – Additional depreciation allowances

	Coefficient of increase in depreciation/amortisation allowances and lease payments	Subsidised investments	Period in which asset purchased
2016 Stability Act	1.4	New capital assets	15.10.2015-31.12.2016
2017 Budget Act	1.4	New capital assets (excluding transport equipment not used in production)	15.10.2016-31.12.2017 (until 30.6.2018 if advance payment of 20 per cent made in 2017)
	2.5	New high-tech capital assets (Industry 4.0)	
	1.4	New intangible assets (software for technology transformation)	
2018 Budget Act	1.3	New capital assets (excluding transport equipment not used in production)	until 31.12.2018 (until 31.12.2019 if advance payment of 20 per cent made in 2018)
	2.5	New high-tech capital assets (Industry 4.0)	
	1.4	New intangible assets (software for technology transformation)	
2019 Budget Act and DL 34/2019	1.3	New capital assets (excluding transport equipment not used in production) up to €2.5 million	1.5.2019-31.12.2019 (until 31.12.2020 if advance payment of 20 per cent made in 2019)
	2.7 for investments up to €2.5 million; 2 from €10 to €2.5 million; 1.5 between €10 and €20 million	New high-tech capital assets (Industry 4.0)	until 31.12.2019 (until 31.12.2020 if advance payment of 20 per cent made in 2019)
	1.4	New intangible assets (software for technology transformation)	
2020 Budget Bill	1.3	New capital assets (excluding transport equipment not used in production) up to €2.5 million	1.5.2019-31.12.2019 (until 31.12.2020 if advance payment of 20 per cent made in 2019)
	2.7 for investments up to €2.5 million; 2 from €10 to €2.5 million; 1.5 between €10 and €20 million	New high-tech capital assets (Industry 4.0)	until 31.12.2019 (until 31.12.2020 if advance payment of 20 per cent made in 2019)
		New intangible assets (software for technology transformation)	

recent for which administrative tax data is available, taking account of the additional depreciation allowance in force in the 2015-2017 period. The quantifications were performed using the PBO's MEDITA model for non-financial companies, which makes it possible, using firm-level and tax data for 2015-2017, to simulate the actual benefit generated by the subsidies.

Due to its characteristics, the increases in depreciation allowances for tax purposes represent an investment grant rather than a tax incentive in the strict sense. The increases are in fact extended to all new investments made in a certain period of time without distinguishing between the trend component represented by replacement of existing capital goods and the incremental component, therefore incorporating a "dead weight" effect represented by investments already planned by companies that would have been carried out even without the preferential depreciation mechanism. Furthermore, the incentive for companies to anticipate planned investments, in view of the temporary nature of the benefit, has been weakened by the multiple extensions of the increase, which has therefore become a structural element in the investment decisions of firms.

It should be borne in mind that the benefits of the preferential regime for firms are conditional on the presence of taxable profit and limited to the amount of that profit, and that any unused portion can be carried forward to subsequent years. Accordingly, the economic and fiscal effectiveness of the incentive depends, among other things, on this fiscal capacity, which delineates the effective possibility, in the medium term, of transforming the additional deductions into tax savings. It is therefore a preferential system that, by its very nature, is effective for companies in good economic and financial health that can expect to be profitable in the medium term. Furthermore, the relationship between the annual amount of the benefit and the useful life of the asset (the higher the depreciation rate the greater the annual share of investment receiving preferential treatment) changes the advantage for firms depending on the composition of their capital assets.

With regard to the impact on the State budget, the loss of revenue resulting from the subsidy mechanism could also increase during more favourable economic conditions – reducing the elasticity of revenue with respect to developments in corporate earnings – and could also extend beyond the useful life of the subsidised assets due to the carryforward of unused deductions.

An overview of companies benefitting from the subsidies. – We can use the PBO's MEDITA microsimulation model to analyse, for non-financial corporations (some 867,000 companies, equal to 75 per cent of all the companies that could potentially benefit from the subsidy in their 2017 tax returns), the actual use of this mechanism in 2015-2017.

In 2015 (the additional depreciation allowance was applicable to purchases made between mid-October and the end of the year), about 77,600 companies benefited from the super-depreciation mechanism; in 2016 and 2017, taking account of the beneficiaries of hyper-depreciation for tangible and intangible assets, an additional 126,500 and 48,200 companies benefitted, respectively. Overall, in 2017 beneficiary companies numbered around 252,300. They represent about 29.1 per cent of the total number of companies considered in the model, but their IRES tax base accounts for about 70 per cent of the total. Overall, the theoretical deduction (i.e. the potential deduction regardless of the amount of profit available for set-off) connected with the additional depreciation allowance corresponds to 5.1 and 7.1 per cent of, respectively, the overall tax base (gross of deductibility of losses and the ACE) and that of the beneficiary companies only. The share of companies that have benefitted from the incentives for the Industry 4.0 programme is relatively small despite the large coefficient of the increase in the deprecation allowance (2.5). Although the amount of this subsidy represents about 12.3 per cent of the total, only 0.9 per cent of companies benefited from the preferential treatment of tangible assets and 2 per cent from that for intangible assets (Table 3.7).

Table 3.7 – Additional depreciation allowances: beneficiary companies and theoretical deduction in 2017
(percentages)

	Total companies			Eligible companies			Share of eligible companies				Theoretical deduction (% of total)			
	Share of companies (1)	Share of value added	Share of tax	Share of companies (2)	Share of value added	Share of tax	Total	Super	Hyper tangible	Hyper intangible	Total	Super	Hyper tangible	Hyper intangible
Agriculture	1.97	0.87	0.35	0.83	0.39	0.24	12.32	11.68	0.20	0.67	0.36	0.35	0.31	0.72
Extraction	0.19	0.39	0.17	0.20	0.23	0.18	30.14	26.41	2.19	3.55	0.40	0.39	0.38	0.64
Industry	14.34	37.27	38.09	4.15	44.02	46.34	49.02	45.02	3.56	4.18	41.40	37.35	85.29	41.30
Utilities	1.86	6.40	7.09	1.60	6.23	7.53	25.08	22.98	0.87	1.95	3.98	4.09	2.58	4.42
Construction	14.48	5.16	5.74	1.58	4.23	4.52	23.28	21.83	0.39	1.38	3.52	3.57	1.71	5.91
Services	65.70	49.41	48.24	0.34	44.49	40.88	26.74	24.93	0.49	1.75	49.35	53.23	9.29	45.77
Other services	1.45	0.51	0.33	1.29	0.41	0.30	25.95	24.41	0.53	1.53	0.99	1.03	0.43	1.23
Micro	85.98	13.40	20.27	71.68	8.49	11.49	24.28	22.80	0.45	1.42	8.46	8.34	7.56	12.68
Small	10.55	17.75	20.55	20.15	15.20	18.94	55.59	50.29	2.95	5.39	15.33	14.18	20.83	28.75
Medium	2.77	19.79	21.84	6.40	20.14	24.46	67.19	60.23	5.63	7.14	19.20	17.90	25.96	33.29
Large	0.59	19.28	18.08	1.48	21.01	21.23	73.50	68.03	9.05	6.33	17.93	17.32	25.83	15.45
Very large (> 250 million)	0.11	29.77	19.26	0.30	35.16	23.88	75.18	71.76	11.56	5.23	39.07	42.26	19.82	9.83
Non exporters	98.77	95.13	94.52	97.74	94.10	92.88	28.81	26.79	0.88	1.99	95.26	95.70	90.50	95.20
Exporters	1.23	4.87	5.48	2.26	5.90	7.12	53.71	48.89	3.85	5.05	4.74	3.47	1.94	1.24
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**29.12**	**27.06**	**0.92**	**2.03**	**100.00**	**100.00**	**100.00**	**100.00**

Source: based on simulations conducted with the PBO's MEDITA model.
(1) The MEDITA model covered 866,700 companies. – (2) Beneficiary companies in 2017 (including those benefitting from additional depreciation allowances in 2015 and 2016) totalled 252,300.

Significant differences can be observed in the distribution of the beneficiary companies and the benefits by sector and size class.

On a sectoral basis, the distribution of beneficiary companies, as with that of the benefit itself, is closely linked to the differences in the scope of eligible investments. Of total investments by firms (excluding the general government sector), only 32.4 per cent, on average, were in plant and machinery eligible for the benefit, with important sectoral differences that depend on the characteristics of the production function: more than 70 per cent of investments were eligible in many manufacturing sectors, while just 20 per cent in the services sector qualified. As a result, the share of beneficiary companies is much higher than the average in industry (49 per cent), while the proportions in agriculture and construction were smaller (12.3 and 23.3 per cent respectively). The theoretical deduction for super-depreciation is concentrated in services (53.2 per cent) and manufacturing (37.3 per cent). The latter sector is also the beneficiary of more than 85 per cent of total Industry 4.0 investment deductions.

These sectoral differences could change in 2018 due to the gradual elimination of transport equipment from eligible assets for the super-depreciation mechanism. The share of these assets is larger in sectors such as services and construction, and therefore the number of beneficiaries and the amount of the super-depreciation benefit could decline.

Considering exporting companies only (about 1.2 per cent of the companies considered in the model), almost 54 per cent took advantage of the subsidy, with an average amount equal to 4.7 per cent of the overall benefit.

In terms of company size, the share of beneficiaries rises with increases in the value of production, ranging from 24.3 per cent of micro-enterprises (those with a value of production of less than €2 million) to 73.5 per cent of large companies (with a value of production of more than €50 million) and 75.2 per cent of very large enterprises (with value of production of more than €250 million). As a result, the theoretical benefit is highly concentrated: less than 1 per cent of companies account for almost 60 per cent of the total theoretical deduction.

The distribution of beneficiaries by selected business indicators. – Companies that have invested in subsidised assets boast certain indicators (profit, ROE, employment growth) that are on average better than those of companies that have not done so.

More specifically, 83.9 per cent of beneficiary companies are profitable, compared with 59.9 per cent of non-beneficiaries (Table 3.8). The stronger performance of the beneficiary companies can also be seen if we consider the distribution of subsidised and non-subsidised companies by business sector and company size.

Significant differences in favour of beneficiary companies and, above all those that have also invested in Industry 4.0 assets, can also be seen for return on equity (ROE), which measures the financial return on the investment. This indicator averaged 12.1 per cent and 13.7 per cent, respectively, for companies benefitting from the super-depreciation

Table 3.8 – Beneficiary companies: business indicators in 2017 *(percentages)*

	Profitable companies		R.O.E.			Change in employment 2017/2016		
	Non-benefic.	Beneficiaries	Non-benefic.	Super and hyper deprec. beneficiaries	Super deprec. beneficiaries	Non-benefic.	Super and hyper deprec. beneficiaries	Super deprec. beneficiaries
Agriculture	42.6	60.4	1.4	6.7	4.0	2.5	5.6	5.6
Extraction	48.6	81.6	2.0	7.8	4.6	-3.4	-3.5	2.1
Industry	64.0	89.0	7.1	14.7	12.3	0.8	4.2	3.2
Utilities	54.1	81.9	7.5	13.0	10.0	2.7	0.9	3.7
Construction	54.5	89.5	9.5	14.0	13.3	1.8	6.9	2.5
Services	61.6	81.4	8.1	13.0	12.0	4.2	6.6	5.4
Other services	50.5	72.9	9.3	13.5	13.5	4.1	10.3	1.0
Micro	58.2	81.1	7.9	13.5	11.9	2.9	6.7	4.1
Small	81.5	91.3	8.5	14.8	13.0	3.5	6.3	5.5
Medium	79.6	92.2	7.4	12.8	11.6	3.5	5.2	5.3
Large	77.5	92.2	7.2	12.8	10.5	4.4	4.0	4.6
Very large (> 250 million)	78.2	92.4	11.1	10.2	9.3	1.1	4.8	2.2
Total	**59.9**	**83.9**	**7.9**	**13.7**	**12.1**	**3.2**	**5.2**	**4.3**

Source: based on simulations conducted with the PBO’s MEDITA model.

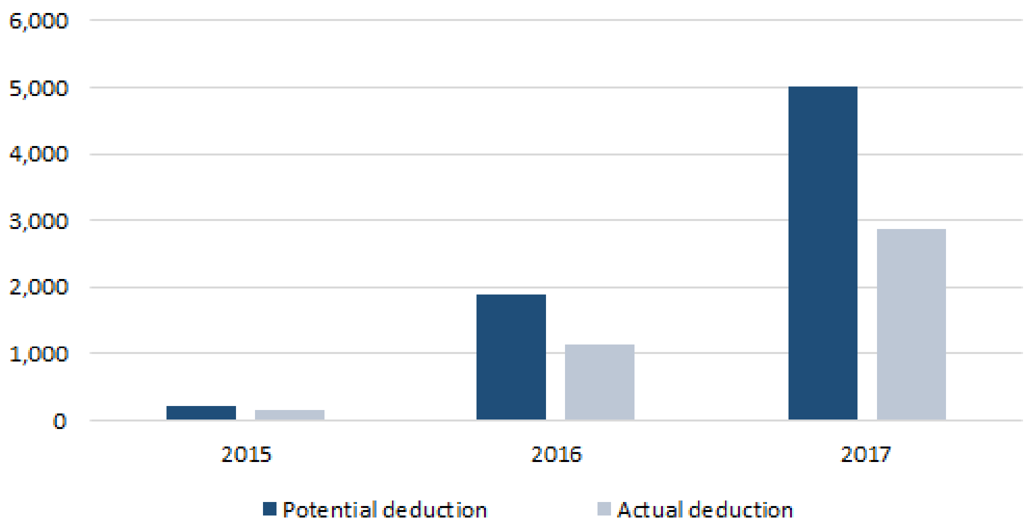
and those that also used hyper-depreciation, compared with 7.9 per cent for firms not benefitting from the preferential depreciation mechanisms.

With regard to employment growth, although it is not possible to identify a causal relationship, we note that beneficiary companies, and in particular those that have invested in Industry 4.0 assets, have experienced a greater increase in employment than other firms (4.3 and 5.2 per cent, respectively, compared with 3.2 per cent).

Implicit tax rates and tax savings. – The MEDITA microsimulation model makes it possible to estimate the fiscal capacity of the individual companies (i.e., the existence of a profit against which the additional depreciation allowance can be set off), enabling us to quantify their effective tax savings. Figure 3.1 shows the aggregate difference between the theoretical and actual deduction in the first three years of application of the preferential treatment. The ratio between the actual and theoretical deduction decreased from 72.8 per cent in 2015 to 57.3 per cent in 2017. In this last year, beneficiary companies actually recorded a benefit of €2.8 billion, compared with a total theoretical deduction of almost €5 billion. However, for companies not benefiting from the subsidy due to insufficient profit or a loss for the year, the smaller effective deduction they recognised in 2015-2017 could result in future tax savings if they do subsequently post a profit. For these companies, the forgone tax savings associated with insufficient fiscal capacity accumulated over those three years exceed €2.8 billion, and future tax savings, given the current IRES tax rate of 24 per cent, could be €0.6 billion.

By restricting the analysis to individual companies only (thus excluding firms that have opted to participate in a tax consolidation mechanism, which generally have a relatively low fiscal capacity), the ratio between the actual deduction and the theoretical

Figure 3.1 – Potential and effective deduction for additional depreciation allowance *(millions of euros)*



Source: based on simulations conducted with the PBO's MEDITA model.

deduction is high at 88.7 per cent in 2017 for companies with super- and hyper-depreciation and 76.9 per cent for those benefitting from super-depreciation only (Table 3.9). Considering fiscal capacity in the various sectors, on average manufacturing industry and utilities are able to exploit a higher proportion of the theoretical benefit thanks to the high capacity ratio of their enterprises (respectively, 89.4 and 92.9 per cent). The capacity ratio is instead more uniform with respect to the size of the beneficiary companies. Note also that, on average, for companies that have used hyper-depreciation for Industry 4.0 assets, the capacity ratio is higher for all sectors and for all company sizes.

For individual companies, the annual tax savings for each euro invested depends not only on fiscal capacity but also on the depreciation rate (the higher the rate, the greater the savings) and therefore on the composition of company assets and the amount of depreciation in relation to the amount of taxable income. All these components are summarised by the variation in the implicit tax rate attributable to the benefit. On average, the tax rate is reduced by almost 1 percentage point for companies that have benefited from super-depreciation only and 1.5 percentage points for those that have also benefited from hyper-depreciation. The average reduction in the implicit tax rate is particularly high in agriculture and other services. Especially in the former, the capacity ratio is lower than average and the effect on the rate is generated by the high depreciation rates compared with the size of the sector's tax base. Considering company size, the reduction in the tax rate is greater than average for larger companies that have only used super-depreciation and for smaller firms that have also invested in Industry 4.0 assets (Table 3.9).

Table 3.9 – Individual beneficiary companies: fiscal capacity, change in implicit tax rates, EBITDA and ACE in 2017
(percentages)

	Fiscal capacity		Change in tax rate		Pre-subsidy gross operating margin		Post-subsidy gross operating margin		Companies with ACE	
	Super and hyper deprec. benefic.	Super deprec. benefic.	Super and hyper deprec. benefic.	Super deprec. benefic.	Non-benefic.	Benefic.	Non-benefic.	Benefic.	Non-benefic.	Benefic.
Agriculture	58.5	49.2	3.2	1.0	5.6	6.6	5.6	6.7	34.0	46.1
Extraction	84.9	65.0	1.6	1.8	12.6	16.9	12.6	17.4	24.1	48.6
Industry	89.4	88.6	1.6	0.8	6.0	11.4	6.0	11.7	40.7	59.0
Utilities	92.9	77.7	1.3	0.8	8.5	9.8	8.5	9.9	41.4	59.2
Construction	89.1	80.9	1.4	1.0	5.2	11.1	5.2	11.4	38.2	64.3
Services	86.7	68.7	1.2	0.9	8.6	9.9	8.6	10.0	43.8	58.6
Other services	89.3	74.8	4.7	3.1	9.7	18.3	9.7	19.2	36.1	53.8
Micro	81.5	76.3	1.7	0.9	9.7	14.7	9.7	15.0	41.7	60.0
Small	88.5	81.7	1.9	1.0	8.7	12.2	8.7	12.4	49.3	57.8
Medium	89.8	80.9	1.5	0.8	6.9	10.5	6.9	10.7	41.7	53.7
Large	94.8	78.6	1.1	0.7	6.0	9.6	6.0	9.8	38.6	56.0
Very large (> 250 million)	85.0	65.0	1.5	1.2	4.6	7.7	4.6	7.8	42.7	56.7
Total	**88.7**	**76.9**	**1.5**	**0.9**	**7.7**	**10.6**	**7.7**	**10.8**	**42.1**	**59.2**

Source: based on simulations conducted with the PBO's MEDITA model.

Finally, confirming the fact that the subsidies were mainly used by "healthy" firms, we can see that companies that invested in subsidised assets have greater liquidity on average, using their gross operating margin as a proxy, than those that did not invest. The increase in depreciation raised the gross operating margin by 0.2 points on average (from 10.6 to 10.8 per cent), further increasing self-financing and therefore the investment capacity of these companies. Above-average increases were observed in other services (0.9 points), mining (0.5 points) and industry (0.3 points). Moreover, companies using the ACE represent a high proportion of those benefiting from the preferential depreciation regime, and are therefore more highly capitalised than the average for other companies.

3.1.2 Changes in the taxation of the self-employed and sole proprietors

The Budget Bill introduces a number of modifications to the substitute tax regimes introduced for sole proprietors and self-employed workers in the 2019 Budget Act. The first is the repeal of the flat-rate mechanism (application of a fixed rate of 20 per cent in lieu of ordinary progressive personal income tax) for self-employed workers and sole proprietors with revenues of between €65,000 and €100,000 that was to have come into force from 2020 (*regime sostitutivo*). Second, a number of changes are introduced to another flat-rate mechanism (application of a fixed rate of 15 per cent in lieu of ordinary progressive personal income tax) applicable to those with revenues of less than €65,000 (*regime forfettario*), which mainly concern eligibility criteria. These changes reintroduce certain limitations envisaged by the flat-rate system in force before the measures enacted with last year's budget (Table 3.10). More specifically, taxpayers who in the previous year received income from employment, pensions and similar sources

Table 3.10 – Eligibility criteria for the *regime forfettario*

	Pre-2019 mechanism	2019 mechanism	New mechanism
Revenues	Revenues below thresholds differentiated by sector	Revenues of less than €65,000	
Income from payroll employment	< €20,000 or less than income from self-employment	No limitation	< €30,000
Personnel expenses	< 5,000	No limitation	< €20,000
Gross cost of capital assets	< €20,000	No limitation	
Other main exclusions	Recipients of other income from equity investments Owners of corporations that are engaged in a business directly or indirectly connected with the principal business Persons who are exclusively or mainly engaged in the sale of buildings Non-EU residents		

exceeding €30,000 are no longer eligible for the flat-rate system.[61] A limitation on personnel expenses, repealed with the 2019 Budget Act, has also been reintroduced and must now not exceed €20,000. However, this condition is less restrictive than that provided for in the original flat-rate scheme (Law 190/2014), which limited access to the subsidised mechanism to self-employed workers only, with personnel costs of less than €5,000. Finally, income calculated in accordance with the rules of the flat-rate mechanism will be relevant in determining income for the calculation of income tax credits.

On the basis of the official estimates contained in the Technical Report, the repeal of the 20 per cent substitute tax would increase tax revenue by about €860 million. The approximately €5.5 billion of taxable income of the taxpayers who would have qualified for the substitute regime would be subject to about €1.6 billion of personal income taxes (IRPEF) and the associated surtaxes, instead of the some €1.1 billion of substitute tax, and about €0.3 billion more in VAT and IRAP (regional business tax).

According to the estimate produced using the PBO microsimulation model on the occasion of the Parliamentary hearing on the 2019 Budget Act,[62] taxpayers participating in the *regime sostitutivo* would have enjoyed a rate reduction of about 10 percentage points. Moreover, taxpayers who would have benefited from the *regime sostitutivo* would have had an average total income of about €49,000, equal to more than double the average for payroll employees. Both of these aspects – a very large differential in fiscal burden at any given income between the self-employed and payroll employees and the fact that the measure favoured taxpayers with relatively high incomes – appear to contrast with the original spirit underlying the introduction of the initial single-rate mechanism, namely simplifying administration and reducing the tax burden for micro-enterprises only.

The objective of the second set of measures, namely the reintroduction of eligibility restrictions for the *regime forfettario*, would seem to be to reduce the distortions in the horizontal equity of the tax (differential tax treatment of the same income level), excluding self-employed workers with income from employment or pensions over €30,000 from the preferential system. These taxpayers are the beneficiaries of the greatest tax savings as a result of participation in the *regime forfettario*; for them, the income tax savings due to the unbundling of self-employment income from the taxable income subject to progressive taxation are the greatest: it is equal the marginal rate applicable from €30,000 and up (from 38 per cent to 43 per cent), with a reduction in the tax rate of more than 23 percentage points.

[61] In the original formulation of the *regime forfettario* (Law 190/2014), eligibility was limited to persons mainly receiving self-employment income or income from payroll employment of less than €20,000. This ceiling was removed in the 2019 Budget Act.

[62] See Ufficio parlamentare di bilancio (2018), "Audizione del Presidente dell'Ufficio parlamentare di bilancio nell'ambito dell'attività conoscitiva preliminare all'esame del disegno di legge recante bilancio di previsione per l'anno finanziario 2019 e bilancio pluriennale per il triennio 2019-2021", 12 November.

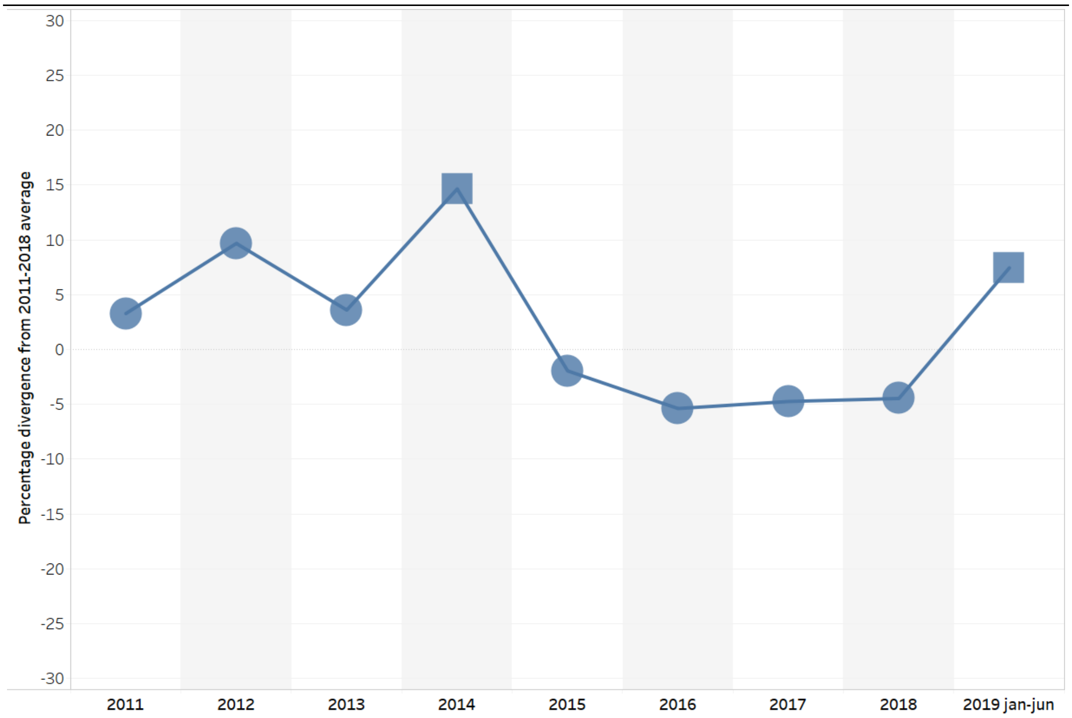
According to the Technical Report, the exclusion of these taxpayers from the *regime forfettario* would increase tax revenue by about €350 million as a result of an increase in personal income tax and the related local surtaxes for about €526 million (around 44 per cent of the associated taxable income, amounting to about €1.2 billion), an increase in IRAP of €5.9 million and a reduction in revenue from the substitute tax and VAT amounting to €177 million and €4.3 million respectively.

The exclusion of sole proprietorships and self-employed workers with personnel costs in excess of €20,000 from the *regime forfettario* has a lower overall impact on revenue, amounting to a total of about €30 million when fully operational.

The measures contained in the Budget Bill modify the new *regime forfettario* introduced in 2019, whose scope cannot yet be fully evaluated. It is necessary to wait until tax data for 2019 are available. For now, however, it is possible to offer a number of remarks on new VAT registrations.

Figure 3.2 shows the percentage difference between new registrations of VAT numbers for self-employed workers in each year compared with those in 2011-2018. In the first

Figure 3.2 – Percentage differential in new VAT registrations for 2011-2018 and the first half of 2019 (1)



Source: MEF – Department of Finance, VAT Registration Observatory.
(1) For each year, the figure reports the annual divergence from the average for the period from 2011 to 2018, excluding 2014, the year of peak registrations. For 2019, the figure refers to the first half of the year and so the differential is that between the first half of that year and the average for the first halves of 2011-2018.

six months of 2019, there was in fact an increase in new registration of VAT numbers compared with the corresponding period of previous years. In particular, the figure shows an increase of around 7.7 per cent in registrations. In the four previous years (2015-2018), the rate of registration of VAT numbers was lower than the average, while a significant increase is seen in 2014, concentrated in December, in proximity to the introduction of the first version of the *regime forfettario*. However, further analysis of the final data is necessary to verify if the new VAT positions have actually benefited from the extended *regime forfettario*.

It is also advisable to perform an ex post evaluation of the effectiveness of the introduction of the *regime forfettario* in terms of the incentive it created for economic activity due to the significant reduction of the marginal rates for the taxpayer segment affected by the measure.

3.1.3 The web tax

The 2019 Budget Act introduced a tax on digital services in Italy that, pending the development of a long-term solution at the international level, is based on the digital services taxation scheme envisaged in the European Commission's proposal of March 2018. However, this tax was not implemented due to the lack of the ministerial decree that was to have established a number of essential elements for its operation. The provisions in the Budget Bill focus precisely on defining these elements: the persons subject to the tax, the tax base, the tax return, frequency of the tax, and exclusions and obligations for residents.

Taxable persons are those who, in the exercise of their business activities, generate revenues from digital services but only above certain size thresholds: total global revenues of at least €750 million and revenues in Italy from digital services at least €5.5 million. The tax base comprises amounts received for the delivery of specifically identified services: digital advertising, intermediation between users and data transmission. In general, these are components of the tax base on which it is possible to avoid payment of direct taxes in Italy due to the absence of a permanent establishment or because it is possible to channel them to countries, such as Ireland, that minimise taxation for large digital multinationals (mainly residing in the United States and China).

The 3 per cent tax rate applies to the share of revenues of the company for the digital services indicated above that can be attributed to users located in Italy, regardless of the share of sales accounted for by Italy. The rationale underlying this mechanism is linked to the importance of the users themselves in the formation of value added through the free provision of their personal data.

Although other countries are moving in the same direction, only France has introduced a very similar tax. In the United Kingdom and Spain, similar proposals have not yet been approved.

In the absence of coordinated decisions at the international level, the unilateral application of this type of tax creates significant implementation challenges, despite the clarifications of the legislation in question. It could be difficult, in the absence of recognition of taxation authority, to require companies not resident in the European Union and without a permanent organisation to submit tax returns and store the data necessary to levy the tax. The effectiveness of the new tax will depend on the collaboration of the multinationals concerned. As such, the legislation will generate compliance costs for the companies and assessment and collection costs for the tax authorities. Nevertheless, unilateral actions such as that taken by Italy represent an important incentive to take coordinated decisions at the international level.

3.2 Measures concerning tax expenditures

Tax expenditures, i.e. the cost in terms of lower tax revenue of measures that grant taxpayers any form of exemption, exclusion, reduction in taxable income or tax or otherwise grant favourable tax treatment, have received particular attention both in legislation and in the policy debate for some time now. With regard to legislation, various initiatives have been proposed to analyse and monitor tax expenditures, with a view to their reorganisation and rationalisation, in order to increase the transparency of taxation and expenditure policies and to minimise distortions in the tax system, in line with various recommendations from both the European Commission and the OECD. At the policy level, the reorganisation of tax expenditures is often mentioned as a possible source of funding for new measures. Box 3.1 provides a summary of the quantification of tax expenditures contained in the last Annual Report on Tax Expenditures.

As in the budgets of the past few years, that for 2020-2022 shows no trace of any reorganisation or rationalisation of tax expenditures. On the contrary, the budget package extends various tax expenditure programmes (for example, those on building renovations and energy efficiency upgrading), increases the scale of certain others compared with current legislation (for example, the flat-rate taxation mechanism for rental income in municipalities with high population densities), and introduces new programmes (as in the case of the tax credit for building façade repairs). However, the budget measures do contain a tentative initial attempt to reduce tax expenditures connected with personal income tax by limiting the tax credits for certain expenditures above a certain level of income, with very limited revenue-generation impact.

The following two sections contain a qualitative and quantitative assessment of this latter measure and of the change made to the flat-rate taxation mechanism for rental income in municipalities with high population densities.

3.2.1 The restructuring of the 19 per cent personal income tax credit

The Budget Bill seeks to reduce tax expenditures by limiting or eliminating the 19 per cent tax credit for most eligible expenditures (those provided for in Article 15 of the Uniform Income Tax Act (TUIR)) for high-income taxpayers.[63] More specifically, the changes eliminates the credit for this spending by taxpayers with a total income of more than €240,000 and reduces the credit – as determined using a coefficient that decreases linearly with respect to income – for taxpayers with incomes of between €120,000 and €240,000.

The spending eligible for the 19 per cent credit affected by the rule change includes: healthcare spending, with the exclusion of that incurred for serious pathologies (i.e. those that give the right

[63] The Budget Bill also limits the 26 per cent credit for donations to non-profit organisations.

to an exemption from co-payments);[64] insurance premiums; funeral expenses; university education; costs for attending primary school and secondary school; other spending, including that for children's sports, for care workers, for rent paid by non-resident students, veterinary expenses, some donations and other minor items.

No restrictions have been imposed for other types of expenditure qualifying for tax credits, such as, for example, interest expense on mortgage loans (purchase of primary residence, agricultural loans), building renovations and energy efficiency upgrading.

For all taxpayers, the expenditures affected by the measure (i.e. the amounts on which the 19 per cent credit is calculated) amount to €23.5 billion. These correspond to tax credits (tax savings) of about €4.5 billion, 11.4 per cent of the total tax expenditures involving personal income tax, equal to €41.5 billion in 2020 (Figure 3.3).[65] Healthcare spending accounts for over two-thirds of the total (€16.7 billion, producing tax credits of around €3 billion), while the other items have a more limited impact: university education spending amounts to about €1.9 billion, insurance premiums come to around €1.5 billion, funeral expenses and those for school attendance amounted to €763 million and €556 million, respectively. The remaining items, which individually do not exceed €500 million, total about €2 billion.

As can be seen in the lower part of Figure 3.3, where spending has been broken down with the help of the PBO tax-benefit microsimulation model by quartiles of total income, the greatest tax benefit connected with the tax credit for these expenditure items accrues to higher-income taxpayers: more than 50 per cent of the expenses are paid by the richest 25 per cent of taxpayers, while only 20 per cent are paid by the poorest 50 per cent. The greatest inequality is in university education spending (62.5 per cent of the expenditure is incurred by the richest quartile, compared with 18 per cent for the bottom two quartiles). By contrast, funeral expenses are distributed most uniformly.

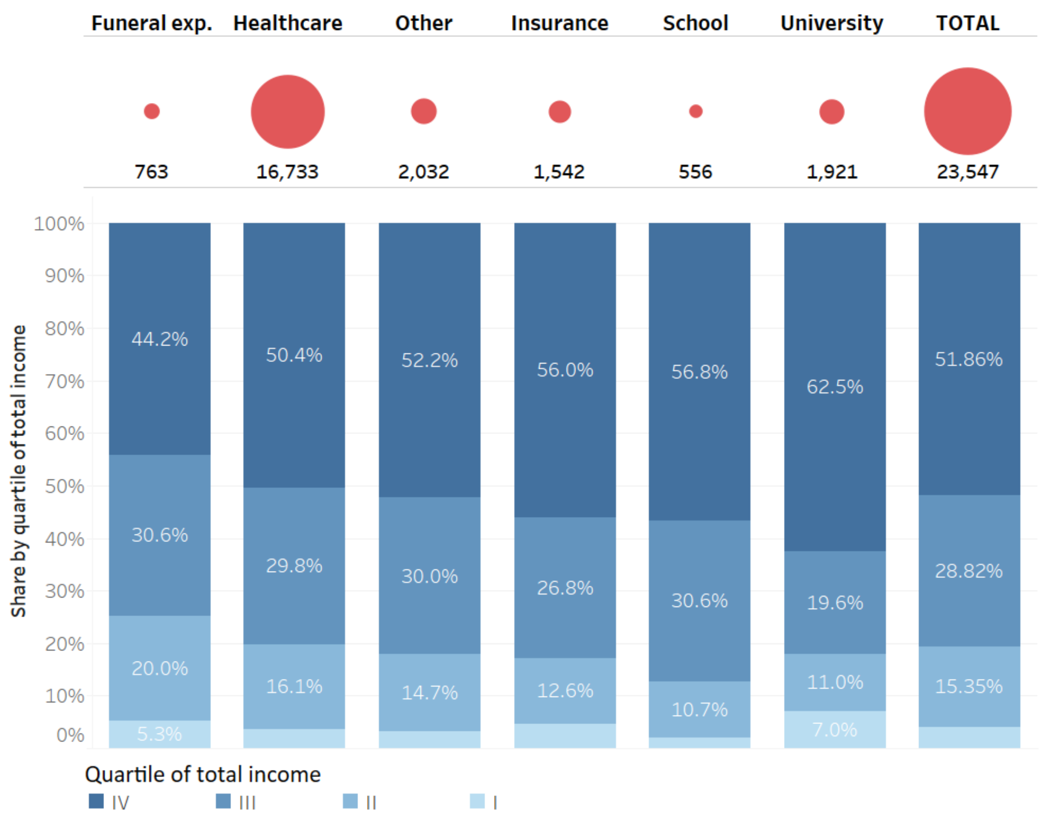
The selection criterion adopted involves an extremely small group of high-income taxpayers, meaning that the measure does not significantly impact the overall value of tax credits despite the sharp concentration of expenditure in the upper band of the income distribution noted here. As indicated in Table 3.11, prepared on the basis of the PBO's tax-benefit microsimulation model, those with an income exceeding €240,000 represent only 0.1 per cent of all taxpayers (58,000 individuals), while those with an income of between €120,000 and €240,000, who qualify for a partial credit, represent 0.6 per cent (248,000 individuals). Accordingly, the tax credits affected by the reform represent only 2.9 per cent of the total, despite the fact that the share of taxpayers in

[64] Also excluded is spending necessary in cases of serious permanent disability, for which a tax deduction from income is available (TUIR, Article 10, paragraph 1 letter b).

[65] These amounts were quantified on the basis of the findings of the 2019 Annual Report on Tax Expenditures attached to the revenue budget for 2020 and the 2020-2022 period (pp. 805 et seq.), available at http://www.senato.it/service/PDF/PDFServer/BGT/01125972.pdf. The €41.5 billion of IRPEF tax expenditures do not include tax credits for dependent children and income from employment, which are considered structural elements of the tax. See Box 3.1.

these income brackets who benefit from the credits is almost double that for incomes below €120,000 (over 84 per cent, compared with 48 per cent) and that the average amount of the tax credits is much higher (double if not triple than that of taxpayers with incomes below €120,000[66]).

Figure 3.3 – Distribution by quartile of total income of expenditure qualifying for 19 per cent tax credit affected by the legislation



Source: based on PBO's tax-benefit microsimulation model.

Table 3.11 – Quantification of the financial impact of limitation on tax credits

Income classes	Taxpayers (thousands)	Taxpayers (%)	Taxpayers with tax credit (thousands)	Share of taxpayers with tax credit (%)	Average tax credit (euros)	Total tax credits (millions)	Total tax credits (%)	Taxpayers affected (thousand	Average loss (euros)	Increase in revenue (millions)
Up to 120	41,054	99.3	19,802	48.2	219	4,342	97.1	0		0.0
from 120 to 240	248	0.6	208	84.0	481	100	2.2	205	-156	32.0
>240	58	0.1	50	85.8	635	32	0.7	50	-634	31.8
Overall total	**41,360**	**100.0**	**20,060**	**48.5**	**223**	**4,474**	**100.0**	**255**	**-250**	**63.8**

Source: based on PBO's tax-benefit microsimulation model.

[66] On average, the total tax credits for spending taken by taxpayers with an income of between €120,000 and €240,000 amount to €481, rising to about €635 for taxpayers with an income of more than €240,000.

Box 3.1 – Tax expenditures in the 2019 Annual Report on Tax Expenditures[67]

In order to promote the reorganisation and rationalisation of the various tax relief measures targeted at specific groups of taxpayers, since 2011 the State revenue budget has contained an annual survey of existing tax expenditures. Since 2016, monitoring has been entrusted to a special Commission, set up at the MEF, which has now published its fourth report. The report provides a three-year quantification of tax expenditures.[68]

The identification of tax expenditures, as widely documented in the literature,[69] is influenced by some basic assumptions used to determine the tax model (benchmark) with respect to which the tax relief measures represent a departure. The Commission's assessments are based on the so-called "legal benchmark", in which reference is made to the current tax system, rather than a more generic theoretical model. However, this approach does not eliminate a certain degree of subjectivity in the identification of tax expenditures, since some measures identified as tax expenditures using the legal benchmark may then be recognised as structural features of the tax and, as such, be excluded from the tax expenditure category in the light of a substantive analysis. Compared with assessments made previously based on this same criterion, the Commission has decided that a variety of tax benefits previously included among tax expenditures should be considered structural. These include, for example, tax credits for income from employment, self-employment and pensions (considered a defining element of the progressive structure of income tax), tax credits for dependents and substitute taxes on capital income. Also considered structural, and therefore not included under tax expenditures, are reduced VAT rates and, as regards IRES, the ACE (from a dual taxation perspective) and the participation exemption. Overall, the Commission has therefore narrowed the scope of the tax relief measures to be considered tax expenditures compared with previous assessments, bringing their total from the approximately €160 billion reported in the annexes to the revenue budget up to 2015 to the approximately €54.5 billion for central government taxes and €22 billion for local taxes[70] given in the Commission's first report in 2016.[71]

The reports of the Commission represent a foundation for the preparation, as provided for by law, of the policy reports on the tax expenditures attached to the Update identifying measures "aimed at reducing, eliminating or reforming tax expenditures that are entirely or partly unjustified or outdated in the light of changing social or economic needs or that overlap with spending programmes having the same purpose, which the Government intends to implement with the budget package". However, the policy reports have so far only given very general guidelines, which have never actually been implemented.[72]

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[67] "Rapporto annuale sulle spese fiscali 2019" attached to the revenue budget for the 2020 fiscal year and for 2020-2022 (pp. 805 et seq), available at http://www.senato.it/service/PDF/PDFServer/BGT/01125972.pdf.

[68] The Report is attached to the State revenue budget, as provided for in Legislative Decree 160/2015.

[69] For a survey, see OECD (2010), "Tax expenditures in OECD countries".

[70] The reports published by the Commission specify that the total values given for tax expenditures should be assessed with caution as they represent an indicative measure of the weight of the individual items taken separately. It is possible that the revenue impact of the simultaneous removal of more than one tax expenditure programme may differ from the sum of the effects measured individually, due to potential interactions between the measures. Accordingly, the total given here cannot be considered as the additional revenue obtainable from the elimination of all tax relief measures.

[71] Even broader is the set identified by the Working Group on Base Erosion in 2011, which used a theoretical benchmark to identify some 720 tax expenditure programmes for a total of more than €254 billion (including local taxes).

[72] The reports attached to the 2017 and 2018 Updates refer to a reorganisation that would broaden the tax base in order to expand tax credits for families and labour, as well as the possibility of implementing in alternative an horizontal programme. In the 2019 policy report, attention is focused on tax expenditures that harm the environment, although here too no specific interventions are indicated.

The assessments of the Commission show that tax expenditures have increased in recent years, rather than decreasing, reaching €61.1 billion in 2019 (forecast in the 2018 report) and €62.5 billion in 2020 (forecast in the 2019 report) compared with the €54.5 billion estimated for 2016. These sums are increased by about €27.7 billion in tax expenditures related to local taxes. Of the approximately €90.2 billion in total tax expenditures expected for 2020, around €20.9 billion have been introduced over the past five years.

Overall, the largest tax expenditures recorded for the 2020-2022 period are concentrated in a limited number of measures: 2.4 per cent of the most significant programmes (13 measures over €1 billion) account for more than two thirds of total forgone revenue, while over 46 per cent of the measures have an impact of less than €100 million (Table B3.1.1).

Almost half of the central government and local tax relief measures (€41.5 billion, or 46 per cent of the total) concerns personal income tax (which also includes the most significant tax expenditures, such as the "€80 bonus" tax credit for lower income employees and tax credits for building renovations) (Figure B3.1.1). Tax expenditures impacting personal income tax represent about 26 per cent of the associated tax revenue.[73] These are followed by those for IRAP, which account for about one-fifth of total tax expenditures, mainly due to the exclusion of labour costs from the tax base, which is worth about €8.4 billion.

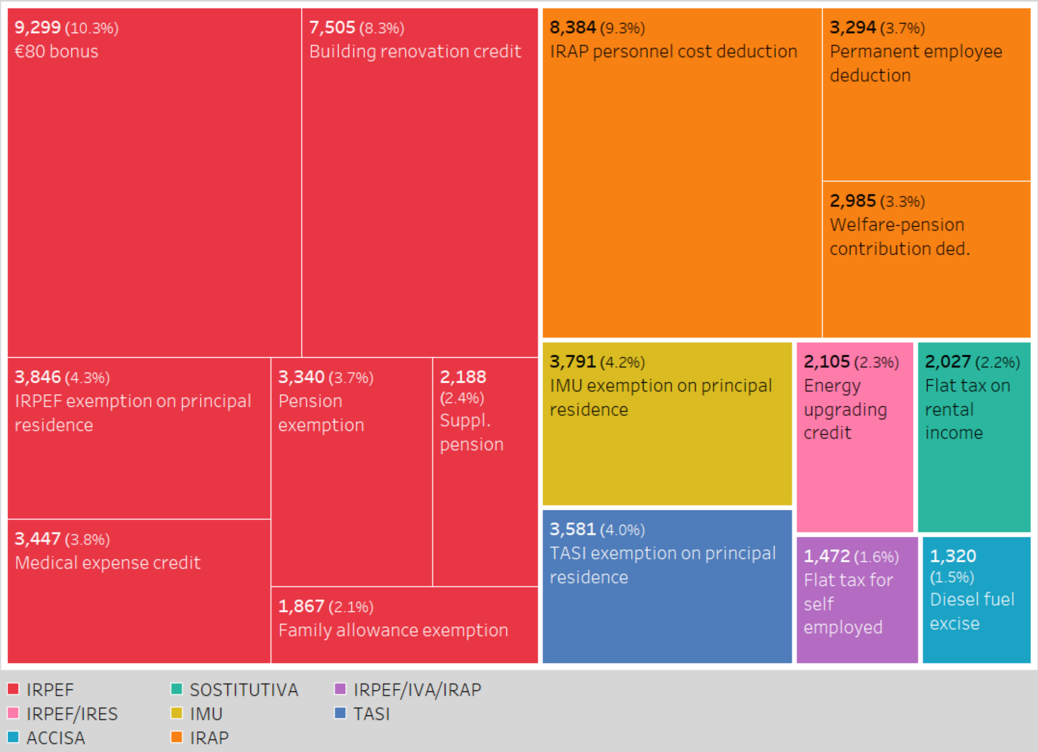
Table B3.1.1 – Central government tax expenditures identified in the 2019 Report

	No. of tax expenditures	No. of tax expenditures *%*	Beneficiary frequency (1) (thousands)	Amount in 2020 *(millions of euros)*	Amount in 2020 *%*	Amount in 2021 *(millions of euros)*	Amount in 2021 *%*	Amount in 2022 *(millions of euros)*	Amount in 2022 *%*
					By tax				
IRPEF	141	26.5	111,564.1	-43,043.4	68.9	-44,392.5	69.0	-44,437.6	70.4
IRES	58	10.9	181.4	-594.9	1.0	-729.9	1.1	-759.4	1.2
IRPEF/IRES	49	9.2	3,249.7	-3,983.0	6.4	-4,591.3	7.1	-4,290.7	6.8
IRPEF/IRES/IRAP/IMU	6	1.1	13.1	-163.9	0.3	-18.4	0.0	-18.4	0.0
VAT	70	13.1	1,006.5	-1,574.5	2.5	-1,574.5	2.4	-1,574.5	2.5
Registration fees, stamp duties and mortgage/land registry fees	71	13.3	457.7	-5,877.1	9.4	-5,877.1	9.1	-5,877.1	9.3
Donation and inheritance tax	9	1.7	0.0	-12.7	0.0	-12.7	0.0	-12.7	0.0
Tax in lieu	25	4.7	2,362.5	-1,809.2	2.9	-1,909.8	3.0	-2,374.2	3.8
Excise taxes	37	6.9	0.0	-3,177.0	5.1	-3,177.0	4.9	-3,177.0	5.0
Tax credits	46	8.6	3.1	-2,137.5	3.4	-1,933.7	3.0	-469.2	0.7
Other	21	3.9	376.8	-104.3	0.2	-104.3	0.2	-104.3	0.2
Total	**533**	**100.0**	**119,214.8**	**-62,477.6**	**100.0**	**-64,321.2**	**100.0**	**-63,095.2**	**100.0**
					By class of foregone revenue				
<10 million	159	29.8	667.4	-367.1	0.6	-460.3	0.7	-416.6	0.7
10-20 million	32	6.0	956.3	-408.3	0.7	-405.2	0.6	-418.1	0.7
20-50 million	28	5.3	2,118.6	-796.4	1.3	-791.4	1.2	-748.8	1.2
50-100 million	27	5.1	4,156.3	-1,820.6	2.9	-1,678.9	2.6	-1,485.7	2.4
100-300 million	29	5.4	10,774.9	-3,992.4	6.4	-5,196.0	8.1	-5,437.2	8.6
300 million - 1 billion	25	4.7	19,943.5	-12,912.2	20.7	-14,034.9	21.8	-13,194.9	20.9
>1 billion	13	2.4	80,597.6	-42,180.5	67.5	-41,754.5	64.9	-41,393.8	65.6
Negligible effects	27	5.1	0.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Not quantifiable	154	28.9	0.1	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Estimate already included in other measure	39	7.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total	**533**	**100.0**	**119,214.8**	**-62,477.6**	**100.0**	**-64,321.2**	**100.0**	**-63,095.1**	**100.0**

Source: Rapporto annuale sulle spese fiscali 2019.
(1) The variable "Beneficiary frequency" includes a repetition effect due to the fact that each individual may benefit from more than one tax relief measure.

[73] IRPEF returns for 2018.

Figure B3.1.1 – Tax expenditures exceeding €1 billion (revenue impact for 2020)



Source: Rapporto annuale sulle spese fiscali 2019.

As regards the breakdown of central government tax expenditures by mission, the protection of housing and urban planning appears to be the area receiving the most relief, at around one-third of the total (€21.7 billion). More specifically, these include tax expenditures associated with building renovations and tax relief on primary residences (IRPEF exemption, IMU and TASI and the mortgage interest credit). The second largest category is labour policy, with a total of €15.6 billion. This includes, for example, the €80 bonus tax credit, the exemption of various types of pension and the preferential taxation of productivity bonuses.

The establishment of the Commission and the production of annual reports have undoubtedly brought benefits in terms of clarity and stability in the quantification of tax expenditures. Another merit is that of having chosen to adopt the legal benchmark instead of a theoretical benchmark, which is too vast and not very useful for the purpose of rationalising tax expenditures. However, application of this criterion must taking account of other aspects in addition to the purely normative data. One example is represented by tax relief for IMU (municipal property tax) and TASI (municipal services tax) on principal residences, which amounts to €3.8 billion and €3.6 billion, respectively, in 2020. These amounts, formally correct (the two relief measures are both incorporated in legislation), are the result of repeated attempts to tax principal dwellings and overlap each other. In particular, the quantification of these tax expenditures derives from the fact that first IMU then TASI, two similar taxes that impact the same tax base, were initially applied to principal residences as well.

Should a new tax be introduced on these dwellings, impacting the same tax base and with similar rates, or if IMU and TASI were again levied on principal residences, the increase in revenue would not be the sum of the two tax expenditures (€7.4 billion) but only half of that.[74]

[74] With the unification of IMU and TASI proposed in the Budget Bill, also the formal reason for the duplication would be eliminated.

To provide Parliament with more complete information on the actual nature of the various existing tax relief measures, it would also be advisable to supplement the list of the largest tax expenditures with more detailed information than just the number of actual beneficiaries given in the report. For natural persons, it would be of considerable interest to be able to have access, for example, to information on the type of taxpayer (payroll employee, pensioner, self-employed) and on their income level and, for legal entities, information on the type of business, the macro-sector to which they belong and their size.

Finally, to better understand the actual tax relief granted on individual taxes, an additional effort would be needed to distinguish the loss of revenue in the case of measures involving multiple taxes. For example, the list reports the impact of the new *regime forfettario* on personal income tax, VAT and IRAP under a single heading.

Furthermore, the outcome of the reconciliation of tax expenditures and any corresponding spending programmes, an explicit objective of the Commission's activities, still appears unsatisfactory. The Commission should highlight those measures that essentially operate on both sides, in order to identify possible corrective measures to rationalise, simplify and enhance the transparency of the measures. So far the Commission has applied a formal criterion that identifies any overlaps between the expenditure and revenue sides only in cases where the spending item explicitly refers to the tax relief measure, something that generally occurs only in the case of tax credits. As a result, interactions between the two sides remain hidden, such as, for example, the non-taxation of certain significant cash transfers. Consider, for example, family allowances, which constitute a leading case of a programme with a single purpose (supporting families with children) that, mainly due to its simplicity, impacts both the expenditure side (the amount of the cash transfer) and the revenue side (the amount of the tax exemption).

When fully operational, the recovery of tax revenue generated by the measure will amount to €63.8 million, in line with the indications in the Technical Report accompanying the Budget Bill, which corresponds to about 1.5 per cent of the total tax credits for expenditures and about 0.15 per cent of total tax expenditures directly connected with IRPEF. The increase in revenue will be equally distributed between taxpayers with incomes over €240,000 (who will lose the entire tax credit, on average €635) and those with incomes between €120,000 and €240,000 (who will see their average tax credit decline by about a third, from €481 to €325).

3.2.2 Reducing the flat-rate tax on rent-controlled properties

The flat-rate tax on rental income is a preferential regime that taxes income from the rental of housing with a proportional tax of 21 per cent in lieu of progressive personal income tax and registration and stamp duty. This regime was introduced in Italy in 2011[75] with a number of objectives: on the one hand, to encourage the reporting of taxable income[76] and, on the other, to boost the supply of housing and increase access to the market.

[75] The flat rate was introduced with Article 3, paragraph 2, of Legislative Decree 23/2011.

[76] Together with the introduction of the tax relief programme, specific penalty mechanisms were originally envisaged (voidance of contract in the case of tax violations) but these were eliminated following legal action. For example, see Constitutional Court ruling 50/2014.

The latter objective is specifically pursued with a provision for a preferential rate (initially 19 per cent) on rental income from properties leased at controlled rents in provincial capitals and neighbouring municipalities, municipalities with housing shortages and in other municipalities with high population densities identified by the Interministerial Committee for Economic Planning (CIPE). Such rent-controlled leases are agreed at the local level between the most representative owner and renter associations pursuant to Article 2, paragraph 3, of Law 431/1998. The amount of the relief has been increased over time. The flat rate was lowered from the original 19 per cent to 15 per cent in 2013[77] and then, temporarily for 2014-2019, to 10 per cent.[78] With the Budget Bill, the 10 per cent rate has been made permanent.

Based on the estimates prepared by the Department of Finance, in 2013,[79] the only year for which this assessment is available, the flat-rate regime was applied to around 39 per cent of the 4.7 million properties rented for residential purposes. Those qualifying for the preferential rate accounted for 5 per cent of the total.

A number of general considerations on the use of the flat-rate tax over a longer time horizon can be made using the information drawn from personal income tax returns. The number of taxpayers with income taxed at a substitute flat rate (both ordinary and subsidised rates) has gradually increased over time. From about 500,000 taxpayers in 2011 (1.2 per cent of the total IRPEF taxpayers), this number rose to 2.4 million taxpayers in 2017 (5.6 per cent of the total), with an average increase of around 320,000 new taxpayers every year. The pace of that growth is showing signs of slowing down, but does not yet appear to have ceased (in the last year observed, the number of taxpayers paying the flat rate increased by 250,000) (Figure 3.4). In the first two years of application, rentals taxed at the preferential rate, where the discount with respect to the ordinary rate was only two percentage points, represented about 13 per cent of the total of those paying a flat rate. In 2013, with the increase in the relief, the share of rent-controlled leases began to grow, reaching 15 per cent. Since 2014, the year in which the tax advantage reached 11 points, the share of preferential-rate rentals has experienced a marked increase, reaching almost 30 per cent in 2017, with the pace of growth remaining high even in the last year of observation (about +19 per cent).

The figures also show a considerable geographical variability in the use of the reduced rate, which is impacted by its restriction to municipalities with housing shortages, which overall account for 50 per cent of the Italian population. Figure 3.5 analyses the territorial distribution of the tax relief in 2017 in the municipalities where it is applicable. In municipalities with housing shortages, 38.3 per cent of taxpayers paying a flat-rate

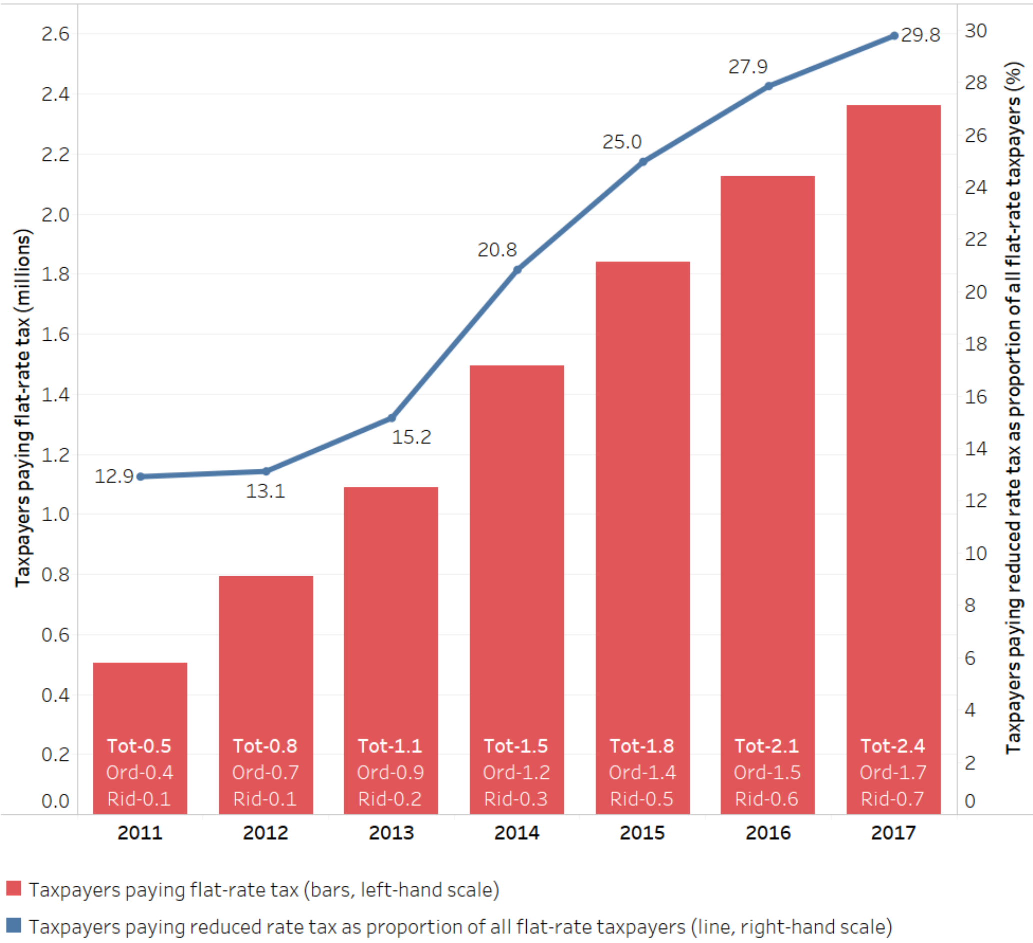
[77] Amendment introduced with Article 4, paragraph 1, of Decree Law 102/2013.

[78] The 10 per cent rate was established for four years (2014-2017) with Decree Law 47/2014 (Article 9) and subsequently extended for a further two years (2018-2019) with the 2018 Budget Act 2018 (Law 205/2017, Article 1, paragraph 16).

[79] Ministero dell'Economia e delle finanze (2017), "Gli immobili in Italia", prepared by the Department of Finance and the Revenue Agency.

substitute tax paid the reduced-rate tax.[80] The greatest proportion of taxpayers benefitting from the preferential rate is found in the North-East (in particular, in the municipalities of Emilia-Romagna), where rent-controlled leases account for more than half of the total. The lowest proportion is found in the North-West and in the South and, in general, in municipalities that are not provincial capitals. Among provincial capitals, the reduced-rate mechanism generally seems less common in regional capitals, especially in the South.

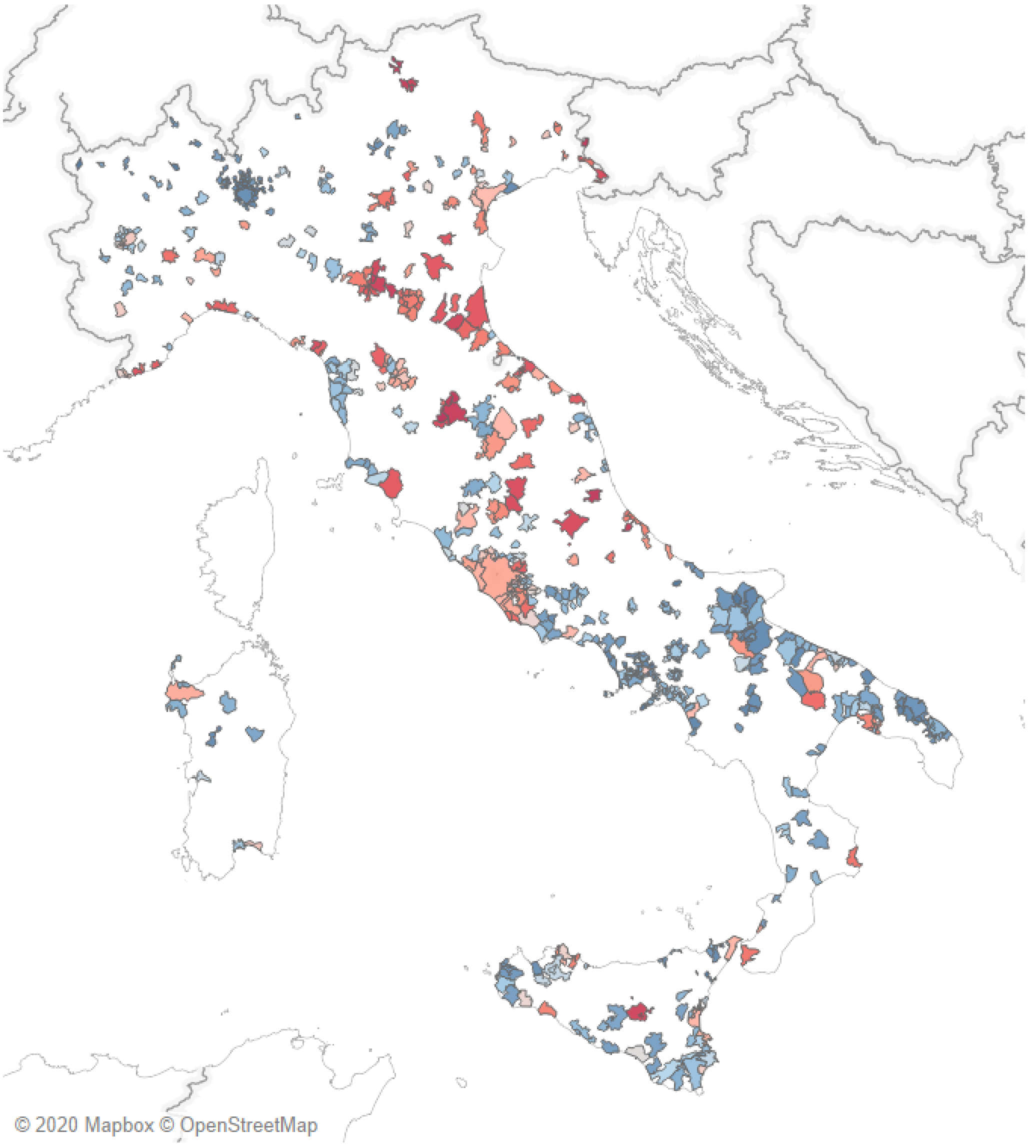
Figure 3.4 – Developments in flat-rate taxation of rental income: number of taxpayers paying a flat rate and taxpayers paying a reduced flat rate as a proportion of all taxpayers paying a flat rate



Source: based on summary data from personal income tax returns filed in 2018.

[80] The available data only indicate the residence of the taxpayer who leased the property, not the actual location of the leased property.

Figure 3.5 – Territorial distribution of taxpayers benefitting from reduced flat rate in 2017: share of taxpayers paying reduced rate as a proportion of total taxpayers paying a flat rate in municipalities with housing shortages



	TOTAL	North West	North East	Centre	South	Islands
TOTAL	38.6	27.9	52.5	44.2	28.7	36.6
Regional capital	39.0	30.0	52.3	45.8	26.3	37.6
Provincial capital	44.6	34.3	53.6	46.1	40.6	38.7
Other municipalities	33.6	20.6	51.2	40.8	24.2	33.4

Source: based on summary data from personal income tax returns filed in 2018.

The 2019 Annual Report on Tax Expenditures[81] puts the overall cost of the flat-rate substitute tax on property rental income for 2020 (both the ordinary rate of 21 per cent and the preferential rate of 10 per cent) at about €2 billion (4.8 per cent of total tax expenditures impacting IRPEF), reflecting the lower revenue from progressive personal income tax and registration and stamp duties only partially offset by the revenue from the corresponding substitute tax.

The Technical Report accompanying the Budget Bill puts the cost of the reduced 10 per cent rate compared with the 15 per cent rate envisaged in current legislation at €212 million. This estimate may not be very conservative as it assumes that the tax base is stable over time, while, as we saw earlier, it has in fact expanded rapidly in recent years.

In the rest of the section, we examine the effectiveness of the flat tax on rental income in achieving the objectives associated with its introduction (encouraging the reporting of taxable income, incentives to boost the supply of housing, increasing market access).

The introduction of the flat-tax mechanism appears to have increased the reporting of taxable income. The Department of Finance[82] estimates that the programme led to the reporting of between €1 billion and €1.5 billion in additional revenue for 2013. The Report on the non-observed economy and on tax and social contribution evasion shows a reduction in the tax gap on rental income[83] due to a "change in the behaviour of taxpayers, who are now inclined towards greater tax compliance" in correspondence with the introduction of the flat-tax regime.

On the other hand, however, the Department of Finance notes that the reduction in evasion has not produced a net benefit for the State budget: "in terms of revenue, the positive effect of the introduction of the flat-rate tax have been more than offset by the adverse impact attributable to the reduction in personal income tax rates, the non-application of local surtaxes and the exemption from payment of stamp duty and registration fees".

With regard to the other two objectives, namely to promote access to the rental market and to control rents in the areas with housing shortages, effectiveness should be measured in terms of the reduction in rents for properties let at controlled rents that benefit from the preferential tax compared with rents on the free market.

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81 "Rapporto annuale sulle spese fiscali 2019" attached to the revenue budget for the 2020 fiscal year and for 2020-2022 (pp. 805 et seq.) available at:
http://www.senato.it/service/PDF/PDFServer/BGT/01125972.pdf.

82 Ministero dell'Economia e delle finanze (2017), "Gli immobili in Italia", prepared by the Department of Finance and the Revenue Agency.

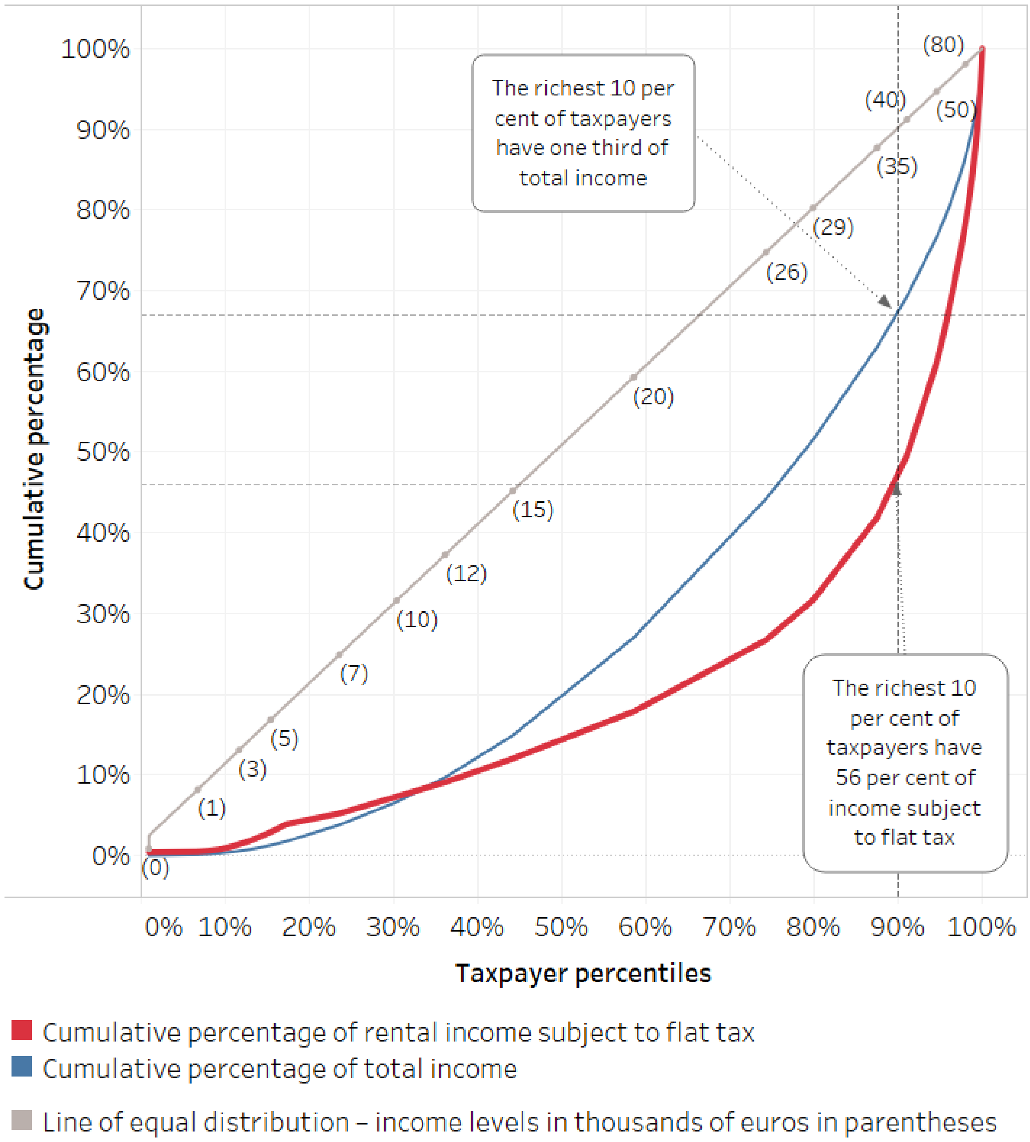
83 "Relazione sull'economia non osservata e sull'evasione fiscale e contributiva" for 2018 and 2019, attached to the 2018 and 2019 Updates to the EFD respectively. The reports indicate that in 2011-2017, the gap fluctuates between a maximum of €1.8 billion in 2011 and a minimum of €0.7 billion in 2017. The scale of under-reporting has fallen sharply, albeit not continuously, going from 21.6 per cent of potential revenues in 2011 to 7.9 per cent in 2017. In 2015 and 2016, the figures were 14.7 per cent and 10.1 per cent respectively.

The full transfer to tenants of the tax savings generated by the application of the preferential flat rate would produce a 12.2 per cent reduction in rents compared with those for similar properties taxed at the ordinary flat rate.[84] The accurate assessment of this impact is challenging, mainly because of the diversity of rental properties – which makes it difficult to compare prices – and the fragmentation of rent-control agreements at the local level. An initial attempt at analysis, conducted using the PBO's microsimulation model for a representative sample of 2015 personal income tax returns, compares the ratio between rents and the imputed rental income of the individual buildings taxed under the ordinary flat-rate system and those receiving preferential treatment within individual municipalities. Comparing actual rents and imputed rental income makes it possible to mitigate some sources of the variety between different buildings that could distort the result. An initial finding of the analysis shows with some regularity that market rents are in fact higher than the rents paid by those benefitting from the reduced rate and that their difference is effectively comparable to that deriving from the lower tax burden on rental income. However, the results must be interpreted with caution as the two populations of buildings taxed at the different flat rates could have different relationships between rent and imputed rental income due to structural factors. For example, if properties on the outskirts of a town (with more up-to-date and therefore higher imputed rental incomes) were leased more frequently at controlled rents, the result could be distorted. For large cities in particular, it would be necessary to pursue the analysis more rigorously on the basis of administrative data grouped by uniform micro-zones.

The measurement of the actual impact of the reduction in the tax on rental income is also crucial in determining the real incidence of the tax and the corresponding distribution of the tax relief. If the tax savings connected with the introduction of the flat rate tax (both ordinary and preferential) were retained in full by the lessor (i.e. did not cause any downward pressure on rents), the distributive effect of the introduction of the flat rate would be highly regressive. Figure 3.6, which shows the concentration curve of the taxable income subject to the flat-rate tax for taxpayers ordered by level of total income, indicates that the flat-rate tax has mainly benefited taxpayers with higher incomes. In fact, over half of the taxable income subject to flat-rate taxation is received by the richest 10 per cent of taxpayers. The flat-rate tax may however be less regressive than it appears when all the benefit is attributed to owners, as the preliminary analysis referred to earlier appears to show that part of the tax savings has been passed through to rents under the preferential flat-rate regime.

[84] The coefficient is calculated as the gross rent taxed at the reduced rate corresponding to the net rent taxed at the ordinary rate, or: 1- (1 – 0.21) / (1 – 0.1).

Figure 3.6 – Concentration curve of taxable income for the flat-rate tax



Source: based on summary data from personal income tax returns filed in 2018.

3.3 The plastic tax, its macroeconomic impact and the international experience

The Budget Bill introduces a tax on the consumption of single-use plastic products as well as incentives for companies that produce biodegradable and compostable plastic products. The purpose of the measure, which is designed to modify the behaviour of producers and consumers, is to progressively reduce the production and consumption of disposable plastic products.

The tax applies to all single-use items that have, or are intended to have, the function of containing, protecting, handling or delivering goods or food products, i.e. packaging, that are entirely or partially made with plastics, excluding compostable products and syringes. The tax obligation arises with the production or import of these products and becomes payable when such products are released for consumption in Italy. It is not levied on exported products. The manufacturer or importer of the product is liable for paying the tax.

The tax is set at the rate of 1 euro per kilogram of plastic contained in the packaging.

Based on the indications provided in the Technical Report accompanying the Budget Bill, the expected revenue from the tax, excluding its effects on direct taxes and IRAP, is equal to €1.1 billion in 2020 (assuming the tax is levied from April 1st 2020) and €2.2 billion in subsequent years.[85] The revenue estimate does not incorporate the effects of a possible decline in the manufacture and consumption of plastic packaging as a result of the disincentive produced by the measure, meaning that the figure is probably overestimated at least for the years after 2021.

Companies in the industry are granted a tax credit equal to 10 per cent of the costs incurred in 2020 to adapt their technology for the production of biodegradable and compostable products, up to a maximum amount of €20,000 for a total cost to the State of €30 million.

The measure does not provide for adjustments in the tax based on the possibility of recycling the different qualities of plastic or on the basis of the amount of recycled plastic used, as is instead envisaged in the scheme developed by the National Packaging Consortium (CONAI) and in other experiences around the world. However, biodegradable and compostable plastics and those that can be reused are exempt from the tax in order to encourage their production in the place of single-use non-biodegradable or non-compostable plastics.

[85] The revenue generated by the plastic tax net of the impact on direct taxes and IRAP is estimated at €1.1 billion in 2020, €1.8 billion in 2021, €1.5 billion in 2022 and €1.7 billion in 2023.

Based on Istat data for 2016,[86] there are 1,540 companies producing plastic packaging (including those manufactured with biodegradable and compostable materials not subject to the proposed plastic tax), equal to 0.4 per cent of manufacturing firms, comprising over 1,780 local units. They employ 29,515 workers, have a turnover of €8.8 billion and produce a value added of €2.1 billion (0.28 per cent of the domestic total). Production and sales are mainly concentrated in the North-West (47.7 and 43.2 per cent, respectively) and, within this area, in Lombardy (34.7 and 31.7 per cent) and Piedmont (12.6 and 11.0 per cent) in particular. In the North-East, value added and sales by these companies amount to 30.3 and 31.2 per cent of the total, driven by Emilia Romagna (respectively, 15.7 and 14.2 per cent) and Veneto (12.8 and 14.6 per cent). Among other areas of the country, the contribution of Tuscany and Campania is significant, but small compared to that of the regions indicated above.

General comments

Plastic has a low recycling rate and a high rate of environmental leakage, making it a challenge for waste management, the efficient use of resources and the environment.[87] The introduction of a tax designed to limit the production and use of this material is therefore quite important.

In general, the purpose of environmental taxes is to reduce the pollution (a negative externality) caused by the taxed product or industry. In many cases, at least in the short/medium term, such a reduction is accompanied by a decline in the economic activity that causes it. However, if designed well, environmental taxes can be an stimulus for the technological modernisation of companies in the industry involved – in addition to reducing or eliminating negative externalities – while reducing pollution can represent a positive opportunity for other economic sectors, such as tourism. For the purposes of introducing an environmental tax, it is therefore important to assess the benefits, both

[86] Istat (2019), "Audizione del Presidente dell'Istituto nazionale di statistica Gian Carlo Blangiardo nell'ambito dell'attività conoscitiva preliminare all'esame del disegno di legge recante bilancio di previsione dello Stato per l'anno finanziario 2020 e bilancio pluriennale per il triennio 2020-2022", 11 November. Data from SBS Territorial Frame.

[87] According to Geyer, R., Jambeck, J. R. and Law, K. L. (2017), "Production, use, and fate of all plastics ever made", Science Advances *3*(7) Research Article (https://advances.sciencemag.org/content/3/7/e1700782.short), between 1950 and 2015 some 8,300 million tonnes of plastic were produced, generating about 6,300 million tonnes of plastic waste, of which 9 per cent was recycled, 12 per cent incinerated and 79 per cent accumulated in landfills or released in the environment. The study estimates that if current trends in production and waste management continue, some 12 billion tonnes of plastic waste will be in landfills or in the natural environment by 2050. In addition, more than 80 per cent of marine waste is made up of plastic, and it is estimated that between 4 and 12 million tonnes of plastic waste generated on land entered the marine environment in 2010 alone.

economic and environmental, against the costs associated with the measure, including the decline in activity of businesses in the taxed industries. [88]

The economic impact of a plastic tax, such as the one being proposed in the Budget Bill, depends crucially on the elasticity of demand and supply of the taxed good. The greater the elasticity of demand for a good, the greater the negative economic impact on businesses, but at the same time the greater the positive environmental effect. This elasticity varies considerably depending on the plastic content of the good and the ease of replacing it with another good containing less plastic or no plastic at all. For example, demand for plastic water bottles would seem inelastic because, at the moment, there are no adequate substitutes or they are very expensive. Conversely, the elasticity of the demand for plastic bags would seem to be very high, because there are various alternatives (biodegradable and compostable plastic, paper and reusable bags).

A tax on plastics should change the behaviour of consumers and producers in the long term. A production tax, like that provided for in the Budget Bill, is less likely to change consumer behaviour, especially if the tax is not transferred onto prices, but it is easier to administer.[89] On the other hand, a consumption tax is better suited to changing consumer behaviour. Theoretically, a scheme with taxes on both producers and consumers would be preferable, to encourage both to use less plastic and increase reuse and recycling.

Examining the measure introduced with the Budget Bill in more detail, we can make a number of observations on the design of the tax and its timing. Regarding the first aspect, in deciding whether to use the value of the product or the quantity as the tax base, the choice was to use the weight. Therefore, greater emphasis is placed on products lower down the production chain. The choice of the weight as the tax base makes it easier to link the tax to the environmental effects caused by plastic products and makes the revenue more predictable for products with high price volatility.

Regarding the timing of the measure, it might be a good idea to introduce the tax more gradually, starting at a lower level and progressively increasing it over time. This would allow companies in the plastic sector to adapt to the new tax on time and, plausibly, to view the measure more favourably.

Finally, the introduction of the new tax should be assessed in terms of its compatibility with other measures that have already been implemented, such as extended producer responsibility (for example, the CONAI system in Italy, which is structured slightly differently from the measure in the Budget Bill).

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[88] Fundaciò ENT (2018), "Research paper on a European tax on plastics – Report", Zero Waste Europe https://zerowasteeurope.eu/downloads/research-paper-on-a-european-tax-on-plastics/.
[89] New Economics Foundation (2018), "The price is right...or is it? – The case for taxing plastic", Zero Waste Europe – Rethink Plastic, https://zerowasteeurope.eu/downloads/the-price-is-right-or-is-it-the-case-for-taxing-plastics/.

Italian companies operating in the plastics industry pay a fee to CONAI[90] for collection and recycling as a measure of extended producer responsibility. This fee is diversified from 2018 and decreases as the post-consumption selectability and recyclability[91] of the packaging increases. In 2019, the maximum fee is €369 per tonne of plastic; from 2020, it will rise to €546 per tonne. The fee applies to all plastic packaging, without excluding reusable or compostable packaging, as instead envisaged in the Budget Bill.

More specifically, CONAI – consistent with the EU Circular Economy Package,[92] which provides for the modulation of environmental fees envisaged in extended producer responsibility systems based on the level of environmental impact – has redefined the fee categories for plastic from 2019 as follows: 1) Category A – selectable and recyclable packaging from the trade and industry circuit, €150 per tonne; 2) Category B1 – selectable and recyclable packaging from the household circuit with an effective and consolidated selection and recycling system, €208 per tonne; 3) Category B2 – other selectable and recyclable packaging from the household circuit: €263 per tonne; 4) Category C – non selectable or recyclable packaging using current technology: €369 per tonne.

Finally, for taxes on imported goods or on finished products, it would appear challenging to apply the tax, requiring a certification system in order to identify the plastic content of a product, in particular that of recycled and biodegradable plastic.

The macroeconomic impact of the plastic tax

The MeMo-It econometric model[93] can be used to assess the macroeconomic effects of the tax on plastic packaging provided for in the Budget Bill. The impact on both real and nominal variables is measured by comparing the result of a simulation, which includes the specification of the plastic tax, with respect to a baseline scenario. The measure envisaged in the Budget Bill is configured as a tax on quantities produced and the highest expected revenue is specified in the model through a change in indirect taxes (excise taxes). The simulation scenario is based on the quantification given in the Technical Report accompanying the Budget Bill, which forecasts a net tax revenue of about €1 billion in 2020 and over €1.5 billion on average in the following two years.

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[90] CONAI (2019), "Programma generale di prevenzione e di gestione degli imballaggi e dei rifiuti di imballaggio – Relazione generale consuntiva 2018", available at: http://www.conai.org/wp-content/uploads/2019/07/PGP_CONAI_2019_def.pdf. The National Packaging Consortium (CONAI) is a private non-profit consortium established with Legislative Decree 22/97 with about 800,000 producer firms as members. Its task is to ensure the achievement of global recycling and recovery objectives throughout the country and, at the same time, ensure the implementation of targeted management policies, including prevention, through eco-innovation. It is a member of EXPRA, the Extended Producer Responsibility Alliance, the European-level umbrella organisation representing non-profit packaging and packaging waste recovery and recycling systems.

[91] According to CONAI (2019), in Italy, plastic packaging released for consumption amounted to 2.3 million tonnes in 2018, of which 44.5 per cent was recycled and 43 per cent was used for energy recovery. Among all types of packaging released for consumption in Italy in 2018, plastic packaging has one of the highest rates of recovery but the lowest rate of recycling.

[92] The EU Circular Economy Package, which entered into force on July 4th 2018 and is to be transposed into national law by 5 July 2020, is composed of four directives, including 851/2018/EU and 852/2018/EU, on waste, packaging and packaging waste, landfills, waste of electric and electronic equipment (WEEE), end-of-life vehicles and batteries.

[93] This is the UPB-Istat model, used under the terms of the framework agreement with this institute.

The measure is forecast to reduce growth by a cumulative one-tenth of a percentage point of GDP in 2020-2022. The slower expansion of gross output would mainly reflect the more rapid increase in demand-side deflators: the change in the private consumption deflator would increase, in cumulative terms, by just under half a percentage point over the three-year period. The slower real growth would primarily be due to slower growth in private consumption expenditure (a cumulative one-tenth of a point less) as a result of the loss of household purchasing power, and would also be impacted by a slight negative contribution from net exports. The faster increase in the deflator would gradually be transferred to wages, resulting in a loss of competitiveness for exports, which would be slowed to a greater extent than imports, which would be reduced due to weaker domestic demand. Since the measure exempts exported plastic products from the tax, it must be noted that in the MeMo-It model export prices do not depend directly on excise taxes, so the adverse effects on competitiveness are of second order.

The simulation incorporates a partial translation of the rise in excise taxes through to final prices: it would amount to about 50 per cent in the first year of the tax, rising to 70 per cent in the third. The portion of the tax not passed through would therefore be offset on the production side through a reduction in the profit margins of firms as a whole (a reduction of about four-tenths of a percentage point over the three-year period). In essence, the simulation is consistent with a transmission mechanism in which most of the effects manifest themselves through an increase in prices. This dynamic is likely in the time frame considered, since it can be plausible that in the short term the demand for the goods concerned will be inelastic, so there will be an incentive to transfer most of the tax onto final prices.

The limits of this exercise should be highlighted. First, the model does not present the sectoral detail required for a more accurate assessment of the measure, which impacts a specific production sector. Second, the exogenous variable used to simulate the introduction of the tax is aggregated, whereas it might be appropriate to consider the different types of excise duties, separating this tax on plastic from those on other goods (energy products, tobacco, etc.). In light of these considerations, the estimated impacts on both real growth and prices must be considered with caution.

The current state of European legislation on plastics

It is helpful to evaluate the proposed measure in the Budget Bill within the European context. In 2015, around 25 million tonnes of plastic waste was generated in the European

Union, of which less than 30 per cent was collected for recycling and of which plastic packaging made up 59 per cent.[94]

Since 2015, the EU has taken measures to reduce the consumption of plastic bags,[95] one of the first steps towards the goal, confirmed in 2017,[96] of ensuring that all plastic packaging is recyclable by 2030.

The European policy to reduce plastic waste would be further strengthened by a proposal of the European Commission[97] published in May 2018 but not yet approved by the Council. The measure would establish an EU Own Resource based in part on contributions determined by the amount of non-recycled plastic packaging waste, which is part of the European strategy for plastics in the circular economy[98] and which aims to recycle 55 per cent of plastic packaging waste by 2025. This EU Own Resource would be financed by national contributions determined by applying a call rate of €0.80 per kilo to the amount of non-recycled plastic packaging waste reported to Eurostat each year by national statistical institutes. This contribution should generate a total of around €7 billion for the EU budget. The Budget Bill measure should eventually finance Italy's contribution to this EU Own Resource, but in order to do so it must be consistent with it.

A more recent development is Directive 2019/904/EU,[99] which the Member States must transpose into national legislation by July 2021. It is intended to prevent and reduce the impact of specific plastic products on the environment. More specifically, it prohibits certain disposable products, such as plastic cutlery, plates, straws, cotton swabs and beverage stirrers. Furthermore, Member States are required to take measures to reduce the consumption of other single-use plastic products. The directive sets a recycling target for plastic bottles of 77 per cent in 2025 and 90 per cent in 2029, providing for a recycled plastic content of at least 25 per cent in 2025 and at least 30 per cent in 2030.

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94 European Commission (2018), "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – A European Strategy for Plastics in a Circular Economy", COM/2018/028 final, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM per cent3A2018 per cent3A28 per cent3AFIN.

95 Directive (EU) 2015/720 of the European Parliament and of the Council of 29 April 2015 amending Directive 94/62/EC as regards reducing the consumption of lightweight plastic carrier bags, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L0720.

96 European Commission (2017), "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Commission Work Programme 2018 – An agenda for a more united, stronger and more democratic Europe", COM(2017) 650 final, https://ec.europa.eu/info/sites/info/files/cwp_2018_en.pdf.

97 European Commission (2018), "Proposal for a Council Decision on the system of Own Resources of the European Union", COM(2018) 325 final, https://eur-lex.europa.eu/resource.html?uri=cellar:d7369bdc-4ed9-11e8-be1d-01aa75ed71a1.0003.02/DOC_1&format=PDF.

98 European Commission (2018), "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – A European Strategy for Plastics in a Circular Economy", COM/2018/028 final, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM per cent3A2018 per cent3A28 per cent3AFIN.

99 Directive (EU) 2019/904 of the European Parliament and of the Council of 5 June 2019 on the reduction of the impact of certain plastic products on the environment, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0904&from=EN.

The measure in the Budget Bill does not indicate targets to achieve with the introduction of the plastic tax. It would be desirable for specific targets to be set and for them to be consistent with those specified in European legislation. Finally, the measure introduces a requirement to indicate on the packaging information on the correct disposal and on the environmental impact of the packaging itself.

Finally, Europe has also adopted regulations to ban or limit the amount of certain chemicals contained in plastic or to ban certain plastic products or to impose standards on certain products. One example is Regulation (EC) No. 1907/2006, the world's most comprehensive regulation regarding chemical substances.

International experience

According to a study on the prevention of plastic waste from the European Environment Agency,[100] of the 173 measures adopted in European countries to prevent plastic waste, 105 apply to the different phases of production while the rest cover the consumption phase. Of the total, 25 are regulatory measures, mainly consisting of bans on micro-plastics and some types of single-use plastics, 37 measures are market-based, most of which refer to single-use plastic bags, and 30 are voluntary measures of various kinds. However, in 2016 only 31 per cent of plastic waste was recovered in Europe and only 6 per cent of plastic demand was met with recycled plastic.

Comparing the characteristics of the plastic tax proposed in the Budget Bill with measures that have been introduced in other countries is not an immediate exercise. There are differences in terms of scope and type of tax base, and therefore a comparison of the amount of the tax is not significant. In the rest of the section, we offer a summary of the main measures introduced in the other countries grouped by type. In some cases, the mechanisms are similar to the measure proposed in the Budget Bill, which is a tax that applies to packaging that is made with the use, in whole or in part, of plastic materials, excluding compostable products and syringes.

The United Kingdom was the first country in Europe to levy a general tax on disposable plastics (it was adopted in 2018 and will enter into force in 2022). It will apply to single-use plastic packaging that contains less than 30 per cent of recycled materials. The administrative costs for retailers and producers have been estimated at between half a million and a million and a half pounds. Finland has levied a tax on the packaging of non-alcoholic beverages, requiring manufacturers and importers to pay a tax of €0.51 per litre if they do not participate in a deposit and refund or extended producer responsibility scheme. Denmark imposes a tax on packaging of any material, the amount of which varies depending on the environmental impact of the material employed.

[100] European Environment Agency (2019), "Preventing plastic waste in Europe", EEA Report No 02/2019, https://www.eea.europa.eu/publications/preventing-plastic-waste-in-europe.

Germany has established a deposit and refund scheme (a deposit of €0.50 per container, which is refunded upon return).

According to a recent study,[101] several European countries already tax packaging. Belgium has levied a tax on disposable plastic beverage packaging of €9.86 per 100 litres since 2004. Since 2005 Croatia has imposed a tax on packaging of all types for beverages equal to €0.0138 per unit. In 2017, the tax in Estonia was €2.5 per kilo. In Hungary, the amount was set at €5.78 per kilo in 1995. That same year, Latvia introduced a tax on packaging and dishes in PET of €1.56 per kilo. In 1995, Poland set a tax on plastic packaging at 20 or 10 per cent of the price depending on the type of plastic used. Outside of the European Union, Norway has applied a tax on non-reusable beverage containers of €0.1308 per unit since 1994. In many cases, the revenue is collected in a fund and earmarked for specific purposes.

In some countries, higher taxes are applied to certain types of plastic and single-use plastics for packaging purposes. This is the case, for example, in Belgium, Denmark, Estonia, Finland, Latvia, The Netherlands and Slovenia. A relatively ambitious example is offered by Belgium, which levies a tax of €3.60 and €3.00 per kilo to cutlery and single-use plastic bags, respectively.

There are various examples of taxes on plastic bags in Europe. Denmark introduced a so-called green tax on packaging and plastic bags in 1994. The tax is equal to 22 kroner (€2.95) per kilo and does not apply to thick and durable plastic bags. Consumers pay between 2 kroner (€0.27) and 3.5 kroner (€0.47) per bag and net revenues for retailers amount to 1 krone (€0.13) per bag in some cases. The tax on plastic bags has cut the consumption of such bags from 800 to 400 million, which amounts to 80 bags per person per year. In January 2018, Greece set a tax of €0.03 plus VAT on lightweight plastic bags, which was increased to €0.07 per bag in January 2019. The resources raised are earmarked by law to the production, distribution and promotion of reusable, biodegradable and compostable bags. Since the introduction of the measure, the use of lightweight plastic bags has fallen by 80 per cent in large-scale retail stores and 60 per cent in the others. Portugal has applied a tax on lightweight plastic bags of €0.10 per bag since February 2015, with the exception of the thinner bags used for food products. Since the introduction of the tax, the use of plastic bags has decreased by more than 90 per cent. In the United Kingdom, various regulations require you to pay £0.05 (€0.06) per bag. In England, only 19 bags per person are purchased annually, compared to the 140 bags used previously, with an 86 per cent reduction since 2015. In Scotland, consumption has fallen by 80 per cent since the rules came into force in 2014. In Wales, where the tax was introduced in 2011, use fell by 70 per cent by 2014. Between 2017 and 2018, Northern Ireland registered a decrease of about 67 per cent.

[101] Fundaciò ENT (2018), "Research paper on a European tax on plastics – Report", *Zero Waste Europe* https://zerowasteeurope.eu/downloads/research-paper-on-a-european-tax-on-plastics/.

Instead of taxing plastic bags, some jurisdictions have gone so far as to ban them outright. This is the case in 132 cities in the United States, São Paulo in Brazil in 2007 and Paris in 2007. Bans were imposed nationally by France in 2017 and by Australia. In Italy, non-biodegradable plastic bags, non-biodegradable cotton swabs and microplastics in cosmetics have been prohibited since January 2019.

In various countries, taxes are levied on single-use plastic bags, such as in France (€10 per kilo, about €0.06 per bag), Ireland (€0.22 per bag), Portugal (€0.10 per bag), the United Kingdom (£0.05 or €0.06 per bag) and several US cities. The tax in Ireland was initially introduced at €0.15 per bag in 2002, before rising to €0.22 in 2007 and €0.44 in 2009. In the United Kingdom, major retailers have distributed 9 billion fewer disposable bags since the plastic bag tax was introduced, a reduction of 83 per cent. In Latvia, taxes on plastics range from a minimum of €0.70 per kilo for oxo-degradable bags to a maximum of €3.70 for single-use bags weighing less than 0.3 grams, with polystyrene taxed at €1.56 per kilo. The state of Colorado grants a 20 per cent tax credit on the costs for up to $10,000 in new plastic recycling technologies.

Convery et al. (2007)[102] assessed the effects of the introduction of the tax on disposable plastic bags in Ireland in 2002. According to this study, the administrative costs connected with the introduction and monitoring of the measure amounted to €1.2 million in the first year and €350,000 in the following years. Revenues amounted to €12 million in the first year and just over this amount in subsequent years, and all the revenue was collected in a fund used to cover administrative costs and promote environmental programmes. The tax reduced the consumption of bags by 94 per cent. The success of this measure is linked to a number of factors. First, the tax, which was intended to encourage the use of reusable bags, was well received by consumers. According to a survey, the tax was set at a level six times higher than the maximum amount consumers were willing to pay for a plastic bag: only 8 per cent of consumers surveyed thought it was worth paying for a plastic bag when its price exceeded only half of the new tax. Furthermore, the tax received the support of all the parties involved, including producers, after agreeing that the introduction of the tax would be accompanied by a major information campaign by the government to explain the reasons for the introduction of the tax.

Another method to reduce the use of plastic are deposit and refund systems that encourage separate waste collection for subsequent recycling. This scheme is applied to plastic bottles in Australia, Canada, Chile, Denmark, Estonia, Germany, Hungary, Iceland, Israel, Latvia, Mexico, The Netherlands, Norway, Poland, Slovenia, Spain, Sweden, Turkey and the United States. In Italy, a deposit and refund scheme for plastic bottles has been implemented in Piedmont.

Finally, extended producer responsibility has been introduced in various other countries in addition to Italy. Under this system, materials are taxed at the production stage to ensure producers take responsibility for the waste they are going to create.

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[102] Convery, F., McDonnell, S. e Ferreira, S. (2007), "The most popular tax in Europe? Lessons from the Irish plastic bags levy", in *Environmental and Resource Economics,* vol. *38*(1), pp. 1-11 (https://link.springer.com/article/10.1007/s10640-006-9059-2).

3.4 *Measures to fight tax evasion*

Revenue increases amounting to €3 billion in 2020, €3.7 billion in 2021 and €3.5 billion in 2022 are expected from measures to combat tax evasion and incentives to use traceable payment methods introduced with the Tax Decree (Decree Law 124/2019). These measures appear to be acceptable in terms of their effectiveness, and their financial quantification is sufficiently conservative. In addition to these provisions, other measures envisaged in the Budget Bill are expected to increase expenditure by €3 billion each year in 2021-2022 – for reimbursements to be paid to those who make traceable payments – and boost revenues by €0.2 billion in 2020, €1.3 billion in 2021 and €1.1 billion in 2022 – again from measures to encourage the use of electronic means of payment and measures to fight tax evasion.

The measures, which do not include any kind of tax amnesty, can be divided into four different types employed for four different purposes: 1) to counter specific areas of VAT and excise duty fraud; 2) to prevent undue tax offsetting; 3) to increase the amount and timeliness of the information available to the Revenue Agency and the *Guardia di finanza* (Finance Police); and 4) to encourage the use of non-cash forms of payment.

Countering fraud. – These measures are designed to combat VAT and excise tax fraud in specific areas such as fuels, certain other hydrocarbons and the intra-EU purchase of vehicles. They are mostly measures that address circumstances and problems uncovered by the Revenue Agency and the Finance Police during their inspection activities and should make it more difficult to undertake some common types of fraud and increase the effectiveness of anti-evasion activities thanks to the expansion of information resources.

Countering undue tax offsetting. – The measures include specific prohibitions on tax offsetting, such as cases in which the taxpayer takes over the tax debts of third parties or holders of VAT numbers who have been ordered to close their VAT registration or have been removed from the database of parties that carry out intra-EU transactions. In addition, previously adopted safeguards introduced for VAT that generated significant positive effects have been extended to the offsetting of direct taxes and IRAP, and specific rules are envisaged for tenders and subcontracts for works involving a high level of labour inputs.

More specifically, tax receivables exceeding €5,000 can only be offset against liabilities subject to filing the annual return certifying the receivables and through the electronic filing of Form F24. As in the case of VAT, this measure not only has a temporary impact in the first year of application connected with the ban on offsetting amounts over a certain threshold before the filing the annual return, it will also have a deterrent effect on offsetting non-existent receivables due to the ex ante verification of their actual existence.

A specific measure is also introduced for tenders and subcontracts for works and services involving a high level of labour content. This is intended to counter both the use of non-existent VAT credits to offset amounts due for withholding taxes and related social security contributions for personnel employed in the project (through the reverse charge mechanism), and the frequent failure to pay these taxes and contributions. This mechanism must first be approved at the EU level. The measure also requires clients to pay employee withholding taxes charged to the contractor or subcontractor after detailed information and the necessary financial resources are made available to them. Although contractors or subcontractors will have to bear the burden of providing the detailed information to the client, they may ask the latter to use amounts not yet paid to them to fund payment of the tax liability. The rule thus also addresses the problem of late payments.

Expansion of information resources. – Various provisions of the tax decree are aimed at enhancing the scope and timeliness of the information available to the Revenue Agency and the Financial Police, both for the performance of audits (both tax audits and, more generally, financial crime investigations) and to strengthen preventive activity and improve collaboration with taxpayers through greater use of persuasive tools (communication to promote compliance) and the automatic preparation of certain tax obligations (draft VAT returns and notification of periodic VAT settlements).

The new measures include a provision of the Budget Bill that would allow the Revenue Agency to supplement, after pseudonymisation of personal data, the databases it already has at its disposal with data from the financial transactions database to develop risk profiles that can be used in identifying positions to be investigated or to encourage voluntary taxpayer compliance. Supplementing the tax authority databases with the financial transations database would enable taxpayer profiling and allow the authorities to determine the probability of irregular conduct, thereby facilitating prevention and enforcement. It would also make it possible to detect situations that are not captured by the use of electronic invoicing data and the electronic transmission of sales data because they are associated with collusive schemes to commit tax evasion.

In short, the innovative scope of the provision of the Budget Bill lies in the possibility for the Revenue Agency to move from deductive reasoning to an inductive approach in its audit activity, thanks to data mining[103] upstream of the determination of risk criteria. In particular, the pseudonymisation of the data would allow the tax authorities, in compliance with the principles set out in the Personal Data Protection Code (Legislative Decree 196/2003), to deploy data mining techniques to cross-check and analyse the data contained in the various databases available (including the financial transactions database). This preventive analysis would then lead, using an inductive rather than deductive approach, to the determination of risk criteria to identify positions to be investigated or to encourage voluntary compliance. Up to now, risk criteria appear to have been determined prior to the database analysis stage – thereby reducing its effectiveness – as a condition established by the Personal Data Protection Authority for the use of the databases themselves. The pseudonymisation of data should plausibly allow the extension of the database cross-checking trials already under way at the

[103] Data mining refers to the set of techniques used to extract useful information from large volumes of data using automated or semi-automated methods.

Revenue Agency for partnerships and corporations for selected tax periods to the universe of taxpayers (all natural persons).[104]

However, the positive aspects of the introduction of the measure are shadowed by a number of more critical issues. The effectiveness of the measure, which is expected to increase revenue by €460 million once fully implemented, depends crucially on: 1) the ability of the Agency to exploit the information resources that it will have at its disposal, i.e. to have access to appropriate statistical-IT skills and staff suitably trained for these tasks; and 2) effectively resolving issues connected with the processing of personal data. With regard to the latter aspect, the Budget Bill would include[105] activities to prevent and combat tax evasion among those for which the data rights of the parties involved may be restricted.[106] Further investigation is required to determine whether the provision as drafted in the Budget Bill is sufficient to enable the limitation of rights, i.e. if all the conditions required by Article 23 of the General Data Protection Regulation are satisfied.[107] Accordingly, it seems advisable to dispel any concern about the effective capacity of the measure to achieve the desired strengthening of the control activities of the Revenue Agency in full compliance with current data protection legislation.

Incentives to the use of traceable payment methods. – The Tax Decree and the Budget Bill contain various measures of this kind.

The Tax Decree contains provisions increasing the payout of the receipt lottery where traceable payment methods are used, imposing penalties on merchants who refuse to accept a taxpayer's tax ID number or fail to transmit transaction data to participate in the lottery, imposing penalties for refusal to accept payment instruments other than cash and establishing a tax credit for fees charged to merchants on electronic payments. Other measures in this category include provisions lowering the ceiling on cash transactions (from €3,000 to €2,000 from July 2020 and €1,000 from January 2022) in non-bank transactions.[108]

The Budget Bill also appropriates €3 billion for a specific fund for 2021 and 2022 that would finance prizes in the form of cash rebates for payments made using electronic

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[104] For more information on the trials, see the measures of the Revenue Agency of 31 August 2018 and 8 August 2019. The Personal Data Protection Authority issued an opinion on each of the trials, which are available at: https://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/6843736 and https://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/9106329).

[105] Article 86, paragraph 2, of the Budget Bill provides for the inclusion of activities to prevent and combat tax evasion in Article 2-undecies, first paragraph, letter a) of the Personal Data Protection Code (Legislative Decree 196/2003).

[106] The rights are those provided for in Articles 15-22 of the General Data Protection Regulation: the rights of access, rectification, erasure, restriction of processing, data portability and objection.

[107] Regulation (EU) No. 2016/679 of the European Parliament and of the Council of 27 April 2016.

[108] Ceilings on the use of cash are fairly common in the European Union. According to Ecorys and CEPS (2017), "Study on an EU initiative for a restriction on payments in cash", 16 Member States have imposed some restrictions. Limits also exist in Peru, Turkey and, for some types of transaction, Mexico (Awasthi, R. and M. Engelschalk (2018), "Taxation and the shadow economy: how the tax system can stimulate and enforce the formalization of business activities", World Bank, Policy Research working paper n. 8391).

payment instruments by adults residing in Italian territory outside the exercise of a business, art or profession. A specific decree of the Minister for the Economy and Finance to be issued by 30 April 2020 will establish the conditions and implementation procedures, including the criteria for the awarding of the prize, which may reflect the volume and frequency of purchases and the type of payment instrument used. Finally, the Budget Bill also makes eligibility for the 19 per cent personal income tax credit for certain expenditure conditional on the use of bank or postal payments or other traceable payment instruments.

A number of general remarks concerning this set of measures may be put forward.

The introduction of a general obligation for the storage and electronic transmission of sales data, the entry into force of the receipt lottery, the increase in chances to win the lottery where traceable payment instruments are used, the establishment of penalties in case of avoidance of the obligation are all measures aimed at countering evasion by focusing attention on the last stage of the retail chain (final consumers). In particular, the provisions focus on the part of tax evasion connected with the failure to submit returns. The measure supplements a number of other instruments that have been in place for some time (quarterly VAT reporting, periodic tax settlements and electronic invoicing) and are concentrated on business-to-business transactions.

All of these tools to expand the availability of information and increase its timeliness can help improve tax authorities' capacity for analysis and preventive control, improve the relationship between tax authorities and taxpayers and increase voluntary compliance. It will also lend further impetus to the digitalisation of the country, reducing costs and enhancing the efficiency of corporate processes. However, such measures could encourage forms of collusion to commit tax evasion (consensual arrangements in which there is an agreement between buyer and seller), expanding rather than reducing evasion in transactions with final consumers. This type of evasion, which is certainly more difficult to combat, has not yet been tackled with determination.

With the emergence of costs fostered by mandatory electronic invoicing and the electronic transmission of sales receipt information, an increase in consensual tax evasion could even lead to a loss of tax revenue. This phenomenon should be countered by establishing appropriate mechanisms for monitoring the stability and credibility of margins.

A mechanism that exploits opposing interests to discourage collusion to commit tax evasion in the final stage of the transaction chain necessarily relies on the provision for substantial incentives to use means of payment other than cash and the imposition of stringent limits on the use of the latter. As noted earlier, in addition to lowering this limit, the budget package appropriates significant resources in a special fund to finance the grant of cash reimbursements for payments made using traceable payment systems.

The cost and effectiveness of the incentive will depend crucially on the way in which the mechanism is designed as well as on its capacity to effectively alter individual behaviour. We must first consider the possibility that, if not properly designed, most of these reimbursements will go to individuals who already make significant use of traceable payment methods without having an impact in terms of reducing tax evasion. To make the tool effective it would also be advisable to direct reimbursements towards purchases in merchandise categories most affected by tax evasion. Finally, to encourage the acceptance of traceable payment instruments by merchants, the Budget Bill provides for a special tax credit to offset part of the cost of the fees charged to merchants. However, it is nevertheless desirable to forge a general consensus on the need to reduce these costs, especially for very low-value transactions.

Ardizzi and Zangrandi (2018)[109] point out that in Italy the reduction in interchange fees (i.e. the fees that the cardholder's bank receives from the merchant's bank following a card payment) after the introduction of the European Union's 2015 Interchange Fee Regulation[110] has increased the level of acceptance of credit and debit cards by merchants.[111] Their estimate, which was performed for a panel of about 400 Italian financial institutions in the 2009-2017 period, indicates that between 30 and 40 per cent of the increase in acceptance of electronic payment instruments that occurred in the two years following the introduction of the regulation is attributable to the reduction in fees. The provision in the budget package for a tax credit for fees could therefore have a positive effect for the spread of traceable payment instruments different from cash.

More generally, it would be necessary to finally implement a long-heralded principle: compatibly with the need to reduce the deficit and the debt, taxpayers should be able to expect that part of any amount recovered by reducing tax evasion will be redistributed in the form of tax cuts to lighten the overall fiscal burden.

Sections 3.4.1 and 3.4.2 provide qualitative and quantitative information on the widespread use of cash by Italian households and on tax evasion by the self-employed.

International experience in the promotion of traceable payment instruments and the use of receipt lotteries

Some of the measures provided for in the Tax Decree and the Budget Bill or similar provisions have been introduced in other countries in the past. Their experience can provide some insight into the effectiveness of these measures in combating tax evasion.

109 Ardizzi G. and M. S. Zangrandi (2018), "The impact of the interchange fee regulation on merchants: evidence from Italy", Banca d'Italia, Questioni di economia e finanza no. 434. Interchange fees are a major component of fees charged to merchants.

110 The Interchange Fee Regulation was introduced by the European Union in 2015. It establishes a ceiling on the fees paid by merchants' banks on card transactions (Regulation (EU) No. 2015/751 of April 2015).

111 The authors note that similar measures had already been introduced previously in Australia, the United States and Spain, having a positive impact in the latter country on the acceptance of electronic payment methods.

Incentives to use traceable payment instruments. – The introduction of such measures, generally consisting of rebates of some form (deductions from the taxable amount, discounts on the price or the VAT paid) of part of the value of purchases, are designed to encourage final consumers to request a receipts for their purchase and thereby reduce unilateral evasion and collusion. As Awasthi and Engelschalk (2018)[112] point out, these measures should represent a mechanism for the final consumer corresponding to the possibility open to merchants (and firms) to offset VAT credits or deduct most of the costs they incur in their tax returns. To be effective in countering collusion to commit tax evasion, however, the measures must provide considerable incentives, meaning that the risk that the costs in terms of lost tax revenue may exceed the expected new revenue should not be underestimated.

The idea of encouraging consumers to voluntarily play an "audit" role is not new. In Colombia and Argentina, for example, some percentage points of VAT are refunded on purchases made with electronic payment instruments.[113] Recently, in Japan, in conjunction with an increase in the consumption tax, a rebate was introduced for card payments.[114] In the state of São Paulo, in Brazil,[115] a VAT discount is granted, without distinction between the payment instrument used, to all those who provide their individual taxpayer number when the receipt is issued.[116] Portugal adopts a system similar to that envisaged in São Paulo, but it is limited to four specific sectors of the economy where the use of cash is especially common.[117] A different case, discussed below, is the Republic of Korea.

As regards São Paulo, Naritomi (2019)[118] analyses the results of the measures introduced with the package known as the "Nota Fiscal Paulista", of which VAT refunds are the most important tool.[119] A difference-in-differences method[120] is used for a panel of companies over a period straddling the introduction of the package. The results show that the net tax revenue generated by the introduction of incentives increased by 9.3 per cent in four years.[121] The reasons for the success of the package of measures include

[112] Awasthi, R. and M. Engelschalk (2018), "Taxation and the shadow economy: how the tax system can stimulate and enforce the formalization of business activities", World Bank, Policy Research Working Paper no. 8391.
[113] Awasthi, R. and M. Engelschalk (2018), op. *cit.*.
[114] Financial Times, "Japan launches cashback reward to offset tax rise", 1/10/2019.
[115] The GDP of the state of São Paulo accounts for 34 per cent of the GDP of Brazil as a whole.
[116] Awasthi, R. and M. Engelschalk (2018), *op. cit.*.
[117] Automobile and motorcycle repair, accommodation services, restaurants and personal services. Awasthi, R. and M. Engelschalk (2018), *op. cit.*.
[118] Naritomi, J. (2019), "Consumers as tax auditors", American Economic Review, vol. 109(9), pp. 3031-3072.
[119] In addition to the VAT refunds, the package includes a receipt lottery, although at least in cost terms it plays a secondary role. The measure is funded with 33 per cent of the VAT collected in final sales transactions: 30 per cent finances VAT rebates and 3 per cent goes to lottery prizes. The rebates and prizes are equal, respectively, to about 1 per cent and 0.1 per cent of the amount of the purchase.
[120] "Treated" firms are those operating in the retail sector, while the "control" group consists of wholesalers.
[121] Naritomi (2019) emphasises that a small portion of the increase in tax revenues generated by the "Nota Fiscal Paulista" also reflected the fact that firms did not increase costs in proportion to the increase in reported revenues. In algebraic terms, we obtain a net increase in tax revenue when $T_1(1-ct)-T_0>0$, where T_0 is revenue prior to introduction of the measure, $T_1=T_0(1+g)$ is gross revenue following the

the simplicity of the tools: to receive the tax relief, consumers just have to provide their taxpayer number to the merchant. The latter is then responsible for reporting the transaction information to the tax authorities.

Although no extensive studies along the lines of that conducted for the "Nota Fiscal Paulista" have been performed for the VAT scheme in Portugal, Awasthi and Engelschalk (2018) report that VAT revenue in the four sectors affected by the measure outperformed VAT revenue in the other sectors not involved in the benefit scheme.

A different case, but which has been carefully studied in the literature, is that of the TIETP (Tax Incentives for Electronically Traceable Payments) system introduced in 1999 in the Republic of Korea. It allows taxpayers to claim tax deductions for purchases made with traceable payment methods.[122] In 2013, 15 per cent of credit card purchases and 30 per cent of those made with debit cards, prepaid cards and cash with electronic receipts were deductible. The deduction is granted for the portion of total spending exceeding a minimum threshold proportional to taxable wage and salary income and up to a maximum ceiling determined as the lower of a fixed amount and a percentage of taxable wage and salary income.

Sung, Awasthi and Lee (2017)[123] argue that the TIETP has increased the share of business income earners who pay income taxes and that although it has reduced the tax burden on wage and salary earners, it has also had a positive net impact on tax revenues. The authors use a counterfactual microsimulation exercise to show that although the TIETP was relatively expensive ($1.7 billion, or about 0.1 per cent of Korean GDP), it produced in a net gain for the government coffers from personal income tax of $1.3 billion in 2014, without counting the effects on VAT revenues and corporate income tax. The simulation also shows that although the deductions produced the greatest tax savings for higher-earning workers, the expansion of tax base led to a modest reduction in the inequality as measured by the Gini index. Finally, with the TIETP, Korea has come closer to being a cashless economy. In particular, since 2005 Korea has been the country with the highest value of debit and credit card transactions as a proportion of GDP among the member countries of the Committee of Payments and Market Infrastructures of the Bank for International Settlements.

Two of the key elements of the TIETP architecture that enable it to function relatively effectively are the legal framework and the simplicity with which economic agents interact with the system. In Korea, card issuers are required to regularly transmit transaction data

introduction of the measure, *c* is the share of tax revenue used to pay tax rebates and *t* is the take-up, i.e. the share of transactions for which a rebate is requested. The condition can be expressed in terms of the rate of revenue increase as $g > \frac{ct}{1-ct}$.

122 Some categories of expenditure, such as healthcare, are not fully eligible under the TIETP to avoid double deductions.

123 Sung, M. J., Awasthi, R. e H. C. Lee (2017), "Can tax incentives for electronic payments curtail the shadow economy? Korea's attempt to reduce underreporting in retail businesses", The Korean Journal of Policy Studies, vol. 32, no. 2, pp. 85-134.

to the National Tax Service and they routinely also send the information to taxpayers. In turn, the National Tax Service provides taxpayers with a pre-completed form with transaction data, including purchases made in cash but accompanied by an electronic receipt, with which it is possible to request the tax deduction. An important role is played by employers acting as withholding tax agents. Another element that probably influenced the operation of the TIETP is the fact that the Korean government pushed strongly for a reduction in credit card fees in light of the increase in purchases made with this payment instrument and the profits of card issuers.

Receipt lottery. – Receipt lotteries are another tool to fight tax evasion that are generally less expensive than the systems discussed previously[124] but still give final consumers an audit role. Experiments of this type have been introduced, and in some cases are still in use, in Taiwan, Malta, the People's Republic of China, the Republic of Korea, Poland, Georgia, Portugal, Puerto Rico, the Slovak Republic and in the state of São Paulo in Brazil.[125] A number are described below.

One of the most closely analysed cases is that of the People's Republic of China, where in 1998, in the city of Haikou, a receipt lottery was tested to encourage voluntary reporting of undeclared income and thus counter the information asymmetry between government and taxpayers. The scope of the trial was gradually expanded and at the end of 2002 the lottery was active in areas administered by about 12 per cent of the country's tax agencies, including the large cities of Beijing and Shanghai.[126] With the introduction of the lottery, receipts issued using a device that gives each receipt a unique identification number also became lottery tickets. Wan (2010) estimates the effect of the introduction of the lottery on sales tax revenue using a natural experiment approach.[127] The results show that the lottery increased sales tax revenue by at least 17 per cent in the areas involved in the trial. The study also emphasised the importance of appropriately calibrating the ratio of the lottery prizes to sales tax revenue in order to give consumers a strong incentive to participate.[128].

In addition to the VAT rebates on purchases made with a taxpayer identification number discussed earlier, Portugal has introduced a receipt lottery for all sectors of the economy, unlike the rebate system. Although no in-depth studies such as those for the Chinese case have been conducted for Portugal, Fooken, Hemmelgarn and Herrmann

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124 The value of the prizes must be sufficiently high to encourage voluntary consumer participation in the lottery.
125 Awasthi, R. and M. Engelschalk (2018), *op. cit.*.
126 Wan, J. (2010), "The incentive to declare taxes and tax revenue: the lottery receipt experiment in China", Review of Development Economics, vol. 14(3), pp. 611-624.
127 Exploiting the fact that the lottery was initially introduced on an experimental basis in only certain districts in the country, the author uses a panel containing data for the years from 1998 to 2003 for 17 districts in which the system was introduced and 20 similar districts where the system was not introduced.
128 Wan (2010) reports an estimate produced by the China Taxation Bureau in 2002 indicating that spending on prizes amounted to 3 per cent of the additional tax revenue generated by the lottery.

(2014)[129] state that participation was significant. Wilks, Cruz and Sousa (2019) [130] stress the greater effectiveness of cash refunds based on the value of receipts in countering tax evasion in Portugal compared with lottery prizes. In particular, an analysis of the responses to a multiple-response questionnaire completed by 942 individuals found that the reasons why consumers ask for receipts in Portugal seem to depend more on ethical considerations (60.2 per cent of respondents) and the possibility of VAT refunds (52 per cent) than on the receipt lottery (6.4 per cent).

In the case of the state of São Paulo in Brazil, Naritomi (2019)[131] reports that net tax revenues have increased following the introduction of the "Nota Fiscal Paulista" system, of which the lottery is a component.[132] One of the reasons for the success of the lottery is undoubtedly the simplicity of the procedure for participating in the prize drawing (registration on an internet portal). As for VAT refunds, the responsibility for notifying transaction information to the tax authorities lies with merchants. Between 2007, the year the lottery was introduced, and 2011, 40 per cent of the population over the age of 14 registered on the portal.

For Malta and the Slovak Republic, Fooken, Hemmelgarn and Herrmann (2014) note that following the introduction of the receipt lotteries there was, respectively, a growing number of receipts submitted for the lottery between 2007 and 2013 and a significant increase in sales of small retailers, among whom evasion is generally more common.

3.4.1 An analysis of the use of cash

Cash continues to be the predominant payment instrument for purchases at point of sales (POS) in Italy and a number of other European countries. It is employed above all for small-value purchases and for goods and services in sectors in which the share of hidden value added is large and therefore, plausibly, the probability of tax evasion is high. A positive relationship of some significance can be noted at the territorial level between the value of the transactions settled in cash and the share of the non-observed economy in value added, with some regions, especially in the South, characterised by the widespread use of cash and a significant non-observed economy. The combination of measures that limit the use of cash and encourage traceable payments with existing or upgradable tools for combating tax evasion, which are generally more effective for this purpose, make it more challenging to evade taxes and make an additional contribution to fighting tax evasion. This section provides some evidence to support this assertion.

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129 Fooken, J., Hemmelgarn, T. and B. Herrmann (2015), "Improving VAT compliance – random awards for tax compliance", Taxation Papers no. 51, Directorate General Taxation and Customs Union, European Commission.
130 Wilks, D. C., Cruz, J. and P. Sousa (2019), "'Please give me an invoice', VAT evasion and the Portuguese tax lottery", International Journal of Sociology and Social Policy, vol. 39, no. 5/6, pp. 412-426.
131 Naritomi, J., (2019), *op. cit.*.
132 The cost of the lottery is just under 10 per cent of the total costs of the "Nota Fiscal Paulista" system.

Microdata and statistics available on household use of cash or traceable payment instruments in their purchases are not widely available and are often incomplete. However, some general observations can be made for the euro-area countries using the data collected by the ECB's 2016 Survey "Study on the use of cash by households".[133] The goal of the survey was to collect data on the use of different payment instruments by citizens of the euro-area countries at points of sale and in transactions between individuals.[134] It should be borne in mind that the survey, which covered a relatively limited number of individuals and regarded purchases that the respondents made on a specific day (three days for Malta and Cyprus), may not have fully captured individual behaviour with regard to less frequent purchases (for example, durable goods and accommodation).

The analyses in this section were produced using the dataset available on the ECB's website, which, however, does not include data for Germany and the Netherlands because they were produced by equivalent surveys conducted by their respective central banks. The information contained in Esselink and Hernández (2017) is therefore used for these countries.

In terms of the number of transactions, the use of cash is particularly high (at least 80 per cent) in southern European countries (Malta, Cyprus, Greece, Spain, Italy and Portugal), Austria, Slovenia and Germany (Table 3.12).[135] The countries that use cash the least are the Netherlands, Estonia and Finland (up to 53 per cent). In terms of transaction value, Greece, Malta and Cyprus (above 72 per cent) are the leaders, while the Netherlands, France, Luxembourg, Belgium, Estonia and Finland (up to 33 per cent) register the lowest values. However, this performance is not linked to substantial differences in the possession of payment cards or access to electronic payment instruments (Figure 3.7). In 12 of the 19 euro-area countries the dissemination of payment cards exceeds 90 per cent; in 6 countries it is between 80 and 90 per cent (including Italy with 89 per cent), while in Cyprus only 66 per cent of respondents were cardholders; the euro-area average is 93 per cent.

In terms of socio-demographic characteristics, the survey shows that cash is used more frequently by males and consumers over the age of 40, while there are no substantial differences across different levels of education.

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133 For a detailed description of the survey, see Esselink, H. and Hernández, L. (2017), "The use of cash by households in the euro area", Occasional Paper Series no. 201. The respondents (a total of 65,281 individuals) were asked to record their purchases and cash withdrawals in a diary during the course a single day (three days for Malta and Cyprus). A subset of respondents (28,099 individuals) were also asked to complete a specific questionnaire. The diary collected information on the transaction value, the place of purchase, the instrument of payment used, the amount of cash carried at the beginning of the day, any replenishments made during the day (withdrawals, receipt of cash from other individuals, etc.) and respondents' perceptions of the seller's willingness to accept non-cash payment instruments. The survey also collected information on the demographic characteristics of the respondents. Among other things, the questionnaire sought to collect information on the attitudes that may influence the payment behaviour of the respondents, such as payment preference, perceived convenience of particular payment instruments, perceived payment and withdrawal behaviour, respondents' access to non-cash payment instruments and information on the use of cash as a store of value. The survey was conducted in all euro-area countries except Germany and the Netherlands. For these two countries, the data collected in surveys conducted by their respective central banks with characteristics similar to that of the ECB were used.

134 This section focuses on points of sale and so does not examine transactions between individuals such as, for example, charitable donations, cash transfers to friends and family members or the payment of home services (babysitters) or purchases made via the Internet.

135 For a broader international comparison, see Esselink, H. and Hernández, L. (2017), "The use of cash by households in the euro area", Occasional Paper Series no. 201.

The choice of payment instrument at the point of sale is largely influenced by the transaction amount. In the euro area, cash is the main instrument used for purchases up to €45, which represent 92 per cent of total purchases at points of sale. The use of the cards is prevalent for the remaining 8 per cent of purchases. The use of cash is significant (around 35 per cent) even for amounts over €100 (Figure 3.8).

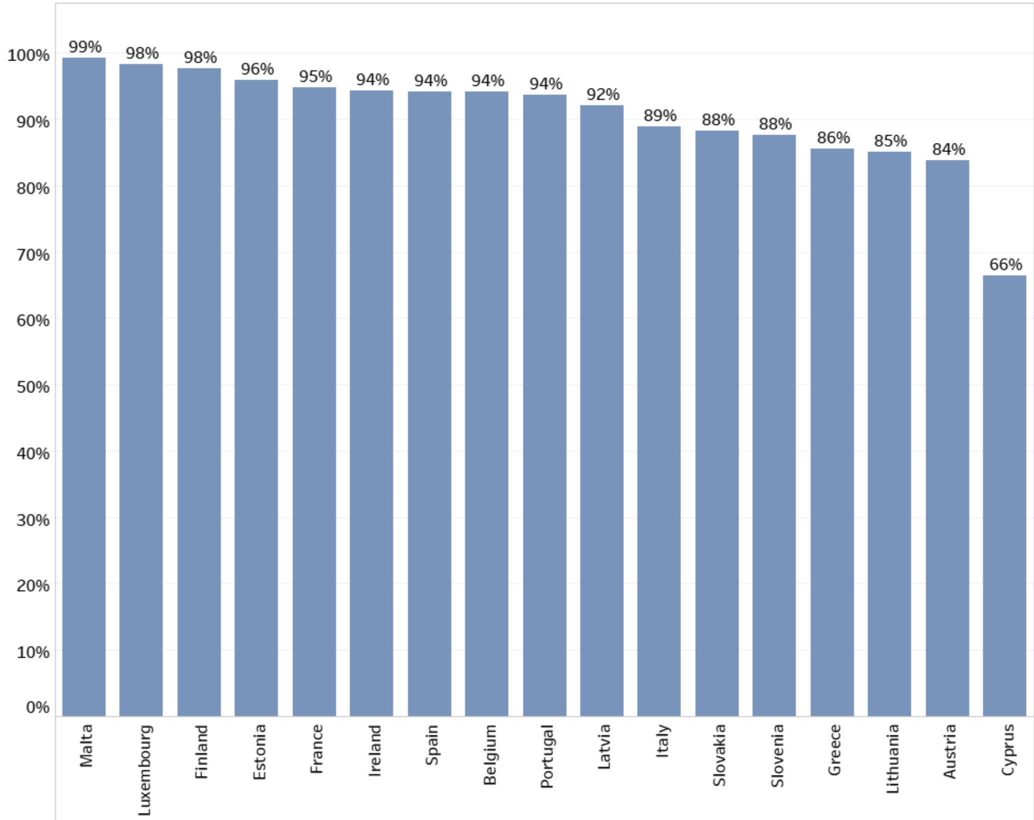
Shifting our attention to place of purchase, the market share of cash payments exceeds 50 per cent in all sectors, with the exception of accommodation (hotels, guesthouses, camping sites) (Figure 3.9). The percentage of cash use is particularly significant among street vendors, restaurants and bars (around 90 per cent), vending machines (88 per cent), shops for day-to-day items, such as supermarkets or bakeries (82 per cent) and in the entertainment and recreation sector (81 per cent). Credit and debit cards, the second most common payment instruments, are used relatively more frequently in the accommodation sector (37 per cent), shops for durable goods (36 per cent) and petrol stations (33 per cent). In the latter, 65 per cent of payments are made in cash, mainly because people also buy cigarettes, newspapers, flowers and snacks, which are generally more frequent and lower value payments.

Table 3.12 – Percentage use of cash in the euro area

	Transactions	Value
Austria	85%	67%
Belgium	62%	31%
Cyprus	88%	72%
Estonia	48%	31%
Finland	53%	33%
France	68%	28%
Germany	80%	55%
Greece	88%	75%
Ireland	79%	49%
Italy	86%	68%
Latvia	71%	54%
Lithuania	75%	62%
Luxembourg	64%	29%
Malta	91%	74%
Netherlands	45%	27%
Portugal	81%	52%
Slovakia	77%	66%
Slovenia	80%	68%
Spain	87%	68%

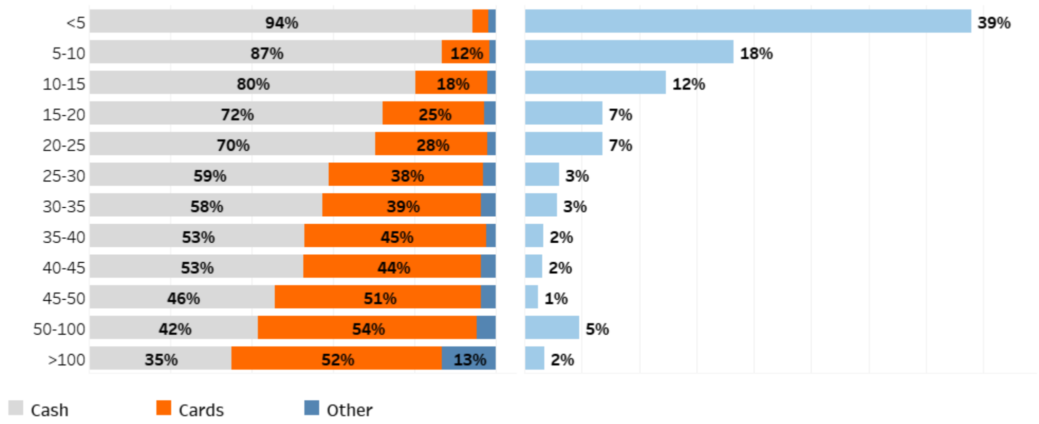
Source: based on data from the "Study on the use of cash by households" of the ECB. The statistics for German and the Netherlands are those reported in Esselink, H. and Hernández, L. (2017), "The use of cash by households in the euro area", Occasional Paper Series no. 201.

Figure 3.7 – Holders of debit or credit cards in the euro area (1)
(percentage of individuals)



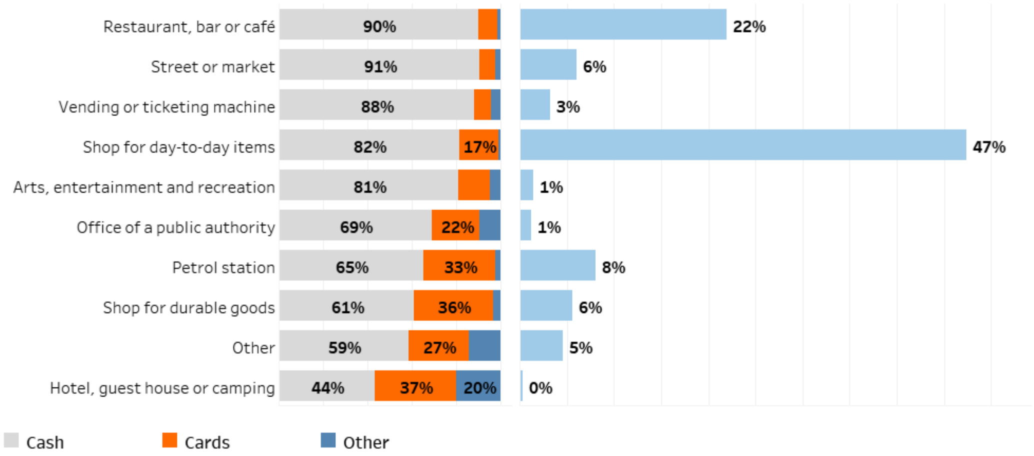
Source: based on data from the "Study on the use of cash by households" of the ECB.
(1) The chart does not give the figures for Germany and the Netherlands because the elementary data were generated by equivalent surveys conducted by their respective central banks and are not included in the ECB dataset.

Figure 3.8 – Transactions at points of sale in the euro area by value and payment instrument (1) (2)



Source: based on data from the "Study on the use of cash by households" of the ECB.
(1) The chart does not reflect the figures for Germany and the Netherlands because the elementary data were generated by equivalent surveys conducted by their respective central banks and are not included in the ECB dataset. – (2) The histograms on the right indicate the share of a specific value band in total transactions.

Figure 3.9 – Transactions at points of sale in the euro area by location and payment instrument (1) (2)



Source: based on data from the "Study on the use of cash by households" of the ECB.
(1) The chart does not reflect the figures for Germany and the Netherlands because the elementary data were generated by equivalent surveys conducted by their respective central banks and are not included in the ECB dataset. – (2) The histograms on the right indicate the share of transactions in a specific sector in total transactions.

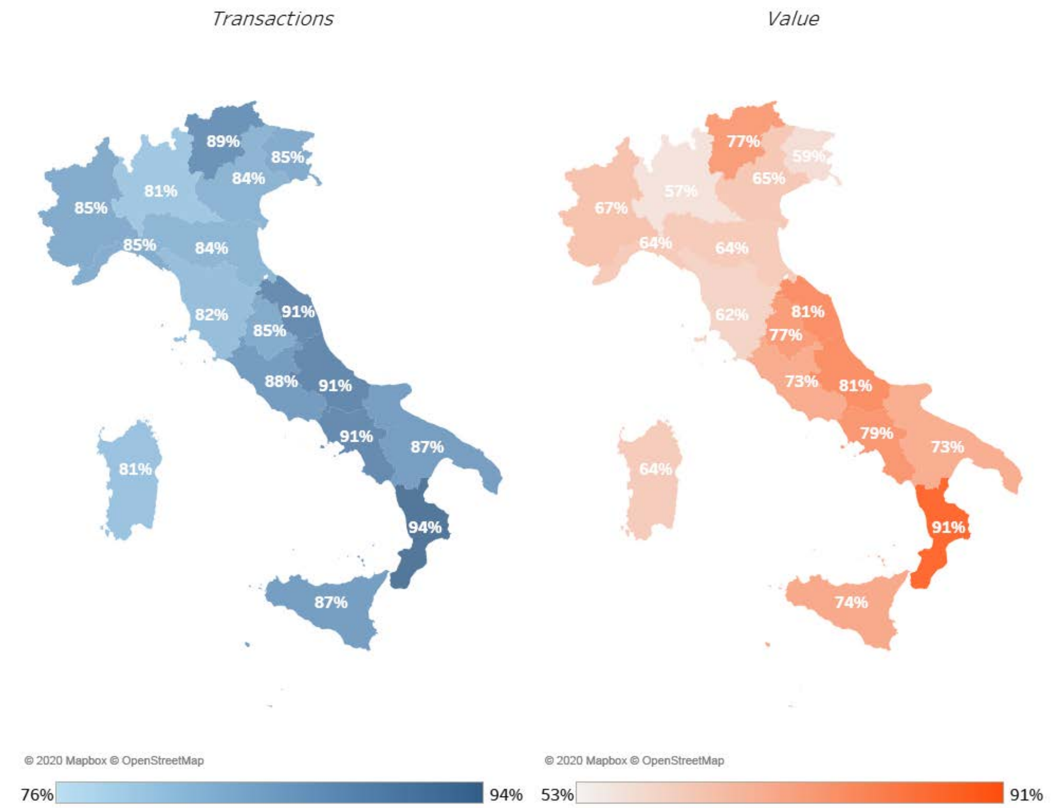
Focusing on Italy, in which the cash is used for almost 86 per cent of transactions in points of sale and accounts for 68 per cent of transaction value, the results for the international comparison are largely confirmed.[136] However, it is worth examining a number of specific characteristics and regional differences that emerge from the analysis in greater detail.

First, the Italian sample of the ECB survey[137] shows that the use of cash, although high in all regions, is greatest in the regions in the Centre-South and in certain regions of the North (Figure 3.10). Only a very small part of this can be explained by differences in the take-up of debit or credit cards at the territorial level (Figure 3.11). Compared with a national average of 89 per cent, Calabria is the only region that is below 80 per cent, the other southern regions fall between 80 and 90 per cent and most northern regions and some regions in the Centre are above 90 per cent.

On the basis of the answers provided by the survey respondents, however, the proportion of cash transactions that could have been settled with traceable payment instruments is larger in the Centre-North than in the South. This could signal the lower availability in some southern regions of points of sale equipped with devices for accepting non-cash means of payment (Figure 3.12).

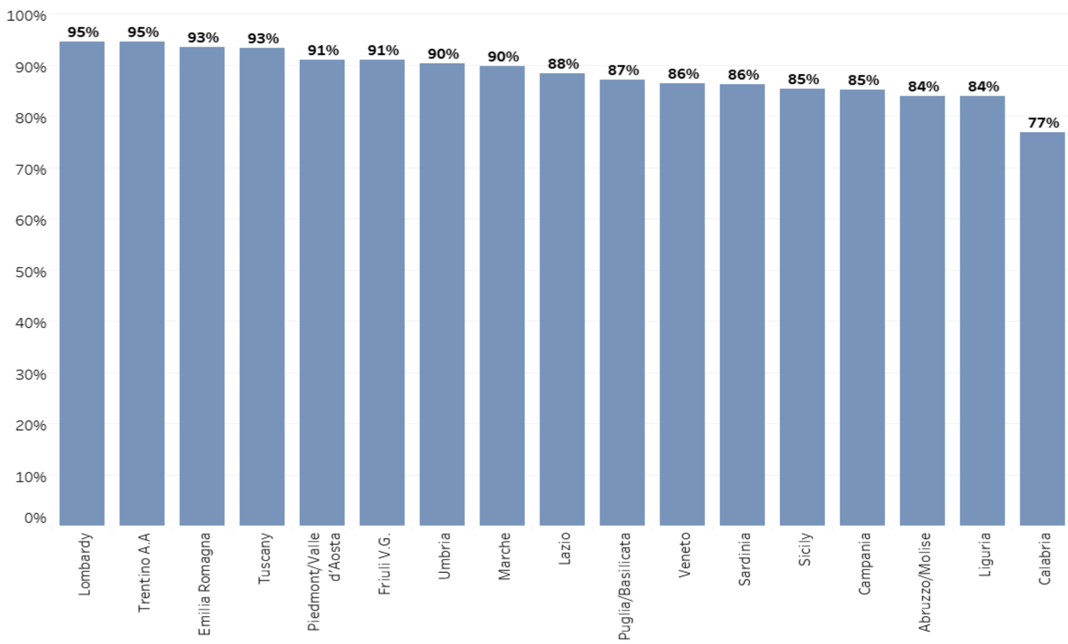
136 A detailed analysis of the results for Italy is also in Rocco, G. (2019), "L'utilizzo del contante in Italia: evidenze dall'indagine BCE 'Study on the use of cash by households'", Questioni di economia e finanza no. 481.
137 The analysis is based on data drawn from the Italian sample in the ECB survey, composed of 4,515 individuals and a total of 10,011 transactions.

Figure 3.10 – Transactions at points of sale in Italy settled in cash



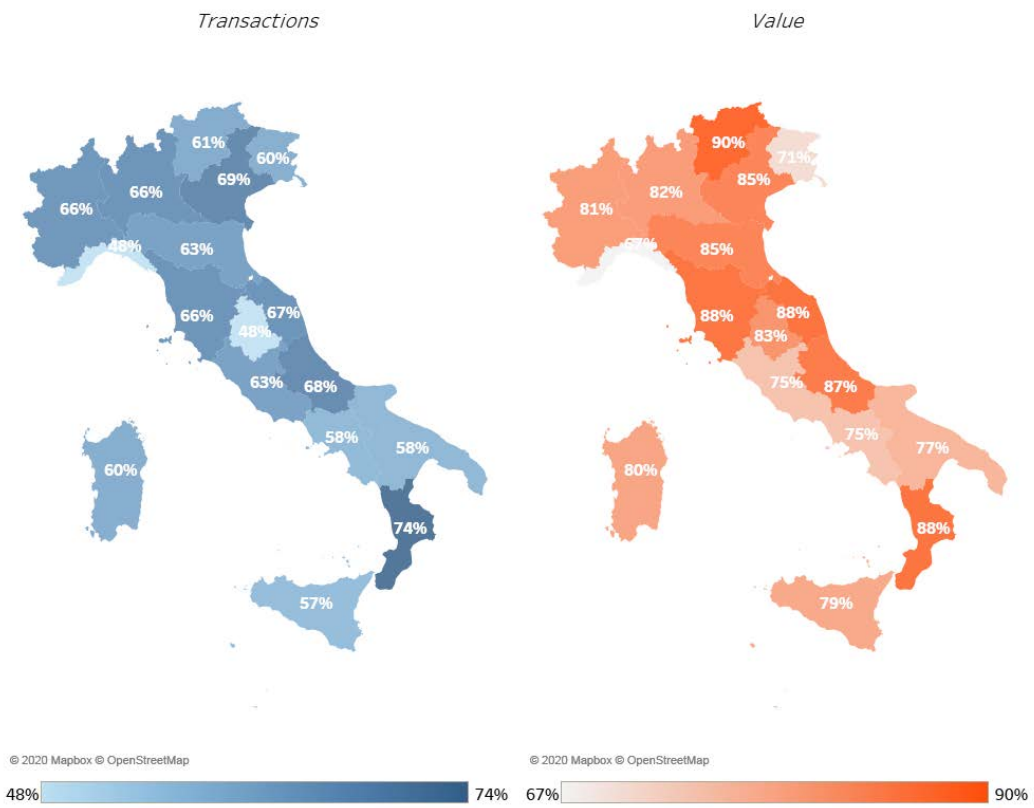
Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB.

Figure 3.11 – Holders of debit or credit cards in Italy
(percentage of individuals)



Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB.

Figure 3.12 – Share of cash transactions at points of sale in Italy that could have been settled with other payment instruments



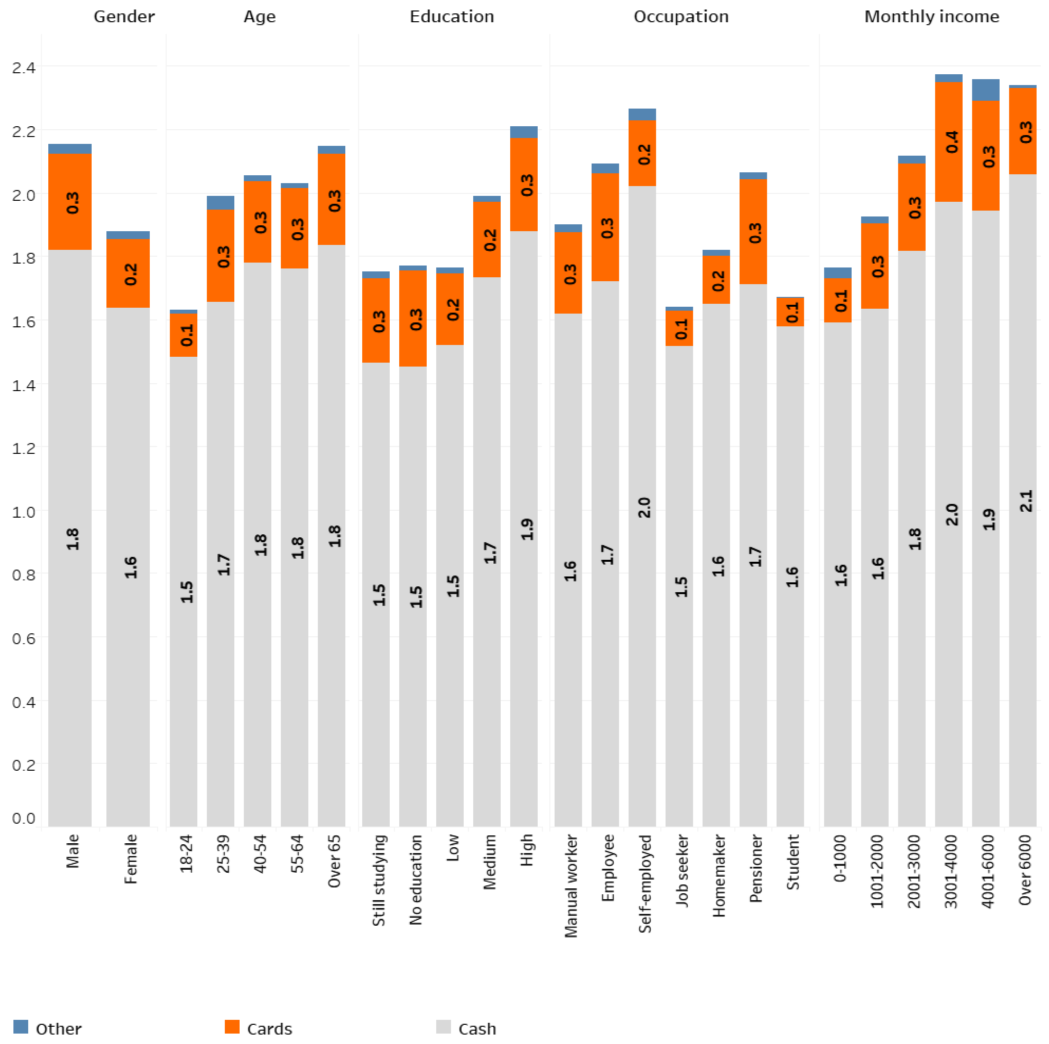
Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB.

The use of cash is prevalent among men, among older respondents and among the self-employed (Figure 3.13).

Finally, as in the other euro-area countries, the choice of payment instrument is largely influenced by the value of the transaction and the place of purchase. In Italy, cash is the main instrument used for purchases up to €100, which represent 98 per cent of total transactions at points of sale. For amounts exceeding €100, the use of cash is slightly less frequent (49 per cent) than the use of traceable payment methods (Figure 3.14).

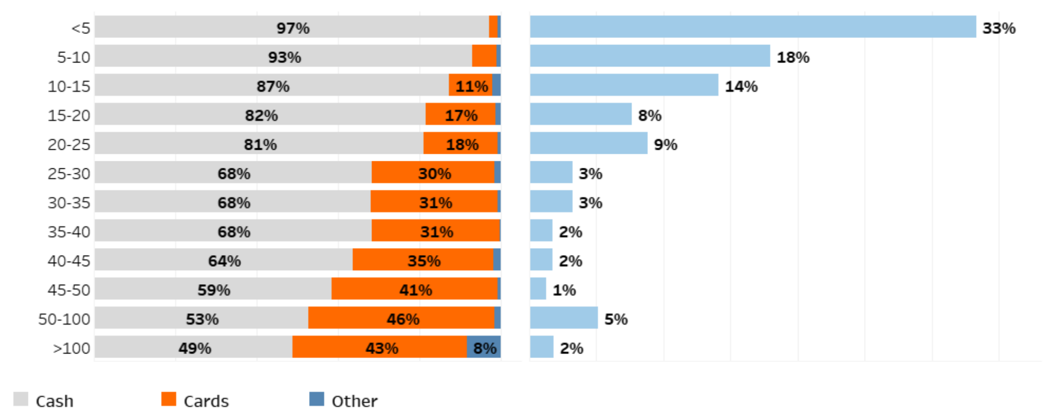
In some cases the sectors in which cash use prevails are also those in which the Istat's estimated share of value added deriving from the unobserved economy is relevant (see par. 3.4.2). Cash transactions exceeded 90 per cent in restaurants, bars and cafés, where it is plausible that alternative means to cash could be used to pay, and at kiosks, markets and vending machines, where it is probable that payment could only be made in cash (Figure 3.15). The share of cash transactions in stores for day-to-day items (supermarket, grocery stores, pharmacies, etc.) or for entertainment and recreational activities was also particularly high. The use of cash was less prevalent for accommodation and durable goods.

Figure 3.13 – Average number of daily transactions at points of sale in Italy by gender, age, education level, occupation and net monthly income



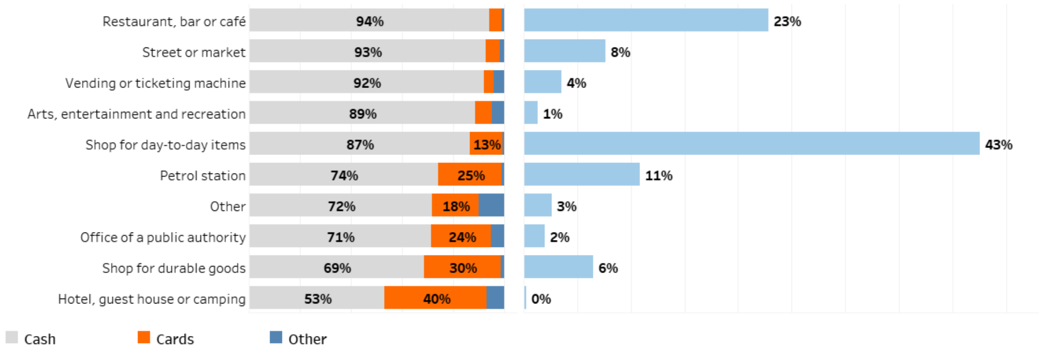
Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB.

Figure 3.14 – Transactions at points of sale in Italy by value and payment instrument (1)



Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB.
(1) The histograms on the right indicate the share of a specific value band in total transactions.

Figure 3.15 – Transactions at points of sale in Italy by location and payment instrument (1)



Source: based on the Italian sample in the “Study on the use of cash by households” of the ECB.
(1) The histograms on the right indicate the share of transactions in a specific sector in total transactions.

Although there is no general consensus on the existence of a relationship between high recourse to the use of cash and tax evasion, some initial evidence of such a relationship is appearing in the literature.[138]

Using a sample of 143 countries, Awasthi and Engelschalk (2018)[139] show the existence of a negative relationship between the size of the shadow economy as a proportion of GDP and the tax revenue to GDP ratio, controlling for per capita GDP: to a 1 per cent reduction of the shadow economy to GDP ratio would correspond a 0.12 per cent increase in the tax revenue to GDP ratio.[140] Moreover, the shadow economy to GDP ratio is inversely correlated with the average number of transactions made with electronic payment instruments.[141]

Using a panel of 25 European countries, Immordino and Russo (2018)[142] show that the use of traceable payment instruments reduces tax evasion. In particular, they identify a negative relationship and a positive relationship between VAT evasion and, respectively, the use of credit and debit cards in payments and the use of cards to withdraw cash from ATMs.[143] It follows, according to the authors, that not only the possession of the cards but also their use in payments should be encouraged to reduce evasion. For Italy, they estimate that a monthly increase of 16 transactions per capita or a monthly increase of €200 in card payments could halve VAT evasion.[144]

Hondroyiannis and Papaoikonomou (2017)[145] focus on the relationships between the use of electronic payments and VAT revenues in the specific case of Greece, where restrictions on cash

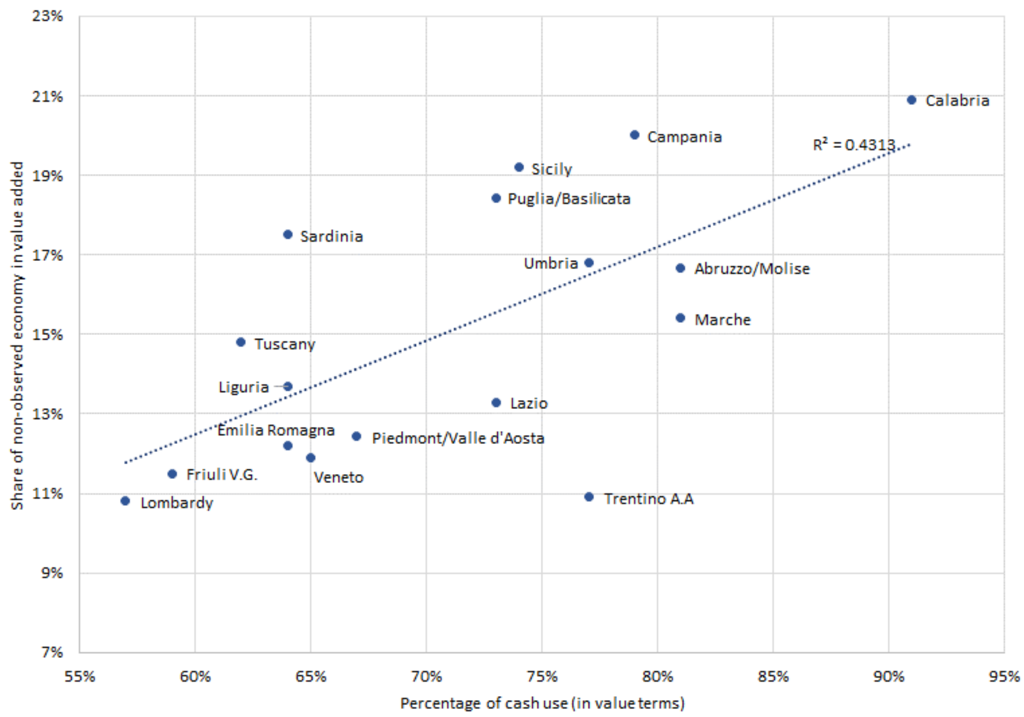
138 The literature considers disincentives for using cash more effective in countering corruption and money-laundering.
139 Awasthi, R. and M. Engelschalk (2018), *op. cit.*.
140 They use a simple regression so endogeneity problems cannot be ruled out.
141 To support this, Awasthi and Engelschalk (2018) report the results of Kearney, A. T. and F. Schneider (2009), “The shadow economy in Europe: using payment systems to combat the shadow economy”, A. T. Kearney.
142 Immordino, G. and F.F. Russo (2018), “Cashless payments and tax evasion”, European Journal of Political Economy, vol. 55, pp. 36-43.
143 In addition to control variables, the models used to estimate the relationships use instrumental variables to address a possible inverse causality problem in which the choice of payment instrument is influenced by the evasion.
144 Compared with, in 2012, an average of 2.2 transactions per month and a median value of €78 of spending per capita using cards.
145 Hondroyiannis, G. and D. Papaoikonomou (2017), “The effect of card payments on VAT revenue: new evidence from Greece”, Economics Letters, vol. 157(C), pp. 17-20.

withdrawals were introduced in 2015 to limit its use. The authors identify compliance as the decisive factor in the sharp increase in VAT revenues that began in the second half of 2015, which in turn was mainly caused by the increase in the proportion of private consumption transactions settled using electronic payment instruments.[146] They estimate that an increase of 1 percentage point in the share of private consumption transactions made with electronic payment instruments could increase of about 1 per cent VAT revenues.

Awasthi and Engelschalk (2018) emphasise that incentives to use traceable payment methods are more effective in countering the shadow economy when tax authorities have detailed transaction information. The authors cite the case of the United States and that of Australia: in the United States, since 2011 card issuers must notify the tax authorities of the total payments received by each merchant each month; in Australia, since 2008 companies must provide information on each individual payment.

There is some moderate evidence for Italy of a relationship between the high level of recourse to the use of cash and tax evasion. In particular, there is a moderately strong positive relationship at the territorial level between the value of transactions settled in cash and the non-observed economy's contribution to value added (Figure 3.16), with some regions, above all in southern Italy, characterised by high cash use and a significant non-observed economy.

Figure 3.16 – Relationship between the value of transactions at points of sale settled in cash and the estimated non-observed economy



Source: based on the Italian sample in the "Study on the use of cash by households" of the ECB and data drawn from the "Relazione sull'economia non osservata e sull'evasione fiscale e contributiva – anno 2019" attached to the 2019 Update.

[146] The increase in VAT revenue was influenced to only a limited extent by changes in average rates and insignificantly by changes in the tax base and the composition of consumption.

3.4.2 *Tax evasion among the self-employed*

Recent official estimates on tax and social contribution evasion confirm that the most widely evaded tax as a percentage of potential revenue is personal income tax (IRPEF) for self-employed workers and enterprises. Istat statistics on the non-observed economy show that the most important component of the non-oserved economy (that due to under-reporting and work in the underground economy) is concentrated in sectors with a large presence of self-employed workers and small businesses. Data drawn from tax returns confirm that the total income of these taxpayers in specific sectors falls within the lower portion of the income distribution, which could reflect under-reporting of turnover or the deduction of higher costs than actually incurred. Moreover, some of these taxpayers have benefited from the recent introduction of simplified tax regimes (the *regime dei minimi* and the *regime forfettario*) that offer especially favourable treatment, both in terms of the level of taxation and the associated accounting and tax reporting obligations. These tax regimes, which are available to self-employed and sole proprietors with turnover under certain thresholds, may have encouraged taxpayers whose actual revenues are just above the eligibility threshold to under-report turnover or overstate costs to keep below the limit. The remainder of this section offers evidence to support this assertion.

The *Relazione sull'economia non osservata e sull'evasione fiscale e contributiva* attached to the 2019 Update of the Economic and Financial Document reports estimates of evasion of social security contributions and almost all taxes (87.5 per cent). The estimate does not include taxes on financial income and real estate transfers because they are not commonly involved in tax evasion. The report shows that in 2016[147] tax and social contribution revenue evaded (the tax gap) amounted to €109.1 billion, almost €98 billion of which deriving from tax revenue. The ratio between tax revenue evaded and theoretical (potential) revenue was equal to 21.4 per cent. The tax for which the tax gap ratio is the largest is the personal income tax due by self-employed workers and enterprises (69.6 per cent in 2017, up from 68 per cent in 2016). In absolute terms this came to €32.1 billion (€33.9 billion in 2016), just under the amount of VAT revenue evaded without consent (€37.2 billion in 2017 and €36.1 billion in 2016) (Table 3.13).

The evasion of IRPEF (personal income tax) due from self-employed workers and enterprises, the focus of this section, reflects the concealment of all or part of their net income and, therefore, the overstatement of costs or the under-reporting of revenues. The latter component is the predominant part of the non-observed economy estimated by Istat in constructing the national accounts. However, it should be taken into consideration that since the estimates of tax evasion are based on a top-down methodology, they depend crucially on national accounts data and therefore on Istat's measurement of the non-observed economy.

[147] Provisional data for 2017 are available for all taxes except IRPEF on underground payroll employment and local IRPEF surtaxes.

Table 3.13 – Tax gap ratio
(percentage of theoretical tax revenue)

	2012	2013	2014	2015	2016	2017 (1)
IRPEF payroll employment (underground)	2.9	3.0	3.8	3.7	3.6	n.a.
IRPEF self-employment and companies	67.4	68.0	68.8	68.1	68.0	69.6
Local IRPEF surtaxes (payroll employment)	6.6	6.6	7.1	7.3	6.5	n.a.
IRES	25.5	26.1	26.2	21.3	23.4	23.8
VAT	27.6	27.2	27.8	26.6	26.9	27.4
IRAP	22.6	23.1	22.9	20.5	21.1	20.9
Rentals	15.7	8.8	8.9	14.7	10.1	7.9
RAI license fee	33.1	34.4	35.6	36.6	9.9	10.3
Excise tax on energy products	4.8	6.2	6.9	7.5	8.4	10.7
IMU	20.9	27.0	26.9	26.5	26.3	25.8
TASI	n.a.	n.a.	n.a.	n.a.	26.9	26.5
Total tax revenue (net of TASI)	**22.1**	**22.1**	**22.8**	**21.3**	**21.4**	**n.a.**

Source: "Relazione sull'economia non osservata e sull'evasione fiscale e contributiva – anno 2019" attached to the 2019 Update.

The non-observed economy consists of: 1) underground production, essentially deriving from the value added deliberately concealed through inaccurate reporting of turnover and/or costs (mainly relevant for estimating VAT and IRPEF evasion by self-employed workers and enterprises), that produced by the use of underground workers (relevant for the quantification of the evasion of personal income tax due by employees) and by other minor components (for example, undeclared rental income of households, tips paid to the staff of hotels and restaurants and the reconciliation of estimates of supply and demand aggregates); 2) illegal production, i.e. the production of illegal goods and services or production that, although involving legal goods and services, is carried out by unauthorised producers; 3) the informal sector, which includes production carried out with a low level of organisation, based on labour relations not governed by formal contracts in the context of personal or family relationships; and 4) the statistical underground, which includes the activities that escape direct observation due to statistical deficiencies (sample and non-sample errors, coverage errors in databases, etc.).

According to Istat estimates,[148] in 2017 the value of the non-observed economy was €210.9 billion, an increase on the €207.7 billion estimated for 2016. The main component is clearly the underground economy (91 per cent of the total, equal to €192 billion), of which the under-reporting of value added is the main determinant (€97.2 billion). As a ratio of value added, the underground economy came to 12.3 per cent, while under-reporting amounted to 6.2 per cent.

With regard to geographical distribution,[149] compared with a national average in 2016 of 6.3 per cent of total value added, the proportion attributable to under-reporting was lower than the average in the North-West and in the North-East (respectively 5.4 and 5.8 per cent) and higher in the South (7.8 per cent). The Centre was close to the national average at 6.6 per cent. The regions in which under-reporting is most marked were Puglia, Umbria, Molise, Marche and Campania (Figure 3.17). As a share of national value added, under-reporting of value added is greatest in the North-West (28.2 per cent) and in the

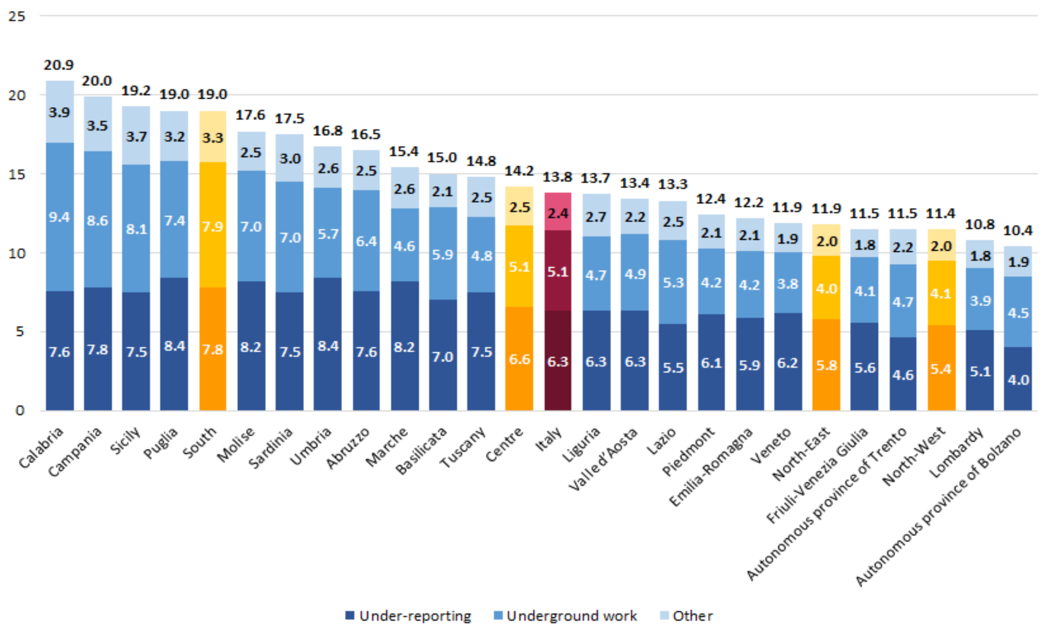
148 Istat (2019), "L'economia non osservata nei conti nazionali – anni 2014-2017", October.

149 The information is drawn from the Report on the non-observed economy and tax and contribution evasion attached to the 2019 Update. For this reason it stops at 2016.

South (27.8 per cent) and less marked in the Centre and North-East (22.6 and 21.4 per cent, respectively). The regions in the highest positions are Lombardy, Lazio and Veneto.

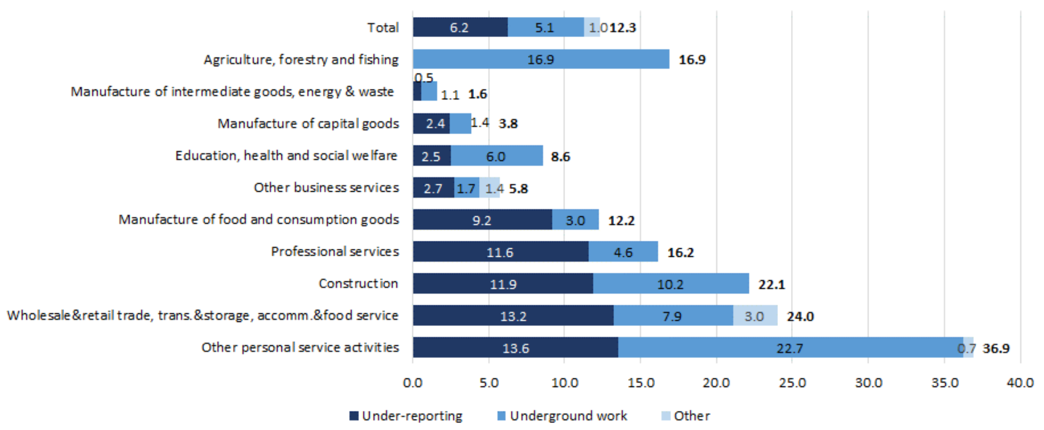
The under-reporting of value added is particularly high in the “other personal services” segment (13.6 per cent of segment value added in 2017), in “wholesale and retail trade, transport, accommodation and catering” (13.2 per cent), in “construction” (11.9 per cent), in “professional services” (11.6 per cent) and in “production of food and consumer goods” (9.2 per cent) (Figure 3.18).

Figure 3.17 – Components of non-observed economy as a share of value added in Italian regions in 2016
(percentages)



Source: Istat (2019), “L’economia non osservata nei conti nazionali – anni 2014-2017”, October.

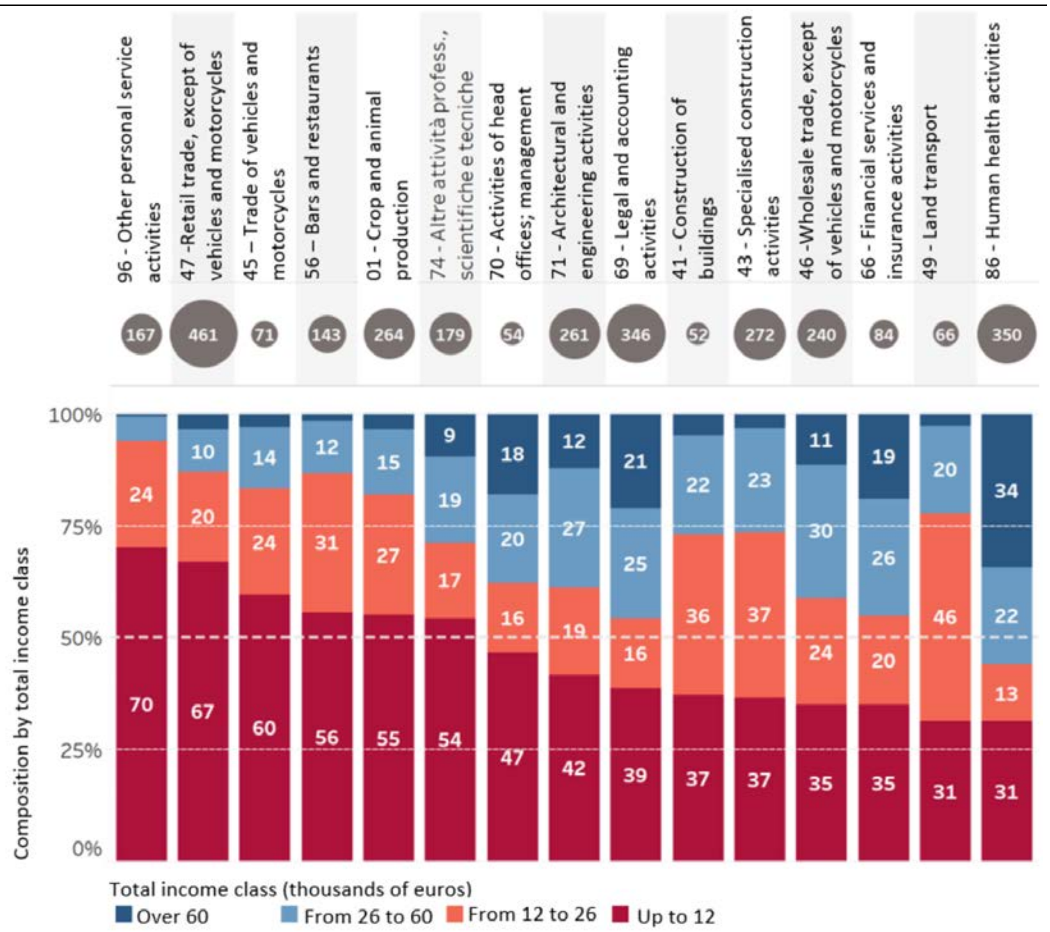
Figure 3.18 – Components of underground economy as a share of value added in 2017
(percentages)



Source: “Relazione sull’economia non osservata e sull’evasione fiscale e contributiva – anno 2019” attached to the 2019 Update.

The data from the income tax returns for the 2017 tax year can be used to analyse the distribution by class of total income of natural persons holding a VAT number (self-employed workers and sole proprietors) for the various sectors to which they belong and compare them with the distribution of the share of under-reporting of value added in the various sectors. The distribution reveals that in sectors in which under-reporting of value added is greatest, the percentage of the taxpayers reporting low incomes is very high. More specifically, 67 per cent of the 461,000 taxpayers in the retail sector (12.8 per cent of all VAT number holders), 60 per cent of the 71,000 taxpayers in retail and wholesale trade and repair of motor vehicles and motorcycles (2 per cent of all VAT number holders) and 56 per cent of the 143,000 taxpayers in the food services sector (4 per cent of all VAT number holders) reported a total income of less than €12,000. In these sectors, the percentages exceed 80 per cent if one considers a total income threshold of €26,000 (Figure 3.19). The concentration of self-employed workers in certain sectors in the lower part of the income distribution could signal under-reporting of revenue or overstatement of costs.

Figure 3.19 – Distribution of natural persons holding VAT numbers by class of total income
(thousands of taxpayers and percentages)



Source: based on income tax returns for the 2017 tax year. Only sectors with more than 50,000 taxpayers are reported.

3.5 Measures for families and the disabled

The Budget Bill contains various measures to support families, some of which are temporary and others of a permanent nature, with an overall increase in current expenditure of €612.2 million in 2020, €1,044 million in 2021 and €1,244 million in 2022.[150]

Temporary measures include the extension and reinforcement of two birth-related measures, namely the "baby bonus" and mandatory parental leave for fathers.

- With regard to the baby bonus, in addition to payment, for 2020 as in previous years, of an allowance for all new-borns equal to €960 per year (divided into monthly instalments of €80), the measure increases the amount for households with a low ISEE (equivalent economic status indicator) and in the case of children after the first.[151] The appropriation – amounting to a total of €758 million, of which €348 million in 2020 and €410 million in 2021 – is structured as a spending ceiling, subject to monitoring and possible limitations on the amount of the benefit if there is a risk of spending overruns.

- With regard to the extension to 2020 of mandatory parental leave for fathers, the period of leave has been increased from 5 to 7 days, with an overall cost in terms of net borrowing of €74 million for 2020.[152]

Permanent measures include:

- the establishment of a fund for the universal allowance and childcare services allowance equal – net of the amounts used to finance other provisions of the measure – to €434 million for 2021 and €1,033 million as from 2022;

- an increase for low-ISEE households in the allowance for the payment of public and private childcare fees, which in the case of children with serious chronic pathologies can also be used to pay for home support. This allowance, currently amounting to €1,500 per year, has been raised to €3,000 and €2,500 per year, respectively, for households with an ISEE of up to €25,000 and €40,000. The total appropriation for the measure has consequently been increased from the current €330 million per year to €520 million (which will rise by about 2 per cent annually for the years after 2020). As in the case of the baby bonus, the appropriation is structured as a spending ceiling, subject to monitoring and

[150] The amount refers to the comprehensive impact of Article 41.

[151] The increase is equal to 50 and 100 per cent respectively for households with an ISEE of less than €40,000 and €7,000. The same amounts are increased by 20 per cent for children subsequent to the first child.

[152] For the purposes of the net balance to be financed, the cost of figurative contributions is also included in the amount of €24.5 million for 2020.

possible limitations on the amount of the benefit if there is a risk of spending overruns.

In addition, indirect support for households is also provided by the capital appropriation for municipalities,[153] amounting to €100 million per year in 2021-2023 and €200 million per year in 2024-2034, for the construction, renovation or safety upgrading of childcare facilities.

The permanent measures, involving the fund to finance the universal family allowance and the allowance for the payment of childcare costs, appear in part to overlap with similar measures contained in an enabling bill currently being examined by Parliament.[154] The aims of the two measures appear to be similar, as both regard a universal family allowance and support for families for childhood educational and care services, but the financial scope of the two programmes differs. The enabling bill envisages raising considerably more resources (not yet identified) than those provided for in the Budget Bill, equal to a total of about €1.3 billion per year for the two programmes taken together.

An analysis of the distribution of the childcare services allowance is warranted. An analysis of INPS monitoring data[155] for 2019, which do not include the last two months of the year, shows sharp regional disparities in the current benefit, both with regard to the coverage ratio of the allowance for resident children under three years of age and to the amount of the allowance paid out (Figure 3.20). The figures range from maximum coverage of 29 per cent in Valle d'Aosta to a minimum of 11 per cent in Campania and Calabria and from a maximum allowance of €651 per beneficiary in the Marche to a minimum of €426, again in Campania. This distribution profile reflects the overall supply of places in childcare facilities (including the private sector), which differs considerably in the various areas of the country (Figure 3.21). The disparities in the level of service delivery are especially marked in the public component of supply, which – on the basis of Istat data at 31 December 2016 – goes from a minimum coverage ratio of 2.5 per cent on average in Calabria to a maximum of 26 per cent in the province of Trento.

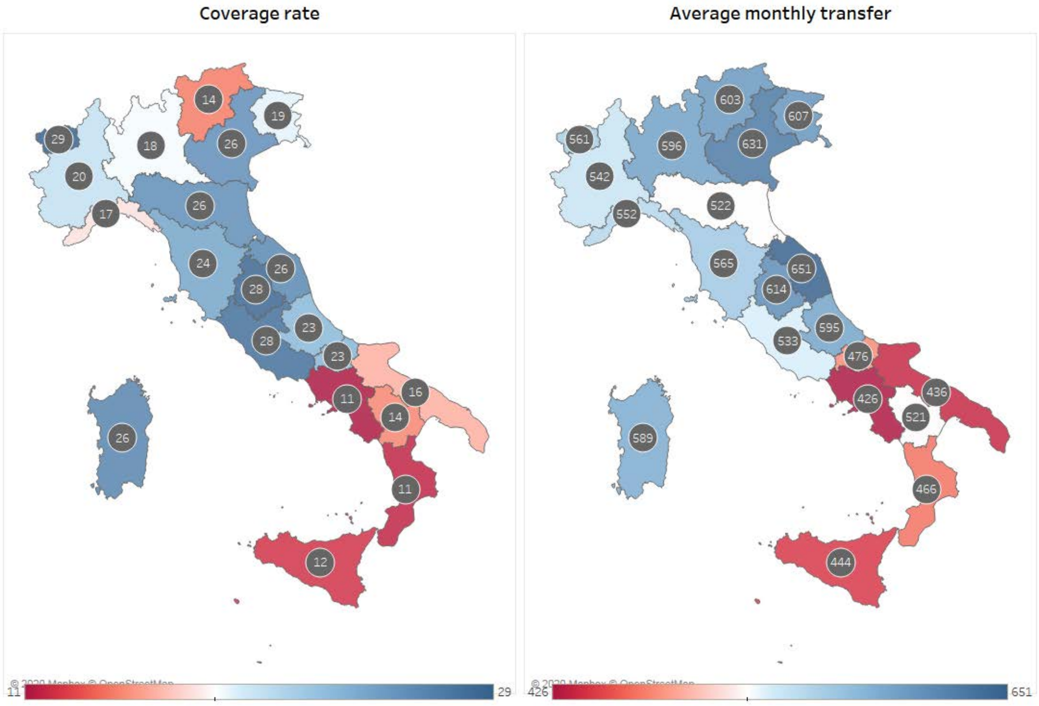
Coordination between the policies supporting the demand and the public supply of childcare facilities is therefore essential, through appropriate measures to reduce regional differences in the availability of public facilities so as to avoid a concentration of double benefits on both the supply and demand sides for people living in regions where such services are available to the detriment of those residing in areas where they are not present.

153 Article 8, paragraph 24.

154 The enabling bill contained in the identical parliamentary acts nos. AC687 and AS472. For more, see the hearing of the Parliamentary Budget Office of 16 October 2019 as part of the examination of enabling bill no. AC687 before the Social Affairs Committee of the Chamber of Deputies.

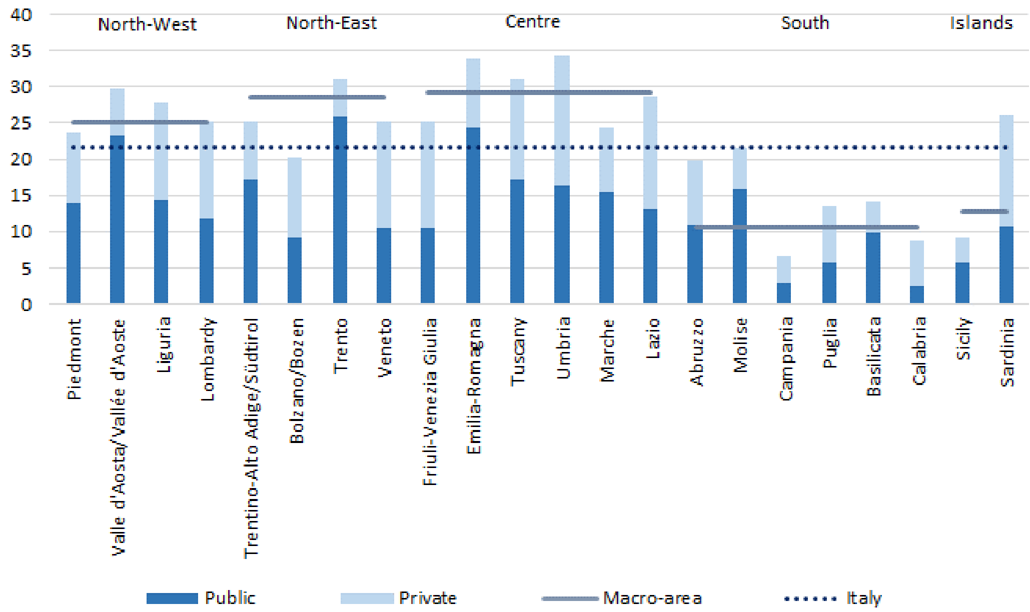
155 Monitoring data of the INPS Central Social Safety Net Department.

Figure 3.20 – Monitoring the use of the childcare facility allowance



Source: based on monitoring data of the INPS Central Social Safety Net Department (Jan-Oct 2019).

Figure 3.21 – Public and private places in childcare facilities at 31 December 2016
(percentage of potential beneficiaries (resident children under the age of 3))



Source: based on Istat data.

In this regard, note that the measure appropriating capital resources for the construction of childcare facilities, in leaving the specification of the allotment criteria to a subsequent Decree of the President of the Council of Ministers, does not specify that priority in using the funds should be given to ensuring the supply of such services – on an efficient basis and with reference to optimal territorial areas – even in areas that currently have a low degree of coverage.

With regard to support measures for people with disabilities, Article 40 of the Budget Bill appropriates increasing resources over the three-year period (€50 million in 2020, €200 million in 2021 and €300 million as from 2022, with equivalent effects on all public finance balances) in a new fund for the disabled and the non-self-sufficient with a view to reorganising the related policies. The appropriated funds must be allocated with "legislative measures" for which no time limit has been set: this presumably refers to the coordinated disabilities bill indicated in the Update, which must be approved in time to employ the resources appropriated in the current year.

Current legislation already provides for a fund for non-self-sufficient persons, with an annual appropriation of about €570 million, to be allocated by way of a ministerial decree, subject to agreement with the State-Regions Conference. The reason the new appropriation in the Budget Bill does not flow into this fund presumably reflects the intent to maintain separate procedures for its use, which have been deferred to future legislative measures. It is to be hoped that following the issue of the coordinated bill, two separate funds with the same purpose will not be retained in the budget.

The Technical Report also notes that the second section of the Budget Bill refinances a number of funds for specific forms of support for the disabled (the right to work of the disabled, transport for the disabled, the hearing impaired, caregivers) that have no or limited resources appropriated for 2020 and increasing over the three years: overall the additional appropriations in the budget for these purposes amount to €45 million in 2020, €65 million in 2021 and €278 million as from 2022.

3.6 Measures concerning pensions

On the pension front, the Budget Bill provides for: 1) the extension of the early retirement programme for hardship categories (*APE sociale*) by one year (up to 31 December 2020); 2) the extension of the "Women's Option" by one year with the inclusion of female workers who as of 31 December 2019 will be 58 years of age (59 if self-employed) and have 35 years of contributions; 3) the revision of the rules for indexing pensions to inflation (with 100 per cent indexation for pensions up to four times the INPS minimum pension, about €513 per month); 4) the allocation of any expenditure savings – compared with the amount estimated in 2018 and at the beginning of 2019 – connected with the introduction of *"Quota 100"* early retirement mechanism and with the temporary suspension of the progressive increase in age requirements for early retirement to improving the public finance balances.[156] The extensions of the *APE sociale* and the "Women's Option" are consistent with past efforts to maintain – compatibly with budget constraints – a degree of flexibility in retirement opportunities, especially for individuals and categories in need.

3.6.1 *The extension of the* APE sociale *and the technical committees*

The *APE sociale* is a programme introduced with the 2017 Budget Act[157] as a "bridge" measure for individuals waiting to qualify for an old-age or early-retirement pension. It is aimed at private and public employees, quasi-employees and the self-employed (freelance professionals are not eligible) residing in Italy and belonging to one of four categories worthy of special protection: *a)* the unemployed; *b)* persons assisting people with severe disabilities; *c)* those with a disability rating of at least 74 per cent; and *d)* those working in hard jobs. To be eligible, potential beneficiaries must be at least 63 years of age and have 30 years of contributions for the first three categories, and 36 years for the fourth.[158] The benefit consists of an allowance paid for twelve months in an amount equal to the theoretical amount of the pension the beneficiaries would receive if it were possible to retire immediately, with a monthly gross maximum of €1,500 not indexed to inflation.[159]

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156 A fifth, smaller, measure allocates expenditure savings deriving from Article 1, paragraph 707, of Law 190/2014 to improving the public finance balance (rather than to financing an ad hoc fund established at INPS as agreed so far). This paragraph currently establishes that the value of pensions calculated on a defined contribution basis subsequent to 2011 pension reform may not exceed the theoretical value that the pension would have had in the absence of the reform. The resources rise from €34 million (€21 million after tax) in 2020 to €42 million (€25.5 million) in 2029.

157 Law 232/2016, Article 1, paragraph 179 and Prime Ministerial Decree 88/2017. For a summary of the characteristics of the mechanism, see also INPS circular no. 100 of 2017.

158 From 1 January 2018 working mothers receive a one year discount for each child, up to a maximum of two years.

159 The benefit is considered employment income and is therefore subject to the same tax rules (for example, beneficiaries are eligible for the "€80 bonus" tax credit). Receipt of the benefit does not impact the calculation of the future pension (it is not an advance on the pension but rather a welfare benefit charged to the State

With regard to the unemployed, the *APE sociale* can be granted to workers whose employment contract is terminated due to dismissal, including as part of a collective layoff, resignation for cause or consensual termination within the scope of a compulsory conciliation procedure.[160] In addition, any other income support benefits (the NASPI scheme, the Outplacement Allowance) must have expired at least three months earlier. From 1 January 2018, the *APE sociale* was also extended to those finding themselves unemployed following the ordinary termination of a fixed-term employment contract, on the condition that in the three previous years they have been employed for at least 18 months.[161]

The category of persons assisting people with severe disabilities[162] includes payroll employees, quasi-employees and the self-employed. To be eligible for the *APE sociale*, at the time of the application beneficiaries must have been assisting a spouse or a cohabiting first-degree relative for at least six months. From 1 January 2018, those assisting second-degree relatives or in-laws with severe disabilities are also eligible, provided they are cohabiting and the parents and spouse of the assisted person are over 70 years of age or are also suffering from a disability.[163]

Those working in hard jobs[164] must work in one of fifteen types of job[165] to be eligible for the *APE sociale* programme, all of which regard private-sector employees, with employers certifying that they actually perform those duties. To be eligible for the *APE sociale*, workers must have performed physically demanding duties for at least six of the last seven years before retirement, or for at least seven in the last ten years.

As initially implemented the *APE sociale* could be requested by those who gained eligibility between 1 May 2017 and 31 December 2018. Decree Law 4/2019[166] then extended this time limit until 31 December 2019.[167] The Budget Bill extends the time limit again to 31

budget). The benefit may only be combined with gross income from employment of up to €8,000 per year in the case of payroll employees and quasi-employees or €4,800 per year for the self-employed. Beneficiaries may not receive income support benefits for involuntary unemployment (NASPI, Outplacement Allowance or DIS-COLL unemployment benefits) or the indemnity for cessation of retail trade activities (introduced on a temporary basis with Legislative Decree 207/1996 and made permanent with the 2019 Budget Act as from 1 January 2019). The benefit may not be combined with a direct pension, but it can be combined with survivor benefits and disability benefits. For public employees who are eligible for the *APE sociale*, any termination benefits (TFR/TFS) will be paid at the time they become eligible for a normal old-age pension.

160 Law 604/1966, Article 7.

161 Law 205/2017, Article 1, paragraph 162.

162 The definition of severe is that given in Law 104/1992, Article 3, paragraph 3.

163 Law 205/2017, Article 1, paragraph 162.

164 The list of physically demanding jobs is given in Annexes C and E of Law 232/2016 as amended by the 2018 Budget Act (Law 205/2017, Article 1, paragraphs 162 et seq.) and by the decree of the Ministry of Labour of 5 February 2018. The *APE sociale* for workers in physically demanding jobs was implemented with the Prime Ministerial Degrees 87/2017 and 88/2017.

165 The fifteen categories are: 1) workers in the mining, building and building maintenance industries; 2) operators of cranes or drilling machinery in the construction industry; 3) leather or fur tanners; 4) train drivers or crew; 5) drivers of heavy vehicles and trucks; 6) hospital nurses and obstetricians doing shift work; 7) careworkers for the non-self-sufficient; 8) childcare teachers and educators; 9) porters, goods movers and similar; 10) unqualified office and shop cleaners; 11) sanitation workers and other waste collectors and separators; 12) steelworkers involved in first and second smelting stages and glass workers involved in high temperature work and not already included in the scope of "wearing" jobs (another category connected with a social benefit mechanism); 13) workers in agriculture, animal husbandry and fishing; 14) fishermen involved in fishing coastal areas, inland waters or the sea, including both employees and members of cooperatives; 15) sailors and travelling crew at sea or on inland waters.

166 Ratified with amendments with Law 26/2019.

167 There are three fixed time periods in which applications can be filed with INPS (see INPS circular no. 15/2019): from 1 January to 31 March (timely application), from 1 April to 15 July (intermediate application), from 16 July to 30 November (late application).

December 2020, including all those who will become eligible during the year.[168] Since its first appearance, this mechanism has been subject to annual spending limits, with applications exceeding the ceiling being deferred to the following year. This spending control measure is retained in the Budget Bill. The Technical Report shows expenditure associated with the extension of the *APE sociale* of €108 million in 2020, €218.7 million in 2021, €184.6 million in 2022, €124.4 million in 2023, €57.1 million in 2024 and €2.2 million in 2025.

These estimates are supported by data drawn from the monitoring report on the *APE sociale* published by INPS on 5 August 2019 regarding applications received between 29 January and 15 July. In particular, extrapolating the number of applications approved and pending through 15 July 2019 to the entire year (about 9,000 net of estimated rejections among pending applications) and taking account of the three fixed time windows when applications can be filed (1 April, 1 August and 1 December), we obtain a pool of about 14,000 new beneficiaries for 2019.[169] Assuming that the same number are accepted in 2020 and that everyone receives a monthly benefit equal to the average amount of benefits approved and paid in 2018 (the last year for which definitive figures are available),[170] in 2020 the increase in expenditure would be less than €110 million.[171] In 2021, spending would more than double (all pensioners receiving *APE sociale* benefits in 2020 would receive the benefit for the entire year) and, from that moment on, would begin to decline as the *APE sociale* beneficiaries meet the normal requirements for old-age or early-retirement pensions.[172] The additional expenditure would decrease to zero by 2025, when the youngest of the beneficiaries (those aged 63 receiving *APE sociale* benefits in the final months of 2020) would meet the requirements to begin receiving an old-age pension.

At the same time, the Budget Bill provides for the establishment of two Technical Commissions without any cost to the public finances: a Commission for the study of hardship in working conditions, considering among other things age, other subjective aspects and environmental conditions; and the Commission for the study of appropriate methods for the reclassification of Italian social spending for pensions and social welfare, partly with a view to making international comparisons more significant.

The Commission for the study of hardship in working conditions, whose activity would terminate at the end of 2020, can help enhance the clarity, certainty and functionality of legislation referring to categories of hard jobs, more clearly specifying the differences with

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[168] Article 56 of the Budget Bill.

[169] INPS only began to receive applications after 29 January (the day Decree Law 4/2019 was ratified). Here we assume that at mid-July 2019 flows have been registered for 6.5 months.

[170] The data from INPS's *APE sociale* monitoring report (August 2019 update) show that for 2018 beneficiaries the average monthly benefit was about €1,300. The monthly amount is calculated on the basis of those who filed an application in 2018 and were observed in 2019 in order to disregard the monthly benefits received in 2018 (in 2019, all beneficiaries receive 12 monthly payments).

[171] For 2019, the usual assumption of a uniform distribution over the course of the year would result in each *APE sociale* recipient receiving an average of 6 monthly payments out of 12.

[172] The Technical Report accompanying the Budget Bill estimates the decline in expenditure – due to transition of beneficiaries to the normal pension system – more conservatively at the start (about -32.6 per cent between 2022 and 2023, -54.0 per cent between 2023 and 2024, about -96.0 per cent between 2024 and 2025).

the categories included in the list of arduous jobs. However, this is not the first time that a Commission with such tasks has been established. Most recently, the 2018 Budget Act provided for one to be established, again for a period of less than a year, although this was extended by forty-five days beyond the original time limit. At the end of its work, the Government was to have presented a report to Parliament on its findings.

The other Commission, however, raises a number of questions. More specifically, all EU countries are required to adopt a uniform methodology in the preparation of statistics, including those on pensions and social assistance. Unilateral methodological changes are not allowed. The uniform treatment of these spending items at the European level is also ensured by the Ageing Working Group within the Economic Policy Committee, whose members include national experts on pension issues (as well as representatives of Eurostat) and produces, among other things, medium/long-term forecasts for spending connected with the ageing of the population.

3.6.2 The extension of the "Women's Option"

The "Women's Option" retirement mechanism was introduced on an experimental basis with Law 243/2004 (as part of the so-called "Maroni" pension reform) and then modified and renewed, most recently with Legislative Decree 4/2019.[173] The latter extended this retirement opportunity to women who by 31 December 2018 had reached at least 58 years of age if they were employees and at least 59 if they were self-employed, together with at least 35 years of contributions. Women opting for this system must accept both the complete recalculation of their benefits on a contributory basis with notional accumulation (the so-called "Dini mechanism") and flexible pension windows under which 12 months for payroll employees and 18 months for self-employed workers must pass between the date the beneficiary qualifies for a pension and the date pension payments begin.[174]

The Budget Bill extends the trial by one year, including all workers who meet the requirements by 31 December 2019. The presence of flexible pension windows means that the first pension payments under this extension will begin in February 2020 for female payroll employees and July 2020 for self-employed workers.

Given the penalty imposed on the value of the recalculated pension benefit, the "Women's Option" initially received little attention, but more women began to opt for the system after the 2011 pension reform (Law 214/2011, the so-called "Fornero reform") to avoid the tighter requirements for old-age and seniority pensions, which affected women in particular.

[173] Ratified with amendments with Law 26/2019.
[174] School personnel have a single annual pension window prior to the start of the school year.

The INPS 2015 Annual Report – the most recent available with a complete survey of the beneficiaries and expenditure connected with the "Women's Option" and which therefore refers to the legislation prior to the amendments introduced with Decree Law 4/2019 – shows that the number of private-sector workers who took advantage of the mechanism rose continuously from 1,328 in 2011 to 19,905 in 2015. Over the same time period, public-sector participants increased from 403 to 8,297. Overall, about 28,000 "Women's Option" retirements were registered in 2015. These are the most recent data published by INPS. It would be desirable for the time series of retirement programmes outside the ordinary system be made more frequent and continuous.

The INPS monitoring report published last October[175] indicates that almost 24,000 applications were received[176] and 15,066 approved in the first ten months of the year (9,807 from private-sector employees, 2,397 from public employees and 2,862 from self-employed workers)[177] under the "Women's Option" mechanism in force in 2019 (i.e. female workers meeting the requirements as of 31 December 2018). Extrapolating these trends for the entire year, at the end of 2019 the number of women opting for the "Women's Option" (in the extended period decided with Decree Law 4/2019) would total 18,000.

The Technical Report accompanying the Budget Bill estimates an increase of 9,100 in the number of women retiring under the "Women's Option" at the end of 2020, implicitly assuming that the number of applications approved in 2020 will be roughly on the same level as in 2019, with estimates of the propensities to retire being based on the monitoring data for previous years.[178] As for benefit payments, the official estimates use the average amounts recorded in the last three years, equal to €1,150 (gross) for private-sector employees, €1,300 gross for public employees and €880 for self-employed women.

On the basis of these assumptions, the Technical Report estimates that the extension of the "Women's Option" trial will increase the number of pensions (as registered at the end of the year) by 9,100 in 2020, 15,400 in 2021, 15,900 in 2022, 12,500 in 2023, 7,900 in 2024, 3,000 in 2025 and 600 in 2026. Beginning in 2023 the increase in the number of pensions begins to decline as women reach the normal age and contribution requirements for the old-age or early-retirement pension.[179] The before tax additional expenditure would amount to €66.7 million in 2020, €187.2 million in 2021, €291.3 million in 2022, €259.8 million in 2023, €163.8 million in 2024 and €50.3 million in 2025.

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175 Pursuant to Article 28 of Decree Law 7/2019, ratified with amendments with Law 26/2019.

176 Of these, about 6 per cent regarded pensions beginning in 2020 and 2021. The monitoring results do not assign yet a start date to a large number of applications (nearly 4,300, or 18 per cent).

177 At the same date, 4,137 applications had been rejected and 4,407 were pending.

178 For payroll employees: 55 per cent at the first available start time, 35 per cent after one year, 10 per cent after two years. For the self-employed: 50 per cent at the first available start time, 40 per cent after one year, 10 per cent after two years. The estimate of 18,000 applications approved seems prudent, bearing in mind that this is the second consecutive renewal of the "option" and there is no initial stock of women who already meet the requirements.

179 Actually, at the end of 2022, when the staging of applications is completed (see previous note), the Technical Report already indicates that the increase in the number of pensions is about 2,000 fewer than the initial pool. The difference is attributable to eligible candidates reaching the requirements for ordinary pension mechanisms and, to a lesser extent, mortality.

In 2026, spending would decline as a result of the smaller size of pensions fully recalculated using the notional contribution mechanism.

These estimates also include the effects that retirement under the “Women’s Option” would have on termination benefits (TFS/TFR) in the public sector. Spending would increase by €51 million in 2022, €47 million in 2023 and €17 million in 2024. From 2025, outlays would decline as the net effect of TFS/TFR that would have been paid in any case upon reaching normal age and contribution requirements for old-age or early-retirement pensions but in smaller amounts owing to shorter careers (€15 million in 2025 and €35 million in 2026).

3.6.3 *Changes in inflation adjustment of pensions*

The Budget Bill eases the pension indexation rules for pensions up to 4 times the minimum INPS pension (equal to €513.01 per month), which had already been modified with the 2019 budget package (Table 3.14). More specifically, as from 2020 the first indexation band, i.e. for fully indexed pensions (100 per cent of the inflation rate), has been expanded, widening it from 3 to 4 times the minimum INPS pension. In addition, for 2020-2021, the number of brackets introduced with the 2019 Budget Act for 2019 has been reduced from seven to six and the percentage of indexation for pensions between 3 and 4 times the minimum INPS benefit has been raised from 97 to 100 per cent. Starting from 2022 the transitioning from the level method to a progressive mechanism continues to persist.[180]

Table 3.14 – The rules for inflation adjustment of pensions

<table>
<tr><th colspan="2"></th><th colspan="7">Value of pension as a multiple of minimum INPS benefit (1)</th></tr>
<tr><th colspan="2"></th><th>Up to 3</th><th>From 3 to 4</th><th>From 4 to 5</th><th>From 5 to 6</th><th>From 6 to 8</th><th>From 8 to 9</th><th>Over 9</th></tr>
<tr><td colspan="2">In force in 2018 (progressive)</td><td>100%</td><td>95%</td><td>75%</td><td>50%</td><td colspan="3">45%</td></tr>
<tr><td colspan="2">In force in 2019 (by level)</td><td>100%</td><td>97%</td><td>77%</td><td>52%</td><td>47%</td><td>45%</td><td>40%</td></tr>
<tr><td rowspan="2">pre 2020 Budget Bill</td><td>2020 and 2021 (by level)</td><td>100%</td><td>97%</td><td>77%</td><td>52%</td><td>47%</td><td>45%</td><td>40%</td></tr>
<tr><td>From 2022 on (progressive)</td><td>100%</td><td colspan="2">90%</td><td colspan="4">75%</td></tr>
<tr><td rowspan="2">post 2020 Budget Bill</td><td>2020 and 2021 (by level)</td><td colspan="2">100%</td><td>77%</td><td>52%</td><td>47%</td><td>45%</td><td>40%</td></tr>
<tr><td>From 2022 on (progressive)</td><td colspan="2">100%</td><td>90%</td><td colspan="4">75%</td></tr>
</table>

(1) In 2019, the minimum INPS pension was €513,01 per month in 13 monthly instalments.

[180] With the level method, pension income is adjusted using the percentage envisaged for the bracket in which the overall income falls; with the progressive mechanism, pensions are indexed by applying the percentage for each intermediate bracket to the income falling within that bracket and the percentage for the subsequent bracket to the remainder.

The 2019 Budget Act had established an indexing mechanism based on seven brackets for 2019-2021 – with percentages decreasing from 100 to 40 per cent – to be applied using the level calculation method. As from 2022, the previous rules (Law 388/2000, Article 69, paragraph 1) based on three brackets – with percentages from 100 to 75 per cent – applied using a progressive mechanism, would have come back into force.

According to the Technical Report, changes to the indexing rules will increase gross expenditure by €8 million in 2020, gradually rising to €498 million in 2029. Net of the tax effects, the increase in spending will rise from €6 million in 2020 to €346 million in 2029. The shift from gross to net spending implies an average tax rate of 25 per cent in 2020, gradually increasing to around 30 per cent in 2029.[181] Taking these aspects into account, the assessments appear to be acceptable.

To produce the estimates, the Technical Report uses the inflation rate and pension expenditure forecasts reported in the 2019 Update.[182] It also assumes that pension incomes between 3 and 4 times the minimum INPS benefit amount to about 18.7 per cent of total pension expenditure,[183] while the total amount of the share of pension incomes between 3 and 4 times the minimum benefit comes to around 9.3 per cent of the total. These percentages are confirmed by the Istat data on the number of recipients and pension incomes by monthly amount classes.[184]

*3.6.4 Expenditure savings connected with the "*Quota 100*" early retirement mechanism and with smaller outlays for old-age pensions*

The Technical Report accompanying Decree Law 4/2019[185] estimated the increase in pension expenditure attributable to the introduction of the "*Quota 100*" mechanism and to the suspension until 2026 of the linkage between early retirement pensions and life expectancy at about €3.8 billion in 2019, €7.9 billion in 2020, €8.3 billion in 2021 and €7.9 billion in 2022.[186] From 2023, the increase in costs would begin to decline until it reached little more than €1.5 billion in 2028 as potential retirees under the "*Quota 100*" system meet existing requirements for old-age and early-retirement pensions.

Last September, the 2019 Update, using the initial findings of the monitoring performed by INPS,[187] revised the official estimates downwards by about €1.2 billion in 2019, €1.7 billion in 2020 and €0.4 billion in 2021. The Budget Bill lowers them further, by €0.3 billion in 2020, €0.9 billion in 2021 and €0.5 billion in 2022 (Table 3.15). At present,

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181 In the first few years, the average rate used is that corresponding to incomes straddling the first and second brackets of personal income tax, broadly equal to pension income 3 to 4 times the INPS minimum benefit. As the years pass, the greater inflation adjustments give rise to bracket creep, with pension incomes and tax rates rising and shifting partially into the next higher indexation bracket (90 per cent adjustment).
182 Equal to €271.1 billion net of minimum pensions and allowances.
183 Net of minimum pensions and allowances.
184 See the Istat online dataset under "*Assistenza e Previdenza*", in the section "*Pensioni: Principali dati*".
185 Ratified with Law 26/2019.
186 Of these, €328 million in 2019, €526 million in 2020, €547 million in 2021 and €567 million in 2022 were connected with the suspension of the linkage with life expectancy for early-retirement pensions.
187 Pursuant to Article 28, paragraph 3 of Decree Law 4/2019.

Table 3.15 – Increase in expenditure due to "*Quota 100*" mechanism and suspension of linkage with life expectancy for early retirement pensions
(millions of euros)

	Technical Report to DL 4/2019		Change in 2019 Update	Change in 2020 Budget Bill	Total post Budget Bill
	Total	Of which: for early retirement			
	a	*b*	*c*	*d*	*e= a+c+d*
2019	3,781	328	-1,200	0	2,581
2020	7,860	526	-1,700	-300	5,860
2021	8,310	547	-400	-900	7,010
2022	7,877	567	0	-500	7,377
2023	6,432	1,398	0	0	6,432
2024	3,912	1,588	0	0	3,912
2025	2,853	2,602	0	0	2,853
2026	1,915	3,131	0	0	1,915
2027	1,898	3,795	0	0	1,898
2028	1,532	3,541	0	0	1,532

Source: based on data from the technical reports accompanying Decree Law 4/2019, the Budget Bill and the 2019 Update.

therefore, the expected increase in expenditure associated with the "*Quota 100*" mechanism and the suspension until 2026 of the linkage between early retirement pensions and life expectancy is estimated at €2.6 billion in 2019, €5.9 billion in 2020, €7.0 billion in 2021 and €7.4 billion in 2022. Prudentially, no changes were made to the assessment of costs for the following years reported in the Technical Report of Decree Law 4/2019.

The PBO has updated its estimates published on the occasion of the hearing held on 16 July 2019[188] regarding solely the "*Quota 100*" mechanism, the new retirement option with the greatest immediate and medium-term impact in terms of participants and expenditure.[189]

To assess the reduction in spending compared with the original forecast, the data published by INPS between March and November 2019 were used to analyse developments in applications for the "*Quota 100*" system received during the year, and those of the INPS monitoring report through the end of October. The data contains information broken down by pension fund, for three age groups and by gender.

As of 11 November,[190] INPS had received 201,022 applications: 41.1 per cent from private-sector employees (the payroll employee pension fund – FPLD – and special funds), 30.6

[188] See Ufficio parlamentare di bilancio (2019), "Audizione del Presidente dell'Ufficio parlamentare di bilancio in merito ai recenti interventi del Governo in materia di saldi di finanza pubblica", 16 July (http://www.upbilancio.it/wp-content/uploads/2019/07/Audizione-UPB-16_07_2019.pdf).

[189] See the update at 31 October of the "Rapporto di Monitoraggio" prepared by INPS. At that date, the number of applications filed came to more than 197,000 for the "*Quota 100*" mechanism, more than 157,000 for the early retirement pension and just under 24,000 for the "Women's Option" mechanism. In addition, the average period of time by which retirement was brought forward (compared with the normal pre-reform requirements) was estimated at two years for the "*Quota 100*" and three months for the old-age pension on an unchanged requirement basis.

[190] At the date on which this report closed, on the INPS website figures for applications received through 21 November were also available. In order to estimate the monthly flow for November, it was decided to

per cent from public employees (former INPDAP), 20.8 per cent from self-employed workers (including entertainment and sports workers and quasi-employees), and 7.5 per cent from workers who were combining contributions from multiple pension schemes.

Table 3.16 summarises the data of ten updates published on the INPS website from 15 March to 11 November 2019.

The data shows that 39.9 per cent of those who applied for the *"Quota 100"* system were aged under 63 years, 42.0 per cent were older than 63 but less than or equal to 65, and 18.1 per cent were over 65 years. Applicants were mainly male (almost 74 per cent). The presence of the April 2019 fixed pension window for private-sector employees and self-employed workers who already met the eligibility requirements at the end of 2018 (the initial cohort), together with the end-of-February deadline for participation by school employees meant that a large number of applications had already been received by March (93,553). In addition, the August 2019 pension window for public employees in sectors other than the school system who already met the eligibility requirements at the end of 2018, together with their obligation to given six months' notice, meant that at the end of June retirement applications had already been received from public employees who could begin receiving their pension in 2019 (48,566 applications as of 20 June and 55,167 as of 6 September).

Table 3.16 – Applications received for *"Quota 100"* mechanism

	15-Mar	26-Mar	5-Apr	17-Apr	26-Apr	13-May	20-Jun	6-Sep	30-Sep	11-Nov	*11-Nov %*
FPLD	32,648	36,310	40,453	43,268	44,471	47,787	54,615	65,120	68,455	71,603	*35.6*
Former INPDAP	33,717	35,835	38,375	40,442	41,307	43,167	48,566	55,167	57,604	61,590	*30.6*
Entertainers and sport	332	372	418	448	461	492	578	677	711	561	*0.3*
Retail	7,545	8,506	9,535	10,107	10,439	11,135	12,521	14,782	15,588	18,178	*9.0*
Craftsmen	7,930	8,940	9,921	10,511	10,802	11,511	12,978	15,135	15,856	18,669	*9.3*
CDCM	1,699	1,974	2,316	2,431	2,501	2,665	2,985	3,466	3,682	4,348	*2.2*
Separate Pension Fund	96	106	114	122	125	129	145	161	167	87	*0.0*
Special funds	4,187	4,643	5,241	5,695	5,892	6,409	7,551	8,997	9,478	10,960	*5.5*
Combination of contributions	5,399	6,279	7,122	7,699	7,978	8,548	10,160	12,490	13,349	15,026	*7.5*
≤ 63 years	31,570	34,610	38,515	41,460	42,714	46,209	54,237	67,249	71,831	80,242	*39.9*
> 63 and ≤ 65	43,136	47,411	51,922	54,960	56,338	59,444	66,658	75,807	78,896	84,474	*42.0*
> 65	18,847	20,944	23,058	24,303	24,924	26,190	29,204	32,939	34,163	36,306	*18.1*
Female	25,314	27,534	30,036	31,786	32,535	34,407	39,202	45,680	48,033	52,393	*26.1*
Male	68,239	75,431	83,459	88,937	91,441	97,436	110,897	130,315	136,857	148,629	*73.9*
Total	**93,553**	**102,965**	**113,495**	**120,723**	**123,976**	**131,843**	**150,099**	**175,995**	**184,890**	**201,022**	***100.0***

Source: based on INPS data.

consider only the applications received by 11 November and extrapolate the data for the full 30 days of the month. It is assumed that part of the applications received afterwards regard pensions that would begin after 2019, as can be deduced from the fact that, having been extrapolated to 30 days, the number of applications increases significantly compared with the figures for the previous three monitoring dates (6 September, 30 September, 11 November).

Estimated expenditure in 2019

To verify whether spending decreased with respect to official forecasts, it is necessary to make certain assumptions about any additional applications to participate in the "*Quota 100*" mechanism that will be received by the end of 2019. One possible assumption is to apply the absolute increase in applications submitted between the last and the penultimate monitoring data, restated on a monthly basis and broken down by pension fund (as they appear in the INPS data),[191] to the November 11 stock recorded by INPS. It would essentially be an approximation of those who progressively meet the age and contribution requirements for the "*Quota 100*" system and, to a more limited extent, of those who, despite having already met the requirements, did not immediately apply for retirement.

This projection also takes account of two aspects briefly mentioned earlier. First, at the end of June all applications had been received from public employees who want to retire by the end of 2019,[192] bearing in mind that such workers must give at least six months' notice, while the school sector is subject to the more stringent deadline for submitting applications by the end of February.[193] Second, the final monthly increase is applied to 19/31sts of a month, corresponding to the remainder of November, as the December applications can plausibly be assumed to regard pensions starting in 2020 (and theoretically part of those will even come after 2020). Using these assumptions, the total number of applications for retirement under the "*Quota 100*" system in 2019 would amount to 200,000.[194]

On the basis of these projections and applying an average rejection rate of 14 per cent,[195] at the end of the year applications under the "*Quota 100*" mechanism for pensions starting in 2019 would number about 172,000, compared with the projection of 269,000 given in the Technical Report accompanying Decree Law 4/2019 (a reduction of about 36.7 per cent). This would break down as follows: about 86,000 private-sector workers (including workers who combined contributions made to multiple pension

[191] The last increases are used to represent developments in participation once the system is operating normally, after the initial months characterised by the winding down of the built-up stock of demand for retirement and the overlap of fixed time windows for retirement. The last two updates are those at 30 September and 11 November.

[192] The figures at 6 September, 30 September and 11 November reflect the progression of the stock of public employees. Half of the increases are attributed to 2020 and half to 2021 (net of mortality).

[193] The end-February deadline currently holds for 2019 only (Decree Law 4/2029, Article 14, paragraph 7). It is possible that school employees will subsequently be subject only to the six-month notice requirement, together with the fixed September time window for retirement.

[194] To calculate monthly increases net of public employees, it is assumed that within each of the three age brackets used by INPS and within the male and female subgroups the proportion of public employees is the same as that for all "*Quota 100*" applications indicated in the most recent monitoring report.

[195] Information drawn from the INPS monitoring report such as the ratio of applications denied and the difference between applications received and pending applications. In truth, in the October report this parameter was just over 14.5 per cent, compared with the 15.5 per cent recorded in the June report. The PBO estimate uses a value of 14 per cent, conservatively assuming a slight downward correction in the closing months of the year. To analyse the sensitivity of the results, it is also assumed that in the next two years the rejection rate could be lower (10 per cent, see below).

schemes), just under 39,000 self-employed (including those who had been paying into the Separate Pension Fund) and over 47,000 public employees. Compared with the figures reported in the Technical Report, significant negative differences would be registered for self-employed workers (about -53 per cent, probably discouraged by the prohibition on combining pension and labour income and the already low level of the benefit) and for public employees (about -49 per cent, probably due to the lower net marginal disutility of their duties, the greater stability of their jobs and the higher average wages). Retirements of private-sector payroll employees are more in line with expectations (-8.8 per cent).

To quantify expenditure for 2019, reference can be made to the average gross annual benefit amounts that have already been paid to pensioners under the "*Quota 100*" mechanism during the year, drawn from INPS data broken down by pension fund: €27,700 for private-sector employees, €18,500 for self-employed workers and €28,100 for public employees.[196] Furthermore, we assume that on average in 2019 those who retire with the "*Quota 100*" system will receive 7 monthly payments (i.e. 7/12ths of the annual gross amount including the thirteenth monthly payment) if employed in the private sector or self-employed and 4 monthly instalments if a public employee.[197] To the extent that the increase in retirements in April (for private-sector and self-employed workers) and in August (for public employees) will *ex-post* prove higher and generate longer durations for pension paid in 2019, 2019 expenditure would be underestimated and, consequently, the decrease in expenditure compared with the figures given in the Technical Report would be overestimated.

Employing the assumptions listed above, gross expenditure for the *"Quota 100"* programme in 2019 would amount to over €2.2 billion, almost €1.2 billion less than estimated in the Technical Report accompanying Decree Law 4/2019 (about €3.5 billion). This amount would not substantially change if applications for admission to the *"Quota 100"* programme from workers combining contributions were attributed not to the payroll employee pension fund (FPLD), as it has been done so far, but rather to public employee pension funds or on a pro rata basis (the average pension benefits for those who retire under the *"Quota 100"* system do not differ much between the private and public sectors). The savings would instead decline more significantly if the *"Quota 100"* applications of workers making use of combined contributions were attributed to the self-employed workers pension fund.[198] The reduction in pension spending deriving from the *"Quota 100"* system could also be overestimated if the average rejection rate for applications turned out to be lower than currently indicated in the INPS data. While

[196] The Technical Report of Decree Law 4/2019 assumes an annual average amount of €28,300 for private sector employees, €18,400 for self-employed workers and €30,200 for public employees.
[197] The average number of instalments is affected by the presence of workers who already met the *"Quota 100"* requirements at the end of 2018, as well as by the three constraints noted earlier: pension payments do not start before April for private-sector employees and self-employed workers, before August for public employees not belonging to the school sector and only in September for those working in the school sector.
[198] The reduction in spending would amount to just under €1.3 billion.

it is true that the figure has probably settled at its final level, the analysis of pending and new applications arriving in the second half of November and in December could prompt downward revisions. By contrast, the savings could be underestimated if some *"Quota 100"* applications received so far referred to pensions taking effect after 2019. From the information published by INPS in its June monitoring report, this percentage, measured with respect to the total number of applications received, not just those approved, was estimated at around 4 per cent (mostly in the private sector). In the October update, this percentage had increased to around 11 per cent.

Estimated expenditure in 2020

Again working on the basis of data published by INPS, we can also estimate, albeit with a high degree of uncertainty, any *"Quota 100"* expenditure for 2020. However, this quantification requires the formulation of a preliminary estimate of the number of *"Quota 100"* pensioners divided into four different categories:

1) the first category is made up of both private-sector workers who apply in December 2019 and whose pension only begins the following month and public employees who have submitted or will submit their application from July 2019 onwards and, due to the six months' notice they must give to their department, will not actually retire before 2020. It is assumed that the rejection rate for their applications remains at 14 per cent (10 per cent in the sensitivity analysis scenario);

2) the second category is made up of those who retired under the *"Quota 100"* mechanism in 2019 (divided between private-sector employees, the self-employed and public-sector workers) and who will receive a pension for the entire year in 2020 if they survive;[199]

3) the third category consists of those who meet the requirements for the *"Quota 100"* programme for the first time in 2020. Using the data in the Technical Report, this analysis approximates their number as the flow of new pensioners in 2020 (the difference between the stock at the end of 2020 and the end of 2019), net of those who, despite meeting the requirements in 2019, decide to postpone retirement, as estimated on the basis of the propensities used in the Technical Report.[200] It is also assumed that this cohort actually decides to retire with the propensity observed in 2019 for the younger age group (no older than

[199] The analysis assumes a mortality rate of 0.08 per cent for the ages affected by the "*Quota 100*" mechanism (http://demo.istat.it/tvm2016/index.php?lingua=ita).

[200] The Technical Report assumes that, among those who become eligible to start receiving a pension under the "*Quota 100*" programme, 85 per cent of private-sector employees and 70 per cent of public employees will actually retire. Those who postpone are expected to retire the following year with a propensity of 40 per cent for both private- and public-sector employees. The propensities remain unchanged at this level in subsequent years.

63) and that the application rejection rate remains 14 per cent (10 per cent in the sensitivity analysis scenario). Finally, it is assumed that these pensioners receive an average of 6.5 monthly pension payments as a result of the assumption that the marginal cohorts have a uniform distribution by month in which their pension begins;

4) finally, the fourth category includes those who, despite meeting the requirements in 2019, decide to postpone retirement to 2020 and those whose application was rejected in 2019 and have re-submitted it in 2020. To estimate their number, the analysis uses the age-group breakdown (≤63 years, >63 years and ≤65 years, and >65 years) given in the INPS data, applying to each group the retirement propensity of the next age group registered through November 2019 and extrapolated for all of 2019:[201] for example, the probability of retiring under the *"Quota 100"* system of the >63 and ≤65 age group is applied to those in the ≤63 age group.[202] Within the different age groups, it is also assumed that there is a constant distribution among the pension funds to which they belong. Once again, the analysis also assumes a rejection rate of 14 per cent for pension applications (10 per cent in the sensitivity analysis scenario) and that those retiring in 2020 will receive 6.5 months of benefit payments (i.e. that the start of pension payments is distributed uniformly across the months of the year).[203] Depending on the extent to which the average duration of payments (monthly instalments) exceeds that, expenditure in 2020 would be underestimated and, consequently, the reduction in expenditure compared with the figures given in the Technical Report would be overestimated.

To quantify expenditure for the "*Quota 100*" programme in 2020, the sizes of the groups so estimated are multiplied by gross annual benefits for 2020 equal to those given in the Technical Report accompanying Decree Law 4/2019 separately by pension fund to which the beneficiaries belong.

On the basis of these assumptions, by 2020 the number of *"Quota 100"* pensioners could reach 246,000, about 19 per cent fewer than the figure reported in the Technical Report (303,000): over 121,000 private-sector employees, over 58,000 self-employed and almost 67,000 public employees. Expenditure would amount to almost €5.4 billion, just under €2.0 billion less than indicated in the Technical Report (a reduction of about 26.7 per cent). As already noted for the estimates for 2019, the values do not vary substantially if the distribution of pensioners who combine contributions to private- and

[201] Pensioners retiring under the "*Quota 100*" mechanism in 2019, taking due account of the application rejection rate, number more than 67,500 in the 62-63 age bracket, more than 71,500 in the 63-65 bracket and just over 31,000 in the over-65 bracket.

[202] For those aged more than 65, who do not have a retirement probability for the subsequent age bracket, the same probability is used.

[203] For public employees, the number of monthly pension payments is revised slightly downwards (from 6.5 to 6) to take account of the fact that, owning to the pension windows, school workers all receive 4 instalments (from September to December) in the year in which they retire.

public-sector employee pension funds is changed. The differences are somewhat larger in the case of contributions combined in the self-employed worker pension fund.[204] On the other hand, significant changes would emerge if the rejection rate for applications submitted in 2020 turned out to be less than 14 per cent. If, for example, the rate were 10 per cent, the reduction in spending in 2020 would amount to about €1.9 billion (about €50 million less).

The magnitude of the estimated expenditure savings for 2020 could increase to the extent that, as already seen for 2019, some applications filed in 2019 actually referred to pensions starting in 2020 or later. In the former case, pension payments would number only 6.5 instead of 12; in the second case, there would be no monthly pension payments in 2020. These reasons for a possible downward revision of the estimated expenditure (and the increase in estimated savings) are set against many other factors that would produce an upwards revision: in addition to the possibility noted earlier that the rejection rate might be less than 14 per cent (nothing rules out the possibility that in 2020 it might also be lower than 10 per cent), the average number of monthly pension payments received by pensioners who postpone retirement from 2019 to 2020 could be greater than 6.5 and the propensities to postpone to the second year may be larger than those extrapolated from the 2019 data.

Estimated expenditure in 2021

It is possible to estimate, albeit with a much higher degree of uncertainty, any *"Quota 100"* expenditure for 2021. However, this quantification requires the formulation of a preliminary estimate of the number of *"Quota 100"* pensioners divided, this time, into three different categories:

1) the first category is made up of all those who retired under the "*Quota 100*" mechanism in 2019 and 2020 (divided between private-sector employees, the self-employed and public-sector workers) and who will receive a pension for the entire year in 2021 if they survive;

2) the second category includes those who, despite meeting the requirements in 2019 or 2020, decide not to retire in either of those years. To estimate their number, the analysis takes the difference between the total number of "Quota 100" pensions estimated by the Technical Report as at December 2020 and the total produced with the PBO estimation at the same date. To these differences in the stock various retirement assumptions can be applied in 2021. For the purposes of the estimation, we take a range with two extremes and a central value: *a)* no-one retires (i.e. those who postpone to 2021 are in fact not

[204] The reduction in spending would amount to just under €2.1 billion.

interested in the "*Quota 100*" option; *b)* private-sector employees retire with a propensity of 40 per cent and public employees at one of 45 per cent (the percentages given in the Technical Report for the years following the first); c) everyone retires at the average propensity registered at the end of 2019 extrapolated to the entire year (about 65 per cent on average for the three age brackets). Once again, the analysis also assumes a rejection rate of 14 per cent for pension applications (10 per cent in the sensitivity analysis scenario) and that those retiring in 2020 will receive 6.5 months of benefit payments (i.e. that the start of pension payments is distributed uniformly across the months of the year). Depending on the extent to which the average duration of payments (monthly instalments) exceeds that, expenditure in 2021 would be underestimated and, consequently, the reduction in expenditure compared with the figures given in the Technical Report would be overestimated;

3) the third category consists of those who meet the requirements for the *"Quota 100"* programme for the first time in 2021. This analysis approximates their number as the flow of new pensioners in 2021 (the difference between the 2021 and 2020 stocks given in the Technical report), net of those who, despite meeting the requirements in 2019 or 2020, decide to postpone retirement (the flows estimated in point 2 above). It is also assumed that this cohort actually decides to retire with the propensity observed in 2019 for the younger age group (no older than 63) and that the application rejection rate remains 14 per cent (10 per cent in the sensitivity analysis scenario). Finally, it is assumed that these pensioners receive an average of 6.5 monthly pension payments as a result of the assumption that the marginal cohorts have a uniform distribution by month in which their pension begins.

To quantify expenditure for the "*Quota 100*" programme in 2021, the sizes of the groups so estimated are multiplied by gross annual benefits for 2021 equal to those given in the Technical Report accompanying Decree Law 4/2019 separately by pension fund to which the beneficiaries belong.

On the basis of these assumptions, in 2021 the number of *"Quota 100"* pensioners could exceed 277,000, about 16 per cent fewer than the figure reported in the Technical Report accompanying Decree Law 4/2019 (330,000): over 127,000 private-sector employees, over 70,000 self-employed and just over 80,000 public employees. If, however, those who postponed retirement in 2019 and 2020 elected not to retire under the *"Quota 100"* mechanism at all, pensioners would number slightly more than 260,000 (-21 per cent). If, conversely, those who postponed retirement under the *"Quota 100"* mechanism in 2019 and 2020 were to retire in 2021 with the propensity observed in

2019 on average for the three age groups reported by INPS (65 per cent), then at the end of 2021, the number of pensioners could exceed 291,000 (-11.6 per cent).[205]

Expenditure would amount to about €6.7 billion, some €1.1 billion less than the figure given in the Technical Report accompanying Decree Law 4/2019 (a reduction of about 14.1 per cent). If none of those who postponed retirement under the *"Quota 100"* programme in 2019 and 2020 should retire in 2021, spending would be close to €6.5 billion, €1.3 billion less than expected (a reduction of about 16.7 per cent). If, on the other hand, these same individuals do retire under *"Quota 100"* in 2021 at the average rate observed in 2019, expenditure would amount to over €6.8 billion, about €0.9 billion less than envisaged in the Technical Report (a decrease of 12.1 per cent).[206]

Unlike in previous years, in 2021 the estimates appear to be more affected by the decision to distribute pensioners who combine contributions among private-sector employee pensions funds, public employee funds or self-employed worker funds (this choice has effects that accumulate and increase over the three-year period). Furthermore, significant changes would result if the application rejection rate turned out to be less than 14 per cent. If, for example, the rate were 10 per cent in both 2020 and 2021, the three previously estimated values for expenditure savings in 2021 would decrease by about €0.1 billion each year (€1 billion compared with €1.1 billion; €1.2 billion compared with €1.3 billion; €0.8 billion compared with €0.9 billion).

In conclusion, comparing the new official estimates of the increase in expenditure produced by the *"Quota 100"* system against those of the PBO essentially brings out three factors that recommend prudence in estimating the possible expenditure savings, especially for 2021 (Table 3.17).

First, if the application rejection rate ultimately proves to be 14 per cent, the estimated cost savings indicated in the Update and the Budget Bill would be sufficiently plausible for the first two years and shifted towards the upper limit of the range estimated by the PBO for 2021. It should be noted, however, that the estimated savings in the Update and the Budget Bill refer to both the *"Quota 100"* programme and early retirement with a freeze on life expectancy adjustments (Articles 14 and 15 of Decree Law 4/2019), while those estimated by the PBO only regard *"Quota 100"*.[207]

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[205] If all those who did not retire under the "Quota 100" mechanism despite having met the requirements in 2019 or 2021 were to retire under the system in 2021, at the end of 2021 the number of beneficiaries could exceed 313,000 (a decrease of 4.9 per cent on the number provided for in the Technical Report).

[206] If all those who did not retire under the "Quota 100" mechanism despite having met the requirements in 2019 or 2021 were to retire under the system in 2021, at the end of 2021 expenditure would be close to €7 billion, about €690 million less than provided for in the Technical Report (about -8.9 per cent).

[207] The savings reported in the Budget Bill could be almost entirely accounted for by *"Quota 100"*, with only a very small portion associated with the ordinary early retirement mechanism. Even if increased not by five months but by three, the requirement for early retirement remains high (41 years and 10 months of contributions plus three months of flexible pension window for women and 42 years and 10 months plus three months of flexible pension window for men), and it is likely that the propensity to opt for this

Table 3.17 – Smaller spending increases connected with *"Quota 100"* mechanism and freeze on life expectancy adjustment for early retirement pensions (1)
(millions of euros)

	Reduction in additional spending for Q100 and freeze on life-expectancy	Reduction in additional spending for Q100			
	Post 2020 Budget Bill	PBO (rejection rate = 14%)		PBO (2019 rejection rate = 14%; 2020-2021 rejection rate = 10%)	
2019	1,200	1,190	1,270	1,190	1,270
2020	2,000	1,960	2,080	1,910	2,040
2021	1,300	940	1,420	840	1,200

Source: based on 2019 Update and technical reports accompanying Decree Law DL 4/2019 and the Budget Bill.
(1) For each combination of year and rejection rate, the estimation range for the decrease in spending depends on two groups of assumptions: 1) the pension fund to which *"Quota 100"* pensioners who combine contributions to multiple funds are allocated; 2) the propensity with which those who did not participate in the *"Quota 100"* programme in 2019 or 2020 decide to use this mechanism in 2021. The extremes of the range correspond to the lowest and largest values for the various combinations of the assumptions.

Second, if the ultimate rejection rate for 2020-2021 should turn out to be lower, the savings would tend to decrease. At 10 per cent instead of 14 per cent, for example, in 2020, the savings would fall by around €50 million, while in 2021 they would decrease by around €100 million and, above all, they would be less than official estimates. In this regard, it should be borne in mind that in the first year of the *"Quota 100"* trial, rejections may have been relatively more frequent owing to a lack of understanding of the new retirement option. Accordingly, it cannot in principle be ruled out that eligible applications may therefore increase as a proportion of the total over the next two years.[208]

Finally, note that the possibility of savings falling below the official estimates increases over the three-year period. In 2021, it is possible that those who had not retired under the *"Quota 100"* mechanism, despite already qualifying, for various reasons (the reduction in pension benefits, the absolute value of benefits, subjective and personal factors, etc.) could decide to retire. This is a sort of threshold/discontinuity effect that the PBO estimates attempt to capture by assuming an average propensity to retire under the *"Quota 100"* programme of 65 per cent for all those who according to the Technical Report accompanying Decree Law DL 4/2019 should have already retired at

mechanism as soon as possible is close to 100 per cent, unchanged from that observed in previous years. In this regard, it is significant that the Technical Report accompanying Decree Law 4/2019 specified the propensities to retire with the *"Quota 100"* system (in the first year individuals would become eligible and then in subsequent years), but did not specify the propensity to retire under the system for early retirement with a freeze on life expectancy adjustments (implicitly assuming that the trend would not change).

[208] As noted already, a reduction can be perceived in a comparison of the INPS monitoring data from June and October 2019. In June the rejection rate (calculated net of pending applications) was 15.5 per cent, while in October it was 14.7 per cent. Note, however, that at 31 October more than 42,000 applications, more than a fifth of those received, still had not been assessed.

the end of 2020 and that the trends emerging from the data for 2019 and extrapolated to 2020 would instead maintain at work.[209]

The threshold/discontinuity effect could be amplified if workers perceived a risk of further legislative changes that might reduce/eliminate access to the "Quota 100" mechanism in the years after 2021 for those maturing the requisites by that year[210] or that could even marginally lengthen the time to reach ordinary retirement channels.[211]

[209] The scenario with the least savings would be the theoretical case in which these individuals decided to retire in 2021. In this circumstance, the reduction in expenditure would not exceed €600 million (less than half the official estimate).

[210] At the end of 2021, someone who in 2019 had turned 62 and had 38 years of contributions would have to wait three years to meet the requirements for an old-age pension and two/three years to meet those for early retirement.

[211] An effect of this type could emerge also in the transition from 2019 to 2020, especially in the light of the debate on possible restrictive amendments of the *"Quota 100"* system, as urged also by international observers such as the OECD. In other words, the threshold/discontinuity effect could manifest itself as soon as 2020, offering an additional reason to be conservative in estimating the reduction in expenditure. More generally, in the coming two years, the uncertainty surrounding spending connected with the *"Quota 100"* mechanism will depend on the combination of two parameters that are difficult to forecast: the rejection rate for applications and the share of those who, despite having met the requirements during the year or in previous years, decide to retire by the end of 2021.

3.7 *Measures for healthcare*

The budget package contains measures affecting the Health Pact, the "superticket" co-payment and healthcare facilities construction.

The Tax Decree shifts the deadline to achieve an agreement on the 2019-2021 Health Pact, which has not been reached within the State-Regions Conference, from the end of March to the end of December 2019. Under the provisions of the 2019 Budget Act, such agreement is a requirement for an increase in the funding of the National Health Service (NHS) of €2 billion in 2020 and €3.5 billion in 2021 from its 2019 level (€114.5 billion). The Pact must contain various planning and improvement measures for the quality of care and services and must increase the efficiency of the system, including a review of co-payment mechanisms in order to foster greater fairness of access.

Other issues to be addressed with the Health Pact include: 1) compliance with national and regional planning obligations, in the context of the reorganisation of healthcare delivery networks, with specific attention to chronic diseases and waiting lists; 2) an assessment of staffing requirements for training and hiring purposes, reviewing the relative standards; 3) the implementation of the interconnection of information systems to track patients' diagnostic and treatment programme; 4) the promotion of research; 5) the enhancement of the efficiency and appropriateness of public healthcare output and the consolidation of programming in the use of accredited providers (with the monitoring and control of results), with possible updating of the expenditure ceiling for the latter; and 6) the assessment of infrastructure requirements for technological modernisation.

Pending the review of the co-payment system in implementation of the Health Pact, the Budget Bill provides for the elimination as from September 2020 of the fixed €10 co-payment per prescription for outpatient specialist care services (the so-called "superticket")[212] – provided for in Law 296/2006, but actually applied since July 2011 – as well as alternative measures adopted by certain regions that would in any case have had an equivalent financial impact. At the same time, the Superticket Reduction Fund, introduced with Law 205/2017 (the 2018 Budget Act), is gradually being defunded.

Over time, the application of the superticket has become highly varied: some regions apply the fixed €10 fee, while others have adjusted the amount and yet others have introduced alternative measures. More specifically,[213] the Autonomous Province of Bolzano and the regions of Basilicata[214] and Sardinia do not apply any superticket; Valle d'Aosta only requires it for services costing more than €20 and the Autonomous Province of Trento has set it at €3. One group of regions (Piedmont, Lombardy, Friuli-Venezia Giulia) adjusts the amount of the co-payment based

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[212] The superticket is levied on top of the co-payment covering the cost of the service up to a maximum of €36.15 per prescription (up to eight services in the same specialist branch, excluding physiotherapy, can be prescribed with a single prescription). Some regions have modified the ceiling on the deductible. More specifically, Lombardy and Friuli-Venezia Giulia have set it at €36, the Marche at €36.20, Tuscany at €38, Calabria at €45 and Sardinia at €46.15.

[213] See Ragioneria Generale dello Stato (2019), "Il monitoraggio della spesa sanitaria, n. 6"; the information is updated to June 2019.

[214] The Basilicata region has implemented alternative measures for pharmacy distribution. According to the Technical Report, the other regions that have implemented measures for pharmaceuticals are Emilia Romagna, Tuscany and Umbria.

on the cost of the prescription, while another group (Veneto, Emilia Romagna, Tuscany and Umbria) considers patients' income in more or less complex ways that in certain cases also consider the type of service involved; the remaining regions (located in the Centre and the South and Liguria) apply the fixed €10 co-payment.[215]

Using Health Card System data for 2018, the Technical Report estimates that the provision will require an increase in central government funding of the NHS of €185 million for 2020 and €554 million starting from 2021, partially financed by the defunding of the Superticket Reduction Fund envisaged in the 2018 Budget Act (€20 million and €60 million respectively).[216] The aim of the measures is to increase the equity of access to services and the uniformity of co-payment systems at the territorial level.

Many observers believe that the superticket has also driven demand towards the private sector or prompted patients to forgo care.[217] The Technical Report estimates about 57.3 million outpatient specialist care prescriptions for non-exempt persons in 2018, corresponding to revenue of €573 million from the fixed €10 fee, compared with €834 million expected at the time the superticket was introduced. If the measure stimulates a recovery in the demand for services from the public sector, further organisational measures will probably be needed to ensure the appropriate planning of services and to prevent waiting lists from growing longer. Some costs may have to be borne by public healthcare facilities, but at the same time co-payment revenue could be higher than expected.

The Budget Bill also increases appropriations for the long-term healthcare construction and technological modernisation programme – introduced in 1988 and subsequently revised and refinanced, including with last year's Budget Act – from €28 billion to €30 billion. The long-term funding will cover the years 2022-2032 (€100 million in the first two years and €200 million subsequently). At the same time, continuing the common practice in recent years of postponing funding to future years, resources previously allocated for healthcare construction have been postponed, shifting €400 million from the appropriation for 2020 and €1,420 million from that for 2021 to years subsequent to 2022.

Note that the long-term programme provides for the signing of programme agreements and that resources are transferred in line with the state of progress of works. At the end of 2018,

[215] Campania, Calabria and Sicily have established additional fees in either a fixed amount or proportional to the value of the prescription, while Molise levies other co-payments on certain services.

[216] The Health Card System reports the revenue generated by the fixed €10 co-payment (€158.8 million), that from alternative measures connected with specialist services (€273.4 million) and that from co-payments for pharmaceuticals distributed through pharmacies introduced in place of the superticket (€43.5 million). It does not report the effects of other measures that have been adopted (co-payments on non-urgent emergency room care, the adjustment of fees in areas such as prevention and the private provision of medical services within NHS facilities). For the latter measures, the regions have to ensure that the revenue generated is equal to that of the superticket, so the cost of abolishing the superticket is estimated as equal to the number of exempt prescriptions multiplied by 10.

[217] With fixed costs that cannot be easily reduced and payment mechanisms for accredited facilities based on predefined budgets, the reduction in services provided by the NHS does not necessarily ensure a comparable reduction in public spending and iimplies a decline in co-payment revenue. With regard to the efficiency and equity aspects of the superticket mechanism, see Ufficio parlamentare di bilancio (2017), "L'emendamento per la riduzione del *superticket*", 28 December.

agreements signed numbered 84, for a total of about €11.6 billion out of the €15.3 billion in available funding (an increase of €400 million compared with the previous year[218]), of which only €10.7 billion received funding.[219] The regions using all of the resources available to them under the agreements are: the northern regions, except Piedmont (which absorbed about 87 per cent of total available funding) and the Autonomous Province of Trento (77 per cent); the central regions (the Marche posted a percentage of 99.9 per cent) except Lazio (75 per cent); and Basilicata. For the other southern regions, the shares of total funding absorbed fluctuate between 57 per cent in Calabria and 21 per cent in Molise. As for the next phase, the group of regions that have obtained approval for funding of all (or almost all) the resources envisaged in the programme agreements is smaller and geographical distribution differs. These include the special statute regions, excluding the Province of Bolzano, which registers the lowest percentage in Italy (59 per cent), Lombardy (97 per cent), Emilia Romagna (95.9 per cent), the Marche, Abruzzo (99.7 per cent), Molise, Puglia and Calabria (97 per cent). The shares of other regions fall between 70 and 95 per cent.

In May 2019, an agreement was reached in the State-Regions Conference for the allocation of the €3.975 billion appropriated in last year's Budget Act to strengthen the special healthcare investment programme (net of €25 million appropriated for the National Oncological Hadron Therapy Centre) and a further €720 million previously appropriated (Law 191/2009) and still to be allocated. Of these resources, €60 million have been earmarked for the construction of six centres of excellence dedicated to innovative CAR T-Cell cancer therapy and €635 million have been set aside for urgent projects, including a spending authorisation of approximately €82 million for the technological modernisation of the Calabrian health service provided for under the so-called "Calabria Decree" (Decree Law 35/2019). The €4 billion distributed to the regions have been allocated on the basis of their share of the national healthcare fund on current account, taking account of the exclusion of the autonomous provinces of Trento and Bolzano,[220] and can be used for programme agreements.

Part of the funding already appropriated but not yet distributed among the regions, amounting to almost €236 million (the result of an estimate of the borrowing requirement given in the Technical Report), has been earmarked for grants for the acquisition of medical equipment for general practitioners (with ownership remaining with local health authorities). The funding will be distributed among the regions on the basis of a requirements plan (which will have to comply with a set of parameters, established with a decree of the Minister of Health to be adopted by the end of next January after agreement within in the State-Regions Conference). The goal is to shift the delivery of certain services away from health service facilities, shorten waiting lists and facilitate the local provision of services, including through home visits or remotely (thanks to digital and ICT technologies), by general practitioners.

In order to enable the resumption and completion of works already begun (and already financed) for renovation projects needed to permit the supplementary professional activity of National Health Service staff within the public health facilities where they are

[218] Regarding the regions of Piedmont and Campania.

[219] In addition, institutes for science-based care and research, experimental veterinary institutes and directly-operated university-affiliated hospitals had reached agreements with a value of €862.4 million out of the €886.4 million available, and €765.4 million were approved for funding.

[220] Pursuant to Law 191/2009 amending Law 386/89 for the coordination of the finances of the Region of Trentino-Alto Adige and the Autonomous Provinces of Trento and Bolzano with the reform of the tax system.

employed (intramoenia regime), the Budget Act extends the deadline for inspection and approval of the works, which had expired at the end of 2014, to the end of 2021.

A photograph of the current investment needs in the NHS is provided by the survey on the state of the healthcare facilities conducted in 2018 by the Ministry of Health and the regions. The overall funding requirement for upgrades was estimated at €32 billion, of which some €12 billion for works in areas exposed to the greatest seismic risk. Using data from the Ministry of Health, the Court of Auditors[221] determined that of the investments to be carried out between 2019 and 2045, 52 per cent regarded regions in the North, 12 per cent regarded regions in the Centre and 36 per cent involved those in the South. Of the total, 38 per cent involved regions subject to a financial recovery plan. The Court of Auditors also noted that an analysis of requirements for investment in new technologies initiated in 2017 found a need for about €1.5 billion in spending for 2018-2020 (relating to almost 1,800 devices), of which €1.1 billion for replacements (connected with equipment obsolescence) and the remainder for upgrading technology. Of the total requirement, 43 per cent regarded regions in the North, 17 per cent those in the Centre and the remaining 40 per cent those in the South. Of the total, 43 per cent regarded regions involved in a recovery plan.

[221] Corte dei Conti (2019), “Rapporto sul coordinamento della finanza pubblica”.

3.8 Measures for public investment

The budget package contains a range of measures concerning investment expenditure and investment grants, which also involve appropriations for the current year. Overall, in terms of general government net borrowing, the resources earmarked for these purposes have been reduced by more than €500 million for 2019 and by more than €1.1 billion for 2020, while they have been increased by about €0.9 billion in 2021 and €2.7 billion in 2022 (Table 3.18).

The reductions in the appropriations on an unchanged legislation basis in the second section of the Budget Bill, containing provisions for the refinancing, defunding and reprogramming of existing measures, have the greatest impact on 2020. In terms of impact on the State budget's net balance to be financed (*saldo netto da finanziare*), the most significant measures involve the Development and Cohesion Fund (DCF, which was cut by more than €750 million), measures to rationalise expenditure (about €500

Table 3.18 – The main capital account measures
(millions of euros)

	2019	2020	2021	2022
Overall impact of budget measures on investment expenditure	**-546**	**-1,157**	**890**	**2,673**
Measures in DL 124/2019 (reduction in ministry capital expenditure)	-546	-10		
Measures in Budget Bill , of which:		-1,147	890	2,673
Section I (new spending provisions)		*568*	*1,706*	*3,417*
Central Government Investment Fund		112	400	767
Construction of Line 2 of Turin underground		15	50	100
Grants to municipalities for energy efficiency and sustainable development projects		235	400	500
Extension of grants to municipalities for securing buildings and territory				200
Grants to municipalities for investments in urban regeneration and improving the quality of urban, social and environmental conditions				300
Grants to municipalities for design costs connected with projects to counter hydrogeological risks, energy efficiency of schools, public buildings and other municipal assets as well as road safety			78	170
Funding of projects to upgrade road safety and energy efficiency of schools			50	250
Extraordinary maintenance programme for road network of provinces and metropolitan areas			50	250
Healthcare facility building and technological modernisation				100
Fund to develop research by universities, and public and private research institutes		15	100	310
Support for research - Aerospace Research Agency		10	200	210
Use of accumulated surpluses for local governments running a deficit - ordinary statute regions		155	312	120
Other investment spending		29	66	140
Reductions in investment spending		-3	0	0
Section II (Refinancing, defunding and reprogramming of current legislation)		*-1,715*	*-816*	*-744*
Increases in investment spending (extension of 2016 earthquake state of emergency and other)		435	250	365
Reductions in investment spending (defunding of DCF, rationalisation of spending, healthcare building and other)		-2,150	-1,066	-1,109

Source: based on data drawn from the financial schedules attached to the 2020 Budget and Decree Law 124/2019.

million, mainly borne by central government departments) and the reprogramming (i.e. postponement) of resources for healthcare construction (€400 million), a number of investment programmes managed by the Ministry of Defence (€200 million) and capital transfers to the Italian State Railways and ANAS, the national road agency (respectively, €400 million and €200 million). Conversely, the Budget Bill refinances spending related to the extension of the state of emergency following the earthquake that hit the regions of central Italy in 2016 (€345 million).

The overall impact on investment of the measures contained in the second section of the budget bill is a negative €1.7 billion in terms of net borrowing in 2020, and remains negative in the following two years (-€0.8 billion and -€0.7 billion, respectively, in 2021 and 2022), mainly due to the profile of the measures for the defunding of the DCF, the rationalisation of spending, healthcare building and capital transfers to the State Railways.

Conversely, the new measures relating to investment contained in the first section of the Budget Bill almost all produce an increase in spending, with an impact on net borrowing of €0.6 billion in 2020, €1.7 billion in 2021 and €3.4 billion in 2022.

One of the most significant measures is the establishment of a Fund for the Revival of Central Government Investment (Article 7), with an impact on the general government accounts of about €110 million in the first year, €400 million in the second and €770 million in the third. The measure provides for appropriations until 2034, with an overall impact for the entire 2020-2034 period of over €22 billion. The fund is intended to finance investment to enhance environmental sustainability (reducing emissions, increasing energy efficiency) and, more generally, to boost innovation.

This fund has the same characteristics as the one of the same name established with the 2019 Budget Act. Similarly, the fund is to be allocated with one or more Decrees of the President of the Council of Ministers (Prime Ministerial Decrees) – to be adopted by 15 February 2020 and submitted to Parliament for assessment by the competent committees – formulated on the basis of programmes proposed by central government departments. In order to encourage the timely use of resources, those decrees shall also specify the criteria and procedures for the withdrawal and reallocation of resources not used within 24 months of their assignment (6 months longer than the period envisaged for the fund established last year). The measure also provides for specific monitoring tools, with each ministry required to report on the status of the respective investments and the state of use of the funding by September 15 of each year, indicating the main critical issues found, within a special section of the Annual Report on the state of progress of measures relating to the fund to finance investment and infrastructure development.

As regards the use of the fund established last year (€42.7 billion of appropriations in 2019-2033, although part of this was used to fund other measures approved during the year), the draft Prime Ministerial Decree allocating the resources was submitted last April, receiving the favourable opinion (with comments) of both branches of Parliament in early June. The decree was approved on 11 June, allocating 37.7 per cent of resources to the Ministry of Infrastructure and Transport

(MIT), 16.8 per cent to the Ministry of Economic Development (MISE), 13.6 per cent to the Ministry of Defence and 9.4 per cent to the Ministry of Education, Universities and Research (MIUR), with smaller percentages going to other departments. The ministerial decree making the associated amendments to the State budget was approved on 4 October. This timeline suggests that the resources have probably not yet been actually used.

Article 7, paragraph 3, appropriates almost €830 million (resources in addition to those in the fund) for 2020-2032 for the construction of Line 2 of the Turin underground, whose feasibility study was approved in 2014, with an overall estimated cost of around €3.7 billion.

Other provisions envisage a series of investment grants for local authorities (Article 8), municipalities in particular. The most significant in terms of impact on net borrowing over the three-year period (€235 million in 2020, €400 million in 2021 and €500 million in 2022) is a programme of grants for each municipality based on the resident population (from €5,000 for municipalities of up to 5,000 inhabitants to €250,000 for municipalities with at least 250,000 inhabitants) for small-scale investments in public works in the field of energy efficiency and sustainable territorial development.

By 10 February 2020 the Ministry of the Interior shall notify each municipality of the grant available to it, with the beneficiary municipalities required to begin execution of the works by 15 September of the year to which the grant refers and to allocate these resources for works that are not already fully financed by other entities and that are additional to the works to be started in the first year of the three-year public works programmes. Drawing on information in the public works monitoring system provided for by Legislative Decree 229/2011, the ministry will assess compliance with these requirements, violation of which shall result in the full or partial restitution (by 31 October of each year) of the amounts not used and their reallocation to other beneficiary municipalities (which must use them by March 15 of the following year) on the basis of the speed with which they use the resources assigned to them. Although the measure seeks to ensure the rapid and complete employment of resources, due consideration must be given to the risk that this mechanism will end up further penalising those municipalities that, in the absence of adequate administrative arrangements for managing investment spending, are already experiencing significant lags.

In this regard, it should be recalled that in 2018 three new bodies were established to support local governments in planning and implementing public investments: (i) the “Strategia Italia” Control Room, provided for in Decree Law 109/2018 (the “Genoa Decree”) and established with the Prime Ministerial Decree of 15 February 2019. The body is composed of the Prime Minister and selected ministers and is charged with verifying the state of implementation of infrastructure investment programmes and territorial risk mitigation measures; (ii) the “Office for the design of public assets and buildings”, provided for in the 2019 Budget Act. According to the website of the Office of the Prime Minister’s, the unit was established with the Prime Ministerial Decree of 15 April 2019, but the text has not been published in the *Gazzetta Ufficiale*; and (iii) the “InvestItalia” unit provided for in the 2019 Budget Act, operating directly under the Prime Minister, established with the Prime Ministerial Decree of 15 February 2019. A call for applications for personnel was published, but with the resignation of the previous Government, the unit, which was temporary, has lapsed as provided for in the law.

For the years 2025 to 2035, the Budget Bill also establishes a fund in the budget of the Ministry of the Interior, with resources of €400 million per year, to support investments for the development of sustainable municipal infrastructure.

In other measures concerning municipalities, the appropriations for public works to upgrade the safety of buildings and the territory established in the 2019 Budget Act have been extended to 2034 and increased from €4.9 billion to €8.8 billion overall between 2021 and 2034, including projects to enhance the energy efficiency of buildings among eligible initiatives (albeit with a low priority) and disqualifying municipalities who have received a grant in one of the two previous years from receiving a grant in a given year.

For the same time horizon (2021-2034), additional grants will be made for investments by municipalities in urban regeneration projects aimed at reducing marginalisation and social dislocation, improving the quality of urban conditions and the social and environmental fabric. In this case, the impact on the general government accounts is just €300 million in 2022, but the total appropriation gradually increases from the €150 million planned for 2021 to €700 million per year from 2025 to 2034, for a total of €9.1 billion in 2021-2034, which will be allocated, managed and monitored in accordance with procedures be defined in a Prime Ministerial Decree in early 2020.

In order to facilitate the effective use of resources for certain types of investments by municipalities, the Budget Bill also provides for grants specifically intended to cover the costs of final and executive design work for projects to secure areas exposed to hydrogeological risk and the road network, as well as upgrading the safety and enhancing the energy efficiency of schools, public buildings and other municipal assets. Appropriations for this type of grant have also been included through 2034, with an impact on net borrowing in 2021-2022 of about €250 million.

Other measures in favour of local authorities concern: (i) grants to provinces and metropolitan areas – in part already envisaged in the 2018 Budget Act – for extraordinary maintenance and safety upgrades of the road network and the extraordinary maintenance and energy efficiency enhancement of schools (for a total in terms of net borrowing of €100 million in 2021 and €500 million in 2022); (ii) the establishment of a fund (with resources of €100 million per year from 2021 to 2023 and €200 million per year until 2034) to finance public works for the safety upgrading, renovation or construction of buildings owned by municipalities intended for childcare facilities and (iii) an increase – starting from 2023 – in the resources that the 2019 Budget Act allocated to the ordinary statute regions for public works for the safety upgrading of buildings and the territory, or for projects involving to the road network, urban regeneration, energy conversion and social infrastructure.

Taken together, the planned measures increase budget appropriations for local authority investment by a total of over €30 billion between 2020 and 2034, with an impact on net borrowing in 2020-2022 of about €2.6 billion overall.

Territorial governments are also affected by the measure that, for ordinary statute regions, brings forward by one year the right to use surpluses and the restricted long-term revenue and expenditure fund to achieve budget balance, introduced with the

2019 Budget Act for all other local authorities following two rulings of the Constitutional Court on the matter.[222] The Technical Report estimates the impact on net borrowing of this provision at €155 million in 2020, €312 million in 2022 and €120 million in 2022 (please see section 3.8).

Although they have no effect on net borrowing, other measures include the appropriation of resources to support investment and other operations (including in partnership with the private sector) to pursue financial sustainable projects with objectives such as the decarbonisation of the economy, the circular economy, urban regeneration. The initiative (the "Green New Deal") involves the establishment of a fund to be allocated (with appropriations of €470 million for 2020, €930 million for 2021, and €1.4 billion for each of 2022 and 2023), financed out of the proceeds from the sale of CO_2 emission allowances, to be used to provide guarantees for consideration or to participate in the equity or debt capital of projects in these areas.

As regards investment in research, a fund has been established in the budget of the MIUR to support research conducted by universities, public and private research institutions and institutes. The same measures also provides for the establishment of a National Research Agency (NRA), a body responsible for pursuing the aims of the fund (performing functions connected with coordinating, policy-making and supporting the internationalisation of research activities) and therefore managing resources, quantified in terms of net borrowing, of €15 million in 2020 and €300 million per year when fully operational (starting from 2025).

In addition, the Budget Bill provides for additional funding of about €400 million a year from 2020 to 2024 (drawn from the fund for the revival of central government investment allocated with the Prime Ministerial Decree of last June) to finance space programmes at the national level, in international cooperative initiatives and within the European Space Agency. The impact on net borrowing will be €10 million in 2020 and around €200 million per year in the following two years.

Finally, while the second section of the Budget Bill reprogrammes resources appropriated for construction of healthcare facilities and technological modernisation in a manner that significantly reduces funding under the chapter in 2020-2021, a measure in the first section helps refinance that expenditure as from 2022 (€100 million in each of the first two years and €200 million in subsequent years through 2032) for a total of €2 billion, to be allocated primarily to the regions that have finished the resources

[222] For a more detailed discussion, see Ufficio parlamentare di bilancio (2019), "Gli avanzi spendibili degli Enti territoriali a seguito delle nuove regole sul pareggio", Focus Paper no. 3.

appropriated in the 2019 Budget Act.[223] For more information on the use of these resources, see section 3.7.

3.8.1 *Ordinary capital account spending in Southern Italy*

In order to support the southern regions and narrow regional disparities, the 2020 Budget Bill strengthens the criterion for allocating resources for ordinary capital expenditure on the basis of population.[224]

The funding earmarked for public capital expenditure in the South (and in the rest of Italy) can be divided into ordinary resources and additional resources, including both EU funds (European Structural Funds and associated national co-financing) and national resources (Development and Cohesion Fund). The additional resources are allocated mainly, but not exclusively, to the South.

The allocation of ordinary resources should comply with the principle of equity, so that citizens, regardless of the area of the country in which they live, potentially have access to an equivalent amount of resources, while the allocation of additional resources is intended to narrow any existing gaps, implementing Article 119, fifth paragraph, of the Constitution.

A third source of funding for capital expenditure is represented by national public enterprises (NPEs) and local public enterprises (LPEs). These are central or local enterprises that produce public services and are controlled directly or indirectly by public entities, but are not part of general government. For the purpose of monitoring expenditure at the territorial level, the Regional Public Accounts system of the Territorial Cohesion Agency is used to construct a second aggregate, called the extended public sector, which in addition to general government entities includes non-general government entities comprising the NPEs, including Leonardo and Enel, and about 4000 LPEs.[225]

Since the 1990s, with the adoption of the "new programming" paradigm,[226] programming documents have allocated a specific share of ordinary central government capital expenditure to the South.

In the Economic and Financial Planning Documents (EFPDs) following the 2000-2006 Structural Funds programming cycle, this target was set at 30 per cent of ordinary resources and 45 per

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223 Recall that the 2019 Budget Bill, while increasing funding by €50 million for the first year in the first section, also reprogrammed resources on an unchanged legislation basis, postponing appropriations of about €1.4 billion from 2020 to 2021.

224 Article 34 of the 2020 Budget Bill.

225 The Regional Public Accounts (RPA) system of the Territorial Cohesion Agency provides an estimate of public spending and revenue on a regional basis, as well as an estimate of the breakdown of ordinary and additional resources. The data in the Regional Public Accounts are stated on a cash basis: expenditure flows are mainly reconstructed on the basis of the final accounts of the entities considered. Note that there are discrepancies between methodological criteria used by Istat and those adopted by the RPA. More specifically, the list of general government entities covered by the RPS system does not coincide with list S13 of Istat. For a more extensive discussion of the differences between the two methodologies, see: Ufficio parlamentare di bilancio (2017), "Audizione del Presidente dell'Ufficio parlamentare di bilancio in merito alla distribuzione territoriale delle risorse pubbliche per aree regionali", 22 November.

226 Ministero del Tesoro, del bilancio e della programmazione economica (1999), "Politiche per lo sviluppo del Mezzogiorno. Primo rapporto".

cent of total resources. Starting with the 2009-2011 EFPDs, this policy objective has no longer been specified in programming documents.[227]

The 2005 Finance Act (Law 311/2004, Article 1, paragraph 17) established that "[...] central government departments shall comply with the objective of allocating at least 30 per cent of ordinary capital expenditure to the South. Central government departments, in the exercise of their shareholder rights in respect of corporations with predominantly public direct or indirect ownership, shall adopt appropriate directives to comply with the principles referred to in this paragraph". The law acknowledged that the investment policies of public enterprises can contribute to reducing territorial disparities, enhancing the action of the State.

An initial version of the population criterion was introduced in 2016,[228] with a measure that requires an assessment, as from the 2018 Budget Act, of whether and to what extent central government departments have complied with the objective of allocating to projects in the territories of the eight southern regions a total annual volume of ordinary capital appropriations proportional to their population, or in accordance with some other criterion relating to specific critical issues, with regard to the capital expenditure programmes identified annually with a directive of the Prime Minister. The 2016 measure essentially provides for the monitoring of certain spending programmes identified each year. The share of the southern population was 34.1 per cent in 2018, a decrease on previous years (it was 36.2 per cent in 2000), due in part to the effects of the resumption of migration to other Italian regions.

The rationale for the reintroduction in 2016 of a measure on the principle of territorial rebalancing of ordinary public capital expenditure appears lie in the fact that in previous years the additional resources allocated to cohesion policy appear in fact to have partially replaced ordinary resources for the South. The partial displacement of ordinary expenditure therefore required that the ratio between ordinary and additional funding be rebalanced, in part to re-establish compliance with the principle of additionality, according to which the resources of the European Structural Funds may not replace the public expenditure of the Member State.[229]

Using data from the Regional Public Accounts system,[230] Table 3.19 presents capital expenditure (ordinary and additional) from 2000 to 2018 by the general government aggregate for the entire country and two macro areas. The table reveals a number of interesting developments:

1) the drastic fall in general government capital expenditure (ordinary and additional) for the entire country following the 2008 crisis. Compared with the 2008 peak, spending decreased from €61.7 billion at constant prices to €34.6 billion in 2018. The downward

[227] Giannola, A. and Prezioso, S. (2017), "La clausola del «34 per cent» delle risorse ordinarie a favore del Sud: una valutazione relativa al periodo 2009-2015", Rivista economica del Mezzogiorno, a. XXXI, no. 1-2.
[228] Decree Law 243/2016, ratified with amendments by Law 18/2017. See Article 7 bis, paragraph 2.
[229] SVIMEZ (2019), *op. cit.*. The additionality principle also applies to national additional financial resources (Development and Cohesion Fund).
[230] Sistema Conti Pubblici Territoriali (CPT) – Agenzia per la Coesione Territoriale (2018), "Relazione Annuale CPT 2018. Politiche nazionali e politiche di sviluppo a livello territoriale", Temi CPT no. 7.

trend in spending after 2008 came to a halt in 2015, thanks in part to the end of the 2007-2013 Structural Funds programming cycle. In 2016 and 2017, spending resumed its downward trajectory, reaching a low of €31.3 billion in 2017. In 2018, expenditure turned upward again;

2) (ordinary and additional) general government capital expenditure in the South in 2018 was just half its level in 2008: €10.3 billion in 2018, compared with €21 billion in 2008, a larger reduction than that registered in the Centre-North;

3) the South's share of ordinary general government capital expenditure has never exceeded 30 per cent, with an annual average of 22.7 per cent between 2000 and 2018;

4) additional resources represent a large share of the total general government capital expenditure in the South, on average accounting for more than half of total capital expenditure, with the highest percentages being registered in the closing stages of the programming periods for European funds: 67.7 per cent in 2001, 59.7 per cent in 2007, 68.4 per cent in 2015. Cohesion policy, in particular that of the European Union, can be seen to have partially crowded out ordinary spending. In 2015, for example, ordinary resources (€4.7 billion) represent less than one-third of total capital account funding (€15.2 billion) and less than half of additional resources (€10.4 billion). In 2016 and 2017, due to the slow start to the 2014-2020 cycle of the European Structural Funds, the relative weight of additional resources declines;[231]

5) the share of total public capital expenditure (ordinary and additional resources) in the South reached or exceeded 40 per cent only in 2001, 2002 and 2015, with an annual average of 36 per cent in 2000-2018.

In any case, it should be noted that if ordinary capital expenditure in the South, as estimated by the Regional Public Accounts system, is lower than the level prescribed in policy or legislation, this could reflect one or more of the following factors:

1) appropriations by central government for the southern regions that are actually lower;

2) difficulties in the implementation of spending programmes by central government departments, as well as the lower administrative and spending capacity of public entities in the South;

3) different level of infrastructure and public works in the regions, which for example could make it difficult, or impossible, to allocate resources for expansion, renovation and extraordinary maintenance based on the population criterion;

[231] Sistema Conti Pubblici Territoriali (CPT) – Agenzia per la Coesione Territoriale (2018), *op. cit.*.

Table 3.19 – General government capital expenditure, ordinary and additional resources (1) (2)
(billions of euros at constant 2010 prices)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 (3)	2018 (3)	Average 2000-18
Italy																				
Capital expenditure net of financial items, of which:	56.8	59.4	61.6	59.7	61.2	57.3	57.5	59.8	61.7	61.5	52.9	48.1	43.5	40.0	35.1	36.9	34.4	31.3	34.6	
Ordinary expenditure	*42.0*	*40.1*	*47.5*	*45.7*	*46.2*	*42.7*	*42.6*	*44.8*	*48.8*	*48.0*	*42.0*	*35.7*	*32.9*	*27.7*	*25.5*	*23.2*	*30.7*	*25.8*	*28.2*	
Additional resources, of which:	*14.8*	*19.3*	*14.1*	*14.0*	*15.0*	*14.6*	*14.9*	*15.0*	*12.8*	*13.5*	*10.9*	*12.4*	*10.7*	*12.2*	*9.6*	*13.8*	*3.7*	*5.5*	6.4	
EU Structural Funds net of training	*4.0*	*5.9*	*2.7*	*4.2*	*4.5*	*4.6*	*4.3*	*4.5*	*3.9*	*4.5*	*3.1*	*4.5*	*3.9*	*4.5*	*4.4*	*7.0*	*0.4*	*0.8*	-	
Co-financing (excluding training) and CAP	*3.8*	*5.5*	*2.8*	*4.2*	*4.5*	*4.6*	*4.3*	*4.4*	*3.6*	*3.4*	*2.4*	*3.2*	*3.0*	*4.1*	*3.5*	*5.3*	*1.2*	*1.4*	-	
Under-utilised area resources	*7.0*	*7.9*	*8.6*	*5.6*	*6.0*	*5.4*	*6.3*	*6.1*	*5.3*	*5.6*	*5.4*	*4.7*	*3.8*	*3.6*	*1.7*	*1.5*	*2.1*	*3.3*	-	
Additional resources in capital expenditure *(percentages)*	**26.1**	**32.5**	**22.9**	**23.5**	**24.5**	**25.5**	**25.9**	**25.1**	**20.7**	**22.0**	**20.6**	**25.8**	**24.6**	**30.5**	**27.4**	**37.4**	**10.8**	**17.6**	**18.5**	**24.3**
Centre-North																				
Capital expenditure net of financial items, of which:	34.6	35.3	36.9	37.3	38.5	36.1	36.5	39.2	40.6	39.9	35.5	30.8	28.6	26.3	22.5	21.8	22.7	20.7	24.3	
Ordinary expenditure	*31.4*	*32.3*	*34.8*	*34.4*	*35.5*	*33.0*	*33.5*	*36.5*	*38.5*	*36.8*	*32.3*	*27.4*	*25.6*	*22.7*	*20.4*	*18.5*	*21.5*	*18.8*	*22.1*	
Additional resources, of which:	*3.2*	*3.0*	*2.0*	*3.0*	*3.1*	*3.2*	*3.0*	*2.8*	*2.1*	*3.1*	*3.3*	*3.4*	*3.0*	*3.6*	*2.1*	*3.2*	*1.1*	*1.9*	*2.2*	
EU Structural Funds net of training	*1.0*	*0.9*	*0.4*	*0.9*	*1.0*	*1.0*	*0.9*	*0.8*	*0.5*	*0.7*	*0.8*	*0.9*	*0.9*	*1.0*	*0.9*	*1.2*	*0.2*	*0.5*	-	
Co-financing (excluding training) and CAP	*1.3*	*1.1*	*0.5*	*1.3*	*1.3*	*1.4*	*1.2*	*1.1*	*0.8*	*1.0*	*1.1*	*1.3*	*1.2*	*1.7*	*0.9*	*1.8*	*0.5*	*0.8*	-	
Under-utilised area resources	*0.9*	*1.0*	*1.1*	*0.8*	*0.8*	*0.8*	*0.9*	*0.9*	*0.8*	*1.4*	*1.4*	*1.2*	*0.9*	*0.9*	*0.3*	*0.2*	*0.4*	*0.6*	-	
Additional resources in capital expenditure *(percentages)*	**9.2**	**8.5**	**5.4**	**8.0**	**8.1**	**8.9**	**8.2**	**7.1**	**5.2**	**7.8**	**9.3**	**11.0**	**10.5**	**13.7**	**9.3**	**14.7**	**4.8**	**9.2**	**9.1**	**8.8**
South																				
Capital expenditure net of financial items, of which:	22.2	24.1	24.8	22.3	22.7	21.3	21.0	20.6	21.0	21.6	17.4	17.3	14.9	13.7	12.7	15.2	11.7	10.6	10.3	
Ordinary expenditure	*10.6*	*7.8*	*12.7*	*11.3*	*10.7*	*9.8*	*9.0*	*8.4*	*10.2*	*11.3*	*9.7*	*8.3*	*7.3*	*5.0*	*5.2*	*4.7*	*9.2*	*6.9*	*6.1*	
Additional resources, of which:	*11.6*	*16.3*	*12.0*	*11.0*	*12.0*	*11.5*	*12.0*	*12.3*	*10.8*	*10.4*	*7.7*	*9.1*	*7.5*	*8.6*	*7.4*	*10.4*	*2.5*	*3.7*	*4.2*	
EU Structural Funds net of training	*3.0*	*5.0*	*2.3*	*3.3*	*3.6*	*3.6*	*3.5*	*3.7*	*3.4*	*3.8*	*2.3*	*3.6*	*3.0*	*3.5*	*3.4*	*5.7*	*0.2*	*0.4*	-	
Co-financing (excluding training) and CAP	*2.5*	*4.4*	*2.2*	*2.9*	*3.2*	*3.2*	*3.1*	*3.3*	*2.9*	*2.4*	*1.3*	*1.9*	*1.7*	*2.4*	*2.6*	*3.4*	*0.7*	*0.6*	-	
Under-utilised area resources	*6.1*	*6.9*	*7.5*	*4.8*	*5.2*	*4.7*	*5.4*	*5.3*	*4.5*	*4.2*	*4.1*	*3.6*	*2.8*	*2.7*	*1.4*	*1.3*	*1.6*	*2.7*	-	
Additional resources in capital expenditure *(percentages)*	**52.3**	**67.6**	**48.4**	**49.3**	**52.9**	**54.0**	**57.1**	**59.7**	**51.4**	**48.1**	**44.3**	**52.6**	**50.3**	**62.8**	**58.3**	**68.4**	**21.4**	**34.9**	**40.8**	**51.3**
South's share of ordinary Italian capital expenditure *(percentages)*	**25.2**	**19.5**	**26.7**	**24.7**	**23.2**	**23.0**	**21.1**	**18.8**	**20.9**	**23.5**	**23.1**	**23.2**	**22.2**	**18.1**	**20.4**	**20.3**	**30.0**	**26.7**	**21.6**	**22.7**
South's share of total Italian capital expenditure *(percentages)*	**39.1**	**40.6**	**40.3**	**37.4**	**37.1**	**37.2**	**36.5**	**34.4**	**34.0**	**35.1**	**32.9**	**36.0**	**34.3**	**34.3**	**36.2**	**41.2**	**34.0**	**33.9**	**29.8**	**36.0**

Source: based on data from Sistema Conti Pubblici Territoriali (CPT) – Agenzia per la Coesione Territoriale (2018), "Relazione Annuale CPT 2018", Temi CPT no. 7; SVIMEZ (2019), "Presentazione Rapporto 2019".
(1) ACP: Action and Cohesion Plans; Under-utilised area resources: currently the Development and Cohesion Fund (DCF), previously the Fund for Under-Utilised Areas (FUA). – (2) For 2000 to 2017, the source is RPA, for 2018 the source is SVIMEZ. – (3) Estimates.

4) the presence of capital expenditure laws that expressly earmark the funding for other purposes.

Strengthening the effectiveness of the criterion has been advocated by many observers, including SVIMEZ, also in light of the severity of current economic and social conditions in the South, which has still far to go to bridge the GDP gap with respect to the rest of the country caused by the 2008 crisis.[232] SVIMEZ underscores the large multiplier associated with capital expenditure, especially for public works, in the South, due to the extreme weakness of the "market" economy in the area.[233]

The 2019 Budget Act[234] retains the principle formulated in 2016, establishing that expenditure programmes to be monitored shall be identified annually in the Economic and Financial Document (EFD) on the basis of a recommendation of the Minister for the South. Furthermore, the principle is extended to programme contracts between the Ministry of Infrastructure and Transport (MIT), on the one hand, and ANAS and the Italian Railway Network (IRN), on the other. In this regard, in 2017 (the most recent year available) these two publicly controlled companies allocated 70 per cent (ANAS) and 29.1 per cent (IRN) of their capital expenditure to the South.[235]

The Decree of the Presidency of the Council of Ministers[236] that currently governs the application of the primary legislation establishes reporting obligations for central government departments, which must notify the Minister for the South and the Minister for the Economy by 30 September of each year whether the ordinary capital appropriations were effectively allocated in accordance with the territorial allocation criterion for each expenditure program identified in the EFD. By 30 June of the following year, the central government departments must transmit to the Minister for the South and the Minister for the Economy a report containing any information relevant for the purpose of the evaluation, including the Unique Project Identifier and the name of each measure, if available, for the capital expenditure programmes identified in the EFD. The Minister for the South may request further clarifications and additional documentation from the departments involved.

The second section of the 2019 EFD contains a list of the ordinary capital expenditure programmes identified, on an experimental basis for the first implementation for 2019, for the purposes of the assessments to be performed pursuant to Law 18/2017. This is the fund for the revival of central government investment, provided for in the 2019 Budget Act, of two programmes of the Ministry of Health, ten programmes of the MIT, two programmes of the Ministry of Justice, one programme of the Ministry of the Interior, and one programme of the Ministry of Education, Universities and Research.[237] The number of programmes indicated is therefore only a small subset of the total.

Article 34 of the 2020 Budget Bill seeks to strengthen the principle of territorial rebalancing, with a comprehensive reformulation of the provision introduced in 2016 (Article 7 bis, paragraph 2). The Bill establishes that the resources of capital expenditure programmes

232 SVIMEZ (2019), "Rapporto SVIMEZ. L'economia e la società nel Mezzogiorno".
233 Giannola, A. and Prezioso, S. (2017), *op. cit.*.
234 Law 145/2018.
235 http://old2018.agenziacoesione.gov.it/opencms/export/sites/dps/it/documentazione/CPT/QuoteSud ContoCap_IPN_2019.pdf
236 Prime Ministerial Decree of 10 May 2019.
237 2019 EFD, second section, p. 119.

aimed at supporting growth or investment to be allocated throughout national territory that do not have previously specified allocation criteria or indicators shall also be allocated in compliance with the objective of directing a total volume of capital resources to programmes in the eight southern regions in proportion to their population. Although there is no explicit reference to ordinary resources, the new formulation essentially excludes the additional resources from EU and national funds from the scope of the "34 per cent allocation criterion", because they already have an allocation criterion.[238]

The procedures for verifying the implementation of the measure, as well as developments in expenditure, will be defined in a new Prime Ministerial Decree replacing the current Prime Ministerial Decree.

Basicallly, the goal of the measure is to move from an essentially *ex-post* monitoring system, although the Prime Ministerial Decree does not neglect the *ex-ante* dimension, to a more binding guide for central government departments in complying with the principle of territorial rebalancing when allocating resources for all ordinary capital spending programmes that are not subject to other allocation criteria or indicators. Furthermore, the population criterion appears to be the only remaining differential allotment criterion in favour of the South (repealing the current reference to "some other criterion relating to specific critical issues").

It could therefore be an interesting exercise to provide a quantitative evaluation of the effectiveness of the 34 per cent criterion through the identification of resources susceptible of "territorial allocation" among those appropriated for capital expenditure in the current version of the 2020 Budget Bill. This is a rather complex and therefore preliminary exercise, in light of the general scope of the measure – which leaves details to secondary legislation – and the difficulty, associated with certain "structural" characteristics of the State budget, of translating these general principles into operational criteria .

The very wording of the new paragraph 2, "... *capital expenditure programmes aimed at supporting growth or investment to be allocated throughout national territory that do not have previously specified allocation criteria or indicators* …" does not appear amenable to easy transposition within the accounting framework that guides the formation of the State budget.

The budget bill contains 177 programmes with positive appropriations in 2020, of which no fewer than 152 include capital appropriations. Excluding certain categories of Title II that do not seem to meet the purposes expressly mentioned in the measure (i.e., "Acquisition of financial assets" and "Grants for foreign investment"), the remaining categories of expenditure (i.e. direct investments of central government departments, investment grants to other public entities and to the private sector and the residual

[238] The report illustrating the Budget Bill, in compliance with the provisions of Article 7-bis, paragraph 2, of Decree Law 243/2016, does describe the application of the measure as being limited to "ordinary" resources.

category “Other capital transfers”) are associated with positive appropriations in 150 programmes, for a total of 1,019 budget chapters involved, in turn divided into 1,522 management plans, for a total of around €52.2 billion in 2020.[239]

Bearing in mind that resources can flow to each elementary accounting aggregate by way of multiple authorisation measures, a precise evaluation would require the analysis of thousands of legislative provisions. By accepting a wider margin of approximation, an analysis limited to the identifying information for the individual management plans (mainly, their name and the name of the chapter to which they belong, as well as various economic-functional and administrative classifications on the basis of which the budget is prepared) can help produce a rough quantification of resources susceptible to territorial allocation on the basis of Article 34.

However, given their large number, this approach would also require an immoderate effort if it involved all the management plans potentially affected, taking due consideration of the small financial impact of many of them. Taking account of only those with appropriations greater than €100 million in 2020, the number of management plans with resources belonging to the relevant categories would fall to 83, for a total of around €40 billion in funding. In order to comprise at least 90 per cent of the resources appropriated for these categories, the “significance” threshold can be set at €25 million, which still permits a significant limitation of the number of management plans to be assessed (245, with €47.7 billion in total appropriations, Table 3.20).

Within these appropriations, we identify by exclusion the management plans to which the 34 per cent allocation criterion can be applied on the basis of the letter of the measure. Accordingly, the following have been excluded:

a) resources financing the revolving fund for the implementation of Community policies (more than €2 billion in 2020) and the resources allocated for the 2014-2020 programming cycle (nearly €7 billion allocated to the Development and Cohesion Fund), as they are additional resources;

b) resources not intended for the entire national territory, but for which a specific territorial earmark has already been imposed. Here, this constraint must be explicitly evident from the name of the chapter or management plan to which the resources are attributed;

[239] It is not clear if Parliament intends – in referring to “supporting growth or investment” – to limit the scope of the provision to a specific subset of capital expenditure, for example one that has certain characteristics from the point of view of its functional allocation. Initially, however, we can consider that indicated in the text of the measure as the broadest possible aggregate consistent with such an expansive definition.

Table 3.20 – Appropriations for investments and investment grants in the 2020 Budget Bill (1)
(millions of euros)

Significance of management plans Art. 34 Economic category	Current legislation BB CL	 Remodulations	Budget package Ref. Def. Rep.	 Sec. I Budget Bill	Supplemented Budget Bill
Significant (> 25 million) (a)	**44,981.5**	**-15.4**	**-585.3**	**3,306.8**	**47,687.6**
Not allocable on territorial basis (a1.1)	**29,981.2**	**183.1**	**-469.2**	**1,341.9**	**31,037.0**
a) Additional resources (EU policies)	*8,819.8*	*0.0*	*214.0*	*0.0*	*9,033.8*
Investment grants to public entities	8,819.8	0.0	214.0	0.0	9,033.8
b) Territorial earmark	*3,790.0*	*162.0*	*90.0*	*50.0*	*4,092.0*
Gross fixed investment and land purchases	118.0	0.0	0.0	0.0	118.0
Investment grants to public entities	1,650.1	0.0	90.0	50.0	1,790.1
Investment grants to firms	1,925.7	162.0	0.0	0.0	2,087.7
Other capital transfers	96.3	0.0	0.0	0.0	96.3
c) Alternative allocation criteria	*17,371.4*	*21.1*	*-773.2*	*1,291.9*	*17,911.2*
Gross fixed investment and land purchases	3,526.0	21.1	-113.2	-3.0	3,430.9
Investment grants to public entities	5,249.1	0.0	-600.0	85.0	4,734.1
Investment grants to firms	4,957.8	0.0	-60.0	819.9	5,717.7
Investment grants to households and non-profit institutions serving households	136.2	0.0	0.0	0.0	136.2
Other capital transfers	3,502.3	0.0	0.0	390.0	3,892.3
Probably not allocable on territorial basis (a1.2)	**10,350.2**	**-162.0**	**-79.2**	**10.0**	**10,119.0**
Gross fixed investment and land purchases	906.5	0.0	-6.5	0.0	900.0
Investment grants to public entities	3,643.5	0.0	41.0	0.0	3,684.5
Investment grants to firms	3,811.1	-162.0	-406.1	0.0	3,243.0
Other capital transfers	1,989.1	0.0	292.3	10.0	2,291.4
Allocable on territorial basis (a)-(a1.1)-(a1.2)	**4,650.1**	**-36.4**	**-36.9**	**1,954.9**	**6,531.7**
Gross fixed investment and land purchases	772.6	-8.2	-4.2	0.0	760.3
Investment grants to public entities	2,097.6	-28.2	-12.7	694.9	2,751.6
Investment grants to firms	1,660.9	0.0	0.0	105.0	1,765.9
Other capital transfers	119.0	0.0	-20.0	1,155.0	1,254.0
Not significant (< 25 million) (b)	**4,983.5**	**-113.6**	**-500.1**	**126.7**	**4,496.4**
Gross fixed investment and land purchases	2,220.2	-82.0	-88.9	0.0	2,049.3
Investment grants to public entities	1,550.6	-9.7	-104.7	56.7	1,492.9
Investment grants to firms	811.1	-21.9	-152.5	50.0	686.6
Investment grants to households and non-profit institutions serving households	63.2	0.0	-15.0	20.0	68.2
Other capital transfers	338.3	0.0	-138.9	0.0	199.4
Total (a+b)	**49,965.0**	**-129.0**	**-1,085.4**	**3,433.5**	**52,184.1**

Source: based on data from 2020 Budget Bill.
(1) All economic categories regarding capital expenditure (Title II) are considered, with the exception of the categories “Acquisition of financial assets” and “Grants for foreign investment”. – (2) This subgroup includes appropriations associated with management plans for which the identifying information is insufficient to definitively exclude them but other information suggests that they are allocated on the basis of alternative criteria and/or institutional channels.

c) resources for which “allocation criteria or indicators” have not already been identified. It is reasonable to believe, for example, that these include amounts earmarked for “defence and security”, as well as those that explicitly refer to strategic works or sectors. More generally, appropriations for which the authorising measures or subsequent administrative instruments have already identified the beneficiaries would have to be excluded. Since most of the laws authorising capital expenditure identify some form of sectoral, territorial or other allocation criteria, this specific passage of the measures is the one which most significantly limits the scope of application of the “34 per cent criterion”.

On the basis of this “reclassification” of the appropriations envisaged in the 2020 Budget Bill, we can exclude €31 billion in appropriations: in other words, about 65 per cent of the resources thus scrutinised may not be allocable on a territorial basis under the provisions of Article 34.

In addition, considerable uncertainty remains concerning all the resources allocated to management plans for which the identifying information is insufficient to definitively exclude them, but which are highly likely to be allocated on the basis of alternative criteria or institutional channels, such as the investment grants that the Ministry of the Interior provides to local authorities or those that the Ministry of Education, Universities and Research distributes to the entities within its purview. As an initial approximation, this “probably not allocable on territorial basis” subgroup of appropriations amounts to just over €10 billion.

After these exclusions, therefore, the value of appropriations provided for in the 2020 Budget Bill that appear susceptible to “territorialisation” (i.e. can be allocated in accordance with the criteria introduced with the measure) can be estimated at around €6.5 billion for 2020. These resources are distributed across 20 spending programmes and represent less than 14 per cent of the total resources analysed. It should also be borne in mind that over 70 per cent of these appropriations are unchanged-legislation provisions (about €4.6 billion out of €6.5 billion): the government entities may therefore have relied on a given time profile to activate investment projects in past years, which probably limits the scope for reallocating them in accordance with the population criterion without compromising their implementation.

Various cases – of not insignificant amounts – involve resources transferred to investee companies (a total of almost €1 billion to ANAS and State Railways/IRN, for example) with a certain degree of decision-making and budgetary autonomy .

Considering resources appropriated for the management plans pertaining to the relevant categories but below the significance threshold of €25 million (equal to about €4.5 billion) and assuming that about half of them can be included among “territorialisable” resources, we have a pool of appropriations of close to €9 billion, or just over 17 per cent of the total resources allocated to the relevant categories (€52.2 billion). The application of the provisions of the Budget Bill would therefore require that at least 34 per cent of the €9 billion in appropriations thus identified be allocated to the southern regions, or approximately €3 billion, of which a part − based on historical data – would be allocated to these regions in any case.

Considering the average implementation coefficients used to calculate the impact of the capital expenditure in terms of net borrowing, the scope in question would be significantly narrower in terms of the national accounts.

More generally, the appropriation of resources in the State budget is not a guarantee of effective disbursement in view of the considerations referred to above (different administrative and spending capacity of local authorities). Expenditure performance for additional EU resources (Structural Funds) underscores, for actually appropriated resources of a certain amount, the lesser administrative capacity of local government entities in the South. The strengthening of local authorities in the southern regions therefore appears to be an essential element of any overall intervention in favour of the South.

The 2020 Budget Bill is also missing the reference to the identification of programmes in the EFD on the recommendation of the Minister for the South, and that therefore the programmes should be identified by the individual central government departments and notified by 28 February each year to the Minister for the South and the Minister for the Economy, as already provided for by Article 7-bis, paragraph 2-bis, of Law 18/2017, which remains in force. In order to increase accountability, the central government departments should assess all their spending programmes, indicating whether or not they are subject to the 34 per cent allocation criterion, providing an explanation of why the latter should be excluded from the scope of application of the measure. In addition to being notified to the Minister for the South and the Minister for the Economy, this information should be made public, to increase the transparency of the budget and encourage discussion of State action in the two macro-areas.

In terms of the scope of application of the principle, it would be advisable to extend the rule to other large national public enterprises in addition to ANAS and RFI, adopting the general formulation already in force for corporations with predominantly public direct or indirect ownership through central government departments.[240]

Furthermore, there are no penalties for central government departments that fail to comply with the principle of rebalancing or do not provide the required disclosures to the entities responsible for verifying compliance with the law. In fact, one of the weaknesses of the system for earmarking resources for the South has so far been the lack of mandatory mechanisms that would strengthen its application.

Finally, the implementation of an effective system for monitoring capital expenditure, both in the appropriation phase and the implementation phase, would enhance the effectiveness of support for the South, as well as generally improve government’s capacity for intervention in the economy.

[240] Law 311/2004.

3.9 Measures for local government finance

The Budget Bill and Decree Law 124/2019 contain various measures of interest to local authorities, which are examined below, grouped by main purpose.

- *Support for capital expenditure*. A number of measures can be comprised in this category, including in particular:

  - the extension to ordinary statute regions (OSRs), in implementation of Constitutional Court rulings nos. 247/2017 and 101/2018, of the possibility, already envisaged for local authorities and special statute regions (SSRs), to use their accumulated surpluses and the Restricted Long-term Fund financed by debt, in compliance with Legislative Decree 118/2011 only.

    The resources that the measure frees up would appear to be large: €5.9 billion for 2018 considering only OSRs with a surplus net of the provision for doubtful accounts. Of this amount, €4.3 billion is available in the cash holdings of each authority. The Technical Report assumes that the amounts will be used extremely gradually by the regions, indicating an only moderate increase in capital expenditure (€155 million in 2020, €312 million in 2021 and €120 million in 2022). However, there is a risk that the measure may give rise to faster-than-expected growth in spending, also contributing to an expansion of current expenditure. A large share of the surpluses are represented by restricted transfers,[241] partly earmarked – through the regions – for transfer to other entities (such as local healthcare authorities or local governments), whose disbursement by the OSRs had previously been hindered by the balanced budget rules, which did not permit use of the surplus. The elimination of this restriction could allow the use of some of the surplus to disburse these transfers. This could consequently result in greater spending than that estimated in the Technical Report assuming that the timing of programming and disbursement of the amounts is consistent with their full use for increasing investment by the OSRs.

    Bear in mind, however, that for transfers by the OSRs to local governments and local healthcare authorities, the actual impact on the general government accounts depends both on the timing of disbursement of the amounts by the OSRs and that of their use by the beneficiary entities.

  - the allocation of State capital transfers to all segments of local authorities and for various purposes over a medium/long-term time horizon, as described in detail in section 3.8.

[241] The surplus deriving from restricted transfers for OSRs with a surplus only amounts to €5.4 billion.

The total amount of capital transfers for all local-level territorial governments is initially moderate but increasing, from €785 million in 2020 to over €2 billion in 2022, then remaining at €2.7-2.8 billion per year until 2032, before finally declining in 2033-2034 to €2.5 billion per year.[242]

The two interventions referred to above represent the bringing forward and the expansion of measures with similar purposes contained in the 2019 budget package.[243] Considering the amount and the time horizon of the capital transfers to local authorities since the last budget, as well as the scale of past surpluses in their accounts, which these entities can now draw on freely under the new budget balance rules, the financial situation of territorial governments is now more favourable for supporting a resumption of investment after the long period of contraction between 2010 and most of 2018. Not only the amount of available resources points in this direction, but also the possibility of better planning of expenditure, as local authorities can know in advance what funding will be available in the medium term.

- *Support for current expenditure.* This objective is pursued by measures that provide for the allocation of current account resources to local authorities, consistent with practice in past years, as well as other measures aimed at increasing the spending capacity of entities for any given volume of State transfers. Examples of such measures are:

  - the allocation of funds for certain categories or groups of entities (reinstatement of the compensatory transfer for the reduction in IMU-TASI revenue in the amount of €110 million for three years;[244] the provision for disputes and relations with special statute regions, with annual funding of between €250 million and €350 million per year, stabilising at €243 million per year as from 2026; other resources for mountain and island municipalities, mergers of municipalities,[245] linguistic minorities and other specific local situations);

  - measures to improve tax collection: in particular, the assessments issued by local authorities for their own taxes and property taxes (excluding fines) shall be immediately enforceable, without the need for the issue of a tax demand order or a tax injunction, as is already the case for assessments of

[242] The amount of these transfers include not only the funds for the investments of local authorities provided for in Article 8 but also the appropriations for the Turin underground (Article 7, paragraph 3) and for healthcare construction (Article 9).
[243] Such as the use of surpluses and debt for local authorities and capital transfers distributed over a long period of time.
[244] This amount comes in addition to the €190 million per year appropriated for the same purpose by Law 145/2018 until 2033.
[245] Of which €30 million are allocated by Article 42 of Decree Law 124/2019 for 2019, an amount made permanent in the Budget Bill as from 2020.

income tax and VAT.[246] An improvement in the tax collection capacity of local authorities would make it possible to increase spending capacity by freeing up resources previously set aside in the provision for doubtful accounts and reducing new accruals to the provision;

- measures to enable the renegotiation of the debts of local authorities, with the aim of reducing their interest expenditure and freeing up resources for other spending purposes.

Local authority debt currently stands at around €43.6 billion (of which €36.9 billion for municipalities), down by around 17 per cent since 2013.[247] The current interest burden on local authorities amounts to around €2 billion, of which about €1.7 billion for municipalities and €0.3 billion for provinces.[248]

The structure of the operation has not yet been defined, but in leaving its configuration to a ministerial decree,[249] the measure refers to the assumption of debt and restructuring operations by the State in order to reduce interest expenditure on loans borne by local authorities. The operation would therefore not involve bonds issued by local authorities, but only existing loans from banks or Cassa Depositi e Prestiti (CDP). The feasibility of conducting operations with no impact on the public finances will depend on counterparties lending at lower rates. This could be attractive to banks in cases where the State has a higher credit rating than the original debtor, benefiting in this case from a lower capital requirement in the event of debt assumption by the State. If it should be necessary to pay a penalty, for example in the case of early repayment of loans from CDP, the fiscal neutrality constraint – where this is understood to refer to each year and not to the overall operation, assessed over its entire time horizon[250] – would require that these charges not exceed the interest savings for the year of the renegotiation.[251]

From an accounting point of view, the impact on the public finances could actually be invariant from the point of view of the size of the overall debt and the total expenditure for general government, but would change the composition of amounts by subsector and by economic category. The assumed debt would shift from local authorities to the State, and also for the purposes of net borrowing there would be an increase in the share pertaining to the State:

[246] It will also be possible for debtors in temporary difficulty to pay the amounts they owe in instalments, with local authorities determining the criteria for instalment plans within specified limits.
[247] See Banca d'Italia (2019), "Debito delle Amministrazioni locali", October.
[248] Data for interest expenditure commitments for 2017 (source Istat: PubblicaAmministrazione.Stat).
[249] To be issued in agreement with the State, Cities and Local Authorities Conference, with no impact on the public finances.
[250] For example, this type of long-term assessment was adopted in assessing the financial neutrality of the assumption by the State of Rome's debt in special administration.
[251] The spread between interest rates on extinguished loans and those on new loans assumed or government securities issued to finance the extinguishment.

the interest expense would in fact affect this sector, while the related repayment by local authorities (commensurate with the lower rates on new loans or government securities issued to finance the extinguishment of local authority debt) would represent an internal general government item, subject to consolidation, with a consequent reduction in net borrowing pertaining to local authorities. Savings on interest would not improve the public finance balances but, with no change in transfers from the State, would allow a corresponding increase in expenditure by local authorities for other purchases and services. Any penalties paid for renegotiation or repayment of loans would negatively affect net borrowing in the year of the transactions were carried out, regardless of the timing of disbursement of the funds.

- *Reorganisation and simplification of local taxes,* with the unification of various major and minor municipal taxes:

  - IMU (municipal property tax) and TASI (municipal services tax) are to be unified, as these are taxes that impact largely coincident tax bases following the exemption of primary residences from TASI (from 2016), with minimal differences in the rationale for the tax.[252] The new IMU brings together the rates of the two taxes, envisaging a basic rate of 0.86 per cent and 1.06 per cent as the maximum rate,[253] producing a minimal increase in revenue (€14.45 million on an annual basis) deriving from the absence of the TASI tax relief previously granted to tenants who use the property as their main residence. This increase in revenue is accompanied by a corresponding reduction of the Municipal Solidarity Fund.

    Other differences between the new IMU and the previous taxes concern:

    - the greater scope for lowering the new tax, whose rates can also be set to zero (with the exception of those on properties used in a business, whose revenue is reserved to the State) and which starting from 2021 can be diversified in the cases to be specified in a ministerial decree, partly with a view to simplifying the vast number of different tax relief measures granted by municipalities;

    - certain differences in the tax deductibility for the purposes of corporate income tax or income from the exercise of arts and professions. In fact, the deductibility of IMU for 2022 is increased from 70 to 100 per cent – bringing forward by one year the full deductibility originally envisaged under current legislation to begin in 2023 – while TASI is no longer

[252] IMU is paid by the owner of buildings and land, while TASI is paid in part by holders of the property.
[253] These rates regard the most common types of building (housing other than principal residences and buildings used in a business), while lower rates are envisaged for other types of building, although they are in any event equal to the sum of the current IMU and TASI rates.

deductible for IRAP purposes, with a net cumulative impact on revenue for the 2021-2024 period of a negative €159 million and a positive impact thereafter of around €11 million per year.

- a series of minor taxes such as the municipal advertising tax, the public land use fee (TOSAP[254]) and the daily waste disposal fee for users of market areas will be merged into a single concession fee (non-tax). The operation appears to be aimed at simplifying the system, with no change in revenue. The financial neutrality of the operation for municipalities will in any case be verified during implementation.

- *Measures to encourage compliance with payment deadlines for trade payables.* The measures provide for*:*

  - an increase from 3 to 5 twelfths[255] in the limit on Treasury advances which local authorities can use to meet their cash requirements;

  - changes in the criteria for determining and applying the penalties provided for in the event of non-compliance with the payment deadlines for trade payables.[256]

    In this regard, Decree Law 124/2019 postponed the connection of the payment deadline verification system to the trade receivable platform in view of misalignments between the information drawn from this platform and that resulting from the accounting records of the government entities. The planned doubling of the provision for local authorities that did not take advantage of the possibility of drawing on a liquidity advance from CDP in 2019 in order to accelerate payments was also eliminated.

- *Governing the transition to fiscal federalism.* A number of measures in Decree Law 124/2019 appear to be directed at:

  - impacting the timing and objectives of the equalisation mechanism for local authorities, making the completion of the transition more gradual (full implementation has been postponed from 2021 to 2030) but at the same time removing the limit on the previously determined final equalisation objective (this limit provided that even once fully operational, 50 per cent of

[254] Or the COSAP public land use fee that municipalities could levy in the place of TOSAP. It is essentially equivalent but is governed independently by the local authorities themselves with their own rules.
[255] The fraction is applied to assessed revenue, regarding the first three titles in local authority budgets, in the penultimate year previous to the current one.
[256] These penalties, which were introduced with the 2019 Budget Act, require the establishment of a specific provision – which can only be used in the year following that in which the entity complied with payment times – equal to 5 per cent of average appropriations for the purchase of goods and services in 2020-2022.

the resources theoretically subject to equalisation would be disbursed on the basis of the historical criterion);

- postponing the implementation of regional federalism provided for in Legislative Decree 68/2011 until 2021.

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